CHAPTER ONE SOLUTIONS

Solution to Assignment Problem One - 1

Note To Instructor If you are assigning this problem, note that only the first two answers can be found in Chapter 1 of the text.

The circumstances under which a general provision of the *Income Tax Act* can be overridden are as follows:

1. In those situations where there is a conflict between the provisions of an international tax treaty and the *Income Tax Act*, the terms of the international tax treaty will prevail.

2. While court decisions cannot be used to change the actual tax law, court decisions may call into question the reasonableness of interpretations of the ITA made by either the CRA or tax practitioners.

3. In some cases, a more specific provision of the *Act* will contain an exception to a general rule. For example, while ITA 18(1)(b) does not allow the deduction of capital expenditures in computing business income, ITA 20(1)(aa) contains a provision that allows the deduction of landscaping costs.

Solution to Assignment Problem One - 2

Some of the possible examples of conflicts between objectives would be as follows:

1. **Revenue Generation And International Competitiveness** The need to lower rates of taxation in order to be competitive on an international basis is in conflict with the need to generate revenues.

2. **Fairness And Simplicity** In order to make a tax system simple, a single or small number of tax rates must be applied to a well established concept of income with only a limited number of deductions or exceptions available. This is in conflict with the goal of tailoring the system to be fair to specific types of individuals, such as the disabled.

3. **Revenue Generation And Social Goals** The desire to provide funds to certain types of individuals (Old Age Security) or to provide certain types of services (health care) may be in conflict with the need to generate tax revenues.

4. **Flexibility And Certainty** To make a tax system flexible in changing economic, political, and social circumstances, there must be some uncertainty.

Solution to Assignment Problem One - 3

A. **Diamonds, South Africa** In a monopoly, the tax will probably be entirely shifted to employees and/or consumers. The incidence shift will depend on competition in world markets and employment levels. If the international diamond market is price sensitive and there is high unemployment in South Africa, then the tax will be shifted almost entirely to employees.

The shifting assumptions affect evaluation of the tax using the characteristics of a "good" tax system. A tax that is entirely shifted to employees is similar to one on wages and is non-neutral, as it affects the decisions of employees to continue working. Some employees will work less and thus increase the excess burden resulting from imposition of the tax.

B. **Diamonds, Sierra Leone** The taxing authorities will find it difficult to enforce the tax, due to their inability to track diamond movements. Records maintained by the mine will likely be inaccessible, and those presented will be incomplete. The tax will not be effective and the tax revenue will be uncertain and inadequate.

C. **Principal Residences, Canada** This exemption is non-neutral because investment decisions are affected by the tax preference. Given the choice of investing in real estate to hold for resale or a principal residence, both of which are likely to appreciate, a taxpayer will invest in a principal residence so that the gain on disposition is tax exempt.

It is also vertically inequitable because it benefits high-income families who can invest in more expensive residences which have the potential of earning greater returns.

This tax expenditure is spread among all taxpayers, and general tax revenue must be larger to compensate for the revenue foregone.

D. **Business Meals, Canada** This restriction adds complexity to accounting for deductible expenses, as all business meals have to be accounted for and accumulated separately from other promotion expenses. The tax could be shifted to consumers, employees and/or shareholders. If it is shifted to consumers, it could be more advantageous to raise personal taxes so that incidence is more certain. If it is shifted to shareholders or employees, then it would be non-neutral as it could affect investment decision making and willingness to work.

E. **Head Tax** A head tax is neutral as it does not affect economic choices. However, it is vertically inequitable, based on the ability to pay concept of equity, as all taxpayers, regardless of their income levels are taxed the same. The head tax is very inelastic. This tax serves the objectives of certainty, simplicity and ease of compliance. It could promote stability in the economy.

Solution to Assignment Problem One - 4

There are a large number of possible responses to a question such as this. Some possibilities would include the following:

- **Simplicity And Ease Of Compliance** A very good feature of this tax is that it is very simple and presents the taxpayer with no compliance problems. Anyone with a head is taxed and no provisions have been made for any modifications in applicability or amounts to be paid.

- **Fairness And Equity** In one sense this is a fair tax in that it applies to every Canadian resident and the amount to be collected from each individual is the same. This could be described as horizontal equity. However, the tax could also be considered unfair in that it gives no consideration to the individual's ability to pay the tax, either in terms of accumulated wealth or income.

- **Regressiveness** Related to fairness is the fact that the tax is regressive. That is, the tax will take a higher percentage of income from low income individuals than it will from high income individuals.

- **Flexibility And Elasticity** Being a very simple tax, it will be very easy to change the rate at which it is assessed. However, as it is a flat tax based simply on the existence of the individual, it will not respond to changing economic conditions.

- **Enforcement And Dependability Of Revenues** Given the presence of a physically visible audit trail (the HAT), there should be no enforcement problems. Further, demographic statistics are reasonably predictable, making it relatively easy for the government to anticipate the expected levels of revenue.

- **Neutrality** Other than decisions related to whether to remain a Canadian resident, the tax appears to be neutral with respect to economic conditions.

- **International Competitiveness** It seems unlikely that a $200 tax would be sufficient to influence a decision to either leave Canada or move to Canada. Therefore, the tax could be thought of as being internationally competitive.

- **Balance Between Sectors** The tax might be criticized as an additional burden on Canadian individuals as opposed to Canadian businesses.

There are, of course, other factors that could be considered.

Solution to Assignment Problem One - 5

Solution According To Textbook

Mr. Valone would be considered a part year resident and would only be assessed for Canadian income taxes on worldwide income during the portion of the year prior to his ceasing to be a resident of Canada.

S5-F1-C1 indicates that, in general, the CRA will view an individual as becoming a non-resident on the latest of three dates:

- The date the individual leaves Canada.
- The date the individual's spouse or common-law partner and dependants leave Canada.
- The date the individual becomes a resident of another country.

While Mr. Valone departed from Canada on March 1, 2017, he will be considered a Canadian resident until his family's departure on June 20, 2017. The fact that his family remained in Canada would lead to this conclusion. While not essential to this conclusion, the fact that he did not sell his Canadian residence until that date would provide additional support.

His Canadian salary from January 1, 2017 to March 1, 2017 would be subject to Canadian taxes. In addition, his U.S. salary for the period March 1, 2017 through June 20, 2017 will be subject, first to U.S. taxes, and then subsequently to Canadian taxes. In calculating his Canadian taxes payable, he will receive a credit for the U.S. taxes which he has paid on this income. However, because Canadian tax rates at a given income level are usually higher than those which prevail in the U.S., it is likely that he will be required to pay some Canadian income taxes in addition to the U.S. taxes.

Note To Instructors

The preceding solution reflects the content of the text with respect to departures from Canada and students should be evaluated on that basis. However, S5-FI-C1 qualifies the general departure rules as follows:

> **Paragraph 1.22** An exception to this will occur where the individual was resident in another country prior to entering Canada and is leaving to re-establish his or her residence in that country. In this case, the individual will generally become a non-resident on the date he or she leaves Canada, even if, for example, his or her spouse or common law partner remains temporarily behind in Canada to dispose of their dwelling place in Canada or so that their dependants may complete a school year already in progress.

On the assumption that Mr. Valone was a resident of the U.S. prior to his working years in Canada, this exception would mean that he would cease to be a resident of Canada on March 1, 2017, the date that he departs from Canada.

The textbook does not deal with the residency rules of countries other than Canada. Although this solution concludes that June 20 is the date residency is terminated in Canada, it is probable that the foreign jurisdiction (the U.S.) would consider Mr. Valone to be resident under their own rules effective March 1. In effect, the period between March 1 and June 20 would become a dual residency period. We would not expect students to come to this conclusion, but include this to illustrate the complexities of international issues in taxation.

Solution to Assignment Problem One - 6

Note To Instructors This problem is based on a Tax Court Of Canada case, Hamel Vs. The Queen (2012 DTC 1004). The actual year in question is 2007, with the judgment being rendered in 2011. We have moved the dates in the problem up by 9 years. It is our opinion that, since this judgment was rendered, there have been no legislative or other changes that would alter the conclusions reached by Tax Court judge in this case.

Background

The minister assessed Mr. Hamel on the basis of his not giving up Canadian residency on January 13, 2007 (the original date in the case). Mr. Hamel appealed to the Tax Court of Canada which resulted in Hamel Vs. The Queen (2012 DTC 1004).

The solution that follows is the judge's analysis and decision in the case (note that it was translated from French). The judge's conclusion also contained a long section of references to other cases which we have not included in this solution. The original dates in the solution have been changed to correspond to the dates in the problem.

Judge's Analysis And Decision

The respondent's main argument is that every person must have a residence. Presuming the appellant had not resided in Qatar, she found that he must necessarily have resided in Canada.

After arriving at this conclusion, she relied on the following facts:

- The appellant came to Canada a few times.
- The appellant had two bank accounts in Canada, which he used to make all his payments, in particular for his credit cards, which were also issued in Canada.
- The appellant had some money in an RRSP.
- The appellant had no postal address in Qatar.

As for the other elements, for example, not having a driver's licence, not having property such as furniture, clothing, accommodations or vehicles, and not having a health insurance card, the respondent claims that they have no impact one way or the other.

The evidence clearly showed that the appellant's decision came after a lengthy period of reflection. It also showed that the appellant did not have any deep roots and did not hesitate to leave when his son, who was ill, let him go with no regrets.

His relationship with his wife was so tense that they tolerated one another only because of their shared concern about their son who was ill.

The appellant had a very good position. He did not want to run away from his responsibilities. He gave all his property and agreed to pay generous support payments before leaving; he has always complied with these commitments. He did not apply for a new Canadian driver's licence when his was suspended, even though the evidence showed it was important for him to be able to use a car if he wanted an international driver's license or even a driver's licence from the country in which he was living.

He specifically gave up his health card in 2017.

Regarding the beginning of the relevant period of the appeal, the beginning of 2014, it must be considered that a reasonable person would be careful. The appellant stated he could only get a work permit if a medical exam showed he was in good health, otherwise he had to return to his country of origin. The same can be said for the position, the duration of which generally depends on the employer, not the employee. In other words, there is, normally, a reasonable delay before a permanent break. This explains the time between the beginning of the period in question and the time the appellant gave up his health insurance.

As for the argument that the appellant never had a residence in Qatar, I do not believe it is cogent, because the appellant was employed and had a residence. The appellant's strong interest in staying in Qatar was shown by the intensive courses he took to get a driver's licence, when he could have traveled with coworkers, even though he had cancelled his Canadian driver's licence. When his employment ended in Qatar, the appellant returned to the country to see the people with whom he had worked and the work he had done.

In particular, in view of the following facts, I find that, on the preponderance of the evidence, the appellant's position must be accepted:

- The family context was special and conducive to a permanent departure.
- The appellant left after disposing of all his own property.
- The appellant waived his right to obtain a new driver's licence a few months before leaving Canada.
- The appellant returned to Canada a few times for very short stays that were for the purpose of visiting his two sons, his mother and friends.

After leaving Qatar upon the expiry of his work contract, the appellant returned to meet friends and business acquaintances, thereby showing he had been happy there.

The break came after a long period of thorough reflection.

The appellant has set out all the facts showing his intention to sever ties with this country permanently.

Although the relevance of prior facts is limited, they tend to confirm that the appellant severed his ties with Canada in mid-January 2016.

For these reasons, I conclude that the appellant ceased being a resident of Canada as of January 13, 2016. As a result, the appeal is allowed with costs in favour of the appellant.

Solution to Assignment Problem One - 7

Case A

John's 2 year tour would be considered a temporary absence from Canada. Given the facts, it appears his intent is not to permanently sever residential ties with Canada. This position is evidenced by the fact his tour is for a limited time and he will not be establishing residency in another country.

John's departure does not appear to be a true departure in that he has not severed any of the primary ties (dwelling, spouse and dependants) the CRA looks to. As a result, examining those ties would not be relevant since they are typically used when there is an intention to sever residential ties, but they are not all severed at the same time.

John will remain a Canadian resident during his tour and would be subject to Canadian tax on his worldwide income during 2017.

Case B

Because she has an employment contract that requires her to return to Canada in three years, she will be viewed as having retained Canadian residence status. Although she has severed her ties with Canada, the requirement to return would show that she does not intend to permanently leave Canada.

Jane will be subject to Canadian tax on her worldwide income during 2017.

Case C

As she is exempt from taxation in Ghana because she is the spouse of a deemed Canadian resident, Laura would be a deemed resident of Canada for income tax purposes during 2017 [(ITA 250(1)(g)].

Laura would be subject to Canadian tax on her worldwide income during 2017.

Case D

As noted in S5-F1-C1, commuting from the U.S. for employment purposes does not make an individual a deemed resident under the sojourner rules. Therefore, Martha would not be considered a Canadian resident for income tax purposes.

She would be exempted by the Canada/U.S. tax treaty under ITA 2(3) if the amount of employment income was less than $10,000, or if she was physically present in Canada for less than 183 days. Her employment income was more than $10,000 and, because she was working 5 days a week, it appears that she was physically present in Canada for more than 183 days. Given these facts, she would not be exempted from Canadian taxation because of the Canada/U.S. tax treaty.

Martha would be subject to Canadian tax on her 2017 Canadian employment income. She would not be subject to Canadian tax on her U.S. savings account interest.

Case E

Residency terminates at the latest of:

- the date the individual leaves Canada;
- the date the individual's family leaves Canada; and
- the date that individual establishes residency elsewhere.

As Barry's family did not leave Canada until July 1, 2017, Barry would be considered a Canadian resident until that date. Provided he has no intention of returning to Canada, he would be subject to Canadian taxes on his worldwide income for the period January 1, 2017 through July 1, 2017. In addition, he would be subject to Canadian tax on his 2017 rental income. As will be discussed in Chapter 20, the tax on the rental income would not be Part I tax. It would be Part XIII tax.

Solution to Assignment Problem One - 8

Canada/U.S. Tax Treaty Tie Breaker Rule

In cases of dual residency for corporations, where a corporation could be considered a resident of both countries, the Canada/U.S. tax treaty indicates that the corporation will be deemed to be a resident only in the country in which it is incorporated.

Case A

The mind and management of the Allor Company are in Canada and this suggests that the Company is a resident of Canada. However, as the Allor Company was incorporated in the U.S., it is also a resident of that country. Using the tie breaker rule, the Allor Company will be considered a resident of the U.S. and a non-resident of Canada.

Case B

Kodar Ltd. was incorporated in Canada after April 26, 1965. This means that, under ITA 250(4)(a), Kodar Ltd. is a deemed resident of Canada. Because the mind and management of the Company are in the United States, it is also considered a resident of the U.S. Using the tie breaker rule, Kodar Ltd. will be considered a resident of Canada as it was incorporated in Canada.

Case C

The Karlos Company was not incorporated in Canada and its mind and management are not currently located in Canada. Therefore, Karlos would not be considered a resident of Canada.

Case D

While Bradlee Inc. is not operating in Canada, it was incorporated here prior to April 27, 1965. If it had not carried on business in Canada after that date, it would not be a Canadian resident. However, it did carry on business in Canada after that date and, as a consequence, it is a deemed resident under ITA 250(4)(c).

As the mind and management of the Company are currently in the United States, the Company is also a resident of that country. Under the tie breaker rule, Bradlee Inc. would be a resident of Canada as it was incorporated in Canada.

Solution to Assignment Problem One - 9

In cases of dual residency, the Canada/U.S. tax treaty has tie breaker rules. Under these rules residence would be determined by applying criteria in the following order:

- **Permanent Home** If the individual has a permanent home available in only one country, the individual will be considered a resident of that country. A permanent home means a dwelling, rented or purchased, that is continuously available at all times. For this purpose, a home that would only be used for a short duration would not be considered a permanent home.
- **Centre of Vital Interests** If the individual has permanent homes in both countries, or in neither, then this test looks to the country in which the individual's personal and economic relations are greatest. Such relations are virtually identical to the ties that are examined when determining factual residence for individuals.
- **Habitual Abode** If the first two tests do not yield a determination, then the country where the individual spends more time will be considered the country of residence.
- **Citizenship** If the tie-breaker rules still fail to resolve the issue, then the individual will be considered a resident of the country where the individual is a citizen.
- **Competent Authority** If none of the preceding tests resolve the question of residency then, as a last resort, the so-called "competent authority procedures" are used. Without describing them in detail, these procedures are aimed at opening a dialogue between the two countries for the purpose of resolving the conflict.

Case A

As Ty was in Canada for more than 183 days, he is a deemed resident through the application of the sojourner rule. This means that he is likely to be considered a resident in both the United States and Canada. In such situations, the tie breaker rules would be applicable

It does not appear that Ty has a permanent home, a centre of vital interests, or a habitual abode. Therefore, it would appear that the fact that Ty is a citizen of the U.S. would be the determining factor. This treaty result would override the sojourner rule, making Ty a non-resident of Canada.

Case B

As he is in Canada for more than 183 days, Jordan would be a deemed Canadian resident under the sojourner rules. As in Case A, it is likely that he would be considered a resident in both countries. Given this the tie breaker rules would be applicable. As Jordan appears to have a permanent home in Kalispell, these rules would make him a resident of the United States. This treaty result would override the sojourner rule, making Jordan a non-resident of Canada.

Solution to Assignment Problem One - 10

The term Net Income For Tax Purposes is commonly used to refer to income as determined under Part I, Division B of the *Income Tax Act*. While Division B does not contain a definition of this income figure, ITA 3 contains a formula for the determination of this amount.

In general terms, Net Income For Tax Purposes would include:

- Net income from employment (Subdivision a).
- Net income from business or property (Subdivision b).
- Taxable capital gains net of allowable capital losses (Subdivision c).
- Other sources of income and other deductions (Subdivisions d and e).

Losses from employment, business, property, and allowable business investment losses can be deducted as long as the total Net Income For Tax Purposes does not go below zero.

In somewhat simplified terms, Taxable Income is simply Net Income For Tax Purposes, less certain deductions that are specified in Division C of the *Income Tax Act*.

As will be explained in subsequent Chapters, these deductions include:

- a portion of stock option income,
- home relocation loan amounts,
- the northern residents deduction,
- the lifetime capital gains deduction, and
- loss carry overs from other years.

Solution to Assignment Problem One - 11

Accountant's View

The accountant's definition uses historical cost accounting following GAAP. Under GAAP, revenue is generally recognized when goods are sold or services delivered. Expenses are then matched against these revenues, with the resulting difference referred to as accounting Net Income.

Economist's View

The economist's definition of income includes all gains, whether realized or unrealized, as increases in net economic power.

Income Tax Act View

Conceptually, the ITA view is very similar to the accountant's view. However, there are many differences which result from the application of complex rules in the ITA. For example, a portion of capital gains is not considered to be Taxable Income under the ITA view. In contrast, both accountants and economists would include 100 percent of such gains in income. Note, however, the timing would be different as economists would tend to recognize such gains prior to the realization. Accountants generally do not recognize capital gains until they are realized through a disposition of the relevant asset.

Solution to Assignment Problem One - 12

Case One

The Case One solution would be calculated as follows:

Income Under ITA 3(a):		
Net Employment Income		$62,350
Income Under ITA 3(b):		
Taxable Capital Gains		
[(1/2)($97,650)]	$48,825	
Allowable Capital Losses		
[(1/2)($5,430)]	(2,715)	46,110
Balance From ITA 3(a) And (b)		$108,460
Subdivision e Deduction:		
Deductible RRSP Contribution		(4,560)
Balance From ITA 3(c)		$103,900
Deduction Under ITA 3(d):		
Net Business Loss		(115,600)
Net Income For Tax Purposes (Division B Income)		Nil

In this Case, Karla has an unused business loss carry over of $11,700 ($103,900 - $115,600).

Case Two

The Case Two solution would be calculated as follows:

Income Under ITA 3(a):		
Net Employment Income	$45,600	
Net Business Income	27,310	$72,910
Income Under ITA 3(b):		
Taxable Capital Gains		
[(1/2)($31,620)]	$15,810	
Allowable Capital Losses		
[(1/2)($41,650)]	(20,825)	Nil
Balance From ITA 3(a) And (b)		$72,910
Subdivision e Deduction:		
Spousal Support Payments [(12)($600)]		(7,200)
Balance From ITA 3(c)		$65,710
Deduction Under ITA 3(d):		
Net Rental Loss		(4,600)
Net Income For Tax Purposes (Division B Income)		$61,110

In this Case, Karla has an unused allowable capital loss carry over of $5,015 ($20,825 - $15,810). As Karla's gambling activity does not appear to be substantial enough to be considered a business, the $46,000 in winnings would not be taxable.

Solution to Assignment Problem One - 13

Case 1

The Case 1 solution would be calculated as follows:

Income Under ITA 3(a):		
Net Employment Income	$123,480	
Interest Income	4,622	$128,102
Income Under ITA 3(b):		
Taxable Capital Gains	$24,246	
Allowable Capital Losses	(4,835)	19,411
Balance From ITA 3(a) And (b)		$147,513
Child Care Costs		(9,372)
Balance From ITA 3(c) And Net Income For Tax Purposes		$138,141

In this Case, Mr. Comfort has no loss carry overs at the end of the year.

Case 2

The Case 2 solution would be calculated as follows:

Income Under ITA 3(a):		
Net Business Income		$72,438
Income Under ITA 3(b):		
Taxable Capital Gains	$4,233	
Allowable Capital Loss	(7,489)	Nil
Balance From ITA 3(a) And (b)		$72,438
RRSP Contributions		(22,000)
Balance From ITA 3(c)		$50,438
Deduction Under ITA 3(d):		
Net Rental Loss		(9,846)
Net Income For Tax Purposes (Division B Income)		$40,592

In this Case, Mr. Comfort has a carry over of $3,256 ($7,489 - $4,233) in unused allowable capital losses.

Case 3

The Case 3 solution would be calculated as follows:

Income Under ITA 3(a):		
Net Employment Income		$47,234
Income Under ITA 3(b):		
Taxable Capital Gains [(1/2)($12,472)]	$6,236	
Allowable Capital Losses [(1/2)($9,332)]	(4,666)	1,570
Balance From ITA 3(a) and (b)		$48,804
Child Care Costs		(3,922)
Balance From ITA 3(c)		$44,882
Deduction Under ITA 3(d):		
Net Business Loss		(68,672)
Net Income For Tax Purposes (Division B Income)		Nil

In this Case, Mr. Comfort would have a business loss carry over in the amount of $23,790 ($68,672 - $44,882).

Case 4

The Case 4 solution would be calculated as follows:

Income Under ITA 3(a):		
Interest Income	$ 6,250	
Net Business Income	43,962	$50,212
Income Under ITA 3(b):		
Taxable Capital Gains [(1/2)($12,376)]	$ 6,188	
Allowable Capital Losses [(1/2)($23,874)]	(11,937)	Nil
Balance From ITA 3(a) And (b)		$50,212
Moving Expenses		(7,387)
Balance From ITA 3(c)		$42,825
Deduction Under ITA 3(d):		
Net Rental Loss		(72,460)
Net Income For Tax Purposes (Division B Income)		Nil

Mr. Comfort would have a rental loss carry over in the amount of $29,635 ($72,460 - $42,825) and unused allowable capital losses in the amount of $5,749 ($11,937 - $6,188).

CHAPTER TWO SOLUTIONS

Solution to Assignment Problem Two - 1

Need For Instalments

Instalments are required when an individual's "net tax owing" exceeds $3,000 in the current year and in either of the two preceding years. In somewhat simplified terms, "net tax owing" is defined as the combined federal and provincial taxes payable, less amounts withheld under ITA 153. Mr. Boardman's net tax owing figures are as follows:

2015 = $750 ($62,350 - $61,600)
2016 = $16,020 ($29,760 - $13,740)
2017 = $4,980 ($52,370 - $47,390) Estimated

As Mr. Boardman's net tax owing in 2017 (the current year) and his net tax owing in 2016 (one of the two preceding years) is greater than $3,000, he is required to make instalment payments.

Amounts

If Mr. Boardman bases the first two quarterly payments on the 2015 net tax owing, they would only be $187.50 each ($750 ÷ 4). However, the payments for the last two quarters would be $7,822.50 each {[$16,020 - (2)($187.50)] ÷ 2}, resulting in total instalment payments of $16,020.

A preferable alternative would be to base the payments on the estimated net tax owing for 2017. These payments would be $1,245 each ($4,980 ÷ 4), for a total of $4,980.

Payment Dates

The quarterly payments would be due on March 15, June 15, September 15, and December 15 of 2017.

Solution to Assignment Problem Two - 2

Part A

Under ITA 157(1), Ledux Inc. would have three alternatives with respect to the calculation of its instalment payments. The alternatives and the relevant calculations are as follows:

Current Year Base The instalment payments could be 1/12th of the estimated Tax Payable for the current year. In this case the resulting instalments would be \$16,945.42 per month (\$203,345 ÷ 12).

Preceding Year Base The instalment payments could be 1/12th of the Tax Payable in the immediately preceding taxation year. The resulting instalments would be \$17,963.92 (\$215,567 ÷ 12).

Preceding And Second Preceding Years The third alternative would be to base the first two instalments on 1/12th of the Tax Payable in the second preceding year and the remaining instalments on 1/10th of the Tax Payable in the preceding year, less the total amount paid in the first two instalments.

In this case, the first two instalments would be \$16,118.33 (\$193,420 ÷ 12) each, a total of \$32,236.66. The remaining 10 instalments would be \$18,333.03 [(\$215,567 - \$32,236.66) ÷ 10] each. The total instalments under this approach would be \$215,567.

While the third approach would provide the lowest payments for the first two instalments, the payments would total \$215,567. As this is larger than the \$203,345 total when the instalments are based on the current year's estimated Tax Payable, the use of the current year's Tax Payable approach would be the best alternative.

Part B

If the Company failed to make instalment payments towards the 2017 taxes payable, it would be liable for interest from the date each instalment should have been paid to the balance due date, March 31, 2017.

Assuming the actual 2017 taxes payable are \$203,345, it would be the least of the amounts described in ITA 157(1), and interest would be calculated based on the current year instalment alternative. The rate charged would be the one prescribed in ITR 4301 for amounts owed to the Minister, the regular base rate plus 4 percentage points.

There is a penalty on large amounts of late or deficient instalments. This penalty is specified in ITA 163.1 and is equal to 50 percent of the amount by which the interest owing on the late or deficient instalments exceeds the greater of \$1,000 and 25 percent of the interest that would be owing if no instalments were made. While detailed calculations are not required, we would note that this penalty would clearly be applicable in this case.

Interest on the entire balance of \$203,345 of taxes payable would be charged beginning on the balance due date, March 31, 2017, two months after the end of the 2017 taxation year. The rate charged would be the one prescribed in ITR 4301 for amounts owed to the Minister, the regular base rate plus 4 percentage points.

There is also a penalty for late filing. If no return is filed by the filing due date of July 31, 2017, the penalty amounts to 5 percent of the tax that was unpaid at the filing date, plus 1 percent per complete month of the unpaid tax for a maximum period of 12 months. This penalty is in addition to any interest charged due to late payment of instalments or balance due. In addition, interest would also be charged on any penalties until such time as the return is filed or the instalments (balance due) paid.

The late file penalty could be doubled to 10 percent, plus 2 percent per month for a maximum of 20 months for a second offence within a three year period.

Solution to Assignment Problem Two - 3

Case 1

Bronson's net tax owing in each of the three years is as follows:

2015 = Nil ($7,843 - $8,946) Note that a negative number is not used here.
2016 = $3,190 ($12,862 - $9,672)
2017 = $3,851 ($14,327 - $10,476 Estimated

As his net tax owing is expected to exceed $3,000 in 2017 and was more than $3,000 in 2016, the payment of instalments is required.

Instalments under the three acceptable alternatives would be as follows:

Alternative 1 Using the estimated net tax owing for the current year would result in quarterly instalments of $962.75 ($3,851 ÷ 4), for a total amount of $3,851.

Alternative 2 Using the net tax owing for the previous year would result in quarterly instalments of $797.50 ($3,190 ÷ 4), for a total amount of $3,190.

Alternative 3 Using the net tax owing for the second previous year would result in the first two instalments being nil. The remaining two instalments would be $1,595 [($3,190 - 0) ÷ 2], a total of $3,190.

The best alternative would be Alternative 3. While the total instalments under this alternative are the same as under Alternative 2, this option offers some deferral as the first two instalments are nil.

The required instalments would be due on September 15 and December 15, 2017.

Case 2

Bronson's net tax owing in each of the three years is as follows:

2015 = Nil ($8,116 - $8,946) Note that a negative number is not used here.
2016 = $4,174 ($13,846 - $9,672)
2017 = $3,066 ($13,542 - $10,476) Estimated

As his net tax owing is expected to exceed $3,000 in 2017 and was more than $3,000 in 2016, the payment of instalments is required.

Instalments under the three acceptable alternatives would be as follows:

Alternative 1 Using the estimated net tax owing for the current year would result in quarterly instalments of $766.50 ($3,066 ÷ 4), for a total amount of $3,066.

Alternative 2 Using the net tax owing for the previous year would result in quarterly instalments of $1,043.50 ($4,174 ÷ 4), for a total amount of $4,174.

Alternative 3 Using the net tax owing for the second previous year would result in the first two instalments being nil. The remaining two instalments would be $2,087 [($4,174 - 0) ÷ 2], a total of $4,174.

The best choice would be Alternative 1. While the first two instalments are lower under Alternative 3, the total for the year under Alternative 3 is $1,108 ($4,174 - $3,066) higher.

The required instalments would be due on March 15, June 15, September 15, and December 15, 2017.

Case 3

Bronson's net tax owing in each of the three years is as follows:

2015 = $4,200 ($13,146 - $8,946)
2016 = $3,170 ($12,842 - $9,672)
2017 = $3,200 ($13,676 - $10,476) Estimated

As his net tax owing is expected to exceed $3,000 in 2017 and was more than $3,000 in both 2015 and 2016, the payment of instalments is required.

Instalments under the three acceptable alternatives would be as follows:

Alternative 1 Using the estimated net tax owing for the current year would result in quarterly instalments of $800 ($3,200 ÷ 4), for a total amount of $3,200.

Alternative 2 Using the net tax owing for the previous year would result in quarterly instalments of $792.50 ($3,170 ÷ 4), for a total amount of $3,170.

Alternative 3 Using the net tax owing for the second previous year would result in the first two instalments being $1,050 ($4,200 ÷ 4) each, a total of $2,100. The remaining two instalments would be $535 [($3,170 - $2,100) ÷ 2], a total of $1,070. When combined with the first two instalments, the total for the year would be $3,170 ($2,100 + $1,070).

In terms of minimizing instalments, the best choice is Alternative 2. While the total amount is $3,170, the same amount as under Alternative 3, there is some deferral with the first two payments being smaller.

The required instalments would be due on March 15, June 15, September 15, and December 15, 2017.

Solution to Assignment Problem Two - 4

Case One

1. As the corporation's tax payable for both the current and the preceding year exceeds \$3,000, instalments are required. As the corporation is a small CCPC, instalments will be quarterly.

2. The three acceptable alternatives would be as follows:

   - Quarterly instalments of \$43,085 (\$172,340 ÷ 4) based on the current year estimate.
   - Quarterly instalments of \$46,635 (\$186,540 ÷ 4) based on the first preceding year.
   - One instalment of \$38,410 (\$153,640 ÷ 4) based on the second preceding year, followed by three instalments of \$49,376.67 [(\$186,540 - \$38,410) ÷ 3], a total of \$186,540.

3. The best alternative in terms of minimum instalments would be four instalments of \$43,085, for total payments of \$172,340. The instalments are due on March 31, June 30, September 30, and December 31, 2017.

Case Two

1. As the corporation's tax payable for both the current and the preceding year exceeds \$3,000, instalments are required. As the corporation is a small CCPC, instalments will be quarterly.

2. The three acceptable alternatives would be as follows:

   - Quarterly instalments of \$43,085 (\$172,340 ÷ 4) based on the current year estimate.
   - Quarterly instalments of \$40,855 (\$163,420 ÷ 4) based on the first preceding year.
   - One instalment of \$38,410 (\$153,640 ÷ 4) based on the second preceding year, followed by three instalments of \$41,670 [(\$163,420 - \$38,410) ÷ 3], a total of \$163,420.

3. The best alternative would be one payment of \$38,410, followed by three payments of \$41,670. While the total instalments are the same \$163,420 in both the second and third alternatives, the third alternative is preferable because the first payment is lower. This provides a small amount of tax deferral.

   The instalments are due on March 31, June 30, September 30, and December 31, 2017.

Case Three

1. As the corporation's tax payable for both the current and the preceding year exceeds \$3,000, instalments are required. As the corporation is not a small CCPC, monthly instalments are required.
2. The three acceptable alternatives would be as follows:
   - Monthly instalments of \$14,361.67 (\$172,340 ÷ 12) based on the current year estimate.
   - Monthly instalments of \$15,545 (\$186,540 ÷ 12) based on the first preceding year.
   - Two monthly instalments of \$12,803.33 (\$153,640 ÷ 12) based on the second preceding year, followed by 10 monthly instalments of \$16,093.33 {[(\$186,540 - (2)(\$12,803.33)] ÷ 10}, a total of \$186,540.03.
3. The best alternative in terms of minimum instalments would be 12 instalments of \$14,361.67, resulting in a total of \$172,340 of instalment payments.

   The instalments would be due on the last day of each month, beginning in January, 2017.

Case Four

1. As the corporation's tax payable for both the current and the preceding year exceeds $3,000, instalments are required. As the corporation is not a small CCPC, monthly instalments are required.

2. The three acceptable alternatives would be as follows:

   - Monthly instalments of $14,361.67 ($172,340 ÷ 12) based on the current year estimate.
   - Monthly instalments of $13,618.33 ($163,420 ÷ 12) based on the first preceding year.
   - Two monthly instalments of $12,803.33 ($153,640 ÷ 12) based on the second preceding year, followed by 10 monthly instalments of $13,781.33 {[$163,420 - (2)($12,803.33)] ÷ 10}, a total of $163,420.

3. The best alternative would be two payments of $12,803.33, followed by ten payments of $13,781.33. While the total instalments are the same $163,420 in both the second and third alternatives, the third alternative is preferable because the first two payments are lower. This provides a small amount of tax deferral.

   The instalments would be due on the last day of each month, beginning in January, 2017.

Solution to Assignment Problem Two - 5

Part A

For individuals, the taxation year is always the calendar year. Individuals without business income are required to file their tax returns no later than April 30 of the year following the relevant taxation year. For individuals with business income, and their spouse or common-law partner, the filing deadline is extended to June 15.

Part B

The general rules are the same for both deceased and living individuals. That is, the return must be filed no later than April 30 of the year following the year of death. If the deceased individual, or his spouse or common-law partner had business income, the due date is June 15 of the year following the year of death.

However, when death occurs between November 1 of a taxation year and the normal filing date for that year's return, representatives of the deceased can file the return on the later of the normal filing due date (April 30th or June 15th of the following year) and six months after the date of death.

Part C

Inter vivos trusts must use the calendar year as their taxation year. As the required tax return must be filed within 90 days of the taxation year end, returns for inter vivos trusts will be due March 31 (March 30 in leap years).

The rules are the same for most testamentary trusts. However, the exception to this is a testamentary trust that has been designated a graduated rate estate (GRE). Such GREs can use a non-calendar fiscal year for up to three years subsequent to the death of the settlor. GRE returns are due 90 days after the date that has been selected as the taxation year end.

Part D

Corporations can use a non-calendar fiscal year as their taxation year. The corporate T2 return must be filed within six months of the end of the taxation year.

Solution to Assignment Problem Two - 6

The following additional information would be relevant in considering Mr. Simon's situation:

A. Determination of the date of the Notice of Reassessment. A notice of objection must be filed prior to the later of:

- 90 days from the date of the Notice of Reassessment; and
- one year from the due date for the return under reassessment.

In this case, the later date is clearly 90 days after the date of the Notice of Reassessment.

B. Determination of the date of the Notice of Assessment for the 2013 taxation year. A three year time limit applies from the date of the Notice of Assessment. As the Notice of Assessment for 2013 could have been sent in early April, 2014, this reassessment could be within the three year limit.

C. Determination of whether Mr. Simon has signed a waiver of the three year time limit or if he is guilty of fraud or misrepresentation. If the reassessment is not within the three year time limit, Mr. Simon would not usually be subject to reassessment. However, if Mr. Simon has signed a waiver of the three year time limit, or if fraud or misrepresentation is involved, he becomes subject to reassessment, regardless of the time period involved.

If the preceding determinations indicate that the reassessment is valid and you decide to accept Mr. Simon as a client, the following steps should be taken:

- You should have Mr. Simon file a Consent Form, T1013, with the CRA which authorizes you to represent him in his affairs with the CRA and/or authorize you to access his file through the online Represent a Client service.
- A notice of objection should be filed before the expiration of the 90 day time limit.
- You should begin discussions of the matter with the relevant assessor at the CRA.

Solution to Assignment Problem Two - 7

Note To Instructor These Cases have been based on examples found in IC 01-1.

Case 1
While the use of the other accountant's business income statements resulted in the tax return that was filed, the tax return preparer would be entitled to the good faith defense since he relied, in good faith, on information provided by another professional on behalf of the client. Therefore, he would not be subject to the preparer penalty.

The third party penalties may be applied to the other accountant if he knew or would be expected to know, but for circumstances amounting to culpable conduct, that the financial statements contained false statements.

Case 2
Since the tax return preparer e-filed the taxpayer's return without viewing the charitable donation receipt, the CRA would consider assessing the tax return preparer with the preparer penalty. Given that the size of the donation is so disproportionate to the taxpayer's apparent resources as to defy credibility, to proceed unquestioningly in this situation would show wilful blindness and thus an indifference as to whether the ITA is complied with.

Case 3
In view of the business that the taxpayer is in, there was nothing in the income statement that would have made the accountant question the validity of the information provided to him. Therefore, he could rely on the good faith reliance exception and would not be subject to the preparer penalty.

Case 4
The accountant would not be subject to the penalties for participating or acquiescing in the understatement of a tax liability. The facts were highly suspect until the accountant asked questions to clear up the doubt in his mind that the client was not presenting him with implausible information. The response addressed the concern and was not inconsistent with the knowledge he possessed.

Case 5
The prospectus prepared by the company contains a false statement (overstated fair market value of the software) that could be used for tax purposes. The company knew or would reasonably be expected to know, but for culpable conduct, that the fair market value of the software was a false statement. The CRA would consider assessing the company and the appraiser with third party civil penalties.

Case 6
The issue here is whether the accountant is expected to know that HST is not payable on wages, interest expense, and zero-rated purchases. It is clear that the accountant should have known that no HST could be claimed on these items. Given this, in filing a claim that includes an HST refund on the preceding items, the accountant made a false statement, either knowingly, or in circumstances amounting to culpable conduct. Consequently, the CRA would consider assessing the accountant with the third party civil penalty, specifically, the preparer penalty.