QUESTION 1 - Estate Freeze - 40 marks

A. Stock dividend

Steps:
- Authorize/confirm preferred shares,
- Declare dividend on common shares payable with preferred shares,
- Set amount of dividend at $100 or less,
- Set redemption price of preferred shares at FMV of common shares (i.e., $1,000,000),
- Set stated capital/PUC of preferred shares at $100,
- May retains her 100 common shares, which now have a nominal FMV.
- Belle subscribes for 66⅔ new common shares at a nominal issue price.

s. 248(1): “amount” of stock dividend is PUC increase.

By setting low PUC, the amount of the dividend is low.

s. 82(1)(a)(ii)(A): amount of dividend is included in income.

If stated capital and PUC are high, a high dividend is included in income.

Pref. shares have low ACB and high FMV. ∴ gain is deferred until preferred shares are sold.

No indirect gift rule applies.

But if redemption price of pref. shares is less than FMV of common shares, Belle could receive a s. 15(1) benefit if she subscribes for new common shares at a nominal amount.

Other

B. Section 51 conversion

Steps:
- Authorize/confirm preferred shares,
- May sells her common shares to Opco for preferred shares having a redemption price and FMV of $1,000,000,
- Set stated capital/PUC of preferred shares at $100,
- May subscribes for 40 new common shares at a nominal price.

s. 51(1)c) states that the sale is not a disposition.

∴ no capital gain is triggered.

s. 51(1)d) states that ACB to May of preferred shares is $100.

∴ gain is deferred until preferred shares are sold.

s. 84(5) values preferred shares at their PUC.

s. 84(3): If PUC of pref. shares exceeds $100, May will have a deemed dividend.

s. 51(3) grinds PUC (if set too high) to $100.

s. 51(2): indirect gift rule.

If FMV of pref. shares is less than $1,000,000, the gift portion will be a capital gain of May.

Alternatively, s. 15(1) could apply.

Other

C. Section 85 rollover

Steps:
- Authorize/confirm preferred shares,
- May sells her common shares to Opco for preferred shares having a redemption price and FMV of $1,000,000,
- Set stated capital/PUC of pref. shares at $100,
- May and Opco file s.85 election (Form T2057)
- Elect at $100,
- May and Belle subscribe for 60 and 40 common shares respectively at a nominal price.

s. 85(1)(c) states that the sale is not a disposition.

∴ no capital gain is triggered.

s. 85(1)(d) states that ACB to May of preferred shares is $100.

∴ the cost to May of preferred shares is $100.

s. 85(1)(g): The cost to May of pref. shares = PoD = agreed amount.

s. 85(2.1) grinds PUC (if set too high) to $100.

s. 85(1)(e.2): indirect gift rule.

If FMV of common shares exceeds FMV of pref. shares, the excess is added to agreed amount to determine PoD.

Alternatively, s. 15(1) could apply.

Other

D. Section 86 reorganization of capital

Steps:
- Confirm authorization of pref. shares or prepare to amend Opco’s articles to create pref. shares having a redemption price and FMV equal to $1,000,000,
- Reorganize Opco’s capital by amending Opco’s articles to change ALL the common shares into preferred shares,
- Set stated capital of preferred shares at $100,
- May subscribes for 60 new common shares and Belle subscribes for 40 new common shares at a nominal subscription price.

s. 86(1)(c): May’s PoD = ACB to her of common shares.

∴ May’s PoD = $100.

s. 86(1)(b): The cost to May of pref. shares = ACB to May of common shares.

∴ the cost to May of pref. shares is $100.

s. 84(5) values preferred shares at their PUC.

s. 84(3): If PUC of pref. shares exceeds $100, May will have a deemed dividend.

s. 86(2.1) grinds PUC (if set too high) to $100.

s. 86(2): indirect gift rule.

If FMV of pref. shares is less than $1,000,000, the gift portion will be a capital gain of May.

Alternatively, s. 15(1) could apply.

Other

QUESTION 2 - RDTOH and Dividend Refund - 15 marks

Recognition of issue (taxable dividend).

Steps to obtain dividend refund:
- RHI declares a taxable dividend of $300,000,
- RHI pays $200,000 in cash and issues promissory note for $100,000,
- RHI applies for, and/or receives, dividend refund of $100,000,
- RHI pays $200,000 in cash and issues promissory note.
- RHI declares a taxable dividend of $300,000,

s. 129(3): definition of RDTOH.

s. 129(1)(a)(i) permits RHI to obtain $1 of dividend refund for every $3 of taxable dividend paid.

Tax consequences to Liz of receiving dividend:

Recognition of issue (dividend received).

s. 82(1)(a)(ii): a taxable dividend must be included in computing income.

∴ Liz must include $300,000 under s. 82(1)(a)(ii).

s. 82(1)(b): the dividend must be grossed up by ¼.

∴ Liz must include $75,000 under s. 82(1)(b).

Recognition of issue (dividend tax credit).

s. 121: dividend tax credit.

s. 82(1)(b): the dividend must be grossed up by ¼.

∴ Liz must include $75,000 under s. 82(1)(b).

Recognition of issue (dividend tax credit).

s. 121: dividend tax credit.

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Student: _________________________
DTC = 3/7 of gross-up.
DTC = $50,000.

Other

**QUESTION 3 - Capital Dividend - 10 marks**
Recognition of issue (capital dividend)
s. 89(1) defines “capital dividend account”.
CDA ¶ (a)(i): the non-taxable portion of capital gain is included in CDA.
∴ $100,000 is included in BSC’s CDA.
s. 83(2); BSC may elect to pay a capital dividend.
s. 83(2)(a): a capital dividend cannot exceed CDA balance.
s. 83(2)(b): a capital dividend is not included in shareholder’s income.
∴ BSC should declare and pay $100,000 capital dividend.

Steps:
- BSC’s directors declare dividend of $100,000,
- BSC’s directors authorize s. 83(2) election be made,
- Prepare schedule to show CDA computation,
- File election, resolution and schedule with CRA before dividend is paid.
Reg. 2101(a) requires Form T2054.
Reg. 2101(b) requires director’s resolution.
Reg. 2101(d) requires CDA computation.

Other

**QUESTION 4 - Association - 10 marks**
Recognition of issue (s.256(1)(d) applicability).
s. 256(1)(d): corporations are associated if one corp. is controlled by person related to each member of group that controls other corporation and person owns 25% of shares of other corporation.
s. 256(1)(d) uses de facto control.
s. 256(5.1): meaning of de facto control.

De facto control includes ownership of voting shares or de jure control.

Granny controls Granco b/c she owns all the shares.
s. 251(2)(a): persons connected by blood relationship are related.
s. 251(6)(a): persons are connected by blood if one is the child or other descendant of the other.
∴ Granny is related to Sonny (child).
∴ Granny is related to Junior (grandson).
s. 251(5)(c): a person is related to herself.
∴ Granny (as s/h of Granco) is related to Granny (as shareholder) of Sudsco.
Sudsco is controlled by Sonny, Junior and Granny or a group of any two of them.
Granny is related to each member of this group.
s. 256(1.1): definition of “specified class”.
s. 256(1.1)(b); voting shares are not of a specified class.
∴ Granny’s 25 shares of Sudsco satisfy s. 256(1)(d).

Other
Conclusion: Granco & Sudsco are associated.

**QUESTION 5 - CCPC Status - 10 marks**
s. 125(7): definition of “CCPC”:
- CSI must be a private corporation,
- CSI must be a Canadian corporation
- CSI must not be controlled in fact by an NR, a public corporation or a combination thereof.
- CSI’s shares must not be listed on a prescribed stock exchange.

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**QUESTION 7 - Director’s Liability - 5 marks**

s. 227.1(3): care, diligence, skill.

s. 227.1(3): reasonably prudent person.

s. 227.1(3): comparable circumstances.

Objective: reasonably prudent

Subjective: skill, comparable circumstances.

*Soper*: hybrid objective subjective standard.

*Peoples*: objective standard

Other

Conclusion: objective standard

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**FACULTY OF LAW**

**FINAL EXAMINATION - April 26, 2006**

**LAW 665:Y5 CORPORATE TAXATION**

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