AFM 201: First Tax Exam

Friday, October 1, 2010

Time: 4:30 pm – 5:20 pm (50 minutes)

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- Where the exam booklet asks you to enter your section number, enter the time of your class instead (e.g., 8:30).

Instructions:

1. Use of a calculator and Volume 2 of the course notes (pink cover) is permitted. Writing in Volume 2 is permitted. Tabs can also be used, subject to the size limits (maximum 1.25cm by 4 cm as specified in the course outline). However, typewritten material and paste-ins are not permitted.

2. Questions which ask the student to "calculate" require only that. Where reasons are requested, give an explanation but do not give statutory references.

3. Show clearly all calculations whether or not they seem relevant to the final answer.

4. If you feel you require more information in a fact situation, outline the exact nature of the information and specify how it would affect your decision, but do not contradict facts or assume the abnormal.

5. Including this page, there are 3 questions on 4 pages (including this page) in this examination. Please ensure that you have them all.

6. Answer all questions in the exam booklets provided.

7. The suggested time allocation after each question indicates the relative importance in the marking scheme.

Question 1 (15 minutes)

Dara Doodle, age 67, has asked you for assistance in preparing her 2010 tax return. She lives with her partner Drake, age 56, who has three children from a previous marriage, ages 22, 20, and 15. The children live with the couple. Dara is a manager with Tax Preparers Unlimited Limited. Drake is an economist who occasionally finds contract work preparing economic forecasts at the minimum wage.

Dot, the 22-year-old, attended the University of Waterloo for eight months during 2010 as a full-time student. She has income for tax purposes and taxable income of $4,500 and paid tuition fees of $5,600. A total of $4,000 of her income is employment income, and on that income Dot paid EI premiums of $125 and made CPP contributions of $100. The rest is grossed-up dividends from Canadian-resident public corporations. Dot incurred $12,000 of expenses for prescription drugs in the year, all of which was paid by Dara.

Duncan, age 20, attended a private high school for 10 months in the year and had tuition of $4,000. Duggan, age 15, attends a special school for the hearing impaired, since he has no hearing. Each child has as his only source of income $225 of interest income from Canada Savings Bonds given to them by Dara on October 31, 2009. Dara paid $6,500 in expenses for rehabilitative therapy fees to Duggan's special school in 2010.

Dara's Division B income and taxable income is $86,076 while Drake's Division B income and taxable income is $5,443.

Required:

Determine the maximum non-refundable tax credits which Dara can claim that relate in any way to each of the people who she supports.

Question 2 (20 minutes)

Mrs. Yeo, a widow who is 68 years old, has Division B and taxable income of $76,400. Here are some additional facts you have learned about her financial results for the year:

Pension income (life annuity from a company pension plan)	50,000
Canada Pension Plan	6,400
Grossed-up dividends from a CCPC	12,500
Old Age Security benefits	5,500
Dividend from U.S.corporation net of 15% withholding tax	1,700
Donations to registered charities	17,000

Required:

Calculate Mrs. Yeo's federal income tax payable for 2010.

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Question 3 (15 minutes)

During 2010, Chazerai Ltd. sold its building which cost $697,000 in 1987 for $195,000. It was the only building in Class 3 at the time of its sale. The undepreciated capital cost of Class 3 at the beginning of 2010 was $220,000. A new piece of land was purchased for $100,000. In April 2010, Chazerai decided to erect a windmill for $150,000 on the new piece of land to honour the company's Dutch heritage and to become the main attraction for a new Dutch theme park the company is planning. That same month, a fence was erected around the windmill due to safety concerns at a cost of $40,000.

Chazerai also leases a warehouse. Leasehold improvements had been made on the warehouse at a cost of $225,000 on January 1, 2008. The lease was entered into on January 1, 2004, with a term of 10 years and two successive renewal options of three years each.

Required:

Prepare a table of the maximum capital cost allowance writeoffs for 2010 and indicate the balances of undepreciated capital cost in the various CCA classes as at January 1, 2011. What is the total amount of CCA deductions for the year?

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Question 1 Solution (✓ 22 possible)

Notes:

(1) Some students will calculate Dara's own credits (basic personal, etc.), even though the question asked only for credits related to people she supports.

(2) Give the marks even if the students do not say which person they relate to.

✓✓ if the 15% is used in a least most places where it should be used. These marks should be awarded if the student implicitly includes the 15%, e.g., if the student writes down $1.086 for the impairment credit instead of 15%*7,239.

Drake:

Spousal tax credit [15% * (10,382✓ – 5,443✓)] $741

[Notes:
(1) If a student written down $1,557 for the married tax credit, they should get one checkmark, because they presumably meant 15%*10382 = $1,557. Apply this principle similarly throughout this exam.
(2) If a student writes down that they assuming the couple are married, do not award the mark. The question makes it clear that the couple are common-law. The spousal credit is given for common-law couples as well, and the student needs to show knowledge of that.]

Dot:
Transfer of tuition, education and textbook credit lesser of:
(i) $750✓
(ii) 15% * [$5,600✓ + $400✓*8✓ + $65✓*8✓] = 1,398 $750✓

Notes:
(1) Dara can claim these credits since Dot's federal taxes payable will be offset by the basic personal credit, i.e., her taxable income of $4,500 is less than the personal tax credit base of $10,382. ✓
(2) The CPP, EI and dividend tax credits cannot be transferred to Dara. The 82(3) election is not available since Dot is not the spouse.

Duncan:

No tax credits available to Dara associated with Duncan. The tuition fees to the private school do not qualify for the tuition tax credit.

Duggan:

Child Amount (Duggan is under the age of 18): 15% * 2,101✓ $315
Transfer of (i) Duggan's impairment credit: 15% * 7,239✓ 1,086
and (ii) the impairment credit supplement for disabled children under 18
15% * $4,223✓ 633
Medical Expenses:
(1) 15% * [$6,500✓ – lesser of $2,024✓ and 3% of $86,076✓] 671
(2) 15% * lesser of 1,500
(i) 10,000✓
(ii) 12,000 ✓– lesser of $2,024✓ and 3% of $4,500✓ = 12,000 – 135 = 11,865

Note: some students will answer this question using a formula A*[(B – C) + D] where:
A = 15%
B = 6,500
C = lesser of 2,024 and 3% of 86.076
D = is the lesser of $10,000 and E - F
E = $12,000
F = lesser of 2,024 and 3% of 4,500

It is OK to use the above approach as long as the calculation following the writing down of this formula suggests they know how to apply the formula.

Question 2 Solution (✓ 31 possible)

Notes:
(1) The question does not state clearly whether the "Canada Pension Plan" is an amount paid (deducted off the employee's pay cheque) or an amount received (CPP benefits). Also, some students did not know that a CCPC was a kind of private corporation. However, neither of these issues affects the marking key below.

Old Age Security repayment is the lesser of:
(i) $5,500✓
(ii) 15% ✓* (76,400✓ – 66,733✓) = $1,450
The lesser amount is $1,450.

Revised Division B income and taxable income $76,400 – 1,450 = $74,950✓

Federal income tax	on first $40,970		$6,146✓
	On next 33,980 (i.e., 74,950 – 40,970)✓ @ 22%✓		7,476
			13,622
Less tax credits (✓✓ if the 15% is used in at least most places where it should be used)			
Basic personal ($10,382✓ * 15%)		$1,557	
Age [$6,446✓ – ((74,950✓ – 32,506✓) * .15✓)]*.15		12	
Pension 15% * (lesser of (i) $2,000✓ and (ii) 50,000✓)		300	
Charitable Donations			
15%*200✓ + 29%✓*(17,000-200) ✓		4,902	
Dividend tax credit**			
2,500✓* 2/3✓		1,667	8,438
Basic Federal tax			5,184
Foreign Tax Credit			
Lesser of (i) 300✓ [2,000* – 1,700]			
(ii) ($2,000✓/74,950✓) * (5,184✓ + 1,667✓) = $183			($183)
Federal tax payable			$5,001
Plus: OAS repayment✓✓			1,450
Total Federal Tax			$6,451

* Calculation: The pre-tax amount is $1,700 / (1 – 0.15) = $2,000✓.
** Calculation: Cash dividend is 12,500/1.25 = 10000✓, so gross-up is 12,500 – 10,000 = 2,500✓. Any other way of calculating the $2,500 gross-up (e.g., 12,500*1/5) should also get full marks.

Question 3 Solution (✓ 20 possible)

Notes:
(1) If a student tries to apply the rule for a short taxation year and then multiplies the calculated CCA by a fraction, just ignore that.

No CCA can be claimed on land.

The difficulty in calculating the ½ net amount for class 3 below is that the ½ net amount is the amount, if any, by which additions exceed disposals. Since additions are less than disposals, this amount is zero.

Note that the check mark for ending UCC is for realizing that the UCC on Jan. 1, 2011 is the UCC after the half net amount (net adj. below) less the UCC but plus the ½ net amount, regardless of whether the calculation is correct.

	Class 3 (5%)	**Class 6 (10%)**	**Class 13**
UCC – Jan 1, 2010	220,000✓	0	187,500 (see below)
Additions	150,000✓	40,000	0
Disposals	(195,000)* ✓	0	0
Subtotal	175,000	40,000	0
½ net amount	0✓	20,000	0
UCC after net adj.	175,000	20,000	0
Terminal Loss	0	0	0
CCA	(5,250) ✓	(2,000) ✓	(25,000)
½ net amount	0	20,000	0
UCC Jan 1, 2011✓	169,750	38,000	162,500

*lesser of cost of $697,000✓ and $195,000✓.

Note 1: 2008 Leasehold Improvements – lesser of:
(i) 1/5✓ * 225,000✓ = $45,000
(ii)$225,000✓/(6✓+3✓) = $25,000 $25,000
The 6 years is from 2008 to 2013.

Unfortunately, the problem did not give the opening UCC balance in class 13. We did not intend to ask students to calculate this, but it can be done using the above calculation. The 2008 amount have been $12,500 (half of the $25,000 above), and the 2009 amount would have been the full $25,000. Thus the opening UCC is $225,000✓ - $12,500✓ - $25,000✓ = $187,500.

Note 2: From the table of assets at the front of the Income Tax Act (pink book), the fence is a class 6 asset✓with a CCA rate of 10%. Check: CCA is 40,000*10%*1/2 = $2,000. Some students might think that the fence is a leasehold improvement, but this is incorrect since the fence is related to the purchased land and not the leased warehouse.

Note 3: From the table of assets at the front of the Income Tax Act (pink book), the windmill is a class 3 asset✓. Some students might choose to classify it as electrical generating equipment purchased after 2000 (class 17, 8%), and this should be accepted as a correct answer. In that case, the following adjustments would be made to class 3 above: additions, zero; “subtotal” and “UCC after net adj., each $25,000; and CCA, $25,000 (terminal loss).

CCA deductions for the year total✓ to $25,000 + $3,750 + $2,000 + $25,000 = $55,750. The mark is just for realizing they should be added; there is no need to check the