

Chapter 02 Fundamentals of Tax Planning

1. The manager at Big Company Corporation has decided to sell a piece of capital equipment after the company's year-end, in order to avoid paying capital gains tax this year. Which tax planning method has the manager used?
 - A.
 - B.
 - C.
 - D.
2. Which of the following scenarios illustrates a potential tax avoidance scheme?
 - A.
 - B.
 - C.
 - D.
3. The manager of Little Company Ltd. has decided to sell a piece of capital equipment after the company's year-end in order to avoid paying tax on capital gains this year. The manager is engaging in
 - A.
 - B.
 - C.
 - D.
4. Certain skills are necessary for successful tax planning. One of these skills is applying the time value of money. Which of the following is FALSE regarding this skill?
 - A.
 - B.
 - C.
 - D.

5.

Which of the following statements regarding GAAR is true?

- A.
- B.
- C.
- D.

6.

Steven James earned \$150,000 this year in profits from his proprietorship, which placed him in a 45% tax bracket. The rate of tax for Canadian-controlled private corporations in his province is 15% on the first \$500,000 of income. Personal tax rates (federal plus provincial) in James' province are:

On the first \$44,000	
On the next \$44,000	
On the next \$48,000	
On income over \$136,000	

(All rates are assumed for this question.)

Steven requires \$3,000 of after-tax withdrawals per month for his personal living expenses. All remaining profits are used to pay taxes and to expand the business. Steven expects the same profits before living expenses next year.

Steven is considering incorporating his business next year. If he incorporates, he will pay himself a gross salary of \$48,000.

Required:

Determine the increase in Steven's cash flow if he incorporates his company? Show all calculations.

- A. Why will Steve set his new salary at \$48,000?
- B. Name the type of tax planning that Steve would be engaging in if he incorporated his company.

7.

Part A: List the three key factors of cash flow.
Part B: List the six skills required for tax planning as suggested in the textbook.

8.

Andrew has \$10,000 to invest. He wants to put his money into an investment earning an annual interest rate of 12%. Andrew is in a 42% tax bracket.

Required:

- a) Calculate the value of Andrew's investment, after-tax, at the end of the year.
- b) Calculate the amount of taxes Andrew will have to pay on his investment.

9.

Match each of the following terms with the most accurate example. Use each example only once.

TERMS:

Tax evasion

Tax planning

Tax avoidance

EXAMPLES:

A. An individual is seeking a beneficial outcome, and therefore, applies an application that is not specifically prohibited by law.

B. A business is seeking a beneficial outcome, and therefore, does not report a portion of revenue earned during the year.

C. Two unrelated companies take steps to become related in order to shift income from the profitable business to the company with losses.

10.

For each of the examples listed below, state which of the following three categories of tax planning has been applied:

1. Shifting income from one time period to another
2. Shifting income from one entity to another
3. Shifting income from one type of income to another.

A. Jack has run a successful proprietorship for the past four years, and has now decided to incorporate his company.

B. Karen has decided not to pay herself a dividend from her corporation, (of which she is the sole shareholder), but has chosen to sell a portion of her shares to an associate instead.

C. XYZ Corporation has chosen to delay the recognition of a discretionary reserve until the following year.

Chapter 02 Fundamentals of Tax Planning **Key**

1.
(p. 10)

The manager at Big Company Corporation has decided to sell a piece of capital equipment after the company's year-end, in order to avoid paying capital gains tax this year. Which tax planning method has the manager used?

- A.
- B.
- C.**
- D.

*Accessibility: Keyboard Navigation
Blooms: Comprehension
Buckwold - Chapter 02 #1*

2.
(p. 20)

Which of the following scenarios illustrates a potential tax avoidance scheme?

- A.
- B.
- C.
- D.**

*Accessibility: Keyboard Navigation
Blooms: Comprehension
Buckwold - Chapter 02 #2*

3.
(p. 8)

The manager of Little Company Ltd. has decided to sell a piece of capital equipment after the company's year-end in order to avoid paying tax on capital gains this year. The manager is engaging in

- A.
- B.
- C.**
- D.

*Accessibility: Keyboard Navigation
Blooms: Knowledge
Buckwold - Chapter 02 #3*

4.
(p. 17)

Certain skills are necessary for successful tax planning. One of these skills is applying the time value of money. Which of the following is FALSE regarding this skill?

- A.
- B.
- C.**
- D.

$$(12\% \times [1 - .4]) = 7.2\% \text{ after-tax return}$$

Accessibility: Keyboard Navigation
Blooms: Application
Blooms: Comprehension
Buckwold - Chapter 02 #4

5.
(p. 20)

Which of the following statements regarding GAAR is true?

- A.
- B.
- C.**
- D.

Accessibility: Keyboard Navigation
Blooms: Comprehension
Buckwold - Chapter 02 #5

6.
(p. 13-14)

Steven James earned \$150,000 this year in profits from his proprietorship, which placed him in a 45% tax bracket. The rate of tax for Canadian-controlled private corporations in his province is 15% on the first \$500,000 of income. Personal tax rates (federal plus provincial) in James' province are:

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Steven is considering incorporating his business next year. If he incorporates, he will pay himself a gross salary of \$48,000.

Required:

Determine the increase in Steven's cash flow if he incorporates his company? Show all calculations.

- A. Why will Steve set his new salary at \$48,000?
- B. Name the type of tax planning that Steve would be engaging in if he incorporated his company.

A) Excess cash as a proprietorship:

Profits	
Tax: 24% × 44,000 \$10,560 32% × 44,000 14,080 40% × 48,000 19,200 45% × 14,000 6,300 (Assumed federal plus provincial rates)	
Living expenses	
Available for expansion	

Excess cash as a corporation:

Profits	
Salary	
Corporate business profits	
Tax: 15% × 102,000	
Available for expansion	
Excess cash (\$86,700 - \$63,860)	

- B) A \$48,000 salary from the corporation will result in \$36,120 of after-tax income, similar to his current withdrawals from the proprietorship.

$$[(\$44,000 \times .76) + (4,000 \times .68)] = \$36,120$$
- C) Transferring income to another entity

*Blooms: Application
Blooms: Comprehension
Buckwold - Chapter 02 #6*

7.
(p. 18-19)

Part A: List the three key factors of cash flow.
Part B: List the six skills required for tax planning as suggested in the textbook.

Three key factors of cash flow

1. Amount of money coming in
2. Amount of money going out
3. Timing

Six skills required for tax planning

1. Anticipation
2. Flexibility
3. Speculation
4. Applying the 8th Wonder of the World
5. Perspective
6. Global approach

*Blooms: Knowledge
Buckwold - Chapter 02 #7*

8.
(p. 18)

Andrew has \$10,000 to invest. He wants to put his money into an investment earning an annual interest rate of 12%. Andrew is in a 42% tax bracket.

Required:

- a) Calculate the value of Andrew's investment, after-tax, at the end of the year.
- b) Calculate the amount of taxes Andrew will have to pay on his investment.

- a) $(\$10,000 \times 1.12) \times (1 - .42) = \$10,696$
- b) $\$10,000 \times .12 \times .42 = \504

*Blooms: Application
Buckwold - Chapter 02 #8*

9.
(p. 8-10)

Match each of the following terms with the most accurate example. Use each example only once.

TERMS:

Tax evasion

Tax planning

Tax avoidance

EXAMPLES:

A. An individual is seeking a beneficial outcome, and therefore, applies an application that is not specifically prohibited by law.

B. A business is seeking a beneficial outcome, and therefore, does not report a portion of revenue earned during the year.

C. Two unrelated companies take steps to become related in order to shift income from the profitable business to the company with losses.

An individual is seeking a beneficial outcome, and therefore, applies an application that is not specifically prohibited by law. **Tax planning**

A business is seeking a beneficial outcome, and therefore, does not report a portion of revenue earned during the year. **Tax evasion**

Two unrelated companies take steps to become related in order to shift income from the profitable business to the company with losses. **Tax avoidance**

10.
(p. 10-17)

For each of the examples listed below, state which of the following three categories of tax planning has been applied:

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C. XYZ Corporation has chosen to delay the recognition of a discretionary reserve until the following year.

A. Shifting income from one entity to another

B. Shifting income from one type of income to another

C. Shifting income from one time period to another

Chapter 02 Fundamentals of Tax Planning Summary