NOTE: 1. This is an open book examination. You may bring into the examination room and use during the examination your casebook, Income Tax Act, class handouts, notes and summaries. Do not use library books, textbooks, or materials prepared by someone other than you.

2. All questions are to be answered, except for your choice of answering either question 2(c.1) or 2(c.2). If, in answering a question, alternative legal arguments are reasonably possible, state and discuss them. Please explain each answer.

3. Suggested times are allocated to each of the questions. The examination is 3 hours or 180 minutes long, and the allocated times total 168 minutes, leaving 12 minutes free for such purposes as reading or review.

THIS EXAMINATION CONSISTS OF 2 QUESTIONS.
MARKS

1. Lionel Hutz graduated from the Faculty of Law at Springfield A&M University with a Juris Doctor (JD) degree and articles in 2013 with a law firm in Shelbyville, British Columbia. Hutz was admitted to the Law Society of British Columbia last January, 2014. Hutz decided to open up a solo practice of law in Springfield, British Columbia and hired you as an associate lawyer/employee of his proprietorship.

25 (a) (Suggested time: 42 minutes)

One of Hutz’s clients is Lurleen Lumpkin, who lives in Springfield. During the daytime on weekdays and occasional weekends, Lurleen earns a base amount and a commission on her sales as a sales representative in the women’s department of Costington’s Department Store, a high-end retailer in downtown Springfield. Costington’s determines Lurleen’s hours of work and her duties. During 2015, Lurleen earned $48,000 ($4,000 per month) as her base amount and $22,000 commission for the year (based on a formula in her contract with Costington’s of 1% of the value of her sales).

During 2015, Lurleen used most of her life savings ($15,000) and borrowed additional funds from the First Bank of Springfield ($35,000) to buy publicly traded common stock in Costington’s for $50,000. The stock did not pay a dividend, but Lurleen expected that the directors of Costington’s could always vote to declare a dividend to the common shareholders. Lurleen made the purchase on the Springfield Stock Exchange through a broker. Later in the year, when Costington’s reported lower than expected quarterly earnings, which disappointed her, and the stock fell in value, she sold her stock through her broker for $30,000. She repaid most of the bank loan with the $30,000, which she received as the selling price, but she still owes the bank $5,000 on the principal of the loan together with interest on the full amount of the loan which she intends to repay in 2016 out of her earnings from Costington’s.

On the other hand, Lurleen’s purchase of Springfield Nuclear Power common shares with the rest of her life savings soared on the exchange: she bought the shares through her broker for $10,000 and sold them for $20,000 in the year.

On weekend evenings, Lurleen performs as a solo country and western singer at bars, weddings and private parties in and around Springfield. Lurleen earned a total $30,000 in gross fees from her numerous gigs. In 2015 Lurleen bought and paid for a motor van (CCA Class 10, 30%) at a cost of $20,000 which she uses only to transport herself and her equipment from her home to the different locations where she has contracted to perform. Lurleen keeps her van beside her house, or outside her performance venues. (Lurleen takes public transit to and from her work at Costington’s and for
her personal travel around Springfield. Lurleen has kept all her
monthly transit passes for the year.)

In her home, Lurleen has set aside a room comprising $\frac{1}{4}$th of the
total space which she uses entirely as a studio for practicing,
rehearsals and recording discs for sale at her gigs. The yearly
expenses of operating the van Lurleen estimates to be around
$10,000 but she has not kept records or receipts for any of these
expenses. During her performances at the various venues, Lurleen
offers her discs for purchase to attendees. In 2015, she sold 1,000
copies at $10 apiece to attendees. Hutz admits he knows nothing
about income tax and asks you to advise Lurleen on the income tax
implications of these matters for 2015 and other years as necessary
to provide her with complete advice.

(b) (Suggested time: 42 minutes)

Another of Hutz’s clients is the Starving Teachers Moving Co Ltd,
a company incorporated in British Columbia by former teachers,
Mr. Dewey Largo (Lisa’s former music teacher) and Ms. Brundella
Pomelhorst (former physical education teacher), who are the only
officers or employees in the business. In February 2015, two
anonymous strangers approached Dewey saying they needed to
borrow one of the moving vans for a “few” hours on a “no-
questions-asked-no-names” basis and offered to pay $50,000 in
advance on his promise not to tell anyone. Dewey was suspicious,
because of the circumstances and the company had never rented
out moving vans (without movers) before or since this one-off
transaction, but he agreed because the offer was too good to pass
up. He regarded the offer as a “once-in-a-lifetime” stroke of luck
during a period when the moving business was extremely slow.
Dewey received the $50,000 in untraceable used small bills, which
he shared equally with Brundella, who was gratefully surprised to
receive her share, because she had had no interaction with the
strangers or prior knowledge of the transaction conducted entirely
by Dewey. Dewey and Brunella secretly kept the money for
themselves, never disclosing it to anyone.

Several evenings later, the van was surreptitiously returned to the
moving company’s parking lot, in a terrible condition, riddled with
bullet-holes, two flat tires punctured by bullets and with its engine
burned out. To the police, Dewey falsely reported the van as
stolen and returned in circumstances that he said he did not know
anything about. The RCMP and the Federal Department of Justice
(DoJ) surmised that strangers had used the van for a secretive drug
deal one night that went wrong, resulting in a high-speed chase and
a gun battle with persons unknown. To fix the damage caused by
the bullet holes cost the company $40,000, to replace the engine
cost another $10,000 and to replace the two tires cost $1,000 each.
The company hired a criminal lawyer to intercede on Dewey's behalf with the RCMP investigators and DoJ prosecutors to prevent the laying of criminal charges against him for obstructing justice by making false statements during the criminal investigation. The officials disbelieved Dewey, because he could not explain how the so-called "thieves" had obtained his key to the van without his involvement. The incident attracted such widespread notoriety that the directors of the moving company and Dewey decided that he could not continue with the company any longer. The company fired him asserting just cause, but Dewey retained a lawyer who managed to negotiate a severance package comprising a payment of $60,000 to Dewey, $5,000 for loss of reputation and charged Dewey a bill for legal services of $6,000, which the company paid on Dewey's behalf. The company will pay the amounts of $60,000, $5,000 and $6,000 in 2016. Advise Dewey, Brundella and the company of the income tax consequences, if any, of these transactions.

(c) (Suggested time: 25 minutes)
Another of Hutz's clients is Professor John Neidelbaum Frink Jr., who is a member of the Springfield Mensa Society (a voluntary group of individuals with high IQ's) and a science professor at the Springfield Heights Institute of Technology. The Mensa Society charges annual membership dues of $2,400. The Institute expects its science professors to wear white lab coats on the premises and provides tailored lab coats to all of them, including Professor Frink, free of charge. Professor Frink wears his lab coat at all times whether he is on or off the campus and regardless of the occasion. In 2015, the Institute paid Professor Frink $1,000 as consolation and heart-balm to relieve the anguish that he suffered when his spouse (from whom he is now divorced) ran off to Shelbyville with a professor of English literature. Professor Frink also received the Scientist of the Year in 2015 award ($50,000 cash and a ribbon) from the Springfield Academy of Science for inventing a process that succeeded in bringing his deceased father back to life briefly. The Institute included the cost of the tailored lab coats and the $1,000 in its 2015 information form as taxable income to Professor Frink. Advise Professor Frink of the income tax consequences, if any, of all these transactions.

2. Dr. Nicholas "Nick" Riviera, a graduate of the Hollywood Upstairs Medical College, practices discount medicine in Springfield, as a sole practitioner.

(a) (Suggested time: 17 minutes)
Dr. Nick seeks from you an explanation of the tax considerations in deciding whether or not he should make an election for income taxation on the bills delivered basis for his professional income. Advise Dr. Nick.
15  
(b) Suggested time: 25 minutes

In 2015, Dr. Nick was awarded a diploma from the Mayo Clinic Correspondence School for passing a continuing medical education course offered by the school. The diploma hangs on the wall of Dr. Nick’s office, but the school is really an unaccredited diploma mill. The tuition for the course cost Dr. Nick $10,000, which he paid. In 2015, Dr. Nick hired a marketing consultant to develop for TV broadcasting an infomercial extolling his practice and attracting new patients. The consultant, for a fee of $12,000, suggested the catch-phrase, “You’ve tried the best, now try the rest,” which Dr. Nick repeated during the television commercial, implicitly referring to himself as one of ‘the rest’. The infomercial had the opposite effect from that intended and caused patients to seek medical assistance elsewhere. Dr. Nick’s earnings from his medical practice actually declined as a result of viewers’ negative reaction to the broadcast. The College of Physicians and Surgeons of British Columbia, the governing body of the medical profession, ordered Dr. Nick to cease the infomercial, reprimanded him and charged him a penalty of $5,000. Dr. Nick wishes to deduct the amounts of $10,000, $12,000 and $5,000, which he paid, in computing his professional income, but anticipates disallowance by the Canada Revenue Agency. Advise Dr. Nick.

Answer EITHER 2(c.1) or 2(c.2), DO NOT ANSWER BOTH

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(c.1) (Suggested time: 17 minutes)

Having watched the T.V. news about tax havens, Mr. Charles Montgomery Burns (Mr. Burns) who is resident in Springfield British Columbia, wishes to plan his estate so that on his death, his wealth will be secreted in an off-shore tax haven. The only person in whom Mr. Burns has any confidence to carry out his wishes posthumously is his faithful personal assistant, Waylon Smithers. Smithers lives in Springfield and, despite Mr. Burns’ entreaties, will not relocate. To effect his estate plan, Mr. Burns proposes to transfer his investments physically to a tax haven and to name Smithers as his sole trustee. Advise Mr. Burns about whether his plan will be effective to avoid Canadian income tax by making his some of his estate non-resident.

OR

(c.2) As the decided cases illustrate, whether an amount received by a taxpayer is capital or revenue ultimately requires the tax courts to formulate legal principles derived from the analogy of the tree and the fruit, and to apply the derived principles to the facts. The Income Tax Act occasionally over-rides the case law. With illustrations from the course, do you agree or disagree with this statement? Critically evaluate.

END OF EXAMINATION