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### Mid-Term Exam #2 (2 hours)

ADM 3345 – Tax I  
November 7, 2009

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Question #1	12 /14	
Question # 2	10 /10	
Question # 3	30 /36	
Total:	52 /60	87 /100
	54	90

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I have read the text on academic integrity and I pledge not to have committed or attempted to commit academic fraud in this examination.

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Question #1: Business Income (14 Marks)

185

12

Corporate Securities Incorporated (CSI) sells security-related items such as key fobs, card keys and monitoring systems to businesses throughout Canada. CSI has just completed the company's financial statements for the year ended December 31, 2009. The income statement indicates the company realized a Net Income for the year of \$215,000. The following information was used in the preparation of these financial statements:

- ✓ 1. The company's Cost of Goods Sold was \$312,000. This included \$75,000 for a Reserve for Inventory Obsolescence, because the technology changes rapidly, and a loss of \$5,600 resulting from a theft by one of the company's employees.
- ✓ 2. The company was forced to pay damages of \$15,000 to settle a breach of contract lawsuit arising from a failure to perform a service contract. The amount was expensed on the Income Statement during 2009.
- ✓ 3. The company's property tax expense of \$12,700 is for tax levies against two adjacent properties. A tax of \$8,700 was levied on the company headquarters and a tax of \$4,000 was levied on the adjacent vacant land. The company plans to expand the headquarters building onto the adjacent land; but currently it remains vacant and is used as a temporary parking lot by the employees. The company collect a nominal \$1,500 in parking revenues on the land. ✓
- ✓ 4. The company's expenses include \$10,000 in charitable contributions.
- ✓ 5. Amortization expense on CSI's building, equipment, and furniture & fixtures was \$62,500.
- ✓ 6. In 2007, the company spent \$10,500 in total landscaping costs. The accountant determined the amount should be amortized straight-line over a 5-year period commencing in 2007. As a result, \$2,100 of landscaping costs were expensed in the current year. ✓  
*D* <sup>8400</sup>
- ✓ 7. The company's expenses include \$25,000 in bonuses to management declared at the end of 2009. These bonuses will be paid on February 1, 2010. ✗
- ✓ 8. The company changed insurers during the year and as a result all of its assets had to be appraised. The cost of this appraisal was \$5,600 and the entire amount was expensed during the year.
- ✓ 9. Bad debt expense amounted to \$11,000. ?
10. The balance in the company's CEC account was 6,000 at January 1, 2009. ✓  
*1* →
11. CCA is correctly calculated as 65,700. ✓  
*D* →
12. The company's legal expenses for the year amounted to \$11,150 and were related to the following transactions:

Review of sales contracts	\$6,550
Costs of amending articles of incorporation	\$4,600 ✓
- ✓ 13. The company's expenses included a total amount of \$11,200 for business meals and entertainment. ✓

$$\begin{array}{r} 6000 \\ 3450 \\ \hline 9450 \end{array}$$

Paved 5000  
 ACB 6000  
 4500  
 4250

D 500

14. When the company purchased the vacant land next door, it had been used for parking by the previous owner. There was a small wooden kiosk on the land which had been used by the parking lot attendant and when the property was purchased, \$6,000 of the total purchased price was allocated to the kiosk. In past years, the company stored landscaping equipment in the building, but this year the company contracted out the landscaping and sold the kiosk for \$5,000. The NBV of the kiosk was \$4,500 and the UCC was \$4,250. The kiosk was the only remaining asset in its CCA class.
15. The company provides a company-owned vehicle for the company president. The vehicle had cost the company \$32,000 and the company pays all of the operating costs. The president drove the vehicle a total of 117,000 kilometers, 112,000 of which were carefully documented business travel. The president did not reimburse the company for his personal usage of the company vehicle.

5000

**Required:**

Calculate Corporate Securities Incorporated (CSI)'s Net Income for Tax Purposes (NIFTP) for the year ending December 31, 2009 on the assumption that CSI claims the maximum deductions available to them for tax purposes.

6450

Accounting Income for the year	\$ 215,000 ✓
Additions:	
Reserve for Inventory Obsolescence	75,000 ✓
Property Tax on Land	2,500 ✓
Charitable Donations	10,000 ✓
Amortization Expense	62,500 ✓
Incorporation Costs (see note 1)	4,500 ✓
Business Meads and Ent (50% * 11200)	5,600 ✓
CCA Recapture on Kiosk (see note 2)	750 ✓

**Deductions:**

Landscaping Expense	(8,400) ✓
CEC Amortization for 2009	(661.50) ✓
CCA	(65,700) ✓
Gain on Sale of Kiosk	(500) ✓

**NIFTP**

300,638.50

Solution to Question #1: (14 Marks)

Note 1:

CEC Beg Balance Jan 1, 2009	6000
Add: Incorporation Costs (75¢ x 4600)	3450
	<hr/>
CEC Balance For Amortization	9450
CEC Amortization for 2009	(661.50)
	<hr/>
CEC For The Year Ending Dec 31, 2009	<u><u>\$ 8788.50</u></u>

Note 2:

Proceeds	5000
NBV	4500
	<hr/>
Gain on Sale of Kiosk	500
	<hr/>
UCC	4250
Less: Prof:	
a) 6000	
b) 5000	(5000)
	<hr/>
CCA Recapture	750

**Question #2: Rental Income and CCA (10 Marks)**

10

The taxpayer owns two rental properties, with the following relevant information:

	<u>Building #1</u>	<u>Building #2</u>
ACB	\$ 95,000	\$108,000
UCC	\$ 90,000	\$ 98,000
FMV	\$135,750	\$176,500

Both buildings are class 1 assets which are depreciated for tax purposes at 4% per annum. The taxpayer has decided that for strategic purposes, whenever the amount he can deduct for CCA purposes is restricted, he would prefer to first take the maximum CCA possible on Building #2 and the remainder of deductible CCA on Building #1.

**Part A: Year 1:**

In year 1, the taxpayer experienced the following:

	<u>Building #1</u>	<u>Building #2</u>	<u>Total</u>
Gross Rental Revenues	\$11,400	\$16,800	28200
Mortgage Interest	(4,500)	(5,300)	(9800)
Property Taxes	(2,700)	(3,300)	(6000)
Repairs & Maintenance	(1,300)	(700)	(2000)
Net Rental Income before CCA	<u>2900</u>	<u>7500</u>	<u>10,400</u>

**Required:**

Calculate the amount of net rental income that the taxpayer must include on their income tax return for year 1. Show all of your calculations to obtain full marks!

Revenue		\$ 28200 ✓	
Expenses:			
Mortgage Interest	(9800)		
Property taxes	(6000)		
Repairs and Maintenance	(2000)		
Income before CCA		<u>10400</u>	
Maximum CCA deductible on Buildings:			
CCA Building 1	(3600) ✓		
CCA Building 2	(3920) ✓		
CCA deducted	<u>7520</u>		
Net Rental Income		<u>2880</u> ✓	

  

			<u>Building 2</u>	
			UCC, Beg.	98000
			CCA (4% * 98000)	(3920)
			UCC, Ending	<u>94080</u>
			<u>Building 1</u>	
			UCC, Beg.	90000
			CCA (4% * 90000)	(3600)
			UCC, Ending	<u>86400</u>

Question #2 Continued

**Part B: Year 2:**

In year 2, the taxpayer encountered difficulty renting building #1 and experienced the following:

	<u>Building #1</u>	<u>Building #2</u>	<u>Total</u>
Gross Rental Revenues	\$5,250	\$21,000	26,250
Mortgage Interest	4,200	5,000	9,200
Property Taxes	2,700	3,300	6,000
Repairs & Maintenance	3,500	2,300	5,800

**Required:**

Calculate the amount of net rental income that the taxpayer must include on their income tax return for year 2. Show all of your calculations to obtain full marks!

Revenues 26250  
 Expenses:  
     Mortgage Interest (9200)  
     Property taxes (6000)  
     Repairs and Maintenance (5800)  
 Income before CCA (21,000)  
 Maximum CCA deduction on buildings:  
     CCA Building 1 ~~(1468.80)~~  
     CCA Building 2 ~~(3763.20)~~  
     CCA deducted (5250)  
 Net Rental Income 0

Building 2  
 UCC Beg 94080  
 CCA (4% \* 94080) 3763.20  
 UCC, End 90316.80  
Building 1  
 UCC Beg 94080  
 CCA (4% \* 94080) (3763.20)  
 CCA Restriction (3763.20 - 1468.80) 2294.40  
 UCC, End 92611.20

**Question #3: Property Income (36 Marks)**

**Property Income Part 1 (12 Marks) 10**

During the current year, Amelia sold the following assets:

	<u>Proceeds</u>	<u>ACB</u>	<u>Selling Expenses</u>
Personal Vehicle	\$25,000	\$32,600	\$100
Jewellery	\$2,000	\$ 800	Nil
Coin Collection	\$ 900	\$1,550	Nil
Antique Vase	\$3,500	\$2,200	\$100

**(A) Required:**

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

WP:

	<u>Personal Vehicle</u>	<u>A. Vase</u>
Proceeds <small>credit of 25,000 to bank</small>	25,000	3,500
ACB <small>credit of 32,600 to bank</small>	(32,600)	(2,200)
Selling Expense	(100)	(100)
Capital Gains/Loss	(7,700)	1,200

PP:

	<u>Jewellery</u>	<u>Coin Collection</u>
Proceeds <small>credit of 2,000 to bank</small>	2,000	1,000
ACB <small>credit of 800 to ACB</small>	(1,000)	(1,550)
Selling Expense	0	0
Capital Gain/Loss	1,000	(550)

(B) Required:

How will Amelia report her capital gains or losses on her income tax return from the sale of her personal vehicle, her jewelry, her coin collection and her antique vase?

Show all your calculations to obtain full marks!

PHP: ✓  
Capital Gain  
Exclude 50%  
Taxable Capital Gain

Personal Vehicle <sup>Losses</sup> (Not Reported for PHP) ✓  
—  
—  
—

Antique Vase  
1200  
(600)  
600

LPP:  
Capital Gain / (Loss)  
Exclude 50%  
Taxable Capital Gain/Loss Reported

Jewelry  
1000  
(500)  
500

Coin Collection  
(550)  
275  
(275)

Taxable Capital Gains on PHP reported:  
Vase

600 ✓

Taxable Capital Gains/Losses LPP reported:

Jewelry 500  
Coin Collection (275) 225

Net Taxable Capital Gain Reported

825

**Property Income Part 2** (24 Marks at 2 Marks per answer)

20

Provide only the answer in the right hand column.

Question	Answer ONLY
During the current year, the taxpayer receives \$2,600 in <sup>x1.25</sup> <u>non-eligible</u> <sup>25%</sup> dividends from taxable Canadian corporations. What is the amount of Taxable Dividend the taxpayer must report on their Income Tax Return?	3250 2
What is the federal dividend tax credit on non-eligible dividends?	$(2/3)^* (\text{Gross up})$ 2
The taxpayer has lived in his personal residence continuously since purchasing it in 1996 for \$150,000 and owns no other residences. This year (2009), 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 amount of capital gains to be reported on the 2009 Income Tax Return?	0 2
During the current year, the taxpayer has been purchasing shares of Loblaws Limited, a publicly traded company. Specifically, she purchased 100 shares for \$2.48/share in February, 200 shares for \$5.00/share in April and 500 shares for \$8.00/share in November. Concerned that the share value will decline, in December, Mr. Schlitz sold 500 of his shares for \$9.00 per share in paid \$230 in broker's fees on the sale. Calculate the taxpayer's average cost per share.	$\$ 6.56 / \text{per share}$ 2
The taxpayer (above) subsequently sells 500 of her Loblaws shares for \$9.00 per share or a total Proceeds of Disposition of \$4,500. The Broker charged a fee of \$230.00 to handle the transaction. What is the taxpayer's taxable capital gains upon the disposition of her Loblaws shares?	495 2
What is the amount of the Dividend Gross-up on eligible dividends?	$44\% (45\%)^* (\text{Dividends Received})$ 2

The taxpayer is a courier, delivering mail and parcels throughout downtown Ottawa. Because the downtown is so crowded, the taxpayer frequently receives parking tickets in the normal course of business and expenses them on the Income Statement. Are these fines deductible for tax purposes also?	No 2
What is the amount of Federal Tax Credit on eligible dividends?	$\left(\frac{11}{18}\right)^{\#}$ (Gross Up) 2
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?	(Greater of: a) Cost of Repaired Property b) Proceeds from old Property) Proceeds from old Property 70,000 750,000
How far back can you carryback a capital loss?	3 years 2
How far forward can you carry forward a capital loss?	7 years <sup>∞</sup> X

Capital Losses: to mind. (20 years to

Infinity  
+ 2

Carry forward: very for that type of losses

LB Parcel

Business investment loss

$$100 \times 2.48 = 248$$

$$200 \times 5 = 1000$$

$$500 \times 8 = 4000$$

6.56

4500

(3200)

(930)