**COMPREHENSIVE CASE SOLUTIONS**

***NOTE****:*

*The cases related to these solutions are on Connect. They are not printed in the text.*

**Solution to COMPREHENSIVE CASE ONE**

*Comparison of two employment offers received by John Smith*

1. Offer of employment from ABC Co.
   1. Salary of $45,000 is included in income when received [ITA 5(1)]
   2. Stock option: The option is “in the money” at the date of grant; exercise price = $20; value at grant date = $25.

If ABC Co is not a Canadian-controlled private corporation (CCPC):

* there will be an employment income inclusion on the exercise date to the extent the value at the exercise date exceeds $20 [ITA 7(1)]
* the stock option deduction will not be available [ITA 110(1)(d)]
* John will have a capital gain or loss on the disposition of the shares based on the difference between the selling price and the value at the date of exercise

If ABC Co is a CCPC:

* the employment income inclusion is deferred until the date of disposition [ITA 7(1.1)]
* if John does not dispose of the ABC Co shares within two years after acquiring them, John is entitled to the stock option deduction which is equal to ½ of the stock option employment benefit [ITA 110(1)(d.1)]
* John will have a capital gain or loss on the disposition of the shares based on the difference between the selling price and the value at the date of exercise
  1. Home purchase loan: John will have an imputed interest benefit included in his employment income. The benefit is calculated by multiplying the loan principal by the prescribed rate of interest. The benefit is reduced by the 1% interest paid by John, provided the interest is paid by 30 days after the end of the calendar year.

If the prescribed rate increases, the loan benefit will continue to be calculated using the 2% prescribed rate in effect at the time the home purchase loan was received (for a period of five years) [ITA 80.4].

* 1. Private health services plan: The annual premium for prescription drugs, dental, and vision coverage does not result in a taxable benefit [ITA 6(1)(a)].
  2. Tax deductions: John will be able to claim the following deductions relating to his car in computing his employment income.

|  |  |  |  |
| --- | --- | --- | --- |
| CCA | $25,000 (includes HST) x 15% (CCA rate in the first year; 30% thereafter) | $ 3,750 | 8(1)(j) |
| Interest | Lesser of :  (i) Amount paid $3,000  (ii) $300 per 30-day period = $3,600 | 3,000 | 8(1)(j)  67.2 |
| Gasoline |  | 5,000 | 8(1)(h.1) |
| Insurance |  | 2,000 | 8(1)(h.1) |
|  |  | $13,750 |  |
|  |  |  |  |
|  | Employment usage 33% | $4,583 |  |

1. Offer of employment from DEF Co.
2. Salary of $60,000 is included in income when received [ITA 5(1)].
3. The group term life insurance premiums are included in income [ITA 6(4)].
4. The fitness club membership results in a taxable benefit [ITA 6(1)(a)].
5. The phone is a capital asset and therefore CCA cannot be claimed for the purposes of computing employment income.
6. Taxable benefit with respect to the car is calculated below for 2018 and 2019.

|  |  |  |
| --- | --- | --- |
|  | **2018** | **2019** |
| Monthly lease payments | $700 | $700 |
|  | x 2/3 | X 2/3 |
| Number of months car available | 1 | 12 |
| Standby Charge | $467 | $5,600 |
|  |  |  |
| Personal kilometers | 1,200 | 14,400 |
| Operating benefit at $0.26 per personal km. | $312 | $3,744 |
|  |  |  |
| TOTAL | $769 | $9,344 |

The reduced standby charge is not available because the car is not used primarily for employment purposes.

The employment offer that provides John with the greatest amount of disposable income after tax should be accepted.

*Discussion with Bob Johnson, CFO of GHI Inc.*

Stock-based compensation is not deductible [ITA 7(3)(b)].

The bonuses declared by GHI Inc. in 2017 will not be deductible in 2017 because they were not paid in 2017 or by June 29, 2018 (180 days [ITA 78(4)]. The bonuses will be deductible in 2018 or when paid.

**Solution to COMPREHENSIVE CASE TWO**

Part 1

Ursula’s employment income for 2018 is $177,583. Below are the details.

|  |  |  |
| --- | --- | --- |
| **Employment Income calculation** | | **Comments** |
| Salary | $180,000 | 5(1) - taxed when received |
| EI/CPP/ income tax | - | Not deductible; must get all 3 correct |
| RPP (employee portion) | (8,000) | 8(1)(m) |
| Gym membership | - | Not deductible 8(2) |
| Golf membership | 2,500 | 6(1)(a); used for recreation so employer is not primary beneficiary |
| Group term life insurance | 900 | 6(4) |
| Private health insurance | - | 6(1)(a)(i) |
| RPP (employer portion) | - | 6(1)(a)(i) |
| Commission | 10,000 | 5(1) - taxed when received |
| Bonus | - | 5(1) - taxed when received |
| Champagne | - | T4130; non-cash gifts and awards under $500 are not taxable |
| Gift card | 200 | T4130; cash and cash equivalent gifts/awards taxable (even if under $500) |
| Samantha salary | (6,000) | 6(1)(i) |
| Rachel salary | - | 67; amount is not reasonable since no work is performed |
| Car Lease payments | (3,254) | 8(1)(h.1) and 67.3; max is $800/month plus tax ($800\*1.13\*6) prorated for 60% employment usage |
| Standby charge | 3,797 | $70,000\*1.13\*2%\*6\*((1,667\*6\*40%)/(1,667\*6)) |
| Operating benefit | 1,040 | Lesser of [$0.26 x 1,667 x 40% x 6] and half of standby charge |
| Spouse airfare | 2,000 | 6(1)(a) |
| Employee operating costs | (3,600) | 8(1)(h); Prorated for 60% employment usage |
| Transportation | (5,000) | 8(1)(h) |
| Sales expenses | - | Ursula is better off claiming car and travel expenses under 8(1)(h)/(h.1) rather than sales expenses (lease costs, operating costs, transport, 50% of meals, and advertising & promo) under 8(1)(f) because of the commission income limitation ($10,000). |
| Tablet | - | Capital expenditure |
| Stock option benefit | 3,000 | 7(1); calculated as ($18-$15) x 1,000 |
| Employment income | $177,583 |  |

Part 2

Deco’s business income for tax purposes for the 2018 taxation year is $6,696,580. The detailed calculation is below.

|  |  |  |
| --- | --- | --- |
|  | Business income | Comments |
| Accounting income | $5,268,000 | 9(1) |
| Donation | 10,000 | 18(1)(a) |
| Amortization | 1,100,000 | 18(1)(b) |
| Stock based compensation | 400,000 | 7(3) |
| Commissions | - | will be paid within 180 days of year end |
| Bonuses | - | will be paid within 180 days of year end |
| Golf memberships | 37,500 | 18(1)(l) |
| Interest paid to CRA | 4,750 | 18(1)(t) |
| Financing fee | 5,680 | 20(1)(e); add back 80% since 100% was deducted for accounting |
| Remaining interest expense | - | 20(1)(c) |
| Site investigation | - | 20(1)(dd) |
| Client meals/ entertainment | 51,750 | 67.1(1); add back 50% since 100% was deducted for accounting |
| Holiday party | - | 67.1(2)(f) |
| Landscaping | - | 20(1)(aa) |
| Warranty accrual | 1,000,000 | 18(1)(e) |
| Actual warranty claims | (650,000) |  |
| Foreign advertising to Canadians | 200,000 | 19(1) |
| Audit fee | - | ordinary expense incurred to earn income |
| General corporate legal fees | - | ordinary expense incurred to earn income |
| Legal fees re: overdue receivables | - | ordinary expense incurred to earn income |
| Legal fees re: issuance of shares | (20,000) | 20(1)(e); was not deducted for accounting purposes, but deductible for tax purposes over 5 years |
| Travel costs (meals) | 400 | 67.1(1); add back 50% since 100% was deducted for accounting |
| Allowance for doubtful accounts | 200,000 | 18(1)(e); not based on specific doubtful accounts |
| CCA | (983,500) | See calculation below |
| Recapture | 100,000 | See calculation below |
| Terminal loss | (150,000) | See calculation below |
| Loss on disposal of assets | 122,000 |  |
| Business income | $6,696,580 |  |

Capital cost allowance (CCA) is determined as follows:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| Class | 1 | 8 | 10 | 12 | 10.1 | Total |
| Rate | 6% | 20% | 30% | 100% | 30% |  |
|  |  |  |  |  |  |  |
| Opening UCC | $5,000,000 | $3,200,000 | $400,000 | - | - |  |
| Additions | 300,000 | 325,000 | - | - | $30,000 |  |
| Disposals (at lower of cost and proceeds) | - | (25,000) | (250,000) | $(100,000) | - |  |
| Net additions (additions less disposals) | 300,000 | 300,000 | - | - | 30,000 |  |
| Half year CCA on net additions | (9,000) | (30,000) | - | - | (4,500) | $(43,500) |
| Full rate CCA on opening UCC | (300,000) | (640,000) | - | - | - | (940,000) |
| Recapture (terminal loss) | - | - | (150,000) | 100,000 | - | (50,000) |
| Closing balance | $4,991,000 | $2,830,000 | - | - | $25,500 | $(1,033,500) |