CHAPTER 10

INDIVIDUALS: DETERMINATION OF TAXABLE INCOME AND TAXES PAYABLE

Review Questions

1. Briefly explain the difference between net income for tax purposes and taxable income for individuals.

2. Explain the difference between an allowable capital loss and a net capital loss.

3. Describe the tax treatment of net capital losses.

4. Explain how a non-capital loss is created and how it is treated for tax purposes.

5. Is it always worthwhile to use a net capital loss or a non-capital loss as soon as the opportunity arises? Explain.

6. Is it possible for taxpayers to pay tax on more income than they actually earned over a period of years? Explain.

7. How does the risk of not being able to use a business loss for tax purposes vary for each of the following individuals?

   • *Individual A* operates the business as a proprietorship.
   • *Individual B* is the sole shareholder of a corporation that owns the business.
   • *Individual C* is a 30% shareholder of a corporation that operates the business.
   • *Individual D* is a 30% partner in a business partnership.

8. What can a taxpayer do to reduce the risk of not being able to use a net capital loss or a non-capital loss?

9. Two separate taxpayers are considering investing in shares of the same public corporation. How is it possible that the risk associated with that investment may be greater for one taxpayer than for the other?

10. If an individual has a net taxable capital gain in a year that qualifies for a capital gains deduction, is there any advantage to not claiming the applicable portion of the deduction in that year? Explain.

11. If an individual is considering selling their business to their child, does it make any difference to them whether that business is a proprietorship or is housed within a corporation?

12. What is the difference between a tax deduction and a tax credit?

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13. An individual usually has taxable income in a year of $130,000 and pays federal and provincial taxes totalling $36,000. Would this information be relevant when the implications of investing in a partnership that operates a small retail business are considered?

14. Does an individual who lives in Alberta and receives a $100 dividend obtain the same tax reduction from the dividend tax credit as an individual who resides in New Brunswick? Explain.

15. In what circumstances may an individual be subject to provincial tax in more than one province in a particular year?

16. An individual resides in Manitoba and operates a business that has no profit from its Alberta operations. Is it possible for that person to have a tax liability in Alberta in a particular year?

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Solutions to Review Questions

R10-1. Net income for tax purposes consists of the aggregate of a taxpayer's current year's income from employment, business, property, capital gains and other sources, taking into account the losses from those sources. Net income for tax purposes is not the base to which the tax rates are applied. Taxable income consists of net income for tax purposes minus certain reductions. For individuals, those reductions consist primarily of losses from other years that were unable to be used in the year incurred and the lifetime capital gains deduction on qualified property. Taxable income is the base to which the annual tax rates apply.

R10-2. An allowable capital loss is one-half of the loss incurred on the sale of capital property in a particular year, and forms part of that year's calculation of net income for tax purposes. To the extent that the aggregating formula for a particular year restricts the deduction of allowable capital losses because there are insufficient taxable capital gains, the restricted portion is classified as a net capital loss. Net capital losses, therefore, may consist of the unused allowable capital losses of a number of years, and may be available for deduction in other years in arriving at the taxable income of those other years (see 3 below) [ITA 111(1)(b)].

R10-3. Net capital losses can be carried back three years and forward indefinitely from the year in which they were incurred. During the carry-over period, the net capital losses can be deducted in arriving at taxable income only to the extent that the taxpayer has realized net taxable capital gains (gains minus losses) for that year [ITA 111(1)(b), 111(1.1)]. There is an exception to this rule for the year of death and the preceding year. In those two years, an individual may deduct net capital losses against all sources of income [ITA 111(2)].

R10-4. If, in a particular year, the aggregating formula for determining a taxpayer's net income for tax purposes does not permit the full deduction of employment losses, business losses, property losses, and allowable business investment losses because there is insufficient income in that year, the unused portion is classified as a non-capital loss. Non-capital losses can be carried back three years and forward twenty years from the year in which they are incurred, and can be deducted in arriving at the taxable income of those other years, regardless of the type of income earned in those other years [ITA 111(1)(a)].

R10-5. It is not always desirable to utilize a loss carry-over as soon as possible. The decision to use the loss carry-over must consider both the timing and the amount of the tax savings that will occur. Obviously, the sooner they are used, the sooner after-tax cash flow will be increased. However, consideration must also be given to the rates of tax that are applicable in the particular year. By forgoing the use of a loss carry-over in a year of relatively low income in order that it can be used in a subsequent year when income is anticipated to be high (and therefore subject to a higher rate of tax) the amount of tax saved will be greater. The decision to delay the use of a loss carry-over must consider both the time value of money as well as the degree of certainty for the anticipated earnings.

R10-6. Yes, it is possible to pay tax on more earnings than were actually achieved over a period of time. Because non-capital losses have a defined and restricted time period in which they can be used, it is possible that they will remain unused indefinitely. For example, if a taxpayer earns taxable income before the three-year carry-back and after the twenty-year carry-forward of non-capital losses, the losses simply expire, but income in those other years is subject to tax.

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R10-7. The risk of not being able to utilize a business loss for tax purposes differs for each taxpayer as follows:

- *Individual A* – As a proprietorship, the business loss belongs to the individual and can be offset against all of his/her sources of income. Therefore, the individual will only lose the loss if he/she cannot generate sufficient income in the required time limit.

- *Individual B* – Incurs the loss in a wholly-owned corporation. The loss is locked in the corporation and can only be used if the corporation earns sufficient income for offset. As the individual shareholder is a separate taxpayer, income earned by the individual cannot be offset against the corporation's loss. Therefore, there is a greater risk of the business loss remaining unused. As the sole controlling shareholder, the individual has some opportunity to transfer income producing activity into the corporation to diminish this risk.

- *Individual C* – The risk in this situation is similar to Individual B (above) except that Individual C does not control the corporation that incurs the losses. Therefore, Individual C is at greater risk of not being able to use the business loss because it is much more difficult for him/her to transfer income producing activities to the corporation. Investing in a business venture with other parties using a corporate structure substantially reduces the shareholders flexibility for loss utilization.

- *Individual D* – Even though this individual is investing with other parties, the use of the partnership structure reduces the risk of not being able to use the business losses. The business losses are allocated directly to the individual and can be used against all of his/her sources of income. Maximum flexibility is therefore achieved.

R10-8. A taxpayer can use the following discretionary actions to reduce the risk of not being able to utilize a non-capital or net capital loss:

- Delay the deduction of discretionary items, such as capital cost allowance, allowance for bad debts and so on.
- Speed up the timing of taxable income by not claiming income reserves from deferred proceeds on the sale of capital property or inventory.
- Trigger the realization of capital gains and/or recapture of capital cost allowance by selling assets. The assets can be sold to a related entity and leased back for the business operations. The created gains will offset the losses that are about to expire in exchange for an increased tax value for the assets transferred to the related corporation. Alternatively, the property can be sold to a third party under a sale and leaseback arrangement.

R10-9. Two separate taxpayers investing in shares of the same public corporation may be subject to different risk because of their abilities to utilize a capital loss from that investment if it should occur. For example, one investor may already own other capital properties that have appreciated in value and have potential capital gains. This investor has little risk of incurring a capital loss on the new investment that will remain unused. On the other hand, another investor may have no other capital properties, in which case a capital loss on the new share investment can only be used to reduce taxes if a future capital gain can be created. Therefore, the first investor is ensured that a loss will create a tax saving which reduces the potential cash loss that can occur, whereas, the second investor runs the risk that any loss will not create a tax saving and his potential cash loss is greater.

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R10-10. The use of the capital gains deduction on specific qualified property is optional and, in some circumstances, it may be desirable to forgo its use until a later year. For example, a person may not want to claim the deduction in a year of low income, and preserve the deduction for a subsequent year when a gain would be taxable at a high rate of tax. Such a decision should not be made unless there is reasonable certainty that a future capital gain on qualified property will occur. In addition, one should be aware that the capital gains deduction, as a tax preference, is subject to continual debate regarding its fairness and runs the risk of being canceled at some future time [ITA 110.6].

R10-11. If the business is a proprietorship, the sale of the business involves the sale of each separate asset. To the extent that capital gains occur from the sale, the taxpayer cannot use the capital gains deduction to reduce the amount of tax. If the business is housed within a corporation, the sale would involve the sale of shares of the corporation rather than the individual assets of the business. In this case, provided that the corporation is a qualified small business corporation (QSBC), a capital gains deduction of $456,815 ($913,630 x ½) is available [ITA 110.6].

R10-12. A tax deduction reduces a taxpayer's taxable income and the resulting tax saving is based upon the marginal tax rate of the taxpayer. For example, a $100 tax deduction will reduce taxes by $45 for a taxpayer subject to a 45% tax rate and by $32 for a taxpayer subject to a 32% tax rate. On the other hand, a tax credit is a specific reduction of tax otherwise payable. A $100 tax credit reduces the taxpayer's tax by $15 ($100 x 15%) regardless of whether they are subject to a 45% tax rate or a 32% tax rate. A tax deduction has more impact than a tax credit.

R10-13. The fact that the individual paid $38,000 of tax on $130,000 of income is not relevant to the decision to invest in the business partnership. This information simply provides the effective rate of tax paid (29%; $38,000/$130,000). What is relevant is the marginal rate of tax applicable to the investor. In other words, the rate of tax applicable on each additional dollar of income earned [ITA 117(2)].

Because personal tax rates are progressive, the $38,000 tax amount consists of several rates of tax on different levels of income. This individual will be taxed on each additional dollar of income at the highest rate. The new venture is structured as a partnership, therefore, profits earned or losses incurred are allocated directly to the investor creating additional tax on income at the high rate, and will save tax from losses at the same rate (unless the losses cross the rate boundary).

R10-14. An individual in Alberta will not receive the same tax reduction from the dividend tax credit on a $100 dividend as an individual in New Brunswick. Although the federal dividend tax credit is the same, the provincial taxes are different. Each province and territory has their own provincial dividend tax credit.

R10-15. Normally an individual is taxable in the province he or she resides in on the last day of the calendar year. An exception to this rule requires that an individual, who resides in a particular province but carries on business from a permanent establishment in other provinces, allocate a portion of the business income to those other provinces [Reg. 2600].

R10-16. Yes, it is possible for this to occur. A taxpayer residing and operating a business in Manitoba that also has operations in Alberta must allocate a portion of the business profits for tax in Alberta provided that the Alberta operations are carried on from a permanent establishment in that province. The profit allocation is based on an arbitrary formula that relates to the percentage of

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sales earned and salaries paid in Alberta and not to the actual profits in Alberta. Therefore, as long as the Alberta operation has sales and salaries, a percentage of the total business profits (Manitoba and Alberta) is allocated to Alberta and is subject to Alberta tax rather than Manitoba tax only. The fact that the Alberta operation did not actually earn a profit is irrelevant [Reg. 402(3)].

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Key Concept Questions

QUESTION ONE

In the current year, Elizabeth Munoz has a taxable capital gain of $20,000 from disposing of shares of various public companies. She has a net capital loss of $7,500 from 1998 when the capital gains inclusion rate was 3/4.

Determine the maximum net capital loss deduction for the current year.

CPA Competency 6.3.2 Loss carry overs. Income tax reference: ITA 111(1)(b), 111(1.1).

QUESTION TWO

Kendra Thomson disposed of shares of A Ltd., a qualified small business corporation (QSBC) - in 2022, realizing a taxable capital gain of $350,000. She has net capital losses from last year of $10,000, which she wants to claim in the current year. Her cumulative net investment loss (CNIL) account at the end of the year is $3,000. Kendra claimed an allowable business investment loss (ABIL) of $12,000 on her previous year's tax return. She incurred a taxable capital gain of $75,000 on QSBC shares four years ago and claimed an equivalent capital gains deduction.

Determine the capital gains deduction claimable by Kendra for 2022.

CPA Competency 6.3.2 Capital gains deduction – limits, basic computations. Income tax reference: ITA 110.6(1), (2), (2.1).

QUESTION THREE

At the end of 2021, Ryan Ali had a balance in his cumulative net investment loss (CNIL) account of $14,500. In 2022, Ryan earned net rental income of $5,000 and received eligible dividends from Canadian corporations of $1,000. He incurred interest expense of $3,000 relating to his stock portfolio.

Determine Ryan's CNIL balance at the end of 2022.

CPA Competency 6.3.2 Capital gains deduction – basic computations. Income tax reference: ITA 110.6(1).

QUESTION FOUR

X Ltd. is a Canadian-controlled private corporation carrying on business in Canada. The net fair market value of X Ltd. is estimated to be $80,000, calculated as follows:

Cash	$ 1,000
Marketable securities	16,000
Accounts receivable	11,000
Furniture and equipment	32,000
Goodwill	40,000
	100,000
Bank loan	(20,000)
	$ 80,000

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The shares of X Ltd. have been owned by Alexander Schneider for the last two years. Throughout that time, the relative values of the assets and liabilities have remained constant.

Determine if X Ltd. is a qualified small business corporation.

CPA Competency 6.3.2 Capital gains deduction – availability. Income tax reference: ITA 110.6(1).

QUESTION FIVE

In 2016, Jackson Garza loaned $10,000 to a small business corporation. By the end of 2022, it was established that the loan was bad and that Jackson would not be receiving the $10,000 principal. Jackson has sheltered $4,000 of capital gains with the capital gains deduction in prior years.

Determine the tax consequences for Jackson for 2022.

CPA Competency 6.2.2 Business investment loss – availability. Income tax reference: ITA 39(1)(c), 39(9), 50(1).

QUESTION SIX

Angelina Tobin has employment income of $130,000 for 2022. She is single and lives alone. Angelina's employer withheld EI and CPP contributions of $4,453 (includes CPP enhanced contributions of $461) and income tax.

Determine Angelina's federal tax payable for 2022 under each of the following assumptions:

(a) She has net income and taxable income of $130,000.
(b) She has net income and taxable income of $180,000.
(c) She has net income and taxable income of $240,000.

CPA Competency 6.3.2 Graduated tax rates & Non-refundable tax credits. Income tax reference: ITA 117(2), 117.1(1), 118(1)(c), 118(1.1), 118(10), 118.7.

QUESTION SEVEN

Mr. Senior turned 67 in 2022 and receives pension income from the following sources:

• Old-age security pension	$ 8,000
• Canada Pension Plan	12,000
• Pension income from former employer	60,000
	$80,000

He has no other income for the year. His spouse, age 66, has net income of $8,500 (OAS and interest income).

Determine Mr. Senior's federal tax payable for 2022 assuming the following:

(a) He does not elect to split his pension income.
(b) He elects to split his pension income.

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CPA Competency 6.3.2 Pension income, Graduated tax rates & Non-refundable tax credits. Income tax reference: ITA 56(1)(a.2), 60(c), 60.03, 117(2), 117.1(1), 118(1)(a), 118(1.1), 118(2),(3), 118.8.

QUESTION EIGHT

Brent Wells is single and lives alone. During 2022 he earned employment income of $140,000. His employer withheld EI ($953) and CPP ($3,500) contributions of $4,453 (including CPP enhanced contributions of $461) and income tax. He has a portfolio of investments that generated eligible dividends from Canadian corporations of $10,000. He donated public company shares worth $1,000 to the Canadian Cancer Society. The adjusted cost base (ACB) of the shares donated was $400.

Determine Brent's federal tax payable for 2022.

CPA Competency 6.3.2 Graduated tax rates & Non-refundable tax credits, including donations & dividends. Income tax reference: ITA 38(a.1), 60(e.1), 117(2), 117.1(1), 118(1)(c), 118(1.1), 18.01(5), 118.1(3), 118.7, 121.

QUESTION NINE

Michelle Campos attended a Canadian university on a full-time basis for eight months during the current year. Her only income for the year was $4,500 of employment income earned during the summer. She paid tuition fees of $7,000 for the current year.

Determine the amount of the tuition credit available to Michelle. What options are available with respect to the unused tuition credit?

CPA Competency 6.3.2 Tuition credit. Income tax reference: ITA 118.5, 118.61, 118.81, 118.9.

QUESTION TEN

Aras Molina and Kelly Boone have two children, Ben, age 14, and Cody, age 20. The medical expenses and net income for each member of the family for 2022 are as follows:

	Medical expenses	Net income
Aras	$ 2,000	$100,000
Kelly	3,000	40,000
Ben	600	500
Cody	12,000	9,000

All of the medical expenses were paid by Aras in the 12-month period ending December 31.

Determine the maximum medical expense credit for 2022.

CPA Competency 6.3.2 Medical expense credit. Income tax reference: ITA 118.2(1).

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QUESTION ELEVEN

An individual made charitable donations of $10,000 during 2022.

Determine the maximum donation credit available under the following assumptions:
(a) The individual's taxable income is $200,000.
(b) The individual's taxable income is $225,000.

CPA Competency 6.3.2 Donation credit. Income tax reference: ITA 118.1(3).

QUESTION TWELVE

An individual has $40,000 in shares of Canadian public company X (with a cost base of $10,000). They are considering selling the shares and donating the after-tax proceeds to a charity. Their accountant recommended that they instead donate the shares directly to the charity.

Determine the after-tax cost of the donation under both alternatives. Assume the individual's marginal tax rate is 50% and that donations receive a 44% tax credit (federal and provincial combined).

CPA Competency 6.3.2 Donation of Canadian public company shares. Income tax reference: ITA 38(a.1), 117(2), 118.1.

QUESTION THIRTEEN

Elle Klein received old-age security (OAS) payments during 2022 totalling $8,000. Her net income for the is $85,000. No amount was withheld from the OAS payments as her income was lower in previous years.

Determine Elle's OAS recovery tax (Part I.2 tax) for 2022.

CPA Competency 6.3.2 OAS clawback. Income tax reference: ITA 60(w), 180.2.

QUESTION FOURTEEN

In 2022, Jon Patel, who is single, earned rental income of $30,000, capital gains of $100,000, and Canadian non-eligible dividends of $20,000. He is exempt from CPP and EI. In addition, Jon is a limited partner in a Canadian limited partnership from which he was allocated a business loss of $34,000.

Does Jon have to pay federal alternative minimum tax (AMT) in 2022 and, if so, how much? Also, briefly explain how AMT paid for the current year will affect tax payable in future years.

CPA Competency 6.3.2 AMT. Income tax reference: ITA 127.5 to 127.55.

QUESTION FIFTEEN

George King's date of death is October 24, 2022. In his final tax return for 2022, taxable capital gains of $200,000 on his stock portfolio were reported. In 2023, the value of his stock portfolio declined severely. The portfolio was sold in late 2023 by the estate executor, creating a large capital loss. As well in 2023, a large donation was made to the local hospital in accordance with George's wishes as documented in his

will.

Describe the best way to use the capital loss and the donations.

CPA Competency 6.6.1 Special carry-back rules (capital losses, charitable donations). Income tax reference: ITA 164(6), 118.1(4.1),(5),(5,1).

QUESTION SIXTEEN

Gavin Philips died suddenly while at work on Wednesday, June 24, 2022. His income consisted of the following items:

- Salary and vacation pay are $90,000. His employer has a bi-weekly payroll, paid one week in arears. On Friday, June 26, salary for the two weeks ended June 19, was received ($7,000). On July 10, salary for June 22 through June 24 ($1,500) and vacation pay ($3,500) were received. Vacation pay of $60 was earned for June 22 through June 24.
- CPP death benefit is $2,500.
- Interest on $10,000 GIC @3%, purchased on March 1, 2022.
- Dividends on bank shares ($2,400) received on July 8, 2022; the dividends were declared payable on June 15, 2022 to shareholders of record on that date.

a) Which of the items can be reported on a rights or things return?
b) Which non-refundable tax credits can be claimed on the rights or things return?
c) Are the non-refundable tax credits prorated to the date of death?
d) What is the benefit of filing a separate rights or things return?
e) When is the rights or things tax return due?
f) When is the balance of tax on the rights or things return due?

CPA Competency 6.6.1 Rights or Things Return. Income tax reference: ITA 70(2), 118.93, 150(1)(b), 156.1(4)

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Solutions to Key Concept Questions

KC 10-1

[ITA: 111(1)(b), 111(1.1) – Net capital losses]

The maximum net capital loss deduction for the current year is $5,000. The 1998 net capital loss is stated at the inclusion rate for the year incurred (3/4). The net capital loss must first be grossed-up to the full capital loss and then multiplied by the current year inclusion rate (1/2).

$7,500 x 4/3 = $10,000 x ½ = $5,000

KC 10-2

[ITA: 110.6(1), (2), (2.1) – Capital gains deduction]

The capital gains deduction claimable by Kendra in 2022 is $325,000 being the least of three amounts; unused capital gains deduction ($381,815), cumulative gains limit ($325,000) and annual gains limit ($340,000).

Unused capital gains deduction available:	
Lifetime limit ($913,630 x 1/2)	$456,815
Claimed previously	(75,000)
Available	$381,815
Annual gains limit:	
Lesser of	
Net taxable capital gains (all assets) $350,000, and	
Net taxable capital gain (QSBC) $350,000	$350,000
Deduct Net capital losses (in excess of other net gains)	(10,000)
Deduct ABIL	(0)
	$340,000
Cumulative gains limit:	
Qualifying taxable capital gains (1985-2022) ($75,000 + $350,000)	$425,000
Net capital losses in excess of other net gains (1985-2022)	(10,000)
ABILs deducted (1985-2022)	(12,000)
Capital gains deductions claimed in prior years (1985-2021)	(75,000)
CNIL at end of 2022	(3,000)
	$325,000

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KC 10-3

[ITA: 110.6(1) - CNIL]

Ryan's CNIL balance at the end of 2022 is

Opening balance	$14,500
Interest expense	3,000
Rental income	(5,000)
Eligible dividends $1,000 x 138%	(1,380)
	$11,120

KC 10-4

[ITA: 110.6(1) – QSBC]

X Ltd. is not currently a QSBC since it is not a SBC at this time. X Ltd. can be turned into a SBC by selling the marketable securities and using the proceeds to repay a portion of the bank loan. If X Ltd. did this, 100% of the fair market value of its assets would be used in an active business.

For X Ltd. to be a qualified small business corporation, it must meet the following tests:

1) At the determination time, X Ltd. must be a small business corporation (SBC).

2) Throughout the preceding 24 months, the shares of X Ltd. must not have been owned by an unrelated person.

3) Throughout the preceding 24 months, more than 50% of the value of the assets must be used in an active business carried on primarily in Canada, or shares of a connected corporation (greater than 10% ownership) meeting the more than 50% asset test.

Test 1) Currently X Ltd. is not a SBC. It does not have 90% or more of the fair market value of its assets used in an active business. The marketable securities represent 16% of the fair market value of the assets.

Test 2) Alexander has owned the shares of X Ltd. throughout the preceding 24 months. Therefore, at no time in the past 24 months, were the shares owned by an unrelated person and test (2) is met.

Test 3) 84% of the fair market value of the assets have been used in an active business carried on in Canada throughout the past 24 months. Therefore, test (3) is met.

Since X Ltd. is a not an SBC (test 1), X Ltd. is not a QSBC.

KC 10-5

[ITA: 39(1)(c); 39(9); 50(1) – ABIL]

The $10,000 loan has become a bad debt in 2022. Jackson can make an election under ITA 50(1) to be deemed to dispose of the loan at the end of the year for proceeds of Nil and to have reacquired it on the first day of 2023 for a cost of Nil. If Jackson makes the election, he will have an allowable business investment loss (ABIL) of $3,000 and an allowable capital loss (ACL) of $2,000 in 2022. The ABIL is

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deductible against all sources of income while the ACL is deductible against taxable capital gains only.

Loan to small business corporation (SBC):

Proceeds	$ 0
ACB	(10,000)
Loss	(10,000)
Gains sheltered by capital gains exemption in prior years	4,000
Business investment loss	$(6,000)
Allowable business investment loss	$(3,000)
Allowable capital loss	$(2,000)

The portion of the loss that is disallowed BIL treatment (gains sheltered by the capital gains exemption in prior years) remains a capital loss.

KC 10-6

[ITA: 117(2), 117.1(1), 118(1)(c), 118(1.1), 118(10), 118.7 – Federal tax and basic credits]

Angelina's federal tax payable for 2022 under each of three income alternatives is as follows:

			(a)	(b)	(c)
Taxable income			$130,000	$180,000	$240,000
ITA 117	Federal Income Tax:				
	On the first		100,392	155,625	221,708
	tax is		17,820	32,180	51,344
	On the remaining $29,608 at	26%	7,698		
	On the remaining $24,375 at	29%		7,069	
	On the remaining $18,292 at	33%			6,036
	Total tax		25,518	39,249	57,380
	Non-refundable tax credits:				
ITA 118(1), 118(1.1)	Basic personal amount		-14,398	-13,779	-12,719
ITA 118.7	EI and CPP ($4,453 - $461)		-3,992	-3,992	-3,992
ITA 118(10)	Canada employment amount		-1,287	-1,287	-1,287
			-19,677	-19,058	-17,998
	x 15%		-2,952	-2,859	-2,700
	Federal tax payable		22,566	36,390	54,680

Basic personal amount (alternative (b). Since the net income is between the start of the 29% tax bracket $155,625 and the start of the 33% bracket $221,708, the basic personal amount equals $14,398 – [(Net income $180,000 - $155,625) x (1,679/66,083)] = $13,779. *The 1,679 = maximum personal amount $14,398 - minimum personal amount $12,719. The 66,083 = Top tax bracket starting point $221,708 - 29% tax bracket starting point $155,625.*

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KC 10-7

[ITA: 56(1)(a.2), 60(c), 60.03, 117(2), 117.1(1), 118(1)(a), 118(2),(3), 118.8 – Federal tax and Senior credits]

(i) Pension income not split:

Federal income tax:			
	15% x $50,197		$7,530
	20.5% x 29,803		6,110
	$80,000		13,640
Deduct non-refundable tax credits:			
118(1)(a)	Basic personal amount	$14,398	
118(1)(a)	Spouse amount ($14,398 - $8,500)	5,898	
118(2)	Age amount $7,898 – 15% ($80,000 - $39,826)	1,872	
118(3)	Pension amount	2,000	
118.8	Amounts transferred from spouse (Age)	7,898	
		$32,066 x 15%	(4,810)
Federal tax payable			$8,830

(ii) Pension income split:

Mr. and Mrs. Senior are assumed to split eligible pension income ($60,000) so that each reports an equal amount ($30,000). [50% of the eligible pension income is the maximum allocation allowed]. This increases Mrs. Senior's net income to $38,500 [ITA 56(1)(a.2)] and reduces Mr. Senior's net income and taxable income to $50,000 [ITA 60(c) & 60.03].

Federal income tax:					
	15% x $50,000				$7,500
Deduct non-refundable tax credits:					
118(1)(a)	Basic personal amount			$14,398	
118(1)(a)	Spouse amount ($14,398 - $38,500)			0	
118(2)	Age amount $7,898 – 15% ($50,000 - $39,826)			6,372	
118(3)	Pension amount			2,000	
118.8	Amounts transferred from spouse –			0	
	Age amount		$ 7,898		
	Pension amount		2,000		
			9,898		
	Income	$38,500			
	Basic amount	(14,398)	(24,102)		
	Available for transfer		$ 0		
				$22,770 x 15%	(3,416)
Federal tax payable					$4,084

Mr. Senior's spouse will pay federal tax of $2,131 (15% ($38,500 - $14,398 - $7,898 - $2,000)). Combined they will pay federal tax of $6,215 ($4,084 + $2,131). Splitting the pension income resulted in a federal tax savings of $2,615 ($8,830 - $6,215). The pension income reallocation can be less than 50% of the pension income from the former employer if that minimizes the combined tax payable.

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KC 10-8

[ITA: 38(a.1), 60(e.1), 117(2), 117.1(1), 118(1)(c), 118(1.1), 18.01(5), 118.1(3), 118.7, 121 – Federal tax, Dividend tax credit and Donation of securities]

Employment income	$140,000
Dividend income $10,000 x 138%	13,800
Taxable capital gain	0
CPP enhanced contributions	(461)
Net income & Taxable income	$153,339

Note: Gains on donations to charities of publicly listed securities are not taxable [ITA 38(a.1)].

Federal income tax [ITA 117]

$100,392	17,820
52,947 x 26%	13,766
$153,339	31,586

Federal non-refundable tax credits:				
ITA 118(1)(c)	Basic personal amount		$14,398	
ITA 118.7	EI & CPP contributions ($4,453 - $461)		3,992	
ITA 118(1)	Canada employment amount		1,287	
			$19,677 x 15%	(2,952)
ITA 118.1	Donation Credit - the first	$ 200 x 15%	$(30)	
	- remainder	800 x 29%	(232)	(262)
		$1,000		
ITA 121	Dividend tax credit $10,000 x 38% x 6/11			(2,073)
Federal tax payable				$26,299

KC 10-9

[ITA: 118.5, 118.61, 118.81, 118.9 – Tuition credit]

Tuition amount	$7,000 x 15%	$1,050

Since Michelle's taxable income is less than the amounts she is entitled to claim as personal tax credits, she does not require any of her tuition credit.

Michelle has two options with respect to the unused tuition credit -

- Carry forward indefinitely,
- Transfer up to $5,000 of the tuition amount to a parent or a grandparent and carry the remainder forward indefinitely. The maximum tuition credit claimable on the parent's/grandparent's tax return is $5,000 x 15% = $750.

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KC 10-10

[ITA: 118.2(1) – Medical expense credit]

The maximum medical expense credit is $2,420. To receive the maximum credit, the family medical expenses should be claimed by Kelly, being the lower-income-earning spouse.

Medical expenses for Aras, Kelly and son under 18		$ 5,600
Less 3% x Kelly's net income $40,000 (limited to $2,479)		(1,200)
		4,400
Medical expenses for dependents 18 and over (Cody)	$12,000	
Less 3% x Cody's net income $9,000 (limited to $2,479)	(270)	11,730
		16,130
		x 15%
		$ 2,420

KC 10-11

[ITA: 118.1(3) – Donation tax credit]

(a) Taxable income $200,000 (under top tax rate threshold):

Donation Credit - the first	$ 200 x 15%	$ 30
- remainder	9,800 x 29%	2,842
	$10,000	$2,872

(b)

Taxable income	$225,000
Top tax rate threshold	(221,708)
Excess	$ 3,292

Donation Credit - the first	$ 200 x 15%	$ 30
	3,292 x 33%	1,086
- remainder	6,508 x 29%	1,887
	$ 10,000	$3,003

KC 10-12

[ITA 38(a.1), 117(2), 118.1 – Donation of Canadian public company shares]

If the shares are sold, the individual will pay $7,500 in tax on the capital gain (($40,000 - $10,000) x ½ x 50%), leaving after-tax proceeds of $32,500 for the donation ($40,000 - $7,500). The individual will receive a donation tax credit of $14,300 ($32,500 x 44%). The after-tax cost of the donation is $33,200 ($40,000 + $7,500 - $14,300) and the charity receives $32,500 in cash.

If the shares are donated to the charity, there will be no tax on the gain. The taxable capital gain is deemed to be nil. The individual will receive a donation tax credit of $17,600 ($40,000 x 44%). The after-tax cost of the donation is $22,400 ($40,000 + 0 - $17,600) and the charity receives $40,000 of value.

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KC 10-13

[ITA: 60(w), 180.2 – OAS clawback]

Pensioners with net income above $81,761 (2022) must repay part, or all, of the OAS pension. The repayment amounts are normally deducted from their monthly pension payments.

The following repayment of Elle's OAS is required:

Net income before ITA 60(w) deduction	$85,000
OAS repayment threshold	(81,761)
Excess	3,239
	x 15%
	$ 486

The OAS received ($8,000) is included in Elle's other income for tax purposes [ITA 56(1)(a)]. The OAS repayment ($486) is included in other deductions [ITA 60(w)].

KC 10-14
[ITA: 127.5 to 127.55]

The alternative minimum tax (AMT) rules are designed to impose a minimum level of tax on individuals when the normal amount of tax has been reduced as a result of certain tax preferences.

	Normal taxable income	Taxable income for AMT
Rental income	$30,000	$ 30,000
Dividends (non-eligible)	23,000 (115%)	20,000 (100%)
Capital gains	50,000 (50%)	80,000 (80%)
Limited partnership loss	(34,000)	(0)
	69,000	130,000
AMT exemption	0	(40,000)
Taxable income	$69,000	$90,000
Federal tax:		
- $7,530 + 20.5% x ($69,000 - $50,197)	$11,385	
- $90,000 x 15%		$13,500
Federal non-refundable tax credits:		
Basic $14,398 x 15%	(2,160)	(2,160)
Dividend tax credit ($20,000 x 15% x 9/13)	(2,077)	0
	$7,148	$11,340

Jonathan pays AMT of $11,340 which is $4,192 higher than normal federal income tax. This additional tax is not a permanent tax. The $4,192 AMT can be carried forward for up to seven years to reduce the normal federal tax of a future year (where the normal federal tax is higher than the AMT for that year).

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KC 10-15

[ITA 164(6), *118.1(4.1),(5),(5,1*]

The capital loss is reported on the T3 *Trust Income Tax and Information Return* for the Estate of George King. However, in the first tax year of a deceased person's graduated rate estate, an election can be made to treat all or part of the loss as a loss of the deceased on the deceased's final return. Therefore, the 2023 loss can be offset against the $200,000 taxable capital gain and tax recovered.

Donations made by Will are deemed to have been made by the estate, at the time the donation is given to the Charity. The estate can allocate the donations among the estate's taxation year in which the donation is made or an earlier taxation year of the estate, or the last two taxation years of the deceased.

The donation credit is calculated in the same manner in the estate as in the final tax return for George. If the taxable income on final tax return for George is higher than the taxable income of the T3 Trust Income Tax return, then the donation should be included in the final tax return for George. To the extent there is taxable income above $221,708 (2022), the federal donation credit will be calculated at 33%.

KC 10-16

[ITA 70(2), 118.93, 150(1)(b), 156.1(4)]

An election can be made to report certain items of income received by a deceased taxpayer on a rights or things return instead of on the final tax return.

Salary of $7,000 for the pay period ended before the date of death, vacation pay of $3,440 ($3,500 - $60), and dividends of $2,400 declared before the date of death, but paid after. The amount totals $13,752, including the dividend gross-up.

The following non-refundable credits can be claimed on the rights or things return:
Basic personal amount, spouse credit (if applicable), age credit (if applicable), EI and CPP credit, Canada employment credit, medical expense credit (if applicable), donation credit (if applicable). The medical expense credit and the donation credit on the final tax return and the rights or things tax return, combined, cannot exceed the amount that could be claimed if no optional (rights or things) return was filed.

The non-refundable credits are not prorated. The full amount can be claimed.
The rights or things return reduces the amount of tax on death. The graduated rates of tax for individuals apply to both the final tax return and the right or things return. As well, many of the non-refundable tax credits can be claimed on both tax returns, therefore enabling the taxpayer to double-up on the credits. Because of this, there is often no tax payable on the rights or things return, as is the case here with $13,752 of income.

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The rights or things return is due the later of (1) 90 days after the CRA issues the notice of assessment or reassessment for the final return, and (2) one year after the date of death, June 24, 2023.

The due date for any balance of tax owing on the rights or things return is April 30, 2023 being the later of six months after the date of death (December 24, 2022) and April 30, 2023.

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