



Mid-Term Exam #2 (2 hours)

ADM 3345 – Tax I
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Question #1	11 /15
Question # 2	20/24
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Total:	73/87 84/100

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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 (15 Marks)

Jefferson Cleaners Inc. (“JCI”) operates a chain of dry cleaning stores in the Ottawa area. JCI has just completed its financial statements for the year ended December 31, 2011. The income statement shows Net Income for the year of \$455,000. JCI does not have any bank loans or mortgages. The following information was used in preparation of these financial statements:

- 1) Advertising and Promotion per the financial statements included \$13,480 for business meals.
- 2) The company’s property tax expense for the year was \$48,000. Of this total, \$3,000 related to a piece of vacant land purchased during 2011. JCI plans on building a new location on this land in 2012. During 2011, the company rented this parcel of land to a neighboring business for parking and earned \$1,200 of parking revenue from this vacant land.
- 3) Prior to making the decision to purchase the new parcel of land, JCI obtained an appraisal of the land’s value, at a cost of \$1,500.
- 4) Bad Debt expense totaled \$1,150.
- 5) Amortization expense on the company’s assets was calculated at \$21,480.
- 6) CCA was correctly calculated to be \$24,620.
- 7) The balance in the company’s CEC account was \$4,000 at January 1, 2011.
- 8) During the year the company incurred legal fees totaling \$6,500 relating to the following transactions:
 - i. Legal action in connection with stolen clothing \$3,000
 - ii. Amending the articles of incorporation \$1,500
 - iii. Purchase of the new parcel of land \$2,000
- 9) The company paid fines of \$80,000 to the city for the illegal disposal of dry cleaning chemicals.
- 10) Included in the insurance expense is \$5,000 of life insurance premiums for a policy on the life of JCI’s president, George Jefferson.
- 11) The company paid \$7,200 for a golf membership for George Jefferson. George dislikes golf and has only ever played with existing and prospective clients.
- 12) The company’s expenses include \$40,000 in bonuses to management declared at the end of 2011. These bonuses will be paid on April 30, 2012.

Required:

Calculate JCI’s Net Income for Tax Purposes (NIFTP) for the year ending December 31, 2011 on the assumption that JCI claims the maximum deductions available to them for tax purposes.

Solution to Question #1: (15 Marks)

Accounting Net Income

455 000 |

Additions

Business meals (50%)	6740
Property tax	1800
land appraisal	1200
Amortization - assets	21480
Article of Incorporation	1500
New Parcel of land	2000
Golf membership	2200
	<hr/>

41920

496920

Deductions

CCA	(24620)
CBC (Note 1)	(463.75)
	<hr/>

(25083.75)

471836.25 |

Net Income for Tax Purposes

Note 1

CBC beginning	4000
Additions	
[.75 x 1500]	1125
[.75 x 2000]	1500
	<hr/>
CBC balance	6625
Deductions (7%)	463.75

Question #2 Continued

Part B: 2012:

In 2012, Mr. Heckles encountered difficulty renting building #2 and experienced the following:

	<u>Building #1</u>	<u>Building #2</u> - min
Gross Rental Revenues	\$24,000	\$9,000
Mortgage Interest	3,500	8,750
Property Taxes	3,700	3,300
Repairs & Maintenance	1,950	2,400

Required:

Calculate the amount of net rental income that Mr. Heckles must include on his 2012 income tax return. Given the difficulty renting building #2, Mr. Heckles is contemplating selling it in the near future. If a decision must be made in 2012 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)! Round to the nearest dollar!

Revenue	33 000	
[24000 + 9000]		
less expenses:		
Mortgage Interest	(12 250)	
[3500 + 8750]		
Property tax	(7 000)	
[3700 + 3300]		
Repairs & Maintenance	(4 350)	(23 600)
[1950 + 2400]	<u> </u>	<u> </u>
Rental Income before CCA		9 400
CCA Building 1	(6 627.84)	
CCA Building 2	(2 772.16)	(9 400)
Net Rental Income		<u> </u> NIL

Building 1

UCC beg	165 696
CCA deduction (47%)	(6 627.84)
UCC ending	<u>159 068.16</u>

Building 2

UCC beg	196 000
CCA deduct (47%)	(7 840)
CCA Restriction	50 67.84
UCC ending	<u>193 227.84</u>

Question #2 Continued

Part C: 2013:

In 2013, Mr. Heckles decides to sell building #2. His total proceeds net of selling costs were \$300,000 (\$240,000 building/\$60,000 land). His total net rental income, before CCA and recapture/terminal loss, is \$5,000.

Required:

Calculate the amount of net rental income Mr. Heckles must include on his 2013 income tax return. Also, calculate any taxable capital gain or loss to be reported on the sale of the second property.

Assume that opening UCC of Building 1 = \$150,000 and opening UCC of Building 2 = \$190,000. DO NOT use your prior numbers from Part B! Show all of your calculations to obtain full marks (including ending UCC balances)!

Net Rental Income before CCA	5000
CCA Recapture	(10000)
CCA deductions	(6000)
Net Rental Income	<u>9000</u>

Also, 20000 [(240000 - 200000) x .5]
should be added to income as
taxable capital gain.

Building 1

UCC beg	150000
CCA deductions (4-1-)	(6000)
UCC ending	<u>144000</u>

Building 2

UCC beg	190000
less Disposition:	
ACB 200000	(200000)
POD 240000	<u>10000</u>
CCA Recapture	

POD	240000
ACB	200000
Capital gain	<u>40000</u>
Taxable capital gain	20000

Question #3 Capital Gains (24 Marks)

Part A:

During the current year, Ms Ellen Parsons sold the following assets:

	<u>Proceeds</u>	<u>ACB</u>	<u>Selling Expenses</u>
Harley Davidson motorcycle	\$19,250	\$12,600	\$100
A 1902 5 cent coin (CDN)	\$11,000	\$ 800	Nil
Stamp Collection	\$ 600	\$ 1,550	\$500
Hyundai Elantra-2010	\$12,000	\$15,500	Nil

Required:

- For each item, identify the tax consequences. Specifically, calculate the amounts that must be included on the income tax return for each item sold.
- Identify the aggregate outcome of the dispositions. How will the gains/losses be reported on Ellen's income tax return? **Show all your calculations to obtain full marks! (9 Marks total)**

PUP

Harley

Proceeds of disposition	19250	
less the aggregate of:		
Adjusted cost base	(12600)	
Expense of disposition	(100)	(12700)
Capital gain		6550
Taxable capital gain		3275

Hyundai

POD	12000	
less the aggregate of:		
ACB	(15500)	
Expense	(0)	(15500)
Capital loss		(3500)
* Not allowed		

LPP

Cent coin

POD	11000	
less the aggregate of:		
ACB	(1000)	
Expenses	(0)	(1000)
Capital gain		10000
Taxable capital gain		5000

Stamp Collection

POD	1000	
less the aggregate of:		
ACB	(1550)	
Expenses	(500)	(2050)
Capital loss		(1050)
Allowable capital loss		(525)

Question 3, Part A continued

2

PUP

Capital gain - Harley 32751

LPP

Capital gain - 5cent coin 50001

Allowable Capital loss - Stamp Collection (525)

Gain added to Income 7750

Question #3 continued

Part B

During the current year, Mr. Hank Moody has been purchasing shares of Bank of Nova Scotia (BNS), a publicly traded company. Specifically, he purchased 100 shares for \$52.50/share in February, 300 shares for \$55.00/share in April and 500 shares for \$60.00/share in September. Concerned that the share value will decline due to the Greek debt issue, Hank sold 800 of his shares in November for \$59.00 per share and paid \$180 in broker's fees on the sale.

Required:

Calculate Hank's adjusted cost base per share and taxable capital gain (loss) upon the disposition of his of Bank of Nova Scotia shares. **Show all your calculations to obtain full marks! (5 Marks)**

Solution:

100	@	52.50	5250
300	@	55	16500
<u>500</u>	@	<u>60</u>	<u>30000</u>
900			<u>51750</u>

$$\text{Cost per share} = \frac{51750}{900} = \$57.5/\text{share}$$

Proceeds		47200
[800 x 59]		
less aggregate of:		
ACB	(46000)	
[800 x 57.5]		
Expense	<u>(180)</u>	<u>(46180)</u>
Capital gain		1020
Taxable capital gain (50%)		<u><u>510</u></u>

(5)

Question #3 continued

Part C:

During 2011, Phil Dunfy sold a condominium to an unrelated person for total proceeds of \$1,000,000. The ACB of the condo was \$500,000 and Phil did not incur any selling costs on the disposition. At no time was the condo ever his principal residence. The buyer paid Phil \$100,000 on closing and was required to pay \$100,000 per year for the next 9 years (starting next year). Phil is not the most financially savvy individual; he is not charging interest on the outstanding balance.

Required:

Calculate the taxable capital gain that Phil will need to report on his tax return in 2011 and 2012. Show all calculations on how this amount determined. Since Phil never knew about the concept of CCA, recapture is not a concern. **Show all your calculations to obtain full marks! (10 marks)**

2011

Proceeds of disposition	1 000 000
Less	(500 000)
Adjusted cost base	<hr/> 500 000
Capital gain	
less current years reserve	
lesser of:	
1) $(500\ 000) \left(\frac{900\ 000}{1\ 000\ 000} \right) = 450\ 000$	
2) $(0.20 \times 500\ 000) (4 - 0) = 400\ 000$	<hr/> (400 000)
Net Capital gain	100 000
Taxable capital gain (50%)	<hr/> <u>50 000</u>

2012

Previous years reserve	400 000
less current years reserve	
lesser of:	
1) $(500\ 000) \left(\frac{800\ 000}{1\ 000\ 000} \right) = 400\ 000$	
2) $(0.20 \times 500\ 000) (4 - 1) = 300\ 000$	<hr/> (300 000)
Net Capital gain	100 000
Taxable capital gain (50%)	<hr/> <u>50 000</u>

(10)

10/24

Question #3, Part C continued

Question #4: Short Answer (24 Marks at 2 Marks per answer)

Provide only the answer in the right hand column.

Question	Answer ONLY
During the current year, Barney Stinson receives \$5,000 in non-eligible dividends from Mosbuis Designs. What is the amount of Taxable Dividend Barney must report on his Income Tax Return? <p style="text-align: right;">.25</p>	6250 <p style="text-align: right;">2</p>
What is the federal dividend tax credit on non-eligible dividends?	2/3 x gross up <p style="text-align: right;">2</p>
During the year, Barney also received \$8,000 in eligible dividends from GNB. What is the amount of the Taxable Dividend he must report on his Income Tax Return? <p style="text-align: right;">.41</p>	11 280 <p style="text-align: right;">2</p>
Nancy Botwin purchased a 5 year \$100,000 GIC on <u>July 1, 2011</u> . The GIC has a 5% interest rate, but Nancy does not receive any annual interest payments; instead, she receives \$25,000 of interest on June 30, 2016 when the GIC matures. When is Nancy first required to report interest on the GIC and how much will this amount be?	July 1, 2012 <p style="text-align: right;">2</p> \$ 5000 <p style="text-align: right;">2</p>
Charlie was tragically killed in a subway accident. Per the terms of his will, his beach house was transferred to his brother Alan. Charlie had lived in the house continuously since purchasing it in 2003 for \$750,000 and he owned no other residences. The fair market value of the house at the time of his death was \$1,260,000. What is Alan's adjusted cost base of the house?	1 260 000 <p style="text-align: right;">2</p>
Assuming all elections and designations are made, what is the taxable capital gain to be reported on Charlie's terminal Income Tax Return?	0 <p style="text-align: right;">2</p>
Dunder-Mifflin has a <u>October 31</u> fiscal year-end. During its 2011 fiscal year, the company decided to expand its operations. As part of the expansion they sold their existing office building on September 30, 2011. By what date do they have to replace the building in order to take advantage of the replacement property rules?	September 30, 2012 <p style="text-align: right;">0</p>
Timmy's is a large coffee shop chain based in southern Ontario. Due to American protectionism laws, they are banned from operating in the US. However, Timmy's decides to run a series of advertisements on a US TV station directed at its Canadian customers. Is the advertising expense deductible for tax purposes?	NO <p style="text-align: right;">2</p>
How far back can you carry back a capital loss?	3 years <p style="text-align: right;">2</p>
How far forward can you carry forward a capital loss?	7 years <p style="text-align: right;">0</p>
A superficial loss occurs if a taxpayer or their spouse or common-law partner acquires the same or identical property within how many days prior to or after the disposition?	36 months <p style="text-align: right;">0</p>