

# TEST ITEM FILE - PROBLEMS

## Byrd & Chen's Canadian Tax Principles 2016 - 2017 Edition

ISBN-0134532201 and 9780134532202  
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### Problem Concordance

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A concordance of the problems in the 2015/16 vs. 2016/17 editions is available to assist instructors who have previously used *Canadian Tax Principles*.

### Bookmarks In PDF File

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To assist you in navigating through the electronic version of this solutions manual, there are bookmarks on the first page of each Assignment Problem solution.

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## **Chapter One Test Item File Problems**

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### **TIF PROBLEM ONE - 1** **Introduction - Essay Questions**

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1. The major source of federal revenues is the personal income tax. Indicate three other types of taxes that contribute to federal revenues.
2. What is the meaning of "person" when the term is used in the *Income Tax Act*?
3. Briefly describe the procedures used in calculating provincial income taxes for individuals in provinces other than Quebec.
4. The Canadian income tax system is often used to achieve various economic objectives. Give three examples that illustrate this point.
5. Provide an example of how taxation policy can be used to influence resource allocation.
6. The government pays a "child tax benefit" to the parents of children who are under 18 years of age. The payments are reduced by a percentage of income in excess of a specified level. What objectives are achieved by this benefit system?
7. Indicate three disadvantages of a tax system that uses progressive rates.
8. A regressive tax is one that taxes high income individuals at lower effective rates. Explain why a sales tax levied at a flat rate of 8 percent can be regressive.
9. Distinguish between horizontal equity and vertical equity as these terms are used in describing tax systems.
10. What are some of the factors that have led to the entrenched use of tax expenditures as opposed to program spending?
11. While the Sections of the *Income Tax Act* are numbered 1 through 260, there are actually more than 260 Sections. Explain why this is the case.
12. What purposes are served by Canada's international tax treaties?
13. List four non-legislative sources of income tax information.
14. What is the meaning of "taxation year" as the phrase is used in the *Income Tax Act*?
15. Under what circumstances will a person who is not resident in Canada be required to pay Canadian income taxes?
16. What are the components of Net Income For Tax Purposes?
17. ITA 3(b) states that a taxpayer should "determine the amount, if any", by which taxable capital gains exceeds allowable capital losses. In this context, what is the meaning of the phrase "the amount, if any"?
18. What is the difference between tax avoidance and tax deferral?
19. What is income splitting? Under what circumstances will it provide tax benefits to an individual?

20. Contributions to a Registered Retirement Savings Plan can be deducted to reduce the taxes of an individual in the year that they are made. However, these contributions will be subject to tax when they are withdrawn from the plan. What type of tax planning is involved in this arrangement?

## **TIF PROBLEM ONE - 2**

### **Introduction - True Or False**

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1. A value added tax is a tax levied on the increase in value of a commodity or service that has been created by the taxpayer's stage of the production or distribution cycle.  
True or False?
2. A partnership can be a taxable entity for income tax purposes.  
True or False?
3. A partnership can be a taxable entity for GST purposes.  
True or False?
4. In general, provincial income taxes are based on a specified percentage of federal tax payable.  
True or False?
5. The federal government does not collect personal or corporate taxes for Ontario or Quebec.  
True or False?
6. A sales tax is a regressive tax even when it is applied at a single rate on all transactions.  
True or False?
7. A major advantage of progressive tax rates is that their use encourages economic growth.  
True or False?
8. Tax expenditures are less costly to administer than direct funding programs.  
True or False?
9. Part I of the *Income Tax Act* is the largest and most important part.  
True or False?
10. The citation ITA 61(4)(b)(ii) would be read Paragraph 61, Subparagraph 4, Section b, Subsection ii.  
True or False?
11. An income tax is payable for each taxation year on the Taxable Income of every person resident in Canada at any time in the year.  
True or False?
12. Any taxpayer can choose the calendar year as their taxation year.  
True or False?

## TIF PROBLEM ONE - 3

### Introduction - Multiple Choice

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#### New For 2016/2017

##### **Canadian Tax System**

1. Which of the following types of taxes is not currently in use by the federal government of Canada?
  - A. Excise Taxes
  - B. Custom Duties
  - C. Head Tax
  - D. Transfer Tax

##### **Tax Policy Concepts**

2. Which of the following statements with respect to Canadian tax policy is **NOT** correct?
  - A. The economic burden of a particular tax may not fall on the same group that has the legal liability to pay the tax.
  - B. Extremely high rates of tax will always encourage individuals to work harder so that they will have more after tax income.
  - C. The inability to harmonize the GST in some provinces has increased the complexity of tax compliance.
  - D. A progressive tax system is unfair to individuals with incomes that fluctuate significantly from year to year.

##### **Income Tax Reference Materials**

3. Which of the following statements with respect to tax reference materials is correct?
  - A. Income Tax Folios are a legislative source of guidance.
  - B. Income Tax Regulations are gradually being replaced by Income Tax Folios.
  - C. Interpretation Bulletins are gradually being replaced by Information Circulars.
  - D. The *Income Tax Act* is the most important source of information for dealing with matters related to the federal income tax.

##### **Liability For Tax**

4. Of the following statements related to liability for Canadian income tax, which statement is **NOT** correct?
  - A. As used in the *Income Tax Act*, the term person refers to individuals, trusts, and corporations.
  - B. Corporations must use the calendar year as their taxation year.
  - C. The Canadian Part I tax is assessed on residents of Canada.
  - D. The Canadian Part I tax is assessed Canadian employment income earned by a non-resident.

##### **Alternative Concepts of Income**

5. Which of the following statements with respect to the relationship between accounting Net Income and Net Income For Tax Purposes is **NOT** correct?
  - A. Both accounting Net Income and Net Income For Tax Purposes value many assets at their historical cost.
  - B. Accounting Net Income requires that costs be matched with revenues.
  - C. Net Income For Tax Purposes requires that costs be matched with revenues.
  - D. Accounting Net Income is determined by applying Generally Accepted Accounting Principles.

**Calculation Of Net Income For Tax Purposes**

6. With respect to the determination of Net Income For Tax Purposes, which of the following statements is correct?
- A. Property losses are deducted from business income before the deduction of RRSP contributions.
  - B. Allowable capital losses can be deducted to the extent of other positive sources of income.
  - C. If not used during the current period, all subdivision e deductions can be carried forward to subsequent periods.
  - D. If a business loss exceeds all other positive sources of income, Net Income For Tax Purposes is equal to nil.

**Net Income to Taxable Income**

7. Which of the following items would be deducted in converting Net Income For Tax Purposes to Taxable Income?
- A. A deduction for spousal support payments made during the year.
  - B. A deduction for the extra costs related to living in prescribed areas of the Canadian north.
  - C. Current year allowable capital losses in excess of current year taxable capital gains.
  - D. Current year business losses in excess of other positive sources of income.

**Tax Planning**

8. Which of the following items does not result in tax avoidance?
- A. Use of the lifetime capital gains deduction.
  - B. Employer contributions to group disability plans.
  - C. Employer contributions to private health care plans.
  - D. Accelerated depreciation (CCA) on rental properties.

**Retained From Previous Editions**

**Canadian Tax System**

9. Which of the following is **NOT** a taxable entity for Canadian income tax purposes?
- A. Darklyn Ltd., a Canadian resident corporation.
  - B. Ms. Sarah Bright, a Canadian resident.
  - C. Walters and Walters, a group of CPAs operating as a partnership.
  - D. The Martin family trust.
10. Which of the following could be required to file a GST return?
- A. Chan's Clothing Store (an unincorporated business)
  - B. The Chan Foundation (a registered charity)
  - C. Min Chan (an individual)
  - D. All of the above could be required to file a GST return.
11. Which of the following forms of taxation provides the largest component of federal government taxation revenues?
- A. Personal income tax
  - B. Corporate income tax
  - C. Goods and services tax
  - D. Employment insurance premiums

12. With respect to provincial income taxes, other than those assessed in Quebec, which of the following statements is **NOT** correct?
- A. Each province can apply different rates to as many brackets for individuals as it wishes.
  - B. The federal government collects the provincial income tax for individuals for every province except Quebec.
  - C. Each province can establish its own tax credits to apply against Tax Payable for individuals.
  - D. Each province can establish rules for determining the Taxable Income of individuals.
13. Which of the following groups of entities are all subject to taxation on income?
- A. Individuals, proprietorships and corporations
  - B. Proprietorships, corporations and trusts
  - C. Individuals, trusts and corporations
  - D. Individuals, partnerships and corporations
14. Income tax is calculated for which of the following groups of jurisdictions?
- A. Municipal, provincial, and federal
  - B. Provincial, federal, and international
  - C. Municipal, federal, and international
  - D. Municipal, provincial, and international

***Tax Policy Concepts***

15. Which of the following goals is **NOT** a current economic policy objective of the Canadian tax system?
- A. Ensure the continued provision of public goods
  - B. Redistribute income and wealth among taxpayers
  - C. Ensure fairness in the allocation of resources to different levels of government.
  - D. Economic stabilization such as stimulating the economy or creating jobs.
16. Which of the following can be considered an advantage of an income tax system based on progressive rates?
- A. A progressive rate system is simpler to administer.
  - B. A progressive rate system provides greater stability in the context of changing economic conditions.
  - C. A progressive system discourages tax evasion.
  - D. A progressive system encourages greater effort on the part of individuals.
17. Which of the following statements accurately describes a regressive tax?
- A. A tax which results in higher effective tax rates for higher income taxpayers.
  - B. A tax which results in lower effective tax rates for higher income taxpayers.
  - C. A tax in which the same effective rate applies to all levels of income.
  - D. A tax that is shifted to consumers through price increases on the goods purchased.
18. Which of the following statements with respect to using tax expenditures rather than program spending is **NOT** correct?
- A. It is more costly to administer tax expenditures as opposed to program spending.
  - B. Tax expenditures reduce the visibility of government actions.
  - C. Tax expenditures leave fewer decisions in the hands of the private sector, thereby providing for more efficient allocation of resources.
  - D. Tax expenditures reduce the impact of progressive rates on higher income taxpayers.

19. Which of the following would **NOT** be considered a desirable characteristic of a tax system?
- A. Balance between sectors.
  - B. Inelasticity.
  - C. Neutrality.
  - D. Flexibility.
20. Which of the following would be considered a desirable characteristic of an effective tax system?
- A. Inelasticity.
  - B. Lack of international competitiveness.
  - C. Simplicity.
  - D. Ambiguity.
21. "We should not have a tax system which encourages investment in particular assets or in specific areas of the country." This statement reflects which of the following qualitative characteristics of an effective tax system?
- A. Neutrality.
  - B. Horizontal equity.
  - C. Simplicity.
  - D. Elasticity.
22. "Taxpayers who earn \$100,000 in dividends should pay the same amount of tax as taxpayers who earn \$100,000 in capital gains." This statement reflects which of the following qualitative characteristics of an effective tax system?
- A. Vertical equity.
  - B. Neutrality.
  - C. Elasticity.
  - D. Horizontal equity.

***Income Tax Reference Materials***

23. With respect to the structure of the *Income Tax Act*, which of the following statements is correct?
- A. The major components of the *Income Tax Act* are called Divisions.
  - B. The *Income Tax Act* has Parts numbered I through XVII, reflecting the fact that there are 17 Parts in the Act.
  - C. All Parts of the *Income Tax Act* have Divisions.
  - D. All Parts of the *Income Tax Act* contain at least one Section.
24. Of the following publications, indicate the one that is **NOT** a legislative source.
- A. *Income Tax Act*.
  - B. Income Tax Folios.
  - C. Income Tax Application Rules.
  - D. International Tax Treaties.
  - E. Income Tax Regulations.
25. Of the following publications, indicate the one that is **NOT** published by the CRA.
- A. Income Tax Folios.
  - B. Information Circulars.
  - C. Dominion Tax Cases.
  - D. Income Tax Technical News.

26. There are a number of common areas of litigation involving the CRA. Indicate which type of transaction is least likely to be in dispute.
- A. Arm's length versus non-arm's length transactions.
  - B. Capital versus income transactions.
  - C. Unreported revenues from business transactions.
  - D. Establishment of fair market value.
  - E. The deductibility of farm losses against other sources of income.
27. Where would an individual find the formula for determining the prescribed rate?
- A. The Income Tax Act.
  - B. The Income Tax Regulations.
  - C. A CRA Income Tax Folio.
  - D. A CRA Information Circular.
28. Which of the following statements is **NOT** correct?
- A. Most major income tax changes are introduced in the annual Federal Budget.
  - B. A federal election can prevent passage of draft legislation.
  - C. Proposed changes in tax law are usually introduced to parliament in the form of a Notice of Ways and Means Motion.
  - D. When there is a conflict between the Canadian *Income Tax Act* and an international agreement, the terms of the Canadian *Income Tax Act* prevail.

### ***Liability For Tax***

29. An individual is liable for income tax in Canada if he:
- A. is a resident in Canada.
  - B. is a citizen of Canada.
  - C. has lived in Canada at any time during the year.
  - D. All of the above are required.
30. Which of the following persons is **NOT** liable for Canadian income tax under Part I of the *Income Tax Act*?
- A. Pheap Chom, an individual who has resided in Canada for the past 15 years.
  - B. Chom Incorporated, a Canadian resident corporation.
  - C. Phon Im, a resident of the United States who earns employment income in Canada.
  - D. Bunly Im, a resident of the United States who earns interest income in Canada.
31. Which of the following types of income earned by a non-resident is **NOT** subject to Canadian income tax under Part I of the *Income Tax Act*?
- A. Employment income earned in Canada
  - B. Business income earned in Canada
  - C. Rental income earned in Canada
  - D. Income from the disposition of Canadian real estate

**Alternative Concepts of Income**

32. Which of the following statements accurately describes the *Income Tax Act* view of income?
- A. Net income is determined by adding revenue based on recognition at the point of sale and deducting expenses which are determined based on generally accepted accounting principles.
  - B. Net income is determined by adding together several different types of income based on an ordering rule.
  - C. Net income is the amount paid to an employee after an employer deducts CPP, EI, income taxes and any other source deductions from employee pay.
  - D. Net income is the total increase in a taxpayer's net worth for the year.

**Calculation Of Net Income For Tax Purposes**

33. With respect to the calculation of Net Income For Tax Purposes, which of the following statements is **NOT** correct?
- A. Subdivision e deductions are subtracted from the total of all positive sources of income.
  - B. Allowable capital losses for the year can only be deducted to the extent of taxable capital gains for the year.
  - C. Business losses can be netted against employment income in determining the positive amounts to be included under ITA 3(a) and 3(b).
  - D. Property losses can only be deducted after the subtraction of Subdivision e deductions.

34. Minjie Liu has the following sources of income and deductions:

Employment income	\$35,000
Interest income	5,000
Taxable dividend income	7,000
Taxable capital gain	5,000
Allowable capital loss	12,000
Subdivision e deductions	2,000

What is Minjie's Net Income for Tax Purposes?

- A. \$47,000
  - B. \$40,000
  - C. \$45,000
  - D. \$49,000
35. Tanya Turek has the following sources of income and deductions:

Gross employment income	\$35,000
Net employment income	34,000
Business loss	14,000
Taxable capital gain	4,000
Allowable capital loss	2,000

What is Tanya's Net Income for Tax Purposes?

- A. \$23,000
- B. \$22,000
- C. \$36,000
- D. \$24,000

36. Fadel Ghanem has the following sources of income and deductions:

Net employment income	34,000
Property income	6,000
Business loss	54,000
Taxable capital gain	4,000
Allowable capital loss	7,000

What is Fadel's Net Income or Loss for Tax Purposes?

- A. \$40,000 Income
  - B. Nil
  - C. \$44,000 Income
  - D. \$12,000 Loss
37. ITA 3(b) requires the taxpayer to "determine the amount, if any, by which taxable capital gains exceed allowable capital losses". The rule that is established by this phrase is:
- A. That allowable capital losses in excess of taxable capital gains during a year are never deductible from income.
  - B. That the current year allowable capital losses can only be deducted to the extent that there are taxable capital gains during the current year.
  - C. That taxable capital gains are only included in income in a year when there are also allowable capital losses that can be used to reduce the effect on income.
  - D. That unused allowable capital losses are deductible against any type of income in one of the past 3 years or in a future year.

***Net Income to Taxable Income***

38. Which of the following amounts is **NOT** deducted in converting Net Income for Tax Purposes to Taxable Income?
- A. Losses of other years.
  - B. The lifetime capital gains deduction.
  - C. An amount related to the exercise or sale of stock options.
  - D. The excess of allowable capital losses over taxable capital gains for the year.

***Tax Planning***

39. Providing employees with private health care benefits involves what type of tax planning?
- A. Tax evasion.
  - B. Tax deferral.
  - C. Income splitting.
  - D. Tax avoidance.
40. Making contributions to an RRSP always involves what type of tax planning?
- A. Tax avoidance and tax deferral.
  - B. Tax deferral.
  - C. Tax avoidance.
  - D. Income splitting.

## **TIF PROBLEM ONE - 4**

### **Introduction - Exam Exercises**

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#### ***Exam Exercise Subject Listing For Chapter 1***

<b>Number</b>	<b>Subject</b>
1	Taxable Entities (Income Taxes)
2	Taxable Entities (GST/HST)
3	Federal And Provincial Tax Payable
4	Federal And Provincial Tax Payable
5	Regressive Taxes
6	Regressive Taxes
7	Non-Resident Liability For Tax
8	Non-Resident Liability For Tax
9	Net Income For Tax Purposes
10	Net Income For Tax Purposes
11	Tax Planning
12	Tax Planning
13	Tax Planning
14	Tax Planning
15	Tax Planning
16	Tax Planning

**Exam Exercise One - 1 (Taxable Entities For Income Tax Purposes)**

Which of the following entities could be required to file an income tax return?

- Sally Forbes (an individual)
- Forbes Boutique (an unincorporated business)
- Forbes and Delaney (a partnership)
- The Forbes family trust (a trust)
- Forbes Enterprises Ltd. (a corporation)
- The Forbes Foundation (an unincorporated charity)

**Exam Exercise One - 2 (Taxable Entities For GST Purposes)**

Which of the following entities could be required to file a GST return?

- Sally Forbes (an individual)
- Forbes Boutique (an unincorporated business)
- Forbes and Delaney (a partnership)
- The Forbes family trust (a trust)
- Forbes Enterprises Ltd. (a corporation)
- The Forbes Foundation (an unincorporated charity)

**Exam Exercise One - 3 (Federal And Provincial Taxes Payable)**

Joan Smith has Taxable Income of \$37,500. For the current year her federal tax rate is 15 percent, while the corresponding provincial rate is 8.2 percent. Determine Ms. Smith's combined federal and provincial tax payable, before consideration of any available credits against Tax Payable.

**Exam Exercise One - 4 (Federal And Provincial Taxes Payable)**

Karla Ho has Taxable Income of \$26,700. For the current year her federal tax rate is 15 percent and the corresponding provincial rate is 10 percent. Determine Ms. Ho's combined federal and provincial Tax Payable, before consideration of any available credits against Tax Payable.

**Exam Exercise One - 5 (Regressive Taxes)**

Samantha Taylor has Taxable Income for the current year of \$625,000, of which \$216,000 is spent on goods and services that are subject to Harmonized Sales Tax (HST) at a rate of 13 percent. Her sister, Martha Taylor, is a part-time student living in the same province and has Taxable Income of \$12,000. During the current year, as a result of using some of her savings, she spends \$21,400 on goods and services that are all subject to HST.

Determine the effective HST rate as a percentage of the income of the two sisters.

**Exam Exercise One - 6 (Regressive Taxes)**

Veronica Simms has Taxable Income for the current year of \$843,000. Because of her modest life style, only \$162,000 of this amount is spent on goods and services that are subject to the Harmonized Sales Tax (HST) at a rate of 13 percent. Her sister is currently attending university on a full time basis and lives in the same city. Her Taxable Income for the current year is \$8,000. Because she is able to use savings accumulated during several years of employment, she spends \$36,000 on goods and services that are subject to HST at 13 percent.

Determine the effective HST rate as a percentage of the income of the two sisters.

**Exam Exercise One - 7 (Non-Resident Liability For Tax)**

Ms. Michelle Walker, a U.S. citizen, has Canadian employment income of \$42,000 and U.S. employment income of \$40,000 Canadian. She lives in Seattle, Washington and is a resident of the United States for the entire year. Ms. Walker does not believe that she is subject to taxation in Canada.

Is she correct? Explain your conclusion.

**Exam Exercise One - 8 (Non-Resident Liability For Tax)**

Daniel Bourne is a U.S. citizen who lives in Fargo, North Dakota. For many years, he has had a cottage on Manitoba's Lake Winnipeg. In recent years, however, he has made little use of this property and, given this, he has sold the property. While there was a gain of \$50,000 on the sale, Daniel assumes that he will not pay Canadian taxes on this amount as he is a U.S. citizen.

Is he correct? Explain your conclusion.

**Exam Exercise One - 9 (Net Income For Tax Purposes)**

Ms. Sonia Nexus is a computer specialist with net employment income of \$66,000. During the current year she has:

- a taxable capital gain on the sale of land of \$13,500,
- an allowable capital loss on the sale of shares of \$24,000,
- interest income of \$10,250,
- net rental losses of \$6,750, and
- a loss from her unincorporated business of \$28,000.

In addition, she makes spousal support payments of \$14,000 and makes a deductible contribution to her RRSP of \$3,000 (these are Subdivision e deductions). Determine her minimum Net Income For Tax Purposes for the current year and indicate the amount and type of any loss carry overs that are available at the end of the year. Show all of your calculations.

**Exam Exercise One - 10 (Net Income For Tax Purposes)**

Harvey Nicastro has current year net employment income of \$45,000. In addition, he has the following additional sources of income, gains, and losses:

- A loss from an unincorporated business of \$23,000.
- Interest income of \$4,500.
- A taxable capital gain of \$13,500.
- An allowable capital loss of \$18,200.
- Spousal support paid of \$24,000.
- A net rental loss of \$14,500.

Determine Harvey's minimum Net Income For Tax Purposes for the current year and indicate the amount and type of any loss carry overs that are available at the end of the year. Show all of your calculations.

**Exam Exercise One - 11 (Tax Planning)**

Mr. Jack Bronson makes a \$5,000 contribution to his Registered Retirement Savings Plan. What type of tax planning is involved in this transaction? Explain your conclusion.

***Exam Exercise One - 12 (Tax Planning)***

Ms. Sarah Bloom convinces her employer to provide her with a private drug plan in lieu of additional salary. What type of tax planning is involved in this transaction? Explain your conclusion.

***Exam Exercise One - 13 (Tax Planning)***

Mr. John Lenonovitz is an unemployed poet. As Mr. Lenonovitz has no known sources of income, his wife Natasha, a successful painter, has decided to make contributions to an RRSP in his name, rather than making contributions to her own plan. What type of tax planning is involved in this decision? Explain your conclusion.

***Exam Exercise One - 14 (Tax Planning)***

Ms. Tricia Jones makes contributions to a Registered Pension Plan sponsored by her employer. What type of tax planning is involved in this transaction? Explain your conclusion.

***Exam Exercise One - 15 (Tax Planning)***

Mrs. Janice Theil gives \$50,000 in Canada Savings Bonds to her 27 year old, unemployed daughter. What type of tax planning is involved in this transaction? Explain your conclusion.

***Exam Exercise One - 16 (Tax Planning)***

Mr. Norman Rock transfers some dividend paying shares to his 25 year son who is attending university on a full time basis. What type of tax planning is involved in this transaction? Explain your conclusion.

**TIF PROBLEM ONE - 5A****Introduction - Key Term Matching (Easy)**

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**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms are listed at the end of Chapter 1, "Introduction To Federal Taxation In Canada":

- A. Fiscal Period
- B. Flat Tax System
- C. Income Tax Regulations
- D. Net Income For Tax Purposes
- E. Person
- F. Regressive Tax System
- G. Tax Expenditures
- H. Value Added Tax

The following list contains ten potential definitions for the preceding key terms.

1. A taxation year that does not exceed 53 weeks.
2. A tax system that applies higher effective rates for individuals with lower incomes and lower effective rates for individuals with higher incomes.
3. The total of net employment income, net business and property income, net taxable capital gains, other sources of income, and other deductions from income.
4. A CRA publication providing their interpretation of various technical issues related to income taxes.
5. A term used in the *Income Tax Act* to refer to taxable entities.
6. Foregone tax revenues due to special exemptions, rate reductions, rebates, and credits that reduce the amount of tax that would otherwise be payable.
7. A tax based on the value added to a product at each stage of production or distribution by a particular entity.
8. A tax on income that is applied at the same rate to all taxpayers, without regard to the level of their income.
9. A set of rules concerning administration and enforcement of the *Income Tax Act*.
10. A tax system that applies higher effective rates for individuals with higher incomes and lower effective rates for individuals with lower incomes.
11. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 10) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (11). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

**TIF PROBLEM ONE - 5B****Introduction - Key Term Matching (Moderate)**

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**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms are listed at the end of Chapter 1, "Introduction To Federal Taxation In Canada":

- A. Fiscal Period
- B. Flat Tax System
- C. Income Tax Regulations
- D. Net Income For Tax Purposes
- E. Person
- F. Regressive Tax System
- G. Tax Expenditures
- H. Value Added Tax

The following list contains 14 potential definitions for the preceding key terms.

1. A taxation year that does not exceed 53 weeks.
2. A tax that is assessed on the sale of goods and services at all stages of the production/distribution chain. The tax that an enterprise must collect and pay to the government is offset by input tax credits for the tax paid on the various inputs required to produce or distribute the goods and services.
3. A tax system that applies higher effective rates for individuals with lower incomes and lower effective rates for individuals with higher incomes.
4. The total of net employment income, net business and property income, net taxable capital gains, other sources of income, and other deductions from income.
5. A CRA publication providing their interpretation of various technical issues related to income taxes.
6. A term used in the *Income Tax Act* to refer to taxable entities.
7. The total of all positive sources of income, including employment income, business and property income, net taxable capital gains, and other sources of income.
8. Foregone tax revenues due to special exemptions, rate reductions, rebates, and credits that reduce the amount of tax that would otherwise be payable.
9. A tax based on the value added to a product at each stage of production or distribution by a particular entity.
10. A tax on income that is applied at the same rate to all taxpayers, without regard to the level of their income.
11. An individual human being.
12. A taxation year that is longer or shorter than 52 weeks.

*Introduction - Key Term Matching (Moderate)*

13. A set of rules concerning administration and enforcement of the *Income Tax Act*.
14. A tax system that applies higher effective rates for individuals with higher incomes and lower effective rates for individuals with lower incomes.
15. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 14) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (15). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

## **TIF PROBLEM ONE - 6**

### **Application Of Qualitative Characteristics**

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The city of Elysium is located on an island in the Nirvana River. Because of its very desirable climate, it has attracted wealthy immigrants from all over the world. These immigrants have either built palatial new homes on the river waterfront, or moved into luxurious residences, largely in high-rise buildings in the city's core.

In general, real estate values on the island are among the highest in the world. In order to protect their extremely orderly environment, the residents have prevented the development of any reasonably priced housing. To help maintain this environment the city has a large, well trained security force.

The economic activity on the island consists of financial services, haute cuisine restaurants, and retail shops which feature high-end products from all over the world. Because of the high real estate cost, staff for these operations must live off island and commute on a daily basis.

To accommodate residents of the island, the city operates a large heliport. This allows the residents of the island to quickly access a nearby airport where most maintain at least one private jet.

Until recently, the only other access to the island was via a city operated ferry. This service was provided free of charge by the city. While it was rarely used by the residents of Elysium, the staff of the various businesses on the island relied on it for access to their jobs.

Last year, the city completed a four lane bridge to access the island. In order to finance the tremendous cost of this project, there is a \$10 toll for each trip across the bridge. To ensure that the bridge produces adequate revenues, the city has canceled the ferry service.

**Required:** Evaluate the \$10 toll on the basis of the qualitative characteristics of tax systems that are listed in your text.

## **TIF PROBLEM ONE - 7**

### **Application Of Qualitative Characteristics**

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**Note** Alsaskatoba is a fictional Canadian province. Any resemblance to an actual Canadian province is purely coincidental.

The Province of Alsaskatoba is experiencing large deficits and, because there is a real possibility of a credit rating downgrade, the Premier has concluded that some type of change is required. The Province has a corporate income tax which is assessed at the lowest rate of any Canadian province. It also has an income tax on individuals which is assessed at a flat rate of 9 percent. However, the province does not participate in the Harmonized Sales Tax (HST) regime and has never had a provincial sales tax.

The Premier has consulted with a large group of experts as to the appropriate solution to the problem. The following suggestions have been put forward:

1. Introduce a provincial sales tax at a rate of 8 percent.
2. Participate in the federal HST regime at a rate of 13 percent.
3. Cut provincial contributions to education services by 10 percent.
4. Cut provincial contributions to health care by 10 percent.
5. Introduce progressive income tax rates on individuals.
6. Increase corporate income tax rates.
7. Introduce a one-time entry fee of \$5,000 per person on new immigrants to the province.

**Required:** Evaluate these alternative suggestions on the basis of the qualitative characteristics that are presented in the text.

## **TIF PROBLEM ONE - 8**

### **Net Income For Tax Purposes**

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The following two Cases make different assumptions with respect to the amounts of income and deductions of Ms. Leslie Burke for the current taxation year:

**Case A** Ms. Burke had employment income of \$17,000 and net rental income of \$8,500. Her unincorporated business lost \$12,300 during this period. As the result of dispositions of capital property, she had taxable capital gains of \$17,400 and allowable capital losses of \$19,200. Her Subdivision e deductions for the year totalled \$6,300. Fortunately for Ms. Burke, she won \$1,000,000 in a lottery on March 3.

**Case B** Ms. Burke had employment income of \$42,100, interest income of \$8,200, and a loss from her unincorporated business of \$51,000. As the result of dispositions of capital property, she had taxable capital gains of \$22,400 and allowable capital losses of \$19,200. Her Subdivision e deductions for the year amounted to \$4,200.

**Required:** For both Cases, calculate Ms. Burke's Net Income For Tax Purposes (Division B income). Indicate the amount and type of any loss carry overs that would be available at the end of the current year, or state that no carry overs are available.

## **TIF PROBLEM ONE - 9**

### **Net Income For Tax Purposes**

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The following two Cases make different assumptions with respect to the amounts of income and deductions of Mr. Morris Dorne for the current taxation year:

**Case A** Mr. Dorne had employment income of \$50,000 and interest income of \$12,000. His unincorporated business lost \$23,000 during this period. As the result of dispositions of capital property, he had taxable capital gains of \$95,000 and allowable capital losses of \$73,000. His Subdivision e deductions for the year totalled \$8,000. He also experienced a loss of \$5,000 on a rental property that he has owned for several years.

**Case B** Mr. Dorne had employment income of \$45,000, net rental income of \$23,000, and a loss from his unincorporated business of \$51,000. As the result of dispositions of capital property, he had taxable capital gains of \$25,000 and allowable capital losses of \$46,000. His Subdivision e deductions for the year amounted to \$10,500. Fortunately for Mr. Dorne, he won \$560,000 in a lottery on February 24.

**Required:** For both Cases, calculate Mr. Dorne's Net Income For Tax Purposes (Division B income). Indicate the amount and type of any loss carry overs that would be available at the end of the current year, or state that no carry overs are available.

## **TIF PROBLEM ONE - 10**

### **Net Income For Tax Purposes**

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The following two Cases make different assumptions with respect to the amounts of income and deductions of Miss Nora Bain for the current taxation year:

	<b>Case A</b>	<b>Case B</b>
Employment Income	\$34,000	\$18,500
Income (Loss) From Business	( 36,000)	( 28,200)
Income From Property	21,000	12,000
Taxable Capital Gains	42,000	9,000
Allowable Capital Losses	( 57,000)	( 12,000)
Subdivision e Deductions (Spousal Support)	( 5,500)	( 10,500)

**Required** For both Cases, calculate Miss Bain's Net Income For Tax Purposes (Division B income). Indicate the amount and type of any loss carry overs that would be available at the end of the current year, or state that no carry overs are available.

## **TIF PROBLEM ONE - 11**

### **Net Income For Tax Purposes**

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The following four Cases make different assumptions with respect to the amounts of income and deductions available to Mr. Martin Bowman for the current taxation year:

	<b>Case 1</b>	
Net Employment Income		\$82,438
Interest Income		3,521
Taxable Capital Gains		16,346
Allowable Capital Losses		( 3,478)
RRSP Contribution		( 6,420)

	<b>Case 2</b>	
Net Business Income		\$56,782
Net Rental Loss		( 6,742)
Taxable Capital Gains		3,426
Allowable Capital Loss		( 4,560)
Spousal Support Payments		( 18,000)

	<b>Case 3</b>	
Net Employment Income		\$36,582
Net Business Loss		( 47,384)
Capital Gains		8,426
Capital Losses		( 6,220)
Child Care Costs		( 2,860)

	<b>Case 4</b>	
Interest Income		\$ 4,850
Net Business Income		35,682
Net Rental Loss		( 51,462)
Capital Gains		8,460
Capital Losses		( 18,462)
Moving Expenses		( 5,643)

**Required** For each Case, calculate Mr. Bowman's Net Income For Tax Purposes (Division B income). Indicate the amount and type of any loss carry overs that would be available at the end of the current year, or state that no carry overs are available.

## **Chapter Two Test Item File Problems**

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### **TIF PROBLEM TWO - 1**

#### **Procedures And Administration - Essay Questions**

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1. An individual can request that an employer reduce the amounts withheld for income taxes. What conditions must be met for this request to be granted? Provide an example of a situation where this request would be granted.
2. In some situations, an employee may request an increase in the amounts that are withheld for future income taxes. What circumstances might lead an employee to make such a request?
3. Under what circumstances must an individual make income tax instalment payments during the current year?
4. If an individual is required to make quarterly instalment payments on their income taxes, how is the required amount of the instalments determined?
5. By making all instalments on the basis of the CRA's instalment reminder, the taxpayer is assured that no interest will be assessed for deficient instalments. However, this may not be the best alternative for making instalment payments. Explain why this is true.
6. One of your clients has received his instalment notice and has asked your advice as to whether he should make the payments. Provide the requested advice.
7. How is interest on late instalments calculated?
8. On April 30 of the current year, her filing due date, Nicole Houde finds that she has a significant net tax owing. She will not be able to pay this until the beginning of July. She doesn't want to file her return until she has the funds available to pay the balance. What advice would you give Ms. Houde in this regard?
9. Under what circumstances must a corporation make income tax instalment payments during its current taxation year?
10. If a corporation that is not a small CCPC is required to make instalment payments on their income taxes, how are the required amounts determined?
11. If a corporation that is a small CCPC is required to make quarterly instalment payments on their income taxes, how are the required amounts determined?
12. A corporation's balance due date is not the same as its return due date. Explain how these dates differ.
13. The normal reassessment period is 3 years for individuals and CCPCs and 4 years for other corporations. Indicate two situations where a reassessment can occur outside the normal reassessment period.
14. Cases can be heard by the Tax Court of Canada using either the general or the informal procedures. How do these two procedures differ?
15. Briefly describe the difference between tax evasion and tax avoidance.

## **TIF PROBLEM TWO - 2**

### **Procedures And Administration - True Or False**

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1. If an individual believes that the amount of income taxes withheld by his employer is greater than the amount that he will have to pay in a particular year, he can make a request to the CRA to have his source deductions reduced.

True or False?

2. Because the taxation year of an individual must be based on the calendar year, all individuals will have the same filing due date.

True or False?

3. If an individual dies after October in a particular taxation year, his legal representatives must file his tax return by the later of his normal filing due date and six months after the date of his death.

True or False?

4. If quarterly instalments must be paid by an individual, they can be calculated as one-quarter of the net tax owing for the preceding year.

True or False?

5. If an individual is required to make income tax instalment payments, one acceptable pattern of payments is to base each payment on one-quarter of the estimated Tax Payable for the current taxation year.

True or False?

6. The interest rate applicable on refunds to individuals is 4 percentage points less than the interest rate applicable on amounts owing to the CRA.

True or False?

7. The penalty for an individual making insufficient instalment payments is 5 percent of the total unpaid tax at the filing date, plus 1 percent per month.

True or False?

8. Without regard to whether an individual's filing due date is April 30 or June 15, any balance of tax owing must be paid by April 30.

True or False?

9. All corporations must file their tax returns no later than six months after the end of their fiscal year, and pay any balance of tax owing no later than three months after the end of their fiscal year.

True or False?

10. The notice of objection for a corporation must be filed within 90 days from the date of mailing of the notice of assessment.

True or False?

11. Tax avoidance involves deliberately ignoring a specific provision in the *Income Tax Act*.

True or False?

**TIF Problem Two - 2**  
*Procedures And Administration - True Or False*

12. The GAAR provisions are not applicable to gifts to adult children.

True or False?

13. Interest and penalties may be waived or reduced in extraordinary circumstances, such as those involving natural disasters or serious illness.

True or False?

## TIF PROBLEM TWO - 3

### Procedures And Administration - Multiple Choice

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#### New For 2016/2017

##### **Individual Filing Requirements**

1. Which of the following statements is **NOT** correct?
  - A. If an individual has business income during the year, the due date for their income tax return is June 15 of the following year.
  - B. An income tax return may be required of an individual, without regard to their age.
  - C. If an individual has no Taxable Income for the year, they do not have to file an income tax return.
  - D. If an individual sells a capital property during the year, they are required to file an income tax return, even if there is no gain or loss on the transaction.
  
2. Which of the following statements is correct?
  - A. When an individual dies in a year, an income tax return must be filed for that year within 6 months of the date of death.
  - B. Only residents of Canada are required to file Canadian income tax returns.
  - C. An individual with business income during the year must pay any balance owing by June 15 of the following year.
  - D. A self employed individual with a net business loss for the year does not have to file an income tax return for the year.

##### **Individual Instalments**

3. Which of the following individuals did **NOT** have to pay instalments in 2016?
  - A. Jane Austen, who had business income of \$50,000 in both 2014 and 2016.
  - B. Charlotte Bronte, who realized capital gains of \$3,500 in 2015 and \$4,000 in 2016.
  - C. George Eliot, who had rental income of \$50,000 in the years 2014 through 2016 and a net allowable capital loss of \$50,000 in 2015.
  - D. Emily Bronte, who received spousal support payments of \$20,000 per year in each of the years 2014 through 2016.

##### **Corporate Filing Requirements**

4. Which of the following statements with respect to corporations is **NOT** correct?
  - A. Corporate income tax returns must be filed within 6 months of the end of the taxation year.
  - B. All corporations must file their income tax returns electronically.
  - C. If the corporation is a CCPC, the due date for any balance owing is three months after the end of the taxation year.
  - D. If a corporation has foreign operations, it can determine its Canadian tax liabilities on the basis of financial statements prepared in the corporation's functional currency.

**Corporate Instalments**

5. A Canadian public company has Tax Payable of \$62,000 in 2014, \$95,000 in 2015, and \$75,000 in 2016. The company would like to minimize its 2016 instalments. What would its instalments be?
- A. One monthly payment of \$5,167 per month, followed by eleven monthly payments of \$8,167 per month.
  - B. Twelve payments of \$5,167 per month.
  - C. Twelve payments of \$6,250 per month.
  - D. Two monthly payments of \$5,167 per month, followed by ten monthly payments of \$8,467 per month.

**Assessments And Appeals**

6. Dora Burch files her 2016 income tax return on March 2, 2017. She receives a nil assessment on June 3, 2017. However, on December 28, 2017, she receives a reassessment indicating that she owes a substantial amount of additional tax. She would like to object to this reassessment. What is the latest date for her to file a notice of objection? (Ignore the effect of leap year if applicable.)
- A. March 2, 2018.
  - B. April 30, 2018.
  - C. March 28, 2018.
  - D. December 28, 2018.

**Retained From Previous Editions**

**Individual Filing Requirements**

7. With respect to the filing of an individual income tax return, which of the following statements is correct?
- A. An individual is required to file an income tax return if their only source of income is business income, even if no tax is payable.
  - B. An individual is required to file an income tax return if they have reached the age of 18 by the end of the year.
  - C. If an individual has disposed of a capital property during the year, they are required to file an income tax return, even if no tax is payable.
  - D. An individual is not required to file an income tax return if no tax is payable for the year.
8. For the 2016 taxation year, John Bookman had a taxable capital gain of \$45,000 and a net business loss of \$45,000, resulting in a Taxable Income of nil. Which of the following statements is correct?
- A. John is not required to file a tax return for 2016.
  - B. John must file a tax return on or before June 15, 2017.
  - C. John must file a tax return on or before December 31, 2017.
  - D. John must file a tax return on or before April 30, 2017.
9. John Barron is self-employed and plans to file his 2016 tax return on June 15, 2017. His balance-due day is:
- A. April 30, 2016.
  - B. April 30, 2017.
  - C. June 15, 2017.
  - D. June 15, 2016.

10. Bunly Im is a self-employed hairdresser. Which of the following dates are correct for the date by which his tax return for a year must be filed (1st item) and his payment due date (2nd item)?
- A. April 30, April 30.
  - B. June 15, April 30.
  - C. April 30, June 15.
  - D. June 15, June 15.
11. Ms. Deveco's 2016 income tax return is due on April 30, 2017. While she is too busy to file her tax return on that date, she remits a cheque to the government for \$10,000, her estimated amount of net tax owing on that date. She has never filed a late return before. She prepares and files her tax return on May 31, 2017. At this time, the return shows that her actual net tax owing was \$9,800. Assuming that the interest rate applicable to late payment of taxes is one-half percent per month without daily compounding, how much will she owe in penalties and interest on the late filing?
- A. \$ 49.
  - B. \$490.
  - C. \$588.
  - D. \$637.
  - E. Nil.
12. Mr. Finlay, a retired individual whose only source of income was pension receipts, dies on August 15, 2016. By what date must Mr. Finlay's final tax return be filed?
- A. April 30, 2017.
  - B. February 28, 2017.
  - C. February 15, 2017.
  - D. December 31, 2016.
  - E. None of the above.
13. Ms. Ali, a self-employed music teacher with business income, dies on November 15, 2016. What is the latest filing date for her 2016 income tax return?
- A. April 30, 2017.
  - B. May 15, 2017.
  - C. May 30, 2017.
  - D. June 15, 2017.
14. Mr. Khan, a self-employed construction contractor, dies on April 1, 2016. What is the latest filing date for his final tax return?
- A. April 30, 2017.
  - B. June 15, 2017.
  - C. October 1, 2017.
  - D. December 31, 2017.
15. Ms. Loren dies on February 1, 2017. All of her income is from employment activities and she does not have a spouse or common-law partner. What is the latest date for filing her 2016 income tax return?
- A. April 30, 2017.
  - B. June 15, 2017.
  - C. August 1, 2017.
  - D. June 30, 2017.

16. Greta died on September 10, 2016. She has never reported any business income. By what date must her final tax return be filed?
- A. April 30, 2017.
  - B. April 30, 2018.
  - C. March 10, 2017.
  - D. June 15, 2017.

***Individual Instalments***

17. Ms. Marston has net tax owing for 2014 of \$4,500, net tax owing for 2015 of \$8,000, and estimated net tax owing for 2016 of \$7,500. If she wishes to pay the minimum total amount of instalments for the 2016 taxation year, her first payment on March 15 will be for what amount?
- A. Nil.
  - B. \$1,125.
  - C. \$1,875.
  - D. \$2,000.
18. Jason Marks has to pay his tax by instalments as a result of his significant investment income. His net tax owing in 2014 was \$13,600. In 2015, it was \$15,000. His estimate for 2016 is \$17,000. If he decides to pay his 2016 tax instalments according to the prior year option, how much should he pay on September 15, 2016?
- A. \$3,400.
  - B. \$3,750.
  - C. \$4,250.
  - D. \$6,500.
19. All of the following people will have to pay tax by instalments this year, except:
- A. Jane White, who received a one-time bonus of \$60,000 last year and, because her employer had not deducted enough tax, found herself with net tax owing of \$8,200.
  - B. Karen Phillips, who has started to earn investment income, which resulted in net tax owing of \$3,100 last year. Her investment income is expected to be even greater this year.
  - C. Blake Fortin, who established a sole proprietorship two years ago. Blake had a very successful first year and, as result, he had net tax owing that year of \$85,000. Business dropped in his second year, resulting in net tax owing of only \$1,500. This year, business has picked up again and he expects to have net tax owing of \$53,000.
  - D. Terri Jones, who has had net taxable capital gains on real estate in excess of \$40,000 in each of the last two years, and who expects to have similar gains this year.
20. Larry Short has self-employment income of \$62,000 in 2016. Prior to this year, he was employed full-time and his employer's withholdings more than covered his tax liability for the year. Larry estimates that, based on his self-employment income, his net tax owing for 2016 will be \$8,000. Which of the following statements is true?
- A. Larry must file his return for 2016 by April 30, 2017.
  - B. Larry should pay instalments in 2016.
  - C. Larry must pay his income tax for 2016 by June 15, 2017.
  - D. If Larry has as much income in 2017 as he had in 2016, he will have to pay instalments during 2017.

21. Individuals are required to pay instalments:
- A. When net tax owing is over \$3,000 for any one of the past two years.
  - B. When net tax owing is over \$3,000 for the current year and both of the two prior years.
  - C. When net tax owing is over \$3,000 for the current year and one of the two prior years.
  - D. When net tax owing is over \$3,000 for the current year only.
22. One way to ensure that no interest will be assessed for late instalments is:
- A. To pay the amounts provided by the CRA in their instalment reminder on or before the required dates.
  - B. To pay the lowest amount calculated using the 3 alternative calculations on or before the required dates.
  - C. To pay the estimated tax owing for the current year on the first instalment due date.
  - D. To pay the average of the three amounts calculated using the 3 alternative calculations on or before the required dates.

***Interest and Penalties***

23. Dora Chen has determined that her minimum tax instalments for 2016 are \$8,000 per quarter. She also owes \$30,000 on her credit card, which carries an interest rate of 20%. She has destroyed her credit card, so no more can be put on it. Dora is unable to pay both the entire instalment amounts and her credit card balance, but she does have \$8,000 in cash each quarter for her debts. Which of the following would be the best choice for Dora from a financial planning perspective?
- A. Dora should pay off her credit card balance before making instalment payments.
  - B. Dora must make all her instalment payments, even if it means she cannot pay anything off on her credit card this year.
  - C. Dora should split her payments equally between the credit card balance and the instalment liability, in order to show the CRA that she is trying her best to meet her obligations to them.
  - D. Dora should pay her first two instalments and then make payments on her credit card balance.
24. Lang Lang Ltd., a CCPC eligible for the small business deduction, has a March 31 year end. Due to the death of the owner/manager, the tax return for the year ended March 31, 2015 was not filed until May 12, 2017. The unpaid tax on March 31, 2015 was \$15,500. Lang Lang Ltd. has never filed a return late before. What is the total late file penalty that the corporation is required to pay? (Do not include any interest payable.)
- A. \$775
  - B. \$2,635
  - C. \$1,860
  - D. \$3,720
25. Which of the following scenarios will result in a penalty being charged by the CRA?
- A. A taxpayer pays less than the required amount of instalments.
  - B. A taxpayer who is owed a refund files their tax return late.
  - C. A taxpayer who has a balance owing files their tax return late, with the payment enclosed.
  - D. A taxpayer who has a balance owing files their tax return on time, but does not include a payment.

**Corporate Filing Requirements**

26. For corporations, the filing deadline for tax returns is:
- A. April 30.
  - B. the fiscal year end.
  - C. three months after the fiscal year end.
  - D. three months after the fiscal year end if the small business deduction is claimed, otherwise two months after the fiscal year end.
  - E. six months after the fiscal year end.
27. PS Swim Inc. has a year end of November 30. It is a small CCPC. For its 2016 taxation year, its income tax return is due on:
- A. January 31, 2017.
  - B. February 28, 2017.
  - C. April 30, 2017.
  - D. May 31, 2017.
  - E. None of the above.
28. For its 2016 taxation year, its first year of operation, PS Swim Inc. filed its return three months late. The unpaid tax at the due date for the return was \$2,500. This amount was not paid until the return was filed. What would its penalty be?
- A. Nil.
  - B. \$75.
  - C. \$125.
  - D. \$200.
  - E. \$500.
29. The balance due date for a corporation is:
- A. April 30 of the following year.
  - B. The same as the filing deadline.
  - C. Three months after the end of the fiscal year, or two months after the end of the fiscal year if the corporation is a small CCPC.
  - D. Two months after the end of the fiscal year, or three months after the end of the fiscal year if the corporation is a small CCPC.

**Corporate Instalments**

30. PP Ltd., a client of your firm, has a November 30 year end and has requested you to advise them on what its monthly instalments for the 2016 tax year will be. Its taxes payable for its November 30, 2014 and November 30, 2015 years were \$13,800 and \$13,200, respectively. Its estimated taxes payable for the November 30, 2016 year are \$14,400. PP Ltd. wants to pay the lowest amount possible, without incurring interest penalties. What would its instalments be?
- A. Twelve payments at \$1,200 per month.
  - B. Twelve payments at \$1,100 per month.
  - C. Twelve payments at \$1,150 per month.
  - D. Two monthly payments at \$1,200 each, followed by ten monthly payments at \$1,140 each.
  - E. None of the above.

*Procedures And Administration - Multiple Choice*

31. A Canadian public corporation had federal taxes payable in 2014 and 2015 exceeding \$3,000. One correct option it has with respect to its 2016 instalments is to pay:
- A. equal instalments, on a quarterly basis, based on its 2015 federal taxes payable.
  - B. on a monthly basis, instalments equal to 1/12th of its estimated 2016 federal taxes payable.
  - C. one lump-sum payment, within three months of its 2016 year end.
  - D. on a monthly basis, instalments equal to 1/12th of its 2014 federal taxes payable.
32. If a Canadian public corporation is experiencing a year-to-year decrease in taxes payable, the most advantageous calculation of instalments that would be allowed is:
- A. monthly, based on the estimated tax for the current year.
  - B. quarterly, based on the estimated tax for the current year.
  - C. monthly, based on the estimated tax for the immediately preceding year.
  - D. quarterly, based on the estimated tax for the immediately preceding year.
  - E. monthly, based on the estimated tax for the second preceding year and the immediately preceding year.
  - F. quarterly, based on the estimated tax for the second preceding year and the immediately preceding year.
33. Which of the following is **NOT** one of the criteria for a CCPC to be considered a small CCPC eligible to pay instalments on a quarterly basis?
- A. Taxable income cannot exceed \$500,000 for the corporation and its associated corporations for the current taxation year and the two previous years.
  - B. The corporation has claimed the small business deduction in the current or previous year.
  - C. The corporation has a perfect compliance record during the last 12 months.
  - D. The corporation and its associated corporations do not have Taxable Capital Employed in Canada that exceeds \$10 million for the current or previous year.

**Assessments And Appeals**

34. Which of the following statements is **NOT** correct?
- A. When the person filing the return has made any misrepresentation due to neglect, carelessness or wilful default, the normal reassessment period can be extended beyond 3 years.
  - B. A taxpayer can choose to file a waiver to extend the 3 year time limit.
  - C. When a return has been reassessed once, no further reassessments are permitted.
  - D. Reassessment can occur outside the normal reassessment period when reassessment within the normal period affects a balance outside of the normal period.
35. Which of the following is **NOT** one of the criteria that must be met before an adjustment to a previous year tax return is permitted?
- A. The CRA must be satisfied that the previous assessment was incorrect.
  - B. The change is based on a successful appeal to the courts by another taxpayer.
  - C. The taxpayer's return was filed within 3 years of the end of the year to which it relates.
  - D. The reassessment must be made within the normal assessment period, or under certain permitted extensions to this period.

36. Tom Arnold filed his 2016 tax return on March 1, 2017. The CRA mailed a notice of assessment to Tom dated May 15, 2017, and Tom received it on May 30, 2017. If Tom disagrees with the notice of assessment, what is the latest date he has to file a notice of objection?
- A. 90 days from March 1, 2017.
  - B. 90 days from April 30, 2017.
  - C. 90 days from May 15, 2017.
  - D. 90 days from May 30, 2017.
  - E. None of the above.
37. Minnie Belanger is retired. She filed her 2016 tax return on March 5, 2017. She received a portion of the tax refund claimed and an assessment notice, dated April 19, 2017, which set out the difference between the amount claimed and the amount of the refund. As Minnie disagrees with the notice of assessment, she wishes to file a notice of objection. What is the latest date she has to file a notice of objection?
- A. March 5, 2018.
  - B. April 19, 2018.
  - C. April 30, 2018.
  - D. July 18, 2017.
  - E. June 15, 2018.
38. For a public corporation, which of the following statements is correct with respect to filing a notice of objection?
- A. It must be filed no later than 180 days from the date on the notice of assessment.
  - B. It must be filed the later of 90 days after the date on the notice of assessment and one year from the filing date for the return under assessment.
  - C. It must be filed the later of 180 days after the date on the notice of assessment and one year from the filing date for the return under assessment.
  - D. It must be filed no later than 90 days after the date on the notice of assessment.
39. Marc Mayer filed his 2016 personal tax return on March 1, 2017. Neither he nor his spouse has business income in any year. The CRA mailed a Notice of Assessment to Marc dated May 5, 2017 and Marc received it on May 14, 2017. If Marc disagrees with the Notice of Assessment, he has until which one of the following dates to file a Notice of Objection?
- A. August 3, 2017.
  - B. August 12, 2017.
  - C. March 1, 2018.
  - D. April 30, 2018.

***Tax Planning***

40. Carice Martin is planning to sell a piece of capital equipment which can be sold for more than its cost. If she waits until after her company's year end to sell it, she is engaging in:
- A. tax evasion.
  - B. tax avoidance.
  - C. GAAR.
  - D. tax planning.

## **TIF PROBLEM TWO - 4**

### **Procedures And Administration - Exam Exercises**

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#### ***Exam Exercise Subject Listing For Chapter 2***

<b>Number</b>	<b>Subject</b>
1	Individual Due Dates
2	Individual Due Dates
3	Deceased Taxpayer Due Date
4	Deceased Taxpayer Due Date
5	Individual Instalments
6	Individual Instalments
7	Individual Instalments
8	Penalties And Interest (Individuals)
9	Penalties And Interest (Individuals)
10	Corporate Instalments - Regular And Small CCPC
11	Corporate Instalments - Regular And Small CCPC
12	Corporate Instalments - Regular And Small CCPC
13	Corporate Due Dates
14	Corporate Due Dates
15	Corporate Due Dates
16	Notice Of Objection
17	Notice Of Objection

**Exam Exercise Two - 1 (Individual Due Dates)**

Mark Brown's 2016 Net Income includes business income. When is his 2016 tax return due? By what date must his 2016 tax liability be paid in order to avoid the assessment of interest on amounts due?

**Exam Exercise Two - 2 (Individual Due Dates)**

Ms. Jeanine Farrel has 2016 Net Income which includes business income. When is her 2016 tax return due? In addition, indicate when any remaining tax liability must be paid in order to avoid having interest assessed on the amount due.

**Exam Exercise Two - 3 (Deceased Taxpayer Due Date)**

George Klause dies on March 1, 2017. All of his income during 2016 was earned through his unincorporated accounting practice. By what date must his representatives file his 2016 income tax return? Explain your answer.

**Exam Exercise Two - 4 (Deceased Taxpayer Due Date)**

Gloria Klump dies on December 1, 2016. Much of her 2016 income resulted from an unincorporated business which she operated. By what date must her representatives file her 2016 income tax return? Explain your answer.

**Exam Exercise Two - 5 (Individual Instalments)**

At the beginning of 2016, the following information relates to Sarah Elmsley:

Year	Net Tax Owing
2014	\$1,800
2015	6,400
2016 (Estimated)	3,600

Indicate whether Ms. Elmsley is required to make instalment payments during 2016. Explain your conclusion and, if your answer is positive, indicate the minimum instalments that will be required and when they are due.

**Exam Exercise Two - 6 (Individual Instalments)**

Horace Greesom filed his 2015 return on time. At the beginning of 2016, the following information relates to Mr. Greesom:

Year	Taxes Payable	Amounts Withheld
2014	\$56,000	\$45,000
2015	49,000	46,200
2016 (Estimated)	65,000	45,000

What amounts will be shown on the Instalment Reminder notices for 2016 and when will the amounts be due? Should he pay those amounts? Explain your conclusion.

**Exam Exercise Two - 7 (Individual Instalments)**

At the beginning of 2016, the following information relates to Jerry Farrow:

<b>Year</b>	<b>Tax Payable</b>	<b>Amounts Withheld</b>
2014	\$83,000	\$78,000
2015	76,000	77,000
2016 (Estimated)	63,000	59,000

Is Mr. Farrow required to make instalment payments during 2016? If he is required to make instalment payments, indicate the amounts that would be required under each of the three alternative methods of calculating instalments. Indicate which alternative would be preferable.

**Exam Exercise Two - 8 (Penalties And Interest For Individuals)**

Despite the fact that her net tax owing has been between \$7,000 and \$8,000 in the two previous years, and is expected to be a similar amount during 2016, Marsha Fields has made no instalment payments for 2016. While her normal filing date would be April 30, 2017, she does not file her 2016 return or pay the balance owing until August 24, 2017. What penalties and interest will be assessed for the 2016 taxation year?

**Exam Exercise Two - 9 (Penalties And Interest For Individuals)**

As his Taxable Income in 2015 was nil, Mark Felton did not make any instalment payments during 2016. In completing his return for 2016, he finds that he has tax payable of \$22,500. While his normal filing date would be April 30, 2017, he does not file his return or pay the balance owing until September 12, 2017. What penalties and interest will be assessed for the 2016 taxation year? Mark has filed his return on time in all previous years.

**Exam Exercise Two - 10 (Corporate Instalments - Regular And Small CCPC)**

Lemar Ltd. has a December 31 year end. It is not a small CCPC. For 2014, its taxes payable were \$71,500, while for 2015, the amount was \$93,600. For 2016, its estimated taxes payable are \$114,700. What would be the minimum instalment payments for the 2016 taxation year and when would they be due? How would your answer differ if Lemar Ltd. qualified as a small CCPC?

**Exam Exercise Two - 11 (Corporate Instalments - Regular And Small CCPC)**

Chemco Inc. has a December 31 year end and is not a small CCPC. For 2014, its taxes payable were \$146,300, while for 2015, the amount was \$94,650. For 2016, its estimated taxes payable are \$52,300. What would be the minimum instalment payments for the 2016 taxation year and when would they be due? How would your answer differ if Chemco Inc. qualified as a small CCPC?

**Exam Exercise Two - 12 (Corporate Instalments - Regular And Small CCPC)**

Dustin Inc. has a September 30 year end and is not a small CCPC. For its taxation year ending September 30, 2014, its tax payable was \$33,500. The corresponding figure for the year ending September 30, 2015 was \$93,400. It is estimated that, for the year ending September 30, 2016, its tax payable will be \$56,200. What would be the minimum instalment payments for the taxation year that ends on September 30, 2016, and when would they be due? How would your answer differ if Dustin Inc. qualified as a small CCPC?

***Exam Exercise Two - 13 (Corporate Due Dates - CCPC)***

The taxation year end for Grange Inc. is March 31, 2016. It is a Canadian controlled private corporation that claims the small business deduction and had Taxable Income for the year ending March 31, 2015 of \$165,000. Indicate the date on which the corporate tax return for the year ending March 31, 2016 must be filed, as well as the date on which any final payment of taxes is due.

***Exam Exercise Two - 14 (Corporate Due Dates)***

The taxation year end for Lawnco Inc. is January 31, 2016. Lawnco Inc. is a Canadian public company and does not qualify for the small business deduction. Indicate the date on which the corporate tax return must be filed, as well as the date on which any final payment of taxes is due.

***Exam Exercise Two - 15 (Corporate Due Dates - CCPC)***

The taxation year end for Breyson Ltd. is June 30, 2016. It is a Canadian controlled private corporation that claims the small business deduction and had Taxable Income for the year ending June 30, 2015 of \$132,000. Indicate the date on which the corporate tax return for the year ending June 30, 2016 must be filed, as well as the date on which any final payment of taxes is due.

***Exam Exercise Two - 16 (Notice of Objection)***

Nancy Forth filed her 2016 tax return as was required on April 30, 2017. Her Notice of Assessment dated May 15, 2017 indicated that her return was accepted as filed. On July 12, 2018, she receives a Notice of Reassessment dated July 2, 2018 indicating that she owes additional taxes, as well as interest on the unpaid amounts. What is the latest date for filing a notice of objection for this reassessment? Explain your answer.

***Exam Exercise Two - 17 (Notice of Objection)***

Norman Foster filed his 2016 tax return as was required on June 15, 2017. His Notice of Assessment dated August 28, 2017, indicated that his return was accepted as filed. On March 15, 2018, he receives a Notice of Reassessment dated March 8, 2018 indicating that he owes additional taxes, as well as interest on unpaid amounts. What is the latest date for filing a notice of objection for this reassessment? Explain your answer.

**TIF PROBLEM TWO - 5A****Procedures And Administration - Key Term Matching (Easy)**

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**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms were listed at the end of Chapter 2, "Procedures And Administration".

- A. Instalment Threshold
- B. Net Tax Owing
- C. NETFILE
- D. Notice Of Assessment
- E. Prescribed Rate
- F. Source Deductions
- G. Tax Avoidance
- H. Tax Evasion

The following list contains ten potential definitions for the preceding key terms.

1. An interest rate which changes quarterly and is based on the average interest rate paid on 90 day Treasury Bills during the first month of the preceding quarter.
2. The undertaking of transactions or arrangements with a view to avoiding or minimizing the payment of taxes.
3. A form that the CRA sends to all taxpayers after they process their returns which describes any changes made to the returns and states the amount of their additional tax payable or their refund.
4. A term used to describe the sum of federal and provincial taxes owing for the year, less amounts withheld for the year.
5. Deliberately ignoring a specific part of the law or willfully refusing to comply with legislated reporting requirements.
6. An electronic filing system that requires the use of an approved software program.
7. Amounts withheld by an employer from the income of employees. The withholdings for income taxes, Canada Pension Plan contributions, and Employment Insurance premiums must be remitted to the government.
8. This ITA 245 provision attempts, in a very generalized manner, to limit the ability of taxpayers to avoid tax through certain types of transactions that have no bona fide purpose other than to obtain a tax benefit.
9. An amount of net tax owing for individuals or taxes payable for corporations that is used to determine the need to make instalment payments.
10. A formal determination of taxes to be paid or refunded.

*Procedures And Administration - Key Term Matching (Easy)*

11. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 10) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (11). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

**TIF PROBLEM TWO - 5B****Procedures And Administration - Key Term Matching (Moderate)**

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**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms were listed at the end of Chapter 2, “Procedures And Administration”.

- A. Instalment Threshold
- B. Net Tax Owning
- C. NETFILE
- D. Notice Of Assessment
- E. Prescribed Rate
- F. Source Deductions
- G. Tax Avoidance
- H. Tax Evasion

The following list contains 14 potential definitions for the preceding key terms.

1. An interest rate which changes quarterly and is based on the average interest rate paid on 90 day Treasury Bills during the first month of the preceding quarter.
2. An electronic system for filing individual tax returns. While the system can be used by anyone, the return must be transmitted by a registered EFILE service provider using approved software.
3. The undertaking of transactions or arrangements with a view to avoiding or minimizing the payment of taxes.
4. A form that the CRA sends to all taxpayers after they process their returns which describes any changes made to the returns and states the amount of their additional tax payable or their refund.
5. A term used to describe the sum of federal and provincial taxes owing for the year, less amounts withheld for the year.
6. Deliberately ignoring a specific part of the law or willfully refusing to comply with legislated reporting requirements.
7. An electronic filing system that requires the use of an approved software program.
8. Amounts withheld by an employer from the income of employees. The withholdings for income taxes, Canada Pension Plan contributions, and Employment Insurance premiums must be remitted to the government.
9. A term used to describe the sum of the total federal and provincial taxes owing for the year.
10. Amounts withheld by an employer from the income of employees. The amounts withheld are based on the expected income tax liability of the employee for the current year.

*Procedures And Administration - Key Term Matching (Moderate)*

11. This ITA 245 provision attempts, in a very generalized manner, to limit the ability of tax-payers to avoid tax through certain types of transactions that have no bona fide purpose other than to obtain a tax benefit.
12. An amount of net tax owing for individuals or taxes payable for corporations that is used to determine the need to make instalment payments.
13. A formal determination of taxes to be paid or refunded.
14. An amount of total tax owing for individuals or taxes payable for corporations that is used to determine the need to make instalment payments.
15. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 14) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (15). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

## **TIF PROBLEM TWO - 6**

### **Instalment Payments For Individuals And Corporations**

For the three years ending December 31, 2016, the taxpayer's combined federal and provincial tax payable was as follows:

<b>Year Ending December 31</b>	<b>Taxes Payable</b>
2014	\$72,300
2015	89,400
2016 (Estimated)	78,300

**Case One** The taxpayer is an individual whose employer withholds combined federal and provincial taxes of \$73,700 in 2014, \$83,200 in 2015, and \$75,000 in 2016.

**Case Two** The taxpayer is an individual whose employer withholds combined federal and provincial taxes of \$65,100 in 2014, \$90,100 in 2015, and \$71,900 in 2016.

**Case Three** The taxpayer is a small CCPC with a taxation year that ends on December 31.

**Case Four** The taxpayer is a corporation with a taxation year that ends on December 31. It is not a small CCPC. Assume that its combined federal and provincial taxes payable for the year ending December 31, 2015 were \$74,500, instead of the \$89,400 given in the problem.

**Required:** For each of the preceding independent Cases, provide the following information:

1. Indicate whether instalments are required during 2016. Provide a brief explanation of your conclusion. This explanation should be provided even if the amount of the required instalments is nil.
2. If instalments are required, calculate the amount of instalments that would be required under each of the acceptable methods available.
3. If instalments are required, indicate which of the available methods would best serve to minimize instalment payments during 2016. If instalments must be paid, indicate the date on which they are due.

## **TIF PROBLEM TWO - 7**

### **Instalment Payments For Corporations**

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For the three years 2014, 2015, and 2016, Mr. George Grafton provides the following information on his combined federal and provincial taxes payable, along with information on withholdings by his employer:

<b>Year</b>	<b>Taxes Payable</b>	<b>Taxes Withheld</b>
2014	\$31,500	\$29,800
2015	14,600	6,200
2016 (Estimated)	27,400	24,300

In January, 2016, you are asked to provide tax advice to Mr. Grafton. He has asked you whether it will be necessary for him to pay instalments in 2016 and, if so, what the minimum amounts that should be paid are, along with the dates on which these amounts are due.

**Required:** Provide the information requested by Mr. Grafton. Be sure to show all required calculations.

## **TIF PROBLEM TWO - 8**

### **Instalment Payments For Individuals**

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For the taxation year ending December 31, 2014, a corporation's combined federal and provincial Tax Payable is \$103,680. The corresponding figure for 2015 is \$122,220. For the year ending December 31, 2016, it is estimated that combined federal and provincial Tax Payable will be \$113,220.

**Case One** The taxpayer is a publicly traded corporation.

**Case Two** The taxpayer is a publicly traded corporation. Assume that its combined federal and provincial taxes payable for the year ending December 31, 2015 were \$110,520, instead of the \$122,220 given in the problem.

**Case Three** The taxpayer is a small CCPC.

**Case Four** The taxpayer is a small CCPC. Assume that its combined federal and provincial taxes payable for the year ending December 31, 2015 were \$110,520, instead of the \$122,220 given in the problem.

**Required:** For each of the preceding independent Cases, provide the following information:

1. Indicate whether instalments are required during 2016. Provide a brief explanation of your conclusion.
2. Calculate the amount of instalments that would be required under each of the acceptable methods available.
3. Indicate which of the available methods would best serve to minimize instalment payments during 2016. If instalments must be paid, indicate the dates on which they are due.

## **TIF PROBLEM TWO - 9**

### **Instalment Payments For Individuals**

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For the three years ending December 31, 2016, George Shivraj had combined federal and provincial Tax Payable as follows:

<b>2014</b>	\$13,500
<b>2015</b>	16,200
<b>2016</b> (Estimated)	18,400

Using this information consider the following three independent cases.

**Case One** Mr. Shivraj's employer withholds \$11,200 in 2014, \$12,900 in 2015, and \$15,100 in 2016.

**Case Two** Mr. Shivraj's employer withholds \$9,200 in 2014, \$10,300 in 2015, and \$14,900 in 2016.

**Case Three** Mr. Shivraj's employer withholds \$10,100 in 2014, \$16,300 in 2015, and \$14,700 in 2016.

**Required:** For each of the preceding independent Cases, calculate the minimum instalment payments that are required to be made towards the settlement of the taxes payable for the year ending December 31, 2016. Show all required calculations.

If instalments must be paid, include in your answer the date that each instalment is due. Note that, in answering this question, you should state a conclusion on whether or not instalments are required, even if the amount of the instalments is nil. You should also state the basis for your conclusion.

## **TIF PROBLEM TWO - 10**

### **Instalment Payments For Corporations**

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For the three taxation years ending December 31, 2016, a corporation's combined federal and provincial tax payable are as follows:

<u>Year Ending December 31</u>	<u>Taxes Payable</u>
2014	\$ 86,500
2015	101,400
2016 (Estimated)	94,600

**Case One** The taxpayer is a small CCPC.

**Case Two** The taxpayer is a small CCPC. Assume that its combined federal and provincial taxes payable for the year ending December 31, 2015 were \$92,100, instead of the \$101,400 given in the problem.

**Case Three** The taxpayer is a publicly traded corporation.

**Case Four** The taxpayer is a publicly traded corporation. Assume that its combined federal and provincial taxes payable for the year ending December 31, 2015 were \$92,100, instead of the \$101,400 given in the problem.

**Required:** For each of the preceding independent Cases, provide the following information:

1. Indicate whether instalments are required during 2016. Provide a brief explanation of your conclusion.
2. Calculate the amount of instalments that would be required under each of the acceptable methods available.
3. Indicate which of the available methods would best serve to minimize instalment payments during 2016. If instalments must be paid, indicate the dates on which they are due.

## **TIF PROBLEM TWO - 11**

### **Instalment Payments For Individuals**

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For the three years ending December 31, 2016, Gloria Sloan had combined federal and provincial Tax Payable as follows:

<b>2014</b>	\$23,600
<b>2015</b>	25,400
<b>2016</b> (Estimated)	27,200

Using this information consider the following three independent cases.

**Case One** Ms. Sloan's employer withholds \$23,100 in 2014, \$21,100 in 2015, and \$23,300 in 2016.

**Case Two** Ms. Sloan's employer withholds \$24,100 in 2014, \$18,600 in 2015, and \$23,700 in 2016.

**Case Three** Ms. Sloan's employer withholds \$19,100 in 2014, \$20,200 in 2015, and \$24,300 in 2016.

#### **Required:**

- A. For each of the three cases:
- indicate whether instalments are required for the 2016 taxation year. Show all of the calculations required to make this decision;
  - in those cases where instalments are required, indicate the amount of the instalments that would be required under the approach used in the CRA's instalment reminder; and
  - in those cases where you have calculated the instalments required under the CRA's instalment reminder, indicate whether you believe there is a better approach and calculate the required instalments under that approach.
- B. For those Cases where instalments are required, indicate the dates on which the payments will be due.

**TIF PROBLEM TWO - 12****Instalment Payments For Corporations**

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For the taxation year ending December 31, 2014, a corporation's combined federal and provincial Tax Payable is \$57,600. The corresponding figure for 2015 is \$67,900. For the year ending December 31, 2016, it is estimated that combined federal and provincial Tax Payable will be \$62,900.

**Case One** The taxpayer is a publicly traded corporation.

**Case Two** The taxpayer is a publicly traded corporation. Assume that its combined federal and provincial taxes payable for the year ending December 31, 2015 were \$61,400, instead of the \$67,900 given in the problem.

**Case Three** The taxpayer is a small CCPC.

**Case Four** The taxpayer is a small CCPC. Assume that its combined federal and provincial taxes payable for the year ending December 31, 2015 were \$61,400, instead of the \$67,900 given in the problem.

**Required:** For each of the preceding independent Cases, provide the following information:

1. Indicate whether instalments are required during 2016. Provide a brief explanation of your conclusion.
2. Calculate the amount of instalments that would be required under each of the acceptable methods available.
3. Indicate which of the available methods would best serve to minimize instalment payments during 2016. If instalments must be paid, indicate the dates on which they are due.

## **Chapter Three Test Item File Problems**

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### **TIF PROBLEM THREE - 1**

#### **Employment Income - Essay Questions**

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1. Explain how a bonus arrangement can be used to defer the taxes paid by an employee.
2. List and briefly describe the major factors that will be considered in determining whether an individual is working as an employee or as an independent contractor.
3. The tax consequences of being classified as an employee rather than as an independent contractor can be significant. As a result, it is not uncommon to find controversy and, in some cases, litigation resulting from the need to make this distinction. Explain the importance, from the point of view of an employee, of the distinction between being classified as an employee versus being classified as a self-employed independent contractor.
4. Briefly described the advantages to an employer of hiring independent contractors, as opposed to hiring employees.
5. Tax planning considerations are very significant in deciding the kinds of benefits that will be provided to employees. Explain why salary payments are considered the basic benchmark with which other types of employee compensation will be compared.
6. List two types of employee benefits that involve tax deferral and two types of benefits that involve tax avoidance.
7. London Wholesalers employs over 50 full time salespeople, all of whom are provided with a company car. While the cars are used primarily for business purposes, all of the sales staff drive them at least 20,000 kilometers per year for personal reasons. As controller of the Company you are aware that there is tax legislation in effect which can create substantial taxable benefits that could accrue to these salespeople because they have the use of a company car.  
  
Indicate some of the ways in which the Company and the sales staff might legitimately reduce the amount of the taxable benefit associated with having the use of a company car.
8. Because of the formula used to calculate the taxable benefit when an employer owned vehicle is provided to an employee, the amount of the benefit can exceed the value of the vehicle. Explain this statement.
9. What is the difference between an allowance and a reimbursement?
10. An employee may be paid a monthly amount for using his own automobile in employment related activities. Alternatively, he may be paid a reasonable amount based on the number of kilometers driven. From the point of view of both the employer and the employee, explain the tax treatment that will be given to these two alternatives.
11. Briefly explain the tax consequences resulting from being a member of an employer sponsored group disability insurance plan.
12. List the factors that will have to be considered in determining whether a particular low interest or interest free loan is an effective form of employee compensation.
13. Briefly describe the calculation of the taxable benefit that is assessed on loans to employees that are not considered to be housing loans.

14. For tax purposes, an employee who receives an option on his employer's stock that is not in-the-money will not have an employment income inclusion at the time the option is received. Do you agree with this treatment? Explain your conclusion.
15. Under what circumstances is an individual entitled to a deduction equal to one-half of the employment income inclusion resulting from exercising or selling stock options?
16. The number of deductions that can be made in computing employment income is fairly limited. Further, certain types of expenses must meet specified conditions in order to be eligible for deduction. Indicate the conditions that must be met in order for a salesperson to deduct expenses in computing employment income. In addition, Indicate the conditions that must be met in order for travel costs to be deducted in computing employment income.
17. Many employees maintain a work space in their home. Describe the kinds of home related costs that can be deducted by an employee.

## **TIF PROBLEM THREE - 2**

### **Employment Income - True Or False**

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1. Employment income is the salary, wages, and other remuneration, including gratuities, that are receivable by an individual during the year.  
True or False?
2. If properly constructed, bonus arrangements can result in tax deferral for employees.  
True or False?
3. One of the advantages of being an independent contractor rather than an employee is that you do not have to make CPP contributions.  
True or False?
4. Employers generally prefer contracting out as it avoids the cost of CPP and EI contributions.  
True or False?
5. Payments by employers of premiums on life insurance for employees are not taxable benefits.  
True or False?
6. When an employee pays all of the premiums for disability insurance coverage, the payments are not deductible and the benefits received are tax free.  
True or False?
7. Payments by employers to private health care plans are not taxable benefits and any benefits received under such plans are tax free.  
True or False?

**Questions 8, 9, and 10 relate to the following facts:**

An employee is given a \$10,000 interest free loan from her employer on January 1 to buy a car to be used for business trips. Due to a serious illness, she used the car for only nine months of the year. Assume that the prescribed rate is 2 percent for the entire year.

8. Her taxable benefit from the loan is \$200 for the year.  
True or False?
9. She pays her employer \$1,000 on September 30 to decrease the loan. Her taxable benefit from the loan is \$180 for the year.  
True or False?
10. In calculating her minimum standby charge, the imputed interest from the loan is part of her operating costs.  
True or False?

## TIF PROBLEM THREE - 3

### Employment Income - Multiple Choice

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#### New For 2016/2017

##### **Employee vs. Self-Employed**

1. Which of the following considerations is **NOT** in the determination of whether an individual performing work is an employee or an independent contractor?
  - A. Opportunity for profit.
  - B. Hours per week spent at work site.
  - C. Ability to subcontract to others.
  - D. Ownership of tools.

##### **Employee Benefits**

2. During 2016, Nellie Ward receives from her current employer:
  - A \$400 gift certificate for online retailer Amazon.
  - A \$600 reclining easy chair for outstanding customer service during the year.
  - A set of 4 coffee mugs with the employer's logo etched on the side. These mugs cost the employer \$20.
  - An Easter basket of gourmet treats valued at \$245.
  - A cash award of \$300 in recognition of 10 years of service with the employer.

What is the amount that will be included in Nellie's 2016 Net Income For Tax Purposes due to the gifts?

- A. \$800.
- B. \$1,000.
- C. \$1,300.
- D. \$700.

##### **Automobile Benefits**

3. With respect to employment related automobile costs and benefits, which of the following statements is correct?
  - A. When an employee is provided with an automobile that is purchased by the employer for \$50,000, the taxable benefit to the employee will be based on the prescribed limit of \$30,000.
  - B. An employee who uses his own vehicle for employment related activities cannot deduct any financing costs related to the acquisition of the car.
  - C. An employee who is provided with a vehicle owned by his employer can deduct capital cost allowance to the extent that the vehicle is used for employment related activities.
  - D. If an employee drives an employer provided vehicle for more than 20,004 kilometers of personal use during a year, there will be no reduction of the basic standby charge.

##### **Allowances and Reimbursements**

4. Which of the following statements with respect to allowances is **NOT** correct?
  - A. An allowance from an employer to cover an employee's professional association dues will not be included in an employee's income.
  - B. Reimbursement by an employer of an employee's moving expenses will not be included in an employee's income.
  - C. Travel allowances provided by an employer are never included in an employee's income.
  - D. In general, employers prefer allowances to reimbursements.

**Loans To Employees**

5. With respect to loans to employees, which of the following statements is correct?
- A. If the rate on the loan is less than the market rate for similar types of debt, the employee will have a taxable benefit equal to the difference.
  - B. If the proceeds from the loan are invested in income producing assets, the interest benefit on the loan will be deductible in determining the employee's Net Income For Tax Purposes.
  - C. When the loan is to assist an employee with a home purchase, the taxable benefit must be calculated using each quarterly value for the prescribed rate.
  - D. The taxable benefit on an employee loan will not be altered by the amount of interest payments the employee makes to the employer.

**Employee Stock Options**

6. Which of the following statements with respect to stock options is correct?
- A. If the option price for shares is less than the grant date market value of the shares, granting the options will create a taxable benefit for the grantee.
  - B. If shares in a Canadian controlled private corporation are acquired through the exercise of stock options, there will be a deduction equal to one-half of the employment income inclusion, provided the shares were held for at least two years.
  - C. When options to acquire the shares of a Canadian public corporation are exercised, there are no immediate tax consequences for the acquirer.
  - D. When shares in a Canadian controlled private corporation that have been acquired through the exercise of options are sold, any loss on the sale can be used to offset any income inclusion that results from the exercise of the options.

**Employment Deductions**

7. Which of the following statements about expense deductions for employees is **NOT** correct?
- A. In order for an employee to deduct work space in the home costs it must be the place where that individual principally carries on his employment duties.
  - B. If an employee uses his own automobile to carry out his employment duties, he can deduct a pro rata share of the interest that he pays on a loan to finance the automobile.
  - C. In order to deduct travel costs, an employee must ordinarily be required to carry on his duties away from the employer's place of business.
  - D. If an employed salesperson who earns commission income acquires a cell phone, he cannot deduct CCA on this asset.

**Retained From Previous Editions****Employee vs. Self-Employed**

8. Veronica mows lawns during the summer. In 2016 she was paid directly by homeowners for her work, in some case on the basis of the completed job, in other cases at an hourly rate. Her friend Jonathon does the same work. However, he is paid at an hourly rate by a lawn maintenance company. Which of the following statements is correct?
- A. Veronica earns business income and Jonathon earns employment income. Veronica will be able to deduct more expenses than Jonathon.
  - B. Veronica and Jonathon both earn employment income.
  - C. Veronica earns business income and Jonathon earns employment income. Their deductible expenses will be the same.
  - D. Veronica and Jonathon both earn business income.

9. Which of the following groups of factors are used by the courts in order to determine a taxpayer's status as an employee or a self-employed contractor?
- A. intent, control test, ownership of tools test, number of hours worked per week
  - B. intent, ability to subcontract test, the type of work being undertaken, ownership of tools test,
  - C. intent, control test, ownership of tools test, opportunity for profit
  - D. intent, ability to subcontract test, the location of the work site, opportunity for profit

### **Employee Benefits**

10. Indicate which of the following benefits provided by an employer is **NOT** considered part of employment income.
- A. Reimbursement of moving expenses.
  - B. Travel expenses of the employee's spouse.
  - C. Payments resulting from wage loss replacement plans.
  - D. Premiums paid by an employer on life insurance policies.
  - E. Individual premiums under provincial hospitalization plans.
11. Indicate which of the following benefits provided by an employer is considered part of employment income.
- A. Subsidized meals provided in employer facilities.
  - B. Low rent housing.
  - C. Transportation to the job in employer vehicles.
  - D. Premiums under private health services plans.
  - E. Uniforms and special clothing.
12. Which of the following is **NOT** a taxable benefit?
- A. A cash Christmas gift to an employee from the employer. All the employees received a cash bonus of \$150.
  - B. Payment of the tuition for an employee completing a general interest degree on a part-time basis.
  - C. A 20 percent discount on the employer's merchandise, available to all employees. The employer's mark-up is 50 percent.
  - D. Low rent housing provided by the employer.
13. Which one of the following benefits received from an employer would **NOT** result in a taxable benefit to the employee?
- A. An allowance of 45 cents per kilometer for driving on employer business.
  - B. An interest free loan used to acquire shares of the employer.
  - C. Employer paid life insurance premiums for \$20,000 of employee coverage.
  - D. Use of the employer's vehicle which is used 95% for employment purposes.
14. In which one of the following lists are **ALL** items relevant when computing net employment income?
- A. Employee contributions to a registered pension plan; signing bonus on accepting employment; use of an employer-owned automobile.
  - B. Monthly automobile allowance; dental plan paid for by the employer; promotional cost incurred in selling the employer's products.
  - C. Subsidized meals in employer's facilities; life insurance paid by the employer; legal fees incurred to collect unpaid salary.
  - D. Tips and gratuities; dental insurance paid by the employer; exercise of options to purchase shares of the publicly traded employer.

15. An employee has been offered a choice of an increase in salary of \$100,000 or a combination of salary and other benefits with a cost to the employer of \$100,000. Assuming that the employee would buy the listed benefits with his own funds if they were not provided in the benefits package, which of the following packages would be the most advantageous from a tax perspective?
- A dental plan plus a leased automobile that would be used only for personal travel by the employee.
  - Life insurance plus a leased automobile that would be used only for personal travel by the employee.
  - Salary plus life insurance.
  - Salary only.
16. Which of the following is **NOT** a tax-free benefit for the employee when it is provided by an employer?
- Premiums for private health care plans.
  - A gift of a digital camera for an employee's wedding.
  - Employer reimbursement for the cost of tools required to perform work.
  - Employer contributions to a registered pension plan.
17. Which of the following is a taxable benefit?
- Payment of the tuition for an employee taking a course that will benefit the employer.
  - A \$350 VISA gift card given as a Christmas present to all employees.
  - A 15 percent discount on the employer's merchandise, available to all employees.
  - Low priced meals in the company cafeteria where the prices are approximately equal to the cost of the meals.

### Automobile Benefits

**Questions 18 Through 21** Questions 18 through 21 are based on the following information:

The cost of the car is \$20,000 including HST. If the car is leased, the monthly lease payment is \$500 including HST. The car is driven for a total of 26,000 km during 2016 and its operating costs for the year are \$4,000. For each of the **independent** questions 8 through 11, choose one of the following answers. Each answer can be used more than once.

- |             |             |
|-------------|-------------|
| A. \$1,150. | G. \$2,455. |
| B. \$1,650. | H. \$3,240. |
| C. \$1,800. | I. \$3,300. |
| D. \$1,964. | J. \$3,959. |
| E. \$2,160. | K. \$4,752. |
| F. \$2,250. | L. \$4,800. |
18. Assume the car is purchased. It was used by an employee for the whole year. He drives it for personal purposes for a total of 9,000 km. The minimum taxable benefit is:
19. Assume the car is leased. It is used by the employee for 11 months of the year. In the other month, he was required to return the car to his employer's premises. He drives it for personal purposes for a total of 6,000 km. The minimum taxable benefit is:
20. Assume the car is purchased. It is used by the employee for 10 months of the year. In the other months, he was required to return the car to his employer's premises. He drives it for personal purposes for a total of 11,000 km. The minimum taxable benefit is:
21. Assume the car is leased. It is used by the employee for 11 months of the year. In the other month, he was required to return the car to his employer's premises. He drives it for personal purposes for a total of 7,500 km and reimburses the employer \$1,100 (\$100 per month) for the use of the car. The minimum taxable benefit is:

22. Mr. Brown's employer provides him with an automobile for his personal use, and pays all operating costs for that vehicle. The vehicle, used by Mr. Brown throughout 2016, cost his employer \$31,500, including GST of \$1,500 (no provincial sales tax was charged on the vehicle purchase). Mr. Brown drove the vehicle 45,000 km during the year, of which 9,000 km were for personal purposes. His employer paid \$7,750 in operating costs for the year. Mr. Brown paid nothing to his employer for the use of the vehicle. Which one of the following amounts represents the **minimum** taxable benefit that Mr. Brown must include in his employment income for the use of this vehicle in 2016?
- A. \$2,268.  
 B. \$4,859.  
 C. \$5,102.  
 D. \$5,741.
23. The following facts relate to an employer provided automobile.
- |  |           |
|--|-----------|
| Original cost of automobile, including HST                   | \$40,000  |
| Replacement value of car at time of providing it to employee | \$30,000  |
| Capital cost allowance claimed by employer                   | \$ 3,000  |
| Personal use kilometers driven by employee during the year   | 2,000 km  |
| Total kilometers driven by employee during the year          | 30,000 km |
| Number of months automobile was used by employee             | 12        |
- Which one of the following amounts represents the employee's minimum standby charge in 2016?
- A. \$720.  
 B. \$960.  
 C. \$640.  
 D. \$9,600.
24. Omar is employed by Sansauto Corp. and uses his own car for employment activities. Which of the following may **NOT** be claimed as an employment expense deduction?
- A. Gas (employment related portion)  
 B. Auto insurance (employment related portion)  
 C. Standby charge (employment related portion)  
 D. Oil change (employment related portion)

### **Allowances and Reimbursements**

25. Which of the following will be included in taxable income because it is **NOT** a "reasonable allowance"?
- A. An allowance of \$500, calculated as 2,000 kilometers at \$0.25/km.  
 B. An allowance of \$6,500, calculated as 10,000 kilometers at \$0.65/km.  
 C. \$750 allowance for employment related trip expenses (actual costs were \$700).  
 D. \$750 allowance for employment related trip expenses (actual costs were \$800).
26. Which of the following employee reimbursements would result in an increase in taxable income?
- A. Housing loss reimbursement of \$20,000  
 B. Moving costs reimbursement of \$20,000  
 C. Travel expense reimbursement of \$20,000  
 D. Employment related tuition reimbursement of \$20,000

27. With respect to the determination of net employment income, which of the following statements is correct?
- If an allowance is included on an employee's T4, any expenses related to the allowance cannot be deducted for tax purposes.
  - One-half of reimbursed meals are taxable.
  - Reasonable vehicle allowances are not included in income.
  - All allowances are included in income, all reimbursements are not included in income.

### Loans To Employees

28. T. Adams commenced employment at Moana Sales Ltd. on February 1, 2016. He had lived in an apartment until May 2016, at which time he purchased a new house. Under the terms of his employment, he received a housing loan on May 1, 2016 of \$80,000 at a rate of 2 percent. He pays the interest on the loan on a monthly basis. Assume the 2016 prescribed interest rates applicable to employee loans are as follows:

First quarter	5%
Second quarter	4%
Third quarter	3%
Fourth quarter	3%

What is T. Adams' taxable benefit on the above loan for 2016?

- Nil.
  - \$267.40.
  - \$670.68.
  - \$1,073.97.
  - \$2,147.95.
29. Sam borrowed \$50,000 from her employer at an annual rate of 1% interest last year to cover her gambling debts. Assume that at the time the loan was made, the prescribed rate of interest was 3% and this rate has not changed. Sam is subject to a combined tax rate of 30 percent. What is the after tax cost of the loan to Sam for the current year?
- \$300
  - \$500
  - \$800
  - \$1,500

### Employee Stock Options

30. Ms. Joan Hanson is an employee of a Canadian controlled private corporation. During 2015, she receives options to purchase 500 shares of her employer's common stock at a price of \$22 per share. At this time, the estimated per share value of the stock is \$20.50. During 2016, she exercises all of these options. At this time, the estimated market value of the stock is \$31.50 per share. On December 1, 2016, she sells the stock for \$38.75 per share. The net effect of the 2016 transactions on her Taxable Income would be:
- An increase of \$1,812.50.
  - An increase of \$2,375.00.
  - An increase of \$4,187.50.
  - An increase of \$4,750.00.
  - An increase of \$6,562.50.

31. An employee of a public Canadian corporation receives an option to purchase 1,000 of her employer's common shares at \$20 per share in July, 2015. At this time, the fair market value of the stock is \$19 per share. In March, 2016, when the fair market value is \$26 per share, she exercises the option and immediately sells the shares. By what amount do these transactions increase her Taxable Income?
- A. \$1,000 in 2015.
  - B. \$3,000 in 2016.
  - C. \$3,500 in 2016.
  - D. \$6,000 in 2016.

**Questions 32 And 33** Questions 32 and 33 are based on the following information:

Scott Bicycle Manufacturing Ltd. (SBM) is a Canadian controlled private corporation. Brian Mills, one of SBM's employees, was granted stock options on January 15, 2013 for 10,000 shares at \$3 per share. The fair market value on January 15, 2013 was \$4 per share.

Brian exercised the stock options on September 30, 2013, when the fair market value was \$6 per share. In June, 2016, Brian purchased a new home and sold the shares for \$7 each.

32. What is the effect of these facts on Brian's Taxable Income?
- A. An increase of \$15,000 in 2013
  - B. An increase of \$15,000 in 2016.
  - C. An increase of \$30,000 in 2013.
  - D. An increase of \$20,000 in 2016.
  - E. None of the above.
33. What is the adjusted cost base to Brian of the SBM shares at the time of sale in June, 2016?
- A. \$30,000.
  - B. \$45,000.
  - C. \$60,000.
  - D. \$70,000.
  - E. None of the above.

**Questions 34 And 35** Questions 34 and 35 are based on the following information:

Mr. Morra commenced employment with Peoples Bank Ltd., a public corporation, on January 1, 2014. On December 31, 2014, he was granted options to purchase 500 shares of Peoples Bank Ltd. stock for \$15 per share. The market value on December 31, 2014 was \$16 per share.

Mr. Morra exercised his options on May 31, 2015, purchasing 500 shares for \$15 per share when the market value was \$17 per share. On September 1, 2016, Mr. Morra sold the shares for \$24 each.

34. What is the effect of the above transactions on Mr. Morra's Taxable Income in 2015?
- A. Nil.
  - B. An increase of \$250.
  - C. An increase of \$500.
  - D. An increase of \$1,000.

35. What is the effect of the above transactions on Mr. Morra's Taxable Income in 2016?
- A. Nil.
  - B. An increase of \$1,750.
  - C. An increase of \$2,750.
  - D. An increase of \$3,500.

**Questions 36 and 37 are based on the following information:**

Parminder is an employee of a public Canadian corporation. On April 1, 2015 she received options to purchase 5,000 shares of her employer's common stock at a price of \$75 per share. She exercised her options and purchased 5,000 shares on November 1, 2015. She sold all of her shares on February 1, 2016. The market price of her employer's common stock was \$74 per share on April 1, 2015; \$79 per share on November 1, 2015 and \$85 per share on February 1, 2016.

36. The effect on her 2015 tax return is:
- A. Increase in Net Income for Tax Purposes of \$12,500; increase in Taxable Income of \$12,500
  - B. Increase in Net Income for Tax Purposes of \$25,000; increase in Taxable Income of \$12,500
  - C. Increase in Net Income for Tax Purposes of \$10,000; increase in Taxable Income of \$10,000
  - D. Increase in Net Income for Tax Purposes of \$20,000; increase in Taxable Income of \$10,000
37. The effect on her 2016 tax return is:
- A. Increase in Net Income for Tax Purposes of \$15,000; increase in Taxable Income of \$15,000
  - B. Increase in Net Income for Tax Purposes of \$30,000; increase in Taxable Income of \$15,000
  - C. Increase in Net Income for Tax Purposes of \$25,000; increase in Taxable Income of \$25,000
  - D. Increase in Net Income for Tax Purposes of \$50,000; increase in Taxable Income of \$25,000
38. Gail works for a Canadian public corporation. Three years ago she was offered an option to purchase 100 shares at \$30 per share from her employer. The fair market value on that day was \$33 per share. Gail exercised her option by purchasing 100 shares in the current year at a time the fair market value was \$42 per share. She is still holding the shares. What is the effect on Gail's Net Income For Tax Purposes in the current year?
- A. \$1,200 increase
  - B. \$900 increase
  - C. \$600 increase
  - D. No effect.

**Employment Deductions**

39. Roger is employed by an Internet based corporation as a technical support representative and is paid a salary of \$40,000 per year. He is required to work from home and uses the 200 square foot den in his 1,000 square foot apartment exclusively for this purpose. Total costs for 2016 were as follows:

Apartment rent	\$18,000
Tenant's insurance	500
Apartment utilities	850
Office Supplies	100

Roger's maximum employment expense deduction for 2016 is:

- A. \$3,890  
 B. \$3,970  
 C. \$3,870  
 D. \$3,790
40. Nancy is employed by a large corporation as a sales representative. She is paid a salary of \$70,000 during 2016. She is required to have a home office and uses the 375 square foot den in her 1,500 square foot house exclusively for this purpose. Total costs for 2016 were as follows:

Mortgage payments (40% principal, 60% interest)	\$24,000
Home owner's insurance	900
Utilities	1,500
Roof repair	800
Property tax	5,000

As Nancy's compensation does not include any commissions, she is unable to use some of these costs as tax deductions. If instead, her compensation of \$70,000 was in the form of commissions, she would be able to claim extra tax deductions of:

- A. \$1,675  
 B. \$3,600  
 C. \$5,075  
 D. \$1,475
41. John secured employment as a commissioned salesman in July, 2016. In 2016, he received a base salary of \$60,000, and \$5,000 of commissions. A further \$6,000 of commissions earned in December was paid to him in January, 2017. John worked away from the office negotiating sales contracts, and he is required to pay his own vehicle and promotional expenses. His employer has signed a Form T2200 certifying that requirement, and certifying that no reimbursements are paid for any expenses John incurs to earn commissions. John incurred the following costs from July through December 2016:

Meals and entertainment for potential customers	\$14,000
Driving costs (90% of driving was for employment purposes):	
Fuel	4,000
Insurance	750
Repairs	2,250
Leasing costs (\$500 per month)	3,000

What is the maximum deduction John may claim for employment expenses in 2016?

- A. \$5,000.  
 B. \$9,000.  
 C. \$11,000.  
 D. \$16,000.

42. Which of the following criteria is **NOT** necessary in order for a salesperson to deduct office costs?
- A. Must pay own expenses.
  - B. Must carry on duties away from the employer's place of business.
  - C. Must not receive an expense allowance which has not been included in income.
  - D. Must receive all remuneration in commissions.

## **TIF PROBLEM THREE - 4**

### **Employment Income - Exam Exercises**

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#### ***Exam Exercise Subject Listing For Chapter 3***

<b>Number</b>	<b>Subject</b>
1	Bonus
2	Bonus
3	GST On Taxable Benefits
4	Taxable Benefits - Purchased Car
5	Taxable Benefits - Purchased Car
6	Taxable Benefits - Leased Car
7	Taxable Benefits - Leased Car
8	Deductible Automobile Costs
9	Deductible Automobile Costs
10	Disability Insurance Benefits
11	Disability Insurance Benefits
12	Employee Housing Loan Benefit
13	Employee Housing Loan Benefit
14	Tax Planning - Employee Loans
15	Tax Planning - Employee Loans
16	Stock Options - Public Company
17	Stock Options - CCPC
18	Stock Options - Public Company
19	Stock Options - CCPC
20	Stock Options - Public Company
21	Stock Options - Public Company
22	Stock Options - CCPC
23	Commission Salesperson Expenses
24	Commission Salesperson Expenses
25	Employment Income Expenses
26	Employment Income Expenses

**Exam Exercise Three - 1 (Bonus)**

Connely Ltd. has an August 31 year end. On August 31, 2016, it declares a bonus of \$250,000 payable to Ms. Sara Connely, the founder of the Company. The bonus is payable on April 1, 2017. Describe the tax consequences of this bonus to both Connely Ltd. and Ms. Sara Connely.

**Exam Exercise Three - 2 (Bonus)**

Brock Inc. has a taxation year that ends on September 30. On July 1, 2016 it declared a bonus of \$100,000 payable to Stan Gable. The bonus will be paid on February 1, 2017. Describe the tax consequences of this bonus declaration and payment on both Stan Gable and Brock Inc.

**Exam Exercise Three - 3 (GST On Taxable Benefits)**

Mr. John Lamarche, as the result of an outstanding sales achievement within his organization, is awarded two airline tickets to Vancouver. His employer pays a travel agent \$5,275, plus \$264 in GST for the tickets. What is the amount of Mr. Lamarche's taxable benefit?

**Exam Exercise Three - 4 (Taxable Benefits - Employer Owned Automobile)**

Ms. Robin Nestor is provided with an automobile that is owned by her employer. The employer purchased the car in 2015 for \$54,000, plus \$7,020 in HST. During 2016, she drives the car a total of 72,000 kilometers, of which 67,000 kilometers were employment related. The automobile was used by Ms. Nestor for 268 days during 2016. When she was not using the automobile, her employer required that it be returned to their premises. Calculate Ms. Nestor's minimum taxable benefit for the use of the automobile.

**Exam Exercise Three - 5 (Taxable Benefits - Employer Owned Automobile)**

Mr. Robert Rhodes is provided with an automobile that is owned by his employer. The car was acquired by the employer in 2014 for \$63,000, plus \$3,150 in GST. During 2016, it was used by Mr. Rhodes for 8 months. When not using the automobile, the employer required that Mr. Rhodes return it to their premises. His total mileage in 2016 was 53,000 kilometers, of which 22,000 were employment related. Calculate Mr. Rhodes' minimum taxable benefit for the use of the automobile.

**Exam Exercise Three - 6 (Taxable Benefits - Employer Leased Automobile)**

During 2016, Mr. Sam Warren is provided with an automobile that is leased by his employer. The monthly lease payment is \$791 per month. This figure includes \$91 HST. During the year, the car is used by Mr. Warren for a total of 310 days. When he is not using the car, his employer requires that it be returned to their premises. During this period, he drives the car a total of 40,000 kilometers, 22,000 of which are employment related. Calculate Mr. Warren's minimum taxable benefit for the use of the automobile.

**Exam Exercise Three - 7 (Taxable Benefits - Employer Leased Automobile)**

Ms. Sarah Wexler is provided with a car by her employer. It is leased by the employer for \$728 per month, including \$78 of HST. The lease payment also includes a payment of \$50 per month to cover insuring the vehicle. During 2016, Ms. Wexler uses the car for 10 months. During the other 2 months, the employer requires that it be returned to their premises. She drives the car 76,000 kilometers during this period, of which 23,000 are for personal use. Calculate Ms. Wexler's minimum taxable benefit for the use of the automobile.

**Exam Exercise Three - 8 (Deductible Automobile Costs)**

Mr. Rudy Jackson is required by his employer to use his own automobile in the course of his employment. To compensate him, he is paid an annual allowance of \$4,200. During 2016, he drove his automobile a total of 26,720 kilometers, of which 8,150 were employment related. His total automobile costs for the year, including lease costs, are \$8,623. What amounts will Mr. Jackson include and deduct from his 2016 employment income related to the use of his automobile?

**Exam Exercise Three - 9 (Deductible Automobile Costs)**

Ms. Rhonda Jewel's employer provides her with an annual allowance of \$6,500 per year to compensate her for the fact that she uses her own automobile for employment related activities. During 2016, she has total automobile related costs, including her monthly lease payments of \$12,472. Her total mileage is 42,000 kilometers, of which 18,000 kilometers were employment related. What amounts will Ms. Jewel include and deduct from her 2016 employment income related to the use of her own automobile?

**Exam Exercise Three - 10 (Disability Insurance Benefits)**

Ms. Jessica Tremblay is a member of a group disability plan sponsored by her employer. The plan provides periodic benefits that compensate for lost employment income. In 2015, Ms. Tremblay was required to pay \$324 in premiums. In 2016, Ms. Tremblay received benefits under the plan of \$6,940. Ms. Tremblay's contributions to the plan for 2016 totalled \$250. During 2016, her employer's share of the annual premium was \$2,175. What amount will Ms. Tremblay include in her 2016 net employment income?

**Exam Exercise Three - 11 (Disability Insurance Benefits)**

John Tertiak's employer sponsors a group disability plan for its employees. The plan provides periodic benefits that compensate for lost employment income. The annual premium on this plan is \$3,200, with this cost being shared equally by the employer and the employee. Because John became disabled in January, 2016, he did not make any contribution for this year. In the years prior to 2016, John had total contributions of \$16,000. During 2016, because of his disability, John receives benefit under the plan totaling \$24,000. What amount will John include in his 2016 net employment income?

**Exam Exercise Three - 12 (Employee Housing Loan Benefits)**

On January 1, 2016, Mr. Packard receives a \$135,000 loan from his employer to assist him in purchasing a home. The loan requires annual interest at a rate of 3.1 percent, which he pays on December 31, 2016. Assume that the relevant prescribed rate is 5 percent during the first quarter of 2016, 6 percent during the second quarter, and 4 percent during the remainder of the year. What is the amount of Mr. Packard's taxable benefit on this loan for the year?

**Exam Exercise Three - 13 (Employee Housing Loan Benefits)**

On May 1, 2016, Ms. Ponti receives a \$210,000 loan from her employer in order to assist her in purchasing a new home. The loan requires no payment of interest, but must be repaid in annual instalments of \$30,000 on December 31 in each of the years 2017 through 2023. Assume that the relevant prescribed rate is 4 percent during the first two quarters of 2016, but is reduced to 3 percent in the third quarter, and to 2 percent in the fourth quarter. What is the amount of Ms. Ponti's taxable benefit on this loan for the year?

**Exam Exercise Three - 14 (Tax Planning - Loan Benefits)**

A senior executive asks her employer for a \$240,000 interest free housing loan that does not qualify as a home relocation loan. At this time, the employer has investment opportunities involving a rate of return of 8.2 percent before taxes. Assume the relevant prescribed rate for the period is 3 percent, while the market rate for home mortgages is 5 percent. The employee is subject to a marginal tax rate of 44 percent, while the employer pays corporate taxes at a marginal rate of 28 percent. Should the employer grant the loan or, alternatively, provide sufficient salary to carry an equivalent loan from a commercial lender? Explain your conclusion.

**Exam Exercise Three - 15 (Tax Planning - Loan Benefits)**

John Baxter is a highly valued employee of Stern Inc. His marginal tax rate is 46 percent and he would like to acquire a vacation property. To assist with this purchase, he has asked the management of Stern for a \$350,000 interest free loan. At this time the mortgage rate for vacation properties is 4.5 percent and the prescribed rate is 2 percent. Stern is subject to a marginal tax rate of 26 percent and has alternative investment opportunities that earn 7 percent before taxes. Should Stern Inc. grant the loan or, alternatively, provide sufficient salary to carry an equivalent loan from a commercial lender? Explain your conclusion.

**Exam Exercise Three - 16 (Stock Options - Public Company)**

Ms. Mary Mason is employed by a large public company. In 2014, she was granted options to acquire 1,000 shares of her employer's common stock at a price of \$23 per share. At the time the options were granted, the shares were trading at \$20 per share. In May, 2016, when the shares are trading at \$45 per share, she exercises her options and acquires 1,000 shares. What is the effect of the exercise of the options on Ms. Mason's 2016 net employment income?

**Exam Exercise Three - 17 (Stock Options - CCPC)**

Note this is the same as Exam Exercise Three-16 except that the employer is a CCPC.

Ms. Mary Mason is employed by a Canadian controlled private corporation. In 2014, she was granted options to acquire 1,000 shares of her employer's common stock at a price of \$23 per share. At the time the options were granted, the shares had a fair market value of \$20 per share. In May, 2016, when the shares had a fair market value of \$45 per share, she exercises her options and acquires 1,000 shares. What is the effect of the exercise of the options on Ms. Mason's 2016 net employment income?

**Exam Exercise Three - 18 (Stock Options - Public Company)**

Mr. John Savage has been employed for many years by a Canadian public company. Several years ago, Mr. Savage was granted options to acquire 4,000 shares of his employer's stock for \$54 per share. At this time, the shares have a fair market value of \$50 per share. On July 15, 2015, Mr. Savage exercises all of these options. At this time, the fair market value of the shares is \$82 per share. In February, 2016, he sells all of the shares for \$97 per share. Calculate the effect of the transactions that took place during 2015 and 2016 on Mr. Savage's Net Income For Tax Purposes and Taxable Income. Where relevant, identify these effects separately.

**Exam Exercise Three - 19 (Stock Options - CCPC)**

Note this is the same as Exam Exercise Three-18 except that the employer is a CCPC.

Mr. John Savage has been employed for many years by a Canadian controlled private corporation. Several years ago, Mr. Savage was granted options to acquire 4,000 shares of his employer's stock for \$54 per share. At this time, the shares have a fair market value of \$50 per share. On July 15, 2015, Mr. Savage exercises all of these options. At this time, the fair market value of the shares is \$82 per share. In February, 2016, he sells all of the shares for \$97 per share. Calculate the effect of the transactions that took place during 2015 and 2016 on Mr. Savage's Net Income For Tax Purposes and Taxable Income. Where relevant, identify these effects separately.

**Exam Exercise Three - 20 (Stock Options - Public Company)**

Several years ago, Mr. Kerry Johnson's employer gave him options to purchase 1,000 shares of the employer's stock at a price of \$13.25 per share. At that time, the shares were trading at \$13.25 per share. The employer is a publicly traded company. During June, 2016, Mr. Johnson exercises the options. At this time, the shares are trading at \$18.50 per share. Prior to the end of the year, Mr. Johnson sells the shares for \$19.75 per share. Determine the effect of these transactions on Mr. Johnson's Net Income For Tax Purposes and Taxable Income. Where relevant, identify these effects separately.

**Exam Exercise Three - 21 (Stock Options - Public Company)**

Joan Smithers has been employed by a Canadian public company for several years. In 2014, she was granted options to acquire 2,200 of her employer's shares at \$10.50 per share. At that time, the shares were trading at \$10.00 per share. In 2015, when the shares are trading at \$15 per share, she exercises all of these options. In 2016 she sells 1,000 of the shares for \$13 per share. Indicate the tax consequences of the events in 2014, 2015, and 2016 on Ms. Smithers' Net Income For Tax Purposes and on her Taxable Income. Where relevant, identify these effects separately.

**Exam Exercise Three - 22 (Stock Options - CCPC)**

Jerry Farrow is employed by a Canadian controlled private corporation. In 2014, he was granted options to acquire 625 of his employer's shares at \$92 per share. At that time, it was estimated that the fair market value of the shares was \$90. In 2015, when the estimated fair market value of the shares is \$95 per share, he exercises all of these options. In 2016, he sells 125 of the shares for \$85 per share. Indicate the tax consequences of the events in 2014, 2015, and 2016 on Mr. Farrow's Net Income For Tax Purposes and on his Taxable Income. Where relevant, identify these effects separately.

**Exam Exercise Three - 23 (Commission Salesperson Expenses)**

Mrs. Joan Conway is a commission salesperson. During the current year, her gross salary was \$46,700. In addition, she earned \$9,200 in commissions. Her employment related costs during the year were advertising costs of \$6,150, client entertainment costs of \$8,850, and travel costs of \$9,325. She is required to pay her own expenses and does not receive any allowance from her employer. What is Mrs. Conway's maximum expense deduction for the current year? Show your calculations.

**Exam Exercise Three - 24 (Commission Salesperson Expenses)**

Barton Ho is a commission salesperson. During the current year, in addition to his salary of \$92,500, he earns and receives \$14,700 in commissions. His costs for advertising were \$12,200 and, in addition, he spent \$6,400 on client entertainment. Because of the extensive travel required by his work, his travel costs totaled \$16,100. He is required to pay his own expenses and does not receive any allowance from his employer. What is Mr. Ho's maximum expense deduction for the current year? Show your calculations.

**Exam Exercise Three - 25 (Employment Income Expenses)**

Doug Evans works for a company that sells video equipment. His records for the current year contain the following information:

Salary Received	\$61,250
Commissions Received	6,250
<u>Total Employment Inclusions</u>	<u>\$67,500</u>
Advertising And Promotion	\$ 1,250
Traveling Expenses	7,500
Capital Cost Allowance On Van*	1,875
Interest On Van Loan*	625
<u>Total Employment Deductions</u>	<u>\$11,250</u>

\*The van is used exclusively for employment related activities.

Mr. Evans meets the conditions for deducting employment income expenses. Given the preceding information, determine Mr. Evans' minimum net employment income for the current year. Explain your conclusions.

**Exam Exercise Three - 26 (Employment Income Expenses)**

Deborah Ekert is employed as a salesperson and receives some of her compensation in the form of commissions. During the current year, her salary totaled \$85,000 and her commissions totaled \$8,400. Her employment related expenses during this period were as follows:

Capital Cost Allowance On Car*	\$ 2,850
Interest On Car Loan*	1,075
Traveling Expenses	10,300
Promotion And Advertising	5,600
Client Entertainment [(1/2)(Actual Costs Of \$5,200)]	2,600
<u>Total Available Deductions</u>	<u>\$22,425</u>

\*The car is used exclusively for employment related activities.

Ms. Ekert meets the conditions for deducting employment income expenses. Given the preceding information, determine Ms. Ekert's minimum net employment income for the current year. Explain your conclusions.

**TIF PROBLEM THREE - 5A****Employment Income - Key Term Matching (Easy)**

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**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms are listed at the end of Chapter 3, "Employment Income".

- A. Allowance
- B. Employee
- C. Employment Income
- D. Imputed Interest
- E. Operating Cost Benefit
- F. Self-Employed Individual
- G. Stock Option
- H. Taxable Benefit

The following list contains ten potential definitions for the preceding key terms.

1. The salary, wages, and other remuneration, including gratuities, received by an employee in the year.
2. A taxable benefit assessed to employees who have been provided with an automobile by their employer.
3. An individual who has a business relationship with an entity.
4. An allowance provided by an employer to an employee that must be included in the employee's employment income.
5. An individual who has an employment relationship with an entity that provides remuneration.
6. Interest on outstanding debt calculated at a specified interest rate without regard to the actual interest rate being paid.
7. A taxable benefit assessed to employees whose employers pay the operating costs of an automobile provided to the employee.
8. A contractual arrangement which gives the holder the right to purchase a specified number of shares for a specified period of time at a specified acquisition price.
9. An amount paid by an employer to an employee to provide for certain types of costs incurred by the employee, usually travel costs or automobile costs.
10. An amount of money, or the value of goods or services, that an employer pays or provides in addition to salary.
11. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 10) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (11). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

**TIF PROBLEM THREE - 5B****Employment Income - Key Term Matching (Moderate)**

**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms are listed at the end of Chapter 3, "Employment Income".

- A. Allowance
- B. Employee
- C. Employment Income
- D. Imputed Interest
- E. Operating Cost Benefit
- F. Self-Employed Individual
- G. Stock Option
- H. Taxable Benefit

The following list contains 14 potential definitions for the preceding key terms.

1. The salary, wages, and other remuneration, including gratuities, received by an employee in the year.
2. A taxable benefit assessed to employees who have been provided with an automobile by their employer.
3. A contractual arrangement which gives the holder the right to require the issuing corporation to redeem the shares that he is holding.
4. Non-cash benefits provided to employees by an employer (e.g., subsidized meals in an employer's facilities).
5. An individual who has a business relationship with an entity.
6. An allowance provided by an employer to an employee that must be included in the employee's employment income.
7. An individual who has an employment relationship with an entity that provides remuneration.
8. Interest on outstanding debt calculated at a specified interest rate without regard to the actual interest rate being paid.
9. A taxable benefit assessed to employees whose employers pay the operating costs of an automobile provided to the employee.
10. A contractual arrangement which gives the holder the right to purchase a specified number of shares for a specified period of time at a specified acquisition price.
11. An amount paid by an employer to an employee to provide for certain types of costs incurred by the employee, usually travel costs or automobile costs.

*Employment Income - Key Term Matching (Moderate)*

12. A taxable benefit, based on a pro rata share of automobile operating costs, assessed to an employee whose employer pays these costs for an automobile provided to the employee.
13. An amount of money, or the value of goods or services, that an employer pays or provides in addition to salary.
14. An individual who is employed by a corporation in which he is a specified shareholder.
15. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 14) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (15). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

## **TIF PROBLEM THREE - 6**

### **Bonus Arrangements**

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Mr. Carl Lange is the president of Lange Enterprises Inc., a Canadian controlled private company. The Company has a September 30 year end. On September 30, 2016, the Company declares a bonus of \$175,000, payable to Mr. Lange.

**Required:** For each of the following cases, indicate the taxation year in which the Company can deduct the bonus, as well as the taxation year in which Mr. Lange will have to include it in his taxable income.

**Case A** The bonus is paid on October 1, 2016.

**Case B** The bonus is paid on January 31, 2017.

**Case C** The bonus is paid on July 30, 2017.

**Case D** The bonus is paid on January 31, 2020.

**TIF PROBLEM THREE - 7****Employer Owned Vs. Employee Owned Automobile**

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Jason Rockwell began working for Morgan Distributors Ltd. at the beginning of 2014. At that time, as one of the benefits provided under his employment contract, the Company purchases an automobile for Jason's use on personal matters. He is not required to use the vehicle for employment related activities. During 2014 and 2015, the Company pays for all of the costs of operating the vehicle.

As of January 1, 2016, the Company has offered Jason two options:

**Option 1** Jason can continue to use the vehicle as per the arrangement that was in place for 2014 and 2015. This would include the Company paying all of the costs of operating the vehicle.

**Option 2** The Company would sell the automobile to Jason for its current fair market value of \$30,000. Under this option, Jason would pay his own operating costs.

Without regard to which option he chooses, Jason will continue to use the vehicle for two more years. At the end of 2017, he plans to sell the car and estimates that the proceeds will be about \$17,000. During each of the years 2016 and 2017, Jason estimates that he will drive the car a total of 50,000 kilometers. He anticipates that operating costs will be \$0.20 per kilometer during this period.

Jason's combined federal/provincial marginal tax rate is 46 percent. Assume that the prescribed operating cost benefit will be \$0.26 per kilometer for both 2016 and 2017.

**Required:** On the basis of undiscounted cash flows, advise Jason as to which option he should accept, assuming that:

- A. Morgan Distributors purchased the car for \$40,000.
- B. Morgan Distributors purchased the car for \$75,000.

Ignore GST/HST considerations.

## **TIF PROBLEM THREE - 8**

### **Taxable Benefits - Automobiles**

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The Martin Distributing Company provides cars for four of its senior executives. While the cars are used for employment related travel, the executives also use them for personal matters. The personal use varies considerably among the four individuals. When the car is not being used by the employee, the Company requires that it be returned to the corporate premises.

The details related to each of these cars, including the amount of personal and employment related travel recorded by the executives, are as follows:

**Mr. Joseph Martin** Mr. Martin is the president of the Company and is provided with a Mercedes that has been leased by the Company for \$2,100 per month. During the current year, the car was driven a total of 42,000 kilometers, of which 19,000 could be considered employment related travel. Operating costs averaged \$0.80 per kilometer. Because of an extended illness which required hospitalization, the car was only used by Mr. Martin for the first seven months of the year.

**Mrs. Grace Martin** Mrs. Martin, the vice president in charge of marketing, is provided with a Lexus that the Company has purchased for \$78,000. During the current year, this car was driven a total of 15,000 kilometers, of which all but 2,000 kilometers were employment related. Operating costs for the year amounted to \$3,500 and the car was used by to Mrs. Martin throughout the year.

**Mr. William Martin** William Martin, the vice president in charge of finance, is provided with a Ford that the Company leases for \$600 per month. The total mileage during the current year amounted to 38,000 kilometers, of which 32,000 kilometers related to personal matters. Operating costs for the year were \$7,400 and the car was used by Mr. Martin throughout the year. William Martin paid the Company \$300 per month for the use of the car.

**Mrs. Sharon Martin-Jones** Mrs. Martin-Jones, the vice president in charge of industrial relations, is provided with a Nissan that the Company purchased for \$39,000. During the current year, the car was driven 24,000 kilometers on employment related matters and 9,500 kilometers on personal matters. The operating costs average \$0.40 per kilometer and, as the result of considerable travel outside of North America, the car was only used by Mrs. Martin-Jones for nine months of the year.

**Required:** Calculate the minimum taxable benefit that will accrue to each of these executives as the result of having the cars supplied by the Company. Ignore all GST/PST/HST implications.

## **TIF PROBLEM THREE - 9**

### **Taxable Benefits - Automobiles**

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Klaxton Inc. provides an automobile to Ms. Roxanne Smith for her to use in carrying out her employment duties. Ms. Smith is given full possession of the car and is allowed to use it for personal needs. However, when she is not using it for employment or personal activities, it must be returned to Klaxton's premises so that it can be used by other employees.

The automobile was purchased in 2014 for \$42,000 and, during the years 2014, 2015, and 2016, the Company has deducted maximum CCA.

During 2016, Ms. Smith drove the car 48,000 kilometers, with the Company paying for all of the operating costs. These costs totaled \$9,850 during the year.

**Required:** Ignore all GST/PST/HST implications. Indicate the minimum taxable benefit that would be allocated to Ms. Smith in each of the following Cases:

**Case A** Ms. Smith has use of the car for 11 months of the year. Personal use during the year totals 4,000 kilometers.

**Case B** Ms. Smith has use of the car for 10 months of the year. Personal use during the year totals 23,000 kilometers.

**Case C** Ms. Smith has use of the car for 8 months of the year. Employment use during the year totals 4,000 kilometers.

## TIF PROBLEM THREE - 10

### Loans To Employees

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Alan Cheng is negotiating a large increase in his compensation. As he is interested in using any tax advantaged form of compensation, he has suggested that his employer give him a \$250,000 interest free loan. He will be using the proceeds of this loan for a variety of investments. Because he will be using the loan for income producing purposes, any interest on the loan will be deductible to Mr. Cheng.

Other information that is relevant to this decision is as follows:

- Mr. Cheng's various sources of income are such that any additional income will be taxed at a rate of 44 percent.
- Mr. Cheng can acquire a similar term, \$250,000 loan at an annual rate of 4 percent.
- His employer is subject to tax at a combined federal/provincial rate of 32 percent. The company has alternative investment opportunities that earn a pre-tax rate of 8 percent.
- The relevant prescribed rate for all periods under consideration is 3 percent.
- Mr. Cheng's investment projects are expected to provide a pre-tax return of 12 percent.

**Required:** Evaluate, from the point of view of the cost to the employer, Mr. Cheng's suggestion of providing him with an interest free loan in lieu of sufficient salary to carry a commercial loan at the rate of 4 percent.

## **TIF PROBLEM THREE - 11**

### **Loans To Employees**

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Albert Lee is an employee of a large Canadian company. As he has performed exceptionally well in recent years and has become sought after by competitors, the Company is planning to increase his compensation in an effort to retain him.

Mr. Lee has developed a growing interest in investing in options and, in order to finance this activity, he is looking to borrow \$500,000. His bank has indicated that they would be prepared to loan this amount to him at a rate of 6 percent. This is attractive in that he anticipates that his activity in the options market will generate a pre-tax return of at least 15 percent.

Given this situation, Mr. Lee has indicated to his employer that, instead of additional remuneration in the form of salary, he would be prepared to accept a \$500,000 interest free loan for 3 years. He would fully invest this sum in options.

The Company is subject to tax at a combined federal/provincial rate of 27 percent. When funds are available, the Company has alternative investment opportunities that earn a pre-tax rate of 9 percent. Any additional compensation for Mr. Lee will be taxed at a combined federal/provincial rate of 46 percent.

Assume that the prescribed rate for the current year is 2 percent.

**Required:**

- A. Determine the tax consequences to Mr. Lee and the cost to the Company, in terms of lost after-tax earnings, of providing Mr. Lee with a \$500,000 interest free loan for the first year of the loan.
- B. Determine the amount of additional salary that could be provided to Mr. Lee for the same after tax cost to the Company that you calculated in Part A.
- C. Which alternative would you recommend that Mr. Lee accept? Explain your conclusion.

## **TIF PROBLEM THREE - 12**

### **Employee Stock Options**

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Ms. Patricia Martin is employed by a Canadian public company. In 2014, she was given options to acquire 1,500 of the company's shares at a price of \$45 per share. At this time the shares are trading at \$47 per share.

During 2015, Patricia exercises all of the options. At this time, the shares are trading at \$50 per share.

During 2016, Patricia sells the shares for \$55 per share.

**Required:**

- A. Indicate the tax effect of the transactions that took place during each of the years 2014, 2015, and 2016. Your answer should include the effect on both Net Income For Tax Purposes and Taxable Income. Where relevant, identify these effects separately.
- B. How would your answer change if the shares had been trading at \$44 per share at the time that the options were issued in 2014?
- C. How would your answer change if Patricia's employer was a Canadian controlled private company?

## TIF PROBLEM THREE - 13

### Employee Stock Options

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During January, 2014, Lastech Inc. issued options to their employee, Ms. Marianne Black. The options allowed Ms. Black to acquire 1,500 of the Company's common shares at an option price of \$23 per share.

At the point in time when the options were exercised, the fair market value of the shares was \$25 per share.

All of the shares that are acquired through the options are sold on December 31, 2016 at a price of \$28 per share.

**Required:** Indicate the tax effect on Ms. Black of the transactions that took place during 2014, 2015, and 2016 under each of the following independent Cases. Your answer should include the effect on both Net Income For Tax Purposes and Taxable Income. Where relevant, identify these effects separately.

**Case A** Lastech Inc. is a Canadian public company. At the time the options were granted, the shares were trading at \$22 per share. The options were exercised on July 1, 2015.

**Case B** Lastech Inc. is a Canadian public company. At the time the options were granted, the shares were trading at \$24 per share. The options were exercised on July 1, 2015.

**Case C** Lastech Inc. is a Canadian controlled private corporation. At the time the options were granted, the Company's shares had a fair market value of \$23 per share. The options were exercised on July 1, 2015.

**Case D** Lastech Inc. is a Canadian controlled private corporation. At the time the options were granted, the Company's shares had a fair market value of \$24 per share. The options were exercised on July 1, 2014.

## **TIF PROBLEM THREE - 14**

### **Comprehensive Employment Income**

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Curt Robinson is employed by a Canadian public company in Toronto and lives downtown. During 2016, he has a base salary of \$183,000. In addition to his salary, he earns commission of \$22,310. Additional information relevant to Curt's 2016 employment income is as follows:

1. Curt is a member of his employer's registered pension plan. During 2016, \$3,750 was withheld from his salary as a contribution to this plan. His employer made a matching contribution of \$3,750.
2. For his employment related travel, Curt drives a car that he purchased on January 1, 2016 for \$38,000. During 2016, he drives 45,000 kilometers, of which 38,000 are employment related. Curt had financed the car with a loan from a local bank and, during 2016, he had paid interest of \$2,300.

The costs of operating the car during 2016 were \$11,420. He has been advised by his accountant that, if the car were used 100 percent for employment related activities, the maximum CCA for 2016 would be \$4,500.

3. Curt's employer requires him to pay all of his employment related expenses, as well as provide his own office space. Curt has the required Form T2200 from his employer.
4. During 2016, he pays dues to his professional association of \$375.
5. At the beginning of 2016, Curt's employer grants him options to buy 250 of the Company's shares at a price of \$11.25 per share. This was the market price of the shares at the time the options were granted. During July, 2016, when the shares are trading at \$14.75 per share, he exercises all of these options. In order to buy Christmas gifts for his family, he sells 100 of these shares in early December, 2016. The proceeds are \$16.50 per share.
6. His employer has a policy of giving all employees gifts to promote employee loyalty and help local businesses. During 2016, Curt received the following gifts:
  - A weekend for him and his wife at a local hotel. The value of this gift was \$375.
  - A \$200 gift certificate at a local hardware store.
  - A basket of fruit, nuts, and cheeses, with a value of \$175.

7. Curt uses 25 percent of his personal residence as an office. During 2016, the costs associated with his home were as follows:

Interest Payments On Mortgage	\$ 8,700
Property Taxes	3,850
Utilities	1,875
Insurance	960
Roof Repairs	3,640
Total	\$19,025

8. Curt's travel costs for 2016, largely airline tickets, food, and lodging, total \$24,600. This includes \$10,300 spent on meals while traveling for his employer. This total includes meals with clients of \$2,400.
9. During 2016, Curt was billed a total of \$9,600 by his golf club in Toronto. Of this amount, \$2,250 was the annual membership fee, with the remaining amount for meals and drinks with clients. He uses the club only when he is with clients.
10. During 2016, Curt purchased tickets to Toronto football games for a total of \$845. He used these tickets to attend these games with key personnel from an important client. He also purchased tickets to a Cirque du Soleil performance in Montreal for \$275. He used these tickets to attend the show with owners of a prospective client located in Montreal.

**Required:** Calculate Curt's minimum net employment income for the 2016 taxation year. Ignore GST and PST considerations.

## **TIF PROBLEM THREE - 15**

### **Comprehensive Employment Income**

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Mr. Carlos Segovia is a very successful salesperson and is employed by a large Canadian public company. For 2016, his base salary is \$252,000. In addition, he earns commissions of \$18,500. Other information relevant to Mr. Segovia's 2016 employment income is as follows:

1. Mr. Segovia is required by his employer to pay all of his own employment related expenses. He is also required to provide his own office space. Mr. Segovia has a Form T2200 signed by his employer that certifies this.
2. His travel costs for 2016, largely airline tickets, food, and lodging, total \$29,000. This includes \$9,500 spent on business meals.
3. His annual dues to the Salesperson's Association (a trade union) were \$450.
4. He is a member of his employer's registered pension plan. During 2016, his employer contributed \$5,500 to this plan on his behalf. In addition, \$5,500 was withheld from his salary and contributed to the plan.
5. During 2016, Mr. Segovia was billed a total of \$15,500 by his golf club located in his neighbourhood. He only uses the club for entertaining clients. Of this amount, \$3,300 was the annual membership fee and the remainder was for meals with clients.
6. During 2016, Mr. Segovia used 35 percent of his personal residence as an office. The designated space is where he principally performs his employment duties. Interest payments on his mortgage totalled \$11,500 for the year and property taxes were \$4,800. Utilities paid for the house totalled \$2,600 and house insurance paid for the year was \$1,250. Other maintenance costs associated with the property amounted to \$1,450. Mr. Segovia does not intend to deduct CCA on the home office portion of the house.
7. For business travel, Mr. Segovia drives a car that he purchased in 2015 for \$49,000. He financed the purchase of the car through his local bank and, for 2016, the interest on the loan was \$2,250. During 2016, he drives the car a total 60,000 kilometers, 45,000 of these being for employment related travel. His accountant has advised him that, if the car were used 100 percent for employment related activities, the CCA (tax depreciation) for 2016 would be \$7,650. The costs of operating the car during the year totalled \$7,500.
8. During 2016, Mr. Segovia received three non-cash awards, none of which were performance related. The first, a spa weekend at a local hotel, had a fair market value of \$300. The second was a \$400 gift certificate at a men's clothing store. The third award, a bottle of 1995 Haut Brion, had a fair market value of \$450.
9. In 2015, his employer granted him options to buy 1,000 shares of the company's stock at \$20 per share. At the time of the grant, the shares were trading at \$19 per share. On June 1, 2016, all of these options are exercised. At this time the shares are trading at \$31 per share. He does not sell the shares in 2016.

**Required:** Calculate Mr. Segovia's minimum net employment income for the 2016 taxation year. Ignore GST and PST considerations.

## **TIF PROBLEM THREE - 16**

### **Simple Employment Income**

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Mr. Siegfried Karson is employed by a publicly traded Canadian corporation. His 2016 salary was \$82,500. In addition, he earned commission of \$8,400. For the 2016 year, his employer withheld the following amounts from his income:

Federal And Provincial Income Taxes	\$18,600
CPP Contributions	2,544
EI Premiums	955
United Way Contributions	250
Registered Pension Plan Contributions	4,200
Union Dues	375

Mr. Karson's employer made a matching contribution of \$4,200 to the registered pension plan.

#### **Other Information:**

1. During 2016, the employer provided Mr. Karson, as well as all other employees of the corporation, with non-cash gifts with a total value of \$450.
2. In 2012, the company provided all of its employees with stock options that allowed them to acquire 500 shares at \$26 per share. At this time, the shares were trading at \$25 per share. During 2016, when the shares were trading at \$37 per share, Mr. Karson exercised all of his options. Before the end of the year, he sold one-half of these shares for \$39 per share.
3. Mr. Karson is provided with an automobile that is leased by the company for \$725 per month. The lease payment includes \$75 per month to cover insurance on the vehicle. The car is used by Mr. Karson for 10 months during 2016 and, when it is not being used by him, he is required to return the vehicle to the premises of the Company. During 2016, he drove the car 46,000 kilometers, of which 11,000 were not related to employment activities. He reimburses his employer \$0.45 per kilometer for his personal use of the vehicle.
4. Mr. Karson is required to pay all travel and promotional expenses with no reimbursement from the Company. He had the following employment related expenses during 2016:

Advertising	\$4,200
Client Entertainment	3,100
Traveling Costs (Hotels, Airlines And 50 Percent of Meals)	9,200

**Required:** Calculate Mr. Karson's minimum net employment income for the year ending December 31, 2016. Show all relevant calculations. Ignore all GST and PST considerations.

## Chapter Four Test Item File Problems

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### TIF PROBLEM FOUR - 1

#### Tax Payable For Individuals - Essay Questions

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1. Tax legislation requires that amounts received under the workers' compensation program be included in the determination of Net Income For Tax Purposes, despite the fact that these same amounts will be deducted in the determination of Taxable Income. If the intent was not to tax these amounts, why didn't the legislation simply exempt them from inclusion in the Net Income For Tax Purposes calculation?
2. Under what circumstances is an individual entitled to a home relocation loan deduction? How is the amount of the deduction calculated?
3. Explain briefly the rules for determining which province will assess an individual for income taxes. From the point of view of tax planning, is the province in which an individual is taxed an important issue?
4. Briefly explain the difference between a tax deduction and a tax credit.
5. The family caregiver amount can be added to the base for three tax credits. List these three credits.
6. ITA 118(1)(a) provides a tax credit for an individual's "spouse or common-law partner". Briefly describe the types of relationships that are eligible for this tax credit.
7. Under what circumstances can a taxpayer deduct the ITA 118(1)(b) credit for an eligible dependant?
8. An unmarried father is supporting a dependent child of 16 who is mentally infirm, but who does not qualify for the disability tax credit. What tax credits, if any, would be available to him related to that child?
9. Will the family caregiver amount always be added to the caregiver tax credit? Explain your conclusion.
10. The same relative of an individual may be eligible for either the ITA 118(1)(d) tax credit for an infirm dependant over 17 or the ITA 118(1)(c.1) caregiver credit including the family caregiver amount. As the value of the two credits is the same, what determines which credit should be used?
11. For individuals 65 or over, several types of income qualify for the pension income tax credit. Indicate three types of pension income that would qualify. Indicate one type of pension income that would not qualify.
12. Fees for sending a child to a summer music and tennis course could qualify for both the children's fitness credit and the children's arts credit. How should the taxpayer decide which credit to claim?
13. Most tax credits involve applying the minimum tax rate (currently 15 percent) to a specified base. In contrast, the charitable donations credit also uses the maximum rates of 29 and 33 percent. What is the likely reason for this difference?
14. An individual may choose not to claim in the current taxation year, the full amount of a charitable donation made in that year. Explain why this may be an appropriate course of action.

*Tax Payable For Individuals - Essay Questions*

15. Explain the advantage that results from being able to claim medical expenses for any 12 month period that ends in the calendar year.
16. A medical expense tax credit, based on the total medical expenses for a family, can be claimed by either spouse. Does it make any difference which spouse makes the claim?
17. Under what circumstances can the disability tax credit be transferred to a supporting person?
18. Indicate the types of tuition fees that are eligible for the tuition fees tax credit.
19. Certain credits against Tax Payable can be transferred to a spouse or common-law partner. Indicate which credits are eligible for this transfer. Include only credits that can be transferred, not credits that can be taken by either spouse or common-law partner.
20. Some tax credits are referred to as “refundable”. What does this mean?
21. Some analysts contend that the OAS clawback is effectively an increase in an individual’s tax rate. Explain this view.

**TIF PROBLEM FOUR - 2****Tax Payable For Individuals - True Or False**

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1. Worker's compensation payments received are not included in an individual's Net Income For Tax Purposes.

True Or False?

2. The home relocation loan deduction is only available when the taxpayer has moved to a new work location and his new dwelling is at least 40 kilometers closer to this new location.

True Or False?

3. Provincial income taxes are calculated as a percent of federal Tax Payable.

True Or False?

4. All federal tax credits are calculated by multiplying the lowest federal income tax bracket rate by an indexed base figure.

True Or False?

5. A person claiming the ITA 118(1)(b) tax credit that is available to an eligible individual supporting a related dependant in a self-contained domestic establishment can claim the credit for their child, even if the child is not a resident of Canada.

True Or False?

6. An individual cannot claim the pension income credit if their only income is from the Canada Pension Plan.

True Or False?

7. If both spouses have medical expenses, it will usually be to their advantage for one of the spouses to claim the credit on the basis of their combined medical expenses.

True Or False?

8. There is no limit on the amount of tuition, education and textbook credits that can be transferred to a spouse.

True Or False?

9. Sharon Jarvis contributed \$500 to the Federal Liberal Party. She is eligible for a federal political contributions tax credit of \$500.

True Or False?

10. The federal political contributions tax credit is deductible in computing Taxable Income, but cannot create a Taxable Loss.

True Or False?

11. The working income tax benefit is not available to individuals who are full-time students.

True Or False?

12. The clawback of OAS payments will not alter the individual's Net Income For Tax Purposes.

True Or False?

**TIF PROBLEM FOUR - 3****Tax Payable For Individuals - Multiple Choice**

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**New For 2016/2017****Taxable Income**

1. Which of the following items is **NOT** a deduction in the determination of an individual's Taxable Income?
  - A. Worker's compensation payments received as a result of injury.
  - B. A business loss incurred during the current year.
  - C. A deduction for residing in a prescribed northern zone.
  - D. An allowable capital loss realized in a previous year.

**Tax Payable**

2. If an individual's total federal tax (before the application of credits) equals \$18,529, then his Taxable Income must have been:
  - A. \$71,265.
  - B. \$63,893
  - C. \$79,695
  - D. \$100,001.
3. Which of the following statements with respect to the calculation of an individual's Tax Payable is correct?
  - A. Provincial tax payable is calculated by applying a group of progressive rates to federal Tax Payable.
  - B. Income that is not taxed in a province is subject to an additional tax at the federal level.
  - C. The provincial tax rate is based on the province in which the individual spends the most number of days in the taxation year.
  - D. The applicable rate varies both with the amount of Tax Payable and the type of income being taxed.

**Tax Credits**

4. With respect to claiming tax credits related to an individual's child, which of the following statements is **NOT** correct?
  - A. To claim the eligible dependant credit for a child, the child must be under the age of 18 at some time during the year.
  - B. The family caregiver amount for a child can be claimed for a child under 18, provided the parent has not claimed the eligible dependant credit for that child.
  - C. If a child is eligible for the eligible dependant credit, the parent cannot claim either the caregiver credit or the infirm dependant over 17 credit for that child.
  - D. A child does not have to qualify for the disability tax credit in order for the parent to claim the infirm dependant credit over 17 tax credit.
5. For 2016, Bart Bixley has Net Income For Tax Purposes and Taxable Income of \$230,000. During the year, he makes a cash gift to a registered charity of \$75,000. What is his maximum charitable donations tax credit for 2016.
  - A. \$21,722
  - B. \$24,714
  - C. \$22,922
  - D. \$24,742

6. Which of the following statements with respect to the children's arts credit and the children's fitness credit is correct?
- If a program involves both physical activity and artistic activity, a claim for the program cannot be made for both of the credits.
  - Both of these credits are refundable tax credits.
  - The maximum children's fitness credit is \$150 [(15%)(\\$1,000)].
  - To qualify for either credit, the child must be under the age of 16 at some time in the year.

## Retained From Previous Editions

### **Taxable Income**

7. On July 1, 2016, Sam Confrey received a five year, \$50,000 loan from his employer. The loan was intended to assist Sam with the purchase of a home in his new employment location. The new home is 47 kilometers closer to Sam's new work location. The interest rate on the loan was 3 percent. Assume that during the third and fourth quarters of 2016, the relevant prescribed rate of interest is 4 percent. The effect of this transaction on his Taxable Income would be:
- An increase of \$250.
  - An increase of \$500.
  - An increase of \$750.
  - An increase of \$1,000.
  - No change.
8. In December 2012, Arcor Co. advanced funds of \$200,000 to Mr. Jones, a new employee of the corporation, to assist him in acquiring a residence when he moved from Newfoundland to commence employment in British Columbia. The loan bears no interest and is to be repaid in full on December 31, 2017. The prescribed interest rate at the time of this advance was 5 percent. Assuming that the prescribed interest rate throughout 2016 was 6 percent, which one of the following represents the increase in Mr. Jones's Taxable Income in 2016 due to this loan?
- \$ 8,750.
  - \$10,000.
  - \$10,500.
  - \$12,000.
9. During the year, Ted Knight received worker's compensation payments totaling \$10,000 as a result of an injury he suffered at work. His only other source of income for the year was his wages of \$25,000. Which one of the following represents Ted's Net and Taxable Incomes for the year?
- Net Income \$25,000, Taxable Income \$25,000.
  - Net Income \$30,000, Taxable Income \$30,000.
  - Net Income \$35,000, Taxable Income \$25,000.
  - Net Income \$35,000, Taxable Income \$35,000.

### **Tax Payable**

10. Which of the following statements is correct?
- Net income for tax purposes minus federal tax credits equals taxable income
  - Taxable income minus federal tax credits equals total federal tax
  - Total federal tax minus federal tax credits equals federal tax payable
  - Net income for tax purposes minus federal tax credits equals federal tax payable

*Tax Payable For Individuals - Multiple Choice*

11. If total federal tax (before tax credits) is equal to \$10,000 then taxable income must be:
- A. \$48,780
  - B. \$56,338
  - C. \$60,931
  - D. \$66,667
12. Which of the following statements with respect to an individual's Tax Payable is **NOT** correct?
- A. Provincial Tax Payable is calculated by applying the appropriate rate to Taxable Income.
  - B. The relevant provincial tax rate is based on the province in which the individual resides on December 31 of the taxation year.
  - C. Only federal taxes are assessed on residents of Canada who are not a resident in any Canadian province on December 31 of the taxation year.
  - D. All provinces use the same tax brackets for applying their rates.

**Tax Credits**

13. Which of the following contains a list of personal federal tax credits that will reduce the tax liability of an individual?
- A. caregiver, employment credit, medical expenses, disability
  - B. medical expense, standby charge, charitable donations, age
  - C. tuition, adoption expenses, work space in home, pension
  - D. public transit pass, child fitness, Canada pension plan, moving expenses
14. Which of the following tax credit bases is **NOT** subject to full indexation?
- A. Amount for an eligible dependant.
  - B. Age amount.
  - C. Disability amount.
  - D. Pension income amount.
15. Of the following statements about tax credits, which one is correct?
- A. They are deducted from total income and are effectively not subject to tax.
  - B. They reduce tax by the same amount regardless of a taxpayer's marginal tax rate.
  - C. They are deducted from Net Income For Tax Purposes and are effectively not subject to tax.
  - D. Their impact is greater for taxpayers with a higher marginal tax rate.
16. Of the following statements about the spousal tax credit, which one is correct?
- A. To claim this credit, the claimant must be legally married to the relevant individual.
  - B. It can be claimed by either spouse.
  - C. If the individuals are married during the year, the base for the credit must be reduced by the spouse's income since the date of the marriage.
  - D. In the year of separation or divorce, an individual can claim both spousal support payments and the spousal tax credit.
17. Jean Marchand is a single parent with a child. Which of the following conditions is **NOT** required for Jean to claim the ITA 118(1)(b) credit for an eligible dependant?
- A. Jean must maintain a self-contained domestic establishment.
  - B. The child must be under 18 years of age, or mentally or physically infirm.
  - C. The child must be a resident of Canada.
  - D. The child must be wholly dependent for support on Jean.

## Tax Payable For Individuals - Multiple Choice

18. Jake Baxter donated \$100,000 in cash to a Canadian registered charity. His Net Income For Tax Purposes and Taxable Income for the year is \$120,000. Calculate Jake's maximum federal tax credit for charitable gifts.
- A. \$13,500.
  - B. \$15,000.
  - C. \$26,072.
  - D. \$28,972.
19. Of the following statements about medical expenses, which one is correct?
- A. A taxpayer can only claim his own medical expenses.
  - B. The claim must be made in the calendar year the expense was incurred.
  - C. Only expenses in excess of a specified amount are eligible for a tax credit.
  - D. The amount of the tax credit is dependent on the taxpayer's marginal tax rate.
20. For an individual who is over 65 years of age, which of the following types of pension income does **NOT** qualify for the ITA 118(3) pension income tax credit?
- A. Payments from the Canada Pension Plan.
  - B. Old Age Security payments.
  - C. Payments from a provincial pension plan.
  - D. All of the above.
21. Which of the following tax credits **CANNOT** be transferred to a spouse?
- A. The age credit.
  - B. The disability credit.
  - C. The education credit.
  - D. The EI and CPP credits.
  - E. The pension income credit.
22. With respect to the federal political contributions tax credit, which of the following statements is correct?
- A. Contributions made to any registered political party are eligible for the credit.
  - B. Contributions made to a candidate at the time of a federal general election are eligible.
  - C. The credit is equal to 29 percent of the eligible contributions made.
  - D. There is no upper limit to the amount of the credit that can be claimed, as long as the contributions are made within the legal limits governing campaign contributions.
23. Shamus pays for monthly transit passes for his wife, his 10 year old son, his 19 year old blind daughter, his wife's 72 year old disabled mother and his 67 year old father. He claims the caregiver tax credit for both his wife's mother and his father. He can claim the public transit pass tax credit for:
- A. His wife and son.
  - B. His wife, son and daughter.
  - C. His wife, son, daughter and wife's mother.
  - D. His wife, son, daughter, wife's mother and his father.
24. Which of the following relatives may **NOT** be used to claim the eligible dependant tax credit?
- A. Healthy grandfather age 65.
  - B. Healthy daughter age 9.
  - C. Mentally infirm spouse age 65.
  - D. Mentally infirm brother age 19.

## Tax Payable For Individuals - Multiple Choice

25. Which of the following relatives may **NOT** be used to claim the caregiver tax credit?
- Physically infirm aunt age 62.
  - Mentally infirm grandchild age 16.
  - Healthy grandfather age 65.
  - Physically infirm sister age 35.
26. During 2016 Fred had the following amounts deducted from his pay:
- |                     |         |
|---------------------|---------|
| CPP                 | \$2,544 |
| EI                  | 955     |
| Union Dues          | 1,500   |
| United Way Donation | 2,000   |
- He can use all of the above to calculate federal tax credits except:
- CPP
  - EI
  - Union Dues
  - United Way Donation
27. Joe supports his 80 year old blind mother who has no income and lives in a nursing home. Which of the following federal tax credits can he claim for his mother?
- Disability tax credit only.
  - Disability tax credit and Caregiver tax credit only.
  - Disability tax credit and Infirm Dependant Over 17 tax credit only.
  - Disability tax credit, Infirm Dependant Over 17 tax credit and Age tax credit.
28. Hilda is a 67 year old widow. She lives in an apartment with her old 12 year old granddaughter, Sue. Both of Sue's parents are on a two year expedition to remote areas of the Yukon. They provide all financial support for Sue and speak with her weekly via satellite. Which of the following federal tax credits can Hilda claim regarding Sue?
- Eligible dependant tax credit.
  - Child tax credit.
  - Caregiver tax credit.
  - No tax credits available.
29. Jennifer is single with no dependants. During the year she had the following amounts deducted from her salary:
- |                    |         |
|--------------------|---------|
| CPP                | \$2,544 |
| EI                 | 955     |
| Federal Income Tax | 15,000  |
- Based on this information, Jennifer's total federal tax credits for 2016 will be:
- \$525
  - \$2,246
  - \$2,420
  - \$2,775
30. Bill is single with no dependants. For 2016 his net income for tax purposes was \$80,000, his Taxable Income was \$70,000 and his medical expenses tax credit was \$300. How much were his eligible medical expenses?
- \$2,000
  - \$4,237
  - \$4,400
  - \$4,100

*Tax Payable For Individuals - Multiple Choice*

31. Harry is divorced with net income for tax purposes of \$50,000. His 21 year old dependent daughter, Ann had net income for tax purposes of \$15,000. During 2016 Harry paid a total of \$2,500 for eligible medical expenses for Ann. Harry's medical expenses tax credit for 2016 is:
- A. \$39
  - B. \$150
  - C. \$308
  - D. \$2,050
32. Mildred has \$300 budgeted for donations. It will go either to the SPCA (a registered charity) or the Green Party (a registered federal political party). If she gives the money to the Green Party, her tax credit will be
- A. The same amount that she would get from donating to the SPCA.
  - B. \$180 more than she would get from donating to the SPCA.
  - C. \$138 more than she would get from donating to the SPCA.
  - D. \$166 more than she would get from donating to the SPCA.
33. George attended university on a part time basis during 2016. He took two courses in the Fall term and two courses in the Spring term. Each term had a duration of four months. Tuition is \$500 per course and textbooks cost an average of \$100 per course. His total education related federal tax credits for 2016 are:
- A. \$468
  - B. \$504
  - C. \$840
  - D. \$858
34. Which of the following may **NOT** be used as a tax credit?
- A. Fees paid to an adoption agency.
  - B. Fees paid for a child's dance class.
  - C. Fees paid for a child's acting class.
  - D. Fees paid to a day care centre.
35. Adam is self-employed. He might be eligible for all of the following federal tax credits except:
- A. CPP tax credit.
  - B. EI tax credit.
  - C. Canada Employment tax credit.
  - D. Working Income Tax Benefit tax credit.
36. Oscar is 73 years old. His 2016 net income for tax purposes from his RRIF and other investments is \$120,000. He lives with his common-law partner, Felix who is 63 years old. Felix's only income for 2016 was investment income of \$6,000. Oscar can claim all of the following federal tax credits except:
- A. Basic personal tax credit.
  - B. Age tax credit.
  - C. Pension tax credit
  - D. Spousal tax credit

37. With regards to the transfer of education related credits, which of the following statements is **NOT** correct?
- A. If the student is married, the tuition credit can be transferred to either the spouse or a parent.
  - B. Any education related amounts that are not transferred to another person can be carried forward and claimed by the student.
  - C. Credits related to tuition paid to a university outside of Canada cannot be transferred to another person.
  - D. Credits related to interest paid on a student loan cannot be transferred to another person.

**TIF PROBLEM FOUR - 4****Tax Payable For Individuals - Exam Exercises****Exam Exercise Subject Listing For Chapter 4**

<b>Number</b>	<b>Subject</b>
1	Home Relocation Loan
2	Home Relocation Loan
3	Tax Payable Before Credits
4	Tax Payable Before Credits
5	Spousal Tax Credit
6	Spousal Tax Credit
7	Caregiver Tax Credit
8	Caregiver Tax Credit
9	Infirm Dependant Over 17 Tax Credit
10	Infirm Dependant Over 17 Tax Credit
11	Eligible Dependant Vs. Caregiver
12	Eligible Dependant Vs. Caregiver
13	Caregiver Vs. Infirm Dependant Over 17
14	Multiple Credits For Dependents
15	Multiple Credits For Dependents
16	Age Tax Credit
17	Age Tax Credit
18	Adoption Expenses Tax Credit
19	Home Accessibility Tax Credit
20	Charitable Donations Tax Credit
21	Charitable Donations Tax Credit - FDSC
22	Charitable Donations Tax Credit
23	Medical Expense Tax Credit
24	Medical Expense Tax Credit
25	Refundable Medical Expense Supplement
26	Disability Tax Credit
27	Disability Tax Credit
28	Education Related Tax Credits
29	Education Related Tax Credits
30	Carry Forward Of Education Credits
31	Transfer Of Education Credits
32	Transfer Of Education Credits
33	Transfer Of Credits From A Spouse
34	Transfer Of Credits From A Spouse
35	Political Contributions Tax Credit
36	Labour Sponsored Funds Credit
37	EI And OAS Clawbacks
38	Tax Payable With OAS Clawback

**Exam Exercise Four - 1 (Home Relocation Loan)**

On January 1, 2016, Ms. Anna Rossi's employer asks her to relocate to one of the company's offices in a different city. In order to facilitate the move, the employer provides her with a \$78,000, five year home relocation loan. Annual interest of 1 percent must be paid on the loan. Assume that throughout 2016, the relevant prescribed rate is 5 percent. Determine the effect of this loan on Ms. Rossi's 2016 Taxable Income.

**Exam Exercise Four - 2 (Home Relocation Loan)**

Darlene Hill has been asked by her employer to relocate to one of the company's other offices that is several hundred kilometers away from her present work location. The move will take place on January 1, 2016. To facilitate the move, she has been provided with a \$125,000 home relocation loan. Annual interest on the loan is at a rate of 1 percent and the principal must be repaid within five years. Assume that throughout 2016, the prescribed rate is 3 percent. What is the effect of this loan on Darlene's 2016 Taxable Income?

**Exam Exercise Four - 3 (Calculation Of Tax Payable Before Credits)**

During 2016, Canadian resident Mark Forbes has calculated his Taxable Income to be \$53,175. Calculate his 2016 federal Tax Payable before consideration of credits.

**Exam Exercise Four - 4 (Calculation Of Tax Payable Before Credits)**

Canadian resident Zack Bronson has 2016 Taxable Income of \$92,485. Calculate his 2016 federal Tax Payable before consideration of credits.

**Exam Exercise Four - 5 (Spousal Tax Credit With FCA)**

Mr. Don Deloran has 2016 Net Income For Tax Purposes of \$26,100. His spouse is dependent on him because of a physical infirmity. The infirmity is not sufficient to qualify for the disability tax credit. She has 2016 Net Income For Tax Purposes of \$5,800. Mr. Deloran has no tax credits other than the basic personal credits for his spouse and himself. Determine Mr. Deloran's federal tax credits for 2016.

**Exam Exercise Four - 6 (Spousal Tax Credit)**

Nadel Lyon has 2016 Net Income For Tax Purposes of \$32,400. His common-law partner has Net Income For Tax Purposes of \$8,420. Nadel has no tax credits other than the basic personal credits for his common-law partner and himself. Determine Nadel's federal tax credits for 2016.

**Exam Exercise Four - 7 (Caregiver Tax Credit)**

Gerrard Bensen lives with his wife and their two children. His wife's income, including Universal Child Care Benefits, is less than the basic personal tax credit amount. Two years ago, his mother who is 72 years old and extremely healthy, moved in with him. Her Net Income For Tax Purposes for 2016 is \$18,400. Determine the amount of Gerrard's caregiver tax credit, if any, for 2016.

**Exam Exercise Four - 8 (Caregiver Tax Credit)**

Elaine Markham lives with her husband and 11 year old daughter. Her husband's income, including Universal Child Care Benefits, is less than the basic personal tax credit amount. Her 81 year old mother also lives with the family. While her mother has 2016 investment income of \$10,000, she has a physical infirmity that makes her dependent on Elaine. Determine the amount of Elaine's caregiver tax credit, if any, for 2016.

**Exam Exercise Four - 9 (Infirm Dependant Over 17 Tax Credit)**

Margo Riche is married and has a 27 year old son who lives in a group home. The son is dependent on Margo because of a physical infirmity. His Net Income For Tax Purposes for 2016 is \$6,920. Determine the amount of Margo's caregiver and infirm dependant over 17 tax credits for 2016.

**Exam Exercise Four - 10 (Infirm Dependant Over 17 Vs. Caregiver Tax Credits)**

Farah Delorme is married and has a 22 year old daughter. The daughter lives with Farah and her husband and is dependent on Farah because of a physical disability. The daughter's Net Income For Tax Purposes is \$7,200. Determine the amount of Farah's caregiver and infirm dependant over 17 tax credit for 2016.

**Exam Exercise Four - 11 (Eligible Dependent Vs. Caregiver Tax Credits)**

Sheila Cox is a single individual with an 83 year old father. While her father is not mentally or physically infirm, he lives with Sheila. He has Net Income For Tax Purposes for 2016 of \$7,675. Calculate the tax credits that will be available to Sheila as a result of her father living with her.

**Exam Exercise Four - 12 (Eligible Dependent Vs. Caregiver Tax Credits)**

Gloria Mason is recently divorced. She has no children. However, her 75 year mother lives with her. While the mother has Net Income For Tax Purposes of \$17,200, she is dependent on Gloria because of a physical infirmity. Calculate the tax credits that will be available to Gloria as a result of her mother living with her.

**Exam Exercise Four - 13 (Caregiver Vs. Infirm Dependant Over 17 Tax Credits)**

Toshiro Mifune is married and has a 28 year old daughter. She lives with him and is dependent because of a physical infirmity. For 2016, she has investment income of \$9,315. Toshiro would like to know whether he should take the caregiver tax credit for his daughter or, alternatively, the infirm dependant over 17 tax credit. Calculate the amount of the credit that you have selected.

**Exam Exercise Four - 14 (Multiple Credits For Dependants)**

Mr. John Foret is 42 years old and divorced from his wife. His Net Income For Tax Purposes consists of rental income. While he received \$360 in Universal Child Care Benefits, he has elected to allocate this income to his 14 year old son. He has retained the family home and both of the children of the marriage live with him. His daughter is 23 years old and has a physical disability that makes her wholly dependent on him for support. However, she does not qualify for the disability tax credit. His son is 14 years old and in good health. His daughter has no income during 2016, while his son has Net Income For Tax Purposes of \$2,100, including \$360 in Universal Child Care Benefits. Determine Mr. Foret's maximum federal tax credits for 2016.

**Exam Exercise Four - 15 (Multiple Credits For Dependants)**

Ingrid Tower is a 45 year old widow. Her Net Income For Tax Purposes consists of rental income. While she received \$360 in Universal Child Care Benefits, she has allocated these to her 13 year old daughter. She maintains a home for herself and her two children. Her 19 year old son has a physical disability that makes him wholly dependent on Ingrid for support. However, he does not qualify for the disability tax credit. He has no income of his own. Her daughter is 13 years old, is in good health, and has 2016 Net Income For Tax Purposes of \$1,230, including \$360 in Universal Child Care Benefits. Determine Ms. Tower's maximum federal tax credits for 2016.

**Exam Exercise Four - 16 (Age Tax Credit)**

Ms. Marlene Burns is 69 years old and has 2016 Net Income For Tax Purposes of \$46,642. Determine Ms. Burns' age credit for 2016.

**Exam Exercise Four - 17 (Age Tax Credit)**

Harry Rose is 71 years of age and has 2016 Net Income For Tax Purposes of \$62,485. Determine Harry's age credit for 2016.

**Exam Exercise Four - 18 (Adoption Expenses Tax Credit)**

Claude Lafleur and his spouse have adopted an infant French orphan. The adoption process began on January 2, 2016 when they applied to a licensed adoption agency. Later that month they traveled to France to discuss the adoption and view available children. The cost of this trip was \$3,850. Their provincial government opens the adoption file on March 15, 2016, and the adoption order is issued on September 29, 2016. In October, the couple returns to France to pick up their new daughter. The happy family returns to Canada on October 20, 2016. The cost of this trip is \$6,280.

Additional expenses paid during the first week of October, 2016 were \$1,759 paid to the French orphanage and \$5,600 paid to a Canadian adoption agency. Legal fees incurred during the adoption period were \$3,250. After arrival in Canada, an additional \$3,200 in medical expenses were incurred for the child prior to the end of 2016. Mr. Lafleur's employer has a policy of providing reimbursement for up to \$4,500 in adoption expenses eligible for the adoption expenses tax credit. This amount is received in October, 2016 and will be considered a taxable benefit to Mr. Lafleur. What is the maximum adoption expenses tax credit that can be claimed by the couple? Show your calculations.

**Exam Exercise Four - 19 (Home Accessibility Tax Credit)**

Mauricio Saidi is a single parent. He and his son, who was born paralyzed from the neck down, live in the house he owns. His son qualifies for the disability tax credit. During 2016, Mauricio spends \$8,600 putting in a more accessible wheel-in shower in the child's bathroom and \$2,500 for a mechanical lift on his truck for his son's wheelchair. What is the maximum amount that Mauricio can claim in 2016 as a home accessibility tax credit?

**Exam Exercise Four - 20 (Charitable Donations Tax Credit)**

Leon Fiero has 2016 Net Income For Tax Purposes and Taxable Income of \$70,400. Each week, without fail, he plays a nation-wide lottery. While over the years he has not had any winnings of consequence, his fortunes have changed and, in 2016, he wins over \$320,000. As he had hoped to do for many years, he donates \$120,000 of these winnings to the Canadian Cancer Society in 2016. He chooses to claim \$15,000 of his donations in 2016. In 2017, his income remains at \$70,400 and he makes no further donations. Mr. Fiero is not eligible for the first-time donor's super credit.

Determine Mr. Fiero's charitable donations tax credit for 2016, as well as the maximum amount of the donation that he can use in 2017. Until what year can he claim any unused portions of his 2016 donation?

**Exam Exercise Four - 21 (Charitable Donations Tax Credit - FDSC)**

Leon Fiero has 2016 Net Income For Tax Purposes and Taxable Income of \$70,400. Each week, without fail, he plays a nation-wide lottery. While over the years he has not had any winnings of consequence, his fortunes have changed and, in 2016, he wins over \$320,000. As he had hoped to do for many years, he donates \$120,000 of these winnings to the Canadian Cancer Society in 2016. He chooses to claim \$15,000 of his donations in 2016. In 2017, his income remains at \$70,400 and he makes no further donations. Mr. Fiero is eligible for the first-time donor's super credit.

Determine Mr. Fiero's charitable donations tax credit for 2016, as well as the maximum amount of the donation that he can use in 2017. Until what year can he claim any unused portions of his 2016 donation?

**Exam Exercise Four - 22 (Charitable Donations Tax Credit)**

Jack Banino has Net Income For Tax Purposes and Taxable Income of \$83,000 in both 2016 and 2017. Because of a recent run of good luck in Las Vegas, he is able to make a 2016 donation of \$120,000 to a registered Canadian charity. He plans to use \$30,000 of the donation as the base for a charitable donations tax credit in 2016. He plans to carry the balance of the \$120,000 forward to subsequent years. Jack is not eligible for the first-time donor's super credit.

Determine Jack's charitable donations tax credit for 2016. In addition, determine the maximum amount of the donation that he can use in 2017. Until what year can he claim any unused portions of his 2016 donation?

**Exam Exercise Four - 23 (Medical Expense Tax Credit)**

Mr. Samuel Silverstein has a spouse and a 19 year old dependent son. Mr. Silverstein's 2016 Net Income For Tax Purposes is \$125,000. For 2016, Mr. Silverstein's spouse has no income and his son has Net Income For Tax Purposes of \$8,675. During 2016, Mr. Silverstein and his spouse have medical expenses of \$2,042. His son has medical expenses of \$7,780 which Mr. Silverstein paid. Determine Mr. Silverstein's medical expense credit for 2016.

**Exam Exercise Four - 24 (Medical Expense Tax Credit)**

Saul Lawson has a spouse, a 20 year old dependent son, and a 12 year old daughter. His 2016 Net Income For Tax Purposes is \$70,000. Medical expenses for Saul, his spouse, and his 12 year old daughter total \$4,500. He also pays medical expenses for his son of \$6,200. His spouse has Net Income For Tax Purposes of \$10,000 and his son has Net Income For Tax Purposes of \$9,200. Determine Saul's medical expense tax credit for 2016.

**Exam Exercise Four - 25 (Refundable Medical Expense Supplement)**

During 2016, Mr. Chris Mackey has Net Income For Tax Purposes and Taxable Income of \$28,248. Mr. Mackey and his common-law partner, Emily, have total medical expenses of \$10,325. Emily has no income of her own. Determine Mr. Mackey's minimum Tax Payable for 2016.

**Exam Exercise Four - 26 (Disability Tax Credit)**

Lorraine Tramer lives with her husband and 20 year old paraplegic daughter, Marie, who qualifies for the disability tax credit. During 2016, Lorraine paid medical expenses of \$9,850 for Marie, none of which involved attendant care expenses. Marie has no income of her own. Lorraine's Net Income For Tax Purposes and Taxable Income for 2016 was \$108,600. Determine the total amount of tax credits related to Marie that will be available to Lorraine.

**Exam Exercise Four - 27 (Disability Tax Credit)**

Larry Osborne has a wife and a 16 year disabled daughter, Suzanne, who qualifies for the disability tax credit. His Net Income For Tax Purposes is \$186,000 and he and his wife have medical expenses of \$3,560. During 2016, Larry paid medical expenses for Suzanne of \$12,400, none of which involved payments for attendant care. Suzanne has a 2016 Net Income For Tax Purposes of \$5,650. Determine the total amount of tax credits related to Suzanne that will be available to Larry.

**Exam Exercise Four - 28 (Education Related Tax Credits)**

During 2016, Frank Balmer attends university for five months of full time study and three months of part time study. His total tuition for the year, including all ancillary fees, is \$4,100, of which he prepaid \$1,400 in 2015. The amount paid in 2016 includes \$415 in fees that are only charged to students in his biology program. Interest paid for the year on his student loan was \$417. Determine the total amount of education related tax credits that would be available for Mr. Balmer for 2016.

**Exam Exercise Four - 29 (Education Related Tax Credits)**

During the first 6 months of 2016, Grace Bucknell attends university on a full time basis. For the last 6 months of the year, her studies continue, but only on a part time basis. The tuition fees for the year total \$10,400, including \$350 of special fees that are only charged to students in her program. As she has taken out a student loan to pay for these studies, she has 2016 interest payments on this loan of \$623. Determine the total amount of education related tax credits that would be available for Grace for 2016.

**Exam Exercise Four - 30 (Carry Forward Of Education Related Tax Credits)**

At the beginning of 2016, Karl Schmidt has a carry forward of education related credits from 2015 of \$525 [(15%)(3,500)]. During 2016, he is in full time attendance at a Canadian university for 10 months of the year. His tuition fees total \$5,650 for the year. His Taxable Income for 2016 is \$34,650. Other than education related tax credits, his only tax credit is his basic personal credit. Determine Karl's total education related tax credits and any available carry forwards.

**Exam Exercise Four - 31 (Transfer Of Education Related Tax Credits)**

Betty Masters has 2016 Taxable Income of \$15,123. She attends university in London, England on a full time basis for 9 months of the year, paying a total amount for tuition of \$26,800 (Canadian dollars). Her only tax credit, other than education related credits, is her basic personal credit. Determine Betty's education related credits and indicate how much of this total could be transferred to a supporting parent and how much would be carried forward.

**Exam Exercise Four - 32 (Transfer Of Education Related Tax Credits)**

Carl Bond is a student at the University of Michigan in the U.S. on a full time basis for 8 months of the year. His tuition fees total \$31,400 (Canadian dollars). For 2016, he has Taxable Income of \$12,150. Other than education related credits, his only tax credit is the basic personal credit. Determine Carl's education related credits and indicate how much of this total could be transferred to a supporting parent and how much would be carried forward.

**Exam Exercise Four - 33 (Transfer Of Credits From A Spouse)**

Mrs. Rhonda Lee is 65 years old and has Net Income For Tax Purposes of \$53,500. Of this total, \$30,600 was from a life annuity that she purchased with funds in her RRSP. Her spouse is 68 years old, has no income of his own as he is ineligible for OAS, and is attending university on a full time basis. His tuition fees for the year were \$3,450 and he was in full time attendance for 3 months of the year. Determine Mrs. Lee's maximum federal tax credits for 2016. Ignore the possibility of splitting her pension income with her spouse.

**Exam Exercise Four - 34 (Transfer Of Credits From A Spouse)**

John Trask is 67 years old and his spouse is 66 years old. He has Net Income For Tax Purposes of \$63,200, largely from various pension funds. His spouse has no income of her own as she is not eligible for OAS payments. During 2016, his spouse attended university on a full time basis for 4 months. Her tuition fees for the attendance were \$4,200 and, in addition, she spent \$800 on textbooks. Determine John's maximum federal tax credits for 2016. Ignore the possibility of splitting his pension income with his spouse.

**Exam Exercise Four - 35 (Political Contributions Tax Credit)**

Mr. Allen Dion contributes \$826 to the Canadian Political Alliance, a registered federal political party. Determine the amount of his federal political contributions tax credit.

**Exam Exercise Four - 36 (Labour Sponsored Funds Credit)**

On June 30, 2016, Ms. Monica Neville purchases newly issued shares in a prescribed Labour Sponsored Venture Capital Corporation (LSVCC) that is registered with the federal government. The cost of these shares is \$4,600. Determine the amount of the federal tax credit that will result from this purchase.

**Exam Exercise Four - 37 (EI And OAS Clawbacks)**

For 2016, Mr. Oliver Clemens has net employment income of \$67,200, receives EI payments of \$9,460, and receives \$7,000 in Old Age Security (OAS) payments. No amount was withheld from the OAS payments because he had very low income in the previous two years due to large business losses. Determine Mr. Clemens' Net Income For Tax Purposes for 2016.

**Exam Exercise Four - 38 (Tax Payable With OAS Clawback)**

Agnes is 66 years old. During 2016 she received OAS payments of \$7,000, CPP payments of \$10,000 and investment income of \$65,000. Assume that no federal tax was withheld at source. Her total federal tax credits for 2016 (including charitable donations) are \$2,500. Taking the OAS clawback into consideration, what is her federal balance owing?

**TIF PROBLEM FOUR - 5A****Tax Payable For Individuals - Key Term Matching (Easy)**

**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

Due to the large number of key terms in Chapter 4, “Taxable Income and Tax Payable for Individuals”, the number of key terms listed is double the other chapters.

The following 15 key terms were listed at the end of Chapter 4, “Taxable Income and Tax Payable for Individuals”.

- A. Canada Pension Plan Tax Credit
- B. Caregiver Tax Credit
- C. Disability Tax Credit
- D. Disability Tax Credit Supplement
- E. Eligible Dependant Tax Credit
- F. Refundable Medical Expense Supplement
- G. Social Benefits Repayment
- H. Dependant
- I. Education Tax Credit
- J. Indexation
- K. Non-Refundable Tax Credit
- L. Old Age Security Clawback
- M. Spouse
- N. Textbook Tax Credit
- O. Tuition Tax Credit

The following list contains 19 potential definitions for the preceding key terms.

1. A refundable credit against tax payable that increases the amount available to certain low income individuals for their eligible medical expenses.
2. A credit against tax payable that is available to individuals with a doctor certified severe mental or physical disability.
3. A credit against tax payable that is available to a single individual supporting a dependant in a self-contained domestic establishment.
4. A credit against tax payable that is available to individuals making contributions to the Canada Pension Plan.
5. A credit against tax payable that is available to individuals with qualifying medical expenses.
6. A credit against tax payable that is available to an individual who provides home care for an adult relative.
7. An income tested taxing back, or reduction, in the payment of Old Age Security benefits and Employment Insurance benefits.

*Tax Payable For Individuals - Key Term Matching (Easy)*

8. A supplement to the disability tax credit that is available for individuals who are under 18 years of age at the end of the year.
9. A pension plan sponsored by the federal government. Individuals with employment or business income must make contributions based on their income and, in return, receive benefits in future years.
10. An individual to whom a taxpayer is legally married.
11. A credit against tax payable that is available to individuals who have a spouse or common-law partner.
12. A credit against tax payable that is available to individuals making qualifying tuition payments.
13. An individual who, at any time during the year, is dependent on the taxpayer for support and is the child or grandchild of the individual or of the individual's spouse or common-law partner, the parent, grandparent, brother, sister, uncle, aunt, niece, or nephew, if resident in Canada at any time in the year, of the individual or of the individual's spouse or common-law partner.
14. A tax credit that can only be used against the tax payable of an individual. It will not be refunded to individuals without sufficient tax payable to make use of it.
15. A monthly payment to residents of Canada who are 65 years of age or older.
16. The process of adjusting tax brackets and some tax credits to reflect changes in the consumer price index.
17. A credit against tax payable that is available to individuals who qualify for the education tax credit.
18. A taxing back, or reduction, in the payment of Old Age Security benefits.
19. A credit against tax payable that is available to individuals attending a designated educational institution on a full or part time basis.
20. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the 15 key terms listed (A through O), indicate the number of the item (1 through 19) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (20). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

**TIF PROBLEM FOUR - 5B****Tax Payable For Individuals - Key Term Matching (Moderate)**

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**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

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The following 15 key terms were listed at the end of Chapter 4, "Taxable Income and Tax Payable for Individuals".

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- B. Caregiver Tax Credit
- C. Disability Tax Credit
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- E. Eligible Dependant Tax Credit
- F. Refundable Medical Expense Supplement
- G. Social Benefits Repayment
- H. Dependant
- I. Education Tax Credit
- J. Indexation
- K. Non-Refundable Tax Credit
- L. Old Age Security Clawback
- M. Spouse
- N. Textbook Tax Credit
- O. Tuition Tax Credit

The following list contains 24 potential definitions for the preceding key terms.

1. A refundable credit against tax payable that increases the amount available to certain low income individuals for their eligible medical expenses.
2. A credit against tax payable that is available to individuals with a doctor certified severe mental or physical disability.
3. A credit against tax payable that is available to a single individual supporting a dependant in a self-contained domestic establishment.
4. A person of the opposite sex to whom a taxpayer is legally married.
5. A credit against tax payable that is available to individuals making contributions to the Canada Pension Plan.
6. A credit against tax payable that is available to individuals with qualifying medical expenses.
7. A taxing back, or reduction, in the payment of Old Age Security or Employment Insurance benefits.
8. A credit against tax payable that is available to an individual who provides home care for an adult relative.
9. An income tested taxing back, or reduction, in the payment of Old Age Security benefits and Employment Insurance benefits.

*Tax Payable For Individuals - Key Term Matching (Moderate)*

10. An individual who, at any time during the year, is dependent on the taxpayer for support and is the child or grandchild of the individual or of the individual's spouse or common-law partner, the parent, grandparent, brother, sister, uncle, aunt, niece, or nephew if resident in Canada at any time in the year, of the individual.
11. A supplement to the disability tax credit that is available for individuals who are under 18 years of age at the end of the year.
12. A pension plan sponsored by the federal government. Individuals with employment or business income must make contributions based on their income and, in return, receive benefits in future years.
13. An individual to whom a taxpayer is legally married.
14. A credit against tax payable that is available to individuals who have a spouse or common-law partner.
15. The process of adjusting tax brackets and all tax credits to reflect changes in the Consumer Price Index.
16. A credit against tax payable that is available to individuals making qualifying tuition payments.
17. An individual who, at any time during the year, is dependent on the taxpayer for support and is the child or grandchild of the individual or of the individual's spouse or common-law partner, the parent, grandparent, brother, sister, uncle, aunt, niece, or nephew, if resident in Canada at any time in the year, of the individual or of the individual's spouse or common-law partner.
18. A tax credit that can only be used against the tax payable of an individual. It will not be refunded to individuals without sufficient tax payable to make use of it.
19. A monthly payment to residents of Canada who are 65 years of age or older.
20. The process of adjusting tax brackets and some tax credits to reflect changes in the consumer price index.
21. A credit against Tax Payable that is available to an individual supporting a dependant in a self-contained domestic establishment.
22. A credit against tax payable that is available to individuals who qualify for the education tax credit.
23. A taxing back, or reduction, in the payment of Old Age Security benefits.
24. A credit against tax payable that is available to individuals attending a designated educational institution on a full or part time basis.
25. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the 15 key terms listed (A through O), indicate the number of the item (1 through 24) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (25). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

**TIF PROBLEM FOUR - 6****Tax Payable For Individuals - Personal Tax Credits**

In each of the following independent Cases, determine the maximum amount of 2016 personal tax credits, including transfers from a spouse or dependant, that can be applied against federal Tax Payable by the taxpayer. Ignore, where relevant, the possibility of pension income splitting.

A calculation of Tax Payable is **NOT** required, only the applicable credits.

1. Sarah Partridge is 72 years old and has Net Income For Tax Purposes of \$61,300. This total is made up of OAS payments and pension income from her former employer. Her husband is 58 years old and has Net Income For Tax Purposes of \$4,725.
2. Martin Brody was divorced from his wife several years ago. He has custody of their four children, ages 7, 9, 12, and 15. His Net Income For Tax Purposes consists of spousal support payments totaling \$54,000 per year. While he received Universal Child Benefits of \$1,440 [(4)(\$360)], he has included these amounts in the Net Income For Tax Purposes of his eligible dependant. The children are all in good health. The oldest child has Net Income For Tax Purposes of \$11,200 during the year.
3. Marion Lassiter has Net Income For Tax Purposes of \$132,450, all of which is rental income. Her husband has Net Income For Tax Purposes of \$1,600. They have three children, ages 14, 16, and 19. All of these children are in good health and continue to live at home. The 19 year old child has Net Income For Tax Purposes of \$8,460. During the current year, Ms. Lassiter pays the following medical expenses:

Marion	\$ 4,240
Her Spouse	3,450
14 Year Old Child	1,860
16 Year Old Child	2,450
19 Year Old Child	6,720
<b>Total</b>	<b>\$18,720</b>

4. Janice Archer has Net Income For Tax Purposes of \$92,100, none of which is employment income or income from self-employment. Her spouse has Net Income For Tax Purposes of \$7,240. Their daughter is 15 years old, lives with them, and has Net Income For Tax Purposes of \$2,150. Their son is 22 years old and, because of a physical disability, continues to live with them. He has no income of his own. His disability is not severe enough to qualify for the disability tax credit.
5. Joan Baxter has Net Income For Tax Purposes of \$85,000, all of which is employment income. Her employer withholds maximum CPP contributions and EI premiums. She is married to John Brown whose Net Income For Tax Purposes is \$4,230. They have three children aged 7, 9, and 11. All of the children are in good health and none of them have income of their own.

**TIF PROBLEM FOUR - 7****Tax Payable For Individuals - Personal Tax Credits**

There are seven independent cases which follow. Each case involves various assumptions as to the amount and type of income earned by Ms. Barbra Baines during 2016, as well as to other information that is relevant to the determination of her 2016 Tax Payable. Barbra's Net Income For Tax Purposes is equal to her Taxable Income in all Cases.

In those cases where we have assumed that the income was from employment, the employer withheld the maximum EI premium and CPP contribution.

**Case 1** Barbra and her husband Billy are both 67 years of age. Billy is sufficiently disabled that he qualifies for the disability tax credit. The components of the 2016 income earned by Barbra and Billy are as follows:

	<b>Barbra</b>	<b>Billy</b>
Interest	\$ 2,600	\$ 650
Canada Pension Plan Benefits	12,600	Nil
Old Age Security Benefits	7,000	7,000
Income From Registered Pension Plan	22,300	1,230
<b>Total Net Income</b>	<b>\$44,500</b>	<b>\$8,880</b>

**Case 2** Barbra is 43 years old and has net rental income of \$86,500. Her husband died last year. She has two children. Mark is 15 and is physically infirm, but not sufficiently to qualify for the disability tax credit. He has income from part time work as a graphic artist of \$3,450. The other child, Sandy, is 12 and is in good health. While Barbra received \$720 in Universal Child Care Benefits, she has elected to include these in the income of Sandy who has no other income during the year.

**Case 3** Barbra is 58 years old and has income from investments of \$102,000. She is divorced and has been awarded custody of her 21 year disabled son. The son qualifies for the disability tax credit. He has Net Income For Tax Purposes of \$7,560, and is dependent on his mother for support. Barbra paid \$850 for a 3 month art appreciation course for her son, as well as \$1,500 for a 6 month fitness program.

**Case 4** Barbra is 31 years old, has employment income of \$83,000, and makes contributions of \$5,600 to registered charities. Barbra qualifies for the first-time donor's super credit. She is not married and has no dependants.

**Case 5** Barbra is 58 years old and has employment income of \$93,500. Her common-law partner is 48 years old and has income of \$7,260. They have an adopted child who is 19 years old and lives at home. Barbra and her partner have medical expenses of \$3,200. Medical expenses for the son total \$8,400. The son has Net Income For Tax Purposes of \$5,600.

**Case 6** Barbra is 45 years old and has employment income of \$84,600. Her husband John is 37 years old and has Net Income For Tax Purposes of \$7,200. They have no children. However, they provide in home care for John's father who is 63 years old, dependent because of a physical infirmity and has no income of his own. His disability is not severe enough to qualify for the disability tax credit. Also living with them is Barbra's 67 year old father. He is in good physical and mental health and has Net Income For Tax Purposes of \$19,400.

*Tax Payable For Individuals - Personal Tax Credits*

**Case 7** Barbra is 46 years old and has employment income of \$163,000. Her husband Larry is 41 years old and has Net Income For Tax Purposes of \$7,240. They have a 20 year old son who lives at home. He is dependent because of a physical infirmity, but it is not severe enough to qualify him for the disability tax credit. However, he is able to attend university on a full time basis for 8 months during 2016. Barbra pays his tuition fees of \$8,300, as well as \$640 for the textbooks that he requires in his program. The son has Net Income For Tax Purposes of \$9,600.

**Required:** In each Case, calculate Barbra Baines' minimum federal Tax Payable for 2016. Indicate any carry forwards available to her and her dependants and the carry forward provisions. Ignore any amounts Barbra might have had withheld or paid in instalments and the possibility of pension splitting.

**TIF PROBLEM FOUR - 8****Tax Payable For Individuals - Personal Tax Credits**

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In each of the following independent Cases, determine the maximum amount of 2016 personal tax credits, including transfers from a spouse or dependant, that can be applied against federal Tax Payable by the taxpayer.

A calculation of Tax Payable is **NOT** required, only the applicable credits.

1. Mr. Hanson has Net Income For Tax Purposes of \$40,000, all of which is investment income. He is single and provides support for his mother. His mother is a widow who resides in England, and has income of \$700 per year.
2. Mr. Johnson has Net Income For Tax Purposes of \$250,000, all of which is employment income. His employer has withheld and remitted the required EI and CPP amounts. Mr. Johnson was married on December 1, 2016. His wife, an accounting student, had salary of \$27,500 for the period from January 1 to November 30, 2016 and \$2,500 for the month of December, 2016.
3. Mr. Massey has Net Income For Tax Purposes of \$60,000, all of which is rental income. He lives with his common-law wife and her two children from a previous marriage. The two children are 8 and 10 years of age and have no income for the year. His wife has Net Income For Tax Purposes of \$1,500.
4. Mr. Jones is married and has Net Income For Tax Purposes of \$70,000, none of which is employment income or income from self-employment. His 19 year old dependent son attends university. His wife has Net Income For Tax Purposes of \$1,200, and his son has Net Income For Tax Purposes of \$2,900. His son does not wish to transfer his tuition, education or textbook credits.
5. Ms. Morrison is divorced and maintains a residence far from her former spouse. She has custody of the two children from the marriage. They are aged 7 and 10 and in good health. Her Net Income For Tax Purposes is \$50,000, all of which is spousal support payments. While she received \$720 in Universal Child Care Benefits, she has elected to have this included in the Net Income For Tax Purposes of the child she claims as her eligible dependant. Other than the Universal Child Care Benefits, neither child had any income for the year.
6. Mr. Bagley is 68 years old and has Net Income For Tax Purposes of \$27,100, which is comprised of OAS benefits and pension income paid out of his Registered Retirement Income Fund. His wife is 52 years old and is blind. She has no income of her own. Ignore the possibility that Mr. Bagley would split his pension income with his wife.

**TIF PROBLEM FOUR - 9****Tax Payable For Individuals - Personal Tax Credits**

Mr. William Norris is 45 years old. The following five independent Cases make varying assumptions for the 2016 taxation year with respect to Mr. Norris' marital status and number of dependants. In all Cases, Mr. Norris earned employment income of \$60,000 and his employer withheld the required EI premiums and CPP contributions.

**Case A** Mr. Norris is married and his wife, Susan, has Net Income For Tax Purposes of \$8,800. Susan's 73 year old mother, Bernice, lives with them. Bernice, an avid skier, had Net Income For Tax Purposes of \$16,000 for the year.

**Case B** Mr. Norris is married and his wife, Susan, has Net Income For Tax Purposes of \$4,410. They have one child, Martha, who is 10 years of age. Martha had no income during the year. During the year, the family had medical expenses as follows:

William	\$1,200
Susan	1,600
Martha	350
<b>Total</b>	<b>\$3,150</b>

**Case C** Mr. Norris is married and his wife, Susan, has Net Income For Tax Purposes of \$4,500. They have a son, Allen, who is 19 years old and lives at home. He attends university on a full time basis during 8 months of the year. Mr. Norris pays \$9,000 for Allen's tuition and \$900 for required textbooks. Allen had employment income during the summer months of \$2,200. He will transfer any unused credits to his father.

**Case D** Mr. Norris is not married and has no dependants. On receipt of a \$300,000 inheritance in December, he donates \$50,000 to his local hospital, a registered charity. He chooses to claim \$15,000 in 2016. As he has donated to this hospital on a regular basis, he is not eligible for the first-time donor's super credit. He also makes contributions to a federal political party in the amount of \$1,000.

**Case E** Mr. Norris is a single father. He has a daughter, Mary, who is 8 years old and lives with him. During the year, Mr. Norris received \$360 in Universal Child Care Benefits. He elected to include these in the Net Income For Tax Purposes of Mary, who had no other income for the year. Two years ago, Mr. Norris graduated from a Canadian university. He currently has a Canada Student Loan outstanding. Mr. Norris pays back this loan in monthly instalments of \$300. During the year, he paid \$450 in interest on this loan.

**Required:** In each Case, calculate Mr. Norris' minimum federal Tax Payable for 2016. Indicate any carry forwards available to him and his dependants and the carry forward provisions. Ignore any tax amounts that Mr. Norris might have had withheld or paid in instalments.

**TIF PROBLEM FOUR - 10****Simple Tax Payable With Employment Income**

For the past 5 years, Mr. Brooks has been employed as a financial analyst by a large Canadian public firm located in Winnipeg. During 2016, his basic gross salary amounts to \$63,000. In addition, he was awarded an \$11,000 bonus based on the performance of his division. Of the total bonus, \$6,500 was paid in 2016 and the remainder is to be paid on January 15, 2017.

During 2016, Mr. Brooks' employer withheld the following amounts from his gross wages:

Federal Income Tax	\$3,000
Employment Insurance Premiums	955
Canada Pension Plan Contributions	2,544
Registered Pension Plan Contributions	2,800
Donations To The United Way	480
Union Dues	240
Payments For Personal Use Of Company Car	1,000

**Other Information:**

- Due to an airplane accident while flying back from Thunder Bay on business, Mr. Brooks was seriously injured and confined to a hospital for two full months during 2016. As his employer provides complete group disability insurance coverage, he received a total of \$4,200 in payments during this period. All of the premiums for this insurance plan are paid by the employer. The plan provides periodic benefits that compensate for lost employment income.
- Mr. Brooks is provided with a car that the company leases at a rate of \$678 per month, including both GST and PST. The company pays for all of the operating costs of the car and these amounted to \$3,500 during 2016. Mr. Brooks drove the car a total of 35,000 kilometers during 2016, 30,000 kilometers of which were carefully documented as employment related travel. While he was in the hospital (see Item 1), his employer required that the car be returned to company premises.
- On January 15, 2015, Mr. Brooks received options to buy 200 shares of his employer's common stock at a price of \$23 per share. At this time, the shares were trading at \$20 per share. Mr. Brooks exercised these options on July 6, 2016, when the shares were trading at \$28 per share. He does not plan to sell the shares for at least a year.
- In order to assist Mr. Brooks in acquiring a new personal residence in Winnipeg, his employer granted him a five year, interest free loan of \$125,000. The loan qualifies as a home relocation loan. The loan was granted on October 1, 2016 and, at this point in time, the interest rate on open five year mortgages was 5 percent. Assume the prescribed rate was 2 percent on this date and remained unchanged during the year. Mr. Brooks purchases a house for \$235,000 on October 2, 2016. He has not owned a home during any of the preceding four years.
- Other disbursements made by Mr. Brooks include the following:

Advanced financial accounting course tuition fees	\$1,200
Music history course tuition fees (University of Manitoba one week intensive course)	600
Fees paid to financial planner	300
Payment of premiums on life insurance	642

Mr. Brooks' employer reimbursed him for the tuition fees for the accounting course, but not the music course.

*Simple Tax Payable With Employment Income*

6. Mr. Brooks is a widower. His wife was killed in a car accident 2 years ago that injured his 8 year old son, Harold, so badly that he qualifies for the disability tax credit. While Mr. Brooks received \$360 in Universal Child Care Benefits during 2016, he has elected to include these payments in the Net Income For Tax Purposes of Harold. Harold has no other Net Income for the year.
7. Mr. Brooks' mother, Grace, lives with Mr. Brooks and cares for Harold. Grace is 67 years old and her Net Income For Tax Purposes is \$7,500. Grace refused to take any payments for caring for Harold as she received a large inheritance in the previous year. As a result, Mr. Brooks did not pay any child care or attendant costs for Harold.
8. Mr. Brooks paid the following eligible medical costs:

For Himself	\$ 9,300
For Harold	2,450
For Grace	1,265
Total	\$13,015

9. Mr. Brooks buys public transit passes for his son, his mother and himself. The monthly cost of these passes is \$26 (son), \$50 (mother) and \$60 (himself). He purchased these passes for 10 months of the year.
10. As Mr. Brooks contributes every year to the United Way, he is not eligible for the first-time donor's super credit.

**Required:** Calculate, for the 2016 taxation year, Mr. Brooks' minimum Taxable Income and federal Tax Payable (Refund).

**TIF PROBLEM FOUR - 11****Comprehensive Tax Payable With Employment Income**

Marvin Combs is 43 years old and is employed by a Canadian public company. His annual salary is \$112,468, none of which is commissions. Because of his outstanding work during 2016, he has been awarded a \$20,000 bonus. The bonus will be paid in 2020 and 2021 at the rate of \$10,000 each year to help ensure he stays with the Company. As Marvin expects to remain at the Company for the rest of his working life, he accepts the delayed payment with no complaints and minimal misgivings.

For 2016, his employer withheld EI premiums of \$955 and CPP contributions of \$2,544. The employer also withheld professional association dues of \$3,400 and contributions to the United Way of \$2,500. This is the first time that Marvin or his spouse have ever contributed to a registered charity.

Also withheld were registered pension plan contributions of \$6,800. On his behalf, the employer also made a contribution to the plan of \$4,600.

Marvin's spouse, Leslie Combs, is 46 years old and is legally blind. Her Net Income For Tax Purposes is \$8,460.

The Combs have three children. Information on these children is as follows:

**Sharon** is 17 years old, in good health, and has income from part time jobs of \$7,625.

**Suzanne** is 19 years old and has serious breathing problems that prevent her from working on a full time basis. She lives with Marvin and Leslie and has income from part time jobs of \$7,250.

**Samantha** is 23 years old and attends university on a full time basis for 11 months of the year. Marvin pays her tuition fees of \$10,300, along with textbook costs of \$1,100. She lives with Marvin and Leslie and is in good health. She has investment income of \$12,800. The investments were purchased with income from part-time jobs during her high school years.

**Other Information:**

1. Marvin is provided with an automobile by his employer. The vehicle is used largely for employment related activity. Total milage for 2016 was 62,000 kilometers, with only 4,000 of this being personal use. The vehicle is leased by his employer at a rate of \$456 per month, including a payment for insurance of \$43 per month. It is available to Marvin for 10 months during 2016. During the other 2 months, the employer required that it be returned to their garage.
2. In 2014, Marvin received options to purchase 300 shares of his employer's common stock at a price of \$72 per share. At the time the options were granted, the market price of the stock was \$70 per share. In January, 2016, when the shares are trading at \$85 per share, Marvin exercises all of the options. He is still holding these shares at the end of the year.
3. During 2016, Marvin receives several gifts from his employer:
  - As a reward for winning the company's Employee Of The Month Award, he receives an expense paid weekend in a local hotel. The regular price for this package was \$1,200.
  - As is the case for all of the company's employees, Marvin received a \$600 gift certificate for merchandise at a local department store.
  - At Christmas, the company provides each employee with a basket of gourmet food. The value of this basket is \$450.
4. During 2016, Marvin spent \$8,400 on employment related meals and entertainment with clients of his employer. His employer reimbursed all but \$1,000 of these costs.

*Comprehensive Tax Payable With Employment Income*

5. During 2016, Marvin and Leslie decide to purchase their first family home (they have rented for the last 15 years). After considerable searching, they identify the perfect property one block from their rented apartment and purchase it for \$462,000. As is his employer's policy, he is granted an interest free loan of \$200,000 to assist with this purchase. The loan was granted on April 1, 2016. Assume that the prescribed rate is 2 percent throughout 2016.
6. Because of her dream of being a martial arts superstar, Marvin enrolls Sharon in a strenuous 6 month martial arts fitness program. The cost of this program is \$3,400, all of which is paid by Marvin.
7. During 2016, both Sharon and Samantha had rhinoplasty surgery. Marvin had to pay \$2,800 for emergency services after Sharon's nose suffered serious trauma during a martial arts class. He also paid \$13,500 for rhinoplasty surgery to reduce and reshape Samantha's nose which she believes has greatly improved her appearance. These amounts are included in the following medical expenses of the family, all of which were paid by Marvin:

Marvin And Leslie	\$2,200
Sharon	3,100
Suzanne	12,300
Samantha	16,000

**Required:**

- A. Determine Marvin's minimum Net Income For Tax Purposes for the 2016 taxation year.
- B. Determine Marvin's minimum Taxable Income for the 2016 taxation year.
- C. Based on your answer in Part B, determine Marvin's federal Tax Payable for the 2016 taxation year.

**TIF PROBLEM FOUR - 12****Comprehensive Tax Payable With Employment Income**

Martin Dorne is 53 years old and employed in construction work by a large public company. His annual salary is \$98,500, none of which involves commissions. As the company was very successful during 2016, Martin has been provided with a \$15,000 bonus. This bonus will be paid in equal amounts (\$3,000) over the period 2016 through 2020.

Martin's employer withheld maximum EI premiums and CPP contributions, along with \$18,000 in federal income taxes. Other amounts withheld by his employer are as follows:

RPP Contributions	\$4,300
Union Dues	450

Martin's common-law partner is Brian Lassiter. Brian is 48 years old and is legally blind. Brian has 2016 income from investments and Universal Child Care Benefits of \$9,400.

Eight years ago, Martin and Brian adopted three brothers from a third-world country. Information on these children is as follows:

**David** is 15 years old, in good health, and has income from part time jobs of \$10,500.

**Devon** is 20 years old and has serious breathing problems that prevent him from working on a full time basis. He lives with Martin and Brian and has income from part time jobs of \$5,150.

**Derek** is 22 years old and attends university on a full time basis for 8 months of the year. Martin pays his tuition fees of \$10,300, along with textbook costs of \$1,200. He lives with Martin and Brian and is in good health. He has self-employed income of \$13,500. Assume he pays no CPP contributions on this income.

**Other Information:**

1. During 2016, Martin spent \$12,300 on employment related meals and entertainment with clients of his employer. His employer reimbursed \$7,300 of these costs.
2. During 2016, Martin makes his regular annual contribution of \$2,000 to a registered charity, The Shepherds Of No Hope. (Martin is a very pessimistic individual.)
3. The family's 2016 medical expenses, all of which were paid by Martin, were as follows:

Martin and Brian	\$ 2,200
David	1,700
Devon	10,600
Derek	4,500

4. Martin buys monthly transit passes for David and Derek. The cost is \$85 per month per child. The passes covered 10 months during 2016.
5. During 2015, Martin received options to purchase 500 shares of his employer's stock at a price of \$45 per share. At the time the options were granted, the market price of the shares was \$50 per share. During July, 2016, when the shares are trading at \$70 per share, Martin exercises all of these options. He is still holding these shares on December 31, 2016.
6. As interest rates continue to be very favourable, Martin and Brian purchase a residence near the rented residence that they have lived in for the last 15 years. The cost of the new residence is \$480,000 and, to assist with the purchase, Martin's employer provides a \$280,000 interest free loan. The loan was granted on July 1, 2016 and will have to be repaid on July 1, 2021. Assume the prescribed rate is 1 percent throughout the year 2016.

*Comprehensive Tax Payable With Employment Income*

7. Martin is provided with an automobile by his employer. The automobile was purchased at a cost of \$45,200, including HST at 13 percent. During 2016, the automobile is driven 48,000 kilometers, of which 37,000 were employment related. The automobile was used by Martin for 11 months during 2016. He was required to return the automobile to his employer's garage during the month that he did not use it.
8. During 2016, Martin receives several gifts from his employer:
  - As is the case for all of the company's employees, Martin receives a \$250 gift certificate that can be used for merchandise at a local department store.
  - In recognition of his 10 years of service, Martin receives an engraved wrist watch. The retail value of this watch is \$800.
  - At Christmas, all of the company's employees receive a gift box of vintage wines. The retail value of these wines is \$400.

**Required:**

- A. Determine Martin's minimum Net Income For Tax Purposes for the 2016 taxation year.
- B. Determine Martin's minimum Taxable Income for the 2016 taxation year.
- C. Based on your answer in Part B, determine Martin's federal Tax Payable and amount owing (refund) for the 2016 taxation year.

**TIF PROBLEM FOUR - 13****Comprehensive Tax Payable With Employment Income**

Margarita Dalvi is a financial analyst employed by a large public company. Her 2016 salary is \$143,000, none of which is commission income. In addition, she was awarded an incentive bonus of \$34,500. Two-thirds of this bonus was paid during 2016, with the balance due in September, 2017.

Ms. Dalvi's employer withheld the following amounts from her earnings:

El Premiums	\$ 955
CPP Contributions	2,544
RPP Contributions	6,400
Federal Income Taxes	29,000
Contributions To United Way	4,000
Professional Association Dues	1,200

Ms. Dalvi is 55 years old and married to Jonathan Dalvi who has been legally blind since an automobile accident that occurred several years ago. Jonathan is 65 years old. He has 2016 income from OAS and Universal Child Care Benefits of \$7,200. The couple have three children:

**Martha** is 15 years old. She has 2016 income from various part time jobs of \$11,000.

**Mary** is 19 years old and has mental health problems that prevent her from working on a full time basis. She lives with her mother and father and has 2016 income from part time jobs of \$4,800.

**Mark** is 21 years old and attends university on a full time basis for 10 months of the year. His tuition fees are \$9,400. As he has no income of his own, he has agreed to transfer all of his education related credits to his mother.

The family's 2016 medical expenses, all of which were paid by Ms. Dalvi, were as follows:

Ms. Dalvi And Her Husband	\$ 6,200
Martha	1,800
Mary	11,300
Mark	2,500

**Other Information:**

- Ms. Dalvi buys monthly transit passes for Mark and Martha. The cost is \$75 per month per child. The passes covered 10 months during 2016.
- Ms. Dalvi is provided with an automobile by her employer. The automobile is leased at a rate of \$728 per month, including applicable HST. This payment also includes a payment of \$50 per month for insurance coverage. During 2016, the automobile is driven 57,000 kilometers, of which 42,000 were employment related. The automobile was used by Ms. Dalvi for 11 months during 2016. She was required to return the automobile to her employer's garage during the month that she did not use it.
- During 2016, Ms. Dalvi spent \$14,800 on employment related meals and entertainment with clients. Her employer reimbursed \$9,500 of these costs.
- Throughout their marriage, the Dalvi's have always lived in rented premises. Seeing the current level of mortgage rates as presenting an opportunity to acquire a residence, they purchase a 4 bedroom bungalow in the same neighbourhood for \$422,000 on July 1, 2016. On this date, her employer provides Ms. Dalvi with a \$250,000 loan that will facilitate this acquisition. The loan does not require any payment of interest. However, the balance must be paid on July 1, 2021. Assume that the prescribed rate is 1 percent throughout 2016.

*Comprehensive Tax Payable With Employment Income*

5. During 2016, Ms. Dalvi receives several gifts from her employer:
  - As is the case for all of her employer's senior staff, she receives a \$400 gift certificate that can be used for merchandise at a local clothing store.
  - In recognition of 10 years of continuous service, she receives an engraved wrist watch. The retail value of this watch is \$1,200.
  - At Christmas all of the employees of her employer receive a gift basket containing gourmet food items. The retail value of this basket is \$300.
6. Ms. Dalvi received options to purchase 1,200 shares of her employer's stock at a price of \$37 per share 2 years ago. At the time the options were granted, the market price of the shares was \$40 per share. During July, 2016, when the shares are trading at \$45 per share, Ms. Dalvi exercises all of these options. She is still holding these shares at the end of the year.
7. As Ms. Dalvi makes a regular annual contribution to the United Way, she does not qualify for the first-time donor's super tax credit.

**Required:**

- A. Determine Ms. Dalvi's minimum Net Income For Tax Purposes for the 2016 taxation year.
- B. Determine Ms. Dalvi's minimum Taxable Income for the 2016 taxation year.
- C. Based on your answer in Part B, determine Ms. Dalvi's federal Tax Payable and amount owing (refund) for the 2016 taxation year.

## **Chapter Five Test Item File Problems**

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### **TIF PROBLEM FIVE - 1** **CCA - Essay Questions**

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1. The calculation of amortization expense under generally accepted accounting principles and the determination of CCA to be deducted for tax purposes can be viewed as somewhat similar procedures. However, there are some differences that arise in the application of these procedures. Describe the similarities and differences between the procedures used to calculate amortization expense for accounting records and those procedures used to establish the amount of CCA to be deducted in tax returns.
2. For accounting purposes, assets are generally recorded at their acquisition cost. This amount would include the basic invoice cost, delivery and installation costs, and other expenditures required to make the asset available for use by the enterprise. Indicate some of the reasons why the capital cost of an asset for tax purposes may differ from the asset cost that will be recorded for accounting purposes.
3. For CCA purposes, most assets are allocated to a Class that contains all of the assets of that Class. However, in some cases individual assets have to be allocated to a separate Class, resulting in multiple balances for that Class. What are some examples of this type of situation?
4. Briefly explain why it is important to take care in allocating assets to the appropriate CCA class.
5. If the government wishes to increase or decrease the rate applicable to a particular type of asset, this can be accomplished using two different approaches. Describe these approaches, indicate which you think is preferable, and explain the reason for your preference.
6. Each passenger vehicles with a cost in excess of \$30,000 must be allocated to a separate Class 10.1. Other passenger vehicles are allocated to a single Class 10. Briefly describe the differences between the rules applicable to Class 10.1, and those applicable to Class 10.
7. Patents are normally allocated to Class 44 where they are subject to declining balance CCA calculations at a 25 percent rate. However, a taxpayer can elect to allocate these assets to Class 14, where they are subject to straight-line CCA over their legal life. Under what circumstances would this election be desirable?
8. Most depreciable assets are subject to the half-year rules. Describe three exceptions to these rules.
9. If a taxpayer has decided, in a particular taxation year, to deduct less than the maximum available CCA, he will need to decide from which classes the amount that will be deducted should be taken. How will he make this decision? Explain your conclusion.
10. When a depreciable asset is sold, there may be no immediate tax consequences related to the sale. Indicate the conditions that must be present for this situation to occur.
11. When there is a disposition of a depreciable asset, there may be recapture of CCA. Another possibility is that a terminal loss may arise. Indicate the conditions that will result in (1) recapture of CCA, and (2) a terminal loss.

12. When there is a disposition of a depreciable asset, there may be recapture of CCA. Another possibility is that a terminal loss may arise. How are these balances treated in the determination of Net Income For Tax Purposes and the UCC balance?
13. When a depreciable asset is sold or retired, the procedures used for tax purposes are usually very different than those used for accounting purposes. Describe the differences between the procedures used for tax purposes and those that would be required under generally accepted accounting principles for dispositions of depreciable assets.
14. When a taxpayer acquires a photocopier to be used in producing business income, he can either allocate its cost to his general Class 8 or, alternatively, elect to allocate it to a separate Class 8. What is the potential advantage of allocating the cost of a photocopier to a separate Class 8?
15. What is the definition of eligible capital property? Provide three examples of such property.
16. Describe the differences between the procedures used in determining the maximum deduction for the CEC amount and the procedures used in determining the maximum CCA deduction.
17. Describe the procedures to be used when there is a disposition of cumulative eligible capital. Assume that no election is made to give separate treatment to the item that is being sold.

**TIF PROBLEM FIVE - 2****CCA - True Or False**

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1. Capital cost allowance is analogous to the accounting term amortization and allocates the cost of the capital asset to current and subsequent taxation years.

True or False?

2. Undepreciated capital cost is decreased by government assistance received to acquire assets and increased by acquisitions of depreciable assets.

True or False?

3. Capital cost allowance for each class can be calculated using the declining balance method or the straight line method, as long as it is the same method used to calculate amortization for the financial statements.

True or False?

4. A corporation with a June 30 year end begins its operations on January 1 of the current year. It acquires \$50,000 of Class 8 assets on March 1. The maximum CCA for its fiscal year ending June 30 of the current year is \$5,000.

True or False?

5. If a patent is acquired near the end of its legal life, it will usually be a good idea to elect to include its cost in Class 14.

True or False?

6. The separate class election for photocopiers should be used only if the assets are retained and used for long periods of time.

True or False?

7. Recapture of CCA occurs when there is a negative balance in the class at the end of the year.

True or False?

8. Only one-half of a terminal loss can be deducted in the determination of a taxpayer's Net Income For Tax Purposes.

True or False?

9. Cumulative eligible capital is amortized at a maximum rate of 7 percent, calculated on a straight line basis.

True or False?

10. Goodwill is purchased for \$60,000 during the year. The maximum CEC amount that can be deducted for tax purposes for the year is \$1,575.

True or False?

## TIF PROBLEM FIVE - 3

### CCA - Multiple Choice

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#### New For 2016/2017

##### CCA Questions

1. Of the following pairs of terms, which pair represents terms that are analogous for accounting work and for tax work?
  - A. Capital Cost and Net Book Value.
  - B. Amortization and Capital Cost Allowance.
  - C. Undepreciated Capital Cost and Acquisition Cost.
  - D. Capital Cost and Amortization.
2. A business has Net Income For Tax Purposes before deducting CCA of \$15,000. It would like to reduce this total to nil after the deduction of CCA. It can take the required \$15,000 in CCA from four CCA classes, all of which have a balance of more than \$15,000. If the business wishes to maximize future CCA, the \$15,000 should be deducted from:
  - A. Class 44
  - B. Class 10
  - C. Class 53
  - D. Class 8
3. A business acquires a rental property several years ago for \$562,000, with \$112,000 of this amount being the estimated value of the land. At the beginning of the current year the UCC for the property is \$374,561. During the current year, the property is sold for \$843,000, with \$262,000 of this amount being allocated to the land. Which of the following statements is correct?
  - A. The business will have recapture of \$75,439 and a capital gain of \$131,000.
  - B. The business will have recapture of \$75,439 and a capital gain of \$281,000.
  - C. The business will have recapture of \$187,439.
  - D. The business will have a taxable capital gain of \$281,000.
4. Which of the following statements with respect to terminal losses is **NOT** correct?
  - A. If assets remain in a CCA Class, there will not be a terminal loss in that Class.
  - B. Terminal losses are deducted in full in the determination of Net Business Income.
  - C. Terminal losses are deducted from the ending UCC to leave a balance in the Class of nil.
  - D. A terminal loss occurs when there are no assets left in the Class and there is a negative balance in the Class at the end of the year.

##### CEC Questions

5. During 2015, Don Buchanan acquires a business that has goodwill. The amount of the purchase price that is allocated to goodwill is \$60,000. For 2015, Don takes the maximum CCA deduction. On January 1, 2016, the business is sold. It is estimated that \$82,000 of the sale price was for the goodwill. The resulting increase in Don's 2016 Net Income For Tax Purposes is:
  - A. \$18,867.
  - B. \$19,650.
  - C. \$14,150.
  - D. \$11,400.

6. Which of the following statements with respect to cumulative eligible capital is **NOT** correct?
- A. If a disposition creates a negative balance in the cumulative eligible capital account at the end of the year, 100 percent of the negative amount must be taken into income.
  - B. Appraisal costs associated with eligible capital property would be added to the cumulative eligible capital account.
  - C. The cumulative eligible capital deduction for the year is calculated as 7 percent of the ending balance in the cumulative eligible capital account.
  - D. If a business ceases to operate and there is a positive balance in the cumulative eligible capital account, it can be deducted in calculating net business income.

## Retained From Previous Years

### CCA Questions

**Questions 7 Through 16** The Nelson Company has a taxation year end of December 31. On January 1 of the current year, the UCC of Class 8 was \$80,000. The Nelson Company has a policy of always deducting maximum CCA. Each of the **independent** Parts of this question deal with transactions during the current year which involved Class 8 assets. Choose one of the following answers for each Part (individual answers can be used more than once).

A. \$4,000	I. \$43,200	Q. \$5,000 Recapture
B. \$10,000	J. \$52,000	R. \$10,000 Recapture
C. \$10,800	K. \$60,800	S. \$5,000 Terminal Loss
D. \$12,000	L. \$67,000	T. \$10,000 Terminal Loss
E. \$13,000	M. \$72,000	U. \$5,000 Allowable Capital Loss
F. \$18,000	N. \$76,000	V. \$10,000 Allowable Capital Loss
G. \$19,000	O. \$91,000	W. \$5,000 Taxable Capital Gain
H. \$20,000	P. \$98,000	X. \$10,000 Taxable Capital Gain

7. An additional class 8 asset was purchased for \$20,000 on April 1. Maximum CCA for Class 8 is:
8. An asset with a capital cost of \$15,000 was sold for \$4,000 on June 30. Minimum UCC on January 1 of the following year is:
9. An asset with a capital cost of \$15,000 was sold for \$26,000 on September 1. Maximum CCA for Class 8 is:
10. An asset with a capital cost of \$15,000 was sold for \$26,000 on September 1. Minimum UCC on January 1 of the following year is:
11. An asset with a capital cost of \$100,000 was sold on June 30 for \$90,000. Also during the year, an asset was purchased for \$60,000. Maximum CCA for Class 8 is:
12. The last asset in the class, with a capital cost of \$85,000, was sold on July 15 for \$90,000. This would give rise to:
13. The last asset in the class, with a capital cost of \$85,000, was sold on August 1 for \$70,000. This would give rise to:
14. An asset with a capital cost of \$40,000 was sold for \$50,000 on September 1. This would give rise to:

15. An asset with a capital cost of \$70,000 was sold on October 1 for \$90,000. An asset was purchased on November 1 for \$100,000. Maximum CCA for Class 8 is:
16. An asset with a capital cost of \$70,000 was sold on May 1 for \$90,000. An asset was purchased on May 15 for \$100,000. Minimum UCC on January 1 of the following year is:
17. The capital cost of an asset includes a number of costs. Indicate which cost would **NOT** be considered part of the capital cost.
- A. Legal fees incurred to acquire the asset.
  - B. Duties paid on the asset.
  - C. Fire and theft insurance paid on the asset.
  - D. Non-refundable provincial sales taxes paid on the asset.
  - E. An appropriate allocation of overhead.
18. A business has \$5,000 in Taxable Income before CCA in the current year. The management anticipates a high income for the subsequent year. The maximum CCA deductible for the year in Class 8 is \$5,000 and the maximum CCA deductible for the year in Class 12 is \$5,000. To minimize the subsequent year's taxes, the business should:
- A. Claim maximum CCA on Class 8 only.
  - B. Claim maximum CCA on Class 12 only.
  - C. Claim maximum CCA on Class 8 and Class 12.
  - D. Claim no CCA for the year.
  - E. Claim \$2,500 CCA on Class 8 and \$2,500 CCA on Class 12.
19. During the current year, Denos Corporation incurred costs of \$45,000 for leasehold improvements to its newly rented building. The lease was signed in the current year for an initial term of three years plus four successive options to renew the lease, each for an additional one year term. Which one of the following amounts represents the **maximum** capital cost allowance claim in the current year?
- A. \$ 4,500.
  - B. \$ 5,625.
  - C. \$ 9,000.
  - D. \$11,250.
20. On December 1 of the current year, Plen Limited purchased a franchise for \$70,000. The franchise has a limited life of 15 years. Which one of the following amounts represents the **maximum** amount of capital cost allowance Plen Limited can deduct for its current year ending on December 31?
- A. \$ 198.
  - B. \$ 396.
  - C. \$1,837.
  - D. \$3,675.
21. In the current fiscal year, a corporation acquired a rental property from its sole shareholder. The building was transferred at its fair market value of \$125,000, but was not allocated to a separate Class 1. The shareholder originally paid \$150,000 for it. The property was included in Class 1 (4%) on the shareholder's tax return. The shareholder has earned rental income on the property since its acquisition. The undepreciated capital cost of the building at the time of the transfer was \$120,000.
- Which one of the following amounts represents the **maximum** allowable capital cost allowance that the corporation may claim for this building in the current fiscal year?
- A. \$2,400.
  - B. \$2,500.
  - C. \$4,800.
  - D. \$5,000.

22. ABC Enterprises began operations on September 1 of the current year. It has chosen December 31 as its year end. On October 1 of the current year, the proprietorship purchased furniture and fixtures for \$40,000. The maximum capital cost allowance on the furniture and fixtures for the current year ending December 31 will be:
- A. \$1,088.22.
  - B. \$1,336.99.
  - C. \$4,000.00.
  - D. \$8,000.00.
23. Robert bought a rental property ten years ago for \$320,000, with \$80,000 of the purchase price allocated to the land. Over the ten years, he claimed CCA such that his UCC at the beginning of this year for the building was \$196,000. Robert sold the property this year for \$520,000, with \$180,000 of the sale price allocated to the land. Which of the following statements is correct?
- A. Robert has recapture of \$44,000.
  - B. Robert has recapture of \$124,000.
  - C. Robert has recapture of \$144,000.
  - D. Robert has a capital gain of \$100,000.
24. Sherry owned a rental property. She originally acquired the property for \$260,000 with \$200,000 of the cost attributed to the building. Over the years, Sherry has claimed CCA of \$32,000, such that her UCC at the beginning of the year was \$168,000. The rental property is the only asset in the class. This year, she sold the property for \$214,000, with \$160,000 of the sale price attributed to the building. Which of the following statements is correct?
- A. Sherry has a terminal loss of \$8,000.
  - B. Sherry has a capital loss of \$36,000.
  - C. Sherry has an allowable capital loss of \$4,000.
  - D. Sherry has recapture of \$32,000.
25. Dresses R Us moved into their new rented premises on January 1, 2015. The term of the lease is 10 years. \$8,000 of leasehold improvements were done during January 2015 with further leasehold improvements of \$4,500 completed during January 2016. The maximum amount of CCA for 2016 is:
- A. \$1,025
  - B. \$1,050
  - C. \$1,250
  - D. \$1,300
26. Fried's Factory Inc. purchased Class 29 assets for \$20,000 on November 1, 2014. The company's fiscal year end is December 31. The maximum CCA deduction for 2014, 2015 and 2016 will be:
- A. \$1,671 for 2014; \$18,329 for 2015; \$0 for 2016.
  - B. \$1,671 for 2014; \$10,000 for 2015; \$8,329 for 2016.
  - C. \$5,000 for 2014; \$10,000 for 2015; \$5,000 for 2016.
  - D. \$10,000 for 2014; \$10,000 for 2015; \$0 for 2016.
27. Curt's Consulting Company purchased a laptop computer on February 15, 2016 for \$2,000. The laptop was destroyed in a fire on April 30, 2016 and Curt's Consulting received \$500 in compensation from the insurance company. It was the only asset in the CCA Class as all computer equipment has been leased for the last two years. The effect on Net Income For Tax Purposes for the year ending December 31, 2016 is:
- A. \$550 decrease.
  - B. \$412.50 decrease.
  - C. \$2,000 decrease.
  - D. \$1,500 decrease.

28. On September 1, 2016 Carla's Company purchased a new computer for \$1,600 and desk-top publishing software for \$400. The maximum CCA deduction for 2016 is:
- A. \$550
  - B. \$640
  - C. \$1,000
  - D. \$1,800
29. During 2016 Desiderata Design Corp. purchased a new BMW for \$42,000. The car is used exclusively for business use. The maximum CCA deduction for 2016 is:
- A. \$4,500
  - B. \$6,300
  - C. \$9,000
  - D. \$12,600
30. Several years ago, Solea Company purchased a Mercedes Benz that is used exclusively for business use. The car is in a separate Class 10.1. On January 1, 2016 the UCC balance is \$17,850. On August 1, 2016 the car was sold for \$17,000. For 2016 tax purposes, the company will report a:
- A. Terminal loss of \$850
  - B. Recapture of \$850
  - C. CCA deduction of \$2,678
  - D. CCA deduction of \$2,245
31. On January 1, 2016 Jorge purchased two newly constructed rental buildings for \$350,000 each. Of the total cost of \$350,000 for each building, \$100,000 represents the value of the land on which the building is situated. One building contains four suites and is rented to students. The other building is rented to a florist business. Each of the buildings is allocated to a separate Class 1. Net rental revenue (before CCA) for 2016 is \$30,000. The maximum CCA deduction for 2016 is:
- A. \$10,000
  - B. \$12,500
  - C. \$15,000
  - D. \$20,000
32. CCC Construction Company purchased three new tools during 2016 as follows:
- |           |       |
|-----------|-------|
| January 1 | \$600 |
| March 15  | \$350 |
| April 30  | \$470 |
- The maximum CCA deduction for 2016 is:
- A. \$142
  - B. \$470
  - C. \$710
  - D. \$880
33. Amazine Inc. purchased Class 8 furniture for \$4,000 in 2014. In 2016, this furniture was sold for proceeds of \$1,000. The UCC balance in Class 8 was \$10,300 at the beginning of 2016 and no Class 8 assets were purchased during the year. What is the UCC of this class at the end of 2016?
- A. \$1,860
  - B. \$7,440
  - C. \$9,300
  - D. \$8,240

34. Which of the following statements regarding recapture is correct?
- A. Recapture occurs when there is a negative UCC balance in a class, even if there are assets remaining in the class.
  - B. Recapture is deductible in the calculation of business income.
  - C. Recapture occurs when there is a positive UCC balance in a class and there are no assets in the class.
  - D. Recapture occurs when there is a positive UCC balance in a class, even if there are assets remaining in the class.
35. Which of the following assets is **NOT** eligible for capital cost allowance in the current year?
- A. A delivery truck is purchased in December of the current year. The truck is not paid for until January of the following year.
  - B. An employee owns and uses a truck for employment duties during December. His pay for December is not received until January of the following year.
  - C. A delivery truck is leased during the year on a 3 year lease.
  - D. A delivery truck is purchased during the year on a 3 year financing term.
36. On September 1, 2016, Lerner Ltd, purchased a franchise for \$75,000. The franchise has a limited life of 10 years. Lerner Ltd. has a September 30 year end. The maximum tax deduction related to the franchise for the year ending September 30, 2016 is:
- A. \$616
  - B. \$3,750
  - C. \$3,938
  - D. \$7,500
37. Wolfe Ltd. has a December 31 year end. It purchased a Class 10.1 automobile four years ago for \$38,000. On January 1, 2016, the undepreciated capital cost for this Class 10.1 was \$12,900. During 2016, it was sold for \$10,000. What is the effect on Net Income For Tax Purposes of this sale?
- A. No effect
  - B. Terminal loss of \$2,900.
  - C. Capital loss of \$2,900.
  - D. CCA deduction of \$1,935.
38. Nestor Nerd paid \$4,000 to purchase various computer applications software for his sole proprietorship, Nerd01 on April 1 of the current year. Nerd01 has a December 31 year end and has been operating for 3 years. What is the maximum tax deduction that Nerd01 can claim on the software for the current year?
- A. \$1,100
  - B. \$1,500
  - C. \$2,000
  - D. \$4,000

**CEC Questions**

39. Fred opened his MacDingle Restaurant franchise on November 1, 2016. He paid \$50,000 for the franchise rights and can use them for an unlimited number of years. The restaurant's fiscal year end is December 31. The maximum CEC deduction was taken for 2016. The CEC balance on January 1, 2017 is:
- A. \$34,875
  - B. \$37,061
  - C. \$47,375
  - D. \$49,561

40. On January 1, 2015 Forest Corp. purchased a patent for \$20,000. The patent has an unlimited life and it is the only eligible capital expenditure. The maximum CEC deduction was taken for 2015. On January 1, 2016 the patent is sold for \$22,000. The ITA14(1.01) election to treat the disposition separately is not taken. The resulting increase in 2016 taxable income is:
- A. \$1,000
  - B. \$1,275
  - C. \$2,050
  - D. \$2,550
41. Fish Magazine bought a customer list during 2014 for \$10,000. This was their only eligible capital expenditure. On January 1, 2016 the CEC balance was \$6,487. On June 30, 2016 Fish Magazine sold the customer list for \$6,000. Their maximum CEC deduction for 2016 is:
- A. \$34
  - B. \$139
  - C. \$487
  - D. \$0. There is no CEC deduction because there are no assets left.
42. Indicate which of the following could not be an eligible capital expenditure.
- A. Cost of fines and penalties.
  - B. Cost of government rights with an unlimited life.
  - C. Appraisal costs associated with capital costs.
  - D. Costs of incorporating a new company.
  - E. Cost of customer lists.
43. Lerner Ltd. purchased an unlimited life franchise at a cost of \$200,000 during the current year. The maximum tax deduction related to the franchise for the current year is:
- A. \$5,250
  - B. \$20,000
  - C. \$10,500
  - D. \$14,000

## TIF PROBLEM FIVE - 4

### CCA - Exam Exercises

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#### *Exam Exercise Subject Listing For Chapter 5*

Number	Subject
1	Segregation Into Classes
2	CCA Error
3	CCA Error
4	Class 13 And Half-Year Rule
5	Class 10 And Half-Year Rule
6	Class 8 And Half-Year Rule
7	Class 14 - No Half-Year Rule
8	Short Fiscal Periods
9	Short Fiscal Periods
10	CCA And Tax Planning
11	CCA And Tax Planning
12	Capital Gains On Depreciable Assets
13	Recapture Of CCA
14	Recapture Of CCA
15	Terminal Loss
16	Terminal Loss
17	Separate Class Election
18	Separate Class Election
19	CEC With Disposition
20	CEC With Disposition
21	Cumulative Eligible Capital Election

**Exam Exercise Five - 1 (Segregation Into Classes)**

For each of the following depreciable assets, indicate the appropriate CCA Class.

- Cash registers
- Boats, canoes, and other vessels
- Airplane runways
- Automobile (i.e., passenger vehicle) with a cost of \$85,000
- Power operated moveable equipment
- Storage tanks for oil
- Residential rental property acquired in 2011 for \$450,000 (Value of land equals \$100,000)
- Manufacturing and processing equipment acquired in 2016

**Exam Exercise Five - 2 (CCA Error)**

During 2016, your company acquired a depreciable asset for \$437,000 and your accountant included this asset in Class 1 at the end of the year (it was not allocated to a separate Class 1). Early in 2017, you discover that the asset should have been allocated to Class 8. What was the impact of this error on your 2016 deductions from business income?

**Exam Exercise Five - 3 (CCA/CEC Error)**

During 2016, the Lardly Company spent \$675,000 to acquire a government license with an unlimited life. The Company's accountant, because of his limited experience with assets of this type, allocated this cost to Class 8. This error was discovered in early 2017. What is the impact of this error on the Company's 2016 deductions from business income?

**Exam Exercise Five - 4 (Class 13 And Half-Year Rule)**

Vador Inc. has a December 31 year end. The Company leases its office space under a lease that was signed on January 1, 2010. The lease term is eight years, with an option to renew at an increased rent for an additional two years. In 2010, the Company spends \$112,000 renovating the premises. In 2016, changing needs require the Company to spend \$41,000 renovating the space. Determine the maximum amount of Class 13 CCA that the Company can deduct for 2016.

**Exam Exercise Five - 5 (Class 10 And Half-Year Rule)**

Lambda Ventures, an unincorporated business with a December 31 year end, has a Class 10 UCC balance on January 1, 2016 of \$453,000. During 2016, it acquires additional Class 10 assets at a cost of \$63,200. Also during 2016, it deducts \$36,700 from the Class 10 UCC for dispositions. Determine the maximum Class 10 CCA for 2016 and the January 1, 2017 UCC balance.

**Exam Exercise Five - 6 (Class 8 And Half-Year Rule)**

Baron Ltd., a Company with a December 31 year end, has a Class 8 UCC balance on January 1, 2016 of \$128,500. During 2016, it acquires additional Class 8 assets at a cost of \$12,400. Also during 2016, the Company sells assets with a capital cost of \$9,600 for proceeds of \$10,200. Determine the maximum Class 8 CCA for 2016 and the January 1, 2017 UCC balance.

**Exam Exercise Five - 7 (Class 14 - No Half Year Rule)**

Baril Ltd. has a December 31 year end. On December 1, 2016, the Company pays \$286,000 to enter into a franchise agreement. The contract is for a period of 5 years. Determine the maximum CCA for 2016, as well as the January 1, 2017 UCC balance.

**Exam Exercise Five - 8 (Short Fiscal Periods)**

Fielding Inc. is incorporated on August 1, 2016. On September 15, 2016, the Company acquires \$150,000 in Class 10 assets. The Company has a December 31 year end and no other depreciable assets are acquired before December 31, 2016. Determine the maximum CCA for the year ending December 31, 2016.

**Exam Exercise Five - 9 (Short Fiscal Periods)**

Murray's Antiques is an unincorporated business which begins operations on May 1, 2016 and rents a store on that day. On June 1, 2016, Murray acquired Class 8 assets for \$92,400. The business will have a taxation year which ends on December 31. No other depreciable assets are acquired prior to December 31, 2016. Determine the maximum CCA for the year ending December 31, 2016.

**Exam Exercise Five - 10 (CCA And Tax Planning)**

Pointer Ltd. has determined that, for the current year, it has Taxable Income before the deduction of CCA of \$40,000. It is the policy of the Company to limit CCA deductions to an amount that would reduce Taxable Income to nil. At the end of the year, before the deduction of CCA, the following UCC balances are present:

Class 1 (Buildings Acquired In 2005)	\$475,000
Class 8	95,000
Class 10	102,000
Class 10.1	26,000

There have been no additions to or dispositions from these classes during the year. Which class(es) should be charged for the \$40,000 of CCA that will be required to reduce Taxable Income to nil? Explain your conclusion.

**Exam Exercise Five - 11 (CCA And Tax Planning)**

Sharma Inc. has determined that, for the current year, it has Taxable Income before the deduction of CCA of \$14,000. At the end of the year, before the deduction of CCA, the following UCC balances are present:

Class 1 (Buildings Acquired In 2006)	\$213,000
Class 8	16,000
Class 10	42,000

There have been no additions to or dispositions from these classes during the year.

It is the policy of the Company to limit CCA deductions to an amount that would reduce Taxable Income to nil. Given this policy, which class(es) should be charged for the \$14,000 of CCA that will be required to reduce Taxable Income to nil? Explain your conclusion.

**Exam Exercise Five - 12 (Capital Gains On Depreciable Assets)**

Barber Ltd. has a Class 10 balance of \$423,000. During the current year, an asset which cost \$42,000 is sold for \$51,000. There are no other dispositions during the year and there are over 50 assets left in Class 10. What are the tax consequences of this disposition?

**Exam Exercise Five - 13 (Recapture)**

At the beginning of 2016, Marquee Inc. has two assets in Class 10. The balance in this class is \$7,423. The cost of each asset in the class was \$7,500. On June 30, 2016, one of the assets is sold for \$7,950. There are no other additions or dispositions prior to the Company's December 31, 2016 year end. What is the effect of the disposition on the Company's 2016 net business income? In addition, determine the January 1, 2017 UCC balance.

**Exam Exercise Five - 14 (Recapture)**

On January 1, 2016, Bard Ltd. has a balance in its Class 8 of \$32,400. The only transaction involving Class 8 assets during 2016 was a disposition on July 12 of a group of Class 8 assets that had cost \$62,300. The proceeds of disposition for these assets was \$41,800. The Company's taxation year ends on December 31. What is the effect of the disposition on the Company's 2016 net business income? In addition, determine the January 1, 2017 UCC balance.

**Exam Exercise Five - 15 (Terminal Loss)**

At the beginning of 2016, Quest Inc. has two assets in Class 29. The cost of each asset was \$72,000 and the Class 29 UCC balance was \$56,472. On June 30, 2016, both of these assets are sold for a total of \$41,500. What is the effect of the disposition on the Company's 2016 net business income? In addition, determine the January 1, 2017 UCC balance.

**Exam Exercise Five - 16 (Terminal Loss)**

Farine Ltd. has a taxation year which ends on December 31. On January 1, 2016, the Company had 10 assets in Class 10. The January 1, 2016 balance in this Class was \$83,400. The capital cost of these 10 assets was \$110,000. Subsequent transactions during the year are as follows:

- On May 1, 2016, all of the original Class 10 assets are sold for \$92,400.
- On June 1, 2016, 10 new assets are acquired at a cost of \$105,000.
- On December 1, 2016, the 10 new assets are sold for \$65,000.

On December 31, 2016, no assets remain in Class 10. What is the effect of these transactions on the Company's 2016 net business income? In addition, determine the January 1, 2017 UCC balance.

**Exam Exercise Five - 17 (Separate Class Election)**

Multilink Inc. has a December 31 year end. In January, 2016, Multilink Inc. acquires 5 photocopiers at a cost of \$5,500 each. In December, 2016, two of these photocopiers are upgraded for newer models. The new photocopiers cost \$6,000 each, and the Company receives an upgrade allowance for each old photocopier of \$2,000. Indicate the amount(s) that would be deducted from 2016 business income if no election is made to put each photocopier in a separate class. Contrast this with the deduction(s) that would be available if the separate class election is used.

**Exam Exercise Five - 18 (Separate Class Election)**

Garick Ltd. has a December 31 year end. In February 2016, the Company acquires 3 photocopiers at a cost of \$23,000 each. Because of their extremely heavy usage, they must be replaced in November, 2016. They are replaced with three new photocopiers at a cost of \$21,500 each. The Company received a trade in allowance of \$2,500 for each of the replaced machines. Indicate the amount(s) that would be deducted from 2016 business income if no election is made to put each photocopier in a separate class. Contrast this with the deduction(s) that would be available if the separate class election is used.

**Exam Exercise Five - 19 (CEC With Disposition)**

During 2014, Korngold Inc. purchases another business and pays \$123,000 for its goodwill. Prior to this acquisition, the cumulative eligible capital balance of Korngold Inc. is nil. There are no additions to this balance in 2015 or 2016. On December 1, 2016, the business acquired in 2014 was sold, and the sale price included a payment for goodwill of \$118,200. Korngold Inc. takes the maximum deduction for cumulative eligible capital in both 2014 and 2015. What amount, if any, will be included in the Company's 2016 income as a result of this sale?

**Exam Exercise Five - 20 (CEC With Disposition)**

Exxor Ltd. has a December 31 year end. On December 1, 2014, it acquired an unlimited life franchise at a cost of \$48,000. The balance in the Company's cumulative eligible capital account on January 1, 2014 was nil. There were no additions to the Company's cumulative eligible capital account during either 2015 or 2016. On May 1, 2016, the unlimited life franchise that was acquired in 2014 is sold for \$84,000. It is the policy of the Company to take the maximum deduction for cumulative eligible capital in each year. What amount, if any, will be included in the Company's 2016 income as a result of this sale?

**Exam Exercise Five - 21 (CEC Election)**

On January 1, 2015, Elector Inc. has no CEC balance. During the taxation year ending December 31, 2015, the Company makes the following eligible capital expenditures:

Cost Of Reorganization	\$146,000
Goodwill	297,000
Unlimited Life Franchise	86,000
Total	\$529,000

During the 2015 taxation year, the Company deducts maximum CEC. In July, 2016, the unlimited life franchise is sold for \$124,000. Compare the tax consequences associated with the sale of the franchise:

- Assuming an election is made under ITA 14(1.01) to treat the disposition of the unlimited life franchise separately.
- Assuming no election is made.

## **TIF PROBLEM FIVE - 5A**

### **CCA - Key Term Matching (Easy)**

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**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms were listed at the end of Chapter 5, “Capital Cost Allowances And Cumulative Eligible Capital”.

- A. Terminal Loss
- B. Cumulative Eligible Capital
- C. Depreciable Capital Property
- D. Half-Year Rules
- E. Non-Depreciable Capital Property
- F. Recapture Of CCA
- G. Separate Class Rules
- H. Undepreciated Capital Cost

The following list contains ten potential definitions for the preceding key terms.

1. An inclusion in business and property income that arises when deductions from a CCA class, engendered by disposals, leave a negative balance in that class at the end of the taxation year.
2. Rules that require certain types of assets that would, in the absence of these special rules, be included in a single Class, be allocated to a separate balance for that Class.
3. A deduction in the calculation of business and property income which arises when the last asset in a CCA Class is retired and a positive balance is left in the Class.
4. The amortized balance of eligible capital expenditures.
5. A group of rules which require, for most CCA Classes, the subtraction of one-half of the year's net additions from the Class, prior to calculating the CCA for the year.
6. An amount expended to acquire an intangible asset that is not eligible for either write-off through CCA deductions or as a deduction in the period in which it is incurred.
7. Capital property that is not subject to depreciation or amortization.
8. The capital cost of a depreciable asset class, less the cumulative CCA that has been taken to date.
9. Capital property that is subject to depreciation or amortization.
10. A deduction in the determination of business or property income based on the capital cost of capital assets.
11. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 10) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (11). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

## **TIF PROBLEM FIVE - 5B**

### **CCA - Key Term Matching (Moderate)**

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**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms were listed at the end of Chapter 5, “Capital Cost Allowances And Cumulative Eligible Capital”.

- A. Terminal Loss
- B. Cumulative Eligible Capital
- C. Depreciable Capital Property
- D. Half-Year Rules
- E. Non-Depreciable Capital Property
- F. Recapture Of CCA
- G. Separate Class Rules
- H. Undepreciated Capital Cost

The following list contains 14 potential definitions for the preceding key terms.

1. An inclusion in business and property income that arises when deductions from a CCA class, engendered by disposals, leave a negative balance in that class at the end of the taxation year.
2. The unamortized balance of total eligible capital expenditures.
3. Rules that require certain types of assets that would, in the absence of these special rules, be included in a single Class, be allocated to a separate balance for that Class.
4. A deduction in the calculation of business and property income which arises when the last asset in a CCA Class is retired and a positive balance is left in the Class.
5. The capital cost of a depreciable asset class, less the CCA that has been taken for the current year.
6. The amortized balance of eligible capital expenditures.
7. A group of rules which require, for most CCA Classes, the subtraction of one-half of the year's net additions from the Class, prior to calculating the CCA for the year.
8. An amount expended to acquire an intangible asset that is not eligible for either write-off through CCA deductions or as a deduction in the period in which it is incurred.
9. An addition in the calculation of business and property income which arises when the last asset in a CCA class is retired and a positive balance is left in the class.
10. Capital property that is not subject to depreciation or amortization.
11. The capital cost of a depreciable asset class, less the cumulative CCA that has been taken to date.
12. Capital property that is subject to depreciation or amortization.

13. An inclusion in business and property income that arises when a depreciable asset is sold for proceeds that exceed the balance in its UCC class.
14. A deduction in the determination of business or property income based on the capital cost of capital assets.
15. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 14) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (15). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

## **TIF PROBLEM FIVE - 6**

### **CCA Calculations Over 4 Years**

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After several years of hard work at the Shawarma Palace Lebanese restaurant, the Haddad brothers decide to start Shawarma On Wheels, a business that will have quick delivery of freshly made Lebanese food. This partnership begins operations on September 1, 2013 and will have a taxation year that ends on December 31. The brothers plan to take maximum CCA in every year.

On September 12, 2013 the business acquires 20 small cars that will be used for deliveries. These vehicles have an individual cost of \$21,500 each. They run a very successful advertising campaign using online coupons and social media that is directed at downtown condo owners.

During the 2014 taxation year, 6 additional cars are acquired at a cost of \$22,800 each. These new vehicles replace 6 of the original cars which are sold for proceeds of \$11,400 each. Shawarma On Wheels accounts for each car sale on an asset by asset basis for tax purposes.

During the 2015 taxation year, 18 additional cars are acquired at a cost of \$24,300 each. Also during this year, the remaining 14 cars from the 2013 purchase are sold. As all the cars had high mileage, the total proceeds from this sale are \$137,200.

In talking to their drivers, the Haddad brothers are repeatedly told that delivering high quality Lebanese food is a great way to meet attractive young women. As a result, the brothers decide to start doing some deliveries themselves. In order to try to improve their success in this area, they acquire two BMW 6 series convertibles at a cost of \$135,000 each. These are to be used exclusively for making deliveries to female callers who are offered a discount if they come down to the lobby to pick up their orders, thus seeing the impressive cars.

Early in 2016, the authorities discover that, in addition to delivering Lebanese food, the brothers have also been providing their clients with a variety of illegal substances. In addition to having to pay hefty fines, they are each sentenced to 3 years in prison. Given this, Shawarma On Wheels is closed down on September 30, 2016. The 24 remaining regular delivery cars are sold for \$8,300 each. The two BMW convertibles are sold for \$85,000 each.

**Required:** For each of the taxation years 2013 through 2016, calculate the maximum available CCA deduction. In addition, determine the amount of any capital gain, recapture, or terminal loss that arises on any of the transactions that occurred during these years. Ignore GST/HST/PST considerations.

## **TIF PROBLEM FIVE - 7**

### **CCA Calculations Over 3 Years**

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All Night Service Ltd. was incorporated on April 1, 2014 to supply computer service 24 hours per day. At the time of incorporation, the Company establishes December 31 as its year end for both tax and accounting purposes.

On April 1, 2014, the Company acquired a new building to be used as an office and communications centre at a cost of \$250,000. This total cost is allocated \$180,000 to the building and \$70,000 to the land. As the building is being used 100 percent for non-residential purposes, it is allocated to a separate Class 1. Also on this date, the Company purchased six cars to be used by the service technicians at a cost of \$25,000 per vehicle.

On May 1, 2014, the Company purchased a variety of computer repair and maintenance equipment at a cost of \$48,000. The Company owns no computers as it leases all of its computer hardware and software.

During 2015, the Company trades in three of its old cars on three new minivans. The list price of the new minivans is \$24,000 per vehicle, and the Company receives a trade-in allowance towards this list price of \$14,000 per old vehicle.

On September 20, 2016, a convertible is acquired at a cost of \$98,000 for use by the president of the Company. In addition, several unusual events occur during 2016. They are as follows:

- Equipment that had a value of \$12,000 was stolen by one of the service technicians.
- One of the original six cars was involved in a severe accident, resulting in repair costs of \$8,270. Because the Company's insurance has a deductibility clause, the insurance proceeds covered only \$7,770 of these repair costs.
- Because he had never received a speeding ticket (despite numerous violations) while driving the car allocated to him, a departing service technician offers the Company \$27,000 for one of its original six cars. The Company accepts the offer.

#### **Required:**

- A. Determine the maximum CCA that can be taken in each of the years 2014 through 2016. In your calculations, include and identify the January 1, 2015, January 1, 2016, and January 1, 2017 UCC balances. Ignore GST/HST/PST considerations.
- B. Explain the tax effects of the unusual events that occurred during 2016.

## **TIF PROBLEM FIVE - 8**

### **CCA Calculations Over 3 Years**

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Ken's Kouriers is an unincorporated business which provides courier services within the city of Halifax. It has a taxation year that ends on December 31 and plans to deduct the maximum CCA each year.

Ken's Kouriers began operating on May 1, 2014 by acquiring a new building at a total cost of \$326,000. Of this total, \$53,000 is allocated to the land on which the building is situated. As it will be used 100 percent for non-residential purposes other than manufacturing, it is allocated to a separate Class 1.

Furnishings for the building are acquired on June 1, 2014 at a cost of \$85,000.

Also on June 1, 2014, the business acquires 12 vehicles to be used by its couriers. The cost of these vehicles is \$23,000 each for a total of \$276,000.

During 2015, the business trades in 5 of its old vehicles for more fuel efficient vehicles. The replacement vehicles cost \$27,000 per vehicle. The company receives a trade-in allowance of \$16,000 for each old vehicle. Also during 2015, the Company acquires a luxury vehicle to be used by Ken, the owner of the business. The cost of this vehicle is \$103,000.

During 2016, Ken and five of his drivers are charged with smuggling counterfeit goods. Ken's Kouriers is closed down on December 31, 2016 and, before closing, Ken sells the assets as follows:

- The building is sold for \$342,000, with \$53,000 of this amount being attributed to the land.
- The remaining 7 vehicles that were purchased in 2014 are sold for \$73,000. The 5 vehicles that were acquired in 2015 are sold for \$62,500. The amount received for each vehicle was less than its capital cost.
- The furniture is sold for \$12,300.
- The luxury vehicle is sold for \$63,800.

**Required:** Determine the maximum CCA that can be taken in each of the years 2014 through 2016. In your calculations, include and identify the UCC balances for January 1, 2015, January 1, 2016, and January 1, 2017.

In addition, indicate any tax effects resulting from the 2015 and 2016 dispositions. Ignore GST/HST/PST considerations.

## TIF PROBLEM FIVE - 9

### CCA Calculations

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The following information relates to the Fortin Aluminum's depreciable assets.

**Class 1** During 2016, a new office building was acquired at a total cost of \$623,000. Of this total, it is estimated that the value of the land is \$145,000. The building will be used 100 percent for non-residential activities, none of which involve manufacturing. It will be allocated to a separate Class 1.

**Class 3** The January 1, 2016 balance in this Class was \$798,000. During 2016, one of the warehouses in this Class burned to the ground. It had a capital cost of \$150,000. Insurance proceeds totaled \$185,000.

**Class 8** The January 1, 2016 balance in this Class was \$346,000. During 2016, the Company acquired Class 8 assets at a cost of \$105,000. Class 8 assets with a capital cost of \$83,000 were sold for proceeds of \$75,000. None of the individual assets sold had proceeds that exceeded their individual capital cost.

**Class 10** The January 1, 2016 balance in this Class was \$150,000. During 2016, 3 passenger vehicles were acquired at a cost of \$25,000 each. In addition, a delivery van with a capital cost of \$42,000 was sold for \$18,000.

**Class 10.1** The January 1, 2016 balance in this Class was \$17,850. The only asset in this Class was the CEO's \$350,000 Bentley. At the instructions of the Company's directors, who felt this vehicle was excessively extravagant, the car was sold for \$275,000 during 2016.

**Class 13** The January 1, 2016 balance in this Class was \$42,500, reflecting improvements that were made in 2014, the year in which the lease commenced. These improvements were made on a property leased as office space for the Company's executives. The basic lease term is for 8 years, with an option to renew for a period of 2 years. Additional improvements, costing \$40,000, were made during 2016.

**Class 29** The January 1, 2016 balance in this Class was \$63,000. The capital cost of the assets in this Class was \$252,000. As the Company has found its manufacturing operations to be unprofitable, all of these assets were sold during 2016. The proceeds totaled \$51,000. None of the individual assets sold had proceeds that exceeded their individual capital cost.

**Class 50** The January 1, 2016 balance in this Class was \$23,000. During 2016, there were additions to this Class with a capital cost of \$18,000.

Fortin Aluminum always takes maximum CCA on each Class of depreciable assets.

**Required:** Calculate the maximum CCA that can be taken by Fortin Aluminum on each class of assets for the year ending December 31, 2016 and calculate the UCC for each class of assets on January 1, 2017. In addition, determine the amount of any capital gain, recapture, or terminal loss that arises. Ignore GST/HST/PST considerations.

## **TIF PROBLEM FIVE - 10**

### **CCA, CEC And Tax Planning**

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For the taxation year ending December 31, 2016, Kreton Inc. has determined that its Net Income For Tax Purposes, before any deductions for CCA or CEC, amounts to \$51,000. As the Company does not have any Division C deductions, Taxable Income, before any deductions for CCA or CEC, would also amount to \$51,000.

On January 1, 2016, the Company has the following UCC and CEC balances:

Class 8	\$220,000
Class 10	152,000
Class 12	56,000
Class 13	272,000
CEC	210,000

During 2016, the cost of additions to Class 8 amount to \$42,000, while the proceeds from dispositions in this class totaled \$16,000. In no case did the proceeds of disposition exceed the capital cost of the assets retired, and there were still assets in the class as of December 31, 2016.

All of the Class 12 assets were acquired in 2015.

The leasehold improvements were made in 2014 at a cost of \$320,000.

There were no 2016 acquisitions or dispositions in Classes 10, 12, or 13. There were no eligible capital expenditures acquired during 2016 and no dispositions of cumulative eligible capital.

In previous years, the Company has always deducted the maximum amount of CCA and CEC.

**Required:**

- A. Calculate the maximum CCA and CEC write-off that could be taken by Kreton Inc. for the taxation year ending December 31, 2016.
- B. As Kreton's tax advisor, indicate how much CCA and CEC you would advise them to take for the 2016 taxation year and the specific classes from which it should be deducted. Provide a brief explanation of the reason for your recommendation. In providing this advice, do not take into consideration the possibility that losses can be carried either back or forward.

**TIF PROBLEM FIVE - 11****Depreciable Asset Retirements And CEC Sale**

Vance Enterprises closes its books on December 31 of each year. On January 1, 2016, the following information on depreciable assets was contained in its records:

Type Of Asset	Undepreciated Capital Cost	Original Capital Cost	Date Of Acquisition
Equipment (Class 8)	\$ 2,100	\$ 26,000	January, 2009
Buildings (Class 1)	205,000	250,000	January, 2004
Automobile (Class 10)	10,200	20,500	June, 2012

There was no balance in the Cumulative Eligible Capital account at this time.

During the 2016 fiscal year, the following transactions occur:

**Sale Of Equipment** - As the result of an extensive analysis, it is decided that it would be better to sell the existing equipment and to replace it with improved equipment that will be leased. The equipment is sold for \$21,000.

**Sale Of Buildings** - A similar decision is made with respect to the buildings. They are sold for \$342,000 and replaced with leased premises. Of the \$342,000 received, \$80,000 is for the land on which the buildings are situated. The adjusted cost base of the land was equal to the \$80,000 proceeds of disposition. The lease term is for four years with no options for renewal. However, a total of \$39,000 is spent on leasehold improvements to make the buildings more suitable for the business.

**Sale Of Automobile** - The automobile is used by Ms. Vance for both business and personal matters. It is sold during the current year and replaced with a leased vehicle. The sale proceeds are \$8,900.

**Sale Of Goodwill** - In order to further streamline her operations, Ms. Vance sells off a portion of her operations to another individual. No depreciable or capital assets were disposed of. However, an amount of \$110,000 was received for the goodwill of this portion of the business.

**Required:** For the taxation year ending December 31, 2016 calculate the maximum CCA that can be deducted by Vance Enterprises for each CCA class. In addition, calculate the January 1, 2017 UCC balances and indicate any other tax consequences that would result from the described transactions.

## **TIF PROBLEM FIVE - 12**

### **Cumulative Eligible Capital**

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The retail division of Moxy Distributors Inc. (MDI) was established through the acquisition of three unincorporated operations. These acquisitions were made during the taxation year ending December 31, 2014, with the following amounts being paid for goodwill:

<u>Operation</u>	<u>Goodwill Acquired</u>
A	\$150,000
B	225,000
C	180,000

Operation A proved to be unprofitable and was sold during the taxation year ending December 31, 2015. The sales proceeds included a payment for goodwill of \$82,000.

As MDI continued to have difficulties with lack of profits in its retail division, Operations B and C were sold during the year ending December 31, 2016. The proceeds from the sale of Operation B included a \$210,000 payment for goodwill, while the proceeds from the sale of Operation C included a payment for goodwill of \$283,000.

On January 1, 2014, MDI had a cumulative eligible capital balance of nil. MDI made the maximum CEC deduction in both 2014 and 2015.

**Required:** Determine the tax consequences resulting from the preceding transactions for each of the years 2014 through 2016.

**TIF PROBLEM FIVE - 13****Cumulative Eligible Capital With Disposal Election**

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On January 1, 2014, Altec Ltd. has no balance in its CEC account. The Company has a taxation year that ends on December 31.

During the 2014 taxation year, Altec acquires the assets of another business at a cost of \$4,250,000. The identifiable assets of this business have a fair value of \$4,000,000, indicating that Altec has acquired \$250,000 of goodwill. In addition, the identifiable assets of Altec included an unlimited life franchise with a fair value of \$175,000.

The unlimited life franchise proved to be incompatible with the Altec's other operations and, during the 2015 taxation year, it is sold for proceeds of \$225,000.

During the 2016 taxation year, Altec sells one of its business divisions. The consideration received included a \$350,000 payment for the division's goodwill.

It is the policy of Altec Ltd. to deduct maximum amounts of CCA and CEC.

**Required:**

- A. What is the maximum deduction that Altec can claim for amortization of cumulative eligible capital in 2014, 2015, and 2016? Assume that no elections are made with respect to the CEC dispositions in any of these years.
- B. Calculate the amounts that will be included in Altec's 2015 and 2016 Net Income For Tax Purposes as a result of the CEC dispositions. Assume that no elections are made with respect to the CEC dispositions.
- C. How would the results in Parts A and B differ if Altec makes all possible CEC disposal elections under ITA 14(1.01)? Explain why a taxpayer might want to make such elections.
- D. Compare the inclusions in Net Income For Tax Purposes that occur without the ITA 14(1.01) election with the inclusions that occur with the ITA 14(1.01) election.

## **TIF PROBLEM FIVE - 14**

### **CCA And CEC Calculations**

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The following information relates to Andorn Ltd. for its taxation year that ends on December 31, 2016:

1. The Company has UCC balances on January 1, 2016 for its tangible assets as follows:

Class 1 (A single building acquired in 2008)	\$478,695
Class 8	243,000
Class 10	126,000
Class 13	127,500

2. During 2016, the building that was acquired in 2008 was sold for cash of \$650,000. Of this total, \$125,000 represented the value of the land on which the building was situated. The building had a capital cost of \$625,000, of which \$80,000 represented the value of the land at time the building was acquired.

The building was replaced during 2016 with a new building at a cost of \$745,000, of which \$125,000 represented the value of the land.

The old building was used 100 percent for office space and was allocated to a separate Class 1. The new replacement building is also used 100 percent for office space and is allocated to a separate Class 1.

3. During 2016, the Company purchased office furnishings for \$74,000. They traded in older furnishings and received an allowance of \$17,000. The capital cost of the furnishings that were traded in was \$56,000.
4. The only vehicle purchased during the year was a Lexus to be used by the president of the Company. The cost of this car was \$93,000. The president drives it 23,000 kilometers during the year, of which 5,750 kilometers are for employment related purposes.
5. Andorn conducts some of its business out of a building which it leases. The lease was signed on January 1, 2014 and had an initial term of 7 years. It has an option to renew for 3 years. At the time the lease was signed, Andorn spent \$150,000 on leasehold improvements.
6. During 2014, the Company purchased two franchises. The first, which was purchased on August 1, 2014, had cost \$62,000 and a legally limited life of 8 years. The second, purchased on September 5, 2014, cost \$84,000 and had an unlimited life. This second franchise was sold during 2016 for \$65,000.
7. Andorn Ltd. has always deducted the maximum CCA and the maximum write-off of cumulative eligible capital allowable in each year of operation.

**Required:** Calculate the maximum CCA and the maximum write-off of cumulative eligible capital that can be deducted for 2016. Your answer should include the maximum that can be deducted for each CCA class. In addition, indicate the amount of any recapture or terminal loss that results from dispositions during 2016.

## **Chapter Six Test Item File Problems**

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### **TIF PROBLEM SIX - 1**

#### **Business Income - Essay Questions**

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1. What are the major types of income that make up Net Income For Tax Purposes?
2. Assets can be acquired for use in a business, for resale by a business, or as investments. For each of these classifications, indicate (1) how the income earned will be classified, and (2) how the income resulting from the sale of the asset would be classified.
3. For tax purposes, the sale of inventories is treated differently than the sale of non-depreciable capital assets. Briefly describe the different treatments given to these two types of sales.
4. While there are many similarities between business income (for tax purposes) and accounting income as determined under GAAP, there are a number of differences. Indicate four such differences.
5. While business income and property income are covered in the same subdivision of the *Income Tax Act*, there are differences in the tax treatment of these two types of income. Briefly describe two of these differences.
6. Why is the distinction between capital gains and business income important?
7. List four criteria that can be used in distinguishing between business income and capital gains. Explanations are not required.
8. Both GAAP and income tax legislation require the allocation of the cost of depreciable assets to income over several years. Briefly describe how the accounting procedures used for this process differ from those required for income tax purposes.
9. What is a reserve? Explain briefly the reserve system that is used in determining net business income.
10. List three reserves that can be deducted in the determination of net business income.
11. Compare the procedures used to determine bad debt expense under GAAP, with those used to determine the annual deduction for bad debts under the *Income Tax Act*.
12. The ability to use a reserve for unpaid amounts gives results that are similar to those that would result from using the cash basis of revenue recognition. However, there are constraints on the use of this reserve that prevent achieving results that are identical to those that result from using cash based revenue recognition. Describe these constraints.
13. Section 18 of the *Income Tax Act* lists a number of general limitations on the deductions that can be made in the determination of net business income. List four of these limitations.
14. Describe the tax rules that apply to interest and property taxes on land.
15. Both employees and self-employed individuals can deduct the costs associated with maintaining a home office. Compare the items that can be deducted by an employee with those that can be deducted by a self-employed individual.

16. Describe the restrictions that the *Income Tax Act* places on the deductibility of costs incurred to place advertising in foreign media.
17. ITA 67 indicates that no deduction is available for an outlay or expense, except to the extent that the outlay or expense was reasonable in the circumstances. Provide an example of an outlay or expense that would be disallowed by this provision.
18. List and briefly describe three of the exceptions to the rule that only 50 percent of the cost of business meals and entertainment can be deducted in the determination of Net Income For Tax Purposes.
19. The *Income Tax Act* limits the deductions associated with the ownership of company cars. Describe these limitations.
20. Describe the alternative methods of inventory valuation that can be used for tax purposes.
21. Compare the accounting treatment for estimated warranty costs with the required treatment for income tax purposes.
22. When an enterprise issues debt obligations, they may be sold at a discount from their maturity value. For accounting purposes, this discount is amortized to income as an addition to interest expense. What is the required treatment of such discount amounts for income tax purposes?
23. In determining whether an individual can deduct farm losses against other sources of income, taxation authorities divide farmers into various categories. Describe these categories and indicate how the farm losses for each category are treated in the year they occur.
24. Explain briefly how the billed basis of determining professional income differs from the normal accrual approach to determining business income.
25. In situations where a business ceases to operate and its assets are being sold, it is important that the parties to the transaction make the ITA 22 election with respect to the accounts receivable that are being transferred. Explain this importance.

## **TIF PROBLEM SIX - 2**

### **Business Income - True Or False**

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1. The tax rules for determining business income are identical to those used for determining property income.  

True or False?
2. When property acquired for personal use is sold for more than its cost, there will be a taxable capital gain.  

True or False?
3. The deduction of CCA cannot be used to create or increase a net business loss.  

True or False?
4. If an asset has been held for a considerable period of time, any gain on its disposition will be treated as business income.  

True or False?
5. Differences between business income for tax purposes and business income as determined under GAAP can be either permanent or temporary.  

True or False?
6. When a business makes payments that are unreasonable in the circumstances, they cannot be deducted in the calculation of either accounting Net Income or net business income.  

True or False?
7. If a reserve is deducted for accounting purposes, it can also be deducted for tax purposes.  

True or False?
8. The amounts charged to income for bad debts on accounts receivable will generally be the same for both tax and accounting purposes.  

True or False?
9. A self-employed individual cannot deduct CCA on a home office in his principal residence unless it is used exclusively for income producing purposes.  

True or False?
10. Landscaping costs can be deducted in the determination of net business income, even if they involve items that would normally be considered capital assets.  

True or False?
11. For the hobby farmer, deductible farming losses for a year are restricted to \$2,500, plus one-half of the next \$30,000.  

True or False?
12. For tax purposes, inventories can be valued at aggregate market, which can mean replacement cost or net realizable value.  

True or False?

**TIF Problem Six - 2**  
*Business Income - True Or False*

13. When a business ceases to operate and its inventories are disposed of, a gain on the inventories will be treated as a capital gain unless an election is made by the selling taxpayer.

True or False?

14. When a business ceases to operate and its accounts receivable are disposed of with the other business assets, any loss on the receivables will be treated as a capital loss unless a joint election is made by the purchaser and seller.

True or False?

## TIF PROBLEM SIX - 3

### Business Income - Multiple Choice

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#### New For 2016/2017

##### **Business Vs. Property Vs. Capital Gains**

1. During 2016, a depreciable capital asset with a capital cost of \$100,000 and a January 1 UCC balance of \$79,400, is sold for \$103,000. In the accounting records, the asset had a net book value of \$83,400. What are the tax consequences of this sale?
  - A. Business income of \$23,600.
  - B. A capital gain of \$1,500.
  - C. A capital gain of \$3,000 and business income of \$20,600.
  - D. A capital gain of \$23,600.

##### **Inclusions And Reserves**

2. With respect to determining net business income for tax purposes, which of the following statements is **NOT** correct?
  - A. A reserve that is deducted in the current taxation year, must be added back to income in the following taxation year.
  - B. Bad debts written off in the previous year for tax purposes that are recovered in the current year must be added to net business income for tax purposes for the current year.
  - C. Amounts received for goods to be delivered in the future must be included in the determination of net business income for tax purposes.
  - D. As long as some part of the proceeds for goods sold is not collectible until future periods, a reserve for uncollected amounts can be deducted.

##### **Limitations On Deductions**

3. Myrle Cocco owns a car that she uses both in her business and for personal use. The cost of the car was \$28,000 and, on January 1, 2016, the UCC for the vehicle (it is the only asset in Class 10) was \$11,662. During the year she drives the car a total of 42,000 kilometers of which 38,000 were related to her business activities. Her insurance for the year was \$950 and her operating costs were \$6,500. What is the amount of her maximum deduction for car costs during 2016?
  - A. \$10,239.
  - B. \$ 9,906.
  - C. \$17,292.
  - D. \$10,949.
4. Which of the following items could **NOT** be deducted during the current year in the determination of net business income for tax purposes?
  - A. Premiums on a life insurance policy on a business owner's life that is required by the bank that has extended a loan to the business.
  - B. The cost of advertising on a U.S. television station that is attempting to attract customers in Florida.
  - C. Fees paid to the business owner's wife for keeping the accounting records of the business.
  - D. Parking fines incurred by delivery vehicles making deliveries in congested areas.

**Specific Deductions**

5. With respect to deductions in the determination of net business income for tax purposes, which of the following statements is correct?
- A. A corporation can deduct the costs of issuing new common shares in the year in which the shares are issued.
  - B. Any premium on the sale of new debt securities by a corporation is amortized over the life of the securities.
  - C. Cost of sales can be determined using inventory valuation based on either replacement cost or net realizable value.
  - D. Landscaping costs are deductible in the year that they are accrued.

**Special Business Income Situations**

6. During 2016, an individual sells his incorporated business for its fair market value. At the time of the sale the business has accounts receivable of \$123,000. The vendor of the business and the purchaser agree on a fair market value for these receivables of \$118,500. In 2015, the vendor had deducted a reserve for estimated bad debts of \$6,800. Which of the following statements is correct?
- A. If no election is made, the vendor will have an addition to net business income for tax purposes of \$2,300.
  - B. If no election is made, the vendor will have an addition to net business income for tax purposes of \$4,550.
  - C. If an election is made under ITA 22, the vendor will have a deduction in the determination of net business income for tax purposes of \$2,300.
  - D. If an election is made under ITA 22, the vendor will have a deduction in the determination of net business income for tax purposes of \$4,500.

**Retained From Previous Editions**

***Business Vs. Property Vs. Capital Gains***

7. Which of the following would be considered by the CRA to be business income rather than property income or capital gains?
- A. Profits from the sale of assets that were used to produce business income
  - B. Profit from the sale of assets that were used to produce property income
  - C. Profit from the sale of inventory items
  - D. Both A and C
8. Fung Wo purchased vacant land on a remote island off the coast of British Columbia on January 1, 2013 for \$50,000. She intended to re-sell it for a profit the next year but due to an oil spill, property values dropped. She was finally able to sell the vacant land for \$45,000 on December 31, 2016. In the meantime, she paid property taxes of \$500 each year. For 2016 tax purposes, Fung Wo has:
- A. An allowable capital loss of \$2,500
  - B. An allowable capital loss of \$3,500
  - C. A net business loss of \$5,000
  - D. A net business loss of \$7,000

9. Which of the following statements is **NOT** correct?
- A. In determining property income, the deduction of CCA cannot be used to create or increase a loss.
  - B. Both business and property income are subject to the income attribution rules.
  - C. In determining business income, the deduction of CCA can be used to create or increase a loss.
  - D. Travel expenses cannot be deducted against property income.
10. In determining whether a gain resulting from a disposition of an asset is capital or business, various criteria have been used. Which of the following considerations would be least likely to affect the decision?
- A. The length of time the asset is held.
  - B. Whether the transaction is related to the taxpayer's business.
  - C. The number and frequency of similar asset dispositions.
  - D. Whether the taxpayer knew the investment could be sold for a profit if the investment return was inadequate.
  - E. Whether the transaction resulted in a gain or loss.
11. Jerry collects baseball cards as a hobby. During the current year, he acquired twenty-five different items at a total cost of \$29,550. During the year, he sold each of those items and received total proceeds of \$55,900. What is the effect of these transactions on Jerry's Net Income For Tax Purposes?
- A. Jerry has a taxable capital gain of \$26,350.
  - B. Jerry has a taxable capital gain of 13,175.
  - C. Jerry has business income of \$26,350.
  - D. Because the collection was a hobby, the gain does not have to be included in Net Income For Tax Purposes.
12. Which of the following is correct?
- A. In determining whether a disposition is capital or business in nature, the number and frequency of transactions is taken into account.
  - B. A taxpayer must include 50 percent of both business income and capital gains in their Taxable Income.
  - C. Amounts collected under an insurance policy are considered capital gains.
  - D. The sale of a depreciable asset can result in a capital gain or capital loss.
13. Marvin purchased a large piece of land 5 years ago when a highway bypass was rumoured to have an exit being built nearby. He had planned to subdivide the land into building lots within 5 years, but has done no work on the land yet. He has rented the land each summer over the Labour Day weekend for \$500. A local non-profit organization holds a huge neighbourhood garage sale on that weekend. A heart attack has convinced Marvin to slow down. As a result, he has advertised the land for sale online and an interested buyer is offering to purchase it at a price that would give him a large gain. That gain would be taxed as:
- A. property income.
  - B. business income.
  - C. a capital gain.
  - D. a taxable capital gain.

**Inclusions And Reserves**

14. A business may sometimes receive amounts of cash for goods or services to be delivered in a future taxation year. Under the requirements of the *Income Tax Act*, these amounts should be:
- included in revenue when the goods or services are delivered.
  - included in revenue no later than 180 days after the end of the taxation year.
  - allocated to revenue over the period between the time the cash is received and the time the goods and services are delivered.
  - included in revenue when the cash is received.
15. Selected items from Mini Move Inc.'s December 31 audited financial statements are as follows:

	2016	2015
<b>Income Statement:</b>		
Revenue	\$200,000	\$180,000
Income before taxes	\$ 30,000	\$ 25,000
Net Income	\$ 24,000	\$ 20,000
<b>Balance Sheet:</b>		
Accounts Receivable	\$12,000	\$11,000
Accounts Payable	\$ 7,000	\$ 4,000
Deferred Revenue	\$ 500	\$ 200

Mini Move's 2016 Net Income for Tax Purposes is:

- \$24,300.
  - \$30,300.
  - \$31,000.
  - \$31,300.
16. In 2015, Marg's Antiques deducted a reserve for doubtful debts of \$12,000. During 2016, she had actual write-offs of \$12,500 and recoveries of previously written off debts of \$1,500. At the end of 2016, she deducted a reserve for doubtful debts of \$14,000. Marg's 2016 net deduction for bad debts would be:
- \$12,500.
  - \$11,000.
  - \$13,000.
  - \$14,000.
17. Ed's Appliances Ltd (Ed's) sold a furnace to a customer in October, 2016 for \$10,000. The mark-up on the \$5,000 cost of the furnace was 100 percent. The customer paid 20 percent of the purchase price on delivery, with the remainder of the purchase price due in March 2017. What is the maximum reserve Ed's can claim for tax purposes for its November 30, 2016 year end?
- \$2,000.
  - \$4,000.
  - \$6,000.
  - \$8,000.
  - None of the above.

**Limitations On Deductions**

18. For income tax purposes, X Co. can deduct life insurance premiums paid providing:
- A. The life insurance policy is required as security on a loan from a financial institution.
  - B. The interest payable on the loan for which the life insurance is required is deductible by X Co. for tax purposes.
  - C. The premium paid is for insurance on the president of X Co.
  - D. Both A and B.
  - E. All of A, B, and C.
19. Maxine is the proprietor of a home based business. She paid \$25,000 to her editorial assistant, \$8,000 to her son as her computer technician, and \$32,000 to herself as salary. How much can she deduct as a business expense on her income tax return?
- A. Nil.
  - B. \$25,000.
  - C. \$33,000.
  - D. \$65,000.
20. Jon Bogen operates a consulting business out of a dedicated space in his home. It is his principal place of business. With respect to the items that he can deduct, which of the following statements is correct?
- A. Jon can only deduct a pro rata share of operating costs and utilities.
  - B. Jon can only deduct a pro rata share of operating costs, utilities, and property taxes.
  - C. Jon can only deduct a pro rata share of operating costs, utilities, property taxes, and mortgage interest.
  - D. Jon can deduct a pro rata share of operating costs, utilities, property taxes, mortgage interest and CCA.
21. Omar owns and manages an unincorporated business. During 2016, a car which he owns was driven 10,000 kilometers for business purposes and 12,000 kilometers for Omar's personal use. The total vehicle related expenses for 2016 were as follows:
- |                       |         |
|-----------------------|---------|
| Lease payments        | \$7,200 |
| Insurance             | 1,000   |
| Other Operating Costs | 1,300   |
- For tax purposes, there is a:
- A. Business deduction of \$4,318 and a taxable benefit of \$0.
  - B. Business deduction of \$5,182 and a taxable benefit of \$0.
  - C. Business deduction of \$9,500 and taxable benefit of \$7,400.
  - D. Business deduction of \$9,500 and taxable benefit of \$7,920.
22. Jean Brochet uses an automobile in his unincorporated business. It cost \$53,000 in 2015, with maximum CCA being deducted in that year. The purchase was financed with a bank loan of \$37,000. For 2016, the interest on this loan was \$4,440. The automobile is used exclusively for business purposes, with the 2016 operating costs totaling \$7,500. In determining his 2016 business income, his maximum automobile related deduction will be:
- A. \$18,800.
  - B. \$19,590.
  - C. \$24,665.
  - D. \$20,150.

23. Which of the following expenses would be denied as a deduction under the *Income Tax Act*?

- A. A speeding ticket received by a truck delivering goods for resale.
- B. The costs of disability related building modifications,
- C. Work space in a home costs for a self-employed contractor.
- D. A reserve for doubtful accounts

24. Antonio Capellini is a successful self-employed accountant. He meets all of his clients in his office in the basement of his home. The office is 800 square feet and the house is 3,000 square feet. Antonio incurred the following costs during the current year:

Business liability insurance	\$ 400
House insurance	880
House utilities	2,600
House repairs and maintenance	3,000
Mortgage interest	5,700
Property tax	1,600
Office supplies	760

What is the amount of the expenses deductible from Antonio's business income?

- A. \$1,160
  - B. \$2,888
  - C. \$3,675
  - D. \$4,835
25. Kyle purchased a large lot on a lake in anticipation of building his home there within 3 years. During the current year, Kyle paid \$650 in property taxes and \$2,500 of interest on the demand loan he obtained to purchase the lot. January to March he rented out the lot to a local snowmobile club for \$1,500. Which of the following statements is correct?
- A. Kyle cannot deduct any of the property taxes or interest paid for the vacant lot.
  - B. Kyle can deduct the \$650 of property taxes paid, but none of the interest paid.
  - C. Kyle can deduct the \$650 of property taxes paid and \$850 of the interest paid.
  - D. Kyle can deduct all of the property taxes and interest paid.
26. Tomas began his unincorporated business on January 1, 2016. During 2016, he received \$40,000 cash in revenues and paid \$33,000 for operating expenses. On December 31, 2016 one of his customers owed him \$1,200 and Tomas owed one of his suppliers \$2,300. In addition to the operating expenses, Tomas can also deduct one-third of his house costs since he operates his business out of the ground floor of his rented 3-storey home. Total house costs for 2016 were: rent of \$19,200; insurance of \$800; utilities of \$2,100. Tomas' maximum work space in the home expense deduction for 2016 is:
- A. \$5,900.
  - B. \$7,000.
  - C. \$7,100.
  - D. \$7,367.

27. Busy Company incurred the following meal costs during 2016:

Meals with Clients:		
Cost of clients' and employees' meals	\$10,000	
Gratuities (tips)	<u>1,500</u>	\$11,500
Company Christmas Party		4,100
Management Dinner Meetings		1,800
Family Picnic (Management only)		1,200
Meal allowances paid to employees during eligible business travel (100 days @ \$51 per day)		5,100
Total		\$23,700

The total deductible meal expense for tax purposes is:

- A. \$11,100
  - B. \$11,850
  - C. \$13,300
  - D. \$13,900
28. 888 Company leased a car throughout 2016 for \$950 per month, \$75 of which was for insurance. There was no down payment or refundable deposit. The manufacturer's suggested list price for the car is \$38,000. Other costs incurred for the vehicle during 2016 were \$1,600 for gas and \$420 for repairs.

The maximum tax deduction for 2016 vehicle expenses is:

- A. \$11,753
- B. \$12,653
- C. \$12,672
- D. \$13,420

**Specific Deductions**

29. For tax purposes, the cost of the end of period inventory can be determined in a variety of ways. Which of the following approaches **CANNOT** be used?
- A. Last-In, First-Out.
  - B. First-In, First-Out.
  - C. Specific Identification.
  - D. Average Cost.
30. Which of the following items is **NOT** deductible in calculating net business income for the current taxation year?
- A. An \$11,000 legal fee paid for services rendered in conjunction with a new issue of the company's common stock.
  - B. A \$125,000 management bonus paid 125 days after the end of the corporation's current taxation year.
  - C. An amount of \$25,000 paid for planting large maple trees in various locations on the grounds of the company's facilities.
  - D. A \$10,000 contribution to a company pension fund.

31. Which of the following business expenses is deductible for tax purposes?
- A. \$25 late filing penalty charged by CRA.
  - B. \$50 speeding ticket incurred while delivering goods to a customer.
  - C. \$15 late payment interest charged by utility company.
  - D. \$20 late payment interest charged by CRA.
32. Which of the following is a deductible expense for an unincorporated business?
- A. Donation made to the United Way.
  - B. Contribution made to the Federal Green Party.
  - C. Estimated cost of providing warranty services in future taxation years.
  - D. Reasonable salary paid to a relative.
33. Old Time Company purchased a Class 10 truck many years ago for \$8,000. The truck has now become a collectors' item and was sold on August 1, 2016 for \$10,000. The net book value on that date was \$500 and the Class 10 UCC balance was \$11,525. There are other assets left in the class. Accounting net income before tax for the year ended December 31, 2016 was \$24,000. Amortization of depreciable capital assets for accounting purposes is equal to the CCA deducted for tax purposes. Net income for tax purposes is:
- A. \$15,000.
  - B. \$15,500.
  - C. \$25,000.
  - D. \$26,000.
34. Sea Tour Company's accounting net income for 2016 is \$12,200. This includes amortization expense for a boat that was purchased for \$28,000 in 2015. The boat is amortized on the straight-line basis over 10 years with no estimated residual value. For tax purposes, it is in Class 7, a declining balance class with a rate of 15 percent. Minimum net income for tax purposes for 2016 is:
- A. \$11,115.
  - B. \$11,430.
  - C. \$15,000.
  - D. \$8,315.
35. Maria has her own accounting practice in Victoria, B.C. During 2016 she paid \$1,650 to attend the following conventions:
- \$400 for a 2 day convention on "Tax issues for the owner/manager" held at Vancouver, B.C.
  - \$500 for a 3 day convention on "Attracting new clients" held at Kelowna, B.C.
  - \$750 for a 5 day convention on "IFRS implementation" held at Whistler, B.C.
- Maria's total deductible convention expense for tax purposes is:
- A. \$1,650
  - B. \$1,250
  - C. \$1,050
  - D. \$825

36. Widget Production Ltd. has a fiscal year end of June 30. In February 2014, the Company borrowed \$750,000 to fund an expansion. The Company paid \$21,000 to obtain this financing. In January 2015, the Company repaid \$250,000 of the principal and in June 2016, it repaid the remaining \$500,000. All repayments were made from cash flow from operations. For tax purposes, which one of the following schedule of claims represents the **most** rapid method of claiming the costs of obtaining this financing.
- A. \$4,200 in each of fiscal 2014 through 2018.
  - B. \$4,200 in each of 2014 and 2015, and the remaining \$12,600 in 2016.
  - C. \$4,200 in 2014, \$8,400 in 2015, and \$8,400 in 2016.
  - D. \$7,000 in 2015 and \$14,000 in 2016.
37. Quality Homes Ltd. (Quality) has a December 31, 2016 year end. The controller has calculated the Company's 2016 income as \$50,000. However, in arriving at this amount, the controller deducted \$30,000 of salary to an employee who is the sole shareholder of the Company and \$5,000 of salary to an arm's length employee. Both of these amounts were paid on June 30, 2017. Which one of the following represents Quality's 2016 Net Income For Tax Purposes?
- A. \$50,000.
  - B. \$55,000.
  - C. \$80,000.
  - D. \$85,000.
38. Mary operates a proprietorship that generated \$100,000 in income under GAAP. Included in this amount are:
- \$7,000 of amortization expense;
  - \$4,000 for bad debt expense;
  - \$112,000 cost of goods sold; and
  - \$12,000 meals and entertainment with clients.
- Mary's maximum CCA has been calculated at \$10,000 for the year. How much is Mary's business income for tax purposes?
- A. \$113,000
  - B. \$109,000
  - C. \$107,000
  - D. \$103,000

**Taxation Year**

39. Jon Avery starts an unincorporated business on December 1, 2016. Which of the following statements is correct with respect to Jon's taxation year end?
- A. Jon must select December 31 as his taxation year end.
  - B. Jon must select November 30 as his taxation year end.
  - C. Jon can choose any date for his year end. However, if Jon chooses a non-calendar year end he will have to adjust his income by an amount referred to as "additional business income".
  - D. Jon can choose any date for his year end. However, if Jon chooses a non-calendar year end he will have to report income for his first two fiscal years in his 2017 tax return.

**Special Business Income Situations**

40. Ginger has her own accounting practice and her fiscal year end is December 31. Her regular billing rate is \$100 per hour. One of her clients has a November 30 year end. Work is done on the file during December and January and the client is billed on February 1 of each year. Billable hours for this client are as follows:

	Dec. 2015	Jan. 2016	Dec. 2016	Jan. 2017
For Nov. 30, 2015 year end	25	35		
For Nov. 30, 2016 year end			32	30

Ginger's 2016 Net Income For Tax Purposes for this particular client is:

- A. \$6,200 on the accrual basis or \$5,500 on the billed basis of recognition
  - B. \$6,200 on the accrual basis or \$6,000 on the billed basis of recognition
  - C. \$6,700 on the accrual basis or \$6,000 on the billed basis of recognition
  - D. \$6,700 on the accrual basis and the billed basis of recognition
41. Which of the following statements regarding farming income is correct?
- A. A full time school teacher has income from his part-time farming activities. His farming income must be calculated on a cash basis.
  - B. A full time school teacher recognized a \$9,500 loss this year from his part-time farming activities. The maximum deduction allowed this year from the farm loss is \$6,000.
  - C. A full time school teacher recognized a \$9,500 loss this year from his part-time farming activities. The maximum deduction allowed this year from the farm loss is \$2,500.
  - D. A full time school teacher has income from his part-time farming activities. His farming income must be calculated on an accrual basis.

## **TIF PROBLEM SIX - 4**

### **Business Income - Exam Exercises**

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#### ***Exam Exercise Subject Listing For Chapter 6***

<b>Number</b>	<b>Subject</b>
1	Business Vs. Property Income
2	Business Income Vs. Capital Gain
3	Business Income Vs. Capital Gain
4	Reserve For Bad Debts
5	Reserve For Bad Debts
6	Bad Debts And Undelivered Services
7	Bad Debts And Undelivered Services
8	Reserve For Unpaid Amounts
9	Reserve For Unpaid Amounts
10	Interest In Thin Capitalization
11	Interest In Thin Capitalization
12	Work Space In The Home Costs
13	Work Space In The Home Costs
14	Automobile Ownership Costs
15	Automobile Ownership Costs
16	Automobile Leasing Costs
17	Automobile Leasing Costs
18	Leases: Tax Vs. GAAP
19	Inventory Valuation
20	Additional Business Income
21	Professional Income
22	Professional Income
23	Sale Of Receivables
24	Sale Of Receivables

***Exam Exercise Six - 1 (Business Vs. Property Income)***

Martin Elwood has purchased the rights to a group of songs written by the Ringtones. He estimates that these songs will produce royalties of about \$100,000 per year for at least 5 years. He does not have plans to acquire additional song rights. Explain whether the royalties he receives would be treated as business income or property income. In addition, indicate how any gain or loss on their disposition would be taxed.

***Exam Exercise Six - 2 (Business Income Vs. Capital Gains)***

William Lemay acquired a six unit apartment building for \$315,000 with the intention of operating it as a rental property. Three weeks after his purchase, he received an unexpected offer to purchase the building for \$387,000. He accepts the offer. Should the \$72,000 be treated as a capital gain or as business income? Justify your conclusion.

***Exam Exercise Six - 3 (Business Income Vs. Capital Gains)***

Several years ago, John Martin purchased a group of internet domain names at a cost of \$1,000 each, hoping at some point that he could sell one or more at a later date. Until this year, none of the names have been sold. However, during this year, two of the names were sold for \$25,000 each. Should the resulting gains be treated as capital gains or as business income? Justify your conclusion.

***Exam Exercise Six - 4 (Bad Debts And Reserve For Doubtful Debts)***

At the end of 2015, Barton's Books has ending accounts receivable of \$87,500. Of this amount, it is estimated that \$3,400 would prove uncollectible. A reserve for tax purposes is deducted for this amount. During 2016, \$3,600 of accounts receivable are written off. At the end of 2016, accounts receivable total \$103,200, with \$4,100 of this amount expected to be uncollectible. By what amount will the 2016 net business income of Barton's Books be increased or decreased by the preceding information with respect to bad debts?

***Exam Exercise Six - 5 (Bad Debts And Reserve For Doubtful Debts)***

During 2016, Leslie's Boutique wrote off \$13,000 in accounts receivable as uncollectible. At the end of this year, the accounts receivable balance was \$256,400. Based on past experience, it is expected that 4 percent of these accounts will prove uncollectible. In its 2015 tax return, Leslie's Boutique had deducted a reserve for bad debts of \$12,300. By what amount will the 2016 net business income of Leslie's Boutique be increased or decreased by the preceding information with respect to bad debts?

***Exam Exercise Six - 6 (Reserve For Doubtful Debts And Undelivered Services)***

Frank's Auto Body, an unincorporated business, keeps its records on a cash basis. During 2016, its first year of operation, the business has cash sales of \$71,200. At the end of the year, an additional \$22,450 of revenues was receivable. Of the amounts received, \$7,100 was for services that will be delivered during 2017. Frank estimates that \$650 of the end of year receivable amounts will be uncollectible. By what amount will the 2016 net business income of Frank's Auto Body be increased by the preceding information?

***Exam Exercise Six - 7 (Reserve For Doubtful Debts And Undelivered Services)***

Bob's Hats is an unincorporated business. During 2016, its first year of operations, the business has cash sales of \$123,000. It also has account sales of \$46,000, of which \$22,000 remains uncollected at the end of 2016. It is estimated that \$4,000 of these accounts will be uncollectible. Of the cash amounts received, \$9,500 is for merchandise that will be delivered in 2017. By what amount will the 2016 net business income of Bob's Hats be increased by the preceding information?

**Exam Exercise Six - 8 (Reserve For Unpaid Amounts)**

During February, 2016, Jacob's Jewels sells a brooch for \$428,000. The cost to the business of this brooch was \$212,000, resulting in a gross profit of \$216,000. The \$428,000 sales price is to be paid in four equal annual instalments on December 31 in each of the years 2017 through 2020. Jacob's Jewels has a December 31 year end. Indicate the amount of the reserve that can be deducted, and the net business income, for each of the years 2016 through 2020.

**Exam Exercise Six - 9 (Reserve For Unpaid Amounts)**

In January, 2016, Marty's Fine Pens sells a limited edition fountain pen for \$125,000. The cost of the pen is \$63,000. There is a down payment of 40 percent in 2016, followed by 3 annual payments of 20 percent in the years 2017, 2018, and 2019. Indicate the amount of the reserve that can be deducted and the net business income that will be included in income for each of the years 2016 through 2019.

**Exam Exercise Six - 10 (Interest In Thin Capitalizations)**

On January 1, 2015, a new Canadian corporation is created by issuing \$9,100,000 in debt securities and \$2,100,000 in common shares. The debt securities pay interest at 7 percent. The new corporation will use December 31 as its year end. At the time the corporation is formed, Mr. Phillip Roundtree, who is a resident of England, acquires \$5,250,000 of the debt securities and 29 percent of the common shares. On January 1, 2016 the Retained Earnings balance of the corporation is \$750,000. How much, if any, of the interest paid in 2016 on Mr. Roundtree's holding of debt securities would be disallowed under the thin capitalization rules in ITA 18(4)?

**Exam Exercise Six - 11 (Interest In Thin Capitalizations)**

On February 28, 2015, a new Canadian corporation is created by issuing \$12,200,000 in debt securities and \$2,500,000 in common shares. The debt securities pay interest at 9 percent. The corporation has elected a December 31 year end. Of the securities issued by the new corporation, one-half of the debt securities and \$1,000,000 of the common shares are acquired by Nathalie Bergeron, a resident of France. As of January 1, 2016, the Retained Earnings balance of the corporation is \$560,000. How much, if any, of the interest paid in 2016 on Ms. Bergeron's holding of debt securities would be disallowed under the thin capitalization rules in ITA 18(4)?

**Exam Exercise Six - 12 (Work Space In The Home Costs)**

During the current year, Janice Teason has the following costs:

Utility Costs For Home	\$3,200
Maintenance And Repairs For Home	3,800
Property Taxes For Home	6,400
House Insurance	1,800
Interest On Mortgage	6,200
Telephone:	
Monthly Charge	480
Personal Long Distance Charges	275
Employment/Business Related Long Distance Charges	780
Office Supplies	675

Ms. Teason estimates that she uses 30 percent of the residence for employment/business related purposes. Maximum CCA on 100 percent of the house would be \$15,000. Determine the maximum deduction that would be available to Ms. Teason assuming:

- A. She is an employee with \$80,000 in income (no commissions).
- B. She is an employee with \$80,000 in commission income.
- C. She is self-employed and earns \$80,000 in business income.

**Exam Exercise Six - 13 (Work Space In The Home Costs)**

During the current year, Jonathan Beasley has the following costs:

Utility Costs For Home	\$2,500
Maintenance And Repairs For Home	3,100
Property Taxes For Home	5,400
House Insurance	1,300
Interest On Mortgage	4,600
Telephone:	
Monthly Charge	240
Personal Long Distance Charges	85
Separate Line To Home Office	480
Employment/Business Related Long Distance Charges	560
Office Supplies	425

Mr. Beasley estimates that he uses 18 percent of the residence for employment/business related purposes. Maximum CCA on 100 percent of the house would be \$12,000. Determine the maximum deduction that would be available to Mr. Beasley assuming:

- A. He is an employee with \$72,000 in income (no commissions).
- B. He is an employee with \$72,000 in commission income.
- C. He is self-employed and earns \$72,000 in business income.

**Exam Exercise Six - 14 (Automobile Ownership Costs)**

Mr. Alex Roddle acquires an automobile to be used 100 percent of the time in his unincorporated business. This business has been in operation for several years. The purchase occurs on October 1, 2016 at a cost of \$83,000. He finances \$70,000 of the car purchase through his bank at an annual rate of 9 percent. Interest charges for the period October 1, 2016 through December 31, 2016 amount to \$1,575. What amounts can Mr. Roddle deduct in his 2016 tax return with respect to this acquisition? Ignore GST and PST considerations.

**Exam Exercise Six - 15 (Automobile Ownership Costs)**

For a number of years, Ms. Alexandria Bouclair has operated an unincorporated business. Because of a growing need to travel for this business, on September 1, 2016, she acquires an automobile that will be used 100 percent for business. The cost of the automobile is \$63,000, of which \$50,000 is financed by the dealer. Interest charges for the period September 1, 2016 through December 31, 2016 total \$2,000. What amounts can Ms. Bouclair deduct in her 2016 tax return with respect to this acquisition? Ignore GST and PST considerations.

**Exam Exercise Six - 16 (Automobile Leasing Costs)**

On November 1, 2016, Ms. Sherry Boland leases an automobile to be used 100 percent of the time in her unincorporated business. The lease cost is \$862 per month, and a total of \$1,724 was paid for the year. The manufacturer's suggested list price for the automobile is \$53,000. Ms. Boland makes no down payment and no refundable deposits. Determine her maximum deduction for lease payments for 2016. Ignore GST and PST considerations.

**Exam Exercise Six - 17 (Automobile Leasing Costs)**

On August 1, 2016, Mr. Jimmy Bond leases an automobile that will be used 100 percent by his unincorporated business. The monthly lease payment is \$797, with a total of \$3,985 being paid during 2016. The manufacturer's list price for the vehicle is \$61,000. Mr. Bond makes no down payment and no refundable deposit is required. Determine his maximum deduction for lease payments for 2016. Ignore GST and PST considerations.

**Exam Exercise Six - 18 (Leases: Tax Vs. GAAP)**

Sharp Ltd. signs an 8 year lease for an asset with an economic life of 9 years. The lease payments are \$32,500 per year. Compare the tax treatment of the lease with its treatment under GAAP.

**Exam Exercise Six - 19 (Inventory Valuation)**

Morton Enterprises sells a single product which it buys from various manufacturers. It has a December 31 fiscal year end. During 2016, its first year of operations, purchases of this item were as follows:

<u>Date</u>	<u>Quantity</u>	<u>Price</u>
February 1	7,500	\$23.00
May 23	5,000	28.00
August 18	6,800	21.00
October 28	5,300	25.00

On December 31, 2016, 7,800 of these items are still on hand. Their replacement cost on this date is \$24.00 and they are being sold for \$31.00. It is estimated that selling costs average 20 percent of the sales price. It is not possible to identify the individual items being sold. Calculate all the values that could be used for the 7,800 remaining units for tax purposes, identifying the method you used for each value.

**Exam Exercise Six - 20 (Additional Business Income)**

Ms. Melinda Gabor starts a business on May 1, 2016. After some consideration, she concludes that it would be best to have a fiscal year that ends on September 30. During the period May 1, 2016 through September 30, 2016, her business has income of \$23,500. What amount of business income will Ms. Gabor report in her personal tax return for the year ending December 31, 2016?

**Exam Exercise Six - 21 (Professional Income - Billed Basis Of Recognition)**

Ms. Joan Vickers is an accountant and, at the beginning of the current year, she had unbilled work in process of \$41,400, as well as uncollected billings of \$48,700. During the year, she bills the remaining work in process and collects all of these new receivables, as well as the uncollected amounts that were present at the beginning of the year. Her work during the year totals potential billings of \$206,350. Of this amount, \$171,300 has been billed and \$152,100 of these billings have been collected. Calculate her inclusion in net business income for the year using:

- the cash basis;
- the billed basis; and
- accrual accounting.

**Exam Exercise Six - 22 (Professional Income - Billed Basis Of Recognition)**

Mr. Jonathan Volke is a lawyer with a medium sized practice in Halifax. At the beginning of 2016, he had unbilled work in process of \$23,800, as well as uncollected billings of \$27,200. During 2016, he bills all of the opening work in process. Also during 2016, his work creates potential billings of \$187,200. Of this amount, \$156,300 has been billed by the end of the year. Collections during the year include all of the opening \$23,800 of unbilled amounts, all of the \$27,200 of opening uncollected billings, as well as \$124,600 of the \$156,300 of new work that was billed during the year. Calculate his inclusion in net business income for the year using:

- the cash basis;
- the billed basis; and
- accrual accounting.

***Exam Exercise Six - 23 (ITA 22 Election On Receivables)***

Mr. Brian Brock is selling his unincorporated business during 2016. Included in his assets are accounts receivable with a face value of \$87,560. He and the purchaser of the business have agreed that the net realizable value of these receivables is \$82,150. In 2015, he deducted a reserve for doubtful debts of \$4,800. Determine the tax effect of selling these receivables for Mr. Brock, provided that he and the purchaser jointly elect under ITA 22.

***Exam Exercise Six - 24 (ITA 22 Election On Receivables)***

Ms. Brooke Besson is selling her unincorporated business during 2016. Included in the assets of this business are accounts receivable with a face value of \$68,500. She and the purchaser of her business have reached an agreement that the net realizable value of these receivables is \$65,300. In 2015, Ms. Besson deducted a reserve for doubtful debts of \$4,200. Determine the tax effect of selling these receivable for Ms. Besson, assuming that:

- she and the purchaser do not elect under ITA 22; and
- she and the purchaser jointly elect under ITA 22.

## **TIF PROBLEM SIX - 5A**

### **Business Income - Key Term Matching (Easy)**

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**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms were listed at the end of Chapter 6, "Income Or Loss From A Business".

- A. Accrual Basis
- B. Billed Basis
- C. Hobby Farmer
- D. Business Income
- E. Reserve
- F. Restricted Farm Loss
- G. Net Business Income
- H. Thin Capitalization

The following list contains 10 potential definitions for the preceding key terms.

1. Income that is earned through active business activity. This would include amounts earned by producing goods, selling goods or services, or delivering services.
2. A method of accounting for income based on cash receipts and cash disbursements.
3. Situations where a non-resident specified shareholder is receiving interest on an amount of debt that exceeds 1.5 times the sum of his share of contributed capital plus 100 percent of retained earnings.
4. A deduction in the calculation of net business income or net taxable capital gains.
5. The period that is covered by a taxpayer's return.
6. A self-sustaining integrated set of activities and assets conducted and managed for the purpose of providing a return to investors.
7. The net of inclusions less deductions, related to business income, with all amounts determined as per Division B, Subdivision b, of the *Income Tax Act*.
8. A method of determining net business income based on recording inclusions when the relevant amounts are billed.
9. A method of accounting for income based on recording assets when the right to receive them is established and liabilities when the obligation to pay them arises.
10. A part-time farmer who does not have a reasonable expectation of profit.
11. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 10) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (11). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

**TIF PROBLEM SIX - 5B****Business Income - Key Term Matching (Moderate)**

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**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms were listed at the end of Chapter 6, "Income Or Loss From A Business".

- A. Accrual Basis
- B. Billed Basis
- C. Hobby Farmer
- D. Business Income
- E. Reserve
- F. Restricted Farm Loss
- G. Net Business Income
- H. Thin Capitalization

The following list contains 14 potential definitions for the preceding key terms.

1. Income that is earned through active business activity. This would include amounts earned by producing goods, selling goods or services, or delivering services.
2. A method of accounting for income based on cash receipts and cash disbursements.
3. Income that is earned through active business activity. This would include amounts earned by producing goods, selling goods or services, or selling capital assets.
4. A method of determining net business income based on recording deductions when the relevant amounts are billed.
5. Situations where a non-resident specified shareholder is receiving interest on an amount of debt that exceeds 1.5 times the sum of his share of contributed capital plus 100 percent of retained earnings.
6. A deduction in the calculation of net business income or net taxable capital gains.
7. The period that is covered by a taxpayer's return.
8. A self-sustaining integrated set of activities and assets conducted and managed for the purpose of providing a return to investors.
9. The net of inclusions less deductions, related to business income, with all amounts determined as per Division B, Subdivision b, of the *Income Tax Act*.
10. An amount of resources set aside to provide for future obligations.
11. A method of determining net business income based on recording inclusions when the relevant amounts are billed.
12. A method of accounting for income based on recording assets when the right to receive them is established and liabilities when the obligation to pay them arises.

*Business Income - Key Term Matching (Moderate)*

13. A farmer who operates a farm as a hobby, but has a reasonable expectation of making a profit.
14. A part-time farmer who does not have a reasonable expectation of profit.
15. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 14) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (15). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

***(Deductible Automobile Costs And Taxable Benefit)***

Maxine's Cleaning Services is a Canadian controlled private corporation with a December 31 year end. Maxine Brott is the sole shareholder of the corporation and actively participates in the operation of the

## TIF PROBLEM SIX - 6

### Reserves

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Opal Schwartz owns and manages an unincorporated business that offers interior decorating services to individuals and businesses. This business began operating on January 1, 2016 and has a taxation year that ends on December 31.

The following information relates to the year ending December 31, 2016:

- Sales of delivered merchandise and services totaled \$259,000. As of December 31, \$88,000 of this total had not been collected. As several of her clients are having financial difficulties, she anticipates that \$7,000 of these outstanding accounts will not be collectible.
- In addition to sales of delivered merchandise, the business received deposits on orders in the amount of \$27,000. This merchandise is scheduled to be delivered in early 2017.
- Opal purchased a large stock of top quality decorating materials from the trustee of a bankrupt decorating business. Since the material is too rococo to appeal to her clientele, she has found another decorating business that is prepared to buy these materials for \$62,000. Her cost for these materials is \$47,000, resulting in an anticipated gross profit of \$15,000. Because of the size of the sale, she has accepted a down payment of \$22,000, followed by two annual instalments of \$20,000. The instalments are due on December 31, 2017 and December 31, 2018.

The following information relates to the year ending December 31, 2017:

- A total of \$6,500 of accounts receivable were written off during the year.
- All of the merchandise on which 2016 deposits were received was delivered.
- The \$20,000 instalment on the large project was received.
- Sales of delivered merchandise and services totaled \$360,000. As of December 31, \$72,000 of this total had not been collected. Opal anticipates that \$9,500 of these outstanding accounts will not be collectible.
- In addition to sales of delivered merchandise, the business received deposits on orders in the amount of \$21,000. This merchandise is scheduled to be delivered in early 2018.

**Required:** How would the preceding information affect the calculation of Opal Schwartz's business income for the 2016 and 2017 taxation years? Include the full details of your calculations for each year, not just the net result for each year. Ignore GST/PST implications.

**TIF PROBLEM SIX - 7****Work Space In Home Costs And CCA**

In order to supplement his income working in a Calgary bookstore, Mr. Victor Larson has decided to start a home based business that will specialize in selling used textbooks to university and college students.

The business will be run out of space that he has set aside in his residence. This space involves 18 percent of the total floor space in the residence.

The residence was acquired on January 1, 2016 at a total cost of \$426,000. It is estimated that \$150,000 of this total value can be attributed to the land on which the residence is situated. For the year ending December 31, 2016, Mr. Larson has the following costs that can be associated with this residence:

Utilities For Home (Heat, Light, And Water)	\$ 3,200
Mortgage Interest Paid	10,100
House Insurance	500
Property Taxes	4,300
Repairs And Maintenance For Home	2,600
<b>Total</b>	<b>\$20,700</b>

The business begins operations on January 31, 2016. On that date, Mr. Larson acquires the following assets to be used in his new business:

Office Furniture And Storage Racks	\$18,500
Computer	1,430
Business Software	570

In addition, he has a separate telephone line installed for dealing exclusively with the mail order business. The telephone charge includes charges for a toll-free number and a long distance package.

During the period January 31, 2016 through December 31, 2016, his mail order sales total \$182,000. Costs associated with these sales are as follows:

Cost Of Merchandise Sold	\$98,000
Unsold Merchandise (Lower Of Cost And Market)	23,500
Packaging Materials	2,400
Shipping Costs	4,600
Miscellaneous Office Supplies	560
Telephone (Total Charge For The Period)	1,100
Printing Of Posters And Brochures Distributed	420

**Required:**

- Can Mr. Larson deduct work space in the home costs? Briefly explain your conclusion.
- Compute the minimum net business income or loss that Mr. Larson must report in his 2016 personal income tax return.
- Briefly describe any issues that should be discussed with Mr. Larson concerning the work space in his home and business costs.

## **TIF PROBLEM SIX - 8**

### **Automobile Costs And Benefits**

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Maxine's Cleaning Services is a Canadian controlled private corporation with a December 31 year end. Maxine Brott is the sole shareholder of the corporation and actively participates in the operation of the business as an employee.

Because of the extensive travel required in supervising her employees, the Company provides Ms. Brott with a car. During the first 6 months of 2016, the provided car was a Honda Accord that had been purchased in 2015 for \$29,000. During this 6 month period, she drove the car a total of 23,000 kilometers, of which 15,000 were related to her employment activities. The Class 10 UCC balance at the beginning of 2016 was \$24,650.

On July 1, 2016, the Honda Accord was sold for \$25,000. It was replaced with a BMW 7 Series sedan at a cost of \$105,000. During the period July 1, 2016 through December 31, 2016, she drove this vehicle a total of 37,000 kilometers, of which 18,000 were related to her employment activities.

Throughout 2016, the Company paid for all of the operating costs of both vehicles, a total of \$12,300.

Other than the Honda Accord and the BMW sedan, the Company did not own any other vehicles during 2016. During the period January 1, 2016 through December 31, 2016, an automobile was always available to Ms. Brott.

**Required:** Determine the following:

- A. The tax consequences to Maxine's Cleaning Services that result from owning and selling the Honda Accord and owning the BMW sedan during 2016.
- B. The minimum amount of the taxable benefit that Maxine will have to include in her Net Income For Tax Purposes for 2016.

Ignore GST and PST considerations in both parts of this question.

## TIF PROBLEM SIX - 9

### Inventory Valuation

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Arnold Fortin owns and operates an unincorporated business which sells hockey jerseys for school teams. The business has a December 31 year end. During his first year of operations, he has the following purchases:

Date	Quantity	Price	Total Cost
January 20	2,200	\$17.00	\$ 37,400
March 12	1,800	\$18.50	33,300
June 15	6,600	\$20.25	133,650
October 8	3,200	\$21.42	68,544
December 9	1,500	\$16.50	24,750
Totals	15,300		\$297,644

On December 31, the end of his first year of operation, the inventory on hand amounts to 5,000 units. It is estimated that these units have a replacement cost of \$16.75 per unit and a net realizable value of \$18.30 per unit.

**Required:** Calculate the various closing inventory values that could be used to determine business income for tax purposes. Your answer should indicate the valuation method being used, as well as the resulting value.

## **TIF PROBLEM SIX - 10**

### **Deductible Business Expenses - Corporation**

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The Vernon Manufacturing Company, a Canadian controlled private corporation, has just ended its first fiscal year. During that year, a number of outlays were made for which the Company is uncertain as to the appropriate tax treatment. You have been asked to advise them in this matter and, to that end, you have been provided with the list of outlays and expenditures that follows:

1. A part of the Company's raw materials had to be imported from Brazil. In order to obtain local financing for these inventories, the Company paid a \$1,200 fee to a Brazilian financial consultant for assistance in locating the required financing.
2. Donations totalling \$12,000 were given to various registered Canadian charities.
3. The Company paid \$2,500 to the owner of a tract of land in return for an option to purchase the land for \$950,000 for a period of 2 years. The land is adjacent to the Company's main factory and management believes it may be required for future expansion of the Company's manufacturing facilities.
4. Direct costs of \$7,500, related to incorporating the Company, were incurred during the year.
5. An amount of \$10,000 was paid for a franchise giving the Company the right to manufacture a Brazilian consumer product for a period of ten years.
6. Because of its rapid growth, the Company was forced to move into a building that they had originally leased to another company. In order to cancel the lease, it paid \$8,000 to the tenant. In addition, \$9,500 was spent to landscape the facilities and another \$13,000 was spent to provide a parking lot for employees.
7. As some of its employees use public transportation, a pedestrian bridge over an adjacent highway was required to allow these employees to reach the plant from the public transportation terminal. The cost of this bridge was \$12,000.

**Required:** Indicate which of the preceding expenditures you feel that the Vernon Manufacturing Company will be able to deduct in the calculation of net business income for the current year, and the tax treatment of the non-deductible expenditures. Explain your conclusions.

## TIF PROBLEM SIX - 11

### Reverse Comprehensive Business Income

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Brown's Forms is a proprietorship owned by Nathan Brown. It has been in operation for several years and has always used a taxation year that ends on December 31.

Because he has had no need to report his income figures to anyone, as a matter of convenience, he has simply used tax procedures to calculate the annual income of the business. This has allowed him to use this figure in reporting his net business income in his tax return.

For the year ending December 31, 2016, using his usual tax procedures, Nathan has calculated his net business income to be \$401,300.

As his business has been very successful, he would like to open a second location. However, in order to do this, he will need financing from his bank. In discussing this with his account manager, he has been advised that he will need to present financial statements prepared in accordance with generally accepted accounting principles (GAAP).

While he is uncertain as to whether he will proceed with opening a second location, he has asked you to assist him in determining how much GAAP based income Brown's Forms had for 2016.

#### Other Information:

1. Nathan deducted \$42,100, the maximum amount of CCA that was available for the year. You have determined that amortization under GAAP would have been \$36,400.
2. In late December, 2016, Nathan spent \$12,000 on landscaping the grounds around his original location. Given the late date at which this work was done, no amortization would be required for accounting purposes with respect to these costs for 2016. It is expected that these landscaping improvements will last at least 10 years.
3. His son, Nathaniel, who is majoring in computer science at a local university, designed the web site for Nathan's business 2 years ago. Since then, Nathaniel has maintained and updated this site. During 2016, Nathan paid Nathaniel \$12,200 for his work. This amount was deducted in his net business income calculation.
4. During 2016, Nathan sold Class 8 assets for \$14,200. These assets had a capital cost of \$21,400 and were not the last assets in Class 8. There was a positive balance in Class 8 at the end of the year. If these assets had been subject to GAAP amortization, their net book value would have been \$12,600.
5. Nathan spent \$5,500 advertising on a U.S. television station. The commercials were directed at Canadian resident viewers.
6. In the net business income calculation based on tax procedures, Nathan deducted \$6,000 in business meals and entertainment costs.
7. One of Nathan's workers stole cash receipts totaling \$4,300.
8. Nathan owns 2 delivery vehicles with a capital cost of \$23,000 each. They are the only assets in Class 10 which has a UCC balance of \$19,159 on January 1, 2016. During 2016, the two vehicles were sold for a total of \$15,000. If the vehicles had been subject to GAAP amortization, their net book value at the time of sale would have been \$11,776 each for a total of \$23,552.
9. During 2016, the business made charitable donations of \$4,200.
10. During 2016, the business provided uniforms for the local girls soccer team. The cost of these uniforms was \$2,500. Nathan thought that this would be good advertising as the name of his business was displayed prominently on the team jerseys.

*Reverse Comprehensive Business Income*

11. For tax purposes, the ending inventories of the business were carried at the market value of \$123,000. Their total cost, determined on a FIFO basis, was \$118,000.
12. As the business is unincorporated, no taxes were deducted in calculating Net Income.

**Required:** Determine the 2016 GAAP based net income for Brown's Forms. Do not include in your calculations any tax that Nathan will have to pay on this income. If you do not use some of the items included in other information, indicate why this is the case.

## **TIF PROBLEM SIX - 12**

### **Business Income - Proprietorship**

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Fairway Distribution is a proprietorship. The business distributes a wide variety of health aid products to retailers. The business is owned by John Fairway. His wife, Jane Fairway, is an avid golfer with no interest or experience in business matters.

For the taxation year ended December 31, 2015, the accountant calculated a pre-tax Net Income for Fairway Distribution of \$273,000. In calculating this figure, Mr. Fairway's accountant relied on generally accepted accounting principles except for the fact that no provision is made at the end of the year for anticipated bad debts. This variance from generally accepted accounting principles resulted from the accountant's belief that Mr. Fairway is a much more reasonable and pleasant person when he is presented with a higher Net Income figure.

**Other Information** Other information related to the 2015 taxation year is as follows:

1. In the previous year, a reserve for bad debts was deducted for tax purposes in the amount of \$15,000. For accounting purposes, only the actual 2015 write-offs of \$17,500 were deducted. The accountant felt that an appropriate reserve to be deducted for tax purposes at the end of 2015 would be \$19,200.
2. Accounting income included a deduction for amortization in the amount of \$78,500. The accountant has determined that the maximum CCA for 2015 would be \$123,600.
3. The following items were included in the accounting expenses:

Cost of advertising in a foreign newspaper that is distributed in Canada	\$ 3,500
Donations to registered charities	1,260
Cost of appraisal on real estate to be sold	1,470
Costs of landscaping work done on the grounds of Mr. Fairway's personal estate	5,260
Management fee to Mrs. Jane Fairway	123,000
4. As the business is unincorporated, no taxes were deducted in calculating Net Income.

**Required:** Calculate the minimum net business income for Fairway Distribution that will be included in Mr. Fairway's tax return for the year ending December 31, 2015.

## **TIF PROBLEM SIX - 13**

### **Business Income - Proprietorship**

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Morton Forms is a proprietorship owned by Viola Morton. Its taxation year ends on December 31. For the current taxation year, Ms. Morton's daughter, Linda, who works in the business, has calculated a Net Income for Morton Forms of \$193,200. In calculating this figure, Linda used generally accepted accounting principles.

#### **Other Information:**

1. During the year, Morton Forms spent \$18,900 for landscaping the grounds around its Vancouver office. In accordance with generally accepted accounting principles, this amount was treated as a capital expenditure. As the work was done late in the year, no amortization was deducted for the current year.
2. The following items were included in the accounting expenses:

Amortization expense	\$69,300
Cost of sponsoring local baseball teams	7,200
Reserve for future inventory obsolescence	15,000
Advertising on a foreign television station (Directed at Canadian market)	9,600
Advertising circulars (Only one-quarter distributed)	12,400
Business meals and entertainment	22,000
Charitable donations	31,900
Loss from theft	16,200
Interest paid on building mortgage	24,200
Appraisal costs on land to be sold	4,200
Damages resulting from breach of contract	3,800
3. Also included in the accounting expenses were \$4,000 in fees paid to Linda's 16 year old son for creating and maintaining the web site of Morton Forms. In pricing this work, Viola found that it would cost at least \$8,000 to obtain the equivalent services from an outside consultant.
4. Maximum CCA has been determined to be \$94,200 for the current taxation year.
5. As the business is unincorporated, no taxes were deducted in calculating Net Income.

**Required:** Calculate the minimum net business income for Morton Forms that will be included in Viola Morton's tax return for the current taxation year. Indicate why you have not included any of the preceding items in your calculations.

**TIF PROBLEM SIX - 14****Business Income With CCA and CEC - Corporation**

For the year ending December 31, 2016, the Income Statement of Markham Ltd., prepared in accordance with generally accepted accounting principles, is as follows:

Revenues		\$973,000
Expenses:		
Cost Of Goods Sold	(\$272,000)	
Selling And Administrative Costs	( 132,000)	
Amortization Expense	( 156,000)	
Other Expenses	( 137,000)	( 697,000)
Income Before Tax Expense		\$276,000
Income Tax Expense:		
Current	(\$ 97,000)	
Future	( 32,000)	( 129,000)
Net Income		\$147,000

**Other Information:**

1. The Company spent \$6,000 during the year on landscaping for its new building. For accounting purposes this was treated as an asset. The Company will not amortize this balance as it believes the work has an unlimited life.
2. Selling And Administrative Costs include \$15,000 in business meals and entertainment.
3. Other Expenses include contributions to registered charities of \$3,700.
4. As the Company expects to issue more shares during 2017, it made a number of amendments to its articles of incorporation and included the legal costs in Other Expenses. These costs totalled \$6,000.
5. During 2015, Markham Ltd. acquired a competing business at a price that included goodwill of \$70,000. For accounting purposes, there is no impairment or write-down of the goodwill purchased in either year.
6. Other Expenses includes bond discount amortization of \$2,500.
7. Selling And Administrative Costs include membership fees for several employees in a local golf and country club. These fees total \$3,400.
8. On January 1, 2016, the Company had the following UCC balances:

Class 1	\$400,000
Class 8	575,000
Class 10	45,000
Class 13	68,000

The Class 1 balance relates to a single building acquired in 2000 at a cost of \$550,000. It is estimated that the value of the land at this time was \$50,000. On February 1, 2016, this building is sold for \$612,000. It is estimated that the value of the land is unchanged at \$50,000. In the accounting records, this real property was carried at \$507,000, \$457,000 for the building and \$50,000 for the land. The resulting gain on the building is included in the accounting revenues.

The old building is replaced on February 15, 2016 with a new building acquired at a cost of \$683,000 of which \$60,000 is allocated to land. The Company chose not to put the new building into a separate Class 1 so it does not qualify for the 6 percent CCA rate. No elections are made with respect to the replacement of the building.

*Business Income With CCA and CEC - Corporation*

There are no dispositions of Class 8 assets during the year. However, there are acquisitions in the total amount of \$126,000.

As the Company has decided to lease all of its vehicles in the future, all of the assets in Class 10 are sold during the year. The capital cost of these assets was \$93,000 and the proceeds of disposition amounted to \$37,000. The net book value of these assets was \$52,000 and the resulting accounting loss of \$15,000 was included in Other Expenses.

The Class 13 balance relates to a single lease that commenced on January 1, 2014. The lease has an initial term of seven years, with two successive options to renew for three years each. Expenditures on this leasehold were \$50,000 in 2014 and \$27,000 in 2015. There were no further expenditures in 2016. The write-off of these expenditures for accounting purposes is included in Amortization Expense.

9. Other Expenses includes interest on late income tax instalments of \$500 and on late municipal tax payments of \$275.
10. Markham Ltd. deducts maximum CCA.

**Required:** Determine Markham Ltd.'s 2016 minimum Net Income For Tax Purposes. In addition, calculate the January 1, 2017 UCC for each CCA class. Indicate why you have excluded some items from your calculations.

## **TIF PROBLEM SIX - 15**

### **Business Income With CCA - Billed Basis**

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Carl Pomery is a Chartered Professional Accountant who is employed as a controller of a medium sized corporation. He has been married three times and is required to make support payments to each of his former spouses. Because of his need for additional income, he operates an unincorporated tax and accounting services business. This business has a December 31 year end and has been in operation for several years.

Carl purchased a new building in 2008. It has been used exclusively for non-residential purposes and was allocated to a separate Class when it was purchased. On January 1, 2016, the business has the following UCC balances:

Class 1 Building	\$242,000
Class 8 Furniture And Fixtures	72,000
Class 10 Vehicle (Purchased For \$19,600)	16,660

During January, 2016, the Class 10 vehicle is involved in a serious accident, requiring it to be permanently taken off the road. The insurance proceeds are \$14,600. On February 1, Carl replaces it with a vehicle with a manufacturer's list price of \$34,000 that is leased for \$525 per month. Both vehicles are used exclusively for business purposes.

During July, 2016, Carl replaces most of the furniture in his office. The old furniture has a capital cost of \$23,000, while the new items cost \$46,000. Carl receives a trade in allowance for the old furniture of \$18,000.

Also during January 2016, Carl acquires a new computer for \$2,500, along with applications software for \$2,200.

During March, 2016, Carl acquires a client list from an accountant who is retiring. The cost of this list is \$82,000.

On January 1, 2016, Carl had unbilled work-in-progress of \$35,000, along with billed receivables of \$48,000. During 2016, his collections total \$123,000. On December 31, 2016, the unbilled work-in-progress has increased to \$42,000 and the billed receivables have increased to \$56,000.

During 2016, the various costs of operating his business, determined on an accrual basis, are as follows:

Building Operating Costs	\$22,000
Vehicle Operating Costs	7,200
Vehicle Lease Payments	5,775
Payments To Assistants	24,000
Miscellaneous Office Costs	4,500
Meals With Clients	3,500

**Required:** Calculate the minimum net business income Carl would include in his 2016 personal income tax return. In preparing your solution, ignore PST and GST considerations.

## **TIF PROBLEM SIX - 16**

### **Comprehensive Business Income**

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Darby Inc. has just completed its fiscal year ended December 31, 2016. Using GAAP, the accountant has determined that, for that taxation year, the Company has experienced a Net Loss Before Taxes and Amortization Expense of \$113,000. The accountant provides the following information that was used in the determination of the Net Loss for accounting purposes:

1. The Company was forced to pay damages of \$12,300 for failure to perform a service contract. The amount was paid when the client threatened to bring action for breach of contract. The \$12,300 was expensed in the current year.
2. The Company's property tax expense of \$19,500 includes an amount of \$1,100 that was paid to a regional municipality in which the Company maintains a fishing lodge for its employees.
3. The Company's expenses include contributions to registered charities of \$13,700.
4. The Company's expenses include costs of new landscaping at their administration building in the amount of \$9,800.
5. The Company deducted a loss of \$10,100 resulting from a theft by one of its clerical employees.
6. Effective December 31, 2016, as the result of a change in its distribution system, the Company was forced to cancel a tenant's lease that would have been in force until January 1, 2024. During the 2016 taxation year, the Company agreed to pay, and deducted, damages in the amount of \$17,000. On December 31, 2016, \$5,000 of this amount had not been paid.
7. The current salary expense included a bonus payable to the Company's president in the amount of \$14,500. It will be paid on February 1, 2017.
8. The insurance expense included the premium on a whole life policy on the life of the president's wife in the amount of \$9,500. This was not a group life policy and the proceeds were payable to the Company.
9. As the Company changed property and casualty insurers during the year, all of its assets had to be appraised. The cost of this appraisal was \$4,150, with the entire amount being expensed in the year.
10. The Company's wage expense included \$51,000 in management bonuses (other than that of the president described in item 7) that will not be paid until May 1, 2017. In addition, \$34,000 in bonuses, which were deducted for both tax and accounting purposes in 2015, were paid in March, 2016.
11. Bad debt expense amounted to \$11,000.
12. Renovation costs in the amount of \$153,000 were charged to expense during the year. This amount resulted from the need to completely renovate one of the Company's offices and involved the installation of plumbing and air conditioning systems, as well as rewiring and installation of new concrete foundations.

13. The president and his wife attended a convention that resulted in \$5,200 in travel expenses for the Company. Of this amount, \$1,900 related to the fact that the president's wife chose to accompany him on this trip.
14. The Company's interest expense included bond discount amortization in the amount of \$950.
15. The Company's legal expenses for the year amount to \$10,500 and were related to the following transactions:
- |  |         |
|--|---------|
| Defense of breach of contract (see item 1)       | \$2,450 |
| Cost of amending articles of incorporation       | 3,600   |
| Defense costs related to income tax reassessment | 4,450   |
16. The Company's expenses included a total amount of \$12,500 for business meals and entertainment.
17. The Company's calculations for CCA and Cumulative Eligible Capital write-offs have not yet been completed.

**Required:** Compute the Company's Net Income For Tax Purposes for the year ending December 31, 2016, before the consideration of CCA or Cumulative Eligible Capital write-offs. Indicate why you have not included any of the preceding items in your calculations.

**TIF PROBLEM SIX - 17****ITA 22 Election**

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Gail Gates is the owner of Gail's Gates (GG), an unincorporated business that provides wholesale distribution of various types of ornamental gates. The business has a December 31 year end.

Gail is about to marry the man of her dreams and, as he is very, very wealthy (this is what she dreamed about), she sees no reason to continue operating GG. Given this, she intends to sell GG to an unrelated party, Ms. Mandy Portals. The transaction will take place on July 1, 2016 and will involve all of the assets of the business. Ms. Portals does not anticipate incorporating the business and will continue to use the December 31 year end.

On the date of the sale, the Accounts Receivable of the business have a face value of \$263,000. Gail and Mandy agree that the current fair market value of these receivables is \$249,000. In 2015, Gail deducted a reserve for doubtful debts under ITA 20(1)(l) of \$15,000.

Between July 1, 2016 and December 31, 2016, \$251,000 of the Accounts Receivable are collected, with the remaining \$12,000 being written off as uncollectible.

Both Gail and Mandy have heard of an election under ITA 22 that may have some influence on the tax treatment of the transfer of accounts receivable. They would like to have your advice on this matter. Gail notes that she did not have any capital gains in the previous three years. Further, she does not expect to have capital gains in 2016 or any subsequent year.

**Required:**

- A. Indicate the tax effects, for both Gail Gates and Mandy Portals, of the disposition of the accounts receivable and the subsequent 2016 collections and write-offs, assuming:
  - that no election is made under ITA 22.
  - that they make an election under ITA 22.
- B. Indicate, from the point of view of each taxpayer, whether making the election would be a desirable course of action.

## **TIF PROBLEM SIX - 18**

### **Comprehensive Case (Chapters 1 To 6)**

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Andrew Bank is 51 years old and lives with his common law partner, John Bream. John is 49, qualifies for the disability tax credit, and has 2016 income of \$4,500, including Universal Child Care Benefits.

They have two adopted children. Their 19 years old son Bart is dependent on Andrew because he is disabled. However, the disability is not sufficient to qualify Bart for the disability tax credit. Bart has 2016 income of \$2,800. Because of his outstanding academic abilities, their 15 year old son, Carl is attending university on a full time basis throughout 2016. Andrew has paid his tuition fees of \$17,000, as well as all of his other costs of attending university. As Carl has no income of his own, he has agreed to transfer all of his education related credits to Andrew.

During 2016, Andrew paid for family medical expenses as follows:

Andrew	\$ 2,300
John	12,600
Bart	4,600
Carl	400
<hr/>	
Total	\$19,900
<hr/>	

Andrew is employed by Martin Inc., a Canadian public company. For 2016, his salary is \$123,000. In addition, he has commissions of \$11,500. For the year ending December 31, 2016, his employer withholds the following amounts from his income.

RPP Contributions*	\$6,300
EI Premiums	955
CPP Contributions	2,544
Parking Fees At Employer's Lot	600

\*Andrew's employer makes a matching contribution of \$6,300 to his RPP.

Andrew is required to use his own car for employment related travel, largely going to meet with clients in their homes. His car was acquired on January 1, 2016 at a cost of \$42,000. During 2016, Andrew drove the car a total of 46,000 kilometers, of which 31,000 were employment related. The remaining 15,000 kilometers involved personal use of the car. His total operating costs for the year were \$9,300. His employer provides him with an allowance of \$800 per month to reimburse him for the employment related use of his car.

Andrew's sales territory is large and during 2016, his employment related expenses were as follows:

Hotels	\$ 8,500
Airline Tickets	4,500
Meals Alone While Travelling	2,000
Meals With Clients And Client Entertainment	8,600
<hr/>	
Total	\$23,600
<hr/>	

Mr. Andrew's employer does not reimburse him for any of these costs.

During 2016, Andrew received options to acquire 500 shares of Martin Inc. at a price of \$23 per share. At that time, the shares were trading at \$25 per share. Near the end of 2016, Andrew exercises all of these options. At the time of exercise, the shares are trading at \$28 per share. He is still holding the shares at year end.

**TIF Problem Six - 18**  
*Comprehensive Case (Chapters 1 To 6)*

Several years ago, Andrew acquired an unincorporated business which he has continued to operate through the current year. On January 1, 2016, the UCC and CEC balances for this business were as follows:

Class 1 (Building Acquired In 2004)	\$472,200
Class 8	143,300
Class 50	12,500
CEC*	55,800

\*The CEC balance reflects an unlimited life franchise that was acquired in 2015 for \$80,000.

Andrew uses tax based accounting for all of his revenues and expenses. He has correctly calculated his net business income for tax purposes, prior to any CCA or CEC amounts, as \$189,000.

In December, 2016, the unlimited life franchise was sold for \$90,000. The results of this sale are not included in his net business income of \$189,000. Andrew will not be electing under ITA 14(1.01) to deem the adjusted cost base equal to the cost of the franchise. No other capital assets were acquired or disposed of during 2016.

**Required:** Calculate Andrew's 2016 Net Income For Tax Purposes, his 2016 Taxable Income, and his minimum 2016 federal Tax Payable without consideration of any income tax withheld by his employer. Ignore GST and PST considerations.

## **TIF PROBLEM SIX - 19**

### **Comprehensive Case (Chapters 1 To 6)**

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Mr. Martin Bowles is 43 years old and is employed by, Dominion Brass, a large public company. During 2016, his basic salary was \$89,000. In addition, he earned \$12,000 in commissions. His employer withheld the following amounts from his income during 2016:

RPP Contributions*	\$3,750
EI Premiums	955
CPP Contributions	2,544
Union Dues	430
Payments For Personal Use Of Company Car	1,200

\*Mr. Bowles' employer makes a matching contribution of \$3,750 to his RPP.

His employer provides Mr. Bowles with a car which is leased at a rate of \$459 per month, a total of \$5,508 for the year. During 2016, the car is driven 33,000 kilometres, of which 24,500 are related to his employment activities. The car was used by Mr. Bowles for 11 months during 2016. When he is not using the car, he is required to return it to the company's garage.

Mr. Bowles is provided with an allowance of \$400 per month to cover hotel and meal costs during his employment related travel. Mr. Bowles' actual costs for 2016 were as follows:

Hotels	\$2,850
Meals	1,875

It is the policy of Dominion Brass to reimburse tuition paid by employees when taking college or university courses. During 2016, Mr. Bowles received reimbursements of \$1,600 for two courses. Of this total, \$1,000 was for a two day marketing course, while \$600 was for a weekend course in art appreciation.

During 2016, Dominion Brass gave Mr. Bowles a \$450 watch in recognition of his 10 years of service with the company. In addition, all employees were given a \$400 gift certificate for purchases at a local department store.

In 2015, Mr. Bowles was granted options to purchase 1,500 shares of Dominion Brass stock at a price of \$52 per share. At that time, the shares were trading at \$50 per share. In June, 2016, when the shares are trading at \$61 per share, Mr. Bowles exercises the options and immediately sells the resulting shares at that price.

On January 1, 2016, Mr. Bowles started a management consulting business located in an office that he rents for \$500 per month. In order to run his business effectively, he made improvements to the office space that cost \$12,000. His lease on the office terminates on December 31, 2018 and does not contain any renewal options.

Other information related to this business is as follows:

**Revenues** During 2016, Mr. Bowles issued invoices for his services totalling \$41,750. In addition, he has unbilled work in progress of \$8,500.

**Capital Expenditures** Mr. Bowles spent \$10,000 for furniture for his new office. In addition, he purchased a computer for \$1,150 and application software for \$836.

**Costs** During 2016, the following costs were incurred in operating the management consulting business:

**TIF Problem Six - 19**  
*Comprehensive Case (Chapters 1 To 6)*

Part Time Assistant	\$5,725
Office Supplies	347
Monthly Telephone Service	312
Cell Phone Charges (For Business Only)	211
Meals With Clients And Client Entertainment	3,150

As the rented office is in the same building complex as his home, Mr. Bowles makes no use of his employer's vehicle for operating this business.

Mr. Bowles is married and has two children:

**Sally**, Martin's spouse, has 2016 income of \$3,450, including Universal Child Care Benefits.

**Marie** is 14 years old and has income of \$2,300. All of this income resulted from the investment of rewards that she has received for science projects.

**Ellen** is 19 years old and attends university on a full time basis for 8 months during 2016. Martin pays her tuition costs of \$9,800, as well as the cost of textbooks and supplies. These latter costs total \$1,500. As Ellen has no income of her own, she intends to transfer all of her education related tax credits to Martin.

Marie is enrolled in a gymnastics program that costs \$1,800 per year. The program has one meeting each week through the months of June, July, and August.

The family's 2016 medical expenses, all paid for by Mr. Bowles, are as follows:

Martin	\$ 2,500
Sally	1,850
Marie	1,600
Ellen	6,540
Total	\$12,490

During 2016, Mr. Bowles makes donations to registered charities of \$1,425, as well as contributions to registered federal political parties in the amount of \$275. He is not eligible for the first time donor's super credit.

**Required:** Calculate Mr. Bowles' 2016 Net Income For Tax Purposes, his 2016 Taxable Income, and his minimum 2016 federal Tax Payable without consideration of any income tax withheld by his employer. Ignore GST and PST considerations.

## **Chapter Seven Test Item File Problems**

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### **TIF PROBLEM SEVEN - 1**

#### **Property Income - Essay Questions**

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1. Indicate two differences between the tax treatment of business income and the tax treatment of property income.
2. One conceptual approach to determining whether interest should be deductible is to limit deductibility to situations where this interest paid is related to the production of income that is fully taxable in the taxation year in which it is earned. List two situations in which interest would not be deductible under this conceptual approach.
3. When an investor receives a payment from a corporation, what characteristics determine whether it is an interest payment or a dividend payment?
4. Briefly describe the “disappearing source” rules.
5. GAAP requires that any premium that is received on the issuance of debt securities be amortized as an adjustment of interest expense over the life of the debt. Explain briefly the tax treatment of premium that is received on the issuance of debt securities.
6. Briefly explain the tax treatment of corporate bonds that are issued at a discount.
7. The tax rules for recognizing interest inclusions for individuals are different than they are for corporations. Briefly describe these differences.
8. When publicly traded debt securities are purchased between interest payment dates, the purchaser pays for any accrued interest to the date of acquisition. Describe the tax treatment of interest received by the purchaser on the next interest payment date.
9. Each rental property that is owned by an individual that has a cost in excess of \$50,000 must be placed in a separate CCA class. What is the objective of this requirement?
10. Briefly explain the concept of integration.
11. Briefly describe the application of the 2016 federal gross up and tax credit procedures for (1) eligible dividends and (2) non-eligible dividends.
12. How is the adjusted cost base of units in an income trust determined?
13. Mutual funds can be organized as either corporations or trusts. How will the choice of organizational structure affect the taxation of income distributions from the fund?
14. What is a stock dividend? How will such dividends be taxed? Describe the manner in which the adjusted cost base of an investor's holding will be changed by a stock dividend.
15. Why are capital dividends received on a tax free basis?
16. Describe the tax treatment of foreign non-business income when the foreign jurisdiction has withheld some portion of the income.

## **TIF PROBLEM SEVEN - 2**

### **Property Income - True Or False**

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1. Corporations must use the full accrual approach to recognize interest inclusions.  
True or False?
2. For tax purposes, neither premium nor discount on long-term debt is ever amortized by the issuer as an adjustment of interest expense.  
True or False?
3. In considering whether interest will be deductible, the direct use of the borrowed money is the relevant consideration.  
True or False?
4. Interest on debt incurred to acquire equity securities is only deductible if the securities have a history of paying regular dividends.  
True or False?
5. An individual purchased a warehouse as an investment property two years ago. During the current year, he received rents of \$8,000 and paid the following expenses; interest of \$6,000, property taxes of \$2,000, heat, light and power of \$500, and maintenance of \$300. The UCC of this Class 1 asset was \$60,000 on January 1 of the current year. He cannot claim a rental loss in the current year.  
True or False?
6. The federal dividend tax credit for eligible dividends can be expressed as 6/11 of the gross up, 20.73 percent of dividends received, or 15.02 percent of grossed up dividends.  
True or False?
7. When the holder of income trust units receives a distribution that contains a return of capital, the amount of the return of capital must be added to the adjusted cost base of the units.  
True or False?
8. Mutual funds can be organized as either corporations or trusts.  
True or False?
9. For tax purposes, stock dividends must be treated in exactly the same manner as cash dividends.  
True or False?
10. When foreign tax authorities withhold taxes on the foreign source income of a Canadian resident, only the net amount received will be included in the Net Income For Tax Purposes of the Canadian resident.  
True or False?

## TIF PROBLEM SEVEN - 3

### Property Income - Multiple Choice

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#### New For 2016/2017

##### ***Interest Deductibility And Interest Inclusion***

1. On July 1, 2015, Janett Koenen acquired 1,000 shares of Techhab Inc. for \$10 per share. The purchase was financed with a \$10,000 bank loan, requiring annual interest payments of 5 percent. These shares were sold on December 1, 2015 for \$6 per share, with the proceeds immediately invested in 500 Flexhub Ltd. shares at \$12 per share. During 2016, the Flexhub shares pay eligible dividends of \$0.50 per share. The bank loan was not repaid in 2015 and remains outstanding on December 31, 2016. On her 2016 tax return, Janett will report:
  - A. Net Property Income Of \$45.
  - B. Net Property Loss Of \$155.
  - C. Net Property Income Of \$345.
  - D. Net Property Loss Of \$50.
  
2. Which of the following statements related to interest deductibility is correct?
  - A. Interest paid on a mortgage secured by a principal residence is never deductible in Canada.
  - B. If a business borrows to pay interest free loans to its employees, the interest on the borrowing will not be deductible.
  - C. If an individual borrows \$100,000 to invest in securities and the securities are later sold for \$60,000, interest on the \$100,000 will continue to be fully deductible provided the \$60,000 is immediately invested in other securities.
  - D. If an individual borrows in order to buy common stocks, the interest on the borrowing will only be deductible if the stocks have a long-term history of paying dividends.

##### ***Rental Income***

3. Which of the following statements with respect to rental properties is **NOT** correct?
  - A. Every rental property with a cost in excess of \$50,000 must be allocated to a separate CCA Class.
  - B. The short fiscal period rules do not apply to the calculation of CCA on a rental property owned by an individual.
  - C. The deduction of CCA cannot be used to create or increase a rental loss.
  - D. If a new rental property is acquired, put into a separate CCA class, and is used more than 90 percent for non-residential purposes, it is eligible for an enhanced CCA rate of 10 percent.

##### ***Dividend Income***

4. Which of the following statements with respect to dividends is **NOT** correct?
  - A. Capital dividends can be received by individuals without tax consequences.
  - B. All taxable dividends paid by Canadian controlled private corporations are non-eligible dividends.
  - C. Stock dividends are subject to the same gross up and tax credit procedures as cash dividends.
  - D. Dividend tax credits are based on a percentage of the gross up on dividends received.

5. During 2016 Thelma Evatt receives eligible dividends of \$23,000. She has no other source of income in that year. What would be the amount of federal Tax Payable or refund on these dividends?
- \$4,761
  - \$3,450
  - Nil
  - A \$6.00 Refund

### **Mutual Funds and Income Trusts**

6. Which of the following statements with respect to income trusts and mutual funds is **NOT** correct?
- Mutual funds can be organized as either trusts or corporations.
  - When an income trust makes a capital distribution, the amount received by a unit holder will be deducted from the adjusted cost base of the units held.
  - Business income received by an income trust will be distributed to investors as business income.
  - Eligible dividends received by a mutual fund will be distributed to investors as eligible dividends.

### **Foreign Source Income**

7. During the current year, Pearlene Monroig earns business income in the U.K. of €10,000 from which the British government withholds €2,000. Assume that the relevant exchange rate was €1.00 = \$1.50 for the year. Which of the following statements is correct?
- Pearlene will have foreign source net business income of \$12,000 and a credit against Tax Payable of \$3,000.
  - Pearlene will have foreign source net business income of \$15,000 and no credit against Tax Payable.
  - Pearlene will have foreign source net business income of \$14,250 and a credit against Tax Payable of \$2,250.
  - Pearlene will have foreign source net business income of \$15,000 and a credit against Tax Payable of \$3,000.

## **Retained From Previous Editions**

### **Interest Deductibility And Interest Inclusion**

8. On January 1, 2016 Bernard borrowed \$5,000 by signing a 1-year note payable at 6% interest and used the money to purchase 2,000 common shares of Import Ltd., a Canadian public corporation for \$2.50 per share. During 2016 Import Ltd. paid eligible dividends of \$0.35 per share. On January 1, 2017 Bernard repaid the \$5,000 he borrowed plus \$300 in interest. On his 2016 tax return, Bernard will report:
- Net Property Income of \$400.
  - Net Property Income of \$666.
  - Net Property Income of \$700.
  - Net Property Income of \$966.
9. Louis received a "hot tip" from a friend about Fine Mine Ltd. He borrowed \$10,000 from the bank on April 1, 2016 by signing a 90 day note payable and bought 1,000 common shares in the company for \$10 each. His friend was right about the company and on June 30, 2016 Louis sold his shares for \$15 each, repaid the bank the total amount owing of \$10,148 and pocketed the difference. As a result, Louis' taxable income for 2016 increased by:
- \$2,352.
  - \$2,426.
  - \$2,500.
  - \$4,852.

10. On July 1, 2016 Esther borrowed \$8,000 from the bank and purchased 400 shares in No Hope Ltd. for \$20 per share. Esther felt that this was a safe investment because she read on-line in a blog that No Hope would be paying dividends of \$1.50 per share during the last half of 2016. Unfortunately, this didn't happen and she only received eligible dividends totalling \$100 during 2016. On December 31 she paid the bank loan interest of \$240. On her 2016 tax return, Esther will report:
- A. Net Property Income of \$100.
  - B. Net Property Income of \$138.
  - C. Net Property Income of \$0.
  - D. Net Property Loss of \$102.
11. Which of the following statements is **NOT** correct?
- A. Income from rental properties can be either business income or property income.
  - B. When property income is earned, the income attribution rules are applicable.
  - C. Interest paid on a mortgage on a principal residence can be deductible.
  - D. Interest paid on funds borrowed to make interest-free loans to employees is not deductible.
12. A taxpayer loaned \$20,000 for one year to his mother-in-law on October 1, 2014. Interest at 6 percent per year was payable on September 30, 2015, but was not paid until February 1, 2016. There are several ways in which the interest can be allocated to the years involved. For the following parts of the question, indicate which method corresponds to the interest allocation if it is a method that is permitted by the ITA. If it is not a permitted method, indicate the answer E.
- A. Accrual Method
  - B. Cash Method
  - C. Compound Interest Method
  - D. Receivable Method
  - E. Not Allowed Method
- i. Income for 2014 is \$300, 2015 income is \$900, and 2016 income is nil.
  - ii. Income for 2014 is nil, 2015 income is \$1,200, and 2016 income is nil.
  - iii. Income for 2014 is nil, 2015 income is \$900, and 2016 income is \$300.
  - iv. Income for 2014 is nil, 2015 income is nil, and 2016 income is \$1,200.
13. A corporation issues debt with a maturity value of \$1,000,000 for proceeds of \$900,000. The debt matures in 10 years and pays annual interest at a rate of 10 percent. Which of the following statements is correct?
- A. The corporation will be able to deduct interest of \$110,000 in each of the years 1 through 10.
  - B. The corporation will be able to deduct interest of \$100,000 in each of the years 1 through 10 and will have a fully deductible loss of \$100,000 in year 10.
  - C. The corporation will be able to deduct interest of \$100,000 in each of the years 1 through 10 and will have a capital loss in year 10 of \$100,000, only one-half of which will be deductible.
  - D. The corporation will be able to deduct interest of \$90,000 in each of the years 1 through 10.

14. A corporation issues debt with a maturity value of \$1,000,000 for proceeds of \$1,100,000. The debt matures in 10 years and pays annual interest at a rate of 10 percent. The issuer is not a money lender and there is no evidence that there was a deliberate creation of a premium. Which of the following statements is correct?
- A. The corporation will be able to deduct interest of \$90,000 in each of the years 1 through 10.
  - B. The corporation will be able to deduct interest of \$100,000 in each of the years 1 through 10 and will have a fully taxable gain of \$100,000 in year 10.
  - C. The corporation will be able to deduct interest of \$100,000 in each of the years 1 through 10 and will have a capital gain in year 10 of \$100,000, only one-half of which will be taxable.
  - D. The corporation will be able to deduct interest of \$100,000 in each of the years 1 through 10 and there will be no tax consequences at maturity.
15. Jorge purchased a newly issued \$20,000 corporate bond for \$19,500 on November 1, 2016. The maturity date of the bond is October 31, 2021 and the annual interest rate is 5%, paid on October 31 of each year. How much interest income should Jorge report on his 2016 and 2017 tax returns if he wants to minimize the interest recognized for tax purposes?
- A. \$0 in 2016 and \$975 in 2017.
  - B. \$0 in 2016 and \$1,000 in 2017.
  - C. \$167 in 2016 and \$833 in 2017.
  - D. \$167 in 2016 and \$1,000 in 2017.
16. Which of the following is **NOT** a characteristic of interest?
- A. It must represent compensation for use of a principal amount.
  - B. It must accrue continuously over time.
  - C. It must be paid on a regular, periodic basis.
  - D. It must be calculated with reference to a principal amount.
17. On July 1, 2016, Jon Laxtor acquires a newly issued investment contract with a maturity value of \$100,000. It matures on June 30, 2021, with interest accruing at 8 percent per annum. Interest is paid for the first one and one-half years on December 31, 2017. The remaining interest will be paid at maturity. With respect to the minimum amount of interest that Jon must recognize for tax purposes, which of the following statements is correct?
- A. Jon will have to recognize \$4,000 in 2016 and \$8,000 in 2017.
  - B. Jon will have to recognize nil in 2016 and \$8,000 in 2017.
  - C. Jon will have to recognize nil in 2016 and nil in 2017.
  - D. Jon will have to recognize nil in 2016 and \$12,000 in 2017.
18. Which of the following statements concerning the tax treatment of interest income is **NOT** correct?
- A. Individuals must accrue interest using the cash basis.
  - B. Corporations must accrue interest on a daily basis.
  - C. Accrued interest from the date of the last interest payment date will be added to the purchase price of a security.
  - D. If there is accrued interest on a security, the seller includes the accrued interest in income and the purchaser deducts a corresponding amount from the interest received on the bonds.

19. With regard to debt securities, which of the following statements is correct?
- A. Provided the issuer is not in the business of lending money, issuing debt securities at a premium will normally reduce the after-tax cost of financing for the issuer.
  - B. Provided the issuer is not in the business of lending money, issuing debt securities at a premium will normally increase the after-tax cost of financing for the issuer.
  - C. Issuing debt securities at a discount results in the borrowing corporation receiving funds above the stated price.
  - D. Issuing debt securities at a premium results in the borrowing corporation receiving funds below the stated price.

**Rental Income**

20. Saul has two residential rental properties that are mortgaged. Both properties are in Class 1 with a CCA rate of 4 percent. At the beginning of the year, Property A has a UCC of \$500,000 and Property B has a UCC of \$1,100,000. Before consideration of CCA, Property A earned net rental income of \$43,000, and Property B had a net rental loss of \$27,000. What is the maximum amount of CCA Saul will be able to claim this year?
- A. Nil.
  - B. \$16,000.
  - C. \$20,000.
  - D. \$44,000.
21. When calculating taxable property income for a rental property, which of the following should never be included in the calculation?
- A. Half year rule.
  - B. Short fiscal period rule.
  - C. Recapture.
  - D. Terminal loss.
22. Rosa owns a duplex and rents both units to tenants. Which one of the following expenditures is not a deduction for tax purposes?
- A. Cost of a new refrigerator.
  - B. Cost of repairing the front stairs.
  - C. Cost of painting the interior of unit # 2
  - D. Interest paid on the mortgage on the duplex.
23. Fergus owns a rental property. Instead of hiring contractors he does all of the property maintenance and repairs himself, keeping careful records. Which one of the following amounts is not a deduction for tax purposes?
- A. \$700 for shrubs and flowers.
  - B. \$150 for bookkeeping services.
  - C. \$400 for lumber, paint and hardware.
  - D. \$500 for his labour (50 hours @ minimum wage of \$10 per hour).
24. Aziz purchased a residential rental property on April 15, 2016. He paid \$300,000 cash for the building and paid an additional \$540 for eligible rental expenses during 2016. He rented the property on May 1 to long term tenants for \$1,400 per month. On his 2016 tax return he should report net rental income of:
- A. \$4,660.
  - B. \$7,173.
  - C. \$6,633.
  - D. \$10,660.

25. Shahrukh owns a residential rental building which he purchased for \$200,000 in 2016. In that year, his rental income before CCA was \$5,000. In 2017, his rental income before CCA was \$8,000. Shahrukh always minimizes his tax liability. Which of the following statements is correct?
- A. Shahrukh has a net rental loss of \$3,000 in 2016.
  - B. Shahrukh has net rental income of \$160 in 2017.
  - C. Shahrukh has net rental income of nil in 2017.
  - D. Shahrukh has net rental income of \$200 in 2017.

***Dividend Income***

26. The federal dividend tax credit cannot be claimed if you receive:
- A. Eligible dividends.
  - B. Non-eligible dividends.
  - C. Stock dividends.
  - D. Capital dividends.
27. Which of the following statements is correct for 2016?
- A. The federal dividend tax credit is equal to 38 percent of the eligible dividends received.
  - B. The federal dividend tax credit is equal to 6/11 of the gross up on eligible dividends received.
  - C. The federal dividend tax credit is equal to 17 percent of the non-eligible dividends received.
  - D. The federal dividend tax credit is equal to 6/11 of the gross up on non-eligible dividends received.
28. Which of the following statements is correct?
- A. Net Property Income =  
Dividends received plus the gross-up minus the dividend tax credit.
  - B. Net Property Income =  
Dividends received minus the gross-up minus the dividend tax credit.
  - C. Federal Tax Payable =  
Federal tax on grossed-up dividends minus the dividend tax credit.
  - D. Federal Tax Payable =  
The gross up on dividends received minus the dividend tax credit.
29. During 2016 Erin received eligible dividends of \$800, non-eligible dividends of \$600 and foreign dividends of \$900 (10% foreign tax was withheld at source). Her 2016 net property income for tax purposes is:
- A. \$2,664.
  - B. \$2,706.
  - C. \$2,764.
  - D. \$2,806.
30. During 2016 Rolf received eligible dividends of \$900 and non-eligible dividends of \$600. His 2016 federal dividend tax credit is:
- A. \$249
  - B. \$260
  - C. \$303
  - D. You can't calculate the dividend tax credit if you don't know his effective tax rate.

31. Sherry's marginal federal tax rate is 29 percent. She lives in a province where her provincial marginal tax rate is 17.5 percent and the provincial dividend tax credit is 31 percent of the dividend gross up. If Sherry receives an eligible dividend of \$16,000 from a Canadian public corporation in 2016, how much will she pay in income tax?
- A. \$5,891.
  - B. \$2,827.
  - C. \$5,066.
  - D. \$8,382.
32. Martin held 2 percent of the outstanding shares of a Canadian public corporation. The corporation issued an eligible stock dividend in 2016 and capitalized \$800,000 of its retained earnings. By how much will Martin's Taxable Income increase as a result of the dividend?
- A. \$ 8,000.
  - B. \$16,000.
  - C. \$18,720.
  - D. \$22,080.

***Mutual Funds and Income Trusts***

33. Maria owns 500 units in a mutual fund that invests exclusively in bonds issued by Canadian public corporations. During 2016 the mutual fund received bond interest and paid income distributions of \$1.12 per unit. Maria reinvested all of her distributions. The effect on Maria's 2016 Taxable Income is:
- A. Increase of \$280.
  - B. Increase of \$560.
  - C. Increase of \$773.
  - D. \$0 because the distributions were reinvested.
34. Yang owns 800 units in a mutual fund that invests exclusively in the shares of Canadian public corporations. During 2016, the fund paid a distribution of \$1.50 per unit. One-half of the distribution was eligible dividend income and the remaining half was capital gains. By how much will Yang's Taxable Income increase as a result of the distribution?
- A. \$600.
  - B. \$1,128.
  - C. \$1,200.
  - D. \$1,428.
35. Which of the following statements is correct for both income trusts that are not specified investment flow-through trusts (i.e., not SIFTs) and mutual fund trusts?
- A. Dividend income is grossed up before it is distributed to the unit holders.
  - B. All after tax distributions are treated as deemed eligible dividends.
  - C. Income earned by the trust is not subject to income tax within the trust if it is distributed to the unit holders.
  - D. If the distributions are a return of capital, the inclusion rate is 50 percent.

36. On January 1, 2016, John Traverse acquires 12,000 units of the RV Income Trust at a cost of \$720,000. During 2016, the trust makes a distribution of \$5.00 per unit. Of this total \$1.50 is a return of capital while the remaining \$3.50 is property income. John reinvests the total distribution in RV units at a cost of \$55 per unit. What is the adjusted cost base of John's units on December 31, 2016?
- A. \$58.21 per unit.
  - B. \$53.62 per unit.
  - C. \$59.58 per unit.
  - D. \$60.00 per unit.

**Foreign Source Income**

37. Julio has a savings account in a foreign country. The account earned \$5,000 interest during 2016 but he only received \$4,500 since \$500 for foreign taxes was withheld by the bank. All amounts are stated in Canadian dollars. The effect on Julio's 2016 tax return is:
- A. An increase in taxable income of \$4,500 and a foreign tax credit of \$0.
  - B. An increase in taxable income of \$5,000 and a foreign tax credit of \$500.
  - C. An increase in taxable income of \$5,000 and a foreign tax credit of \$75.
  - D. Nothing since the interest was earned outside of Canada.
38. Bernadette owns 1,000 shares of a German public corporation. The corporation paid dividends of \$1.50 per share during 2016 but Bernadette only received \$1,275 since 15% tax was withheld in Germany. All amounts are stated in Canadian dollars. Bernadette's 2016 net property income from this investment is:
- A. \$1,275.
  - B. \$1,500.
  - C. \$1,760.
  - D. \$2,070.
39. Ravinder's marginal federal tax rate is 29 percent. He has a foreign investment that earns \$50,000 (Canadian) of non-business income. The government of the foreign country withholds \$10,000 of this amount, with the remaining \$40,000 being remitted to Ravinder during 2016. By what amount will Ravinder's 2016 federal Tax Payable increase as a result of this transaction?
- A. \$ 4,500.
  - B. \$ 6,275.
  - C. \$11,600.
  - D. \$14,500.

**General**

40. Which of the following will provide the lowest amount of after-tax income for an individual in the top federal tax bracket?
- A. \$100 of interest income from Canadian bonds
  - B. \$100 of capital gains from Canadian stocks
  - C. \$100 of non-eligible dividends from Canadian corporations
  - D. \$100 of eligible dividends from Canadian corporations

## **TIF PROBLEM SEVEN - 4**

### **Property Income - Exam Exercises**

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***Exam Exercise Subject Listing For Chapter 7***

<b>Number</b>	<b>Subject</b>
1	Discount Bonds
2	Discount Bonds
3	Premium Bonds
4	Premium Bonds
5	Annual Accrual Rules
6	Annual Accrual Rules
7	Accrued Interest At Transfer
8	Accrued Interest At Transfer
9	Rental Income
10	Rental Income
11	Non-Eligible Dividend Income
12	Non-Eligible Dividend Income
13	Eligible Dividend Income
14	Eligible Dividend Income
15	Income Trust Distributions
16	Income Trust Distributions
17	Mutual Fund Distributions
18	Mutual Fund Distributions
19	Stock Dividends
20	Stock Dividends
21	Foreign Source Income
22	Foreign Source Income

**Exam Exercise Seven - 1 (Discount Bonds)**

On January 1, 2016, Latkin Inc. issues bonds with a maturity value of \$1,250,000 and a maturity date of December 31, 2021. The bonds pay interest on December 31 of each year at an annual coupon rate of 2 percent. They are sold for proceeds of \$1,150,000 for an effective yield of 3.5 percent. The maturity amount is paid on December 31, 2021. What are the tax consequences related to this bond issue for Latkin Inc. in each of the years 2016 through 2021? How would these tax consequences differ from the information included in Latkin's GAAP based financial statements? Latkin Inc. uses the straight-line method to amortize the discount on the bonds for accounting purposes.

**Exam Exercise Seven - 2 (Discount Bonds)**

On January 1, 2016, Leno Ltd. issues bonds for \$770,000. The bonds have a maturity value of \$800,000 and mature on December 31, 2018. The coupon rate on the bonds is 3 percent, with the interest paid annually on December of each year. The maturity amount is paid on December 31, 2018. What are the tax consequences related to this bond issue for Leno Ltd. in each of the years 2016 through 2018? How would these tax consequences differ from the information included in Leno's GAAP based financial statements? Leno Ltd. uses the straight-line method to amortize the discount on the bonds for accounting purposes.

**Exam Exercise Seven - 3 (Premium Bonds)**

On January 1 of the current year, Dryer Inc. issues 8 year bonds payable with a maturity value of \$1,500,000. The bonds have a coupon rate of 14 percent, pay interest on January 1 of each year, and are sold for \$1,750,000. The Company has a December 31 year end. Determine the current year tax consequences under each of the following assumptions:

- Dryer is in the business of lending money.
- Dryer is not in the business of lending money and the CRA does not believe that they made a deliberate effort to create a premium on the issuance of the bonds.
- Dryer is not in the business of lending money and the CRA believes that they made a deliberate effort to create a premium on the issuance of the bonds.

**Exam Exercise Seven - 4 (Premium Bonds)**

On January 1, 2016, Desay Inc. issues 5 year bonds payable with a maturity value of \$900,000. They have a coupon rate of 12 percent, pay interest on January 1 of each year, and are sold for \$1,200,000. The Company has a December 31 year end. Determine the current year tax consequences under each of the following assumptions:

- Desay is in the business of lending money.
- Desay is not in the business of lending money and the CRA does not believe that they made a deliberate effort to create a premium on the issuance of the bonds.
- Desay is not in the business of lending money and the CRA believes that they made a deliberate effort to create a premium on the issuance of the bonds.

**Exam Exercise Seven - 5 (Annual Accrual Rules)**

On June 1, 2016, Mr. Michael Leiner acquires a newly issued debt instrument with a maturity value of \$80,000. It matures on May 31, 2022 and pays interest at an annual rate of 7 percent. Payment for the first three and one-quarter years of interest is due on August 31, 2019, with interest for the remaining two and three-quarters years payable on the maturity date. What amount of interest will Mr. Leiner have to include in his tax returns for each of the years 2016 through 2022?

**Exam Exercise Seven - 6 (Annual Accrual Rules)**

Ms. Marilyn Lox invests in a newly issued debt instrument on April 1, 2016. It has a maturity value of \$50,000, matures on March 31, 2020, and pays interest at an annual rate of 5 percent. The terms of the instrument call for payment of interest for the first two and one-half years on September 30, 2018. The remaining interest is paid at the maturity date of the instrument. What amount of interest will Ms. Lox have to include in her tax returns for each of the years 2016 through 2020?

**Exam Exercise Seven - 7 (Accrued Interest At Transfer)**

On May 1, 2016, Mrs. Anna White purchases bonds with a maturity value of \$40,000 at par. These bonds pay semi-annual interest of \$2,000 on June 30 and December 31 of each year. She purchases the bonds for \$41,326, including interest accrued to the purchase date. She holds the bonds for the remainder of the year, receiving both the June 30 and December 31 interest payments. What amount of interest will be included in Mrs. White's 2016 tax return?

**Exam Exercise Seven - 8 (Accrued Interest At Transfer)**

Lexor Inc. has bonds outstanding with a maturity date of December 31, 2024. The bonds pay semi-annual interest at an annual rate of 5 percent. Payments of \$2,500 are made on June 30 and December 31 of each year. The bonds are currently trading at their maturity value. On April 1, 2016, Arnold Wexler acquires some of these bonds. He pays \$101,243, including an amount for accrued interest, for bonds with a maturity value of \$100,000. He holds the bonds for the remainder of the year, receiving both the June 30 and December 31 interest payments. What amount of interest will be included in Mr. Wexler's 2016 tax return?

**Exam Exercise Seven - 9 (Rental Income)**

Alex Bodvin acquires a residential rental property on June 1, 2016 at a total cost of \$423,000. Of this total, \$132,000 can be allocated to the value of the land. He immediately spends \$42,000 to make major improvements to the property. Rents for the year total \$32,000, while rental expenses other than CCA total \$27,500. This is the only rental property owned by Mr. Bodvin. Determine the maximum CCA that is available for 2016. In addition, determine Mr. Bodvin's minimum net rental income for the year.

**Exam Exercise Seven - 10 (Rental Income)**

Alice Baxter acquires a residential property on May 1, 2016. The total cost of the property is \$385,000, with \$95,000 of this total being allocated to the land. She spends \$3,500 to paint the interior and exterior of the building. During 2016, rents total \$29,000 and expenses other than CCA and the cost of painting total \$20,100. Determine the maximum CCA that is available for 2016. In addition, determine Ms. Baxter's minimum net rental income for the year.

**Exam Exercise Seven - 11 (Eligible Dividend Income)**

During 2016, Mr. Franz Schlitz receives \$23,500 in eligible dividends from Canadian public corporations. His income is such that this additional amount will be taxed at a 29 percent federal rate and a 14 percent provincial rate. On eligible dividends, the province has a dividend tax credit equal to 25 percent of the gross up. Determine the total federal and provincial tax that will be payable on these dividends and his after tax retention.

**Exam Exercise Seven - 12 (Eligible Dividend Income)**

Mr. Martin Pabst owns publicly traded shares which, during 2016, paid eligible dividends of \$10,200. His Taxable Income for this year exceeds \$300,000 and he lives in a province where the maximum individual tax rate is 16 percent. The provincial tax credit on eligible dividends is equal to 29 percent of the gross up. Determine the total federal and provincial tax that will be payable on these dividends and his after tax retention.

**Exam Exercise Seven - 13 (Non-Eligible Dividend Income)**

During 2016, Ms. Marion Blatz receives \$5,600 in non-eligible dividends from taxable Canadian corporations. Her income is such that this additional amount will be taxed at a 26 percent federal rate and a 10 percent provincial rate. On such non-eligible dividends, the province has a dividend tax credit equal to 38 percent of the gross up. Determine the total federal and provincial tax that will be payable on these dividends and her after tax retention.

**Exam Exercise Seven - 14 (Non-Eligible Dividend Income)**

During the 2016 taxation year, Ms. Andrea Molsen receives non-eligible dividends of \$14,200. Her income is such that this additional amount will be taxed at a 26 percent federal rate and a 7 percent provincial rate. The provincial dividend tax credit on non-eligible dividends is 25 percent. Determine the total federal and provincial tax that will be payable on these dividends and her after tax retention.

**Exam Exercise Seven - 15 (Income Trust Distributions)**

On January 1, 2016, Jeanine Dorset acquires 1,700 units of Blackwell Income Trust at \$37 per unit, a total cost of \$62,900. During 2016, the trust distributes \$2.75 per unit, \$0.85 of which is a return of capital and \$1.90 of which is a business income distribution. Jeanine has asked the trust to reinvest all distributions. The \$2.75 per unit distribution was reinvested at a cost of \$32 per additional unit. What are the tax consequences to Jeanine of the 2016 distribution and its reinvestment? What will be her adjusted cost base per unit after the reinvestment?

**Exam Exercise Seven - 16 (Income Trust Distributions)**

On June 1, 2016 Jerry Driggs acquires 2,500 units of the Belle Realty Trust at \$12 per unit. During September, 2016, the trust makes a distribution of \$1.50 per unit, of which \$1.00 represents a return of capital. Mr. Driggs decides to reinvest the entire distribution at a cost of \$12.50 per additional unit. What are the tax consequences to Mr. Driggs of the 2016 distribution and its reinvestment? What will be his adjusted cost base per unit after the reinvestment?

**Exam Exercise Seven - 17 (Mutual Fund Distributions)**

John Bordy owns 2,200 units of the DRC Growth Fund, a mutual fund trust. These units were purchased at a price of \$8.15 per unit, for a total value of \$17,930. His adjusted cost base for these units has not changed since their acquisition. On December 12 of the current year, the Fund has an income distribution of \$0.27 per unit, resulting in an addition of \$594 to John's account. All of this distribution is reinvested at a purchase price per unit of \$10.40. What will be his adjusted cost base per unit after the reinvestment?

**Exam Exercise Seven - 18 (Mutual Fund Distributions)**

Arial Horton owns 3,400 units of the Canadian Growth Fund, a mutual fund trust. The total cost of the 3,400 units was \$17,000. Her adjusted cost base for these units has not changed since she acquired them. In June of the current year, the fund has an income distribution of \$0.45 per unit. All of this distribution is reinvested at a unit price of \$5.10. What will be Arial's adjusted cost base per unit after the reinvestment?

**Exam Exercise Seven - 19 (Stock Dividends)**

Melific Ltd. has 4,500,000 common shares outstanding. Jerry Fry acquired 5 percent of these shares at a cost of \$19 per share. During the current year, the Company declares a 6 percent stock dividend which it designates as eligible. At this time the shares are trading at \$21 per share. The Company transfers the amount of the stock dividend to paid up capital. What are the tax consequences to Jerry Fry of this transaction? Your answer should include the adjusted cost base per share of Jerry's holding.

**Exam Exercise Seven - 20 (Stock Dividends)**

Jupiter Inc. has 1,800,000 common shares outstanding. Harry Keller acquired 8 percent of these shares at a cost of \$11 per share. During the current year, the Company declares an 8 percent stock dividend which it designates as eligible. At this time the shares are trading at \$12 per share. The Company transfers the amount of the stock dividend to paid up capital. What are the tax consequences to Harry Keller of this transaction? Your answer should include the adjusted cost base per share of Harry's holding.

**Exam Exercise Seven - 21 (Foreign Source Income)**

Isaac Lemming has foreign investments that earn \$27,000 in income during the current year. As the foreign jurisdiction withholds 22 percent of such income, he only receives \$21,060. He has other income such that this foreign source income will be taxed at the maximum federal rate of 33 percent. Determine the amount by which this foreign income would increase Isaac's Taxable Income and federal Tax Payable, assuming that:

- A. the foreign source income is non-business income.
- B. the foreign source income is business income.

**Exam Exercise Seven - 22 (Foreign Source Income)**

Isabelle Lemming holds foreign investments that earn \$34,000 during the current year. Because of withholdings by the foreign jurisdiction, she only receives \$27,200 of these earnings. These earnings are in addition to over \$250,000 in employment income. Determine the amount by which this foreign income would increase Isabelle's Taxable Income and federal Tax Payable, assuming that:

- A. the foreign source income is non-business income.
- B. the foreign source income is business income.

**TIF PROBLEM SEVEN - 5A****Property Income - Key Term Matching (Easy)**

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**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms are listed at the end of Chapter 7, "Property Income".

- Capital Dividend
- Disappearing Source Rules
- Dividend Gross Up
- Dividend Tax Credit
- Net Property Income
- Eligible Dividends
- Property Income
- Stock Dividend

The following list contains ten potential definitions for the preceding key terms.

1. Rules designed to provide relief to investors who have borrowed money to make an investment and subsequently sold the investment for less than the related borrowings.
2. Dividends that have not been designated by the payor as eligible for the enhanced gross up and tax credit procedure.
3. The net of inclusions less deductions, related to property income, with all amounts determined as per Division B, Subdivision b, of the *Income Tax Act*.
4. An amount that is based on a percentage of the dividends from taxable Canadian corporations that have been received by an individual or trust.
5. Dividends that have been designated by the payor as eligible for the enhanced gross up and tax credit procedure.
6. A pro rata distribution of a corporation's shares to its existing shareholders.
7. A dividend paid out of a private corporation's capital dividend account. It is received on a tax free basis.
8. A credit against the tax payable of an individual or trust. The amount is based on a fraction of the dividend gross up that has been included in net income for tax purposes.
9. Income that is earned through the passive ownership of property.
10. An amount that represents compensation for the use of money, is calculated with reference to a principal sum, and that accrues on a continuous basis.
11. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 10) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (11). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

**TIF PROBLEM SEVEN - 5B****Property Income - Key Term Matching (Moderate)**

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**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms are listed at the end of Chapter 7, "Property Income".

- A. Capital Dividend
- B. Disappearing Source Rules
- C. Dividend Gross Up
- D. Dividend Tax Credit
- E. Net Property Income
- F. Eligible Dividends
- G. Property Income
- H. Stock Dividend

The following list contains 14 potential definitions for the preceding key terms.

1. Rules designed to provide relief to investors who have borrowed money to make an investment and subsequently sold the investment for less than the related borrowings.
2. Dividends that have not been designated by the payor as eligible for the enhanced gross up and tax credit procedure.
3. Dividends that are eligible to receive a federal and provincial dividend tax credit .
4. The net of inclusions less deductions, related to property income, with all amounts determined as per Division B, Subdivision b, of the *Income Tax Act*.
5. An amount that is based on a percentage of the dividends from taxable Canadian corporations that have been received by an individual or trust.
6. Dividends that have been designated by the payor as eligible for the enhanced gross up and tax credit procedure.
7. A dividend paid out of the taxable portion of capital gains earned by the corporation. It will be taxed as a capital gain in the hands of the recipient.
8. A pro rata distribution of a corporation's shares to its existing shareholders.
9. A dividend paid out of a private corporation's capital dividend account. It is received on a tax free basis.
10. A credit against Tax Payable based on taxes withheld by a foreign taxing authority on foreign source income.
11. A credit against the tax payable of an individual or trust. The amount is based on a fraction of the dividend gross up that has been included in net income for tax purposes.
12. Income that is earned through the passive ownership of property.

*Property Income - Key Term Matching (Moderate)*

13. A dividend paid in stock of another corporation.
14. An amount that represents compensation for the use of money, is calculated with reference to a principal sum, and that accrues on a continuous basis.
15. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 14) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (1). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

## **TIF PROBLEM SEVEN - 6**

### **Interest Deductibility - 3 Cases**

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Each of the following independent Cases involves the payment of interest and the issue of whether the interest will be deductible for tax purposes.

**Case A** Joan Allenby has owned her home for many years and, over this period of time, has completely paid off the mortgage. Given the low interest rates that are available on mortgages, she negotiates a \$300,000, five year, variable rate mortgage, with an interest rate of 2.5 percent. She invests the entire \$300,000 in publicly traded securities. Would the interest on the mortgage be deductible? Explain your conclusion.

**Case B** Athro Tulee borrows \$50,000 and acquires an income producing property for \$50,000. He subsequently sells the property for \$80,000. Without repaying the funds borrowed to acquire the first property, he uses the proceeds to acquire two other properties. The cost of property A is \$32,000, while the cost of property B is \$48,000. How will the \$50,000 in borrowing be linked to the two new properties?

**Case C** Janice Bronson borrows \$250,000 and invests the entire amount in the shares of Nor-Tell Ltd. Three months later, after the discovery of significant accounting irregularities at Nor-Tell, the value of the shares has fallen to \$30,000. She sells her shares and uses the proceeds to pay off \$30,000 of the loan. This leaves a balance of \$220,000. Can Janice continue to deduct the interest payments on this \$220,000 balance? Explain your conclusion.

## **TIF PROBLEM SEVEN - 7**

### **Rental Income And CCA On Rental Properties**

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Ms. Serravalle has a firm belief in the advantages of investing in real estate. Because of this belief, she has invested most of her discretionary income in residential rental properties over the past four decades. On January 1, 2016, she owns four rental properties. The relevant facts on these properties are as follows:

**642 Kent Street** This is a Class 3 building that has a capital cost of \$722,000. Its UCC at the beginning of the year was \$412,000. During the year, it generated rents of \$63,000 and incurred property taxes of \$7,800, interest charges of \$11,700, and other expenses (excluding CCA) of \$12,750.

**1256 Montreal Road** This is a Class 3 building that had a capital cost of \$37,000. It was sold on August 1. For CCA purposes, it was included in the same Class 3 pool as 112 Lisgar Avenue. Of the sale proceeds, \$65,000 was allocated to the building. From January 1 to July 31, the building generated rents of \$4,800 and incurred property taxes of \$1,100, interest charges of \$1,450, and other expenses (excluding CCA) of \$900.

This property contained furniture that Ms. Serravalle had acquired at a cost of \$8,000. On January 1, 2016, this furniture had a UCC balance of \$4,200. It was sold at the same time as the rental property. The proceeds of the furniture sale were \$2,100.

**112 Lisgar Avenue** This is a Class 3 building that has a capital cost of \$45,000. At the beginning of the year, the UCC of the Class 3 pool, which included both 1256 Montreal Road and 112 Lisgar Avenue, was \$48,000. During the year, it generated rents of \$5,000 and incurred property taxes of \$1,550, interest charges of \$650, and other expenses (excluding CCA) of \$2,500.

**23 Durham Private** This Class 1 building has a capital cost of \$225,000. Its UCC at the beginning of the year was \$216,000. During the year, the unit generated rents of \$22,000 and incurred property taxes of \$3,850, interest charges of \$11,500, and other expenses (excluding CCA) of \$8,700.

**Required:** Calculate Ms. Serravalle's net rental income for 2016. You should provide a separate calculation for each property. Specify how much CCA should be taken for each building.

**TIF PROBLEM SEVEN - 8****Rental Income And CCA On Rental Properties**

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In March, 2015, Andrew Thorne acquired a four unit apartment building at a cost of \$875,000. Of this total, it is estimated that the land on which the building is situated is worth \$185,000. The units in the apartment are similar in size, and for purposes of allocation to a CCA class, the property is considered to be a single asset.

Two of the units will be rented on a furnished basis. To this end, Andrew has acquired furniture at a cost of \$43,000.

During April, 2015, all of the units were rented for the remainder of the year. For this year, the units generated rents of \$63,600 and expenses, other than CCA, of \$23,400 were incurred.

In July, 2016, the tenants in both of the furnished units terminate their leases and move out. Because he is unable to find tenants who are interested in furnished units, the two units remain empty for three months. Given this situation, Andrew sells all of the furniture for \$31,000.

During 2016, the units generate rents of \$54,500. Expenses for the year, other than CCA, total \$29,400.

Andrew deducts the maximum CCA allowable in both 2015 and 2016.

**Required:** Calculate the Net Rental Income for each of the two years 2015 and 2016. Also, determine his UCC balances on January 1, 2017. Include in your solution any tax consequences associated with the sale of the furniture.

**TIF PROBLEM SEVEN - 9****Rental Income**

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Mr. Taylor bought a large triplex on February 1, 2015 for a total cost of \$345,000. Of this amount, it is estimated that \$255,000 should be allocated to the building and \$90,000 to the land on which it is located. The three rental units in the triplex are identical in size and features and, for purposes of allocation to a CCA class, the property is considered to be a single unit.

At a bankruptcy sale in February, 2015, Mr. Taylor purchased furniture and appliances for one of the units at a total cost of \$12,800.

Early in February, 2015, all three units were rented. For 2015, Mr. Taylor's triplex generated rents of \$26,000 and incurred expenses, other than CCA, of \$10,900.

In May, 2016, the tenants in the furnished unit moved out and purchased all the furniture and appliances from Mr. Taylor for \$10,400. For 2016, Mr. Taylor's triplex generated rents of \$28,400 and incurred expenses, other than CCA, of \$18,180.

Mr. Taylor deducts the maximum CCA allowable in both years.

**Required:** Calculate the Net Rental Income for each of the two years 2015 and 2016. Also, determine his UCC balances on January 1, 2017. Include in your solution any tax consequences associated with the sale of the furniture and appliances.

**TIF PROBLEM SEVEN - 10****Property Income - Alternative Investment Strategies**

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Sarah, Sally, and Suzanne Baxter are three sisters who live in the same province. Because of their alternative career choices, they have enjoyed varying degrees of economic success.

**Sarah** Sarah has devoted her life to the arts. However, the scarcity of work in her field has resulted in her being in the 15 percent federal tax bracket and the 5 percent provincial bracket.

**Sally** Sally has always worked in retail and is doing well as a store manager. She is in the 26 percent federal tax bracket and the 11 percent provincial tax bracket.

**Suzanne** Suzanne is a very successful attorney. Her income places her in the 33 percent federal tax bracket and the 16 percent provincial tax bracket.

The provincial dividend tax credit on eligible dividends is equal to 27 percent of the dividend gross up.

On January 1 of the current year, as the result of an inheritance from a distant uncle, each of the sisters has \$15,000 to invest. They are looking at the following alternatives:

**Corporate Bonds** The issue that they are considering has a 4.5 percent coupon rate, is selling at par, and matures in 25 years.

**Preferred Stock** The shares that they are considering has a dividend yield of 5.6 percent. The eligible dividend is cumulative but not participating.

The income from these investments would not move any of the three sisters to a higher federal or provincial tax bracket. Each sister has sufficient income to use all of her available tax credits.

**Required:** Advise each of the Baxter sisters as to which investment they should make. As part of your recommendation, calculate the after tax income that would be generated for each of the sisters, assuming that they invested their \$15,000 in:

- A. The corporate bonds.
- B. The preferred stock.

**TIF PROBLEM SEVEN - 11****Property Income - Alternative Investment Strategies**

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On January 1, 2016, Mr. Saul Goldfarb is notified that he has won \$250,000 in the provincial lottery. This amount is immediately available to Mr. Goldfarb and is not subject to any form of taxation.

Mr. Goldfarb has no immediate need for these funds. However, he is retiring on January 1, 2017 and would like to have the funds available at that time for use in relocating to a warmer climate. Given this, he would like to invest the funds for the period ending December 31, 2016. He is considering the following alternatives:

**Guaranteed Investment Certificate** The \$250,000 can be invested in a guaranteed investment certificate that matures on December 31, 2016. The certificate pays interest at 3 percent.

**Common Stock** The \$250,000 can be invested in the shares of a Canadian public company. The shares are currently trading at \$125 per share and pay an annual eligible dividend of \$6.00 per share. Mr. Goldfarb's broker assures him that the shares will be trading at \$135 per share by December 31, 2016.

Mr. Goldfarb has sufficient employment income that he is in the 29 percent federal tax bracket and the 15 percent provincial tax bracket. The provincial dividend tax credit for eligible dividends is equal to 30 percent of the gross up.

**Required:** Write a brief memorandum providing investment advice to Mr. Goldfarb.

**TIF PROBLEM SEVEN - 12****Property Income - Alternative Investment Strategies**

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Late in the year 2015, Ms. Sarah Stein inherits \$550,000 from an eccentric uncle. The terms of his will require that Sarah use \$250,000 of this amount for luxury travel within 12 months of her receipt of the funds. Any unspent balance of this \$250,000 will be returned to the uncle's estate and distributed to a specified group of charities.

With respect to the remaining \$300,000, there are no restrictions on its use. Because of the time commitment related to the luxury travel, Ms. Stein would like to invest this balance for a one year period, commencing January 1. She is considering the following alternative investments and would like your advice on the appropriate choice:

**H & R Real Estate Investment Trust** On January 1, 2016, this trust is selling for \$20 per unit. It makes a distribution of \$0.0725 per unit per month. This distribution is property income only and does not include any dividends, capital gains or return of capital. Ms. Stein does not expect any price change in the units over the year ending December 31, 2016.

**Dream Spinner Tech Common Stock** On January 1, 2016, these shares are selling for \$10 each. The Company pays an annual dividend of \$0.05 per share. This will be an eligible dividend. Ms. Stein anticipates that these shares will be selling for at least \$10.50 per share on December 31, 2016.

In order to accommodate the required luxury travel, Ms. Stein will use her six months of accumulated vacation pay and take an unpaid leave of absence from her employer for the rest of the year. Her net employment income will be \$50,000 for 2016. Taxes on this income are sufficient to use all of her available tax credits before considering the effects of the two investments described above.

Given her net employment income, any additional income from her investment will be taxed at a federal rate of 22 percent and a provincial rate of 10 percent. In her province of residence, the dividend tax credit for eligible dividends is equal to 25 percent of the gross up.

**Required:** Write a brief memorandum providing investment advice to Ms. Stein.

**TIF PROBLEM SEVEN - 13****Income Trusts, Mutual Funds And Foreign Income**

Late in 2015, Ms. Betty Tang sells her Vancouver residence for \$800,000. It is her intention to not replace this property and, in future years, she plans to rent a unit in a downtown condominium building.

On January 1, 2016, she invests the proceeds from the sale as follows:

**Foreign Term Deposit** She acquires a U.K. Pound Sterling (£) term deposit with a maturity value of £200,000 at a Canadian dollar cost of \$360,000. Assume that throughout 2016, £1 = \$2.00.

**Income Trust Units** She acquires 8,000 units of the B&B real estate investment trust. The units are acquired at a cost of \$30 per unit.

**Common Shares** She acquires 2,000 shares of Liberty Inc., a publicly traded company, at a total cost of \$100,000.

**Mutual Fund Units** She acquires 2,500 units of Temple Small Cap, a mutual fund trust. The cost is \$40 per unit.

The following transactions occur during the year ending December 31, 2016:

**Foreign Term Deposit** On December 31, 2016, annual interest is paid at the rate of 7 percent. The U.K. authorities withhold 25 percent of this amount, with the remainder being remitted to Betty.

**B&B Trust Units** The trust has a distribution of \$1.50 per unit. Of this total \$0.50 represents a return of capital, with the remainder being property income. Betty invests the entire distribution in additional units at a cost of \$52 per unit.

**Liberty Inc.** The Liberty Inc. shares pay an eligible dividend of \$1.60 per share.

**Temple Small Cap** The trust has a distribution of \$2.40 per unit. All of this distribution is reinvested to acquire additional Temple units at \$38 per unit. The composition of the distribution is as follows:

Capital Gains	\$0.40
Eligible Dividends	1.00
Interest	1.00
<b>Total Per Unit</b>	<b>\$2.40</b>

Betty 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 16 percent and the dividend tax credit on eligible dividends is 30 percent of the gross up.

**Required:** Calculate the amount of Taxable Income and Tax Payable that will result from the described distributions. In addition, indicate the per unit adjusted cost base for each of the two trust units on December 31, 2016. Ignore any tax implications resulting from the Canada/U.K. tax treaty.

## **TIF PROBLEM SEVEN - 14**

### **Business And Property Income**

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Ms. Sarah Smursch is an accountant who specializes in preparing financial statements for small businesses. She has a well established practice in London, Ontario.

Relevant information on her practice for the taxation year ending December 31, 2016, is as follows:

January 1 Unbilled Work In Progress	\$ 23,000
Billable Hours (1,725 Hours At \$200)	345,000
December 31 Unbilled Work In Progress	14,000
Office Supplies And Office Expenses	23,000
Rent	60,000
Business Meals And Entertainment	18,000

During 2016, Ms. Smursch attended two conventions. The first, held in Toronto, dealt with using accounting software. For this convention, her conference fees and travel costs were \$2,400. The second convention, held in Beirut, Lebanon, dealt with war zone vacations for tourists in the Middle East. The costs for this convention were \$7,400. She incurred no costs for meals or entertainment during the convention as she stayed with family in Beirut.

In addition to her professional income, Ms. Smursch owns 2,500 units of Realty Income Trust. These units were acquired on December 31, 2015 at a cost of \$43 per unit. During 2016, she received a distribution of \$3.50 per unit, of which \$1.50 was a return of capital and the remainder was property income. The distribution was reinvested at a price of \$45 per unit.

On December 31, 2016, all units are sold for proceeds of \$129,333.

For tax purposes, Ms. Smursch uses the billed basis of revenue recognition.

**Required:** Determine Ms. Smursch's minimum Net Income For Tax Purposes for the year ending December 31, 2016.

**TIF PROBLEM SEVEN - 15****Comprehensive Case (Chapters 1 To 7)**

Ms. Caroline Graham is a full time employee of KLY Incorporated, an on-line clothing retailer. She has an annual salary of \$75,000, from which the following amounts were withheld in 2016:

Registered Pension Plan Contributions	\$3,500
CPP Contributions	2,544
EI Premiums	955
Annual Donation to United Way	1,500
Long term disability insurance	500

The long term disability plan provides periodic benefits that compensate for lost employment income. In addition, Caroline's employer provided her with a life insurance policy at a cost of \$350.

Caroline is a single parent with a 15-year-old daughter, Grace, who has no income of her own. While Caroline receives Universal Child Care Benefits of \$360, for tax purposes she will include these in the Net Income For Tax Purposes of her daughter Grace.

Caroline's father lives with the family, and is financially dependent on Caroline as his only income is Old Age Security of \$7,000. Caroline's father moved in with her after her mother passed away in 2015, and as a result, in January, 2016, Caroline purchased a home for the family to live in for \$350,000. Caroline and Grace had lived in a rented home for the past 6 years.

Caroline has purchased a bus pass for Grace for 10 months in 2016, costing \$75 per month. She also purchased bus passes for her father for 12 months at the same rate. Grace is enrolled in figure skating lessons throughout the winter and Caroline has paid fees of \$5,000 for skating lessons. Grace attends a private high school at a cost of \$12,000 per year.

Caroline provides financial support to her sister, Kristin. Kristin has lived in France for the last 10 years. She has been in university there for the last 2 years. Caroline paid her university tuition of \$15,000 for 2016 and \$12,000 for medical costs related to her hospitalization after an automobile accident in March, 2016.

Caroline has provided the following information regarding the 2016 income from her investment portfolio.

**Term Deposits** Caroline has the following two term deposits:

- A \$200,000 term deposit purchased on November 1, 2015 at 3.25 percent. Interest is payable at maturity on October 31, 2017.
- A \$20,000 term deposit purchased on November 30, 2016 at 3 percent. Interest is payable at maturity in 6 months.

**Investments In Shares** The income amounts from Caroline's share investments are as follows:

- Caroline owns 1,000 shares of Royal Scotia Bank. The company paid an eligible dividend of \$24 per share on October 15, 2016.
- Caroline also owns 100 shares in Graham Company Limited, a corporation solely owned and operated by her brother. This company paid a non-eligible dividend of \$50 per share on November 30, 2016.
- Caroline inherited 500 shares of Americo Limited, a U.S. company from her mother. In 2016, these shares paid a dividend of \$2 (Canadian) per share. The U.S. government withheld 12 percent of the total dividend amount.

**Future Investments** When Caroline's mother passed away, she left Caroline with a substantial sum of money which Caroline wants to invest wisely. She is planning to invest substantial funds in 2016 in one of the three following alternatives:

- term deposits,
- shares in public Canadian corporations which will pay eligible dividends, or
- additional shares in her brother's corporation which will pay non-eligible dividends.

Caroline had owned a rental property for several years, and when she received her inheritance, she sold the old property and purchased a new one.

The old rental property cost \$125,000 when it was purchased, with \$28,000 allocated to the land, and \$2,500 allocated to appliances. UCC on this property was \$90,450 on January 1, 2016 for the building and \$2,145 for the appliances. The property was sold on January 1, 2016 for \$120,000 with \$28,000 allocated to the land and \$1,000 to the appliances.

The new property was purchased on February 1, 2016, and cost a total of \$200,000, with \$45,000 allocated to land. Caroline also purchased the on-site appliances for \$6,500.

Caroline rented the property from March 1 to November 30 and collected rent during this period of \$16,150. Costs to operate the property, including mortgage interest, insurance, utilities and property taxes totaled \$12,500.

In order to increase the future rent, during December, 2016, Caroline spent the following amounts on the property:

New windows	\$14,500
Roof repairs	1,200
Carpeting and flooring replacements	7,500
Cleaning	500
Painting interior and exterior	2,000

**Required:**

- A. For the 2016 taxation year, calculate Caroline's minimum:
  1. Net Income For Tax Purposes,
  2. Taxable Income,
  3. Federal Tax Liability.
- B. Based on the top marginal tax rate applied to determine Caroline's tax payable, calculate the effective federal tax rate that Caroline pays on eligible dividends, non-eligible dividends and interest income (ignore provincial taxes). What advice would you give her with respect to her investment choices?

In completing the requirements of this problem, ignore GST, PST and HST considerations.

**TIF PROBLEM SEVEN - 16****Comprehensive Case (Chapters 1 To 7)**

Ms. Jezebel Forest is 67 years old and has been married to the same man, Bernard Forest, for over 40 years. She has never applied for OAS as she knows that, for the foreseeable future, it will all be clawed back. In addition, she has not applied for CPP as she is aware that deferring the application will result in larger benefits. She has elected to continue contributing to the CPP.

She has been employed by a number of organizations over her working life and, during 2016, she receives pension income from various RPPs totalling \$4,000 per month.

Currently, she is a full time employee of Dartmor Enterprises Ltd. (DTL) with an annual salary of \$71,500. DTL withheld the following amounts from this salary:

RPP Contributions	\$2,500
EI Premiums	955
CPP Contributions	2,544
Union Dues	336
Annual United Way Contributions	1,800

Jezebel's spouse, Bernard Forest is 69 years old and has Net Income For Tax Purposes of \$15,200. This consists of pension income from his RRSP and OAS payments. He has not applied for CPP.

The couple have two children. Their 42 year old daughter Samantha has been blind since an automobile accident when she was a teenager. She lives with Jezebel and Bernard, is totally dependent on them, and has no income of her own.

Their 44 year old son Norman has had a long history of substance abuse. However, he is currently living with Jezebel and Bernard and is in a rehabilitation program that seems to be working. The program provides him with a monthly income of \$2,000, conditional on his staying enrolled in a university program leading to an accounting degree. During 2016, he attends university on a full time basis for 10 months. His tuition fees are \$11,300 and he has textbook costs of \$1,100. Jezebel pays all of these costs and Norman has agreed to transfer any unused education credits to her. Norman's only tax credits are his basic personal credit and education related credits.

During 2016, Jezebel received the following dividends (all amounts in Canadian dollars):

Eligible Dividends From Taxable Canadian Corporations	\$15,400
Non-Eligible Dividends On Shares In Her Sister's CCPC	2,600
Dividends On Foreign Shares - Net Of 15 Percent Withholding	13,600
<u>Total Dividends Received</u>	<u>\$31,600</u>

In addition to dividends, Jezebel had 2016 interest income of \$1,456.

The family's medical expenses, all of which have been paid by Jezebel, are as follows:

Jezebel	\$ 450
Bernard	1,475
Samantha	11,400
Norman	8,470
<u>Total Medical Expenses</u>	<u>\$21,795</u>

Jezebel also operates a management consulting business which she started in 2013. In that year, she acquired a building to be used exclusively as an office for this business. The building cost \$383,000, of which \$112,000 reflects the value of the land on which the building is situated. On January 1, 2016, the UCC of the building is \$232,272. This is the only building owned by Jezebel other than her principal residence.

When she acquired the building in 2013, she also acquired office furniture and fixtures at a cost of \$18,500. On January 1, 2016, the UCC of these assets is \$10,656.

During 2016, Jezebel spends \$23,500 in improvements to the building and \$24,500 on new furniture and fixtures. The older furniture and fixtures are sold for \$6,200.

As this business has expanded, on January 1, 2016, Jezebel acquires an automobile to be used exclusively in the business. The cost of the car is \$41,500, all of which was financed with a bank loan. During 2016, interest charges on the bank loan total \$4,980, all of which was deducted in determining the cash flows from operating the business. The 2016 operating costs for the vehicle totaled \$5,600.

As Jezebel has no reason to keep detailed accounting records, she records business income on a cash basis. For 2016, her net cash flow from operations was \$96,400. Relevant figures for the beginning and end of 2016 are as follows:

	<b>January 1</b>	<b>December 31</b>
Billed Receivables	\$8,400	\$11,250
Unbilled Work In Process	12,600	18,400
Accounts Payable	6,240	7,485

**Required:** Calculate Jezebel's 2016 minimum Net Income For Tax Purposes, her 2016 minimum Taxable Income, and her 2016 minimum federal Tax Payable. Ignore GST/HST/PST considerations and the possibility of pension income splitting. Ignore the fact that 2016 is a leap year with 366 days.

## **Chapter Eight Test Item File Problems**

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### **TIF PROBLEM EIGHT - 1**

#### **Capital Gains And Losses - Essay Questions**

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1. Capital gains have always been given very favourable tax treatment relative to interest income. What is the justification for this treatment?
2. Describe three different types of capital asset dispositions. In each case, indicate how the proceeds of disposition would be determined.
3. How is government assistance for the purchase of capital assets dealt with in the *Income Tax Act*? How does this differ from the accounting treatment of government assistance for the purchase of capital assets?
4. What is a superficial loss? What is the required tax treatment for such losses?
5. Describe how a taxpayer calculates a taxable capital gain or an allowable capital loss.
6. A taxpayer may acquire a number of identical properties at different points in time at different costs. When there is a sale of part of a group of identical properties, how do you determine the adjusted cost base of the properties sold?
7. When a capital asset is sold and not all of the proceeds of disposition are received in the year of sale, the *Income Tax Act* allows a taxpayer to deduct a reserve. How is the maximum amount of this reserve determined?
8. When an enterprise sells a capital asset, it sometimes provides a warranty related to the performance of that asset. This may involve incurring warranty costs in periods subsequent to the period in which the asset is sold. How are such costs dealt with for income tax purposes? How does this differ from the accounting treatment of such costs?
9. When a taxpayer disposes of a combination of land and buildings, ITA 13(21.1)(a) contains a special rule for determining the amount of proceeds to be allocated to the building. If applicable, this special rule increases the amount of the proceeds that will be allocated to the building. What is the tax policy objective of this special rule?
10. Describe the tax treatment that will be given to personal use property dispositions. How does this treatment differ if the property is listed personal property?
11. An enterprise buys €100,000 of merchandise in France, with the payable recorded in Euros. Between the time of the purchase and the payment of the account, the exchange rate for the Euro increases by \$0.04. How will this increase be dealt with for tax purposes? Will this differ from the accounting treatment of the amount?
12. An individual purchases an option to acquire a tract of land at a later date. If the individual exercises the option, how will the cost of the option be dealt with? Alternatively, how would the cost be dealt with if the option expires without being exercised?
13. When the use of a capital property is changed from personal use to business use, there is a deemed disposition/reacquisition of that property. If the original cost of the property is less than the fair market value of the property at the time of the change in use, the cost of the property for UCC purposes is limited to its cost, plus one-half of the difference between the cost and fair market value. What is the reason for this limitation?

14. It is not uncommon for a person, when moving out of a principal residence, to retain that property as a rental unit. If no election is made, this change in use will be treated as a deemed disposition, possibly resulting in capital gains being assessed. Explain how this result can be avoided, as well as the tax consequences of making the required election.
15. When an individual converts his principal residence to a rental property, an election under ITA 45(2) is available to avoid having a deemed disposition based on a change in use. Briefly describe how this election works.
16. When an individual departs from Canada, there is a deemed disposition of most of his capital property. What major categories of property are the exceptions to this deemed disposition rule?
17. The *Income Tax Act* contains a provision which allows an individual to defer the taxation on capital gains resulting from the sale of shares of an "eligible small business corporation". What is the definition of an eligible small business corporation?
18. Having business property destroyed in a natural disaster (e.g., flood or earthquake) would normally have very adverse tax consequences. Briefly describe the tax consequences of receiving insurance payments in this situation in the absence of special rules.
19. The replacement property rules cover both voluntary dispositions and involuntary dispositions. However, they are applied differently to the two types of dispositions. Briefly describe the differences between the treatment for voluntary dispositions and involuntary dispositions.
20. In terms of tax planning, capital gains and losses have an advantage that is not available for other types of income. Briefly describe this advantage.

**TIF PROBLEM EIGHT - 2****Capital Gains And Losses - True Or False**

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1. One of the reasons for the favourable tax treatment of capital gains is that the amounts received often have to be reinvested in the business in order to maintain its productive capacity.

True or False?

2. A superficial loss occurs when, in the 30 days following the disposition that resulted in the loss, an identical asset is acquired.

True or False?

3. Mr. Schmidt purchased 250 shares of Doss Limited on February 1 of the current year for \$20 per share. On May 1 of the current year, he purchased 100 more shares for \$25 per share. On June 20 of the current year, Mr. Schmidt sells 100 shares for \$15 per share. His allowable capital loss on June 20 is \$643.

True or False?

4. When there is a disposition of a capital asset and not all of the proceeds of disposition are collected at the time of disposition, a reserve can be deducted. In the year of the disposition, the reserve cannot be less than 80 percent of the total gain.

True or False?

5. Capital gains on a principal residence are not taxable.

True or False?

6. Losses on the disposition of listed personal property can be deducted, but only against gains on the disposition of listed personal property.

True or False?

7. A dining room suite that had been purchased for \$700 was sold during the year.

- a. The proceeds of disposition totalled \$900. The capital gain on the transaction is \$200.

True or False?

- b. The proceeds of disposition totalled \$500. The allowable capital loss on the transaction is \$100.

True or False?

- c. The proceeds of disposition totalled \$1,500. The taxable capital gain on the transaction is \$250.

True or False?

8. When there is a change in use, there will be a deemed disposition/reacquisition.

True or False?

9. When an individual emigrates from Canada, there is a deemed disposition of all of his capital property at fair market value.

True or False?

10. To be an eligible corporation for purposes of the deferral provisions on small business investments, more than 50 percent of the fair market value of its assets must be used to produce active business income in Canada.

True or False?

11. When there is an involuntary disposition of a depreciable asset, any resulting capital gain can be eliminated if the asset is replaced by an asset of equal or greater value, no later than the end of the second taxation year following the disposition.

True or False?

**TIF PROBLEM EIGHT - 3****Capital Gains And Losses - Multiple Choice**

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**New For 2016/2017****General Rules**

1. Which of the following statements with respect to capital gains is **NOT** correct?
  - A. Insurance proceeds to compensate for a business building destroyed in a fire is a proceeds of disposition.
  - B. The adjusted cost base of capital assets is reduced by any government assistance received for their acquisition.
  - C. The lifetime capital gains deduction reduces the amount of capital gains included in Net Income For Tax Purposes.
  - D. The expropriation of a capital asset by a municipal government is considered to be a disposition.

**Superficial Loss**

2. On November 12, 2016, Hubert Robbins sells 100 shares of Loser Inc. for \$120 per share. He had purchased these shares several years ago at \$220 per share. On November 18, 2016, he acquires 80 shares of Loser Inc. for \$100 per share. On December 22, 2016, he acquires 50 shares of Loser Inc. at \$80 per share. What is the adjusted cost base of the 130 shares that he holds after the December 22, 2016 purchase?
  - A. \$12,000.
  - B. \$20,000.
  - C. \$22,000.
  - D. \$14,000.

**Detailed Application Of The Rules**

3. With respect to dispositions of capital assets, which of the following statements is correct?
  - A. The cost of providing a warranty on the sale of a capital asset cannot be deducted for tax purposes.
  - B. When identical properties are sold, the cost can be determined using either FIFO or Average Cost valuation.
  - C. The cost of providing a warranty on the sale of a capital asset can be deducted in full in the determination of business income.
  - D. If a portion of a property is sold, the adjusted cost base must be determined using the fair market value of the portion sold as a fraction of the total fair market value of the property.

**Capital Gains Reserves**

4. Which of the following statements with respect to capital gains reserves is correct?
  - A. There is no limit on how many years a reserve can be deducted.
  - B. The maximum capital gains reserve is equal to the ratio between the proceeds not yet collected and the total proceeds, multiplied by the capital gain.
  - C. The maximum capital gains reserve is limited to 20 percent of the total capital gain in the first year after the sale.
  - D. Any capital gains reserve that is deducted in the current taxation year must be added back to income in the subsequent taxation year.

**Special Rule for Sales of Real Property**

5. A business sells real property for \$950,000, with \$600,000 of this amount being allocated to the building and the remaining \$350,000 allocated to the land. The building, the only asset in its Class, had a capital cost of \$800,000 and a UCC of \$650,000. The adjusted cost base of the land was \$250,000. What are the tax consequences of this disposition?
- A. A capital gain of \$100,000 and a terminal loss of \$50,000.
  - B. A capital gain of \$50,000 and a terminal loss of nil.
  - C. A capital gain of \$100,000 and a capital loss of \$50,000.
  - D. A capital gain of \$50,000 and a terminal loss of \$50,000.

**Principal Residences Rules**

6. Which of the following statements with respect to the tax rules for principal residences is correct?
- A. If a farmer's principal residence is on a farm, any capital gain on the disposition of the farm will be exempt.
  - B. An individual and his spouse can each own real property in which they reside for a part of the year, only one of them can claim a principal residence exemption for the year.
  - C. If an individual sells a principal residence and buys another principal residence in a single year, he will not be able to completely eliminate any gain on the disposition of the second residence by using the principal residence exemption.
  - D. If an individual owns only one real property, it is not necessary to file the Form T2091, *Designation Of A Property As A Principal Residence By An Individual*, in order to claim the principal residence exemption.

**Personal Use Property**

7. Which of the following statements about personal use property is **NOT** correct?
- A. Losses on the disposition of personal use property can be deducted to the extent of gains on the disposition of personal use property.
  - B. An antique chest would be classified as personal use property.
  - C. The minimum value for both the proceeds of disposition and the adjusted cost base of personal use property that is being sold is \$1,000.
  - D. When losses on listed personal property are carried forward, they can be deducted to the extent of gains on the disposition of listed personal property.

**Foreign Currency**

8. On July 1, 2016, Chester Aguilar acquires 1,000 shares of a British company at €10 per share. He acquired the funds for this purchase when €1 = \$2.00, a value that did not change prior to the date on which he purchased the shares. He sells the 1,000 shares December 1, 2016 for €12 per share. On this date the exchange rate is €1 = C\$1.98. What is the effect of the sale transaction on Chester's 2016 Net Income For Tax Purposes?
- A. \$3,760.
  - B. \$1,680.
  - C. \$3,560.
  - D. \$1,880.

**Options**

9. Crystal Collins acquires an option to buy a piece of land at a price of \$100,000. The land will be used to expand her greenhouse business. The cost of the option is \$5,000. Which of the following statements is **NOT** correct?
- A. If the option expires, Crystal will have a business loss of \$5,000.
  - B. If Crystal exercises the option and acquires the land, the adjusted cost base of the land will be \$105,000.
  - C. If the option expires, Crystal will have an allowable capital loss of \$2,500.
  - D. If Crystal sells the option for \$5,000, the transaction will have no effect on her Net Income For Tax Purposes.

**Change In Use**

10. Mamie Hanson converts her principal residence into a rental property. This property had cost \$850,000 several years ago. It is converted on January 1, 2016 and, at that time, it is estimated that the value of the property has increased to \$1,100,000. At this time the value of the land is unchanged at \$400,000. Provided her rental income before CCA is more than this amount, what is the maximum CCA that Mamie can claim for 2016?
- A. \$16,000.
  - B. \$32,000.
  - C. \$44,000.
  - D. \$22,000.

**Change In Use - Principal Residence Elections**

11. In 2008, Rochelle Parsons acquired a home in Calgary, Alberta for \$350,000, with \$75,000 of this amount being the estimated value of the land. In 2010, she was required by her employer to move to London, Ontario. As she believed Calgary real estate was an outstanding investment, she decided to convert the home to a rental property, but would not be deducting CCA on it. Related to this decision was the fact that she decided to rent a home in London, rather than acquiring a second property in that city. In 2016, recognizing that she was unlikely to return to Calgary, she sold the Calgary home for \$500,000, with \$150,000 of this amount being the estimated value of the land. What is the minimum capital gain that Rochelle will have to recognize in 2016?
- A. \$33,333.
  - B. \$16,667.
  - C. \$50,000.
  - D. \$150,000.

**Departures From Canada**

12. On January 1, 2016, Marcus Abbott permanently emigrates from Canada. At that time, his only property consists of his principal residence and a small apartment building. His principal residence was purchased several years ago at a cost of \$650,000. Of this total \$150,000 relates to the land. The current fair market value of his residence is \$975,000. The value of the land is unchanged at the time of his departure. The apartment building had a capital cost of \$870,000, with \$170,000 of this total allocated to the land. The building had a January 1, 2016 UCC of \$476,000. At the time of his departure, the apartment building has a fair market value of \$1,200,000, with the value of the land remaining at \$170,000. What is the minimum addition to Mr. Abbott's Net Income For Tax Purposes that results from his departure?
- A. \$655,000.
  - B. \$724,000
  - C. \$559,000
  - D. Nil

**Deferral Provisions on Small Business Investments**

13. Which of the following statements with respect to the ITA 44.1 deferral provisions on small business investments is **NOT** correct?
- A. The replacement shares must be the common shares of an eligible small business corporation that are acquired within 120 days after the end of the year in which the qualifying disposition took place
  - B. The use of the deferral provision will not affect the adjusted cost base of the replacement shares.
  - C. The deferral is limited to a fraction of the capital gain resulting from the qualifying disposition.
  - D. The eligible small business corporation and corporations related to it cannot have assets with a carrying value in excess of \$50 million.

**Deferral Provisions on Replacement Property**

14. On July 1, 2015, the Flex Company's warehouse was completely destroyed in a fire. The capital cost of the warehouse was \$1,500,000 and its January 1, 2015 UCC was \$1,248,539. On December 1, 2015, the company received insurance proceeds of \$1,650,000, an amount equal to the estimated fair market value of the building. On April 1, 2016, the Company acquires an existing warehouse building for \$1,800,000. Provided the Company makes all possible elections to reduce Tax Payable, what amount will be added to the Class 1 UCC as the result of this acquisition?
- A. \$1,548,539.
  - B. \$1,650,000
  - C. \$1,398,539.
  - D. \$1,248,539

**Retained From Previous Editions****General Rules**

15. Which of the following statements with respect to capital gains is correct?
- A. The inclusion rate for taxable capital gains has always been one-half of the capital gain.
  - B. All gains on the sale of Canadian securities are treated as capital gains.
  - C. The favourable taxation of capital gains is designed to partially compensate businesses for the effects of inflation.
  - D. The lifetime capital gains deduction is no longer available to Canadian individuals.
16. The term proceeds of disposition can be used in a number of situations. Indicate which of the following would not be considered proceeds of disposition for the PD Company.
- A. Amounts paid to PD Company under insurance policies for property that has been destroyed.
  - B. Amounts paid to PD Company under insurance policies for property unlawfully taken.
  - C. Amounts paid to PD Company by a municipal government for property that has been expropriated.
  - D. Amounts paid to PD Company on the sale of inventories.
  - E. Amounts paid to PD Company on the sale of a warehouse.

17. Which of the following statements about the tax treatment of gifts of capital assets is **NOT** correct?
- The adjusted cost base to the recipient will be the fair market value of the asset gifted.
  - The tax treatment of gifts is different when the gift is made to a non-arm's length party rather than to an arm's length party.
  - The proceeds of disposition to the person giving the gift will be the fair market value of the asset gifted.
  - If the fair market value of the asset being given exceeds its tax cost to the person giving the gift, that person will have a capital gain.
18. Which of the following is **NOT** included in ITA 53 as an adjustment to the cost base of an asset?
- Government assistance with the cost of acquisition.
  - CCA taken in previous years.
  - Superficial losses.
  - In the case of vacant land, interest and property taxes.
19. Carine purchased a piece of land with her inheritance. She was planning to open a mini-golf course and put in a zip-line course. Carine had been laid off for a year and could not find work as a golf pro. After spending some time researching mini-golf and zip line course designs, she received a job offer which she decided to take. She has received an offer to purchase the land at a significant gain. Which of the following statements is correct?
- Since Carine's primary intent was to use the land in her business, the gain is business income.
  - Since Carine's primary intent was to use the land in her business, the property taxes on the land are deductible.
  - Since Carine's primary intent was to use the land in her business, the gain is a capital gain.
  - Since the gain relates to property, the gain is property income.

### Superficial Loss

20. Chi has the following transactions in Smoke Corp. and Mirrors Corp. shares:

	Smoke	Mirror
May 1, 2015 Purchase	100 @ \$22.50	100 @ \$25.00
December 20, 2015 Sale	100 @ \$28.00	100 @ \$24.00
January 3, 2016 Purchase	N/A	100 @ \$23.20
June 1, 2016 Sale	N/A	100 @ \$26.00

Chi's taxable capital gains for 2015 and 2016 are:

- \$225 for 2015, \$90 for 2016
- \$225 for 2015, \$140 for 2016
- \$275 for 2015, \$90 for 2016
- \$275 for 2015, \$140 for 2016

**Detailed Application Of The Rules**

21. Which of the following statements is **NOT** correct?
- A. When there is a disposition of an identical property, the taxpayer must use the average cost of all such properties as the adjusted cost base.
  - B. When a taxpayer provides a warranty on the sale of a capital asset, the cost incurred to provide the warranty is treated as a capital loss.
  - C. When there is a partial disposition of land that is held as a capital asset, the adjusted cost base must be based on a proportionate share of the total area of the land.
  - D. When a bad debt arises from the sale of a capital asset, its writeoff must be treated as a capital loss.

**Capital Gains Reserves**

**Question 22 And 23** Questions 22 and 23 are based on the following information:

BMP Products Ltd. (BMP) has been in operation for more than 20 years. Ten years ago, planning for future growth of its manufacturing facilities, BMP purchased a plot of land in an industrial area for \$150,000. During the last couple of years, BMP has not met expectations. Business has fallen slightly and cash flows are tight. Due to the decrease in product demand, management does not believe that BMP will use this plot of land in the near future. As a result, during the taxation year ended March 31, 2016, BMP sold this land for \$400,000. \$150,000 was received in February, 2016, with the remainder to be paid in two equal instalments in February, 2017 and February, 2018. You have been advised that capital gains treatment is appropriate for this transaction.

22. BMP can claim a reserve on the above sale at March 31, 2016 of:
- A. Nil.
  - B. \$156,250.
  - C. \$200,000.
  - D. \$250,000.
23. BMP can claim a reserve on the above sale at March 31, 2017 of:
- A. Nil.
  - B. \$78,125.
  - C. \$125,000.
  - D. \$150,000.
24. Bob sold a capital property on December 31, 2016 for \$300,000. \$280,000 is payable on December 31, 2018, and the balance was paid immediately in cash. The adjusted cost base of the property was \$170,000 and the selling costs totalled \$10,000. Which one of the following amounts represents the **minimum** taxable capital gain in 2016?
- A. \$4,000.
  - B. \$10,000.
  - C. \$12,000.
  - D. \$24,000.
25. Shun Li sold a capital property on July 31, 2016 for \$400,000. She received \$100,000 at the time of sale with the balance of \$300,000 payable on July 31, 2019. The adjusted cost base of the property was \$160,000. The minimum taxable capital gain that Shun Li can report in the 2016 taxation year is:
- A. \$30,000.
  - B. \$60,000.
  - C. \$120,000.
  - D. \$180,000.

**Special Rule for Sales of Real Property**

26. The special rules for a disposition of property that includes land and buildings should be applied when:
- A. There is a capital gain on the land and a capital loss on the building
  - B. There is a capital gain on the building and a capital loss on the land
  - C. There is a capital gain on the land and a terminal loss on the building
  - D. There is a capital gain on the building and a terminal loss on the land

**Principal Residence Rules**

27. Mr. Winestock owned two homes from 2013 to 2015. He had purchased Home A in 2002 for \$60,000. In 2013, he purchased Home B for \$180,000, with the intention of selling Home A immediately. Due to market conditions, mortgage rates, and the asking price, he was unable to sell Home A until 2015. The proceeds received on the sale of Home A were \$150,000. In 2016, he was transferred to a different city and sold Home B. He designated 2013 and 2014 to Home A when it was sold. The proceeds received on the sale of Home B were \$200,000. What is his taxable capital gain on Home B?
- A. Nil.
  - B. \$2,500.
  - C. \$5,000.
  - D. \$10,000.
  - E. \$20,000.
28. Heidi bought a mountain chalet in 2011 for \$150,000 and sold it in 2016 for \$180,000. She bought a lakeside cabin in 2012 for \$100,000 and sold it in 2016 for \$130,000. She lived full-time at the chalet in 2011 and spent an equal amount of time at the chalet and the cabin during the 5 years from 2012 to 2016. How should she allocate her principal residence gain reduction for the year 2012 to minimize her 2016 taxable capital gains?
- A. 2012 should be allocated to the cabin
  - B. 2012 should be allocated to the chalet
  - C. 2012 should be split between the cabin and the chalet
  - D. 2012 cannot be allocated to either the cabin or the chalet
29. Which of the following statements regarding the tax treatment of a principal residence is **NOT** correct?
- A. If a taxpayer owns two residences, and both are sold in the same year, the principal residence formula will eliminate the capital gain on only one of the residences.
  - B. If a taxpayer owns two residences, the decision to designate a particular property as the principal residence must be made when the residence is sold.
  - C. If a taxpayer owns only one residence, the principal residence formula will eliminate any capital gain on the sale.
  - D. A capital loss cannot be realized on the sale of a principal residence.

**Personal Use Property**

30. Mike sold the following assets during the current year:

	Sales Price	Cost
Painting	\$2,500	\$ 800
Stamp collection	600	1,200
Outboard motor	900	100
Antique desk	1,300	1,950

Which one of the following amounts represents his taxable capital gain, net of allowable capital losses, for tax purposes during the current year?

- A. \$325.
- B. \$625.
- C. \$650.
- D. \$750.

31. Song Ming sold the following assets during the current year:

	Sales Price	Cost
Diamond Necklace	\$1,200	\$ 600
Rare Book	1,800	1,200
Coin Collection	900	1,100
Vintage Car	16,500	17,000

Which one of the following amounts represents her taxable capital gain, net of allowable capital losses, for tax purposes during the current year?

- A. \$100
- B. \$250
- C. \$350
- D. \$500

32. Indicate which of the following is **NOT** listed personal property:

- A. A stamp.
- B. A rare manuscript.
- C. An antique chair.
- D. A piece of jewelry.
- E. A piece of sculpture.

**Foreign Currency**

33. Which of the following statements related to the taxation of foreign currency transactions is correct?

- A. All gains or losses that result from foreign currency transactions are treated as capital gains and losses.
- B. When a Canadian corporation issues foreign currency debt, a gain or loss will only be recognized when the debt is repaid.
- C. A foreign currency gain or loss will arise when Canadian dollars are converted to a different currency.
- D. For individuals, the first \$200 of foreign currency gains can always be excluded from income.

**Options**

34. Nigel buys an option for \$1,000 which allows him to purchase a block of shares for \$40,000. Which of the following statements is **NOT** correct?
- A. If Nigel allows the option to expire, he has an allowable capital loss of \$500.
  - B. If Nigel sells the option for \$700, he has a taxable capital gain of \$350.
  - C. If Nigel purchases the shares, the adjusted cost base of the shares will be \$41,000.
  - D. If Nigel allows the option to expire, the vendor has a taxable capital gain of \$500.

**Change In Use**

35. Jose Montana owns a cottage that he purchased in 2007 for \$330,000, with \$100,000 of this amount reflecting the value of the land. On January 1, 2016, this cottage is converted to a rental property. At the time of conversion, it is estimated that the cottage has a fair market value of \$600,000, with \$150,000 of this amount reflecting the value of the land. For 2016, rental income, net of all expenses except CCA equals \$10,200. What is the maximum amount of CCA that Jose can deduct on this rental property for 2016?
- A. \$10,200.
  - B. \$6,800.
  - C. \$9,000.
  - D. \$18,000.

Questions 36 and 37 are based on the following information:

Ramon lives in Calgary. In 2013 he purchased a second house in Lethbridge for \$180,000 (land \$100,000; building \$80,000). His grandmother lives in the house rent free and was the only occupant from 2013 to 2016. In March 2016, Ramon converted the house into a duplex. His grandmother lives in one unit rent free and the other unit is rented to tenants. The market value of the house in March 2016 was \$215,000 (land \$115,000; building \$100,000).

36. What is Ramon's taxable capital gain for the 2016 change in use? He will not use his principal residence gain reduction for the Lethbridge house.
- A. \$5,000
  - B. \$8,750
  - C. \$10,000
  - D. \$17,500
37. What is Ramon's maximum 2016 CCA deduction for this rental property? The net rental income before CCA is \$6,000.
- A. \$800
  - B. \$900
  - C. \$1,600
  - D. \$1,800

38. If a business asset with a capital cost of \$100,000 and a UCC of \$80,000 is converted to personal use at a time when its fair market value is \$150,000, which of the following statements is **NOT** correct?
- A. The deemed disposition will create recapture of \$20,000.
  - B. The deemed disposition will create a taxable capital gain of \$25,000.
  - C. The capital cost for CCA purposes will be \$125,000.
  - D. The capital cost for capital gains purposes will be \$150,000.
39. Arnold Swartz converted his principal residence into a rental property after having lived in it for 5 years. He has not been able to find a tenant during the current year. The house had cost \$1 million. At the time of conversion, the property had a fair market value of \$1.4 million. What is the UCC balance in the rental property's Class 1 before any CCA is taken?
- A. \$1,000,000
  - B. \$1,200,000
  - C. \$1,400,000
  - D. Nil

#### **Change In Use - Principal Residence Elections**

40. Susan Cousins purchased a house in Oshawa in March, 2014, for \$250,000 (land; \$80,000, building; \$170,000). Even though Susan would be unable to reside in the house immediately, she felt it was a very good price and did not want to miss the opportunity to own this house. She rented out the house as of April, 2014. Her tenants will move out in December, 2015, and she will move into her house in January, 2016. The fair market value of the house at January 1, 2016 was \$300,000 (land; \$130,000, building; \$170,000). The UCC of the house on this date is \$163,000.
- Which of the following is correct?
- A. The capital cost of the house for CCA purposes at January 1, 2016 is \$275,000.
  - B. Susan must recognize a capital gain for tax purposes of \$50,000 at January 1, 2016.
  - C. Susan must recognize a capital gain for tax purposes of \$25,000 at January 1, 2015.
  - D. Susan can elect to designate the house as her principal residence for the years 2014 and 2015 so there is no capital gain on the house.
  - E. None of the above.
41. In 1993, Ms. Boisvert became a homeowner, acquiring a residence in Halifax at a cost of \$135,000. In 2004, she was transferred by her employer to Winnipeg. She rented accommodations in Winnipeg and leased the Halifax residence. Ms. Boisvert elected to be deemed not to have converted the property to an income producing use. She did not take CCA on the property during the period that it was rented. In July, 2016, after 24 years of ownership, she sold the Halifax house for \$207,000, netting a gain of \$72,000. She had decided she would not return to Halifax. Which one of the following amounts represents the **minimum** capital gain that she may report in 2016?
- A. Nil.
  - B. \$21,000.
  - C. \$33,000.
  - D. \$36,000.

**Departures From Canada**

42. When an individual departs from Canada, there is a deemed disposition of several types of property. Which of the following properties would **NOT** be subject to this deemed disposition rule?
- A. A large painting by a well known Canadian artist.
  - B. Land and building that is being used as a rental property.
  - C. Shares in a CCPC involved in earning active business income.
  - D. Shares in a CCPC that is used to hold investments.
43. Joel has lived in Canada his entire life. He is planning to depart permanently from Canada. The deemed disposition rules on departure would **NOT** apply to his:
- A. Shares in a Canadian public corporation.
  - B. Shares in a Canadian private corporation.
  - C. Coin collection
  - D. House in Ontario.

**Deferral Provisions on Small Business Investments**

44. On November 25, 2015 Ervin sold 100 shares of Mighty Ltd., an eligible small business corporation, for \$32 per share. He purchased the shares in 2014 for \$28 per share. On December 15, 2015 he reinvested the proceeds by buying 80 shares of Mouse Ltd. for \$40 per share. Mouse Ltd. is also an eligible small business corporation so he was able to use the ITA 44.1 election to defer the 2015 capital gains. Ervin sold all of the Mouse Ltd. shares on July 5, 2016 for \$52 per share. His taxable capital gain for 2016 is:
- A. \$680.
  - B. \$960.
  - C. \$480.
  - D. \$1,360.

**Deferral Provisions on Replacement Property**

45. Equipment was stolen from Far East Corp. on May 1, 2016. The cost of the equipment was \$10,000 and the UCC was \$7,500. The insurance proceeds of \$12,000 were received on September 15, 2016 and replacement equipment was purchased for \$11,500 on September 30, 2016. Far East makes all elections to minimize the tax effect of replacing the equipment. Which of the following statements is correct?
- A. The 2016 taxable capital gain is \$250 and the deemed capital cost of the new equipment is \$10,000
  - B. The 2016 taxable capital gain is \$250 and the deemed capital cost of the new equipment is \$11,500
  - C. The 2016 taxable capital gain is \$250 and the deemed capital cost of the new equipment is \$10,750
  - D. The 2016 taxable capital gain is \$1,000 and the deemed capital cost of the new equipment is \$12,000

46. With respect to the deferral provisions for replacement property, which of the following statements is **NOT** correct?
- A. In the case of involuntary dispositions, for the deferral provisions to apply, the replacement of the property must occur within 24 months after the end of the year in which the proceeds of disposition were received.
  - B. Provided the replacement cost of the property exceeds the proceeds of disposition, 100 percent of any capital gain that results from an involuntary disposition can be reversed.
  - C. When the disposition is voluntary, the deferral provisions only apply to former business properties.
  - D. Provided the replacement cost of the property is less than the proceeds of disposition, 100 percent of any recapture recognized as a result of an involuntary disposition can be reversed.
47. Assume that in all of the following situations the company's fiscal year is the calendar year and that recapture arose due to the disposition of the asset. In which situation would the company **NOT** be permitted to defer the recognition of the recapture?
- A. A warehouse was destroyed in a fire in December, 2014. The insurance proceeds received were used to build a new warehouse that was finished in June, 2016.
  - B. A backhoe was stolen in December, 2014. The insurance proceeds received were used to buy a new backhoe in June, 2016.
  - C. A backhoe was destroyed in a fire in December, 2014. The insurance proceeds received were used to buy a new backhoe in June, 2016.
  - D. A warehouse was sold in December, 2014 with half the proceeds received at time of sale and half of the proceeds receivable on January 1, 2016. A new warehouse was purchased in June, 2016.

**TIF PROBLEM EIGHT - 4****Capital Gains And Losses - Exam Exercises**

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**Exam Exercise Subject Listing For Chapter 8**

<b>Number</b>	<b>Subject</b>
1	Government Assistance
2	Government Assistance
3	Superficial Loss
4	Superficial Loss
5	Capital Gains - Depreciable Property
6	Identical Properties
7	Identical Properties
8	Warranties On Capital Assets
9	Warranties On Capital Assets
10	Capital Gains Reserves
11	Capital Gains Reserves
12	Bad Debts On Capital Assets
13	Bad Debts On Capital Assets
14	Special Rules - Sale Of Real Property
15	Sale Of Principal Residence
16	Sale Of Principal Residence
17	Personal Use Property
18	Personal Use Property
19	Foreign Currency Gains And Losses
20	Foreign Currency Gains And Losses
21	Change In Use
22	Change In Use
23	Emigration
24	Emigration
25	Deferral Of Small Business Gains
26	Deferral Of Small Business Gains
27	Involuntary Disposition
28	Involuntary Disposition
29	Voluntary Disposition

**Exam Exercise Eight - 1 (Government Assistance)**

On January 1 of the current year, Michaels Inc. acquires a used property at a cost of \$4,200,000. Of this amount, \$375,000 represents the fair market value of the land. In order to encourage Michaels' move to this location, the local government has given them \$1,100,000 to assist in the acquisition of the building. Michaels Inc. has a December 31 year end. What is the maximum amount of CCA that Michaels can deduct on this building for the current year?

**Exam Exercise Eight - 2 (Government Assistance)**

On July 1, 2016, Frodam Ltd. acquires a used property at a cost of \$3,400,000. This total cost is allocated \$800,000 to the land and \$2,600,000 to the building. In order to assist with this purchase and encourage the Company's move to this location, the provincial government has provided a grant of \$500,000 to assist in the acquisition of the building. What is the maximum amount of CCA that Frodam can deduct on this building for the taxation year that ends on December 31, 2016?

**Exam Exercise Eight - 3 (Superficial Loss)**

Mr. Franklin Sharp owns 750 shares of Guard Inc. They have an adjusted cost base of \$21.50 per share. On June 15, 2016, he sells all of these shares at \$13.75 per share. On June 21, 2016, he acquires 400 shares of Guard Inc. at a cost of \$12.15 per share and is still holding the shares at the end of the year. What are the tax consequences of these transactions?

**Exam Exercise Eight - 4 (Superficial Loss)**

Ms. Linda Udall owns 800 shares of Fordam Inc. that she acquired several years ago at \$10 per share. On April 30, 2016, she acquires an additional 200 shares at \$12 per share. On July 15, 2016, after Fordam releases unexpectedly bad second quarter results, Ms. Udall sells all 1,000 of her shares at \$5 per share. On August 1, 2016, she purchases 200 shares at \$1 per share as she believes the market has overreacted to the bad news. Ms. Udall is still holding the shares at the end of the year. What are the tax consequences of these transactions?

**Exam Exercise Eight - 5 (Capital Gain On Depreciable Assets)**

On July 1, 2016, Lorty Inc. sells equipment for \$126,000. This equipment had an original cost of \$111,000 and a net book value of \$93,000. For tax purposes, these assets were in Class 8. The UCC balance in this class on January 1, 2016 was \$103,000. There were no other additions or dispositions of Class 8 assets during the taxation year ending December 31, 2016. Indicate the adjustments that would be required to Lorty Inc.'s accounting income in the determination of 2016 Net Income For Tax Purposes.

**Exam Exercise Eight - 6 (Identical Properties)**

Mr. Levon Park makes frequent purchases of the common shares of Donner Ltd. During 2015, he purchased 700 shares at \$22.75 per share on January 15, and 410 shares at \$25.50 per share on March 12. He sold 250 shares on September 15, 2015 at \$26.45 per share. On February 14, 2016, he purchases an additional 925 shares at \$28.25 per share and, on October 1, 2016, he sells 410 shares at \$30.75 per share. Determine Mr. Park's taxable capital gains for 2015 and 2016.

**Exam Exercise Eight - 7 (Identical Properties)**

For the last two years, Margaret Lane has been interested in the shares of Garod Inc. During the period, her transactions in these securities were as follow:

	Shares Purchased (Sold)	Per Share Value
January, 2015 Purchase	300	\$4.75
July, 2015 Purchase	200	5.25
November, 2015 Sale	(250)	5.40
July, 2016 Purchase	400	5.50
December, 2016 Sale	(150)	4.80

Determine Margaret's taxable capital gains (losses) for 2015 and 2016.

**Exam Exercise Eight - 8 (Warranties On Capital Assets)**

During the taxation year ending December 31, 2015, Pointer Inc. sells a capital asset with an adjusted cost base of \$226,000 for proceeds of \$279,000. The Company provides the purchaser with a one year warranty and the Company estimates that it will cost \$4,100 to fulfill the warranty provisions. On September 22, 2016, the Company spends \$4,400 to fulfill the warranty provisions. Determine the effect of these transactions on Net Income For Tax Purposes for 2015 and 2016.

**Exam Exercise Eight - 9 (Warranties On Capital Assets)**

During 2015, John Ritton sells a capital asset with an adjusted cost base of \$126,000 for proceeds of disposition that total \$182,000. He provides the purchaser with a one year warranty that he estimates will cost \$2,600 to provide. During 2016, he spends \$2,400 to fulfill the warranty provision. Determine the effect of these transactions on Net Income For Tax Purposes for 2015 and 2016.

**Exam Exercise Eight - 10 (Capital Gains Reserve)**

During June, 2016, Ms. Janet Houston sells a capital asset with an adjusted cost base of \$112,500, for proceeds of \$172,300. She receives \$33,000 of this amount in cash, with the balance due at the end of the following year. What is the minimum amount that she will have to include in her 2016 Net Income For Tax Purposes as a result of this transaction?

**Exam Exercise Eight - 11 (Capital Gains Reserve)**

During 2015, Jack Harris sells a capital asset with an adjusted cost base of \$87,200 for proceeds of \$105,300. He receives a down payment of \$5,300 in 2015, a second payment of \$50,000 in 2016, and a final payment of \$50,000 in 2017. What is the minimum amount that Jack will have to include in Net Income For Tax Purposes in 2015, 2016, and 2017 as a result of this sale?

**Exam Exercise Eight - 12 (Bad Debts On Capital Assets)**

During 2015, a capital property with an adjusted cost base of \$131,000 is sold for \$115,000. The proceeds of disposition are made up of \$82,000 in cash, plus the purchaser's one-year note for \$33,000. In 2016, the note proves to be uncollectible. What are the tax consequences of these events in 2015 and 2016?

**Exam Exercise Eight - 13 (Bad Debts On Capital Assets)**

In November, 2015, John Bradley sells a capital property with an adjusted cost base of \$182,000, for proceeds of disposition of \$213,000. He receives \$63,000 of the proceeds in cash, with the balance of \$150,000 payable on December 1, 2016. When the balance falls due on December 1, 2016, it is clear that none of this amount will ever be paid. What are the tax consequences of these events in 2015 and 2016?

**Exam Exercise Eight - 14 (Special Rules For Sale Of Real Property)**

Saba Corp. bought an apartment complex during 2015 for \$450,000 (\$100,000 for the land, \$350,000 for the building) and sold it during 2016 for \$460,000 (\$120,000 for the land, \$340,000 for the building). \$7,000 was deducted for CCA in 2015. Determine the tax consequences of the sale for 2016.

**Exam Exercise Eight - 15 (Sale Of Principal Residence)**

Mr. Jerry Haggard owns a house in Calgary, as well as a cottage in Canmore. He purchased the house in 2005 for \$186,000. The cottage was purchased in 2008 for \$105,000. During December, 2016, both properties are sold, the house for \$263,000 and the cottage for \$197,000. He has lived in the Calgary house during the year, but has spent his summers in the Canmore cottage. Determine the minimum capital gain that he must report on the 2016 sale of the two properties.

**Exam Exercise Eight - 16 (Sale Of Principal Residence)**

Ms. Harriet Lowe owns a city home in Vernon, as well as a chalet at the Silver Star ski area. The city home was purchased in 2003 at a cost of \$172,000. The chalet was purchased in 2009 for \$89,000. On July 1, 2016, the house is sold for \$214,000 and the chalet is sold for \$122,000. A real estate commission of 6 percent was paid on each sale. She has spent some time in each property in every year from 2009 through 2016. Determine the minimum capital gain that she must report for 2016 as a result of the sale of the two properties.

**Exam Exercise Eight - 17 (Personal Use Property)**

During the current year, Robert Langois disposes of several items. The proceeds of disposition and the adjusted cost base of the various items are as follows:

	Adjusted Cost Base	Proceeds Of Disposition
Collector Car	\$45,000	\$61,000
Marble Sculpture	800	13,000
Antique Furniture	21,000	12,000
Stamp Collection	50,500	26,000

What is the net tax consequence of these dispositions?

**Exam Exercise Eight - 18 (Personal Use Property)**

During the current year, Rhonda Fontaine disposes of several items of her personal property. Relevant information on these properties is as follows:

	Adjusted Cost Base	Proceeds Of Disposition
Coin Collection	\$ 18,000	\$ 11,500
Sailboat	42,000	56,000
Antique Sports Car	24,000	12,000
Group Of Seven Painting	142,000	145,000

What is the net tax consequence of these dispositions?

**Exam Exercise Eight - 19 (Foreign Currency Gains And Losses)**

During 2013, Ms. Lorenda Jacks acquires 300 shares of a Barbadian company, Tellen Ltd., at a price of 51 Barbadian dollars (B\$) per share. She paid for the shares with Barbadian dollars purchased at a rate of B\$1 = C\$0.70. During September, 2016, the shares are sold for B\$85 per share. The Barbadian dollars are immediately converted into Canadian dollars at a rate of B\$1 = C\$0.72. What amounts will be included in Ms. Jacks' 2016 Net Income For Tax Purposes as a result of these transactions?

**Exam Exercise Eight - 20 (Foreign Currency Gains And Losses)**

In 2014, Lex Steller acquires 500 shares of a British company, Upper Lip Ltd., at a price of £20 per share. He paid for the shares in British pounds and, at this time, the exchange rate was £1 = \$2.00. In January, 2016, he sells all of the shares for £32 per share, leaving all of the British pounds in his trading account. At this time, £1 = \$1.80. In December, 2016, he converts the British pounds to Canadian dollars at a rate of £1 = \$1.90. What amounts will be included in Mr. Steller's 2016 Net Income For Tax Purposes as a result of these transactions?

**Exam Exercise Eight - 21 (Change In Use - CCA On Rental Property)**

For a number of years, Ms. Danine Post has owned a rural cottage property that has been used for her personal enjoyment. The cottage cost \$142,000 in 2012 and, on July 1, 2016, it has a fair market value of \$242,000. She estimates that the fair market value of the land on which the cottage is located is \$22,000 on both of these dates. It will not be designated as her principal residence for any of the years owned. On July 1, 2016, she rents the property to an arm's length party for an amount of \$1,000 per month for a period of three years. Net rental income for the year ending December 31, 2016, before the deduction of any CCA, is \$4,800. What is the maximum amount of CCA that she can deduct for 2016?

**Exam Exercise Eight - 22 (Change In Use - ACB, UCC And CCA)**

On December 1, 2016, Mr. Jordan Jordy converts his summer cottage into a rental property. The cottage has an original cost of \$57,000 and it will not be designated as his principal residence for any of the years owned. At the time of the conversion, the fair market value of the property is \$136,400. It is estimated that the land value that is included in both the \$57,000 cost and the \$136,400 fair market value is \$20,000. Determine the 2016 tax consequences of this change in use. Your answer should include the maximum CCA that would be available for 2016, and the January 1, 2017 UCC for the rental property, assuming the maximum 2016 CCA is deducted.

**Exam Exercise Eight - 23 (Emigration)**

Mr. Ryan Marchand owns publicly traded securities with an adjusted cost base of \$30,000 and a fair market value of \$56,000. On August 15, 2016, he permanently departs from Canada still owning the shares. What would be the tax consequences of his departure, if any, with respect to these securities?

**Exam Exercise Eight - 24 (Emigration)**

Ms. Renee Black owns publicly traded securities with an adjusted cost base of \$45,000 and a fair market value of \$52,000. On December 1, 2016, she permanently departs from Canada without selling the shares. What would be the tax consequences of her departure, if any, with respect to these securities?

**Exam Exercise Eight - 25 (Deferral Of Small Business Gains)**

On January 15, 2016, Chad Brant sells all of his common shares of Brant Inc., an eligible small business corporation. He had owned the shares for 15 years. The adjusted cost base of these shares is \$600,000 and they are sold for \$1,100,000. On February 15, 2016, \$940,000 of these proceeds are invested in the common shares of Quint Ltd., a new eligible small business corporation. How much of the capital gain arising on the sale of the Brant Inc. shares can be deferred by the investment in Quint Ltd.? If the maximum deferral is elected, what will be the adjusted cost base of the Quint Ltd. shares?

**Exam Exercise Eight - 26 (Deferral Of Small Business Gains)**

In early 2016, Carol Martin sells all of her common shares in Martin Ltd., an eligible small business corporation. She had owned the shares for 10 years. The shares had an adjusted cost base of \$895,000 and were sold for proceeds of disposition of \$985,000. Using these proceeds, she made two investments in other eligible small business corporations:

- She used \$200,000 of the proceeds to invest in Barby Ltd.
- She used \$600,000 of the proceeds to invest in Ken Inc.

The remaining proceeds remained in her savings account at the end of 2016. How much of the capital gain arising on the sale of the Martin Ltd. shares can be deferred by the investments in Barby and Ken? If the maximum deferral is elected, what will be the adjusted cost base of these two investments?

**Exam Exercise Eight - 27 (Involuntary Dispositions)**

Multi Inc., a company with a December 31 year end, operates out of a single building that cost \$815,000. At the beginning of 2015, the UCC for its Class 1 was \$648,275. On June 30, 2015, the building was completely destroyed in a tornado. The building was insured for its fair market value of \$1,000,000 and this amount was received in September, 2015. The building is replaced in 2016 with a 10 year old building at a cost of \$1,075,000. Multi Inc. wishes to minimize taxes.

Describe the 2015 and 2016 tax consequences of these events, including the capital cost and UCC for the replacement building at the end of 2016. Ignore any gain or loss related to the land on which the building is located.

**Exam Exercise Eight - 28 (Involuntary Dispositions)**

In October 2015 a thief broke into Guda Corporation's head office and stole their electronic communications equipment. The equipment originally cost \$18,000 and was in a separate Class 8 with a UCC balance of \$12,000. Fortunately, the equipment was insured for replacement cost so Guda received insurance proceeds of \$20,000. The equipment was replaced in January, 2016 for \$20,000. Guda has a taxation year that ends on December 31.

Provided the appropriate elections are made to minimize the 2015 income inclusions, determine the tax values for the equipment at the end of 2016.

**Exam Exercise Eight - 29 (Voluntary Dispositions)**

On December 1, 2015, Morteaux Ltd. sells its only building in anticipation of moving to a new location in 2016. Morteaux Ltd. has a taxation year that ends on December 31. The property is sold for \$2,300,000 and, at the time of the sale, the land had an adjusted cost base equal to its fair market value of \$1,200,000, while the building had a capital cost equal to its fair market value of \$1,100,000 and a UCC of \$250,000. During February, 2016, the store building is replaced at a total cost of \$2,700,000, with \$1,300,000 allocated to the land and \$1,400,000 allocated to the building. The replacement building is a 25 year old building.

Assume the appropriate election is made to minimize total taxes for the two years 2015 and 2016.

Calculate the effect on 2015 Net Income For Tax Purposes of the sale and acquisition and the maximum CCA that can be taken on the new building in 2016.

**TIF PROBLEM EIGHT - 5A****Capital Gains And Losses - Key Term Matching (Easy)**

**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms were listed at the end of Chapter 8 on Capital Gains and Losses:

- A. Involuntary Disposition
- B. Capital Loss
- C. Deemed Disposition
- D. Capital Asset
- E. Listed Personal Property
- F. Real Property
- G. Superficial Loss
- H. Taxable Capital Gain

The following list contains ten potential definitions for the preceding key terms.

1. A disposition of a capital property resulting from theft, destruction through natural causes, or expropriation by a statutory authority.
2. The taxable portion of a capital gain.
3. A requirement to assume that a disposition has taken place when, in fact, a disposition transaction has not occurred.
4. An asset that is held for the purpose of producing income.
5. The disposal of an asset through sale, gift, physical destruction, conversion, expropriation, or other means.
6. Any property that is owned by the taxpayer and used primarily for his enjoyment.
7. Land and all appurtenances to it, including buildings, crops, and mineral rights.
8. A loss on the disposition of property that is disallowed for tax purposes because the taxpayer has acquired an identical property, either 30 days before the disposition or, alternatively, 30 days after the disposition.
9. The excess of the sum of the adjusted cost base of a capital asset plus any costs of disposition, over the proceeds resulting from the disposition of the asset.
10. A defined subset of personal use property. The included items are works of art, jewelry, rare books, stamps, and coins.
11. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 10) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (11). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

**TIF PROBLEM EIGHT - 5B****Capital Gains And Losses - Key Term Matching (Moderate)**

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**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms were listed at the end of Chapter 8 on Capital Gains and Losses:

- A. Involuntary Disposition
- B. Capital Loss
- C. Deemed Disposition
- D. Capital Asset
- E. Listed Personal Property
- F. Real Property
- G. Superficial Loss
- H. Taxable Capital Gain

The following list contains 14 potential definitions for the preceding key terms.

1. A disposition of a capital property resulting from theft, destruction through natural causes, or expropriation by a statutory authority.
2. The taxable portion of a capital gain.
3. A requirement to assume that a disposition has taken place when, in fact, a disposition transaction has not occurred.
4. A loss on the disposition of property that is disallowed for tax purposes because the transfer was to a non-arm's length person.
5. A disposition of a capital property resulting from repossession by creditors.
6. An asset that is held for the purpose of producing income.
7. The disposal of an asset through sale, gift, physical destruction, conversion, expropriation, or other means.
8. Any property that is owned by the taxpayer and used primarily for his enjoyment.
9. Land and all appurtenances to it, including buildings, crops, and mineral rights.
10. A defined subset of personal use property. The included items are works of art, jewelry, rare books, antiques, and coins.
11. An asset that is classified as non-current for accounting purposes.
12. A loss on the disposition of property that is disallowed for tax purposes because the taxpayer has acquired an identical property, either 30 days before the disposition or, alternatively, 30 days after the disposition.

*Capital Gains And Losses - Key Term Matching (Moderate)*

13. The excess of the sum of the adjusted cost base of a capital asset plus any costs of disposition, over the proceeds resulting from the disposition of the asset.
14. A defined subset of personal use property. The included items are works of art, jewelry, rare books, stamps, and coins.
15. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 14) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (11). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

**TIF PROBLEM EIGHT - 6****Capital Gains And Losses - Identical Properties**

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Martin Blair has purchased the shares of two companies over the years. Each company has only one class of shares. Purchases and sales of shares in the first of these companies, Marek Ltd., are as follows:

March, 2010 purchase	650 @ \$11
September 2011 purchase	922 @ 13
May, 2013 purchase	480 @ 17
November, 2013 sale	(610) @ 21
July, 2016 purchase	240 @ 18
October, 2016 sale	(460) @ 12

Purchases and sales of shares in the second company, Dunsmore Inc., are as follows:

April, 2015 purchase	2,200 @ \$12
December, 2015 purchase	1,450 @ 17
July, 2016 sale	(2,840) @ 22

**Required:**

- A. Determine the cost to Mr. Blair of the Marek Ltd. shares that are still being held on December 31, 2016.
- B. Determine the taxable capital gain resulting from the July, 2016 disposition of the Dunsmore Inc. shares.

## **TIF PROBLEM EIGHT - 7**

### **Warranties And Bad Debts**

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Ms. Houde is a wealthy entrepreneur. She owns a large tract of undeveloped land near Lethbridge, Alberta. The land was acquired a number of years ago at a cost of \$3,500,000. As she has decided to move to Newfoundland, on December 31, 2016, Ms. Houde sells this tract to a local real estate developer for \$6,000,000.

The developer provides a down payment of \$1,000,000 and agrees to further payments of \$1,000,000 per year, commencing on December 31, 2017. Interest is charged at the annual rate of 5 percent on the outstanding balance at the beginning of each year. Due to a large business loss, Ms. Houde chooses not to use a capital gains reserve to defer the taxation on this sale.

The developer plans to subdivide the property into 100 equal sized lots which he anticipates will sell quickly at \$125,000 each. However, because of the large amount of risk associated with the project, Ms. Houde agrees to pay the developer \$10,000 for each lot that is not sold by December 31, 2017.

By December 31, 2017, only 60 of the lots have been sold, a result which requires Ms. Houde to pay the developer \$400,000 [(\$10,000)(40 Lots)]. The developer pays Ms. Houde the required interest and principal payments for 2017.

During 2017, the developer continues to market the remaining 40 lots. However, because of a successful competing housing development, he is unable to sell any of these properties. While he is able to pay the required interest on December 31, 2018, he is unable to make the required principal payment on that date. Despite this default, Ms. Houde expects to be able to collect the remaining balance in subsequent years.

In early 2019, the developer declares bankruptcy. Of the remaining loan balance, Ms. Houde is only able to recover \$1,000,000.

**Required:** Calculate the tax effects of the transactions that took place during 2016 through 2019 on Ms. Houde's Net Income For Tax Purposes. Include in your solution the effect on the Tax Payable of other years.

## TIF PROBLEM EIGHT - 8

### Capital Gains Reserves

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Ms. Helm acquired two tracts of land near Ottawa 5 years ago. Tract A cost \$71,000, while Tract B cost \$87,000.

On July 1, 2016, Tract A is sold for \$127,000. The terms of the sale require a down payment of \$17,000. A payment of \$25,000 is required on January 1, 2017.

Also on July 1, 2016, Tract B is sold for \$106,000. The terms of the sale require a down payment of \$32,000. No further payment on the principal amount is required for five years.

**Required:** Determine the amount of the minimum taxable capital gain that will have to be included in Ms. Helm's Net Income For Tax Purposes for both 2016 and 2017.

## **TIF PROBLEM EIGHT - 9**

### **Capital Gains Reserves**

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For many years, Mr. Martin Fox has owned a parcel of land near the city of London, Ontario. On January 1, 2016, he sells the land for \$895,000. The real estate agent charges a commission of 4 percent. The adjusted cost base of the land is \$135,000.

The terms of sale require a down payment at the time of closing, with Mr. Fox accepting a 6 percent mortgage for the balance of the \$895,000 sales price.

On each January 1 of subsequent years, a principal payment equal to 10 percent of the sales price (\$89,500) is required. This is in addition to the interest on the outstanding balance of the mortgage during the previous year.

Mr. Martin wishes to use reserves to defer the payment of taxes on capital gains for as long as possible.

**Required:** For the years 2016 through 2020, compare the capital gains taxation effects of this sale assuming:

- A. The down payment was 10 percent of the sales price.
- B. The down payment was 50 percent of the sales price.

## **TIF PROBLEM EIGHT - 10**

### **Principal Residence Designation**

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Since 1997, Petumala Fluffy has owned a residence in Kelowna, British Columbia. It was acquired in that year at a cost of \$623,000.

In 2005, Petumala was appointed to the Senate and, because of the significant amount of time that she was required to be present in Ottawa, she acquired a second residence in that city. The cost of this residence was \$426,000. In each of the subsequent years, she spent some time at each residence.

In 2016, following allegations that she had claimed and double claimed completely inappropriate travel costs, she resigned from the Senate. As this created severe financial difficulties (among other problems), she sold both residences and moved in with her mother. The Kelowna house sold for \$897,000, while the Ottawa home sold for \$534,000. These amounts are net of all real estate fees.

Ms. Fluffy would like to minimize any capital gain that arises as the result of selling the two properties.

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

## **TIF PROBLEM EIGHT - 11**

### **Personal Property Dispositions**

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After a lengthy career as a successful stock market analyst, Ross Howard lost his job. While he has searched extensively for a new position for more than a year, he has been unable to find suitable employment. Given this, he begins to sell some of his prized possessions. The following transactions occur during the current year:

- His beloved collection of limited edition fountain pens had a total cost of \$42,000. However, the proceeds from their sale to another collector, the sole interested party, amounted to only \$13,000. These pens were used largely for decorative purposes. They were all displayed on his work desk and he always carried one prominently in the pocket of his jacket or shirt in order to impress clients.
- His first edition of Hemingway's *The Sun Also Rises* had cost \$12,000 and sold for \$31,000.
- He had inherited a small Paul Borduas painting from his grandfather. The painting had cost his grandfather \$1,500. At the time of the bequest, its fair market value had increased to \$128,000. It is sold privately by Mr. Howard for \$132,000.
- For several years he has driven a Bentley Flying Spur which had cost \$185,000. It is sold for \$64,000.
- His antique Chris Craft race boat had cost \$45,000 several years ago. It is sold for \$62,000.

**Required:** Indicate the tax consequences of each of these dispositions. In addition, indicate the total amount that will be included in Mr. Howard's Net Income For Tax Purposes, as well as any carry over amounts that can be used in previous or subsequent years.

## **TIF PROBLEM EIGHT - 12**

### **Capital Gains On Foreign Securities**

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Mr. Oskar Franklin, a Canadian citizen and resident, spent most of his early years living in Switzerland. This experience left him with a strong belief that Swiss companies are the best run companies in the world. Given this, he opens a Swiss Franc (SF, hereafter) account in a Canadian brokerage firm.

During the years 2014 through 2016, activity in that account is as follows:

- In May, 2014, he acquires 5,000 shares of Matterhorn Ltd., a Swiss company, at a cost of SF25 per share. He acquired the Swiss Francs necessary for this purchase at SF1 = \$1.25.
- In August, 2015, he receives dividends on the Matterhorn shares in the amount of SF1.10 per share. The funds are left in his Swiss Franc trading account and remain there at the end of 2015. The trading account does not pay interest.
- In April, 2016, all 5,000 of the Matterhorn shares are sold for SF23 per share. At this time, the Swiss Francs from this sale are left in his Swiss Franc trading account.
- In December, 2016, fearing that developments in Europe will lead to a further decline in the Swiss Franc, he closes his Swiss Franc trading account and converts all of the funds (the Matterhorn dividend and the proceeds from the Matterhorn share sale) into Canadian dollars.

Assume relevant exchange rates between the Swiss Franc and the Canadian dollar are as follows:

May 2014	SF1.00 = \$1.25
August, 2015	SF1.00 = \$1.35
April, 2016	SF1.00 = \$1.38
December, 2016	SF1.00 = \$1.34

**Required:** Calculate the minimum amount that will have to be included in Mr. Franklin's Net Income For Tax Purposes in each of the years 2014 through 2016, as a result of these transactions involving Swiss Francs.

**TIF PROBLEM EIGHT - 13****Court Cases - Identification Of Capital Gains**

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Each of the following Cases contains a brief description of an actual court case involving the identification of capital gains. For each Case, indicate whether you feel the transaction should have generated a capital gain or income. Explain the basis for your conclusion.

**Case A** An individual constructed an apartment building and operated it as a rental property for a period of three years. At that time, as the result of an unsolicited offer, he decided to sell the building. His decision was also influenced by the fact that he encountered unexpected difficulties in operating the building. The proceeds of the sale exceeded the cost of the building. (73 DTC 5060)

**Case B** An operator of a taxicab business decided to dispose of it as it had proved to be unprofitable. He was not able to obtain a favourable price for the business as a complete unit and, as a consequence, he decided to sell the individual cars. During the subsequent two year period, he engaged in over 40 transactions involving the cars, largely because some worn out cabs had to be replaced and some trade-ins were accepted. A profit was made on most transactions. (57 DTC 144)

**Case C** A taxpayer carried on a full time business as an interior designer. While carrying on this business he bought, lived in for short periods of time, and resold numerous residential properties. In most cases, improvements were made and the property modernized prior to resale. The sales prices were usually well in excess of costs. (64 DTC 56)

**Case D** An optical organization bought the assets of an optical company whose shares were held by a group of medical doctors. The sale was accompanied by an agreement to pay each doctor a "kickback" for every prescription filled. A provincial statute eventually made these payments illegal, at which point the doctors sold their shares to the optical organization. Even though each doctor sold one share, the payments to them varied from \$1,800 to \$57,000. The payments were to be made over a period of ten years and the agreement required the doctors to continue sending patients to the optical company. The amounts paid to the doctors were proportional to the size of their practices. (57 DTC 48)

**Case E** A private company with broadly stated charter powers claimed that it was engaged in the business of dairy farming. Three different farms were acquired and operations started. However, in each case a loss was experienced. The parcels of farmland were then subdivided and sold at a price in excess of their cost. (65 DTC 89)

**Case F** The manager of a company that operated vans designed for the transportation of horses engaged in several transactions involving the purchase and sale of racehorses. He attended race tracks on a regular basis and kept numerous horses for his own personal enjoyment. On most of the purchase and sale transactions, the proceeds of the sale exceeded the cost of the horse. (67 DTC 240)

## TIF PROBLEM EIGHT - 14

### Change In Use - Depreciable Property

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On January 1, 2014, Ms. Laura Darn purchases a real property for \$725,000, of which \$225,000 reflects the estimated value of the land on which the building is situated, and \$500,000 is the estimated value of the building.

Of the floor space in the building, 80 percent will be used to operate her mail order food supplements business, with the remaining 20 percent being used as her residence.

During 2014, Ms. Darn enters into a relationship with Mr. Lance Buffer, her personal fitness trainer. Their relationship develops quickly and Mr. Buffer moves in with Ms. Darn on January 1, 2015. Because this requires additional space for Mr. Buffer's considerable wardrobe, part of the space used for her mail order business is converted to residential space. Specifically, 20 percent of the total space is converted to residential use, reducing the space used for her business to 60 percent of the total. At the time of this conversion, the total market value of the property has increased to \$815,000, with \$230,000 the estimated value of the land, and the remaining \$585,000 allocated to the building.

In November, 2015, Mr. Buffer begins to have an increasingly large number of late night appointments for his services. Trying to ignore her suspicions, Ms. Darn spends her nights promoting her business on social media and her business experiences considerable growth. A trusted friend finally informs Ms. Darn that most of Mr. Buffer's late night appointments are with attractive young females and, while he is providing some services, they are not related to personal fitness (at least not directly).

Furious, Ms. Darn throws Mr. Buffer out. Because of the tainted memories associated with him, she feels she cannot continue living in the same residence. Since her business is being constrained due to lack of space, on January 1, 2016, she moves out of the residential part of the building and converts the entire space to business usage. At this time, the fair market value of the building has increased to \$875,000, with \$245,000 of this total reflecting the value of the land, and the remaining \$630,000 reflecting the value of the building.

**Required:** Determine the maximum CCA that can be deducted by Ms. Darn in 2014, 2015, and 2016. In addition, ignoring the principal residence gain deduction, indicate any other tax consequences that will result from the changes in use of this property.

## **TIF PROBLEM EIGHT - 15**

### **Deemed Dispositions On Emigration**

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Until 2016, Marcie Doan has been a resident of Canada. However, on January 1, 2016, she decides to move to Scottsdale, Arizona. On this date, she owns the following assets:

	<b>Adjusted Cost Base</b>	<b>Fair Market Value</b>
Common Shares In ABC Ltd. (a Canadian controlled private corporation)	\$42,000	\$86,000
Vacant land	63,000	84,000
Common Shares In Power Corp (a public company)	38,000	72,000
Preferred Shares In TD Bank (a public company)	84,000	72,000
Sailboat	97,000	54,000
Oil Painting	5,000	11,000
Stamp Collection	12,000	3,000

Ms. Doan has come to you for advice just prior to moving to Arizona.

**Required:** Determine the amount of the taxable capital gain or allowable capital loss that Ms. Doan will report in her Canadian income tax return for 2016 as a result of her departure from Canada. Assume that the usual tax rules apply, with no elections being made by Ms. Doan.

## **TIF PROBLEM EIGHT - 16**

### **Deferral On Small Business Shares**

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Your very wealthy client, Ms. Nell Tosh is holding investments in a number of small venture capital companies. In order to diversify her holdings, she has decided to sell two of her many investments in 2016 and use the proceeds to invest in companies in different industries.

Her first sale, in January, involves Tech Ltd., a company she acquired 4 years ago for \$3,500,000. Her common shares are sold for \$4,200,000. Of the proceeds, \$3,800,000 is immediately invested in Small Oil Inc. common shares. The remainder of the funds are used to purchase preferred shares in Small Bank Inc. All three corporations are eligible small business corporations.

The second sale, in October, involves Future Inc. common shares and results in proceeds of \$5,600,000. This company is an eligible small business corporation and was acquired 6 years ago at a cost of \$3,800,000. The proceeds are invested in November in common shares of the following companies:

Sombra Inc. (An Eligible Small Business Corporation)	\$2,400,000
Ziff Ltd. (An Eligible Small Business Corporation)	2,800,000
BCE (A Canadian Public Company)	400,000

In December, Ms. Tosh is approached by her brother, Niels, a brilliant biochemist. He is planning to start a new company which will be an eligible small business corporation. Niels would like her to invest \$1,000,000 in his company's common shares. The company will sell his revolutionary new weight loss pill.

At a February 20, 2017 meeting Ms. Tosh informs you that she has not invested in any shares since November. She would like to minimize her tax liability in any way legally possible.

**Required:** Determine the tax consequences for Ms. Tosh of the two sales of shares and the adjusted cost base of each of her new investments assuming she does not invest in any other eligible small business corporations. What advice would you give Ms. Tosh regarding an investment in her brother's company?

## TIF PROBLEM EIGHT - 17

### Voluntary Dispositions - With ITA 44(6) Election

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The current operations of Morcan Inc. (MI) are located in Toronto. Because of the high cost of living in this venue, the Company is experiencing difficulty in attracting new employees. In order to correct this situation, the Company has decided to move its operations to Tweed, Ontario, a small community with much lower living costs.

To this end, it sells all of its Toronto assets during December, 2016. Details of these transactions are as follows:

**Land And Building** The Company's building and the land on which it is situated is sold for a total of \$3,400,000, of which \$2,300,000 can be allocated to the building and \$1,100,000 can be allocated to the land. The land was acquired many years ago at a cost of \$350,000. After acquiring the land, the building was constructed at a cost of \$2,100,000. On January 1, 2016, the UCC of the building was \$850,000. The Company has no other Class 1 assets.

**Equipment** The equipment, all of which falls into Class 8, was acquired at a cost of \$450,000. On January 1, 2016, the UCC for Class 8 is \$165,000. The equipment is sold for \$320,000.

In early 2017, the Company acquires a replacement building in Tweed for \$3,100,000. Of this total, it is estimated that \$2,500,000 can be allocated to the building, with \$600,000 allocated to the land. As it is not a new building, it does not qualify for the enhanced CCA rate for Class 1.

New equipment is acquired for the use in the building at a cost of \$520,000. All of this equipment is allocated to Class 8.

The Company would like to minimize any capital gains or recapture resulting from the sale of the Toronto property. The Company's tax year ends on December 31, 2016, and it does not own any buildings or equipment on this date.

#### Required:

- A. For the disposition of each property, indicate the tax effects that would be included in the Company's 2016 tax return.
- B. Indicate how these tax effects could be altered in an amended 2016 return by using the elections available under ITA 44(1) (to defer capital gains) and ITA 13(4) (to defer recapture), but without the use of the election under ITA 44(6) (to reallocate the proceeds of disposition). Also indicate the adjusted cost base and, where appropriate, the UCC of the replacement properties, subsequent to the application of the ITA 44(1) and ITA 13(4) elections.
- C. Indicate the maximum amount of any reduction in income in the amended 2016 Net Income For Tax Purposes that could result from the use of the ITA 44(6) election and calculate the UCC balance that would result from electing to use this amount. Should the Company make the election? Explain your conclusion.

**TIF PROBLEM EIGHT - 18****Involuntary Dispositions - No ITA 44(6) Election**

Winding Inc. has a Class 1 building with an original cost of \$900,000, of which \$150,000 can be attributed to the land. It is the only Class 1 asset owned by the Company and, on January 1, 2016, its UCC balance is \$425,000.

On July 1, 2016, this building is completely destroyed in a major earthquake. It is estimated that, at the time of this event, the fair market value of the building and land was \$1,200,000, with \$200,000 of this total applicable to the land. With respect to the building, insurance proceeds of \$1,000,000 are received on November 1, 2016. Also on this date, the land is sold for \$200,000.

On February 1, 2017, the Company finds a suitable replacement building that is located near the site of the old building. It is acquired on that date at a cost of \$1,400,000, including an estimated value for the land of \$300,000. As it is not a new building, it does not qualify for the enhanced CCA rate for Class 1 buildings.

**Required:**

- A. Indicate the tax consequences of the involuntary disposition that will be reported in the Company's 2016 tax return.
- B. Indicate the changes that will be reported in the amended 2016 return, provided the Company makes elections under ITA 13(4) (to defer recapture) and ITA 44(1) (to defer capital gains). In addition, determine the capital cost and UCC for the replacement assets, subsequent to the application of these elections.
- C. Calculate the maximum CCA that Winding will be able to claim for the building in 2017, assuming the Company makes the elections under ITA 13(4) and ITA 44(1).

**TIF PROBLEM EIGHT - 19****Involuntary Dispositions - No ITA 44(6) Election**

On July 1, 2016, the manufacturing plant of Janчек Ltd. was expropriated by the provincial government in order to make way for a new expressway. It is the only building that Janчек Ltd. owns. The land on which the plant was situated was purchased for \$88,000. The building, a Class 1 asset, was erected at a cost of \$290,000. The Company's year end is December 31.

On November 23, 2016, after extended negotiations between Janчек and the provincial government, the Company received compensation in the amount of \$130,000 for the land and \$430,000 for the building. On January 1, 2016, the UCC balance in Class 1 was \$248,000.

On June 20, 2017, a replacement manufacturing plant was purchased for a total cost of \$1,050,000. Of this amount, \$210,000 was allocated to the land, with the remaining \$840,000 going to the building. As this was not a new building, it did not qualify for the 10 percent CCA rate that is available for manufacturing and processing buildings.

Janчек Ltd. will make any available elections in order to reduce the tax effects of the replacement of the expropriated property.

**Required:**

- A. Determine the tax effects in 2016 that will result from the receipt of the expropriation compensation.
- B. Indicate how the results in Part A could be altered through the application of ITA 44(1) (to defer capital gains) and ITA 13(4) (to defer recapture) in an amended 2016 return.
- C. Determine the adjusted cost base of the land and the building, as well as the UCC of the building, subsequent to the replacement of these assets and the application of ITA 44(1) (to defer capital gains) and ITA 13(4) (to defer recapture).

## **TIF PROBLEM EIGHT - 20**

### **Short Cases On Capital Gains**

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Each of the following independent Cases describes a situation with a proposed tax treatment.

1. Mr. Acker has owned a small triplex for a number of years and, throughout this period, all three of the units have been rented. In determining his income from this property, he has deducted CCA in each year. During the current year, Mr. Acker has moved into one of the three units and, as a result, will be reporting reduced rental revenues in his tax return. As he has not sold any property, he will not report any capital gains or losses during the current year.
2. Mr. Jones has sold a property with an adjusted cost base of \$72,000 for total proceeds of \$105,000. He is providing a warranty on the property that he estimates will cost him \$6,000 to service. As a consequence, he is recognizing a capital gain of \$27,000.
3. Ms. Turner sold her dining room table to her daughter for \$400 and a painting to her brother for \$900. These prices equalled their estimated fair market values. Several years ago, she purchased the table for \$950, and the painting for \$667. She does not plan to report any capital gain or loss.
4. Mrs. Brown purchased corporate bonds for \$11,200, of which \$800 was accrued interest and \$10,400 represented the principal. The bonds were later sold for \$11,600 that includes \$200 for accrued interest. Mrs. Brown recognizes a taxable capital gain of \$500.
5. Several years ago, Miss Lee transferred three sports cars, with a total value of \$182,000, to a corporation in return for all of the shares of the company. The cars are profitably used in her personal escort business. During the current year, all of the cars are destroyed in a fire on her estate. Unfortunately, Miss Lee did not believe that people in her financial position needed insurance and, as a consequence, no compensation was available for the loss. As the corporation had no assets other than the cars, there was no reason for her to continue to hold the shares. In view of this situation, she sells the shares to a friend who requires a corporate shell for some business operations. The sale price is \$500 and Miss Lee uses the allowable capital loss of \$90,750  $[(1/2)(\$182,000 - \$500)]$  to offset taxable capital gains resulting from real estate transactions.

**Required:** In each of the preceding Cases, indicate whether or not you believe that the tax treatment being proposed is the correct one. Explain your conclusion.

**TIF PROBLEM EIGHT - 21****Comprehensive Case (Chapters 1 to 8)**

Mr. Arnold Bosch is 41 years old and earns most of his income through an unincorporated business, Bosch's Better Boats (BBB). For the taxation year ending December 31, 2016, Mr. Bosch's accountant has determined that BBB had accounting income before taxes, determined in accordance with generally accepted accounting principles, of \$196,000. In determining his business income for tax purposes, the following information is relevant:

1. The accounting income figure included a deduction for amortization of \$29,000.
2. On January 1, 2016, BBB had the following UCC balances:

• Class 1 (Building Acquired In 2005)	\$275,000
• Class 8	83,000
• Class 10	28,000

On March 1, 2016, Class 8 assets with a cost of \$46,000 were sold for \$28,500. On March 15, 2016, these assets were replaced with other Class 8 assets costing \$63,250.

3. During 2016, BBB spent \$30,000 landscaping the grounds around its building. This amount was recorded as an asset in the accounting records. It is being amortized over 10 years on a straight line basis and the amortization is included in the \$29,000 amortization figure in Part 1 of this problem.
4. BBB's 2016 accounting income included a deduction for meals and entertainment of \$27,600.
5. BBB's 2016 accounting income included a deduction for charitable donations of \$5,500, as well as a deduction for donations to federal political parties of \$700.
6. For accounting purposes, BBB charges estimated warranty costs to expense. On January 1, 2016, the liability for these warranties was \$22,000. On December 31, 2016, the liability balance was \$17,500.

Because of the income earned by his business, Mr. Bosch is required to make CPP contributions of \$5,088 [(2)(\$2,544)]. He does not choose to make EI contributions.

Mr. Bosch has a common-law partner, Mr. Fritz Mann. Three years ago, Mr. Bosch and his partner adopted two Chinese orphans. Chris, aged 9, has a severe and prolonged disability that qualifies him for the disability tax credit. Martin, aged 12, is in good health. Neither Chris nor Martin has any income of their own. Because Mr. Mann provides full time care for the children, his only income during 2016 was Universal Child Care Benefits of \$720.

The family's 2016 medical expenses, all paid for by Mr. Bosch, are as follows:

Arnold	\$ 2,050
Fritz	1,080
Chris (No Attendant Care)	16,470
Martin	1,645
<u>Total Medical Expenses</u>	<u>\$21,245</u>

During 2016, Mr. Bosch sold a piece of vacant land for \$85,000. Mr. Bosch received a payment of \$35,000 during 2016, with the \$50,000 balance due in 5 equal instalments in the years 2017 through 2021. The adjusted cost base of this land was \$33,000.

Mr. Bosch owns a rural cottage property that he purchased at a property auction in 2008 at a cost of \$25,000. As of June 30, 2016, an appraiser indicates that it has a value of \$375,000, with \$100,000 of that value being associated with the land. The appraiser indicates that, when Mr. Bosch purchased the cottage, the land value was \$5,000.

Although Mr. Bosch and Mr. Mann used to spend a great deal of time in the summer at the cottage, since the adoptions, the family has made little use of this property. As a result, he decides to begin renting it as of July 1, 2016.

During the period July 1, 2016 through December 31, 2016, rents on the cottage total \$12,000. Expenses other than CCA during this period total \$3,200. For 2016, he intends to take maximum CCA on the property.

Mr. Bosch purchased his city home in 2011. Prior to that, he and Mr. Mann lived in a rented apartment. As the city home has experienced a greater increase in value during the last six years, he will designate the city home as his principal residence for the years 2011 through 2016.

Over the years, Mr. Bosch has made several purchases of the common shares of Low Tech Ltd., a widely held public company. In 2014 he bought 150 shares at \$55 per share. In 2015, he bought an additional 125 shares at \$75 per share. In February, 2016, he bought an additional 300 shares at \$95 per share. On November 11, 2016, after the company announced that most of its product claims had been falsified, Mr. Bosch sold 275 shares at \$5 per share.

**Required:** Calculate Mr. Bosch's minimum 2016 Net Income For Tax Purposes, his 2016 minimum Taxable Income, and his minimum 2016 Balance Owing to the CRA, including any CPP contributions payable. Ignore provincial income taxes, any instalment payments he may have made during the year, and GST/HST/PST considerations.

**TIF PROBLEM EIGHT - 22****Comprehensive Case (Chapters 1 to 8)****Family Information**

Mr. Paul Klee is 39 year of age and lives with his spouse, Virginia Klee. They have two children, May who is 9 years old and Max who is 12 years old. May has been blind since birth. During 2016, Max has income of \$8,200.

Virginia is 38 years and until recently was employed by a large public company. However, in September, 2015, she commenced full time studies at her local university. During 2016, she was in full time attendance for 9 months. Her tuition fees were \$9,350. She had 2016 income from Universal Child Care Benefits and various part time sources of \$8,400.

Paul purchases transit passes for himself, Virginia, and Max for all 12 months during 2016. The cost is \$200 per month for himself and Virginia and \$100 per month for Max. Also during 2016, Max participates in a qualifying arts program that cost \$950.

During 2016, the family incurs medical expenses as follows:

Paul	\$ 1,100
Virginia	1,750
May (No Attendant Care Costs)	13,300
Max	650
<b>Total</b>	<b>\$16,800</b>

**Employment Information**

Paul is employed as a salesperson by a Canadian public company. His annual salary is \$85,000 and, in addition, he earns commissions of \$62,500. The following amounts are withheld by his employer during 2016:

RPP Contributions	\$4,100
EI	955
CPP	2,544
Professional Association Dues	1,500
Annual United Way Donations	1,200

Paul's employer makes a matching contribution to his RPP of \$4,100.

Paul's employer requires that he maintain an office in his home and has provided him with the requisite Form T2200. This office occupies 20 percent of the total floor space in his home. His home operating costs for 2016 are as follows:

Maintenance And Utilities	\$3,400
Property Taxes	7,200
Insurance	850
Mortgage Interest	4,200

Paul's employer provides a \$2,500 per month allowance to cover all of his employment related expenses, including an automobile that he owns personally. The automobile was acquired in 2015 at a cost of \$45,000. In his 2015 tax return he claimed CCA based on the automobile being used 55 percent for employment related activities. For 2016, the usage increased to 80 percent.

Paul's employment related expenses for 2016 are as follows:

Automobile Operating Expenses	\$ 6,100
Hotels	11,500
Airline And Other Transportation	9,200
Client Meals And Entertainment	10,400

Two years ago, Paul's employer granted him options to buy 1,500 shares of the company stock at \$15 per share. At that time, the shares were trading at \$12 per share. In February, 2016, when the shares are trading at \$19 per share, Paul exercises all of these options. In November, 2016, he sells all of these securities for \$22 per share.

### **Other Information**

1. Paul owned two very large oil paintings, each of which cost \$10,000. Since he renovated his home and added many more windows, he no longer had the wall space to hang these paintings. During 2016, he sells one painting for \$15,000 and the other painting for \$4,000.
2. Paul inherited a tract of land from his father. Paul's adjusted cost base for it was \$100,000. In July, 2016, he sells the land to help finance his home renovations. The terms of the sale require a 2016 payment of \$100,000, with the balance being paid in annual instalments of \$50,000 in each of the years 2017 through 2021. Paul would like to use a capital gains reserve to defer as much of this gain as possible.
3. During 2016, Paul received non-eligible dividends of \$5,400.
4. Since 2012, Paul and his family have owned a cottage on a nearby lake. It had cost \$250,000, including an estimated value for the land of \$75,000. As their use of this property has declined over the years, they have decided to convert the cottage to a rental property. At the time of the change, the property was appraised at \$375,000, including \$100,000 for the land. During 2016, net rental income before the deduction of CCA equals \$23,000. Since his city home has had a very substantial increase in value, Paul does not intend to designate the cottage as his principal residence for any of the years of ownership.

**Required:** Calculate Mr. Klee's minimum 2016 Net Income For Tax Purposes, his 2016 minimum Taxable Income, and his minimum 2016 federal Tax Payable. Ignore provincial income taxes, any instalments he may have paid during the year, any income tax withholdings that would be made by his employer, and GST/HST/PST considerations.

## **Chapter Nine Test Item File Problems**

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### **TIF PROBLEM NINE - 1**

#### **Other Income/Deductions, Attribution - Essay Questions**

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1. What is a retiring allowance? What are the tax consequences associated with receiving a retiring allowance?
2. What is a death benefit? Indicate any special tax features that are associated with the receipt of a death benefit.
3. Briefly describe the treatment of amounts received as scholarships.
4. As evidenced by the ability to deduct these items in the calculation of Taxable Income, the government does not intend to tax social assistance payments or worker's compensation payments. Given this, why are these amounts included in Net Income For Tax Purposes?
5. Explain the options that single parents have for including the universal child tax benefit in Net Income For Tax Purposes.
6. List the situations in which an individual can deduct moving expenses.
7. Can an employer compensate an individual for a loss on a home that was sold because the employee was required to move, without creating a taxable benefit for the employee? Explain your conclusion.
8. For purposes of deducting child care costs, how is an "eligible child" defined?
9. What is the objective of providing a disability supports deduction. Cite two examples of costs that can be deducted using this provision.
10. Splitting pension income with a spouse may not be a desirable tax planning strategy. Explain this statement.
11. What are the conditions that must be met for spousal support payments to be deductible to the payor and taxable to the recipient?
12. John Withers is receiving an annuity payment of \$500 per month. How will this payment be taxed?
13. What are the tax advantages and other benefits associated with making contributions to a Registered Education Savings Plan?
14. What is the Canada Learning Bonds program? Briefly describe the program.
15. What are the major tax advantages of Tax Free Savings Accounts (TFSA's)?
16. How is the balance in a Tax Free Savings Account (TFSA) dealt with when the beneficiary of the plan dies?
17. ITA 69 deals with non-arm's length transfers of capital property at values that are different from the fair market value of the property. Why would an individual wish to transfer a property to an adult child at a value that is below its fair market value? Briefly explain your conclusion.

*Other Income/Deductions, Attribution - Essay Questions*

18. An individual wishes to transfer several properties to related parties, some of whom are in higher tax brackets, some of whom are in lower tax brackets. What advice would you give this individual with respect to the consideration that he should take back in return for the property transferred?
19. What are the normal tax consequences, at the time of transfer, for an individual who is transferring property to a spouse or common-law partner? In these circumstances, at what value will the transfer be deemed to take place? Is there an election that can be used to alter these results? If so, briefly describe the election.
20. When there is a non-arm's length transfer of a depreciable property that has a fair market value in excess of its capital cost, the capital cost to the transferee for UCC and recapture purposes will be equal to the transferor's capital cost, plus one-half of the difference between the fair market value and the transferor's capital cost. What is the reason for this rule?
21. Briefly describe the general rules applicable to the treatment of an individual's capital property at death.
22. While the general rules for dealing with an individual's capital property at death require a deemed disposition and the recognition of fair market values, there are rollovers available that can eliminate or reduce the income that would be recognized on such deemed dispositions. Briefly describe these rollovers.
23. When a transfer is made to a spouse or common-law partner, the income attribution rules may be applicable. Briefly describe the conditions under which the income attribution rules would be applicable on such transfers.
24. An individual is considering making a gift of a portfolio of publicly traded stocks. On the basis of tax considerations, provide advice to this individual as to whether he should give the stocks to his 12 year old daughter or, alternatively, to his spouse.
25. One of your clients is a successful businessman with both a spouse and a minor child that have no income of their own. He would like to transfer some of his income into their hands for tax purposes. However, he is concerned about the income attribution rules. Provide him with three tax tips for dealing with these rules.

**TIF PROBLEM NINE - 2****Other Income/Deductions, Attribution - True Or False**

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1. The widow of Peter Toscan received a death benefit from his employer of \$25,000. She must include the \$25,000 in income in the year of receipt.

True or False?

2. The entire amount of a retiring allowance received must be included in income, even if some part of the allowance is transferred to an RRSP.

True or False?

3. Chris Shaffer is being transferred by his employer from Prince George, British Columbia to Red Deer, Alberta.

- i. His airfare from Prince George to Red Deer is a deductible moving cost.

True or False?

- ii. His wife spent \$750 for gas, meals, and lodging while driving their car from Prince George to Red Deer. The \$750 is a deductible moving cost.

True or False?

- iii. The Shaffers paid \$1,000 in legal fees to sell their Prince George home and \$800 in legal fees to buy their new home in Red Deer. The total \$1,800 in legal fees is a deductible moving cost.

True or False?

- iv. Before moving into their new home, the Shaffers had to pay \$2,000 to repair faulty wiring. The \$2,000 is a deductible moving cost.

True or False?

- v. The \$5,000 in real estate fees paid to sell their Prince George house is a deductible moving cost.

True or False?

- vi. All moving expenses can only be deducted from income earned in Red Deer in the year of the move. There are no carry forward provisions for moving costs.

True or False?

4. Sarah and David Johnston paid \$5,500 during the year for child care for their three children, aged 3, 5, and 7. Her annual salary was \$8,000 and his annual salary was \$30,000. Sarah can deduct the \$5,500 paid from her income.

True or False?

5. For purposes of deducting child care costs, an "eligible child" must be under 16 at some time during the year.

True or False?

6. If the lower income spouse was in prison for the entire year, the higher income spouse would be able to deduct child care costs during this period.

True or False?

*Other Income/Deductions, Attribution - True Or False*

7. Jim and Shirley Noonan decide to separate after ten years of marriage. They have no children. To keep the separation amiable, they decide not to involve lawyers or the courts at this stage. They have a written separation agreement in which Shirley agrees to pay Jim \$500 per month until he remarries. The payments will be taxed in Jim's hands and will be deductible from Shirley's income.

True or False?

8. The tax treatment of payments received under an annuity contract will depend on whether the annuity was purchased with after tax funds or, alternatively, from funds that are in an RRSP.

True or False?

9. The contributions that can be made to an RESP for one beneficiary are limited to \$50,000.

True or False?

10. Earnings on amounts contributed to an RESP accumulate on a tax free basis.

True or False?

11. For 2016, contributions to a Tax Free Savings Account (TFSA) are limited to a maximum of \$5,500 for the year.

True or False?

12. While earnings on assets held in a Tax Free Savings Account (TFSA) will not be taxed while the assets are in the plan, the accumulated income will be subject to tax when it is withdrawn from the plan.

True or False?

13. A rollover is a term that is used to describe any transfer of assets between parties that are not dealing at arm's length.

True or False?

14. The term arm's length can apply to transactions involving trusts, corporations, and individuals.

True or False?

15. Johan Deroi has securities with an adjusted cost base of \$1,000 and a fair market value of \$1,500. If he sells these securities to his brother for \$2,000, he will have a capital gain of \$1,000.

True or False?

16. Martha Stuart has a depreciable asset with a UCC of \$50,000, a capital cost of \$80,000, and a fair market value of \$100,000. If she gifts this property to her spouse without making any election, she will have a capital gain of \$50,000.

True or False?

17. When an individual dies, there is a deemed disposition of all of his capital property at fair market value, without regard to his relationship to the beneficiary of his estate.

True or False?

*Other Income/Deductions, Attribution - True Or False*

18. At her death on August 1 of the current year, Nancy Mori owned stocks with an adjusted cost base of \$11,000 and a fair market value of \$20,000, and a term deposit of \$30,000. She also owned a building that had a cost of \$98,750, a fair market value of \$110,000, and a UCC of \$70,000.

- a. She bequeaths all of her assets to a spousal trust. Her Taxable Income at death arising from the dispositions is nil.

True or False?

- b. She bequeaths all of her assets to her daughter, Christine. Nancy's Taxable Income at death arising from the dispositions totals \$10,125.

True or False?

- c. She bequeaths all of her assets to her daughter, Christine, who sells the building before the end of the current year for \$125,000. Christine's Taxable Income arising from the sale is \$7,500.

True or False?

19. A father gives \$10,000 in securities to his 19 year old daughter who is living at home. Any dividends declared on the securities will be attributed to the father.

True or False?

20. Brian Lawson gives equity securities to his 15 year old son. If the securities are sold, in the following year, for more than their fair market value at the time of the gift, the resulting capital gain will be taxed in the hands of Mr. Lawson.

True or False?

**TIF PROBLEM NINE - 3****Other Income/Deductions, Attribution - Multiple Choice****New For 2016/2017****Other Inclusions – Subdivision d Inclusions**

1. Which of the following statements with respect to other inclusions in income is **NOT** correct?
  - A. The \$10,000 exclusion from income of a death benefit must be claimed by a spouse.
  - B. Social assistance payments will increase the recipient's Net Income For Tax Purposes but not their Taxable Income.
  - C. The minimum withdrawal amount from a RRIF must be included in income, even if it is not withdrawn from the plan.
  - D. Research grants are included in income net of unreimbursed expenses related to carrying on the research work.

**CPP Payments Deduction**

2. Dwayne Brooks is self employed and, because of the high level of his income, is required to make a 2016 CPP contribution of \$5,088 [(2)(\$2,544)]. How will this affect his 2016 Net Income For Tax Purposes and his 2016 Taxable Income?
  - A. Both his Net Income For Tax Purposes and his Taxable Income will be reduced by \$5,088.
  - B. Both his Net Income For Tax Purposes and his Taxable Income will be reduced by \$2,544.
  - C. Neither his Net Income For Tax Purposes nor his Taxable Income will be affected.
  - D. Both his Net Income For Tax Purposes and his Taxable Income will be reduced by \$763.

**Moving Costs Deduction**

3. Which of the following statements related to the costs of an eligible relocation is correct?
  - A. If the employer provides an allowance for these moving costs that is less than the actual moving costs, it is not included in income.
  - B. All legal and other costs associated with acquiring a residence in the new work location are deductible.
  - C. The costs of visiting the new work location in order to find a new residence are deductible.
  - D. The costs of selling a residence where the taxpayer lived prior to the relocation is always deductible.

**Child Care Costs**

4. Which of the following statements with respect to child care costs is **NOT** correct?
  - A. In calculating earned income for child care cost purposes, net business income is included, but net business losses are not.
  - B. Amounts paid to a person under the age of 18 are never deductible.
  - C. The higher income spouse can deduct child care costs if the lower income spouse is a person confined to a prison or similar institution throughout a period of not less than 2 weeks in the year.
  - D. There is no requirement that amounts be spent on specific children.

**Disability Supports Deduction**

5. Which of the following statements with respect to the disability supports deduction is correct?
- A. To qualify for this deduction, the individual must be performing duties as an employee.
  - B. The total amount of the deduction is limited to \$15,000 per taxation year.
  - C. Some amounts can be claimed both as a disability supports deduction and as an inclusion in the base for the medical expense tax credit.
  - D. This deduction is available to individuals who do not qualify for the disability tax credit.

**Pension Income Splitting**

6. Which of the following statements with respect to pension income splitting is **NOT** correct?
- A. Neither OAS payments nor CPP payments are eligible for the pension income splitting provisions.
  - B. If an individual and his spouse are in different tax brackets, pension income splitting will always reduce their combined federal Tax Payable.
  - C. These provisions allow a taxpayer to allocate up to 50 percent of his qualifying pension income to a spouse.
  - D. Lump sum withdrawals from RRSPs are not eligible for pension income splitting.

**Spousal And Child Support**

7. With respect to spousal and child support, which of the following statements is **NOT** correct?
- A. Any amounts that are not specifically identified in the agreement as spousal support will be considered child support.
  - B. An amount qualifies as a support payment only if it is payable or receivable on a periodic basis.
  - C. The recipient of child support payments will not be able to claim the tax credit for an eligible dependant.
  - D. Deductible support payments reduce the taxpayer's Earned Income for RRSP purposes.

**Income From Annuities**

8. Which of the following statements about annuity payments received is correct?
- A. Net Income For Tax Purposes is increased by the amount of any annuity payment received.
  - B. If the taxpayer uses funds from his savings account to purchase an annuity, the taxable amount of any payment is reduced by the capital element that is included in the payment.
  - C. To qualify as an annuity, the payments cannot extend beyond the life of the annuitant.
  - D. If the annuity was purchased inside an RRSP, none of the payments will be subject to tax.

**Registered Savings Plans**

9. Arnold Ingram has \$5,000 in funds that he does not currently need. He has a young son who he expects will pursue university education when he is older. Arnold is trying to decide whether the unneeded funds should be invested in a TFSA or an RESP. With respect to this decision, which of the following statements is **NOT** correct?
- A. His current Tax Payable will not be affected by the choice between the two types of registered plans.
  - B. Withdrawals from either plan will be received tax free.
  - C. If he chooses the RESP, the plan will receive additional funds from the government in the form of Canada Education Savings Grants.
  - D. Contributions from either type of registered plan can be removed on a tax free basis.

**Non-Arm's Length Transactions**

10. With respect to non-arm's length transfers of depreciable property, which of the following statements is correct?
- A. Gifting a non-depreciable property with an accrued capital gain to a non-arm's length individual can result in double taxation of some part of that gain.
  - B. When there is a non-arm's length transfer of a depreciable capital property with a fair market value that exceeds its capital cost to the transferor, the capital cost to the transferee will be the same as the old capital cost to the transferor.
  - C. When there is a non-arm's length transfer of a depreciable capital property that has a fair market value that is less than the transferor's capital cost, the transferee's new capital cost is deemed to be equal to the transferor's old capital cost.
  - D. If there is a transfer of a non-depreciable capital property at a value that is less than its fair market value, the adjusted cost base to the transferee will be the fair market value.

**Death Of A Taxpayer**

11. Lance Mann dies, leaving a depreciable property to his son, Paul Mann. The property has a capital cost of \$150,000 and a fair market value of \$120,000. It is the only asset in a CCA Class with a UCC balance of \$100,000. The tax consequences of this bequest would be:
- A. Recapture of \$20,000 for Lance and the capital cost of the asset for Paul will be \$150,000.
  - B. A taxable capital gain for Lance of \$10,000 and a capital cost of the asset for Paul of \$150,000.
  - C. Recapture of \$20,000 for Lance and a capital cost of the asset to Paul of \$120,000.
  - D. Recapture of \$20,000 for Lance and a capital cost of the asset for Paul of \$100,000.

**Income Attribution**

12. Which of the following situations will **NOT** result in the attribution of income to the transferor?
- A. The transfer of a capital property to a spouse for consideration equal to fair market value of the property. The transferor does not elect out of ITA 73(1).
  - B. The transfer of a capital property to a spouse in return for a non-interest bearing note. The transferor elects out of ITA 73(1).
  - C. The transfer of an unincorporated business to a spouse. The transferor does not elect out of ITA 73(1).
  - D. The transfer of a capital property to the 15 year old son of the transferor's sister.

**Retained From Previous Editions****Other Inclusions – Subdivision d Inclusions**

13. Which of the following statements with respect to Subdivision d income inclusions is correct?
- A. 100 percent of any death benefit received by a spouse must be included in income.
  - B. 100 percent of any scholarships received must be included in income.
  - C. 100 percent of any retiring allowance received must be included in income.
  - D. Social assistance payments received are not included in income.
14. Which of the following sources of income would **NOT** result in any increase in Taxable Income for the taxpayer who receives it or another family member?
- A. Amounts that are withdrawn from an RRSP.
  - B. A research grant received by a student in a university program.
  - C. Workers' compensation payments.
  - D. Universal Child Care Benefit payments.
15. Minjie and Yijun are the parents of 4 year old Yan. The couple had deductible child care costs of \$2,000 for the year. Minjie receives the Universal Child Care Benefit of \$960 for the year. Because Yijun is a full time student, he has a lower income than Minjie. Which of the following statements regarding the Universal Child Care Benefit is correct?
- A. Minjie must report the benefit in her income.
  - B. Whoever is claiming the child care costs must report the benefit in income.
  - C. Yijun must report the benefit in his income.
  - D. The family can include the benefit in Yan's income.

**CPP Payments Deduction**

16. Adhira has Taxable Income of \$110,000 before any consideration of a CPP deduction. She is a self-employed hairdresser. How much will her federal tax payable decrease as a result of the \$5,088 contribution to CPP that she must make in 2016?
- A. \$382
  - B. \$1,043
  - C. \$763
  - D. \$1,323

**Moving Costs Deduction**

17. Stan Aiken changed employers during 2016 and, as a result of the change, moved 150 kilometers, from Windsor to London. His new employer was located in London and reimbursed 50 percent of Stan's eligible moving expenses. On his 2016 personal tax return, Stan can:
- A. Claim 0 percent of his moving expenses.
  - B. Claim 50 percent of his moving expenses against his income from employment.
  - C. Claim 50 percent of his moving expenses against his income from his new employer.
  - D. Claim 100 percent of his moving expenses against his income from employment.

*Other Income/Deductions, Attribution - Multiple Choice*

18. In 2016, Mr. Kumar moved from Saskatchewan to Prince Edward Island to start a new business. In his 2016 fiscal year, the business generated income in excess of \$50,000. Mr. Kumar incurred the following costs of moving:

Transport of household effects	\$5,000
Travel - self, spouse, and three children	2,000
Legal fees - house purchase in PEI	900
Cancellation costs - lease in Saskatchewan	750
Temporary accommodation while waiting for new house at \$70 per day for 30 days	2,100
House-hunting trip (prior to move)	500

Which one of the following amounts represents the **maximum** amount that Mr. Kumar may deduct for moving expenses in his 2016 personal income tax return?

- A. \$ 8,800.  
 B. \$ 9,700.  
 C. \$10,200.  
 D. \$11,250.
19. During 2016, Jan Harding accepted a job transfer from British Columbia to Ontario. She will begin her new position on December 1. Her new salary will be \$102,000 per annum or \$8,500 per month. Upon arriving, Jan spent 25 days staying in a hotel due to an unfortunate delay in moving into her new residence. Jan incurred expenses related to the move of \$13,402. Included in this total was \$1,125 for meals and \$2,125 for hotel stays while waiting for her new residence to be ready. How much can she claim on her 2016 tax return for moving expenses?
- A. \$ 8,500.  
 B. \$12,102.  
 C. \$12,952.  
 D. \$13,402.
20. Maxine used to work and live in Alberta, but has accepted a new job in Ontario. The new job has a starting salary of \$105,600 per year, or \$8,800 per month. She moved there with her family in October, so she could start her new job on November 1. While she had rented her accommodations in Alberta, she bought a new house in Ontario. She incurred the following expenses as a result of the move:
- canceling the lease on her rental apartment, \$1,200.
  - hiring movers to pack and move her household effects, \$12,000.
  - legal fees on the house purchase, \$1,400.
  - land transfer tax on the house purchase, \$3,000.
  - cost of disconnecting utilities in Alberta, \$100.
  - cost of connecting utilities in Ontario, \$200.
  - gas, food, and lodging while traveling from Alberta to Ontario, \$2,800.

How much can she claim for moving expenses for the year of the move?

- A. \$16,000.  
 B. \$16,300.  
 C. \$17,700.  
 D. \$20,700.

**Child Care Costs**

21. John and Alexandria are married and they have two children, aged 2 and 5. They pay Alexandria's 22 year old sister \$150 per week to take care of their children for 48 weeks each year. John works full time and earns a salary of \$90,000 per year. Alexandria works part time, earning a salary of \$28,000 per year. She also goes to college part time during the fall semester, for a total of 17 weeks, or 4 months, each year. Which of the following is correct with respect to John and Alexandria's ability to claim a deduction for child care expenses?
- A. Neither John nor Alexandria can claim child care expenses because they paid a relative to take care of their children.
  - B. Alexandria must claim all of the child care expenses because she is the supporting person with the lower Net Income.
  - C. John can claim child care expenses of \$1,600 and Alexandria can claim the remaining \$5,600.
  - D. John can claim child care expenses of \$7,200.
22. Charam and Baka each have income of over \$200,000. During the year, they paid a nanny \$20,000 to care for their three children. Divya, age 5, has no income. Elina, age 10 is disabled and eligible for the disability tax credit. Hi
- A. \$18,000nda is 12 and has income of \$25,000 which he earns from a TV acting job. What is the maximum deduction for child care costs for this family?
  - B. \$19,000
  - C. \$24,000
  - D. \$22,000

**Disability Supports Deduction**

23. Which of the following statements is **NOT** correct with respect to the Disability Supports Deduction?
- A. The deduction is limited to individuals who qualify for the disability tax credit.
  - B. The deduction is available to disabled individuals who are carrying on research.
  - C. The deduction is available to disabled individuals who are attending a designated educational institution.
  - D. Many of the items that can be claimed under the disability supports deduction could also be claimed as medical expenses.
24. Katrina has cerebral palsy, but does not qualify for the disability tax credit. During 2016, she earned \$75,000 in income working at a facility for disabled children. In order to work, Katrina required full time attendant care that cost \$25,000. Of this total, \$10,000 was paid for by her employer, and \$5,000 by her benefit plan. In addition, Katrina purchased equipment to increase her mobility at work costing \$12,000. What is Katrina's maximum claim for the disability supports deduction?
- A. \$10,000
  - B. \$12,000
  - C. \$22,000
  - D. \$32,000

**Pension Income Splitting**

25. Aaron, aged 65 and Abbie, aged 63 are married. Aaron received OAS of \$4,000 and pension income of \$65,000 from a plan that was sponsored by his former employer. If Aaron shares the maximum amount of pension income with Abbie, what will his Net Income For Tax Purposes be?
- A. \$32,500.
  - B. \$34,500.
  - C. \$36,500.
  - D. \$69,000.
26. Elijah, aged 62 and Dara, aged 68 are married. Elijah collects CPP of \$7,200 and has a \$35,000 withdrawal from his RRSP. If Elijah shares the maximum amount of pension income with Dara, what will his Net Income For Tax Purposes be?
- A. \$17,500.
  - B. \$21,100.
  - C. \$24,700.
  - D. \$42,200.

**Spousal And Child Support**

27. Which of the following is **NOT** a requirement for spousal support payments to be deductible?
- A. The payments must be made on a periodic basis.
  - B. The payments must be made for a period of time that the spouses, or former spouses, are living apart.
  - C. The payments must be made pursuant to a separation agreement.
  - D. None of the above.
28. Jack and his wife, Sally, separated during 2004. The written separation agreement requires Jack to make payments for the maintenance of Sally and their child. Payments were set at \$250 per month for Sally and \$150 per month for their child. During 2016 Jack's payments totaled \$4,000. How much of the 2016 payments can Jack deduct on his 2016 personal tax return?
- A. \$4,000.
  - B. \$3,000.
  - C. \$1,800.
  - D. \$2,200.

**Income From Annuities**

29. Mr. Dayani purchases an annuity with funds from his savings account on January 1, 2016. The annuity has a 5 year term, and cost him \$25,000. Payments are made annually on December 31 in the amount of \$5,772. The annuity provides an effective yield of 5%. How much of the annuity payment is taxable in 2016?
- A. Nil
  - B. \$772.
  - C. \$1,250.
  - D. \$5,000.

**Registered Savings Plans**

30. With respect to the tax rules for Registered Education Savings Plans (RESPs), which of the following statements is **NOT** correct?
- A. The total contributions to one individual's plan cannot exceed \$50,000.
  - B. Earnings paid out of the plan are subject to tax in the hands of the recipient.
  - C. The annual contributions made by any one individual cannot exceed \$4,000.
  - D. Distributions can be made to a beneficiary of a plan when they commence full-time studies at an institution that would qualify the individual for the education tax credit.
31. There are a number of benefits and tax advantages associated with Registered Education Savings Plans (RESPs). Which of the following is **NOT** a benefit or advantage?
- A. Contributions to the plans are deductible.
  - B. Earnings on assets within the plan are not subject to tax.
  - C. The government makes contributions in the form of Canada Education Savings Grants and Canada Learning Bonds.
  - D. Distributions from the plan may be received by some recipients without incurring any additional taxation.
32. With respect to Tax Free Savings Accounts (TFSA), which of the following statements is **NOT** correct?
- A. Contributions to the accounts are not deductible.
  - B. Contributions to the accounts can be returned tax free at any time.
  - C. Earnings on assets in the accounts accumulate tax free.
  - D. Withdrawals of accumulated account earnings will be subject to tax.
33. Ms. Eli has \$10,000 in pre-tax income that she does not need in the current year, but will require in two years to purchase a condo. She is considering whether she should use this money to contribute to a Tax Free Savings Account (TFSA) or a Registered Retirement Savings Plan (RRSP). She expects her marginal tax rate to increase in two years. She expects her invested funds will earn the same rate of return in either account. Which of the following statements is correct with respect to her investment decision?
- A. Whether she invests in the RRSP or the TFSA, the effect on her Net Income For Tax Purposes will be the same.
  - B. Ms. Eli should invest in the RRSP.
  - C. Ms. Eli should invest in the TFSA.
  - D. Ms. Eli should not invest in either the RRSP or the TFSA since she will need the money in two years.
34. Which of the following statements regarding the Tax Free Savings Account (TFSA) is **NOT** correct?
- A. Any Canadian resident individual over 17 years of age can establish a TFSA.
  - B. Any unused amounts not contributed in a year may be carried forward indefinitely to future years.
  - C. The contributions are tax deductible up to a maximum of \$5,500 for 2016.
  - D. Capital gains earned within TFSA's are not taxed.

**Non-Arm's Length Transactions**

35. John Bartel owns land with an adjusted cost base of \$250,000 and a fair market value of \$320,000. He sells the land to his son for \$250,000. Which of the following statements is correct?
- A. John will have a taxable capital gain of \$70,000 and the adjusted cost base of the land to his son will be \$250,000.
  - B. John will have a taxable capital gain of \$70,000 and the adjusted cost base of the land to his son will be \$320,000.
  - C. John will have a taxable capital gain of \$35,000 and the adjusted cost base of the land to his son will be \$320,000.
  - D. John will have a taxable capital gain of \$35,000 and the adjusted cost base of the land to his son will be \$250,000.
36. John Bartel owns land with an adjusted cost base of \$250,000 and a fair market value of \$320,000. He gifts the land to his son for no consideration. Which of the following statements is correct?
- A. John will have a taxable capital gain of \$70,000 and the adjusted cost base of the land to his son will be \$250,000.
  - B. John will have a taxable capital gain of \$70,000 and the adjusted cost base of the land to his son will be \$320,000.
  - C. John will have a taxable capital gain of \$35,000 and the adjusted cost base of the land to his son will be \$320,000.
  - D. John will have a taxable capital gain of \$35,000 and the adjusted cost base of the land to his son will be \$250,000.

**Questions 37 through 39 are based on the following information:**

Jolinda Morris has a depreciable property with a capital cost of \$225,000, a UCC of \$175,000, and a fair market value of \$240,000. Because of his exceptional performance during the last year, she gives this property to her common-law partner Biff.

37. What is the minimum increase in Net Income For Tax Purposes that Ms. Morris will record as a result of this gift if she does not elect out of ITA 73(1)?
- A. \$57,500.
  - B. \$65,000.
  - C. \$7,500.
  - D. Nil
38. What is the minimum increase in Net Income For Tax Purposes that Ms. Morris will record as a result of this gift if she does elect out of ITA 73(1)?
- A. \$57,500.
  - B. \$65,000.
  - C. \$7,500.
  - D. Nil
39. What is the most likely motivation for Ms. Morris to elect out of ITA 73(1)?
- A. To avoid attribution.
  - B. She is in a higher tax bracket than Biff.
  - C. She has some unused terminal losses.
  - D. She has some unused capital losses.

*Other Income/Deductions, Attribution - Multiple Choice*

40. Sonya owns 500 shares of Roxy Corp. that she bought in 2015 for \$10 per share. On June 1, 2016 Sonya sold all of her shares to her sister for \$15 per share and then later the same day her sister sold the shares for their fair market value of \$18 per share. The taxable capital gain that should be reported for each sister is:
- \$2,000 for Sonya and \$750 for her sister
  - \$1,250 for Sonya and \$750 for her sister
  - \$750 for Sonya and \$1,250 for her sister
  - \$1,000 for Sonya and \$1,000 for her sister
41. Hugo owns a farm. Both Hugo and his son work on the farm raising sheep. On February 16, 2016 Hugo sold a shearing machine to his son for \$5,000. The original cost of the machine was \$10,000, the UCC is \$8,000 and the fair market value is \$5,000. The machine was the last asset in its CCA class. On September 1, 2016, his son took the machine to an auction in another province where an enthusiast bidder paid \$6,000 for it. The tax consequences are:
- Hugo has a terminal loss of \$3,000 and his son has a taxable capital gain of \$500.
  - Hugo has a terminal loss of \$3,000 and his son has recapture of CCA of \$1,000.
  - Hugo has a terminal loss of \$2,000 and his son has no tax consequences.
  - Hugo has no tax consequences and his son has a terminal loss of \$2,000.

**Death Of A Taxpayer**

42. Which of the following statement that relate to the death of a taxpayer is **NOT** correct?
- A farm property owned by the deceased can be transferred to a child on a tax free basis.
  - When an individual dies, there is a deemed disposition of all of his capital property.
  - In recording the deemed disposition that occurs when an individual dies, the proceeds of disposition will always be the fair market value of the property.
  - When the capital cost of a property that was owned by a deceased taxpayer exceeds its fair market value, the beneficiary is required to retain the original capital cost, with the difference being treated as deemed CCA.
43. Erica Ho dies, leaving a depreciable property to her daughter that has a capital cost of \$150,000, a fair market value of \$90,000, and a UCC of \$65,000. Which of the following statements related to this event is **NOT** correct?
- Erica will have a taxable capital gain of nil.
  - Erica will have recapture of \$25,000.
  - If her daughter later sells the property for \$100,000, she will have a capital gain of \$10,000.
  - For calculating CCA, the daughter's UCC will be \$90,000.
44. Upon the death of a taxpayer, which of the following statements is correct?
- Capital property that is bequeathed to a spouse is transferred on a rollover basis.
  - Capital property that is bequeathed to a spousal trust is deemed to be sold at fair market value.
  - Capital property, whether bequeathed to a spouse or to anyone else, is transferred on a rollover basis.
  - Capital property, whether bequeathed to a spouse or to anyone else, is deemed to be sold at fair market value.

*Other Income/Deductions, Attribution - Multiple Choice*

45. When Alyssa Weinstein died, she left her estate to her spouse and daughter as shown below. Her assets had the following tax costs and fair market values (FMV):

<b>Asset</b>	<b>Beneficiary</b>
Jewelry - Cost = \$10,000, FMV = \$17,000	Spouse
Automobile - Cost = \$55,000, FMV = \$20,000	Daughter
Rental building - Cost = \$100,000, UCC = \$70,000, FMV = \$220,000	Daughter
Common shares - Cost = \$140,000, FMV = \$500,000	Spouse

What is the minimum amount that must be included in Ms. Weinstein's income for her final tax return in respect of these assets?

- A. \$60,000
- B. \$72,500
- C. \$90,000
- D. \$273,500

**Income Attribution**

46. Mr. Johnson wants to help his daughter, Erin, save for her college education. To this end, in 2014, when she was 15 years old, he put \$3,000 into a GIC in her name, for a one year term. The GIC renews on an annual basis. On its maturity in 2015, Erin rolled the \$3,000 into another GIC for one year and the interest earned during the first year into a second one-year GIC for \$300. In 2016, the interest earned on the two GICs was \$240 and \$24 respectively.

How much of this interest, if any, must Mr. Johnson report on his 2016 income tax return?

- A. Nil.
- B. \$24.
- C. \$240.
- D. \$264.
- E. None of the above.

47. Agatha Harkness wishes to gift mutual funds to her three grandchildren, all of whom are under the age of 6. She wants to minimize any income that will be attributed to her. Which one of the following mutual funds will best accomplish this goal?
- A. An equity fund that invests in preferred shares of top Canadian corporations and earns primarily dividend income.
  - B. A bond fund that invests in long-term, interest-bearing Government of Canada bonds, earning interest income and capital gains.
  - C. A growth fund that invests in corporations with a history of paying minimal dividends and earns its income primarily in the form of capital gains.
  - D. A money-market fund that invests in short-term treasury bills and earns only interest income.

*Other Income/Deductions, Attribution - Multiple Choice*

48. William Choring owned shares of two publicly traded companies, as follows:

	Fair Market Value On Date Of Disposition	Adjusted Cost Base
TriStar Limited	\$1,000	\$10,000
Global Inc.	2,500	200

William gifted the TriStar Limited shares to his wife on July 1, 2016. His wife kept the shares and received \$138 of taxable dividends (grossed up amount) in September, 2016. William sold the Global Inc. shares on the open market. Assuming William earned no other income, did not elect out of ITA 73(1), and these are the only transactions that occurred in the year, which one of the following represents William's 2016 Net Income For Tax Purposes?

- A. Nil.  
 B. \$1,150.  
 C. \$1,250.  
 D. \$1,288.
49. Hans Myers wishes to transfer an investment to his wife, Olga. However, Olga does not have sufficient cash to purchase the investment for fair value. Hans would like to loan the funds to Olga to facilitate the purchase, as he wants the income on this investment to be reported by her. Olga will pay interest on the loan, as Hans expects the investment to generate substantial income.
- Which one of the following is **NOT** a requirement to ensure that the income on this investment will be taxable to Olga, and not attributed to Hans, in the future?
- A. Hans must elect to realize any gains inherent in the property at the transfer date.  
 B. Interest on the loan must be paid from Olga to Hans annually, by January 30 of the following year.  
 C. Olga must pay no less than the full fair market value of the investment (although this can include the loan's face value).  
 D. The interest rate on the loan must be at fair market value, even when that rate is greater than the prescribed rate.
50. Martin has a marginal tax rate of 46 percent. His wife, Carmen, has a marginal tax rate of 26 percent. In order to give his wife a supplemental source of income, he gave her a portion of his investment portfolio. Carmen's new investment portfolio generated interest income of \$6,800 and taxable capital gains of \$9,900. Which of the following statements is **NOT** correct?
- A. Martin faces an additional tax liability of \$3,128 as a result of Carmen's interest income.  
 B. Martin faces an additional tax liability of \$4,554 as a result of Carmen's capital gains.  
 C. Carmen has no additional tax liability as a result of the investment portfolio.  
 D. Carmen faces a tax liability of \$2,574 as a result of her capital gains.
51. Sandy gives a gift of \$12,000 to each of the following people. Each of them used the money they received from Sandy to invest in shares of publicly trading companies. In which situation will the resulting dividend income **NOT** be attributed to Sandy?
- A. The gift is to Sandy's long-time business partner.  
 B. The gift is to Sandy's wife.  
 C. The gift is to Sandy's 14 year old nephew.  
 D. The gift is to Sandy's 10 year old daughter.

*Other Income/Deductions, Attribution - Multiple Choice*

52. Pere gifted shares in a public corporation with a fair market value of \$50,000 to his 12 year old son, Fils. After Fils received \$1,000 in dividends, he sold the shares for \$53,000. What are the tax effects of the dividend and the sale?
- A. Pere will claim the dividends on his tax return and Fils will claim the capital gain on his tax return.
  - B. Fils will claim the dividends and a capital gain on his tax return.
  - C. Pere will claim the dividends and a capital gain on his tax return.
  - D. Fils will claim the dividends on his tax return and Pere will claim the capital gain on his tax return.

**TIF PROBLEM NINE - 4****Other Income/Deductions, Attribution - Exam Exercises**

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**Exam Exercise Subject Listing For Chapter 9**

<b>Number</b>	<b>Subject</b>
1	Moving Expenses
2	Moving Expenses
3	Child Care Costs
4	Child Care Costs
5	Disability Supports Deduction
6	Pension Income Splitting
7	Support Payments
8	Support Payments
9	Annuity Payments
10	Annuity Payments
11	Canada Education Savings Grants
12	Inadequate Consideration
13	Inadequate Consideration
14	Non-Depreciable Asset To A Spouse
15	Depreciable Asset To A Spouse
16	Transfer Of Depreciable Property
17	Transfer Of Depreciable Property
18	Inter Vivos Farm Property To A Child
19	Inter Vivos Farm Property To A Child
20	Transfers On Death
21	Transfer On Death
22	Income Attribution - Spouse
23	Income Attribution - Spouse
24	Income Attribution - Spouse
25	Income Attribution - Related Minor
26	Income Attribution - Related Minor
27	Income Attribution - Shares
28	Income Attribution - Use Of Loans
29	Income Attribution - Use Of Loans

**Exam Exercise Nine - 1 (Moving Expenses)**

On November, 15, 2016, at the request of his employer, Mr. John Havlik moves from Halifax to Moncton (Moncton is 260 kilometers from Halifax). He lived in a rented apartment in Halifax, but has purchased a house in Moncton. Legal fees and other costs associated with the acquisition of this house totaled \$3,250. The total cost of the actual move, including the costs of moving his personal possessions, is \$8,300. In addition, he spent \$650 on a house hunting trip to Moncton, but he did not decide on a house until his return to Halifax. He also incurred a \$1,200 penalty for breaking his lease in Halifax.

During the year, his salary totaled \$53,000, of which \$6,625 can be allocated to the period after November 15, 2016. His employer is prepared to pay up to \$6,000 towards the cost of the move. Determine Mr. Havlik's maximum moving expense deduction for 2016, as well as any carry forward available.

**Exam Exercise Nine - 2 (Moving Expenses)**

On November 1, 2016, Joan Hatch moves from Windsor to Toronto at the request of her employer. Prior to this date, she spent \$950 on a house hunting trip to Toronto. However, she was not successful and, given this, she has signed a one-year lease for an apartment at her new location. The legal fees and real estate commissions associated with the sale of her Windsor house were \$7,200. The actual costs of the move, including amounts paid to a moving company, totaled \$12,600. Her employer agreed to pay \$7,000 of her moving costs.

Ms. Hatch's salary for 2016 was \$54,000. Determine Ms. Hatch's maximum moving expense deduction for 2016, as well as any carry forward that is available.

**Exam Exercise Nine - 3 (Child Care Expenses)**

Mr. Renaud and Ms. Fortune have lived together for over 15 years and have three children. The ages of the children at the end of the current year are 3, 11, and 15. All three children enjoy good mental and physical health. Mr. Renaud works as a carpenter and has received income for the year of \$52,000. However, he will only report \$12,000 of this total in his current tax return (he believes that, because most of the income is received in cash and he has no receipts for his expenses, he does not have to report the full amount).

Ms. Fortune has business income of \$62,000, all of which she reports. As Mr. Renaud is the lower income spouse, he receives \$1,680 in universal child care benefits during the current year. The child care costs for the current year, all paid for by cheque and properly documented for tax purposes, total \$11,200.

Determine the maximum deduction for child care costs and indicate who should claim them.

**Exam Exercise Nine - 4 (Child Care Expenses)**

Mrs. and Mr. Anders have three children who, at the end of the current year, are 4, 12, and 18 years of age. The 18 year old child has a serious physical infirmity, but does not qualify for the disability tax credit.

Mrs. Anders had earned income of \$18,000, while Mr. Anders had earned income of \$69,000. Payments for child care were \$190 per week for a total of 50 weeks. As the lower income spouse, Mrs. Anders received \$1,320 in universal child care benefits during the current year.

During the current year, Mrs. Anders spent six weeks in jail as the result of a conviction for possession of an illegal substance. Following her release, Mr. Anders spent three weeks in the hospital because of a stress related disorder.

Determine the maximum deduction for child care costs and indicate who should claim them.

**Exam Exercise Nine - 5 (Disability Supports Deduction)**

Lara Craft has several disabilities, none of which are severe enough to allow a claim for the disability tax credit. Despite her disabilities, in 2016, she works full time as a financial consultant, earning employment income of \$94,000.

Her need for full time attendant care has been certified by a medical practitioner and, during 2016, the cost of this care was \$32,000. Additional costs related to her disabilities totaled \$17,000. Her medical insurance reimbursed her for \$8,000 of these costs. None of these costs will be included in the base for her medical expense tax credit. Determine the amount of Lara's disability supports deduction for 2016.

**Exam Exercise Nine - 6 (Pension Income Splitting)**

Jerry Mason lives with his spouse, Janice Sparks. Both Jerry and Janice are 66 years old and, during 2016, they each receive \$7,000 in OAS payments. As the result of many years with his employer, Jerry receives \$88,000 in pension income from the plan that was sponsored by that employer. Janice has no source of income other than the OAS payments she receives. Neither Jerry nor Janice have applied for CPP and they have no tax credits other than the basic personal credit, the age credit, and pension income tax credit.

Jerry has asked you to indicate the savings in federal tax that would result from making optimum use of pension income splitting for the 2016 taxation year.

**Exam Exercise Nine - 7 (Support Payments)**

On May 1, 2016, Leon and Shannon Weiss sign a separation agreement that calls for Shannon to pay Leon \$1,200 per month in child support (Leon will have custody of their three children) and \$2,100 per month in spousal support beginning on June 1. To the end of 2016, Shannon's payments total only \$9,500. How will these payments be dealt with in Shannon and Leon's 2016 tax returns?

**Exam Exercise Nine - 8 (Support Payments)**

Under the terms of their divorce settlement, Barry Low must pay his former spouse, Mandy Brock, \$1,000 per month in child support and \$1,800 per month in spousal support. While in previous years, Barry has paid the full amounts required by the settlement, in 2016, his payments total only \$14,000. How will these payments be dealt with in the tax returns filed by Barry and Mandy?

**Exam Exercise Nine - 9 (Annuity Payments)**

On January 1 of the current year, Ms. Lorraine Brock uses \$10,000 of her savings to acquire a fixed term annuity. The term of the annuity is three years, the annual payments are \$4,020, the payments are received on December 31 of each year, and the rate inherent in the annuity is 10 percent. What is the effect of the \$4,020 annual payment on Ms. Brock's Net Income For Tax Purposes.

**Exam Exercise Nine - 10 (Annuity Payments)**

On January 1, 2016, Sal Miner uses \$2,673 of his savings to pay for an annuity that will return \$1,000 at the end of each year in 2016, 2017, and 2018. The effective rate of interest in this annuity is 6 percent. What is the effect of the \$1,000 payment on Mr. Miner's 2016 Net Income For Tax Purposes?

**Exam Exercise Nine - 11 (Canada Education Savings Grants)**

Marco was born in 2015. As his mother is very keen on tax planning, she establishes an RESP for Marco by contributing \$1,000 to the plan in 2015. Marco's grandmother contributes an additional \$400 to the plan on the same day.

In 2016, Marco's mother contributes \$2,200 to the plan, while the grandmother contributes an additional \$1,900. Marco's family has never had family income of more than \$40,000. Determine the amount of the CESGs that would be added to Marco's RESP in 2015 and 2016.

**Exam Exercise Nine - 12 (Inadequate Consideration)**

Ms. Veronica Lox owns securities with an adjusted cost base of \$150,000 and a fair market value of \$175,000. She sells these securities to her father for \$130,000. He immediately sells them to an arm's length party for \$175,000. Determine the tax consequences for Ms. Lox and her father.

**Exam Exercise Nine - 13 (Inadequate Consideration)**

Ms. Veronica Lox owns securities with an adjusted cost base of \$150,000 and a fair market value of \$175,000. She sells these securities to her father for \$210,000. He immediately sells them to an arm's length party for \$175,000. Determine the tax consequences for Ms. Lox and her father.

**Exam Exercise Nine - 14 (Inter Vivos Transfers To A Common-Law Partner)**

Marilyn Fox owns a large piece of land that she acquired several years ago for \$85,000. For several years, she has been using the property to run a high security parking lot operation. On January 1, 2016, she gives the property to her common-law partner Ellen Degen. At this time, the fair market value of the land is \$170,000. Marilyn does not elect out of ITA 73(1).

During 2016, Ellen continues the parking lot operation, which produces a net business income of \$8,500. On January 1, 2017, Ellen sells the parking lot for \$190,000.

What are the tax consequences of these events for Marilyn and Ellen during 2016 and 2017? If there are no tax consequences for either individual in a given year, you should clearly state this fact in your answer.

**Exam Exercise Nine - 15 (Transfer Of Depreciable Asset To A Spouse)**

During the current year, Geoff Lionel transferred a depreciable property to his spouse. The property had a fair market value of \$200,000, a capital cost of \$160,000, and a UCC of \$107,000. It is the only asset in its CCA class. In return for the property, his spouse pays \$200,000 from funds that she has received as an inheritance. Describe the tax consequences to Mr. Lionel and the tax cost of the property to his spouse after the transfer, assuming that he does not elect out of ITA 73(1). How would these results differ if Mr. Lionel elects out of ITA 73(1)?

**Exam Exercise Nine - 16 (Non-Arm's Length Transfer Of Depreciable Property)**

Mr. Norman Low owns a depreciable asset that he has used in his unincorporated business. It has a cost of \$145,000 and a fair market value of \$132,000. It is the only asset in its CCA class and the balance in the class is \$63,500. Mr. Low sells the asset to his father for \$132,000. During the year, prior to taking any CCA on the asset, Mr. Low's father sells the asset for \$135,000. Determine the amount of income to be recorded by Mr. Low and his father as a result of these transactions.

**Exam Exercise Nine - 17 (Non-Arm's Length Transfer Of Depreciable Property)**

John Travis owns a depreciable property that has a fair market value of \$295,000. Its capital cost was \$350,000 and it is the only asset in its CCA class. The balance in its CCA class is \$245,000. John sells the property to his brother for its fair market value of \$295,000. Later in the year, prior to taking any CCA on the asset, his brother sells the property for \$315,000. Determine the amount of income that would be recorded by Mr. Travis and his brother as a result of these transactions.

**Exam Exercise Nine - 18 (Inter Vivos Farm Property Transfer To A Child)**

Mrs. Betty Wong owns farm property consisting of land with an adjusted cost base of \$271,000 and a fair market value of \$365,000, along with a barn with a UCC of \$90,000, a capital cost of \$120,000, and a fair market value of \$110,000. The property is transferred to her 67 year old son in return for a payment of \$300,000 for the land. No payment is made for the barn. Describe the tax consequences of this transfer, for both Mrs. Wong and her son.

**Exam Exercise Nine - 19 (Inter Vivos Farm Property Transfer To A Child)**

Martin Ho owns a farm property. Relevant information is as follows:

**Land** The land has an adjusted cost base of \$435,000 and a fair market value of \$584,000.

**Building** The barn has a UCC of \$140,000, a capital cost of \$165,000, and a fair market value of \$175,000.

The property is transferred to his son. The son pays \$470,000 for the land. No payment is made for the barn. Describe the tax consequences of this transfer for both Martin and his son.

**Exam Exercise Nine - 20 (Transfers On Death)**

Mr. Norm Norten dies in July, 2016. At the time of his death, he owned two backhoes that were used in his construction business. His will leaves one backhoe to his spouse, Linda, with the other backhoe going to his daughter, Mary. The backhoes cost \$180,000 each and each had a fair market value at the time of Mr. Norten's death of \$122,000. The UCC balance for the class that contains the backhoes is \$148,000. What are the tax consequences resulting from Mr. Norten's death with respect to the two backhoes? Your answer should include the capital cost and UCC for the backhoes in the hands of Linda and Mary.

**Exam Exercise Nine - 21 (Transfers On Death)**

At the time of her death, Nancy Stein owns two depreciable assets. Her will leaves one of these assets to her spouse Mark, with the other asset going to her son Nick. Each of these assets cost \$125,000 and, at the time of Nancy's death, they each have a fair market value of \$86,000. They are the only assets in their CCA class and the UCC balance for that class is \$104,000. What are the tax consequences resulting from Ms. Stein's death with respect to the two assets? Your answer should include the capital cost and UCC for the assets in the hands of Mark and Nick.

**Exam Exercise Nine - 22 (Income Attribution - Spouse)**

On December 28, 2015, Mrs. Chastity Blue gives her husband shares in a public company with an adjusted cost base of \$42,000 and a fair market value of \$38,000. During 2016, the shares pay taxable dividends of \$4,968 [(138%)(3,600)]. On December 1, 2016, Mr. Blue sells the shares for \$53,000. Assume that Mrs. Blue does not elect out of ITA 73(1). What are the tax consequences for Mr. and Mrs. Blue in each of the years 2015 and 2016? If there are no tax consequences for either individual in a given year, you should clearly state this fact in your answer.

**Exam Exercise Nine - 23 (Income Attribution - Spouse)**

On December 31, 2015, Mr. Tom London gives shares with an adjusted cost base of \$21,500 and a fair market value of \$35,200 to his wife, Barbara London. On February 24, 2016, the shares pay eligible dividends of \$2,060 (\$2,843 taxable amount) and, on August 31, 2016, Mrs. London sells the shares for \$39,800. Assume that Mr. London does not elect out of ITA 73(1). What are the tax consequences for Mr. and Mrs. London in each of the years 2015 and 2016? If there are no tax consequences for either individual in a given year, you should clearly state this fact in your answer.

**Exam Exercise Nine - 24 (Income Attribution - Spouse)**

In 2015, Charlotte Ramp gives shares to her spouse Michael Ramp. The shares have an adjusted cost base of \$23,000 and, at the time of the gift, they have a fair market value of \$35,000. Charlotte elects out of ITA 73(1) in her return of income.

During 2016, the shares pay eligible dividends of \$1,800. Prior to the end of 2016, Michael sells the shares for \$42,000. What are the tax consequences to Charlotte and Michael in each of the years 2015 and 2016? If there are no tax consequences for either individual in a given year, you should clearly state this fact in your answer.

**Exam Exercise Nine - 25 (Income Attribution - Related Minor)**

On December 31, 2015, Mr. Tom London gives shares with an adjusted cost base of \$21,500 and a fair market value of \$35,200 to his 9 year old son, Patrick London. On February 24, 2016, the shares pay eligible dividends of \$2,060 (\$2,843 taxable amount) and, on August 31, 2016, Patrick sells the shares for \$39,800. What are the tax consequences for Mr. London and Patrick in each of the years 2015 and 2016? If there are no tax consequences for either individual in a given year, you should clearly state this fact in your answer.

**Exam Exercise Nine - 26 (Income Attribution - Related Minor)**

In 2015, Charlotte Ramp gives shares to her 12 year old daughter Vanessa. The shares have an adjusted cost base of \$23,000 and, at the time of the gift, they have a fair market value of \$35,000.

During 2016, the shares pay eligible dividends of \$1,800. Prior to the end of 2016, Vanessa sells the shares for \$42,000. What are the tax consequences to Charlotte and Vanessa in each of the years 2015 and 2016? If there are no tax consequences for either individual in a given year, you should clearly state this fact in your answer.

**Exam Exercise Nine - 27 (Income Attribution - Spouse And Related Minor)**

Mr. Randy Cleroux owns 1,000 shares of Lyton Industries Ltd. These shares have an adjusted cost base of \$105 per share. On December 31, 2015, the shares are trading at \$156 per share. At this time, he gives 400 of these shares to his 12 year old son. He gives the remaining 600 shares to his wife.

During 2016, the shares pay eligible dividends of \$4.50 per share. On December 31, 2016, both his son and his spouse sell their shares for \$142 per share. Assume that Mr. Cleroux does not elect out of ITA 73(1). Indicate the tax consequences of these transactions for Mr. Cleroux, his son, and his spouse, in each of the years 2015 and 2016. If there are no tax consequences for either individual in a given year, you should clearly state this fact in your answer.

**Exam Exercise Nine - 28 (Income Attribution - Use Of Loans)**

On December 31, 2015, Mrs. Danielle Lafarge gives corporate bonds to her husband in exchange for a note with a face value of \$131,000. The corporate bonds have an adjusted cost base of \$119,000 and a fair market value of \$131,000. The note from her husband does not pay interest and has no specific maturity date. Mrs. Lafarge does not report a gain or loss on these bonds in 2015.

During 2016, the bonds pay interest to Mr. Lafarge in the amount of \$5,600. On October 1, 2016, immediately after an interest payment, Mr. Lafarge sells the bonds for \$134,000. He uses \$131,000 of the proceeds to pay off the loan owing to his wife. What are the tax consequences for Mr. and Mrs. Lafarge in each of the years 2015 and 2016?

**Exam Exercise Nine - 29 (Income Attribution - Use Of Loans)**

In December, 2015, John Barton gives corporate bonds to his spouse Julie Barton, in exchange for a note with a face value of \$210,000. In John's hands, the bonds have an adjusted cost base of \$205,000, and a fair market value of \$210,000. John elects out of ITA 73(1). The interest free note provided by Julie must be repaid when she sells the bonds.

During 2016, the bonds pay interest of \$11,000. Immediately after receiving the interest payment, Julie sells the bonds for \$216,000. What are the tax consequences for John and Julie in each of the years 2015 and 2016? If there are no tax consequences for either individual in a given year, you should clearly state this fact in your answer.

**TIF PROBLEM NINE - 5A****Other Income/Deductions - Key Term Matching (Easy)**

**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms were listed at the end of Chapter 9, “Other Income, Other Deductions And Income Attribution”.

- A. Canada Learning Bonds
- B. Canada Education Savings Grants
- C. Child Care Expenses
- D. Child Support
- E. Disability Supports Deduction
- F. Income Attribution
- G. Registered Education Savings Plan
- H. Support Amount

The following list contains ten potential definitions for the preceding key terms.

1. A support amount that is for the benefit of a spouse or common-law partner, or a former spouse or common-law partner.
2. A trust arrangement that allows individuals to make non-deductible contributions that will be invested on a tax-free basis, with the accumulated funds being used to provide for the post-secondary education of a child.
3. A system of grants under which the federal government makes contributions to an individual's RESP based on the number of years in which the individual's family is eligible for the National Child Benefit supplement.
4. A support amount that is not identified as being for the benefit of a spouse or common-law partner, or a former spouse or common-law partner.
5. Amounts paid as the result of the separation or divorce of two individuals who were spouses or common-law partners.
6. The allocation of some types of income, on assets that have been transferred to a spouse or related minors, back to the transferor for inclusion in the transferor's net income for tax purposes.
7. A system of grants under which the federal government makes contributions to an individual's RESP based on a percentage of the contributions to that individual's RESP that have been made by others.
8. Costs associated with caring for an eligible child.
9. A deduction available to individuals for attendant care and other disability support expenses, incurred to allow the disabled individual to work or to attend a designated educational institution.
10. A group of tax planning techniques designed to divide a given stream of income among family members or other related parties.

*Other Income/Deductions - Key Term Matching (Easy)*

11. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 10) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (11). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

**TIF PROBLEM NINE - 5B****Other Income/Deductions - Key Term Matching (Moderate)**

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**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms were listed at the end of Chapter 9, "Other Income, Other Deductions And Income Attribution".

- Canada Learning Bonds
- Canada Education Savings Grants
- Child Care Expenses
- Child Support
- Disability Supports Deduction
- Income Attribution
- Registered Education Savings Plan
- Support Amount

The following list contains 14 potential definitions for the preceding key terms.

1. A deduction available to individuals for medical expenses incurred to allow the disabled individual to work or to attend a designated educational institution.
2. A support amount that is for the benefit of a spouse or common-law partner, or a former spouse or common-law partner.
3. A trusted arrangement that allows individuals to make non-deductible contributions that will be invested on a tax-free basis, with the accumulated funds being used to provide for the post-secondary education of a child.
4. A trusted arrangement that allows individuals to make deductible contributions that will be invested on a tax-free basis, with the accumulated funds being used to provide for the post-secondary education of a child.
5. A system of grants under which the federal government makes contributions to an individual's RESP based on the number of years in which the individual's family is eligible for the National Child Benefit supplement.
6. A support amount that is not identified as being for the benefit of a spouse or common-law partner, or a former spouse or common-law partner.
7. Amounts paid as the result of the separation or divorce of two individuals who were spouses or common-law partners.
8. The allocation of some types of income, on assets that have been transferred to a spouse or related minors, back to the transferor for inclusion in the transferor's net income for tax purposes.
9. All amounts in excess of \$10,000 that are received by a taxpayer in a taxation year, on or after the death of an employee, in recognition of the employee's service in an office or employment.

*Other Income/Deductions - Key Term Matching (Moderate)*

10. A system of grants under which the federal government makes contributions to an individual's RESP based on a percentage of the contributions to that individual's RESP that have been made by others.
11. Costs associated with caring for an eligible child.
12. A non-deductible support amount that is for the benefit of a child of the payor.
13. A deduction available to individuals for attendant care and other disability support expenses, incurred to allow the disabled individual to work or to attend a designated educational institution.
14. A group of tax planning techniques designed to divide a given stream of income among family members or other related parties.
15. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 14) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (15). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

## **TIF PROBLEM NINE - 6**

### **Moving Expenses**

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Ms. Michelle Wong has worked for Famous Food Importers for over 20 years. For 2016, her salary is \$15,000 per month. For this entire period, she has worked in the Montreal office of the company. However, she is finding Montreal winters to be increasingly less attractive and, as a consequence, asked to be transferred to the Vancouver office of the company.

As she is considered to be a highly valuable employee, the company agrees to this move.

During September, 2016, she flies to Vancouver in order to locate a new residence. While she is there, she is unable to locate a property at a price that she can afford. After her return to Montreal, she searches online and finally manages to lease a suitable condominium for \$2,500 per month. The lease is for 12 months, beginning December 1, 2016. The costs associated with this trip are as follows:

Air Fare - Return	\$1,125
Rental Car Costs (5 Days)	342
Hotel (5 Nights At \$200)	1,000
Food (5 Days - Total)	450

At the beginning of September, 2016, she lists her Montreal residence for sale. She had paid \$625,000 for the residence several years ago. However, because a crematorium has begun operating in the neighborhood, it sells for only \$550,000. Costs associated with this sale are as follows:

Real Estate Commissions	\$27,500
Legal Fees	800
Unpaid Property Taxes To Date Of Sale	1,500
Cost Of Cleaning And Minor Repairs Prior To Sale	3,800

While Michelle will continue to work in Montreal until November 15, the closing on the old house is on October 20. Because of this, all of her furnishings must be put into storage until they are shipped on November 20. The storage costs are \$2,200. In addition, the moving company charges \$10,200 for the costs of the move, including packing in Montreal and unpacking at the apartment in Vancouver.

During the period, October 20 through November 15, 2016 Michelle resides in a downtown Montreal hotel.

On November 15, she departs for Vancouver. She drives her own vehicle, arriving in Vancouver on November 24. The trip is 4,558 kilometers.

As the condominium unit is not available until December 1, she spends 7 nights in a Vancouver hotel.

Her expenses for the period October 20 through December 1 are as follows:

Hotel In Montreal (26 Nights At \$350)	\$9,100
Food In Montreal (26 Days - Total)	2,050
Gas For Trip	685
Lodging For 9 Nights On The Trip*	1,575
Food On The Trip (9 Days - Total)	825
Lodging In Vancouver (7 Nights At \$320)	2,240
Food In Vancouver (7 Days - Total)	1,330

\* The hotel charges did not exceed \$200 for any one night.

Michelle will use the simplified method of determining vehicle and food costs in calculating her moving expenses. Assume that the relevant flat rate for vehicle expenses is \$0.505 for Saskatchewan and \$0.485 for British Columbia, and the flat rate for meals is \$51 per day.

To assist her with the move, the company will do the following:

- They will provide her with a \$20,000 allowance to cover her general moving costs.
- They will compensate her, in full, for any loss on the sale of her Montreal residence. The loss will be determined without consideration of applicable selling costs.
- They will provide a one-time payment of \$10,000 to assist her in dealing with the higher housing costs in Vancouver.

Michelle begins working in Vancouver on December 1. She will take the maximum moving expense deduction for 2016.

**Required:** Determine the amount of Michelle's maximum 2016 deduction for moving expenses and indicate the amount of any carry forward that is available at the end of the year under the following assumptions regarding the amounts related to the move that are paid by Famous Food Importers:

- A. The Vancouver office has agreed to pay these amounts from their funds and does so during December, 2016.
- B. The Montreal office has agreed to pay these amounts from their funds and does so during October, 2016.

## **TIF PROBLEM NINE - 7**

### **Moving Expenses**

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Mr. Lawrence Harvey has lived and worked in Halifax for most of his adult life. In July, 2016, he discovers that his wife of many years has been having an affair with both his father and his brother. He immediately begins divorce proceedings and submits a request to his employer for a transfer away from Halifax.

As he has skills that are uniquely valuable to his employer, the employer wishes to comply. After considering alternative locations, Lawrence and his employer agree on a move to the company's main office in Ottawa. Lawrence will begin working in that location at the beginning of December, 2016. Lawrence's salary is \$8,000 per month, with the first 11 months of 2016 being paid by the Halifax office, the remaining one month being paid by the Ottawa office.

As part of the uncontested divorce settlement, Lawrence receives the family residence. During October, 2016, it is sold for \$435,000. As he was anxious to sell quickly, there is a loss of the sale of \$52,000. Costs associated with the sale are as follows:

Real Estate Commissions	\$21,000
Legal Fees	800
Unpaid Property Taxes To Date Of Sale	1,500
Cost Of Cleaning And Minor Repairs Prior To Sale	3,800

In October, 2016, Lawrence flies to Ottawa to locate suitable housing. As he is now living alone, he decides to lease a condominium. After 2 days, he finds a suitable property which he leases for \$2,500 per month, beginning November 1. He remains in Ottawa for an additional 4 days in order to find furnishings for the rental unit. The costs associated with this trip are as follows:

Air Fare - Return	\$1,250
Rental Car Costs (6 Days)	420
Hotel (6 Nights At \$200)	1,200
Food (6 Days - Total)	510

His employer has agreed to the following to provide assistance with the move:

- They will provide him with an \$18,000 allowance to cover his general moving costs.
- They will compensate him, to the extent of \$30,000, for the loss on the sale of his Halifax home.

All of these amounts will be paid by the Ottawa office during December, 2016.

On November 7, Lawrence leaves for Ottawa by air. Because the acquired furnishings have not been delivered yet, he has to live in an Ottawa hotel until November 25.

His expenses for the period November 7 through November 25 are as follows:

Air Fare - One Way	\$ 600
Hotel (19 Nights At \$160)	3,040
Food (6 Days - Total)	510

He contracts a car moving company to transport his car to Ottawa and it is delivered on November 8. The cost for this service is \$1,100.

A moving company takes care of moving Lawrence's personal belongings to Ottawa. The invoice for this service is \$3,500. In addition, there is a \$1,200 charge for storing these belongings until the Ottawa condominium becomes available.

**TIF Problem Nine - 7**  
*Moving Expenses*

Lawrence begins working in Ottawa on December 1. He would like to take the maximum moving expense deduction for 2016.

Lawrence will use the simplified method of determining food costs in calculating his moving expenses. Assume that the flat rate for meals is \$51 per day.

**Required:** Determine the amount of Lawrence's maximum 2016 deduction for moving expenses. In addition, indicate the amount of any carry forward that is available at the end of the year.

## **TIF PROBLEM NINE - 8**

### **Child Care Expenses**

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Both Mr. Fortin and Mrs. Fortin are employed. During 2016, Mr. Fortin had opened a restaurant and had business income of \$8,000. Mrs. Fortin had employment income of \$84,000, mostly from commission sales during 2016. Since Mrs. Fortin's work required a good deal of travel away from home and Mr. Fortin's new restaurant required him to work long hours, including many evenings, they had to pay for care of their children. Payments for child care amounted to \$400 per week, for a total of 48 weeks.

Also during the current year, there was a period of six weeks during which Mr. Fortin was hospitalized due to injuries suffered during a game of Ultimate Frisbee. This period was part of the 48 weeks for which child care payments were made. During 2016, as the lower income spouse, Mr. Fortin received the Universal Child Care Benefits.

**Required:** Determine the maximum amount that can be deducted by Mr. and Mrs. Fortin for the year ending December 31, 2016 for child care expenses under the following assumptions:

- A. They have two children, neither of whom qualify for the disability tax credit. Their ages are 2 and 4 years old. In this case, Mr. Fortin received \$1,920 in Universal Child Care Benefits.
- B. They have three children, none of whom qualify for the disability tax credit. Their ages are 2, 4, and 15 years old. In this case, Mr. Fortin received \$2,280 in Universal Child Care Benefits.

## TIF PROBLEM NINE - 9

### Child Care Expenses

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During 2016, Mr. Morris Holmes starts a new business venture. While he expects that, in the long run, the business will be profitable, it only produced net business income of \$18,000 during its first year of operations. Because of the time he committed to this venture, this was the only income Mr. Holmes earned during 2016. However, as the lower income spouse, he received Universal Child Care Benefits.

Mrs. Holmes is employed as a management consultant. Her 2016 gross employment income was \$81,000 and RPP contributions of \$3,000 were withheld from her pay. Her only other source of income was interest received of \$1,200.

During 2016, Mr. Holmes spent 6 weeks attending a college course dealing with the management of a small business. The course required Mr. Holmes to spend at least 15 hours per week in classes and preparing assignments.

Because of the requirement of Mr. Holmes' business and Mrs. Holmes' employment, the couple incurred child care costs during 2016 of \$300 per week for 50 weeks.

**Required:** Determine the maximum amount that can be deducted by Mr. and Mrs. Holmes for the year ending December 31, 2016 for child care expenses under the following assumptions:

- A. They have two children, neither of whom qualify for the disability tax credit. Their ages are 3 and 5 years old. In this case, Mr. Holmes received \$1,920 in Universal Child Care Benefits during 2016.
- B. They have three children, none of whom qualify for the disability tax credit. Their ages are 3, 5, and 10 years old. In this case, Mr. Holmes received \$2,280 in Universal Child Care Benefits during 2016.

## **TIF PROBLEM NINE - 10**

### **Pension Income Splitting**

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Martin Jones and his wife Sally are both 68 years of age. Sally received OAS payments of \$7,000 during 2016. In addition to her OAS benefits, Sally earns interest of \$43,000 during 2016. The investments which provide this interest were inherited from her mother. Because of a serious accident several years ago, Sally qualifies for the disability tax credit.

During 2016, Martin receives an annual pension benefit from his former employer of \$124,000. This is his only source of income other than the OAS payments described in Scenario 2 below.

**Scenario 1** Martin prepares his and Sally's tax returns and does not split his pension income. Martin has never applied for OAS payments, thinking that they would simply be clawed back by the government because of his ongoing high level of income.

**Scenario 2** An accountant prepares Martin and Sally's tax returns and splits Martin's pension income, with \$62,000 going into each of their tax returns. Martin applied for OAS as soon as he turned 65 and received \$7,000 in OAS benefits in 2016.

Neither Martin nor Sally are eligible for any tax credits other than the basic personal credit, the age credit, the pension income credit, and the disability tax credit. Further, they have no deductions that will be used in the determination of Taxable Income.

**Required:**

- A. Calculate the amount of Net Income For Tax Purposes and Taxable Income for both Martin and Sally under each of the two Scenarios.
- B. Based on your figures from Part A, calculate the amount owing to the CRA for both Martin and Sally under each of the two Scenarios. Provide a comparison of the amounts owing under the two alternatives.

## **TIF PROBLEM NINE - 11**

### **Pension Income Splitting**

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Bennett Bixlar and his wife Belinda are both 66 years of age and in good health.

For 2016, Bennett receives payments totaling \$120,000 from his former employer's RPP. Other than OAS payments described in Alternative 2, Bennett has no other income during 2016.

Belinda has received a significant portfolio of dividend paying stocks from her family. During 2016, she received eligible dividends of \$39,000. In addition, she received OAS payments of \$7,000 during the year.

They have been advised of the possibility of splitting Bennett's pension income. To assist in deciding whether or not they should use this election they have asked you to provide information under each of two alternatives:

**Alternative 1** Their tax returns are prepared without splitting income. Bennett does not file for OAS payment as they would be clawed back due to his ongoing high level of income.

**Alternative 2** Their tax returns are prepared using the pension income splitting election. Bennett's pension income is evenly split, with \$60,000 going to each spouse. Bennett applied for OAS when he turned 65 and received OAS payments of \$7,000 during the year.

They have no deductions that will be used in the determination of Taxable Income. Neither Bennett nor Belinda are eligible for any tax credits other than the:

- basic personal credit,
- age credit,
- dividend tax credit, and
- pension income credit.

**Required:**

- A. Calculate the amount of Net Income For Tax Purposes and Taxable Income for both Bennett and Belinda under each of the two Alternatives.
- B. Based on your figures from Part A, calculate the amount owing to the CRA for both Bennett and Belinda under each of the two Alternatives. Provide a comparison of the amounts owing under the two alternatives.

**TIF PROBLEM NINE - 12****Other Income And Deductions Including RESPs**

Katrina Watts is 42 years old and has custody of her two children from a previous marriage. The son is 11 years old and the daughter is 9 years old. They are both in good health. She is currently married to very successful electrician who earns an income in excess of \$300,000 per year.

As her children are now in school most of the year, she has decided to pursue a career in environmental design. To this end, she has enrolled, on a full time basis, at the University of Calgary. Her studies began on January 1, 2016.

As she was very successful in her first term of studies, she was able to obtain summer employment as an assistant in an environment study in Cold Lake, Alberta. As this location was over 600 kilometres from Calgary, she and her children moved to a rented cottage in Cold Lake for the period June 1, 2016 through September 1, 2016. As this was a temporary move, it was accomplished using a rented van at a total cost of \$685.

During her summer in Cold Lake, Ms. Watts required someone to take care of her two children while she was at work. For this service, she paid a local retired teacher \$125 per week for a period of 12 weeks. She has the appropriate documentation to support these costs.

She returned to Calgary on September 1, 2016 in order to resume her studies at the University of Calgary. Once again, the move was accomplished using a rented van. The total cost was \$826. During the fall term, she found a part time job working in a Calgary architecture firm.

On January 1, 2016, Ms. Watts did not have a Tax Free Savings Account (TFSA). In October, 2016, she opened a TFSA and deposited a total of \$4,500. Her husband also made a contribution in the amount of \$5,000.

During 2016, Ms. Watts received the following amounts:

Universal Child Care Benefits	\$ 720
Wages From Cold Lake Employment	9,600
Wages From Part Time Employment In Calgary	600
Scholarship Granted By University for September 2016 Semester	4,000
Eligible Dividends Received	3,500
Child Support Received	10,500
Inheritance From Aunt	30,000
TFSA Withdrawal	8,000

During November, 2016 Ms. Watts establishes RESPs for both of her children. She contributes \$1,000 to each of these plans.

**Required:**

- A. Determine the minimum Net Income For Tax Purposes that Ms. Watts will have to report for her 2016 taxation year. Provide reasons for omitting items that you have not included in your calculations. Also, indicate any amounts that can be carried forward to future years.
- B. Provide any advice you feel would assist her in planning future actions concerning the RESPs that have been established for her children.

**TIF PROBLEM NINE - 13****Non-Arm's Length Transfer Of Shares**

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Martin Forest has owned a tract of land for over 10 years. He acquired the land at a cost of \$360,000. An appraiser has advised him that the land has a current fair market value of \$500,000. It is Martin's intention to sell the land.

The following four Cases make different assumptions as to the identity of the purchaser and the proceeds of disposition. In each Case, we will assume that the purchaser immediately re-sells the land for its fair market value of \$500,000.

**Case 1** Martin sells the land to an arm's length party for \$500,000.

**Case 2** Martin sells the land to his sister for its cost of \$360,000.

**Case 3** Martin gifts the land to his 10 year old son.

**Case 4** Martin sells the land to his mother for \$600,000.

**Required:**

- A. For each of the alternatives under consideration, advise Martin of the tax consequences that will result from the disposition. Indicate the tax consequences to the purchaser of the land when it is resold.
- B. In those cases where the land is sold by Martin for a value other than fair market value, indicate what might motivate him to make the sale at that price.

**TIF PROBLEM NINE - 14****Non-Arm's Length Transfer Of Depreciable Property**

The following independent cases involve non-arm's length transfers of depreciable assets.

**Case One - FMV Greater Than Capital Cost** John Barth sells a depreciable asset to his son for cash of \$165,000, an amount equal to the fair market value of the asset. The asset has a capital cost of \$97,000. It is the only asset in its CCA Class. The UCC balance for the class is \$69,000.

**Case Two - FMV Less Than Capital Cost** John Barth sells a depreciable asset to his daughter for cash of \$210,000, an amount equal to the fair market value of the asset. The asset has a capital cost \$286,000. It is the only asset in its CCA Class. The UCC balance for the class is \$189,000.

**Required:** For each of the two Cases, indicate the tax consequences for John that result from the sale. In addition, indicate the tax values that will be used by the transferee subsequent to the transfer.

## **TIF PROBLEM NINE - 15**

### **Deemed Dispositions At Death**

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Ms. Margarette Ferrero lives with her spouse, Gianni Ferrero. On August 3, 2016, Margarette dies of a heart attack while competing in a 10 kilometer race.

Margarette and Gianni have a 32 year old daughter, Ciara. Ciara is employed with a large public company and, for 2016, has employment income of \$72,000. As she actively trades in the stock market, she normally experiences taxable capital gains of at least \$25,000 per year. This was the case for 2016, and the three preceding years.

For several years, Margarette owned a commercial rental property in Lethbridge. The property was acquired at a cost of \$623,000, with \$473,000 of this total allocated to the building and \$150,000 allocated to the land. As it is a rental property with a value in excess of \$50,000, it is allocated to a separate Class 1. Since its acquisition, the building has always been fully occupied. As of January 1, 2016, the UCC balance for this Class 1 is \$363,000.

As of the date of Margarette's death, it is estimated that the fair market value of the property has increased to \$746,000, with \$571,000 of this total allocated to the building and the remaining \$175,000 allocated to the land.

Due to a major city improvement project that started at the beginning of 2017, the main road access to the building will be under construction for at least 3 years. As a result, on May 1, 2017, the building is sold for \$685,000, with \$525,000 of this total being allocated to the building and the remaining \$160,000 allocated to the land.

#### **Required:**

- A. For each of the following cases, indicate the tax effects to be included in Margarette's tax return as a result of the 2016 deemed disposition at her death, as well as the tax effects associated with the 2017 sale of the property.

**Case 1** Margarette's will leaves the apartment building to her spouse, Gianni. During 2016, Gianni continues to operate the building and takes maximum CCA for that year.

**Case 2** Margarette's will leaves the apartment building to her daughter, Ciara. During 2016, she continues to operate the building and takes maximum CCA for that year.

- B. Assume that in Case 2, the proceeds of the 2017 sale of the property by Ciara were allocated \$300,000 to the land and \$385,000 to the building. Calculate the tax effects associated with the sale of the property for Ciara.

**TIF PROBLEM NINE - 16****Deemed Dispositions At Death And Emigration**

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Mr. Cheever is 66 years of age and his wife, Doreen, is 56. They have one daughter, Mary, who is 32 years of age. On July 1 of the current year, Mr. Cheever owns the following properties:

**Rental Property** Mr. Cheever owns a rental building that was acquired at a cost of \$550,000 (\$100,000 of this amount represents the estimated value of the Land on which the building is situated). On July 1 of the current year, its UCC is \$270,000 and its fair market value is estimated to be \$970,000 (the estimated value of the land is unchanged at \$100,000).

**Brazeway Dynamics** Mr. Cheever owns 2,500 shares of Brazeway Dynamics, a Canadian public company. These shares have a cost of \$275,000 and a current fair market value of \$425,000. Mr. Cheever has never owned more than 1 percent of the outstanding shares of this Company.

**Farm Land** Mr. Cheever owns farm land with a cost of \$525,000 and a current fair market value of \$750,000. The land is farmed on a full time basis by Mr. Cheever's daughter, Mary.

**Cheever Inc.** Mr. Cheever owns 100 percent of the voting shares of Cheever Inc., a Canadian controlled private corporation. The Company was established with an investment of \$155,000 and it is estimated that the current fair market value of the shares is \$227,000. Cheever Inc. is not a qualified small business corporation for purposes of the lifetime capital gains deduction.

**Required:** Assuming that no elections are made and that normal deemed disposition values apply, explain the tax consequences to Mr. Cheever for the current year, in each of the following Cases:

- A. Mr. Cheever dies on July 1 of the current year, leaving all of his property to his spouse, Doreen.
- B. Mr. Cheever dies on July 1 of the current year, leaving all of his property to his daughter, Mary.
- C. Mr. Cheever departs from Canada and ceases to be a resident on July 1 of the current year.

**TIF PROBLEM NINE - 17****Transfers To A Spouse - Income Attribution**

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For a number of years, Mr. James Hadley has owned several rental properties. On January 1, 2016, he marries Ms. Gwyneth Rowe and, on the following day, as part of their pre-nuptial agreement, he gifts one of these properties to her. At the time of the gift, the relevant information on the property is as follows:

	<b>Land</b>	<b>Building</b>
Original Cost	\$ 52,000	\$170,000
Market Value - Date Of Transfer	102,000	214,000
UCC - Date Of Transfer	N/A	97,000

During 2016, there was a net rental loss on the property of \$7,400 and no CCA was deducted on the building.

On January 1, 2017, after concluding that other investments would provide a better return, Gwyneth sells the rental property for \$346,000. At this time, an appraisal indicates that the market value of the land is unchanged at \$102,000.

**Required:** Determine the tax effects associated with the transfer and subsequent sale of the property for both Mr. and Mrs. Hadley assuming:

- A. The facts are as stated in the problem and that Mr. Hadley does not elect out of ITA 73(1).
- B. Instead of receiving the rental property as a gift, Gwyneth purchases the property for its fair market value, using funds that were accumulated prior to the marriage. Mr. Hadley elects out of ITA 73(1) on this sale.

**TIF PROBLEM NINE - 18****Income Attribution**

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For several years, Ms. Tiffani Langston has owned 21,000 shares of Modal Inc., a Canadian public company. These shares were acquired at a cost of \$10 per share.

On January 12, 2016, Tiffani gives 7,000 of these shares to her spouse Hugh Langston. She does not elect out of the ITA 73(1) spousal rollover. Also on this date, Tiffani gives the remaining 14,000 shares to her 9 year old son, Mark. On this date, the shares are trading at \$11 per share.

On August 1, 2016, the shares pay an eligible dividend of \$0.50 per share.

On December 15, 2016, both her spouse, Hugh and her son, Mark sell their shares for \$13 per share.

**Required:** Determine the total Net Income For Tax Purposes to be recorded for the 2016 taxation year by Tiffani, her spouse Hugh, and his son Mark, on the preceding transactions. Assume Tiffani dies on November 11, 2016. How would that change your solution?

**TIF PROBLEM NINE - 19****Income Attribution**

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For a number of years, Mr. Alonso Robelo has owned 15,000 shares of Lisgar Inc., a Canadian public company. These shares were acquired at a cost of \$12.50 per share.

On March 2, 2016, Alonso gives 5,000 shares of these shares to his spouse Alice. The remaining 10,000 shares are given to his 12 year old son Alonso Jr. On this date the shares are trading at \$17.00 per share.

On July 1, 2016, the Lisgar Inc. shares pay an eligible dividend of \$0.80 per share.

On November 1, 2016, Alice and Alonso Jr. sell all of their Lisgar Inc. shares for \$16.00 per share.

**Required:** Determine the total Net Income For Tax Purposes to be recorded for the 2016 taxation year by Alonso, his spouse Alice, and his son Alonso Jr., on the preceding transactions. Assume that Alonso did not elect out of the ITA 73(1) spousal rollover provision.

**TIF PROBLEM NINE - 20****Comprehensive Case (Chapters 1 to 9)**

Mr. Carlos Santini is 45 years of age and divorced from his former spouse, Gloria. Because Gloria is an extremely successful actress, she is constantly traveling. Given this, Carlos and Gloria concluded it would be best if he retained custody of their three children. None of the children had any income during 2016. They can be described as follows:

**Andrew** Andrew is 5 years old.

**Lolita** Lolita is 12 years old and blind.

**Estelle** Estelle is 19 years old and is dependent on Carlos because of a physical disability. She does not, however, qualify for the disability tax credit.

Carlos receives \$1,320 in Universal Child Care Benefits during 2016.

Gloria is very well paid for her work and, as a consequence, is required to make monthly payments of \$10,000 per month to Carlos. Of this amount, \$3,500 is designated as spousal support, with the remaining \$6,500 designated as child support. All required amounts were paid during 2016. In addition, because she experienced a large increase in her performance fees during 2016, Gloria paid an additional lump-sum amount to Carlos of \$15,000.

Medical expenses for Mr. Santini and his dependants during 2016 were as follows:

Carlos	\$ 850
Andrew	1,250
Lolita	8,560
Estelle	10,260
Total Medical Expenses	\$20,920

Mr. Santini uses a national agency to provide full time child care. The 2016 costs for the three children total \$22,500. In addition, Lolita and Estelle attend a summer camp for four weeks during 2016. The cost of this camp is \$500 per child per week. The camp fees do not qualify for the child fitness credit or the children's arts credit. During the period when Lolita and Estelle are at camp, Carlos incurs additional costs for care of Andrew of \$1,000. This \$1,000 is not included in the \$22,500 paid to the national agency.

In 2014 and previous years, Carlos worked for a large public company. During this period, he received options to purchase 8,000 shares of the Company's stock for \$15 per share. The shares were trading for \$14 per share at this time. On June 1, 2016, he exercises these options. On this date, the shares are trading at \$22.50 per share. His former employer withholds the maximum 2016 CPP contributions due to the exercise of the stock options.

On December 1, 2016, he sells all of these shares for \$25.00 per share. The commission on the transaction is \$2,000.

Beginning in 2011 on a part time basis and then on a full time basis beginning in 2014, Mr. Santini operated an unincorporated accounting and tax return preparation business in Toronto. The business uses a taxation year that ends on December 31. On January 1, 2016, the business has the following capital assets (all computer equipment is leased):

	Adjusted Cost Base Or Capital Cost	UCC
Building	\$200,000	\$165,000
Land (Site For The Building)	100,000	N/A
Furniture And Fixtures	45,000	28,600

Mr. Santini owns a minivan that he uses for personal purposes. On January 3, 2016, he purchased an automobile for \$52,000 that he will use exclusively for business purposes.

Despite the fact that he is an accountant, he keeps his business records on a cash basis. For 2016, the business has a net cash flow of \$59,300, not including the January 3 payment for the automobile. Relevant balances at the beginning and end of 2016 are as follows:

	January 1	December 31
Billed Receivables	\$37,000	\$15,000
Unbilled Work In Process	42,000	26,000
Accounts Payable	14,000	32,000

During April, 2016, Carlos' parents and twin brother are arrested in a highly publicized raid on a counterfeit operation and he loses most of his clients. As a result, he decides to move his family and his business from Toronto, Ontario to Kamloops, British Columbia.

He flies to Kamloops in June, 2016 for 5 days to find a suitable home. He returns to Toronto where he learns that his offer to purchase a house has been accepted. Carlos plans to move to his new home in September, 2016. He will continue his tax practice in Kamloops, beginning in January, 2017.

Mr. Santini arranges to have his business automobile stored at a Toronto garage belonging to his brother, who will drive the automobile to Kamloops in January, 2017.

The building in which his business operates in Toronto is sold for \$425,000. Of this amount, it is estimated that \$125,000 relates to the land. The furniture and fixtures are sold for \$32,400. Carlos acquires a building in Kamloops in November, 2016 for \$520,000 of which \$140,000 relates to the value of the land. As this is not a new building, it does not qualify for the enhanced CCA rate and, because of this, it is allocated to the regular Class 1. New furniture and fixtures are acquired in December, 2016 at a cost of \$58,000.

Mr. Santini always deducts the maximum available CCA, even if this results in a loss for the current year.

Since 2005, Mr. Santini has owned both a house in Toronto and a cottage near Huntsville where he and his family spent the summers. The house cost \$273,900 and is sold in 2016 for \$420,000. As part of the sale agreement, he replaced the heating system at a cost of \$5,000. The cottage cost \$156,000 and is sold in 2016 for \$350,000.

A selling commission is paid on each sale in the amount of 4.5 percent of the selling price. On the advice of his tax accountant, Mr. Santini plans to deduct the sales commission and legal fees on the house as moving expenses and account for the sales commission and legal fees on the cottage as selling costs.

On their arrival in Kamloops in September, the family is unable to move into the new house as renovations are behind schedule. They are forced to stay in a hotel for 12 days.

Other costs associated with the move are as follows:

Legal Fees On Sale Of Huntsville Cottage	\$ 675
Legal Fees On Sale Of Toronto House	850
Legal Fees On Acquisition Of Kamloops House	940
Payments For Moving And Storage Of Household Effects	9,800
Fee For Storage and Transport Of Minivan	1,500
Cost Of Kamloops Trip To Locate New Residence	
Airfare (Return)	450
Hotel In Kamloops (5 Nights At \$100)	500
Food In Kamloops (5 Days - Total)	175
Cost Of Kamloops Move For Family	
Airfare For Family To Kamloops (One Way)	1,860
Hotel In Kamloops (12 Nights At \$300)	3,600
Food In Kamloops (12 Days - Total)	1,975

Mr. Santini will use the simplified method of determining food costs in calculating his moving expenses. Assume that the flat rate for meals is \$51 per person per day.

Mr. Santini receives the following amounts of investment income during 2016:

Interest	\$2,500
Eligible Dividends From Taxable Canadian Companies	3,820
<u>Total Investment Income Received</u>	<u>\$6,320</u>

During 2016, Mr. Santini makes contributions to registered charities in the amount of \$2,400. Because he makes regular contributions to these charities, he is not eligible for the first-time donor's super credit.

During 2016, Mr. Santini made the following payments:

- \$5,000 to a Tax Free Savings Account (TFSA) in his name,
- \$3,000 to a Tax Free Savings Account (TFSA) in the name of Estelle,
- \$2,000 to a Registered Education Savings Plan for Andrew, and
- \$2,000 to a Registered Disability Savings Plan for Lolita.

Due to the large cash expenditures needed for his move, Mr. Santini withdraws \$6,300 from his TFSA.

**Required:** Calculate the following for Mr. Santini:

- his minimum 2016 Net Income For Tax Purposes,
- his minimum 2016 Taxable Income,
- his minimum 2016 Balance Owing to the CRA, including any CPP contributions payable,
- the January 1, 2017 adjusted cost base and UCC of any business assets, and
- any carry overs available to Mr. Santini and any rules applicable to claiming the carry overs.

Ignore GST/HST/PST considerations.

## **Chapter Ten Test Item File Problems**

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### **TIF PROBLEM TEN - 1**

#### **Retirement Savings - Essay Questions**

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1. What are the tax advantages associated with making contributions to an RPP or an RRSP?
2. In almost all cases, making contributions to an RRSP will provide for the deferral of income tax. In some cases, making such contributions may result in avoidance of tax. Explain these statements.
3. Tax advisors generally recommend making RRSP contributions as early in the year as possible. What is the basis for these recommendations?
4. Describe the difference between a defined benefit pension plan and a money purchase pension plan.
5. An individual has shares that have declined in value since he acquired them several years ago. As he is short of cash, he would like to use these shares as a contribution to his RRSP. As his tax advisor, would you approve of this decision?
6. In many cases, investors with various types of investments in their RRSPs also have a portfolio of investments that are held outside of their RRSPs. When this is the case, tax advisors will indicate that, to the degree possible, they should include their debt securities inside of their RRSP, while allocating equity securities to their non-RRSP investment portfolio. What is the basis for this advice?
7. The RRSP Deduction Limit, as defined in ITA 146(1), is not a limit on RRSP contributions. Explain this statement.
8. How is Earned Income defined for purposes of determining the RRSP Deduction Limit?
9. In calculating an individual's Pension Adjustment, it is necessary to have a mechanism for equating contributions in defined contribution plans with benefits earned in defined benefit plans. How does the RRSP legislation deal with this issue? Would you consider this approach to be fair to all taxpayers? Explain your conclusion.
10. An individual's RRSP deduction room is reduced by past service pension adjustments. Describe two situations that would give rise to such adjustments.
11. Describe the circumstances that give rise to pension adjustment reversals.
12. Many individuals do not have sufficient funds to maximize their contributions to both an RRSP and a TFSA. Briefly compare the tax features of these two alternative plans.
13. One of your friends, a very wealthy businessman, has indicated that he never makes contributions to his RRSP in excess of amounts that he can deduct. His reasoning is that this doesn't make sense because, even though the contributions cannot be deducted when they are made, they will be subject to tax when they are withdrawn. Do you agree with your friend? Explain your conclusion, indicating any assumptions that you have made.
14. If an individual wishes to terminate his RRSP, making a lump-sum withdrawal is generally not the best alternative. Describe the disadvantages of such withdrawals.

15. Briefly describe the options available to an individual in the year he reaches age 71 with respect to the assets in his RRSP. Also indicate the tax consequences of each alternative.
16. Under what circumstances would it be desirable for an individual to make contributions to an RRSP in favour of their spouse or common-law partner? What are the advantages of making such contributions?
17. Explain the income attribution rule that applies to spousal RRSPs.
18. One of your clients is considering the withdrawal of a portion of his RRSP balance under the provisions of the Home Buyers' Plan. List and briefly explain any factors that should be considered before deciding to make this withdrawal.
19. An individual is returning to university after several years of full time employment. He has a substantial RRSP balance and is considering withdrawing some of this balance under the lifelong learning plan provisions. What factors should he consider in choosing this method of financing his return to university studies?
20. Describe the alternative tax situations that may arise when an individual dies as the registrant of an unmatured RRSP.
21. Describe the types of individuals that can be members of a pooled registered pension plan.
22. Describe the basic differences between an RRSP and a RRIF.
23. Profit Sharing Plans (PSPs) are not as effective as Deferred Profit Sharing Plans (DPSPs) in providing tax advantaged compensation to employees. Briefly explain this statement.
24. Describe the tax features associated with retirement compensation arrangements.
25. What is a salary deferral arrangement?

## **TIF PROBLEM TEN - 2**

### **Retirement Savings - True Or False**

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1. In terms of tax planning, the use of Registered Retirement Savings Plans can provide for both tax deferral and tax avoidance.  
True or False?
2. A pension plan that provides for a pension equal to 3 percent of an employee's average annual salary for each year of service is a defined benefit plan.  
True or False?
3. Earned Income for RRSP purposes includes taxable spousal support received, business losses, and net rental income.  
True or False?
4. All RRSP contributions that cannot be deducted in the current year will be subject to a penalty of 1 percent per month.  
True or False?
5. A Registered Retirement Savings Plan is considered to be a spousal Registered Retirement Savings Plan if a spouse or common-law partner has made any contributions to the plan at any time since its inception.  
True or False?
6. Amounts withdrawn from a Registered Retirement Savings Plan under the provisions of the Home Buyers' Plan must be repaid over a period of 15 years, beginning in the second calendar year after the year of withdrawal.  
True or False?
7. Amounts withdrawn from a Registered Retirement Savings Plan under the provisions of the Lifelong Learning Plan must be used to pay tuition fees for a qualifying educational program at a designated educational institution.  
True or False?
8. An employer contributes \$25,000 to a Registered Pension Plan on March 1, 2016. Each of the 15 employees in the plan has contributed \$1,000 to the plan during 2016. The employer can deduct a maximum of \$15,000 in contributions for the taxation year ending December 31, 2016.  
True or False?
9. Employees are allocated a taxable benefit for all amounts that an employer contributes to a Deferred Profit Sharing Plan.  
True or False?
10. There is no limit on the amount of a retiring allowance that can be transferred to a Registered Retirement Savings Plan on a tax free basis as long as the employer was not making vested contributions to a Registered Pension Plan or a Deferred Profit Sharing Plan for the employee.  
True or False?

## **TIF PROBLEM TEN - 3**

### **Retirement Savings - Multiple Choice**

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#### **New For 2016/2017**

##### ***Defined Benefit Vs. Defined Contribution***

1. Which of the following statements with respect to pension plan categories is correct?
  - A. Pension adjustment reversals can only arise when the plan is a defined contribution plan.
  - B. If the pension adjustment is based on the employer and employee contributions, it is a defined benefit plan.
  - C. A plan in which the benefit is based on employer contributions is a defined benefit plan.
  - D. Past Service Pension Adjustments can only arise when the plan is a defined benefit plan.

##### ***RRSPs***

2. Which of the following statements with respect to RRSP terminations is **NOT** correct?
  - A. All RRSPs must be terminated in the year an individual turns 71 years old.
  - B. A lump sum withdrawal from an RRSP is not eligible for pension income splitting.
  - C. If an individual has terminated his RRSP because he has turned 71, he can no longer make RRSP contributions, even if he has Earned Income.
  - D. If RRSP funds are used to purchase a life annuity, only the annuity payments would be subject to tax.

##### ***Home Buyers' Plan***

3. Which of the following statements about Home Buyers' Plans (HBPs) is correct?
  - A. If a withdrawal is made under the plan, any contributions made 90 days prior to the withdrawal cannot be deducted.
  - B. Any RRSP contribution made in a particular year will count first towards the HPB repayment requirement for that year.
  - C. Repayments in excess of an annual requirement will reduce future annual requirements.
  - D. When an individual dies with an outstanding Home Buyers' Plan balance, this balance will not be subject to tax.

##### ***Lifelong Learning Plan***

4. Which of the following statements about Lifelong Learning Plans (LLPs) is **NOT** correct?
  - A. The maximum withdrawal is \$10,000 in any single year, to a cumulative total of \$20,000 over four years.
  - B. An individual can only participate in this program once during his life.
  - C. Repayments must begin no later than the fifth year after the year of the first Lifelong Learning Plan withdrawal (actually the sixth year if payments are made within 60 days of the end of the fifth year).
  - D. If an individual ceases to be a resident of Canada, any unpaid balance under the LLP must be repaid before the date the tax return for the year of departure should be filed, or 60 days after becoming a non-resident, whichever date is earlier.

**RPPs**

5. Which of the following statements with respect to Registered Pension Plans (RPPs) is **NOT** correct?
- A. An employer can sponsor both an RPP and a Deferred Profit Sharing Plan.
  - B. Employee contributions provide the contributor with a credit against tax payable.
  - C. Employer contributions do not constitute a taxable benefit for the employee.
  - D. Employee options at retirement are determined by the terms of the plan.

**RRIFs**

6. Which of the following statements with respect to Registered Retirement Income Funds (RRIFs) is **NOT** correct?
- A. Withdrawals from a RRIF are not eligible for pension income splitting.
  - B. Withdrawals from a RRIF are eligible for the pension Income tax credit.
  - C. An individual can have multiple RRIFs.
  - D. Registered Pension Plan balances can be transferred to a RRIF on a tax free basis.

**Deferred Profit Sharing Plans**

7. Which of the following statements with respect to Deferred Profit Sharing Plans (DPSPs) is correct?
- A. Both the employers and employees can make contributions to DPSPs.
  - B. Contributions to DPSPs are limited to one-half the money purchase limit for the year.
  - C. Employer contributions are treated as a taxable benefit to the employees.
  - D. Withdrawals from DPSPs are not taxable to the recipient.

**Profit Sharing Plans**

8. Which of the following statements with respect to profit sharing plans is correct?
- A. Employer contributions are not taxable benefits to the employees.
  - B. Earnings within the plan accumulate on a tax free basis.
  - C. Employer contributions are limited to one-half of the money purchase limit for the year.
  - D. Withdrawals from the plan are received tax free by employee.

**Retirement Compensation Arrangements**

9. Which of the following statements with respect to Retirement Compensation Arrangements (RCAs) is **NOT** correct?
- A. Contributions to RCAs are fully deductible to the employer.
  - B. Contributions to RCAs are subject to a 50 percent, non-refundable tax.
  - C. Contributions can only be made by an employer, a former employer of a taxpayer, or by a person with whom the employer or former employer does not deal at arm's length.
  - D. Any taxes on contributions or earnings within the arrangement are refunded at the rate of 50 percent.

## **Retained From Previous Editions**

**Defined Benefit Vs. Defined Contribution**

10. With respect to a defined benefit Registered Pension Plan, which of the following statements is correct?
- A. The employer is required to make a specific contribution to the plan in each year.
  - B. The employer promises each employee a retirement benefit that is based on a contractually specified formula.
  - C. The Pension Adjustment that will be calculated for each employee is based on the amounts of contributions that have been made by the employer.
  - D. Employees cannot make contributions to this type of plan.

11. With respect to a defined contribution Registered Pension Plan, which of the following statements is **NOT** correct?
- A. The employer agrees to make a specified contribution for each year of service.
  - B. The Pension Adjustment that will be calculated for each employee is based on the amounts of contributions that have been made by the employee and employer.
  - C. Both the employee and employer can make contributions to such plans.
  - D. The employee's pension benefit is not affected by rates of return on the pension plan assets.

**RRSPs**

12. With respect to self-administered Registered Retirement Savings Plans, which of the following is **NOT** a qualified investment?
- A. Shares in a publicly traded company.
  - B. A mortgage on the principal residence of the plan beneficiary.
  - C. Direct investments in rental properties.
  - D. Canada Savings Bonds.
13. During the year ending December 31, 2015, Donna Collins has employment income before the deduction of any RPP contributions of \$40,000, a net rental loss of \$16,000, interest income of \$6,000, and income from royalties of \$7,000. The royalties were on a book written by Ms. Collins in her undergraduate years at university. She has no Unused RRSP Deduction Room from previous years.
- Ms. Collins is a member of a money purchase Registered Pension Plan in which, during 2015, she has contributed \$2,000 and her employer has contributed \$3,000. Her maximum deductible Registered Retirement Savings Plan contribution for 2016 is:
- A. \$2,580
  - B. \$580
  - C. \$3,580
  - D. \$1,660
14. During the year ending December 31, 2015, Ramona Collins has employment income before the deduction of any RPP contributions of \$40,000, a net business loss of \$16,000, interest income of \$6,000, and income from royalties of \$7,000. The royalties were on a book written by Ms. Collins in her undergraduate years at university. She has no Unused RRSP Deduction Room from previous years.
- She is a member of a Deferred Profit Sharing Plan in which, during 2015, her employer has contributed \$3,000 per employee. Her maximum deductible Registered Retirement Savings Plan contribution for 2016 is:
- A. \$3,660
  - B. \$1,320
  - C. \$5,580
  - D. \$2,580

15. During the year ending December 31, 2015, Wilma Collins has employment income before the deduction of any RPP contributions of \$40,000, a net rental loss of \$16,000, dividends from taxable Canadian corporations with a total grossed up amount of \$6,000, and income from royalties of \$7,000. The royalties were on a book written by Ms. Collins in her undergraduate years at university. She has no Unused RRSP Deduction Room from previous years.

She is not a member of a Registered Pension Plan or a Deferred Profit Sharing Plan during 2015. Her maximum deductible 2016 Registered Retirement Savings Plan contribution is:

- A. \$5,400
  - B. \$5,580
  - C. \$6,660
  - D. \$9,540
16. During the year ending December 31, 2015, Joyce Collins has employment income before the deduction of any RPP contributions of \$40,000, a net rental loss of \$16,000, interest income of \$6,000, and income from royalties of \$7,000. The royalties were on a book written by Ms. Collins in her undergraduate years at university. She has no Unused RRSP Deduction Room from previous years.

She is not a member of a Registered Pension Plan during 2015. She has contributed \$2,000 to her husband's Registered Retirement Savings Plan in 2016. The maximum deductible 2016 Registered Retirement Savings Plan contribution to a plan in her name is:

- A. \$3,580
  - B. \$5,580
  - C. \$4,660
  - D. \$6,660
17. Mrs. Jacks is employed by RME Industries Ltd. RME Industries Ltd. does not offer a Registered Pension Plan or a Deferred Profit Sharing Plan to its employees. She has no Earned Income prior to 2014. Given the following, what is the maximum RRSP contribution that Mrs. Jacks can deduct for the 2016 taxation year?

	2014	2015	2016
Earned Income	\$50,000	\$52,000	\$53,000
RRSP Contributions Deducted	Nil	\$ 6,000	?

- A. \$9,000.
  - B. \$9,360.
  - C. \$12,000.
  - D. \$12,360.
  - E. None of the above.
18. Which one of the following lists describes items that are all included in the determination of Earned Income for RRSP purposes?
- A. Author's royalties, net rental income or losses, and spousal support received/paid.
  - B. Auto standby charge, salesperson's expenses, and resource royalties.
  - C. Business income or losses, CPP retirement benefits, and research grants.
  - D. Rental income or losses, salaries, and scholarships.

19. With respect to RRSP contributions, which of the following statements is correct?
- A. Contributions made during the current year and within 30 days of the end of the current year, must be deducted in the current year.
  - B. Contributions in excess of available deduction room cannot be deducted in the current year or in any subsequent year.
  - C. There is no penalty for making contributions that are in excess of available deduction room.
  - D. Contributions made during the current year can be deducted in any subsequent year.
20. On April 1, 2015 Mrs. Wu contributed \$1,000 to her RRSP. On October 1, 2015 Mr. Wu contributed \$1,000 to the same RRSP in his wife's name. On June 1, 2016 Mrs. Wu withdrew \$1,600 from her RRSP. As a result of the withdrawal:
- A. Mrs. Wu's 2016 taxable income increased by \$1,600.
  - B. Mr. Wu's 2016 taxable income increased by \$1,600.
  - C. Mrs. Wu's 2016 taxable income increased by \$800 and Mr. Wu's increased by \$800.
  - D. Mrs. Wu's 2016 taxable income increased by \$600 and Mr. Wu's increased by \$1,000.
21. Harleen, who is 70 years old, requested a lump sum withdrawal of \$10,000 from her RRSP on November 1, 2016. Which of the following statements is correct?
- A. She will receive cash of \$8,000 and her 2016 taxable income will increase by \$10,000.
  - B. She will receive cash of \$9,000 and her 2016 taxable income will increase by \$9,000.
  - C. She will receive cash of \$8,000 and her 2016 taxable income will increase by \$8,000.
  - D. She will receive cash of \$10,000 and her 2016 taxable income will increase by \$10,000.
22. Mehrdad contributed \$10,000 to an RRSP ten years ago. On May 1, 2016 the fair market value of the fund is \$15,000 due solely to eligible dividends reinvested by the fund. On May 2, 2016 Mehrdad withdrew \$2,000 from his RRSP. Which of the following statements is correct?
- A. His tax payable will be reduced by the dividend tax credit on \$2,000 of eligible dividends.
  - B. His taxable income will be increased by the sum of the \$2,000 received plus the gross up on \$2,000 of eligible dividends.
  - C. His tax payable will be reduced by the pension income credit on \$2,000 of pension income.
  - D. His taxable income will be increased by \$2,000.
23. Yukie has net employment income of \$35,000. During the year, she received spousal support payments of \$8,000, child support payments for her 10 year old daughter of \$12,000 and an inheritance consisting of a \$50,000 term deposit that paid interest of \$2,000 in the year. Her Earned Income for RRSP purposes is:
- A. \$35,000
  - B. \$43,000
  - C. \$45,000
  - D. \$55,000

**Home Buyers' Plan**

24. Which of the following statements with respect to the Home Buyers' Plan (HBP) is **NOT** correct?
- A. All amounts withdrawn must be repaid within 10 years of the year of withdrawal.
  - B. Amounts withdrawn must be used to acquire a dwelling by October 1 of the year following withdrawal.
  - C. The maximum RRSP withdrawal is \$25,000 per individual.
  - D. In the year an individual departs from Canada, any outstanding HBP balance must be repaid by the due date for his tax return for the year of departure.
25. Cecilia withdrew \$24,000 from her RRSP under the Home Buyers' Plan in 2014 and used the funds for a down payment on a qualifying home. She made a repayment of \$1,000 during 2016. Her minimum repayment for 2017 will be:
- A. \$1,493.33
  - B. \$1,533.33
  - C. \$1,600.00
  - D. \$1,642.86
26. Parviz withdrew \$15,000 from his RRSP under the Home Buyers' Plan in 2014 and used the funds for a down payment on a qualifying home. He made a repayment of \$700 during 2016. Taking into consideration his repayment, his Home Buyers' Plan will have what effect on his 2016 taxable income?
- A. An increase of \$1,000.
  - B. An increase of \$300.
  - C. A decrease of \$700.
  - D. No effect.

**Lifelong Learning Plan**

27. Which of the following statements is correct about the Lifelong Learning Plan?
- A. The maximum tax-free withdrawal is \$10,000 per year for up to four years.
  - B. A taxpayer cannot participate in a Home Buyers' Plan and a Lifelong Learning Plan in the same year.
  - C. Minimum repayments must be made over a period of ten years.
  - D. Tax-free withdrawals can be made by a part-time student as long as they are repaid within two years.
28. Jenelle was a full-time student in a four-year qualifying program from September 2012 to April 2016. She withdrew \$5,000 from her RRSP each year on September 1 under the Lifelong Learning Plan to finance her education. Her first repayment is due on:
- A. September 1, 2016
  - B. March 1, 2017
  - C. September 1, 2017
  - D. March 1, 2018

**RPPs**

29. Eileen is a member of her employer's Registered Pension Plan to which her employer contributed \$3,500 and Eileen contributed \$2,600 in the current year. Which of the following statements is correct?
- A. Eileen can deduct her contribution from her Net Income For Tax Purposes and her employer's contribution is not considered a taxable benefit.
  - B. Eileen cannot deduct her contribution from her Net Income For Tax Purposes and her employer's contribution is not considered a taxable benefit.
  - C. Eileen can deduct her contribution from her Net Income For Tax Purposes and she must include her employer's contribution in her income.
  - D. Eileen cannot deduct her contribution from her Net Income For Tax Purposes and her employer's contribution is considered a taxable benefit.
30. Which of the following statements about a RPP is **NOT** correct?
- A. Contributions can be made only by employers.
  - B. Pension adjustments reflect the benefits earned under both money purchase and defined benefit RPPs.
  - C. Contributions made by an employer to an unregistered pension plan are not deductible.
  - D. An RPP from a previous employer may be transferred into the new employer's plan.

**RRIFs**

31. Which of the following statements with respect to Registered Retirement Income Funds (RRIFs) is correct?
- A. An individual can make non-deductible contributions to a RRIF.
  - B. The minimum annual withdrawal from a RRIF is always determined by dividing the fair market value of the assets in the plan by 90, less the age of the beneficiary at the beginning of the year.
  - C. Earnings accumulate within the RRIF on a tax free basis.
  - D. A RRIF can only be established by individuals over the age of 71.
32. Mrs. Yus is 96 years old. She has a RRIF which was established in 1985. On January 1, 2016 the adjusted cost base of her RRIF is \$50,000 and the fair market value is \$62,000. Her minimum withdrawal for 2016 is:
- A. \$12,400
  - B. \$10,333
  - C. \$10,000
  - D. \$8,333

**Transfers Between Plans**

33. On January 1, 2016 Mr. Yang celebrated his 65th birthday and transferred \$85,000 from his RRSP into a RRIF. For what reason would he make this transfer?
- A. He wants to split his RRIF withdrawal with his wife.
  - B. He wants to decrease his taxable income by transferring his high income investments from his RRSP.
  - C. He can no longer maintain an RRSP because of his age.
  - D. He is terminally ill and a RRIF will have more tax advantages to his wife on his death than his RRSP would have had.

34. There are a number of tax free transfers of accumulated pension entitlements. Indicate the transfer that is **NOT** tax free.
- A. Registered Pension Plan to Registered Retirement Savings Plan.
  - B. Registered Retirement Savings Plan to Registered Retirement Income Fund.
  - C. Profit Sharing Plan to Deferred Profit Sharing Plan.
  - D. Deferred Profit Sharing Plan to Registered Pension Plan.
  - E. Registered Pension Plan to different Registered Pension Plan.
35. The most common reason to transfer funds from a RRSP to a RRIF is:
- A. the individual has officially retired
  - B. the list of qualified investments is much longer for a RRIF
  - C. the individual reaches age 65
  - D. the individual reaches age 71

**Retiring Allowances**

36. Mr. Smith, the sole shareholder and employee of Smithco Ltd. since its incorporation in 1976, has decided to sell the corporation and retire in 2016. He has never belonged to a pension plan, and wishes to maximize his RRSP. Which one of the following amounts represents the **largest** retiring allowance from Smithco that Mr. Smith can transfer to his RRSP in the year he retires?
- A. \$40,000.
  - B. \$56,000.
  - C. \$59,500.
  - D. \$70,000.

**Pension Tax Credit**

37. Which of the following would be eligible for the pension income tax credit?
- A. a lump sum withdrawal from an RRSP
  - B. a lump sum withdrawal from a RRIF
  - C. a lump sum withdrawal from a spousal RRSP
  - D. all of the above

**Profit Sharing Plans**

38. Which of the following statements about Profit Sharing Plans is **NOT** correct?
- A. The employer's contributions are taxable benefits.
  - B. Income earned within the plan is accumulated on a tax-free basis.
  - C. Lump sum withdrawals from the plan are not included in taxable income.
  - D. The employer's contribution can be higher than under a Deferred Profit Sharing Plan.

## **TIF PROBLEM TEN - 4**

### **Retirement Savings - Exam Exercises**

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#### ***Exam Exercise Subject Listing For Chapter 10***

<b>Number</b>	<b>Subject</b>
1	Dividends Earned In An RRSP
2	Earned Income
3	Earned Income
4	Pension Adjustments
5	Pension Adjustments
6	Unused RRSP Deduction Room
7	Unused RRSP Deduction Room
8	Maximum RRSP Deduction
9	Maximum RRSP Deduction
10	Excess RRSP Contributions
11	Excess RRSP Contributions
12	Spousal RRSP Withdrawal
13	Spousal RRSP Withdrawal
14	Home Buyer's Plan
15	Home Buyer's Plan
16	Lifelong Learning Plan
17	Lifelong Learning Plan
18	Minimum RRIF Withdrawal
19	Minimum RRIF Withdrawal
20	Retiring Allowance
21	Retiring Allowance

**Exam Exercise Ten - 1 (Dividends Earned In An RRSP)**

Barry Notting has just received an inheritance of \$50,000 in cash. As he is a very successful professional, he does not need the funds currently. Given this, he intends to invest the funds in preferred shares which pay an eligible dividend of 5.5 percent. As he intends to purchase a new home in five years, he plans to liquidate his investment at the end of that period. He is considering two alternatives:

**Alternative 1** - Invest the \$50,000 outside of his RRSP.

**Alternative 2** - Invest the \$50,000 in his RRSP (he has sufficient unused deduction room) and apply the deduction against his professional income. The tax savings resulting from the RRSP deduction would be invested outside of his RRSP in the 5.5 percent preferred shares.

Barry's marginal tax rate on ordinary income is 43 percent, while his marginal rate on eligible dividends is 26 percent. Ignoring the effect of any reinvestment of the dividends received, determine which alternative will provide more funds for Barry's home purchase.

**Exam Exercise Ten - 2 (Earned Income)**

Mr. Marco Marconi has net employment income of \$78,300, after the deduction of \$2,400 in RPP contributions for the year. In addition, he has a business loss of \$6,750, taxable dividends of \$5,640, and pays \$12,400 of deductible support to his former spouse. What is the amount of Mr. Marconi's Earned Income for RRSP purposes for the year?

**Exam Exercise Ten - 3 (Earned Income)**

Susan Copley has net employment income of \$56,200, after the deduction of \$1,800 in RPP contributions. Her Net Income For Tax Purposes also includes \$4,500 in taxable capital gains, a net rental loss of \$2,300, spousal support payments received of \$12,000, and eligible dividends received of \$1,500. What is the amount of Susan's Earned Income for RRSP purposes for the year?

**Exam Exercise Ten - 4 (Pension Adjustments)**

Ms. Calvin's employer sponsors both a money purchase RPP and a DPSP. During the current year, her employer contributes \$2,600 to the RPP and \$1,700 to the DPSP on behalf of Ms. Calvin. Ms. Calvin contributes \$2,600 to the RPP. Calculate the amount of the Pension Adjustment that will be included on Ms. Calvin's T4 for the current year.

**Exam Exercise Ten - 5 (Pension Adjustments)**

John Darby's employer sponsors both a money purchase RPP and a DPSP. During the current year, the employer contributes \$2,500 to the RPP and \$1,250 to the DPSP on behalf of Mr. Darby. Mr. Darby contributes \$2,500 to the RPP. Calculate the amount of the Pension Adjustment that will be included on Mr. Darby's T4 for the current year.

**Exam Exercise Ten - 6 (Unused RRSP Deduction Room)**

Mrs. Alison Lair has 2015 Earned Income for RRSP purposes of \$43,500. She is not a member of an RPP or a DPSP. At the end of 2015, her Unused RRSP Deduction Room was \$5,100 and she has no undeducted contributions. During 2016, she contributes \$7,000 to her RRSP and makes an RRSP deduction of \$5,200. What is the amount of Mrs. Lair's Unused RRSP Deduction Room and undeducted RRSP contributions at the end of 2016?

**Exam Exercise Ten - 7 (Unused RRSP Deduction Room)**

For 2015, Andrew Flack has Earned Income for RRSP purposes of \$96,000. He is not a member of an RPP or a DPSP. While he had no undeducted contributions at the end of 2015, he had unused RRSP deduction room of \$6,500. During 2016, he contributes \$9,000 to his RRSP and make an RRSP deduction of \$8,500. What is the amount of Mr. Flack's Unused RRSP Deduction Room and undeducted RRSP contributions at the end of 2016?

**Exam Exercise Ten - 8 (Maximum RRSP Deduction)**

During 2015, Mrs. White has taxable capital gains of \$21,750, net rental income of \$5,720, pays spousal support of \$15,000, and has net employment income of \$80,200. Based on her RPP contributions of \$3,000 and the matching contributions made by her employer, her employer reports a 2015 PA of \$6,000. At the end of 2015, Mrs. White has Unused RRSP Deduction Room of \$11,120. Also at this time, her RRSP contains undeducted contributions of \$6,275. During 2016, she makes contributions to her RRSP of \$13,000.

Determine Mrs. White's maximum RRSP deduction for 2016. Assuming she deducts her maximum, determine the amount of any Unused RRSP Deduction Room that she will have available at the end of 2016, and indicate the amount of any undeducted contributions remaining at the end of 2016.

**Exam Exercise Ten - 9 (Maximum RRSP Deduction)**

For the 2015 taxation year, Marion Blue has net employment income of \$45,000, spousal support received of \$18,000, a net business loss of \$3,500, and interest receipts of \$1,600. She is a member of her employer's RPP to which she contributes \$1,800. Her employer makes a matching contribution and reports a 2015 PA of \$3,600. At the end of 2015, she has unused RRSP deduction room of \$4,800 and undeducted RRSP contributions of \$3,800. In early 2016, she contributes \$9,400 to her RRSP.

Determine Marion's maximum RRSP deduction for 2016. Assuming she deducts her maximum, determine the amount of any Unused RRSP Deduction Room that she will have available at the end of 2016, and indicate the amount of any undeducted contributions remaining at the end of 2016.

**Exam Exercise Ten - 10 (Excess RRSP Contributions)**

Mr. Jack Parnell is not a member of an RPP or a DPSP. At the beginning of 2015, Mr. Parnell has no Unused RRSP Deduction Room. During 2014 and 2015, he has Earned Income of \$75,000 each year. On July 1, 2015, he makes a \$13,500 RRSP contribution, but does not make any deduction for the year. In 2016, he has Earned Income of \$60,000, makes a \$16,000 contribution on May 1, but still does not make a deduction for the year. Determine any penalty that will be assessed to Mr. Parnell for excess contributions during either 2015 or 2016.

**Exam Exercise Ten - 11 (Excess RRSP Contributions)**

At the beginning of 2015, Bob Pilon has no Unused RRSP Deduction Room. In each of the years 2014 and 2015 he has earned income of \$105,000. On August 1, 2015, he makes a \$18,900 contribution to his RRSP. On April 1, 2016, he makes an additional contribution of \$22,000. He does not make an RRSP deduction in either 2015 or 2016. He is not a member of an RPP or a DPSP. Determine any penalty that will be assessed to Mr. Pilon for excess contributions during either 2015 or 2016.

***Exam Exercise Ten - 12 (Spousal RRSP Withdrawal)***

During 2014, Austin Peters makes a \$1,500 contribution to a new RRSP in which his wife is the registrant. His wife also makes a \$2,800 contribution to this RRSP in 2014. During 2015, he makes a \$2,000 contribution to this RRSP. During 2016, Mr. Peters' wife makes a withdrawal of \$4,300 from this RRSP. How will this withdrawal be taxed?

***Exam Exercise Ten - 13 (Spousal RRSP Withdrawal)***

Cody Bryant's spouse has had an RRSP for several years. For the first time, during 2014, Cody makes a contribution to this plan. The amount of the 2014 contribution is \$4,500 and this is followed, in 2015, by an additional contribution to his spouse's plan of \$5,500. Cody deducts both of these contributions.

At the beginning of 2016, his spouse's plan has a balance of \$226,000. During this year, she withdraws \$11,000 from her RRSP. How will this withdrawal be taxed?

***Exam Exercise Ten - 14 (Home Buyers' Plan)***

During 2013, Mr. John Debon withdraws \$15,000 from his RRSP, using the provisions of the Home Buyers' Plan (HBP). As he received the proceeds from a winning lottery ticket in 2014, he repaid \$8,500 of the HBP balance in that year. What is the minimum repayment that must be paid during 2015? If he makes no payment during 2015, what will be the minimum payment that must be made during 2016?

***Exam Exercise Ten - 15 (Home Buyers' Plan)***

In early 2013, Jason Borshiov withdraws \$21,000 from his RRSP under the provisions of the Home Buyers' Plan (HBP). Because of a large bonus received from his employer, he repays \$7,000 of this in 2014. What is the minimum required payment for 2015? If he makes no payment in 2015, what will be the minimum required payment in 2016?

***Exam Exercise Ten - 16 (Lifelong Learning Plan)***

Mr. Jules Forsyth enrolls in a four year university program running from September, 2011, through April, 2015. In order to finance this program under the provisions of the Lifelong Learning Plan (LLP), he withdraws \$10,000 from his RRSP in September, 2011, a further \$5,000 in September, 2012, and an additional \$5,000 in September, 2013. The university course is completed successfully.

In June, 2016, a designated repayment of \$2,900 is made. In November, 2017, a designated repayment of \$1,500 is made.

Explain the tax consequences of the withdrawals and repayments described for Mr. Forsyth.

***Exam Exercise Ten - 17 (Lifelong Learning Plan)***

Charles Botterill enrolls in a three year university program which runs from September, 2011 through May, 2014. To assist with financing this program, Charles uses the provisions of the Lifelong Learning Plan (LLP) to withdraw \$6,000 from his RRSP in each of the three years 2011, 2012, and 2013. He is successful in completing the university program and receives his degree in April, 2014.

In 2016, he makes a designated repayment of \$2,200. This is followed by a designated repayment of \$1,200 in 2017.

Explain the tax consequences of the withdrawals and repayments described for Mr. Botterill.

***Exam Exercise Ten - 18 (Minimum RRIF Withdrawal)***

On January 1, 2016, Ms. Sheila Salon transfers all of her RRSP balances into a RRIF. At this time, Ms. Salon is 67 years of age. On January 1, 2016, the fair market value of these assets is \$1,450,000. The corresponding balance on January 1, 2017 is \$1,350,000. What is the minimum withdrawal that Ms. Salon must make from the RRIF during 2016 and during 2017?

***Exam Exercise Ten - 19 (Minimum RRIF Withdrawal)***

During 2016, Saul Bronson transfers his entire RRSP balance into a RRIF. At this time, Mr. Bronson is 69 years old. On January 1, 2016, these assets had a fair market value of \$2,400,000. The corresponding figure on January 1, 2017 is \$2,600,000. What is the minimum withdrawal that Mr. Bronson must make from the RRIF during 2016 and during 2017?

***Exam Exercise Ten - 20 (Retiring Allowance)***

As of December 31, 2016, Mrs. Mary Barth has worked for her current employer for 33 years. On this date she retires and, in recognition of her devoted service, her employer pays her a retiring allowance of \$85,000. Her employer has never sponsored an RPP or DPSP. What is the maximum deductible contribution that Mrs. Barth can make to her RRSP as a result of receiving this retiring allowance?

***Exam Exercise Ten - 21 (Retiring Allowance)***

As of the end of 2016, Merideth Jones has worked for the current employer for 35 years. She retires on this date and, under the terms of the applicable collective agreement, she receives a retiring allowance of \$62,000. Her employer has never sponsored an RPP or DPSP. What is the maximum deductible contribution that Ms. Jones can make to her RRSP as a result of receiving this retiring allowance?

**TIF PROBLEM TEN - 5A****Retirement Savings - Key Term Matching (Easy)**

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**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms were listed at the end of Chapter 10 on Retirement Savings:

- A. Defined Benefit Plan
- B. Lifelong Learning Plan
- C. Money Purchase Plan
- D. Pension Adjustment
- E. Registered Retirement Income Fund
- F. RRSP Deduction Room
- G. Salary Deferral Arrangement
- H. Unused RRSP Deduction Room

The following list contains ten potential definitions for the preceding key terms.

1. An arrangement, whether funded or not, under which an individual who has the right to receive compensation postpones the receipt of that compensation, and it is reasonable to assume that one of the main purposes of this postponement was to defer the payment of taxes.
2. A retirement savings plan sponsored by an employer, to which the employer will make contributions which are not taxable to the employee, and the employee may make contributions which are deductible.
3. The excess of the RRSP Deduction Limit, over the amount of RRSP contributions that have been deducted.
4. The cumulative total of all RRSP Deduction Limits, less amounts deducted in those years.
5. A trustee plan to which a resident individual can transfer balances from retirement savings plans on a tax free basis.
6. A trustee plan to which a resident individual can make deductible contributions.
7. A retirement savings plan in which the plan sponsor (employer or Individual) makes known or determinable contributions. The retirement benefit is based on the accumulated contributions and earnings on investments within the plan.
8. An adjustment reported by employers which reflects, for an individual employee, the employee and employer contributions to RPPs and DPSPs for the previous year.
9. A provision that allows individuals to make temporary, non-taxable withdrawals from their RRSP when they are enrolled in a qualifying education program at a qualifying educational institution.
10. A retirement savings plan in which the plan sponsor (usually an employer) promises a known or determinable retirement benefit and assumes financial responsibility for providing that benefit.

*Retirement Savings - Key Term Matching (Easy)*

11. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 10) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (11). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

**TIF PROBLEM TEN - 5B****Retirement Savings - Key Term Matching (Moderate)**

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**Note to Instructor** There are two versions of this matching problem. The list of key terms is the same in both versions, but the potential definitions given are different.

- Version A is easy, there is only one possible answer for each term.
- Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms were listed at the end of Chapter 10 on Retirement Savings:

- A. Defined Benefit Plan
- B. Lifelong Learning Plan
- C. Money Purchase Plan
- D. Pension Adjustment
- E. Registered Retirement Income Fund
- F. RRSP Deduction Room
- G. Salary Deferral Arrangement
- H. Unused RRSP Deduction Room

The following list contains 14 potential definitions for the preceding key terms.

1. An arrangement, whether funded or not, under which an individual who has the right to receive compensation postpones the receipt of that compensation, and it is reasonable to assume that one of the main purposes of this postponement was to defer the payment of taxes.
2. A retirement savings plan sponsored by an employer, to which the employer will make contributions which are not taxable to the employee, and the employee may make contributions which are deductible.
3. A provision that allows individuals to make permanent non-taxable withdrawals from their RRSP when they are enrolled in a qualifying education program at a qualifying educational institution.
4. The excess of the RRSP Deduction Limit, over the amount of RRSP contributions that have been deducted.
5. The cumulative total of all RRSP Deduction Limits, less amounts deducted in those years.
6. A trusteed plan to which a resident individual can transfer balances from retirement savings plans on a tax free basis.
7. The amount that is the sum of the unused RRSP deduction room at the end of the preceding year, plus the amount by which the lesser of the RRSP Dollar Limit and 18 percent of earned income for the preceding year exceeds the Pension Adjustment for the preceding year. This sum is adjusted for any Past Service Pension Adjustment or Pension Adjustment Reversal. It represents the maximum amount of contributions that have been made to an RRSP that can be deducted for a year.
8. A trusteed plan to which a resident individual can make deductible contributions.
9. A retirement savings plan in which the plan sponsor (employer or Individual) makes known or determinable contributions. The retirement benefit is based on the accumulated contributions and earnings on investments within the plan.

*Retirement Savings - Key Term Matching (Moderate)*

10. A retirement savings plan in which the plan sponsor (employer or individual) makes known or determinable contributions. The retirement benefit is based on a formula which is tied to the individual's historical earnings record.
11. An adjustment reported by employers which reflects, for an individual employee, the employee and employer contributions to RPPs and DPSPs for the previous year.
12. A provision that allows individuals to make temporary, non-taxable withdrawals from their RRSP when they are enrolled in a qualifying education program at a qualifying educational institution.
13. A retirement savings plan in which the plan sponsor (usually an employer) promises a known or determinable retirement benefit and assumes financial responsibility for providing that benefit.
14. An adjustment reported by employers which reflects, for an individual employee, the employer's contributions to RPPs and DPSPs for the previous year.
15. None of the above definitions apply. (This answer can be used more than once.)

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 14) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (15). Explanations are not required.

Indicate only one number for each key term. No marks will be awarded if you indicate more than one number for any key term.

## TIF PROBLEM TEN - 6

### Calculation Of PAs, PSPAs, And PARs

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Each of the following **independent** Cases involves calculations of the Pension Adjustment (PA), Past Service Pension Adjustment (PSPA), or Pension Adjustment Reversal (PAR) that would be reported by the employer.

**Case 1** Fredia Frye's employer sponsors a deferred profit sharing plan as well as a registered pension plan. During 2016, the employer contributed, on Fredia's behalf, \$2,500 to the deferred profit sharing plan and \$1,000 to the registered pension plan. Fredia also contributed \$1,000 to the registered pension plan.

**Required:** Calculate Fredia's 2016 pension adjustment.

**Case 2** Barton Huling's employer sponsors a defined benefit registered pension plan. During 2016, Barton's employer contributes \$3,000 to the registered pension plan on his behalf. In addition, Barton is required to make a matching contribution of \$3,000. The plan provides a benefit of 1.25 percent of pensionable earnings for each year of service. For 2016 Barton has pensionable earnings of \$71,000.

**Required:** Calculate Barton's 2016 pension adjustment.

**Case 3** Janee Borel has worked for her current employer since 2014. In January, 2016, the employer implements a defined benefit registered pension plan, with benefits extended to employees for all prior years of service. The benefit formula provides for a benefit equal to 1.1 percent of pensionable earnings for each year of service. Janee's pensionable earnings for her current and previous years of service are as follows:

2014	\$38,000
2015	42,000
2016	51,000

**Required:** Calculate Janee's past service pension adjustment for 2016, as well as her pension adjustment for 2016.

**Case 4** Santiago Premo began working for Atak Ltd. in 2014. The Company sponsors a defined benefit registered pension plan which requires four years of service prior to benefits becoming vested. In 2014, the Company reported a pension adjustment for Santiago of \$5,200, followed by a 2015 pension adjustment of \$5,400.

At the beginning of 2016, it is discovered that Santiago has been embezzling corporate funds during the last few months of 2015. He is immediately fired and the Company is considering criminal charges.

**Required:** Calculate Santiago's pension adjustment reversal for 2016.

**Case 5** Roy Carswell has worked for his current employer since 2014. His employer provides a defined benefit pension plan which, until 2016, provided a benefit of 1.3 percent of pensionable earnings for each year of service. Roy was admitted to the plan with full vesting as of 2014. His 2014 pensionable earnings were \$58,000, with a corresponding figure for 2015 of \$62,000.

As the result of negotiations with Roy's union, as of January 1, 2016, the benefit has been increased to 1.5 percent of pensionable earnings. The change will be applied retroactively for all prior years of service.

**Required:** Calculate Roy's 2016 past service pension adjustment.

## **TIF PROBLEM TEN - 7**

### **Excess RRSP Contributions Vs. TFSA**

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At the beginning of 2015, Deeta Oldham had unused RRSP deduction room of \$35,000. Her account also contained an undeducted contribution of \$37,000. She made the contribution just before she was fired from her high paying job in 2015 because a video of her physically abusing her assistant was posted to YouTube.

As she remained unemployed during 2015 and had little taxable income, she does not make any RRSP deduction during 2015. During 2015, Deeta withdrew a total of \$25,000 from her RRSP in order to cover her living expenses. She had no earned income for RRSP purposes in either 2014 or 2015.

At the beginning of 2016, Deeta finally finds employment at a fitness boot camp, resulting in her having a 2016 earned income for RRSP purposes of \$61,000. She is also fortunate in that she wins \$225,000 in the provincial lottery. Because she now has excess funds, on May 2, 2016, she deposits \$40,000 in her RRSP.

Deeta's wealthy grandmother is gravely ill and Deeta expects to inherit a substantial sum on her death. On December 15, 2016, Deeta meets with you to discuss tax planning. In preliminary discussions, you find she does not have a TFSA.

**Required:**

- A. Determine Deeta's maximum RRSP deduction for 2016.
- B. Determine the ITA 204.1 penalty (excess RRSP contributions), if any, that would be assessed to Deeta for the year ending December 31, 2016.
- C. What advice would you give to Deeta about her RRSP and TFSA contributions?

## **TIF PROBLEM TEN - 8**

### **RRSPs, TFSAs, And Tax Planning**

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Ms. Janine Wheeler found a position in retail sales in September, 2015. During the remainder of that year, she had gross employment income of \$22,000. Prior to 2015, Ms. Wheeler had no Earned Income and made no contributions to either an RRSP or a TFSA.

Prior to July, 2015, Ms. Wheeler had been supported by and living with her common-law partner. On June 30, they formally separate and sign a document which provides Ms. Wheeler with a lump-sum payment of \$80,000, plus \$1,200 per month in spousal support. The lump-sum payment was deposited in a savings account which earned interest of \$550 during the remainder of 2015. She receives six months of support payments in 2015.

Janine did not contribute to an RRSP during 2015. However, her employer sponsored an RPP to which Janine contributed \$1,200 during 2015. This contribution was matched by a \$1,200 contribution by Janine's employer.

In addition to her employment income and interest income, Janine had the following other sources of income during 2015:

- Dividends from Canadian public companies of \$900.
- A net business loss of \$2,500 from her new web-based photos on canvas service.
- An inheritance from an uncle of \$250,000.

For 2015, Ms. Wheeler's income places her in the lowest federal income tax bracket. Further, she anticipates that her 2016 income will also be taxed at this rate. However, she has been promised a management position beginning in January, 2017. This position involves a significant increase in salary and this, combined with her increasingly profitable web-based business, will result in her being in the 26 percent federal income tax bracket.

**Required:**

- A. Calculate Ms. Wheeler's net employment income for 2015.
- B. Determine Ms. Wheeler's maximum deductible RRSP contribution for 2016.
- C. As Ms. Wheeler's personal financial consultant, what advice would you give her regarding her TFSA and RRSP contribution and deduction for 2016?

## **TIF PROBLEM TEN - 9**

### **RRSP Contribution Calculations**

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After being unemployed for two years, Donald Parker found employment with a large, publicly traded corporation in early 2015. His gross 2015 salary was \$40,000 and, in addition, he earned commissions of \$20,000. The corresponding figures for 2016 were \$53,000 and \$32,000. Deductible expenses related to the commission income were \$3,000 in 2015 and \$4,000 in 2016.

From his earnings, Donald's employer withheld the following amounts:

	<b>2016</b>	<b>2015</b>
Federal And Provincial Income Taxes	\$26,000	\$18,000
CPP Contributions	2,544	2,480
EI Premiums	955	931
Disability Insurance Premiums	250	250
Registered Pension Plan (RPP) Contributions	1,500	1,400

The Registered Pension Plan is a money purchase plan. The employer makes RPP contributions and pays disability insurance premiums equal to those amounts withheld from employee earnings for these items. In addition, the employer provided Donald with a low interest loan. The taxable benefit on this loan was \$2,750 in 2015 and \$2,500 in 2016.

Other information for the years 2015 and 2016 is as follows:

	<b>2016</b>	<b>2015</b>
Net Rental Income (Loss)	\$1,400	(\$2,500)
Taxable Spousal Support Received	2,600	2,400
Deductible Spousal Support Paid	( 3,600)	( 3,500)
Capital Gains (Losses)	( 2,200)	1,750
Royalties*	875	920
Interest Income	273	496

\*The royalties are on a song written by Donald's mother in 1962.

In 2013, just prior to losing his job, Donald contributed \$7,500 to an RRSP. As he realized he would be in the minimum tax bracket until he found work, Donald did not deduct this RRSP contribution prior to 2016. He has Unused RRSP Deduction Room of \$25,000 at the end of 2015.

In December, 2016, Donald wins \$200,000 in a lottery. He would like to put as much of this amount as possible into his RRSP prior to the end of 2016.

#### **Required:**

- A. Determine Donald's RRSP Deduction Limit for 2016.
- B. Calculate the amount you would recommend that Donald contribute to his RRSP for 2016.

**TIF PROBLEM TEN - 10****RPP And RRSP Contribution Calculations**

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Henry Plate's Earned Income for RRSP purposes for 2015 was \$52,000. During the year ending December 31, 2015, Mr. Plate's records indicate that he contributed \$2,500 to a money purchase RPP sponsored by his employer. His employer contributed the same amount on his behalf during this period. At the end of 2015, he had no Unused RRSP Deduction Room or undeducted RRSP contributions.

Mr. Plate's 2016 Earned Income was \$65,000. During the year ending December 31, 2016, Mr. Plate's records indicate that he contributed \$2,800 to a money purchase RPP sponsored by his employer. His employer again matched his contribution to his RPP during 2016.

Mr. Plate made a \$5,000 contribution to his RRSP on April 30, 2016.

**Required:** Indicate which of the RRSP and RPP contributions that have been made by Mr. Plate can be deducted in calculating his Net Income For Tax Purposes for the 2016 taxation year. In addition, if he makes the maximum RRSP deduction in 2016, indicate any carry forwards available to him at the end of 2016.

**TIF PROBLEM TEN - 11****RRSP Contribution**

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During 2015, Ms. Storm is employed in Vernon by a large public company. The employer sponsors a defined contribution pension plan and, during 2015, the company made contributions on Ms. Storm's behalf of \$2,500. Ms. Storm made a matching contribution of \$2,500.

At the end of 2015, Ms. Storm had unused deduction room of \$17,000 and undeducted contributions of \$8,000.

During 2015, Ms. Storm has the following income and loss data:

Salary	\$86,200
Taxable Benefits From Employer	5,600
Union Dues	( 450)
Net Loss From Mail Order Business	( 4,500)
Net Rental Income	6,700
Common-Law Partner Support Paid	( 12,000)
Eligible Dividends Received	2,850
Interest On Savings Account	850

**Required:** Calculate the maximum deductible RRSP contribution that can be made by Ms. Storm for 2016.

**TIF PROBLEM TEN - 12****Net Income And RRSP Contribution Calculations**

Alicia Arnold operates an unincorporated business with a December 31 year end. During the year ending December 31, 2016, accounting Net Income for this business was \$183,000. Other information related to the 2016 operations of this business are as follows:

1. Amortization deducted in the determination of accounting Net Income was \$23,000. Her tax advisor has calculated maximum CCA for this period of \$31,000.
2. During the year, the business sold depreciable assets for \$34,500. The net book value of the assets was \$24,000, their capital cost was \$30,000, and their UCC on January 1, 2016 was \$18,000.
3. During the year, Alicia spent \$14,000 on business meals and entertainment. This amount was deducted in the determination of accounting Net Income.

Other information related to Alicia's tax position is as follows:

Interest On Savings Account	\$ 1,200
Taxable Capital Gains On Personal Assets	18,000
Allowable Capital Loss On Sale Of Shares	1,000
Spousal Support Paid	3,600
Royalties On Cookbook That She Authored	8,400

At the beginning of 2016, Alicia had Unused RRSP Deduction Room of \$6,500. She also had undeducted contributions of \$4,500.

**Required:**

- A. For the 2016 taxation year, calculate Alicia's minimum Net Income For Tax Purposes before any deduction is made for RRSP purposes. Ignore CPP contributions in your calculations.
- B. Calculate the maximum RRSP deduction that can be made by Alicia for 2016. In making this calculation, assume that Alicia's 2015 Earned Income is equal to her 2016 Earned Income. Determine the amount of additional contributions that she would have to make in order to make the maximum RRSP deduction.

## **TIF PROBLEM TEN - 13**

### **Employment Income With RRSP**

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During the year ending December 31, 2016, Ms. Nancy Harcourt earned a gross salary of \$72,000. Her employer withheld the following amounts from her salary:

Canada Pension Plan Contributions	\$ 2,544
Employment Insurance Premiums	955
Income Taxes	18,500
Registered Pension Plan Contributions	4,200
Parking Fees - Company Garage	480
Donations To United Way	800
Union Dues	360

#### **Other Information:**

1. Ms. Harcourt is a member of her employer's money purchase RPP. Her employer made a contribution on her behalf that was equal to the \$4,200 contribution that was withheld from her salary.
2. Ms. Harcourt was the year's top salesperson. The award from her employer was an all-expense paid trip to the Bahamas in December, 2016. The cost of this trip was \$5,600 and, in addition, Ms. Harcourt was provided with \$1,000 in cash for incidental expenses during the month that she was on the trip.
3. Ms. Harcourt's employer provides her with a car that cost the company \$53,000, plus \$6,890 of HST. The employer purchased the car in 2015. Ms. Harcourt drives the car a total of 36,000 kilometers during the year, 16,000 kilometers of which were for employment related purposes. The car was used by Ms. Harcourt for the entire year, with the exception of the one month that she was in the Bahamas. Her employer required that the car be left in the company garage during the month that it was not in use.
4. Ms. Harcourt's employer provides a 20 percent discount to employees on all merchandise sold by the enterprise. During the year, Ms. Harcourt purchased merchandise with a list price of \$12,000 and received a discount of \$2,400.
5. In addition to her employment income, Ms. Harcourt had taxable capital gains from stock market trading of \$6,200, a net rental loss of \$3,900, and a self-employed business loss of \$24,600.
6. At the end of 2015, Ms. Harcourt's Unused RRSP Deduction Room was \$4,500 and she had no undeducted RRSP contributions. Her employer reported that she had a 2015 Pension Adjustment of \$7,000. Assume her Earned Income for 2015 is equal to her 2016 Earned Income.

#### **Required:**

- A. Calculate Ms. Harcourt's net employment income for the year ending December 31, 2016.
- B. Calculate Ms. Harcourt's maximum deductible RRSP contribution for 2016.

## TIF PROBLEM TEN - 14

### Retiring Allowances

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Jerry White is married and his wife has not worked since she gave birth to triplets 8 years ago. Mr. White began working for Dynamics Inc. in 1984. The Company does not have a Registered Pension Plan or a Deferred Profit Sharing Plan.

Due to competitive pressures, Dynamics Inc. is attempting to reduce its overall work force. With this goal in mind, they have offered Mr. White a cash payment of \$68,000 if he will immediately resign his position with the Company.

**Required:** Describe the tax consequences to Mr. White if he accepts this offer in 2016. Explain any alternatives that he might have in this regard and advise Mr. White as to an appropriate course of action.

## TIF PROBLEM TEN - 15

### Comprehensive Case (Chapters 1 to 10)

Mr. Allen Arnold lives in Burlington, Ontario. He is 38 years old. His wife Brenda is 32 years old and, for 2016, she has Net Income For Tax Purposes of \$8,500 which includes the universal child care benefits. They have two children. Their daughter Sarah is 12 and has income from part time jobs of \$300. Their son Derek is 10 and has no income of his own.

Mr. Arnold works for a large public company and, during 2016, his basic salary is \$103,000. In addition, he has commission income of \$26,140. During 2016, his employer withholds the following amounts from his earnings:

Registered Pension Plan Contributions	\$4,200
Canada Pension Plan Contributions	2,544
Employment Insurance Premiums	955
Donations To United Way	1,200
Union Dues	260
Payments For Personal Use Of Company Car	600
Contributions To Company's Disability Plan	1,200

#### Other Information:

- Mr. Arnold's employer makes a matching \$4,200 contribution to the company's RPP on behalf of Mr. Arnold.
- Mr. Arnold's employer makes a matching \$1,200 contribution to the company's disability plan on behalf of Mr. Arnold. The comprehensive disability plan provides periodic benefits during any period of disability to compensate for lost employment income. Due to a two month sick leave, Mr. Arnold receives disability benefits of \$10,950. Mr. Arnold has been making a \$1,200 contribution each year since 2013. He has had no benefit claims in the years 2013 through 2015.
- Mr. Arnold's employer provides him with a car that was purchased in 2013 for \$38,000. His employer pays all of the operating costs which, during 2016 totalled \$9,800. During the year, Mr. Arnold drove the car a total of 48,000 kilometers, 42,000 of which were for employment related travel. During Mr. Arnold's two month sick leave, he was required to return the car to the company garage.

- Medical expenses for Mr. Arnold's family are as follows:

Allen	\$3,650
Brenda	2,600
Sarah	1,300
Derek	6,200

- Mr. Arnold is required to maintain an office in his home without reimbursement from his employer. His employer provides the required T2200 form. He uses 20 percent of the home's floor space for his office. The costs for his home are as follows:

Utilities And Maintenance	\$ 5,000
Insurance	4,500
Property Taxes	7,600
Mortgage Interest	9,600

- Mr. Arnold receives a travel allowance of \$4,800 per year to cover his hotel costs. His actual hotel costs for 2016 were \$5,100. In addition, he spent \$6,300 on client meals and entertainment. His employer does not reimburse any of these costs.

7. As with all of the other employees, Mr. Arnold received a \$750 gift certificate for use at a local department store. He also received a \$300 cash reward for his sales performance.
8. In addition to his employment income, Mr. Arnold has taxable capital gains from stock market trading of \$4,500, a net rental loss of \$6,000 from a residential rental property, and \$8,600 in net business income from selling used items on his website.
9. Mr. Arnold supports the church that he attends with donations of \$200 per month throughout 2016. He is not eligible for the first-time donor's super credit.
10. In 2015, Mr. Arnold's Net Income For Tax Purposes was \$98,000. This was made up of net employment income of \$93,000 (after the deduction of \$4,000 in RPP contributions), interest income of \$3,000, a net rental loss of \$7,000, and net business income of \$9,000.
11. At the end of 2015, Mr. Arnold's Unused RRSP Deduction Room was \$6,200 and he had no undeducted contributions. His employer reported that he had a 2015 Pension Adjustment of \$8,000.

**Required:** Ignore GST/HST considerations.

- A. Calculate Mr. Arnold's maximum deductible RRSP contribution for 2016.
- B. Assume that Mr. Arnold contributes the amount calculated in Part A to his RRSP. Calculate Mr. Arnold's 2016 minimum:
  - Net Income For Tax Purposes,
  - Taxable Income, and
  - Federal Tax Payable before consideration of any income tax that would have been withheld or paid in instalments.

## TIF PROBLEM TEN - 16

### Comprehensive Case (Chapters 1 to 10)

Mr. Sali is 42 years of age and lives in Calgary, Alberta, a province that does not have a provincial sales tax. He has never been married and has no dependants.

During the year ending December 31, 2016, Mr. Ron Sali earned a gross salary of \$76,000. In addition, he has commission income of \$2,800. His employer withheld the following amounts from his salary:

Canada Pension Plan Contributions	\$2,544
Employment Insurance Premiums	955
Registered Pension Plan Contributions	3,500
Parking Fees - Company Garage	480
Donations To United Way	800
Union Dues	360

#### Other Information:

- Mr. Sali is a member of his employer's money purchase RPP. His employer made a contribution on his behalf that was equal to the \$3,500 contribution that was withheld from his salary.
- Mr. Sali's employer provides him with a car that is leased for \$642 per month. Mr. Sali drives the car a total of 38,000 kilometers during the year, 24,000 kilometers of which were for employment related purposes. The car was used by Mr. Sali for the entire year, with the exception of the one month that he was away from the business on sick leave. During this one month period, he was required to return the car to the company garage.
- Mr. Sali is required to maintain an office in his home without reimbursement from his employer. His employer provides the required T2200 form. Based on the portion of the house used for this office, the related costs are as follows:

Utilities And Maintenance	\$ 600
Insurance	900
Property Taxes	1,200
Mortgage Interest	1,800

- Mr. Sali's employer reimburses him for all airline tickets and meals and a portion of his lodging costs. Mr. Sali is required by his employer to pay the remainder of his employment related travel costs. During 2016, this remainder amounted to \$3,700.
- Mr. Sali has accumulated a large number of Aeroplan frequent flyer miles as a result of travel that he has done for his employer. During 2016, he uses these miles to acquire two airline tickets. The first is a round trip to Miami which he uses for a short vacation. The economy fare to Miami is \$625. The second ticket is a round trip to Edmonton to deal with one of his employer's clients. The economy fare to Edmonton is \$575.
- During 2016, in addition to his employment income, Mr. Sali had taxable capital gains from stock market trading of \$6,200, a net rental loss of \$3,900, and a self-employed business loss of \$2,600. He also received eligible dividends of \$2,500.
- Due to his illness during his sick leave, Mr. Sali has medical expenses totalling \$16,250 in 2016. His medical plan covers 80 percent of all of his medical expenses and he receives the reimbursement during 2016.
- In addition to the \$800 in United Way donations that were deducted by his employer, Mr. Sali makes contributions to other registered charities of \$1,400. He is not eligible for the first-time donor's super credit.

9. In 2015, his Net Income For Tax Purposes was \$71,000. This was made up of net employment income of \$77,000 (after the deduction of \$3,200 in RPP contributions), grossed up dividend income of \$8,000, a net rental loss of \$9,000, and a net business loss of \$5,000.
10. At the end of 2015, Mr. Sali's Unused RRSP Deduction Room was \$3,400 and he had no undeducted RRSP contributions. His employer reported that he had a 2015 Pension Adjustment of \$6,400.

**Required:** Ignore GST considerations.

- A. Calculate Mr. Sali's maximum deductible RRSP contribution for 2016.
- B. Assume that Mr. Sali contributes the amount calculated in Part A to his RRSP. Calculate Mr. Sali's 2016 minimum:
  - Net Income For Tax Purposes,
  - Taxable Income, and
  - federal Tax Payable before consideration of any income tax that would have been withheld or paid in instalments.