

Chapter 01 Taxation—Its Role in Decision Making

Note : Test bank Cases is available

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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Blooms: Remember

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

2. Which of the following attitudes and actions is most likely to 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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Topic: 01-04 The Fundamental Income Tax Structure and Its Complexity

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 The 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 The 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 treated as 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

8. Logan holds a 7% interest-bearing debt instrument in Glow Co. Glow Co.'s tax rate is 27% and Logan is in a 45% tax bracket. Which of the following statements is correct?
- A.** The after-tax cost of the debt instrument is 5.11% to Glow Co. and the after-tax value to Logan is 3.85%.
 - B. The after-tax cost of the debt instrument is 5.11% to Glow Co. and the after-tax value to Logan is 3.15%.
 - C. The after-tax cost of the debt instrument is 1.89% to Glow Co. and the after-tax value to Logan is 3.15%.
 - D. The after-tax cost of the debt instrument is 7% to Glow Co. and the after-tax value to Logan is 7%.

$$.07 \times (1-.27) = 5.11\%$$

$$.07 \times (1-.45) = 3.85\%.$$

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Blooms: Apply

Topic: 01-03 Cash Flow after Tax

Short Answer Questions

9. 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 The Fundamental Income Tax Structure and Its Complexity

10. Jamie is an employee at ABC Ltd. and is in a 45% tax bracket. ABC Ltd. has a tax rate of 27%. The company has offered Jamie a 10% pay raise. Jamie's current salary is \$50,000.

Required:

A) Calculate the after-tax cost of the raise to the ABC Ltd.

B) Calculate the after-tax value of the raise for Jamie.

Show all calculations.

A) After-tax cost to ABC Ltd.: $(\$50,000 \times 10\%) \times (1 - .27) = \$3,650$

B) After-tax value for Jamie: $(\$50,000 \times 10\%) \times (1 - .45) = \$2,750$

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Blooms: Apply

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Topic: 01-03 Cash Flow after Tax

11. 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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Topic: 01-02 Taxation - A Controllable Cost

12. Blake holds a 5% interest-bearing debt instrument in Day Co. Day Co.'s tax rate is 27% and Blake is in a 50% tax bracket.

Required:

A) Calculate the after-tax cost of the debt-instrument to Day Co.

B) Calculate the after-tax value of the interest for Blake.

A) $.05 \times (1-.27) = 3.65\%$

B) $.05 \times (1-.50) = 2.5\%$

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Blooms: Apply

Blooms: Understand

Topic: 01-03 Cash Flow after Tax

13. Tanner holds a 7% interest-bearing debt instrument in Eve Co. Eve Co.'s tax rate is 13% and Tanner is in a 45% tax bracket.

Required:

- A) Calculate the after-tax cost of the debt-instrument to Eve Co.
- B) Calculate the after-tax value of the interest for Tanner.

A) $.07 \times (1-.13) = 6.09\%$

B) $.07 \times (1-.45) = 3.85\%$

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Topic: 01-03 Cash Flow after Tax