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

**Chapter 14 Other Issues in Corporate Taxation**

14.1 Online Exercises

1) Why does the government believe that it is necessary to have rules related to the AOC of a corporation that has accumulated losses.

Answer: There are many companies that have accumulated losses that they have no hope of realizing. This situation is of concern to the government in that there are billions of dollars of such benefits available in the economy at any point in time. If access to these benefits was relatively trouble-free, the cost to the government in lost tax revenues could be enormous. As a consequence, the government has enacted legislation which significantly restricts the use of losses in situations where there has been an AOC.

Type: ES

Topic: Acquisition of control (AOC) - general concepts

2) How is an acquisition of control (AOC) defined? Describe a common event that would result in an AOC.

Answer: Control requires ownership of shares that carry with them the ability or right to elect a majority of the members of the board of directors. An AOC occurs when some event results in a taxpayer (or group) who did not have control of the corporation acquires that control. A common event of this type would be a majority shareholder selling all of their shares to an unrelated person.

Type: ES

Topic: Acquisition of control (AOC) - general concepts

3) ITA 249(4) requires that, when there is an acquisition of control (AOC), the acquired corporation will have a deemed taxation year end on the day preceding the AOC. What is the objective of this requirement?

Answer: As the use of losses will be restricted after the AOC, this rule prevents losses from being used prior to the normal end of the taxation year in which the AOC took place. In addition the AOC rules deem a taxation year end to measure the extent of unrealized losses prior to the AOC. It is these losses that are then subject to the restrictions imposed by the AOC rules.

Type: ES

Topic: Acquisition of control (AOC) - general concepts

4) Briefly describe the basic income tax consequences that result from an acquisition of control (AOC).

Answer: The basic income tax consequences of an AOC are as follows:

• There is a deemed taxation year end at the time the AOC occurs.

• There are special rules requiring the recognition of unrealized losses on certain property by deeming dispositions at FMV at the deemed taxation year end.

• With respect to non-capital losses, they can only be used in years subsequent to the AOC to offset income from the same or similar business. There are similar restrictions on the use of pre-AOC investment tax credits. In addition it is only the portion of a non-capital loss represented by a business loss that may be used in taxation years subsequent to an AOC. The part of a non-capital loss that relates to property losses or ABILs is treated identically to net capital losses.

• With respect to net capital losses, they cannot be carried forward to years subsequent to the AOC. In addition, if there are capital gains in the three years before the deemed taxation year end, net capital losses from years subsequent to the deemed taxation year end cannot be carried back to those earlier taxation years.

• Unused charitable deductions cannot be carried forward to years subsequent to an AOC. In addition, no deduction is available on a gift made subsequent to the AOC if the gifted property was acquired prior to the acquisition date in anticipation of the AOC.

Type: ES

Topic: Acquisition of control - basic rules

5) When control of a corporation is acquired, ITA 111(4)(e) permits the acquired corporation to elect to have a deemed disposition of any of its capital properties on which there is either unrealized recapture of CCA and/or unrealized capital gains. Under what circumstances would you advise a client to make this election? Briefly explain your conclusion.

Answer: The ITA 111(4)(e) election is clearly desirable when there are:

• charitable donation carryovers,

• net capital losses;

•allowable capital losses in the current year; or

• allowable business investment losses in the current year.

If these items are not used in the taxation year created by the deemed taxation year end, they cannot be claimed in subsequent taxation years.

With respect to non-capital losses from previous or current years, the desirability of the election will depend on whether the company believes they can be used in future years against profits in the same business during the relevant carry forward period.

Type: ES

Topic: Acquisition of control - basic rules

6) Why are the associated corporation rules necessary?

Answer: It is the intent of the government to limit the availability of the small business deduction (SBD) to an amount of active business income not exceeding $500,000. In the absence of special rules, the owner of a corporation with $1,000,000 in active business income could easily split that income among multiple controlled corporations and claim multiple SBDs. The associated company rules prevent this from happening by requiring that two or more corporations must share one $500,000 annual business limit.

Type: ES

Topic: Associated corporations - general concepts

7) What characteristics define "shares of a specified class" under the provisions governing associated corporations? What is a common designation for such shares?

Answer: Such shares generally have the following characteristics:

• An absence of voting rights.

• A fixed dividend rate.

• A specified redemption amount.

Such share attributes are commonly found in preferred or preference shares. that are the economic equivalent to debt.

Type: ES

Topic: Associated corporations - shares of a "specified class"

8) How is "group" defined by the associated corporations legislation?

Answer: ITA 256(1.2)(a) defines a group as simply two or more persons, each of whom owns shares in the corporation in question. This would include corporations, individuals, and trusts. There is no requirement that they be related or even know each other. This is in contrast to the meaning of a group which would require some connection between the members other than the simple ownership of shares.

Type: ES

Topic: Associated corporations - basic rules

9) There are multiple control concepts applied for purposes of the associated corporation rules. One of the deemed other control concepts relates to the ownership of shares. What is required in terms of share ownership to be considered to control a corporation?

Answer: For purposes of applying the associated company rules, the extended share ownership control concept is defined as follows:

**Control -** A corporation is deemed to be controlled by another corporation, a person, or a group of persons, if the corporation, person, or group of persons owns either:

• shares (common and/or preferred) of capital stock with an FMV of more than 50% of all issued and outstanding shares of capital stock; or

• common shares with a FMV of more than 50% of all issued and outstanding common shares.

Type: ES

Topic: Associated corporations - control

10) For purposes of applying the associated company rules, there is a deeming rule with respect to the holding of option rights to acquire shares. Briefly describe this rule.

Answer: This deeming provision requires that rights to acquire shares be treated as though they were exercised for purposes of determining control for associated corporation purposes.

Type: ES

Topic: Associated corporations - basic rules

11) If the government wanted to provide additional tax benefits, how would they choose between using a general rate reduction (GRR) and, alternatively, one or more investment tax credits?

Answer: Investment tax credits can limit their benefits to very specific types of activity or specific geographical regions of Canada. For example, an investment tax credit is available on purchases of qualified property in the Atlantic provinces. In contrast, GRRs are usually available to all corporate taxpayers in all parts of Canada, without regard to the type of property they acquire or the region of Canada in which property is acquired. Choosing between these two types of tax benefits would be based on whether the government wished to achieve a specific objective (e.g., assistance to business in the Atlantic provinces) or, alternatively, provide general tax relief to corporations.

Type: ES

Topic: Investment tax credits - general concepts

12) In general, investment tax credits require a taxpayer to exchange a given amount of tax deductions for the same amount of tax credits. Explain why this is favourable to the taxpayer.

Answer: It is favourable because the deduction that is being given up has a value equal to the amount of the deduction multiplied by the taxpayer's income tax rate. For example, if a corporation with a tax rate of 25% gives up a $1,000 deduction, the cost is only $250 [($1,000)(25%)]. In contrast, the credit is a direct reduction in income tax payable. A $1,000 credit would be worth $1,000, regardless of the corporation's income tax rate.

Type: ES

Topic: Investment tax credits - general concepts

13) Indicate the types of taxpayers that are eligible for refundable investment tax credits.

Answer: The following types of taxpayers are eligible for refundable investment tax credits:

• an individual;

• a "qualifying corporation", which is a CCPC throughout the year with taxable income in the previous taxation year of $500,000 or less before loss carry backs; or

• a trust where each beneficiary is an individual or a qualifying corporation.

Type: ES

Topic: Investment tax credits - refundable ITCs (ITA 127.1)

14) When a business receives an investment tax credit as the result of the purchase of depreciable property, how does this affect the amount of CCA that can be claimed in the current and subsequent taxation years?

Answer: Investment tax credits (ITC) are deducted from the capital cost of depreciable property in the taxation year following receipt. This means that there will no effect on CCA in the year the ITC is received. In subsequent years, the capital cost will be reduced by the amount of the credit, thereby reducing CCA in those subsequent taxation years.

Type: ES

Topic: Investment tax credits - basic rules

15) The Paid Up Capital (PUC) per shares will often be different than the ACB of the share. Briefly explain how such differences can occur.

Answer: Per share PUC is based on the total amount of consideration received by a corporation for issuing its shares, divided by the total number of shares issued and outstanding on a class by class basis.

Per share ACB, in contrast, is shareholder specific. It is based on the average amount paid for shares of a particular class of a corporation by that investor. If all of the shares of a corporation are issued to a single individual at a point in time, the PUC and ACB would be the same for all shares.

While this might be the situation for a private company (e.g., a CCPC issues all of its shares to a single individual and this individual has retained these shares from the date of incorporation), it would be very unusual for a large public company. While the PUC for all shares of a particular class will be the same, each open market purchase will create a new and unique ACB for that individual's shares. It would be very rare for this new ACB to be equal to the PUC of those shares.

Type: ES

Topic: PUC (paid-up capital) & ACB (adjusted cost base)

16) What is the basic purpose of the capital dividend account (CDA)?

Answer: It is the intent of the government to allow certain types of income to be received on a tax free basis by most taxpayers. While there are other types of income that fall into this category, the most important example of this type of income is the non-taxable one-half of capital gains. When such amounts are earned by a private corporation, a special mechanism is required to allow the corporation to distribute the funds that represent the tax free portion to its shareholders without losing that tax free status. The capital dividend account (CDA) is that mechanism. Eligible income amounts, such as one-half of capital gains and one-half of capital losses realized by the corporation, are added to or subtracted from the CDA. To the extent there is a balance in this account, the corporation can elect to distribute such amounts to shareholders as a tax free capital dividend.

Type: ES

Topic: Capital dividend account (CDA) - basic rules

17) What is a stock dividend? What are the income tax consequences for an individual receiving such dividends, as well as for the corporation declaring and paying the dividend?

Answer: A stock dividend is a pro rata distribution of shares to existing shareholders of a corporation. For the corporation, this will generally involve an increase in the PUC of the company's shares to the extent of the FMV of the new shares issued. To the extent that the company has increased the PUC of its shares, such dividends will be treated as dividends to the recipients. For individuals, stock dividends will be subject to either the eligible or non-eligible dividend gross up and tax credit procedures. Stock dividends can also be elected as capital dividends.

Type: ES

Topic: Dividends - stock dividends

18) Corporations sometimes issue shares as payment on existing debt. In some cases, the value of the shares issued will exceed the reduction in the debt. Describe the income tax consequences that result from such a transaction.

Answer: This type of transaction generates an increase in PUC that is larger than the related increase in net assets. Because PUC represents an amount that can be distributed to shareholders on a tax free basis, an economic advantage results from this type of transaction. This benefit is treated as a deemed dividend under ITA 84(1). As PUC amounts are averaged over all shares of a class, the deemed dividend is allocated to all of the company's shareholders of that class, not just to creditors or lenders receiving shares as settlement of debt. The ACB of all of the shares however is increased by the deemed dividend amount.

Type: ES

Topic: Dividends - ITA 84(1) deemed dividend

19) When there is a dissolution of a Canadian corporation, the shareholders will often receive a distribution with respect to the disposition of their shares typically by way of cancellation. What are the income tax consequences of receiving such a distribution?

Answer: To the extent of the PUC of the shares, the distribution will be received tax free. However, the excess of the amount of the distribution over the PUC of the shares will be treated as a deemed dividend. This deemed dividend is further subdivided as follows:

• To the extent that the corporation has a balance in its capital dividend account, part of the distribution will be considered a separate capital dividend, which will be received on a tax free basis under ITA 83(2). This treatment will only apply if an appropriate election is made.

• To the extent that the company has a pre-1972 capital surplus on hand account, the balance will be deemed not to be a dividend.

• Any remaining amount of the deemed dividend will be treated as a taxable dividend under ITA 84(2), subject to either the eligible or non-eligible dividend gross up and tax credit procedures.

Type: ES

Topic: Dividends - ITA 84(2) deemed dividend

20) A redemption of shares may result in an ITA 84(3) deemed dividend. As the redemption is also a disposition, there may also be a capital gain or capital loss. Explain the mechanics of a share redemption.

Answer: There are two steps in the process, The first requires that the amount received (POD) be reduced by the PUC of the redeemed shares. The result is a deemed dividend. The second step requires that the POD be adjusted and reduced by the deemed dividend to obtain an adjusted or modified POD. That POD is then used to calculate a capital gain or capital loss by taking that POD and subtracting the ACB of the shares (and selling costs if any). This methodology ensures that the deemed dividend and either capital gain or capital loss do not result in a double count.

Type: ES

Topic: Dividends - ITA 84(3) deemed dividend on redemptions of shares

21) When there is an acquisition of control, any non-depreciable property with an ACB in excess of its FMV is deemed to have been disposed of at that FMV to recognize the unrealized loss.

Answer: TRUE

Type: TF

Topic: Acquisition of control (AOC) - general concepts

22) When a deemed taxation year end is required as the result of an acquisition of control, this event will always be followed by a short taxation year.

Answer: FALSE

Explanation: The corporation is permitted to elect a new taxation year end after an acquisition of control. This could provide for a full 365 day taxation year.

Type: TF

Topic: Acquisition of control (AOC) - general concepts

23) If a corporation elects to have a deemed disposition of a non-depreciable capital property whose FMV is greater than its ACB prior to an acquisition of control, the elected amount can be any amount between the ACB and the FMV of that property.

Answer: TRUE

Type: TF

Topic: Acquisition of control (AOC) - general concepts

24) Any net capital loss balances that remain after an acquisition of control cannot be used in taxation years subsequent to the acquisition of control.

Answer: TRUE

Explanation: Unused net capital losses cannot be used in taxation years subsequent to the deemed taxation year end that occurred as a result of the acquisition of control.

Type: TF

Topic: Acquisition of control (AOC) - general concepts

25) For purposes of determining associated corporations, a group is any two or more related persons who own shares in a corporation.

Answer: FALSE

Explanation: A group is any two or more persons who hold shares in a corporation. They do not have to be related.

Type: TF

Topic: Associated corporations - general concepts

26) For purposes of determining associated companies, a parent is deemed to own any of a corporation's shares that are owned by any of the individual's children who are under the age of 18.

Answer: TRUE

Type: TF

Topic: Associated corporations - general concepts

27) When a business is entitled to an investment tax credit as a result of making a capital expenditure, the amount of the credit must be deducted from the UCC of the class in the taxation year in which the credit is received.

Answer: FALSE

Explanation: Credits related to capital expenditures will be deducted from the related UCC in the immediately following taxation year.

Type: TF

Topic: Investment tax credits - basic rules

28) Non-refundable investment tax credits that are not used during the current year can be carried back 3 years and forward for 20 years.

Answer: TRUE

Type: TF

Topic: Investment tax credits - basic rules

29) An individual investor's PUC per share will generally be changed if the corporation issues additional shares of that class, despite the fact that the ACB will not change.

Answer: TRUE

Type: TF

Topic: PUC (paid-up capital) & ACB (adjusted cost base)

30) A private corporation sells a depreciable property with a capital cost and ACB of $200,000 for $250,000. The UCC balance at the time was $1,200,000 and there were other properties in the Class. There will an addition to the capital dividend account of $50,000.

Answer: FALSE

Explanation: The addition would be $25,000 [(1/2)($250,000 - $200,000)].

Type: TF

Topic: Capital dividend account (CDA) - calculating the CDA

31) Because no payments are made with cash or property, stock dividends do not increase the net income of shareholders.

Answer: FALSE

Explanation: To the extent that there is an increase in PUC as the result of the dividend, there is an increase in net income. This increase is treated as a dividend.

Type: TF

Topic: Dividends - stock dividends

32) While dividends in kind are treated as a taxable dividend to the recipient shareholders, they have no income tax consequences for the corporation declaring and paying the dividend.

Answer: FALSE

Explanation: The payment of the dividend with corporate property is considered a disposition of that property for POD equal to the FMV of the property.

Type: TF

Topic: Dividends in kind - ITA 52(2)

33) When a corporation redeems all or part of its outstanding shares, the difference between the proceeds of redemption and the PUC of the shares will be treated as a capital gain for income tax purposes.

Answer: FALSE

Explanation: Under ITA 84(3), the difference will be treated as a deemed dividend.

Type: TF

Topic: Dividends - ITA 84(3) deemed dividend on redemptions of shares

34) Capital dividends that have been declared using the ITA 83(2) election are not subject to the usual gross up and tax credit procedures.

Answer: TRUE

Type: TF

Topic: Capital dividend account (CDA) - basic rules

35) Which of the following amounts items would **NOT** be lost if they existed prior to an acquisition of control?

A) Charitable donations carryovers.

B) Farm losses.

C) The part of a non-capital loss represented by an Allowable business investment loss.

D) Net capital losses.

Answer: B

Explanation: B) Farm losses. While they would not be lost, they could only be applied in future periods to the extent of farm income from the same or similar farming business.

Type: MC

Topic: Acquisition of control (AOC) - general concepts

36) Which of the following is **NOT** a consequence of an acquisition of control (AOC)?

A) A deemed taxation year end.

B) The complete inability to deduct existing non-capital losses subsequent to the AOC.

C) The complete inability to deduct existing net capital losses subsequent to the AOC.

D) A requirement to write down non-depreciable capital property to FMV to recognize unrealized losses.

Answer: B

Explanation: B) The inability to deduct non-capital losses subsequent to the AOC.

Type: MC

Topic: Acquisition of control (AOC) - general concepts

37) Which of the following statements with respect to an acquisition of control (AOC) is **NOT** correct?

A) Prior to the deemed taxation year end, non-depreciable capital property will have to be written down to FMV to recognize accrued but unrealized losses.

B) Net capital losses in taxation years after an AOC cannot be carried back to a taxation year prior to the AOC.

C) Subsequent to the deemed taxation year end, non-capital losses from taxation years before the AOC can be deducted against any type of income.

D) For to the deemed taxation year end, the acquired company can elect to have a deemed disposition of any of their capital properties with unrealized capital gains or recapture.

Answer: C

Explanation: C) Subsequent to the deemed taxation year end, non-capital losses from taxation years before the AOC can be deducted against any type of income.

Type: MC

Topic: Acquisition of control (AOC) - general concepts

38) Which of the following is **NOT** an implication of a deemed taxation year end on an acquisition of control (AOC) which creates a short taxation year?

A) The corporate tax rate must be prorated for the shortened taxation year.

B) CCA calculations must be based on a fraction of a year.

C) The annual business limit must be prorated.

D) The period during which time-limited losses can be used is shortened.

Answer: A

Explanation: A) The corporate tax rate must be prorated for the shortened taxation year.

Type: MC

Topic: Acquisition of control (AOC) - general concepts

39) Which of the following is **NOT** a restriction that applies to the use of non-capital losses after an acquisition of control (AOC)?

A) The corporation must continue to carry on the loss business.

B) There must be a reasonable expectation of profit in the loss business.

C) The losses cannot be applied in any short taxation years that occur as a result of the AOC.

D) The losses can only be applied against future income generated by the same or a similar business.

Answer: C

Explanation: C) The losses cannot be applied in any short taxation years that occur as a result of the AOC.

Type: MC

Topic: Acquisition of control (AOC) - general concepts

40) VanDeKamp Holdings operates two separate business — a catering business and a cookbook publishing business. During the taxation year that ended December 31, 2022, the company lost $300,000 from the catering business and earned a profit of $100,000 from the cookbook publishing business. The $200,000 non-capital loss could not be carried back, and as a result it was carried forward. On January 1, 2022, VanDeKamp Holdings is acquired by another company. During the 2022 taxation year, the catering business lost another $150,000 while the cookbook publishing business earned $350,000. What portion of the 2021 non-capital loss carry forward can be claimed in the 2022 taxation year?

A) None.

B) $100,000.

C) $150,000.

D) $200,000.

Answer: A

Explanation: A) None. Because the loss was generated from the operations of the catering business, which did not earn a profit in 2022.

B) $100,000. [The amount of the loss that is deductible against the cookbook business income]

C) $150,000. [The amount of the 2022 loss in the catering business]

D) $200,000 [Loss = $200,000; Taxable income = $350,000 - $150,000 = $200,000]

Type: MC

Topic: Acquisition of control - calculations

41) Solis Enterprises Inc. operates two separate business — a fashion design business and an investment business. During the taxation year that ended December 31, 2022, the company lost $3 million from the fashion design business and earned a profit of $1 million from the investment business. The $2 million non-capital loss could not be carried back, and as a result it was carried forward. On January 1, 2022, Solis Enterprises Inc. is acquired by another company. During the 2022 taxation year, the fashion design business lost $1.5 million while the investment business earned $4 million. What is the minimum taxable income for 2022?

A) Nil.

B) $500,000.

C) $2,500,000.

D) $4,000,000.

Answer: C

Explanation: A) $0

B) $500,000 [$4 million - $1.5 million - $2 million

C) $2,500,000 [$4 million - $1.5 million] None of the 2021 non-capital loss can be claimed in 2022 since it can only be applied against the profits of the loss business which was fashion design.

D) $4,000,000

Type: MC

Topic: Acquisition of control - calculations

42) Hagrid Inc. is subject to an acquisition of control (AOC) on January 1, 2023. The company has a business loss of $65,000 in its 2022 taxation year prior to the AOC, which cannot be carried back. On December 31, 2022, the company had two capital properties, land with an ACB of $150,000 and FMV of $65,000; and a depreciable property with a capital cost and ACB of $100,000, a UCC of $75,000 and a FMV of $200,000. Assuming Hagrid will continue in business and will return to profitability in 2023, what write downs and elections are available to Hagrid Inc. in order to optimize the amount of 2022 non-capital losses carried forward to the 2023 taxation year?

A) Hagrid Inc. should elect to recognize the allowable capital loss of $42,500 on the land at the end of 2022. A capital gain on the depreciable property would be realized equal to $50,000 and there would be recapture of $25,000.

B) Hagrid Inc. will be required to write the land down to its FMV and recognize the allowable capital loss of $42,500 at the end of 2022. A deemed disposition of the depreciable property should be elected at a amount of $185,000, resulting in recapture of $25,000 and a taxable capital gain of $42,500.

C) Hagrid Inc. will be required to write the land down to its FMV and recognize the allowable capital loss of $42,500 at the end of 2022. No elections are available to the company.

D) Hagrid Inc. should elect to recognize the allowable capital loss of $42,500 on the land at the end of 2022. A deemed disposition of the depreciable property should be elected at an amount of $100,000, resulting in recapture of $25,000.

Answer: B

Explanation: B) Hagrid Inc. will be required to write the land down to its FMV and recognize the allowable capital loss of $42,500 at the end of 2022. A deemed disposition of the depreciable property should be elected at a amount of $185,000, resulting in recapture of $25,000 and a taxable capital gain of $42,500.

Type: MC

Topic: Acquisition of control - calculations

43) When there is an acquisition of control (AOC) of a corporation, which of the following is correct?

A) A capital loss arising prior to the AOC may be applied against capital gains realized by the business that incurred the capital loss on property owned prior to the AOC.

B) Any capital losses that arise subsequent to the AOC will be lost.

C) Non-capital losses arising prior to the AOC may, after the AOC, be applied against income earned by the loss business that incurred the loss as long as the loss has not expired and the loss business continues to be carried on has a reasonable expectation of making a profit.

D) Non-capital losses and net capital losses arising prior to the AOC will be lost.

Answer: C

Explanation: C) Non-capital losses arising prior to the AOC may, after the AOC, be applied against income earned by the loss business that incurred the loss as long as the loss has not expired and the loss business continues to be carried on has a reasonable expectation of making a profit.

Type: MC

Topic: Acquisition of control - basic rules

44) John Dough owns 100% of the shares of Doughboy Ltd. His spouse, Kneada Dough, owns 100% of the shares of Yeast Ltd. and 100% of the shares of Flour Inc. Which of the following statements is correct?

A) Doughboy and Yeast are associated.

B) Flour and Yeast are associated.

C) Doughboy and Flour are associated.

D) Doughboy is associated with both Yeast and Flour.

Answer: B

Explanation: B) Flour and Yeast are associated.

Type: MC

Topic: Associated corporations - analysis (applying the rules)

45) Mr. Hanes owns 100% of the common shares of Jimbo Corp. and 40% of the common shares of Hughes Corp. Hughes Corp. owns 80% of the common shares of ARC Ltd. Mr. Hanes' daughter-in-law also owns 5% of the common shares of Hughes Corp., and 15% of the common shares of ARC Ltd. The remaining shares are held by unrelated persons. The following Companies are associated:

A) Only Jimbo and Hughes are associated.

B) Only Jimbo and ARC are associated

C) Hughes and ARC are associated, and Jimbo and ARC are associated.

D) Only Hughes and ARC are associated.

E) None of Jimbo Corp., Hughes Corp., and ARC Ltd. are associated.

Answer: C

Explanation: C) Hughes and ARC are associated, and Jimbo and ARC are associated. Hughes and ARC are associated under ITA 256(1)(a). Hughes controls ARC.

Jimbo and ARC - Mr. Hanes is deemed to own 32% [(40%)(80%)] of ARC and his daughter-in-law is deemed to own 4% [(5%)(80%)] of ARC by the look through rules in ITA 256(1.2)(d). When added to the 15% that the daughter-in-law owns outright, a related group owns 51% (32% + 4% + 15%) of ARC. The corporations are associated by ITA 256(1)(d) since Mr. Hanes controls Jimbo, a related group controls ARC, and Mr. Hanes is deemed to own greater than 25% of ARC.

Type: MC

Topic: Associated corporations - analysis (applying the rules)

46) In which of the following situations are A Ltd. and B Ltd. associated?

A) Mrs. Jax owns 60% of A Ltd. and Mrs. Jax's niece owns 80% of B Ltd. Mrs. Jax's husband owns the other 40% of A Ltd. and 20% of B Ltd.

B) Mr. B. owns 60% of A Ltd. and 20% of B Ltd. Mrs. B,Mr. B's spouse, owns the remaining 40% of A Ltd. The remaining 80% of B Ltd. is owned equally by Mr. D and Mrs. D, who are not related to Mr. B and Mrs. B.

C) Amos Dans owns 35% of each of A Ltd. and B Ltd. Amos Dan's brother owns an additional 20% of A Ltd. and 30% of B Ltd. The remaining 45% of A Ltd. and 35% of B Ltd. are owned by XYZ Ltd. and JBC Ltd., respectively. XYZ Ltd. and JBC Ltd. are not associated corporations.

D) Young Ltd. owns 55% of B Ltd. and 40% of A Ltd. Boyle Holdings Ltd. owns the remaining 45% of B Ltd., and Kula Holdings Ltd. owns the remaining 60% of A Ltd. Kula Holdings Ltd. and Boyle Holdings Ltd. are owned by L. Kula and A. Boyle, respectively, who are not related.

Answer: C

Explanation: C) A Ltd. and B Ltd. are associated under ITA 256(1)(b) as they are controlled by the same group (Amos and his brother). The fact that they are related is not relevant.

Type: MC

Topic: Associated corporations - analysis (applying the rules)

47) Simon Williams owns 100% of Wonder Technologies Inc. Peter Maximoff owns 100% of Speedy Delivery Service Ltd. Simon and Peter each own 50% of Scarlet Decorating Ltd. Simon is married to Peter's sister, Wanda. Assuming each of the three corporations is a CCPC and has at least $500,000 of active business income earned in Canada, what is the maximum combined corporate income on which the three corporations can claim the small business deduction?

A) Nil.

B) $ 500,000.

C) $1,000,000.

D) $1,500,000.

Answer: C

Explanation: C) Wonder and Speedy are associated in that they are both associated with Scarlet as a result of ITA 256(1)(d). They would normally share the $500,000 small business limit. However, since they are associated solely by virtue of their mutual association with the third corporation, the third corporation can elect not to be associated with them. With this election, the two corporations are eligible for the full $500,000 small business deduction, for a total of $1,000,000. As a consequence of making this election, Scarlet is deemed to have an annual business limit of nil.

Type: MC

Topic: Associated corporations - analysis (applying the rules)

48) Which of the following situations does **NOT** describe two associated corporations?

A) K Corp. owns 51% of the shares of L Corp. The remainder of the shares are owned by a party unrelated to K Corp.

B) Mr. and Mrs. G each own 50% of the shares of W Corp. Their adult children, Girl F and Boy F, each own 40% of V Corp. Mrs. G owns the remaining 20% of the V Corp. shares.

C) D Corp. is wholly owned by Mrs. X. Mr. X, the spouse of Mrs. X, owns 65% of the shares of E Corp. Mrs. X owns the remaining 35% of the E Corp shares.

D) Boy M, an adult, owns 100% of the shares of Z Corp. Boy M, his mother and his father each own 30% of the shares of Y Corp. The remaining shares of Y Corp. are owned by Boy M's girlfriend.

Answer: B

Explanation: B) Mr. and Mrs. G each own 50% of the shares of W Corp. Their adult children, Girl F and Boy F, each own 40% of V Corp. Mrs. G owns the remaining 20% of the shares.

Type: MC

Topic: Associated corporations - analysis (applying the rules)

49) Low Tech Inc. is a CCPC with 2022 SR&ED expenditures of $685,000. In 2021, the Company's Taxable Capital Employed in Canada (TCEC) was $7 million. Determine their total investment tax credit for 2022 and indicate the amount that would be refundable.

A) The total credit would be $239,750. The refundable amount would be $239,750.

B) The total credit would be $239,750. The refundable amount would be $102,750.

C) The total credit would be $102,750. The refundable amount would be $102,750.

D) The total credit would be $102,750. The refundable amount would be $41,100.

Answer: A

Explanation: A) The total credit would be $239,750 [($685,000)((35%)]. The refundable amount would be $239,750.

Type: MC

Topic: Investment tax credits - calculating the credits

50) Miracle Works Inc. is located in Newfoundland. The company hires 3 eligible apprentices, paying each of them $30,000 in the current taxation year. It also acquires $2,000,000 in qualified depreciable property. What are the income tax consequences of these transactions in the current year?

A) The company will be entitled to investment tax credits of $206,000. CCA for the current year will be based on the addition of $2,000,000 to the CCA class of the qualified property.

B) The company will be entitled to investment tax credits of $6,000. CCA for the current year will be based on the addition of $2,000,000 to the CCA class of the qualified property.

C) The company will be entitled to investment tax credits of $206,000. CCA for the current year will be based on the addition of $1,800,000 to the CCA class of the qualified property.

D) The company will be entitled to investment tax credits of $209,000. CCA for the current year will be based on the addition of $2,000,000 to the CCA class of the qualified property.

Answer: A

Explanation: A) The company will be entitled to investment tax credits of $206,000. ITC = [10%][(3)($20,000) + ($2,000,000)]. CCA will be based on additions to qualified property of $2,000,000. The ITC will reduce the UCC in the following taxation year.

B) The company will receive investment tax credits of $6,000. CCA will be based on additions to qualified property of $2,000,000. [ITC = (3)($20,000)(10%)]

C) The company will receive investment tax credits of $206,000. CCA will be based on additions t o qualified property of $1,800,000. IT C = [10%][(3)($20,000) + ($2,000,000)] [addition to CCA = $2,000,000 — ($2,000,000)(10%)]

D) The company will receive investment tax credits of $209,000. CCA will be based on additions to qualified property of $2,000,000. [IT C = (3)($30,000)(10%) + ($2,000,000)(10%)]

Type: MC

Topic: Investment tax credits - calculating the credits

51) Mira Glow Ltd. is a CCPC. In 2021, the company had Taxable Capital Employed in Canada (TCEC) of $14,000,000 and in 2022 the TCEC is $15,000,000. What is the annual SR&ED expenditure limit for Mira Glow Ltd. for its 2022 taxation year?

A) $ 3,000,000

B) $ 2,700,000

C) $ 1,950,000

D) $ 300,000

Answer: B

Explanation: A) $3,000,000 × [($40,000,000 - Nil) ÷ $40,000,000]

B) $3,000,000 × [($40,000,000 - $4,000,000) ÷ $40,000,000]

C) $3,000,000 × [($40,000,000 - $14,000,000) ÷ $40,000,000]

D) $3,000,000 × [($40,000,000 - $36,000,000) ÷ $40,000,000]

Type: MC

Topic: Investment tax credits - the expenditure limit (ITA 127(10.1) & (10.2))

52) Tardex Inc. has only one class of shares. At the end of its 2022 taxation year, the company had 30,000 shares outstanding. The shares had been sold in 3 blocks of 10,000 each. The first block was issued for $8 per share, the second at $9 per share, and the third at $11 per share. Mark Forest purchased 200 shares of the first block and an additional 300 shares of the second block. The total PUC of Mark's shares is equal to:

A) $4,300.

B) $4,665.

C) $4,250.

D) $5,500.

Answer: B

Explanation: A) $4,300 [(200)($8) + (300)($9)]

B) $4,665

PUC Per Share = $9.33 {[(10,000)($8) + (10,000)($9) + (10,000)($11)] ÷ 30,000] Mark's PUC = $4,665 [(500)($9.33)]

C) {[[(10,000)($8) + (10,000)($9)] ÷ 20,000] = $8.50; [($8.50)(500)] = $4,250

D) $5,500 [(500)($11)]

Type: MC

Topic: PUC (paid-up capital) - calculating PUC

53) Torin Inc. has 500,000 shares issued and outstanding. These shares were issued for $1,125,000. At a later point in time, Jane Dow acquired 1,000 of these shares at a total cost of $3,500. With respect to the share owned by Ms. Dow's, which of the following statements is **NOT** correct?

A) The PUC of Ms. Dow's shares is $2,250.

B) The ACB of Ms. Dow's shares is $3,500.

C) If she were to sell the Torin shares for $4,000, she would have a taxable capital gain of $250.

D) If she were to sell the Torin shares for $4,000, she would have a deemed dividend of $500.

Answer: D

Explanation: D) If she were to sell the Torin shares for $4,000, she would have a deemed dividend of $500.

Type: MC

Topic: PUC (paid-up capital) & ACB (adjusted cost base)

54) Which of the following items would **NOT** be added to the capital dividend account of a private company?

A) Life insurance proceeds received.

B) Taxable dividends received from other taxable Canadian corporations.

C) Capital dividends received from other corporations.

D) The non-taxable portion of capital gains.

Answer: B

Explanation: B) Taxable dividends received from other taxable Canadian corporations.

Type: MC

Topic: Capital dividend account (CDA) - basic rules

55) Gains Inc. had a balance in its capital dividend account (CDA) of $150,000 at January 1, 2022. During the 2022 taxation year, the company had taxable capital gains of $50,000, allowable capital losses of $30,000, received a capital dividend of $35,000 from a subsidiary, and paid eligible dividends of $45,000. On November 15, 2022, a capital dividend of $32,000 was paid, and the appropriate election was filed. What is the balance in the CDA at November 16, 2022?

A) $128,000

B) $138,000

C) $173,000

D) $203,000

Answer: C

Explanation: A) $128,000 [$150,000 + $50,000 - $30,000 + $35,000 - $32,000 - $45,000]

B) $138,000 [$150,000 + $50,000 -$30,000 - $32,000]

C) $173,000 [$150,000 + $50,000 - $30,000 + $35,000 - $32,000]

D) $203,000 [$150,000 + $50,000 + $35,000 - $32,000]

Type: MC

Topic: Capital dividend account (CDA) - calculating the CDA

56) Which of the following is **NOT** a component of retained earnings for a CCPC from an income tax perspective?

A) Post-1971 Undistributed Surplus

B) Pre-1972 Capital Surplus on Hand

C) Capital Dividend Account

D) LRIP

Answer: D

Explanation: D) LRIP

Type: MC

Topic: PUC (paid-up capital) & ACB (adjusted cost base)

57) Which of the following statements with respect to stock dividends is correct?

A) Stock dividends that are taxable dividends are not subject to the usual gross up and tax credit procedures.

B) A stock dividend can never be designated as an eligible dividend.

C) A dividend will be included in income to the extent that the corporation has increased its PUC as a result of the dividend.

D) When an investor receives a stock dividend, it does not affect the ACB of the shares received.

Answer: C

Explanation: C) A dividend will be included in income to the extent that the corporation has increased its PUC as a result of the dividend.

Type: MC

Topic: Dividends - stock dividends

58) Vadel Inc., a Canadian public company, has 1,000,000 shares outstanding with a total PUC of $1,750,000. Mr. Vincent Dorval owns 5,000 of these shares with an ACB of $11,250. Vadel Inc. declares a 5% non-eligible stock dividend at a time when its shares are trading at $2.50 per share. Which of the following statements is correct?

A) Mr. Dorval's net income will increase by $719 as a result of the dividend.

B) After the dividend, the ACB of Mr. Dorval's shares will be $11,875.

C) After the dividend, the PUC of Vadel's shares will be $1,875,000.

D) All of the above.

E) None of the above.

Answer: D

Explanation: D) All of the above.

A = [(5%)(5,000)($2.50)(115%) = $718.75

Type: MC

Topic: Dividends - stock dividends

59) With respect to dividends in kind, which of the following statements is correct?

A) A dividend in kind that is a taxable dividend is not subject to the usual gross up and tax credit procedures.

B) A dividend in kind will not affect the income of the corporation that pays the dividend.

C) A dividend in kind can result in a capital gain for the corporation that pays the dividend.

D) A dividend in kind can never be designated as an eligible dividend.

Answer: C

Explanation: C) A dividend in kind can result in a capital gain for the corporation that pays the dividend.

Type: MC

Topic: Dividends in kind - ITA 52(2)

60) Mark is the only shareholder of Sico Ltd., a CCPC with a GRIP account balance of nil. In 2022, Sico paid a taxable dividend in kind by distributing investments with a FMV of $72,000 and an ACB of $56,000. Which of the following statements properly reflects the income tax consequences of this transaction?

A) Sico has income of $8,000 and Mark has income of $72,000.

B) Sico has income of $8,000 and Mark has income of $82,800.

C) Sico has income of nil and Mark has income of $72,000.

D) Sico has income of $16,000 and Mark has income of $82,800.

Answer: B

Explanation: B) Sico has income of $8,000 and Mark has income of $82,800.

Type: MC

Topic: Dividends in kind - ITA 52(2)

61) Scranton Inc. is a CCPC with a nil GRIP balance. It has 100,000 shares outstanding, all of which were issued for $8.00 per share. Nellie Ward owns 10,000 of these shares which she acquired at a cost of $7.00 per share. In 2022, the company redeems Nellie's shares at a price of $10.00 per share. Which of the following amounts will be included in Nellie's 2022 net income as a result of the redemption?

A) $25,000.

B) $33,000.

C) $30,000.

D) $28,000.

Answer: D

Explanation: D) $28,000 ($23,000 + $5,000)

Proceeds of Redemption [(10,000)($10.00)] $100,000

PUC [(10,000)($8.00)] ( 80,000)

ITA 84(3) Deemed Dividend $ 20,000

Gross Up [(15%)($20,000)] 3,000

Taxable Dividend $ 23,000

POD [(10,000)($10.00)] $100,000

Less: ITA 84(3) Deemed Dividend ( 20,000)

Modified POD $80,000

ACB [(10,000)($7.00)] ( 70,000)

Capital Gain $ 10,000

Inclusion Rate 1/2

Taxable Capital Gain $ 5,000

Type: MC

Topic: Dividends - ITA 84(3) deemed dividend on redemptions of shares

62) Which of the following transactions will **NOT** result in a deemed dividend?

A) Paying off $500,000 in debt by issuing shares with a FMV of $525,000.

B) Redeeming shares for $350,000. The PUC of the shares was $350,000 and the ACB $250,000.

C) A liquidating dividend is paid to shareholders in the amount of $400,000. At this time, PUC is reduced by $300,000.

D) A total of $1,000,000 was paid to shareholders as part of a winding-up. The PUC of the shares was $200,000 and there was no CDA balance.

Answer: B

Explanation: B) Redeeming shares for $350,000. The PUC of the shares was $350,000 and the ACB $250,000. There is no deemed dividend as the proceeds are equal to the PUC.

Type: MC

Topic: Dividends - deemed dividends general concepts

63) Aris Ltd. has 2,000,000 shares outstanding with a total PUC of $30,000,000. The Company is a CCPC and has no balance in its GRIP account. John Aris owns 10% of the shares. They were acquired at a total cost of $2,250,000. During the current year, John's shares were redeemed by the corporation for $3,500,000. Which of the following amounts must be included in John's income as a result of this redemption?

A) $1,250,000

B) $ 950,000

C) $1,325,000

D) $ 875,000

Answer: B

Explanation: B) $950,000 ($575,000 + $375,000). These amounts would be calculated as follows:

Proceeds of Redemption $3,500,000

PUC [(10%)($30,000,000)] ( 3,000,000)

ITA 84(3) Deemed Dividend $ 500,000

Gross Up [(15%)($500,000)] 75,000

Taxable Dividend $ 575,000

POD $3,500,000

Less: ITA 84(3) Deemed Dividend ( 500,000)

Modified POD $3,000,000

ACB ( 2,250,000)

Capital Gain $ 750,000

Inclusion Rate 1/2

Taxable Capital Gain $ 375,000

Type: MC

Topic: Dividends - ITA 84(3) deemed dividend on redemptions of shares

64) Which of the following transactions that involve an increase in PUC will result in an ITA 84(1) deemed dividend?

A) A stock dividend is declared that increases PUC in excess of the increase in net assets.

B) The PUC of one class of shares is increased, and the PUC of another class is decreased by an equivalent amount.

C) A corporation issues shares to a creditor in order to settle debt where the amount owing is less than the PUC of the newly issued shares.

D) When consideration received for shares issued is equal to the amount added to PUC.

Answer: C

Explanation: C) A corporation issues shares to a creditor in order to settle debt where the amount owing is less than the PUC of the newly issued shares.

Type: MC

Topic: Dividends - ITA 84(1) deemed dividend

65) What are the income tax consequences associated with a corporation issuing shares to a creditor in order to retire a debt where the amount owing is less than the PUC of the shares issued to retire that debt?

A) There will be a reduction in PUC and ACB for all the shares that were outstanding prior to the debt retirement transaction.

B) There will be a deemed dividend which will be allocated to all shareholders including the new shareholder who accepted shares as full payment for the debt. The ACB of the shares will increase by the amount of the deemed dividend.

C) There will be a deemed dividend allocated to the new shareholder who accepted shares as full payment for the debt. The ACB of the shares will increase by the amount of the deemed dividend.

D) There will be a deemed dividend allocated to all shareholders including the new shareholder who accepted shares as full payment for the debt. The ACB of the shares will not be affected.

Answer: B

Explanation: B) There will be a deemed dividend which will be allocated to all shareholders including the new shareholder who accepted shares as full payment for the debt. The ACB of the shares will increase by the amount of the deemed dividend.

Type: MC

Topic: Dividends - ITA 84(1) deemed dividend

66) At the beginning of the current year, Brou Inc. sells all of its assets and pays its liabilities. Afterwards, the company has $350,000 in cash which is distributed to the sole shareholder, Mr. Daniel. Mr. Daniel purchased the shares from the former shareholder for $50,000. The PUC of the shares is $10,000. The CDA balance is $65,000, and the company makes all appropriate elections with respect to this balance. What is the amount of the deemed dividend to Mr. Daniel?

A) $ 65,000.

B) $ 275,000.

C) $ 300,000.

D) $ 340,000.

Answer: D

Explanation: A) $ 65,000. [ the amount of the capital dividend]

B) $ 275,000. [$340,000 - $65,000]

C) $ 300,000. [$350,000 - $50,000]

D) $ 340,000. [$350,000 - $10,000]

Type: MC

Topic: Dividends - ITA 84(2) deemed dividend

67) At the beginning of the current year, Shahbaz Inc., a CCPC, has shares with a PUC of $4,000,000, and a CDA balance of $300,000. The company was incorporated by Mr. Sheikh, who made a $4,000,000 investment in the common shares. During the current year, the company has disposed of a major division, and it will distribute $1,000,000 to its sole shareholder, Mr. Sheikh. The company will reduce the PUC by $600,000 in order to minimize the income tax consequences to Mr. Sheikh. What is the ACB of Mr. Sheikh's shares after this transaction is completed?

A) $3,000,000.

B) $3,400,000.

C) $3,600,000.

D) $4,000,000.

Answer: B

Explanation: A) $3,000,000 [$4,000,000 - $1,000,000]

B) $3,400,000. [Deemed dividend = $1,000,000 - $600,000 = $400,000. ACB will be reduced by $600,000 from $4,000,000 to $3,400,000]

C) $3,600,000 [$4,000,000 - $400,000]

D) $4,000,000 [ No change]

Type: MC

Topic: Dividends - ITA 84(2) deemed dividend

68) SSS Corp agrees to accept as full payment, a special class of common shares with a PUC of $100,000 from TTT Ltd. in exchange for a debt owing to SSS Corp in the amount of $90,000. SSS Corp will be the only shareholder of this special class of shares. What are the income tax consequences of this exchange?

A) SSS Corp. will be deemed to have received a dividend of $10,000.

B) Other shareholders of TTT Corp will be deemed to have received a dividend of $10,000.

C) SSS Corp will have realized a capital gain of $10,000.

D) There will be no immediate tax consequences.

Answer: A

Explanation: A) SSS Corp. will be deemed to have received a dividend of $10,000.

Type: MC

Topic: Dividends - ITA 84(1) deemed dividend

69) Lead Services Ltd. carries on two separate businesses, one of which sells drafting pencils, the other provides professional engineering services. In its first year of operations ending December 31, 2021, the engineering services business had a loss of $104,000, and the pencil business had income of $24,600, resulting in 2021 net and taxable income of nil and a 2021 non-capital loss of $79,400.

For the taxation year ending December 31, 2022, the engineering services business had income of $21,250 and the pencil business had income of $133,400, resulting in a 2022 net income $154,650. The Company has no taxable income deductions other than the 2021 non-capital loss. Determine the minimum taxable income for each of the 2021 and 2022 taxation years, and any 2021 non-capital loss balance available assuming that there was no acquisition of control (AOC) in either taxation year. How would your answer be different if there was an AOC on January 1, 2022?

Answer: For the 2021 taxation year, net and taxable income would be nil, without regard to whether there was an AOC. There would also be a 2021 non-capital loss of $79,400 ($104,000 - $24,600).

**No AOC -** If there was no AOC, the entire $79,400 of the 2021 non-capital loss could be deducted in the 2022 taxation year. For the year ending December 31, 2022, taxable income would be:

2022 Net Income ($133,400 + $21,250) $154,650

Less: 2021 Non-capital loss ( 79,400)

2022 Taxable Income $75,250

**AOC -** There would be a deemed taxation year end on December 31, 2021, the day before the AOC. However, as this matches the normal taxation year end, there would be no income tax consequences with respect to a short taxation year. In the 2022 taxation year, the 2021 non-capital loss could only be used to the extent of the profits in the loss business from engineering services. 2022 taxable income would be:

2022 Net Income $154,650

Less: 2021 Non-capital loss (Limited to $21,250) ( 21,250)

2022 Taxable Income $133,400

This would leave a 2021 non-capital loss balance of $58,150 ($79,400 - $21,250).

Type: ES

Topic: Acquisition of control - calculations

70) Ambee Ltd. commenced business in 2021, and has two separate businesses. They are a mail order business selling organic food products, and an accounting services business. The income (loss) of the two businesses for the 2021 and 2022 taxation years are:

**Mail Order Accounting**

**Business Business**

2021 ($146,000) $ 43,000

2022 56,000 85,000

The Company has no taxable income deductions other than a 2021 non-capital loss.

Determine the minimum taxable income for each of 2021 and 2022, and any non-capital loss carryover balance assuming that there was no AOC in either year. How would your answer change if there was an AOC on January 1, 2022?

Answer: For the 2021 taxation year both net and taxable income are nil, without regard to whether there was an AOC. In 2021 there is a non-capital loss of $103,000 ($146,000 - $43,000).

**No AOC -** If there was no AOC, the 2021 non-capital loss could be deducted in full. For the 2022 taxation year, taxable income would be:

2022 Net Income ($56,000 + $85,000) $141,000

Less: 2021 Non-capital loss ( 103,000)

2022 Taxable Income $ 38,000

**AOC -** There would be a deemed taxation year end on December 31, 2021, the day before the AOC which coincides with the normal taxation year avoiding any implications in connection with a short taxation year. In the 2022 taxation year, the 2021 non-capital loss could only be used to the extent of the profits in the loss business that was the mail order business. Taxable Income would be:

2022 Net Income ($56,000 + $85,000) $141,000

Less: 2021 Non-capital loss - Limited to

income from the loss business ( 56,000)

2022 Taxable Income $ 85,000

This would leave a 2021 non-capital loss balance of $47,000 ($103,000 - $56,000).

Type: ES

Topic: Acquisition of control - calculations

71) Static Controls Inc. has a December 31 taxation year end. On May 1, 2022, all of the Company's shares are purchased by an unrelated person. For the period January 1, 2021 to April 30, 2022, the Company has a business loss of $91,000.

On April 30, 2022, the Company has a 2019 net capital loss balance of $125,000. In addition, the Company has the following capital properties:

**Capital Property ACB & Capital Cost UCC FMV**

Non-Depreciable $610,000 N/A $740,000

Depreciable 375,000 $280,000 515,000

Advise the Company with respect to the most appropriate elections to be made prior to the AOC and explain your results.

Answer: It would be preferable to elect to have a deemed disposition of the non-depreciable capital property at FMV of $740,000. This would result in a $65,000 taxable capital gain [(1/2)($740,000 - $610,000)] on the deemed disposition. This will leave $60,000 ($125,000 - $65,000) of the 2019 net capital loss to absorb.

This $60,000 could be eliminated by electing to have a deemed disposition of the depreciable property at an elected amount of $495,000. This election would result in a taxable capital gain of $60,000 [(1/2)($495,000 - $375,000)] fully utilizing the 2019 net capital loss which could not be applied to taxation years ending after the AOC.

The election however would also result in the recognition of recapture of $95,000 ($375,000 (lesser of $495,000 deemed POD and capital cost of $375,000) - UCC of $280,000). As this is $4,000 ($95,000 - $91,000) greater than the business loss, there would be some minimal taxable income and income tax payable. However, the ability to utilize the remaining $60,000 of the 2019 net capital loss would be worth the additional cost of income tax on the extra $4,000 of income. In addition, the election would increase future CCA claims.

Type: ES

Topic: Acquisition of control - calculations

72) During its taxation year ending December 31, 2022, all of the shares of Vick Ltd. are purchased by an unrelated person. The acquisition occurs on May 1, 2022 and, at that time, Vick has available a 2018 net capital loss balance of $175,000. Also at that time the company has the following capital properties:

**Capital Property ACB & Capital Cost UCC FMV**

Non-Depreciable $754,000 N/A $950,000

Depreciable 490,000 $325,000 612,000

For the period January 1, 2022 to April 30, 2022, the company has a business loss of $143,000. This becomes a 2022 non-capital loss of $143,000.

Advise the Company with respect to the most appropriate elections to be made prior to the AOC. Justify your answer with explanations.

Answer: With a 2018 net capital loss balance of $175,000, it would clearly be desirable to elect to have a deemed disposition of the non-depreciable capital property at FMV. This will result in a taxable capital gain of $98,000 [(1/2)($950,000 - $754,000), and leave a 2018 net capital loss balance of $77,000 ($175,000 - $98,000) to offset.

If an election at FMV is also made with respect to the depreciable property, the result will be a taxable capital gain of $61,000 [(1/2)($612,000 - $490,000)], as well as recapture of $165,000. This would reduce the 2018 net capital loss balance to $16,000 ($77,000 - $61,000), and offset the $143,000 business loss for the short taxation year ending April 30, 2022. However, it would leave $22,000 ($165,000 - $143,000) in additional taxable income and require the payment of some income tax for the short taxation year.

It is likely that, in most situations, management would conclude that the benefits of using a large portion of the 2018 net capital loss which cannot be applied to taxation years ending after an AOC would be worth the cost of the additional income taxes that would be payable on $22,000 of income. In addition, the election would increase future CCA claims since the depreciable property would be deemed to have been reacquired at its FMV with a slight downward adjustment for the capital gains element.

Type: ES

Topic: Acquisition of control - calculations

73) Anderson Inc., BDO Ltd., and Copper Inc., are three CCPCs. The voting common share ownership is as follows:

**Anderson Inc. -** John Anderson owns 100% of the common shares.

**BDO Ltd. -** John Anderson owns 30% of the common shares and his spouse, Wilma Anderson, owns 10% of the common shares. Basil Copper owns 35% of the common shares and his spouse, Holly Copper, owns 25% of the common shares. Holly Copper is John Anderson's sister.

**Copper Inc. -** Basil Copper and Holly Copper each own 50% of the common shares.

Indicate which of the Companies described are associated. Explain your conclusions.

Answer: **Anderson Inc. and BDO Ltd. -** These Companies are associated under ITA 256(1)(d) as follows:

• John Anderson controls Anderson Inc.

• John Anderson is related to each member of the group that controls BDO Ltd.

• John Anderson owns 25% or more of the shares of BDO Ltd.

**Copper Inc. and BDO Ltd. -** These companies are associated under ITA 256(1)(e) as follows:

• Each corporation is controlled by a related group (Copper Inc. by Mr. and Mrs. Copper, BDO Ltd. by Mr. and Mrs. Anderson and Mrs. Copper).

• Each of the members of one of the related groups was related to all of the members of the other related group.

• One person (Mrs. Copper) who is a member of both related groups owns at least 25% of the shares of each corporation.

They are also associated under ITA 256(1)(b) as both Companies are controlled by the same group (Mr. and Mrs. Copper).

**Anderson Inc. and Copper Inc. -** Provided they do not elect to not be associated, these Companies are associated under ITA 256(2) as they are both associated with a third corporation, BDO.

Type: ES

Topic: Associated corporations - analysis (applying the rules)

74) Sarah Kern owns 80% of the shares of Kern Ltd. and 5% of the shares of Lorne Inc. Kern Ltd. owns 30% of the shares of Lorne Inc. Sarah's 12 year old daughter owns 25% of the shares of Lorne Inc. There are no other shareholders who own shares in both Companies. Are Kern Ltd. and Lorne Inc. associated? Explain your conclusion.

Answer: With 80% ownership, Sarah controls Kern Ltd. In addition, she also controls Lorne Inc. as per the following calculation:

Direct Interest 5%

Indirect Income through Control of Kern Ltd. 30%

Deemed Interest (Daughter's Shares) 25%

Total Interest 60%

As both Companies are controlled by the same person, Kern Ltd. and Lorne Inc. are associated under ITA 256(1)(b).

Type: ES

Topic: Associated corporations - analysis (applying the rules)

75) During the taxation year ending December 31, 2022, Dwanto Ltd. has current expenditures of $460,000 on which a 10% investment tax credit is available and incurs $675,000 of Class 10 property on which a 10% investment tax credit is available.

Describe the 2022 and 2023 income tax consequences associated with these expenditures and claiming the related investment tax credits. Include in your solution the CCA for 2022 and 2023.

Answer: With respect to the $460,000 in current expenditures, there will be a $46,000 [(10%)($460,000)] credit against 2022 income tax payable. This $46,000 credit will be added to income in 2023.

With respect to the $675,000 in capital expenditures, there will be a 2022 credit against income tax payable of $67,500 [(10%)($675,000)].

The $67,500 credit will not influence the calculation of CCA for 2022 which will be $303,750 [(30%)(1.5)($675,000)].

In 2023, the $67,500 investment tax credit will be deducted from the January 1, 2023 UCC, resulting in a balance of $303,750 ($675,000 - $303,750 - $67,500). Given this, the CCA for 2022 is $91,125 [(30%)($303,750)].

Type: ES

Topic: Investment tax credits - calculating the credits

76) During the taxation year ending December 31, 2022, Enco Ltd. incurs current expenditures of $722,000 on which a 10% investment tax credit is available and incurs capital expenditures of $942,000 on Class 8 property on which a 10% investment tax credit is also available. Describe the 2022 and 2023 income tax consequences associated with these expenditures and claiming the related investment tax credits. Include in your solution the Class 8 CCA for both 2022 and 2023.

Answer: The $722,000 in current expenditures will generate an investment tax credit of $72,200 [(10%)($722,000)] to be deducted from the 2022 income tax payable. The $72,200 amount will be added to income in 2023.

The $942,000 in capital expenditures will generate an investment tax credit of $94,200 [(10%)($942,000)]. This will not be deducted from the capital cost of the acquired property until 2023. Given this, 2022 CCA is $282,600 [(1.5)(20%)($942,000)].

In 2023, the $94,200 credit will be subtracted, leaving a UCC balance of $565,200 ($942,000- $282,600 - $94,200) and, as a result, the 2023 CCA will be $113,040 [(20%)($565,200)].

Type: ES

Topic: Investment tax credits - calculating the credits

77) During the taxation year ending December 31, 2022, Future Ventures has made a number of expenditures that qualify for investment tax credits. They are as follows:

• $132,000 in Qualified Property in the Gaspe Peninsula.

• $1,060,000 in current expenditures for Scientific Research and Experimental Development (SRED).

The Company is a CCPC. In 2021, Future Ventures has taxable income of $161,000 and Taxable Capital Employed in Canada (TCEC) of $8,500,000. The Company has no income tax payable for its 2022 taxation year or in any of the three preceding taxation years.

Determine the amount of the refund that Future Ventures will receive as a result of the investment tax credits and any available carry forwards. Include in your answer any other income tax consequences of these investment tax credits.

Answer: As Future Ventures has TCEC of less than $10 million, the Company's annual expenditure is not reduced from the maximum amount of $3,000,000. Given the $3,000,000 annual expenditure limit for the 35% rate, the total amount of investment tax credits available can be calculated as follows:

Qualified Property [(10%)($132,000)] $ 13,200

SRED Current Expenditures [(35%)($1,060,000)] 371,000

Total Available Credit Amount $384,200

The refund available would be as follows:

Qualified Property [(40%)($13,200)] $ 5,280

SRED Current Expenditures [(100%)($371,000)] 371,000

Total Refund Available $376,280

The non-refunded investment tax credit of $7,920 ($384,200 - $376,280) can be carried forward 20 years to be applied against income tax payable. There was no income tax payable in the last three taxation years therefore the credits cannot be carried back.

The cost of the qualified property will be reduced in the following year by the refundable investment tax credit of $5,280. The refundable investment tax credit on current expenditures of $371,000 will also be added to income in the following taxation year.

Type: ES

Topic: Investment tax credits - refundable ITCs (ITA 127.1)

78) During the taxation year ending December 31, 2022, Forward Ltd. makes the following expenditures that qualify for investment tax credits:

• $1,450,000 in current expenditures for Scientific Research and Experimental Development (SRED).

• $220,000 in expenditures for Qualified Property in the Atlantic Provinces.

The Company is a CCPC with 2021 taxable income of $417,000 and Taxable Capital Employed in Canada (TCEC) of $6,200,000. The Company has no income tax payable for 2022 or in any of the three preceding taxation years.

Determine the amount of the refund that Forward Ltd. will receive as a result of earning the investment tax credits and any available carry forwards. Include in your answer any other income tax consequences of these investment tax credits.

Answer: As Forward Ltd. has TCEC of less than $10 million, the Company's annual expenditure limit is not reduced from the maximum of $3,000,000.

Given the $3,000,000 annual expenditure limit for the 35% eligible rate, the total amount of investment tax credits available can be calculated as follows:

Qualified Property [(10%)($220,000)] $ 22,000

SR&ED Current Expenditures [(35%)($1,450,000)] 507,500

Total Available Credit Amount $529,500

The refund available would be as follows:

Qualified Property [(40%)($22,000)] $ 8,800

SRED Current Expenditures [(100%)($507,500)] 507,500

Total Refund Available $516,300

The non-refunded investment tax credit of $13,200 ($529,500 - $516,300) can be carried forward 20 years to be applied against income tax payable. There was no income tax payable in the last three taxation years therefore the credit amounts cannot be carried back.

The cost of the qualified property will be reduced in the following taxation year by the refundable investment tax credit of $8,800. The refundable investment tax credit on current expenditures of $507,500 will also be added to income in the following taxation year.

Type: ES

Topic: Investment tax credits - refundable ITCs (ITA 127.1)

79) When it was first established, Lichter Inc. issued 123,000 shares at a price of $5.60 per share. Four years later, an additional 32,000 shares were issued for $8.62 per share. During the current year, a further 81,000 shares were issued for $10.15 per share. One of the investors in the Company purchased 1,350 shares of the first group of shares issued, and an additional 4,230 shares from the most recent issue. Determine the ACB and PUC of the investor's shares.

Answer: The ACB of the shares would be determined as follows:

**Number of Shares Cost/Share Total Cost**

First Purchase 1,350 $ 5.60 $ 7,560

Second Purchase 4,230 $10.15 42,935

Totals 5,580 $50,495

The ACB per share would be $9.05 ($50,495 ÷ 5,580).

The PUC would be calculated as follows:

**Number of Shares PUC/Share Total PUC**

First Issuance 123,000 $5.60 $ 688,800

Second Issuance 32,000 $8.62 275,840

Third Issuance 81,000 $10.15 822,150

Total PUC of outstanding shares 236,000 $1,786,790

Number of Shares (From first table) 5,580

PUC Per Share [$1,786,790 ÷ 236,000 Shares] $ 7.57

PUC for Investor's Shares $42,241

Type: ES

Topic: PUC (paid-up capital) & ACB (adjusted cost base)

80) Martex Inc. has 560,000 shares outstanding. Information on their issuance is as follows:

**Shares Issue Total**

**Date Issued Price Proceeds**

January, 2021 400,000 $16.00 $6,400,000

June, 2022 160,000 18.00 2,880,000

Totals 560,000 $9,280,000

Joan Fox acquired 10,000 shares of the 2021 issue and 5,000 shares of the 2022 issue. Determine the ACB and PUC of Joan's shares.

Answer: The ACB of the shares would be determined as follows:

**Number of Shares Cost/Share Total Cost**

First Purchase 10,000 $16.00 $160,000

Second Purchase 5,000 $18.00 90,000

Totals 15,000 $250,000

The ACB per share would be $16.67 ($250,000 ÷ 15,000).

The PUC for the investor's shares would be calculated as follows:

**Number of Shares PUC/Share Total PUC**

2021 Issuance 400,000 $16.00 $6,400,000

2022 Issuance 160,000 $18.00 2,880,000

Total PUC of outstanding shares 560,000 $9,280,000

Number of Shares (From first table) 15,000

PUC Per Share [$9,280,000 ÷ 560,000 Shares] $ 16.57

PUC for Investor's Shares $248,550

Type: ES

Topic: PUC (paid-up capital) & ACB (adjusted cost base)

81) The following transactions involve the Logic Corporation's capital dividend account (CDA):

• In 2019, capital property with an ACB of $105,000 was sold for $129,000.

• In 2020, capital property with an ACB of $91,000 was sold for $83,000.

• In 2021 the Company received a capital dividend of $10,600.

• In July 2022, goodwill was sold for $50,000. The goodwill had been internally developed and, as a result, its cost for income tax purposes and ACB were nil. On January 1, 2022, the Class 14.1 UCC balance was nil.

• On October 31, 2022, the Company elected and paid a capital dividend of $13,750.

Determine the CDA balance at December 31, 2022.

Answer: The balance in the CDA as at December 31, 2022 would be as follows:

2019 Capital Gain [(1/2)($129,000 - $105,000)] $12,000

2020 Capital Loss [(1/2)($83,000 - $91,000)] ( 4,000)

2021 Capital Dividend Received 10,600

2022 Capital Gain [(1/2)($50,000 - Nil)] 25,000

2022 Capital Dividend Paid ( 13,750)

Balance - December 31, 2022 $29,850

Type: ES

Topic: Capital dividend account (CDA) - calculating the CDA

82) Export Ltd. is a CCPC with a December 31 taxation year end. The transactions which follow involve Export Ltd.'s capital dividend account (CDA).

• In 2019, the Company received a capital dividend of $23,000.

• In 2020, the Company sold capital property with an ACB of $156,000 for $199,000.

• In 2021, the Company sold a non-depreciable capital property with an ACB of $120,000 for $102,000.

• In 2022, the Company sold goodwill for $150,000. The goodwill had been internally developed and therefore had a cost for income tax purposes and an ACB of nil. On January 1, 2022, the Class 14.1 balance was nil.

• In 2022, the Company elected and paid a capital dividend of $10,400.

Determine the CDA balance at December 31, 2022.

Answer: The December 31, 2022 CDA balance is:

2019 Capital Dividend Received $ 23,000

2020 Capital Gain [(1/2)($199,000 - $156,000)] 21,500

2021 Capital Loss [(1/2)($102,000 - $120,000)] ( 9,000)

2022 Capital Gain [(1/2)($150,000 - Nil)] 75,000

2022 Capital Dividends Paid ( 10,400)

Balance - December 31, 2022 $100,100

Type: ES

Topic: Capital dividend account (CDA) - calculating the CDA

83) On June 30, 2022, the Shareholders' Equity of Mondo Inc. is as follows:

Common Shares (56,000 Shares Outstanding) $ 672,000

Retained Earnings 726,000

Total Shareholders' Equity $1,398,000

On this date, the Company declares a 10% stock dividend. This dividend is not elected as a capital dividend nor designated as an eligible dividend. At this time, the shares are trading at $27 per share. The Company increases its PUC by the FMV of the new shares issued.

Jerry Folder owns 1,000 of the Mondo shares which he acquired several years ago at a cost of $17 per share. Determine the effect of the stock dividend on Jerry's 2022 net income, his 2022 federal income tax payable and the ACB of his shares.

Answer: Jerry will receive 100 new shares [(10%)(1,000)] with a FMV of $2,700 [(100)($27)]. This $2,700 non-eligible dividend will be grossed up to a taxable amount of $3,105 [($2,700)(115%)]. As a result, his 2022 net income will increase by $3,105. The receipt of this dividend will generate a dividend tax credit of $280 [(9/13)(15%)($2,700)] which will reduce his 2022 federal income tax payable.

Before the stock dividend, the ACB of Jerry's shares was $17,000 [(1,000)($17)]. The $2,700 dividend will be added to to the ACB, resulting in a new ACB of $19,700. When the 100 new shares are added to his 1,000 shares, the ACB per share will be $17.91 ($19,700 ÷ 1,100).

Type: ES

Topic: Dividends - stock dividends

84) Jason Bright owns 500 shares of Latec Inc. These were purchased several years ago at $15 per share, a total cost of $7,500. On June 30, 2022, the Shareholder's Equity accounts of Latec were as follows:

Common Stock (100,000 Shares Outstanding) $1,200,000

Retained Earnings 1,800,000

Total Shareholders's Equity $3,000,000

On this date, Latec declares and pays a 5% non-eligible stock dividend. As the shares are trading at $18 per share, PUC increases by $90,000 [(5%)(100,000)($18)].

Determine the effect of this transaction on Jason's 2022 net income, 2022 federal income tax payable and the ACB of his shares.

Answer: Jason will receive 25 [(5%)(500)] new shares with a FMV of $450 [(25)($18)]. This will be grossed up to a taxable amount of $518 [(115%)($450)]. This amount will be included in Jason's 2022 net income. In addition, he will have a dividend tax credit of $47 [(9/13)(15%)($450)] which will reduce his 2022 federal income tax payable.

Before the stock dividend, Jason's shares had an ACB of $7,500 [(500)($15)]. The $450 dividend will be added to the ACB, resulting in a new ACB of $7,950. His total number of shares will be 525 (500 + 25), resulting in a per share ACB of $15.14 ($7,950 ÷ 525).

Type: ES

Topic: Dividends - stock dividends

85) Martine Cloutier owns 23% of the 400,000 outstanding shares of Boucher Inc. Boucher Inc. owns 45,000 shares of Montagne Inc. The Montagne Inc. shares were acquired at a cost of $33 per share and have a current FMV of $42 per share. On June 30, 2022, Boucher Inc. declares a non-eligible dividend involving the distribution of all of the Montagne Inc. shares on a pro rata basis to its existing shareholders.

Determine the effect of the payment of this dividend on Boucher Inc.'s 2022 net income and Martine Cloutier's 2022 net income and 2022 federal income tax payable.

Answer: For Boucher Inc., the results will be as follows:

POD [(45,000)($42)] $1,890,000

AACB [(45,000)($33)] ( 1,485,000)

Capital Gain $ 405,000

Inclusion Rate 1/2

2022 Taxable Capital Gain to Boucher $ 202,500

The results for Martine Cloutier will be as follows:

Dividend Received [(23%)(45,000)($42)] $434,700

Gross Up [(15%)($434,700)] 65,205

Taxable Dividend to Martine Cloutier $499,905

Dividend Tax Credit [(9/13)(15%)($434,700)] $ 45,142

Type: ES

Topic: Dividends in kind - ITA 52(2)

86) Topex Ltd. owns 62,000 shares of Boron Ltd. While the shares were purchased at a total cost of $372,000 ($6.00 per share), the shares are currently trading at $8.50 per share. Topex wishes to dispose of these shares and, to this end, they declare a non-eligible dividend on August 28, 2022 payable with a distribution of Boron Ltd. shares on a pro rata basis to the Topex shareholders.

Determine the effect of paying this dividend on Topex's 2022 net income and the effect of receiving this dividend for an individual who owns 10% of the Topex Ltd. shares.

Answer: For Topex Ltd, the results will be as follows:

POD [(62,000)($8.50)] $527,000

ACB ( 372,000)

Capital Gain $155,000

Inclusion Rate 1/2

2022 Taxable Capital Gain to Topex $ 77,500

The results for a 10% shareholder will be as follows:

Dividend Received [(10%)($527,000)] $52,700

Gross Up [(15%)($52,700)] 7,905

2022 Taxable Dividend to 10% shareholder $60,605

Dividend Tax Credit [(9/13)(15%)($52,700)] $ 5,473

Type: ES

Topic: Dividends in kind - ITA 52(2)

87) At the beginning of the current year, Scott Inc. has 131,000 common shares outstanding. The shares were originally issued at $11.25 per share for total issuance of $1,473,750, with this amount being the PUC. During the current year, a creditor with a debt receivable of $505,000 from the Company's agrees to accept the issuance of 43,000 newly issued common shares of the Company as full payment of the debt. At the time of the settlement of the debt the shares are trading at $12.05 per share. Subsequent to the exchange, Mr. Scott, who had purchased 7,000 Scott Inc. shares at the time of their original issue, sells the shares for $14.36 per share.

Describe the income tax consequence(s) to all of the shareholders of Scott Inc. as a result of the settlement of the debt for common shares. In addition, describe the income tax consequences to Mr. Scott resulting from the sale of his Scott Inc. shares.

Answer: The settlement transaction will result in an ITA 84(1) deemed dividend for all common shareholders, calculated as follows:

PUC of New Shares [(43,000)($12.05)] $518,150

Increase in Net Assets ( 505,000)

ITA 84(1) Deemed Dividend $ 13,150

This would be allocated to all 174,000 (131,000 + 43,000) shares outstanding, on the basis of $0.08 per share. This would be an eligible or non-eligible taxable dividend. The $0.08 per share dividend would be added to the ACB of all 174,000 shares.

With the addition of $0.08, the revised ACB of Mr. Scott's shares would be $11.33 ($11.25 + $0.08) per share. The taxable capital gain on shares sale would be calculated as follows:

POD [(7,000)($14.36)] $100,520

ACB [(7,000)($11.33)] ( 79,310)

Capital Gain $ 21,210

Inclusion Rate 1/2

Taxable Capital Gain $ 10,605

Type: ES

Topic: Dividends - ITA 84(1) deemed dividend

88) Zhao Inc. has 50,000 common shares outstanding which were issued for $450,000. On November 30, 2022, a creditor with a debt receivable from the company of $100,000 agrees to accept 10,000 newly issued common shares as full payment of the debt. At the time of this transaction, the shares are trading for $11.25 per share. Mr. Kai owns 1,000 shares in Zhao Inc, which he purchased from an existing shareholder for $10 each on January 15, 2022. What is the amount of the deemed dividend to Mr. Kai?

Answer: The transaction will result in an ITA 84(1) deemed dividend as follows:

PUC of New Shares [($11.25)(10,000)] $112,500

Increase in Net Assets ( 100,000)

ITA 84(1) Deemed Dividend $ 12,500

This will result in a deemed dividend per share of $0.208 ($12,500 ÷ 60,000). On Mr. Kai's 1,000 shares this will total $208.00. The ACB of his shares will be increased by the same amount.

Type: ES

Topic: Dividends - ITA 84(1) deemed dividend

89) At the time of its incorporation, Alleham Ltd. issued 176,000 common shares for $3,960,000 ($22.50 per share). All of the shares were issued to Mr. Izaak Alleham, the founder of the Company. Mr. Alleham continues to own all of the originally issued shares, except for 30,000 shares that he sold to his sister for $18.75 per share, which was the estimated FMV of the shares at that time. The company redeems all of the 30,000 shares owned by Mr. Alleham's sister at $24.35 per share. All of the dividends will be non-eligible dividends. Determine the income tax consequences of the redemption to Mr. Alleham's sister.

Answer: The redemption transaction would have no income tax consequences for Mr. Alleham. For his sister, the income tax consequences are be as follows:

Proceeds of Redemption [(30,000)($24.35)] $730,500

PUC [(30,000)($22.50)] ( 675,000)

ITA 84(3) Deemed Dividend $ 55,500

Gross Up of 15% 8,325

Taxable Non-eligible Dividend $ 63,825

Proceeds of Redemption [(30,000)($24.35)] $730,500

Less: ITA 84(3) Deemed Dividend ( 55,500)

Modified POD $675,000

ACB [(30,000)($18.75)] ( 562,500)

Capital Gain (PUC - ACB) $112,500

Inclusion Rate 1/2

Taxable Capital Gain $ 56,250

Both the taxable dividend and the taxable capital gain would be included in Mr. Alleham's sister's net income and there will also be a dividend tax credit of $5,763 [(9/13)(15%)($55,500)] which will reduce her federal income tax payable for the year of the redemption.

Type: ES

Topic: Dividends - ITA 84(3) deemed dividend on redemptions of shares

90) Elton Inc. has 220,000 common shares outstanding. All of these shares were issued for $12 each, for a total of $2,640,000 which is also equal to the PUC of the shares. A shareholder, who acquired 15,000 shares at a price of $10 per share, has repeatedly voiced dissent with the direction of the company. As a result the company has agreed to sever the connection and has offered to redeem the shares at $12.50 each, an offer which has been accepted. Any dividends resulting from the redemption will be considered as non-eligible.

Determine the income tax consequences of this redemption to the departing shareholder.

Answer: The income tax consequences are as follows:

Proceeds of Redemption [(15,000)($12.50)] $187,500

PUC [(15,000)($12.00)] ( 180,000)

ITA 84(3) Deemed Dividend $ 7,500

Gross Up of 15% 1,125

Taxable Non-eligible Dividend $ 8,625

Proceeds of Redemption [(15,000)($12.50)] $187,500

Less: ITA 84(3) Deemed Dividend ( 7,500)

Modified POD $180,000

ACB [(15,000)($10.00)] ( 150,000)

Capital Gain (PUC - ACB) $ 30,000

Inclusion Rate 1/2

Taxable Capital Gain $ 15,000

Both the taxable dividend and the taxable capital gain would be included in the departing shareholder's net income for the year of the redemption. The non-eligible dividend would also qualify for a federal dividend tax credit of $779 [(9/13)(15%)($7,500)].

Type: ES

Topic: Dividends - ITA 84(3) deemed dividend on redemptions of shares

91) Ms. Daniels owns all of the outstanding shares of Daniels Inc., a CCPC. The shares have a PUC of $390,000 and an ACB of $545,000. Because it has recently consolidated its operations, Daniels Inc. pays a liquidating dividend of $299,000, accompanied by a PUC reduction of $217,000.

What are the income tax consequences of the distribution to Ms. Daniels?

Answer: The portion of the distribution that represents the reduction in PUC is not required to be included in income and will therefore be treated as a tax free distribution. The income tax attributes of her shares however will be reduced by this tax free distribution and, as a result, the revised PUC will be $173,000 ($390,000 - $217,000) and the revised ACB $328,000 ($545,000 - $217,000).

The $82,000 ($299,000 - $217,000) excess of the distribution over the PUC reduction will be an ITA 84(2) deemed dividend that will be eligible for either capital dividend treatment or be treated as a taxable dividend that is either eligible or non-eligible.

Type: ES

Topic: Dividends - ITA 84(2) deemed dividend

92) Martin Forbes owns all of the outstanding shares of Carson Ltd., a CCPC. These shares have a PUC of $225,000 and an ACB of $310,000. Having sold a large segment of the operations, Carson Ltd. pays a liquidating dividend of $112,000, accompanied by a PUC reduction of $84,000.

What are the income tax consequences of the distribution to Mr. Forbes?

Answer: The portion of the distribution that represents the reduction in PUC is not required to be included in income and will therefore be treated as a tax free distribution. The income tax attributes of his shares however will be reduced by this tax free distribution and, as a result, the revised PUC will be $141,000 ($225,000 - $84,000) and the revised ACB $226,000 ($310,000 - $84,000).

The remaining $28,000 ($112,000 - $84,000) will be treated as a deemed dividend under ITA 84(2). The deemed dividend will be eligible for either capital dividend treatment or be treated as a taxable dividend that is either eligible or non-eligible.

Type: ES

Topic: Dividends - ITA 84(2) deemed dividend

93) Nicastro Ltd., a CCPC, with a December 31 taxation year end has been in business for many years and, until recently, it has been fairly profitable. All of its shares are owned by Luigi Nicastro.

The Company has always manufactured and sold fresh pasta, largely to restaurants and stores in the local Italian community. All went well until the beginning of 2021 when a local Italian newspaper discovered that Mr. Nicastro's real name was Stanley Kowalski and that he had never been to Italy. Demand for his Company's products immediately fell off, resulting in a business loss in 2021 of $189,000 resulting in a 2021 non-capital loss of the same amount.

In addition, in 2021, the company was forced to sell some business properties to meet its cash flow needs. This resulted in an allowable capital loss of $48,000 which resulted in a 2021 net capital loss of the same amount.

While $114,000 of the 2021 non-capital loss could be carried back to previous taxation years, all of the 2021 net capital loss had to be carried forward since there were no net taxable capital gains in the three previous taxation years.

In early 2022, he began looking for a buyer for his Nicastro Ltd. shares. After considerable searching, he found a buyer and, as of June 1, 2022, all of the Nicastro Ltd. shares were sold to Stella d'Oro Inc, an unrelated person.

For the period January 1, 2022 through May 31, 2022, Nicastro Ltd.'s accountant determined that there was a business loss of $79,000. During this deemed short taxation year, the Company had rental income of $5,500. There was also a disposition of preferred share investments owned by the company that resulted in an allowable capital loss of $7,200.

On May 31, 2022, Nicastro owned the following capital properties:

**Capital Properties Cost & ACB UCC FMV**

Investments In TD Common Shares $ 32,000 N/A $ 28,000

Land 85,000 N/A 235,000

Building 427,000 $285,000 327,000

Equipment 120,000 60,000 50,000

**Required:**

A. Calculate Nicastro's net income and taxable income for the short taxation year ending May 31, 2022. Indicate the amount of any non-capital and net capital loss balances that would be available to apply to other taxation years, using the assumption that Nicastro makes all of the available elections using the maximum elected amounts.

B. Provide the information required in Part A assuming that Nicastro makes only those election(s) required to offset any non-capital and net capital losses.

C. Briefly discuss which course of action (Part A or B) would be more advantageous for Stella d'Oro Inc.

Answer:

***Part A - Non-Capital and Net Capital Losses - All Available Elections***

**Required Adjustments** The following adjustments would be required under the acquisition of control (AOC) rules:

**Investments in Common Shares -** As the $28,000 FMV of the investments is below their $32,000 cost, there would be a deemed disposition to realize the loss which would be an allowable capital loss of $2,000 [(1/2)($32,000 - $28,000)].

**Equipment -** As the $50,000 FMV of the equipment is less than its $60,000 UCC, it would also be deemed to have been disposed of to trigger the unrealized terminal loss of $10,000 which is treated as deemed CCA.

**Elections -** If all available elective dispositions were made, the results would be as follows:

**Land -** The Land would be deemed to have been disposed of at FMV of $235,000, resulting in a taxable capital gain of $75,000 [(1/2)($235,000 - $85,000)].

**Building -** The Building would be deemed to have been disposed of for POD equal to its FMV of $327,000 resulting in recapture of $42,000 ($327,000 - $285,000).

**Business Income (Loss) -** Based on the above analysis, the business income (loss) would be calculated as follows:

Loss as originally determined ($79,000)

Deemed loss on Equipment (Treated as CCA) ( 10,000)

Recapture on Building (Elected) 42,000

Business Loss for the taxation year ending May 31, 2022 ($47,000)

**Net Income and Taxable Income -** If all of the available elections were made, Nicastro Ltd.'s net income and taxable income for the taxation year ending May 31, 2022 would be calculated as follows:

ITA 3(a) - Rental Income $ 5,500

ITA 3(b) - Net Taxable Capital Gains:

Taxable Capital Gain on Land Election $75,000

Allowable Capital Loss on Preferred Shares Sold ( 7,200)

Allowable Capital Loss on

Common Shares (Required) ( 2,000) 65,800

ITA 3(c) - Total $71,300

ITA 3(d) - Business Loss ( 47,000)

Net Income - May 31, 2022 taxation year $24,300

2021 Net Capital Loss ( 48,000)

Taxable Income - May 31, 2022 taxation year Nil

**2021 Net Capital Loss Balance -** As the 2021 net capital loss balance was less than the net taxable capital gains, the full amount was deductible.

**2021 & 2022 Non-Capital Loss Balances -** With respect to the 2021 and 2022 non-capital losses the total non-capital losses would be calculated as follows:

Business Loss for taxation year ending May 31, 2022 $47,000

Add: 2021 Net Capital Loss Deducted 48,000

Subtotal $95,000

Income Under ITA 3(c) ( 71,300)

2022 Non-Capital Loss for taxation year ending May 31, 2022 $23,700

2021 Non-capital loss balance ($189,000 - $114,000) 75,000

Total Non-Capital Losses $98,700

***Part B - Non-Capital and Net Capital Losses - Limited Elections***

The losses that could not be carried forward at the year end on May 31, 2021 consist of the 2021 net capital loss balance of $48,000 and the current year total allowable capital loss of $9,200 ($7,200 + $2,000) which would potentially become a 2022 net capital loss unless there were taxable capital gains to offset these amounts. To be able to use these net capital and allowable losses, a taxable capital gain of $57,200 ($48,000 + $9,200) would have to be created. This will require a capital gain of $114,400 [(2)($57,200)]. This can be achieved by electing a disposition amount for the land of $199,400 ($85,000 + $114,400).

**Business Income (Loss) -** Based on the required adjustment, the business income (loss) would be calculated as follows:

Loss as Originally Stated ($79,000)

Deemed Loss on Equipment (Treated as deemed CCA) ( 10,000)

Business Loss for the taxation year ending May 31, 2022 ($89,000)

**Net Income and Taxable Income for the taxation year ending May 31, 2022 -** Under this alternative as well, none of the capital losses will be lost. 2022 net and taxable income would be:

ITA 3(a) - Rental Income $ 5,500

ITA 3(b) - Net Taxable Capital Gains:

Taxable Capital Gain on Land Election $57,200

Allowable Capital Loss on Preferred Shares Sold ( 7,200)

Allowable Capital Loss on deemed disposition of

Common Shares (Required) ( 2,000) 48,000

ITA 3(c) - Total $53,500

ITA 3(d) - Business Loss ( 89,000)

2022 Net Income (Year ending May 31, 2022) Nil

2021 Net Capital Loss ( 48,000)

2022 Taxable Income (Year ending May 31, 2022) Nil

**Non-Capital Loss Carry Forward -** With respect to the 2021 non-capital loss and the total carry forward after May 31, 2022, this amount would be calculated as follows:

Business Loss for taxation year ending May 31, 2022 $ 89,000

Add: 2021 Net Capital Loss Deducted 48,000

Subtotal $137,000

Income under ITA 3(c) ( 53,500)

2022 Non-Capital Loss (Year ending May 31, 2022) $ 83,500

2021 Non-Capital Loss ($189,000 - $114,000) 75,000

Total Non-Capital Losses $158,500

The difference in the non-capital loss carry forward between Part A and B is equal to $59,800 ($158,500 - $98,700). This is the total of the recapture on the building of $42,000 plus the $17,800 ($75,000 - $57,200) larger taxable capital gain on the land in Part A.

***Part C - Advice on Course of Action***

If Stella d’Oro either does not intend to continue the same business in which the loss occurred, or does not expect to have sufficient profits in that business to absorb the non-capital losses within the relevant carry forward period, Nicastro should make all elections as per Part A.

Alternatively, if Stella d’Oro expects to have sufficient profits in continuing the pasta business to absorb the losses, Nicastro should use the Part B approach that maximizes the non-capital loss balances. The reason for this is that the tax benefit of the non-capital losses will be realized as soon as profits are earned in the post-acquisition period.

Type: ES

Topic: Acquisition of control - calculations

94) Blackburn Inc., a CCPC that uses a December 31 taxation year, began carrying on the business of providing cleaning services to residential properties. All of the shares were owned by Aaron Blackburn and, in addition, he was actively involved in managing the business.

Mr. Blackburn, whose previous career was as a professor of business strategy at a major Canadian university, showed little aptitude for actually running a business. In 2020, the business had a loss of $123,000 and a further loss of $87,000 in 2021.

When the business began, Blackburn Inc. had purchased land on which the intention was to expand the business with a second location once the first location became successful. As success did not appear to be on the horizon, Blackburn Inc. sold the land in 2021 realizing a capital loss of $192,000 which became a 2021 net capital loss of $96,000.

In early 2022, Mr. Blackburn decided to sell the company. White Enterprises, a large public company agreed to buy all of his shares and, on May 1, 2022, the shares were sold resulting in an acquisition of control (AOC)

On the AOC there was a deemed taxation year end of April 30, 2022, Blackburn Inc. prepared an income statement for the deemed short taxation year of January 1, 2022 to April 30, 2022 (the 2022 taxation year). There was a business loss of $46,000 but no further capital losses for the 2022 taxation year.

On April 30, 2022, the company owned the following capital property:

**Capital Properties Cost & ACB UCC FMV**

Temporary Investments $ 45,000 N/A $ 12,000

Accounts Receivable 90,000 N/A 76,000

Land 180,000 N/A 262,000

Building 325,000 $300,000 380,000

Equipment 93,000 60,000 45,000

Vehicles (Class 10) 145,000 110,000 132,000

Shortly after taking over Blackburn Inc., White Enterprises decided that some of the extra space in Blackburn's facilities could be used for manufacturing customized small kitchen appliances. Blackburn's income (loss) from the two separate businesses for the period May 1, 2022 to December 31, 2022 and the 2023 taxation year was as follows:

**Business May 1 to Dec. 31, 2022 2023**

Kitchen Appliances $146,000 ($ 52,000)

Cleaning Services ( 23,000) 263,000

**Required:**

A. If Blackburn Inc. makes all possible elections to minimize the net capital and non-capital loss balances, determine the amount of the non-capital losses that will be carried forward after the AOC by White Enterprises, and the amount of the net capital loss balances that will no longer be available to apply to post-AOC taxation years.

B. Indicate the maximum amount of the non-capital losses that can be used during the period May 1 through December 31, 2022, and the amount available to apply to the 2023 and subsequent taxation years.

C. Indicate the maximum amount of the non-capital losses that can be claimed for the taxation year ending December 31, 2022, and the 2023 taxation year.

Answer:

***Part A - Non-Capital and Net Capital Losses***

**Business Loss -** The business loss for the taxation year ending April 30, 2022 would be as follows:

Loss as per April 30, 2022 Income Statement ($46,000)

Required Accounts Receivable Adjustment ($90,000 - $76,000) ( 14,000)

Building Election - Recaptured CCA ($325,000 - $300,000) 25,000

Equipment - Deemed CCA ($60,000 - $45,000) ( 15,000)

Vehicles Election - Recaptured CCA ($132,000 - $110,000) 22,000

Business Loss f the taxation year ending April 30, 2022 ($28,000)

**Net Income & Taxable Income -** Net income and taxable income for the taxation year April 30, 2022, calculated as per the ITA 3 rules, would be as follows:

ITA 3(a) - Income Nil

ITA 3(b) - Net Taxable Capital Gains (Losses):

Elections under ITA 111(4)(e):

Gain on Land [(1/2)($262,000 - $180,000)] $ 41,000

Gain on Building [(1/2)($380,000 - $325,000)] 2 7,500

Deemed Dispositions - ITA 111(4)(c) and (d)

Loss on Temporary Investments

[(1/2)($45,000 - $12,000)] ( 16,500) $ 52,000

ITA 3(c) - Total $ 52,000

ITA 3(d) - Business Loss ( 28,000)

Net Income for the taxation year ending April 30, 2022 $ 24,000

2021 Net Capital Loss

(Limited To Amount Included Under ITA 3(b)) ( 52,000)

Taxable Income - April 30, 2022 Nil

**2021 Net Capital Loss -** The net capital loss balance that cannot be claimed in taxation years subsequent to the AOC are:

2021 Net Capital loss balance $96,000

Less: Amount claimed for taxation year ending April 30, 2021 ( 52,000)

2021 Net Capital Loss Balance $44,000

**Non-Capital Losses -** The non-capital losses available to taxation years ending after the AOC are as follows:

Business Loss - Taxation year ending April 30, 2022 $ 28,000

Add: 2021 Net Capital Loss Deducted 52,000

Subtotal $ 80,000

Income Under ITA 3(c) ( 52,000)

Non-Capital Loss - Taxation year ending April 30, 2022 $ 28,000

2020 Non-Capital Loss Balance 123,000

2021 Non-Capital Loss Balance 87,000

Non-Capital Losses post-AOC $238,000

***Part B - Non-Capital Loss Carry Forward to December 31, 2022 taxation year***

The net income for the taxation year ending December 31, 2022 will be $123,000 ($146,000 - $23,000). As none of this income was from the cleaning services business, none of the non-capital losses can be claimed. This will leave the non-capital losses available to the 2023 and subsequent taxation years unchanged at $238,000.

***Part C - Loss Carry Forward in 2023***

2023 net income will be $211,000 ($263,000 - $52,000). As all of this income is from the cleaning services business, a taxable income deduction can be claimed for the non-capital losses in the amount of $211,000, resulting in 2023 taxable income of nil. This will leave a non-capital loss for the taxation year ending April 30, 2022 of $27,000 ($238,000 - $211,000).The 2020 and 2021 non-capital loss balances would be claimed in full and therefore nil. Note that ITA 111(3) requires that the oldest losses be applied first.

Type: ES

Topic: Acquisition of control - calculations

95) Each of the following is an **independent** Case involving the ownership of voting shares of CCPCs. All of the corporations have taxation years that end on December 31 and have only one class of shares.

1. Ms. Sarah Brandt owns 100% of the voting shares of SB Inc. Her common-law partner, Ms. Melissa Frank, owns 100% of the shares of MF Inc.

2. John Brody owns 65% of the shares of Heresy Inc. His spouse, Jessica Brody, owns 85% of the shares of Porter Inc. John and Jessica each own 35% of Lason Ltd.

3. Surcal Inc. owns 75% of the shares of Basik Inc. Basik Inc. owns 70% of the shares of Freon Ltd.

4. Martin Friedman owns 75% of the shares of Bloc Ltd. and 20% of the shares of Lorne Inc. Bloc Ltd. owns 25% of the shares of Lorne Inc. Martin's 12 year old son owns 25% of the share of Lorne Inc. There are no other shareholders who own shares in both companies.

5. Ms. Bright owns 75% of the shares of Aurora Ltd. and 20% of the shares of Bock Inc. Ms. Favreau owns 80% of the shares of Bock Inc. and 20% of the shares of Aurora Ltd. Ms. Bright and Ms. Favreau are not related.

**Required:** For each of the preceding Cases, determine whether the corporations are associated. Support your conclusions with references to specific provisions of ITA 256. In order to assist you in answering this question, we have provided you with the content of ITA 256(1).

**ITA 256(1) Associated corporations** – For the purposes of this Act, one corporation is associated with another in a taxation year if, at any time in the year,

(a) one of the corporations controlled, directly or indirectly in any manner whatever, the other;

(b) both of the corporations were controlled, directly or indirectly in any manner whatever, by the same person or group of persons;

(c) each of the corporations was controlled, directly or indirectly in any manner whatever, by a person and the person who so controlled one of the corporations was related to the person who so controlled the other, and either of those persons owned, in respect of each corporation, not less than 25% of the issued shares of any class, other than a specified class, of the capital stock thereof;

(d) one of the corporations was controlled, directly or indirectly in any manner whatever, by a person and that person was related to each member of a group of persons that so controlled the other corporation, and that person owned, in respect of the other corporation, not less than 25% of the issued shares of any class, other than a specified class, of the capital stock thereof; or

(e) each of the corporations was controlled, directly or indirectly in any manner whatever, by a related group and each of the members of one of the related groups was related to all of the members of the other related group, and one or more persons who were members of both related groups, either alone or together, owned, in respect of each corporation, not less than 25% of the issued shares of any class, other than a specified class, of the capital stock thereof.

Answer:

***Case 1***

The two Companies are not associated. While Sarah Brandt and Melissa Frank are related, they are not a group with respect to the two Companies. For association to apply in a case such as this, there would have to be cross-ownership of at least 25% of the shares of one of the two companies. That is, either Sarah Brandt would have to own 25% or more of MF Inc., or Melissa Frank would have to own 25% or more of SB Inc.

***Case 2***

John Brody controls Heresy Inc., is related to each member of the group (himself and his spouse) that controls Lason Ltd., and has cross-ownership of Lason Ltd. in excess of 25%. This means that these two Companies are associated under ITA 256(1)(d).

Jessica Brody controls Porter Inc., is related to each member of a group that controls Lason Ltd., and has the necessary cross-ownership of at least 25% of Lason Ltd. shares. This means that these two Companies are also associated under ITA 256(1)(d).

As they are not controlled by the same individual or group, Heresy Inc. and Porter Inc. are not associated under ITA 256(1). However, as they are both associated with the same third corporation (Lason Ltd.), Heresy Inc. and Porter Inc. would be associated under ITA 256(2). Note that ITA 256(2) allows Heresy Inc. and Porter Inc. to avoid association, provided Lason Ltd. elects not to be associated with either Company. This will mean, however, that Lason Ltd. will have a business limit for the period of nil.

***Case 3***

Surcal Inc. is associated with Basik Inc. under ITA 256(1)(a) as it has control of Basik. Surcal Inc. is associated with Freon Ltd. under ITA 256(1)(a) as it has indirect control by virtue of its control of Basik. Basik Inc. and Freon Ltd. are associated under ITA 256(1)(a) in that Basik Inc. has direct control of Freon Ltd. Basik Inc. and Freon are also associated under ITA 256(1)(b) in that they are both controlled by the same person (Surcal).

***Case 4***

For the purposes of determining associated companies, Martin controls Bloc Ltd. which gives him control over that company's 25% interest in Lorne Inc. In addition, he is deemed to own the 25% interest in Lorne Inc. that is held by his minor child [ITA 256(1.3)]. This means his total interest is as follows:

Direct Interest 20%

Indirect Interest Through Control of Bloc Ltd. 25%

Son's Shares (Deemed ownership) 25%

Total Interest 70%

As this is a controlling interest, Martin has control of both Bloc Ltd. and Lorne Inc. Given this, the two companies are associated under ITA 256)(1)(b).

***Case 5***

As a group, Ms. Bright and Ms. Favreau control both Aurora Ltd. and Bock Inc. As a consequence, these two Companies would be associated under ITA 256(1)(b).

Type: ES

Topic: Associated corporations - analysis (applying the rules)

96) The following situations are **independent** of each other. All of the corporations involved are CCPCs and have only one class of shares.

A. Mr. Johnson, Mr. Kohn, and Mr. Langley are three unrelated individuals.

• Mr. Johnson owns 50% of the shares of Astro Inc. and 25% of the shares of Borealis Ltd.

• Mr. Kohn owns 50% of the shares of Borealis Ltd.

• Mr. Langley owns 50% of the shares of Astro Inc. and 25% of the shares of Borealis Ltd.

B. Ms. Martineau and Ms. Olson each own 50% of the shares of Kisler Inc. Ms. Martineau owns 70% of the shares of Pardo Ltd. Ms. Olson owns the remaining 30% of this Company's shares. Ms. Martineau and Ms. Olson are not related.

C. Fiona and Jennifer Lane are sisters. Fiona owns 100% of the shares of FL Inc. and 31% of Lane Ltd. Her sister Jennifer owns 60% of the shares of JL Inc., with the remaining 40% of the shares held by her father. Jennifer also owns 39% of the shares of Lane Ltd. The remaining shares of Lane Ltd. are held by an unrelated party.

D. Ms. Garland owns 90% of the shares of Garland Inc. She also owns 10% of the shares of Newton Ltd. Her 13 year old son Newton owns 10% of the shares of Newton Ltd. While the remaining shares of Newton Ltd. are owned by Newton's father, Mr. Isaac, Ms. Garland has options to acquire up to 40% of the Newton shares from him. Ms. Garland and Mr. Isaac have never been married or lived in a common-law relationship. They are, however, good friends.

E. Mr. Barnes owns 70% of the shares of Noble Inc. and 24% of the shares of Borders Ltd. Noble Inc. owns 40% of the shares of Borders Ltd.

**Required:** For each of the preceding situations, indicate whether the corporations are associated and explain your conclusion with reference to the ITA. In order to assist you in answering this question, we have provided you with the content of ITA 256(1).

**ITA 256(1) Associated corporations** – For the purposes of this Act, one corporation is associated with another in a taxation year if, at any time in the year,

(a) one of the corporations controlled, directly or indirectly in any manner whatever, the other;

(b) both of the corporations were controlled, directly or indirectly in any manner whatever, by the same person or group of persons;

(c) each of the corporations was controlled, directly or indirectly in any manner whatever, by a person and the person who so controlled one of the corporations was related to the person who so controlled the other, and either of those persons owned, in respect of each corporation, not less than 25% of the issued shares of any class, other than a specified class, of the capital stock thereof;

(d) one of the corporations was controlled, directly or indirectly in any manner whatever, by a person and that person was related to each member of a group of persons that so controlled the other corporation, and that person owned, in respect of the other corporation, not less than 25% of the issued shares of any class, other than a specified class, of the capital stock thereof; or

(e) each of the corporations was controlled, directly or indirectly in any manner whatever, by a related group and each of the members of one of the related groups was related to all of the members of the other related group, and one or more persons who were members of both related groups, either alone or together, owned, in respect of each corporation, not less than 25% of the issued shares of any class, other than a specified class, of the capital stock thereof.

Answer:

***Part A***

Mr. Johnson and Mr. Langley are a group that controls Astro Inc. However, they do not control Borealis Ltd., as Mr. Kohn (not a member of the group that controls Astro Inc.) owns 50% of the shares. Therefore, Astro Inc. and Borealis Ltd. are not associated.

***Part B***

While they are not related, Ms. Martineau and Ms. Olson constitute a group [ITA 256(1.2)(a)] with respect to both Kisler Inc. and Pardo Ltd. As both Kisler Inc. and Pardo Ltd. are controlled by the same group, the two Companies are associated under ITA 256(1)(b).

***Part C***

The Lane sisters are related. In addition, under ITA 256(1.5) a person who owns shares in two or more corporations shall be, as a shareholder of one of the corporations, deemed to be related to himself or herself as a shareholder of the other corporation(s).

Given this, FL Inc. and Lane Ltd. are associated under ITA 256(1)(d). Fiona Lane controls FL Inc., is a member of a related group (Fiona and Jennifer Lane) that controls Lane Ltd., and Fiona owns more than 25% of the shares of Lane Ltd.

In similar fashion, JL Inc. is associated with Lane Ltd. under ITA 256(1)(d). Jennifer Lane controls JL Inc., is a member of a related group (Fiona and Jennifer Lane) that controls Lane Ltd., and Jennifer owns more than 25% of the shares of Lane Ltd.

Based on these associations, FL Inc. and JL Inc. are associated under ITA 256(2), as they are both associated with a third corporation, Lane Ltd.

***Part D***

For purposes of determining associated companies, Ms. Garland is deemed to own the 10% interest in Newton Ltd. that is held by her minor child [ITA 256(1.3)], as well as the 40% interest for which she holds options [ITA 256(1.4)]. When these interests are combined with her 10% direct interest in Newton Ltd., she would be considered to be in control of Newton Ltd. As she controls both Garland Inc. and Newton Ltd., these two Companies would be associated under ITA 256(1)(b).

***Part E***

With his 70% interest, Mr. Barnes controls Noble. This, in turn, gives him control over Noble's 40% interest in Borders. When combined with his direct interest of 24%, his total interest of 64% gives him control over Borders.

As both companies are controlled by the same person, the two Companies are associated under ITA 256(1)(b).

Type: ES

Topic: Associated corporations - analysis (applying the rules)

97) The following three independent cases involve the expenditures associated with various types of investment tax credits.

***Case A***

In 2021, Carlton Ltd. employed 12 eligible apprentices. The total amount paid to these individuals is $230,000. Seven of the apprentices are paid $15,000 for the year, with the remaining five

each being paid $25,000.

In addition, on December 12, 2021, the Company acquires $1,500,000 in Class 10 property on which a 10% investment tax credit is available.

**Required:** Describe the 2021 and 2022 income tax consequences associated with making these expenditures and claiming the related investment tax credits. Include in your solution the CCA for 2021 and 2022.

***Case B***

Since its date of incorporation, Lanson Ltd. has always qualified as a CCPC. For the taxation year ending December 31, 2021, it had taxable income of $652,000 and $714,000 in 2022.

Its Taxable Capital Employed In Canada (TCEC) was $12,300,000 in 2021 and $13,100,000 in 2022.

**Required:** Determine Lanson's SRED annual expenditure limit for the 2022 taxation year.

***Case C***

Martin Processes has been a CCPC since it was incorporated several years ago. In the taxation year ending December 31, 2021, it had taxable income of $32,000 and $12,000 in 2022. The Company has no federal income tax payable for the taxation year ending December 31, 2022, or for any of the three previous taxation years.

Its TCEC is $11,100,000 in 2021 and $12,400,000 in 2022. In 2022, the Company incurred a number of expenditures that qualify for investment tax credits:

• $110,000 for qualified property in the Atlantic Provinces.

• $3,300,000 in current expenditures for SRED.

**Required:** Determine the amount of the refund that Martin Processes will receive as a result of earning these investment tax credits and any available carry forwards. Include in your answer any other income tax consequences with respect to these investment tax credits.

Answer:

***Case A***

With respect to the $230,000 in apprentice salaries, the investment tax credit is available on an annual salary maximum of $20,000 per apprentice. As a result, there will be a $20,500 [(7)(10%)($15,000) + (5)(10%)($20,000 maximum)] credit against 2021 federal income tax payable. This $20,500 amount will be added to income in 2022.

With respect to the $1,500,000 in capital expenditures, there will be a 2022 credit against federal income tax payable of $150,000 [(10%)($1,500,000)].

The $150,000 credit will not influence the calculation of CCA for 2021 which will be $675,000 [(30%)(1.5)($1,500,000)].

In 2022, the $150,000 credit will be deducted from the January 1, 2022 UCC, leaving a balance of $675,000 ($1,500,000 - $675,000 - $150,000). Given this, 2022 CCA will be $202,500 [(30%)($675,000)].

***Case B***

Luxor's annual expenditure limit would be $2,827,500. This amount is calculated as follows:

[$3,000,000][($40,000,000 — $2,300,000) ÷ $40,000,000]

***Case C***

Martin's annual expenditure limit would be $2,917,500, calculated as follows:

[$3,000,000][($40,000,000 — $1,100,000) ÷ $40,000,000]

As the eligible SRED current expenditures exceed this limit, some of the expenditures will only be eligible for the 15% rate:

Total Current SRED Expenditures $3,300,000

Annual Expenditure Limit (Eligible for the 35% Rate) ( 2,917,500)

Limited to a rate of 15% $ 382,500

The total amount of investment tax credits available can be calculated as follows:

Qualified Property [(10%)($110,000)] $ 11,000

SRED Current Expenditures:

At 35% Rate [(35%)($2,917,500)] 1,021,125

At 15% Rate [(15%)($382,500)] 57,375

Total Available Amount $1,089,500

Martin is a qualifying corporation. The refund available would be as follows:

**Rate ITC Refund**

Qualified Property 40% $ 11,000 $ 4,400

SRED Current Expenditures 100% 1,021,125 1,021,125

SRED Current Expenditures 40% 57,375 22,950

Total Available $1,089,500 $1,048,475

The non-refunded investment tax credit of $41,025 ($1,089,500 - $1,048,475) can be carried forward 20 years to be applied against federal income tax payable. Since there was no federal income tax payable in the last three taxation years no amount can be carried back.

The cost of the qualified property will be reduced in the following year by the refundable investment tax credit of $4,400. The $1,044,075 ($1,021,125 + $22,950) refundable tax credit on current SRED expenditures will be added to income in the 2023 taxation year.

Type: ES

Topic: Investment tax credits - calculating the credits

98) Braken Ltd. is a CCPC that was incorporated in 2011. Between the date of its corporation and December 31, 2022, it has had the following transactions that relate to the Company's capital dividend account (CDA).

• In 2012, the Company sold a non-depreciable capital property with an ACB of $73,600 for $114,200.

• In 2015, the Company received a capital dividend of $42,100.

• In 2017, the Company paid a capital dividend of $23,100. The required election was made.

• In 2018, the Company sold two parcels of land. The first parcel of land, which had an ACB of $123,400, was sold for $176,200 and the second with an ACB of $220,400, was sold for $198,600.

• In 2019, the Company received life insurance proceeds, net of the adjusted cost basis of the policy, in the amount of $131,600.

• Early in 2022, Braken purchased an unlimited life franchise at a cost of $180,000. While Braken intended to operate this franchise as part of its overall business, the Company received an unsolicited offer to purchase this franchise for $240,000. Braken accepted this offer and the franchise was sold on November 1, 2022. On January 1, 2022, the UCC balance for Class 14.1 was nil.

• In 2022, the Company paid a capital dividend of $45,200. The required election was made.

**Required:** Determine the balance in the Company's CDA as of December 31, 2022. Provide a separate calculation of the income inclusion resulting from the sale of the franchise.

Answer: The December 31, 2022 CDA is calculated as follows:

2012 Capital Gain [(1/2)($114,200 - $73,600)] $ 20,300

2015 Capital Dividend Received 42,100

2017 Capital Dividend Paid ( 23,100)

2018 Capital Gain [(1/2)($176,200 - $123,400)] 26,400

2018 Capital Loss [(1/2)($198,600 - $220,400)] ( 10,900)

2019 Life Insurance Proceeds 131,600

2022 Capital Gain [(1/2)($240,000 - $180,000)] 30,000

2022 Capital Dividend Paid ( 45,200)

CDA Balance December 31, 2022 $171,200

Type: ES

Topic: Capital dividend account (CDA) - calculating the CDA

99) **Required:** Indicate the income tax consequences to the relevant shareholders of the transaction(s) described in each of the following **independent** Cases that are the result of transactions with the corporation and not between shareholders except where there is a sale of effected shares following the corporate event. Income tax consequences include the increase or decrease in the individual shareholder's net income, any change in the ACB or PUC of any shares that are still owned after the various events described in each case, and any federal dividend tax credits that result from the transaction(s). Assume that any taxable dividends are non-eligible.

***Case One***

When Austen Inc. was first incorporated, it issued 233,000 shares at $18 per share.

The following year, Jane Lessing acquired 20% of these shares at $21 per share from existing shareholders. The total cost of the 46,600 [(20%)(233,000)] shares was $978,600.

During the current year, a creditor of the Company has agreed to accept 17,000 new Austen Inc. shares in settlement of an amount owing of $350,000. At this time, the FMV of the shares is $22 per share.

Shortly after the debt settlement transaction, Jane Lessing sells her shares to an arm's length person for $24 per share.

***Case Two***

After liquidating all of its assets and paying off all of its liabilities, Eliot Ltd. is left with cash of $3,850,000. The $3,850,000 is distributed to the corporation's only shareholder, George Christie. He has owned the shares for more than 20 years. The PUC of the shares is $106,000 and the ACB $597,000. In addition the corporation has a CDA balance of $347,000 that will be utilized with respect to any distribution that results in a dividend (deemed or otherwise). Subsequent to the distribution, the company is dissolved and its shares cancelled.

***Case Three***

When Bronte Ltd. was incorporated several years ago, 250,000 common shares were issued at a price of $35 per share. As the original owner wished to retire, all of the shares were sold to Charlotte Austen for $32 per share. The following year, the Company redeemed 75,000 of the Bronte Ltd. shares for $37 each.

***Case Four***

Doris Eliot owns all of the outstanding shares of Lessing Inc. Lessing Inc. is a CCPC. The PUC of the shares is $343,000 and the ACB $451,000. During the current year Lessing Inc. is authorized to makes a return of capital and distributes $123,000 which was accompanied by a PUC reduction of $63,000.

Answer:

***Case One***

The debt settlement transaction will result in an ITA 84(1) deemed dividend, calculated as follows:

PUC of New Shares [(17,000)($22)] $374,000

Increase in Net Assets (Liability Eliminated) ( 350,000)

ITA 84(1) Deemed Dividend $ 24,000

This deemed dividend would be allocated to the 250,000 (233,000 + 17,000) shares that are now outstanding on the basis of $0.096 ($24,000 ÷ 250,000) per share.

For Jane, this would result in a deemed dividend of $4,474 [($0.096)(46,600)] of which $5,145 [(115%)($4,474) would be added to her income as a taxable non-eligible dividend.

The deemed dividend is added to the ACB of Jane's shares resulting in a revised ACB of $21.096 per share ($21.00 + $0.096).

The income tax consequences when Jane sells her her shares would be as follows:

POD [(46,600)($24.00)] $1,118,400

ACB [(46,600)($21.096)] ( 983,074)

Capital Gain $ 135,326

Inclusion Rate 1/2

Taxable Capital Gain $ 67,663

This will result in a total increase in her net income of $72,808 ($67,663 + $5,145) There will also be a federal dividend tax credit of $465 [(9/13)(15%)($4,474)] that will reduce her federal income tax payable.

***Case Two***

The analysis of the distribution would be as follows:

Cash Distributed $3,850,000

PUC ( 106,000)

ITA 84(2) Deemed Dividend $3,744,000

ITA 83(2) Capital Dividend ( 347,000)

Net Taxable Eligible Dividend $3,397,000

Cash Distributed $3,850,000

Less: ITA 84(2) Deemed Dividend ( 3,744,000)

Adjusted POD $ 106,000

ACB ( 597,000)

Capital Loss ($ 491,000)

Inclusion Rate 1/2

Allowable Capital Loss ($ 245,500)

The capital dividend would be distributed tax free. The $3,397,000 taxable non-eligible dividend would be grossed up to $3,906,550 [(115%)($3,397,000)]. It will also provide for a federal dividend tax credit of $352,765 [(9/13)(15%)($3,397,000)].

The allowable capital loss can be used in the current year, only to the extent of taxable capital gains realized in the current year. The stop loss rule will not deny the allowable capital loss since the corporation is being wound-up.

***Case Three***

The income tax consequences to Charlotte Austen resulting from the redemption of her shares would be as follows:

Proceeds of Redemption [(75,000)($37)] $2,775,000

PUC [(75,000)($35)] ( 2,625,000)

ITA 84(3) Deemed Dividend $ 150,000

Proceeds of Redemption $2,775,000

Less: ITA 84(3) Deemed Dividend ( 150,000)

Modified POD $2,625,000

ACB [($32)(75,000)] ( 2,400,000)

Capital Gain $ 225,000

Inclusion Rate 1/2

Taxable Capital Gain $ 112,500

The deemed dividend will be grossed up to $172,500 [(115%)($150,000)]. This will result in a total increase in net income of $285,000 ($172,500 + $112,500). The dividend will generate a federal credit of $15,577 [(9/13)(15%)($150,000)].

With respect to the shares still held by Charlotte Austen, they would have a PUC of $6,125,000 [($35)(250,000 - 75,000)] and the ACB would be $5,600,000 [($32)(250,000 - 75,000)].

***Case Four***

To the extent of the $63,000 PUC reduction, the liquidating dividend will be treated as a tax free distribution to Ms. Eliot. However, there will be income tax consequences with respect to this distribution:

• The PUC of Ms. Eliot's shares will be reduced to $280,000 ($343,000 - $63,000).

• The ACB of Ms. Eliot's shares will be reduced to $388,000 ($451,000 - $63,000).

The $60,000 ($123,000 - $63,000) excess of the distribution over the PUC reduction will be an ITA 84(4) deemed dividend. For purposes of determining net income, this amount will be grossed up to $69,000 [(115%)($60,000)]. It will generate a federal dividend tax credit of $6,231 [(9/13)(15%)($60,000)].

Type: ES

Topic: Dividends - deemed dividends 4 cases ITA 84(1) to 84(4)

100) **Required:** Indicate the income tax consequences to the relevant shareholders of the transaction(s) described in each of the following **independent** Cases that are the result of transactions with the corporation and not between shareholders except where there is a sale of effected shares following the corporate event. Income tax consequences include the increase or decrease in the individual shareholder's net income, any change in the ACB and/or PUC of any shares that are owned by individual shareholders after the described transaction(s), and any federal dividend tax credits that result from the described transaction(s). Assume that any taxable dividends are non-eligible.

***Case 1***

Marion Scope owns 100% of the outstanding shares of Scope Ltd, a CCPC. The PUC of the shares of the Company are $683,000 and Marion's ACB is $723,000.

During the current year, a distribution of $223,000 was paid to Marion. This was accompanied by a PUC reduction of $162,000.

***Case 2***

Jason Mark owns 15% of the outstanding voting shares of Mark Ltd. These shares were acquired when the Company was incorporated. At that time, 225,000 shares were issued for $15 each.

One of the Company's creditors has agreed to accept 30,000 new Mark Ltd. shares as full payment for a debt owed by the company in the amount of $550,000. At that time the FMV of the Mark Ltd. shares is $20 each.

Later that year Jason Mark sells all of his shares for $23 each.

***Case 3***

After liquidating all of its assets and paying off all of its liabilities, a corporation is left with cash of $1,875,000. The $1,875,000 is distributed to the corporation's sole shareholder, Veronica Venus who has owned the shares for more than 10 years. The PUC of the shares is $125,000 and the ACB $364,000. The company has a CDA balance of $321,000 which it intends to use with respect to any distribution. Subsequent to the distribution, the company is dissolved and its shares. are cancelled

***Case 4***

At incorporation, Lason Inc. issued 300,000 common shares for $32 each. The original shareholder later sold these shares to Lawrence Foster for $28 each. During the year subsequent to the sale, the Company redeemed 50,000 of these shares for $1,700,000.

Answer:

***Case 1***

To the extent of the $162,000 PUC reduction, the liquidating dividend will be treated as a tax free distribution to Marion. However, there will be income tax consequences related to this distribution:

• The PUC of Marion's shares will be reduced to $521,000 ($683,000 - $162,000).

• The ACB of Marion's shares will be reduced to $561,000 ($723,000 - $162,000).

The $61,000 ($223,000 - $162,000) excess of the distribution over the PUC reduction will be an ITA 84(4) deemed dividend. Since such a distribution does not result in a disposition of any shares there are no capital gains or capital losses.

• Increase in net income = Grossed up Dividend [(115%)($61,000)] $70,150

• Federal Dividend Tax Credit [(9/13)(15%)($61,000)] $ 6,335

***Case 2***

This transaction will result in an ITA 84(1) deemed dividend for all shareholders, calculated as follows:

PUC of New Shares [(30,000)($20)] $600,000

Increase in Net Assets (Liability Eliminated) ( 550,000)

ITA 84(1) Deemed Dividend $ 50,000

This would be allocated to all 255,000 (225,000 + 30,000) shares outstanding, on the basis of $0.196 per share ($50,000 ÷ 255,000). This amount will also be added to the ACB of the shares.

Given that Jason acquired his 33,750 [(15%)(225,000)] shares for $15 per share, the income tax consequences of Jason owning and selling his shares would be as follows:

Grossed up Dividend [(33,750)(115%)($0.196)] $ 7,607

POD [(33,750)($23.00)] $776,250

ACB [(33,750)($15.00 + $0.196)] ( 512,865)

Capital Gain $263,385

Inclusion Rate 1/2

Taxable Capital Gain (All Shares Sold) $131,693

• Increase in net income ($7,607 + $131,693) $139,300

• Federal Dividend Tax Credit [(33,750)(9/13)(15%)($0.196)] $687

***Case 3***

The analysis of the distribution would be as follows:

Cash Distributed $1,875,000

PUC ( 125,000)

ITA 84(2) Deemed Dividend $1,750,000

ITA 83(2) Capital Dividend ( 321,000)

Taxable Non-eligible Dividend $1,429,000

Cash Distributed $1,875,000

Less: ITA 84(2) Deemed Dividend ( 1,750,000)

Modified POD $ 125,000

ACB ( 364,000)

Capital Loss ($ 239,000)

Inclusion Rate 1/2

Allowable Capital Loss ($ 119,500)

The capital dividend would be distributed tax free.

The allowable capital loss can be used in the current year, only to the extent of taxable capital gains realized in the current year. The capital loss would not be denied by the stop loss rule of ITA 40(3.6) because the corporation was dissolved.

• Increase in net income = Grossed up Dividend

[(115%)($1,429,000)] $1,643,350

• Federal Dividend Tax Credit [(9/13)(15%)($1,429,000)] $148,396

***Case 4***

The income tax consequences to Lawrence Foster resulting from the redemption of his shares would be as follows:

Proceeds of Redemption $1,700,000

PUC [(50,000)($32)] ( 1,600,000)

ITA 84(3) Deemed Dividend $ 100,000

Proceeds of Redemption $1,700,000

Less: ITA 84(3) Deemed Dividend ( 100,000)

Modified POD $1,600,000

ACB

[(50,000/300,000)($8,400,000)] ( 1,400,000)

Capital Gain $ 200,000

Inclusion Rate 1/2

Taxable Capital Gain $ 100,000

• Increase in net income [(115%)($100,000) + $100,000] $215,000

• Federal Dividend Tax Credit [(9/13)(15%)($100,000)] $10,385

• No effect on the per share ACB or PUC of the remaining shares.

With respect to the shares still owned, they would have a PUC of $8,000,000 [($32)(300,000 - 50,000)] and an ACB of $7,000,000 [($28)(300,000 - 50,000)].

Type: ES

Topic: Dividends - deemed dividends 4 cases ITA 84(1) to 84(4)