

## Assignment Problems

**Assignment Problem Twenty - 4 (Residency Of Corporations - 4 Cases)**

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 1961. While it operated in Canada for a number of years, all of its operations and management 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 director 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 U.K., with all of the company's board of directors meetings held in that country.

**Assignment Problem Twenty - 5 (Residency/Dual Residency - Individuals)**

Determine the residency status of the three individuals in the following Cases. Use the tie-breaker rules found in the Canada/U.S. tax treaty where appropriate.

**Case A** Brad is a U.S. citizen who has been living in Seattle, Washington. Through an online dating service, he meets Sarah in 2012. She is a Canadian citizen who lives and works in Vancouver. After several face-to-face meetings they conclude that they should marry and, after much discussion, they decide that they will live in Seattle after the marriage. Since Sarah is committed to remaining in her position in Vancouver until September, 2013, in December, 2012, Brad takes a 10 month leave of absence from his job and gives up his apartment in Seattle. On January 1, 2013, they move in together sharing an apartment in Vancouver which is leased on a month-to-month basis. On September 15, 2013, they get married, terminate the Vancouver lease, and move to a newly purchased house in Seattle.

**Case B** Helen is a single individual who makes her living painting portraits of wealthy individuals. She is a U.S. citizen and has, in recent years, worked in Burlington, Vermont. Of late, business has dropped off and, as a consequence, she decided to try working in Montreal. Because of the uncertainty involved in her line of work, she does not sell her Burlington residence, asking a friend to watch it while she is absent. On April 15, 2013, she moves to Montreal. She lives in various Montreal hotels until January 15, 2014. At this time she concludes that the work situation is no better in Montreal than it was in Burlington. Given this, she returns to Burlington.

**Assignment Problem Twenty - 6 (Part I Tax On Non-Residents)**

The following material describes several independent cases which involve U.S. citizens or companies that have some type of Canadian source income.

**Case 1** Marlene is a U.S. citizen and also a resident of that country. Several years ago, she established an Alberta private company in order to acquire rental properties in Calgary and Edmonton. Other than necessary cash balances used for operations, all of the assets of the corporation are rental properties in these two cities. During the current year, she sells all of the shares of the Alberta corporation, resulting in a capital gain of \$275,000.

*Assignment Problems*

**Case 2** Maria is a U.S. citizen and is also a resident of that country. She is the sole shareholder of a U.S. private company that owns a block of rental properties located in Canada's maritime provinces. During the current year, she sells all of the shares in this company, realizing a capital gain of \$410,000.

**Case 3** Manuflex, a U.S. manufacturing company ships its products to a Lethbridge, Alberta warehouse. The warehouse is rented on a month-to-month lease that can be cancelled by either party with 60 days notice. They have hired Mark Bridges, a Lethbridge resident, to sell their product throughout western Canada. Mark works out of an office in his home. He does not have authority to conclude individual sales contracts without approval from the U.S. head office.

**Case 4** Manuflex, a U.S. manufacturing company ships its products to a Lethbridge, Alberta warehouse. The warehouse is rented on a month-to-month lease that can be cancelled by either party with 60 days notice. They have hired Mark Bridges, a Lethbridge resident, to sell their product throughout western Canada. Mark uses a significant part of the warehouse space as an office. He does not have authority to conclude individual sales contracts without approval from the U.S. head office.

**Case 5** Saul Bekham is a U.S. citizen who accepts temporary employment in Regina. This work requires him to live in Canada for 4 months. During this period, his employment income is \$63,000, all of which is paid by a resident Canadian corporation.

**Case 6** Sarah Block is a U.S. citizen who is asked by her U.S. employer to work in Canada for a period of 3 months. During this period, her earnings total \$36,000, all of which is paid by her U.S. employer.

**Required:** For each of the preceding cases, determine the applicability of Part I tax on the Canadian source income.

**Assignment Problem Twenty - 7 (Permanent Establishments)**

A U.S. gun cabinet manufacturer is considering entering the Canadian market. The company will use one of the following approaches to expand its market in Canada:

- A. Advertising in gun magazines.
- B. Selling cabinets to Canadian distributors. The distributors pay the shipping costs on the cabinets from the U.S. port or border crossing closest to them.
- C. Direct sales to wholesalers by non-exclusive agents. The agents will represent other suppliers.
- D. Direct sales to wholesalers by full-time salespeople in each of three regions of Canada. No sales offices will be opened, and the cabinets will be shipped from a warehouse in the U.S. Shipment will be made only after a customer's credit and contract are approved by the U.S. head office.
- E. Direct sales to wholesalers by full-time salespeople who report to a sales office in each of three regions of Canada. The sales offices will co-ordinate marketing and shipping of products from two warehouses located in Canada. However, formal approval of contracts will be administered in the U.S. head office.
- F. The sales offices described in Part E would be independent profit centres, with regional credit managers. The four warehouses from which orders are filled will be near the sales offices.

**Required:** For each market expansion approach, assess whether or not the U.S. manufacturer will be deemed to have a permanent establishment in Canada. Justify your assessment, and identify any other information required to support your position.

## Assignment Problems

---

(The solutions for these problems are only available in the solutions manual that has been provided to your instructor.)

### **Assignment Problem Three - 1 (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, 2013 and paid on December 31, 2013.

**Case B** The company's year end is July 31. The bonus is declared on March 2, 2013 and paid on January 1, 2014.

**Case C** The company's year end is December 31. The bonus is declared on December 1, 2013 and paid on July 1, 2014.

**Case D** The company's year end is September 30. The bonus is declared on October 31, 2013 and paid on October 31, 2017.

**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.

### **Assignment Problem Three - 2 (Employee Vs. Self-Employed)**

The Alberta Motor Association (the Payor) carried on a business of training and providing instruction to individuals who wanted to obtain vehicle operator's licenses. Mr. Bansal (the Appellant) had an arrangement with the Payor to provide such instruction.

The Payor had treated Mr. Bansal as an independent contractor from 2006 to 2008. Mr. Bansal was claiming that he was an employee of the Alberta Motor Association in 2008.

The agreed upon facts in this case are as follows:

- the Payor operated as a membership based association; (admitted)
- the Payor had clients who wanted to obtain motor vehicle operator's licences; (admitted)
- the Appellant was hired as a driving instructor; (admitted)
- the Appellant entered into a written contract with the Payor which stated that the Appellant was a contractor and not an employee;
- the Appellant had been under contract with the Payor since 2006;
- the Appellant earned a set fee of \$26.00 per hour;
- the Appellant also received fees for new bookings, student home pickups and a fuel subsidy;
- the Appellant invoiced the Payor;
- the Appellant did not receive any employee benefits such as health, dental or vacation pay;
- the Payor did not guarantee the Appellant a minimum amount of pay;
- the Payor's hours of operation were from 8:00AM to 5:00PM, Monday to Saturday;
- the Appellant set his own schedule of hours and days of work;
- the Appellant could work anytime between 8:00AM and 10:00PM, Monday to Sunday;
- the Appellant did not have a set minimum number of hours of work required;
- the Appellant kept a record of his hours worked;
- the Payor provided the Appellant with the names of the students;
- the Appellant contacted the students and scheduled the road instruction;
- the Payor provided the Appellant with an in-vehicle lesson guide;
- the Appellant chose the routes for the lessons;

*Assignment Problems*

- the Appellant was able to hire his own helper for administrative tasks;
- the Appellant provided the major tool which was the vehicle;
- the Payor provided vehicle signage, mirrors, traffic cones and an emergency brake;
- the Appellant paid for the installation and removal of the emergency brake provided by the Payor;
- the Appellant incurred operating expenses including vehicle expenses, liability insurance and a driver training endorsement;
- the Appellant's vehicle expenses included insurance, maintenance and fuel;
- the Payor's intention was that the Appellant was a contractor and not an employee;
- the Appellant had a GST number;
- the Appellant charged the Payor GST;
- the Appellant had operated his own taxi business since 1990;
- the Appellant maintained his own business books and records;
- the Appellant declared business income and business expenses on his 2006, 2007 and 2008 income tax returns.

**Required:** Should Mr. Bansal be viewed as an employee of the Alberta Motor Association or, alternatively, an independent contractor? List all of the factors that should be considered in reaching a conclusion.

**Assignment Problem Three - 3 (Employer Provided Vs. Employee Owned Car)**

John Rush is a key employee of Megan Ltd. (ML), a Canadian public company. He is not required to use an automobile in carrying out his employment duties.

In 2011 and 2012, ML has provided John with a car with ML paying all of the operating costs of the car. John uses the car exclusively for personal travel.

On January 2, 2013, ML has indicated to John that, as an alternative to continuing to provide the car for him, they will sell the car to him at its current fair market value of \$20,000. If he chooses to purchase the car, ML will no longer pay the operating costs.

John expects that, whether he chooses to purchase the car or not, he will use the car for two more years, 2013 and 2014. If he purchases the car, the estimated sales price at the end of these two years would be \$12,000. He expects to drive the car about 40,000 kilometers in each of the two years.

Assume that operating costs will be \$0.20 per kilometer and the prescribed operating cost benefit will be \$0.27 per kilometre throughout both years.

John's combined federal/provincial marginal tax rate is 48 percent.

**Required:** On the basis of undiscounted cash flows, advise John as to whether he should purchase the car assuming:

- A. ML purchased the car for \$35,000.
- B. ML purchased the car for \$70,000.

Ignore GST/HST considerations.

**Assignment Problem Three - 4 (Taxable Automobile Benefits)**

Jordan Ltd. owns a car with an original cost of \$28,500. The car has been owned by the company for over three years, with the Company deducting maximum CCA in each year. Jordan Ltd. requires that cars be returned to the corporate premises when they are not being used by the employee.

During 2013, the car has been used by Ms. Rachel Smith, the Company's regional marketing manager. During this year, she drove the car a total of 52,000 kilometers, with all of the operating expenses being paid for by the Company. These operating expenses averaged \$0.12 per kilometer, a total of \$6,240.

**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 the entire year and drives it a total of 18,000 kilometers for personal purposes.

**Case B** Ms. Smith has use of the car for 10 months of the year and drives it a total of 11,000 kilometers for personal purposes.

**Case C** Ms. Smith has use of the car for 6 months of the year and drives it a total of 28,300 kilometers for personal purposes.

### **Assignment Problem Three - 5 (Taxable Automobile Benefits)**

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

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

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

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

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

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

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

### **Assignment Problem Three - 6 (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:

*Assignment Problems*

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

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

**Assignment Problem Three - 7 (Loans To Employees)**

Ms. Teresa Monson is employed by Elmwood Inc. She has asked the employer for a \$300,000 interest free loan that will be used to acquire a summer cottage in Huntsville, Ontario. The cottage will be used exclusively as a recreational property. As she is a highly valued employee, Elmwood Inc. is considering her request.

Ms. Monson can acquire a regular mortgage at a rate of 4.5 percent. Assume that the relevant prescribed rate is 2.5 percent for all periods that the employee loan will be outstanding.

Ms. Monson's tax rate on any additional income is 46 percent. Elmwood Inc. has alternative investment opportunities that earn a before tax rate of 7 percent. Elmwood Inc. is subject to a tax rate of 36 percent on additional amounts of income.

**Required:** Evaluate Ms. Monson's suggestion of providing her with an interest free loan in lieu of salary from the point of view of the cost to Elmwood Inc.

**Assignment Problem Three - 8 (Employee Stock Options)**

Ms. Patricia Martin is employed by a Canadian public company. In 2011, 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 2012, Patricia exercises all of the options. At this time, the shares are trading at \$50 per share. During 2013, Patricia sells the shares for \$55 per share. The commission on the sales price is 1 percent.

**Required:**

- Indicate the tax effect of the transactions that took place during each of the years 2011, 2012, and 2013. Your answer should include the effect on both Net Income For Tax Purposes and Taxable Income. Where relevant, identify these effects separately.
- How would your answer change if the shares had been trading at \$44 per share at the time that the options were issued in 2011?
- How would your answer change if Patricia's employer was a Canadian controlled private company?

**Assignment Problem Three - 9 (Employee Stock Options)**

During 2011, her first year as an employee of Borden Ltd., Ms. Marcia Balzac was granted options to purchase 2,500 of the Company's shares at a price of \$8.00 per share.

When Ms. Balzac exercises the options, the shares are trading at \$8.30 per share.

On November 1, 2013, Ms. Balzac sells all of her shares at a price of \$8.55 per share.

**Required:** Indicate the tax effect on Ms. Balzac of the transactions that took place during 2011, 2012, and 2013 under each of the following independent Cases. Your answer should

**Assignment Problem Three - 12 (Employment Income)****(This Problem Is Continued In Assignment Problem Four - 4)**

For the past five years, Mr. Brooks has been employed as a financial analyst by a large Canadian public firm located in Winnipeg. During 2013, his basic gross salary amounts to \$53,000. 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 2013 and the remainder is to be paid on January 15, 2014.

During 2013, Mr. Brooks' employer withheld the following amounts from his gross wages:

Federal Income Tax	\$3,000
Employment Insurance Premiums	891
Canada Pension Plan Contributions	2,356
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 2013. 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 2013. Mr. Brooks drove the car a total of 35,000 kilometers during 2013, 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, 2012, 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, 2013, 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, 2013 and, at this point in time, the interest rate on open five year mortgages was 5 percent. Assume the relevant ITR 4301 rate was 2 percent on this date. Mr. Brooks purchases a house for \$235,000 on October 2, 2013. 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.

**Required:** Calculate Mr. Brooks' net employment income for the taxation year ending December 31, 2013.