Problem 1

Effect on Income

Investments: ACL $^1/_2 \times$ (\$22,000 – (\$60,000 + \$500))		\$ (19,250)
Land: TCG $^1/_2 \times$ (\$200,000 – (\$40,000 + \$10,000))		75,000
Building: TCG $^1/_2 \times$ (\$125,000 – (\$70,000 + \$6,000))		24,500
Building: recapture (\$45,000 – \$70,000)		25,000
Equipment: recapture ((\$8,000 – \$400) – nil)		7,600
Eligible capital property: goodwill and customer lists:		
Proceeds ($^3/_4 \times$ (60K + 35K))	\$ 71,250	
Less: CEC balance	16,000	
	\$ 55,250	
Previous CECA claims (($^3/_4 \times$ \$40,000) – \$16,000)	14,000	
	\$ 41,250	
Income ($^2/_3 \times$ \$41,250)	27,500	
Income (recapture of CECA)	14,000	41,500
Income effect		\$ 154,350

Capital Dividend Account

Balance: January 1, 2011	Nil
Investments: $^1/_2 \times$ (\$22,000 – (\$60,000 + \$500))	\$ (19,250)
Land: $^1/_2 \times$ (\$200,000 – (\$40,000 + \$10,000))	75,000
Building: $^1/_2 \times$ (\$125,000 – (\$70,000 + \$6,000))	24,500
Eligible capital property: goodwill and customer lists: $^2/_3 \times$ \$41,250	27,500
Balance: December 31, 2011	\$ 107,750

The above can be summarized in tabular form as follows:

	Income effect		*Capital dividend account*					
Asset	*ABI*	*AII*	*Untaxed fraction of net cap. gains*	*Capital dividend received*	*Untaxed fraction of net gain on ECP*	*Untaxed life ins. proceeds*	*Capital dividend paid*	*Balance*
Investments		\$ (19,250)	\$ (19,250)					\$ (19,250)
Land		75,000	75,000					75,000
Building	\$ 25,000	24,500	24,500					24,500
Equipment	7,600							
ECP	41,500				\$ 27,500			27,500
	\$ 74,100	\$ 80,250	\$ 80,250	Nil	\$ 27,500	Nil	Nil	\$ 107,750

Problem 5

(A)

	Actual or deemed proceeds	Income generated ABI	Income generated AII	Capital dividend account	RDTOH
Opening balance		Nil	Nil	$ 4,000	Nil
Cash	$ 2,500	Nil	Nil		
Accounts receivable(1)	7,500	$ (1,250)	Nil		
Inventory(2)	15,500	(6,750)	Nil		
Land(3)	45,000	Nil	$ 17,000	17,000	
Building(4)	95,000	27,500	30,000	30,000	
Equipment(5)	10,000	(12,000)	Nil		
Marketable securities(6)	32,000	Nil	8,875	8,875	
Goodwill(7)	47,500	23,750	Nil	23,750	
Liabilities	(54,000)				
Income taxes(8)	(32,325)	$ 31,250	$ 55,875		$ 14,900
RDTOH(9)	14,900				$ 14,900
	$ 183,575			$ 83,625	

(B)	Funds available for distribution	$ 183,575
	Less: Paid-up capital	(10,000)
	Deemed dividend [ssec. 84(2)]	$ 173,575
	Less: Capital dividend [ssec. 83(2)]	(83,625)
	Deemed taxable dividend	$ 89,950
(C)	Proceeds	$ 183,575
	Less: Deemed dividend [sec. 54: def. of proceeds of disposition]	(173,575)
	Adjusted proceeds of disposition	$ 10,000
	Less: Adjusted cost base	(10,000)
	Capital gain (loss)	$ Nil

(D)

In order to deduct a reserve for doubtful debt or write off a bad debt, an amount in respect of the debt must have been included previously in income. This is not the case, if accounts receivable had been purchased from someone else. Where a person has sold all or substantially all of the property used in a business to a purchaser who will continue the business, section 22 provides for a joint election by the vendor and purchaser which results in permitting the purchaser to take the reserve or write-off with respect to the accounts receivable.

Under section 22, the purchaser must include in income the difference between the face amount and amounts paid. This inclusion will allow the purchaser to deduct a reasonable reserve for doubtful debts on the accounts receivable purchased and to deduct any bad debts as they occur.

The vendor, regardless of whether section 22 is used, must add to income the reserve for doubtful accounts. Under section 22, the vendor would have a business loss with respect to the disposition of the accounts receivable.

If section 22 is not used, any loss on the disposition of the accounts receivable would be considered a capital loss, and any loss realized by the purchaser on the collection of accounts receivable will be a capital loss with no reserve or write-off permitted to the purchaser.

—*NOTES TO SOLUTION*

(1) The reserve for doubtful accounts of $1,500 must be added to income regardless of whether a section 22 election is used.

If a section 22 election is used, the excess of face amount over proceeds of $2,750 would be a business loss such that the net effect on income would be a $1,250 business loss.

(2) Income/loss from business is the difference between the fair market value and the cost of inventory. In this case such a loss results due to:

Fair market value (proceeds)	$ 15,500
Cost of inventory	22,250
	$ (6,750)

(3)	**Land**	
	Taxable capital gain:	
	Proceeds	$ 45,000
	Adjusted cost base	11,000
	Gain	$ 34,000
	Taxable capital gain ($^1/_2$ of gain)	$ 17,000 (A)
	Capital dividend account ($^1/_2$ of gain)	$ 17,000 (B)
(4)	**Building**	
	Taxable capital gain:	
	Proceeds	$ 95,000
	Capital cost (adjusted cost base)	35,000
	Gain	$ 60,000
	Taxable capital gain ($^1/_2$ of gain)	$ 30,000 (A)
	Capital dividend account ($^1/_2$ of gain)	$ 30,000 (B)
	Active business income	
	Cost	$ 35,000
	UCC	7,500
	Recapture	$ 27,500 (C)
	Increase in value	
	P of D	$ 95,000
	UCC	7,500
	(A) + (B) + (C)	$ 87,500
(5)	**Equipment**	
	Proceeds	$ 10,000
	UCC	22,000
	Terminal loss	$ 12,000
(6)	**Marketable securities**	
	Taxable capital gain:	
	Proceeds	$ 32,000
	Adjusted cost base	14,250
	Gain	$ 17,750
	Taxable capital gain ($^1/_2$ of gain)	$ 8,875
	Capital dividend account ($^1/_2$ of gain)	$ 8,875
(7)		
	(a) Unrecorded goodwill (given)	$ 47,500
	(b) Business income $^2/_3 \times {}^3/_4$ of $47,500	$ 23,750
	(c) Capital dividend account ($^2/_3 \times {}^3/_4$) × $47,500	$ 23,750
(8)	**Income taxes**	
	Investment income:	
	$46^2/_3\%$ × $55,875	$ 26,075
	Business income:	
	20% × $31,250	6,250
	Tax payable	$ 32,325
(9)	**RDTOH**	
	$26^2/_3\%$ × $55,875	$ 14,900