CHARTERED PROFESSIONAL ACCOUNTANTS CANADA

CFE CANDIDATE NUMBER: | | | | | | | |

Common Final Examination
May 26, 2021 – Day 1
(Booklet #1 – WDI Version 1)

Total examination time: 4 hours.
Further details on the examination can be found on the next page.

GENERAL INSTRUCTIONS BEFORE THE EXAMINATION

1. Fill in your 7-digit candidate number on the booklets. The examination booklets (or paper response, as instructed) must be submitted before leaving the examination room. They must NOT BE REMOVED from the examination room. If these items are not received, the response may not be accepted.
2. Follow the instructions provided. Instructions must not be removed from the examination room.
3. Sign the Policy Statement and Agreement Regarding Examination Confidentiality below.

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I affirm that I have had the opportunity to read the *CPA Examination Regulations* and I agree to all of its terms and conditions.

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_____ _____

CANDIDATE NAME (Please print) SIGNATURE

Examination Details

The examination consists of:

Booklet #1 – Linked Case (240 minutes) (this booklet)
Booklet #2 – Capstone 1 case (for reference) and rough notes

The case should be answered using the software provided, which includes a word processor and spreadsheet for inputting your response. The main body of your response should be in the word processor file. Only supporting calculations should appear in the spreadsheet file, in **Sheet 1**. You are responsible for clearly explaining all your calculations.

Answers or part answers will not be evaluated if they are recorded on anything other than on the computer or the CPA Canada writing paper provided. Rough-note paper is available in the second booklet, which also includes a copy of the Capstone 1 case. Rough notes, and any other notations made in the examination booklets will not be evaluated.

The CPA Canada Handbooks and the *Income Tax Act* are available in *Folio Views* throughout the entire examination. *Folio Views* provides the standards in effect and tax laws substantively enacted as at December 31, 2020.

A tax shield formula and other relevant tax information are available at the end of this booklet.

Candidates are instructed to consider and respond to the case as presented and ignore the potential impacts of COVID-19.

Common Final Examination, May 2021

Chartered Professional Accountants of Canada
277 Wellington Street West
Toronto, Ontario M5V 3H2

Case **(Suggested time: 240 minutes)**

It is March 2023, and Shawn Bryson, your boss at Stineman Consulting Group, assigns you, CPA, to another consulting engagement with Waste Disposal Inc. (WDI).

At a recent meeting, you received the following update from Laura Simmons.

There have been no changes to WDI's vision, mission or core values and, other than an upgrade that allows WDI to recycle PET plastics, the company's operations have not substantively changed. WDI has been successfully meeting its sustainability goals by switching its fleet vehicles to natural gas and investing in landfill biogas recapture equipment, both of which have helped reduce its greenhouse gas emissions by 30%.

Four of the six municipalities proceeded to construct the planned organic waste treatment facility; however, because WDI declined the project, a national competitor was used. These municipalities did not renew their contracts with WDI. However, WDI was able to replace these contracts with new contracts with similar-sized customers. As few competitors provide PET-plastic recycling, WDI has acquired new customers by offering that service. WDI has retained its other customers by keeping the same contract terms and holding the increase in annual fees to only 1%.

WDI invested heavily in leading-edge technology at all its recycling plants. In addition to enabling PET-plastic recycling, the upgrades improved the OCC and mixed-paper recycling functions. To help pay for these investments, WDI issued preferred shares to Kingsley Investment Inc. (Kingsley). The upgrades have significantly increased WDI's operating margin in the recycling division, and overall.

Although Jack Kingsley (Jack) wants to sell Kingsley's shares of WDI to a strategic buyer in the next year or two, he has decided to get a more immediate return on his investment through dividend payments. To make up for the fact that there have been no common share dividends paid since 2017, Jack will demand that a common share dividend of $7.5 million be declared, in addition to a preferred share dividend payment of $3.2 million.

Laura asks you to prepare a report for WDI's board that strategically evaluates the available proposals. For each proposal, you are to advise the board of any significant factors that may not have been considered, identify information that should be obtained before making decisions, and where possible, recommend a course of action that is best suited to WDI. Laura also asks you to bring to attention any other significant issues you identify.

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APPENDIX I
BOARD MEETING DIALOGUE WITH CPA IN ATTENDANCE
March 15, 2023

Laura: Thank you, CPA, for attending our board meeting. Dianne McTavish from Kingsley, who has experience in the waste management industry and expertise in recycling, replaced Marlene as the chair on November 15, 2020. There have been no other changes in board members or key management positions, but the following significant events have occurred:

April 15, 2020	WDI sold its surplus recycled materials and decided to continue to process all recyclable materials in its plants.
June 1, 2020	Issued 600,000 non-voting cumulative 12% convertible preferred shares to Kingsley for $15 per share, with dividends payable annually on May 31 and all other conditions as originally proposed.
June 15, 2020	Signed a five-year contract, expiring May 31, 2025, with Kingsley, whereby it provides drivers and collection trucks at an initial cost of $5 per kilometre, with annual increases tied to inflation. Kingsley agreed to purchase some of WDI's vehicles and has acquired 60% of the fleet to date.
February 20, 2021	Completed upgrades at two recycling plants, at a total cost of $4 million.
May 3, 2021	Updated website to improve customer interaction and provide marketing materials for potential new customers.
September 4, 2021	Renewed line of credit, with the same conditions and terms. The next renewal will occur in September 2023.
October 10, 2021	Completed upgrades at the remaining two recycling plants, at a total cost of $6 million.
May 3, 2022	Completed conversion of the remaining fleet to natural gas.

Laura: The Board of Director's 2023 objective is to improve the return on assets (ROA), which was 7.2% in 2022, compared to an industry average of 10%. The board has agreed that any assets with an ROA less than 5% should potentially be sold. The board also expressed that, for any investments, preference should be given to projects that support WDI's stated mission, vision and core values.

Dianne: I represent Kingsley on this board and, even though I might disagree with Jack's approach, he wants to receive the highest return on this investment through dividends and capital gains. Therefore, if any new investments are made, there should still be enough cash available to pay out both the preferred share and common share dividends. Also, Jack will likely only support investments that provide a more immediate return.

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APPENDIX I (continued)
BOARD MEETING DIALOGUE WITH CPA IN ATTENDANCE

Laura: Personally, I think keeping our cash in the company and investing it where it can generate a strong return will appeal most to a potential buyer. But let us discuss it further after we have reviewed the proposals. Brian, please start.

Brian: TN Composting Limited (TNC), a privately-owned company that operates an anaerobic composting facility, is for sale. Giselle Laflamme, the sole shareholder, wishes to retire. She is asking $14 million for the assets. I have gathered information on TNC.

Laura: I support this investment for the same reasons that I supported the organic-waste treatment facility proposed in 2020. It is a great opportunity for WDI to get into this sector with an existing plant and customer base. If we meet with Giselle now, I am confident we can develop a viable transition plan.

Brian: It will bring in new customers and is one of only a few privately-owned companies in the area in this industry. We can offer these customers our other waste management services, thereby increasing revenues and their connection to us. Our new contracts can be designed to entice these customers to give us their waste collection and disposal business. It is important to note, however, that this facility is due for a $2 million equipment upgrade.

Robert: My recommendations continue to be based on what I think is best for WDI, which I think will also be best for Jack in the long run. Therefore, I am not in favour of stripping cash out of WDI and have told Jack he is being short-sighted. I agree with investing in an organic-waste processing facility, but am just not sure this is the right one. The upgrades may cost more like $6 million and will take at least five months to complete, during which time the facility will be closed.

Brian: Perhaps, but there are likely other synergies with this acquisition that we have not considered. The purchase would allow us to enter this sector at a reasonable price. As there is a lot of interest in TNC, I am sure one of our competitors will buy it if we do not.

Dianne: This investment will require significant upfront cash, and I wonder whether the return will be high enough for Jack. Based on my knowledge of the industry, I think this investment is a favourable long-term project, but Jack may reject it.

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APPENDIX I (continued)
BOARD MEETING DIALOGUE WITH CPA IN ATTENDANCE

Dianne: Instead, consider this about the New Brunswick (NB) assets. With a combined ROA of less than 3%, it makes sense to sell the collection centres and transfer station as stand-alone items. But no one seems interested in buying just these assets, and I doubt that will change. However, we have an offer for $93 million from Canada Waste Management Incorporated (CWM), a national competitor, to purchase the entire NB division. WDI should accept this offer as the price is excellent! Recent market transactions for a similar bundle of assets (collection, transfer, landfill and recycling) indicate that the price offered is more than fair.

Laura: Sell it all? But WDI is one of the few local companies remaining, and the NB assets represent a significant portion of our business.

Robert: I do not think we should sell any of our plants that recycle PET plastics, as demand for these services is increasing. In fact, we should expand to include aluminum recycling next year.

Dianne: That is exactly why CWM's offer should be accepted, to secure other opportunities, such as aluminum recycling.

Brian: Laura, I understand your reluctance, but WDI is short on cash and the funds from this sale could be invested in new growth areas within the industry.

Robert: That is true. In fact, Manchester Design Limited (MDL) proposed an agreement whereby WDI would become its sole supplier of a newly engineered type of recycled flexible plastic.

Laura: MDL's owners are professional engineers with backgrounds in recycled materials. They have a growing business and appear to be industry innovators.

Robert: Yes, Laura, and they are experimenting with using a new type of recycled flexible plastic (Flexi-P) in their products. Compared to what is available in the marketplace, Flexi-P appears superior. It is strong, durable and environmentally friendly upon disposal. MDL hopes that WDI will supply the new material. To do so, WDI would need to build a new recycling plant capable of producing Flexi-P.

Brian: I like this proposal. MDL's engineering expertise would help WDI enter a new, emerging market segment.

Dianne: Okay, but how much would it cost for us to build a facility capable of producing Flexi-P? How long before there is a decent return on this investment? Further, Jack will not like WDI expanding into areas not tied to traditional waste management, which is our core competency.

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APPENDIX I (continued)
BOARD MEETING DIALOGUE WITH CPA IN ATTENDANCE

Brian: Of course, it will take time to build the new facility, but just look at how successful our addition of PET-plastic recycling has been. With this investment, we will be able to produce Flexi-P and recycled PET plastics. We can further diversify our revenue streams and become more competitive.

Dianne: This seems awfully risky. What if Flexi-P does not turn out to be the wonder product that MDL's engineers seem to think it will be?

Laura: There may be another way to diversify. Rayland Energy Inc. (REI) manufactures alkaline batteries and wants to make a $34 million joint investment in a battery-recycling plant. REI is owned by a family I have known all my life. They started their business around the same time my father started WDI.

Brian: If, as anticipated, alkaline batteries are regulated as a hazardous waste product, REI will be required to collect and recycle these products at the end of their life, and they want to be ready.

Dianne: Because of their low metal content, there is very little financial return for recycling alkaline batteries. I do not think the investment will meet Jack's requirements.

Robert: That is because current volumes are too low. If legislation is passed, the increased volume of batteries required to be recycled would make it profitable. However, it will be vital for WDI to secure a sufficient volume of batteries through long-term contracts. I support this venture because the batteries will be diverted from landfills.

Brian: I do not like joint investments as they often lead to inaction when an agreement cannot be reached. I also do not want to put WDI at risk of having to invest more than the initial $17 million if things do not work out.

Laura: I believe REI's goals and objectives are similar to WDI's, and we can ensure our needs are clearly stated in the agreement. From what I know, REI does not make risky investments and tends to make careful, informed decisions.

The last item is the contract for trucks and drivers. We transferred the New Brunswick collection operations to Kingsley but have yet to transfer the Nova Scotia operations. Customers in New Brunswick are complaining that the drivers are rude and that waste has been left behind. I discussed the complaints with Jack but there has been no improvement. Also, the contract with Kingsley states annual increases will be limited to inflation, but each year, the increase has been more than double that rate. Another rate increase, above inflation, is coming on May 1—this is a violation of our agreement and I want to cancel the contract.

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APPENDIX I (continued)
BOARD MEETING DIALOGUE WITH CPA IN ATTENDANCE

Dianne: WDI's costs are still lower under this contract compared to using its own drivers and trucks, and Kingsley can justify the annual increases.

Brian: Actually, that is not true. Since converting to natural gas, our costs in Nova Scotia are slightly less compared to Kingsley's contract rate.

Dianne: If you are serious about cancelling the contract, I will need to advise Jack and Kingsley's lawyers.

Laura: I am serious. Tell them we are considering more serious steps than terminating the contract. I have had enough of being pushed around.

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APPENDIX II
EXCERPTS FROM WDI'S INTERNAL REPORTS

Earnings Comparison
For the year ended December 31, 2022, compared to December 31, 2020
(in thousands of Canadian dollars)

	Collection Centres	**Transfer Stations**	**Landfill Sites**	**Recycling Plants**	**Total**
Revenue	$49,500	$8,400	$14,600	$46,206	$118,706
2020 comparatives	*$48,400*	*$8,200*	*$17,300*	*$7,300*	*$81,200*
% change	*2%*	*2%*	*-16%*	*533%*	*46%*
Labour and benefits	3,510	1,350	2,290	1,230	8,380
Cost of goods sold	0	0	0	28,204	28,204
Purchases – fuel	5,800	1,560	1,840	100	9,300
Trucking costs paid to Kingsley	17,175	0	0	0	17,175
Amortization	3,900	700	3,950	1,365	9,915
Remediation of landfill accretion	0	0	220	0	220
Other operating costs	12,700	3,190	4,210	1,263	21,363
Selling and administrative	Not allocated	Not allocated	Not allocated	Not allocated	10,890
	43,085	6,800	12,510	32,162	105,447
Operating income	$ 6,415	$ 1,600	$ 2,090	$ 14,044	$ 13,259
Operating margin	*13%*	*19%*	*14%*	*30%*	*11%*
2020 comparatives	*16%*	*22%*	*30%*	*2%*	*8%*
% change	*-3%*	*-3%*	*-16%*	*28%*	*3%*

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APPENDIX III
SUMMARY OF CASH AVAILABLE
(in thousands of Canadian dollars)

Cash on hand	$ 2,650
Cash from operating activities (projected)	14,000
Long-term debt payment (GBI term loan)	(4,000)
Cash available	$ 12,650

WDI can access an additional $20 million in debt financing without breaching any of its existing debt covenants.

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APPENDIX IV
INDUSTRY UPDATE

As predicted, the amount of all types of waste has increased. The volume of PET plastics recycled is expected to increase by 8% annually for the next three years, causing more competitors to enter this market. Organic waste is expected to increase by 5% annually for several years.

In the last few years, regulations that divert organic and recyclable-material waste from landfills to other processing centres have tightened. Legislation is being proposed that will require many types of plastic products to be made from at least 55% recycled material. Alkaline batteries, which now account for 90% of all batteries sold and which are currently disposed of in landfill sites, are more toxic to the environment than was originally thought. Legislation is being considered that will require these batteries to be recycled; however, municipalities do not anticipate this change to take effect for at least another three years.

The economy has grown by about 3%, with consumer spending keeping pace. With fears of inflation climbing from its current rate of 3.2%, interest rates have been increasing, with the prime rate currently at 4%. Total industry revenues are expected to increase by 2% annually. It is expected that landfill tipping fees will remain low whereas the processing fees for organic-waste composting and the selling price of recycled materials will continue to increase.

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APPENDIX V
TN COMPOSTING LIMITED PROPOSAL
(Prepared by Brian Leung)

TNC is an organic-waste processing facility that uses anaerobic digestion to produce compost and biogas. The compost is sold to landscapers, farmers, and gardeners, whereas the biogas is captured and converted into electricity to fuel the facility.

TNC collects and processes organic waste from 400 restaurants, 250 food processors, three hospitals, and one university, all in Nova Scotia. None are currently WDI customers.

TNC's contracts are all for three years, and collection and processing rates are based on weight. About 55% of the contracts, which generate most of TNC's collection and processing revenues, will expire in 2023, and the remaining 45% expire in 2024. Five of TNC's customers account for 70% of total revenue.

Giselle is very involved in TNC's daily operations and has an excellent reputation in the community. She is the sole contact for all TNC customers and deals with all their problems. As a result, many customers have been with TNC since its inception in 2007 and customer turnover is very low in comparison to the industry average.

The plant currently processes 40,000 tonnes of organic waste annually and has the capacity to process 50,000 tonnes. The equipment has not been upgraded in the past five years and relies on outdated technology.

At the current usage rate of 40,000 tonnes and after the equipment has been upgraded, TNC can expect an operating income of $1.6 million per year.

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APPENDIX VI
SALE OF NEW BRUNSWICK ASSETS

The following excerpt from internal reports provides details for the NB assets *(in thousands of Canadian dollars)*:

	Collection Centres	Transfer Station	Landfill Site	Recycling Plants	Total
Revenue	$30,244	$5,040	$8,800	$21,580	$65,664
Labour and benefits	1,500	790	1,480	625	4,395
Cost of goods sold	0	0	0	14,100	14,100
Purchases – fuel	0	980	870	60	1,910
Trucking costs paid to Kingsley	17,175	0	0	0	17,175
Amortization	1,300	350	2,760	680	5,090
Remediation of landfill accretion	0	0	160	0	160
Other operating costs	7,100	1,970	2,340	620	12,530
Total costs	27,075	4,090	7,610	16,085	54,860
Operating income	$ 3,169	$ 950	$1,190	$ 5,495	$10,804
Operating margin	*10%*	*19%*	*14%*	*25%*	*16%*
Return on assets	*3%*	*2%*	*17%*	*28%*	*11%*

Selling and administrative costs of $4.8 million are allocated to NB; these costs are not included above.

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APPENDIX VII
PROPOSED AGREEMENT WITH MANCHESTER DESIGN LIMITED

(Prepared by Robert Manning)

MDL currently manufactures products using recycled PET plastic and wants to expand its product offering to include products made from a new type of advanced flexible plastic (Flexi-P). MDL has been operating in Nova Scotia for 11 years and sells across Canada. Since 2019, MDL's sales have grown by 30% annually.

As part of a 10-year agreement, MDL would provide WDI with exclusive access to the technology involved in Flexi-P's production process. In return, WDI would be required to fulfill MDL's Flexi-P supply needs before selling to other customers.

The new plant will convert recyclable PET plastic into Flexi-P. It must be ready to produce within two years of signing an agreement. MDL estimates a cost of between $18 million and $22 million to build the plant. Given that the technology is changing so quickly, it is assumed that this plant will be obsolete in 10 years.

According to MDL's engineers, the new plant will have a total annual capacity of 30,000 tonnes, of which MDL will initially utilize 17,000 tonnes. MDL predicts its demand for Flexi-P will increase by 9% annually. MDL will pay WDI $750 per tonne of Flexi-P. The plant's fixed costs are estimated by MDL to be $1.25 million per year and variable costs to be $415 per tonne. However, because this is a completely new technology, MDL's engineers cautioned that the costs are difficult to estimate with accuracy.

WDI uses a discount rate of 15% when assessing this type of investment.

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APPENDIX VIII
JOINT INVESTMENT WITH RAYLAND ENERGY INC.

(Prepared by Laura Simmons)

Proposal

- REI and WDI will each own 50% of a separate corporation that will hold the assets and liabilities of the battery-recycling facility.
- Each party will initially contribute $17 million toward the expected cost of building the battery-recycling plant, which should be operational by June 2024. Any additional financing requirements will be shared equally.
- To manage the daily operations of the facility, WDI will be paid a fixed percentage of revenue as a management fee (percentage to be determined).
- There will be four directors on the board (each party will provide two). The chairman will rotate between the parties every two years.
- The board will make all decisions related to operation, strategy, and finances. All decisions must be unanimous.
- Shares will not be transferable or sold to outside parties unless agreed to by the other party. Each party will have the right of first refusal to purchase the shares of the other party.
- The corporation will be dissolved when either party no longer agrees to the terms, or if required, due to legal, financial, or market concerns.

Based on REI's projection, WDI's return on assets would approximate 8%, and the facility would have capacity for additional outside contracts.

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End of Examination

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CPA COMMON FINAL EXAMINATION REFERENCE SCHEDULE

1. PRESENT VALUE OF TAX SHIELD FOR AMORTIZABLE ASSETS

Present value of total tax shield from CCA for a new asset acquired after November 20, 2018

$$= \frac{CdT}{(d+k)}\left(\frac{1+1.5k}{1+k}\right)$$

Notation for above formula:
C = net initial investment
T = corporate tax rate
k = discount rate or time value of money
d = maximum rate of capital cost allowance

2. SELECTED PRESCRIBED AUTOMOBILE AMOUNTS

	2020	**2021**
Maximum depreciable cost — Class 10.1	$30,000 + sales tax	$30,000 + sales tax
Maximum depreciable cost — Class 54	$55,000 + sales tax	$55,000 + sales tax
Maximum monthly deductible lease cost	$800 + sales tax	$800 + sales tax
Maximum monthly deductible interest cost	$300	$300
Operating cost benefit — employee	28¢ per km of personal use	27¢ per km of personal use
Non-taxable automobile allowance rates		
— first 5,000 kilometres	59¢ per km	59¢ per km
— balance	53¢ per km	53¢ per km

3. INDIVIDUAL FEDERAL INCOME TAX RATES

For 2020

If taxable income is between			Tax on base amount	Tax on excess
$0	and	$48,535	$0	15%
$48,536	and	$97,069	$7,280	20.5%
$97,070	and	$150,473	$17,230	26%
$150,474	and	$214,368	$31,115	29%
$214,369	and	any amount	$49,644	33%

For 2021

If taxable income is between			Tax on base amount	Tax on excess
$0	and	$49,020	$0	15%
$49,021	and	$98,040	$7,353	20.5%
$98,041	and	$151,978	$17,402	26%
$151,979	and	$216,511	$31,426	29%
$216,512	and	any amount	$50,141	33%

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4. SELECTED INDEXED AMOUNTS FOR PURPOSES OF COMPUTING INCOME TAX

Personal tax credits are a maximum of 15% of the following amounts:

	2020	2021
Basic personal amount, and spouse, common-law partner, or eligible dependant amount for individuals whose net income for the year is greater than or equal to the amount at which the 33% tax bracket begins	$12,298	$12,421
Basic personal amount, and spouse, common-law partner, or eligible dependant amount for individuals whose net income for the year is less than or equal to the amount at which the 29% tax bracket begins	13,229	13,808
Age amount if 65 or over in the year	7,637	7,713
Net income threshold for age amount	38,508	38,893
Canada employment amount	1,245	1,257
Disability amount	8,576	8,662
Canada caregiver amount for children under age 18	2,273	2,295
Canada caregiver amount for other infirm dependants age 18 or older (maximum amount)	7,276	7,348
Net income threshold for Canada caregiver amount	17,085	17,256
Adoption expense credit limit	16,563	16,729

Other indexed amounts are as follows:

	2020	2021
Medical expense tax credit — 3% of net income ceiling	$2,397	$2,421
Annual TFSA dollar limit	6,000	6,000
RRSP dollar limit	27,230	27,830
Lifetime capital gains exemption on qualified small business corporation shares	883,384	892,218

5. PRESCRIBED INTEREST RATES (base rates)

Year	Jan. 1 – Mar. 31	Apr. 1 – June 30	July 1 – Sep. 30	Oct. 1 – Dec. 31
2021	1			
2020	2	2	1	1
2019	2	2	2	2

This is the rate used for taxable benefits for employees and shareholders, low-interest loans, and other related-party transactions. The rate is 4 percentage points higher for late or deficient income tax payments and unremitted withholdings. The rate is 2 percentage points higher for tax refunds to taxpayers, with the exception of corporations, for which the base rate is used.

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6. MAXIMUM CAPITAL COST ALLOWANCE RATES FOR SELECTED CLASSES

Class 1……	4%	for all buildings except those below
Class 1……	6%	for buildings acquired for first use after March 18, 2007 and ≥ 90% of the square footage is used for non-residential activities
Class 1……	10%	for buildings acquired for first use after March 18, 2007 and ≥ 90% of the square footage is used for manufacturing and processing activities
Class 8……	20%	
Class 10…….	30%	
Class 10.1…….	30%	
Class 12……	100%	
Class 13…….	n/a	Straight line over original lease period plus one renewal period (minimum 5 years and maximum 40 years)
Class 14…….	n/a	Straight line over length of life of property
Class 14.1…….	5%	For property acquired after December 31, 2016
Class 17…….	8%	
Class 29…….	50%	Straight-line
Class 43…….	30%	
Class 44…….	25%	
Class 45…….	45%	
Class 50…….	55%	
Class 53…….	50%	
Class 54…….	30%	

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