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Point allocations are shown in red  
Comments are shown in green italics

## Results

	Q1	Q2	Q3	Q4	Total	
OUT OF	18	20	10	12	60	
Mean	13	14	8	8	44	73%
Median	14	14	9	8	45	74%
Max	18	20	10	12	58	97%
Min	2	6	-	1	16	27%

### Overall comments:

- In general, we think the exam provided a good assessment of your understanding of some fundamental concepts. We were surprised that the grades were not slightly higher, but were encouraged by the quality of many of the answers given.*
- The most common mistake that cost people significant points was not answering the question that was asked. A great answer to the wrong question is not a great answer.*
- If you want to discuss the exam, please make an appointment with your professor. However, no adjustments to grades will be made in such meetings.*
- If you wish to appeal your grade, a formal process for doing so will be posted on LEARN.*

**Spring 2012**

**AFM 361: Taxation I**

**All Sections**

**Friday, May 25, 2012**

**Midterm Examination 1**

**60 minutes**

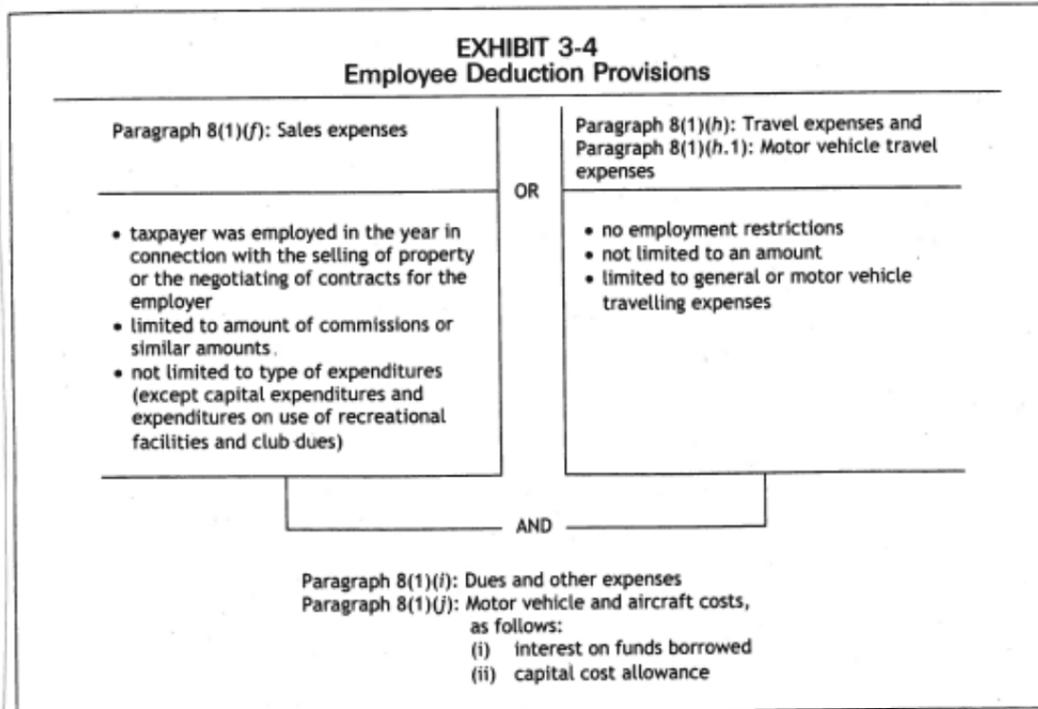
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### Instructions:

- You may not ask questions during the exam.** If you think you require more information in a fact situation, outline the exact information you need, specify how it would affect your decision, and then make an assumption. Do not contradict the given facts or assume the abnormal.
- You are permitted to use a calculator (with no other functionality); no other electronic devices are permitted.
- Time allotments are provided for each question as a guide to ensure that you spend the appropriate amount of time on each question.
- Clearly annotate all calculations you wish to have included in the grading.
- Round all answers to the nearest dollar.
- The next page of the exam contains excerpts from the textbook.
- There are 4 questions in this examination. The exam is out of 60 points and counts for 10% of your grade in the course.
- Answer all questions in the space provided. If you require additional space, use the blank sides of the pages.

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Excerpts from the textbook



The Act provides a computational formula to establish a reasonable standby charge as:

$$\frac{A}{B} \times [2\% \times (C \times D) + \frac{1}{3}(E - F)]$$

where A\* is the lesser of:

- (a) total personal-use kilometres driven during the available time period, and
- (b) the value determined for B (as defined below) during the days the automobile is available;

B\*\* is  $1,667 \text{ km} \times \left( \frac{\text{total available days}}{30} \right)$ ;

C\*\*\* is the full original cost of an employer-owned vehicle, including HST;

D\*\* is  $\frac{\text{the total available days when the employer owned the automobile}}{30}$

E is the lease payments, including HST, made by the employer;

F is the portion of the lease payments which pertains to insurance for loss or damages and any liability in using the automobile.

\* Note that amount A, above, is deemed to be equal to amount B unless:  
 (i) the taxpayer is required by the employer to use the automobile in respect of his or her duties of employment, and  
 (ii) the automobile is used primarily (more than 50%) in his or her duties of employment.  
 \*\* Rounded according to the rule in the definition (i.e., to the nearest whole number, unless the fractional part is .5, in which case round the fraction down).  
 \*\*\* The capital cost limitations in paragraph 13(7)(g) and Regulation 7307, as subsequently described, do not apply.

**Comparison of Deductions**

	Ordinary Employee*	Salesperson/Negotiator		Proprietor
	[s. 8(1)(h), (h.1), (i), (j)]	[s. 8(1)(f)]	[s. 8(1)(i), (j)]	
Home Office:				
Utilities	✓		✓	✓
Mortgage interest				✓
House insurance		✓		✓
Property taxes		✓		✓
Maintenance and repairs	✓		✓	✓
Office supplies	✓		✓	✓
CCA on computer				✓
Automobile expenses:				
Operating	✓	✓		✓
CCA	✓		✓	✓
Interest on loan	✓		✓	✓
Convention (excl. meals)				✓
Promotional expenses		✓		✓
Limit on expenses	None	Commission Income	None	None

\* Required to travel for employer, but no sales commission earned.

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### Question 1

(18 points, 18 minutes)

Treat each of the following questions independently. You may use any style (e.g., bullets, full sentences, etc.) that you feel conveys your answer clearly.

- A. Under common law, the determination of whether an individual taxpayer is liable for Canadian tax in a given tax year ultimately comes down to answering what question?

Does the taxpayer have a continuing state of relationship with Canada? (2 points)

- B. Except when specifically excepted by the Income Tax Act, a non-salary payment made by an employer to or on behalf of an employee will be treated as a benefit if \_\_\_\_\_

It increases the net worth of the individual. (2 points)

- C. True or False: Allowances are always taxable. Explain your answer.

False. A reasonable allowance for things like travel and automobile will not be taxable. (3 points)

- D. True or False: Reimbursements are never taxable. Explain your answer.

False. A reimbursement that exceeds the actual costs incurred would be taxable. (3 points)

- E. Assuming that a taxpayer qualifies as a commissioned salesperson and that all other conditions to be allowed to deduct employment expenses are met, under what conditions would the taxpayer deduct his employment expenses under sections 8(1)(h) and 8(1)(h.1) rather than under section 8(1)(f)? Be as specific as you can in your answer.

Under 8(1)(f), the expenses are limited to the amount of commission income, while under 8(1)(h) and (h.1), they are not. However, there are certain expenses (for example, property tax and house insurance related to home office, and promotional expenses) that are allowable under (f) but not under (h). If the amount by which the expenses exceed commission income is greater than the expenses not allowed under (h), the taxpayer would use (h) and (h.1). (8 points)

*This question was generally well done. Many students wasted time and ink writing long answers to very simple questions. That didn't likely cost you points on this question, but it may have resulted in missed points on subsequent questions if you ran out of time.*

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*Your answers to these questions did not need to match those given here exactly, but the fundamental elements had to be there. In the case of E., you had to mention the limit imposed by commission income and the trade-off between exceeding the cap in (f) and having fewer things deductible in (h) and (h.1).*

## Question 2

(20 points, 20 minutes)

Mr. Nuko Mer moved to Canada from Sweden in 2011. He arrived in Canada on May 25 and didn't leave again until going home to Sweden for two weeks on December 23. Mr. Mer works for a Swedish furniture company that has a large subsidiary in Canada and they are willing to let him work in either country. He is not sure whether he wants his move to Canada to be permanent or not, but so far he really likes it here.

The following are some facts about Mr. Mer's income in 2011:

<i>Employment income earned in Sweden January 1 – May 25 according to Swedish law</i>	<i>C\$50,000</i>
<i>Employment income earned in Sweden January 1 – May 25 according to Canadian law</i>	<i>C\$53,000</i>
<i>Employment income earned in Canada May 25 – December 31 according to Swedish law</i>	<i>C\$120,000</i>
<i>Employment income earned in Canada May 25 – December 31 according to Canadian law</i>	<i>C\$115,000</i>

- A. Ignoring any treaty considerations, how much employment income would Mr. Mer report on his 2011 Canadian tax return if he was considered a non-resident?

115,000 (2 points) *Generally well done, but many students wrote way too much.*

- B. Ignoring any treaty considerations, how much employment income would Mr. Mer report on his 2011 Canadian tax return if he was considered a part-year resident?

115,000 (2 points) *Generally well done, but many students wrote way too much.*

- C. Ignoring any treaty considerations, how much employment income would Mr. Mer report on his 2011 Canadian tax return if he was considered a full-time resident?

168,000 (2 points) *Generally well done, but many students wrote way too much.*

- D. Knowing nothing more about his situation than is given in the question, which of the degrees of residency in Canada could Mr. Mer fall under in 2011? Explain your reasoning.

He could be a part-year resident if he makes a fresh start. (2 points)

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He could be **deemed** to be a full-time resident since he was in Canada for more than 183 days in the year. **(3 points)**

He could not be a non-resident of Canada. **(2 points)**

(Question 2 continues on the next page)

*This question was done very poorly by many people. It is a good example of people answering a question different from the one that is asked. Changing "could" to "would" fundamentally changes the question. And that is the question that many students answered. Many points were also lost by students that ignored the fact that the question specifically asked for degrees (multiple) of residency.*

E. For each of the degrees of residency that you list in Part D, list several key facts which, if present in his case, would make that particular degree of residency the one he would fall under in 2011.

Part-year: **(4 points)**

- Family came with him
- Established social ties (joined clubs, church, etc.)
- Opened a Canadian bank account and kept the money here
- Got Canadian driver's licence
- Severed significant ties in Sweden
- Was paid by the Canadian subsidiary
- Can see a path to career advancement in Canada
- Bought a house
- Brought all or most of his possessions with him
- Bought a car

Deemed full-time: **(3 points)**

- Family stayed in Sweden
- Sent most of his income back to Sweden
- Left most of his possessions in Sweden
- Rented very temporary housing
- Did not establish any social ties

*This question was done very poorly, mostly because students simply did not answer the question that was asked. You were asked to list several key facts additional to those given in the question. Many students changed the question to be "what degree of residency does he fall under?" and made it into an A vs. B*

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*analysis with a conclusion. Perhaps this is because that was the type of question we did in class. Unfortunately, it was not asked here.*

*Among those that did try to list additional facts, many students did not seem to understand that to be deemed a full-time resident, the taxpayer must have the characteristics of a non-resident, but be in the country for 183 or more days.*

### Question 3

(10 points, 10 minutes)

Ms. Singh has full use of an employer-owned car and her employer also pays all operating costs for the car. The original cost of the car when it was purchased two years ago was \$20,000, including HST. Other details about the car in the current taxation year are as follows:

Capital cost allowance to be claimed by the employer	\$3,570
Capital cost allowance rate for cars	30%
Operating costs, including HST and \$600 for insurance	\$3,500
Personal-use kilometres	12,000
Business-use kilometres	18,000
Number of months available	12
Reimbursement to employer for personal use (at 10 cents per kilometre), paid in December	\$1,200

A. Compute any income inclusions and/or deductions related to the car that Ms. Singh should include on her personal tax return.

Standby charge-as business km > 50% total km for the period, the numerator in the Standby Charge Calculation = the personal km driven

$$= 12000\text{km}/(1,667\text{km} \times 12) \times 2\% \times \$20,000 \times 12 \text{ months} = 2,880 \text{ (5 points)}$$

Operating benefit -as business km > 50% total km for the period, Ms. Singh can elect to use the lesser of calculation for the operating benefit as follows:

$$= \text{lesser of } [50\% \times 2,880 = 1,440] \text{ and } [12,000 \times 0.24 = 2,880] = 1,440 - 1,200 = 240 \text{ (5 points)}$$

*This question, which is taken almost straight from an Exercise on the syllabus, was done well, overall. The most common mistake was not annotating to say that she qualifies for the standby charge reduction (A not equal to B) because business kms are more than 50%. Bullet 4 in the instructions for the exam clearly states that this is necessary.*

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*Others lost points for jumping straight to the conclusion that the operating cost benefit was 50% of the standby charge. The lesser of calculation is necessary... at least to the extent of acknowledging that there was another number to be considered (the 24c per km number).*

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**Question 4**

**(12 points, 12 minutes)**

Danita Crewson worked for Laurel Wood Products, Inc. (LWPI), a public company, in 2011. Due to the nature of the employment agreement she had with LWPI, Ms. Crewson is unsure whether she should file her tax return as an employee of LWPI or as a self-employed individual. The following are the details she has provided:

1. She received gross pay of \$80,000. She did not receive any bonus or commission related to sales.
2. On Jan 1, 2011, she was granted an option to purchase 1,000 shares of LWPI for \$10/share, the price they were trading at that day. She exercised the option on 500 of the shares on November 23, 2011, when the shares were trading at \$15/share.
3. LWPI did not provide her with permanent office space and required her to work out of an office in her home most days. The home office takes up 18% of the usable floor space of her house. The following are the amounts she spent in the year (\* indicates the amount was for the house):

i. Maintenance*	500
ii. Insurance*	800
iii. Office supplies	900
iv. Utilities*	2,300
v. Property tax*	4,500
vi. Kitchen renovation*	12,000
vii. Mortgage interest*	24,000

- A. If Ms. Crewson is treated as an employee of LWPI, how much should she report as employment income in 2011?

Employment income =  $80,000 + 2,500 - 1,404 = 80,896$  (6 points)

Home office expenses =  $(500 + 2,300) * 18\% + 900 = 1,404$  (3 points)

*This part was generally well done. Most common errors were including all 1,000 shares in the stock option benefit, including non-includable things in the home office expenses, and prorating the office supplies.*

- B. If Ms. Crewson is treated as a self-employed individual, how much should she report as employment income in 2011?

Zero. All of her income would be self-employed (i.e., business) income. (3 points)

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*This part was done very poorly. You may view it as a “trick” question, but it isn’t that. It is just another way to ask the question “As far as the Income Tax Act is concerned, are employment and self-employed income fundamentally different?”. And the answer is yes. Most people did a full calculation of what the self-employed (i.e., business income) would be and did it correctly. Zero points were given for doing so. It is important to answer the question that is asked.*