

FACULTY OF LAW

FINAL EXAMINATION – April 26, 2006

LAW 665:Y5 CORPORATE TAXATION (Sommerfeldt)

Time Allotted: Two (2) Hours Plus Ten (10) Minutes Reading Time

Code Number: **DO NOT ENTER YOUR NAME ON ANY ANSWER SHEETS OR BOOKLETS.** A list will be circulated and your name is to be entered opposite a number on that sheet. That number will be your code number **FOR THIS EXAMINATION ONLY** and should be entered on the examination booklets in the space provided for surname. This will provide for anonymity during marking.

- Special Instructions:**
1. This examination paper contains 7 questions on 6 pages. Check to ensure that the examination paper is complete before starting.
 2. Answer ALL questions.
 3. Questions are NOT of equal value. Apportion your time intelligently. A suggested time allotment (based on a proportionate allocation of the available time among the potential marks) is:

<u>Question</u>	<u>Marks</u>	<u>Time</u>
Reading Time		10 minutes
Q. 1	40	48
Q. 2	15	18
Q. 3	10	12
Q. 4	10	12
Q. 5	10	12
Q. 6	10	12
Q. 7	<u>5</u>	<u>6</u>
	100 marks	130 minutes

4. This is a **CLOSED BOOK** examination. However, you may use a clean, unmarked copy of the course syllabus (which is provided to you with this examination paper). You may also use *Stikeman Income Tax Act, Annotated* or a comparable edition of the *Income Tax Act (Canada)* (the “ITA”), provided that it complies with the following guidelines:
 - (a) portions of the book may be underlined, side-barred, shaded or otherwise highlighted in an unwritten manner;
 - (b) flags or stickies may be used to mark portions of the book, provided that the flags or stickies do not contain any written annotations other than numerical references to sections or other provisions of the ITA; and
 - (c) no written annotations (other than those of the editor or publisher or those designating section numbers) may be placed in, or attached to, the book.
 5. Adhere to the time limitation imposed on this examination strictly. Failure to stop writing at the end of the examination may lead to a deduction of grades or a failure to accept the examination paper.
 6. Cell phones, pagers, beepers and related equipment are strictly forbidden. These items must be turned off and stowed. Except by permission of the instructor, which will not routinely be given, lap top computers are not allowed in examinations.
 7. Since it is very disruptive for those students finishing examinations while others are leaving the examination room and discussing the examination outside the examination door, it is requested that no individual leave the examination room during the last 15 minutes of the examination period.
 8. All monetary amounts referred to in this examination paper are expressed in Canadian currency.
 9. Unless otherwise stated, all individuals referred to in this examination paper are resident in Canada.
 10. Unless otherwise stated, all statutory references in this examination paper are references to the *Income Tax Act (Canada)* (the “ITA”).
 11. Support all answers with references to applicable statutory provisions and jurisprudence.
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VALUE QUESTION

40

1.

In a typical estate freeze, a shareholder of a corporation who initially owns common shares of the corporation generally participates in a transaction whereby the shareholder acquires fixed-value preferred shares having a redemption price and a fair market value equal to the fair market value of the common shares immediately before the transaction. After that initial transaction, the shareholder, family members, other related persons or a combination of such persons subscribe for, or retain, common shares having a nominal fair market value.

May Chanelle (“May”) owns 100 common shares of Olfactory Pleasures Corporation (“Opco”), which operates a perfume distributorship business. Opco has not issued any other shares to any other person. The 100 common shares owned by May have the following attributes:

Adjusted cost base	\$100
Paid-up capital	\$100
Fair market value	\$1,000,000

May would like to implement a partial estate freeze, such that, at the conclusion of the series of transactions, she will own all the preferred shares and 60% of the common shares of Opco and her daughter, Belle Chanelle, will own the other 40% of the common shares of Opco.

Under the ITA, a variety of methods may be used to implement an estate freeze. The four methods of creating a partial estate freeze that May is considering are the following:

- (a) stock dividend,
- (b) section 51 conversion of shares,
- (c) section 85 rollover, and
- (d) section 86 reorganization of capital.

For each of the methods set out in items (a) through (d) above:

- (i) summarize the transactional steps required to implement a partial estate freeze in respect of Opco, so as to achieve May’s objectives,

- (ii) discuss the provisions of the ITA which permit the partial estate freeze to be implemented on a tax-deferred (or rollover) basis,
- (iii) comment on the risk of triggering adverse tax consequences by reason of the selection of the amount of the stated capital and paid-up capital in respect of the preferred shares and the possible application of the indirect gift rule, and
- (iv) identify the statutory provisions which give rise to such risks or contain such rules.

VALUE	QUESTION
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15	2. Royalty Holdings Inc. (“RHI”), which is a Canadian-controlled private corporation, has issued 100 voting common shares to Elizabeth Regeena (“Liz”), an octogenarian. Liz is the sole shareholder of RHI.
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RHI has refundable dividend tax on hand (“RDTOH”) in the amount of \$100,000. RHI has retained earnings in the amount of \$300,000 and cash in the bank in the amount of \$200,000.

RHI would like to obtain a refund of the \$100,000 of RDTOH.

Explain the steps which RHI should take to obtain a refund of the \$100,000 of RDTOH. Explain the statutory provisions which permit RHI to obtain such a refund. Explain the tax consequences, if any, to Liz if RHI undertakes the steps necessary to obtain a refund of the RDTOH.

In explaining the tax consequences, if any, to Liz, you need only discuss the impact, if any, on her income and taxable income. You need not calculate the actual amount of tax, if any, payable by her.

VALUE	QUESTION
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10	3. Barry Bondz (“Barry”) owns 100 voting common shares of Bulk Supplements Corp. (“BSC”), which is a Canadian-controlled private corporation and which operates a health food store. BSC has not issued any other shares to any other person.
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BSC has recently disposed of a capital property, as a result of which BSC realized a capital gain of \$200,000, which corresponds to a taxable capital gain of \$100,000.

BSC would like to distribute \$100,000 to Barry on a tax-free basis.

Explain the legislative provisions that permit this to be done and explain the transactional steps and documentation that are required in order to achieve this objective.

VALUE	QUESTION
10	<p>4. Granny Bubbles (“Granny”) is the mother of Sonny Bubbles (“Sonny”), who is the father of Junior Bubbles (“Junior”).</p> <p>Granco Ltd. (“Granco”) and Suds Corp. (“Sudsko”) are Canadian-controlled private corporations, each of which has only one class of authorized shares, namely voting common shares. Granny owns 100 voting common shares of Granco. Sonny owns 40 voting common shares of Sudsko, Junior owns 35 voting common shares of Sudsko and Granny owns 25 common shares of Sudsko. Neither Granco nor Sudsko has issued any shares to anyone other than those set out above.</p> <p>Is Granco associated with Sudsko for purposes of the ITA? Explain your answer.</p>

VALUE	QUESTION
10	<p>5. Canuck Stix Inc. (“CSI”), which manufactures hockey sticks, was incorporated on June 1, 1965 under the laws of Alberta. CSI has only one class of authorized shares, namely, voting common shares, of which only 100 are issued. CSI’s shares are not publicly traded, are not listed on a stock exchange and are not qualified for issuance to the public. CSI has only three shareholders, described as follows:</p> <p>(a) Guy L. Flower, who resides in Beaumont, Alberta and who owns 50 voting common shares of CSI,</p> <p>(b) Doug Wait, who is a resident of the United States and a non-resident of Canada, and who owns 30 voting common shares of CSI, and</p>

- (c) Public Equities Corp., which is a public corporation incorporated in Canada on May 1, 1965, whose shares are listed on the Toronto Stock Exchange, and which owns 20 voting common shares of CSI.

Is CSI a Canadian-controlled private corporation? Explain your answer.

VALUE	QUESTION
10	6. In the context of corporate control and using references to both the ITA and relevant jurisprudence, compare and contrast <i>de jure</i> control and <i>de facto</i> control.

VALUE	QUESTION
5	7. Subsection 227.1(3) of the ITA sets out the standard of care that a director of a corporation must meet in ensuring that the corporation undertakes the appropriate withholding and remittance of tax under subsection 227.1(1) of the ITA. Is the standard of care: (a) objective, (b) subjective, (c) both objective and subjective, or (d) none of the above? Explain your answer.

TOTAL MARKS: 100

End of Examination