

# Practice Examination

## Chapter 7 (Property Income)

### 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 Property Income

---

### 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 Questions	10	9.0
2 - 7	True Or False	9	8.1
8 - 14	Multiple Choice	21	18.9
15	Alternative Investments	25	22.5
16	Income Trusts, Mutual Funds, and Foreign Source Income	35	31.5
Total		100	90.0

### Question 1 (10 Marks)

Provide answers to each of the following questions.

- A. There are two special rules that apply to CCA calculations on rental properties. Briefly describe these rules.
- B. An investor earns \$10,000 of non-business income from a foreign source. The tax authorities in the foreign jurisdiction withhold \$4,000, with the investor receiving the net amount of \$6,000. What are the tax consequences related to this receipt of income?

### Questions 2 Through 7 (9 Marks)

2. To be classified as interest for tax purposes, payments must be calculated on a principal sum and must be compensation for the use of that principal sum.

True Or False?

3. When long-term debt is issued at a discount, the discount will always be fully deductible when the debt is repaid.

True Or False?

4. Both corporations and partnerships must calculate deductible interest using the full accrual method.

True Or False?

5. An individual purchases a debt contract for \$223,000. While the contract calls for no payment of interest, at the end of five years, it will pay \$263,000 to the investor. The \$40,000 difference will be a capital gain, only one-half of which will be subject to tax.

True Or False?

6. Every rental building acquired after 1987 must be allocated to a separate Class 1.  
True Or False?
7. The gross up and tax credit procedures for non-eligible dividends are based on the assumption of a 20 percent corporate tax rate.  
True Or False?

**Questions 8 Through 14 (21 Marks)**

8. On May 1, 2013, Jerri Blain acquires an investment contract with a maturity value of \$250,000. The contract matures on April 30, 2018, with interest accruing at 6 percent per annum. Interest is paid for the first 1-2/3 years on December 31, 2014, with the remaining interest due on April 30, 2018. With respect to the minimum interest that must be recognized for tax purposes, which of the following statements is correct?
- A. Jerri will have to recognize \$10,000 in 2013, and \$15,000 in 2014.
  - B. Jerri will have to recognize Nil in 2013, and \$15,000 in 2014.
  - C. Jerri will have to recognize Nil in 2013, and \$25,000 in 2014.
  - D. Jerri will have to recognize Nil in 2013, and Nil in 2014.
9. Maxim Ltd. issues debt securities with a maturity value of \$500,000. They are sold for proceeds of \$475,000. They mature in 5 years and pay annual interest at the rate of 8 percent. Which of the following statements is correct?
- A. The corporation will be able to deduct \$40,000 in each of the years 1 through 5, and will have a \$25,000 capital loss in year 5, only one-half of which will be deductible.
  - B. The corporation will be able to deduct \$45,000 in each of the years 1 through 5.
  - C. The corporation will be able to deduct \$35,000 in each of the years 1 through 5.
  - D. The corporation will be able to deduct \$40,000 in each of the years 1 through 5, and will have a fully deductible loss of \$25,000 in year 5.
10. Sally Frampton has two Class 1 rental properties. Property 1 has a UCC at the beginning of the year of \$550,000 and has net rental income before the deduction of CCA of \$43,000. Property 2 has a UCC of \$985,000 at the beginning of the year, but has incurred a net rental loss before CCA of \$26,000. What is the maximum amount of CCA that Sally can claim this year?
- A. \$22,000.
  - B. \$61,400.
  - C. \$17,000.
  - D. \$39,400.
11. Jen Louzon is in the top federal tax bracket of 29 percent and lives in a province where the top provincial bracket is 14 percent. The provincial dividend tax credit is 27 percent on non-eligible dividends. If she receives a \$24,000 non-eligible dividend from a taxable Canadian corporation, how much will she retain after taxes?
- A. \$7,280.
  - B. \$22,720.
  - C. \$17,100.
  - D. \$16,720.

12. With respect to the gross up and tax credit procedures applicable to dividends from taxable Canadian corporations, which of the following statements is not correct?
- A. The gross up is intended to adjust the taxable amount of the dividend to the pretax amount that was required at the corporate level in order to pay the dividend.
  - B. The federal dividend tax credit is equal to two-thirds of the gross up.
  - C. The amount of the gross up depends on whether the dividend is eligible or non-eligible.
  - D. The dividend tax credit is intended to compensate the shareholder for the taxes that were paid at the corporate level.
13. On January 1 of the current year, Adesina Bakare acquires 1,000 units of the Trader's Group mutual fund at a cost of \$150 per unit. During the year, the fund makes a distribution of \$12.00 per unit, consisting of capital gains of \$7.00 and interest income of \$5.00. All of the amount received is reinvested in the fund at a price of \$156 per share. What is the per unit adjusted cost base of Ms. Bakare's units on December 31 of the current year?
- A. \$162.00.
  - B. \$150.43.
  - C. \$150.00.
  - D. \$139.29.
14. During the current year, Benoit Chartrand earns \$12,000 in foreign source non-business income. The taxation authorities in the foreign jurisdiction withhold \$3,600 in taxes. Benoit's combined federal/provincial tax rate is 45 percent. As a result of this transaction, Benoit's Net Income For Tax Purposes will increase by what amount?
- A. \$12,000.
  - B. \$8,400.
  - C. \$6,600.
  - D. \$10,200.

### Question 15 (25 Marks)

On January 1, 2013, Miss Heather Plant receives a \$50,000 cheque from an attorney representing the estate of her recently deceased aunt, Mildred. The money was bequeathed by Miss Plant's aunt without any conditions and is not subject to any form of taxes at the time that it is received.

In anticipation of this bequest, Miss Plant has purchased a condominium that will be available for occupancy on January 1, 2014. As she has no need for the \$50,000 until the condominium becomes available, she would like to invest the funds for the year ending December 31, 2013. She is considering the following two alternatives:

- Investment of the full \$50,000 in a guaranteed investment certificate that will pay annual interest at the rate of 6 percent for the year ending December 31, 2013.
- Investment of the full \$50,000 in 1,000 shares of a common stock of a Canadian public company that is selling for \$50 per share on January 1, 2013. For a number of years, this stock has paid an annual eligible dividend of \$1 per share. In addition, Miss Plant is advised that the unit price of the shares is likely to increase to at least \$55 by December 31, 2013.

Miss Plant has sufficient employment income that she is in the 29 percent federal tax bracket and the 14 percent provincial tax bracket. The provincial dividend tax credit on eligible dividends is equal to 25 percent of the gross up.

**Required:** Determine the after tax amounts that would be retained by Miss Plant for each of the two alternative investments.

**Question 16 (35 Marks)**

On January 1, 2013, Ms. Alice Wong acquires the following investments:

- A €500,000 term deposit that pays interest at 7 percent per annum. Interest of €35,000 is paid for 2013. The taxation authorities in the foreign jurisdiction withhold 20 percent of the €35,000, with the remaining 80 percent remitted to Alice. Assume the average exchange rate for 2013 is €1 = \$1.49.
- 1,200 units of the Golden Mountain Real Estate Income Trust. The cost is \$92.00 per unit for a total cost of \$110,400.
- 8,500 units of the Blackman European Fund, a mutual fund trust. The cost is \$23.00 per unit for a total cost of \$195,500.

During 2013, the Golden Mountain Real Estate Income Trust makes an annual distribution of \$8.75 per unit, of which \$3.25 is designated as a return of capital. The remaining \$5.50 is business income. Alice has elected to use the Trust's DRIP and, as a consequence, the entire distribution is reinvested in new trust units at a cost of \$100.00 per unit.

Also during 2013, the Blackman European Fund makes a distribution of \$2.10 per unit. This distribution is made up of capital gains of \$0.80, eligible dividends of \$0.70, and interest income of \$0.60. The entire distribution is reinvested in Blackman European Fund units at a cost of \$20.00 per unit.

Alice has other investment income that places her in the 29 percent federal tax bracket. Taxes on this income are sufficient to use all of her available tax credits before considering the effects of the investments described above. She lives in a province where the maximum rate is 13 percent and the tax credit on eligible dividends is 21 percent of the gross up.

**Required:** Calculate the amount of Taxable Income and Tax Payable that will result from the interest on the term deposit and the distributions by the two trusts. In addition, indicate the per unit adjusted cost base for each of the two trust units on December 31, 2013.

**END OF EXAMINATION**