

Practice Examination

Chapter 5 (CCA And CEC)

Instructions To Students

Create An Examination Environment

Your text and the accompanying Study Guide provide you with a large number of Exercises and Self Study Problems for which solutions are provided. These problems are designed to assist you with understanding the content of each Chapter. In contrast, the goal of this Practice Examination is to allow you to evaluate your ability to write the examinations in your tax course.

To get maximum benefits from this Practice Examination, you should write it under examination conditions. It is designed as a 90 minute examination and it should be written within that time constraint. You should make an effort to set aside 90 minutes of time during which you will not be interrupted. You should also pick a location where you will not be distracted by extraneous influences.

Materials To Be Used

The materials that you use while writing this Practice Examination should be consistent with the materials that will be available during the examinations that you will be writing in your tax course. These vary from course to course, and include the following possibilities:

- you may be allowed to bring a copy of the *Income Tax Act* into the examination room,
- you may be provided with the list of “Rates and Other Data” that is found in the front of your *Canadian Tax Principles* textbook and as a .PDF file on your Student CD-ROM,
- you may be allowed to bring a “cheat sheet” with various notes into the examination room, or
- you may be allowed to bring your *Canadian Tax Principles* textbook into the examination room.

You should determine, either from your course outline or directly from your instructor, which of these approaches applies in your situation. You should write this Practice Examination using only the materials permitted for your examination.

Types Of Questions

Different instructors use alternative types of questions on their examinations. This examination includes essay questions, true or false questions, and multiple choice questions. However, the majority of the marks on this examination are allocated to problems that are similar to the Exercises and Self Study Problems that are available in your *Canadian Tax Principles* text.

This content may not be consistent with the types of questions used by the instructor in the course you are taking (e.g., an instructor might choose to have an examination that contains only multiple choice questions, or only one comprehensive question). You should take this into consideration when you are evaluating your results on this examination.

How To Use The Marking Guides

For each question on this Practice Examination, we have provided information as to how marks would be allocated. In some cases, this allocation is very straightforward. For example, if a 12 mark question consists of 6 multiple choice questions, 2 marks will be allocated to each correct answer.

However, in other situations the allocation process is more complex. Consider, for example, an employment income calculation that has 11 separate components (i.e., salary, RPP contributions and so forth). If 15 grading marks were assigned to this problem, the marking guide could assign 1.36 marks (15 marks divided by 11 components) to each line or, alternatively, award more than one mark to some components. Both of these approaches can be awkward.

To resolve this problem, the marking guides that we provide in these more complex situations will be based on “grading points”. In the preceding example, 11 grading points would be assigned to this question — one for each component in the calculation. These “grading points” would then be converted into the relevant mark. Continuing the example, if you had 8 of 11 components in the calculation correct, this result would be converted to a mark as follows:

$$[(8 \div 11)(15\%)] = 10.9\%$$

In the solution that we have provided for this Practice Examination, these grading points have been identified with **highlighting** the appropriate number or word.

Practice Examination On CCA And CEC

Examination Content

The content of this examination, along with the marks and times for each question, are found in the following table.

Question	Type Of Question Or Subject	Marks	Time In Minutes
1	Essay Question	10	9.0
2 - 7	True Or False	9	8.1
8 - 14	Multiple Choice	21	18.9
15	CCA Calculations	45	40.5
16	CEC Calculations	15	13.5
Total		100	90.0

Question 1 (10 Marks)

The disposition of a depreciable capital asset can result in:

1. no immediate tax consequences;
2. a capital gain;
3. recapture of CCA; or
4. a terminal loss.

For each of these four outcomes, indicate the conditions under which that outcome would occur.

Questions 2 Through 7 (9 Marks)

2. The method specified in the *Income Tax Regulations* must be used to determine the CCA that can be deducted in each taxation year.

True Or False?

3. For purposes of determining CCA, the capital cost of an asset includes any amounts of GST, HST, or PST that was included in the amount paid for the asset.

True Or False?

4. With respect to rental properties with a cost greater than \$50,000, a taxpayer can elect to allocate each such property to a separate CCA Class.

True Or False?

5. The half-year rules do not apply to CCA Class 14 which contains limited life intangibles.

True Or False?

6. A business with a calendar year taxation year, begins operations on December 1 of the current year. On that date it acquires \$20,000 in Class 8 assets. Maximum CCA for the current year on Class 8 assets would be \$2,000.

True Or False?

7. In situations where an enterprise chooses not to take maximum CCA, the amount that is taken should be deducted from the CCA Classes with the lowest rates.

True Or False?

Questions 8 Through 14 (21 Marks)

8. In dealing with depreciable assets, accounting and tax material use different terms to refer to similar items. Of the following pairs of accounting and tax terms, which pair does not represent similar items?
- A. Net book value and undepreciated capital cost.
 - B. Amortization expense and capital cost allowance.
 - C. Acquisition cost and capital cost.
 - D. Net book value and capital cost.
9. Which of the following items cannot be allocated to a separate CCA Class?
- A. A new Mercedes with a cost of \$180,000.
 - B. A rental property with a cost of \$125,000.
 - C. Equipment that is used 100 percent for manufacturing activity.
 - D. A building which cost \$625,000 and is used 100 percent for non-residential purposes.
10. With respect to the half-year rules, which of the following statements is correct?
- A. The half-year rules apply to all CCA Classes.
 - B. The half-year rules never apply when an asset is acquired in a non-arm's length transaction.
 - C. The half-year rules are applicable when the amounts deducted for disposals exceed the cost of acquisitions.
 - D. The half-year rules require that, prior to the calculation of CCA, one-half of the net additions for the year must be deducted from the UCC balance.
11. In November 1 of the current year, Perry Inc. acquires a franchise for \$32,000. The franchise has a limited life of 12 years. What is the maximum amount of CCA that Perry Inc. can deduct in its current taxation year which ends on December 31?
- A. \$445.66.
 - B. \$2,666.67.
 - C. \$1,333.33.
 - D. \$222.83.
12. On December 1 of the previous year, a corporation spends \$126,000 on leasehold improvements to a building which it rents for use in its business activities. The lease was signed in the previous taxation year and has a term of 10 years. There are two renewal options, each for a term of 3 years. What is the maximum CCA claim on these improvements for the current taxation year which ends December 31?
- A. \$12,600.
 - B. \$9,692.
 - C. \$4,846.
 - D. \$6,300.

13. Which of the following classes uses the straight-line method for determining maximum CCA?
- A. Class 10.
 - B. Class 43.
 - C. Class 29.
 - D. Class 10.1
14. Which of the following statements with respect to eligible capital expenditures is not correct?
- A. When there is a disposal of CEC, three-quarters of the proceeds of disposition is subtracted from the CEC balance.
 - B. When goodwill is acquired, three-quarters of its cost will be added to the CEC balance.
 - C. A disposal of CEC may result in the need to recognize an income inclusion.
 - D. The maximum CEC deduction is equal to 7 percent of the beginning of the year CEC balance.

Question 15 (45 Marks)

Sorrento Pizza begins operations in Ottawa on June 30, 2008. These operations include a formal dining room specializing in the cuisine of northern Italy, as well as a take out operation that provides home delivery throughout the city. To facilitate this latter operation, on August 1, 2008, the Company acquires 10 small cars to be used as delivery vehicles. The cost of these cars is \$20,000 each and, for purposes of calculating CCA, they are allocated to Class 10 (30 percent declining balance CCA). Sorrento Pizza takes maximum CCA in each year of operation.

During the first year of operations, the Company establishes a fiscal year ending on December 31. In 2008 through 2013, the following transactions take place with respect to the Company's fleet of delivery cars:

2009 The Company acquires 10 more cars at a cost of \$21,000 each. In addition, 3 of the older cars are sold for total proceeds of \$43,000.

2010 There are no new acquisitions of cars during this year. However, 4 of the original cars are sold for total proceeds of \$60,000.

2011 Near the end of 2011, 3 of the original cars and 9 of the newer cars are sold for \$168,000. It was the intent of the Company to replace these cars. However, because of a delay in delivery by the car dealer, the replacement did not occur until early 2012.

2012 In January of 2012, the Company receives 20 new delivery cars at a cost of \$28,000 each. No cars are disposed of during the year.

2013 Early in this year, the management of Sorrento Pizza concludes that the take out operation is not profitable and is causing severe employee discipline problems. As a consequence, the take out operation is closed and the 21 remaining delivery cars are sold. Because of the large number of cars being sold, the total proceeds are only \$348,000.

Required: For each of the fiscal years 2008 through 2013, calculate CCA, recapture, or terminal loss and the UCC with respect to the fleet of delivery cars owned by Sorrento Pizza.

Question 16 (15 Marks)

McLean Stores is a group of unincorporated retail stores, owned and operated by George McLean, specializing in the sale of bulk foods in Vancouver. In 2011, in order to expand his operations to Vancouver Island, he purchased five similar stores that were being operated as a group in the city of Victoria. The purchase price of these stores included a payment of \$90,000 for the goodwill of the operation. The availability of this goodwill was insured by a long-term no competition agreement signed by the former owner of the stores. The agreement covers all of Vancouver Island and is transferable.

In 2013, Mr. McLean sells McLean Stores at a price that includes a payment for goodwill of \$300,000. It is estimated that \$200,000 of this goodwill should be allocated to the Vancouver operations, while the remaining \$100,000 relates to the Victoria stores that were purchased in 2011.

The Company's year end is December 31. Mr. McLean has taken the maximum cumulative eligible capital deductions in all years.

Required:

- A. What is the maximum deduction that Mr. McLean can claim for amortization of cumulative eligible capital in 2011 and 2012?
- B. What amounts will be included in Mr. McLean's 2013 Net Income For Tax Purposes as a result of the sale of McLean Stores?

END OF EXAMINATION