**INSTRUCTOR SOLUTIONS MANUAL**

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**Byrd & Chen’s Canadian Tax Principles**

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# CHAPTER ELEVEN SOLUTIONS

**Solution to Assignment Problem Eleven-1**

###### 2017 Analysis

The required information can be calculated as follows:

|  |  |  |
| --- | --- | --- |
| ITA 3(a) |  |  |
| Business Income | $18,000 |  |
| Taxable (Grossed Up) Dividends | 2,360 | $20,360 |
| ITA 3(b) |  |  |
| Taxable Capital Gains [(1/2)($1,200)] | $ 600 |  |
| Allowable Capital Losses [(1/2)($4,200)] | ( 2,100) | Nil |
| ITA 3(c) ITA 3(d)  Farm Loss (See Note) |  | $20,360  ( 6,250) |
| Net Income For Tax Purposes And Taxable Income |  | $14,110 |
| **Note** Ms. Breau’s farm losses are restricted as follows: | | |
| Total Farm Loss  Deductible Amount: First $2,500 |  | $10,000 |
| ($ 2,500) |  |
| One-Half Of $7,500 ($10,000 - $2,500) | ( 3,750) | ( 6,250) |
| Restricted Farm Loss Carry Forward |  | $ 3,750 |

As noted in the problem, none of the losses can be carried back before 2017. This would leave the following carry forward balances at the end of 2017:

* Restricted Farm Loss Carry Forward $3,750
* Net Capital Loss Carry Forward [(1/2)($4,200 - $1,200)] $1,500

###### 2018 Analysis

The required information can be calculated as follows: ITA 3(a)

|  |  |  |
| --- | --- | --- |
| Farm Income | $ 2,000 |  |
| Taxable (Grossed Up) Dividends | 2,950 | $ 4,950 |
| ITA 3(b)  Taxable Capital Gains [(1/2)($2,000)] Allowable Capital Losses | $ 1,000  Nil | 1,000 |
| ITA 3(c) ITA 3(d)  Business Loss |  | $ 5,950  ( 14,000) |
| Net Income For Tax Purposes  2017 Net Capital Loss Carry Forward |  | Nil  ($ 1,000) |
| Taxable Income (Loss) |  | Nil |

Since there are taxable capital gains this year, and the problem states that Ms. Breau would like to deduct the maximum amount of her net capital loss carry forwards, the net capital loss carry forward of $1,000 is added to the balance of the non-capital loss.

The non-capital loss carry over is calculated as follows:

|  |  |  |
| --- | --- | --- |
| Business Loss | $14,000 | |
| 2017 Net Capital Loss Deducted |  | 1,000 |
| ITA 3(c) Income | ( | 5,950) |
| Non-Capital Loss Carry Over For 2018 | $ 9,050 | |

The entire non-capital loss carry over could be carried back to 2017, but since Ms. Breau requires

$14,000 in Taxable Income to fully utilize her tax credits, the maximum carry back to 2017 is $110, calculated as follows:

|  |  |  |
| --- | --- | --- |
| 2017 Taxable Income (As Reported) | $14,110 | |
| Non-Capital Loss Carry Back From 2018 | ( | 110) |
| 2017 Amended Taxable Income (Minimum) | $14,000 | |

This carry back leaves Ms. Breau with her required $14,000 in Taxable Income. There would be the following carry forward balances at the end of 2018:

* + Restricted Farm Loss Carry Forward (Unchanged) $3,750
  + Net Capital Loss Carry Forward ($1,500 - $1,000)] $ 500
  + Non-Capital Loss Carry Forward ($9,050 - $110) $8,940

###### 2019 Analysis

The required information can be calculated as follows:

ITA 3(a)

Business Income $30,000

Farm Income 3,150

Taxable (Grossed Up) Dividends 3,963 $37,113 ITA 3(b)

Taxable Capital Gains [(1/2)($4,000)] $ 2,000

Allowable Capital Losses Nil 2,000

Net Income For Tax Purposes $39,113

Restricted Farm Loss Carry Forward (Equal To Farm Income) ( 3,150) Net Capital Loss Carry Forward (Less Than $2,000) ( 500)

Non-Capital Loss Carry Forward (All) ( 8,940)

Taxable Income $26,523

There would be the following carry forward balance at the end of 2019:

* + Restricted Farm Loss Carry Forward ($3,750 - $3,150) $ 600

###### 2020 Analysis

The required information can be calculated as follows:

ITA 3(a)

Taxable (Grossed Up) Dividends $ 6,450

ITA 3(b)

|  |  |  |
| --- | --- | --- |
| Taxable Capital Gains [(1/2)($4,500)] | $ 2,250 |  |
| Allowable Capital Losses [(1/2)($14,500)] | ( 7,250) | Nil |
| ITA 3(c) ITA 3(d)  Business Loss |  | $ 6,450 |
| ($19,000) |  |
| Farm Loss | ( 2,000) | ( 21,000) |
| Net Income For Tax Purposes And Taxable Income |  | Nil |

The available non-capital loss can be calculated as follows:

|  |  |
| --- | --- |
| Business Loss | $19,000 |
| ITA 3(c) Income | ( 6,450) |
| Non-Capital Loss Carry Over | $12,550 |
| Farm Loss (Unrestricted) | 2,000 |
| Total Loss Carry Over For 2020 | $14,550 |

Although technically the farm loss is accounted for separately from the non-capital loss, since the farm loss is less than $2,500 it is treated as an unrestricted farm loss and can be applied against all types of income. Given the carry over rules are the same, we have treated this farm loss as part of the non-capital loss carry over. The preceding loss carry over of $14,550 is available for carry back to 2019.

With respect to the net capital loss of $5,000 [(1/2)($10,000)], there are $1,500 ($2,000 - $500) in taxable capital gains left in 2019 as the basis for a carry back. This means that $1,500 of this year’s allowable capital loss can be carried back, leaving $3,500 ($5,000 - $1,500) to be carried forward as a net capital loss balance.

If both the $14,550 non-capital loss and the $1,500 net capital loss were carried back to 2019, the result would be a Taxable Income of $10,473, less than the $14,000 that is required to fully utilize Ms. Breau’s available tax credits. As the net capital loss can only be deducted to the extent of taxable capital gains, it would be advisable to claim the full amount of this loss carry back. Based on this view, the non-capital loss deduction will be limited to $11,023 ($26,523 - $14,000 - $1,500), an amount that will provide for full use of Ms. Breau’s 2019 tax credits:

|  |  |
| --- | --- |
| 2019 Taxable Income (As Reported) | $26,523 |
| Non-Capital Loss Carry Back From 2020 | ( 11,023) |
| Net Capital Loss Carry Back From 2020 | ( 1,500) |
| 2019 Amended Taxable Income | $14,000 |

These carry backs leave Ms. Breau with her required $14,000 in 2019 Taxable Income. There would be the following carry forward balances at the end of 2020:

* Restricted Farm Loss Carry Forward (Unchanged) $ 600
* Net Capital Loss Carry Forward ($5,000 - $1,500)] $3,500
* Non-Capital Loss Carry Forward (Nil + $14,550 - $11,023) $3,527

# Solution to Assignment Problem Eleven-2

Before consideration of any carry backs, Lucinda would have 2019 Taxable Income as follows:

|  |  |
| --- | --- |
| Net Rental Income | $ 91,450 |
| Interest Income | 38,275 |
| Taxable Capital Gains | 17,300 |
| Net Income For Tax Purposes And Taxable Income | $147,025 |

The loss on Recovery Inc. is a Business Investment Loss (BIL). However, because of her use of the lifetime capital gains deduction in 2018, $156,000 of this amount would be disallowed. Given this, the available Allowable Business Investment Loss (ABIL) would be calculated as follows:

|  |  |
| --- | --- |
| Total Loss | $675,000 |
| Disallowed By Lifetime Capital Gains Deduction Use | ( 156,000) |
| Balance | $519,000 |
| Inclusion Rate | 1/2 |
| Allowable Business Investment Loss (ABIL) | $259,500 |

Using this value, Lucinda’s 2020 Taxable Income is calculated as follows:

##### Income Under ITA 3(a)

Net Rental Income $86,300

Interest Income 27,438 $113,738

##### Income Under ITA 3(b)

Taxable Capital Gains $18,620 Allowable Capital Loss (Disallowed ABIL)

[(1/2)($156,000)] (Note 1) ( 78,000) Nil

Balance Under ITA 3(c) $113,738

##### Deduction Under ITA 3(d)

ABIL (Note 2) ( 259,500)

Net Income For Tax Purposes And Taxable Income Nil

**Note 1** As the $156,000 disallowed BIL becomes an ordinary capital loss, it must be deducted against the 2020 capital gain. This leaves a net capital loss carry over of $59,380 ($78,000 - $18,620), of which $17,300 can be carried back to 2019.

**Note 2** As the ABIL was realized in 2020, it must be used to reduce that year’s income to nil. Note that, because of this rule, Lucinda cannot deduct a smaller amount in order to have sufficient income to absorb her basic personal tax credit. After this deduction, a carry over of $145,762 ($259,500 - $113,738) remains.

The amount that should be carried back is calculated as follows:

|  |  |
| --- | --- |
| 2019 Net Income For Tax Purposes (As Originally Calculated) | $147,025 |
| Net Capital Loss Carried Back | ( 17,300) |
| Optimum Taxable Income = 2019 Basic Personal Amount | ( 12,069) |

Non-Capital Loss Carried Back $117,656

As planned, these deductions would leave a Taxable Income of $12,069 ($147,025 - $17,300 -

$117,656). The taxes on this amount will be eliminated by Lucinda’s basic personal amount. Since there was no Tax Payable prior to 2019, there would be no additional carry backs. The following carry forwards remain after the carry back amounts are deducted:

Net Capital Loss Carry Forward ($59,380 - $17,300) $42,080 Non-Capital Loss Carry Forward ($145,762 - $117,656) $28,106

For the next 10 years, the ABIL will be treated as a non-capital loss carry forward that can be deducted against other sources of income. If it has not been utilized within the 10 years, it then becomes a net capital loss carry forward, deductible for an unlimited number of future periods, but only against net taxable capital gains.

# Solution to Assignment Problem Eleven-3

Business Investment Losses (BIL) are capital losses that meet certain conditions such as investing in “small business corporations” by either purchasing shares or lending money. Even if all of the requisite conditions are met a BIL can be reduced or eliminated altogether depending upon whether the capital gains deduction was claimed in preceding years. The effect of this reduction is to split a BIL into two components – one representing the part of the BIL not reduced and the second representing the reduction. The first part is the BIL for the year and the second part a regular capital loss for that same year. The result is calculated as follows:

|  |  |
| --- | --- |
| 2020 Potential BIL [($82,000 + $200) - $21,000] | $ 61,200 |
| ITA 39(9) Reduction for Previous Years Use Of ITA 110.6  ($20,000 + $14,000) | ( 34,000) |
| Business Investment Loss | $ 27,200 |
| Inclusion Rate | 1/2 |
| Allowable Business Investment Loss | $ 13,600 |

David’s Net Income For Tax Purposes would be calculated as follows:

|  |  |  |
| --- | --- | --- |
| ITA 3(a) |  | |
| Net Business Income |  | $110,000 |
| Non-eligible dividends | $ 8,000 |  |
| Gross-up at 15% | 1,200 | 9,200 |

ITA 3(b)

Taxable Capital Gain

[(1/2)($167,000 - $33,000 - $2,000)] $ 66,000

Allowable Capital Loss (Disallowed part of the ABIL)

[(1/2)($61,200 - $27,200)] ( 17,000) 49,000

|  |  |
| --- | --- |
| ITA 3(c)  ITA 3(d) | $168,200 |
| Allowable Business Investment Loss | ( 13,600) |
| Net Income For Tax Purposes | $154,600 |

David’s Taxable Income under the two different assumptions would be calculated as follows:

|  |  |  |
| --- | --- | --- |
|  | **Part A** | **Part B** |
| Net Income For Tax Purposes | $154,600 | $154,600 |
| Net Capital Loss Carry Forward Deducted | ( 5,500) | Nil |
| Lifetime Capital Gains Deduction (Note) | ( 27,100) | ( 32,600) |
| Taxable Income | $122,000 | $122,000 |

**Note** As the only capital gains during 2020 are on qualified property, the simplified formula for the annual gains limit as described in the textbook can be used. Given this, the lifetime capital gains deduction is the cumulative gains limit for both Part A and B as it is the least of the following: **Amount Available** The amount available would be calculated as follows:

|  |  |  |
| --- | --- | --- |
|  | **Part A** | **Part B** |
| Amount Available [(1/2)($883,834\*)] | $441,917 | $441,917 |
| Amount Used in 2011 [(1/2)($20,000)] | ( 10,000) | ( 10,000) |
| Amount Used in 2015 [(1/2)($14,000)] | ( 7,000) | ( 7,000) |
| Amount Available | $424,917 | $424,917 |

\*This is the 2020 limit for gains on dispositions of shares of a qualified small business corporations. For gains on qualified farm or fishing property, the 2020 limit remains unchanged from 2019 at $1,000,000.

**Annual Gains limit** The annual gains limit would be calculated as follows:

|  |  |  |
| --- | --- | --- |
|  | **Part A** | **Part B** |
| Taxable Capital Gain On Qualified Property | $66,000 | $66,000 |
| ABIL Realized | ( 13,600) | ( 13,600) |
| Allowable Capital Loss Deducted (Disallowed ABIL) | ( 17,000) | ( 17,000) |
| Net Capital Loss Carry Forward Deducted | ( 5,500) | Nil |
| Annual Gains Limit | $29,900 | $35,400 |

**Cumulative Gains Limit** The cumulative gains limit would be calculated as follows:

|  |  |  |
| --- | --- | --- |
|  | **Part A** | **Part B** |
| Sum Of Annual Gains Limits |  |  |
| ($10,000 + $7,000 + $29,900) | $46,900 |  |
| ($10,000 + $7,000 + $35,400) |  | $52,400 |
| Amounts Deducted In Previous Years |  |  |
| ($10,000 + $7,000) | ( 17,000) | ( 17,000) |
| CNIL ($12,000 - $9,200)\* | ( 2,800) | ( 2,800) |
| Cumulative Gains Limit | $27,100 | $32,600 |

\*The CNIL is reduced by investment income, which would include any grossed-up eligible or non- eligible dividends.

In Part B, David will retain his 2016 $5,500 net capital loss carry forward, but will have $5,500 less of his capital gains deduction available for future years. His Taxable Income in both cases is the same.

# Solution to Assignment Problem Eleven-4

###### Case 1

Neither Sam nor Sandra work the 20 hours per week that is required by the “bright line” test for an excluded business. However, they are both actively engaged in the activities of the business and this, combined with the fact that no other employees are required by operations of Mobus, should satisfy the excluded business criteria. The dividends received by Sam and Sandra would not be classified as split income.

###### Case 2

Max and Mary are over 17 years of age and easily meet the 20 hours per week test during most of the period that the GoGreen business operates. The fact that they have to return to their university in mid-September and cannot work in the business during the short period from that date until the business closes at the end of September would not prevent them from taking the position that they are actively engaged in the business on a continuous and substantial basis. This means that the dividends received are from an excluded business and will not be classified as split income.

###### Case 3

The dividends received by Edward would not be classified as split income. As they originated from property that was transferred to him pursuant to a marriage separation agreement, the dividends would be an excluded amount.

###### Case 4

The dividends received by Larry would not be classified as split income as Musken is an excluded business for him. He has met the “bright line” test by being actively engaged in a continuous and substantive manner for over five years.

With respect to Louise, her spouse has obtained the age of 64 before the end of the year and the dividends would have been an excluded amount had they been paid to him. Given this, they are not split income as ITA 120.4(1.1)(c) deems them to be an excluded amount with respect to Louise.

###### Case 5

From Donald’s point of view, Dontar is an excluded business and the 2020 dividends that he receives would not be classified as split income.

David is not involved in the business in 2020 and he is not over 24 years of age. In addition, he has not been involved in the business in any five years prior to 2020. Therefore, from David’s point of view Dontar is not an excluded business. While David owns shares with a fair market value that exceeds 10 percent of all of the company’s shares, the shares are non-voting. In addition, David is not 25 or older. Given these facts, David’s shares are not excluded shares.

David is between 18 and 24 years old and he has contributed capital to the business. Unless he can successfully argue that 5 percent is a reasonable return on the capital contributed to the business, the dividends that are in excess of the 2 percent safe harbour return will be classified as Split Income.

# Solution to Assignment Problem Eleven-5

###### Part A - Taxable Income

Mr. and Mrs. Bahry’s Taxable Income would be calculated as follows:

|  |  |  |
| --- | --- | --- |
|  | **Mr. Bahry** | **Mrs. Bahry** |
| Old Age Security Benefits (See Note) | $ 7,400 | $ 7,400 |
| Registered Pension Plan Receipts | 12,340 | 820 |
| Registered Retirement Income Fund Receipts | N/A | 1,000 |
| Canada Pension Plan Receipts | 3,690 | 830 |
| Dividends Received | 1,600 | 336 |
| Gross Up On Dividends (38 Percent) | 608 | 128 |
| Interest On Savings Accounts | 1,239 | 3,500 |
| Net Taxable Capital Gain | Nil | Nil |

Net Income For Tax Purposes And Taxable Income $26,877 $14,014

**Note** Neither Mr. nor Mrs. Bahry would have to repay any OAS benefits as both Net Income figures are well below the threshold income of $79,054.

Mrs. Bahry cannot transfer her dividends under ITA 82(3) as the transfer would give her Net Income of $13,550 ($14,014 - $336 - $128) and this would not increase or create a spousal credit.

###### Part A - Tax Credits

Mrs. Bahry must include the $128 gross up on her dividends in her Taxable Income, which decreases the amount of tax credits she can transfer. She must decrease the amount of the age and pension credits she can transfer by the excess of her Taxable Income (including the dividends) over the basic personal amount. As a result, she cannot claim the dividend tax credit. Since Mr. Bahry is not eligible for the ITA 82(3) election, her dividend tax credit will be lost.

Credits Available For Transfer:

|  |  |  |
| --- | --- | --- |
| Age |  | $7,637 |
| Pension (On $820 + $1,000 Only) |  | 1,820 |
| Total Available Reduced By Excess Of:  Mrs. Bahry’s Net Income |  | $9,457 |
| ($14,014) |  |
| Over Basic Personal Credit Amount | 13,229 | ( 785) |
| Credit Base Transferred To Spouse |  | $8,672 |

Mr. Bahry’s maximum tax credits would be as follows:

|  |  |
| --- | --- |
| Basic Personal Amount  Spousal (Mrs. Bahry’s Net Income Is Too High) Age (No Reduction Required) | $13,229  Nil 7,637 |
| Pension | 2,000 |
| Transfers From Mrs. Bahry (See Preceding) | 8,672 |
| Credit Base | $31,538 |
| Rate | 15% |
| Total | $ 4,731 |
| Dividend Tax Credit [(6/11)($608)] | 332 |
| Charitable Donations (See Note)  [(15%)($200) + (29%)($1,210 + $300 - $200)] | 410 |
| Total Credits | $ 5,473 |

**Note** Charitable donations can be claimed by either spouse, as long as the total donations are less than 75 percent of the claiming spouse’s Net Income For Tax Purposes. As Mrs. Bahry has no Tax Payable, Mr. Bahry will claim her charitable donations. It is usually advantageous for one spouse to claim all the charitable donations if they total more than

$200, as the low rate of credit is only applied once.

###### Part A - Loss Carry Overs

Neither Mr. Bahry’s allowable capital loss of $1,988 [(1/2)($3,975)] nor Mrs. Bahry’s allowable capital loss of $160 [(1/2)($820 - $500)] can be deducted in 2020. They can be carried back three years and carried forward indefinitely to be applied against taxable capital gains.

###### Part B - Pension Income Splitting

Since Mr. and Mrs. Bahry are both in the lowest tax bracket and neither has any OAS clawback, the optimum use of pension income splitting would accomplish the following objectives:

* it would permit Mrs. Bahry to claim her dividend tax credit, and
* it would permit Mrs. Bahry to fully utilize her pension income tax credit.

# Solution to Assignment Problem Eleven-6

###### Regular Part 1 Federal Tax Payable

The minimum regular Taxable Income and Tax Payable calculations would be as follows:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Albert** | **Milana** | **Therese** |
| Net Business Income | $ 26,000 | $120,000 | $ Nil |
| Net Employment Income | Nil | Nil | 60,000 |
| Eligible Dividends Received | Nil | Nil | 25,000 |
| Dividend Gross Up (38%) | Nil | Nil | 14,400 |
| Non-Eligible Dividends Received | 94,000 | Nil | Nil |
| Dividend Gross Up (15%) | 14,100 | Nil | Nil |
| Taxable Capital Gains | 180,000 | 140,000 | 500,000 |
| Retiring Allowance | Nil | 80,000 | Nil |
| RRSP Deductions (Note 1) | ( 3,960) | ( 46,000) | ( 23,000) |
| ABIL | Nil | Nil | ( 60,000) |
| Net Income For Tax Purposes | $310,140 | $294,000 | $516,400 |
| Lifetime Capital Gains Deduction | ( 100,000) | Nil | ( 440,000) |
| Non-Capital losses | (60,000) | ( 173,000) | Nil |
| Taxable Income | $150,140 | $121,000 | $ 76,400 |
| Federal Tax (Note 2) | $31,029 | $ 23,452 | $ 12,992 |
| Basic Personal Credit (Note 3) | ( 1,845) | ( 1,845) | ( 1,845) |
| Dividend Tax Credit |  |  |  |
| (9/13 of Gross Up) | ( 9,762) | Nil | Nil |
| (6/11 of Gross-Up) | Nil | Nil | ( 7,855) |
| Regular Federal Tax Payable | $19,422 | $ 21,607 | $ 3,292 |

**Note 1** Albert’s 2020 RRSP deduction room is calculated as follows: Lesser Of:

2020 RRSP Dollar Limit = $27,230

18% Of 2019 Earned Income Of $22,000 = $3,960 $3,960 Less 2019 PA Nil

2019 RRSP Deduction Limit $3,960

Although he contributed $5,000, his RRSP deduction is limited to $3,960 and he has $1,040 ($5,000 -

$3,960) in undeducted contributions that can be carried forward and deducted in a subsequent year in which there is sufficient RRSP deduction room.

|  |  |
| --- | --- |
| Therese’s 2020 RRSP deduction room is calculated as follows: |  |
| Unused Deduction Room - End of 2019 Annual Addition - Lesser Of:  2020 RRSP Dollar Limit = $27,230  18% of 2019 Earned Income Of $120,000 = $21,600 | $21,000  21,600 |
| Less 2019 PA | ( 11,600) |
| 2020 RRSP Deduction Limit | $31,000 |
| Un-deducted Contributions From Previous Years | ( 8,000) |
| Maximum RRSP Contribution | $23,000 |

Therese’s RRSP deduction is limited to $31,000. Since she has undeducted contributions of $8,000 from previous years her deductible additional contribution for 2020 is restricted to $23,000. As she contributed $24,000 the additional $1,000 amount can be carried forward as an undeducted contribution deductible in future years as additional contribution room is generated. Therese will not be subject to the penalty tax for overcontributions since the amount is not in excess of $2,000.

**Note 2** The federal Tax Payable, before the dividend tax credit, was calculated as follows:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Taxable Income** | **Federal Tax Calculations** | **Federal Tax** |
| Albert | $150,140 | $17,230 + (26%)($53,071) | $31,029 |
| Milana | $121,000 | $17,230 + (26%)($23,931) | $23,452 |
| Therese | $ 76,400 | $7,280 + (20.5%)($27,865) | $12,992 |

**Note 3** In 2020 an enhanced basic personal tax credit was introduced. For individuals with net income of $150,473 or less the tax credit is equal to $13,229, which at 15 percent equals

$1,984. For individuals with net income of $214,368 or more the credit is $12,298, which at 15 percent would be equal to $1,845. When Net Income is between $150,474 and $214,367, the credit is determined using a formula that prorates the additional $931 ($13,229 - $12,298). Since the Net Income of all three individuals is $214,368 or more the basic personal credit for each is determined using $12,298.

###### Alternative Minimum Tax Payable

The alternative minimum tax (AMT) calculations would be as follows:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Albert** | **Milana** | **Therese** |
| Regular Taxable Income | $150,140 | $121,000 | $ 76,400 |
| 60% Of Taxable Capital Gains (Note 4) | 108,000 | 84,000 | 300,000 |
| 60% of ABIL (Note 4) | Nil | Nil | ( 36,000) |
| Dividend Gross Up | ( 14,100) | Nil | ( 14,400) |
| Adjusted Taxable Income | $244,040 | $205,000 | $326,000 |
| AMT Exemption | ( 40,000) | ( 40,000) | ( 40,000) |
| AMT Base | $204,040 | $165,000 | $286,000 |
| Rate | 15% | 15% | 15% |
| Federal AMT Before Credit | $ 30,606 | $ 24,750 | $ 42,900 |
| Basic Personal Credit | ( 1,845) | ( 1,845) | ( 1,845) |
| Federal AMT | $ 28,761 | $ 22,905 | $ 41,055 |
| Regular Federal Tax Payable | ( 19,422) | ( 21,607) | ( 3,292) |
| Additional Tax Required | $ 9,339 | $ 1,298 | $ 37,763 |

**Note 4** The addition, or deduction in the case of the ABIL, can be determined by multiplying twice the “capital gain” or the “business investment loss” by 30 percent or by multiplying 60 percent by the “taxable capital gain” or “allowable business investment loss”. Both methods are acceptable.

The excess of AMT over regular Tax Payable for rach of Albert, Milana, and Therese can be carried forward for seven years and applied against any future excess of Part 1 Tax Payable over the alternative minimum tax.

**Bonus Question Solution:** There a number of methods that can be used to reduce or eliminate an AMT tax liability altogether. It is important, however, to keep in mind that the AMT is recoverable over the subsequent seven years. If it is anticipated that Part 1 tax will exceed any potential AMT liability over that period of time to recover the amount in full, then it may be preferable to wait it out. If, however, the AMT creates cash flow difficulties or it is unlikely that the AMT carry over could be recovered, then you may wish to explore strategies to reduce or eliminate the AMT before it arises.

While there are many strategies, some of the more common include avoiding excess optional deductions such as RRSP deductions or non-capital loss claims, both of which reduce Part 1 taxes. Another common strategy is to claim capital gain reserves where possible, which reduces the impact of adding back 60 percent of taxable capital gains, particularly where those gains have not been subject to Part 1 tax because of the capital gains deduction. A further option where there is flexibility as to the type of income such as between salary/bonuses and dividends is to choose salary over dividends. While this latter strategy will not eliminate the total federal income tax, it will increase Part 1 tax with a corresponding reduction in the AMT.

**Albert – Analysis:** Given the flexibility of being the sole shareholder of his own CCPC, Albert could have reduced Part 1 tax by opting for a greater amount of salary or dividends. Had he opted to take

$120,000 in salary/bonus instead of dividends he would have reduced his AMT by approximately

$6,000, although his Part 1 tax would have increased by the same amount. The additional salary would have increased his ability to contribute and deduct a larger contribution to his RRSP. Albert could also have opted not to claim any non-capital losses. This strategy would also have shifted the AMT liability to Part 1. Finally, Albert could have structured the capital gain transaction to be in a position to be able to claim capital gain reserves. That particular strategy would have reduced his AMT and immediate Part 1 liability.

**Milana – Analysis:** In Milana’s case she claimed all of her non-capital loss of $173,000 and reduced her Part 1 tax significantly. This would have been fine had she not had to include an addition for the capital gain in determining her AMT. Milana could have avoided the AMT by claiming a smaller amount of the non-capital loss. Had she limited her non-capital loss deduction to approximately

$160,000 there would not have been an AMT liability.

**Therese – Analysis:** Options available for Therese to reduce or eliminate her AMT liability of $37,763 are to (1) reduce her RRSP deduction, (2) claim a smaller amount for the capital gains deduction, and

1. structure the capital gain transaction to enable her to claim capital gains reserves. If Therese were eligible to spread the $500,000 taxable capital gain equally over five years and limit her capital gains deduction to approximately $15,000, her AMT liability would have been reduced to nil.

# Solution to Assignment Problem Eleven-7

###### Deemed Dispositions Immediately Before Death

Under ITA 70(5), there is a deemed disposition of all of the capital property of a deceased taxpayer (decedent) immediately before the moment of death. In general, the deemed proceeds of disposition will be the fair market value of the property.

There is, however, an exception to this rule provided by ITA 70(6). Under this provision, if the transfer is to a spouse, common-law partner, or a trust in favour of a spouse or common-law partner, the deemed proceeds of disposition will be the tax cost of the property, adjusted cost base for non- depreciable property, and UCC for depreciable property.

With respect to this exception, the executor of the decedent’s estate can elect out of ITA 70(6) and use the values that would apply in ITA 70(5). This will result in the use of deemed proceeds based on fair market value, thereby resulting in tax consequences that will be reported on the decedent’s final tax return. As stated in the problem, Rachelle’s will instructs the executor to opt out of the ITA 70(6) spousal rollover provisions.

Any property inherited by her daughter could not be exempt from the usual deemed disposition rules on death as there is no rollover that would be applicable to the assets she has inherited.

###### Net Business Income

Rachelle’s Net Business Income would be calculated as follows:

|  |  |
| --- | --- |
| Net Business Income From Proprietorship | $69,400 |
| Recapture On Sale Of Business Assets (Given) | 5,900 |
| Net Business Income | $75,300 |

###### Property Income

Rachelle’s property income is calculated as follows:

|  |  |
| --- | --- |
| Interest Attributed From Martin (Note 1) | $ 876 |
| Net Rental Income ($46,300 - $31,400) | 14,900 |
| Recapture On Rental Property ($210,000 - $174,795) | 35,205 |
| Eligible Dividends | 860 |
| Gross Up On Eligible Dividends [(38%)($860)] | 327 |
| Non-Eligible Dividends | 6,200 |
| Gross Up On Non-Eligible Dividends [(15%)($6,200)] | 930 |
| Total Property Income | $59,298 |

**Note 1** With respect to the interest received by Martin, it was earned on a guaranteed investment certificate given to him by Rachelle and, as a consequence, it would be attributed to her up until the day of her death. As she died 188 days into the year, the attributed amount would be $876 [(188/365)($1,700)]. As attribution from a spouse ceases when the transferor spouse dies, the remaining $824 ($1,700 - $876) would be included in Martin’s income. When this is combined with his $2,100 salary, his total income for the year is $2,924. His income for the whole year, not just prior to Rachelle’s death, will decrease the spousal credit available on Rachelle’s final return.