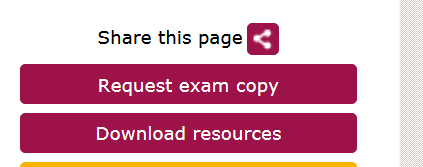
Canadian Tax Principles 2019 / 2020  
Test Items Solutions – Chapters 1 to 10

Test Items Solutions Table of Contents – Chapters 1 to 10

The .PDF version of the Test Items Solutions is available at the Instructor’s Resource Centre on the online catalogue listing for this book, at

**catalogue.pearsoned.ca**

Click on “Download resources” (shown below) in the upper right hand corner of the web page for this edition.



The table of contents is hyperlinked to the beginning of each Solution. To go to a Solution, hold down the Control key and click on the solution listing. Control + Home will bring you back to this table of contents from anywhere in the document.

[Chapter One Test Item File Solutions 6](#_Toc13664992)

[TIF Solution One - 1 6](#_Toc13664993)

[TIF Solution One - 2 11](#_Toc13664994)

[TIF Solution One - 3 13](#_Toc13664995)

[TIF Solution One - 4 17](#_Toc13664996)

[TIF Solution One - 5A 22](#_Toc13664997)

[TIF Solution One - 5B 23](#_Toc13664998)

[TIF Solution One - 6 24](#_Toc13664999)

[TIF Solution One - 7 26](#_Toc13665000)

[TIF Solution One - 8 27](#_Toc13665001)

[TIF Solution One - 9 28](#_Toc13665002)

[TIF Solution One - 10 29](#_Toc13665003)

[TIF Solution One - 11 30](#_Toc13665004)

[TIF Solution One - 12 31](#_Toc13665005)

[TIF Solution One - 13 32](#_Toc13665006)

[TIF Solution One - 14 33](#_Toc13665007)

[TIF Solution One - 15 34](#_Toc13665008)

[TIF Solution One - 16 35](#_Toc13665009)

[Chapter Two Test Item File Solutions 37](#_Toc13665010)

[TIF Solution Two - 1 37](#_Toc13665011)

[TIF Solution Two - 2 40](#_Toc13665012)

[TIF Solution Two - 3 41](#_Toc13665013)

[TIF Solution Two - 4 44](#_Toc13665014)

[TIF Solution Two - 5A 48](#_Toc13665015)

[TIF Solution Two - 5B 49](#_Toc13665016)

[TIF Solution Two - 6 50](#_Toc13665017)

[TIF Solution Two - 7 52](#_Toc13665018)

[TIF Solution Two - 8 53](#_Toc13665019)

[TIF Solution Two - 9 55](#_Toc13665020)

[TIF Solution Two - 10 57](#_Toc13665021)

[TIF Solution Two - 11 59](#_Toc13665022)

[TIF Solution Two - 12 60](#_Toc13665023)

[TIF Solution Two - 13 62](#_Toc13665024)

[TIF Solution Two - 14 63](#_Toc13665025)

[Chapter Three Test Item File Solutions 64](#_Toc13665026)

[TIF Solution Three - 1 64](#_Toc13665027)

[TIF Solution Three - 2 69](#_Toc13665028)

[TIF Solution Three - 3 70](#_Toc13665029)

[TIF Solution Three - 4 74](#_Toc13665030)

[TIF Solution Three - 5A 81](#_Toc13665031)

[TIF Solution Three - 5B 82](#_Toc13665032)

[TIF Solution Three - 6 83](#_Toc13665033)

[TIF Solution Three - 7 84](#_Toc13665034)

[TIF Solution Three - 8 85](#_Toc13665035)

[TIF Solution Three - 9 86](#_Toc13665036)

[TIF Solution Three - 10 87](#_Toc13665037)

[TIF Solution Three - 11 88](#_Toc13665038)

[TIF Solution Three - 12 89](#_Toc13665039)

[TIF Solution Three - 13 91](#_Toc13665040)

[TIF Solution Three - 14 93](#_Toc13665041)

[TIF Solution Three - 15 95](#_Toc13665042)

[TIF Solution Three - 16 96](#_Toc13665043)

[TIF Solution Three - 17 98](#_Toc13665044)

[TIF Solution Three - 18 100](#_Toc13665045)

[Chapter Four Test Item File Solutions 101](#_Toc13665046)

[TIF Solution Four - 1 101](#_Toc13665047)

[TIF Solution Four - 2 104](#_Toc13665048)

[TIF Solution Four - 3 105](#_Toc13665049)

[TIF Solution Four - 4 107](#_Toc13665050)

[TIF Solution Four - 5A 117](#_Toc13665051)

[TIF Solution Four - 5B 118](#_Toc13665052)

[TIF Solution Four - 6 119](#_Toc13665053)

[TIF Solution Four - 7 121](#_Toc13665054)

[TIF Solution Four - 8 124](#_Toc13665055)

[TIF Solution Four - 9 126](#_Toc13665056)

[TIF Solution Four - 10 129](#_Toc13665057)

[TIF Solution Four - 11 131](#_Toc13665058)

[TIF Solution Four - 12 134](#_Toc13665059)

[TIF Solution Four - 13 137](#_Toc13665060)

[Chapter Five Test Item File Solutions 140](#_Toc13665061)

[TIF Solution Five - 1 140](#_Toc13665062)

[TIF Solution Five - 2 144](#_Toc13665063)

[TIF Solution Five - 3 145](#_Toc13665064)

[TIF Solution Five - 4 150](#_Toc13665065)

[TIF Solution Five - 5A 160](#_Toc13665066)

[TIF Solution Five - 5B 161](#_Toc13665067)

[TIF Solution Five - 6 162](#_Toc13665068)

[TIF Solution Five - 7 164](#_Toc13665069)

[TIF Solution Five - 8 166](#_Toc13665070)

[TIF Solution Five - 9 168](#_Toc13665071)

[TIF Solution Five - 10 170](#_Toc13665072)

[TIF Solution Five - 11 173](#_Toc13665073)

[TIF Solution Five - 12 175](#_Toc13665074)

[TIF Solution Five - 13 176](#_Toc13665075)

[Chapter Six Test Item File Solutions 179](#_Toc13665076)

[TIF Solution Six - 1 179](#_Toc13665077)

[TIF Solution Six - 2 184](#_Toc13665078)

[TIF Solution Six - 3 185](#_Toc13665079)

[TIF Solution Six - 4 188](#_Toc13665080)

[TIF Solution Six - 5A 194](#_Toc13665081)

[TIF Solution Six - 5B 195](#_Toc13665082)

[TIF Solution Six - 6 196](#_Toc13665083)

[TIF Solution Six - 7 197](#_Toc13665084)

[TIF Solution Six - 8 199](#_Toc13665085)

[TIF Solution Six - 9 200](#_Toc13665086)

[TIF Solution Six - 10 201](#_Toc13665087)

[TIF Solution Six - 11 202](#_Toc13665088)

[TIF Solution Six - 12 203](#_Toc13665089)

[TIF Solution Six - 13 204](#_Toc13665090)

[TIF Solution Six - 14 206](#_Toc13665091)

[TIF Solution Six - 15 207](#_Toc13665092)

[TIF Solution Six - 16 209](#_Toc13665093)

[TIF Solution Six - 17 211](#_Toc13665094)

[TIF Solution Six - 18 214](#_Toc13665095)

[Chapter Seven Test Item File Solutions 218](#_Toc13665096)

[TIF Solution Seven - 1 218](#_Toc13665097)

[TIF Solution Seven - 2 221](#_Toc13665098)

[TIF Solution Seven - 3 222](#_Toc13665099)

[TIF Solution Seven - 4 225](#_Toc13665100)

[TIF Solution Seven - 5A 233](#_Toc13665101)

[TIF Solution Seven - 5B 234](#_Toc13665102)

[TIF Solution Seven - 6 235](#_Toc13665103)

[TIF Solution Seven - 7 236](#_Toc13665104)

[TIF Solution Seven - 8 238](#_Toc13665105)

[TIF Solution Seven - 9 240](#_Toc13665106)

[TIF Solution Seven - 10 242](#_Toc13665107)

[TIF Solution Seven - 11 243](#_Toc13665108)

[TIF Solution Seven - 12 244](#_Toc13665109)

[TIF Solution Seven - 13 246](#_Toc13665110)

[TIF Solution Seven - 14 248](#_Toc13665111)

[TIF Solution Seven - 15 250](#_Toc13665112)

[TIF Solution Seven - 16 253](#_Toc13665113)

[Chapter Eight Test Item File Solutions 257](#_Toc13665114)

[TIF Solution Eight - 1 257](#_Toc13665115)

[TIF Solution Eight - 2 260](#_Toc13665116)

[TIF Solution Eight - 3 261](#_Toc13665117)

[TIF Solution Eight - 4 267](#_Toc13665118)

[TIF Solution Eight - 5A 278](#_Toc13665119)

[TIF Solution Eight - 5B 279](#_Toc13665120)

[TIF Solution Eight - 6 280](#_Toc13665121)

[TIF Solution Eight - 7 281](#_Toc13665122)

[TIF Solution Eight - 8 282](#_Toc13665123)

[TIF Solution Eight - 9 284](#_Toc13665124)

[TIF Solution Eight - 10 285](#_Toc13665125)

[TIF Solution Eight - 11 287](#_Toc13665126)

[TIF Solution Eight - 12 288](#_Toc13665127)

[TIF Solution Eight - 13 290](#_Toc13665128)

[TIF Solution Eight - 14 291](#_Toc13665129)

[TIF Solution Eight - 15 292](#_Toc13665130)

[TIF Solution Eight - 16 295](#_Toc13665131)

[TIF Solution Eight - 17 296](#_Toc13665132)

[TIF Solution Eight - 18 298](#_Toc13665133)

[TIF Solution Eight - 19 302](#_Toc13665134)

[TIF Solution Eight - 20 304](#_Toc13665135)

[TIF Solution Eight - 21 306](#_Toc13665136)

[TIF Solution Eight - 22 307](#_Toc13665137)

[TIF Solution Eight - 23 311](#_Toc13665138)

[Chapter Nine Test Item File Solutions 314](#_Toc13665139)

[TIF Solution Nine - 1 314](#_Toc13665140)

[TIF Solution Nine - 2 319](#_Toc13665141)

[TIF Solution Nine - 3 321](#_Toc13665142)

[TIF Solution Nine - 4 326](#_Toc13665143)

[TIF Solution Nine - 5A 334](#_Toc13665144)

[TIF Solution Nine - 5B 335](#_Toc13665145)

[TIF Solution Nine - 6 336](#_Toc13665146)

[TIF Solution Nine - 7 337](#_Toc13665147)

[TIF Solution Nine - 8 338](#_Toc13665148)

[TIF Solution Nine - 9 339](#_Toc13665149)

[TIF Solution Nine - 10 340](#_Toc13665150)

[TIF Solution Nine - 11 341](#_Toc13665151)

[TIF Solution Nine - 12 343](#_Toc13665152)

[TIF Solution Nine - 13 346](#_Toc13665153)

[TIF Solution Nine - 14 348](#_Toc13665154)

[TIF Solution Nine - 15 350](#_Toc13665155)

[TIF Solution Nine - 16 352](#_Toc13665156)

[TIF Solution Nine - 17 354](#_Toc13665157)

[TIF Solution Nine - 18 356](#_Toc13665158)

[TIF Solution Nine - 19 358](#_Toc13665159)

[TIF Solution Nine - 20 359](#_Toc13665160)

[TIF Solution Nine - 21 361](#_Toc13665161)

[Chapter Ten Test Item File Solutions 364](#_Toc13665162)

[TIF Solution Ten - 1 364](#_Toc13665163)

[TIF Solution Ten - 2 369](#_Toc13665164)

[TIF Solution Ten - 3 370](#_Toc13665165)

[TIF Solution Ten - 4 373](#_Toc13665166)

[TIF Solution Ten - 5A 378](#_Toc13665167)

[TIF Solution Ten - 5B 379](#_Toc13665168)

[TIF Solution Ten - 6 380](#_Toc13665169)

[TIF Solution Ten - 7 381](#_Toc13665170)

[TIF Solution Ten - 8 382](#_Toc13665171)

[TIF Solution Ten - 9 383](#_Toc13665172)

[TIF Solution Ten - 10 384](#_Toc13665173)

[TIF Solution Ten - 11 385](#_Toc13665174)

[TIF Solution Ten - 12 386](#_Toc13665175)

[TIF Solution Ten - 13 388](#_Toc13665176)

[TIF Solution Ten - 14 390](#_Toc13665177)

[TIF Solution Ten - 15 393](#_Toc13665178)

Chapter One Test Item File Solutions

TIF Solution One - 1

1. The other sources of federal revenues that are shown in Figure 1-1 of the text are:

Corporate income taxes.

Non-resident income taxes.

GST.

Customs and import duties.

Other excise taxes.

EI premiums.

2. In the *Income Tax Act*, the term “person” can refer to an individual, a corporation, or a trust.

3. Provincial income taxes on individuals are calculated by applying a provincial rate schedule to the same Taxable Income figure that is used to calculate the federal income tax for individuals.  Provincial credits are then applied to the resulting figure.  The provincial brackets may differ from the federal brackets.  In addition, provincial credits may be different than the federal credits.

4. There are many examples that could be used here.  The text divides them into resource allocation (e.g., public health care), distribution effects (e.g., federal GST credit), stabilization effects (e.g., deficit reduction), and fiscal federalism (e.g., allocations to various levels of government).

5. Examples provided in the text are as follows:

Tax revenues are used to provide public goods and services.

Excise taxes are used to discourage the consumption of alcohol and tobacco products.

There are, of course, many other examples that could be cited.

6. The Canada Child Benefit system is designed to assist families with children.  It would appear that the government is encouraging people to have children.  The fact that the benefits are reduced as income increases suggests that it is also designed to assist lower income families care for these children.

7. There are a number of possibilities here.  They include:

Progressive rates increase the complexity of the system.

Progressive rates are unfair to individuals with highly variable income streams.

Progressive rates are unfair to single income family units.

Progressive rates lead to pressure for various types of tax concessions.

Progressive rates discourage high income individuals from making additional efforts.

Progressive rates encourage tax evasion.

8. While the sales tax rate is the same for all individuals without regard to their income level, lower income individuals normally spend a higher percentage of their total income.  Since the sales tax is levied on the amounts spent, this means that the sales tax paid by lower income individuals represents a larger percentage of their income.  As a consequence, they are generally considered to be regressive in nature.

9. Horizontal equity is achieved when taxpayers in similar economic circumstances are subject to similar levels of taxation.  Vertical equity is achieved when taxpayers in different economic circumstances are subject to taxes in a different manner.

10. The reasons that are listed in the text are as follows:

It is less costly to administer tax expenditures than it is to administer government funding programs.

More decisions are left to the private sector so that funds may be allocated more efficiently.

Tax expenditures reduce the visibility of certain government actions.  This is particularly beneficial if some social stigma is attached to the programs.  For example, a child tax benefit system is more acceptable than increasing social assistance payments.

Tax expenditures reduce the progressivity of the tax system.  As many of the tax expenditures, such as tax shelters, are more available to higher income taxpayers, they serve to reduce effective tax rates in the higher rate brackets.

11. This situation reflects the fact that when a new Section is added, it has been more convenient to attach a decimal designation to the new Section, as opposed to renumbering all of the Sections that follow the new Section.  As an example, over several years, the Department of Finance has added six new Sections after Section 12.  They have been numbered Section 12.1 through Section 12.6.  If they had used whole numbers for these new Sections, it would have been necessary to renumber all of the remaining Sections in the *Act* each time a new Section was added*.*

12. The purposes of these treaties are as follows:

They attempt to avoid double taxation of taxpayers who may have reason to pay taxes in more than one jurisdiction.

They try to prevent international evasion of taxes.

13. The required four items can be selected from the following:

CRA Web Site

Interpretation Bulletins

Income Tax Folios

Information Circulars

Income Tax Technical News

CRA News Releases, Tax Tips, and Fact Sheets

CRA Guides

CRA Pamphlets

Advance Income Tax Rulings

Technical Interpretations

14. For individuals and inter vivos trusts, the taxation year is equal to the calendar year.  In contrast, corporations can always use a fiscal period.  A fiscal period can end on any date, with the only constraint being that it cannot exceed 53 weeks for a corporation.  With respect to testamentary trusts, prior to 2016, like corporations, they could always use a non-calendar fiscal year.  In 2016 and subsequent years, their use of non-calendar fiscal periods is significantly restricted (see Chapter 19).

15. The circumstances that would result in a non-resident person having to pay income taxes in Canada are as follows:

The non-resident person earns employment income in Canada.

The non-resident person carried on a business in Canada.

The non-resident person has a gain on the disposal of a taxable Canadian property.

16. As stated in the text, residence is the cornerstone of Canadian income taxation.  If a person is considered a resident of Canada in a given year, that person will be subject to Canadian income tax for that year on all sources of income.  Alternatively, if the person is a non-resident, Canadian Part I tax will only apply to Canadian employment income, Canadian business income, and gains on the disposition of Taxable Canadian Property.

17. As stated in S5-F1-C1, the primary factors that will be considered by the CRA are as follows:

Whether the individual is continuing to maintain a dwelling in Canada.

Whether the spouse or common-law partner of the individual remains in Canada.

Whether the individual has dependants who remain in Canada.

18. The main factors here would be:

Does the individual have a dwelling in Canada?

Does the individual’s spouse or common-law partner live in Canada?

Do the dependants of the individual live in Canada?

Other factors that could be mentioned include:

Owning personal property in Canada (such as furniture, clothing, automobiles, and recreational vehicles).

Social ties with Canada (such as memberships in Canadian recreational and religious organizations).

Economic ties with Canada (such as employment with a Canadian employer and active involvement in a Canadian business, and Canadian bank accounts, retirement savings plans, credit cards, and securities accounts).

Hospitalization and medical insurance coverage from a province or territory of Canada.

A driver’s license from a province or territory of Canada.

A vehicle registered in a province or territory of Canada.

A seasonal dwelling place in Canada or a leased dwelling place.

Holding a Canadian passport.

Membership in Canadian unions or professional organizations.

19. As noted in the text, S5-F1-C1 identifies the following factors:

**Intent** The issue here is whether the individual intended to permanently sever residential ties with Canada.  If, for example, the individual has a contract for employment, if and when he returns to Canada, this could be viewed as evidence that he did not intend to permanently depart.  Another factor would be whether the individual complied with the rules related to permanent departures (i.e., as noted in Chapter 8, there is a deemed disposition of an individual’s property at the time of departure from Canada, resulting in the need to pay taxes on any gains).

**Frequency Of Visits** If the individual continues to visit Canada on a regular and continuing basis, particularly if other secondary residential ties are present, this would suggest that he did not intend to permanently depart from Canada.

**Residential Ties Outside Of Canada** A further consideration is whether or not the individual establishes residential ties in another country.  If someone leaves Canada and travels for an extensive period of time without settling in any one location, it will be considered as evidence that he has not permanently departed from Canada.

20. A Canadian resident normally becomes a non-resident on the latest of the following days:

on leaving Canada,

when a spouse and/or dependants leave Canada, and

on becoming a resident of another country.

21. As a sojourner, Jane would be assessed Canadian income taxes on her world wide income for the entire year.  As she would not be considered a resident of a province, she would be assessed an additional federal income tax of 48 percent of her basic federal tax otherwise payable.

In contrast, Jack would only be assessed Canadian income taxes on his world wide income for the 210 day period prior to his departure from Canada.  In addition, he would be assessed provincial income tax in the province of Manitoba for this 210 day period.

22. The required three items could be selected from the following:

**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.

23. If an enterprise is incorporated in Canada after April 26, 1965, it will always be considered resident in Canada.  However, if it is incorporated in Canada prior to April 27, 1965, it will only be considered resident in Canada in those situations where it either:

carried on business in Canada at any time after that date;  or

was resident in Canada at any time after that date (as measured by the location of the mind and management of the corporation).

24. Limon Inc. is a U.S. resident because it was incorporated in that country.  It is also a Canadian resident under the mind and management test.  In such dual residency cases, the tie-breaker rule in the Canada/U.S. tax treaty indicates that the taxes will be assessed in the country of incorporation.  That means that Limon Inc. would be subject to U.S. income taxes.

25. The components of Net Income For Tax Purposes are employment income, business and property income, net taxable capital gains, other sources of income, and other deductions from income.

26. The phrase “the amount, if any” is used throughout the *Income Tax Act* to indicate that only positive amounts should be considered.  In the context of ITA 3(b), the requirement that negative amounts be ignored, in effect, prevents the deduction of current year allowable capital losses in excess of current year taxable capital gains in the determination of Net Income For Tax Purposes.

27. Tax avoidance is a form of tax planning in which the taxpayer, through means that are within the boundaries of tax legislation, arranges his affairs in a manner that allows him to receive benefits without the payment of taxes.  Tax planning to achieve tax deferral involves either the delayed recognition of income, or the accelerated recognition of deductions.  The payment of tax is delayed, as opposed to permanently avoided.

28. Income splitting involves efforts to share the total income accruing to an individual with family members or other related parties.  It will only benefit a taxpayer who is in a high tax bracket in those circumstances where there are family members or other related parties who are in lower tax brackets.

29. The basic type of tax planning that is involved in Registered Retirement Savings Plans is tax deferral — a tax savings results from making contributions that will have to be paid back at a later point in time.  There may also be an element of avoidance in that, after retirement, an individual may be in a lower tax bracket than he was during his working years.  If this is the case, there will be an absolute reduction in taxes.  (This assumes that the basic rate structure is unchanged.)

30. The basic goals of tax planning can be summarized as follows:

Tax avoidance  - To permanently avoid the payment of some amount of tax.

Tax deferral - To delay the recognition of certain types of income or accelerate the timing of certain deductions.

Income splitting - To have a family or other related group’s aggregate taxable income allocated as evenly as possible among the members of the group.

He should contribute the $5,000 to the spousal RRSP.  By contributing to an RRSP he will be deferring taxes.  By contributing to a spousal RRSP he is also income splitting and there may be possible tax avoidance if his spouse is taxed at a lower rate when the funds become taxable to her.