

CHAPTER ELEVEN SOLUTIONS

Solution to Assignment Problem Eleven - 1

2009 Analysis

The required information can be calculated as follows:

ITA 3(a)		
Property Income	\$27,600	
Dividends Received	3,120	
Gross Up	780	\$31,500
ITA 3(b)		
Taxable Capital Gains [(1/2)(\$1,800)]	\$ 900	
Allowable Capital Losses [(1/2)(\$9,200)]	(4,600)	Nil
ITA 3(c)		\$31,500
ITA 3(d)		
Farm Loss (See Note)		(7,350)
Net Income For Tax Purposes And Taxable Income		\$24,150

Note Mr. Barkin's farm losses are restricted as follows:

Total Farm Loss		\$12,200
Deductible Amount:		
First \$2,500	(\$2,500)	
One-Half Of \$9,700 (\$12,200 - \$2,500)	(4,850)	(7,350)
Restricted Farm Loss Carry Forward		\$4,850

As noted in the problem, none of the losses can be carried back before 2009. This would leave the following carry forward balances at the end of 2009:

• Restricted Farm Loss Carry Forward	\$4,850
• Net Capital Loss Carry Forward (\$4,600 - \$900)	\$3,700

2010 Analysis

The required information can be calculated as follows:

ITA 3(a)		
Farm Income	\$ 2,320	
Non-Eligible Dividends Received	4,120	
Gross Up	1,030	\$ 7,470
ITA 3(b)		
Taxable Capital Gains [(1/2)(\$3,000)]	\$ 1,500	
Allowable Capital Losses	Nil	1,500
ITA 3(c)		\$ 8,970
ITA 3(d)		
Property Loss		(22,250)
Net Income For Tax Purposes		Nil
2009 Net Capital Loss Carry Forward		(\$ 1,500)
Taxable Income (Loss)		Nil

Since there are taxable capital gains this year, and the problem states that Mr. Barkin would like to deduct the maximum amount of his net capital loss carry forwards, the net capital loss carry forward of \$1,500 is added to the balance of the non-capital loss.

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

Property Loss	\$22,250
2009 Net Capital Loss Deducted	1,500
ITA 3(c) Income	(8,970)
Non-Capital Loss Carry Over For 2010	\$14,780

The entire non-capital loss carry over could be carried back to 2009, but since Mr. Barkin requires \$18,500 in Taxable Income to fully utilize his tax credits, the maximum carry back to 2009 is \$5,650, calculated as follows:

2009 Taxable Income (As Reported)	\$24,150
Required 2009 Income For Tax Credits	(18,500)
Maximum Carry Back	\$ 5,650

This carry back leaves Mr. Barkin with his required \$18,500 in 2009 amended Taxable Income.

There would be the following carry forward balances at the end of 2010:

• Restricted Farm Loss Carry Forward (Unchanged)	\$4,850
• Net Capital Loss Carry Forward (\$3,700 - \$1,500)]	\$2,200
• Non-Capital Loss Carry Forward (\$14,780 - \$5,650)	\$9,130

2011 Analysis

The required information can be calculated as follows:

ITA 3(a)		
Property Income	\$44,100	
Farm Income	3,840	
Non-Eligible Dividends Received	5,980	
Gross Up	1,495	\$55,415
ITA 3(b)		
Taxable Capital Gains [(1/2)(\$6,000)]	\$3,000	
Allowable Capital Losses	Nil	3,000
Net Income For Tax Purposes		\$58,415
Restricted Farm Loss Carry Forward (Equal To Farm Income)		(3,840)
Net Capital Loss Carry Forward (Less Than \$3,000)		(2,200)
Non-Capital Loss Carry Forward (All)		(9,130)
Taxable Income		\$43,245

There would be the following carry forward balances at the end of 2011:

• Restricted Farm Loss Carry Forward (\$4,850 - \$3,840)	\$1,010
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2012 Analysis

The required information can be calculated as follows:

ITA 3(a)		
Non-Eligible Dividends Received	\$ 8,720	
Gross Up	<u>2,180</u>	\$10,900
ITA 3(b)		
Taxable Capital Gains [(1/2)(\$6,700)]	\$ 3,350	
Allowable Capital Losses [(1/2)(\$21,300)]	<u>(10,650)</u>	Nil
ITA 3(c)		\$10,900
ITA 3(d)		
Property Loss	(\$30,800)	
Farm Loss	<u>(2,400)</u>	(33,200)
Net Income For Tax Purposes And Taxable Income		<u>Nil</u>

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

Property Loss	\$30,800
ITA 3(c) Income	<u>(10,900)</u>
Non-Capital Loss Carry Over	\$19,900
Farm Loss (Unrestricted)	<u>2,400</u>
Total Loss Carry Over For 2012	<u>\$22,300</u>

Although technically, the farm loss is accounted for separately from the non-capital loss, since the farm loss is less than \$2,500 it is treated as an unrestricted farm loss and can be applied against all types of income. Given the carry over rules are the same, we have treated this farm loss as part of the non-capital loss carry over. The preceding loss carry over of \$22,300 is available for carry back to 2011.

With respect to the net capital loss of \$7,300 (\$10,650 - \$3,350), there are \$800 (\$3,000 - \$2,200) in taxable capital gains left in 2011 as the basis for a carry back. This means that \$800 of this year's allowable capital loss can be carried back, leaving \$6,500 (\$7,300 - \$800) to be carried forward as a net capital loss balance.

If both the \$22,300 available farm and non-capital loss, as well as the \$800 net capital loss were carried back, the amended 2011 Taxable Income would be as follows:

2011 Taxable Income (As Reported)	\$43,245
Non-Capital Loss Carry Back From 2012	<u>(22,300)</u>
Net Capital Loss Carry Back From 2012	<u>(800)</u>
2011 Amended Taxable Income	<u>\$20,145</u>

This is more than the \$18,500 of Taxable Income required to use the 2011 tax credits.

Given these carry backs, the remaining loss carry forwards would be as follows:

• Restricted Farm Loss Carry Forward (Unchanged)	\$1,010
• Net Capital Loss Carry Forward (\$7,300 - \$800)	\$6,500

Solution to Assignment Problem Eleven - 2

The calculation of Mr. Atkins' Taxable Income for 2011 would be as follows:

Net Rental Income	\$36,870
Interest Income	5,250
Net Income For Tax Purposes And Taxable Income	<u>\$42,120</u>

In 2012, there is a loss of \$210,000 (\$275,000 - \$65,000) on the common shares. As these were shares in a Canadian controlled private company that used all of its assets to produce active business income, this would be a business investment loss (BIL).

The allowable portion (ABIL) would be \$105,000 $[(1/2)(\$210,000)]$. In contrast to other types of capital losses, ABILs can be deducted against any source of income.

Based on this analysis, Mr. Atkins' Taxable Income for 2012 would be calculated as follows:

Net Rental Income	\$41,200	
Interest Income	<u>5,650</u>	\$46,850
Allowable Business Investment Loss		(105,000)
Net Income For Tax Purposes And Taxable Income		<u>Nil</u>

As the ABIL was recognized in 2012, it must first be used to reduce that year's income to nil. Note that, because of this rule, Mr. Atkins cannot deduct a smaller amount in order to have sufficient income to absorb his basic personal tax credit. This will use up \$46,850 of the \$105,000 total and leave a balance of \$58,150 to be carried over to other years.

In carrying this amount back to 2011, the optimum solution would leave \$10,527 of Taxable Income so that Mr. Atkins can take advantage of his basic personal tax credit. Note that the calculation of the optimum carry back uses the basic personal amount of the carry back year, not the current year.

This means that Larry will need a loss carry back deduction of \$47,623 (\$58,150 - \$10,527 in 2011). This deduction will leave a Taxable Income of \$10,527. As planned, the taxes on this amount will be eliminated by Larry's basic personal credit.

A carry back of \$47,623 in 2011 leaves a carry forward balance of \$10,527 (\$58,150 - \$47,623) to be used in future years.

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

Solution to Assignment Problem Eleven - 3

To the extent that there has been use of the lifetime capital gains deduction in previous years, business investment losses (BILs) are disallowed. When they are disallowed, they become ordinary capital losses that must be deducted against the current year's taxable capital gains. Given this, the non-disallowed portion of the BIL would be calculated as follows:

2012 BIL Realized (\$109,000 - \$228,000 - \$1,000)	\$120,000
BIL Disallowed By Previous Use Of ITA 110.6 (\$38,000 + \$21,000)	(59,000)
Remaining Business Investment Loss	\$ 61,000
Inclusion Rate	1/2
Allowable Business Investment Loss	\$ 30,500

Using this analysis, Mr. Barkin's minimum Net Income For Tax Purposes and Taxable Income would be calculated as follows:

Net Employment Income	\$115,000
Net Taxable Capital Gains:	
Taxable Capital Gain	
[(1/2)(\$328,000 - \$153,000 - \$2,000)]	\$86,500
Disallowed ABIL [(1/2)(\$59,000)]	(29,500)
Allowable Business Investment Loss	(30,500)
Net Income For Tax Purposes	\$141,500
Lifetime Capital Gains Deduction (See Note)	(21,700)
Net Capital Loss Carry Forward Deducted	Nil
Taxable Income	\$119,800

Note The lifetime capital gains deduction is \$21,700, the least of:

Amount Available [(1/2)(\$750,000)]	\$375,000
Amount Used [(1/2)(\$38,000 + \$21,000)]	(29,500)
Amount Available	\$345,500
Taxable Capital Gain On Qualified Property	\$86,500
Allowable Loss Deducted (Disallowed ABIL)	(29,500)
Net Capital Loss Carry Forward Deducted	Nil
ABIL Realized	(30,500)
Annual Gains Limit	\$26,500
Sum Of Annual Gains Limits (\$19,000 + \$10,500 + \$26,500)	\$56,000
Amounts Deducted In Previous Years (\$19,000 + \$10,500)	(29,500)
CNIL	(4,800)
Cumulative Gains Limit	\$21,700

Solution to Assignment Problem Eleven - 4

Part A

Mr. and Mrs. Baxter's Taxable Income would be calculated as follows:

	Mrs. Baxter	Mr. Baxter
Registered Pension Plan Receipts	Nil	\$48,000
RRIF Withdrawals	Nil	28,000
Interest On Government Bonds	\$1,100	3,400
Non-Eligible Dividends Received	3,000	Nil
Gross Up On Dividends (25 Percent)	750	Nil
Old Age Security Benefits	6,500	6,500
Net Income Before Clawback	\$11,350	\$85,900
Social Benefits Repayment (Note 1)	Nil	(2,451)
Net Income For Tax Purposes And Taxable Income		
Before Any Transfer Of Dividends	\$11,350	\$83,449

Note 1 Mrs. Baxter would not have to repay any of his OAS benefits as her Net Income is well below the threshold income of \$69,562. Mr. Baxter's social benefits repayment would be \$2,451, the lesser of:

- \$6,500, and
- $[(15\%)(\$85,900 - \$69,562)] = \$2,451$.

Mrs. Baxter's Tax Payable would be calculated as follows:

Federal Tax Before Credits $[(15\%)(\$11,350)]$		\$1,703
Tax Credits		
Basic Personal	\$10,822	
Other (Transferred To Mr. Baxter)	Nil	
Total Base	\$10,822	
Rate	15%	(1,623)
Dividend Tax Credit $[(2/3)(\$750)]$		(500)
Federal Tax Payable		Nil

The transfer to Mr. Baxter would be calculated as follows:

Credits Available For Transfer:		
Age		\$ 6,720
Disability		7,546
Total Available		\$14,266
Reduced By Excess Of:		
Mr. Dalton's Net Income	(\$11,350)	
Over Basic Personal Credit Amount	10,822	(528)
Available For Transfer		\$13,738

The amount owing for Mr. Baxter would be calculated as follows:

Tax On First \$42,707	\$ 6,406	
Tax On Next \$40,742 (\$83,449 - \$42,707) At 22 Percent	<u>8,963</u>	\$15,369
Tax Credits		
Basic Personal	(\$10,822)	
Spousal Including FCA (\$12,822 - \$11,350)	(1,472)	
Age { \$6,720 - [(15%)(\$83,449 - \$33,884)] }	Nil	
Pension	(2,000)	
Transfer From Spouse (Preceding Calculation)	(13,738)	
Credit Base	(\$28,032)	
Rate	<u>15%</u>	(4,205)
Charitable Donations [(15%)(\$200) + (29%)(\$560 + \$450 - \$200)] (Note 2)		(265)
Federal Tax Payable		\$10,899
OAS Clawback		<u>2,451</u>
Amount Owing		<u>\$13,350</u>

Note 2 Charitable donations can be claimed by either spouse, as long as the total donations are less than 75 percent of the claiming spouse's Net Income For Tax Purposes. As Mrs. Baxter has no Tax Payable, Mr. Baxter will claim her charitable donations. It is usually advantageous for one spouse to claim all the charitable donations if they total more than \$200, as the low rate of credit is only applied once.

Part B - Eligibility For Transfer

Mr. Baxter's current spousal credit is \$1,472. If Mrs. Baxter's dividends are transferred, she would be left with Net Income For Tax Purposes of \$7,600 (\$11,350 - \$3,000 - \$750). This would leave a spousal credit of \$5,222 (\$12,822 - \$7,600). As this is an increase from the previous amount, the transfer is permitted.

Part C

If all of Mrs. Baxter's dividends are transferred to Mr. Baxter, their new Taxable Income figures would be calculated as follows:

	Mrs. Baxter	Mr. Baxter
Net Income Before Clawback As Per Part A	\$11,350	\$85,900
Dividend Transfer	(3,000)	3,000
Gross Up Transfer	(750)	750
Net Income After Dividend Transfer Before Clawback	\$ 7,600	\$89,650
Social Benefits Repayment (Note 3)	Nil	(3,013)
Net Income For Tax Purposes And Taxable Income	\$ 7,600	<u>\$86,637</u>

Note 3 Mrs. Baxter would not have to repay any of her OAS benefits as her Net Income is well below the threshold income of \$69,562. Mr. Baxter's social benefits repayment would be \$3,013, the lesser of:

- \$6,500, and
- [(15%)(\$89,650 - \$69,562)] = \$3,013.

Solution To AP Eleven - 4

As Mrs. Baxter's revised income figure is below the basic personal credit of \$10,822, her Tax Payable would continue to be nil. The transfer to Mr. Baxter would be calculated as follows:

Credits Available For Transfer:		
Age		\$ 6,720
Disability		7,546
Total Available		\$14,266
Reduced By Excess Of:		
Mr. Baxter's Net Income	(\$ 7,600)	
Over Basic Personal Credit Amount	10,822	(Nil)
Available For Transfer		\$14,266

With respect to Mr. Baxter, his amount owing would be calculated as follows:

Tax On First \$85,414	\$15,802	
Tax On Next \$1,223 (\$86,637 - \$85,414) At 26 Percent	318	\$16,120
Tax Credits		
Basic Personal	(\$10,822)	
Spousal Including FCA (\$12,822 - \$7,600)	(5,222)	
Age {\$6,720 - [(15%)((\$87,199 - \$33,884))}]	Nil	
Pension	(2,000)	
Transfer From Spouse (Preceding Calculation)	(14,266)	
Credit Base	(\$32,310)	
Rate	15%	(4,847)
Charitable Donations [(15%)(200) + (29%)(560 + 450 - 200)]		(265)
Dividend Tax Credit [(2/3)(750)]		(500)
Federal Tax Payable		\$10,508
OAS Clawback		3,013
Amount Owing		\$13,521

The use of the ITA 82(3) dividend transfer has decreased Mr. Baxter's federal Tax Payable from \$10,899 to \$10,508. However, it has increased the OAS clawback from \$2,451 to \$3,013. Overall, the net effect is an increase in the amount owing of \$171. Clearly, the transfer of dividends is not a desirable alternative.

Solution to Assignment Problem Eleven - 5

The regular Tax Payable calculations would be as follows:

	Walter	Wendel	Winston
Employment And Business Income	\$ 52,100	\$42,300	\$ 41,300
Non-Eligible Dividends Received	82,300	Nil	12,300
Dividend Gross Up (25 Percent)	20,575	Nil	3,075
Retiring Allowance	Nil	35,000	Nil
RRSP Deduction	Nil	(35,000)	Nil
Taxable Capital Gains	36,400	Nil	226,550
Net Income For Tax Purposes	\$191,375	\$42,300	\$283,225
Lifetime Capital Gains Deduction	(36,400)	Nil	(221,500)
Taxable Income	\$154,975	\$42,300	\$ 61,725
Federal Tax (Note)	\$ 34,565	\$ 6,345	\$ 10,590
Basic Personal Credit	(1,623)	(1,579)	(1,623)
Dividend Tax Credit (2/3 of Gross Up)	(13,717)	Nil	(2,050)
Regular Federal Tax Payable	\$ 19,225	\$ 4,766	\$ 6,917

Note The federal tax payable, before the dividend tax credit, is as follows:

	Taxable Income	Federal Tax Calculations	Federal Tax
Walter	\$154,975	\$28,020 + (29%)(\$22,569)	\$34,565
Wendel	\$ 42,300	(15%)(\$42,300)	\$ 6,345
Winston	\$ 61,725	\$6,406 + (22%)(\$19,018)	\$10,590

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

	Walter	Wendel	Winston
Regular Taxable Income	\$154,975	\$42,300	\$ 61,725
30% Of Capital Gains (Note)	21,840	Nil	135,930
Dividend Gross Up	(20,575)	Nil	(3,075)
Adjusted Taxable Income	\$156,240	\$42,300	\$194,580
AMT Exemption	(40,000)	(40,000)	(40,000)
AMT Base	\$116,240	\$ 2,300	\$154,580
Rate	15%	15%	15%
Federal AMT Before Credit	\$ 17,436	\$ 345	\$ 23,187
Basic Personal Credit	(1,623)	(1,623)	(1,623)
Federal AMT	\$ 15,813	Nil	\$ 21,564
Regular Federal Tax Payable	(19,225)		(6,917)
Additional Tax Required	Nil		\$ 14,647

Note The 30 percent capital gain inclusion can be calculated by taking 30 percent of double the taxable capital gain.

The excess AMT over regular tax payable for Winston can be carried forward for seven years and applied against any future excess of regular Tax Payable over the alternative minimum tax.

Solution to Assignment Problem Eleven - 6

Net Income For Tax Purposes And Taxable Income

Ms. Klaus' minimum Net Income For Tax Purposes and Taxable Income would be calculated as follows:

Net Employment Income		
Gross Salary - Ottawa	\$62,000	
RPP Contributions - Ottawa	(2,500)	
Stock Option Benefit (Note One)	10,000	
Gross Salary - Toronto	13,000	
RPP Contributions - Toronto	(650)	
Moving Allowance (Note Two)	7,500	\$ 89,350
Business And Property Income		
Non-Eligible Dividends On Lintz Shares	\$ 7,500	
Gross Up [(25%)(7,500)]	1,875	
Mail Order Business (Note Three)	22,500	31,875
Taxable Capital Gains (Allowable Capital Losses)		
Lintz Shares [(1/2)(\$105,000 - \$95,000 - \$1,050)]	\$ 4,475	
Employer's Shares (Note Four)	(175)	4,300
Other Sources Of Income (Subdivision d)		
Child Support (Note Five)	\$ -0-	
Retiring Allowance (Note Six)	30,000	30,000
Other Deductions From Income (Subdivision e)		
Moving Expenses (Note Two)	(\$ 5,160)	
Child Care Costs (Note Seven)	(7,560)	
RRSP Contributions (Note Eight)	(36,498)	(49,218)
Net Income For Tax Purposes		\$106,307
Stock Option Deduction (Note One)		(5,000)
Taxable Income		\$101,307

Note One The required inclusion would be calculated as follows:

Fair Market Value At Exercise [(20)(2,000 Shares)]	\$40,000
Cost Of Shares [(\$15)(2,000 Shares)]	(30,000)
Stock Option Benefit	\$10,000

As the option price at the time the options were issued was greater than the fair market value of the shares at that time, Ms. Klaus is entitled to a deduction under ITA 110(1)(d), equal to one-half of the \$10,000 employment income benefit.

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

Moving Company Charges	\$3,800
Airfare For Toronto Trip (Not Deductible)	Nil
Meals And Lodging On Toronto Trip (Not Deductible)	Nil
Gas For October 31 Move To Toronto	65
Lodging In Ottawa On October 30	110
Meals On October 30 And October 31	250
Lease Cancellation Charges	935
Legal Fees On Acquisition Of Toronto Home (Not Deductible)	Nil
Total	\$5,160

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

Note Three The interest on the demand loan is deductible and does not require adjustment. The \$27,000 withdrawal would have no effect on business income.

Note Four For shares acquired through the exercise of stock options, the adjusted cost base is the fair market value of the shares at the time of exercise. As a consequence, the allowable capital loss arising on the disposition of the employer's shares would be calculated as follows:

Proceeds Of Disposition [(20)(2,000 Shares)]	\$40,000
Less:	
Adjusted Cost Base [(20)(2,000)]	(\$40,000)
Selling Costs	(350)
Capital Gain (Loss)	(\$ 350)
Inclusion Rate	1/2
Taxable Capital Gain (Allowable Capital Loss)	(\$ 175)

Note Five Ms. Klaus cannot deduct the \$2,500 in legal fees paid in connection with her separation agreement. However, as her husband will not be able to deduct the \$25,000 lump sum payment, it does not have to be included in her income. The \$48,000 [(\$4,000)(12 Months)] in child support will not be deductible to her husband and will be excluded from her Net Income For Tax Purposes.

Note Six All of the retiring allowance must be included in income under ITA 56(1)(a)(ii). Subject to a limit of \$2,000 per year of service prior to 1996, amounts transferred to an RRSP can be deducted under ITA 60(j.1). Ms. Klaus had 20 years of service prior to 1996. As a result, her maximum transfer would be \$40,000 [(20)(\$2,000)]. Given this, she can transfer to her RRSP, and deduct, the entire \$30,000 retiring allowance.

Note Seven The deductible child care costs of \$7,560 would be the least of:

• Actual Child Care Expense Plus Deductible Camp Fees	
[\$7,160 + (\$100 Limit)(4 Weeks)]	\$ 7,560
• Annual Limit (\$10,000 For Louise + \$4,000 For Martin)	14,000
• Two-Thirds Of Earned Income	
[(2/3)(\$89,350 + \$2,500 + \$650 + \$22,500)]	76,667

Note Eight Ms. Klaus' maximum deductible RRSP contribution of \$36,498, which includes her retiring allowance, is calculated as follows:

Solution To AP Eleven - 6

Unused Deduction Room - End Of 2011	Nil
Lesser Of:	
• 2012 RRSP Dollar Limit = \$22,970	
• 18% Of 2011 Earned Income Of \$61,100 = \$10,998	\$10,998
Less 2011 PA	(4,500)
RRSP Deduction Limit	\$ 6,498
Retiring Allowance	30,000
Maximum Deductible RRSP Contribution For 2012	\$36,498

Tax Payable

The Tax Payable would be calculated as follows:

Tax on First \$85,414		\$15,802
Tax on Next \$15,893 (\$101,307 - \$85,414) At 26 Percent		4,132
Total Before Credits		\$19,934
Basic Personal Amount	(\$10,822)	
Eligible Dependant - Martin (Note 9)	(10,822)	
Caregiver Including FCA - Louise (Note 9)	(6,402)	
Child	(2,191)	
CPP (Maximum)	(2,307)	
EI (Maximum)	(840)	
Canada Employment	(1,095)	
Transfer Of Louise's Disability	(7,546)	
Medical Expenses (Note Ten)	(15,561)	
Credit Base	(\$57,586)	
Rate	15%	(8,638)
Non-Eligible Dividend Tax Credit [(2/3)(\$1,875)]		(1,250)
Charitable Donations		
[(15%)(\$200) + (29%)(\$1,500 - \$200)]		(407)
Political Contributions Tax Credit		
[(3/4)(\$400) + (1/2)(\$350) + (1/3)(\$150)]		(525)
Net Federal Tax		\$ 9,114
CPP Overpayment (\$2,307 + \$500 - \$2,307)		(500)
EI Overpayment (\$840 + \$390 - \$840)		(390)
Amount Owing To The CRA		\$ 8,224

Note Nine As the eligible dependant credit can only be claimed for one individual, claiming it for Martin means that Louise does not qualify for this credit. As she does not qualify for this credit, she would be eligible for both the infirm dependant over 17 and the caregiver tax credits. In these circumstances, ITA 118(4)(d) deems Louise not to be a dependant, in effect requiring the caregiver credit to be claimed. Because Louise is disabled, and her income is below the threshold for the caregiver credit, Ms. Klaus can claim the full amount of the caregiver credit, as well as the family caregiver amount.

Note Ten

Marcia And Martin's Medical Expenses (\$9,700 + \$900)	\$10,600
Threshold - Lesser Of: [(3%)(\$106,307)] and \$2,109	(2,109)
Subtotal	\$ 8,491
Louise's Medical Expense	\$7,250
Lesser Of:	
• [(3%)(\$6,000)] = \$180	
• 2012 Limit = \$2,109	(180)
Allowable Medical Expenses	\$15,561

Solution to Assignment Problem Eleven - 7

Net And Taxable Income

Mr. Pharmacy's Net Income For Tax Purposes and Taxable Income would be calculated as follows:

Employment Income	\$378,000
Employment Expenses [(650/5,000)(\$3,200 + \$4,000 + \$3,800 + \$6,700)]	(2,301)
Net Rental Income (Note One)	Nil
Taxable Capital Gains (Note Two)	4,418
Net Income For Tax Purposes	\$380,117
Net Capital Loss Carry Forward From 2011 (Note Three)	(4,418)
Taxable Income	\$375,699

Note One Mr. Pharmacy's net rental income can be calculated as follows:

Gross Rents		\$ 16,000
Less Expenses:		
Property Taxes	\$5,128	
Insurance	1,890	
Interest	3,175	
Maintenance And Repairs (\$550 + \$3,469)	4,019	(14,212)
Rental Income Before CCA		\$ 1,788
CCA On Class 1 Building* (Maximum Allowed)		(1,788)
Net Rental Income		Nil

*As the deduction of CCA cannot be used to create or increase a net rental loss, maximum CCA cannot be taken. When the maximum CCA cannot be deducted, the CCA should usually be taken from the classes with the lowest rates. In this case, the Class 1 building at 4 percent is less than the 20 percent applicable to Class 8. Since the building was not a new building, the applicable rate is 4 percent, not 6 percent. While CCA of \$4,297 [(4%)(107,441)] is available on Class 1, only \$1,788 can be taken in 2012.

Note Two - Listed Personal Property The painting and coin collection are classified as listed personal property. The gain and loss calculations are as follows:

	Painting	Coin Collection
Proceeds Of Disposition (Minimum = \$1,000)	\$1,100	\$ 1,000
Adjusted Cost Base (Minimum = \$1,000)	(1,000)	(1,800)
Capital Gain (Loss)	\$ 100	(\$ 800)
Inclusion Rate	1/2	1/2
Taxable Capital Gain (Allowable Loss)	\$ 50	(\$ 400)

As losses on listed personal property can only be claimed against gains on such property, the unused loss of \$350 (\$400 - \$50) cannot be applied in the current year. However, the listed personal property loss can be carried forward.

Note Two - Other Capital Property The motorcycle and sailboat would be classified as personal use property. Therefore, the loss realized on the motorcycle cannot be recognized. However, the gain on the sailboat must be recognized, along with the Molson shares and the loss on the Imperial Oil shares. The required calculations are as follows:

Solution To AP Eleven - 7

	Molson Inc.	Imperial Oil	Sailboat
Proceeds Of Dispositions	\$37,000	\$ 9,600	\$74,000
Adjusted Cost Base	(27,600)	(12,100)	(72,000)
Selling Costs	(35)	(29)	N/A
Capital Gain (Loss)	\$ 9,365	(\$ 2,529)	\$ 2,000
Inclusion Rate	1/2	1/2	1/2
Taxable Capital Gain	\$ 4,683	(\$ 1,265)	\$ 1,000

Net Taxable Capital Gain The net taxable capital gain is \$4,418 (\$4,683 - \$1,265 + \$1,000).

Note Three The \$10,500 net capital loss carry forward from the 2011 sale of shares can be deducted in 2012 to the extent of the \$4,418 in taxable capital gains realized in 2012. This leaves a net capital loss carry forward of \$6,082 (\$10,500 - \$4,418).

Tax Payable

Mr. Pharmacy's federal Tax Payable would be calculated as follows:

Federal Tax On First \$132,406		\$28,020
Federal Tax On Next \$243,293 (\$375,699 - \$132,406) At 29 Percent		70,555
Gross Federal Tax		\$98,575
Basic Personal Amount	(\$10,822)	
Spousal [\$10,822 - \$5,800]	(5,022)	
Child (Includes Family Caregiver Amount)	(4,191)	
Caregiver - Joan (Includes Family Caregiver Amount)	(6,402)	
Transfer - Valerie's Age Amount	(6,720)	
Transfer - Kevin's Disability	(7,546)	
Disability Supplement	(4,402)	
EI Premiums	(840)	
CPP Contributions	(2,307)	
Canada Employment	(1,095)	
Medical Expenses (Note Four)	(37,539)	
Credit Base	(\$86,886)	
Rate	15%	(13,033)
Charitable Donations		
[(15%)(\$200) + (29%)(\$400 + \$1,000 + \$3,000 - \$200)]		(1,248)
Federal Tax Payable		\$ 84,294
Provincial Tax Payable (Given)		26,000
Income Tax Withheld		(114,000)
Refund		(\$ 3,706)

Loss Carry Forwards

There are two loss carry forwards available:

Listed Personal Property Loss Carry Forward	\$ 350
Net Capital Loss Carry Forward	\$6,082

Note Four The allowable medical expenses can be calculated as follows:

George, Spouse, And Minor Child (Kevin) Medical Expenses		
(\$731 + \$155 + \$109 + \$67 + \$30,000 + \$800)		\$31,862
Threshold - Lesser Of: [(3%)((\$375,699))] And \$2,109		(2,109)
Subtotal		\$29,753
Martin's Medical Expenses	\$6,000	
Lesser Of:		
• [(3%)((\$8,300))] = \$249		
• 2012 Threshold Amount = \$2,109	(249)	5,751
Joan's Medical Expenses	\$2,050	
Lesser Of:		
• [(3%)((\$500))] = \$15		
• 2012 Threshold Amount = \$2,109	(15)	2,035
Allowable Medical Expenses		\$ 37,539

Notes To George's Tax Return

- Since Valerie's father David is not a Canadian resident, he cannot be claimed as a dependant. In addition, his medical expense cannot be claimed.
- Valerie's age credit is transferred to George as her Net Income For Tax Purposes is less than the basic personal amount. George's income is too high to claim his own age credit.
- Kevin's disability credit for all ages and his disability supplement credit for under 18 are claimed by George.
- Martin's education related credits can only be transferred to a spouse, parent, or grandparent. As a result, they cannot be transferred to George and must be carried forward by Martin for his own use.
- Although it will not affect George Pharmacy, Martin should file his tax return to receive the GST credit. Filing a tax return will also make his education related tax credits easier to keep track of for carry forward purposes.
- Joan Parker should file a tax return to receive the GST credit. She would need a Social Insurance Number before she can file a return.
- The reimbursement of his employment expenses has no effect on his income taxes.
- The cost of a residential phone line, the internet connection, mortgage interest, and mortgage life insurance premiums cannot be deducted as home office costs.
- The new computer and software are capital assets and no part of their cost can be deducted as an employment expense.

Tax Planning Points

- George should immediately open a spousal RRSP and contribute as much as he can for as long as he can. Since Valerie is one year older than he is, George will be able to contribute to his own RRSP for one year more than he could to a spousal RRSP. The pension income splitting rules should benefit him when he begins to withdraw from his RRIF. Since he and Valerie are approaching 71 years of age, he does not have much time to contribute to RRSPs.

Solution To AP Eleven - 7

- Given his employment income and the fact it appears his employer does not have an RPP, he should have considerable RRSP deduction room. Since Kevin is blind, it is likely that he would be considered a financially dependent child. As a result, if Kevin is named beneficiary of the RRSP or RRIF on the death of George and Valerie, the tax burden to the estate could be considerably reduced.
- George should consider an RESP for Kevin. Since Kevin is blind, he can also be a beneficiary of an RDSP. If George makes any contributions to these plans, he should try to maximize the Canada Education Savings Grant and the Canada Disability Savings Grant that the government will contribute.
- George should consider TFSAs for himself and his wife. The decision as to whether he should contribute to a spousal RRSP, an RESP, an RDSP or TFSAs requires the consideration of many factors (see the text).

Solution to Assignment Problem Eleven - 8

Part A - Net Income For Tax Purposes

Ms. Son's Net Income For Tax Purposes would be calculated as follows:

Net Employment Income (Salary - Musical Notes Inc.)	\$150,000
Property Income (Note 1)	115,500
Net Taxable Capital Gains (Note 2)	386,900
RRSP Deduction	(9,500)
Net Income For Tax Purposes	\$642,900

Child care expenses have not been deducted because Jihoon has income in excess of the personal tax credit base amount of \$10,822. Also because of this income level, Ms. Son will not be able to claim the eligible dependant tax credit. The child support payments are not taxable.

Note 1 Ms. Son's property income would be calculated as follows:

Non-Eligible Dividend On Son Enterprises Shares	\$ 60,000
Gross Up [(25%)(60,000)]	15,000
Interest Income From South Korean Bank Account	500
Royalties	40,000
Property Income	\$115,500

Note 2 Ms. Son's net taxable capital gains would be calculated as follows:

Gain On Musical Notes Inc. Shares (\$575,000 - \$100)	\$574,900
Listed Personal Property Gain On Painting (\$50,000 Minus The Lesser Of \$200 And \$1,000 Floor)	49,000
Listed Personal Property Loss Carry Forward (See Explanation Below)	(500)
Sale Of Vacant Land (\$175,000 - \$25,000)*	150,000
Net Foreign Currency Gain (\$700 - \$100)	600
Foreign Currency Exemption For Individuals	(200)
Net Capital Gains	\$773,800
Inclusion Rate	1/2
Net Taxable Capital Gain	\$386,900

* Since Jimin had made a small profit annually on renting the land, the property taxes must have been deducted each year and would have no effect on the calculation of the capital gain.

Under ITA 41(2) the net gain on listed personal property is defined as the gains for the current year, reduced by the carry over amounts from the seven preceding years or the three subsequent years. Ms. Son had a listed personal property loss carry forward of \$500, which is deducted against her listed personal property gain on the painting that was sold in 2012. Note that the listed property loss carry forward is deducted in the calculation of net taxable capital gains and Net Income For Tax Purposes.

Part A - Taxable Income

Ms. Son's Taxable Income would be calculated as follows:

Net Income For Tax Purposes	\$642,900
Less: Lifetime Capital Gains Deduction (Note 3)	(267,450)
Less: Net Capital Loss Carry Forward	(2,000)
Taxable Income	\$373,450

Note 3 The maximum lifetime capital gains deduction would be \$267,450 calculated as the least of the following amounts:

Capital Gains Deduction Available

Maximum lifetime limit $[(1/2)(\$750,000)]$	\$375,000
Less: used in previous year $[(1/2)(\$200,000)]$	(100,000)
Capital Gains Deduction available	\$275,000

Annual Gains Limit This limit is equal to A - B, where

A = The lesser of:

- Net TCG - All Capital Assets $[(1/2)(\$773,800)] = \$386,900$
- Net TCG - Qualifying Property $[(1/2)(\$574,900)] = \$287,450$

A Is Equal to \$287,450

B = The total of:

- The amount, if any, by which net capital loss carry overs deducted for the year under ITA 111(1)(b), exceeds the excess of net taxable capital gains for the year [ITA 3(b)] over the amount determined in Part A of this formula. This amount is nil $[\$2,000 - (\$386,900 - \$287,450)]$; and
- Allowable Business Investment Losses realized during the current year. This amount is also nil.

B Is Equal To Nil

Annual Gains Limit (\$287,450 - Nil)	\$287,450
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Cumulative Gains Limit

Annual Gains Limit From Previous Years	\$100,000
Current Year Annual Gains Limit	287,450
Less: Previous Lifetime Capital Gains Deduction	(100,000)
Less: CNIL (Given)	(20,000)
Capital Gains Deduction Available	\$ 267,450

Part A - Tax Payable

Ms. Son's regular Tax Payable would be determined as follows:

Tax On First \$132,406		\$28,020
Tax on Next \$241,044 (\$373,450 - \$132,406) at 29%		69,903
<hr/>		
Tax Before Credits		\$97,923
Tax Credits:		
Basic Personal	(\$10,822)	
Child credit	(2,191)	
CPP	(2,307)	
Canada Employment Credit	(1,095)	
Children's Arts Credit (\$500 Maximum)	(500)	
Child Fitness Credit	(200)	
Medical Expenses (Note 4)	(17,891)	
<hr/>		
Total Credit Base	(\$35,006)	
Rate	15%	(5,251)
Charitable Donation (Note 5)		(5,047)
Foreign Tax Credit on non-business income (Note 6)		(50)
Dividend Tax Credit on non-eligible dividend		
[(2/3)(\$15,000)]		(10,000)
<hr/>		
Federal Tax Payable		\$77,575
<hr/>		

Note 4 The base for Ms. Son's medical expense credit can be calculated as follows:

Eligible Medical Expenses – Jihoon Son	\$20,000
Lesser Of:	
• [(3%)(\$642,900)] = \$19,287	
• 2012 Threshold Amount = \$2,109	(2,109)
<hr/>	
Total Credit Base	\$17,891
<hr/>	

Note 5 The maximum charitable donation receipt she can receive is for \$17,500, the fair market value of the collection donated to the university as it is less than Jimin's adjusted cost base. Since this is personal use property, the loss is not deductible. The credit is calculated as: [(15%)(200) + (29%)(17,500 - 200)] = \$5,047.

Note 6 Since the foreign non-business tax withheld is less than 15 percent of the foreign income, Ms. Son's credit for foreign tax paid would be the lesser of the foreign tax withheld of \$50 and an amount determined by the following formula:

$$\frac{[(\text{Foreign Non-Business Income}) \div (\text{Adjusted Division B Income})](\text{Tax Otherwise Payable})}{1}$$

In this formula, the Adjusted Division B Income would be calculated as follows:

Net Income For Tax Purposes	\$642,900
Lifetime Capital Gains Deduction Taken	(267,450)
Capital Loss Carry Forward Deducted	(2,000)
<hr/>	
Adjusted Division B Income = Taxable Income	\$373,450
<hr/>	

Her Tax Otherwise Payable would be calculated as follows:

Tax Before Credits	\$97,923
Basic Personal Credits	(5,251)
Charitable Donation Credit	(5,047)
<hr/>	
Tax Otherwise Payable	\$87,625
<hr/>	

Solution To AP Eleven - 8

Using these figures, the calculation would be as follows:

$$[(\$500 \div \$373,450)(\$87,625)] = \$117$$

As the amount withheld would be the lesser of the two figures, her foreign tax credit for 2012 would be \$50.

Part A – Alternative Minimum Tax Payable

Ms. Son's Adjusted Taxable Income for alternative minimum tax purposes would be calculated as follows:

Regular Taxable Income	\$373,450
30 Percent Of Capital Gains [(30%)(2)(\\$386,900)]	232,140
Dividend Gross Up [(25%)(\\$60,000)]	(15,000)
Adjusted Taxable Income	\$590,590

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

Adjusted Taxable Income	\$590,590
Basic Exemption	(40,000)
Amount Subject To Tax	\$550,590
Rate	15%
Minimum Tax Before Credits	\$ 82,589
Tax Credits:	
Basic Personal Credit	(\$10,822)
Child credit	(2,191)
CPP	(2,307)
Canada Employment Credit	(1,095)
Children's Arts Credit (\$500 Maximum)	(500)
Child Fitness Credit	(200)
Medical Expenses (Note 4)	(17,891)
Subtotal	(\$35,006)
Rate	15%
	(5,251)
Charitable donations credit (Note 5)	(5,047)
Alternative Minimum Tax Payable	\$ 72,291

As the alternative minimum tax payable is less than the regular tax payable, the regular amount would be paid.

Part B - Net Income For Tax Purposes

Note, because Jihoon's income is subject to the tax on split income, the income attribution rules are not applicable. Given this, Jihoon Son's Net Income For Tax Purposes would be calculated as follows:

Dividends Received	\$20,000
Gross Up [(25%)(\\$20,000)]	5,000
Net Income For Tax Purposes	\$25,000

Part B - Taxable Income

As he has no deductions from Net Income For Tax Purposes, Jihoon Son's Taxable Income would be equal to his Net Income For Tax Purposes of \$25,000.

Part B - Tax Payable

Jihoon Son's regular Tax Payable would be calculated as follows:

Tax On Split Income [(29%)(125%)(20,000)]	\$7,250
Tax On Balance	N/A
Dividend Tax Credit [(2/3)(25%)(20,000)]	(3,333)
Basic Personal Credit [(15%)(10,822)]	(1,623)
Regular Tax Payable	\$2,294

The alternative calculation under ITA 120.4(3) is as follows:

Tax On Split Income [(29%)(125%)(20,000)]	\$7,250
Tax On Balance	N/A
Dividend Tax Credit [(2/3)(25%)(20,000)]	(3,333)
Basic Personal Credit (Not Available)	Nil
ITA 120.4(3) Tax	\$3,917

Jihoon's Tax Payable would be the greater of these two amounts, \$3,917.

Part C

Ms. Son – RRSP, TFSA and cash flow considerations

Ms. Son has asked you to consider whether she should use her TFSA or her RRSP funds if she needs cash in the next few years as her jazz quartet develops a following and becomes a significant source of income for her.

If the condo Ms. Son is planning to buy will be her principal residence, she will be eligible to withdraw funds from her RRSP under the Home Buyers' Plan. Since the maximum withdrawal available under this Plan is \$25,000, that may not prove adequate for all her cash needs.

It would be best for her to use her TFSA funds next should she need access to additional cash or if she does not qualify for the Home Buyers' Plan. Withdrawing money from her TFSA will not result in any additional tax cost to Jimin. In addition, she will be able to return funds to her TFSA in the future, which will not be possible if funds are withdrawn from her RRSP other than through the Home Buyers' Plan.

With respect to withdrawing money from her RRSP other than through the Home Buyers' Plan, it is possible to do so, but not recommended. These withdrawals from an RRSP account will be taxed in the year of withdrawal. Also, this type of RRSP withdrawal does not result in an increase in the ability to make future contributions, so it would result in a permanent reduction in the amount of money that Ms. Son could save for her retirement in a tax deferred savings arrangement.

Solution to Assignment Problem Eleven - 9

The various components of Mr. Bronson's Net Income For Tax Purposes would be calculated as follows:

Pension Income

RPP Receipts	\$83,000
Canada Pension Plan Receipts	10,680
Pension Income	\$93,680

Land Sales (Note 1)

Capital Gain On Plot A (\$150,000 - \$125,000)	\$ 25,000
Capital Gain On Plot B (\$250,000 - \$175,000)	75,000
Total Capital Gain	\$100,000
Inclusion Rate	1/2
Taxable Capital Gain	\$ 50,000

Note 1 As these are non-arm's length sales, ITA 69 is applicable. Plot A was sold below fair market value and, because of this, the proceeds would be deemed to be the fair market value of \$150,000. Note that Phil's adjusted cost base would be limited to the \$50,000 that was paid. Since the note was paid during 2012, there is no capital gains reserve available. Plot B was sold at a value in excess of fair market value and, in this case, ITA 69 indicates that the sale price will be the proceeds of disposition. Note that Gary's adjusted cost base would be the \$210,000 fair market value.

YP Real Estate Income Trust Units (Note 2)

Income Distribution [(1)(\$800) + (11)(\$800)]	\$ 9,600
Capital Gain (\$310,000 - \$300,000)	\$10,000
Inclusion Rate	1/2
Taxable Capital Gain	\$ 5,000

Note 2 As Brenda is under 18 years of age, all of the income on the trust units that is paid to her (\$8,800) would be attributed back to Mr. Bronson. The income attribution will stop when Mr. Bronson dies. As there is no rollover provision with respect to transfers to a minor, Mr. Bronson must transfer the units at fair market value and will have to pay taxes on the taxable capital gain resulting from the gift to Brenda. If Brenda had sold the units while he was alive, there would have been no attribution of capital gains.

Gift Of Baron Inc. Shares

Proceeds Of Disposition (Note 3)	\$294,000
Adjusted Cost Base [(4,500)(\$60)]	(270,000)
Capital Gain	\$ 24,000
Inclusion Rate	1/2
Taxable Capital Gain	\$ 12,000

Note 3 Since the problem requires the minimum Net Income For Tax Purposes, Mr. Bronson will not elect out of the ITA 73(1) rollover. As a result, the 1,500 shares given to his spouse will be transferred at their adjusted cost base. This means the proceeds of disposition for these shares will be their average cost of \$60 per share $\{[(4,000)(\$50) + (8,000)(\$65)] \div 12,000\}$. The proceeds of disposition for the 3,000 shares that are gifted to his children will be the fair market value of \$68 per share. This gives proceeds of disposition of \$294,000 $[(1,500)(\$60) + (3,000)(\$68)]$.

Dividends Received And Attributed Back (Note 4)	\$13,500
Gross Up Of 38 Percent	5,130
Taxable Dividends	\$18,630

Note 4 The dividends on the 1,500 shares gifted to Melissa would be attributed back to Mr. Bronson. The dividends on the shares gifted to his (adult) children will be taxed in their hands. Since he is holding 7,500 shares on July 1, the dividends he will be taxed on for the year total \$13,500 $[(1,500 + 7,500)(\$1.50)]$.

Condominium Units

Net Rental Income (Note 5)	\$ 93,750
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Note 5 As Mr. Bronson died on December 31, 2012, there is a deemed disposition prior to the end of the year. As a consequence, no CCA can be deducted for the year.

Recapture (Note 6)	\$190,000
Capital Gain (Note 6)	\$240,000
Inclusion Rate	1/2
Taxable Capital Gain	\$120,000

Note 6 Immediately before the time of Mr. Bronson's death, there is a deemed disposition of all of his capital property. If the beneficiary is a spouse, the deemed proceeds of disposition are equal to the tax cost of the property (UCC in this case). This means there will be no recapture or capital gain on the property transferred to Melissa and her deemed cost will be his original cost of \$300,000. For the transfers to his children, the deemed proceeds of disposition will be equal to fair market value, resulting in recapture of \$190,000 $[(\$300,000 - \$205,000)(2)]$ and capital gains of \$240,000 $[(\$420,000 - \$300,000)(2)]$.

Other Properties At Death

Baron Inc. Shares At the time of his death, Mr. Baron owns the 7,500 remaining shares of Baron Inc. As these are transferred to his spouse, the deemed proceeds will be equal to the tax cost of the shares and there will be no 2012 tax consequences.

Principal Residence As with the Baron Inc. shares, the property can be transferred to Melissa at its tax value. Alternatively, the executor could elect to transfer it at fair market value and use the principal residence gain reduction formula to eliminate the \$417,000 capital gain. In either case, there are no tax consequences for Mr. Bronson.

Part A - Net Income For Tax Purposes And Taxable Income

Mr. Bronson's minimum Net Income For Tax Purposes and Taxable Income would be calculated as follows:

Pension Income		\$ 93,680
Income Trust Distribution		9,600
Taxable Dividends		18,630
Net Rental Income		93,750
Recapture		190,000
Taxable Capital Gains:		
On Land	\$ 50,000	
On Trust Units	5,000	
On Gift Of Baron Inc. Shares	12,000	
On Condominium Units	120,000	187,000
Net Income For Tax Purposes		\$592,660
Net Capital Loss From 1989 (Note 7)		(30,000)
Taxable Income		\$562,660

Note 7 As the Net Capital Loss will be applied against current taxable capital gains, it must be converted from \$40,000 on a two-thirds basis, to \$30,000 on a one-half basis. If it were being deducted against other types of income, it would have been deducted at the two-thirds inclusion rate.

Part A - Tax Payable

Mr. Bronson's minimum federal Tax Payable would be calculated as follows:

Tax On First \$132,406		\$ 28,020
Tax On Next \$430,254 (\$562,660 - \$132,406) At 29 Percent		124,774
Tax Before Credits		\$152,794
Tax Credits:		
Basic Personal	(\$10,822)	
Spousal Including FCA	(12,822)	
Age (Income Too High)	Nil	
Pension Income	(2,000)	
Spouse's Disability	(7,546)	
Medical Expenses (Note 8)	(54,891)	
Total Credit Base	(\$88,081)	
Rate	15%	(13,212)
Dividend Tax Credit [(6/11)(\$5,130)]		(2,798)
Federal Tax Payable		\$136,784

Note 8 The base for the medical expenses tax credit would be the total medical costs of \$57,000 (\$45,000 + \$12,000), reduced by the lesser of \$17,780 [(3%)(592,660)] and \$2,109.

Part B - Pension Splitting Tax Savings

If the pension splitting of Mr. Bronson's RPP payments is for \$41,500, it will increase Melissa's income by \$41,500 and decrease Wally's by the same amount. Melissa's federal Tax Payable will be as follows:

Tax Before Credits [(15%)(41,500)]		\$6,225
Basic Personal	(\$10,822)	
Disability	(7,546)	
Pension (Not Previously Available)	(2,000)	
Total Credit Base	(\$20,368)	
Rate	15%	(3,055)
Melissa's Federal Tax Payable		<u>\$3,170</u>

Wally's Tax Saving [(29%)(41,500)]		\$12,035
Spousal Credit Including FCA Lost	(\$12,822)	
Disability Credit Taken By Melissa	(7,546)	
Total Credits Transferred	(\$20,368)	
Rate	15%	(3,055)
Wally's Net Tax Savings		<u>\$ 8,980</u>

Because of the family caregiver amount, the spousal credit amount that Wally loses is \$2,000 higher than the basic personal amount that Melissa can claim herself.

With pension income splitting, the total federal tax savings amount to \$5,810 (\$8,980 - \$3,170). Further savings would be available at the provincial level.

Note that the total medical expenses are much greater than Melissa's income. As a result, although Melissa could claim a larger medical expense credit given her lower Net Income, she could not fully utilize that credit, so it remains on Wally's return.

Solution to Problem Tax Software Eleven - 1

This problem and solution contain 2011 (not 2012) information as software for 2012 is not yet available. Shortly after the first filing version of the 2012 Intuit ProFile software is available in January, 2013, the updated 2012 version of this problem will be available on the textbook web site at:

www.pearsoncanada.ca/byrdchen/ctp2013

The complete tax return is available on the Instructor's Resource CD-ROM under the heading "Tax Software Assignment Problems" in two forms, a ProFile version and a .PDF version.

- To view the .PDF file that contains the complete tax return, select the file "PDF Software Problem 11-1" from the PDF Format drop-down list.
- To view the ProFile file of the complete tax return, select the file "Software Problem 11-1" from the ProFile Format drop-down list.

For more information on how to use the ProFile tax program, please refer to the sample tax returns in the Study Guide.

Notes To Tax Return

- When the Universal Child Care Benefits are input on Buddy's Form RC62, the amounts will be transferred to show on S2 as Natasha's income.
- Richard, Sarah, Eunice, and Earl should all file tax returns in order to receive the GST credit. Filing a tax return will also make the unused education related tax credits of Richard and Sarah easier to keep track of for carry forward purposes. Sarah, Eunice, and Earl will need to have a Social Insurance Number to file returns.
- Mr. Musician can deduct the caregiver tax credit for both his father and mother. He can claim the full amount because neither has income in excess of the threshold.
- The ITA 118(1)(d) infirm dependant over 17 tax credit is only available for dependants who have attained the age of 18 by the end of the year and are dependent because of mental or physical infirmity. The only dependant of Mr. Musician who satisfies these criteria is his mother. However, since he is claiming the caregiver tax credit for her, he cannot claim this credit for her.
- Mr. Musician's mother's unused disability tax credit can be transferred to him. If she filed a tax return, her age credit would eliminate any Tax Payable.
- The medical expense rules require that the medical expense payments be paid in respect of medical services provided to persons who are dependants of Buddy within the meaning of ITA 118(6). ITA 118(6) requires that the persons be dependent on Buddy at some point during the year for support and that they are his children. Since it is stated in the problem that the children of Ms. Holt and Mr. Musician are not dependent on him for support, Megan's medical expenses cannot be claimed by him.
- An individual can claim a tax credit based on the medical expenses of a spouse and any other individual who meets the ITA 118(6) definition of a dependant. The medical expenses of Lori Musician (\$300) and Dolly Holt (\$675) would not be eligible as neither woman is his spouse or common-law partner.
- Although the spousal support can be deducted, the child support payments cannot be deducted.

- The transfer of education related amounts is limited to \$5,000 per child. For Richard, the total of \$4,860 [$\$3,000 + (4)(\$400) + (4)(\$65)$] is within this limit. Sarah has available amounts of \$15,180 [$\$9,600 + (12)(\$400) + (12)(\$65)$], well over the limit. Given this, the maximum transfer for Sarah is \$5,000. However, the \$10,180 excess can be carried forward indefinitely to be used against her future Tax Payable.
- Mr. Musician's age credit is nil as his Net Income For Tax Purposes is higher than the income threshold.
- Mr. Musician is not eligible for the refundable medical expense supplement or the working income tax benefit as his Net Income For Tax Purposes is too high.
- The Industry Code must be chosen from the list near the top right corner of the T2125. The appropriate choice is 711130, "Musical Groups and Artists".
- The royalties are received from Buddy's work as a composer. As a result they are entered as professional income on the T2125. His rent of \$1,400 (2 months) and CCA on his piano are deducted on the T 2125. Although he would have to be a GST registrant given his level of self-employed income, the problem states that GST/HST implications should be ignored.
- There is no CPP payable on Mr. Musician's employment income or self-employed income as he is receiving CPP benefits.
- Pension income splitting would definitely be advantageous for Mr. Musician. However it is available on annuity payments out of an RRSP, but not non-annuity withdrawals. If he thinks he will require funds from his RRSP on a regular basis before he turns 71, he could set up an annuity in his RRSP in order to take advantage of the pension income tax credit and pension income splitting. Alternatively, he could transfer some or all of his RRSP funds into a RRIF. Any withdrawals from the RRIF would be eligible for both the pension income credit and pension splitting.
- He could apply to split his CPP pension income with his wife.
- Mr. Musician should consider contributing to a spousal RRSP in the future. Although he will not be able to contribute to his own RRSP after he turns 71, he can contribute to an RRSP in the name of his wife until she is 71 (should he live so long).
- Mr. Musician should also consider RESPs for his minor children and TFSAs for himself, his wife and Sarah. The decision as to whether he should contribute to a spousal RRSP, RESPs or TFSAs requires the consideration of many factors (see the text).