IS SAFE INCOME REALLY SAFE?

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Introduction: Overview of the Changes to Subsection 55(2) of the Act[5] in Budget 2015[6]

Budget 2015 broadened the ambit of subsection 55(2) by adding two new purpose tests for actual dividends under subsection 55(2.1). Budget 2015 also narrowed the paragraph 55(3)(a) related party exception to subsection 55(2). The uncertainty surrounding what constitutes a "proper" purpose and the loss of the paragraph 55(3)(a) exception (for actual dividends) will result in an increased reliance on safe income[7] as an "out" to subsection 55(2).

However, the narrowing of the safe income exception (under Budget 2015) means that the existence of safe income in a particular corporation won't necessarily allow a taxpayer to avoid subsection 55(2). In particular, in order for the safe income exception to apply, safe income must contribute to the capital gain of the share on which the dividend is received. An inherent asymmetry arises between the charging provision of subsection 55(2) and its exceptions, where none existed before. Indeed, old subsection 55(2) applied where the purpose of the dividend was to reduce *the capital gain on any share*, and the safe income exception applied if that capital gain (that was reduced by the dividend) was attributable to safe income. Now, subsection 55(2) applies where "one" of the dividend purposes is met on any share, whether or not such a share has an inherent gain. However, the safe income exception depends *on*

[1] The authors would like to thank Kam Lee of Manu Kakkar CPA Inc. Montreal for his assistance on this paper. We would also like to thank Tax Templates Inc. for the use of their safe income template. However, all errors and omission on this paper are the sole responsibility of the authors.

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[5] Income Tax Act (R.S.C., 1985, c. 1 (5th Supp.))(hereinafter referred to as the "Act")

[6] Federal budget tabled on April 21, 2015. The changes to subsection 55(2) received Royal Assent on June 22nd, 2016 and apply to dividends received after April 20th, 2015

[7] Safe income and "safe income on hand" are generally used interchangeably in this paper.

whether the share on which the dividend is received has a capital gain that is attributable to safe income.[8]

Finally, the paper will discuss the procedure for allocating safe income to various share classes, now of fundamental importance, as this will determine whether the share on which the dividend is received enjoys any safe income.

The last part of the paper will examine when a safe income calculation is necessary (when retained earnings cannot be relied on). Also, some conceptual issues are discussed and reviewed insofar as to how to compute safe income and safe income on hand. A detailed calculation of safe income is presented in Appendix A of this paper. The detailed spreadsheet in the computation of safe income on hand reflects *Kruco*[9] and not necessarily Canada Revenue Agency's (CRA's) historical positions.

New Purposes

Under new subsection 55(2.1), two new purpose tests for *actual dividends* have been included—meaning there are now three purposes tests for actual dividends in total. The purpose test is satisfied where one of the purposes of the actual dividend is to effect:

- Significant reduction of the FMV of any share;
- Significant increase in the cost of property for the dividend recipient;
- Significant reduction in the capital gain that would have been realized on the disposition at FMV of any share.

Under the old rules, subsection 55(2) could only apply if there had been a significant reduction on the capital gain inherent in any share. Given the 2 new purpose tests, subsection 55(2) now also catches dividends the purpose of which is to reduce the FMV of loss shares or shares with no gain (FMV=ACB). This will materially increase the number of instances where subsection 55(2) may apply.

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[8] Similarly, for deemed dividends, subsection 55(2) applies where the result of the dividend is to reduce the capital gain on any share, however, the safe income exception only applies to the *extent the share which the dividend is received has a capital gain that is attributable to safe income*.
[9] 2003 FCA 284

Same Results Test

For subsection 84(3) deemed dividends, the same results test applies. As before, if the result of a subsection 84(3) deemed dividend is to effect a significant reduction in the capital gain that would have been realized on the disposition at FMV of any share, subsection 55(2) may apply.

Paragraph 55(3)(a) exception narrowed:

Old paragraph 55(3)(a) excepted all (deemed and actual) inter-corporate dividends from the application of subsection 55(2) if, as part of a series of transactions in which the dividend was received, none of the 5 events described in subparagraphs 55(3)a)(i) to (v) occurred. Essentially, old paragraph 55(3)(a) exempted from subsection 55(2) all inter-corporate dividends paid as part of series of transactions where no unrelated party was involved.

New paragraph 55(3)(a) now applies to dividends referred to in subsection 84(2) and 84(3) only. Thus, paragraph 55(3)(a) no longer applies to actual (cash) dividends. Henceforth, inter-corporate actual dividends may be subject to subsection 55(2), even though there is no unrelated party involved in the series of transactions.

Thus, if no safe income is available on a share on which an actual dividend is paid, the avoidance of subsection 55(2) will depend on documenting a proper purpose. The paper will offer suggestions as to what constitutes a proper purpose to avoid subsection 55(2).

For subsection 84(3) deemed dividends, the purpose of the dividend is irrelevant. When the result of a share redemption is to reduce a capital gain on any share, in the absence of safe income, only paragraph 55(3)(a) provides an "out" to subsection 55(2).

Any proper purposes?

At CTF's June 8, 2016 Technical Seminar in Ottawa, CRA stated that it would not provide any "automatic or blanket exemption" for any particular category of dividend. Rather, CRA stated that one must look at the purpose of each dividend on a case by case basis. CRA stated that it would issue rulings on purpose provided they are given all the relevant facts. It is regrettable that CRA appears to be shying away from providing guidance on "purpose" at this time of uncertainty.

Dividends in "the normal course"

In TI 2015-0613821C6, CRA stated that where a dividend is paid pursuant to a well-established policy of paying regular dividends and the amount of the dividend does not exceed the amount that one would normally expect to receive as on a comparable listed share issued by a comparable payer corporation in the same industry, the purpose tests are not met. CRA qualified this position at CTF's June 8 Technical Seminar, stating this was simply an example and not a blanket exception, and that every dividend purpose must be examined on a case by case basis.

Creditor Proofing

In 2015-0617731E5 CRA opined that the purpose of a creditor proofing dividend is necessarily to significantly reduce the FMV of a share in the stock capital of a corporation. CRA reiterated this position at CTF's June 8, 2016 Technical Seminar in Ottawa. Some tax authors have disagreed with CRA's position.[10]

Purification Dividend for Claiming Capital Gains Exemption

Is a purification dividend--allowing a corporation to qualify as small business corporation for the purpose of the capital gains exemption—a proper purpose? Or, like a creditor proofing dividend, is it equivalent to a purpose of significantly reducing the FMV of the Opco shares? To the authors' knowledge, there is no CRA commentary on this issue. Arguably, the purpose of a purification dividend is not the same purpose as reducing the FMV of shares. On a policy level, if one can't pay a purification dividend to avail oneself of the capital gains exemption, why have the capital gains exemption in the first place?

Liquidity to shareholders

For example, Holdco needs to withdraw some funds for general corporate purposes or to buy property. Arguably, the purpose is not to "reduce the FMV of the shares". Again, the authors are not aware of any CRA commentary on this issue.

Because of the lack of certainty on purpose, taxpayers will more often rely on the safe income exception to avoid subsection 55(2).

<u>Tightening of the Safe Income Exception</u>

[10] Perry J. Kiefer and Crystal L. Taylor: "Lumpy Creditor-Protection Dividends and Subsection 55(2)" *Tax for the Owner-Manager* Volume 16, Number 3, July 2016.

Budget 2015 reworded the safe income exception, with apparently minor, but significant, changes. In particular, in order for the new safe income exception to apply under par 55(2.1)(c), safe income must reasonably be considered to contribute to the capital gain of the share on which the dividend is received. Contrast with the broader wording under the old safe income exception, where safe income had to contribute to the capital gain which had been reduced by the dividend[11]. As shall be illustrated in the examples below, this change *appears* minor but is actually quite significant:

Tightening of Safe Income Exception : Example 1:

- Opco pays a creditor proofing cash dividend on a share with no gain, i.e. FMV=ACB.
- Opco has sufficient global safe income to cover the dividend.
- Assume reduction of FMV is the purpose of the dividend payment.
- There is no safe income attributable to the share on which the dividend is received since the discretionary dividend share has nil gain.

In this example, the safe income exception does not provide a safe harbour against the application of subsection 55(2). This is because the share on which the dividend is received does not have an inherent gain to which safe income could contribute.

Under the old rules, subsection 55(2) would have only applied if the dividend reduced the capital gain on any share. Furthermore, safe income would have provided a safe harbour to the extent that the capital gain (that was reduced by the dividend) was attributable to the global safe income.

Tightening of Safe Income Exception: Example 2:

- Opco redeems a fixed value preferred share with no gain, i.e. FMV=ACB.
- Opco has another class of fluctuating value common shares.
- OPCO has sufficient global safe income to cover the dividend.

[11] Paragraph 55(2) as it read prior to April 2015

- Assume <u>result</u> of redemption payment is to reduce capital gain on the common shares.
- There is no safe income attributable to the share on which the dividend is received since the preferred share has nil gain.

In this example, the safe income exception does not provide a safe harbour against subsection 55(2) despite there is sufficient global safe income in Opco to cover the dividend. This is because the share on which the dividend is received does not have an inherent gain to which safe income could contribute.

Under the old rules, safe income would have provided a safe harbour to the extent that the capital gain which was reduced by the dividend on the common shares was attributable to the global safe income.

As has been illustrated by the examples above, the safe income exception has effectively been tightened. Indeed, safe income must contribute to a "capital gain" of the share on which the dividend is received, which means safe income <u>is inaccessible</u> where the dividend is paid on a loss share or a share where FMV=ACB.

How does one determine whether existing safe income contributes to the class of shares on which the dividend was received? The question of safe income allocation to various share classes is critical and will ultimately determine whether the safe income exception will apply in any given situation.

<u>Traditional CRA Administrative and Jurisprudence on Safe Income Allocation</u>

Safe income is, essentially, income that has been realized and taxed in the corporation. The safe income harbour allows corporate income that has already been taxed to be distributable to another corporation without triggering further tax under subsection 55(2).

The traditional set of administrative rules which govern the allocation of safe income to various classes of shares has been historically complex. Under CRA's traditional approach, safe income tracks *particular* classes of shares and *particular* shareholders. Indeed, Robertson[12] wrote that: "each share of a corporation represents only its proportionate share of the value of the company and therefore is entitled only to its proportionate share of the safe income"

[12] John R. Robertson, "Capital Gains Strips: A Revenue Canada Perspective on the Provisions of Section 55," *Report of Proceedings of the Thirty-Third Tax Conference*, 1981 Conference Report (Toronto: Canadian Tax Foundation, 1982), 81-109.

(the “Pro-Rata Approach”); and further: “the computation of safe income with respect to shares held by the shareholder of one company is <u>independent</u> of the computation of safe income with respect to shares held by another shareholder of the same company”.

For example, CRA’s holding period rule illustrates the traditional approach, in that safe income tracks particular shares and particular shareholders. Under the holding period rule, safe income must be earned <u>after</u> the shareholder acquires the share in order to contribute to any gain on the share[13]. This rule has generally been considered as equitable because any safe income predating the share acquisition would be notionally reflected in the ACB of the acquired shares. However the ACB is only useful to the extent the share is disposed of. Thus, assume Holdco A and Holdco B each hold 50 common shares of Opco, Opco has FMV of $100, and safe income of $50. The safe income is allocated $25/$25 to each Holdco A and Holdco B. If Holdco C acquires 50 common shares of Opco from Holdco B for $50, Holdco C’s shares effectively have no safe income allocated to them at the time of the acquisition because the safe income is notionally reflected in the $50 ACB of the Opco shares held by Holdco C. Safe income of $25 remains on Holdco A’s common shares. Thus, if an actual dividend is paid on the common shares immediately after acquisition, Holdco A would enjoy safe income on its common shares, whereas Holdco C would not.

In the same vein, where all of a corporation’s issued shares consist of participating common shares with a discretionary dividend entitlement, CRA had adopted the position that it was not appropriate to allocate all of a corporation’s safe income to a single class of shares (TI 2003-0006305). CRA stated that while it would be impossible to allocate safe income without analyzing the share attributes and the terms of any unanimous shareholder agreements, it suggested that a pro-rata allocation of safe income as between the various share classes would be the preferred approach, quoting *R. v. Nassau Walnut Investments Inc.* 97 DTC 5051 in this regard.

However, *Nassau* did not deal with disproportionate allocations of safe income as between various classes of shares. In *Nassau*, a corporate shareholder (Nassau Walnut Investments Inc.) owned common shares of an Opco. Opco redeemed all of Nassau’s common shares in tranches. No safe-income designations were filed under paragraph 55(5)(f), and the entire deemed dividend received by Nassau, the corporate shareholder, was reassessed as proceeds

[13] John R. Robertson, "Capital Gains Strips: A Revenue Canada Perspective on the Provisions of Section 55," *Report of Proceedings of the Thirty-Third Tax Conference*, 1981 Conference Report (Toronto: Canadian Tax Foundation, 1982), 81-109.

of disposition. The judge rejected the argument that the total safe income could be allocated entirely to the first tranches of repurchased Opco shares. Rather, *Nassau* establishes that a pro-rata allocation of safe income is a reasonable approach. (The judge in *Nassau* stated in *obiter* that he would not hesitate to conclude that the only acceptable method for allocating safe income is the pro-rata approach, were it necessary to do so. However, the judge refrained from doing so as it was not necessary to decide that point.)

Similarly, in *Gestion Jean Paul Champagne*[14], the judge rejected the argument that all the safe income could be allocated to one shareholder where only one corporate shareholder's shares had been redeemed. In *Gestion Jean Paul Champagne*, each corporate shareholder held the same class of common shares. Basing himself on the notion of share equality[15], the judge inferred that safe income should have been allocated to the common shares pro-rata.

To the authors' knowledge, a court of law has never considered disproportionate allocations of safe income as between various classes of shares. In particular, *Nassau Walnut* and *Gestion Jean Paul Champagne* dealt with disproportionate allocations of safe income as between shares of the same class and are arguably not relevant to the discussion of how to allocate between various share classes.

<u>Where Are We Now With Safe Income Allocation?</u>

In a recent TI, Safe Income Allocation – TI 2015-0593941E5 (in French), CRA allowed for a disproportionate allocation of safe income where the only issued shares were various classes of common shares with a discretionary dividend entitlement. The holding period test was not referred to in any of the 5 examples except example 3 in which CRA stated that all the discretionary dividend common shares had been issued at the same time. Furthermore, CRA considered that the declaration of the dividend on the common share in and of itself increased the FMV of the share, and therefore increased the gain on the share up to which safe income could be allocated.[16] In this manner, the safe income of the corporation could effectively be declared on any class of discretionary dividend common shares as the corporation saw fit.

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[14] 97 DTC 155 (TCC)

[15] The judge in *Gestion Jean Paul Champagne* cited the following passage from *McClurg* 91 DCT 5001 "the rights carried by all shares to receive a dividend are equal unless otherwise provided in the Articles of Incorporation".

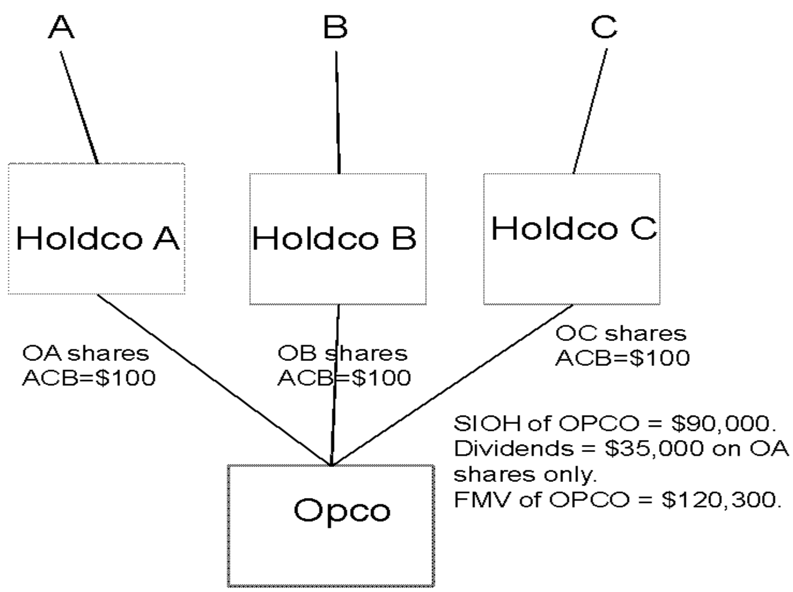
[16] Indeed, new paragraph 55(2.1)(c) provides that safe income must contribute to the capital gain on the shares on which the dividend is received.

In allowing safe income to be disproportionately allocated between discretionary dividend common shares, TI 2015-0593941E5 reverses CRA's old position in 2003-0006305 on pro-rata allocation. More significantly perhaps, the TI also seems to represent a departure from the traditional CRA approach that safe income tracks to particular classes of shares and particular shareholders. It is interesting that the holding period test is only briefly mentioned in 1 of the 5 examples discussed in that letter. Furthermore it is noteworthy that CRA suggests that shares with a greater gain may have a greater proportion of safe income allocated to them.

TI 2015-0593941E5 Example 1

- Three unrelated shareholders Aco, Bco and Cco, holding shares of OPCO.
- Each Aco, Bco and Cco holds a distinct class of voting and participating shares: class OA, OB and OC respectively.
- Aco has 100 OA shares with ACB =$100
- Bco has 100 OB shares with ACB=$100
- Cco has 100 OC shares with ACB=$100
- Each class of OPCO shares is entitled to discretionary dividends.
- FMV of OPCO = $120,300.
- Safe Income of OPCO = $90,000.
- It is proposed that a dividend of $35,000 be paid on OA shares only.
- FMV of the share would be established immediately before the payment of the dividend, taking into account that such share would be entitled to the additional dividend of $35,000.
- Hypothetical capital gain = $40,000 + $35,000.
- Dividend of $35,000 would neither exceed the global safe income of $90,000 nor the hypothetical capital gain.

Technical Interpretation TI 2015-0593941E5 -— Example 1



According to CRA, after payment of the $35,000 dividend on the OA shares of Opco, the FMV of the company would be reduced to $85,300 and the safe income on hand of OPCO would decrease to $55,000. Thus, a non-proportional allocation of safe income was allowed in this example.

However, CRA did not allow a disproportionate allocation of safe income in TI 2016--0633101E5 (also in French). In that TI, Opco had issued **fixed value** Class A participating shares with a discretionary dividend entitlement and **fluctuating value** Class B participating common shares with a discretionary dividend entitlement.[17] The facts in that TI were as follows:

[17] Incidentally, CRA cautioned against use of discretionary dividends generally. They stated that in some situations discretionary dividends may lead to the application of 15(1), 56(2), 69(1) and 246(1). CRA further suggested that in

TI 2016-0633101E5 Safe Income Allocation

- OPCO has a FMV=$2M.
- OPCO has Safe Income=$1M.
- Individuals X and Y are unrelated.
- X holds the shares of Holdco1.
- Y holds the shares of Holdco2.
- Holdco1 has Opco Class A shares that are fixed value participating with discretionary dividends.
- Holdco2 has Opco Class B shares that are participating shares with discretionary dividends.
- Opco pays $1M dividend on the Class B shares.
- This would reduce the value of Class B shares to $1.00 but value of Class A shares would remain fixed.
- Then buyback B shares for $1.00.
- CRA states $500,000 safe income would be allocated to Class B shares.
- This means $500,000 would be a distinct taxable dividend under 55(5)(f)
- Safe income attributable to Class A shares would be $500,000.

The inability to do a disproportionate allocation of safe income on the Class B shares hinged on the fact that the FMV of the Class A shares was fixed and that the payment of the dividend on the Class B shares would not reduce the FMV of the Class A shares. However, CRA stated it would have allowed a disproportionate allocation of safe income to the Class B shares if the dividend payment had reduced the FMV of all the participating shares of the corporation.

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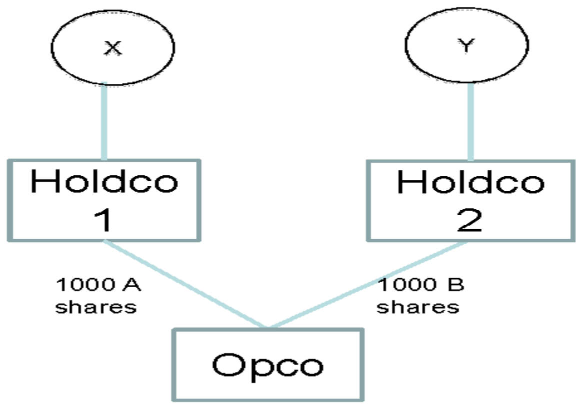
a butterfly transaction, the difficulty in valuating discretionary dividend shares may mean it would be difficult to determine whether a “distribution” had occurred within the meaning of subsection 55(1).

TI 2016-0633101E5 Safe income allocation



To the extent TI 2015-0593941E5 represents a new approach on safe income allocation, it is welcome. However, the TI does raise a number of questions. What if Opco's issued share capital solely consisted of different classes common shares with a discretionary dividend entitlement, but the common shares had been issued at different times? Would CRA still allow a disproportionate allocation of safe income? Would CRA allow a disproportionate allocation of safe income as between various classes of common shares with a discretionary dividend entitlement if Opco has also issued fixed value preference shares?

When it comes to rules on safe income allocation, is CRA moving in a new direction? If the safe income allocation rules could be simplified and corporations could be given more discretion in how to allocate the safe income to various shares, this would be a welcome development. On a policy level, if a corporation has FMV both reflected by safe income and untaxed appreciation in its assets, who is to say that the gain on particular shares is traceable to safe income, and not to the untaxed appreciation? On a policy level, what is the harm in viewing safe income as a corporate surplus account (such as the Capital Dividend Account, the General Rate Income Pool Account, or the Refundable Dividend Tax On Hand Account) that the corporation can allocate as it wishes, to the extent the allocation is supported by the share attributes and the gain on the shares? If safe income has been "used up" in the disproportionate allocation, and is deducted from the surplus account once allocated, other shareholders won't unduly benefit.

Incidentally, it was the "global" "corporate surplus account" approach that the court in *729658 Alberta Ltd*. seemed to be describing in the passage below:

> In interpreting the phrase "reasonably be attributable," there has never been any suggestion that an accrued gain should generally be apportioned on a *pro rata* basis between "income earned or realized" and "unrealized appreciation in the value of underlying assets." The accepted approach is that gain is first allocated to "income earned or realized" and, only if dividends exceed this amount, is gain allocated to "unrealized appreciation in the value of underlying assets." There is nothing in the statute that implies this ordering but it is critical in order that subsection 55(2) achieve the legislative purpose.

Other Changes to Safe Income

<u>New Paragraph 55(5)(f)</u>

Paragraph 55(5)(f) now applies automatically for actual or deemed dividends (but not stock dividends as will be discussed in the following section). A designation is no longer required. Paragraph 55(5)(f) automatically splits the amount of a taxable dividend in two separate dividends. Where the safe income that contributes to the capital gain on which the dividend is received is LESS than the taxable dividend received, paragraph 55(5)(f) automatically splits the taxable dividend into two separate taxable dividends, a safe income taxable dividend, and a non safe income taxable dividend.

It is thus no longer possible to trigger subsection 55(2) deliberately by failing to file the 55(5)(f) designation on the entire taxable dividend. This strategy was especially useful where the client wanted the larger CDA account to extract from the private corporation and was willing to pay the upfront although cheaper corporate capital gain rates.

Subsection 55(2) may still be triggered deliberately for the portion of the dividend which exceeds the SIOH. This will force taxpayers and their advisors to keep more up to date and current safe income calculations to notionally separate the safe income dividend and the taxable dividend that may be subject to subsection 55(2). A transitional rule exists which allows a designation for dividends received after April 20, 2015 and before April 18, 2016.

Safe Income and Stock Dividends

According to new subsection 55(2.2), the amount of a stock dividend is the greater of paid-up capital and the FMV of the share. Thus, if Company A pays a stock dividend to Company B for which the paid-up capital is $1.00 and the FMV is $1 million, according to new subsection 55(2.2), the dividend amount will be $1 million, whereas, under the old rule, the dividend amount would be $1.00.

Subsection 55(2.4) will determine when subsection 55(2.3) will apply which is essentially when the FMV of the stock dividend exceeds its PUC increase resulting from the dividend. According to new paragraph 55(2.3)(a), the amount of the stock dividend up to safe income is deemed to be a separate dividend. This rule parallels the aforementioned new paragraph 55(5)(f) for stock dividends.

New paragraph 55(2.3)(b) specifies that the amount of the stock dividend referred to in 55(2.3)(a) reduces the amount of the safe income on hand of any corporation which therefore legislatively prevents the doubling up of safe income via a corporate chain using stock dividends that was permitted in the *D & D Livestock case*[18].

Part IV Tax Trap

A Part IV tax problem may arise when family trusts allocate safe income dividends to its corporate beneficiaries.[19] Indeed, although safe income characterization flows through, Part IV tax may apply in certain situations. For example, assume that on May 31, Opco pays safe income dividends to Holdco 1. On the same day, Holdco1 pays the safe income dividend to the trust. On the following day, June 1, the trust sells its Holdco1 shares to an unrelated third party. As at December 31, when trust makes the allocation to Holdco2, its corporate beneficiaries,

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[18] 2013 TCC 318.

[19] In TI 2014-0538061C6, a dividend allocated by a family trust to a corporate beneficiary retained its character as a safe income dividend paid from the operating company. See Kakkar & Halil "Corporate Beneficiary Can Add to Its Safe Income on Hand," *Tax for the Owner-Manager*, July 2015

Holdco 1 and Holdco 2 are no longer connected. Thus, Part IV tax will be applicable on safe income dividend allocated to Holdco 2.

According to CRA TI 2016-0647621E5, the time for determining whether Holdco1 is connected with Holdco2 in such situations is at the end of the year. Indeed, a trust may make a subsection 104(19) designation if it is resident in Canada "throughout" the year. Accordingly, a trust may allocate dividends under subsection 104(19) only at the end of its year—that is, on December 31. We also note that the designation by the trust must be made in the trust's return of income for the year under paragraph 104(19)(a). Since the trust's return of income may only be filed upon or after the year-end, this gives further credence to CRA's position that the time for determining whether Holdco 1 and Holdco 2 are connected is on December 31.

If the corporate beneficiary of the trust and the corporate payer are no longer connected as at December 31, Part IV tax may apply.

Is a Safe Income Calculation Required?

The calculation of safe income and safe income on hand ("safe income") has become paramount as a result of the 2015 Budget. As discussed in various other papers[20] one of the

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[20] Section 55: A Review of Current Issues (Robert J.L. Read, Report of Proceedings of the Fortieth Tax Conference, 1988 Conference Report (Toronto: Canadian Tax Foundation, 1989), 18:1-28.

Income Earned or Realized: Some Reflections (Michael Hiltz, Report of Proceedings of the Forty Third Tax Conference, 1991 Conference Report (Toronto: Canadian Tax Foundation, 1992), 15:1-24

Kim G.C. Moody and Kenneth Keung, "Subsection 55(2) – The Road Ahead," 2016 Prairie Provinces Tax Conference, (Toronto: Canadian Tax Foundation, 2016), 10:1-43

Capital Gains Strips: A Revenue Canada Perspective on the Provisions of Section 55 (John Robertson, Report of Proceedings of the Thirty-third Tax Conference, 1981 Conference Report. (Toronto: Canadian Tax Foundation, 1982), 81-109.

Section 55: An Update (Michael A. Hiltz, 1984 Corporate Management Tax Conference (Toronto: Canadian Tax Foundation, 1984), 40-46.

Section 55: A Review of Current Issues (Robert J.L. Read, Report of Proceedings of the Fortieth Tax Conference, 1988 Conference Report (Toronto: Canadian Tax Foundation, 1989), 18:1-28.

safe harbors that taxpayers rely on to avoid subsection 55(2) is the concept of "income earned or realized by a corporation." Over the years, this concept has proved challenging to the tax community.

It is generally the exception--not the norm--that a corporation's retained earnings will equal a corporation's safe income. There are a number of factors that affect safe income on hand for a particular share that is not reflected in the retained earnings number on a company's balance sheet. Some examples are:

a) Differences in book to tax adjustments in computing net income for tax purposes;
b) Research and development expenses and investment tax credits[21];
c) Share redemptions;
d) Estate freezes;
e) Multiple classes of shares; and
f) Stock splits

Statutory rules for Safe Income Calculation:

The statutory rules under paragraphs 55(5)(b), (c) and (d) are the only forms of legislative guidance a practitioner can rely upon to calculate the income earned or realized by a corporation. Paragraphs (55)(b), (c) and (d) are broken out as follows:

Paragraph 55(5)(b)

A corporation that is not a private corporation (generally a public or a subsidiary of a public corporation) will calculate its safe income under the provisions of paragraph 55(5)(b), which essentially adjusts safe income by:

Income Earned or Realized: Some Reflections (Michael Hiltz, Report of Proceedings of the Forty Third Tax Conference, 1991 Conference Report (Toronto: Canadian Tax Foundation, 1992), 15:1-24.

[21] Please refer to the *Kruco* case discussed later on in this paper.

i) Adding back the inventory allowance under former paragraph 20(1)(gg)[22] and former section 37.1 which was the additional allowance for scientific research and development[23].

ii) Adding back the non-taxable portions of capital gains and the non-deductible portion of capital losses of the corporation. (Because non-private corporations do not have a capital dividend account).

iii), iv) and v) Adding back the non-taxable portions of capital gains that arise from paragraph 14(1)(b) in respect of eligible capital property. However, amounts are netted by any bad debts or capital losses claimed on eligible capital property. The proposed repeal of section 14[24] likely won't have an impact on paragraph 55(5)(b) as safe income is a historical calculation.

Paragraph 55(5)(c)

Under paragraph 55(5)(c), private corporations may not deduct from safe income amounts as a result of the former paragraph 20(1)(gg)[25] (Inventory allowance) and former section 37.1[26] (additional allowance for scientific research and development). Unlike 55(5)(b), par. 55(5)(c) does not include the adjustments for capital gains and losses and eligible capital amounts because a private corporation has a capital dividend account.

Paragraph 55(5)(d)

This paragraph details rules that are applicable to the calculation of safe income of a foreign affiliate as defined under subsection 95(1) of the ITA. The rules generally state that the safe income of a foreign affiliate is deemed to be the lesser of:

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[22] Provided a 3% Inventory allowance, repealed in 1986

[23] Additional R&D allowance that was eliminated in 1983 subject to grandfathering provisions

[24] The March 22nd 2016 Budget Notice of Ways and Means Motion, s.64 ,will repeal section 14, in force January 1, 2017

[25] Provided a 3% Inventory allowance, repealed in 1986

[26] Additional R&D allowance that was eliminated in 1983 subject to grandfathering provisions

a) The foreign affiliates tax free surplus balance pursuant to Income Tax Regulation 5905(5.5) and without taking into account Regulation 5905(5.6).

b) The fair market value of the shares of the foreign affiliate at the determination time of all the issued and outstanding shares of the foreign affiliate.

Beyond these statutory rules found under the Act, there is a body of case law surrounding the computation of safe income on hand. A summary of the guidance provided by the courts in calculating safe income on hand is as follows (though not inclusive, this may assist a practitioner in calculating safe income):

Case Law Surrounding the Computation of Safe Income

454538 Ontario Limited[27]

This case established that the term "income earned or realized" as referred to in the Act is income determined pursuant to Division B of Part 1 of the Act.

The taxpayer had argued that generally accepted accounting principles were sufficient in calculating of safe income. In response, the Minister's argued that "income earned or realized" as referred to in the Act is income determined pursuant to Division B of Part 1 of the Act. The Court found in favor of the Minister, specifying that safe income is to be determined in accordance with the Act, and not generally accepted accounting principles.

Gestion Jean-Paul Champagne Inc. ("Champagne")[28]

The *Champagne* case considered the issue of whether dividends should be deducted from safe income. The taxpayer argued that that safe income should be calculated pursuant to paragraph 55(5)(c) of the Act only, and accordingly dividends should not be taken into consideration when determining the safe income on hand for a corporation.

[27] 93 DTC 427
[28] 97 DTC 921

The Minister contended that dividends previously paid reduce the safe income as that income is no longer “on hand” and therefore available to the taxpayer to distribute out of safe income.

Ultimately, the Court sided with the Minister in deciding that dividends paid prior to the safe income determination time cannot be “on hand” to contribute to the gain on the shares.

Deuce Holdings Limited (“Deuce Holdings”)[29]

This case considered whether the payment of federal and provincial taxes is relevant in the calculation of safe income on hand. As no purchaser would pay for a share on the basis of a pre-tax amount, and as it is rarely the case that pre-tax profits would be wholly distributable, the Court concluded that the payment of taxes reduce the safe income on hand that can be distributed by way of a safe income dividend.

Brelco Drilling Ltd. (“Brelco”)[30]

In *Brelco*, the Federal Court of Appeal addressed the issue of whether exempt deficits incurred by its foreign affiliates should reduce its safe income.

The Federal Court of Appeal stated safe income is a net calculation and that “safe income” means “safe income on hand”. Accordingly, exempt deficits, or any other cost which reduces the safe income on hand, must be taken into account in determining “income earned or realized”.

The Federal Court of Appeal confirmed that subsection 55(5) is only the starting point for the calculation of safe income on hand. Whether the losses of a foreign affiliate are to be included in the calculation of safe income on hand is based on the facts of each case.

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[29] 97 DTC 921
[30] 99 DTC 5253

Kruco Inc. ("Kruco")[31]

The *Kruco* case focused on the meaning of "income earned or realized" and whether income as determined by Division B of Part 1 of the Act should be reduced by items for which there was not corresponding increase in the taxpayer's cash flow. Such items are termed "phantom income".

In *Kruco*, the Minister argued that income from investment tax credits claimed by the taxpayer were "phantom income" and should thus reduce the taxpayer's safe income. Both the Tax Court and the Federal Court of Appeal rejected the Minister's argument. The term "income earned or realized" is deemed to be income that is calculated as per paragraph 55(5)(c) of the Act. Pursuant to subsection 55(2) and paragraph 55(5)(c), adjustments to safe income at the computation of income stage are limited to those provided in paragraph 20(1)(gg) or section 37.1. If Parliament had intended there to be other adjustments, it would have so provided. Therefore, the Courts concluded that the phantom income that arose as a result of the investment tax credits claimed by the taxpayer and one of its subsidiaries should not reduce the safe income available to the taxpayer.

However, both levels of Court recognized that certain adjustments to safe income could nonetheless be made which would not affect the computation of a taxpayer's income, and that the safe income adjustments can and ought to be made concerning a taxpayer's cash position and involving balance sheet items that do not affect the calculation of income as such.

There has been some debate about whether *Kruco* (FCA) stands for the proposition that such adjustments should include non-deductible expenses. We note, in this regard, that the Federal Court of Appeal summarized a passage from the trial court decision in which the trial court judge stated that negative adjustments could be made for taxes paid or payable, dividends, and non deductible expenses[32].

[31] 2001 DTC 668 affirmed by 2003 FCA 284

[32] At paragraph 22 of the FCA decision. Incidentally, the Tax Court Judge distinguished *Brelco* on the basis that, in that case, the adjustment at issue (which derived from losses of foreign affiliates) did not affect the computation of income. In his view, these amounts could properly be deducted from safe income inasmuch as they reflected cash flow shown on the balance sheet and did not affect the computation of income.

Further, at paragraph 31 of the judgment, The Federal Court of Appeal stated that: "…the Tax Court Judge came to the correct conclusion, essentially for the reasons that I have attempted to summarize in the preceding paragraphs".

Subsequent to the *Kruco* decision, the CRA released Income Tax Technical News ("ITTN") 33 on September 16, 2005 and ITTN 34 on April 27th 2006, in both these ITTN's the CRA commented on the Kruco decision. In both technical bulletins the CRA accepted the Federal Court of Appeal's decision on calculating safe income and indicated that it would follow the decision released in *Kruco* with respect to investment tax credits and capital cost allowance deductions. Also, the CRA mentioned that safe income would be computed on the basis of net income as provided under the Act, and only subject to adjustments paragraphs 55(5)(b) and (55)(5)(c). With respect to the calculation of safe income on hand, the CRA would only consider cash outflows that reduce the potential capital gain attributable to the share, for example taxes and dividends. The CRA in both the ITTN's did not mention other types of outlays which could reduce safe income.

On February 15th, 2008 the CRA released ITTN 37, in which it altered its position in respect to non-deductible expenses as they relate to safe income on hand. In summary, CRA stated that based on *Kruco* and *Champagne*, non-deductible expenses would reduce the safe income on hand available to a taxpayer.

<u>For What Period Does Safe Income Have to be Calculated?</u>

The first step in calculating safe income is to determine the holding period of the shares. Generally, this period is the later of the date of acquisition of the share and January 1, 1972. It is CRA's historical position that the price paid by the acquiring shareholder for the particular share reflects the corporate income earned to the date of the acquisition. The safe income therefore, is reflected in the shareholder's adjusted cost base.

However, there is an exception to this rule in the event that the share is acquired by the taxpayer on a tax deferred basis pursuant to the rollover provisions of the Act, such as section 85. In this case, where shares are transferred at their adjusted cost base all the safe income that is attributable to the transferred shares will become the safe income of the newly acquired shares. Should more than one class of shares be acquired upon the rollover, the safe income will be allocated proportionally over the various classes of shares.

The CRA has commented in various technical interpretations[33] that where shares of a taxable Canadian corporation are transferred on a tax deferred exchange such as under subsection 85(1) from one taxable Canadian corporation to another and the fair market value of the shares disposed is equal to the fair market value of the shares acquired, all of the safe income in the transferred shares will become the safe income of the acquired shares.

However, it should be noted that the same holding period does not apply when an individual transfers the shares of a foreign affiliate to a Canadian holding company. Paragraph 55(5)(d) uses as a starting point, the surplus pools of a foreign affiliate of a Canadian corporate shareholder in the computation of safe income of a foreign affiliate. The surplus pools, and therefore the safe income of a foreign affiliate, can only start when a Canadian corporation holds an equity percentage of at least 1% and through related parties 10% of the equity percentage of a foreign affiliate[34].

Safe Income Determination Time - The Ending Point

The safe income determination time is defined under subsection 55(1) of the Act as:

> ...for a transaction or event or a series of transactions or events or events means the time that is the earlier of
>
> a) The time that is immediately after the earliest disposition or increase in interest described in any of subparagraphs (3)(a)(i) to (v) that resulted from the transaction, event or series, and
>
> b) The time that is immediately before the earliest time that a dividend is paid as part of the transaction, event or series.

Pinpointing the commencement of a "series of transactions or events" is of paramount importance for the practitioner. The meaning of series of transactions or events has been developed in the jurisprudence. For example, in *Canada Trustco Mortgage Co. v. The Queen*[35]

[33] 2000-0003253; see also 2001-0093375
[34] Subsection 95(1) of the Act and Subsection 5907(1) of the Regulations
[35] [2005] 5 C.T.C. 215

the Supreme Court stated that steps must be pre-ordained in order for them to be considered to be part of the same series.

Subsection 248(10) of the Act defines a series of transactions as:

> For the purposes of this Act, where there is a reference to a series of transactions or events, the series shall be deemed to include any related transactions or event completed in contemplation of the series.

This definition of series is broad, resulting in unintended consequences for a practitioner when determining the endpoint of the safe income calculation.

Safe Income Calculation for Stub Periods

When computing the safe income per share, the practitioner will often have to account for stub periods. There are likely two important stub periods that the practitioner has to be aware of:

a) From the date that the share was acquired by the taxpayer to the first taxation year of the dividend payor.

b) From the beginning of the taxation year to the safe income determination time.

In *VIH Logging,*[36] the Federal Court of Appeal established that stub period income should be accounted for when calculating the safe income for the period.

In rendering its judgment, the Federal Court of Appeal stated that the phrase “net income for the year” does not appear in subsection 55(2) of the Act, therefore, allowing the inclusion of stub period income into the safe income calculation.

[36] 2005 DTC 5095 (FCA)

Other Factors to Consider When Calculating Safe Income

Certain adjustments under Division B of Part I of the Act must be taken into account to determine the safe income on hand of a corporation.

Subsequent to *Kruco,* safe income is determined under paragraph 55(5)(b) and (c) of the Act. However, such income earned by the particular corporation may not be “on hand” to contribute to the capital gain of its share. Further adjustments must be made to determine what income is “on hand’ to contribute to the capital gain.

These adjustments to safe income on hand are further complicated by the fact that it may be difficult to obtain historical tax returns, notices of assessments and various other data relating the tax situation of a company from years past. In particular this can become a concern when you have not been the accountant of the corporation since the onset and now are relying on CRA to obtain the information.

Some of the key variables to take into account when computing safe income on hand are as follows:

Refundable Taxes

It is CRA’s position that refundable taxes that are not yet refunded are to be deducted from safe income on hand and subsequently included into the safe income on hand when received[37].

CRA’s position on refundable taxes may not be entirely accurate as value may be assigned to the receivable. Indeed, a potential buyer may be willing to pay for the receivable when acquiring the shares of the company, which would contribute to the gain on the share.

CRA’s approach may understate the safe income at the safe income determination time, even though that particular receivable is contributing to the gain on the share.

[37]Capital Gains Strips: A Revenue Canada Perspective on the Provisions of Section 55 (John Robertson, Report of Proceedings of the Thirty-Third Tax Conference, 1981 Conference Report. (Toronto: Canadian Tax Foundation, 1982), 81-109.

Capital Losses

It is CRA's position that capital losses reduce safe income when incurred and not when claimed for tax purposes[38]. The rationale for this position is that safe income has been expended to finance the losses and therefore cannot add to the value of the shares.

The CRA's historical position on capital losses may be incorrect. When a corporation incurs a capital loss it is likely that this unclaimed loss would have reduced a portion of the gain on a share that is attributable to something other than safe income given that the loss is capital in nature. This lends itself to the argument that the safe income should be reduced only when the capital loss is claimed against a capital gain which is in line with the FCA *Kruco* decision[39].

Denied Losses

In a 2011 technical interpretation (post - *Kruco)*[40] the CRA considered a situation where a Canadian Controlled Private Corporation whose shares were owned by a holding company pays a dividend in kind of a loan receivable to the holding company for which it realizes a denied loss under s. 40(2)(e.1). The CRA stated that the loss should be reflected in the safe income on hand when incurred or sustained by the dividend recipient (the holding company) during the holding period and not when deducted for tax purposes. [41]

Under the principles established under *Kruco*, a denied loss would be considered in the calculation of net income under paragraphs 55(5)(b) and (c) as "phantom income". A loss that has been denied should not in and of itself reduce safe income as there has been no cash outflow. Therefore the denied loss should not reduce the safe income on hand of a corporation. It remains to be seen if the CRA will change its position post - *Kruco*.

[38] 2011-0395701E5
[39] McLean page 63.
[40] 2011-0395701E5
[41]This position by CRA is consistent with its position pre-*Kruco*: See TI 9132625

Accounting Deficits

It is CRA's position that accounting deficit is not, in and of itself, an indicator that can prevent a safe income dividend. An accounting deficit is however, an indicator that a particular corporation may not have sufficient safe income on hand.

Therefore, should an accounting deficit exist, the deficit itself should be reviewed to ensure that there is safe income on hand that is contributing to the gain on the share.

Amounts Expended but not Yet Deducted

Post – *Kruco,* the CRA has maintained its position that safe income should be reduced for the non deductible portion of financing expenses under paragraph 20(1)(e) of the Act at the time the expenses were incurred. Safe income on hand should then be increased when the financing expenses are actually deducted in the four following years[42].

This is consistent with ITTN 37 in that non-deductible expenses will reduce the safe income on hand of a corporation because funds have already been expended and therefore, are not "on hand".

Capital Expenditures

Cash outflows for the purchase of both tangible and intangible assets will not reduce the safe income on hand as because one asset is replacing another asset[43].

Accounting Reserves

It is CRA's position that accounting reserves such as warranty reserves and pension plan obligations are a reduction to safe income when deducted for accounting purposes and **not** for

[42] 2007-0243151C6

[43] Capital Gains Strips: A Revenue Canada Perspective on the Provisions of Section 55 (John Robertson, Report of Proceedings of the Thirty-Third Tax Conference, 1981 Conference Report. (Toronto: Canadian Tax Foundation, 1982), 81-109.

tax purposes[44]. The rationale for position is that these amounts have been set aside from safe income to fund the future obligation and therefore, cannot contribute to the gain on a share.

The CRA has not updated its position on this issue post *Kruco* and therefore, it is subject to debate if this position is accurate. As mentioned earlier, post *Kruco* the starting point for the calculation of safe income is net income for tax purposes under Division B, Part 1 of the Act and then to adjust for the provisions identified under paragraphs 55(5)(b), (c) and (d) as required.

Therefore, an appropriate position based on *Kruco* would be to not reduce safe income by an accounting reserve that has been deducted for accounting purposes and not for tax purposes, but to reduce the gain when in fact the expense is deductible for tax purposes.

Conclusion

Taxpayers must be resourceful in overcoming the challenges and obstacles that new subsection 55(2) may present. The safe income harbour is the only objective exception that can be used when the purpose tests are not clearly identifiable due to subjective fact patterns. However, the new legislation as well as CRA's administrative positions renders previously murky safe income "rules of thumb" even more fraught with uncertainty. It is hoped that the CRA will clarify the path for tax advisors to tread in performing safe income calculations.

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[44] 9231575, February 2, 1993

IS SAFE INCOME REALLY SAFE?

APPENDIX A

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Appendix A

Opco's situation:

First year end	Dec 31, 2011
Determination date	Dec 31, 2015
Financing fees tax deduction (2011 to 2015)	8,000 per year
Federal and Provincial taxes	agree to F/S

2011-12-31	
Capital cost allowance	9,000
Cumulative eligible capital	140
SR&ED expenditures	42,975
Investment tax credit refund from Sch 31	24,066
Provincial refundable credits from Sch 5	8,000

2012-12-31	
Capital cost allowance	17,460
Cumulative eligible capital	130
SR&ED expenditures	18,909
Recapture of SR&ED ITCs – Provincial	4,215
Investment tax credit refund from Sch 31	23,314
Provincial refundable credits from Sch 5	7,750

2013-12-31	
Capital cost allowance	16,412
Cumulative eligible capital	121
Recapture of SR&ED ITCs - Federal	23,314
Recapture of SR&ED ITCs - Provincial	3,864

2014-12-31	
Capital cost allowance	15,428
Cumulative eligible capital	113

2015-12-31	
Cumulative eligible capital	105
Recapture of CCA	58,300
Taxable capital gains	100,000
Net capital losses of previous years	1,000
Federal Part I tax	49,400

Appendix A (continued)

Opco's Financial Statements

Balance sheet:

	2011-12-31	2012-12-31	2013-12-31	2014-12-31	2015-12-31
Assets					
Cash	–	52,500	292,500	551,000	41,750
Accounts receivable	10,000	15,000	20,000	25,000	30,000
Investments (at cost)	–	–	100,000	80,000	480,000
ITC receivable	35,000	30,000	–	–	–
Land	500,000	500,000	500,000	500,000	–
Building	300,000	300,000	300,000	300,000	–
Accumulated amortization	(15,000)	(30,000)	(45,000)	(60,000)	–
Total assets	**830,000**	**867,500**	**1,167,500**	**1,396,000**	**551,750**
Liabilities					
Accounts payable	15,000	15,000	15,000	20,000	20,000
Taxes payable	–	–	30,000	40,000	40,000
Due to shareholder	52,000	52,000	57,000	57,000	–
Due to bank	800,000	800,000	800,000	800,000	–
Warranty reserve	–	–	10,000	15,000	8,000
Total liabilities	**867,000**	**867,000**	**912,000**	**932,000**	**68,000**
Equity					
Opening retained earnings	–	(138,000)	(100,500)	154,500	363,000
Net income	(138,000)	37,500	260,000	213,500	319,750
(Dividends paid)	–	–	(5,000)	(5,000)	(200,000)
Common shares	1,000	1,000	1,000	1,000	1,000
Preferred shares	100,000	100,000	100,000	100,000	–
Total equity	**(37,000)**	**500**	**255,500**	**464,000**	**483,750**

Continued on next page

Appendix A (continued)

Income statement:

	2011-12-31	2012-12-31	2013-12-31	2014-12-31	2015-12-31
Revenue					
Sales	100,000	300,000	600,000	700,000	800,000
Interest income	–	–	–	500	3,750
Dividend income	–	–	–	3,000	3,000
Capital gains	–	–	–	–	275,000
Total revenue	**100,000**	**300,000**	**600,000**	**703,500**	**1,081,750**
Expenses					
Amortization	15,000	15,000	15,000	15,000	15,000
Bank fees	1,000	1,500	2,000	2,500	3,000
Charitable donations	–	–	–	25,000	–
Financing fees	40,000	–	–	–	–
Incorporation fees	2,000	–	–	–	–
Interest expense	40,000	40,000	40,000	40,000	40,000
Life insurance fees	–	–	–	–	10,000
Loss on disposed assets	–	–	–	2,000	–
Meals and entertainment	3,000	4,000	5,000	6,000	7,000
Non-deductible interest	–	–	–	3,000	–
Office expenses	10,000	20,000	30,000	25,000	30,000
Rent	12,000	12,000	12,000	12,000	12,000
Salary expense	100,000	150,000	200,000	300,000	600,000
SR&ED expense	50,000	50,000	–	–	–
(SR&ED income)	(35,000)	(30,000)	(4,000)	(500)	–
Warranty expense	–	–	10,000	20,000	5,000
Total expenses	**238,000**	**262,500**	**310,000**	**450,000**	**722,000**
Net income (loss) before taxes	**(138,000)**	**37,500**	**290,000**	**253,500**	**359,750**
Provision for taxes					
Federal taxes	–	–	25,000	28,000	22,000
Provincial taxes	–	–	5,000	12,000	18,000
Refundable taxes	–	–	–	1,000	28,400
(Dividend refund)	–	–	–	(1,000)	(28,400)
Net income (loss)	**(138,000)**	**37,500**	**260,000**	**213,500**	**319,750**

Safe Income on Hand Calculation
Determined as at Dec 31, 2015

Appendix A (continued)

Determination date	Dec 31, 2015

Input of net income for income tax purposes

Tax year ended		Dec 31, 2011		Dec 31, 2012		Dec 31, 2013		Dec 31, 2014		Dec 31, 2015	
Mark "s" if this row adjusts safe income balance	▼ s	Ref	Amount	Ref	Amount	Ref	Amount	Ref	Amount	Ref	Amount
Net income (loss) from financial statements			(138,000)		37,500		260,000		213,500		319,750
Provision for income taxes - current							30,000		40,000		40,000
Provision for income taxes - deferred											
Interest and penalties on taxes	s								3,000		
Amortization of assets			15,000		15,000		15,000		15,000		15,000
Recapture of CCA											58,300
Gain on sale of ECP											
Loss on disposal of assets									2,000		
Loss on disposal of Class 10.1 vehicles	s										
Charitable donations and gifts	s								25,000		
Taxable capital gains											100,000
Political donations	s										
Gross allowable SR&ED deducted per F/S			50,000		50,000						
(SR&ED ITC journalized against gross SR&ED)			(35,000)		(30,000)						
Non-deductible club dues and fees	s										
Non-deductible meals and entertainment	s		1,500		2,000		2,500		3,000		3,500
Non-deductible automobile expenses	s										
Non-deductible life insurance premiums	s										10,000
Other reserves on lines 270-275 from Sch 13											
Warranty reserve per F/S	s						10,000		15,000		8,000
Unfunded pension per F/S	s										
Other reserves per F/S											
Financing fees deducted	s		40,000								
Non-deductible advertising	s										
Non-deductible interest	s										
Non-deductible legal and accounting	s										
Recapture of SR&ED expenditures							23,314				
Provincial ITCs from prior year					4,215		3,864				
Incorporation fees			2,000								
(Gain on disposal of assets per F/S)											(275,000)
(Non-taxable dividend under section 83)											
(Capital cost allowance)			(9,000)		(17,460)		(16,412)		(15,428)		
(Terminal loss)											
(Cumulative eligible capital deduction)			(140)		(130)		(121)		(113)		(105)
(Allowable business investment loss)											
(Foreign non-business tax deduction)											
(SR&ED expenditures)			(42,975)		(18,909)						
(Other reserves of line 280 from Sch 13)											
(Warranty reserve per F/S)	s								(10,000)		(15,000)
(Unfunded pension per F/S)	s										
(Other reserves per F/S)											
(Deduction under 20(1)(e))	s		(8,000)		(8,000)		(8,000)		(8,000)		(8,000)
(SR&ED income per F/S)							(4,000)		(500)		
Net income (loss) for income tax purposes			(124,615)		34,216		316,145		282,459		256,445

Safe Income on Hand Calculation
Determined as at Dec 31, 2015

Appendix A (continued)

Determination date	Dec 31, 2015

Calculation of safe income on hand

Tax year ended		Dec 31, 2011		Dec 31, 2012		Dec 31, 2013		Dec 31, 2014		Dec 31, 2015	
Mark "r" if this row adjusts retained earnings	▼ r	Ref	Amount	Ref	Amount	Ref	Amount	Ref	Amount	Ref	Amount
Net income (loss) for income tax purposes		from above	(124,615)	from above	34,216	from above	316,145	from above	282,459	from above	256,445
(Net income items - marked by "s")		from above	(33,500)	from above	6,000	from above	(4,500)	from above	(28,000)	from above	1,500
(Federal Part I tax)	r						(25,000)		(28,000)		(49,400)
(Federal Part IV tax)	r								(1,000)		(1,000)
(Other federal taxes)	r										
(Provincial corporate tax)	r						(5,000)		(12,000)		(18,000)
(Other provincial tax)	r										
(Other income taxes)	r										
(Financing fees capitalized per F/S)	r										
(Net capital losses of previous years)	r										(1,000)
Refundable taxes	r								1,000		28,400
Investment tax credit refund from Sch 31	r		24,066		23,314						
Provincial refundable credits from Sch 5	r		8,000		7,750						
Recovery of taxes paid in prior years	r										
Debt forgiveness	r										
Safe income on hand - before dividends			(126,049)		71,280		281,645		214,459		216,945

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