***Canadian Tax Principles, 2022-2023* (Byrd/Chen)**

**Chapter 7 Income or Loss from Property**

7.1 Online Exercises

1) Indicate two differences between the income tax treatment of business income and property income.

Answer: The required two differences can be selected from the following differences which were described in the text:

• When some types of property income are being earned, the deduction of CCA cannot be used to create or increase a property loss.

• When property income is being earned by individuals, there is no requirement for a pro rata CCA reduction to reflect a short fiscal period since a fiscal period is a concept that applies to a business source and not a property source.

• Property income is subject to the income attribution rules (see Chapter 9) whereas business income in general is not.

• Certain expenses specifically allowed in ITA 20(1) are only deductible against business income, but not property income (e.g. ITA 20(1)(aa) for landscaping expenditures).

Type: ES

Topic: Business vs. property income

2) One conceptual approach to determining whether interest should be deductible is to limit deductibility to situations in which non-exempt income is earned. List two situations in which interest would not be deductible under this conceptual approach.

Answer:

• Interest relates to the purchase of personal property(e.g., a loan to purchase a sail boat).

• Interest relates to the purchase of tax sheltered investments such as RRSPs.

• Interest relates to the purchase of property that can only generate capital gains or capital losses.

• Interest relates to the purchase of property that will not generate income for many years (e.g., ITA 18(2) or 18(3.1)).

Type: ES

Topic: Interest deductibility - ITA 20(1)(c)

3) When an investor receives a payment from a corporation, what characteristics determine whether the amount received is interest or a dividend?

Answer: Interest requires meeting three criteria:

• The payment must accrue on a continuous basis.

• It must be calculated with reference to a principal sum.

• It must be compensation for the use of that principal sum.

Dividend payments are also compensation for the use of a principal sum and, in some cases (preferred shares), they are calculated with reference to a specific amount. Given this, the most reliable distinguishing feature is that dividends do not accrue on a continuous basis. They arise only when they are declared by the Board of Directors of a company.

Type: ES

Topic: Interest vs dividends - conceptual

4) Briefly describe the "disappearing source" rules.

Answer: The disappearing source rules are founded and based upon the source concept that only recognizes expenses as long as a source of income exists. If investments are purchased with financing and the financing remains in part after the investment has been sold perhaps because the value of the investments had declined then technically any interest expenses on the remaining debt would not be allowed since the source of income (the investments) has disappeared. ITA 20.1 was added to allow a person to continue claiming interest expenses after the source has disappeared. The legislation does this by deeming the source to exist for purposes of determining the interest expense deduction.

Type: ES

Topic: Interest deductibility - disappearing source ITA 20.1

5) Accounting principles (ASPE and IFRS) requires that any premium that is received on the issuance of debt securities be amortized as an adjustment of interest expense over the life of the debt. Explain briefly the income tax treatment of a premium received on the issuance of debt obligations.

Answer: If the issuer of the debt is in the business of lending money and the issuance of the debt is part of that business, the premium will be included in income when the debt is issued. For most other situations, the premium will be treated as a tax free capital receipt (e.g. not income), with no further income tax consequences.

Type: ES

Topic: Premiums on debt obligations

6) Briefly explain the income tax treatment of corporate bonds that are issued at a discount.

Answer: Over the life of the bond interest is expensed based on the amount required to be repaid at maturity. Technically the company would, at maturity, be required to pay a larger amount than was received. The result would be a loss but since a bond payable is not property the loss could not be recognized without rules in the ITA to the contrary. ITA 20(1)(f) sets out those rules that either (1) allow the full amount of the discount to be claimed as a business expense or (2) allow only one half of the discount to be claimed as a business expense. The discount is only fully deductible if the bonds are issued for not less than 97% of their maturity value and have an effective yield that does not exceed 4/3 of the stated yield.

Type: ES

Topic: Discount on debt obligations - ITA 20(1)(f)

7) The income tax rules for interest income are different for individuals than they are for corporations. Briefly describe the differences.

Answer: Corporations are required to recognize interest income on a full accrual basis, including all amounts receivable at the end of a taxation year. In contrast, individuals can use either cash or accrual. However individuals are subject to a modified accrual method under ITA 12(4) that requires interest be recognized on each anniversary date of an investment contract (e.g. debt obligations).

Type: ES

Topic: Interest income

8) When publicly traded debt obligations are purchased between interest payment dates, the purchaser pays for any accrued interest to the date of acquisition. Describe the income tax consequences of the accrued interest and ultimate receipt of interest to both the purchaser and seller.

Answer: The seller must include the accrued interest in income for the year of the sale. The purchaser must include all of the income received and can also deduct the interest amount accrued. In this way the effect is that accrued interest to the date of the sale is included in the income of the seller and the interest accruing from the date of the sale is included in the income of the purchaser.

Type: ES

Topic: Accrued interest on sale of debt obligations - ITA 20(14)

9) Each rental property that is owned by an individual that has a cost in excess of $50,000 is added to a separate Class. What is the purpose of this separate class treatment?

Answer: The goal here is to ensure that the individual is not able to avoid recapture when a rental property is sold. Rental properties often have a FMV that exceeds the UCC. If each rental property is in a separate class, the proceeds of disposition are subtracted from the UCC resulting in a negative balance that is recapture that is then included in income. If the property was not in a a separate class, this result could be avoided by simply acquiring another rental property in the same taxation year and adding its cost to the class. As recapture only arises if there is a negative balance at the end of the period, there would be no recapture if this addition creates a positive balance in the class.

Type: ES

Topic: Rental property

10) Briefly explain the concept of integration.

Answer: The concept of integration is the idea that an individual should pay the same amount of income tax on income without regard to whether it is earned personally or earned by a corporation in which the individual owns all of the shares. with the after corporate tax income distributed to the individual shareholder as a dividend. Where a corporation is used to earn the income the combination of the corporate income tax and individual income tax on a dividend distribution will equal the income tax that the individual would have paid without the use of a corporation. In brief the cash after paying income taxes under both alternatives would be the same.

Type: ES

Topic: Integration

11) Briefly describe the federal gross up and dividend tax credit mechanism for (1) eligible dividends and (2) non-eligible dividends.

Answer: In 2022 eligible dividends are grossed-up by 38% meaning that the amount added to income as a taxable dividend is 138% of the dividends received. Non-eligible dividends are grossed up by 15% meaning that 115% of the non-eligible dividend received is considered a taxable dividend and added to income. Both eligible and non-eligible dividends entitle the individual recipient to a federal dividend tax credit which is applied to reduce federal income tax payable. The federal dividend tax credit for eligible dividends is 6/11 of the amount of the gross up of 38% and is 9/13 of the amount of the gross up.of 15% for non-eligible dividends.

Type: ES

Topic: Integration

12) How is the ACB of units in a mutual trust fund determined?

Answer: The ACB of mutual fund trust units at the time they are acquired is equal to their cost. During the ownership of the units there are two types of ACB adjustments:

• The ACB will be reduced by any return of capital (ROC) distributed to investor (unit holders).

• In those cases where the investor has chosen to reinvest distributions, the ACB will be increased by the amount reinvested. As new units will be issued, this addition, when combined with the new number of units, will result in a revised average cost of the units. The reinvestment of income still requires the investor to include the income distributions in income. The effect is equivalent to an investor receiving the income distribution and then using that same distribution to purchase additional mutual trust fund units. These two ACB adjustments occur at the time the ROC and reinvestments are made.

Type: ES

Topic: Mutual trust fund - ACB

13) Mutual funds can be structured as either corporations or trusts. How will the choice of structure affect the income distributions from the fund?

Answer: If the mutual fund is structured as a corporation (a Mutual Fund corporation), its after-tax distributions will generally be considered as capital or taxable (eligible or non-eligible) dividends. The corporation may also return capital to shareholders which is considered a distribution of one's investment cost and therefore not required to be included in income but will reduce the ACB of the shares.

If the mutual fund is structured as a trust, its pre-tax distributions will consist of the same types of income that were earned by the trust (eligible dividends, non-eligible dividends, capital gains, and foreign interest and foreign dividend income). In other words the nature and character of the income is retained in the hands of the mutual fund unit holders. Some part of the distributions may also be a return of capital which would also reduce the ACB of the trust units.

Type: ES

Topic: Mutual funds - trusts vs corporations

14) What is a stock dividend and what is the income tax treatment of stock dividends including determining their ACB?

Answer: A stock dividend occurs when a corporation declares a dividend payable by a pro rata distribution of its shares.

The recipient of a stock dividend is deemed to have received a dividend based on the increase in the paid up capital of the corporation as a result of the stock dividend. The stock dividend can be treated as a capital dividend or taxable dividend depending upon the circumstances. Where the dividend is an eligible or non-eligible dividend the dividend gross-up and dividend tax credits will apply.

Shares issued as a stock dividend are deemed to have a cost and therefore ACB equal to the dividend amount required to be included in income without consideration of the gross-up.

Type: ES

Topic: Stock dividends

15) Why are capital dividends received tax free by residents of Canada?

Answer: The capital dividend rules ensure that certain tax free amounts received by a resident corporation retain their tax free character when distributed to shareholders as dividends. For example only one-half of capital gains are required to be included in income with the remaining one-half being tax free. The capital dividend account or CDA was created to track this tax free component allowing a corporation to decide to distribute the tax free portion of the capital gain as a capital dividend on an elective basis.

Type: ES

Topic: Capital dividends - ITA 83(2)

16) Describe the income tax treatment of foreign investment (e.g. non-business ) income to individuals when foreign income tax has been withheld.

Answer: The foreign investment income is required to be included in income. Any foreign income tax withheld is eligible for a combination of a property income deduction and a foreign tax credit. The foreign tax credit, which reduces federal income tax payable, is limited to a maximum of 15% with any excess eligible for a property income deduction under ITA 20(11).

Type: ES

Topic: Foreign income tax - ITA 20(11)

17) Corporations must use the full accrual approach to recognize interest income.

Answer: TRUE

Explanation: Corporations must use the full accrual approach.

Type: TF

Topic: Interest income

18) For income tax purposes, premiums on debt obligations are amortized by the issuer as an adjustment of interest expense.

Answer: FALSE

Explanation: Premiums are either treated as income to money lenders and as a tax free capital receipt to other issuers.

Type: TF

Topic: Premiums on debt obligations

19) In determining whether interest expense is deductible, the direct use to which the borrowed money is put is an important consideration.

Answer: TRUE

Explanation: The case law is clear that it is the direct use of the borrowed money that is relevant and not the indirect use.

Type: TF

Topic: Interest deductibility - ITA 20(1)(c)

20) Interest on debt incurred to purchase shares of a corporation is only deductible if the corporation has a history of paying regular dividends.

Answer: FALSE

Explanation: A share is a source of income and therefore as long as there is a potential for the payment of dividends then interest expenses related to financing the shares would be deductible irrespective of whether dividends are actually paid. Folio S3-F6-C1 however indicates that if there is a legal restriction in certain classes of shares that prevents the payment of dividends then interest would not be deductible since there would be no possibility of earning investment income.

Type: TF

Topic: Interest deductibility - ITA 20(1)(c)

21) An individual purchased a warehouse as an investment property two years ago. During the current year, the individual earned rents of $8,000 and paid the following expenses; interest of $6,000, property taxes of $2,000, heat, light and power of $500, and maintenance of $300. The UCC of this Class 1 property was $60,000 on January 1 of the current year. The individual cannot claim a rental loss in the current year.

Answer: FALSE

Explanation: A rental loss of $800 can be claimed. The rental loss however cannot be increased with CCA.

Type: TF

Topic: Rental property

22) The federal dividend tax credit for eligible dividends can be expressed as 6/11 of the gross up, 20.7273% of dividends actually received, or 15.0198% of grossed up dividends.

Answer: TRUE

Explanation: All of these variations will produce the correct result although 6/11 is the method adopted by the ITA.

Type: TF

Topic: Dividend tax credit

23) When a unitholder of a mutual trust fund receives a distribution that is in part a return of capital, the amount of the return of capital must be added to the ACB of the trust units.

Answer: FALSE

Explanation: The return of capital reduces the ACB of the units.

Type: TF

Topic: Mutual trust fund distributions

24) Mutual funds can be structured as either corporations or trusts.

Answer: TRUE

Explanation: While mutual funds are usually structured as trusts, they can also be structured as corporations.

Type: TF

Topic: Mutual funds - trusts vs corporations

25) For income tax purposes, the amount of a stock dividend is treated in exactly the same manner as cash dividends.

Answer: TRUE

Explanation: The amount determined as the stock dividend equal to the increase in the PUC of the shares issued is treated the same as any other dividend.

Type: TF

Topic: Stock dividends

26) When foreign income taxes are withheld on foreign investment income of a Canadian resident individual, only the actual net amount received is required to be included in income.

Answer: FALSE

Explanation: The full amount of the foreign investment income must be included in income of the Canadian resident individual. The amount withheld will first be treated as a foreign tax credit up to 15% of the foreign investment income with a foreign tax deduction for any foreign income taxes in excess of 15%.

Type: TF

Topic: Foreign income tax - ITA 20(11)

27) On July 1, 2021, Janett Koenen purchased 1,000 shares of Techhab Inc. for $10 per share. The purchase was financed with a $10,000 bank loan, requiring annual interest payments of 5%. The shares were sold on December 1, 2021 for $6 per share, with the proceeds immediately invested in 500 Flexhub Ltd. shares at $12 per share. In 2022, the Flexhub shares pay eligible dividends of $0.50 per share. The original $10,000 bank loan was not repaid in 2022 and remains outstanding on December 31, 2022. Her 2022 income or loss from property will be:

A) Property Income of $45.

B) Property Loss of $155.

C) Property Income of $345.

D) Property Loss of $50.

Answer: B

Explanation: A) Property Income of $45 [(500)($0.50)(1.38) - ($6,000)(5%)]

B) Property Loss of $155 [(500)($0.50)(138%) - ($10,000)(5%)] Since all of the $6,000 proceeds were used to purchase other sources of income the interest expense is fully deductible.

C) Property Income of $345 [(500)($0.50)(1.38)]

D) Property Loss of $50 [(500)($0.50) - ($6,000)(5%)]

Type: MC

Topic: Income or loss from property

28) Which of the following statements related to interest deductibility is correct?

A) Interest paid on a mortgage secured by a principal residence is never deductible.

B) If a business borrows to provide interest free loans to its employees, the interest on the borrowing will not be deductible.

C) If an individual borrows $100,000 to purchase investments and the investments are later sold for $60,000, interest on the $100,000 will continue to be fully deductible provided the $60,000 is used to purchase other investments.

D) If an individual borrows in order to buy common shares, the interest on the borrowing will only be deductible if the shares have a long-term history of paying dividends.

Answer: C

Explanation: C) If an individual borrows $100,000 to invest in securities and the securities are later sold for $60,000, interest on the $100,000 will continue to be fully deductible provided the $60,000 is immediately invested in other securities.

Type: MC

Topic: Interest deductibility - ITA 20(1)(c)

29) On January 1, 2022 Bernard borrowed $5,000 by signing a 1-year note payable at 6% interest. He used the money to purchase 2,000 common shares of Import Ltd., a Canadian public corporation for $2.50 per share. In 2022 Import Ltd. paid eligible dividends of $0.35 per share. On January 1, 2023 Bernard repaid the $5,000 he borrowed plus $300 in interest. Bernard's 2022 income from property will be:

A) $400.

B) $666.

C) $700.

D) $966.

Answer: B

Explanation: B) Property Income of $666 ($966\* — 300).

\*Dividend Income (2,000 × $0.35) = $700 × 138% = $966. The accrued interest to the end of 2022 is deductible in 2022.

Type: MC

Topic: Income or loss from property

30) Louis received a "hot tip" from a friend about Fine Mine Ltd. He borrowed $10,000 from a bank April 1, 2022 and used the funds to purchase 1,000 common shares in the company for $10 each. Louis sold the shares June 30, 2022 for $15 a share and repaid the loan which included $148 of interest. As a result of these transactions Louis's 2022 net income would increase by:

A) $4,852.

B) $2,426.

C) $2,500.

D) $2,352.

Answer: A

Explanation: A) $4.852 ($5,000 — 148) The "hot tip" suggests that the transaction was an adventure or concern in the nature of trade with the shares being treated as inventory instead of capital property.

[Calculated as: $10,000 × 6% × 90/365 = $147.95

B) ($5,000 — 148) × 50% = $2,426

C) $5,000 × 50% = $2,500

D) $2,352. [(50%)(1,000)($15 — $10) - $148\*]

\*Interest Expense = $10,148 — 10,000 = $148

Type: MC

Topic: Business income vs. capital gains

31) On July 1, 2022 Esther borrowed $8,000 from the bank and purchased 400 shares in No Hope Ltd. for $20 per share. Esther felt that this was a safe investment because she read online in a blog that No Hope would be paying dividends of $1.50 per share during the last half of 2022. Unfortunately, this didn't happen and she only received eligible dividends totalling $100 during 2022. On December 31 she paid the bank loan interest of $240. Esther's 2022 income or loss from property will be:

A) Property Income of $100.

B) Property Income of $138.

C) Property Income of $0.

D) Property Loss of $102.

Answer: D

Explanation: D) Property Loss of $102.

($100 × 138%) = $138 — $240 interest

Type: MC

Topic: Income or loss from property

32) Which of the following statements is **NOT** correct?

A) Income from rental properties can be either business income or property income.

B) When property income is earned, the income attribution rules may apply.

C) Interest paid on a mortgage on a principal residence can be deductible.

D) Interest paid on funds borrowed to make interest-free loans to employees is not deductible.

Answer: D

Explanation: D) Interest paid on funds borrowed to make interest-free loans to employees is not deductible. Considered a deductible remuneration expense to the employer.

Type: MC

Topic: Interest deductibility - ITA 20(1)(c)

The questions below are based on the following information:

An individual loaned $20,000 for one year to his mother-in-law on October 1, 2020. Interest at 6% per year was payable on September 30, 2021, but was not paid until February 1, 2022. There are several ways in which the interest can be allocated to the years involved. For the situations described in the following questions, indicate which method (A, B, C, or D) corresponds to an interest allocation that would be acceptable. If it is not a permitted method, indicate the answer E.

33) Income for 2020 is $300, 2021 income is $900, and 2022 income is nil.

A) Accrual Method

B) Cash Method

C) Compound Interest Method

D) Receivable Method

E) Not Allowed Method

Answer: A

Explanation: A) The accrual method.

Type: MC

Topic: Interest income

34) Income for 2020 is nil, 2021 income is $1,200, and 2022 income is nil.

A) Accrual Method

B) Cash Method

C) Compound Interest Method

D) Receivable Method

E) Not Allowed Method

Answer: D

Explanation: D) The receivable method.

Type: MC

Topic: Interest income

35) Income for 2020 is nil, 2021 income is $900, and 2022 income is $300.

A) Accrual Method

B) Cash Method

C) Compound Interest Method

D) Receivable Method

E) Not Allowed Method

Answer: E

Explanation: E) Not allowed method ($1,200 interest would have to be accrued by the September 30, 2021 anniversary of the loan).

Type: MC

Topic: Interest income

36) Income for 2020 is nil, 2021 income is nil, and 2022 income is $1,200.

A) Accrual Method

B) Cash Method

C) Compound Interest Method

D) Receivable Method

E) Not Allowed Method

Answer: E

Explanation: E) Not allowed method (interest would have to be accrued on the September 30, 2021 anniversary of the loan).

Type: MC

Topic: Interest income

37) A corporation issues debt with a maturity value of $1,000,000 for proceeds of $900,000. The debt matures in 10 years and pays annual interest at a rate of 10%. Which of the following statements is correct?

A) The corporation will be able to deduct interest of $110,000 in each of the years 1 through 10.

B) The corporation will be able to deduct interest of $100,000 in each of the years 1 through 10 and will have a fully deductible loss of $100,000 in year 10.

C) The corporation will be able to deduct interest of $100,000 in each of the years 1 through 10 and will have a business deduction in year 10 of $50,000.

D) The corporation will be able to deduct interest of $90,000 in each of the years 1 through 10.

Answer: C

Explanation: C) The corporation will be able to deduct interest of $100,000 in each of the years 1 through 10 and will have a business deduction in year 10 of $50,000.

Type: MC

Topic: Discount on debt obligations - ITA 20(1)(f)

38) A corporation issues debt with a maturity value of $1,000,000 for proceeds of $1,100,000. The debt matures in 10 years and pays annual interest at a rate of 10%. The issuer is not a money lender. Which of the following statements is correct?

A) The corporation will be able to deduct interest of $90,000 in each of the years 1 through 10.

B) The corporation will be able to deduct interest of $100,000 in each of the years 1 through 10 and will have a fully taxable gain of $100,000 in year 10.

C) The corporation will be able to deduct interest of $100,000 in each of the years 1 through 10 and will have a capital gain in year 10 of $100,000, only one-half of which will be taxable.

D) The corporation will be able to deduct interest of $100,000 in each of the years 1 through 10 and there will be no income tax consequences at maturity with respect to the premium.

Answer: D

Explanation: D) The corporation will be able to deduct interest of $100,000 in each of the years 1 through 10 and there will be no income tax consequences at maturity with respect to the premium.

Type: MC

Topic: Premiums on debt obligations

39) Jorge purchased a newly issued $20,000 corporate bond for $19,500 on November 1, 2022. The maturity date of the bond is October 31, 2027 and the annual interest rate is 5%, paid on October 31 of each year. How much interest income should Jorge include in his income for 2022 and 2023 if he wants to minimize the interest recognized for income tax purposes?

A) $0 in 2022 and $975 in 2023.

B) $0 in 2022 and $1,000 in 2023.

C) $167 in 2022 and $833 in 2023.

D) $167 in 2022 and $1,000 in 2023.

Answer: B

Explanation: A) $0 in 2022 and $975 in 2023 ($19,500 × 5% = $975)

B) $0 in 2022 and $1,000 in 2023 ($20,000 × 5% = $1,000).

C) $167 in 2022 and $833 in 2023 $1,000 interest × 61/365 = $167, $1,000 — 167 = $833

D) $167 in 2022 and $1,000 in 2023 $1,000 interest × 61/365 = $167, $1,000 for the year.

Type: MC

Topic: Interest income

40) Which of the following is **NOT** a characteristic of interest?

A) It must represent compensation for use of a principal amount.

B) It must accrue continuously over time.

C) It must be paid on a regular, periodic basis.

D) It must be calculated with reference to a principal amount.

Answer: C

Explanation: C) It must be paid on a regular, periodic basis.

Type: MC

Topic: Interest - meaning of

41) On July 1, 2022, Jon Laxtor acquires a newly issued investment contract with a maturity value of $100,000. It matures on June 30, 2027, with interest accruing at 8% per year. Interest is paid for the first one and one-half years on December 31, 2023. The remaining interest will be paid at maturity. With respect to the minimum amount of interest that Jon must include in his income, which of the following statements is correct?

A) Jon will have to include $4,000 in 2022 and $8,000 in 2023.

B) Jon will have to include nil in 2022 and $8,000 in 2023.

C) Jon will have to include nil in 2022 and nil in 2023.

D) Jon will have to include nil in 2022 and $12,000 in 2023.

Answer: D

Explanation: D) Jon will have to recognize nil in 2022 and $12,000 in 2023. $8,000 would be included as a result of the contract anniversary date which first falls in 2023 plus the remaining $4,000 of interest actually received at the end of 2023.

Type: MC

Topic: Interest income

42) Which of the following statements concerning the income tax treatment of interest income is **NOT** correct?

A) Individuals must account for interest using the cash basis.

B) Corporations must accrue interest on a daily basis.

C) Accrued interest from the date of the last interest payment date is adjusted to ensure it is not part of the ACB of the debt obligation.

D) If there is accrued interest on a debt obligation, the seller includes the accrued interest in income and the purchaser deducts a corresponding amount from the interest received on the debt obligations.

Answer: A

Explanation: A) Individuals must account for interest using the cash basis.

Type: MC

Topic: Accrued interest on sale of debt obligations - ITA 20(14)

43) With regard to debt obligations, which of the following statements is correct?

A) Provided the issuer is not in the business of lending money, issuing debt obligations at a premium will normally reduce the after-tax cost of financing for the issuer.

B) Provided the issuer is not in the business of lending money, issuing debt obligations at a premium will normally increase the after-tax cost of financing for the issuer.

C) Issuing debt obligations at a discount results in the borrowing corporation receiving funds above the stated maturity price.

D) Issuing debt obligations at a premium results in the borrowing corporation receiving funds below the stated maturity price.

Answer: A

Explanation: A) Provided the issuer is not in the business of lending money, issuing debt obligations at a premium will normally reduce the after-tax cost of financing for the issuer.

Type: MC

Topic: Premiums on debt obligations

44) Which of the following statements with respect to rental properties is **NOT** correct?

A) Every rental property with a cost of $50,000 or more must be in a separate Class.

B) The short fiscal period rules do not apply to the calculation of CCA on a rental property owned by an individual that is not part of a business.

C) The deduction of CCA cannot be used to create or increase a rental loss.

D) If a new rental property is acquired, put into a separate CCA class, and is used more than 90% for non-residential purposes, it is automatically eligible for an enhanced CCA rate of 10%.

Answer: D

Explanation: D) If a new rental property is acquired, put into a separate CCA class, and is used more than 90% for non-residential purposes, it is eligible for an enhanced CCA rate of 10%. The 10% rate would only apply if the 90% or more test related to manufacturing and processing.

Type: MC

Topic: Rental property

45) Saul has two residential rental properties (Property A and Property B) that are mortgaged. Both properties are in a separate Class 1 with a CCA rate of 4%. At the beginning of the year, Property A has a UCC of $500,000 and Property B has a UCC of $1,100,000. Before consideration of CCA, Rental income from Property A is $43,000, and Property B has a rental loss of $27,000. What is the maximum amount of CCA Saul will be able to claim for the year?

A) Nil.

B) $16,000.

C) $20,000.

D) $44,000.

Answer: B

Explanation: B) $16,000 ($43,000 - $27,000).

Type: MC

Topic: Rental income

46) When determining property income for a rental property owned by an individual, which of the following should never be considered in the calculations?

A) AccII provisions.

B) Short fiscal period rule.

C) Recapture.

D) Terminal loss.

Answer: B

Explanation: B) Short fiscal period rule (only required when the rental property activity is a business).

Type: MC

Topic: Rental income

47) Rosa owns a duplex and rents both units to tenants. Which one of the following expenditures is not a current expense for income tax purposes?

A) Cost of a new refrigerator.

B) Cost of repairing the front stairs.

C) Cost of painting the interior of unit #2.

D) Interest paid on the mortgage on the duplex.

Answer: A

Explanation: A) Cost of a new refrigerator is a capital expenditure and only part of its cost can be claimed annually as CCA.

B) Deductible current expense.

C) Deductible current expense.

D) Interest paid on a mortgage related to capital property (the duplex) is also a capital expenditure but it is expressly allowed as a deduction by ITA 20(1)(c).

Type: MC

Topic: Current vs capital expenditures

48) Fergus owns a rental property. Instead of hiring contractors he does all of the property maintenance and repairs himself, keeping careful records. Which one of the following amounts is not a deductible expense for income tax purposes?

A) $700 for shrubs and flowers.

B) $250 for bookkeeping services.

C) $400 for lumber, paint and hardware.

D) $1,000 for his labour (50 hours @ minimum wage of $20 per hour).

Answer: D

Explanation: D) $1,000 for his labour (50 hours @ minimum wage of $20 per hour). An individual cannot employ themselves therefore there is no genuine legal expense.

Type: MC

Topic: Deductible expenses

49) Aziz purchased a residential rental property on April 15, 2022. He paid $300,000 for the building. During the year he has rental property expenses of $540. He rented the property on May 1, 2022 to an individual on a long term rental basis at $2,500 per month. What is Aziz's 2022 rental income?

A) $1,460.

B) $7,918.

C) $7,378.

D) $19,460.

Answer: A

Explanation: A) $1,460 ($20,000 — CCA $18,000 — $540) Calculations:

Rental revenue: [($2,500)(8) = $20,000

CCA: [(1.5)($300,000(4%)] = $18,000

B) $20,000 — (18,000 × 245/365) — 0 = $7,918 days is May 1 — Dec 31 (days rented)

C) $20,000 — (18,000 × 245/365) — 540 = $7,378

D) $20,000 — 540 = $19,460

Type: MC

Topic: Rental income

50) Shahrukh owns a residential rental building which he purchased for $200,000 in 2022. In that year, his rental income before CCA was $5,000. In 2023, his rental income before CCA was $8,000. Sharukh always minimizes his income tax by claiming the maximum available deductions. Which of the following statements is correct?

A) Shahrukh has a rental loss of $3,000 in 2022.

B) Shahrukh has rental income of $480 in 2023.

C) Shahrukh has rental income of nil in 2023.

D) Shahrukh has rental loss of $7,000 in 2022.

Answer: B

Explanation: B) 2022: [(1.5)($200,000)(4%)] = $12,000, UCC = $200,000 - $12,000 = $188,000

2022: $188,000 × 4% = $7,520, Rental income = $8,000 - $7,520 = $480

Type: MC

Topic: Rental income

51) Which of the following statements with respect to dividends is **NOT** correct?

A) Capital dividends can be received by individuals without income tax consequences.

B) All taxable dividends paid by Canadian controlled private corporations are non-eligible dividends.

C) Stock dividends are subject to the same gross up and tax credit procedures as regular cash dividends.

D) Dividend tax credits are based on a fraction/percentage of the gross up on dividends received.

Answer: B

Explanation: B) All taxable dividends paid by Canadian controlled private corporations are non-eligible dividends.

Type: MC

Topic: Dividend income

52) In 2022 Thelma Evatt receives eligible dividends of $23,000. She has no other income in the year. What would be the amount of her federal income tax payable or refund on these dividends?

A) $4,761

B) $3,450

C) Nil

D) A $6.00 Refund

Answer: C

Explanation: A) [($23,000)(1.38)(15%) = $4,761

B) [($23,000)(15%)] = $3,450

C) Nil [(138%)($23,000)(15%) - (38%)($23,000)(6/11)]

D) [(1.38)($23,000(15%) - (38%)($23,000)(6/11)] A $6 Refund

Type: MC

Topic: Dividend income

53) The federal dividend tax credit cannot be claimed by individuals if the dividends are:

A) Eligible dividends paid in cash.

B) Non-eligible dividends paid in cash.

C) Eligible or non-eligible dividends paid as Stock dividends.

D) Capital dividends.

Answer: D

Explanation: D) Capital Dividends. (Only eligible or non-eligible dividends are eligible for a dividend tax credit when received by individuals.)

Type: MC

Topic: Dividend tax credit

54) Which of the following statements is correct?

A) The federal dividend tax credit is equal to 38% of eligible dividends received.

B) The federal dividend tax credit is equal to 6/11 of the gross up on eligible dividends received.

C) The federal dividend tax credit is equal to 15% of the non-eligible dividends received.

D) The federal dividend tax credit is equal to 6/11 of the gross up on non-eligible dividends received.

Answer: B

Explanation: B) The federal dividend tax credit is equal to 6/11 of the gross up on eligible dividends received.

Type: MC

Topic: Dividend tax credit

55) Which of the following statements is correct?

A) Property Income =

Dividends received plus the gross-up minus the dividend tax credit.

B) Property Income =

Dividends received minus the gross-up minus the dividend tax credit.

C) Federal Income Tax Payable =

Federal income tax on grossed-up dividends minus the dividend tax credit.

D) Federal Income Tax Payable =

The gross up on dividends received minus the dividend tax credit.

Answer: C

Explanation: C) Federal Income Tax Payable = Federal tax on grossed-up dividends minus the dividend tax credit.

Type: MC

Topic: Dividend income

56) In 2022 Erin received eligible dividends of $800, non-eligible dividends of $600 and foreign dividends of $1,000 before 10% foreign income tax was withheld. Her 2022 property income is:

A) $2,648.

B) $2,694.

C) $2,748.

D) $2,794.

Answer: D

Explanation: A) [ ($800 × 115%) + ($600 × 138%) + $900 = $2,648

B) [ ($800 × 138%) + ($600 × 115%) + $900 ] = $2,694

C) [ ($800 × 115%) + ($600 × 138%) + ($1,000) ] = $2,748

D) $2,794 [($800)(138%) + ($600)(115%) + ($1,000)]

Type: MC

Topic: Dividend income

57) In 2022 Rolf received eligible dividends of $900 and non-eligible dividends of $600. His 2022 federal dividend tax credit is:

A) $231

B) $249

C) $286

D) You can't calculate the dividend tax credit if you don't know his effective tax rate.

Answer: B

Explanation: A) [ ($900 × 15% × 6/11) + ($600 × 38% × 9/13] = $231

B) [ ($900)(38%)(6/11) + ($600)(15%)(9/13)] = $249

C) [ ($900 × 38% × 9/13) + ($600 × 15% × 6/11)] = $286

Type: MC

Topic: Dividend tax credit

58) Sherry's marginal federal income tax rate is 29%. She lives in a province where her provincial marginal income tax rate is 17.5% and the provincial dividend tax credit is 31% of the dividend gross up. If Sherry receives an eligible dividend of $16,000 from a Canadian public corporation in 2022, how much income tax will she pay on that dividend?

A) $6,150.

B) $2,827.

C) $5,066.

D) $8,382.

Answer: C

Explanation: A) $6,150 [(115%)($16,000)(29% + 17.5%)] - [(15%)($16,000)(9/13+ 31%)]

B) $2,827 [(38%)($16,000)(29% + 17.5%)]

C) $5,066.

Taxes on the grossed up eligible dividends

[(138%)($16,000)(29% + 17.5%)] $10,267

Dividend tax credit [(38%)($16,000)(6/11 + 31%)] (5,201)

Federal and Provincial Income Tax $ 5,066

D) $8,382 [(138%)($16,000)(29% + 17.5%)] - [(38%)($16,000)(31%)]

Type: MC

Topic: Dividends - income tax payable for individuals

59) Martin owns 2% of the outstanding shares of a Canadian public corporation. The corporation declared a an eligible stock dividend in 2022. The PUC of the class of shares upon which the stock dividend is paid is increased by $800,000. The receipt of the stock dividend will increase Martin's income by:

A) $ 8,000.

B) $16,000.

C) $18,400.

D) $22,080.

Answer: D

Explanation: A) $ 8,000 as if stock option (1/2)

B) $16,000 - no gross up

C) $18,400 [(115%)($800,000)(2%)]

D) $22,080 [(2%)($800,000)(138%)].

Type: MC

Topic: Stock dividends

60) Maria owns 500 units in a mutual trust fund that invests exclusively in bonds issued by Canadian public corporations. In 2022 the mutual trust fund received bond interest and paid income distributions of that bond interest of $1.12 per unit. Maria reinvested all of her distributions. What is the effect on Maria's 2022 net income?

A) Increase of $280.

B) Increase of $560.

C) Increase of $773.

D) $0 because the distributions were reinvested.

Answer: B

Explanation: A) Increase of $280 ($560 × 50%)

B) Increase of $560 [(500)($1.12)]

C) Increase of $773 ($560 × 138%)

D) $0 because the distributions were reinvested

Type: MC

Topic: Mutual trust fund distributions

61) Yang owns 800 units in a mutual trust fund that invests exclusively in the shares of Canadian public corporations. In 2022, the trust fund paid a distribution of $1.50 per unit. One-half of the distribution was eligible dividend income and the remaining half was capital gains. What is the effect of the mutual fund distribution on Yang's net income?

A) $600.

B) $1,128.

C) $1,200.

D) $1,428.

Answer: B

Explanation: A) $600 ($1,200 × 50%)

B) $1,128 [($1,200)(50%)(138%) + ( $1,200)(50%)(50%)]

C) $1,200 (800 × $1.50)

D) $1,428 [($1,200 × 50% × 138%) + ( $1,200 × 50%)]

Type: MC

Topic: Mutual trust fund distributions

62) On January 1, 2022, John Traverse acquires 12,000 units of a mutual trust fund at a cost of $720,000. In 2022, the trust fund makes a distribution of $5.00 per unit. Of this total $1.50 is a return of capital while the remaining $3.50 as interest income. John reinvests the total distribution units at a cost of $55 per unit. What is the ACB of John's units on December 31, 2022?

A) $58.21 per unit.

B) $53.62 per unit.

C) $59.58 per unit.

D) $60.00 per unit.

Answer: A

Explanation: A) $58.21 [($720,000 + $60,000 - $18,000) ÷ (12,000 + 1,090.91)] $60,000 reinvested at $55 per unit results in 1,090.91 units.

Type: MC

Topic: Mutual trust fund - ACB

63) During the current year, Pearlene Monroig, a resident of Canada, earns business income in the U.K. of €10,000 from which the British income taxes of €2,000 are withheld. Assume that the relevant exchange rate was €1.00 = $1.70 for the year. Which of the following statements is correct?

A) Pearlene will have foreign business income of $13,600 and a foreign tax credit of $3,400.

B) Pearlene will have foreign business income of $17,000 and no foreign tax credit.

C) Pearlene will have foreign business income of $16,150 and a foreign tax credit of $2,550.

D) Pearlene will have foreign business income of $17,000 and a foreign tax credit of $3,400.

Answer: D

Explanation: A) [(€8,000)($1.70)] = $13,600; [(€2,000)($1.70)] = $3,400

B) [(€10,000)($1.70)] = $17,000

C) [(€10,000 - €500)($1.70)] = $16,150; [(€1,500)($1.70)] = $2,550

D) Pearlene will have foreign business income of $17,000 and a foreign tax credit of $3,400. [(€10,000)($1.70)] = $17,000; [(€2,000)($1.70)] = $3,400

Type: MC

Topic: Foreign source income

64) Julio has a savings account in a foreign country. The account earned $5,000 interest in 2022 but he only received $4,500 since $500 for foreign income taxes were withheld by the bank. All amounts are stated in Canadian dollars. What are the income tax consequences to Julio for 2022?

A) An increase in income of $4,500 and a foreign tax credit of $0.

B) An increase in income of $5,000 and a foreign tax credit of $500.

C) An increase in income of $5,000 and a foreign tax credit of $75.

D) Nothing since the interest was earned outside of Canada.

Answer: B

Explanation: B) An increase in income of $5,000 and a foreign tax credit of $500

Type: MC

Topic: Foreign source income

65) Bernadette, a resident of Canada, owns 1,000 shares of a German public corporation. The corporation paid dividends of $1.50 per share in 2022 but Bernadette only received $1,275 since 15% foreign income tax was withheld in Germany. All amounts are stated in Canadian dollars. Bernadette's 2022 income from this investment is:

A) $1,275.

B) $1,500.

C) $1,760.

D) $2,070.

Answer: B

Explanation: A) $1,275 ITA 20(11) allows a deduction for any foreign income tax on the dividend that is in excess of 15%. Since this is not the case there would be no deduction.

B) $1,500 ($1,275 ÷ 85%) or 1,000 @ $1.50

C) $1,760 ($1,275 + 38% gross-up)

D) $2,070 ($1,500 + 38% gross-up)

Type: MC

Topic: Foreign source income

66) Ravinder's marginal federal income tax rate is 29%. He has foreign investments that results in $50,000 (Canadian) of interest income. The government of the foreign country withholds $10,000 of this amount, with the after-tax amount of $40,000 paid to Ravinder in 2022. Ravinder's 2022 federal income tax payable will increase by: (Note: assume that Ravinder would be entitled to a full foreign tax credit)

A) $ 4,500.

B) $ 6,275.

C) $11,600.

D) $14,500.

Answer: B

Explanation: B) $6,275 [(29%)($50,000 - $2,500) - $7,500]. The foreign tax credit is limited to $7,500, 15% of the foreign "non-business" income. The remaining $2,500 of can be claimed as a deduction against the foreign income (ITA 20(11)).

Type: MC

Topic: Foreign source income

67) Which of the following will provide the lowest amount of after-tax income for an individual in the top federal income tax bracket of 33%?

A) $100 of interest income from Canadian bonds

B) $100 of capital gains from Canadian stocks

C) $100 of non-eligible dividends from Canadian corporations

D) $100 of eligible dividends from Canadian corporations

Answer: A

Explanation: A) $100 of interest income from Canadian bonds. Interest is fully taxable whereas capital gains are only one-half taxable and both eligible and non-eligible dividends are taxed favourably because of the dividend tax credit.

Type: MC

Topic: Canadian source income - individuals

68) On January 1, 2022, Latkin Inc. issues bonds with a maturity amount of $1,250,000 and a maturity date of December 31, 2027. The bonds pay interest on December 31 of each year at an annual coupon rate of 2%. They are sold for proceeds of $1,150,000 for an effective yield of 3.5%. What are the income tax consequences related to this bond issue for Latkin Inc. in each of the years 2022 through 2027? How would the income tax consequences differ from the accounting treatment under ASPE or IFRS? Latkin Inc. uses the straight-line method to amortize the discount on the bonds for accounting purposes.

Answer: **Income Tax Consequences -** The income tax consequences would be as follows:

Annual Deduction - 2022 to 2027 [($1,250,000)(2%)] $25,000

Maturity Amount $1,250,000

Proceeds received on the issuance ( 1,150,000)

2027 Loss $ 100,000

Inclusion Rate ITA 20(1)(f) 1/2

Allowable deduction (See Note) $ 50,000

**NOTE -** As the bonds were sold for less than 97% of their maturity amount and, in addition, the effective rate of 3.5% which is more than four-thirds of the coupon rate [(2%)(4/3) = 2.7%], only one-half of the $100,000 loss, or $50,000 would be deductible as a business deduction. The total deduction for the 6 year period would be $200,000 [($25,000)(6) interest expense + $50,000 bond discount].

**Accounting Consequences -** The accounting consequences would be as follows:

Annual Interest [($1,250,000)(2%)] $25,000

Discount Amortization ($100,000 ÷ 6) 16,667

Annual Interest Expense - 2022 to 2027 $41,667

Payment of the maturity amount in 2027 would have no accounting income consequences. Note that the total accounting deduction for the 6 year period would be $250,000 [(6)($41,667)], $50,000 more than could be deducted for income tax purposes. In the annual reconciliation of accounting income to income for tax purposes adjustments would have to be made to account for these differences.

Type: ES

Topic: Discount on debt obligations - ITA 20(1)(f)

69) On January 1, 2022, Leno Ltd. issues bonds for $770,000. The bonds have a maturity amount of $800,000 and mature on December 31, 2024. The coupon rate on the bonds is 3%, with the interest paid annually in December of each year. What are the income tax consequences related to this bond issue for Leno Ltd. in each of the years 2022 through 2024? How would the income tax consequences differ from the accounting treatment under ASPE or IFRS? Leno Ltd. uses the straight-line method to amortize the discount on the bonds for accounting purposes.

Answer: **Income Tax Consequences -** The income tax consequences would be as follows:

Annual Deduction - 2022 to 2024 [($800,000)(3%)] $24,000

Maturity Amount $800,000

Proceeds received on the issuance ( 770,000)

2024 Loss $ 30,000

Inclusion Rate 1/2

Allowable Amount (See Note) $ 15,000

**NOTE -** As the bonds are sold for less than 97% of their maturity value, only one-half of this loss would be deductible as a business deduction. The yield test cannot be applied as the problem does not give the effective yield on the bonds. The total deduction for the 3 year period would be $87,000 [(3)($24,000) + $15,000].

**Accounting Consequences -** The accounting consequences would be as follows:

Annual Interest [($800,000)(3%)] $24,000

Discount Amortization ($30,000 ÷ 3) 10,000

Annual Interest Expense - 2022 to 2024 $34,000

Payment of the maturity amount in 2024 would have no accounting income consequences. The total deduction for the 3 year period would be $102,000 [(3)($34,000)], $15,000 more than could be deducted for income tax purposes. In the annual reconciliation of accounting income to income for tax purposes adjustments would have to be made to account for these differences.

Type: ES

Topic: Discount on debt obligations - ITA 20(1)(f)

70) On January 1 of the current year, Dryer Inc. issues 8 year bonds payable with a maturity amount of $1,500,000. The bonds have a coupon rate of 14%, pay interest on January 1 of each year, and are sold for $1,750,000. The Company has a December 31 year end. Determine the current year income tax consequences under each of the following assumptions:

• Dryer is in the business of lending money.

• Dryer is not in the business of lending money.

Answer: The income tax consequences under each of the two assumptions would be as follows:

**Money Lender -** In this case, the premium would be treated as business income in the year of receipt. The annual interest deduction for the year would be $210,000 [(14%)($1,500,000)].

**Not a Money Lender -** In this case, the premium would have no income tax consequences on the receipt of the premium and no income tax consequences when the bonds mature. The receipt of the premium is treated as a capital receipt of $250,000 which is not required to be included in income.

Type: ES

Topic: Premiums on debt obligations

71) On January 1, 2022, Desay Inc. issues 5 year bonds payable with a maturity amount of $900,000. They have a coupon rate of 12%, pay interest on January 1 of each year, and are sold for $1,200,000. The Company has a December 31 taxation year end. Determine the current year income tax consequences under each of the following assumptions:

• Desay is in the business of lending money.

• Desay is not in the business of lending money.

Answer: The tax consequences under each of the two assumptions would be as follows:

**Money Lender -** In this case, the premium of $300,000 would be treated as business income in the year of receipt. The annual interest expense for the year would be $108,000 [(12%)($900,000)].

**Not a Money Lender -** In this case, the premium would have no income tax consequences on the receipt of the premium and no income tax consequences when the bonds mature. The receipt of the premium is treated as a capital receipt of $250,000 which is not required to be included in income. The annual interest expense for the year would be $108,000 [(12%)($900,000)].

Type: ES

Topic: Premiums on debt obligations

72) On June 1, 2022, Mr. Michael Leiner acquires a newly issued debt obligation with a maturity amount of $80,000. It matures on May 31, 2028 and pays interest at an annual rate of 7%. Payment for the first three and one-quarter years of interest is due on August 31, 2025, with interest for the remaining two and three-quarters years payable on the maturity date. What amount of interest will Mr. Leiner have to include in his income for each of the 2022 through 2028 taxation years?

Answer: The total interest income over the six year period would be $33,600 [($80,000)(7%)(6 years)]. The interest income would be included in the following years:

**Year Interest Paid Interest Reported**

2022 Nil Nil

2023 Nil $ 5,600

2024 Nil 5,600

2025 $18,200 7,000

2026 Nil 4,200

2027 Nil 5,600

2028 15,400 5,600

Total $33,600 $33,600

**2022 -** As no anniversary date occurred and no interest was received in 2022, no interest will be required to be included in income.

**2023 -** The first anniversary date occurs on May 31 and this requires the recognition of $5,600 [(7%)($80,000)] of interest income.

**2024 -** The second anniversary date of May 31 occurs and this requires the recognition of an additional $5,600 of interest income.

**2025 -** The third anniversary date requires the recognition of $5,600 and, in addition, an $18,200 [(7%)($80,000)(3.25 years)] interest payment is received. As $16,800 [(3)($5,600)] of this amount has been included in income on the three anniversary dates, only $1,400 of this amount will is added to income. This gives a total for the year 2025 of $7,000 ($5,600 + $1,400).

**2026 -** The anniversary date will require recognition of $5,600. However, only $4,200 of this amount will be included in income for the year since as $1,400 of the annual interest of $5,600 was included in income in 2025.

**2027 -** $5,600 will be recognized on the anniversary date.

**2028 -** A payment of $15,400 [(2.75)($5,600)] will be received. As $9,800 ($4,200 + $5,600) of the amount received has already been recorded in income in the two previous anniversary dates, the total for 2028 will be $5,600 ($15,400 - $9,800).

Type: ES

Topic: Interest income - annual accrual rules

73) Ms. Marilyn Lox invests in a newly issued debt obligation on April 1, 2022. It has a maturity amount of $50,000, matures on March 31, 2026, and pays interest at an annual rate of 5%. The terms of the debt obligation call for payment of interest for the first two and one-half years on September 30, 2024. The remaining interest is paid at the maturity date. What amount of interest will Ms. Lox have to include in her income for the taxation years 2022 to 2026?

Answer: The total interest to be recorded on the instrument for the four year period will be $10,000 [($50,000)(5%)(4 years)]. It will be allocated as follows:

**Year Interest Paid Interest Reported**

2022 Nil Nil

2023 Nil $ 2,500

2024 $ 6,250 3,750

2025 Nil 1,250

2026 3,750 2,500

Total $10,000 $10,000

**2022 -** As there is no anniversary date and no interest was received, no interest will have to be included in Ms. Lox's income for 2022.

**2023 -** The first anniversary date occurs on March 31 of this year and requires the recognition of $2,500 [(5%)($50,000)] of interest.

**2024 -** The second anniversary date occurs on March 31 of this year and requires the recognition of $2,500 [(5%)($50,000)] of interest. In addition, on September 30 of this year, an interest payment of $6,250 [(5%)($50,000)(2.5)] is received. As $5,000 of this amount has been recognized on previous anniversary dates, only an additional $1,250 ($6,250 - $5,000) must be included in income because of the payment. This gives a total of $3,750 ($2,500 + $1,250) to be included in Ms. Lox's income for 2024.

**2025 -** The third anniversary date occurs on March 31 of this year and requires recognition of an additional $2,500 [(5%)($50,000)]. However, $1,250 of this amount was included in 2024, leaving only $1,250 to be included in income for 2025.

**2026 -** The fourth anniversary date occurs on March 31 of this year and requires recognition of an additional $2,500 [(5%)($50,000)] of interest. In addition, a payment of $3,750 [(5%)($50,000)(1.5)] is received. As $1,250 of this amount has been included in 2025 and the remaining $2,500 must be recognized because of the fourth anniversary date, this payment does not require the recognition of any additional amounts of interest income.

Type: ES

Topic: Interest income - annual accrual rules

74) On May 1, 2022, Mrs. Anna White purchases bonds with a maturity amount of $40,000 at par. These bonds pay semi-annual interest of $2,000 on June 30 and December 31 of each year. She purchases the bonds for $41,326, which includes $1,326 of interest accrued to the purchase date. She holds the bonds for the remainder of the year, receiving both the June 30 and December 31 interest payments. What amount of interest must be included in her income for 2022?

Answer: Mrs. White will have to include the full $4,000 received in the year. However, under ITA 20(14) she is eligible for a deduction of $1,326 [($2,000)(120/181)], reflecting the interest that was accrued on the bonds at the time of the purchase. She will be required to include $2,674 ($4,000 - $1,326) in her income for 2022. The $1,326 that is not included in her income is included in the income of the seller.

Type: ES

Topic: Accrued interest on sale of debt obligations - ITA 20(14)

75) Lexor Inc. has bonds outstanding with a maturity date of December 31, 2030. The bonds pay semi-annual interest at an annual rate of 5%. Payments of $2,500 are made on June 30 and December 31 of each year. The bonds are currently trading at their maturity amount. On April 1, 2022, Arnold Wexler purchases some of these bonds. He pays $101,243, which includes accrued interest of $1,243, for bonds with a maturity amount of $100,000. He holds the bonds for the remainder of the year, receiving both the June 30 and December 31 interest payments. What amount of interest will be required to be included in his income for 2022?

Answer: In 2022, Mr. Wexler will receive interest of $5,000 [(5%)($100,000)]. However, under ITA 20(14) he can deduct the $1,243 [($2,500)(90/181)] of interest that was accrued when the bonds were acquired on April 1, 2022. He will include $3,757 ($5,000 - $1,243) as interest income for 2022. The $1,243 that is not included in her income is included in the income of the seller.

Type: ES

Topic: Accrued interest on sale of debt obligations - ITA 20(14)

76) Alex Bodvin acquires a residential rental property on June 1, 2022 at a cost of $423,000. Of this total, $132,000 is attributable to the land and $291,000 to the building. He immediately spends $42,000 to make major improvements to the property. Rents for the year total $32,000, while rental expenses other than CCA total $27,500. This is the only rental property owned by Mr. Bodvin. Determine the maximum CCA that can be claimed for 2022. In addition, determine Mr. Bodvin's minimum rental income for the year.

Answer: Rental income for Mr. Bodvin will be calculated as follows:

Rents $32,000

Rental Expenses other than CCA ( 27,500)

Rental Income before CCA $ 4,500

CCA (See Note) ( 4,500)

Rental Income Nil

**Note -** Maximum CCA would be $19,980 [(150%)(4%)($291,000 + $42,000)]. However, the maximum CCA that can be claimed is limited to the rental income before CCA of $4,500.

Type: ES

Topic: Rental income

77) Alice Baxter acquires a residential property on May 1, 2022. The cost of the property is $385,000, with $95,000 attributable to the land and $290,000 to the building. She spends $3,500 to paint the interior and exterior of the building. In 2022, rents total $29,000 and expenses other than CCA and the cost of painting total $20,100. Determine the maximum CCA that can be claimed for 2022. In addition, determine Ms. Baxter's rental income for 2022.

Answer: Rental income will be calculated as follows:

Rents $29,000

Rental Expenses other than CCA and painting ( 20,100)

Painting ( 3,500)

Rental Income before CCA $ 5,400

CCA (See Note) ( 5,400)

Rental Income Nil

**Note -** Maximum CCA would be $17,400 [(150%)(4%)($290,000). However, the maximum CCA that can be deducted is limited to the rental income before CCA of $5,400.

Type: ES

Topic: Rental income

78) In 2022, Mr. Franz Schlitz receives $23,500 in eligible dividends from Canadian public corporations. His income is such that this additional amount will be subject to federal income tax of 29% plus 14% for provincial income tax. On eligible dividends, the province provides a dividend tax credit equal to 25% of the gross up. Determine the total federal and provincial income tax that will be payable on these dividends and the after tax retention.

Answer: Eligible Dividends Received $23,500

Gross Up (38%) 8,930

Taxable Dividends $32,430

Combined Federal/Provincial income tax (29% + 14%) 43%

Income Tax before Credit $13,945

Dividend Tax Credit [(6/11 + 25%)($8,930)] ( 7,103)

Income Tax Payable $ 6,842

The after tax retention is $16,658 ($23,500 - $6,842).

Type: ES

Topic: Eligible dividend income

79) Mr. Martin Pabst owns publicly traded shares which, in 2022, paid eligible dividends of $10,200. His taxable income for 2022 exceeds $300,000 and he lives in a province where the maximum individual income tax rate is 16%. The provincial dividend tax credit on eligible dividends is equal to 29% of the gross up. Determine the total federal and provincial income tax that will be payable on these dividends and his after tax retention.

Answer:

Eligible Dividends Received $10,200

Gross Up (38%) 3,876

Taxable Dividends $14,076

Combined Federal/Provincial Income Tax (33% + 16%) 49%

Tax before Credit $ 6,897

Dividend Tax Credit [(6/11 + 29%)($3,876)] ( 3,238)

Income Tax Payable $ 3,659

The after tax retention is $6,541 ($10,200 - $3,659).

Type: ES

Topic: Eligible dividend income

80) In 2022, Ms. Marion Blatz receives $5,600 in non-eligible dividends from taxable Canadian corporations. Her income is such that this additional amount will be subject to a federal income tax rate of 26% and a provincial income tax rate of 10%. The province provides a dividend tax credit equal to 38% of the gross up. Determine the total federal and provincial income tax that will be payable on these dividends and the after tax retention.

Answer: Federal and provincial income tax payable on these dividends would be calculated as follows:

Non-Eligible Dividends Received $5,600

Gross Up (15%) 840

Taxable Dividends $6,440

Combined Federal/Provincial Income Tax (26% + 10%) 36%

Tax before Credit $2,318

Dividend Tax Credit [(9/13 + 38%)($840)] ( 901)

Income Tax Payable $1,417

The after tax retention is $4,183 ($5,600 - $1,417).

Type: ES

Topic: Non-eligible dividend income

81) In 2022, Ms. Andrea Molsen receives non-eligible dividends of $14,200. Her income is such that this additional amount will be subject to a federal income tax taxed of 26% and a 7% provincial income tax rate. The provincial dividend tax credit on non-eligible dividends is equal to 25% of the dividend gross-up. Determine the total federal and provincial income tax that will be payable on these dividends and the after tax retention.

Answer: Federal and provincial income tax payable on these dividends would be calculated as follows:

Non-Eligible Dividends Received $14,200

Gross Up (15%) 2,130

Taxable Dividends $16,330

Combined Federal/Provincial Income Tax (26% + 7%) 33%

Tax Before Credit $ 5,389

Dividend Tax Credit [(9/13 + 25%)($2,130)] ( 2,007)

Income Tax Payable $ 3,382

The after tax retention is $10,818 ($14,200 - $3,382).

Type: ES

Topic: Non-eligible dividend income

82) On January 1, 2022, Jeanine Dorset purchases 1,700 units of the Blackwell Mutual Trust Fund at $37 per unit, a total cost of $62,900. In 2022, the trust distributes $2.75 per unit, $0.85 of which is a return of capital and $1.90 of which is interest income. Jeanine has asked the trust to reinvest all distributions. The $2.75 per unit distribution was reinvested at a cost of $32 per additional unit. What are the income tax consequences to Jeanine with respect to the 2022 distribution and its reinvestment? What is the ACB per unit subsequent to the reinvestment?

Answer: Jeanine will include interest of $3,230 [(1,700)($1.90)] in her income for 2022. The ACB per unit is calculated as follows:

Original Investment - Purchase Cost $62,900

Reinvestment of Distribution [(1,700)($2.75)] 4,675

Return Of Capital [(1,700)($0.85)] ( 1,445)

Total ACB $66,130

Original Investment - Number of Units 1,700

Reinvestment of Distribution ($4,675 ÷ $32) 146

Number of Units 1,846

The ACB per unit is therefore $35.82 ($66,130 ÷ 1,846) per unit.

Type: ES

Topic: Mutual trust fund - ACB

83) On June 1, 2022 Jerry Driggs purchases 2,500 units of the Belle Mutual Trust Fund at $12 per unit. In September, 2022, the trust makes a distribution of $1.50 per unit, of which $1.00 represents a return of capital and $0.50 is interest income. Mr. Driggs decides to reinvest the entire distribution at a cost of $12.50 per additional unit. What are the income tax consequences to Mr. Driggs with respect to the 2022 distribution and subsequent reinvestment? What is the ACB per unit subsequent to the reinvestment?

Answer: Jerry will include $1,250 [(2,500)($0.50)] in income for 2022. The ACB calculations are as follows:

Original Investment - Purchase Cost $30,000

Reinvestment of Distribution [(2,500)($1.50)] 3,750

Return of Capital [(2,500)($1.00)] ( 2,500)

Total ACB $31,250

Original Investment - Number of Units 2,500

Reinvestment of Distribution ($3,750 ÷ $12.50) 300

Total number of Units 2,800

This will result in an average cost of $11.16 ($31,250 ÷ 2,800) per unit.

Type: ES

Topic: Mutual trust fund - ACB

84) John Bordy owns 2,200 units of the DRC Growth Fund, a mutual trust fund. These units were purchased at a cost of $8.15 per unit, for a total of $17,930. The ACB for these units has not changed since their purchase. On December 12 of the current year, the Fund has an interest income distribution of $0.27 per unit, resulting in an addition of $594 to John's account. All of this distribution is reinvested at a purchase price per unit of $10.40. What is the ACB per unit subsequent to the reinvestment?

Answer: Given the purchase price per unit is $10.40, the reinvestment will result in Mr. Bordy receiving 57.12 ($594 ÷ $10.40) additional units. This will leave him with 2,257.12 units with a total ACB of $18,524 ($17,930 + $594). His ACB per unit subsequent to the reinvestment is $8.21 ($18,524 ÷ 2,257.12).

Type: ES

Topic: Mutual trust fund - ACB

85) Arial Horton owns 3,400 units of the Canadian Growth Fund, a mutual trust fund. The total cost of the 3,400 units was $17,000. The ACB of these units has not changed since they were purchased. In June of the current year, the fund has an interest income distribution of $0.45 per unit. All of this distribution is reinvested at a unit price of $5.10. What is the ACB per unit subsequent to the reinvestment?

Answer: The amount of the distribution would be $1,530 [(3,400)($0.45)]. Reinvestment of this amount at $5.10 per unit would result in Ariel receiving 300 additional units. Given this, the ACB per unit would be $5.01 [($17,000 + $1,530) ÷ (3,400 + 300)].

Type: ES

Topic: Mutual trust fund - ACB

86) Melific Ltd. has 4,500,000 common shares outstanding. Jerry Fry acquired 5% of these shares at a cost of $19 each. During the current year, the Company declares a 6% stock dividend which it designates as eligible. At this time the shares are trading at $21 per share. The stock dividend results in an increase in the paid up capital (PUC) of $21 per stock dividend share. What are the income tax consequences to Jerry Fry of the receipt of the stock dividend? Your answer should include the ACB per share to Jerry subsequent to the receipt of the stock dividend.

Answer: The required calculations would be as follows:

Original number of shares owned [(5%)(4,500,000)] 225,000

Stock Dividend Percentage 6%

Number of stock dividend shares 13,500

Per share increase in PUC $ 21

Eligible Stock Dividend Received $283,500

Gross Up 38% 107,730

Taxable Eligible Dividend $391,230

There would be a federal dividend tax credit of $58,762 [(6/11)($107,730)]. The $283,500 stock dividend would be considered the cost of each stock dividend share.

The ACB per share would be calculated as follows:

[($4,275,000 + $283,500) ÷ (225,000 + 13,500)] = $19.11

Type: ES

Topic: Stock dividends

87) Jupiter Inc. has 1,800,000 common shares outstanding. Harry Keller acquired 8% of these shares at a cost of $11 each. During the current year, the Company declares an 8% stock dividend which it designates as eligible. At this time the shares are trading at $12 per share. The Company increases paid up capital (PUC) by $12 per share. What are the income tax consequences to Harry Keller of the receipt of the stock dividend? Your answer should include the ACB per share subsequent to the receipt of the stock dividend.

Answer: The required calculations would be as follows:

Original shares owned [(8%)(1,800,000)] 144,000

Stock Dividend Percentage 8%

Number of stock dividend shares 11,520

Per Share increase in PUC $ 12

Stock Dividend Received $138,240

Gross Up 38% 52,531

Taxable Eligible Dividend $190,771

There would be a federal dividend tax credit of $28,653 [(6/11)($52,531)]. The $138,240 stock dividend would be added to the $1,584,000 [($11)(144,000)] original cost of the shares.

The ACB per share would be calculated as follows:

[($1,584,000 + $138,240) ÷ (144,000 + 11,520)] = $11.07

Type: ES

Topic: Stock dividends

88) Isaac Lemming owns foreign sources of income that earns $27,000 in income in the current year. As the foreign jurisdiction withholds 22% in income tax, he only receives $21,060. He has other income in the year such that this foreign source income will be subject to a federal income tax rate of 33%. How much will his income increase as a result of the foreign source income and how much additional federal income tax will he be required to pay, assuming that:

A. the foreign source income is non-business income.

B. the foreign source income is business income.

For each part A and B assume that the full amount of any foreign tax deduction or credit is based upon the foreign income tax withheld.

Answer:

**Part A -** If the foreign source income is non-business income such as interest income, the foreign tax credit is limited to 15% of the foreign non-business income. Given this, the required calculations would be as follows:

Amount Received $21,060

Withholdings [(22%)($27,000)] 5,940

Foreign Non-Business Income $27,000

Deduction [(22% - 15%)($27,000)] ( 1,890)

Increase in nat and taxable income $25,110

Federal Income Tax 33%

Federal Income Tax before Credit $ 8,286

Foreign Tax Credit [(15%)($27,000)] ( 4,050)

Federal Income Tax Payable $ 4,236

**Part B -** If the foreign source income is business income, the full amount of the withholdings can be used as a foreign tax credit. Given this, the required calculations are as follows:

Amount Received $21,060

Withholdings [(22%)($27,000)] 5,940

Increase in net and taxable income $27,000

Federal Income Tax 33%

Federal Income Tax before Credit $ 8,910

Foreign Tax Credit (Amount Withheld) ( 5,940)

Federal Income Tax Payable $ 2,970

Type: ES

Topic: Foreign source income

89) Isabelle Lemming owns foreign sources of income that results in $34,000 of income in the current year. Because of income tax withholdings of 20% by the foreign jurisdiction, she only receives $27,200 of this amount. These earnings are in addition to over $250,000 in employment income. Determine the amount by which this foreign income would increase Isabelle's taxable income and federal income tax payable, assuming that:

A. the foreign source income is non-business income.

B. the foreign source income is business income.

For each part A and B assume that the full amount of any foreign tax deduction or credit is based upon the foreign income tax withheld.

Answer:

**Part A -** If the foreign source income is non-business income, the foreign tax credit is limited to 15% of the foreign non-business income. Given this, the required calculations would be as follows:

Amount Received $27,200

Withholdings [(20%)($34,000)] 6,800

Foreign source income $34,000

Deduction [(20% - 15%)($34,000)] ( 1,700)

Increase in taxable income $32,300

Federal income tax 33%

Federal Income Tax Payable before Credit $ 10,659

Foreign Tax Credit [(15%)($34,000)] ( 5,100)

Federal Income Tax Payable $ 5,559

**Part B -** If the foreign source income is business income, the full amount of the foreign income taxes withheld can be used as a foreign tax credit. The required calculations are as follows:

Amount Received $27,200

Withholdings [(20%)($34,000)] 6,800

Increase in taxable income $34,000

Federal Income Tax 33%

Federal Income Tax Payable before Credit $ 11,220

Foreign Tax Credit (Amount Withheld) ( 6,800)

Federal Income Tax Payable $ 4,420

Type: ES

Topic: Foreign source income

90) Each of the following independent Cases involves the payment of interest and the determination of whether the interest will be deductible.

**Case A -** Thomas Sanjuan finances the purchase of an income producing property. The cost of the property is $435,000 and Thomas finances 100% of the purchase. The investment proves successful, with the property being sold for $610,000. He uses the sale proceeds to purchase two properties with costs of $495,000 and $115,000 respectively. Is the interest expense on the original loan still deductible and if yes how does this occur?

**Case B -** Tamara Sherrell has a trading account which holds shares she she owns. in various companies The shares are currently worth $1,500,000. She would like to purchase a new Bentley for $325,000. Her bank will finance her purchase with a $325,000 loan at 8.3%. However, as her shares are in a margin account, she can use her margin balance to borrow the $325,000 at a rate of 3.25%. She chooses the latter approach.

During the year, she pays interest on this loan of $10,500. Also during the year, the securities in her trading account pay total dividends of $75,000. Can she deduct the $10,500 of interest against the dividend income generated by the securities in her trading account? Explain your conclusion.

**Case C -** Manuel Pettie takes out a mortgage on his home for $500,000 and immediately transfers the entire amount to his brokerage account to invest in publicly traded shares. Relying solely on company names that come to him in his dreams, he makes some very bad investment choices. As a result, one year later, the value of the shares have declined to only $240,000. Feeling very discouraged, he sells all of the shares and uses the sale proceeds to reduce the loan balance. He will not have the resources to pay off the remaining $260,000 until he receives $500,000 from his trust fund in two years. Is the interest on the mortgage deductible before he sells the shares? If so, does this change after he sells the shares? Explain your conclusion.

**Case D -** Bo Godina borrows $220,000 in order to purchase an income producing property for that same amount. The results from this investment are not promising and, as a result, he sells the investment for $150,000. He uses these funds to buy two properties. The first property costs $35,000, while the second costs $115,000. How will the $220,000 in borrowing be traced to the two properties?

Answer:

***Case A***

The loan on the original property relates to that property or that source of income. Once the property is sold the connection between the loan and the property is severed. Technically no further interest could be deducted as a result. However the courts and the CRA have provided that the interest remains deductible as long as the funds borrowed can be traced to another source of income. In this situation, since the sale proceeds are traceable to other sources of income the interest remains deductible. The CRA provides flexibility in come situations to effectively connect the initial borrowed funds to a particular source of income where two or more sources of income have replaced the initial source. Since in this case the sale proceeds exceed the loan balance the loan can be connected to the new properties on a discretionary basis. The individual could allocate all of the loan balance to the $495,000 property, with none going to the $115,000 property. Similarly, $115,000 could be connected to the $115,000 property, leaving $320,000 for the $495,000 property. There are, many other possible variations that are acceptable to the CRA.

***Case B***

While the dividend paying shares serve as collateral for her car loan, the direct use of the loan is to purchase the Bentley which is personal property. As this is not an income earning property, she cannot deduct the $10,500 in interest.

***Case C***

Although interest to purchase a principal residence is not generally deductible, the direct use of the funds from the mortgage was to purchase income producing property. As a result, the interest is deductible. Under ITA 20.1 (disappearing source provision), the $260,000 balance remaining after the sale of the shares will be deemed to continue to be used to produce income. Therefore, the interest can continue to be deducted after the sale of the shares until the loan balance is paid off.

***Case D***

The loan on the original property relates to that property or that source of income. Once the property is sold the connection between the loan and the property is severed. Technically no further interest could be deducted as a result. However the courts and the CRA provide that the initial interest can continue to be deducted as long as the original borrowed funds can be traced to income earning property. Since the sale proceeds were all reinvested in income earning properties the necessary connection has been maintained ensuring that interest on the original borrowed funds remains deductible. The CRA provides some flexibility where the sale proceeds are used to purchase two or more income earning properties. In this situation since the individual amount of both replacement properties is less than the amount borrowed, a pro-rata allocation of the borrowed money. must be used. In this case, the result would be connecting $51,333 [($35,000 ÷ $150,000)($220,000)] of the existing loan balance to the first property, and connecting $168,667 [($115,000 ÷ $150,000)($220,000)] to the second property.

Type: ES

Topic: Interest deductibility - ITA 20(1)(c)

91) In 2022, Ms. Jessica Roberts owns four residential rental properties. Information on

these properties is as follows:

**124 Glengarry 4251 Oak 1322 Curry 436 Rankin**

**Avenue Street Avenue Avenue**

CCA Class 3 1 1 1

Capital Cost of Building $827,000 $456,000 $246,000 $947,000

January 1, 2022 UCC $563,086 $411,845 $213,018 Nil

Rents and rental expenses, not including CCA, for the 2022 taxation year are as follows:

**124 Glengarry 4251 Oak 1322 Curry 436 Rankin**

**Avenue Street Avenue Avenue**

Rents $50,400 $37,200 $12,800 $63,600

Property Taxes ( 12,400) ( 6,840) ( 9,690) ( 14,205)

Interest Charges ( 24,000) ( 10,200) ( 4,200) ( 41,300)

Other Expenses

(Not including CCA) ( 5,400) ( 8,400) ( 1,100) ( 3,600)

Rental Income (Loss)

Before CCA $ 8,600 $11,760 ($ 2,190) $ 4,495

**Other Information:**

1. In 2022, Ms. Roberts spent $63,000 on improvements to the property at 124 Glengarry Avenue. While none of the changes were required, the tenant insisted on the changes before he was prepared to renew his lease. These improvements will also enhance the value of this property.

2. The building at 4251 Oak Street was sold in 2022 for $523,000. At this time, the value of the land on which the building was situated was equal to its ACB.

3. The building at 1322 Curry Avenue was sold in 2022 for $185,000. At this time, the value of the land on which the building was situated was equal to its ACB. Ms. Roberts had furnished this property several years ago at a cost of $23,000. The Class 8 UCC at January 1, 2022 was $3,598. Given the condition of the furnishings, they were simply given to the former tenants who agreed to take them when they moved out.

4. The building at 436 Rankin Avenue was purchased in 2022 for $1,147,000, including an estimated value for the land of $200,000 and $947,000 for the building.

**Required:** Calculate Ms. Robert's minimum 2022 rental income. You should provide a separate CCA calculation for each property and specify how much CCA should be claimed for each building. Include in your solution any income tax consequences associated with the sale of the two buildings and the disposition of the furniture.

Answer:

***Rental Income***

For the four properties, CCA and other information related to disposals, would be calculated as follows:

**124 Glengarry 436 Rankin**

**Avenue Avenue**

January 1, 2022 UCC $563,086 Nil

Additions 63,000 $ 947,000

AccII Adjustments:(Note)

[(50%) of $63,000 & $947,000] 31,500 473,500

CCA Base $657,586 $1,420,500

Rate 5% 4%

Maximum CCA for 2021 $ 32,879 $ 56,820

**Note:** The capital improvements qualify for the AccII because the capital expenditure is treated as a separate property acquisition and no CCA would have previously been claimed by anyone with respect to this separate property. This result is consistent with retroactive changes made to the AccII that became law in June of 2021.

**4251 Oak 1322 Curry**

**Street Avenue**

January 1, 2022 UCC $411,845 $213,018

Dispositions - Lesser of:

$456,000 Cost and $523,000 POD ( 456,000)

$246,000 Cost and $185,000 POD ( 185,000)

Subtotal ($ 44,155) $ 28,018

Recapture (Note 1) 44,155

Terminal Loss (Note 2) ( 28,018)

CCA Base Nil Nil

**Note 1** -As each rental property with a cost of $50,000 or more must be allocated to a separate CCA Class, the negative balance for the 4251 Oak Street property must be included in income as recapture.

**Note 2** -As no property remains in the separate class for 1322 Curry Avenue, the positive balance that remains at December 31, 2022 can be claimed as a terminal loss.

The terminal loss for Class 8 would be calculated as follows:

January 1, 2022 UCC $3,598

Disposition - Lesser of:

• Cost = $23,000

• POD = Nil Nil

Balance with no remaining property in the class $3,598

Terminal Loss on Class 8 property ( 3,598)

UCC January 1, 2023 Nil

The calculation of rental income would be as follows:

Income (Loss) before CCA

124 Glengarry Avenue $ 8,600

4251 Oak Street 11,760

1322 Curry Avenue ( 2,190)

436 Rankin Avenue 4,495

Recapture 44,155

Terminal Loss on Class 1 ( 28,018)

Terminal Loss on Class 8 ( 3,598)

Income Before CCA $35,204

CCA (Note 3) ( 35,204)

2022 Rental Income Nil

**Note 3** -Maximum available CCA is $89,699 ($32,879 + $56,820). However, as CCA cannot be used to create or increase a rental loss, the CCA deduction is limited to $35,204, the rental income before CCA.

With respect to the question of the Class from which this amount will be deducted, when CCA is not maximized, the general rule is to deduct the amount taken from the Class with the lowest CCA rate. This means the entire $35,204 should be claimed from the Class 1 property.

If Ms. Roberts had any plans to sell 436 Rankin in the near future, it might be more beneficial to consider claiming the maximum CCA on the 124 Glengarry Avenue building instead.

**Taxable Capital Gain**

While the rental income is nil, there would be a taxable capital gain of $33,500 [(1/2)($523,000 - $456,000)] on the disposition of the 4251 Oak Street building.

Note that the ITA doe snot permit capital losses on the sale of depreciable property therefore there is no capital loss on the sale of the building at 1322 Curry Avenue. The difference between its capital cost of $246,000 and the POD of $185,000 has been claimed through CCA and the terminal loss that arose when it was sold.

Type: ES

Topic: Rental income including CCA

92) Mr. Beau Truett has always believed that real estate was a better investment than equity securities. While real estate has a downside in its lack of liquidity, it has three major advantages:

• Current income taxes can be minimized or avoided by claiming CCA. In fact, if properties are heavily financed, the interest expenses can result in losses that can be used to reduce income tax on other income.

• Over long periods of time, gains can be substantial. Further, as these gains are, in general, capital gains, only one-half will be taxable.

• Income tax on any appreciation in value is only subject to income tax when a property is sold.

Based on these views, Beau has, for many years, actively invested in rental properties. At the beginning of 2022, he owns four rental properties. Relevant information on these properties for the 2022 taxation year is as follows:

**13 Jane -** The cost of this property was $825,000, of which $650,000 was allocated to the building and $175,000 for the land. It is in a separate Class 1 with a January 1, 2022 UCC of $531,044. In 2022, the rental income, before the deduction of CCA, was calculated as follows:

Rents $42,000

Property Taxes ($ 7,000)

Mortgage Interest ( 16,250)

Other Expenses (Other than CCA) ( 8,600) ( 31,850)

Rental Income (Before CCA) $10,150

**146 Bronsen -** This property has been owned for many years and had an original cost of $48,000. This was divided into $36,000 for the building and $12,000 for the land. It is included in a single Class 3, along with 27 Front (see next property). The UCC balance in this Class on January 1, 2022 is $21,000. The property was sold in 2022 for $146,000, with $110,000 for the building and $36,000 for the land. Prior to its sale, rental income was determined as follows:

Rents $13,500

Property Taxes ($1,500)

Mortgage Interest ( 1,400)

Other Expenses (Other than CCA) ( 1,100) ( 4,000)

Rental Income (Before CCA) $ 9,500

**27 Front -** This property had an original cost of $58,000 with $42,000 attributable to the building and $16,000 to the land. It is included in the Class 3 balance with 146 Bronsen. In 2022, the property had rental income, before the deduction of CCA, calculated as follows:

Rents $16,700

Property Taxes ($ 1,800)

Mortgage Interest ( 2,600)

Other Expenses (Other than CCA) ( 2,100) ( 6,500)

Rental Income (Before CCA) $10,200

**4826 Jarvus -** This property had an original cost of $750,000 with $600,000 attributable to the building and $150,000 to the land. It is included in a separate Class 1 with a January 1, 2022 UCC balance of $479,439. In 2022, the rental income, before the deduction of CCA, was calculated as follows:

Rents $ 8,400

Property Taxes ($ 6,200)

Mortgage Interest ( 15,250)

Other Expenses (Other than CCA) ( 7,400) ( 28,850)

Rental Loss (Before CCA) ($20,450)

Unlike the other properties, this property was rented fully furnished. However, when this unit became empty early in 2022, Beau had considerable difficulty finding a new tenant. Finally, in October 2022, he decided to replace the aging furnishings and appliances and repaint the property. With the improvement in appearance, he was able to rent the property in late November 2022.

The old furnishings and appliances, all Class 8 property, were purchased at a cost of $46,000. The January 1, 2022 UCC balance was $21,197. In 2022, all of the Class 8 properties were replaced at a cost of $51,000. A generous trade-in allowance of $5,000 was provided.

Beau has received an unsolicited offer for 4826 Jarvus that would result in a substantial capital gain. Although he has not made up his mind, he thinks he could use the funds to purchase real estate that would provide him with a better return.

**Required:** Determine the income tax consequences for the 2022 taxation year of the operation of these rental properties, the sale of 146 Bronsen, and replacement of the furnishings in 4826 Jarvus. Your answer should include Beau's 2022 rental income and the January 1, 2023 UCC balances for the rental properties. Assume that the rental activity would be considered a rental business.

Answer:

***Class 3 Recapture***

As the buildings (not including the land) at 146 Bronsen and 27 Front each cost less than $50,000, they could be grouped into a single CCA Class 3 since the two properties are part of a rental business. If the activity was not considered a rental business then each property would be in a separate class based upon each source of income. When 146 Bronsen is sold, the results would be as follows:

Class 3 Balance - January 1, 2022 $21,000

Disposition - Lesser of:

• Capital Cost = $36,000

• POD = $110,000 ( 36,000)

Negative UCC Balance = Recapture of CCA ($15,000)

This would leave a balance of nil in Class 3, resulting in no CCA being available on this Class in 2022.

***Rental Income Before CCA***

The rental income before CCA can be calculated as follows:

Rental Income before CCA

13 Jane $10,150

146 Bronsen 9,500

27 Front 10,200

4826 Jarvus ( 20,450)

Rental Income before CCA and Recapture $ 9,400

Recapture of Class 3 CCA - 146 Bronsen 15,000

Rental Income before CCA $24,400

***CCA Deduction***

Maximum CCA on the furniture would be calculated as follows:

Class 8 Balance - January 1, 2022 $21,197

Disposition - Lesser of:

• Cost = $46,000

• POD = $5,000 ($ 5,000)

Additions 51,000 46,000

AccII Adjustment [(50%)($46,000)] 23,000

CCA Base $90,197

Rate 20%

Maximum 2022 Class 8 CCA (4826 Jarvus) $18,039

Maximum available CCA on the three remaining buildings would be calculated as follows:

13 Jane [(4%)($531,044)] $21,242

4826 Jarvus [(4%)($479,439)] 19,178

27 Front (UCC of Class 3 is Nil) Nil

Maximum 2022 CCA $40,420

The deduction of CCA cannot be used to create or increase a rental loss and, as a consequence, the actual deduction would be limited in this situation to $24,400, the amount of rental income on the four properties before CCA. Since this is less than the maximum CCA available of $58,459 ($18,039 + $40,420), a decision must be made as to whether the $24,400 should be claimed from Class 8 and/or Class 1.

The general rule is that CCA should be claimed first on property with the lower CCA rate in order to leave larger potential deductions in the future. This would suggest taking the limited amount of $24,400 from Class 1 where the CCA rate is only 4%.

There are two Class 1 properties, 13 Jane and 4826 Jarvus, each in a separate class. The maximum CCA on 13 Jane is $21,242, leaving a need for an additional $3,158 ($24,400 - $21,242) to reduce rental income to nil. As 4826 Jarvus may be sold, any CCA claimed on this property will be recaptured in the year of disposition. Given this, it would be preferable to claim the additional CCA amount from Class 8 as there will be no recapture on the disposition of the properties in this class.

***Rental Income and UCC Balances***

The calculation of rental income would be as follows:

Rental Income before CCA $24,400

Maximum CCA (Class 8 $3,158 + Class 1 $21,242) ( 24,400)

2022 Rental Income Nil

The January 1, 2023 UCC balances would be calculated as follows:

**Class 8**

December 31, 2022 UCC $21,197

Additions 46,000

AccII Adjustment 23,000

CCA Base $90,197

2022 CCA ($24,400 - $21,242) ( 3,158)

AccII Adjustment Reversal ( 23,000)

January 1, 2023 UCC $64,039

**Class 1 Class 1**

**13 Jane 4826 Jarvus**

December 31, 2022 UCC $531,044 $479,439

2022 CCA (Maximum) ( 21,242) Nil

January 1, 2023 UCC $509,802 $479,439

The Class 3 January 1, 2023 UCC balance would be nil after the recapture in the Class.

***Taxable Capital Gains***

While Rental Income is nil, there would be taxable capital gains resulting from the sale of 146 Bronsen as follows:

**Land Building**

POD $36,000 $110,000

ACB (equal to Capital Cost) ( 12,000) ( 36,000)

Capital Gain $24,000 $ 74,000

Inclusion Rate 1/2 1/2

Taxable Capital Gain $12,000 $ 37,000

Type: ES

Topic: Rental income including CCA

93) Mr. Taylor bought a large triplex on February 1, 2021 for a total cost of $345,000. Of this amount, it is estimated that $255,000 is attributable to the building and $90,000 to the land. The three rental units in the triplex are identical in size and features and, for purposes of allocation to a CCA class, the property is considered to be a single unit.

At a bankruptcy sale in February, 2021, Mr. Taylor purchased furniture and appliances for one of the units at a total cost of $12,800.

Early in February, 2021, all three units were rented. In 2021, Mr. Taylor's triplex generated rents of $36,000 and incurred expenses, other than CCA, of $10,900.

In May, 2022, the tenants in the furnished unit moved out and purchased all the furniture and appliances from Mr. Taylor for $7,840. In 2022, Mr. Taylor's triplex generated rents of $28,400 and incurred expenses, other than CCA, of $18,180.

Mr. Taylor claims the maximum CCA allowable in both the 2021 and 2022 taxation years.

**Required**: Calculate the rental income for each of 2021 and 2022. Also, determine the UCC balances on January 1, 2023. Include in your solution any income tax consequences associated with the sale of the furniture and appliances.

Answer:

***2021***

The maximum CCA for 2021 would be calculated as follows:

**Class 1 Class 8**

Addition $255,000 $12,800

AccII Adjustment 127,500 6,400

CCA Base $382,500 $19,200

Maximum CCA for 2021:

[(4%)($382,500)] ( 15,300)

[(20%)($19,200)] ( 3,840)

AccII Adjustment Reversal ( 127,500) ( 6,400)

January 1, 2022 UCC $239,700 $8,960

Rental Income for 2021 would be calculated as follows:

Rental Revenue $36,000

Expenses other than CCA ( 10,900)

Income Before CCA $25,100

Class 1 CCA ( 15,300)

Class 8 CCA ( 3,840)

2021 Rental Income $ 5,960

Note that when an individual uses property to earn income from property (e.g., rental income), the full calendar year is the taxation year of the individual. This means that the short fiscal period rules do not apply to Mr. Taylor as they are restricted to businesses.

***2022***

The terminal loss for Class 8 would be calculated as follows:

January 1, 2022 UCC $8,960

Disposition - Lesser of:

• Cost = $12,800

• POD = $7,840 ( 7,840)

Balance $ 1,120

Terminal Loss ( 1,120)

January 1, 2023 UCC - Class 8 Nil

The terminal loss will be deducted from the Class 8 UCC leaving a January 1, 2023 balance of nil.

The maximum CCA for 2022 would be $9,588 [(4%)($239,700)]. However, as the deduction of CCA cannot be used to create or increase a loss, the actual amount deducted would be limited to $9,100, as shown in the calculation of rental income for 2022:

Rental Revenue $28,400

Expenses other than CCA and Terminal Loss ( 18,180)

Terminal Loss Class 8 ( 1,120)

Income Before CCA $ 9,100

CCA (Limited to income before CCA) ( 9,100)

2022 Rental Income Nil

The January 1, 2023 UCC of the Class 1 building would be calculated as follows:

January 1, 2022 UCC $239,700

2021 CCA ( 9,100)

January 1, 2023 UCC - Class 1 $230,600

Type: ES

Topic: Rental income including CCA

94) Betty, Barbra, and Becky Larson are sisters who live in the same city. Due to disparate life choices, they have experienced varying degrees of financial success. Because of this, any additional income will be subject to different income tax rates as follows:

**Betty Barbra Becky**

Federal Marginal Income Tax Rate 15% 20.5% 33%

Provincial Marginal Income Tax Rate 8% 12% 20%

In 2021, the three sisters jointly purchased lottery tickets and agreed to an equal sharing of any winnings. One of the tickets turned out to be a winner, and they shared a $60,000 prize.

They each intend to invest their $20,000 in January of 2022 and are considering the following alternative investments:

**Corporate Bonds -** Corporate bonds that provide a 5% coupon rate. These bonds can be purchased at their maturity amount. The bonds mature in 20 years.

**Preferred Shares -** Preferred shares are available at a price of $25 per share. These shares pay a non-cumulative eligible dividend of $1.50 per share.

The income from these investments would not move any of the three sisters to a higher federal or provincial income tax bracket. The provincial dividend tax credit on eligible dividends is equal to 27% of the dividend gross up. Each sister has sufficient income to use all of her available personal tax credits.

**Required:** Advise each of the Larson sisters as to which investment they should make. As part of your recommendation, calculate the after tax income that would be generated for each of the sisters, assuming that they invested their lottery winnings of $20,000 each in:

A. The corporate bonds.

B. The preferred shares.

Answer:

***Part A***

The combined income tax rates for the three sisters are 23% (15% + 8%), 32.5% (20.5% + 12%), and 53% (33% + 20%). Given these rates, the after tax returns on the bonds would be calculated as follows:

**Betty (23%) Barbra (32.5%) Becky (53%)**

Interest [(5%)($20,000)] $1,000 $1,000 $1,000

Federal/Provincial income tax

at 23%, 32.5%, and 53% ( 230) ( 325) ( 530)

After Tax Return — Interest $ 770 $ 675 $ 470

***Part B***

The after tax returns resulting from an investment in the preferred shares begins with the calculation of the federal and provincial income taxes:

**Betty (23%) Barbra (32.5%) Becky (53%)**

Dividends [($20,000/$25)($1.50)] $1,200 $1,200 $1,200

Gross Up 38% 456 456 456

Taxable Dividend $1,656 $1,656 $1,656

Combined Rate (See Part A) 23% 32.5% 53%

Income tax before Dividend Tax Credit $ 381 $ 538 $ 878

Dividend Tax Credit

[(6/11 + 27%)($456)] ( 372) ( 372) ( 372)

Income Tax Payable $ 9 $ 166 $ 506

Based on the preceding calculation of combined income tax payable, the after tax returns on the preferred shares are calculated as follows:

**Betty (23%) Barbra (32.5%) Becky (53%)**

Dividends Received $1,200 $1,200 $1,200

Tax Income Payable ( 9) ( 166) ( 506)

After Tax Return — Dividends $1,191 $1,034 $ 694

***Comparison***

A comparison of the after tax rates of return can be made as follows:

**Betty (23%) Barbra (32.5%) Becky (53%)**

After Tax Dividends $1,191 $1,034 $694

After Tax Interest ( 770) ( 675) ( 470)

Advantage of Preferred Shares $ 421 $ 359 $224

***Recommendation***

As would be expected, the preferred shares provide higher after tax returns for each of the three sisters. However, you should also advise them that the preferred shares have a greater level of risk. As the preferred shares are not cumulative, there is the possibility that not all of the scheduled dividends will actually be paid. In addition, the FMV of the shares can vary which could result in fluctuating values that could be more or less than $25 per share at the time of sale.

Type: ES

Topic: Dividend vs. interest income

95) On January 1, 2022, Mr. Saul Goldfarb is notified that he has won $250,000 in the provincial lottery. This amount is immediately available to Mr. Goldfarb.

Mr. Goldfarb has no immediate need for these funds. However, he plans to retire on January 1, 2023 and would like to have the funds available at that time for use in relocating to a warmer climate. Given this, he would like to invest the funds for the 2022 taxation year. He is considering the following alternatives:

**Guaranteed Investment Certificate (GIC) -** The $250,000 can be invested in a GIC that matures on December 31, 2022. The GIC will pay interest of 3%.

**Common Shares -** The $250,000 can be invested in the shares of a Canadian public company. The shares are currently trading at $125 per share and pay an annual eligible dividend of $6.00 per share. Mr. Goldfarb's broker assures him that the shares should be trading at $135 per share by December 31, 2022.

Mr. Goldfarb has sufficient employment income that he is in the 29% federal income tax bracket and the 15% provincial income tax bracket. The provincial dividend tax credit for eligible dividends is equal to 30% of the gross up.

**Required:** Write a brief memorandum providing investment advice to Mr. Goldfarb with respect to the alternative investments.

Answer: The major considerations in deciding between the two alternative investment strategies are the after tax return and the certainty of the related cash flows.

**GIC -** As long as the GIC is purchased from a financial institution that is guaranteed by the federal government, there is virtually no risk that the principal or interest could be lost. Your combined federal and provincial income tax rate for interest is 44% (29% + 15%). Based on this, the after tax retention on the GIC would be as follows:

Interest [(3%)($250,000)] $7,500

Income Tax [(44%)($7,500)] ( 3,300)

After Tax Return $4,200

**Common Shares -** If you invest the $250,000 in common shares, you will acquire 2,000 shares ($250,000 ÷ $125). With the dividend at $6.00 per share, the total eligible dividend will be $12,000. However, there is no guarantee that the shares will pay a dividend of $6.00 per share in the year. There is the possibility that more or less than $6.00 per share will be paid. In addition, the estimated FMV of at least $135 on December 31, 2022 is also uncertain. The FMV on that date could be higher or lower.

Assuming that the common shares do pay $12,000 in dividends and that you sell the shares for $135 per share on December 31, 2022, your after tax return on the investment is as follows:

Dividends Received $12,000

Gross Up [(38%)($12,000)] 4,560

Taxable Dividends $16,560

Taxable Capital Gain [(1/2)(2,000)($135 - $125)] 10,000

Increase in taxable income $26,560

Income Tax (29% + 15%) 44%

Income Tax before Dividend Tax Credit $11,686

Dividend Tax Credit [(6/11 + 30%)($4,560)] ( 3,855)

Income Tax Payable $ 7,831

Dividends Received $12,000

Capital Gain (100%) 20,000

Income Tax Payable ( 7,831)

After Tax Return $24,169

**Conclusion -** Based purely on after tax returns, the common shares are preferable as it provides an additional $19,969 ($24,169 - $4,200). However, as previously indicated, the common shares involves more risk and uncertainty. You will have to make a decision as to whether the additional $19,969 warrants the assumption of additional risk. Other factors which may influence your decision are as follows:

• The funds are locked into the GIC and can only be withdrawn prior to maturity at a severe interest penalty, if at all.

• The investment in common shares would give you more flexibility if you should require some of the funds before the end of the year. All or some portion of the shares could be sold during the year.

• Any dividends that are paid will be available for your use as at the payment date. The interest will not be available to you until maturity.

Type: ES

Topic: Property income - alternative investments

96) On January 1, 2022, Carolyn Jackson received a $200,000 inheritance from her mother. While she has no plans to use any of these funds in 2022, she and her three sisters plan to open a bed and breakfast next year and she will need the funds to purchase her share of the business on January 1, 2023.

In the meantime, she would like to invest the $200,000 for a one year period. She is considering the following investments and would like your advice on the appropriate choice:

**Mutual Trust Fund -** On January 1, 2022, this trust is selling for $25 per unit. It makes a distribution of $0.10 per unit per month. This distribution includes a return of capital of $0.01 per month, with the balance of the distribution being property income. Carolyn will sell the units at the end of 2022. She anticipates that these units will be selling for at least $26 per unit at that time.

**Ventex Inc. Common Shares -** On January 1, 2022, the shares of this public company are selling for $80 per share. The Company pays an annual eligible dividend of $3.00 per share. Carolyn anticipates that these shares will be selling for at least $85.00 per share on December 31, 2022.

In 2022, Carolyn will continue to work at her present job. Her employment income is such that any additional income will be subject to income tax at a combined federal/provincial rate of 32%. Carolyn resides in a province where the provincial dividend tax credit for eligible dividends is equal to 30% of the gross up.

**Required:** Write a brief memorandum providing investment advice to Carolyn with respect to these two alternative investments.

Answer:

***Analysis***

The major considerations in deciding between the two alternative investment strategies are the after tax return and the certainty of the related cash flows.

**Mutual Trust Fund Units -** The cash flows associated with investments in trust fund units are not guaranteed. However, the distributions made by these trusts tend to be fairly stable and, in general, involve less risk than dividends on common shares. Your investment of $200,000 will result in you owning 8,000 units ($200,000 ÷ $25).

As the monthly per unit distribution includes $0.01 as a return of capital, you will only be taxed on $0.09 per unit of the monthly distribution. Based on this, your income tax payable will be calculated as follows:

Trust Income [(12)($0.09)(8,000)] $8,640

Income Tax 32%

Income Tax Payable on Trust Income Distributions $2,765

When you sell the units at $26 per unit, there will be additional taxes as follows:

POD [($26)(8,000)] $208,000

ACB:

Original Cost $200,000

Less Tax Free Return of Capital

[(12)($0.01)(8,000)] ( 960) ( 199,040)

Capital Gain $ 8,960

Inclusion Rate 1/2

Taxable Capital Gain $ 4,480

Income Tax 32%

Income Tax Payable on Sale of Units $ 1,434

The $0.01 per unit return of capital included in the monthly distribution increased your capital gain for tax purposes.

Your after tax return would be calculated as follows:

Cash Flow - Sale of Units

[(8,000)($26 - $25)] $ 8,000

Trust Distributions [(12)($0.10)(8,000)] 9,600

Pre Tax Cash Flows $17,600

Income Tax Payable ($2,765 + $1,434) ( 4,199)

After Tax Retention - Mutual Trust Fund $13,401

**Common Shares -** If you invest the $200,000 in the common stock, you will acquire 2,500 shares ($200,000 ÷ $80). The anticipated additional taxable income from these shares for the year is calculated as follows:

Eligible Dividends [($3.00)(2,500)] $ 7,500

Gross Up [(38%)($7,500)] 2,850

Taxable Capital Gain on Sale [(1/2)(2,500)($85 - $80)] 6,250

Additional Taxable Income $16,600

Based on this figure, your income tax payable would be calculated as follows:

Additional Income $16,600

Income Tax 32%

Income Tax Payable before Credits $5,312

Dividend Tax Credit [(6/11 + 30%)($2,850)] ( 2,410)

Income Tax Payable $2,902

Your after tax return would be calculated as follows:

Eligible Dividends Received $ 7,500

Capital Gain (100%) 12,500

Pre Tax Cash Flow $20,000

Income Tax ( 2,902)

After Tax Retention - Common Shares $17,098

***Conclusion***

Using your estimates for investment returns, the better investment, based purely on after tax returns, is the common shares. It provides an additional $3,697 ($17,098 - $13,401). However, the common shares generally involves greater risk and uncertainty.

You will have to make a decision as to whether the additional $3,697 warrants the assumption of additional risk.

Type: ES

Topic: Investments in mutual trust fund and common shares

97) As a result of receiving a large inheritance, Ms. Belinda Ho invests in five different types of investments in 2021. The investments, along with their results during the 2022 taxation year, are as follows:

**Public Company Shares -** She acquires 5,000 shares of Avator Inc. at a cost of $20 per share. In 2022, the shares pay eligible dividends of $1.10 per share. On December 31, 2022, the shares are sold for $22 per share.

**CCPC Shares -** She acquires 1,250 shares of a Canadian controlled private company (CCPC) at a price of $80 per share. In 2022, these shares pay non-eligible dividends of $5 per share. She continues to own the shares at December 31, 2022.

**Riokan Mutual Trust Fund -** She acquires 12,500 units of the RioKan Mutual Trust Fund at a cost of $8 per unit. In 2022, the trust makes a distribution of $0.90 per unit. Of this total, $0.40 represents a return of capital, with the balance being interest income. The proceeds of this distribution are invested in additional RioKan units at a cost of $8.75 per unit. She continues to own the units at December 31, 2022.

**Fidel Cap Mutual Trust Fund -** She acquires 4,000 units of Fidel Cap, a mutual trust fund, at a price of $25 per unit. In 2022, the trust makes a distribution of $1.75 per unit. The composition of this distribution is as follows:

Capital Gains $0.60

Eligible Dividends 0.80

Interest 0.35

Total Per Unit $1.75

Belinda reinvests this distribution in new Fidel Cap Mutual Trust Fund units at $26.50 per unit. She continues to own the units at December 31, 2022.

**Foreign Term Deposit -** On January 1, 2022, she acquires a Euro (€) term deposit with a maturity value of €80,000 at a Canadian dollar cost of $100,000. On December 31, 2022, the principal amount of the term deposit is paid, along with interest of €8,000. Foreign income taxes are withheld equal to 20% of the interest. Assume that throughout 2022, €1.00 = $1.45.

This additional investment income will be subject to a federal income tax rate of 29% and a 16% provincial income tax rate. Her other income is sufficient to fully utilize all of her available personal tax credits. She lives in a province where the dividend tax credit on eligible dividends is 30% of the gross up, and on non-eligible dividends is 25% of the gross up.

**Required:** Determine the amount of any additional taxable income and income tax payable as a result of these investments. In addition, calculate the per unit ACB of both the Riokan and Fidel Cap mutual trust funds on December 31, 2022.

Answer:

***Additional Taxable Income and Income Tax Payable***

The amount of additional taxable income and income tax payable resulting from the investments would be calculated as follows:

**Public Company Shares**

Eligible Dividends [($1.10)(5,000)] $ 5,500

Gross Up [($5,500)(38%)] 2,090 $ 7,590

Taxable Capital Gain

[(1/2)(5,000)($22 - $20)] 5,000 $12,590

**CCPC Shares**

Non-Eligible Dividends [($5.00)(1,250)] $ 6,250

Gross Up [($6,250)(15%)] 938 7,188

**Riokan Mutual Trust Fund**

Distribution [($0.90)(12,500)] $11,250

Return of Capital [($0.40)(12,500)] ( 5,000) 6,250

**Fidel Cap Mutual Trust Fund**

Capital Gain [(1/2)($0.60)(4,000)] $ 1,200

Eligible Dividends [($0.80)(4,000)] $ 3,200

Gross Up [($3,200)(38%)] 1,216 4,416

Interest Income [($0.35)(4,000)] 1,400 7,016

**Foreign Term Deposit**

Foreign Interest [(€8,000)($1.45)] $11,600

Excess Withholding - See Note

[(20% - 15%)(€8,000)($1.45)] ( 580) 11,020

Additional Taxable Income $44,064

Income Tax (29% + 16%) 45%

Income Tax before related tax credits $19,829

Dividend Tax Credit - Eligible Dividends

[(6/11 + 30%)($2,090 + $1,216)] ( 2,795)

Dividend Tax Credit - Non-Eligible Dividends

[(9/13 + 25%)($938)] ( 884)

Foreign Tax Credit [(15%)(€8,000)($1.45)] - See Note ( 1,740)

Total Income Tax Payable on Additional Taxable Income $14,410

**Note - Foreign Source Property Income** Individuals are able to claim a foreign tax credit equal to 15% of the foreign source income and to claim any excess amount as a deduction against the foreign source income in the calculation of net income.

***ACB - RioKan Mutual Trust Fund***

The investment of the $11,250 [($0.90)(12,500)] distribution will result in an additional 1,285.71 ($11,250 ÷ $8.75) units, for a total of 13,785.71 (12,500 + 1,285.71) units. The ACB of all of the units would be calculated as follows:

Original Units [($8.00)(12,500)] $100,000

Reinvestment in new units [($0.90)(12,500)] 11,250

Return of Capital [($0.40)(12,500)] ( 5,000)

ACB $106,250

Based on this, the ACB per unit would be: $106,250 ÷ 13,785.71 = $7.71

***ACB - Fidel Cap Mutual Trust Fund***

The investment of the $7,000 [($1.75)(4,000)] distribution at $26.50 per unit will result in an additional 264.15 ($7,000 ÷ $26.50) units, for a total of 4,264.15 units. The total ACB of these units would be $107,000 [(4,000)($25) + $7,000). Given this, the ACB per unit would be

$107,000 ÷ 4,264.15 = $25.09

Type: ES

Topic: Alternative investments - foreign property income, shares of corporations and mutual trust funds

98) ***Family Information***

Christopher Dunn is 37 years old. He has been married to Kathy Dunn for 12 years. In 2022, Kathy has net income of $8,200, all from investments. In 2022, Christopher works 275 hours as a volunteer firefighter in his local community. He did not receive any compensation for this work.

After many years of renting, on February 1, 2022, Christopher and Kathy purchase a new residence for $432,000. The property is financed with a $200,000 mortgage at an annual interest rate of 2.5%.

Christopher and Kathy's only surviving parent is her father, Jason. He is 66 years old and, while he is dependent on Christopher and Kathy because of a physical infirmity requiring the use of a wheelchair, his condition is not severe enough for him to qualify for the disability tax credit. His 2022 net income is $9,400. This includes OAS payments and a small pension from a former employer.

In 2022, Christopher spent $12,000 modifying their new home to accommodate Jason's wheelchair. The work was enduring in nature and will allow Jason to be much more mobile within the home.

Christopher paid the following amounts in 2022:

Root Canal Fee for Christopher $1,525

Hair Replacement Fees for Christopher 4,300

Prescription Glasses and Contact Lenses for Kathy 1,342

Teeth Whitening Fees for Kathy 2,000

Psychologist Consulting Fees for Kathy 2,450

Electric Wheelchair for Jason 3,300

Physiotherapy Fees for Jason 3,420

***Employment Information***

Christopher works for a large Canadian public company. His salary is $67,460, none of which is commissions. His employer withholds the following amounts in 2022:

Registered Pension Plan (RPP) Contributions (Note 1) $4,200

EI Premiums 953

CPP Contributions 3,500

Contributions to Registered Charities 3,200

**Note 1 -** Christopher's employer makes a matching contribution of $4,200.

Christopher is required to travel fairly extensively by his employer and uses his own automobile for this purpose. His current non-zero-emission automobile was purchased on January 1, 2022 at a cost of $42,000. In 2022, the automobile was driven 32,000 kilometers, 25,600 of which were employment purposes and 6,400 for personal use. Operating expenses for the year totaled $4,900 none of which were reimbursed by his employer.

At the time he purchased the automobile, his employer provided him with an interest free loan of $20,000 to assist in the car purchase. None of this loan will be repaid until 2023. Assume that the relevant prescribed rate of interest on employee loans throughout 2022 was 1%.

In addition to his automobile expenses, his other 2022 travel expenses were:

Hotels $2,700

Food while travelling for the employer 1,800

His employer provides him with the following allowances for his travel:

Hotels and Food $4,800

Use of personal automobile ($100 per week) 5,200

***Investment Information***

Early in 2022, Christopher's father died of cancer and left him a very large inheritance which Christopher used to create a substantial investment portfolio. Christopher paid off his mortgage on September 25, 2022 with funds from the inheritance. On October 1, 2022, he used his house as collateral for a new $200,000 mortgage at the same 2.5% annual interest rate. He invested the mortgage funds in shares of Canadian public companies.

The 2022 results for his investments are:

**Shares in Canadian Public Companies -** During the year he receives $23,000 in eligible dividends.

**Shares in Canadian Controlled Private Company (CCPC)-** He has invested in a local company that has developed a revolutionary new product. As the product is becoming successful, the Company pays Christopher non-eligible dividends of $15,000 in 2022.

**Foreign Preferred Shares -** In 2022 he purchased US$25,000 in preferred shares of U.S. based public companies. At the time he purchased these shares, the exchange rate was US$1.00 = C$1.40. In 2022, these shares pay dividends throughout the year totaling US$1,800. Foreign income taxes of 10% were withheld. The average exchange rate for 2022 was US$1.00 = C$1.35.

**Mutual Trust Fund -** During the year, Christopher's owned mutual trust fund units that made distributions totaling $34,250. The breakdown of these distributions is as follows:

Capital Gains $20,000

Eligible Dividends 9,000

Interest Income 5,250

Total $34,250

**Required:** Ignore GST/HST & PST considerations in your solution, as well as the provisions of the U.S./Canada tax treaty.

A. Determine Christopher's 2022 net income

B. Determine Christopher's 2022 taxable income

C. Determine Christopher's 2022 federal income tax payable.

Answer:

**Part A - Net Income**

***Employment Income***

Christopher's 2022 employment income would be calculated as follows:

Salary $67,460

Additions:

Travel Allowances (Note 1)

Hotels and food Nil

Use of personal automobile 5,200

Interest loan benefit [(1%)($20,000)] 200

Deductions:

Hotels and Food (Note 1) Nil

Automobile Costs (Note 2) ( 14,880)

RPP Contributions (4,200)

2022 Employment Income $53,780

**Note 1 -** Given his actual costs, the allowance for hotels and food seems reasonable. This means it does not have to be included in income. However, this will prevent Christopher from claiming his actual travel expenses. Note that the actual determination of the reasonableness of an allowance is not based on a comparison of the actual expenses with the allowance. With respect to the allowance for personal use of his automobile, it is not based on kilometers driven and is therefore deemed unreasonable requiring it to be included in income.

**Note 2 -** His deductible automobile costs would be calculated as follows:

Operating Expenses $4,900

CCA on Class 10.1 [(150%)(30%)($30,000)] 13,500

Interest benefit on loan [(1%)($20,000)] 200

Total Automobile Expenses $18,600

Employment Related Percentage (25,600 ÷ 32,000) 80%

Total Deductible automobile Expenses $14,880

The luxury car rules for zero-emission vehicles limit the capital cost of the automobile to $30,000 for vehicles purchased in 2022. Also note that the $200 of imputed interest on the car loan is deemed to be interest paid for purposes of determining motor vehicle expenses under ITA 8(1)(j). (ITA 80.5)

***2022 Property Income***

Christopher's property income would be:

Public Company Eligible Dividends $23,000

Gross Up [(38%)($23,000)] 8,740

Non-Eligible Dividends - Private Company 15,000

Gross Up [(15%)($15,000)] 2,250

Foreign Preferred Shares Dividends [(100%)(US$1,800)(C$1.35)] 2,430

Mutual Trust Fund Eligible Dividends 9,000

Gross Up [(38%)($9,000)] 3,420

Mutual Trust Fund Interest Income 5,250

Less: Interest on loan for investments [(2.5%)($200,000)(3/12)] ( 1,250)

2022 Property Income $67,840

The interest on the home mortgage taken out to purchase the house is not deductible as the funds were not used to produce income. However, when the original loan was repaid and the house remortgaged, the direct use of the funds was to purchase property that would earn property income. As a result, the interest is deductible.

***2022 Taxable Capital Gains***

Christopher has taxable capital gains from the mutual trust fund distribution as follows:

Mutual Fund Taxable Capital Gains [(1/2)($20,000)] $10,000

***2022 Net Income***

Christopher's 2022 net income can be calculated as follows:

Employment Income $ 53,780

Property Income 67,840

Taxable Capital Gains 10,000

CPP Deduction ($3,500 - $3,039) (461)

2022 Net Income $131,159

**Part B - Taxable Income**

As Christopher has no taxable income deductions, his 2022 taxable income is equal to his 2022 net income of $131,159.

**Part C - Federal Income Tax Payable**

Christopher's 2022 federal income tax payable would be calculated as follows:

Tax on First $100,392 $17,820

Tax on Next $30,767 ($131,159 - $100,392) at 26% 7,999

Federal Income Tax before Credits $25,819

Tax Credits:

BPA ($14,398)

Spousal ($14,398 - $8,200) ( 6,198)

Volunteer Firefighters ( 3,000)

First Time Home Buyers ( 5,000)

Canada Caregiver for Jason ( 7,525)

Medical Expenses (Note 3) ( 21,276)

Home Accessibility Credit (Note 4) ( 10,000)

EI Premiums ( 953)

CPP Contributions ( 3,039)

Canada Employment ( 1,287)

Credit Base ($72,676)

Rate 15% ( 10,901)

Charitable Donations (Note 5)

[(15%)($200) + (29%)($3,200 - $200)] ( 900)

Dividend Tax Credits:

Eligible Dividends [(6/11)($8,740 + $3,420)] ( 6,633)

Non-Eligible Dividends [(9/13)($2,250)] ( 1,558)

Foreign Tax Credit [(10%)(US$1,800)(C$1.35)] ( 243)

2022 Federal Income Tax Payable $ 5,584

**Note 3 -** The amount for medical expenses would be calculated as follows:

Christopher And Kathy ($1,525 + $1,342 + $2,450) $ 5,317

Reduced by the lesser of:

• [(3%)($131,159)] = $3,935

• 2022 Threshold Amount = $2,479 ( 2,479)

Jason's Medical Expenses

($12,000 + $3,300 + $3,420) $18,720

Reduced by the lesser of:

• [(3%)($9,400)] = $282

• $2,479 ( 282) 18,438

Allowable Medical Expenses $21,276

The home modifications were made to allow Jason, who is confined to a wheelchair, to be more mobile within the home. As a result, the costs are allowable medical expenses. As indicated in Note 4, $10,000 of this amount can be used again in the base for the home accessibility credit.

The fees for hair replacement and teeth whitening are not allowable medical costs.

**Note 4 -** The home accessibility tax credit base is equal to the lesser of the actual costs of $12,000 and an unindexed amount of $10,000. Also note that, despite the fact that the full $12,000 was used in the base for the medical expense credit, $10,000 of this amount can be used again in the base for the home accessibility credit.

**Note 5 -** As none of his income is subject to the 33% income tax rate this rate will not apply to the calculation of the charitable donations tax credit.

Type: ES

Topic: Comprehensive case covering chapters 1 to 7

99) ***Family Information***

John Davis is 66 years old. He has been married to Martha Davis for over 40 years. Martha is 72 years old and has 2022 net income of $10,000. This total is made up of OAS payments of $7,400, plus a $2,600 withdrawal from her RRIF.

John and Martha have two children. Their 28 year old son, Brian has been blind since birth. He is totally dependant on John and Martha, lives with them, and has no 2022 net income.

Their daughter, Nadine Spence is 33 years old and was recently divorced. Her only income is $38,400 in child support that she receives under the provisions of the divorce settlement. She and her two children live with John and Martha. Neither Nadine nor her children have any net income in 2022.

In order to establish a new life, Nadine is attending university on a full time basis. Her tuition for 2022 was $11,300, all of which was paid by John. Nadine has agreed to transfer the maximum tuition tax credit to her father.

The family's medical expenses, all of which have been paid by John, are as follows:

John $ 900

Martha\* 2,100

Brian 11,600

Nadine 2,450

Nadine's Children 700

Total Medical Expenses $17,750

\*Martha's medical expenses consisted of a $1,000 charge for teeth whitening and $1,100 in charges for 3 pairs of prescription eyeglasses, including prescription sunglasses.

***Employment and Pension Income***

While John is over 65 and receives a significant pension from a former employer's RPP, he is a full time employee of Larson Enterprises Ltd. In 2022, his gross salary was $71,500. Larson made the following payroll deductions:

RPP Contributions $3,890

EI Premiums 953

CPP Contributions 3,500

Union Dues 633

Donations to Registered Charities 2,200

In 2022, his pension income from his former employer was $51,000. He has not applied for OAS as he knows that all of it will be clawed back. Further, he has not applied for CPP as he is aware that deferring the application will result in larger future benefits.

***Property Income***

In 2022, John received the following dividends (all amounts in Canadian dollars):

Eligible Dividends from Taxable Canadian Corporations $13,200

Non-Eligible Dividends on shares of a CCPC 4,100

Dividends on foreign shares - 15% foreign income taxes are withheld 14,000

Total Dividends Received $31,300

In addition to dividends, John had 2022 interest income of $2,843.

***Business Income***

Because of the project management skills that he has acquired over the years, John started a management consulting business in 2019 which he carries on as a sole proprietor. In that year he acquired a new building to be used as an office for his business. The building cost $523,000 of which $123,000 was attributable to the land and $400,000 to the building. On January 1, 2022, the UCC of the building is $342,847.

The building contains office furniture and fixtures that were acquired in 2019 at a cost of $51,000. On January 1, 2022, the UCC is $29,376.

In 2022, he spends $37,000 on improving and upgrading the building. In addition, he sells the old furniture and fixtures for $21,300 and purchases replacement furniture and fixtures for $58,000.

As John has no reason to keep detailed accounting records, he records his business income on a cash basis. In 2022, his net cash flow from the business was $146,300. Relevant amounts for the beginning and end of 2022 are as follows:

**January 1 December 31**

Billed Receivables $14,100 $19,100

Unbilled WIP 18,300 22,300

Accounts Payable 9,200 10,400

Since the beginning of the business, John has owned an automobile that is used 100% for business purposes. The automobile that he purchased in 2019 was sold in 2021. He purchased a new non-zero-emission vehicle on January 1, 2022 at a cost of $56,200. He financed the automobile through his bank and, in 2022, he made payments on the loan of $12,600. All of this amount was deducted in determining his net cash flow from the business. Of the total, $4,610 represented interest payments with $7,990 representing principal payments. John's automobile operating expenses in 2022 were $8,600.

**Required**: Calculate John’s 2022 minimum net income, taxable income and federal income tax payable. Ignore GST/HST & PST considerations and the possibility of pension income splitting.

Answer:

***2022 Employment Income***

John's employment income would be calculated as follows:

Gross Wages $71,500

RPP Contributions ( 3,890)

Union Dues ( 633)

2022 Employment Income $66,977

***2022 Property Income***

John's property income would be calculated as follows:

Eligible Dividends $13,200

Gross Up 38% 5,016

Non-Eligible Dividends 4,100

Gross Up 15% 615

Foreign Dividends 14,000

Interest 2,843

2022 Property Income $39,774

***2022 Business Income***

John's business income would be calculated as follows:

Net Cash Flow $146,300

Principal Payments on car loan ($12,600 - $4,610) 7,990

Non-Deductible Interest [($4,610 - (365)($10 Daily Maximum)] 960

December 31 Billed Receivables 19,100

January 1 Billed Receivables ( 14,100)

December 31 WIP 22,300

January 1 WIP ( 18,300)

December 31 Accounts Payable ( 10,400)

January 1 Accounts Payable 9,200

Subtotal $163,050

CCA ($23,901 + $16,885 + $13,500) (Note 1) ( 54,286)

Automobile operating expenses (already deducted) Nil

2022 Business Income $108,764

**Note 1 -** The CCA would be calculated as follows:

**Class 1 CCA**

January 1, 2022 UCC $342,847

Addition Improvements including AccII [(150%)($37,000)] 55,500

Base For CCA $398,347

Rate 6%

CCA $ 23,907

As the building was acquired new and was used 100% for non-residential purposes, it is eligible for the 6% CCA rate as long as an election is made to include the building in a separate class. Note also that the improvement qualify for the AccII since the addition is treated as a separate property component with no CCA having been previously claimed by anyone. This is consistent with the retroactive changes made to the AccII regulations that became law in June 2021.

**Class 8 CCA**

January 1, 2022 UCC $29,376

Additions 58,000

Disposals - Lesser of:

• POD = $21,300

• Capital Cost = $51,000 ( 21,300)

AccII Adjustment [(50%)($58,000 - $21,300)] 18,350

Base For CCA $84,426

Rate 20%

CCA $16,885

**Class 10.1 CCA**

As the cost of the car exceeds $30,000, the addition to Class 10.1 is limited to $30,000. The maximum deduction for 2022 would be $13,500 [(150%)(30%)($30,000)].

***2022 Net Income and Taxable Income***

There are no taxable income deductions available therefore taxable income is equal to net income.

Employment Income $ 66,977

Property Income 39,774

Business Income 108,764

Pension Income 51,000

Deductible CPP ($3,500 - $3,039) ( 461)

2022 Net and Taxable Income $266,054

***2022 Federal Income Tax Payable***

Federal Income Tax Payable would be calculated as follows:

Tax on First $221,708 $51,345

Tax on Next $44,346 ($266,054 - $221,708) at 33% 14,634

Income Tax before Credits $65,979

Tax Credits:

Basic Personal Amount (John) ($12,719)

Spouse ($12,719 - $10,000) ( 2,719)

Canada Caregiver - Brian ( 7,525)

John’s Age Credit [$7,898 - (15%)($266,054 - $39,826)] Nil

John’s Pension Credit ( 2,000)

EI ( 953)

CPP ( 3,039)

Canada Employment ( 1,287)

Transfer of Spouse’s Age Credit

[$7,898 - (15%)($10,100 - $39,826) ( 7,898)

Transfer of Spouse’s Pension Credit ( 2,000)

Transfer of Brian’s Disability Credit ( 8,870)

Transfer of Nadine’s Tuition Credit (Note 1) ( 5,000)

Medical Expenses (Note 2) ( 14,750)

Total Credit Base ($68,760)

Rate 15% ( 10,314)

Charitable Donations (Note 3) ( 690)

Dividend Tax Credit on:

Eligible Dividends [(6/11)($5,016)] ( 2,736)

Non-Eligible Dividends [(9/13)($615)] ( 425)

Foreign Tax Credit - Amount Withheld [(15%)($14,000)] ( 2,100)

2022 Federal Income Tax Payable $49,714

**Note 1 -** Nadine’s child support received is not included in her 2021 net income as it not taxable. Given this, Nadine has nil net income and would qualify as an eligible dependant of John’s if he was not married. Even though she and her children live with John, he cannot claim the Canada caregiver tax credit for them as they are not mentally or physically infirm.

With respect to the transfer of the tuition credit, the maximum transfer would be the lesser of:

• The actual tuition cost of $11,300.

• The absolute maximum of $5,000.

**Note 2 -** The claim for medical expenses is determined as follows:

Medical Expenses of John and Martha

($900 + $2,100 - $1,000)\* $2,000

Reduced by the lesser of:

• [(3%)($266,054)] = $7,982

• 2022 Threshold Amount = $2,479 ( 2,479)

Balance before Dependants 18 and over Nil

Brian’s Medical Expenses $11,600

Reduced by the lesser of:

• $2,479

• [(3%)(Nil)] = Nil Nil 11,600

Nadine and her children’s

Medical Expenses ($2,450 + $700) $ 3,150

Reduced by the lesser of:

• $2,479

• [(3%)(Nil)] = Nil Nil 3,150

Total Medical Expense Claim $14,750

\*The $1,000 spent for teeth whitening cannot be added to the credit base as it is for cosmetic purposes.

**Note 3 -** John's charitable donations credit would be calculated as follows:

15% of $200 $ 30

33% of the lesser of:

($2,200 - $200) = $2,000

($266,054 - $221,708) = $44,346 660

29% of [$2,200 - ($2,000 + $200)] Nil

Total Credit $690

Type: ES

Topic: Comprehensive case covering chapters 1 to 7

100) Ms. Jezebel Forest is 67 years old and has been married to Bernard Forest, for over 40 years. She has never applied for OAS as she knows that, for the foreseeable future, it will all be clawed back. In addition, she has not applied for CPP as she is aware that deferring the application will result in larger future benefits. She continues to make contributions towards the CPP.

She has been employed by a number of organizations over her working life and, in 2022, she receives pension income from various RPPs totalling $4,000 per month.

Currently, she is a full time employee of Dartmor Enterprises Ltd. with an annual salary of $71,500. Dartmor made the following payroll deductions:

RPP Contributions $2,500

EI Premiums 953

CPP Contributions 3,500

Union Dues 336

Donations to Registered Charities 1,800

Jezebel's spouse, Bernard Forest is 69 years old and has 2022 net income of $15,200. This consists of pension income from his RRSP and OAS payments. He has not applied for CPP.

The couple have two children. Their 42 year old daughter Samantha has been blind since an automobile accident when she was a teenager. She lives with Jezebel and Bernard, is totally dependent on them, and has no 2022 net income.

Their 44 year old son Norman has had a long history of substance abuse. However, he is currently living with Jezebel and Bernard and is in a rehabilitation program that seems to be working. The program provides him with a monthly income of $2,000, conditional on his staying enrolled in a university program leading to an accounting degree. In 2022, he attends university on a full time basis for 10 months. His tuition fees are $11,300 and he has textbook costs of $1,100. Jezebel pays all of these costs and Norman has agreed to transfer the maximum education related credits to her. Norman's only tax credits are the BPA and any education related credits.

In 2022, Jezebel received the following dividends (all amounts in Canadian dollars):

Eligible Dividends from Taxable Canadian Corporations $15,400

Non-Eligible Dividends on shares in a CCPC 2,600

Dividends on foreign shares - 15% foreign income taxes are withheld 16,000

Total Dividends Received $34,000

In addition to dividends, Jezebel had 2022 interest income of $1,456.

The family’s medical expenses, all of which have been paid by Jezebel, are as follows:

Jezebel $ 450

Bernard 1,475

Samantha 11,400

Norman 8,470

Total Medical Expenses $21,795

Jezebel also carries on a management consulting business which she started in 2019 as a sole proprietor. In that year, she purchased a building to be used exclusively as an office for the business. The building cost $383,000, of which $112,000 is attributable to the land on which the building is situated and $271,000 to the building. On January 1, 2022, the UCC of the building is $232,272. This is the only building owned by Jezebel other than her principal residence.

When she purchased the building in 2019, she also purchased office furniture and fixtures at a cost of $18,500. On January 1, 2022, the UCC of the class is $10,656.

In 2022, Jezebel spends $23,500 in improvements to the building and $24,500 on new furniture and fixtures. The older furniture and fixtures are sold for $6,200.

As the business has expanded, on January 1, 2022, Jezebel purchased a non-zero-emission automobile to be used exclusively in the business. The cost of the automobile is $41,500, all of which was financed with a bank loan. In 2022, interest charges on the bank loan total $4,980, all of which was deducted in determining the cash flows from the business. The 2022 operating expenses for the automobile totaled $5,600.

As Jezebel has no reason to keep detailed accounting records, she records business income on a cash basis. In 2022, her net cash flow from the business was $96,400. Relevant amounts for the beginning and end of 2022 are as follows:

**January 1 December 31**

Billed Receivables $8,400 $11,250

Unbilled WIP 12,600 18,400

Accounts Payable 6,240 7,485

**Required**: Calculate Jezebel’s 2022 minimum net income, taxable income and federal income tax payable. Ignore GST/HST & PST considerations and the possibility of pension income splitting.

Answer:

***2022 Employment Income***

Jezebel's employment income would be calculated as follows:

Gross Wages $71,500

RPP Contributions ( 2,500)

Union Dues ( 336)

2022 Employment Income $68,664

***2022 Property Income***

Jezebel's property income would be calculated as follows:

Eligible Dividends $15,400

Gross Up 38% 5,852

Non-Eligible Dividends 2,600

Gross Up 15% 390

Foreign Dividends 16,000

Interest 1,456

2022 Property Income $41,698

***2022 Business Income***

Jezebel's business income would be calculated as follows:

Net Cash $96,400

December 31 Billed Receivables 11,250

January 1 Billed Receivables ( 8,400)

December 31 WIP 18,400

January 1 WIP ( 12,600)

December 31 Accounts Payable ( 7,485)

January 1 Accounts Payable 6,240

Non-Deductible Interest [($4,980 - (365)($10 Daily Maximum)] 1,330

Automobile Operating Expenses (Already Deducted) Nil

CCA ($16,051 + $7,621 + $13,500) (Note 2) ( 37,172)

2022 Business Income $67,963

**Note 1 -** The CCA would be calculated as follows:

**Class 1 CCA**

January 1, 2022 UCC $232,272

Additional Improvements & AccII [($23,500)(1.5)] 35,250

Base For CCA $267,522

Rate 6%

CCA For Class 1 $ 16,051

As the building was acquired new and was used 100% for non-residential purposes, it is eligible for the 6% CCA rate as long as an election is made to include the building in a separate class. Note also that the improvement qualify for the AccII since the addition is treated as a separate property component with no CCA having been previously claimed by anyone. This is consistent with the retroactive changes made to the AccII regulations that became law in June 2021.

**Class 8 CCA**

January 1, 2022 UCC $10,656

Additions 24,500

Disposals - Lesser of:

• POD = $6,200

• Capital Cost = $18,500 ( 6,200)

AccII Adjustment [(50%)($24,500 - $6,200)] 9,150

Base For CCA $38,106

Rate 20%

CCA For Class 8 $ 7,621

**Class 10.1 CCA**

As the cost of the automobile exceeds $30,000, the addition to Class 10.1 is limited to $30,000. The maximum deduction for 2021 would be $13,500 [(150%)(30%)($30,000)].

***2022 Net and Taxable Income***

There are no taxable income deductions available. As a consequence, taxable income is equal to net income.

Employment Income $ 68,664

Property Income 41,698

Business Income 67,963

Pension Income [(12)($4,000)] 48,000

Deductible CPP ($3,500 - $3,039) ( 461)

2022 Net and Taxable Income $225,864

***2022 Federal Income Tax Payable***

The *ITA* defines dependant as follows:

***ITA 118(6)*** *Definition of "dependant" – ..."dependant" of an individual for a taxation year means a person who at any time in the year is dependent on the individual for support and is (a) the child or grandchild of the individual or of the individual's spouse or common-law partner; or ...*

Although Norman has $24,000 in net income, he is living with his parents, in a rehab program and going to university full time. This would indicate that he is dependent on Jezebel for support.

In the following calculation, Norman would not qualify for the caregiver tax credit as he is not infirm, but Jezebel can claim his medical expenses as he is a dependant and she has paid his medical expenses.

2022 Federal Income Tax Payable would be calculated as follows:

Tax on First $221,708 $51,345

Tax on Next $4,156 ($225,864 - $221,708) at 33% 1,372

Federal Income Tax before Credits $52,717

Tax Credits:

BPA (Jezebel) ($12,719)

Spouse ($12,719 - $15,200) ( Nil)

Canada Caregiver - Samantha (Note 2) ( 7,525)

Jezebel’s Age Credit

[$7,898 - (15%)($226,740 - $39,826)] Nil

Jezebel’s Pension Credit ( 2,000)

EI ( 953)

CPP ( 3,039)

Canada Employment ( 1,287)

Transfer of Spouse’s Age Credit (Note 3)

($7,898 - $802) ( 7,096)

Transfer of Spouse’s Pension Credit (Note 4) ( 2,000)

Transfer of Samantha’s Disability Credit ( 8,870)

Transfer of Norman’s Tuition Credits (Note 5) ( Nil)

Medical Expenses (Note 6) ( 19,150)

Total Credit Base ($64,639)

Rate 15% ( 9,696)

Charitable Donations (Note 7) ( 558)

Dividend Tax Credit On:

Eligible Dividends [(6/11)($5,852)] ( 3,192)

Non-Eligible Dividends [(9/13)($390)] ( 270)

Foreign Tax Credit - Amount Withheld [(15%)($16,000)] ( 2,400)

2021 Federal Income Tax Payable $36,601

**Note 2 -** As Samantha has a physical infirmity, Jezebel can claim the Canada caregiver credit for her.

**Note 3 -** Bernard's 2022 net income is below the threshold amount for the age credit of $39,826, so his age credit will not be reduced. Since Bernard has no deductions from his Net Income For Tax Purposes, his Taxable Income is equal to $15,200.

In order to calculate how much of his age credit can be transferred, he must first reduce his federal income tax payable to nil using a portion of his age credit calculated as follows:

Bernard's Taxable Income $15,200

Bernard's Basic Personal Amount ( 14,398)

Age Credit Base used by Bernard $ 802

**Note 4 -** Bernard can transfer all of his pension income credit since his federal income tax payable has been reduced to nil by the use of his age credit.

**Note 5 -** Norman's tuition credit is $11,300. While the maximum transfer is $5,000, this amount has to be reduced by the excess of Norman's net income over his basic personal amount. This amount would be $9,602 ($24,000 - $14,398), an amount that would reduce the maximum transfer to nil.

**Note 6**

The claim for medical expenses is determined as follows:

Medical Expenses of Jezebel and Bernard ($450 + $1,475) $1,925

Reduced by the lesser of:

• [(3%)($225,864)] = $6,776

• 2022 Threshold Amount = $2,479 ( 2,479)

Balance before Dependants 18 and over Nil

Samantha’s Medical Expenses $11,400

Reduced by the lesser of:

• $2,479

• [(3%)(Nil)] = Nil Nil $11,400

Norman’s Medical Expenses $ 8,470

Reduced by the lesser of:

• $2,479

• [(3%)($24,000)] = $720 ( 720) 7,750

Total Medical Expense Claim $19,150

**Note 7-** Jezebel's charitable donations credit would be calculated as follows:

15% of $200 $ 30

33% of the lesser of:

($1,800 - $200) = $1,600

($225,864 - $221,708) = $4,156 528

29% of $1,800 - ($1,600 + $200) Nil

Total Donation Credit $558

Type: ES

Topic: Comprehensive case covering chapters 1 to 7