10

2

QUESTION 1 [16 *marks*]

a) [4 marks] "It is possible to have a flat tax, or to have democracy, but not both." Explain.

To have a flat tax rate would require all taxpayers to pay tax at the same rate which is against the democratic view ~~of~~ horizontal equity. Flat tax does not take into one's ability to pay the tax, but provides a single tax to all tax payers.

2. ?

b) [4 marks] Provide one argument for and one argument against the taxation of frequent flyer miles.

One argument for is that the frequent flyer miles may be used for personal inqueries with points acquired from employment activities.

2

One argument against, is that as long as the miles are not converted into cash, it is unecessary to tax the use.

c) [4 marks] What do recapture and terminal loss mean economically?

Recapture is when you deducted CCA too quickly, and one required to add the amount back onto income and terminal loss is when you did not deduct enough CCA and you deduct the positive balance from income

4

Economically speaking, for recapture, the asset did not depreciate as quickly as expected, and terminal loss, the asset depreciated faster than expected.

d) [4 marks] Taxing 100% of capital gains will contribute to horizontal and vertical equity. Explain.

For horizontal equity, the tax rate will be based on the individual's ability to pay and so the tax payer is in the position to be able to pay the tax on the capital gain, because the capital gain is taxed at such a rate that is payable in accordance with the level of income

4.

For vertical equity, higher income tax payers will get a higher rate of tax, and the tax on capital gain will contribute to the total amount of tax proportional to income and because the tax payer is in the higher income bracket, they recieve higher tax.

7

QUESTION 2 [*8 marks*]

In 2011, Roy began working at SilverMoon Ltd and was granted options to purchase 5000 of the company's shares at a price of $9.00 per share. On November 1, 2013, Roy sells all of his shares at a price of $10.00 per share.

—REQUIRED

Indicate the tax effect on Roy of the transactions that took place during 2011, 2012, and 2013 under each of the following independent cases. Your answers should include the effect on both **Net Income for Tax Purposes and Taxable Income**. If there is no effect in the year, indicate so by writing "Nil". Also be sure to provide an explanation for any deductions, if any, in arriving at Taxable Income. **Show all of your work** whether or not you feel it is relevant to your final answer.

Case A: SilverMoon Ltd. is a Canadian public company. At the time the options were granted, the shares were trading at $8.75 per share. The options were exercised on October 1, 2012 when the shares were trading at $9.75 per share.

Case B: SilverMoon Ltd. is a Canadian controlled private corporation. At the time the options were granted, the Company's shares had a fair market value of $9.25 per share. The options were exercised on October 1, 2011 when the shares were trading at $9.50 per share.

CASE A	CASE B
2011: nil (no positive amount assumed)	2011: nil
2012: 5000 (9 − 9.75) = $3750 (1/2) = 1875 $1875 is deducted in Net income for tax purposes and $3750 is included in Taxable Income	2012: nil
2013: 5000 (9.75 − 10) → $1250 1/2 deduction (625) taxable gain $625 $1250 included in taxable income $625 deducted in net income for tax purposes	2013: 5000 (9.5 − 9) = 2500 5000 (10 − 9.5) = 2500 deferred employment income $2500 1/2 deduction (held for 2 yrs) 1250 1250 5000 (10 − 9.5) (2500) (1250) → employment loss (1/2 deductible) $625 is deducted in Taxable income

b/c cost > FMV

7 1/2

QUESTION 3 [8 *marks*]

Sugarcane Limited, "The Company", has a December 31 year-end. On January 1, 2013, the UCC balances for two of its asset classes are as follows:

- Class 8 (office furniture and equipment) $1,800, and
- Class 13 (leasehold improvements) of $195,000.

During the year, the Company bought one new piece of office furniture for $1,200. This purchase replaced an old piece of Class 8 office furniture that was originally purchased in a prior year for $6,000 and was sold in 2013 for $4,500.

The opening balance in Class 13 represents leasehold improvements of $240,000 made during 2011. The six-year lease was negotiated two years ago (in 2011). It has two renewal options, each for two years. No other leasehold improvements were made until 2013. During 2013, The Company made leasehold improvements of $36,000.

The CCA rate for Class 8 is 20%. Calculate the maximum CCA for the year that can be taken on each class of assets and the opening UCC balance for each class for next year.

Class 8

UCC beg 1800

add: 1200

deduc (4500)

(3300)

(1500)

recapture 1500

opening UCC balance (next yr) nil

max CCA is nil

Class 13

UCC beg 195 000

36 000

231 000

CCA (240 000 ÷ 8) = (30 000)

(36 000 ÷ 6) 1/2 = (3000)

opening UCC balance (next yr) 198 000

max CCA is 33 000

5 1/2

QUESTION 4 [*6 marks*]

Nikita has come to you for advice on the tax consequences of the disposition of the following two residences in 2013:

Residence	Date of Purchase	Cost		Proceeds of Disposition		Capita gain
City Home	1998	$490,000	−	$560,000	=	70 000
Cottage	2004	$305,000	−	$372,000	=	67 000

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

—REQUIRED

Compute the minimum amount of taxable capital gains for 2013. **Show all of your work.**

capital gain / yr : Cottage : 67 000 ÷ 10 = 67 00

City Home : 70 000 ÷ 16 = 4 375

Cottage

$$67\,000 - \left[67000\left(\frac{9+1}{10}\right)\right] = 67\,000$$

City Home

$$70\,000 - \left[70\,000\left(\frac{7+1}{16}\right)\right] = 35\,000 \text{ reduction}$$

minimum amont of taxable capital is $ 35 000

9

QUESTION 5 [9 *marks*]

During 2013, Roger has a business that produces $65,000 in income. Roger's income is subject to a 24-percent federal tax rate and a 12-percent provincial tax rate. The combined federal/provincial tax rate on corporations is 28%. What is Roger's after-tax cash retention for earning the business income directly vs. earning it through the use of a corporation? Assume that the dividends are eligible dividends, which have a gross-up rate of 38%, a federal dividend tax credit of 6/11 of the gross-up, and a provincial dividend tax credit of 25% of the gross-up. **Show all of your work.**

Earning income directly	
income	65 000
36%	23400
after tax retention	41 600
Earning income through a corporation	
income	65 000
28%	18 200
dividend payable	46 800
dividend payable	46 800
Gross up (38%)	17 784
taxable dividend	64 584
36% tax	23 250
cred (6/11 + 25%) of gross up	(14 140)
Tax payable	9 104
dividend payable	46 800
tax payable	9 104
after tax retention	37 696

9

QUESTION 6 [13 *marks*]

Jay is a sales representative for a Canadian public company that manufactures office furniture. His gross salary for the year ending December 31, 2013 is $48,000 and, in addition, he earns commissions of $21,500. For the 2013 taxation year, Jay's employer withheld the following amounts from his income:

- Federal and Provincial Income Taxes - $11,000
- Registered Pension Plan Contributions - $3,200
- Contributions for group disability insurance - $220

His employer contributed $1,600 to his RPP and $110 to his group disability insurance.

In 2013, Jay was hospitalized for four weeks and he received $3,100 from the disability plan. He had started contributing to the plan in 2010 for $220 each year up to and including 2013.

On July 1, 2013, Jay received a $40,000 loan from his employer for an annual interest rate of 1%. He paid the interest for 2013 on January 9, 2014. The loan was still outstanding at the end of 2013. Assume the prescribed rates for 2013 were as follows: Q1 – 4%, Q2 - 4%, Q3 – 3%, Q4 – 3%.

During the year, Jay travelled extensively on business. He had travel costs of $3,275 in airfares, $5,550 in travel lodging, and $1,650 in meals while on the road. He also spent $3,600 to entertain clients. His employer reimbursed him fully for these costs on presentation of the receipts.

—REQUIRED

a) Calculate Jay's minimum net employment income for the year ending December 31, 2013. Ignore all GST and PST considerations. **Show all of your work.**

b) Briefly explain why any items were omitted from your calculations.

a)

Gross Salary		48000	
Commissions		21500	69500
Addition:			
disability insurance			2220
interest benefit			1000
Deductions: employer ~~employer~~ expenses contributions			3200
			(1600)
			(11 450)
net employment income			59 670

b) - Federal and Provincial Taxes are not deducted to find net employment income.

- The employer contribution of $110 is not included because the benefit recieved for the insurance is a taxable benefit

- Employer reimbursement was not included because it was reasonable

group disability insurance

3100 − (220 × 4) = 2220

Interest

40 000 × .01 = $400 outstanding but paid within 30 days of yr end

benefit is lesser :

. 40 000 × .04 = 1600

. 40 000 (.04, .04, .03, .03) = 1400

deduct paid (400)

taxable benefit 1000

Sales person expense

travel costs	3275
lodging	5550
meals (½)	825
entertain (½)	1800
total	$11 450

less than commission so all is included

END OF EXAMINATION