

## CHAPTER ONE SOLUTIONS

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### Solution to Assignment Problem One - 1

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**Note To Instructor** If you are assigning this problem, note that only the first two answers can be found in Chapter 1 of the text.

The circumstances under which a general provision of the *Income Tax Act* can be overridden are as follows:

1. In those situations where there is a conflict between the provisions of an international tax treaty and the *Income Tax Act*, the terms of the international tax treaty will prevail.
2. While court decisions cannot be used to change the actual tax law, court decisions may call into question the reasonableness of interpretations of the ITA made by either the CRA or tax practitioners.
3. In some cases, a more specific provision of the *Act* will contain an exception to a general rule. For example, while ITA 18(1)(b) does not allow the deduction of capital expenditures in computing business income, ITA 20(1)(aa) contains a provision that allows the deduction of landscaping costs.

## Solution to Assignment Problem One - 2

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Some of the possible examples of conflicts between objectives would be as follows:

1. **Revenue Generation And International Competitiveness** The need to lower rates of taxation in order to be competitive on an international basis is in conflict with the need to generate revenues.
2. **Fairness And Simplicity** In order to make a tax system simple, a single or small number of tax rates must be applied to a well established concept of income with only a limited number of deductions or exceptions available. This is in conflict with the goal of tailoring the system to be fair to specific types of individuals, such as the disabled.
3. **Revenue Generation And Social Goals** The desire to provide funds to certain types of individuals (Old Age Security) or to provide certain types of services (health care) may be in conflict with the need to generate tax revenues.
4. **Flexibility And Certainty** To make a tax system flexible in changing economic, political, and social circumstances, there must be some uncertainty.

## Solution to Assignment Problem One - 3

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There is, of course, no one solution to this problem. Further, student answers will be limited as, at this point, their understanding of tax concepts and procedures is fairly limited. However, the problem should provide the basis of an interesting discussion. What we have provided here are some suggested comments related to the various qualitative characteristics.

**International Competitiveness** This is, perhaps, the most important reason for the tax rate reduction for corporations. At 35 percent, the U.S. corporate tax rate was higher than the corresponding rate in any other OECD country (e.g., the federal rate in Canada is 15 percent). If a country's tax system has rates that are out of line with those in comparable countries, the result will be an outflow of both business and skilled individuals to those countries that have more favourable tax rates.

**Adequacy** This is another important consideration. There is a belief in some circles that lowering tax rates on business will, because of the positive effect on economic activity, produce an increase in tax revenues. Evidence on the validity of this view is mixed. If this view is not valid, a reduction in corporate tax revenues will have to be accompanied by an increase in other types of taxes or, alternatively, a reduction in government expenses.

**Balance Between Sectors** Prior to the rate reduction, the U.S. had a high corporate tax rate, a relatively low maximum rate on individuals and no federal sales tax. If cutting the corporate tax rate results in either an increase in individual tax rates or the introduction of a federal sales tax, this would represent a significant change in the balance between corporations and individuals.

**Equity Or Fairness** If the reduction in corporate taxes results in increased taxes on individuals, some would argue that the change is not equitable or fair.

**Neutrality** The reduction in corporate taxes is not neutral in that it is likely to have a large impact on economic decisions. For example, it could result in some of the huge cash balances that U.S. companies are holding abroad being repatriated to the U.S.

**Elasticity** The reduction in corporate taxes wouldn't really alter the elasticity of the corporate tax system. Revenues would continue to move in a manner that is directly related to corporate profits.

**Flexibility** The reduction in corporate taxes would not alter flexibility of the corporate tax system. Before and after the reduction, tax rates can be changed by the relevant legislative body.

**Simplicity And Ease Of Compliance** Ease of compliance has little to do with the specific rate being charged. This characteristic is controlled by the rules related to the application of the rate.

**Certainty** There is uncertainty related to the reduction in corporate taxes in that the revenue outcome is uncertain. Proponents of the reduction expect an increase in revenue while opponents expect a decline in revenues.

## Solution to Assignment Problem One - 4

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While there is not one “correct” solution to this problem, the following solution contains comments on each of the listed qualitative characteristics.

**Equity Or Fairness** The toll is clearly regressive in nature in that it is assessed almost exclusively on lower income individuals. In general, regressive taxes are viewed as being less fair. While the toll has horizontal equity (individuals with the same Taxable Income would pay the same amounts), it lacks vertical equity (the higher income residents of the island would not normally be subject to the tolls).

**Neutrality** The concept of neutrality calls for a tax system that interferes as little as possible with decision making. The toll may influence employment decisions. If the non-residents have off-island employment opportunities, they may choose not to work on the island.

**Adequacy** While we do not have any information on this, it would be safe to assume that the toll was established at a level that would be adequate for the funding requirements related to the bridge.

**Elasticity** Tax revenues should be capable of being adjusted to meet changes in economic conditions, without necessitating tax rate changes. It is not clear from the problem whether economic conditions would influence the number of individuals who work on the island and pay the toll.

**Flexibility** This refers to the ease with which the tax system can be adjusted to meet changing economic or social conditions. The tolls can be easily adjusted and, thereby get high marks for this characteristic.

**Simplicity And Ease Of Compliance** A good tax system is easy to comply with and does not present significant administrative problems for the people enforcing the system. The toll would receive high marks in this regard.

**Certainty** Individual taxpayers should know how much tax they have to pay, the basis for payments, and the due date. There is no uncertainty associated with a clearly posted toll rate.

**Balance Between Sectors** A good tax system should not be overly reliant on either corporate or individual taxation. The toll is, of course, totally reliant on the taxation of individuals.

**International Competitiveness** If a country’s tax system has rates that are out of line with those in comparable countries, the result will be an outflow of both business and skilled individuals to those countries that have more favourable tax rates. Although international competitiveness would not appear to be an issue with the toll, it would affect the ability of the city to maintain and attract workers.

## Solution to Assignment Problem One - 5

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### ***Solution According To Textbook***

Mr. Valone would be considered a part year resident and would only be assessed for Canadian income taxes on worldwide income during the portion of the year prior to his ceasing to be a resident of Canada.

S5-F1-C1 indicates that, in general, the CRA will view an individual as becoming a non-resident on the latest of three dates:

- The date the individual leaves Canada.
- The date the individual's spouse or common-law partner and dependants leave Canada.
- The date the individual becomes a resident of another country.

While Mr. Valone departed from Canada on March 1, 2019, he will be considered a Canadian resident until his family's departure on June 20, 2019. The fact that his family remained in Canada would lead to this conclusion. While not essential to this conclusion, the fact that he did not sell his Canadian residence until that date would provide additional support.

His Canadian salary from January 1, 2019 to March 1, 2019 would be subject to Canadian taxes. In addition, his U.S. salary for the period March 1, 2019 through June 20, 2019 will be subject, first to U.S. taxes, and then subsequently to Canadian taxes. In calculating his Canadian taxes payable, he will receive a credit for the U.S. taxes which he has paid on this income. However, because Canadian tax rates at a given income level are usually higher than those which prevail in the U.S., it is likely that he will be required to pay some Canadian income taxes in addition to the U.S. taxes.

### ***Note To Instructors***

The preceding solution reflects the content of the text with respect to departures from Canada and students should be evaluated on that basis. However, S5-F1-C1 qualifies the general departure rules as follows:

**Paragraph 1.22** An exception to this will occur where the individual was resident in another country prior to entering Canada and is leaving to re-establish his or her residence in that country. In this case, the individual will generally become a non-resident on the date he or she leaves Canada, even if, for example, his or her spouse or common law partner remains temporarily behind in Canada to dispose of their dwelling place in Canada or so that their dependants may complete a school year already in progress.

On the assumption that Mr. Valone was a resident of the U.S. prior to his working years in Canada, this exception would mean that he would cease to be a resident of Canada on March 1, 2019, the date that he departs from Canada.

The textbook does not deal with the residency rules of countries other than Canada. Although this solution concludes that June 20 is the date residency is terminated in Canada, it is probable that the foreign jurisdiction (the U.S.) would consider Mr. Valone to be resident under their own rules effective March 1. In effect, the period between March 1 and June 20 would become a dual residency period. We would not expect students to come to this conclusion, but include this to illustrate the complexities of international issues in taxation.

## Solution to Assignment Problem One - 6

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**Note To Instructors** This problem is based on a Tax Court Of Canada case, Hamel Vs. The Queen (2012 DTC 1004). The actual year in question is 2007, with the judgment being rendered in 2011. We have moved the dates in the problem up by 8 years. It is our opinion that, since this judgment was rendered, there have been no legislative or other changes that would alter the conclusions reached by Tax Court judge in this case.

### **Background**

The minister assessed Mr. Hamel on the basis of his not giving up Canadian residency on January 13, 2007 (the original date in the case). Mr. Hamel appealed to the Tax Court of Canada which resulted in Hamel Vs. The Queen (2012 DTC 1004).

The solution that follows is the judge's analysis and decision in the case (note that it was translated from French). The judge's conclusion also contained a long section of references to other cases which we have not included in this solution. The original dates in the solution have been changed to correspond to the dates in the problem.

### **Judge's Analysis And Decision**

The respondent's main argument is that every person must have a residence. Presuming the appellant had not resided in Qatar, she found that he must necessarily have resided in Canada.

After arriving at this conclusion, she relied on the following facts:

- The appellant came to Canada a few times.
- The appellant had two bank accounts in Canada, which he used to make all his payments, in particular for his credit cards, which were also issued in Canada.
- The appellant had some money in an RRSP.
- The appellant had no postal address in Qatar.

As for the other elements, for example, not having a driver's licence, not having property such as furniture, clothing, accommodations or vehicles, and not having a health insurance card, the respondent claims that they have no impact one way or the other.

The evidence clearly showed that the appellant's decision came after a lengthy period of reflection. It also showed that the appellant did not have any deep roots and did not hesitate to leave when his son, who was ill, let him go with no regrets.

His relationship with his wife was so tense that they tolerated one another only because of their shared concern about their son who was ill.

The appellant had a very good position. He did not want to run away from his responsibilities. He gave all his property and agreed to pay generous support payments before leaving; he has always complied with these commitments. He did not apply for a new Canadian driver's licence when his was suspended, even though the evidence showed it was important for him to be able to use a car if he wanted an international driver's license or even a driver's licence from the country in which he was living.

He specifically gave up his health card in 2017.

Regarding the beginning of the relevant period of the appeal, the beginning of 2016 (the original year), it must be considered that a reasonable person would be careful. The appellant stated he could only get a work permit if a medical exam showed he was in good health, otherwise he had to return to his country of origin. The same can be said for the position, the duration of which generally depends on the employer, not the employee. In other words, there is, normally, a reasonable delay before a permanent break. This explains the time between the beginning of the period in question and the time the appellant gave up his health insurance.

As for the argument that the appellant never had a residence in Qatar, I do not believe it is cogent, because the appellant was employed and had a residence. The appellant's strong interest in staying in Qatar was shown by the intensive courses he took to get a driver's licence, when he could have traveled with coworkers, even though he had cancelled his Canadian driver's licence. When his employment ended in Qatar, the appellant returned to the country to see the people with whom he had worked and the work he had done.

In particular, in view of the following facts, I find that, on the preponderance of the evidence, the appellant's position must be accepted:

- The family context was special and conducive to a permanent departure.
- The appellant left after disposing of all his own property.
- The appellant waived his right to obtain a new driver's licence a few months before leaving Canada.
- The appellant returned to Canada a few times for very short stays that were for the purpose of visiting his two sons, his mother and friends.

After leaving Qatar upon the expiry of his work contract, the appellant returned to meet friends and business acquaintances, thereby showing he had been happy there.

The break came after a long period of thorough reflection.

The appellant has set out all the facts showing his intention to sever ties with this country permanently.

Although the relevance of prior facts is limited, they tend to confirm that the appellant severed his ties with Canada in mid-January 2016.

For these reasons, I conclude that the appellant ceased being a resident of Canada as of January 13, 2016. As a result, the appeal is allowed with costs in favour of the appellant.

## Solution to Assignment Problem One - 7

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### Case A

Residency terminates at the latest of:

- the date the individual leaves Canada;
- the date the individual's family leaves Canada; and
- the date that individual establishes residency elsewhere.

As Gary's family did not leave Canada until June 30, 2019, Gary would be considered a Canadian resident until that date. Provided he has no intention of returning to Canada, he would be a Canadian resident for the period January 1, 2019 through June 30, 2019. He would be subject to Part I tax on his world wide income during this period. He would not be subject to Part I tax on his rental income subject to that date.

**Note To Instructors** As will be discussed in Chapter 20, the tax on the rental income would not be subject to Part I tax. It would be Part XIII tax.

### Case B

As noted in S5-F1-C1, "Determining an Individual's Residence Status", commuting from the U.S. for employment purposes does not make an individual a deemed resident under the sojourner rules. Therefore, Sarah would not be considered a Canadian resident for income tax purposes.

Sarah would be subject to Canadian tax on her 2019 Canadian employment income. She would not be subject to Canadian tax on her U.S. savings account interest.

### Case C

Byron's cruise would be considered a temporary absence from Canada. Given the facts, it appears his intent is not to permanently sever residential ties with Canada. This position is evidenced by the fact his cruise is for a limited time and he will not be establishing residency in another country.

Byron's departure does not appear to be a true departure in that he has only taken a leave of absence from his job. In addition, he has retained some residential ties.

Given these facts, Byron will remain a Canadian resident during his cruise and would be subject to Canadian tax on his worldwide income during all of 2019.

### Case D

As she is exempt from taxation in Germany because she is the spouse of a deemed Canadian resident, Hilda would be a deemed resident of Canada for income tax purposes during 2019 [(ITA 250(1)(g)].

Hilda would be subject to Canadian tax on her worldwide income during 2019.

### Case E

Because she has an employment contract that requires her to return to Canada in 2022, she will be viewed as having retained Canadian residence status. Although she has severed her ties with Canada, the requirement to return would show that she does not intend to permanently leave Canada.

Jessica will be subject to Canadian tax on her worldwide income during 2019.



## Solution to Assignment Problem One - 8

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### ***Canada/U.S. Tax Treaty Tie Breaker Rule***

In cases of dual residency for corporations, where a corporation could be considered a resident of both countries, the Canada/U.S. tax treaty indicates that the corporation will be deemed to be a resident only in the country in which it is incorporated.

### ***Case A***

The mind and management of the Allor Company are in Canada and this suggests that the Company is a resident of Canada. However, as the Allor Company was incorporated in the U.S., it is also a resident of that country. Using the tie breaker rule, the Allor Company will be considered a resident of the U.S. and a non-resident of Canada.

### ***Case B***

Kodar Ltd. was incorporated in Canada after April 26, 1965. This means that, under ITA 250(4)(a), Kodar Ltd. is a deemed resident of Canada. Because the mind and management of the Company are in the United States, it is also considered a resident of the U.S. Using the tie breaker rule, Kodar Ltd. will be considered a resident of Canada as it was incorporated in Canada.

### ***Case C***

The Karlos Company was not incorporated in Canada and its mind and management are not currently located in Canada. Therefore, Karlos would not be considered a resident of Canada.

### ***Case D***

While Bradlee Inc. is not operating in Canada, it was incorporated here prior to April 27, 1965. If it had not carried on business in Canada after that date, it would not be a Canadian resident. However, it did carry on business in Canada after that date and, as a consequence, it is a deemed resident under ITA 250(4)(c).

As the mind and management of the Company are currently in the United States, the Company is also a resident of that country. Under the tie breaker rule, Bradlee Inc. would be a resident of Canada as it was incorporated in Canada.

## Solution to Assignment Problem One - 9

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### **Part A**

Brian Palm would be considered a part year resident of Canada until July 31, 2019, the date of his departure and would be taxed on his worldwide income for this period. As his presence in Canada during the first part of the year was on a full time basis, he would not fall under the sojourning rules.

### **Part B**

Rachel is a deemed resident of Canada under ITA 250(1)(b). As Gunter is exempt from German taxation because he is related to Rachel, he is also considered a deemed resident of Canada under ITA 250(1)(g).

### **Part C**

As she is present in Canada on a temporary basis for more than 183 days per year, she would be considered a sojourner. Under ITA 250(1)(a), this would make her a Canadian resident for income tax purposes for all of 2019.

### **Part D**

Martha would be a Canadian resident for income tax purposes during 2019. An individual is not considered to have departed from Canada until the latest of the departure date, the date of departure for their spouse and children, and the date on which residence is established in a different country. As her family is staying in Canada and Martha will not be establishing residency in another country, she will remain a Canadian resident during her trip. The fact that she is a U.S. citizen is irrelevant to her residency status.

### **Part E**

ITA 250(4)(c) indicates that a corporation is resident in Canada if it was incorporated in Canada prior to April 27, 1965 and carried on business, or was resident in Canada, in any year ending after April 26, 1965. However, as the mind and the management of the company is in the U.S., it is also a resident of that country. In cases of dual residency for corporations, where a corporation could be considered a resident of both countries, the Canada/U.S. tax treaty indicates that the corporation will be deemed to be a resident only in the country in which it is incorporated. Given this, Bronson Inc. would be a resident of Canada.

### **Part F**

The company was not incorporated in Canada and the mind and management of the company is not in Canada. Ubex Ltd. is not a resident of Canada.

## Solution to Assignment Problem One - 10

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In cases of dual residency, the Canada/U.S. tax treaty has tie breaker rules. Under these rules residence would be determined by applying criteria in the following order:

- **Permanent Home** If the individual has a permanent home available in only one country, the individual will be considered a resident of that country. A permanent home means a dwelling, rented or purchased, that is continuously available at all times. For this purpose, a home that would only be used for a short duration would not be considered a permanent home.
- **Centre of Vital Interests** If the individual has permanent homes in both countries, or in neither, then this test looks to the country in which the individual's personal and economic relations are greatest. Such relations are virtually identical to the ties that are examined when determining factual residence for individuals.
- **Habitual Abode** If the first two tests do not yield a determination, then the country where the individual spends more time will be considered the country of residence.
- **Citizenship** If the tie-breaker rules still fail to resolve the issue, then the individual will be considered a resident of the country where the individual is a citizen.
- **Competent Authority** If none of the preceding tests resolve the question of residency then, as a last resort, the so-called "competent authority procedures" are used. Without describing them in detail, these procedures are aimed at opening a dialogue between the two countries for the purpose of resolving the conflict.

### Case A

As Ty was in Canada for more than 183 days, he is a deemed resident through the application of the sojourner rule. This means that he is likely to be considered a resident in both the United States and Canada. In such situations, the tie breaker rules would be applicable

It does not appear that Ty has a permanent home, a centre of vital interests, or a habitual abode. Therefore, it would appear that the fact that Ty is a citizen of the U.S. would be the determining factor. This treaty result would override the sojourner rule, making Ty a non-resident of Canada.

### Case B

As he is in Canada for more than 183 days, Jordan would be a deemed Canadian resident under the sojourner rules. As in Case A, it is likely that he would be considered a resident in both countries. Given this the tie breaker rules would be applicable. As Jordan appears to have a permanent home in Kalispell, these rules would make him a resident of the United States. This treaty result would override the sojourner rule, making Jordan a non-resident of Canada.

## Solution to Assignment Problem One - 11

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### ***Accountant's View***

The accountant's definition uses historical cost accounting following GAAP. Under GAAP, revenue is generally recognized when goods are sold or services delivered. Expenses are then matched against these revenues, with the resulting difference referred to as accounting Net Income.

### ***Economist's View***

The economist's definition of income includes all gains, whether realized or unrealized, as increases in net economic power.

### ***Income Tax Act View***

Conceptually, the ITA view is very similar to the accountant's view. However, there are many differences which result from the application of complex rules in the ITA. For example, a portion of capital gains is not considered to be Taxable Income under the ITA view. In contrast, both accountants and economists would include 100 percent of such gains in income. Note, however, the timing would be different as economists would tend to recognize such gains prior to the realization. Accountants generally do not recognize capital gains until they are realized through a disposition of the relevant asset.

## Solution to Assignment Problem One - 12

### Case One

The Case One solution would be calculated as follows:

Income Under ITA 3(a):		
Net Employment Income		\$62,350
Income Under ITA 3(b):		
Taxable Capital Gains		
[(1/2)(\$97,650)]	\$48,825	
Allowable Capital Losses		
[(1/2)(\$5,430)]	( 2,715)	46,110
Balance From ITA 3(a) And (b)		\$108,460
Subdivision e Deduction:		
Deductible RRSP Contribution		( 4,560)
Balance From ITA 3(c)		\$103,900
Deduction Under ITA 3(d):		
Net Business Loss		( 115,600)
Net Income For Tax Purposes (Division B Income)		Nil

In this Case, Karla has an unused business loss carry over of \$11,700 (\$103,900 - \$115,600).

### Case Two

The Case Two solution would be calculated as follows:

Income Under ITA 3(a):		
Net Employment Income	\$45,600	
Net Business Income	<u>27,310</u>	\$72,910
Income Under ITA 3(b):		
Taxable Capital Gains		
[(1/2)(\$31,620)]	\$15,810	
Allowable Capital Losses		
[(1/2)(\$41,650)]	( 20,825)	Nil
Balance From ITA 3(a) And (b)		\$72,910
Subdivision e Deduction:		
Spousal Support Payments [(12)(\$600)]		( 7,200)
Balance From ITA 3(c)		\$65,710
Deduction Under ITA 3(d):		
Net Rental Loss		( 4,600)
Net Income For Tax Purposes (Division B Income)		\$61,110

In this Case, Karla has an unused allowable capital loss carry over of \$5,015 (\$20,825 - \$15,810). As Karla's gambling activity does not appear to be substantial enough to be considered a business, the \$46,000 in winnings would not be taxable.

## Solution to Assignment Problem One - 13

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### Case A

The Case A solution would be calculated as follows:

Income Under ITA 3(a):		
Employment Income	\$58,200	
Rental Income	<u>5,400</u>	\$63,600
Income Under ITA 3(b):		
Taxable Capital Gains	\$31,600	
Allowable Capital Losses	<u>( 12,400)</u>	19,200
Balance From ITA 3(a) And (b)		\$82,800
Subdivision e Deductions		<u>( 4,100)</u>
Balance From ITA 3(c)		\$78,700
Deduction Under ITA 3(d):		
Business Loss		<u>( 12,300)</u>
Net Income For Tax Purposes (Division B Income)		<u>\$66,400</u>

In this Case, Mr. Denham has no loss carry overs at the end of the year.

### Case B

The Case B solution would be calculated as follows:

Income Under ITA 3(a):		
Employment Income	\$82,600	
Rental Income	<u>12,200</u>	\$94,800
Income Under ITA 3(b):		
Taxable Capital Gains	\$15,600	
Allowable Capital Losses	<u>( 23,400)</u>	Nil
Balance From ITA 3(a) And (b)		\$94,800
Subdivision e Deductions		<u>( 5,400)</u>
Balance From ITA 3(c)		\$89,400
Deduction Under ITA 3(d):		
Business Loss		<u>( 8,400)</u>
Net Income For Tax Purposes (Division B Income)		<u>\$81,000</u>

In this Case, Mr. Denham has an allowable capital loss carry over of \$7,800 (\$15,600 - \$23,400).

**Case C**

The Case C solution would be calculated as follows:

Income Under ITA 3(a):		
Employment Income	\$46,700	
Rental Income	2,600	\$49,300
Income Under ITA 3(b):		
Taxable Capital Gains	\$11,600	
Allowable Capital Losses	( 10,700)	900
Balance From ITA 3(a) and (b)		\$50,200
Subdivision e Deductions		( 11,600)
Balance From ITA 3(c)		\$38,600
Deduction Under ITA 3(d):		
Business Loss		( 62,300)
Net Income For Tax Purposes (Division B Income)		Nil

In this Case, Mr. Denham would have a business loss carry over in the amount of \$23,700 (\$38,600 - \$62,300).

**Case D**

The Case D solution would be calculated as follows:

Income Under ITA 3(a):		
Employment Income		\$33,400
Income Under ITA 3(b):		
Taxable Capital Gains	\$23,100	
Allowable Capital Losses	( 24,700)	Nil
Balance From ITA 3(a) And (b)		\$33,400
Subdivision e Deductions		( 5,600)
Balance From ITA 3(c)		\$27,800
Deduction Under ITA 3(d):		
Business Loss		( 46,200)
Rental Loss		( 18,300)
Net Income For Tax Purposes (Division B Income)		Nil

Mr. Denham would have a carry over business and rental losses in the amount of \$36,700 (\$27,800 - \$46,200 - \$18,300) and of allowable capital losses in the amount of \$1,600 (\$23,100 - \$24,700).

## CHAPTER TWO SOLUTIONS

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### Solution to Assignment Problem Two - 1

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While there are alternatives in all Cases, the following answers represent the “minimum” instalments, as required in the problem.

#### **Part A - Case One**

Ms. Nite's net tax owing in each of the three years is as follows:

$$\begin{aligned} 2017 &= \$4,400 (\$18,880 - \$14,480) \\ 2018 &= \$600 (\$20,320 - \$19,720) \\ 2019 &= \$3,120 (\$21,760 - \$18,640) \text{ Estimated} \end{aligned}$$

As her net tax owing is expected to exceed \$3,000 in 2019 and was more than \$3,000 in 2017, the payment of instalments is required.

If the CRA's instalment reminder approach was used, the first two instalments total \$2,200  $[(2)(\$4,400 \div 4)]$ . As this \$2,200 exceeds the total for 2018, the remaining two instalments would be nil.

The best alternative would be to base the instalments on 2018 net tax owing. This would result in quarterly instalments of \$150  $(\$600 \div 4)$ , for a total of \$600. This is significantly lower than the \$2,200 required in the first two instalments under the CRA approach.

#### **Part A - Case Two**

Ms. Nite's net tax owing in each of the three years is as follows:

$$\begin{aligned} 2017 &= \text{Nil} (\$18,880 - \$19,280) \\ 2018 &= \$5,440 (\$20,320 - \$14,880) \\ 2019 &= \$3,200 (\$21,760 - \$18,560) \text{ Estimated} \end{aligned}$$

As her net tax owing is expected to exceed \$3,000 in 2019 and was more than \$3,000 in 2018, the payment of instalments is required.

If the CRA's instalment reminder approach was used, the first two instalments would be nil. However, the remaining two instalments would be \$2,720 each  $[(\$5,440 - \text{Nil}) \div 2]$ , for a total of \$5,440.

The best alternative would be to base the instalments on 2019 net tax owing. This would result in quarterly instalments of \$800  $(\$3,200 \div 4)$ , for a total of \$3,200. This is significantly less than the \$5,440 total required under the CRA approach.

#### **Part A - Case Three**

Ms. Nite's net tax owing in each of the three years is as follows:

$$\begin{aligned} 2017 &= \$3,600 (\$18,880 - \$15,280) \\ 2018 &= \$4,160 (\$20,320 - \$16,160) \\ 2019 &= \$2,320 (\$21,760 - \$19,440) \text{ Estimated} \end{aligned}$$

As her net tax owing is not expected to exceed \$3,000 in 2019, the payment of instalments is not required. However, if the 2019 net tax owing turned out to exceed \$3,000, then instalments would have been required. She may be charged interest on the insufficient instalments if the interest totals more than \$25.

#### **Part B**

In Case One and Case Two, the required instalments would be due on March 15, 2019, June 15, 2019, September 15, 2019 and December 15, 2019.



## Solution to Assignment Problem Two - 2

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### Part A

Under ITA 157(1), Ledux Inc. would have three alternatives with respect to the calculation of its instalment payments. The alternatives and the relevant calculations are as follows:

**Current Year Base** The instalment payments could be 1/12th of the estimated Tax Payable for the current year. In this case the resulting instalments would be \$16,945.42 per month ( $\$203,345 \div 12$ ).

**Preceding Year Base** The instalment payments could be 1/12th of the Tax Payable in the immediately preceding taxation year. The resulting instalments would be \$17,963.92 ( $\$215,567 \div 12$ ).

**Preceding And Second Preceding Years** The third alternative would be to base the first two instalments on 1/12th of the Tax Payable in the second preceding year and the remaining instalments on 1/10th of the Tax Payable in the preceding year, less the total amount paid in the first two instalments.

In this case, the first two instalments would be \$16,118.33 ( $\$193,420 \div 12$ ) each, a total of \$32,236.66. The remaining 10 instalments would be \$18,333.03 [ $(\$215,567 - \$32,236.66) \div 10$ ] each. The total instalments under this approach would be \$215,567.

While the third approach would provide the lowest payments for the first two instalments, the payments would total \$215,567. As this is larger than the \$203,345 total when the instalments are based on the current year's estimated Tax Payable, the use of the current year's Tax Payable approach would be the best alternative.

### Part B

If the Company failed to make instalment payments towards the 2019 taxes payable, it would be liable for interest from the date each instalment should have been paid to the balance due date, March 31, 2019.

Assuming the actual 2019 taxes payable are \$203,345, it would be the least of the amounts described in ITA 157(1), and interest would be calculated based on the current year instalment alternative. The rate charged would be the one prescribed in ITR 4301 for amounts owed to the Minister, the regular base rate plus 4 percentage points.

There is a penalty on large amounts of late or deficient instalments. This penalty is specified in ITA 163.1 and is equal to 50 percent of the amount by which the interest owing on the late or deficient instalments exceeds the greater of \$1,000 and 25 percent of the interest that would be owing if no instalments were made. While detailed calculations are not required, we would note that this penalty would clearly be applicable in this case.

Interest on the entire balance of \$203,345 of taxes payable would be charged beginning on the balance due date, March 31, 2019, two months after the end of the 2019 taxation year. The rate charged would be the one prescribed in ITR 4301 for amounts owed to the Minister, the regular base rate plus 4 percentage points.

There is also a penalty for late filing. If no return is filed by the filing due date of July 31, 2019, the penalty amounts to 5 percent of the tax that was unpaid at the filing date, plus 1 percent per complete month of the unpaid tax for a maximum period of 12 months. This penalty is in addition to any interest charged due to late payment of instalments or balance due. In addition, interest would also be charged on any penalties until such time as the return is filed or the instalments (balance due) paid.

The late file penalty could be doubled to 10 percent, plus 2 percent per month for a maximum of 20 months for a second offence within a three year period.

## Solution to Assignment Problem Two - 3

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### Case 1

Bronson's net tax owing in each of the three years is as follows:

**2017** = Nil (\$7,843 - \$8,946) Note that a negative number is not used here.

**2018** = \$3,190 (\$12,862 - \$9,672)

**2019** = \$3,851 (\$14,327 - \$10,476 Estimated)

As his net tax owing is expected to exceed \$3,000 in 2019 and was more than \$3,000 in 2018, the payment of instalments is required.

Instalments under the three acceptable alternatives would be as follows:

**Alternative 1** Using the estimated net tax owing for the current year would result in quarterly instalments of \$962.75 ( $\$3,851 \div 4$ ), for a total amount of \$3,851.

**Alternative 2** Using the net tax owing for the previous year would result in quarterly instalments of \$797.50 ( $\$3,190 \div 4$ ), for a total amount of \$3,190.

**Alternative 3** Using the net tax owing for the second previous year would result in the first two instalments being nil. The remaining two instalments would be \$1,595 [ $(\$3,190 - 0) \div 2$ ], a total of \$3,190.

The best alternative would be Alternative 3. While the total instalments under this alternative are the same as under Alternative 2, this option offers some deferral as the first two instalments are nil.

The required instalments would be due on September 15 and December 15, 2019.

### Case 2

Bronson's net tax owing in each of the three years is as follows:

**2017** = Nil (\$8,116 - \$8,946) Note that a negative number is not used here.

**2018** = \$4,174 (\$13,846 - \$9,672)

**2019** = \$3,066 (\$13,542 - \$10,476 Estimated)

As his net tax owing is expected to exceed \$3,000 in 2019 and was more than \$3,000 in 2018, the payment of instalments is required.

Instalments under the three acceptable alternatives would be as follows:

**Alternative 1** Using the estimated net tax owing for the current year would result in quarterly instalments of \$766.50 ( $\$3,066 \div 4$ ), for a total amount of \$3,066.

**Alternative 2** Using the net tax owing for the previous year would result in quarterly instalments of \$1,043.50 ( $\$4,174 \div 4$ ), for a total amount of \$4,174.

**Alternative 3** Using the net tax owing for the second previous year would result in the first two instalments being nil. The remaining two instalments would be \$2,087 [ $(\$4,174 - 0) \div 2$ ], a total of \$4,174.

The best choice would be Alternative 1. While the first two instalments are lower under Alternative 3, the total for the year under Alternative 3 is \$1,108 ( $\$4,174 - \$3,066$ ) higher.

The required instalments would be due on March 15, June 15, September 15, and December 15, 2019.

**Case 3**

Bronson's net tax owing in each of the three years is as follows:

**2017** = \$4,200 (\$13,146 - \$8,946)

**2018** = \$3,170 (\$12,842 - \$9,672)

**2019** = \$3,200 (\$13,676 - \$10,476) Estimated

As his net tax owing is expected to exceed \$3,000 in 2019 and was more than \$3,000 in both 2017 and 2018, the payment of instalments is required.

Instalments under the three acceptable alternatives would be as follows:

**Alternative 1** Using the estimated net tax owing for the current year would result in quarterly instalments of \$800 ( $\$3,200 \div 4$ ), for a total amount of \$3,200.

**Alternative 2** Using the net tax owing for the previous year would result in quarterly instalments of \$792.50 ( $\$3,170 \div 4$ ), for a total amount of \$3,170.

**Alternative 3** Using the net tax owing for the second previous year would result in the first two instalments being \$1,050 ( $\$4,200 \div 4$ ) each, a total of \$2,100. The remaining two instalments would be \$535 [ $(\$3,170 - \$2,100) \div 2$ ], a total of \$1,070. When combined with the first two instalments, the total for the year would be \$3,170 ( $\$2,100 + \$1,070$ ).

In terms of minimizing instalments, the best choice is Alternative 2. While the total amount is \$3,170, the same amount as under Alternative 3, there is some deferral with the first two payments being smaller.

The required instalments would be due on March 15, June 15, September 15, and December 15, 2019.

## Solution to Assignment Problem Two - 4

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### Part A

Under ITA 157(1), Lanterna Inc. would have three alternatives with respect to the calculation of its instalment payments. The alternatives and the relevant calculations are as follows:

**Current Year Base** The instalment payments could be 1/12th of the estimated Tax Payable for the current year. In this case the resulting instalments would be \$11,621.67 per month ( $\$139,460 \div 12$ ).

**Preceding Year Base** The instalment payments could be 1/12th of the Tax Payable in the immediately preceding taxation year. The resulting instalments would be \$11,810 ( $\$141,720 \div 12$ ).

**Preceding And Second Preceding Years** The third alternative would be to base the first two instalments on 1/12th of the Tax Payable in the second preceding year and the remaining instalments on 1/10th of the Tax Payable in the preceding year, less the total amount paid in the first two instalments.

In this case, the first two instalments would be \$11,054.17 ( $\$132,650 \div 12$ ) each, a total of \$22,108.34. The remaining 10 instalments would be \$11,961.17 [ $(\$141,720 - \$22,108.34) \div 10$ ] each. The total instalments under this approach would be \$141,720.

While the third approach would provide the lowest payments for the first two instalments, the payments would total \$141,720. As this is larger than the \$139,460 total when the instalments are based on the current year's Tax Payable, the use of the current year's Tax Payable approach would be the best alternative.

### Part B

If the Company failed to make instalment payments towards the 2019 taxes payable, it would be liable for interest from the date each instalment should have been paid to the balance due date, September 30, 2019.

Assuming the actual 2019 taxes payable are \$139,460, it would be the least of the amounts described in ITA 157(1), and interest would be calculated based on this instalment alternative. The rate charged would be the one prescribed in ITR 4301 for amounts owed to the Minister, the regular rate plus 4 percentage points.

There is a penalty on large amounts of late or deficient instalments. This penalty is specified in ITA 163.1 and is equal to 50 percent of the amount by which the interest owing on the late or deficient instalments exceeds the greater of \$1,000 and 25 percent of the interest that would be owing if no instalments were made. While detailed calculations are not required, we would note that this penalty would clearly be applicable in this case.

Interest on the entire balance of \$139,460 of taxes payable would be charged beginning on the balance due date, September 30, 2019. The rate charged would be the one prescribed in ITR 4301 for amounts owed to the Minister, the regular rate plus 4 percentage points.

There is also a penalty for late filing. If no return is filed by the filing date, the penalty amounts to 5 percent of the tax that was unpaid at the filing date, plus 1 percent per complete month of the unpaid tax for a maximum period of 12 months. This penalty is in addition to any interest charged due to late payment of instalments or balance due. In addition, interest would also be charged on any penalties until such time as the return is filed or the instalments (balance due) paid.

The late file penalty could be doubled to 10 percent, plus 2 percent per month for a maximum of 20 months for a second offence within a three year period.

## Solution to Assignment Problem Two - 5

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### **Part A**

For individuals, the taxation year is always the calendar year. Individuals without business income are required to file their tax returns no later than April 30 of the year following the relevant taxation year. For individuals with business income, and their spouse or common-law partner, the filing deadline is extended to June 15.

### **Part B**

The general rules are the same for both deceased and living individuals. That is, the return must be filed no later than April 30 of the year following the year of death. If the deceased individual, or his spouse or common-law partner had business income, the due date is June 15 of the year following the year of death.

However, when death occurs between November 1 of a taxation year and the normal filing date for that year's return, representatives of the deceased can file the return on the later of the normal filing due date (April 30th or June 15th of the following year) and six months after the date of death.

### **Part C**

Inter vivos trusts must use the calendar year as their taxation year. As the required tax return must be filed within 90 days of the taxation year end, returns for inter vivos trusts will be due March 31 (March 30 in leap years).

The rules are the same for most testamentary trusts. However, the exception to this is a testamentary trust that has been designated a graduated rate estate (GRE). Such GREs can use a non-calendar fiscal year for up to three years subsequent to the death of the settlor. GRE returns are due 90 days after the date that has been selected as the taxation year end.

### **Part D**

Corporations can use a non-calendar fiscal year as their taxation year. The corporate T2 return must be filed within six months of the end of the taxation year.

## Solution to Assignment Problem Two - 6

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The following additional information would be relevant in considering Mr. O'Brien's situation:

- A. Determination of the date of the Notice of Reassessment. A notice of objection must be filed prior to the later of:
- 90 days from the date of the Notice of Reassessment; and
  - one year from the due date for the return under reassessment.

In this case, the later date is clearly 90 days after the date of the Notice of Reassessment.

- B. Determination of the date of the Notice of Assessment for the 2015 taxation year. A three year time limit applies from the date of the Notice of Assessment. If he filed his 2015 return on April 30, 2016, the Notice of Reassessment would be within the three year time limit applicable to such reassessments if the reassessment is dated before May 1, 2019.
- C. Determination of whether Mr. O'Brien has signed a waiver of the three year time limit or if he is guilty of misrepresentation attributable to neglect, carelessness, or fraud. If the reassessment is not within the three year time limit, Mr. O'Brien would not usually be subject to reassessment. However, if Mr. O'Brien has signed a waiver of the three year time limit, or if he is guilty of misrepresentation attributable to neglect, carelessness, or fraud, he becomes subject to reassessment, regardless of the time period involved.

If the preceding determinations indicate that the reassessment is valid and you decide to accept Mr. O'Brien as a client, the following steps should be taken:

- You should have Mr. O'Brien file a Consent Form, T1013, with the CRA which authorizes you to represent him in his affairs with the CRA and/or authorize you to access his file through the online Represent a Client service.
- A notice of objection should be filed before the expiration of the 90 day time limit.
- You should begin discussions of the matter with the relevant assessor at the CRA.

## Solution to Assignment Problem Two - 7

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**Note To Instructor** These Cases have been based on examples found in IC 01-1.

### **Case 1**

While the use of the other accountant's business income statements resulted in the tax return that was filed, the tax return preparer would be entitled to the good faith defense since he relied, in good faith, on information provided by another professional on behalf of the client. Therefore, he would not be subject to the preparer penalty.

The third party penalties may be applied to the other accountant if he knew or would be expected to know, but for circumstances amounting to culpable conduct, that the financial statements contained false statements.

### **Case 2**

Since the tax return preparer e-filed the taxpayer's return without viewing the charitable donation receipt, the CRA would consider assessing the tax return preparer with the preparer penalty. Given that the size of the donation is so disproportionate to the taxpayer's apparent resources as to defy credibility, to proceed unquestioningly in this situation would show wilful blindness and thus an indifference as to whether the ITA is complied with.

### **Case 3**

In view of the business that the taxpayer is in, there was nothing in the income statement that would have made the accountant question the validity of the information provided to him. Therefore, he could rely on the good faith reliance exception and would not be subject to the preparer penalty.

### **Case 4**

The accountant would not be subject to the penalties for participating or acquiescing in the understatement of a tax liability. The facts were highly suspect until the accountant asked questions to clear up the doubt in his mind that the client was not presenting him with implausible information. The response addressed the concern and was not inconsistent with the knowledge he possessed.

### **Case 5**

The prospectus prepared by the company contains a false statement (overstated fair market value of the software) that could be used for tax purposes. The company knew or would reasonably be expected to know, but for culpable conduct, that the fair market value of the software was a false statement. The CRA would consider assessing the company and the appraiser with third party civil penalties.

### **Case 6**

The issue here is whether the accountant is expected to know that HST is not payable on wages, interest expense, and zero-rated purchases. It is clear that the accountant should have known that no HST could be claimed on these items. Given this, in filing a claim that includes an HST refund on the preceding items, the accountant made a false statement, either knowingly, or in circumstances amounting to culpable conduct. Consequently, the CRA would consider assessing the accountant with the third party civil penalty, specifically, the preparer penalty.

## CHAPTER THREE SOLUTIONS

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### Solution to Assignment Problem Three - 1

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***Cheeco Marques***

As the bonus is not paid within 3 years of the end of the year in which the services were rendered, this is a salary deferral arrangement. The company will deduct the bonus in the taxation year ending November 30, 2019. As it was earned in 2019, Cheeco will have to include the bonus in the calendar year ending December 31, 2019.

***Zeppo Marques***

In this case, the bonus is paid within 180 days of the company's November 30, 2019 year end. Given this, the company will be able to deduct the bonus in that year. However, Zeppo will not have to include it in income until the calendar year ending December 31, 2020.

***Groucho Marques***

The company will deduct the bonus in the year ending November 30, 2019. Groucho will include it in income in the calendar year ending December 31, 2019.

***Harpo Marques***

In this case, the bonus is not paid within 180 days of the company's November 30, 2019 year end. This means that the company will not be able to deduct the bonus until the taxation year ending November 30, 2020. Harpo will include the bonus in income in the calendar year ending December 31, 2020.



## Solution to Assignment Problem Three - 2

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### **Background**

The facts in this case reflect a Tax Court Of Canada case that was decided in June, 2010 (Vipan Bansal vs. Minister Of National Revenue).

At issue was whether the appellant worked as an employee or as an independent contractor during the period from January 1, 2008 to October 21, 2008 for the purposes of the Canada Pension Plan and the Employment Insurance Act. The appellant argued that he was an employee of the payor whereas the Minister determined that he was not.

We have changed the name of the appellant and updated the dates in order to avoid having students locate the actual case if this is used as an assignment problem.

### **Intent**

The most important factor in the employer/independent contractor decision is the intent of both parties. The court noted that, as there was a disagreement between the parties as to intent, it becomes necessary to look at all of the facts to determine the legal relationship that they reflect.

### **Factors Suggesting Independent Contractor Status**

**Tools** The Appellant provided his own car.

#### **Risk Of Loss**

- The Appellant had liability exposing him to a risk of loss.
- The Appellant incurred vehicle expenses, including insurance, maintenance and fuel.
- The Appellant incurred operating expenses such as liability insurance and a driver training endorsement.
- The Appellant paid for the installation and removal of the emergency brake provided by the Payor.

**Chance Of Profit** The more hours (over 20) the Appellant worked the greater were his chances of profit. Although not stated in the problem, this was not the case for the driving instructors having employee status since they were limited in the number of hours they could work.

#### **Control**

- The Appellant did not have a set schedule of hours or days of work.
- The Appellant could choose the routes for the lessons.
- The Appellant could work for anyone else (except as a driving instructor).

**Behaviour As An Entrepreneur** He behaved like an independent contractor in that he invoiced the Payor, charged the Payor GST, maintained his own books and records, and reported business income and business expenses on his 2017, 2018 and 2019 income tax returns.

### **Factors Suggesting Employee Status**

**Tools** The Payor provided vehicle signage, mirrors, traffic cones and an emergency brake.

#### **Control**

- The Payor provided the Appellant with a guide and the Appellant had to comply with all the instructions therein regarding the method of teaching.
- Although the Appellant could hire an assistant, he could not have someone replace him.

The conclusion of the Tax Court Of Canada was as follows: