

Question #1: Business Income (14 Marks)

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.

non-deductible
 ↑
 deductible
 ↓
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. ✓ $10500 - 2100 = 8400$
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.

~~$6000 \times 0.07 = 420$~~
 $[6000 + \frac{3}{4}(4600)] \times 0.07$
11. CCA is correctly calculated as 65,700.
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 × Capitalize CEC
13. The company's expenses included a total amount of \$11,200 for business meals and entertainment.

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.

UCC 4250
 - 5000
 -750
 750 recapture

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.

GAAP treatment applies

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.

Solution to Question #1: (14 Marks)

Net Income through GAAP 215,000 (1)

Additions

- Reserve for obsolete inventory 75,000 (1)
- Since the land is being used as a temporary parking lot & collecting business income, the property tax may be expensed 10,000 (1)
- Charitable donations 62,500 (1)
- Amortization expense 5,600 (-1)
- Appraisals 4,600 (1)
- Legal costs - add back amount related to incorporating articles, it should be considered CEC 560 (1)
- Meals & Entertainment $(11,200 \times .5)$ 750 (1)
- Recapture on sold kiosk $(4250 - 5000)$ 379,050

Deductions

- Landscaping costs $(10500 - 2100)$ (8400) x
- CEC $\rightarrow [6000 + \frac{3}{4}(4600)] \times .07$ (662)
- CCA \rightarrow (65,700) (1)

Taxable income (1) \rightarrow \$304,288

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

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>
Gross Rental Revenues	\$11,400	\$16,800
Mortgage Interest	4,500	5,300
Property Taxes	2,700	3,300
Repairs & Maintenance	1,300	700

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!

Rental Income (11,400 + 16,800)	28,200 (1)
Mortgage interest expense (4,500 + 5,300)	(9,800)
Property tax expense (2,700 + 3,300)	(6,000)
Repairs & Maintenance (1,300 + 700)	(2,000)
CCA [⁽¹⁾ 90,000(.04) + ⁽¹⁾ 98,000(.04)]	(7,520)
Net rental income	<u>2,880 (1)</u>

$$\begin{aligned} \text{UCC Building 1 } & (90,000 - (90,000 \times .04)) = 86,400 \\ \text{Building 2 } & (98,000 - (98,000 \times .04)) = 94,080 \end{aligned}$$

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>
Gross Rental Revenues	\$5,250	\$21,000
Mortgage Interest	4,200	5,000
Property Taxes	2,700	3,300
Repairs & Maintenance	3,500	2,300

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!

Rental income (5,250 + 21,000)	26,250
Mortgage interest expense (5,000 + 4,200)	(9,200)
Property taxes (2,700 + 3,300)	(6,000)
Repairs & Maintenance (3,500 + 2,300)	(5,800)
Net rental income before CCA	5,250 (1)
CCA - lesser of -5,250 →	(5,250)
$[(86,400 + 94,080) \cdot 0.04] = 7,219$ (1)	
Net rental income	Nil (1)

if < 5,250
↑

UCC building 2 $94,080 - (94,080 \times 0.04)$
 $94,080 - 3,763 (1) = 90,317$

building 1 $86,400 - (5,250 - 3,763) = 84,913$
 $86,400 - 1,487 =$
(1)

Question #3: Property Income (36 Marks)

Property Income Part 1 (12 Marks)

During the current year, Amelia sold the following assets:

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

	PUP	LPP
Personal vehicle		
proceeds (25,000-100) ⁽¹⁾	24,900	
Cost	(32,600)	
Capital loss	<u>(7,700)</u> ⁽¹⁾	
Jewellery		
proceeds		2,000
Cost (1000 Floor)		(1000) ⁽¹⁾
Capital gain		<u>1000</u> ⁽¹⁾
Coin Collection		
proceeds (1000 Floor)		1000 ⁽¹⁾
Cost		(1550)
Capital loss		<u>(550)</u> ⁽¹⁾
Antique vase		
proceeds (3500-100) ⁽¹⁾		3400
Cost		(2200)
Capital gain		<u>1200</u> ⁽¹⁾

(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!

The items she sold will be classified under 2 categories

- Personal use property (PUP)

- personal vehicle, capital loss of 7,700

Income Tax: She will not report a capital loss since it can only be deducted against ~~PUP~~^X capital gains.

- Listed personal property (LPP)

- Jewellery capital gain \$1000 (2000 - 1000)

- Coin collection capital loss \$(550) (1000 - 1550)

- Antique vase capital gain \$1200 (3500 - 1000 - (2200))

Total capital gain \$1650

On the income tax, Amelia will report a taxable capital gain of $\frac{1}{2}$ of her capital gain of 1650

$$\text{Taxable capital gain } \frac{1650}{2} = \$825$$

① for allocation though incurred

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

Provide only the answer in the right hand column.

Question	Answer ONLY
During the current year, the taxpayer receives \$2,600 in non-eligible 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 of the gross ✓(2) UP
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 /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?	45% ✓(2)

<p>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?</p>	<p>NO! ✓⁽²⁾</p>
<p>What is the amount of Federal Tax Credit on eligible dividends?</p>	<p>11/18 of the gross up ✓⁽²⁾</p>
<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?</p>	<p>1000 X</p>
<p>How far back can you carryback a capital loss?</p>	<p>3 years ✓⁽²⁾</p>
<p>How far forward can you carry forward a capital loss?</p>	<p>7 years X</p>