Canadian Tax Principles 2017 / 2018  
Test Items Problems – Chapters 1 to 10

Test Items Problems Table of Contents – Chapters 1 to 10

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Chapter One Test Item File Problems

TIF Problem One - 1

Introduction - Essay Questions

1. The major source of federal revenues is the personal income tax.  Indicate three other types of taxes that contribute to federal revenues.

2. What is the meaning of “person” when the term is used in the *Income Tax Act*?

3. Briefly describe the procedures used in calculating provincial income taxes for individuals in provinces other than Quebec.

4. The Canadian income tax system is often used to achieve various economic objectives.  Give three examples that illustrate this point.

5. Provide an example of how taxation policy can be used to influence resource allocation.

6. The government pays a “child tax benefit” to the parents of children who are under 18 years of age.  The payments are reduced by a percentage of income in excess of a specified level.  What objectives are achieved by this benefit system?

7. Indicate three disadvantages of a tax system that uses progressive rates.

8. A regressive tax is one that taxes high income individuals at lower effective rates.  Explain why a sales tax levied at a flat rate of 8 percent can be regressive.

9. Distinguish between horizontal equity and vertical equity as these terms are used in describing tax systems.

10. What are some of the factors that have led to the entrenched use of tax expenditures as opposed to program spending?

11. While the Sections of the *Income Tax Act* are numbered 1 through 260, there are actually more than 260 Sections.  Explain why this is the case.

12. What purposes are served by Canada’s international tax treaties?

13. List four non-legislative sources of income tax information.

14. What is the meaning of “taxation year” as the phrase is used in the *Income Tax Act*?

15. Under what circumstances will a person who is not resident in Canada be required to pay Canadian income taxes?

16. What is the importance of residence in Canadian income taxation?

17. When an individual leaves Canada, the CRA may take the position that he has retained his residence status.  What are the primary factors that the CRA will consider in determining whether such an individual has, in fact, ceased to be a Canadian resident?

18. List three factors that would be considered in the determination of whether or not an individual is a resident of Canada.

19. If an individual leaves Canada for a temporary absence, this raises the question of whether he was a Canadian resident during the period of absence, particularly if some residential ties have been retained.  What are the major factors that are considered in determining whether an individual continues to be a Canadian resident during a temporary absence?

20. One of your friends is leaving Canada and would like to know when he will no longer be considered a Canadian resident.  Briefly explain the rules related to terminating an individual’s status as a Canadian resident.

21. For the current year, Jane Doe is deemed to a Canadian resident because she sojourned in Canada for 210 days.  Also for the current year, Jack Fawn, a long-time resident of Manitoba, was considered a part year resident for the first 210 days, after which he permanently departed from Canada.  Explain how these two individuals will be taxed in Canada.

22. It is possible that an individual could be considered resident in more than one country.  In such situations, “tie-breaker” rules are used to avoid the individual being subject to taxation in both countries.  List and describe three factors that would be considered in implementing the tie-breaker rules.

23. Are enterprises that are incorporated in Canada always considered to be resident in Canada?  Explain your conclusion.

24. Limon Inc. was incorporated in the U.S. five years ago.  However, all of the directors of the corporation are Canadian residents, holding all of their meetings in Montreal.  How would Limon Inc. be taxed?

25. What are the components of Net Income For Tax Purposes?

26. ITA 3(b) states that a taxpayer should “determine the amount, if any”, by which taxable capital gains exceeds allowable capital losses.  In this context, what is the meaning of the phrase “the amount, if any”?

27. What is the difference between tax avoidance and tax deferral?

28. What is income splitting?  Under what circumstances will it provide tax benefits to an individual?

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

30. Your client, a government employee, would like to reduce his taxes.  He is trying to decide whether he should contribute $5,000 to an RRSP this year.  He has an RRSP as does his wife, a part time employee at a day care centre.

Briefly describe the basic goals of tax planning.  What advice would you give your client regarding his RRSP contribution?   Explain your conclusion.

TIF Problem One - 2

Introduction - True Or False

1. A value added tax is a tax levied on the increase in value of a commodity or service that has been created by the taxpayer’s stage of the production or distribution cycle.

True or False?

2. A partnership can be a taxable entity for income tax purposes.

True or False?

3. A partnership can be a taxable entity for GST purposes.

True or False?

4. In general, provincial income taxes are based on a specified percentage of federal tax payable.

True or False?

5. The federal government does not collect personal or corporate taxes for Ontario or Quebec.

True or False?

6. A sales tax is a regressive tax even when it is applied at a single rate on all transactions.

True or False?

7. A major advantage of progressive tax rates is that their use encourages economic growth.

True or False?

8. Tax expenditures are less costly to administer than direct funding programs.

True or False?

9. Part I of the *Income Tax Act* is the largest and most important part.

True or False?

10. The citation ITA 61(4)(b)(ii) would be read Paragraph 61, Subparagraph 4, Section b, Subsection ii.

True or False?

11. Any taxpayer can choose the calendar year as their taxation year.

True or False?

12. If there is a conflict between an international tax treaty and Canadian tax legislation, the Canadian tax legislation will prevail.

True or False?

13. An income tax is payable for each taxation year on the Taxable Income of every person resident in Canada at any time in the year.

True or False?

14. Canadian citizens are required to file a Canadian income tax return, without regard to where they currently live.

True or False?

15. When an individual is absent from Canada for some period of time, the length of their absence is an important factor in determining whether they continued to be a Canadian resident during the period of their absence.

True or False?

16. If an individual moves to Canada and is here less than 183 days prior to the end of the year, that individual will be subject to Part I tax on their world wide income for the entire year.

True or False?

17. The residency of a trust depends on the country in which the central management and control of the trust takes place, not where the beneficiaries reside.

True or False?

18. If an individual leaves Canada, the three most significant factors in determining whether he has ceased to be a resident are:

Whether he continues to own a dwelling in Canada.

Whether he is accompanied by his spouse or common-law partner.

Whether he maintains social ties in Canada.

True or False?

19. If an individual returns to Canada after an absence of less than two years, S5-F1-C1 indicates that, in general, he will be considered to have retained Canadian residency during his absence.

True or False?

20. A part year resident for the current year is an individual who either establishes residency in Canada during the current year or, alternatively, terminates residency in Canada during the current year.

True or False?

21. A sojourner is any individual who has been present in Canada for 183 consecutive days in one year.

TIF Problem One - 3

Introduction - Multiple Choice

Canadian Tax System

1. Which of the following types of taxes is not currently in use by the federal government of Canada?

A. Excise Taxes

B. Custom Duties

C. Head Tax

D. Transfer Tax

2. Which of the following is **NOT** a taxable entity for Canadian income tax purposes?

A. Darklyn Ltd., a Canadian resident corporation.

B. Ms. Sarah Bright, a Canadian resident.

C. Walters and Walters, a group of CPAs operating as a partnership.

D. The Martin family trust.

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

A. Chan’s Clothing Store (an unincorporated business)

B. The Chan Foundation (a registered charity)

C. Min Chan (an individual)

D. All of the above could be required to file a GST return.

4. Which of the following forms of taxation provides the largest component of federal government taxation revenues?

A. Personal income tax

B. Corporate income tax

C. Goods and services tax

D. Employment insurance premiums

5. With respect to provincial income taxes, other than those assessed in Quebec, which of the following statements is **NOT** correct?

A. Each province can apply different rates to as many brackets for individuals as it wishes.

B. The federal government collects the provincial income tax for individuals for every province except Quebec.

C. Each province can establish its own tax credits to apply against Tax Payable for individuals.

D. Each province can establish rules for determining the Taxable Income of individuals.

6. Which of the following groups of entities are all subject to taxation on income?

A. Individuals, proprietorships and corporations

B. Proprietorships, corporations and trusts

C. Individuals, trusts and corporations

D. Individuals, partnerships and corporations

7. Income tax is calculated for which of the following groups of jurisdictions?

A. Municipal, provincial, and federal

B. Provincial, federal, and international

C. Municipal, federal, and international

D. Municipal, provincial, and international

Tax Policy Concepts

8

Which of the following statements with respect to Canadian tax policy is **NOT** correct?

A. The economic burden of a particular tax may not fall on the same group that has the legal liability to pay the tax.

B. Extremely high rates of tax will always encourage individuals to work harder so that they will have more after tax income.

C. The inability to harmonize the GST in some provinces has increased the complexity of tax compliance.

D. A progressive tax system is unfair to individuals with incomes that fluctuate significantly from year to year.

9. Which of the following goals is **NOT** a current economic policy objective of the Canadian tax system?

A. Ensure the continued provision of public goods

B. Redistribute income and wealth among taxpayers

C. Ensure fairness in the allocation of resources to different levels of government.

D. Economic stabilization such as stimulating the economy or creating jobs.

10. Which of the following can be considered an advantage of an income tax system based on progressive rates?

A. A progressive rate system is simpler to administer.

B. A progressive rate system provides greater stability in the context of changing economic conditions.

C. A progressive system discourages tax evasion.

D. A progressive system encourages greater effort on the part of individuals.

11. Which of the following statements accurately describes a regressive tax?

A. A tax which results in higher effective tax rates for higher income taxpayers.

B. A tax which results in lower effective tax rates for higher income taxpayers.

C. A tax in which the same effective rate applies to all levels of income.

D. A tax that is shifted to consumers through price increases on the goods purchased.

12. Which of the following statements with respect to using tax expenditures rather than program spending is **NOT** correct?

A. It is more costly to administer tax expenditures as opposed to program spending.

B. Tax expenditures reduce the visibility of government actions.

C. Tax expenditures leave fewer decisions in the hands of the private sector, thereby providing for more efficient allocation of resources.

D. Tax expenditures reduce the impact of progressive rates on higher income taxpayers.

13. Which of the following would **NOT** be considered a desirable characteristic of a tax system?

A. Balance between sectors.

B. Inelasticity.

C. Neutrality.

D. Flexibility.

14. Which of the following would be considered a desirable characteristic of an effective tax system?

A. Inelasticity.

B. Lack of international competitiveness.

C. Simplicity.

D. Ambiguity.

15. “We should not have a tax system which encourages investment in particular assets or in specific areas of the country.”  This statement reflects which of the following qualitative characteristics of an effective tax system?

A. Neutrality.

B. Horizontal equity.

C. Simplicity.

D. Elasticity.

16. “Taxpayers who earn $100,000 in dividends should pay the same amount of tax as taxpayers who earn $100,000 in capital gains.”  This statement reflects which of the following qualitative characteristics of an effective tax system?

A. Vertical equity.

B. Neutrality.

C. Elasticity.

D. Horizontal equity.

Income Tax Reference Materials

17. Which of the following statements with respect to tax reference materials is correct?

A. Income Tax Folios are a legislative source of guidance.

B. Income Tax Regulations are gradually being replaced by Income Tax Folios.

C. Interpretation Bulletins are gradually being replaced by Information Circulars.

D. The *Income Tax Act* is the most important source of information for dealing with matters related to the federal income tax.

18. With respect to the structure of the *Income Tax Act*, which of the following statements is correct?

A. The major components of the *Income Tax Act* are called Divisions.

B. The *Income Tax Act* has Parts numbered I through XVII, reflecting the fact that there are 17 Parts in the *Act*.

C. All Parts of the *Income Tax Act* have Divisions.

D. All Parts of the *Income Tax Act* contain at least one Section.

19. Of the following publications, indicate the one that is **NOT** a legislative source.

A. *Income Tax Act*.

B. Income Tax Folios.

C. Income Tax Application Rules.

D. International Tax Treaties.

E. Income Tax Regulations.

20. Of the following publications, indicate the one that is **NOT** published by the CRA.

A. Income Tax Folios.

B. Information Circulars.

C. Dominion Tax Cases.

D. Income Tax Technical News.

21. There are a number of common areas of litigation involving the CRA.  Indicate which type of transaction is least likely to be in dispute.

A. Arm’s length versus non-arm’s length transactions.

B. Capital versus income transactions.

C. Unreported revenues from business transactions.

D. Establishment of fair market value.

E. The deductibility of farm losses against other sources of income.

22. Where would an individual find the formula for determining the prescribed rate?

A. The Income Tax Act.

B. The Income Tax Regulations.

C. A CRA Income Tax Folio.

D. A CRA Information Circular.

23. Which of the following statements is **NOT** correct?

A. Most major income tax changes are introduced in the annual Federal Budget.

B. A federal election can prevent passage of draft legislation.

C. Proposed changes in tax law are usually introduced to parliament in the form of a Notice of Ways and Means Motion.

D. When there is a conflict between the Canadian *Income Tax Act* and an international agreement, the terms of the Canadian *Income Tax Act* prevail.

Liability For Tax

24. Of the following statements related to liability for Canadian income tax, which statement is **NOT** correct?

A. As used in the *Income Tax Act*, the term person refers to individuals, trusts, and corporations.

B. Corporations must use the calendar year as their taxation year.

C. The Canadian Part I tax is assessed on residents of Canada.

D. The Canadian Part I tax is assessed Canadian employment income earned by a non-resident.

25. An individual is liable for income tax in Canada if he:

A. is a resident in Canada.

B. is a citizen of Canada.

C. has lived in Canada at any time during the year.

D. All of the above are required.

26. Which of the following persons is **NOT** liable for Canadian income tax under Part I of the *Income Tax Act*?

A. Pheap Chom, an individual who has resided in Canada for the past 15 years.

B. Chom Incorporated, a Canadian resident corporation.

C. Phon Im, a resident of the United States who earns employment income in Canada.

D. Bunly Im, a resident of the United States who earns interest income in Canada.

27. Which of the following types of income earned by a non-resident is **NOT** subject to Canadian income tax under Part I of the *Income Tax Act*?

A. Employment income earned in Canada

B. Business income earned in Canada

C. Rental income earned in Canada

D. Income from the disposition of Canadian real estate

Residence

Residence Of Individuals

20. Which of the following is an essential factor in determining whether an individual has ceased to be a resident of Canada?

A. The individual has closed his Canadian savings account.

B. The individual has given up his membership in the Canuck Country Club.

C. The individual has become a resident of another country.

D. The individual given up his Ontario driver’s licence.

29. Ms. Floot has been out of Canada for several years.  She is presumed to be a non-resident as long as certain tests are met.  Indicate the condition that does **NOT** have to be met.

A. She did not leave a spouse or other dependants in Canada.

B. She does not return to Canada on a regular or frequent basis.

C. She did not leave personal property or social ties in Canada.

D. She did not leave taxable Canadian property in Canada.

E. She did establish permanent residence in another jurisdiction.

30. All of the following statements are true, except:

A. Canadian residents must report their worldwide income for tax purposes.

B. If an individual is a resident of Canada for part of the calendar year, that individual only has to report his worldwide income during the period of residency for Canadian tax purposes.

C. An individual who immigrates to Canada during the year is a resident of Canada for tax purposes for the full calendar year.

D. An individual can be a resident of Canada for tax purposes, even if she is not a Canadian citizen.

31. Of the following individuals, who would be a resident or deemed resident of Canada for tax purposes this year?

Alex is a U.S. citizen who commutes each day to Canada for employment purposes.

Bob is a U.S. citizen who lives in Canada during the week for employment purposes, but returns to the U.S. on weekends to the house he shares with his wife and children.

Charles is a Canadian citizen who lived in Toronto until March of last year, at which time he left for a four year aid mission in Africa under an agreement with the Canadian International Development Agency.

Dick is a Canadian citizen who goes to school in the U.S. for eight months of each year but returns to Canada to live with his parents each summer.

A. Alex, Bob and Charles.

B. Bob, Charles and Dick.

C. Bob and Charles.

D. Alex and Dick.

32. With respect to the residency of an individual, which of the following statements is **NOT** correct?

A. To be a resident for tax purposes, an individual must be a Canadian citizen.

B. If an individual leaves or enters Canada during the current year, he will be considered a part-year resident for tax purposes.

C. An individual is a Canadian resident for tax purposes if his principal residential ties are in Canada.

D. An individual is considered to be a Canadian resident for tax purposes if he visits for more than 183 days in a calendar year.

33. Which of the following factors would **NOT** be relevant under the Canada/U.S. tax treaty tie-breaker rules for determining the residence of an individual?

A. The country in which the individual earns business income.

B. The country in which the individual is a citizen.

C. The country in which the individual has a permanent home available to him.

D. The country in which the individual has a habitual abode.

34. Jamal, his wife and two teenage children are all Canadian citizens.  For the last 2 years he and his family have been living in Mexico while he works for the Mexican subsidiary of a Canadian company.  Jamal still owns his house in Canada.  His wife and children stay there for 2 months in the summer and he spends 4 weeks a year there.   The rest of the time the house is empty as his wife visits family in Canada regularly.  Jamal has no definite plans to return to Canada and loves living in Mexico.  However, since his mother-in-law is very ill, it is possible that his wife will have to return to Canada for at least 6 months to nurse her mother.  Which of the following statements is correct?

A. Jamal is considered a part-time resident of Canada for the 4 weeks he spends in Canada.

B. If Jamal’s wife returns alone to Canada to care for her mother, Jamal is considered a part-time resident of Canada for the 6 months she is in Canada.

C. Jamal is considered a non-resident of Canada.

D. Since Jamal owns a house in Canada that is not rented out under a long-term lease he is considered a Canadian resident for income tax purposes.

35. Of the following individuals, who would be considered a part-year resident of Canada for the current taxation year?

A. Ravi is a citizen of India, where he was born and lived until moving to Canada on March 1 of the current year with his wife and child.  He was transferred by his employer to its Canadian head office.

B. Helga had lived and worked in Canada for 10 years.  She was transferred by her employer to its flagship hotel in Switzerland on March 1 of the current year for a 1 year training assignment.  Her husband remained in Canada to complete his MBA.

C. Marc is a French citizen who lives in Paris.  On March 1 of the current year he begins work as a translator in Ottawa.  It is a 1 year assignment.

D. Billy Bob is a U.S. Marshall on loan to the RCMP detachment in Nunavut.  It is a 9 month assignment.

36. Dominique, a Canadian citizen, lives in Buffalo, NY, USA. Throughout the current year she commutes to Fort Erie, Ontario, Canada, where she is the bartender at the Cross Border Bar.  She normally works 7 pm to 3 am Tuesday through Saturday. Dominique is:

A. A deemed resident (sojourner)

B. A non-resident

C. A full-time resident

D. A part-year resident

37. Vanessa moves to Germany on July 15 of the current year.  She is 35 and has lived in Canada all of her life. Which one of the following best indicates Vanessa’s Canadian residency status for the current year?

A. A deemed resident (sojourner)

B. A non-resident

C. A full-time resident

D. A part-year resident

Residence Of Corporations

38. Which of the following corporations would **NOT** be considered a resident of Canada?

A. Dram Inc. was incorporated in Alberta in 2005.  While it has operations in both the U.S. and Canada, its management has always been located in New York.

B. Craser Ltd. was incorporated in Ontario in 2010.  All of its business activities are in Canada and its management is located in Toronto.

C. Alor Inc. was incorporated in British Columbia in 2004.  While most of its operations are in Canada, management is located in Seattle.

D. Exeter Ltd. was incorporated in Alberta in 1956.  However, it has never carried on business in Canada and its management has always been located in Montana.

Residence Of Individuals/Corporations

39. Of the persons described, which one would **NOT** be considered a Canadian resident?

A. A person who lives in Leamington, Ontario and commutes to work each day in Detroit, Michigan.

B. A corporation that was incorporated in North Dakota, but carries on all of its business in southern Manitoba.

C. A member of the Canadian armed forces who has, for the last 3 years, been stationed in Germany.

D. A corporation that was incorporated in Winnipeg, but carries on all of its business in North Dakota.

40. In which of the following situations is the person considered a non-resident of Canada, in 2017, for income tax purposes?

A. James Arder, a recently qualified CPA, based in Montreal, accepted a transfer to an office in Sydney, Australia for the period May 1, 2017 to August 31, 2017.  James is not married and had lived at his parent’s house in Montreal.

B. Karen Cotin, a computer programmer, had been employed by ABC Systems Ltd. in Toronto.  In 2016, she accepted a minimum two-year contract with CS Services Inc. in London, England.  Her position with CS Services Inc. started October 1, 2016.  Before moving to England, where she will join her fiance, Karen terminated the lease on her apartment in Toronto and sold her car.

C. N Limited was incorporated in Canada in 1996 and, until May 2016, its manufacturing plant was located in Mississauga, Ontario.  In May 2016, it moved all of its operations, including the manufacturing plant, to North Carolina, U.S.A.

D. B. Bath, a member of the Canadian Armed Forces, who was stationed in Lahr, Germany from September 1, 2015 to February 1, 2018.

Alternative Concepts of Income

41. Which of the following statements with respect to the relationship between accounting Net Income and Net Income For Tax Purposes is **NOT** correct?

A. Both accounting Net Income and Net Income For Tax Purposes value many assets at their historical cost.

B. Accounting Net Income requires that costs be matched with revenues.

C. Net Income For Tax Purposes requires that costs be matched with revenues.

D. Accounting Net Income is determined by applying Generally Accepted Accounting Principles.

42. Which of the following statements accurately describes the *Income Tax Act* view of income?

A. Net income is determined by adding revenue based on recognition at the point of sale and deducting expenses which are determined based on generally accepted accounting principles.

B. Net income is determined by adding together several different types of income based on an ordering rule.

C. Net income is the amount paid to an employee after an employer deducts CPP, EI, income taxes and any other source deductions from employee pay.

D. Net income is the total increase in a taxpayer’s net worth for the year.

Calculation Of Net Income For Tax Purposes

43. With respect to the determination of Net Income For Tax Purposes, which of the following statements is correct?

A. Property losses are deducted from business income before the deduction of RRSP contributions.

B. Allowable capital losses can be deducted to the extent of other positive sources of income.

C. If not used during the current period, all subdivision e deductions can be carried forward to subsequent periods.

D. If a business loss exceeds all other positive sources of income, Net Income For Tax Purposes is equal to nil.

44. With respect to the calculation of Net Income For Tax Purposes, which of the following statements is **NOT** correct?

A. Subdivision e deductions are subtracted from the total of all positive sources of income.

B. Allowable capital losses for the year can only be deducted to the extent of taxable capital gains for the year.

C. Business losses can be netted against employment income in determining the positive amounts to be included under ITA 3(a) and 3(b).

D. Property losses can only be deducted after the subtraction of Subdivision e deductions.

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

Employment income $35,000

Interest income 5,000

Taxable dividend income 7,000

Taxable capital gain 5,000

Allowable capital loss 12,000

Subdivision e deductions 2,000

What is Minjie’s Net Income for Tax Purposes?

A. $47,000

B. $40,000

C. $45,000

D. $49,000

46. Tanya Turek has the following sources of income and deductions:

Gross employment income $35,000

Net employment income 34,000

Business loss 14,000

Taxable capital gain 4,000

Allowable capital loss 2,000

What is Tanya’s Net Income for Tax Purposes?

A. $23,000

B. $22,000

C. $36,000

D. $24,000

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

Net employment income 34,000

Property income 6,000

Business loss 54,000

Taxable capital gain 4,000

Allowable capital loss 7,000

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

A. $40,000 Income

B. Nil

C. $44,000 Income

D. $12,000 Loss

48. ITA 3(b) requires the taxpayer to “determine the amount, if any, by which taxable capital gains exceed allowable capital losses”.  The rule that is established by this phrase is:

A. That allowable capital losses in excess of taxable capital gains during a year are never deductible from income.

B. That the current year allowable capital losses can only be deducted to the extent that there are taxable capital gains during the current year.

C. That taxable capital gains are only included in income in a year when there are also allowable capital losses that can be used to reduce the effect on income.

D. That unused allowable capital losses are deductible against any type of income in one of the past 3 years or in a future year.

49. Fred Hopkins has employment income of $45,000, a business loss of $14,000, capital gains of $20,000, capital losses of $12,000, and subdivision deductions of $3,000.  Fred’s Net Income For Tax Purposes is equal to:

A. $36,000

B. $50,000

C. $39,000

D. $32,000

Net Income to Taxable Income

50. Which of the following items would be deducted in converting Net Income For Tax Purposes to Taxable Income?

A. A deduction for spousal support payments made during the year.

B. A deduction for the extra costs related to living in prescribed areas of the Canadian north.

C. Current year allowable capital losses in excess of current year taxable capital gains.

D. Current year business losses in excess of other positive sources of income.

51. Which of the following amounts is **NOT** deducted in converting Net Income for Tax Purposes to Taxable Income?

A. Losses of other years.

B. The lifetime capital gains deduction.

C. An amount related to the exercise or sale of stock options.

D. The excess of allowable capital losses over taxable capital gains for the year.

Tax Planning

52. Which of the following items does not result in tax avoidance?

A. Use of the lifetime capital gains deduction.

B. Employer contributions to group disability plans.

C. Employer contributions to private health care plans.

D. Accelerated depreciation (CCA) on rental properties.

53. Providing employees with private health care benefits involves what type of tax planning?

A. Tax evasion.

B. Tax deferral.

C. Income splitting.

D. Tax avoidance.

54. Making contributions to an RRSP always involves what type of tax planning?

A. Tax avoidance and tax deferral.

B. Tax deferral.

C. Tax avoidance.

D. Income splitting.

55. Which of the following will always result in tax avoidance?

A. Making contributions to a registered retirement savings plan.

B. Making contributions to an employer’s registered pension plan.

C. Making use of the lifetime capital gains deduction.

D. Making maximum capital cost allowance deductions.

TIF Problem One - 4

Introduction - Exam Exercises

Exam Exercise Subject Listing For Chapter 1

|  |  |
| --- | --- |
| **Number** | **Subject** |
| 1 | Taxable Entities (Income Taxes) |
| 2 | Taxable Entities (GST/HST) |
| 3 | Federal And Provincial Tax Payable |
| 4 | Federal And Provincial Tax Payable |
| 5 | Regressive Taxes |
| 6 | Regressive Taxes |
| 7 | Non-Resident Liability For Tax |
| 8 | Non-Resident Liability For Tax |
| 9 | Residential Ties |
| 10 | Temporary Absences |
| 11 | Temporary Absences |
| 12 | Part Year Residence |
| 13 | Part Year Residence |
| 14 | Individual Residence |
| 15 | Individual Residence |
| 16 | Corporate Residency |
| 17 | Corporate Residency |
| 18 | Corporate Residency |
| 19 | Net Income For Tax Purposes |
| 20 | Net Income For Tax Purposes |
| 21 | Tax Planning |
| 22 | Tax Planning |
| 23 | Tax Planning |
| 24 | Tax Planning |
| 25 | Tax Planning |
| 26 | Tax Planning |

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

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

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

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

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

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

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

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

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

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

Exam Exercise One - 5  (Regressive Taxes)

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

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

Exam Exercise One - 6  (Regressive Taxes)

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

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

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

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

Is she correct?  Explain your conclusion.

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

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

Is he correct?  Explain your conclusion.

Exam Exercise One - 9 (Residential Ties)

At the end of the current year, Michael Resner departed from Canada in order to take a permanent position in Mexico.  He was accompanied by his common-law partner and their children, as well as what personal property he had not sold.  Due to the intent of his neighbour to start a pig farm, he was unable to sell his residence at a satisfactory price.  However, he was able to rent it for a period of two years.  He also retained his membership in the CPA (Chartered Professional Accountants) Alberta.  After his departure, would he still be considered a Canadian resident for tax purposes?  Explain your conclusion.

Exam Exercise One - 10 (Temporary Absences)

Mary is a Canadian citizen who is employed by a corporation operating in Canada and the U.S.  While she has worked for many years in the Canadian office of this organization, she agreed to transfer to the corporation’s U.S. head office in New York City.  Before leaving, she disposed of her residence and other personal property that she did not wish to move.  She canceled her Saskatchewan driver’s licence and health care card, and closed all of her Canadian banking and brokerage accounts.

Because her boyfriend remained in Regina, she found herself flying back to Canada at least once a month.  After two years, she concluded that between the high cost of living in New York City and the travel required to maintain the relationship with her boyfriend, she would return to Canada.  Would Mary be considered a Canadian resident during the two years that she was absent from Canada?  Explain your conclusion.

Exam Exercise One - 11 (Temporary Absences)

John Acheever is employed by Research In Limbo.  He has worked for a number of years in their office in Kitchener, Ontario.  However, he has become convinced that he would have quicker advancement if he transferred to their office in New York City.  He requests this transfer and moves to that location in September, 2017.  Before leaving he cancels his apartment lease, sells all of the personal property that he does not wish to move, and cancels his Ontario driver’s licence.  However, he retains his Canadian banking and brokerage accounts and, because of concerns about the cost of U.S. health care, he does not cancel his Ontario health care card (he changes the address to that of his parents in Waterloo, Ontario).  He has also left his dog, Bart with his parents.

After the move, he is shocked to realize how much he misses Bart.  He finds himself flying back to Kitchener at least twice a month to spend the weekend caring for Bart.  By February, 2019, after not being able to find a suitable dog-friendly apartment in New York City, John returns to his position in Kitchener.  He has no plans to return to the U.S.  Would John be considered a Canadian resident during the 18 months that he was absent from Canada?  Explain your conclusion.

Exam Exercise One - 12 (Part Year Residence)

Melissa is a Canadian citizen who has been employed in Vancouver for the last five years.  She has accepted a new position in the United States and, as of March 15 of the current year, flies to New Mexico to assume her responsibilities.   She has been granted a green card to enable her to work in the U.S.  Her husband remains behind with the children until July 1, after the end of their school year.  On that date, they fly to New Mexico to join Melissa.  Their residence is sold on August 1 of the current year, at which time a moving company picks up their furniture and other personal possessions.  The moving company delivers these possessions to their new house in New Mexico on August 15.  Explain how Melissa will be taxed in Canada during the current year.

Exam Exercise One - 13 (Part Year Residence)

Barton Vader is a Canadian citizen who has always lived in London, Ontario.  He has a spouse and two school-aged children.  As of May 2017, he accepts a new employment position in Akron, Ohio.  On October 1, 2017, he moves to Akron to locate housing for his family.  In order for his children to finish the school term, his family remains in London until January 1, 2018.  When they move, John severs all residential ties with Canada other than the family residence.  The residence is placed on the market in January, 2018.  However, it has not been sold as of December 31, 2018.

While Barton was scheduled to begin working in the U.S. in early 2018, he is unable to obtain the required residency documents until July 1, 2018.

Explain Barton’s Canadian tax status for the years 2017 and 2018.

Exam Exercise One - 14 (Individual Residency)

Mary Sothor is the Canadian ambassador to Tanzania.  She was a resident of Canada immediately prior to her appointment as ambassador.  Living with her in Tanzania’s capital city are her husband and two children.  Her husband was born in Canada and was a Canadian resident at the time of their marriage.  He is exempt from Tanzanian taxation because he is the spouse of a foreign diplomat.  Her 25 year old son was born in Canada and works for a Tanzanian company.  His income exceeds $30,000 annually.  Her 16 year old son was born in Kenya and is a full time student with no income of his own.  Which of these individuals would be considered Canadian residents for tax purposes?  Explain your conclusions.

Exam Exercise One - 15 (Individual Residency)

Ms. Sharon Washton was born 26 years ago in Bahn, Germany.  She is the daughter of a Canadian High Commissioner serving in that country.  Her father still holds this position.  However, Ms. Washton is now working in Prague, Czechoslovakia.  The only income that she earns in the year is from her Prague marketing job and is subject to taxes in Czechoslovakia.  She has never visited Canada.  Determine the residency status of Sharon Washton.

Exam Exercise One - 16 (Corporate Residency)

Nixon Inc. was incorporated as an Ontario corporation in 2009.  However, since 2012, all of the Company’s business has been carried on outside of Canada.  Determine the residency status of Nixon Inc.

Exam Exercise One - 17 (Corporate Residency)

Wolfhowl Ltd. was incorporated in Banff, Alberta in 1961.  Despite its Canadian charter, the Company has never carried on business in Canada.  However, until 1971, all meetings of the Board of Directors were held in Banff.  Since 1971, all board of directors meetings have been held in Wyoming.  Determine the residency status of Wolfhowl Ltd.

Exam Exercise One - 18 (Corporate Residency)

Acton Enterprises was incorporated in Montana in 1964.  Until 2013, all of the company’s directors were residents of Bozeman, Montana, with all meetings held in that city.  However, in 2013, all of the directors moved to Calgary, Alberta, with all subsequent meetings held in that city.  Determine the residency status of Acton Enterprises for the taxation year ending December 31, 2017.

Exam Exercise One - 19 (Net Income For Tax Purposes)

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

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

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

Exam Exercise One - 20 (Net Income For Tax Purposes)

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

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

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

Exam Exercise One - 21  (Tax Planning)

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

Exam Exercise One - 22  (Tax Planning)

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

Exam Exercise One - 23 (Tax Planning)

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

Exam Exercise One - 24  (Tax Planning)

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

Exam Exercise One - 25 (Tax Planning)

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

Exam Exercise One - 26  (Tax Planning)

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

TIF Problem One - 5A

Introduction - Key Term Matching (Easy)

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

Version A is easy, there is only one possible answer for each term.

Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

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

A. Fiscal Period

B. Flat Tax System

C. Part Year Resident

D. Net Income For Tax Purposes

E. Person

F. Regressive Tax System

G. Sojourner

H. Dual Resident

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

1. A taxation year that does not exceed 53 weeks.

2. A tax system that applies higher effective rates for individuals with lower incomes and lower effective rates for individuals with higher incomes.

3. The total of net employment income, net business and property income, net taxable capital gains, other sources of income, and other deductions from income.

4. A CRA publication providing their interpretation of various technical issues related to income taxes.

5. A term used in the *Income Tax Act* to refer to taxable entities.

6. An individual who is deemed under ITA 250 to be a Canadian resident for the full taxation year as the result of having been temporarily present in Canada for 183 days or more.

7. A taxpayer who is considered to be a resident of two countries.

8. A tax on income that is applied at the same rate to all taxpayers, without regard to the level of their income.

9. An individual who either enters Canada during the year and becomes a resident or, alternatively, an individual who departs from Canada during the year and gives up their Resident status.

10. A tax system that applies higher effective rates for individuals with higher incomes and lower effective rates for individuals with lower incomes.

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

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

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

TIF Problem One - 5B

Introduction - Key Term Matching (Moderate)

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

Version A is easy, there is only one possible answer for each term.

Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

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

A. Fiscal Period

B. Flat Tax System

C. Part Year Resident

D. Net Income For Tax Purposes

E. Person

F. Regressive Tax System

G. Sojourner

H. Dual Resident

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

1. A taxation year that does not exceed 53 weeks.

2. An individual who has a residence in more than one country.

3. A tax system that applies higher effective rates for individuals with lower incomes and lower effective rates for individuals with higher incomes.

4. The total of net employment income, net business and property income, net taxable capital gains, other sources of income, and other deductions from income.

5. A CRA publication providing their interpretation of various technical issues related to income taxes.

6. A term used in the *Income Tax Act* to refer to taxable entities.

7. The total of all positive sources of income, including employment income, business and property income, net taxable capital gains, and other sources of income.

8. An individual who is deemed under ITA 250 to be a Canadian Resident for the full taxation year as the result of having been temporarily present in Canada for 183 days or more.

9. A taxpayer who is considered to be a resident of two countries.

10. A tax on income that is applied at the same rate to all taxpayers, without regard to the level of their income.

11. An individual human being.

12. A taxation year that is longer or shorter than 52 weeks.

13. An individual who either enters Canada during the year and becomes a resident or, alternatively, an individual who departs from Canada during the year and gives up their Resident status.

14. A tax system that applies higher effective rates for individuals with higher incomes and lower effective rates for individuals with lower incomes.

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

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

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

TIF Problem One - 6

Application Of Qualitative Characteristics

Since it came into power in 2015, the new Liberal government has made a number of changes in the Canadian tax system.  A brief description of five of these changes follows.

**Increase In Maximum Tax Rate** For many years the maximum federal tax rate for individuals has been 29 percent.  For 2016 and subsequent years, this maximum has been increased to 33 percent.  This has resulted in a situation where the maximum combined federal/provincial rate on individuals is over 50 percent in most provinces.  It reaches as high as 54 percent in one province.

**Repeal Of The Family Tax Cut** This provision provided a tax reduction based on a limited amount of income splitting.  Specifically, a separate calculation of Tax Payable was based on the assumption that up to $50,000 of Taxable Income was transferred from a higher income spouse to a lower income spouse.  It was only available to couples with a child under the age of 18.  It was repealed for 2016 and subsequent years.

**Reduction To Tax Free Savings Account (TFSA) Contributions Limit** The TFSA provision allows non-deductible contributions to be made to a registered account where earnings accumulate on a tax free basis.  Withdrawals from these accounts are not taxed.  For 2016 and subsequent years, the maximum annual contribution has been reduced from $10,000 to $5,500.

**Small Business Tax Rate** For many years, the federal tax rate on active business income earned by Canadian Controlled Private Corporations was 11 percent, 4 percentage points less than the rate applicable to most other corporate income.  In 2015, the Conservative government announced that the rate would gradually be reduced to 9 percent by 2019.  The new Liberal government accepted the scheduled rate reduction to 10.5 percent for 2016, but cancelled any further reduction in the rate.

**Early Child Educator School Supply Tax Credit** The new Liberal government has introduced a new tax credit equal to 15 percent of eligible expenditures for supplies (e.g., paper, glue, paint for art projects, etc.).  The maximum base for the credit will be $1,000 of eligible supplies in each year.  To qualify, the taxpayer must have a certificate or diploma in early childhood education.

**Required:** Analyze each of the described changes using two of the qualitative characteristics of tax systems that are listed in your text.  For your convenience, the list of qualitative characteristics presented in the text is as follows:

* equity or fairness
* neutrality
* adequacy
* elasticity
* flexibility
* simplicity and ease of compliance
* certainty
* balance between sectors
* international competitiveness

TIF Problem One - 7

Application Of Qualitative Characteristics

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

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

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

1. Introduce a provincial sales tax at a rate of 8 percent.

2. Participate in the federal HST regime at a rate of 13 percent.

3. Cut provincial contributions to education services by 10 percent.

4. Cut provincial contributions to health care by 10 percent.

5. Introduce progressive income tax rates on individuals.

6. Increase corporate income tax rates.

7. Introduce a one-time entry fee of $5,000 per person on new immigrants to the province.

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

TIF Problem One - 8

Residency After Departure From Canada

Mr. Desmond Morris has spent his entire working life with his current employer, the Alcorn Manufacturing Company.  In his first years with the Company, he was located in Winnipeg, Manitoba as a production supervisor.  More recently, he was transferred to the Company’s Calgary based subsidiary, where he has served as a manufacturing vice president until the current year.

Early in the current year, Mr. Morris was asked to move to the United States by April 1 to oversee the construction of a new manufacturing operation in Sarasota, Florida.  It is expected that when the facility is completed, Mr. Morris will remain as the senior vice president in charge of all of the Florida operations.  He does not have any intention of returning to live in Canada during the foreseeable future.

On April 1, Mr. Morris left Canada.  In preparation for his departure, he had taken care to sell his residence, dispose of most of his personal property, and resign from all memberships in social and professional clubs.  However, because Mr. Morris and his wife had three school age dependent children, it was decided that they would remain in Canada until the end of the current school year.  As a consequence, Mrs. Morris and the children did not leave Canada until June 30.  Until their departure, they resided in a small furnished apartment, rented on a month to month basis.

**Required** For purposes of assessing Canadian income taxes, determine when Mr. Morris ceased to be a Canadian resident and the portion of his annual income which would be assessed for Canadian taxes.  Explain your conclusions.

TIF Problem One - 9

Residence Of Individuals

The following independent Cases describe situations in which income has been earned by an individual.  In each of the Cases, indicate whether the income amounts described would be subject to Canadian taxation.  Explain the basis for your conclusions.

**Case A** Donald Plesser is a U.K. citizen who immigrated to Canada on July 1 of the current year.  He immediately began employment as a retail clerk and, during the period July 1 through December 31, his employment income totaled $11,000.  In addition, he has retained a large savings account in the U.K.  Interest on this account, which was earned uniformly over the current year, totaled £11,000.

**Case B** Uta Jurgens is the spouse of Colin Jurgens, a member of the Canadian armed forces stationed in Germany.  Mrs. Jurgens is a German citizen and has never visited Canada.  During the current year, she has employment income of €28,000.  She is exempt from German taxation because she is the spouse of a member of the Canadian armed forces.

**Case C** Martin Downs is a U.S. citizen who lives in Detroit, Michigan.  He is employed two days each week in Windsor, Ontario by a local landscaping business.  During the current year, he is paid $15,000 (Canadian) for this work.  In addition, he maintains a savings account at a bank in Windsor.  This account earned interest of $1,500 during the current year.

**Case D** Sarah Mennan is a Canadian citizen who lives in Syracuse, New York.  She works as an accountant in that city, and has professional income of $72,000.  Ten years ago, she left her husband at the end of the second period of the final game of the Stanley Cup Playoffs.  She departed from Canada the following day, and has vowed to never set foot in Canada again.  She is divorced from her husband and has no assets in Canada, other than a small savings account on which she earned interest of $150 during the current year.

TIF Problem One - 10

Residency Of Corporations

Indicate which of the corporations described in the following Cases would be considered residents of Canada for the current year.  Explain the basis for your conclusion.

**Case A** Bonix Ltd. was incorporated in Canada in 1981.  While it operated in Canada for a number of years, all of its operations, management and directors relocated to the United States in 2008.

**Case B** Dorad Inc. was incorporated in Ohio in 2003.  For several years, all of its directors were residents of Canada, with board meetings being held in Windsor, Ontario.  However, in 2008, all of the directors moved to Toledo, Ohio.  All Board Of Directors meetings are now held in that city.

**Case C** Upton Inc. was incorporated in Delaware in 2008.  However, the head office of the corporation is in Halifax, Nova Scotia.  All of the directors of the corporation are Canadian residents and all meetings of the board of directors are held in Halifax.

**Case D** Carlin Inc. was incorporated in Canada in 2005.  However, its directors have always been residents of the United States, with all of the company’s Board Of Directors meetings held in that country.

TIF Problem One - 11

Residence - Individuals And Corporations

For each of the following persons, indicate how they would be taxed in Canada for the current year.  Your answer should explain whether the person is a Canadian resident, what parts of their income would be subject to Canadian taxation, and the basis for your conclusions.

A. Mr. Samuel Salazar lives in Detroit, Michigan and is a full time employee of a business in Windsor, Ontario.  His responsibilities with the business in Windsor require him to be present for about eight hours per day, five days per week.  His annual salary in his Windsor position is $72,000 per year.

B. Mr. John Wills is a Canadian citizen who, until September 1 of the current year, had spent his entire life living in Regina.  On September 1 of the current year, after disposing of all of his Canadian property, Mr. Wills moved his entire family to Bismarck, North Dakota where he opened a mixed martial arts school.

C. Joan Brothers was born in Livonia, Michigan.  She is seven years old and has never visited Canada.  She has no income of her own.  Her father has been consul in the Canadian Consulate in Livonia for the past 15 years.  He was a resident of Canada immediately prior to his appointment as consul.

D. Brogan Inc. was incorporated in Montana in 1990, but until five years ago, all of the directors’ meetings were held in Calgary, Alberta.  Five years ago, the president of the Company moved to Butte, Montana and since that time all of the directors meetings have been held in Butte.

E. Mercer Ltd. was incorporated in British Columbia in 1963 and all of its directors’ meetings were held in Vancouver until May, 1994.  In June, 1994, all of the directors moved to Portland, Oregon and all subsequent directors’ meetings were held in Portland.

F. The Booker Manufacturing Company was incorporated in 1963 in Minnesota.  The directors of the Company have always been residents of Winnipeg and, as a consequence, all meetings of the Board of Directors have been held in Winnipeg since the Company was first incorporated.

TIF Problem One - 12

Residence - Individuals And Corporations

Pertinent facts are given for a different individual or corporation in each of the Parts of this problem.  For each Part, indicate whether or not this individual or corporation would be considered a Canadian resident for income tax purposes during the current year.  Briefly explain your conclusion.

**Part A** Dorothy is married to Jack, who is a member of the Canadian armed forces serving in Indonesia.  Other than a brief visit to Jack’s parents’ home in Halifax, she has never been to Canada in her life.  Because Jack is a member of the Canadian armed forces, neither he nor his wife is subject to taxation in Indonesia.

**Part B** Alice is a U.S. citizen living in Seattle, Washington.  While she leaves many of her belongings at her parent’s home in that city, she spends at least four days every week living with her boyfriend in Burnaby, British Columbia.  They plan to be married at some future date.

**Part C**  Last year, John transferred to the Cayman Islands office at the request of his Canadian employer.  His three year employment contract calls for him to return to work in Canada after its completion.  On his departure from Canada, he severed all residential ties with Canada.

**Part D** Millicent is a U.S. citizen who, until last year, had lived and worked in Canada as a landed immigrant for over 20 years.  Last year, after winning $2 million in an Ontario lottery, she left Canada on a two year pleasure trip that will take her to virtually every country in the world.  Her husband and children, all Canadian citizens, continue to live at the family home in Port Hope, Ontario.

**Part E** Berkly Management Inc. was incorporated in Alberta in 1963.  Until 1986, its only director resided in that province.  In that year, the director was replaced by an individual resident in Fresno, California.

**Part F** Lorris Ltd. was incorporated in Wisconsin in 1983.  Until 1992, all of the directors of the corporation lived in Kenora, Ontario.  During this period, the Board of Directors meetings were held in that city.  Beginning in 1992, all of the directors have been residents of Green Bay, Wisconsin and all of the Board of Directors meetings have been held in Green Bay.

TIF Problem One - 13

Net Income For Tax Purposes

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

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

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

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

TIF Problem One - 14

Net Income For Tax Purposes

The following two Cases make different assumptions with respect to the amounts of income and deductions that are available to Carl Suzak, a Canadian resident, for the current year.

**Case A** Carl had employment income of $126,100, as well as income from an unincorporated business of $14,100.  A rental property owned by Carl experienced a net loss of $4,600.  Dispositions of capital property during the current year had the following results:

Capital Gains $56,400

Capital Losses 72,300

In compliance with the terms of his divorce agreement, Carl paid deductible spousal support of $600 per month for the entire year.  In addition to the preceding items, Carl had a winning lottery ticket which resulted in his receiving a prize of $562,000.

**Case B** Carl had employment income of $89,000, interest income of $3,100, and net rental income of $8,600.  Carl also operated an unincorporated business.  Unfortunately, during the current year, it experienced a net loss of $187,400.  Dispositions of capital property during the current year had the following results:

Capital Gains $46,200

Capital Losses 26,300

Also during the current year, Carl made deductible contributions of $8,600 to his RRSP.

**Required**:  For each Case, calculate Carl’s Net Income For Tax Purposes (Division B income).  Indicate the amount and type of any loss carry overs that would be available at the end of the current year.

TIF Problem One - 15

Net Income For Tax Purposes

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

**Case A**  **Case B**

Employment Income $34,000 $18,500

Income (Loss) From Business ( 36,000) ( 28,200)

Income From Property 21,000 12,000

Taxable Capital Gains 42,000 9,000

Allowable Capital Losses ( 57,000) ( 12,000)

Subdivision e Deductions (Spousal Support) ( 5,500) ( 10,500)

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

TIF Problem One - 16

Net Income For Tax Purposes

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

Case 1

Net Employment Income $82,438

Interest Income 3,521

Taxable Capital Gains 16,346

Allowable Capital Losses ( 3,478)

RRSP Contribution ( 6,420)

Case 2

Net Business Income $56,782

Net Rental Loss ( 6,742)

Taxable Capital Gains 3,426

Allowable Capital Loss ( 4,560)

Spousal Support Payments ( 18,000)

Case 3

Net Employment Income $36,582

Net Business Loss ( 47,384)

Capital Gains 8,426

Capital Losses ( 6,220)

Child Care Costs ( 2,860)

Case 4

Interest Income $ 4,850

Net Business Income 35,682

Net Rental Loss ( 51,462)

Capital Gains 8,460

Capital Losses ( 18,462)

Moving Expenses ( 5,643)

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

Chapter Two Test Item File Problems

TIF Problem Two - 1

Procedures And Administration - Essay Questions

1. An individual can request that an employer reduce the amounts withheld for income taxes.  What conditions must be met for this request to be granted?  Provide an example of a situation where this request would be granted.

2. In some situations, an employee may request an increase in the amounts that are withheld for future income taxes.  What circumstances might lead an employee to make such a request?

3. Under what circumstances must an individual make income tax instalment payments during the current year?

4. If an individual is required to make quarterly instalment payments on their income taxes, how is the required amount of the instalments determined?

5. By making all instalments on the basis of the CRA’s instalment reminder, the taxpayer is assured that no interest will be assessed for deficient instalments.  However, this may not be the best alternative for making instalment payments.  Explain why this is true.

6. One of your clients has received his instalment notice and has asked your advice as to whether he should make the payments.  Provide the requested advice.

7. How is interest on late instalments calculated?

8. On April 30 of the current year, her filing due date, Nicole Houde finds that she has a significant net tax owing.  She will not be able to pay this until the beginning of July.  She doesn’t want to file her return until she has the funds available to pay the balance.  What advice would you give Ms. Houde in this regard?

9. Under what circumstances must a corporation make income tax instalment payments during its current taxation year?

10. If a corporation that is not a small CCPC is required to make instalment payments on their income taxes, how are the required amounts determined?

11. If a corporation that is a small CCPC is required to make quarterly instalment payments on their income taxes, how are the required amounts determined?

12. A corporation’s balance due date is not the same as its return due date.  Explain how these dates differ.

13. The normal reassessment period is 3 years for individuals and CCPCs and 4 years for other corporations.  Indicate two situations where a reassessment can occur outside the normal reassessment period.

14. Cases can be heard by the Tax Court of Canada using either the general or the informal procedures.  How do these two procedures differ?

15. Briefly describe the difference between tax evasion and tax avoidance.

TIF Problem Two - 2

Procedures And Administration - True Or False

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

True or False?

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

True or False?

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

True or False?

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

True or False?

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

True or False?

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

True or False?

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

True or False?

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

True or False?

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

True or False?

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

True or False?

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

True or False?

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

True or False?

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

True or False?

TIF Problem Two - 3

Procedures And Administration - Multiple Choice

Individual Filing Requirements

1. Which of the following statements is **NOT** correct?

A. If an individual has business income during the year, the due date for their income tax return is June 15 of the following year.

B. An income tax return may be required of an individual, without regard to their age.

C. If an individual has no Taxable Income for the year, they do not have to file an income tax return.

D. If an individual sells a capital property during the year, they are required to file an income tax return, even if there is no gain or loss on the transaction.

2. Which of the following statements is correct?

A. When an individual dies in a year, an income tax return must be filed for that year within 6 months of the date of death.

B. Only residents of Canada are required to file Canadian income tax returns.

C. An individual with business income during the year must pay any balance owing by June 15 of the following year.

D. A self employed individual with a net business loss for the year does not have to file an income tax return for the year.

3. With respect to the filing of an individual income tax return, which of the following statements is correct?

A. An individual is required to file an income tax return if their only source of income is business income, even if no tax is payable.

B. An individual is required to file an income tax return if they have reached the age of 18 by the end of the year.

C. If an individual has disposed of a capital property during the year, they are required to file an income tax return, even if no tax is payable.

D. An individual is not required to file an income tax return if no tax is payable for the year.

4. For the 2017 taxation year, John Bookman had a taxable capital gain of $45,000 and a net business loss of $45,000, resulting in a Taxable Income of nil.  Which of the following statements is correct?

A. John is not required to file a tax return for 2017.

B. John must file a tax return on or before June 15, 2018.

C. John must file a tax return on or before December 31, 2018.

D. John must file a tax return on or before April 30, 2018.

5. John Barron is self-employed and plans to file his 2017 tax return on June 15, 2018.  His balance-due day is:

A. April 30, 2017.

B. April 30, 2018.

C. June 15, 2018.

D. June 15, 2017.

6. Bunly Im is a self-employed hairdresser.  Which of the following dates are correct for the date by which his tax return for a year must be filed (1st item) and his payment due date (2nd item)?

A. April 30, April 30.

B. June 15, April 30.

C. April 30, June 15.

D. June 15, June 15.

7. Ms. Deveco’s 2017 income tax return is due on April 30, 2018.  While she is too busy to file her tax return on that date, she remits a cheque to the government for $10,000, her estimated amount of net tax owing on that date. She has never filed a late return before.   She prepares and files her tax return on May 31, 2018.  At this time, the return shows that her actual net tax owing was $9,800.  Assuming that the interest rate applicable to late payment of taxes is one-half percent per month without daily compounding, how much will she owe in penalties and interest on the late filing?

A. $  49.

B. $490.

C. $588.

D. $637.

E. Nil.

8. Mr. Finlay, a retired individual whose only source of income was pension receipts, dies on August 15, 2017. By what date must Mr. Finlay’s final tax return be filed?

A. April 30, 2018.

B. February 28, 2018.

C. February 15, 2018.

D. December 31, 2017.

E. None of the above.

9. Ms. Ali, a self-employed music teacher with business income, dies on November 15, 2017.  What is the latest filing date for her 2017 income tax return?

A. April 30, 2018.

B. May 15, 2018.

C. May 30, 2018.

D. June 15, 2018.

10. Mr. Khan, a self-employed construction contractor, dies on April 1, 2017.  What is the latest filing date for his final tax return?

A. April 30, 2018.

B. June 15, 2018.

C. October 1, 2018.

D. December 31, 2018.

11. Ms. Loren dies on February 1, 2018.  All of her income is from employment activities and she does not have a spouse or common-law partner.  What is the latest date for filing her 2017 income tax return?

A. April 30, 2018.

B. June 15, 2018.

C. August 1, 2018.

D. June 30, 2018.

12. Greta died on September 10, 2017. She has never reported any business income.  By what date must her final tax return be filed?

A. April 30, 2018.

B. April 30, 2019.

C. March 10, 2018.

D. June 15, 2018.

Individual Instalments

13. Which of the following individuals did **NOT** have to pay instalments in 2017?

A. Jane Austen, who had business income of $50,000 in both 2015 and 2017 and a $1,000 business loss in 2016.

B. Charlotte Bronte, who realized capital gains of $3,500 in 2016 and $4,000 in 2017.  Her only other income during the years 2015 through 2017 was $5,000 in employment income.

C. George Eliot, who had rental income of $50,000 in the years 2015 through 2017 and a net allowable capital loss of $50,000 in 2016.

D. Emily Bronte, who received spousal support payments of $20,000 per year in each of the years 2015 through 2017.

14. Ms. Marston has net tax owing for 2015 of $4,500, net tax owing for 2016 of $8,000, and estimated net tax owing for 2017 of $7,500.  If she wishes to pay the minimum total amount of instalments for the 2017 taxation year, her first payment on March 15 will be for what amount?

A. Nil.

B. $1,125.

C. $1,875.

D. $2,000.

15. Jason Marks has to pay his tax by instalments as a result of his significant investment income. His net tax owing in 2015 was $13,600.  In 2016, it was $15,000.  His estimate for  2017  is $17,000. If he decides to pay his 2017 tax instalments according to the prior year option, how much should he pay on September 15, 2017?

A. $3,400.

B. $3,750.

C. $4,250.

D. $6,500.

16. All of the following people will have to pay tax by instalments this year, except:

A. Jane White, who received a one-time bonus of $60,000 last year and, because her employer had not deducted enough tax, found herself with net tax owing of $8,200.

B. Karen Phillips, who has started to earn investment income, which resulted in net tax owing of $3,100 last year.  Her investment income is expected to be even greater this year.

C. Blake Fortin, who established a sole proprietorship two years ago.  Blake had a very successful first year and, as result, he had net tax owing that year of $85,000.  Business dropped in his second year, resulting in net tax owing of only $1,500.  This year, business has picked up again and he expects to have net tax owing of $53,000.

D. Terri Jones, who has had net taxable capital gains on real estate in excess of $40,000 in each of the last two years, and who expects to have similar gains this year.

17. Larry Short has self-employment income of $62,000 in 2017. Prior to this year, he was employed full-time and his employer’s withholdings more than covered his tax liability for the year.  Larry estimates that, based on his self-employment income, his net tax owing for 2017 will be $8,000. Which of the following statements is true?

A. Larry must file his return for 2017 by April 30, 2018.

B. Larry should pay instalments in 2017.

C. Larry must pay his income tax for 2017 by June 15, 2018.

D. If Larry has as much income in 2018 as he had in 2017, he will have to pay instalments during 2018.

18. Individuals are required to pay instalments:

A. When net tax owing is over $3,000 for any one of the past two years.

B. When net tax owing is over $3,000 for the current year and both of the two prior years.

C. When net tax owing is over $3,000 for the current year and one of the two prior years.

D. When net tax owing is over $3,000 for the current year only.

19. One way to ensure that no interest will be assessed for late instalments is:

A. To pay the amounts provided by the CRA in their instalment reminder on or before the required dates.

B. To pay the lowest amount calculated using the 3 alternative calculations on or before the required dates.

C. To pay the estimated tax owing for the current year on the first instalment due date.

D. To pay the average of the three amounts calculated using the 3 alternative calculations on or before the required dates.

Interest and Penalties

20. Dora Chen has determined that her minimum tax instalments for 2017 are $8,000 per quarter.  She also owes $30,000 on her credit card, which carries an interest rate of 20%.  She has destroyed her credit card, so no more can be put on it.  Dora is unable to pay both the entire instalment amounts and her credit card balance, but she does have $8,000 in cash each quarter for her debts.  Which of the following would be the best choice for Dora from a financial planning perspective?

A. Dora should pay off her credit card balance before making instalment payments.

B. Dora must make all her instalment payments, even if it means she cannot pay anything off on her credit card this year.

C. Dora should split her payments equally between the credit card balance and the instalment liability, in order to show the CRA that she is trying her best to meet her obligations to them.

D. Dora should pay her first two instalments and then make payments on her credit card balance.

21. Lang Lang Ltd., a CCPC eligible for the small business deduction, has a March 31 year end.  Due to the death of the owner/manager, the tax return for the year ended March 31, 2016 was not filed until May 12, 2018. The unpaid tax on March 31, 2016 was $15,500. Lang Lang Ltd. has never filed a return late before.  What is the total late file penalty that the corporation is required to pay?  (Do not include any interest payable.)

A. $775

B. $2,635

C. $1,860

D. $3,720

22. Which of the following scenarios will result in a penalty being charged by the CRA?

A. A taxpayer pays less than the required amount of instalments.

B. A taxpayer who is owed a refund files their tax return late.

C. A taxpayer who has a balance owing files their tax return late, with the payment enclosed.

D. A taxpayer who has a balance owing files their tax return on time, but does not include a payment.

Corporate Filing Requirements

23. Which of the following statements with respect to corporations is **NOT** correct?

A. Corporate income tax returns must be filed within 6 months of the end of the taxation year.

B. All corporations must file their income tax returns electronically.

C. If the corporation is a CCPC, the due date for any balance owing is three months after the end of the taxation year.

D. If a corporation has foreign operations, it can determine its Canadian tax liabilities on the basis of financial statements prepared in the corporation’s functional currency.

24. For corporations, the filing deadline for tax returns is:

A. April 30.

B. the fiscal year end.

C. three months after the fiscal year end.

D. three months after the fiscal year end if the small business deduction is claimed, otherwise two months after the fiscal year end.

E. six months after the fiscal year end.

25. PS Swim Inc. has a year end of November 30.  It is a small CCPC.  For its 2017 taxation year, its income tax return is due on:

A. January 31, 2018.

B. February 28, 2018.

C. April 30, 2018.

D. May 31, 2018.

E. None of the above.

26. For its 2017 taxation year, its first year of operation, PS Swim Inc. filed its return three months late. The unpaid tax at the due date for the return was $2,500. This amount was not paid until the return was filed. What would its penalty be?

A. Nil.

B. $75.

C. $125.

D. $200.

E. $500.

27. The balance due date for a corporation is:

A. April 30 of the following year.

B. The same as the filing deadline.

C. Three months after the end of the fiscal year, or two months after the end of the fiscal year if the corporation is a small CCPC.

D. Two months after the end of the fiscal year, or three months after the end of the fiscal year if the corporation is a small CCPC.

Corporate Instalments

28. A Canadian public company has Tax Payable of $62,000 in 2015, $95,000 in 2016, and $75,000 in 2017.  The company would like to minimize its 2017 instalments.  What would its instalments be?

A. One monthly payment of $5,167 per month, followed by eleven monthly payments of $8,167 per month.

B. Twelve payments of $5,167 per month.

C. Twelve payments of $6,250 per month.

D. Two monthly payments of $5,167 per month, followed by ten monthly payments of $8,467 per month.

29. PP Ltd., a client of your firm, has a November 30 year end and has requested you to advise them on what its monthly instalments for the 2017 tax year will be.  Its taxes payable for its November 30, 2015 and November 30, 2016 years were $13,800 and $13,200, respectively.  Its estimated taxes payable for the November 30, 2017 year are $14,400.  PP Ltd. wants to pay the lowest amount possible, without incurring interest penalties.   What would its instalments be?

A. Twelve payments at $1,200 per month.

B. Twelve payments at $1,100 per month.

C. Twelve payments at $1,150 per month.

D. Two monthly payments at $1,200 each, followed by ten monthly payments at $1,140 each.

E. None of the above.

30. A Canadian public corporation had federal taxes payable in 2015 and 2016 exceeding $3,000.  One correct option it has with respect to its 2017 instalments is to pay:

A. equal instalments, on a quarterly basis, based on its 2016 federal taxes payable.

B. on a monthly basis, instalments equal to 1/12th of its estimated 2017 federal taxes payable.

C. one lump-sum payment, within three months of its 2017 year end.

D. on a monthly basis, instalments equal to 1/12th of its 2015 federal taxes payable.

31. If a Canadian public corporation is experiencing a year-to-year decrease in taxes payable, the most advantageous calculation of instalments that would be allowed is:

A. monthly, based on the estimated tax for the current year.

B. quarterly, based on the estimated tax for the current year.

C. monthly, based on the estimated tax for the immediately preceding year.

D. quarterly, based on the estimated tax for the immediately preceding year.

E. monthly, based on the estimated tax for the second preceding year and the immediately preceding year.

F. quarterly, based on the estimated tax for the second preceding year and the immediately preceding year.

32. Which of the following is **NOT** one of the criteria for a CCPC to be considered a small CCPC eligible to pay instalments on a quarterly basis?

A. Taxable income cannot exceed $500,000 for the corporation and its associated corporations for the current taxation year and the two previous years.

B. The corporation has claimed the small business deduction in the current or previous year.

C. The corporation has a perfect compliance record during the last 12 months.

D. The corporation and its associated corporations do not have Taxable Capital Employed in Canada that exceeds $10 million for the current or previous year.

Assessments And Appeals

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

A. March 2, 2019.

B. April 30, 2019.

C. March 28, 2019.

D. December 28, 2019.

34. Which of the following statements is **NOT** correct?

A. When the person filing the return has made any misrepresentation due to neglect, carelessness or wilful default, the normal reassessment period can be extended beyond 3 years.

B. A taxpayer can choose to file a waiver to extend the 3 year time limit.

C. When a return has been reassessed once, no further reassessments are permitted.

D. Reassessment can occur outside the normal reassessment period when reassessment within the normal period affects a balance outside of the normal period.

35. Which of the following is **NOT** one of the criteria that must be met before an adjustment to a previous year tax return is permitted?

A. The CRA must be satisfied that the previous assessment was incorrect.

B. The change is based on a successful appeal to the courts by another taxpayer.

C. The taxpayer’s return was filed within 3 years of the end of the year to which it relates.

D. The reassessment must be made within the normal assessment period, or under certain permitted extensions to this period.

36. Tom Arnold filed his 2017 tax return on March 1, 2018.  The CRA mailed a notice of assessment to Tom dated May 15, 2018, and Tom received it on May 30, 2018.  If Tom disagrees with the notice of assessment, what is the latest date he has to file a notice of objection?

A. 90 days from March 1, 2018.

B. 90 days from April 30, 2018.

C. 90 days from May 15, 2018.

D. 90 days from May 30, 2018.

E. None of the above.

37. Minnie Belanger is retired.  She filed her 2017 tax return on March 5, 2018.   She received a portion of the tax refund claimed and an assessment notice, dated April 19, 2018, which set out the difference between the amount claimed and the amount of the refund.  As Minnie disagrees with the notice of assessment, she wishes to file a notice of objection.  What is the latest date she has to file a notice of objection?

A. March 5, 2019.

B. April 19, 2019.

C. April 30, 2019.

D. July 18, 2018.

E. June 15, 2019.

38. For a public corporation, which of the following statements is correct with respect to filing a notice of objection?

A. It must be filed no later than 180 days from the date on the notice of assessment.

B. It must be filed the later of 90 days after the date on the notice of assessment and one year from the filing date for the return under assessment.

C. It must be filed the later of 180 days after the date on the notice of assessment and one year from the filing date for the return under assessment.

D. It must be filed no later than 90 days after the date on the notice of assessment.

39. Marc Mayer filed his 2017 personal tax return on March 1, 2018. Neither he nor his spouse has business income in any year. The CRA mailed a Notice of Assessment to Marc dated May 5, 2018 and Marc received it on May 14, 2018. If Marc disagrees with the Notice of Assessment, he has until which one of the following dates to file a Notice of Objection?

A. August 3, 2018.

B. August 12, 2018.

C. March 1, 2019.

D. April 30, 2019.

Tax Planning

40. Carice Martin is planning to sell a piece of capital equipment which can be sold for more than its cost.  If she waits until after her company’s year end to sell it, she is engaging in:

A. tax evasion.

B. tax avoidance.

C. GAAR.

D. tax planning.

TIF Problem Two - 4

Procedures And Administration - Exam Exercises

Exam Exercise Subject Listing For Chapter 2

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

Exam Exercise Two - 1 (Individual Due Dates)

Mark Brown’s 2017 Net Income includes business income.  When is his 2017 tax return due?  By what date must his 2017 tax liability be paid in order to avoid the assessment of interest on amounts due?

Exam Exercise Two - 2 (Individual Due Dates)

Ms. Jeanine Farrel has 2017 Net Income which includes business income.  When is her 2017 tax return due?  In addition, indicate when any remaining tax liability must be paid in order to avoid having interest assessed on the amount due.

Exam Exercise Two - 3 (Deceased Taxpayer Due Date)

George Klause dies on March 1, 2018.  All of his income during 2017 was earned through his unincorporated accounting practice.  By what date must his representatives file his 2017 income tax return?  Explain your answer.

Exam Exercise Two - 4 (Deceased Taxpayer Due Date)

Gloria Klump dies on December 1, 2017.  Much of her 2017 income resulted from an unincorporated business which she operated.  By what date must her representatives file her 2017 income tax return?  Explain your answer.

Exam Exercise Two - 5 (Individual Instalments)

At the beginning of 2017, the following information relates to Sarah Elmsley:

**Year Net Tax Owing**

2015 $1,800

2016 6,400

2017 (Estimated) 3,600

Indicate whether Ms. Elmsley is required to make instalment payments during 2017.  Explain your conclusion and, if your answer is positive, indicate the minimum instalments that will be required and when they are due.

Exam Exercise Two - 6 (Individual Instalments)

Horace Greesom filed his 2016 return on time.  At the beginning of 2017, the following information relates to Mr. Greesom:

**Amounts**

**Year Taxes Payable Withheld**

2015 $56,000 $45,000

2016 49,000 46,200

2017 (Estimated) 65,000 45,000

What amounts will be shown on the Instalment Reminder notices for 2017 and when will the amounts be due?   Should he pay those amounts?  Explain your conclusion.

Exam Exercise Two - 7 (Individual Instalments)

At the beginning of 2017, the following information relates to Jerry Farrow:

**Amounts**

**Year Tax Payable Withheld**

2015 $83,000 $78,000

2016 76,000 77,000

2017 (Estimated) 63,000 59,000

Is Mr. Farrow required to make instalment payments during 2017?  If he is required to make instalment payments, indicate the amounts that would be required under each of the three alternative methods of calculating instalments.  Indicate which alternative would be preferable.

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

Despite the fact that her net tax owing has been between $7,000 and $8,000 in the two previous years, and is expected to be a similar amount during 2017, Marsha Fields has made no instalment payments for 2017.  While her normal filing date would be April 30, 2018, she does not file her 2017 return or pay the balance owing until August 24, 2018.  What penalties and interest will be assessed for the 2017 taxation year?

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

As his Taxable Income in 2016 was nil, Mark Felton did not make any instalment payments during 2017.  In completing his return for 2017, he finds that he has tax payable of $22,500. While his normal filing date would be April 30, 2018, he does not file his return or pay the balance owing until September 12, 2018.  What penalties and interest will be assessed for the 2017 taxation year?  Mark has filed his return on time in all previous years.

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

Lemar Ltd. has a December 31 year end.  It is not a small CCPC.  For 2015, its taxes payable were $71,500, while for 2016, the amount was $93,600.  For 2017, its estimated taxes payable are $114,700.  What would be the minimum instalment payments for the 2017 taxation year and when would they be due?  How would your answer differ if Lemar Ltd. qualified as a small CCPC?

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

Chemco Inc. has a December 31 year end and is not a small CCPC.  For 2015, its taxes payable were $146,300, while for 2016, the amount was $94,650.  For 2017, its estimated taxes payable are $52,300.   What would be the minimum instalment payments for the 2017 taxation year and when would they be due?  How would your answer differ if Chemco Inc. qualified as a small CCPC?

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

Dustin Inc. has a September 30 year end and is not a small CCPC.  For its taxation year ending September 30, 2015, its tax payable was $33,500.  The corresponding figure for the year ending September 30, 2016 was $93,400.  It is estimated that, for the year ending September 30, 2017, its tax payable will be $56,200.  What would be the minimum instalment payments for the taxation year that ends on September 30, 2017, and when would they be due?  How would your answer differ if Dustin Inc. qualified as a small CCPC?

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

The taxation year end for Grange Inc. is March 31, 2017.  It is a Canadian controlled private corporation that claims the small business deduction and had Taxable Income for the year ending March 31, 2016 of $165,000.  Indicate the date on which the corporate tax return for the year ending March 31, 2017 must be filed, as well as the date on which any final payment of taxes is due.

Exam Exercise Two - 14 (Corporate Due Dates)

The taxation year end for Lawnco Inc. is January 31, 2017.  Lawnco Inc. is a Canadian public company and does not qualify for the small business deduction.  Indicate the date on which the corporate tax return must be filed, as well as the date on which any final payment of taxes is due.

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

The taxation year end for Breyson Ltd. is June 30, 2017.  It is a Canadian controlled private corporation that claims the small business deduction and had Taxable Income for the year ending June 30, 2016 of $132,000.  Indicate the date on which the corporate tax return for the year ending June 30, 2017 must be filed, as well as the date on which any final payment of taxes is due.

Exam Exercise Two - 16 (Notice of Objection)

Nancy Forth filed her 2017 tax return as was required on April 30, 2018.  Her Notice of Assessment dated May 15, 2018 indicated that her return was accepted as filed.  On July 12, 2019, she receives a Notice of Reassessment dated July 2, 2019 indicating that she owes additional taxes, as well as interest on the unpaid amounts.  What is the latest date for filing a notice of objection for this reassessment?  Explain your answer.

Exam Exercise Two - 17 (Notice of Objection)

Norman Foster filed his 2017 tax return as was required on June 15, 2018.  His Notice of Assessment dated August 28, 2018, indicated that his return was accepted as filed.  On March 15, 2019, he receives a Notice of Reassessment dated March 8, 2019 indicating that he owes additional taxes, as well as interest on unpaid amounts.  What is the latest date for filing a notice of objection for this reassessment?  Explain your answer.

TIF Problem Two - 5A

Procedures And Administration - Key Term Matching (Easy)

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

Version A is easy, there is only one possible answer for each term.

Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

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

A. Instalment Threshold

B. Net Tax Owing

C. NETFILE

D. Notice Of Assessment

E. Prescribed Rate

F. Source Deductions

G. Tax Avoidance

H. Tax Evasion

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

1. An interest rate which changes quarterly and is based on the average interest rate paid on 90 day Treasury Bills during the first month of the preceding quarter.

2. The undertaking of transactions or arrangements with a view to avoiding or minimizing the payment of taxes.

3. A form that the CRA sends to all taxpayers after they process their returns which describes any changes made to the returns and states the amount of their additional tax payable or their refund.

4. A term used to describe the sum of federal and provincial taxes owing for the year, less amounts withheld for the year.

5. Deliberately ignoring a specific part of the law or willfully refusing to comply with legislated reporting requirements.

6. An electronic filing system that requires the use of an approved software program.

7. Amounts withheld by an employer from the income of employees.  The withholdings for income taxes, Canada Pension Plan contributions, and Employment Insurance premiums must be remitted to the government.

8. This ITA 245 provision attempts, in a very generalized manner, to limit the ability of taxpayers to avoid tax through certain types of transactions that have no bona fide purpose other than to obtain a tax benefit.

9. An amount of net tax owing for individuals or taxes payable for corporations that is used to determine the need to make instalment payments.

10. A formal determination of taxes to be paid or refunded.

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

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

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

TIF Problem Two - 5B

Procedures And Administration - Key Term Matching (Moderate)

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

Version A is easy, there is only one possible answer for each term.

Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

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

A. Instalment Threshold

B. Net Tax Owing

C. NETFILE

D. Notice Of Assessment

E. Prescribed Rate

F. Source Deductions

G. Tax Avoidance

H. Tax Evasion

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

1. An interest rate which changes quarterly and is based on the average interest rate paid on 90 day Treasury Bills during the first month of the preceding quarter.

2. An electronic system for filing individual tax returns.  While the system can be used by anyone, the return must be transmitted by a registered EFILE service provider using approved software.

3. The undertaking of transactions or arrangements with a view to avoiding or minimizing the payment of taxes.

4. A form that the CRA sends to all taxpayers after they process their returns which describes any changes made to the returns and states the amount of their additional tax payable or their refund.

5. A term used to describe the sum of federal and provincial taxes owing for the year, less amounts withheld for the year.

6. Deliberately ignoring a specific part of the law or willfully refusing to comply with legislated reporting requirements.

7. An electronic filing system that requires the use of an approved software program.

8. Amounts withheld by an employer from the income of employees.  The withholdings for income taxes, Canada Pension Plan contributions, and Employment Insurance premiums must be remitted to the government.

9. A term used to describe the sum of the total federal and provincial taxes owing for the year.

10. Amounts withheld by an employer from the income of employees.  The amounts withheld are based on the expected income tax liability of the employee for the current year.

11. This ITA 245 provision attempts, in a very generalized manner, to limit the ability of taxpayers to avoid tax through certain types of transactions that have no bona fide purpose other than to obtain a tax benefit.

12. An amount of net tax owing for individuals or taxes payable for corporations that is used to determine the need to make instalment payments.

13. A formal determination of taxes to be paid or refunded.

14. An amount of total tax owing for individuals or taxes payable for corporations that is used to determine the need to make instalment payments.

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

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

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

TIF Problem Two - 6

Instalment Payments For Individuals

In the three independent cases which follow, assume that Barry Levenor’s combined federal and provincial Tax Payable is as follows:

2015 $14,256

2016 15,776

2017 (Estimated) 16,483

The amount Barry’s employer withholds for the three independent cases is as follows:

**Case 1** $11,800 in 2015, $14,150 in 2016, and $12,400 (estimated) in 2017.

**Case 2** $14,920 in 2015, $11,400 in 2016, and $13,226 (estimated) in 2017.

**Case 3** $11,220 in 2015, $13,275 in 2016, and $12,873 (estimated) in 2017.

**Required:**

A. For each of the three cases:

indicate whether instalments are required for the 2017 taxation year;

in those Cases where instalments are required, calculate the amount of the instalments that would be required under each of the three acceptable methods;  and

in those cases where instalments are required, indicate which of the three acceptable methods would be the best alternative.

B. For those Cases where instalments are required, indicate the dates on which the payments will be due.

TIF Problem Two - 7

Instalment Payments For Individuals

For the three years 2015, 2016, and 2017, Mr. George Grafton provides the following information on his combined federal and provincial taxes payable, along with information on withholdings by his employer:

**Year Taxes Payable Taxes Withheld**

2015 $31,500 $29,800

2016 14,600 6,200

2017 (Estimated) 27,400 24,300

In January, 2017, you are asked to provide tax advice to Mr. Grafton.  He has asked you whether it will be necessary for him to pay instalments in 2017 and, if so, what the minimum amounts that should be paid are, along with the dates on which these amounts are due.

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

TIF Problem Two - 8

Instalment Payments For Corporations

For the taxation year ending December 31, 2015, a corporation’s combined federal and provincial Tax Payable is $103,680.  The corresponding figure for 2016 is $122,220.  For the year ending December 31, 2017, it is estimated that combined federal and provincial Tax Payable will be $113,220.

**Case One**

The taxpayer is a publicly traded corporation.

**Case Two**

The taxpayer is a publicly traded corporation.  Assume that its combined federal and provincial taxes payable for the year ending December 31, 2016 were $110,520, instead of the $122,220 given in the problem.

**Case Three**

The taxpayer is a small CCPC.

**Case Four**

The taxpayer is a small CCPC.  Assume that its combined federal and provincial taxes payable for the year ending December 31, 2016 were $110,520, instead of the $122,220 given in the problem.

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

1. Indicate whether instalments are required during 2017.  Provide a brief explanation of your conclusion.

2. Calculate the amount of instalments that would be required under each of the acceptable methods available.

3. Indicate which of the available methods would best serve to minimize instalment payments during 2017.  If instalments must be paid, indicate the dates on which they are due.

TIF Problem Two - 9

Instalment Payments For Individuals

For the three years ending December 31, 2017, George Shivraj had combined federal and provincial Tax Payable as follows:

**2015** $13,500

**2016** 16,200

**2017** (Estimated) 18,400

Using this information consider the following three independent cases.

**Case One** Mr. Shivraj’s employer withholds $11,200 in 2015, $12,900 in 2016, and $15,100 in 2017.

**Case Two** Mr. Shivraj’s employer withholds $9,200 in 2015, $10,300 in 2016, and $14,900 in 2017.

**Case Three** Mr. Shivraj’s employer withholds $10,100 in 2015, $16,300 in 2016, and $14,700 in 2017.

**Required:** For each of the preceding independent Cases, calculate the minimum instalment payments that are required to be made towards the settlement of the taxes payable for the year ending December 31, 2017.  Show all required calculations.

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

TIF Problem Two - 10

Instalment Payments For Corporations

For the three taxation years ending December 31, 2017, a corporation’s combined federal and provincial tax payable are as follows:

**Year Ending December 31 Taxes Payable**

2015 $ 86,500

2016 101,400

2017 (Estimated) 94,600

**Case One**

The taxpayer is a small CCPC.

**Case Two**

The taxpayer is a small CCPC.  Assume that its combined federal and provincial taxes payable for the year ending December 31, 2016 were $92,100, instead of the $101,400 given in the problem.

**Case Three**

The taxpayer is a publicly traded corporation.

**Case Four**

The taxpayer is a publicly traded corporation.  Assume that its combined federal and provincial taxes payable for the year ending December 31, 2016 were $92,100, instead of the $101,400 given in the problem.

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

1. Indicate whether instalments are required during 2017.  Provide a brief explanation of your conclusion.

2. Calculate the amount of instalments that would be required under each of the acceptable methods available.

3. Indicate which of the available methods would best serve to minimize instalment payments during 2017.  If instalments must be paid, indicate the dates on which they are due.

TIF Problem Two - 11

Instalment Payments For Individuals

For the three years ending December 31, 2017, Gloria Sloan had combined federal and provincial Tax Payable as follows:

**2015** $23,600

**2016** 25,400

**2017** (Estimated) 27,200

Using this information consider the following three independent cases.

**Case One** Ms. Sloan’s employer withholds $23,100 in 2015, $21,100 in 2016, and $23,300 in 2017.

**Case Two** Ms. Sloan’s employer withholds $24,100 in 2015, $18,600 in 2016, and $23,700 in 2017.

**Case Three** Ms. Sloan’s employer withholds $19,100 in 2015, $20,200 in 2016, and $24,300 in 2017.

**Required:**

A. For each of the three cases:

indicate whether instalments are required for the 2017 taxation year.  Show all of the calculations required to make this decision;

in those cases where instalments are required, indicate the amount of the instalments that would be required under the approach used in the CRA’s instalment reminder; and

in those cases where you have calculated the instalments required under the CRA’s instalment reminder, indicate whether you believe there is a better approach and calculate the required instalments under that approach.

B. For those Cases where instalments are required, indicate the dates on which the payments will be due.

TIF Problem Two - 12

Instalment Payments For Corporations

For the taxation year ending December 31, 2015, a corporation’s combined federal and provincial Tax Payable is $57,600.  The corresponding figure for 2016 is $67,900.  For the year ending December 31, 2017, it is estimated that combined federal and provincial Tax Payable will be $62,900.

**Case One**

The taxpayer is a publicly traded corporation.

**Case Two**

The taxpayer is a publicly traded corporation.  Assume that its combined federal and provincial taxes payable for the year ending December 31, 2016 were $61,400, instead of the $67,900 given in the problem.

**Case Three**

The taxpayer is a small CCPC.

**Case Four**

The taxpayer is a small CCPC.  Assume that its combined federal and provincial taxes payable for the year ending December 31, 2016 were $61,400, instead of the $67,900 given in the problem.

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

1. Indicate whether instalments are required during 2017.  Provide a brief explanation of your conclusion.

2. Calculate the amount of instalments that would be required under each of the acceptable methods available.

3. Indicate which of the available methods would best serve to minimize instalment payments during 2017.  If instalments must be paid, indicate the dates on which they are due.

TIF Problem Two - 13

Third Party Civil Penalties

For each of the following independent cases, indicate whether you believe any penalty would be assessed under ITA 163.2 on any of the parties involved.  Explain your conclusion.

Case A

A newly acquired client, who is self-employed, brings to his accountant a listing of his business expenses. The client also provides the accountant with a figure for his total revenue. He instructs his accountant to prepare an income statement and his tax return based on this information. The accountant has a quick look at the expenses. The expenses seem to be related to the type of business of the client and nothing stands out as obviously unreasonable. After the client’s income statement is prepared, it reflects $80,000 of revenue and $55,000 of expenses and the income tax return is filed on that basis.

Upon audit, the CRA finds a large proportion of the expenses claimed cannot be substantiated by adequate documentation and may not have been incurred. Furthermore, the reported revenue is only half of actual revenue.

Case B

A company is selling units in a limited partnership tax shelter. The company had acquired software for $50,000 on the open market and transferred it to the limited partnership on the same day for $10,000,000. The prospectus prepared by the company states that the fair market value of the software is $10,000,000 and is supported by an appraisal. The tax shelter is registered with the CRA and is available as an investment opportunity in the current year. The company’s gross entitlements are $2,000,000.

The CRA reviews the tax shelter and determines that the fair market value of the software on the day of transfer into the limited partnership is $50,000. The appraisal supporting the $10,000,000 value was prepared by an independent appraiser. However, it was not prepared using normal valuation principles. The appraiser informed the CRA that all his calculations were based on the assumptions and other relevant facts provided to him by the company. The appraiser was paid $75,000 for the appraisal.

Case C

An accountant relies on the financial statements prepared by another professional accountant to report his client’s self-employment income on the client’s tax return. The statements did not look obviously unreasonable. The CRA conducts an audit and discovers that the income statement contained material misrepresentations.

Case D

An accountant has prepared a tax return for a new client.  While, the accountant has known the individual for some time, this is the first time that he has done any work for him.

In preparing the new client’s tax return he is given a T4 slip which reports $40,000 in income.  The client indicates that this is his only source of income.

You are surprised by this as you know that the client lives a home that is worth at least $2 million, has an expensive cottage in Huntsville, and drives a $275,000 Bentley.  When the accountant asks the client about this, he indicates that, several years ago, he received a large inheritance from his parents.

The accountant does not ask any further questions and prepares and files the return. When the taxpayer is audited it is discovered that he has over $400,000 in unreported income.

Case E

A taxpayer approaches a tax return preparer to prepare and file his tax return. Prior to this, the tax return preparer and his firm did not provide any services to the taxpayer and they did not know each other.

The taxpayer provides the tax return preparer with a T4 slip indicating that the taxpayer has $32,000 of employment income, which represents his sole source of income.

The taxpayer tells the tax return preparer that he made a charitable donation of $20,000 but forgot the receipt at home. The taxpayer asks that the tax return preparer prepare and e-file the tax return without obtaining the receipt as it is April 29.  The tax return preparer does so in order to avoid late filing the return.

Case F  (Requires Basic GST Knowledge)

An annual GST return filer informs her accountant that she has not kept records of the GST paid or payable on her business purchases for the year. The accountant informs her that he will make an input tax credit claim for GST paid based on the financial statements of her business.  The amounts on the financial statements are reasonable and have been incurred.

The income statement includes a large amount for wages and interest expense on which GST is not paid.  The cost of sales includes a large proportion of purchases that are zero-rated on which GST is not paid.  The accountant applies a factor of 5/105 to all expenses shown in the income statement.  This results in an overstatement of input tax credits reported on the GST return.

Chapter Three Test Item File Problems

TIF Problem Three - 1

Employment Income - Essay Questions

1. Explain how a bonus arrangement can be used to defer the taxes paid by an employee.

2. List and briefly describe the major factors that will be considered in determining whether an individual is working as an employee or as an independent contractor.

3. The tax consequences of being classified as an employee rather than as an independent contractor can be significant.  As a result, it is not uncommon to find controversy and, in some cases, litigation resulting from the need to make this distinction.  Explain the importance, from the point of view of an employee, of the distinction between being classified as an employee versus being classified as a self-employed independent contractor.

4. Briefly described the advantages to an employer of hiring independent contractors, as opposed to hiring employees.

5. Tax planning considerations are very significant in deciding the kinds of benefits that will be provided to employees.  Explain why salary payments are considered the basic benchmark with which other types of employee compensation will be compared.

6. List two types of employee benefits that involve tax deferral and two types of benefits that involve tax avoidance.

7. London Wholesalers employs over 50 full time salespeople, all of whom are provided with a company car.  While the cars are used primarily for business purposes, all of the sales staff drive them at least 20,000 kilometers per year for personal reasons.  As controller of the Company you are aware that there is tax legislation in effect which can create substantial taxable benefits that could accrue to these salespeople because they have the use of a company car.

Indicate some of the ways in which the Company and the sales staff might legitimately reduce the amount of the taxable benefit associated with having the use of a company car.

8. Because of the formula used to calculate the taxable benefit when an employer owned vehicle is provided to an employee, the amount of the benefit can exceed the value of the vehicle.  Explain this statement.

9. What is the difference between an allowance and a reimbursement?

10. An employee may be paid a monthly amount for using his own automobile in employment related activities.  Alternatively, he may be paid a reasonable amount based on the number of kilometers driven.  From the point of view of both the employer and the employee, explain the tax treatment that will be given to these two alternatives.

11. Briefly explain the tax consequences resulting from being a member of an employer sponsored group disability insurance plan.

12. List the factors that will have to be considered in determining whether a particular low interest or interest free loan is an effective form of employee compensation.

13. Briefly describe the calculation of the taxable benefit that is assessed on loans to employees that are not considered to be housing loans.

14. For tax purposes, an employee who receives an option on his employer’s stock that is not in-the-money will not have an employment income inclusion at the time the option is received.  Do you agree with this treatment?  Explain your conclusion.

15. Under what circumstances is an individual entitled to a deduction equal to one-half of the employment income inclusion resulting from exercising or selling stock options?

16. The number of deductions that can be made in computing employment income is fairly limited.  Further, certain types of expenses must meet specified conditions in order to be eligible for deduction.  Indicate the conditions that must be met in order for a salesperson to deduct expenses in computing employment income.  In addition, Indicate the conditions that must be met in order for travel costs to be deducted in computing employment income.

17. Many employees maintain a work space in their home.  Describe the kinds of home related costs that can be deducted by an employee.

TIF Problem Three - 2

Employment Income - True Or False

1. Employment income is the salary, wages, and other remuneration, including gratuities, that are receivable by an individual during the year.

True or False?

2. If properly constructed, bonus arrangements can result in tax deferral for employees.

True or False?

3. One of the advantages of being an independent contractor rather than an employee is that you do not have to make CPP contributions.

True or False?

4. Employers generally prefer contracting out as it avoids the cost of CPP and EI contributions.

True or False?

5. Payments by employers of premiums on life insurance for employees are not taxable benefits.

True or False?

6. When an employee pays all of the premiums for disability insurance coverage, the payments are not deductible and the benefits received are tax free.

True or False?

7. Payments by employers to private health care plans are not taxable benefits and any benefits received under such plans are tax free.

True or False?

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

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

8. Her taxable benefit from the loan is $200 for the year.

True or False?

9. She pays her employer $1,000 on September 30 to decrease the loan.  Her taxable benefit from the loan is $180 for the year.

True or False?

10. In calculating her minimum standby charge, the imputed interest from the loan is part of her operating costs.

True or False?

TIF Problem Three - 3

Employment Income - Multiple Choice

Employee vs. Self-Employed

1. Which of the following considerations is **NOT** in the determination of whether an individual performing work is an employee or an independent contractor?

A. Opportunity for profit.

B. Hours per week spent at work site.

C. Ability to subcontract to others.

D. Ownership of tools.

2. Veronica mows lawns during the summer.  In 2017 she was paid directly by homeowners for her work, in some case on the basis of the completed job, in other cases at an hourly rate.  Her friend Jonathon does the same work.  However, he is paid at an hourly rate by a lawn maintenance company.  Which of the following statements is correct?

A. Veronica earns business income and Jonathon earns employment income.  Veronica will be able to deduct more expenses than Jonathon.

B. Veronica and Jonathon both earn employment income.

C. Veronica earns business income and Jonathon earns employment income.  Their deductible expenses will be the same.

D. Veronica and Jonathon both earn business income.

3. Which of the following groups of factors are used by the courts in order to determine a taxpayer’s status as an employee or a self-employed contractor?

A. intent, control test, ownership of tools test, number of hours worked per week

B. intent, ability to subcontract test, the type of work being undertaken, ownership of tools test,

C. intent, control test, ownership of tools test, opportunity for profit

D. intent, ability to subcontract test, the location of the work site, opportunity for profit

Employee Benefits

4. During 2017, Nellie Ward receives from her current employer:

A $400 gift certificate for online retailer Amazon.

A $600 reclining easy chair for outstanding customer service during the year.

A set of 4 coffee mugs with the employer’s logo etched on the side.  These mugs cost the employer $20.

An Easter basket of gourmet treats valued at $245.

A cash award of $300 in recognition of 10 years of service with the employer.

What is the amount that will be included in Nellie’s 2017 Net Income For Tax Purposes due to the gifts?

A. $800.

B. $1,000.

C. $1,300.

D. $700.

5. Indicate which of the following benefits provided by an employer is **NOT** considered part of employment income.

A. Reimbursement of moving expenses.

B. Travel expenses of the employee’s spouse.

C. Payments resulting from wage loss replacement plans.

D. Premiums paid by an employer on life insurance policies.

E. Individual premiums under provincial hospitalization plans.

6. Indicate which of the following benefits provided by an employer is considered part of employment income.

A. Subsidized meals provided in employer facilities.

B. Low rent housing.

C. Premiums under private health services plans.

D. Uniforms and special clothing.

7. Which of the following is **NOT** a taxable benefit?

A. A cash Christmas gift to an employee from the employer.  All the employees received a cash bonus of $150.

B. Payment of the tuition for an employee completing a general interest degree on a part-time basis.

C. A 20 percent discount on the employer’s merchandise, available to all employees. The employer’s mark-up is 50 percent.

D. Low rent housing provided by the employer.

8. Which one of the following benefits received from an employer would **NOT** result in a taxable benefit to the employee?

A. An allowance of 45 cents per kilometer for driving on employer business.

B. An interest free loan used to acquire shares of the employer.

C. Employer paid life insurance premiums for $20,000 of employee coverage.

D. Use of the employer’s vehicle which is used 95% for employment purposes.

9. In which one of the following lists are **ALL** items relevant when computing net employment income?

A. Employee contributions to a registered pension plan;  signing bonus on accepting employment;  use of an employer-owned automobile.

B. Monthly automobile allowance;  dental plan paid for by the employer;  promotional cost incurred in selling the employer’s products.

C. Subsidized meals in employer’s facilities;  life insurance paid by the employer;  legal fees incurred to collect unpaid salary.

D. Tips and gratuities;  dental insurance paid by the employer;  exercise of options to purchase shares of the publicly traded employer.

10. An employee has been offered a choice of an increase in salary of $100,000 or a combination of salary and other benefits with a cost to the employer of $100,000.  Assuming that the employee would buy the listed benefits with his own funds if they were not provided in the benefits package, which of the following packages would be the most advantageous from a tax perspective?

A. A dental plan plus a leased automobile that would be used only for personal travel by the employee.

B. Life insurance plus a leased automobile that would be used only for personal travel by the employee.

C. Salary plus life insurance.

D. Salary only.

11. Which of the following is **NOT** a tax-free benefit for the employee when it is provided by an employer?

A. Premiums for private health care plans.

B. A gift of a digital camera for an employee’s wedding.

C. Employer reimbursement for the cost of tools required to perform work.

D. Employer contributions to a registered pension plan.

12. Which of the following is a taxable benefit?

A. Payment of the tuition for an employee taking a course that will benefit the employer.

B. A $350 VISA gift card given as a Christmas present to all employees.

C. A 15 percent discount on the employer’s merchandise, available to all employees.

D. Low priced meals in the company cafeteria where the prices are approximately equal to the cost of the meals.

Automobile Benefits

13. With respect to employment related automobile costs and benefits, which of the following statements is correct?

A. When an employee is provided with an automobile that is purchased by the employer for $50,000, the taxable benefit to the employee will be based on the prescribed limit of $30,000.

B. An employee who uses his own vehicle for employment related activities cannot deduct any financing costs related to the acquisition of the car.

C. An employee who is provided with a vehicle owned by his employer can deduct capital cost allowance to the extent that the vehicle is used for employment related activities.

D. If an employee drives an employer provided vehicle for more than 20,004 kilometers of personal use during a year, there will be no reduction of the basic standby charge.

**Questions 14 Through 17** Questions 14 through 17 are based on the following information:

The cost of the car is $20,000 including HST.  If the car is leased, the monthly lease payment is $500 including HST.  The car is driven for a total of 26,000 km during 2017 and its operating costs for the year are $4,000.  For each of the **independent** questions 8 through 11, choose one of the following answers.  Each answer can be used more than once.

A. $1,150. G. $2,455.

B. $1,650. H. $3,240.

C. $1,800. I.  $3,300.

D. $1,964. J. $3,959.

E. $2,160. K. $4,752.

F. $2,250. L. $4,800.

14. Assume the car is purchased.  It was used by an employee for the whole year.  He drives it for personal purposes for a total of 9,000 km.  The minimum taxable benefit is:

15. Assume the car is leased.  It is used by the employee for 11 months of the year.  In the other month, he was required to return the car to his employer’s premises.  He drives it for personal purposes for a total of 6,000 km.  The minimum taxable benefit is:

16. Assume the car is purchased.  It is used by the employee for 10 months of the year.  In the other months, he was required to return the car to his employer’s premises.  He drives it for personal purposes for a total of 11,000 km.  The minimum taxable benefit is:

17. Assume the car is leased.  It is used by the employee for 11 months of the year.  In the other month, he was required to return the car to his employer’s premises.  He drives it for personal purposes for a total of 7,500 km and reimburses the employer $1,100 ($100 per month) for the use of the car. The minimum taxable benefit is:

18. Mr. Brown’s employer provides him with an automobile for his personal use, and pays all operating costs for that vehicle.  The vehicle, used by Mr. Brown throughout 2017, cost his employer $31,500, including GST of $1,500 (no provincial sales tax was charged on the vehicle purchase).  Mr. Brown drove the vehicle 45,000 km during the year, of which 9,000 km were for personal purposes.  His employer paid $7,750 in operating costs for the year.  Mr. Brown paid nothing to his employer for the use of the vehicle.  Which one of the following amounts represents the **minimum** taxablebenefit that Mr. Brown must include in his employment income for the use of this vehicle in 2017?

A. $2,268.

B. $4,859.

C. $5,102.

D. $5,651.

19. The following facts relate to an employer provided automobile.

Original cost of automobile, including HST $40,000

Replacement value of car at time of providing it to employee $30,000

Capital cost allowance claimed by employer $ 3,000

Personal use kilometers driven by employee during the year 2,000 km

Total kilometers driven by employee during the year 30,000 km

Number of months automobile was used by employee 12

Which one of the following amounts represents the employee’s minimum standby charge in 2017?

A. $720.

B. $960.

C. $640.

D. $9,600.

20. Omar is employed by Sansauto Corp. and uses his own car for employment activities.  Which of the following may **NOT** be claimed as an employment expense deduction?

A. Gas (employment related portion)

B. Auto insurance (employment related portion)

C. Standby charge (employment related portion)

D. Oil change (employment related portion)

Allowances and Reimbursements

21. Which of the following statements with respect to allowances is **NOT** correct?

A. An allowance from an employer to cover an employee’s professional association dues will not be included in an employee’s income.

B. Reimbursement by an employer of an employee’s moving expenses will not be included in an employee’s income.

C. Travel allowances provided by an employer are never included in an employee’s income.

D. In general, employers prefer allowances to reimbursements.

22. Which of the following will be included in taxable income because it is **NOT** a “reasonable allowance”?

A. An allowance of $500, calculated as 2,000 kilometers at $0.25/km.

B. An allowance of $6,500, calculated as 10,000 kilometers at $0.65/km.

C. $750 allowance for employment related trip expenses (actual costs were $700).

D. $750 allowance for employment related trip expenses (actual costs were $800).

23. Which of the following employee reimbursements would result in an increase in taxable income?

A. Housing loss reimbursement of $20,000

B. Moving costs reimbursement of $20,000

C. Travel expense reimbursement of $20,000

D. Employment related tuition reimbursement of $20,000

24. With respect to the determination of net employment income, which of the following statements is correct?

A. If an allowance is included on an employee’s T4, any expenses related to the allowance cannot be deducted for tax purposes.

B. One-half of reimbursed meals are taxable.

C. Reasonable vehicle allowances are not included in income.

D. All allowances are included in income, all reimbursements are not included in income.

Loans To Employees

25. With respect to loans to employees, which of the following statements is correct?

A. If the rate on the loan is less than the market rate for similar types of debt, the employee will have a taxable benefit equal to the difference.

B. If the proceeds from the loan are invested in income producing assets, the interest benefit on the loan will be deductible in determining the employee’s Net Income For Tax Purposes.

C. When the loan is to assist an employee with a home purchase, the taxable benefit must be calculated using each quarterly value for the prescribed rate.

D. The taxable benefit on an employee loan will not be altered by the amount of interest payments the employee makes to the employer.

26. T. Adams commenced employment at Moana Sales Ltd. on February 1, 2017.  He had lived in an apartment until May 2017, at which time he purchased a new house.  Under the terms of his employment, he received a housing loan on May 1, 2017 of $80,000 at a rate of 2 percent.  He pays the interest on the loan on a monthly basis.  Assume the 2017 prescribed interest rates applicable to employee loans are as follows:

First quarter 5%

Second quarter 4%

Third quarter 3%

Fourth quarter 3%

What is T. Adams’ taxable benefit on the above loan for 2017?

A. Nil.

B. $267.40.

C. $670.68.

D. $1,073.97.

E. $2,147.95.

27. Sam borrowed $50,000 from her employer at an annual rate of 1% interest last year to cover her gambling debts. Assume that at the time the loan was made, the prescribed rate of interest was 3% and this rate has not changed. Sam is subject to a combined tax rate of 30 percent.  What is the after tax cost of the loan to Sam for the current year?

A. $300

B. $500

C. $800

D. $1,500

Employee Stock Options

28. Which of the following statements with respect to stock options is correct?

A. If the option price for shares is less than the grant date market value of the shares, granting the options will create a taxable benefit for the grantee.

B. If shares in a Canadian controlled private corporation are acquired through the exercise of stock options, there will be a deduction equal to one-half of the employment income inclusion, provided the shares were held for at least two years.

C. When options to acquire the shares of a Canadian public corporation are exercised, there are no immediate tax consequences for the acquirer.

D. When shares in a Canadian controlled private corporation that have been acquired through the exercise of options are sold, any loss on the sale can be used to offset any income inclusion that results from the exercise of the options.

29. Ms. Joan Hanson is an employee of a Canadian controlled private corporation.  During 2016, she receives options to purchase 500 shares of her employer’s common stock at a price of $22 per share.  At this time, the estimated per share value of the stock is $20.50.  During 2017, she exercises all of these options.  At this time, the estimated market value of the stock is $31.50 per share.  On December 1, 2017, she sells the stock for $38.75 per share.  The net effect of the 2017 transactions on her Taxable Income would be:

A. An increase of $1,812.50.

B. An increase of $2,375.00.

C. An increase of $4,187.50.

D. An increase of $4,750.00.

E. An increase of $6,562.50.

30. An employee of a public Canadian corporation receives an option to purchase 1,000 of her employer’s common shares at $20 per share in July, 2016.  At this time, the fair market value of the stock is $19 per share.  In March, 2017, when the fair market value is $26 per share, she exercises the option and immediately sells the shares.  By what amount do these transactions increase her Taxable Income?

A. $1,000 in 2016.

B. $3,000 in 2017.

C. $3,500 in 2017.

D. $6,000 in 2017.

**Questions 31 And 32** Questions 31 and 32are based on the following information:

Scott Bicycle Manufacturing Ltd. (SBM) is a Canadian controlled private corporation.  Brian Mills, one of SBM’s employees, was granted stock options on January 15, 2014 for 10,000 shares at $3 per share.   The fair market value on January 15, 2014 was $4 per share.

Brian exercised the stock options on September 30, 2014, when the fair market value was $6 per share.  In June, 2017, Brian purchased a new home and sold the shares for $7 each.

31. What is the effect of these facts on Brian’s Taxable Income?

A. An increase of $15,000 in 2014

B. An increase of $15,000 in 2017.

C. An increase of $30,000 in 2014.

D. An increase of $20,000 in 2017.

E. None of the above.

32. What is the adjusted cost base to Brian of the SBM shares at the time of sale in June, 2017?

A. $30,000.

B. $45,000.

C. $60,000.

D. $70,000.

E. None of the above.

**Questions 33 And 34** Questions 33 and 34 are based on the following information:

Mr. Morra commenced employment with Peoples Bank Ltd., a public corporation, on January 1, 2015.  On December 31, 2015, he was granted options to purchase 500 shares of Peoples Bank Ltd. stock for $15 per share.  The market value on December 31, 2015 was $16 per share.

Mr. Morra exercised his options on May 31, 2016, purchasing 500 shares for $15 per share when the market value was $17 per share.  On September 1, 2017, Mr. Morra sold the shares for $24 each.

33. What is the effect of the above transactions on Mr. Morra’s Taxable Income in 2016?

A. Nil.

B. An increase of $250.

C. An increase of $500.

D. An increase of $1,000.

34. What is the effect of the above transactions on Mr. Morra’s Taxable Income in 2017?

A. Nil.

B. An increase of $1,750.

C. An increase of $2,750.

D. An increase of $3,500.

**Questions 35 and 36 are based on the following information:**

Parminder is an employee of a public Canadian corporation.  On April 1, 2016 she received options to purchase 5,000 shares of her employer’s common stock at a price of $75 per share.  She exercised her options and purchased 5,000 shares on November 1, 2016.  She sold all of her shares on February 1, 2017.  The market price of her employer’s common stock was $74 per share on April 1, 2016; $79 per share on November 1, 2016 and $85 per share on February 1, 2017.

35. The effect on her 2016 tax return is:

A. Increase in Net Income for Tax Purposes of $12,500; increase in Taxable Income of $12,500

B. Increase in Net Income for Tax Purposes of $25,000; increase in Taxable Income of $12,500

C. Increase in Net Income for Tax Purposes of $10,000; increase in Taxable Income of $10,000

D. Increase in Net Income for Tax Purposes of $20,000; increase in Taxable Income of $10,000

36. The effect on her 2017 tax return is:

A. Increase in Net Income for Tax Purposes of $15,000; increase in Taxable Income of $15,000

B. Increase in Net Income for Tax Purposes of $30,000; increase in Taxable Income of $15,000

C. Increase in Net Income for Tax Purposes of $25,000; increase in Taxable Income of $25,000

D. Increase in Net Income for Tax Purposes of $50,000; increase in Taxable Income of $25,000

37. Gail works for a Canadian public corporation. Three years ago she was offered an option to purchase 100 shares at $30 per share from her employer. The fair market value on that day was $33 per share. Gail exercised her option by purchasing 100 shares in the current year at a time the fair market value was $42 per share.  She is still holding the shares.  What is the effect on Gail’s Net Income For Tax Purposes in the current year?

A. $1,200 increase

B. $900 increase

C. $600 increase

D. No effect.

Employment Deductions

38. Which of the following statements about expense deductions for employees is **NOT** correct?

A. In order for an employee to deduct work space in the home costs it must be the place where that individual principally carries on his employment duties.

B. If an employee uses his own automobile to carry out his employment duties, he can deduct a pro rata share of the interest that he pays on a loan to finance the automobile.

C. In order to deduct travel costs, an employee must ordinarily be required to carry on his duties away from the employer’s place of business.

D. If an employed salesperson who earns commission income acquires a cell phone, he cannot deduct CCA on this asset.

39. Roger is employed by an Internet based corporation as a technical support representative and is paid a salary of $40,000 per year.  He is required to work from home and uses the 200 square foot den in his 1,000 square foot apartment exclusively for this purpose.   Total costs for 2017 were as follows:

Apartment rent $18,000

Tenant’s insurance 500

Apartment utilities 850

Office Supplies 100

Roger’s maximum employment expense deduction for 2017 is:

A. $3,890

B. $3,970

C. $3,870

D. $3,790

40. Nancy is employed by a large corporation as a sales representative.  She is paid a salary of $70,000 during 2017.  She is required to have a  home office and uses the 375 square foot den in her 1,500 square foot house exclusively for this purpose.   Total costs for 2017 were as follows:

Mortgage payments (40% principal, 60% interest) $24,000

Home owner’s insurance 900

Utilities 1,500

Roof repair 800

Property tax 5,000

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

A. $1,675

B. $3,600

C. $5,075

D. $1,475

41. John secured employment as a commissioned salesman in July, 2017.  In 2017, he received a base salary of $60,000, and $5,000 of commissions.  A further $6,000 of commissions earned in December was paid to him in January, 2018.  John worked away from the office negotiating sales contracts, and he is required to pay his own vehicle and promotional expenses.  His employer has signed a Form T2200 certifying that requirement, and certifying that no reimbursements are paid for any expenses John incurs to earn commissions.  John incurred the following costs from July through December 2017:

Meals and entertainment for potential customers $14,000

Driving costs (90% of driving was for employment purposes):

Fuel 4,000

Insurance 750

Repairs 2,250

Leasing costs ($500 per month) 3,000

What is the maximum deduction John may claim for employment expenses in 2017?

A. $5,000.

B. $9,000.

C. $11,000.

D. $16,000.

42. Which of the following criteria is **NOT** necessary in order for a salesperson to deduct office costs?

A. Must pay own expenses.

B. Must carry on duties away from the employer’s place of business.

C. Must not receive an expense allowance which has not been included in income.

D. Must receive all remuneration in commissions.

TIF Problem Three - 4

Employment Income - Exam Exercises

Exam Exercise Subject Listing For Chapter 3

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

Exam Exercise Three - 1 (Bonus)

Connely Ltd. has an August 31 year end.  On August 31, 2017, it declares a bonus of $250,000 payable to Ms. Sara Connely, the founder of the Company.  The bonus is payable on April 1, 2018.  Describe the tax consequences of this bonus to both Connely Ltd. and Ms. Sara Connely.

Exam Exercise Three - 2 (Bonus)

Brock Inc. has a taxation year that ends on September 30.  On July 1, 2017 it declared a bonus of $100,000 payable to Stan Gable.  The bonus will be paid on February 1, 2018.  Describe the tax consequences of this bonus declaration and payment on both Stan Gable and Brock Inc.

Exam Exercise Three - 3 (GST On Taxable Benefits)

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

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

Ms. Robin Nestor is provided with an automobile that is owned by her employer.  The employer purchased the car in 2016 for $54,000, plus $7,020 in HST.  During 2017, she drives the car a total of 72,000 kilometers, of which 67,000 kilometers were employment related.  The automobile was used by Ms. Nestor for 268 days during 2017.  When she was not using the automobile, her employer required that it be returned to their premises.  Calculate Ms. Nestor’s minimum taxable benefit for the use of the automobile.

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

Mr. Robert Rhodes is provided with an automobile that is owned by his employer.  The car was acquired by the employer in 2015 for $63,000, plus $3,150 in GST.  During 2017, it was used by Mr. Rhodes for 8 months.  When not using the automobile, the employer required that Mr. Rhodes return it to their premises.  His total milage in 2017 was 53,000 kilometers, of which 22,000 were employment related.  Calculate Mr. Rhodes’ minimum taxable benefit for the use of the automobile.

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

During 2017, Mr. Sam Warren is provided with an automobile that is leased by his employer.  The monthly lease payment is $791 per month.  This figure includes $91 HST.  During the year, the car is used by Mr. Warren for a total of 310 days.  When he is not using the car, his employer requires that it be returned to their premises.  During this period, he drives the car a total of 40,000 kilometers, 22,000 of which are employment related.  Calculate Mr. Warren’s minimum taxable benefit for the use of the automobile.

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

Ms. Sarah Wexler is provided with a car by her employer.  It is leased by the employer for $728 per month, including $78 of HST.  The lease payment also includes a payment of $50 per month to cover insuring the vehicle.  During 2017, Ms. Wexler uses the car for 10 months.   During the other 2 months, the employer requires that it be returned to their premises.  She drives the car 76,000 kilometers during this period, of which 23,000 are for personal use.  Calculate Ms. Wexler’s minimum taxable benefit for the use of the automobile.

Exam Exercise Three - 8 (Deductible Automobile Costs)

Mr. Rudy Jackson is required by his employer to use his own automobile in the course of his employment.  To compensate him, he is paid an annual allowance of $4,200.  During 2017, he drove his automobile a total of 26,720 kilometers, of which 8,150 were employment related.  His total automobile costs for the year, including lease costs, are $8,623.  What amounts will Mr. Jackson include and deduct from his 2017 employment income related to the use of his automobile?

Exam Exercise Three - 9 (Deductible Automobile Costs)

Ms. Rhonda Jewel’s employer provides her with an annual allowance of $6,500 per year to compensate her for the fact that she uses her own automobile for employment related activities.  During 2017, she has total automobile related costs, including her monthly lease payments of $12,472.  Her total milage is 42,000 kilometers, of which 18,000 kilometers were employment related.  What amounts will Ms. Jewel include and deduct from her 2017 employment income related to the use of her own automobile?

Exam Exercise Three - 10 (Disability Insurance Benefits)

Ms. Jessica Tremblay is a member of a group disability plan sponsored by her employer.  The plan provides periodic benefits that compensate for lost employment income.  In 2016, Ms. Tremblay was required to pay $324 in premiums.  In 2017, Ms. Tremblay received benefits under the plan of $6,940.  Ms. Tremblay’s contributions to the plan for 2017 totalled $250.  During 2017, her employer’s share of the annual premium was $2,175.  What amount will Ms. Tremblay include in her 2017 net employment income?

Exam Exercise Three - 11 (Disability Insurance Benefits)

John Tertiak’s employer sponsors a group disability plan for its employees.  The plan provides periodic benefits that compensate for lost employment income.  The annual premium on this plan is $3,200, with this cost being shared equally by the employer and the employee.  Because John became disabled in January, 2017, he did not make any contribution for this year.  In the years prior to 2017, John had total contributions of $16,000.  During 2017, because of his disability, John receives benefit under the plan totaling $24,000.  What amount will John include in his 2017 net employment income?

Exam Exercise Three - 12 (Employee Housing Loan Benefits)

On January 1, 2017, Mr. Packard receives a $135,000 loan from his employer to assist him in purchasing a home.  The loan requires annual interest at a rate of 3.1 percent, which he pays on December 31, 2017.  Assume that the relevant prescribed rate is 5 percent during the first quarter of 2017, 6 percent during the second quarter, and 4 percent during the remainder of the year.  What is the amount of Mr. Packard’s taxable benefit on this loan for the year?

Exam Exercise Three - 13 (Employee Housing Loan Benefits)

On May 1, 2017, Ms. Ponti receives a $210,000 loan from her employer in order to assist her in purchasing a new home.  The loan requires no payment of interest, but must be repaid in annual instalments of $30,000 on December 31 in each of the years 2018 through 2024.  Assume that the relevant prescribed rate is 4 percent during the first two quarters of 2017, but is reduced to 3 percent in the third quarter, and to 2 percent in the fourth quarter.  What is the amount of Ms. Ponti’s taxable benefit on this loan for the year?

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

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

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

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

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

Ms. Mary Mason is employed by a large public company.  In 2015, she was granted options to acquire 1,000 shares of her employer’s common stock at a price of $23 per share.  At the time the options were granted, the shares were trading at $20 per share.  In May, 2017, when the shares are trading at $45 per share, she exercises her options and acquires 1,000 shares.  What is the effect of the exercise of the options on Ms. Mason’s 2017 net employment income?

Exam Exercise Three - 17 (Stock Options - CCPC)

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

Ms. Mary Mason is employed by a Canadian controlled private corporation.  In 2015, she was granted options to acquire 1,000 shares of her employer’s common stock at a price of $23 per share.  At the time the options were granted, the shares had a fair market value of $20 per share.  In May, 2017, when the shares had a fair market value of $45 per share, she exercises her options and acquires 1,000 shares.  What is the effect of the exercise of the options on Ms. Mason’s 2017 net employment income?

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

Mr. John Savage has been employed for many years by a Canadian public company.  Several years ago, Mr. Savage was granted options to acquire 4,000 shares of his employer’s stock for $54 per share.  At this time, the shares have a fair market value of $50 per share.  On July 15, 2016, Mr. Savage exercises all of these options.  At this time, the fair market value of the shares is $82 per share.  In February, 2017, he sells all of the shares for $97 per share.  Calculate the effect of the transactions that took place during 2016 and 2017 on Mr. Savage’s Net Income For Tax Purposes and Taxable Income.  Where relevant, identify these effects separately.

Exam Exercise Three - 19 (Stock Options - CCPC)

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

Mr. John Savage has been employed for many years by a Canadian controlled private corporation.  Several years ago, Mr. Savage was granted options to acquire 4,000 shares of his employer’s stock for $54 per share.  At this time, the shares have a fair market value of $50 per share.  On July 15, 2016, Mr. Savage exercises all of these options.  At this time, the fair market value of the shares is $82 per share.  In February, 2017, he sells all of the shares for $97 per share.  Calculate the effect of the transactions that took place during 2016 and 2017 on Mr. Savage’s Net Income For Tax Purposes and Taxable Income.  Where relevant, identify these effects separately.

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

Several years ago, Mr. Kerry Johnson’s employer gave him options to purchase 1,000 shares of the employer’s stock at a price of $13.25 per share.  At that time, the shares were trading at $13.25 per share.  The employer is a publicly traded company.  During June, 2017, Mr. Johnson exercises the options.  At this time, the shares are trading at $18.50 per share.  Prior to the end of the year, Mr. Johnson sells the shares for $19.75 per share.  Determine the effect of these transactions on Mr. Johnson’s Net Income For Tax Purposes and Taxable Income.  Where relevant, identify these effects separately.

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

Joan Smithers has been employed by a Canadian public company for several years.  In 2015, she was granted options to acquire 2,200 of her employer’s shares at $10.50 per share.  At that time, the shares were trading at $10.00 per share.  In 2016, when the shares are trading at $15 per share, she exercises all of these options.  In 2017 she sells 1,000 of the shares for $13 per share.  Indicate the tax consequences of the events in 2015, 2016, and 2017 on Ms. Smithers’ Net Income For Tax Purposes and on her Taxable Income.  Where relevant, identify these effects separately.

Exam Exercise Three - 22 (Stock Options - CCPC)

Jerry Farrow is employed by a Canadian controlled private corporation.  In 2015, he was granted options to acquire 625 of his employer’s shares at $92 per share.  At that time, it was estimated that the fair market value of the shares was $90.  In 2016, when the estimated fair market value of the shares is $95 per share, he exercises all of these options.  In 2017, he sells 125 of the shares for $85 per share.  Indicate the tax consequences of the events in 2015, 2016, and 2017 on Mr. Farrow’s Net Income For Tax Purposes and on his Taxable Income.  Where relevant, identify these effects separately.

Exam Exercise Three - 23 (Commission Salesperson Expenses)

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

Exam Exercise Three - 24 (Commission Salesperson Expenses)

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

Exam Exercise Three - 25 (Employment Income Expenses)

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

Salary Received $61,250

Commissions Received 6,250

Total Employment Inclusions $67,500

Advertising And Promotion $ 1,250

Traveling Expenses 7,500

Capital Cost Allowance On Van\* 1,875

Interest On Van Loan\* 625

Total Employment Deductions $11,250

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

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

Exam Exercise Three - 26 (Employment Income Expenses)

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

Capital Cost Allowance On Car\* $ 2,850

Interest On Car Loan\* 1,075

Traveling Expenses 10,300

Promotion And Advertising 5,600

Client Entertainment [(1/2)(Actual Costs Of $5,200)] 2,600

Total Available Deductions $22,425

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

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

TIF Problem Three - 5A

Employment Income - Key Term Matching (Easy)

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

Version A is easy, there is only one possible answer for each term.

Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

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

A. Allowance

B. Employee

C. Employment Income

D. Imputed Interest

E. Operating Cost Benefit

F. Self-Employed Individual

G. Stock Option

H. Taxable Benefit

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

1. The salary, wages, and other remuneration, including gratuities, received by an employee in the year.

2. A taxable benefit assessed to employees who have been provided with an automobile by their employer.

3. An individual who has a business relationship with an entity.

4. An allowance provided by an employer to an employee that must be included in the employee’s employment income.

5. An individual who has an employment relationship with an entity that provides remuneration.

6. Interest on outstanding debt calculated at a specified interest rate without regard to the actual interest rate being paid.

7. A taxable benefit assessed to employees whose employers pay the operating costs of an automobile provided to the employee.

8. A contractual arrangement which gives the holder the right to purchase a specified number of shares for a specified period of time at a specified acquisition price.

9. An amount paid by an employer to an employee to provide for certain types of costs incurred by the employee, usually travel costs or automobile costs.

10. An amount of money, or the value of goods or services, that an employer pays or provides in addition to salary.

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

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

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

TIF Problem Three - 5B

Employment Income - Key Term Matching (Moderate)

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

Version A is easy, there is only one possible answer for each term.

Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

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

A. Allowance

B. Employee

C. Employment Income

D. Imputed Interest

E. Operating Cost Benefit

F. Self-Employed Individual

G. Stock Option

H. Taxable Benefit

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

1. The salary, wages, and other remuneration, including gratuities, received by an employee in the year.

2. A taxable benefit assessed to employees who have been provided with an automobile by their employer.

3. A contractual arrangement which gives the holder the right to require the issuing corporation to redeem the shares that he is holding.

4. Non-cash benefits provided to employees by an employer (e.g., subsidized meals in an employer’s facilities).

5. An individual who has a business relationship with an entity.

6. An allowance provided by an employer to an employee that must be included in the employee’s employment income.

7. An individual who has an employment relationship with an entity that provides remuneration.

8. Interest on outstanding debt calculated at a specified interest rate without regard to the actual interest rate being paid.

9. A taxable benefit assessed to employees whose employers pay the operating costs of an automobile provided to the employee.

10. A contractual arrangement which gives the holder the right to purchase a specified number of shares for a specified period of time at a specified acquisition price.

11. An amount paid by an employer to an employee to provide for certain types of costs incurred by the employee, usually travel costs or automobile costs.

12. A taxable benefit, based on a pro rata share of automobile operating costs, assessed to an employee whose employer pays these costs for an automobile provided to the employee.

13. An amount of money, or the value of goods or services, that an employer pays or provides in addition to salary.

14. An individual who is employed by a corporation in which he is a specified shareholder.

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

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

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

TIF Problem Three - 6

Bonus Arrangements

Each of the following independent Cases involves a Canadian public company paying a bonus to a key executive named Christine Lane.

**Case A** The company’s year end is August 31.  The bonus is declared on August 31, 2017 and paid on December 31, 2017.

**Case B** The company’s year end is July 31.  The bonus is declared on March 2, 2017 and paid on January 1, 2018.

**Case C** The company’s year end is December 31.  The bonus is declared on December 1, 2017 and paid on July 1, 2018.

**Case D** The company’s year end is September 30.  The bonus is declared on October 31, 2017 and paid on October 31, 2021.

**Required:** For each of these Cases, indicate the taxation year in which the Company can deduct the bonus, as well as the taxation year in which Ms. Lane will include it in her taxable income.

TIF Problem Three - 7

Employer Provided Vs. Employee Owned Automobile

Jason Rockwell began working for Morgan Distributors Ltd. at the beginning of 2015.  At that time, as one of the benefits provided under his employment contract, the Company purchases an automobile for Jason’s use on personal matters.  He is not required to use the vehicle for employment related activities.  During 2015 and 2016, the Company pays for all of the costs of operating the vehicle.

As of January 1, 2017, the Company has offered Jason two options:

**Option 1** Jason can continue to use the vehicle as per the arrangement that was in place for 2015 and 2016.  This would include the Company paying all of the costs of operating the vehicle.

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

Without regard to which option he chooses, Jason will continue to use the vehicle for two more years.  At the end of 2018, he plans to sell the car and estimates that the proceeds will be about $17,000.  During each of the years 2017 and 2018, Jason estimates that he will drive the car a total of 50,000 kilometers.  He anticipates that operating costs will be $0.20 per kilometer during this period.

Jason’s combined federal/provincial marginal tax rate is 46 percent.  Assume that the prescribed operating cost benefit will be $0.25 per kilometer for both 2017 and 2018.

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

A. Morgan Distributors purchased the car for $40,000.

B. Morgan Distributors purchased the car for $75,000.

Ignore GST/HST considerations.

TIF Problem Three - 8

Taxable Benefits - Automobiles

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

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

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

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

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

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

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

TIF Problem Three - 9

Taxable Benefits - Automobiles

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

The automobile was purchased in 2015 for $42,000 and, during the years 2015, 2016, and 2017, the Company has deducted maximum CCA.

During 2017, Ms. Smith drove the car 48,000 kilometers, with the Company paying for all of the operating costs.  These costs totaled $9,850 during the year.

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

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

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

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

TIF Problem Three - 10

Loans To Employees

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

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

* Mr. Cheng’s various sources of income are such that any additional income will be taxed at a rate of 44 percent.
* Mr. Cheng can acquire a similar term, $250,000 loan at an annual rate of 4 percent.
* His employer is subject to tax at a combined federal/provincial rate of 28 percent.  The company has alternative investment opportunities that earn a pre-tax rate of 8 percent.
* The relevant prescribed rate for all periods under consideration is 3 percent.
* Mr. Cheng’s investment projects are expected to provide a pre-tax return of 12 percent.

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

TIF Problem Three - 11

Loans To Employees

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

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

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

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

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

**Required:**

A. Determine the tax consequences to Mr. Lee and the cost to the Company, in terms of lost after-tax earnings, of providing Mr. Lee with a $500,000 interest free loan for the first year of the loan.

B. Determine the amount of additional salary that could be provided to Mr. Lee for the same after tax cost to the Company that you calculated in Part A.

C. Which alternative would you recommend that Mr. Lee accept?  Explain your conclusion.

TIF Problem Three - 12

Employee Stock Options

Ms. Patricia Martin is employed by a Canadian public company.  In 2015, she was given options to acquire 1,500 of the company’s shares at a price of $45 per share.  At this time the shares are trading at $47 per share.

During 2016, Patricia exercises all of the options.  At this time, the shares are trading at $50 per share.

During 2017, Patricia sells the shares for $55 per share.

**Required:**

A. Indicate the tax effect of the transactions that took place during each of the years 2015, 2016, and 2017.  Your answer should include the effect on both Net Income For Tax Purposes and Taxable Income.  Where relevant, identify these effects separately.

B. How would your answer change if the shares had been trading at $44 per share at the time that the options were issued in 2015?

C. How would your answer change if Patricia’s employer was a Canadian controlled private company?

TIF Problem Three - 13

Employee Stock Options

During January, 2015, Lastech Inc. issued options to their employee, Ms. Marianne Black.  The options allowed Ms. Black to acquire 1,500 of the Company’s common shares at an option price of $23 per share.

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

All of the shares that are acquired through the options are sold on December 31, 2017 at a price of $28 per share.

**Required:** Indicate the tax effect on Ms. Black of the transactions that took place during  2015, 2016, and 2017 under each of the following independent Cases.  Your answer should include the effect on both Net Income For Tax Purposes and Taxable Income.  Where relevant, identify these effects separately.

**Case A** Lastech Inc. is a Canadian public company.  At the time the options were granted, the shares were trading at $22 per share.  The options were exercised on July 1, 2016.

**Case B** Lastech Inc. is a Canadian public company.  At the time the options were granted, the shares were trading at $24 per share.  The options were exercised on July 1, 2016.

**Case C** Lastech Inc. is a Canadian controlled private corporation.  At the time the options were granted, the Company’s shares had a fair market value of $23 per share.  The options were exercised on July 1, 2016.

**Case D** Lastech Inc. is a Canadian controlled private corporation.  At the time the options were granted, the Company’s shares had a fair market value of $24 per share.  The options were exercised on July 1, 2015.

TIF Problem Three - 14

Alternative Employment Offers

Alicia Arden has established herself as a very effective sales representative for products related to health care services.  While she has worked independently for a number of years, she has received two very attractive offers of employment.  Both of these offers would require that she begin work on January 2, 2017.

**Offer One**

This offer would provide her with a fixed salary of $225,000 per year with no commissions on her sales.  The employer would provide an allowance of $30,000 per year to cover hotel, meals, and airline costs.  The employer believes that the CRA will consider this allowance to be reasonable in the circumstances.  With respect to advertising and promotion expenses, no allowance or reimbursement would be provided.

This employer would provide her with an automobile which would be leased at a cost of $850 per month, including a $75 per month payment for insurance.  The employer will pay all of the operating costs of the automobile.

This employer would provide her with a $200,000 interest free loan in order to facilitate her investment activities.  The loan will have to be repaid after five years.

**Offer Two**

This offer would provide her with a fixed salary of $175,000 per year, plus a commission on all of her sales.  Ms. Arden estimates that for 2017, these commissions will total $85,000.  The employer would reimburse her hotel, meal, and airline costs.  With respect to advertising and promotion expenses, no allowance or reimbursement would be provided.

While this employer will not provide her with an automobile, the business will provide her with an allowance for using her own automobile of $1,500 per month.  Ms. Arden estimates that for 2017 the total costs associated with driving her own vehicle will be as follows:

Operating Costs $10,600

Capital Cost Allowance (Tax Depreciation) (100%) 4,500

Financing Costs 1,800

Total $16,900

**Other Information**

The following information is applicable to either of the alternative offers.

1. She estimates that her employment related expenses during 2017 would be as follows:

Travel Costs (Hotel And Airline Costs) $18,000

Travel Costs (Meals) 8,500

Advertising And Promotion 23,000

2. Whether it is the employer’s automobile or her own personal vehicle, she would use the car throughout 2017.  She expects to drive this vehicle a total of 53,000 kilometers during 2017, with 37,000 of these kilometers required by her employment activities.

3. Both offers include a group disability insurance plan for which the company will pay all of the premiums.  The plan provides periodic benefits that compensate for lost employment income.  This will cost the employer $4,500 per year.

4. Both offers include a $1,000,000 face value life insurance policy.  All of the premiums, which will total $3,800 per year, will be paid by the employer.

5. Assume that the prescribed rate is 2 percent throughout 2017.

**Required:**

A. Based on the estimates made by Ms. Arden, calculate Ms. Arden’s minimum 2017 net employment income for each of the two offers.  Ignore PST and GST considerations.

B. Discuss the factors that Ms. Arden should consider in deciding between the two alternatives.

TIF Problem Three - 15

Commission Income And Work Space In Home Costs

Curt Robinson is employed by a Canadian public company in Toronto and lives downtown.  During 2017, he has a base salary of $183,000.  In addition to his salary, he earns commission of $22,310.  Additional information relevant to Curt’s 2017 employment income is as follows:

1. Curt is a member of his employer’s registered pension plan.  During 2017, $3,750 was withheld from his salary as a contribution to this plan.  His employer made a matching contribution of $3,750.

2. For his employment related travel, Curt drives a car that he purchased on January 1, 2017 for $38,000.  During 2017, he drives 45,000 kilometers, of which 38,000 are employment related.  Curt had financed the car with a loan from a local bank and, during 2017, he had paid interest of $2,300.

The costs of operating the car during 2017 were $11,420.  He has been advised by his accountant that, if the car were used 100 percent for employment related activities, the maximum CCA for 2017 would be $4,500.

3. Curt’s employer requires him to pay all of his employment related expenses, as well as provide his own office space.  Curt has the required Form T2200 from his employer.

4. During 2017, he pays dues to his professional association of $375.

5. At the beginning of 2017, Curt’s employer grants him options to buy 250 of the Company’s shares at a price of $11.25 per share.  This was the market price of the shares at the time the options were granted.  During July, 2017, when the shares are trading at $14.75 per share, he exercises all of these options.  In order to buy Christmas gifts for his family, he sells 100 of these shares in early December, 2017.  The proceeds are $16.50 per share.

6. His employer has a policy of giving all employees gifts to promote employee loyalty and help local businesses.  During 2017, Curt received the following gifts:

A weekend for him and his wife at a local hotel.  The value of this gift was $375.

A $200 gift certificate at a local hardware store.

A basket of fruit, nuts, and cheeses, with a value of $175.

7. Curt uses 25 percent of his personal residence as an office.  During 2017, the costs associated with his home were as follows:

Interest Payments On Mortgage $ 8,700

Property Taxes 3,850

Utilities 1,875

Insurance 960

Roof Repairs 3,640

Total $19,025

8. Curt’s travel costs for 2017, largely airline tickets, food, and lodging, total $24,600.  This includes $10,300 spent on meals while traveling for his employer.  This total includes meals with clients of $2,400.

9. During 2017, Curt was billed a total of $9,600 by his golf club in Toronto.  Of this amount, $2,250 was the annual membership fee, with the remaining amount for meals and drinks with clients.  He uses the club only when he is with clients.

10. During 2017, Curt purchased tickets to Toronto football games for a total of $845.  He used these tickets to attend these games with key personnel from an important client.  He also purchased tickets to a Cirque du Soleil performance in Montreal for $275.  He used these tickets to attend the show with the owners of a prospective client located in Montreal.

**Required:** Calculate Curt’s minimum net employment income for the 2017 taxation year.  Ignore GST and PST considerations.

TIF Problem Three - 16

Commission Income And Work Space In Home Costs

Mr. Carlos Segovia is a very successful salesperson and is employed by a large Canadian public company.  For 2017, his base salary is $252,000.  In addition, he earns commissions of $18,500.  Other information relevant to Mr. Segovia’s 2017 employment income is as follows:

1. Mr. Segovia is required by his employer to pay all of his own employment related expenses.  He is also required to provide his own office space.  Mr. Segovia has a Form T2200 signed by his employer that certifies this.

2. His travel costs for 2017, largely airline tickets, food, and lodging, total $29,000.  This includes $9,500 spent on business meals.

3. His annual dues to the Salesperson’s Association (a trade union) were $450.

4. He is a member of his employer’s registered pension plan.  During 2017, his employer contributed $5,500 to this plan on his behalf.  In addition, $5,500 was withheld from his salary and contributed to the plan.

5. During 2017, Mr. Segovia was billed a total of $15,500 by his golf club located in his neighbourhood.  He only uses the club for entertaining clients.  Of this amount, $3,300 was the annual membership fee and the remainder was for meals with clients.

6. During 2017, Mr. Segovia used 35 percent of his personal residence as an office.  The designated space is where he principally performs his employment duties.  Interest payments on his mortgage totalled $11,500 for the year and property taxes were $4,800.  Utilities paid for the house totalled $2,600 and house insurance paid for the year was $1,250.  Other maintenance costs associated with the property amounted to $1,450.  Mr. Segovia does not intend to deduct CCA on the home office portion of the house.

7. For business travel, Mr. Segovia drives a car that he purchased in 2016 for $49,000.  He financed the purchase of the car through his local bank and, for 2017, the interest on the loan was $2,250.  During 2017, he drives the car a total 60,000 kilometers, 45,000 of these being for employment related travel.  His accountant has advised him that, if the car were used 100 percent for employment related activities, the CCA (tax depreciation) for 2017 would be $7,650.  The costs of operating the car during the year totaled $7,500.

8. During 2017, Mr. Segovia received three awards, none of which were performance related.  The first, a spa weekend at a local hotel, had a fair market value of $300.  The second was a $400 gift certificate at a men’s clothing store.  The third award, a bottle of 1995 Haut Brion, had a fair market value of $450.

9. His employer granted him options to buy 1,000 shares of the company’s stock at $20 per share a year ago.  At the time of the grant, the shares were trading at $19 per share.  On June 1, 2017, all of these options are exercised.  At this time the shares are trading at $31 per share.  He does not sell the shares in 2017.

**Required:** Calculate Mr. Segovia’s minimum net employment income for the 2017 taxation year.  Ignore GST and PST considerations.

TIF Problem Three - 17

Employment Income

Olin Packett has been employed for over 10 years by a large Canadian public corporation.  He works in their Victoria office.

For the 2017 year, his gross salary is $75,000.  While he does not receive commissions, he was awarded a bonus of $15,000 during 2017 based on his sales performance.  One-half of this is paid in December, 2017, with the balance to be paid in February, 2018.

During 2017, Olin’s employer withheld the following amounts from his gross wages:

Federal Income Tax $14,350

Employment Insurance Premiums 836

Canada Pension Plan Contributions 2,564

Registered Pension Plan Contributions 3,100

Donations To The United Way 750

Union Dues 275

Payments For Personal Use Of Company Car 1,500

Premiums For Group Life Insurance Policy 423

**Other Information**

1. Olin is provided with a car that the company leases at a rate of $723 per month, including both GST and PST.   The company pays for all of the operating costs of the car and these amounted to $4,200 during 2017.  Olin drove the car a total of 33,000 kilometers during 2017, 27,500 kilometers of which were carefully documented as employment related travel.  While he was in the hospital for 2 months (see Item 4), his employer required that the car be returned to company premises.

2. Olin was granted options to acquire 500 shares of his employer’s common stock at a price of $31.00 per share 2 years ago.  On the date the options were granted, the shares were trading at $29.50 per share.  These options were exercised by Olin on February 16, 2017, when the shares were trading at $34.75 per share.  Olin does not plan to sell the shares for  at least 2 years.

3. In order to assist Olin in acquiring a new residence in Victoria, his employer granted him a three year, interest free loan of $175,000.  The loan was granted on July 1, 2017 and, at this point in time, the interest rate on open five year mortgages was 4.5 percent.  Assume the relevant prescribed rate was 2 percent on this date. Olin purchases a house for $327,000 on October 2, 2017.

4. On his birthday, Olin received several gifts including a hoverboard and drone.  In his enthusiasm for his new toys, he flew the drone over his neighbor’s swimming pool while maneuvering the hoverboard on the sidewalk in front of the two homes to watch it.  The result was a concussion, a broken leg, a shattered wrist and a drowned drone.  He was unable to work for a period of two months.  As his employer provides disability insurance coverage, he received benefit during this period totaling $8,500.  All of the premiums for this insurance plan are paid for by the employer and totaled $560 for 2017.  The plan provides periodic benefits that compensate for lost employment income.

5. Other disbursements made by Olin include the following:

Tuition Fee For Operations Management Course $1,300

Tuition Fee For Medieval History Course 950

Fees Paid To Employer Recommended Financial Planner 450

Olin’s employer reimbursed for the tuition fees for both the operations management course and the medieval history course, as well as the fees paid to the financial planner.

6. Olin’s employer made a matching payment to the group life insurance policy.  The premiums for 2017 on his behalf totalled $423.

**Required:** Calculate Olin’s net employment income for the taxation year ending December 31, 2017.

Chapter Four Test Item File Problems

TIF Problem Four - 1

Tax Payable For Individuals - Essay Questions

1. Tax legislation requires that amounts received under the workers’ compensation program be included in the determination of Net Income For Tax Purposes, despite the fact that these same amounts will be deducted in the determination of Taxable Income.  If the intent was not to tax these amounts, why didn’t the legislation simply exempt them from inclusion in the Net Income For Tax Purposes calculation?

2. Under what circumstances is an individual entitled to a home relocation loan deduction?  How is the amount of the deduction calculated?

3. Explain briefly the rules for determining which province will assess an individual for income taxes.  From the point of view of tax planning, is the province in which an individual is taxed an important issue?

4. Briefly explain the difference between a tax deduction and a tax credit.

5. Describe the relationships that are eligible for the regular Canada caregiver amount of $6,883 for 2017.

6. ITA 118(1)(a) provides a tax credit for an individual’s “spouse or common-law partner”.  Briefly describe the types of relationships that are eligible for this tax credit.

7. Under what circumstances can a taxpayer deduct the ITA 118(1)(b) credit for an eligible dependant?

8. An unmarried father is supporting a dependent child of 16 who is mentally infirm, but who does not qualify for the disability tax credit.  What tax credits, if any, would be available to him related to that child?

9. The Canada caregiver provisions treat infirm children over 17 differently than infirm children under 18.  Describe the difference.

10. When a taxpayer claims the spousal credit for an infirm spouse ($11,635 + $2,150 for 2017), an additional amount of the Canada caregiver amount may be available.  Under what circumstances is this additional amount available and, when it is available, how is it calculated?

11. For individuals 65 or over, several types of income qualify for the pension income tax credit.  Indicate three types of pension income that would qualify.  Indicate one type of pension income that would not qualify.

12. Most tax credits involve applying the minimum tax rate (currently 15 percent) to a specified based.  In contrast, the charitable donations credit also uses the rates of 29 and 33 percent.  What is the likely reason for this difference?

13. An individual may choose not to claim in the current taxation year, the full amount of a charitable donation made in that year.  Explain why this may be an appropriate course of action.

14. Explain the advantage that results from being able to claim medical expenses for any 12 month period that ends in the calendar year.

15. A medical expense tax credit, based on the total medical expenses for a family, can be claimed by either spouse.  Does it make any difference which spouse makes the claim?

16. Under what circumstances can the disability tax credit be transferred to a supporting person?

17. Indicate the types of tuition fees that are eligible for the tuition fees tax credit.

18. Certain credits against Tax Payable can be transferred to a spouse or common-law partner.  Indicate which credits are eligible for this transfer.  Include only credits that can be transferred, not credits that can be taken by either spouse or common-law partner.

19. Some tax credits are referred to as “refundable”.  What does this mean?

20. Some analysts contend that the OAS clawback is effectively an increase in an individual’s tax rate.  Explain this view.

TIF Problem Four - 2

Tax Payable For Individuals - True Or False

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

True Or False?

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

True Or False?

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

True Or False?

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

True Or False?

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

True Or False?

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

True Or False?

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

True Or False?

8. There is no limit on the amount of the tuition credit that can be transferred to a spouse.

True Or False?

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

True Or False?

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

True Or False?

11. The refundable medical expense supplement is available to any individual who is 18 yeras of age or older.

True Or False?

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

True Or False?

TIF Problem Four - 3

Tax Payable For Individuals - Multiple Choice

Taxable Income

1. Which of the following items is **NOT** a deduction in the determination of an individual’s Taxable Income?

A. Worker’s compensation payments received as a result of injury.

B. A business loss incurred during the current year.

C. A deduction for residing in a prescribed northern zone.

D. An allowable capital loss realized in a previous year.

2. On July 1, 2017, Sam Confrey received a five year, $50,000 loan from his employer.  The loan was intended to assist Sam with the purchase of a home in his new employment location.  The new home is 47 kilometers closer to Sam’s new work location.  The interest rate on the loan was 3 percent.  Assume that during the third and fourth quarters of 2017, the relevant prescribed rate of interest is 4 percent.  The effect of this transaction on his Taxable Income would be:

A. An increase of $250.

B. An increase of $500.

C. An increase of $750.

D. An increase of $1,000.

E. No change.

3. In December 2013, Arcor Co. advanced funds of $200,000 to Mr. Jones, a new employee of the corporation, to assist him in acquiring a residence when he moved from Newfoundland to commence employment in British Columbia. The loan bears no interest and is to be repaid in full on December 31, 2018.  The prescribed interest rate at the time of this advance was 5 percent.  Assuming that the prescribed interest rate throughout 2017 was 6 percent, which one of the following represents the increase in Mr. Jones’s Taxable Income in 2017 due to this loan?

A. $  8,750.

B. $10,000.

C. $10,500.

D. $12,000.

4. During the year, Ted Knight received worker’s compensation payments totaling $10,000 as a result of an injury he suffered at work.  His only other source of income for the year was his wages of $25,000.  Which one of the following represents Ted’s Net and Taxable Incomes for the year?

A. Net Income $25,000, Taxable Income $25,000.

B. Net Income $30,000, Taxable Income $30,000.

C. Net Income $35,000, Taxable Income $25,000.

D. Net Income $35,000, Taxable Income $35,000.

Tax Payable

5. If an individual’s total federal tax (before the application of credits) equals $18,529, then his Taxable Income must have been:

A. $71,265.

B. $63,893

C. $79,695

D. $100,404.

6. Which of the following statements with respect to the calculation of an individual’s Tax Payable is correct?

A. Provincial tax payable is calculated by applying a group of progressive rates to federal Tax Payable.

B. Income that is not taxed in a province is subject to an additional tax at the federal level.

C. The provincial tax rate is based on the province in which the individual spends the most number of days in the taxation year.

D. The applicable rate varies both with the amount of Tax Payable and the type of income being taxed.

7. Which of the following statements is correct?

A. Net income for tax purposes minus federal tax credits equals taxable income

B. Taxable income minus federal tax credits equals total federal tax

C. Total federal tax minus federal tax credits equals federal tax payable

D. Net income for tax purposes minus federal tax credits equals federal tax payable

8. If total federal tax (before tax credits) is equal to $10,000 then taxable income must be:

A. $48,780

B. $56,338

C. $61,101

D. $66,667

9. Which of the following statements with respect to an individual’s Tax Payable is **NOT** correct?

A. Provincial Tax Payable is calculated by applying the appropriate rate to Taxable Income.

B. The relevant provincial tax rate is based on the province in which the individual resides on December 31 of the taxation year.

C. Only federal taxes are assessed on residents of Canada who are not a resident in any Canadian province on December 31 of the taxation year.

D. All provinces use the same tax brackets for applying their rates.

Tax Credits

10. With respect to claiming tax credits related to an individual’s child, which of the following statements is **NOT** correct?

A. To claim the eligible dependant credit for a child, the child must be under the age of 18 at some time during the year.

B. The Canada caregiver credit for a child under 18 cannot be claimed if the parent is claiming the eligible dependant credit for that child.

C. An individual cannot claim the eligible dependant credit if they are living with, supporting, or being supported by a spouse

D. To claim the eligible dependant credit for a child, the child does not have to be a resident of Canada, provided they are living with the taxpayer.

11. For 2017,  Bart Bixley has Net Income For Tax Purposes and Taxable Income of $230,000.  During the year, he makes a cash gift to a registered charity of $75,000.  What is his maximum charitable donations tax credit for 2017?

A. $21,722

B. $24,714

C. $22,810

D. $24,742

12. Which of the following contains a list of personal federal tax credits that will reduce the tax liability of an individual?

A. caregiver, employment credit, medical expenses, disability

B. medical expense, standby charge, charitable donations, age

C. tuition, adoption expenses, work space in home, pension

D. public transit pass, home accessibility, Canada pension plan, moving expenses

13. Which of the following tax credit bases is **NOT** subject to full indexation?

A. Amount for an eligible dependant.

B. Age amount.

C. Disability amount.

D. Pension income amount.

14. Of the following statements about tax credits, which one is correct?

A. They are deducted from total income and are effectively not subject to tax.

B. They reduce tax by the same amount regardless of a taxpayer’s marginal tax rate.

C. They are deducted from Net Income For Tax Purposes and are effectively not subject to tax.

D. Their impact is greater for taxpayers with a higher marginal tax rate.

15. Of the following statements about the spousal tax credit, which one is correct?

A. To claim this credit, the claimant must be legally married to the relevant individual.

B. It can be claimed by either spouse.

C. If the individuals are married during the year, the base for the credit must be reduced by the spouse’s income since the date of the marriage.

D. In the year of separation or divorce, an individual can claim both spousal support payments and the spousal tax credit.

16. Jean Marchand is a single parent with a child.  Which of the following conditions is **NOT** required for Jean to claim the ITA 118(1)(b) credit for an eligible dependant?

A. Jean must maintain a self-contained domestic establishment.

B. The child must be under 18 years of age, or mentally or physically infirm.

C. The child must be a resident of Canada.

D. The child must be wholly dependent for support on Jean.

17. Jake Baxter donated $100,000 in cash to a Canadian registered charity.  His Net Income For Tax Purposes and Taxable Income for the year is $120,000.  Calculate Jake’s maximum federal  tax credit for charitable gifts.

A. $13,500.

B. $15,000.

C. $26,072.

D. $28,972.

18. Of the following statements about medical expenses, which one is correct?

A. A taxpayer can only claim his own medical expenses.

B. The claim must be made in the calendar year the expense was incurred.

C. Only expenses in excess of a specified amount are eligible for a tax credit.

D. The amount of the tax credit is dependent on the taxpayer’s marginal tax rate.

19. For an individual who is over 65 years of age, which of the following types of pension income does **NOT** qualify for the ITA 118(3) pension income tax credit?

A. Payments from the Canada Pension Plan.

B. Old Age Security payments.

C. Payments from a provincial pension plan.

D. All of the above.

20. Which of the following tax credits **CANNOT** be transferred to a spouse?

A. The age credit.

B. The disability credit.

C. The EI and CPP credits.

D. The pension income credit.

21. With respect to the federal political contributions tax credit, which of the following statements is correct?

A. Contributions made to any registered political party are eligible for the credit.

B. Contributions made to a candidate at the time of a federal general election are eligible.

C. The credit is equal to 29 percent of the eligible contributions made.

D. There is no upper limit to the amount of the credit that can be claimed, as long as the contributions are made within the legal limits governing campaign contributions.

22. Shamus provides support for the following dependants:

His 42 year old spouse who has a physical infirmity.

His 63 year old father who has a mental infirmity.

His 67 year old mother who is in good health.

His 12 year old son who has a physical infirmity.

He can claim the regular Canada caregiver credit (based on $6,883 for 2017) for:

A. His father only.

B. All of the listed dependants.

C. His mother only.

D. His spouse, his father, and his mother.

23. Which of the following relatives may **NOT** be used to claim the eligible dependant tax credit?

A. Healthy grandfather age 65.

B. Healthy daughter age 9.

C. Mentally infirm spouse age 65.

D. Mentally infirm brother age 19.

24. Which of the following relatives may **NOT** be used to claim the regular Canada caregiver tax credit ($6,883 for 2017)?

A. A physically infirm 62 year old aunt.

B. A mentally infirm 21 year old child.

C. A healthy 67 year old grandfather.

D. A physically infirm 35 year old sister.

25. During 2017 Fred had the following amounts deducted from his pay:

CPP $2,564

EI   836

Union Dues 1,500

United Way Donation 2,000

He can use all of the above to calculate federal tax credits except:

A. CPP

B. EI

C. Union Dues

D. United Way Donation

26. Joe, who is single, supports his 80 year old blind mother who has no income and lives in a nursing home.  Which of the following federal tax credits can he claim for his mother?

A. Disability tax credit only.

B. Disability tax credit and Canada caregiver tax credit only.

C. Disability tax credit and eligible dependant tax credit only.

D. Canada caregiver credit only.

27. Hilda is a 67 year old widow.  She lives in an apartment with her old 12 year old granddaughter, Sue.  Both of Sue’s parents are on a two year expedition to remote areas of the Yukon.  They provide all financial support for Sue and speak with her weekly via satellite.  Which of the following federal tax credits can Hilda claim regarding Sue?

A. Eligible dependant tax credit.

B. Canada caregiver tax credit (child under 18).

C. Canada caregiver tax credit (regular).

D. No tax credits available.

28. Jennifer is single with no dependants.  During the year she had the following amounts deducted from her salary:

CPP $2,564

EI 836

Federal Income Tax 15,000

Based on this information, Jennifer’s total federal tax credits for 2017 will be:

A. $510

B. $2,255

C. $2,432

D. $2,760

29. Bill is single with no dependants.  For 2017 his net income for tax purposes was $80,000, his Taxable Income was $70,000 and his medical expenses tax credit was $300.  How much were his eligible medical expenses?

A. $2,000

B. $4,268

C. $4,400

D. $4,100

30. Harry is divorced with net income for tax purposes of $50,000.  His 21 year old dependent daughter, Ann had net income for tax purposes of $15,000.  During 2017 Harry paid a total of $2,500 for eligible medical expenses for Ann.  Harry had no medical expenses of his own.  Harry’s medical expenses tax credit for 2017 is:

A. $35

B. $150

C. $308

D. $2,050

31. Mildred has $300 budgeted for donations.  It will go either to the SPCA (a registered charity) or the Green Party (a registered federal political party).  If she gives the money to the Green Party, her tax credit will be

A. The same amount that she would get from donating to the SPCA.

B. $180 more than she would get from donating to the SPCA.

C. $138 more than she would get from donating to the SPCA.

D. $166 more than she would get from donating to the SPCA.

32. Adam is self-employed.  He might be eligible for all of the following federal tax credits except:

A. CPP tax credit.

B. EI tax credit.

C. Canada employment tax credit.

D. Working Income Tax Benefit tax credit.

33. Oscar is 73 years old.  His 2017 net income for tax purposes from his RRIF and other investments is $120,000.  He lives with his common-law partner, Felix who is 63 years old.  Felix’s only income for 2017 was investment income of $6,000.  Oscar can claim all of the following federal tax credits except:

A. Basic personal tax credit.

B. Age tax credit.

C. Pension tax credit

D. Spousal tax credit

34. With regards to the transfer of education related credits, which of the following statements is **NOT** correct?

A. If the student is married, the tuition credit can be transferred to either the spouse or a parent.

B. Any education related amounts that are not transferred to another person can be carried forward and claimed by the student.

C. Credits related to tuition paid to a university outside of Canada cannot be transferred to another person.

D. Credits related to interest paid on a student loan cannot be transferred to another person.

TIF Problem Four - 4

Tax Payable For Individuals - Exam Exercises

Exam Exercise Subject Listing For Chapter 4

|  |  |
| --- | --- |
| **Number** | **Subject** |
| 1 | Home Relocation Loan |
| 2 | Home Relocation Loan |
| 3 | Tax Payable Before Credits |
| 4 | Tax Payable Before Credits |
| 5 | Spousal Tax Credit |
| 6 | Spousal Tax Credit |
| 7 | Canada Caregiver Tax Credit |
| 8 | Canada Caregiver Tax Credit |
| 9 | Infirm Spouse And Infirm Child |
| 10 | Infirm Spouse And Infirm Child |
| 11 | Infirm Eligible Dependant - Child Under 18 |
| 12 | Infirm Eligible Dependant - Child Under 18 |
| 13 | Canada Caregiver Credit - Additional Amount |
| 14 | Multiple Credits For Dependants |
| 15 | Multiple Credits For Dependants |
| 16 | Age Tax Credit |
| 17 | Age Tax Credit |
| 18 | Adoption Expenses Tax Credit |
| 19 | Home Accessibility Tax Credit |
| 20 | Charitable Donations Tax Credit |
| 21 | Charitable Donations Tax Credit - FDSC |
| 22 | Charitable Donations Tax Credit |
| 23 | Medical Expense Tax Credit |
| 24 | Medical Expense Tax Credit |
| 25 | Disability Tax Credit |
| 26 | Disability Tax Credit Plus Child Supplement |
| 27 | Education Related Tax Credits |
| 28 | Education Related Tax Credits |
| 29 | Carry Forward Of Tuition Credit |
| 30 | Transfer Of Tuition Credit |
| 31 | Transfer Of Tuition Credit |
| 32 | Transfer Of Credits From A Spouse |
| 33 | Transfer Of Credits From A Spouse |
| 34 | Political Contributions Tax Credit |
| 35 | Refundable Medical Expense Supplement |
| 36 | EI And OAS Clawbacks |
| 37 | Tax Payable With OAS Clawback |

Exam Exercise Four - 1 (Home Relocation Loan)

On January 1, 2017, Ms. Anna Rossi’s employer asks her to relocate to one of the company’s offices in a different city.  In order to facilitate the move, the employer provides her with a $78,000, five year home relocation loan.  Annual interest of 1 percent must be paid on the loan.  Assume that throughout 2017, the relevant prescribed rate is 5 percent.  Determine the effect of this loan on Ms. Rossi’s 2017 Taxable Income.

Exam Exercise Four - 2 (Home Relocation Loan)

Darlene Hill has been asked by her employer to relocate to one of the company’s other offices that is several hundred kilometers away from her present work location.  The move will take place on January 1, 2017.  To facilitate the move, she has been provided with a $125,000 home relocation loan.  Annual interest on the loan is at a rate of 1 percent and the principal must be repaid within five years.  Assume that throughout 2017, the prescribed rate is 3 percent.  What is the effect of this loan on Darlene’s 2017 Taxable Income?

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

During 2017, Canadian resident Mark Forbes has calculated his Taxable Income to be $53,175.  Calculate his 2017 federal Tax Payable before consideration of credits.

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

Canadian resident Zack Bronson has 2017 Taxable Income of $92,485.  Calculate his 2017 federal Tax Payable before consideration of credits.

Exam Exercise Four - 5 (Infirm Spousal Tax Credit)

Mr. Don Deloran has 2017 Net Income For Tax Purposes of $26,100.  His spouse is dependent on him because of a physical infirmity.  The infirmity is not sufficient to qualify for the disability tax credit.  She has 2017 Net Income For Tax Purposes of $5,800.  Mr. Deloran has no tax credits other than the basic personal credits for his spouse and himself.  Determine Mr. Deloran’s federal tax credits for 2017.

Exam Exercise Four - 6 (Spousal Tax Credit)

Nadel Lyon has 2017 Net Income For Tax Purposes of $32,400.  His common-law partner has Net Income For Tax Purposes of $8,420.  Nadel has no tax credits other than the basic personal credits for his common-law partner and himself.  Determine Nadel’s federal tax credits for 2017.

Exam Exercise Four - 7 (Canada Caregiver Tax Credit)

Gerrard Bensen lives with his wife and their two children.  His wife’s income is less than the basic personal tax credit amount.  Two years ago, his mother who is 72 years old and extremely healthy, moved in with him.  Her Net Income For Tax Purposes for 2017 is $18,400.  Determine the amount of Gerrard’s Canada caregiver tax credit, if any, for 2017.

Exam Exercise Four - 8 (Canada Caregiver Tax Credit)

Elaine Markham lives with her husband and 11 year old daughter.  Her husband’s income is less than the basic personal tax credit amount.  Her 81 year old mother also lives with the family.  While her mother has 2017 investment income of $10,000, she has a physical infirmity that makes her dependent on Elaine.  Determine the amount of Elaine’s Canada caregiver tax credit, if any, for 2017.

Exam Exercise Four - 9 (Infirm Spouse And Infirm Child)

Margo Riche is married to John Riche.  John has a mental infirmity.  They have a 22 year old daughter who also has a physical infirmity.  Neither infirmity is severe enough to qualify for the disability tax credit.  John has 2017 Net Income For Tax Purposes of $6,600.  Their daughter has no 2017 income.  Determine the amount of any 2017 tax credits that Margo will have related to her spouse and son.

Exam Exercise Four - 10 (Infirm Spouse And Infirm Child)

Farah Delorme is married to Frank Delorme.  Frank has a mental infirmity.  They have a 26 year old son who is dependant because of a physical infirmity.  Neither infirmity is severe enough to qualify for the disability tax credit.  Frank has 2017 Net Income For Tax Purposes of $4,600.  Their son has no 2017 income.  Determine the amount of any 2017 tax credits that Farah will have related to her spouse and son.

Exam Exercise Four - 11 (Infirm Eligible Dependant Who Is Child Under 18)

Sheila Cox is a single mother who takes care of her 14 year old daughter, Susan.  Susan has a physical infirmity.  The infirmity is not severe enough to qualify for the disability tax credit.  Susan has 2017 Net Income For Tax Purposes of $3,400.  Determine the amount of any 2017 tax credits that Sheila will have related to her daughter.

Exam Exercise Four - 12 (Infirm Eligible Dependant Who Is Child Under 18)

Gloria Mason is a single mother who takes care of her 10 year old son, Mark.  Mark has a physical infirmity.  The infirmity is not severe enough to qualify for the disability tax credit.  Mark has no income of his own.  Determine the amount of any 2017 tax credits that Gloria will have related to her son.

Exam Exercise Four - 13 (Canada Caregiver Tax Credit - Additional Amount)

Toshiro Mifune is single and lives with his 62 year old mother, Anna Mifune.  Anna has a physical infirmity which makes her dependent on Toshiro.  It is not, however, severe enough to qualify for the disability tax credit.  Anna has 2017 Net Income For Tax Purposes of $18,300.  Determine the amount of 2017 tax credits that Toshiro will have related to his mother.

Exam Exercise Four - 14 (Multiple Credits For Dependants)

Mr. John Foret is 42 years old and divorced from his wife.  His Net Income For Tax Purspoes consists of rental income.  He has retained the family home and both of the children of the marriage live with him.  His daughter is 23 years old and has a physical disability that makes her wholly dependent on him for support.  However, she does not qualify for the disability tax credit.  His son is 14 years old and in good health.  His daughter has no income during 2017, while his son has Net Income For Tax Purposes of $2,100.  Determine Mr. Foret’s maximum federal tax credits for 2017.

Exam Exercise Four - 15 (Multiple Credits For Dependants)

Ingrid Tower is a 45 year old widow.   Her Net Income For Tax Purposes consists of rental income.  She maintains a home for herself and her two children.  Her 19 year old son has a physical disability that makes him wholly dependent on Ingrid for support.  However, he does not qualify for the disability tax credit.  He has no income of his own.  Her daughter is 13 years old, is in good health, and has 2017 Net Income For Tax Purposes of $1,230.  Determine Ms. Tower’s maximum federal tax credits for 2017.

Exam Exercise Four - 16 (Age Tax Credit)

Ms. Marlene Burns is 69 years old and has 2017 Net Income For Tax Purposes of $46,642.  Determine Ms. Burns’ age credit for 2017.

Exam Exercise Four - 17 (Age Tax Credit)

Harry Rose is 71 years of age and has 2017 Net Income For Tax Purposes of $62,485.  Determine Harry’s age credit for 2017.

Exam Exercise Four - 18 (Adoption Expenses Tax Credit)

Claude Lafleur and his spouse have adopted an infant French orphan.  The adoption process began on January 2, 2017 when they applied to a licensed adoption agency.  Later that month they traveled to France to discuss the adoption and view available children.  The cost of this trip was $3,850.  Their provincial government opens the adoption file on March 15, 2017, and the adoption order is issued on September 29, 2017.  In October, the couple returns to France to pick up their new daughter.  The happy family returns to Canada on October 20, 2017.  The cost of this trip is $6,280.

Additional expenses paid during the first week of October, 2017 were $1,759 paid to the French orphanage and $5,600 paid to a Canadian adoption agency.  Legal fees incurred during the adoption period were $3,250.  After arrival in Canada, an additional $3,200 in medical expenses were incurred for the child prior to the end of 2017.  Mr. Lafleur’s employer has a policy of providing reimbursement for up to $4,500 in adoption expenses eligible for the adoption expenses tax credit.  This amount is received in October, 2017 and will be considered a taxable benefit to Mr. Lafleur.  What is the maximum adoption expenses tax credit that can be claimed by the couple?  Show your calculations.

Exam Exercise Four - 19 (Home Accessibility Tax Credit)

Mauricio Saidi is a single parent.  He and his 10 year old son, who was born paralyzed from the neck down, live in the house he owns.  His son qualifies for the disability tax credit.  During 2017, Mauricio spends $8,600 putting in a more accessible wheel-in shower in the child’s bathroom and $2,500 for a mechanical lift on his truck for his son’s wheelchair.  What is the maximum amount that Mauricio can claim in 2017 as a home accessibility tax credit?

Exam Exercise Four - 20 (Charitable Donations Tax Credit)

Leon Fiero has 2017 Net Income For Tax Purposes and Taxable Income of $70,400.  Each week, without fail, he plays a nation-wide lottery.  While over the years he has not had any winnings of consequence, his fortunes have changed and, in 2017, he wins over $320,000.  As he had hoped to do for many years, he donates $120,000 of these winnings to the Canadian Cancer Society in 2017.   He chooses to claim $15,000 of his donations in 2017.  In 2018, his income remains at $70,400 and he makes no further donations.  Mr. Fiero is not eligible for the first-time donor’s super credit.

Determine Mr. Fiero’s charitable donations tax credit for 2017, as well as the maximum amount of the donation that he can use in 2018.  Until what year can he claim any unused portions of his 2017 donation?

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

Leon Fiero has 2017 Net Income For Tax Purposes and Taxable Income of $70,400.  Each week, without fail, he plays a nation-wide lottery.  While over the years he has not had any winnings of consequence, his fortunes have changed and, in 2017, he wins over $320,000.  As he had hoped to do for many years, he donates $120,000 of these winnings to the Canadian Cancer Society in 2017.   He chooses to claim $15,000 of his donations in 2017.  In 2018, his income remains at $70,400 and he makes no further donations.  Mr. Fiero is eligible for the first-time donor’s super credit.

Determine Mr. Fiero’s charitable donations tax credit for 2017, as well as the maximum amount of the donation that he can use in 2018.  Until what year can he claim any unused portions of his 2017 donation?

Exam Exercise Four - 22 (Charitable Donations Tax Credit)

Jack Banino has Net Income For Tax Purposes and Taxable Income of $83,000 in both 2017 and 2018.  Because of a recent run of good luck in Las Vegas, he is able to make a 2017 donation of $120,000 to a registered Canadian charity.  He plans to use $30,000 of the donation as the base for a charitable donations tax credit in 2017.  He plans to carry the balance of the $120,000 forward to subsequent years.  Jack is not eligible for the first-time donor’s super credit.

Determine Jack’s charitable donations tax credit for 2017.  In addition, determine the maximum amount of the donation that he can use in 2018.  Until what year can he claim any unused portions of his 2017 donation?

Exam Exercise Four - 23 (Medical Expense Tax Credit)

Mr. Samuel Silverstein has a spouse and a 19 year old dependent son.  Mr. Silverstein’s 2017 Net Income For Tax Purposes is $125,000.  For 2017, Mr. Silverstein’s spouse has no income  and his son has Net Income For Tax Purposes of $8,675.  During 2017, Mr. Silverstein and his spouse have medical expenses of $2,042.  His son has medical expenses of $7,780 which Mr. Silverstein paid.  Determine Mr. Silverstein’s medical expense credit for 2017.

Exam Exercise Four - 24 (Medical Expense Tax Credit)

Saul Lawson has a spouse, a 20 year old dependent son, and a 12 year old daughter.  His 2017 Net Income For Tax Purposes is $70,000.  Medical expenses for Saul, his spouse, and his 12 year old daughter total $4,500.  He also pays medical expenses for his son of $6,200.  His spouse has Net Income For Tax Purposes of $10,000 and his son has Net Income For Tax Purposes of $9,200.  Determine Saul’s medical expense tax credit for 2017.

Exam Exercise Four - 25 (Disability Tax Credit)

Lorraine Tramer lives with her husband and 20 year old paraplegic daughter, Marie, who qualifies for the disability tax credit.  During 2017, Lorraine paid medical expenses of $9,850 for Marie, none of which involved attendant care expenses.  Marie has no income of her own.  Lorraine’s Net Income For Tax Purposes and Taxable Income for 2017 was $108,600.  Determine the total amount of tax credits related to Marie that will be available to Lorraine.

Exam Exercise Four - 26 (Disability Tax Credit With Child Supplement)

Larry Osborne has a wife and a 16 year disabled daughter, Suzanne, who qualifies for the disability tax credit.  His Net Income For Tax Purposes is $186,000 and he and his wife have medical expenses of $3,560.  During 2017, Larry paid medical expenses for Suzanne of $12,400, none of which involved payments for attendant care.  Suzanne has a 2017 Net Income For Tax Purposes of $5,650.  Determine the total amount of tax credits related to Suzanne that will be available to Larry.

Exam Exercise Four - 27 (Education Related Tax Credits)

During 2017, Frank Balmer attends university for 5 months of full time study and 3 months of part time study.  His total tuition for the year, including all ancillary fees, is $4,100, of which he prepaid $1,400 in 2016.  The amount paid in 2017 includes $415 in fees that are only charged to students in his biology program.  Interest paid for the year on his student loan was $417.  Determine the total amount of education related tax credits that would be available for Mr. Balmer for 2017.

Exam Exercise Four - 28 (Education Related Tax Credits)

During the first 6 months of 2017, Grace Bucknell attends university on a full time basis.  For the last 6 months of the year, her studies continue, but only on a part time basis.  The tuition fees for the year total $10,400, including $350 of special fees that are only charged to students in her program.  As she has taken out a student loan to pay for these studies, she has 2017 interest payments on this loan of $623.  Determine the total amount of education related tax credits that would be available for Grace for 2017.

Exam Exercise Four - 29 (Carry Forward Of Tuition Credit)

At the beginning of 2017, Karl Schmidt has a carry forward of a tuition tax credit from 2016 of $525 [(15%)($3,500)].  During 2017, he is in full time attendance at a Canadian university for 10 months of the year.  His tuition fees total $5,650 for the year.  His Taxable Income  for 2017 is $34,650.  Other than his tuition credit, his only current tax credit is his basic personal credit.  Determine Karl’s total tuition tax credit and any available carry forward.

Exam Exercise Four - 30 (Transfer Of Tuition Credit)

Betty Masters has 2017 Taxable Income of $15,123.  She attends university in London, England on a full time basis for 9 months of the year, paying a total amount for tuition of $26,800 (Canadian dollars).  Her only tax credit, other than the tuition credit, is her basic personal credit.  Determine Betty’s tuition credit and indicate how much of this total could be transferred to a supporting parent and how much would be carried forward.

Exam Exercise Four - 31 (Transfer Of Tuition Credit)

Carl Bond is a student at the University of Michigan in the U.S. on a full time basis for 8 months of the year.  His tuition fees total $31,400 (Canadian dollars).  For 2017, he has Taxable Income of $12,150.  Other than his tuition credit, his only tax credit is the basic personal credit.  Determine Carl’s tuition credit and indicate how much of this total could be transferred to a supporting parent and how much would be carried forward.

Exam Exercise Four - 32 (Transfer Of Credits From A Spouse)

Mrs. Rhonda Lee is 65 years old and has Net Income For Tax Purposes of $53,500.  Of this total, $30,600 was from a life annuity that she purchased with funds in her RRSP.  Her spouse is 68 years old, has no income of his own as he is ineligible for OAS, and is attending university on a full time basis.  His tuition fees for the year were $3,450 and he was in full time attendance for 3 months of the year.  Determine Mrs. Lee’s maximum tax credits for 2017.  Ignore the possibility of splitting her pension income with her spouse.

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

John Trask is 67 years old and his spouse is 66 years old.  He has Net Income For Tax Purposes of $63,200, largely from various pension funds.  His spouse has no income of her own as she is not eligible for OAS payments.  During 2017, his spouse attended university on a full time basis for 4 months.  Her tuition fees for the attendance were $4,200 and, in addition, she spent $800 on textbooks.  Determine John’s maximum tax credits for 2017.  Ignore the possibility of splitting his pension income with his spouse.

Exam Exercise Four - 34 (Political Contributions Tax Credit)

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

Exam Exercise Four - 35 (Refundable Medical Expense Supplement)

During 2017, Mr. Chris Mackey has Net Income For Tax Purposes and Taxable Income of $28,248.   Mr. Mackey and his common-law partner, Emily, have total medical expenses of $10,325.  Emily has no income of her own.  Determine Mr. Mackey’s minimum Tax Payable for 2017.

Exam Exercise Four - 36 (EI And OAS Clawbacks)

For 2017, Mr. Oliver Clemens has net employment income of $67,200, receives EI payments of $9,460, and receives $7,000 in Old Age Security (OAS) payments.  No amount was withheld from the OAS payments because he had very low income in the previous two years due to large business losses.  Determine Mr. Clemens’ Net Income For Tax Purposes for 2017.

Exam Exercise Four - 37 (Tax Payable With OAS Clawback)

Agnes is 66 years old.  During 2017, she received OAS payments of $7,000, CPP payments of $10,000 and investment income of $65,000.  No federal tax was withheld at source.  Her total federal tax credits for 2017 (including charitable donations) are $2,500.  Taking the OAS clawback into consideration, what is her federal balance owing?

TIF Problem Four - 5A

Tax Payable For Individuals - Key Term Matching (Easy)

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

Version A is easy, there is only one possible answer for each term.

Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following 13 key terms were listed at the end of Chapter 4, “Taxable Income and Tax Payable for Individuals”.

A. Canada Pension Plan Tax Credit

B. Canada Caregiver Tax Credit

C. Disability Tax Credit

D. Disability Tax Credit Supplement

E. Eligible Dependant Tax Credit

F. Refundable Medical Expense Supplement

G. Social Benefits Repayment

H. Dependant

I. Indexation

J. Non-Refundable Tax Credit

K. Old Age Security Clawback

L. Spouse

M. Tuition Tax Credit

The following list contains 17 potential definitions for the preceding key terms.

1. A refundable credit against tax payable that increases the amount available to certain low income individuals for their eligible medical expenses.

2. A credit against tax payable that is available to individuals with a doctor certified severe mental or physical disability.

3. A credit against tax payable that is available to a single individual supporting a dependant in a self-contained domestic establishment.

4. A credit against tax payable that is available to individuals making contributions to the Canada Pension Plan.

5. A credit against tax payable that is available to individuals with qualifying medical expenses.

6. A credit against tax payable that is available to an individual who provides care and/or support for certain specified dependants who have a mental or physical infirmity.

7. An income tested taxing back, or reduction, in the payment of Old Age Security benefits and Employment Insurance benefits.

8. A supplement to the disability tax credit that is available for individuals who are under 18 years of age at the end of the year.

9. A pension plan sponsored by the federal government.  Individuals with employment or business income must make contributions based on their income and, in return, receive benefits in future years.

10. An individual to whom a taxpayer is legally married.

11. A credit against tax payable that is available to individuals who have a spouse or common-law partner.

12. A credit against tax payable that is available to individuals making qualifying tuition payments.

13. An individual who, at any time during the year, is dependent on the taxpayer for support and is the child or grandchild of the individual or of the individual’s spouse or common-law partner, the parent, grandparent, brother, sister, uncle, aunt, niece, or nephew, if resident in Canada at any time in the year, of the individual or of the individual’s spouse or common-law partner.

14. A tax credit that can only be used against the tax payable of an individual.  It will not be refunded to individuals without sufficient tax payable to make use of it.

15. A monthly payment to residents of Canada who are 65 years of age or older.

16. The process of adjusting tax brackets and some tax credits to reflect changes in the consumer price index.

17. A taxing back, or reduction, in the payment of Old Age Security benefits.

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

**Required:** For each of the 13 key terms listed (A through M), indicate the number of the item (1 through 17) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (18).  Explanations are not required.

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

TIF Problem Four - 5B

Tax Payable For Individuals - Key Term Matching (Moderate)

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

Version A is easy, there is only one possible answer for each term.

Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following 13 key terms were listed at the end of Chapter 4, “Taxable Income and Tax Payable for Individuals”.

A. Canada Pension Plan Tax Credit

B. Canada Caregiver Tax Credit

C. Disability Tax Credit

D. Disability Tax Credit Supplement

E. Eligible Dependant Tax Credit

F. Refundable Medical Expense Supplement

G. Social Benefits Repayment

H. Dependant

I. Indexation

J. Non-Refundable Tax Credit

K. Old Age Security Clawback

L. Spouse

M. Tuition Tax Credit

The following list contains 22 potential definitions for the preceding key terms.

1. A refundable credit against tax payable that increases the amount available to certain low income individuals for their eligible medical expenses.

2. A credit against tax payable that is available to individuals with a doctor certified severe mental or physical disability.

3. A credit against tax payable that is available to a single individual supporting a dependant in a self-contained domestic establishment.

4. A person of the opposite sex to whom a taxpayer is legally married.

5. A credit against tax payable that is available to individuals making contributions to the Canada Pension Plan.

6. A credit against tax payable that is available to individuals with qualifying medical expenses.

7. A taxing back, or reduction, in the payment of Old Age Security or Employment Insurance benefits.

8. A credit against tax payable that is available to an individual who provides care and/or support for certain specified dependants who have a mental or physical infirmity.

9. An income tested taxing back, or reduction, in the payment of Old Age Security benefits and Employment Insurance benefits.

10. An individual who, at any time during the year, is dependent on the taxpayer for support and is the child or grandchild of the individual or of the individual’s spouse or common-law partner, the parent, grandparent, brother, sister, uncle, aunt, niece, or nephew if resident in Canada at any time in the year, of the individual.

11. A supplement to the disability tax credit that is available for individuals who are under 18 years of age at the end of the year.

12. A pension plan sponsored by the federal government.  Individuals with employment or business income must make contributions based on their income and, in return, receive benefits in future years.

13. An individual to whom a taxpayer is legally married.

14. A credit against tax payable that is available to individuals who have a spouse or common-law partner.

15. The process of adjusting tax brackets and all tax credits to reflect changes in the Consumer Price Index.

16. A credit against tax payable that is available to individuals making qualifying tuition payments.

17. An individual who, at any time during the year, is dependent on the taxpayer for support and is the child or grandchild of the individual or of the individual’s spouse or common-law partner, the parent, grandparent, brother, sister, uncle, aunt, niece, or nephew, if resident in Canada at any time in the year, of the individual or of the individual’s spouse or common-law partner.

18. A tax credit that can only be used against the tax payable of an individual.  It will not be refunded to individuals without sufficient tax payable to make use of it.

19. A monthly payment to residents of Canada who are 65 years of age or older.

20. The process of adjusting tax brackets and some tax credits to reflect changes in the consumer price index.

21. A credit against Tax Payable that is available to an individual supporting a dependant in a self-contained domestic establishment.

22. A taxing back, or reduction, in the payment of Old Age Security benefits.

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

**Required:** For each of the 13 key terms listed (A through M), indicate the number of the item (1 through 22) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (23).  Explanations are not required.

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

TIF Problem Four - 6

Tax Payable For Individuals - Personal Tax Credits

In each of the following independent Cases, determine the maximum amount of 2017 personal tax credits, including transfers from a spouse or dependant, that can be applied against federal Tax Payable by the taxpayer.  Ignore, where relevant, the possibility of pension income splitting.

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

1. Sarah Partridge is 72 years old and has Net Income For Tax Purposes of $61,300.  This total is made up of OAS payments and pension income from her former employer.  Her husband is 58 years old and has Net Income For Tax Purposes of $4,725.

2. Martin Brody was divorced from his wife several years ago.  He has custody of their four children, ages 7, 9, 12, and 15.  His Net Income For Tax Purposes consists of spousal support payments totaling $54,000 per year.The children are all in good health.  The oldest child has Net Income For Tax Purposes of $11,200 during the year.

3. Marion Lassiter has Net Income For Tax Purposes of $132,450, all of which is rental income.  Her husband has Net Income For Tax Purposes of $1,600.  They have three children, ages 14, 16, and 19.  All of these children are in good health and continue to live at home.  The 19 year old child has Net Income For Tax Purposes of $8,460.  During the current year, Ms. Lassiter pays the following medical expenses:

Marion $ 4,240

Her Spouse 3,450

14 Year Old Child 1,860

16 Year Old Child 2,450

19 Year Old Child 6,720

Total $18,720

4. Janice Archer has Net Income For Tax Purposes of $92,100, none of which is employment income or income from self-employment.  Her spouse has Net Income For Tax Purposes of $7,240.  Their daughter is 15 years old, lives with them, and has Net Income For Tax Purposes of $2,150.  Their son is 22 years old and, because of a physical disability, continues to live with them.  He has no income of his own.  His disability is not severe enough to qualify for the disability tax credit.

5. Joan Baxter has Net Income For Tax Purposes of $85,000, all of which is employment income.  Her employer withholds maximum CPP contributions and EI premiums.  She is married to John Brown whose Net Income For Tax Purposes is $4,230.  They have three children aged 7, 9, and 11.  All of the children are in good health and none of them have income of their own.

TIF Problem Four - 7

Tax Payable For Individuals - Personal Tax Credits

There are seven independent cases which follow.  Each case involves various assumptions as to the amount and type of income earned by Ms. Barbra Baines during 2017, as well as to other information that is relevant to the determination of her 2017 Tax Payable.  Barbra’s Net Income For Tax Purposes is equal to her Taxable Income in all Cases.

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

**Case 1** Barbra and her husband Billy are both 67 years of age.  Billy is sufficiently disabled that he qualifies for the disability tax credit.  The components of the 2017 income earned by Barbra and Billy are as follows:

**Barbra Billy**

Interest $ 2,600 $ 650

Canada Pension Plan Benefits 12,600 Nil

Old Age Security Benefits 7,000 7,000

Income From Registered Pension Plan 22,300 1,230

Total Net Income $44,500 $8,880

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

**Case 3** Barbra is 58 years old and has income from investments of $102,000.  She is divorced and has been awarded custody of her 21 year disabled son.  The son qualifies for the disability tax credit.  He has Net Income For Tax Purposes of $7,560, and is dependent on his mother for support.

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

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

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

**Case 7** Barbra is 46 years old and has employment income of $163,000.  Her husband Larry is 41 years old and has Net Income For Tax Purposes of $7,240.  They have a 20 year old son who lives at home.  He is dependent because of a physical infirmity, but it is not severe enough to qualify him for the disability tax credit.  However, he is able to attend university on a full time basis for 8 months during 2017.  Barbra pays his tuition fees of $8,300, as well as $640 for the textbooks that he requires in his program.  The son has agreed to transfer the maximum tuition amount allowable to Barbra.  The son has Net Income For Tax Purposes of $9,600.

**Required:** In each Case, calculate Barbra Baines’ minimum federal Tax Payable for 2017.    Indicate any carry forwards available to her and her dependants and the carry forward provisions.  Ignore any amounts Barbra might have had withheld or paid in instalments and the possibility of pension splitting.

TIF Problem Four - 8

Tax Payable For Individuals - Personal Tax Credits

In each of the following independent Cases, determine the maximum amount of 2017 personal tax credits, including transfers from a spouse or dependant, that can be applied against federal Tax Payable by the taxpayer.

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

1. Mr. Hanson has Net Income For Tax Purposes of $40,000, all of which is investment income.  He is single and provides support for his mother.  His mother is a widow who resides in England, and has income of $700 per year.

2. Mr. Johnson has Net Income For Tax Purposes of $250,000, all of which is employment income.  His employer has withheld and remitted the required EI and CPP amounts.  Mr. Johnson was married on December 1, 2017.  His wife, an accounting student, had salary of $27,500 for the period from January 1 to November 30, 2017 and $2,500 for the month of December, 2017.

3. Mr. Massey has Net Income For Tax Purposes of $60,000, all of which is rental income.  He lives with his common-law wife and her two children from a previous marriage.  The two children are 8 and 10 years of age and have no income for the year.  His wife has Net Income For Tax Purposes of $1,500.

4. Mr. Jones is married and has Net Income For Tax Purposes of $70,000, none of which is employment income or income from self-employment.  His 19 year old dependent son attends university.  His wife has Net Income For Tax Purposes of $1,200, and his son has Net Income For Tax Purposes of $2,900.  His son does not wish to transfer his tuition credit to his father.

5. Ms. Morrison is divorced and maintains a residence far from her former spouse.  She has custody of the two children from the marriage.  They are aged 7 and 10 and in good health.  Her Net Income For Tax Purposes is $50,000, all of which is spousal support payments.  Neither child had any income for the year.

6. Mr. Bagley is 68 years old and has Net Income For Tax Purposes of $27,100, which is comprised of OAS benefits and pension income paid out of his Registered Retirement Income Fund.  His wife is 52 years old and is blind.  She has no income of her own.  Ignore the possibility that Mr. Bagley would split his pension income with his wife.

TIF Problem Four - 9

Tax Payable For Individuals - Personal Tax Credits

Mr. Wallace Burns is a very successful executive with a Canadian public company.  During 2017, he had Net Income For Tax Purposes and Taxable Income of $96,000, all of which was employment income.

The following five independent Cases make assumptions with respect to Wallace’s marital status and number of dependants, as well as provides other information that is relevant to the determination of his 2017 Tax Payable.  In all cases, his employer withholds the required EI premiums and CPP contributions.

**Case A** Wallace is married to Sharon Burns.  Sharon has Net Income For Tax Purposes of $6,750.  Their 20 year old son Kenneth attends university on a full time basis during 11 months of the year.  Wallace pays all of his son’s costs including $9,850 for tuition and $1,350 for textbooks.  Through part time jobs, Kenneth has income of $4,620.  Kenneth has agreed to transfer the maximum tuition amount to his father.

**Case B** While Wallace has never been married, he obtained custody of his 8 year daughter Sheila, when her mother, his high school girl friend, was killed in a car accident.  Although he graduated several years ago, Wallace still has a Canada Student Loan outstanding of $35,000.  During the year, interest paid on this loan totalled $1,750 and he paid down $5,000 of the principal.

**Case C** Wallace is married to Sharon Burns.  Sharon has Net Income For Tax Purposes of $4,580.  Wallace’s 82 year old father, Wilbur and Sharon’s 63 year old mother, Samantha live with Wallace and Sharon.  Wilbur had Net Income For Tax Purposes of $18,450, while Samantha had Net Income For Tax Purposes of $8,750.  Both Wilbur and Samantha are feisty and healthy.

**Case D** Wallace is married to Sharon Burns.  Sharon has Net Income For Tax Purposes of $5,785.  Wallace and Sharon have two children, Sonia who is 10 years old and Zack who is 8 years old.  Neither child has any income during the year.  The family’s eligible medical expenses were as follows:

Wallace $ 800

Sharon 1,200

Sonia 4,600

Zack 3,700

Total $10,300

**Case E** Wallace has never been married and does not like small children.  He is being treated by a psychologist for post traumatic stress disorder, but it is not severe enough to obtain a doctor’s certificate for the disability tax credit.  During the year he won $100,000 in the provincial lottery.  Reflecting his belief that Canada is overpopulated, he donates the entire amount to Planned Parenthood, a registered Canadian charity.  For 2017, he claims only $45,000 of his total donation.  As he has donated to this charity on a regular basis, he is not eligible for the first-time donor’s super credit.  Wallace also makes contributions to a federal political party in the amount of $1,200.

**Required:** In each Case, calculate Wallace’s minimum federal Tax Payable for 2017.  Indicate any carry forwards available to him and his dependants and the carry forward provisions.  Ignore any tax amounts that Wallace might have had withheld or paid in instalments.

TIF Problem Four - 10

Simple Tax Payable With Employment Income

For the past 5 years, Mr. Brooks has been employed as a financial analyst by a large Canadian public firm located in Winnipeg.  During 2017, his basic gross salary amounts to $63,000.  In addition, he was awarded an $11,000 bonus based on the performance of his division.  Of the total bonus, $6,500 was paid in 2017 and the remainder is to be paid on January 15, 2018.

During 2017, Mr. Brooks’ employer withheld the following amounts from his gross wages:

Federal Income Tax $3,000

Employment Insurance Premiums 836

Canada Pension Plan Contributions 2,564

Registered Pension Plan Contributions 2,800

Donations To The United Way 480

Union Dues 240

Payments For Personal Use Of Company Car 1,000

**Other Information**:

1. Due to an airplane accident while flying back from Thunder Bay on business, Mr. Brooks was seriously injured and confined to a hospital for two full months during 2017.  As his employer provides complete group disability insurance coverage, he received a total of $4,200 in payments during this period.  All of the premiums for this insurance plan are paid by the employer.  The plan provides periodic benefits that compensate for lost employment income.

2. Mr. Brooks is provided with a car that the company leases at a rate of $678 per month, including both GST and PST.  The company pays for all of the operating costs of the car and these amounted to $3,500 during 2017.  Mr. Brooks drove the car a total of 35,000 kilometers during 2017, 30,000 kilometers of which were carefully documented as employment related travel.  While he was in the hospital (see Item 1), his employer required that the car be returned to company premises.

3. On January 15, 2016, Mr. Brooks received options to buy 200 shares of his employer’s common stock at a price of $23 per share.  At this time, the shares were trading at $20 per share.  Mr. Brooks exercised these options on July 6, 2017, when the shares were trading at $28 per share.  He does not plan to sell the shares for at least a year.

4. In order to assist Mr. Brooks in acquiring a new personal residence in Winnipeg, his employer granted him a five year, interest free loan of $125,000.  The loan qualifies as a home relocation loan.  The loan was granted on October 1, 2017 and, at this point in time, the interest rate on open five year mortgages was 5 percent.  Assume the prescribed rate was 2 percent on this date and remained unchanged during the year.  Mr. Brooks purchases a house for $235,000 on October 2, 2017.  He has not owned a home during any of the preceding four years.

5. Other disbursements made by Mr. Brooks include the following:

Advanced financial accounting course tuition fees $1,200

Music history course tuition fees

(University of Manitoba one week intensive course) 600

Fees paid to financial planner 300

Payment of premiums on life insurance 642

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

6. Mr. Brooks is a widower.  His wife was killed in a car accident 2 years ago that injured his 8 year old son, Harold, so badly that he qualifies for the disability tax credit.  Harold has no Net Income for the year.

7. Mr. Brooks’ mother, Grace, lives with Mr. Brooks and cares for Harold.  Grace is 67 years old and her Net Income For Tax Purposes is $7,500.  Grace refused to take any payments for caring for Harold as she received a large inheritance in the previous year.  As a result, Mr. Brooks did not pay any child care or attendant costs for Harold.

8. Mr. Brooks paid the following eligible medical costs:

For Himself $ 9,300

For Harold 2,450

For Grace 1,265

Total $13,015

9. As Mr. Brooks contributes every year to the United Way, he is not eligible for the first-time donor’s super credit.

**Required:** Calculate, for the 2017 taxation year, Mr. Brooks’ minimum Taxable Income and federal Tax Payable (Refund).

TIF Problem Four - 11

Comprehensive Tax Payable With Employment Income

Marvin Combs is 43 years old and is employed by a Canadian public company.  His annual salary is $112,468, none of which is commissions.  Because of his outstanding work during 2017, he has been awarded a $20,000 bonus.  The bonus will be paid in 2021 and 2022 at the rate of $10,000 each year to help ensure he stays with the Company.   As Marvin expects to remain at the Company for the rest of his working life, he accepts the delayed payment with no complaints and minimal misgivings.

For 2017, his employer withheld EI premiums of $836 and CPP contributions of $2,564.  The employer also withheld professional association dues of $3,400 and contributions to the United Way of $2,500.  This is the first time that Marvin or his spouse have ever contributed to a registered charity.

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

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

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

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

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

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

**Other Information:**

1. Marvin is provided with an automobile by his employer.  The vehicle is used largely for employment related activity.  Total milage for 2017 was 62,000 kilometers, with only 4,000 of this being personal use.  The vehicle is leased by his employer at a rate of $456 per month, including a payment for insurance of $43 per month.  It is available to Marvin for 10 months during 2017.  During the other 2 months, the employer required that it be returned to their garage.

2. In 2014, Marvin received options to purchase 300 shares of his employer’s common stock at a price of $72 per share.  At the time the options were granted, the market price of the stock was $70 per share.  In January, 2017, when the shares are trading at $85 per share, Marvin exercises all of the options.  He is still holding these shares at the end of the year.

3. During 2017, Marvin receives several gifts from his employer:

As a reward for winning the company’s Employee Of The Month Award, he receives an expense paid weekend in a local hotel.  The regular price for this package was $1,200.

As is the case for all of the company’s employees, Marvin received a $600 gift certificate for merchandise at a local department store.

At Christmas, the company provides each employee with a basket of gourmet food.  The value of this basket is $450.

4. During 2017, Marvin spent $8,400 on employment related meals and entertainment with clients of his employer.  His employer reimbursed all but $1,000 of these costs.

5. During 2017, Marvin and Leslie decide to purchase their first family home (they have rented for the last 15 years).  After considerable searching, they identify the perfect property one block from their rented apartment and purchase it for $462,000.  As is his employer’s policy, he is granted an interest free loan of $200,000 to assist with this purchase.  The loan was granted on April 1, 2017.  Assume that the prescribed rate is 2 percent throughout 2017.

6. During 2017, both Sharon and Samantha had rhinoplasty surgery.  Marvin had to pay $2,800 for emergency services after Sharon’s nose suffered serious trauma during a martial arts class.  He also paid $13,500 for rhinoplasty surgery to reduce and reshape Samantha’s nose which she believes has greatly improved her appearance.  These amounts are included in the following medical expenses of the family, all of which were paid by Marvin:

Marvin And Leslie $ 2,200

Sharon 3,100

Suzanne 12,300

Samantha 16,000

**Required:**

A. Determine Marvin’s minimum Net Income For Tax Purposes for the 2017 taxation year.

B. Determine Marvin’s minimum Taxable Income for the 2017 taxation year.

C. Based on your answer in Part B, determine Marvin’s federal Tax Payable for the 2017 taxation year.

TIF Problem Four - 12

Comprehensive Tax Payable With Employment Income

Martin Dorne is 53 years old and employed in construction work by a large public company.  His annual salary is $98,500, none of which involves commissions.  As the company was very successful during 2017, Martin has been provided with a $15,000 bonus.  This bonus will be paid in equal amounts ($3,000) over the period 2017 through 2021.

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

RPP Contributions $4,300

Union Dues 450

Martin’s common-law partner is Brian Lassiter.  Brian is 48 years old and is legally blind.  Brian has 2017 income from investments of $9,400.

Martin and Brian adopted three orphaned brothers from a war torn country 8 years ago, .  Information on these brothers is as follows:

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

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

**Derek** is 22 years old and attends university on a full time basis for 8 months of the year.  Martin pays his tuition fees of $14,300, along with textbook costs of $1,200.  He lives with Martin and Brian and is in good health.  He has self-employed income of $13,500.  Assume he pays no CPP contributions on this income.

**Other Information:**

1. During 2017, Martin spent $12,300 on employment related meals and entertainment with clients of his employer.  His employer reimbursed $7,300 of these costs.

2. During 2017, Martin makes his regular annual contribution of $2,000 to a registered charity, The Shepherds Of No Hope.  (Martin is a very pessimistic individual.)

3. The family’s 2017 medical expenses, all of which were paid by Martin, were as follows:

Martin and Brian $ 2,200

David 1,700

Devon 10,600

Derek 4,500

4. Martin received options to purchase 500 shares of his employer’s stock at a price of $45 per share 2 years ago.  At the time the options were granted, the market price of the shares was $50 per share.  During July, 2017, when the shares are trading at $70 per share, Martin exercises all of these options.  He is still holding these shares on December 31, 2017.

5. As interest rates continue to be very favourable, Martin and Brian purchase a residence near the rented residence that they have lived in for the last 15 years.  The cost of the new residence is $480,000 and, to assist with the purchase, Martin’s employer provides a $280,000 interest free loan.  The loan was granted on July 1, 2017 and will have to be repaid on July 1, 2022.  Assume the prescribed rate is 1 percent throughout the year 2017.

6. Martin is provided with an automobile by his employer.  The automobile was purchased at a cost of $45,200, including HST at 13 percent.  During 2017, the automobile is driven 48,000 kilometers, of which 37,000 were employment related.  The automobile was used by Martin for 11 months during 2017.  He was required to return the automobile to his employer’s garage during the month that he did not use it.

7. During 2017, Martin receives several gifts from his employer:

As is the case for all of the company’s employees, Martin receives a $250 gift certificate that can be used for merchandise at a local department store.

In recognition of his 10 years of service, Martin receives an engraved wrist watch.  The retail value of this watch is $800.

At Christmas, all of the company’s employees receive a gift box of vintage wines.  The retail value of these wines is $400.

**Required:**

A. Determine Martin’s minimum Net Income For Tax Purposes for the 2017 taxation year.

B. Determine Martin’s minimum Taxable Income for the 2017 taxation year.

C. Based on your answer in Part B, determine Martin’s federal Tax Payable and amount owing (refund) for the 2017 taxation year.

TIF Problem Four - 13

Comprehensive Tax Payable With Employment Income

Margarita Dalvi is a financial analyst employed by a large public company.  Her 2017 salary is $143,000, none of which is commission income.  In addition, she was awarded an incentive bonus of $34,500. Two-thirds of this bonus was paid during 2017, with the balance due in September, 2018.

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

EI Premiums $ 836

CPP Contributions 2,564

RPP Contributions 6,400

Federal Income Taxes 29,000

Contributions To United Way 4,000

Professional Association Dues 1,200

Ms. Dalvi is 55 years old and married to Jonathan Dalvi who has been legally blind since an automobile accident that occurred several years ago.  Jonathan turned 65 years old on December 25, 2017.  He has 2017 income from investments of $7,200.  The couple have three children:

**Martha** is 15 years old.  She has 2017 income from various part time jobs of $11,000.

**Mary** is 19 years old and has mental health problems that prevent her from working on a full time basis.  She lives with her mother and father and has 2017 income from part time jobs of $4,800.

**Mark** is 21 years old and attends university on a full time basis for 10 months of the year.  His tuition fees were $9,400 and paid for by Ms. Dalvi.  As he has no income of his own, he has agreed to transfer the maximum tuition amount to his mother.

The family’s 2017 medical expenses, all of which were paid by Ms. Dalvi, were as follows:

Ms. Dalvi And Her Husband $ 6,200

Martha 1,800

Mary 11,300

Mark 2,500

**Other Information:**

1. Ms. Dalvi is provided with an automobile by her employer.  The automobile is leased at a rate of $728 per month, including applicable HST.  This payment also includes a payment of $50 per month for insurance coverage.  During 2017, the automobile is driven 57,000 kilometers, of which 42,000 were employment related.  The automobile was used by Ms. Dalvi for 11 months during 2017.  She was required to return the automobile to her employer’s garage during the month that she did not use it.

2. During 2017, Ms. Dalvi spent $14,800 on employment related meals and entertainment with clients.  Her employer reimbursed $9,500 of these costs.

3. Throughout their marriage, the Dalvi’s have always lived in rented premises.  Seeing the current level of mortgage rates as presenting an opportunity to acquire a residence, they purchase a 4 bedroom bungalow in the same neighbourhood for $422,000 on July 1, 2017.  On this date, her employer provides Ms. Dalvi with a $250,000 loan that will facilitate this acquisition.  The loan does not require any payment of interest.  However, the balance must be paid on July 1, 2022.  Assume that the prescribed rate is 1 percent throughout 2017.

4. During 2017, Ms. Dalvi receives several gifts from her employer:

As is the case for all of her employer’s senior staff, she receives a $400 gift certificate that can be used for merchandise at a local clothing store.

In recognition of 10 years of continuous service, she receives an engraved wrist watch.  The retail value of this watch is $1,200.

At Christmas all of the employees of her employer receive a gift basket containing gourmet food items.  The retail value of this basket is $300.

5. Ms. Dalvi received options to purchase 1,200 shares of her employer’s stock at a price of $37 per share 2 years ago.  At the time the options were granted, the market price of the shares was $40 per share.  During July, 2017, when the shares are trading at $45 per share, Ms. Dalvi exercises all of these options.  She is still holding these shares at the end of the year.

6. Ms. Dalvi does not qualify for the first-time donor’s super tax credit.

**Required:**

A. Determine Ms. Dalvi’s minimum Net Income For Tax Purposes for the 2017 taxation year.

B. Determine Ms. Dalvi’s minimum Taxable Income for the 2017 taxation year.

C. Based on your answer in Part B, determine Ms. Dalvi’s federal Tax Payable and amount owing (refund) for the 2017 taxation year.

Chapter Five Test Item File Problems

TIF Problem Five - 1

CCA - Essay Questions

1. The calculation of amortization expense under generally accepted accounting principles and the determination of CCA to be deducted for tax purposes can be viewed as somewhat similar procedures.  However, there are some differences that arise in the application of these procedures.  Describe the similarities and differences between the procedures used to calculate amortization expense for accounting records and those procedures used to establish the amount of CCA to be deducted in tax returns.

2. For accounting purposes, assets are generally recorded at their acquisition cost.  This amount would include the basic invoice cost, delivery and installation costs, and other expenditures required to make the asset available for use by the enterprise.  Indicate some of the reasons why the capital cost of an asset for tax purposes may differ from the asset cost that will be recorded for accounting purposes.

3. For CCA purposes, most assets are allocated to a Class that contains all of the assets of that Class.  However, in some cases individual assets have to be allocated to a separate Class, resulting in multiple balances for that Class.  What are some examples of this type of situation?

4. Briefly explain why it is important to take care in allocating  assets to the appropriate CCA class.

5. If the government wishes to increase or decrease the rate applicable to a particular type of asset, this can be accomplished using two different approaches.  Describe these approaches, indicate which you think is preferable, and explain the reason for your preference.

6. Each passenger vehicles with a cost in excess of $30,000 must be allocated to a separate Class 10.1.  Other passenger vehicles are allocated to a single Class 10.  Briefly describe the differences between the rules applicable to Class 10.1, and those applicable to Class 10.

7. Patents are normally allocated to Class 44 where they are subject to declining balance CCA calculations at a 25 percent rate.  However, a taxpayer can elect to allocate these assets to Class 14, where they are subject to straight-line CCA over their legal life.  Under what circumstances would this election be desirable?

8. Most depreciable assets are subject to the half-year rules.  Describe three exceptions to these rules.

9. If a taxpayer has decided, in a particular taxation year, to deduct less than the maximum available CCA, he will need to decide from which classes the amount that will be deducted should be taken.  How will he make this decision?  Explain your conclusion.

10. When a depreciable asset is sold, there may be no immediate tax consequences related to the sale.  Indicate the conditions that must be present for this situation to occur.

11. When there is a disposition of a depreciable asset, there may be recapture of CCA.  Another possibility is that a terminal loss may arise.  Indicate the conditions that will result in (1) recapture of CCA, and (2) a terminal loss.

12. When there is a disposition of a depreciable asset, there may be recapture of CCA.  Another possibility is that a terminal loss may arise.  How are these balances treated in the determination of Net Income For Tax Purposes and the UCC balance?

13. When a depreciable asset is sold or retired, the procedures used for tax purposes are usually very different than those used for accounting purposes.  Describe the differences between the procedures used for tax purposes and those that would be required under generally accepted accounting principles for dispositions of depreciable assets.

14. When a taxpayer acquires a photocopier to be used in producing business income, he can either allocate its cost to his general Class 8 or, alternatively, elect to allocate it to a separate Class 8.  What is the potential advantage of allocating the cost of a photocopier to a separate Class 8?

15. Describe the type of items that are included in CCA Class 14.1 and give two examples.

16. Describe the treatment of goodwill under the tax legislation that was introduced in 2017.

TIF Problem Five - 2

CCA - True Or False

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

True or False?

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

True or False?

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

True or False?

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

True or False?

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

True or False?

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

True or False?

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

True or False?

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

True or False?

9. The cost of each rental property owned by a taxpayer must be allocated to a separate CCA Class.

True or False?

10. Goodwill is purchased for $60,000 during the year.  There are no other assets in Class 14.1.  The maximum CCA that can be deducted for tax purposes for the year is $3,000.

True or False?

TIF Problem Five - 3

CCA - Multiple Choice

1. Of the following pairs of terms, which pair represents terms that are analogous for accounting work and for tax work?

A. Capital Cost and Net Book Value.

B. Amortization and Capital Cost Allowance.

C. Undepreciated Capital Cost and Acquisition Cost.

D. Capital Cost and Amortization.

2. A business has Net Income For Tax Purposes before deducting CCA of $15,000.  It would like to reduce this total to nil after the deduction of CCA.  It can take the required $15,000 in CCA from four CCA classes, all of which have a balance of more than $15,000.  If the business wishes to maximize future CCA, the $15,000 should be deducted from:

A. Class 44

B. Class 10

C. Class 53

D. Class 8

3. A business acquires a rental property several years ago for $562,000, with $112,000 of this amount being the estimated value of the land.  At the beginning of the current year the UCC for the property is $374,561.  During the current year, the property is sold for $843,000, with $262,000 of this amount being allocated to the land.  Which of the following statements is correct?

A. The business will have recapture of $75,439 and a capital gain of $131,000.

B. The business will have recapture of $75,439 and a capital gain of $281,000.

C. The business will have recapture of $187,439.

D. The business will have a taxable capital gain of $281,000.

4. Which of the following statements with respect to terminal losses is **NOT** correct?

A. If assets remain in a CCA Class, there will not be a terminal loss in that Class.

B. Terminal losses are deducted in full in the determination of Net Business Income.

C. Terminal losses are deducted from the ending UCC to leave a balance in the Class of nil.

D. A terminal loss occurs when there are no assets left in the Class and there is a negative balance in the Class at the end of the year.

**Questions 5 Through 14** The Nelson Company has a taxation year end of December 31.  On January 1 of the current year, the UCC of Class 8 was $80,000. The Nelson Company has a policy of always deducting maximum CCA.  Each of the **independent** Parts of this question deal with transactions during the current year which involved Class 8 assets.  Choose one of the following answers for each Part (individual answers can be used more than once).  \

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

5. An additional class 8 asset was purchased for $20,000 on April 1.  Maximum CCA for Class 8 is:

6. An asset with a capital cost of $15,000 was sold for $4,000 on June 30.  Minimum UCC on January 1 of the following year is:

7. An asset with a capital cost of $15,000 was sold for $26,000 on September 1.  Maximum CCA for Class 8 is:

8. An asset with a capital cost of $15,000 was sold for $26,000 on September 1.  Minimum UCC on  January 1 of the following year is:

9. An asset with a capital cost of $100,000 was sold on June 30 for $90,000.  Also during the year, an asset was purchased for $60,000.  Maximum CCA for Class 8 is:

10. The last asset in the class, with a capital cost of $85,000, was sold on July 15 for $90,000.  This would give rise to:

11. The last asset in the class, with a capital cost of $85,000, was sold on August 1 for $70,000.  This would give rise to:

12. An asset with a capital cost of $40,000 was sold for $50,000 on September 1.  This would give rise to:

13. An asset with a capital cost of $70,000 was sold on October 1 for $90,000.  An asset was purchased on November 1 for $100,000.  Maximum CCA for Class 8 is:

14. An asset with a capital cost of $70,000 was sold on May 1 for $90,000.  An asset was purchased on May 15 for $100,000.  Minimum UCC on January 1 of the following year is:

15. The capital cost of an asset includes a number of costs.  Indicate which cost would **NOT** be considered part of the capital cost.

A. Legal fees incurred to acquire the asset.

B. Duties paid on the asset.

C. Fire and theft insurance paid on the asset.

D. Non-refundable provincial sales taxes paid on the asset.

E. An appropriate allocation of overhead.

16. A business has $5,000 in Taxable Income before CCA in the current year.  The management anticipates a high income for the subsequent year.  The maximum CCA deductible for the year in Class 8 is $5,000 and the maximum CCA deductible for the year in Class 12 is $5,000.  To minimize the subsequent year’s taxes, the business should:

A. Claim maximum CCA on Class 8 only.

B. Claim maximum CCA on Class 12 only.

C. Claim maximum CCA on Class 8 and Class 12.

D. Claim no CCA for the year.

E. Claim $2,500 CCA on Class 8 and $2,500 CCA on Class 12.

17. During the current year, Denos Corporation incurred costs of $45,000 for leasehold improvements to its newly rented building. The lease was signed in the current year for an initial term of three years plus four successive options to renew the lease, each for an additional one year term. Which one of the following amounts represents the **maximum** capital cost allowance claim in the current year?

A. $  4,500.

B. $  5,625.

C. $  9,000.

D. $11,250.

18. On December 1 of the current year, Plen Limited purchased a franchise for $70,000.  The franchise has a limited life of 15 years.  Which one of the following amounts represents the **maximum** amount of capital cost allowance Plen Limited can deduct for its current year ending on December 31?

A. $   198.

B. $   396.

C. $1,837.

D. $3,675.

19. In the current fiscal year, a corporation acquired a rental property from its sole shareholder.  The building was transferred at its fair market value of $125,000, but was not allocated to a separate Class 1.  The shareholder originally paid $150,000 for it.  The property was included in Class 1 (4%) on the shareholder’s tax return.  The shareholder has earned rental income on the property since its acquisition.  The undepreciated capital cost of the building at the time of the transfer was $120,000.

Which one of the following amounts represents the **maximum** allowable capital cost allowance that the corporation may claim for this building in the current fiscal year?

A. $2,400.

B. $2,500.

C. $4,800.

D. $5,000.

20. ABC Enterprises began operations on September 1 of the current year.  It has chosen December 31 as its year end.  On October 1 of the current year, the proprietorship purchased furniture and fixtures for $40,000.  The maximum capital cost allowance on the furniture and fixtures for the current year ending December 31 will be:

A. $1,088.22.

B. $1,336.99.

C. $4,000.00.

D. $8,000.00.

21. Robert bought a rental property ten years ago for $320,000, with $80,000 of the purchase price allocated to the land.  Over the ten years, he claimed CCA such that his UCC at the beginning of this year for the building was $196,000.  Robert sold the property this year for $520,000, with $180,000 of the sale price allocated to the land.  Which of the following statements is correct?

A. Robert has recapture of $44,000.

B. Robert has recapture of $124,000.

C. Robert has recapture of $144,000.

D. Robert has a capital gain of $100,000.

22. Sherry owned a rental property.  She originally acquired the property for $260,000 with $200,000 of the cost attributed to the building.  Over the years, Sherry has claimed CCA of $32,000, such that her UCC at the beginning of the year was $168,000. The rental property is the only asset in the class.  This year, she sold the property for $214,000, with $160,000 of the sale price attributed to the building.  Which of the following statements is correct?

A. Sherry has a terminal loss of $8,000.

B. Sherry has a capital loss of $36,000.

C. Sherry has an allowable capital loss of $4,000.

D. Sherry has recapture of $32,000.

23. Dresses R Us moved into their new rented premises on January 1, 2016.  The term of the lease is 10 years.  $8,000 of leasehold improvements were done during January 2016 with further leasehold improvements of $4,500 completed during January 2017.  The maximum amount of CCA for 2017 is:

A. $1,025

B. $1,050

C. $1,250

D. $1,300

24. Fried’s Factory Inc. purchased Class 29 assets for $20,000 on November 1, 2015.  The company’s fiscal year end is December 31.  The maximum CCA deduction for 2015, 2016 and 2017 will be:

A. $1,671 for 2015; $18,329 for 2016; $0 for 2017.

B. $1,671 for 2015; $10,000 for 2016; $8,329 for 2017.

C. $5,000 for 2015; $10,000 for 2016; $5,000 for 2017.

D. $10,000 for 2015; $10,000 for 2016; $0 for 2017.

25. Curt’s Consulting Company purchased a laptop computer on February 15, 2017 for $2,000.  The laptop was destroyed in a fire on April 30, 2017 and Curt’s Consulting received $500 in compensation from the insurance company.  It was the only asset in the CCA Class as all computer equipment has been leased for the last two years.  The effect on Net Income For Tax Purposes for the year ending December 31, 2017 is:

A. $550 decrease.

B. $412.50 decrease.

C. $2,000 decrease.

D. $1,500 decrease.

26. On September 1, 2017 Carla’s Company purchased a new computer for $1,600 and desktop publishing software for $400.  The maximum CCA deduction for 2017 is:

A. $550

B. $640

C. $1,000

D. $1,800

27. During 2017 Desiderata Design Corp. purchased a new BMW for $42,000.  The car is used exclusively for business use.    The maximum CCA deduction for 2017 is:

A. $4,500

B. $6,300

C. $9,000

D. $12,600

28. Several years ago, Solea Company purchased a Mercedes Benz that is used exclusively for business use.  The car is in a separate Class 10.1.  On January 1, 2017 the UCC balance is $17,850.  On August 1, 2017 the car was sold for $17,000.  For 2017 tax purposes, the company will report a:

A. Terminal loss of $850

B. Recapture of $850

C. CCA deduction of $2,678

D. CCA deduction of $2,245

29. On January 1, 2017 Jorge purchased two newly constructed rental buildings for $350,000 each.  Of the total cost of $350,000 for each building, $100,000 represents the value of the land on which the building is situated.  One building contains four suites and is rented to students.  The other building is rented to a florist business.  Each of the buildings is allocated to a separate Class 1.  Net rental revenue (before CCA) for 2017 is $30,000.  The maximum CCA deduction for 2017 is:

A. $10,000

B. $12,500

C. $15,000

D. $20,000

30. CCC Construction Company purchased three new tools during 2017 as follows:

January 1 $600

March 15 $350

April 30 $470

The maximum CCA deduction for 2017 is:

A. $142

B. $470

C. $710

D. $880

31. Amazine Inc. purchased Class 8 furniture for $4,000 in 2015.  In 2017, this furniture was sold for proceeds of $1,000. The UCC balance in Class 8  was $10,300 at the beginning of 2017 and no Class 8 assets were purchased during the year.  What is the UCC of this class at the end of 2017?

A. $1,860

B. $7,440

C. $9,300

D. $8,240

32. Which of the following statements regarding recapture is correct?

A. Recapture occurs when there is a negative UCC balance in a class, even if there are assets remaining in the class.

B. Recapture is deductible in the calculation of business income.

C. Recapture occurs when there is a positive UCC balance in a class and there are no assets in the class.

D. Recapture occurs when there is a positive UCC balance in a class, even if there are assets remaining in the class.

33.

Which of the following assets is **NOT** eligible for capital cost allowance in the current year?

A. A delivery truck is purchased in December of the current year.  The truck is not paid for until January of the following year.

B. An employee owns and uses a truck for employment duties during December.  His pay for December is not received until January of the following year.

C. A delivery truck is leased during the year on a 3 year lease.

D. A delivery truck is purchased during the year on a 3 year financing term.

34. On September 1, 2017, Lerner Ltd, purchased a franchise for $75,000. The franchise has a limited life of 10 years.  Lerner Ltd. has a September 30 year end.  The maximum tax deduction related to the franchise for the year ending September 30, 2017 is:

A. $616

B. $3,750

C. $3,938

D. $7,500

35. Wolfe Ltd. has a December 31 year end.   It purchased a Class 10.1 automobile four years ago for $38,000. On January 1, 2017, the undepreciated capital cost for this Class 10.1 was $12,900. During 2017, it was sold for $10,000. What is the effect on Net Income For Tax Purposes of this sale?

A. No effect

B. Terminal loss of $2,900.

C. Capital loss of $2,900.

D. CCA deduction of $1,935.

36. Nestor Nerd paid $4,000 to purchase various computer applications software for his sole proprietorship, Nerd01 on April 1 of the current year.  Nerd01 has a December 31 year end and has been operating for 3 years.  What is the maximum tax deduction that Nerd01 can claim on the software for the current year?

A. $1,100

B. $1,500

C. $2,000

D. $4,000

37. On January 1, 2017, Don Buchanan acquires a business that has goodwill.  The amount of the purchase price that is allocated to goodwill is $60,000.  The business has a taxation year that ends on December 31 and, for 2017, Don takes the maximum CCA deduction.  On January 1, 2018, the business is sold.  It is estimated that $82,000 of the sale price was for the goodwill.  The resulting increase in Don’s 2018 Net Income For Tax Purposes is:

A. $11,000.

B. $13,500.

C. $12,500.

D. $14,000.

38. Which of the following statements with respect to Class 14.1 is **NOT** correct?

A. If a disposition creates a negative balance in the UCC of the Class at the end of the year, 100 percent of the negative amount must be taken into income.

B. Appraisal costs associated with intangible business assets would be added to the Class.

C. The maximum CCA for the year is calculated as 5 percent of the ending balance in the Class.

D. If a business ceases to operate and there is a positive balance in the Class, it can be deducted in calculating net business income.

39. Fred opened his MacDingle Restaurant franchise on November 1, 2017.  He paid $50,000 for the franchise rights and can use them for an unlimited number of years.  The restaurant’s fiscal year end is December 31.  The maximum CCA deduction was taken for 2017.  The Class 14.1 balance on January 1, 2018 is:

A. $47,500

B. $49,582

C. $48,750

D. $49,791

40. Indicate which of the following items would not be added to Class 14.1.

A. Cost of fines and penalties.

B. Cost of government rights with an unlimited life.

C. Appraisal costs associated with intangible capital assets.

D. Cost of amending the articles of incorporation of an existing company.

E. Cost of customer lists.

TIF Problem Five - 4

CCA - Exam Exercises

Exam Exercise Subject Listing For Chapter 5

|  |  |
| --- | --- |
| **Number** | **Subject** |
| 1 | Segregation Into Classes |
| 2 | CCA Error |
| 3 | CCA Error |
| 4 | Class 13 And Half-Year Rule |
| 5 | Class 10 And Half-Year Rule |
| 6 | Class 8 And Half-Year Rule |
| 7 | Class 14 - No Half-Year Rule |
| 8 | Short Fiscal Periods |
| 9 | Short Fiscal Periods |
| 10 | CCA And Tax Planning |
| 11 | CCA And Tax Planning |
| 12 | Capital Gains On Depreciable Assets |
| 13 | Recapture Of CCA |
| 14 | Recapture Of CCA |
| 15 | Terminal Loss |
| 16 | Terminal Loss |
| 17 | Depreciable Asset Dispositions |
| 18 | Disposition Of Goodwill |
| 19 | Disposition Of Goodwill |
| 20 | Separate Class Election |
| 21 | Separate Class Election |
| 22 | Conversion Of CEC Balances |
| 23 | Conversion Of CEC Balances |
| 24 | Determination Of Capital Cost |
| 25 | Determination Of Capital Cost |
| 26 | Allocation Of Capital Cost |
| 27 | Allocation Of Capital Cost |

Exam Exercise Five - 1 (Segregation Into Classes)

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

* Cash registers
* Boats, canoes, and other vessels
* Airplane runways
* Automobile (i.e., passenger vehicle) with a cost of $85,000
* Power operated moveable equipment
* Storage tanks for oil
* Residential rental property acquired in 2012 for $450,000 (Value of land equals $100,000)
* Manufacturing and processing equipment acquired in 2017

Exam Exercise Five - 2 (CCA Error)

During 2017, your company acquired a depreciable asset for $437,000 and your accountant included this asset in Class 1 at the end of the year (it was not allocated to a separate Class 1).  Early in 2018, you discover that the asset should have been allocated to Class 8.  What was the impact of this error on your 2017 deductions from business income?

Exam Exercise Five - 3 (CCA Error)

During 2017, the Lardly Company spent $675,000 to acquire a government license with an unlimited life.  The Company’s accountant, because of his limited experience with assets of this type, allocated this cost to Class 8.  This error was discovered in early 2018.  What was the impact of this error on the Company’s 2017 deductions from business income?

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

Vador Inc. has a December 31 year end.  The Company leases its office space under a lease that was signed on January 1, 2011.  The lease term is eight years, with an option to renew at an increased rent for an additional two years.  In 2011, the Company spends $112,000 renovating the premises.  In 2017, changing needs require the Company to spend $41,000 renovating the space.  Determine the maximum amount of Class 13 CCA that the Company can deduct for 2017.

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

Lambda Ventures, an unincorporated business with a December 31 year end, has a Class 10 UCC balance on January 1, 2017 of $453,000.  During 2017, it acquires additional Class 10 assets at a cost of $63,200.  Also during 2017, it deducts $36,700 from the Class 10 UCC for dispositions.  Determine the maximum Class 10 CCA for 2017 and the January 1, 2018 UCC balance.

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

Baron Ltd., a Company with a December 31 year end, has a Class 8 UCC balance on January 1, 2017 of $128,500.  During 2017, it acquires additional Class 8 assets at a cost of $12,400.  Also during 2017, the Company sells assets with a capital cost of $9,600 for proceeds of $10,200.  Determine the maximum Class 8 CCA for 2017 and the January 1, 2018 UCC balance.

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

Baril Ltd. has a December 31 year end.  On December 1, 2017, the Company pays $286,000 to enter into a franchise agreement.  The contract is for a period of 5 years.  Determine the maximum CCA for 2017, as well as the January 1, 2018 UCC balance.

Exam Exercise Five - 8 (Short Fiscal Periods)

Fielding Inc. is incorporated on August 1, 2017. On September 15, 2017, the Company acquires $150,000 in Class 10 assets.  The Company has a December 31 year end and no other depreciable assets are acquired before December 31, 2017.  Determine the maximum CCA for the year ending December 31, 2017.

Exam Exercise Five - 9 (Short Fiscal Periods)

Murray’s Antiques is an unincorporated business which begins operations on May 1, 2017 and rents a store on that day.  On June 1, 2017, Murray acquired Class 8 assets for $92,400.  The business will have a taxation year which ends on December 31.  No other depreciable assets are acquired prior to December 31, 2017.  Determine the maximum CCA for the year ending December 31, 2017.

Exam Exercise Five - 10 (CCA And Tax Planning)

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

Class 1 (Buildings Acquired In 2005) $475,000

Class 8 95,000

Class 10 102,000

Class 10.1 26,000

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

Exam Exercise Five - 11 (CCA And Tax Planning)

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

Class 1 (Buildings Acquired In 2006) $213,000

Class 8 16,000

Class 10 42,000

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

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

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

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

Exam Exercise Five - 13 (Recapture)

At the beginning of 2017, Marquee Inc. has two assets in Class 10.  The balance in this class is $7,423.  The cost of each asset in the class was $7,500.  On June 30, 2017, one of the assets is sold for $7,950.  There are no other additions or dispositions prior to the Company’s December 31, 2017 year end.  What is the effect of the disposition on the Company’s 2017 net business income?  In addition, determine the January 1, 2018 UCC balance.

Exam Exercise Five - 14 (Recapture)

On January 1, 2017, Bard Ltd. has a balance in its Class 8 of $32,400.  The only transaction involving Class 8 assets during 2017 was a disposition on July 12 of a group of Class 8 assets that had cost $62,300.  The proceeds of disposition for these assets was $41,800.  The Company’s taxation year ends on December 31.  What is the effect of the disposition on the Company’s 2017 net business income?  In addition, determine the January 1, 2018 UCC balance.

Exam Exercise Five - 15 (Terminal Loss)

At the beginning of 2017, Quest Inc. has two assets in Class 10.  The cost of each asset was $72,000 and the Class 10 UCC balance was $56,472.  On June 30, 2017, both of these assets are sold for a total of $41,500.  What is the effect of the disposition on the Company’s 2017 net business income?  In addition, determine the January 1, 2018 UCC balance.

Exam Exercise Five - 16 (Terminal Loss)

Farine Ltd. has a taxation year which ends on December 31.  On January 1, 2017, the Company had 10 assets in Class 10.  The January 1, 2017 balance in this Class was $83,400.  The capital cost of these 10 assets was $110,000.  Subsequent transactions during the year are as follows:

* On May 1, 2017, all of the original Class 10 assets are sold for $92,400.
* On June 1, 2017, 10 new assets are acquired at a cost of $105,000.
* On December 1, 2017, the 10 new assets are sold for $65,000.

On December 31, 2017, no assets remain in Class 10.  What is the effect of these transactions on the Company’s 2017 net business income?  In addition, determine the January 1, 2018 UCC balance.

Exam Exercise Five - 17 (Depreciable Asset Dispositions - Tax Vs, Accounting)

Sherd Inc. disposes of a Class 8 asset for proceeds of $246,000.  The capital cost of this asset was $183,000 and it had a net book value of $92,500.  The Company’s Class 8 contains a number of other assets and the balance for the Class prior to this disposition was $1,648,000.  Describe briefly the accounting and tax treatments of this disposition.

Exam Exercise Five - 18 (Disposition Of Goodwill)

During 2017, Dortran Ltd. acquires two businesses.  The cost of the first acquisition includes a payment for goodwill of $243,000, while the cost of the second includes a payment for goodwill of $317,000.  Neither of these businesses will be operated as a separate business entity.  Dortran Ltd. had no Class 14.1 balance as of January 1, 2017, and there were no other Class 14.1 transactions during the year.

In December, 2018, two portions of Dortan’s business activities are sold.  The first results in a goodwill receipt of $187,000, while the second results in a goodwill receipt of $307,000.  Dortan always claims maximum CCA.

Determine the January 1, 2018 UCC balance.  What is the tax effect of the dispositions?

Exam Exercise Five - 19 (Disposition Of Goodwill)

During 2017, Brondor Ltd. acquires two businesses.  The cost of the first acquisition includes a payment for goodwill of $213,000, while the cost of the second includes a payment for goodwill of $243,000.  Neither of these businesses will be operated as a separate business entity.  Brondor Ltd. had no Class 14.1 balance as of January 1, 2017, and there were no other Class 14.1 transactions during the year.

In December 2018, two portions of Brondor’s business activities are sold.  The first results in a goodwill receipt of $165,000, while the second results in a goodwill receipt of $276,000.  Brondor always claims maximum CCA.

Determine the January 1, 2018 UCC balance.  What is the tax effect of the dispositions?

Exam Exercise Five - 20 (Separate Class Election)

Multilink Inc. has a December 31 year end.  In January, 2017, Multilink Inc. acquires five photocopiers at a cost of $5,500 each.  In December, 2017, two of these photocopiers are upgraded for newer models.  The new photocopiers cost $6,000 each, and the Company receives an upgrade allowance for each old photocopier of $2,000.  Indicate the amount(s) that would be deducted from 2017 business income if no election is made to put each photocopier in a separate class.  Contrast this with the deduction(s) that would be available if the separate class election is used.

Exam Exercise Five - 21 (Separate Class Election)

Garick Ltd. has a December 31 year end.  In February 2017, the Company acquires three photocopiers at a cost of $23,000 each.  Because of their extremely heavy usage, they must be replaced in November, 2017.  They are replaced with three new photocopiers at a cost of $21,500 each.  The Company received a trade in allowance of $2,500 for each of the replaced machines.   Indicate the amount(s) that would be deducted from 2017 business income if no election is made to put each photocopier in a separate class.  Contrast this with the deduction(s) that would be available if the separate class election is used.

Exam Exercise Five - 22 (Conversion Of CEC Balances)

On December 31, 2016, Ferris Ltd. has a CEC balance $163,400.  During 2017, it acquires an unlimited life franchise at a cost of $112,000.  What is the maximum amount of Class 14.1 CCA that can be deducted for 2017?

Exam Exercise Five - 23 (Conversion Of CEC Balances)

On December 31, 2016, Livol Inc. has a CEC balance $48,600.  During 2017, it acquires an unlimited life franchise at a cost of $46,000.  What is the maximum amount of Class 14.1 CCA that can be deducted for 2017?

Exam Exercise Five - 24 (Determination Of Capital Cost)

Fronco. Inc’s CEC balance on December 31, 2016 was $180,980.  This is the unamortized balance of two unlimited life franchises that were acquired in 2014.  The first was acquired to $240,000.  The second for $60,000.  What is the total capital cost of the two unlimited life franchises on January 1, 2017?

Exam Exercise Five - 25 (Determination Of Capital Cost)

Xenon Ltd.’s CEC balance on December 31, 2016 was $142,060.  This is the unamortized balance of two unlimited life franchises that were acquired in 2015.  The first was acquired to $96,000.  The second for $123,000.  What is the total capital cost of the two unlimited life franchises on January 1, 2017?

Exam Exercise Five - 26 (Allocation Of Capital Cost)

During January, 2016, Kantex Ltd. acquires three unlimited life franchises.The first cost $175,000, the second $260,000, and the third, $141,000.  As Kantex had a significant tax liability and no funds to pay it, the first and second of these franchises were sold during December, 2016.  The first was sold for $211,000 and the second for $315,000.  Kantex claims the maximum CEC deduction for 2016.  Determine the total capital cost of the third franchise as of January 1, 2017.

Exam Exercise Five - 27 (Allocation Of Capital Cost)

During January, 2016, Sannet Ltd. acquires three unlimited life franchises from a company in bankruptcy. The first cost $42,000, the second $96,000, and the third, $118,000.  During September, 2016 the first and second of these franchises were sold.  The first was sold for $51,000 and the second for $108,000.  Sannet claims the maximum CEC deduction for 2016.  Determine the total capital cost of the third franchise as of January 1, 2017.

TIF Problem Five - 5A

CCA - Key Term Matching (Easy)

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

Version A is easy, there is only one possible answer for each term.

Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms were listed at the end of Chapter 5, “Capital Cost Allowances And Cumulative Eligible Capital”.

A. Terminal Loss

B. Declining Balance Method

C. Depreciable Capital Property

D. Half-Year Rules

E. Non-Depreciable Capital Property

F. Recapture Of CCA

G. Separate Class Rules

H. Undepreciated Capital Cost

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

1. An inclusion in business and property income that arises when deductions from a CCA class, engendered by disposals, leave a negative balance in that class at the end of the taxation year.

2. Rules that require certain types of assets that would, in the absence of these special rules, be included in a single Class, be allocated to a separate balance for that Class.

3. A deduction in the calculation of business and property income which arises when the last asset in a CCA Class is retired and a positive balance is left in the Class.

4. A method of calculating CCA in which a specified rate is applied to the ending UCC balance in a depreciable asset Class in order to determine the CCA for the period.

5. A group of rules which require, for most CCA Classes, the subtraction of one-half of the year’s net additions from the Class, prior to calculating the CCA for the year.

6. An amount expended to acquire an intangible asset that is not eligible for either write-off through CCA deductions or as a deduction in the period in which it is incurred.

7. Capital property that is not subject to depreciation or amortization.

8. The capital cost of a depreciable asset class, less the cumulative CCA that has been taken to date.

9. Capital property that is subject to depreciation or amortization.

10. A deduction in the determination of business or property income based on the capital cost of capital assets.

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

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

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

TIF Problem Five - 5B

CCA - Key Term Matching (Moderate)

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

Version A is easy, there is only one possible answer for each term.

Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms were listed at the end of Chapter 5, “Capital Cost Allowances And Cumulative Eligible Capital”.

A. Terminal Loss

B. Declining Balance Method

C. Depreciable Capital Property

D. Half-Year Rules

E. Non-Depreciable Capital Property

F. Recapture Of CCA

G. Separate Class Rules

H. Undepreciated Capital Cost

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

1. An inclusion in business and property income that arises when deductions from a CCA class, engendered by disposals, leave a negative balance in that class at the end of the taxation year.

2. A method of calculating CCA in which a declining rate is applied to the capital cost of a depreciable asset.

3. Rules that require certain types of assets that would, in the absence of these special rules, be included in a single Class, be allocated to a separate balance for that Class.

4. A deduction in the calculation of business and property income which arises when the last asset in a CCA Class is retired and a positive balance is left in the Class.

5. The capital cost of a depreciable asset class, less the CCA that has been taken for the current year.

6. A method of calculating CCA in which a specified rate is applied to the ending UCC balance in a depreciable asset Class in order to determine the CCA for the period.

7. A group of rules which require, for most CCA Classes, the subtraction of one-half of the year’s net additions from the Class, prior to calculating the CCA for the year.

8. An amount expended to acquire an intangible asset that is not eligible for either write-off through CCA deductions or as a deduction in the period in which it is incurred.

9. An addition in the calculation of business and property income which arises when the last asset in a CCA class is retired and a positive balance is left in the class.

10. Capital property that is not subject to depreciation or amortization.

11. The capital cost of a depreciable asset class, less the cumulative CCA that has been taken to date.

12. Capital property that is subject to depreciation or amortization.

13. An inclusion in business and property income that arises when a depreciable asset is sold for proceeds that exceed the balance in its UCC class.

14. A deduction in the determination of business or property income based on the capital cost of capital assets.

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

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

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

TIF Problem Five - 6

Purchase And Sale Of Goodwill

Fromor is a Canadian public company with a taxation year that ends on December 31.  It is the policy of Fromor Ltd. to claim maximum CCA for all Classes.  On January 1, 2017, Fromor had no balance in its Class 14.1.

What follows is two independent cases involving payments for goodwill and receipts for goodwill.  In each case assume that Fromor has no other transactions during 2017 or 2018 that involve Class 14.1

**Case One** During 2017, Fromor acquires two businesses.  With the first acquisition, a payment is made for goodwill of $127,000.  With the second, a payment of $186,000 is made for goodwill.  Both of these businesses are absorbed into the other operations of Fromor Ltd.

During 2018, Fromor sells a portion of its business and, as a consequence, receives a payment for goodwill of $142,000.

**Case Two** During 2017, Fromor acquires a business.  The cost of this business includes a payment for goodwill of $64,000.  The business is absorbed into Fromor’s other operations and is not operated separately.  Also during 2017, Fromor acquires an unlimited life franchise at a cost of $98,000.

During 2018, Fromor sells a portion of its business and, as a consequence, receives a payment for goodwill of $85,000.

**Required:** Determine the tax consequences for the years 2017 and 2018 in each of these two cases.  Your answer should include the January 1, 2019 UCC balance for Class 14.1.

TIF Problem Five - 7

CCA Calculations Over 4 Years

After several years of hard work at the Shawarma Palace Lebanese restaurant, the Haddad brothers decide to start Shawarma On Wheels, a business that will have quick delivery of freshly made Lebanese food.  This partnership begins operations on September 1, 2014 and will have a taxation year that ends on December 31.  The brothers plan to take maximum CCA in every year.

On September 12, 2014 the business acquires 20 small cars that will be used for deliveries.  These vehicles have an individual cost of $21,500 each.  They run a very successful advertising campaign using online coupons and social media that is directed at downtown condo owners.

During the 2015 taxation year, 6 additional cars are acquired at a cost of $22,800 each.  These new vehicles replace 6 of the original cars which are sold for proceeds of $11,400 each.  Shawarma On Wheels accounts for each car sale on an asset by asset basis for tax purposes.

During the 2016 taxation year, 18 additional cars are acquired at a cost of $24,300 each.  Also during this year, the remaining 14 cars from the 2014 purchase are sold.  As all the cars had high mileage, the total proceeds from this sale are $137,200.

In talking to their drivers, the Haddad brothers are repeatedly told that delivering high quality Lebanese food is a great way to meet attractive young women.  As a result, the brothers decide to start doing some deliveries themselves.  In order to try to improve their success in this area, they acquire two BMW 6 series convertibles at a cost of $135,000 each.  These are to be used exclusively for making deliveries to female callers who are offered a discount if they come down to the lobby to pick up their orders, thus seeing the impressive cars.

Early in 2017, the authorities discover that, in addition to delivering Lebanese food, the brothers have also been providing their clients with a variety of illegal substances.  In addition to having to pay hefty fines, they are each sentenced to 3 years in prison.  Given this, Shawarma On Wheels is closed down on September 30, 2017.  The 24 remaining regular delivery cars are sold for $8,300 each.  The two BMW convertibles are sold for $85,000 each.

**Required:** For each of the taxation years 2014 through 2017, calculate the maximum available CCA deduction.  In addition, determine the amount of any capital gain, recapture, or terminal loss that arises on any of the transactions that occurred during these years.  Ignore GST/HST/PST considerations.

TIF Problem Five - 8

CCA Calculations Over 3 Years

All Night Service Ltd. was incorporated on April 1, 2015 to supply computer service 24 hours per day.  At the time of incorporation, the Company establishes December 31 as its year end for both tax and accounting purposes.

On April 1, 2015, the Company acquired a new building to be used as an office and communications centre at a cost of $250,000.  This total cost is allocated $180,000 to the building and $70,000 to the land.  As the building is being used 100 percent for non-residential purposes, it is allocated to a separate Class 1.  Also on this date, the Company purchased six cars to be used by the service technicians at a cost of $25,000 per vehicle.

On May 1, 2015, the Company purchased a variety of computer repair and maintenance equipment at a cost of $48,000.  The Company owns no computers as it leases all of its computer hardware and software.

During 2016, the Company trades in three of its old cars on three new minivans.  The list price of the new minivans is $24,000 per vehicle, and the Company receives a trade-in allowance towards this list price of $14,000 per old vehicle.

On September 20, 2017, a convertible is acquired at a cost of $98,000 for use by the president of the Company.  In addition, several unusual events occur during 2017.  They are as follows:

* Equipment that had a value of $12,000 was stolen by one of the service technicians.
* One of the original six cars was involved in a severe accident, resulting in repair costs of $8,270.  Because the Company’s insurance has a deductibility clause, the insurance proceeds covered only $7,770 of these repair costs.
* Because he had never received a speeding ticket (despite numerous violations) while driving the car allocated to him, a departing service technician offers the Company $27,000 for one of its original six cars.  The Company accepts the offer.

**Required:**

A. Determine the maximum CCA that can be taken in each of the years 2015 through 2017.  In your calculations, include and identify the January 1, 2016, January 1, 2017, and January 1, 2018 UCC balances.  Ignore GST/HST/PST considerations.

B. Explain the tax effects of the unusual events that occurred during 2017.

TIF Problem Five - 9

CCA Calculations Over 3 Years

Ken’s Kouriers is an unincorporated business which provides courier services within the city of Halifax.  It has a taxation year that ends on December 31 and plans to deduct the maximum CCA each year.

Ken’s Kouriers began operating on May 1, 2015 by acquiring a new building at a total cost of $326,000.  Of this total, $53,000 is allocated to the land on which the building is situated.  As it will be used 100 percent for non-residential purposes other than manufacturing, it is allocated to a separate Class 1.

Furnishings for the building are acquired on June 1, 2015 at a cost of $85,000.

Also on June 1, 2015, the business acquires 12 vehicles to be used by its couriers.  The cost of these vehicles is $23,000 each for a total of $276,000.

During 2016, the business trades in 5 of its old vehicles for more fuel efficient vehicles.  The replacement vehicles cost $27,000 per vehicle.  The company receives a trade-in allowance of $16,000 for each old vehicle.  Also during 2016, the Company acquires a luxury vehicle to be used by Ken, the owner of the business.  The cost of this vehicle is $103,000.

During 2017, Ken and five of his drivers are charged with smuggling counterfeit goods.  Ken’s Kouriers is closed down on December 31, 2017 and, before closing, Ken sells the assets as follows:

* The building is sold for $342,000, with $53,000 of this amount being attributed to the land.
* The  remaining 7 vehicles that were purchased in 2015 are sold for $73,000.  The 5 vehicles that were acquired in 2016 are sold for $62,500.  The amount received for each vehicle was less than its capital cost.
* The furniture is sold for $12,300.
* The luxury vehicle is sold for $63,800.

**Required:** Determine the maximum CCA that can be taken in each of the years 2015 through 2017.  In your calculations, include and identify the UCC balances for January 1, 2016, January 1, 2017, and January 1, 2018.

In addition, indicate any tax effects resulting from the 2016 and 2017 dispositions.  Ignore GST/HST/PST considerations.

TIF Problem Five - 10

CCA Calculations

The following information relates to the Fortin Aluminum’s depreciable assets.

**Class 1** During 2017, a new office building was acquired at a total cost of $623,000.  Of this total, it is estimated that the value of the land is $145,000.  The building will be used 100 percent for non-residential activities, none of which involve manufacturing.  It will be allocated to a separate Class 1.

**Class 3**  The January 1, 2017 balance in this Class was $798,000.  During 2017, one of the warehouses in this Class burned to the ground.  It had a capital cost of $150,000.  Insurance proceeds totaled $185,000.

**Class 8** The January 1, 2017 balance in this Class was $346,000.  During 2017, the Company acquired Class 8 assets at a cost of $105,000.  Class 8 assets with a capital cost of $83,000 were sold for proceeds of $75,000.  None of the individual assets sold had proceeds that exceeded their individual capital cost.

**Class 10** The January 1, 2017 balance in this Class was $150,000.  During 2017, 3 passenger vehicles were acquired at a cost of $25,000 each.  In addition, a delivery van with a capital cost of $42,000 was sold for $18,000.

**Class 10.1** The January 1, 2017 balance in this Class was $17,850.  The only asset in this Class was the CEO’s $350,000 Bentley.  At the instructions of the Company’s directors, who felt this vehicle was excessively extravagant, the car was sold for $275,000 during 2017.

**Class 13** The January 1, 2017 balance in this Class was $42,500, reflecting improvements that were made in 2015, the year in which the lease commenced.  These improvements were made on a property leased as office space for the Company’s executives.  The basic lease term is for 8 years, with an option to renew for a period of 2 years.  Additional improvements, costing $40,000, were made during 2017.

**Class 50** The January 1, 2017 balance in this Class was $23,000.  During 2017, there were additions to this Class with a capital cost of $18,000.

**Class 53** The January 1, 2017 balance in this Class was $63,000.  The capital cost of the assets in this Class was $84,000.  As the Company has found its manufacturing operations to be unprofitable, all of these assets were sold during 2017.  The proceeds totaled $51,000.  None of the individual assets sold had proceeds that exceeded their individual capital cost.

Fortin Aluminum always takes maximum CCA on each Class of depreciable assets.

**Required:** Calculate the maximum CCA that can be taken by Fortin Aluminum on each class of assets for the year ending December 31, 2017 and calculate the UCC for each class of assets on January 1, 2018.  In addition, determine the amount of any capital gain, recapture, or terminal loss that arises.  Ignore GST/HST/PST considerations.

TIF Problem Five - 11

CCA And Tax Planning

For the taxation year ending December 31, 2017, Kreton Inc. has determined that its Net Income For Tax Purposes, before any deductions for CCA, amounts to $51,000.  As the Company does not have any Division C deductions, Taxable Income, before any deductions for CCA, would also amount to $51,000.

On January 1, 2017, the Company has the following UCC  balances:

Class 8 $220,000

Class 10 152,000

Class 12 56,000

Class 13 272,000

Class14.1 (See Note) 210,000

**Note** The balance in Class 14.1 is equal to the December 31, 2016 balance in Kreton’s CEC account.  It was transferred to Class 14.1 under a transitional provision resulting from the repeal of the CEC provisions in the *Income Tax Act*.

During 2017, the cost of additions to Class 8 amount to $42,000, while the proceeds from dispositions in this class totaled $16,000.  In no case did the proceeds of disposition exceed the capital cost of the assets retired, and there were still assets in the class as of December 31, 2017.

All of the Class 12 assets were acquired in 2016.

The leasehold improvements were made in 2015 at a cost of $320,000.

There were no 2017 acquisitions or dispositions in Classes 10, 12, 13 or 14.1.

In previous years, the Company has always deducted the maximum amount of CCA.

**Required:**

A. Calculate the maximum CCA write-off that could be taken by Kreton Inc. for the taxation year ending December 31, 2017.

B. As Kreton’s tax advisor, indicate how much CCA you would advise them to take for the 2017 taxation year and the specific classes from which it should be deducted.  Provide a brief explanation of the reason for your recommendation.  In providing this advice, do not take into consideration the possibility that losses can be carried either back or forward.

TIF Problem Five - 12

CCA And Tax Planning

For its taxation year ending December 31, 2017, Axel Ltd. has determined that its Net Income For Tax Purposes, before any deductions for CCA, amounts to $42,000.  The Company does not have any Division C deductions, so whatever amount is determined as Net Income For Tax Purposes will also be the amount of Taxable Income for the 2017 taxation year.

On January 1, 2017 the Company has the following UCC balances:

Class 1 (Two Buildings) $462,000

Class 13\* 94,500

Class 10 139,000

\*This balance reflects leasehold improvements made on January 1, 2015 at a total cost of $126,000.  The original term of the lease was 4 years.  However, there are two available renewal options, each allowing Axel Ltd. to renew for a period of two years.

During 2017, the cost of additions to Class 10 amounted to $76,000, while the proceeds from dispositions in this class totalled $58,000.  In no case did the proceeds of disposition exceed the capital cost of the assets disposed of, and there were still assets in the class as of December 31, 2017.

There were no acquisitions or dispositions in either Class 1 or Class 8 during 2017.  However, Axel has received an unsolicited offer to purchase one of its buildings which it is considering.

**Required:**

A. Calculate the maximum CCA that could be taken by Axel Ltd. for the taxation year ending December 31, 2017.  Your answer should include the maximum that can be deducted for each CCA class.

B. As Axel’s tax advisor, indicate how much CCA you would advise them to take for the 2017 taxation year and the specific classes from which it should be deducted.  Provide a brief explanation of the reason for your recommendation.  In providing this advice, do not take into consideration the possibility that losses can be carried either back or forward.

TIF Problem Five - 13

CCA Calculations

The following information relates to Andorn Ltd. for its taxation year that ends on December 31, 2017:

1. The Company has UCC balances on January 1, 2017 for its tangible assets as follows:

Class 1 (A single building acquired in 2008) $478,695

Class 8 243,000

Class 10 126,000

Class 13 127,500

2. During 2017, the building that was acquired in 2008 was sold for cash of $650,000.  Of this total, $125,000 represented the value of the land on which the building was situated.  The building had a capital cost of $625,000, of which $80,000 represented the value of the land at time the building was acquired.

The building was replaced during 2017 with a new building at a cost of $745,000, of which $125,000 represented the value of the land.

The old building was used 100 percent for office space and was allocated to a separate Class 1.  The new replacement building is also used 100 percent for office space and is allocated to a separate Class 1.

3. During 2017, the Company purchased office furnishings for $74,000.  They traded in older furnishings and received an allowance of $17,000.  The capital cost of the furnishings that were traded in was $56,000.

4. The only vehicle purchased during the year was a Lexus to be used by the president of the Company.  The cost of this car was $93,000.  The president drives it 23,000 kilometers during the year, of which 5,750 kilometers are for employment related purposes.

5. Andorn conducts some of its business out of a building which it leases.  The lease was signed on January 1, 2015 and had an initial term of 7 years.  It has an option to renew for 3 years.  At the time the lease was signed, Andorn spent $150,000 on leasehold improvements.

6. During 2015, the Company purchased two franchises.  The first, which was purchased on August 1, 2015, had cost $62,000 and a legally limited life of 8 years.  The second, purchased on September 5, 2015, cost $84,000 and had an unlimited life.  This second franchise was sold during 2017 for $65,000.

7. Andorn Ltd. has always deducted the maximum CCA and the maximum write-off of cumulative eligible capital allowable in each year of operation.

**Required:** Calculate the maximum CCA write-off that can be deducted for 2017.  Your answer should include the maximum that can be deducted for each CCA class.  In addition, indicate the amount of any recapture or terminal loss that results from dispositions during 2017.

Chapter Six Test Item File Problems

TIF Problem Six - 1

Business Income - Essay Questions

1. What are the major types of income that make up Net Income For Tax Purposes?

2. Assets can be acquired for use in a business, for resale by a business, or as investments.  For each of these classifications, indicate (1) how the income earned will be classified, and (2) how the income resulting from the sale of the asset would be classified.

3. For tax purposes, the sale of inventories is treated differently than the sale of non-depreciable capital assets.  Briefly describe the different treatments given to these two types of sales.

4. While there are many similarities between business income (for tax purposes) and accounting income as determined under GAAP, there are a number of differences.  Indicate four such differences.

5. While business income and property income are covered in the same subdivision of the *Income Tax Act*, there are differences in the tax treatment of these two types of income.  Briefly describe two of these differences.

6. Why is the distinction between capital gains and business income important?

7. List four criteria that can be used in distinguishing between business income and capital gains.  Explanations are not required.

8. Both GAAP and income tax legislation require the allocation of the cost of depreciable assets to income over several years.  Briefly describe how the accounting procedures used for this process differ from those required for income tax purposes.

9. What is a reserve? Explain briefly the reserve system that is used in determining net business income.

10. List three reserves that can be deducted in the determination of net business income.

11. Compare the procedures used to determine bad debt expense under GAAP, with those used to determine the annual deduction for bad debts under the *Income Tax Act*.

12. The ability to use a reserve for unpaid amounts gives results that are similar to those that would result from using the cash basis of revenue recognition.  However, there are constraints on the use of this reserve that prevent achieving results that are identical to those that result from using cash based revenue recognition.  Describe these constraints.

13. Section 18 of the *Income Tax Act* lists a number of general limitations on the deductions that can be made in the determination of net business income.  List four of these limitations.

14. Describe the tax rules that apply to interest and property taxes on land.

15. Both employees and self-employed individuals can deduct the costs associated with maintaining a home office.  Compare the items that can be deducted by an employee with those that can be deducted by a self-employed individual.

16. Describe the restrictions that the *Income Tax Act* places on the deductibility of costs incurred to place advertising in foreign media.

17. ITA 67 indicates that no deduction is available for an outlay or expense, except to the extent that the outlay or expense was reasonable in the circumstances.  Provide an example of an outlay or expense that would be disallowed by this provision.

18. List and briefly describe three  of the exceptions to the rule that only 50 percent of the cost of business meals and entertainment can be deducted in the determination of Net Income For Tax Purposes.

19. The *Income Tax Act* limits the deductions associated with the ownership of company cars.  Describe these limitations.

20. Describe the alternative methods of inventory valuation that can be used for tax purposes.

21. Compare the accounting treatment for estimated warranty costs with the required treatment for income tax purposes.

22. When an enterprise issues debt obligations, they may be sold at a discount from their maturity value.  For accounting purposes, this discount is amortized to income as an addition to interest expense.  What is the required treatment of such discount amounts for income tax purposes?

23. In determining whether an individual can deduct farm losses against other sources of income, taxation authorities divide farmers into various categories.  Describe these categories and indicate how the farm losses for each category are treated in the year they occur.

24. Explain briefly how the billed basis of determining professional income differs from the normal accrual approach to determining business income.

25. In situations where a business ceases to operate and its assets are being sold, it is important that the parties to the transaction make the ITA 22 election with respect to the accounts receivable that are being transferred.  Explain this importance.

TIF Problem Six - 2

Business Income - True Or False

1. The tax rules for determining business income are identical to those used for determining property income.

True or False?

2. When property acquired for personal use is sold for more than its cost, there will be a taxable capital gain.

True or False?

3. The deduction of CCA cannot be used to create or increase a net business loss.

True or False?

4. If an asset has been held for a considerable period of time, any gain on its disposition will be treated as business income.

True or False?

5. Differences between business income for tax purposes and business income as determined under GAAP can be either permanent or temporary.

True or False?

6. When a business makes payments that are unreasonable in the circumstances, they cannot be deducted in the calculation of either accounting Net Income or net business income.

True or False?

7. If a reserve is deducted for accounting purposes, it can also be deducted for tax purposes.

True or False?

8. The amounts charged to income for bad debts on accounts receivable will generally be the same for both tax and accounting purposes.

True or False?

9. A self-employed individual cannot deduct CCA on a home office in his principal residence unless it is used exclusively for income producing purposes.

True or False?

10. Landscaping costs can be deducted in the determination of net business income, even if they involve items that would normally be considered capital assets.

True or False?

11. For the hobby farmer, deductible farming losses for a year are restricted to $2,500, plus one-half of the next $30,000.

True or False?

12. For tax purposes, inventories can be valued at aggregate market, which can mean replacement cost or net realizable value.

True or False?

13. When a business ceases to operate and its inventories are disposed of, a gain on the inventories will be treated as a capital gain unless an election is made by the selling taxpayer.

True or False?

14. When a business ceases to operate and its accounts receivable are disposed of with the other business assets, any loss on the receivables will be treated as a capital loss unless a joint election is made by the purchaser and seller.

True or False?

TIF Problem Six - 3

Business Income - Multiple Choice

Business Vs. Property Vs. Capital Gains

1. During 2017, a depreciable capital asset with a capital cost of $100,000 and a January 1 UCC balance of $79,400, is sold for $103,000.  In the accounting records, the asset had a net book value of $83,400.  What are the tax consequences of this sale?

A. Business income of $23,600.

B. A capital gain of $1,500.

C. A capital gain of $3,000 and business income of $20,600.

D. A capital gain of $23,600.

2. Which of the following would be considered by the CRA to be business income rather than property income or capital gains?

A. Profits from the sale of assets that were used to produce business income

B. Profit from the sale of assets that were used to produce property income

C. Profit from the sale of inventory items

D. Both A and C

3. Fung Wo purchased vacant land on a remote island off the coast of British Columbia on January 1,  2014 for $50,000.  She intended to re-sell it for a profit the next year but due to an oil spill, property values dropped.  She was finally able to sell the vacant land for $45,000 on December 31, 2017.  In the meantime, she paid property taxes of $500 each year.   For 2017 tax purposes, Fung Wo has:

A. An allowable capital loss of $2,500

B. An allowable capital loss of $3,500

C. A net business loss of $5,000

D. A net business loss of $7,000

4. Which of the following statements is **NOT** correct?

A. In determining property income, the deduction of CCA cannot be used to create or increase a loss.

B. Both business and property income are subject to the income attribution rules.

C. In determining business income, the deduction of CCA can be used to create or increase a loss.

D. Travel expenses cannot be deducted against property income.

5. In determining whether a gain resulting from a disposition of an asset is capital or business, various criteria have been used.  Which of the following considerations would be least likely to affect the decision?

A. The length of time the asset is held.

B. Whether the transaction is related to the taxpayer’s business.

C. The number and frequency of similar asset dispositions.

D. Whether the taxpayer knew the investment could be sold for a profit if the investment return was inadequate.

E. Whether the transaction resulted in a gain or loss.

6. Jerry collects baseball cards as a hobby.  During the current year, he acquired twenty-five different items at a total cost of $29,550.  During the year, he sold each of those items and received total proceeds of $55,900.  What is the effect of these transactions on Jerry’s Net Income For Tax Purposes?

A. Jerry has a taxable capital gain of $26,350.

B. Jerry has a taxable capital gain of 13,175.

C. Jerry has business income of $26,350.

D. Because the collection was a hobby, the gain does not have to be included in Net Income For Tax Purposes.

7. Which of the following is correct?

A. In determining whether a disposition is capital or business in nature, the number and frequency of transactions is taken into account.

B. A taxpayer must include 50 percent of both business income and capital gains in their Taxable Income.

C. Amounts collected under an insurance policy are considered capital gains.

D. The sale of a depreciable asset can result in a capital gain or capital loss.

8. Marvin purchased a large piece of land 5 years ago when a highway bypass was rumoured to have an exit being built nearby.  He had planned to subdivide the land into building lots within 5 years, but has done no work on the land yet.  He has rented the land each summer over the Labour Day weekend for $500.  A local non-profit organization holds a huge neighbourhood garage sale on that weekend.  A heart attack has convinced Marvin to slow down.  As  a result, he has advertised the land for sale online and an interested buyer is offering to purchase it at a price that would give him a large gain.   That gain would be taxed as:

A. property income.

B. business income.

C. a capital gain.

D. a taxable capital gain.

Inclusions And Reserves

9. With respect to determining net business income for tax purposes, which of the following statements is **NOT** correct?

A. A reserve that is deducted in the current taxation year, must be added back to income in the following taxation year.

B. Bad debts written off in the previous year for tax purposes that are recovered in the current year must be added to net business income for tax purposes for the current year.

C. Amounts received for goods to be delivered in the future must be included in the determination of net business income for tax purposes.

D. As long as some part of the proceeds for goods sold is not collectible until future periods, a reserve for uncollected amounts can be deducted.

10. A business may sometimes receive amounts of cash for goods or services to be delivered in a future taxation year. Under the requirements of the *Income Tax Act*, these amounts should be:

A. included in revenue when the goods or services are delivered.

B. included in revenue no later than 180 days after the end of the taxation year.

C. allocated to revenue over the period between the time the cash is received and the time the goods and services are delivered.

D. included in revenue when the cash is received.

11. Selected items from Mini Move Inc.’s December 31 audited financial statements are as follows:

**2017 2016**

**Income Statement:**

Revenue $200,000 $180,000

Income before taxes $ 30,000 $ 25,000

Net Income $ 24,000 $ 20,000

**Balance Sheet:**

Accounts Receivable $12,000 $11,000

Accounts Payable $ 7,000 $ 4,000

Deferred Revenue $ 500 $ 200

Mini Move’s 2017 Net Income for Tax Purposes is:

A. $24,300.

B. $30,300.

C. $31,000.

D. $31,300.

12. In 2016, Marg’s Antiques deducted a reserve for doubtful debts of $12,000.  During 2017, she had actual write-offs of $12,500 and recoveries of previously written off debts of $1,500.  At the end of 2017, she deducted a reserve for doubtful debts of $14,000.  Marg’s 2017 net deduction for bad debts would be:

A. $12,500.

B. $11,000.

C. $13,000.

D. $14,000.

13. Ed’s Appliances Ltd (Ed’s) sold a furnace to a customer in October, 2017 for $10,000.  The mark-up on the $5,000 cost of the furnace was 100 percent.  The customer paid 20 percent of the purchase price on delivery, with the remainder of the purchase price due in March 2018.  What is the maximum reserve Ed’s can claim for tax purposes for its November 30, 2017 year end?

A. $2,000.

B. $4,000.

C. $6,000.

D. $8,000.

E. None of the above.

Limitations On Deductions

14. Myrle Cocco owns a car that she uses both in her business and for personal use.  The cost of the car was $28,000 and, on January 1, 2017, the UCC for the vehicle (it is the only asset in Class 10) was $11,662.  During the year she drives the car a total of 42,000 kilometers of which 38,000 were related to her business activities.  Her insurance for the year was $950 and her operating costs were $6,500.  What is the amount of her maximum deduction for car costs during 2017?

A. $10,239.

B. $ 9,906.

C. $17,292.

D. $10,949.

15. Which of the following items could **NOT** be deducted during the current year in the determination of net business income for tax purposes?

A. Premiums on a life insurance policy on a business owner’s life that is required by the bank that has extended a loan to the business.

B. The cost of advertising on a U.S. television station that is attempting to attract customers in Florida.

C. Fees paid to the business owner’s wife for keeping the accounting records of the business.

D. Parking fines incurred by delivery vehicles making deliveries in congested areas.

16. For income tax purposes, X Co. can deduct life insurance premiums paid providing:

A. The life insurance policy is required as security on a loan from a financial institution.

B. The interest payable on the loan for which the life insurance is required is deductible by X Co. for tax purposes.

C. The premium paid is for insurance on the president of X Co.

D. Both A and B.

E. All of A, B, and C.

17. Maxine is the proprietor of a home based business.  She paid $25,000 to her editorial assistant, $8,000 to her son as her computer technician, and $32,000 to herself as salary. How much can she deduct as a business expense on her income tax return?

A. Nil.

B. $25,000.

C. $33,000.

D. $65,000.

18. Jon Bogen operates a consulting business out of a dedicated space in his home.  It is his principal place of business.  With respect to the items that he can deduct, which of the following statements is correct?

A. Jon can only deduct a pro rata share of operating costs and utilities.

B. Jon can only deduct a pro rata share of operating costs, utilities, and property taxes.

C. Jon can only deduct a pro rata share of operating costs, utilities, property taxes, and mortgage interest.

D. Jon can deduct a pro rata share of operating costs, utilities, property taxes, mortgage interest and CCA.

19. Omar owns and manages an unincorporated business.  During 2017, a car which he owns was driven 10,000 kilometers for business purposes and 12,000 kilometers for Omar’s personal use.  The total vehicle related expenses for 2017 were as follows:

Lease payments $7,200

Insurance  1,000

Other Operating Costs  1,300

For tax purposes, there is a:

A. Business deduction of $4,318 and a taxable benefit of $0.

B. Business deduction of $5,182 and a taxable benefit of $0.

C. Business deduction of $9,500 and taxable benefit of $7,300.

D. Business deduction of $9,500 and taxable benefit of $7,800.

20. Jean Brochet uses an automobile in his unincorporated business.  It cost $53,000 in 2016, with maximum CCA being deducted in that year.  The purchase was financed with a bank loan of $37,000.  For 2017, the interest on this loan was $4,440.  The automobile is used exclusively for business purposes, with the 2017 operating costs totaling $7,500.  In determining his 2017 business income, his maximum automobile related deduction will be:

A. $18,800.

B. $19,590.

C. $24,665.

D. $20,150.

21. Which of the following expenses would be denied as a deduction under the *Income Tax Act*?

A. A speeding ticket received by a truck delivering goods for resale.

B. The costs of disability related building modifications,

C. Work space in a home costs for a self-employed contractor.

D. A reserve for doubtful accounts

22. Antonio Capellini is a successful self-employed accountant. He meets all of his clients in his office in the basement of his home.  The office is 800 square feet and the house is 3,000 square feet. Antonio incurred the following costs during the current year:

Business liability insurance $ 400

House insurance 880

House utilities 2,600

House repairs and maintenance 3,000

Mortgage interest 5,700

Property tax 1,600

Office supplies 760

What is the amount of the expenses deductible from Antonio’s business income?

A. $1,160

B. $2,888

C. $3,675

D. $4,835

23. Kyle purchased a large lot on a lake in anticipation of building his home there within 3 years.  During the current year, Kyle paid $650 in property taxes and $2,500 of interest on the demand loan he obtained to purchase the lot.   January to March he rented out the lot to a local snowmobile club for $1,500.  Which of the following statements is correct?

A. Kyle cannot deduct any of the property taxes or interest paid for the vacant lot.

B. Kyle can deduct the $650 of property taxes paid, but none of the interest paid.

C. Kyle can deduct the $650 of property taxes paid and $850 of the interest paid.

D. Kyle can deduct all of the property taxes and interest paid.

24. Tomas began his unincorporated business on January 1, 2017.  During 2017, he received $40,000 cash in revenues and paid $33,000 for operating expenses.  On December 31, 2017 one of his customers owed him $1,200 and Tomas owed one of his suppliers $2,300.  In addition to the operating expenses, Tomas can also deduct one-third of his house costs since he operates his business out of the ground floor of his rented 3-storey home.  Total house costs for 2017 were:  rent of $19,200; insurance of $800; utilities of $2,100.  Tomas’ maximum work space in the home expense deduction for 2017 is:

A. $5,900.

B. $7,000.

C. $7,100.

D. $7,367.

25. Busy Company incurred the following meal costs during 2017:

Meals with Clients:

Cost of clients’ and employees’ meals  $10,000

Gratuities (tips)   1,500 $11,500

Company Christmas Party    4,100

Management Dinner Meetings    1,800

Family Picnic (Management only)    1,200

Meal allowances paid to employees during eligible business travel

(100 days @ $51 per day)    5,100

Total $23,700

The total deductible meal expense for tax purposes is:

A. $11,100

B. $11,850

C. $13,300

D. $13,900

26. 888 Company leased a car throughout 2017 for $950 per month, $75 of which was for insurance.  There was no down payment or refundable deposit.  The manufacturer’s suggested list price for the car is $38,000.  Other costs incurred for the vehicle during 2017 were $1,600 for gas and $420 for repairs.

The maximum tax deduction for 2017 vehicle expenses is:

A. $11,753

B. $12,653

C. $12,672

D. $13,420

Specific Deductions

27. With respect to deductions in the determination of net business income for tax purposes, which of the following statements is correct?

A. A corporation can deduct the costs of issuing new common shares in the year in which the shares are issued.

B. Any premium on the sale of new debt securities by a corporation is amortized over the life of the securities.

C. Cost of sales can be determined using inventory valuation based on either replacement cost or net realizable value.

D. Landscaping costs are deductible in the year that they are accrued.

28. For tax purposes, the cost of the end of period inventory can be determined in a variety of ways.  Which of the following approaches **CANNOT** be used?

A. Last-In, First-Out.

B. First-In, First-Out.

C. Specific Identification.

D. Average Cost.

29. Which of the following items is **NOT** deductible in calculating net business income for the current taxation year?

A. An $11,000 legal fee paid for services rendered in conjunction with a new issue of the company’s common stock.

B. A $125,000 management bonus paid 125 days after the end of the corporation’s current taxation year.

C. An amount of $25,000 paid for planting large maple trees in various locations on the grounds of the company’s facilities.

D. A $10,000 contribution to a company pension fund.

30. Which of the following business expenses is deductible for tax purposes?

A. $25 late filing penalty charged by CRA.

B. $50 speeding ticket incurred while delivering goods to a customer.

C. $15 late payment interest charged by utility company.

D. $20 late payment interest charged by CRA.

31. Which of the following is a deductible expense for an unincorporated business?

A. Donation made to the United Way.

B. Contribution made to the Federal Green Party.

C. Estimated cost of providing warranty services in future taxation years.

D. Reasonable salary paid to a relative.

32. Old Time Company purchased a Class 10 truck many years ago for $8,000.  The truck has now become a collectors’ item and was sold on August 1, 2017 for $10,000.  The net book value on that date was $500 and the Class 10 UCC balance was $11,525.  There are other assets left in the class.   Accounting net income before tax for the year ended December 31, 2017 was $24,000.  Amortization of depreciable capital assets for accounting purposes is equal to the CCA deducted for tax purposes.  Net income for tax purposes is:

A. $15,000.

B. $15,500.

C. $25,000.

D. $26,000.

33. Sea Tour Company’s accounting net income for 2017 is $12,200.  This includes amortization expense for a boat that was purchased for $28,000 in 2016.  The boat is amortized on the straight-line basis over 10 years with no estimated residual value.  For tax purposes, it is in Class 7, a declining balance class with a rate of 15 percent.  Minimum net income for tax purposes for 2017 is:

A. $11,115.

B. $11,430.

C. $15,000.

D. $8,315.

34. Maria has her own accounting practice in Victoria, B.C.  During 2017 she paid $1,650 to attend  the following conventions:

$400 for a 2 day convention on “Tax issues for the owner/manager” held at Vancouver, B.C.

$500 for a  3 day convention on “Attracting new clients” held at Kelowna, B.C.

$750 for a 5 day convention on “IFRS implementation” held at Whistler, B.C.

Maria’s total deductible convention expense for tax purposes is:

A. $1,650

B. $1,250

C. $1,050

D. $825

35. Widget Production Ltd. has a fiscal year end of June 30.  In February 2015, the Company borrowed $750,000 to fund an expansion.  The Company paid $21,000 to obtain this financing.  In January 2016, the Company repaid $250,000 of the principal and in June 2017, it repaid the remaining $500,000.  All repayments were made from cash flow from operations.  For tax purposes, which one of the following schedule of claims represents the **most** rapid method of claiming the costs of obtaining this financing.

A. $4,200 in each of fiscal 2015 through 2019.

B. $4,200 in each of 2015 and 2016, and the remaining $12,600 in 2017.

C. $4,200 in 2015, $8,400 in 2016, and $8,400 in 2017.

D. $7,000 in 2016 and $14,000 in 2017.

36. Quality Homes Ltd. (Quality) has a December 31, 2017 year end.  The controller has calculated the Company’s 2017 income as $50,000.  However, in arriving at this amount, the controller deducted $30,000 of salary to an employee who is the sole shareholder of the Company and $5,000 of salary to an arm’s length employee.  Both of these amounts were paid on June 30, 2018.  Which one of the following represents Quality’s 2017 Net Income For Tax Purposes?

A. $50,000.

B. $55,000.

C. $80,000.

D. $85,000.

37. Mary operates a proprietorship that generated $100,000 in income under GAAP. Included in this amount are:

$7,000 of amortization expense;

$4,000 for bad debt expense;

$112,000 cost of goods sold; and

$12,000 meals and entertainment with clients.

Mary’s maximum CCA has been calculated at $10,000 for the year. How much is Mary’s business income for tax purposes?

A. $113,000

B. $109,000

C. $107,000

D. $103,000

Taxation Year

38. Jon Avery starts an unincorporated business on December 1, 2017.  Which of the following statements is correct with respect to Jon’s taxation year end?

A. Jon must select December 31 as his taxation year end.

B. Jon must select November 30 as his taxation year end.

C. Jon can choose any date for his year end.  However, if Jon chooses a non-calendar year end he will have to adjust his income by an amount referred to as “additional business income”.

D. Jon can choose any date for his year end.  However, if Jon chooses a non-calendar year end he will have to report income for his first two fiscal years in his 2018 tax return.

Special Business Income Situations

39. During 2017, an individual sells his incorporated business for its fair market value.  At the time of the sale the business has accounts receivable of $123,000.  The vendor of the business and the purchaser agree on a fair market value for these receivables of $118,500.  In 2016, the vendor had deducted a reserve for estimated bad debts of $6,800.  Which of the following statements is correct?

A. If no election is made, the vendor will have an addition to net business income for tax purposes of $2,300.

B. If no election is made, the vendor will have an addition to  net business income for tax purposes of $4,550.

C. If an election is made under ITA 22, the vendor will have a deduction in the determination of net business income for tax purposes of $2,300.

D. If an election is made under ITA 22, the vendor will have a deduction in the determination of net business income for tax purposes of $4,500.

40. Ginger has her own accounting practice and her fiscal year end is December 31.  Her regular billing rate is $100 per hour.  One of her clients has a November 30 year end.  Work is done on the file during December and January and the client is billed on February 1 of each year.  Billable hours for this client are as follows:

Dec. 2016 Jan. 2017 Dec. 2017 Jan. 2018

For Nov. 30, 2016 year end 25 35

For Nov. 30, 2017 year end 32 30

Ginger’s 2017 Net Income For Tax Purposes for this particular client is:

A. $6,200 on the accrual basis or $5,500 on the billed basis of recognition

B. $6,200 on the accrual basis or $6,000 on the billed basis of recognition

C. $6,700 on the accrual basis or $6,000 on the billed basis of recognition

D. $6,700 on the accrual basis and the billed basis of recognition

41. Which of the following statements regarding farming income is correct?

A. A full time school teacher has income from his part-time farming activities. His farming income must be calculated on a cash basis.

B. A full time school teacher recognized a $9,500 loss this year from his part-time farming activities. The maximum deduction allowed this year from the farm loss is $6,000.

C. A full time school teacher recognized a $9,500 loss this year from his part-time farming activities. The maximum deduction allowed this year from the farm loss is $2,500.

D. A full time school teacher has income from his part-time farming activities. His farming income must be calculated on an accrual basis.

TIF Problem Six - 4

Business Income - Exam Exercises

Exam Exercise Subject Listing For Chapter 6

|  |  |
| --- | --- |
| **Number** | **Subject** |
| 1 | Business Vs. Property Income |
| 2 | Business Income Vs. Capital Gain |
| 3 | Business Income Vs. Capital Gain |
| 4 | Reserve For Bad Debts |
| 5 | Reserve For Bad Debts |
| 6 | Bad Debts And Undelivered Services |
| 7 | Bad Debts And Undelivered Services |
| 8 | Reserve For Unpaid Amounts |
| 9 | Reserve For Unpaid Amounts |
| 10 | Interest In Thin Capitalization |
| 11 | Interest In Thin Capitalization |
| 12 | Work Space In The Home Costs |
| 13 | Work Space In The Home Costs |
| 14 | Automobile Ownership Costs |
| 15 | Automobile Ownership Costs |
| 16 | Automobile Leasing Costs |
| 17 | Automobile Leasing Costs |
| 18 | Leases: Tax Vs. GAAP |
| 19 | Inventory Valuation |
| 20 | Additional Business Income |
| 21 | Professional Income |
| 22 | Professional Income |
| 23 | Sale Of Receivables |
| 24 | Sale Of Receivables |

Exam Exercise Six - 1 (Business Vs. Property Income)

Martin Elwood has purchased the rights to a group of songs written by the Ringtones.  He estimates that these songs will produce royalties of about $100,000 per year for at least 5 years.  He does not have plans to acquire additional song rights.  Explain whether the royalties he receives would be treated as business income or property income.  In addition, indicate how any gain or loss on their disposition would be taxed.

Exam Exercise Six - 2 (Business Income Vs. Capital Gains)

William Lemay acquired a six unit apartment building for $315,000 with the intention of operating it as a rental property.  Three weeks after his purchase, he received an unexpected offer to purchase the building for $387,000.  He accepts the offer.  Should the $72,000 be treated as a capital gain or as business income?  Justify your conclusion.

Exam Exercise Six - 3 (Business Income Vs. Capital Gains)

Several years ago, John Martin purchased a group of internet domain names at a cost of $1,000 each, hoping at some point that he could sell one or more at a later date.  Until this year, none of the names have been sold.  However, during this year, two of the names were sold for $25,000 each.  Should the resulting gains be treated as capital gains or as business income?  Justify your conclusion.

Exam Exercise Six - 4 (Bad Debts And Reserve For Doubtful Debts)

At the end of 2016, Barton’s Books has ending accounts receivable of $87,500.  Of this amount, it is estimated that $3,400 would prove uncollectible.  A reserve for tax purposes is deducted for this amount.  During 2017, $3,600 of accounts receivable are written off.  At the end of 2017, accounts receivable total $103,200, with $4,100 of this amount expected to be uncollectible.  By what amount will the 2017 net business income of Barton’s Books be increased or decreased by the preceding information with respect to bad debts?

Exam Exercise Six - 5 (Bad Debts And Reserve For Doubtful Debts)

During 2017, Leslie’s Boutique wrote off $13,000 in accounts receivable as uncollectible.  At the end of this year, the accounts receivable balance was $256,400.  Based on past experience, it is expected that 4 percent of these accounts will prove uncollectible.  In its 2016 tax return, Leslie’s Boutique had deducted a reserve for bad debts of $12,300.  By what amount will the 2017 net business income of Leslie’s Boutique be increased or decreased by the preceding information with respect to bad debts?

Exam Exercise Six - 6 (Reserve For Doubtful Debts And Undelivered Services)

Frank’s Auto Body, an unincorporated business, keeps its records on a cash basis.  During 2017, its first year of operation, the business has cash sales of $71,200.  At the end of the year, an additional $22,450 of revenues was receivable.  Of the amounts received, $7,100 was for services that will be delivered during 2018.  Frank estimates that $650 of the end of year receivable amounts will be uncollectible. By what amount will the 2017 net business income of Frank’s Auto Body be increased by the preceding information?

Exam Exercise Six - 7 (Reserve For Doubtful Debts And Undelivered Services)

Bob’s Hats is an unincorporated business.  During 2017, its first year of operations, the business has cash sales of $123,000.  It also has account sales of $46,000, of which $22,000 remains uncollected at the end of 2017.  It is estimated that $4,000 of these accounts will be uncollectible.  Of the cash amounts received, $9,500 is for merchandise that will be delivered in 2018.  By what amount will the 2017 net business income of Bob’s Hats be increased by the preceding information?

Exam Exercise Six - 8 (Reserve For Unpaid Amounts)

During February, 2017, Jacob’s Jewels sells a brooch for $428,000.  The cost to the business of this brooch was $212,000, resulting in a gross profit of $216,000.  The $428,000 sales price is to be paid in four equal annual instalments on December 31 in each of the years 2018 through 2021.  Jacob’s Jewels has a December 31 year end.  Indicate the amount of the reserve that can be deducted, and the net business income, for each of the years 2017 through 2021.

Exam Exercise Six - 9 (Reserve For Unpaid Amounts)

In January, 2017, Marty’s Fine Pens sells a limited edition fountain pen for $125,000.  The cost of the pen is $63,000.  There is a down payment of 40 percent in 2017, followed by 3 annual payments of 20 percent in the years 2018, 2019, and 2020.  Indicate the amount of the reserve that can be deducted, and the net business income, for each of the years 2017 through 2020.

Exam Exercise Six - 10 (Interest In Thin Capitalizations)

On January 1, 2016, a new Canadian corporation is created by issuing $9,100,000 in debt securities and $2,100,000 in common shares.  The debt securities pay interest at 7 percent.  The new corporation will use December 31 as its year end.  At the time the corporation is formed, Mr. Phillip Roundtree, who is a resident of England, acquires $5,250,000 of the debt securities and 29 percent of the common shares.   On January 1, 2017 the Retained Earnings balance of the corporation is $750,000.  How much, if any, of the interest paid in 2017 on Mr. Roundtree’s holding of debt securities would be disallowed under the thin capitalization rules in ITA 18(4)?

Exam Exercise Six - 11 (Interest In Thin Capitalizations)

On February 28, 2016, a new Canadian corporation is created by issuing $12,200,000 in debt securities and $2,500,000 in common shares.  The debt securities pay interest at 9 percent.  The corporation has elected a December 31 year end.  Of the securities issued by the new corporation, one-half of the debt securities and $1,000,000 of the common shares are acquired by Nathalie Bergeron, a resident of France.  As of January 1, 2017, the Retained Earnings balance of the corporation is $560,000.  How much, if any, of the interest paid in 2017 on Ms. Bergeron’s holding of debt securities would be disallowed under the thin capitalization rules in ITA 18(4)?

Exam Exercise Six - 12 (Work Space In The Home Costs)

During the current year, Janice Teason has the following costs:

Utility Costs For Home $3,200

Maintenance And Repairs For Home 3,800

Property Taxes For Home 6,400

House Insurance 1,800

Interest On Mortgage 6,200

Home Telephone:

Monthly Charge 480

Personal Long Distance Charges 275

Employment/Business Related Long Distance Charges 780

Home Internet Service Fees 675

Ms. Teason estimates that she uses 30 percent of her residence and 40 percent of her home phone and home internet  service for employment/business related purposes.  Maximum CCA on 100 percent of the house would be $15,000.  Determine the maximum deduction that would be available to Ms. Teason assuming:

A. She is an employee with $80,000 in income (no commissions).

B. She is an employee with $80,000 in commission income.

C. She is self-employed and earns $80,000 in business income.

Exam Exercise Six - 13 (Work Space In The Home Costs)

During the current year, Jonathan Beasley has the following costs:

Utility Costs For Home $2,500

Maintenance And Repairs For Home 3,100

Property Taxes For Home 5,400

House Insurance 1,300

Interest On Mortgage 4,600

Home Telephone Monthly Charge 600

Separate Line To Home Work Space Monthly Charge 480

Employment/Business Related Long Distance Charges 560

Home Internet Service Fees 720

Mr. Beasley estimates that he uses 18 percent of his residence and 30 percent of his home internet  service for employment/business related purposes.  Maximum CCA on 100 percent of the house would be $12,000.  Determine the maximum deduction that would be available to Mr. Beasley assuming:

A. He is an employee with $72,000 in income (no commissions).

B. He is an employee with $72,000 in commission income.

C. He is self-employed and earns $72,000 in business income.

Exam Exercise Six - 14 (Automobile Ownership Costs)

Mr. Alex Roddle acquires an automobile to be used 100 percent of the time in his unincorporated business.  This business has been in operation for several years.  The purchase occurs on October 1, 2017 at a cost of $83,000.  He finances $70,000 of the car purchase through his bank at an annual rate of 9 percent.  Interest charges for the period October 1, 2017 through December 31, 2017 amount to $1,575.  What amounts can Mr. Roddle deduct in his 2017 tax return with respect to this acquisition?  Ignore GST and PST considerations.

Exam Exercise Six - 15 (Automobile Ownership Costs)

For a number of years, Ms. Alexandria Bouclair has operated an unincorporated business.  Because of a growing need to travel for this business, on September 1, 2017, she acquires an automobile that will be used 100 percent for business.  The cost of the automobile is $63,000, of which $50,000 is financed by the dealer.  Interest charges for the period September 1, 2017 through December 31, 2017 total $2,000.   What amounts can Ms. Bouclair deduct in her 2017 tax return with respect to this acquisition?  Ignore GST and PST considerations.

Exam Exercise Six - 16 (Automobile Leasing Costs)

On November 1, 2017, Ms. Sherry Boland leases an automobile to be used 100 percent of the time in her unincorporated business.  The lease cost is $862 per month, and a total of $1,724 was paid for the year.  The manufacturer’s suggested list price for the automobile is $53,000.  Ms. Boland makes no down payment and no refundable deposits.  Determine her maximum deduction for lease payments for 2017.  Ignore GST and PST considerations.

Exam Exercise Six - 17 (Automobile Leasing Costs)

On August 1, 2017, Mr. Jimmy Bond leases an automobile that will be used 100 percent by his unincorporated business.  The monthly lease payment is $797, with a total of $3,985 being paid during 2017.  The manufacturer’s list price for the vehicle is $61,000.  Mr. Bond makes no down payment and no refundable deposit is required.  Determine his maximum deduction for lease payments for 2017.  Ignore GST and PST considerations.

Exam Exercise Six - 18 (Leases:  Tax Vs. GAAP)

Sharp Ltd. signs an 8 year lease for an asset with an economic life of 9 years.  The lease payments are $32,500 per year.  Compare the tax treatment of the lease with its treatment under GAAP.

Exam Exercise Six - 19 (Inventory Valuation)

Morton Enterprises sells a single product which it buys from various manufacturers.  It has a December 31 fiscal year end.  During 2017, its first year of operations, purchases of this item were as follows:

**Date Quantity Price**

February 1 7,500 $23.00

May 23 5,000 28.00

August 18 6,800 21.00

October 28 5,300 25.00

On December 31, 2017, 7,800 of these items are still on hand.  Their replacement cost on this date is $24.00 and they are being sold for $31.00.  It is estimated that selling costs average 20 percent of the sales price.  It is not possible to identify the individual items being sold.  Calculate all the values that could be used for the 7,800 remaining units for tax purposes, identifying the method you used for each value.

Exam Exercise Six - 20 (Additional Business Income)

Ms. Melinda Gabor starts a business on May 1, 2017.  After some consideration, she concludes that it would be best to have a fiscal year that ends on September 30.  During the period May 1, 2017 through September 30, 2017, her business has income of $23,500.  What amount of business income will Ms. Gabor report in her personal tax return for the year ending December 31, 2017?

Exam Exercise Six - 21 (Professional Income - Billed Basis Of Recognition)

Ms. Joan Vickers is an accountant and, at the beginning of the current year, she had unbilled work in process of $41,400, as well as uncollected billings of $48,700.  During the year, she bills the remaining work in process and collects all of these new receivables, as well as the uncollected amounts that were present at the beginning of the year.  Her work during the year totals potential billings of $206,350.  Of this amount, $171,300 has been billed and $152,100 of these billings have been collected.  Calculate her inclusion in net business income for the year using:

the cash basis;

the billed basis;  and

accrual accounting.

Exam Exercise Six - 22 (Professional Income - Billed Basis Of Recognition)

Mr. Jonathan Volke is a lawyer with a medium sized practice in Halifax.  At the beginning of 2017, he had unbilled work in process of $23,800, as well as uncollected billings of $27,200.  During 2017, he bills all of the opening work in process.  Also during 2017, his work creates potential billings of $187,200.  Of this amount, $156,300 has been billed by the end of the year.  Collections during the year include all of the opening $23,800 of unbilled amounts, all of the $27,200 of opening uncollected billings, as well as $124,600 of the $156,300 of new work that was billed during the year.  Calculate his inclusion in net business income for the year using:

* the cash basis;
* the billed basis;  and
* accrual accounting.

Exam Exercise Six - 23 (ITA 22 Election On Receivables)

Mr. Brian Brock is selling his unincorporated business during 2017.  Included in his assets are accounts receivable with a face value of $87,560.  He and the purchaser of the business have agreed that the net realizable value of these receivables is $82,150.  In 2016, he deducted a reserve for doubtful debts of $4,800.  Determine the tax effect of selling these receivables for Mr. Brock, provided that he and the purchaser jointly elect under ITA 22.

Exam Exercise Six - 24 (ITA 22 Election On Receivables)

Ms. Brooke Besson is selling her unincorporated business during 2017.  Included in the assets of this business are accounts receivable with a face value of $68,500.  She and the purchaser of her business have reached an agreement that the net realizable value of these receivables is $65,300.  In 2016, Ms. Besson deducted a reserve for doubtful debts of $4,200.  Determine the tax effect of selling these receivable for Ms. Besson, assuming that:

* she and the purchaser do not elect under ITA 22;  and
* she and the purchaser jointly elect under ITA 22.

TIF Problem Six - 5A

Business Income - Key Term Matching (Easy)

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

Version A is easy, there is only one possible answer for each term.

Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms were listed at the end of Chapter 6, “Income Or Loss From A Business”.

A. Accrual Basis

B. Billed Basis

C. Hobby Farmer

D. Business Income

E. Reserve

F. Restricted Farm Loss

G. Net Business Income

H. Thin Capitalization

The following list contains 10 potential definitions for the preceding key terms.

1. Income that is earned through active business activity.  This would include amounts earned by producing goods, selling goods or services, or delivering services.

2. A method of accounting for income based on cash receipts and cash disbursements.

3. Situations where a non-resident specified shareholder is receiving interest on an amount of debt that exceeds 1.5 times the sum of his share of contributed capital plus 100 percent of retained earnings.

4. A deduction in the calculation of net business income or net taxable capital gains.

5. The period that is covered by a taxpayer’s return.

6. A self-sustaining integrated set of activities and assets conducted and managed for the purpose of providing a return to investors.

7. The net of inclusions less deductions, related to business income, with all amounts determined as per Division B, Subdivision b, of the *Income Tax Ac*t.

8. A method of determining net business income based on recording inclusions when the relevant amounts are billed.

9. A method of accounting for income based on recording assets when the right to receive them is established and liabilities when the obligation to pay them arises.

10. A part-time farmer who does not have a reasonable expectation of profit.

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

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

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

TIF Problem Six - 5B

Business Income - Key Term Matching (Moderate)

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

Version A is easy, there is only one possible answer for each term.

Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms were listed at the end of Chapter 6, “Income Or Loss From A Business”.

A. Accrual Basis

B. Billed Basis

C. Hobby Farmer

D. Business Income

E. Reserve

F. Restricted Farm Loss

G. Net Business Income

H. Thin Capitalization

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

1. Income that is earned through active business activity.  This would include amounts earned by producing goods, selling goods or services, or delivering services.

2. A method of accounting for income based on cash receipts and cash disbursements.

3. Income that is earned through active business activity.  This would include amounts earned by producing goods, selling goods or services, or selling capital assets.

4. A method of determining net business income based on recording deductions when the relevant amounts are billed.

5. Situations where a non-resident specified shareholder is receiving interest on an amount of debt that exceeds 1.5 times the sum of his share of contributed capital plus 100 percent of retained earnings.

6. A deduction in the calculation of net business income or net taxable capital gains.

7. The period that is covered by a taxpayer’s return.

8. A self-sustaining integrated set of activities and assets conducted and managed for the purpose of providing a return to investors.

9. The net of inclusions less deductions, related to business income, with all amounts determined as per Division B, Subdivision b, of the *Income Tax Ac*t.

10. An amount of resources set aside to provide for future obligations.

11. A method of determining net business income based on recording inclusions when the relevant amounts are billed.

12. A method of accounting for income based on recording assets when the right to receive them is established and liabilities when the obligation to pay them arises.

13. A farmer who operates a farm as a hobby, but has a reasonable expectation of making a profit.

14. A part-time farmer who does not have a reasonable expectation of profit.

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

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

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

TIF Problem Six - 6

Reserves

Opal Schwartz owns and manages an unincorporated business that offers interior decorating services to individuals and businesses.  This business began operating on January 1, 2017 and has a taxation year that ends on December 31.

The following information relates to the year ending December 31, 2017:

* Sales of delivered merchandise and services totaled $259,000.  As of December 31, $88,000 of this total had not been collected.  As several of her clients are having financial difficulties, she anticipates that $7,000 of these outstanding accounts will not be collectible.
* In addition to sales of delivered merchandise, the business received deposits on orders in the amount of $27,000.  This merchandise is scheduled to be delivered in early 2018.
* Opal purchased a large stock of top quality decorating materials from the trustee of a bankrupt decorating business.  Since the material is too rococo to appeal to her clientele, she has found another decorating business that is prepared to buy these materials for $62,000.  Her cost for these materials is $47,000, resulting in an anticipated gross profit of $15,000.  Because of the size of the sale, she has accepted a down payment of $22,000, followed by two annual instalments of $20,000.  The instalments are due on December 31, 2018 and December 31, 2019.

The following information relates to the year ending December 31, 2018:

* A total of $6,500 of accounts receivable were written off during the year.
* All of the merchandise on which 2017 deposits were received was delivered.
* The $20,000 instalment on the large project was received.
* Sales of delivered merchandise and services totaled $360,000.  As of December 31, $72,000 of this total had not been collected.  Opal anticipates that $9,500 of these outstanding accounts will not be collectible.
* In addition to sales of delivered merchandise, the business received deposits on orders in the amount of $21,000.  This merchandise is scheduled to be delivered in early 2019.

**Required:** How would the preceding information affect the calculation of Opal Schwartz’s business income for the 2017 and 2018 taxation years?  Include the full details of your calculations for each year, not just the net result for each year.  Ignore GST/PST implications.

TIF Problem Six - 7

Work Space In Home Costs And CCA

In order to supplement his income working in a Calgary bookstore, Mr. Victor Larson has decided to start a home based business that will specialize in selling used textbooks to university and college students.

The business will be run out of space that he has set aside in his residence.  This space involves 18 percent of the total floor space in the residence.

The residence was acquired on January 1, 2017 at a total cost of $426,000.  It is estimated that $150,000 of this total value can be attributed to the land on which the residence is situated.  For the year ending December 31, 2017, Mr. Larson has the following costs that can be associated with this residence:

Utilities For Home (Heat, Light, And Water) $ 3,200

Mortgage Interest Paid 10,100

House Insurance 500

Property Taxes 4,300

Repairs And Maintenance For Home 2,600

Total $20,700

The business begins operations on January 31, 2017.  On that date, Mr. Larson acquires the following assets to be used in his new business:

Office Furniture And Storage Racks $18,500

Computer 1,430

Business Software 570

In addition, he has a separate telephone line installed for dealing exclusively with the mail order business.  The telephone charge includes charges for a toll-free number and a long distance package.

During the period January 31, 2017 through December 31, 2017, his mail order sales total $182,000.  Costs associated with these sales are as follows:

Cost Of Merchandise Sold $98,000

Unsold Merchandise (Lower Of Cost And Market) 23,500

Packaging Materials 2,400

Shipping Costs 4,600

Miscellaneous Office Supplies 560

Telephone (Total Charge For The Period) 1,100

Printing Of Posters And Brochures Distributed 420

**Required:**

A. Can Mr. Larson deduct work space in the home costs?  Briefly explain your conclusion.

B. Compute the minimum net business income or loss that Mr. Larson must report in his 2017 personal income tax return.

C. Briefly describe any issues that should be discussed with Mr. Larson concerning the work space in his home and business costs.

TIF Problem Six - 8

Automobile Costs And Benefits

Maxine’s Cleaning Services is a Canadian controlled private corporation with a December 31 year end.  Maxine Brott is the sole shareholder of the corporation and actively participates in the operation of the business as an employee.

Because of the extensive travel required in supervising her employees, the Company provides Ms. Brott with a car.  During the first 6 months of 2017, the provided car was a Honda Accord that had been purchased in 2016 for $29,000.  During this 6 month period, she drove the car a total of 23,000 kilometers, of which 15,000 were related to her employment activities.  The Class 10 UCC balance at the beginning of 2017 was $24,650.

On July 1, 2017, the Honda Accord was sold for $25,000.  It was replaced with a BMW 7 Series sedan at a cost of $105,000.  During the period July 1, 2017 through December 31, 2017, she drove this vehicle a total of 37,000 kilometers, of which 18,000 were related to her employment activities.

Throughout 2017, the Company paid for all of the operating costs of both vehicles, a total of $12,300.

Other than the Honda Accord and the BMW sedan, the Company did not own any other vehicles during 2017.  During the period January 1, 2017 through December 31, 2017, an automobile was always available to Ms. Brott.

**Required:**  Determine the following:

A. The tax consequences to Maxine’s Cleaning Services that result from owning and selling the Honda Accord and owning the BMW sedan during 2017.

B. The minimum amount of the taxable benefit that Maxine will have to include in her Net Income For Tax Purposes for 2017.

Ignore GST and PST considerations in both parts of this question.

TIF Problem Six - 9

Inventory Valuation

Arnold Fortin owns and operates an unincorporated business which sells hockey jerseys for school teams.  The business has a December 31 year end.  During his first year of operations, he has the following purchases:

**Date Quantity Price Total Cost**

January 20 2,200 $17.00 $ 37,400

March 12 1,800 $18.50 33,300

June 15 6,600 $20.25 133,650

October 8 3,200 $21.42 68,544

December 9 1,500 $16.50 24,750

Totals 15,300 $297,644

On December 31, the end of his first year of operation, the inventory on hand amounts to 5,000 units.  It is estimated that these units have a replacement cost of $16.75 per unit and a net realizable value of $18.30 per unit.

**Required:** Calculate the various closing inventory values that could be used to determine business income for tax purposes.  Your answer should indicate the valuation method being used, as well as the resulting value.

TIF Problem Six - 10

Deductible Business Expenses - Corporation

The Vernon Manufacturing Company, a Canadian controlled private corporation, has just ended its first fiscal year.  During that year, a number of outlays were made for which the Company is uncertain as to the appropriate tax treatment.  You have been asked to advise them in this matter and, to that end, you have been provided with the list of outlays and expenditures that follows:

1. A part of the Company’s raw materials had to be imported from Brazil.  In order to obtain local financing for these inventories, the Company paid a $1,200 fee to a Brazilian financial consultant for assistance in locating the required financing.

2. Donations totalling $12,000 were given to various registered Canadian charities.

3. The Company paid $2,500 to the owner of a tract of land in return for an option to purchase the land for $950,000 for a period of 2 years.  The land is adjacent to the Company’s main factory and management believes it may be required for future expansion of the Company’s manufacturing facilities.

4. Direct costs of $7,500, related to incorporating the Company, were incurred during the year.

5. An amount of $10,000 was paid for a franchise giving the Company the right to manufacture a Brazilian consumer product for a period of ten years.

6. Because of its rapid growth, the Company was forced to move into a building that they had originally leased to another company.  In order to cancel the lease, it paid $8,000 to the tenant.  In addition, $9,500 was spent to landscape the facilities and another $13,000 was spent to provide a parking lot for employees.

**Required:** Indicate which of the preceding expenditures you feel that the Vernon Manufacturing Company will be able to deduct in the calculation of net business income for the current year, and the tax treatment of the non-deductible expenditures.  Explain your conclusions.

TIF Problem Six - 11

Reverse Comprehensive Business Income

Brown’s Forms is a proprietorship owned by Nathan Brown.  It has been in operation for several years and has always used a taxation year that ends on December 31.

Because he has had no need to report his income figures to anyone, as a matter of convenience, he has simply used tax procedures to calculate the annual income of the business.  This has allowed him to use this figure in reporting his net business income in his tax return.

For the year ending December 31, 2017, using his usual tax procedures, Nathan has calculated his net business income to be $401,300.

As his business has been very successful, he would like to open a second location.  However, in order to do this, he will need financing from his bank.  In discussing this with his account manager, he has been advised that he will need to present financial statements prepared in accordance with generally accepted accounting principles (GAAP).

While he is uncertain as to whether he will proceed with opening a second location, he has asked you to assist him in determining how much GAAP based income Brown’s Forms had for 2017.

**Other Information:**

1. Nathan deducted $42,100, the maximum amount of CCA that was available for the year.  You have determined that amortization under GAAP would have been $36,400.

2. In late December, 2017, Nathan spent $12,000 on landscaping the grounds around his original location.  Given the late date at which this work was done, no amortization would be required for accounting purposes with respect to these costs for 2017.  It is expected that these landscaping improvements will last at least 10 years.

3. His son, Nathaniel, who is majoring in computer science at a local university, designed the web site for Nathan’s business 2 years ago.  Since then, Nathaniel has maintained and updated this site.  During 2017, Nathan paid Nathaniel $12,200 for his work.  This amount was deducted in his net business income calculation.

4. During 2017, Nathan sold Class 8 assets for $14,200.  These assets had a capital cost of $21,400 and were not the last assets in Class 8.  There was a positive balance in Class 8 at the end of the year.  If these assets had been subject to GAAP amortization, their net book value would have been $12,600.

5. Nathan spent $5,500 advertising on a U.S. television station.  The commercials were directed at Canadian resident viewers.

6. In the net business income calculation based on tax procedures, Nathan deducted $6,000 in business meals and entertainment costs.

7. One of Nathan’s workers stole cash receipts totaling $4,300.

8. Nathan owns 2 delivery vehicles with a capital cost of $23,000 each.  They are the only assets in Class 10 which has a UCC balance of $19,159 on January 1, 2017.  During 2017, the two vehicles were sold for a total of $15,000.  If the vehicles had been subject to GAAP amortization, their net book value at the time of sale would have been $11,776 each for a total of $23,552.

9. During 2017, the business made charitable donations of $4,200.

10. During 2017, the business provided uniforms for the local girls soccer team.  The cost of these uniforms was $2,500.  Nathan thought that this would be good advertising as the name of his business was displayed prominently on the team jerseys.

11. For tax purposes, the ending inventories of the business were carried at the market value of $123,000.  Their total cost, determined on a FIFO basis, was $118,000.

12. As the business is unincorporated, no taxes were deducted in calculating Net Income.

**Required:** Determine the 2017 GAAP based net income for Brown’s Forms.  Do not include in your calculations any tax that Nathan will have to pay on this income.  If you do not use some of the items included in other information, indicate why this is the case.

TIF Problem Six - 12

Business Income - Proprietorship

Fairway Distribution is a proprietorship.  The business distributes a wide variety of health aid products to retailers. The business is owned by John Fairway.  His wife, Jane Fairway, is an avid golfer with no interest or experience in business matters.

For the taxation year ended December 31, 2017, the accountant calculated a pre-tax Net Income for Fairway Distribution of $273,000.  In calculating this figure, Mr. Fairway’s accountant relied on generally accepted accounting principles except for the fact that no provision is made at the end of the year for anticipated bad debts.  This variance from generally accepted accounting principles resulted from the accountant’s belief that Mr. Fairway is a much more reasonable and pleasant person when he is presented with a higher Net Income figure.

**Other Information** Other information related to the 2017 taxation year is as follows:

1. In the previous year, a reserve for bad debts was deducted for tax purposes in the amount of $15,000.  For accounting purposes, only the actual 2017 write-offs of $17,500 were deducted.  The accountant felt that an appropriate reserve to be deducted for tax purposes at the end of 2017 would be $19,200.

2. Accounting income included a deduction for amortization in the amount of $78,500.  The accountant has determined that the maximum CCA for 2017 would be $123,600.

3. The following items were included in the accounting expenses:

Cost of advertising in a foreign newspaper

that is distributed in Canada $ 3,500

Donations to registered charities 1,260

Cost of appraisal on real estate to be sold 1,470

Costs of landscaping work done on the

grounds of Mr. Fairway’s personal estate 5,260

Management fee to Mrs. Jane Fairway 123,000

4. As the business is unincorporated, no taxes were deducted in calculating Net Income.

**Required**:  Calculate the minimum net business income for Fairway Distribution that will be included in Mr. Fairway’s tax return for the year ending December 31, 2017.

TIF Problem Six - 13

Business Income - Proprietorship

For the year ending December 31, 2017, the Income Statement of Markham Ltd., prepared in accordance with generally accepted accounting principles, is as follows:

Revenues $973,000

Expenses:

Cost Of Goods Sold ($272,000)

Selling And Administrative Costs ( 132,000)

Amortization Expense ( 156,000)

Other Expenses ( 137,000) ( 697,000)

Income Before Tax Expense $276,000

Income Tax Expense:

Current ($ 97,000)

Future ( 32,000) ( 129,000)

Net Income $147,000

**Other Information:**

1. The Company spent $6,000 during the year on landscaping for its new building.  For accounting purposes this was treated as an asset.  The Company will not amortize this balance as it believes the work has an unlimited life.

2. Selling And Administrative Costs include $15,000 in business meals and entertainment.

3. Other Expenses include contributions to registered charities of $3,700.

4. As the Company expects to issue more shares during 2018, it made a number of amendments to its articles of incorporation in 2017 and included the legal costs in Other Expenses.  These costs totalled $6,000.

5. During 2016, Markham Ltd. acquired a competing business at a price that included goodwill of $70,000.  For accounting purposes, there is no impairment or write-down of the goodwill purchased in either year.

6. Other Expenses includes bond discount amortization of $2,500.

7. Selling And Administrative Costs include membership fees for several employees in a local golf and country club.  These fees total $3,400.

8. On January 1, 2017, the Company had the following UCC balances:

Class 1 $400,000

Class 8 575,000

Class 10 45,000

Class 13 68,000

The Class 1 balance relates to a single building acquired in 2000 at a cost of $550,000.  It is estimated that the value of the land at this time was $50,000.  On February 1, 2017, this building is sold for $612,000.  It is estimated that the value of the land is unchanged at $50,000.  In the accounting records, this real property was carried at $507,000, $457,000 for the building and $50,000 for the land.  The resulting gain on the building is included in the accounting revenues.

The old building is replaced on February 15, 2017 with a new building acquired at a cost of $683,000 of which $60,000 is allocated to land.  The Company chose not to put the new building into a separate Class 1 so it does not qualify for the 6 percent CCA rate.  No elections are made with respect to the replacement of the building.

There are no dispositions of Class 8 assets during the year.  However, there are acquisitions in the total amount of $126,000.

As the Company has decided to lease all of its vehicles in the future, all of the assets in Class 10 are sold during the year.  The capital cost of these assets was $93,000 and the proceeds of disposition amounted to $37,000.  The net book value of these assets was $52,000 and the resulting accounting loss of $15,000 was included in Other Expenses.

The Class 13 balance relates to a single lease that commenced on January 1, 2015.  The lease has an initial term of seven years, with two successive options to renew for three years each.  Expenditures on this leasehold were $50,000 in 2015 and $27,000 in 2016.  There were no further expenditures in 2017.  The write-off of these expenditures for accounting purposes is included in Amortization Expense.

9. Other Expenses includes interest on late income tax instalments of $500 and on late municipal tax payments of $275.

10. Markham Ltd. deducts maximum CCA.

**Required:** Determine Markham Ltd.’s 2017 minimum Net Income For Tax Purposes.  In addition, calculate the January 1, 2018 UCC for each CCA class.  Indicate why you have excluded some items from your calculations.

TIF Problem Six - 14

Business Income With CCA

Cody Jewel is an accountant who has not incorporated his professional practice.  The practice has a December 31 year end.

Cody operates his practice out of a building which he owns.  Cody purchased this building in 2014 for $550,000, with the estimated value of the land at that time being $125,000.  His practice occupies 100 percent of the building and, because it was a new building when he acquired it, it has been allocated to a separate Class 1.  On January 1, 2017, the building has a UCC of $380,000.

Because he is attracting an increasingly wealthy clientele, Cody has decided to upgrade his office.  During February, 2017, he replaces all of his old furniture and fixtures.  The old furniture and fixtures had a capital cost of $65,000 and a UCC of $41,000.  It is sold for $22,000.  The new furniture and fixtures have a capital cost of $136,000.

Other asset acquisitions during 2017 are as follows:

New Computer $1,800

Applications Software 2,700

Client List From Retiring Accountant 32,000

Because he has started to provide in-home services for many of his clients, he has a car which is used largely for this purpose.  Cody purchased this car for $56,000 on January 1, 2017.  During 2017, it is driven a total of 23,000 kilometers, of which 21,000 kilometers related to providing services for his clients.  Operating costs for the year totalled $4,140.

Other 2017 costs of operating his business, determined on an accrual basis, are as follows:

Building Operating Costs $18,600

Payments To Assistants 31,200

Miscellaneous Office Costs 9,400

Meals With Clients 10,500

On January 1, 2017, Cody had unbilled work-in-progress of $52,000, along with billed receivables of $64,000.  During 2017, his collections total $216,000.  On December 31, 2017, the unbilled work-in-progress has increased to $61,000 and the billed receivables have increased to $72,000.

**Required**: Calculate the minimum net business income Cody would include in his 2017 personal income tax return.  In preparing your solution, ignore GST and PST implications.

TIF Problem Six - 15

Business Income With CCA

Darby Inc. has just completed its fiscal year ended December 31, 2017.  Using GAAP, the accountant has determined that, for that taxation year , the Company has experienced a Net Loss Before Taxes and Amortization Expense of $113,000.  The accountant provides the following information that was used in the determination of the Net Loss for accounting purposes:

1. The Company was forced to pay damages of $12,300 for failure to perform a service contract.  The amount was paid when the client threatened to bring action for breach of contract.  The $12,300 was expensed in the current year.

2. The Company’s property tax expense of $19,500 includes an amount of $1,100 that was paid to a regional municipality in which the Company maintains a fishing lodge for its employees.

3. The Company’s expenses include contributions to registered charities of $13,700.

4. The Company’s expenses include costs of new landscaping at their administration building in the amount of $9,800.

5. The Company deducted a loss of $10,100 resulting from a theft by one of its clerical employees.

6. Effective December 31, 2017, as the result of a change in its distribution system, the Company was forced to cancel a tenant’s lease that would have been in force until January 1, 2025.  During the 2017 taxation year, the Company agreed to pay, and deducted, damages in the amount of $17,000.  On December 31, 2017, $5,000 of this amount had not been paid.

7. The current salary expense included a bonus payable to the Company’s president in the amount of $14,500.  It will be paid on February 1, 2018.

8. The insurance expense included the premium on a whole life policy on the life of the president’s wife in the amount of $9,500.  This was not a group life policy and the proceeds were payable to the Company.

9. As the Company changed property and casualty insurers during the year, all of its assets had to be appraised.  The cost of this appraisal was $4,150, with the entire amount being expensed in the year.

10. The Company’s wage expense included $51,000 in management bonuses (other than that of the president described in item 7) that will not be paid until May 1, 2018.  In addition, $34,000 in bonuses, which were deducted for both tax and accounting purposes in 2016, were paid in March, 2017.

11. Bad debt expense amounted to $11,000.

12. Renovation costs in the amount of $153,000 were charged to expense during the year.  This amount resulted from the need to completely renovate one of the Company’s offices and involved the installation of plumbing and air conditioning systems, as well as rewiring and installation of new concrete foundations.

13. The president and his wife attended a convention that resulted in $5,200 in travel expenses for the Company.  Of this amount, $1,900 related to the fact that the president’s wife chose to accompany him on this trip.

14. The Company’s interest expense included bond discount amortization in the amount of $950.

15. The Company’s legal expenses for the year amount to $10,500 and were related to the following transactions:

Defense of breach of contract (see item 1) $2,450

Cost of amending articles of incorporation 3,600

Defense costs related to income tax reassessment 4,450

16. The Company’s expenses included a total amount of $12,500 for business meals and entertainment.

17. The Company’s calculations for CCA and Cumulative Eligible Capital write-offs have not yet been completed.

**Required:** Compute the Company’s Net Income For Tax Purposes for the year ending December 31, 2017, before the consideration of CCA.  Indicate why you have not included any of the preceding items in your calculations.

TIF Problem Six - 16

ITA 22 Election

Gail Gates is the owner of Gail’s Gates (GG), an unincorporated business that provides wholesale distribution of various types of ornamental gates.  The business has a December 31 year end.

Gail is about to marry the man of her dreams and, as he is very, very wealthy (this is what she dreamed about), she sees no reason to continue operating GG.  Given this, she intends to sell GG to an unrelated party, Ms. Mandy Portals.  The transaction will take place on July 1, 2017 and will involve all of the assets of the business.  Ms. Portals does not anticipate incorporating the business and will continue to use the December 31 year end.

On the date of the sale, the Accounts Receivable of the business have a face value of $263,000.  Gail and Mandy agree that the current fair market value of these receivables is $249,000.  In 2016, Gail deducted a reserve for doubtful debts under ITA 20(1)(l) of $15,000.

Between July 1, 2017 and December 31, 2017, $251,000 of the Accounts Receivable are collected, with the remaining $12,000 being written off as uncollectible.

Both Gail and Mandy have heard of an election under ITA 22 that may have some influence on the tax treatment of the transfer of accounts receivable.  They would like to have your advice on this matter.  Gail notes that she did not have any capital gains in the previous three years.  Further, she does not expect to have capital gains in 2017 or any subsequent year.

**Required:**

A. Indicate the tax effects, for both Gail Gates and Mandy Portals, of the disposition of the accounts receivable and the subsequent 2017 collections and write-offs, assuming:

that no election is made under ITA 22.

that they make an election under ITA 22.

B. Indicate, from the point of view of each taxpayer, whether making the election would be a desirable course of action.

TIF Problem Six - 17

Comprehensive Case (Chapters 1 To 6)

Andrew Bank is 51 years old and lives with his common-law partner, John Bream.  John is 49, qualifies for the disability tax credit, and has 2017 income of $4,500.

They have two adopted children.  Their 19 years old son Bart is dependent on Andrew because he is disabled.  However, the disability is not sufficient to qualify Bart for the disability tax credit.  Bart has 2017 income of $2,800.  Because of his outstanding academic abilities, their 15 year old son, Carl is attending university on a full time basis throughout 2017.  Andrew has paid his tuition fees of $17,000.  As Carl has no income of his own, he has agreed to transfer the maximum tuition credit to Andrew.

During 2017, Andrew paid for family medical expenses as follows:

Andrew $ 2,300

John 12,600

Bart 4,600

Carl 400

Total $19,900

Andrew is employed by Martin Inc., a Canadian public company.  For 2017, his salary is $123,000.  In addition, he has commissions of $11,500.  For the year ending December 31, 2017, his employer withholds the following amounts from his income.

RPP Contributions\* $6,300

EI Premiums 836

CPP Contributions 2,564

Parking Fees At Employer’s Lot 600

\*Andrew’s employer makes a matching contribution of $6,300 to his RPP.

Andrew is required to use his own car for employment related travel, largely going to meet with clients in their homes.  His car was acquired on January 1, 2017 at a cost of $42,000.  During 2017, Andrew drove the car a total of 46,000 kilometers, of which 31,000 were employment related.  The remaining 15,000 kilometers involved personal use of the car.  His total operating costs for the year were $9,300.  His employer provides him with an allowance of $800 per month to reimburse him for the employment related use of his car.

Andrew’s sales territory is large and during 2017, his employment related expenses were as follows:

Hotels $ 8,500

Airline Tickets 4,500

Meals Alone While Travelling 2,000

Meals With Clients And Client Entertainment 8,600

Total $23,600

Mr. Andrew’s employer does not reimburse him for any of these costs.

During 2017, Andrew received options to acquire 500 shares of Martin Inc. at a price of $23 per share.  At that time, the shares were trading at $25 per share.  Near the end of 2017, Andrew exercises all of these options.  At the time of exercise, the shares are trading at $28 per share.  He is still holding the shares at year end.

Several years ago, Andrew acquired an unincorporated business which he has continued to operate through the current year.  On January 1, 2017, the UCC balances for this business were as follows:

Class 1 (Building Acquired In 2004) $472,200

Class 8 143,300

Class 50 12,500

Andrew uses tax based accounting for all of his revenues and expenses.  He has correctly calculated his net business income for tax purposes, prior to any CCA amounts, as $189,000.

**Required:** Calculate Andrew’s 2017 Net Income For Tax Purposes, his 2017 Taxable Income, and his minimum 2017 federal Tax Payable without consideration of any income tax withheld by his employer.  Ignore GST and PST considerations.

TIF Problem Six - 18

Comprehensive Case (Chapters 1 To 6)

Joan Galley is a salesperson for Goodship Lollipop Ltd., a Canadian public corporation.  The company produces various sweets such as candy and chocolate bars.

It has been a stressful time for Joan these last 18 months.  In the summer of 2016, her spouse passed away.  Joan has two children: Ryan who is 13 and Julie who turned 18 on April 30, 2017.

Joan’s 2017 employment contract states that she will be paid an annual base salary of $50,000 plus a commission of 1.5 percent of her annual cash sales.  Her 2016 sales totaled $3,200,000, but $200,000 of such was collected by the company in 2017.  Her 2017 sales amounted to $2,800,000, but the company had yet to collect $300,000 of these by December 31, 2017.

In 2017, her employer paid Joan her base salary plus her commission income.  A review of her last pay stub for 2017 reveals the following was withheld from her salary:

Contributions To Her Company Pension Plan $3,000

CPP Contributions 2,564

EI Premiums 836

Premiums For The Company’s Dental And Health Plan\* 1,500

Federal Income Tax Withheld 15,000

\* The plan is funded 50/50 by the employees and the employer.

Joan is covered by the company’s group term life insurance.  Her coverage is equal to her annual base salary.  The company pays a premium of $5 for every $1,000 of coverage to the Sweet Life Insurance Company.

In January of 2017, Joan detected a packaging problem with a particular line of candies before these were to be shipped.  Her keen eye saved the company an estimated $360,000 in product recalls.  This helped her win the employee of the year reward of an iPad2 which cost the company $900.

In September of 2016, her employer transferred her from Montreal to Toronto.  She thought the change would be beneficial after the death of her spouse a few months earlier.  Her employer paid for all her moving expenses.  Unfortunately, due to the quick sale of her Montreal home, she incurred a $30,000 loss on its sale. Goodship Lollipop agreed to reimburse her $20,000 of the $30,000 loss, but only in January of 2017.  The $20,000 was actually received by Joan on January 14, 2017.

In April of 2016, Joan’s employer granted her the right to purchase up to 5,000 shares of the company for $17 per share under the employee stock option plan.  At the time the option was granted, the shares were trading for $15.  On February 1, 2017, when the shares were trading at $20 per share, she exercised her option on 3,000 shares. She sold 2,000 shares at $22 per share with a settlement date of December 30, 2017.

In order to purchase the 3,000 shares, Joan negotiated an interest free loan from her employer for the purchase price.  The loan was received on February 1, 2017.  Joan repaid the loan on December 31, 2017.

Throughout 2017 her employer provided her with an automobile, which it leases for $450 per month.  The automobile was available for her personal use.  During the year, Joan drove a total of 35,000 kilometers, 8,000 of which were personal.  Except for $2,200 of car insurance, Goodship Lollipop did not pay for any of her automobile operating expenses as these were Joan’s responsibility.

Joan is responsible for her salesperson expenses (including the automobile operating expenses).  During the year she incurred the following:

Total Automobile Expenses (Excluding Insurance) $5,400

Meals And Entertainment With Clients 2,600

Hotels 1,500

Joan is a member of the Confectioners’ Association of Canada, a professional association.  Her annual membership dues are $1,400.

Joan meets all of the conditions of ITA 8(1)(f) of the *Income Tax Act* (deductible salesperson expenses).

Joan has a sideline business which is called The Cup Cake Diva.  She started her business venture a few years ago and has continued it in Toronto.  Joan prepares and sells cupcakes and other pastries from her home.  Most of her sales are made for social events which are typically held on weekends.

Joan provides you with the following information for 2017 with respect to her business:

Sales Revenues $40,000

Supplies (Flour, Sugar, Boxes, Etc.) Purchased 12,000

Purchase Of New Commercial Oven

(For Business Use Only) 2,200

Purchase Of New Automobile For Cash 39,000

Automobile Operating Expenses 3,000

With respect to the supplies, she had an opening inventory of $1,600. On December 31, 2017 she had $900 of supplies on hand.

Early in January, 2017, Joan sold her old automobile for $12,000.  It had cost $35,000.  Both the old and the new automobiles were used solely for her business, as she uses the employer provided automobile for the little bit of personal travel that she does do.

Her daughter Julie helps in the business.  She is making the deliveries to practice her driving and shows real aptitude for dealing with clients.  Joan has not offered her any monetary compensation as Julie is just happy to be driving a new car at this point in time.

Joan uses 20 percent of the space in her home for the business.  Her 2017 household expenses include the following:

All Utilities $5,400

Property Taxes 3,800

Maintenance 1,600

Phone Line Dedicated To The Business 800

Insurance On Her Home 1,900

Mortgage Interest 12,300

The UCC balances at January 1, 2017 are as follows:

Class 8 $3,100

Class 10.1 9,000

Joan does not claim CCA on her home as she realizes that if she did, this would result in future recapture and capital gains implications.

Her son Ryan is in high school and has no income of his own.

Her daughter Julie, not knowing which university program she would like to enroll in, was enrolled part-time (4 months) at a local college.  Joan agreed to pay her tuition of $1,600 as long as Julie transferred the related credit to her (Joan).  Julie’s 2017 Net Income For Tax Purposes is $7,200.

During the year, Joan paid $5,000 for orthodontic work (braces) for Ryan.  She was reimbursed 50 percent of the amount through the company’s dental and health plan.

During 2017, Joan made $1,600 of contributions to registered charities.  She is not eligible for the first time donor’s super credit.

Assume the prescribed rate for benefits during all four quarters of 2017 is 1 percent.

**Required:**

A. For the 2017 taxation year, calculate Ms. Galley’s minimum:

1. Net Income For Tax Purposes,

2. Taxable Income,

3. Federal Tax Liability.

In determining these amounts, ignore GST, PST and HST considerations.

B. Do you have any tax planning advice for Joan Galley? Discuss.

Chapter Seven Test Item File Problems

TIF Problem Seven - 1

Property Income - Essay Questions

1. Indicate two differences between the tax treatment of business income and the tax treatment of property income.

2. One conceptual approach to determining whether interest should be deductible is to limit deductibility to situations where this interest paid is related to the production of income that is fully taxable in the taxation year in which it is earned.  List two situations in which interest would not be deductible under this conceptual approach.

3. When an investor receives a payment from a corporation, what characteristics determine whether it is an interest payment or a dividend payment?

4. Briefly describe the “disappearing source” rules.

5. GAAP requires that any premium that is received on the issuance of debt securities be amortized as an adjustment of interest expense over the life of the debt.  Explain briefly the tax treatment of premium that is received on the issuance of debt securities.

6. Briefly explain the tax treatment of corporate bonds that are issued at a discount.

7. The tax rules for recognizing interest inclusions for individuals are different than they are for corporations.  Briefly describe these differences.

8. When publicly traded debt securities are purchased between interest payment dates, the purchaser pays for any accrued interest to the date of acquisition.  Describe the tax treatment of interest received by the purchaser on the next interest payment date.

9. Each rental property that is owned by an individual that has a cost in excess of $50,000 must be placed in a separate CCA class.  What is the objective of this requirement?

10. Briefly explain the concept of integration.

11. Briefly describe the application of the federal gross up and tax credit procedures for (1) eligible dividends and (2) non-eligible dividends.

12. How is the adjusted cost base of units in an income trust determined?

13. Mutual funds can be organized as either corporations or trusts.  How will the choice of organizational structure affect the taxation of income distributions from the fund?

14. What is a stock dividend?  How will such dividends be taxed?  Describe the manner in which the adjusted cost base of an investor’s holding will be changed by a stock dividend.

15. Why are capital dividends received on a tax free basis?

16. Describe the tax treatment of foreign non-business income when the foreign jurisdiction has withheld some portion of the income.

TIF Problem Seven - 2

Property Income - True Or False

1. Corporations must use the full accrual approach to recognize interest inclusions.

True or False?

2. For tax purposes, neither premium nor discount on long-term debt is ever amortized by the issuer as an adjustment of interest expense.

True or False?

3. In considering whether interest will be deductible, the direct use of the borrowed money is the relevant consideration.

True or False?

4. Interest on debt incurred to acquire equity securities is only deductible if the securities have a history of paying regular dividends.

True or False?

5. An individual purchased a warehouse as an investment property two years ago.  During the current year, he received rents of $8,000 and paid the following expenses; interest of $6,000, property taxes of $2,000, heat, light and power of $500, and maintenance of $300.  The UCC of this Class 1 asset was $60,000 on January 1 of the current year.  He cannot claim a rental loss in the current year.

True or False?

6. The federal dividend tax credit for eligible dividends can be expressed as 6/11 of the gross up, 20.73 percent of dividends received, or 15.02 percent of grossed up dividends.

True or False?

7. When the holder of income trust units receives a distribution that contains a return of capital, the amount of the return of capital must be added to the adjusted cost base of the units.

True or False?

8. Mutual funds can be organized as either corporations or trusts.

True or False?

9. For tax purposes, stock dividends must be treated in exactly the same manner as cash dividends.

True or False?

10. When foreign tax authorities withhold taxes on the foreign source income of a Canadian resident, only the net amount received will be included in the Net Income For Tax Purposes of the Canadian resident.

True or False?

TIF Problem Seven - 3

Property Income - Multiple Choice

Interest Deductibility And Interest Inclusion

1. On July 1, 2016, Janett Koenen acquired 1,000 shares of Techhab Inc. for $10 per share.  The purchase was financed with a $10,000 bank loan, requiring annual interest payments of 5 percent.  These shares were sold on December 1, 2016 for $6 per share, with the proceeds immediately invested in 500 Flexhub Ltd. shares at $12 per share.  During 2017, the Flexhub shares pay eligible dividends of $0.50 per share.  The bank loan was not repaid in 2016 and remains outstanding on December 31, 2017.  On her 2017 tax return, Janett will report:

A. Net Property Income Of $45.

B. Net Property Loss Of $155.

C. Net Property Income Of $345.

D. Net Property Loss Of $50.

2. While of the following statements related to interest deductibility is correct?

A. Interest paid on a mortgage secured by a principal residence is never deductible in Canada.

B. If a business borrows to pay interest free loans to its employees, the interest on the borrowing will not be deductible.

C. If an individual borrows $100,000 to invest in securities and the securities are later sold for $60,000, interest on the $100,000 will continue to be fully deductible provided the $60,000 is immediately invested in other securities.

D. If an individual borrows in order to buy common stocks, the interest on the borrowing will only be deductible if the stocks have a long-term history of paying dividends.

3. On January 1, 2017 Bernard borrowed $5,000 by signing a 1-year note payable at 6% interest and used the money to purchase 2,000 common shares of Import Ltd., a Canadian public corporation for $2.50 per share.  During 2017 Import Ltd. paid eligible dividends of $0.35 per share.  On January 1, 2018 Bernard repaid the $5,000 he borrowed plus $300 in interest.  On his 2017 tax return, Bernard will report:

A. Net Property Income of $400.

B. Net Property Income of $666.

C. Net Property Income of $700.

D. Net Property Income of $966.

4. Louis received a “hot tip” from a friend about Fine Mine Ltd.  He borrowed $10,000 from the bank on April 1, 2017 by signing a 90 day note payable and bought 1,000 common shares in the company for $10 each.  His friend was right about the company and on June 30, 2017 Louis sold his shares for $15 each, repaid the bank the total amount owing of $10,148 and pocketed the difference.   As a result, Louis’ taxable income for 2017 increased by:

A. $2,352.

B. $2,426.

C. $2,500.

D. $4,852.

5. On July 1, 2017 Esther borrowed $8,000 from the bank and purchased 400 shares in No Hope Ltd. for $20 per share.  Esther felt that this was a safe investment because she read on-line in a blog that No Hope would be paying dividends of $1.50 per share during the last half of 2017.  Unfortunately, this didn’t happen and she only received eligible dividends totalling $100 during 2017.  On December 31 she paid the  bank loan interest of $240.  On her 2017 tax return, Esther will report:

A. Net Property Income of $100.

B. Net Property Income of $138.

C. Net Property Income of $0.

D. Net Property Loss of $102.

6. Which of the following statements is **NOT** correct?

A. Income from rental properties can be either business income or property income.

B. When property income is earned, the income attribution rules are applicable.

C. Interest paid on a mortgage on a principal residence can be deductible.

D. Interest paid on funds borrowed to make interest-free loans to employees is not deductible.

7. A taxpayer loaned $20,000 for one year to his mother-in-law on October 1, 2015.  Interest at 6 percent per year was payable on September 30, 2016, but was not paid until February 1, 2017.  There are several ways in which the interest can be allocated to the years involved.  For the following parts of the question, indicate which method corresponds to the interest allocation if it is a method that is permitted by the ITA.  If it is not a permitted method, indicate the answer E.

A. Accrual Method

B. Cash Method

C. Compound Interest Method

D. Receivable Method

E. Not Allowed Method

i. Income for 2015 is $300, 2016 income is $900, and 2017 income is nil.

ii. Income for 2015 is nil, 2016 income is $1,200, and 2017 income is nil.

iii. Income for 2015 is nil, 2016 income is $900, and 2017 income is $300.

iv. Income for 2015 is nil, 2016 income is nil, and 2017 income is $1,200.

8. A corporation issues debt with a maturity value of $1,000,000 for proceeds of $900,000.  The debt matures in 10 years and pays annual interest at a rate of 10 percent.  Which of the following statements is correct?

A. The corporation will be able to deduct interest of $110,000 in each of the years 1 through 10.

B. The corporation will be able to deduct interest of $100,000 in each of the years 1 through 10 and will have a fully deductible loss of $100,000 in year 10.

C. The corporation will be able to deduct interest of $100,000 in each of the years 1 through 10 and will have a capital loss in year 10 of $100,000, only one-half of which will be deductible.

D. The corporation will be able to deduct interest of $90,000 in each of the years 1 through 10.

9. A corporation issues debt with a maturity value of $1,000,000 for proceeds of $1,100,000.  The debt matures in 10 years and pays annual interest at a rate of 10 percent.  The issuer is not a money lender and there is no evidence that there was a deliberate creation of a premium.  Which of the following statements is correct?

A. The corporation will be able to deduct interest of $90,000 in each of the years 1 through 10.

B. The corporation will be able to deduct interest of $100,000 in each of the years 1 through 10 and will have a fully taxable gain of $100,000 in year 10.

C. The corporation will be able to deduct interest of $100,000 in each of the years 1 through 10 and will have a capital gain in year 10 of $100,000, only one-half of which will be taxable.

D. The corporation will be able to deduct interest of $100,000 in each of the years 1 through 10 and there will be no tax consequences at maturity.

10. Jorge purchased a newly issued $20,000 corporate bond for $19,500 on November 1, 2017.  The maturity date of the bond is October 31, 2022 and the annual interest rate is 5%, paid on October 31 of each year.  How much interest income should Jorge report on his 2017 and 2018 tax returns if he wants to minimize the interest recognized for tax purposes?

A. $0 in 2017 and $975 in 2018.

B. $0 in 2017 and $1,000 in 2018.

C. $167 in 2017 and $833 in 2018.

D. $167 in 2017 and $1,000 in 2018.

11. Which of the following is **NOT** a characteristic of interest?

A. It must represent compensation for use of a principal amount.

B. It must accrue continuously over time.

C. It must be paid on a regular, periodic basis.

D. It must be calculated with reference to a principal amount.

12. On July 1, 2017, Jon Laxtor acquires a newly issued investment contract with a maturity value of $100,000.  It matures on June 30, 2022, with interest accruing at 8 percent per annum.  Interest is paid for the first one and one-half years on December 31, 2018.  The remaining interest will be paid at maturity.  With respect to the minimum amount of interest that Jon must recognize for tax purposes, which of the following statements is correct?

A. Jon will have to recognize $4,000 in 2017 and $8,000 in 2018.

B. Jon will have to recognize nil in 2017 and $8,000 in 2018.

C. Jon will have to recognize nil in 2017 and nil in 2018.

D. Jon will have to recognize nil in 2017 and $12,000 in 2018.

13. Which of the following statements concerning the tax treatment of interest income is **NOT** correct?

A. Individuals must accrue interest using the cash basis.

B. Corporations must accrue interest on a daily basis.

C. Accrued interest from the date of the last interest payment date will be added to the purchase price of a security.

D. If there is accrued interest on a security, the seller includes the accrued interest in income and the purchaser deducts a corresponding amount from the interest received on the bonds.

14. With regard to debt securities, which of the following statements is correct?

A. Provided the issuer is not in the business of lending money, issuing debt securities at a premium will normally reduce the after-tax cost of financing for the issuer.

B. Provided the issuer is not in the business of lending money, issuing debt securities at a premium will normally increase the after-tax cost of financing for the issuer.

C. Issuing debt securities at a discount results in the borrowing corporation receiving funds above the stated price.

D. Issuing debt securities at a premium results in the borrowing corporation receiving funds below the stated price.

Rental Income

15. Which of the following statements with respect to rental properties is **NOT** correct?

A. Every rental property with a cost in excess of $50,000 must be allocated to a separate CCA Class.

B. The short fiscal period rules do not apply to the calculation of CCA on a rental property owned by an individual.

C. The deduction of CCA cannot be used to create or increase a rental loss.

D. If a new rental property is acquired, put into a separate CCA class, and is used more than 90 percent for non-residential purposes, it is eligible for an enhanced CCA rate of 10 percent.

16. Saul has two residential rental properties that are mortgaged.  Both properties are in Class 1 with a CCA rate of 4 percent.  At the beginning of the year, Property A has a UCC of $500,000 and Property B has a UCC of $1,100,000.  Before consideration of CCA, Property A earned net rental income of $43,000, and Property B had a net rental loss of $27,000.  What is the maximum amount of CCA Saul will be able to claim this year?

A. Nil.

B. $16,000.

C. $20,000.

D. $44,000.

17. When calculating taxable property income for a rental property owned by an individual, which of the following should never be included in the calculation?

A. Half year rule.

B. Short fiscal period rule.

C. Recapture.

D. Terminal loss.

18. Rosa owns a duplex and rents both units to tenants.  Which one of the following expenditures is not a deduction for tax purposes?

A. Cost of a new refrigerator.

B. Cost of repairing the front stairs.

C. Cost of painting the interior of unit #2.

D. Interest paid on the mortgage on the duplex.

19. Fergus owns a rental property.  Instead of hiring contractors he does all of the property maintenance and repairs himself, keeping careful records.  Which one of the following amounts is not a deduction for tax purposes?

A. $700 for shrubs and flowers.

B. $250 for bookkeeping services.

C. $400 for lumber, paint and hardware.

D. $500 for his labour (50 hours @ minimum wage of $10 per hour).

20. Aziz purchased a residential rental property on April 15, 2017.  He paid $300,000 cash for the building and paid an additional $540 for eligible rental expenses during 2017.  He rented the property on May 1 to long term tenants for $1,400 per month.   On his 2017 tax return he should report net rental income of:

A. $4,660.

B. $7,173.

C. $6,633.

D. $10,660.

21. Shahrukh owns a residential rental building which he purchased for $200,000 in 2017. In that year, his rental income before CCA was $5,000.  In 2018, his rental income before CCA was $8,000.  Sharukh always minimizes his tax liability. Which of the following statements is correct?

A. Shahrukh has a net rental loss of $3,000 in 2017.

B. Shahrukh has net rental income of $160 in 2018.

C. Shahrukh has net rental income of nil in 2018.

D. Shahrukh has net rental income of $200 in 2018.

Dividend Income

22. Which of the following statements with respect to dividends is **NOT** correct?

A. Capital dividends can be received by individuals without tax consequences.

B. All taxable dividends paid by Canadian controlled private corporations are non-eligible dividends.

C. Stock dividends are subject to the same gross up and tax credit procedures as cash dividends.

D. Dividend tax credits are based on a percentage of the gross up on dividends received.

23. During 2017 Thelma Evatt receives eligible dividends of $23,000.  She has no other source of income in that year.  What would be the amount of federal Tax Payable or refund on these dividends?

A. $4,761

B. $3,450

C. Nil

D. A $6.00 Refund

24. The federal dividend tax credit cannot be claimed if you receive:

A. Eligible dividends.

B. Non-eligible dividends.

C. Stock dividends.

D. Capital dividends.

25. Which of the following statements is correct?

A. The federal dividend tax credit is equal to 38 percent of the eligible dividends received.

B. The federal dividend tax credit is equal to 6/11 of the gross up on eligible dividends received.

C. The federal dividend tax credit is equal to 17 percent of the non-eligible dividends received.

D. The federal dividend tax credit is equal to 6/11 of the gross up on non-eligible dividends received.

26. Which of the following statements is correct?

A. Net Property Income =   
Dividends received plus the gross-up minus the dividend tax credit.

B. Net Property Income =   
Dividends received minus the gross-up minus the dividend tax credit.

C. Federal Tax Payable =   
Federal tax on grossed-up dividends minus the dividend tax credit.

D. Federal Tax Payable =   
The gross up on dividends received minus the dividend tax credit.

27. During 2017 Erin received eligible dividends of $800, non-eligible dividends of $600 and foreign dividends of $900 (10% foreign tax was withheld at source).  Her 2017 net property income for tax purposes is:

A. $2,664.

B. $2,706.

C. $2,764.

D. $2,806.

28. During 2017 Rolf received eligible dividends of $900 and non-eligible dividends of $600.  His 2017 federal dividend tax credit is:

A. $249

B. $260

C. $303

D. You can’t calculate the dividend tax credit if you don’t know his effective tax rate.

29. Sherry’s marginal federal tax rate is 29 percent.  She lives in a province where her provincial marginal tax rate is 17.5 percent and the provincial dividend tax credit is 31 percent of the dividend gross up.  If Sherry receives an eligible dividend of $16,000 from a Canadian public corporation in 2017, how much will she pay in income tax?

A. $5,891.

B. $2,827.

C. $5,066.

D. $8,382.

30. Martin held 2 percent of the outstanding shares of a Canadian public corporation.  The corporation issued an eligible stock dividend in 2017 and capitalized $800,000 of its retained earnings.  By how much will Martin’s Taxable Income increase as a result of the dividend?

A. $ 8,000.

B. $16,000.

C. $18,720.

D. $22,080.

Mutual Funds and Income Trusts

31. Which of the following statements with respect to income trusts and mutual funds is **NOT** correct?

A. Mutual funds can be organized as either trusts or corporations.

B. When an income trust makes a capital distribution, the amount received by a unit holder will be deducted from the adjusted cost base of the units held.

C. Business income received by an income trust will be distributed to investors as business income.

D. Eligible dividends received by a mutual fund will be distributed to investors as eligible dividends.

32. Maria owns 500 units in a mutual fund that invests exclusively in bonds issued by Canadian public corporations.  During 2017 the mutual fund received bond interest and paid income distributions of $1.12 per unit.  Maria reinvested all of her distributions.  The effect on Maria’s 2017 Taxable Income is:

A. Increase of $280.

B. Increase of $560.

C. Increase of $773.

D. $0 because the distributions were reinvested.

33. Yang owns 800 units in a mutual fund that invests exclusively in the shares of Canadian public corporations.  During 2017, the fund paid a distribution of $1.50 per unit.  One-half of the distribution was eligible dividend income and the remaining half was capital gains.  By how much will Yang’s Taxable Income increase as a result of the distribution?

A. $600.

B. $1,128.

C. $1,200.

D. $1,428.

34. Which of the following statements is correct for both income trusts that are not specified investment flow-through trusts (i.e., not SIFTs) and mutual fund trusts?

A. Dividend income is grossed up before it is distributed to the unit holders.

B. All after tax distributions are treated as deemed eligible dividends.

C. Income earned by the trust is not subject to income tax within the trust if it is distributed to the unit holders.

D. If the distributions are a return of capital, the inclusion rate is 50 percent.

35. On January 1, 2017, John Traverse acquires 12,000 units of the RV Income Trust at a cost of $720,000.  During 2017, the trust makes a distribution of $5.00 per unit.  Of this total $1.50 is a return of capital while the remaining $3.50 is property income.  John reinvests the total distribution in RV units at a cost of $55 per unit.  What is the adjusted cost base of John’s units on December 31, 2017?

A. $58.21 per unit.

B. $53.62 per unit.

C. $59.58 per unit.

D. $60.00 per unit.

Foreign Source Income

36. During the current year, Pearlene Monroig earns business income in the U.K. of €10,000 from which the British government withholds €2,000.  Assume that the relevant exchange rate was €1.00 = $1.50 for the year.  Which of the following statements is correct?

A. Pearlene will have foreign source net business income of $12,000 and a credit against Tax Payable of $3,000.

B. Pearlene will have foreign source net business income of $15,000 and no credit against Tax Payable.

C. Pearlene will have foreign source net business income of $14,250 and a credit against Tax Payable of $2,250.

D. Pearlene will have foreign source net business income of $15,000 and a credit against Tax Payable of $3,000.

37. Julio has a savings account in a foreign country.  The account earned $5,000 interest during 2017 but he only received $4,500 since $500 for foreign taxes was withheld by the bank.  All amounts are stated in Canadian dollars.  The effect on Julio’s 2017 tax return is:

A. An increase in taxable income of $4,500 and a foreign tax credit of $0.

B. An increase in taxable income of $5,000 and a foreign tax credit of $500.

C. An increase in taxable income of $5,000 and a foreign tax credit of $75.

D. Nothing since the interest was earned outside of Canada.

38. Bernadette owns 1,000 shares of a German public corporation.  The corporation paid dividends of $1.50 per share during 2017 but Bernadette only received $1,275 since 15% tax was withheld in Germany.  All amounts are stated in Canadian dollars.  Bernadette’s 2017 net property income from this investment is:

A. $1,275.

B. $1,500.

C. $1,760.

D. $2,070.

39. Ravinder’s marginal federal tax rate is 29 percent.  He has a foreign investment that earns $50,000 (Canadian) of non-business income.  The government of the foreign country withholds $10,000 of this amount, with the remaining $40,000 being remitted to Ravinder during 2017.  By what amount will Ravinder’s 2017 federal Tax Payable increase as a result of this transaction?

A. $ 4,500.

B. $ 6,275.

C. $11,600.

D. $14,500.

General

40. Which of the following will provide the lowest amount of after-tax income for an individual in the top federal tax bracket?

A. $100 of interest income from Canadian bonds

B. $100 of capital gains from Canadian stocks

C. $100 of non-eligible dividends from Canadian corporations

D. $100 of eligible dividends from Canadian corporations

TIF Problem Seven - 4

Property Income - Exam Exercises

Exam Exercise Subject Listing For Chapter 7

|  |  |
| --- | --- |
| **Number** | **Subject** |
| 1 | Discount Bonds |
| 2 | Discount Bonds |
| 3 | Premium Bonds |
| 4 | Premium Bonds |
| 5 | Annual Accrual Rules |
| 6 | Annual Accrual Rules |
| 7 | Accrued Interest At Transfer |
| 8 | Accrued Interest At Transfer |
| 9 | Rental Income |
| 10 | Rental Income |
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| 12 | Non-Eligible Dividend Income |
| 13 | Eligible Dividend Income |
| 14 | Eligible Dividend Income |
| 15 | Income Trust Distributions |
| 16 | Income Trust Distributions |
| 17 | Mutual Fund Distributions |
| 18 | Mutual Fund Distributions |
| 19 | Stock Dividends |
| 20 | Stock Dividends |
| 21 | Foreign Source Income |
| 22 | Foreign Source Income |

Exam Exercise Seven - 1 (Discount Bonds)

On January 1, 2017, Latkin Inc. issues bonds with a maturity value of $1,250,000 and a maturity date of December 31, 2022.  The bonds pay interest on December 31 of each year at an annual coupon rate of 2 percent.  They are sold for proceeds of $1,150,000 for an effective yield of 3.5 percent.  The maturity amount is paid on December 31, 2022.  What are the tax consequences related to this bond issue for Latkin Inc. in each of the years 2017 through 2022?  How would these tax consequences differ from the information included in Latkin’s GAAP based financial statements?  Latkin Inc. uses the straight-line method to amortize the discount on the bonds for accounting purposes.

Exam Exercise Seven - 2 (Discount Bonds)

On January 1, 2017, Leno Ltd. issues bonds for $770,000.  The bonds have a maturity value of $800,000 and mature on December 31, 2019.  The coupon rate on the bonds is 3 percent, with the interest paid annually on December of each year.  The maturity amount is paid on December 31, 2019.  What are the tax consequences related to this bond issue for Leno Ltd. in each of the years 2017 through 2019?  How would these tax consequences differ from the information included in Leno’s GAAP based financial statements?  Leno Ltd. uses the straight-line method to amortize the discount on the bonds for accounting purposes.

Exam Exercise Seven - 3 (Premium Bonds)

On January 1 of the current year, Dryer Inc. issues 8 year bonds payable with a maturity value of $1,500,000.  The bonds have a coupon rate of 14 percent, pay interest on January 1 of each year, and are sold for $1,750,000.  The Company has a December 31 year end.  Determine the current year tax consequences under each of the following assumptions:

Dryer is in the business of lending money.

Dryer is not in the business of lending money and the CRA does not believe that they made a deliberate effort to create a premium on the issuance of the bonds.

Dryer is not in the business of lending money and the CRA believes that they made a deliberate effort to create a premium on the issuance of the bonds.

Exam Exercise Seven - 4 (Premium Bonds)

On January 1, 2017, Desay Inc. issues 5 year bonds payable with a maturity value of $900,000.  They have a coupon rate of 12 percent, pay interest on January 1 of each year, and are sold for $1,200,000.  The Company has a December 31 year end.  Determine the current year tax consequences under each of the following assumptions:

Desay is in the business of lending money.

Desay is not in the business of lending money and the CRA does not believe that they made a deliberate effort to create a premium on the issuance of the bonds.

* Desay is not in the business of lending money and the CRA believes that they made a deliberate effort to create a premium on the issuance of the bonds.

Exam Exercise Seven - 5 (Annual Accrual Rules)

On June 1, 2017, Mr. Michael Leiner acquires a newly issued debt instrument with a maturity value of $80,000.  It matures on May 31, 2023 and pays interest at an annual rate of 7 percent.  Payment for the first three and one-quarter years of interest is due on August 31, 2020, with interest for the remaining two and three-quarters years payable on the maturity date.  What amount of interest will Mr. Leiner have to include in his tax returns for each of the years 2017 through 2023?

Exam Exercise Seven - 6 (Annual Accrual Rules)

Ms. Marilyn Lox invests in a newly issued debt instrument on April 1, 2017.  It has a maturity value of $50,000, matures on March 31, 2021, and pays interest at an annual rate of 5 percent.  The terms of the instrument call for payment of interest for the first two and one-half years on September 30, 2019.  The remaining interest is paid at the maturity date of the instrument.  What amount of interest will Ms. Lox have to include in her tax returns for each of the years 2017 through 2021?

Exam Exercise Seven - 7 (Accrued Interest At Transfer)

On May 1, 2017, Mrs. Anna White purchases bonds with a maturity value of $40,000 at par.  These bonds pay semi-annual interest of $2,000 on June 30 and December 31 of each year.  She purchases the bonds for $41,326, including interest accrued to the purchase date.  She holds the bonds for the remainder of the year, receiving both the June 30 and December 31 interest payments.  What amount of interest will be included in Mrs. White’s 2017 tax return?

Exam Exercise Seven - 8 (Accrued Interest At Transfer)

Lexor Inc. has bonds outstanding with a maturity date of December 31, 2025.  The bonds pay semi-annual interest at an annual rate of 5 percent.  Payments of $2,500 are made on June 30 and December 31 of each year.  The bonds are currently trading at their maturity value.  On April 1, 2017, Arnold Wexler acquires some of these bonds.  He pays $101,243, including an amount for accrued interest, for bonds with a maturity value of $100,000.  He holds the bonds for the remainder of the year, receiving both the June 30 and December 31 interest payments.  What amount of interest will be included in Mr. Wexler’s 2017 tax return?

Exam Exercise Seven - 9 (Rental Income)

Alex Bodvin acquires a residential rental property on June 1, 2017 at a total cost of $423,000.  Of this total, $132,000 can be allocated to the value of the land.  He immediately spends $42,000 to make major improvements to the property.  Rents for the year total $32,000, while rental expenses other than CCA total $27,500.  This is the only rental property owned by Mr. Bodvin.  Determine the maximum CCA that is available for 2017.  In addition, determine Mr. Bodvin’s minimum net rental income for the year.

Exam Exercise Seven - 10 (Rental Income)

Alice Baxter acquires a residential property on May 1, 2017.  The total cost of the property is $385,000, with $95,000 of this total being allocated to the land.  She spends $3,500 to paint the interior and exterior of the building.  During 2017, rents total $29,000 and expenses other than CCA and the cost of painting total $20,100.  Determine the maximum CCA that is available for 2017.  In addition, determine Ms. Baxter’s minimum net rental income for the year.

Exam Exercise Seven - 11 (Eligible Dividend Income)

During 2017, Mr. Franz Schlitz receives $23,500 in eligible dividends from Canadian public corporations.  His income is such that this additional amount will be taxed at a 29 percent federal rate and a 14 percent provincial rate.  On eligible dividends, the province has a dividend tax credit equal to 25 percent of the gross up.  Determine the total federal and provincial tax that will be payable on these dividends and his after tax retention.

Exam Exercise Seven - 12 (Eligible Dividend Income)

Mr. Martin Pabst owns publicly traded shares which, during 2017, paid eligible dividends of $10,200.  His Taxable Income for this year exceeds $300,000 and he lives in a province where the maximum individual tax rate is 16 percent.  The provincial tax credit on eligible dividends is equal to 29 percent of the gross up. Determine the total federal and provincial tax that will be payable on these dividends and his after tax retention.

Exam Exercise Seven - 13 (Non-Eligible Dividend Income)

During 2017, Ms. Marion Blatz receives $5,600 in non-eligible dividends from taxable Canadian corporations.  Her income is such that this additional amount will be taxed at a 26 percent federal rate and a 10 percent provincial rate.  On such non-eligible dividends, the province has a dividend tax credit equal to 38 percent of the gross up.  Determine the total federal and provincial tax that will be payable on these dividends and her after tax retention.

Exam Exercise Seven - 14 (Non-Eligible Dividend Income)

During the 2017 taxation year, Ms. Andrea Molsen receives non-eligible dividends of $14,200.  Her income is such that this additional amount will be taxed at a 26 percent federal rate and a 7 percent provincial rate.  The provincial dividend tax credit on non-eligible dividends is 25 percent.  Determine the total federal and provincial tax that will be payable on these dividends and her after tax retention.

Exam Exercise Seven - 15  (Income Trust Distributions)

On January 1, 2017, Jeanine Dorset acquires 1,700 units of Blackwell Income Trust at $37 per unit, a total cost of $62,900.  During 2017, the trust distributes $2.75 per unit, $0.85 of which is a return of capital and $1.90 of which is a property income distribution.  Jeanine has asked the trust to reinvest all distributions.  The $2.75 per unit distribution was reinvested at a cost of $32 per additional unit.  What are the tax consequences to Jeanine of the 2017 distribution and its reinvestment?  What will be her adjusted cost base per unit after the reinvestment?

Exam Exercise Seven - 16  (Income Trust Distributions)

On June 1, 2017 Jerry Driggs acquires 2,500 units of the Belle Realty Trust at $12 per unit.  During September, 2017, the trust makes a distribution of $1.50 per unit, of which $1.00 represents a return of capital.  Mr. Driggs decides to reinvest the entire distribution at a cost of $12.50 per additional unit.  What are the tax consequences to Mr. Driggs of the 2017 distribution and its reinvestment?  What will be his adjusted cost base per unit after the reinvestment?

Exam Exercise Seven - 17 (Mutual Fund Distributions)

John Bordy owns 2,200 units of the DRC Growth Fund, a mutual fund trust.  These units were purchased at a price of $8.15 per unit, for a total value of $17,930.  His adjusted cost base for these units has not changed since their acquisition.  On December 12 of the current year, the Fund has an income distribution of $0.27 per unit, resulting in an addition of $594 to John’s account.  All of this distribution is reinvested at a purchase price per unit of $10.40.   What will be his adjusted cost base per unit after the reinvestment?

Exam Exercise Seven - 18 (Mutual Fund Distributions)

Arial Horton owns 3,400 units of the Canadian Growth Fund, a mutual fund trust.  The total cost of the 3,400 units was $17,000.  Her adjusted cost base for these units has not changed since she acquired them.  In June of the current year, the fund has an income distribution of $0.45 per unit.  All of this distribution is reinvested at a unit price of $5.10.  What will be Arial’s adjusted cost base per unit after the reinvestment?

Exam Exercise Seven - 19 (Stock Dividends)

Melific Ltd. has 4,500,000 common shares outstanding.  Jerry Fry acquired 5 percent of these shares at a cost of $19 per share.  During the current year, the Company declares a 6 percent stock dividend which it designates as eligible.  At this time the shares are trading at $21 per share.  The Company transfers the amount of the stock dividend to paid up capital.  What are the tax consequences to Jerry Fry of this transaction?  Your answer should include the adjusted cost base per share of Jerry’s holding.

Exam Exercise Seven - 20 (Stock Dividends)

Jupiter Inc. has 1,800,000 common shares outstanding. Harry Keller acquired 8 percent of these shares at a cost of $11 per share.  During the current year, the Company declares an 8 percent stock dividend which it designates as eligible.  At this time the shares are trading at $12 per share.  The Company transfers the amount of the stock dividend to paid up capital.  What are the tax consequences to Harry Keller of this transaction?  Your answer should include the adjusted cost base per share of Harry’s holding.

Exam Exercise Seven - 21 (Foreign Source Income)

Isaac Lemming has foreign investments that earn $27,000 in income during the current year.  As the foreign jurisdiction withholds 22 percent of such income, he only receives $21,060.  He has other income such that this foreign source income will be taxed at the maximum federal rate of 33 percent.  Determine the amount by which this foreign income would increase Isaac’s Taxable Income and federal Tax Payable, assuming that:

A. the foreign source income is non-business income.

B. the foreign source income is business income.

Exam Exercise Seven - 22 (Foreign Source Income)

Isabelle Lemming holds foreign investments that earn $34,000 during the current year.  Because of withholdings by the foreign jurisdiction, she only receives $27,200 of these earnings.  These earnings are in addition to over $250,000 in employment income.  Determine the amount by which this foreign income would increase Isabelle’s Taxable Income and federal Tax Payable, assuming that:

A. the foreign source income is non-business income.

B. the foreign source income is business income.

TIF Problem Seven - 5A

Property Income - Key Term Matching (Easy)

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

Version A is easy, there is only one possible answer for each term.

Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms are listed at the end of Chapter 7, “Property Income”.

A. Capital Dividend

B. Disappearing Source Rules

C. Dividend Gross Up

D. Dividend Tax Credit

E. Net Property Income

F. Eligible Dividends

G. Property Income

H. Stock Dividend

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

1. Rules designed to provide relief to investors who have borrowed money to make an investment and subsequently sold the investment for less than the related borrowings.

2. Dividends that have not been designated by the payor as eligible for the enhanced gross up and tax credit procedure.

3. The net of inclusions less deductions, related to property income, with all amounts determined as per Division B, Subdivision b, of the *Income Tax Act*.

4. An amount that is based on a percentage of the dividends from taxable Canadian corporations that have been received by an individual or trust.

5. Dividends that have been designated by the payor as eligible for the enhanced gross up and tax credit procedure.

6. A pro rata distribution of a corporation’s shares to its existing shareholders.

7. A dividend paid out of a private corporation’s capital dividend account.  It is received on a tax free basis.

8. A credit against the tax payable of an individual or trust.  The amount is based on a fraction of the dividend gross up that has been included in net income for tax purposes.

9. Income that is earned through the passive ownership of property.

10. An amount that represents compensation for the use of money, is calculated with reference to a principal sum, and that accrues on a continuous basis.

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

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

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

TIF Problem Seven - 5B

Property Income - Key Term Matching (Moderate)

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

Version A is easy, there is only one possible answer for each term.

Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms are listed at the end of Chapter 7, “Property Income”.

A. Capital Dividend

B. Disappearing Source Rules

C. Dividend Gross Up

D. Dividend Tax Credit

E. Net Property Income

F. Eligible Dividends

G. Property Income

H. Stock Dividend

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

1. Rules designed to provide relief to investors who have borrowed money to make an investment and subsequently sold the investment for less than the related borrowings.

2. Dividends that have not been designated by the payor as eligible for the enhanced gross up and tax credit procedure.

3. Dividends that are eligible to receive a federal and provincial dividend tax credit .

4. The net of inclusions less deductions, related to property income, with all amounts determined as per Division B, Subdivision b, of the *Income Tax Act*.

5. An amount that is based on a percentage of the dividends from taxable Canadian corporations that have been received by an individual or trust.

6. Dividends that have been designated by the payor as eligible for the enhanced gross up and tax credit procedure.

7. A dividend paid out of the taxable portion of capital gains earned by the corporation.  It will be taxed as a capital gain in the hands of the recipient.

8. A pro rata distribution of a corporation’s shares to its existing shareholders.

9. A dividend paid out of a private corporation’s capital dividend account.  It is received on a tax free basis.

10. A credit against Tax Payable based on taxes withheld by a foreign taxing authority on foreign source income.

11. A credit against the tax payable of an individual or trust.  The amount is based on a fraction of the dividend gross up that has been included in net income for tax purposes.

12. Income that is earned through the passive ownership of property.

13. A dividend paid in stock of another corporation.

14. An amount that represents compensation for the use of money, is calculated with reference to a principal sum, and that accrues on a continuous basis.

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

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

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

TIF Problem Seven - 6

Interest Deductibility

Each of the following independent Cases involves the payment of interest and the issue of whether the interest will be deductible for tax purposes.

**Case A** Joan Allenby has owned her home for many years and, over this period of time, has completely paid off the mortgage.  Given the low interest rates that are available on mortgages, she negotiates a $300,000, five year, variable rate mortgage, with an interest rate of 2.5 percent.  She invests the entire $300,000 in publicly traded securities.  Would the interest on the mortgage be deductible?  Explain your conclusion.

**Case B** Athro Tulee borrows $50,000 and acquires an income producing property for $50,000.  He subsequently sells the property for $80,000.  Without repaying the funds borrowed to acquire the first property, he uses the proceeds to acquire two other properties.  The cost of property A is $32,000, while the cost of property B is $48,000.  How will the $50,000 in borrowing be linked to the two new properties?

**Case C** Janice Bronson borrows $250,000 and invests the entire amount in the shares of Nor-Tell Ltd.  Three months later, after the discovery of significant accounting irregularities at Nor-Tell, the value of the shares has fallen to $30,000.  She sells her shares and uses the proceeds to pay off $30,000 of the loan.  This leaves a balance of $220,000.  Can Janice continue to deduct the interest payments on this $220,000 balance?  Explain your conclusion.

TIF Problem Seven - 7

Rental Income And CCA On Rental Properties

Ms. Serravalle has a firm belief in the advantages of investing in real estate.  Because of this belief, she has invested most of her discretionary income in residential rental properties over the past four decades.  On January 1, 2017, she owns four rental properties  The relevant facts on these properties are as follows:

**642 Kent Street** This is a Class 3 building that has a capital cost of $722,000.  Its UCC at the beginning of the year was $412,000.  During the year, it generated rents of $63,000 and incurred property taxes of $7,800, interest charges of $11,700, and other expenses (excluding CCA) of $12,750.

**1256 Montreal Road** This is a Class 3 building that had a capital cost of $37,000. It was sold on August 1.  For CCA purposes, it was included in the same Class 3 pool as 112 Lisgar Avenue.  Of the sale proceeds, $65,000 was allocated to the building.  From January 1 to July 31, the building generated rents of $4,800 and incurred property taxes of $1,100, interest charges of $1,450, and other expenses (excluding CCA) of $900.

This property contained furniture that Ms. Serravalle had acquired at a cost of $8,000.  On January 1, 2017, this furniture had a UCC balance of $4,200.  It was sold at the same time as the rental property.  The proceeds of the furniture sale were $2,100.

**112 Lisgar Avenue** This is a Class 3 building that has a capital cost of $45,000.  At the beginning of the year, the UCC of the Class 3 pool, which included both 1256 Montreal Road and 112 Lisgar Avenue, was $48,000.  During the year, it generated rents of $5,000 and incurred property taxes of $1,550, interest charges of $650, and other expenses (excluding CCA) of $2,500.

**23 Durham Private** This Class 1 building has a capital cost of $225,000.  Its UCC at the beginning of the year was $216,000.  During the year, the unit generated rents of $22,000 and incurred property taxes of $3,850, interest charges of $11,500, and other expenses (excluding CCA) of $8,700.

**Required:** Calculate Ms. Serravalle’s net rental income for 2017.  You should provide a separate calculation for each property.  Specify how much CCA should be taken for each building.

TIF Problem Seven - 8

Rental Income And CCA On Rental Properties

In March, 2016, Andrew Thorne acquired a four unit apartment building at a cost of $875,000.  Of this total, it is estimated that the land on which the building is situated is worth $185,000.  The units in the apartment are similar in size, and for purposes of allocation to a CCA class, the property is considered to be a single asset.

Two of the units will be rented on a furnished basis.  To this end, Andrew has acquired furniture at a cost of $43,000.

During April, 2016, all of the units were rented for the remainder of the year.  For this year, the units generated rents of $63,600 and expenses, other than CCA, of $23,400 were incurred.

In July, 2017, the tenants in both of the furnished units terminate their leases and move out.  Because he is unable to find tenants who are interested in furnished units, the two units remain empty for three months.  Given this situation, Andrew sells all of the furniture for $31,000.

During 2017, the units generate rents of $54,500.  Expenses for the year, other than CCA, total $29,400.

Andrew deducts the maximum CCA allowable in both 2016 and 2017.

**Required**: Calculate the Net Rental Income for each of the two years 2016 and 2017.  Also, determine his UCC balances on January 1, 2018.  Include in your solution any tax consequences associated with the sale of the furniture.

TIF Problem Seven - 9

Rental Income And CCA On Rental Properties

Mr. Taylor bought a large triplex on February 1, 2016 for a total cost of $345,000.  Of this amount, it is estimated that $255,000 should be allocated to the building and $90,000 to the land on which it is located.  The three rental units in the triplex are identical in size and features and, for purposes of allocation to a CCA class, the property is considered to be a single unit.

At a bankruptcy sale in February, 2016, Mr. Taylor purchased furniture and appliances for one of the units at a total cost of $12,800.

Early in February, 2016, all three units were rented.   For 2016, Mr. Taylor’s triplex generated rents of $26,000 and incurred expenses, other than CCA, of $10,900.

In May, 2017, the tenants in the furnished unit moved out and purchased all the furniture and appliances from Mr. Taylor for $10,400.  For 2017, Mr. Taylor’s triplex generated rents of $28,400 and incurred expenses, other than CCA, of $18,180.

Mr. Taylor deducts the maximum CCA allowable in both years.

**Required**: Calculate the Net Rental Income for each of the two years 2016 and 2017.  Also, determine his UCC balances on January 1, 2018.  Include in your solution any tax consequences associated with the sale of the furniture and appliances.

TIF Problem Seven - 10

Dividend vs. Interest Income

Sarah, Sally, and Suzanne Baxter are three sisters who live in the same province.  Because of their alternative career choices, they have enjoyed varying degrees of economic success.

**Sarah** Sarah has devoted her life to the arts.  However, the scarcity of work in her field has resulted in her being in the 15 percent federal tax bracket and the 5 percent provincial bracket.

**Sally** Sally has always worked in retail and is doing well as a store manager.  She is in the 26 percent federal tax bracket and the 11 percent provincial tax bracket.

**Suzanne** Suzanne is a very successful attorney.  Her income places her in the 33 percent federal tax bracket and the 16 percent provincial tax bracket.

The provincial dividend tax credit on eligible dividends is equal to 27 percent of the dividend gross up.

On January 1 of the current year, as the result of an inheritance from a distant uncle, each of the sisters has $15,000 to invest.  They are looking at the following alternatives:

**Corporate Bonds** The issue that they are considering has a 4.5 percent coupon rate, is selling at par, and matures in 25 years.

**Preferred Stock** The shares that they are considering has a dividend yield of 5.6 percent.  The eligible dividend is cumulative but not participating.

The income from these investments would not move any of the three sisters to a higher federal or provincial tax bracket.  Each sister has sufficient income to use all of her available tax credits.

**Required:** Advise each of the Baxter sisters as to which investment they should make.  As part of your recommendation, calculate the after tax income that would be generated for each of the sisters, assuming that they invested their $15,000 in:

A. The corporate bonds.

B. The preferred stock.

TIF Problem Seven - 11

Property Income - Alternative Investment Strategies

On January 1, 2017, Mr. Saul Goldfarb is notified that he has won $250,000 in the provincial lottery.  This amount is immediately available to Mr. Goldfarb and is not subject to any form of taxation.

Mr. Goldfarb has no immediate need for these funds.  However, he is retiring on January 1, 2018 and would like to have the funds available at that time for use in relocating to a warmer climate.  Given this, he would like to invest the funds for the period ending December 31, 2017.  He is considering the following alternatives:

**Guaranteed Investment Certificate** The $250,000 can be invested in a guaranteed investment certificate that matures on December 31, 2017.  The certificate pays interest at 3 percent.

**Common Stock** The $250,000 can be invested in the shares of a Canadian public company.  The shares are currently trading at $125 per share and pay an annual eligible dividend of $6.00 per share.  Mr. Goldfarb’s broker assures him that the shares will be trading at $135 per share by December 31, 2017.

Mr. Goldfarb has sufficient employment income that he is in the 29 percent federal tax bracket and the 15 percent provincial tax bracket.  The provincial dividend tax credit for eligible dividends is equal to 30 percent of the gross up.

**Required:** Write a brief memorandum providing investment advice to Mr. Goldfarb.

TIF Problem Seven - 12

Investments In Income Trusts and Common Stock

On January 1, 2017, Shirley Struthers won $450,000 in a provincial lottery.  As she is currently renting an apartment in the city, she would like to use the money to purchase a home in the country.  However, as she has had no experience with real estate, she plans to take the coming year to investigate various areas and properties.

In the meantime, she would like to invest the $450,000 for a one year period.  She is considering the following investments and would like your advice on the appropriate choice:

**RioKan Income Trust** On January 1, 2017, this trust is  selling for $15 per unit.  It makes a distribution of $0.055 per unit per month.  This distribution includes a return of capital of $0.025 per month, with the balance of the distribution being property income.  Sally will sell the units at the end of 2017.  She does not expect any price change over the year.

**Publico Inc. Common Stock** On January 1, 2017, these shares are selling for $120 per share.  The  Company pays an annual eligible dividend of $1.75 per share.  Ms. Struthers anticipates that these shares will be selling for at least $124.00 per share on December 31, 2017.

During 2017, Sally will continue to work at her present job.  Her employment income is such that any additional income will be taxed at a combined federal/provincial rate of 34 percent.  Sally lives in a province where the provincial dividend tax credit for eligible dividends is equal to 36 percent of the gross up.

**Required:** Write a brief memorandum providing investment advice to Ms. Struthers.

TIF Problem Seven - 13

Foreign Property Income, Income Trusts And Mutual Funds

Late in 2016, Ms. Betty Tang sells her Vancouver residence for $800,000.  It is her intention to not replace this property and, in future years, she plans to rent a unit in a downtown condominium building.

On January 1, 2017, she invests the proceeds from the sale as follows:

**Foreign Term Deposit** She acquires a U.K. Pound Sterling (£) term deposit with a maturity value of £200,000 at a Canadian dollar cost of $360,000.  Assume that throughout 2017, £1 = $1.70.

**Income Trust Units** She acquires 8,000 units of the B&B real estate investment trust.  The units are acquired at a cost of $30 per unit.

**Common Shares** She acquires 2,000 shares of Liberty Inc., a publicly traded company, at a total cost of $100,000.

**Mutual Fund Units** She acquires 2,500 units of Temple Small Cap, a mutual fund trust.  The cost is $40 per unit.

The following transactions occur during the year ending December 31, 2017:

**Foreign Term Deposit** On December 31, 2017, annual interest is paid at the rate of 7 percent.  The U.K. authorities withhold 25 percent of this amount, with the remainder being remitted to Betty.

**B&B Trust Units** The trust has a distribution of $1.50 per unit.  Of this total $0.50 represents a return of capital, with the remainder being property income.  Betty invests the entire distribution in additional units at a cost of $52 per unit.

**Liberty Inc.** The Liberty Inc. shares pay an eligible dividend of $1.60 per share.

**Temple Small Cap** The trust has a distribution of $2.40 per unit.  All of this distribution is reinvested to acquire additional Temple units at $38 per unit.  The composition of the distribution is as follows:

Capital Gains $0.40

Eligible Dividends 1.00

Interest 1.00

Total Per Unit $2.40

Betty has other investment income that places her in the 29 percent federal tax bracket.  Taxes on this income are sufficient to use all of her available tax credits before considering the effects of the investments described above.  She lives in a province where the maximum rate is 16 percent and the dividend tax credit on eligible dividends is 30 percent of the gross up.

**Required:** Calculate the amount of Taxable Income and Tax Payable that will result from the described distributions.  In addition, indicate the per unit adjusted cost base for each of the two trust units on December 31, 2017. Ignore any tax implications resulting from the Canada/U.K. tax treaty.

TIF Problem Seven - 14

Business Income And Income Trusts

Ms. Sarah Smursch is an accountant who specializes in preparing financial statements for small businesses.  She has a well established practice in London, Ontario.

Relevant information on her practice for the taxation year ending December 31, 2017, is as follows:

January 1 Unbilled Work In Progress $ 23,000

Billable Hours (1,725 Hours At $200) 345,000

December 31 Unbilled Work In Progress 14,000

Office Supplies And Office Expenses 23,000

Rent 60,000

Business Meals And Entertainment 18,000

During 2017, Ms. Smursch attended two conventions.  The first, held in Toronto, dealt with using accounting software.  For this convention, her conference fees and travel costs were $2,400.  The second convention, held in Beirut, Lebanon, dealt with war zone vacations for tourists in the Middle East.  The costs for this convention were $7,400.  She incurred no costs for meals or entertainment during the convention as she stayed with family in Beirut.

In addition to her professional income, Ms. Smursch owns 2,500 units of Realty Income Trust.  These units were acquired on December 31, 2016 at a cost of $43 per unit.  During 2017, she received a distribution of $3.50 per unit, of which $1.50 was a return of capital and the remainder was property income.  The distribution was reinvested at a price of $45 per unit.

On December 31, 2017, all units are sold for proceeds of $129,333.

For tax purposes, Ms. Smursch uses the billed basis of revenue recognition.

**Required:** Determine Ms. Smursch’s minimum Net Income For Tax Purposes for the year ending December 31, 2017.  Ignore GST/HST/PST considerations and the need to make CPP contributions by Ms. Smursch.

TIF Problem Seven - 15

Comprehensive Case (Chapters 1 To 7)

Ms. Caroline Graham is a full time employee of KLY Incorporated, an on-line clothing retailer.  She has an annual salary of $75,000, from which the following amounts were withheld in 2017:

Registered Pension Plan Contributions $3,500

CPP Contributions  2,564

EI Premiums      836

Annual Donation to United Way   1,500

Long term disability insurance      500

The long term disability plan provides periodic benefits that compensate for lost employment income.  In addition, Caroline’s employer provided her with a life insurance policy at a cost of $350.

Caroline is a single parent with a 15-year-old daughter, Grace, who has no income of her own.

Caroline’s father lives with the family, and is financially dependent on Caroline as his only income is Old Age Security of $7,000.  He enjoys good physical and mental health.  Caroline’s father moved in with her after her mother passed away in 2016, and as a result, in January, 2017, Caroline purchased a home for the family to live in for $350,000.  Caroline and Grace had lived in a rented home for the past 6 years.

Caroline provides financial support to her sister, Kristin.  Kristin has lived in France for the last 10 years.  She has been in university there for the last 2 years.   Caroline paid her university tuition of $15,000 for 2017 and $12,000 for medical costs related to her hospitalization after an automobile accident in March, 2017.

Caroline has provided the following information regarding the 2017 income from her investment portfolio.

**Term Deposits** Caroline has the following two term deposits:

A $200,000 term deposit purchased on November 1, 2016  at 3.25 percent.  Interest is payable at maturity on October 31, 2018.

A $20,000 term deposit purchased on November 30, 2017 at 3 percent.  Interest is payable at maturity in 6 months.

**Investments In Shares** The income amounts from Caroline’s share investments are as follows:

Caroline owns 1,000 shares of Royal Scotia Bank.  The company paid an eligible dividend of $24 per share on October 15, 2017.

Caroline also owns 100 shares in Graham Company Limited, a corporation solely owned and operated by her brother.  This company paid a non-eligible dividend of $50 per share on November 30, 2017.

Caroline inherited 500 shares of Americo Limited, a U.S. company from her mother.  In 2017, these shares paid a dividend of $2 (Canadian) per share.  The U.S. government withheld 12 percent of the total dividend amount.

**Future Investments** When Caroline’s mother passed away, she left Caroline with a substantial sum of money which Caroline wants to invest wisely.   She is planning to invest substantial funds in 2017 in one of the three following alternatives:

term deposits,

shares in public Canadian corporations which will pay eligible dividends, or

additional shares in her brother’s corporation which will pay non-eligible dividends.

Caroline had owned a rental property for several years, and when she received her inheritance, she sold the old property and purchased a new one.

The old rental property cost $125,000 when it was purchased, with $28,000 allocated to the land, and $2,500 allocated to appliances.  UCC on this property was $90,450 on January 1, 2017 for the building and $2,145 for the appliances.  The property was sold on January 1, 2017 for $120,000 with $28,000 allocated to the land and $1,000 to the appliances.

The new property was purchased on February 1, 2017, and cost a total of $200,000, with $45,000 allocated to land.  Caroline also purchased the on-site appliances for $6,500.

Caroline rented the property from March 1 to November 30 and collected rent during this period of $16,150.  Costs to operate the property, including mortgage interest, insurance, utilities and property taxes totaled $12,500.

In order to increase the future rent, during December, 2017, Caroline spent the following amounts on the property:

New windows $14,500

Roof repairs 1,200

Carpeting and flooring replacements 7,500

Cleaning 500

Painting interior and exterior 2,000

**Required:**

A. For the 2017 taxation year, calculate Caroline’s minimum:

1. Net Income For Tax Purposes,

2. Taxable Income,

3. Federal Tax Liability.

B. Based on the top marginal tax rate applied to determine Caroline’s tax payable, calculate the effective federal tax rate that Caroline pays on eligible dividends, non-eligible dividends and interest income (ignore provincial taxes).  What advice would you give her with respect to her investment choices?

In completing the requirements of this problem, ignore GST, PST and HST considerations.

TIF Problem Seven - 16

Comprehensive Case (Chapters 1 To 7)

Jeremy Bromont is 67 years old and has been married to Sandra Bromont for over 40 years.  Sandra is 65 years old and has Net Income For Tax Purposes of $8,400.  This consists of OAS payments of $6,000 (for less than a year) and pension income from an RPP.  She has not, at this point in time, applied for CPP.

Jeremy and Sandra have two children:

**Sarah** Sarah is 36 years old and has been blind since birth.  She has no income of her own, lives with them, and is totally dependent on Jeremy and Sandra.

**Samantha** Samantha is 38 years old and has recently gone through a messy divorce.  She has custody of the two pre-teen children of the marriage and her only source of income is $24,000 in child support from her former husband.  As this is not enough for her to maintain a separate residence, she and her children live with Jeremy and Sandra and currently rely on them for support.

As she is dedicated to becoming self-supporting, she is currently working on an MBA.  She began full time attendance in September of this year.  Jeremy paid her tuition cost of $16,400.  Samantha has agreed to transfer any unused tuition credit to Jeremy.

The family’s medical expenses, all of which have been paid by Jeremy, are as follows:

Jeremy $ 4,000

Sandra 1,700

Sarah 9,400

Samantha 1,800

Total Medical Expenses $16,900

Jeremy has a number of different sources of income.  They are as follows:

**Pension Income** During 2017, Jeremy receives $32,500 from an RPP sponsored by a former employer.

**Employment** During 2017, Jeremy’s gross wages from his current employer were $74,000.  The employer withheld the following amounts from these wages:

RPP Contributions $5,600

EI Premiums 836

CPP Contributions 2,564

Union Dues 896

Annual United Way Contributions 2,400

**OAS And CPP** Jeremy has not applied for OAS as he is aware that it would all be clawed back.  He has deferred applying for CPP in order to receive the enhanced benefits that accrue with later application.

**Dividends** During 2017, Jeremy received the following dividends (all amounts are in Canadian dollars):

Eligible Dividends From Taxable Canadian Corporations $ 8,600

Non-Eligible Dividends On Shares In His Sister’s CCPC 6,400

Dividends On Foreign Shares - Net Of 15 Percent Withholding 13,600

Total Dividends Received $28,600

**Interest** During 2017, Jeremy had interest income of $3,420.

**Business Income** Four years ago, Jeremy started a management consulting business.  To house this business, he acquired a new building at a cost of $523,000 of which $123,000 was the estimated value of the land.  The building is allocated to a separate CCA Class 1.  On January 1, 2017, the UCC for this class is $342,837.  He acquired furniture and fixtures for the building at a cost of $30,000.  The Class 8 UCC on January 1, 2017 is $10,564.

During 2017, he spends $62,000 upgrading and improving the building.  In addition, he sells some old furniture and fixtures for $23,200 (capital cost $25,000) and acquires replacement furniture and fixtures for $47,000.

As Jeremy has no reason to keep detailed accounting records, he records business income on a cash basis.  For 2017, his net cash flow from operations was $187,000.  Relevant figures for the beginning and end of 2017 are as follows:

**January 1 December 31**

Billed Receivables $23,200 $26,700

Unbilled Work In Process 28,900 31,300

Accounts Payable 15,600 14,200

At the inception of the business, Jeremy leased a car for business purposes.  After the lease agreement expired, he acquired a new car on January 1, 2017 at a cost of $72,500.  He financed the car through his bank and, during 2017, he made payments on the loan of $14,400.  All of this amount was deducted in determining his net cash flow from operations.  Of the total, $5,100 represented payments for interest.  Jeremy paid car operating costs totalling $12,600 during 2017.

**Required**: Calculate Jeremy’s 2017 minimum Net Income For Tax Purposes, his 2017 minimum Taxable Income, and his 2017 minimum federal Tax Payable.  Ignore GST/HST/PST considerations and the possibility of pension income splitting.

Chapter Eight Test Item File Problems

TIF Problem Eight - 1

Capital Gains And Losses - Essay Questions

1. Capital gains have always been given very favourable tax treatment relative to interest income.  What is the justification for this treatment?

2. Describe three different types of capital asset dispositions.  In each case, indicate how the proceeds of disposition would be determined.

3. How is government assistance for the purchase of capital assets dealt with in the *Income Tax Act*?  How does this differ from the accounting treatment of government assistance for the purchase of capital assets?

4. What is a superficial loss?  What is the required tax treatment for such losses?

5. Describe how a taxpayer calculates a taxable capital gain or an allowable capital loss.

6. A taxpayer may acquire a number of identical properties at different points in time at different costs.  When there is a sale of part of a group of identical properties, how do you determine the adjusted cost base of the properties sold?

7. When a capital asset is sold and not all of the proceeds of disposition are received in the year of sale, the *Income Tax Act* allows a taxpayer to deduct a reserve.  How is the maximum amount of this reserve determined?

8. When an enterprise sells a capital asset, it sometimes provides a warranty related to the performance of that asset.  This may involve incurring warranty costs in periods subsequent to the period in which the asset is sold.  How are such costs dealt with for income tax purposes?  How does this differ from the accounting treatment of such costs?

9. When a taxpayer disposes of a combination of land and buildings, ITA 13(21.1)(a) contains a special rule for determining the amount of proceeds to be allocated to the building.  If applicable, this special rule increases the amount of the proceeds that will be allocated to the building.  What is the tax policy objective of this special rule?

10. Describe the tax treatment that will be given to personal use property dispositions.  How does this treatment differ if the property is listed personal property?

11. An enterprise buys €100,000 of merchandise in France, with the payable recorded in Euros.  Between the time of the purchase and the payment of the account, the exchange rate for the Euro increases by $0.04.  How will this increase be dealt with for tax purposes?  Will this differ from the accounting treatment of the amount?

12. An individual purchases an option to acquire a tract of land at a later date.  If the individual exercises the option, how will the cost of the option be dealt with?  Alternatively, how would the cost be dealt with if the option expires without being exercised?

13. When the use of a capital property is changed from personal use to business use, there is a deemed disposition/reacquisition of that property.  If the original cost of the property is less than the fair market value of the property at the time of the change in use, the cost of the property for UCC purposes is limited to its cost, plus one-half of the difference between the cost and fair market value.  What is the reason for this limitation?

14. It is not uncommon for a person, when moving out of a principal residence, to retain that property as a rental unit.  If no election is made, this change in use will be treated as a deemed disposition, possibly resulting in capital gains being assessed.  Explain how this result can be avoided,  as well as the tax consequences of making the required election.

15. When an individual converts his principal residence to a rental property, an election under ITA 45(2) is available to avoid having a deemed disposition based on a change in use.  Briefly describe how this election works.

16. When an individual departs from Canada, there is a deemed disposition of most of his capital property.  What major categories of property are the exceptions to this deemed disposition rule?

17. The *Income Tax Act* contains a provision which allows an individual to defer the taxation on capital gains resulting from the sale of shares of an “eligible small business corporation”.  What is the definition of an eligible small business corporation?

18. Having business property destroyed in a natural disaster (e.g., flood or earthquake) would normally have very adverse tax consequences.  Briefly describe the tax consequences of receiving insurance payments in this situation in the absence of special rules.

19. The replacement property rules cover both voluntary dispositions and involuntary dispositions.  However, they are applied differently to the two types of dispositions.  Briefly describe the differences between the treatment for voluntary dispositions and involuntary dispositions.

20. In terms of tax planning, capital gains and losses have an advantage that is not available for other types of income.  Briefly describe this advantage.

TIF Problem Eight - 2

Capital Gains And Losses - True Or False

1. One of the reasons for the favourable tax treatment of capital gains is that the amounts received often have to be reinvested in the business in order to maintain its productive capacity.

True or False?

2. A superficial loss occurs when, in the 30 days following the disposition that resulted in the loss, an identical asset is acquired.

True or False?

3. Mr. Schmidt purchased 250 shares of Doss Limited on February 1 of the current year for $20 per share.  On May 1  of the current year, he purchased 100 more shares for $25 per share.  On June 20  of the current year, Mr. Schmidt sells 100 shares for $15 per share.  His allowable capital loss on June 20 is $643.

True or False?

4. When there is a disposition of a capital asset and not all of the proceeds of disposition are collected at the time of disposition, a reserve can be deducted.  In the year of the disposition, the reserve cannot be less than 80 percent of the total gain.

True or False?

5. Capital gains on a principal residence are not taxable.

True or False?

6. Losses on the disposition of listed personal property can be deducted, but only against gains on the disposition of listed personal property.

True or False?

7. A dining room suite that had been purchased for $700 was sold during the year.

a. The proceeds of disposition totalled $900.  The capital gain on the transaction is $200.

True or False?

b. The proceeds of disposition totalled $500.  The allowable capital loss on the transaction is $100.

True or False?

c. The proceeds of disposition totalled $1,500.  The taxable capital gain on the transaction is $250.

True or False?

8. When there is a change in use, there will be a deemed disposition/reacquisition.

True or False?

9. When an individual emigrates from Canada, there is a deemed disposition of all of his capital property at fair market value.

True or False?

10. To be an eligible corporation for purposes of the deferral provisions on small business investments, more than 50 percent of the fair market value of its assets must be used to produce active business income in Canada.

True or False?

11. When there is an involuntary disposition of a depreciable asset, any resulting capital gain can be eliminated if the asset is replaced by an asset of equal or greater value, no later than the end of the second taxation year following the disposition.

True or False?

TIF Problem Eight - 3

Capital Gains And Losses - Multiple Choice

General Rules

1. Which of the following statements with respect to capital gains is **NOT** correct?

A. Insurance proceeds to compensate for a business building destroyed in a fire is a proceeds of disposition.

B. The adjusted cost base of capital assets is reduced by any government assistance received for their acquisition.

C. The lifetime capital gains deduction reduces the amount of capital gains included in Net Income For Tax Purposes.

D. The expropriation of a capital asset by a municipal government is considered to be a disposition.

2. Which of the following statements with respect to capital gains is correct?

A. The inclusion rate for taxable capital gains has always been one-half of the capital gain.

B. All gains on the sale of Canadian securities are treated as capital gains.

C. The favourable taxation of capital gains is designed to partially compensate businesses for the effects of inflation.

D. The lifetime capital gains deduction is no longer available to Canadian individuals.

3. The term proceeds of disposition can be used in a number of situations.  Indicate which of the following would not be considered proceeds of disposition for the PD Company.

A. Amounts paid to PD Company under insurance policies for property that has been destroyed.

B. Amounts paid to PD Company under insurance policies for property unlawfully taken.

C. Amounts paid to PD Company by a municipal government for property that has been expropriated.

D. Amounts paid to PD Company on the sale of inventories.

E. Amounts paid to PD Company on the sale of a warehouse.

4. Which of the following statements about the tax treatment of gifts of capital assets is **NOT** correct?

A. The adjusted cost base to the recipient will be the fair market value of the asset gifted.

B. The tax treatment of gifts is different when the gift is made to a non-arm’s length party rather than to an arm’s length party.

C. The proceeds of disposition to the person giving the gift will be the fair market value of the asset gifted.

D. If the fair market value of the asset being given exceeds its tax cost to the person giving the gift, that person will have a capital gain.

5. Which of the following is **NOT** included in ITA 53 as an adjustment to the cost base of an asset?

A. Government assistance with the cost of acquisition.

B. CCA taken in previous years.

C. Superficial losses.

D. In the case of vacant land, interest and property taxes.

6. Carine purchased a piece of land with her inheritance.  She was planning to open a mini-golf course and put in a zip-line course.  Carine had been laid off for a year and could not find work as a golf pro.  After spending some time researching mini-golf and zip line course designs, she received a job offer which she decided to take.  She has received an offer to purchase the land at a significant gain.  Which of the following statements is correct?

A. Since Carine’s primary intent was to use the land in her business, the gain is business income.

B. Since Carine’s primary intent was to use the land in her business, the property taxes on the land are deductible.

C. Since Carine’s primary intent was to use the land in her business, the gain is a capital gain.

D. Since the gain relates to property, the gain is property income.

Superficial Loss

7. On November 12, 2017, Hubert Robbins sells 100 shares of Loser Inc. for $120 per share.  He had purchased these shares several years ago at $220 per share.  On November 18, 2017, he acquires 80 shares of Loser Inc. for $100 per share.  On December 22, 2017, he acquires 50 shares of Loser Inc. at $80 per share.  What is the adjusted cost base of the 130 shares that he holds after the December 22, 2017 purchase?

A. $12,000.

B. $20,000.

C. $22,000.

D. $14,000.

8. Chi has the following transactions in Smoke Corp. and Mirrors Corp. shares:

**Smoke Mirror**

May 1, 2016 Purchase 100 @ $22.50 100 @ $25.00

December 20, 2016 Sale 100 @ $28.00 100 @ $24.00

January 3, 2017 Purchase N/A 100 @ $23.20

June 1, 2017 Sale N/A 100 @ $26.00

Chi’s taxable capital gains for 2016 and 2017 are:

A. $225 for 2016, $90 for 2017

B. $225 for 2016, $140 for 2017

C. $275 for 2016, $90 for 2017

D. $275 for 2016, $140 for 2017

Detailed Application Of The Rules

9. With respect to dispositions of capital assets, which of the following statements is correct?

A. The cost of providing a warranty on the sale of a capital asset cannot be deducted for tax purposes.

B. When identical properties are sold, the cost can be determined using either FIFO or Average Cost valuation.

C. The cost of providing a warranty on the sale of a capital asset can be deducted in full in the determination of business income.

D. If a portion of a property is sold, the adjusted cost base must be determined using the fair market value of the portion sold as a fraction of the total fair market value of the property.

10. Which of the following statements is **NOT** correct?

A. When there is a disposition of an identical property, the taxpayer must use the average cost of all such properties as the adjusted cost base.

B. When a taxpayer provides a warranty on the sale of a capital asset, the cost incurred to provide the warranty is treated as a capital loss.

C. When there is a partial disposition of land that is held as a capital asset, the adjusted cost base must be based on a proportionate share of the total area of the land.

D. When a bad debt arises from the sale of a capital asset, its writeoff must be treated as a capital loss.

Capital Gains Reserves

11. Which of the following statements with respect to capital gains reserves is correct?

A. There is no limit on how many years a reserve can be deducted.

B. The maximum capital gains reserve is equal to the ratio between the proceeds not yet collected and the total proceeds, multiplied by the capital gain.

C. The maximum capital gains reserve is limited to 20 percent of the total capital gain in the first year after the sale.

D. Any capital gains reserve that is deducted in the current taxation year must be added back to income in the subsequent taxation year.

**Questions 12 And 13** are based on the following information:

BMP Products Ltd. (BMP) has been in operation for more than 20 years. Ten years ago, planning for future growth of its manufacturing facilities, BMP purchased a plot of land in an industrial area for $150,000.  During the last couple of years, BMP has not met expectations. Business has fallen slightly and cash flows are tight.  Due to the decrease in product demand, management does not believe that BMP will use this plot of land in the near future.  As a result, during the taxation year ended March 31, 2017, BMP sold this land for $400,000.  $150,000 was received in February, 2017, with the remainder to be paid in two equal instalments in February, 2018 and February, 2019.  You have been advised that capital gains treatment is appropriate for this transaction.

12. BMP can claim a reserve on the above sale at March 31, 2017 of:

A. Nil.

B. $156,250.

C. $200,000.

D. $250,000.

13. BMP can claim a reserve on the above sale at March 31, 2018 of:

A. Nil.

B. $78,125.

C. $125,000.

D. $150,000.

14. Bob sold a capital property on December 31, 2017 for $300,000.  $280,000 is payable on December 31, 2018, and the balance was paid immediately in cash. The adjusted cost base of the property was $170,000 and the selling costs totalled $10,000.  Which one of the following amounts represents the **minimum** taxable capital gain in 2017?

A. $4,000.

B. $10,000.

C. $12,000.

D. $24,000.

15. Shun Li sold a capital property on July 31, 2017 for $400,000.  She received $100,000 at the time of sale with the balance of $300,000 payable on July 31, 2020. The adjusted cost base of the property was $160,000. The minimum taxable capital gain that Shun Li can report in the 2017 taxation year is:

A. $30,000.

B. $60,000.

C. $120,000.

D. $180,000.

Special Rule for Sales of Real Property

16. A business sells real property for $950,000, with $600,000 of this amount being allocated to the building and the remaining $350,000 allocated to the land.  The building, the only asset in its Class, had a capital cost of $800,000 and a UCC of $650,000.  The adjusted cost base of the land was $250,000.  What are the tax consequences of this disposition?

A. A capital gain of $100,000 and a terminal loss of $50,000.

B. A capital gain of $50,000 and a terminal loss of nil.

C. A capital gain of $100,000 and a capital loss of $50,000.

D. A capital gain of $50,000 and a terminal loss of $50,000.

17. The special rules for a disposition of property that includes land and buildings should be applied when:

A. There is a capital gain on the land and a capital loss on the building

B. There is a capital gain on the building and a capital loss on the land

C. There is a capital gain on the land and a terminal loss on the building

D. There is a capital gain on the building and a terminal loss on the land

Principal Residences Rules

18. Which of the following statements with respect to the tax rules for principal residences is correct?

A. If a farmer’s principal residence is on a farm, any capital gain on the disposition of the farm will be exempt.

B. If an individual and his spouse can each own real property in which they reside for a part of the year, they each can claim the principal residence exemption for that year on the property that they own.

C. If an individual sells a principal residence and buys another principal residence in a single year, he will not be able to completely eliminate any gain on the disposition of the second residence by using the principal residence exemption.

D. If an individual owns only one real property, it is not necessary to file the Form T2091, *Designation Of A Property As A Principal Residence By An Individual*, in order to claim the principal residence exemption.

19. Mr. Winestock owned two homes from 2014 to 2016.  He had purchased Home A in 2003 for $60,000.  In 2014, he purchased Home B for $180,000, with the intention of selling Home A immediately.  Due to market conditions, mortgage rates, and the asking price, he was unable to sell Home A until 2016.  The proceeds received on the sale of Home A were $150,000.  In 2017, he was transferred to a different city and sold Home B.  He designated 2014 and 2015 to Home A when it was sold.  The proceeds received on the sale of Home B were $200,000.  What is his taxable capital gain on Home B?

A. Nil.

B. $2,500.

C. $5,000.

D. $10,000.

E. $20,000.

20. Heidi bought a mountain chalet in 2012 for $150,000 and sold it in 2017 for $180,000.  She bought a lakeside cabin in 2013 for $100,000 and sold it in 2017 for $130,000.  She lived full-time at the chalet in 2012 and spent an equal amount of time at the chalet and the cabin during the 5 years from 2013 to 2017.  How should she allocate her principal residence gain reduction for the year 2013 to minimize her 2017 taxable capital gains?

A. 2013 should be allocated to the cabin

B. 2013 should be allocated to the chalet

C. 2013 should be split between the cabin and the chalet

D. 2013 cannot be allocated to either the cabin or the chalet

21. Which of the following statements regarding the tax treatment of a principal residence is **NOT** correct?

A. If a taxpayer owns two residences, and both are sold in the same year, the principal residence formula will eliminate the capital gain on only one of the residences.

B. If a taxpayer owns two residences, the decision to designate a particular property as the principal residence must be made when the residence is sold.

C. If a taxpayer owns only one residence, the principal residence formula will eliminate any capital gain on the sale.

D. A capital loss cannot be realized on the sale of a principal residence.

Personal Use Property

22. Which of the following statements about personal use property is **NOT** correct?

A. Losses on the disposition of personal use property can be deducted to the extent of gains on the disposition of personal use property.

B. An antique chest would be classified as personal use property.

C. The minimum value for both the proceeds of disposition and the adjusted cost base of personal use property that is being sold is $1,000.

D. When losses on listed personal property are carried forward, they can be deducted to the extent of gains on the disposition of listed personal property.

23. Mike sold the following assets during the current year:

**Sales Price Cost**

Painting $2,500 $ 800

Stamp collection 600 1,200

Outboard motor 900 100

Antique desk 1,300 1,950

Which one of the following amounts represents his taxable capital gain, net of allowable capital losses, for tax purposes during the current year?

A. $325.

B. $625.

C. $650.

D. $750.

24. Song Ming sold the following assets during the current year:

**Sales Price Cost**

Diamond Necklace $1,200 $  600

Rare Book 1,800 1,200

Coin Collection 900 1,100

Vintage Car 16,500 17,000

Which one of the following amounts represents her taxable capital gain, net of allowable capital losses, for tax purposes during the current year?

A. $100

B. $250

C. $350

D. $500

25. Indicate which of the following is **NOT** listed personal property:

A. A stamp.

B. A rare manuscript.

C. An antique chair.

D. A piece of jewelry.

E. A piece of sculpture.

Foreign Currency

26. On July 1, 2017, Chester Aguilar acquires 1,000 shares of a foreign company at 10 Foreign Currency units (FC, hereafter) per share.  He acquired the funds for this purchase when FC1 = $1.48, a value that did not change prior to the date on which he purchased the shares.  He sells the 1,000 shares December 1, 2017 for FC12 per share.  On this date the exchange rate is FC1 = $1.46.  What is the effect of the sale transaction on Chester’s 2017 Net Income For Tax Purposes?

A. $2,720.

B. $1,160.

C. $2,520.

D. $1,360.

27. Which of the following statements related to the taxation of foreign currency transactions is  correct?

A. All gains or losses that result from foreign currency transactions are treated as capital gains and losses.

B. When a Canadian corporation issues foreign currency debt, a gain or loss will only be recognized when the debt is repaid.

C. A foreign currency gain or loss will arise when Canadian dollars are converted to a different currency.

D. For individuals, the first $200 of foreign currency gains can always be excluded from income.

Options

28. Crystal Collins acquires an option to buy a piece of land at a price of $100,000.  The land will be used to expand her greenhouse business.  The cost of the option is $5,000.  Which of the following statements is **NOT** correct?

A. If the option expires, Crystal will have a business loss of $5,000.

B. If Crystal exercises the option and acquires the land, the adjusted cost base of the land will be $105,000.

C. If the option expires, Crystal will have an allowable capital loss of $2,500.

D. If Crystal sells the option for $5,000, the transaction will have no effect on her Net Income For Tax Purposes.

29. Nigel buys an option for $1,000 which allows him to purchase a block of shares for $40,000.  Which of the following statements is **NOT** correct?

A. If Nigel allows the option to expire, he has an allowable capital loss of $500.

B. If Nigel sells the option for $700, he has a taxable capital gain of $350.

C. If Nigel purchases the shares, the adjusted cost base of the shares will be $41,000.

D. If Nigel allows the option to expire, the vendor has a taxable capital gain of $500.

Change In Use

30. Mamie Hanson converts her principal residence into a rental property.  This property had cost $850,000 several years ago.  It is converted on January 1, 2017 and, at that time, it is estimated that the value of the property has increased to $1,100,000.  At this time the value of the land is unchanged at $400,000.  Provided her rental income before CCA is more than this amount, what is the maximum CCA that Mamie can claim for 2017?

A. $16,000.

B. $32,000.

C. $44,000.

D. $22,000.

31. Jose Montana owns a cottage that he purchased in 2008 for $330,000, with $100,000 of this amount reflecting the value of the land.  On January 1, 2017, this cottage is converted to a rental property.  At the time of conversion, it is estimated that the cottage has a fair market value of $600,000, with $150,000 of this amount reflecting the value of the land.  For 2017, rental income, net of all expenses except CCA equals $10,200.  What is the maximum amount of CCA that Jose can deduct on this rental property for 2017?

A. $10,200.

B. $6,800.

C. $9,000.

D. $18,000.

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

Ramon lives in Calgary.  In 2014 he purchased a second house in Lethbridge for $180,000 (land $100,000; building $80,000).  His grandmother lives in the house rent free and was the only occupant from 2014 to 2017.   In March 2017, Ramon converted the house into a duplex.  His grandmother lives in one unit rent free and the other unit is rented to tenants.  The market value of the house in March 2017 was $215,000 (land $115,000; building $100,000).

32. What is Ramon’s taxable capital gain for the 2017 change in use?  He will not use his principal residence gain reduction for the Lethbridge house.

A. $5,000

B. $8,750

C. $10,000

D. $17,500

33. What is Ramon’s maximum 2017 CCA deduction for this rental property?  The net rental income before CCA is $6,000.

A. $800

B. $900

C. $1,600

D. $1,800

34. If a business asset with a capital cost of $100,000 and a UCC of $80,000 is converted to personal use at a time when its fair market value is $150,000, which of the following statements is **NOT** correct?

A. The deemed disposition will create recapture of $20,000.

B. The deemed disposition will create a taxable capital gain of $25,000.

C. The capital cost for CCA purposes will be $125,000.

D. The capital cost for capital gains purposes will be $150,000.

35. Arnold Swartz converted his principal residence into a rental property after having lived in it for 5 years. He has not been able to find a tenant during the current year.  The house had cost $1 million.  At the time of conversion, the property had a fair market value of $1.4 million. What is the UCC balance in the rental property’s Class 1 before any CCA is taken?

A. $1,000,000

B. $1,200,000

C. $1,400,000

D. Nil

Change In Use - Principal Residence Elections

36. In 2009, Rochelle Parsons acquired a home in Calgary, Alberta for $350,000, with $75,000 of this amount being the estimated value of the land.  In 2011, she was required by her employer to move to London, Ontario.  As she believed Calgary real estate was an outstanding investment, she decided to convert the home to a rental property, but would not be deducting CCA on it.  Related to this decision was the fact that she decided to rent a home in London, rather than acquiring a second property in that city.  In 2017, recognizing that she was unlikely to return to Calgary, she sold the Calgary home for $500,000, with $150,000 of this amount being the estimated value of the land.  What is the minimum capital gain that Rochelle will have to recognize in 2017?

A. $33,333.

B. $16,667.

C. $50,000.

D. $150,000.

37. Susan Cousins purchased a house in Oshawa in March, 2015, for $250,000 (land; $80,000, building; $170,000).  Even though Susan would be unable to reside in the house immediately, she felt it was a very good price and did not want to miss the opportunity to own this house.  She rented out the house as of April, 2015.  Her tenants will move out in December, 2016, and she will move into her house in January, 2017.  The fair market value of the house at January 1, 2017 was $300,000 (land; $130,000, building; $170,000).  The UCC of the house on this date is $163,000.

Which of the following is correct?

A. The capital cost of the house for CCA purposes at January 1, 2017 is $275,000.

B. Susan must recognize a capital gain for tax purposes of $50,000 at January 1, 2017.

C. Susan must recognize a capital gain for tax purposes of $25,000 at January 1, 2016.

D. Susan can elect to designate the house as her principal residence for the years 2015 and 2016 so there is no capital gain on the house.

E. None of the above.

38. In 1994, Ms. Boisvert became a homeowner, acquiring a residence in Halifax at a cost of $135,000.  In 2005, she was transferred by her employer to Winnipeg.  She rented accommodations in Winnipeg and leased the Halifax residence.  Ms. Boisvert elected to be deemed not to have converted the property to an income producing use.  She did not take CCA on the property during the period that it was rented.  In July, 2017, after 24 years of ownership, she sold the Halifax house for $207,000, netting a gain of $72,000.  She had decided she would not return to Halifax.  Which one of the following amounts represents the **minimum** capital gain that she may report in 2017?

A. Nil.

B. $21,000.

C. $33,000.

D. $36,000.

Departures From Canada

39. On January 1, 2017, Marcus Abbott permanently emigrates from Canada.  At that time, his only property consists of his principal residence and a small apartment building.  His principal residence was purchased several years ago at a cost of $650,000.  Of this total $150,000 relates to the land.  The current fair market value of his residence is $975,000.  The value of the land is unchanged at the time of his departure  The apartment building had a capital cost of $870,000, with $170,000 of this total allocated to the land.  The building had a January 1, 2017 UCC of $476,000.  At the time of his departure, the apartment building has a fair market value of $1,200,000, with the value of the land remaining at $170,000.  What is the minimum addition to Mr. Abbott’s Net Income For Tax Purposes that results from his departure?

A. $655,000.

B. $724,000

C. $559,000

D. Nil

40. When an individual departs from Canada, there is a deemed disposition of several types of property.  Which of the following properties would **NOT** be subject to this deemed disposition rule?

A. A large painting by a well known Canadian artist.

B. Land and building that is being used as a rental property.

C. Shares in a CCPC involved in earning active business income.

D. Shares in a CCPC that is used to hold investments.

41. Joel has lived in Canada his entire life.  He is planning to depart permanently from Canada.  The deemed disposition rules on departure would **NOT** apply to his:

A. Shares in a Canadian public corporation.

B. Shares in a Canadian private corporation.

C. Coin collection

D. House in Ontario.

Deferral Provisions on Small Business Investments

42. Which of the following statements with respect to the ITA 44.1 deferral provisions on small business investments is **NOT** correct?

A. The replacement shares must be the common shares of an eligible small business corporation that are acquired within 120 days after the end of the year in which the qualifying disposition took place

B. The use of the deferral provision will not affect the adjusted cost base of the replacement shares.

C. The deferral is limited to a fraction of the capital gain resulting from the qualifying disposition.

D. The eligible small business corporation and corporations related to it cannot have assets with a carrying value in excess of $50 million.

43. On November 25, 2016 Ervin sold 100 shares of Mighty Ltd., an eligible small business corporation, for $32 per share.  He purchased the shares in 2015 for $28 per share.  On December 15, 2016 he reinvested the proceeds by buying 80 shares of Mouse Ltd. for $40 per share.  Mouse Ltd. is also an eligible small business corporation so he was able to use the ITA 44.1 election to defer the 2016 capital gains.  Ervin sold all of the Mouse Ltd. shares on July 5, 2017 for $52 per share.  His taxable capital gain for 2017 is:

A. $680.

B. $960.

C. $480.

D. $1,360.

Deferral Provisions on Replacement Property

44. On July 1, 2016, the Flex Company’s warehouse was completely destroyed in a fire.  The capital cost of the warehouse was $1,500,000 and its January 1, 2016 UCC was  $1,248,539.  On December 1, 2016, the company received insurance proceeds of $1,650,000, an amount equal to the estimated fair market value of the building.  On April 1, 2017, the Company acquires an existing warehouse building for $1,800,000.  Provided the Company makes all possible elections to reduce Tax Payable, what amount will be added to the Class 1 UCC as the result of this acquisition?

A. $1,548,539.

B. $1,650,000

C. $1,398,539.

D. $1,248,539

45. Equipment was stolen from Far East Corp. on May 1, 2017.  The cost of the equipment was $10,000 and the UCC was $7,500.  The insurance proceeds of $12,000 were received on September 15, 2017 and replacement equipment was purchased for $11,500 on September 30, 2017.  Far East makes all elections to minimize the tax effect of replacing the equipment.  Which of the following statements is correct?

A. The 2017 taxable capital gain is $250 and the deemed capital cost of the new equipment is $10,000

B. The 2017 taxable capital gain is $250 and the deemed capital cost of the new equipment is $11,500

C. The 2017 taxable capital gain is $250 and the deemed capital cost of the new equipment is $10,750

D. The 2017 taxable capital gain is $1,000 and the deemed capital cost of the new equipment is $12,000

46. With respect to the deferral provisions for replacement property, which of the following statements is **NOT** correct?

A. In the case of involuntary dispositions, for the deferral provisions to apply, the replacement of the property must occur within 24 months after the end of the year in which the proceeds of disposition were received.

B. Provided the replacement cost of the property exceeds the proceeds of disposition, 100 percent of any capital gain that results from an involuntary disposition can be reversed.

C. When the disposition is voluntary, the deferral provisions only apply to former business properties.

D. Provided the replacement cost of the property is less than the proceeds of disposition, 100 percent of any recapture recognized as a result of an involuntary disposition can be reversed.

47. Assume that in all of the following situations the company’s fiscal year is the calendar year and that recapture arose due to the disposition of the asset.  In which situation would the company **NOT** be permitted to defer the recognition of the recapture?

A. A warehouse was destroyed in a fire in December, 2015.  The insurance proceeds received were used to build a new warehouse that was finished in June, 2017.

B. A backhoe was stolen in December, 2015.  The insurance proceeds received were used to buy a new backhoe in June, 2017.

C. A backhoe was destroyed in a fire in December, 2015.  The insurance proceeds received were used to buy a new backhoe in June, 2017.

D. A warehouse was sold in December, 2015 with half the proceeds received at time of sale and half of the proceeds receivable on January 1, 2017.  A new warehouse was purchased in June, 2017.

TIF Problem Eight - 4

Capital Gains And Losses - Exam Exercises

Exam Exercise Subject Listing For Chapter 8

|  |  |
| --- | --- |
| **Number** | **Subject** |
| 1 | Government Assistance |
| 2 | Government Assistance |
| 3 | Superficial Loss |
| 4 | Superficial Loss |
| 5 | Capital Gains - Depreciable Property |
| 6 | Identical Properties |
| 7 | Identical Properties |
| 8 | Warranties On Capital Assets |
| 9 | Warranties On Capital Assets |
| 10 | Capital Gains Reserves |
| 11 | Capital Gains Reserves |
| 12 | Bad Debts On Capital Assets |
| 13 | Bad Debts On Capital Assets |
| 14 | Special Rules - Sale Of Real Property |
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| 16 | Sale Of Principal Residence |
| 17 | Personal Use Property |
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| 20 | Foreign Currency Gains And Losses |
| 21 | Change In Use |
| 22 | Change In Use |
| 23 | Emigration |
| 24 | Emigration |
| 25 | Deferral Of Small Business Gains |
| 26 | Deferral Of Small Business Gains |
| 27 | Involuntary Disposition |
| 28 | Involuntary Disposition |
| 29 | Voluntary Disposition |

Exam Exercise Eight - 1 (Government Assistance)

On January 1 of the current year, Michaels Inc. acquires a used property at a cost of $4,200,000.  Of this amount, $375,000 represents the fair market value of the land.  In order to encourage Michaels’ move to this location, the local government has given them $1,100,000 to assist in the acquisition of the building.  Michaels Inc. has a December 31 year end.  What is the maximum amount of CCA that Michaels can deduct on this building for the current year?

Exam Exercise Eight - 2 (Government Assistance)

On July 1, 2017, Frodam Ltd. acquires a used property at a cost of $3,400,000.  This total cost is allocated $800,000 to the land and $2,600,000 to the building.  In order to assist with this purchase and encourage the Company’s move to this location, the provincial government has provided a grant of $500,000 to assist in the acquisition of the building.  What is the maximum amount of CCA that Frodam can deduct on this building for the taxation year that ends on December 31, 2017?

Exam Exercise Eight - 3 (Superficial Loss)

Mr. Franklin Sharp owns 750 shares of Guard Inc.  They have an adjusted cost base of $21.50 per share.  On June 15, 2017, he sells all of these shares at $13.75 per share.  On June 21, 2017, he acquires 400 shares of Guard Inc. at a cost of $12.15 per share and is still holding the shares at the end of the year.  What are the tax consequences of these transactions?

Exam Exercise Eight - 4 (Superficial Loss)

Ms. Linda Udall owns 800 shares of Fordam Inc. that she acquired several years ago at $10 per share.  On April 30, 2017, she acquires an additional 200 shares at $12 per share.  On July 15, 2017, after Fordam releases unexpectedly bad second quarter results, Ms. Udall sells all 1,000 of her shares at $5 per share.  On August 1, 2017, she purchases 200 shares at $1 per share as she believes the market has overreacted to the bad news.  Ms. Udall is still holding the shares at the end of the year.  What are the tax consequences of these transactions?

Exam Exercise Eight - 5 (Capital Gain On Depreciable Assets)

On July 1, 2017, Lorty Inc. sells equipment for $126,000.  This equipment had an original cost of $111,000 and a net book value of $93,000.  For tax purposes, these assets were in Class 8.  The UCC balance in this class on January 1, 2017 was $103,000.  There were no other additions or dispositions of Class 8 assets during the taxation year ending December 31, 2017.  Indicate the adjustments that would be required to Lorty Inc.’s accounting income in the determination of 2017 Net Income For Tax Purposes.

Exam Exercise Eight - 6 (Identical Properties)

Mr. Levon Park makes frequent purchases of the common shares of Donner Ltd.  Her transactions during 2016 and 2017 are as follows:

**Shares**

**Purchased (Sold) Per Share Value**

January 15, 2016 Purchase 700 $22.75

March 12, 2016 Purchase 410 25.50

September 15, 2016 Sale (250) 26.45

February 14, 2017 Purchase 925 28.25

October 1, 2017 Sale (410) 30.75

Determine Mr. Park’s taxable capital gains (losses) for 2016 and 2017.

Exam Exercise Eight - 7 (Identical Properties)

For the last two years, Margaret Lane has been interested in the shares of Garod Inc.  During the period, her transactions in these securities were as follows++++++++++++:

**Shares**

**Purchased (Sold) Per Share Value**

January 2016 Purchase 300 $4.75

July 2016 Purchase 200 5.25

November 2016 Sale (250) 5.40

July 2017 Purchase 400 5.50

December 2017 Sale (150) 4.80

Determine Ms. Lane’s taxable capital gains (losses) for 2016 and 2017.

Exam Exercise Eight - 8 (Warranties On Capital Assets)

During the taxation year ending December 31, 2016, Pointer Inc. sells a capital asset with an adjusted cost base of $226,000 for proceeds of $279,000.  The Company provides the purchaser with a one year warranty and the Company estimates that it will cost $4,100 to fulfill the warranty provisions.  On September 22, 2017, the Company spends $4,400 to fulfill the warranty provisions.  Determine the effect of these transactions on Net Income For Tax Purposes for 2016 and 2017.

Exam Exercise Eight - 9 (Warranties On Capital Assets)

During 2016, John Ritton sells a capital asset with an adjusted cost base of $126,000 for proceeds of disposition that total $182,000.  He provides the purchaser with a one year warranty that he estimates will cost $2,600 to provide.  During 2017, he spends $2,400 to fulfill the warranty provision.  Determine the effect of these transactions on Net Income For Tax Purposes for 2016 and 2017.

Exam Exercise Eight - 10 (Capital Gains Reserve)

During June, 2017, Ms. Janet Houston sells a capital asset with an adjusted cost base of $112,500, for proceeds of $172,300.  She receives $33,000 of this amount in cash, with the balance due at the end of the following year.  What is the minimum amount that she will have to include in her 2017 Net Income For Tax Purposes as a result of this transaction?

Exam Exercise Eight - 11 (Capital Gains Reserve)

During 2016, Jack Harris sells a capital asset with an adjusted cost base of $87,200 for proceeds of $105,300.  He receives a down payment of $5,300 in 2016, a second payment of $50,000 in 2017, and a final payment of $50,000 in 2018.  What is the minimum amount that  Jack will have to include in Net Income For Tax Purposes in 2016, 2017, and 2018 as a result of this sale?

Exam Exercise Eight - 12 (Bad Debts On Capital Assets)

During 2016, a capital property with an adjusted cost base of $131,000 is sold for $115,000.  The proceeds of disposition are made up of $82,000 in cash, plus the purchaser’s one-year note for $33,000.  In 2017, the note proves to be uncollectible.  What are the tax consequences of these events in 2016 and 2017?

Exam Exercise Eight - 13 (Bad Debts On Capital Assets)

In November, 2016, John Bradley sells a capital property with an adjusted cost base of $182,000, for proceeds of disposition of $213,000.  He receives $63,000 of the proceeds in cash, with the balance of $150,000 payable on December 1, 2017.  When the balance falls due on December 1, 2017, it is clear that none of this amount will ever by paid.  What are the tax consequences of these events in 2016 and 2017?

Exam Exercise Eight - 14 (Special Rules For Sale Of Real Property)

Saba Corp.  bought an apartment complex during 2016 for $450,000 ($100,000 for the land, $350,000 for the building) and sold it during 2017 for $460,000 ($120,000 for the land, $340,000 for the building).  $7,000 was deducted for CCA in 2016.   Determine the tax consequences of the sale for 2017.

Exam Exercise Eight - 15 (Sale Of Principal Residence)

Mr. Jerry Haggard owns a house in Calgary, as well as a cottage in Canmore.  He purchased the house in 2006 for $186,000.  The cottage was purchased in 2009 for $105,000.  During December, 2017, both properties are sold, the house for $263,000 and the cottage for $197,000.  He has lived in the Calgary house during the year, but has spent his summers in the Canmore cottage.  Determine the minimum capital gain that he must report on the 2017 sale of the two properties.

Exam Exercise Eight - 16 (Sale Of Principal Residence)

Ms. Harriet Lowe owns a city home in Vernon, as well as a chalet at the Silver Star ski area.  The city home was purchased in 2004 at a cost of $172,000.  The chalet was purchased in 2010 for $89,000.  On July 1, 2017, the house is sold for $214,000 and the chalet is sold for $122,000.  A real estate commission of 6 percent was paid on each sale.  She has spent some time in each property in every year from 2010 through 2017.  Determine the minimum capital gain that she must report for 2017 as a result of the sale of the two properties.

Exam Exercise Eight - 17 (Personal Use Property)

During the current year, Robert Langois disposes of several items.  The proceeds of disposition and the adjusted cost base of the various items are as follows:

**Adjusted Proceeds Of**

**Cost Base Disposition**

Collector Car   $45,000 $61,000

Marble Sculpture 800 13,000

Antique Furniture 21,000 12,000

Stamp Collection 50,500 26,000

What is the net tax consequence of these dispositions?

Exam Exercise Eight - 18 (Personal Use Property)

During the current year, Rhonda Fontaine disposes of several items of her personal property.  Relevant information on these properties is as follows:

**Adjusted Proceeds Of**

**Cost Base Disposition**

Coin Collection $ 18,000 $ 11,500

Sailboat 42,000 56,000

Antique Sports Car 24,000 12,000

Group Of Seven Painting 142,000 145,000

What is the net tax consequence of these dispositions?

Exam Exercise Eight - 19 (Foreign Currency Gains And Losses)

On June 1, 2014, Ms. Lorenda Jacks acquires 15,300 Barbadian dollars (B$) at a rate of B$1 = C$0.70.  She immediately invests the B$15,300 in 300 shares of a Barbadian company, Tellen Ltd.  uring September, 2017, the shares are sold for B$85 per share.  The Barbadian dollars are immediately converted into Canadian dollars at a rate of B$1 = C$0.72.  What amounts will be included in Ms. Jacks’ 2017 Net Income For Tax Purposes as a result of these transactions?

Exam Exercise Eight - 20 (Foreign Currency Gains And Losses)

In 2015, Lex Steller acquires £10,000 at a rate of £1 = $1.80.  The funds are immediately used to acquire 500 shares of a British company, Upper Lip Ltd., at a price of £20 per share.  In January, 2017, he sells all of the shares for £32 per share, leaving all of the British pounds in his trading account.  At this time, £1 = $1.60.  In December, 2017, he converts the British pounds to Canadian dollars at a rate of £1 = $1.70.  What amounts will be included in Mr. Steller’s 2017 Net Income For Tax Purposes as a result of these transactions?

Exam Exercise Eight - 21 (Change In Use - CCA On Rental Property)

For a number of years, Ms. Danine Post has owned a rural cottage property that has been used for her personal enjoyment.  The cottage cost $142,000 in 2013 and, on July 1, 2017, it has a fair market value of $242,000.  She estimates that the fair market value of the land on which the cottage is located is $22,000 on both of these dates.  It will not be designated as her principal residence for any of the years owned.   On July 1, 2017, she rents the property to an arm’s length party for an amount of $1,000 per month for a period of three years.  Net rental income for the year ending December 31, 2017, before the deduction of any CCA, is $4,800.  What is the maximum amount of CCA that she can deduct for 2017?

Exam Exercise Eight - 22 (Change In Use - ACB, UCC And CCA)

On December 1, 2017, Mr. Jordon Jordu converts his summer cottage into a rental property.  The cottage has an original cost of $57,000 and it will not be designated as his principal residence for any of the years owned.   At the time of the conversion, the fair market value of the property is $136,400.  It is estimated that the land value that is included in both the $57,000 cost and the $136,400 fair market value is $20,000.  Determine the 2017 tax consequences of this change in use.  Your answer should include the maximum CCA that would be available for 2017, and the January 1, 2018 UCC for the rental property, assuming the maximum 2017 CCA is deducted.

Exam Exercise Eight - 23 (Emigration)

Mr. Ryan Marchand owns publicly traded securities with an adjusted cost base of $30,000 and a fair market value of $56,000.  On August 15, 2017, he permanently departs from Canada still owning the shares.  What would be the tax consequences of his departure, if any, with respect to these securities?

Exam Exercise Eight - 24 (Emigration)

Ms. Renee Black owns publicly traded securities with an adjusted cost base of $45,000 and a fair market value of $52,000.  On December 1, 2017, she permanently departs from Canada without selling the shares.  What would be the tax consequences of her departure, if any, with respect to these securities?

Exam Exercise Eight - 25 (Deferral Of Small Business Gains)

On January 15, 2017, Chad Brant sells all of his common shares of Brant Inc., an eligible small business corporation.  He had owned the shares for 15 years.  The adjusted cost base of these shares is $600,000 and they are sold for $1,100,000.  On February 15, 2017, $940,000 of these proceeds are invested in the common shares of Quint Ltd., a new eligible small business corporation.  How much of the capital gain arising on the sale of the Brant Inc. shares can be deferred by the investment in Quint Ltd.?  If the maximum deferral is elected, what will be the adjusted cost base of the Quint Ltd. shares?

Exam Exercise Eight - 26 (Deferral Of Small Business Gains)

In early 2017, Carol Martin sells all of her common shares in Martin Ltd., an eligible small business corporation.  She had owned the shares for 10 years.  The shares had an adjusted cost base of $895,000 and were sold for proceeds of disposition of $985,000.  Using these proceeds, she made two investments in other eligible small business corporations:

* She used $200,000 of the proceeds to invest in Barby Ltd.
* She used $600,000 of the proceeds to invest in Ken Inc.

The remaining proceeds remained in her savings account at the end of 2017.  How much of the capital gain arising on the sale of the Martin Ltd. shares can be deferred by the investments in Barby and Ken?  If the maximum deferral is elected, what will be the adjusted cost base of these two investments?

Exam Exercise Eight - 27 (Involuntary Dispositions)

Multi Inc., a company with a December 31 year end, operates out of a single building that cost $815,000.  At the beginning of 2016, the UCC for its Class 1 was $648,275.  On June 30, 2016, the building was completely destroyed in a tornado.  The building was insured for its fair market value of $1,000,000 and this amount was received in September, 2016.  The building is replaced in 2017 with a 10 year old building at a cost of $1,075,000.  Multi Inc. wishes to minimize taxes.

Describe the 2016 and 2017 tax consequences of these events, including the capital cost and UCC for the replacement building at the end of 2017.  Ignore any gain or loss related to the land on which the building is located.

Exam Exercise Eight - 28 (Involuntary Dispositions)

In October 2016 a thief broke into Guda Corporation’s head office and stole their electronic communications equipment.  The equipment originally cost $18,000 and was in a separate Class 8 with a UCC balance of $12,000.  Fortunately, the equipment was insured for replacement cost so Guda received insurance proceeds of $20,000.  The equipment was replaced in January, 2017 for $20,000.  Guda has a taxation year that ends on December 31.

Provided the appropriate elections are made to minimize the 2016 income inclusions, determine the tax values for the equipment at the end of 2017.

Exam Exercise Eight - 29 (Voluntary Dispositions)

On December 1, 2016, Morteaux Ltd. sells its only building in anticipation of moving to a new location in 2017.  Morteaux Ltd. has a taxation year that ends on December 31.  The property is sold for $2,300,000 and, at the time of the sale, the land had an adjusted cost base equal to its fair market value of $1,200,000, while the building had a capital cost equal to its fair market value of $1,100,000 and a UCC of $250,000.  During February, 2017, the store building is replaced at a total cost of $2,700,000, with $1,300,000 allocated to the land and $1,400,000 allocated to the building.  The replacement building is a 25 year old building.

Assume the appropriate election is made to minimize total taxes for the two years 2016 and 2017.

Calculate the effect on 2016 Net Income For Tax Purposes of the sale and acquisition and the maximum CCA that can be taken on the new building in 2017.

TIF Problem Eight - 5A

Capital Gains And Losses - Key Term Matching (Easy)

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

Version A is easy, there is only one possible answer for each term.

Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms were listed at the end of Chapter 8 on Capital Gains and Losses:

A. Involuntary Disposition

B. Capital Loss

C. Deemed Disposition

D. Capital Asset

E. Listed Personal Property

F. Real Property

G. Superficial Loss

H. Taxable Capital Gain

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

1. A disposition of a capital property resulting from theft, destruction through natural causes, or expropriation by a statutory authority.

2. The taxable portion of a capital gain.

3. A requirement to assume that a disposition has taken place when, in fact, a disposition transaction has not occurred.

4. An asset that is held for the purpose of producing income.

5. The disposal of an asset through sale, gift, physical destruction, conversion, expropriation, or other means.

6. Any property that is owned by the taxpayer and used primarily for his enjoyment.

7. Land and all appurtenances to it, including buildings, crops, and mineral rights.

8. A loss on the disposition of property that is disallowed for tax purposes because the taxpayer has acquired an identical property, either 30 days before the disposition or, alternatively, 30 days after the disposition.

9. The excess of the sum of the adjusted cost base of a capital asset plus any costs of disposition, over the proceeds resulting from the disposition of the asset.

10. A defined subset of personal use property.  The included items are works of art, jewelry, rare books, stamps, and coins.

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

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

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

TIF Problem Eight - 5B

Capital Gains And Losses - Key Term Matching (Moderate)

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

Version A is easy, there is only one possible answer for each term.

Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms were listed at the end of Chapter 8 on Capital Gains and Losses:

A. Involuntary Disposition

B. Capital Loss

C. Deemed Disposition

D. Capital Asset

E. Listed Personal Property

F. Real Property

G. Superficial Loss

H. Taxable Capital Gain

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

1. A disposition of a capital property resulting from theft, destruction through natural causes, or expropriation by a statutory authority.

2. The taxable portion of a capital gain.

3. A requirement to assume that a disposition has taken place when, in fact, a disposition transaction has not occurred.

4. A loss on the disposition of property that is disallowed for tax purposes because the transfer was to a non-arm’s length person.

5. A disposition of a capital property resulting from repossession by creditors.

6. An asset that is held for the purpose of producing income.

7. The disposal of an asset through sale, gift, physical destruction, conversion, expropriation, or other means.

8. Any property that is owned by the taxpayer and used primarily for his enjoyment.

9. Land and all appurtenances to it, including buildings, crops, and mineral rights.

10. A defined subset of personal use property.  The included items are works of art, jewelry, rare books, antiques, and coins.

11. An asset that is classified as non-current for accounting purposes.

12. A loss on the disposition of property that is disallowed for tax purposes because the taxpayer has acquired an identical property, either 30 days before the disposition or, alternatively, 30 days after the disposition.

13. The excess of the sum of the adjusted cost base of a capital asset plus any costs of disposition, over the proceeds resulting from the disposition of the asset.

14. A defined subset of personal use property.  The included items are works of art, jewelry, rare books, stamps, and coins.

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

**Required:** For each of the eight key terms listed (A through H), indicate the number of the item (1 through 14) that provides the **BEST** definition of that term, or, alternatively, that none of the definitions apply (11).  Explanations are not required.

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

TIF Problem Eight - 6

Capital Gains And Losses - Identical Properties

Martin Blair has purchased the shares of two companies over the years.  Each company has only one class of shares.  Purchases and sales of shares in the first of these companies, Marek Ltd., are as follows:

March, 2011 purchase 650  @ $11

September 2012 purchase 922  @ 13

May, 2014 purchase 480  @ 17

November, 2014 sale (610) @ 21

July, 2017 purchase 240  @ 18

October, 2017 sale (460) @ 12

Purchases and sales of shares in the second company, Dunsmore Inc., are as follows:

April, 2016 purchase 2,200  @ $12

December, 2016 purchase 1,450  @ 17

July, 2017 sale (2,840) @ 22

**Required**:

A. Determine the cost to Mr. Blair of the Marek Ltd. shares that are still being held on December 31, 2017.

B. Determine the taxable capital gain resulting from the July, 2017 disposition of the Dunsmore Inc. shares.

TIF Problem Eight - 7

Warranties And Bad Debts

Ms. Houde is a wealthy entrepreneur.  She owns a large tract of undeveloped land near Lethbridge, Alberta.  The land was acquired a number of years ago at a cost of $3,500,000.  As she has decided to move to Newfoundland, on December 31, 2017, Ms. Houde sells this tract to a local real estate developer for $6,000,000.

The developer provides a down payment of $1,000,000 and agrees to further payments of $1,000,000 per year, commencing on December 31, 2018.  Interest is charged at the annual rate of 5 percent on the outstanding balance at the beginning of each year.  Due to a large business loss, Ms. Houde chooses not to use a capital gains reserve to defer the taxation on this sale.

The developer plans to subdivide the property into 100 equal sized lots which he anticipates will sell quickly at $125,000 each.  However, because of the large amount of risk associated with the project, Ms. Houde agrees to pay the developer $10,000 for each lot that is not sold by December 31, 2018.

By December 31, 2018, only 60 of the lots have been sold, a result which requires Ms. Houde to pay the developer $400,000 [($10,000)(40 Lots)].  The developer pays Ms. Houde the required interest and principal payments for 2018.

During 2018, the developer continues to market the remaining 40 lots.  However, because of a successful competing housing development, he is unable to sell any of these properties.  While he is able to pay the required interest on December 31, 2019, he is unable to make the required principal payment on that date.  Despite this default, Ms. Houde expects to be able to collect the remaining balance in subsequent years.

In early 2020, the developer declares bankruptcy.  Of the remaining loan balance, Ms. Houde is only able to recover $1,000,000.

**Required:** Calculate the tax effects of the transactions that took place during 2017 through 2020 on Ms. Houde’s Net Income For Tax Purposes.  Include in your solution the effect on the Tax Payable of other years.

TIF Problem Eight - 8

Capital Gains Reserves

Ms. Helm acquired two tracts of land near Ottawa 5 years ago. Tract A cost $71,000, while Tract B cost $87,000.

On July 1, 2017, Tract A is sold for $127,000.  The terms of the sale require a down payment of $17,000.  A payment of $25,000 is required on January 1, 2018.

Also on July 1, 2017, Tract B is sold for $106,000.  The terms of the sale require a down payment of $32,000.  No further payment on the principal amount is required for five years.

**Required**: Determine the amount of the minimum taxable capital gain that will have to be included in Ms. Helm’s Net Income For Tax Purposes for both 2017 and 2018.

TIF Problem Eight - 9

Capital Gains Reserves

For many years, Mr. Martin Fox has owned a parcel of land near the city of London, Ontario.  On January 1, 2017, he sells the land for $895,000.  The real estate agent charges a commission of 4 percent.  The adjusted cost base of the land is $135,000.

The terms of sale require a down payment at the time of closing, with Mr. Fox accepting a 6 percent mortgage for the balance of the $895,000 sales price.

On each January 1 of subsequent years, a principal payment equal to 10 percent of the sales price ($89,500) is required.  This is in addition to the interest on the outstanding balance of the mortgage during the previous year.

Mr. Martin wishes to use reserves to defer the payment of taxes on capital gains for as long as possible.

**Required:** For the years 2017 through 2021, compare the capital gains taxation effects of this sale assuming:

A. The down payment was 10 percent of the sales price.

B. The down payment was 50 percent of the sales price.

TIF Problem Eight - 10

Principal Residence Designation

Since 1998, Petumala Fluffy has owned a residence in Kelowna, British Columbia.  It was acquired in that year at a cost of $623,000.

In 2006, Petumala was appointed to the Senate and, because of the significant amount of time that she was required to be present in Ottawa, she acquired a second residence in that city.  The cost of this residence was $426,000.  In each of the subsequent years, she spent some time at each residence.

In 2017, following allegations that she had claimed and double claimed completely inappropriate travel costs, she resigned from the Senate.  As this created severe financial difficulties (among other problems), she sold both residences and moved in with her mother.  The Kelowna house sold for $897,000, while the Ottawa home sold for $534,000.  These amounts are net of all real estate fees.

Ms. Fluffy would like to minimize any capital gain that arises as the result of selling the two properties.

**Required:** Describe how the residences should be designated in order to accomplish Ms. Petumala’s goal.  In addition, calculate the total amount of the gain that would arise under the designation that you have recommended.

TIF Problem Eight - 11

Personal Property Dispositions

After a lengthy career as a successful stock market analyst, Ross Howard lost his job.  While he has searched extensively for a new position for more than a year, he has been unable to find suitable employment.  Given this, he begins to sell some of his prized possessions.  The following transactions occur during the current year:

* His beloved collection of limited edition fountain pens had a total cost of $42,000.  However, the proceeds from their sale to another collector, the sole interested party, amounted to only $13,000.  These pens were used largely for decorative purposes.  They were all displayed on his work desk and he always carried one prominently in the pocket of his jacket or shirt in order to impress clients.
* His first edition of Hemingway’s *The Sun Also Rises* had cost $12,000 and sold for $31,000.
* He had inherited a small Paul Borduas painting from his grandfather.  The painting had cost his grandfather $1,500.  At the time of the bequest, its fair market value had increased to $128,000.  It is sold privately by Mr. Howard for $132,000.
* For several years he has driven a Bentley Flying Spur which had cost $185,000.  It is sold for $64,000.
* His antique Chris Craft race boat had cost $45,000 several years ago.  It is sold for $62,000.

**Required:** Indicate the tax consequences of each of these dispositions.  In addition, indicate the total amount that will be included in Mr. Howard’s Net Income For Tax Purposes, as well as any carry over amounts that can be used in previous or subsequent years.

TIF Problem Eight - 12

Capital Gains On Foreign Securities

Mr. Oskar Franklin, a Canadian citizen and resident, spent most of his early years living in Switzerland.  This experience left him with a strong belief that Swiss companies are the best run companies in the world.  Given this, he opens a Swiss Franc (SF, hereafter) account in a Canadian brokerage firm.

During the years 2015 through 2017, activity in that account is as follows:

* In May, 2015, he acquires 5,000 shares of Matterhorn Ltd., a Swiss company, at a cost of SF25 per share.  He acquired the Swiss Francs necessary for this purchase at SF1 = $1.25.
* In August, 2016, he receives dividends on the Matterhorn shares in the amount of SF1.10 per share.  The funds are left in his Swiss Franc trading account and remain there at the end of 2016.  The trading account does not pay interest.
* In April, 2017, all 5,000 of the Matterhorn shares are sold for SF23 per share.  At this time, the Swiss Francs from this sale are left in his Swiss Franc trading account.
* In December, 2017, fearing that developments in Europe will lead to a further decline in the Swiss Franc, he closes his Swiss Franc trading account and converts all of the funds (the Matterhorn dividend and the proceeds from the Matterhorn share sale) into Canadian dollars.

Assume relevant exchange rates between the Swiss Franc and the Canadian dollar are as follows:

May 2015 SF1.00 = $1.25

August, 2016 SF1.00 = $1.35

April, 2017 SF1.00 = $1.38

December, 2017 SF1.00 = $1.34

**Required:** Calculate the minimum amount that will have to be included in Mr. Franklin’s Net Income For Tax Purposes in each of the years 2015 through 2017, as a result of these transactions involving Swiss Francs.

TIF Problem Eight - 13

Court Cases - Identification Of Capital Gains

Each of the following Cases contains a brief description of an actual court case involving the identification of capital gains.  For each Case, indicate whether you feel the transaction should have generated a capital gain or income.  Explain the basis for your conclusion.

**Case A** An individual constructed an apartment building and operated it as a rental property for a period of three years.  At that time, as the result of an unsolicited offer, he decided to sell the building.  His decision was also influenced by the fact that he encountered unexpected difficulties in operating the building.  The proceeds of the sale exceeded the cost of the building.  (73 DTC 5060)

**Case B** An operator of a taxicab business decided to dispose of it as it had proved to be unprofitable.  He was not able to obtain a favourable price for the business as a complete unit and, as a consequence, he decided to sell the individual cars.  During largely because some worn out cabs had to be replaced and some trade-ins were the subsequent two year period, he engaged in over 40 transactions involving the cars, accepted.  A profit was made on most transactions.  (57 DTC 144)

**Case C** A taxpayer carried on a full time business as an interior designer.  While carrying on this business he bought, lived in for short periods of time, and resold numerous residential properties.  In most cases, improvements were made and the property modernized prior to resale.  The sales prices were usually well in excess of costs.  (64 DTC 56)

**Case D** An optical organization bought the assets of an optical company whose shares were held by a group of medical doctors.  The sale was accompanied by an agreement to pay each doctor a “kickback” for every prescription filled.  A provincial statute eventually made these payments illegal, at which point the doctors sold their shares to the optical organization.  Even though each doctor sold one share, the payments to them varied from $1,800 to $57,000.  The payments were to be made over a period of ten years and the agreement required the doctors to continue sending patients to the optical company.  The amounts paid to the doctors were proportional to the size of their practices.  (57 DTC 48)

**Case E** A private company with broadly stated charter powers claimed that it was engaged in the business of dairy farming.  Three different farms were acquired and operations started.  However, in each case a loss was experienced.  The parcels of farmland were then subdivided and sold at a price in excess of their cost.  (65 DTC 89)

**Case F** The manager of a company that operated vans designed for the transportation of horses engaged in several transactions involving the purchase and sale of racehorses.  He attended race tracks on a regular basis and kept numerous horses for his own personal enjoyment.  On most of the purchase and sale transactions, the proceeds of the sale exceeded the cost of the horse.  (67 DTC 240)

TIF Problem Eight - 14

Change In Use - Depreciable Property

On January 1, 2015, Ms. Laura Darn purchases a real property for $725,000, of which $225,000 reflects the estimated value of the land on which the building is situated, and $500,000 is the estimated value of the building.

Of the floor space in the building, 80 percent will be used to operate her mail order food supplements business, with the remaining 20 percent being used as her residence.

During 2015, Ms. Darn enters into a relationship with Mr. Lance Buffer, her personal fitness trainer.   Their relationship develops quickly and Mr. Buffer moves in with Ms. Darn on January 1, 2016.  Because this requires additional space for Mr. Buffer’s considerable wardrobe, part of the space used for her mail order business is converted to residential space.  Specifically, 20 percent of the total space is converted to residential use, reducing the space used for her business to 60 percent of the total.  At the time of this conversion, the total market value of the property has increased to $815,000, with $230,000 the estimated value of the land, and the remaining $585,000 allocated to the building.

In November, 2016, Mr. Buffer begins to have an increasingly large number of late night appointments for his services.  Trying to ignore her suspicions, Ms. Darn spends her nights promoting her business on social media and her business experiences considerable growth.   A trusted friend finally informs Ms. Darn that most of Mr. Buffer’s late night appointments are with attractive young females and, while he is providing some services, they are not related to personal fitness (at least not directly).

Furious, Ms. Darn throws Mr. Buffer out.  Because of the tainted memories associated with him, she feels she cannot continue living in the same residence.  Since her business is being constrained due to lack of space, on January 1, 2017, she moves out of the residential part of the building and converts the entire space to business usage.  At this time, the fair market value of the building has increased to $875,000, with $245,000 of this total reflecting the value of the land, and the remaining $630,000 reflecting the value of the building.

**Required:** Determine the maximum CCA that can be deducted by Ms. Darn in 2015, 2016, and 2017.  In addition, ignoring the principal residence gain deduction, indicate any other tax consequences that will result from the changes in use of this property.

TIF Problem Eight - 15

Deemed Dispositions On Emigration

Until 2017, Marcie Doan has been a resident of Canada.  However, on January 1, 2017, she decides to move to Scottsdale, Arizona.  On this date, she owns the following assets:

**Adjusted Fair Market**

**Cost Base Value**

Common Shares In ABC Ltd. (a Canadian

controlled private corporation) $42,000 $86,000

Vacant land 63,000 84,000

Common Shares In Power Corp (a public company) 38,000 72,000

Preferred Shares In TD Bank (a public company) 84,000 72,000

Sailboat 97,000 54,000

Oil Painting 5,000 11,000

Stamp Collection 12,000 3,000

Ms. Doan has come to you for advice just prior to moving to Arizona.

**Required**: Determine the amount of the taxable capital gain or allowable capital loss that Ms. Doan will report in her Canadian income tax return for 2017 as a result of her departure from Canada.  Assume that the usual tax rules apply, with no elections being made by Ms. Doan.

TIF Problem Eight - 16

Deferral On Small Business Shares

Your very wealthy client, Ms. Nell Tosh is holding investments in a number of small venture capital companies.  In order to diversify her holdings, she has decided to sell two of her many investments in 2017 and use the proceeds to invest in companies in different industries.

Her first sale, in January, involves Tech Ltd., a company she acquired 4 years ago for $3,500,000.  Her common shares are sold for $4,200,000.  Of the proceeds, $3,800,000 is immediately invested in Small Oil Inc. common shares.  The remainder of the funds are used to purchase preferred shares in Small Bank Inc.  All three corporations are eligible small business corporations.

The second sale, in October, involves Future Inc. common shares and results in proceeds of $5,600,000.  This company is an eligible small business corporation and was acquired 6 years ago at a cost of $3,800,000.  The proceeds are invested in November in common shares of the following companies:

Sombra Inc. (An Eligible Small Business Corporation) $2,400,000

Ziff Ltd. (An Eligible Small Business Corporation) 2,800,000

BCE (A Canadian Public Company) 400,000

In December, Ms. Tosh is approached by her brother, Niels, a brilliant biochemist.  He is planning to start a new company which will be an eligible small business corporation.  Niels would like her to invest $1,000,000 in his company’s common shares.  The company will sell his revolutionary new weight loss pill.

At a February 20, 2018 meeting Ms. Tosh informs you that she has not invested in any shares since November.  She would like to minimize her tax liability in any way legally possible.

**Required:** Determine the tax consequences for Ms. Tosh of the two sales of shares and the adjusted cost base of each of her new investments assuming she does not invest in any other eligible small business corporations.  What advice would you give Ms. Tosh regarding an investment in her brother’s company?

TIF Problem Eight - 17

Voluntary Dispositions

The current operations of Morcan Inc. (MI) are located in Toronto.  Because of the high cost of living in this venue, the Company is experiencing difficulty in attracting new employees.  In order to correct this situation, the Company has decided to move its operations to Tweed, Ontario, a small community with much lower living costs.

To this end, it sells all of its Toronto assets during December, 2017.  Details of these transactions are as follows:

**Land And Building** The Company’s building and the land on which it is situated is sold for a total of $3,400,000, of which $2,300,000 can be allocated to the building and $1,100,000 can be allocated to the land.  The land was acquired many years ago at a cost of $350,000.  After acquiring the land, the building was constructed at a cost of $2,100,000.  On January 1, 2017, the UCC of the building was $850,000.  The Company has no other Class 1 assets.

**Equipment** The equipment, all of which falls into Class 8, was acquired at a cost of $450,000.  On January 1, 2017, the UCC for Class 8 is $165,000.  The equipment is sold for $320,000.

In early 2018, the Company acquires a replacement building in Tweed for $3,100,000.  Of this total, it is estimated that $2,500,000 can be allocated to the building, with $600,000 allocated to the land.  As it is not a new building, it does not qualify for the enhanced CCA rate for Class 1.

New equipment is acquired for the use in the building at a cost of $520,000.  All of this equipment is allocated to Class 8.

The Company would like to minimize any capital gains or recapture resulting from the sale of the Toronto property.  The Company’s tax year ends on December 31, 2017, and it does not own any buildings or equipment on this date.

**Required:**

A. For the disposition of each property, indicate the tax effects that would be included in the Company’s 2017 tax return.

B. Indicate how these tax effects could be altered in an amended 2017 return by using the elections available under ITA 44(1) (to defer capital gains) and ITA 13(4) (to defer recapture), but without the use of the election under ITA 44(6) (to reallocate the proceeds of disposition).  Also indicate the adjusted cost base and, where appropriate, the UCC of the replacement properties, subsequent to the application of the ITA 44(1) and ITA 13(4) elections.

C. Indicate the maximum amount of any reduction in income in the amended 2017 Net Income For Tax Purposes that could result from the use of the ITA 44(6) election and calculate the UCC balance that would result from electing to use this amount.  Should the Company make the election?  Explain your conclusion.

TIF Problem Eight - 18

Involuntary Dispositions

Winding Inc. has a Class 1 building with an original cost of $900,000, of which $150,000 can be attributed to the land.  It is the only Class 1 asset owned by the Company and, on January 1, 2017, its UCC balance is $425,000.

On July 1, 2017, this building is completely destroyed in a major earthquake.  It is estimated that, at the time of this event, the fair market value of the building and land was $1,200,000, with $200,000 of this total applicable to the land.  With respect to the building, insurance proceeds of $1,000,000 are received on November 1, 2017.  Also on this date, the land is sold for $200,000.

On February 1, 2018, the Company finds a suitable replacement building that is located near the site of the old building.  It is acquired on that date at a cost of $1,400,000, including an estimated value for the land of $300,000.  As it is not a new building, it does not qualify for the enhanced CCA rate for Class 1 buildings.

**Required:**

A. Indicate the tax consequences of the involuntary disposition that will be reported in the Company’s 2017 tax return.

B. Indicate the changes that will be reported in the amended 2017 return, provided the Company makes elections under ITA 13(4) (to defer recapture) and ITA 44(1) (to defer capital gains).  In addition, determine the capital cost and UCC for the replacement assets, subsequent to the application of these elections.

C. Calculate the maximum CCA that Winding will be able to claim for the building in 2018, assuming the Company makes the elections under ITA 13(4) and ITA 44(1).

TIF Problem Eight - 19

Involuntary Dispositions

On August 1, 2016, the only building owned by Wilson Ltd. is completely destroyed in a fire.  The building was acquired several years ago at a cost of $890,000, of which $140,000 can be attributed to the land.  Wilson Ltd. has a June 30 year end.  On July 1, 2016, the UCC of the building was $599,298.

Within six months of the fire, the company receives insurance proceeds equal to $1,250,000, the fair market value of the destroyed building.

As the building site is not large enough for the planned replacement, the land on which it was situated is sold for $250,000.

The replacement building is acquired on November 1, 2017 at a cost of $1,600,000, of which $300,000 can be attributed to the land.  It is a new building that will be used 100 percent for non-residential purposes, none of which is manufacturing.  It is the intent of Wilson Ltd. to keep this building in a separate Class 1.

**Required:**

A. Indicate the tax consequences of the involuntary disposition that will be reported in the Company’s tax return for the fiscal year ending June 30, 2017.

B. Indicate the changes that will be reported in the amended return for the fiscal year ending June 30, 2017, provided the Company makes elections under ITA 13(4) (to defer recapture) and ITA 44(1) (to defer capital gains).  In addition, determine the capital cost and UCC for the replacement assets, subsequent to the application of these elections.

C. Calculate the maximum CCA that Wilson will be able to claim for the building in the fiscal year ending June 30, 2018, assuming the Company makes the elections under ITA 13(4) and ITA 44(1).

TIF Problem Eight - 20

Short Cases - Various Issues

Each of the following independent Cases describes a situation with a proposed tax treatment.

1. Mr. Acker has owned a small triplex for a number of years and, throughout this period, all three of the units have been rented.  In determining his income from this property, he has deducted CCA in each year.  During the current year, Mr. Acker has moved into one of the three units and, as a result, will be reporting reduced rental revenues in his tax return.  As he has not sold any property, he will not report any capital gains or losses during the current year.

2. Mr. Jones has sold a property with an adjusted cost base of $72,000 for total proceeds of $105,000.  He is providing a warranty on the property that he estimates will cost him $6,000 to service.  As a consequence, he is recognizing a capital gain of $27,000.

3. Ms. Turner sold her dining room table to her daughter for $400 and a painting to her brother for $900.  These prices equalled their estimated fair market values.  Several years ago, she purchased the table for $950, and the painting for $667.  She does not plan to report any capital gain or loss.

4. Mrs. Brown purchased corporate bonds for $11,200, of which $800 was accrued interest and $10,400 represented the principal.  The bonds were later sold for $11,600 that includes $200 for accrued interest.  Mrs. Brown recognizes a taxable capital gain of $500.

5. Several years ago, Miss Lee transferred three sports cars, with a total value of $182,000, to a corporation in return for all of the shares of the company.  The cars are profitably used in her personal escort business.  During the current year, all of the cars are destroyed in a fire on her estate.  Unfortunately, Miss Lee did not believe that people in her financial position needed insurance and, as a consequence, no compensation was available for the loss.  As the corporation had no assets other than the cars, there was no reason for her to continue to hold the shares.  In view of this situation, she sells the shares to a friend who requires a corporate shell for some business operations.  The sale price is $500 and Miss Lee uses the allowable capital loss of $90,750 [(1/2)($182,000 - $500)] to offset taxable capital gains resulting from real estate transactions.

**Required:** In each of the preceding Cases, indicate whether or not you believe that the tax treatment being proposed is the correct one.  Explain your conclusion.

TIF Problem Eight - 21

Comprehensive Case (Chapters 1 to 8)

Ms. Anita Brock is a marketing executive employed by a Canadian public company with a December 31 year end.  Her base salary for 2017 is $142,000.  She also earned $36,000 in commissions and was awarded a bonus of $42,000 for outstanding performance during the year.  The bonus will not be paid until December 1, 2018.

Her employer withheld the following amounts from her base salary:

RPP Contributions $5,900

EI 836

CPP 2,564

Professional Association Dues 1,500

Life Insurance Premiums 1,100

Group Disability Insurance Premiums 260

Anita’s employer makes matching contributions to her RPP, her life insurance policy, and group disability insurance plan.  The disability plan was introduced in 2016 and Anita’s premiums for that year were $240.

Her employer provides her with an allowance of $2,500 a month in order to cover her travel costs, including the use of her personally owned automobile.  The automobile was purchased for $28,500 in 2016 and, during that year, was used 70 percent for employment related activities.  In 2017, her employment related use of the vehicle increased to 80 percent.

Her employer requires her to maintain an office in her home and has provided her with a signed Form T2200.  The office occupies 20 percent of the floor space in her home.  The 2017 costs of operating this property are as follows:

Maintenance And Utilities $1,800

Property Taxes 7,200

Insurance 1,200

Mortgage Interest 11,400

Other employment related expenditures during 2017 are as follows:

Automobile Operating Expenses $5,400

Hotels 6,300

Airline And Other Transportation 12,300

Client Meals And Entertainment 8,400

Three years ago, Anita’s employer granted her options to buy 1,500 of the company’s common shares at a price of $32 per share.  At that time, the shares were trading at $34 per share.  During 2017, when the per share price had increased to $41 per share, Anita exercises all of these options.  Unfortunately, the company’s earnings started plummeting during the 4th quarter and, based on the possibility of further declines, Anita sold the shares for $31 per share in December.

In 2017, Anita was off work for three weeks due to a surgical procedure.  During this period, the group disability plan provided benefits of $2,000 per week.

Family Information

Anita is 46 years old and lives with her common-law partner Peaches Lamont.  Both women have a child from a previous marriage.  Anita’s child Nancy is 12 years old and has no income of her own.  Peaches’ child Lex is 14 and is sufficiently disabled that he qualifies for the disability tax credit.  Lex has no income of his own.  Both children were formally adopted in 2014.

Peaches is 32 years old and attends university on a full time basis for 7 months of the year.  Her tuition fees are $9,400.  Peaches has agreed to transfer any unused tuition credit to Anita.

During 2017, Peaches receives child support payments of $2,000 per month, along with spousal support payments of $500 per month.

The family’s 2017 medical expenses are as follows:

Anita $ 1,400

Peaches 11,400

Nancy 2,200

Lex (No Attendant Care Costs) 4,600

Total $19,600

Other Information

1. For a number of years, Anita has owned a tract of land with an adjusted cost base of $85,000.  While she had hoped to construct a rental property on the land, during 2017 she received an accepted an unsolicited offer of $220,000.  The purchaser provides a down payment of $50,000, with the balance payable in 10 annual instalments of $17,000 beginning in 2018.

2. During 2017, Anita receives eligible dividends of $2,200.

3. Anita owns a rare, vintage sailboat that had cost $123,000 when she purchased it 8 years ago.  While she was once an avid sailor, her interest has declined over the years and, given this, she decides to rent out the boat to people with advanced sailing skills.  Her first charter is on June 1, 2017.  On this date, it is estimated that the fair market value of the sailboat is $147,000.  Her charter revenues for 2017 total $46,000, while her expenses other than CCA total $13,000.  For CCA purposes, she knows that sailboats are in Class 7 and subject to a declining balance CCA rate of 15 percent.

4. At the beginning of 2017, Anita owned 1,500 units of Capital Income Trust.  The adjusted cost base of these units at that time was $23 per unit.  During 2017, the trust had a distribution of $2 per unit, all of which was property income.  Anita had all of this distribution invested in additional units at $25 per unit.  In December, 2017, all of her Capital Income Trust units were sold for $27 per unit.

5. Anita owned an antique clock that she sold for $5,000 in 2017.  It was a wedding gift from her ex-husband’s parents and its fair market value at the time of the gift was $300.  Her ex-husband thought it was tacky and willingly left it with her.

6. Anita makes 2017 contributions to registered Canadian charities of $3,600.  She does not qualify for the first-time donor’s super credit.

**Required:** Calculate Anita’s minimum 2017 Net Income For Tax Purposes, her 2017 minimum Taxable Income, and her minimum 2017 federal Tax Payable.  Ignore provincial income taxes, any instalments she may have paid during the year, any income tax withholdings that would be made by her employer, and GST/HST/PST considerations.

TIF Problem Eight - 22

Comprehensive Case (Chapters 1 to 8)

Mr. Paul Klee is 39 year of age and lives with his spouse, Virginia Klee.  They have two children, May who is 9 years old and Max who is 12 years old.  May has been blind since birth.  During 2017, Max has income of $8,200.

Virginia is 38 years and until recently was employed by a large public company.  However, in September, 2016, she commenced full time studies at her local university.  During 2017, she was in full time attendance for 9 months.  Her tuition fees were $9,350.  She had 2017 income from various part time sources of $8,400.

During 2017, the family incurs medical expenses as follows:

Paul $ 1,100

Virginia 1,750

May (No Attendant Care Costs) 13,300

Max 650

Total $16,800

Employment Information

Paul is employed as a salesperson by a Canadian public company.  His annual salary is $85,000 and, in addition, he earns commissions of $62,500.  The following amounts are withheld by his employer during 2017:

RPP Contributions $4,100

EI 836

CPP 2,564

Professional Association Dues 1,500

Annual United Way Donations 1,200

Paul’s employer makes a matching contribution to his RPP of $4,100.

Paul’s employer requires that he maintain an office in his home and has provided him with the requisite Form T2200.  This office occupies 20 percent of the total floor space in his home.  His home operating costs for 2017 are as follows:

Maintenance And Utilities $3,400

Property Taxes 7,200

Insurance 850

Mortgage Interest 4,200

Paul’s employer provides a $2,500 per month allowance to cover all of his employment related expenses, including an automobile that he owns personally.  The automobile was acquired in 2016 at a cost of $45,000.  In his 2016 tax return he claimed CCA based on the automobile being used 55 percent for employment related activities.  For 2017, the usage increased to 80 percent.

Paul’s employment related expenses for 2017 are as follows:

Automobile Operating Expenses $ 6,100

Hotels 11,500

Airline And Other Transportation 9,200

Client Meals And Entertainment 10,400

Two years ago, Paul’s employer granted him options to buy 1,500 shares of the company stock at $15 per share.  At that time, the shares were trading at $12 per share.  In February, 2017, when the shares are trading at $19 per share, Paul exercises all of these options.  In November, 2017, he sells all of these securities for $22 per share.

Other Information

1. Paul owned two very large oil paintings, each of which cost $10,000.  Since he renovated his home and added many more windows, he no longer had the wall space to hang these paintings.  During 2017, he sells one painting for $15,000 and the other painting for $4,000.

2. Paul inherited a tract of land from his father.  Paul’s adjusted cost base for it was $100,000.  In July, 2017, he sells the land to help finance his home renovations.  The sale price is $350,000 and the terms of the sale require a 2017 payment of $100,000, with the balance being paid in annual instalments of $50,000 in each of the years 2018 through 2022.  Paul would like to use a capital gains reserve to defer as much of this gain as possible.

3. During 2017, Paul received non-eligible dividends of $5,400.

4. Since 2012, Paul and his family have owned a cottage on a nearby lake.  It had cost $250,000, including an estimated value for the land of $75,000.  As their use of this property has declined over the years, they have decided to convert the cottage to a rental property.  At the time of the change, the property was appraised at $375,000, including $100,000 for the land.  During 2017, net rental income before the deduction of CCA equals $23,000.  Since his city home has had a very substantial increase in value, Paul does not intend to designate the cottage as his principal residence for any of the years of ownership.

**Required:** Calculate Mr. Klee’s minimum 2017 Net Income For Tax Purposes, his 2017 minimum Taxable Income, and his minimum 2017 federal Tax Payable.  Ignore provincial income taxes, any instalments he may have paid during the year, any income tax withholdings that would be made by his employer, and GST/HST/PST considerations.

Chapter Nine Test Item File Problems

TIF Problem Nine - 1

Other Income/Deductions, Attribution - Essay Questions

1. What is a retiring allowance?  What are the tax consequences associated with receiving a retiring allowance?

2. What is a death benefit?  Indicate any special tax features that are associated with the receipt of a death benefit.

3. Briefly describe the treatment of amounts received as scholarships.

4. As evidenced by the ability to deduct these items in the calculation of Taxable Income, the government does not intend to tax social assistance payments or worker’s compensation payments.  Given this, why are these amounts included in Net Income For Tax Purposes?

5. List the situations in which an individual can deduct moving expenses.

6. Can an employer compensate an individual for a loss on a home that was sold because the employee was required to move, without creating a taxable benefit for the employee?  Explain your conclusion.

7. For purposes of deducting child care costs, how is an “eligible child” defined?

8. What is the objective of providing a disability supports deduction.  Cite two examples of costs that can be deducted using this provision.

9. Splitting pension income with a spouse may not be a desirable tax planning strategy.  Explain this statement.

10. What are the conditions that must be met for spousal support payments to be deductible to the payor and taxable to the recipient?

11. John Withers is receiving an annuity payment of $500 per month.  How will this payment be taxed?

12. What are the tax advantages and other benefits associated with making contributions to a Registered Education Savings Plan?

13. What is the Canada Learning Bonds program?  Briefly describe the program.

14. What are the major tax advantages of Tax Free Savings Accounts (TFSAs)?

15. How is the balance in a Tax Free Savings Account (TFSA) dealt with when the beneficiary of the plan dies?

16. ITA 69 deals with non-arm’s length transfers of capital property at values that are different from the fair market value of the property.  Why would an individual wish to transfer a property to an adult child at a value that is below its fair market value?  Briefly explain your conclusion.

17. An individual wishes to transfer several properties to related parties, some of whom are in higher tax brackets, some of whom are in lower tax brackets.  What advice would you give this individual with respect to the consideration that he should take back in return for the property transferred?

18. What are the normal tax consequences, at the time of transfer, for an individual who is transferring property to a spouse or common-law partner?  In these circumstances, at what value will the transfer be deemed to take place?  Is there an election that can be used to alter these results?  If so, briefly describe the election.

19. When there is a non-arm’s length transfer of a depreciable property that has a fair market value in excess of its capital cost, the capital cost to the transferee for UCC and recapture purposes will be equal to the transferor’s capital cost, plus one-half of the difference between the fair market value and the transferor’s capital cost.  What is the reason for this rule?

20. Briefly describe the general rules applicable to the treatment of an individual’s capital property at death.

21. While the general rules for dealing with an individual’s capital property at death require a deemed disposition and the recognition of fair market values, there are rollovers available that can eliminate or reduce the income that would be recognized on such deemed dispositions.  Briefly describe these rollovers.

22. When a transfer is made to a spouse or common-law partner, the income attribution rules may be applicable.  Briefly describe the conditions under which the income attribution rules would be applicable on such transfers.

23. An individual is considering making a gift of a portfolio of publicly traded stocks.  On the basis of tax considerations, provide advice to this individual as to whether he should give the stocks to his 12 year old daughter or, alternatively, to his spouse.

24. One of your clients is a successful businessman with both a spouse and a minor child that have no income of their own.  He would like to transfer some of his income into their hands for tax purposes.  However, he is concerned about the income attribution rules.  Provide him with three tax tips for dealing with these rules.

TIF Problem Nine - 2

Other Income/Deductions, Attribution - True Or False

1. The widow of Peter Toscan received a death benefit from his employer of $25,000.  She must include the $25,000 in income in the year of receipt.

True or False?

2. The entire amount of a retiring allowance received must be included in income, even if some part of the allowance is transferred to an RRSP.

True or False?

3. Chris Shaffer is being transferred by his employer from Prince George, British Columbia to Red Deer, Alberta.

i. His airfare from Prince George to Red Deer is a deductible moving cost.

True or False?

ii. His wife spent $750 for gas, meals, and lodging while driving their car from Prince George to Red Deer.  The $750 is a deductible moving cost.

True or False?

iii. The Shaffers paid $1,000 in legal fees to sell their Prince George home and $800 in legal fees to buy their new home in Red Deer. The total $1,800 in legal fees is a deductible moving cost.

True or False?

iv. Before moving into their new home, the Shaffers had to pay $2,000 to repair faulty wiring.  The $2,000 is a deductible moving cost.

True or False?

v. The $5,000 in real estate fees paid to sell their Prince George house is a deductible moving cost.

True or False?

vi. All moving expenses can only be deducted from income earned in Red Deer in the year of the move.  There are no carry forward provisions for moving costs.

True or False?

4. Sarah and David Johnston paid $5,500 during the year for child care for their three children, aged 3, 5, and 7.  Her annual salary was $8,000 and his annual salary was $30,000.  Sarah can deduct the $5,500 paid from her income.

True or False?

5. For purposes of deducting child care costs, an ”eligible child” must be under 16 at some time during the year.

True or False?

6. If the lower income spouse was in prison for the entire year, the higher income spouse would be able to deduct child care costs during this period.

True or False?

7. Jim and Shirley Noonan decide to separate after ten years of marriage.  They have no children.  To keep the separation amiable, they decide not to involve lawyers or the courts at this stage.  They have a written separation agreement in which Shirley agrees to pay Jim $500 per month until he remarries.  The payments will be taxed in Jim’s hands and will be deductible from Shirley’s income.

True or False?

8. The tax treatment of payments received under an annuity contract will depend on whether the annuity was purchased with after tax funds or, alternatively, from funds that are in an RRSP.

True or False?

9. The contributions that can be made to an RESP for one beneficiary are limited to $50,000.

True or False?

10. Earnings on amounts contributed to an RESP accumulate on a tax free basis.

True or False?

11. For 2017, contributions to a Tax Free Savings Account (TFSA) are limited to a maximum of $5,500 for the year.

True or False?

12. While earnings on assets held in a Tax Free Savings Account (TFSA) will not be taxed while the assets are in the plan, the accumulated income will be subject to tax when it is withdrawn from the plan.

True or False?

13. A rollover is a term that is used to describe any transfer of assets between parties that are not dealing at arm’s length.

True or False?

14. The term arm’s length can apply to transactions involving trusts, corporations, and individuals.

True or False?

15. Johan Deroi has securities with an adjusted cost base of $1,000 and a fair market value of $1,500.  If he sells these securities to his brother for $2,000, he will have a capital gain of $1,000.

True or False?

16. Martha Stuart has a depreciable asset with a UCC of $50,000, a capital cost of $80,000, and a fair market value of $100,000.  If she gifts this property to her spouse without making any election, she will have a capital gain of $50,000.

True or False?

17. When an individual dies, there is a deemed disposition of all of his capital property at fair market value, without regard to his relationship to the beneficiary of his estate.

True or False?

18. At her death on August 1 of the current year, Nancy Mori owned stocks with an adjusted cost base of $11,000 and a fair market value of $20,000, and a term deposit of $30,000.  She also owned a building that had a cost of $98,750, a fair market value of $110,000, and a UCC of $70,000.

a. She bequeaths all of her assets to a spousal trust.  Her Taxable Income at death arising from the dispositions is nil.

True or False?

b. She bequeaths all of her assets to her daughter, Christine.  Nancy’s Taxable Income at death arising from the dispositions totals $10,125.

True or False?

c. She bequeaths all of her assets to her daughter, Christine, who sells the building before the end of the current year for $125,000.  Christine’s Taxable Income arising from the sale is $7,500.

True or False?

19. A father gives $10,000 in securities to his 19 year old daughter who is living at home.  Any dividends declared on the securities will be attributed to the father.

True or False?

20. Brian Lawson gives equity securities to his 15 year old son.  If the securities are sold, in the following year, for more than their fair market value at the time of the gift, the resulting capital gain will be taxed in the hands of Mr. Lawson.

True or False?

TIF Problem Nine - 3

Other Income/Deductions, Attribution - Multiple Choice

Other Inclusions – Subdivision d Inclusions

1. Which of the following statements with respect to other inclusions in income is **NOT** correct?

A. The $10,000 exclusion from income of a death benefit must be claimed by a spouse.

B. Social assistance payments will increase the recipient’s Net Income For Tax Purposes but not their Taxable Income.

C. The minimum withdrawal amount from a RRIF must be included in income, even if it is not withdrawn from the plan.

D. Research grants are included in income net of unreimbursed expenses related to carrying on the research work.

2. Which of the following statements with respect to Subdivision d income inclusions is correct?

A. 100 percent of any death benefit received by a spouse must be included in income.

B. 100 percent of any scholarships received must be included in income.

C. 100 percent of any retiring allowance received must be included in income.

D. Social assistance payments received are not included in income.

3. Which of the following sources of income would **NOT** result in any increase in Taxable Income for the taxpayer who receives it or another family member?

A. Amounts that are withdrawn from an RRSP.

B. A research grant received by a student in a university program.

C. Workers’ compensation payments.

D. Spousal support payments.

CPP Payments Deduction

4. Dwayne Brooks is self employed and, because of the high level of his income, is required to make a 2017 CPP contribution of $5,128 [(2)($2,564)].  How will this affect his 2017 Net Income For Tax Purposes and his 2017 Taxable Income?

A. Both his Net Income For Tax Purposes and his Taxable Income will be reduced by $5,128.

B. Both his Net Income For Tax Purposes and his Taxable Income will be reduced by $2,564.

C. Neither his Net Income For Tax Purposes nor his Taxable Income will be affected.

D. Both his Net Income For Tax Purposes and his Taxable Income will be reduced by $769.

5. Adhira has Taxable Income of $110,000 before any consideration of a CPP deduction.  She is a self-employed hairdresser.  How much will her federal tax payable decrease as a result of the $5,128 contribution to CPP that she must make in 2017?

A. $385

B. $1,051

C. $769

D. $1,333

Moving Costs Deduction

6. Which of the following statements related to the costs of an eligible relocation is correct?

A. If the employer provides an allowance for these moving costs that is less than the actual moving costs, it is not included in income.

B. All legal and other costs associated with acquiring a residence in the new work location are deductible.

C. The costs of visiting the new work location in order to find a new residence are deductible.

D. The costs of selling a residence where the taxpayer lived prior to the relocation is always deductible.

7. Stan Aiken changed employers during 2017 and, as a result of the change, moved 150 kilometers, from Windsor to London.  His new employer was located in London and reimbursed 50 percent of Stan’s eligible moving expenses.  On his 2017 personal tax return, Stan can:

A. Claim 0 percent of his moving expenses.

B. Claim 50 percent of his moving expenses against his income from employment.

C. Claim 50 percent of his moving expenses against his income from his new employer.

D. Claim 100 percent of his moving expenses against his income from employment.

8. In 2017, Mr. Kumar moved from Saskatchewan to Prince Edward Island to start a new business.  In his 2017 fiscal year, the business generated income in excess of $50,000.  Mr. Kumar incurred the following costs of moving:

Transport of household effects $5,000

Travel - self, spouse, and three children 2,000

Legal fees - house purchase in PEI 900

Cancellation costs - lease in Saskatchewan 750

Temporary accommodation while waiting for new house   
 at $70 per day for 30 days 2,100

House-hunting trip (prior to move) 500

Which one of the following amounts represents the **maximum** amount that Mr. Kumar may deduct for moving expenses in his 2017 personal income tax return?

A. $ 8,800.

B. $ 9,700.

C. $10,200.

D. $11,250.

9. During 2017, Jan Harding accepted a job transfer from British Columbia to Ontario.  She will begin her new position on December 1.  Her new salary will be $102,000 per annum or $8,500 per month.  Upon arriving,  Jan spent 25 days staying in a hotel due to an unfortunate delay in moving into her new residence.  Jan incurred expenses related to the move of $13,402.  Included in this total was $1,125 for meals and $2,125 for hotel stays while waiting for her new residence to be ready.  How much can she claim on her 2017 tax return for moving expenses?

A. $ 8,500.

B. $12,102.

C. $12,952.

D. $13,402.

10. Maxine used to work and live in Alberta, but has accepted a new job in Ontario.  The new job has a starting salary of $105,600 per year, or $8,800 per month.  She moved there with her family in October, so she could start her new job on November 1.  While she had rented her accommodations in Alberta, she bought a new house in Ontario.  She incurred the following expenses as a result of the move:

canceling the lease on her rental apartment, $1,200.

hiring movers to pack and move her household effects, $12,000.

legal fees on the house purchase, $1,400.

land transfer tax on the house purchase, $3,000.

cost of disconnecting utilities in Alberta, $100.

cost of connecting utilities in Ontario, $200.

gas, food, and lodging while traveling from Alberta to Ontario, $2,800.

How much can she claim for moving expenses for the year of the move?

A. $16,000.

B. $16,300.

C. $17,700.

D. $20,700.

Child Care Costs

11. Which of the following statements with respect to child care costs is **NOT** correct?

A. In calculating earned income for child care cost purposes, net business income is included, but net business losses are not.

B. Amounts paid to a person under the age of 18 are never deductible.

C. The higher income spouse can deduct child care costs if the lower income spouse is a person confined to a prison or similar institution throughout a period of not less than 2 weeks in the year.

D. There is no requirement that amounts be spent on specific children.

12. John and Alexandria are married and they have two children, aged 2 and 5.  They pay Alexandria’s 22 year old sister $150 per week to take care of their children for 48 weeks each year.  John works full time and earns a salary of $90,000 per year.  Alexandria works part time, earning a salary of $28,000 per year.  She also goes to college part time during the fall semester, for a total of 17 weeks, or 4 months, each year.  Which of the following is correct with respect to John and Alexandria’s ability to claim a deduction for child care expenses?

A. Neither John nor Alexandria can claim child care expenses because they paid a relative to take care of their children.

B. Alexandria must claim all of the child care expenses because she is the supporting person with the lower Net Income.

C. John can claim child care expenses of $1,600 and Alexandria can claim the remaining $5,600.

D. John can claim child care expenses of $7,200.

13. Charam and Baka each have income of over $200,000.  During the year, they paid a nanny $20,000 to care for their three children.  Divya, age 5, has no income.  Elina, age 10 is disabled and eligible for the disability tax credit.  Hinda is 12 and has income of $25,000 which he earns from a TV acting job.  What is the maximum deduction for child care costs for this family?

A. $18,000

B. $19,000

C. $24,000

D. $22,000

Disability Supports Deduction

14. Which of the following statements with respect to the disability supports deduction is correct?

A. To qualify for this deduction, the individual must be performing duties as an employee.

B. The total amount of the deduction is limited to $15,000 per taxation year.

C. Some amounts can be claimed both as a disability supports deduction and as an inclusion in the base for the medical expense tax credit.

D. This deduction is available to individuals who do not qualify for the disability tax credit.

15. Which of the following statements is **NOT** correct with respect to the Disability Supports Deduction?

A. The deduction is limited to individuals who qualify for the disability tax credit.

B. The deduction is available to disabled individuals who are carrying on research.

C. The deduction is available to disabled individuals who are attending a designated educational institution.

D. Many of the items that can be claimed under the disability supports deduction could also be claimed as medical expenses.

16. Katrina has cerebral palsy, but does not qualify for the disability tax credit.  During 2017, she earned $75,000 in income working at a facility for disabled children.  In order to work, Katrina required full time attendant care that cost $25,000.  Of this total, $10,000 was paid for by her employer, and $5,000 by her benefit plan.  In addition, Katrina purchased equipment to increase her mobility at work costing $12,000.  What is Katrina’s maximum claim for the disability supports deduction?

A. $10,000

B. $12,000

C. $22,000

D. $32,000

Pension Income Splitting

17. Which of the following statements with respect to pension income splitting is **NOT** correct?

A. Neither OAS payments nor CPP payments are eligible for the pension income splitting provisions.

B. If an individual and his spouse are in different tax brackets, pension income splitting will always reduce their combined federal Tax Payable.

C. These provisions allow a taxpayer to allocate up to 50 percent of his qualifying pension income to a spouse.

D. Lump sum withdrawals from RRSPs are not eligible for pension income splitting.

18. Aaron, aged 65 and Abbie, aged 63 are married.  Aaron received OAS of $4,000 and pension income of $65,000 from a plan that was sponsored by his former employer.  If Aaron shares the maximum amount of pension income with Abbie, what will his Net Income For Tax Purposes be?

A. $32,500.

B. $34,500.

C. $36,500.

D. $69,000.

19. Elijah, aged 62 and Dara, aged 68 are married.  Elijah collects CPP of $7,200 and has a $35,000 withdrawal from his RRSP.  If Elijah shares the maximum amount of pension income with Dara, what will his Net Income For Tax Purposes be?

A. $17,500.

B. $21,100.

C. $24,700.

D. $42,200.

Spousal And Child Support

20. With respect to spousal and child support, which of the following statements is **NOT** correct?

A. Any amounts that are not specifically identified in the agreement as spousal support will be considered child support.

B. An amount qualifies as a support payment only if it is payable or receivable on  a periodic basis.

C. The recipient of child support payments will not be able to claim the tax credit for an eligible dependant.

D. Deductible support payments reduce the taxpayer’s Earned Income for RRSP purposes.

21. Which of the following is **NOT** a requirement for spousal support payments to be deductible?

A. The payments must be made on a periodic basis.

B. The payments must be made for a period of time that the spouses, or former spouses, are living apart.

C. The payments must be made pursuant to a separation agreement.

D. None of the above.

22. Jack and his wife, Sally, separated during 2004.  The written separation agreement requires Jack to make payments for the maintenance of Sally and their child.  Payments were set at $250 per month for Sally and $150 per month for their child.  During 2017 Jack’s payments totaled $4,000.  How much of the 2017 payments can Jack deduct on his 2017 personal tax return?

A. $4,000.

B. $3,000.

C. $1,800.

D. $2,200.

Income From Annuities

23. Which of the following statements about annuity payments received is correct?

A. Net Income For Tax Purposes is increased by the amount of any annuity payment received.

B. If the taxpayer uses funds from his savings account to purchase an annuity, the taxable amount of any payment is reduced by the capital element that is included in the payment.

C. To qualify as an annuity, the payments cannot extend beyond the life of the annuitant.

D. If the annuity was purchased inside an RRSP, none of the payments will be subject to tax.

24. Mr. Dayani purchases an annuity with funds from his savings account on January 1, 2017.  The annuity has a 5 year term, and cost him $25,000.  Payments are made annually on December 31 in the amount of $5,772.  The annuity provides an effective yield of 5%.  How much of the annuity payment is taxable in 2017?

A. Nil

B. $772.

C. $1,250.

D. $5,000.

Registered Savings Plans

25. Arnold Ingram has $5,000 in funds that he does not currently need.  He has a young son who he expects will pursue university education when he is older.  Arnold is trying to decide whether the unneeded funds should be invested in a TFSA or an RESP.  With respect to this decision, which of the following statements is **NOT** correct?

A. His current Tax Payable will not be affected by the choice between the two types of registered plans.

B. Withdrawals from either plan will be received tax free.

C. If he chooses the RESP, the plan will receive additional funds from the government in the form of Canada Education Savings Grants.

D. Contributions from either type of registered plan can be removed on a tax free basis.

26. With respect to the tax rules for Registered Education Savings Plans (RESPs), which of the following statements is **NOT** correct?

A. The total contributions to one individual’s plan cannot exceed $50,000.

B. Earnings paid out of the plan are subject to tax in the hands of the recipient.

C. The annual contributions made by any one individual cannot exceed $4,000.

D. Distributions can be made to a beneficiary of a plan when they commence full-time studies at a qualifying educational institution.

27. There are a number of benefits and tax advantages associated with Registered Education Savings Plans (RESPs).  Which of the following is **NOT** a benefit or advantage?

A. Contributions to the plans are deductible.

B. Earnings on assets within the plan are not subject to tax.

C. The government makes contributions in the form of Canada Education Savings Grants and Canada Learning Bonds.

D. Distributions from the plan may be received by some recipients without incurring any additional taxation.

28. With respect to Tax Free Savings Accounts (TFSAs), which of the following statements is **NOT** correct?

A. Contributions to the accounts are not deductible.

B. Contributions to the accounts can be returned tax free at any time.

C. Earnings on assets in the accounts accumulate tax free.

D. Withdrawals of accumulated account earnings will be subject to tax.

29. Ms. Eli has $10,000 in pre-tax income that she does not need in the current year, but will require in two years to purchase a condo.  She is considering whether she should use this money to contribute to a Tax Free Savings Account (TFSA) or a Registered Retirement Savings Plan (RRSP).  She expects her marginal tax rate to increase in two years.  She expects her invested funds will earn the same rate of return in either account.  Which of the following statements is correct with respect to her investment decision?

A. Whether she invests in the RRSP or the TFSA, the effect on her Net Income For Tax Purposes will be the same.

B. Ms. Eli should invest in the RRSP.

C. Ms. Eli should invest in the TFSA.

D. Ms. Eli should not invest in the either the RRSP or the TFSA since she will need the money in two years.

30. Which of the following statements regarding the Tax Free Savings Account (TFSA) is **NOT** correct?

A. Any Canadian resident individual over 17 years of age can establish a TFSA.

B. Any unused amounts not contributed in a year may be carried forward indefinitely to future years.

C. The contributions are tax deductible up to a maximum of $5,500 for 2017.

D. Capital gains earned within TFSAs are not taxed.

Non-Arm’s Length Transactions

31. With respect to non-arm’s length transfers of depreciable property, which of the following statements is correct?

A. Gifting a non-depreciable property with an accrued capital gain to a non-arm’s length individual can result in double taxation of some part of that gain.

B. When there is a non-arm’s length transfer of a depreciable capital property with a fair market value that exceeds its capital cost to the transferor, the capital cost to the transferee will be the same as the old capital cost to the transferor.

C. When there is a non-arm’s length transfer of a depreciable capital property that has a fair market value that is less than the transferor’s capital cost, the transferee’s new capital cost is deemed to be equal to the transferor’s old capital cost.

D. If there is a transfer of a non-depreciable capital property at a value that is less than its fair market value, the adjusted cost base to the transferee will be the fair market value.

32. John Bartel owns land with an adjusted cost base of $250,000 and a fair market value of $320,000.  He sells the land to his son for $250,000.  Which of the following statements is correct?

A. John will have a taxable capital gain of $70,000 and the adjusted cost base of the land to his son will be $250,000.

B. John will have a taxable capital gain of $70,000 and the adjusted cost base of the land to his son will be $320,000.

C. John will have a taxable capital gain of $35,000 and the adjusted cost base of the land to his son will be $320,000.

D. John will have a taxable capital gain of $35,000 and the adjusted cost base of the land to his son will be $250,000.

33. John Bartel owns land with an adjusted cost base of $250,000 and a fair market value of $320,000.  He gifts the land to his son for no consideration.  Which of the following statements is correct?

A. John will have a taxable capital gain of $70,000 and the adjusted cost base of the land to his son will be $250,000.

B. John will have a taxable capital gain of $70,000 and the adjusted cost base of the land to his son will be $320,000.

C. John will have a taxable capital gain of $35,000 and the adjusted cost base of the land to his son will be $320,000.

D. John will have a taxable capital gain of $35,000 and the adjusted cost base of the land to his son will be $250,000.

**Questions 34 through 36 are based on the following information:**

Jolinda Morris has a depreciable property with a capital cost of $225,000, a UCC of $175,000, and a fair market value of $240,000.  Because of his exceptional performance during the last year, she gives this property to her common-law partner Biff.

34. What is the minimum increase in Net Income For Tax Purposes that Ms. Morris will record as a result of this gift if she does not elect out of ITA 73(1)?

A. $57,500.

B. $65,000.

C. $7,500.

D. Nil

35. What is the minimum increase in Net Income For Tax Purposes that Ms. Morris will record as a result of this gift if she does elect out of ITA 73(1)?

A. $57,500.

B. $65,000.

C. $7,500.

D. Nil

36. What is the most likely motivation for Ms. Morris to elect out of ITA 73(1)?

A. To avoid attribution.

B. She is in a higher tax bracket than Biff.

C. She has some unused terminal losses.

D. She has some unused capital losses.

37. Sonya owns 500 shares of Roxy Corp. that she bought in 2016 for $10 per share.  On June 1, 2017 Sonya sold all of her shares to her sister for $15 per share and then later the same day her sister sold the shares for their fair market value of $18 per share.  The taxable capital gain that should be reported for each sister is:

A. $2,000 for Sonya and $750 for her sister

B. $1,250 for Sonya and $750 for her sister

C. $750 for Sonya and $1,250 for her sister

D. $1,000 for Sonya and $1,000 for her sister

38. Hugo owns a farm.  Both Hugo and his son work on the farm raising sheep.  On February 16, 2017 Hugo sold a shearing machine to his son for $5,000.  The original cost of the machine was $10,000, the UCC is $8,000 and the fair market value is $5,000.  The machine was the last asset in its CCA class.  On September 1, 2017, his son took the machine to an auction in another province where an enthusiast bidder paid $6,000 for it.  The tax consequences are:

A. Hugo has a terminal loss of $3,000 and his son has a taxable capital gain of $500.

B. Hugo has a terminal loss of $3,000 and his son has recapture of CCA of $1,000.

C. Hugo has a terminal loss of $2,000 and his son has no tax consequences.

D. Hugo has no tax consequences and his son has a terminal loss of $2,000.

Death Of A Taxpayer

39. Lance Mann dies, leaving a depreciable property to his son, Paul Mann.  The property has a capital cost of $150,000 and a fair market value of $120,000.  It is the only asset in a CCA Class with a UCC balance of $100,000.  The tax consequences of this bequest would be:

A. Recapture of $20,000 for Lance and the capital cost of the asset for Paul will be $150,000.

B. A taxable capital gain for Lance of $10,000 and a capital cost of the asset for Paul of $150,000.

C. Recapture of $20,000 for Lance and a capital cost of the asset to Paul of $120,000.

D. Recapture of $20,000 for Lance and a capital cost of the asset for Paul of $100,000.

40. Which of the following statement that relate to the death of a taxpayer is **NOT** correct?

A. A farm property owned by the deceased can be transferred to a child on a tax free basis.

B. When an individual dies, there is a deemed disposition of all of his capital property.

C. In recording the deemed disposition that occurs when an individual dies, the proceeds of disposition will always be the fair market value of the property.

D. When the capital cost of a property that was owned by a deceased taxpayer exceeds its fair market value, the beneficiary is required to retain the original capital cost, with the difference being treated as deemed CCA.

41. Erica Ho dies, leaving a depreciable property to her daughter that has a capital cost of $150,000, a fair market value of $90,000, and a UCC of $65,000.  Which of the following statements related to this event is **NOT** correct?

A. Erica will have a taxable capital gain of nil.

B. Erica will have recapture of $25,000.

C. If her daughter later sells the property for $100,000, she will have a capital gain of $10,000.

D. For calculating CCA, the daughter’s UCC will be $90,000.

42. Upon the death of a taxpayer, which of the following statements is correct?

A. Capital property that is bequeathed to a spouse is transferred on a rollover basis.

B. Capital property that is bequeathed to a spousal trust is deemed to be sold at fair market value.

C. Capital property, whether bequeathed to a spouse or to anyone else, is transferred on a rollover basis.

D. Capital property, whether bequeathed to a spouse or to anyone else, is deemed to be sold at fair market value.

43. When Alyssa Weinstein died, she left her estate to her spouse and daughter as shown below.  Her assets had the following tax costs and fair market values (FMV):

**Asset Beneficiary**

Jewelry - Cost = $10,000, FMV = $17,000 Spouse

Automobile - Cost = $55,000, FMV = $20,000 Daughter

Rental building - Cost = $100,000, UCC = $70,000, FMV = $220,000 Daughter

Common shares - Cost = $140,000, FMV = $500,000 Spouse

What is the minimum amount that must be included in Ms. Weinstein’s income for her final tax return in respect of these assets?

A. $60,000

B. $72,500

C. $90,000

D. $273,500

Income Attribution

44. Which of the following situations will **NOT** result in the attribution of income to the transferor?

A. The transfer of a capital property to a spouse for consideration equal to fair market value of the property.  The transferor does not elect out of ITA 73(1).

B. The transfer of a capital property to a spouse in return for a non-interest bearing note.  The transferor elects out of ITA 73(1).

C. The transfer of an unincorporated business to a spouse.  The transferor does not elect out of ITA 73(1).

D. The transfer of a capital property to the 15 year old son of the transferor’s sister.

45. Mr. Johnson wants to help his daughter, Erin, save for her college education. To this end, in 2015, when she was 15 years old, he put $3,000 into a GIC in her name, for a one year term. The GIC renews on an annual basis.  On its maturity in 2016, Erin rolled the $3,000 into another GIC for one year and the interest earned during the first year into a second one-year GIC for $300.  In 2017, the interest earned on the two GICs was $240 and $24 respectively.

How much of this interest, if any, must Mr. Johnson report on his 2017 income tax return?

A. Nil.

B. $24.

C. $240.

D. $264.

E. None of the above.

46. Agatha Harkness wishes to gift mutual funds to her three grandchildren, all of whom are under the age of 6.  She wants to minimize any income that will be attributed to her.  Which one of the following mutual funds will best accomplish this goal?

A. An equity fund that invests in preferred shares of top Canadian corporations and earns primarily dividend income.

B. A bond fund that invests in long-term, interest-bearing Government of Canada bonds, earning interest income and capital gains.

C. A growth fund that invests in corporations with a history of paying minimal dividends and earns its income primarily in the form of capital gains.

D. A money-market fund that invests in short-term treasury bills and earns only interest income.

47. William Choring owned shares of two publicly traded companies, as follows:

**Fair Market Value Adjusted**

**On Date Of Disposition Cost Base**

TriStar Limited $1,000 $10,000

Global Inc. 2,500 200

William gifted the TriStar Limited shares to his wife on July 1, 2017. His wife kept the shares and received $138 of taxable dividends (grossed up amount) in September, 2017. William sold the Global Inc. shares on the open market. Assuming William earned no other income, did not elect out of ITA 73(1), and these are the only transactions that occurred in the year, which one of the following represents William’s 2017 Net Income For Tax Purposes?

A. Nil.

B. $1,150.

C. $1,250.

D. $1,288.

48. Hans Myers wishes to transfer an investment to his wife, Olga.  However, Olga does not have sufficient cash to purchase the investment for fair value.  Hans would like to loan the funds to Olga to facilitate the purchase, as he wants the income on this investment to be reported by her.  Olga will pay interest on the loan, as Hans expects the investment to generate substantial income.

Which one of the following is **NOT** a requirement to ensure that the income on this investment will be taxable to Olga, and not attributed to Hans, in the future?

A. Hans must elect to realize any gains inherent in the property at the transfer date.

B. Interest on the loan must be paid from Olga to Hans annually, by January 30 of the following year.

C. Olga must pay no less than the full fair market value of the investment (although this can include the loan’s face value).

D. The interest rate on the loan must be at fair market value, even when that rate is greater than the prescribed rate.

49. Martin has a marginal tax rate of 46 percent.  His wife, Carmen, has a marginal tax rate of 26 percent.  In order to give his wife a supplemental source of income, he gave her a portion of his investment portfolio. Carmen’s new investment portfolio generated interest income of $6,800 and taxable capital gains of $9,900.  Which of the following statements is **NOT** correct?

A. Martin faces an additional tax liability of $3,128 as a result of Carmen’s interest income.

B. Martin faces an additional tax liability of $4,554 as a result of Carmen’s capital gains.

C. Carmen has no additional tax liability as a result of the investment portfolio.

D. Carmen faces a tax liability of $2,574 as a result of her capital gains.

50. Sandy gives a gift of $12,000 to each of the following people.  Each of them used the money they received from Sandy to invest in shares of publicly trading companies.  In which situation will the resulting dividend income **NOT** be attributed to Sandy?

A. The gift is to Sandy’s long-time business partner.

B. The gift is to Sandy’s wife.

C. The gift is to Sandy’s 14 year old nephew.

D. The gift is to Sandy’s 10 year old daughter.

51. Pere gifted shares in a public corporation with a fair market value of $50,000 to his 12 year old son, Fils. After Fils received $1,000 in dividends, he sold the shares for $53,000.  What are the tax effects of the dividend and the sale?

A. Pere will claim the dividends on his tax return and Fils will claim the capital gain on his tax return.

B. Fils will claim the dividends and a capital gain on his tax return.

C. Pere will claim the dividends and a capital gain on his tax return.

D. Fils will claim the dividends on his tax return and Pere will claim the capital gain on his tax return.

TIF Problem Nine - 4

Other Income/Deductions, Attribution - Exam Exercises

Exam Exercise Subject Listing For Chapter 9

|  |  |
| --- | --- |
| **Number** | **Subject** |
| 1 | Moving Expenses |
| 2 | Moving Expenses |
| 3 | Child Care Costs |
| 4 | Child Care Costs |
| 5 | Disability Supports Deduction |
| 6 | Pension Income Splitting |
| 7 | Support Payments |
| 8 | Support Payments |
| 9 | Annuity Payments |
| 10 | Annuity Payments |
| 11 | Canada Education Savings Grants |
| 12 | Inadequate Consideration |
| 13 | Inadequate Consideration |
| 14 | Non-Depreciable Asset To A Spouse |
| 15 | Depreciable Asset To A Spouse |
| 16 | Transfer Of Depreciable Property |
| 17 | Transfer Of Depreciable Property |
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| 19 | Inter Vivos Farm Property To A Child |
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| 21 | Transfer On Death |
| 22 | Income Attribution - Spouse |
| 23 | Income Attribution - Spouse |
| 24 | Income Attribution - Spouse |
| 25 | Income Attribution - Related Minor |
| 26 | Income Attribution - Related Minor |
| 27 | Income Attribution - Shares |
| 28 | Income Attribution - Use Of Loans |
| 29 | Income Attribution - Use Of Loans |

Exam Exercise Nine - 1 (Moving Expenses)

On November, 15, 2017, at the request of his employer, Mr. John Havlik moves from Halifax to Moncton (Moncton is 260 kilometers from Halifax).  He lived in a rented apartment in Halifax, but has purchased a house in Moncton.  Legal fees and other costs associated with the acquisition of this house totaled $3,250.  The total cost of the actual move, including the costs of moving his personal possessions, is $8,300.  In addition, he spent $650 on a house hunting trip to Moncton, but he did not decide on a house until his return to Halifax.  He also incurred a $1,200 penalty for breaking his lease in Halifax.

During the year, his salary totaled $53,000, of which $6,625 can be allocated to the period after November 15, 2017.  His employer is prepared to pay up to $6,000 towards the cost of the move.  Determine Mr. Havlik’s maximum moving expense deduction for 2017, as well as any carry forward available.

Exam Exercise Nine - 2 (Moving Expenses)

On November 1, 2017, Joan Hatch moves from Windsor to Toronto at the request of her employer.  Prior to this date, she spent $950 on a house hunting trip to Toronto.  However, she was not successful and, given this, she has signed a one-year lease for an apartment at her new location.  The legal fees and real estate commissions associated with the sale of her Windsor house were $7,200.  The actual costs of the move, including amounts paid to a moving company, totaled $12,600.  Her employer agreed to pay $7,000 of her moving costs.

Ms. Hatch’s salary for 2017 was $54,000.  Determine Ms. Hatch’s maximum moving expense deduction for 2017, as well as any carry forward that is available.

Exam Exercise Nine - 3 (Child Care Expenses)

Mr. Renaud and Ms. Fortune have lived together for over 15 years and have three children.  The ages of the children at the end of the current year are 3, 11, and 15.  All three children enjoy good mental and physical health.  Mr. Renaud works as a carpenter and has received income for the year of $52,000.  However, he will only report $12,000 of this total in his current tax return (he believes that, because most of the income is received in cash and he has no receipts for his expenses, he does not have to report the full amount).

Ms. Fortune has business income of $62,000, all of which she reports.  The child care costs for the current year, all paid for by cheque and properly documented for tax purposes, total $11,200.

Determine the maximum deduction for child care costs and indicate who should claim them.

Exam Exercise Nine - 4 (Child Care Expenses)

Mrs. and Mr. Anders have three children who, at the end of the current year, are 4, 12, and 18 years of age.  The 18 year old child has a serious physical infirmity, but does not qualify for the disability tax credit.

Mrs. Anders had earned income of $18,000, while Mr. Anders had earned income of $69,000.  Payments for child care were $190 per week for a total of 50 weeks.

During the current year, Mrs. Anders spent six weeks in jail as the result of a conviction for possession of an illegal substance.  Following her release, Mr. Anders spent three weeks in the hospital because of a stress related disorder.

Determine the maximum deduction for child care costs and indicate who should claim them.

Exam Exercise Nine - 5 (Disability Supports Deduction)

Lara Craft has several disabilities, none of which are severe enough to allow a claim for the disability tax credit.  Despite her disabilities, in 2017, she works full time as a financial consultant, earning employment income of $94,000.

Her need for full time attendant care has been certified by a medical practitioner and, during 2017, the cost of this care was $32,000.  Additional costs related to her disabilities totaled $17,000.  Her medical insurance reimbursed her for $8,000 of these costs.  None of these costs will be included in the base for her medical expense tax credit.  Determine the amount of Lara’s disability supports deduction for 2017.

Exam Exercise Nine - 6 (Pension Income Splitting)

Jerry Mason lives with his spouse, Janice Sparks.  Both Jerry and Janice are 66 years old and, during 2017, they each receive $7,000 in OAS payments.  As the result of many years with his employer, Jerry receives $88,000 in pension income from the plan that was sponsored by that employer.  Janice has no source of income other than the OAS payments she receives.  Neither Jerry nor Janice have applied for CPP and they have no tax credits other than the basic personal credit, the age credit, and pension income tax credit.

Jerry has asked you to indicate the savings in federal tax that would result from making optimum use of pension income splitting for the 2017 taxation year.

Exam Exercise Nine -  7 (Support Payments)

On May 1, 2017, Leon and Shannon Weiss sign a separation agreement that calls for Shannon to pay Leon $1,200 per month in child support (Leon will have custody of their three children) and $2,100 per month in spousal support beginning on June 1.  To the end of 2017, Shannon’s payments total only $9,500.  How will these payments be dealt with in Shannon and Leon’s 2017 tax returns?

Exam Exercise Nine - 8 (Support Payments)

Under the terms of their divorce settlement, Barry Low must pay his former spouse, Mandy Brock, $1,000 per month in child support and $1,800 per month in spousal support.  While in previous years, Barry has paid the full amounts required by the settlement, in 2017, his payments total only $14,000.  How will these payments be dealt with in the tax returns filed by Barry and Mandy?

Exam Exercise Nine -  9 (Annuity Payments)

On January 1 of the current year, Ms. Lorraine Brock uses $10,000 of her savings to acquire a fixed term annuity.  The term of the annuity is three years, the annual payments are $4,020, the payments are received on December 31 of each year, and the rate inherent in the annuity is 10 percent.  What is the effect of the $4,020 annual payment on Ms. Brock’s Net Income For Tax Purposes.

Exam Exercise Nine -  10 (Annuity Payments)

On January 1, 2017, Sal Miner uses $2,673 of his savings to pay for an annuity that will return $1,000 at the end of each year in 2017, 2018, and 2019.  The effective rate of interest in this annuity is 6 percent.  What is the effect of the $1,000 payment on Mr. Miner’s 2017 Net Income For Tax Purposes?

Exam Exercise Nine - 11 (Canada Education Savings Grants)

Marco was born in 2016.  As his mother is very keen on tax planning, she establishes an RESP for Marco by contributing $1,000 to the plan in 2016.  Marco’s grandmother contributes an additional $400 to the plan on the same day.

In 2017, Marco’s mother contributes $2,200 to the plan, while the grandmother contributes an additional $1,900.  Marco’s family has never had family income of more than $40,000.  Determine the amount of the CESGs that would be added to Marco’s RESP in 2016 and 2017.

Exam Exercise Nine - 12 (Inadequate Consideration)

Ms. Veronica Lox owns securities with an adjusted cost base of $150,000 and a fair market value of $175,000.  She sells these securities to her father for $130,000.  He immediately sells them to an arm’s length party for $175,000.  Determine the tax consequences for Ms. Lox and her father.

Exam Exercise Nine - 13 (Inadequate Consideration)

Ms. Veronica Lox owns securities with an adjusted cost base of $150,000 and a fair market value of $175,000.  She sells these securities to her father for $210,000.  He immediately sells them to an arm’s length party for $175,000.  Determine the tax consequences for Ms. Lox and her father.

Exam Exercise Nine - 14 (Inter Vivos Transfers To A Common-Law Partner)

Marilyn Fox owns a large piece of land that she acquired several years ago for $85,000.  For several years, she has been using the property to run a high security parking lot operation.  On January 1, 2017, she gives the property to her common-law partner Ellen Degen.  At this time, the fair market value of the land is $170,000.  Marilyn does not elect out of ITA 73(1).

During 2017, Ellen continues the parking lot operation, which produces a net business income of $8,500.  On January 1, 2018, Ellen sells the parking lot for $190,000.

What are the tax consequences of these events for Marilyn and Ellen during 2017 and 2018?   If there are no tax consequences for either individual in a given year, you should clearly state this fact in your answer.

Exam Exercise Nine - 15 (Transfer Of Depreciable Asset To A Spouse)

During the current year, Geoff Lionel transferred a depreciable property to his spouse.  The property had a fair market value of $200,000, a capital cost of $160,000, and a UCC of $107,000.  It is the only asset in its CCA class.  In return for the property, his spouse pays $200,000 from funds that she has received as an inheritance.  Describe the tax consequences to Mr. Lionel and the tax cost of the property to his spouse after the transfer, assuming that he does not elect out of ITA 73(1).  How would these results differ if Mr. Lionel elects out of ITA 73(1)?

Exam Exercise Nine - 16 (Non-Arm’s Length Transfer Of Depreciable Property)

Mr. Norman Low owns a depreciable asset that he has used in his unincorporated business.  It has a cost of $145,000 and a fair market value of $132,000.  It is the only asset in its CCA class and the balance in the class is $63,500.  Mr. Low sells the asset to his father for $132,000.  During the year, prior to taking any CCA on the asset, Mr. Low’s father sells the asset for $135,000.  Determine the amount of income to be recorded by Mr. Low and his father as a result of these transactions.

Exam Exercise Nine - 17 (Non-Arm’s Length Transfer Of Depreciable Property)

John Travis owns a depreciable property that has a fair market value of $295,000.  Its capital cost was $350,000 and it is the only asset in its CCA class.  The balance in its CCA class is $245,000.  John sells the property to his brother for its fair market value of $295,000.  Later in the year, prior to taking any CCA on the asset, his brother sells the property for $315,000.  Determine the amount of income that would be recorded by Mr. Travis and his brother as a result of these transactions.

Exam Exercise Nine - 18 (Inter Vivos Farm Property Transfer To A Child)

Mrs. Betty Wong owns farm property consisting of land with an adjusted cost base of $271,000 and a fair market value of $365,000, along with a barn with a UCC of $90,000, a capital cost of $120,000, and a fair market value of $110,000.  The property is transferred to her 67 year old son in return for a payment of $300,000 for the land.  No payment is made for the barn.  Describe the tax consequences of this transfer, for both Mrs. Wong and her son.

Exam Exercise Nine - 19 (Inter Vivos Farm Property Transfer To A Child)

Martin Ho owns a farm property.  Relevant information is as follows:

**Land** The land has an adjusted cost base of $435,000 and a fair market value of $584,000.

**Building**  The barn has a UCC of $140,000, a capital cost of $165,000, and a fair market value of $175,000.

The property is transferred to his son.  The son pays $470,000 for the land.  No payment is made for the barn.  Describe the tax consequences of this transfer for both Martin and his son.

Exam Exercise Nine - 20 (Transfers On Death)

Mr. Norm Norten dies in July, 2017.  At the time of his death, he owned two backhoes that were used in his construction business.  His will leaves one backhoe to his spouse, Linda, with the other backhoe going to his daughter, Mary.  The backhoes cost $180,000 each and each had a fair market value at the time of Mr. Norten’s death of $122,000.  The UCC balance for the class that contains the backhoes is $148,000.  What are the tax consequences resulting from Mr. Norten’s death with respect to the two backhoes?  Your answer should include the capital cost and UCC for the backhoes in the hands of Linda and Mary.

Exam Exercise Nine - 21 (Transfers On Death)

At the time of her death, Nancy Stein owns two depreciable assets.  Her will leaves one of these assets to her spouse Mark, with the other asset going to her son Nick.  Each of these assets cost $125,000 and, at the time of Nancy’s death, they each have a fair market value of $86,000.  They are the only assets in their CCA class and the UCC balance for that class is $104,000.  What are the tax consequences resulting from Ms. Stein’s death with respect to the two assets?  Your answer should include the capital cost and UCC for the assets in the hands of Mark and Nick.

Exam Exercise Nine - 22 (Income Attribution - Spouse)

On December 28, 2016, Mrs. Chastity Blue gives her husband shares in a public company with an adjusted cost base of $42,000 and a fair market value of $38,000.  During 2017, the shares pay taxable dividends of $4,968 [(138%)($3,600)].  On December 1, 2017, Mr. Blue sells the shares for $53,000. Assume that Mrs. Blue does not elect out of ITA 73(1).   What are the tax consequences for Mr. and Mrs. Blue in each of the years 2016 and 2017?   If there are no tax consequences for either individual in a given year, you should clearly state this fact in your answer.

Exam Exercise Nine - 23 (Income Attribution - Spouse)

On December 31, 2016, Mr. Tom London gives shares with an adjusted cost base of $21,500 and a fair market value of $35,200 to his wife, Barbara London.  On February 24, 2017, the shares pay eligible dividends of $2,060 ($2,843 taxable amount) and, on August 31, 2017, Mrs. London sells the shares for $39,800.  Assume that Mr. London does not elect out of ITA 73(1).  What are the tax consequences for Mr. and Mrs. London in each of the years 2016 and 2017?   If there are no tax consequences for either individual in a given year, you should clearly state this fact in your answer.

Exam Exercise Nine - 24 (Income Attribution - Spouse)

In 2016, Charlotte Ramp gives shares to her spouse Michael Ramp.  The shares have an adjusted cost base of $23,000 and, at the time of the gift, they have a fair market value of $35,000.  Charlotte elects out of ITA 73(1) in her return of income.

During 2017, the shares pay eligible dividends of $1,800.  Prior to the end of 2017, Michael sells the shares for $42,000.  What are the tax consequences to Charlotte and Michael in each of the years 2016 and 2017?   If there are no tax consequences for either individual in a given year, you should clearly state this fact in your answer.

Exam Exercise Nine - 25 (Income Attribution - Related Minor)

On December 31, 2016, Mr. Tom London gives shares with an adjusted cost base of $21,500 and a fair market value of $35,200 to his 9 year old son, Patrick London.  On February 24, 2017, the shares pay eligible dividends of $2,060 ($2,843 taxable amount) and, on August 31, 2017, Patrick sells the shares for $39,800.  What are the tax consequences for Mr. London and Patrick in each of the years 2016 and 2017?   If there are no tax consequences for either individual in a given year, you should clearly state this fact in your answer.

Exam Exercise Nine - 26 (Income Attribution - Related Minor)

In 2016, Charlotte Ramp gives shares to her 12 year old daughter Vanessa.  The shares have an adjusted cost base of $23,000 and, at the time of the gift, they have a fair market value of $35,000.

During 2017, the shares pay eligible dividends of $1,800.  Prior to the end of 2017, Vanessa sells the shares for $42,000.  What are the tax consequences to Charlotte and Vanessa in each of the years 2016 and 2017?   If there are no tax consequences for either individual in a given year, you should clearly state this fact in your answer.

Exam Exercise Nine - 27 (Income Attribution - Spouse And Related Minor)

Mr. Randy Cleroux owns 1,000 shares of Lyton Industries Ltd.  These shares have an adjusted cost base of $105 per share.  On December 31, 2016, the shares are trading at $156 per share.  At this time, he gives 400 of these shares to his 12 year old son.  He gives the remaining 600 shares to his wife.

During 2017, the shares pay eligible dividends of $4.50 per share.  On December 31, 2017, both his son and his spouse sell their shares for $142 per share.  Assume that Mr. Cleroux does not elect out of ITA 73(1).  Indicate the tax consequences of these transactions for Mr. Cleroux, his son, and his spouse, in each of the years 2016 and 2017.   If there are no tax consequences for either individual in a given year, you should clearly state this fact in your answer.

Exam Exercise Nine - 28 (Income Attribution - Use Of Loans)

On December 31, 2016, Mrs. Danielle Lafarge gives corporate bonds to her husband in exchange for a note with a face value of $131,000.  The corporate bonds have an adjusted cost base of $119,000 and a fair market value of $131,000.  The note from her husband does not pay interest and has no specific maturity date.  Mrs. Lafarge does not report a gain or loss on these bonds in 2016.

During 2017, the bonds pay interest to Mr. Lafarge in the amount of $5,600.  On October 1, 2017, immediately after an interest payment, Mr. Lafarge sells the bonds for $134,000.  He uses $131,000 of the proceeds to pay off the loan owing to his wife.  What are the tax consequences for Mr. and Mrs. Lafarge in each of the years 2016 and 2017?

Exam Exercise Nine - 29 (Income Attribution - Use Of Loans)

In December, 2016, John Barton gives corporate bonds to his spouse Julie Barton, in exchange for a note with a face value of $210,000.  In John’s hands, the bonds have an adjusted cost base of $205,000, and a fair market value of $210,000.  John elects out of ITA 73(1).  The interest free note provided by Julie must be repaid when she sells the bonds.

During 2017, the bonds pay interest of $11,000.  Immediately after receiving the interest payment, Julie sells the bonds for $216,000.  What are the tax consequences for John and Julie in each of the years 2016 and 2017?   If there are no tax consequences for either individual in a given year, you should clearly state this fact in your answer.

TIF Problem Nine - 5A

Other Income/Deductions - Key Term Matching (Easy)

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

Version A is easy, there is only one possible answer for each term.

Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms were listed at the end of Chapter 9, “Other Income, Other Deductions And Income Attribution”.

A. Canada Learning Bonds

B. Canada Education Savings Grants

C. Child Care Expenses

D. Child Support

E. Disability Supports Deduction

F. Income Attribution

G. Registered Education Savings Plan

H. Support Amount

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

1. A support amount that is for the benefit of a spouse or common-law partner, or a former spouse or common-law partner.

2. A trusteed arrangement that allows individuals to make non-deductible contributions that will be invested on a tax-free basis, with the accumulated funds being used to provide for the post-secondary education of a child.

3. A system of grants under which the federal government makes contributions to an individual’s RESP based on the number of years in which the individual’s family is eligible for the National Child Benefit supplement.

4. A support amount that is not identified as being for the benefit of a spouse or common-law partner, or a former spouse or common-law partner.

5. Amounts paid as the result of the separation or divorce of two individuals who were spouses or common-law partners.

6. The allocation of some types of income, on assets that have been transferred to a spouse or related minors, back to the transferor for inclusion in the transferor’s net income for tax purposes.

7. A system of grants under which the federal government makes contributions to an individual’s RESP based on a percentage of the contributions to that individual’s RESP that have been made by others.

8. Costs associated with caring for an eligible child.

9. A deduction available to individuals for attendant care and other disability support expenses, incurred to allow the disabled individual to work or to attend a designated educational institution.

10. A group of tax planning techniques designed to divide a given stream of income among family members or other related parties.

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

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

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

TIF Problem Nine - 5B

Other Income/Deductions - Key Term Matching (Moderate)

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

Version A is easy, there is only one possible answer for each term.

Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms were listed at the end of Chapter 9, “Other Income, Other Deductions And Income Attribution”.

A. Canada Learning Bonds

B. Canada Education Savings Grants

C. Child Care Expenses

D. Child Support

E. Disability Supports Deduction

F. Income Attribution

G. Registered Education Savings Plan

H. Support Amount

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

1. A deduction available to individuals for medical expenses incurred to allow the disabled individual to work or to attend a designated educational institution.

2. A support amount that is for the benefit of a spouse or common-law partner, or a former spouse or common-law partner.

3. A trusteed arrangement that allows individuals to make non-deductible contributions that will be invested on a tax-free basis, with the accumulated funds being used to provide for the post-secondary education of a child.

4. A trusteed arrangement that allows individuals to make deductible contributions that will be invested on a tax-free basis, with the accumulated funds being used to provide for the post-secondary education of a child.

5. A system of grants under which the federal government makes contributions to an individual’s RESP based on the number of years in which the individual’s family is eligible for the National Child Benefit supplement.

6. A support amount that is not identified as being for the benefit of a spouse or common-law partner, or a former spouse or common-law partner.

7. Amounts paid as the result of the separation or divorce of two individuals who were spouses or common-law partners.

8. The allocation of some types of income, on assets that have been transferred to a spouse or related minors, back to the transferor for inclusion in the transferor’s net income for tax purposes.

9. All amounts in excess of $10,000 that are received by a taxpayer in a taxation year, on or after the death of an employee, in recognition of the employee’s service in an office or employment.

10. A system of grants under which the federal government makes contributions to an individual’s RESP based on a percentage of the contributions to that individual’s RESP that have been made by others.

11. Costs associated with caring for an eligible child.

12. A non-deductible support amount that is for the benefit of a child of the payor.

13. A deduction available to individuals for attendant care and other disability support expenses, incurred to allow the disabled individual to work or to attend a designated educational institution.

14. A group of tax planning techniques designed to divide a given stream of income among family members or other related parties.

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

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

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

TIF Problem Nine - 6

Death Benefits

On January 2, 2016, Mrs. Long died in an automobile crash.  Mrs. Long was 55 years old and, at the time of her death, was a full time employee of Apex Distribution Systems.  During 2015, Mrs. Long earned $47,000 in employment income.

Because of her years of faithful service, Apex decides to pay a death benefit to Mrs. Long’s surviving spouse in the amount of $24,000.  The amount is to be paid in annual instalments of $6,000 per year, with the first instalment being paid in 2016.

**Required:** What effect will this death benefit have on the Net Income For Tax Purposes of Mrs. Long’s spouse in 2016 and in subsequent years?

TIF Problem Nine - 7

Moving Expenses

Ms. Michelle Wong has worked for Famous Food Importers for over 20 years.  For 2017, her salary is $15,000 per month.  For this entire period, she has worked in the Montreal office of the company.  However, she is finding Montreal winters to be increasingly less attractive and, as a consequence, asked to be transferred to the Vancouver office of the company.

As she is considered to be a highly valuable employee, the company agrees to this move.

During September, 2017, she flies to Vancouver in order to locate a new residence.  While she is there, she is unable to locate a property at a price that she can afford.  After her return to Montreal, she searches online and finally manages to lease a suitable condominium for $2,500 per month.  The lease is for 12 months, beginning December 1, 2017.  The costs associated with this trip are as follows:

Air Fare - Return $1,125

Rental Car Costs (5 Days) 342

Hotel (5 Nights At $200) 1,000

Food (5 Days - Total) 450

At the beginning of September, 2017, she lists her Montreal residence for sale.  She had paid $625,000 for the residence several years ago.  However, because a crematorium has begun operating in the neighborhood, it sells for only $550,000.  Costs associated with this sale are as follows:

Real Estate Commissions $27,500

Legal Fees 800

Unpaid Property Taxes To Date Of Sale 1,500

Cost Of Cleaning And Minor Repairs Prior To Sale 3,800

While Michelle will continue to work in Montreal until November 15, the closing on the old house is on October 20.  Because of this, all of her furnishings must be put into storage until they are shipped on November 20.  The storage costs are $2,200.  In addition, the moving company charges $10,200 for the costs of the move, including packing in Montreal and unpacking at the apartment in Vancouver.

During the period, October 20 through November 15, 2017 Michelle resides in a downtown Montreal hotel.

On November 15, she departs for Vancouver.  She drives her own vehicle, arriving in Vancouver on November 24.  The trip is 4,558 kilometers.

As the condominium unit is not available until December 1, she spends 7 nights in a Vancouver hotel.

Her expenses for the period October 20 through December 1 are as follows:

Hotel In Montreal (26 Nights At $350) $9,100

Food In Montreal (26 Days - Total) 2,050

Gas For Trip 685

Lodging For 9 Nights On The Trip\* 1,575

Food On The Trip (9 Days - Total) 825

Lodging In Vancouver (7 Nights At $320) 2,240

Food In Vancouver (7 Days - Total) 1,330

\*  The hotel charges did not exceed $200 for any one night.

Michelle will use the simplified method of determining vehicle and food costs in calculating her moving expenses.  Assume that the relevant flat rate for vehicle expenses is $0.495 for Saskatchewan and $0.475 for British Columbia, and the flat rate for meals is $51 per day.

To assist her with the move, the company will do the following:

* They will provide her with a $20,000 allowance to cover her general moving costs.
* They will compensate her, in full, for any loss on the sale of her Montreal residence.  The loss will be determined without consideration of applicable selling costs.
* They will provide a one-time payment of $10,000 to assist her in dealing with the higher housing costs in Vancouver.

Michelle begins working in Vancouver on December 1.  She will take the maximum moving expense deduction for 2017.

**Required:** Determine the amount of Michelle’s maximum 2017 deduction for moving expenses and indicate the amount of any carry forward that is available at the end of the year under the following assumptions regarding the amounts related to the move that are paid by Famous Food Importers:

A. The Vancouver office has agreed to pay these amounts from their funds and does so during December, 2017.

B. The Montreal office has agreed to pay these amounts from their funds and does so during  October, 2017.

TIF Problem Nine - 8

Moving Expenses

Mr. Lawrence Harvey has lived and worked in Halifax for most of his adult life.  In July, 2017, he discovers that his wife of many years has been having an affair with both his father and his brother.  He immediately begins divorce proceedings and submits a request to his employer for a transfer away from Halifax.

As he has skills that are uniquely valuable to his employer, the employer wishes to comply.  After considering alternative locations, Lawrence and his employer agree on a move to the company’s main office in Ottawa.  Lawrence will begin working in that location at the beginning of December, 2017.  Lawrence’s salary is $8,000 per month, with the first 11 months of 2017 being paid by the Halifax office, the remaining one month being paid by the Ottawa office.

As part of the uncontested divorce settlement, Lawrence receives the family residence.  During October, 2017, it is sold for $435,000.  As he was anxious to sell quickly, there is a loss of the sale of $52,000.  Costs associated with the sale are as follows:

Real Estate Commissions $21,000

Legal Fees 800

Unpaid Property Taxes To Date Of Sale 1,500

Cost Of Cleaning And Minor Repairs Prior To Sale 3,800

In October, 2017, Lawrence flies to Ottawa to locate suitable housing.  As he is now living alone, he decides to lease a condominium.  After 2 days, he finds a suitable property which he leases for $2,500 per month, beginning November 1.  He remains in Ottawa for an additional 4 days in order to find furnishings for the rental unit.  The costs associated with this trip are as follows:

Air Fare - Return $1,250

Rental Car Costs (6 Days) 420

Hotel (6 Nights At $200) 1,200

Food (6 Days - Total) 510

His employer has agreed to the following to provide assistance with the move:

* They will provide him with an $18,000 allowance to cover his general moving costs.
* They will compensate him, to the extent of $30,000, for the loss on the sale of his Halifax home.

All of these amounts will be paid by the Ottawa office during December, 2017.

On November 7, Lawrence leaves for Ottawa by air.  Because the acquired furnishings have not been delivered yet, he has to live in an Ottawa hotel until November 25.

His expenses for the period November 7 through November 25 are as follows:

Air Fare - One Way $ 600

Hotel Room With Kitchenette (19 Nights At $160) 3,040

Food (19 Days – Total Including Groceries For

Cooking In Hotel)  660

He contracts a car moving company to transport his car to Ottawa and it is delivered on November 8.  The cost for this service is $1,100.

A moving company takes care of moving Lawrence’s personal belongings to Ottawa.  The invoice for this service is $3,500.  In addition, there is a $1,200 charge for storing these belongings until the Ottawa condominium becomes available.

Lawrence begins working in Ottawa on December 1.  He would like to take the maximum moving expense deduction for 2017.

Lawrence will use the simplified method of determining food costs in calculating his moving expenses.  Assume that the flat rate for meals is $51 per day.

**Required:** Determine the amount of Lawrence’s maximum 2017 deduction for moving expenses.  In addition, indicate the amount of any carry forward that is available at the end of the year.

TIF Problem Nine - 9

Child Care Expenses

Both Mr. Fortin and Mrs. Fortin are employed.  During 2017, Mr. Fortin had opened a restaurant and had business income of $8,000.  Mrs. Fortin had employment income of $84,000, mostly from commission sales during 2017.  Since Mrs. Fortin’s work required a good deal of travel away from home and Mr. Fortin’s new restaurant required him to work long hours, including many evenings, they had to pay for care of their children.  Payments for child care amounted to $400 per week, for a total of 48 weeks.

Also during the current year, there was a period of six weeks during which Mr. Fortin was hospitalized due to injuries suffered during a game of Ultimate Frisbee.  This period was part of the 48 weeks for which child care payments were made.

**Required**:  Determine the maximum amount that can be deducted by Mr. and Mrs. Fortin for the year ending December 31, 2017 for child care expenses under the following assumptions:

A. They have two children, neither of whom qualify for the disability tax credit.  Their ages are 2 and 4 years old.

B. They have three children, none of whom qualify for the disability tax credit.  Their ages are 2, 4, and 15 years old.

TIF Problem Nine - 10

Child Care Expenses

During 2017, Mr. Morris Holmes starts a new business venture.  While he expects that, in the long run, the business will be profitable, it only produced net business income of $18,000 during its first year of operations.  Because of the time he committed to this venture, this was the only income Mr. Holmes earned during 2017.

Mrs. Holmes is employed as a management consultant.  Her 2017 gross employment income was $81,000 and RPP contributions of $3,000 were withheld from her pay.  Her only other source of income was interest received of $1,200.

During 2017, Mr. Holmes spent 6 weeks attending a college course dealing with the management of a small business.  The course required Mr. Holmes to spend at least 15 hours per week in classes and preparing assignments.

Because of the requirement of Mr. Holmes’ business and Mrs. Holmes’ employment, the couple incurred child care costs during 2017 of $300 per week for 50 weeks.

**Required**:  Determine the maximum amount that can be deducted by Mr. and Mrs. Holmes for the year ending December 31, 2017 for child care expenses under the following assumptions:

A. They have two children, neither of whom qualify for the disability tax credit.  Their ages are 3 and 5 years old.

B. They have three children, none of whom qualify for the disability tax credit.  Their ages are 3, 5, and 10 years old.

TIF Problem Nine - 11

Pension Income Splitting - With OAS

Martin Jones and his wife Sally are both 68 years of age.  Sally received OAS payments of $7,000 during 2017.  In addition to her OAS benefits, Sally earns interest of $43,000 during 2017.  The investments which provide this interest were inherited from her mother.  Because of a serious accident several years ago, Sally qualifies for the disability tax credit.

During 2017, Martin receives an annual pension benefit from his former employer of $124,000.  This is his only source of income other than the OAS payments described in Scenario 2 below.

**Scenario 1** Martin prepares his and Sally’s tax returns and does not split his pension income.  Martin has never applied for OAS payments, thinking that they would simply be clawed back by the government because of his ongoing high level of income.

**Scenario 2** An accountant prepares Martin and Sally’s tax returns and splits Martin’s pension income, with $62,000 going into each of their tax returns.  Martin applied for OAS as soon as he turned 65 and received $7,000 in OAS benefits in 2017.

Neither Martin nor Sally are eligible for any tax credits other than the basic personal credit, the age credit, the pension income credit, and the disability tax credit.  Further, they have no deductions that will be used in the determination of Taxable Income.

**Required:**

A. Calculate the amount of Net Income For Tax Purposes and Taxable Income for both Martin and Sally under each of the two Scenarios.

B. Based on your figures from Part A, calculate the amount owing to the CRA for both Martin and Sally under each of the two Scenarios.  Provide a comparison of the amounts owing under the two alternatives.

TIF Problem Nine - 12

Pension Income Splitting - With OAS

Bennett Bixlar and his wife Belinda are both 66 years of age and in good health.

For 2017, Bennett receives payments totaling $120,000 from his former employer’s RPP.  Other than OAS payments described in Alternative 2, Bennett has no other income during 2017.

Belinda has received a significant portfolio of dividend paying stocks from her family.  During 2017, she received eligible dividends of $39,000.  In addition, she received OAS payments of $7,000 during the year.

They have been advised of the possibility of splitting Bennett’s pension income.  To assist in deciding whether or not they should use this election they have asked you to provide information under each of two alternatives:

**Alternative 1** Their tax returns are prepared without splitting income.  Bennett does not file for OAS payment as they would be clawed back due to his ongoing high level of income.

**Alternative 2** Their tax returns are prepared using the pension income splitting election.  Bennett’s pension income is evenly split, with $60,000 going to each spouse.  Bennett applied for OAS when he turned 65 and received OAS payments of $7,000 during the year.

They have no deductions that will be used in the determination of Taxable Income.  Neither Bennett nor Belinda are eligible for any tax credits other than the:

* basic personal credit,
* age credit,
* dividend tax credit, and
* pension income credit.

**Required:**

A. Calculate the amount of Net Income For Tax Purposes and Taxable Income for both Bennett and Belinda under each of the two Alternatives.

B. Based on your figures from Part A, calculate the amount owing to the CRA for both Bennett and Belinda under each of the two Alternatives.  Provide a comparison of the amounts owing under the two alternatives.

TIF Problem Nine - 13

Other Income And Deductions Including RESP

Katrina Watts is 42 years old and has custody of her two children from a previous marriage.  The son is 11 years old and the daughter is 9 years old.  They are both in good health.  She is currently married to very successful electrician who earns an income in excess of $300,000 per year.

As her children are now in school most of the year, she has decided to pursue a career in environmental design.  To this end, she has enrolled, on a full time basis, at the University of Calgary.  Her studies began on January 1, 2017.

As she was very successful in her first term of studies, she was able to obtain summer employment as an assistant in an environment study in Cold Lake, Alberta.  As this location was over 600 kilometres from Calgary, she and her children moved to a rented cottage in Cold Lake for the period June 1, 2017 through September 1, 2017.  As this was a temporary move, it was accomplished using a rented van at a total cost of $685.

During her summer in Cold Lake, Ms. Watts required someone to take care of her two children while she was at work.  For this service, she paid a local retired teacher $125 per week for a period of 12 weeks.  She has the appropriate documentation to support these costs.

She returned to Calgary on September 1, 2017 in order to resume her studies at the University of Calgary.  Once again, the move was accomplished using a rented van.  The total cost was $826.  During the fall term, she found a part time job working in a Calgary architecture firm.

On January 1, 2017, Ms. Watts did not have a Tax Free Savings Account (TFSA).  In October, 2017, she opened a TFSA and deposited a total of $4,500.  Her husband also made a contribution in the amount of $5,000.

During 2017, Ms. Watts received the following amounts:

Wages From Cold Lake Employment 9,600

Wages From Part Time Employment In Calgary 600

Scholarship Granted By University for September 2017 Semester 4,000

Eligible Dividends Received 3,500

Child Support Received 10,500

Inheritance From Aunt 30,000

TFSA Withdrawal 8,000

During November, 2017 Ms. Watts establishes RESPs for both of her children.  She contributes $1,000 to each of these plans.

**Required:**

A. Determine the minimum Net Income For Tax Purposes that Ms. Watts will have to report for her 2017 taxation year.   Provide reasons for omitting items that you have not included in your calculations.  Also, indicate any amounts that can be carried forward to future years.

B. Provide any advice you feel would assist her in planning future actions concerning the RESPs that have been established for her children.

TIF Problem Nine - 14

Non-Arm’s Length Transfer Of Land

Martin Forest has owned a tract of land for over 10 years.  He acquired the land at a cost of $360,000.  An appraiser has advised him that the land has a current fair market value of $500,000.  It is Martin’s intention to sell the land.

The following four Cases make different assumptions as to the identity of the purchaser and the proceeds of disposition.  In each Case, we will assume that the purchaser immediately re-sells the land for its fair market value of $500,000.

**Case 1** Martin sells the land to an arm’s length party for $500,000.

**Case 2** Martin sells the land to his sister for its cost of $360,000.

**Case 3** Martin gifts the land to his 10 year old son.

**Case 4** Martin sells the land to his mother for $600,000.

**Required:**

A. For each of the alternatives under consideration, advise Martin of the tax consequences that will result from the disposition.  Indicate the tax consequences to the purchaser of the land when it is resold.

B. In those cases where the land is sold by Martin for a value other than fair market value, indicate what might motivate him to make the sale at that price.

TIF Problem Nine - 15

Non-Arm’s Length Transfer Of Depreciable Asset

The following independent cases involve non-arm’s length transfers of depreciable assets.

**Case One - FMV Greater Than Capital Cost** John Barth sells a depreciable asset to his son for cash of $165,000, an amount equal to the fair market value of the asset.  The asset has a capital cost of $97,000.  It is the only asset in its CCA Class.  The UCC balance for the class is $69,000.

**Case Two - FMV Less Than Capital Cost**  John Barth sells a depreciable asset to his daughter for cash of $210,000, an amount equal to the fair market value of the asset.  The asset has a capital cost $286,000.  It is the only asset in its CCA Class.  The UCC balance for the class is $189,000.

**Required:** For each of the two Cases, indicate the tax consequences for John that result from the sale.  In addition, indicate the tax values that will be used by the transferee subsequent to the transfer.

TIF Problem Nine - 16

Deemed Dispositions At Death Including Disposition Of Land And Building

Ms. Margarette Ferrero lives with her spouse, Gianni Ferrero.  On August 3, 2017, Margarette dies of a heart attack while competing in a 10 kilometer race.

Margarette and Gianni have a 32 year old daughter, Ciara.  Ciara is employed with a large public company and, for 2017, has employment income of $72,000.  As she actively trades in the stock market, she normally experiences taxable capital gains of at least $25,000 per year.  This was the case for 2017, and the three preceding years.

For several years, Margarette owned a commercial rental property in Lethbridge.  The property was acquired at a cost of $623,000, with $473,000 of this total allocated to the building and $150,000 allocated to the land.  As it is a rental property with a value in excess of $50,000, it is allocated to a separate Class 1.  Since its acquisition, the building has always been fully occupied.  As of January 1, 2017, the UCC balance for this Class 1 is $363,000.

As of the date of Margarette’s death, it is estimated that the fair market value of the property has increased to $746,000, with $571,000 of this total allocated to the building and the remaining $175,000 allocated to the land.

Due to a major city improvement project that started at the beginning of 2018, the main road access to the building will be under construction for at least 3 years.  As a result, on May 1, 2018, the building is sold for $685,000, with $525,000 of this total being allocated to the building and the remaining $160,000 allocated to the land.

**Required**:

A. For each of the following cases, indicate the tax effects to be included in Margarette’s tax return as a result of the 2017 deemed disposition at her death, as well as the tax effects associated with the 2018 sale of the property.

**Case 1** Margarette’s will leaves the apartment building to her spouse, Gianni.  During 2017, Gianni continues to operate the building and takes maximum CCA for that year.

**Case 2** Margarette’s will leaves the apartment building to her daughter, Ciara.  During 2017, she continues to operate the building and takes maximum CCA for that year.

B. Assume that in Case 2, the proceeds of the 2018 sale of the property by Ciara were allocated $300,000 to the land and $385,000 to the building.  Calculate the tax effects associated with the sale of the property for Ciara.

TIF Problem Nine - 17

Deemed Dispositions On Death And Emigration

Mr. Cheever is 66 years of age and his wife, Doreen, is 56.  They have one daughter, Mary, who is 32 years of age.  On July 1 of the current year, Mr. Cheever owns the following properties:

**Rental Property** Mr. Cheever owns a rental building that was acquired at a cost of $550,000 ($100,000 of this amount represents the estimated value of the Land on which the building is situated).  On July 1 of the current year, its UCC is $270,000 and its fair market value is estimated to be $970,000 (the estimated value of the land is unchanged at $100,000).

**Brazeway Dynamics** Mr. Cheever owns 2,500 shares of Brazeway Dynamics, a Canadian public company.  These shares have a cost of $275,000 and a current fair market value of $425,000.  Mr. Cheever has never owned more than 1 percent of the outstanding shares of this Company.

**Farm Land** Mr. Cheever owns farm land with a cost of $525,000 and a current fair market value of $750,000.  The land is farmed on a full time basis by Mr. Cheever’s daughter, Mary.

**Cheever Inc.**  Mr. Cheever owns 100 percent of the voting shares of Cheever Inc., a Canadian controlled private corporation.  The Company was established with an investment of $155,000 and it is estimated that the current fair market value of the shares is $227,000.  Cheever Inc. is not a qualified small business corporation for purposes of the lifetime capital gains deduction.

**Required:** Assuming that no elections are made and that normal deemed disposition values apply, explain the tax consequences to Mr. Cheever for the current year, in each of the following Cases:

A. Mr. Cheever dies on July 1 of the current year, leaving all of his property to his spouse, Doreen.

B. Mr. Cheever dies on July 1 of the current year, leaving all of his property to his daughter, Mary.

C. Mr. Cheever departs from Canada and ceases to be a resident on July 1 of the current year.

TIF Problem Nine - 18

Transfers To A Spouse - Income Attribution

For a number of years, Mr. James Hadley has owned several rental properties.  On January 1, 2017, he marries Ms. Gwyneth Rowe and, on the following day, as part of their pre-nuptial agreement, he gifts one of these properties to her.  At the time of the gift, the relevant information on the property is as follows:

**Land Building**

Original Cost $ 52,000 $170,000

Market Value - Date Of Transfer 102,000 214,000

UCC - Date Of Transfer N/A 97,000

During 2017, there was a net rental loss on the property of $7,400 and no CCA was deducted on the building.

On January 1, 2018, after concluding that other investments would provide a better return, Gwyneth sells the rental property for $346,000.  At this time, an appraisal indicates that the market value of the land is unchanged at $102,000.

**Required:** Determine the tax effects associated with the transfer and subsequent sale of the property for both Mr. and Mrs. Hadley assuming:

A. The facts are as stated in the problem and that Mr. Hadley does not elect out of ITA 73(1).

B. Instead of receiving the rental property as a gift, Gwyneth purchases the property for its fair market value, using funds that were accumulated prior to the marriage.  Mr. Hadley elects out of ITA 73(1) on this sale.

TIF Problem Nine - 19

Income Attribution

For several years, Ms. Tiffani Langston has owned 21,000 shares of Modal Inc., a Canadian public company.  These shares were acquired at a cost of $10 per share.

On January 12,  2017, Tiffani gives 7,000 of these shares to her spouse Hugh Langston.  She does not elect out of the ITA 73(1) spousal rollover.  Also on this date, Tiffani gives the remaining 14,000 shares to her 9 year old son, Mark.  On this date, the shares are trading at $11 per share.

On August 1, 2017, the shares pay an eligible dividend of $0.50 per share.

On December 15, 2017, both her spouse, Hugh and her son, Mark sell their shares for $13 per share.

**Required:** Determine the total Net Income For Tax Purposes to be recorded for the 2017 taxation year by Tiffani, her spouse Hugh, and his son Mark, on the preceding transactions.  Assume Tiffani dies on November 11, 2017.  How would that change your solution?

TIF Problem Nine - 20

Income Attribution

For a number of years, Mr. Alonso Robelo has owned 15,000 shares of Lisgar Inc., a Canadian public company.  These shares were acquired at a cost of $12.50 per share.

On March 2, 2017, Alonso gives 5,000 shares of these shares to his spouse Alice.  The remaining 10,000 shares are given to his 12 year old son Alonso Jr.  On this date the shares are trading at $17.00 per share.

On July 1, 2017, the Lisgar Inc. shares pay an eligible dividend of $0.80 per share.

On November 1, 2017, Alice and Alonso Jr. sell all of their Lisgar Inc. shares for $16.00 per share.

**Required:** Determine the total Net Income For Tax Purposes to be recorded for the 2017 taxation year by Alonso, his spouse Alice, and his son Alonso Jr., on the preceding transactions.  Assume that Alonso did not elect out of the ITA 73(1) spousal rollover provision.

TIF Problem Nine - 21

Comprehensive Case (Chapters 1 to 9)

John Winded celebrated his 65th birthday on February 14, 2017.  On February 28, 2017, John retired from Celebrate Ltd., a public corporation, after 35 years of service. John’s annual remuneration was $84,000.  A review of his last pay stub reveals the following deductions:

CPP contributions $700

EI premiums 200

RPP contributions 500

Employee premiums to the company dental and health plan 150

John had the use of a company car for January and February.  The car was leased at a monthly rate of $360.  During these two months, Celebrate Ltd. paid the $800 in automobile operating expenses.  John drove a total of 3,000 kilometers, 90 percent of which were personal.

As a token of their appreciation for John’s dedicated service, the company gave him a watch that cost $700.

Since John wanted to live in the Vancouver area once retired, he asked his employer to transfer him from their Winnipeg to their Vancouver office, effective January 1, 2017.  He incurred the following expenses related to his move:

**October, 2016**

Air fare for John and his spouse for trip to Vancouver to find a home $ 900

Hotel for four days in Vancouver for purposes of finding a new home 800

Meals while in Vancouver for purposes of finding a new home 320

Car rental while in Vancouver for purposes of finding a new home 325

**December, 2016**

Legal fees and land transfer taxes on purchase of new home $ 4,800

**January, 2017**

Air fare for John and his spouse to Vancouver $ 1,200

Legal fees and commissions on sale of old home (sold in January, 2017) 13,000

Cost of transporting furniture and other household goods

from Winnipeg to Vancouver 4,000

Mr. Winded has kept all of his receipts with respect to his moving costs.

Mr. Winded made sure he acquired the maximum allowable number of shares under the company stock option plan prior to his retirement date.  On February 1, 2017, when the shares were trading for $11 per share, he acquired 1,500 shares at $8 per share.  When the option was granted, the shares were trading for $7 per share.  Mr. Winded sold 1,000 of the 1,500 shares in June, 2017 for $17 per share.  Mr. Winded did not own any other shares of Celebrate Ltd., other than the ones he acquired in February.

Mr. Winded received the following “pension” income for the period March 1 through December 31:

Old Age Security $ 5,350

Canada Pension Plan 9,600

Pension Income from his company pension plan 44,000

Registered Retirement Income Fund 8,000

Mr. Winded also has a number of investments.  During 2017, he received interest income of $3,478 and eligible dividends from Canadian public corporations of $1,700.  He owns shares of Sail Ltd., a private investment corporation that is controlled by his brother-in-law.  During 2017, he received non-eligible dividends from Sail Ltd. of $800.

Mr. Winded owns two rental properties.  The information for 2017 is as follows:

**Property A Property B**

Rental Revenues $ 98,000 $ 62,000

Operating Expenses ( 104,000) ( 54,000)

Net Rental Income (Loss) ($ 6,000) $ 8,000

Class 1 UCC Balance - January 1 $180,000 $210,000

Class 8 UCC Balance - January 1 12,000 16,000

Mr. Winded divested himself of a number of capital assets during 2017:

**Description Cost Gross Proceeds**

Stamp collection $ 8,000 $ 5,000

Rare book 700 4,200

Furniture 4,800 900

Painting 300 800

Shares of Sail Ltd. (Note 1) 12,000 48,000

Shares of CNR Company Note 2 20,100

Shares of BCE Ltd. Note 2 36,000

Sale of Winnipeg home (Note 3) 140,000 300,000

Sale of Lake Winnipeg cottage (Note 3) 80,000 290,000

**Note 1** Sail Ltd. is a private company whose shares do not qualify for the lifetime capital gains deduction.

**Note 2** Mr. Winded’s history of purchases and sales in the shares of Canadian National Railway (CNR) Company and BCE Ltd. are as follows:

May 1, 2013 purchase 200 CNR shares @ $52 per share

May 1, 2014 purchase 300 CNR shares @ $46 per share

May 1, 2015 sale 400 CNR shares @ $55 per share

May 1, 2016 purchase 200 CNR shares @ $64 per share

May 1, 2017 sale 300 CNR shares @ $67 per share

July 11, 2017 purchase 1,000 BCE shares @ $38 per share

August 1, 2017 sale 1,000 BCE shares @ $36 per share

August 29, 2017 purchase 600 BCE shares @ $39 per share

**Note 3** The cottage was acquired in 2002.  It was sold for gross proceeds of $290,000. Mr. Winded incurred $10,000 of selling costs on this property.

The Winnipeg home which was acquired in 2008 was sold for gross proceeds of $300,000. Mr. Winded incurred selling costs of $13,000 on the sale of his Winnipeg home.

Mr. Winded plans to deduct the selling costs on the house as a moving expense and account for the selling costs on the cottage as a selling cost on the disposition.

Mr. Winded has operated a sideline woodworking business for 10 years which he has continued in Vancouver.  For 2017, the details are as follows:

Revenues $38,000

Supplies 16,000

Advertising 1,000

Purchase of a new computer 3,800

Purchase of woodworking equipment 1,600

Purchase of two hand tools 450

Mr. Winded converted his large Vancouver garage to a woodworking shop in December, 2016. The shop occupies 20 percent of the total area of his Vancouver home.  His 2017 home expenses are as follows:

Mortgage interest $4,000

Utilities 3,600

Property taxes 4,500

Home telephone line 700

Insurance 1,400

Maintenance 1,800

As he does not wish to have to report any capital gain or recapture upon its eventual disposition, Mr. Winded will not claim CCA on the portion of his home that is used in his woodworking business.  The only UCC balance related to his woodworking business as at January 1, 2017 is the Class 8 UCC balance of $2,400.

Mr. Winded’s spouse, Rachel, is 67 years old.  Her 2017 income consists of $7,000 in Old Age Security, $3,100 from the Canada Pension Plan and $1,400 of eligible dividends that she received from preferred shares that were given to her as a birthday present in 2016 by her husband.  The shares, which have an adjusted cost base of $27,000, were sold for $31,000 in 2017.

Mrs. Winded is disabled and qualifies for the disability tax credit.  In 2017, she incurred $4,600 in medical expenses, $1,200 of which was reimbursed by Mr. Winded’s dental and health plan when he was an employee of Celebrate Ltd.

In 2017, Mr. Winded made $3,700 in charitable donations to registered charities.  As John makes regular contributions to these charities, he is not eligible for the first-time donor’s super credit.

Mr. and Mrs. Winded would like to use all possible elections, include pension income splitting, in order to minimize their combined tax liability.

**Required:**  In determining these amounts, ignore GST, PST and HST considerations.

A.

For the 2017 taxation year, calculate Mr. and Mrs. Winded’s Net Income For Tax Purposes and Taxable Income.

B. For the 2017 taxation year, calculate Mr. and Mrs. Winded’s Federal Balance Owing Or Refund (tax plus any social benefits repayment).

Chapter Ten Test Item File Problems

TIF Problem Ten - 1

Retirement Savings - Essay Questions

1. What are the tax advantages associated with making contributions to an RPP or an RRSP?

2. In almost all cases, making contributions to an RRSP will provide for the deferral of income tax.  In some cases, making such contributions may result in avoidance of tax.  Explain these statements.

3. Tax advisors generally recommend making RRSP contributions as early in the year as possible.  What is the basis for these recommendations?

4. Describe the difference between a defined benefit pension plan and a money purchase pension plan.

5. An individual has shares that have declined in value since he acquired them several years ago.  As he is short of cash, he would like to use these shares as a contribution to his RRSP.  As his tax advisor, would you approve of this decision?

6. In many cases, investors with various types of investments in their RRSPs also have a portfolio of investments that are held outside of their RRSPs.  When this is the case, tax advisors will indicate that, to the degree possible, they should include their debt securities inside of their RRSP, while allocating equity securities to their non-RRSP investment portfolio.  What is the basis for this advice?

7. The RRSP Deduction Limit, as defined in ITA 146(1), is not a limit on RRSP contributions.  Explain this statement.

8. How is Earned Income defined for purposes of determining the RRSP Deduction Limit?

9. In calculating an individual’s Pension Adjustment, it is necessary to have a mechanism for equating contributions in defined contribution plans with benefits earned in defined benefit plans.  How does the RRSP legislation deal with this issue?  Would you consider this approach to be fair to all taxpayers?  Explain your conclusion.

10. An individual’s RRSP deduction room is reduced by past service pension adjustments.  Describe two situations that would give rise to such adjustments.

11. Describe the circumstances that give rise to pension adjustment reversals.

12. Many individuals do not have sufficient funds to maximize their contributions to both an RRSP and a TFSA.  Briefly compare the tax features of these two alternative plans.

13. One of your friends, a very wealthy businessman, has indicated that he never makes contributions to his RRSP in excess of amounts that he can deduct.  His reasoning is that this doesn’t make sense because, even though the contributions cannot be deducted when they are made, they will be subject to tax when they are withdrawn.  Do you agree with your friend?  Explain your conclusion, indicating any assumptions that you have made.

14. If an individual wishes to terminate his RRSP, making a lump-sum withdrawal is generally not the best alternative.  Describe the disadvantages of such withdrawals.

15. Briefly describe the options available to an individual in the year he reaches age 71 with respect to the assets in his RRSP.  Also indicate the tax consequences of each alternative.

16. Under what circumstances would it be desirable for an individual to make contributions to an RRSP in favour of their spouse or common-law partner?  What are the advantages of making such contributions?

17. Explain the income attribution rule that applies to spousal RRSPs.

18. One of your clients is considering the withdrawal of a portion of his RRSP balance under the provisions of the Home Buyers’ Plan.  List and briefly explain any factors that should be considered before deciding to make this withdrawal.

19. An individual is returning to university after several years of full time employment.  He has a substantial RRSP balance and is considering withdrawing some of this balance under the lifelong learning plan provisions.  What factors should he consider in choosing this method of financing his return to university studies?

20. Describe the alternative tax situations that may arise when an individual dies as the registrant of an unmatured RRSP.

21. Describe the types of individuals that can be members of a pooled registered pension plan.

22. Describe the basic differences between an RRSP and a RRIF.

23. Profit Sharing Plans (PSPs) are not as effective as Deferred Profit Sharing Plans (DPSPs) in providing tax advantaged compensation to employees.  Briefly explain this statement.

24. Describe the tax features associated with retirement compensation arrangements.

25. What is a salary deferral arrangement?

TIF Problem Ten - 2

Retirement Savings - True Or False

1. In terms of tax planning, the use of Registered Retirement Savings Plans can provide for both tax deferral and tax avoidance.

True or False?

2. A pension plan that provides for a pension equal to 3 percent of an employee’s average annual salary for each year of service is a defined benefit plan.

True or False?

3. Earned Income for RRSP purposes includes taxable spousal support received, business losses, and net rental income.

True or False?

4. All RRSP contributions that cannot be deducted in the current year will be subject to a penalty of 1 percent per month.

True or False?

5. A Registered Retirement Savings Plan is considered to be a spousal Registered Retirement Savings Plan if a spouse or common-law partner has made any contributions to the plan at any time since its inception.

True or False?

6. Amounts withdrawn from a Registered Retirement Savings Plan under the provisions of the Home Buyers’ Plan must be repaid over a period of 15 years, beginning in the second calendar year after the year of withdrawal.

True or False?

7. Amounts withdrawn from a Registered Retirement Savings Plan under the provisions of the Lifelong Learning Plan must be used to pay tuition fees for a qualifying educational program at a designated educational institution.

True or False?

8. An employer contributes $25,000 to a Registered Pension Plan on March 1, 2017.  Each of the 15 employees in the plan has contributed $1,000 to the plan during 2017.  The employer can deduct a maximum of $15,000 in contributions for the taxation year ending December 31, 2017.

True or False?

9. Employees are allocated a taxable benefit for all amounts that an employer contributes to a Deferred Profit Sharing Plan.

True or False?

10. There is no limit on the amount of a retiring allowance that can be transferred to a Registered Retirement Savings Plan on a tax free basis as long as the employer was not making vested contributions to a Registered Pension Plan or a Deferred Profit Sharing Plan for the employee.

True or False?

TIF Problem Ten - 3

Retirement Savings - Multiple Choice

Defined Benefit Vs. Defined Contribution

1. Which of the following statements with respect to pension plan categories is correct?

A. Pension adjustment reversals can only arise when the plan is a defined contribution plan.

B. If the pension adjustment is based on the employer and employee contributions, it is a defined benefit plan.

C. A plan in which the benefit is based on employer contributions is a defined benefit plan.

D. Past Service Pension Adjustments can only arise when the plan is a defined benefit plan.

2. With respect to a defined benefit Registered Pension Plan, which of the following statements is correct?

A. The employer is required to make a specific contribution to the plan in each year.

B. The employer promises each employee a retirement benefit that is based on a contractually specified formula.

C. The Pension Adjustment that will be calculated for each employee is based on the amounts of contributions that have been made by the employer.

D. Employees cannot make contributions to this type of plan.

3. With respect to a defined contribution Registered Pension Plan, which of the following statements is **NOT** correct?

A. The employer agrees to make a specified contribution for each year of service.

B. The Pension Adjustment that will be calculated for each employee is based on the amounts of contributions that have been made by the employee and employer.

C. Both the employee and employer can make contributions to such plans.

D. The employee’s pension benefit is not affected by rates of return on the pension plan assets.

RRSPs

4. Which of the following statements with respect to RRSP terminations is **NOT** correct?

A. All RRSPs must be terminated in the year an individual turns 71 years old.

B. A lump sum withdrawal from an RRSP is not eligible for pension income splitting.

C. If an individual has terminated his RRSP because he has turned 71, he can no longer make RRSP contributions, even if he has Earned Income.

D. If RRSP funds are used to purchase a life annuity, only the annuity payments would be subject to tax.

5. With respect to self-administered Registered Retirement Savings Plans, which of the following is **NOT** a qualified investment?

A. Shares in a publicly traded company.

B. A mortgage on the principal residence of the plan beneficiary.

C. Direct investments in rental properties.

D. Canada Savings Bonds.

6. During the year ending December 31, 2016,  Donna Collins has employment income before the deduction of any RPP contributions of $40,000, a net rental loss of $16,000, interest income of $6,000, and income from royalties of $7,000.  The royalties were on a book written by Ms. Collins in her undergraduate years at university.  She has no Unused RRSP Deduction Room from previous years.

Ms. Collins is a member of a money purchase Registered Pension Plan in which, during 2016, she has contributed $2,000 and her employer has contributed $3,000.  Her maximum deductible Registered Retirement Savings Plan contribution for 2017 is:

A. $2,580

B. $580

C. $3,580

D. $1,660

7. During the year ending December 31, 2016, Ramona Collins has employment income before the deduction of any RPP contributions of $40,000, a net business loss of $16,000, interest income of $6,000, and income from royalties of $7,000.  The royalties were on a book written by Ms. Collins in her undergraduate years at university.  She has no Unused RRSP Deduction Room from previous years.

She is a member of a Deferred Profit Sharing Plan in which, during 2016, her employer has contributed $3,000 per employee.  Her maximum deductible Registered Retirement Savings Plan contribution for 2017 is:

A. $3,660

B. $1,320

C. $5,580

D. $2,580

8. During the year ending December 31, 2016, Wilma Collins has employment income before the deduction of any RPP contributions of $40,000, a net rental loss of $16,000, dividends from taxable Canadian corporations with a total grossed up amount of $6,000, and income from royalties of $7,000.  The royalties were on a book written by Ms. Collins in her undergraduate years at university.  She has no Unused RRSP Deduction Room from previous years.

She is not a member of a Registered Pension Plan or a Deferred Profit Sharing Plan during 2016.  Her maximum deductible 2017 Registered Retirement Savings Plan contribution is:

A. $5,400

B. $5,580

C. $6,660

D. $9,540

9. During the year ending December 31, 2016,  Joyce Collins has employment income before the deduction of any RPP contributions of $40,000, a net rental loss of $16,000, interest income of $6,000, and income from royalties of $7,000.  The royalties were on a book written by Ms. Collins in her undergraduate years at university.  She has no Unused RRSP Deduction Room from previous years.

She is not a member of a Registered Pension Plan during 2016.  She has contributed $2,000 to her husband’s Registered Retirement Savings Plan in 2017.  The maximum deductible 2017 Registered Retirement Savings Plan contribution to a plan in her name is:

A. $3,580

B. $5,580

C. $4,660

D. $6,660

10. Mrs. Jacks is employed by RME Industries Ltd.  RME Industries Ltd. does not offer a Registered Pension Plan or a Deferred Profit Sharing Plan to its employees.  She has no Earned Income prior to 2015.  Given the following, what is the maximum RRSP contribution that Mrs. Jacks can deduct for the 2017 taxation year?

**2015 2016 2017**

Earned Income $50,000 $52,000 $53,000

RRSP Contributions Deducted Nil $  6,000 ?

A. $9,000.

B. $9,360.

C. $12,000.

D. $12,360.

E. None of the above.

11. Which one of the following lists describes items that are all included in the determination of Earned Income for RRSP purposes?

A. Author’s royalties, net rental income or losses, and spousal support received/paid.

B. Auto standby charge, salesperson’s expenses, and resource royalties.

C. Business income or losses, CPP retirement benefits, and research grants.

D. Rental income or losses, salaries, and scholarships.

12. With respect to RRSP contributions, which of the following statements is correct?

A. Contributions made during the current year and within 30 days of the end of the current year, must be deducted in the current year.

B. Contributions in excess of available deduction room cannot be deducted in the current year or in any subsequent year.

C. There is no penalty for making contributions that are in excess of available deduction room.

D. Contributions made during the current year can be deducted in any subsequent year.

13. On April 1, 2016 Mrs. Wu contributed $1,000 to her RRSP.  On October 1, 2016 Mr. Wu contributed $1,000 to the same RRSP in his wife’s name.  On June 1, 2017 Mrs. Wu withdrew $1,600 from her RRSP.  As a result of the withdrawal:

A. Mrs. Wu’s 2017 taxable income increased by $1,600.

B. Mr. Wu’s 2017 taxable income increased by $1,600.

C. Mrs. Wu’s 2017 taxable income increased by $800 and Mr. Wu’s increased by $800.

D. Mrs. Wu’s 2017 taxable income increased by $600 and Mr. Wu’s increased by $1,000.

14. Harleen, who is 70 years old, requested a lump sum withdrawal of $10,000 from her RRSP on November 1, 2017.  Which of the following statements is correct?

A. She will receive cash of $8,000 and her 2017 taxable income will increase by $10,000.

B. She will receive cash of $9,000 and her 2017 taxable income will increase by $9,000.

C. She will receive cash of $8,000 and her 2017 taxable income will increase by $8,000.

D. She will receive cash of $10,000 and her 2017 taxable income will increase by $10,000.

15. Mehrdad contributed $10,000 to an RRSP ten years ago.  On May 1, 2017 the fair market value of the fund is $15,000 due solely to eligible dividends reinvested by the fund.  On May 2, 2017 Mehrdad withdrew $2,000 from his RRSP.  Which of the following statements is correct?

A. His tax payable will be reduced by the dividend tax credit on $2,000 of eligible dividends.

B. His taxable income will be increased by the sum of the $2,000 received plus the gross up on $2,000 of eligible dividends.

C. His tax payable will be reduced by the pension income credit on $2,000 of pension income.

D. His taxable income will be increased by $2,000.

16. Yukie has net employment income of $35,000.  During the year, she received spousal support payments of $8,000, child support payments for her 10 year old daughter of $12,000 and an inheritance consisting of a $50,000 term deposit that paid interest of $2,000 in the year.  Her Earned Income for RRSP purposes is:

A. $35,000

B. $43,000

C. $45,000

D. $55,000

Home Buyers’ Plan

17. Which of the following statements about Home Buyers’ Plans (HBPs) is correct?

A. If a withdrawal is made under the plan, any contributions made 90 days prior to the withdrawal cannot be deducted.

B. Any RRSP contribution made in a particular year will count first towards the HPB repayment requirement for that year.

C. Repayments in excess of an annual requirement will reduce future annual requirements.

D. When an individual dies with an outstanding Home Buyers’ Plan balance, this balance will not be subject to tax.

18. Which of the following statements with respect to the Home Buyers’ Plan (HBP) is **NOT** correct?

A. All amounts withdrawn must be repaid within 10 years of the year of withdrawal.

B. Amounts withdrawn must be used to acquire a dwelling by October 1 of the year following withdrawal.

C. The maximum RRSP withdrawal is $25,000 per individual.

D. In the year an individual departs from Canada, any outstanding HBP balance must be repaid by the due date for his tax return for the year of departure.

19. Cecilia withdrew $24,000 from her RRSP under the Home Buyers’ Plan in 2015 and used the funds for a down payment on a qualifying home.  She made a repayment of $1,000 during 2017.  Her minimum repayment for 2018 will be:

A. $1,493.33

B. $1,533.33

C. $1,600.00

D. $1,642.86

20. Parviz withdrew $15,000 from his RRSP under the Home Buyers’ Plan in 2015 and used the funds for a down payment on a qualifying home.  He made a repayment of $700 during 2017.  Taking into consideration his repayment, his Home Buyers’ Plan will have what effect on his 2017 taxable income?

A. An increase of $1,000.

B. An increase of $300.

C. A decrease of $700.

D. No effect.

Lifelong Learning Plan

21. Which of the following statements about Lifelong Learning Plans (LLPs) is **NOT** correct?

A. The maximum withdrawal is $10,000 in any single year, to a cumulative total of $20,000 over four years.

B. An individual can only participate in this program once during his life.

C. Repayments must begin no later than the fifth year after the year of the first Lifelong Learning Plan withdrawal (actually the sixth year if payments are made within 60 days of the end of the fifth year).

D. If an individual ceases to be a resident of Canada, any unpaid balance under the LLP must be repaid before the date the tax return for the year of departure should be filed, or 60 days after becoming a non-resident, whichever date is earlier.

22. Which of the following statements is correct about the Lifelong Learning Plan?

A. The maximum tax-free withdrawal is $10,000 per year for up to four years.

B. A taxpayer cannot participate in a Home Buyers’ Plan and a Lifelong Learning Plan in the same year.

C. Minimum repayments must be made over a period of ten years.

D. Tax-free withdrawals can be made by a part-time student as long as they are repaid within two years.

23. Jenelle was a full-time student in a four-year qualifying program from September 2013 to April 2017.  She withdrew $5,000 from her RRSP each year on September 1 under the Lifelong Learning Plan to finance her education.  Her first repayment is due on:

A. September 1, 2017

B. March 1, 2018

C. September 1, 2018

D. March 1, 2019

RPPs

24. Which of the following statements with respect to Registered Pension Plans (RPPs) is **NOT** correct?

A. An employer can sponsor both an RPP and a Deferred Profit Sharing Plan.

B. Employee contributions provide the contributor with a credit against tax payable.

C. Employer contributions do not constitute a taxable benefit for the employee.

D. Employee options at retirement are determined by the terms of the plan.

25. Eileen is a member of her employer’s Registered Pension Plan to which her employer contributed $3,500 and Eileen contributed $2,600 in the current year.  Which of the following statements is correct?

A. Eileen can deduct her contribution from her Net Income For Tax Purposes and her employer’s contribution is not considered a taxable benefit.

B. Eileen cannot deduct her contribution from her Net Income For Tax Purposes and her employer’s contribution is not considered a taxable benefit.

C. Eileen can deduct her contribution from her Net Income For Tax Purposes and she must include her employer’s contribution in her income.

D. Eileen cannot deduct her contribution from her Net Income For Tax Purposes and her employer’s contribution is considered a taxable benefit.

26. Which of the following statements about a RPP is **NOT** correct?

A. Contributions can be made only by employers.

B. Pension adjustments reflect the benefits earned under both money purchase and defined benefit RPPs.

C. Contributions made by an employer to an unregistered pension plan are not deductible.

D. An RPP from a previous employer may be transferred into the new employer’s plan.

RRIFs

27. Which of the following statements with respect to Registered Retirement Income Funds (RRIFs) is **NOT** correct?

A. Withdrawals from a RRIF are not eligible for pension income splitting.

B. Withdrawals from a RRIF are eligible for the pension Income tax credit.

C. An individual can have multiple RRIFs.

D. Registered Pension Plan balances can be transferred to a RRIF on a tax free basis.

28. Which of the following statements with respect to Registered Retirement Income Funds (RRIFs) is correct?

A. An individual can make non-deductible contributions to a RRIF.

B. The minimum annual withdrawal from a RRIF is always determined by dividing the fair market value of the assets in the plan by 90, less the age of the beneficiary at the beginning of the year.

C. Earnings accumulate within the RRIF on a tax free basis.

D. A RRIF can only be established by individuals over the age of 71.

29. Mrs. Yus is 96 years old.  She has a RRIF which was established in 1985.  On January 1, 2017 the adjusted cost base of her RRIF is $50,000 and the fair market value is $62,000.  Her minimum withdrawal for 2017 is:

A. $12,400

B. $10,333

C. $10,000

D. $8,333

Deferred Profit Sharing Plans

30. Which of the following statements with respect to Deferred Profit Sharing Plans (DPSPs) is correct?

A. Both the employers and employees can make contributions to DPSPs.

B. Contributions to DPSPs are limited to one-half the money purchase limit for the year.

C. Employer contributions are treated as a taxable benefit to the employees.

D. Withdrawals from DPSPs are not taxable to the recipient.

Profit Sharing Plans

31. Which of the following statements with respect to profit sharing plans is correct?

A. Employer contributions are not taxable benefits to the employees.

B. Earnings within the plan accumulate on a tax free basis.

C. Employer contributions are limited to one-half of the money purchase limit for the year.

D. Withdrawals from the plan are received tax free by employee.

32. Which of the following statements about Profit Sharing Plans is **NOT** correct?

A. The employer’s contributions are taxable benefits.

B. Income earned within the plan is accumulated on a tax-free basis.

C. Lump sum withdrawals from the plan are not included in taxable income.

D. The employer’s contribution can be higher than under a Deferred Profit Sharing Plan.

Transfers Between Plans

33. On January 1, 2017 Mr. Yang celebrated his 65th birthday and transferred $85,000 from his RRSP into a RRIF.  For what reason would he make this transfer?

A. He wants to split his RRIF withdrawal with his wife.

B. He wants to decrease his taxable income by transferring his high income investments from his RRSP.

C. He can no longer maintain an RRSP because of his age.

D. He is terminally ill and a RRIF will have more tax advantages to his wife on his death than his RRSP would have had.

34. There are a number of tax free transfers of accumulated pension entitlements.  Indicate the transfer that is **NOT** tax free.

A. Registered Pension Plan to Registered Retirement Savings Plan.

B. Registered Retirement Savings Plan to Registered Retirement Income Fund.

C. Profit Sharing Plan to Deferred Profit Sharing Plan.

D. Deferred Profit Sharing Plan to Registered Pension Plan.

E. Registered Pension Plan to different Registered Pension Plan.

35. The most common reason to transfer funds from a RRSP to a RRIF is:

A. the individual has officially retired

B. the list of qualified investments is much longer for a RRIF

C. the individual reaches age 65

D. the individual reaches age 71

Retirement Compensation Arrangements

36. Which of the following statements with respect to Retirement Compensation Arrangements (RCAs) is **NOT** correct?

A. Contributions to RCAs are fully deductible to the employer.

B. Contributions to RCAs are subject to a 50 percent, non-refundable tax.

C. Contributions can only be made by an employer, a former employer of a taxpayer, or by a person with whom the employer or former employer does not deal at  arm’s length.

D. Any taxes on contributions or earnings within the arrangement are refunded at the rate of 50 percent.

Retiring Allowances

37. Mr. Smith, the sole shareholder and employee of Smithco Ltd. since its incorporation in 1976, has decided to sell the corporation and retire in 2017.  He has never belonged to a pension plan, and wishes to maximize his RRSP.  Which one of the following amounts represents the **largest** retiring allowance from Smithco that Mr. Smith can transfer to his RRSP in the year he retires?

A. $40,000.

B. $56,000.

C. $59,500.

D. $70,000.

Pension Tax Credit

38. Which of the following would be eligible for the pension income tax credit?

A. a lump sum withdrawal from an RRSP

B. a lump sum withdrawal from a RRIF

C. a lump sum withdrawal from a spousal RRSP

D. all of the above

TIF Problem Ten - 4

Retirement Savings - Exam Exercises

Exam Exercise Subject Listing For Chapter 10

|  |  |
| --- | --- |
| **Number** | **Subject** |
| 1 | Dividends Earned In An RRSP |
| 2 | Earned Income |
| 3 | Earned Income |
| 4 | Pension Adjustments |
| 5 | Pension Adjustments |
| 6 | Unused RRSP Deduction Room |
| 7 | Unused RRSP Deduction Room |
| 8 | Maximum RRSP Deduction |
| 9 | Maximum RRSP Deduction |
| 10 | Excess RRSP Contributions |
| 11 | Excess RRSP Contributions |
| 12 | Spousal RRSP Withdrawal |
| 13 | Spousal RRSP Withdrawal |
| 14 | Home Buyer's Plan |
| 15 | Home Buyer's Plan |
| 16 | Lifelong Learning Plan |
| 17 | Lifelong Learning Plan |
| 18 | Minimum RRIF Withdrawal |
| 19 | Minimum RRIF Withdrawal |
| 20 | Retiring Allowance |
| 21 | Retiring Allowance |

Exam Exercise Ten - 1 (Dividends Earned In An RRSP)

Barry Notting has just received an inheritance of $50,000 in cash.  As he is a very successful professional, he does not need the funds currently.  Given this, he intends to invest the funds in preferred shares which pay an eligible dividend of 5.5 percent.  As he intends to purchase a new home in five years, he plans to liquidate his investment at the end of that period.  He is considering two alternatives:

**Alternative 1** - Invest the $50,000 outside of his RRSP.

**Alternative 2** - Invest the $50,000 in his RRSP (he has sufficient unused deduction room) and apply the deduction against his professional income.  The tax savings resulting from the RRSP deduction would be invested outside of his RRSP in the 5.5 percent preferred shares.

Barry’s marginal tax rate on ordinary income is 43 percent, while his marginal rate on eligible dividends is 26 percent.  Ignoring the effect of any reinvestment of the dividends received, determine which alternative will provide more funds for Barry’s home purchase.

Exam Exercise Ten - 2 (Earned Income)

Mr. Marco Marconi has net employment income of $78,300, after the deduction of $2,400 in RPP contributions for the year.  In addition, he has a business loss of $6,750, taxable dividends of $5,640, and pays $12,400 of deductible support to his former spouse.  What is the amount of Mr. Marconi’s Earned Income for RRSP purposes for the year?

Exam Exercise Ten - 3 (Earned Income)

Susan Copley has net employment income of $56,200, after the deduction of $1,800 in RPP contributions.  Her Net Income For Tax Purposes also includes $4,500 in taxable capital gains, a net rental loss of $2,300, spousal support payments received of $12,000, and eligible dividends received of $1,500.  What is the amount of Susan’s Earned Income for RRSP purposes for the year?

Exam Exercise Ten - 4 (Pension Adjustments)

Ms. Calvin’s employer sponsors both a money purchase RPP and a DPSP.  During the current year, her employer contributes $2,600 to the RPP and $1,700 to the DPSP on behalf of Ms. Calvin.  Ms. Calvin contributes $2,600 to the RPP.  Calculate the amount of the Pension Adjustment that will be included on Ms. Calvin’s T4 for the current year.

Exam Exercise Ten - 5 (Pension Adjustments)

John Darby’s employer sponsors both a money purchase RPP and a DPSP.  During the current year, the employer contributes $2,500 to the RPP and $1,250 to the DPSP on behalf of Mr. Darby.  Mr. Darby contributes $2,500 to the RPP.  Calculate the amount of the Pension Adjustment that will be included on Mr. Darby’s T4 for the current year.

Exam Exercise Ten - 6 (Unused RRSP Deduction Room)

Mrs. Alison Lair has 2016 Earned Income for RRSP purposes of $43,500.  She is not a member of an RPP or a DPSP.  At the end of 2016, her Unused RRSP Deduction Room was $5,100 and she has no undeducted contributions.  During 2017, she contributes $7,000 to her RRSP and makes an RRSP deduction of $5,200.  What is the amount of Mrs. Lair’s Unused RRSP Deduction Room and undeducted RRSP contributions at the end of 2017?

Exam Exercise Ten - 7 (Unused RRSP Deduction Room)

For 2016, Andrew Flack has Earned Income for RRSP purposes of $96,000.  He is not a member of an RPP or a DPSP.  While he had no undeducted contributions at the end of 2016, he had unused RRSP deduction room of $6,500.  During 2017, he contributes $9,000 to his RRSP and make an RRSP deduction of $8,500.  What is the amount of Mr. Flack’s Unused RRSP Deduction Room and undeducted RRSP contributions at the end of 2017?

Exam Exercise Ten - 8 (Maximum RRSP Deduction)

During 2016, Mrs. White has taxable capital gains of $21,750, net rental income of $5,720, pays spousal support of $15,000, and has net employment income of $80,200.  Based on her RPP contributions of $3,000 and the matching contributions made by her employer, her employer reports a 2016 PA of $6,000.  At the end of 2016, Mrs. White has Unused RRSP Deduction Room of $11,120.  Also at this time, her RRSP contains undeducted contributions of $6,275.  During 2017, she makes contributions to her RRSP of $13,000.

Determine Mrs. White’s maximum RRSP deduction for 2017.  Assuming she deducts her maximum, determine the amount of any Unused RRSP Deduction Room that she will have available at the end of 2017, and indicate the amount of any undeducted contributions remaining at the end of 2017.

Exam Exercise Ten - 9 (Maximum RRSP Deduction)

For the 2016 taxation year, Marion Blue has net employment income of $45,000, spousal support received of $18,000, a net business loss of $3,500, and interest receipts of $1,600.  She is a member of her employer’s RPP to which she contributes $1,800.  Her employer makes a matching contribution and reports a 2016 PA of $3,600.  At the end of 2016, she has unused RRSP deduction room of $4,800 and undeducted RRSP contributions of $3,800.  In early 2017, she contributes $9,400 to her RRSP.

Determine Marion’s maximum RRSP deduction for 2017.  Assuming she deducts her maximum, determine the amount of any Unused RRSP Deduction Room that she will have available at the end of 2017, and indicate the amount of any undeducted contributions remaining at the end of 2017.

Exam Exercise Ten - 10 (Excess RRSP Contributions)

Mr. Jack Parnell is not a member of an RPP or a DPSP.  At the beginning of 2016, Mr. Parnell has no Unused RRSP Deduction Room.  During 2015 and 2016, he has Earned Income of $75,000 each year.  On July 1, 2016, he makes a $13,500 RRSP contribution, but does not make any deduction for the year.  In 2017, he has Earned Income of $60,000, makes a $16,000 contribution on May 1, but still does not make a deduction for the year.  Determine any penalty that will be assessed to Mr. Parnell for excess contributions during either 2016 or 2017.

Exam Exercise Ten - 11 (Excess RRSP Contributions)

At the beginning of 2016, Bob Pilon has no Unused RRSP Deduction Room.  In each of the years 2015 and 2016 he has earned income of $105,000.  On August 1, 2016, he makes a $18,900 contribution to his RRSP.  On April 1, 2017, he makes an additional contribution of $22,000.  He does not make an RRSP deduction in either 2016 or 2017.  He is not a member of an RPP or a DPSP.  Determine any penalty that will be assessed to Mr. Pilon for excess contributions during either 2016 or 2017.

Exam Exercise Ten - 12 (Spousal RRSP Withdrawal)

During 2015, Austin Peters makes a $1,500 contribution to a new RRSP in which his wife is the registrant.  His wife also makes a $2,800 contribution to this RRSP in 2015.  During 2016, he makes a $2,000 contribution to this RRSP.   During 2017, Mr. Peters’ wife makes a withdrawal of $4,300 from this RRSP.  How will this withdrawal be taxed?

Exam Exercise Ten - 13 (Spousal RRSP Withdrawal)

Cody Bryant’s spouse has had an RRSP for several years.  For the first time, during 2015, Cody makes a contribution to this plan.  The amount of the 2015 contribution is $4,500 and this is followed, in 2016, by an additional contribution to his spouse’s plan of $5,500.  Cody deducts both of these contributions.

At the beginning of 2017, his spouse’s plan has a balance of $226,000.  During this year, she withdraws $11,000 from her RRSP.  How will this withdrawal be taxed?

Exam Exercise Ten - 14 (Home Buyers’ Plan)

During 2014, Mr. John Debon withdraws $15,000 from his RRSP, using the provisions of the Home Buyers’ Plan (HBP).  As he received the proceeds from a winning lottery ticket in 2015, he repaid $8,500 of the HBP balance in that year.  What is the minimum repayment that must be paid during 2016?  If he makes no payment during 2016, what will be the minimum payment that must be made during 2017?

Exam Exercise Ten - 15 (Home Buyers’ Plan)

In early 2014, Jason Borshiov withdraws $21,000 from his RRSP under the provisions of the Home Buyers’ Plan (HBP).  Because of a large bonus received from his employer, he repays $7,000 of this in 2015.  What is the minimum required payment for 2016?  If he makes no payment in 2016, what will be the minimum required payment in 2017?

Exam Exercise Ten - 16 (Lifelong Learning Plan)

Mr. Jules Forsyth enrolls full time in a four year university program running from September, 2012, through April, 2016. In order to finance this program under the provisions of the Lifelong Learning Plan (LLP), he withdraws $10,000 from his RRSP in September, 2012, a further $5,000 in September, 2013, and an additional $5,000 in September, 2014.  The university course is completed successfully.

In June, 2017, a designated repayment of $2,900 is made.  In November, 2018, a designated repayment of $1,500 is made.

Explain the tax consequences of the withdrawals and repayments described for Mr. Forsyth.

Exam Exercise Ten - 17 (Lifelong Learning Plan)

Charles Botterill enrolls full time in a three year university program which runs from September, 2012 through May, 2015.  To assist with financing this program, Charles uses the provisions of the Lifelong Learning Plan (LLP) to withdraw $6,000 from his RRSP in each of the three years 2012, 2013, and 2014.  He is successful in completing the university program and receives his degree in April, 2015.

In 2017, he makes a designated repayment of $2,200.  This is followed by a designated repayment of $1,200 in 2018.

Explain the tax consequences of the withdrawals and repayments described for Mr. Botterill.

Exam Exercise Ten - 18 (Minimum RRIF Withdrawal)

On January 1, 2017, Ms. Sheila Salon transfers all of her RRSP balances into a RRIF.  At this time, Ms. Salon is 67 years of age.  On January 1, 2017, the fair market value of these assets is $1,450,000.  The corresponding balance on January 1, 2018 is $1,350,000.  What is the minimum withdrawal that Ms. Salon must make from the RRIF during 2017 and during 2018?

Exam Exercise Ten - 19 (Minimum RRIF Withdrawal)

During 2017, Saul Bronson transfers his entire RRSP balance into a RRIF.  At this time, Mr. Bronson is 69 years old.  On January 1, 2017, these assets had a fair market value of $2,400,000.  The corresponding figure on January 1, 2018 is $2,600,000.  What is the minimum withdrawal that Mr. Bronson must make from the RRIF during 2017 and during 2018?

Exam Exercise Ten - 20 (Retiring Allowance)

As of December 31, 2017, Mrs. Mary Barth has worked for her current employer for 34 years.  On this date she retires and, in recognition of her devoted service, her employer pays her a retiring allowance of $85,000.  Her employer has never sponsored an RPP or DPSP.  What is the maximum deductible contribution that Mrs. Barth can make to her RRSP as a result of receiving this retiring allowance?

Exam Exercise Ten - 21 (Retiring Allowance)

As of the end of 2017, Merideth Jones has worked for the current employer for 36 years.  She retires on this date and, under the terms of the applicable collective agreement, she receives a retiring allowance of $62,000.  Her employer has never sponsored an RPP or DPSP.  What is the maximum deductible contribution that Ms. Jones can make to her RRSP as a result of receiving this retiring allowance?

TIF Problem Ten - 5A

Retirement Savings - Key Term Matching (Easy)

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

Version A is easy, there is only one possible answer for each term.

Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms were listed at the end of Chapter 10 on Retirement Savings:

A. Defined Benefit Plan

B. Lifelong Learning Plan

C. Money Purchase Plan

D. Pension Adjustment

E. Registered Retirement Income Fund

F. RRSP Deduction Room

G. Salary Deferral Arrangement

H. Unused RRSP Deduction Room

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

1. An arrangement, whether funded or not, under which an individual who has the right to receive compensation postpones the receipt of that compensation, and it is reasonable to assume that one of the main purposes of this postponement was to defer the payment of taxes.

2. A retirement savings plan sponsored by an employer, to which the employer will make contributions which are not taxable to the employee, and the employee may make contributions which are deductible.

3. The excess of the RRSP Deduction Limit, over the amount of RRSP contributions that have been deducted.

4. The cumulative total of all RRSP Deduction Limits, less amounts deducted in those years.

5. A trusteed plan to which a resident individual can transfer balances from retirement savings plans on a tax free basis.

6. A trusteed plan to which a resident individual can make deductible contributions.

7. A retirement savings plan in which the plan sponsor (employer or Individual) makes known or determinable contributions.  The retirement benefit is based on the accumulated contributions and earnings on investments within the plan.

8. An adjustment reported by employers which reflects, for an individual employee, the employee and employer contributions to RPPs and DPSPs for the previous year.

9. A provision that allows individuals to make temporary, non-taxable withdrawals from their RRSP when they are enrolled in a qualifying education program at a qualifying educational institution.

10. A retirement savings plan in which the plan sponsor (usually an employer) promises a known or determinable retirement benefit and assumes financial responsibility for providing that benefit.

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

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

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

TIF Problem Ten - 5B

Retirement Savings - Key Term Matching (Moderate)

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

Version A is easy, there is only one possible answer for each term.

Version B is more difficult in that there are additional possible answers that are similar to the correct answers.

The following eight key terms were listed at the end of Chapter 10 on Retirement Savings:

A. Defined Benefit Plan

B. Lifelong Learning Plan

C. Money Purchase Plan

D. Pension Adjustment

E. Registered Retirement Income Fund

F. RRSP Deduction Room

G. Salary Deferral Arrangement

H. Unused RRSP Deduction Room

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

1. An arrangement, whether funded or not, under which an individual who has the right to receive compensation postpones the receipt of that compensation, and it is reasonable to assume that one of the main purposes of this postponement was to defer the payment of taxes.

2. A retirement savings plan sponsored by an employer, to which the employer will make contributions which are not taxable to the employee, and the employee may make contributions which are deductible.

3. A provision that allows individuals to make permanent non-taxable withdrawals from their RRSP when they are enrolled in a qualifying education program at a qualifying educational institution.

4. The excess of the RRSP Deduction Limit, over the amount of RRSP contributions that have been deducted.

5. The cumulative total of all RRSP Deduction Limits, less amounts deducted in those years.

6. A trusteed plan to which a resident individual can transfer balances from retirement savings plans on a tax free basis.

7. The amount that is the sum of the unused RRSP deduction room at the end of the preceding year, plus the amount by which the lesser of the RRSP Dollar Limit and 18 percent of earned income for the preceding year exceeds the Pension Adjustment for the preceding year.  This sum is adjusted for any Past Service Pension Adjustment or Pension Adjustment Reversal.  It represents the maximum amount of contributions that have been made to an RRSP that can be deducted for a year.

8. A trusteed plan to which a resident individual can make deductible contributions.

9. A retirement savings plan in which the plan sponsor (employer or Individual) makes known or determinable contributions.  The retirement benefit is based on the accumulated contributions and earnings on investments within the plan.

10. A retirement savings plan in which the plan sponsor (employer or individual) makes known or determinable contributions.  The retirement benefit is based on a formula which is tied to the individual’s historical earnings record.

11. An adjustment reported by employers which reflects, for an individual employee, the employee and employer contributions to RPPs and DPSPs for the previous year.

12. A provision that allows individuals to make temporary, non-taxable withdrawals from their RRSP when they are enrolled in a qualifying education program at a qualifying educational institution.

13. A retirement savings plan in which the plan sponsor (usually an employer) promises a known or determinable retirement benefit and assumes financial responsibility for providing that benefit.

14. An adjustment reported by employers which reflects, for an individual employee, the employer’s contributions to RPPs and DPSPs for the previous year.

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

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

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

TIF Problem Ten - 6

Calculation Of PAs, PSPAs, And PARs

Each of the following **independent** Cases involves calculations of the Pension Adjustment (PA), Past Service Pension Adjustment (PSPA), or Pension Adjustment Reversal (PAR) that would be reported by the employer.

**Case 1** Fredia Frye’s employer sponsors a deferred profit sharing plan as well as a registered pension plan.  During 2017, the employer contributed, on Fredia’s behalf,  $2,500 to the deferred profit sharing plan and $1,000 to the registered pension plan.  Fredia also contributed $1,000 to the registered pension plan.

**Required:**  Calculate Fredia’s 2017 pension adjustment.

**Case 2** Barton Huling’s employer sponsors a defined benefit registered pension plan.  During 2017, Barton’s employer contributes $3,000 to the registered pension plan on his behalf.  In addition, Barton is required to make a matching contribution of $3,000.  The plan provides a benefit of 1.25 percent of pensionable earnings for each year of service.  For 2017 Barton has pensionable earnings of $71,000.

**Required:**  Calculate Barton’s 2017 pension adjustment.

**Case 3** Janee Borel has worked for her current employer since 2015.  In January, 2017, the employer implements a defined benefit registered pension plan, with benefits extended to employees for all prior years of service.  The benefit formula provides for a benefit equal to 1.1 percent of pensionable earnings for each year of service.  Janee’s pensionable earnings for her current and previous years of service are as follows:

2015 $38,000

2016 42,000

2017 51,000

**Required:**  Calculate Janee’s past service pension adjustment for 2017, as well as her pension adjustment for 2017.

**Case 4** Santiago Premo began working for Atak Ltd. in 2015.  The Company sponsors a defined benefit registered pension plan which requires four years of service prior to benefits becoming vested.  In 2015, the Company reported a pension adjustment for Santiago of $5,200, followed by a 2016 pension adjustment of $5,400.

At the beginning of 2017, it is discovered that Santiago has been embezzling corporate funds during the last few months of 2016.  He is immediately fired and the Company is considering criminal charges.

**Required:**  Calculate Santiago’s pension adjustment reversal for 2017.

**Case 5** Roy Carswell has worked for his current employer since 2015.  His employer provides a defined benefit pension plan which, until 2017, provided a benefit of 1.3 percent of pensionable earnings for each year of service.  Roy was admitted to the plan with full vesting as of 2015.  His 2015 pensionable earnings were $58,000, with a corresponding figure for 2016 of $62,000.

As the result of negotiations with Roy’s union, as of January 1, 2017, the benefit has been increased to 1.5 percent of pensionable earnings.  The change will be applied retroactively for all prior years of service.

**Required:**  Calculate Roy’s 2017 past service pension adjustment.

TIF Problem Ten - 7

Excess RRSP Contributions vs. TFSA

At the beginning of 2016, Deeta Oldham had unused RRSP deduction room of $35,000.  Her account also contained an undeducted contribution of $37,000.  She made the contribution just before she was fired from her high paying job in 2016 because a video of her physically abusing her assistant was posted to YouTube.

As she remained unemployed during 2016 and had little taxable income, she does not make any RRSP deduction during 2016.  During 2016, Deeta withdrew a total of $25,000 from her RRSP in order to cover her living expenses.  She had no earned income for RRSP purposes in either 2015 or 2016.

At the beginning of 2017, Deeta finally finds employment at a fitness boot camp, resulting in her having a 2017 earned income for RRSP purposes of $61,000.  She is also fortunate in that she wins $225,000 in the provincial lottery.  Because she now has excess funds, on May 2, 2017, she deposits $40,000 in her RRSP.

Deeta’s wealthy grandmother is gravely ill and Deeta expects to inherit a substantial sum on her death.  On December 15, 2017, Deeta meets with you to discuss tax planning.  In preliminary discussions, you find she does not have a TFSA.

**Required:**

A. Determine Deeta’s maximum RRSP deduction for 2017.

B. Determine the ITA 204.1 penalty (excess RRSP contributions), if any, that would be assessed to Deeta for the year ending December 31, 2017.

C. What advice would you give to Deeta about her RRSP and TFSA contributions?

TIF Problem Ten - 8

RRSPs, TFSAs And Tax Planning

Ms. Janine Wheeler found a position in retail sales in September, 2016.  During the remainder of that year, she had gross employment income of $22,000.  Prior to 2016, Ms. Wheeler had no Earned Income and made no contributions to either an RRSP or a TFSA.

Prior to July, 2016, Ms. Wheeler had been supported by and living with her common-law partner.  On June 30, they formally separate and sign a document which provides Ms. Wheeler with a lump-sum payment of $80,000, plus $1,200 per month in spousal support.  The lump-sum payment was deposited in a savings account which earned interest of $550 during the remainder of 2016.  She receives six months of support payments in 2016.

Janine did not contribute to an RRSP during 2016.  However, her employer sponsored an RPP to which Janine contributed $1,200 during 2016.  This contribution was matched by a $1,200 contribution by Janine’s employer.

In addition to her employment income and interest income, Janine had the following other sources of income during 2016:

* Dividends from Canadian public companies of $900.
* A net business loss of $2,500 from her new web-based photos on canvas service.
* An inheritance from an uncle of $250,000.

For 2016, Ms. Wheeler’s income places her in the lowest federal income tax bracket.  Further, she anticipates that her 2017 income will also be taxed at this rate.  However, she has been promised a management position beginning in January, 2018.  This position involves a significant increase in salary and this, combined with her increasingly profitable web-based business, will result in her being in the 26 percent federal income tax bracket.

**Required:**

A. Calculate Ms. Wheeler’s net employment income for 2016.

B. Determine Ms. Wheeler’s maximum deductible RRSP contribution for 2017.

C. As Ms. Wheeler’s personal financial consultant, what advice would you give her regarding her TFSA and RRSP contribution and deduction for 2017?

TIF Problem Ten - 9

RRSP Contribution Calculations

After being unemployed for two years, Donald Parker found employment with a large, publicly traded corporation in early 2016.  His gross 2016 salary was $40,000 and, in addition, he earned commissions of $20,000.  The corresponding figures for 2017 were $53,000 and $32,000.  Deductible expenses related to the commission income were $3,000 in 2016 and $4,000 in 2017.

From his earnings, Donald’s employer withheld the following amounts:

**2017 2016**

Federal And Provincial Income Taxes $26,000 $18,000

CPP Contributions 2,564 2,544

EI Premiums 836 955

Disability Insurance Premiums 250 250

Registered Pension Plan (RPP) Contributions 1,500 1,400

The Registered Pension Plan is a money purchase plan.  The employer makes RPP contributions and pays disability insurance premiums equal to those amounts withheld from employee earnings for these items.  In addition, the employer provided Donald with a low interest loan. The taxable benefit on this loan was $2,750 in 2016 and $2,500 in 2017.

Other information for the years 2016 and 2017 is as follows:

**2017 2016**

Net Rental Income (Loss) $1,400 ($2,500)

Taxable Spousal Support Received 2,600 2,400

Deductible Spousal Support Paid ( 3,600) ( 3,500)

Capital Gains (Losses) ( 2,200) 1,750

Royalties\* 875 920

Interest Income 273 496

\*The royalties are on a song written by Donald’s mother in 1962.

In 2014, just prior to losing his job, Donald contributed $7,500 to an RRSP.  As he realized he would be in the minimum tax bracket until he found work, Donald did not deduct this RRSP contribution prior to 2017.  He has Unused RRSP Deduction Room of $25,000 at the end of 2016.

In December, 2017, Donald wins $200,000 in a lottery.  He would like to put as much of this amount as possible into his RRSP prior to the end of 2017.

**Required:**

A. Determine Donald’s RRSP Deduction Limit for 2017.

B. Calculate the amount you would recommend that Donald contribute to his RRSP for 2017.

TIF Problem Ten - 10

RPP And RRSP Contribution Calculations

Henry Plate’s Earned Income for RRSP purposes for 2016 was $52,000.  During the year ending December 31, 2016, Mr. Plate’s records indicate that he contributed $2,500 to a money purchase RPP sponsored by his employer.  His employer contributed the same amount on his behalf during this period.  At the end of 2016, he had no Unused RRSP Deduction Room or undeducted RRSP contributions.

Mr. Plate’s 2017 Earned Income was $65,000.  During the year ending December 31, 2017, Mr. Plate’s records indicate that he contributed $2,800 to a money purchase RPP sponsored by his employer.  His employer again matched his contribution to his RPP during 2017.

Mr. Plate made a $5,000 contribution to his RRSP on April 30, 2017.

**Required:** Indicate which of the RRSP and RPP contributions that have been made by Mr. Plate can be deducted in calculating his Net Income For Tax Purposes for the 2017 taxation year.  In addition, if he makes the maximum RRSP deduction in 2017, indicate any carry forwards available to him at the end of 2017.

TIF Problem Ten - 11

RRSP Contribution Calculations

During 2016, Ms. Storm is employed in Vernon by a large public company.  The employer sponsors a defined contribution pension plan and, during 2016, the company made contributions on Ms. Storm’s behalf of $2,500.  Ms. Storm made a matching contribution of $2,500.

At the end of 2016, Ms. Storm had unused deduction room of $17,000 and undeducted contributions of $8,000.

During 2016, Ms. Storm has the following income and loss data:

Salary $86,200

Taxable Benefits From Employer 5,600

Union Dues ( 450)

Net Loss From Mail Order Business ( 4,500)

Net Rental Income 6,700

Common-Law Partner Support Paid ( 12,000)

Eligible Dividends Received 2,850

Interest On Savings Account 850

**Required:** Calculate the maximum deductible RRSP contribution that can be made by Ms. Storm for 2017.

TIF Problem Ten - 12

Net Income And RRSP Contribution Calculations

Alicia Arnold operates an unincorporated business with a December 31 year end.  During the year ending December 31, 2017, accounting Net Income for this business was $183,000.  Other information related to the 2017 operations of this business are as follows:

1. Amortization deducted in the determination of accounting Net Income was $23,000.  Her tax advisor has calculated maximum CCA for this period of $31,000.

2. During the year, the business sold depreciable assets for $34,500.  The net book value of the assets was $24,000, their capital cost was $30,000, and their UCC on January 1, 2017 was $18,000.

3. During the year, Alicia spent $14,000 on business meals and entertainment.  This amount was deducted in the determination of accounting Net Income.

Other information related to Alicia’s tax position is as follows:

Interest On Savings Account $ 1,200

Taxable Capital Gains On Personal Assets 18,000

Allowable Capital Loss On Sale Of Shares 1,000

Spousal Support Paid 3,600

Royalties On Cookbook That She Authored 8,400

At the beginning of 2017, Alicia had  Unused RRSP Deduction Room of $6,500.  She also had undeducted contributions of $4,500.

**Required:**

A. For the 2017 taxation year, calculate Alicia’s minimum Net Income For Tax Purposes before any deduction is made for RRSP purposes.  Ignore CPP contributions in your calculations.

B. Calculate the maximum RRSP deduction that can be made by Alicia for 2017.  In making this calculation, assume that Alicia’s 2016 Earned Income is equal to her 2017 Earned Income.  Determine the amount of additional contributions that she would have to make in order to make the maximum RRSP deduction.

TIF Problem Ten - 13

Employment Income With RRSP

During the year ending December 31, 2017, Ms. Nancy Harcourt earned a gross salary of $72,000.  Her employer withheld the following amounts from her salary:

Canada Pension Plan Contributions $ 2,564

Employment Insurance Premiums 836

Income Taxes 18,500

Registered Pension Plan Contributions 4,200

Parking Fees - Company Garage 480

Donations To United Way 800

Union Dues 360

**Other Information:**

1. Ms. Harcourt is a member of her employer’s money purchase RPP.  Her employer made a contribution on her behalf that was equal to the $4,200 contribution that was withheld from her salary.

2. Ms. Harcourt was the year’s top salesperson.  The award from her employer was an all expense paid trip to the Bahamas in December, 2017.  The cost of this trip was $5,600 and, in addition, Ms. Harcourt was provided with $1,000 in cash for incidental expenses during the month that she was on the trip.

3. Ms. Harcourt’s employer provides her with a car that cost the company $53,000, plus $6,890 of HST.  The employer purchased the car in 2016.  Ms. Harcourt drives the car a total of 36,000 kilometers during the year, 16,000 kilometers of which were for employment related purposes.  The car was used by Ms. Harcourt for the entire year, with the exception of the one month that she was in the Bahamas.  Her employer required that the car be left in the company garage during the month that it was not in use.

4. Ms. Harcourt’s employer provides a 20 percent discount to employees on all merchandise sold by the enterprise.  During the year, Ms. Harcourt purchased merchandise with a list price of $12,000 and received a discount of $2,400.

5. In addition to her employment income, Ms. Harcourt had taxable capital gains from stock market trading of $6,200, a net rental loss of $3,900, and a self-employed business loss of $24,600.

6. At the end of 2016, Ms. Harcourt’s Unused RRSP Deduction Room was $4,500 and she had no undeducted RRSP contributions.  Her employer reported that she had a 2016 Pension Adjustment of $7,000.  Assume her Earned Income for 2016 is equal to her 2017 Earned Income.

**Required**:

A. Calculate Ms. Harcourt’s net employment income for the year ending December 31, 2017.

B. Calculate Ms. Harcourt’s maximum deductible RRSP contribution for 2017.

TIF Problem Ten - 14

Retiring Allowances

Jerry White is married and his wife has not worked since she gave birth to triplets 8 years ago.  Mr. White began working for Dynamics Inc. in 1984.  The Company does not have a Registered Pension Plan or a Deferred Profit Sharing Plan.

Due to competitive pressures, Dynamics Inc. is attempting to reduce its overall work force.  With this goal in mind, they have offered Mr. White a cash payment of $68,000 if he will immediately resign his position with the Company.

**Required:** Describe the tax consequences to Mr. White if he accepts this offer in 2017.  Explain any alternatives that he might have in this regard and advise Mr. White as to an appropriate course of action.

TIF Problem Ten - 15

Comprehensive Case (Chapters 1 to 10)

Mr. Allen Arnold lives in Burlington, Ontario.  He is 38 years old.  His wife Brenda is 32 years old and, for 2017, she has Net Income For Tax Purposes of $8,500.  They have two children.  Their daughter Sarah is 12 and has income from part time jobs of $300.  Their son Derek is 10 and has no income of his own.

Mr. Arnold works for a large public company and, during 2017, his basic salary is $103,000.  In addition, he has commission income of $26,140.  During 2017, his employer withholds the following amounts from his earnings:

Registered Pension Plan Contributions $4,200

Canada Pension Plan Contributions 2,564

Employment Insurance Premiums 836

Donations To United Way 1,200

Union Dues 260

Payments For Personal Use Of Company Car 600

Contributions To Company’s Disability Plan 1,200

**Other Information:**

1. Mr. Arnold’s employer makes a matching $4,200 contribution to the company’s RPP on behalf of Mr. Arnold.

2. Mr. Arnold’s employer makes a matching $1,200 contribution to the company’s disability plan on behalf of Mr. Arnold.  The comprehensive disability plan provides periodic benefits during any period of disability to compensate for lost employment income.  Due to a two month sick leave, Mr. Arnold receives disability benefits of $10,950.  Mr. Arnold has been making a $1,200 contribution each year since 2014.  He has had no benefit claims in the years 2014 through 2016.

3. Mr. Arnold’s employer provides him with a car that was purchased in 2014 for $38,000.  His employer pays all of the operating costs which, during 2017 totalled $9,800.  During the year, Mr. Arnold drove the car a total of 48,000 kilometers, 42,000 of which were for employment related travel.  During Mr. Arnold’s two month sick leave, he was required to return the car to the company garage.

4. Medical expenses for Mr. Arnold’s family are as follows:

Allen $3,650

Brenda 2,600

Sarah 1,300

Derek 6,200

5. Mr. Arnold is required to maintain an office in his home without reimbursement from his employer.  His employer provides the required T2200 form.  He uses 20 percent of the home’s floor space for his office.  The costs for his home are as follows:

Utilities And Maintenance $ 5,000

Insurance 4,500

Property Taxes 7,600

Mortgage Interest 9,600

6. Mr. Arnold receives a travel allowance of $4,800 per year to cover his hotel costs.  His actual hotel costs for 2017 were $5,100.  In addition, he spent $6,300 on client meals and entertainment.  His employer does not reimburse any of these costs.

7. As with all of the other employees, Mr. Arnold received a $750 gift certificate for use at a local department store.  He also received a $300 cash reward for his sales performance.

8. In addition to his employment income, Mr. Arnold has taxable capital gains from stock market trading of $4,500, a net rental loss of $6,000 from a residential rental property, and $8,600 in net business income from selling used items on his website.

9. Mr. Arnold supports the church that he attends with donations of $200 per month throughout 2017.  He is not eligible for the first-time donor’s super credit.

10. In 2016, Mr. Arnold’s Net Income For Tax Purposes was $98,000.  This was made up of net employment income of $93,000 (after the deduction of $4,000 in RPP contributions), interest income of $3,000, a net rental loss of $7,000, and net business income of $9,000.

11. At the end of 2016, Mr. Arnold’s Unused RRSP Deduction Room was $6,200 and he had no undeducted contributions.  His employer reported that he had a 2016 Pension Adjustment of $8,000.

**Required**:  Ignore GST/HST considerations.

A. Calculate Mr. Arnold’s maximum deductible RRSP contribution for 2017.

B. Assume that Mr. Arnold contributes the amount calculated in Part A to his RRSP.  Calculate Mr. Arnold’s 2017 minimum:

Net Income For Tax Purposes,

Taxable Income, and

Federal Tax Payable before consideration of any income tax that would have been withheld or paid in instalments.

TIF Problem Ten - 16

Comprehensive Case (Chapters 1 to 10)

Family Information

Aldo Broome is 39 years old and married to Cynthia Broome.  They have been married for 17 years.  They have a 13 year old son Martin, and an 8 year old daughter Ruth, both of whom are in good health.  Martin has income from part time jobs of $1,400, while Ruth has no income of her own.

Other family information for the 2017 taxation year is as follows:

* Aldo worked 212 hours as a search and rescue volunteer.  He received no compensation for this work.
* The family’s medical expenses, all of which were paid for by Aldo, were as follows:

Hair Replacement Fees For Aldo $4,300

Prescription Contact Lenses For Cynthia 850

Teeth Whitening Fees For Cynthia 950

Prescription Glasses For Martin 350

Psychologist Consulting Fees For Martin 1,500

Physiotherapy Fees For Ruth 725

Total $8,675

Aldo’s Business Income

Aldo is an accountant who has not incorporated his professional practice.  His business uses a December 31 year end.

When he began his practice in 2012, he purchased an office building for $750,000, of which $180,000 reflected the estimated fair market value of the land.  It was a new building and it has been allocated to a separate Class 1.  Aldo uses all of the building for his practice.  On January 1, 2017, the building had a UCC of $431,676.

In an attempt to attract a wealthier clientele, Aldo upgrades his office during March, 2017.  He spends $204,000 on new furniture and fixtures.  The old furniture and fixtures were sold for $31,000.  These assets had a capital cost of $93,000 and a UCC of $34,284.

Other asset acquisitions during 2017 are as follows:

New Computer $ 1,200

Applications Software 2,044

Client List From Retiring Accountant 41,000

As many of his clients are disabled, his business requires a car to be used to provide in-home services.  On January 1, 2017 he acquired a new vehicle at a cost of $42,000.  During the year, it was driven a total of 32,000 kilometers, of which 29,000 related to providing in-home services for his clients.  Operating costs for the year totaled $4,800.

Other 2017 costs of operating his business, determined on an accrual basis, are as follows:

Building Operating Costs $24,300

Payments To Staff 42,000

Miscellaneous Office Costs 17,500

Meals With Clients 15,300

On January 1, 2017, Aldo had unbilled work-in-progress of $71,000, along with billed receivables of $92,000.  During 2017, his collections total $321,000.  On December 31, 2017, the unbilled work-in-progress has increased to $82,000 and the billed receivables have increased to $105,000.

Cynthia’s Employment Income

Cynthia works for a large Canadian public company.  Her 2017 salary is $62,000, none of which involves commissions.  Her employer withholds the following amounts during the year:

Registered Pension Plan Contributions\* $2,500

EI Premiums 836

CPP Contributions 2,564

\*Cynthia’s employer makes a matching contribution of $2,500.

In order to deal with her employer’s out-of-town customers, Cynthia is required to do some amount of travel.  She uses her own vehicle for this travel, currently an automobile that she purchased on January 1, 2017 at a cost of $38,000.  During 2017, she drove the vehicle 36,000 kilometers, of which 31,500 were employment related.  Her operating costs for the year were $3,465.

In addition to automobile costs, Cynthia has other travel costs as follows:

Hotels $3,200

Food On Out Of Town Trips 1,300

Cynthia’s employer provides her with the following allowances for her travel, in addition to her salary:

Hotels And Food $4,400

Use Of Personal Automobile ($100 Per Week) 5,200

Investment Information

Through careful spending for himself and his family, Aldo has been able to accumulate an investment portfolio of over $500,000.  All of these funds have been invested in Mutual Fund Trusts and, during 2017, these trusts made distributions totaling $36,960.  The breakdown of these distributions is as follows:

Capital Gains $22,960

Eligible Dividends 8,500

Interest Income 5,500

Total $36,960

All of these investments are owned by Aldo.  Cynthia has no 2017 investment income.

RRSP Information

Both Aldo and Cynthia have invested regularly in RRSPs.  Information for these plans is as follows:

**Aldo’s Plan** At the beginning of 2017, there was $11,000 in unused deduction room in Aldo’s RRSP.  There were also $13,000 in undeducted contributions in the plan.  During 2017, he contributes $22,000 to the plan.  He plans to take the maximum deduction available on the basis of this information.

In December, 2014, Aldo withdrew $25,000 from his RRSP under the provisions of the Home Buyers’ Plan.  In January, 2015, he used these funds, along with funds from the sale of his house, to purchase a new home.  Because he acquired the home for a lower price than anticipated, he repaid $10,000 of the Home Buyers’ Plan balance in that year.  He did not make any repayment during either 2016 or 2017.

Aldo’s Earned Income for 2016 was $123,000.  He did not have a pension adjustment.

**Cynthia’s Plan**  At the beginning of 2017, there was unused deduction room in Cynthia’s plan of $7,000.  She had no undeducted contributions.

In February, 2015, Aldo made a contribution to Cynthia’s plan of $5,000 and deducted it on his 2014 return.  Since then he has learned of the attribution rules associated with spousal plans and has made no further contributions to Cynthia’s plan.

In December, 2017, Cynthia withdraws $7,000 from her RRSP to loan to her brother who Aldo dislikes intensely.  In February, 2018, her brother, after a successful trip to Las Vegas, pays her back the $7,000, along with a gift of $5,000 for being such a great sister.  Cynthia immediately contributes the $7,000 to her RRSP.  She plans to take the maximum deduction available for 2017 based on this information.

At the beginning of 2017, Cynthia’s employer agrees to increase the benefit formula for the plan.  In prior years the benefit was based on 1.5 percent of pensionable earnings for each year of service.  The new agreement calls for a benefit based on 1.75 percent of pensionable earnings for each year of service.  This change will be applied retroactively.  Cynthia has been a member of the plan since 2014.  Her pensionable earnings during those years are as follows:

**Year Pensionable Earnings**

2014 $40,000

2015 45,000

2016 48,000

Cynthia’s Earned Income for 2016 was $51,000.  Her employer reported a pension adjustment for that year of $4,800.

Aldo and Cynthia will allocate tax credits between them to minimize the family’s tax liability.  Where either spouse can claim the credit and it makes no difference in the combined tax payable, Aldo will claim the credit.

**Required:**  Ignore GST/HST/PST considerations in your solution.

A. Determine Cynthia’s Net Income For Tax Purposes and Taxable Income for 2017.

B. Determine Aldo’s Net Income For Tax Purposes and Taxable Income for 2017.

C. Determine Cynthia’s federal Tax Payable for 2017.

D. Determine Aldo’s federal Tax Payable for 2017.