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| You dont have to worry about the group case. I found the solution to it. Just have to solve thr 7th question thats missing. **PROBLEM TWO** Conquest Enterprises is a partnership that operates a smallwares wholesale firm. The partners are Cameron Traders Ltd. and Kando Construction Ltd. They share profits equally. The partnership business has improved this year, and it is anticipated that by year end, profits before capital cost allowance will amount to $620,000 (compared with $290,000 the previous year). During the year, the partnership acquired two additional delivery vehicles for $80,000. At the end of the previous year, the partnership held the following property:

|  |  |
| --- | --- |
|  Class | Undepreciated capital cost |
|  1  | $800,000 |
|  8  | 100,000 |
| 10  | 100,000 |

 Cameron Traders is a Canadian-controlled private corporation owned by GeorgeCameron. The company operates an import/export business and earns trading commissions from a wide range of customers. For years, it has earned a modest profit($30,000 last year, after a reasonable salary to Cameron).However, his years of hard work establishing international contacts have finally paid off, and he expects this year’s profits to be $250,000 and future years’ profits to continue at least at this level. Kando Construction is owned by Sheila Hampton. Kando has suffered major losses over the past years even after earnings have been allocated from the partnership. Currently, the company has unused non-capital losses of $600,000, of which $300,000 will expire in two years. The company appears to have its losses under control and is not in serious financial difficulty, although cash flow has been tight. The partnership has been seeking to acquire a new warehouse building. Coincidentally,Hampton personally owns a warehouse property, which will be vacated by its tenant in six months. The property has appreciated in value and is worth $80,000 more than its original cost. Hampton has claimed capital cost allowance of $30,000 over the years. She is willing to sell the property to the partnership, as she could use the cash to strengthen Kando. However, she needs all the cash she can get and is not anxious to pay tax on the sale. **Required:** 1. ​Determine the minimum and maximum business income for tax purposes that might be earned by the partnership (Conquest Enterprises) for the current year and allocated to the partners.2. ​Which amount of income from the partnership would Cameron Traders and Kando prefer? Explain.3. ​Estimate the tax liability of Cameron Traders for the current year.4. ​If you owned Cameron Traders, would you recommend that Conquest Enterprises be incorporated? Explain.5. ​How would the incorporation of the partnership affect Kando?6. ​What can Hampton do to avoid tax on the sale of the warehouse property to the partnership and generate the maximum amount of cash to help Kando? Solution to P 15-2 1.​Discretionary items for determining income for taxpurposes (capital cost allowance, reserves, and so on)must be established at the partnership level [S.96(1)]. The available capital cost allowance in this problem is $94,000 calculated as follows:

|  |  |  |
| --- | --- | --- |
| Class 1 $800,000 @ 4% |   | $ 32,000 |
| Class 8 $100,000 @ 20% |   | 20,000 |
| Class 10 |   |   |
| opening amount $100,000 @ 30% | $30,000 |   |
| additions $80,000 @ 30% (1/2) |  12,000 |  42,000  |
|   |   | $94,000 |

 ​Therefore, the minimum and maximum partnership profits for allocation are:

|  |  |  |
| --- | --- | --- |
|   | Minimum | Maximum |
| Profit before CCA | $620,000 | $620,000 |
| CCA |   94,000 |              0  |
|   | $526,000 | $620,000 |

 2.​Cameron Traders earns $300,000 from its own business separate from its 50% share of partnership income. As Cameron Traders is taxable on income allocated by the partnership, it would prefer the minimum partnership profits of $526,000 ($263,000 allocated to Traders) after claiming the full CCA. ​On the other hand, Kando Construction has a $600,000 loss carry-over of which $300,000 will expire in two years.Therefore, Kando would prefer the maximum profit from the partnership of $620,000 (Kando's share --$310,000) as this higher income can be offset against its losses and, in particular, against the $300,000 losses that are at risk of expiring. ​In partnership structures the tax impact is more dynamic because it directly involves the tax status of each partner as well as the partnership entity itself. In this case, the two partners have a conflict and regardless of the decision made one will have a negative effect. 3.​As a CCPC, Cameron Traders is assumed to have a tax rate of 16% on $500,000 of active business income and 31% on the excess. As it earns $300,000 from its own business only $200,000 of partnership profits allocated is eligible for the low rate.​The partnership also has a limit on business income eligible for the small business deduction as follows:

|  |  |  |
| --- | --- | --- |
|   | Minimum | Maximum |
|   |   |   |
| Partnership income | $526,000 | $620,000 |
|   |   |   |
| Eligible for SBD | $500,000 | $500,000 |
| High rate |    26,000 |  120,000 |
|   | $526,000 | $620,000 |
|   |   |   |
| Cameron Traders' share (50%) |   |   |
| Eligible for SBD | $250,000  | $250,000 |
|     High rate |    13,000 |    60,000 |
|   | $263,000 | $310,000 |

 ​Even though the partnership allocates $250,000 of income eligible for the SBD, Cameron Traders can only use $200,000 because its own business income is $300,000 ($300,000 + $200,000 = $500,000 limit). Cameron's tax liability will therefore be:

|  |  |  |
| --- | --- | --- |
|   | Minimum | Maximum |
|   |   |   |
| Import-Export profit | $300,000 | $300,000 |
| Partnership profit |  263,000 |  310,000 |
| Total | $563,000 | $610,000 |
|   |   |   |
| Tax on 1st $500,000 @ 16% | $  80,000 | $   80,000 |
| on excess @ 31%  |    19,530 |    34,100 |
|   | $99,530 |      $114,100 |

 ​Therefore, if Kando's desire to not claim CCA prevails, Cameron Traders will incur an additional tax cost of $14,570 ($114,100 - $99,530). This additional cost is not permanent as the unclaimed CCA is available for use in future years (gradually at the normal CCA rate for each class). 4.​If the partnership (Conquest Enterprises) wasincorporated, Cameron Traders and Kando Construction would each own 50% of its shares. Consequently, the new corporation would not be associated with either of its corporate shareholders. Therefore, the new corporation would be entitled to its own $500,000 small businessdeduction limit. In addition, dividend distributions to Cameron Traders and Kando would flow tax free. Using the minimum profits of the partnership ($526,000) the following taxes would result with respect to Cameron Traders on its 50% interest in Conquest.

|  |  |
| --- | --- |
| Conquest (as a corporation): |   |
| Income |   | $526,000 |
|   |   |   |
| Tax  | $500,000 | @ 16% | $80,000 |
|   |    26,000 | @ 31% |    8,060 |
|   | $526,000 |   | $88,060 |
|   |   |   |
| Cameron Traders: |   |   |
| Income (Import-Export) |   | $300,000 |
|   |   |   |
| Tax @ 16% |   | $48,000 |

 ​Cameron Traders share of after-tax profits for each structure is compared below:

|  |  |  |  |
| --- | --- | --- | --- |
|   |   | Partnership | Corporation |
|   |   |   |   |   |
| Income | - Conquest | $263,000 |   | $263,000 |   |
|   | - Cameron Traders | 300,000  |   | 300,000  |   |
|   |   | 563,000 |   | 563,000 |   |
| Less tax  | - Conquest |   |   |   |   |
|   | (50% of $88,060) |                  0 |   | (44,030 | ) |
|   | - Cameron Traders |   (99,530 | ) |   (48,000  | ) |
|   |   |   |   |   |
| After-tax income | $463,470 |   | $470,970 |   |

 ​Therefore, the corporate structure expands the SBD limit and based on current income would create an annual tax saving of $7,500 ($463,470 - $470,970). In addition, Cameron Traders has $200,000 of additional SBD limit available which can be used if the profit of its import-export business expands beyond $300,000. In effect, using a non-associated corporate entity for Conquest, the available small business deduction base for Cameron Traders and Kando is increased to $750,000 each compared to the partnership structure of $500,000. This is shown below for Cameron Traders.

|  |  |
| --- | --- |
| SBD limit Cameron Traders | $500,000 |
| SBD limit in Conquest ($500,000) |   |
| of which Cameron has a 50% interest |  250,000 |
|   | $750,000 |

 5.​As indicated above, converting the partnership to a corporation would also expand the SBD limits for Kando. However, Kando currently is not taxable because of its $600,000 loss carry-over. Consequently, incorporating the partnership would mean that Kando's share of profits would not be able to be offset against its losses from the construction business which magnifies the risk of their expiration. In addition, because Kando's share of Conquests' profits would now be taxable in the new corporation, there would be less cash available for distribution to Kando, which adds to its problem of tight cash flow. Therefore, Kando again finds itself in conflict with the interests of Cameron Traders because of their differing tax positions. 6.​If Hampton sells the warehouse property directly to the partnership, she will incur taxable income of $70,000 as follows:

|  |  |
| --- | --- |
| Recapture of CCA  | $30,000 |
| Taxable capital gain (1/2 of $80,000) |  40,000 |
|   | $70,000 |

 ​Hampton is not entitled to use the election option on the sale to the partnership because she is not a partner[S.97(2)]. As an alternative, Hampton could transfer the property to the partnership by taking the following steps: • ​Sell the warehouse property to Kando Construction and avoid tax on this sale by using the election option which permits Hampton to choose an elected price for tax purposes equal to the UCC for the building and the ACB for the land[S.85(1)]. Payment would be in the form of a note payable plus shares. • ​Subsequently, Kando Construction would sell the land and building to the partnership at fair market value in exchange for cash. Because Kando acquired the property at an elected price but sold it at fair market value it would incur a taxable capital gain of $40,000 (1/2 of $80,000) and a recapture of $30,000. ​The above transactions have the following advantages: • Hampton avoids personal tax on the sale.  • ​Kando generates $70,000 of income which can be offset against its losses and is therefore not taxable. In particular, the $70,000 will reduce the losses that will expire in two years. • ​Kando receives the full cash value for the sale of the property which will alleviate its cash flow problems |

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