



## Term Test #1 (1 hour, 15 Minutes)

ADM 4344M– Tax II  
January 23, 2014  
Prof. Kathryn Pedwell

Student Name:: Michelle Auger

Student I.D.: 6399239

Question #1	8 /9
Question # 2	30.5 /33.5
Question #3	8 /8
Total:	46.5 /50   93.4% /100

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

Signed: Michelle Auger

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

## Question #1: Taxable Income from Business (9 Marks)

Handy-Dandy Tools is a successful proprietorship that sells and services power tools of all types. Using GAAP, the accountant for the business has calculated the Net Income for the business for the year January 1 to December 31, 2013 was \$298,000.

1. The following information relates to the calculation of that Net Income: ✓
2. The increase in the Reserve for Warranties during the year was \$14,500, based on a self-insurance warranty program. ✓
3. Parking tickets received by the owner of the proprietorship totaled \$980. These tickets were incurred in the course of conducting business and, therefore, deducted in the accounting records. ✓
4. During the year, Handy-Dandy Tools spent \$15,600 landscaping the grounds around the retail store. The entire amount was deducted as an expense in the accounting records. OK
5. The Net Income includes an amortization expense of \$53,750. CCA has been correctly calculated as \$62,000. ✓
6. The business failed to pay its municipal taxes on time and was charged interest of \$975. ? OK
7. A contribution of \$4,300 was made to a registered charity during the year. ✓
8. Included in revenues was a payment of \$31,200 from an insurance company to compensate for the loss of profits when Handy-Dandy Tools was closed for two weeks due to a major water leak. ✓
9. Handy-Dandy Tools provides volume discounts to its best customers. During the year, such discounts amounted to \$21,250. ✓
10. Handy-Dandy Tools paid \$1,400 for membership in a local golf and country club and another \$3,400 for meals and entertainment expenses incurred at the club for entertaining important clients and suppliers. ✓
11. Handy-Dandy Tools incurred and expensed appraisal costs of \$7,400 in order to determine the current market values of certain capital assets that it intends to sell. sell - add back
12. Because the owner's 6 year old son is very popular with his peers at his school, he was paid a monthly fee of \$1,000 (\$12,000 for the year) to promote Handy-Dandy tools to the students in his school. The fee was deducted as an advertising expense on the financial statements.
13. During 2013, the owner of Handy-Dandy Tools began to operate a marijuana grow-op in the back storage room of the business premises.. Although this "business" is illegal, he insisted that the profits of \$28,500 be included in the Net Income of Handy-Dandy Tools. OK
14. As the business is unincorporated, no taxes were deducted in calculating Net Income on the financial statements.

**Required:**

Calculate the Business Income (Loss) that will be included on the owner's Income Tax Return for 2013.

**Show all your calculations to obtain full marks!**

Net income under GAAP		298 000
additions:		
warranty reserve	(1)	14 500
parking tickets	(1)	980
amortization	(1)	53 750
charity membership	(1)	4 300
meals	(1)	1 400
appraisal costs	(1)	1 700
		7 400
		13 000 ?
deduct:		
CCA	(1)	(62 000)
business income		<hr/> 320 030
		SON + 12 000
		income = 332 030

**Question #2: Acquisition of Control**

Lawn Fertilizer Inc. (LF) is struggling to stay in business in a very competitive industry – the gardening and lawn services industry. LF has a December 31 year end.

Owing to the competitive market, LF has experienced the following losses:

Year	Non-Capital Loss	Net Capital Loss
2011	\$180,000	\$65,000 = (1/2)(\$130,000)
2012	\$140,000	Nil

= 320 000

= 65 000

Ontario Lawn Care Ltd. (OLCL) will purchase all the shares of LF effective May 1, 2012. The relevant values for LF's assets on May 1, 2013 are as follows:

Asset	Cost	UCC	FMV
Inventory	\$100,000		\$105,000
Land	\$450,000		\$925,000
Building (Class 1)	\$675,000	\$515,000	\$650,000
Furniture (Class 8)	\$ 25,000	\$ 10,000	\$ 15,000
Manufacturing Equipment (Class 29)	\$415,000	\$375,000	\$285,000

} 25  
10  
40

Examining the business prospects for 2013, LF estimates that it will lose \$125,000 in 2013. This is composed of the actual loss of \$55,000 up to April 30, 2013 and an estimated loss of \$70,000 for the remainder of the year.

**Required:**

Answer the questions on the following pages.

**Show all your calculations!**

lesser of:

1. FMV

2. greater of

ACB

designated

**Part A:** If LC decides to utilize election ITA 111(4)(e) by writing up ALL of its assets to its maximum allowable values, what would be the tax consequences (amount and designation)?

Asset	Effect
Inventory	write down to lower of ACB and FMV $105,000 - 100,000 = 5,000$ business loss (NON capital) <span style="float: right;">5</span>
Land	$925,000 - 450,000 = 475,000$ capital gain <span style="float: right;">3(b)</span> $237,500$ taxable <span style="float: right;">2</span>
Building	CCA recapture = $650,000 - 515,000 = 135,000$ <span style="float: right;">1</span> <del>loss of = <math>675,000 - 650,000 = 25,000</math> (NON capital)</del> <span style="float: right;">1</span>
Furniture	CCA recapture = $15,000 - 10,000 = 5,000$ <span style="float: right;">1</span> <del>loss of = <math>25,000 - 15,000 = 10,000</math> (NON capital)</del> <span style="float: right;">1</span>
Mfg Equipment	terminal loss = $375,000 - 285,000 = 90,000$ <span style="float: right;">2</span> normally would be reduced by CCA but not given rate <span style="float: right;">5</span>

B	F	E
$675$ ACB $650$ FMV $515$ UCC }	$25$ ACB $15$ FMV $10$ UCC	$415$ ACB $375$ UCC  $285$ FMV

**Part B:** Calculate LF's 2013 Business Income ending April 30, 2013.

actual business loss	(55,000)
written down on inventory	(5,000)
CCA recapture (building)	135,000
loss on sale	(25,000)
CCA recapture (furniture)	5,000
loss on sale	(10,000)
terminal loss on equipment	(90,000)
	(45,000)

correct

(55,000)
5,000
135,000
5,000
(90,000)
0

7.5

+ 7.5

Part C: Using proper aggregating formula format, calculate LF's Taxable Income for the year ending April 30, 2013.

3(a) income from all sources

∅ (1) (2)

3(b) net taxable capital gains  
gain on land

237 500 (1)

3(c) subdivision e deductions

N/A

3(d) current year losses  
business loss (45000)  
elect to use

∅ (1)

---

237 500

NIFTP

division C deductions:

charity ∅  
capital LCF (restricted)  
to 3(b)

(65 000) (1)

NON-CAPITAL LCF  
(237 500 - 65 000)

(172 500) (1)

taxable income

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0 (1)

8

---

15.5

Part D: Identify the amount of Net Capital Loss that expires on April 30, 2013.

begin amount	65 000
amount used	<u>(65 000)</u>
left	Ø

∴ nothing expires on April 30, 2013 because it was all used up. (1)

Part E: Identify the amount of Non-Capital Loss that remains for OLCL to utilize after April 30, 2013 AND identify the conditions under which OLCL can use those losses.

Correct

190 000
140 000
<u>(172 500)</u>
147 500

2011 amount	180 000
2012 amount	140 000
2013 amount	45 000
used amount	<u>(172 500)</u>
	192 500

(1)

the amount of non-capital loss that remains for OLCL is \$ 192 500.

Conditions under which OLCL can use these Non-Capital losses:

1. they have to continue in the same line of business (or similar line) (1)
2. reasonable expectation of future profits (1)
3. they will use the carry-forwards against income generated under the same or similar line of business (1)

5  
2015

+ - 20.5

**Part F:** LF wants to use ITA 111(4)(e) more strategically. It wants to create only enough capital gains to offset its capital losses. To which asset(s) do you recommend that LF apply ITA 111(4)(e) AND to what amount would you recommend LF write that asset(s)? they would only

Need to generate a capital gain of 65000.  
to create this gain:

why you can write the land up to an amount that would create this.

ACB land:	450 000
gain needed:	<u>130 000</u>
	580 000

(2)

$$(580000 - 450000) \times 0.5 = 65000 \text{ taxable gain}$$

write land at \$580 000.

**Part G:** Calculate the Net Business Income of LF as of April 30, 2013, given that ITA 111(4)(e) is used strategically.

business loss	(55000)
equipment terminal loss	(90000)
write down inventory	(5000)
CCA recapture (building)	135000
building loss on sale	(25000)
CCA recapture (furniture)	5000
furniture loss on sale	(10000)
	<u>(45000)</u>

not unc.

correct:

(55000)
(90000) terminal
<u>(145000)</u>

amount stays the same because only land was changed.

~~2~~  
22.5

+ -22.5

**Part H:** Using proper aggregating formula format, calculate LF's Taxable Income for the year ending April 30, 2013 when it uses ITA 111(4)(e) strategically.

3(a) income from all sources	∅	(1)	(2)
3(b) net taxable capital gains gain on sale of land	65000	(1)	
3(c) subdivision e deductions	NA		
3(d) current year losses max. business loss (45000)	∅	(1)	
NIF TP			
division C deductions			
charity	∅		
capital LCF (restricted to 3b)	(65000)	(1)	
taxable income	∅	(1)	

**Part I:** Calculate the Non-Capital Losses to carried forward to OLCL effective May 1, 2013 under this strategic option.

correct

180 000
140 000
145 000
<hr/>
465 000

2011 amount	190 000
2012 amount	140 000
2013 amount	45 000
used	∅

<hr/>	
365 000 left	(1)
	8
	30.5

**Corporate Tax Short Answer Questions (8 Marks – 2 marks per question)**

Question	Your Answer												
How long can a capital loss be carried forward?	indefinitely 2												
What is the maximum amount of Charitable Contribution that can be deducted by a corporate taxpayer in Division C?	75% NIFTP 2												
What is the carry back provision for Charitable contributions that cannot be deducted in the current year?	No carrybacks 5 year carry forward 2												
<p>Diversco Inc. has the following provincial allocation:</p> <table border="1" data-bbox="198 856 912 1018"> <tbody> <tr> <td>New Brunswick</td> <td><math>(20\% + 15\%)/2</math></td> <td>17.5%</td> </tr> <tr> <td>Ontario</td> <td><math>(30\% + 20\%)/2</math></td> <td>25.0%</td> </tr> <tr> <td>British Columbia</td> <td><math>(40\% + 35\%)/2</math></td> <td>37.5%</td> </tr> <tr> <td>Fargo, North Dakota</td> <td><math>(10\% + 30\%)/2</math></td> <td>20.0%</td> </tr> </tbody> </table> <p>Identify the total dollar value of the Abatement available to Diversco Inc. on its Taxable Income of \$150,000.</p>	New Brunswick	$(20\% + 15\%)/2$	17.5%	Ontario	$(30\% + 20\%)/2$	25.0%	British Columbia	$(40\% + 35\%)/2$	37.5%	Fargo, North Dakota	$(10\% + 30\%)/2$	20.0%	<p>80% Canadian income</p> $= 150,000 \times 80\% \times 10\%$ $= 12,000$ <p>2</p>
New Brunswick	$(20\% + 15\%)/2$	17.5%											
Ontario	$(30\% + 20\%)/2$	25.0%											
British Columbia	$(40\% + 35\%)/2$	37.5%											
Fargo, North Dakota	$(10\% + 30\%)/2$	20.0%											