Instructor’s Solutions Manual

Chapter 11 – Solutions to Assignment Problems

Solution to AP 11-1

###### 2020 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 | $ 600 |  |
| Allowable Capital Losses | (2,100) | Nil |
| ITA 3(c) ITA 3(d)  Unrestricted Farm Loss (See Note) |  | $20,360  (6,250) |
| 2020 Net Income and Taxable Income |  | $14,110 |
| **Note** Ms. Breau’s farm losses are restricted as follows: | | |
| Total Farm Loss  Unrestricted Amount: First $2,500 |  | $10,000 |
| ($ 2,500) |  |
| One-Half of $7,500 ($10,000 – $2,500) | (3,750) | (6,250) |
| 2020 Restricted Farm Loss |  | $ 3,750 |

As noted in the problem, none of the losses can be carried back before 2020. This would leave the following 2020 loss carry over balances:

* 2020 Restricted Farm Loss $3,750
* 2020 Net Capital Loss [($2,100 (ITA 3(b)(ii)) – $600 (ITA 3)(b)(i))] $1,500

In this first year the taxable income is less than the required $15,000 to fully utilize available personal tax credits; however, there is no choice to limit any of the ITA 3 amounts to a smaller amount so as to achieve the $15,000 taxable income.

###### 2021 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  Allowable Capital Losses | $ 1,000  Nil | 1,000 |
| ITA 3(c) ITA 3(d)  Non-Farming Business Loss |  | $5,950  (14,000) |
| 2021 Net Income  2020 Net Capital Loss |  | Nil  ($1,000) |
| 2021 Taxable Income |  | Nil |

Since there are $1,000 of net taxable capital gains this year, and the problem states that Ms. Breau would like to deduct the maximum amount of net capital losses, the net capital loss of $1,000 is applied against the ITA 3(b) amount of $1,000, which effectively increases the 2021 non-capital loss.

The 2021 non-capital loss is calculated as follows:

|  |  |  |
| --- | --- | --- |
| Business Loss | $14,000 | |
| Add: 2020 Net Capital Loss Deducted |  | 1,000 |
| ITA 3(c) Income |  | (5,950) |
| 2021 Non-Capital Loss | $ 9,050 | |

The entire 2021 non-capital loss could be carried back to 2020, but since Ms. Breau requires $15,000 in taxable income to fully utilize her personal tax credits, no carry back is contemplated.

There would be the following loss balances at the end of 2021:

* + 2020 Restricted Farm Loss (Unchanged) $3,750
  + 2020 Net Capital Loss ($1,500 – $1,000)] $ 500
  + 2021 Non-Capital Loss $9,050

###### 2022 Analysis

The required information can be calculated as follows:

ITA 3(a)

Non-Farming Business Income $30,000

Farm Income 3,150

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

ITA 3(b)

Taxable Capital Gains $ 2,000

Allowable Capital Losses Nil 2,000

2022 Net Income $39,113

2020 Restricted Farm Loss (Equal to Farm Income) (3,150)

2020 Net Capital Loss (Less than the $2,000 taxable capital gain) (500)

2021 Non-Capital Loss Carry Forward (All) ( 9,050)

2022 Taxable Income $26,413

There would be the following loss balances at the end of 2022:

* + 2020 Restricted Farm Loss ($3,750 – $3,150) $ 600

###### 2023 Analysis

The required information can be calculated as follows:

ITA 3(a)

Taxable (Grossed Up) Dividends $ 6,450

ITA 3(b)

|  |  |  |
| --- | --- | --- |
| Taxable Capital Gains | $ 2,250 |  |
| Allowable Capital Losses | (7,250) | Nil |
| ITA 3(c) ITA 3(d)  Non-Farming Business Loss |  | $ 6,450 |
| ($19,000) |  |
| Farm Loss | (2,000) | (21,000) |
| 2023 Net Income and Taxable Income |  | Nil |

The 2023 non-capital loss can be calculated as follows:

|  |  |
| --- | --- |
| Business Loss | $19,000 |
| ITA 3(c) Income | (6,450) |
| Non-Capital Loss | $12,550 |
| Farm Loss (Unrestricted) | 2,000 |
| 2023 Non-capital loss | $14,550 |

The total loss carry over of $14,550 is available for carry back to any of the three preceding years.

The 2023 net capital loss would be equal to $5,000 [ITA 3)(b)(ii) $7,250 – ITA 3(b)(i) of $2,250)]. $1,500 of the 2023 net capital loss can be applied to the 2022 year as there is $1,500 ($2,000 – $500) in net taxable capital gains remaining in 2022 as the basis for a carry back. This leaves a balance of $3,500 ($5,000 – $1,500).

If both the $14,550 non-capital loss and the $1,500 net capital loss were carried back to 2022, the result would be a Taxable Income of $10,363, less than the $15,000 that is required to fully utilize Ms. Breau’s available personal tax credits. As the 2022 net capital loss can only be deducted to the extent of net taxable capital gains, it would be advisable to first claim the full amount of this loss. Based on this view, the deduction of the 2023 non-capital loss will be limited to $9,913 ($26,413 – $15,000 – $1,500), an amount that will provide for the full use of Ms. Breau’s 2022 personal tax credits:

|  |  |
| --- | --- |
| 2022 Taxable Income (As Reported) | $26,413 |
| 2023 Net Capital Loss | ( 1,500) |
| 2023 Non-Capital Loss | ( 9,913) |
| 2022 Revised Taxable Income | $15,000 |

These loss applications leave Ms. Breau with her required $15,000 in 2022 taxable income. The following loss balances remain at the end of 2023:

* 2020 Restricted Farm Loss $ 600
* 2023 Net Capital Loss ($5,000 – $1,500)] $3,500
* 2023 Non-Capital Loss ($14,550 – $9,913) $4,637

Solution to AP 11-2

Before the consideration of any loss carry overs, Lucinda’s taxable income for 2022 would be as follows:

|  |  |
| --- | --- |
| Rental Income | $ 91,450 |
| Interest Income | 38,275 |
| Taxable Capital Gains | 17,300 |
| 2022 Net Income and Taxable Income | $147,025 |

The loss on the Recovery Inc. loan receivable in 2023 qualifies as a Business Investment Loss (BIL) because it is a transaction to which ITA 50(1) applies. However, because of her use of the capital gains deduction in 2021, $156,000 of this amount would be disallowed as a result of ITA 39(9). Given this, the ABIL would be calculated as follows:

|  |  |
| --- | --- |
| Total Capital Loss | $675,000 |
| Reduced by previous Capital Gains Deduction | (156,000) |
| BIL | $519,000 |
| Inclusion Rate | 1/2 |
| 2023 ABIL | $259,500 |

Once the ABIL amount is determined, Lucinda’s 2023 taxable income can be calculated as follows:

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

Rental Income $86,300

Interest Income 27,438 $113,738

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

Taxable Capital Gains $18,620

Allowable Capital Loss

[(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)

2023 Net Income and Taxable Income Nil

**Note 1** The part of the capital loss of $675,000 that does not qualify as a BIL retains its character as a regular capital loss of $156,000. The allowable capital loss is therefore 50% of that amount or $78,000. As a result, there would be a 2023 net capital loss of $59,380 (ITA 3(b)(ii) $78,000 – ITA 3(b)(i)) $18,620). This 2023 net capital loss can be carried back to 2022 and applied to the extent of the net taxable capital gains of $17,300 in that year.

**Note 2** As the ABIL was realized in 2023, it must be used to reduce net income for 2023. The 2023 non-capital loss would equal $145,762 (ITA 3(d) of $259,500 – ITA 3(c) of $113,738).

The amount that should be carried back to 2022 would be calculated as follows:

|  |  |
| --- | --- |
| 2022 Net Income (As Originally Calculated) | $147,025 |
| 2023 Net Capital Loss | (17,300) |
| 2023 Non-Capital Loss | (115,327) |
| 2022 Taxable income (equal to the 2022 BPA) | $ 14,398 |

As planned, these deductions would leave a 2022 taxable income of $14,398 ($147,025 – $17,300 − $115,327). The income tax on this amount will be eliminated by Lucinda’s 2022 BPA. Since there was no federal income tax payable prior to 2022, there would be no additional loss carry backs. The following loss balances remain after the loss carry back applications:

2023 Net Capital Loss Carry Forward ($59,380 – $17,300) $42,080

2023 Non-Capital Loss Carry Forward ($145,762 – $115,327) $30,435

For the next 10 years, the ABIL will be part of the 2023 non-capital loss. Any unused amount remaining after 10 years will be transferred from the 2023 non-capital loss to a net capital loss in year 11. As a net capital loss, it may then be carried forward indefinitely (until the year of death).

Solution to AP 11-3

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 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 the same year. The result is calculated as follows:

|  |  |
| --- | --- |
| 2023 Capital Loss [($82,000 + $200) – $21,000] | $ 61,200 |
| ITA 39(9) Reduction for previous years capital gains deduction  ($20,000 + $14,000) | (34,000) |
| BIL | $ 27,200 |
| Inclusion Rate | 1/2 |
| 2023 ABIL | $ 13,600 |

David’s 2023 net income would be calculated as follows:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| ITA 3(a) |  | | | |
| 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 | |  |
| Regular Allowable Capital Loss |  | |  |
| [(1/2)($34,000)] | (17,000) | | 49,000 |
| ITA 3(c) |  | | $168,200 |
| ITA 3(d) |  | |  |
| ABIL |  | | (13,600) |
| 2023 Net Income |  | | $154,600 |

David’s 2023 taxable income under the two different assumptions would be determined as follows:

|  |  |  |
| --- | --- | --- |
|  | **Part A** | **Part B** |
| 2023 Net Income | $154,600 | $154,600 |
| 2019 Net Capital Loss | (5,500) | Nil |
| Capital Gains Deduction (Note) | (27,100) | (32,600) |
| 2023 Taxable Income | $122,000 | $122,000 |

**Note** As the only capital gains in 2023 are on QSBC shares, the simplified formula for the annual gains limit as described in the textbook can be used. Given this, the 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)($971,190\*)] | $485,595 | $485,595 |
| Amount Used in 2014 [(1/2)($20,000)] | (10,000) | (10,000) |
| Amount Used in 2018 [(1/2)($14,000)] | (7,000) | (7,000) |
| Capital Gains Deduction Available | $468,595 | $468,595 |

\*This is the 2023 limit for gains on dispositions of QSBC shares. For gains on qualified farm or fishing property (QFP), the 2023 limit remains unchanged from 2022 at $1,000,000 in total adding $28,810 for QFP.

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

|  |  |  |
| --- | --- | --- |
|  | **Part A** | **Part B** |
| ITA 3(b) amount | $49,000 | $49,000 |
| ABIL Realized | (13,600) | (13,600) |
| 2019 Net Capital Loss Deducted | (5,500) | Nil |
| 2023 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 Prior 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 2019 $5,500 net capital loss balance but will have $5,500 less of his capital gains deduction available for future years. Taxable income in both cases is the same.

Solution to AP 11-4

###### Part A – 2023 Taxable Income

Mr. and Mrs. Bahry’s 2023 taxable income would be calculated as follows:

|  |  |  |
| --- | --- | --- |
|  | **Mr. Bahry** | **Mrs. Bahry** |
| OAS (See Note) | $ 8,500 | $ 8,500 |
| RPP | 12,340 | 820 |
| RRIF | N/A | 1,000 |
| CPP | 3,690 | 830 |
| Eligible Dividends Received | 1,600 | 336 |
| Gross Up on Dividends (38%) | 608 | 128 |
| Interest Income on Savings Accounts | 1,239 | 3,500 |
| Net Taxable Capital Gain | Nil | Nil |
| 2023 Net Income and Taxable Income | $27,977 | $15,114 |

**Note** Neither Mr. nor Mrs. Bahry would have to repay any OAS benefits as both of their net incomes are well below the 2023 threshold income of $86,912.

Mr. Bahry can elect to include Mrs. Bahry’s taxable dividends in his income under ITA 82(3) as the transfer would leave her with net income of $14,650 ($15,114 – $336 – $128). This would allow an increase in the spousal credit to $350 [$15,000 − $14,650], from Nil [$15,000 - $15,114] in the absence of an election. This would also allow Mr. Bahry to use the dividend tax credit that would have been available to Mrs. Bahry but which could not actually be used because her taxable income, and therefore her federal income tax payable, was not high enough.

###### Part A - Tax Credits

Mrs. Bahry excludes the $464 grossed-up taxable dividends as a result of the ITA 82(3) election. This increases the amount of personal tax credits she can transfer.

|  |  |  |
| --- | --- | --- |
| Credits Available for Transfer: |  |  |
| Age |  | $8,396 |
| Pension (On $820 + $1,000 only) |  | 1,820 |
| Total Available Reduced by Excess of:  Mrs. Bahry’s Net Income |  | $10,216 |
| ($14,650) |  |
| Over BPA | 15,000 | Nil |
| Credit Base Transferred to Spouse |  | $10,216 |

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

|  |  |
| --- | --- |
| BPA | $15,000 |
| Spousal Credit ($15,000 - $14,650) | 350 |
| Age (No Reduction Required) | 8,396 |
| Pension | 2,000 |
| Transfers from Mrs. Bahry (see preceding calculation) | 10,216 |
| Credit Base | $35,962 |
| Rate | 15% |
| Total | $ 5,394 |
| Dividend Tax Credit [(6/11)($608)] | 332 |
| Dividend Tax Credit [(6/11)($128)] | 70 |
| Charitable Donations (See Note)  [(15%)($200) + (29%)($1,210 + $300 – $200)] | 410 |
| Total Credits | $ 6,206 |

**Note** Charitable donations can be claimed by either spouse, as long as the total donations are less than 75% of the claiming spouse’s net income. As Mrs. Bahry has no federal income 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 15% 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 2023. As a result, they become 2023 net capital losses to each of them that can be carried back three years or carried forward indefinitely to be applied against net taxable capital gains (the ITA 3(b) amount) in those carry over years.

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

Since Mr. and Mrs. Bahry are both in the lowest federal income tax bracket of 15% and neither has any OAS clawback, the optimum use of pension income splitting would accomplish the following objectives:

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

###### Based on the facts however Mrs. Bahry would not pay any federal income tax and neither would Mr. Bahry since, with the ITA 82(3) election, his 2023 taxable income would be $28,441 [$ 27,977 + $464]. At a tax rate of 15% the gross federal income tax payable would be $4,266 [(15%)( $28,441)] which is less than his total credits of $6,206. Pension splitting would not improve this result.

Solution to AP 11-5

###### Regular Part 1 2023 Federal Income Tax Payable

The minimum regular 2023 taxable income and 2023 federal income tax payable calculations would be as follows:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Milana** | **Albert** | **Therese** |
| Business Income | $120,000 | $ Nil | $ Nil |
| Employment Income | Nil | 26,000 | 60,000 |
| Eligible Dividends Received | Nil | Nil | 25,000 |
| Dividend Gross Up (38%) | Nil | Nil | 9,500 |
| Non-Eligible Dividends Received | Nil | 94,000 | Nil |
| Dividend Gross Up (15%) | Nil | 14,100 | Nil |
| Taxable Capital Gains | 140,000 | 180,000 | 500,000 |
| Retiring Allowance | 80,000 | Nil | Nil |
| RRSP Deductions (Note 1) | (46,000) | (3,960) | (31,000) |
| ABIL | Nil | Nil | (60,000) |
| 2023 Net Income | $294,000 | $310,140 | $503,500 |
| Capital Gains Deduction | Nil | (100,000) | (440,000) |
| Non-Capital losses | (173,000) | (60,000) | Nil |
| 2023 Taxable Income | $121,000 | $150,140 | $ 63,500 |
| Federal Income Tax (Note 2) | $ 22,656 | $30,232 | $ 10,083 |
| BPA (Note 3) | (2,028) | (2,028) | (2,028) |
| Dividend Tax Credit |  |  |  |
| (9/13 of Gross Up) | Nil | (9,762) | Nil |
| (6/11 of Gross-Up) | Nil | Nil | (5,182) |
| 2023 Federal Income Tax Payable | $ 20,628 | $ 18,442 | $ 2,873 |

**Note 1** Albert’s 2023 RRSP deduction room is calculated as follows:

|  |  |
| --- | --- |
| Lesser of: |  |
| 2023 RRSP Dollar Limit = $30,780 |  |
| 18% of 2022 Earned Income of $22,000 = $3,960 | $3,960 |
| Less 2022 PA | Nil |
| 2023 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. Albert will not be subject to the RRSP penalty tax for overcontributions since the amount is not in excess of $2,000.

Therese’s 2023 RRSP deduction room is calculated as follows:

|  |  |
| --- | --- |
| Unused Deduction Room - End of 2022 Annual Addition - Lesser of:  2023 RRSP Dollar Limit = $30,780  18% of 2022 Earned Income of $120,000 = $21,600 | $21,000  21,600 |
| Less 2022 PA | (11,600) |
| 2023 RRSP Deduction Limit | $31,000 |
| Un-deducted Contributions from Previous Years | (8,000) |
| 2023 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 2023 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 RRSP penalty tax for over-contributions since the amount is not in excess of $2,000.

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

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Taxable Income** | **Federal Tax Calculations** | **Federal Tax** |
| Milana | $121,000 | $18,942 + (26%)( $14,283) | $22,656 |
| Albert | $150,140 | $18,942 + (26%)( $43,423) | $30,232 |
| Therese | $ 63,500 | $8,004 + (20.5%)( $10,141) | $10,083 |

**Note 3** Since the 2023 net income of all three individuals is more than $235,675 the BPA for each is $2,028 [(15%)($13,521)].

###### AMT Payable

The AMT calculations would be as follows:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Milana** | **Albert** | **Therese** |
| Regular Taxable Income | $121,000 | $150,140 | $ 63,500 |
| 60% of Taxable Capital Gains (Note 4) | 84,000 | 108,000 | 300,000 |
| 60% of ABIL (Note 4) | Nil | Nil | (36,000) |
| Dividend Gross Up | Nil | (14,100) | (9,500) |
| Adjusted Taxable Income | $205,000 | $244,040 | $318,000 |
| AMT Exemption | (40,000) | (40,000) | (40,000) |
| AMT Base | $165,000 | $204,040 | $278,000 |
| Rate | 15% | 15% | 15% |
| Federal AMT before Credit | $ 24,750 | $ 30,606 | $ 41,700 |
| BPA | (2,028) | (2,028) | (2,028) |
| Federal AMT | $ 22,722 | $ 28,578 | $ 39,672 |
| Regular Federal Income Tax Payable | (20,628) | (18,442) | (2,873) |
| Additional Income Tax Required | $ 2,094 | $ 10,136 | $ 36,799 |

**Note 4** There are two acceptable methods for determining the addition for capital gains or the deduction for an ABIL. Either one may be used:

* multiplying the “capital gain” or the “business investment loss” by 30%

OR

* multiplying the “taxable capital gain” or “allowable business investment loss” by 60%.

The excess of AMT over regular federal income tax payable for each of Milana, Albert, and Therese can be carried forward for seven years and applied against any future excess of federal income tax payable over the AMT for that year.

**Bonus Question Solution:** There are a number of methods that can be used to reduce or eliminate an AMT liability altogether. It is important, however, to keep in mind that the AMT is recoverable over the subsequent seven years albeit without interest. If it is anticipated that Part 1 federal income 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 strategies should be explored 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 federal income tax. Another common strategy is to claim capital gain reserves where possible, which reduces the impact of adding back 60% 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.

**Milana – Analysis:** In Milana’s case she claimed all her non-capital losses 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 non-capital losses. Had she limited her non-capital loss deduction to approximately $155,000 there would not have been an AMT liability.

**Albert – Analysis:** Given the flexibility of being the sole shareholder of his own CCPC, Albert could have reduced his AMT by opting for a greater amount of salary instead of 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 income tax. 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.

**Therese – Analysis:** Options available for Therese to reduce the additional tax of $36,799 created by the AMT are to (1) reduce her RRSP deduction, (2) claim a smaller amount for the capital gains deduction, and (3) 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 AP 11-6

###### Deemed Dispositions Immediately before Death

Under ITA 70(5), there is a deemed disposition of all the capital property of an individual immediately prior to the moment of death. In general, the deemed POD is the FMV 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 POD will be the tax cost of the property, ACB for non-depreciable capital property, and proportionate UCC for depreciable property.

With respect to this exception, the executor of the estate can elect out of ITA 70(6) and use the values that would apply in ITA 70(5). This results in the use of deemed POD based on FMV, thereby resulting in income tax consequences that will be reported on the deceased individual’s final income tax return. As stated in the problem, Rachelle’s will instructs the executor to opt out of the ITA 70(6) spousal rollover.

Any property inherited by Rachelle’s daughter would not be exempt from the usual deemed disposition rules on death as there is no rollover that applies to properties she inherits.

###### Business Income

Rachelle’s Business Income is calculated as follows:

|  |  |
| --- | --- |
| Business Income | $69,400 |
| Recapture on sale of depreciable property (Given) | 5,900 |
| 2023 Business Income | $75,300 |

###### Property Income

Rachelle’s property income is calculated as follows:

|  |  |
| --- | --- |
| Interest Attributed from Martin (Note 1) | $ 876 |
| 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 |
| 2023 Property Income | $59,298 |

**Note 1** The interest income received by Martin 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 is $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 2023 net income 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 income tax return.

###### Net Taxable Capital Gains

Rachelle’s net taxable capital gains are calculated as follows:

|  |  |
| --- | --- |
| Rental Property - Land ($112,000 – $102,000) | $10,000 |
| Rental Property - Building ($243,000 – $210,000) | 33,000 |
| RAF Ltd. Shares (Note 2) | Nil |
| Flax Fittings Inc. Shares ($104,000 – $72,000) | 32,000 |
| Principal Residence ($507,000 – $382,600) | 124,400 |
| Principal Residence Exemption (100%) | (124,400) |
| Listed Personal Property:  Gain on Art ($57,000 – $23,400) $33,600  Loss on Jewelry ($32,000 – $8,300) (23,700)  2020 Listed Personal Property Loss  (Note 3) (5,400) | 4,500 |
| Taxable Capital Gains | $79,500 |
| Inclusion Rate | 1/2 |
| 2023 Net Taxable Capital Gains | $39,750 |

**Note 2** Donations of publicly listed securities benefit from special rules that make gifting these types of shares particularly attractive. While a donor is entitled to a donations tax credit based on the full FMV of such property, ITA 38(a.1) deems the capital gain on gifts of publicly listed securities to be nil.

**Note 3** The listed personal property loss decreases the net gain on listed personal property in the calculation of net income. All the carry forward amount can be claimed as it is less than the net capital gains on listed personal property for the year of $9,900 [$33,600 – $23,700].

###### 2023 Net Income

Rachelle’s 2023 net income would be calculated as follows:

|  |  |
| --- | --- |
| Business Income | $ 75,300 |
| Property Income | 59,298 |
| Net Taxable Capital Gains | 39,750 |
| Other Income - RRSP (Tax Free Transfer to Spouse) | Nil |
| Deductible CPP Contributions |  |
| [(2)($ 3,754) – $ 3,123] | (4,385) |
| 2023 Net Income | $169,963 |

###### 2023 Taxable Income

Rachelle’s 2023 taxable income would be calculated as follows:

|  |  |
| --- | --- |
| 2023 Net Income | $169,963 |
| 2021 Net Capital Loss (Note 4) | (89,400) |
| 2023 Taxable Income | $ 80,563 |

**Note 4** In the year of death, net capital losses can be deducted against any type of income, not just capital gains (as long as the capital gains deduction has not been claimed in previous years). As a result, all the available net capital loss balance can be deducted.

###### 2023 Federal Income Tax Payable

Rachelle’s minimum 2023 federal income tax payable would be calculated as follows:

|  |  |  |  |
| --- | --- | --- | --- |
| Tax on First $53,359 |  | $ 8,004 | |
| Tax on Remaining $27,204 ($80,563 - $53,359) at 20.5% |  | 5,577 | |
| Federal Tax before Credits |  | $ 13,581 | |
| BPA | ( $15,000) |  | |
| Spousal ( $15,000 − $2,924) (See Note 1) | ( 12,076) |  | |
| CPP | ( 3,123) |  | |
| Credit Base | ($ 30,199) |  | |
| Rate | 15% |  | ( 4,530) |
| Eligible Dividend Tax Credit [(6/11)(38%)($860)] |  |  | (178) |
| Non-Eligible Dividend Tax Credit [(9/13)(15%)($6,200)]  Charitable Donation (Note 5) |  |  | (644) |
| [(15%)($200) + (29%)($28,600 − $200)] |  | (8,266) |
| 2023 Federal Income Tax Payable |  | $ Nil | |

**Note 5** As none of her income is subject to the 33% income tax bracket, this rate will not be applicable to the calculation of the charitable donations tax credit. Note that the total non-refundable personal tax credits exceed federal income tax by $37. A number of strategies are available to reduce this to nil, including avoiding FMV dispositions to her spouse, Martin. Also note that there are no income tax consequences associated with the RRSP given that there is a spousal/common-law partner rollover.

Solution to AP 11-7

### Part A

###### Lyla’s 2023 Federal Income Tax Payable

Lyla’s 2023 net inco135me and taxable income would be calculated as follows:

|  |  |
| --- | --- |
| Salary | $270,000 |
| Group Disability Plan | Nil |
| RPP Contributions | (12,450) |
| Deductible CPP ($3,754 - $3,123) | ( 631) |
| 2023 Net Income and Taxable Income | $ 256,919 |

As Lyla has no other income and no taxable income deductions her 2023 net income is equal to her taxable income. Given this, her 2023 federal income tax payable would be calculated as follows:

|  |  |  |  |
| --- | --- | --- | --- |
| Tax on First $235,675 |  |  | $54,578 |
| Tax on Next $21,244 ($256,919 - $235,675) at 33% | | | 7,011 |
| Income Tax Payable (Before Credits) |  |  | $61,589 |
| BPA | ($13,521) | |  |
| Spousal (Income too High) | Nil | |  |
| EI Premiums | ( 1,002) | |  |
| CPP Contributions | ( 3,123) | |  |
| Canada Employment | ( 1,368) | |  |
| Medical Expenses (Note 1) | ( 78,365) | |  |
| Credit Base for Personal Tax Credits | ( $97,379) | |  |
| Rate | 15% | | ( 14,607) |
| Charitable Donations (Note 2) |  | | ( 51,572) |
| 2023 Federal Income Tax Payable  (Credits exceed federal income tax by $4,590) |  | | Nil |

**Note 1** The base for the medical expense tax credit, after taking into consideration the 100% coverage of Canadian medical expenses, would be calculated as follows:

|  |  |
| --- | --- |
| Total Expenses |  |
| ($70,200 + $10,800 + $4,800 – $4,800) | $81,000 |
| Lesser Of: |  |
| [(3%)( $256,919)] = $7,708 |  |
| 2023 Limit = $ 2,635 | ( 2,635) |
| Medical Expense Credit Base | $78,365 |

Because a doctor has indicated the required treatment was not available in a reasonable period of time, the travel expenses associated with the surgery would be included in the base for the medical expense tax credit. Since the medical expenses were incurred outside Canada, Lyla’s medical insurance does not cover the expenses related to the surgery in the United States.

**Note 2** The charitable donations tax credit would be calculated as follows:

|  |  |  |
| --- | --- | --- |
| 15% of $200  33% of the lesser of: | $ 30 |  |
| $175,000 – $200 = $174,800  $256,919 - $235,675 = $21,244 | 7,011 |  |
| 29% of $153,556 [$175,000 – ($200 + $21,244)] | 44,531 |  |
| Total Donation Credit | $ 51,572 |  |

Clark’s property income would be calculated as follows:

|  |  |
| --- | --- |
| Interest income | $ 28,600 |
| Eligible Dividends | 136,000 |
| Eligible Dividends Gross Up [(38%)($136,000)] | 51,680 |
| Net Taxable Capital Gains | 77,000 |
| Mortgage Interest expense\* | (12,000) |
| 2023 Net Income and Taxable Income | $281,280 |

\*As the direct use of the mortgage funds was for investments, the interest is deductible against the investment source of income.

As Clark has no other income and no taxable income deductions his property income and net taxable capital gains would be both his 2023 net income and his taxable income. Given this, his 2023 federal income tax payable would be calculated as follows:

|  |  |  |
| --- | --- | --- |
| Tax on First $235,675 | | $ 54,578 |
| Tax on Next $45,605 ($281,280 – $235,675) at 33% | | 15,050 |
| Gross Tax Payable  BPA ($13,521) Spousal (Income too High) Nil | | $ 69,628 |
| Credit Base for Personal Tax Credits | ($ 13,521) |  |
| Rate | 15% | ( 2,028) |
| Dividend Tax Credit [(6/11)(38%)($136,000)] |  | (28,189) |
| 2023 Federal Income Tax Payable |  | $ 39,411 |

###### Combined 2023 Federal Income Tax Payable

The couple’s combined 2023 federal income tax payable, assuming the Lyla claims all the medical expenses and charitable donations, would be as follows:

Lyla’s Federal Income Tax Payable Nil

Clark’s Federal Income Tax Payable $ 39,411

Combined 2023 Federal Income Tax Payable $ 39,411

### Part B

###### Lyla’s 2023 Federal Income Tax Payable

If Lyla did not claim the medical expenses and charitable donation amounts, her 2023 taxable income would be unchanged from Part A. Based on this, her federal income tax payable would be calculated as follows:

|  |  |  |  |
| --- | --- | --- | --- |
| Tax on First $235,675 |  |  | $ 54,578 |
| Tax on Next $ 21,244 ($ 256,919 – $ 235,675) at 33% | | | 7,011 |
| Income Tax Payable (Before Credits) |  |  | $ 61,589 |
| BPA ($ 13,521)  Spousal (Income too High) Nil | | | |
| EI Premiums |  | ( 1,002) |  |
| CPP Contributions |  | ( 3,123) |  |
| Canada Employment |  | ( 1,368) |  |
| Credit Base For Personal Credits | ($19,014) | |  |
| Rate |  | 15% | ( 2,852) |
| 2023 Federal Income Tax Payable |  |  | $ 58,737 |

If Clark claims the medical and charitable donations amounts, his taxable income would be unchanged from Part A. Based on this, his federal income tax payable would be calculated as follows:

|  |  |  |
| --- | --- | --- |
| Tax on First $235,675 | $ 54,578 | |
| Tax On Next $ 45,605 ($281,280 – $ 235,675) at 33% |  | 15,050 |
| Income Tax Payable (Before Credits)  BPA ($13,521) Spousal (Income too High) Nil Medical Expense Tax Credit (Note 3) (78,365) | $ 69,628 | |
| Credit Base For Personal Credits ($ 91,886)  Rate 15% |  | ( 13,783) |
| Dividend Tax Credit [(6/11)(38%)($136,000)] |  | (28,189) |
| Charitable Donations Tax Credit (Note 4) |  | ( 52,517) |
| 2023 Federal Income Tax Payable  (Credits exceed federal income tax by $24,861) |  | Nil |

**Note 3** The base for this credit would not be changed from Part A when Lyla claimed the expenses. The calculation is as follows:

|  |  |  |
| --- | --- | --- |
| Total Expenses ($70,200 + $10,800 + $4,800 – $4,800) |  | $81,000 |
| Lesser of: |  |  |
| [(3%)($281,280)] = $8,438 |  |  |
| 2023 Limit = $ 2,635 |  | ( 2,635) |
| Medical Expense Credit Base |  | $78,365 |

**Note 4** Clark’s charitable donations tax credit would be calculated as follows:

|  |  |
| --- | --- |
| 15% of $200 | $ 30 |
| 33% of the lesser of: |  |
| $175,000 – $200 = $174,800 |  |
| $281,280 – $ 235,675 = $ 45,605 | 15,050 |
| 29% of $ 129,195 [$175,000 – ($200 + $ 45,605)] | 37,467 |
| Total Donation Credit | $ 52,517 |

###### Combined 2023 Federal Income Tax Payable

The couple’s combined 2023 federal income tax payable, assuming that Clark claims all the medical expenses and charitable donations, would be as follows:

|  |  |
| --- | --- |
| Lyla’s Federal Income Tax Payable | $ 58,737 |
| Clark’s Federal Income Tax Payable | Nil |
| Combined 2023 Federal Income Tax Payable | $ 58,737 |

###### Part C

The combined net federal tax payable in Part B is $19,326 ($58,737 – $39,411) higher than in Part A. This is despite the fact that Clark’s charitable donation credit is $ 945 ($52,517 – $51,572) larger than Lyla’s.

The difference is due to unused personal tax credits. In Part A, $4,590 in credits available to Lyla are not used. In Part B, $24,861 in personal tax credits available to Clark are not used.

In looking to reduce combined 2023 federal income tax payable, three things should be noted:

* + While the value of the medical expense tax credit is the same without regard to who claims it, it would be better for Lyla to make the claim as it would not leave any unused credits for her since her net income is less than that of Clark.
  + With respect to the charitable donations credit, as Clark has the higher taxable income, a larger amount of the donation is eligible for a credit based on 33%.
  + When the entire donation is claimed by either individual, a significant part of the claim results in a credit based on the 29% rate, $153,556 when Lyla claims the entire amount, and $129,195 when Clark claims the entire amount.

This would suggest that Lyla should claim all the medical expenses and $21,444 ($256,919 – $235,675 + $200) of the donations. Based on this, her 2023 federal income tax payable would be as follows:

|  |  |  |
| --- | --- | --- |
| Tax on First $235,675 |  | $ 54,578 |
| Tax on Next $ 21,244 ($ 256,919 – $ 235,675) at 33% |  | 7,011 |
| Income Tax Payable (Before Credits) |  | $ 61,589 |
| BPA | ($ 13,521) |  |
| Spousal (Income too High)  EI Premiums | Nil  ( 1,002) |  |
| CPP Contributions | ( 3,123) |  |
| Canada Employment | ( 1,368) |  |
| Medical Expenses (As in Part A and B) | ( 78,365) |  |
| Credit Base for Personal Credits | ($ 97,379) |  |
| Rate | 15% | ( 14,607) |
| Charitable Donations (Note 5) |  | ( 7,041) |
| 2023 Federal Income Tax Payable |  | $ 39,941 |

**Note 5** The charitable donations tax credit would be calculated as follows:

|  |  |
| --- | --- |
| 15% of $200 | $ 30 |
| 33% of the lesser of: |  |
| $ 21,444 – $200 = $ 21,244 |  |
| $ 256,919 – $ 235,675 = $21,244 | 7,011 |
| 29% of Nil [$ 21,444 – ($200 + $ 21,244)] | Nil |
| Total Donation Credit | $ 7,041 |

This would leave $153,556 ($175,000 – $21,444) of the donations to be claimed by Clark. Based on this, his 2023 federal income tax payable would be calculated as follows:

|  |  |  |
| --- | --- | --- |
| Tax on First $235,675 | | $ 54,578 |
| Tax on Next $45,605 ($281,280 – $235,675) at 33% | | 15,050 |
| Income Tax Payable (Before Credits)  BPA ($13,521)  Spousal (Income too High) Nil | | $ 69,628 |
| Credit Base for Personal Tax Credits | ($13,521) |  |
| Rate | 15% | ( 2,028) |
| Dividend Tax Credit [(6/11)(38%)($136,000)] |  | (28,189) |
| Charitable Donations Tax Credit (Note 6) |  | ( 46,298) |
| 2023 Federal Income Tax Payable  (Credits exceed federal income tax by $6,887) |  | $ Nil |

**Note 6** Clark’s charitable donations tax credit would be calculated as follows:

|  |  |
| --- | --- |
| 15% of $200  33% of the lesser of: | $ 30 |
| $153,556 – $200 = $153,356  $281,280 – $ 235,675 = $45,605 | 15,050 |
| 29% of $107,751 [$153,556 – ($200 + $45,605)] | 31,248 |
| Total Donation Credit | $ 46,298 |

###### Combined 2023 Federal Income Tax Payable

The couple’s combined 2023 federal income tax payable, for all three parts, would be as follows:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Part A** | **Part B** | **Part C** |
| Lyla’s Federal Income Tax Payable | Nil | $58,737 | $39,941 |
| Clark’s Federal Income Tax Payable | $39,411 | Nil | Nil |
| Combined 2022 Federal Income Tax Payable | $39,411 | $58,737 | $39,941 |

The combined 2023 federal income tax payable in Part C is slightly more than that for Part A and a significant improvement over the combined federal income tax payable in Part B.

In Part C there are unused personal tax credits of $6,887 compared to $4,590 for Part A, a difference of $2,297, which partly explains the $530 difference in federal income tax payable (Part C $39,941 – Part A $39,411). In all three parts there is a considerable amount of donations that are only benefitting from the 29% rate ($153,556 for Part A, $129,195 for Part B, and $107,751 for Part C). The four percentage point difference between the 29% and 33% federal income tax rates represents additional income tax savings that are not being used to their best advantage.

If Lyla and Clark expect to have taxable income amounts in excess of the 33% threshold and they do not expect to make large donations in the future, any carry forward amount could result in a credit based on 33% rather than the 29%. It would be advisable for the couple to only claim donations to the extent they benefit from the 33% rate.

###### Tax Planning Notes

If Clark claimed $23,748 less donations, his unused credit would become nil. This number is calculated as $6,887 ÷ 0.29. If these same donations are claimed by Lyla, her federal income tax payable would then be reduced by $6,887 resulting in federal income tax payable of $33,054 ($39,941 - $6,887). A similar strategy in Part A could be applied, which would eliminate the unused credits of $4,590 and reduce Clark’s federal income tax to $34,821 ($39,411 - $4,590).

As an additional point, as a rule, donations are claimed by the higher income earner and medical expenses claimed by the lowest income earner. However, the tax planning goal of having a high-income earner claiming donations is to take advantage of the 33% rate. If there is sufficient income of both income earners to absorb all personal tax credits but neither has income subject to the 33% rate, then the general planning point is moot. Similarly, low-income individuals generally claim the medical expenses to minimize the threshold limit, which is the lesser of $2,635 and 3% of net income. However, if the low-income earner has income that is greater than $87,833 [$2,635 ÷ 0.03], then the tax planning point is irrelevant since both spouses or common-law partners would then be subject to the $2,635 limit.

Although it is not required by the problem, it could be tax advantageous for Clark to donate public company shares from his portfolio rather than cash. If he has public company shares the ACB of which is less than the FMV at the time of donation, he would be able to reduce his present and/or future income tax liability.

Solution to AP 11-8

###### 2023 Net Income and Taxable Income

Ms. Arsenault’s minimum 2023 net income and taxable income would be calculated as follows:

|  |  |  |
| --- | --- | --- |
| **Employment Income** |  |  |
| Gross Salary - Ottawa | $82,000 |  |
| RPP Contributions - Ottawa | (2,500) |  |
| Stock Option Benefit (Note One) | 10,000 |  |
| Gross Salary - Toronto | 13,000 |  |
| RPP Contributions - Toronto | (650) |  |
| Moving Allowance (Note Two) | 7,500 | $109,350 |
| **Business and Property Income** |  |  |
| Non-Eligible Dividends on Lintz Shares | $ 7,500 |  |
| Gross Up [(15%)($7,500)] | 1,125 |  |
| Non-Eligible Dividends on Gifted Shares | 10,000 |  |
| Gross Up [(15%)($10,000)] | 1,500 |  |
| Deduction for Split Income (Note Three) | (11,500) |  |
| Mail Order Business (Note Four) | 22,500 | 31,125 |
| Other Income (Subdivision d) |  |  |
| Child Support (Note Six) |  | Nil |
| Net Taxable Capital Gains |  |  |
| Lintz Shares [(1/2)($105,000 – $95,000 – $850)] | $ 4,575 |  |
| Employer’s Shares (Note Five) | (175) | 4,400 |
| Other Deductions (Subdivision e) |  |  |
| Moving Expenses (Note Two) | ($ 5,160) |  |
| Child Care Expenses (Note Seven) | (7,660) |  |
| RRSP Contributions (Note Eight) | (10,098) |  |
| Deductible CPP Contributions ($3,754 - $3,123) | ( 631) | ( 23,549) |
| 2023 Net Income |  | $ 121,326 |
| Stock Option Deduction (Note One) |  | (5,000) |
| 2023 Taxable Income |  | $ 116,326 |

**Note One** The required inclusion would be calculated as follows:

|  |  |
| --- | --- |
| FMV at Exercise [($20)(2,000 Shares)]  Cost of Shares [($15)(2,000 Shares)] | $40,000  (30,000) |
| Stock Option Benefit | $10,000 |

As the option price at the time the options were issued was greater than the FMV of the shares at that time, Ms. Arsenault is entitled to a deduction under ITA 110(1)(d), equal to one-half of the $10,000 employment income benefit. The new stock option deduction restrictions would not apply since the stock option plan was granted before July 1, 2021.

**Note Two** All allowances received from an employer, except for those that are specifically exempted, must be included in employment income. As there is no exemption for a moving expense allowance, the $7,500 received by Ms. Arsenault must be added to income. However, she can then deduct the following moving expenses in the calculation of her net income for 2023:

Moving Company Charges $3,800

Airfare for Toronto Trip (Not Deductible) Nil

Meals and Lodging on Toronto Trip (Not Deductible) Nil

Gas for October 31 Move to Toronto 65

Lodging in Ottawa on October 30 110

Meals on October 30 and October 31 while Moving 250

Lease Cancellation Charges 935

Legal Fees on Acquisition of Toronto Home (Not Deductible) Nil

Total $5,160

From an income tax perspective, this situation should have been structured differently. By giving an allowance not based on actual expenses, the employer placed Ms. Arsenault in the position of having to list her expenses. As a consequence, she was limited to those deductions specified in ITA 62(3). The result is a net inclusion in income of $2,340 ($7,500 – $5,160). As an alternative, the employer could have reimbursed her for all the expenses listed in the problem, without creating a taxable benefit for Ms. Arsenault. This would have cost the employer less than $7,500 and, in addition, Ms. Arsenault would have avoided the additional income of $2,340. The legal fees on the new home are not deductible because she did not own a home in the old location.

**Note Three** Ms. Arsenault is a specified individual with respect to her father’s CCPC, which is a related business. As Ms. Arsenault has never been involved in her father’s business, with respect to her, it is not an excluded business. Further, her shares are non-voting and cannot be classified as excluded shares. Given this, the non-eligible dividends received are subject to the Tax on Split Income (TOSI).

**Note Four** The interest on the demand loan is a deductible business expense and does not require any adjustment. The $27,000 withdrawal would have no income tax consequences to an individual carrying on a business as a sole proprietor.

**Note Five** For shares acquired through the exercise of stock options, the ACB is the FMV of the shares at the time of exercise. As a consequence, the allowable capital loss arising on the disposition of the employer’s shares is calculated as follows:

|  |  |  |
| --- | --- | --- |
| POD [($20)(2,000 Shares)] |  | $40,000 |
| Less: |  |  |
| ACB [($20)(2,000)] | ($40,000) |  |
| Selling Costs | (350) | (40,350) |
| Capital Loss |  | ($350) |
| Inclusion Rate |  | ½ |
| Allowable Capital Loss |  | ($175) |

**Note Six** Ms. Arsenault cannot deduct the $2,500 in legal fees paid in connection with her separation agreement. However, as her husband will not be able to deduct the $25,000 lump sum payment, it does not have to be included in her income. The $48,000 [($4,000)(12 Months)] in child support will not be deductible to her husband and is not required to be included in her net income.

**Note Seven** The deductible child care expenses of $7,660 is the least of:

* + - Actual Child Care Expense Plus Deductible Camp Fees

[$7,160 + ($125 Limit)(4 Weeks)] $ 7,660

* + - Annual Limit ($11,000 for Janine + $5,000 for Jerry) 16,000
    - Two-Thirds of Earned Income

[(2/3)($82,000 + $10,000 + $13,000 + $7,500 + $22,500)] 90,000

**Note Eight** Ms. Arsenault’s maximum deductible RRSP contribution is calculated as follows:

|  |  |
| --- | --- |
| Unused Deduction Room - End of 2022 | Nil |
| Lesser of: |  |
| * 2023 RRSP Dollar Limit = $ 30,760 |  |
| * 18% of 2022 Earned Income of $81,100 = $14,598 | $14,598 |
| Less 2022 PA | (4,500) |
| Maximum Deductible RRSP Contribution for 2023 | $10,098 |

###### 2023 Federal Income Tax Payable

The TOSI payable is calculated as follows:

|  |  |
| --- | --- |
| Split Income – Taxable Non–Eligible Dividends (Note Three) | $11,500 |
| Tax Rate | 33% |
| Federal TOSI Payable before Dividend Tax Credit | $ 3,795 |
| Non-Eligible Dividend Tax Credit [(9/13)(15%)($10,000)] | (1,038) |
| 2023 TOSI Payable | $ 2,757 |

The amount owing is calculated as follows:

|  |  |  |
| --- | --- | --- |
| Tax on First $ 106,717 |  | $ 18,942 |
| Tax on Next $9,609 ($116,326 - $106,717) at 26% |  | 2,498 |
| Federal Income Tax before Credits |  | $ 21,440 |
| BPA | ($ 15,000) |  |
| Eligible Dependant – Jerry (Note Nine) | ( 15,000) |  |
| Canada Caregiver – Janine (Note Ten) | ( 7,999) |  |
| CPP | ( 3,123) |  |
| EI | ( 1,002) |  |
| Canada Employment | ( 1,368) |  |
| Transfer of Janine’s Disability | ( 9,428) |  |
| Medical Expenses (Note Eleven) | ( 15,035) |  |
| First Time Home Buyers’ Plan | (10,000) |  |
| Credit Base | ($ 77,955) |  |
| Rate | 15% | ( 11,693) |
| Non-Eligible Dividend Tax Credit [(9/13)($1,125)]  Charitable Donations  [(15%)($200) + (29%)($1,500 – $200)] |  | (779)  (407) |
| Political Contributions Tax Credit |  |  |
| [(3/4)($400) + (1/2)($350) + (1/3)($150)] | (525) | |
| 2023 Federal Income Tax Payable | $ 8,036 | |
| 2023 TOSI Payable (See Previous Calculation) | 2,757 | |
| CPP Overpayment ($ 3,754 + $500 – $ 3,754) | (500) | |
| EI Overpayment ($1,002 + $390 – $1,002) | (390) | |
| Amount Owing to the CRA | $ 9,903 | |

**Note Nine** Although Ms. Arsenault can claim either Jerry or Janine as an eligible dependant, she should pick Jerry because he has no net income in 2023. This allows for the maximum eligible dependant credit.

**Note Ten** Because Janine is disabled and her income is below the income threshold for the Canada caregiver credit of $18,753, Ms. Arsenault can claim the full amount of the Canada caregiver credit for her.

**Note Eleven** Because Janine is over 18, the medical expense credit for her needs to be calculated separately from Ms. Arsenault and Jerry. Ms. Arsenault can still claim a credit for Janine because she is a disabled dependant.

|  |  |  |
| --- | --- | --- |
| Ms. Arsenault and Jerry’s Medical Expenses ($9,700 + $900)  Threshold - Lesser of: | | $10,600 |
| * [(3%)($ 121,326)] = $ 3,640 * 2023 Limit = $ 2,635 |  | ( (2,635) |
| Subtotal  Janine’s Medical Expense Reduced by the Lesser of: | $7,250 | $ 7,965 |
| * [(3%)($6,000)] = $180 |  |  |
| * 2023 Limit = $ 2,635 | (180) | 7,070 |
| Allowable Medical Expenses |  | $ 15,035 |

**Solution to AP 11-9**

**Part A - Bert’s Results**

###### 2023 Net Income

**Note:** If both the TOSI and attribution rules would apply to the same amount a rule in ITA 74.5(13) ensures that only the TOSI will apply. However, since the shares were owned by Bert and purchased with his own funds the attribution rules would not apply. In most situations, the receipt of dividends from a private corporation by a minor (under 18 years of age) are “split income” and therefore subject to the TOSI. Given this, Bert’s regular 2023 net income is nil, calculated as follows:

|  |  |
| --- | --- |
| Non-eligible Dividends Received from PS World | $34,000 |
| Gross Up [(15%)($34,000)] | 5,100 |
| ITA 20(1)(ww) Deduction for Split Income | (39,100) |
| 2023 Net Income | Nil |

###### 2023 Taxable Income

Since there are no taxable income deductions available to Bert, his 2023 net income and taxable income are both nil.

###### 2023 Federal Income Tax Payable

While the 2023 federal income tax payable on his regular income is nil, Bert will have an addition to 2023 federal income tax payable on his split income as follows:

|  |  |
| --- | --- |
| Split Income | $39,100 |
| Rate | 33% |
| Income Tax before Credit | $12,903 |
| Dividend Tax Credit [(9/13) ($5,100)] | (3,531) |
| 2023 TOSI (Tax on Split Income) | $ 9,372 |

Since Bert is under 18 years of age, Jody is jointly liable for his TOSI (ITA 160(1.2)).

### Part B - Jody’s Results

###### 2023 Net Income

Jody’s 2023 net income is calculated as follows:

|  |  |
| --- | --- |
| ITA 3(a)  Employment Income (Salary – PS World Inc.) (Note 1) | $128,000 |
| Property Income (Note 2)  Spousal Support | 159,587  25,000 |
| ITA 3(a) total  ITA 3(b) | $312,587 |
| Net Taxable Capital Gains (Note 4) | 100,194 |
| Total of 3(a) + 3(b)  ITA 3(c) – Subdivision e deductions | $412,781 |
| Child Care Expenses (annual limit is $5,000) | (5,000) |
| CPP Enhanced Deduction ($3,754 - $3,123) | ( 631) |
| RRSP Deduction (Given) | (11,300) |
| 2023 Net Income | $ 395,850 |

**Note 1** [($1,500)(52 weeks) + $50,000 bonus received in 2023]. The $60,000 bonus declared at the end of 2023 will be included in Jody’s income when it is received in 2024.

**Note 2** Jody’s property income is calculated as follows:

|  |  |
| --- | --- |
| Non-Eligible Dividend on Pickers Ltd Shares (Note 3) | $ 40,000 |
| Gross Up [(15%)($40,000)] | 6,000 |
| Non-Eligible Dividend on PS World Inc Shares | 84,000 |
| Gross Up [(15%)($84,000)] | 12,600 |
| Interest on share indebtedness [(5%)($200,000)(5/12)] | 4,167 |
| Dividends from U.S. Public Company [($10,000)(1.282)] | 12,820 |
| 2023 Property Income | $159,587 |

**Note 3** The dividend from Jody’s parents’ company, Pickers Ltd., is not subject to the TOSI. The basic analysis looks first to the type of income, which includes taxable dividends from non-public companies (i.e., private). The next step is to determine whether the business of Pickers Ltd is a “related business”, which generally means a business in which someone related to Jody is actively involved. Clearly the business that generated the taxable dividends is a related business. The next step is to determine whether the business is an “excluded business” because of Jody’s participation currently and in past years. If she participated in that business, then the TOSI would not apply. Since she made no contributions or participated in any manner, the business is not an excluded business. Finally, the last possible exception is whether the shares she owns in Pickers Ltd are “excluded shares”. If they are then the TOSI will not apply. The shares are excluded shares because all of the conditions are met: (i) less than 90% of the company’s gross revenue is from providing services, (ii) the company is not a “professional corporation”, (iii) less than 10% of its business income is as a result of doing business with other related businesses, and (iv) the individual owns shares that represent more than 10% of the value of the company and shares that give the owner more than 10% of the votes. Since the shares are “excluded shares”, the taxable dividends Jody received are not subject to the TOSI.

**Note 4** Jody’s 2023 net taxable capital gains is calculated as follows:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Capital Gain on sale of PS World Inc shares (Note 5)  Listed Personal Property | |  | | $197,988 | |
| Gain on Painting ($8,700 – $1,700) | $7,000 | |  | |
| Gain on Stamp Collection ($11,000 – $9,500) | 1,500 | |  | |
| Gain on Rare Book ($5,000 – $1,000) (Note 6) | 4,000 | |  | |
| Loss on Coin Collection ($11,000 – $19,000) | (8,000) | |  | |
| 2021 Listed Personal Property Loss | (1,200) | | 3,300 | | |
| Net Foreign Currency Exchange Loss [($20,000)(1.25) – $26,100)] | |  | | (1,100) | |
| Foreign Currency Exemption for Individuals\* | |  | | 200 | |
| Net Capital Gains | |  | | $200,388 | |
| Inclusion Rate | |  | | 1/2 | |
| 2023 Net Taxable Capital Gain | |  | | $100,194 | |

\*The foreign currency exemption reduces the first $200 of a capital gain or capital loss.

**Note 5**

POD $400,000

ACB [(25 shares)($1/each)] & Selling Costs $4,000 (4,025)

Total Gain $395,975

Less Reserve - Lesser of:

* [($395,975)($200,000 ÷ $400,000)] = $197,987
* [($395,975)(20%)(4 – 0)] = $316,780 (197,987)

Capital Gain $197,988

**Note 6** Even though the cost or ACB would be $250, the $1,000 rule deems the ACB to be the greater of $1,000 and its actual cost of $250. ITA 46(1)

###### 2023 Taxable Income

Jody’s 2023 taxable income would be calculated as follows:

|  |  |
| --- | --- |
| 2023 Net Income | $ 395,850 |
| Capital Gains Deduction (Note 8) | (76,694) |
| 2019, 2020, and 2021 Non-capital Losses | (60,800) |
| 2020 Net Capital Loss | (4,500) |
| 2023 Taxable Income | $ 253,856 |

**Note 8** The maximum capital gains deduction is $76,494, calculated as the least of the following three amounts:

##### Capital Gains Deduction Available = $361,692

|  |  |
| --- | --- |
| Maximum Limit On Shares [(1/2)($ 971,190\*)] | $ 485,595 |
| Less: Used In Previous Years [(1/2)($160,000)] | (80,000) |
| Capital Gains Deduction Available in 2023 | $ 405,595 |

\*This is the limit for gains on dispositions of QSBC shares for 2023. For gains on qualified farm or fishing property, the 2023 limit is unchanged at $1,000,000, which adds an additional $28,810 ($1,000,000 - $971,190).

##### Annual Gains Limit = $95,694

This limit is equal to A - B, where

A = $98,994 [(1/2)($197,988)]

The lesser of the net taxable capital gains (see Note 4) on:

All Capital Property = $100,194

Qualifying Property [(1/2)($197,988)] = $98,994

B = $3,300

The total of:

The amount, if any, by which net capital loss carry overs deducted for the year under ITA 111(1)(b) exceeds the excess of net taxable capital gains for the year [ITA 3(b)] over the amount determined in Part A of this formula. This amount is $3,300 [$4,500 – ($100,194 – $98,994)]; and

Allowable Business Investment Losses realized during the current year. This amount is nil. This provides an annual gains limit of $95,694 ($98,994 – $3,300).

##### Cumulative Gains Limit = $76,694

|  |  |
| --- | --- |
| Annual Gains Limit from Previous Years | $160,000 |
| Current Year Annual Gains Limit | 95,694 |
| Less: Previous Capital Gains Deduction | (160,000) |
| Less: CNIL (Given - See Note 9) | (19,000) |
| Cumulative Gains Limit | $ 76,694 |

**Note 9** Note that if Jody had paid herself an additional $16,522 in non-eligible dividends it would have equaled $19,000 with the gross-up of 15% and would have reduced the CNIL account to nil, allowing an additional $19,000 in capital gains deduction to be claimed.

###### 

###### 2023 Federal Income Tax Payable

Jody’s regular 2023 federal income tax payable would be determined as follows:

|  |  |  |  |
| --- | --- | --- | --- |
| Tax on First $ 235,675 |  | $ 54,578 |  |
| Tax on Next $18,181 ($253,856 - $235,675) at 33% |  | 6,000 |  |
| 2023 Federal Income Tax Payable (Before Credits) |  | $ 60,578 |  |
| Tax Credits: |  |  |  |
| BPA | ($ 13,521) |  |  |
| Eligible Dependant (Note 10) | Nil |  |  |
| CPP | ( 3,123) |  |  |
| Canada Employment Credit | ( 1,368) |  |  |
| Medical Expenses (Note 11) | ( 8,962) |  |  |
| Total Credit Base | ($ 26,974) |  |  |
| Rate | 15% | ( 4,046) |  |
| Charitable Donation Credit (Note 12) |  | (4,254) |  |
| Foreign Tax Credit (Note 13) |  | (1,923) |  |
| Non-Eligible Dividend Tax Credit [(9/13)($6,000 + $12,600)] |  | (12,877) |  |
| 2023 Federal Income Tax Payable – Regular |  | $ 37,478 |  |

**Note 10** Since Jody’s income exceeds $235,675 she is not entitled to the full BPA of $15,000. Bert’s net income would otherwise be nil since split income is subtracted in its determination. However, for the personal tax credit purposes the split income deduction is ignored (ITA 118(4)(a.2)), which means that Bert’s income is $39,100, which exceeds the eligible dependant threshold [($13,521 – $39,100)].

**Note 11** Jody’s medical expenses are $23,000 – $13,800 (60% of expenses reimbursed by the insurer) + $2,400 in medical insurance premiums = $11,600.

The base for Jody’s medical expense credit can be calculated as follows:

Eligible Medical Expenses $11,600

Reduced by the Lesser of:

* [(3%)($ 395,850)] = $ 11,876
* 2023 Threshold Amount = 2,638 ( 2,638)

Total Credit Base $ 8,962

**Note 12** Jody’s donations total $13,000: $1,000 for Plan Canada + $1,000 for the Humane Society + the FMV of the coin collection of $11,000. Using this as the base, Jody’s charitable donations tax credit would be calculated as follows:

|  |  |
| --- | --- |
| 15% of $200  33% of the lesser of: | $ 30 |
| $13,000 – $200 = $12,800 |  |
| $ 253,856 – $ 235,675 = $ 18,181 | 4,224 |
| 29% of [$13,000 – ($200 + $12,800)] | Nil |
| Total Credit | $ 4,254 |

**Note 13** Jody’s Adjusted Division B Income would be calculated as follows:

|  |  |
| --- | --- |
| Net Income | $ 395,850 |
| Capital Gains Deduction | (76,694) |
| 2020 Net Capital Loss | (4,500) |
| Adjusted Division B Income | $ 314,656 |

Her tax otherwise payable would be calculated as follows:

|  |  |
| --- | --- |
| Tax before Credits | $ 60,578 |
| Personal Tax Credits | ( 4,046) |
| Charitable Donation Credit | (4,254) |
| Tax otherwise payable | $ 52,278 |

Since the foreign non-business income tax withheld is not greater than 15% of the foreign income, Jody’s credit for foreign income tax paid would be the lesser of the foreign income tax withheld of $1,923 [(1.282)($1,500 US)] and an amount determined by the following formula:

[(Foreign Non-Business Income ÷ Adjusted Division B Income)(Tax Otherwise Payable)] = [($12,820 ÷ $ 314,650)($ 52,278)] = $ 2,130

As the amount withheld is the lesser of the two amounts, her non-business foreign tax credit is $1,923.

###### 2023 Alternative Minimum Tax (AMT) Payable

Jody’s 2023 adjusted taxable income for alternative minimum tax purposes would be calculated as follows:

|  |  |
| --- | --- |
| Regular Taxable Income | $ 253,856 |
| 60% of Net Taxable Capital Gains [(60%)($100,194)] | 60,116 |
| Dividend Gross Up [(15%)($84,000 + $40,000)] | (18,600) |
| Adjusted Taxable Income (for AMT) | $ 295,372 |

The calculation of the alternative minimum tax would be as follows:

|  |  |
| --- | --- |
| Adjusted Taxable Income | $ 295,372 |
| Basic Exemption | (40,000) |
| Amount Subject to Tax | $ 255,372 |
| Rate | 15% |
| Minimum Tax before Credits | $ 38,306 |
| Personal Tax Credits | ( 4,046) |
| Charitable Donation Credit | (4,254) |
| 2023 AMT Payable | $ 30,006 |

As the AMT payable of $ 30,006 is less than the regular federal income tax of $ 37,478, Jody would not be liable for any AMT in 2023.

### Part C

###### Jody – RRSP, TFSA, and Cash Flow Considerations

Jody has asked you to consider whether she should use her TFSA or her RRSP funds if she needs additional cash to acquire the home she is currently renting. Given that the home would be her principal residence, she would be eligible to withdraw funds from her RRSP under the Home Buyers’ Plan (HBP). To qualify, an individual must not have occupied a home that the individual, their spouse, or common-law partner owned within the four years preceding the withdrawal; however, this rule is generally waived in the cases of legal separation or divorce. Since the maximum withdrawal amount available under the HBP is only $35,000, that may not be adequate to meet all of Jody’s additional cash needs.

If she must choose between the two alternatives, it would be better for her to use her TFSA funds if she needs access to additional cash. Withdrawals from her TFSA would be tax free. In addition, she will be able to return funds to her TFSA in the future, which will not be possible if funds are withdrawn from her RRSP other than through the HBP (or other qualifying programs such as the Lifelong Learning Plan).

As Jody expects her income to remain high for years to come, she would potentially be subject to the highest income tax rates. Unlike a TFSA, withdrawals from an RRSP would need to be included in her taxable income and would permanently reduce her contribution room without an ability to reinstate that room. This would mean smaller amounts of RRSP-based retirement income in the future.

If she were not planning to immediately purchase a home, she could also consider the tax- free First Home Savings Account (see Chapter 10), which allows an individual who would qualify for the HBP to make an annual contribution up to a maximum of $8,000 beginning in 2023. The amount contributed would be fully deductible and the withdrawal would be tax free, resulting in an income-tax-based home purchase assistance program that includes features of both an RRSP and a TFSA. While there is a lifetime contribution limit of $40,000 per individual, given the impending decision to purchase the rental home the use of this program would provide little assistance in this case.

Solution to AP 11-10

### Part A - Adam’s 2023 Federal Income Tax Payable

###### Adam’s 2023 Employment Income

Adam’s 2023 employment income would be calculated as follows:

Salary $350,000

Additions:

Travel Allowances (Note 1)

Hotels and Meals Nil

Use of Personal Automobile 15,600

Stock Option Benefit [(1,000)($28 – $25)] 3,000

Deductions:

Hotels and Meals (Note 1) Nil

Automobile Expenses (Note 2) ( 25,754)

RPP Contributions (12,300)

2023 Employment Income $330.546

**Note 1** Given his actual expenses, the allowance for hotels and meals seems reasonable. This means it does not have to be included in income. However, this will prevent Adam from deducting his actual expenses. While a comparison of actual expenses to the allowance received suggests that the allowance was reasonable it is not determinative. An assessment of the reasonableness of an allowance is dependent upon how it is determined in respect of the actual anticipated travel to a specific region. With respect to the allowance for personal use of his automobile, it is not based on kilometres driven and, as a result ITA 6(1)(b)(x) deems the allowance not to be reasonable requiring it to be included in employment income.

**Note 2** His deductible automobile expenses for 2023 are calculated as follows:

|  |  |
| --- | --- |
| Operating Expenses | $11,300 |
| CCA on Class 10.1 [(1.5)(30%)($ 36,000)] | 16,200 |
| Total Automobile Costs | $ 27,500 |
| Employment Related Percentage (59,000 ÷ 63,000) | 93.65% |
| Total Deductible Expenses | $ 25,754 |

The luxury automobile rules limit the capital cost of the automobile to $ 36,000 for automobiles purchased on or after January 1, 2023, whether new or used, and that meet the definition of a “passenger vehicle.” Passenger vehicles are “automobiles” as defined in ITA 248(1). The automobile definition contains several exceptions such as certain vans, pick-ups and other vehicles that are used in certain businesses. The BMW that Adam uses would not meet any of these exceptions and is therefore a passenger vehicle.

###### Adam’s 2023 Net Income and Taxable Income

Adam’s 2023 net income and taxable income can be calculated as follows:

|  |  |
| --- | --- |
| Employment Income | $ 330,546 |
| Taxable Capital Gains on Donation (Note 3) | 57,500 |
| Recapture on Donation (Note 3) | 30,141 |
| Deductible CPP ($3,754 - $3,123) | ( 631) |
| 2022 Net Income | $ 417,556 |
| Stock Option Deduction [(1/2)($3,000)] | (1,500) |
| 2023 Taxable Income – Adam | $ 416,056 |

**Note 3** The taxable capital gains realized on Adam’s donation to the Canadian Red Cross is calculated as follows:

|  |  |  |
| --- | --- | --- |
|  | **Land** | **Building** |
| POD | $75,000 | $250,000 |
| ACB | (60,000) | (150,000) |
| Capital Gain | $15,000 | $100,000 |
| Inclusion Rates | 1/2 | 1/2 |
| Taxable Capital Gains | $ 7,500 | $ 50,000 |

The recapture on this donation is calculated as follows:

|  |  |  |
| --- | --- | --- |
| lesser of cost of $150,000 and POD of $250,000 |  | $150,000 |
| UCC Balance |  | (119,859) |
| Recapture |  | $ 30,141 |

###### 

###### Adam’s 2023 Federal Income Tax Payable

Adam’s 2023 federal income tax payable would be calculated as follows:

|  |  |  |  |
| --- | --- | --- | --- |
| Tax on First $ 235,675 |  |  | $ 54,578 |
| Tax on Next $180,381 ($416,056 - $235,675) at 33% | | | 59,526 |
| Federal Tax Payable (Before Credits) |  |  | $ 114,104 |
| Tax Credits:  BPA | | ($ 13,521) |  |
| Spousal (Income too high) | | Nil |  |
| Volunteer Firefighter  Transfer of Portia’s Tuition – Lesser of: |  | (3,000) |  |
| * Absolute Limit = $5,000 * Actual Tuition = $5,400 |  | (5,000) |  |
| Canada Caregiver for Jack |  | ( 7,999) |  |
| EI Premiums |  | ( 1,002) |  |
| CPP Contributions |  | ( 3,123) |  |
| Canada Employment |  | ( 1,368) |  |
| Credit Base | ($ 35,013) | |  |
| Rate | 15% | | ( 5,252) |
| Charitable Donations (Note 4) |  | | ( 101,408) |
| 2023 Federal Income Tax Payable – Adam |  | | $ 7,444 |

**Note 4** The maximum charitable donation that Adam can use in the current year is calculated as follows:

|  |  |
| --- | --- |
| Net Income [(75%)($ 417,556)] | $ 313,167 |
| Taxable Capital Gains [(25%)($57,500)] | 14,375 |
| Recapture [(25%)($30,141)] | 7,535 |
| Donation Credit Limit | $ 335,077 |

Since the limit is greater than the amount of the income tax receipt, the entire $325,000 can be used in the following calculation:

15% of $200 $ 30

33% of the lesser of:

$325,000 – $200 = $324,800

$ $416,056 - $235,675 = $ 180,381 59,526

29% of $ 144,419

[$325,000 – ($200 + $ 180,381)] 41,882

Charitable Donation Credit $ 101,408

Adam might consider carrying forward $ 144,419 of the charitable donation that is subject to the 29% donation rate if he is confident that he will have taxable income that will be subject to the 33% tax rate in the next five years. The credit would be 4% points larger [33% – 29%] resulting in income tax savings of $5,777 [(4%)($144,419)].. However, he would pay more income tax in the current year in order to do this.

### Part B - Estelle’s 2023 Federal Income Tax Payable

###### Estelle’s 2023 Net Income and Taxable Income

Estelle’s 2023 net income and taxable income would be calculated as follows:

|  |  |  |
| --- | --- | --- |
| Non-Eligible Dividends |  | $ 32,000 |
| Gross Up [(15%)($32,000)]  Taxable Capital Gain on GHI Shares [(1/2)($302,000)] |  | 4,800 |
| $151,000 |  |
| Allowable Capital Loss on JKL Shares |  |  |
| (Note 5) [(1/2)($20,000)] | (10,000) | 141,000 |
| 2023 Net Income |  | $177,800 |
| 2017 Net Capital Loss |  | (15,000) |
| Capital Gains Deduction (Note 6) |  | (126,000) |
| 2023 Taxable Income – Estelle |  | $ 36,800 |

**Note 5** Normally, the loss on the JKL shares would be classified as a business investment loss (BIL) and would be deductible against any type of income. However, potential BILs are reduced to the extent of the previous cumulative use of the capital gains deduction. The reduction to a potential BIL leaves the loss as a regular capital loss.

**Note 6** The capital gains deduction would be the least of the following three amounts:

**Capital Gains Deduction Available**

|  |  |
| --- | --- |
| Beginning Amount for 2023 [(1/2)($ 971,190\*)]  Amounts Used: | $ 485,595 |
| [(1/2)($500,000 – $275,000)] | (112,500) |
| [(1/2)($623,000 – $216,000)] | (203,500) |
| **Capital Gains Deduction Available for 2023** | $ 169,595 |

\*This is the limit for gains on dispositions of QSBC shares for 2023. If there were gains on qualified farm or fishing property, the 2023 limit would be increased by $28,810 to $1,000,000.

##### Annual Gains Limit

Lesser of:

* + Net Taxable Capital Gains = $141,000
  + Net Taxable Capital Gains on QSBC shares only

|  |  |
| --- | --- |
| = $ 141,000 | $141,000 |
| 2017 Net Capital Loss Deducted | (15,000) |
| **Annual Gains Limit** | $126,000 |

##### 

##### Cumulative Gains Limit

|  |  |
| --- | --- |
| Sum of Annual Gains Limits |  |
| ($112,500+ $203,500 + $126,000) | $442,000 |
| Amounts Deducted in Previous Years |  |
| ($112,500 + $203,500) | (316,000) |
| **Cumulative Gains Limit** | $126,000 |

The least of these amounts is $126,000.

###### Estelle’s 2023 Federal Income Tax Payable

|  |  |  |
| --- | --- | --- |
| Tax on $36,800 at 15% |  | $5,520 |
| Federal Tax  Tax Credits  BPA |  | $5,520 |
| ($ 15,000) |  |
| Medical Expenses (Note 7) | ( 4,226) |  |
| Total | ($ 19,226) |  |
| Rate | 15% | ( 2,884) |
| Non-Eligible Dividends Tax Credit [(9/13) ($4,800)] | | (3,323) |
| 2023 Federal Income Tax Payable – Estelle (Excess credits = $687) |  | $ Nil |

**Note 7** The base amount for medical expenses would be calculated as follows:

|  |  |  |
| --- | --- | --- |
| Adam, Estelle, and Portia ($1,350 + $360 + $820 + $500) |  | $3,030 |
| Reduced by the Lesser of: |  |  |
| * [(3%)($177,800)] = $5,334 |  |  |
| * 2023 Threshold Amount = $ 2,635 |  | ( 2,635) |
| Jack’s Medical Expenses | $4,200 |  |
| Reduced by the Lesser of: |  |  |
| * [(3%)($12,300)] = $369 |  |  |
| * 2023 Threshold amount = $2,635 | (369) | 3,831 |
| Allowable Medical Expenses |  | $ 4,226 |

The fees for teeth whitening and cosmetic surgery would not be allowable medical expenses.

###### 2023 Alternative Minimum Tax (AMT)

Because of Estelle’s extensive use of the capital gains deduction, it is necessary to calculate her AMT for 2023:

|  |  |  |
| --- | --- | --- |
| Regular Taxable Income | $ 36,800 | |
| 60% of Net Taxable Capital Gains [(60%)($141,000)] |  | 84,600 |
| Non-Eligible Dividends Gross Up |  | (4,800) |
| 60% of Net Capital Loss deducted  [(60%)($15,000)] |  | (9,000) |
| Adjusted Taxable Income | $107,600 | |
| AMT Exemptions |  | (40,000) |
| AMT Base | $ 67,600 | |
| Rate |  | 15% |
| Federal AMT before Credits Tax Credits  BPA ($ 15,000)  Medical Expenses (Note 7) ( 4,226 ) | $ 10,140 | |
| Total ($ 19,226)  Rate 15% |  | ( 2,884) |
| Estelle’s Federal AMT | $ 7,256 | |

Estelle’s 2023 federal income tax payable would be the AMT amount of $ 7,256 as it is larger than her regular federal income tax payable of nil. She would have a total AMT liability carry forward of $ 7,256 that can be carried forward to 2030 to be applied against any future excess of regular federal income tax payable over the AMT for that year.

###### Canada Caregiver Credit - No Difference

ITA 127.531 specifies the personal tax credits, as calculated for the determination of regular federal income tax payable, which can be applied against the AMT. The credits specified include the following:

* Personal credits under ITA 118(1)
* Charitable donations credit under ITA 118.1
* Medical expense credit under ITA 118.2

Estelle could claim the Canada caregiver credit for Jack, but there would be no decrease of federal income tax payable for the family unit. It would decrease her AMT by the same amount as it would increase Adam’s 2023 federal income tax payable.