



CENTRE — FOR — TAXATION IN A GLOBAL ECONOMY



SCHOOL OF ACCOUNTING AND FINANCE DECODING BOTTLENECKS IN TAX LEARNING

July 2013

BACKGROUND

After many years of teaching tax to undergraduates, we've determined that key concepts in tax can be challenging for many students to grasp. As a result, they take a surface approach to learning – memorizing the basics to meet the requirements of our tax courses – rather than developing the deeper understanding needed to become competent tax professionals who can respond to the complex and evolving needs of clients. Our redesigned undergraduate tax program at the School of Accounting and Finance (School) will have a strong emphasis on what the students will be able to do (output) instead of the topics we cover (input). Emphasis will be given to encouraging students to adopt a deeper approach to learning, rather than to see tax as a collection of rules to memorize. The goal is to hone their judgement skills, allowing them to see how all the pieces are integrated, and to develop and apply contextually relevant solutions to complex problems.

IDENTIFYING BOTTLENECKS (difficult tax issues)

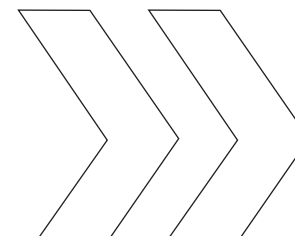
The Fall 2012 and Winter 2013 terms were spent identifying topics in our undergraduate tax program that students found challenging (bottlenecks). Information gathered from students and faculty was used to develop and prioritize a list of topics that presented the greatest barriers.

WHAT WE DISCOVERED

Students rated a list of potential bottlenecks in terms of their perceived level of importance and their perceived level of understanding. The topics that were rated as the most important and least understood were:

1. Being able to identify tax issues in a non-directed fact situation
2. Being able to read and understand the Income Tax Act
3. Recognizing and understanding the implications of an acquisition of control.

We worked with tax faculty and tax practitioners to “decode” these bottlenecks – that is, to construct a series of steps that experts in the field would use to address these issues. By following these steps, students will be able to develop their skills faster and more completely than if they are left to figure out these steps on their own.





HOW YOU CAN HELP

The charts at the end of this document outline the steps our experts have suggested for addressing these tax bottlenecks. We invite you to use these charts and provide us with feedback based on your experience with them and any suggestions for improvement. You can provide your feedback to Jim Barnett (jbarnett@uwaterloo.ca).

Thank you for helping us move tax education forward.

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PROJECT BACKGROUND and REFERENCES

Learning stumbling blocks are referred to as “bottlenecks” within an area of the higher education teaching and learning literature called “Decoding the Disciplines” (DtD). Underlying each bottleneck are often disciplinary ways of thinking about a subject that are natural and tacit for experts, but difficult for students. “Decoding” bottlenecks therefore involves experts “reconstruct[ing] the steps that they themselves do when solving similar problems¹,” so that they may be modeled for students and integrated into teaching. Thus, DtD is also a methodology², as it provides a clearly-delineated, seven-step process for identifying and deconstructing bottlenecks and provides guidelines for designing instructional, motivational, and assessment strategies that support deep learning of the troublesome concepts. We have found the DtD model to be an appropriate fit for informing the redesign of the courses in the tax sequence.

Working with students, faculty and tax professionals gave us a broad range of input that better informed our curriculum re-design. To our knowledge, engaging these three groups to identify and decode bottlenecks represents a novel approach within the DtD methodology.

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- Diaz, A., Middendorf, J., Pace, D., & Shopkow, L. (2011). *Definition of Decoding the Disciplines*. Retrieved from: <http://decodingthedisciplines.org>
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- Middendorf, J., & Pace, D. (Eds.). (2004a). Decoding the Disciplines: Helping students learn disciplinary ways of thinking. *New Directions for Teaching and Learning*, 98. San Francisco: Jossey Bass.
- Middendorf, J., & Pace, D. (2004b). Decoding the Disciplines: A model for helping students learn disciplinary ways of thinking. In J. Middendorf, & D. Pace (Eds.), Decoding the Disciplines: Helping students learn disciplinary ways of thinking. *New Directions for Teaching and Learning*, 98 (pp. 1-12). San Francisco: Jossey Bass.
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- Shopkow, L., Diaz, A., Middendorf, J., & Pace, D. (2012). The History Learning Project “decodes” a discipline: The union of research and teaching. In K. McKinney (Ed.), *Scholarship of teaching and learning in and across the disciplines*. Bloomington, IN: Indiana University Press.



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¹ Middendorf & Pace, 2004b, p.5

² Diaz & Pace, 2012

DECODING the BOTTLENECK

Identifying tax issues in a non-directed fact situation

GATHER AND SORT INFORMATION

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| 1. What is my role? | <ol style="list-style-type: none">1. Primary adviser – e.g., tax partner2. Supporting adviser – e.g., tax specialist reporting to manager or partner3. Person responsible – e.g., VP Tax, VP Finance |
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| 2. Who is involved and what do we know about them? | <ol style="list-style-type: none">1. Draw a diagram indicating all of the parties involved and their relationships to each other:<ol style="list-style-type: none">i. Parent, child, brother, sisterii. Shareholder, employee2. Who is my client and what are their objectives?<ol style="list-style-type: none">i. Individual, corporation, partnership, trustii. What is their “business”/how do they earn income?iii. What are my client’s short, mid and long-term objectives, and what is important to them?3. Develop a tax profile for each of the parties:<ol style="list-style-type: none">i. Liability for tax – resident, non-residentii. Types of income – employment, business, property (including dividends), capital gains/losses, otheriii. Tax relationships – related, affiliated, arm’s length, associated, connectediv. Shareholdings – legal and de facto controlv. Type of corporation – private, public, CCPCvi. Tax risk tolerance – client and advisorvii. Compliance and filing requirements – income tax, GST/HST |
| <hr/> | |
| 3. What are the transactions? | <ol style="list-style-type: none">1. Identify all of the completed or planned transactions – sale, purchase, loan given or received, gift given or received, benefit given or received.2. Draw one or more diagrams showing the transaction or series of transactions and all of the parties involved.3. Draw a timeline identifying dates of the completed or planned transactions.4. What is the taxpayer’s purpose for the transaction or sequence of transactions?<ol style="list-style-type: none">i. Business planning e.g. expansion, creditor proofingii. Tax planning/avoidance e.g. income splitting, loss utilization5. How is the transaction accounted for? This may impact the plan. |
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| 4. What is missing? | <ol style="list-style-type: none">1. Identify any information that you think is missing from what you have been given.2. Look for gaps in the tax profile or missing information about a transaction.3. Identify/list any assumptions you are making. |

ANALYZE AND IDENTIFY THE ISSUES

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| 5. What type of income is impacted on each side of the transaction? | <ol style="list-style-type: none">1. Employment/personal service business2. Business – Canadian or foreign3. Property – Canadian or foreign4. Dividends – for individuals – eligible or not eligible, Canadian or foreign<ul style="list-style-type: none">– for corporations – connected or portfolio, Canadian or foreign5. Other income or deductions |
| 6. What tax attributes are impacted? | <ol style="list-style-type: none">1. ACB2. UCC3. PUC |
| 7. Does an anti-avoidance provision apply? | <ol style="list-style-type: none">1. Non-arm's length transaction2. Losses are being recognized3. Losses are moved to another taxpayer4. Income is moved to another taxpayer5. A benefit is conferred on another taxpayer |
| 8. Based on the above, what are the issues? | <ol style="list-style-type: none">1. Identify all of the issues that are supported by the facts (tax and non-tax, accounting, finance, ethical, business, personal, etc.)2. Identify compliance vs. planning issues3. Are the benefits of the plan worth the cost of designing, implementing and maintaining the plan?4. Explain why these issues are relevant to the client |
| 9. Which issues are more important? | <ol style="list-style-type: none">1. Use judgement to prioritize and group the issues in terms of importance to your role and importance to the client's objectives. Considerations include urgency, materiality and risk.2. Ask yourself:<ol style="list-style-type: none">i. What am I being asked to do?ii. What extra value can I provide? There may be important tax issues the client is not aware of.3. Are there non-tax issues that must be decided first? |

When referencing this document, use the following format:
Barnett, J., & Timmermans, J. (2013). *Decoding bottlenecks in tax*.
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DECODING the BOTTLENECK

Being able to read and understand the Income Tax Act

1. How do I find something?
 1. Know how the Act is structured
 - Parts, divisions, subdivisions (particularly Part I)
 - Know the definition sections for each Division and subdivision and for the Act. For example,
 - s.248(1) – in this Act
 - s.54 – in this subdivision
 - s.74.4(1) – in this section
 2. Look in the index.
 3. Look in the Table of Sections.
 4. Look at the related provisions and notes within a particular section to see if there are any other provisions or issues to consider.

2. How do I read the legislation?
 1. Does this provision apply?
 - Identify the start and end of the sentence.
 - Who does this provision apply to? Look in the preamble. Put in client names to keep all the parties straight.
 - To understand the basics, on the first read, eliminate any exceptions.
 - What transaction is it directed at? What activity, event, or condition is mentioned?
 - Watch for grammar, including punctuation.
 - What timeframe is stated, either in the provision or in the historical notes?
 2. What is the policy purpose of this provision?
 - Look at commentary and explanatory notes.
 3. Look for key words and phrases:
 - “may” – 20(1)(a) – permissive
 - “shall” – 6(1)(a) – required
 - “and”, “or” – 8(1)(f) uses both
 - “means” – 248(1) “retiring allowance”
 - “includes” – 54 “proceeds of disposition” – not necessarily a complete list
 - “except” – 6(1)(b) – exceptions to the previous rule
 - “in this Act” – 248(1) – this definition applies to the entire Act
 - “in this section” – this rule applies to this section only
 - “for greater certainty” – 256(1.2)(b)
 - “deemed” – 84(2) – this changes the result
 - “prescribed” – reference to a Regulation
 - “control” – de jure or de facto
 - “notwithstanding” – generally means “except for” e.g. 212.1(4)
 - “subject to” – consider another section of the Act
 - “idem” – refers to the same heading as the previous section/subsection
 - “for purposes of” – this provision only applies to those sections listed

Always ask “What does this word or phrase mean in this provision?” Meaning is established by other provisions of the Act, the courts and ordinary meaning.
 4. What are the results of this provision applying? For example,
 - Charging someone with a responsibility or liability for doing something
 - Income inclusion or deduction
 - Permit or deny a deduction
 - Change the nature of the income or deduction
 - Change the timing of the income or deduction
 - Change the person who pays tax
 5. Is the result reasonable based on my understanding of the purpose of the provision?

3. What am I missing?
 1. Consider the consequences of one provision on another i.e. impact of proceeds to vendor on the ACB of the purchaser; impact of relationship between the parties on proceeds and cost.
 - Look for related provisions and regulations.
 2. Consider anti-avoidance provisions and the GAAR
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4. Am I reading the provision correctly?
 1. Look for other sources to confirm your interpretation, such as:
 - ITs, ICs technical interpretations, etc. for CRA's views
 - Articles in technical publications such as the Canadian Tax Journal and Conference Reports for the views of other professionals
 - Court cases for the judicial position.

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DECODING the BOTTLENECK

Recognizing and understanding implications of an acquisition of control

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| 1. How do I recognize an acquisition of control? | <ol style="list-style-type: none">1. Understand the policy purpose of these rules. The rules are designed to restrict the utilization of realized or unrealized losses or other attributes (e.g. SR&ED ITCs) where a purchaser acquires control of a company.2. Consider whenever there is a change in the share ownership of a company.3. In its basic form, shares are acquired of the company, or its resident or non-resident parent company, by a third party that gives the purchaser legal control.4. These rules apply whether or not the target company has any realized or unrealized losses.5. Ask for an updated organization chart every year. |
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| 2. Result: I need to prepare and file the corporate tax return of the target company | <ol style="list-style-type: none">2. Automatic<ol style="list-style-type: none">a. The target company will have a deemed year end immediately before the acquisitionb. In the target company, determine preliminary income and taxable income before the application of any AOC rulesc. In the target company, determine any accrued losses and unrealized gains that are in the assetsd. In the target company, determine the tax position once the accrued losses have been automatically realizede. In the target company, determine whether, after the acquisition,<ol style="list-style-type: none">i. The loss business will be carried on with a reasonable expectation of profitii. The target company will carry on the same business or sell similar products or servicesiii. Any losses that will survive the acquisition of control restrictions are likely to be utilized in the remaining carry over period2. Decision<ol style="list-style-type: none">a. In the target company, if there are assets with accrued gains, elect to create income to use up any losses that will not survive the acquisition of control, or are unlikely to be utilized in the carry over period.b. Be careful about electing on depreciable property since recapture may result.3. Calculate or re-calculate<ol style="list-style-type: none">a. In the target company, recalculate Division B, taxable incomes, net and non-capital losses after any elections.b. Consider other implications of a short taxation year e.g. proration of CCA, proration of small business deduction limits, claiming reserves, SR&ED claims.c. In the target company, recalculate the cost base of the properties where accrued losses or accrued gains are triggered.d. In the target company, calculate the non-capital losses that are available after the acquisition of control and determine when they will expire given the new year end chosen. |
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| 3. What future planning should I consider? | <ol style="list-style-type: none">i. Establish a plan to use up the non-capital loss either in the loss company or in another company in the purchaser's group of companies. |

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