

Practice Examination Solution

Chapter 7 (Property Income)

Examination Summary

The marks you have received on each question can be added in the final column.

Question	Type Of Question Or Subject	Total Marks	Your Mark
1	Essay Question	10	
2 - 7	True Or False	9	
8 - 14	Multiple Choice	21	
15	Alternative Investments	25	
16	Income Trusts, Mutual Funds, and Foreign Source Income	35	
Total		100	

Solution 1 (10 Marks)

Part A

The two special rules are:

- Each rental property with a cost that is greater than \$50,000 must be included in a separate CCA Class.
- Taxpayers are not allowed to either create or increase a net rental loss through the deduction of CCA.

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Part B

The full \$10,000 will have to be included in the investor's Net Income For Tax Purposes. He will be entitled to a tax credit of only \$1,500 as, on non-business income, the credit is limited to 15 percent.

10

The remaining \$2,500 (\$4,000 - \$1,500) can be deducted in the determination of Net Income For Tax Purposes.

1 grading point for each highlighted item. Total 17

Your Mark = [(# of grading points ÷ 17)(10%)] = ____%

Solutions 2 Through 7 (9 Marks)

2. **True.** To be classified as interest for tax purposes, payments must be calculated on a principal sum and must be compensation for the use of that principal sum.
3. **False.** In some cases, only one-half of the loss will be deductible.
4. **True.** Both corporations and partnerships must calculate deductible interest using the full accrual method.
5. **False.** This is a prescribed debt obligation and this means that interest will have to be accrued using the effective interest rate method over the five year period that the debt is outstanding.
6. **False.** Only those rental buildings with a cost in excess of \$50,000 must be allocated to a separate Class 1.
7. **True.** The gross up and tax credit procedures for non-eligible dividends are based on the assumption of a 20 percent corporate tax rate.

1 grading point for each correct answer. Total 6

Your Mark = [(# of grading points ÷ 6)(9%)] = ____%

Solutions 8 Through 14 (21 Marks)

8. **C.** Jerri will have to recognize Nil in 2013, and \$25,000 in 2014.
9. **A.** The corporation will be able to deduct \$40,000 in each of the years 1 through 5, and will have a \$25,000 capital loss in year 5, only one-half of which will be deductible. As the bonds were sold for less than 97 percent of their maturity value, the discount will be treated as a capital loss.
10. **C.** CCA is limited to the combined net rental income on the two properties of \$17,000 (\$43,000 - \$26,000).
11. **D.** The amount would be calculated as follows:

Dividends Received	\$24,000
Gross Up Of 25 percent	6,000
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Taxable Dividends	\$30,000
Tax Rate (29% + 14%)	43%
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Tax Before Credit	\$12,900
Dividend Tax Credit [(2/3 + 27%)(6,000)]	(5,620)
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Tax Payable On Dividend	\$ 7,280
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After Tax Retention (\$24,000 - \$7,280)	\$16,720
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12. **B.** The federal dividend tax credit for eligible dividends is not equal to two-thirds of the gross up.

13. **B.** The \$12,000 distribution would result in 76.92 additional units. Given this, the adjusted cost base of the units would be \$150.43 $[(\$150,000 + \$12,000) \div (1,000 + 76.92)]$.
14. **D.** While the tax credit is limited to \$1,800 $[(15\%)(\$12,000)]$, the additional \$1,800 of withholding can be deducted. This leaves an increase in Net Income For Tax Purposes of \$10,200 $(\$12,000 - \$1,800)$.

1 grading point for each correct answer. Total 7

Your Mark = $[(\# \text{ of grading points} \div 7)(21\%)] = ___\%$

Solution 15 (25 Marks)

Guaranteed Investment Certificate

If the \$50,000 is invested in the guaranteed investment certificate, the after tax retention would be as follows:

Interest Earned $[(6\%)(\$50,000)]$	\$3,000
Taxes $[(29\% + 14\%)(\$3,000)]$	(1,290)
After Tax Retention $(\$3,000 - \$1,290)$	<u>\$1,710</u>

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Common Stock Purchase

If the \$50,000 is invested in the common stock and the common stock is sold for \$55 per share, the after tax retention would be as follows:

Dividends Received $[(1,000)(\$1.00)]$	\$1,000	
Gross Up $[(38\%)(\$1,000)]$	380	
Taxable Dividends		\$1,380
Capital Gain $[(1,000)(\$55 - \$50)]$	\$5,000	
Inclusion Rate	<u>1/2</u>	
Taxable Capital Gain		2,500
Taxable Income		<u>\$3,880</u>
Tax $[(29\% + 14\%)(\$3,880)]$		\$1,668
Dividend Tax Credit $[(6/11 + 25\%)(\$380)]$		(302)
Tax Payable		<u>\$1,366</u>
After Tax Return $(\$1,000 + \$5,000 - \$1,366)$		<u>\$4,634</u>

17

1 grading point for each highlighted item. Total 24

Your Mark = $[(\# \text{ of grading points} \div 24)(25\%)] = ___\%$

Solution 16 (35 Marks)

The amount of taxable income and tax payable resulting from the investments would be calculated as follows:

Interest On Term Deposit [(€35,000)(1.49)] (Note)	\$52,150	
Excess Withholding [(20% - 15%)(€35,000)(1.49)]	(2,608)	\$49,542
Golden Mountain Distribution [(\$8.75)(1,200)]	\$10,500	
Return Of Capital [(\$3.25)(1,200)]	(3,900)	6,600
Blackman Capital Gain [(\$0.80)(8,500)]	\$ 6,800	
Inclusion Rate	<u>1/2</u>	
Taxable Capital Gain		3,400
Blackman Eligible Dividends [(\$0.70)(8,500)]	\$ 5,950	
Dividend Gross Up [(38%)(5,950)]	<u>2,261</u>	8,211
Blackman Interest [(\$0.60)(8,500)]		5,100
Taxable Income		\$72,853
Tax Rate (29% + 13%)		42%
Tax Before Credits		\$30,598
Dividend Tax Credit [(\$2,261)(6/11 + 21%)]	(1,708)	
Foreign Tax Credit [(15%)(€35,000)(1.49)] (Note)	(7,823)	
Tax Payable		<u>\$21,067</u>

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Note - Foreign Source Property Income As required, 100 percent of the foreign interest is included in Net Income For Tax Purposes. However, for individuals, the credit against Tax Payable that is provided under ITA 126(1) is limited to a maximum of 15 percent of the foreign source non-business income. Since the withheld amount exceeds 15 percent, the excess is deducted and does not qualify for treatment as a foreign tax credit.

Adjusted Cost Base - Golden Mountain

The reinvestment of the \$10,500 [(\$8.75)(1,200)] distribution at \$100 per unit would acquire an additional 105 units (\$10,500 ÷ \$100)0. After recognizing these changes, the adjusted cost base per unit would be as follows:

$$\$89.66 [(\$110,400 + \$10,500 - \$3,900) \div (1,200 + 105)]$$

8**Adjusted Cost Base - Blackman**

The reinvestment of the \$17,850 [(\$2.10)(8,500)] distribution at \$20 per unit would acquire an additional 892.5 units (\$17,850 ÷ \$20). After recognizing these changes, the adjusted cost base per unit would be as follows:

$$\$22.71 [(\$195,500 + \$17,850) \div (8,500 + 892.5)]$$

7

1 grading point for each highlighted item. Total 42

Your Mark = [(# of grading points ÷ 42)(35%)] = ____ %