

Chapter 01 Taxation-Its Role in Decision Making

Multiple Choice Questions

1. Which of the following is not considered to be a separate entity for tax purposes in Canada?

- A. An individual
- B. A proprietorship**
- C. A corporation
- D. A trust

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Topic: 01-04 Fundamental Income Tax Structure and Its Complexity

2. Which of the following attitudes and actions will help decision-makers develop an efficient approach to taxation?

- A. Cash flows should be considered from a before-tax perspective when making decisions.
- B. Functional managers should not be held responsible for the tax effects of decisions within their divisions.
- C. Tax costs to a business should be regarded as controllable expenses, much like product costs and selling costs.**
- D. All managers should own a copy of the Income Tax Act.

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Topic: 01-02 Taxation - A Controllable Cost

3. Which of the following statements is true?

- A. Dividends paid by a corporation are deductible by that corporation and are a form of property income for the recipient.
- B. Dividends paid by a corporation are deductible by that corporation and are a form of business income for the recipient.
- C. Dividends paid by a corporation are not deductible by that corporation and are a form of business income for the recipient.
- D.** Dividends paid by a corporation are not deductible by that corporation and are a form of property income for the recipient.

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4. When assessing the value of a corporation, the most relevant information that decision-makers normally consider is

- A. the potential for before-tax profits.
- B.** the potential for after-tax profits.
- C. the current corporate tax rate.
- D. cash flow before-tax.

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Topic: 01-03 Cash Flow after Tax

5. Income tax is calculated for which of the following jurisdictional groups?

- A. Municipal, provincial, and federal
- B. Municipal, federal, and foreign
- C.** Provincial, federal, and foreign
- D. Municipal, provincial, and foreign

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Topic: 01-04 Fundamental Income Tax Structure and Its Complexity

6. Two investor corporations may *not* enter jointly into which of the following?
- A. Joint venture
 - B. Partnership
 - C. Separate corporation
 - D.** Proprietorship

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Topic: 01-04 Fundamental Income Tax Structure and Its Complexity

7. Which of the following statements is *false*?
- A. Cash flow should be calculated on an after-tax basis.
 - B.** The tax cost to a business should not be regarded as a cost of doing business.
 - C. Income tax should be considered a controllable cost.
 - D. The value of an enterprise should not be based on pre-tax cash flow.

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Topic: 01-02 Taxation - A Controllable Cost

Topic: 01-03 Cash Flow after Tax

Short Answer Questions

8. The text book lists four fundamental tax variables which a manager needs to consider when making business decisions. These variables are: 1) primary types of income; 2) entities subject to taxation on income; 3) alternative forms of business and investing structures used by taxable entities structure; and 4) tax jurisdictions. List the relevant variables within these four categories.

Income: Business, Property, Employment, Capital Gains, Other Entities: Individuals, Corporations, Trusts

Forms of business: Proprietorship, Corporation, Partnership, Limited Partnership, Joint Venture, Income Trusts

Tax Jurisdictions: Provincial, Federal, Foreign

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Topic: 01-04 Fundamental Income Tax Structure and Its Complexity

9. ABC Corporation is in a 25% income tax bracket. John Adams is an employee at ABC and is in a 40% tax bracket. The company has offered John a 10% pay raise. His current salary is \$50,000.

Required:

- A) Calculate the after-tax cost of the raise to the corporation.
- B) Calculate the after-tax value of the raise for John.

Show all calculations.

- A) After-tax cost to ABC: $(\$50,000 \times 10\%) \times (1 - .25) = \$3,750$
- B) After-tax value for John: $(\$50,000 \times 10\%) \times (1 - .4) = \$3,000$

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Topic: 01-03 Cash Flow after Tax

10. Explain what is meant by the statement that 'tax should be treated as a 'controllable cost'.

Just as decision makers in business must control costs such as product, occupancy, selling, and many others, so should tax costs be regarded as controllable. The actions and activities of the organization must be analyzed at all levels, and across departments, to determine the impact on the overall tax cost.

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