Planning to avoid high tax rate in 2005

PC must pay bonus for 2005 to reduce income to business limit. 1
STU must pay bonus for 2005 to reduce income to business limit. 1
Since PC and STU are associated in 2005, together they must pay bonuses aggregating $600,000 ($500,000 + $400,000 = $900,000).
Bonuses must be paid or payable before end of 2005. 1
Directors should pass resolutions approving bonuses and advise employees of bonuses before end of 2005.
s.78(4): Bonuses must actually be paid within first 180 days of 2006. ½
Other 1

Planning for 2006

s.125(2) applies if two corporations are associated for even one day in a taxation year. 1
PC and STU must disassociate before 2006. 1
Parties should amend USA to give Payne and Fudge equal rights to elect directors. 1
STU could issue additional voting share(s) to Fudge. ½
Other 1

QUESTION 2: Deemed Dividend & Loan - 35 marks

Tax status of ARU
s.89(1): definition of "taxable Canadian corporation" ½
s.89(1): definition of "Canadian corporation" ½
s.89(1): definition of "private corporation" ½
s.125(7): definition of "CCPC" ½
ARU is a TCC, a Can. corp., a private corp. and a CCPC. 1
Other 1

Share Repurchase
Issue recognition 1
s.84(3)(a): Where a corporation repurchases a share, it is deemed to pay a dividend. 1
s.84(3)(a): Amount of dividend = purchase price – PUC. 1
Deemed dividend = $12,010 – $10 = $12,000. 1
Other 1

Deemed dividend received by shareholder
Issue recognition 1
s.84(3)(b): Shareholder is deemed to receive deemed dividend. 1
s.82(1)(a)(ii)(A): A taxable dividend is included in income. 1
s.82(1)(b): An individual must gross up dividend by ¼ . 1
John includes in income $15,000 ($12,000 + $3,000). 1
Other 1

Capital gain/loss impact
Issue recognition 1
s.54 “proceeds of disposition” does not include deemed div. 1
John’s P/D = $12,010 – $12,000 = $10 1
John’s gain/loss = P/D – ACB 1
John has no gain or loss (G/L = $10 – $10). 1
Other 1

Tax calculation re: dividend
Issue recognition 1
Uncertainty re: applicable marginal rate ½
S.117(2)(c): Top marginal tax rate is 29%. 1
Notional federal tax (29% of $15,000) = $4,350 1
s.121: DTC is ¾ of gross-up. 1
DTC = ¾ x $3,000 = $2,000 1
Federal tax = $4,350 – $2,000 = $2,350 1
Other 1
Loan to shareholder

Issue recognition

s.15(2): Loan to shareholder is included in income. 1
s.15(2.4)(b): s.15(2) does not apply to a loan to an employee to assist in acquisition of a dwelling. 1
John is an officer and director of an employee. 1
s.15(2.4)(e): Loan must be received quâ employee. 1
It is questionable whether John received loan quâ employee. 1
s.15(2.4)(f): There must be bona fide arrangements for repayment within a reasonable time.

Lavoie: Demand promissory note issued to controlled corporation is not a bona fide arrangement for repayment within a reasonable time.

Davidson: “Payable on demand” is insufficient unless there is a determinative collateral arrangement.

Intention to win lottery may be insufficient. 1
s.15(2.6): s.15(2) does not apply if loan is repaid by end of following year.

John did not repay loan by December 31, 2004. 1
$25,000 is included in John’s income for 2003. 1

Other

Tax calculation re: loan

Issue recognition

Federal tax = taxable income × marginal rate ½
Federal tax = $25,000 × 0.29 = $7,250 1

Other

QUESTION 3: Section 85 Election - 10 marks

Eligible property

Issue recognition ½
s.85(1): Transferred property must be eligible property. ½
s.85(1.1)(a): Eligible property includes capital property. ½
Opco shares are eligible property. ½

Other

Taxable Canadian corporation

Issue recognition ½
s.85(1): Transferee must be a TCC. ½
s.89(1): definition of “taxable Canadian corporation” ½
s.89(1): definition of “Canadian corporation” ½
s.250(4)(a): A corporation incorporated in Canada is resident in Canada. ½
Newco is a taxable Canadian corporation. ½

Other

Share consideration

Issue recognition 1
s.85(1): Consideration must include shares. 1
Dale (TCC): Consideration may be executory. 1
Dale (TCC): Shares need not be issued at time of transfer. 1
Dale (TCC): It is sufficient if shares are issued within a reasonable time.
Dale (TCC): Shares need not be issued in same taxation year as transfer. 1

Dale (FCA dissent): s.85 requires executed consideration. 1
Dale (FCA dissent): MNR may not consider facts occurring after taxation year of transfer. 1
Dale (FCA dissent): Share must be issued before election is filed. 1
Dale (FCA majority): No rule that facts must be established as of end of taxation year. 1

Other

Conclusion 1

QUESTION 4: Amalgamation - 10 marks

Concept of new corporation

Issue recognition (meaning of new corporation) 1
s.87(2)(a) deems Amalco to be a new corporation. 1

Guar. Prop.: Although s.87(2)(a) deems Amalco to be a new corporation, it does not deem predecessors to cease to exist.

Guar. Prop.: Predecessors continue to be liable for their pre-amalgamation taxes.

Guar. Prop.: s.87(2)(a) does not supplant corporate law rule that Amalco is a continuation of the predecessors.

Pan Ocean: Tax consequences of an amalgamation are determined under ITA, not corporate law.

Pan Ocean: In Guar. Prop. FCA intended to hold that s.87(2)(a) does not apply to whole of ITA, but FCA did not intend to limit s.87(2)(a) to timing of Amalco’s first taxation year.

Pan Ocean: Amalco is a new corporation for all purposes related to computation of income, taxable income and tax.

Pan Ocean: Notwithstanding corporate law, s. 87(2)(a) deems Amalco to be a new corporation for income and tax computation purposes.

Reconciliation: Amalco is a new corporation for substantive purposes, but not procedural purposes. 2

Other

QUESTION 5: Director’s Liability - 10 marks

Introductory comment

s.227.1(1) imposes personal liability on a director for failure of corporation to withhold or remit certain items. ½

Functions of inside director and outside director

Cadrin: Inside director is involved in day-to-day management of corporation. 1
Cadrin: Inside director has greater influence over conduct of corporation’s business affairs. 1
Cadrin: Outside director is not involved in day-to-day management of corporation.
Cameron: Inside director is a hands-on person involved in day-to-day operation of corporation. ½
Cameron: Inside director has considerable influence on management. ½
Cameron: Outside director is concerned mainly with general policy. 1
Cameron: Outside director has only limited influence on management. ½

Other

Standard of Care

s.227.1(3) requires director to exercise degree of care, diligence and skill that reasonably prudent person would exercise.

Cadrin: Inside director has most difficulty to establish due diligence defence. 1
Cadrin: Unless there is reason for suspicion, outside director may rely on day-to-day corporate managers. 1
Cadrin: For an outside director, total passivity and unwillingness to know are not excusable. ½
Cadrin: An outside director must engage reliable and competent management personnel, stay generally informed and act quickly when suspicion is aroused or problems arise.
Cameron: The standard is reasonableness, not perfection. ½
Cameron: Standard is objective-subjective. ½
Cameron: Outside director may rely on management. ½
Cameron: Outside director cannot remain passive. ½
Cameron: Outside director need not be overly attentive, skeptical or assertive. ½

Other
FACULTY OF LAW

FINAL EXAMINATION - April 23, 2005

LAW 665:Y5 CORPORATE TAXATION

Student: _____________________________________________________

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