1.

TB 01-01 Which of the following is not considered to be a s...
Which of the following is not considered to be a separate entity for tax purposes in Canada?

- Individuals
- → Proprietorships
- Corporations
- Trusts

Multiple Choice	*TB 01-01 Which of the following is not considered to be a s...*

2.

TB 01-02 Which of the following attitudes and actions will ...
Which of the following attitudes and actions will help decision-makers develop an efficient approach to taxation?

- Cash flows should be considered from a before-tax perspective when making decisions.
- Functional managers should not be held responsible for the tax effects of decisions within their divisions.
- → Tax costs to a business should be regarded as controllable expenses, much like product costs and selling costs.
- All managers should own a copy of the Income Tax Act.

Multiple Choice	*TB 01-02 Which of the following attitudes and actions will ...*

3.

TB 01-03 Which of the following statements is true?
Which of the following statements is true?

- Payment of the return on equity is deductible by the corporation and is a form of property income for the individual.
- Payment of the return on equity is deductible by the corporation and is a form of business income for the individual.
- Payment of the return on equity is not deductible by the corporation and is a form of business income for the individual.
- → Payment of the return on equity is not deductible by the corporation and is a form of property income for the individual.

Multiple Choice	*TB 01-03 Which of the following statements is true?*

4.

TB 01-04 When assessing the value of a corporation, the mos...
When assessing the value of a corporation, the most relevant information that decision-makers normally consider is

- the potential for before-tax profits.
- → the potential for after-tax profits.
- the current rate of corporate tax.
- cash flow before-tax.

Multiple Choice	*TB 01-04 When assessing the value of a corporation, the mos...*

5.

TB 01-05 Income tax is calculated for which of the followin...
Income tax is calculated for which of the following jurisdictional groups?

- Municipal, provincial, and federal
- Municipal, federal, and international
- → Provincial, federal, and international
- Municipal, provincial, and international

Multiple Choice	*TB 01-05 Income tax is calculated for which of the followin...*

6.

TB 01-06 Two investor corporations may not enter jointly in...
Two investor corporations may *not* enter jointly into which of the following?

- Joint venture
- Partnership
- Separate corporation
- → Proprietorship

Multiple Choice	*TB 01-06 Two investor corporations may not enter jointly in...*

7.

TB 01-07 Which of the following statements is false?
Which of the following statements is false?

- Cash flow should be calculated on an after-tax basis.
- → The tax cost to a business should not be regarded as a cost of doing business.
- Income tax should be considered a controllable cost.
- The value of an enterprise should not be based on pre-tax cash flow.

Multiple Choice	*TB 01-07 Which of the following statements is false?*

8.

TB 01-08 The text book lists four fundamental tax variables...
The text book lists four fundamental tax variables that a manager needs to consider when making business decisions. These variables are: 1) primary types of income; 2) entities subject to taxation on income; 3) alternative forms of business and investing structures used by taxable entities structure; and 4) tax jurisdictions. List the relevant variables within these four categories.

Income: Business, Property, Employment, Capital Gains
Entities: Individuals, Corporations, Trusts
Forms of business: Proprietorship, Corporation, Partnership, Limited Partnership, Joint Venture, Income Trusts
Tax Jurisdictions: Provincial, Federal, Foreign

Short Answer	*TB 01-08 The text book lists four fundamental tax variables...*

9.

TB 01-09 ABC Corporation is in a 25% income tax bracket. Jo...
ABC Corporation is in a 25% income tax bracket. John Adams is an employee at ABC. He is in a 40% tax bracket. The company has offered John a 10% pay raise. His current salary is $50,000.

Required:

A) Calculate the after-tax cost of the raise to the corporation.
B) Calculate the after-tax cost of the raise for John.

Show all calculations.

A) Actual cost to ABC: ($50,000 × 10%) × (1 - .25) = $3,750
B) Actual value for John: ($50,000 × 10%) × (1 - .4) = $3,000

Short Answer	*TB 01-09 ABC Corporation is in a 25% income tax bracket. Jo...*

10.

TB 01-10 Explain what is meant by the principle that tax sh...
Explain what is meant by the principle that tax should be treated as a ‘controllable cost'.

Just as decision makers in business must control costs such as product, occupancy, selling, and many others, so should tax costs be regarded as controllable. The actions and activities of the organization must be analyzed at all levels, and across departments, to determine the impact on the overall tax cost.

Short Answer	*TB 01-10 Explain what is meant by the principle that tax sh...*

11.

TB 02-01 The manager at Big Company Corporation has decided...
The manager at Big Company Corporation has decided to sell a piece of capital equipment after the company's year-end, in order to avoid paying capital gains tax this year. Which tax planning method has the manager used?

- Transferring income to another entity.
- Converting the nature of income from one type to another.
- → Shifting income from one time period to another.
- This is a form of tax evasion and is not allowed.

Multiple Choice	*TB 02-01 The manager at Big Company Corporation has decided...*

12.

TB 02-02 Which of the following scenarios illustrates a pot...
Which of the following scenarios illustrates a potential tax avoidance scheme?

- Property transferred between arm's-length parties is valued at fair market value.
- Dividends received from shares transferred from a wife to her husband are taxed in the hands of the wife.
- A shareholder owns two corporations and undertakes legal steps in order to permit loss utilization between the two companies.
- → A man transfers property to his child at a value less than fair market value.

Multiple Choice	*TB 02-02 Which of the following scenarios illustrates a pot...*

13.

TB 02-03 The manager of Little Company Ltd. has decided to ...
The manager of Little Company Ltd. has decided to sell a piece of capital equipment after the company's year-end in order to avoid paying tax on capital gains this year. The manager is engaging in

- tax avoidance.
- tax evasion.
- → tax planning.
- GAAR.

Multiple Choice	*TB 02-03 The manager of Little Company Ltd. has decided to ...*

14.

TB 02-04 Certain skills are necessary for successful tax pl...
Certain skills are necessary for successful tax planning. One of these skills is applying the time value of money. Which of the following is FALSE regarding this skill?

- Applying the time value of money is a tool used for wealth accumulation.
- If a taxpayer invests $1,000 at 8% and subsequently earns $48 in after-tax income on the investment at the end of the first year, the taxpayer's tax rate is 40%.
- → If a taxpayer earns an annual return of 12% and is subject to a 40% tax rate, the annual after-tax return is 4.8%.
- If a taxpayer invests $1,000 for one year at a rate of return of 14% and is subject to a 45% tax rate, the compounded after-tax value of the investment will be $1,077.

(12% × [1 - .4]) = 7.2% after-tax return

Multiple Choice	*TB 02-04 Certain skills are necessary for successful tax pl...*

15.

TB 02-05 Which of the following statements regarding GAAR i...
Which of the following statements regarding GAAR is true?

- The purpose of GAAR is to catch tax evaders.
- When an avoidance transaction takes place, the anti-avoidance rule is automatically applied in all circumstances.
- → The Canada Revenue Agency states that "A transaction will not be an avoidance transaction if the taxpayer establishes that it is undertaken primarily for bona fide business, investment or family purposes."
- GAAR can correctly be defined as "Organizing one's affairs in a manner that results in paying the least amount of tax possible."

Multiple Choice	*TB 02-05 Which of the following statements regarding GAAR i...*

16.

TB 02-06 Steven James earned $150,000 this year in profits ...

Steven James earned $150,000 this year in profits from his proprietorship, which placed him in a 45% tax bracket. The rate of tax for Canadian-controlled private corporations in his province is 15% on the first $500,000 of income. Personal tax rates (federal plus provincial) in James' province are:

On the first $44,000	24%
On the next $44,000	32%
On the next $48,000	40%
On income over $136,000	45%

(*All rates are assumed for this question.*)

Steven requires $3,000 of after-tax withdrawals per month for his personal living expenses. All remaining profits are used to pay taxes and to expand the business. Steven expects the same profits before living expenses next year.

Steven is considering incorporating his business next year. If he incorporates, he will pay himself a gross salary of $48,000.

Required:

Determine the increase in Steven's cash flow if he incorporates his company? Show all calculations.

A. Why will Steve set his new salary at $48,000?
B. Name the type of tax planning that Steve would be engaging in if he incorporated his company.

A) Excess cash as a proprietorship:

Profits	$150,000
Tax: 24% × 44,000 $10,560 32% × 44,000 14,080 40% × 48,000 19,200 45% × 14,000 6,300 (Assumed federal plus provincial rates)	(50,140)
	$ 99,860
Living expenses	(36,000)
Available for expansion	$ 63,860

Excess cash as a corporation:

Profits	$150,000
Salary	(48,000)
Corporate business profits	102,000
Tax: 15% × 102,000	(15,300)
Available for expansion	$86,700
Excess cash ($86,700 - $63,860)	$22,840

B) A $48,000 salary from the corporation will result in $36,120 of after-tax income, similar to his current withdrawals from the proprietorship.

[($44,000 × .76) + (4,000 × .68)] = $36,120
C) Transferring income to another entity

Short Answer	*TB 02-06 Steven James earned $150,000 this year in profits ...*

17.

TB 02-07 Part A: List the three key factors of cash flow.Pa...

Part A: List the three key factors of cash flow.
Part B: List the six skills required for tax planning as suggested in the textbook.

Three key factors of cash flow

1. Amount of money coming in
2. Amount of money going out
3. Timing

Six skills required for tax planning

1. Anticipation
2. Flexibility
3. Speculation
4. Applying the 8^{th} Wonder of the World
5. Perspective
6. Global approach

Short Answer	*TB 02-07 Part A: List the three key factors of cash flow.Pa...*

18.

TB 02-08 Andrew has $10,000 to invest. He wants to put his ...

Andrew has $10,000 to invest. He wants to put his money into an investment earning an annual interest rate of 12%. Andrew is in a 42% tax bracket.

Required:

a) Calculate the value of Andrew's investment, after-tax, at the end of the year.
b) Calculate the amount of taxes Andrew will have to pay on his investment.

a) ($10,000 × 1.12) × (1 - .42) = $10,696
b) $10,000 × .12 × .42 = $504

Short Answer	*TB 02-08 Andrew has $10,000 to invest. He wants to put his ...*

19.

TB 02-09 Match each of the following terms with the most ac...
Match each of the following terms with the most accurate example. Use each example only once.

TERMS:
Tax evasion
Tax planning
Tax avoidance

EXAMPLES:

A. An individual is seeking a beneficial outcome, and therefore, applies an application that is not specifically prohibited by law.
B. A business is seeking a beneficial outcome, and therefore, does not report a portion of revenue earned during the year.
C. Two unrelated companies take steps to become related in order to shift income from the profitable business to the company with losses.

An individual is seeking a beneficial outcome, and therefore, applies an application that is not specifically prohibited by law. **Tax planning**
A business is seeking a beneficial outcome, and therefore, does not report a portion of revenue earned during the year. **Tax evasion**
Two unrelated companies take steps to become related in order to shift income from the profitable business to the company with losses. **Tax avoidance**

Short Answer	*TB 02-09 Match each of the following terms with the most ac...*

20.

TB 02-10 For each of the examples listed below, state which...
For each of the examples listed below, state which of the following three categories of tax planning has been applied:

1. Shifting income from one time period to another
2. Shifting income from one entity to another
3. Shifting income from one type of income to another.

A. Jack has run a successful proprietorship for the past four years, and has now decided to incorporate his company.
B. Karen has decided not to pay herself a dividend from her corporation, (of which she is the sole shareholder), but has chosen to sell a portion of her shares to an associate instead.
C. XYZ Corporation has chosen to delay the recognition of a discretionary reserve until the following year.

A. Shifting income from one entity to another
B. Shifting income from one type of income to another
C. Shifting income from one time period to another

Short Answer	*TB 02-10 For each of the examples listed below, state which...*

21.

TB 03-01 Joe is a Canadian citizen. In March of 20X1, Joe w...

Joe is a Canadian citizen. In March of 20X1, Joe was transferred to the United States with his company. His wife and child moved with him at that time. Joe chose not to sell his house, and instead, lends it to his family during the winter months when they visit Canada from overseas. Joe has five weeks of vacation each summer, at which time he and his family return to Canada and stay in their house. Joe did not cancel his country club membership in order that he could golf with his friends on his vacations. He did close his bank accounts, however. Which of the following statements is true?

- Joe is a Canadian citizen, and will therefore, automatically be considered a Canadian resident for tax purposes.
- Joe no longer resides in Canada, and will therefore, automatically be considered a non-resident of Canada.
- Joe is considered a part-time resident of Canada for the five weeks he vacations in the country.
- → Joe might be considered to have a continuing state of relationship with Canada.

Multiple Choice	*TB 03-01 Joe is a Canadian citizen. In March of 20X1, Joe w...*

22.

TB 03-02 Of the following individuals, which would not be c...

Of the following individuals, which would *not* be considered a resident of Canada for the entire 20XX taxation year?

- John had lived in Canada all of his life, prior to moving to Germany in 20XX, where he was assigned to a seven-month assignment to set up the international operations for his Canadian employer. He did not sell his home on Vancouver Island, as his wife and children remained in Canada for work and schooling reasons.
- Marie is a Swiss citizen who lived in Canada from February to October of 20XX. While in Canada, she joined the local fitness club, gained part-time employment, and opened an account in a Canadian bank.
- → Prasham is a citizen of India, where he lived his entire life prior to moving to Canada on April 30th, 20XX. Upon arriving in Canada, he began full-time work and purchased a home.
- June moved to Canada three years ago from the United States, and has maintained her American citizenship.

Multiple Choice	*TB 03-02 Of the following individuals, which would not be c...*

23.

TB 03-03 Segment A of the aggregate formula includes which ...

Segment A of the aggregate formula includes which of the following?

- Income from employment, income from property, and income from capital transactions.
- Income from employment, income from property, income from business, and income from capital transactions.
- Income from business, 'other' income, and income from capital transactions.
- → Income from employment, income from property, income from business, and ‘other' income.

Multiple Choice	*TB 03-03 Segment A of the aggregate formula includes which ...*

24.

TB 03-04 Which of the following type of payment is NOT subj...
Which of the following type of payment is NOT subject to Canadian withholding tax when paid to a non-resident?

- Dividends
- → Interest paid to an arm's length party
- Pension benefits
- Registered retirement income fund payments

Multiple Choice	*TB 03-04 Which of the following type of payment is NOT subj...*

25.

TB 03-05 Regarding taxation years, which of the following s...
Regarding taxation years, which of the following statements is TRUE?

- Corporate taxpayers must use the calendar year as their taxation year.
- The taxation year for an individual taxpayer ends on April 30^{th}.
- An individual taxpayer can choose any twelve month period as their taxation year.
- → A corporation may have a taxation year less than twelve months during a year the corporation is formed, dissolved, or is granted a change in its year end.

Multiple Choice	*TB 03-05 Regarding taxation years, which of the following s...*

TB 03-06 Your neighbor, Mrs. White, has heard that you are ...

Your neighbor, Mrs. White, has heard that you are studying personal tax. She has come to you with her financial information for 20XX. In 20XX, Mrs. White had employment income of $40,000, property income of $3,000, a business loss of $22,000, an allowable business investment loss of $5,000, income from an RRSP withdrawal of $2,000, and a capital loss of $40,000 on the sale of shares in a public corporation.

Mrs. White hopes that her losses will result in a net income for tax purposes of $0.

Required:

A) Determine Mrs. White's net income for tax purposes in accordance with the aggregating formula.
B) Based on your answer in Part A, explain to Mrs. White why she will or will not have a tax liability this year.
C) How would your answer change in Part A if Mrs. White realized a taxable capital gain of $30,000 in 20XX?

A)

Segment A:	$40,000
	3,000
	2,000
Segment B:	0
Segment C:	0
Segment D:	(22,000)
	(5,000)
Net Income for Tax Purposes:	$18,000

B) Mrs. White does not have a $0 balance for tax purposes as she is unable to use the capital loss since she had no capital gains in the year.
C) If Mrs. White had realized a taxable capital gain of $30,000 in 20XX she would have been able to apply the allowable capital loss of $20,000 ($40,000 × .5). This would add $10,000 to her income, resulting in $28,000 in net income for tax purposes.

Short Answer	*TB 03-06 Your neighbor, Mrs. White, has heard that you are ...*

27.

TB 03-07 George and Gina Anderson, (Canadian citizens), mov...

George and Gina Anderson, (Canadian citizens), moved to Europe on August 15th, 20X1 to open a café in a small Italian village. The restaurant was called 'Gina's Italian Eatery Inc.'. Prior to moving, George earned $65,000 in 20X1 as a computer programmer and Susan earned $67,000 in 20X1 as a registered nurse. They are both in their 60s and plan to retire in Italy, which is Gina's birthplace. They were able to sell their home in time to invest the proceeds prior to leaving for Europe. As they only expect to return to Canada every second year, they cancelled their bank accounts and driver's licenses. Their café was successful in 20X1 and earned a pre-tax profit of $25,000 by year's end.

Required:

Determine the residency status of George and Gina and their café for Canadian tax purposes in 20X1 and discuss the Canadian tax treatment, if any, of their personal and business income.

George and Gina would be considered 'part-time' residents (or 'residents until August 15th') since they severed their ties with Canada prior to leaving. When filing their Canadian tax returns, they would only be liable for tax on their *Canadian* earnings in 20X1.

The café is not a Canadian resident. It was not incorporated in Canada, and its central management and control is not exercised from within Canada. Therefore, the café is not required to file a Canadian tax return. The income would be subject to Italian tax laws.

Short Answer	*TB 03-07 George and Gina Anderson, (Canadian citizens), mov...*

28.

TB 03-08 Allison Hill moved to Canada on April 30th of this...

Allison Hill moved to Canada on April 30th of this year. She was born and raised in Belgium, and moved to Canada to start a career in architecture. She earned $45,000 from May to December of this year from her new employer. Prior to leaving Belgium, Allison earned $10,000 of employment income. She also received $1,000 in dividends in March and $1,000 in dividends in September from stocks in a European corporation. Allison's parents sent her a cheque for $2,000 as a gift for her 25th birthday in August.

Required:

Determine Allison's residency status for Canadian tax purposes for the current year. How much income is Allison required to report on her T1 tax return? Explain why any items have not been included in your calculations.

'Part-time resident' or 'Resident as of April 30th'
$45,000 + $1,000 = $46,000

The following items have been omitted:

- Income from employer in Belgium prior to Allison becoming a Canadian resident
- Dividends received prior to becoming a Canadian resident
- Birthday gift from parents is not taxable

Short Answer	*TB 03-08 Allison Hill moved to Canada on April 30th of this...*

TB 03-09 Answer the following questions which pertain to th...
Answer the following questions which pertain to the administration of the Canadian Income Tax system.

1. Individuals (who do not carry on a business) must file an income tax return for the most recent calendar year by what date?
2. Individuals who carry on an unincorporated business must file an income tax return for the most recent calendar year by what date?
3. Who is responsible for the filing of a deceased taxpayer's tax return?
4. What is the taxation year for an inter vivos trust?
5. What is the taxation year for a testamentary trust?
6. A trust must file an income tax return within how many days of its taxation year-end?
7. What is the taxation year for a corporation (other than a professional corporation)?
8. A corporation is required to file an income tax return within how many months of its taxation year-end?

1. April 30
2. June 15
3. The deceased's legal representative
4. The calendar year
5. A chosen fiscal period
6. 90 days
7. A chosen fiscal period, not exceeding 53 weeks
8. 6 months

Short Answer	*TB 03-09 Answer the following questions which pertain to th...*

30.

TB 03-10 ABC Corporation purchased inventory from Galaxy Wh...
ABC Corporation purchased inventory from Galaxy Wholesalers. The cost on the invoice was $25,000. The inventory was marked up by 35% and sold to a retailer. The retailer subsequently marked the goods up 45% and sold the products to its consumers. (Pre-GST costs were used to calculate marked up prices.)

Required:

Calculate how much GST was collected and remitted by both the wholesaler and the retailer.

Wholesaler:			
Sale price to retailer	$33,750 ($25,000 × 1.35)	× 5% =	$1,687.50
Cost from manufacturer	(25,000)	× 5% =	(1,250.00)
Gain	$ 8,750		437.50
Remitted to CRA			437.50
GST cost			-0-
Retailer:			
Sale price to consumer	$48,937.50 ($33,750 × 1.45)	× 5% =	$2446.88
Cost from wholesaler	(33,750)	× 5% =	(1,687.50)
Gain	$15,187.50		$ 759.38
Remitted to CRA			759.38
GST cost			-0-

Short Answer	*TB 03-10 ABC Corporation purchased inventory from Galaxy Wh...*

31.

TB 04-01 Susan was provided with a company car to drive dur...
Susan was provided with a company car to drive during March to December of the current year. The car cost the company $22,000 plus GST and PST totalling 11%. Susan drove the car a total of 15,000 kilometres during the year. 11,000 kilometres were for business purposes and the other 4,000 kilometres were for personal use. Susan's employer pays for all of the vehicle's operating costs which totaled $1,100. What is the minimum amount that Susan can report as her *total* taxable benefit for the use of the car during the year? (Round your answer.)

- $1,172
- → $1,758
- $2,252
- $5,964

Standby Charge: [($22,000 × 1.11) × .02 × 10] × 4,000/(1,667 × 10) = 1,172
Operating Benefit: Lessor of: 4,000 × .27 = 1,080 and 1,172 × .5 = 586
1,172 + 586 = 1,758

Multiple Choice	*TB 04-01 Susan was provided with a company car to drive dur...*

32.

TB 04-02 Which of the following factors are used by the cou...
Which of the following factors are used by the courts in order to determine a taxpayer's status as an employee or a self-employed contractor?

- control test, ownership of tools test, chance of lawsuit, integration test
- control test, employer test, chance of lawsuit, integration test
- → control test, ownership of tools test, chance of profit and loss, integration test
- control test, employer test, chance of profit and loss, integration test

Multiple Choice	*TB 04-02 Which of the following factors are used by the cou...*

33.

TB 04-03 Cindy works for Sky Manufacturers, a public corpor...
Cindy works for Sky Manufacturers, a public corporation. In 20X1 she was offered an option to purchase shares at $15 per share from her employer. The fair market value on that day was $17 per share. The option had a four year exercise time-limit. Cindy exercised her option in 20X3 and purchased 500 shares. The fair market value at that time was $21 per share. What is Cindy's tax treatment of this option in the year 20X3?

- $1,000 taxable benefit
- $2,000 taxable benefit
- → $3,000 taxable benefit
- Not taxable until the shares are sold.

500 × ($21 - $15) = $3,000. The benefit is taxable in the year she exercises her option.

Multiple Choice	*TB 04-03 Cindy works for Sky Manufacturers, a public corpor...*

34.

TB 04-04 Which of the following, when provided by an employ...
Which of the following, when provided by an employer, is NOT a tax-deferred or tax-free benefit for the employee?

- Premiums for private health care plans.
- Counselling services to prepare the employee for retirement.
- Contributions to the employee's registered pension plan.
- → A near-cash gift for the employee's wedding.

Multiple Choice	*TB 04-04 Which of the following, when provided by an employ...*

35.

TB 04-05 Sarah borrowed $25,000 from her employer at a rate...

Sarah borrowed $25,000 from her employer at a rate of 1% interest. At the time the loan was made, the CRA's prescribed rate of interest was 3%. Sarah is in a 40% income tax bracket. What is the actual cost (rate) of Sarah's loan? (Assume there are no fluctuations in the prescribed rate of interest.)

- 1%
- 1.2%
- → 1.8%
- 2%

Prescribed interest	$750 ($25,000 × 3%)
Actual interest paid	250 ($25,000 × 1%)
Benefit	$500
Tax cost	$200 ($500 × 40%)
Actual interest	$250
Tax cost	200
Total cost	$450
Effective rate	1.8% (450/25,000)

Multiple Choice	*TB 04-05 Sarah borrowed $25,000 from her employer at a rate...*

TB 04-06 Simon Stevens is a high school history teacher. Si...

Simon Stevens is a high school history teacher. Simon is a national expert in ancient Mayan ruins. In July of 20X1, he was hired by the local university to teach an elective course in ancient Mayan history. Simon then conducted a field trip of the ruins in Guatemala with some of the local students from July 27th to August 7th. He recruited another local expert to teach his last class that fell during the dates of the trip.

Simon earned $55,000 from his teaching job. He negotiated a contract price of $5,000 to teach the university elective and $7,000 to conduct the tour. The university provided Simon with office space during the month of July. He used his laptop computer to prepare his lectures and the tour material. Additionally, Simon used his extensive collection of books to prepare his notes. He was not provided any benefits or insurance by the university. Simon was paid on July 31st and August 31st.

Simon is not sure how to prepare his tax return. He has a number of expenses from his university job, and wants to know if he can use them to reduce his taxes payable.

Required:

Determine the tax treatment of Simon's income for 20X1. Apply the four tests within the guidelines used by the courts to determine whether a taxpayer is an employee or an independent contractor.

Based on the facts of Laura J. Foley (Appellant) v. Her Majesty the Queen (Respondent), 2006 DTC 2281)

Control test:

Arguments for Employee: The university sets the courses to be offered; university enrols students
Arguments for Independent Contractor: Simon prepares his lectures, unsupervised. He conducts the tours of the ruins without any assistance. He is allowed to hire a fellow expert to teach one of his classes.

Ownership of Tools:

Arguments for Employee: Classroom and office space provided by the university.
Arguments for Independent Contractor: Collection of books; laptop computer; background experience; knowledge; and ability to lecture.

Chance of Profit and Risk of Loss:

Argument for Employee: Salary paid by university
Arguments for Independent Contractor: Contract price was negotiated; ability to turn down contracts; lack of benefits and insurance

Integration:

Argument for Employee: Course offered by the university
Arguments for Independent Contractor: Course is an elective and not integral to the university's curriculum; tour is an option for students

Based on the facts of Foley vs. the Queen, Simon may very well be able to claim his university earnings as self-employed earnings and deduct some of the expenses. His teaching salary would fall under 'employee earnings'.

Short Answer	*TB 04-06 Simon Stevens is a high school history teacher. Si...*

TB 04-07 Kate Bell was employed by The Tea Shop (a Canadian...

Kate Bell was employed by The Tea Shop (a Canadian controlled private corporation) from January to December of 20X4. She earned a gross salary of $72,000.

She had the following deductions from her pay during the year:

Income tax	$15,000
Canada Pension Plan	2,426
Employment Insurance	914
Registered Pension Plan contribution	3,000

The following amounts were paid by The Tea Shop in 20X4 on Kate's behalf:

Canada Pension Plan	$2,426
Employment Insurance	1,280
Registered Pension Plan	3,000
Premiums for a private health plan	800
Group life insurance	1,000

Additional information:

On January 15, 20X2, Kate was given an option to purchase 500 shares of The Tea Shop for $5.00 per share. The market value of the shares on that date was $5.50. Kate exercised her option on June 1, 20X3 when the shares were valued at $7.00. She then sold the shares on March 17, 20X4 when the market value was $8.00 per share.

Kate pays $50 a month for her cell phone which she uses to keep in touch with friends and family. She also pays $80 a month to dry-clean her suits, and she purchases a new suit for $200 every three months. She also accumulated 800 frequent flyer points from her business travels, which she used to fly to see her mother during the summer. (Kate's employer does not control Kate's point plan.)

Kate purchased a $1,000 RRSP during the year.

Required:

A) Calculate Kate's net income for tax purposes in 20X4 using the aggregating formula. Assume that Kate defers tax whenever possible. Identify items that have been omitted in your calculations.
B) Will Kate be able to deduct the *stock option deduction* to arrive at her taxable income? Why or why not?

A)

Segment A:	
Additions to Employment Income: Remuneration:	
S5(1) Salary	$72,000
Benefits:	
S6(1)(a), S6(4) Life insurance premium	1,000
S7(1) Stock option benefit (500 × $7) – (500 × $5)	1,000
Deductions from Employment Income:	
S.8(1)(m) Registered pension plan contributions	(3,000)
Segment B:	
Capital gain	
Proceeds of sale $4,000 Less: Cost of shares plus taxable benefit (3,500) Capital Gain $ 500	
Taxable Capital Gain (50%)	250
(May be eligible for Capital Gains Exemption if conditions are met– beyond scope of chapter, therefore CGE is excluded here.)	
Segment C: RRSP Contribution	0 (1,000)
Segment D:	0
Net Income for Tax Purposes	$70,250

Omitted items:

Employer's portion of CPP, EI
Income tax deducted
Employer's contribution to RPP - specifically exempt

Kate's CPP, EI - deduction not allowed, eligible for tax credit
Cell phone, dry-cleaning, suits - not deductible - personal expenses

Frequent flyer points - controlled by Kate

B) The shares are from a Canadian controlled private corporation. Therefore, Kate either has to hold the shares for two years after acquisition, or the option price must be equal to or greater than the fair market value at the option date. Neither of these requirements has been met. Therefore, Kate will not be able to deduct the *stock option deduction* in arriving at her taxable income.

Short Answer	*TB 04-07 Kate Bell was employed by The Tea Shop (a Canadian...*

TB 04-08 An individual has the option to receive a $1000 an...

An individual has the option to receive a $1000 annual bonus and invest the after-tax amount for 25 years, or receive $1000 per annum in a registered pension plan for the next 25 years. Assuming a constant rate of return of 8% and a tax rate of 40%, what will be the total after-tax difference between the two plans? Show all of your work.

Salary	
Salary	$1000
Tax (40%)	(400)
Available for investment	$600
Net accumulated funds compounded for 25 years at 4.8% after-tax (8% - 40% tax = 4.8%)	$27,859 (Ordinary annuity)
	$29,196 (Annuity due)
RPP	
RPP	$1000
Compounded for 25 years at 8%	
(Ordinary annuity)	$ 73,106
Tax (40%)	(29,242)
Net accumulated funds	$ 43,864
(Annuity due)	$ 78,954
Tax (40%)	$(31,582)
Net accumulated funds	$ 47,372

The RPP nets an increase of $16,005 under the ordinary annuity method, and $18,176 with the annuity due method.

Short Answer	*TB 04-08 An individual has the option to receive a $1000 an...*

TB 04-09 Steven is employed by Big Rigs Inc., a Canadian co...
Steven is employed by Big Rigs Inc., a Canadian controlled private corporation. Steven earned $85,000 in 20X1. During the year, the following occurred:

1. A cash bonus of $8,000 was announced on December 3rd, to be paid to Steven on January 10th of the following year.
2. Steven was provided with a company car which he drove all year. The cost of the car (including taxes) was $42,000. All operating costs were paid by the employer. Steven drove the car 21,000 kilometres in 20X1, of which 10,000 kilometres were for personal use.
3. Big Rigs contributed $5,000 towards Steven's registered pension plan.
4. Steven contributed $5,000 towards his registered pension plan.
5. Steven was presented with a watch valued at $200 on his birthday.
6. The company provided Steven with a $200 cell phone to be used for business purposes.
7. In January of 20X1, Big Rigs loaned Steven $30,000 at a rate of 1% interest, to be used towards the purchase of his home. The CRA's prescribed rate of interest at the time was 3%. By the end of 20X1, the prescribed rate of interest was 2%.
8. In January, Steven was offered a stock option to purchase 2000 shares in Big Rigs at a cost of $8.00 per share. At that time, the fair market value per share was $9.00. Steven exercised his option in February when the market value had risen to $9.50 per share. At the end of the year, Steven had not sold any of the shares, and he was hoping to purchase more shares in the company in the upcoming year.
9. Big Rigs provided Steven with a $25 meal allowance every week due to the two hours of overtime that he was required to work each Wednesday immediately following his eight hours of regular work.

Steven's annual union dues totalled $850, which was deducted from his pay.

Required:

Calculate Steven's minimum employment income for tax purposes, deferring taxes wherever possible. Explain why any items have been omitted in your calculations.

Remuneration S5(1)	$85,000
Standby charge S6(1)(e)	5,040*
Operating charge S6(1)(k)	2,520**
Interest benefit S6(9)	300***
RPP (employee contribution) S8(1)(m)	(5,000)
Annual union dues S8(1)(j)	(850)
Employment income for tax purposes	$87,010

*($42,000 × 2% × 12) × 10,000/(1667 × 12) = $5,040
**Lessor of: a) .27 × 10,000 kms = $2,700 and b) $5,040 × .5 = $2,520
***$30,000 × (.02 - .01) (This is a housing loan; therefore, the lower prescribed rate may be used.)

Omitted items:

Cash bonus - received in the following year; therefore not taxable in current year
RPP - employer contribution is a deferred benefit
Watch - non-cash gift within non-taxable limit
Cell phone - used for work, therefore, not taxable
Stock option - CCPC shares, therefore, the benefit may be deferred until the year of sale.
Meal allowance for "infrequent" overtime of two hours worked immediately following his scheduled shift

Short Answer	*TB 04-09 Steven is employed by Big Rigs Inc., a Canadian co...*

TB 04-10 Andy worked for High Speed Bikes Inc. from March 1...

Andy worked for High Speed Bikes Inc. from March 1st - December 31st during 20X1. He earned a monthly salary of $4,000 plus 1% commission on all of his sales. During 20X1, Andy's sales totalled $800,000. Andy was required to pay for his employment expenses. He traveled out of town most days in order to sell to customers in surrounding towns. He received an allowance of $500 per month to cover his traveling costs. Andy and his employer each contributed $2,000 to the company's registered pension plan.

Andy provided you with the following receipts for 20X1:

Gasoline receipts related to employment	$5,200
Meals with clients	3,200
Purchase of a laptop	1,000
Advertising costs	800
Phone call charges for business	1,200
Consumable supplies for work	500
Membership to a local golf club	8,000

Andy purchased a new vehicle for work, and drove it a total of 25,000 kms while employed at High Speed Bikes. 12,000 of these kms were for business. The vehicle cost Andy $32,000 plus GST of 5% and PST of 5%. Work-related interest payments on the car loan totaled $200 per month.

Required:

Calculate Andy's employment income for 20X1.

Remuneration S5(1)		$40,000 (10 months × $4,000)
Commissions S5(1)		8,000 ($800,000 × .01)
Travel allowance (considered to be unreasonable:		
$500 × 10 = $5,000) S6(1)(b)(v)		5,000
Less: RPP contribution S8(1)(m)		(2,000)
Less limited expenses S8(1)(f)		
Gasoline (work related)	$5,200	
Meals ($3,200 × .5)	1,600	
Advertising costs	800	
Phone charges	1,200	
Consumable supplies	500	
Total	$ 9,300	(8,000) (Limited to commissions)
Non-limited expenses		
Capital cost allowance S8(1)(j)		
$30,000 × 1.1 × .3 × .5 × 12/25	(2,376)	
Work-related interest on loan ($200 × 10)	(2,000)	
		(4,376)
Employment income		$38,624

Short Answer	*TB 04-10 Andy worked for High Speed Bikes Inc. from March 1...*

41.

TB 05-01 TriStar Industries was recently denied the deducti...
TriStar Industries was recently denied the deduction of the life insurance premiums on the life insurance policies of their key executives on its most recent tax return. Which of the following general limitations to business profit determination best describes the reason for the Canada Revenue Agency's decision?

→ exempt-income test
- personal-expense test
- insurance proceeds exemption
- reserve test

Multiple Choice	*TB 05-01 TriStar Industries was recently denied the deducti...*

42.

TB 05-02 Which of the following expenses would be denied as...
Which of the following expenses would be denied as a deduction in the *Income Tax Act*?

- Maintenance fees on a yacht at Yellow Yacht Leasing Inc.

→ Legal and accounting fees incurred during the construction of a building.
- Advertising costs in a non-Canadian newspaper directed at an American market.
- Work space in a home used as a taxpayer's principal place of business.

Multiple Choice	*TB 05-02 Which of the following expenses would be denied as...*

43.

TB 05-03 Sam runs a proprietorship that generated $75,000 i...
Sam runs a proprietorship that generated $75,000 in profits in 20X0. Included in these profits are: a) $10,000 of amortization expense; b) $5,000 bad debt expense; c) $55,000 cost of goods sold; and $8,000 meals and entertainment with clients. Sam's capital cost allowance has been accurately calculated at $8,500 for the year. How much is Sam's business income for tax purposes?

- $73,500
- $75,000

→ $80,500
- $89,000

$75,000 + $10,000 + $4,000 - $8,500 = $80,500

Multiple Choice	*TB 05-03 Sam runs a proprietorship that generated $75,000 i...*

44.

TB 05-04 Joe invested in a piece of land seven years ago wh...
Joe invested in a piece of land seven years ago when real estate prices were rising in his area, and he hoped that the land would double in value within five years. The land remained vacant and was only used in 20X0 when Joe was approached by a businessman to rent the land for two weeks for a local carnival for a fee of $1,000. It is now 20X2 and Joe has been offered a significant sum of money for his land in response to an advertisement he placed in a local newspaper. Based on Joe's primary intention for the land, the gain on the sale would be classified as:

→ business income.
- property income.
- a capital gain.
- exempt income.

Joe's intended use at the time of acquisition was to earn a profit on the value of the land.

Multiple Choice	*TB 05-04 Joe invested in a piece of land seven years ago wh...*

45.

TB 05-05 Which of the following regarding farming income is...
Which of the following regarding farming income is TRUE?

- Farming income must be calculated on an accrual basis.

→ A taxpayer who earns a full-time income as a lawyer recognized a $40,000 loss this year from her recreational farming activities. The maximum deduction allowed this year from the farm loss is $17,500.
- A taxpayer who earns a full-time income as a lawyer recognized a $40,000 loss this year from her recreational farming activities. The maximum deduction allowed this year from the farm loss is $21,250.
- A taxpayer who earns a full-time income as a lawyer recognized a $40,000 loss this year from her recreational farming activities. The maximum deduction allowed this year from the farm loss is $40,000.

$2,500 + ½($40,000 - 2,500) = $21,250 Maximum loss allowed = $17,500.

Multiple Choice	*TB 05-05 Which of the following regarding farming income is...*

46.

TB 05-06 List the six general limitations to business profi...
List the six general limitations to business profit determination and give an example for three of the items.

(One example is given per item, however, students may choose others.)

1. Income-Earning Purpose Test
Example-Expenses for a taxpayer's hobby are not deductible if the taxpayer does not have a reasonable expectation of profit from the hobby.
2. Capital Test
Example-Accumulated amortization for financial accounting purposes is not an allowable deduction as it is on account of capital. However, CCA is allowed, using the prescribed rates of the Income Tax Act.
3. Exempt-Income Test
Example-Premiums on a life insurance policy for a key employee are not deductible since the proceeds are not taxable income.
4. Reserve Test
Example-Warranty expense is not an allowable expense for income tax purposes.
5. Personal-Expense Test
Example-Interest on the mortgage of a principal residence is not an allowable expense as the home is for personal use.
6. Reasonableness Test
Example-$100 per hour paid to a small business owner's child for wages when comparable wages are $10 per hour may very well be deemed to be unreasonable, and therefore, not an allowable expense.

Short Answer	*TB 05-06 List the six general limitations to business profi...*

TB 05-07 Ken Gray runs a small proprietorship (Ken's Fish) ...
Ken Gray runs a small proprietorship (Ken's Fish) that specializes in fishing gear. He has provided you with the following information:

Sales	$150,000
Cost of goods sold*	80,000
Advertising in a local paper	1,000
Advertising in a small American newspaper directed at the Canadians living in that city	2,000
Meals and entertainment	10,000
Property taxes on a vacant piece of land adjacent to the business that earns no income	2,500
Golf course fees for Ken	1,500
Cost of one convention held on a cruise ship in the Mediterranean Sea sponsored by The Canadian Fisherman's Association	2,000

(*All inventory is valued at market value.)

Required:

A) Calculate the net income for tax purposes for Ken's Fish.
B) Explain why any items have been omitted.
C) Briefly discuss how your answer in A) would change if Ken had valued his inventory at cost.

A)

Revenue		$150,000
Cost of goods sold		(80,000)
Advertising		(1,000)
Meals and entertainment		(5,000)
Net income for tax purposes		$ 64,000

B) Omitted items:

• Advertising in an American newspaper is not deductible when the targeted market is Canadian. S.19
• Half of the meals and entertainment are not deductible. S 67.1
• Property taxes on vacant land is only deductible to the extent that income is earned. S.18(2), (3) The amount can be added to the cost base of the land.
• Recreational fees are not permitted as deductions. S.18(1)(l)
• The convention is not within the territorial scope of the organization hosting the conference, therefore, it is not an allowable deduction. S.20(10)

C) The Income Tax Act requires that inventories be valued at either:

1) the lower of cost or market value of each item, or
2) market value of all items of inventory.

Therefore, Ken would need to revalue his inventory in order to determine the lower of cost or market, which could affect the balance of the company's cost of goods sold and net income.

48.

TB 05-08 Alice Smith has provided you with the following in...

Alice Smith has provided you with the following information pertaining to her 20X0 taxes:

• Her dental practice generated $110,000 in income. $35,000 of this income consisted of unbilled work in progress. There was no unbilled work in progress in the prior year. Alice has made a Section 34 election.
• Alice conducted scientific research and experimental development (SR&ED) in 20X0. She met with a CRA agent who verified that $40,000 of her expenditures were qualified SR&ED activities. These costs were treated as capital items on her financial statements.
• Alice raises sheep on her land at her home in the country. She had a farming loss of $9,000 in 20X0.

Required:

Calculate Alice's minimum net income for tax purposes for 20X0.

Business income	$110,000
Less:	
Work in progress (S.34)	(35,000)
Less:	
SR&ED (S.37(1))	(40,000)
Less:	
Farm loss (S.31) *	(5,750)
Net income for tax purposes	$ 29,250

*Restricted to:
$2,500 + ½($9,000 - $2,500) = $5,750

Short Answer	*TB 05-08 Alice Smith has provided you with the following in...*

49.

TB 05-09 Determine whether the transactions concerning the ...

Determine whether the transactions concerning the following assets (shown in italics) would be classified as a) *income from capital* for tax purposes, b) *business income* for tax purposes, or c) neither; and briefly explain the reason for your decision.

	Asset	Income from Capital Property (indicate with an x)	Business Income (indicate with an x)	Neither (indicate with an x)
1.	How should a small business categorize the income from the sale of a *display case* which had been used to showcase its products?			
2.	A contractor constructed a *house* for resale, which was then sold immediately on the market. How should the contractor report this income for tax purposes?			
3.	XYZ Mining Inc. recently upgraded their machinery and purchased a new *fleet of trucks* from LM Trucks Ltd. How should LM report this income for tax purposes?			
4.	Jean's Coffee Shop purchased 100 new *porcelain coffee cups* for customers to use while in the coffee shop. How will these cups be reported for tax purposes?			
5.	George purchased a piece of *land* earlier in the year, which he had solely intended to use for the site of a new hotel. Due to a family situation, however, George had to suddenly relocate to another country, and consequently sold the land to a third party.			

	Asset	Income from Capital Property (indicate with an x)	Business Income (indicate with an x)	Neither
1.	How should a small business categorize the income from the sale of a *display case* which had been used to showcase its products?	x The display case was used to display inventory, thus has a long-term economic benefit and, therefore, can be claimed as a capital asset.		
2.	A contractor constructed a *house* for resale, which was then sold immediately on the market. How should the contractor report this income for tax purposes?		x This is business income for the contractor.	
3.	XYZ Mining Inc. recently upgraded their machinery and purchased a new *fleet of trucks* from LM Trucks Ltd. How should LM report this income for tax purposes?		x This is business income for LM.	
4.	Jean's Coffee Shop purchased 100 new *porcelain coffee cups* for customers to use while in the coffee shop. How will these cups be reported for tax purposes?			x The cups are not being sold by Jean, so there is no income to report. (Note: the cups will be eligible for a capital cost allowance deduction.)
5.	George purchased a piece of *land* earlier in the year, which he had solely intended to use for the site of a new hotel. Due to a family situation, however, George had to suddenly relocate to another country and consequently sold the land to a third party.	x As George's intention was to build a hotel, the land should qualify as a capital asset.		

Short Answer *TB 05-09 Determine whether the transactions concerning the ...*

TB 05-10 KM Ltd. is a Canadian-controlled private corporati...

KM Ltd. is a Canadian-controlled private corporation, operating a small gift store in Vancouver. The company has a December 31st year-end. KM's financial statements reported net income before taxes of $210,000 in 20X0.

Financial information relating to 20X0 is as follows:

Land adjacent to the gift shop was purchased with a bank loan during year for $75,000 to allow for an outdoor sales area during warm weather. Interest expense on the loan for the year was $9,600, and the cost to prepare the loan was $1,000. Both the interest and the preparation costs were expensed by KM.

The company hired a contractor to landscape the land. The $5,000 bill for the landscaping was paid in full during the year and capitalized on the Balance Sheet.
Amortization expense of $21,000 was deducted during the year. CCA of $16,000 was accurately recorded in the tax accounts, but was not transferred to the financial statements.
During the year, a new display case worth $2,000 was expensed on the books.

The following were also expensed during the year:

Meals with clients	$1,400
Snow removal service	$1,000
Golf dues for employees	$5,000
A reasonable reserve for bad debt	$2,000

On December 30th, KM's president announced a bonus to be paid to the company's key employee in the amount of $5,000, which was expensed that day. The employee will receive the bonus in 20X1 in equal payments of $2,500, to be issued on January 30th and July 30th.

Required:

Determine KM Ltd.'s net income for tax purposes for 20X0.

Net income from financial statements	$210,000
Add:	
Amortization 18(1)(b)	21,000
Display cases (capital item)	2,000
Financing costs 20(1)(e) 4/5 × 1,000	800
Meals 67.1	700
Golf club dues 18(1)(l)	5,000
Bonus payment (July 30th) 78(4)	2,500
Subtract:	
Landscaping 20(1)(aa)	(5,000)
CCA 20(1)(a)	(16,000)
Net income for taxation purposes	$221,000

Short Answer *TB 05-10 KM Ltd. is a Canadian-controlled private corporati...*

51.

TB 06-01 Green Gardens Inc. purchased a piece of Class 8 ma...

Green Gardens Inc. purchased a piece of Class 8 machinery in 20X0. The cost of the machine was $5,000. In 20X2, the machine was sold for proceeds of $2,000 and there were no other purchases or disposals during the year. The UCC in the Class 8 pool was $5,500 at the beginning of 20X2. What is the UCC of this class at the end of 20X2?

- $700
- → $2,800
- $3,500
- $4,800

$5,500 - 2,000 = $3,500
3,500 × .2 = 700
3,500 - 700 = 2,800

Multiple Choice	*TB 06-01 Green Gardens Inc. purchased a piece of Class 8 ma...*

52.

TB 06-02 Which of the following statements regarding recapt...

Which of the following statements regarding recapture is true?

- Recapture occurs when there is a positive balance in a class pool and the pool is empty.
- Recapture may be deducted from business income.
- Recapture occurs when there is a positive balance in a class pool, even if there are assets remaining in the class pool.
- → Recapture occurs when there is a negative balance in a class pool, even if there are assets remaining in the class pool.

Multiple Choice	*TB 06-02 Which of the following statements regarding recapt...*

53.

TB 06-03 Ben purchased Miller Co. in 20X1 for $430,000, whi...
Ben purchased Miller Co. in 20X1 for $430,000, which included $35,000 of goodwill. It is now 20X3 and Ben is considering selling Miller Co. which has a current goodwill value of $55,000. What is the balance in the cumulative eligible capital account at the end of 20X2, assuming there are no other intangible assets in the company? (Rounded)

- $1,709
- $2,279
- → $22,704
- $30,272

(20X1)

Addition of Goodwill (75% of $35,000)	$26,250
20X1 amortization (7% × $26,250)	1,837.50
Unamortized balance	$24,412.50

(20X2)

20X2 amortization (7% × 24,412.50)	1,708.88
Unamortized balance	$22,703.62

Multiple Choice	*TB 06-03 Ben purchased Miller Co. in 20X1 for $430,000, whi...*

54.

TB 06-04 Which of the following cases is not eligible for c...
Which of the following cases is not eligible for capital cost allowance in the current year?

- A new engine is installed in a semi-trailer that is used to haul produce to the United States.
- An employee owns and uses an automobile in the course of her employment duties during the month of December. Her pay for December is not received until January of the following year.
- A piece of equipment was purchased during the year on a 5 year financing term.
- → A building under construction is scheduled for completion in eighteen months. The building will be used as a production facility.

Multiple Choice	*TB 06-04 Which of the following cases is not eligible for c...*

55.

TB 06-05 Which of the following situations would not be per...

Which of the following situations would not be permitted to defer the recognition of any recapture that might arise from the disposition of the asset?

- A building that was used for income earning purposes was destroyed in a fire. Insurance proceeds were received which generated recapture. A new building was built one and a half years later.
- A half-ton truck that belonged to a construction company was stolen in 20X0. Insurance proceeds were received which generated recapture. The truck was replaced in 20X1.
- → A customized half-ton truck that belonged to a construction company was sold in 20X0. The proceeds from the sale generated recapture. A new customized truck was purchased fourteen months later in order to carry out the duties of a large contract awarded to the company.
- A building that was used for income earning purposes was sold in December 20X0. The proceeds from the sale generated recapture. A new building was purchased in April 20X1. The company's fiscal year-end is December 31st.

Multiple Choice	*TB 06-05 Which of the following situations would not be per...*

TB 06-06 Angela Smith runs a small bakery. The company's ye...

Angela Smith runs a small bakery. The company's year-end is December 31st. Angela is trying to calculate the amount of capital cost allowance that she may deduct in 20X0 and has asked for your assistance. She has provided you with the following information:

Assets owned prior to 20X0 and their UCC balances on January 1, 20X0:

Asset	UCC Balance
Store (building purchased prior to 2007)	$100,000
Baking equipment (Class 43)	55,000
Delivery van	15,000
Photocopier (purchased three years ago)	2,000
Patent (purchased two years ago)	10,000

Additional information:

During 20X0, Angela purchased $2,000 worth of small tools (each costing under $500). She sold her delivery van for $12,000 (the original cost was $20,000) and purchased a second-hand van for $16,000. She also installed a $15,000 air conditioning system in her building. In December of 20X0 she sold her photocopier for $1,500 and will replace it in January, 20X1 with a secondhand model valued at $1,700. (Angela amortizes the patent in Class 44.)

Required:

A) Calculate: 1) the total CCA that Angela will be able to claim for her bakery in 20X0.
2) the UCC balances as of December 31, 20X0.
3) any recapture of terminal losses that arose during the year.

B) What would the tax effect have been if Angela had purchased the new photocopier during 20X0?

A)

CLASS	1 – 4%	8 – 20%	10 – 30%	12 – 100%	43 – 30%	44 – 25%
UCC, 01/01	$100,000	$2,000	$15,000	$ 0	$55,000	$10,000
PURCHASES	15,000	0	16,000	2,000	0	0
DISPOSITIONS	0	1,500	12,000	0	0	0
CCA	4,300*	0	5,100**	2,000	16,500	2,500
UCC, 12/31	$110,700	0	$13,900	0	$38,500	$ 7,500
TERMINAL LOSS		$ 500				

*(100,000 × .04) + (15,000 × .04 × .5) = 4,300
**(15,000 × .3) + [(16,000 - 12,000) × .3 × .5) = 5,100

B) The tax effect would have been the same since photocopiers are afforded special treatment and may be placed in their own class if they cost more than $1,000 (based on a specified time period).

Short Answer	*TB 06-06 Angela Smith runs a small bakery. The company's ye...*

57.

TB 06-07 ABC Corp. leased an office and paid $20,000 on lea...

ABC Corp. leased an office and paid $20,000 on leasehold improvements in January of this year. This cost included dry wall, new carpets, and all new light fixtures. The term of the lease is 2 years plus an option to renew for 2 more years.

Required:

Calculate the maximum CCA that ABC Corp. will be allowed to deduct this year.

Lessor of:

$$\frac{\$20{,}000}{2\text{ (lease term)} + 2\text{ (option renewal)}} = \$5{,}000 \times .5 = \$2{,}500$$

$$\frac{\$20{,}000}{5\text{ (minimum)}} = \$4{,}000 \times .5 = \$2{,}000$$

Short Answer	*TB 06-07 ABC Corp. leased an office and paid $20,000 on lea...*

TB 06-08 (Originally Problem Eleven from Chapter Six in p...
(Originally "Problem Eleven" from Chapter Six in previous editions of the textbook)

Alpha Ltd. is a Canadian-controlled private corporation operating a small land-development business. In June 20X2, it acquired a license to manufacture pre-fab homes and began operations immediately. Financial information for the 20X2 taxation year is outlined below:

Alpha's profit before income taxes for the year ended November 30, 20X2, was $245,000, as follows:

Income from land development and pre-fab home manufacturing	$248,000
Loss of sale of properties	(3,000)
	$245,000

The loss on sale of property results from two transactions. On October 1, 20X2, Alpha sold all of its shares of Q Ltd., a 100% subsidiary, for $100,000. (The shares were acquired seven years ago for $80,000.) Also, during the year, Alpha sold some of its vehicles for $25,000.The vehicles originally cost $50,000 and had a book value of $48,000 at the time of sale. New vehicles were obtained under a lease arrangement.

The 20X1 corporate tax return shows the following UCC balances:

Undepreciated capital cost:	
Class 8	$ 30,000
Class 10	120,000
Class 13	41,000

Alpha occupies leased premises under a seven-year lease agreement that began three years ago. At the time, Alpha spent $60,000 to improve the premises. The lease agreement gives Alpha the option to renew the lease for two three-year periods. Alpha began manufacturing pre-fab homes on June 1, 20X2. At that time, it acquired the following:

Licence: right to manufacture for 10 years	$ 90,000
Manufacturing equipment	105,000
Trucks	60,000

Accounting amortization in 20X2 amounted to $60,000.

Alpha normally acquires raw land, which it then develops into building lots for resale to individuals or housing contractors. In 20X2, it sold part of its undeveloped land inventory to another developer for $400,000. The sale realized a profit of $80,000, which is included in the land-development income above. The proceeds consisted of $40,000 in cash, with the balance payable in five annual instalments beginning in 20X3.

Travel and entertainment expense includes the following:

Professional hockey tickets for suppliers and staff	$7,000
Hotel and airfare	9,000
Charitable donations	4,000

Legal and accounting expense includes the following:

Revising the corporation's articles of association	
to conduct business in all provinces	$2,000
Collection of bad debts	1,500
Reviewing the terms of a collateral agreement	
on a long-term bank loan	3,000
Annual audit	8,000

Required:

Calculate Alpha's net income for tax purposes for the 20X2 taxation year.

Income per financial statement (Nov 30, 20X2) [ITA 9(1)]	$245,000
Loss on sale of properties [ITA 18(1)(b)]	3,000
Taxable capital gain - Q shares: ½(100,000 – 80,000)	10,000
Amortization [ITA 18(1)(b)]	60,000
CCA [ITA 20(1)(a)]:	
- Class 13 - lesser of 1/5(60,000) or 60,000/(7+3)	(6,000)
- Class 14 – 10 year licence - 183/3650 days × $90,000	(4,512)
- Class 29 - manufacturing equipment - 50%(1/2)(105,000) *	(26,250)
- Class 8 - equipment - 20%(30,000)	(6,000)
- Class 10 - 30%(120,000) + 30%(1/2)(60,000 - 25,000)	(41,250)
CEC deduction - 7%: (2,000) [ITA 20(1)(b)]	(105)
Reserve for deferred proceeds on land inventory sale - 360,000/400,000 × 80,000 [ITA 20(1)(n)]	(72,000)
Hockey tickets - 50%(7,000) [ITA 67.1]	3,500
Donations [ITA 18(1)(a)]	4,000
Legal - articles of association (add to CEC) [ITA 18(1)(b)]	2,000
Legal collateral agreement - cost of financing 4/5(3,000) [ITA 20(1)(e)]	2,400
Net income for tax purposes	$173,783

* Manufacturing equipment - assumed purchased after March 18, 2007 and before December 31, 2015. Otherwise, would be added to Class 43.

Short Answer	*TB 06-08 (Originally Problem Eleven from Chapter Six in p...*

TB 06-09 Tom's Tool Rentals began operations in 20X0. The n...

Tom's Tool Rentals began operations in 20X0. The nature of the business clearly defines any income as 'business income'. The following information pertains to transactions in 20X0:

Tom signed an 8 year lease for a building when he began the business. The building is in an excellent location and is estimated to be worth $500,000. Tom has an option to renew the lease for an additional 2 years.
Tom spent $100,000 in 20X0 on improvements to the leased building at the beginning of the year.
Tom purchased a small piece of adjacent land and a small building on the land for $120,000 in 20X0. The building was valued at $50,000, and is used as a storage facility.
Tom's inventory of rental tools is valued at $200,000. All of the tools were purchased in 20X0 and are required to be placed in Class 8 by the CRA.
Tom purchased several small tools in 20X0 that he uses to maintain his rental tools. The total cost of these tools was $8,000, and each tool cost under $500.
A delivery van costing $50,000 was purchased in 20X0, to be used solely in the business.
Tom furnished the reception area of his business at a cost of $5000.
A computer was purchased for tracking sales and inventory. The computer cost $1,000.
Incorporation costs for the business were $2,000.

Business was quick to pick up in the first year so Tom chose to use all of the CCA that was available to him.

The following transactions occurred in 20X1:

Tom sold the delivery truck for $48,000, and immediately purchased a newer and larger model for $55,000.
New shelving was purchased for the reception area, at a cost of $1,000.
Maximum CCA was claimed for the year; however, Tom has chosen not to take any additional allowance on his Class 1 assets.

In 20X2 the storage facility was destroyed in a fire. The market value of the building, which was insured, was $55,000. A new building was built one year after the fire at a cost of $60,000.

Required:

A) Calculate the capital cost allowance and cumulative eligible capital claimed by the company in 20X0 and 20X1.
B) Show the amended recapture calculation to be filed, pertaining to the storage building, in the year the new building is built.

20X0

20X0	Class 1	Class 8	Class 10	Class 12	Class 13	Class 50
CCA rate	4%	20%	30%	100%	10 years	55%
Opening UCC	-	-	-	-	-	-
Purchases	$50,000	$205,000	$50,000	$8,000	$100,000	$1,000
Disposals	-	-	-	-	-	-
CCA	$ 1,000	$ 20,500	$ 7,500	$8,000	$ 5,000	$ 275
Recapture /Terminal Loss	-	-	-	-	-	-
Ending UCC	$ 49,000	$184,500	$42,500	$ -0-	$ 95,000	$ 725

CEC deduction: $2,000 × 75% × 7% = $105 Ending CEC = $1,895

20X1

20X1	Class 1	Class 8	Class 10	Class 12	Class 13	Class 50
CCA rate	4%	20%	30%	100%	10 years	55%
Opening UCC	$ 49,000	$184,500	$42,500	$ -0-	$ 95,000	$ 725
Purchases	-0-	1,000	55,000	-0-	-0-	-0-
Disposals	-0-	-0-	48,000	-0-	-0-	-0-
CCA	1,960	37,000	13,800	-0-	10,000	399
Recapture / Terminal Loss	-0-	-0-	-0-	-0-	-0-	-0-
Ending UCC	$ 47,040	148,500	35,700	-0-	85,000	326

CEC: $1,895 × 7% = $133

20X2 Amended:		
UCC balance, beginning of 20X2		$47,040
Purchases		-0-
Disposals (limited to original cost)	$(50,000)	
Less the lessor of:		
- Normal recapture $2,960	$ 2,960	(47,040)
- Cost of new storage facility $60,000		
Recapture of CCA		-0-

Short Answer	*TB 06-09 Tom's Tool Rentals began operations in 20X0. The n...*

TB 06-10 Green Business Ltd. (GBL) began operating ten year...

Green Business Ltd. (GBL) began operating ten years ago, and has always claimed maximum CCA. The company has a December 31st year-end.

The following information is known about GBL's capital assets:

1. The undepreciated capital cost in Class 8 was $10,000 at the end of 20X1. None of the assets in the class were purchased in 20X1.

2. In 20X2, GBL expanded into the manufacturing of recycle bins and purchased a Class 29 asset for $50,000.

3. The undepreciated capital cost in Class 10 was $12,000 at the end of 20X0. Due to the company's growth, GBL sold the only asset in the pool (a small pickup truck) on December 15th of 20X1 for $5,000. GBL immediately spent $8,000 on a slightly larger used truck to use temporarily until an appropriate work truck could be found in the upcoming year.

Required:

1. Calculate the net increase or decrease in GBL's net income for tax purposes for 20X2 if the maximum CCA is claimed.
2. Based strictly on the information provided, what tax advice would have been beneficial for GBL in 20X1 in order to minimize the company's net income for tax purposes?

Class 10 (Need to calculate ending balance for 20X1)

UCC beginning of year:	$12,000
Purchases	$ 8,000
Disposals	($ 5,000)
CCA	$ 4,050*
UCC end of year:	$10,950

$*12{,}000 \times .3 = 3{,}600$
$(8{,}000 - 5{,}000) \times .3 \times .5 = 450$
$3{,}600 + 450 = 4{,}050$

20X2:

1.

Class 8

UCC beginning of year:	$10,000
Purchases	NIL
Disposals	NIL
CCA	$2,000 (10,000 × .2)

Class 10

UCC beginning of year:	$10,950
Purchases	NIL
Disposals	NIL
CCA	$3,285 (10,950 × .3)

Class 29

UCC beginning of year:	NIL
Purchases	$50,000
Disposals	NIL
CCA	$12,500 (50,000 × .5 × .5)

Net decrease in NITP in 20X2 = $17,785 (2,000 + 3,285 + 12,500)
2. BRL could have waited to buy the $8,000 truck until 20X2 in order to recognize a terminal loss of $7,000 in 20X1.

Short Answer	*TB 06-10 Green Business Ltd. (GBL) began operating ten year...*

61.

TB 07-01 Which of the following statements concerning the t...
Which of the following statements concerning the tax treatment of interest income is true?

- Individuals must accrue interest on a daily basis.
- Private corporations do not have to accrue interest on a daily basis.
- Foreign interest income and Canadian interest income are recognized under different sets of tax rules.
- → The anniversary day accrual method of recognizing interest income requires that interest income received by an individual be recognized for tax purposes for every twelve month period from the date the investment is made.

Multiple Choice	*TB 07-01 Which of the following statements concerning the t...*

62.

TB 07-02 Jim Smith owns two rental properties which he purc...
Jim Smith owns two rental properties which he purchased in 20X0. Property A cost him $100,000 (land $60,000 and building $40,000) and property B cost him $120,000 (land $75,000 and building $45,000). After all allowable expenses other than CCA, his rental income for the past two years was $1,000 in 20X0 and $10,000 in 20X1. Jim has chosen to deduct the maximum CCA allowed for both years. What is the UCC for his rental properties at the end of 20X1? (The properties are both Class 1 assets, depreciated at 4%)

- $3,360
- $79,968
- → $80,640
- $206,976

20X0

Purchases $40,000 + $45,000 =	$85,000
CCA	(1,000)*
UCC	$84,000

20X1

UCC	$84,000
CCA	(3,360)**
UCC	$80,640

*($40,000 + $45,000 = $85,000 × .04 × .5 = $1,700, which is restricted to $1,000 rental income)
**($84,000 × .04) = $3,360, which is less than the $10,000 received in rental income for the year.

Multiple Choice	*TB 07-02 Jim Smith owns two rental properties which he purc...*

63.

TB 07-03 Which of the following is true concerning dividend...
Which of the following is true concerning dividends?

→ ◯ The scheme to eliminate double taxation assumes that the corporate tax rate is 27.5% when dividends are grossed-up to include 138% of the dividend.

◯ Dividends received from a CCPC's business income that is not subject to the small business deduction are grossed-up to include 118% of the dividend.

◯ Dividends received from a CCPC's business income that is subject to the small business deduction are grossed-up to include 138% of the dividend.

◯ Eligible dividends require a 118% gross-up.

Multiple Choice	*TB 07-03 Which of the following is true concerning dividend...*

64.

TB 07-04 Pear Corporation earned $150,000 of pre-tax income...
Pear Corporation earned $150,000 of pre-tax income. The tax rate for the company is 15%. The sole shareholder received all of the net earnings in the form of a non-eligible dividend in 2014. The shareholder's personal tax rate is 40%. The shareholder is entitled to a total (federal + provincial) dividend tax credit equal to $22,568. What is the net personal tax owing on the dividend by the shareholder? (Round all numbers to zero decimal places.)

◯ $22,500

◯ $22,568

→ ◯ $37,612

◯ $60,180

Corporation	
Corporate income	$150,000
Tax (at 15%)	(22,500)
Net earnings available for dividend	$127,500

Shareholder	
Taxable dividend ($127,500 × 1.18)	$150,450
Tax (at 40%)	$ 60,180
Less dividend tax credit	(22,568)
Net personal tax	$ 37,612

Multiple Choice	*TB 07-04 Pear Corporation earned $150,000 of pre-tax income...*

65.

TB 07-05 Joanne owns a rental property, which she purchased...

Joanne owns a rental property, which she purchased for $100,000 in 20X0. In the same year, her rental income before CCA was $8,000. Her rental income before CCA was $3000 in 20X1. Joanne always minimizes her tax liability whenever possible. Which of the following statements is *true*? (The rental property is a Class 1 asset, depreciable at a rate of 4%.)

- Joanne has a rental loss of $840 in 20X1.
- Joanne has a rental loss of $920 in 20X1.
- → Joanne's rental income is $0 in 20X1.
- Joanne's rental income in 20X0 was $4,000.

20X0: $100,000 × 4% × 50% = $2,000 (All deductible) $100,000 - $2,000 = $98,000
20X1: $98,000 × 4% = $3,920 Limited to $3,000 of rental income $3,000 - $3,000 = $0

Multiple Choice	*TB 07-05 Joanne owns a rental property, which she purchased...*

66.

TB 07-06 Martha Shine owned the following in 20X4...

Martha Shine owned the following in 20X4:

• Rental properties originally valued at $275,000 (Property 1: land $70,000, building $55,000) (Property 2: land $90,000, building $60,000)

-Net rental income before CCA was $11,000.
-The UCC on building 1, as of January 1, 20X4 was $50,000.
-The UCC on building 2, as of January 1, 20X4 was $40,000.
-Property 2 was sold in 20X4 for $250,000 (land $200,000, building $50,000)

• Shares in ABC Inc. (a CCPC) valued at $50,000
-Non-eligible dividends paid to Martha in 20X4 totalled $5,000.

• Savings of $30,000
-Interest earned in 20X4 was $1,000.

Martha also worked full-time as a baker in 201X4, earning a gross salary of $45,000.
Martha is in a 40% tax bracket.

Required:

Calculate Martha's net income for tax purposes in 20X4. Assume that Martha will take the maximum CCA allowed this year on her rental properties.

A:

Employment income			$ 45,000
Property income: Rental income	$11,000		
CCA – bldg 1	(2,000)		
Recapture – bldg 2 UCC $40,000 less lower of cost or proceeds $50,000	10,000		
Total rental income	$19,000	$19,000	
Dividend income (5,000 × 1.18		5,900	
Interest income		1,000	
Total property income		$25,900	25,900

B:

Capital gain:		
Land: Proceeds	$200,000	
ACB	90,000	
Capital Gain	$110,000	
Taxable Capital Gain	$ 55,000	55,000
Net Income for Tax Purposes		$125,900

Short Answer *TB 07-06 Martha Shine owned the following in 20X4...*

67.

TB 07-07 Stella Flier has received an inheritance of $100,0...

Stella Flier has received an inheritance of $100,000. She is trying to decide what to do with this money and has come to you for some advice. She has an excellent credit rating and no outstanding debts. She would like to buy a $225,000 house and invest $100,000 in bonds as a safety net.

Required:

What would you recommend to Stella, and why, assuming only the facts given?

Stella could use the $100,000 for a down payment on her house and borrow $125,000 for the remainder. She could then borrow $100,000 to purchase the bonds. The interest on the investment loan would be deductible against any income earned on the bonds. If Stella were to borrow the full amount required for her house while buying the bonds with her inheritance, she would not have any allowable deductions for tax purposes.

Short Answer *TB 07-07 Stella Flier has received an inheritance of $100,0...*

TB 07-08 A public corporation earns $500,000 in pre-tax pro...

A public corporation earns $500,000 in pre-tax profits and pays out all of its after-tax earnings in dividends. The corporate tax rate is 27.5% and the shareholders are all in a 45% tax bracket. The dividend gross-up rate is 1.38 and the total dividend tax credit (federal and provincial) is 27.5%.

Required:

A) Calculate:

1) the total amount of federal tax paid by the corporation, and
2) the total net federal tax paid by the shareholders on the dividends.

B) Briefly explain how this tax structure illustrates the theory of integration.

A)

1)

Corporation	
Corporate income	$500,000
Tax (at 27.5%)	(137,500)
Net earnings available for dividend	$362,500

2)

Shareholder	
Taxable dividend ($362,500 × 1.38)	$500,250
Tax (at 45%)	$225,113
Less dividend tax credit	
($500,250 × .275)	(137,569)
Net personal federal tax	$ 87,544

Total tax on corporate profits:	
Paid by corporation	$137,500
Paid by shareholders	87,544
	$225,044

B) (Note: This concept is not introduced in the textbook until later.)

The total tax paid by the corporation and the shareholder on the corporate profits of $500,000 is $225,044 which is roughly equal to 45% of $500,000. The shareholder is in a 45% tax bracket and would have paid $225,000 in tax if he/she had received the profits directly ($500,000 × 45%). Therefore, the total tax paid by the two entities is virtually the same due to the optimal combination of the corporate tax rate, the gross-up rate, and the dividend tax credit.

Short Answer	*TB 07-08 A public corporation earns $500,000 in pre-tax pro...*

TB 07-09 On March 1, 20X1, Notes Inc. purchased a two-year ...

On March 1, 20X1, Notes Inc. purchased a two-year guaranteed investment certificate (GIC) for $15,000. The interest compounds annually at 8%, and will be received at the end of the full term. Notes Inc. has a marginal tax rate of 30%, which will increase to 34% in 20X2. Notes Inc. uses the calendar year as its fiscal year.

Angela Major also invested $15,000 in a GIC with an 8% annual return, on March 1, 20X1. Angela's marginal tax rate in 20X1 is 40%, which is expected to rise to 45% in 20X3.

(Assume there are no leap years in this time period.)

Required:

Calculate the after-tax interest income for each year for Notes Inc. and for Angela. (Round all numbers.)

Notes Inc.:

20X1: $\$15,000 \times .08 \times 306/365 \times (1-.3) =$		$704
20X2: $\$15,000 \times .08 \times 59/365 \times (1-.34) =$	128	
20X2: $\$16,200 \times .08 \times 306/365 \times (1-.34) =$	717	845
20X3: $\$16,200 \times .08 \times 59/365 \times (1-.34) =$		138
Total after-tax interest		$1,687

Angela:

20X1: $0	
20X2: $\$15,000 \times .08 \times (1-.4) =$	$720
20X3: $\$16,200 \times .08 \times (1-.45) =$	713
Total after-tax interest	$1,433

Short Answer	*TB 07-09 On March 1, 20X1, Notes Inc. purchased a two-year ...*

TB 07-10 Amanda received a $300,000 inheritance on May 1st,...

Amanda received a $300,000 inheritance on May 1st, 20X2. With the proceeds, she purchased the following investments:

1) Two rental properties: Property A has a value of $85,000, of which $40,000 is allocated to the building. Property B has a value of $110,000, of which $60,000 is allocated to the building. The properties earned $9,750 in rental income before CCA. The capital growth of the two buildings combined is expected to be 5%.
2) A bond: Valued at $50,000 with 10% annual interest paid at maturity
3) Portfolio shares: Worth $10,000 - Eligible dividends in the amount of $700 were paid to Amanda before the end of the year. The capital growth of the shares is expected to be 3%.
4) The remainder of the money was applied to her $150,000 mortgage.

Amanda is in a personal marginal tax bracket of 45%. Her marginal tax rate for dividends is 21%, and her marginal tax rate for capital gains is 23%.

Required:

A) Calculate Amanda's minimum property income for 20X2.
B) Calculate the annual pre-tax yield (as a percentage) for each of the three investments.
C) Calculate the after-tax yield (as a percentage) for each of the three investments.
D) Briefly explain the tax benefit that Amanda could have realized had she used her inheritance to pay off her mortgage and then borrowed funds to make the above investments.

A) Rental income: $9,750 - ($40,000 × .04 x.5) - ($60,000 × .04 x.5) = $7,750
Interest income: $0 (Does not have to included in income until the year of the first anniversary)
Dividend income: $700 × 1.38 = $966
Minimum property income = $7,750 + $0 + $966 = $8,716

B) Rental properties: Net rents (pre - CCA) $9,750/($85,000 + $110,000) = 5% + Capital growth of 5% = 10%
Bond: as stated: 10%
Shares: Dividends $700/$10,000 = 7% + Capital growth of 3% = 10%

C) Rental Property: (.05[1 - .45] + .05[1 - .23]) = 6.6%
Bond: (.1[1 - .45]) = 5.5%
Shares: (.07[1 - .21] + .03[1 - .23]) = 7.84%

D) By paying off her mortgage, Amanda would have eliminated the non-deductible interest payments from her cash flow. Borrowing against her home and reinvesting the funds would have allowed Amanda to deduct the interest payments from her property income, thereby increasing her cash flow and return on investment.

Short Answer	*TB 07-10 Amanda received a $300,000 inheritance on May 1st,...*

71.

TB 08-01 Sarah Ives purchased a piece of land in 20X8 in or...
Sarah Ives purchased a piece of land in 20X8 in order to operate a greenhouse and an evergreen nursery. This was Sarah's first entrepreneurial adventure which she engaged in when not teaching her grade six classes. Now, one year later, she still has not started her business and upon receiving an offer to teach on a tropical island, has decided to sell the land. Which of the following statements is TRUE?

- Sarah's primary intent suggests that the income should be treated as a business transaction.
- Sarah purchased the land with the primary intent to resell it at a profit.
- → Sarah purchased the land with the primary intent to recognize a long-term economic benefit.
- The intent of the purchase is insignificant when determining the type of income to report.

Multiple Choice	*TB 08-01 Sarah Ives purchased a piece of land in 20X8 in or...*

72.

TB 08-02 Which of the following rules regarding the tax tre...
Which of the following rules regarding the tax treatment of a principal residence is FALSE?

- If a taxpayer only owns one residence, the 'principal residence formula' reduces any capital gain on the sale to nil.
- When a taxpayer owns more than one residence, the decision to designate a particular property as the 'principal residence' occurs at the time of sale.
- → Properties can be designated to each married or common-law partner in a family for the purpose of reducing the gains on the sale of two principal residences.
- A capital loss cannot be realized on the sale of a principal residence.

Multiple Choice	*TB 08-02 Which of the following rules regarding the tax tre...*

TB 08-03 John sold a piece of land in 20X9 for $350,000. Th...

John sold a piece of land in 20X9 for $350,000. The land was recognized as capital property. The original cost of the land was $75,000. The selling costs incurred in 20X9 were $5,000. The terms of the payment included an immediate down payment of $50,000, with the remainder of the cost to be paid over the next three years in three equal payments. John wishes to report the minimum taxable capital gain allowed each year. How much will he report in 20X9? (Round all numbers to zero decimal places.)

- $0
- → $27,000
- $50,000
- $216,000

Capital gain:			
Proceeds of disposition		$350,000	
Less			
Adjusted cost base	75,000		
Costs of disposition	5,000	80,000	
Capital gain		$270,000	
Taxable capital gain		$135,000	

Capital gain (20X9)			
Capital gain			$270,000
Less the lessor of:			
$\frac{\$300{,}000 \text{ (deferred proceeds)}}{\$350{,}000 \text{ (total proceeds)}} \times \$270{,}000$		= $231,429	
80% × $270,000		= $216,000	216,000
Capital gain			$ 54,000
Taxable capital gain			$ 27,000

Multiple Choice	*TB 08-03 John sold a piece of land in 20X9 for $350,000. Th...*

74.

TB 08-04 Mandy holds shares in Y Co. Recently, the shares h...

Mandy holds shares in Y Co. Recently, the shares have been experiencing a decline in market value. She originally purchased 1000 shares in 20X0 at $5 per share. On September 22nd of 20X1 she sold the shares when they were trading for only $3 per share. On October 3rd she felt optimistic that the market value would rise substantially by the end of the year, so she repurchased 1000 shares of Y Co. at $2.50 per share. Which of the following is true for Mandy?

- Mandy can recognize a $2,000 capital loss on the sale of her shares on her 20X1 tax return.
- Mandy can recognize a $2,000 superficial loss on the sale of her shares on her 20X1 tax return.
- → The adjusted cost base of Mandy's new shares is $4,500.
- The adjusted cost base of Mandy's new shares is $2,500.

20X1	
Proceeds of disposition	$ 3,000
Less	
Adjusted cost base	($5,000)
Actual capital loss	$ 2,000
Superficial loss deemed to be	NIL
Cost of new shares:	
Actual cost of 1000 shares	$ 2,500
Add	
Loss previously denied	2,000
Adjusted cost base of new shares	$ 4,500

Multiple Choice	*TB 08-04 Mandy holds shares in Y Co. Recently, the shares h...*

75.

TB 08-05 When establishing whether the sale of an asset is ...

When establishing whether the sale of an asset is capital income or business income, which of the following is *not* one of the factors that the courts take into consideration when determining the original intention of a transaction?

- Period of ownership
- → Canadian securities test
- Number and frequency of transactions
- Relation of transaction to taxpayer's business

Multiple Choice	*TB 08-05 When establishing whether the sale of an asset is ...*

TB 08-06 Mr. Yee sold a piece of land in 20X0 for $500,000....

Mr. Yee sold a piece of land in 20X0 for $500,000. He originally paid $100,000 for the land. Selling costs totalled $15,000. The land is classified as capital property. The purchaser of the land paid Mr. Yee $80,000 in 20X0, and will pay $84,000 each year for the next five years.

Required:

Calculate the taxable capital gain that Mr. Yee will have to include in his income for tax purposes in 20X0 and 20X1.

Capital gain:	
Proceeds of disposition $500,000 Less Adjusted cost base $100,000 Selling costs 15,000 (115,000) Capital gain $385,000 Taxable capital gain $192,500	
20X0	
Capital gain	$385,000
Less deferred portion:	
Lessor of:	
(1) $\frac{\$420,000 \text{ (deferred proceeds)}}{\$500,000 \text{ (total proceeds)}} \times 385,000 = \$323,400$	
(2) 80% × $385,000 = $308,000	(308,000)
Capital gain	$ 77,000
Taxable capital gain	$ 38,500
20X1	
Unrecognized gain (prior year's reserve)	$308,000
Less deferred portion:	
Lessor of:	
(1) $\frac{\$336,000 \text{ (deferred proceeds)}}{\$500,000 \text{ (total proceeds)}} \times 385,000 = \$258,720$	
(2) 60% × $385,000 = $231,000	(231,000)
Capital gain	$ 77,000
Taxable capital gain	$ 38,500

Short Answer	*TB 08-06 Mr. Yee sold a piece of land in 20X0 for $500,000....*

TB 08-07 Greta Snow sold the following items prior to movin...
Greta Snow sold the following items prior to moving to Europe:

	Original Cost	Proceeds
Sportscar	$24,000	$10,000
Antique cabinet	1,000	2,000
A rare coin	100	1,100
Shares in a public corporation	4,000	3,000
Canoe	500	600
Limited edition painting	800	2,500
Sculpture	1,100	900

Required:

Calculate the tax consequences of Greta's sales, placing the items into the appropriate categories of capital property.

Personal Use Property

Asset	Original Cost	Proceeds	Capital Gain/Loss
Sportscar	$24,000	$10,000	Nil
Antique cabinet	1,000	2,000	$1,000 Gain
Canoe	1,000	1,000	Nil

Listed Personal Property

Asset	Original Cost	Proceeds	Capital Gain/Loss
Rare coin	$ 1,000	$ 1,100	$ 100 Gain
Limited edition painting	1,000	2,500	1,500 Gain
Sculpture	1,100	1,000	100 Loss

Financial Property

Asset	Original Cost	Proceeds	Capital Gain/Loss
Shares in a public corporation	$4,000	$3,000	$1,000 Loss

$1,000 (PUP Gain) + $1,500 (Net LPP Gain) - $1,000 (Financial Loss) = $1,500 Capital Gain $750 Taxable Capital Gain

78.

TB 08-08 Anne Smith acquired her house in 20X0 for $150,000...

Anne Smith acquired her house in 20X0 for $150,000 and her cottage in 20X4 for $100,000. Due to a rise in real estate prices, she decided to sell both properties and backpack around the world for two years. Both properties were sold in October of 20X8. Anne received $375,000 in proceeds for the house, and $250,000 for the cottage.

Required:

Calculate the minimum taxable capital gain that the Anne can report for her house and for her cottage on her 20X8 tax return.

House:	
Capital gain ($375,000 - $150,000)	$225,000
Capital gain per year: $225,000/9	$ 25,000
Cottage:	
Capital gain ($250,000 - $100,000)	$150,000
Capital gain per year: $150,000/5	$ 30,000

The capital gain on the cottage should be eliminated first as it will receive a higher exemption per year ($30,000) than the house ($25,000).

Cottage:	
Capital gain ($250,000 - $100,000)	$150,000
Exemption:	
$\frac{4+1}{5} \times \$150,000 =$	150,000
Net capital gain	$0
House:	
Capital gain ($375,000 - $150,000)	$225,000
Exemption:	
$\frac{5+1}{9} \times \$225,000 =$	150,000
Net capital gain	$75,000
Taxable capital gain	$37,500

Short Answer	*TB 08-08 Anne Smith acquired her house in 20X0 for $150,000...*

TB 08-09 The following cases pertain to some of the unique ...

The following cases pertain to some of the unique aspects regarding the sale of various types of capital properties. Next to each case, identify (from the list) the type of capital property that applies. (Select only one category of capital property for each case and use each category only once.)

Gains are treated as business income or business losses.	
The weighted average method is used to determine the adjusted cost base in order to determine the capital gain or loss.	
Though typically of an inventory nature, the CRA allows gains on these sales to be reported as capital unless the nature of the taxpayer's business is closely related.	
A capital gain deferral may be recognized provided a reinvestment in common shares from the treasury of a replacement entity is made. A gain resulting from the receipt of compensation for expropriated property may be deferred if the property is replaced before the end of the second taxation year that begins following the year of expropriation.	
The grantor must report a capital gain in the year received.	

List of capital properties:

1. Identical properties
2. Options and warrants
3. Commodities and futures transactions
4. Goodwill and eligible capital property
5. Voluntary and involuntary dispositions
6. Eligible small-business investments
7. Gifts of Canadian public securities

Gains are treated as business income or business losses.	4. Goodwill and eligible capital property
The weighted average method is used to determine the adjusted cost base in order to determine the capital gain or loss.	1. Identical properties
Though typically of an inventory nature, the CRA allows gains on these sales to be reported as capital unless the nature of the taxpayer's business is closely related.	3. Commodities and futures transactions
A capital gain deferral may be recognized provided a reinvestment in common shares from the treasury of a replacement entity is made.	6. Eligible small-business investments
A gain resulting from the receipt of compensation for expropriated property may be deferred if the property is replaced before the end of the second taxation year that begins following the year of expropriation.	5. Voluntary and involuntary dispositions
The grantor must report a capital gain in the year received.	2. Options and warrants

Short Answer	*TB 08-09 The following cases pertain to some of the unique ...*

TB 08-10 Evergreen Trees Inc. is a CCPC operating in Nova S...
Evergreen Trees Inc. is a CCPC operating in Nova Scotia.

Three asset sales occurred prior to the end of 20X1. The following information pertains to the net gain on the sale of the assets:

Building (One of several owned by the company)

The building was previously purchased for $80,000. At the time of the sale, the accumulated amortization on the building was $10,000. The UCC balance was $65,000. Proceeds on the sale were $110,000.

Land

The land was purchased for $200,000 and sold for $250,000. Proceeds of $60,000 will be received in the current year. The remainder of the payment will be received in equal installments over the next eight years.

Marketable Securities

The company sold its entire public portfolio in the current year. The adjusted cost base of the shares was $100,000. The market value of the shares at the time of sale was $135,000. Selling costs on the sale were $5,000.

Required:

A) Calculate the minimum taxable capital gain that Evergreen Trees Inc. will have to report in 20X1.
B) Calculate the minimum taxable capital gain that must be reported in 20X2.

A)

Building:	
Proceeds of disposition:	$110,000
Adjusted cost base:	(80,000)
Capital gain	$ 30,000
Taxable capital gain	$ 15,000
Land:	
Proceeds of disposition:	$250,000
Adjusted cost base:	(200,000)
Capital gain	$ 50,000
Gains reserve:	
Lessor of:	
1) 190,000/250,000 × $50,000 = $38,000	
2) 4/5 × $50,000 = $40,000	(38,000)
Capital gain	$ 12,000
Taxable capital gain	$ 6,000
Marketable Securities:	
Proceeds of disposition:	$135,000
Adjusted cost base:	(100,000)
Selling costs	(5,000)
Capital gain	$ 30,000
Taxable capital gain	$ 15,000
Total minimum taxable capital gain for 20X1:	$ 36,000

B)

Minimum taxable capital gain in 20X2:	
Gain (20X1 reserve)	$38,000
Capital gains reserve - lessor of:	
166,250/250,000 × $50,000 = $33,250	
3/5 × $50,000 = $30,000	(30,000)
Capital gain	$ 8,000
Taxable capital gain	$ 4,000
Total minimum taxable capital gain for 20X2:	$ 4,000

Short Answer	*TB 08-10 Evergreen Trees Inc. is a CCPC operating in Nova S...*

81.

TB 09-01 Which of the following deductions are allowed as...
Which of the following deductions are allowed as ‘other' deductions for tax purposes?

- Contributions to an individual's Canada Savings Bonds, fees for an appeal in relation to an assessment under the Income Tax Act, and contributions to an individual's RRSP.
- Lump sum support payments to a former spouse, contributions to an individual's RRSP, and fees for an appeal in relation to an assessment under the Income Tax Act.
- Support payments for a child, moving expenses against income at the previous location and child care expenses.
- → Contributions to an individual's RRSP, fees for an appeal in relation to an assessment under the Income Tax Act, and moving expenses against income at the new location.

Multiple Choice	*TB 09-01 Which of the following deductions are allowed as...*

82.

TB 09-02 Steve gifted shares in a public corporation which ...
Steve gifted shares in a public corporation which cost $10,000 to his fifteen year old son, Simon. During the year, Simon received $500 in dividends. Simon then sold the shares for $12,000. Which of the following tax situations is true for Steve and Simon?

- Simon will have to claim the dividends and capital gain on his tax return.
- → Steve will have to claim the dividends on his tax return and Simon will have to recognize the capital gain on his tax return.
- Steve will have to claim the dividends and a capital gain on his tax return.
- Simon will have to claim the dividends on his tax return and Steve will have to recognize the capital gain on his tax return.

Multiple Choice	*TB 09-02 Steve gifted shares in a public corporation which ...*

83.

TB 09-03 Which of the following is FALSE regarding the Tax ...
Which of the following is FALSE regarding the Tax Free Savings Account (TFSA)?

- There is no mandatory age by which a TFSA must be wound up.
- → TFSA contributions are tax deductible.
- Any unused amounts not contributed in a year may be carried forward indefinitely to future years.
- Capital gains earned within TFSAs are not taxed.

Multiple Choice	*TB 09-03 Which of the following is FALSE regarding the Tax ...*

84.

TB 09-04 Car Co. is selling its land and building to Truck ...
Car Co. is selling its land and building to Truck Co. for $340,000 (Land $200,000; Building $140,000). These values have not been officially appraised, and Truck Co. is arguing that the land is only worth $150,000 and the building is worth $190,000. (Car Co. originally paid $100,000 for the land and constructed the building for $150,000. The UCC on the building is currently $130,000.) Which of the following statements is true based on these facts?

- Future CCA will be higher for Truck Co. under Car Co.'s terms.
- Car Co. will recognize higher net capital gains under Truck Co.'s terms.
- → Car Co. will recognize higher recapture under Truck Co.'s terms.
- The allocation of the costs is irrelevant as the total price is the same under both sets of terms.

Multiple Choice	*TB 09-04 Car Co. is selling its land and building to Truck ...*

85.

TB 09-05 Upon the death of a taxpayer, which of the followi...
Upon the death of a taxpayer, which of the following statements is true?

- → Capital property that is left to a spouse is deemed to be sold at cost, and all other capital property is deemed to be sold at market value.
- Capital property that is left to a spouse is deemed to be sold at market value, and all other capital property is deemed to be sold at cost.
- All property left to a spouse and to others is deemed to be sold at cost.
- All property left to a spouse and to others is deemed to be sold at market value.

Multiple Choice	*TB 09-05 Upon the death of a taxpayer, which of the followi...*

TB 09-06 Case OneMarsha had total income of $112,000 and ea...
Case One

Marsha had total income of $112,000 and earned income of $75,000 in 2013. At the end of 2013, she had unused RRSP contribution room of $12,000. Her pension adjustment from 2013 was $5,000. She anticipates a pension adjustment of $7,000 in 2014.

Required:

Calculate the maximum RRSP deduction that Marsha can make for the 2014 taxation year.

Case Two (Independent of Case One)

Marsha is 35 years old. She has the option of investing $2,000 per year in a savings account at 8%, or $2,000 in an RRSP at 8%. The money will be invested for the next 30 years, and will not be withdrawn until she retires.

Required:

Calculate the amount of each option, net of taxes, if Marsha withdraws all of the money when she turns 65? Assume that her tax rate will be 35% every year until she retires.

Case One

Lessor of:	
18% × 75,000 = $13,500 Prescribed limit for 2014 $24,270	$13,500
Plus unused RRSP contribution limit at the end of 2013	12,000
Less PA from 2013	(5,000)
Maximum deduction allowed for 2014	$20,500

Case Two

Savings Account:
Ordinary Annuity:
$2,000 × 68.766 (future value annuity factor, i = 5.2*, n = 30) = $137,532
*8 × (1 - .35)
Annuity Due: $144,684
RRSP:
Ordinary Annuity:
$2,000 × 113.283 (future value annuity factor, i = 8, n = 30) = $226,566 × (1 - .35) = $147,268
Annuity Due:
$244,692 × (1 - .35) = $159,050

Ordinary Annuity:
Marsha will have an extra $9,736 if she chooses the RRSP alternative.

Annuity Due:
Marsha will have an extra $14,366 if she chooses the RRSP alternative.

TB 09-07 In 20X4, Tom Depuis moved 2874 kilometers from Any...

In 20X4, Tom Depuis moved 2874 kilometers from Anytown, Province1 to Newtown, Province2 to assume the position of manager for his company at the Newtown head office, beginning October 1st. Tom received a salary of $5,100 per month at his new job. He incurred the following moving costs:

Legal fees on purchase of new home	$ 3,000
Payment to a national moving company for the cost of the move	16,000
Payment to the moving company for container storage until Tom got possession of his new home	1,000
Commission fees on sale of Anytown home	10,000
21 days accommodations at a hotel in Newtown until he took possession of his new home	2,100
Meals for Tom and his wife and daughter on the two day trip from Anytown to Newtown.	200
Gas receipts for the two day trip. (Assume the CRA travel rates for Province1 and Province2 are 55 cents and 45 cents (respectively) per kilometer.)	450

Tom received a reimbursement of $15,000 from his employer.

Required:

Calculate the maximum amount of moving expenses that Tom may deduct this year, and next year.

Legal fees on purchase of new home	$ 3,000
Payment to a national moving company for the cost of the move	16,000
Payment to the moving company for container storage until Tom got possession of his new home	1,000
Commission fees on sale of Anytown home	10,000
15 days accommodations at a hotel in Newtown until he took possession of his new home ($2,100 × 15/21)	1,500*
Meals using the simplified method of $17 per meal to a maximum of $51 per day, per person	306
Travel using the simplified method of 55 cents × 2874 kilometers (round all numbers)	1,581
Total moving expenses	$33,387
Less reimbursement	(15,000)
	$18,387
Restricted to salary earned in new location (3 months × 5,100)	$15,300
Carried forward to next year	$ 3,087

*Maximum - 15 days allowed

Short Answer	*TB 09-07 In 20X4, Tom Depuis moved 2874 kilometers from Any...*

TB 09-08 Identify whether the following sources of income a...

Identify whether the following sources of income and expenditures are included for the calculation of net income for tax purposes.

Source of Income or Expenditure	Check box below if included in the calculation of net income for tax purposes	Check box below if not included in the calculation of net income for tax purposes
Old age security payments received from the Canadian government		
Disability pension received by a member of the RCMP		
Scholarship received by a student entitled to claim the education tax credit		
Universal Child Care Benefit Program payments received		
Babysitting for a child 16 years of age or younger if incurred so the taxpayer can pursue employment, a business, or research activities.		
An inheritance received		
Research grants covering only the expenses incurred to conduct related research		
Support payments for a child		
Foreign pension benefits		
Selling costs of an old residence and the new residence is 20 kilometers closer to the new work location than the previous residence.		

Source of Income or Expenditure	Check box below if included **in** the calculation of net income for tax purposes	Check box below if not included in the calculation of net income for tax purposes
Old age security payments received from the Canadian government	X	
Disability pension received by a member of the RCMP		X
Scholarship received by a student entitled to claim the education tax credit		X
Universal Child Care Benefit Program payments received	X	
Babysitting for a child 16 years of age or younger if incurred so the taxpayer can pursue employment, a business, or research activities.	X	
An inheritance received		X
Research grants covering only the expenses incurred to conduct related research		X
Support payments for a child		X
Foreign pension benefits	X	
Selling costs of an old residence and the new residence is 20 kilometers closer to the new work location than the previous residence.		X

Short Answer *TB 09-08 Identify whether the following sources of income a...*

TB 09-09 Agatha earned $35,000 at her job from January 1st ...

Agatha earned $35,000 at her job from January 1st - October 10th of 20X4. She accepted a new position with the company in a town 1312 kms away, and began the new job on November 1st, 20X4, earning a gross salary of$4000 per month.

Agatha's moving expenses included:
$7,000 for a moving van
$500 in meals en route for Agatha and her 4 year old daughter
$700 in accommodations en route
$4000 ($200 per day) for 20 nights of accommodations and meals in the new location until her apartment was available. (Agatha used the receipt method for these meals.)
$550 in gas receipts

Agatha also received the following amounts in 20X4:

• Support payments from her former spouse ($3,000 × 12)*	$36,000
• Inheritance	25,000
• Scholarship for part-time tuition (used solely for tuition)	2,000
• RRSP withdrawal (not withdrawn under the Lifelong Learning Plan or Home Buyer's Plan)	15,000
• Lottery winnings	500

*The support payments are in accordance with Agatha's divorce agreement, which calls for monthly support payments of $1,500 for Agatha and $1,500 for her daughter.

The 20X4 meal and vehicle rates used to calculate travel and meal expenses under the simplified method are:
$17 per meal to a maximum of three meals per day, per person

Hypothetical mileage:	
New location:	50 cents per kilometer
Previous location:	47 cents per kilometer

Required:

Determine Agatha's net income for tax purposes for 20X4, using the aggregate formula to show your work.

Segment A	
Employment income:	
$35,000 + $8,000	$43,000
Other income:	
$18,000(support payments) + $15,000(RRSP withdrawal)	33,000
Total segment A	$76,000

Segment C
Moving expenses:
$7,000 van
$510 (51 × 2 × 5) meals (simplified method)
$700 hotels en route
$3000 (4000/20 × 15) accommodations
$617 (.47 × 1312) vehicle (simplified method) (rounded)
$11,827

Moving expenses restricted in income earned in new location:	($ 8,000)
Total Net Income for Tax Purposes	$ 68,000

Short Answer	*TB 09-09 Agatha earned $35,000 at her job from January 1st ...*

90.

TB 09-10 Indicate whether or not the parties in the followi...
Indicate whether or not the parties in the following situations are "related" for tax purposes.

A) Mr. Grey and his sister's son, Matthew, are negotiating an economic transaction. Are Mr. Grey and Matthew related for tax purposes?
B) Mr. Field is the sole shareholder of Corporation X, and Mrs. Field, (Mr. Field's wife) is the sold shareholder of Corporation Y. Are the two corporations related for tax purposes?
C) Sarah owns seventy percent of the shares of ABC Co. Andrew owns the remaining thirty percent. Sarah and Andrew are not related. Is Andrew related to ABC Co.?
D) Glen owns thirty percent of the shares of Corporation A. Glen's wife also owns thirty percent of the shares of Corporation A. The remaining forty percent of the shares are owned by Steven, who is a friend of the family. Is Glen related to Corporation A for tax purposes?
E) Tammy and her brother's wife Angela are negotiating an economic transaction. Are Tammy and Angela related for tax purposes?

A) No
B) Yes
C) No
D) Yes
E) Yes

Short Answer	*TB 09-10 Indicate whether or not the parties in the followi...*

91.

TB 10-01 ABC. Ltd. had unused allowable capital losses of $...
ABC. Ltd. had unused allowable capital losses of $20,000 during the current fiscal year and an unused business loss of $10,000. Which of the following statements is true?

- All of the losses will be lost if not used in this fiscal year.
- → The unused allowable capital loss will be converted to a net-capital loss and can be carried back 3 years and forward indefinitely, and the unused business loss will be converted to a non-capital loss and can be carried back 3 years and forward twenty years.
- The unused business loss will be converted to a net-capital loss and can be carried back 3 years and forward indefinitely, and the unused allowable capital loss will be converted to a non-capital loss and can be carried back 3 years and forward twenty years.
- The unused business loss will be converted to a non-capital loss and can be carried back 3 years and forward indefinitely.

Multiple Choice	*TB 10-01 ABC. Ltd. had unused allowable capital losses of $...*

92.

TB 10-02 Which of the following is false with respect to th...

Which of the following is false with respect to the final returns of deceased taxpayers?

- Unused net capital losses less any capital gains deductions previously claimed are deductible against any income.
- → Non-refundable tax credits are prorated to the date of death on the final tax return.
- A Rights and Things return may be filed in addition to the final tax return.
- Of the tax returns available for a deceased taxpayer, only the final tax return must be filed.

Multiple Choice	*TB 10-02 Which of the following is false with respect to th...*

93.

TB 10-03 Which of the following is a requirement for a busi...

Which of the following is a requirement for a business to qualify as a ‘qualified small business corporation'?

- The corporation must be a CCPC that uses at least 50% of the fair market value its assets for active business purposes in Canada at the time the shares are sold.
- More than fifty percent of the fair market value of the assets of the business must have been used for active business in the past 36 months.
- → The shares must not have been owned by another non-related individual in the past 24 months.
- The shares must not have been owned by another related individual in the past 24 months.

Multiple Choice	*TB 10-03 Which of the following is a requirement for a busi...*

94.

TB 10-04 On February 16th, 20X4, Samantha received an eligi...

On February 16th, 20X4, Samantha received an eligible dividend in the amount of $2,000. She is in a 40% tax bracket. How much is Samantha's dividend tax credit for 20X4? (Assume a DTC of 15%.)

- $300
- → $414
- $2,000
- $2,760

Dividend received	$2,000
Gross-up of dividend (1.38)	2,760
Dividend tax credit:	
15% × $2,760	(414)

Multiple Choice	*TB 10-04 On February 16th, 20X4, Samantha received an eligi...*

95.

TB 10-05 Which of the following is an accurate list of some...
Which of the following is an accurate list of some of the personal federal tax credits available to reduce the federal tax liability?

- dividend, non-capital loss, charitable donations, age amount
- → caregiver, employment credit, medical expenses, disability
- education amount, adoption expenses, farming, child fitness credit
- public transit pass, pension, Canada pension plan, qualified small business deduction

Multiple Choice	*TB 10-05 Which of the following is an accurate list of some...*

TB 10-06 Susan White incurred the following income, disburs...

Susan White incurred the following income, disbursements, and losses in 20X1 and 20X2:

	20X1	20X2
Employment income	$25,000	$28,000
Proprietorship income	-0-	5,000
Proprietorship loss	(3,000)	-0-
Dividend income (non-eligible dividends)	10,000	10,000
Bond interest	1,000	1,100
Business investment in a qualified small business corporation	(10,000)	-0-
RRSP deduction	(2,000)	(1,000)
Taxable capital gains	-0-	7,000
Allowable capital losses	(2,000)	-0-

Susan has no taxable income or losses from prior years.

Required:

Calculate Susan's minimum taxable income for both years.

20X1		
Net income for tax purposes:		
Segment A		
Employment income	$25,000	
Business income	-0-	
Property income (10,000 × 1.18) + 1,000	12,800	
		$37,800
Segment B		
Taxable capital gains	-0-	
Allowable capital losses	(2,000)	-0-
Segment C		
RRSP		(2,000)
Segment D		
Business loss	(3,000)	
Allowable business investment loss	(5,000)	(8,000)
Net income for tax purposes		$27,800
Special reductions		-0-
Taxable income		$27,800
20X2		
Net income for tax purposes:		
Segment A		
Employment income	$28,000	
Business income	5,000	
Property income (10,000 × 1.18) + 1,100	12,900	
		$45,900
Segment B		
Taxable capital gains	7,000	
Allowable capital losses	-0-	7,000
Segment C		
RRSP		(1,000)
Segment D		-0-
Net income for tax purposes		$51,900
Special reductions		
Net-capital loss carry-forward		(2,000)
Taxable income		$49,900

Short Answer *TB 10-06 Susan White incurred the following income, disburs...*

TB 10-07 Theodore is 37 years old. He earns $92,000 a year ...

Theodore is 37 years old. He earns $92,000 a year at his job as a financial analyst. His CPP and EI contributions totaled $3,340. Last year he enrolled in an accounting program in order to earn his designation. He was enrolled for eight months, part-time (attending evening classes), and his tuition fees totalled $1,500. Theodore donated $2,000 to Ducks Unlimited (a registered charity for tax purposes), and $800 to a political party. (Theodore has made annual contributions to these organizations for the past five years.) He spent a total of $4,200 on eyeglasses, dental care and prescriptions, none of which was reimbursed. Theodore's wife did not work during the year, as she was enrolled in full-time studies for eight months as a nursing student. Her tuition fees for the year were $8,000. She transferred as much of her tuition and education amount allowable to Theodore. Theodore had a $2,000 non-capital loss carry-forward from the previous year that he incurred during the wind-up of his proprietorship. Theodore and his wife do not have any children.

Required:

Calculate Theodore's *federal* tax payable for the current year.

Net income for tax purposes				$92,000	
Deduct:					
	Non-capital loss carry-forward			(2000)	
Taxable income				$90,000	
Federal tax liability					
Primary tax (2012 - rounded)					
$90,000					
$43,953	0.15	$6,593			
$43,954	0.22	$9,670			
$2,093	0.26	$544			$16,807
$0					
Less: Personal federal tax credits:					
Basic				11,138	
Spousal				11,138	
Employment				1,127	
CPP/EI				3,340	
Tuition and education				2,620	
Tuition and education from spouse				5,000	
Medical	$4,200 less lesser of:				
	92,000 x .03		2760		
			2171	2029	
			15% x	36,392	$5,459
Donations	($200 x .15) + ($1,800 x .29)				$552
Basic federal tax					$10,796
Other federal tax credits:					
Political contribution					
($400 x .75) + (350 x .5) + (50 x .3333)					$492
Total federal tax					$10,305

Short Answer	*TB 10-07 Theodore is 37 years old. He earns $92,000 a year ...*

98.

TB 10-08 Archie Smith works full-time as a dentist. He live...

Archie Smith works full-time as a dentist. He lives on an acreage where he raises chickens. He sells the chickens' eggs at local markets. During the current year, Archie incurred farm expenses totalling $8,500 and received $5,200 in farm revenues from the sale of eggs.

Required:

a) What is the name of the type of loss that Archie will be able to recognize on his tax return?
b) Calculate the loss that Archie can apply against his other sources of income in the current year.

a) Archie will recognize a restricted farm loss.
b) His farm loss equals $2,900. $2,500 + 50% [3,300 - $2,500] = $2,900.

Short Answer	*TB 10-08 Archie Smith works full-time as a dentist. He live...*

TB 10-09 Stuart Planter owns a small country plot where he ...

Stuart Planter owns a small country plot where he resides with his family. In the spring and summer, Stuart and his family grow vegetables to sell at the local farmer's market. Stuart earned $83,000 this year at his full-time teaching job. During the year he also incurred farm expenses totaling $12,000 and farm revenues totaling $8,000.

Stuart has asked you to help him prepare his tax return for the year, and provides you with the following additional information:

• Net capital losses from the previous year total $10,000.
• Stuart had the following amounts deducted from his pay during the year: CPP and EI of $3,340; and federal income tax of $21,000.
• Stuart invested a total of $20,000 during the year to a TFSA and GICs. He contributed $5,000 to his TFSA, and the remainder to a guaranteed investment certificate which pays 4% annually. His first interest payment is due on June 30th of the following year.
• Stuart's wife works full-time and earns $68,000 a year. She does not claim any of the children's tax items on her tax return.
• Stuart's three children (born in 2000, 2002, and 2005) were all fitted with braces on their teeth during the year. The total cost was $7,500 and Stuart did not receive any reimbursement for the cost.
• All three of his children played soccer during the year. The registration cost for each child was $700.
• None of the children have a source of income.

Required:

Calculate Stuart's minimum federal tax liability for the current year. Explain why any items may have been omitted. (Round all numbers to zero decimal places.)

Net Income for Tax Purposes:					
a) Employment				$83,000	
d) Restricted farm loss*				-3,250	
	Net Income for Tax Purposes			$79,750	
	Taxable Income			$79,750	
*$2,500 + 50% ($4,000 - $2,500)					
Federal tax liability					
Primary tax (2012 - rounded)					
$79,750					
$43,953	0.15	$6,593			
$35,797	0.22	$7,875			
					$14,468
Less: Personal federal tax credits:					
Basic				11,138	
Children under age 18 at end of year					
(2,255x3)				6,765	
Employment				1,127	
CPP/EI				3,340	
Children's fitness (500x3)				1,500	
Medical	$7,500 less lesser of:				
	79,750 x .03		2393		
			2171	5329	
			15 x	29,199	$4,380
Basic federal tax					$10,088

Items omitted:

Net-capital loss: Archie did not incur a capital gain during the year, so cannot apply this loss.
Property income: The interest on the TFSA is non-taxable; and the interest on the GIC may be claimed in the following year.

Short Answer	*TB 10-09 Stuart Planter owns a small country plot where he ...*

TB 10-10 Sally earned $210,000 during 20X4. She also receiv...

Sally earned $210,000 during 20X4. She also received eligible dividends in the amount of $10,000. She sold a piece of land during the year and recognized a capital gain of $500,000. Sally is married. Her husband earned $100,000 during the year.

Required:

A) Calculate 1) Sally's normal taxable income, 2) Sally's taxable income for the alternative minimum tax, and 3) her federal tax liability, before the deduction of any allowable non-refundable tax credits, for both methods.
B) Which method would allow for a deduction of the non-refundable dividend tax credit?
C) Which method will Sally have to use to report her tax liability?

A)

	Normal taxable income	Taxable income for alternative minimum tax
Salary	$210,000	$210,000
Dividends (eligible)	13,800	10,000
Capital gain	250,000	400,000
Net income	$473,800	$620,000
AMT exemption	-0-	(40,000)
	$473,800	$580,000

Federal tax liability (before non-refundable tax credits)

Normal:

Federal tax liability				
$473,800				
$43,953	0.15	$6,593		
$43,954	0.22	$9,670		
$48,363	0.26	$12,574		
$337,530	0.29	$97,884		$126,721

AMT:

$580,000 × 15% = $ 87,000

B) The dividend tax credit is deductible under the normal method.
C) Sally will be liable for taxes under the normal method, as this calculation is the larger of the two.

Short Answer	*TB 10-10 Sally earned $210,000 during 20X4. She also receiv...*

101.

TB 11-01 When shares are transferred from one group of shar...
When shares are transferred from one group of shareholders to another and there is a change in control, which of the following is correct?

- Any net capital losses that arise following the change in control will be lost.
- Non-capital losses are automatically deemed to have expired.
- Net capital losses arising prior to the change in control will be lost and any non-capital losses arising prior to the change in control may be used if the business that incurred the loss is terminated.
- → Non-capital business losses arising prior to the change in control may be used against income from the business that incurred the loss if that business is carried on at a profit or reasonable expectation of profit in the year in which the losses are applied.

Multiple Choice	*TB 11-01 When shares are transferred from one group of shar...*

102.

TB 11-02 Which of the following statements accurately descr...
Which of the following statements accurately describes the tax treatment for Canadian corporations?

- Public and private Canadian corporations are eligible for the small business deduction.
- → Public and private Canadian corporations are eligible for the general tax reduction.
- Public corporations are granted beneficial tax treatment on the first $500,000 of business income.
- CCPCs recognize the general tax reduction on all business income.

Multiple Choice	*TB 11-02 Which of the following statements accurately descr...*

TB 11-03 In 20X0, Coffee Co. recognized $37,000 in business...

In 20X0, Coffee Co. recognized $37,000 in business income and $1,000 in taxable capital gains. In 20X1, the company incurred a business loss of $25,000, a taxable capital gain of $2,000, and an allowable capital loss of $5,000. Business income for 20X2 was $50,000, taxable capital gains were $4,000, and the company received $10,000 in dividends from a taxable Canadian corporation. Assuming Coffee Co. utilizes any unused losses in the earliest years possible, which of the following taxable incomes are correct, after all carry-over adjustments have been made?

- → 20X0: $12,000; 20X1: $0; 20X2: $52,000
- 20X0: $38,000; 20X1: ($28,000); 20X2: $64,000
- 20X0: $13,000; 20X1: ($2,000); 20X2: $62,000
- 20X0: $37,000; 20X1: $0; 20X2: $27,000

20X0	
Business Income	$37,000
Taxable Capital Gain	1,000
Net Income for Tax Purposes	$38,000
Less:	
Non-capital loss from 20X1	($25,000)
Net-capital loss from 20X1	(1,000)
Taxable Income	$ 12,000

20X1		
Business Income	($25,000)	$0
Taxable Capital Gain	2,000	
Allowable Capital Loss	(5,000)	$0
Net Income for Tax Purposes		$0
Taxable Income		$0

Loss carry-overs	
Non-capital loss	($25,000)
Net-capital loss	(3,000)

20X2	
Business Income	$50,000
Taxable Capital Gain	4,000
Taxable Canadian dividend	10,000
Net Income for Tax Purposes	$64,000
Less:	
Net-capital loss from 20X1	(2,000)
Taxable Canadian dividend	(10,000)
Taxable Income	$52,000

104.

TB 11-04 Many corporations carry on business in more than o...

Many corporations carry on business in more than one province. Assuming a corporation from Province A wishes to conduct business in Province B, the corporation will not have to pay tax in Province B if:

- the parent corporation sets up a branch in Province B.
- the permanent establishment in Province B has a lower sales to wage ratio than the ratio in Province A.
- a branch treaty exists between the two provinces.
- → business is conducted with the other province by way of direct sales from Province A.

Multiple Choice	*TB 11-04 Many corporations carry on business in more than o...*

105.

TB 11-05 Which of the following is false with regard to div...

Which of the following is *false* with regard to dividends, corporations, and shareholders?

- Corporate taxable income is generally reduced by the amount of dividends received from other taxable Canadian corporations.
- → An individual's taxable income is generally reduced by the amount of dividends received from taxable Canadian corporations.
- Corporate taxable income is generally reduced by the amount of dividends received from affiliated foreign corporations.
- Generally, Canadian corporate after-tax profits may be shifted to other Canadian corporations by way of dividends, without a tax consequence.

Multiple Choice	*TB 11-05 Which of the following is false with regard to div...*

TB 11-06 The Canadian tax system practices integration betw...

The Canadian tax system practices integration between corporations and individuals. Using the data in Table 1 and assumed rates, illustrate and explain the concept of integration.

Table 1

Corporate income	$200,000
Non-eligible dividends paid to shareholder	170,000
Corporate tax rate	15%
Personal tax rate	45%
Marginal non-eligible dividend tax rate	35%

Corporate income	$200,000
Corporate tax (15%)	(30,000)
Retained earnings	$170,000
Retained earnings paid to shareholder in form of dividend	$170,000
Personal marginal tax (35%)	59,500
Net cash	$110,500
Total tax on $200,000 or corporate income:	
Tax paid by corporation	$ 30,000
Tax paid by individual	59,500
Total tax	$ 89,500
Effective rate of tax (89,500/200,000)	45%*

*rounded

The concept of integration illustrated here shows that as income flows through a corporation and ultimately to an individual, the total tax paid on that income is relatively equivalent to the amount that the individual would have paid had he/she received the income directly, rather than through a corporation. Thus, double taxation is avoided. However, this concept is based on set tax rates, which may not always be the case due to varying factors, and double taxation may occur in some scenarios.

Short Answer	*TB 11-06 The Canadian tax system practices integration betw...*

107.

TB 11-07 Using general terms, explain how a change in contr...

Using general terms, explain how a change in control of a corporation can affect the net-capital losses and the non-capital losses.

When there is a change in control, net-capital losses are deemed to have expired. Non-capital losses may only be used against the business that originated the losses, or against income from a ‘similar' business, provided that the original business is not terminated before the losses are used, and the original business must be carried on to earn a profit or a reasonable expectation of profit in the year the loss is deducted.

Short Answer	*TB 11-07 Using general terms, explain how a change in contr...*

TB 11-08 Johnson Co. is a CCPC with active business income ...
Johnson Co. is a CCPC with active business income of $350,000 in 20X2. The company engages in retail and wholesale activities. Capital gains in 20X0 were $84,000.

Johnson Co. will utilize a net capital loss carry-over of $28,000 on its 20X2 tax return.

Required:

Calculate the federal tax payable by Johnson Co. in 20X2.

Business income	$350,000		
Taxable capital gain	42,000		
Net Income for Tax Purposes	$392,000		
Less:			
Loss carry-over	(28,000)		
Taxable Income	$364,000		
Primary federal tax		$364,000 × 38% =	$138,320
Less federal abatement		$364,000 × 10% =	(36,400)
Refundable tax on investment income:			
6 2/3 × lessor of:			
$14,000 aggregate investment income (taxable capital gain less net-loss carry-over)			
$14,000 (TI $364,000 - SBD amount $350,000)			933
Less small business deduction:			
17% × the lessor of:			
taxable income	$364,000		
active business income	$350,000		(59,500)
small business limit	$500,000		
General tax reduction 13% × ($364,000 - $350,000 - $14,000)			0
Federal tax			$43,353

Short Answer	*TB 11-08 Johnson Co. is a CCPC with active business income ...*

TB 11-09 The Stevens Company is a public Canadian corporati...

The Stevens Company is a public Canadian corporation that is primarily engaged in manufacturing. The company's head office is located in Saskatchewan. In 20X1, a small branch was established in Manitoba, to be used for sales purposes only.

In 20X2, the company's books showed the following:

Sales in Saskatchewan	$5,000,000
Sales in Manitoba	$1,000,000
Total cost of depreciable capital used in the company	$1,000,000
Depreciable capital used in manufacturing	$ 800,000
Total labour costs of the company	$2,000,000
Wages paid in Saskatchewan	$1,500,000
Labour costs associated with manufacturing	$1,300,000
Wages at the Manitoba branch	$ 500,000
Profits from manufacturing	$ 550,000
Profit from sales	$ 100,000
Dividend received from a taxable Canadian corporation	$ 50,000

Required:

A) Calculate the company's net income for tax purposes for 20X2.
B) Calculate the company's taxable income, both federal and provincial. (Round all number to two decimal places.)
C) Calculate the manufacturing and processing profits for the company.
D) Calculate the federal tax liability. (Round all numbers to zero decimal points.)

A) Net income for tax purposes:

Income from manufacturing	$550,000
Income from sales	100,000
Dividend income	50,000
Net income for tax purposes	$700,000

B) Federal taxable income:

Net income for tax purposes	$700,000
Deduct:	
Taxable Canadian dividends	(50,000)
Taxable income	$650,000

Provincial taxable income:

Saskatchewan:

(Wages)
$$\frac{\$1{,}500{,}000}{\$2{,}000{,}000} = 75\%$$

(Sales)
$$\frac{\$5{,}000{,}000}{\$6{,}000{,}000} = 83\%$$

(Average)
$$\frac{75 + 83}{2} = 79\%$$

$650,000 × .79 = $513,500
Manitoba:
100 - 79% = 21%
$650,000 × .21 = $136,500

C) Manufacturing and processing profit:

Manufacturing capital (MC) $800,000 × 10% × 100/85 =	$ 94,118
Total capital (TC) $1,000,000 × 10% =	$ 100,000
Manufacturing labour (ML) $1,300,000 × 100/75	$1,733,333
Total labour (TL) $2,000,000	$2,000,000

M & P profit:

$$\frac{\text{MC } \$94{,}118 + \text{ML } \$1{,}733{,}333}{\text{TC } \$100{,}000 + \text{TL } \$2{,}000{,}000} \times (\$550{,}000 + \$100{,}000) = \$\ 565{,}640$$

D) Federal tax:

Primary federal tax	38% × $650,000	$ 247,000
Less abatement	10% × $650,000	(65,000)
		$ 182,000
M & P deduction	13% × 565,640	(73,533)
General tax reduction	13% × ($650,000 – 565,640)	(10,967)
Total federal tax		$ 97,500

110.

TB 11-10 Bride and Groom Co. is a Canadian controlled priva...

Bride and Groom Co. is a Canadian controlled private corporation with active business income of $750,000. The company is in the business of producing and selling bridal wear. Dividends were received from a taxable Canadian corporation in the amount of $80,000.

Additional information is as follows:
Net capital loss carry-over balance is $200,000.
Non capital loss carry-over balance is $70,000.

Required:

Calculate the minimum federal Part I tax payable by Bride and Groom Co. for the year.

Business income	$750,000		
Dividends	80,000		
Net Income for Tax Purposes	$830,000		
Less:			
Non capital loss carry-over	(70,000)		
Dividend	(80,000)		
Taxable Income	$680,000		
Primary federal tax		$680,000 × 38% =	$258,400
Less federal abatement		$680,000 × 10% =	(68,000)
Less small business deduction:			
17% × the lessor of:			
taxable income	$680,000		
active business income	$750,000		
small business limit	$500,000		(85,000)
General tax reduction:			
Taxable income		$680,000	
Less:			
Income eligible for small-business deduction		(500,000)	
Income eligible for general rate reduction		$180,000	
13% × 180,000			(23,400)
Federal tax			$ 82,000

Short Answer	*TB 11-10 Bride and Groom Co. is a Canadian controlled priva...*

111.

TB 12-01 Which of the following scenarios would be most app...
Which of the following scenarios would be most appropriate for a Section 85 rollover?

- A shareholder of a corporation wishes to transfer his vehicle to his corporation. The vehicle originally cost $20,000 and has a market value of $12,000.
- A corporation wishes to convert land owned by the company into a parking lot.
- → A taxpayer wishes to transfer property worth $200,000 that originally cost $90,000 to her corporation.
- A corporation is selling its equipment to another corporation and does not wish to own shares in the other corporation.

Multiple Choice	*TB 12-01 Which of the following scenarios would be most app...*

112.

TB 12-02 Which of the following statements is true regardin...
Which of the following statements is true regarding the disposal of shares by a shareholder?

- When a shareholder sells shares to other shareholders, the corporation's capital base increases.
- The sale of shares to other shareholders is known as a 'buy-back'.
- The sale of shares to the corporate treasury is not allowed in the Income Tax Act.
- → The sale of shares to the corporate treasury may result in a deemed dividend and a capital gain or loss to the shareholder.

Multiple Choice	*TB 12-02 Which of the following statements is true regardin...*

113.

TB 12-03 Tony Brown sold 5000 of his shares back to ABC Co....
Tony Brown sold 5000 of his shares back to ABC Co. for $25,000 during the current fiscal year. He purchased these shares from Carrie White three years ago for $15,000, who had originally purchased the shares from the corporate treasury for $10,000. Which of the following tax consequences will Tony recognize?

- He will have a deemed dividend of $10,000 and no capital gain or loss.
- → He will have a deemed dividend of $15,000 and a capital loss of $5,000.
- He will have a deemed dividend of $15,000 and a capital gain of $10,000.
- He will have a deemed dividend of $10,000 and a capital gain of $10,000.

Deemed dividend:

Redemption price	$25,000
Paid-up capital	(10,000)
Deemed dividend	$15,000

Capital gain/loss

Deemed proceeds of disposition	$10,000
Adjusted cost base	(15,000)
Capital loss	($ 5,000)

Multiple Choice	*TB 12-03 Tony Brown sold 5000 of his shares back to ABC Co....*

114.

TB 12-04 Green Co. transferred a small piece of land to one...
Green Co. transferred a small piece of land to one of its shareholders as a dividend in kind. The land originally cost $50,000 and had a fair market value of $175,000 at the time of the transfer. The corporation will realize ________, and the shareholder will realize ________.

- no tax effect; a dividend of $125,000.
- a dividend of $125,000; no tax effect.
- → a capital gain of $125,000; a dividend of $175,000.
- a capital gain of $50,000; a dividend of $125,000.

$175,000 - $50,000 = $125,000 capital gain; $175,000 received as a dividend in kind.

Multiple Choice	*TB 12-04 Green Co. transferred a small piece of land to one...*

115.

TB 12-05 Corporation A is a Canadian controlled private cor...

Corporation A is a Canadian controlled private corporation and Corporation B is a public Canadian corporation. The paid-up capital of both corporations was established with $25,000 in common shares. Both corporations have a paid-up capital balance of $25,000. Which of these statements is true, provided the proper legal steps are followed?

- → If the private corporation makes a payment of $25,000 to its shareholders by reducing its paid-up capital, there will be no tax consequence.
- If the private corporation makes a payment of $25,000 to its shareholders by reducing its paid-up capital, only 50% of the payment will be taxable.
- If the public corporation makes a payment of $25,000 to its shareholders by reducing its paid-up capital, there will be no tax consequence.
- If the public corporation makes a payment of $25,000 to its shareholders by reducing its paid-up capital, only 50% of the payment will be taxable.

Multiple Choice	*TB 12-05 Corporation A is a Canadian controlled private cor...*

TB 12-06 Ben is incorporating his proprietorship and wishes...
Ben is incorporating his proprietorship and wishes to transfer the following assets using a Section 85 rollover:

	Tax Cost	FMV
Land	$ 50,000	$200,000
Building (capital cost $120,000)	100,000	140,000
Equipment (capital cost $100,000)	75,000	70,000
Inventory	25,000	30,000
Goodwill	0	20,000

Ben wishes to defer all gains at this time. He will receive the maximum note receivable possible, and the remainder of the transfer in preferred shares.

Required:

1. What is the elected transfer amount for each of the assets under Section 85?
2. What is the value of the note receivable and preferred shares that Ben must receive in order to defer any gains at this point in time?

Asset	FMV	Tax Value	Elected Amount	Non-share (note receivable) consideration	Share consideration	Total consideration
Land	$200,000	$50,000	$50,000	$50,000	$150,000	$200,000
Building	140,000	100,000	100,000	100,000	40,000	140,000
Inventory	30,000	25,000	25,000	25,000	5,000	30,000
Goodwill	20,000	0	1	0	20,000	20,000

Equipment - S.85 does not apply as the equipment is in a terminal loss position.

Short Answer	*TB 12-06 Ben is incorporating his proprietorship and wishes...*

TB 12-07 Compare shareholder equity to shareholder debt, ad...

Compare shareholder equity to shareholder debt, addressing 1) return on investment, 2) loss on investment, and 3) return of capital.

	Shareholder debt	**Shareholder equity**
Return on investment	Interest payments made to shareholders Interest is deductible by corporation Taxed in the hands of the shareholder at ordinary marginal rate	Dividend payments made to shareholders Dividends are not deductible by corporation Taxed in the hands of the shareholder at marginal dividend rate Double taxation may occur if corporate tax rate is high
Loss on investment	Preferential timing of loss Recognized in year established to be uncollectible Capital loss, or ABIL may apply	Restrictions on timing of loss Recognized when shares are sold or corporation is insolvent or bankrupt Capital loss, or ABIL may apply
Return of capital	Easily returned if enough capital in corporation Repayment is not taxable	May be sold to other shareholders of corporation Sale of shares to shareholder may create a capital gain or loss Sale of shares back to corporation may result in a deemed dividend (if redemption value is higher than paid up capital), and may result in a capital gain or loss, also.

Short Answer	*TB 12-07 Compare shareholder equity to shareholder debt, ad...*

TB 12-08 Janko Corp. has transferred three assets to Jumbo ...

Janko Corp. has transferred three assets to Jumbo Corp., a Canadian controlled private corporation, under Section 85 of the *Income Tax Act.* The following assets were transferred:

	Building	Land	Goodwill
Adjusted cost base	$230,000	$ 70,000	-0-
Fair market value	$220,000	$150,000	$50,000
UCC	$120,000	N/A	-0-
Sale price	$220,000	$150,000	$50,000
Cash received	$100,000	$100,000	-0-
Shares received	$120,000	$ 50,000	$50,000

Required:

Determine the following amounts:

a) The minimum amount that Janko may elect to transfer each asset.
b) Janko's income or loss for tax purposes
c) Jumbo's ACB for the assets acquired.
d) The ACB of the shares received by Janko.
e) The PUC of the shares received by Janko.

	a) Minimum elected value	b) Janko's income or loss	c) Jumbo's ACB	d) ACB of Janko's shares	e) PUC of Janko's shares
Building	$120,000	-0-	$230,000	$20,000	$20,000
Land	$100,000	$ 15,000	$100,000	$ 0	$ 0
Goodwill	$ 1	$ 0.50	N/A	$ 1	$ 1

Short Answer	*TB 12-08 Janko Corp. has transferred three assets to Jumbo ...*

TB 12-09 Robert Smith owns 20% of the shares of Quarks Inc....

Robert Smith owns 20% of the shares of Quarks Inc., a Canadian qualified small business corporation. He purchased the shares from a previous shareholder for $50,000. The stated paid up capital of the shares is $10,000. Two other shareholders own equal portions of the remaining shares of Quarks.

Robert has decided to sell his shares, which have a market value of $120,000. The shares are to be sold either to the two other shareholders, or back to the corporate treasury. All three shareholders used all of their capital gains deductions earlier in the year.

Robert has employment income of $185,000, capital gains in the amount of $50,000, and property income of $20,000 for the current year.

All three shareholders are in a 45% tax bracket. The marginal rate on dividends is 33%. The corporate tax rate for Quarks is 15%.

Required:

A) Determine the total tax consequences for Robert is he sells his shares to:

1) the other shareholders, and
2) the corporate treasury.

B) Determine the cost of the share purchase for:

1) the other shareholders, assuming that the purchase will be made using dividend income paid to the two shareholders from the corporation, and
2) the corporation, assuming that the purchase will be made from business profits.

C) Which option is preferential for 1) Robert and 2) the other shareholders?

A)

1) Sell to other shareholders:

Proceeds	$120,000
Adjusted cost base	(50,000)
Capital gain	$ 70,000
Taxable capital gain	$ 35,000

Tax cost: $35,000 × 45% = $15,750

2) Sell back to the corporate treasury:

Proceeds	$120,000
Less paid up capital	(10,000)
Deemed dividend S.84(3)	$110,000

Tax cost: $110,000 × 33% = $36,300

Proceeds	$120,000
Less deemed dividend	110,000
Adjusted proceeds S.54	$ 10,000
Adjusted cost base	(50,000)
Capital loss	($ 40,000)
Allowable capital loss	($ 20,000)

Tax saving: $20,000 × 45% = $9,000

Total tax consequence: Tax cost of $36,300 less tax saving of $9,000 = $27,300

B) 1) Cost to the other shareholders:
1x - .33x = $120,000
x = $179,104
1x - .15x = $179,104
x = $210,711 of pre-tax corporate income

2) Cost to the corporation:
1x - .15x = $120,000
x = $141,176 of pre-tax corporate income.

C) Robert would prefer to sell his shares to the other shareholders due to the lower tax cost for himself. The other shareholders would prefer that Robert sell his shares back to the corporate treasury as less business income would be required for the buy-back.

Short Answer	*TB 12-09 Robert Smith owns 20% of the shares of Quarks Inc....*

TB 12-10 Anthony is the sole shareholder of Glass Co. He wo...

Anthony is the sole shareholder of Glass Co. He would like to lend $500,000 to his company by way of a shareholder loan. He is not sure whether to issue an interest free loan or a loan with an interest rate of 10%. Anthony does not pay himself a salary, but rather issues all after-tax profits to himself in the form of a dividend.

Required:

A) Calculate the total combined tax liability for Anthony and Glass Co. under both alternatives. (Assume that the CRA's prescribed rate of interest is 2%; Anthony's personal tax rate is 45%; his marginal tax rate on dividends is 35%; and Glass Co. has income of $200,000, and is subject to a 15% tax rate.)
B) Briefly explain the reason for the tax differential in your results.

A) Glass Co:

	10% interest		Interest free
Business income	$200,000		$200,000
Interest paid	50,000	($500,000 × .10)	-0-
Net income for tax purposes	$150,000		$200,000
Corporate tax @ 15%	(22,500)		(30,000)
Available for dividend	$127,500		$170,000

Anthony:

Interest income	$ 50,000	
Tax @ 45%	(22,500)	
Dividend income	$127,500	$170,000
Tax @ 35%	(44,625)	(59,500)
Net proceeds	$110,375	$110,500

Combined tax:

Corporate	$ 22,500	$30,000
Anthony	67,125	59,500
Total tax cost	$ 89,625	$89,500

B) The tax liability is slightly higher in the alternative with the 10% loan because the income is shifted, by way of an interest payment, from the low corporate tax rate to the highest individual tax rate.

Short Answer	*TB 12-10 Anthony is the sole shareholder of Glass Co. He wo...*

121.

TB 13-01 Which of the following types of corporate income a...
Which of the following types of corporate income are subject to the special refundable tax of 62/3%, and a tax reduction of 262/3% upon distribution of the income?

- Business income and net property income.
- Specified investment income and dividend income.
- → Specified investment income and taxable capital gains.
- Dividend income and net taxable capital gains.

Multiple Choice	*TB 13-01 Which of the following types of corporate income a...*

122.

TB 13-02 There are several benefits to incorporating a busi...
There are several benefits to incorporating a business. Some of those benefits are:

- Lower tax rates are often recognized; the shareholder may receive compensation; and the corporation offers preferable tax rates on the business' investment income.
- → The shareholder may choose when they will receive dividend income from the corporation; a capital gains deduction may be available if conditions are met when shares are transferred to the shareholder's children; and active business income under $500,000 is eligible for a lower tax rate.
- There is greater flexibility to bring family members on board as owners; non-taxable benefits may be provided to the shareholder; and dividend distributions are deductible for tax purposes.
- A tax deferral is available if the shareholder requires the corporation's profits for personal use in the year; the shareholder may participate in a registered pension plan through the corporation; and dividend payments may be deferred until after a shareholder has retired.

Multiple Choice	*TB 13-02 There are several benefits to incorporating a busi...*

123.

TB 13-03 Private Co. received a $5,000 dividend from Public...
Private Co. received a $5,000 dividend from Public Co., which is a non-connected corporation. Which of the following applies?

- The dividends can be reinvested by Private Co. on a tax-free basis.
- The dividend will be subject to Part I tax.
- → The dividend will be subject to a tax rate of 33 1/3%.
- Receipt of the dividend will result in an immediate dividend refund for Private Co.

Multiple Choice	*TB 13-03 Private Co. received a $5,000 dividend from Public...*

124.

TB 13-04 Which of the following scenarios does not describe...
Which of the following scenarios does not describe two associated corporations (in a de jure context)?

- Blue Corp. owns 90% of the shares of White Corp.
- Yellow Corp. is wholly owned by Mrs. Smith. James Smith (Mrs. Smith's son), owns 65% of the shares of Green Corp. His mother owns the remaining 35% of the shares.
- Kelly Booker owns 100% of the shares of Read Co. His mother and father each own 30% of the shares of Write Co. A friend, Mr. Words, owns 10% of Write Co., and Kelly owns the remaining shares.
- → Mr. and Mrs. Field each own 50% of the shares of Green Co. Their children, Sue and Tim, each own 40% of Brown Co., and Mrs. Field owns the remaining 20% of the shares.

Multiple Choice	*TB 13-04 Which of the following scenarios does not describe...*

125.

TB 13-05 Corporation X had an RDTOH balance of $15,000 at t...
Corporation X had an RDTOH balance of $15,000 at the end of 20X0, and the dividend refund to the company that year was $7,000. The company's Part IV tax for 20X1 is $8,000. The company's active business income was $475,000 and its taxable income was $410,000. Corporation Y, which is associated with Corporation X, was allocated $125,000 of the small business deduction in 20X1. Corporation X's aggregate investment income was $50,000 in 20X1. Part I tax for 20X1 was $60,000. The RDTOH balance at the end of 20X1 is
(Round all numbers)

- $ 8,000
- $16,000
- → $25,335
- $29,335

RDTOH at the end of 20X0		$15,000
Less dividend refund for 20X0		(7,000)
		$ 8,000
Add:		
Part IV tax for 20X1		$ 8,000
Refundable portion of Part I tax: lessor of:		
26 2/3 × aggregate investment income ($50,000)	$13,335	
26 2/3 × (taxable income [$410,000] - income subject to small business deduction [$375,000*])	$ 9,335	$ 9,335
Part I tax	$60,000	
RDTOH at the end of 20X1		$25,335

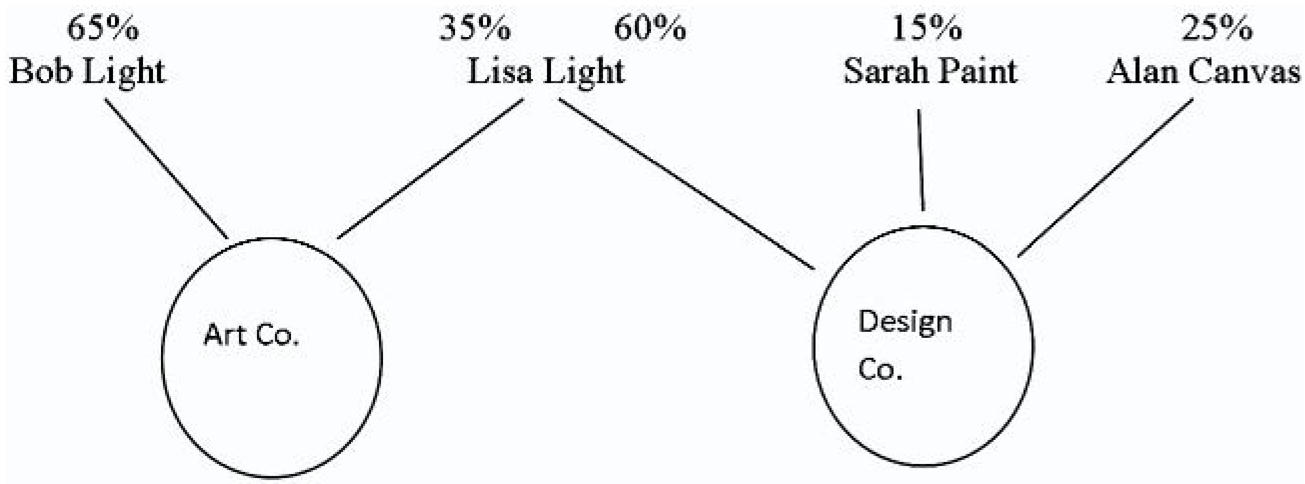
*Small business deduction:
17% × lessor of:

Active business income	$475,000
Taxable income	$410,000
Annual limit ($500,000 - $125,000 allocated to Corporation Y)	$375,000

Multiple Choice	*TB 13-05 Corporation X had an RDTOH balance of $15,000 at t...*

TB 13-06 The following diagram depicts the ownership struct...

The following diagram depicts the ownership structure of two CCPCs. Bob Light is Lisa Light's son. Sarah Paint and Alan Canvas are not related to Bob and Lisa in any manner, what-so-ever. All of the shares held are common shares.



Required:

A) Determine if the two companies are associated, referring to the Income Tax Act.
B) Briefly explain what the most significant tax implication is when two or more corporations are associated.

A) The two corporations are associated as defined by paragraph 256(1)(c) of the ITA.
Each corporation is controlled by one person, and the two people are related, and one of the people, Lisa Light, owns not less than 25% of the shares of either corporation.
B) The associated companies will have to share the small business deduction.

Short Answer	*TB 13-06 The following diagram depicts the ownership struct...*

TB 13-07 Beans Co. is a Canadian-controlled private corpora...
Beans Co. is a Canadian-controlled private corporation with a December 31 year-end. The company had profits of $200,000 during the year. Of this amount, $15,000 was from dividend income. The remaining income was from active business.

Additional information:

The dividends were received from Grow Ltd., a connected Canadian-controlled private corporation. Grow has only one class of shares, and the total amount of dividends paid was $75,000. Grow received a refund of $9,000 as a result of paying the dividend.

Beans Co. had a balance in its Refundable Dividend Tax on Hand Account of $3,000 at the end of the previous year.

Beans Co. is associated with Peas Co. which used $220,000 of the small business deduction limit.

The profits include a donation expense of $1,000.

Amortization was $30,000 this year. CCA was $28,500. Beans utilizes the maximum CCA deduction each year.

Required:

A) Calculate the small-business deduction for Beans Co. for the current fiscal year.
B) Calculate the Part IV Tax for Beans Co. for the current fiscal year.

Income	$200,000
Amortization	30,000
CCA	(28,500)
Donations	1,000
Net income for tax purposes	$202,500
Deduct	
Dividends	(15,000)
Donations	(1,000)
Taxable income	$186,500

A) Small business deduction - 17% × lessor of:

• Active business income - $187,500 (Net income for tax purposes $202,500 - dividends $15,000)
• Taxable income - $186,500
• Annual limit - $280,000 ($500,000 - $220,000 used by Peas Co.)

17% × $186,500 = $31,705

B) Part IV Tax:

Dividend received by Beans: $15,000 × Grow's dividend refund of $9,000 = $1,800
Total dividend paid by Grow: $75,000

Short Answer	*TB 13-07 Beans Co. is a Canadian-controlled private corpora...*

TB 13-08 Chartered Tours Inc. (CTI) started operations this...

Chartered Tours Inc. (CTI) started operations this year and had a net income for tax purposes of $800,000. (Chartered Tours Inc. operates in a province which has a provincial tax reduction on income earned from manufacturing and processing.)

CTI also:

a) made a contribution of $25,000 to eligible charities;
b) received $30,000 in dividends from taxable Canadian corporations;
c) recognized manufacturing and processing profits of $250,000;
d) had active business income of $770,000; and
e) did not receive any taxable dividends from other corporations, or pay out any taxable dividends in the previous year.

For tax purposes, CTI is associated with Rocky Mountain Hikers Inc. (RMHI). RMHI was able to use $310,000 of the small business deduction.

Required:

Calculate the following, ignoring provincial taxes:

a) CTI's taxable income
b) CTI's small business deduction
c) The M & P deduction available to CTI
d) CIT's general rate reduction
e) The balance in CTI's GRIP account at the end of the year

a)

Net income for tax purposes	$800,000
Less:	
Donations	(25,000)
Dividends	(30,000)
Taxable Income	$745,000

b)

17% × lessor of:	
Active business income	$770,000
Taxable income	$745,000
Annual limit ($500,000 - $310,000 used by RMHI)	$190,000

Small business deduction = $190,000 × 17% = $32,300

c) Manufacturing and processing deduction:
13% × lessor of:

M & P profit	$250,000
Less: income applied to small business deduction	(190,000)
	$ 60,000
Taxable income	$745,000
Less: income applied to small business deduction	(190,000)
	$555,000

$60,000 × 13% = $7,800

d) General rate reduction:

Taxable income	$745,000
Less:	
Income eligible for the M & P deduction	60,000
Income eligible for the small business deduction	190,000
Investment income	0
Income eligible for the general rate reduction	$495,000

$495,000 × 13% = 64,350

e) General Rate Income Pool

Balance at the end of the previous year		$ 0
Add:		
72% of:		
Taxable income	$745,000	
Less:		
Income subject to the small business deduction	(190,000)	
Aggregate investment income	(0)	
	$555,000	
72% × $555,000		$399,600
Balance at the end of the current year		$399,600

Short Answer	*TB 13-08 Chartered Tours Inc. (CTI) started operations this...*

129.

TB 14-01 Which of the following is one of the conditions ne...

Which of the following is one of the conditions necessary for an amalgamation to result in a tax-free combination?

- At least one of the corporations must be Canadian.
- At least 50 percent of the assets and liabilities of the old corporation must become assets and liabilities of the new corporation.
- The two corporations must be in a similar line of business.
- → All of the shareholders of the old corporations must become shareholders of the new corporations.

Multiple Choice	*TB 14-01 Which of the following is one of the conditions ne...*

130.

TB 14-02 Tom and Bob are equal shareholders of a profitable...

Tom and Bob are equal shareholders of a profitable operating company. The company is growing and dividend payouts are increasing. The two men have heard that ‘holding corporations' might suit their needs. Which of the following would apply?

- Dividends received by the holding companies from the operating company must be invested in the same ventures.
- → The holding companies would receive the dividends from the operating company, free of tax, to be invested in ventures of Tom and Bob's separate choices.
- The establishment of holding corporations would allow Tom and Bob to access the profits of the operating company for personal expenditures without paying a second level of tax.
- Dividends would flow from the operating company to Tom and Bob, and then to the holding corporations.

Multiple Choice	*TB 14-02 Tom and Bob are equal shareholders of a profitable...*

131.

TB 14-03 The Browns have owned and operated The Tile Compan...

The Browns have owned and operated The Tile Company Inc. for thirty years and are ready to retire. Their long-time employee wishes to buy the company but does not have the funds available to do so at this time. Which section of the income tax act would allow the Browns to transfer the value of their common shares to preferred shares on a tax-deferred basis while issuing new common shares to the employee for a nominal value?

- Section 85
- → Section 86
- Section 87
- Section 88

Multiple Choice	*TB 14-03 The Browns have owned and operated The Tile Compan...*

132.

TB 14-04 Mr. Chan has created a holding company between him...

Mr. Chan has created a holding company between himself and his corporation. This will permit which of the following?

- The corporation's income will not be taxed.
- Mr. Chan will receive dividends from the holding company, free of tax.
- → The holding company will receive dividends from the corporation, free of tax.
- Mr. Chan will receive dividends from the corporation, free of tax.

Multiple Choice	*TB 14-04 Mr. Chan has created a holding company between him...*

133.

TB 14-05 Jack Grey is the sole shareholder of Grey's Garden...

Jack Grey is the sole shareholder of Grey's Garden tools. He owns one class of common shares which have a value of $200,000. Jack is approaching retirement age and would like his two key employees to take over his company some day. At this point in time, the employees do not have enough excess cash to buy Jack's shares. Which of the following statements is true with regard to a corporate reorganization that would allow the employees to take over the ownership?

- Section 86 of the Income Tax Act would allow Jack to restructure the ownership of his company and would result in an immediate tax consequence for himself.
- Section 86 of the Income Tax Act would allow Jack to restructure the ownership of his company and would result in an immediate tax consequence for his employees.
- → Section 86 of the Income Tax Act would allow Jack to restructure the ownership of his company and would result in the conversion of his common shares to preferred shares.
- Section 86 of the Income Tax Act would allow Jack to restructure the ownership of his company and would result in a continual growth of preferred shares.

Multiple Choice	*TB 14-05 Jack Grey is the sole shareholder of Grey's Garden...*

134.

TB 14-06 Hold Co. is a Canadian controlled private corporat...

Hold Co. is a Canadian controlled private corporation that acquired 100% of the shares of Small Co. in 20X5. Hold Co. paid $50,000 for the shares. Big Co., an arm's length corporation, is now interested in purchasing Hold Co.'s investment in Small Co. Small Co.'s shares are currently worth $500,000 and the retained earnings of the company are $200,000. In order to reduce the fair market value of the shares, Small Co. will pay a dividend of $450,000 to Hold Co., and then sell the shares for $50,000.

Required:

Presuming Subsection 55(2) applies, how much is the capital gain that Hold Co. will have to realize on this sale? (Ignore Part IV tax.)

Actual proceeds of disposition		$ 50,000
Add: Deemed proceeds of disposition		
Dividend received	$450,000	
Retained earnings	(200,000)	250,000
Proceeds		$300,000
ACB		(50,000)
Capital gain		$250,000

Short Answer	*TB 14-06 Hold Co. is a Canadian controlled private corporat...*

135.

TB 14-07 The shareholders of Parent Co. and Sub Co. wish to...

The shareholders of Parent Co. and Sub Co. wish to combine the business activities of the two companies through a business combination. Both companies have assets that have appreciated in value above their capital cost. Parent Co. owns 85% of the shares of Sub Co.

Required:

Suggest a business combination (amalgamation or wind-up) that would defer the tax consequences associated with the increased value of the assets, and explain why you did not choose the other option.

Parent Co. and Sub Co. can amalgamate, as this will allow them to transfer the assets at their tax values, thereby deferring any tax consequences. Since Parent Co. owns less than 90% of Sub Co. a wind-up would not allow for a deferral of the tax gains.

Short Answer	*TB 14-07 The shareholders of Parent Co. and Sub Co. wish to...*

TB 14-08 Stan is the sole shareholder of Hardware Ltd. Hard...

Stan is the sole shareholder of Hardware Ltd. Hardware purchased all of the shares of Tools Inc. in 20X6 for $500,000. Tools incurred a non-capital loss of $25,000 in the year ended December 31, 20X5. Stan has decided to initiate a wind-up of Tools Inc. into Hardware Ltd. on June 23, 20X9. Due to the seasonal nature of his sales, Stan would like to maintain the April 30th year end that he has used since beginning his business.

Stan's accountant has prepared the following anticipated balance sheet for Tools Inc. as of June 22, 20X9. The fair market value of the assets on both June 22, 20X9 and the date of acquisition in 20X6 are presented in the following table:

	Balance Sheet	FMV June 22, 20X9	FMV 20X6
Shares in PubCo.	$25,000	$80,000	$70,000
Accounts Receivable (net of $2,000 in doubtful accounts)	$18,000	$18,000	
Goodwill	$0	$70,000	$30,000
Land	$125,000	$500,000	$300,000
Building (*UCC)	$100,000*	$300,000	$210,000
Total Assets	$268,000		
Bank Loan	$70,000		
Common shares	$10,000		
Retained earnings	$188,000		
Total liabilities	$268,000		

Tools paid dividends of $8,000 to Hardware in 20X9.

Required:

Answer the following questions (filling in the charts where provided):

1) Immediately following the windup, Hardware will report the above assets at what values?

Shares in PubCo.	
Accounts receivable	
Goodwill	
Land	
Building	

2) Calculate the value of the "bump" available on the ACB for the non-depreciable capital property.
3) Identify the assets which may use the bump, and the amount of the bump available for each asset identified. Identify any unusable bump amount.

1)

Shares in PubCo.	$25,000
Accounts receivable	$20,000
Goodwill	NIL
Land	$125,000
Building	$100,000

2)

Hardware's ACB of Tool's shares		$ 500,000
Less cost amount of subsidiary net assets:		
Shares of PubCo. at cost	25,000	
Accounts receivable (Net)	18,000	
Land at cost	125,000	
Building at UCC	100,000	
Goodwill ($^4/_3 \times$ Nil CEC balance)	Nil	
Loan payable	(70,000)	
	$ 198,000	
Add: dividends paid by Tools to Hardware	8,000	206,000
Maximum bump allowed [Sec.88(1)(d)]		$ 294,000

3) The bump available to the public shares is $45,000 ($70,000 - $25,000).
The bump available to the land is $175,000 ($300,000 - $125,000).
The bump cannot be allocated to the depreciable assets.
$294,000 - 45,000 - 175,000 = $74,000 of the bump in unusable.

Short Answer	*TB 14-08 Stan is the sole shareholder of Hardware Ltd. Hard...*

137.

TB 15-01 Which of the following statements regarding partne...
Which of the following statements regarding partnerships is TRUE?

- Partnership income is taxed in the partnership.
- Partnership losses *cannot* be offset against the partner's other income.
- Partnership income does not have to be reported to the Canada Revenue Agency.
- → Partnerships may earn business income, property income, and capital gains.

Multiple Choice	*TB 15-01 Which of the following statements regarding partne...*

138.

TB 15-02 ABC Co. and XYZ Co. have entered into a 50/50 part...

ABC Co. and XYZ Co. have entered into a 50/50 partnership for business purposes. Both companies are CCPCs and they share the profits and losses of the business equally. During the year, the partnership earned $200,000 of active business income, and ABC Co. earned $450,000 in business income from operations other than the partnership. All of the companies have a December 31st year-end. How much of ABC Co.'s share of the partnership profits will be eligible for the small business deduction.

- $200,000
- $100,000
- → $50,000
- $0

	Available for SBD	Not available for SBD
Business income from ABC Co. (200,000/2 = 100,000)	$ 50,000	$ 50,000
Business income from other business sources	450,000	
	$500,000	

Multiple Choice	*TB 15-02 ABC Co. and XYZ Co. have entered into a 50/50 part...*

139.

TB 15-03 Small Corp. and Big Corp. are equal partners in Me...

Small Corp. and Big Corp. are equal partners in Medium Enterprises. The total partnership has a net worth of $210,000, split 50/50 between the two corporations. Size Co. has been asked to join the partnership. When the transaction is complete, all three partners will have an equal interest. To accomplish this structural change, Size Co. will contribute $105,000 to the partnership treasury. This transaction which

- → dilute the original partners' interests.
- increase the original partners' interests.
- result in a capital gain for the partners.
- result in a capital loss for the partners.

Multiple Choice	*TB 15-03 Small Corp. and Big Corp. are equal partners in Me...*

140.

TB 15-04 Small Corp. and Big Corp. are equal partners in Me...
Small Corp. and Big Corp. are equal partners in Medium Enterprises. The partnership has a net worth of $210,000, split 50/50 between the two corporations. Size Co. has been asked to join the partnership in a manner that will not have a tax consequence to the existing partners. When the transaction is complete, all three partners will have an equal interest. To accomplish this structural change, Size Co. must

- contribute $210,000 to the partnership treasury.
- → contribute $105,000 to the partnership treasury.
- pay $105,000 to each of the partners.
- pay $70,000 to each of the partners.

Multiple Choice	*TB 15-04 Small Corp. and Big Corp. are equal partners in Me...*

141.

TB 15-05 Which of the following statements regarding partne...
Which of the following statements regarding partnerships is true?

- Partners must contribute equal portions of capital to the partnership.
- → It is possible that a minority partner will have significant influence over the partnership.
- A holding corporation cannot act as a partner.
- A general partnership is a protected legal entity, separate from the partner's affairs.

Multiple Choice	*TB 15-05 Which of the following statements regarding partne...*

142.

TB 15-06 John Brown and Alice Green want to start a busines...

John Brown and Alice Green want to start a business together. They will have equal ownership of the company. Alice would like to know whether a partnership or a corporation would be the best form of business (in her situation), strictly from a tax perspective. Alice would not take any form of payment from the company in the first year.

The following information is available for Alice.

Alice Green:	
Employment income:	$100,000
Interest income:	5.000

Assume a constant tax rate of 41%.
A loss of $25,000 is anticipated for Year 1 of the business.
The corporate tax rate is 15%.

Required:

Based solely on minimizing Alice's Year 1's tax liability, which form of business will be most beneficial to Alice? Support your answer with calculations.

If the business is incorporated:
$105,000 × .41 = Personal tax liability of $43,050 + $0 corporate tax on the business due to the loss
If a partnership is formed:
$105,000 - 12,500 (Alice's share of the loss) = 92,500 Net income for tax purposes × .41 = Personal tax liability of $37,925
Tax savings = $5,125
Solely from a tax perspective, a partnership would be most beneficial for Alice at this point in time.

Short Answer	*TB 15-06 John Brown and Alice Green want to start a busines...*

TB 15-07 Sharon is a forty percent partner in Green Nursery...

Sharon is a forty percent partner in Green Nursery. She also works full-time as an engineer, earning a gross salary of $100,000, annually. Green Nursery's net income for tax purposes is $210,000. During the year, Green Nursery received $10,000 in non-eligible dividends from a CCPC. The company sold a capital asset and recognized a gain of $16,000. (The dividend income and capital gains income have been included in the net income.) Sharon withdrew $20,000 from the partnership. The ACB of Sharon's partnership interest was $75,000 at the end of the previous year.

Required:

A) Calculate the partnership's business income for 2013.
B) Calculate Sharon's net income for tax purposes for 2013.
C) Calculate the ACB of Sharon's partnership interest for the year for 2013.

A) Net income for tax purposes	$210,000
Less:	
Dividend income	10,000
Taxable capital gain	8,000
Business income	$192,000
B) Employment income	$100,000
Business income from partnership $192,000 × 40%	76,800
Property income (dividend) (10,000 × .4) × 1.18	4,720
Taxable capital gain $8,000 × 40%	3,200
Sharon's net income for tax purposes	$184,720
C) ACB, beginning of year	$ 75,000
Add:	
Sources of partnership income $210,000 × .4	84,000
Non-taxable portion of capital gain $16,000 × .5 × .4	3,200
Deduct:	
Cash withdrawals	($ 20,000)
ACB, end of year	$142,200

Short Answer	*TB 15-07 Sharon is a forty percent partner in Green Nursery...*

TB 15-08 Green Co. and Blue Co. are equal partners in Turqu...
Green Co. and Blue Co. are equal partners in Turquoise Paint. Turquoise Paint had profits this year of $300,000, before CCA.

Green Co. is a CCPC owned by Bob. Green Co.'s net income for tax purposes is $200,000.
Blue Co. is a CCPC owned by Sally. Blue Co. has suffered losses over the past five years. This year Blue Co. had a loss of $150,000.
Blue Co. has carry-forward non-capital losses of $200,000.

The capital cost allowance for Turquoise Paint this year is $72,000.

Required:

A) Calculate the partnership's business income for tax purposes that Bob would prefer to use, and explain why.
B) Calculate the partnership's business income for tax purposes that Sally would prefer to use, and explain why.

A) Partnership profit before CCA	$300,000
CCA	(72,000)
Profits for allocation	$228,000
Bob would prefer the minimum profits allowed since Green Co. has taxable earnings, and his portion of the partnerships profits will be added to the Green Co.'s earnings.	
B) Partnership profit before CCA	$300,000
CCA	(0)
Profits for allocation	$300,000
Sally would prefer the maximum profits allowed since Blue Co. is in a loss position, and her portion of the partnership profits can be offset against the losses of Blue Co.	

Short Answer	*TB 15-08 Green Co. and Blue Co. are equal partners in Turqu...*

145.

TB 16-01 Wayne and Wendy are equal partners in ABC Windows....

Wayne and Wendy are equal partners in ABC Windows. Wayne is a general partner and Wendy is a limited partner. Both partners have invested $20,000 in the company. ABC Windows experienced a loss of $50,000 this year. Which of the following statements regarding this loss is TRUE?

- → Wayne may claim a loss for tax purposes of $25,000 this year.
- Wendy may claim a loss for tax purposes of $25,000 this year.
- Wayne may claim a loss for tax purposes of $50,000 this year.
- Wendy may claim a loss for tax purposes of $50,000 this year.

Multiple Choice	*TB 16-01 Wayne and Wendy are equal partners in ABC Windows....*

146.

TB 16-02 While partnerships and joint ventures have some si...

While partnerships and joint ventures have some similarities, they have significant differences. Which of the following is FALSE with regard to partnerships and joint ventures?

- Neither joint ventures nor partnerships are separate taxable entities.
- All partners in a partnership are subject to the same CCA decision in a given tax year, while members of a joint venture may each decide their own amount of CCA to be deducted.
- → Partners in a partnership and members of a joint venture are both restricted to their profit-sharing ratio of the $500,000 small business deduction limit.
- Joint ventures are more limited in their use than partnerships, although they have more flexibility with regard to their tax decisions.

Multiple Choice	*TB 16-02 While partnerships and joint ventures have some si...*

147.

TB 16-03 An outside passive investor has $50,000 to invest ...

An outside passive investor has $50,000 to invest in a limited partnership. The individual will be one of several limited partners in the business. The business is not expected to make a profit for at least five years, and there is a chance that it may not succeed at all due to its nature. Why has the investor most likely chosen to invest in this business?

- The investor will be guaranteed to receive the $50,000 back if the venture fails.
- → The flow-through of losses is an important issue for the investor.
- The investor is not in a hurry to recover his/her investment.
- None of the above. An investor would never choose to invest in such a business.

Multiple Choice	*TB 16-03 An outside passive investor has $50,000 to invest ...*

148.

TB 16-04 Steven Howe invested $25,000 as an outside passive...

Steven Howe invested $25,000 as an outside passive investor in a limited partnership. His partnership interest is 30%. During the first year, the partnership had a business loss of $100,000. Steven is in a 45% tax bracket. What was the net amount of Steven's investment at the end of the year?

- $11,250
- $11,500
- $13,500
- → $13,750

Cash contributed	$25,000
Tax savings from loss	
($25,000* × 45%)	(11,250)
Net amount of investment	$13,750

*Restricted to 'at-risk amount'

Multiple Choice	*TB 16-04 Steven Howe invested $25,000 as an outside passive...*

149.

TB 16-05 Three Hills Partnership had profits of $210,000 in...

Three Hills Partnership had profits of $210,000 in 20X1. Shawna Hill had invested $100,000 as a limited partner, and her partnership interest is 30%. Shawna is in a 45% tax bracket. What is Shawna's after-tax return on her investment in the partnership? (Rounded)

- 30%
- → 35%
- 48%
- 63%

Partnership income	$210,000
Shawna's share (30%)	$ 63,000
Less tax of 45%	(28,350)
After-tax return	$ 34,650

Return on investment $34,650/$100,000 = 35% (rounded)

Multiple Choice	*TB 16-05 Three Hills Partnership had profits of $210,000 in...*

150.

TB 16-06 Teresa White is one of 5 equal limited partners in...
Teresa White is one of 5 equal limited partners in House Designs Enterprises (HDE). She contributed $100,000 five years ago when the enterprise began. During the year, HDE generated pre-tax profits of $500,000. The sole general partner, Betty Carmel, receives 55% of the company's profits. Both Teresa and Betty are subject to a 45% marginal personal tax rate.

Required:

Calculate Teresa's after-tax rate of return on her investment.

Partnership income	$500,000
Teresa's shares (100 – 55)/5 = 9%	$ 45,000
After-tax return (1-.45) × $45,000	$ 24,750
Return on investment: $24,750/$100,000 = 24.75%	

Short Answer	*TB 16-06 Teresa White is one of 5 equal limited partners in...*

151.

TB 16-07 A friend of yours is considering entering into a j...
A friend of yours is considering entering into a joint venture but knows very little about this form of business structure. You have been asked to provide the following information:

A) What is the purpose of a joint venture?
B) How are joint ventures taxed?
C) Give an example of a joint venture.

A) The purpose of a joint venture is to carry out a single transaction or to engage in an activity of limited duration.
B) A joint venture is not a separate taxable entity. The income from a joint venture is distributed to its members, and members can individually choose the timing and use of some expenses, such as CCA and doubtful accounts.
C) Examples of joint ventures are: construction projects, resource exploration activities, research and development projects, entertainment projects-i.e. movies, concerts, and plays

Short Answer	*TB 16-07 A friend of yours is considering entering into a j...*

152.

TB 16-08 Jerome has a 10% interest in a limited partnership...
Jerome has a 10% interest in a limited partnership. The adjusted cost base of Jerome's partnership interest at the beginning of 20X0 was $30,000. During 20X0 the partnership reported a $10,000 taxable capital gain and $150,000 in business income. At the end of 20X0 Jerome had an outstanding loan balance of $10,000 with the partnership.

Required:

Determine Jerome's "at-risk amount" at the end of 20X0.

Beginning ACB	$30,000
Percentage of taxable capital gain (10,000 × 10%)	1,000
Percentage of non-taxable capital gain (10,000 × 10%)	1,000
Percentage of business income (150,000 × 10%)	15,000
Balance of loan	(10,000)
At-risk amount [ITA 96(2.2)]	$37,000

Short Answer	*TB 16-08 Jerome has a 10% interest in a limited partnership...*

153.

TB 17-01 Which of the following statements is true regardin...
Which of the following statements is true regarding trusts?

- Losses that exceed income in a trust are allocated to the beneficiary for tax purposes.
- → If an individual, who is the beneficiary of a trust, has a tax rate in the year that is greater than the tax rate of his/her trust, amounts payable to the beneficiary from the trust can be designated not to be payable.
- Income that is payable to a beneficiary cannot be subtracted from the trust's income.
- The residence of a trust is determined by the residence of the trustees.

Multiple Choice	*TB 17-01 Which of the following statements is true regardin...*

154.

TB 17-02 A trust that is created upon the death of an indiv...
A trust that is created upon the death of an individual, and which is taxed applying the full range of tax rates within the individual's progressive scale is a(n):

- Unit investment trust
- Inter vivos trust
- Investment trust
- → Testamentary trust

Multiple Choice	*TB 17-02 A trust that is created upon the death of an indiv...*

155.

TB 17-03 Which of the following statements accurately descr...
Which of the following statements accurately describes the rules pertaining to testamentary trusts?

- Testamentary trusts must use the calendar year as their taxation year, and they are subject to the highest federal personal tax rate.
- Testamentary trusts must use the calendar year as their taxation year, and they may apply the full range of rates from the personal graduated tax rate scale.
- Testamentary trusts may use the calendar year as their taxation year or choose a taxation year that ends within twelve months of inception of the trust, and they are subject to the highest federal personal tax rate.
- → Testamentary trusts may use the calendar year as their taxation year or choose a taxation year that ends within twelve months of inception of the trust, and they may apply the full range of rates from the personal graduated tax rate scale.

Multiple Choice	*TB 17-03 Which of the following statements accurately descr...*

156.

TB 17-04 If a trust qualifies as a spousal trust, which of ...
If a trust qualifies as a spousal trust, which of the following does not apply?

- Property is deemed to have been sold at its cost amount when transferred to the trust.
- Upon the death of the surviving spouse, the trust property is deemed to be sold at market value.
- → Both the spouse and any adult children can receive the capital of the trust prior to the settlor's death.
- In many situations, the assets in the trust remain tax-free until the death of the surviving spouse due to the waiver of the 21-year rule at the first 21-year anniversary.

Multiple Choice	*TB 17-04 If a trust qualifies as a spousal trust, which of ...*

157.

TB 17-05 A trust account holds two buildings as its assets....
A trust account holds two buildings as its assets. Building 1 originally cost $150,000 and Building 2 originally cost $210,000. It is now the 21st anniversary of the trust, and the assets have not been transferred to the beneficiary. The undepreciated capital cost of Building 1 is $85,000 and its market value is $200,000. The undepreciated capital cost of Building 2 is $145,000 and its market value is $190,000. Which costs will be the deemed acquisition values of the buildings for the trust?

- B1 = $150,000; B2 = $210,000
- B1 = $85,000; B2 = $145,000
- B1 = $200,000; B2 = $190,000
- → B1 = $200,000; B2 = $210,000

Multiple Choice	*TB 17-05 A trust account holds two buildings as its assets....*

TB 17-06 Walter Adamson passed away this year at the age of...
Walter Adamson passed away this year at the age of 62.

Previously, Walter had structured his will so that his wife would receive his stocks and land, to be held in a trust on her behalf. Additionally, his 33 year old son, Steven, would receive a building to be held in a trust until Steven reached the age of 45.

The assets transferred to Mrs. Adamson consist of a piece of land with an ACB of $100,000 and a FMV of $300,000; and stocks valued at $200,000, with a cost base of $150,000.

The assets transferred to Steven consist of a building with an ACB of $200,000, a UCC of $180,000, and a FMV of $300,000.

Required:

Discuss the immediate tax consequences for Walter's tax return, Mrs. Adamson, and Steven, regarding the initial transfer of these assets, showing calculations where necessary.

Walter:

Walter's estate will have a taxable capital gain of $50,000 and recapture of $20,000 upon the disposal of the building bequeathed to Steven.

Building transferred to Steven's testamentary trust:

Taxable Capital Gain:	
	Building
Proceeds (FMV)	$300,000
ACB	200,000
Capital gain	$100,000
Taxable capital gain	$ 50,000
Recapture:	
UCC	$180,000
ACB	(200,000)
Recapture	($ 20,000)

Mrs. Adamson:

There will be no tax consequence on the $100,000 cash received by Mrs. Adamson.
The other assets will be transferred to a testamentary spousal trust at their tax values, and therefore, there will not be any immediate tax effects.

Steven:

The building will be transferred to a testamentary trust at its FMV. The taxable capital gain and recapture realized on the transfer are taxed in Walter's estate.

Short Answer	*TB 17-06 Walter Adamson passed away this year at the age of...*

159.

TB 17-07 Your friend Andrew has heard that you are studying...

Your friend Andrew has heard that you are studying Canadian income taxation. He has heard people discussing something called the ‘21 Year Rule' with regard to trusts. He has come to you with questions regarding this rule, since his father recently established inter vivos trusts for Andrew and his mother.

Required:

Briefly answer the following questions. (Base your answers to Questions 1 - 4 on non-spousal trusts.)

1) What is the purpose of the "21 Year Rule"?
2) What event occurs on the 21^{st} anniversary of a trust?
3) What types of properties are subject to the 21 Year Rule?
4) How can the consequences of the 21 Year Rule be avoided?
5) What is the exception to the 21 Year Rule for spousal trusts?

A) The 21 Year Rule applies to inter vivos and testamentary trusts. It is in effect in order to prevent trusts from escaping tax on specific types of property held for long periods of time.
B) The specific properties of the trust are deemed to be sold at their market values, thereby realizing capital gains and recapture when applicable.
C) Capital properties (non-depreciable), depreciable properties, land that is inventory, and resource property are subject to the 21 Year Rule.
D) Properties can be transferred to the beneficiaries prior to the 21^{st} anniversary, at their tax cost, thereby deferring the tax effects.
E) Spousal trusts are exempt from realizing a deemed disposition of the properties at the first 21 Year anniversary.

Short Answer	*TB 17-07 Your friend Andrew has heard that you are studying...*

160.

TB 17-08 Jasmine is the beneficiary of an inter vivos trust...

Jasmine is the beneficiary of an inter vivos trust. During 20X4, the trust received the following income:

Capital gains: $16,000
Interest: $12,000
Non-eligible dividends: $8,000

One half of the trust's income from 20X4 was paid to Jasmine, who does not currently have any other sources of income. The remainder of the income stayed in the trust.

Required:

a) Determine the federal tax payable for Jasmine.
b) Explain how the federal tax liability will differ for the trust. (Support your answer with calculations.)

a) Net and taxable income for Jasmine:
$16,000 × 50% × 50% = $4,000
$12,000 × 50% = $6,000
$8,000 × 1.18 × 50% = $4,720
$4,000 + $6,000 + $4,720 = $14,720
$14,720 × 15% federal tax = $2,208

Less: Basic personal tax credit	
($11,138 × 15%)	(1,671)
Less: Dividend tax credit	
($4,720 × .11)	(519)
Federal tax liability (rounded):	$ 18

b) The federal tax liability will differ for the trust because the trust is taxed at the highest tax bracket of 29%, and the basic personal tax credit is not available to the trust.

Therefore, the trust will have a federal tax liability of $3,683.

Net and taxable income for the trust:
$16,000 × 50% × 50% = $4,000
$12,000 × 50% = $6,000
$8,000 × 1.18 × 50% = $4,720
$4,000 + $6,000 + $4,720 = $14,720
$14,720 × 29% federal tax = $4,269

Less: Dividend tax credit	
($4,720 × .11)	(519)
Federal tax liability (rounded):	$3,750

Short Answer	*TB 17-08 Jasmine is the beneficiary of an inter vivos trust...*

161.

TB 18-01 Sam Sherwood wishes to purchase Kitchen Cabinets, ...
Sam Sherwood wishes to purchase Kitchen Cabinets, Inc. (KCI), from its sole shareholder, Steve Oaks. Which of the following is TRUE if Sam purchases the assets rather than the shares of the corporation?

- Payment of the purchase price will flow directly to Steve Oaks.
- Sam will have no choice but to assume the liabilities of KCI.
- → Kitchen Cabinets Inc. may be subject to business income and capital gains.
- Sam will have to acquire all of the assets of KCI.

Multiple Choice	*TB 18-01 Sam Sherwood wishes to purchase Kitchen Cabinets, ...*

162.

TB 18-02 The Flower Company is for sale. The anticipated av...
The Flower Company is for sale. The anticipated average profits for the next five years of the business have been calculated at $150,000. The business has been valued at $750,000 using the earnings method. The net tangible assets have been appraised at $625,000. Which of the following is true for the Flower Company?

- The company is expected to yield a 20% return for the purchaser, and the cost of the business is too low.
- → The company is expected to yield a 20% return for the purchaser, and goodwill of $125,000 is present.
- The company is expected to yield a 24% return for the purchaser, and goodwill of $125,000 is present.
- The company is expected to yield a 24% return for the purchaser, and goodwill of $475,000 is present.

Multiple Choice	*TB 18-02 The Flower Company is for sale. The anticipated av...*

163.

TB 18-03 A purchaser has agreed to purchase all of the shar...
A purchaser has agreed to purchase all of the shares of Tee Co., a CCPC. Tee Co. owns fifteen significant capital assets, some of which have appreciated in value. Which of the following is TRUE?

- The purchaser will obtain a cost base of the assets equal to fair market value.
- The capital cost allowance on the assets will be higher for the purchaser than it was for the vendor.
- The sale will result in business income for the vendor.
- → The purchaser will be responsible for the liabilities of Tee Co.

Multiple Choice	*TB 18-03 A purchaser has agreed to purchase all of the shar...*

164.

TB 18-04 Stick Co. owns land with a fair market value of $1...
Stick Co. owns land with a fair market value of $100,000, a building with a fair market value of $75,000, and equipment with a fair market value of $25,000. These assets are used for active business conducted in Canada. Which of the following would disqualify Stick Co. from being a small business corporation?

- Stick Co. also owns 40% of the shares of Rock Co. (a small business corporation), which have a fair market value of $20,000.
- Stick Co. also owns shares in Leaf Co., (a public corporation), which have a fair market value of $5,000.
- → Stick Co. also has long-term investments valued at $30,000.
- Stick Co. sold the equipment and used the funds to purchase 35% of the shares of Tree Co., a small business corporation.

$100,000 + $75,000 + $25,000 + $30,000 = $230,000 ($230,000 - $30,000 = $200,000) $200,000/$230,000 = 87%. (< 90% active assets)

Multiple Choice	*TB 18-04 Stick Co. owns land with a fair market value of $1...*

165.

TB 18-05 When deciding whether to purchase the shares or as...
When deciding whether to purchase the shares or assets in business acquisitions, which of the following are the three major tax considerations for the purchaser?

- → Future tax rates, impact on cash flow, potential tax liability after share acquisition if assets are sold
- Future tax rates, impact on cash flow, potential tax liability after share acquisition if new assets are purchased
- Future interest rates, impact on cash flow, potential tax liability after share acquisition if assets are sold
- Future interest rates, impact on cash flow, potential tax liability after share acquisition if new assets are purchased

Multiple Choice	*TB 18-05 When deciding whether to purchase the shares or as...*

TB 18-06 Mountain Wear Inc. (MWI) is a Canadian-controlled ...

Mountain Wear Inc. (MWI) is a Canadian-controlled private corporation owned 100% by Fred Martin. The ACB of Fred's shares in MWI is $10,000. The year-end balance sheet for MWI is as follows:

Current assets		$300,000
Land		350,000
Building	175,000	
Accumulated Amortization	(25,000)	150,000
		$800,000
Current liabilities		$200,000
Mortgage on land and building		150,000
Shareholder's equity:		
Share capital	10,000	
Retained earnings	440,000	450,000
		800,000

Additional information is available for MWI:

The current assets consist of accounts receivables and inventory, which have costs equal to their market values.
The UCC of the building is $160,000.
The land is currently valued at $450,000.
The building has a FMV of $205,000.

Additionally:

Fred has used all of his capital gains exemption.
MWI is not associated with any other corporations for tax purposes.
Fred has recently been offered $450,000 for his shares by a local competitor.
Fred is in a 45% tax bracket.
Due to the timing of the sale, if assets are sold, the small business deduction will be available.
Assume a 15% tax rate on earnings subject to the small business deduction.
Assume a combined 44 2/3% tax rate on corporate investment income.

Required:

A) Calculate the after-tax proceeds of the sale if the shares of MWI are sold.
B) Calculate the amount of proceeds available for distribution if the assets of MWI are sold.
C) If the proceeds are distributed in a wind-up, what type of taxes will Fred be subject to? (It is not necessary to show calculations for this part of the question.)

A) Sale of Shares:		
Tax Effect:		
Proceeds	$450,000	
ACB	(10,000)	
Capital gain	$440,000	
Taxable capital gain	$220,000	
Proceeds:		
Proceeds	$450,000	
Less tax (45% × 220,000)	(99,000)	
After-tax proceeds	$351,000	
B) Sales of Assets:		
Proceeds from sale:		
Current assets	$300,000	
Land	450,000	
Building	205,000	
		$955,000
Less liabilities		
Current liabilities	$200,000	
Mortgage	150,000	
		(350,000)
		$605,000
Less corporate tax (note 1)		(31,286)
Plus refund of corporate taxes (note 2)		17,336
Available for distribution		$591,050

Note 1:

	Business Income	Taxable Capital Gain	Non-taxable Income
Land (1/2 [$450,000 - $350,000])		$50,000	$50,000
Building (1/2 [$205,000 - $175,000])		15,000	15,000
(Recapture: $175,000 - $160,000)	$15,000		
Taxable Amounts	$15,000	$65,000	$65,000

Corporate tax (rounded):

Business income of $15,000 × .15 =	$ 2,250
Taxable capital gains of $65,000 × .4467 =	29,036
	$31,286

Note 2:

Maximum refund when income is distributed to Fred = $17,336 ($65,000 × 26 2/3%).

C) If the proceeds are distributed to Fred, any portion in excess of PUC will be deemed to be a taxable dividend.

Short Answer	*TB 18-06 Mountain Wear Inc. (MWI) is a Canadian-controlled ...*

167.

TB 18-07 Identify the tax effects for 1) the vendor and 2) ...

Identify the tax effects for 1) the vendor and 2) the purchaser when a business divestiture and acquisition involves a) the sale of assets, and b) the sale of shares.

Vendor	Vendor	Purchaser	Purchaser
Sale of Assets	Sale of Shares	Purchase of Assets	Purchase of Shares
-No immediate tax effect for individual shareholder	-Capital gain or loss to shareholder (50% applicable)	-CCA calculated on market value of assets	-UCC balances are carried forward
-Capital gains/losses and recapture may occur in the business	-Capital gain exemption may apply	-New cost base for assets based on market value	-Asset costs are carried forward
-Small business deduction may apply	-No tax consequences to the corporation		

Short Answer	*TB 18-07 Identify the tax effects for 1) the vendor and 2) ...*

TB 18-08 ABC Inc. (a CCPC) is for sale, and Jane, the sole ...

ABC Inc. (a CCPC) is for sale, and Jane, the sole shareholder would like to know if the company is currently a small business corporation. Jane has provided you with the following information:

All of the business activities of ABC Inc. have taken place in Canada.

The following amounts represent fair market values.

ABC Inc. owns the following assets:	
Equipment used for active business activities	$ 50,000
Land used for active business activities	300,000
Shares in public corporations	50,000
Shares in XYZ Ltd. (a CCPC) (70% ownership)	450,000
Long-term investments	25,000

All of the business activities of XYZ Ltd. have taken place in Canada.

XYZ Ltd. owns the following assets:	
Building and equipment used for active business activities	$300,000
Long-term investments	300,000

The shares have not changed hands since the companies began operations four years ago. The asset values have remained constant for the past three and a half years.

Required:

Determine if ABC Inc. is a ‘small business corporation'. Show calculations to support your answer.
List three reasons from a tax perspective as to why the status of ‘small business corporation' may be significant.

ABC Inc. is not a small business corporation.

ABC cannot meet the 90% test based solely on its assets in active business: 50,000 + 300,000 = 350,000/875,000 = 40%

The rule that 90% or more of the fair market value of ABC's assets are a combination of 1) assets used in active business in Canada, and 2) the shares of a connected *SBC* has not been met, either. While ‘90%* or more of the fair market value of its assets' are a combination of 1) assets used in active business in Canada, and 2) the shares of XYZ Ltd. (a connected corporation), XYZ Ltd. is not a small business corporation since only 50%** of its assets are used in active business.

*ABC Inc.:	
Equipment used for active business activities	$ 50,000
Land used for active business activities	300,000
Shares in public corporations	50,000
Shares in XYZ Ltd. (75% ownership)	450,000
Long-term investments	25,000
Total assets	$875,000

50,000 + 300,000 + 450,000 = 800,000/875,000 = 91.4%

**XYZ Ltd.:	
Building and equipment used for active business activities	$300,000
Long-term banking investments	300,000
Total assets	$600,000

300,000/600,000 = 50%

b) If a CCPC is a small business corporation, the following may be applied in situations where applicable:

1) Capital gains deduction may apply if QSBC test is also met
2) Allowable business investment loss
3) Corporate attribution rules on transfer and loans to corporations

Short Answer	*TB 18-08 ABC Inc. (a CCPC) is for sale, and Jane, the sole ...*

169.

TB 19-01 Which of the following is not typically used to de...
Which of the following is not typically used to defer taxes in business reorganizations?

- Transfer of depreciable assets at their undepreciated capital costs, from one corporation to another.
- Transfer of shares at their adjusted cost base, from one corporation to another.
- → Transfer of non-depreciable assets at their fair market values, from one corporation to another.
- An amalgamation

Multiple Choice	*TB 19-01 Which of the following is not typically used to de...*

170.

TB 19-02 Which of the following statements most accurately ...
Which of the following statements most accurately describes an aspect of a *tax-deferred sale* of a business to a group of employees, through share reorganization?

- The employees will purchase the corporation's original common shares from the vendor.
- → There is a risk to the original shareholder, as the value of his/her preferred shares depends on the success of the corporation following the sale.
- This method of sale is appropriate when the vendor is unsure of the purchaser's ability to manage the business.
- The vendor generally does not participate in financing the sale of the business.

Multiple Choice	*TB 19-02 Which of the following statements most accurately ...*

171.

TB 19-03 Mr. and Mrs. Leon would like to transfer their fam...

Mr. and Mrs. Leon would like to transfer their family business to their son. However, their son does not have the required funds to purchase the company at this time. Which of the following can the Leons chose to do in order to make the transfer possible without any immediate tax effect for themselves?

- A sale of their shares to their son
- An amalgamation
- → A reorganization of share capital
- A wind-up

Multiple Choice	*TB 19-03 Mr. and Mrs. Leon would like to transfer their fam...*

172.

TB 19-04 Corporation A is selling a depreciable asset to Co...

Corporation A is selling a depreciable asset to Corporation B. The asset has a fair market value of $200,000. The original cost of the asset was $175,000 and the undepreciated capital cost is $160,000. The two corporations wish to structure the sale in a manner that will defer all taxes at this time. Corporation A has no unused losses. Which of the following is *false*?

- For legal purposes, the asset will be sold for $200,000.
- → The elected value for tax purposes would be $175,000.
- The sale can include cash or a note receivable to a maximum value of $160,000.
- Corporation A will receive shares from Corporation B in the transaction.

Multiple Choice	*TB 19-04 Corporation A is selling a depreciable asset to Co...*

173.

TB 19-05 Which of the following is not a common feature oft...

Which of the following is *not* a common feature often associated with closely held corporations?

- The corporation has only one, or relatively few, shareholders.
- The corporation is often sold due to the owner's wish to retire.
- The corporation may be sold to family members or employees who do not have enough cash to buy the business.
- → The corporation pays regular dividends to its public shareholders.

Multiple Choice	*TB 19-05 Which of the following is not a common feature oft...*

TB 19-06 Match the following situations with the appropriat...

Match the following situations with the appropriate sections of the Income Tax Act.

Situation

1. Shares are exchanged between two corporations at their tax costs. As a formal tax agreement is not required, this is a useful method for public corporations with many shareholders.
2. Shares of two or more corporations are exchanged for shares of a new entity, and all of the assets of the corporations are transferred to the new entity.
3. Common shares are converted to preferred shares and held by the seller. New common shares are issued (often at a nominal value) to the purchaser.
4. Assets are sold from a vendor corporation to a buyer corporation at an elected value, usually the assets' tax costs (i.e. UCC or ACB), in exchange for shares and a non-share payment not exceeding the elected value.

Section from the Income Tax Act

_______ Subsection 85(1)
_______ Subsection 85.1(1)
_______ Subsection 86(1)
_______ Subsection 87(1)

4	Subsection 85(1)
1	Subsection 85.1(1)
3	Subsection 86(1)
2	Subsection 87(1)

Short Answer	*TB 19-06 Match the following situations with the appropriat...*

175.

TB 19-07 Samantha is an architect, and she is also the sole...
Samantha is an architect, and she is also the sole shareholder of Sam's Shoes Inc. She wants to semi-retire from the shoe business soon and her three employees have all expressed great interest in taking over the company, however, they do not have the financial resources necessary to make the purchase at this point in time. Samantha is not in a hurry to receive the proceeds from the business as she will continue with her architectural work for another five years.

Samantha has heard about something called a 'share reorganization' and she has asked you to explain what it means and if it would apply to her situation.

Required:

A) Explain what a Subsection 86(1) share reorganization is, and if it would be useful for Samantha in her plans to semi-retire from her shoe store.

B) What is a significant risk factor that might be involved with a share reorganization?

A) Subsection 86(1) of the Income Tax Act allows shareholders to reorganize their shares by exchanging their common shares for preferred shares of the same value in the corporation. New common shares are then issued to the purchasers of the business, often for a nominal amount.

This method would satisfy Samantha's wish to semi-retire, as the employees would become the new common shareholders, and would then run the company. It would also satisfy the employees' desire to purchase the company with limited resources.

B) A significant risk factor involved with such a transaction is that Samantha's ability to realize the value of her preferred shares rests with her employees' ability to run the shoe store once she is no longer in charge.

Short Answer	*TB 19-07 Samantha is an architect, and she is also the sole...*

176.

TB 19-08 Brian Snow owns all of the common shares of Treeli...
Brian Snow owns all of the common shares of Treeline Boots Ltd., a Canadian-controlled private corporation. The shares have a fair market value of $150,000, an ACB of $30,000, and a PUC of $5,000. Brian would like to retire soon, so he has offered the company to his son, Walter. Walter is young and does not have a lot of disposable income, and as such, a Section 86(1) estate freeze has been recommended to Brian. Brian's common shares will be converted to preferred shares, which are redeemable for $150,000.

Required:

Discuss the tax consequences of this transaction for Brian, indicating the ACB and the PUC of the new shares.

Income tax reference: ITA 86(1) Section 86(1) allows for a deferral on the accrued gain of the common shares, through the exchange of the shares. The common shares are deemed to have been disposed of at their ACB of $30,000, which then becomes the ACB of the new shares. As there is no non-share consideration, a deemed dividend does not arise. Since the non-share consideration is NIL, the PUC of the new shares is equal to the $5,000 PUC of the old shares.

Short Answer	*TB 19-08 Brian Snow owns all of the common shares of Treeli...*

177.

TB 20-01 Which of the following statements is true concerni...
Which of the following statements is *true* concerning domestic expansion of a business?

- Cash funding requirements will be lower for a corporation than a corporate division if the expansion activity incurs start-up losses.
- → Cash funding requirements will be higher for a corporation than a corporate division if the expansion activity incurs start-up losses.
- Obligations of a new division are separate from the parent company due to the limited liability of the division.
- The main advantage of incorporating an expansion activity is the use of start-up losses against income from other divisions of the founding corporation.

Multiple Choice	*TB 20-01 Which of the following statements is true concerni...*

178.

TB 20-02 In the Canada-U.S. tax treaty, the definition of a...
In the Canada-U.S. tax treaty, the definition of a 'permanent establishment' does not include:

- a place of management
- a factory
- → a storage facility
- an office

Multiple Choice	*TB 20-02 In the Canada-U.S. tax treaty, the definition of a...*

179.

TB 20-03 The Running Shoe Corp. is a Canadian corporation w...
The Running Shoe Corp. is a Canadian corporation which plans to expand internationally. The company has decided to establish a foreign branch in another country. Which of the following will *not* apply?

- The branch will be subject to branch taxes in the foreign country.
- The branch profits will be included in the Canadian corporation's worldwide income.
- Provided a treaty is in place with the foreign country, a foreign tax credit will reduce the Canadian taxes payable.
- → If the foreign country has a lower tax rate, a tax benefit will be recognized.

Multiple Choice	*TB 20-03 The Running Shoe Corp. is a Canadian corporation w...*

180.

TB 20-04 The Sweater Corp. is a Canadian corporation which ...
The Sweater Corp. is a Canadian corporation which plans to expand internationally. The company has decided to establish a foreign subsidiary corporation in another country. Which of the following is *false*?

- The subsidiary will be subject to taxes in the foreign country.
- → The subsidiary's profits will be included in the Canadian corporation's worldwide income.
- Dividends received by the Canadian corporation from the foreign subsidiary are not included in Canadian corporate taxable income.
- Dividends received by the Canadian corporation from the foreign subsidiary may be subject to a withholding tax in the foreign jurisdiction.

Multiple Choice	*TB 20-04 The Sweater Corp. is a Canadian corporation which ...*

181.

TB 20-05 Which of the following lists are acceptable method...
Which of the following lists are acceptable methods that may be used in adopting a reasonable transfer price between a Canadian parent and its foreign subsidiary corporations?

- → Comparable arm's-length selling price method; cost-plus method; resale price method
- Cost-plus method; resale price method; profit-margin method
- Lowest tax rate method; resale price method; comparable arm's-length selling price method
- Comparable arm's-length selling price method; lowest tax rate method; profit-margin method

Multiple Choice	*TB 20-05 Which of the following lists are acceptable method...*

TB 20-06 Crispy Chips Inc. is considering an expansion into...

Crispy Chips Inc. is considering an expansion into the United States. Jeff Arthur, the CEO, is not sure how to structure this new venture and would like some general information before he meets with his accountant and lawyer.

Required:

Write a memo to Jeff, informing him of the two fundamental approaches he can take to conduct his foreign operations (branch and subsidiary corporation); listing two advantages and two disadvantages of both approaches.

MEMO

To: Jeff Arthur, CEO, Crispy Chips Inc.
From: You, Accounting Assistant
Re: Foreign Business Expansion
Date: dd/mm/yyyy

This memo is in response to your enquiry about the structure of a foreign expansion for your business. I will identify the two fundamental approaches that are available to you for a foreign business expansion, and will then address the advantages and disadvantages of both.

The alternatives available to you for expansion are 1) a branch location; and 2) a separate foreign corporation. A branch would be part of your Canadian corporation, and therefore, would not be a separate legal entity. A separate corporation, on the other hand, would be incorporated in the foreign jurisdiction, and would be a separate entity from your Canadian operations.

The advantages and disadvantages of a branch and a separate subsidiary are as follows (based on the laws of the Canada-U.S. tax treaty):

Branch

Advantages

1. The losses of the branch may be applied against the income of the parent corporation.
2. A Canadian foreign tax credit is available to offset the foreign branch tax.

Disadvantages

1. Foreign taxes will apply to the branch profits.
2. Depending on tax rates applied, double taxation could occur on the foreign profits.

Foreign Subsidiary

Advantages

1. The subsidiary is only taxed in the foreign jurisdiction, which is advantageous if the foreign tax rate is lower than the Canadian rate.
2. Dividends flow tax-free from the foreign affiliate to the Canadian corporation.

Disadvantages

1. Losses incurred in the foreign subsidiary cannot be applied against the parent corporation's income.
2. A foreign withholding tax will be imposed on dividends paid to foreign shareholders.

Should you have any other questions, please feel free to contact our office at ___.

Short Answer	*TB 20-06 Crispy Chips Inc. is considering an expansion into...*

183.

TB 20-07 The Great Big Company (GBC) is a CCPC located in S...

The Great Big Company (GBC) is a CCPC located in Saskatchewan. GBC owns a foreign subsidiary, The Little Company (TLC), which is located in a foreign country. GBC manufactures electronic component parts which are then sold to TLC for assembly. GBC is subject to a 25% corporate tax rate and TLC is subject to a 19% corporate tax rate. Fiona Big, the CEO of GBC, has mentioned that due to the lower tax rate in the foreign country, the profits of GBC could be shifted to TLC by adjusting the selling price of the component parts.

Required:

A) Can Fiona Big adjust the selling price of the component parts in order to take advantage of the lower tax rate? Why or why not?
B) What are three methods used to establish transfer prices for non-arm's length transactions?

A) Fiona cannot adjust the selling price of the component parts in order to take advantage of the lower tax rate, if the new selling price is ‘unreasonable'. An unreasonable selling price would be in violation of the reasonableness test in Canadian tax law.
B) The most common method to establish transfer prices between non-arm's length parties is to compare the prices to those used between arm's length parties. When this method is difficult to establish, two other methods are available: a) the cost plus method which is based on a reasonable mark-up of the actual cost; and b) the resale price method which works backwards from the foreign corporation's selling price, deducting a reasonable profit margin to determine the cost.

Short Answer	*TB 20-07 The Great Big Company (GBC) is a CCPC located in S...*

184.

TB 20-08 Andy Griffin would like to invest $150,000 in his ...

Andy Griffin would like to invest $150,000 in his friend Ernie's company, which was founded and operates in a foreign country. This investment would give Andy 25% ownership of the company. An annual dividend of $15,000 is anticipated.

Andy's personal marginal tax rate is 45% on regular income, 28% on eligible dividends, and 35% on non-eligible dividends. Ernie's company is subject to a tax rate of 38% on all business income. Any dividends received by Andy, personally, will be subject to a 15% withholding tax.

Required:

1) Determine a) the total tax liability (foreign and Canadian) that Andy will be subject to upon receiving dividends from Ernie's company, and b) the after-tax proceeds.
2) How would your answer in part 1 change if Andy established a Canadian holding company to purchase the shares, (subject to a 5% withholding tax on dividends received)?
3) What would Andy's proceeds be if he received the dividend income from the holding company?

1. The combination of foreign and Canadian taxes that Andy will be subject to is $6,750.

a)		
Foreign dividend (Canadian dollars)	$15,000	
Withholding tax of 15%		$ 2,250
Tax on property income ($15,000 × 45%)	$ 6,750	
Less withholding tax	(2,250)	
Canadian tax		$ 4,500
Total tax liability		$ 6,750
b)		
Proceeds	$15,000	
Less tax	(6,750)	
After-tax proceeds	$ 8,250	

2. Ernie's corporation would qualify as a foreign affiliate, therefore, there is no tax on the dividends received by Andy's corporation. The only tax liability is the withholding tax at source.

Dividend (Canadian dollars)	$15,000
Withholding tax at 5%	$ 750

3. Dividend received by Andy's holding company:

Dividend received by Andy's holding company:	
Dividend income	$15,000
Less withholding tax at 5%	(750)
Available for distribution to Andy	$14,250
Personal tax on Canadian eligible dividend at 28%	(3,990)
After-tax proceeds	$10,260

Short Answer	*TB 20-08 Andy Griffin would like to invest $150,000 in his ...*

185.

TB 21-01 Which of the following statements regarding prefer...
Which of the following statements regarding preferred share financing is *false*?

- Preferred share dividend payments are non-deductible.
- There is a special tax on preferred dividends in excess of $500,000 annually, even if the issuing corporation has no taxable income.
- → Current tax laws simplify the nature of preferred share financing for corporations.
- The preferred share issue may be structured so as to enhance the after-tax return of investors.

Multiple Choice	*TB 21-01 Which of the following statements regarding prefer...*

186.

TB 21-02 Joe Genius of ABC Corporation is considering wheth...
Joe Genius of ABC Corporation is considering whether to lease or purchase a large capital asset. If he purchases the asset, he will use debt financing. Which of the following is a *true* statement describing a similarity in the tax treatment of leasing and purchasing with debt?

- → Both allow for a tax deduction.
- Principal payments are deductible for both alternatives.
- Cash payments and tax savings will usually occur simultaneously for both alternatives.
- Capital cost allowance is always calculated for both alternatives.

Multiple Choice	*TB 21-02 Joe Genius of ABC Corporation is considering wheth...*

187.

TB 21-03 Mary is deciding where to invest $10,000. Based on...
Mary is deciding where to invest $10,000. Based on her decision, she will either receive a 5% capital gain or a 7% non-eligible dividend as her return on investment. Mary's marginal tax rates are: 45% on regular income, 35% on non-eligible dividends, 28% on eligible dividends, and 23% (rounded) on capital gains. Which of the following is correct?

- Mary will receive a higher after-tax rate of return on the capital gain due to the higher tax rate for non-eligible dividends.
- Mary will receive an after-tax rate of return of 5% on the capital gain and 7% on the non-eligible dividends.
- → Mary will receive an after-tax rate of return of 3.85% on the capital gain and 4.55% on the non-eligible dividends.
- There is no difference in the after-tax rate of return on the two investments.

[1 - .23] × 5 = 3.85% and [1 - .35] × 7 = 4.55%

Multiple Choice	*TB 21-03 Mary is deciding where to invest $10,000. Based on...*

188.

TB 21-04 During the year, The Light Corporation paid $550,0...
During the year, The Light Corporation paid $550,000 in preferred share dividends to ABC Inc. Both companies are Canadian corporations. Which of the following is *true*?

- ABC Inc. will have to pay Part VI.1 tax on the dividend, regardless of whether or not it has taxable income.
- → The Light Corporation will have to pay Part VI.1 tax on the dividend, regardless of whether or not it has taxable income.
- ABC Inc. will have to pay Part VI.1 tax on the dividend, only if it has taxable income.
- The Light Corporation will have to pay Part VI.1 tax on the dividend, only if it has taxable income.

Multiple Choice	*TB 21-04 During the year, The Light Corporation paid $550,0...*

189.

TB 21-05 With regard to debt securities, which of the follo...
With regard to debt securities, which of the following statements is *true*?

- Issuing debt securities at a premium is not allowed for tax purposes.
- Issuing debt securities at a premium results in the borrowing corporation receiving funds below the stated price.
- Issuing debt securities at a premium will normally increase the after-tax cost of financing for the issuer, provided they are 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, provided they are not in the business of lending money.

Multiple Choice	*TB 21-05 With regard to debt securities, which of the follo...*

190.

TB 21-06 Silver Photo Studios Inc. (SPS) requires $50,000 c...
Silver Photo Studios Inc. (SPS) requires $50,000 capital for a proposed expansion. Simon Silver, the company's president and CEO is trying to decide whether to issue preferred shares with a fixed dividend rate of 5%, or to borrow from the bank at a rate of 7%. SPS pays a corporate tax rate of 15%.

Required:

A) Determine the amount of corporate income that would be required for each of the alternative funding methods.
B) Calculate the actual cost (as a %) of the debt and the actual cost (as a %) of issuing the preferred shares.

A) Corporate income of $3,500 ($50,000 × 7%) is required to finance the interest on the bank loan.
Corporate income of $2,941 ($50,000 × 5%)/(1 - .15) is required to finance the dividends on the preferred shares.
B) The cost of the 7% debt is 7%. (3,500/50,000)
The cost of the 5% dividend is 5.9%. (2,941/50,000)

Short Answer	*TB 21-06 Silver Photo Studios Inc. (SPS) requires $50,000 c...*

TB 21-07 Andrea Houser recently inherited $500,000. She wou...

Andrea Houser recently inherited $500,000. She would like to invest the money and receive an after-tax return of $30,000 on the investment income. She has a number of investment alternatives available to her and she would pay 45% tax on interest, 28% tax on eligible dividends, 35% tax on non-eligible dividends, and 23% (rounded) on capital gains.

Required:

Advise Andrea as to how much taxable income she would need to receive in a) interest, b) eligible dividends, c) non-eligible dividends, and d) capital gains in order to realize a $30,000 after-tax return. (Round all answers to zero decimal points.)

Interest	Eligible Dividends	Non-eligible Dividends	Capital Gain
$30,000/(1 - .45) = $54,545	$30,000/(1 - .28) = $41,667	$30,000/(1 - .35) = $46,154	$30,000 (1 - .23) = $38,961

Short Answer	*TB 21-07 Andrea Houser recently inherited $500,000. She wou...*

192.

TB 21-08 Jet Dry Inc. is undergoing a sale/leaseback arrang...

Jet Dry Inc. is undergoing a sale/leaseback arrangement on a piece of its equipment. The equipment has a fair market value of $250,000, and currently generates $75,000 in annual revenue. The lease agreement is for five years, with no residual value at the end of the term. The annual leasing cost is $55,000.

The current UCC of the equipment is $150,000. Other assets will remain in the asset pool, and recapture will not occur as a result of the sale.

The company is subject to a corporate tax rate of 25%, and achieves a 12% after-tax rate of return.

Required:

Calculate the net present value of the cash flow that will result from this sale-and-leaseback arrangement. (Round all numbers to zero decimal points.)

Proceeds from sale		$250,000
Annual income		
Revenue	$75,000	
Leasing expenses	(55,000)	
Net income	$20,000	
Tax (25%)	(5,000)	
Net cash in	$15,000	
Present Value of $15,000 annuity (5 years, 12%)		$ 54,072
		$304,072
Reduction of CCA expense reduction following sale:		
$\frac{\$250,000 \times .25 \times .30}{.30 \times .12} =$		(44,643)
Net cash from sale and leaseback arrangement		$259,429

Short Answer	*TB 21-08 Jet Dry Inc. is undergoing a sale/leaseback arrang...*