Canadian Income Taxation 2019 2020 (Canadian) 22nd edition Buckwold Test Bank

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Chapter 02
Fundamentals of Tax Planning

Multiple Choice Questions

1. The CEO at Big Company Corporation has decided to sell a piece of capital equipment after the company's year-end in order to avoid paying capital gains tax this year. Which tax planning method will the CEO be using?
A. Transferring income to another entity.
B. Converting the nature of income from one type to another.
C. Shifting income from one time period to another.
D. This is a form of tax evasion and is not allowed.

Blooms: Understand
Topic: 02-05 Types of Tax Planning
Topic: 02-06 Shifting Income from One Time Period to Another
Topic: 02-07 Transferring Income to Another Entity
Topic: 02-08 Converting Income from One Type to Another

2. Which of the following scenarios illustrates a potential tax avoidance scheme?
A. Property transferred between arm's-length parties is valued at fair market value.
B. Dividends received from shares transferred from a wife to her husband are taxed in the hands of the wife.
C. A shareholder owns two corporations and undertakes legal steps in order to permit loss utilization between the two companies.
D. A man transfers property to his child at a value less than fair market value.

Blooms: Understand
Topic: 02-04 Tax Avoidance

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3. The controller of Little Company Ltd. has decided to sell a piece of capital equipment after the company's year-end in order to avoid paying tax on capital gains this year. The controller is engaging in
A. tax avoidance.
B. tax evasion.
C. tax planning.
D. GAAR.

Blooms: Remember
Topic: 02-02 Tax Planning Defined

4. Certain skills are necessary for successful tax planning. One of these skills is applying the time value of money. Which of the following is FALSE regarding this skill?
A. Applying the time value of money is a tool used for wealth accumulation.
B. If a taxpayer invests $1,000 at 8% and subsequently earns $48 in after-tax income on the investment at the end of the first year, the taxpayer's tax rate is 40%.
C. If a taxpayer earns an annual return of 12% and is subject to a 40% tax rate, the annual after-tax return is 4.8%.
D. If a taxpayer invests $1,000 for one year at a rate of return of 14% and is subject to a 45% tax rate, the after-tax value of the interest will be $77.

Blooms: Apply
Blooms: Understand
Topic: 02-09 Skills Required for Tax Planning

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5. Which of the following statements regarding GAAR is true?
A. The purpose of GAAR is to catch tax evaders.
B. When an avoidance transaction takes place, the anti-avoidance rule is automatically applied in all circumstances.
C. Canada Revenue Agency states that "A transaction will not be an avoidance transaction if the taxpayer establishes that it is undertaken primarily for bona fide business, investment or family purposes."
D. Individuals who organize their affairs in order to pay as little tax as possible will automatically be subject to GAAR.

Blooms: Understand
Topic: 02-11 Specific Anti-Avoidance Rules

Short Answer Questions

6. Steven earned $150,000 this year in profits from his proprietorship. Personal tax rates (federal plus provincial) in Steven's province are:

On the first $48,000	24%
On the next $47,000	32%
On the next $53,000	40%
On the next $62,000	45%
On income over $210,000	50%

The combined federal and provincial rate of tax for Canadian-controlled private corporations in Steven's province is 13% on the first $500,000 of income.

(All rates are assumed for this question.)

Steven has been considering incorporating his business.

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Required:

A. How would Steven's after-tax profits have differed if the company had been incorporated? Show all calculations.
B. Name the type of tax planning that Steve would be engaging in if he incorporated his company.

A) After-tax profits as a proprietorship:

$150,000.00		$150,000.00
Less Tax:		
$48.000.00	× 24%	$11,520.00
$47,000.00	× 32%	$15,040.00
$53,000.00	× 40%	$21,200.00
$2,000.00	× 45%	$900.00
After-tax profits:		$101,340.00

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After-tax profits as a corporation:

$150,000.00		$150,000.00
Less Tax:		
$150,000.00	× 13%	$19,500.00
After-tax profits:		$130,500.00

B) Transferring income from one entity to another (individual to corporation)

Blooms: Apply
Blooms: Understand
Topic: 02-02 Tax Planning Defined
Topic: 02-07 Transferring Income to Another Entity

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7. Part A: List the three key factors of cash flow.

Part B: List the six skills required for tax planning as suggested in the textbook.

Part A:
Three key factors of cash flow

1. Amount of money coming in
2. Amount of money going out
3. Timing

Part B:
Six skills required for tax planning

1. Anticipation
2. Flexibility
3. Speculation
4. Applying the 8th Wonder of the World
5. Perspective
6. Global approach

Blooms: Remember
Topic: 02-09 Skills Required for Tax Planning
Topic: 02-13 Summary and Conclusion

8. Andrew has $10,000 to invest. He wants to put his money in a one-year investment earning an annual interest rate of 12%. Andrew is in a 42% tax bracket.

Required:

a) Calculate the total value of Andrew's investment, after-tax, at the end of the year.
b) Calculate the amount of taxes Andrew will pay on his investment.

a) $10,000 + (($10,000 × 12) × (1 - .42)) = $10,696
b) $10,000 × .12 × .42 = $504

Blooms: Apply
Topic: 02-09 Skills Required for Tax Planning

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9. Match each of the following terms with the most accurate example. Use each example only once.

TERMS:

Tax evasion
Tax planning
Tax avoidance

EXAMPLES:

A. An individual is seeking a beneficial outcome, and therefore, applies an application that is not specifically prohibited by law.
B. A business is seeking a beneficial outcome, and therefore, does not report a portion of revenue earned during the year.
C. Two unrelated companies take steps to become related solely for the purpose of loss utilization.

An individual is seeking a beneficial outcome, and therefore, applies an application that is not specifically prohibited by law. **Tax planning**

A business is seeking a beneficial outcome, and therefore, does not report a portion of revenue earned during the year. **Tax evasion**

Two unrelated companies take steps to become related solely for the purpose of loss utilization. **Tax avoidance**

Blooms: Understand
Topic: 02-03 Tax Evasion
Topic: 02-04 Tax Avoidance
Topic: 02-05 Types of Tax Planning

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10. For each of the three examples listed below (1-3), identify the category of tax planning (A-C) that has been applied.

1. Jack has run a successful proprietorship for the past four years and has now decided to incorporate his company.
2. Karen has decided not to pay herself a dividend from her corporation, (of which she is the sole shareholder), but has chosen to sell a portion of her shares to a third party instead.
3. XYZ Corporation has chosen to delay the recognition of a discretionary reserve until the following year.

A. Shifting income from one time period to another
B. Transferring income from one entity to another
C. Converting income from one type of income to another.

1. B. Transferring income from one entity to another
2. C. Converting income from one type of income to another
3. A. Shifting income from one time period to another

Blooms: Understand
Topic: 02-05 Types of Tax Planning
Topic: 02-06 Shifting Income from One Time Period to Another
Topic: 02-07 Transferring Income to Another Entity
Topic: 02-08 Converting Income from One Type to Another

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