

Spring 2011

AFM 361: Taxation I
Midterm Examination I

All Sections

Friday, May 27, 2011

60 minutes

Instructions:

1. One copy of the *Income Tax Act* is allowed. The *Act* can have writing in it, but no paper can be pasted, stapled or otherwise attached into the *Act*. Tabs are permitted if they are less than 10 cm², used solely for the purpose of allowing the student to find a location quickly, and used judiciously. If an *Act* is not brought to the exam, the student will be allowed three sheets of paper of standard size (21.6 cm by 28 cm) with **handwritten** notes (on both sides). Nothing may be attached to these pages and no machine-generated notes or images are permitted. Failure to comply with these rules will cause the *Act* or notes pages to be confiscated immediately and the student will be required to write the exam without aids.
2. Calculators are also allowed (with no other functionality); and **no other** electronic devices are permitted.
3. **Time allotments are provided at the beginning of each question as a guide to ensure that you spend the appropriate amount of time on each question. Do not exceed these times.**
4. Do not cite sections of the *Act* unless specifically required. However, when necessary to convey your understanding, provide brief reasons for your answers indicating justification for the tax treatment determined.
5. Indicate clearly all calculations whether or not they seem relevant to the final answer.
6. If you feel you require more information in a fact situation, outline the exact information you need and specify how it would affect your decision, but do not contradict fact or assume the abnormal.
7. There are 2 questions and 5 pages in this examination.
8. Answer all questions in the examination booklets provided.

Question One (23 marks, 28 minutes)

Leia has worked for her present employer, Federated Planners, Ltd., for many years. In 2010 she agreed to teach two sections of a tax course at the local university.

Terms of the university arrangement were that she provided instruction 6 hours and held 3 hours of office hours per week. She used a shared office for the office hours, but it was expected that she would do all other out-of-class course-related work at home. Leia spent, on average, 12 hours per week working on the course at home.

She was responsible for all aspects of the course including all marking. She was permitted (but not required) to hire outside markers, but she must supervise their work. It has been the university policy to treat adjunct lecturers, like Leia, as employees for tax purposes. All parties (including CRA) agree with this treatment.

Compensation from the university was as follows:

Salary	\$30,000
Payroll deductions—Income tax withheld	(4,000)
	<u>26,000</u>

Additional facts

- (1) No CPP or EI were withheld because her main employer, Federated, withholds the maximum.
- (2) The university provides free parking to Adjunct Lecturers. The regular price of the parking charged to the public for the same lot is \$10/day, or \$250 for the 25 teaching days during the term.
- (3) As a member of the university community, she was allowed to use the athletic facilities because the university believes that healthy employees are more productive. She used this opportunity to begin a new exercise program. When she stopped teaching, and could no longer use the facilities, she joined the local exercise club for \$100 per month.
- (4) During her teaching term, the accounting unit was named for a large donor and each faculty and staff member, including Leia, received a golf shirt prominently displaying the new name. Each shirt's value was \$50.
- (5) During the term, Leia incurred the following costs that she felt directly relate to her teaching duties:

hired one employee to mark	\$ 600
lost salary from Federated because she took one unpaid day to administer the final exam	450
reference books required to teach the class	350

- (6) Leia drove to the university to teach. Her gas, maintenance and insurance to drive for the year totaled \$3,000. Each of the 25 trips involved 30 km of driving. Total driving for the year was 15,000 km.
- (7) Leia dedicated one room to use as an office for the 4 months of the teaching term as was required. The room takes up 15% of her home. The office is not required for her duties at Federated. Leia's home costs for the year are as follows:

house insurance	800
house electricity, water	5,000
house heating fuel	1,000
Bell services (phone, 500; TV, 1,500)	2,000
property tax	3,000

Required:

- (A) Determine Leia's income from the university employment under Division B of the *Act* for 2010. You **must** provide a reference to the *Act* or other authoritative sources to support your treatment. Where judgment is required to apply the tax rules for an item or items, provide a brief explanation to support the treatment used. Round any numbers to the nearest dollar.
- (B) List items you did not include in the above calculation. Provide reference to the *Act* or other authoritative sources to support the exclusion. Where judgment is required to apply the tax rules for an item or items, provide a brief explanation to support the treatment used.

Question Two (27 marks, 32 minutes)

Sadie was hired as an employee of Eukanuba Ltd. and she began her employment on June 8, 2009. Her job is manager of sales. Her negotiated annual compensation for 2010 is as follows:

Salary		\$130,000
Bonus based on incremental sales generated by her division		22,000
Dinner and entertainment reimbursements (as described below)		4,000
Payroll deductions:		
Income tax withheld	50,000	
Canada pension plan contributions	2,163	
Employment insurance premiums	747	
Contributions to company's group registered retirement savings plan (RRSP); matched by employer	<u>5,000</u>	(57,910)
		<u>98,090</u>

In addition to the above, Sadie has informed you of the following additional benefits she received.

During the first year of her employment, Sadie was required to supply her own vehicle. When hired, she was driving an SUV that she had bought on January 2, 2008. On January 1, 2010, the UCC on the vehicle was \$20,170. She sold the vehicle on June 12, 2010. CCA for the year is available at a rate of 15%. The cost to operate the SUV for the period January 1, 2010 to June 12, 2010, which she paid, was as follows:

Fuel	2,400
Maintenance	500
Insurance	800
Interest on car loan	1,100

On June 9, 2010, the company started to provide her a vehicle, which it purchased for her. The company paid \$44,000 plus HST at 13%, for a total of \$49,720. The company also pays all operating costs of the vehicle. The company uses this policy to provide a built-in raise to new managers after one year. Sadie maintained careful records of business and personal use, and reports the following usage:

	Jan 1 to Jun 12	Jun 9 to Dec 31
Business use	7,500 km	12,000 km
Personal use	5,000 km	6,500 km
Total use	12,500 km	18,500 km

Periodically, Sadie is asked to take clients out for dinner or to various sporting events. The company reimburses her all receipted costs of these activities. The total cost to Sadie was \$4,000.

During the year, Sadie took a vacation with her family. She used frequent flyer points for two tickets. The points were obtained through work-related travel while she worked for her

previous employer. The third ticket for her daughter, on the same flight, cost \$400. In Florida, she stayed at the private house of Eukanuba's owner. Eukanuba reimburses the owner for the costs of operating the house because senior employees occasionally stay there when the owner is not using it. A similar house would rent for \$1,600. Sadie was charged nothing, but she left a thoughtful gift that cost her \$75. Meals and sightseeing while in Florida cost Sadie an additional \$2,000.

The prescribed rate of interest in 2010 was 1%, 1%, 1% and 2% for the four quarters.

Required:

- (A) Determine Sadie's income from employment under Division B of the *Act* for 2010. You do not need to cite references to the *Act*. Where judgment is required to apply the tax rules for an item or items, provide a brief explanation to support the treatment used. Round any numbers to the nearest dollar.
- (B) List items you did not include in the above calculation. Where judgment is required to apply the tax rules for an item or items, provide a brief explanation to support the treatment used.

Question 1: 23 marks, ✓ = 1.0 marks, max 27✓**(A) Calculation of employment income**

Salary			30,000 ✓	5 ✓
Parking			250 ✓	6(1)(a) ✓
Less:				
*Wages of marker			(600) ✓	8(1)(i) ✓
Deductible home office costs:				
Electricity and water	5,000 ✓			
Heating fuel	<u>1,000</u> ✓			
Prorated	6,000	x 15% ✓ / 3 ✓	(300)	8(1)(i) ✓
			<u>29,000</u>	

(B) Omitted items

*(alternative answer) Wages of marker ✓	not under 8(1)(i) ✓
Book ✓	not under 8(1)(i) ✓
Income tax withheld ✓	not deductible under sec 8; 8(2) ✓
Health facilities ✓	IT-470R, or just say CRA document ✓
Shirt ✓	6(1)(a) [IT-470R also accepted**] ✓
Lost wages ✓	not deductible under sec 8; 8(2) ✓
Driving to work ✓	not deductible under 8(1)(h.1) ✓
Other home office costs: not in 8(1)(i); not in 8; or cite 8(2). Not deductible. ✓	
insurance ✓	
Bell services ✓	
property tax ✓	

* The part of the question re wages of the marker is ambiguous. It talks about her ability to “hire” outside markers, but it is silent about who pays for them. If one assumes that she pays for them and is required to do so, then the amount is deductible under paragraph 8(1)(i). If the employer pays for them, or she pays for them but is not required to do so, then the wages do not fall under paragraph 8(1)(i) and are thus non-deductible.

**Re the shirt, IT-470R mentions this briefly, but only in the section on awards, and that has now been superseded by the issue of Income Tax Technical News in 2009. The latter document is much more clear, but few students would have read that.

Question 2: 27 marks, ✓ = 1.0 marks, max 32 ✓

(A) Calculation of employment income

Salary		130,000 ✓
Bonus		22,000 ✓
RRSP – employer's		5,000 ✓
Standby charge	$6,500 ✓ / (1,667 ✓ \times 7 ✓) \times 2\% ✓ \times 7 ✓ \times 49,720 ✓$	3,877
Operating cost benefit: lesser of (a)	$6,500 ✓ \times 0.24 ✓ = 1,560$	
	(b) $0.5 ✓ \times 3,877$ (standby chg) ✓ = 1,939	1,560
Use of house in Florida	$1,600 ✓ - 75 ✓$	1,525
Less: amounts deductible under 8(1)(f) or 8(1)(h.1)		
Auto costs: Fuel		2,400 ✓
Maintenance		500 ✓
Insurance		<u>800 ✓</u>
		<u>3,700</u>
prorated	$\times 7,500 / 12,500 ✓$	2,220
Not limited by commission income ✓		(2,220)
Capital items on car CCA:	$20,170 ✓ \times 15\% ✓$	1,815
interest: lesser of (a)	$1,100 ✓$	
	(b) $300 ✓ \times 163 ✓ / 30 = 1,620$	<u>1,100</u>
		2,915
prorated	$\times 7,500 / 12,500 ✓$	(1,749)
		<u>159,993</u>

(B) Omitted items

- Dinner and entertainment reimbursement ✓
- Income tax withheld ✓
- CPP and EI ✓
- RRSP contribution of employee ✓
- Use of frequent flyer points ✓
- Personal vacation costs while in Florida ✓