

Practice Examination

Chapter 8 (Capital Gains)

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 Capital Gains

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	Capital Gains Reserves	15	13.5
16	Involuntary Dispositions	25	22.5
17	Principal Residence Rules	20	18.0
Total		100	90.0

Question 1 (10 Marks)

Provide brief answers to each of the following questions.

- A. What is personal use property?
- B. What is the relationship between personal use property and listed personal property? You are not required to define listed personal property, only indicate how it relates to personal use property.
- C. How are gains and losses resulting from the sale of personal use property treated for income tax purposes? Compare this with the treatment for gains and losses resulting from the sale of listed personal property.

Question 2 Through 7 (9 Marks)

2. If a capital asset has a negative adjusted cost base during the year, but has a positive adjusted cost base at the end of the year, the deficiency will have to be included in the taxpayer's income.

True Or False?

3. When shares of stock are sold, their adjusted cost base must be determined on the basis of the average cost of the shares acquired.

True Or False?

4. When an individual sells a capital asset and provides a warranty, the estimated cost of providing the warranty must be deducted as a capital loss in the year of sale.

True Or False?

5. When there is a change in use and the fair market value of the building exceeds its cost, the capital cost for CCA purposes will be equal to cost, plus one-half of the difference between fair market value and cost.

True Or False?

6. When a property is converted from a rental property to a principal residence, the taxpayer can elect to have the property designated as his principal residence for up to four years prior to the time it stopped being used as a rental property.

True Or False?

7. If an individual holding an option to acquire a capital property exercises that option, the cost of the option will be added to the adjusted cost base of the acquired asset.

True Or False?

Question 8 Through 14 (21 Marks)

8. An individual is holding 500 shares of Matrix Ltd. that have an adjusted cost base of \$25 per share. On December 1 of the current year, all of these shares are sold for \$10 per share. On December 15 of the current year, he purchases 300 shares of Matrix Ltd. for \$12 per share. What is the net tax consequence of these two transactions?

- A. An allowable capital loss of \$3,750.
- B. An allowable capital loss of \$1,500.
- C. An allowable capital loss of \$3,000.
- D. No gain or loss.

9. With respect to the taxation of an individual's principal residence, which of the following statements is correct?

- A. Any real property that is owned by a taxpayer can be designated as a principal residence in a given year.
- B. If a principal residence is converted to a rental property, an individual can elect not to have a deemed disposition and can continue to designate the property as his principal residence for up to four years after the change in use.
- C. The disposition of a property that could be designated as a principal residence will never result in a capital gain.
- D. A farm property, including all of the land that is used for farming, can be designated as a principal residence.

10. Which of the following statements with respect to the taxation of capital gains is not correct?

- A. When government assistance is provided to acquire a capital asset, it is deducted from the adjusted cost base of the asset.
- B. Gains resulting from dispositions of personal use capital assets are subject to tax.
- C. When an individual sells shares in a Canadian small business corporation, any resulting capital gain can be deferred if the proceeds are reinvested in shares of another Canadian small business corporation.
- D. When a part of a group of identical securities is sold, the adjusted cost base of the shares sold must be based on the average cost of the group.

11. Bashir Jallow owns a cottage that was purchased several years ago for \$275,000. This figure includes land with an estimated value of \$50,000. After using the cottage on a regular basis until last year, on January 1 of the current year, he converts the cottage to a rental property. At this time the appraised value of the cottage is \$400,000, with \$80,000 of this amount attributable to the land. During the current year, net rental income before the deduction of CCA is \$12,200. For the current year, what is the maximum CCA deduction on the property?
- A. \$ 5,450
 - B. \$ 6,400
 - C. \$12,200
 - D. \$10,900
12. During the current year, Bruce Wong permanently departs from Canada. At the time of his departure he owns a rental property with a fair market value of \$600,000, a capital cost of \$450,000, and a UCC of \$425,000. The only other capital asset that he owns is shares in a Canadian public company. These shares have an adjusted cost base of \$150,000 and a fair market value of \$175,000. Which of the following amounts will be included in Bruce's income as a result of his departure from Canada?
- A. A taxable capital gain of \$175,000, along with recapture of \$25,000.
 - B. A taxable capital gain of \$87,500, along with recapture of \$25,000.
 - C. A taxable capital gain of \$25,000.
 - D. A taxable capital gain of \$12,500.
13. During 2012, an individual sells a capital asset with an adjusted cost base of \$122,000. The sales price is \$187,000, with \$40,000 of this amount being paid immediately. An additional \$40,000 will be paid in 2013, with the \$107,000 balance due in 2014. What is the maximum amount of the capital gains reserve that can be deducted for 2013?
- A. \$107,000
 - B. \$39,000
 - C. \$52,000
 - D. \$37,193
14. An individual acquires an option on a real property that will be used in his business. The cost of this option is \$5,000. With respect to this option, which of the following statements is correct?
- A. If he sells the option for \$8,000, he will have business income of \$3,000.
 - B. If the option expires without being exercised, he will have an allowable capital loss of \$2,500.
 - C. If the option is exercised, \$2,500 will be added to the capital cost of the acquired property.
 - D. If the option is exercised, he will have a taxable capital gain of \$2,500.

Question 15 (15 Marks)

During January, 2012, Jason Guild sells a capital asset with an adjusted cost base of \$150,000 for proceeds of disposition of \$220,000. He receives a down payment of \$70,000 in 2012, with the balance payable on January 1, 2014. What is the minimum taxable capital gain that Jason will have to include in income in each of the three years 2012, 2013, and 2014? Show your calculations.

Question 16 (25 Marks)

In 2013, Leblanc Ltd. replaced a Class 8 asset destroyed by a fire in May, 2012, with another Class 8 asset that cost \$500,000. Insurance proceeds of \$300,000 were received in December, 2012. The original cost in 2000 of the destroyed asset was \$250,000. These were the only Class 8 transactions in either 2012 or 2013. The UCC of Class 8 at the beginning of 2012 was \$175,000.

The Company has a December 31 year end. The sole shareholder of Leblanc Ltd. wants to minimize the Company's Tax Payable in all years.

Required:

- A. Indicate the tax consequences of the involuntary disposition that will be reported in the Company's 2012 tax return.
- B. Indicate the changes that will be reported in the amended 2012 return, provided the Company makes elections under ITA 13(4) (to defer recapture) and ITA 44(1) (to defer capital gains).
- C. Calculate the maximum CCA that Leblanc Ltd. will be able to claim for Class 8 assets for 2013 assuming the Company makes elections under ITA 13(4) and ITA 44(1).

Question 17 (20 Marks)

At the end of 2013, Mr. Vaughn sold both his city home and his summer cottage. Every year he has spent at least a portion of the year living in each of the two locations. When he is not residing in these properties they are left vacant. Relevant information on the two properties is as follows:

	City Home	Cottage
Year acquired	1997	1997
Cost	\$264,000	\$ 36,000
Gross proceeds from sale	528,000	330,000
Real estate commissions	32,000	16,000

Mr. Vaughn wishes to minimize any capital gains resulting from the sale of the two properties.

Required: Describe how the residences should be designated in order to accomplish Mr. Vaughn's goal. In addition, calculate the amount of the gain that would arise under the designation that you have recommended.

END OF EXAMINATION