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

**Chapter 17 Other Corporate Rollovers and Sale of a Corporate Business**

17.1 Online Exercises

1) Describe, in general terms, the type of situation in which ITA 85.1, Share For Share Exchange, is used. What is the major tax advantage of using this rollover provision?

Answer: The usual situation in which ITA 85.1 is applied involves a shareholder of a Canadian corporation (Corporation A) who wishes to sell shares, on an arm's length basis, to another Canadian corporation (Corporation B). ITA 85.1 allows the shareholder to exchange shares in Corporation A for shares of Corporation B, with the transaction taking place at the ACB of the Corporation A shares. That is, the POD for the Corporation A shares will be their ACB, and this will also be the cost of the shares to the purchasing company. The major tax advantage is the fact that any gain on the Corporation A shares is deferred until such time as the Corporation B shares are sold.

Type: ES

Topic: Rollovers (ITA 85.1) - basic rules & concepts

2) Briefly describe the general rules applicable to the vendor in a ITA 85.1 share for share exchange.

Answer: The basic rules are that the vendor is deemed to have (1) disposed of the exchanged shares for POD equal to their ACB, and (2) acquired the shares of the purchaser at a cost to the vendor equal to the ACB to the vendor of the exchanged shares immediately before the exchange. In other words the tax attributes (ACB and PUC) of the shares acquired become the tax attributes of the shares sold.

Type: ES

Topic: Rollovers (ITA 85.1) - basic rules & concepts

3) There are several conditions that are required for an ITA 85.1 rollover to apply. List three of these conditions.

Answer: The required three can be chosen from the following:

• The vendor's shares must be capital property.

• The vendor and purchaser must be dealing with each other at arm's length.

• The vendor, or persons with whom the vendor does not deal at arm's length, cannot control the purchaser corporation immediately after the exchange. Likewise, they cannot own shares having a FMV in excess of 50% of the total FMV of the purchasing corporation's outstanding shares.

• The vendor and purchaser cannot have filed an election under ITA 85 with respect to the exchanged shares.

• The vendor must not have received any consideration, other than shares of the purchaser, in return for the shares given up in the exchange. In other words no NSC.

Type: ES

Topic: Rollovers (ITA 85.1) - basic rules & concepts

4) The provisions of ITA 85.1, share for share exchange, apply automatically unless the vendor opts out. How does the vendor opt out?

Answer: The vendor opts out by reporting the share exchange as a disposition at FMV in their income tax return which would result in the reporting of a capital gain or capital loss. Note that, unlike ITA 85(1), the only amount that can be used in opting out is the FMV of the exchanged shares.

Type: ES

Topic: Rollovers (ITA 85.1) - basic rules & concepts

5) Jerome Barris is 85 years old and, while his spouse is deceased, he has three adult children, ages 45, 50, and 52. He owns all of the outstanding common shares of Barris Ltd., a CCPC. These shares have a PUC and ACB of $50,000, and a current FMV of $3 million. He would like to retain control of Barris Ltd. However, given his advanced age, he would like to ensure that any future growth in the value of the Company accrues to the benefit of his three adult children. Briefly explain how ITA 86 could be used to accomplish the desired objective.

Answer: Under ITA 86, Mr. Barris could exchange his common shares in Barris Ltd. for some combination of NSC and redeemable preferred shares, with a total FMV equal to the $3 million FMV of the common shares. As long as the NSC does not exceed the $50,000 PUC and ACB of the common shares, there would be no immediate income tax consequences to Mr. Barris. As the FMV of any preferred share consideration together with any NSC represent 100% of the value of Barris Ltd., common shares could be sold to the children for a nominal amount of consideration. In order for Mr. Barris to retain control, the preferred shares should be voting.

Type: ES

Topic: Rollovers (ITA 86) - basic rules & concepts

6) Several conditions must be met in order for the provisions of ITA 86 to apply. List two of the conditions.

Answer: The required two conditions can be selected from the following:

• The shares to be exchanged must be capital property to the owner. They cannot be part of an inventory of securities that is being held for trading purposes.

• The transaction must result in an exchange of all of the outstanding shares of a particular class that are owned by the particular person.

• The share exchange must be integral to a reorganization of the capital of the corporation.

• The transferor must receive shares of the capital stock of the corporation.

Type: ES

Topic: Rollovers (ITA 86) - basic rules & concepts

7) When preferred shares are issued in an ITA 86 reorganization, it is important that their FMV be sustainable to ensure that the participating shareholder remains able to recover the full amount of their pre-reorganization value. List three preferred share attributes considered essential to maintaining the value of these preferred shares.

Answer: The required three share attributes provisions include the following:

• The preferred shares must be redeemable at the option of the shareholder.

• The preferred shares should be entitled to a dividend at a reasonable rate.

• The corporation must guarantee that dividends will not be paid on any other class of shares, if the payment would result in the corporation being unable to redeem the preferred shares at their specified redemption price.

• The preferred shares must become cumulative if the FMV of the net assets of the corporation falls below the redemption amount of the preferred shares, or if the corporation is unable to redeem the shares on a call for redemption.

• The preferred shares should have preference on liquidation of the corporation.

Type: ES

Topic: Rollovers (ITA 86) - basic rules & concepts

8) When new shares are issued in an ITA 86 reorganization, how is their ACB determined?

Answer: The ACB of the new shares issued in an ITA 86(1) reorganization would be equal to the ACB of the old shares less any NSC. However, if a gift is involved, ITA 86(2) would apply and in that case, the ACB of the new shares will be equal to the ACB of the old shares, reduced by the sum of any NSC plus the gift amount.

Type: ES

Topic: Rollovers (ITA 86) - basic rules & concepts

9) When new shares are issued in an ITA 86 reorganization, how is the PUC determined?

Answer: The paid up capital (PUC) of new shares issued in a reorganization of capital to which ITA 86 applies would be equal to their legal capital, less a PUC reduction. This reduction calculation would start with the legal capital of the new shares. From this total, the formula requires the subtraction of any excess of the PUC of the old shares over any NSC received. If the NSC exceeds the old PUC, the reduction will be equal to the legal capital, resulting in a PUC of nil. This is the same result even if the gifting rule applies.

Type: ES

Topic: Rollovers (ITA 86) - basic rules & concepts

10) In a reorganization of capital under ITA 86, it is necessary to calculate both a proceeds of redemption and a POD. How do these two calculations differ if there is no gift involved?

Answer: The proceeds of redemption are equal to the sum of any NSC received, plus the reduced PUC of the new shares issued. The POD are equal to the sum of any NSC received, plus the ACB of the new shares issued to redeem the old shares.

Type: ES

Topic: Rollovers (ITA 86) - basic rules & concepts

11) Briefly describe the calculation of the PUC of new shares issued in a reorganization of capital under ITA 86(1).

Answer: The initial PUC is equal to the legal capital of the new shares issued. However, this amount is subject to a PUC reduction equal to the legal capital of the new shares, reduced by the excess, if any, of the PUC of the old shares over the NSC. This reduction is then subtracted from the legal capital to arrive at a final amount for the PUC of the new shares. In those cases where the NSC equals or exceeds the PUC of the old shares, the PUC reduction is equal to the legal capital of the new shares, resulting in PUC of nil.

Type: ES

Topic: Rollovers (ITA 86) - basic rules & concepts

12) ITA 86(2) has special rules that must be applied when a ITA 86 reorganization involves a gift to a related person. What condition create a gift?

Answer: The basic condition for a gift is that the FMV of the old shares exceeds the sum of the FMV of the new shares and the FMV of any NSC received. In addition, a related person must be in a position to economically benefit from this difference. This would generally require that the related person own common shares in the reorganized corporation.

Type: ES

Topic: Rollovers (ITA 86) - the gifting rule (ITA 86(2)

13) When a reorganization of capital involves a gift to a related person, the provisions of ITA 86(2) modify the general ITA 86(1) rules. Briefly describe the main changes that result from these modifications.

Answer: The modifications can be described as follows:

• Under ITA 86(2)(e), the cost to the taxpayer of the new shares will be equal to the cost of the old shares, less the sum of the NSC and the gift amount. This compares to a cost for the new shares under ITA 86(1)(b) equal to the cost of the old shares, less any NSC.

• Under ITA 86(2)(c), the POD for capital gains purposes on the old shares will be equal to the lesser of (1) the NSC plus the gift, and (2) the FMV of the old shares. This compares to the POD under ITA 86(1)(c), which is equal to the cost of the new shares, plus any NSC.

• Under ITA 86(2)(d), any capital loss resulting from the disposition of the old shares will be deemed to be nil. There is no such restriction under ITA 86(1).

Type: ES

Topic: Rollovers (ITA 86) - the gifting rule (ITA 86(2)

14) Estate freezes can be carried out using either ITA 85(1) or ITA 86. What are the major advantages of using ITA 86(1) over using ITA 85(1)?

Answer:

• An ITA 86 share reorganization is generally simpler to implement than a rollover under ITA 85(1).

• The use of ITA 86(1) does not require an election to be filed with the CRA.

Type: ES

Topic: Rollovers - ITA 85(1) vs ITA 86

15) List two conditions that are necessary for the amalgamation rollover of ITA 87 to apply.

Answer: The required two conditions can be selected from the following:

• All of the predecessor corporations must be taxable Canadian corporations.

• All shareholders of the predecessor corporations must receive shares of the amalgamated corporation due to the amalgamation.

• All of the property and liabilities of the predecessor corporations, other than intercompany accounts, must become property and liabilities of the amalgamated corporation.

• The transfer cannot simply be a normal purchase of property, or involve the distribution of property on the winding-up of a corporation. The amalgamation must be undertaken within the relevant Canadian corporate law.

Type: ES

Topic: Rollovers (ITA 87) - basic rules & concepts

16) What is the income tax position of the shareholders of a company that has been amalgamated with another company under ITA 87, Amalgamations.

Answer: The shareholders of the predecessor corporations are deemed to have received POD equal to the ACB of their shares. In addition, they are deemed to have acquired the shares of the amalgamated company at the same amount. In effect the tax attributes of the predecessor corporation shares become the tax attributes of the amalgamated corporation shares.

Type: ES

Topic: Rollovers (ITA 87) - basic rules & concepts

17) Subsections 88(1) and 88(2) cover two different types of transactions. Describe these two types of transactions.

Answer: ITA 88(1) deals with the wind-up of a subsidiary in which the parent company owns 90% or more of each class of shares issued by the subsidiary. It is a rollover provision that allows the subsidiary property to be distributed to the parent, essentially at tax costs. ITA 88(2) deals with all other corporate wind ups meaning that those occuring on a taxable basis. ITA 88(2) is not a rollover.

Type: ES

Topic: Rollovers (ITA 88(1)) - basic rules & concepts

18) Both ITA 87, Amalgamations, and ITA 88(1), Wind-Up of a 90% owned subsidiary, provide for a bump-up in the tax cost of certain property. Describe the two basic limitations on the amount of this bump-up.

Answer: The limits on the bump are described in the text as follows:

• The basic amount of the bump-up is found in ITA 88(1)(d)(i) and (i.1). This amount is the excess of the ACB of the subsidiary shares held by the parent, over the sum of:

• the net tax values (NTV) of the subsidiary at the time of the winding-up; and

• any dividends paid by the subsidiary to the parent since the time of the acquisition of control (including capital dividends).

• ITA 88(1)(d)(ii) further limits the amount of the bump that can be applied to the excess of the FMV of the subsidiary's non-depreciable capital property over their tax costs measured using FMV determined at the time the parent last acquired control of the subsidiary.

Type: ES

Topic: Rollovers (ITA 87(11) & 88(1)) - the bump

19) If a parent company wishes to incorporate the property of a majority owned subsidiary into its operations, this income tax goal of avoiding income tax can be accomplished either through an amalgamation, using ITA 87, or through the winding-up or a dissolution using ITA 88(1). Briefly describe the different income tax consequences from choosing one or the other of these alternative income tax rollovers.

Answer: ITA 88(1), applies when a parent corporation owns 90% or more of each class of the subsidiary's shares. Where the ACB of the subsidiary shares exceeds the net tax value of the subsidiary the opportunity exists to increase the tax cost (bump) of certain subsidiary property to retain the lost tax cost of the subsidiary shares that are cancelled once the subsidiary is dissolved. This same bump opportunity is also available under ITA 87, but only in those cases where the parent owns 100% of the subsidiary's shares. This means that the only real difference with respect to the availability of this "bump" is that its applicability is more limited under ITA 87, since it can only be used when share ownership is 100%.

A second difference between these two provisions involves the use of loss carryovers. In the case of an ITA 87 amalgamation, loss carryovers can be used immediately after the amalgamation transaction takes place. In the case of an ITA 88(1) wind-up, subsidiary loss carryovers will not become available until the first taxation year of the parent that begins after the date that the wind-up period commences.

A third difference is that, in an amalgamation, CCA can be claimed in the last year of the predecessor corporations and the first year of the amalgamated corporation. In the case of a wind-up under ITA 88(1), the subsidiary will not be able to claim CCA in the year of the wind-up.

A final difference is that, in an amalgamation, both predecessor companies have a deemed year end. In the ITA 88(1) wind-up, the parent company does not have a deemed year end.

Type: ES

Topic: Rollovers - wind-ups (ITA 88(1) vs amalgamations (ITA 87(11))

20) When a corporation is wound up or dissolved and ITA 88(2) applies, properties will be sold and liabilities will be settled. When the resulting proceeds are distributed to shareholders, the distribution will usually be made up of several different components. Briefly indicate the components that can be included in this type of distribution.

Answer: The components may consist of the following amounts:

• PUC.

• Capital dividends.

• Taxable dividends, including any balance in the Eligible and Non-Eligible RDTOH accounts.

• POD for the shares.

Type: ES

Topic: Winding up a Canadian corporation - ITA 84(2) & 88(2)

21) Companies sometimes issue bonds that can be converted, at the discretion of the holder, into common shares of the company. In general, conversion will only occur if the FMV of the common shares available upon conversion exceed the FMV of the bonds. What are the income tax consequences to the holder of such bonds when they exercise their option to convert?

Answer: The conversion transaction involves a disposition of a debt, along with the acquisition of shares. The POD for the debt would be the FMV of the shares received on the conversion and, in the absence of a special rollover rule, the result would be a capital gain. However, relief is found in the rollover rule of ITA 51(1). ITA 51(1)(c), deems such exchanges not to be a disposition. Given that there is no disposition, no capital gain or capital loss will occur. ITA 51(1)(d) deems the cost of the acquired shares to be equal to the cost of the debt given up. These provisions, in effect, permit a rollover of the two different types of investments. In effect the tax cost of the bond becomes the tax cost of the shares.

Type: ES

Topic: Rollovers (ITA 51) - basic rules & concepts

22) When a taxpayer receives a payment for signing a restrictive covenant, the general rule is that the full amount must be included in the taxpayer's income when it is received or receivable. The proposed legislation on this subject provides for three exceptions to this general rule. Briefly describe these exceptions.

Answer: The three exceptions are as follows:

• In cases where the payment relates employment, the receipt will be treated by the recipient as employment income.

• When certain types of intangible capital property is being sold and the payor and the recipient jointly elect in prescribed form, the payment can be treated by the recipient as a disposition of a Class 14.1 property.

• In a situation where a restrictive covenant is sold in conjunction with an eligible interest such shares of a corporation, the amount received can be added to the POD resulting in capital gain treatment.

Type: ES

Topic: Restrictive covenants (ITA 56.4) - basic rules & concepts

23) When business properties of a CCPC are sold, the following will usually be involved in the sale:

• Accounts Receivable

• Inventory

• Depreciable Property excluding Goodwill

• Goodwill

Briefly describe the income tax implications resulting from the sale of each of the preceding types of property.

Answer: **Accounts Receivable -** In general terms, the sale of accounts receivable is treated as a capital transaction. This means that losses are capital in nature and treated as a capital loss. However, any doubtful debt reserve from the previous year must be brought into income in the current year. There is a joint election available under ITA 22 that will allow the seller to fully deduct any losses, provided the purchaser agrees to include the same amount in their business income.

**Inventory -** Gains and losses on the sale of inventories are either fully included in income or fully deductible against business income.

**Depreciable Property -** The sale of depreciable property is somewhat more complex than other types of property. They can be outlined as follows:

1. If the sale proceeds (POD) exceed the ACB (e.g. capital cost), the excess will be treated as a capital gain. In addition, the difference between the UCC and the capital cost will be included in income as recapture.

2. If the proceeds are less than the balance in the UCC of the class and there are no other properties in the class on the last day of the taxation year, the deficiency will be fully deductible as a terminal loss.

3. If the proceeds are less than the capital cost but more than the UCC balance, the excess will also be treated as recapture.

**Goodwill -** If there is goodwill some amount of the consideration received for the purchase of a business will generally be allocated to goodwill. This allocated amount will treated as POD for a Class 14.1 property to the seller and, the lesser of this amount and the capital cost of the goodwill, if any, will be subtracted from any Class 14.1 balance. As the capital cost of goodwill will most commonly be nil, the result will be that the entire POD will be treated as a capital gain.

The purchaser of the business will add the allocated cost of the goodwill to Class 14.1 where it will be subject to CCA on a 5% declining balance basis. The AccII applies to this Class.

Type: ES

Topic: Purchase and sale of a business

24) In general, the purchaser of a corporate business would prefer to purchase the business assets (properties) rather than the shares of the corporation. Provide three reasons for this preference.

Answer: The three reasons can be selected from the following:

• The purchaser acquires a completely new, and usually higher, set of tax costs for assets purchased based in their individual FMV. This will result in higher CCA claims and/or lower gains on future dispositions.

• Goodwill can be recognized when assets are acquired. The CCA deductions related to Class 14.1 are not available if shares are acquired because there is no purchase and sale of a business.

• If shares are acquired, generally all of the assets must also be acquired unless certain assets are removed prior to the purchase and sale which influences the share purchase price.

• If shares are acquired, the purchaser may become responsible for any future income tax reassessments that relate to taxation years prior to the purchase and sale. While this exposure could occur because the corporation continues to carry on the business. Purchase and sale agreements often contain indemnity and other similar clauses to protect the purchaser from any contingencies.

• If shares are acquired, the purchaser may become responsible for potential non-tax liabilities related to product or environmental liabilities. However, this is another issue that is normally dealt with in the purchase and sale agreement.

Type: ES

Topic: Purchase and sale of a business

25) In an ITA 85.1 share-for-share exchange, the vendor must not receive any NSC.

Answer: TRUE

Type: TF

Topic: Rollovers (ITA 85.1) - basic rules & concepts

26) ITA 85.1 was designed to be used in situations where a public company acquires a widely held corporation with a large number of shareholders as part of a takeover.

Answer: TRUE

Type: TF

Topic: Rollovers (ITA 85.1) - basic rules & concepts

27) In a share for share exchange under ITA 85.1, the selling shareholder cannot control the purchasing company subsequent to the rollover transaction.

Answer: TRUE

Type: TF

Topic: Rollovers (ITA 85.1) - basic rules & concepts

28) In an ITA 86(1) exchange of shares in a reorganization, the transferor cannot receive any NSC.

Answer: FALSE

Type: TF

Topic: Rollovers (ITA 86) - basic rules & concepts

29) When used in an ITA 86(1) exchange of shares in a reorganization, preferred shares cannot have voting rights.

Answer: FALSE

Type: TF

Topic: Rollovers (ITA 86) - basic rules & concepts

30) In an ITA 86 exchange of shares in a capital reorganization, if the transaction involves a gift to a related person, the POD for capital gains purposes on the old shares will be equal to the lesser of:

• the NSC, plus the gift and

• the FMV of the old shares.

Answer: FALSE

Explanation: The two items listed would be the proceeds of redemption. To arrive at the POD, any deemed dividend would be subtracted.

Type: TF

Topic: Rollovers (ITA 86) - basic rules & concepts

31) The most common application of the ITA 86 exchange of shares in a reorganization is to incorporate a business.

Answer: FALSE

Explanation: Such a transfer cannot be made under ITA 86(1).

Type: TF

Topic: Rollovers (ITA 86) - basic rules & concepts

32) In an ITA 86 exchange of shares in a reorganization, the transferor must transfer all of the shares of all classes owned in the transferee corporation.

Answer: FALSE

Explanation: The only requirement is that he transfer all of the shares owned of a particular class.

Type: TF

Topic: Rollovers (ITA 86) - basic rules & concepts

33) In an ITA 86 exchange of shares in a reorganization, if the transferor received NSC in excess of the PUC of the old shares, the PUC of the new shares issued will be reduced to nil.

Answer: TRUE

Type: TF

Topic: Rollovers (ITA 86) - basic rules & concepts

34) In an ITA 86 exchange of shares in a reorganization, if the transferor receives shares with a FMV that is greater than the FMV of the shares given up, it may be considered a gift to a related person.

Answer: FALSE

Explanation: Such gifts may occur when the FMV of the shares received is less than the FMV of the shares given up.

Type: TF

Topic: Rollovers (ITA 86) - basic rules & concepts

35) In an ITA 87 amalgamation, losses carried forward from the amalgamating companies cannot be used by the amalgamated company until the first taxation year beginning after the beginning of the amalgamation process.

Answer: FALSE

Explanation: They can be used immediately.

Type: TF

Topic: Rollovers (ITA 87) - basic rules & concepts

36) When a 90% owned subsidiary is wound up under the provisions of ITA 88(1), the subsidiary will not be able to claim CCA in its final taxation year.

Answer: TRUE

Type: TF

Topic: Rollovers (ITA 88(1)) - basic rules & concepts

37) If a parent company controls a subsidiary, its properties can always be distributed to the parent on a tax free basis using either an ITA 87 amalgamation or ITA 88(1).

Answer: FALSE

Explanation: ITA 88(1) can only be used when there is 90% or greater ownership of each class of shares of the subsidiary. ITA 87 does not require any percentage for a parent/subsidiary amalgamation however access to the bump requires that the parent own 100% of the shares of the subsidiary.

Type: TF

Topic: Rollovers - wind-ups (ITA 88(1) vs amalgamations (ITA 87(11))

38) If, when a corporation is wound up under the provisions of ITA 88(2), the distribution of property to the shareholders exceeds the PUC of the shares being cancelled, the excess will be treated as a capital gain, one-half of which will be included in the shareholder's income.

Answer: FALSE

Explanation: The excess will be treated as an ITA 84(2) deemed dividend.

Type: TF

Topic: Dividends - ITA 84(2) deemed dividend

39) If an investor uses a conversion feature to exchange his debt securities for shares in the same company, there is a rollover which can prevent the transaction from being treated as a disposition at FMV and therefore avoiding any immediate income tax.

Answer: TRUE

Type: TF

Topic: Rollovers (ITA 51) - basic rules & concepts

40) Which of the following statements about ITA 85.1 is **NOT** correct?

A) This provision is commonly used in business combination transactions.

B) The vendor and the purchaser must be dealing with each other at arm's length.

C) The vendor can receive a combination of shares and NSC in return for the exchanged shares without any special restructuring.

D) The vendor will be deemed to have disposed of any shares for POD equal to their ACB.

Answer: C

Explanation: C) The vendor can receive a combination of shares and NSC in return for the exchanged shares without any special restructuring.

Type: MC

Topic: Rollovers (ITA 85.1) - basic rules & concepts

41) An individual owns 100% of the shares of a CCPC and wishes to exchange these shares for shares of a large public company without incurring an income tax liability. Which rollover provision would be the easiest to use for this purpose?

A) ITA 85(1) - Transfer of property to a corporation.

B) ITA 87 - Amalgamation.

C) ITA 85.1 - Share for share exchange.

D) ITA 51 - Convertible property.

Answer: C

Explanation: C) ITA 85.1 - Share for share exchange.

Type: MC

Topic: Rollovers - general rules & concepts

42) Which of the following is **NOT** an advantage that to using ITA 85.1 in a situation where a diverse group of shareholders will exchange their shares in one company for shares in a purchasing corporation?

A) There is no need for each shareholder to file an election, the provisions of ITA 85.1 apply automatically

B) Individual vendors may choose to defer the gain from the transaction in their income.

C) The vendor can receive cash equal to an amount of the PUC of the shares tax-free.

D) Individual vendors may choose to include the gain or loss from the transaction in their income.

Answer: C

Explanation: C) The vendor can receive cash equal to an amount of the PUC of the shares tax-free.

Type: MC

Topic: Rollovers (ITA 85.1) - basic rules & concepts

43) Ms. Takase is the sole shareholder of Takase Ltd. She owns 2,500 shares with a PUC and ACB of $400,000, and a FMV of $1,000,000. Giant Holdings Ltd. acquires these shares in return for 10,000 of its common shares, which are currently trading for $100 per share. The rollover rules of ITA 85.1 apply. The results of the transaction will be:

A) Ms. Takase will report a capital gain of $600,000 as a result of her deemed disposition. The ACB of her new shares in Giant Holdings Ltd. will be nil.

B) Ms. Takase will be deemed to have disposed of her Takase Ltd. shares for an amount equal to their ACB. There will be no capital gain.

C) The shares of Giant Holdings Ltd. that Ms. Takase acquires will have a deemed ACB of $1,000,000, the greater of the FMV and the PUC of the Takase Ltd. shares. There will be no capital gain.

D) The shares of Giant Holdings Ltd. that Ms. Takase acquires will have a deemed PUC of $1,000,000. She will report a capital gain on the disposition of $600,000.

Answer: B

Explanation: B) Ms. Takase will be deemed to have disposed of her Takase Ltd. shares for an amount equal to their ACB. There will be no capital gain.

Type: MC

Topic: Rollovers (ITA 85.1) - basic rules & concepts

44) Tiffany owns shares in the public corporation, Zoom Inc. She has received an offer from the public corporation Mooz Inc. to exchange all of her shares in Zoom Inc for shares in Mooz. The ACB of her shares is $28,000, the PUC $10,000 and the FMV $39,000. She would receive shares of Mooz Inc. with a FMV of $39,000 and a legal capital of $39,000. What is the ACB of the Mooz Inc. shares received by Tiffany under the provisions of ITA 85.1?

A) $10,000

B) $28,000

C) $33,500

D) $39,000

Answer: B

Explanation: B) $28,000, her ACB for the Zoom shares.

Type: MC

Topic: Rollovers (ITA 85.1) - basic rules & concepts

45) Jerome Owen owns 70% of the common shares of Nexto Ltd. Jerome's shares have an ACB of $1,050,000. The Nexto common shares have a total PUC of $2,300,000 and a total FMV of $2,500,000. Using the provisions of ITA 86, Jerome exchanged his shares for cash of $1,050,000 and preferred shares with a legal capital and FMV of $700,000. What is the PUC of Jerome's preferred shares?

A) Nil.

B) $560,000.

C) $140,000.

D) $700,000

Answer: B

Explanation: B) $560,000.

The calculation of this amount would be as follows:

Increase in Legal Capital $700,000

PUC - Old Shares [(70%)($2,300,000)] ($1,610,000)

Less: FMV of NSC 1,050,000 ( 560,000)

PUC Reduction $140,000

This will leave a PUC of $560,000 ($700,000 - $140,000)

Type: MC

Topic: Rollovers (ITA 86) - calculating the tax attributes of new shares

46) Several conditions are required in order that the provisions of ITA 86 apply. Which one of the following conditions is **NOT** required?

A) All of the outstanding shares of the particular class must be exchanged.

B) The transferor of the original shares must receive shares of the reorganized corporation as consideration for the shares exchanged.

C) The new shares that will be issued must be authorized by the corporation's articles of incorporation (currently, or through an amendment prior to the reorganization).

D) The original shares must be capital property.

Answer: A

Explanation: A) All of the outstanding shares of the particular class must be exchanged. This is not required. The only requirement is that all of the shares of that class that are held by the transferor must be exchanged.

Type: MC

Topic: Rollovers (ITA 86) - basic rules & concepts

47) When preferred shares are issued in an ITA 86 reorganization, it is important that they have characteristics that serve to lock in their FMV. Which of the following would **NOT** be useful in establishing the FMV of preferred shares?

A) A fixed dividend rate.

B) A priority claim to net assets in the event of the dissolution of the company.

C) A provision which requires redemption at a specified amount at the discretion of the shareholder subject to liquidity concerns under corporate law.

D) Voting rights.

Answer: D

Explanation: D) Voting rights.

Type: MC

Topic: Rollovers (ITA 86) - calculating the tax attributes of new shares

48) With respect to an exchange of shares in an ITA 86 reorganization, which of the following statements is **NOT** correct?

A) The cost of the new shares will be equal to the cost of the old shares, reduced by the FMV of NSC received.

B) The PUC of the new shares will be equal to their legal capital.

C) The proceeds of redemption will be equal to the PUC of the new shares, plus the FMV of any NSC received.

D) The POD will be equal to the cost of the new shares, plus the FMV of any NSC received.

Answer: B

Explanation: B) The PUC of the new shares will be equal to their legal capital.

Type: MC

Topic: Rollovers (ITA 86) - basic rules & concepts

49) John Smurt owns 80% of the common shares of Smurt Ltd. John's shares have an ACB of $600,000. The Smurt common shares have a total PUC of $1,000,000, and a total FMV of $2,500,000. Using the provisions of ITA 86, John exchanged all of his shares for cash of $600,000 and preferred shares with a legal capital and FMV of $1,400,000. What is the ACB of John's preferred shares?

A) Nil.

B) $250,000.

C) $1,400,000.

D) $650,000.

Answer: A

Explanation: A) Nil. The ACB of the new preferred shares would be equal to the $600,000 ACB of the old shares, less the $600,000 in FMV NSC received.

Type: MC

Topic: Rollovers (ITA 86) - calculating the tax attributes of new shares

50) Jeri Nardwal owns 80% of the common shares of Nardwal Ltd. Her son owns the other 20%. Her common shares have an ACB and PUC of $960,000. The FMV of her shares is $4,800,000. She exchanges these shares for $500,000 in cash and preferred shares with a legal capital and FMV of $3,840,000. What is the ACB of the preferred shares?

A) $460,000.

B) $3,840,000.

C) Nil.

D) $960,000.

Answer: C

Explanation: C) The ACB will be nil, the ACB of the old shares, less the sum of the FMV of NSC and the gift ($960,000 - $500,000 - $460,000).

Type: MC

Topic: Rollovers (ITA 86) - calculating the tax attributes of new shares

51) Mamma Mia is the sole shareholder of iPasta. She would like her son to eventually takeover the company so she can retire. If she chooses to use ITA 86, which of the following statements is correct?

A) Mamma Mia could restructure the ownership of her company, which would result in no immediate income tax consequence for herself, with future growth accruing to her son.

B) Mamma Mia could restructure the ownership of her company, which would result in an immediate income tax consequence for herself, with future growth accruing to her son.

C) Mamma Mia could restructure the ownership of her company, which would result in an immediate income tax consequence for her son, with future growth accruing to her son.

D) Mamma Mia could restructure the ownership of her company, but her son must purchase her common shares at their FMV to have future growth accruing to him.

Answer: A

Explanation: A) Mamma Mia could restructure the ownership of her company, which would result in no immediate income tax consequence for herself, with future growth accruing to her son.

Type: MC

Topic: Rollovers (ITA 86) - basic rules & concepts

52) Mr. Couture would like to transfer ownership of his corporation to his son who has started to work in the business. His son will not have the funds to purchase all of the shares for at least 5 years. Which of the following will permit Mr. Couture to transfer the future growth of the company to his son without any immediate income tax consequences for himself?

A) A sale of his shares to his son with payment in 5 years

B) A reorganization of share capital

C) An amalgamation

D) A wind-up

Answer: B

Explanation: B) A reorganization of share capital

Type: MC

Topic: Rollovers - general rules & concepts

53) With respect to the application of ITA 87 to amalgamations, which of the following statements is correct?

A) Any capital dividend account balances of the two predecessor companies cannot be carried forward.

B) There is no "bump-up" of the property tax costs of the two predecessor companies.

C) Losses of the two predecessor companies cannot be used until the first taxation year of the amalgamated company that begins after the date of the amalgamation.

D) The depreciable capital property of the predecessor companies will be carried forward to the amalgamated company at their UCC balances while retaining capital costs.

Answer: D

Explanation: D) The depreciable capital property of the predecessor companies will be carried forward to the amalgamated company at their UCC balances while retaining capital costs.

Type: MC

Topic: Rollovers (ITA 87) - basic rules & concepts

54) Which of the following statements related to ITA 87 amalgamations is correct?

A) An amalgamation cannot increase the total amount of income eligible for the manufacturing and processing deduction.

B) By bringing together a profitable and an unprofitable company, an amalgamation can result in a faster write off of depreciable property through CCA deduction.

C) An acquisition of control can be effected through an amalgamation which would enable prior year net capital losses of both predecessor companies to be claimed by the amalgamated company.

D) After an amalgamation, the losses of one of the predecessor companies cannot be used against the taxable income of the other predecessor company.

Answer: B

Explanation: B) By bringing together a profitable and an unprofitable company, an amalgamation can result in a faster write off of depreciable property through CCA deduction.

D) This is incorrect since the predecessor corporations effectively come to an end for income tax purposes when the amalgamation takes place. This is why the amalgamated company is referred to as the "new" company.

Type: MC

Topic: Rollovers (ITA 87) - basic rules & concepts

55) Which of the following statements is **NOT** correct with respect to the bump available in some ITA 87 amalgamations and wind-up transactions under ITA 88(1)?

A) The bump is available in a vertical amalgamation when the parent company owns 100% of the subsidiary and in a wind up when the parent company owns 90% or more of the shares of each class of the subsidiary.

B) The bump is only available in a wind up when the parent company owns 100% of the shares of the subsidiary.

C) In a wind up, the bump is only available on non-depreciable capital property of the subsidiary.

D) In a vertical amalgamation, the bump up is only available on the non-depreciable capital property of the subsidiary.

Answer: B

Explanation: B) The bump is only available in a wind up when the parent company owns 100% of the shares of the subsidiary.

Type: MC

Topic: Rollovers (ITA 87(11) & 88(1)) - the bump

56) Which of the following is **NOT** one of the conditions necessary for the ITA 87(1) (amalgamation) rollover to apply?

A) All the predecessor corporations must be CCPCs.

B) All shareholders of the predecessor corporations must receive shares of the amalgamated corporation as a result of the amalgamation.

C) All of the property and liabilities of the predecessor corporations, other than intercompany amounts, must become property and liabilities of the amalgamated corporation.

D) The transfer must be an amalgamation approved by corporate law.

Answer: A

Explanation: A) All the predecessor corporations must be CCPCs.

Type: MC

Topic: Rollovers (ITA 87) - basic rules & concepts

57) Which of the following tax accounts will **NOT** flow through from a predecessor company to the amalgamated company as a result of an amalgamation under ITA 87?

A) Eligible RDTOH of a public company.

B) GRIP when the amalgamated company is a CCPC.

C) Non-capital losses.

D) Net capital losses.

Answer: A

Explanation: A) Eligible RDTOH of a public company. Public companies cannot have any RDTOH.

Type: MC

Topic: Rollovers (ITA 87) - basic rules & concepts

58) Shareholders of predecessor corporations are deemed to have disposed of their shares for proceeds equal to the ACB of their shares as long as certain conditions are met. Which of the following is **NOT** one of the necessary conditions?

A) The shareholders must not receive any consideration other than shares of the amalgamated company.

B) The original shares must be capital property of the shareholders.

C) The shareholders must receive NSC that is equal to the ACB of their shares.

D) The amalgamation must not result in a gift to a related person.

Answer: C

Explanation: C) The shareholders must receive NSC that is equal to the ACB of their shares.

Type: MC

Topic: Rollovers (ITA 87) - basic rules & concepts

59) In a situation where a parent corporation combines with a subsidiary corporation, which of the following statements is correct?

A) If the parent owns 90% or more of any class of capital stock of the subsidiary, it is possible to combine the companies on a rollover basis using either ITA 87 or ITA 88(1).

B) If the parent owns 90% or more of any class of capital stock of the subsidiary, it will be able to take advantage of the bump in certain subsidiary property, regardless of whether the combination is by way of a subsidiary dissolution or an amalgamation.

C) If the parent owns 90% or more of the shares of each class of capital stock of the subsidiary, it will be able to take advantage of the bump in certain subsidiary property, regardless of whether the combination is by way of a subsidiary dissolution or an amalgamation.

D) If the parent owns 90% or more of the shares of each class of capital stock of the subsidiary, it is possible to combine the companies using either ITA 87(1) or ITA 88(1).

Answer: D

Explanation: D) If the parent owns more than 90% of the shares of each class of capital stock of the subsidiary, it will be possible to combine the companies using either ITA 87 or ITA 88(1). Some of the ITA 87 benefits however such as certain losses and the bump would only apply if ITA 87(11) applies in a wholly owned subsidiary situation.

Type: MC

Topic: Rollovers - ITA 87 vs ITA 88(1)

60) Two unrelated companies (both with December 31 taxation year ends), one of which has both non-capital and net capital losses, are amalgamated on January 1, 2022 to form Parent Inc which also uses a December 31 taxation year end. After the amalgamation, the shareholders of the predecessor company with losses own 10% of Parent Inc. and the shareholders of the other predecessor own 90%. During the taxation year ended December 31, 2022, Parent Inc. has net income which includes a taxable capital gain. Parent Inc. continues to carry on the businesses of both predecessor corporations on a profitable basis.

Which of the following statements best describes the situation of Parent Inc. with respect to the ability to claim the net and non-capital losses of the predecessor?

A) All losses carried forward from the predecessor companies will be deductible to Parent Inc. as soon as the amalgamation is complete.

B) Parent Inc. will not be able to claim any of the losses against its taxable income.

C) Parent Inc. will be able to utilize the non-capital loss against profits from the same business in which the loss was incurred beginning with the 2022 taxation year. The net capital losses cannot be utilized by Parent Inc. since those losses are restricted by an the acquisition of control of the loss predecessor.

D) Parent Inc. will be able to utilize the non-capital loss against profits from the same business in which the loss was incurred beginning in the 2023 taxation year. The net capital losses cannot be utilized by Parent Inc.

Answer: C

Explanation: C) Parent Inc. will be able to utilize the non-capital loss against profits from the same business in which the loss was incurred beginning with the 2022 taxation year. The net capital loss cannot be utilized by Parent Inc. This is because the predecessor with the net and non-capital losses was deemed to have been subject to an acquisition of control.

Type: MC

Topic: Rollovers (ITA 87) - basic rules & concepts

61) With respect to the application of ITA 88(1), winding up of a 90% owned subsidiary, which of the following statements is **NOT** correct?

A) A bump in the cost of non-depreciable capital property may be available.

B) Both the subsidiary and the parent will have a deemed taxation year end.

C) Subsidiary losses will become available to the parent company in its first taxation year which begins after the commencement of the wind-up.

D) The tax costs of subsidiary property distributed to the parent on the winding-up will become the tax costs of that property to the parent company.

Answer: B

Explanation: B) Both the subsidiary and the parent will have a deemed taxation year end.

Type: MC

Topic: Rollovers (ITA 88(1)) - basic rules & concepts

62) With respect to the application of ITA 88(1), winding up of a 90% owned subsidiary, which of the following statements is **NOT** correct?

A) The GRIP balance will flow through to the parent company if both the subsidiary and the parent were CCPC's before the wind-up.

B) LRIP balances will only flow through to the parent if the subsidiary was a CCPC.

C) The subsidiary is deemed to have disposed of its property to the parent at cost amount, which is an amount that represents the various tax costs of property.

D) The subsidiary can not claim CCA in the year of the wind-up, but the parent is able to claim CCA on subsidiary property in the wind-up year.

Answer: B

Explanation: B) LRIP balances will only flow through to the parent if the subsidiary was a CCPC.

Type: MC

Topic: Rollovers (ITA 88(1)) - basic rules & concepts

63) Okanagan Limited has a November 30 taxation year end, while its 95% owned subsidiary Valley Limited has a March 31 taxation year end. Valley Limited is wound up using the rollover provisions of ITA 88(1) on September 15, 2022. At that time, Valley Limited has a 2022 non-capital loss of $150,000 for the period from April 1 to September 15, 2022. The earliest taxation year in which Okanagan Limited can make use of this $150,000 non-capital loss is the taxation year ending:

A) September 15, 2022.

B) November 30, 2023.

C) November 30, 2024.

D) March 31, 2023.

Answer: B

Explanation: B) November 30, 2023.

Type: MC

Topic: Rollovers (ITA 88(1)) - basic rules & concepts

64) What is the purpose of the bump in the tax cost of the property of a subsidiary distributed to the parent that is sometimes available in a vertical amalgamation or wind up of a 90% owned subsidiary?

A) The bump gives full recognition to the fact that the cost of acquiring a subsidiary usually exceeds the underlying tax costs of the subsidiary's properties.

B) The bump gives partial recognition to the fact that the cost of acquiring a subsidiary usually exceeds the underlying tax costs of the subsidiary's properties.

C) The bump gives partial recognition to the fact that the cost of acquiring a subsidiary always exceeds the total underlying tax costs of the subsidiary's properties.

D) The bump gives full recognition to the fact that the cost of acquiring a subsidiary exceeds the total underlying tax costs of the subsidiary's properties.

Answer: B

Explanation: B) The bump gives partial recognition to the fact that the cost of acquiring a subsidiary usually exceeds the underlying tax costs of the subsidiary's properties.

Type: MC

Topic: Rollovers (ITA 87(11) & 88(1)) - the bump

65) Danton is the only shareholder of a corporation that has liquidated all of its properties. After paying all of its liabilities, there is $450,000 in cash available for distribution on the winding up and dissolution of the company. The common shares have a PUC of $45,000 and an ACB of $80,000 and there is a balance in the company's CDA of $51,000.

There is no balance in the company's GRIP account. The distribution to Danton is:

A) a capital dividend of $51,000, along with a taxable non-eligible dividend of $354,000.

B) a capital dividend of $51,000, along with a taxable eligible dividend of $354,000.

C) return of capital of $45,000, along with a taxable non-eligible dividend of $405,000.

D) a capital dividend of $51,000, along with a taxable non-eligible dividend of $405,000.

Answer: A

Explanation: A) Deemed dividend on winding-up of $405,000 ($450,000 - $45,000). This is made up of a capital dividend of $51,000 and a taxable non-eligible dividend of $354,000.

B) B uses eligible instead of non- eligible.

Type: MC

Topic: Winding up a Canadian corporation - ITA 84(2) & 88(2)

66) Jasmine Lee owns all of the shares of Tee Ltd. The ACB of her shares is $50,000. Because of declining sales, she has decided to wind up the Company. The rules of ITA 88(2) will apply. Once all corporate properties have been sold and all corporate taxes paid, there is $2,000,000 available for a final distribution. The balances in the various tax accounts and PUC of Tee Ltd. are as follows:

PUC $ 100,000

Eligible RDTOH Nil

Non-Eligible RDTOH Nil

CDA 400,000

If Jasmine properly files all elections that would minimize the income tax consequences of the distribution, of the following statements, which one is correct?

A) Jasmine will receive dividends subject to tax of $1,500,000 (before any gross up), as well as a taxable capital gain of $25,000, when she receives the $2,000,000 distribution.

B) Jasmine will have a taxable capital gain of $975,000 when she receives the $2,000,000 distribution.

C) As a rollover provision is being used, there will be no current tax consequences when she receives the $2,000,000 distribution.

D) Jasmine will receive dividends subject to tax of $1,500,000 (before any gross up), as well as a taxable capital gain of $225,000, when she receives the $2,000,000 distribution.

Answer: A

Explanation: A) Jasmine will receive dividends subject to tax of $1,500,000 ($2,000,000 - PUC $100,000 - CDA $400,000), as well as a taxable capital gain of $25,000 [($2,000,000 - $1,900,000 - $50,000)(1/2)], when she receives the $2,000,000 distribution.

Type: MC

Topic: Winding up a Canadian corporation - ITA 84(2) & 88(2)

67) Ku Jung owns all of the shares of Jay Ltd. The ACB of the shares is $5,000. He has decided to retire, and has wound up the Company. The rules of ITA 88(2) apply. After the properties have been sold and all corporate taxes paid, there is $700,000 available for a final distribution. The balances in the various tax accounts and PUC of Jay Ltd. are as follows:

PUC $ 1,000

Eligible RDTOH Nil

Non-Eligible RDTOH 20,000

GRIP Account 30,000

CDA 100,000

If Mr. Jung properly files all elections that would minimize the income tax consequences of the distribution, what is the maximum amount he could receive tax free?

A) $1,000

B) $5,000

C) $100,000

D) $101,000

Answer: D

Explanation: A) $1,000 [PUC]

B) $5,000 [ACB]

C) $100,000 [CDA]

D) $101,000 [PUC ($1,000) + CDA ($100,000)]

Type: MC

Topic: Winding up a Canadian corporation - ITA 84(2) & 88(2)

68) Ariella Buxo owns convertible bonds of Lion Holdings Inc. Ariella acquired these bonds for $100,000. The bonds are convertible into 1,000 common shares of Lion Holdings Inc. At the time of her purchase of the bonds, the common shares were trading at $95 per share. The bonds are converted when the common shares are trading at $125 per share. The conversion of the bond is eligible for rollover treatment under ITA 51 and will result in:

A) a capital gain of $25,000.

B) no capital gain.

C) a deemed dividend of $25,000.

D) a capital gain of $30,000.

Answer: B

Explanation: A) A capital gain of $25,000. [(1,000)($125-$100)]

B) No capital gain.

C) A deemed dividend of $25,000. [(1,000)($125-$100)]

D) A capital gain of $30,000. [(1,000)($125-$95)]

Type: MC

Topic: Rollovers (ITA 51) - basic rules & concepts

69) Which of the following is one of the conditions required for ITA 51 to apply?

A) The exchange must be part of a reorganization of capital.

B) The exchange must involve NSC.

C) The exchange must involve an exchange of convertible debt for common shares or preferred shares.

D) The exchange must not involve any NSC.

Answer: D

Explanation: C) ITA 51 also applies to a share for share exchange meaning that convertible debt is not a necessity.

D) The exchange must not involve any NSC.

Type: MC

Topic: Rollovers (ITA 51) - basic rules & concepts

70) Indicate which of the following would be considered an advantage of purchasing assets rather than shares in the purchase of a business.

A) The availability of the capital gains deduction.

B) The ability to carry forward non-capital losses of the business after the acquisition.

C) The ability to recognize goodwill.

D) The ability to avoid land transfer tax.

Answer: C

Explanation: C) The ability to recognize goodwill.

Type: MC

Topic: Purchase and sale of a business

71) Nancy recently received an offer for the shares of her corporation, Eager Beaver Consultants Ltd. Nancy's shares have an ACB of $600,000. The shares of the Company do not qualify for the capital gains deduction. Although Nancy would like to sell her shares and retire, she will only sell her shares if her after tax retention from the sale totals at least $2 million. Assuming that Nancy's combined federal and provincial marginal income tax rate is 50%, what is the minimum price Nancy should accept for her shares?

A) $2,466,667.

B) $4,600,000.

C) $2,840,000.

D) $3,400,000.

Answer: A

Explanation: A) Nancy will realize a capital gain of $1,866,667, resulting in a taxable capital gain of

$933,334. She will pay $466,667 in taxes, leaving her with $2,000,000.

The supporting calculation is:

X - [(X - $600,000)(1/2)(50%)] = $2,000,000

X - (0.25X - $150,000) = $2,000,000

0.75X + $150,000 = $2,000,000

0.75X = $1,850,000

X = $2,466,667

Type: MC

Topic: Purchase and sale of a business

72) During the current year, all of the property of Linden Enterprises, a CCPC, were sold. Among the property was goodwill with a FMV of $425,000. As the goodwill was internally generated, its capital cost was nil. Which of the following statements is correct?

A) Linden will include active business income of $425,000 in its income, with no addition to the capital dividend account.

B) Linden will include a taxable capital gain of $212,500 in its income, and there will be a $212,500 addition to the capital dividend account.

C) Linden will include active business income of $212,500 in its income, and there will be a $212,500 addition to the capital dividend account.

D) Linden will include active business income of $425,000 in its income, and there will be a $212,500 addition to the capital dividend account.

Answer: B

Explanation: B) Linden will include a taxable capital gain of $212,500 in its income, and there will be a $212,500 addition to the capital dividend account.

Type: MC

Topic: Purchase and sale of a business

73) Yamaguchi Inc purchases all the property of Ito Inc. after months of negotiation. The FMV of all of the properties purchased exceed their tax costs. Which of the following will **NOT** be a result of this transaction?

A) Yamaguchi will obtain a higher tax cost for the properties purchased resulting in higher future CCA claims.

B) Goodwill can be recognized and as a result, Yamaguchi will be able to claim future CCA (Class 14.1).

C) Yamaguchi will be held liable for any future income tax reassessments of Ito Inc.

D) Any non-capital losses of Ito Inc. cannot be utilized by Yamaguchi Inc.

Answer: C

Explanation: C) Yamaguchi will be held liable for future income tax reassessments of Ito Inc.

Type: MC

Topic: Purchase and sale of a business

74) Mr. Germotte has two offers to purchase his wholly owned corporation, one for all of the property and another for all of the shares. In considering the offer to purchase all of the property, which of the following is correct?

A) The sale of corporate property will avoid a wind-up.

B) Mr. Germotte can take advantage of the capital gains deduction if the shares of the corporation qualify.

C) Mr. Germotte may be subject to income taxes on business income and capital gains.

D) The corporation may be subject to income taxes on business income and capital gains.

Answer: D

Explanation: D) The corporation may be subject to income taxes on business income and capital gains.

Type: MC

Topic: Purchase and sale of a business

75) Mr. Morgan Forbes is the sole shareholder of Forbes Ltd., a CCPC the shares of which do not qualify for the capital gains deduction. The corporation was incorporated several years ago by Mr. Forbes with an investment of $540,000 which is currently valued (FMV) at $2,640,000. The shares of his Company are acquired by a large publicly traded company, Megopolis Ltd., through the issuance of 75,000 new Megopolis shares. At the time of this business combination, the Megopolis Ltd. shares are trading at $36 per share. Indicate the income tax consequences of this transaction to both Mr. Forbes and Megopolis Ltd.

Answer: The transaction involves a share for share exchange that meets the conditions of ITA 85.1. Unless Mr. Forbes opts out of this rollover provision in his income tax return, by reporting any capital gain or capital loss as if the shares were sold at FMV, the income tax consequences of this transaction for him would be as follows:

• Mr. Forbes would be deemed to have disposed of his Forbes Ltd. shares for POD equal to the ACB of $540,000. As a consequence, there would be no capital gain or capital loss on the disposition.

• Mr. Forbes would be deemed to have acquired his Megopolis Ltd. shares at a cost equal to the ACB of the Forbes Ltd. shares, or $540,000.

• The ACB of the Forbes Ltd. shares that have been acquired by Megopolis Ltd. would be deemed to be the lesser of their FMV of $2,640,000 and their PUC of $540,000. In this case, the $540,000 PUC amount is the lower amount.

• The PUC of the Megopolis Ltd. shares that have been issued to Mr. Forbes would be $540,000, the PUC of the Forbes Ltd. shares that were given up.

Type: ES

Topic: Rollovers (ITA 85.1) - basic rules & concepts

76) Farnum Ltd. is a CCPC that was incorporated by Freddy Farnum with an original investment of $400,000 for the shares. The shares of Farnum Ltd. do not qualify for the capital gains deduction. In 2021, Freddy sold all of the shares to John Gage for $700,000. In early, 2022, John is approached by a large public company, Gross Enterprises, that offers him 200,000 of their shares in return for all of John's shares. The offer is accepted by John and, at this time, the shares of Gross Enterprises are trading at $6 per share. Indicate the income tax consequences of this transaction to both John and Gross Enterprises.

Answer: This transaction involves a share for share exchange that meets the conditions of ITA 85.1. Unless Mr. Gage opts out of this rollover provision in his income tax return by reporting any capital gain or capital loss as if the shares were sold at FMV, the income tax consequences of this transaction would be as follows:

• Mr. Gage would be deemed to have disposed of his Farnum Ltd. shares at their ACB of $700,000.

• Mr. Gage would be deemed to have acquired his Gross Enterprises shares at a cost equal to the $700,000 ACB of the Farnum Ltd. shares.

• The ACB of the Farnum Ltd. shares that have been acquired by Gross Enterprises would be deemed to be the lesser of their FMV of $1,200,000 and their PUC of $400,000. In this case, the $400,000 PUC is the lower amount.

• The PUC of the Gross Enterprises shares that have been issued to Mr. Gage would be $400,000, the PUC of the Farnum Ltd. shares that were given up.

Type: ES

Topic: Rollovers (ITA 85.1) - basic rules & concepts

77) Ms. Laura Cooper is the sole shareholder of Cooper Inc, a CCPC. The ACB and PUC of the common shares are $1,375,000 and the FMV $2,950,000. At this time, Cooper Inc. has no balance in its GRIP account. Ms. Cooper exchanges all of her Cooper Inc. shares for cash of $1,375,000 and preferred shares of the company that are redeemable for $1,575,000.

Determine the ACB and the PUC of the redeemable preferred shares. Indicate the amount, and type, of any income that will result from this transaction. Show your calculations.

Answer: The required PUC reduction on the retractable preferred shares would be calculated as follows:

Increase in Legal Capital $1,575,000

Less The Excess, if any, of:

PUC of Common Shares ($1,375,000)

Over the FMV of NSC 1,375,000 Nil

PUC Reduction $1,575,000

This means that the redeemable preferred shares would have a PUC of nil ($1,575,000 - $1,575,000).

The ACB of the redeemable preferred shares would be calculated as follows:

ACB of Common Shares $1,375,000

Less: FMV of NSC ( 1,375,000)

ACB of redeemable Preferred Shares Nil

Because Laura took back cash equal to the PUC and ACB, there would be no ITA 84(3) deemed dividend and no capital gain or loss. These calculations would be as follows:

PUC of New Shares Nil

Plus FMV of NSC $1,375,000

Proceeds of Redemption under ITA 84(5)(d) $1,375,000

PUC of Old Shares ( 1,375,000)

ITA 84(3) Deemed Dividend Nil

ACB of New Shares Nil

Plus FMV of NSC $1,375,000

POD under ITA 86(1)(c) $1,375,000

Less: ITA 84(3) Deemed Dividend Nil

Modified POD $1,375,000

ACB of Old Shares ( 1,375,000)

Capital Gain (Loss) Nil

Type: ES

Topic: Rollovers (ITA 86) - comprehensive problem

78) Sundance Ltd. is a CCPC. All of its issued common shares have always been owned by Rob Red. The FMV of the shares is $900,000 and the PUC and ACB are both $200,000. The Company has no balance in its GRIP account. At this time, Mr. Red exchanges all of his Sundance common shares for cash of $200,000 and preferred shares that are redeemable for $700,000.

Determine the ACB and the PUC of the redeemable preferred shares. Indicate the amount, and type, of any income that will result from this transaction. Show your calculations.

Answer: The required PUC reduction on the redeemable preferred shares would be calculated as follows:

Increase in Legal Capital $700,000

Less the Excess, if any, of:

PUC of Common Shares ($200,000)

Over the FMV of NSC 200,000 Nil

PUC Reduction $700,000

This means that the redeemable preferred shares would have a PUC of nil ($700,000 - $700,000).

The ACB of the redeemable preferred shares would be calculated as follows:

ACB of Common Shares $200,000

Less: FMV of NSC ( 200,000)

ACb of Redeemable Preferred Shares Nil

Because Mr. Red took back cash equal to his PUC and ACB, there would be no ITA 84(3) deemed dividend and no capital gain or capital loss. These calculations would be as follows:

PUC of New Shares Nil

Plus FMV of NSC $200,000

Proceeds of Redemption under ITA 84(5)(d) $200,000

PUC of Old Shares ( 200,000)

ITA 84(3) Deemed Dividend Nil

ACB of New Shares Nil

Plus FMV of NSC $200,000

POD under ITA 86(1)(c) $200,000

Less: ITA 84(3) Deemed Dividend Nil

Modified POD $200,000

ACB of Old Shares ( 200,000)

Capital Gain (Loss) Nil

Type: ES

Topic: Rollovers (ITA 86) - comprehensive problem

79) Ms. Samantha Shields is the sole shareholder of Shields Ltd, a CCPC. The tax attributes of its issued common shares are - FMV $920,000; ACB $500,000; and PUC $400,000. The balance in its GRIP account is nil. Ms. Shields exchanges all of her Shields Ltd. common shares for cash of $480,000 and preferred shares that are redeemable for $440,000.

Determine the ACB and the PUC of the redeemable preferred shares. Indicate the amount, and type, of any income that will result from this transaction. Show your calculations.

Answer: The required PUC reduction on the redeemable preferred shares would be calculated as follows:

Increase in Legal Capital $440,000

Less the Excess, if any, of:

PUC of Common Shares ($400,000)

Over the FMV of NSC 480,000 Nil

PUC Reduction $440,000

This means that the redeemable preferred shares would have a PUC of nil ($440,000 - $440,000).

The ACB of the redeemable preferred shares would be calculated as follows:

ACB of Common Shares $500,000

Less: FMV of NSC ( 480,000)

ACB of Redeemable Preferred Shares $ 20,000

Because the NSC was greater than the PUC of the old shares, the resulting ITA 84(3) deemed dividend and the capital loss would be calculated as follows:

PUC of New Shares Nil

Plus FMV of NSC $480,000

Proceeds of Redemption under ITA 84(5)(d) $480,000

PUC of Old Shares ( 400,000)

ITA 84(3) Deemed Dividend (Non-Eligible) $ 80,000

ACB of New Shares $ 20,000

Plus FMV of NSC 480,000

POD under ITA 86(1)(c) $500,000

Less: ITA 84(3) Deemed Dividend ( 80,000)

Modified POD $420,000

ACB of Old Shares ( 500,000)

Capital Loss ($ 80,000)

Inclusion Rate 1/2

Allowable Capital Loss ($ 40,000)

Type: ES

Topic: Rollovers (ITA 86) - comprehensive problem

80) Mr. Hal Brook is the sole shareholder of HB Ltd., a CCPC. The tax attributes of the shares are a FMV of $1,450,000, an ACB of $400,000, and a PUC of $700,000. The Company has no balance in its GRIP account. At this time, Mr. Brook exchanges all of his HB Ltd. common shares for cash of $700,000 and HB Ltd. preferred shares that are redeemable for $750,000.

Determine the ACB and the PUC of the redeemable preferred shares. Indicate the amount, and type, of any income that will result from this transaction. Show your calculations.

Answer: The required PUC reduction on the redeemable preferred shares would be calculated as follows:

Increase in Legal Capital $750,000

Less the Excess, if any, of:

PUC of Common Shares ($700,000)

Over the FMV of NSC 700,000 Nil

PUC Reduction $750,000

This means that the redeemable preferred shares would have a PUC of nil ($750,000 - $750,000).

The ACB of the redeemable preferred shares would be calculated as follows:

ACB of Common Shares $400,000

Less: FMV of NSC ( 700,000)

ACB of Redeemable Preferred Shares Nil

While there is no ITA 84(3) deemed dividend in this problem, there is a taxable capital gain. because the NSC exceeded the ACB of the exchanged (old) shares.

The relevant calculations are as follows:

PUC of New Shares Nil

Plus FMV of NSC $700,000

Proceeds of Redemption under ITA 84(5)(d) $700,000

PUC of Old Shares ( 700,000)

ITA 84(3) Deemed Dividend (Non-Eligible) Nil

ACB of New Shares $ Nil

Plus FMV of NSC 700,000

POD under ITA 86(1)(c) $700,000

Less: ITA 84(3) Deemed Dividend Nil

Modified POD $700,000

ACB of Old Shares ( 400,000)

Capital Gain $300,000

Inclusion Rate 1/2

Taxable Capital Gain $150,000

Type: ES

Topic: Rollovers (ITA 86) - comprehensive problem

81) Mr. Jean Doyen owns 80% of the common shares of Jondon Inc. His shares have an ACB of $420,000. The remaining common shares are owned by his 19 year old son and his shares have an ACB of $105,000. The corporation is a CCPC and its shares have a total FMV of $3,360,000 and PUC of $525,000. In 2022, Mr. Doyen exchanged all of his Jondon Inc. common shares for cash of $630,000 and preferred shares that are redeemable for $1,680,000. At this time, Jondon Inc. has no balance in its GRIP account.

Determine the ACB and the PUC of the redeemable preferred shares. Indicate the amount, and type, of any income that will result from this transaction. Show your calculations.

Answer: Mr. Doyen gave up shares with a FMV of $2,688,000 [(80%)($3,360,000)] in return for consideration of $2,310,000 ($630,000 + $1,680,000). As his son owns the remaining common shares, there is a gift to the son of $378,000 ($2,688,000 - $2,310,000). This means that ITA 86(2) is applicable.

The PUC reduction on the new shares would be calculated as follows:

Increase in Legal Capital $1,680,000

Less the Excess of:

PUC of Common Shares [(80%)($525,000)] ($420,000)

Over the FMV of NSC 630,000 Nil

PUC Reduction $1,680,000

This means that the redeemable preferred shares would have a PUC of nil ($1,680,000 - $1,680,000).

Under ITA 86(2)(e), the ACB of the redeemable preferred shares would be calculated as follows:

ACB of Mr. Doyen's Common Shares $ 420,000

Deduct:

FMV of NSC ($630,000)

Gift ( 378,000) (1,008,000)

ACB of Preferred Shares Nil

The calculation of the deemed dividend and capital gain would be as follows:

PUC of New Shares Nil

Plus FMV of NSC $630,000

Proceeds of Redemption under ITA 84(5)(d) $630,000

PUC of Old Shares ( 420,000)

ITA 84(3) Deemed Dividend (Non-Eligible) $210,000

POD under ITA 86(2)(c) - Lesser of:

• FMV of Shares Given Up

[(80%)($3,360,000)] = $2,688,000

• FMV of NSC + Gift

($630,000 + $378,000) = $1,008,000 $1,008,000

Less ITA 84(3) Deemed Dividend ( 210,000)

Modified POD $ 798,000

ACB of Old Shares ( 420,000)

Capital Gain $ 378,000

Inclusion Rate 1/2

Taxable Capital Gain $189,000

The taxable non-eligible dividend would be $241,500 [(115%)($210,000)]. The taxable dividend would qualify for a federal dividend tax credit of $21,808 [(9/13)(15%)($210,000)].

Type: ES

Topic: Rollovers (ITA 86) - comprehensive problem with gift

82) Margaret Hutch owns 60% of the common shares of MH Inc., a CCPC. Her shares have an ACB of $300,000. Her common-law partner, Jane Evans, owns the remaining 40% and her shares have an ACB of $200,000. The FMV of the common shares are $2,300,000 and the PUC is $500,000. In 2022, Ms. Hutch exchanges all of her MH Inc. shares for cash of $350,000 and redeemable preferred shares of $830,000. MH Inc. does not have a balance in its GRIP account.

Determine the ACB and the PUC of the redeemable preferred shares. Indicate the amount, and type, of any income that will result from this transaction. Show your calculations.

Answer: Ms. Hutch gave up shares with a FMV of $1,380,000 [(60%)($2,300,000)] in return for consideration of $1,180,000 ($350,000 + $830,000). As her common-law partner, Jane, holds the remaining common shares, there is a gift to Jane of $200,000 ($1,380,000 - $1,180,000). This means that ITA 86(2) is applicable.

The PUC reduction on the new shares would be calculated as follows:

Increase in Legal Capital $830,000

Less the Excess of:

PUC of Common Shares [(60%)($500,000)] ($300,000)

Over the FMV of NSC 350,000 Nil

PUC Reduction $830,000

This means that the redeemable preferred shares would have a PUC of nil ($830,000 - $830,000). Under ITA 86(2)(e), the ACB of the redeemable preferred shares would be calculated as follows:

ACB of Ms. Hutch's Common Shares $300,000

Deduct:

FMV of NSC ($350,000)

Plus Gift ( 200,000) ( 550,000)

ACBV of Preferred Shares Nil

The calculation of the deemed dividend and capital gain would be as follows:

PUC of New Shares Nil

Plus FMV of NSC $350,000

Proceeds of Redemption under ITA 84(5)(d) $350,000

PUC of Old Shares ( 300,000)

ITA 84(3) Deemed Dividend (Non-Eligible) $ 50,000

POD under ITA 86(2)(c) - Lesser of:

• FMV of Shares Given Up

[(60%)($2,300,000)] = $1,380,000

• FMV of NSC Plus the Gift Amount

($350,000 + $200,000) = $550,000 $550,000

Less ITA 84(3) Deemed Dividend ( 50,000)

Modified POD $500,000

ACB of Old Shares ( 300,000)

Capital Gain $200,000

Inclusion Rate 1/2

Taxable Capital Gain $100,000

The taxable non-eligible dividend would be $57,500 [(115%)($50,000)]. The taxable dividend would qualify for a federal dividend tax credit of $5,192 [(9/13)(15%)($50,000)].

Type: ES

Topic: Rollovers (ITA 86) - comprehensive problem with gift

83) During its taxation year ending December 31, 2021, Loser Inc. has a non-capital loss of $74,400 and an net capital loss of $120,000. Neither loss can be carried back. On January 1, 2022 the Company is amalgamated with Winner Ltd., a company that also has a December 31 taxation year end. ITA 87 applies to the amalgamation. The amalgamated company is named Combo Inc. and it elects to use a December 31 taxation year end. The terms of the amalgamation give 16,000 Combo Inc. shares to the Loser Inc. shareholders, and 120,000 Combo Inc. shares to the Winner Ltd. shareholders.

During the taxation year ending December 31, 2022, Combo Inc. has net income of $960,000, including over $240,000 in taxable capital gains. Will Combo Inc. be able to deduct the net capital and non-capital losses inherited from Loser Inc. in its 2022 taxation year? Explain your conclusion.

Answer: As Winner Ltd. has a clear majority of the shares in Combo Inc., there would be a deemed acquisition of control of Loser prior to the amalgamation (ITA 256(7)(b)). The non-capital loss carry forward of Loser Inc. is available to the amalgamated company to the extent that the loss business is carried on for profit. The non-capital loss however is only deductible to the amalgamated corporation to the extent of profits from that loss business and any other similar business. The net capital loss however cannot be claimed by the amalgamated corporation.

Type: ES

Topic: Rollovers (ITA 87) - comprehensive problem

84) For the taxation year ending December 31, 2021, Hub Ltd. has a net capital loss of $115,000, as well as a non-capital loss of $85,000. Neither of these losses can be carried back. The Company has no loss carry forwards from taxation years prior to 2021.

On January 1, 2022 Hub Ltd. is amalgamated with Core Inc. The amalgamation complies with ITA 87. The amalgamated Company is named Hubcore Ltd. and, because Core is much larger than Hub, its shareholders receive the majority of voting shares in the amalgamated company. Hubcore will have a December 31 taxation year end.

During the year ending December 31, 2022 Hubcore has $200,000 of net income. This total is made up $85,000 in taxable capital gains and $115,000 of business income. Of the $115,000 in net business income, $52,000 relates to the business of Hub.

Will Hubcore Ltd. be able to claim the net capital or non-capital losses inherited from Hub Ltd. for its 2022 taxation year? Explain your conclusion.

Answer: As the shareholders of Core own a majority of the shares in Hubcore, there has been an acquisition of control of Hub immediately prior to the amalgamation. This means that Hub's net capital loss cannot be claimed by Hubcore. However, to the extent that Hubcore has profits from the business of Hub, the non-capital loss carry forward can be claimed. This means that $52,000 of the $85,000 non-capital loss carry forward could be deducted by Hubcore, leaving a non-capital loss balance of $33,000 ($85,000 - $52,000).

Type: ES

Topic: Rollovers (ITA 87) - comprehensive problem

85) On January 1, 2018, Chipper Ltd. acquired 100% of the outstanding shares of Intell Inc. at a cost of $1,800,000. At that time, the FMV of Intell's is $1,275,000 with land representing $405,000 of that value.

On December 31, 2022, Intell Inc. is wound up and its properties distributed to its parent. ITA 88(1) applies to the wind-up. Intell Inc. has paid no dividends since its acquisition by Chipper Ltd. On December 31, 2022, the condensed Balance Sheet of Intell Inc. is as follows:

Cash $180,000

Land - At Cost (Purchased in 2014) 210,000

Depreciable Property - At UCC (Purchased in 2014) 360,000

Total $750,000

Liabilities $112,500

Shareholders' Equity 637,500

Total Equities $750,000

Determine the tax costs of the property distributed to Chipper Ltd. by Intell Inc.'s on the wind-up.

Answer: Under ITA 88(1), a limited bump in the cost of non-depreciable capital property is available. The basic limit would be calculated as follows:

ACB of Intell Inc. Shares $1,800,000

Net Tax Value of Intell Inc

At Winding-Up ($750,000 - $112,500) ( 637,500)

Dividends paid by Intell Since Acquisition Nil

Excess (Maximum Bump) $1,162,500

However, this basic amount cannot exceed the difference between the FMV of the non-depreciable capital property at the time of the share acquisition and their tax cost at that time. This amount would be $195,000 ($405,000 - $210,000). The bump in the cost of the land is limited to that amount, resulting in the following tax cost for the Intell's property acquired by Chipper on the wind-up:

Cash $180,000

Land ($210,000 + $195,000) 405,000

Depreciable Property - At UCC 360,000

Total Assets $945,000

Type: ES

Topic: Rollovers (ITA 88(1)) - comprehensive problem

86) Kelowna Corporation acquires 100% of the shares of Columbia Inc. on October 31, 2015 for $2,750,000. At that time, Columbia Inc. owned one non-depreciable capital property, a piece of vacant land with an ACB of $400,000 and a FMV of $750,000. Since November 1, 2015, Columbia Inc. has paid dividends of $300,000 to Kelowna Corporation. On October 31, 2022 the net tax value (NTV) of Columbia Inc. is $2,200,000 and the company is wound up. ITA 88(1) applies to the wind-up. What will be the tax cost of the land after the wind-up?

Answer: Under ITA 88(1), a limited bump in the cost of non-depreciable capital property is available. The basic limit would be calculated as follows:

ACB of Columbia Inc. shares $2,750,000

Net Tax Values (NTV) of Columbia Inc. ( 2,200,000)

Dividends paid by Columbia Inc. Since Acquisition ( 300,000)

Excess (Maximum Bump) $ 250,000

The other limit is the excess of the FMV of the non-depreciable capital property at the time of acquisition in 2015 and their tax cost at that time. This amount would be $350,000 ($750,000 - $400,000). The bump would be $250,000, the lesser of these amounts. The ACB of the land to Kelowna us therefore $650,000 ($400,000 + $250,000).

Type: ES

Topic: Rollovers (ITA 88(1)) - comprehensive problem

87) Nanaimo Corporation acquires 100% of the shares of Island Inc. on December 31, 2015 for $2,750,000. At that time, Island Inc. owned one non-depreciable capital property, a piece of vacant land with an ACB of $200,000 and a FMV of $350,000. Since January 1, 2015, Island Inc. has paid dividends totaling $300,000 to Nanaimo Corporation. On December 31, 2022 when the net tax value (NTV) of Island Inc. is $2,200,000. Island is wound up into Nanaimo. The wind-up qualifies for ITA 88(1) treatment. Nanaimo Corporation then sells the vacant land that was owned by Island Inc. for $1,600,000. What taxable capital gain will Nanaimo report as a result of that sale?

Answer: Under ITA 88(1), a limited bump-up in the cost of non-depreciable capital property is available. The basic limit would be calculated as follows:

ACB of Island Inc. shares $2,750,000

NTV at Winding-Up ( 2,200,000)

Dividends paid by Island Inc. since acquisition ( 300,000)

Excess (Maximum Bump) $ 250,000

However, this excess amount cannot exceed the difference between the FMV of non-depreciable capital property at the time of the share acquisition in 2015 and their tax cost at that time.

This amount would be $150,000 ($350,000 - $200,000).

As a result, the ACB of the land would be equal to its original cost to Island Inc. of $200,000 plus a bump of $150,000. The taxable capital gain is [(1/2)($1,600,000 - $350,000)] = $625,000.

Type: ES

Topic: Rollovers (ITA 88(1)) - comprehensive problem

88) Sundown Inc. is a CCPC. After disposing of all of its properties and paying all of its liabilities, including income tax payable, Sundown Inc. is left with cash of $2,854,500. The ACB and PUC of the Company's shares are both $290,400. After the sale of all of its properties, the Company has a Non-Eligible RDTOH account balance of $155,100, a CDA balance of $85,800 and a GRIP balance of nil.

Determine the income tax consequences to the shareholders of Sundown Inc. if, in 2022, the Company makes the maximum cash distribution to its shareholders on the winding-up of the corporation. Assume that appropriate elections will be made to minimize any income tax to the shareholders. You are not required to calculate income tax payable for the shareholders.

Answer: Given the size of the proceeds, the balance in the Non-Eligible RDTOH account will clearly be less than 38-1/3% of taxable dividends. Given this, the required calculations are as follows:

Available Cash $2,854,500

Dividend Refund (Non-Eligible RDTOH Balance) 155,100

Total Distribution $3,009,600

PUC ( 290,400)

ITA 84(2) Deemed Dividend $2,719,200

Capital Dividend (Election Required) ( 85,800)

Non-Eligible Dividend $2,633,400

The taxable dividend is $3,028,410 [(115%)($2,633,400)] and the related federal dividend tax credit is $273,468 [(9/13)(15%)($2,633,400)]. As a disposition of shares has occurred, we must also determine whether there is a capital gain or capital loss. The calculations are as follows:

Total Distribution $3,009,600

Less: ITA 84(2) Deemed Dividend ( 2,719,200)

Modified POD $ 290,400

ACB of Shares ( 290,400)

Capital Gain or Capital Loss Nil

Type: ES

Topic: Winding up a Canadian corporation - ITA 84(2) & 88(2)

89) Ku Jung owns all of the shares of Jay Ltd, a CCPC. The ACB of his shares is $1,000. He has decided to retire, and to dissolve the Company. The rules of ITA 88(2) will apply) After all corporate property has been sold and all liabilities including corporate taxes paid, there is $700,000 available for distribution. The balances in the tax accounts of Jay Ltd. including the PUC are as follows:

PUC $ 1,000

Combined RDTOH Balances 20,000

GRIP Account 30,000

Capital Dividend Account (CDA) 100,000

What are the income tax consequences if, in 2022, the final payment is made to Mr. Jung? Assume that all elections are made to minimize any income tax consequences.

Answer: Given the size of the proceeds, the combined balances in the RDTOH accounts will clearly be less than 38-1/3% of the taxable dividends to be paid. Given this, the required calculations are as follows:

Available Cash $700,000

Dividend Refund (Combined RDTOH Balances) 20,000

Total Distribution $720,000

PUC ( 1,000)

ITA 84(2) Deemed Dividend $719,000

Capital Dividend ( 100,000)

Taxable Dividend $619,000

Less: Eligible Dividend designation (GRIP Balance) ( 30,000)

Non-Eligible Dividend $589,000

The eligible dividend would be grossed up to a taxable amount of $41,400 [(138%)($30,000)]. The related federal dividend tax credit would be $6,218 [($30,000(38%)(6/11)].

The non-eligible dividend would be grossed up to a taxable amount of $677,350 [(115%) ($589,000)]. The related federal dividend tax credit would be $61,165 [(9/13)(15%)($589,000)].

As a disposition of shares has occurred, we must also determine whether there is a capital gain or capital loss. The calculations are as follows:

Total Distribution $720,000

Less: ITA 84(2) Deemed Dividend ( 719,000)

Modified POD $ 1,000

ACB of Shares ( 1,000)

Capital Gain or Capital Loss Nil

Type: ES

Topic: Winding up a Canadian corporation - ITA 84(2) & 88(2)

90) In 2016, John Shipley began to carry on a business as a sole proprietor that specialized in high end linens for both bedrooms and dining rooms. As he needed all of the income from the business in order to cover his living expenses, he did not want to incorporate the business right away

As a result of several celebrity endorsements the business became extremely profitable and, by 2018, it was earning much more income than he needed to maintain his current standard of living. Given this, he decided to incorporate the business.

His accountant advised him that he could avoid any immediate income tax implications of incorporating the business by using the income tax rollover of ITA 85(1) to sell all of the business properties to a newly incorporated company in which he would be the sole shareholder. To facilitate this, on January 1, 2019, the following amounts were determined with respect to the business.

Tax costs of all business properties $1,234,000

FMV of all business properties $2,132,000

On that date, the business properties are sold to the new corporation, Sheets Inc., at a combined elected amount of $1,234,000. As consideration, John received a promissory note for $600,000, redeemable preferred shares with a FMV of $634,000, and 10,000 common shares with a FMV of $898,000. No other shares are issued at this time.

Over the next few years, the business continued to expand and prosper and, on January 1, 2022, he receives an offer from Linens Ltd., a large public company, for all of the common shares. Under terms of this offer, John will give up all of the common shares of Sheets Inc. in return for a separate class of shares issued by the Linens Ltd. These shares have a FMV of $1,300,000. In addition, subsequent to the exchange transaction, John's preferred shares will be redeemed for $634,000. Sheets Inc. does not have a GRIP balance or an RDTOH balance at this time. John and the controlling shareholders of Linen Ltd. deal with each other at arm's length.

While John has been very successful with his business, his stock portfolio performance has been abysmal and he has a 2020 net capital loss of $300,000. As a consequence, he has joined Investor's Anonymous, subscribing to their 10 step program to kick the stock market habit. If he manages to stick to the program, he will be unable to generate capital gains to use the loss carryover through stock market transactions.

**Required:**

A. Advise John with respect to the income tax consequences that would arise for him from the redemption of his preferred shares and the acceptance of the offer from the public company for the exchange of shares. Your answer should consider both the application of ITA 85.1 and opting out of this provision.

B. Indicate the ACB of the Sheets Inc. to Linens Ltd.

C. Advise John as to the alternative approaches that could be used to utilize his 2020 net capital loss in conjunction with the share exchange.

Answer:

**Note To Instructor -** To answer this problem, a basic understanding of ITA 85(1) is required which is covered in Chapter 16.

***Part A - ITA 85.1 Applies***

In order to determine the income tax consequences of the ITA 85.1 transaction, we must evaluate the results of the ITA 85(1) transaction to determine the tax attributes of the shares. The ACB of the shares issued as part of the ITA 85(1) rollover would be calculated as follows:

Elected amount $1,234,000

FMV of NSC ( 600,000)

Available for Shares $ 634,000

ACB of the Preferred Shares

(Limited to FMV) ( 634,000)

ACB of Common Shares Nil

There would also be a PUC reduction, calculated as follows:

Increase in Legal Capital ($634,000 + $898,000) $1,532,000

Less: the Excess of

Total Elected Amount $1,234,000

Over FMV of NSC ( 600,000) ( 634,000)

PUC Reduction $ 898,000

The PUC of the shares, after the allocation of the $898,000 PUC reduction, would be as follows:

PUC of Preferred Shares

= [$634,000 - ($634,000 ÷ $1,532,000)($898,000)] = $262,373

PUC of Common Shares

= [$898,000 - ($898,000 ÷ $1,532,000)($898,000)] = $371,627

Note that the total PUC of the preferred and common shares is equal $634,000 ($262,373 + $371,627), the same amount as the total ACB of the preferred and common shares.

Based on these calculations, the income tax consequences of the redemption of the preferred shares would be as follows:

Proceeds of Redemption $634,000

PUC of Preferred Shares ( 262,373)

ITA 84(3) Deemed Dividend $371,627

Proceeds of Redemption $634,000

Less: ITA 84(3) Deemed Dividend ( 371,627)

Modified POD $262,373

ACB ( 634,000)

Capital Loss ($371,627)

Inclusion rate 1/2

Allowable Capital Loss ($185,814)

The non-eligible dividend would be grossed up to $427,371 [(115%)($371,627)], and would create a federal dividend tax credit of $38,592 [(9/13)(15%)($371,627)].

Using these amounts for the common shares of Sheets Inc., if John does not opt out of ITA 85.1, the Income tax consequences would be as follows:

• John would be deemed to have disposed of his Sheets Inc. common shares for POD equal to the ACB of nil. Given this, there would be no capital gain or capital loss on the disposition.

• John would be deemed to have acquired the shares of Linens Ltd. at a cost equal to nil, the ACB of his Sheets Inc. common shares.

• The PUC of the Linens Ltd. shares that have been issued to John would be $371,627, the PUC of the Sheets Inc. common shares that were given up.

***Part A - Opting out of ITA 85.1***

The total FMV of the Sheets Inc. common shares is $1,300,000. In order to opt out of ITA 85.1, John will have to include a taxable capital gain of $650,000 [(1/2)($1,300,000 - Nil)] in his 2022 income tax return. This has the advantage of absorbing his $185,814 current allowable capital loss on his preferred shares, as well as his $300,000 2020 net capital loss. However, it will result in his being required to pay income tax on the remaining $164,186 ($650,000 - $185,814 - $300,000). Because all of his shares are involved in the exchange, he has no choice as to the amount of the gain to be recognized unless he wishes to structure the exchanges as to allocate the proceeds effectively creating two exchanges - one that is tax free and the second taxable to create sufficient capital gains to offset his existing 2020 net capital loss and 2022 allowable capital losses. This latter approach is discussed in Part C.

***Part B - ACB for Linens Ltd.***

The ACB of the Sheets Inc. common shares to Linens Ltd. would be $371,627, the lesser of their $1,300,000 FMV and their PUC of $371,627.

***Part C - Alternative Solutions***

Given the allowable capital loss resulting from the preferred share redemption and his 2020 net capital loss carry forward, John would like to have a taxable capital gain of $485,814 ($185,814 + $300,000) in order to utilize these losses. There are two possible alternatives that would generate this gain.

**Alternative One -** John could use ITA 85(1) to exchange the shares at an elected amount of $971,628. This would result in the required taxable capital gain of $485,814 [(1/2)($971,628 - Nil)]. Note that this would leave the ACB of the acquired Linens Ltd. shares at the elected amount of $971,628. This compares to nil if ITA 85.1 is used.

**Alternative Two -** Each of the common shares of Sheets Inc. has a FMV of $130 ($1,300,000 ÷ 10,000) and an ACB of nil. This means that each share of Sheets Inc. sold to Linens Ltd. would generate a taxable capital gain of $65 [(1/2)($130)] per share. In order to generate a total taxable capital gain of $485,810, John could simply sell 7,474 ($485,814 ÷ $65) of the shares to Linen Ltd. without using a rollover provision. This would result in a taxable capital gain of $485,810 [($65)(7,474)], slightly more than the amount required to absorb both the current allowable capital loss and the 2020 net capital loss. The remaining 2,526 (10,000 - 7,474) common shares of Sheets Inc. could then be exchanged for Linen Ltd. shares on a tax free basis under either ITA 85(1) or ITA 85.1.

Type: ES

Topic: Rollovers (ITA 85.1) - comprehensive problem [ITA 85.1 share exchange after ITA 85(1) rollover]

91) Mimi Farrow is the founder and sole shareholder of Farrow Ltd, a CCPC. Her initial and only investment was $600,000 in return for all 6,000 of the Company's authorized common shares when the company was incorporated. This amount represents both the PUC and the ACB of these shares. The Company has a December 31 taxation year end and has enjoyed a high level of profits since its first year of operations.

On August 1, 2022, the condensed Balance Sheet of the business is as follows:

**Farrow Ltd.**

**Balance Sheet**

**As at August 1, 2022**

Tangible Assets (Tax Costs) $11,625,000

Bank Loan $ 1,112,000

Common Shares (No Par - 6,000 Shares) 600,000

Retained Earnings 9,913,000

Total Debt and Shareholders' Equity $11,625,000

An independent appraiser has indicated that the FMV of the tangible assets of the business are equal to their tax costs. In addition to tangible assets, the appraiser indicates that the business has $1,500,000 of goodwill.

Ms. Farrow has contacted you with respect to transferring future growth in Farrow Ltd. to her 23 year old son, Woody. However, for at least a few years, she would like to retain control of the operations of the business. Woody is prepared to invest $5,000 in the corporation.

She has heard that there is a method where she would be able to exchange her shares in a capital reorganization that would allow her to transfer future growth in Farrow Ltd. to Woody without any immediate income tax consequences. She has asked for your advice in this matter.

**Required**: Advise Ms. Farrow. Include in your solution the August 1, 2022 Balance Sheet after your proposed share transactions.

Answer: The FMV of the business is $12,013,000, which is composed of tangible assets of $11,625,000, plus goodwill of $1,500,000, less the bank loan balance of $1,112,000.

The method that Ms. Farrow referred to is provided for under ITA 86(1). In order to implement this rollover and achieve Ms. Farrow's goals, Woody should invest $5,000 in exchange for new common shares in Farrow Ltd as part of the capital reorganization.

Ms. Farrow can exchange, on a rollover basis, her existing common shares for new preferred shares with a redemption value of $12,013,000. In order for Ms. Farrow to retain control of Farrow Ltd., the preferred shares should be voting shares or she should acquire sufficient common shares together with her son as part of the capital reorganization.

Under ITA 86(1), this exchange would have no immediate income tax consequences. After the exchange, the ACB and PUC of the new preferred shares would be calculated as follows:

ACB of Shares Given Up $600,000

Less: FMV of NSC Nil

ACB of Preferred Shares $600,000

Legal Capital - Preferred Shares $12,013,000

Less Excess, if any, of:

PUC - Shares Given Up ($600,000)

Over FMV of NSC Nil ( 600,000)

Required PUC Reduction $11,413,000

PUC - Preferred Shares ($12,013,000 - $11,413,000) $600,000

Ms. Farrow's preferred shares will not participate in the future growth of the Farrow Ltd. This means that all of the future growth in this company will accrue to the common shares which are all owned by her son Woody.

Subsequent to these transactions, the August 1, 2022 Balance Sheet would be as follows:

**Farrow Ltd.**

**Shareholders' Equity**

**As at August 1, 2022**

Tangible Assets at tax costs

($11,625,000 + $5,000) $11,630,000

Bank Loan $ 1,112,000

Preferred Shares (PUC) 600,000

Common Shares (PUC) 5,000

Retained Earnings 9,913,000

Total $11,630,000

Note that Ms. Farrow's potential capital gain of $11,413,000 ($12,013,000 - $600,000) has not disappeared. If her preferred shares are sold for the FMV of $12,013,000, with the ACB of the shares being $600,000, there would be a capital gain of $11,413,000. Alternatively, if the preferred shares are redeemed, their PUC is $600,000, which would result in an ITA 84(3) deemed dividend of $11,413,000 (there would be no capital gain or capital loss). The planning described above will simply defer the potential gain until the new preferred shares are sold or redeemed.

Type: ES

Topic: Rollovers (ITA 86) - comprehensive problem

92) Marian Soft began to carry on a software business as a sole proprietor in 2011. The business, registered as Home Software, was carried on successfully for a number of years, becoming sufficiently profitable that Marian no longer needed all of the income that was being earned by the business. Given this, she was advised that she could defer a significant amount of income tax by incorporating the business and that she could avoid any immediate income tax as a result of using ITA 85(1).

On January 1, 2017, the tax costs of all business properties total $1,373,000 and their FMV is $1,650,000. On this date the business properties are sold to a new corporation, Home Software Inc., at an elected amount of $1,373,000. As consideration, Marian receives a promissory note for $1,000,000 and common shares with a FMV of $650,000. The new Company will have a December 31 taxation year end.

The business continues to operate very successfully and, on January 1, 2022, the business properties have a total tax cost of $5,263,000 and a FMV of $6,406,000.

In recent years, Marian's adult son Jeff has been actively involved in running the corporate business. This fact, along with the desire to retire from the business in a few years, has led Marian decide to transfer the future growth of the business to Jeff. After consultation with her tax adviser, she is going to exchange all of her common shares in Home Software Inc. for $906,000 in cash and redeemable preferred shares with a FMV of $5,500,000. Subsequent to this exchange, her son Jeff will invest $10,000 for new common shares in Home Software Inc.

The company will amend its share structure so as to allow the authorization and issuance of a new class of preferred shares.

The GRIP and RDTOH account balances are all nil at January 1, 2022.

**Required**:

A. Determine the income tax consequences for Marian that will result from the exchange of shares. As part of your answer, you should indicate both the ACB and PUC of the newly issued preferred shares.

B. Determine the income tax consequences for Marian if her preferred shares were redeemed on February 1, 2022 for $5,500,000.

Answer:

***Part A The incorporation of the Business***

The ACB of the common shares issued on January 1, 2017 would be calculated as follows:

Elected Amount $1,373,000

Less: FMV of NSC ( 1,000,000)

ACB of Common Shares $ 373,000

The PUC of these shares would be calculated as follows:

Legal Capital $650,000

Excess, if any, of

Total Elected Amount ($1,373,000)

Over FMV of NSC 1,000,000 ( 373,000)

PUC Reduction $277,000

PUC Of Common Shares ($650,000 - $277,000) $373,000

***Part A Share-For-Share Exchange***

The ACB of the preferred shares would be calculated as follows:

ACB of Shares Given Up $373,000

Less: FMV of NSC ( 906,000)

ACB of Preferred Shares Nil

The PUC of the preferred shares would be calculated as follows:

Legal Capital $5,500,000

Excess, if any, of

PUC of Shares Given Up ($373,000)

Over FMV of NSC 906,000 Nil

PUC Reduction $5,500,000

PUC of Preferred Shares ($5,500,000 - $5,500,000) Nil

The ITA 84(3) deemed dividend would be calculated as follows:

PUC of Preferred Shares $ Nil

FMV of NSC 906,000

Proceeds of Redemption $906,000

PUC of Shares Given Up ( 373,000)

ITA 84(3) Deemed Dividend (Non-Eligible) $533,000

As a result of the share-for-share exchange, the amount to be included in Marian's income would be the grossed up dividend of $612,950 [(115%)($533,000)]. In addition, there would be a federal dividend tax credit of $55,350 [9/13)(15%)($533,000)].

The exchange would not result in a capital gain as shown in the following calculation:

ACB of Preferred Shares $ Nil

FMV of NSC 906,000

POD $906,000

Less: ITA 84(3) Deemed Dividend (Non-Eligible) ( 533,000)

Modified POD $373,000

ACB ( 373,000)

Capital Gain Nil

***Part B***

The results of having Home Software Inc. redeem her preferred shares would be as follows:

Proceeds of Redemption $5,500,000

PUC Nil

ITA 84(3) Deemed Dividend (Non-Eligible) $5,500,000

As a result of the redemption, the amount to be included in Marian's income would be the grossed up dividend of $6,325,000 [(115%)($5,500,000)]. In addition, there would be a federal dividend tax credit of $571,154 [(9/13)(15%)($5,500,000)].

As was the case with the share-for-share exchange, where will be no capital gain on the redemption:

POD $5,500,000

Less: ITA 84(3) Deemed Dividend (Non-Eligible) ( 5,500,000)

Modified POD Nil

ACB Nil

Capital Gain Nil

Type: ES

Topic: Rollovers (ITA 86) - comprehensive problem [ITA 85(1) and ITA 86(1)]

93) Nome Industries was incorporate in 2014 with the issuance of 15,000 common shares for $60 per share in cash to Gnancy Gnome. No additional shares have been issued since the incorporation.

In 2016, Derek Blume and his son, James acquired all of the shares at a price of $85 per share from Ms. Gnome. Derek acquired 12,000 of the shares, while James acquired the remaining 3,000.

On January 1, 2022, the FMV of the Nome shares is $1,500,000 ($100 per share). The shares do not qualify for the capital gains deduction. The GRIP and RDTOH account balances are nil for all taxation years under consideration.

In 2022 Derek decides to freeze the value of his shares at their January 1, 2022 FMV and to pass on future corporate growth to his son James. To accomplish this, he intends to exchange his 12,000 common shares for cash of $200,000 and 8,000 preferred shares with a legal capital and a redemption value of $800,000. Subsequent to this transaction, his son James will own all of the outstanding common shares of Nome Industries.

**Required:**

A. Describe the immediate income tax consequences of this transaction to Derek Blume, including the following:

• the amount of any gift;

• the PUC of the preferred shares;

• the ACB of the preferred shares;

• the amount of any deemed dividends arising on the exchange; and

• any capital gain or capital loss resulting from the exchange of the common shares.

B. Describe the income tax consequences of this transaction to James.

C. Describe the income tax consequences of this transaction to Derek Blume, if the new preferred shares in Nome Ltd. were redeemed at their FMV of $800,000 in 2022.

Answer:

***Part A***

**Gift -** Derek owns 80 % (12,000 ÷ 15,000) of the Nome Industries shares. His gift to James would be calculated as follows:

FMV of Old Common Shares

[(80%)($1,500,000)] $1,200,000

FMV of Consideration:

NSC ($200,000)

Preferred Shares (FMV) ( 800,000) ( 1,000,000)

Gift $ 200,000

It is fair to assume that this amount is a gift to James, as he is the only common shareholder in Nome Ltd after the exchange.

**PUC of new Preferred Shares -** The PUC reduction required under ITA 86(2.1) would be calculated as follows:

Legal Capital of New Shares $800,000

Less the Excess, if any, of:

PUC of Old Shares [(12,000)($60)] ($720,000)

Over FMV of NSC 200,000 ( 520,000)

PUC Reduction $280,000

PUC of Preferred Shares ($800,000 - $280,000) $520,000

**ACB of New Preferred Shares -** This amount would be calculated as follows:

ACB of Old Shares [(12,000)($85)] $1,020,000

Deduct:

FMV of NSC ($200,000)

Gift ( 200,000) ( 400,000)

ACB of New Preferred Shares $ 620,000

**ITA 84(3) Dividend -** For the purposes of determining any ITA 84(3) deemed dividend on the redemption of the old shares, the proceeds of redemption would be as follows:

PUC of New Preferred Shares $520,000

FMV of NSC 200,000

Proceeds of Redemption $720,000

As shown in the following calculation, there would be no ITA 84(3) dividend:

Proceeds of Redemption $720,000

PUC of Old Shares ( 720,000)

ITA 84(3) Dividend Nil

**Capital Gain or Capital Loss -** For the purposes of determining any capital gain or Capital loss on the redemption of the common shares, the POD is the lesser of the $1,200,000 FMV of the common shares and the following amount:

FMV of NSC $200,000

Gift 200,000

POD $400,000

As shown in the following calculation, there would be a capital loss:

POD $ 400,000

Less: ITA 84(3) Deemed Dividend Nil

Modified POD $ 400,000

ACB ( 1,020,000)

Capital Loss ($ 620,000)

This capital loss would be disallowed by ITA 86(2)(d), resulting in no immediate income tax consequences for Derek Blume.

***Part B***

This transaction will not alter the total FMV of the Company. However, the FMV of the common shares will increase by the $200,000 amount of the gift. There will be no corresponding increase in the ACB of these shares and, as a consequence, this amount will be included in James' income when he sells the common shares or they are redeemed. As a result this $200,000 amount is effectively included in income twice.

***Part C***

If Derek's preferred shares were redeemed at their FMV of $800,000, the income tax consequences would be as follows:

Redemption Proceeds $800,000

PUC ( 520,000)

ITA 84(3) Deemed Dividend (Non-Eligible) $280,000

The gross up amount of the dividend will be $322,000 [(115%)($280,000)]. It will generate a federal dividend tax credit of $29,077 [(9/13)(15%)($280,000)].

Redemption Proceeds $800,000

Less: ITA 84(3) Deemed Dividend (Non-Eligible) ( 280,000)

Modified POD $520,000

ACB ( 620,000)

Capital Loss ($100,000)

If Derek had simply sold his shares, there would have been a capital gain of $180,000 ($1,200,000 - $1,020,000). The net result of this redemption is the same $180,000 ($280,000 in dividends - $100,000 capital loss). However, as noted in Part B, his son James will be paying income tax on an additional $200,000 of capital gains because of the increased FMV of his shares as a result of the gift.

A further problem is the form of the income. On the straight sale of shares, the $180,000 would have been a capital gain, only one-half of which would be taxable. The inappropriate use of ITA 86 has resulted in a $280,000 dividend which will be subject to higher income tax rates, offset by a $100,000 capital loss which is only one-half deductible. Although capital losses can generally be deducted only to the extent of available capital gains. These results could have been avoided by adding a price adjustment clause to the underlying agreements.

Type: ES

Topic: Rollovers (ITA 86) - comprehensive problem with gift

94) Espana Ltd. was incorporated with an initial investment of $465,000 in cash. In return for this investment, Ms. Portia Cruz received common shares with a legal capital and PUC of $465,000.

In 2017, Mr. Jose Martinez acquired all of Ms. Cruz's shares in return for a payment of $1,340,000. As there was no additional investment in Espana Ltd. subsequent to its incorporation, Mr. Martinez became the sole shareholder of the Company at this point in time.

Under Mr. Martinez's direction, the Company continued to prosper, with the FMV of the shares on December 1, 2022 estimated to be $3,500,000.

As he is nearly 70 years of age, Mr. Martinez would like to freeze the value of his shares of Espana Ltd. To accomplish this, on December 1, 2022, he sells 25% of his shares to his 42 year old daughter for cash of $875,000 [(25%)($3,500,000)]. In addition he exchanges the remaining 75% of the common shares for cash of $625,000, plus redeemable preferred shares with a FMV and legal capital of $2,000,000.

The shares of Espana Ltd. do not qualify for the capital gains deduction. The Company has a nil balance in its GRIP and RDTOH accounts for all taxation years under consideration.

**Required**: Determine the following:

A. The amount of the gift to a related person, if any, resulting from the exchange of shares.

B. The PUC of the newly issued preferred shares.

C. The ACB of the newly issued preferred shares.

D. The POD and POR (Proceeds of Redemption ITA 84(5)(d)) that Mr. Martinez received when he exchanged the old common shares of Espana Ltd. for new preferred shares.

E. The immediate income tax consequences for Mr. Martinez resulting from the sale of shares to his daughter and the exchange of shares.

F. The income tax consequences for Mr. Martinez if the new Espana Ltd. preferred shares are immediately redeemed for their FMV.

Answer:

***Part A - Gift***

The FMV of the common shares exchanged was $2,625,000 [(75%)($3,500,000)]. As this amount is equal to the $2,625,000 ($2,000,000 + $625,000) total of cash and preferred shares received, there is no gift to a related person.

***Part B - PUC of Preferred Shares***

Since Mr. Martinez purchased the shares directly from Ms. Cruz, the PUC of the common shares remains at $465,000. The PUC of the preferred shares would be calculated as follows:

Increase in Legal Capital $2,000,000

Less the Excess, if any, of:

PUC of Common Shares

[(75%)($465,000)] ($348,750)

Over the FMV of NSC 625,000 Nil

PUC Reduction $2,000,000

PUC of Preferred Shares ($2,000,000 - $2,000,000) Nil

***Part C - ACB of Preferred Shares***

The ACB of the preferred shares would be calculated as follows:

ACB of Common Shares [(75%)($1,340,000)] $1,005,000

Less: FMV of NSC ( 625,000)

ACB of Preferred Shares $ 380,000

***Part D - Proceeds of Redemption and POD for Common Shares***

The Proceeds of Redemption would be calculated as follows:

FMV of NSC $625,000

PUC of Preferred Shares Nil

Proceeds of Redemption [ITA 84(5)(d)] $625,000

The POD would be calculated as follows:

ACB of Preferred Shares $ 380,000

FMV of NSC 625,000

POD [ITA 86(1)(c)] $1,005,000

***Part E - Income Tax Consequences of Sale and Share Exchange***

The sale of shares to his daughter would result in a taxable capital gain calculated as follows:

POD $875,000

ACB [(25%)($1,340,000)] ( 335,000)

Capital Gain $540,000

Inclusion Rate 1/2

Taxable Capital Gain $270,000

The exchange of shares would have income tax consequences as follows:

Proceeds of Redemption $625,000

PUC of Common Shares [(75%)($465,000)] ( 348,750)

ITA 84(3) Deemed Dividend (Non-Eligible) $276,250

POD $1,005,000

Less: ITA 84(3) Deemed Dividend ( 276,250)

Modified POD $ 728,750

ACB of Common Shares [(75%)($1,340,000)] ( 1,005,000)

Capital Loss ($ 276,250)

Inclusion Rate 1/2

Allowable Capital Loss ($ 138,125)

The overall income tax consequences of the sale to his daughter and the share exchange would be as follows:

Taxable Dividend [($276,250)(115%)] $317,688

Net Taxable Capital Gain ($270,000 - $138,125) 131,875

Additional Income $449,563

The deemed non-eligible dividend would qualify for a federal dividend tax credit of $28,688 [(9/13)(15%)($276,250)].

***Part F - Income Tax Consequences of Preferred Share Redemption***

The income tax consequences of the immediate redemption of the preferred shares is:

Proceeds of Redemption $2,000,000

Less: PUC of Preferred Shares Nil

ITA 84(3) Deemed Dividend (Non-Eligible) $2,000,000

POD $2,000,000

Less: ITA 84(3) Deemed Dividend (Non-Eligible) ( 2,000,000)

Modified POD Nil

ACB of Preferred Shares ( 380,000)

Capital Loss ($ 380,000)

Inclusion Rate 1/2

Allowable Capital Loss ($ 190,000)

The deemed non-eligible dividend would be grossed up to $2,300,000 [(115%)($2,000,000)]. It would qualify for a federal dividend tax credit of $207,692 [(9/13)(15%)($2,000,000)]

Assuming Mr. Martinez has no other taxable capital gains in the year, there is a 2022 net capital loss of $58,125 ($270,000 - $138,125 - $190,000).

Type: ES

Topic: Rollovers (ITA 86) - comprehensive problem with gift

95) Due to his advanced age, Gordon Korngold, the only shareholder of Korngold Ltd., has decided to retire. As the Company activities are largely based on Gordon's effort, he intends to sell the business properties of the company, followed by a wind-up and distribution of the resulting cash.

Korngold Ltd. is a CCPC with a December 31 taxation year end. In contemplation of this liquidation, a Balance Sheet has been prepared based on the income tax values of its properties and liabilities as at January 1, 2022. This Balance Sheet, after all closing entries, is as follows:

**Korngold Ltd.**

**Balance Sheet**

**As at January 1, 2022**

Inventory (Net Realizable Value and Tax Cost) $ 48,650

Eligible RDTOH Nil

Non-Eligible RDTOH 32,345

Land - ACB 942,450

Building - UCC 723,640

Total $1,747,085

Liabilities $ 313,260

PUC 625,000

Capital Dividend Account (CDA) 326,470

Other Retained Income 482,355

Total $1,747,085

**Other Information:**

1. The current FMV of the Land is $2,600,000.

2. The Building had a capital cost of $1,160,000. Its FMV on January 1, 2022 is $1,846,000.

3. The ACB and PUC of the common shares are both $625,000.

4. On January 1, 2022, the Company has a nil GRIP account balance.

5. All of the properties are sold on January 1, 2022 for their FMV. The corporation's liabilities are paid in full on this date. The after tax proceeds from the sale are distributed to shareholders on December 31, 2022.

6. The provincial income tax rate for the corporation on income that qualifies for the SBD is 3% and is 14% on all other income.

7. No dividends (taxable or capital) have been paid in the previous two taxation years.

**Required:**

A. Calculate the amount that will be available for distribution to Mr. Korngold on the liquidation.

B. Determine the components of the distribution to Mr. Korngold, and the amount of taxable capital gains that will be realized as a result of the winding-up of Korngold Ltd. Assume that appropriate elections or designations will be made to minimize any income tax.

Answer:

***Part A - Funds Available for Distribution***

The taxable capital gains and active business income (recapture) to the corporation are calculated as follows:

**Taxable Active Business**

**Property Capital Gains Income**

Inventory Nil Nil

Taxable Capital Gains:

On Land [(1/2)($2,600,000 - $942,450)] $ 828,775 Nil

On Building [(1/2)($1,846,000 - $1,160,000)] 343,000

Recapture on Building ($1,160,000 - $723,640) $436,360

Totals $1,171,775 $436,360

As the active business income is less than the $500,000 annual business limit, there will be no addition to the GRIP account.

Taxable Income will be $1,608,135 ($1,171,775 + $436,360). Income tax payable will be calculated as follows:

Federal Tax on Investment Income [(28% + 10-2/3%)($1,171,775)] $453,086

Federal Tax on Business Income [(9%)($436,360)] 39,272

Federal Part I Tax $492,358

Provincial Tax on Investment Income [(14%)($1,171,775)] 164,049

Provincial Tax on Business Income [(3%)($436,360)] 13,091

Total Corporate Income Tax $669,498

There was no balance in the Eligible RDTOH at the beginning of the year and no additions during the year, resulting in a nil balance at the end of the year. The end of year balance in the Non-Eligible RDTOH would be calculated as follows:

Beginning Non-Eligible RDTOH $ 32,345

Addition - The least of:

• [(30-2/3%)($1,171,775)] = $359,344

• [(30-2/3%)($1,608,135 - $436,360)] = $359,344

• Part I Tax Payable = $492,358 359,344

Ending Non-Eligible RDTOH $391,689

The amount available for distribution to Mr. Korngold, after the payment of the liabilities and corporate income tax can be calculated as follows:

FMVs:

Inventory $ 48,650

Land 2,600,000

Building 1,846,000

Gross Sale Proceeds $4,494,650

Liabilities ( 313,260)

Corporate Income Tax ( 669,498)

Dividend Refund (Note) 391,689

Funds Available for Distribution $3,903,581

**Note -** The dividend refund is equal to the balance in the Non-Eligible RDTOH account. As will be shown in a subsequent calculation, the taxable dividends paid on the winding-up will be well in excess of the amount required to maximize the dividend refund.

With respect to the CDA, the final balance is calculated as follows:

Opening CDA Balance $ 326,470

Disposition of Land 828,775

Disposition of Building 343,000

Ending CDA Balance $1,498,245

***Part B - Components of Distribution***

Assuming a capital dividend election has been made the taxable dividend component of the total distribution to Mr. Korngold can be calculated as follows:

Distribution to Mr. Korngold $3,903,581

PUC ( 625,000)

ITA 84(2) Deemed Dividend $3,278,581

Capital Dividend (CDA Balance) ( 1,498,245)

Deemed Dividend (Non-Eligible) $1,780,336

As Korngold has no GRIP balance, all of the taxable dividend will be non-eligible. The taxable amount will be $2,047,386 [(115%)($1,780,336)]. This dividend will qualify for a federal dividend tax credit of $184,881 [(9/13)(15%)($1,780,336)].

***Part B - Capital Gain***

With respect to capital gains, ITA 54 requires that the POD for purposes of determining any capital gain on the disposition of shares is reduced by any amount of a deemed dividend under ITA 84(2). Given the preceding calculation, the capital gain to Mr. Korngold would be determined as follows:

Actual Distribution To Mr. Korngold $3,903,581

Less: ITA 84(2) Deemed Dividend ( 3,278,581)

Modified POD $ 625,000

ACB ( 625,000)

Capital Gain Nil

Type: ES

Topic: Winding-up a Canadian corporation (ITA 88(2)) - comprehensive problem

96) Pellerin Fabrication Ltd. is a CCPC with a December 31 taxation year end. All of the shares of the corporation are owned by Mr. Denis Pellerin, the incorporator of the corporation. On December 31, 2021, the Balance Sheet of the Company, prepared in accordance with ASPE, is as follows:

Cash $ 50,000

Accounts Receivable 215,000

Inventory (Lower of Cost and Market) 375,000

Land (Cost) 132,000

Building (Cost) 850,000

Accumulated Amortization ( 263,000)

Total Assets $1,359,000

Liabilities $ 373,000

Common Shares 600,000

Retained Earnings 386,000

Total Equities $1,359,000

Mr. Pellerin wishes to retire and has agreed to sell all of the non-cash assets of the business, including goodwill, at FMV on January 31, 2022. The buyer will assume all of the liabilities of the corporation and will pay the purchase price in cash. The relevant FMVs and the resulting purchase prices are as follows:

Accounts Receivable $195,000

Inventory 375,000

Land 193,875

Building 550,000

Goodwill 56,250

Liabilities ( 386,125)

Purchase Price $984,000

**Other Information:**

1. With respect to the sale of the Accounts Receivable, a joint election is filed under ITA 22.

2. The UCC of the Class 1 building is $492,000.

3. As at January 31, 2022, the corporation has a balance in its Non-Eligible RDTOH of $31,000. No dividends (taxable or capital) were paid during the previous taxation year ending December 31, 2021.

There is no balance in the Eligible RDTOH on this date.

4. As at January 1, 2022, the capital dividend account (CDA) has a balance of $63,000 and there is a nil balance in the GRIP account.

5. The PUC and ACB of the common shares are both $600,000.

6. The corporation is subject to a provincial income tax rate of 3% on income eligible for the SBD and 13% on other income.

7. In 2022, Mr. Pellerin will have other income in excess of $300,000. This means his marginal federal income tax rate is 33% and the provincial income tax rate is 16%. The provincial dividend tax credit for non-eligible dividends is equal to 4/13 of the gross up.

8. Shares of Pellerin Fabrication Ltd. do not qualify for the capital gains deduction.

**Required:**

A. Calculate the after-tax corporate income that will be available for distribution to Mr. Pellerin after the sale of the business.

B. Calculate the amount that will be available to Mr. Pellerin, after personal income taxes are paid, on the distribution of the funds resulting from the winding-up and dissolution of Pellerin Fabrication Ltd. Assume that all elections and designations are made to minimize any income tax.

Answer:

**Part A - After Tax Funds to the Corporation**

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

Taxable income and income tax payable resulting from the sale of the non-cash assets can be calculated as follows:

**Active Business Taxable**

**Income Capital Gains**

Accounts Receivable ($195,000 - $215,000) ($20,000) Nil

Land [(1/2)($193,875 - $132,000)] Nil $30,938

Recapture on Building ($550,000 - $492,000) 58,000 Nil

Goodwill [($56,250 - Nil)(1/2)] Nil 28,125

Totals $38,000 $59,063

Total taxable income would be $97,063 ($38,000 + $59,063). The corporate income tax payable on this amount would be calculated as follows:

Federal Tax on:

Business Income [(38% - 10% - 9%)($38,000)] $ 3,420

Investment Income [(38% - 10% + 10-2/3%)($59,063)] 22,838

Part I Income Tax Payable $26,258

Provincial Tax on Business Income [(3%)($38,000)] 1,140

Provincial Tax on Investment Income [(13%)($59,063)] 7,678

Total Corporate Income Tax Payable $35,076

**Note:** The small business limit is $41,096 [(30 ÷ 365 days)($500,000)] which is below the active business income of $38,000.

***Capital Dividend Account (CDA)***

The balance in the CDA is calculated as follows:

Opening CDA Balance $ 63,000

Addition from Sale of Land 30,938

Addition from Sale of Goodwill 28,125

Closing CDA Balance $122,063

***Non-Eligible RDTOH Balance***

There is no addition to the Eligible RDTOH and therefore the balance remains nil at the time of the sale. With respect to the Non-Eligible RDTOH, the closing balance in that account would be calculated as follows:

Opening Non-Eligible RDTOH $31,000

Add: Least of:

• 30-2/3% of Investment Income [(30-2/3%)($59,063)] = $18,113

• 30-2/3% of Taxable Income, Less Amount Eligible for the SBD

[(30-2/3%)($97,063 - $38,000)] = $18,113

• Part I Tax = $26,258 18,113

Closing Non-Eligible RDTOH $49,113

***Funds Available for Distribution to Shareholder***

Given the preceding calculation, the after tax funds available for distribution would be calculated as follows:

Purchase Price, Plus Cash ($984,000 + $50,000) $1,034,000

Corporate Income Tax ( 35,076)

Balance Before Dividend Refund $ 998,924

Dividend Refund (Non-Eligible RDTOH Balance) 49,113

After Tax Distribution $1,048,037

The dividend refund is equal to the balance in the Non-Eligible RDTOH account. As will be shown in a subsequent calculation, the taxable dividends paid on the winding-up will be well in excess of the amount required to maximize the dividend refund.

**Part B - After Tax Retention by Mr. Pellerin**

***Taxable Dividend***

Assuming a capital dividend election has been filed, the taxable dividend component of the distribution can be analyzed as follows:

Total Distribution $1,048,037

PUC ( 600,000)

ITA 84(2) Deemed Dividend $ 448,037

Capital Dividend (CDA Balance) ( 122,063)

Deemed Dividend (Non-Eligible) $ 325,974

For capital gains purposes, the cancellation of the shares that occurred as part of the winding-up would not have any income tax effect. This is demonstrated by the following calculation:

Proceeds of Redemption $1,048,037

Less: ITA 84(2) Deemed Dividend ( 448,037)

Modified POD $ 600,000

ACB ( 600,000)

Capital Gain Nil

***Personal Income Tax Payable***

The PUC amount, as well as the capital dividend, would be received by Mr. Pellerin on a tax free basis. Income tax payable on the deemed non-eligible dividend would be calculated as follows:

Deemed Dividend $325,974

Gross Up of 15% 48,896

Taxable Dividend $374,870

Personal Income Tax Rate (33% + 16%) 49%

Tax before Dividend Tax Credit $183,686

Dividend Tax Credit [(9/13 + 4/13)($48,896)] ( 48,896)

Personal Income Tax Payable $134,790

***After Tax Retention***

Given the preceding calculations, the after tax cash available to Mr. Pellerin would be calculated as follows:

Total Distribution $1,048,037

Personal Income Tax Payable ( 134,790)

After Tax Cash Retained $ 913,247

Type: ES

Topic: Purchase and sale of a business - comprehensive problem

97) Paulo Titano is the only shareholder of Titano Ltd., a CCPC. The Company was incorporated several years ago, with an investment in common shares of $168,000. No additional shares have been issued since that time. The Company has always had a taxation year which ends on December 31.

As he is now over 65 years of age and eager to see the world while he can still fully enjoy the experience, Paulo is planning to sell his corporation. He is considering two offers that he has received:

**Asset Purchase -** A potential purchaser has indicated that she would buy all of the corporate properties, including goodwill, at FMV. This investor would assume all of the liabilities of the corporation and has agreed to file an ITA 22 election with respect to the sale of the accounts receivable. If the assets are sold, it is Paulo's intention to wind up the corporation immediately thereafter.

**Share Purchase -** A different potential purchaser has offered a cash payment of $2,700,000 in return for all of the shares of the Company.

In order to evaluate these alternatives, the following statement of information about the Company's assets has been prepared:

**Titano Ltd.**

**Statement of Assets**

**As at December 31, 2022**

**Accounting Value Tax Cost FMV**

Cash $ 37,600 $ 37,600 $ 37,600

Accounts Receivable 312,500 312,500 278,900

Inventory 623,400 623,400 676,250

Land 326,000 326,000 403,000

Building (UCC) (Note One) 427,300 396,400 1,265,000

Equipment (UCC) (Note Two) 326,500 285,400 297,600

Goodwill Nil Nil 624,000

Totals $2,053,300 $1,981,300 $3,582,350

**Note One -** Paulo constructed the Building on the Land for a total capital cost of $983,200.

**Note Two -** The Equipment had a capital cost of $623,500.

At the same time that this Statement of Assets was prepared, a similar Statement of Equities was drawn up. This latter statement contained the following accounting amounts and tax costs:

**Accounting Amounts Tax Costs**

Current Liabilities $ 426,250 $ 426,250

Loan from Shareholder 186,400 186,400

Future Income Tax Liability 363,200 N/A

Common Shares 168,000 168,000

Capital Dividend Account (CDA) N/A 94,550

Other Retained Income N/A 1,106,100

Retained Earnings 909,450 N/A

Totals $2,053,300 $1,981,300

In addition to the information included in the preceding statements, the following information about the Company is available:

• The Company has a 2019 non-capital loss balance of $62,000.

• The Company has a 2019 net capital loss balance of $86,350.

• On January 1, 2022, the Company has no balance in either of its RDTOH accounts or in its GRIP account.

• Titano Ltd. is subject to a provincial income tax rate of 2% on income that qualifies for the SBD and 13% on all other income.

• The shares of Titano Ltd. are not eligible for the capital gains deduction.

Paulo lives in a province where the provincial dividend tax credit on eligible dividends is 32% of the gross up, and on non-eligible dividends is equal to 25% of the gross up. As he has other income totaling more than $350,000, he is in the maximum federal income tax bracket of 33% and the maximum provincial income tax bracket of 16%.

**Required:** Determine which of the two offers Paulo should accept. Ignore the possibility that Paulo might be subject to the alternative minimum tax (AMT). Assume that all appropriate elections or designations will be made to minimize income tax.

Answer:

**Sale of Assets - December 31, 2022**

This calculation requires two steps. First, we must determine the after tax proceeds that will be available to the corporation after the sale of the assets. Then, a second stage analysis is required to determine the amount that will be retained by Paulo after he pays all of the income taxes that are due on the proceeds that are distributed to him. Assume that the business broke even in 2022 with respect to its normal business operations.

***Calculation of Corporate Income on the Sale of the Assets***

**Active Business Taxable**

**Asset Income (Loss) Capital Gains**

Accounts Receivable (Note 1) ($ 33,600)

Inventory ($676,250 - $623,400) 52,850

Land [(1/2)($403,000 - $326,000)] $ 38,500

Building:

($983,200 - $396,400) 586,800

[(1/2)($1,265,000 - $983,200)] 140,900

Recapture on Equipment ($297,600 - $285,400) 12,200

Goodwill [(1/2)($624,000)] 312,000

Total Income $618,250 $491,400

**Note 1 -** The loss on the Accounts Receivable is a business loss because of the ITA 22 election. The amount of the loss is the tax cost of $312,500, less the FMV of $278,900. The purchaser will be required to include this same amount in income.

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

Based on the preceding analysis, Titano Ltd. would have Taxable Income calculated as follows:

Net Income ($618,250 + $491,400) $1,109,650

2019 Non-Capital Loss ( 62,000)

2019 Net Capital Loss ( 86,350)

Taxable Income $ 961,300

Basic Federal Tax [(38%)($961,300)] $365,294

Federal Abatement [(10%)($961,300)] ( 96,130)

SBD (Note 2) ( 95,000)

ART (Note 3) 43,205

GRR [(13%)($961,300 - $500,000 - $405,050)] ( 7,313)

Part I Income Tax $210,056

Provincial Income Tax:

[(2%)($500,000)] 10,000

[(13%)($961,300 - $500,000)] 59,969

Total Corporate Income Tax $280,025

**Note 2 -** The small business deduction (SBD) is equal to 19% of the least of:

• Active Business Income $618,250

• Taxable Income $961,300

• Annual Business Limit $500,000

The SBD is equal to $95,000 [(19%)($500,000)].

**Note 3 -** Aggregate Investment Income (AII) is calculated as follows:

Taxable Capital Gains $491,400

Less: 2019 Net Capital Loss Deducted ( 86,350)

AII $405,050

ART is equal to 10-2/3% of the lesser of:

• AII = $405,050

• Taxable income less the amount eligible for the SBD

= $461,300 ($961,300 - $500,000)

ART is equal to $43,205 [(10-2/3%)($405,050)].

***GRIP Balance***

The GRIP balance can be calculated as follows:

Taxable Income $961,300

Amount eligible for the SBD ( 500,000)

AII ( 405,050)

Subtotal $ 56,250

Rate 72%

GRIP Balance $ 40,500

***RDTOH Balance***

There are no balances in either RDTOH on January 1, 2022. The only addition to either balance in 2022 would would be the refundable portion of Part I tax. This amount would be the least of:

• 30-2/3% of AII [(30-2/3%)($405,050)] $124,215

• 30-2/3% of Taxable Income, Less the amount eligible for

the SBD [(30-2/3%)($961,300 - $500,000)] $141,465

• Part I Tax $210,056

The least of these amounts is $124,215 and it would added to the Non-Eligible RDTOH, leaving a closing balance in that account of $124,215.

***Funds Available for Distribution***

The funds available for distribution would be calculated as follows:

Total FMV of Assets (From Statement) $3,582,350

Current Liabilities Assumed ( 426,250)

Loan from Shareholder Assumed ( 186,400)

Total Sale Proceeds $2,969,700

Corporate Income Tax ( 280,025)

Dividend Refund (Note 4) 124,215

Funds Available for Distribution $2,813,890

**Note 4 -** Technically, the dividend refund is the lesser of the $124,215 balance in the Non-Eligible RDTOH account and 38-1/3% of taxable dividends paid. However, given the size of the distribution in this example, it is clear that $124,215 will be the lower amount.

***Capital Dividend Account (CDA)***

The CDA balance is calculated as follows:

Opening CDA Balance $ 94,550

Non-Taxable One-Half of Capital Gains

(From Table Calculating Corporate Income

on Asset Dispositions) 491,400

Closing CDA Balance $585,950

***Taxable Dividends resulting from Distribution***

Assuming a capital dividend election has been filed for the maximum capital dividend and the maximum eligible dividend, the taxable dividend component of the total distribution to Paulo can be calculated as follows:

Funds available for Distribution $2,813,890

PUC ( 168,000)

ITA 84(2) Deemed Dividend $2,645,890

ITA 83(2) Capital Dividend (CDA Balance) ( 585,950)

Deemed Taxable Dividend $2,059,940

Eligible Dividend (Designated) ( 40,500)

Non-Eligible Dividend (Remainder) $2,019,440

As shown in the following calculation, Paulo will not have a capital gain on the disposition of his shares:

Amount Distributed $2,813,890

Less: ITA 84(2) Deemed Dividend ( 2,645,890)

Modified POD $ 168,000

ACB ( 168,000)

Capital Gain Nil

***Personal Income Tax***

As there is no capital gain and the capital dividend is received tax free, the personal income tax payable on the dividend subject to tax would be calculated as follows:

Eligible Dividends $ 40,500

Gross Up 38% 15,390

Non-Eligible Dividends 2,019,440

Gross Up 15% 302,916

Taxable Amount of Dividends $2,378,246

Combined Income Tax Rate (33% + 16%) 49%

Income Tax Payable before Dividend Tax Credit $1,165,341

Dividend Tax Credits:

Eligible Dividends [(6/11 + 32%)($15,390)] ( 13,319)

Non-Eligible Dividends [(9/13 + 25%)($302,916)] ( 285,440)

Personal Income Tax $ 866,582

**Sale of Shares**

This relatively simple calculation is as follows:

POD $2,700,000

ACB ( 168,000)

Capital Gain $2,532,000

Inclusion Rate 1/2

Taxable Capital Gain $1,266,000

Income Tax Rate (33% + 16%) 49%

Personal Income Tax $ 620,340

**Conclusion**

The after tax proceeds from the two alternative dispositions can be calculated as follows:

**Sale of Shares Sale of Assets**

Proceeds $2,700,000 $2,813,890

Personal Income Tax ( 620,340) ( 866,582)

After Tax Retention $2,079,660 $1,947,308

The conclusion is very clear. The cash retained from the sale of shares is $132,352 ($2,079,660 - $1,947,308) greater than the cash retained from selling the assets and distributing the net proceeds. In addition, if Paulo could convert his Titano Ltd. shares to shares that qualify for the capital gains deduction, this result would be even more favourable to the sale of shares.

The full $2,813,890 could be left in the business for further operations as an investment company as Paulo travels the world. However, given the current rate of income tax on the investment income of a corporation, it is not likely that this would be an attractive alternative.

Type: ES

Topic: Purchase and sale of a business - comprehensive problem