Solutions for Canadian Income Taxation 2021 2022 24th Edition by Buckwold

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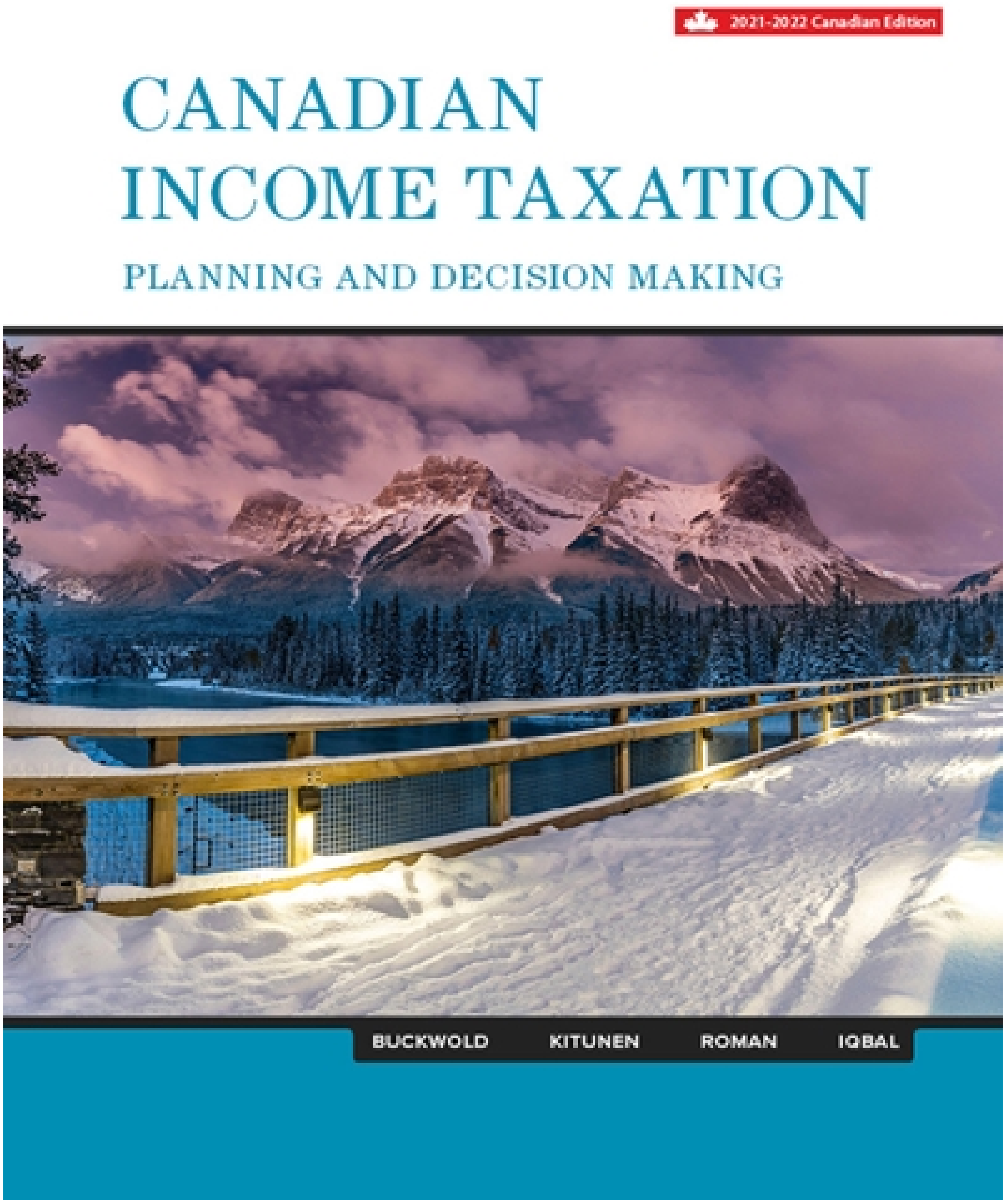

Solutions

CHAPTER 1

TAXATION— ITS ROLE IN BUSINESS DECISION MAKING

Review Questions

1. If income tax is imposed after profits have been determined, why is taxation relevant to business decision making?

2. Most business decisions involve the evaluation of alternative courses of action. For example, a marketing manager may be responsible for choosing a strategy for establishing sales in new geographical territories. Briefly explain how the tax factor can be an integral part of this decision.

3. What are the fundamental variables of the income tax system that decision-makers should be familiar with so that they can apply tax issues to their areas of responsibility?

4. What is an “after-tax” approach to decision making?

Solutions to Review Questions

R1-1 Once profit is determined, the *Income Tax Act* determines the amount of income tax that results. However, at all levels of management, alternative courses of action are evaluated. In many cases, the choice of one alternative over the other may affect both the amount and the timing of future taxes on income generated from that activity. Therefore, the person making those decisions has a direct input into future after-tax cash flow. Obviously, decisions that reduce or postpone the payment of tax affect the ultimate return on investment and, in turn, the value of the enterprise. Including the tax variable as a part of the formal decision process will ultimately lead to improved after-tax cash flow.

R1-2 Expansion can be achieved in new geographic areas through direct selling, or by establishing a formal presence in the new territory with a branch office or a separate corporation. The new territories may also cross provincial or international boundaries. Provincial income tax rates vary amongst the provinces. The amount of income that is subject to tax in the new province will be different for each of the three alternatives mentioned above. For example, with direct selling, none of the income is taxed in the new province, but with a separate corporation, all of the income is taxed in the new province. Because the tax cost is different in each case, taxation is a relevant part of the decision and must be included in any cost-benefit analysis that compares the three alternatives [Reg. 400-402.1].

R1-3 A basic understanding of the following variables will significantly strengthen a decision maker's ability to apply tax issues to their area of responsibility.

Types of Income	-	Employment, Business, Property, Capital gains
Taxable Entities	-	Individuals, Corporations, Trusts
Alternative Business Structures	-	Corporation, Proprietorship, Partnership, Limited partnership, Joint arrangement, Income trust
Tax Jurisdictions	-	Federal, Provincial, Foreign

R1-4 All cash flow decisions, whether related to revenues, expenses, asset acquisitions or divestitures, or debt and equity restructuring, will impact the amount and timing of the tax cost. Therefore, cash flow exists only on an after tax basis, and, the tax impacts whether or not the ultimate result of the decision is successful. An after-tax approach to decision-making requires each decision-maker to think "after-tax" for every decision at the time the decision is being made, and, to consider alternative courses of action to minimize the tax cost, in the same way that decisions are made regarding other types of costs.

Failure to apply an after-tax approach at the time decisions are made may provide inaccurate information for evaluation, and, result in a permanently inefficient tax structure.

SOLUTION TO COMPREHENSIVE CASE FIVE: KAREN LANCTOT AND KLPC

Part 1				
Net income for tax purposes				$560,000
	Dividends from Canadian corporations			(18,000)
	Donations			(15,000)
	Net capital losses			-
	Non-capital losses			-
	Taxable income			$527,000
Active business income				
	Net income for tax purposes			560,000
	Less: dividends received			(18,000)
	Less: taxable capital gains			(32,000)
	Less: interest income (excluding AR)			(4,000)
	Active business income			506,000
Aggregate investment income				
	Taxable capital gains			32,000
	Net capital losses			-
	Interest income (excluding AR)			4,000
				36,000
Part I tax				
Basic federal tax - 38%				200,260
Abatement - 10%				(52,700)
				147,560
Small business deduction - 19% x least of				
(i) ABI (excluding SCI)		426,000	426,000	(80,940)
(ii) TI		527,000		
(iii) Business limit		500,000		
General tax reduction - 13% of				
Taxable income			527,000	
Less: Income subject to SBD			(426,000)	
Less: AII			(36,000)	
			65,000	(8,450)
Refundable tax on investment income				
10 2/3% times the least of:				
AII		36,000		
TI - income subject to SBD		101,000	36,000	3,841
		PART I TAX		62,011

Part IV Tax				
38 1/3% x Dividends from non-connected corporations				
	38 1/3% x $18,000			6,900
Dividends from connected corporations				
				-
				6,900

Active business income should also include $6,000 of interest income on overdue AR since this pertains to the active business.

The $80,000 of revenue from Lanctot Painters Ltd. is specified corporate income (SCI) since a person not dealing at arm's length with KLPC (Karen's brother) has a direct interest in Lanctot Painters Ltd. and since the amount represents more than 10% of KLPC's active business income. The active business income is reduced by this amount due to ITA 125(1)(a)(i)(B).

For this $80,000 to be eligible for the small business deduction, Lanctot Painters Ltd. would need to assign some of its own business limit to KLPC. Assignments must be designated on the corporate tax return of both companies involved. It is assumed that no assignment was made since there was no mention of it in the information provided.

Part 2		
Non-eligible RDTOH		
Balance at end of previous year		-
Less: Dividend refund for preceding year		-
Add: Part IV tax on non-eligible dividends		-
Add: refundable Part I tax - least of:		
(i) 30 2/3% x AII	11,041	
(ii) 30 2/3% (TI - income subject to SBD)	30,977	
(iii) Part I tax	62,011	11,041
		11,041
Eligible RDTOH		
Balance at end of previous year		-
Less: Dividend refund for preceding year		-
Add: Part IV tax on eligible dividends		6,900
		6,900

Part 3			
Dividend Refund			
(i) Lessor of:			
(a) 38 1/3% x eligible dividends paid		-	-
(b) Eligible RDTOH balance		6,900	
Plus			
(ii) Lessor of:			
(a) 38 1/3% x non-eligible dividends paic		38,333	
(b) Non-eligible RDTOH balance		11,041	11,041
			11,041

Part 4

By maintaining a mix of passive and active income, Karen will now have adjusted aggregate investment income for 2021 will be $54,000 (calculated as the aggregate investment income plus the portfolio dividends). Since this exceeds $50,000, the annual limit for the small business deduction for 2022 will be reduced by $20,000 [($54,000 – 50,000) x 5]. This reduction will likely increase over time as the company generates more income from passive sources.