Introduction to Financial Management

Learning Problems

**Share Price Maximization**

Rita Wexler is the CFO of Augusta Inc. Augusta’s common shares are thought to be worth CAD 37.65 per share based on estimated future cash flows of CAD 3.20 per share in perpetuity and a cost of capital of 8.5%. A new U.S. competitor has entered the market, so Wexler now believes Augusta’s cash flows per share will fall to CAD 2.85 per share and its cost of capital will rise to 9.5% because of additional risk.

**REQUIRED:**

1. What effect will these changes have on Augusta’s share price?
2. What is Augusta’s RRR, and how does it relate to its cost of capital?

**Average and Marginal Tax Rates**

Bert Thomas is a Manitoba resident and earned CAD 156,000 last year. The tax rates and brackets federally and provincially were:

|  |  |  |
| --- | --- | --- |
| **Federal** | 15.00% | Up to 48,535 |
| 20.50% | 48,536 to 97,069 |
| 26.00% | 97,070 to 150,473 |
| 29.00% | 150,474 to 214,368 |
| 33.00% | 214,369 and over |

|  |  |  |
| --- | --- | --- |
| **Manitoba** | 10.80% | Up to 33,389 |
| 12.75% | 33,390 to 72,164 |
| 17.40% | 72,165 and over |

**REQUIRED:**

1. What was Thomas’s average tax rate? Marginal tax rate?

**Effective Tax Rates on Capital Gains and Dividends**

Mary Robbins earned CAD 10,000 in capital gains on the sale of shares and CAD 10,000 in dividend income. Robbins resides in Manitoba and earned CAD 350,000 last year.

|  |  |  |
| --- | --- | --- |
| **Federal** | 15.00% | Up to 48,535 |
| 20.50% | 48,536 to 97,069 |
| 26.00% | 97,070 to 150,473 |
| 29.00% | 150,474 to 214,368 |
| 33.00% | 214,369 and over |

|  |  |  |
| --- | --- | --- |
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| 12.75% | 33,390 to 72,164 |
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The Federal Dividend Tax Credit and Provincial Dividend Tax Credit are 15.02% and 8.00% of Grossed-up Dividends. Dividends are grossed up at a rate of 38.00%.

**REQUIRED:**

1. What is the effective tax rate on the capital gains earned?
2. What is the effective tax rate on the dividend income earned?

**Capital Cost Allowance at Elmer**

Elmer Industries purchased new equipment for CAD 550,000 plus taxes of CAD 85,000 and CAD 45,000 in transportation and installation expenses. The asset is in a CCA class with a rate of 30%, which is subject to the half-year rule. Elmer received a 10% investment tax credit on the asset purchase. Other assets in this class were sold for CAD 65,000. The class had a UCC of CAD 3,250,000 at the beginning of the year.

**REQUIRED:**

1. Determine the CCA deduction for the CCA class for the next two years.

**Capital Cost Allowance at Cranston**

Cranston Enterprises purchased a new building for CAD 8,500,000. The asset is in a CCA class with a rate of 5% that is subject to the half-year rule. Under the ITA, all buildings are put in separate classes and not pooled with other assets. The corporate tax rate is 25%.

**REQUIRED:**

1. Determine the CCA deduction for the next two years.
2. What are the tax consequences if the building is sold for CAD 8,000,000 at the beginning of the third year? What if it were sold for CAD 7,200,000?

**Loss Carrybacks and Carryforwards at Hollinger**

Hollinger Inc. has been in operation for four years. Its taxable income (loss) over those years was:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Year 1** | **Year 2** | **Year 3** | **Year 4** |
| Taxable income (loss) | (CAD 250,000) | (CAD 75,000) | CAD 100,000 | CAD 400,000 |

The income tax rate is 25.0%.

**REQUIRED:**

1. What income tax expense will be incurred by Hollinger at the end of year 4?

**Loss Carrybacks and Carryforwards at Amstel**

Amstel Ltd. experienced a taxable loss of CAD 300,000 in its sixth year of operations due to a recession. Taxable income (losses) over its first five years were:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | **Year 1** | **Year 2** | **Year 3** | **Year 4** | **Year 5** |
| Taxable income (loss) | (CAD 125,000) | CAD 55,000 | CAD 75,000 | CAD 125,000 | CAD 135,000 |

The combined federal and provincial corporate tax rate was 25%.

**REQUIRED:**

1. What tax benefit will Amstel realize in Year 6?

**Professional Designations**

**REQUIRED:**

1. Select the professional designation in finance that is of the most interest to you and research the educational requirements and potential employment opportunities.
2. Prepare a 200-word submission describing your decision in Part 1. All submissions should be thoroughly researched, carefully written, and edited before being posted to the discussion board.
3. Respond to the posts of at least three classmates.

**Financial Reporting Disclosures on SEDAR and SEDI**

**REQUIRED:**

1. Access the filings for Canadian Tire Corporation on SEDAR and the insider trading reports for Martha G. Billes on SEDI.
2. Prepare a 200-word submission describing the different filings that the company has made over the last 12 months and the position of the insider Billes. All submissions should be carefully researched, written, and edited before being posted to the discussion board.
3. Respond to the posts of at least three classmates.