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THE UNIVERSITY OF BRITISH COLUMBIA
FACULTY OF LAW

FINAL EXAMINATION – APRIL 2022

LAW 407/506

Section 2
Professor Cui

TOTAL MARKS: 100

TIME ALLOWED: 3.5 HOURS

- NOTE:
1. This is an open book examination.
 2. ANSWER ALL QUESTIONS.

THIS EXAMINATION CONSISTS OF 1 NARRATIVE, WITH 3 SETS OF
QUESTIONS IDENTIFIED AT THE END

(ALLOCATION OF MARKS AMONG THE SETS OF QUESTION INDICATED IN
BRACKETS AFTER THE NARRATIVE)

Ivan Shevchenko and his wife Tatiana live in White Rock. Ivan runs a Honda dealership in Surrey. Tatiana is a senior administrator at an independent school. Both are respected members in the Greater Vancouver Ukrainian community, which has a long history and has enjoyed especially active participation from its members since the Russian annexation of Crimea in 2014. Ivan and Tatiana are also proud parents of three children. Svetlana, the oldest, is a talented data analyst in her early 30s. She has just been poached from Microsoft by Salesforce (an American cloud-based software company) to play a senior management role in its Vancouver office. The second child, Aleksandr, is in his late 20s, has worked for various employers in the financial services industry. The youngest child, Vykto, turned 17 in December 2021 and still lives with his parents. But he is a budding filmmaker who has already produced a couple of shorts. He is taking a year off from high school to launch a more ambitious production. He plans eventually to go to the U.S., following the footsteps of many Canadian film artists.

2021 was an eventful year for Ivan. His business experienced ups and downs just like other car dealerships: new car supplies became restricted, shipments were delayed, but customer demand, including for used cars, shot up. Many customers that initially leased cars from Ivan's dealership either exercised their purchase options or renewed their leases, which indirectly led to increased business in the dealership's repair and maintenance operations. Overall, Ivan managed to achieve a respectable increase in total business revenue despite supply chain challenges: the increase in profit margins was even more significant. Seeing his business weathering the pandemic well, Ivan made several entrepreneurial decisions.

First, his old friend Serhei Koval ran a car repair shop also located in Surrey. Until recently, Serhei had been upgrading his business, but then had a change of mind and decided to retire. Ivan offered to acquire Serhei's shop both because of its location and its possession of some new equipment and supplies that Ivan was interested in. (For instance, Serhei dabbled in offering a service that converts gasoline cars into all electric cars, and was able to secure a decent supply of Lithium Ion batteries, which has become highly valuable—one can make a profit just by re-selling the batteries to others.) In all, Ivan told Serhei, he valued his business at \$1.8 million: \$400,000 for the land the shop sits on, \$200,000 for the shop's building and fixtures, \$100,000 for equipment and machinery, \$100,000 for parts and other inventory (including a stock of Lithium Ion batteries), and \$1 million for existing contracts with suppliers and goodwill. Serhei was flattered by this valuation—he was making net profits of not much more than \$100,000 a year—and agreed to sell his business to Ivan. One complication is that Serhei had taken on debt to upgrade his business and \$200,000 of the debt was still outstanding. After discussion, it was agreed that Ivan would assume the \$200,000 of the debt and pay \$1.6 million of cash to Serhei. They would close the transaction in early 2022.

Ivan consulted with his regular financial advisor at RBC about the proposed acquisition of Serhei's business. RBC took a favorable view of the proposal and is willing to lend as much as \$1.2 million to Ivan for the transaction: Ivan has plenty of cash flow from his dealership business to service the debt. Ivan is in fact able to assemble \$1 million in cash for the acquisition, meaning that he only needs to borrow \$0.6 million. However, since

interest rates were still low, he decided that borrowing \$1.2 million from RBC was a sensible thing to do, given another purchase he had in mind.

Ivan has long wanted to own a ski lodge in Whistler. Over the years he has often taken his employees to skiing retreats in Whistler, and had many occasions to think about how owning a lodge there would make it easier to organize such retreats, entertain other business guests, and also arrange meetings for leaders of the Vancouver Ukrainian community to discuss important issues. Because of how busy he is, and the facts that Tatiana does not ski and that two of their children are already grown up, it is not clear how much he will use the ski lodge himself. But opportunities for business and community networking activities in the next few years using the lodge as a venue would be considerable, in Ivan's vision. Moreover, it may not be hard to rent out the lodge for use to other businesses and individuals. Earlier in 2021, he had found out that an acquaintance was looking to sell a very attractive lodge in the prestigious Blueberry Hill neighborhood for \$4 million, and indicated his interest in buying. He had separately arranged a mortgage for the purchase, such that he would only need to make a \$0.8 million down payment.

In early 2022, therefore, Ivan secured a new line of credit of \$1.5 million from RBC, drew down \$1.2 million of the credit, and put the \$1.2 million loan proceeds into an account together with \$1.2 million of his own funds. With the total of \$2.4 million funds in the account, he proceeded in March to close both the purchase of Serhei's business and the purchase of the Blueberry Hill Lodge.

Gathering \$1.2 million of his own funds did take some financial arrangements on Ivan's part. First, he delayed payment on about \$100,000 of amounts payable due to his lawyers and accountants, knowing that he will incur interest expenses of only 1% per annum for late payments. He can thus use more of the current cash flow from the dealership operations to finance the acquisitions. Second, He had invested in both stock and bond markets. The stock market was high but also very volatile at the end of 2021; it was not easy to decide to sell. In contrast, interest rate was widely expected to go up, and bond prices began a clear decline. He decided that it was time to sell some of the high yield bonds he purchased before the pandemic. His broker executed the appropriate trades for him and he obtained sales proceeds (net of sales expenses) of approximately \$700,000 from the sale of high-yield bonds, of which approximately \$35,000 represented accrued and unpaid interest. His original cost in the purchase of such bonds was about \$600,000. He also liquidated some investments in money market funds (i.e. portfolios of short-term corporate debt), received \$0.4 million of net proceeds. His costs in these latter investments were about \$390,000.

Pushing through all these transactions was straightforward for Ivan. Life's complications at the beginning of 2022 came when Tatiana tested positive for COVID and displayed significant symptoms for three weeks in January (though they were not bad enough for her to go to the hospital). Tatiana had to isolate herself at home and work from there. Fortunately, Svetlana stepped up. To help her parents and look after Vyktor, she temporarily moved into her parents' house and stayed until late February, working 60%

of the time from there for 6 weeks. The second day she moved in, she upgraded the internet connection at the house, bought two HEPA air purifiers, and purchased some other accessories necessary for her to perform her duties. The total expenses involved were about \$1,500.

Tatiana, when she was able to work, also found these accessories to be helpful/comforting. She offered to pay for a portion of the expenses if Svetlana could not get reimbursed from Salesforce. Svetlana waved off this offer, although she knew she would not have any time soon to claim reimbursement.

Instead, Svetlana had some more urgent matters to deal with. First, after leaving Microsoft (MS) in October 2021, she'd thought about what to do with the MS stock options she had been granted between 2016 and 2021. At the beginning of 2016, MS stock traded at about \$50 (in USD, same below) a share. Both in that year and each year subsequently until 2021, Svetlana received options to purchase MS shares at the average price in the year prior. At the beginning of 2021, MS stock traded at around \$210 a share, and in November 2021, MS stock reached a peak of \$343 per share. Svetlana never exercised any of the MS options she was granted over the years (in total, for about 1,600 shares) as a MS employee. But now that she has left MS, and MS price had reached stratospheric levels, she decided to exercise all of her options and immediately sell the shares acquired, when MS share price was \$310 per share in January. This resulted in a handsome \$280,000 of net cash proceeds for Svetlana.

Second, Svetlana was thinking of launching her own start-up not too far in the future. With this in mind, she made sure when negotiating the terms of her employment that Salesforce would pay for the cost of an executive MBA degree. In January 2022, Svetlana was working through the EMBA application process at UBC and the University of Washington. Whichever school she ends up going to, her plan was to start in the fall of 2022.

Third, Svetlana thought about supporting her little brother Vyktor's artistic endeavor. She told that Vyktor that she would give him \$20,000 immediately to support his new film project, and that she could also lend him up to \$50,000 if he decides to go to film school of his dream.

Vyktor was of course very excited by and grateful for Svetlana's offer. Two years ago, his mother had "lent" him \$5,000 to make his short films, although he didn't know how that differed from a gift because he didn't think he was going to be able to repay Ivan any time soon. More recently, his brother Aleksandr said that he would lend \$100,000 to Vyktor—but only on condition that Vyktor used the money to buy Meta's stock, and that Vyktor repaid the \$100,000 to Aleksandr at a time of the latter's choosing: Vyktor would do so by selling the Meta stock, and Aleksandr would split half of any gain from the sale with Vyktor. Although Vyktor liked the idea of being able to boast of being an owner of Facebook and Instagram, he has a sneaking suspicion that Aleksandr had some secret plan. He knew that Aleksandr made a small fortune in 2021 trading stock, that he had invested in Meta, and that the price of Meta's shares dropped by more than \$100 in

February 2022. Aleksandr's unusual loan offer to Vyktor to buy Meta stock seems not entirely unrelated. By contrast, Svetlana's generous offer made a lot more sense: and he is determined to pay Svetlana back when his new project achieves the spectacular success that he is convinced it will.

Please analyze the consequences of the transactions described above for members of the Shevchenko family under the Income Tax Act (ITA), taking the ITA as it stood at the beginning of 2022. In particular, please explain:

1. What deductible expenses might Ivan be able to claim in 2022 in connection with his purchases of Serhei's business and the Blueberry Hill ski lodge? Are there special tax advantages to making such purchases in 2022? Provide Ivan with an estimate of the magnitude of these deductions. What tax consequences follow from Ivan's activities in preparation for the financing of these acquisitions? **(40 points)**
2. What tax consequences might arise in 2022 for Svetlana from her exercise of stock options in January 2022, her stint working from her parents' home, and from her beginning to study for an EMBA degree financed by sales force? **(35 points)**
3. How should Vyktor think about the tax consequences of various financial support he has received from Tatiana, Svetlana and Aleksandr, both for him and his family members? **(25 points)**

END OF EXAMINATION