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

**Chapter 8 Capital Gains and Capital Losses**

8.1 Online Exercises

1) Describe three different types of capital property dispositions. In each case, indicate how the POD would be determined.

Answer: Possible answers here would include:

• Sale of the capital property. The POD would be the sales price.

• Expropriation by a government body. The POD here would be the amount of compensation paid by the government body.

• Destruction through fire, flood, or other natural disasters. The POD here would be any insurance payments received.

• Theft. The POD may be nil unless there is insurance coverage in which case any amount paid by the insurer would be the POD.

• Deemed dispositions. The deemed POD would be whatever amount is specified in the specific provision of the ITA.

Type: ES

Topic: Dispositions and POD - general

2) How is government assistance provided for the purchase of capital property dealt with in the ITA? How does this differ from the accounting treatment of government assistance?

Answer: Government assistance for the purchase of capital property is a reduction in the capital cost for depreciable property and a reduction in the ACB of non-depreciable capital property. This is, in general, consistent with the accounting treatment of government assistance.

Type: ES

Topic: Government assistance

3) What is a superficial loss? What is the income tax treatment of such losses?

Answer: A superficial loss is one that results from the sale of non-depreciable capital property that is reacquired (identical property) within 30 days before, or 30 days after, the disposition. The reacquisition can be by an affiliated person. Superficial losses are deemed to be nil and therefore cannot be claimed. The superficial loss is added to the ACB of the replacement capital property reducing any future gain on the property for individuals. Superficial losses are handled differently where the person who owns the property is a trust, partnership or corporation.

Type: ES

Topic: Superficial loss

4) Describe the calculation of a taxable capital gain or an allowable capital loss.

Answer: The taxpayer subtracts the sum of the ACB plus selling costs, from the POD. The result is then multiplied by one-half resulting in a taxable capital gain (positive amounts) or an allowable capital loss (negative amount).

Type: ES

Topic: Capital gains and capital losses - general rules

5) A taxpayer may acquire a number of identical properties at different points in time at different costs. When there is a sale of part of a group of identical properties, how do you determine the ACB of the properties sold?

Answer: The ACB would be based on the weighted average cost of the identical properties.

Type: ES

Topic: Identical properties

6) When a capital property is sold and not all of the POD are receivable in the year of sale, a capital gains reserve is permitted. How is the reserve determined?

Answer: The maximum amount of the reserve in each year is the lesser of two amounts. The first is the capital gain multiplied by the ratio of the proceeds due after the end of the year to the total POD. The second is the capital gain multiplied by a percentage which is 20% of the gain multiplied by, 4 minus the number of preceding taxation years ending after the disposition. The latter part of the calculation is designed to ensure that a minimum of 20% of the capital gain is included in income over a five year period.

Type: ES

Topic: Capital gains reserve

7) When a business sells capital property, it sometimes provides a warranty. This may involve incurring warranty costs in periods subsequent to the sale. How are such warranty expenses treated for income tax purposes? How does this differ from the accounting treatment of such costs?

Answer: For income tax purposes, warranty expenses related to the sale of capital property can only be deducted when costs are actually incurred. In other words estimated warranty cost reserves are not permitted for income tax purposes. The income tax treatment depends on the timing of the consideration received by the seller for providing the warranty and the seller incurring expenses to fulfill warranty obligations. If these events occur before the filing date for the taxation year in which the capital property was sold then the warranty consideration increases the POD of the property and the warranty expenses reduce the POD of the property. If the warranty consideration and warranty expenses occur after the filing due date for the income tax return the warranty consideration is treated as a capital gain and the warranty expenses treated as a capital loss.

In contrast, for accounting purposes, the business must deduct the estimated cost of providing the warranty in the year in which the property is sold. When actual costs are incurred, they are charged to the allowance that was established in the year of sale. If the actual costs are higher of lower than the estimate, there will be an adjustment which will be charged to income in the year that the warranty expires. Differences between income tax and accounting must be adjusted in the annual reconciliation.

Type: ES

Topic: Warranties on capital property - ITA 42

8) When a taxpayer disposes of a combination of land and buildings, ITA 13(21.1)(a) contains a special rule for determining the amount of proceeds to be allocated to the building. If applicable, this special rule increases the amount of the proceeds that will be allocated to the building. What is the tax policy objective of this special rule?

Answer: When a combination of land and buildings is sold, there will often be a capital gain (only 50% of which is taxable) on the land and a terminal loss on the building which is fully deductible. This result may tempt taxpayers into allocating a larger amount of the total proceeds to the land and a correspondingly smaller amount of the total proceeds to the building. The special rule in ITA 13(21.1)(a) increases the building proceeds to the point where any terminal loss will either be eliminated altogether, or reduced to the point that it does not offset any capital gain on the land.

Type: ES

Topic: Terminal loss on sale of land and building - ITA 13(21.1)

9) Describe the income tax treatment that will be given to personal use property dispositions. How does this treatment differ if the property is listed personal property?

Answer: While capital gains on personal use property are included in income, capital losses cannot be claimed. In addition, a special rule specifies that each property will have a minimum POD of $1,000 and a minimum ACB of $1,000 to effectively weed out any gains and losses on dispositions of small value property. The treatment of listed personal property differs in that capital losses can be claimed but only to the extent of capital gains on listed personal property. Listed personal property is also subject to the same $1,000 POD/ACB rule.

Type: ES

Topic: Personal use property - general rules

10) A business purchases €100,000 of inventory in France, with the payable reflected in Euros. Between the time of the purchase and the payment of the account, the exchange rate for the Euro increases by $0.04. How will this increase be dealt with for income tax purposes? Will this differ from the accounting treatment of the amount?

Answer: The business will be able to deduct the difference as a loss of $4,000 [(€100,000)($0.04)]. The accounting treatment is the same.

Type: ES

Topic: Foreign exchange gains and losses

11) When the use of capital property changes from personal use to business use, there is a deemed disposition/reacquisition of that property. If the original cost of the property is less than the FMV of the property at the time of the change in use, the cost of the property for UCC purposes is limited to its cost, plus one-half of the difference between the cost and FMV. What is the reason for this limitation?

Answer: If the FMV of personal use property exceeds its original cost, there will be a capital gain resulting from the deemed disposition/reacquisition only one-half of which is included in income. Given this, it would not be appropriate to allow the appreciation in value taxed as a capital gain to be fully added to capital cost and therefore fully deductible as CCA. In effect the restriction only allows the taxable part of the capital gain to be added to the UCC of depreciable property which is then available in future years as deductible CCA.

Type: ES

Topic: Change in use - depreciable property

12) It is not uncommon for a person, when moving out of a principal residence, to retain the property as a rental property. If no election is made, there will be a change in use which will trigger a deemed disposition at FMV, possibly resulting in capital gains some of which may not be eligible for the principal residence exemption. Explain how this result can be avoided, as well as the income tax consequences of making the required election.

Answer: This result can be avoided by electing under ITA 45(2) for there not to be a change in use which prevents a deemed disposition. In addition, the individual can continue to designate the property as a principal residence for up to four years after the change in use. The one disadvantage of this election is that the individual will not be able to claim CCA on the rental property.

Type: ES

Topic: Change in use - principal residence elections

13) When an individual converts a principal residence to a rental property, an election under ITA 45(2) is available to avoid a deemed disposition based on the change in use. Briefly describe how this election works.

Answer: When an individual converts a principal residence to a rental property it is a change in use and, in the absence of an election, is treated as a deemed disposition/reacquisition at FMV. However, if the individual makes an election under ITA 45(2), there will be no deemed disposition of the property and it will continue to be eligible for the principal residence exemption for up to four years even though the property was not ordinarily inhabited by the individual or certain family members. However, if the individual claims CCA, the election is rescinded. If the individual leaves the residence because of an employer required move, the election can be extended without limit beyond four years, but the individual must return to that residence while still with the same employer.

Type: ES

Topic: Change in use - principal residence elections

14) When an individual departs from Canada and severs Canadian residency, there is a deemed disposition of most of the individual's capital property. What major categories of property are exempted from this treatment?

Answer: The exceptions that are listed in the text are:

• Real property situated in Canada.

• Property of a business carried on in Canada through a fixed place of business (permanent establishment) in Canada.

• Excluded rights and interests (largely retirement savings plans).

Type: ES

Topic: Departure from Canada - general rules

15) ITA 44.1 is a provision which allows an individual to defer the taxation of capital gains resulting from the sale of shares of an "eligible small business corporation" (ESBC). What is the definition of an eligible small business corporation?

Answer: An ESBC is a CCPC that has substantially all (meaning more than 90%) of the FMV of its assets devoted principally to an active business carried on primarily (meaning more than 50%) in Canada. The corporation's qualifying assets include any shares or debt in other ESBCs that it owns. To be eligible, the small business corporation and corporations related to it cannot have assets with a carrying value in excess of $50 million. Shares or debt of related corporations are not counted when determining the $50 million limit on assets.

Type: ES

Topic: Capital gains deferral ITA 44.1 (ESBC)

16) When business properties are destroyed in a natural disaster (e.g., flood, tornado, earthquake etc) there may be adverse income tax consequences. Briefly describe the income tax consequences of receiving proceeds of an insurance policy to compensate for the involuntary loss of property in the absence of special elective rules.

Answer: Most business properties are insured for their replacement cost. When a property is destroyed by a natural disaster, it is a disposition with the insurance payments constituting the POD. As will often be the case, if the insurance proceeds exceed the cost of the destroyed property, the result will be a taxable capital gain. In addition, the required deduction from the relevant UCC classes may result in recapture if the property is not replaced prior to the end of the taxation year. Both the taxable capital gains and the recapture must be included in income and, in the absence of the replacement property rules, could not be reduced or reversed.

Type: ES

Topic: Dispositions and POD - general

17) The replacement property rules cover both voluntary dispositions and involuntary dispositions. However, they are applied differently to the two types of dispositions. Briefly describe the differences between the treatment for voluntary dispositions and involuntary dispositions.

Answer: There are two differences. The first difference relates to the type of property that is eligible. The rules apply to involuntary dispositions where capital property is lost, stolen, destroyed, or expropriated, without regard to its type. If the disposition is voluntary, only real property is eligible.

The second difference relates to the timing of the replacement. For involuntary dispositions, the taxpayer has to replace the property within 24 months after the end of the taxation year in which the POD become receivable. When the disposition is voluntary, the time period is limited to 12 months.

Type: ES

Topic: Replacement property - general rules

18) In terms of tax planning, capital gains and capital losses have an advantage that is not available for other types of income. Briefly describe this advantage.

Answer: The unique income tax planning feature with respect to capital gains and capital losses is that they are within the discretion of the taxpayer. This results from the fact that they are only required to be included in income or deductible when there is a disposition and, in most circumstances, the taxpayer decides when a disposition will occur.

Type: ES

Topic: Capital gains and capital losses - general rules

19) A superficial loss occurs when, in the 30 days following the disposition that resulted in a capital loss, an identical property is acquired.

Answer: TRUE

Explanation: Note that it would also be a superficial loss if an identical property was acquired 30 days prior to the disposition.

Type: TF

Topic: Superficial loss

20) Mr. Schmidt purchased 250 shares of Doss Limited on February 1 of the current year for $20 per share. On May 1 of the current year, he purchased 100 more shares for $25 per share. On June 20 of the current year, Mr. Schmidt sells 100 shares for $15 per share. His allowable capital loss on June 20 is $643.

Answer: FALSE

Explanation: The ACB of the shares would be equal to their average cost of $21.43 [((250)($20) + (100)($25)) ÷ 350]. This means that the allowable capital loss would be $321.50 [($15.00 - $21.43)(100)(1/2)].

Type: TF

Topic: Capital gains and capital losses - general rules

21) When there is a disposition of capital property and not all of the POD are receivable until after the year of disposition, a reserve a capital gains reserve can be claimed. In the year of the disposition, the reserve cannot be less than 80% of the total gain.

Answer: FALSE

Explanation: The reserve cannot be more than 80% of the total gain.

Type: TF

Topic: Capital gains reserve

22) Capital gains on a principal residence are not taxable.

Answer: FALSE

Explanation: Capital gains on a principal residence may be taxable depending on the circumstances. ITA 40(2)(b) provides a formula for determining the portion of the capital gain that is exempt.

Type: TF

Topic: Principal residence - general rules

23) Capital losses on the disposition of listed personal property can be deducted, but only against net capital gains on listed personal property.

Answer: TRUE

Explanation: While losses on personal use property can, in general, not be deducted, an exception is made for listed personal property.

Type: TF

Topic: Listed personal property - general rules

24) A dining room suite that had been purchased for $700 for personal use was sold for $900. The capital gain is $200.

Answer: FALSE

Explanation: The capital gain is nil since both the POD and ACB are deemed to be $1,000.

Type: TF

Topic: Personal use property - general rules

25) A dining room suite that had been purchased for $700 for personal use was sold for $500. The allowable capital loss on the transaction is $100.

Answer: FALSE

Explanation: The capital loss would have been nil since both the POD and ACB would be deemed to be $1,000 (ITA 40(1) and 46). Although there is another provision of the ITA (ITA 40(2)(g)) that deems capital losses on the disposition of personal use property to be nil it would not have applied since there would have been no capital loss as a result of the $1,000 rule.

Type: TF

Topic: Personal use property - general rules

26) A dining room suite that had been purchased for personal use for $700 was sold for $1,500. The taxable capital gain on the transaction is $250.

Answer: TRUE

Explanation: The taxable capital gain equals one-half of the $1,500 POD less the deemed ACB of $1,000.

Type: TF

Topic: Personal use property - general rules

27) When there is a change in use from an income earning use to a personal use or vice versa, there will be a deemed disposition/reacquisition subject to any elective treatment.

Answer: TRUE

Explanation: There will always be a deemed disposition/reacquisition when there is a change in use subject to elections such as ITA 45(2) with respect to principal residences.

Type: TF

Topic: Change in use - general rules

28) When an individual emigrates from Canada, there is a deemed disposition of all capital property at FMV.

Answer: FALSE

Explanation: There is a deemed disposition/reacquisition of most capital property, but there are types of property that are exempt.

Type: TF

Topic: Departure from Canada - general rules

29) To be an eligible small business corporation (ESBC) for purposes of deferring capital gains (ITA 44.1), one of the conditions requires that more than 50% of the FMV of its assets must be used to earn income from an active business in Canada.

Answer: FALSE

Explanation: The active business income requirement is 90% or more.

Type: TF

Topic: Capital gains deferral ITA 44.1 (ESBC)

30) When there is an involuntary disposition of a depreciable property, any resulting capital gain can be eliminated if the cost of the replacement property is equal to or greater than the POD of the property that was replaced, no later than 24 months from the end of the taxation year of the disposition.

Answer: TRUE

Explanation: If it were a voluntary disposition, replacement would have to occur within 12 months.

Type: TF

Topic: Replacement property - general rules

31) Which of the following statements with respect to capital gains is **NOT** correct?

A) Insurance proceeds to compensate for the destruction of a building destroyed in a fire is the POD.

B) The ACB of non-depreciable capital property is reduced by any related government assistance received.

C) The capital gains deduction reduces the amount of taxable capital gains included in net income.

D) The expropriation of capital property by a municipal government is considered to be a disposition.

Answer: C

Explanation: C) The capital gains deduction reduces the amount of taxable capital gains included in taxable income not net income.

Type: MC

Topic: Capital gains and capital losses - general rules

32) Which of the following statements with respect to capital gains is correct?

A) The inclusion rate for taxable capital gains has always been one-half of the capital gain.

B) All gains on the sale of Canadian securities are treated as capital gains.

C) The superficial loss rules would apply if you sold shares at a loss but your spouse acquired the same shares within thirty days of the sale.

D) The capital gains deduction is no longer available to Canadian individuals.

Answer: C

Explanation: C) The superficial loss rules would apply if you sold shares at a loss but your spouse acquired the same shares within thirty days of the sale.

Type: MC

Topic: Capital gains and capital losses - general rules

33) Which of the following statements about the income tax treatment of gifts of non-depreciable capital property is **NOT** correct?

A) The ACB to the recipient will be the FMV of the property gifted.

B) The income tax treatment of gifts is different when the gift is made to a non-arm's length person rather than to an arm's length person.

C) The POD to the person making the gift will be the FMV of the property gifted.

D) If the FMV of the property being gifted exceeds its ACB, there will be a capital gain.

Answer: B

Explanation: B) The tax treatment of gifts is different when the gift is made to a non-arm's length person rather than to an arm's length person.

Type: MC

Topic: Gifts of capital property

34) Which of the following does **NOT** represent an ACB adjustment?

A) Government assistance.

B) CCA claimed in previous years.

C) Superficial losses.

D) In the case of vacant land, interest and property taxes.

Answer: B

Explanation: B) CCA claimed in previous years.

Type: MC

Topic: ACB adjustments - ITA 53

35) On November 12, 2022, Hubert Robbins sells 100 shares of Loser Inc. for $120 per share. He had purchased these shares several years ago at $220 per share. On November 18, 2022, he purchases 80 shares of Loser Inc. for $100 per share. On December 22, 2022, he purchases 50 shares of Loser Inc. at $80 per share. What is the ACB of the 130 shares that he owns after the December 22, 2022 purchase?

A) $12,000.

B) $20,000.

C) $22,000.

D) $14,000.

Answer: B

Explanation: A) $12,000 ($8,000 + $4,000)

B) $20,000. The calculations are as follows:

**November 12 Sale**

POD [(100)($120)] $12,000

ACB [(100)($220)] ( 22,000)

Capital Loss ($10,000)

Disallowed Portion [($10,000)(80 ÷ 100)] 8,000

Allowable Portion ($ 2,000)

**Cost of 130 Shares**

November 18 Purchase [(80)($100)] $ 8,000

Disallowed Loss 8,000

December 22 Purchase [(50)($80)] 4,000

ACB $20,000

C) $22,000 ($8,000 + $4,000 + $10,000)

D) $14,000 ($8,000 + $4,000 + $2,000)

Type: MC

Topic: Superficial loss

36) Chi has the following transactions in Smoke Corp. and Mirrors Corp. shares:

**Smoke Mirror**

May 1, 2021 Purchase 100 @ $22.50 100 @ $25.00

December 20, 2021 Sale 100 @ $28.00 100 @ $24.00

January 3, 2022 Purchase N/A 100 @ $23.20

June 1, 2022 Sale N/A 100 @ $26.00

Chi's taxable capital gains for 2021 and 2022 are:

A) $225 for 2021, $90 for 2022.

B) $225 for 2021, $140 for 2022.

C) $275 for 2021, $90 for 2022.

D) $275 for 2021, $140 for 2022.

Answer: C

Explanation: A) ($550 — 100) × 50% = $225

B) 100 × ($26.00 — 23.20) × 50% = $140

C) $275 for 2021, $90 for 2022

Smoke shares: 100 × ($28.00 — 22.50) = $550 × 50% = $275

2021 Mirrors shares: 100 × ($25.00 — 24.00) = $100 superficial loss

2022 Mirrors shares: (100 × $26.00) — [ (100 × $23.20) + $100 superficial loss ] = $180 × 50% = $90

Type: MC

Topic: Superficial loss

37) With respect to dispositions of non-depreciable capital property, which of the following statements is correct?

A) The actual cost of providing warranty coverage on the sale of a capital property cannot be deducted for income tax purposes.

B) When identical properties are sold, the cost can be determined using either FIFO or Average Cost valuation.

C) The actual cost of providing a warranty can be deducted in full in the determination of business income.

D) If a portion of a property is sold, the ACB of that portion must be determined on a reasonable basis which is generally equal to the FMV of the portion sold as a fraction of the total FMV of the property.

Answer: D

Explanation: D) If a portion of a property is sold, the ACB of that portion must be determined on a reasonable basis which is generally equal to the FMV of the portion sold as a fraction of the total FMV of the property.

Type: MC

Topic: Capital gains and capital losses - general rules

38) Which of the following statements is **NOT** correct?

A) When there is a disposition of an identical property, the taxpayer must use the average cost of all such properties as the ACB.

B) When a taxpayer provides a warranty on the sale of non-depreciable capital property at the end of the second taxation year, the cost incurred to provide the warranty is treated as a capital loss.

C) When there is a partial disposition of land that is capital property, the ACB must be based on a proportionate share of the total area of the land.

D) When a bad debt arises from the sale of non-depreciable capital property, it is treated as a capital loss.

Answer: C

Explanation: C) When there is a partial disposition of land that is a capital property, the ACB must be based on a proportionate share of the total area of the land. Proportionate allocation would not be appropriate if there are variances in the quality of the land (e.g., one part was a swamp that could not be used).

Type: MC

Topic: Capital gains and capital losses - general rules

39) Which of the following statements with respect to capital gains reserves is correct?

A) There is no limit on how many years a reserve can be deducted.

B) The maximum capital gains reserve is equal to the ratio between the proceeds receivable after the end of the year and the total proceeds, multiplied by the capital gain.

C) The maximum capital gains reserve is limited to 20% of the total capital gain in the first year after the sale.

D) Any capital gains reserve that is deducted in the current taxation year must be added back to income in the immediately following taxation year.

Answer: D

Explanation: D) Any capital gains reserve that is deducted in the current taxation year must be added back to income in the immediately following taxation year.

Type: MC

Topic: Capital gains reserve

The questions below are based on the following information:

BMP Products Ltd. (BMP) has carried on business for more than 20 years. Ten years ago, planning for future growth of its manufacturing facilities, BMP purchased a plot of land in an industrial area for $150,000. During the last couple of years, BMP has not met expectations. Business has fallen slightly and cash flows are tight. Due to the decrease in product demand, management does not believe that BMP will use this plot of land in the near future. As a result, during the taxation year ended March 31, 2022, BMP sold the land for $400,000. $150,000 was received in February, 2022, with the remainder to be paid in two equal instalments in February, 2023 and February, 2024. You have been advised that capital gains treatment is appropriate for this transaction.

40) BMP can claim a reserve for the 2022 taxation year of:

A) Nil.

B) $156,250.

C) $200,000.

D) $250,000.

Answer: B

Explanation: B) $156,250 - The maximum reserve that can be claimed is the lesser of:

• [($250,000)($250,000/$400,000)] = $156,250

• [($250,000)(20%)(4 - 0)] = $200,000

Type: MC

Topic: Capital gains reserve

41) BMP can claim a reserve for the 2023 taxation year of:

A) Nil.

B) $78,125.

C) $125,000.

D) $150,000.

Answer: B

Explanation: B) $78,125 - The maximum reserve that can be claimed is the lesser of:

• [($250,000)($125,000/$400,000)] = $78,125

• [($250,000)(20%)(4 - 1)] = $150,000

Type: MC

Topic: Capital gains reserve

42) Bob sold a capital property on December 31, 2022 for $300,000 with $20,000 paid in cash and $280,000 payable December 31, 2023. The ACB of the property was $170,000 and the selling costs totalled $10,000. Which one of the following amounts represents the minimum taxable capital gain required to be included in income for the 2022 taxation year?

A) $4,000.

B) $10,000.

C) $12,000.

D) $24,000.

Answer: C

Explanation: C) $12,000 - The maximum reserve that can be claimed is the lesser of:

• [(Capital Gain $120,000)($280,000/$300,000)] = $112,000

• [(Capital Gain $120,000)(20%)(4 - 0)] = $96,000

Taxable capital gain = [(1/2)($120,000 - $96,000)] = $12,000

Type: MC

Topic: Capital gains reserve

43) Shun Li sold a capital property on July 31, 2022 for $400,000. She received $100,000 at the time of sale with the balance of $300,000 payable on July 31, 2025. The ACB of the property was $160,000. The minimum taxable capital gain that Shun Li is required to include in income for the 2022 taxation year is:

A) $30,000.

B) $60,000.

C) $120,000.

D) $180,000.

Answer: A

Explanation: A) $400,000 - $160,000 = $240,000. [(1/2)($240,000 - $180,000)] = $30,000

• (300,000/400,000)(Capital Gain $240,000) = $180,000

• (20%)(4 - 0)($240,000) = $192,000

Type: MC

Topic: Capital gains reserve

44) A business sells real property for $950,000, with $600,000 of this amount attributable to the building and $350,000 to the land. The building, the only property in its Class, had a capital cost of $800,000 and a UCC of $650,000. The ACB of the land was $250,000. What are the income tax consequences of this disposition?

A) A capital gain of $100,000 and a terminal loss of $50,000.

B) A capital gain of $50,000 and a terminal loss of nil.

C) A capital gain of $100,000 and a capital loss of $50,000.

D) A capital gain of $50,000 and a terminal loss of $50,000.

Answer: B

Explanation: B) A capital gain of $50,000 and a terminal loss of nil. The deemed proceeds for the building would be calculated as follows: The lesser of:

• The FMV of the land and building $950,000

Reduced by the lesser of:

• The ACB of the land = $250,000

• The FMV of the land = $350,000 ( 250,000) $700,000

• The greater of:

• The FMV of the building = $600,000

• The lesser of:

The cost of the building = $800,000

The UCC of the building = $650,000 $650,000

Based on this, the deemed POD for the land would be $300,000 ($950,000 - $650,000) instead of the original $350,000, resulting in a capital gain of $50,000 ($300,000 - $250,000). The terminal loss on the building would be reduced to Nil ($650,000 - $650,000) from $50,000. In other words $50,000 of capital gains on the land is reduced by $50,000 of terminal loss on the building.

Type: MC

Topic: Terminal loss on sale of land and building - ITA 13(21.1)

45) The special rules for a disposition of property that includes land and buildings should be applied when:

A) there is a capital gain on the land and a capital loss on the building.

B) there is a capital gain on the building and a capital loss on the land.

C) there is a capital gain on the land and a terminal loss on the building.

D) there is a capital gain on the building and a terminal loss on the land.

Answer: C

Explanation: C) There is a capital gain on the land and a terminal loss on the building

Type: MC

Topic: Special rule for sales of real property

46) Which of the following statements with respect to principal residences is correct?

A) If an individual lives on a house boat the principal residence exemption cannot be used.

B) If an individual and their spouse can each own real property in which they reside for a part of the year, they each can claim the principal residence exemption for that year on the property that they own.

C) If an individual sells a principal residence and buys another principal residence in a single year, the individual will not be able to completely eliminate any gain on the disposition of the second residence by using the principal residence exemption.

D) If an individual owns only one real property, it is only necessary to complete the first page of Form T2091, Designation of a Property as a Principal Residence by an Individual, in order to claim the principal residence exemption.

Answer: D

Explanation: D) If an individual owns only one real property, it is only necessary to complete the first page of Form T2091, Designation of a Property as a Principal Residence by an Individual, in order to claim the principal residence exemption.

Type: MC

Topic: Principal residence - general rules

47) Mr. Winestock owned two homes from 2019 to 2021. Home A was purchased in 2007 for $60,000. In 2019, he purchased Home B for $180,000, with the intention of selling Home A immediately. Due to market conditions, mortgage rates, and the asking price, he was unable to sell Home A until 2021. The proceeds received on the sale of Home A were $150,000. In 2022, he was transferred to a different city and sold Home B. He designated 2019 and 2020 to Home A when it was sold. The proceeds received on the sale of Home B were $200,000. What is his taxable capital gain on Home B?

A) Nil.

B) $2,500.

C) $5,000.

D) $10,000.

E) $20,000.

Answer: B

Explanation: B) $2,500 taxable capital gain on Home B.

Home B owned 4 years (2019 to 2022)

• 2019 and 2020 designated to Home A

• 2021 and 2022 can be used for Home B

In the following formula, A is the number of years the property is designated a principal residence and B is the number of years the property was owned after 1971.

Exempt portion of gain = {[Total capital gain][(1 + A) ÷ B]}

= [$200,000 - $180,000][(1 + 2)/4] = $15,000

Taxable capital gain = [(1/2)($20,000 - $15,000)] = $2,500

Type: MC

Topic: Principal residence - general rules

48) Heidi bought a mountain chalet in 2017 for $150,000 and sold it in 2022 for $180,000. She bought a lakeside cabin in 2018 for $100,000 and sold it in 2022 for $130,000. She lived full-time at the chalet in 2017 and spent an equal amount of time at the chalet and the cabin during the 5 years from 2018 to 2022. How should she designate her principal residence exemption for the year 2018 to minimize her 2022 taxable capital gains?

A) 2018 should be designated to the cabin

B) 2018 should be designated to the chalet

C) 2018 should be split between the cabin and the chalet

D) 2018 cannot be designated to either the cabin or the chalet

Answer: A

Explanation: A) 2018 should be designated to the cabin. Annual gain for the cabin is $6,000 ($30,000 / 5 years) which is greater than the annual gain for the chalet which is $5,000 ($30,000 / 6 years).

Type: MC

Topic: Principal residence - general rules

49) Which of the following statements regarding the income tax treatment of a principal residence is **NOT** correct?

A) If an individual owns two residences, and both are sold in the same year, the principal residence formula will eliminate the capital gain on only one of the residences.

B) If an individual owns two residences, the decision to designate a particular property as the principal residence must be made when the residence is sold.

C) If an individual owns only one residence, the principal residence formula will eliminate any capital gain on the sale.

D) A capital loss cannot be realized on the sale of a principal residence.

Answer: A

Explanation: A) If a taxpayer owns two residences, and both are sold in the same year, the principal residence formula will eliminate the capital gain on only one of the residences.

Type: MC

Topic: Principal residence - general rules

50) Which of the following statements about personal use property is **NOT** correct?

A) Losses on the disposition of personal use property can be deducted to the extent of gains on the disposition of personal use property.

B) An antique desk purchased by an individual for their home would be considered personal use property.

C) The minimum value for both the POD and the ACB of personal use property that is being sold is $1,000.

D) When losses on listed personal property are carried forward, they can be deducted to the extent of net gains on the disposition of listed personal property.

Answer: A

Explanation: A) Losses on the disposition of personal use property can be deducted to the extent of gains on the disposition of personal use property.

Type: MC

Topic: Personal use property - general rules

51) Mike sold the following personal use property during the current year:

|  |  |  |
| --- | --- | --- |
|  | Sales Price | Cost |
| Painting | $2,500 | $ 800 |
| Stamp collection | 600 | 1,200 |
| Outboard motor | 900 | 100 |
| Antique desk | 1,300 | 1,950 |

What is his taxable capital gain, net of allowable capital losses, for the current year?

A) $325.

B) $625.

C) $650.

D) $750.

Answer: C

Explanation: C) $650 [(1/2)($1,500 - $200)]

The net gain on listed personal property consists of a $1,500 gain ($2,500 - $1,000) on the painting and a $200 loss ($1,000 - $1,200) on the stamp collection. There is no net capital gain on the personal use property as the outboard motor gain is eliminated by the $1,000 rule and the loss on the antique desk is not allowed.

Type: MC

Topic: Personal use property - general rules

52) Song Ming sold the following personal use property in the current year:

|  |  |  |
| --- | --- | --- |
|  | Sales Price | Cost |
| Diamond Necklace | $1,200 | $ 600 |
| Rare Book | 1,800 | 1,200 |
| Coin Collection | 900 | 1,100 |
| Vintage Car | 16,500 | 17,000 |

What is her taxable capital gain, net of allowable capital losses, for the current year?

A) $100

B) $250

C) $350

D) $500

Answer: C

Explanation: C) $350 [($1,200 — 1,000) + (1,800 — 1,200) + (1,000 — 1,100)] × 50% = $350

Type: MC

Topic: Personal use property - general rules

53) Indicate which of the following is **NOT** listed personal property.

A) A stamp.

B) A rare manuscript.

C) An antique chair.

D) A piece of jewelry.

E) A piece of sculpture.

Answer: C

Explanation: C) An antique chair.

Type: MC

Topic: Listed personal property - general rules

54) On July 1, 2022, Chester Aguilar acquires 1,000 shares of a foreign company at 10 Foreign Currency units (FC, hereafter) per share. He acquired the funds for this purchase when FC1 = $1.48, a value that did not change prior to the date on which he purchased the shares. He sells the 1,000 shares December 1, 2022 for FC12 per share. On this date the exchange rate is FC1 = $1.46. What is the effect of the sale transaction on Chester's net income for 2022?

A) $2,720.

B) $1,160.

C) $2,520.

D) $1,360.

Answer: D

Explanation: A) $2,720

B) $1,160 ($1,360 - $200)

C) $2,520 ($2,720 - $200)

D) $1,360.

The effect can be calculated as follows:

POD [(1,000)(FC12)($1.46)] $17,520

ACB [(1,000)(FC10)($1.48)] ( 14,800)

Capital Gain $ 2,720

Inclusion Rate 1/2

Taxable Capital Gain $ 1,360

Type: MC

Topic: Foreign currency

55) Which of the following statements related to the taxation of foreign currency transactions is correct?

A) All gains or losses that result from foreign currency transactions are treated as either capital gains or capital losses.

B) When a Canadian corporation issues foreign currency debt, a gain or loss will only be recognized when the debt is repaid.

C) A foreign currency gain or loss may arise when Canadian dollars are converted to a different currency.

D) The first $200 of foreign currency gains are exempt for all taxpayers.

Answer: B

Explanation: B) When a Canadian corporation issues foreign currency debt, a gain or loss will only be recognized when the debt is repaid.

Type: MC

Topic: Foreign currency

56) Mamie Hanson converts her principal residence into a rental property. This property had cost $850,000 several years ago. It is converted on January 1, 2022 and, at that time, it is estimated that the total value of the property has increased to $1,100,000. At this time the value of the land is unchanged at $400,000 with $700,000 attributable to the house. Provided her rental income before CCA is more than this amount, what is the maximum CCA that Mamie can claim for 2022?

A) $48,000.

B) $32,000.

C) $46,000.

D) $23,000.

Answer: A

Explanation: A) $16,000.

The maximum CCA is calculated as follows:

Opening UCC Nil

Addition

Cost ($850,000 - $400,000) $450,000

Bump Up [(1/2)($1,100,000 - $400,000)] 350,000 $800,000

AccII 400,000

Base For CCA $1,200,000

Rate 4%

Maximum CCA $ 48,000

B) $32,000 [(4%)($800,000)]

C) $46,000 [(4%)($1,150,000)]

D) $23,000 [(4%)(1/2)($1,150,000)]

Type: MC

Topic: Change in use - general rules

57) Jose Montana owns a cottage that he purchased in 2013 for $330,000, with $100,000 of this amount reflecting the value of the land and $230,000 for the building. On January 1, 2022, this cottage is converted to a rental property. At the time of conversion, it is estimated that the FMV of the cottage is $600,000, with $150,000 of this amount attributable to the land and $450,000 to the building. In 2022, rental income, net of all expenses except CCA equals $30,200. What is the maximum amount of CCA that Jose can deduct on this rental property for 2021?

A) $27,000.

B) $20,400.

C) $ 9,000.

D) $18,000.

Answer: B

Explanation: A) $27,000 [(4%)(150%)($450,000)]

B) $6,800 {[4%][150%][$230,000 + (1/2)($450,000 - $230,000)]}.

C) $9,000 [(4%)(1/2)($450,000)]

D) $18,000 [(4%)($450,000)]

Type: MC

Topic: Change in use - general rules

The questions below are based on the following information:

Ramon lives in Calgary. In 2019 he purchased a second house in Lethbridge for $180,000 (land $100,000; building $80,000). His grandmother lives in the house rent free and was the only occupant from 2019 to 2022. In March 2022, Ramon converted the house into a duplex. His grandmother lives in one unit rent free and the other unit is rented to tenants. The FMV of the house in March 2022 was $215,000 (land $115,000; building $100,000).

58) What is Ramon's taxable capital gain for the 2022 change in use? He will not use the principal residence exemption for the Lethbridge house.

A) $5,000

B) $8,750

C) $10,000

D) $17,500

Answer: B

Explanation: A) Capital gain on building only: ($100,000 — 80,000) × 50% (one side) = $10,000 × 50% = $5,000

B) $8,750. Taxable capital gain on entire property: ($215,000 — 180,000) × 50% (one unit) = $17,500 × 50% = $8,750

Type: MC

Topic: Change in use - general rules

59) What is Ramon's maximum 2022 CCA deduction for this rental property? The rental income before CCA is $6,000.

A) $2,400

B) $2,700

C) $1,600

D) $1,800

Answer: B

Explanation: A) No bump -up + AccII

B) $2,700 Deemed Cost [1/2][$80,000 + (50%)($100,000 - $80,000)] = $45,000 capital cost.

CCA = [(150%)($45,000)(4%) = $2,700

C) No bump -up

D) No Half-Year

Type: MC

Topic: Change in use - general rules

60) A depreciable property owned by an individual that was used in a business carried on by the individual as a sole proprietor.is converted to personal use. The capital cost of the property is $100,000 and the UCC is $80,000. The FMV of the property at the time of the change in use is $150,000. Which of the following statements is **NOT** correct?

A) The deemed disposition will create recapture of $20,000 that is business income.

B) The deemed disposition will create a taxable capital gain of $25,000.

C) The capital cost for CCA purposes will be $125,000.

D) The cost for capital gains purposes will be $150,000.

Answer: C

Explanation: C) Capital cost is the expression used to describe the cost of depreciable property. Depreciable property is property that is used to earn either business or property income. Since personal use is not an income earning function there can be no capital cost once property is converted to personal.

Type: MC

Topic: Change in use - general rules

61) Arnold Swartz converted his principal residence into a rental property after having lived in it for 5 years. He has not been able to find a tenant in the current year. The house had cost $1 million. At the time of conversion, the building had a FMV of $1.4 million. What is the UCC balance in the rental property's Class 1 before any CCA is claimed? Assume that the property is a source of income when converted.

A) $1,000,000

B) $1,200,000

C) $1,400,000

D) Nil

Answer: B

Explanation: B) $1,000,000 + (1/2)($1,400,000 - $1,000,000) = $1,200,000.

Type: MC

Topic: Change in use - general rules

62) In 2014, Rochelle Parsons purchased a home in Calgary, Alberta for $350,000, with $75,000 of this amount being the estimated value of the land and $275,000 for the building. In 2016, she was required by her employer to move to London, Ontario. As she believed Calgary real estate was an outstanding investment, she decided to convert the home to a rental property, but decided not to claim any CCA. She decided to rent a home in London, rather than purchasing a second residence. In 2022, recognizing that she was unlikely to return to Calgary, she sold the Calgary home for $500,000, with $150,000 of this amount being the estimated value of the land and $350,000 the value of the building. What is the minimum capital gain that Rochelle will have to include in her income for 2022? Assume that she filed the election under ITA 45(2) on time.

A) $33,333.

B) $16,667.

C) $50,000.

D) $150,000.

Answer: B

Explanation: A) $33,333 {$150,000 - [($150,000)(7 ÷ 9)]}

B) $16,667.

The total gain on property is $150,000 ($500,000 - $350,000). Rochelle can designate the property as her principal residence for the 3 years 2014 through 2016. In addition, she can elect to not have a deemed change in use for an additional 4 years, bringing the total to 7 years. Given that her total ownership period was 9 years, the exempt portion of the gain would be calculated as follows:

[$150,000][(7 + 1) ÷ 9] = $133,333

Based on this, Rochelle would only have to recognize a gain of $16,667.

C) $50,000 {$150,000 - [$150,000][3 + 1) ÷ 9]}

D) $150,000

Type: MC

Topic: Change in use - principal residence elections

63) Susan Cousins purchased a house in Oshawa in March, 2020, for $250,000 (land; $80,000, building; $170,000). Even though Susan would be unable to reside in the house immediately, she felt it was a very good price and did not want to miss the opportunity to own this house. She rented out the house as of April, 2020. The tenants will move out in December, 2021, and she will move into the house in January, 2022. The FMV of the house at January 1, 2022 was $300,000 (land; $130,000, building; $170,000). The UCC of the house on this date is $163,000. Which of the following is correct?

A) The capital cost of the house for CCA purposes at January 1, 2022 is $275,000.

B) Susan must recognize a capital gain of $50,000 at January 1, 2022.

C) Susan must recognize a capital gain for tax purposes of $25,000 at January 1, 2021.

D) Susan can elect to designate the house as her principal residence for the years 2020 and 2021 so there is no capital gain on the house.

E) None of the above.

Answer: B

Explanation: A) There is no capital cost since the property is only used for personal purposes.

B) Susan must recognize a capital gain for tax purposes of $50,000 at January 1, 2022. The house would not be considered a principal residence since the facts indicate that she never "ordinarily inhabited" the home.

Type: MC

Topic: Change in use - principal residence elections

64) In 1999, Ms. Boisvert became a homeowner, acquiring a residence in Halifax at a cost of $135,000. In 2010, she was transferred by her employer to Winnipeg. She rented accommodations in Winnipeg and rented the Halifax residence. Ms. Boisvert elected to be deemed not to have converted the property to an income producing use. She did not claim CCA on the property during the period that it was rented. In July, 2022, after 24 years of ownership, she sold the Halifax house for $207,000. She had decided she would not return to Halifax. Which one of the following amounts represents the minimum capital gain that she must include in her income for 2022?

A) Nil.

B) $57,000.

C) $33,000.

D) $36,000.

Answer: B

Explanation: B) When Ms. Boisvert moved, she filed an election to be deemed not to have converted the property to an income earning use. As a result, she could claim no CCA on the property, but she is able to designate it her principal residence for years in which she did not ordinarily inhabit the home. The additional designation time is limited to four years when the residence is vacated due to a transfer by one's employer and the house is not reoccupied after that employment ceases. In the following formula, A is the number of years the property is designated a principal residence and B is the number of years the property was owned after 1971.

Exempt portion of gain = {[Total capital gain][(1 + A) ÷ B]}

= [$72,000][(1 + 4) ÷ 24] = $15,000

Minimum capital gain = ($72,000 - $15,000) = $57,000

Note that the election could have been extended for more than four years if Ms. Boisvert had returned to resume habitation of the home, prior to leaving the employer who required her to move.

Type: MC

Topic: Change in use - principal residence elections

65) On January 1, 2022, Marcus Abbott permanently emigrates from Canada. At that time, his only property consists of his principal residence and a small apartment building. His principal residence was purchased several years ago at a cost of $650,000. Of this total $150,000 relates to the land and $500,000 to the building. The current FMV of his residence is $975,000. The value of the land is unchanged at the time of his departure. The apartment building had a capital cost of $870,000, with $170,000 of this total allocated to the land and $700,000 to the building. The building had a January 1, 2022 UCC of $476,000. At the time of his departure, the FMV of the apartment building is $1,200,000, with the value of the land remaining at $170,000 and the building at $1,030,000. What is the minimum amount to be added to Mr. Abbott's 2022 net income with respect to his emigration from Canada?

A) $655,000.

B) $724,000

C) $559,000

D) Nil

Answer: D

Explanation: A) $655,000 [($975,000 - $650,000) + ($1,200,000 - $870,000)]

B) $724,000 [($1,200,000 - $870,000) + ($870,000 - $476,000)]

C) $559,000 [(1/2)($1,200,000 - $870,000) + ($870,000 - $476,000)]

D) Nil

As both the residence and the apartment building are real property situated in Canada and are therefore exempt from any deemed disposition.

Type: MC

Topic: Departure from Canada - general rules

66) When an individual emigrates from Canada, there is a deemed disposition of several types of property. Which of the following properties would **NOT** be subject to this deemed disposition rule?

A) A large painting by a well known Canadian artist.

B) Land and building that is being used as a rental property.

C) Shares in a CCPC involved in earning active business income.

D) Shares in a CCPC that is used to own investments.

Answer: B

Explanation: B) Land and building that is being used as a rental property.

Type: MC

Topic: Departure from Canada - general rules

67) Joel has lived in Canada his entire life. He is planning to depart permanently from Canada severing his Canadian residency. The deemed disposition rules on departure would **NOT** apply to his:

A) shares in a Canadian public corporation.

B) shares in a Canadian private corporation.

C) coin collection.

D) house in Ontario.

Answer: D

Explanation: D) House in Ontario.

Type: MC

Topic: Departure from Canada - general rules

68) Which of the following statements with respect to the capital gains deferral election of ITA 44.1 is **NOT** correct?

A) The replacement shares must be the common shares of an eligible small business corporation that are acquired within 120 days after the end of the year in which the qualifying disposition took place

B) The use of the deferral provision will not affect the ACB of the replacement shares.

C) The deferral is limited to a fraction of the capital gain resulting from the qualifying disposition.

D) The eligible small business corporation and corporations related to it cannot have assets with a carrying value in excess of $50 million.

Answer: B

Explanation: B) The use of the deferral provision will not affect the ACB of the replacement shares.

Type: MC

Topic: Capital gains deferral ITA 44.1 (ESBC)

69) On November 25, 2021 Ervin sold 100 shares of Mighty Ltd., an eligible small business corporation (ESBC), for $32 per share. He purchased the shares in 2020 for $28 per share. On December 15, 2021 he reinvested the proceeds by buying 80 shares of Mouse Ltd. for $40 per share. Mouse Ltd. is also an ESBC so he was able to use the ITA 44.1 election to defer the 2021 capital gain. Ervin sold all of the Mouse Ltd. shares on July 5, 2022 for $52 per share. His taxable capital gain for 2022 is:

A) $680.

B) $960.

C) $480.

D) $1,360.

Answer: A

Explanation: A) $680.

Deferred 2022 capital gain = $400 [(100)($32 - $28)]. ACB of Mouse shares = $2,800 [(80)($40) - $400].

Capital gain = $1,360 [(80)($52) - $2,800]. The taxable amount = $680 [(1/2)($1,360)].

B) [($52 - $40)(80)] = $960

C) [($960)(1/2)]

D) [(80)($52) - $2,800] = $1,360

Type: MC

Topic: Capital gains deferral ITA 44.1 (ESBC)

70) On July 1, 2021, the Flex Company's warehouse was completely destroyed in a fire. The capital cost of the warehouse was $1,500,000 and its January 1, 2021 UCC was $1,248,539. On December 1, 2021, the company received insurance proceeds of $1,650,000, an amount equal to the estimated FMV of the building. On April 1, 2022, the Company acquires an existing warehouse building for $1,800,000. Provided the Company makes all possible elections, what amount will be added to the Class 1 UCC as the result of this acquisition?

A) $1,548,539.

B) $1,650,000

C) $1,398,539.

D) $1,248,539

Answer: C

Explanation: A) $1,548,539 ($1,800,000 - $251,461)

B) $1,650,000 ($1,800,000 - $150,000

C) $1,398,539.

When the insurance proceeds were received in 2021, the Company would have a capital gain of $150,000 ($1,650,000 - $1,500,000) as well as recapture of $251,461 ($1,500,000 - $1,248,539). Since the replacement cost of the new building exceeded the insurance proceeds for the old building, both of these amounts can be reversed through a request to the CRA to reassess the year of the disposition. This will result in a UCC balance of $1,398,539 ($1,800,000 - $150,000 - $251,461).

D) $1,248,539 (In Problem)

Type: MC

Topic: Replacement property - general rules

71) Equipment was stolen from Far East Corp. on May 1, 2022. The cost of the equipment was $10,000 and the UCC was $7,500. The insurance proceeds of $12,000 were received on September 15, 2022 and replacement equipment was purchased for $11,500 on September 30, 2022. Far East makes all replacement property elections. Which of the following statements is correct?

A) The 2022 taxable capital gain is $250 and the deemed capital cost of the new equipment is $10,000.

B) The 2022 taxable capital gain is $250 and the deemed capital cost of the new equipment is $11,500.

C) The 2022 taxable capital gain is $250 and the deemed capital cost of the new equipment is $10,750.

D) The 2022 taxable capital gain is $1,000 and the deemed capital cost of the new equipment is $12,000.

Answer: A

Explanation: A) The 2022 taxable capital gain is $250 and the deemed capital cost of the new equipment is $10,000.

Taxable Capital Gain:

Lesser of a) $12,000 — 10,000 = $2,000 and b) $12,000 — 11,500 = $500

× 50% = $250

Reversed Capital Gain = $2,000 — 500 = $1,500

Deemed Capital Cost = $11,500 — 1,500 = $10,000

B) $11,500 replacement

C) $11,500 — (1,500 × 50%) = $10,750

D) $12,000 insurance proceeds

Type: MC

Topic: Replacement property - general rules

72) With respect to the deferral provisions for replacement property, which of the following statements is **NOT** correct?

A) In the case of involuntary dispositions, for the deferral provisions to apply, the replacement of the property must occur within 24 months after the end of the year in which the POD were received.

B) Provided the replacement cost of the property exceeds the POD, 100% of any capital gain that results from an involuntary disposition can be reversed.

C) When the disposition is voluntary, the deferral provisions only apply to former business properties.

D) Provided the replacement cost of the property is less than the POD, 100% of any recapture recognized as a result of an involuntary disposition can be reversed.

Answer: D

Explanation: D) Provided the replacement cost of the property is less than the POD, 100% of any recapture recognized as a result of an involuntary disposition can be reversed.

Type: MC

Topic: Replacement property - general rules

73) Assume that in all of the following situations the company's taxation year is the calendar year and that recapture arose as a result of a disposition. In which disposition situation would the company **NOT** be permitted to defer the recognition of the recapture with a replacement property election?

A) A warehouse was destroyed in a fire in December, 2020. The insurance proceeds received were used to build a new warehouse that was finished in June, 2022.

B) A backhoe was stolen in December, 2020. The insurance proceeds received were used to buy a new backhoe in June, 2022.

C) A backhoe was destroyed in a fire in December, 2020. The insurance proceeds received were used to buy a new backhoe in June, 2022.

D) A warehouse was sold in December, 2020. A new warehouse was purchased in June, 2022.

Answer: D

Explanation: D) A warehouse was sold in December, 2020. A new warehouse was purchased in June, 2022. Replacement properties must be purchased within 12 months of the taxation year in which a voluntary disposition of real property occurred.

Type: MC

Topic: Replacement property - general rules

74) On January 1, 2022, Michaels Inc. purchases a used building at a cost of $4,200,000. Of this amount, $375,000 represents the FMV of the land and $3,825,000 the value of the building. In order to encourage Michaels' move to this location, the local government has provided the company with assistance of $1,100,000 towards the purchase of the building. Michaels Inc. has a December 31 taxation year end. What is the maximum amount of CCA that Michaels can claim with respect to the building for 2022?

Answer: The capital cost of this Class 1 building would be $2,725,000 ($3,825,000 - $1,100,000). Given this, the maximum CCA for 2022 would be $163,500 [(150%)($2,725,000)(4%)]. The building does not qualify for the enhanced CCA rates. of either 6% or 10% since it is not new.

Type: ES

Topic: Government assistance

75) On July 1, 2022, Frodam Ltd. purchases a used building at a cost of $3,400,000. The value of the land is $800,000 and the value of the building $2,600,000. In order to assist with this purchase and encourage the Company's move to this location, the provincial government has provided assistance in the form of a grant of $500,000 towards the purchase of the building. What is the maximum amount of CCA that Frodam can claim with respect to the building for the taxation year that ends on December 31, 2022?

Answer: The capital cost of this Class 1 building would be $2,100,000 ($2,600,000 - $500,000). Based on this, the maximum CCA for 2022 would be $126,000 [(150%)($2,100,000)(4%)]. The building does not qualify for the enhanced CCA rates. of either 6% or 10% since it is not new.

Type: ES

Topic: Government assistance

76) Mr. Franklin Sharp owns 750 shares of Guard Inc. The ACB per share is $21.50. On June 15, 2022, he sells all of these shares for $13.75 each. On June 21, 2022, he purchases 400 shares of Guard Inc. at a cost of $12.15 each. He continues to own the shares at the end of the year. What are the income tax consequences of these transactions including the ACB of the shares on hand at December 31, 2022?

Answer: The allowed portion of the loss would be calculated as follows:

POD [(750)($13.75)] $10,313

ACB [(750)($21.50)] ( 16,125)

Capital Loss ($ 5,812)

Disallowed Loss Portion [(400)($21.50 - $13.75)] 3,100

Revised Capital Loss ($ 2,712)

Inclusion Rate 1/2

Allowable Capital Loss ($ 1,356)

The ACB of the shares on hand at December 31, 2022 would be:

Purchase Price [(400)($12.15)] $4,860

Disallowed Loss [(400)($21.50 - $13.75)] 3,100

ACB $7,960

Type: ES

Topic: Superficial loss

77) Ms. Linda Udall owns 800 shares of Fordam Inc. that she purchased several years ago at $10 per share. On April 30, 2022, she purchases an additional 200 shares at $12 per share. On July 15, 2022, after Fordam releases unexpectedly bad second quarter results, Ms. Udall sells all 1,000 of her shares at $5 per share. On August 1, 2022, she purchases 200 shares at $1 per share as she believes the market has overreacted to the bad news. Ms. Udall continues to own the shares at December 31, 2022. What are the income tax consequences of these transactions including the ACB of the shares owned at December 31, 2022?

Answer: The allowed portion of the loss would be calculated as follows:

POD [(1,000)($5)] $ 5,000

ACB [(800)($10) + (200)($12)]\* ( 10,400)

Capital Loss ($ 5,400)

Disallowed Loss Portion [(200)($10.40\* - $5)] 1,080

Revised Capital Loss ($ 4,320)

Inclusion Rate 1/2

Allowable Capital Loss ($ 2,160)

\*ACB equal $10.40 ($10,400 ÷ 1,000) per share

The ACB of the shares owned December 31, 2022 is:

Initial cost [(200)($1)] $ 200

Disallowed Loss [(200)($10.40 - $5)] 1,080

ACB $1,280

Type: ES

Topic: Superficial loss

78) On July 1, 2022, Lorty Inc. sells equipment for $126,000. The capital cost of the equipment is $111,000 and the carrying value for accounting purposes is $93,000. For equipment was included in Class 8. The UCC balance in the class on January 1, 2022 was $103,000. There were no other additions or dispositions to the class during the taxation year ending December 31, 2022. Indicate the reconciliation adjustments that would be required to Lorty Inc.'s accounting income for 2022.

Answer: The required adjustments would be as follows:

Add:

Taxable Capital Gain [(1/2)($126,000 - $111,000)] $ 7,500

Recapture ($111,000 - $103,000) 8,000

Deduct:

Accounting Gain ($126,000 - $93,000) ( 33,000)

Total 2022 Reconciliation Adjustments ($17,500)

Type: ES

Topic: Depreciable property - reconciliation adjustments

79) Mr. Levon Park transacts frequently in the common shares of Donner Ltd. Purchases and sales of these shares in 2021 and 2022 are as follows:

**Shares**

**Purchased (Sold) Per Share Amount**

January 15, 2021 Purchase 700 $22.75

March 12, 2021 Purchase 410 25.50

September 15, 2021 Sale (250) 26.45

February 14, 2022 Purchase 925 28.25

October 1, 2022 Sale (410) 30.75

Determine Mr. Park's taxable capital gains and allowable capital losses for 2021 and 2022.

Answer: The relevant average cost calculations are as follows:

**Purchase Shares Cost Average**

**or Sale Date Purchased (Sold) Per Share Total Cost Cost/Share**

January 15, 2021 Purchase 700 $22.75 $15,925

March 12, 2021 Purchase 410 25.50 10,455

Subtotal 1,110 $26,380 $23.77

September 15, 2021 Sale ( 250) $23.77 ( 5,943)

Subtotal 860 $20,437

February 14, 2022 Purchase 925 $28.25 26,131

Subtotal 1,785 $46,568 $26.09

October 1, 2022 Sale ( 410) $26.09 ( 10,697)

ACB Year end 1,375 $35,871

Mr. Park's taxable capital gain for 2021 is calculated as follows:

POD [($26.45)(250)] $6,613

ACB [($23.77)(250)] ( 5,943)

Capital Gain $ 670

Inclusion Rate 1/2

Taxable Capital Gain $ 335

Mr. Park's taxable capital gain for 2022 is calculated as follows:

POD [($30.75)(410)] $12,608

ACB [($26.09)(410)] ( 10,697)

Capital Gain $ 1,911

Inclusion Rate 1/2

Taxable Capital Gain $ 956

Type: ES

Topic: Identical properties

80) For the last two years, Margaret Lane has Invested in the shares of Garod Inc. Details of her purchases and sales of these shares are as follows:

**Shares**

**Purchased (Sold) Per Share Amount**

January 2021 Purchase 300 $4.75

July 2021 Purchase 200 5.25

November 2021 Sale (250) 5.40

July 2022 Purchase 400 5.50

December 2022 Sale (150) 4.80

Determine Ms. Lane's taxable capital gains and allowable capital losses for 2021 and 2022.

Answer: The relevant average cost calculations are as follows:

**Purchase or Shares Cost Average**

**Sale Date Purchased (Sold) Per Share Total Cost Cost/Share**

January 2021 Purchase 300 $4.75 $ 1,425

July 2021 Purchase 200 5.25 1,050

Subtotal 500 $2,475 $4.95

November 2021 Sale ( 250) $4.95 ( 1,238)

Subtotal 250 $ 1,237

July 2022 Purchase 400 $5.50 2,200

Subtotal 650 $3,437 $5.29

December 2022 Sale ( 150) $5.29 ( 794)

ACB Year End 500 $2,643

Ms. Lane's taxable capital gain for 2021 is calculated as follows:

POD [($5.40)(250)] $1,350

ACB [($4.95)(250)] ( 1,238)

Capital Gain $ 112

Inclusion Rate 1/2

Taxable Capital Gain $ 56

Ms. Lane's taxable capital gain for 2022 is calculated as follows:

POD [($4.80)(150)] $720

ACB [($5.29)(150)] ( 794)

Capital Loss ($ 74)

Inclusion Rate 1/2

Allowable Capital Loss) ($ 37)

Type: ES

Topic: Identical properties

81) During the taxation year ending December 31, 2021, Pointer Inc. sells capital property with an ACB of $226,000 for $279,000 which includes a fee for the warranty. The Company provides the purchaser with a one year warranty and the Company estimates that it will cost $4,100 to fulfill the warranty. On September 22, 2022, the Company spends $4,400 to fulfill the warranty. Determine the effect of these transactions on net income for 2021 and 2022. Would your answer change if the warranty expenses were incurred in May of 2022?

Answer: For 2021, there will be a taxable capital gain of $26,500 [(1/2)($279,000 - $226,000)]. In 2022, there will be an allowable capital loss of $2,200 [(1/2)($4,400)]. This allowable capital loss will only be deductible in 2022 to the extent there are net taxable capital gains in 2022 (e.g. a positive ITA 3(b) amount). Any capital loss that cannot be claimed in the current year becomes a 2022 net capital loss that can be applied against net income of other taxation years.

If the warranty costs were incurred prior to the corporate filing due date of June 30, 2022 then the expenses would reduce the POD of the capital property. In that case the taxable capital gain would be $24,300 [(1/2)($279,000 - $4,400 - $226,000)].

Type: ES

Topic: Warranties on capital property - ITA 42

82) In 2021, John Ritton carries on a business as a sole proprietor. He sells non-depreciable capital property with an ACB of $126,000 for $182,000 which includes a fee for a warranty. The warranty is for a one year period that he estimates will cost $2,600. In 2022, he spends $2,400 to fulfill the warranty. Determine the income tax consequences for 2021 and 2022 of the sale of the property and the impact of the warranty expenses. Assume that the warranty expenses were incurred May 19, 2022.

Answer: Since the warranty expenses were incurred prior to the 2021 filing due date of June 15, 2022 the warranty costs will reduce the POD of the sale of the property in 2021. The 2021 taxable capital gain will be of $26,800 [(1/2)($182,000 - $2,400 - $126,000)].

Type: ES

Topic: Warranties on capital property - ITA 42

83) In June of 2022, Ms. Janet Houston sells capital property with an ACB of $112,500, for $172,300. She receives a down payment of $33,000 in cash, with the balance only due at the end of the following taxation year. What is the minimum amount that she will have to include in her income for 2022 as a result of the sale?

Answer: The capital gain on the property would be $59,800 ($172,300 - $112,500). As $139,300 ($172,300 - $33,000) of the proceeds are only receivable after the end of the year a capital gains reserve can be claimed equal to the lesser of:

• [($59,800)($139,300 ÷ $172,300)] $48,347

• [($59,800)(20%)(4 - 0)] $47,840

The addition to her income for 2021 is $5,980 [(1/2)($59,800 - $47,840)].

Type: ES

Topic: Capital gains reserve

84) In 2021, Jack Harris sells capital property with an ACB of $87,200 for $105,300. In accordance with the sales agreement he receives a down payment of $5,300 in 2021, a second payment of $50,000 in 2022, and a final payment of $50,000 in 2023. What is the minimum amount that Jack will have to include in his income for 2021, 2022, and 2023 as a result of the sale?

Answer: The capital gain on the property would be $18,100 ($105,300 - $87,200).

At the end of 2021, the amount that is receivable after the end of the year is $100,000 ($105,300 - $5,300). Based on this, the 2021 reserve is the lesser of:

• [($18,100)($100,000 ÷ $105,300) $17,189

• [($18,100)(20%)(4 - 0)] $14,480

This means that $1,810 [(1/2)($18,100 - $14,480)] will be required to be added to his 2021 income.

At the end of 2022, the amount that is receivable after the end of that year is $50,000 ($100,000 - $50,000). Based on this, the 2022 reserve is the lesser of:

• [($18,100)($50,000 ÷ $105,300) $ 8,594

• [($18,100)(20%)(4 - 1)] $10,860

The capital gain for 2022 would be calculated as follows:

2021 Reserve $14,480

2022 Reserve ( 8,594)

2022 Capital Gain $ 5,886

As a result $2,943 [(1/2)($5,886)] will be required to be added to his 2022 income as a taxable capital gain. At the end of 2022 there is no amount that is receivable after the end of that year and therefore no reserve can be claimed. However, the 2022 reserve will have to be added back to income in 2023 resulting in a taxable capital gain of $4,297 [(1/2)($8,594)].

Type: ES

Topic: Capital gains reserve

85) In 2021, non-depreciable capital property with an ACB of $131,000 is sold for $115,000. In accordance with the sale agreement $82,000 is paid in cash on the day of the sale and $33,000 becomes payable in 2022. In 2022, the receivable for $33,000 proves to be uncollectible and there is no ability to recover the property. What are the income tax consequences of these events in 2021 and 2022? Assume the seller will file any necessary elections to minimize income tax.

Answer: The sale of the property in 2021 results in an allowable capital loss of $8,000 [(1/2)($115,000 - $131,000)]. In 2022, there will be an allowable capital loss of $16,500 [(1/2)(Nil - $33,000)] if an election is filed under ITA 50(1) which would deem the debt to have been disposed of for nil proceeds.

Type: ES

Topic: Bad debts on capital property - ITA 50(1)

86) In November of 2021, John Bradley sells non-depreciable capital property with an ACB of $182,000, for $213,000. In accordance with the sale agreement he receives $63,000 in cash on the day of the sale with the balance of $150,000 payable December 1, 2022. When the balance becomes due on December 1, 2022, it is clear that none of this amount will ever by paid as the purchaser has since become insolvent. The sale agreement does not allow the seller to recover the property. What are the income tax consequences of these events in 2021 and 2022? Assume that the seller decides not to claim a capital gains reserve.

Answer: In 2021, there will be a taxable capital gain of $15,500 [(1/2)($213,000 - $182,000)]. In 2022, the uncollectible balance will result in an allowable capital loss of $75,000 [(1/2)(POD Nil - ACB of the amount owing $150,000)] on the filing of an election under ITA 50(1). The allowable capital loss can be deducted in 2022, to the extent of any net taxable capital gains in that year (e.g. a positive ITA 3(b) amount). Any part of the allowable capital loss that cannot be claimed in 2022 becomes a 2022 net capital loss that can be claimed in other taxation years such as the 2021 taxation year to offset the $15,500 taxable capital gain.

Type: ES

Topic: Bad debts on capital property - ITA 50(1)

87) Saba Corp. purchased an apartment complex in 2021 for $450,000 ($100,000 for the land, $350,000 for the building) and sold it in 2022 for $460,000 ($120,000 for the land, $340,000 for the building). $7,000 was claimed as CCA in 2021 resulting in a UCC of $343,000 at the beginning of the 2022 taxation year. Determine the income tax consequences of the sale for 2022.

Answer: In the absence of the special rules related to the sale of real property, there would be taxable capital gain of $10,000 [(1/2)($120,000 - $100,000)], and a terminal loss on the building of $3,000 [UCC $343,000 - lesser of POD and capital cost $340,000]. However, in these circumstances, ITA 13(21.1)(a) would require a deemed proceeds for the building to be calculated as follows:

The Lesser of:

• The FMV of the land and building $460,000

Reduced by the lesser of:

• The ACB of the land = $100,000

• The FMV of the land = $120,000 ( 100,000) $360,000

• The Greater of:

• The FMV of the building = $340,000

• The Lesser of:

The cost of the building = $350,000

The UCC of the building = $343,000 $343,000

With the deemed proceeds for the building set at $343,000, the terminal loss on the building would be reduced to nil [(UCC $343,000) - Deemed POD $343,000]. With the addition of $3,000 to the building proceeds, the land proceeds are reduced by an equivalent amount to $117,000, reducing the taxable capital gain to $8,500 [(1/2)($117,000 - $100,000)].

Type: ES

Topic: Terminal loss on sale of land and building - ITA 13(21.1)

88) Mr. Jerry Haggard owns a house in Calgary, as well as a cottage in Canmore. He purchased the house in 2011 for $186,000. The cottage was purchased in 2014 for $105,000. In December, 2022, both properties are sold, the house for $263,000 and the cottage for $197,000. He has lived in the Calgary house during the year, but has spent his summers in the Canmore cottage. Determine the minimum capital gain that must be included in his 2022 income as a result of the sale of the two properties.

Answer: The capital gain on each of the two properties is as follows:

**House Cottage**

Sales Price (POD) $263,000 $197,000

ACB ( 186,000) ( 105,000)

Capital Gain $ 77,000 $ 92,000

Annual Gain - House ($77,000 ÷ 12) $6,417

Annual Gain - Cottage ($92,000 ÷ 9) $10,222

Given these amounts, the years 2015 through 2022 should be designated to the cottage and the years 2011 through 2014 designated for the house. This results in the following capital gain exemption for the two properties:

Cottage {[$92,000][(8 + 1) ÷ 9]} $92,000

City Home {[$77,000][(4 + 1) ÷ 12]} $32,083

This will leave a minimum capital gain on the sale of the two properties of $44,917 ($92,000 - $92,000 + $77,000 - $32,083).

Type: ES

Topic: Principal residence - general rules

89) Ms. Harriet Lowe owns a city home in Vernon, as well as a chalet at the Silver Star ski area. The city home was purchased in 2009 at a cost of $172,000. The chalet was purchased in 2015 for $89,000. On July 1, 2022, the house is sold for $214,000 and the chalet is sold for $122,000. A real estate commission of 6% was paid on each sale. She has spent some time in each property in every year from 2015 through 2022.

Determine the minimum capital gain that she must report for 2022 as a result of the sale of the two properties.

Answer: The total capital gain on the two properties can be calculated as follows:

**City Home Chalet**

POD (Sales Price) $214,000 $122,000

ACB ( 172,000) ( 89,000)

Sales Commission 6% ( 12,840) ( 7,320)

Capital Gain $ 29,160 $ 25,680

Annual Gain - City Home ($29,160 ÷ 14) $2,083

Annual Gain - Chalet ($25,680 ÷ 8) $3,210

Given these amounts, the years 2016 through 2022 should be designated for the chalet. This leaves the years 2009 through 2015 for the Vernon house. This gives the following gain exemption for the two properties:

Chalet {[$25,680][(7 + 1) ÷ 8]} $25,680

City Home {[$29,160][(7 + 1) ÷ 14]} $16,663

This will leave a minimum capital gain of $12,497 ($25,680 - $25,680+$29,160 - $16,663).

Type: ES

Topic: Principal residence designation

90) During the current year, Robert Langois disposes of several properties. The POD and the ACB of these properties are as follows:

**Adjusted Proceeds of**

**Cost Base (ACB) Disposition (POD)**

Collector Car $45,000 $61,000

Marble Sculpture 800 13,000

Antique Furniture 21,000 12,000

Stamp Collection 50,500 26,000

What are the income tax consequence of the dispositions?

Answer: The income tax consequences are as follows:

Personal Use Property

Gain on Collector Car ($61,000 - $45,000) $ 16,000

Loss on Antique Furniture (Personal Use Property) Nil

Listed Personal Property

Gain on Marble Sculpture

($13,000 - $1,000 floor) $12,000

Loss on Stamp Collection

(See Note) ( 12,000) Nil

Capital Gain $16,000

Inclusion Rate 1/2

Net Taxable Capital Gains $ 8,000

**Note:** The ACB of the marble sculpture is deemed to be $1,000 using the $1,000 floor rule. While there is a capital loss of $24,500 ($50,500 - $26,000), on the coin collection, it can only be deducted to the extent of the $12,000 capital gain on the sale of the sculpture because it is listed personal property. The balance of $12,500 ($24,500 - $12,000) is a net gain on listed personal property for the current year that can be carried back 3 years and forward 7 years.

Type: ES

Topic: Personal use property - general rules

91) During the current year, Rhonda Fontaine disposes of several personal use properties. Relevant information with respect to these properties follows:

**Adjusted Proceeds of**

**Cost Base (ACB) Disposition (POD)**

Coin Collection $ 18,000 $ 11,500

Sailboat 42,000 56,000

Antique Sports Car 24,000 12,000

Group of Seven Painting 142,000 145,000

What are the income tax consequence of these dispositions?

Answer: The results are as follows:

Personal Use Property

Gain on Sailboat ($56,000 - $42,000) $14,000

Loss on Antique Sports Car (Personal Use Property) Nil

Listed Personal Property

Gain on Group of Seven Painting

($145,000 - $142,000) $3,000

Loss on Coin Collection (See Note) ( 3,000) Nil

Capital Gain $14,000

Inclusion Rate 1/2

Net Taxable Capital Gains $ 7,000

**Note:** While there is a capital loss of $6,500 ($11,500 - $18,000), on the coin collection, it can only be deducted to the extent of the $3,000 capital gain on the sale of the painting. The balance of $3,500 ($6,500 - $3,000) is a net gain on listed personal property for the current year that can be carried back 3 years and forward 7 years.

Type: ES

Topic: Personal use property - general rules

92) On June 1, 2019, Ms. Lorenda Jacks acquires 15,300 Barbadian dollars (B$) at a rate of B$1 = C$0.70. She immediately invests the B$15,300 in 300 shares of a Barbadian company, Tellen Ltd. In September of 2022, the shares are sold for B$85 per share. The Barbadian dollars are immediately converted into Canadian dollars at a rate of B$1 = C$0.72. What amounts will be included in Ms. Jacks' income for 2022 as a result of these transactions?

Answer: The taxable capital gain on the sale is calculated as follows:

POD [(300)(B$85)(C$0.72)] $18,360

ACB [(B$15,300)(C$0.70)] ( 10,710)

Capital Gain $ 7,650

Inclusion Rate 1/2

Taxable Capital Gain $ 3,825

None of this gain qualifies under ITA 39(1.1), so there would be no $200 exemption.

Type: ES

Topic: Foreign exchange gains and losses

93) In 2020, Lex Steller acquires £10,000 at a rate of £1 = $1.80. The funds are immediately used to acquire 500 shares of a British company, Upper Lip Ltd., at a price of £20 per share. In January, 2022, he sells all of the shares for £32 per share, leaving all of the British pounds in his trading account. At this time, £1 = $1.60. In December of 2022, he converts the British pounds to Canadian dollars at a rate of £1 = $1.70. What amounts will be included in Mr. Steller's income for 2022 as a result of these transactions?

Answer: At the time of the January sale, Mr. Steller will have a taxable capital gain, calculated as follows:

POD [(500)(£32)($1.60)] $25,600

ACB [(500)(£20)($1.80)] ( 18,000)

Capital Gain $ 7,600

Inclusion Rate 1/2

Taxable Capital Gain $ 3,800

When the currency is converted in December 2022, Mr. Steller will have a taxable capital gain

calculated as follows:

POD [(500)(£32)($1.70)] $27,200

ACB of Currency [(500)(£32)($1.60)] ( 25,600)

Foreign Exchange Gain $ 1,600

Exclusion (Permitted to Individuals - ITA 39(1.1)) ( 200)

Foreign Exchange Gain $ 1,400

Inclusion Rate 1/2

Foreign Exchange Taxable Capital Gain $ 700

Type: ES

Topic: Foreign exchange gains and losses

94) For a number of years, Ms. Danine Post has owned a rural cottage that has been used only for her personal use and enjoyment. The cottage cost $142,000 in 2018 and, on July 1, 2022, the FMV is $242,000. She estimates that the FMV of the land on which the cottage is located is $22,000 on both of these dates. It will not be designated as her principal residence for any of the years owned. On July 1, 2022, she rents the property to an arm's length person for $1,000 per month on a three year rental agreement. Rental income for the year ending December 31, 2022, before the deduction of any CCA, is $4,800. What is the maximum amount of CCA that can be claimed in 2022?

Answer: The required calculations are as follows:

Cost of Building ($142,000 - $22,000) $120,000

FMV at Change in Use

($242,000 - $22,000) $220,000

Cost ( 120,000)

Gain $100,000

Bump Up 1/2 50,000

Capital Cost for CCA Purposes = UCC $170,000

AccII [(50%)($170,000)] 85,000

CCA Base $255,000

Rate 4%

Maximum 2022 CCA $10,200

The short fiscal period rules do not apply to an individual earning property (rental) income. In addition the AccII rules (as amended in June of 2021) apply since no CCA had been previously claimed on the property by anyone for a previous taxation year. CCA, with respect to rental properties, cannot be used to create or increase a loss and is restricted to the rental income after deducting all expenses except CCA. As a result the maximum CCA that can be claimed is $4,800 resulting in nil rental income.

Type: ES

Topic: Change in use - CCA on rental property

95) On December 1, 2022, Mr. Jordon Jordu converts his summer cottage into a rental property. The cottage has an original cost of $57,000 and it will not be designated as his principal residence for any of the years owned. At the time of the conversion, the FMV of the property is $136,400. The value of the land was originally $20,000 and has not changed. Determine the income tax consequences of the change in use for 2022. Your answer should include the maximum CCA that can be claimed in 2022, and the January 1, 2023 UCC for the rental property, assuming the maximum CCA is claimed.

Answer: There would be a taxable capital gain resulting from the change in use as follows:

Deemed disposition POD ($136,400 - $20,000) $116,400

ACB ($57,000 - $20,000) ( 37,000)

Capital Gain $ 79,400

Inclusion Rate 1/2

Taxable Capital Gain $ 39,700

Cost of Building ($57,000 - $20,000) $ 37,000

FMV at Change in Use

($136,400 - $20,000) $116,400

Cost ( 37,000)

Gain $79,400

Bump Up 1/2 39,700

Capital Cost for CCA Purposes = UCC $ 76,700

AccII [(50%)($76,700)] 38,350

CCA Base $115,050

Rate 4%

Maximum CCA for 2021 $ 4,602

January 1, 2023 UCC ($76,700 - $4,602) $ 72,098

The short fiscal period rules do not apply to an individual earning property (rental) income. In addition the AccII rules (as amended in June of 2021) apply since no CCA had been previously claimed on the property by anyone for a previous taxation year.

Type: ES

Topic: Change in use - rental property (ACB, UCC and CCA)

96) Mr. Ryan Marchand owns publicly traded securities with an ACB of $30,000 and a FMV of $56,000. On August 15, 2022, he becomes a non-resident and emigrates from Canada still owning the shares. What are the income tax consequences of the emigration, if any, with respect to these securities?

Answer: There would be a deemed disposition on his departure, resulting in a taxable capital gain of $13,000 [(1/2)($56,000 - $30,000)] which would be added to his income for the short taxation year ending August 15, 2022. The ACB of the shares would increase to $56,000.

Type: ES

Topic: Emigration

97) On December 1, 2022 Ms. Renee Black becomes a non-resident and emigrates from Canada. At the time of her departure she owns publicly traded securities with an ACB of $45,000 and a FMV of $52,000. What are the income tax consequences of her becoming a non-resident, if any, with respect to these securities?

Answer: There would be a deemed disposition on her departure, resulting in a taxable capital gain of $3,500 [(1/2)($52,000 - $45,000)] which would be added to her income for the short taxation year ending December 1, 2022. The ACB of the shares would increase to $52,000.

Type: ES

Topic: Emigration

98) On January 15, 2022, Chad Brant sells all of the common shares he owns in Brant Inc., an eligible small business corporation (ESBC). He had owned the shares for 15 years. The ACB of the shares is $600,000 and they are sold for $1,100,000. On February 15, 2022, $940,000 of these proceeds are invested in the common shares of Quint Ltd., another ESBC. How much of the capital gain arising on the sale of the Brant Inc. shares can be deferred by the investment in Quint Ltd.? Assuming that the maximum deferral is elected, how will this affect the ACB of the Quint Ltd. shares?

Answer: The capital gain on the sale of the Brant shares is $500,000 (POD $1,100,000 - ACB $600,000). As the $940,000 cost of the replacement shares is less than the POD of $1,100,000, the permitted deferral is calculated as follows:

[($500,000)($940,000 ÷ $1,100,000)] = $427,273

The deferral reduces the ACB of the Quint Ltd. shares to $512,727 ($940,000 - $427,273).

Type: ES

Topic: Capital gains deferral ITA 44.1 (ESBC)

99) In early 2022, Carol Martin sells all of the common shares she owns in Martin Ltd., an eligible small business corporation (ESBC). She has owned the shares for 10 years. The shares had an ACB of $895,000 and were sold for $985,000. With the sale proceeds she made two investments in other ESBCs as follows:

• $200,000 to invest in Barby Ltd.

• $600,000 to invest in Ken Inc.

The remaining proceeds of $185,000 are deposited in her savings account at the end of 2022. How much of the capital gain arising on the sale of the Martin Ltd. shares can be deferred by the investments in Barby and Ken? Assuming that the maximum deferral is elected, how will this affect the ACB of the shares purchased?

Answer: The required calculations are as follows:

Capital Gain ($985,000 - $895,000) $90,000

Maximum Deferral [($90,000)($800,000 ÷ $985,000)] $73,096

This reduction will be allocated to the two investments as follows:

**Barby Shares Ken Shares**

Cost of Investments $200,000 $600,000

Deferral:

[($73,096)($200,000 ÷ $800,000)] ( 18,274)

[($73,096)($600,000 ÷ $800,000)] ( 54,822)

ACB $181,726 $545,178

Type: ES

Topic: Capital gains deferral ITA 44.1 (ESBC)

100) Multi Inc., a company with a December 31 taxation year end, that carries on business out of a single Class 1 building that cost $815,000. At the beginning of 2021, the UCC for the class was $648,275. On June 30, 2021, the building was completely destroyed by a tornado. The building was insured for its FMV of $1,000,000 and this amount was received in September, 2021. The building is replaced in 2022 with a used building at a cost of $1,075,000. Multi Inc. wishes to minimize income taxes to the extent possible.

Describe the 2021 and 2022 income tax consequences of these events, including the capital cost and UCC for the replacement building at the end of 2022. Ignore any gain or loss related to the land on which the building is situated.

Answer: As the replacement of the building did not occur until 2022, there will be a taxable capital gain and recapture in 2021:

Insurance Proceeds (POD) $1,000,000

ACB ( 815,000)

Capital Gain $ 185,000

Inclusion Rate 1/2

Taxable Capital Gain $ 92,500

UCC $648,275

Disposition - Lesser of

Capital Cost = $815,000

POD = $1,000,000 ( 815,000)

Negative Ending UCC Balance = Recapture ($166,725)

Using the ITA 44(1) election, the revised capital gain for 2021 will be nil, the lesser of:

• The reported gain of $185,000

• Nil - The amount by which the POD of the replaced property exceeds the cost of the replacement building ($1,000,000 - $1,075,000) which would be nil.

With the ITA 13(4) election, the reassessed 2021 recapture is as follows:

January 1, 2021 UCC $648,275

Deduction:

Lesser of:

• POD = $1,000,000

• Capital Cost = $815,000 $815,000

Reduced by the lesser of:

• Normal Recapture = $166,725

• Replacement Cost = $1,075,000 ( 166,725) ( 648,275)

Reassessed 2021 Recapture Nil

These revised amounts will be reflected in the tax costs of the new building as follows:

Cost of the replacement building $1,075,000

Capital Gain Deferred by the election ( 185,000)

Deemed Capital Cost $ 890,000

Recapture Deferred by the election ( 166,725)

UCC - December 31, 2022 $ 723,275

These amounts are $75,000 more than the old capital cost and UCC. This reflects the $75,000 ($1,075,000 - $1,000,000) over and above the insurance proceeds that the Company spent on replacing the building.

Type: ES

Topic: Involuntary dispositions

101) In October of 2021 a thief broke into Guda Corporation's head office and stole their electronic communications equipment. The equipment originally cost $18,000 and was in a separate Class 8 with a UCC balance of $12,000. Fortunately, the equipment was insured for replacement cost so Guda received insurance proceeds of $20,000. The equipment was replaced in January of 2022 for $20,000. Guda has a taxation year end of December 31.

Provided the appropriate elections are made to minimize 2021 income, determine the income tax consequences of the theft of the equipment, the insurance payout and the capital cost and UCC of the replacement equipment at the end of 2022.

Answer: The results in 2021 would be as follows:

POD (Insurance proceeds) $20,000

ACB ( 18,000)

Capital Gain $ 2,000

Inclusion Rate 1/2

Taxable Capital Gain $ 1,000

January 1, 2021 UCC $12,000

Lesser of:

Capital Cost of $18,000

POD of $20,000 ( 18,000)

Negative Ending Balance = Recapture ($ 6,000)

Using the ITA 44(1) election, the reassessed capital gain for 2021 will be nil, the lesser of:

• The reported gain of $2,000

• Nil - The excess of the proceeds of disposition ($20,000) over the cost of the new equipment ($20,000).

With the ITA 13(4) election, the reassessed 2022 recapture is as follows:

January 1, 2021 UCC $12,000

Deduction:

Lesser of:

• POD = $20,000

• Capital Cost = $18,000 $18,000

Reduced by the lesser of:

• Recapture = $6,000

• Replacement Cost = $20,000 ( 6,000) ( 12,000)

Reassessed 2021 Recapture Nil

Subsequent to the application of these elections, the capital cost and UCC would be determined as:

Cost of New Equipment $20,000

Capital Gain Deferred by the election ( 2,000)

Deemed Capital Cost of New Equipment $18,000

Recapture Deferred by the election ( 6,000)

UCC December 31, 2022 $12,000

Type: ES

Topic: Involuntary dispositions

102) On December 1, 2021, Morteaux Ltd. sells its only building in anticipation of moving to a new location in 2022. Morteaux Ltd.'s taxation year ends December 31. The property is sold for $2,300,000 and, at the time of the sale, the ACB and FMV of the land are both $1,200,000, while the capital cost of the building is equal to its FMV of $1,100,000. The UCC is $250,000. In February of 2022, the building is replaced at a cost of $2,700,000, with $1,300,000 attributable to the land and $1,400,000 to the building. The replacement building is a used building. Assume the appropriate replacement property election is made to minimize income tax for each of 2021 and 2022.

Calculate the effect on 2021 income of the sale of the old building, purchase of the replacement and the maximum CCA that can be claimed in 2022.

Answer: There is no capital gain as the POD is equal to the cost of the property. However, as the replacement did not occur until 2022, there will be recapture of CCA in 2021 calculated as follows:

UCC $ 250,000

Lesser of:

Capital Cost = $1,100,000

POD = $1,100,000 ( 1,100,000)

Negative Ending Balance = Recapture of CCA ($ 850,000)

Using the ITA 13(4) election in 2022, the reassessed 2021 recapture is calculated as follows:

January 1, 2021 UCC $250,000

Deduction:

Lesser of:

• POD = $1,100,000

• Capital Cost = $1,100,000 ($1,100,000)

Reduced by the lesser of:

• Recapture = $850,000

• Replacement Cost = $1,400,000 850,000 ( 250,000)

Reassessed 2021 Recapture Nil

The maximum CCA that can be claimed in 2022 is as follows:

Capital Cost $1,400,000

Recapture Reversal ( 850,000)

UCC $ 550,000

AccII Adjustment [(1/2)($550,000)] 275,000

CCA Base $ 825,000

Rate 4%

2022 CCA $ 33,000

Type: ES

Topic: Voluntary dispositions

103) Over the last five years, Mary Blaise has bought and sold the shares of two companies, Sadean Ltd. and Dorcan Inc. Both companies are publicly traded and pay eligible dividends on an irregular basis.

Transactions involving Sadean Ltd. shares over this period are as follows:

January, 2018 Purchase 1,250 @ $24

November, 2020 Purchase 860 @ 29

June, 2022 Sale 1,750 @ 31

Transactions involving Dorcan Inc. shares over this period are as follows:

March, 2018 Purchase 960 @ $ 7.50

September 2019 Purchase 1,230 @ 8.75

February, 2020 Purchase 620 @ 9.20

July, 2020 Sale ( 980) @ 10.15

March, 2021 Purchase 375 @ 11.23

April, 2022 Sale ( 625) @ 8.10

**Required:**

A. Determine the taxable capital gain resulting from the June 2022 sale of the Sadean Ltd. shares.

B. With respect to the transactions involving Dorcan Inc., determine the following:

• The ACB of the shares that are still on hand on December 31, 2022.

• The taxable capital gain or allowable capital loss resulting from the 2020 sale.

• The taxable capital gain or allowable capital loss resulting from the 2022 sale.

Answer:

***Part A***

The average cost of the shares sold during June, 2022 would be calculated as follows:

January, 2018 Purchase [(1,250)($24)] $30,000

November, 2020 Purchase [(860)($29)] 24,940

Total ACB $54,940

Average Cost [$54,940 ÷ (1,250 + 860)] $26.04

Given this average cost, the taxable capital gain on the June, 2022 sale of shares would be calculated as follows:

POD [(1,750)($31)] $54,250

ACB [(1,750)($26.04)] ( 45,570)

Capital Gain $8,680

Inclusion Rate 1/2

Taxable Capital Gain $4,340

***Part B***

The total cost of the 1,580 shares remaining on December 31, 2022 would be $14,063.65.

This is calculated in the following table:

**Shares Cost Average**

**Purchased Per Cost Per**

**Purchase or Sale Date (Sold) Share Total Cost Share**

March 2018 Purchase 960 $ 7.50 $ 7,200.00

September, 2019 Purchase 1,230 8.75 10,762.50

February, 2020 Purchase 620 9.20 5,704.00

Subtotal 2,810 $23,666.50 $8.42

July, 2020 Sale ( 980) $ 8.42 ( 8,251.60)

March, 2021 Purchase 375 11.23 4,211.25

Subtotal 2,205 $19,626.15 $8.90

April, 2022 Sale ( 625) $ 8.90 ( 5,562.50)

December 31, 2022 Balances 1,580 $14,063.65

The taxable capital gain resulting from the 2020 sale would be calculated as follows:

POD [(980)($10.15)] $9,947.00

ACB [(980)($8.42)] ( 8,251.60)

Capital Gain $1,695.40

Inclusion Rate 1/2

Taxable Capital Gain $ 847.70

The allowable capital loss resulting from the 2022 sale would be calculated as follows:

POD [(625)($8.10)] $5,062.50

ACB [(625)($8.90)] ( 5,562.50)

Capital Loss ($ 500.00)

Inclusion Rate 1/2

Allowable Capital Loss ($ 250.00)

Type: ES

Topic: Identical properties

104) For a number of years, Lester Wayne has owned a large tract of undeveloped land near Windsor, Ontario. He had acquired this land at a cost of $1,585,000, all of which was paid in cash.

Despite the dwindling activity in its automobile plants, the relatively mild climate of the Windsor area has encouraged population growth in the surrounding region. Because of this, a local developer has offered Lester $3,650,000 for his land, expecting to turn the area into 100 building lots for large, single family homes. The terms of the offer are as follows:

• An initial payment of $650,000 will be made on January 1, 2022.

• Annual instalments of $1,000,000 will be made on January 1, 2023, January 1, 2024, and January 1, 2025.

• Interest on the outstanding balance will be paid to Lester on December 31 of each of the years 2022 to and including 2025. It will be calculated at a rate of 5% of the balance outstanding on January 1 of each year.

Also, because of the high level of risk involved in the project, Lester is asked to provide a warranty. Specifically, the builder would like to have a payment of $15,000 for each lot that remains unsold as of July 1, 2024. Lester agrees to this arrangement.

The required instalment payments due on January 1, 2023 and 2024, as well as the interest due at the end of the years 2022 and 2023 are paid on time as agreed. However, the developer is not successful in his promotion of the lots. As a result, on July 1, 2024, 40 of the lots remain unsold. Lester makes the required warranty payment of $600,000 [(40)($15,000)].

The developer is unable to sell any additional lots after July 1, 2024. Because of these difficulties, he does not make the required interest payment on December 31, 2024, or the final instalment due on January 1, 2025.

When Lester does not receive these payments and grows suspicious of the developer's excuses, he tries very hard to locate the developer. In July, 2025, he finally accepts that this individual has disappeared, leaving many angry creditors. At this point, Lester writes off the interest that was accrued on December 31, 2024, as well as the remaining instalment that was due on January 1, 2025.

During the years 2022 to and including 2025, Lester does not have any capital gains or losses, other than those related to the sale of this tract of land. He has pension and investment income totalling more than $80,000 in each year.

**Required:** Determine the income tax consequences of these transactions to Lester for each of the 2022 to 2025 taxation years.

Answer:

***Capital Gains Reserve***

With respect to the capital gains, under ITA 40(1)(a)(iii), the amount that can be deducted as a capital gains reserve is equal to the lesser of:

• [(Capital Gain)(Proceeds receivable after the end of the year ÷ Total Proceeds)]

• [(Capital Gain)(20%)(4 - Number of preceding years ending after the year of disposition)]

***2022 Results***

The capital gain resulting form the disposition of the land would be $2,065,000 ($3,650,000 - $1,585,000. Based on this, the 2022 capital gains reserve would be the lesser of:

• [($2,065,000)($3,000,000 ÷ $3,650,000)] = $1,697,260

• [($2,065,000)(20%)(4 - 0)] = **$1,652,000**

The results for 2022 are therefore as follows:

POD $3,650,000

ACB ( 1,585,000)

Capital Gain $2,065,000

Capital Gains Reserve ( 1,652,000)

Capital Gain $ 413,000

Inclusion Rate 1/2

2022 Taxable Capital Gain $ 206,500

Interest [(5%)($3,000,000)] 150,000

Total additional income for 2022 $ 356,500

***2023 Results***

The capital gains reserve would be the lesser of:

• [($2,065,000)($2,000,000 ÷ $3,650,000)] = **$1,131,507**

• [($2,065,000)(20%)(4 - 1)] = $1,239,000

Based on this, the total additional income for 2023 would be as follows:

2022 Capital Gains Reserve $1,652,000

2023 Capital Gains Reserve ( 1,131,507)

Capital Gain $ 520,493

Inclusion Rate 1/2

Taxable Capital Gain $ 260,247

Interest [(5%)($2,000,000)] 100,000

Total additional income for 2023 $ 360,247

***2024 Results***

The capital gains reserve would be the lesser of:

• [($2,065,000)($1,000,000 ÷ $3,650,000)] = **$565,753**

• [($2,065,000)(20%)(4 - 2)] = $826,000

Based on this, the results would be as follows:

2023 Capital Gains Reserve $1,131,507

2024 Capital Gains Reserve ( 565,753)

Capital Gain $ 565,754

Warranty Payment (a Capital Loss) ( 600,000)

Capital Loss ($ 34,246)

Inclusion Rate 1/2

2024 Allowable Capital Loss ($ 17,123)

The problem states that Lester has no other capital gains or capital losses unrelated to this land sale. This means that the allowable capital loss has no effect on income for 2024. The allowable capital loss becomes a 2024 net capital loss which can be carried over to other taxation years (3 years back and an indefinite carry forward). This net capital loss could be carried back to 2022 and 2023.

The only addition to income for 2024 would be as follows:

Accrued Interest [(5%)($1,000,000)] $50,000

***2025 Results***

There are no amounts that are receivable after 2025 and therefore no capital gains reserve can be claimed for the year.

2024 Capital Gains Reserve $ 565,753

2025 Capital Gains Reserve N/A

Capital Gain $ 565,753

Bad Debt (a Capital Loss) Requires election ITA 50(1) ( 1,000,000)

Capital Loss ($ 434,247)

Inclusion Rate 1/2

Allowable Capital Loss ($ 217,124)

The allowable capital loss has no effect on income for 2025 instead it represents a 2025 Net capital loss that can be applied to other taxation years (3 years back and an indefinite carry forward).

Since Lester has income of more than $80,000, the write-off of the interest accrued decreases his net income by $50,000.

Summary (Not Required)

The results can be summarized as follows:

**Net**

**Taxable Gain**

**Taxation Year Interest (Allowable Loss)**

2022 $150,000 $206,500

2023 100,000 260,247

2024 50,000 ( 17,123)

2025 ( 50,000) ( 217,124)

Totals $250,000 $232,500

The amount of the taxable capital gain can be verified as follows:

Initial Capital Gain $2,065,000

Warranty Payment ( 600,000)

Bad Debt ( 1,000,000)

Capital Gain $ 465,000

Inclusion Rate 1/2

Taxable Capital Gain $ 232,500

Type: ES

Topic: Warranties, bad debts, and reserves

105) Each of the following independent Cases describes a situation with a proposed tax treatment.

1. Herbert Nash has owned a 200 acre parcel of land for a number of years. He had acquired this land for $250,000 with the intention of eventually building a home on the property. However, he received an offer of $425,000 for 75 acres of the property. Because this 75 acres has waterfront and better road access, he believes that the FMV of the remaining 125 acres is only $175,000. He accepts the offer and plans to use an ACB of $177,083 {[$250,000][$425,000 ÷ ($425,000 + $175,000)]} in calculating his gain or loss.

2. Gregory Hayes sells a capital property with an ACB of $85,000 for $135,000. The $135,000 price includes a charge for a warranty on the property which he anticipates will cost him $5,000 to service. He does not anticipate any of the warranty expenses will be incurred in the year of the sale. He plans to recognize a capital gain on the transaction of $45,000 after the consideration of the estimated warranty costs.

3. During the current year Ms. Kristy Stone sold her sailboat to an arm's length person for $71,000. She had purchased the boat several years ago for $51,000. Also during the year, she sold securities with an ACB of $22,000 for $12,000. She intends to deduct the loss on the securities against the gain on the sailboat.

4. Nellie Ward has a cottage which she has owned for a number of years. The cottage was purchased for $125,000. It is currently worth more than $500,000. While she has rarely used it, preferring to stay in her penthouse in the city, she believes that it will continue to increase in value. Given this, she decides to convert it to a rental property. While she plans to report her future rental income to the CRA, she does not plan to recognize a capital gain on the conversion of the property since there was no actual disposition.

5. During the current year, Ignacio Rogers sells a non-depreciable capital property for $216,000. The ACB of the property was $184,000, resulting in a capital gain of $32,000. Under the terms of the sale, he will receive 10% ($21,600) of the sale price in the year of the sale, with the remainder due in the following year. As a result, he will recognize only $3,200 of the capital gain in year of the sale.

**Required:** In each of the preceding Cases, indicate whether or not you believe that the income tax treatment being proposed is the correct one. Explain your conclusion.

Answer:

1. The proposed treatment is correct. While the parcel sold represents only 37.5% of the total acreage, Mr. Nash can justify the apportionment of the ACB which is based on its relative FMV. This equals 70.8% [$425,000 ÷ ($425,000 + $175,000)] of the total ACB of $250,000 or $177,083. Mr. Nash should obtain a valuation in support of this conclusion in case the CRA questions the allocation. ITA 43 provides that in determining the portion of the ACB of a property that a reasonable approach must be used which supports the allocation.

2. This interpretation is incorrect. No recognition can be given to the estimated warranty expenses prior to the actual provision of the warranty services. As a consequence there will be a capital gain of $50,000. However, if warranty expenses are incurred prior to the filing due date for the taxation year in which the sale is made then the reported capital gain will be reduced by those expenses. If warranty expenses are incurred after that filing due date the actual warranty expenses will be treated as a capital loss in that subsequent taxation year.

3. The proposed treatment is correct. While losses on personal use property (e.g., the sailboat) are not permitted, gains are required to be included in income. The allowable capital loss on the securities can be applied against the taxable capital gain on the sailboat.

4. The described treatment is incorrect. While Nellie has not actually sold the cottage the change in use is deemed to be a disposition at FMV. Any resulting capital gain will have to be included in her income for the year of the change in use. Given the facts, the principal residence exemption is not relevant. If she plans to designate the property as a principal residence she would be required to report the deemed disposition. Failing to do so could result in a penalty.

5. The described treatment is incorrect. The amount of any capital gains reserve is based on the lesser of (1) the gain multiplied by the ratio of the proceeds receivable after the end of the year (the approach that Ignacio is using) to the total proceeds; and (2) the amount of the gain multiplied by the following formula: [(20%)(4 - The number of taxation years ending after the year of the sale).

This mean that Ignacio's maximum reserve would be $25,600 [($32,000)(20%)(4 - 0)] which requires him to include a minimum of 20% of the capital gain in the year of the sale. The capital gain would be $6,400 ($32,000 - $25,600).

Type: ES

Topic: Capital gains - short cases

106) Several years ago, Erin acquired two tracts of land located near the city of Richmond, British Columbia. These tracts cost $325,000 and $430,000.

His original intention was to develop the tracts into two subdivisions of 40 lots each for the purpose of then leasing the land to others. However, because of the ongoing responsibilities associated with his position at the University of British Columbia, he has not found time for this project. Even though he has made no effort to market the tracts, he receives two very attractive offers from a developer to purchase them. The terms of the two offers are as follows:

**Tract 1 -** The offer for the $325,000 tract was $879,000. The terms require a down payment on January 1, 2022 of $395,550 (45% of the sales price), with the balance due on December 31, 2025. Interest, calculated at an annual rate of 6% of the beginning of the year balance, is due on December 31 of 2023, 2024, and 2025.

**Tract 2 -** The offer for the $430,000 tract was $1,000,000. The terms require a down payment on January 1, 2022 of $100,000. (10% of the sales price). Further payments of $300,000 each will be required on December 31 of 2023, 2024, and 2025. Interest, calculated at an annual rate of 6% of the beginning of the year balance, is due on December 31 of 2023, 2024, and 2025.

Erin decides to accept both of these offers.

**Required:** Determine the minimum amounts that will be required to be included in Erin's income as a result of these transactions. Show the effect for each of the years 2022, 2023, 2024, and 2025 separately. Your answer should include taxable capital gains and any interest income. Assume that the land was purchased as capital property.

Answer:

***Capital Gains Treatment***

The amount of the capital gains resulting from the dispositions would be calculated as follows:

**Tract 1 Tract 2**

POD $879,000 $1,000,000

ACB ( 325,000) ( 430,000)

Capital Gain $554,000 $ 570,000

Inclusion Rate 1/2 1/2

Taxable Capital Gain $277,000 $ 285,000

***2022 Solution***

At the end of 2022, the amounts not receivable until after the end of the year are $483,450 ($879,000 - $395,550) for Tract 1 and $900,000 ($1,000,000 - $100,000) for Tract 2.

The minimum taxable capital gain to be included in Erin's income for 2022 would be calculated as follows:

**Tract 1 Tract 2**

Total Capital Gain $554,000 $570,000

Maximum Capital Gains Reserve for 2022:

Tract 1 - Lesser of:

[($554,000)($483,450 ÷ $879,000)] = **$304,700**

[($554,000)(20%)(4)] = $443,200 ( 304,700)

Tract 2 - Lesser of:

[($570,000)($900,000 ÷ $1,000,000)] = $513,000

[($570,000)(20%)(4)] = **$456,000** ( 456,000)

Subtotal $249,300 $114,000

Inclusion Rate 1/2 1/2

2022 Taxable Capital Gains $124,650 $ 57,000

In addition to the taxable capital gains, Erin would have to include the following amounts of interest income:

Tract 1 [(6%)($483,450)] $29,007

Tract 2 [(6%)($900,000)] 54,000

2022 Interest income $83,007

The additional amounts required to be included in Erin's 2022 income is as follows:

Tract 1 Taxable Capital Gain $124,650

Tract 2 Taxable Capital Gain 57,000

Interest Income 83,007

Total additional income for 2022 $264,657

***2023 Solution***

At the end of 2023, the proceeds that are not receivable until after the end of the year are unchanged at $483,450 for Tract 1 and $600,000 ($900,000 - $300,000) for Tract 2. Given this, the minimum taxable capital gains for 2023 can be calculated as follows:

**Tract 1 Tract 2**

2022 Capital Gains Reserve $304,700 $456,000

2023 Capital Gains Reserve:

Tract A - Lesser of:

[($554,000)($483,450 ÷ $879,000)] = **$304,700**

[($554,000)(20%)(3)] = $332,400 ( 304,700)

Tract 2 - Lesser of:

[($570,000)($600,000 ÷ $1,000,000)] = **$342,000**

[($570,000)(20%)(3)] = $342,000 ( 342,000)

Subtotal Nil $114,000

Inclusion Rate N/A 1/2

2023 Taxable Capital Gains Nil $ 57,000

In addition to the taxable capital gain, Erin would have to include the following amounts of interest income:

Tract 1 [(6%)($483,450)] $29,007

Tract 2 [(6%)($900,000)] 54,000

2023 Interest Income $83,007

The additional amounts required to be included in Erin's 2023 income is as follows:

Tract 1 Taxable Capital Gain $ Nil

Tract 2 Taxable Capital Gain 57,000

Interest income 83,007

Total additional income for 2023 $140,007

***2024 Solution***

At the end of 2024, the proceeds not receivable until after the end of the year is unchanged at $483,450 for Tract 1 and $300,000 ($600,000 - $300,000) for Tract 2. Given this, the minimum taxable capital gains for 2024 can be calculated as follows:

**Tract 1 Tract 2**

2023 Capital Gains Reserve $304,700 $342,000

2024 Capital Gains Reserve:

Tract A - Lesser of:

[($554,000)($483,450 ÷ $879,000)] = $304,700

[($554,000)(20%)(2)] = **$221,600** ( 221,600)

Tract 2 - Lesser of:

[($570,000)($300,000 ÷ $1,000,000)] = **$171,000**

[($570,000)(20%)(2)] = $228,000 ( 171,000)

Subtotal $ 83,100 $171,000

Inclusion Rate 1/2 1/2

2024 Taxable Capital Gains $ 41,550 $ 85,500

In addition to the taxable capital gain, Erin would also have to include the following amounts of interest income:

Tract 1 [(6%)($483,450)] $29,007

Tract 2 [(6%)($600,000)] 36,000

Total Interest Income $65,007

The total amount to be included in Erin's 2024 income would be calculated as follows:

Tract 1 Taxable Capital Gain $ 41,550

Tract 2 Taxable Capital Gain 85,500

Interest Income 65,007

Total additional income for 2024 $192,057

***2025 Solution***

At the end of 2025, the proceeds not receivable until after the end of the year for both Tract 1 and Tract 2 are nil. Given this, the minimum taxable capital gains for 2025 can be calculated as follows:

**Tract 1 Tract 2**

2024 Capital Gains Reserve $221,600 $171,000

2025 Capital Gains Reserve:

Tract A - Lesser of:

[($554,000)(Nil ÷ $879,000)] = **Nil**

[($554,000)(20%)(1)] = $110,800 Nil

Tract 2 - Lesser of:

[($570,000)(Nil ÷ $1,000,000)] = **Nil**

[($570,000)(20%)(1)] = $114,000 Nil

Subtotal $221,600 $171,000

Inclusion Rate 1/2 1/2

2025 Taxable Capital Gains $110,800 $ 85,500

In addition to the taxable capital gains, Erin would have to recognize the following amounts of interest income:

Tract 1 [(6%)($483,450)] $29,007

Tract 2 [(6%)($300,000)] 18,000

Total Interest Income $47,007

The total amount to be included in Erin's 2025 income would be calculated as follows:

Tract 1 Taxable Capital Gain $110,800

Tract 2 Taxable Capital Gain 85,500

Interest Income 47,007

Total additional income for 2025 $243,307

***Verification***

As calculated at the beginning of this solution, the taxable capital gain on Tract 1 should total $277,000, while the taxable capital gain on Tract 2 should be $285,000. That the use of reserves has produced the same total amount can be verified as follows:

**Year Tract 1 Tract 2**

2022 $124,650 $ 57,000

2023 Nil 57,000

2024 41,550 85,500

2025 110,800 85,500

Total Gain $277,000 $285,000

Type: ES

Topic: Capital gains reserve

107) Ms. Annalisa Philson has been married to Spiro Philson for over 10 years. While Annalisa is 62, her husband is 75 and has been in poor health for a number of years. They live in a home in Ottawa which Annalisa had just purchased in 2011 for $628,000 prior to the marriage to Spiro. In 2014, Annalisa purchased a condo in downtown Calgary for $325,000. In every year since its purchase, she has spent considerable time with Arnold in this property.

Annalisa has decided to sell both properties in 2022. She has spent time in each property during every year of ownership and therefore both properties can be designated as her principal residence for any given year of ownership.

Both properties are sold in 2022, with the Ottawa home sold for $724,000 and the Calgary condo selling for $415,000. The real estate commission on each sale are 4% of the sales price.

**Required:** Describe how the residences should be designated to minimize income tax. In addition, calculate the total amount of the gain based on the designation that you have recommended.

Answer: The gains on the two properties can be calculated as follows:

**Calgary**

**Ottawa Home Condominium**

POD $724,000 $415,000

ACB ( 628,000) ( 325,000)

Real Estate Commissions

[(4%)($724,000)] ( 28,960)

[(4%)($415,000)] ( 16,600)

Capital Gain $ 67,040 $ 73,400

As the period of ownership differs for the two properties, it is necessary to calculate the annual amount of the capital gain:

Ottawa Home: $67,040 ÷ 12 = $5,587

Calgary Condominium: $73,400 ÷ 9 = $8,156

As the annual gain is significantly larger on the Calgary condominium and its ownership period is shorter than that of the Ottawa home, this gain should be completely eliminated. Because of the plus 1 in the exemption formula, this can be accomplished by designating the property as her principal residence for the 8 years 2015 through 2022. This leaves the 4 years 2011 through 2014 for designation of the Ottawa home as her principal residence.

The required calculations would be as follows:

**Calgary**

**Ottawa Home Condominium**

Total Capital Gain $67,040 $73,400

Exemption:

Ottawa Home

[$67,040][(4 + 1) ÷ 12] ( 27,933)

Condominium

[$73,400][(8 + 1) ÷ 9] ( 73,400)

Capital Gain $39,107 Nil

Inclusion Rate 1/2 N/A

Taxable Capital Gain $19,554 Nil

This gives a total taxable capital gain on the two properties of $19,554.

Type: ES

Topic: Principal residence - general rules

108) Due to financial difficulties resulting from unfortunate business decisions, Mr. Bo Godina has been forced to sell a number of items.

• An A. Y. Jackson oil painting which he acquired for $140,000 is sold at auction for $180,000, with the auction house claiming a 20% commission on the sale price.

• An antique armoire that he acquired for $850 is sold privately for $1,300. No selling costs were incurred.

• A vintage Chris Craft boat which he acquired several years ago for $85,000 is sold for $61,000 with no related selling costs.

• As a life long admirer of George Bernard Shaw, he had acquired a first edition of the play Pygmalion for $22,000. Since his purchase, the works of Shaw have become less popular and the sale of this manuscript nets Mr. Godina only $4,200.

• An extensive stamp collection is sold for $16,000. The cost of all of the stamps totalled $12,500. No selling costs were involved.

• Mr. Godina's father left him a vintage automobile in his will several years ago. Mr. Godina's father had purchased it for $23,000 and spent an additional $17,000 restoring the vehicle. The estimated value of the automobile was $60,000 when Mr. Godina received it and he sells it for $110,000, with no related selling costs.

**Required:** Mr. Godina has asked you to determine the minimum amount that would be included in his income for the current year as a result of these dispositions. Indicate any amounts that are available for carry over to other years.

Answer:

***Classification of Property***

All of the items sold are personal use property. However, any such property that meets the definition of "listed personal property" will receive preferential treatment. Under ITA 54, the following items are listed personal property:

(i) print, etching, drawing, painting, sculpture, or other similar work of art,

(ii) jewellery,

(iii) rare folio, rare manuscript, or rare book,

(iv) stamp, or

(v) coin.

***Personal Use Property (Armoire, Boat and Automobile)***

While gains on the disposition of personal use property are required to be included in income, losses cannot be claimed. As a result the loss on sale of the boat would have no effect on Mr. Godina's net income. However, the gains on both the armoire and the automobile would be required to be included in income. The capital gains, taking into consideration the $1,000 rule, would be calculated as follows:

**Automobile Armoire**

POD $110,000 $1,300

ACB - Automobile (Note 1) ( 60,000)

ACB - Armoire - Greater of:

• Cost = $850

• $1,000 Floor ( 1,000)

Capital Gain $50,000 $ 300

**Note 1** - The ACB of the automobile would be equal to its FMV at the time it was received from his father's estate.

***Listed Personal Property (Painting, First Edition, and Stamp Collection)***

The calculations here are as follows:

**Stamp**

**Painting First Edition Collection**

POD $180,000 $ 4,200 $16,000

ACB ( 140,000) ( 22,000) ( 12,500)

Selling Costs - Painting

[(20%)($180,000)] ( 36,000)

Capital Gain (Loss) $ 4,000 ($17,800) $ 3,500

***Summary***

The total addition to net income would be as follows:

**Personal Use Property**

Gain on Automobile $50,000

Gain on Armoire 300

Loss on Boat N/A $50,300

**Listed Personal Property**

Gain on Painting $ 4,000

Gain on Stamp Collection 3,500

Total Gain on Listed Personal Property $ 7,500

Loss on Manuscript (Note 2) ( 7,500) Nil

Net Capital Gains $50,300

Inclusion Rate 1/2

Addition to net income $25,150

**Note 2** - The total loss on the first edition is $17,800. However, it can only be claimed to the extent of the gains on other listed personal property dispositions. The remaining loss of $10,300 ($17,800 - $4,000 - $3,500) can be carried over to other years specifically to be carried back 3 years and forward for 7 years to be claimed only against gains on listed personal property in those years.

Type: ES

Topic: Personal use property - general rules

109) Richie Desjardins is a resident of Canada. On September 4, 2018, he receives an inheritance of $200,000 U.S. dollars (US$, hereafter) from an uncle who was a U.S. resident. The funds are immediately transferred into his brokerage account and used to purchase 4,500 shares of Facehow Industries, a tech company that is traded on the New York Stock Exchange. The shares are acquired at US$43 per share, a total investment of US$193,500. The remaining US$6,500 is left in the brokerage account.

The shares pay an annual dividend of US$2.05 per share. Richie receives the dividends of US$9,225 [(4,500)(US$2.05)] on the following dates:

June 1, 2019

June 1, 2020

June 1, 2021

All of these funds are left in his brokerage account and his account does not earn interest. On July 13, 2021, all of the Facehow shares are sold for US$35 per share, a total of US$157,500. The US$157,500 balance is left in the brokerage account until January 31, 2022, at which time they are converted, along with the unused US$6,500 balance and the accumulated dividends, into Canadian dollars (C$, hereafter). He withdraws all the funds in his brokerage account on June 6, 2022 in order to purchase a house.

Assume relevant exchange rates between the Canadian dollar and the U.S. dollar are as follows:

September 4, 2018 US$1.00 = C$0.98

June 1, 2019 US$1.00 = C$1.03

June 1, 2020 US$1.00 = C$1.09

June 1, 2021 US$1.00 = C$1.26

July 13, 2021 US$1.00 = C$1.28

January 31, 2022 US$1.00 = C$1.35

June 6, 2022 US$1.00 = C$1.40

**Required:** Calculate the minimum amount that will be required to be included in Mr. Desjardins' net income for each of the years 2018 through 2022.

Answer:

***2018 Result***

Neither the receipt of the inheritance nor the purchase of shares create any additions to income. Note, however, that the ACB of the shares is:

[(4,500)(US$43)(C$0.98)] C$189,630

The ACB of the funds remaining in the account would be calculated as follows:

[(US$6,500)(C$0.98)] C$6,370

***2019 Result***

The receipt of the dividends will result in the following addition to Richie's 2019 net income:

[(4,500)(US$2.05)(C$1.03)] C$9,501.75

***2020 Results***

The receipt of the dividends will result in the following addition to Richie's 2020 net income:

[(4,500)(US$2.05)(C$1.09)] C$10,055.25

***2021 Results***

The receipt of the dividends will result in the following addition to Richie's 2021 net income:

[(4,500)(US$2.05)(C$1.26)] C$11,623.50

In addition to the dividends, there will be a taxable capital gain resulting from the sale of the

shares:

POD

[(4,500)(US$35)] = US$157,500 @ $1.28 C$201,600

ACB

[(4,500)(US$43)] = US$193,500 @ $0.98 (C$189,630)

Gain (Loss) C$ 11,970

Inclusion Rate 1/2

Taxable Capital Gain C$ 5,985

This results in a total addition to Richie's net income of C$17,608.50

(C$11,623.50 + C$5,985.00)

***2022 Results***

At this point, Richie's brokerage account contains cash of US$191,675 [US$6,500 + (3@US$9,225) + US$157,500). There will be a capital gain on the conversion of this amount to Canadian dollars calculated as follows:

POD Converted Dollars [(US$191,675)(C$1.35)] C$258,761.25

ACB:

[(US$6,500)(C$0.98)] (C$ 6,370.00)

[(4,500)(US$2.05)(C$1.03)] ( 9,501.75)

[(4,500)(US$2.05)(C$1.09)] ( 10,055.25)

[(4,500)(US$2.05)(C$1.26)] ( 11,623.50)

[(4,500)(US$35)(C$1.28)] ( 201,600.00) ( 239,150.50)

Capital Gain C$ 19,611

ITA 39(1.1) Reduction of Capital Gain ( 200)

Net Capital Gain C$ 19,411

Inclusion Rate 1/2

Taxable Capital Gain C$ 9,705.50

Because Richie is an individual, the ITA 39(1.1) deduction of $200 reduces the capital gain on the foreign exchange conversion.

Type: ES

Topic: Capital gains - foreign securities & foreign exchange

110) Each of the following Cases contains a brief description of an actual court case involving the identification of capital gains. For each Case, indicate whether you believe that the transaction should have generated a capital gain or business income. Explain the basis for your conclusion.

**Case A -** An individual constructed an apartment building and operated it as a rental property for a period of three years. At that time, as the result of an unsolicited offer, the individual decided to sell the building. The decision was also influenced by the fact that there were unexpected difficulties in operating the building. The proceeds of the sale exceeded the cost of the building. (73 DTC 5060)

**Case B -** An operator of a taxicab business decided to sell the business as it had proved to be unprofitable. He was not able to obtain a favourable price for the business as a whole and, as a consequence, he decided to sell the cars separately. During the subsequent two year period, he engaged in over 40 transactions involving the cars, largely because some worn out cabs had to be replaced and trade-ins were accepted from some buyers. A gain/profit was made on most transactions. (57 DTC 144)

**Case C -** A individual carried on a full time interior design business as a sole proprietor. While carrying on the business the individual bought, lived in for short periods of time, and resold numerous residential properties. In most cases, improvements were made and the property modernized prior to resale. The sales prices were usually well in excess of costs. (64 DTC 56)

**Case D -** An optical business purchased the assets of an optical company whose shares were owned by a group of medical doctors. The sale was accompanied by an agreement to pay each doctor a "kickback" for every prescription filled. A provincial statute eventually made these payments illegal, at which point the doctors sold their shares to the optical business. Even though each doctor sold one share, the payments to them varied from $1,800 to $57,000. The payments were to be made over a period of ten years and the agreement required the doctors to continue sending patients to the optical company. The amounts paid to the doctors were proportional to the size of their practices. (57 DTC 48)

**Case E -** The manager of a company that operated vans designed for the transportation of horses engaged in several transactions involving the purchase and sale of racehorses. He attended race tracks on a regular basis and kept numerous horses for his own personal enjoyment. On most of the purchase and sale transactions, the proceeds of the sale exceeded the cost of the horse. (67 DTC 240)

Answer:

***Case A***

In this Case, the Federal Court Trial Division decided that the profit on the sale of the apartment building was a capital gain. They based their decision largely on the fact that it appeared that the Intent of the taxpayer was to operate the apartment building as an income producing property. In other words the rental property was capital property and not inventory.

***Case B***

In this Case, the Minister of National Revenue argued that because of the frequency of transactions, the taxpayer was in the business of buying and selling cars and, as a consequence, profits on the sale of cars should be treated as business income. However, the taxpayer was successful in refuting the Minister's view by arguing that the nature of the transaction was such that the cars should be viewed as capital property and any resulting gains were capital gains and not business profits. The distinction is important given that in years prior to 1972 capital gains were not taxable at all. This case demonstrates that the nature of the activity is critical. While the tax authorities perceived the formation of a new business of buying and selling cars the court viewed the activity as a method to sell the business. In that case the cars remained capital property. This case the danger of relying on IT bulletins that refer to multiple criteria such as the frequency of transactions and other such criteria to label the nature of a transaction.

***Case C***

The gains on the various sales of residential property were considered to be income from a business. The nature of the activity with respect to the purchase of residential properties supported a contention that the properties represented inventory of a business given the level of activity. Gains were therefore considered profits from a business and not capital gains.

***Case D***

The Tax Appeals Board (TAB) concluded that the amounts paid represented business income rather than capital gains. The character of the payments were such that had the amounts been received directly the amounts would have been income from the professional business of each doctor. The TAB indicated that the transaction was no more than an ingeniously contrived scheme to pay sums of money for another ten years in return for the right to fill the doctors' prescriptions.

***Case E***

The profits on trading in racehorses were considered business income given the level of activity involved in the purchase and sale.

Type: ES

Topic: Capital gains vs business income (mini cases)

111) Darin Roberts has carried on a consulting business as a sole proprietor out of rented space since 2016. On January 1, 2020, he acquires a property in a suburban location for $1,350,000. The building has 10,000 feet of floor space, and in the year ending December 31, 2020, he uses 2,000 square feet of this space as his principal residence, with the remaining 8,000 square feet used for the business.

In 2020, his total dedication to work results in significant business growth. Because of this, on January 1, 2021, he converts 1,000 of the square feet that was being used as his personal residence to business use. This results in 9,000 square feet being used for his business and only 1,000 square feet being used as his residence.

Because the business continues to grow, he opens a second location in rented space and hires a business manager. With the availability of space in this new location, he no longer needs as much space in the building that he owns. On January 1, 2022, reflecting this change in his operations, he expands his residential use of the building to 5,000 square feet, leaving the remaining 5,000 square feet for business use.

Information on the estimated values associated with the building and the land on which it is situated on January 1, 2020, 2021, and 2022 is as follows:

**Land Building**

January 1, 2020 $350,000 $1,000,000

January 1, 2021 375,000 1,150,000

January 1, 2022 390,000 1,300,000

**Required:** Determine the maximum CCA that can be claimed by Darin in 2020, 2021, and 2022. In addition, ignoring the principal residence exemption, indicate any other income tax consequences that will result from the changes in use of the property.

Answer:

***2020 Results***

In 2020, 80% (8,000 ÷ 10,000) of the property is used for income earning purposes. Based on this, the maximum CCA for this year is calculated as follows:

Capital Cost [(80%)($1,000,000)] $800,000

AccII Adjustment [(50%)($800,000)] 400,000

CCA Base $1,200,000

Maximum CCA [(4%)($1,200,000)] ( 48,000)

AccII Reversal ( 400,000)

UCC - January 1, 2021 $752,000

The maximum CCA is $48,000. There are no additional income tax consequences during this year. The 6% CCA rate was not available since 90% or more of the building was not used for non-manufacturing business purposes.

***2021 Results - Personal Use to Business Use***

On January 1, 2021, there would be a deemed disposition/acquisition of 10% (1,000 ÷ 10,000) of the total property. This would result in a taxable capital gain on the land calculated as follows:

POD [(10%)($375,000)] $37,500

ACB [(10%)($350,000)] ( 35,000)

Capital Gain $ 2,500

Inclusion Rate 1/2

Taxable Capital Gain on Land $ 1,250

There would also be a taxable capital gain on the building, calculated as follows:

POD [(10%)($1,150,000)] $115,000

ACB [(10%)($1,000,000)] ( 100,000)

Capital Gain $ 15,000

Inclusion Rate 1/2

Taxable Capital Gain on Building $ 7,500

The maximum CCA for 2021 would be calculated as follows:

January 1, 2021 UCC $752,000

Add Deemed Cost of 10% of property

Cost [(10%)($1,000,000)] $100,000

Bump Up [(1/2)(10%)($1,150,000 - $1,000,000)] 7,500 107,500

AccII [(50%)($107,500)] 53,750

CCA Base $913,250

Maximum CCA [(4%)($913,250)] ( 36,530)

AccII Reversal ( 53,750)

January 1, 2022 UCC $822,970

As the change in use is from personal to business, for CCA and recapture purposes, the bump up is limited to one-half of 10 % of the excess of the FMV of the building over its capital cost.

The AccII provisions apply as reflected by the amendments made in June of 2021. Specifically since no CCA was previously claimed by anyone in a previous taxation year with respect to the personal use space the AccII would apply as a result.

The total taxable capital gain for the year is $8,750 ($1,250 + $7,500). The maximum CCA is $36,530.

***2022 Results - Business to Personal Use***

On January 1, 2022, there would be a deemed disposition/acquisition of 40% (4,000 ÷ 10,000) of the total business use of the property. This would result in a taxable capital gain on the land, calculated as follows:

POD [(40%)($390,000)] $156,000

ACB (See Note) ( 141,111)

Capital Gain $ 14,889

Inclusion Rate 1/2

Taxable Capital Gain on Land $ 7,445

**Note:** The ACB of the business portion of the property is as follows:

[(80%)($350,000)] ($280,000)

[(10%)($375,000)] ( 37,500)

Total for 90% ($317,500)

The ACB of the business portion disposed of would be $141,111 (40%/90%)($317,500)]

There would also be a taxable capital gain on the building, calculated as follows:

POD [(40%)($1,300,000)] $520,000

ACB:

[(80%)($1,000,000)] ($800,000)

[(10%)($1,150,000)] (Not Limited) ( 115,000)

Total for 90% ($915,000)

Portion Disposed 40%/90% ( 406,667)

Capital Gain $113,333

Inclusion Rate 1/2

Taxable Capital Gain $ 56,667

The maximum CCA for the year would be calculated as follows:

January 1, 2022 UCC $822,970

Disposition - Lesser of:

POD [(40%)($1,300,000)] = $520,000

Capital Cost (See Note) ( 403,333)

CCA Base $419,637

Maximum CCA [(4%)($419,637)] ( 16,785)

January 1, 2023 UCC $402,852

**Note:** The ACB for capital gains purposes of the 10% share acquired in 2021 was $115,000 [(10%)($1,150,000)]. However, for UCC and CCA purposes, the amount is limited to $107,500 [$100,000 + (1/2)($115,000 - $100,000). This gives a total capital cost for 90% of the property of $907,500 ($800,000 + $107,500). The resulting capital cost for the 40% portion disposed of is $403,333 (40%/90%)($907,500)].

The total taxable capital gain for the year is $64,112 ($7,445 + $56,667). The maximum CCA is $16,785.

**Note To Instructors**

We have asked students to ignore the principal residence exemption as the focus of the problem is on the change in use. As CCA was claimed in 2020 on the part of the building that was used for business purposes, Darin would not be able to claim the principal residence exemption on the portion of the building that was changed from personal to business use in 2021.

Type: ES

Topic: Change in use - depreciable property

112) Elly Councill is 57 years old, was born in Canada and has always been a resident of Canada. Having become fed up with Halifax winters, she decides to move to California. Ms. Councill has come to you for advice prior to leaving Canada for good and becoming a non-resident.

She will sever her Canadian residency on December 31, 2022. At that time she owns the following properties which are all located in Canada:

**ACB FMV**

Oil Painting $ 33,000 $ 38,000

Coin Collection 11,000 4,000

Shares in Enbridge (A Canadian Public Company) 42,000 68,000

Shares in Veresan (A Canadian Public Company) 63,000 52,000

Vacant Land 87,000 108,000

Principal Residence 220,000 342,000

Power Boat (Recreational use only) 72,000 56,000

Shares in Councill Ltd. (A CCPC) 16,000 48,000

Assume she will make no special elections in connection with the departure/emigration from Canada.

**Required**: Determine the amount of any taxable capital gains or allowable capital losses that Ms. Councill will have for 2022 as a result of her emigration from Canada.

Answer: Ms. Councill's taxable capital gain on deemed dispositions resulting from her departure from Canada would be calculated as follows:

Listed Personal Property:

Oil Painting ($38,000 - $33,000) $ 5,000

Coin Collection (Note 1) ( 5,000) Nil

Enbridge Shares ($68,000 - $42,000) $26,000

Veresan Shares ($52,000 - $63,000) ( 11,000)

Vacant Land (Note 2) N/A

Personal Residence (Note 2) N/A

Power Boat (Note 3) N/A

Councill Ltd. Shares 32,000

Total Net Capital Gain $47,000

Inclusion Rate 1/2

2022 Net Taxable Capital Gain on Emigration $23,500

**Note 1 -** Both the oil painting and the coin collection are listed personal property. While there is a $7,000 ($11,000 - $4,000) loss on the coin collection, it can only be deducted to the extent of the $5,000 gain on the oil painting. However, the remaining $2,000 ($7,000 - $5,000) can be carried back 3 years to be applied against any gains on listed personal property that occurred in those years. Although it can also be carried forward for up to 7 years, it is unlikely that Ms. Councill will have listed personal property in Canada once she becomes a non-resident.

**Note 2 -** Real property is exempted from the ITA 128.1(4)(b) deemed disposition requirement. However, as it is taxable Canadian property, a later sale of either the vacant land or the principal residence will potentially attract income tax in Canada. She might wish to elect to have a disposition of the residence to take advantage of the principal residence exemption.

**Note 3 -** Losses on personal use property are not deductible.

Type: ES

Topic: Departure from Canada - general rules

113) For many years, Kargo Inc. has carried on business out of a building in Vancouver. The major properties of this publicly traded Company are as follows:

**Land and Building —** The building was constructed for the Company at a total cost of $3,100,000. It is the only property in Class 1. The January 1, 2022 UCC balance in this Class is $1,286,690. The building is situated on land that the Company acquired at a cost of $430,000.

**Equipment —** All of the Company's equipment falls into Class 8. It has a capital cost of $670,000. The January 1, 2022 balance in Class 8 is $285,371.

The Company has become aware that, because of the real estate boom in Vancouver, their property has become very valuable. Further, because of the high cost of housing in the area, it has become almost impossible to attract new employees. Given this, they have decided to relocate.

They begin the process by selling their Vancouver properties and temporarily suspending business. The total proceeds for the land and building are $4,800,000, with $1,500,000 of this total reflecting the value of the land and $3,300,000 for the building. The equipment is sold for $523,000.

After more investigation than they had anticipated, they finally conclude that Vernon, British Columbia would be an attractive and cost efficient location. In March, 2023, they acquire a property in that city for $4,300,000. Based on estimates, $3,500,000 is for the building and $800,000 for the land. As it is not a new building, it does not qualify for the enhanced Class 1 CCA rate of either 6% or 10%.

The Class 8 equipment is replaced at a cost of $723,000.

The Company uses a calendar based taxation year ending on December 31. At the end of its 2022 taxation year the company does not own any buildings or equipment as the building Kargo ultimately purchased was not available for use on that date. The Company would like to minimize any capital gains or recapture resulting from the sale of the Vancouver property.

**Required:**

A. For the disposition of each property, indicate the income tax consequences for the 2022 taxation year.

B. Indicate the effect of replacement property elections available under ITA 44(1) (to defer capital gains) and ITA 13(4) (to defer recapture), but without the use of the election under ITA 44(6) (to reallocate the POD). Also indicate the ACB and, where appropriate, the UCC of the replacement properties, subsequent to the application of the ITA 44(1) and ITA 13(4) elections.

C. Indicate the maximum amount of any reduction in income for the 2022 taxation year from the use of the ITA 44(6) election and calculate the UCC balance that would result from electing to use this amount. Should the Company make the election? Explain your conclusion.

Answer:

***Part A***

The 2022 income tax consequences would be as follows:

**Land —** The Company would have a taxable capital gain on the Land calculated as follows:

POD $1,500,000

ACB ( 430,000)

Capital Gain $1,070,000

Inclusion Rate 1/2

Taxable Capital Gain $ 535,000

**Building —** The Company would have a taxable capital gain and recapture calculated as follows:

POD $3,300,000

ACB ( 3,100,000)

Capital Gain $ 200,000

Inclusion Rate 1/2

Taxable Capital Gain $ 100,000

Opening UCC $1,286,690

Deduct Disposition - Lesser of:

Capital Cost = $3,100,000

POD = $3,300,000 ( 3,100,000)

Negative Closing UCC Balance = Recapture ($1,813,310)

Recapture 1,813,310

UCC - January 1, 2023 Nil

**Equipment —** The Company would have recapture calculated as follows:

Opening UCC $285,371

Deduct Disposition - Lesser of:

Capital Cost = $670,000

POD = $523,000 ( 523,000)

Negative Closing UCC Balance = Recapture ($237,629)

Recapture 237,629

UCC - January 1, 2023 Nil

Part B

Land With respect to the Land, the capital gain resulting from the use of the ITA 44(1) election would be the lesser of:

• $1,070,000 (regular capital gain); and

• $700,000 (the excess of the $1,500,000 POD for the replaced land over the $800,000 cost of the new replacement land).

The revised taxable capital gain would be $350,000 [(1/2)($700,000)] and would be included in net income for 2022 replacing the original taxable capital gain of $535,000 [(1/2)($1,070,000)].

If the ITA 44(1) election is filed in 2023, the deemed ACB of the replacement land would be calculated as follows:

Actual Cost $800,000

Capital Gain Reversed by election ($1,070,000 - $700,000) ( 370,000)

Deemed ACB of Replacement Land $430,000

**Building —** If the ITA 44(1) election is filed in 2023, the revised 2022 capital gain would be nil, the lesser of:

• $200,000 (regular capital gain); and

• Nil (reflecting the fact that there was no excess of the $3,300,000 POD for the old replaced building over the $3,500,000 cost of the replacement building).

Using this election will reduce the deemed capital cost for the building as follows:

Actual Cost $3,500,000

Capital Gain Reversed by election ( 200,000)

Deemed Capital Cost of Replacement Building $3,300,000

If the ITA 13(4) election is filed in 2023, the revised 2022 recapture would be calculated as follows:

January 1, 2022 UCC Balance $1,286,690

Deduction:

Lesser of:

• POD = $3,300,000

• Capital Cost = $3,100,000 ($3,100,000)

Reduced by the lesser of:

• Normal Recapture = $1,813,310

• Replacement Cost = $3,500,000 1,813,310 (1,286,690)

2022 Recapture (Reassessed) Nil

If both elections are filed in 2023, the UCC of the replacement building is calculated as follows:

Deemed Capital Cost $3,300,000

Recapture Reversed by the election ( 1,813,310)

UCC - Replacement Building $1,486,690

Note that the $1,486,690 UCC for the new building is equal to the UCC of the old building ($1,286,690), plus the additional cost of $200,000 ($3,500,000 - $3,300,000).

**Equipment —** As this is a voluntary disposition, the ITA 13(4) and 44(1) elections can only be used on real property (land and buildings). They cannot be used for the equipment and, as a consequence, the $237,629 in recapture cannot be changed. As the elections cannot be used, both the capital cost and the UCC of the new equipment will be $723,000.

***Part C***

**The Election —** The ITA 44(6) election applies when there is a disposition involving a combination of land and building. If, for either of the land or building, the POD exceed the ACB, the election allows the transfer of all or part of that excess to be applied to the other property.

This can provide some additional relief when ITA 44(1) and ITA 13(4) fail to eliminate all of the capital gains arising on one part of the disposition of the old property. ITA 44(1) fully eliminated the capital gain on the building. However, a $700,000 capital gain remained on the land. This would suggest that it could be advantageous to transfer some of the POD from the land to the building.

The excess of the POD of the old land over the cost of the replacement land was $700,000 ($1,500,000 - $800,000). This is the amount that would be required to eliminate the capital gain on the land. However, the excess of the cost of the replacement building over the old building's proceeds of disposition is only $200,000 ($3,500,000 - $3,300,000). If a transfer in excess of this amount is made, any reduction in the capital gain on the land will be matched by an increased capital gain on the building.

Applying ITA 44(6) in an optimal manner will result in the following adjusted POD:

**Land Building**

Actual POD $1,500,000 $3,300,000

POD Transfer Land to Building ( 200,000) 200,000

Adjusted POD $1,300,000 $3,500,000

**Application to the Land —** If both ITA 44(1) and ITA 44(6) are applied, the resulting capital gain on the land will be calculated as the lesser of:

• $870,000 ($1,300,000 - $430,000); and

• $500,000 (the excess of the $1,300,000 adjusted POD for the replaced land over the $800,000 cost of the replacement land).

This is a reduction of $200,000 ($700,000 - $500,000) from the amount that was calculated when only ITA 44(1) was applied. However, the ACB of the land would be unchanged by the use of ITA 44(6):

Actual Cost $800,000

Capital Gain Reversed by election ($870,000 - $500,000) ( 370,000)

Deemed ACB of the Replacement Land $430,000

**Application to the Building —** With the POD transfer limited to $200,000, the capital gain on the building remains nil. Specifically, the gain will be the lesser of:

• $400,000 ($3,500,000 - $3,100,000); and

• Nil (reflecting the fact that there was no excess of the $3,500,000 adjusted POD for the replaced building over the $3,500,000 cost of the replacement building).

However, the capital cost and UCC of the building will be reduced by the application of ITA 44(6):

Actual Cost $3,500,000

Capital Gain Reversed by the Elections ( 400,000)

Deemed Capital Cost $3,100,000

Recapture Reversed by election ( 1,813,310)

UCC - Replacement Building $1,286,690

The UCC of the replacement building is now equal to the UCC of the old building.

**Comparison —** The table which follows compares the results of using only ITA 44(1) and ITA 13(4) with the results that arise when the ITA 44(6) election is also used.

**No ITA 44(6) With ITA 44(6)**

Capital Gains

Land $700,000 $500,000

Building Nil Nil

Replacement Property

ACB of Land $ 430,000 $ 430,000

Capital Cost of Building 3,300,000 3,100,000

UCC 1,486,690 1,286,690

As you can see in the table, the use of ITA 44(6) has reduced the capital gain on the land by $200,000. However, it has done so at the cost of reducing the capital cost and UCC of the replacement building. There is an income tax cost associated with this trade off in that only one-half of the capital gain would have been included in income in the current year, whereas the future CCA that has been lost of $200,000 would have been fully deductible.

Type: ES

Topic: Voluntary dispositions - with ITA 44(6) election

114) Kontex Ltd. is a Canadian public company with a December 31 taxation year end. The Company carries on business out of a single building that was purchased several years ago at a cost of $1,782,000 with $400,000 for the land and $1,382,000 for the building. The building is the only property in Class 1 and, on January 1, 2022, the UCC is $985,926.

On October 1, 2022, the building is completely destroyed in a fire that was started by a disgruntled former executive. While the Company could rebuild on the site of the destroyed building, it expects significant growth in the next few years and decides to purchase a larger building.

Given this, the Company sells the site for $550,000 on December 5, 2022 and begins to search for a replacement site. As it does not appear that the Company had any involvement in starting the fire, on December 1, 2022, the Company receives insurance proceeds equal to the $1,600,000 FMV of the building.

A replacement building is acquired on July 15, 2023 at a cost of $2,500,000, of which $1,700,000 is for the building and $800,000 for the land. It is a new building that will be used 100% for non-residential purposes, none of which is manufacturing. The company will elect to place the building in a separate Class 1 in order to take advantage of a higher CCA rate.

**Required:**

A. Indicate the income tax consequences of the involuntary disposition for the 2022 taxation year.

B. Indicate the revisions that will be made to the 2022 income tax consequences ae a result of filing elections under ITA 13(4) (to defer recapture) and ITA 44(1) (to defer capital gains). In addition, determine the capital cost and UCC for the replacement property as a result of the election.

C. Calculate the maximum CCA that Kontex will be able to claim for the new building in the 2023 taxation year, assuming the Company makes the elections under ITA 13(4) and ITA 44(1).

Answer:

***Part A***

The 2022 income tax consequences of the involuntary disposition would include both taxable capital gains and recapture. The amounts would be calculated as follows:

**Land Building**

POD:

Sale Price of Land $550,000

Insurance Proceeds for Building $1,600,000

ACB ( 400,000) ( 1,382,000)

Capital Gain $150,000 $ 218,000

Inclusion Rate 1/2 1/2

Taxable Capital Gain $ 75,000 $ 109,000

January 1, 2022 UCC Balance $ 985,926

Lesser of:

• Cost = $1,382,000

• POD = $1,600,000 ( 1,382,000)

December 31, 2022 UCC ($ 396,074)

Recapture 396,074

January 1, 2023 UCC Nil

For the taxation year ending December 31, 2022, no CCA can be claimed. Instead, there is $396,074 in recaptured CCA that must be included as business income.

As a result of this involuntary disposition, Kontex will have an addition to 2022 net income of $580,074 ($75,000 + $109,000 + $396,074).

***Part B***

After the land and building are replaced in the taxation year ending December 31, 2023, an election can be filed under ITA 44(1), revising amounts included in income in 2022. The capital gains will be revised to nil, the lesser of the amounts calculated in Part A and the following:

**Land Building**

POD $550,000 $1,600,000

Less: Cost of Replacement Property ( 800,000) ( 1,700,000)

Excess, if any Nil Nil

The reversed amounts will reduce the capital costs of the replacement property, resulting in the following revised cost:

**New Land New Building**

Cost $800,000 $1,700,000

Capital Gain Reversed by Election ( 150,000) ( 218,000)

Deemed Cost $650,000 $1,482,000

These amounts can also be determined or verified by taking the ACB of the replaced property of $400,000 and $1,382,000, and adding the additional amounts spent to purchase the replacement property($250,000 for the land and $100,000 for the building).

An election can also be made under ITA 13(4) to revise the recapture for 2022 to nil. The calculation would be as follows:

January 1, 2022 UCC Balance $985,926

Deduction:

Lesser of:

• POD = $1,600,000

• Capital Cost = $1,382,000 $1,382,000

Reduced by the lesser of:

• Normal Recapture = $396,074

• Replacement Cost = $1,700,000 ( 396,074) ( 985,926)

2022 Recapture (Reassessed) Nil

The UCC of the new building will be adjusted for this change as follows:

Deemed Capital Cost of Building

(See Preceding Calculation) $1,482,000

Recapture Reversed - ITA 13(4) Election ( 396,074)

UCC $1,085,926

This $1,085,926 can also be calculated as the old UCC of $985,926, plus the additional amount of $100,000 ($1,700,000 - $1,600,000) spent to purchase the replacement property in excess of the insurance proceeds.

***Part C***

The CCA claim for the 2023 taxation year would be determined as follows:

Opening UCC Balance Nil

Addition of New Building UCC $1,085,926

AccII Adjustment 542,963

CCA Base $1,628,889

Enhanced Rate for Class 1

Non-Residential Buildings 6%

CCA for 2023 $ 97,733

Type: ES

Topic: Involuntary dispositions - No ITA 44(6) election

115) On August 1, 2021, the only building owned by Wilson Ltd. is completely destroyed in a fire. The building was acquired several years ago at a cost of $890,000, of which $140,000 is for the land and $750,000 for the building. Wilson Ltd. has a June 30 taxation year end. On July 1, 2021, the UCC of the building was $599,298.

Within six months of the fire, the company receives insurance proceeds equal to $1,250,000, the FMV of the destroyed building.

As the building site is not large enough for the planned replacement, the land on which it was situated is sold for $250,000.

The replacement building is acquired on November 1, 2022 at a cost of $1,600,000, of which $300,000 is for the land and $1,300,000 for the building. It is a new building that will be used exclusively (100%) for non-residential purposes, none of which is manufacturing. The company will file the necessary election to place the building in a separate Class 1.

**Required:**

A. Indicate the income tax consequences of the involuntary disposition for the 2022 taxation year.

B. Indicate the revisions to the reported amounts for 2022 provided the Company files elections under ITA 13(4) (to defer recapture) and ITA 44(1) (to defer capital gains). In addition, determine the capital cost and UCC for the replacement property, as a result of these elections.

C. Calculate the maximum CCA that Wilson will be able to claim for the building for the taxation year ending June 30, 2023, again assuming the Company files the elections under ITA 13(4) and ITA 44(1).

Answer:

***Part A***

The 2022 income tax consequences as a result of the involuntary disposition are as follows:

**Land Building**

POD:

Sale Price of Land $250,000

Insurance Proceeds for Building $1,250,000

ACB ( 140,000) ( 750,000)

Capital Gain $110,000 $ 500,000

Inclusion Rate 1/2 1/2

Taxable Capital Gain $ 55,000 $ 250,000

July 1, 2021 UCC Balance $ 599,298

Lesser of:

• Cost = $750,000

• POD = $1,250,000 ( 750,000)

June 30, 2022 UCC ($ 150,702)

Recapture 150,702

July 1, 2022 UCC Nil

No CCA claim can be made for the 2022 taxation year since there is no property in the class on the last day of the taxation year. Instead, there is $150,702 of recapture that will be added to business income.

As a result of this involuntary disposition,Wilson will have an addition to net income in 2022 of $455,702 ($55,000 + $250,000 + $150,702).

***Part B***

When the land and building are replaced in the taxation year ending June 30, 2023, an election can be filed under ITA 44(1), and revisions processed for the 2022 taxation year. The capital gains will be revised to nil since the original POD does not exceed the replacement cost of the land and building. This is illustrated as follows:

**Land Building**

POD $250,000 $1,250,000

Less: Cost of Replacement Property ( 300,000) ( 1,300,000)

Revised Capital Gain Nil Nil

The elimination of the capital gains impacts the cost of the replacement property with the following results:

**New Land New Building**

Cost $300,000 $1,300,000

Capital Gain Reversed by Election ( 110,000) ( 500,000)

Deemed Cost $190,000 $ 800,000

These amounts can also be verified by taking the costs of the replaced property of $140,000 and $750,000, and adding the additional amounts required to replace the properties - ($50,000 for the land and $50,000 for the building).

An election can also be made under ITA 13(4) to revise the recapture for the 2022 taxation year to nil. The calculation would be as follows:

July 1, 2021 UCC Balance $599,298

Deduction:

Lesser of:

• POD = $1,250,000

• Capital Cost = $750,000 $750,000

Reduced by the lesser of:

• Normal Recapture = $150,702

• Replacement Cost = $1,300,000 ( 150,702) ( 599,298)

Recapture of 2022 CCA (Reassessed) Nil

The UCC of the new building will be adjusted for this change as follows:

Deemed Capital Cost of Building

(See Preceding Calculation) $ 800,000

Recapture Reversed - ITA 13(4) Election ( 150,702)

UCC $ 649,298

This $649,298 can be verified as the UCC of the replaced building of $599,298, plus the $50,000 ($1,300,000 - $1,250,000) in additional amounts spent in excess of the insurance proceeds.

***Part C***

The CCA claim for the taxation year ending June 30, 2023 would be calculated as follows:

Opening UCC Nil

Addition of New Building UCC $649,298

AccII One-Half Net Additions 324,649

CCA Base $973,947

Enhanced Rate for new Class 1

Non-Residential Buildings 6%

Maximum CCA for 2023 $ 58,437

Type: ES

Topic: Involuntary dispositions - No ITA 44(6) election

116) Each of the following independent Cases describes a situation with a proposed tax treatment.

1. Mr. Acker has owned a small triplex for a number of years and, throughout this period, all three of the units have been rented. In determining his income from this property, CCA has been claimed in each year with respect to all three units. In the current year, Mr. Acker has moved into one of the three units and, as a result, will be reporting rental income for only two of the three units. As he has not actually sold any of the units, he will not report any capital gains or losses during the current year.

2. Mr. Jones sold non-depreciable capital property with an ACB of $72,000 for $105,000. He is providing a warranty on the property that he estimates will cost him $6,000 to service. No service related expenses are expected until late in the second year after the year of the sale. As a consequence, he is recognizing a capital gain of $27,000.

3. Ms. Turner sold her dining room table to her daughter for $400 and a painting to her brother for $900. The sale prices were based upon the estimated FMV of both properties. Several years ago, she purchased the table for $950, and the painting for $667. She does not plan to report these dispositions since there would not be any capital gains as a result of these sales. Ms. Turner has no other income in the year and will therefore not be filing an income tax return.

4. Mrs. Brown purchased corporate bonds for $11,200, of which $800 was accrued interest and $10,400 represented the principal. The bonds were later sold for $11,600 that includes $200 for accrued interest. Mrs. Brown recognizes a taxable capital gain of $500.

5. Several years ago, Miss Lee sold three sports cars for their combined FMV of $182,000, to a corporation she had incorporated for all of the preferred shares of the company. The cars were used in a business she had carried on as a sole proprietor. During the current year, all of the cars are destroyed in a fire. Unfortunately, the cars were not insured. As the corporation had no assets other than the cars, there was no reason for her to continue to own the shares. In view of this situation, she sells the preferred shares to a friend who required a corporation for business purposes for $500. Miss Lee plans to use the resulting allowable capital loss of $90,750 [(1/2)($182,000 - $500)] to offset taxable capital gains realized from real estate transactions.

**Required:** In each of the preceding Cases, indicate whether or not you believe that the income tax treatment being proposed is the correct one. Explain your conclusion.

Answer:

1. The income tax treatment is incorrect. While Mr. Acker has not sold any of the units, a part of his building has undergone a change in use from an income earning use to a personal use. As a consequence, there will be a deemed disposition at FMV for that portion of the building that he is now occupying. Any resulting capital gain will have to be included in income for the year of the change in use. No part of any capital gain could be exempted as a result of the principal residence exemption since the property was never used for personal purposes since its acquisition. In addition no election could be filed under ITA 45(2) which requires that the property was used at one time for personal use.

2. The intended reporting is incorrect since the capital gain is reduced by the expected warranty service expenses. Since the warranty expenses are only expected late in the second year they will be treated as a capital loss at that time when incurred. The individual will have to include $16,500 in income for the current year with respect to the sale [(1/2)(POD $105,000 - ACB $72,000)].

3. While the $1,000 POD/ACB rule applies to both properties with the result that there is no capital gain or capital loss ITA 150(1.1) technically requires the filing of an income tax return when capital property is sold regardless of whether there is a capital gain or a capital loss. This reporting allows the CRA to question the amounts if they so choose at some later time.

4. The described capital gain treatment is correct.

POD ($11,600 - $200) $11,400

ACB ($11,200 - $800) ( 10,400)

Capital Gain $ 1,000

Inclusion Rate 1/2

Taxable Capital Gain $ 500

The accrued interest would also have to be included in her income.

5. The recognition of the allowable capital loss is correct.

Type: ES

Topic: Capital gains - short cases

117) **Family Information**

Owen Winehouse is 51 years old and has been married to Arlene Winehouse for over 25 years. Having made his fortune through a wildly successful initial public offering, he devotes most of his time to mentoring young entrepreneurs and participating in volunteer activities. Arlene is also very active in various charitable causes. For the 2022 taxation year, her net and taxable income is $7,650.

Owen and Arlene have two daughters:

**Martha** is 14 years old and is in good health. She has net income from part time summer jobs of $5,620.

**Marlene** is 19 years old. She is in good health and attends university on a full time basis for 9 months of the year. Owen pays all of her costs including tuition of $11,400, textbook costs of $1,600, and residence fees of $10,400. Marlene has no income of her own. Given this, she has agreed to transfer the maximum tuition credit to her father.

Owen's father, Philip lives with the family. He is 73 years old and in good health. His net income for 2022 is $17,300.

**Other Information**

Other information relevant to Owen for 2022 is the following:

1. Owen received eligible dividends from Canadian public companies in the amount of $42,400.

2. For several years Owen has owned shares of an eligible small business corporation (ESBC). The ACB of the shares is $520,000. On January 4, 2022, the shares are sold for $600,000. Assume that none of the gain is eligible for the capital gains deduction. Owen uses $500,000 of the proceeds to immediately invest in another ESBC. The new ESBC paid non-eligible dividends of $22,000.

3. The residence occupied by Owen and Arlene was purchased in 2007 for $320,000. As their space needs have grown considerably, particularly since Philip has moved in, they have decided to look for a bigger place. The residence is sold in February, 2022 for $375,000. Selling costs, including real estate commissions, total $20,000. Their new residence, purchased at the beginning of 2022, cost $458,000.

4. Owen purchased a cottage for the family's use in 2012 for $215,000, of which $65,000 reflects the cost of the land on which the cottage is situated and $150,000 for the building. The family has made some use of the cottage in every subsequent year. Anticipating spending more time in their new and larger city residence, Owen decides to convert the cottage to a rental property. On January 4, 2022, it is estimated that the FMV of the property is $235,000, of which $75,000 can be allocated to the land and $160,000 to the building. As Owen plans to claim CCA on this property, he does not elect under ITA 45(2) to have the property continue as his principal residence. In addition, Owen spends $42,000 furnishing the cottage. All of the furnishings are Class 8 property. On March 1, 2022, the cottage is rented for $4,000 per month for the remainder of the year. Expenses, other than CCA, total $23,600 for March 1 to December 31, 2022.

5. In 2021, Owen purchased 1,000 units of ReCan, a mutual trust fund, at $40 per unit. In July, 2022, the trust fund makes a distribution of $2 per unit of which $0.75 is designated as a return of capital and $1.25 is interest income. All of this distribution is re-invested in ReCan units at a price of $42 per unit. No other distributions are made in the year. In December, 2022, all of the units are sold for $39 each.

6. In 2021, Owen sold a piece of undeveloped land for $125,000. This land had been purchased several years before for $100,000. While Owen's original intent was to construct a backwoods retreat for personal use on the site, he had not found the time to improve the land and decided the offer of $125,000 was too attractive to turn down. Owen had paid a total of $2,000 in property taxes on the land prior to its sale. The terms of the sale required the buyer to provide a down payment of $37,500, with the remaining balance to be paid in 2023. Owen uses reserves to defer as much of the income tax on the capital gain as possible.

7. For several years, Owen has been interested in a French common shares Debit Agricole (DA). The shares trade in Euros (€€) and Owen's first purchase of 1,000 shares was made on October 1, 2019 for €€14.00 per share. Assume he acquired the Euros at a rate of €€1 = $1.57. Subsequent transactions were as follows:

**Assumed**

**Quantity Price Per Exchange Rate**

**Date Purchased (Sold) Share (**€) **(Canadian $)**

November 4, 2020 300 €14.50 $1.55

January 6, 2021 (400) 15.00 1.54

June 24, 2022 600 15.50 1.51

On December 2, 2022, he sells all of the shares for €€13.00 each. Assume at this time €€1 = $1.50. The Euros are immediately converted into Canadian Dollars.

8. As Owen will no longer have use of his cottage, he decides to sell his vintage power boat. He had purchased this boat several years ago in damaged condition for $10,000. He subsequently spent $24,627 restoring it to mint condition. As a result, he was able to sell it for $50,000 in 2022.

9. Owen sold his stamp collection for $12,000. The total cost of the collected stamps was $8,000. He also sold an oil painting for $700. This painting, which he had always hated, had been a gift from Arlene's mother. At the time of the gift, the painting had a value of $4,000.

10. Owen spends 225 hours volunteering in a search and rescue program sponsored by the province in which he lives. He receives no compensation for this work.

11. Owen makes contributions to registered charities in the amount of $5,000.

12. Owen pays for medical expenses provided to various family members as follows:

Dental Work (Root Canal) for Arlene $1,500

Dental Work (Cavities) for Martha 875

Physiotherapy (Back Pain) for Arlene 1,300

Surgery (Tummy Tuck) for Owen 1,800

Total $5,475

**Required:** Determine Owen's 2022:

A. Minimum net income.

B. Minimum taxable income.

C. Minimum federal income tax payable or refund.

Ignore any GST/HST & PST considerations.

Answer:

***Part A - Net Income***

**2022 Property Income —** Owen's property income can be calculated as follows:

Eligible Dividends $42,400

Gross Up [(38%)($42,400)] 16,112

Non-Eligible Dividends 22,000

Gross Up [(15%)($22,000)] 3,300

Rental Income (Note 1) Nil

Trust Fund Distribution [(1,000)($1.25)] 1,250

2022 Income from Property $85,062

**Note 1 -** Rental income can be calculated as follows:

Gross Rents [(10)($4,000)] $40,000

Expenses other than CCA ( 23,600)

Income before CCA $16,400

CCA

Building (See Following Calculation) ($ 3,800)

Furnishings [(20%)(150%)($42,000)] ( 12,600) ( 16,400)

2022 Rental Income $ Nil

Original Cost of Building $150,000

FMV at Change in use $160,000

Original Cost ( 150,000)

Excess $ 10,000

Bump Up 50% 5,000

Cost for CCA Purposes $155,000

AccII [(50%)($155,000)]\* 77,500

CCA Base $232,500

Rate 4%

CCA - Class 1 $ 9,300

The property qualifies for the AccII since no CCA was claimed by anyone in a previous taxation year. This reflects a change in the AccII that became law in June of 2021. The maximum CCA claim is restricted to the rental income before any deduction for CCA.

**2022 Capital Gains —** Owen's net taxable capital gains are calculated as follows:

ESBC Shares (Note 2) $ 13,333

House And Cottage (Note 3) 16,364

Trust Fund Units (Note 4) ( 393)

Land (Note 5) 2,500

Debit Agricole Shares (Note 6) ( 4,678)

Power Boat (Note 7) 15,373

Net Gain on Stamp Collection and Oil Painting (Note 8) 1,000

Net Capital Gains $43,499

Inclusion Rate 1/2

Net Taxable Capital Gains $21,750

**Note 2 -** The capital gain to be recognized on the sale of ESBC shares can be calculated as follows:

POD $600,000

ACB ( 520,000)

Capital Gain $ 80,000

Deferral (See Following Calculation) ( 66,667)

Capital Gain $ 13,333

If Owen had invested all of the proceeds in a different ESBC, the entire $80,000 gain could be deferred. However, since he only used $500,000 of the proceeds for re-investment, the deferral is limited to $66,667 [($80,000)($500,000 ÷ $600,000)]. Note that the ACB of the new ESBC shares is reduced by the deferred gain to $433,333 ($500,000 - $66,667).

**Note 3 -** While there is a gain on both the sale of the house and the deemed disposition of the cottage, the principal residence exemption can be applied against either or both of these properties. The relevant calculations are as follows:

**House Cottage**

POD (Actual and Deemed) $375,000 $235,000

ACB ( 320,000) ( 215,000)

Selling Costs ( 20,000) N/A

Capital Gain $ 35,000 $ 20,000

As the house was owned for 16 years, the annual gain on this property is $2,187.50 ($35,000 ÷ 16). The annual gain on the cottage, owned for 11 years, is $1,818.18 ($20,000 ÷ 11).

As the annual gain on the house is larger, the maximum number of required years should be applied to that property. This would be the 15 years 2007 through 2021, leaving the year 2022 for the cottage. The results are as follows:

**House Cottage**

Pre-Exemption Gain $35,000 $20,000

Exemption:

House [($35,000)(15 + 1) 16] ( 35,000)

Cottage [($20,000)(1 + 1) 11] ( 3,636)

Capital Gain after Exemption Nil $16,364

**Note 4 -** The total distribution by this trust was $2,000 [(1,000)($2)]. At a price of $42 per unit, this would result in Owen acquiring an additional 47.62 (2,000 ÷ $42) units, resulting in a total of 1,047.62 (1,000 + 47.62) units. Based on this, the capital loss on the sale of the trust units would be calculated as follows:

POD [(1,047.62)($39.00)] $40,857

ACB

Original Cost [(1,000)($40)] $40,000

Additional Investment 2,000

Return of Capital [(1,000)($0.75)] ( 750) ( 41,250)

Capital Loss ($ 393)

**Note 5 -** Since the land had not been used to earn income, the property taxes are not deductible and not added to the ACB of the land. The capital gain on the 2022 sale of the land would be calculated as follows:

POD $125,000

ACB ( 100,000)

Capital Gain before Reserve $ 25,000

At the end of 2021, the proceeds that are only receivable after the end of the year are $87,500 ($125,000 - $37,500).

Given this, the maximum 2021 capital gain reserve would have been $17,500, the lesser of:

• [($25,000)($87,500 $125,000] = $17,500

• [($25,000)(20%)(4 - 0)] = $20,000

At the end of 2022, the proceeds receivable after the end of the year are unchanged at $87,500. Based on this, the capital gain to be recognized for 2023 would be as follows:

2021 Capital Gains Reserve $17,500

2022 Capital Gains Reserve - Lesser of:

[($25,000)($87,500 $125,000] = $17,500

[($25,000)(20%)(4 - 1] = $15,000 ( 15,000)

2022 Capital Gain $ 2,500

**Note 6 -** The cost of Owen's purchases of the Debit Agricole shares, converted to Canadian dollars, is as follows:

**Cost In**

**Canadian**

**Purchase/Sale Date Dollars**

October 1, 2019 Purchase [(1,000)(€14.00)($1.57)] $21,980

November 4, 2020 Purchase [(300)(€14.50)($1.55)] 6,743

Sub-Total $28,723

January 6, 2021 Sale [(400)($28,723 ÷ 1,300)] (Rate Irrelevant) ( 8,838)

Sub-Total (900 Shares) $19,885

June 24, 2022 Purchase [(600)(€15.50)($1.51)] 14,043

ACB on December 2, 2022 $33,928

There would be a capital loss on the sale of the 1,500 shares, calculated as follows:

POD [(1,500)(€13.00)($1.50)] $29,250

ACB ( 33,928)

Capital Loss ($ 4,678)

Since Owen immediately converts the Euros to dollars, there is no gain or loss on the foreign currency conversion.

**Note 7** - The power boat is personal use property. While losses on such property are not deductible, capital gains are required to be included in income. The capital gain would be calculated as follows:

POD $50,000

Original Cost ($10,000)

Restoration Costs (Capital expenditures) ( 24,627) ( 34,627)

Capital Gain $15,373

**Note 8 -** The net capital gain on listed personal property would be calculated as follows:

**Stamp Oil**

**Collection Painting**

POD ($1,000 Floor) $12,000 $1,000

ACB ( 8,000) ( 4,000)

Capital Gain (Loss) $ 4,000 ($3,000)

As losses on listed personal property can be deducted against gains on listed personal property, the net inclusion is $1,000 ($4,000 - $3,000).

Based on the preceding calculations, Owen's 2022 net income is determined as follows:

Income from Property $85,062

Net Taxable Capital Gains 21,750

2022 Net Income $106,812

***Part B - 2022 Taxable Income***

As Owen has no taxable income deductions, his taxable income is equal to his net income.

***Part C - 2022 Federal Income Tax Payable or Refund***

Owen's federal income tax payable or refund would be calculated as follows:

Tax on First $100,392 $17,820

Tax on next $6,420 ($106,812 - $100,392) at 26% 1,669

Federal Income Tax Payable before Credits $19,489

Tax Credits:

BPA ($14,398)

Spousal ($14,398 - $7,650) ( 6,748)

Canada Caregiver - Philip is not infirm N/A

Volunteer Search and Rescue ( 3,000)

Transfer of Tuition - Lesser of:

• Maximum $5,000

• Actual Tuition of $11,400 ( 5,000)

Medical Expenses (Note 9) ( 1,196)

Credit Base ($30,342)

Rate 15% ( 4,551)

Charitable Donations (Note 10)

[(15%)($200) + (29%)($5,000 - $200)] ( 1,422)

Dividend Tax Credits:

Eligible Dividends [(6/11)($16,112)] ( 8,788)

Non-Eligible Dividends [(9/13)($3,300)] ( 2,285)

2022 Federal Income Tax Payable $ 2,443

**Note 9 -** All of the $5,475 of services paid for by Owen would be eligible medical expenses, with the exception of his tummy tuck surgery which would generally be cosmetic. Given this, the available credit would be calculated as follows:

Eligible Expenses ($5,475 - $1,800) $3,675

Reduced by the lesser of:

• [(3%)($106,812)] = $3,204

• 2022 Threshold Amount = $2,479 ( 2,479)

Allowable Medical Expenses $1,196

**Note 10 -** As none of his income is taxed at 33%, this rate is not applied in the determination of the charitable donations tax credit.

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118) ***Family Information***

Mrs. Joan Brockton is 42 years of age and lives with her husband Jack Brockton. They have two children who live with them. Their son Joshua is 15 years old and has net income for 2022 of $5,600, largely from part-time summer employment. Their daughter Anna is 12 and qualifies for the disability tax credit. Anna has no net income for 2022.

Joan's husband Jack is 41 years old and has gone back to university on a full time basis for all of 2022. His tuition fees for the year are $11,500. Jack's 2022 net income is $8,400, largely from investment income.

The family's 2022 medical expenses are as follows:

Joan $ 1,800

Jack 2,500

Joshua 3,400

Anna (No Attendant Care expenses) 11,500

Total Medical Expenses $19,200

Joan makes donations to registered Canadian charities of $2,300 in 2022.

***Employment Information***

Joan is employed by a large public corporation at an annual salary of $122,000. In addition, she received $46,000 in commissions. Her employer withholds the following amounts from her income:

RPP Contributions $2,700

EI 953

CPP 3,500

Professional Association Dues 1,500

Joan's employer makes a matching contribution to her RPP of $2,700.

Her employer requires her to maintain an office in her home and has provided her with a signed Form T2200. The office use accounts for 15% of the floor space (including a component for common areas) in her home including an allocation for the use of common areas. The 2022 home office expenses are:

Maintenance and Utilities $2,200

Property Taxes 4,800

Insurance 950

Mortgage Interest 9,800

Several years ago, Joan's employer granted her options to purchase 2,000 shares of the company's common shares at a price of $20 per share. The option price was equal to the FMV of the shares at the time the options were granted. In January, 2022, when the shares are trading at $32 per share, Joan exercises all of the options. In December, 2022, she sells all of the 2,000 stock option shares for $35 each.

Joan’s employer pays her an allowance of $1,500 per month to cover all of her employment related expenses, including her use of a personally owned automobile. The automobile was purchased in 2021 at a cost of $29,500. She claimed CCA in 2021 based on the automobile being used 75%of the time for employment purposes 25% for personal use. In 2022, only 60% of the use of the automobile was for employment purposes with 40% for personal use. Joan’s employment related expenses during the year are:

Automobile Operating Expenses $4,200

Hotels 5,500

Airline and other Transportation 7,600

Business Meals and Entertainment 6,400

***Other 2022 Information***

1. Joan received eligible dividends of $2,350.

2. At the beginning of 2022, Joan owned 1,000 units of the Torstar Mutual Trust Fund. The ACB of these units at that time was $12 each. In 2022, the trust made a distribution of $1.00 per unit, all of which was interest income. Joan had all of this distribution invested in additional units at $14 per unit. In December, 2022, all of her Torstar units were sold for $16 each.

3. At the beginning of 2022, Joan owned land with an ACB of $125,000. She had owned the land for a number of years, hoping at some point to construct a rental property on the site. However, in 2022 she receives an unsolicited offer for the property of $375,000. She accepts the offer and immediately receives a payment of $100,000. The remaining $275,000 will be paid in 11 annual instalments of $25,000, beginning in 2023. Joan would like to the capital gains reserve to defer as much income tax as possible on any capital gain.

4. For many years, Joan has owned a cottage on a nearby lake that had cost $75,000, including an estimated value for the land of $20,000 and $55,000 for the building. In January of 2022, because of her family’’s declining use of this property, Joan decides to convert the property to a rental property. At this time, the property is appraised at $250,000, with $50,000 representing the value of the the land and $200,000 for the building. Rental income in 2022 before the deduction of CCA is $3,900. Joan does not intend to designate the cottage as her principal residence in any of her years of ownership.

5. Joan owns a painting with an ACB of $2,000. She sells the painting in 2022 for $22,000.

**Required:** calculate Mrs. Brockton’’s minimum net income, taxable income and her minimum federal income tax payable or refund for 2022. Ignore any income tax instalments she may have paid during the year, any income tax withholdings made by her employer, and GST/HST & PST considerations.

Answer:

***2022 Employment Income***

Joan's employment expenses that would have been restricted by commission income will not be restricted given that the commissions received exceed her available employment expenses. The required calculations here would be as follows:

Salary $122,000

Additions

Commissions 46,000

Expense Allowance [(12)($1,500)] 18,000

Stock Option Benefit [(2,000)($32 - $20)] 24,000

Deductions:

RPP Contributions ( 2,700)

Professional Association Dues ( 1,500)

Home Office Expenses (Note 1) ( 1,193)

Automobile Costs

CCA (Note 2) ( 2,921)

Operating expenses [(60%)($4,200)] ( 2,520)

Hotel expenses ( 5,500)

Airline and other Transportation ( 7,600)

Business Meals and Entertainment [(1/2)($6,400)] ( 3,200)

2022 Employment Income $ 182,866

**Note 1 -** As Joan has commission income, she can deduct 15% of all of the expenses except the mortgage interest. This will provide a deduction of $1,193 [(15%)($2,200 + $4,800 + $950)].

**Note 2 -** The 2022 CCA would be based on a UCC calculated as though 100% of the available CCA had been claimed in 2021. The 100% CCA for 2021 would be $13,275 [(50%)($29,500)+($29,500)][(30%)]. Using this amount, the deductible 2022 CCA would be $2,921 [(60%)(30%)($29,500 - $13,275)].

***2022 Property Income***

The required calculations here would be as follows:

Eligible Dividends $2,350

Gross Up [(38%)($2,350)] 893

Mutual Trust Fund Distribution [(1,000)($1.00)] 1,000

Rental Income (Note 3) Nil

2022 Income from Property $4,243

**Note 3 -** As the change in use is from personal to business, the base for calculating CCA would be as follows:

Cost of Building $55,000

FMV at the Change in use $200,000

Cost ( 55,000)

Increase In Value $145,000

Inclusion Factor 1/2 72,500

Cost for UCC and CCA Purposes $127,500

AccII [(50%)($127,500)] 63,750

CCA Base $191,250

Rate For Class 1 4%

CCA $ 7,650

Using this CCA amount, rental income would be $ Nil ($3,900 - $3,900) since CCA cannot be used to increase or create a rental loss. Note that the AccII is available since no CCA had previously been claimed by anyone with respect to the cottage. This change is reflected in amendments made to the AccII provisions that retroactively became law in June of 2021.

***2022 Net Taxable Capital Gains***

The required calculations here would be as follows:

Stock Option Shares [(2,000)($35 - $32)] $ 6,000

Torstar Mutual Trust Fund (Note 4) 4,143

Land Sale (POD $375,000 - ACB $125,000) $250,000

Reserve For Land Sale (Note 5) ( 183,333) 66,667

Painting ($22,000 - $2,000) 20,000

Change in Use:

Cottage - Land ($50,000 - $20,000) $ 30,000

Cottage - Building ($200,000 - $55,000) 145,000 175,000

Total Capital Gains $271,810

Inclusion Rate 1/2

2022 Net Taxable Capital Gains $135,905

**Note 4 -** The $1,000 mutual trust fund distribution was used to purchase 71.43 additional units ($1,000 ÷ $14). Using this amount, the capital gain calculation would be as follows:

POD [(1,071.43)($16)] $17,143

ACB [(1,000)($12) + $1,000)] ( 13,000)

Capital Gain $ 4,143

**Note 5 -** The gain on the land would be $250,000 ($375,000 - $125,000). The maximum reserve would be $183,333, the lesser of:

• $183,333 [($250,000)($275,000 ÷ $375,000)]

• $200,000 [($250,000)(20%)(4 - 0)]

***2022 Net and Taxable Income***

The required calculations here would be as follows:

Employment Income $182,866

Income from Property 4,243

Net Taxable Capital Gains 135,905

Deductible CPP ($3,500 - $3,039) ( 461)

2022 Net Income $322,553

Stock Option Deduction [(1/2)($24,000)] ( 12,000)

2022 Taxable Income $310,553

***2022 Federal Income Tax Payable or Refund***

The required calculations here would be as follows:

Tax on first $221,708 $51,345

Tax on next $88,845 ($310,553 - $221,708) at 33% 29,319

Federal Income Tax before Credits $80,664

Tax Credits:

BPA ($12,719)

Spouse ($12,719 - $8,400) ( 4,319)

Canada Caregiver for child - Anna ( 2,350)

Transfer of Anna’s Disability ( 8,870)

Disability Supplement ( 5,174)

Transfer of Tuition - Lesser of:

• Maximum of $5,000

• Actual Tuition of $11,500 ( 5,000)

Medical Expenses (Note 6) ( 16,721)

EI ( 953)

CPP ( 3,039)

Canada Employment Credit ( 1,287)

Total Credit Base ($60,432)

Rate 15% ( 9,065)

Subtotal $71,599

Charitable Donations Credit (Note 7) ( 723)

Dividend Tax Credit [(6/11)($893)] ( 487)

2022 Federal Income Tax Payable $70,389

**Note 6 -** The base for the medical expense tax credit would be calculated as follows:

Total Medical Expenses $19,200

Reduced by the lesser of:

• [(3%)($322,553)] = $9,677

• 2022 Threshold Amount = $2,479 ( 2,479)

Medical Expense Tax Credit Base $16,721

**Note 7 -** The charitable donations tax credit would be calculated as follows:

15% of $200 $ 30

33% of the lesser of:

$2,300 - $200 = $2,100

$31,553 - $221,708 = $88,845 693

29% of Nil [$2,300 - ($200 + $2,100)] Nil

Total Charitable Donations Credit $723

Type: ES

Topic: Comprehensive case covering chapters 1 to 8