Canadian Tax Principles 2016 / 2017  
Solutions Manual – Chapters 1 to 10

Solutions Manual Table of Contents– Chapters 1 to 10

For a listing of the subjects covered and difficulty of each Assignment Problem, please refer to the .PDF version of the Solutions Manual that is available at the Instructor’s Resource Centre on the online catalogue listing for this book, at

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CHAPTER ONE SOLUTIONS

Solution to Assignment Problem One - 1

**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

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

**Note** The descriptions of these tax measures are significantly simplified.  The objective of this problem is to present the basic ideas so they can be understood by students at this introductory level, while still providing a basis for discussion.  It is obvious that there is no definitive solution to this problem.  The analysis provided below is intended to be no more than suggestive of possible points that could be made.  There are, of course, many alternative solutions.

Increase In The Maximum Tax Rate

Possible comments here would be as follows:

**Adequacy** As this increase was accompanied by a reduction in the second tax bracket from 22.0 percent to 20.5 percent, as well as a number of new spending initiatives, the government felt that this increase was necessary in order to provide compensating revenues.

**International Competitiveness** The fact that, in most provinces, the maximum tax rate on individuals is over 50 percent makes Canada less competitive with many other jurisdictions.  In particular, in the United States, maximum tax rates are generally much lower.

Repeal Of The Family Tax Cut

Possible comments here would be as follows:

**Simplicity And Ease Of Compliance** This was an extremely complex provision that few individuals, other than those working as tax professionals really understood.  Elimination of the provision reduces the complexity of the Canadian tax system.

**Equity Or Fairness** The family tax cut was widely criticized for providing most of its benefits to middle and upper income Canadians.  Lower income individuals rarely benefitted from its provisions.  It can be argued that the elimination of the family tax cut improves the fairness of the system.

Reduction In Contributions To Tax Free Savings Accounts

Possible comments here would be as follows:

**Adequacy** The reduction in the 22 percent tax bracket to 20.5 percent and several new and expensive programs have increased the government’s need for additional revenues.  Reducing this limit on the amount of investment income that can be earned tax free will increase revenues.

**Balance Between Sectors** As this provision is only available to individuals, the ability to earn tax free investment income reduces taxes for this group of taxpayers.  A reduction in the maximum contribution has the effect of increasing taxes for the group.  This serves to increase the already heavy tax burden on this group of taxpayers.

Small Business Tax Rate

Possible comments here would be as follows:

**Certainty** By clearly indicating that the small business tax rate will remain at 10.5 percent for the foreseeable future, certainty is increased for this group of taxpayers.

**Neutrality** The small business tax rate is designed to assist a specific group of taxpayers.  The fact that the scheduled reductions in this rate have been cancelled is an unfavourable event for this group.

Early Child Educator School Supply Tax Credit

Possible comments here would be as follows:

**Simplicity And Ease Of Compliance** The large number of existing tax credits and the fact that new ones are added nearly every year, has greatly increased the complexity of the Canadian tax system.  Another addition will exacerbate this problem.  Additional complexity is also created by issues such as defining eligible supplies and determining who qualifies for the credit.

**Neutrality** This credit results in a benefit related to the costs associated with being a particular type of employee.  It is not neutral in that it does not provide similar benefits for the costs associated with other types of employment (e.g., construction workers cannot deduct the cost of protective clothing).

Solution to Assignment Problem One - 4

There are a large number of possible responses to a question such as this.  Some possibilities would include the following:

* **Simplicity And Ease Of Compliance** A very good feature of this tax is that it is very simple and presents the taxpayer with no compliance problems.  Anyone with a head is taxed and no provisions have been made for any modifications in applicability or amounts to be paid.
* **Fairness And Equity** In one sense this is a fair tax in that it applies to every Canadian resident and the amount to be collected from each individual is the same.  This could be described as horizontal equity.  However, the tax could also be considered unfair in that it gives no consideration to the individual’s ability to pay the tax, either in terms of accumulated wealth or income.
* **Regressiveness** Related to fairness is the fact that the tax is regressive.  That is, the tax will take a higher percentage of income from low income individuals than it will from high income individuals.
* **Flexibility And Elasticity** Being a very simple tax, it will be very easy to change the rate at which it is assessed.  However, as it is a flat tax based simply on the existence of the individual, it will not respond to changing economic conditions.
* **Enforcement And Dependability Of Revenues** Given the presence of a physically visible audit trail (the HAT), there should be no enforcement problems.  Further, demographic statistics are reasonably predictable, making it relatively easy for the government to anticipate the expected levels of revenue.
* **Neutrality** Other than decisions related to whether to remain a Canadian resident, the tax appears to be neutral with respect to economic conditions.
* **International Competitiveness** It seems unlikely that a $200 tax would be sufficient to influence a decision to either leave Canada or move to Canada.  Therefore, the tax could be thought of as being internationally competitive.
* **Balance Between Sectors** The tax might be criticized as an additional burden on Canadian individuals as opposed to Canadian businesses.

There are, of course, other factors that could be considered.

Solution to Assignment Problem One - 5

The term Net Income For Tax Purposes is commonly used to refer to income as determined under Part I, Division B of the *Income Tax Act*.  While Division B does not contain a definition of this income figure, ITA 3 contains a formula for the determination of this amount.

In general terms, Net Income For Tax Purposes would include:

* Net income from employment (Subdivision a).
* Net income from business or property (Subdivision b).
* Taxable capital gains net of allowable capital losses (Subdivision c).
* Other sources of income and other deductions (Subdivisions d and e).

Losses from employment, business, property, and allowable business investment losses can be deducted as long as the total Net Income For Tax Purposes does not go below zero.

In somewhat simplified terms, Taxable Income is simply Net Income For Tax Purposes, less certain deductions that are specified in Division C of the *Income Tax Act*.

As will be explained in subsequent Chapters, these deductions include:

* a portion of stock option income,
* home relocation loan amounts,
* the northern residents deduction,
* the lifetime capital gains deduction, and
* loss carry overs from other years.

Solution to Assignment Problem One - 6

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 - 7

Case A

The Case A solution would be calculated as follows:

Income Under ITA 3(a):

Employment Income $126,100

Business Income 14,100 $140,200

Income Under ITA 3(b):

Taxable Capital Gains

[(1/2)($56,400)] $28,200

Allowable Capital Losses

[(1/2)($72,300)] ( 36,150) Nil

Balance From ITA 3(a) And (b) $140,200

Spousal Support Payments [(12)($600)] ( 7,200)

Balance From ITA 3(c) $133,000

Deduction Under ITA 3(d):

Net Rental Loss ( 4,600)

Net Income For Tax Purposes (Division B Income) $128,400

In this Case, Carl has an unused allowable capital loss carry over of $7,950 ($28,200 - $36,150).  The lottery winnings would not be included in income.

Case B

The Case B solution would be calculated as follows:

Income Under ITA 3(a):

Employment Income $89,000

Interest Income 3,100

Net Rental Income 8,600 $100,700

Income Under ITA 3(b):

Taxable Capital Gains

[(1/2)($46,200)] $23,100

Allowable Capital Losses

[(1/2)($26,300)] ( 13,150) 9,950

Balance From ITA 3(a) And (b) $110,650

Deductible RRSP Contribution ( 8,600)

Balance From ITA 3(c) $102,050

Deduction Under ITA 3(d):

Unincorporated Business Loss ( 187,400)

Net Income For Tax Purposes (Division B Income) Nil

In this Case, Carl has an unused business loss carry over of $85,350 ($102,050 - $187,400).

Solution to Assignment Problem One - 8

Case 1

The Case 1 solution would be calculated as follows:

Income Under ITA 3(a):

Net Employment Income $123,480

Interest Income 4,622 $128,102

Income Under ITA 3(b):

Taxable Capital Gains $24,246

Allowable Capital Losses ( 4,835) 19,411

Balance From ITA 3(a) And (b) $147,513

Child Care Costs ( 9,372)

Balance From ITA 3(c) And Net Income For Tax Purposes $138,141

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

Case 2

The Case 2 solution would be calculated as follows:

Income Under ITA 3(a):

Net Business Income $72,438

Income Under ITA 3(b):

Taxable Capital Gains $4,233

Allowable Capital Loss ( 7,489) Nil

Balance From ITA 3(a) And (b) $72,438

RRSP Contributions ( 22,000)

Balance From ITA 3(c) $50,438

Deduction Under ITA 3(d):

Net Rental Loss ( 9,846)

Net Income For Tax Purposes (Division B Income) $40,592

In this Case, Mr. Comfort has a carry over of $3,256 ($7,489 - $4,233) in unused allowable capital losses.

Case 3

The Case 3 solution would be calculated as follows:

Income Under ITA 3(a):

Net Employment Income $47,234

Income Under ITA 3(b):

Taxable Capital Gains [(1/2)($12,472)] $6,236

Allowable Capital Losses [(1/2)($9,332)] ( 4,666) 1,570

Balance From ITA 3(a) and (b) $48,804

Child Care Costs ( 3,922)

Balance From ITA 3(c) $44,882

Deduction Under ITA 3(d):

Net Business Loss ( 68,672)

Net Income For Tax Purposes (Division B Income) Nil

In this Case, Mr. Comfort would have a business loss carry over in the amount of $23,790 ($68,672 - $44,882).

Case 4

The Case 4 solution would be calculated as follows:

Income Under ITA 3(a):

Interest Income $ 6,250

Net Business Income 43,962 $50,212

Income Under ITA 3(b):

Taxable Capital Gains [(1/2)($12,376)] $ 6,188

Allowable Capital Losses

[(1/2)($23,874)] ( 11,937) Nil

Balance From ITA 3(a) And (b) $50,212

Moving Expenses ( 7,387)

Balance From ITA 3(c) $42,825

Deduction Under ITA 3(d):

Net Rental Loss ( 72,460)

Net Income For Tax Purposes (Division B Income) Nil

Mr. Comfort would have a rental loss carry over in the amount of $29,635 ($72,460 - $42,825) and unused allowable capital losses in the amount of $5,749 ($11,937 - $6,188).

CHAPTER TWO SOLUTIONS

Solution to Assignment Problem Two - 1

Need For Instalments

Instalments are required when an individual’s “net tax owing” exceeds $3,000 in the current year and in either of the two preceding years.  In somewhat simplified terms, “net tax owing” is defined as the combined federal and provincial taxes payable, less amounts withheld under ITA 153.  Mr. Boardman’s net tax owing figures are as follows:

**2014** = $750 ($62,350 - $61,600)

**2015** = $16,020 ($29,760 - $13,740)

**2016** = $4,980 ($52,370 - $47,390) Estimated

As Mr. Boardman’s net tax owing in 2016 (the current year) and his net tax owing in 2015 (one of the two preceding years) is greater than $3,000, he is required to make instalment payments.

Amounts

If Mr. Boardman bases the first two quarterly payments on the 2014 net tax owing, they would only be $187.50 each ($750 ÷ 4).  However, the payments for the last two quarters would be $7,822.50 each {[$16,020 - (2)($187.50)] ÷ 2}, resulting in total instalment payments of $16,020.

A preferable alternative would be to base the payments on the estimated net tax owing for 2016.  These payments would be $1,245 each ($4,980 ÷ 4), for a total of $4,980.

Payment Dates

The quarterly payments would be due on March 15, June 15, September 15, and December 15 of 2016.

Solution to Assignment Problem Two - 2

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 ÷ 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 ÷ 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 ÷ 12) each, a total of $32,236.66.  The remaining 10 instalments would be $18,333.03 [($215,567 - $32,236.66) ÷ 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 2016 taxes payable, it would be liable for interest from the date each instalment should have been paid to the balance due date, March 31, 2016.

Assuming the actual 2016 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, 2016, two months after the end of the 2016 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, 2016, 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

Part A - Case 1

Barry’s net tax owing in each of the three years is as follows:

**2014** = $2,456 ($14,256 - $11,800)

**2015** = $1,626 ($15,776 - $14,150)

**2016** = $4,083 ($16,483 - $12,400) Estimated

While the net tax owning in the current year is expected to exceed $3,000, it did not exceed $3,000 in either of the two previous years.  The payment of instalments is not required.

Part A - Case 2

Barry’s net tax owing in each of the three years is as follows:

**2014** = Nil ($14,256 - $14,920)  Note that a negative number is not used here.

**2015** = $4,376 ($15,776 - $11,400)

**2016** = $3,257 ($16,483 - $13,226) Estimated

As his net tax owing is expected to exceed $3,000 in 2016 and was more than $3,000 in 2015, 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 $814.25 ($3,257  4), for a total amount of $3,257.

**Alternative 2** Using the net tax owing for the previous year would result in quarterly instalments of $1,094 ($4,376  4), for a total amount of $4,376.

**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 $2,188 ($4,376  2), a total of $4,376.

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 $1,119 ($4,376 - $3,257) higher.

Part A - Case 3

Barry’s net tax owing in each of the three years is as follows:

**2014** = $3,036 ($14,256 - $11,220)

**2015** = $2,501 ($15,776 - $13,275)

**2016** = $3,610 ($16,483 - $12,873) Estimated

As his net tax owing is expected to exceed $3,000 in 2016 and was more than $3,000 in 2014, 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 $902.50 ($3,610  4), for a total amount of $3,610.

**Alternative 2** Using the net tax owing for the previous year would result in quarterly instalments of $625.25 ($2,501  4), for a total amount of $2,501.

**Alternative 3** Using the net tax owing for the second previous year would result in the first two instalments being $759 ($3,036  4) each, a total of $1,518.  The remaining two instalments would be $491.5 [($2,501 - $1,518)  2], a total of $983.  When combined with the first two instalments, the total for the year would be $2,501 ($1,518 + $983).

The best choice would be Alternative 2.  While the total for the year under Alternative 3 is the same, the first two instalments are lower under Alternative 2, allowing for a small amount of tax deferral.

Part B

In Case Two and Case Three, the required instalments would be due on March 15, June 15, September 15, and December 15, 2016.

Solution to Assignment Problem Two - 4

Case One

1. As the corporation’s tax payable for both the current and the preceding year exceeds $3,000, instalments are required.  As the corporation is a small CCPC, instalments will be quarterly.

2. The three acceptable alternatives would be as follows:

Quarterly instalments of $43,085 ($172,340 ÷ 4) based on the current year estimate.

Quarterly instalments of $46,635 ($186,540 ÷ 4) based on the first preceding year.

One instalment of $38,410 ($153,640 ÷ 4) based on the second preceding year, followed by three instalments of $49,376.67 [($186,540 - $38,410) ÷ 3], a total of $186,540.

3. The best alternative in terms of minimum instalments would be four instalments of $43,085, for total payments of $172,340.  The instalments are due on March 31, June 30, September 30, and December 31, 2016.

Case Two

1. As the corporation’s tax payable for both the current and the preceding year exceeds $3,000, instalments are required.  As the corporation is a small CCPC, instalments will be quarterly.

2. The three acceptable alternatives would be as follows:

Quarterly instalments of $43,085 ($172,340 ÷ 4) based on the current year estimate.

Quarterly instalments of $40,855 ($163,420 ÷ 4) based on the first preceding year.

One instalment of $38,410 ($153,640 ÷ 4) based on the second preceding year, followed by three instalments of $41,670 [($163,420 - $38,410) ÷ 3], a total of $163,420.

3. The best alternative would be one payment of $38,410, followed by three payments of $41,670.  While the total instalments are the same $163,420 in both the second and third alternatives, the third alternative is preferable because the first payment is lower.  This provides a small amount of tax deferral.

The instalments are due on March 31, June 30, September 30, and December 31, 2016.

Case Three

1. As the corporation’s tax payable for both the current and the preceding year exceeds $3,000, instalments are required.  As the corporation is not a small CCPC, monthly instalments are required.

2. The three acceptable alternatives would be as follows:

Monthly instalments of $14,361.67 ($172,340 ÷ 12) based on the current year estimate.

Monthly instalments of $15,545 ($186,540 ÷ 12) based on the first preceding year.

Two monthly instalments of $12,803.33 ($153,640 ÷ 12) based on the second preceding year, followed by 10 monthly instalments of $16,093.33 {[($186,540 - (2)($12,803.33)] ÷ 10}, a total of $186,540.03.

3. The best alternative in terms of minimum instalments would be 12 instalments of $14,361.67, resulting in a total of $172,340 of instalment payments.

The instalments would be due on the last day of each month, beginning in January, 2016.

Case Four

1. As the corporation’s tax payable for both the current and the preceding year exceeds $3,000, instalments are required.  As the corporation is not a small CCPC, monthly instalments are required.

2. The three acceptable alternatives would be as follows:

Monthly instalments of $14,361.67 ($172,340 ÷ 12) based on the current year estimate.

Monthly instalments of $13,618.33 ($163,420 ÷ 12) based on the first preceding year.

Two monthly instalments of $12,803.33 ($153,640 ÷ 12) based on the second preceding year, followed by 10 monthly instalments of $13,781.33 {[$163,420 - (2)($12,803.33)] ÷ 10}, a total of $163,420.

3. The best alternative would be two payments of $12,803.33, followed by ten payments of $13,781.33.  While the total instalments are the same $163,420 in both the second and third alternatives, the third alternative is preferable because the first two payments are lower.  This provides a small amount of tax deferral.

The instalments would be due on the last day of each month, beginning in January, 2016.

Solution to Assignment Problem Two - 5

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

As of 2016, both inter vivos and testamentary trusts must use the calendar year as their taxation year.  As both types of trusts must file within 90 days of the end of their taxation year, the filing due date for a specific year’s income tax returns will be March 31 (March 30 in leap years) of the following year.

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

The following additional information would be relevant in considering Mr. Simon’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 2012 taxation year.  A three year time limit applies from the date of the Notice of Assessment.  As the Notice of Assessment for 2012 could have been sent in early April, 2013, this reassessment could be within the three year limit.

C. Determination of whether Mr. Simon has signed a waiver of the three year time limit or if he is guilty of fraud or misrepresentation.  If the reassessment is not within the three year time limit, Mr. Simon would not usually be subject to reassessment.  However, if Mr. Simon has signed a waiver of the three year time limit, or if fraud or misrepresentation is involved, 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. Simon as a client, the following steps should be taken:

You should have Mr. Simon 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

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

Case A

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 B

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.  Since the company is engaged in an excluded activity, it cannot rely on the good faith reliance exception with respect to the valuation. The CRA would consider assessing the company with third-party civil penalties in the amount of $2,000,000 (i.e., the gross entitlements). The CRA would also consider assessing the appraiser with third-party civil penalties. The amount of the penalty would be his gross entitlements from the valuation activity, which is $75,000.

Case C

Although the tax return contains one or more false statements, the tax return preparer would be entitled to the good faith defense since he relied, in good faith, on information (the financial statements that were not obviously unreasonable) 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 D

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 E

Since the tax return preparer e-filed the taxpayer’s return without obtaining 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 F

The issue here is whether the accountant is expected to know that GST is not payable on wages, interest expense, and zero-rated purchases. It is clear that the accountant should have known that no GST could be claimed on these items.  Given this, in filing a claim that includes a GST 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.