02

Student: ____

1. The manager 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 has the manager used?
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.

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.

3. The manager 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 manager is engaging in
A. tax avoidance.
B. tax evasion.
C. tax planning.
D. GAAR.

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 compounded after-tax value of the investment will be $1,077.

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. The 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. GAAR can correctly be defined as "Organizing one's affairs in a manner that results in paying the least amount of tax possible."

6. Steven James earned $150,000 this year in profits from his proprietorship, which placed him in a 45% tax bracket. The rate of tax for Canadian-controlled private corporations in his province is 15% on the first $500,000 of income. Personal tax rates (federal plus provincial) in James' province are:

On the first $44,000	24%
On the next $44,000	32%
On the next $48,000	40%
On income over $136,000	45%

(*All rates are assumed for this question.*)

Steven requires $3,000 of after-tax withdrawals per month for his personal living expenses. All remaining profits are used to pay taxes and to expand the business. Steven expects the same profits before living expenses next year.

Steven is considering incorporating his business next year. If he incorporates, he will pay himself a gross salary of $48,000.

Required:

Determine the increase in Steven's cash flow if he incorporates his company? Show all calculations.

A. Why will Steve set his new salary at $48,000?
B. Name the type of tax planning that Steve would be engaging in if he incorporated his company.

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.

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

Required:

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

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 in order to shift income from the profitable business to the company with losses.

10. For each of the examples listed below, state which of the following three categories of tax planning has been applied:

1. Shifting income from one time period to another
2. Shifting income from one entity to another
3. Shifting income from one type of income to another.

A. Jack has run a successful proprietorship for the past four years, and has now decided to incorporate his company.
B. 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 an associate instead.
C. XYZ Corporation has chosen to delay the recognition of a discretionary reserve until the following year.

02 Key

1. *(p. 10)* The manager 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 has the manager used?
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.

Accessibility: Keyboard Navigation
Blooms: Comprehension
Buckwold - Chapter 02 #1

2. *(p. 20)* 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.

Accessibility: Keyboard Navigation
Blooms: Comprehension
Buckwold - Chapter 02 #2

3. *(p. 8)* The manager 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 manager is engaging in
A. tax avoidance.
B. tax evasion.
C. tax planning.
D. GAAR.

Accessibility: Keyboard Navigation
Blooms: Knowledge
Buckwold - Chapter 02 #3

4. *(p. 17)* 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 compounded after-tax value of the investment will be $1,077.

(12% × [1 - .4]) = 7.2% after-tax return

Accessibility: Keyboard Navigation
Blooms: Application
Blooms: Comprehension
Buckwold - Chapter 02 #4

5. *(p. 20)* 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. The 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. GAAR can correctly be defined as "Organizing one's affairs in a manner that results in paying the least amount of tax possible."

Accessibility: Keyboard Navigation
Blooms: Comprehension
Buckwold - Chapter 02 #5

6. *(p. 13-14)* Steven James earned $150,000 this year in profits from his proprietorship, which placed him in a 45% tax bracket. The rate of tax for Canadian-controlled private corporations in his province is 15% on the first $500,000 of income. Personal tax rates (federal plus provincial) in James' province are:

On the first $44,000	24%
On the next $44,000	32%
On the next $48,000	40%
On income over $136,000	45%

(*All rates are assumed for this question.*)

Steven requires $3,000 of after-tax withdrawals per month for his personal living expenses. All remaining profits are used to pay taxes and to expand the business. Steven expects the same profits before living expenses next year.

Steven is considering incorporating his business next year. If he incorporates, he will pay himself a gross salary of $48,000.

Required:

Determine the increase in Steven's cash flow if he incorporates his company? Show all calculations.

A. Why will Steve set his new salary at $48,000?
B. Name the type of tax planning that Steve would be engaging in if he incorporated his company.

A) Excess cash as a proprietorship:

Profits	$150,000
Tax: 24% × 44,000 $10,560 32% × 44,000 14,080 40% × 48,000 19,200 45% × 14,000 6,300 (Assumed federal plus provincial rates)	(50,140)
	$ 99,860
Living expenses	(36,000)
Available for expansion	$ 63,860

Excess cash as a corporation:

Profits	$150,000
Salary	(48,000)
Corporate business profits	102,000
Tax: 15% × 102,000	(15,300)
Available for expansion	$86,700
Excess cash ($86,700 - $63,860)	$22,840

B) A $48,000 salary from the corporation will result in $36,120 of after-tax income, similar to his current withdrawals from the proprietorship.
[($44,000 × .76) + (4,000 × .68)] = $36,120
C) Transferring income to another entity

Blooms: Application
Blooms: Comprehension
Buckwold - Chapter 02 #6

7. *(p. 18-19)* 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.

<u>Three key factors of cash flow</u>

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

<u>Six skills required for tax planning</u>

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

Blooms: Knowledge
Buckwold - Chapter 02 #7

8. *(p. 18)* Andrew has $10,000 to invest. He wants to put his money into an investment earning an annual interest rate of 12%. Andrew is in a 42% tax bracket.

Required:

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

a) ($10,000 × 1.12) × (1 - .42) = $10,696
b) $10,000 × .12 × .42 = $504

Blooms: Application
Buckwold - Chapter 02 #8

9. *(p. 8-10)* 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 in order to shift income from the profitable business to the company with losses.

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 in order to shift income from the profitable business to the company with losses. **Tax avoidance**

Blooms: Comprehension
Buckwold - Chapter 02 #9

10. *(p. 10-17)* For each of the examples listed below, state which of the following three categories of tax planning has been applied:

1. Shifting income from one time period to another
2. Shifting income from one entity to another
3. Shifting income from one type of income to another.

A. Jack has run a successful proprietorship for the past four years, and has now decided to incorporate his company.
B. 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 an associate instead.
C. XYZ Corporation has chosen to delay the recognition of a discretionary reserve until the following year.

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

Blooms: Comprehension
Buckwold - Chapter 02 #10

02 Summary

Category	*# of Questions*
Accessibility: Keyboard Navigation	5
Blooms: Application	3
Blooms: Comprehension	7
Blooms: Knowledge	2
Buckwold - Chapter 02	10