

Question 1 (week 5,7)	17
Question 2 (week 8) (week9)	25
Question 3 (week 7)	11
Question 4 (week 5)	9
Question 5 (Theory questions)	13
Total	75

Question 1 (17 MARKS)

For more practice, go to Chapter 4 Self-study (4-1). Please study this topic as it will be tested on the final to prepare you for 4th year personal tax course.

Molly is a single parent with two daughters at the age of 4 and 7

Had the following cash inflow:

- Employment income \$50,000
- Dividends from shares of CCPC: \$10,000
- Dividends from shares of public corporation: \$1,000

Cash outflow:

- Molly made RRSP contributions of 1230
- Had 1200 federal tax withheld from employment income, did not pay any installments
- CPP of contributions of 2000, EI contributions of 900

Following year, Molly sold the following

Share capitals

POD = 6000, ACB = 2300

Non capital assets

POD = 4000, ACB= 12500

Had a previous net capital loss of 6000

During the year, Molly had the following medical expenses, \$750 for herself and \$1500 for both her children combined. Her children had no net income.

Molly incurred a total of \$2500 of child care expense for the year so that she could go to work.

Molly also made the following donations:

- Made political contributions of \$750
- Made Charitable donation of \$300

Required:

- A) Determine the net employment income
- B) The taxable income
- C) The refundable tax credit or federal tax balance due
- D) Omitted and brief summary why

Employment Income =	50,000
Property income (Note 1) =	13080
Net taxable capital gains (Note 2) =	1850
Non capital Loss (Note 3) =	(8500)
Other deductions (Note 4) =	(1230)
	<u>(2500)</u>
Division B net income =	52700
Divison C deduction (Note 5) =	(1850)
Taxable Income =	50850
Federal Tax using graduated rate (Note 6) =	7868.12
Federal tax credits (Note 7) =	2995

Note 1 – Property Income

Non eligible dividends: $10,000 * 1.17 = 11700$

Eligible Dividends: $1,000 * 1.38 = 1380$

Note 2 – Net taxable capital Gains

$0.5 (6000 - 2300) = 1850$

Note 3 – Non capital Loss

$4500 - 12000$

Non capital loss does not need to be adjusted on a net basis and can be applied to other income.

Note 4 – other deductions

RRSP – **1230**

*ADMS 4561 will go in more depth

It is the lessor of the 3

1. 18% Of last year's employment income + unused RRSP carry forward
2. Maximum limit of year 24,930
3. Pension Adjustment

Limited to the actual RRSP contribution in the year or 60 days after (which was 1230)

Note 4 - Child care deduction

This year's EI = 40,000

The lessor of the 3

- | | |
|-----------------|---------------|
| 1. Amount paid: | 2500 |
| 2. Annual limit | $8000 + 5000$ |
| 3. 2/3 of EI | 26,000 |

Lessor = 2500

Note 5 – Division C deduction carry forward

Net capital loss can only offset capital gain which was 1850 for the year

Note 6 – Federal Tax

- 15% **on the first** \$45,916 of taxable income, +
- 20.5% **on the next** \$45,915 of taxable income (on the portion of taxable income over \$45,916 up to \$91,831), +
- 26% **on the next** \$50,522 of taxable income (on the portion of taxable income over \$91,831 up to \$142,353), +
- 29% **on the next** \$60,447 of taxable income (on the portion of taxable income over \$142,353 up to \$202,800), +
- 33% of taxable income **over** \$202,800

Federal tax payable is 50,700

$$15\% \text{ of } 45,916 = 6887.4$$

$$20.5\% \text{ of } 4784 \text{ which is excess} = 980.72$$

Total federal tax payable = 7868.12

For those confused how marginally rate works.

Every dollar from 0 to 45,916 is taxed at 15% federally.

45916 to 91,831 is taxed at 20.5% federally.

91,831 to 142,353 is taxed at 26% federally

ETC.

In this case, Molly had taxable income of 50,700. A common misconception is that this entire amount will be taxed at 20.5% federally.

No.

From 0 to 45,916 @ 15%

Excess = 50,700 – 45916 = **4784 @ 20.5%**

What if Molly's taxable income was 100,000?

15% of 45,916 = 6887.4

91831-45916 = 45916 @ 20% = 9412.78

100,000 – 91831 = 8169 @ 26% = 2123.94

Note 7 – Tax credits

Federal tax credits

Basic 11635

Employment 1177

*Medical expense 700

CPP 2000

EI 900

Sum of above = 16412

@15%

= **2461**

Political donation credit =

(75% for first 400) + (50% for next 350) = 475

Charitable donation credit

(15% for 200) + (29% 300-200) = 59

Total federal tax credit = 2995

*Medical expense calculation

Molly \$700 + her two children \$1500	=	2200
Lessor of \$2237 or 3% of NI (52700)	=	<u>1581</u>
		700

Please know how to use the

Disability credit

EI/ CPP CREDIT

Dividend tax credit

Political contribution credit

Charitable donations credit

Spousal

Equivalent spousal

PRACTICE using THEM is the key. You will be given the formula sheet for this.

Question 2 (25 MARKS)

(Similar to Self-study question 6-8, 6-9, 6-10)

The company Darling, had accounting income of 278,000 that included the following adjustments:

1.	<u>Tax provision:</u>	
	Current 48,275	
	Future 27,500	
2.	Company recorded amortization of	20,000
3.	The actual CCA for the year	18,000
4.	Company donated to charity	2800
5.	The company spent for marketing U.S publications targeting the Canadian market	5000
6.	Bank loan was used to purchase common shares of a CCPC company that gave dividends	6000
7.	The company incurred tax and accounting fees to dispute tax	500
8.	The company paid life insurance premium to one of the executives of Darling, this was not required as a collateral	10,000
9.	Company spent for landscaping, this amount was deducted as an expense	500
10.	Company recorded bonus expense to be paid out in Feb 20, 2016. The bonus was declared in Dec 30, 2015.	
11.	Company deducted golf club membership for accounting purposes	1000
12.	Company issued treasury shares of \$2000	500
13.	Estimated warranty of \$20,000, actual amount for the year was \$15,000	

Required:

Determine net income for tax purposes. Indicate why you omit the items in your calculations. IGNORE GST/PST.

Study TIPS

Question 2

This topic is guaranteed to be tested and is worth 25-33% of the final exam as it prepares you for 4th corporate tax. You will have to memorize every adjustments (addition/subtractions) + Division C deduction. There is no short cut to this problem other than practice and time to memorize these rules. Just remember every additions and deductions is worth 1 mark on the final exam.

Your first objective is to arrive **Division B** Net Income

- 1) You start from **Accounting income** (this will be given to you)
- 2) **Additions** (you add back the expenses in the Financial statement not deductible for tax purposes)
- 3) **Deductions** (these are items that are deductible for tax purpose but not accounting purposes)

Next you want to arrive to **Taxable Income**

- 4) Subtract Division B income with Division C deductions for Corporations

DIVISION C DEDUCTION

(Note 1) Dividends from taxable CDN corp	<u>xxx</u>
(Note 2) Charitable donations	<u>xxx</u>
(Note 3) Net capital loss	<u>xxx</u>
(Note 4) non-capital Loss	<u>xxx</u>

(Note 1): ANY DIVIDENDS you receive from a Canadian taxable corporation, you can deduct ALL of it under Division C

(Note 2): If company deducted charity expenses for net income, you ADD back the full amount under step 2), and you deduct it under step 4) division C

Company A donated 50,000

Net income 175,000

The maximum you can deduct for company A for charitable donations WILL BE: **75% X NET INCOME**

$75\% \times 175k = 131.25k$

You can deduct a maximum of 131.25k donations

Company A donated 50k, which is less than 131.25k so the company is able to include the entire amount.

(Note 3): Remember, taxable capital loss is limited to the taxable capital gain, if you do not have any capital gain, you can't use it.

(Note 4): Business Loss can be carry forward and deducted against the division B income.

FROM CORPORATE TAX LECTURE NOTE (ADMS 4562)!

Add back any expenses in the financial statements which are not deductible for tax purposes

- Income tax provision on financial statements (s. 18(1)(e))
- Reserves for contingencies (e.g. warranty, inventory) (s. 18(1)(e)). Recall that inventory must be valued at LCM (lower of cost or market); can't claim a reserve for anticipated future declines in inventory
- Capital expenditures, depreciation and amortization of capital expenditures. Note: the following capital expenses are also not deductible for tax purposes: a write down in value of a long term asset; a write down in value of goodwill; and stock option compensation expense
- Accounting losses (s. 18(1)(b))
- Legal expenses (and/or commissions etc.) on purchase of a capital asset
- Expenses relating to the issue of shares, debt, partnership units (i.e., financing)
- Foreign taxes (if not already included in income)
- Interest and penalties on late income tax payments
- Donations to registered charities - deducted later under Division C (see below)
- 50% of meals and entertainment
- Government fines and penalties
- Expenses in excess of a reasonable amount
- Club membership dues
- Political donations
- Accrued bonuses still unpaid 180 days after year end
- Advertising in foreign media directed primarily to Canada.
- Property taxes and interest on vacant land in excess of rental income
- Net cost of insurance of life insurance premiums
(if corporation = beneficiary and not required for financing)
- Car expenses in excess of maximum deductions for tax purposes
- **LIFO Cost of Goods Sold minus FIFO (or Average Cost) Cost of Goods Sold***
- Net taxable capital gains = Taxable (1/2) capital gains - allowable (1/2) capital losses

Deduct amounts deductible for tax purposes which are not deducted on financial statements

- 1/5 of expenses relating to the issue of shares, debt, partnership units (i.e., financing)
- Site investigation costs which have been capitalized
- Amounts paid for landscaping business premises which have been capitalized
- Capital cost allowance (CCA) (s. 20(1)(a)) and Cumulative eligible capital amount (CECA)
- Accounting gains
- Other expenses that have been capitalized for accounting purposes: such as pre-production/development stage expenses (incurred prior to the start of a business); and inducement payments paid to acquire a long-term revenue contract. Hence, net income for tax purposes does not always follow GAAP

Net income under Division B

Deduct: Division C deductions for Corporations

Charitable donations made (limited to 75% Net Income under Division B)

Dividends received from taxable Canadian corporations

Loss carryovers

- Non capital losses (-3 years, +20 years for taxation years ending after 2005)

(forward 10 years for taxation years ending after March 22 and before Jan 1, 2006) (forward 7 years for taxation years ending before March 23/04)

- Net capital losses (-3 years, + indefinitely, limited to net TCGs, adjust to 1/2 inclusion rate, if needed)

Question 3 (11 marks)

You will need to know how to deduct the child care expense for the final! Check self-study problem 9-2 as well

Self Study Problem Nine - 3 (Child Care Expenses)

Maureen Hadley and her common-law partner Sue Brendal have three adopted children. At the end of 2014, their ages are as follows:

- Their daughter Lori is 4 years old.
- Their son Jack is 8 years old and qualifies for the disability tax credit.
- Their son Bob is 14 years old.

None of the children have any income of their own.

Maureen is a very successful accountant with net business income in 2014 of \$216,000. Her partner, Sue Brendal, works on a part time basis in retail. Her 2014 gross employment income is \$24,000. In addition, because she was previously married, she receives child support payments of \$1,200 per month from the father of Lori.

Both Maureen and Sue spend a considerable amount of time at their work and, because of this, they employ a full time person to care for the children. The cost for this care is \$12,480 (\$260 per week for 48 weeks).

During the four week period in the summer when they do not employ the child care worker, the children attend a live-in camp. The cost for this camp is \$2,000 per week, per child. None of the camp fees are eligible for the child fitness credit or the children's arts credit.

In January, 2014, Maureen slipped on an icy sidewalk and broke both of her ankles. As a consequence of this accident, she spent three weeks in the hospital.

Sue has always been concerned about her lack of formal education. To make progress in this area, she enrolls in an intensive 5 week accounting course at a designated educational institution. Class attendance and work in this course require nearly 60 hours per week of Sue's time.

Required: Determine the maximum amount that can be deducted by Maureen and Sue for child care costs for the year ending December 31, 2014.

Tips on doing the question.

Recall that child care expense deduction is the **lessor** of the three. THIS IS VERY EASY TO CALCULATE. You find out/calculate these three, THEN USE THE LOWEST ONE!

LESSOR OF

1. Actual cost
2. Annual limit¹
3. 2/3 of earned income

¹ Annual limit:

Child	Annual ceiling	Per week of boarding school or day camp	If a parent is at school	
			Per week of full-time study ¹¹	Per month of part-time study ¹²
Under age 7	8,000	175	175	175
Between 7 and 16 years	5,000	100	100	100
Suffering from severe disability	11,000	250	250	250

Question: What is the annual child care expense limit for this family? Use the table above.

4 year old daughter

8 year old son with a disability

14 year old son

Answer:

$$8,000 + 11,000 + 5000 = \underline{\$24,000}$$

Question: What is 2/3 of earned income for the parents?

Maureen's income 2014 - \$216,000

Sue's income 2014 - \$24,000

Sue

Actual cost: 14,800

Annual expense Limit: 24,000

2/3 of Earned Income: 16,000

Lowest of the three = 14,800

Sue claims 14,800 child care deduction of 14,800!

- Normally, the spouse with the lower income (SUE) must claim the deduction for child care expense.

However, under certain circumstances the spouse with the HIGHER INCOME can claim the **deduction**. This however is subject to weekly limitation. When the lower income spouse is attending on a full time basis at a designated financial institution, the higher income spouse (Maureen) can claim the deduction to a limitation based on a formula.

For the 5 weeks SUE is attending school, Maureen can deduct Periodic expense limit. (The amount was in the table above)

5weeks * \$175 per week (4year old daughter)	= 875
5 weeks * \$100 per week (14 year old son)	= 500
5 weeks * \$250 per week (disability son)	= <u>1,250</u>
Total	2625

Revisiting

Maureen

Actual Cost:	\$14,800
Annual expense Limit:	\$24,000
2/3 of Earned income:	\$144,000
Periodic Expense Limit (5 week limit):	\$2625

Maureen claims a \$2625 child care expense deduction

Sue claims \$12,175 child care expense deduction.

This question seems longer than it really is due to the additional explanations, but in reality this should take you 10-15mins top. If it takes longer, you did not study or practice the child care expense concept thoroughly. I am 90% sure this will be tested.

Question 4 (**attribution rule** 9 marks)

Martha owns 10,000 common shares of SENEDGE INC (CCPC). These shares were acquired in 2010 by exercising her stock options. The exercise price was \$10 per share, which was the fair market value at the time the options was granted. Martha exercised her options at the end of 2010 when the FMV of the shares was at \$12 per Share. Martha gifts her husband and 14 year old daughter each 5000 shares in 2012, when the fair market value of the shares was \$13.

Near the end of Dec 2015, SENEDGE INC declared and paid dividends of \$1 for each share. The husband and daughter both sold all their shares in 2016 at FMV of \$16.

Determine the taxable income to each individual for each case, write nil if zero

- A) Common shares gifted
- B) Dividends received 2015
- C) Shares sold at 2016

Martha

Husband

Daughter

A)

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B)

--	--	--

C)

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Martha

Husband

Daughter

A)

Employment income: $(12-10) \times 10,000$ $= 20,000$ 110(1)(d) - deduction of half of the benefit = $(10,000)$ $CG = (13-12) \times 5,000$ $TCG = \frac{1}{2} \times CG$ $TCG = 2,500$ Taxable Income = 12,500	Nil	Nil
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B)

TI = 5,000	Nil, attributed back to Martha	Kiddie Tax applies. \$5000 of dividend is taxed at the highest tax bracket for the Daughter.
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C)

$CG = (16-12) \times 5000$ $= 20,000$ $TCG = 10,000$ (husband sold the shares but is attributed back to Martha)	Nil, attributed back to Martha	$CG = (16-13) \times 5000$ $= 15,000$ $TCG = 7,500$
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Question 4 (Notes)

You will be tested on basic attribution and kiddie tax rules. I made this question to also incorporate the CCPC stock option benefit, similarly to what you were tested on the midterm. If you understand this, you will be able to do any attribution/kiddie tax question they may ask on the final.

How to approach this problem.

- 1) The stock option benefit
- 2) The gifting/sale

The stock option benefit

Employee stock options is a taxable benefit. The timing depends on whether the company is a public company or a CCPC. In this question, the company is a CCPC so there is no initial income tax consequence. IT IS ONLY WHEN THEY ARE DISPOSED.

Why do you think this is?

Public company shares have an ACTIVE market and you're able to dispose and trade them very quickly. Compare that with shares of a private company that's not publicly listed.

2012 - Martha's Taxable income

Employment income (THE DEFERRED INCOME):

$(12-10) * 10,000$

= 20,000

Where the numbers come from.

\$10 = exercise price per share

\$12 = FMV on the date Martha exercised the shares

10,000 common stocks

Remember these two sections that allows you to reduce the taxable benefit by half (deduction is always good)

110(1)(d): FMV on grant date is less than or equal to the option exercise price.

110(1)(d.1): Company is a CCPC and you hold the shares for two years.

In this problem, it really doesn't matter since both the criteria are met. However, if I changed the FMV of the shares to \$12 when the options were granted. Martha would not be able to claim section 110(1)(d) deduction. Instead, you would claim 110(1)(d.1) deduction.

Martha GIFTS her husband and daughter both 5000 common shares in 2012.

$$CG = (13-12) * 5,000$$

$$TCG = \frac{1}{2} * CG$$

$$TCG = 2,500$$

Where the numbers come from.

$$FMV (2012) = \$13$$

ACB = \$12 which was the FMV when the options were exercised.

When the daughter receives the shares, the ACB will be \$13.

When the husband receives the shares, the ACB will be \$12

Why does the ACB DIFFER IN THIS CASE?

The general rule = A gift results in a deemed disposition at FMV. So why isn't the ACB for the husband \$13?

Because **there is an exception when you gift to a spouse, there is an automatic rollover S. 73(1)** (aka deemed to have disposed at ACB NOT FMV).

$(12-12)*5000 = 0$. That is why Martha's TCG in the year she gifted to both her husband and daughter is only \$2,500 not \$5,000,

However, there is no automatic rollover for the daughter, so Martha is deemed to have disposed at \$13 per share. That is why the ACB is different for the daughter and spouse. **(IF THEY ASK YOU THIS ON THE FINAL, YOU NEED TO BE AWARE OF THIS CONCEPT SO YOU CAN MAKE SURE YOU CALCULATE THE PROPER AMOUNT OF CG/TCG)**

Dividends declared explanation.

The attribution rule applies to the HUSBAND. While KIDDIE tax applies to the daughter.

Kiddie tax simply taxes the minor at the top marginal rate with no basic credit to prevent income splitting. This rule prevents minors from receiving dividends and not paying any taxes.

Kiddie tax and attribution rules do not apply to minors for CAPITAL GAINS. **(You can do tax planning knowing that CG is not taxed for minors).**

Question 5 (13 marks) (theory questions)

- 1) Explain what it means when partnership is earned through an entity

My answer: Partnership does not pay for the tax itself, instead all of the profits, credits, and deductions are passed to the individual partners

- 2) Why it is important to know whether or not a Canadian company is associated?

Associated companies must share the benefits of small business deduction limit and also prevents individuals from forming multiple companies to enjoy the benefit of being classified as CCPC

- 3) What are the similarities and differences between the charitable donations credit and the political donations credit? (4 marks)

They are similar in regards to having a marginal rate depending on the amount donated. They are different in which charitable donation give incentives by increasing the % credit the more you donate, whereas political donations tax credit decreases the more you donate

- 4) A business is able to claim the legal benefit of its assets, does a partnership arrangement do the same?

Yes, however the benefits of its assets will be shared in a partnership