

INSTRUCTOR'S SOLUTIONS MANUAL

Byrd & Chen's Canadian Tax Principles 2012 - 2013 Edition

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www.pearsoncanada.ca/byrdchen/ctp2013

The Instructor's password protected web site can be accessed by clicking on the Instructor Resources jump link on the above web page.

Here you will find:

- Updates and corrections to the supplements package
- PowerPoint slide presentations for all chapters
- Online posting policy for assignment problem solutions and permission form
- Solutions to Tax Software Problems, updated for the 2012 version of ProFile (January, 2013)

Problem Concordance

A concordance of the problems in the 2011/12 vs. 2012/13 editions is available after the Problem Listing (and separately on the instructor's web site) to assist instructors who have previously used *Canadian Tax Principles*.

Bookmarks In PDF File

To assist you in navigating through the electronic version of this solutions manual, (available on the Instructor's CD-ROM) there are bookmarks on the first page of each Assignment Problem solution.

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Assignment Problems Listing and Description

Next to each problem number you will find a general indication as to whether we think the problem is: Easy (E), Medium (M), or Difficult (D).

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This Problem Concordance shows the problem number in the 2011/12 edition in regular type and the number of the updated problem in the 2012/13 (New) edition in **bold**.

The number of new essay questions, multiple choice questions (see separate Concordance) and Exam Exercises is shown in the last column.

SS = Self Study AP = Assignment Prob. TIF = Test Item File

| Chap 1 | 2012/13 | 2011/12 | 2012/13 | 2011/12 | 2012/13 | 2011/12 | New Questions |
|---------------|----------------|----------------|----------------|----------------|-----------------|----------------|---------------------------|
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| | SS 1-2 | SS 1-2 | AP 1-2 | AP 1-2 | TIF 1-2 | TIF 1-2 | |
| | SS 1-3 | SS 1-3 | AP 1-3 | AP 1-3 | TIF 1-3 | TIF 1-3 | New MC = 13 |
| | SS 1-4 | SS 1-4 | AP 1-4 | AP 1-4 | TIF 1-4 | TIF 1-4 | New Exam Exer = 7 |
| | SS 1-5 | SS 1-5 | AP 1-5 | AP 1-5 | TIF 1-5 | TIF 1-5 | |
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| | | | AP 1-8 | New | TIF 1-8 | TIF 1-8 | |
| | | | | | TIF 1-9 | TIF 1-9 | |
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| | SS 2-2 | SS 2-2 | AP 2-2 | AP 2-2 | TIF 2-2 | TIF 2-2 | |
| | SS 2-3 | SS 2-3 | AP 2-3 | New | TIF 2-3 | TIF 2-3 | New MC = 11 |
| | SS 2-4 | TIF 2-10 | AP 2-4 | New | TIF 2-4 | TIF 2-4 | New Exam Exer = 7 |
| | SS 2-5 | SS 2-4 | AP 2-5 | AP 2-5 | TIF 2-5 | TIF 2-5 | |
| | SS 2-6 | SS 2-5 | AP 2-6 | AP 2-6 | TIF 2-6 | TIF 2-6 | |
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| | SS 3-2 | SS 3-2 | AP 3-2 | AP 3-2 | TIF 3-2 | TIF 3-2 | |
| | SS 3-3 | SS 3-3 | AP 3-3 | AP 3-3 | TIF 3-3 | TIF 3-3 | New MC = 7 |
| | SS 3-4 | SS 3-4 | AP 3-4 | AP 3-4 | TIF 3-4 | TIF 3-4 | New Exam Exer = 10 |
| | SS 3-5 | SS 3-5 | AP 3-5 | AP 3-5 | TIF 3-5 | TIF 3-5 | |
| | SS 3-6 | SS 3-6 | AP 3-6 | AP 3-6 | TIF 3-6 | TIF 3-6 | |
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The number of new essay questions, multiple choice questions (see separate Concordance) and Exam Exercises is shown in the last column.

SS = Self Study AP = Assignment Prob. TIF = Test Item File

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|---------------|------------------|------------------|------------------|------------------|-----------------|-----------------|---------------------------|
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| | SS 4-2 | SS 4-2 | AP 4-2 | New | TIF 4-2 | TIF 4-2 | |
| | SS 4-3 | SS 4-1 | AP 4-3 | AP 4-3 | TIF 4-3 | TIF 4-3 | New MC = 17 |
| | SS 4-4 | SS 4-3 | AP 4-4 | AP 4-4 | TIF 4-4 | TIF 4-4 | New Exam Exer = 15 |
| | SS 4-5 | SS 4-4 | AP 4-5 | New | TIF 4-5 | TIF 4-5 | |
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| | TS SS Cha | TS SS Cha | TS AP 4-2 | TS AP 4-2 | TIF 4-8 | TIF 4-7 | |
| | | | TS AP 4-3 | TS AP 4-3 | TIF 4-9 | TIF 4-8 | |
| | | | | | TIF 4-10 | TIF 4-10 | |
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| | SS 5-2 | SS 5-2 | AP 5-2 | AP 5-2 | TIF 5-2 | TIF 5-2 | |
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| | SS 5-5 | SS 5-5 | AP 5-5 | New | TIF 5-5 | TIF 5-5 | |
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| | | | | | TIF 5-14 | TIF 5-11 | |
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| | SS 6-1 | SS 6-1 | AP 6-1 | New | TIF 6-1 | TIF 6-1 | New Essay Q = 10 |
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| | SS 6-3 | SS 6-2 | AP 6-3 | AP 6-3 | TIF 6-3 | TIF 6-3 | New MC = 14 |
| | SS 6-4 | SS 6-4 | AP 6-4 | AP 6-4 | TIF 6-4 | TIF 6-4 | New Exam Exer = 14 |
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| | SS 6-8 | SS 6-8 | AP 6-8 | AP 6-8 | TIF 6-8 | TIF 6-8 | |
| | SS 6-9 | SS 6-7 | AP 6-9 | New | TIF 6-9 | TIF 6-9 | |
| | SS 6-10 | SS 6-9 | AP 6-10 | AP 6-10 | TIF 6-10 | TIF 6-10 | |
| | SS 6-11 | AP 6-9 | AP 6-11 | AP 6-11 | TIF 6-11 | TIF 6-11 | |
| | SS 6-12 | SS 6-11 | AP 6-12 | AP 6-13 | TIF 6-12 | TIF 6-12 | |
| | SS 6-13 | SS 6-10 | AP 6-13 | New | TIF 6-13 | TIF 6-13 | |
| | SS 6-14 | SS 6-12 | | | TIF 6-14 | TIF 6-14 | |
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The number of new essay questions, multiple choice questions (see separate Concordance) and Exam Exercises is shown in the last column.

SS = Self Study AP = Assignment Prob. TIF = Test Item File

| Chap 7 | 2012/13 | 2011/12 | 2012/13 | 2011/12 | 2012/13 | 2011/12 | New Questions |
|---------------|----------------|----------------|----------------|----------------|-----------------|----------------|----------------------|
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| | SS 7-2 | SS 7-1 | AP 7-2 | AP 7-2 | TIF 7-2 | TIF 7-2 | |
| | SS 7-3 | SS 7-2 | AP 7-3 | AP 7-3 | TIF 7-3 | TIF 7-3 | New MC = 20 |
| | SS 7-4 | SS 7-3 | AP 7-4 | AP 7-4 | TIF 7-4 | TIF 7-4 | New Exam Exer = 11 |
| | SS 7-5 | SS 7-4 | AP 7-5 | AP 7-5 | TIF 7-5 | TIF 7-5 | |
| | SS 7-6 | SS 7-5 | AP 7-6 | AP 7-6 | TIF 7-6 | New | |
| | SS 7-7 | SS 7-6 | AP 7-7 | AP 7-8 | TIF 7-7 | TIF 7-6 | |
| | SS 7-8 | AP 7-7 | AP 7-8 | New | TIF 7-8 | TIF 7-7 | |
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| | | | | | TIF 7-12 | TIF 7-11 | |
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| | SS 8-1 | SS 8-1 | AP 8-1 | AP 8-1 | TIF 8-1 | TIF 8-1 | New Essay Q = 7 |
| | SS 8-2 | SS 8-2 | AP 8-2 | New | TIF 8-2 | TIF 8-2 | |
| | SS 8-3 | SS 8-3 | AP 8-3 | AP 8-3 | TIF 8-3 | TIF 8-3 | New MC = 15 |
| | SS 8-4 | SS 8-4 | AP 8-4 | AP 8-4 | TIF 8-4 | TIF 8-4 | New Exam Exer = 12 |
| | SS 8-5 | SS 8-12 | AP 8-5 | AP 8-5 | TIF 8-5 | TIF 8-5 | |
| | SS 8-6 | AP 8-15 | AP 8-6 | AP 8-13 | TIF 8-6 | TIF 8-6 | |
| | SS 8-7 | SS 8-9 | AP 8-7 | AP 8-14 | TIF 8-7 | AP 8-2 | |
| | SS 8-8 | SS 8-10 | AP 8-8 | New | TIF 8-8 | TIF 8-7 | |
| | SS 8-9 | New | AP 8-9 | AP 8-10 | TIF 8-9 | TIF 8-18 | |
| | SS 8-10 | SS 8-8 | AP 8-10 | AP 8-11 | TIF 8-10 | TIF 8-14 | |
| | SS 8-11 | SS 8-6 | AP 8-11 | AP 8-7 | TIF 8-11 | TIF 8-15 | |
| | SS 8-12 | SS 8-7 | AP 8-12 | AP 8-8 | TIF 8-12 | TIF 8-16 | |
| | SS 8-13 | SS 8-13 | AP 8-13 | New | TIF 8-13 | TIF 8-17 | |
| | SS 8-14 | AP 8-16 | AP 8-14 | AP 8-17 | TIF 8-14 | TIF 8-11 | |
| | | | AP 8-15 | New | TIF 8-15 | TIF 8-12 | |
| | | | | | TIF 8-16 | AP 8-9 | |
| | | | | | TIF 8-17 | TIF 8-19 | |
| | | | | | TIF 8-18 | TIF 8-9 | |
| | | | | | TIF 8-19 | TIF 8-10 | |
| | | | | | TIF 8-20 | TIF 8-11 | |

For Instructors Using Previous Editions

For those instructors who have used the previous 2011/12 edition of *Canadian Tax Principles*, we have described below the reorganization of the Chapter 8 topics for the 2012/13 edition. The main objective was to organize the Chapter 8 topics so that they increased in difficulty as students moved through the chapter.

Two topics have been moved to Chapter 9. We felt that non-arm's length transfers of property and deemed dispositions at death were a better fit with existing Chapter 9 topics such as income attribution.

Economic Background - No change in position in Chapter 8.

General Rules - No change in position in Chapter 8.

Detailed Application Of The Rules - No change in position in Chapter 8.

Non-Arm's Length Transfers Of Property

- Moved to **CHAPTER 9** beginning Paragraph 9-145.

- Inadequate Considerations - ITA 69
- Inter Vivos Transfers To A Spouse - ITA 73(1) And 73(1.01)
- Non-Arm's Length Transfers Of Depreciable Assets - ITA 13(7)(e)
- Inter Vivos Farm Or Fishing Property To A Child - ITA 73(3) And 73(4)

Deferral Provisions On Replacement Property

- Moved to end of Chapter 8 beginning Paragraph 8-136.

- Voluntary And Involuntary Dispositions
- Timing Considerations
- Application Of ITA 44(1) To Capital Gains
- Application Of ITA 13(4) To Recapture Of CCA
- Combined Application Of ITA 13(4) And 44(1)

Deferral Provisions On Small Business Investments

- Moved back in Chapter 8 beginning Paragraph 8-133.

Deemed Dispositions Except On Death

- Moved forward in Chapter 8 beginning Paragraph 8-109.

- Change In Use
- Departures From Canada

Death Of A Taxpayer (Deemed Dispositions)

- Moved to **CHAPTER 9** beginning Paragraph 9-145.

Provisions For Special Assets

- Moved forward in Chapter 8 beginning Paragraph 8-70.

- Principal Residence
- Personal Use Property
- Listed Personal Property
- Gains And Losses On Foreign Currency
- Options

The number of new essay questions, multiple choice questions (see separate Concordance) and Exam Exercises is shown in the last column.

SS = Self Study AP = Assignment Prob. TIF = Test Item File

| Chap 9 | 2012/13 | 2011/12 | 2012/13 | 2011/12 | 2012/13 | 2011/12 | New Questions |
|----------------|----------------|----------------|----------------|----------------|------------------|-----------------|---------------------------|
| | SS 9-1 | SS 9-1 | AP 9-1 | AP 9-1 | TIF 9-1 | TIF 9-1 | New Essay Q = 8 |
| | SS 9-2 | SS 9-2 | AP 9-2 | AP 9-3 | TIF 9-2 | TIF 9-2 | |
| | SS 9-3 | SS 9-3 | AP 9-3 | AP 9-4 | TIF 9-3 | TIF 9-3 | New MC = 17 |
| | SS 9-4 | SS 9-4 | AP 9-4 | AP 9-5 | TIF 9-4 | TIF 9-4 | New Exam Exer = 13 |
| | SS 9-5 | SS 8-5 | AP 9-5 | AP 9-2 | TIF 9-5 | TIF 9-5 | |
| | SS 9-6 | SS 8-11 | AP 9-6 | AP 8-6 | TIF 9-6 | TIF 9-6 | |
| | SS 9-7 | SS 9-5 | AP 9-7 | New | TIF 9-7 | TIF 9-7 | |
| | SS 9-8 | SS 9-6 | AP 9-8 | AP 8-12 | TIF 9-8 | TIF 9-8 | |
| | SS 9-9 | SS 9-7 | AP 9-9 | AP 9-6 | TIF 9-9 | TIF 9-12 | |
| | SS 9-10 | SS 9-8 | AP 9-10 | AP 9-7 | TIF 9-10 | TIF 9-9 | |
| | | | AP 9-11 | AP 9-8 | TIF 9-11 | TIF 8-8 | |
| | | | AP 9-12 | AP 9-10 | TIF 9-12 | TIF 8-13 | |
| | | | AP 9-13 | New | TIF 9-13 | TIF 8-20 | |
| | | | | | TIF 9-14 | TIF 9-10 | |
| | | | | | TIF 9-15 | TIF 9-11 | |
| | | | | | TIF 9-16 | TIF 9-13 | |
| | | | | | TIF 9-17 | AP 9-9 | |
| Chap 10 | 2012/13 | 2011/12 | 2012/13 | 2011/12 | 2012/13 | 2011/12 | New Questions |
| | SS 10-1 | SS 10-1 | AP 10-1 | AP 10-1 | TIF 10-1 | TIF 10-1 | New Essay Q = 14 |
| | SS 10-2 | SS 10-2 | AP 10-2 | AP 10-2 | TIF 10-2 | TIF 10-2 | |
| | SS 10-3 | SS 10-3 | AP 10-3 | AP 10-3 | TIF 10-3 | TIF 10-3 | New MC = 11 |
| | SS 10-4 | SS 10-4 | AP 10-4 | AP 10-4 | TIF 10-4 | TIF 10-4 | New Exam Exer = 11 |
| | SS 10-5 | SS 10-5 | AP 10-5 | AP 10-5 | TIF 10-5 | TIF 10-5 | |
| | SS 10-6 | SS 10-6 | AP 10-6 | AP 10-6 | TIF 10-6 | TIF 10-6 | |
| | SS 10-7 | SS 10-7 | AP 10-7 | AP 10-7 | TIF 10-7 | TIF 10-7 | |
| | SS 10-8 | AP 10-8 | AP 10-8 | AP 10-9 | TIF 10-8 | TIF 10-8 | |
| | | | AP 10-9 | New | TIF 10-9 | TIF 10-9 | |
| | | | | | TIF 10-10 | TIF 10-10 | |
| | | | | | TIF 10-11 | TIF 10-11 | |
| | | | | | TIF 10-12 | TIF 10-12 | |

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

- A. **Diamonds, South Africa** In a monopoly, the tax will probably be entirely shifted to employees and/or consumers. The incidence shift will depend on competition in world markets and employment levels. If the international diamond market is price sensitive and there is high unemployment in South Africa, then the tax will be shifted almost entirely to employees.

The shifting assumptions affect evaluation of the tax using the characteristics of a “good” tax system. A tax that is entirely shifted to employees is similar to one on wages and is non-neutral, as it affects the decisions of employees to continue working. Some employees will work less and thus increase the excess burden resulting from imposition of the tax.

- B. **Diamonds, Sierra Leone** The taxing authorities will find it difficult to enforce the tax, due to their inability to track diamond movements. Records maintained by the mine will likely be inaccessible, and those presented will be incomplete. The tax will not be effective and the tax revenue will be uncertain and inadequate.

- C. **Principal Residences, Canada** This exemption is non-neutral because investment decisions are affected by the tax preference. Given the choice of investing in real estate to hold for resale or a principal residence, both of which are likely to appreciate, a taxpayer will invest in a principal residence so that the gain on disposition is tax exempt.

It is also vertically inequitable because it benefits high-income families who can invest in more expensive residences which have the potential of earning greater returns.

This tax expenditure is spread among all taxpayers, and general tax revenue must be larger to compensate for the revenue foregone.

- D. **Business Meals, Canada** This restriction adds complexity to accounting for deductible expenses, as all business meals have to be accounted for and accumulated separately from other promotion expenses. The tax could be shifted to consumers, employees and/or shareholders. If it is shifted to consumers, it could be more advantageous to raise personal taxes so that incidence is more certain. If it is shifted to shareholders or employees, then it would be non-neutral as it could affect investment decision making and willingness to work.

- E. **Head Tax** A head tax is neutral as it does not affect economic choices. However, it is vertically inequitable, based on the ability to pay concept of equity, as all taxpayers, regardless of their income levels are taxed the same. The head tax is very inelastic. This tax serves the objectives of certainty, simplicity and ease of compliance. It could promote stability in the economy.

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

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 | \$46,200 | |
| Business Income | <u>13,500</u> | \$59,700 |
| Income Under ITA 3(b): | | |
| Taxable Capital Gains | \$14,320 | |
| Allowable Capital Losses | <u>(23,460)</u> | Nil |
| Balance From ITA 3(a) And (b) | | \$59,700 |
| Spousal Support Payments | | <u>(4,800)</u> |
| Balance From ITA 3(c) | | \$54,900 |
| Deduction Under ITA 3(d): | | |
| Net Rental Loss | | <u>(2,350)</u> |
| Net Income For Tax Purposes (Division B Income) | | <u>\$52,550</u> |

In this Case, Christina has an unused allowable capital loss carry over of \$9,140 (\$14,320 - \$23,460). The roulette winnings would not be included in income and the related expenses would not be deductible.

Case B

The Case B solution would be calculated as follows:

| | | |
|---|------------------|------------------|
| Income Under ITA 3(a): | | |
| Employment Income | \$64,000 | |
| Interest Income | 2,600 | |
| Net Rental Income | <u>4,560</u> | \$71,160 |
| Income Under ITA 3(b): | | |
| Taxable Capital Gains | \$32,420 | |
| Allowable Capital Losses | <u>(29,375)</u> | 3,045 |
| Balance From ITA 3(a) And (b) | | \$74,205 |
| Deductible RRSP Contribution | | <u>(12,480)</u> |
| Balance From ITA 3(c) | | \$61,725 |
| Deduction Under ITA 3(d): | | |
| Partnership Business Loss [(50%)(\$144,940)] | | <u>(72,470)</u> |
| Net Income For Tax Purposes (Division B Income) | | <u>Nil</u> |

In this Case, Christina has an unused business loss carry over of \$10,745 (\$72,470 - \$61,725).

Solution to Assignment Problem One - 8

Case A

The Case A solution would be calculated as follows:

| | | |
|---|------------------|------------------|
| Income Under ITA 3(a): | | |
| Employment Income | \$78,400 | |
| Rental Income | <u>8,400</u> | \$ 86,800 |
| Income Under ITA 3(b): | | |
| Taxable Capital Gains | \$42,500 | |
| Allowable Capital Losses | <u>(16,300)</u> | 26,200 |
| Balance From ITA 3(a) And (b) | | \$113,000 |
| Subdivision e Deductions | | <u>(8,100)</u> |
| Balance From ITA 3(c) | | \$104,900 |
| Deduction Under ITA 3(d): | | |
| Business Loss | | <u>(12,300)</u> |
| Net Income For Tax Purposes (Division B Income) | | <u>\$ 92,600</u> |

In this Case, Ms. DeBoo 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 | \$23,600 | |
| Rental Income | <u>16,000</u> | \$39,600 |
| Income Under ITA 3(b): | | |
| Taxable Capital Gains | \$12,500 | |
| Allowable Capital Losses | <u>(18,600)</u> | Nil |
| Balance From ITA 3(a) And (b) | | \$39,600 |
| Subdivision e Deductions | | <u>(3,200)</u> |
| Balance From ITA 3(c) | | \$36,400 |
| Deduction Under ITA 3(d): | | |
| Business Loss | | <u>(4,500)</u> |
| Net Income For Tax Purposes (Division B Income) | | <u>\$31,900</u> |

In this Case, Ms. DeBoo has a carry over of \$6,100 (\$12,500 - \$18,600) in unused allowable capital losses.

Case C

The Case C solution would be calculated as follows:

| | | |
|---|-----------|-----------|
| Income Under ITA 3(a): | | |
| Employment Income | \$33,400 | |
| Rental Income | 3,400 | \$36,800 |
| Income Under ITA 3(b): | | |
| Taxable Capital Gains | \$21,400 | |
| Allowable Capital Losses | (20,700) | 700 |
| Balance From ITA 3(a) and (b) | | \$37,500 |
| Subdivision e Deductions | | (12,400) |
| Balance From ITA 3(c) | | \$25,100 |
| Deduction Under ITA 3(d): | | |
| Business Loss | | (42,300) |
| Net Income For Tax Purposes (Division B Income) | | Nil |

In this Case, Ms. DeBoo would have a business loss carry over in the amount of \$17,200 (\$25,100 - \$42,300).

Case D

The Case D solution would be calculated as follows:

| | | |
|---|-----------|-----------|
| Income Under ITA 3(a): | | |
| Employment Income | | \$46,200 |
| Income Under ITA 3(b): | | |
| Taxable Capital Gains | \$41,200 | |
| Allowable Capital Losses | (43,400) | Nil |
| Balance From ITA 3(a) And (b) | | \$46,200 |
| Subdivision e Deductions | | (9,300) |
| Balance From ITA 3(c) | | \$36,900 |
| Deduction Under ITA 3(d): | | |
| Business Loss | | (22,300) |
| Rental Loss | | (32,400) |
| Net Income For Tax Purposes (Division B Income) | | Nil |

Ms. DeBoo would have a carry over of unused non-capital losses in the amount of \$17,800 (\$36,900 - \$22,300 - \$32,400) and of unused allowable capital losses in the amount of \$2,200 (\$41,200 - \$43,400).

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. Grafton's net tax owing figures are as follows:

2010 = \$1,700 (\$31,500 - \$29,800)

2011 = \$8,400 (\$14,600 - \$6,200)

2012 = \$3,100 (\$27,400 - \$24,300) Estimated

As Mr. Grafton's net tax owing in 2012 (the current year) and his net tax owing in 2011 (one of the two preceding years) is greater than \$3,000, he is required to make instalment payments.

Amounts

If Mr. Grafton bases the first two quarterly payments on the 2010 net tax owing, they would only be \$425 each ($\$1,700 \div 4$). However, the payments for the last two quarters would be \$3,775 each $\{[\$8,400 - (2)(\$425)] \div 2\}$, resulting in total instalment payments of \$8,400.

A preferable alternative would be to base the payments on the net tax owing for 2012. These payments would be \$775 each ($\$3,100 \div 4$), for a total of \$3,100.

Payment Dates

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

Solution to Assignment Problem Two - 2

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:

Estimated Current Year's Tax Payable The instalment payments could be based on 1/12th of the estimated Tax Payable calculated at current rates on the estimated Taxable Income for the current year. In this case the resulting instalments would be \$3,288.33 per month ($\$39,460 \div 12$).

Preceding Year's Tax Payable The instalment payments could be based on 1/12th of the Tax Payable in the immediately preceding taxation year. The resulting instalments would be \$3,476.67 ($\$41,720 \div 12$).

Preceding One And Two Year's Tax Payable 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 \$2,720.83 ($\$32,650 \div 12$) each, a total of \$5,441.66. The remaining 10 instalments would be \$3,627.83 [$(\$41,720 - \$5,441.66) \div 10$] each. The total instalments under this approach would be \$41,720.

While the third approach would provide the lowest payments for the first two instalments, the payments would total \$41,720. As this is significantly larger than the \$39,460 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 2012 taxes payable, it would be liable for interest from the date each instalment should have been paid to the balance due date, September 30, 2012.

Assuming the actual 2012 taxes payable are \$39,460, 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 be applicable in this case.

Interest on the entire balance of \$39,460 of taxes payable would be charged beginning on the balance due date, September 30, 2012. 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 no penalty for late payment of taxes, provided a return has been filed. If no return is filed, 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.

The 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. In addition, interest would be charged on the penalty until such time as the return is filed.

Solution to Assignment Problem Two - 3

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

Case One

Mr. Shivraj’s net tax owing in each of the three years is as follows:

2010 = \$2,300 (\$13,500 - \$11,200)
2011 = \$3,300 (\$16,200 - \$12,900)
2012 = \$3,300 (\$18,400 - \$15,100) Estimated

As his net tax owing is expected to exceed \$3,000 in 2012 and was more than \$3,000 in 2011, the payment of instalments is required.

The best alternative would be to base the first two instalments on 2010. These would be \$575 ($\$2,300 \div 4$) each. The remaining two instalments would each be \$1,075 $\{[\$3,300 - (2)(\$575)] \div 2\}$.

They would be due on March 15, June 15, September 15, and December 15. They would total \$3,300.

Case Two

Mr. Shivraj’s net tax owing in each of the three years is as follows:

2010 = \$4,300 (\$13,500 - \$9,200)
2011 = \$5,900 (\$16,200 - \$10,300)
2012 = \$3,500 (\$18,400 - \$14,900) Estimated

As his net tax owing is expected to exceed \$3,000 in 2012 and was more than \$3,000 in both 2010 and 2011, the payment of instalments is required.

Using the 2012 net tax owing would result in minimum instalment payments \$875 ($\$3,500 \div 4$).

They would be due on March 15, June 15, September 15, and December 15. They would total \$3,500.

Case Three

Mr. Shivraj’s net tax owing in each of the three years is as follows:

2010 = \$3,700 (\$13,500 - \$9,800)
2011 = Nil (\$16,200 - \$16,300)
2012 = \$3,700 (\$18,400 - \$14,700) Estimated

As his net tax owing is expected to exceed \$3,000 in 2012 and was more than \$3,000 in 2010, the payment of instalments is required.

Using the 2011 net tax owing would result in minimum instalment payments. Based on this year, the required quarterly instalments would be nil.

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 \$23,650 ($\$94,600 \div 4$) based on the current year estimate.
 - Quarterly instalments of \$25,350 ($\$101,400 \div 4$) based on the first preceding year.
 - One instalment of \$21,625 ($\$86,500 \div 4$) based on the second preceding year, followed by three instalments of \$26,591.67 [$(\$101,400 - \$21,625 \div 3)$], a total of \$101,400.
3. The best alternative in terms of minimum instalments would be four instalments of \$23,650, for total payments of \$94,600. The instalments are due on March 31, June 30, September 30, and December 31, 2012.

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 \$23,650 ($\$94,600 \div 4$) based on the current year estimate.
 - Quarterly instalments of \$23,025 ($\$92,100 \div 4$) based on the first preceding year.
 - One instalment of \$21,625 ($\$86,500 \div 4$) based on the second preceding year, followed by three instalments of \$23,491.67 [$(\$92,100 - \$21,625) \div 3$], a total of \$92,100.
3. The best alternative would be one payment of \$21,625, followed by three payments of \$23,491.67. While the total instalments are the same \$92,100 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, 2012.

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 \$7,883.33 ($\$94,600 \div 12$) based on the current year estimate.
 - Monthly instalments of \$8,450.00 ($\$101,400 \div 12$) based on the first preceding year.
 - Two monthly instalments of \$7,208.33 ($\$86,500 \div 12$) based on the second preceding year, followed by 10 monthly instalments of \$8,698.33 [$(\$101,400 - (2)(\$7,208.33)) \div 10$], a total of \$101,400.
3. The best alternative in terms of minimum instalments would be 12 instalments of \$7,883.33, resulting in a total of \$94,600 of instalment payments.

The instalments would be due on the last day of each month, beginning in January, 2012.

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 \$7,883.33 ($\$94,600 \div 12$) based on the current year estimate.
 - Monthly instalments of \$7,675 ($\$92,100 \div 12$) based on the first preceding year.
 - Two monthly instalments of \$7,208.33 ($\$86,500 \div 12$) based on the second preceding year, followed by 10 monthly instalments of \$7,768.33 $\{[(\$92,100 - (2)(\$7,208.33)) \div 10]\}$, a total of \$92,100.
3. The best alternative would be two payments of \$7,208.33, followed by ten payments of \$7,768.33. While the total instalments are the same \$92,100 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, 2012.

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

Testamentary trusts are permitted to use a non-calendar fiscal year as their taxation year. In contrast, inter vivos trusts must use the calendar year as their taxation year. Without regard to the type of trust, its tax return must be filed within 90 days of the end of the taxation 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 when the notice of reassessment was mailed. A notice of objection must be filed prior to the later of:
- 90 days from the date of mailing of the assessment or reassessment; and
 - one year from the due date for the return under assessment or reassessment.

In this case, the later date is clearly 90 days after the mailing of the notice of reassessment.

- B. Determination of when the original assessment for the 2008 taxation year was mailed. A three year time limit applies from the date the original assessment was mailed. As the original assessment for 2008 would normally have been mailed after April, 2009, this reassessment is likely 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.
- 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

Part A

Accountant X is not liable for participating in an understatement of Client A's taxes payable because Accountant X did not know the expense receipt was personal in nature, and would not be reasonably expected to know, but for circumstances amounting to culpable conduct, that this was the case. This is because X relied in good faith on the information provided by A.

Part B

Based on these facts, Accountant X would be liable for a third party penalty. However, if Accountant X had determined that there was a reasonable basis upon which the Tax Court decision could be overturned by a higher court, the penalty would not apply.

Part C

Based on these facts, if X were to prepare and EFILE Z's return without obtaining the charitable donation receipt, X would be liable for a third party penalty. Given that the size of the donation is so disproportionate to Z's apparent income as to defy credibility, to EFILE the return without verifying the amount of the receipt would show an indifference as to whether the Act is complied with or would show a wilful, reckless, or wanton disregard of the law.