



Term Test #3 (1 hour 15 Minutes)

ADM 4344A – Tax II
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Question #1	8 /22	
Question # 2	7 /12	
Question # 3	16 /16	
Total:	31 /50	62 /100

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Statement to be signed by the student:
 I have read the text on academic integrity and I pledge not to have committed or attempted to commit academic fraud in this examination.

Signed: Lisa Godin

Note: an examination copy or booklet without that signed statement will not be graded and will receive a final exam grade of zero.

Provincial Tax For Corp $\begin{cases} 47\% \text{ of SBD out} \\ 14\% \text{ of other} \end{cases}$
 Provincial Tax For Individuals = 10% / Prov Div = 30%
 - No TC Tax credit

Question #1: Salary and/or Dividend (22 Marks)

Arcland Inc. is a Canadian controlled private corporation with Net Income for Tax Purposes and Taxable Income of \$550,000 for the year ending December 31, 2009. All of the company's income qualifies as active business income. The company's activities are confined to a province which levies a 4% tax on income that is eligible for the small business deduction and 14% on other income. The company has substantial amounts of cash on deposit at its bank to pay the entire \$550,000 to its sole shareholder/employee, Ms. Arcland.

~~Pro~~ TI = NIFTT
N. TC

Ms. Arcland has no other source of income than that paid to her by her corporation. She lives in a province that has a flat provincial tax rate for individuals equal to 10%. The provincial dividend tax credit is 30% of the dividend gross up for all dividends (eligible and non-eligible). Ms. Arcland has combined personal tax credits for the 2009 taxation year in the amount of \$3,800.

Required:

- Determine the after-tax amount of cash that Ms. Arcland will retain if all of the company's income is paid to her in the form of salary. Ignore CPP contributions and any other potential tax credits. Your solution should go on **Page 3**.
- Determine the after-tax amount of cash that Ms. Arcland will retain if the company pays her the maximum possible dividend. Your solution should go on **Page 4 (and 5)**.
- Identify 2 other considerations for an owner manager, besides maximum after-tax remuneration.

Eligible

- 1) Bonuses 2) Only salary is earned income for RRSP, CPP

Show all your calculations to obtain full marks!

Consider BOTH Taxpayers!

3) Dividends Reduce CNIL $\begin{cases} \text{Reduce } 750,000 \\ \text{with the CG} \end{cases}$
Account, salary doesn't

Round your answers to the nearest dollar.

4) Manager/owner must

The last page of this exam provides some of the formulas you may require.

earn enough to absorb all TQX credits

- Availability of Bonuses
- Only salary is earned income for RRSP, CPP
- Dividends Reduce the CNIL, reduce 750,000 with the CG limit.
- Other fringe benefits
- Owner decides benefits

Solution to Question #1: (22 Marks)

1. Salary Option:

For Arcland Inc:

Corporate Income	\$550,000
Salary	(550,000)
Taxes Payable	<u>nil</u> ✓

For Ms. Arcland:

Salary Received	\$550,000	
Federal taxes [26720 + (550000 - 126,264)(29%)]	(149,603)	✓ - Using table of Tax rates
Provincial Taxes (10% (550,000))	(55,000)	✓
Personal Tax Credits	<u>3,800</u>	✓
After Tax Retention	<u>\$349,197</u>	

∴ The amount Ms. Arcland will retain, after tax, if only paid salary is \$349,197

Solution to Question #1 Continued: (16 Marks)

2. Dividend Option:

For Arcland Inc.

Corporate Income		\$550,000
Federal Taxes (38% x 550,000)		(209,000)
Abatement (10% x 550,000)		55,000
SBE (17% x 500,000)		85,000
GRR (9% x 500,000)		4,500
Provincial Taxes:		
On income eligible for SBD (500,000 x 4%)	29,000	
On other income (50,000 x 14%)	7,000	(27,000)
Income available for dividends		<u>\$458,500</u>

$\frac{700,000}{69\%} \rightarrow 1,014,493$
 $\frac{1,014,493}{68\%} \rightarrow 1,491,901$
 GRIP = (TI - SBD) (68%)

Question says Maximum Dividend not correct.

For Ms Arcland

Dividends Received	\$458,500
* Non-eligible Dividend Gross Up (25% x 458,500)	107,125
Total Taxable Income	<u>565,625</u>

$44\% \cdot 34,000 = 14,960$
 Eligible = ~~34,000~~
 Eligible Dividend Gross Up (94% x 34,000)

* Assuming all dividends are non-eligible because it is a CCPC.

Federal Taxes (26,720 + (565,625 - 126,261) x 29%)	158,183
Provincial Taxes (10% x 565,625)	\$154,135
Dividend Tax Credit (E) (2/3 + 30%) (107,125)	56,562
Personal Tax Credits (1% + 30%) (14,960)	(102,587)
Taxes Payable	<u>103,343</u>

After tax retention = 458,500 - 103,343 = \$355,157

∴ If the company pays only dividends, Ms Arcland's after-tax retention is \$362,033

Solution to Question #1 Continued:

3) Two other considerations for an owner/manager, besides minimum after tax remuneration, are:

- 1) The possibility of receiving bonuses. ✓
- 2) Advantages/disadvantages of incorporation rather than proprietorship.

↑ Limited Liability
Unlimited Life

2) Added cost of salary CPP, EI

3) Provincial Payroll Taxes

4) CPP + EI rules

5)

A/R → 5.22 - lowest

Equipment

WWW

Question #2: S. 85 Rollover (11 Marks)

ACB 120,000

FMV 66,000

UCC 64,000

7/2011 recap - BI

Mr. Tippler is the sole owner of an unincorporated business. The following information pertains to the assets of business as of December 31, 2009:

UCC or ~~ACB~~

NOT TRANSFER

Account	Cost	Tax Values	Fair Market Value
Cash ✓	\$ 20,000	\$ 20,000	\$ 20,000
Accounts Receivable ✓		\$ 42,000	\$ 38,500
Equipment ✓	\$120,000	62,000	\$ 66,000
Land ✓	\$106,000	\$106,000	\$185,000
Building ✓	\$246,000	\$178,000	\$323,000
Goodwill <i>any time later, 1/2 - FMV, Business Income = 1/2</i>			\$ 95,000
Total Assets		\$408,000	\$727,500
Liabilities		\$123,000	\$123,000
Owner's Equity		\$285,000	\$604,500
Total Equities		\$408,000	\$727,500

Mr. Tippler has established a new corporation, Tippler Ltd. Unless there is some tax reason not to do so, he would like to transfer all the assets of the unincorporated business to the new corporation.

He is aware that by using a S. 85 rollover, he could avoid any unwanted tax consequences at the time of the rollover. However, Mr. Tippler has a net capital loss carry forward from 2007 in the amount of \$20,000 (1/2 of \$40,000). He has not yet been able to deduct this LCF, therefore he would like to elect a transfer under S. 85 in a manner that will create a \$20,000 taxable capital gain. Other than this, he would like to avoid having any other tax consequences as a result of this transfer.

The corporation will assume all of the liabilities of the unincorporated business. In addition, it will issue new debt to Mr. Tippler in the amount of \$77,000 and new common shares with a fair market value equal to the difference between the Fair Market Value of the assets transferred and fair market value of the non-share consideration (boot) received by Mr. Tippler.

CSA → CSB
 Cash → Boot

Greater - FMV Boot
 118,500 - FMV
 - UCC
 - 1/2 LCF

Max 95,000
 Min Greater of BOOT
 148,500 FMV
 UCC

Required:

- Which asset(s) should Mr. Tippler transfer at higher value(s) in order to create the desired taxable capital gain? What value(s) should these asset(s) be transferred at? (2 Marks)

Mr. Tippler should transfer goodwill at a higher value. Goodwill should be transferred at least at \$1, but in order to create a capital gain of \$40,000, the goodwill should be transferred at \$40,000. This will make a taxable capital gain of \$20,000. ✓✓

- Answer the questions on the following 2 pages.

Solution to Question #2: (6 Marks)

On the table below, indicate which assets Mr. Tippler should transfer to his new corporation.

Also provide the value at which he should transfer these assets, INCLUDING the asset(s) selected in the first question on page 6.

(Yes, I have provided more lines in the table than required.)

$$\text{Boot} = 77000 + 123000 = 200,000$$

Assets to be Transferred		Elected Value for the Transfer
Equipment	✓	\$ 66,000 → 62,000 ^x
Land	✓	\$ 185,000 106,000 ^x
Building	✓	\$ 200,000 178,000 ^x
Goodwill GW		\$ 40,000 40,000
Cash		20,000
ARR (S. 22)		38,500
GW		\$1 / \$95,000
Total Transfer Value		491,000 394,500

	Equipment	Land	Building
1) FMV of Property	66,000	185,000	323,000
2) Lesser of			
1) FMV of Boot	200,000	200,000	200,000
2) Greater of			
a) FMV of property	66,000	185,000	323,000
b) UCC or 43(CEC) of Property	60,000	160,000	178,000
c) ACE of Property	16,000	100,000	245,000

Solution to Question #2: (4 Marks)

What would be the Adjusted Cost Base of Mr. Tippler's common shares?

Fair Value of Asset's Transferred Fair Value of Boot Fair Value of Mr. Tippler's Common Shares ACB of all shares	Elected T-value of \$ 394,500 574,000 (200,000) ✓✓ 374,000 (194,500)
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Increase in DUC	\$ 374,000
Increase in net assets	(123,000)
Capital gain	
Deemed Dividend	251,000

don't need

Deemed Dividend (251,000) added to ACB of Mr Tippler's common shares. xx

$$\begin{array}{r}
 \text{Elected Transfer} \\
 - \text{Boot} \\
 \hline
 \text{ACB of all shares} \\
 - \text{ACB Preferred} \\
 \hline
 \text{ACB Common}
 \end{array}$$

$$\begin{array}{r}
 \text{LSC} \\
 - \text{ACB all shares} \\
 \hline
 \text{PUC Red} \\
 \text{PUC-P} = \text{LSC-P} - \left(\frac{\text{PUC Red}}{\text{LSC}} \right) (\text{LSC-P})
 \end{array}$$

incr in PUC (40,000 x 12.70)
 incr in net assets
 Deemed Dividend

Debt
 (450,000)
 58,000

Question #3: (2 Marks per question = 16 Total Marks)

Question	Answer Only
In 2008, Unilev Inc. went public and issued an IPO of 126,000 shares of common stock at \$10.50 per share for total proceeds of \$1,323,000, which constitutes its PUC. During the current year (2009), a creditor holding \$450,000 of the company's debt agrees to accept 40,000 newly issued common shares of the company in exchange for settlement of the debt. At the time of this exchange, the shares are trading at \$12.70 per share. Identify the amount of the deemed dividend.	$(40,000 \cdot 12.70) - 450,000$ \$58,000 ✓✓
In the situation above, what would be the amount of deemed dividend allocated to each share?	$\frac{58,000}{(40,000 + 126,000)}$ \$0.35 per share ✓✓
At the time Unilev issued its IPO of 126,000 shares (above), a taxpayer purchased 5,000 shares. After the company settled its debt and paid out the deemed dividends, the taxpayer sold all of his Unilev shares for \$13.42 per share. What are his tax consequences?	When dividends paid out, taxpayer increases ACB by 0.35 to 910.85 per share. Taxable capital gain on sale = \$6,425 ✓✓
When a corporation redeems all or part of its outstanding shares, the difference between the proceeds of redemption and the PUC of the shares will be treated as capital gains for tax purposes. True or False?	False ✓✓
When a corporation issues dividends in kind, the only tax consequences to the corporation will be reduction in the Retained Earnings upon payment of the dividend. True or False?	False ✓✓
What is the maximum number of days after year-end that a corporation has in which to pay any dividends declared in order to avoid incurring adverse tax consequences?	180 days ✓✓
The taxpayer has come to you for advice. She is the sole shareholder in her corporation and in addition to salary and dividends, she would like to receive benefits from her company. She is considering having her company pay Canada Pension Plan, Employment Insurance [Medical & Dental, Life Insurance and a company car.] The corporation has sufficient funds to do so. Which of these benefits is she ineligible for, if any?	Canada Pension Plan Employment Insurance ✓✓
What does LRIP stand for?	Lower Rate Income Pool General Rate Income Pool ✓✓

sc'd
 dmed
 IV =
 1750

Small Business Deduction is •17% deduction on the least of:

- a) Net Canadian Active Business Income 550,000
- b) Taxable Income, Less 550,000
 •10/3 times the foreign tax credit
 on non-business income (10/3)(\$8,250) 0
 •3 times the foreign tax credit
 on foreign business income without
 considering the general rate reduction 0
550,000 550,000
- c) The Annual Business Limit, Less 500,000
 Any portion allocated to associated corporations 0
 The reduction for large corporations 0
500,000 500,000

SBD: $(17\%) \times 500,000 = 85,000$

General Rate Reduction: 9% times:
 Taxable Income, Less
 Amount Eligible for the MP&P Deduction
 Income Eligible for the SBD
 Aggregate Investment Income of a CCPC
 Amount Eligible for the GRR

$$\begin{array}{r} 550,000 \\ 0 \\ (500,000) \\ 0 \\ \hline 50,000 \end{array}$$

GRR: $(9\%) \times 50,000 = 4,500$

GRIP Balance:

Balance from last year

0
 + ~~(68%)~~ (CCPC taxable Income – income eligible for SBD – CCPC aggregate Investment Income)

68% (550,000 – 500,000 – 0)

34,000

+ eligible dividends Rec'd

– eligible dividends paid in previous year

Federal Tax Rates for Individuals

Taxable Income in Excess of:	Federal Tax Payable	Marginal Rate on Excess
\$0	\$0	15%
\$ 40,726	\$ 6,109	22%
\$ 81,452	\$15,069	26%
\$126,264	\$26,720	29%