Taxable Income and Tax Payable Revisited

Net Income for Tax Purposes

- Net Employment Income
- Net Business Income
- Net Property Income
- Capital Gains and Losses
- Other Income
- Other Deductions
- <u>Current Year Losses – Capital or Non-Capital</u>

- = Net Income For Tax Purposes

From Where We Were:

Net Income for Tax Purposes		=
Less:	Allowable capital losses	-
	Employee Stock Options	-
	Deductions – sections 60 to 66.8	-
	Capital gains deduction	-
	Losses from an office or employment	-
	Losses from a business	-
	Losses from property	-
Taxable Income		=

Capital and Non-Capital Loss Carryovers

Types of Losses

- Non- Capital Losses
  - Can be applied against any income or gains
  - Can be carried back 3 years
  - Can be carried forward 20 years

- Capital Losses
  - Can be applied only against capital gains
  - Can be carried back 3 years
  - Can be carried forward indefinitely

Types of Losses

- Loss on Listed Personal Property
  - Can be applied against gains on listed personal property
  - Can be carried back 3 years
  - Can be carried forward 7 years

Application of Losses

- Losses Incurred in Current Year

  - Step 1: Applied where able against current year income. (mandatory)

  - Step 2: Taxpayer can apply to carry back losses if income in past three years (optional)

    Will recover taxes if they were paid in those years.

  - Step 3: Losses carried forward until income arises that they can reduce or the losses expire (optional)

Example

- Bob has non-capital losses carried forward from 1990 of $20,000 and 1997 of $15,000.
- In 2014 his income from taxable capital gains is $30,000 and his income from business income is $10,000.
- Calculate the lowest amount of taxable income he can report in 2014.

$40,000 Combined net income
(15,000) Loss carried forward from 1997 – non-capital losses can reduce capital gains.

25,000 Minimum income. 1990 losses have expired (over 20 years old)

Example

- Bob has non-capital losses carried forward from 2009 of $5,000 and capital losses carried forward from 1980 of $30,000.
- In 2014 his income from a rental operations is $50,000.
- Calculate the lowest amount of taxable income he can report in 2014.

$50,000 rental income
(5,000) Loss carried forward from 2009 – less than 20 years old.
capital losses can only be applied against capital gains.

45,000 Minimum income

Capital vs. Non-Capital Losses

- What IF…
- Current year non-capital losses &

  Capital gains in the current year &

  Capital losses carried forward

- Based on the mandatory reduction of income rules, you might think that you'd need to apply current year losses first & be unable to use capital losses carried forward.
- Not so, act allows capital loss use because of restrictions.

Example

- Bob has capital losses carried forward from 2008 of $20,000.
- In 2014 he has a net business loss of $50,000 and taxable capital gains of $15,000.
- Calculate the lowest amount of taxable income he can report & his loss carryforward balances.

(50,000) Current non-capital losses
15,000 taxable capital gains
(15,000) Carried forward losses (can only use up to current year gains)

(50,000) Current year non-capital loss. Can be carried forward or back
(5,000) End of year capital loss balance. (20,000 less 15,000 used)

Planning Considerations

- Personal credits are non-refundable.
- Therefore, it is better to use them fully against some form of income.
- Losses carried forward should be saved for years with income not reduced by credits.

- Example: Brent earns $11,000 of income in 2014 and has losses carried forward of $20,000. Should he reduce his income using his losses carried forward?

No, Brent's income is already offset by his $11,000 personal tax credit. He should save his losses until a year when he pays tax that can be refunded.

Example

- Bob had taxable income in 2009, 2010, 2011, and 2012 of $90,000, $50,000, $20,000, and $3,000, respectively.
- In 2013 he has a business loss of $150,000
- Calculate his non-capital loss carryforward if he were to fully reduce income in past years where he is able.
- Should he do this?

150,000 Current year loss
(3,000) carried back to first prior year
(20,000) carried back to second prior year
(50,000) carried back to third prior year
77,000 Losses available for carry forward. Cannot go back more than 3 yrs

No! He should use his non-refundable credits against income each year.

Allowable Business Investment Losses (ABILs)

- Loss on disposition of debt or shares of:
- Active, Canadian, private investment.
- Because of insolvency, bankruptcy, or uncollectible.

- Impact:

  50% of loss which would otherwise have been a restricted capital loss is instead deductible against ordinary income.

  Carry back 3 years

  If unused after 20 years, turns back into a capital loss

Capital Gains Deduction

Capital Gains Deduction

- $880,000 deduction against capital gains on Qualified Small Business Corporation (QSBC) Shares (indexed to inflation)
- So $880,000 tax free capital gains, or $440,000 tax free taxable capital gains (this is an exemption on the gross vs. deduction on the net)

Capital Gains Deduction

Available to residents of Canada.

QSBC Shares:

- Canadian Controlled Private Corporation (CCPC)
- In the last 24 months cannot have been owned by anyone other than the vendor or someone related to them
- Throughout the 24 months preceding sale at least 50% of the FMV of total assets must be used in active business carried on in Canada
- At the time of sale 90% of the FMV of total assets must be used in active business carried on in Canada

Capital Gains Deduction

<u>Balance Sheet</u>

Cash	100,000
Inventory	25,000
PP&E	500,000
Boat	<u>10,000</u>
Total	635,000
Liabilities	<u>(135,000)</u>
Net assets/equity	$500,000

The net assets of the company are $500,000

The value of the company is $700,000

Net Assets = Total Assets – Total Liabilities. The Book Value of the company.

700,000 FMV – 500,000 Book Value = 200,000 Goodwill.

Calculate the value of non-active investments

Capital Gains Deduction

<u>Balance Sheet - Accounting</u>

Cash	100,000
Inventory	25,000
PP&E	500,000
Boat	<u>10,000</u>
Total	635,000
Liabilities	(135,000)
Equity	<u>(500,000)</u>
Total	(635,000)

<u>Balance Sheet – Valuation</u>

Cash	100,000
Inventory	25,000
PP&E	500,000
Boat	10,000 (1.2%)
Goodwill	**<u>200,000 (active)</u>**
Total	835,000
Liabilities	(135,000)
Market Value	**<u>(700,000)</u>**
Total	(835,000)

Alternative Minimum Tax

"AMT"

- Using the CGD to reduce your taxes can give rise to AMT.
- A notional tax that is refundable, over 7 years, if taxable income is earned in the future.

Retrieved December 2, 2013 from: http://www.bbt.com/bbtdotcom/financial-education/income_tax_and_estate_planning/alternative_minimum_tax.page

Kiddie Tax

Kiddie Tax

- <u>Applies to children under 18</u>
  - Dividends and other benefits received from a private corporation
  - Shareholder benefits or loans
  - Partnership or trust income where the income is derived from a business carried on by a relative of the child.

Income is taxed at the highest marginal rate.

Kiddie Tax

There are methods of compensating underage children to avoid the kiddie tax rules. They include:

- Fair pay for work performed (ie hourly wage reasonable for the job they do).
- Dividends from a public company
- Income from property inherited from a parent (never any attribution after death, since no one to attribute income to)