



École de gestion

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School of Management

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Mid-Term Exam #2 (2 hours)

ADM 3345 – Tax I
November 13, 2010

Student Name: _____

Student I.D.: _____

Question #1	11 /12	
Question # 2	12 /14	
Question # 3	13 /14	
Question# 4	18 /20	
Total:	54 /60	90 /100

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Signed: _____

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Question #1: Business Income (12 Marks)

Vandelay Industries ("Vandelay") sells latex products in the Ottawa/Gatineau area. Vandelay has just completed its financial statements for the year ended December 31, 2010. The income statements shows Net Income for the year of \$473,925. The following information was used in preparation of these financial statements:

- 1) Included in Cost of Goods Sold was a loss of \$1,967 resulting from a theft by one of the company's employees.
- 2) Advertising and Promotion per the financial statements included meals and entertainment of \$24,680.
- 3) Advertising also included \$1,500 of advertising in a foreign Latex industry magazine. The magazine is directed at companies around the world.
- 4) The president and his wife Elaine attended a convention that resulted in the company incurring and expensing \$4,500 in travel costs. Of this amount, \$1,300 was related to the travel costs of Elaine. It was not required that she attend the convention.
- 5) The company's property tax expense for the year was \$9,500. \$6,000 related to the company's headquarters. The remaining \$3,500 related to a piece of vacant land where the company planned to relocate in the future. The company earned \$1,000 of parking income from this vacant land.
- 6) Bad Debt expense totaled \$5,670.
- 7) Amortization expense on the company's assets was calculated at \$43,210.
- 8) CCA was correctly calculated to be \$45,670.
- 9) The balance in the company's CEC account was \$10,000 at January 1, 2010.
- 10) During the year the company incurred legal fees totaling \$4,250 relating to the following transactions:
 - i. Review of sales contracts \$2,250
 - ii. Amending the articles of incorporation \$2,000
- 11) The company paid a \$4,000 penalty for late filing their corporate income tax return.
- 12) Included in the insurance expense is \$5,200 of life insurance premiums. The insurance is required as part of their financing arrangements.
- 13) The company paid \$7,200 for a golf membership for their chief business developer. He routinely took clients to the course.
- 14) The company declared bonuses to management totaling \$35,790 at the end of 2010. These bonuses will be paid on June 1, 2011.

Required:

Calculate Vandelay's Net Income for Tax Purposes (NIFTP) for the year ending December 31, 2010 on the assumption that Vandelay claims the maximum deductions available to them for tax purposes.

Solution to Question #1: (12 Marks)

Net income for accounting purposes

473,925 (1)

Additions:

Non deductible portion of meals (24,680)(.5)

12,340 (1)

President's wife travel costs

1,300 (1)

Amortization

43,210 (1)

Amending articles of incorporation

2,000 (1)

Penalty for late filing

4,000 (1)

Golf membership

7,200 (1)

Total Additions

70,050

Deductions:

CCA

45,670 (1)

* CEC amount

805 ✓

46,475

Net Income for Tax Purposes (1)

\$497,500

1. OK

* CEC calculation O.B 10,000

2.

Amending articles of incorporation 1,500 (1)
(2,000 x .75)

3. OK

CEC AMT 805

(11,500 x .07)

(1)

Solution to Question #1: (12 Marks)

Net income for accounting purposes

473,925 (1)

Additions:

Non deductible portion of meals (24,680)(.5)

12,340 (1)

President's wife travel costs

1,300 (1)

Amortization

43,210 (1)

Amending articles of incorporation

2,000 (1)

Penalty for late filing

4,000 (1)

Golf membership

7,200 (1)

Total Additions

70,050

Deductions:

CCA

45,670 (1)

* CEC amount

805 ✓

46,475

Net Income for Tax Purposes (1)

\$497,500

1. OK

* CEC calculation O.B

10,000

2.

Amending articles of incorporation
(2,000 x .75)

1,500 (1)

3. OK

CEC AMT

805

(11,500 x .07)

(1)

Question #2: Rental Income and CCA (14 Marks)

Mr. Furly owns a rental property with the following relevant information at December 31, 2009:

	<u>Building #1</u>
ACB	\$ 105,000
UCC	\$ 102,900
FMV	\$ 117,750

The building is a class 1 asset which is depreciated for tax purposes at 4% per annum.

Part A: 2010:

In 2010, Mr. Furly acquired an additional rental property. The purchase price was \$125,000. Of this amount \$100,000 was allocated to the building (class 1 - 4%) and the remaining \$25,000 was allocated to the land.

The following is a summary of income received and expenses incurred in 2010:

	<u>Building #1</u>	<u>Building #2</u>
Gross Rental Revenues	\$15,000	\$10,000
Mortgage Interest	4,500	5,300
Property Taxes	2,700	1,650
Repairs & Maintenance	1,300	0

9,550 ①
available for CCA

Required:

Calculate the amount of net rental income that Mr. Furly must include on his 2010 income tax return. Assume he claims the maximum CCA allowed each year.

Show all of your calculations to obtain full marks!

Solution:

	Rental Income 2010.
Rental Revenue (15,000 + 10,000)	\$ 25,000 ①
Mtg Interest (4,500 + 5,300)	(9,800)
Property taxes (2,700 + 1,650)	(4,350)
Repairs + maintenance (1,300)	(1,300)
	(6,116)
** CCA (4,116 + 2,000)	
<u>Net rental Income.</u>	<u>\$ 3,434 ①</u>

** CCA calculations.

Building #1

$$(UCC \times .04) = (102,900 \times .04) = 4,116 \text{ ①}$$

Building #2 ①

$$(100,000 \times .04 \times \frac{1}{2}) = 2,000$$

Question #2 Continued

Part B: 2011:

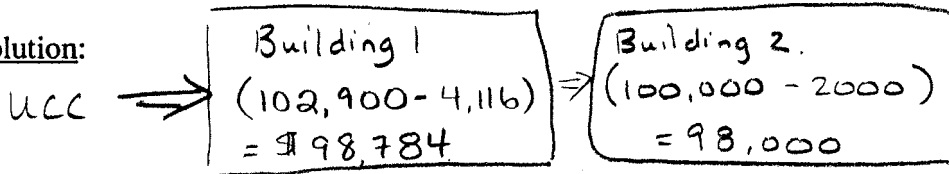
In 2011, Mr. Furley encountered difficulty renting building #1 and experienced the following:

	<u>Building #1</u>	<u>Building #2</u>
Gross Rental Revenues	\$7,500	\$20,000
Mortgage Interest	3,700	8,700
Property Taxes	2,700	3,300
Repairs & Maintenance	1,900	2,400

Required:

Calculate the amount of net rental income that Mr. Furley must include on his 2011 income tax return. Given the difficulty renting building #1, Mr. Furley is contemplating selling it in the near future. If a decision must be made in 2011 as to how CCA is claimed, he would prefer to minimize recapture of CCA arising from the sale. However, he still wants to claim the maximum CCA allowed. **Show all of your calculations to obtain full marks (including ending UCC balances)!**

Solution:



Rental Income.

Rental Revenues (7,500 + 20,000)	27,500
Mtg. Interest (3,700 + 8,700)	(12,400)
Property Tax (2,700 + 3,300)	(6,000)
Rep + Maintenance (1,900 + 2,400)	(4,300)
*** CCA (3,920 + 880)	(4,800)
<u>Net rental income</u>	<u>-nil-</u> ①

*** CCA
Revenue available for CCA deductions (27,500 - (12,400 + 6,000 + 4,300)) = 4,800 ①
We want to minimize the amount of CCA taken on Building #1.

Building 2 CCA (98,000 x .04) = 3,920 ①
Building 1 CCA (98,784 x .04) = 3,951 ①

∴ We will only take (4800 - 3,920) = 880 CCA from building #1. ①

Question #3: Capital Gains (14 Marks)

Strapped for cash after another one of her husband's failed business ventures, Marge sold the following assets during the year:

	<u>Proceeds</u>	<u>ACB</u>	<u>Selling Expenses</u>
Personal Vehicle	\$3,000	\$7,600	Nil
Jewellery	\$1,500	\$ 700	Nil
Coin Collection	\$ 500	\$1,150	Nil
Sewing Machine	\$1,900	\$1,400	\$100
Shares of Duff	\$2,400	\$1,200	\$ 60

(A) Required:

For each item, calculate the capital gain or loss that Marge incurs when she sells that item. **Show all your calculations to obtain full marks!**

① Part B

PUP.	Proceeds	Cost	Selling\$	Difference	Capital Gain/Loss
Vehicle	3,000			-4,600 ①	- nil -
Sewing machine	1,900	1,400	100 ①	400 ①	Gain 400
Shares of duff NOT PUP	2,400	1,200	60 ①	1,140 ①	Gain 1,140
TOTAL					1,540
CAP					
gain on					
PUP.					

Listed Property.

Jewellery	1,500	1,000* ①	- nil -	500 ①	Gain 500
Coin collection	1,000* ①	1,150	- nil -	(150) ①	Loss 150
Total					350
Capital					
gain.					

* Price floor of \$1,000 rule.

(B) Required:

How will Marge report her capital gains or losses on her income tax return?
Show all your calculations to obtain full marks!

Marge would report a Capital gain of :

$$\textcircled{1} (1,540 \times .5) = 770 \text{ on personal use property}$$

and

A capital gain of $(350 \times .5) = 175$ on the listed property. $\textcircled{1}$

Therefore, she would report a total of :

$$(770 + 175) = 945 \text{ of capital gain on her income tax return.}$$

$\textcircled{1}$ for allocation

Question #4: Short Answer (20 Marks at 2 Marks per answer)

Provide only the answer in the right hand column.

Question	Answer ONLY
<p>During the current year, the taxpayer receives \$3,000 in eligible dividends from taxable Canadian corporations. What is the amount of Taxable Dividend the taxpayer must report on their Income Tax Return?</p>	<p>* 4,320 ✓</p>
<p>What is the federal dividend tax credit on non-eligible dividends?</p>	<p>2/3 of the gross-up.</p>
<p>What is the gross-up on a non-eligible dividend?</p>	<p>25% ✓</p>
<p>The taxpayer has lived in his personal residence continuously since purchasing it in 2000 for \$200,000 and owns no other residences. This year (2010), he sold his house for \$260,000 in a private sale, therefore he did not pay real estate fees. Assuming all elections and designations are made, what is the taxable capital gain to be reported on his 2010 Income Tax Return?</p>	<p>-nil- ✓</p>
<p>The taxpayer sells a piece of land for \$800,000. The adjusted cost base of the property is \$300,000 (there are no selling costs). The taxpayer receives \$200,000 in 2010. The remaining \$600,000 is to be paid in \$100,000 annual installments commencing in 2011. What is the amount of the capital gain to be reported on the 2010 Income Tax Return assuming the maximum reserve is claimed?</p>	<p>** 62,500 ✓</p>
<p>Over the past couple of years, the taxpayer has been purchasing shares of Binford Tools, a publicly traded company. Specifically, she purchased 200 shares for \$4.50/share in November 2009, 100 shares for \$2.25/share in April 2010 and 500 shares for \$5.35/share in August 2010. Calculate the taxpayer's adjusted cost base per share.</p>	<p>*** \$4.75 ✓</p>
<p>DairyCo is a large Canadian milk producer. Demand for their product was extremely high so they deliberately exceeded their milk quota to meet this demand. The company was fined \$25,000 by the Provincial Milk Marketing Board for exceeding their quota and expensed the fine on their Income Statement. Is this fine deductible for tax purposes?</p>	<p>Yes, this fine was paid to earn X business income ∴ deductible. Actual answer is -no.</p>

Some of the Capital Gains on small business, farming and fishing property is exempt from tax under the Lifetime Capital Gains Exemption. What is the current amount of the Lifetime Capital Gains Exemption?	750,000 ✓
How far back can you carryback a capital loss? (1 Mark)	3 years. ✓
How far forward can you carry forward a capital loss? (1 Mark)	indefinitely. ✓
On August 31, 2010, the building in which the taxpayer operates their business burns down. The company has a September 30, 2010 year end. By what date do they have to replace the building in order to take advantage of the replacement property rules?	September 30, 2012. ✓

Ult. * 3,000 × 1.44 = 4,320

** Capital Gain Reserve 500,000

lesser of:
 (500,000) ($\frac{600,000}{300,000}$) 375,000

(100,000)(4-0) 400,000

Capital gain 125,000

1/2 inclusion 62,500

*** Transaction	# shares	Total Value
(200 × 4.50)	200	
(100 × 2.25)	300	
(500 × 5.35)	800	3,800
		\$ 4.75