CHAPTER 9

OTHER INCOME, OTHER DEDUCTIONS, AND SPECIAL RULES FOR COMPLETING NET INCOME FOR TAX PURPOSES

Review Questions

1. In addition to income from employment, business, property, and capital gains, taxpayers must include income from *other sources* when determining their income for tax purposes. How does the *Income Tax* Act limit the scope of *other sources* of income?

2. Explain why the receipt of property from an inheritance is not included in net income for tax purposes.

3. Can an individual deduct for tax purposes the amount of regular support payments to a former spouse? Would it matter if that individual's only source of income were from interest on bond investments? Explain.

4. Why is the category *other deductions* considered to be the last test for determining the deductibility of an expenditure?

5. Briefly explain why an RRSP is an attractive investment.

6. If you hold investments both inside and outside an RRSP and usually invest in both corporate bonds and corporate shares, which type of investment would you prefer to hold within the RRSP? Explain.

7. Briefly explain why a TFSA is an attractive investment. How does a TFSA differ from an RRSP?

8. Briefly explain the tax treatment of an RESP.

9. What is the significance of the special rules for net income determination, and how do they relate to the five categories of income that are taxable?

10. "When in doubt, it is always best to claim a deduction for an expenditure because the worst possible result is that the CRA will simply deny the deduction." Is this statement true? Explain.

11. If a group of business assets is being sold for a total agreed price, is it important that the vendor and the purchaser seriously consider how the total price will be allocated to the separate assets in the group? Explain.

12. What are the tax consequences if a parent sells property to a child at a price that is less than the actual value of the property? What difference would it make if the property were simply gifted to the child?

13. What are the tax consequences if an individual sells property to their spouse at a price that is less than the property's market value but more than its cost?

14. How are property income (losses) and capital gains (losses) treated for tax purposes if the funds used to acquire the property were provided by the taxpayer's spouse? How does the tax treatment differ if the funds were provided by the taxpayer's parent?

15. Can the owner of an incorporated business reduce the overall tax burden by having their two children own shares of the corporation through a trust? The corporation would pay dividends to the trust and the trust would distribute the dividends to the children. The children are not involved in any aspect of the business.

16. What is the implication to the employer and to the employee if the employer delays the payment of remuneration to the employee?

17. What difference does it make for tax purposes when an individual's last will and testament bequeaths property to a spouse, rather than to a child?

18. The scope of the income tax system is defined by five specific types of income—employment, business, property, capital gains, and other sources. This being so, why is it necessary for the Income Tax Act to specifically list a number of items that are not included in income?

19. Briefly outline the process that can be used to establish the tax treatment of a particular transaction.

Solutions to Review Questions

R9-1. "Other sources of income" is a catch-all category that includes taxable items of income that do not qualify as employment income, business income, property income or capital gains. Its scope is limited because the Income Tax Act defines other sources of income as a specific list of items described in sections 56 through 59. Therefore, the term "other sources" is not open-ended as it suggests.

R9-2. The receipt of property from an inheritance would be included in the recipient's net income for tax purposes only if it qualified as one of the five designated types of income. The inheritance is not income from employment because it was not earned from providing services to an employer. It is not business income because it was not earned from carrying on a business involving the sale of goods or services. It does not constitute a return on invested capital and, therefore, is not property income. It is not a capital gain because it did not result from the disposition of capital property. The inheritance can only be taxable if it qualifies as "other sources of income." A review of the limited list of items in this category does not include wealth enhancement from an inheritance and, therefore, by a process of elimination, it is not part of net income for tax purposes.

R9-3. Yes, support payments to a former spouse are deductible as part of the "other deductions" category provided that the support payments are pursuant to a legal agreement or court order and are on a periodic basis (not a lump sum) [ITA 56.1(4), 60(b), 60.1(4)]. It does not matter that the payer's only source of income is interest from bonds (which is property income). Items that qualify as "other deductions" are deducted as part of the aggregating formula after income from employment, business, property and capital gains have first been included. Therefore, support payments, as part of "other deductions" can be deducted from any source of income.

R9-4. Each of the primary categories of income (employment, business, property, and capital gains) permit certain items of expenditure to be deducted in arriving at the net income from that source. If those categories do not permit an expenditure to be deducted, the only remaining area of the tax system, which may permit its deduction, is the category of "other deductions." If this category does not mention the specific item, then it is not deductible for tax purposes. Therefore, the category of "other deductions" is important because it is the last test in the income tax scheme to determine the deductibility of an expenditure [ITA 60].

R9-5. Investing in an RRSP is attractive for four reasons:

- Contributions to an RRSP are deductible (within limits) from income and, therefore, reduce the amount of tax otherwise payable. Therefore, the cost of a $5,000 RRSP contribution to a taxpayer subject to a 40% tax rate is only $3,000 ($5,000 - 40% of $5,000 = $3,000). Effectively the tax deduction means that a certain amount of income can be invested before tax rather than after-tax.
- Investment returns on amounts invested within the plan are not subject to taxation when earned and, therefore, compound annually on a pre-tax basis compared to an investment outside of the plan which compounds at a substantially reduced after-tax amount.
- Funds within the plan continue to be tax sheltered until they are withdrawn from the fund. Therefore, even when the plan is converted into regular pension payments, the undistributed funds continue to earn investment returns without tax. Tax is payable only in proportion to the periodic annual payments from the fund to the beneficiary [ITA 56(1)(h)].

- By contributing to a spousal RRSP, future retirement income can be split between wife and husband, which may result in lower tax costs at that time [ITA 146(5.1)].

R9-6. Given that an individual will invest in both bonds and stocks, it is preferable to hold the bond investments within the RRSP and the stocks personally. Stocks will yield both dividends and capital gains, both of which receive preferential tax treatment. Dividends receive the dividend tax credit, and capital gains are only one-half taxable. By including stocks in the RRSP, the gains will be ultimately returned to the owner as pension income that is fully taxable and the otherwise preferential treatment is lost. On the other hand, bond interest is fully taxable when earned [ITA 12(1)(c), 12(4)] and, therefore, including these returns in the RRSP provides a tax deferral. The income is fully taxable when removed from the plan [ITA 56(1)(h)].

R9-7 The TFSA is an attractive investment because all investment income (interest, dividends and capital gains) is tax free when earned and when withdrawn from the account. Unlike an RRSP, contributions to a TFSA are not deductible and withdrawals are not taxable. The annual contribution limit for a TFSA is $6,000 in 2022 ($6,000 in 2021, 2020 & 2019; $5,500 in 2018, 2017 & 2016; $10,000 in 2015; $5,500 in 2013 & 2014; $5,000 in 2009 - 2012) [ITA 146.2].

R9-8 Contributions to an RESP are not deductible. Income earned in a RESP is not taxable until withdrawn and in that year is normally taxed as the student's income. The RESP can receive a Canada Education Savings Grant for children up to age 17. The grant is limited to 20% of the first $2,500 contribution, annually. Additional grants may be available for low-income families.

R9-9. The determination of the primary sources of income (employment, business, property, and capital gains) is governed by a set of fundamental rules for each source. However, within each source, unusual transactions may occur for which the treatment cannot be ascertained by the basic rules. In addition, taxpayers often attempt to structure transactions in a manner that will avoid the application of those rules. The special rules for net income determination outlined in sections 67 through 81 of the Income Tax Act are important because they are designed to deal with unusual transactions and tax avoidance schemes. Although, the special rules are provided separately, they effectively modify the general rules of the primary categories of income and, therefore, form an integral part of the rules for determining income from employment, business, property and capital gains.

R9-10. The statement is not true. In some circumstances, the denial of a deduction is accompanied by a penalty cost to the taxpayer or a related party. For example, if a corporation pays an unreasonable salary to a shareholder or a member of the shareholder's family, the unreasonable portion of the salary is denied as a deduction to the payer [ITA 67] but remains fully taxable to the recipient [ITA 5(1)]. Therefore, amongst the related parties, double taxation will occur. This penalty is severe, and caution must be used for transactions involving related parties.

R9-11. When a group of assets are being sold for a total agreed price, it is important for the vendor and the purchaser to consider the allocation of the price amongst the assets involved [ITA 68]. For the vendor, the allocation will establish the type of income on the sale (recapture and capital gain) and consequently the amount of the related tax. For the purchaser, the allocation of the price determines the amount of CCA deductions that are available in the future. A variance in the allocation can alter the amount of tax payable for the vendor and the amount of tax savings from deductions for the purchaser.

As the decision to buy is influenced by future cash flows, it is important that the purchaser accurately determine what the future tax costs will be. The special rules for determining net income permit the tax authorities to allocate the total purchase price in relation to the fair value of each separate asset. Consequently, to avoid unanticipated tax costs, the vendor and the purchaser should consider working together to establish a proper allocation.

R9-12. The parent is deemed to have sold the property at its fair market value [ITA 69(1)(b)(i)], even though that amount has not been received as payment, and the gain or loss will be determined accordingly. However, the cost of the property to the child remains at the actual purchase price (i.e., less than the fair value). Therefore, when the child sells the property for its fair value, a taxable gain occurs to the extent the selling value exceeds the purchase cost. Consequently, both the parent and the child are liable for tax on the same gain and double taxation occurs.

If the parent had gifted the property to the child, the parent's position is unchanged from that above [ITA 69(1)(b)(ii)] but the child is deemed to have acquired the gifted property at its fair value [ITA 69(1)(c)]. Therefore, double taxation does not occur when a gift is made but it does when an attempt is made to avoid tax by selling to a related person at less than fair value.

R9-13. The sale of property to a spouse is treated differently than the sale of property to other related persons. In this case, assuming the property is capital property, the vendor spouse is deemed to sell the property for tax purposes at his/her adjusted cost base resulting in no taxable income on the sale [ITA 73(1)(a)(ii), 73(1.01)]]. This occurs even though the actual selling price was higher than the cost amount. Similarly, if the property was depreciable property, the deemed selling price would be equal to the property's undepreciated capital cost [ITA 73(1)(a)(i)]. However, the vendor may elect that the transfer price for tax purposes is the fair market value and accordingly recognize the related gain [ITA 73(1)].

R9-14. If the funds were provided from a spouse either as a gift or a non-interest or low-interest loan, both the future property income earned and capital gains from a future sale are included in the income for tax purposes of the spouse who provided the funds [ITA 74.1(1), 74.2(1)]. This result could have been avoided if the spouse providing the funds had done so by way of a loan with normal commercial terms and a proper rate of interest and the interest for each taxation year was paid not later than 30 days after the end of the taxation year [ITA 74.5(2)].

If the funds had been provided by the taxpayer's parent, by way of a gift or a non-interest loan, and if the child was under 18 years of age, only the property income would attribute to the parent but not the capital gain [ITA 74.1(2)]. If the child was 18 years of age or older, attribution of income normally will not occur if the funds were transferred by way of gift. If a loan is made to a non-arm's length person who is 18 years of age or older *and* one of the *main purposes* for making the loan was to reduce or avoid tax, the resulting income earned by the debtor from the borrowed funds will be included in the income of the lender [ITA 56(4.1)].

Dividends from a *private corporation* received by a person who is under the age of 18 are subject to tax on split income (TOSI) and as such are taxable to that child at the highest marginal tax rate but are not subject to the attribution rules [ITA 120.4]. For 2018 and subsequent years, the TOSI is extended to dividends and interest received by adult family members (who are not active in the business) from private corporations, with few exceptions.

R9-15. The purpose of the tax on split income (“TOSI”) rules is to prevent business owners from reducing tax by sprinkling income among family members.

Dividends received by a child under age 18 from a private corporation are subject to TOSI at the highest personal tax rate on the child’s tax return. The dividend tax credit is the only credit that would be available to reduce TOSI [ITA 120.4(2)].

Dividends received by a child age 18 or older would also be subject to TOSI since the dividends would be received from a related business and the child is not actively involved in the business [ITA 120.4(1), (1.1)].

R9-16. If the payment of remuneration by the employer is delayed beyond 179 days after the taxation year in which the expense occurred, the employer cannot deduct the remuneration for tax purposes until the year in which the remuneration is actually paid [ITA 78(4)]. In other words, the accrual method is denied and the cash method is substituted. The tax treatment to the employee follows the normal rules of employment income. Remuneration is included for tax purposes as employment income in the year in which it is received, not when it is earned [ITA 5(1)].

R9-17. On death, a deemed disposition of all property occurs. If the property is left to a spouse, depreciable property is deemed to be sold at a price equal to its undepreciated capital cost, and capital property is deemed to be sold at a price equal to its adjusted cost base [ITA 70(6)]. Therefore, no taxable income is created. The executors of the decedent's estate may elect, if they so desire, to have the deemed disposition occur at fair market value and recognize the related gains [ITA 70(6.2)]. On the other hand, property left to children is treated differently. Capital property and depreciable property left to a child is deemed to be sold at fair market value [ITA 70(5)]. Therefore, capital gains and recapture of capital cost allowance may occur.

R9-18. Although the five primary types of income define the scope of the Canadian tax system, certain types of income which do not fall within the five categories may be exempt for special reasons. These exceptions are all listed together in section 81 of the Income Tax Act. For example, employment income includes allowances received from the employer [ITA 6(1)(b)]. However, allowances received by a member of a provincial legislature are not taxable as stated in the specific list of items that are not included in income [ITA 81(2)]. The list may affect any of the five normal categories of income.

R9-19. The process used to establish the tax treatment of a particular transaction is:

- Define the nature of the transaction to determine which of the five income sources it relates.
- Apply the principles of income determination for that source.
- Determine whether the special rules for income determination may override the established principles.
- Relate the item to the aggregating formula to determine its overall impact.

Key Concept Questions

QUESTION ONE

Fred Dunn contributed $12,000 to his RRSP in November 2022 and $10,000 to a spousal RRSP in February 2023. Fred earned income of $80,000 in 2021 and $100,000 in 2022. Fred's notice of assessment showed unused RRSP deduction room at the end of 2021 of $5,000. His T4 for 2021 showed a pension adjustment (PA) of $3,000.

Determine Fred's maximum RRSP deduction for 2022.

CPA Competency 6.3.3 RRSPs. Income tax reference: ITA 60(i), 146(1), (5), (5.1).

QUESTION TWO

Victoria Le had income for tax purposes for the current year as follows:

Salary	$65,000
Taxable benefits	5,000
Registered pension plan deduction	(3,000)
Employment income for tax purposes	67,000
Loss from a part-time business	(6,000)
Spousal support received	12,000
Interest income	1,000
Rental income	22,000
	$96,000

Determine Victoria's earned income for RRSP purposes for the current year, 2022.

CPA Competency 6.3.3 RRSP earned income. Income tax reference: ITA 146(1) earned income definition.

QUESTION THREE

Tom Mendez retired from X Corp. on June 30, 2022, after turning 65 in December 2021. He plans to travel with his spouse, who is 45 years of age. On retirement, Tom received a retiring allowance of $40,000 for his years of loyal service. Tom started his employment with X Corp. in 1990.

Determine the income tax consequences of the retiring allowance for Tom.

CPA Competency 6.3.2 Retiring allowances & 6.3.3 RRSPs. Income tax reference: ITA 56(1)(a), 60(j.1).

QUESTION FOUR

In November of the current year, Beth Sharma withdrew $24,000 from her spousal RRSP. Her spouse had contributed $2,500 to the spousal RRSP on February 1 of each of the last 20 years. Beth also withdrew $8,000 from her TFSA. All contributions to her TFSA were made by her spouse.

Determine the tax implications, if any, of the RRSP and TFSA withdrawals.

CPA Competency 6.3.3 RRSPs. Income tax reference: ITA 56(1)(h), 146.2, 146(8.3).

QUESTION FIVE

Wendy Chang received the following amounts in the current year:

• Support payments from her former spouse ($4,000 x 12)	$48,000
• Employment insurance benefits	4,100
• Inheritance	20,000
• Scholarship	5,000
• RRSP withdrawal (LLP)	10,000
• Canada child benefit (CCB)	6,400
• Lottery winnings	300

The support payments are in accordance with Wendy's divorce agreement, which calls for monthly support payments of $1,500 for Wendy and $2,500 for their 4-year-old daughter. Wendy became frustrated during the year with not being able to find suitable employment and returned to school. She enrolled as a full-time student at the University of Toronto. She withdrew $10,000 from her RRSP to help finance her education.

Determine the amount to be included in Wendy's income for tax purposes for the current year.

CPA Competency 6.3.2 Other income. Income tax reference: ITA 56(1)(a), (b), (n), (h), (h.2), 56(3),(6) 56.1(4), 60(b), 122.6, 146.02.

QUESTION SIX

Norman Donnelly moved from the Ottawa office of Safety Corp. to the head office in Toronto, in October 2022. He incurred a loss of $35,000 on the sale of his Ottawa home after it had sat empty for five months while the real estate agent tried to sell it. The real estate commission of $20,000 and legal fees of $1,200 are included in the $35,000 loss. In addition, he incurred the following costs with respect to the move:

- Airline ticket ($1,000), hotel room for a two-night stay ($400) and meals ($100) when Norman and his spouse made a trip to Toronto to search for a new home—$1,500
- Purchase price of new home—$420,000
- Legal fees and land transfer tax on purchase of new home—$1,800
- Moving company to pack their belongings and move them to their new home in Toronto— $6,000
- Gasoline and other car expenses plus two meals for each of the five family members. Norman drove himself and his family from Ottawa to their new home in Toronto (450 km)—$210
- Cost of carrying Ottawa house for five months while vacant (mortgage interest, property tax, and utilities)—$7,200
- Cost of revising legal documents to reflect the new address—$25

Norman's T4 slip showed employment income for the year of $120,000, of which $30,000 was earned after his move to Toronto.

Determine Norman's maximum deduction for moving expenses for the current year, 2022.

CPA Competency 6.3.2 Moving expenses. Income tax reference: ITA 62; Folio S1-F3-C4.

QUESTION SEVEN

Dan Reid and Janet Reilly are married and have three children, ages 6, 9, and 17. They both work full-time and incurred the following child care costs during the current year, all of which were paid by Janet.

Month	***Payee***	***Amount***
January through June	Janet's mother	$ 3,000
July	17-year-old son	1,000
August	Overnight camp (4 weeks; cost $2,000 per child)	4,000
September through December	Live–in nanny	8,000
TOTAL		$16,000

Dan received commission income of $125,000 during the current year. He was able to claim sales expenses of $25,000 on this tax return. Janet had the following sources of income - salary plus taxable benefits $115,000, spousal support from her former spouse $12,000, and net rental income $8,000.

Determine the maximum tax deduction for child care available to Dan and Janet for the current year, 2022.

CPA Competency 6.3.2 Moving expenses. Income tax reference: ITA 63.

QUESTION EIGHT

Neil Mohamed owns 100% of the issued shares of N Ltd. His spouse, Susan, owns 60% of the issued shares of S Ltd. Their son, Ron, owns 50% of the shares of R Ltd. The remainder of the shares of S Ltd. and the remainder of the shares of R Ltd. are owned by strangers.

Determine which individuals and corporations are related.

CPA Competency 6.2.1 Related. Income tax reference: ITA 251(1)&(2).

QUESTION NINE

Early in the current year, Alex Manuel gifted shares of a public corporation to his 16-year-old son. Alex had paid $1,000 for the shares. They were worth $15,000 at the time of the gift. After receiving the gift, his son received dividends of $800 on the shares. Also, in the current year, Alex sold shares of a public corporation to his spouse. The shares, which had a value of $10,000 at the time of the sale, originally cost $2,000. Alex sold them to his spouse for $7,000. His spouse received dividends of $500 on these shares.

Determine the tax consequences of these transactions.

CPA Competency 6.2.1 Related party transactions and attribution. Income tax reference: ITA 69(1), 73(1), 74.1, 74.2.

QUESTION TEN

Brody Gil has a lawn care business, which he incorporated in 2022. On incorporation, Brody and a trust for his 15-year-old son each subscribed for 1 common share at $100 per share. Brody paid the $200 for both the shares. The corporation will pay dividends annually to Brody and the trust, which will distribute the dividend to the son.

Describe the tax treatment of the dividend income received by Brody's son.

CPA Competency 6.2.1 Tax on spit income. Income tax reference: ITA 120.4.

QUESTION ELEVEN

Parent A, age 67, owns 84% of the common shares of Opco. Parent B owns 8%. The remaining 8% is owned by Child, age 22, who works full-time in the business with Parent A. Parent B is not involved in any aspect of the business. Opco is in the business of manufacturing furniture. In the current year, Opco paid dividends to Parent A, Parent B, and Child.

Explain why the dividends received by Parent A, Parent B, and Child are not subject to tax on split income.

CPA Competency 6.2.1 Tax on spit income. Income tax reference: ITA 120.4(1), (1.1).

QUESTION TWELVE

X Ltd. is in financial difficulty. It has just learned that its major supplier is willing to forgive $100,000 of the debt owed by X Ltd. in order that X Ltd. will not be forced to declare bankruptcy. X Ltd. has built up non-capital losses of $80,000 over the last few years. It still owns the following assets: land (cost $70,000), building (cost $120,000; UCC $92,000), and equipment (cost $40,000; UCC $32,000).

Determine the tax implications of the debt forgiveness.

Debt forgiveness. Income tax reference: ITA 80.

QUESTION THIRTEEN

Irene Salomon died in 2022. At the time of her death, she owned the following assets:

- Antique furniture: fair market value (FMV) - $30,000; cost - $10,000
- Rental property—land: FMV - $100,000; cost - $60,000; building: FMV - $60,000; cost - $50,000; UCC - $45,000
- RRSP: FMV - $80,000
- TFSA: FMV - $50,000

In her will, Irene directed her executors to transfer the antique furniture to her spouse and the rental property to her son. Her spouse was the named beneficiary on her RRSP and TFSA.

Determine the tax implications for the above assets on Irene's death

CPA Competency 6.6.1 Dispositions on death. Income tax reference: ITA 60(l), 70(5), 70(6).

Solutions to Key Concept Questions

KC 9-1

[ITA: 60(i), 146(1),(5),(5.1) - RRSP]

RRSP deduction:		
Lesser of -		
Prescribed dollar limit (2022)	$29,210	
18% x earned income (18% x $80,000)	$14,400	$14,400
Deduct: pension adjustment (PA)		(3,000)
		11,400
Add: unused RRSP deduction room		5,000
Maximum RRSP deduction		$16,400

Fred can deduct RRSP contributions of up to $16,400 on his 2022 tax return, provided he makes the RRSP contributions either during 2022 or within 60 days after 2022 to his RRSP or to a spousal RRSP [ITA 60(i); 146(1),(5),(5.1)]. Fred made RRSP contributions totalling $22,000; $12,000 to his RRSP during 2022 and $10,000 to a spousal RRSP in February 2023. Therefore, Fred's 2022 RRSP deduction is $16,400. The remainder of his spousal contribution can be deducted in 2023. Fred can continue to have an RRSP until December 31 of the year he turns 71 [ITA 146(2)(b.4)]. After that he can continue to make spousal contributions if he has earned income.

KC 9-2

[ITA 146(1) - RRSP earned income definition]

Victoria's earned income for RRSP purposes is $98,000 calculated in accordance with the definition in ITA 146(1).

Employment income for tax purpose		$67,000
Add:	RPP deduction	3,000
	Rental income	22,000
	Spousal support received	12,000
Deduct:	Business loss	(6,000)
Earned income		$98,000

KC 9-3

[ITA: 56(1)(a), 60(j.1) – Retiring allowance]

The $40,000 retiring allowance must be included in Tom's other sources of income for the current year [ITA 56(1)(a)]. To the extent he contributes $12,000 to his RRSP by 60 days after the end of the current year, he is entitled to an RRSP deduction of $12,000 [ITA 60(j.1)].

The deduction is calculated as follows:

- $2,000 x number of pre-1996 years (or part years) that Tom was employed by this employer ($2,000 x 6 years = $12,000)

  plus

- $1,500 x number of pre-1989 years (or part years) that Tom was employed by this employer ($1,500 x 0 years = 0).

This RRSP contribution **cannot** be made to a spousal plan.

KC 9-4

[ITA: 56(1)(h), 146.2, 146(8.3) - Spousal RRSPs and attribution]

In order to prevent abuses of the income splitting provided by spousal RRSPs, there is an anti-avoidance rule stating that the withdrawal is included in the contributing spouse's income to the extent of any contributions made by the spouse in the year of the withdrawal and the two preceding years [ITA 146(8.3)].

In this case, the spouse contributed $2,500 in the year of the withdrawal and in each of the two preceding years. Therefore, $7,500 ($2,500 x 3) must be included in the spouse's income for tax purposes. The remaining $16,500 (withdrawal $24,000 - $7,500) is included in Beth's income for tax purposes [ITA 56(1)(h)].

The $8,000 withdrawn from the TFSA is received tax-free. All funds withdrawn from a TFSA are not taxable.

KC 9-5

[ITA: 56(1)(a),(b),(n),(h),(h.2), 56(3),(6) 56.1(4), 60(b), 122.6, 146.02 – Other income]

Wendy must include $22,100 of income from other sources.

Support payments of $18,000 ($48,000 - $2,500 x 12) are included [ITA 56(1)(b)]. Child support payments are not taxable. Since the child is 4 years old, the child support is being paid pursuant to an agreement entered into after April 30, 1997 [ITA 56.1(4)]. Where spousal support is included in income, an offsetting deduction is normally allowed to the payer [ITA 60(b)].

The employment insurance benefits, $4,100, are included [ITA 56(1)(a)].

The scholarship is not taxable since Wendy's enrollment as a full-time student at the University of Toronto qualifies her for the education credit [ITA 56(1)(n), 56(3)].

The RRSP withdrawal is not taxable. The Lifelong Learning Plan (LLP) allows withdrawal of funds, tax-free, from an RRSP to fund full-time post-secondary education. The maximum withdrawal is $10,000 per year ($20,000 cumulative limit over 4 years). The amount withdrawn must be repaid over a period of time, failing which they are included into income [ITA 146.02].

The inheritance, the Canada Child benefit, and the lottery winnings are not taxable because they are not included in the other sources of income, specifically listed in the ITA. The Canada child benefit (CCB) is administered by the CRA. It is a tax-free monthly payment made to eligible families to help with the cost of raising children under 18 years of age.

KC 9-6

[ITA: 62; Folio S1-F3-C4, Moving expenses]

Moving expenses in respect of an eligible relocation are deductible. The deduction is limited to the income earned at the new location which in this case is $30,000 [ITA 62(1)].

The move from Ottawa to Toronto is an eligible relocation as defined in ITA 248 –

- The relocation occurred to enable Norman to be employed at a new work location in Canada,
- His old home and his new home are both in Canada, and
- His new home is at least 40 km closer to the new work location than his old home would be.

Norman's deductible moving expenses total $34,514 as calculated below. His deduction for the current year is limited to $30,000 (Norman's income from his new work location). The excess can be carried forward and deducted next year.

ITA 62(3)(a) Travel costs in the course of moving Norman and members of his household from the old house to the new house - $489.

Travel expenses can optionally be calculated under the simplified method without receipts: $23/meal (up to $69/day per person) and vehicle expenses based on a prescribed amount per km for the province in which the move starts [the prescribed amounts for each province can be found on the CRA website at *Canada.ca/taxes-travel-costs*].

Detailed method: Actual cost (receipts required)	$210
Simplified method: Meals - $23 x 2 meals x 5 people	$230
Car – 57.5¢ (Ontario rate) x 450 km	259
	$489

ITA 62(3)(b) cost of transporting household effects from the old home to the new home - $6,000.
ITA 62(3)(e) selling costs in respect of the old home – $21,200 (legal fees $1,200 + commission $20,000).
ITA 62(3)(f) legal fees and land transfer tax on the purchase of the new home - $1,800.
ITA 62(3)(g) cost of carrying the Ottawa home while vacant and trying to sell – limited to $5,000.
ITA 62(3)(h) cost of revising legal documents - $25

The airline ticket, hotel and meals while in Toronto to search for a new home are not deductible. Only the actual move qualifies. House hunting travel costs were denied in *Nazih, 2016 TCC 70, para. 9*.

KC 9-7

[ITA: 63 – Child care]

Dan can claim a child-care deduction of $12,300.

Qualifying child-care expenses paid [ITA 63(3)]:	
Janet's mother	$ 3,000
17-year-old child (related & under 18)	0
Overnight camp amount deductible ($200 x 4 wk) + ($125 x 4 wk)	1,300
Nanny	8,000
Child care expenses eligible for deduction	$12,300

The child care deduction must be claimed by the spouse with the lower net income, which in this case is Dan ($125,000 – $25,000 = $100,000). Janet has net income of $135,000 ($115,000 + $12,000 + $8,000) before the child care deduction.

	Dan	
Earned income for purposes of the child care deduction [ITA 63(3)]		
Commission income	$125,000	
Deductible amount [ITA 63(1)] - least of		
(a) amount paid		$12,300
(b) $8,000 + $5,000		$13,000
(c) 2/3 x earned income		$83,333
Deductible amount		$12,300

KC 9-8

[ITA: 251 - Related]

Related individuals [ITA 251(2)(a)]:

- Neil, Susan and Ron are related. Neil and Susan are related by marriage [ITA 251(6)(b)]. Neil and Susan are related to Ron by blood relationship [ITA 251(6)(a)].

Individuals related to corporations [ITA 251(2)(b)]:

- Neil is related to N Ltd., the corporation he controls. Likewise, Susan is related to S Ltd. Ron does not control R Ltd. and so is not related to R Ltd. [251(2)(b)(i)].

- Neil is related to S Ltd. since he is related to Susan, the person who controls S Ltd. Likewise, Susan is related to N Ltd. [251(2)(b)(iii)].

- Ron is related to N Ltd. and S Ltd. since he is related to the individuals who control these corporations [251(2)(b)(iii)].

Related corporations [ITA 251(2)(c)]:

- N Ltd. and S Ltd. are related [ITA 251(2)(c)(ii)].

KC 9-9

[ITA: 69(1), 73(1), 74.1, 74.2 – Related party transactions and attribution]

Gift to 16-year-old son –

- Alex is deemed to receive proceeds of $15,000 (FMV) for the shares gifted to his son [ITA 69(1)(b)]. Thus, he has a taxable capital gain on the transaction of $7,000 (1/2 x ($15,000 - $1,000).

- The son has an ACB for the shares of $15,000 (FMV) [ITA 69(1)(c)]. When the son resells the shares, the capital gain/loss is not subject to attribution. The gain will be taxed in the son's income.

- The dividend income received by the son attributes to Alex and is included in Alex's income for tax purposes. This attribution of income will continue until the year the son turns 18 [ITA 74.1(2)].

Sale to spouse–

- Alex is deemed to receive proceeds of $2,000 (ACB) for the shares sold to his spouse [ITA 73(1)]. Thus, the capital gain on these shares is deferred until the shares are resold by his spouse.

- The spouse has an ACB for the shares of $2,000 [ITA 73(1)]. When the spouse sells the shares, the capital gain/loss will attribute to Alex and be included in his income for tax purposes [ITA 74.2(1)].

- The dividend income received by the spouse will attribute to Alex and be included in his income.

- When his spouse sells the shares, if they reinvest the proceeds, any income earned on the reinvested proceeds (substituted property) will also attribute to Alex and be included in his income for tax purposes. When the spouse sells the substituted property, the gain/loss will also attribute to Alex.

Sale to spouse; elect out of spousal rollover [ITA 73(1)] – Alex has the option of electing out of the spousal rollover when he files his tax return for the year he sold the shares to his spouse. If he makes the election, the tax implications are as follows:

- Alex is deemed to receive proceeds of $10,000 (FMV) for the shares sold to his spouse [ITA 69(1)(b)]. Thus, he has a taxable capital gain on the transaction of $4,000 (1/2 x ($10,000 - $2,000)).

- The spouse has an ACB for the shares of $7,000 (her cost). When the spouse sells the shares, the capital gain/loss will attribute to Alex and be included in his income for tax purposes [ITA 74.2(1)]. The effect is that the gain between $7,000 and $10,000 is taxed twice.

- The dividend income received by the wife will attribute to Alex and be included in his income.

- In this case, Alex should NOT elect out of the spousal rollover.

KC 9-10

[ITA: 120.4 – Tax on split income]

In this case, a child under age 18 is receiving dividend income from a private corporation. This income does not attribute to Brody. This income is not included in the son's income for his normal tax calculation (Part I tax) [ITA 20(1)(ww)]. Instead, the son is subject to a special *tax on split income* [ITA 120.4]. This tax is calculated at the top marginal tax rate (less any applicable dividend tax credit). Because the dividends are taxed at the top rate, the benefit of splitting dividend income from private corporations is eliminated.

KC 9-11

[ITA: 120.4(1), (1.1) – Tax on split income

The dividends received by Parent A are excluded because they own 84% (being 10% or more) of the corporation and less than 90% of the corporation's income is earned from providing services.

The dividends received by Parent B are excluded because Parent A, the business owner, is 65 years of age or older.

The dividends received by Child are excluded because Child works more than 20 hours a week in the business.

KC 9-12

[ITA: 80 – Debt forgiveness]

Forgiven amount	$100,000
Applied in accordance with the ordering rules [ITA 80(2)(c)]:	
Reduce non-capital losses [ITA 80(3)]	(80,000)
Reduce capital cost and UCC of depreciable property [ITA 80(5)]	
- Property with the lowest CCA rate would be selected	(20,000)
Balance	$ Nil

If there remains an unapplied portion of the gain after the reduction of the losses, then the gain is applied to reduce the capital cost and UCC of depreciable property, and the ACB of capital assets, at the election of the taxpayer, through a series of designations. However, these reductions must be applied in order and to the maximum extent possible. If not all of the forgiven debt is consumed by applying it to the above items, one-half of any remaining balance is included in income.

The optimal use of the $20,000 unapplied forgiven amount (assuming the election to reduce the UCC balances is made) would be to reduce the UCC of the building by $20,000 to $72,000. Since equipment has a 20% CCA rate, the building has the lowest CCA rate (4%, 6%, or 10%).

KC 9-13

[ITA: 60(l), 70(5), 70(6) – Dispositions on death]

All capital property, including depreciable property, owned by Irene is deemed to have been sold at its fair market value immediately before her death [ITA 70(5)]. However, assets left to a spouse, or a spouse trust, are deemed to have been sold at their cost amount [ITA 70(6)].

The antique furniture left by will to Irene's spouse is deemed to be sold at its tax value, $10,000. Thus, the capital gain is deferred until the husband disposes of the furniture. The spouse is deemed to have acquired the furniture at a cost of $10,000.

The rental property, left to her son, is deemed to be sold at its fair market value resulting in recapture of $5,000 and taxable capital gains of $25,000 being included in Irene's final tax return.

Recapture on Building (UCC $45,000 – Cost $50,000)		$ 5,000
Taxable capital gain		
- Building ($60,000 - $50,000) x ½	$ 5,000	
- Land ($100,000 - $60,000) x ½	20,000	25,000
		$30,000

RRSP - Where there is an unmatured RRSP, the deceased is considered to have received from the RRSP, immediately before death, an amount equal to the value of the assets held in the RRSP. Where the spouse is the beneficiary, the spouse has the income inclusion, not the deceased [ITA 146(8.8),(8.9) *refund of premiums*]. The spouse is entitled to an equal RRSP deduction [ITA 60(l)] provided the amount (refund of premiums) is transferred to an RRSP in the spouse's name in the year he receives it or within 60 days after the end of the year.

TFSA - The deceased is not considered to have received an amount from the TFSA at the time of death if her spouse is named as the successor holder of the TFSA. In this situation, the TFSA continues to exist and the successor holder assumes ownership of the TFSA contract and all of its contents. The TFSA continues to exist and both its value at the date of the original holder's death and any income earned after that date continues to be sheltered from tax under the new successor holder.