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Ontario Budget Commentary

2007

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Introduction

Finance Minister Greg Sorbara today delivered the Province's 2007 Budget. This is the Liberal Government's last Budget before this October's provincial election. Not surprisingly there are no new taxes announced in this Budget. Additionally, there are no changes to personal and corporate income tax rates.

The minimum hourly wage will be increased by 75 cents annually commencing March 31, 2008 reaching \$10.25 on March 31, 2010.

The Budget projects a balanced budget for 2006-07.

The following summarizes the tax-related measures included in the Budget.

Personal Taxes

Ontario Child Benefit

The Government intends to revamp the system of providing financial assistance to low-income families with children. Currently, such support is generally through the social assistance system. As an alternative method of funding, the Budget proposes the creation of the Ontario Child Benefit. The Ontario Child Benefit will be combined with the Ontario Child Care Supplement for Working Families and will be phased in starting in July, 2007.

In July, 2007 there will be a lump sum payment of up to \$250 per child under 18, reduced by 3.4% of family net income over \$20,000.

Starting in July 2008, there will be monthly payments for each child under 18. The maximum annualized payment per child will be as follows:

July 2008 – June 2009	\$ 600
July 2009 – June 2010	\$ 805
July 2010 – June 2011	\$ 900
July 2011 – June 2012	\$1,100

After July 1, 2008, the benefit will be reduced by 8% of family net income in excess of \$20,000.

Pension Income Splitting

On October 31, 2006, the federal government announced its intention to allow a recipient of qualifying pension income to transfer for tax purposes up to half of the amount received to his or her spouse, including a common-law partner, starting with the 2007 taxation year. The Budget proposes that Ontario parallel this measure, contingent on the federal legislation receiving Royal Assent.

Property and Sales Tax Credits for Seniors

The refundable Ontario Property and Sales Tax Credits for qualifying seniors have been regularly enhanced since their introduction. The credits are reduced by income over a threshold amount. The Budget proposes to increase the threshold for 2007 for senior couples over the current \$23,090. The increased income threshold will be set so that those receiving the guaranteed minimum level of income from governments will not have their credit reduced. The threshold will be determined once the

federal government finalizes Old Age Security and Guaranteed Income Supplement amounts for 2007.

Locked-In Retirement Accounts

The Budget proposes changes to locked-in retirement accounts, effective January 2008, at the earliest. The intention is to give seniors, with locked-in retirement savings transferred from employer pension plans, increased flexibility in planning their retirement income.

Proposed is the establishment of a new Life Income Fund (LIF) to replace existing Life Income Funds and Locked-In Retirement Income Funds. This will eliminate mandatory annuity purchase requirements. In addition, the retiree will have the right to an optional one-time unlocking of up to 25% of the locked-in funds and withdraw additional income based on investment performance. This optional “unlocking” can be done no earlier than the early-retirement date under the pension plan from which the money was transferred (in most cases at age 55). Amended annual payment schedules will also be implemented and permit withdrawal of the entire remaining account balance when the LIF holder reaches age 90. Consultations will be initiated on the process for implementing the new LIF and other changes to the rules for locked-in accounts.

Enhanced Dividend Tax Credit

In November, 2006, legislation was passed to provide enhanced dividend tax credits to parallel federal legislation. For eligible dividends, the federal

dividend tax credit is approximately 19% of the grossed-up dividend. An enhanced Ontario credit is being phased in. The credit rate, as a percentage of the grossed-up dividend is 6.5% for 2006, 6.7% for 2007, 7% for 2008, 7.4% for 2009 and 7.7% for 2010 and subsequent taxation years. The Budget proposes no changes to this schedule. Consequently, the maximum tax rate on eligible dividends in Ontario is expected to be reduced from approximately 25% in 2006 to 22% in 2010.

For ineligible dividends, the Ontario dividend tax credit remains at 5.13% of the grossed-up dividend. Consequently, the maximum tax on ineligible dividends in Ontario is approximately 31%.

Corporate Taxes

Elimination of the Ontario Capital Tax

A plan to eliminate Ontario’s capital tax by 2012 was implemented in 2004. The 2006 Ontario Budget announced the intention to accelerate the elimination by 2010, subject to favourable fiscal conditions.

This Budget confirms the elimination of the capital tax effective July 1, 2010. As implemented in the 2006 Budget, the capital deduction was increased to \$12.5 million from \$10 million January 1, 2007 and will increase to \$15 million January 1, 2008. No further changes to the capital deduction are proposed by this Budget. The 2006 Budget reduced the capital tax rate for regular corporations to .285% from .3% January 1, 2007, to .225% January 1, 2009, and to .15% January 1, 2010. The rate and

capital deduction are pro-rated for taxation years straddling these effective dates.

Ontario – Federal Corporate Tax Harmonization

In October 2006, the Ontario and federal governments agreed to transfer the administration of Ontario corporate income tax to the federal government for taxation years ending after 2008. A condition of this agreement is for Ontario to eliminate its deduction of the portion of the federal investment tax credit related to scientific research and experimental development (SR&ED) in Ontario. This deduction was replaced by the Ontario Research and Development Tax Credit. This Budget provides further details of this tax credit.

This non-refundable credit will be 4.5% of eligible expenditures and will be applicable for taxation years ending after 2008. Eligible expenditures will be those incurred by a corporation in taxation years ending after 2008 for SR&ED carried on through an Ontario permanent establishment and must be qualified SR&ED expenditures for purposes of the federal investment tax credit. This credit will be determined after the application of the corporate tax harmonization credits but before the corporate minimum tax credit. Corporations will be able to waive all or part of their credit entitlement. Partnerships will be able to flow the credit through to corporate partners active in the partnership. Unused credits will be able to be carried forward 20 years and back 3 years with no carry back to years ending before 2009.

The current 10% Ontario Innovation Tax Credit remains.

There are further proposals related to the transition from separate Ontario and federal tax pools to harmonize tax pools with respect to various items, including unclaimed deductions for losses and SR & ED expenditures. Under the proposal, each Ontario tax pool will be adjusted to the federal balance. Any increase or decrease to Ontario tax as a result of these adjustments will be spread out evenly over five years, commencing with the corporation's first taxation year ending after 2008.

There will be special rules with respect to this five-year adjustment as it relates to the new 4.5% tax credit.

Corporate Minimum Tax (CMT)

Corporate minimum tax credits and losses currently carry forward for 10 years. The Budget proposes to extend the carry-forward period to 20 years to parallel the carry-forward period for non-capital losses. This measure is applicable for credits and losses arising in taxation years ending after March 22, 2007. Corporate minimum tax credits from earlier years still unused at the beginning of a corporation's first taxation year ending after 2008 will have their carry-forward period extended by 10 years.

Recent changes to Canadian accounting standards require corporations to report certain assets at fair market value rather than historical cost. These changes will require any gain or loss accruing on such

assets to be recognized in net income for that period. The Budget proposes to amend the CMT rules so that income for CMT purposes would be calculated without reference to unrealized gains and losses.

Similar adjustments would be made when calculating a corporation's total assets for the purpose of determining whether the corporation qualifies for the CMT exemption for small business corporations.

These measures would be effective for taxation years ending after March 22, 2007.

To ensure that the CMT does not hinder the ability of corporations to reorganize their business affairs, corporations are allowed to exclude from their CMT income accounting gains that are deferred on a corporate reorganization for income tax purposes. A gain is deferred until the asset is disposed of in a transaction not involving a corporate reorganization. This deferral also applies to gains arising from the replacement of assets where a deferral is provided for income tax purposes. The rules that apply to these situations can be complex and often require taxpayers to track the gains over many years.

To further support the government's efforts to reduce tax compliance costs and streamline tax administration, the Budget proposes to simplify these rules, which includes eliminating the need to track gains. The Budget proposes to exempt from CMT the accounting gains arising from corporate reorganizations or the replacement of assets. In addition,

when a transferee disposes of a property that was acquired from a transferor that deferred the CMT gain, the transferee would no longer be liable for CMT on that deferred gain. These measures would apply to a disposition, amalgamation or winding-up completed after March 21, 2007.

Further CMT amendments will be implemented to repeal the provisions that allow a flow-through of a subsidiary's losses to a parent corporation when a subsidiary is wound up or amalgamated with the parent.

Special Additional Tax (SAT) on Life Insurers

The SAT is a tax paid by life insurance companies. To maintain the effect of SAT under the harmonized corporate income tax base, Ontario proposes to introduce a SAT carry-forward credit effective for taxation years ending after 2008. The credit would be equal to the amount of SAT paid for a taxation year ending after 2008. The credit could be applied in a future taxation year to reduce Ontario income tax payable in excess of the greater of CMT (calculated without reference to the future year's income tax liability) and SAT (calculated without reference to the future year's income tax and CMT liability). The SAT credit would have the same carry-forward period of 20 years that is proposed for CMT.

Expanding the Apprenticeship Training Tax Credit

This 25% to 30% refundable tax credit, available to employers of eligible

apprentices on their salaries and wages in the first three years of the apprenticeship program, was introduced in 2004. Under current legislation, the apprentice must commence employment before January 1, 2008 in order for the credit to be available. The Budget proposes to extend the credit to salaries and wages paid before January 1, 2015 in respect of apprentices who commence employment before January 1, 2012. In addition, six new trades will qualify for this credit.

Extending the Ontario Production Services Tax Credit

The Ontario Production Services Tax Credit is available to Ontario-based corporations in respect of foreign and domestic productions not claimed under the Ontario Film and Tax Credit program. The rate of credit was temporarily increased to 18% from 11% in 2005. The increased rate was to have expired March 31, 2007. The Budget proposes to extend the rate increase to March 31, 2008.

Simplifying the Ontario Computer Animation and Special Effects Tax Credit

The 20% refundable Ontario Computer Animation and Special Effects Tax Credit is available to Ontario-based corporations in respect of labour costs incurred in Ontario for certain digital animation and special effects activities. In order to simplify the claims process, the Budget proposes that, for productions commencing after March 22, 2007, a wholly-owned subsidiary will be able to file for the credit in

respect of labour costs of its parent company in respect of the subsidiary's production.

Retail Sales Tax (RST)

Tax Credit for Fuel Conservation

A Budget amendment proposes that vendors leasing vehicles eligible for the fuel conservation tax credit will be allowed to deduct the credit from their RST remittances.

Simplified Tax Calculation for Small Software Businesses

Effective April 1, 2006, the Ministry of Finance initiated a pilot project to simplify RST calculations for small software businesses. Pilot project participants use an optional simplified RST calculation, which applies a 6% rate to the total contract price. The Ministry of Finance feels more time is needed to evaluate the effectiveness of this simplified calculation, and therefore it is proposed to extend the pilot project until March 31, 2009.

Exemption for Destination Marketing Fees

To support the hotel and tourism industry the government proposes to extend the RST exemption for destination marketing fees. Any destination marketing fees billed on or before June 30, 2008 would qualify for exemption from the 5% RST on accommodations.

Rebate for Clean Home Energy Systems

The temporary RST rebate for residential purchases of solar, wind, micro hydro-electric and geothermal energy systems is being extended to purchases made before January 1, 2010.

Electricity Act

Public electricity utilities make payments-in-lieu (PILs) under the Electricity Act equal to the amount of tax they would pay if they were not exempt from the corporate income tax. The following amendments are proposed to the Electricity Act to maintain a level playing field between private and public electricity utilities and their shareholders:

- The Act will be amended to ensure that in qualifying circumstances public electricity utilities will be able to defer PILs on rollovers under section 85 and 97 of the Income Tax Act.
- Effective for all interest payments made after March 22, 2007, new rules will limit the interest rate on debt owed by public electricity utilities to municipalities and impose a limit on the debt-to-equity ratio.
- Where public electricity utilities operate businesses other than electricity distribution, any losses incurred by such business can only be used to offset income from that particular business for taxation years ending after March 22, 2007.

Business Property Taxes

Starting in 2008, the ceiling for the education portion of property taxes imposed on business will be reduced. Ontario will reduce the ceiling rate for Business Education Taxes (BET) over the next 7 years. By 2014 the ceiling BET rate will be 1.6% for both commercial and industrial properties.

Other Measures

A number of measures are proposed to assist in the enforcement of Tobacco Tax compliance. These measures are intended to assist in the protection of Tobacco Tax revenue.

As a result of expanded diamond mining in the province, a diamond royalty system will be introduced under the Mining Act. Effective March 22, 2007, a diamond mine's output will be excluded from taxation under the Mining Tax Act but will be subject to the province's royalty on diamonds.

- The Fuel Tax Act will be amended to ensure railways are registered with Ontario for fuel tax purposes. This measure will ensure appropriate reporting and remittance of fuel tax where railways operate across provincial and international boundaries.