



## Second Exam

**ADM 3345**  
**Taxation I**  
**March 12, 2016**

Professor: Kerr

Duration: 2 hours

**INSTRUCTIONS**

1. Books and notes **are not** permitted.
2. Calculators **are** permitted.
3. Answer in the exam booklets provided.

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18  
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**NAME:** \_\_\_\_\_

**STUDENT** \_\_\_\_\_

**Statement of Academic Integrity**

The School of Management does not condone academic fraud, an act by a student that may result in a false academic evaluation of that student or of another student. Without limiting the generality of this definition, academic fraud occurs when a student commits any of the following offences: plagiarism or cheating of any kind, use of books, notes, mathematical tables, dictionaries or other study aid unless an explicit written note to the contrary appears on the exam, to have in his/her possession cameras, radios (radios with head sets), tape recorders, pagers, cell phones, or any other communication device which has not been previously authorized in writing.

**Statement to be signed by the student:**

I have read the + \_\_\_\_\_ academic integrity and I pledge not to have committed or attempted + \_\_\_\_\_ nic fraud in this examination.

Signed: \_\_\_\_\_

Note: an examination copy or booklet without that signed statement will not be graded and will receive a final exam grade of zero.

**Part I**

Mr. Carlos Santini is 45 years of age and divorced from his former spouse, Gloria. Because Gloria is an extremely successful actress, she is constantly traveling. Given this, Carlos and Gloria concluded it would be best if he retained custody of their three children. None of the children had any income during 2015. They can be described as follows:

**Andrew** Andrew is 5 years old.

**Lolita** Lolita is 12 years old and blind.

**Estelle** Estelle is 19 years old and is dependent on Carlos because of a physical disability. She does not, however, qualify for the disability tax credit.

Gloria is very well paid for her work and, as a consequence, is required to make monthly payments of \$10,000 per month to Carlos. Of this amount, \$3,500 is designated as spousal support, with the remaining \$6,500 designated as child support. All required amounts were paid during 2015.

Mr. Santini uses a national agency to provide full time child care. The 2015 costs for the three children total \$22,500. In addition, Lolita and Estelle attend a summer camp for four weeks during 2015. The cost of this camp is \$500 per child per week. The camp fees do not qualify for the child fitness credit or the children's arts credit. During the period when Lolita and Estelle are at camp, Carlos incurs additional costs for care of Andrew of \$1,000. This \$1,000 is not included in the \$22,500 paid to the national agency.

In 2013 and previous years, Carlos worked for a large public company. During this period he received options to purchase 8,000 shares of the Company's stock for \$15 per share. The shares were trading for \$14 per share at this time. On June 1, 2015, he exercises these options. On this date, the shares are trading at \$22.50 per share.

On December 1, 2015, he sells all of these shares for \$25.00 per share. The commission on the transaction is \$2,000.

Beginning in 2010 on a part time basis and then on a full time basis beginning in 2013, Mr. Santini operated an unincorporated accounting and tax return preparation business in Toronto. The business uses a taxation year that ends on December 31. On January 1, 2015, the business has the following capital assets (all computer equipment is leased):

	Adjusted Cost Base Or Capital Cost	UCC
Building	\$200,000	\$165,000
Land (Site For The Building)	100,000	N/A
Furniture And Fixtures	45,000	28,600

Mr. Santini owns a minivan that he uses for personal purposes. On January 3, 2015, he purchased an automobile for \$52,000 that he will use exclusively for business purposes.

For 2015, the business has net income before CCA expense of \$19,300.

During April 2015, Carlos' parents and twin brother are arrested in a highly publicized raid on a counterfeit operation and he loses most of his clients. As a result, he decides to move his family and his business from Toronto, Ontario to Kamloops, British Columbia. He flies to Kamloops in June, 2015 to find a suitable home. He returns to Toronto where he learns that his offer to purchase a house has been accepted. Carlos moves to his new home in September, 2015. He earns \$34,000 of employment income for the remainder of the year.

Mr. Santini sells his 'new' automobile back to the dealership for \$45,000 in August of 2015.

The building in which his business operates in Toronto is sold for \$425,000. Of this amount, it is estimated that \$125,000 relates to the land. The furniture and fixtures are sold for \$32,400.

Since 2004, Mr. Santini has owned both a house in Toronto and a cottage near Huntsville where he and his family spent the summers. The house cost \$273,900 and is sold in 2015 for \$420,000. As part of the sale agreement, he replaced the heating system at a cost of \$5,000. The cottage cost \$156,000 and is sold in 2015 for \$350,000.

✓ A selling commission is paid on each sale in the amount of 4.5 percent of the selling price. ✓ On the advice of his tax accountant, Mr. Santini plans to deduct the sales commission and legal fees on the house as moving expenses and account for the sales commission and legal fees on the cottage as selling costs.

Other costs associated with the move are as follows:

Legal Fees On Sale Of Huntsville Cottage	\$ 675 ✓
Legal Fees On Sale Of Toronto House	850 ✓
Legal Fees On Acquisition Of Kamloops House	940 ✓
Payments For Moving And Storage	9,800 ✓
Cost Of Kamloops Trip To Locate New Residence	1,400 ✓
Hotel, Food, And Gasoline On Drive To Kamloops (5 Days)	1,860 ✓
Costs Of Hotel And Food In Kamloops While Waiting For Completion Of Renovations On New House (12 Days)	<u>4,675</u> ✓
Total	\$20,200 ✓

**Required:** Calculate the following for Mr. Santini (please clearly show all calculations):

1. 4 marks

His net employment income and ensuing capital gain relating to the stock options,

No longer works, but stock options count as employment income. Public Company, benefits factored in at option exercise.

$$\begin{aligned} \text{Employment Income} &= (8,000 \text{ shares}) (\$22.50 - \$15.00) \\ &= (8,000 \text{ shares}) (\$7.50) \end{aligned}$$

$$\boxed{\text{Employment Income} = \$60,000}$$

not included in

$$\begin{aligned} \text{Taxable Capital Gains} \\ \text{Shares} & \frac{172}{172} (1800 (\$22.50) - \$2000) \\ &= \$9,000 \end{aligned}$$

+ End of year Employment Income	\$34,000
Employment Income (Stock)	60,000
<u>Net Employment Income</u>	<u>\$94,000</u>

2. 8 marks

His child care expenses for 2015,

Cost limit = \$275/week Lolita = \$125 Estelle

Child Care cost (\$22,500 + \$1,000)	\$23,500
Deductible limit - 4 weeks x (\$275 + \$125)	1,600
Total Child Care Cost	<u>\$25,100</u>

Least Between:

(2/3) (Employment income)  
 $\Rightarrow (2/3) (\$94,000) \approx \$62,666.67$

Child Care Expense for 2015

\$24,000

b) Annual Limit

- ① \$11,000 - Lolita (disable tax credit)
  - ② \$8,000 - Arthur (Age 7 or younger)
  - ③ \$5,000 - Estelle (dependent over 16, not eligible for disability)
- } \$24,000

Amount Paid for Child Care Cost = \$25,100

3. 2 marks

How much of the payments from Gloria to Carlos are taxable?

Spousal Support

Spousal Support (\$3,500 x 12 months)

\$42,000 => taxable

\* \$6,800/month child support not included.

4. 8 marks

What are the capital gains, recapture and/or terminal loss relating to sale of the Toronto business assets (show all calculations)?

Building

Buy UCC

\$165,000

P. Basis

Proceeds of Disposition

\$300,000

ACB

(200,000)

Capital Gain

\$100,000

Taxable Capital Gain (50%)

\$50,000

Less: Disposition, lessor dt:

(a) cost 200,000

(b) proceed 300,000

\$200,000

UCC Recapture (\$35,000)

\$50,000 + \$35,000 = \$85,000 added to taxable income

~~Automobile~~

Furniture

~~Proceeds~~

~~\$45,000~~

Proceeds

\$32,400

~~ACB~~

~~(52,000)~~

ACB

(45,000)

~~Capital Loss~~

~~(\$7,000)~~

Capital Loss

(12,600)

~~Taxable Capital Gain~~

~~NA~~

Taxable Capital Gain

AC/A

Loss:

(a) cost = \$45,000

(b) proceed = \$32,400 (\$12,600)

Terminal Loss

\$6,900

Land

Proceeds

\$125,000

ACB

(100,000)

Capital Gain

\$25,000

Taxable Capital Gain

\$12,500

(50%)

5. 8 marks

Determine how much of a capital gain he'll pay tax on relating to sale of the two Ontario properties using his principal residence deduction (show detailed calculation).

	<u>House</u>	<u>Cottage</u>
Proceeds of Disposition	\$420,000	\$360,000
Adjusted Cost Base <sup>including</sup> - (273,400 + 5000) <sub>system</sub> <sup>dependent</sup>	(278,900)	
- 156,000		(156,000)
Commissions @ 4.5%		
- N/A (Money spent can't be deducted (capital gain))	N/A	
- Cost of Selling (\$360,000 x 4.5%)		(15,750)
Legal fees		
- N/A	N/A	
- <del>On</del> Sale of Hantsville Cottage		(675)
Capital Gain Before Exemption	\$141,100	\$177,575
Exemption		
- (\$141,000) $\left[ \frac{(1+18)}{12} \right] \times 2$	(28,517)	
→ (\$177,575) $\left[ \left( \frac{11-1}{12} \right) \right] \times 3$		(177,575)
Capital Gain	\$112,583	Nil
Inclusion Rate	(1/2)	(1/2)
Taxable Capital Gain	<u>\$56,291.50</u>	<u>Nil</u>

6. 10 marks

What is the amount of moving expense deduction he will claim in 2015, what is the amount (if any) of carry-forward he will have?

Can deduct, since has employment income since Sept. 15 - End 2015.

Real Estate Commissions on <sup>Toronto</sup> House (\$470,000 x 4.5%)	\$8,400
Legal Fees on sale of Toronto House	800
Legal Fees sale of Kamloops House	940
	9,000
Moving & Storage Payments	
Hotel, Food, & Gasoline on Drive to Kamloops	1,860
(cost of Hotel & Food in Kamloops while waiting for completion of Renovations on New House 12 Days)	4675.2
<u>Total Moving Expenses Deduction</u>	<u>937,025</u>
	(3400)

limited

Part II

1. 5 marks

In early 2015, Carol Martin sells all of her common shares in Martin Ltd., an eligible small business corporation. She had owned the shares for 10 years. The shares had an adjusted cost base of \$895,000 and were sold for proceeds of disposition of \$985,000. Using these proceeds, she made two investments in other eligible small business corporations:

1. She used \$200,000 of the proceeds to invest in Barby Ltd.
2. She used \$600,000 of the proceeds to invest in Ken Inc.

The remaining proceeds remained in her savings account at the end of 2015. How much of the capital gain arising on the sale of the Martin Ltd. shares can be deferred by the investments in Barby and Ken? If the maximum deferral is elected, what will be the adjusted cost base of these two investments?

ACB of new investments?

ACB \$895,000 Disposition \$985,000

Capital Gain = \$985,000 - \$895,000 = \$90,000

$(\$90,000) (\$800,000 \div \$985,000) = \boxed{73,046.45}$  <sup>Max</sup> Gain Deferral Limit

Cost of Investments	<u>Acty Shares</u>	<u>Ken Shares</u>
	\$700,000	\$600,000
Deferral		
- [ \$73,046.45 ( $\frac{\$200,000}{\$600,000}$ ) ]	(18,274.11)	(54,822.34)
- [ ( \$73,046.45 ) ( $\frac{\$600,000}{\$800,000}$ ) ]		
ACB	<u>\$181,725.89</u>	<u>\$545,177.66</u>

2. 5 marks

During the 2015 taxation year, Ms. Andrea Molsen receives non-eligible dividends of \$14,200. Her income is such that this additional amount will be taxed at a 26 percent federal rate and a 7 percent provincial rate. The provincial dividend tax credit on non-eligible dividends is 25 percent. Determine the total federal and provincial tax that will be payable on these dividends and her after tax retention.

Non-Eligible Dividends Received	\$14,200
Gross Up At 18%	2,556
Taxable Dividend	\$16,756
Combined Fed/Prov Tax Rate (26% + 7%)	33%
Tax Before Dividend Temp Credit	\$5,529.48
Dividend Tax Credit [ (18% + 25%) (2556) ]	(2,485)
Federal & Prov Tax Payable	<u>\$3,044.48</u>

33%

After Tax Retention  
 = \$14,200 - \$3,044.48  
 = \$11,155.52

3. 8 marks

Dr. Sweet is a dentist with a well established practice in Smith Falls, Ontario. She has sought your advice regarding the deductibility of the following expenditures made during the current taxation year:

- Insurance payments included a \$680 premium for coverage of her office and contents, \$1,800 for malpractice coverage, and \$1,700 in life insurance premiums. ✓ + y
- Payments were made to a collection agency in the amount of \$1,250 for assistance in collecting past due amounts from patients.
- Contributions of \$600 were made to various registered charities. ✗
- Dr. Sweet paid a total of \$18,000 to her husband for his services as a full time bookkeeper and receptionist. ✓
- A total of \$4,600 was spent to attend a dental convention in Phoenix, Arizona. Dr. Sweet was accompanied by her husband and \$1,500 of the total cost of the trip relates directly to him.

- 6. An amount of \$1,000 was paid for membership in a racquets club. In addition, \$1,300 was spent for court time, approximately 40 percent of which was for time spent playing with patients.
- 7. Dr. Sweet paid \$1,200 in legal and accounting fees. These fees related to fighting a personal income tax reassessment for a previous tax year. The fight was not successful and, as a consequence, Dr. Sweet was required to pay additional taxes of \$13,000, plus \$1,600 in interest on the late payments.
- 8. During the year, Dr. Sweet spent \$3,200 purchasing provincial lottery tickets.

**Required:** Advise Dr. Sweet with respect to the deductibility of the preceding expenditures in the calculation of Net Income For Tax Purposes. Explain your position on each expenditure.

1. Life Insurance \$1,200 not deductible. Life insurance not included in business income. \$680 premium for coverage of office; \$1,600 for malpractice coverage are deductible off business income.

2. \$1,250 for assistance in collecting past due amounts (acc. receivable) is deductible off business income.

3. Charitable donations are not deductible off business income but will be subtracted off tax payable. (\$600)

4. Can be deducted as business expense, since services are rendered for the practice and is a necessity for business to function. \$8,100

5. \$4,600 = (\$1,800 + \$3,100) is deductible as business expense, since husband rendered services for the practice, he can be included for full amount.

6. \$1,000 membership not deductible. But part of \$1,300 is since it relates to clients.  $(\$1,300 \times \frac{1}{2} \times 40\%) = \$260$  deductible.

7. All fees deductible here other than interest of late payment.

8. Lottery tickets will not be part of business income, so not deductible. Does not contribute to business operations. Lottery winnings will be taxed separately.

