

ADMN 4817 CORPORATE TAXATION

MIDTERM EXAM

FEBRUARY 24, 2011

Question 1 (44) (65 minutes) [Chapters 11, 12]

Dripper Catcher Ltd. is a Canadian-Controlled Private Corporation with head offices in Langley, British Columbia. Dripper Catcher manufactures aluminum eavestroughs and sells them directly to builders. It also has a construction business that installs its products (and related products) on consumers' homes. For its fiscal year ended December 31, 2010, the corporation had correctly calculated its income for tax purposes under Division B as follows:

Canadian operating profits (Note 1)	\$493,000
Foreign: income before tax from U.S. branch in C\$ (Note 2)	40,000
Royalty income (Note 3)	15,000
Interest income on outstanding A/R in construction business	4,500
Recapture of CCA (Note 4)	12,500
Rental income (Note 5)	19,000
Taxable capital gains net of allowable capital losses	3,000
Dividends from taxable Canadian corporations — non-connected	<u>13,000</u>
Division B income for tax purposes	<u>\$600,000</u>

Notes:

- (1) Operating profits are from its two businesses; geographic and business line details described below.
- (2) Foreign income tax was paid in the amount of C\$10,500 on this income.
- (3) The royalty income had been determined to be property income.
- (4) The recapture resulted from the sale of some equipment used in the construction business.
- (5) The rental income was derived from a five-year lease of the entire space of an unused warehouse owned by the corporation.

Additional Information:

- (A) The balance in the tax accounts at the end of 2009 and other information from the 2009 taxation year were:

Unused business foreign tax credit	\$ 4,000
Refundable dividend tax on hand	20,000
Dividend refund for 2009	8,000

- (B) A net capital loss of \$6,000 was realized in June 2009; no capital gains were realized by the corporation in 2009 or in the prior three years.
- (C) DCL made charitable donations of \$12,500 during the year.
- (D) Four quarterly dividends of \$25,000 were declared at the end of each calendar quarter of 2010 and, as always, were paid two weeks after their declaration. Similarly, the dividend for the last

quarter of 2009 of \$22,500 was paid on January 14, 2010.

(E) The corporation has permanent establishments in British Columbia, Ontario, and the United States. Its gross revenues, salary and wages, operating profit, and gross asset values are as follows:

<i>Location</i>	<i>Gross revenue (\$000s)</i>	<i>Payroll (\$000s)</i>	<i>Operating profit (\$000s)</i>	<i>Gross asset value (\$000s)</i>
British Columbia	1,750	1,950	123	4,500
Ontario	2,500	900	140	800
U.S.	<u>750</u>	<u>150</u>	<u>40</u>	<u>700</u>
Totals	<u>5,000</u>	<u>3,000</u>	<u>303</u>	<u>6,000</u>

(F) The corporation has taxable capital of \$4,500,000.

(G) Manufacturing and processing profits (M&P) have been correctly computed as \$352,494.

Required:

Calculate the federal taxes and provincial taxes at an assumed net tax rate of 10% on federal taxable income payable by Dripper Catcher Ltd. Assume initially that the *general tax reduction* is \$3,750 and confirm this amount. Also compute the refundable dividend tax on hand balance as at December 31, 2010 and compute the dividend refund for 2010. Show all calculations.

Question 2 (46) (51 minutes) [Chapters 11, 12]

BC Enterprises Ltd. is a Canadian-controlled private corporation located in Vancouver, British Columbia. For its fiscal year ended December 31, 2010, the corporation had correctly calculated its income for tax purposes under Division B and some of the federal Part I tax as follows:

Domestic sources —

Manufacturing income (Note 1)	\$ 160,000
Advertising agency loss	(80,000)
Rental income from unused warehouse fully rented on a five-year lease	35,000
Retailing income	330,000
Interest on outstanding accounts receivable in retailing business	15,000
Recapture of CCA from sale of fixtures used in retailing business	10,000
Interest income from five-year bonds	60,000
Taxable capital gains net of losses from sale of marketable securities purchased with short-term surplus manufacturing business funds	70,000
Dividends from non-connected taxable Canadian corporations	12,000

Foreign sources —

Foreign business income in C\$ earned through unincorporated branch in United States before C\$11,500 in income tax paid in United States	45,000
Foreign non-business income in C\$ before C\$4,500 withheld	<u>30,000</u>
Division B net income for tax purposes	\$687,000
Division C deductions:	
charitable donations (\$12,500 + \$3,000)	(15,500)
dividends (Canadian-source)	(12,000)
non-capital losses	(50,000)
net capital losses ($\$13,500 \times \frac{1}{2} \div \frac{3}{4}$)	<u>(9,000)</u>
Taxable income	<u>\$600,500</u>
Federal tax @ 38%	\$228,190
Federal abatement (Note 2)	<u>(38,939)</u>
Partial Part I tax correctly computed	<u>\$189,251</u>

Notes with additional information —

- (1) This amount of manufacturing income was computed correctly under Division B. Manufacturing and processing profits, computed according to the provisions of regulation 5200, as correctly computed as \$334,170 for 2010. All manufacturing activities were carried on in British Columbia.
- (2) The corporation has permanent establishments in British Columbia and the state of Washington in the United States. The federal abatement has been correctly computed based on its gross revenue and salary and wages information.
- (3) BC Enterprises Ltd. made the following selected payments during the year:

Scientific research and experimental development	\$165,000
Charitable donations	12,500
- (4) Four quarterly dividends of \$30,000 were declared at the end of each quarter of the 2010 fiscal year and were paid within two weeks of their declaration. The dividend for the last quarter of 2010 was paid in January 2011. A dividend of \$25,000 declared in the last quarter of 2009 was paid in January 2010.
- (5) BC Enterprises Ltd. had allocated all but \$230,000 of its \$500,000 business limit to other associated corporations. Taxable capital does not exceed \$10,000,000 within the associated group. The only scientific research and experimental development expenditures of the associated group were made by BC Enterprises Ltd.
- (6) The balances in the tax accounts on December 31, 2009 were:

Charitable donation carryforward	\$ 3,000
Unused business foreign tax credit	3,500
Non-capital losses from 2005	50,000
Net capital losses from 1999	13,500
Refundable dividend tax on hand	20,000
Dividend refund for 2009	9,000

(7) Assume that the general rate reduction has been correctly computed as \$8,033 for 2010.

Required:

Determine, by clearly presenting all component parts and their calculations,

- (a) total federal Part I tax payable, assuming that the foreign tax credits are equal to the foreign taxes paid, without recalculating the parts of the Part I tax already computed or assumed correctly above, and

(33 minutes)

- (b) the amount of the dividend refund for 2010.

(18 minutes)

Show all calculations whether or not necessary to the final answer.

Question 3 (bonus 5 marks)



Using exactly 10 words, what are they doing?