



## Ontario Budget – March 25, 2008

### BUDGET OVERVIEW

On March 25, 2008, Ontario Finance Minister Dwight Duncan delivered the 2008 Ontario budget (the “Budget”). The Budget projects a \$600 million surplus for 2007-08. Spending initiatives intended to boost Ontario’s economy include the \$1.5 billion Skills to Jobs Action Plan, the \$355 million Second Career Strategy and a \$1.0 billion investment in municipal infrastructure.

The Budget does not deliver any general corporate or personal tax rate reductions. Instead the government provides modest tax relief to the manufacturing and resource sector in the form of retroactive capital tax elimination and enhanced capital cost allowance rates to encourage Ontario manufacturers and forestry companies to invest in new equipment.

The Budget proposes the following significant tax changes:

- To retroactively eliminate the capital tax for Ontario companies primarily engaged in manufacturing and resource activities, effective January 1, 2007.
- To introduce a 10-year tax holiday for new corporations that commercialize intellectual property developed by qualifying Canadian universities, colleges and research institutes.
- To parallel recent federal budget proposals:
  - To extend the temporary enhanced Capital Cost Allowance (“CCA”) rates for Manufacturing and Processing (“M&P”) machinery and equipment acquired before 2012.
  - To introduce adjustments to the Ontario Scientific Research & Experimental Development (“SR&ED”) regime to harmonize the Ontario SR&ED incentives with the federal regime.
  - To adjust the eligible dividend tax system to recognize the previous reductions in the federal corporate tax rate.
  - To facilitate personal savings through the adoption of the Tax-Free Savings Account (“TFSA”).

The highlights of the tax changes announced in the Budget are summarized below. In addition, our commentary discusses the transitional rules regarding the integration of the Ontario and federal corporate tax systems under the new single administration regime.

## **BUSINESS TAX MEASURES**

### **Capital Tax Measures**

The Ontario Ministry of Finance's 2007 Economic Outlook and Fiscal Review proposed to eliminate the capital tax for Ontario companies primarily engaged in manufacturing & processing ("M&P") and resource activities, effective January 1, 2008. Due to the recent economic slowdown in these sectors, the Budget proposes to eliminate the capital tax for such companies retroactive to January 1, 2007.

This special retroactive measure will apply to corporations whose salaries and wages relating to M&P, mining, logging, farming or fishing activities in Ontario represent 50% or more of their total salaries and wages in Ontario. For corporations whose salaries and wages in Ontario for such activities comprise between 20% and 50% of their total wages and salaries in Ontario, the capital tax would be reduced proportionately on a straight-line basis. As an example, a corporation whose Ontario salaries and wages for these activities comprise 35% of its total Ontario salaries and wages would have one-half of its capital tax eliminated.

The proposed elimination for 2007 would apply to a qualifying corporation if it, or a successor corporation, has employees reporting to an Ontario permanent establishment on March 25, 2008.

The 2007 Ontario budget previously announced that the capital tax will be fully eliminated for all corporations as of July 1, 2010.

### **Ontario Tax Holiday for Commercialization of Intellectual Property**

The Budget proposes a ten-year holiday from Ontario corporate income tax and corporate minimum tax for qualifying corporations established after March 24, 2008 and before March 25, 2012, which commercialize certain intellectual property developed by qualified Canadian universities, colleges or research institutes. A qualifying corporation must be incorporated in Canada and derive all or substantially all of its income from eligible commercialization activities (e.g. the development of prototypes and the marketing and manufacturing of products related to the intellectual property) carried on in Ontario.

### **Capital Cost Allowance ("CCA") Rate Changes**

#### ***Temporary Enhanced CCA for Manufacturing & Processing ("M&P") Equipment***

The Budget proposes to parallel the 2008 federal budget proposal to extend the enhanced 50% straight-line CCA rate for M&P equipment acquired in calendar 2009. In addition, the Budget proposes to parallel the 2008 federal budget proposal to enhance CCA claims for M&P equipment acquired in calendar years 2010 and 2011, as follows:

- i) M&P equipment acquired in 2010 will be eligible for CCA computed at a 50% declining balance rate in the first taxation year, a 40% declining balance rate in the second taxation year, and the regular 30% declining-balance rate thereafter.
- ii) M&P equipment acquired in 2011 will be eligible for CCA computed at a 40% declining balance rate in the first taxation year, and the regular 30% declining-balance rate thereafter.

The half-year rule, which limits the CCA claim in the year an asset is acquired to one-half of the normal CCA deduction, will apply to properties subject to the enhanced CCA rates.

### *Other CCA Measures*

The Budget also proposes to parallel the other CCA measures announced in the 2008 federal budget. Please refer to the GSP 2008 Federal Budget Commentary for further details.

### **Ontario Interactive Digital Media Tax Credit (“OIDMTC”)**

A 30% refundable OIDMTC is available to eligible corporations, with annual gross revenue of up to \$20 million and total assets of up to \$10 million, for qualifying expenditures incurred to create and market original interactive digital media products in Ontario. In addition, a 20% refundable OIDMTC applies to larger multimedia developers that exceed the size test, and to fee-for-service contractors (such as a video game developer creating a product under a contract with a publishing company) that develop all or substantially all of an eligible product in Ontario under contract with an arm's length party.

The Budget proposes to increase the 20% tax credit rate for corporations exceeding the size test and for fee-for-service work to 25% for qualifying expenditures incurred after March 25, 2008 and before January 1, 2012. The Budget also proposes to extend the enhanced 30% OIDMTC rate for small corporations in respect of qualifying expenditures incurred before January 1, 2012. In addition, the Budget proposes to extend the eligibility period for eligible labour expenses for qualifying digital media products for the OIDMTC from two to three years, for products completed after March 25, 2008.

### **Ontario Innovation Tax Credit (“OITC”)**

The Budget proposes to parallel certain enhancements to the federal investment tax credit for SR&ED expenditures, as proposed in the 2008 federal budget. The Budget proposes to increase the OITC expenditure limit from \$2 million to \$3 million of qualifying SR&ED expenditures and to increase the upper limit of the taxable income phase-out range from \$600,000 to \$700,000.

## **Harmonization of Ontario Corporate Tax Instalments**

For taxation years ending after 2008, the Canada Revenue Agency (the “CRA”) will administer Ontario’s corporate income tax, minimum tax and capital taxes. This measure will have the following significant implications for the remittance of Ontario corporate tax instalments:

- Ontario corporations are required to make blended federal and Ontario instalments for taxation years ending in 2009 and later. For example, a corporation with a January 31 year-end should have started making blended monthly instalment payments to the CRA commencing with its February 2008 instalment payment.
- The Budget proposes to increase the threshold amount, above which corporations are required to pay income tax and capital tax instalments, from \$2,000 to \$3,000, in order to parallel the federal threshold.
- The Budget proposes to parallel the federal legislation that permits a small Canadian-controlled private corporation (“CCPC”) to remit its instalments on a quarterly basis. Please refer to the GSP 2007 Federal Budget Commentary for the criteria to be considered a small CCPC for this purpose.

## **PERSONAL TAX MEASURES**

### **Eligible Dividend Tax System**

Since 2006, *eligible dividends* received by individuals have been subject to a higher gross-up and enhanced dividend tax credit (“DTC”), in recognition of the fact that the underlying corporate income was taxed at the general corporate tax rate. The 2008 federal budget proposed to adjust the gross-up factor and the federal DTC for eligible dividends received in 2010 and later years, to reflect the proposed lower federal general corporate tax rates. The Budget stipulates that Ontario will harmonize the gross-up factors for an eligible dividend with those announced in the 2008 federal budget.

Furthermore, the Budget indicates that the Ontario DTC for an eligible dividend will continue to be implemented as originally announced, and as set out in the chart below.

Therefore, the following gross-up factors and DTCs on grossed-up dividends will apply to eligible dividends, based on the 2008 federal and Ontario budget proposals:

	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012 and Beyond</b>
<b>Gross-Up Factor</b>	45%	45%	44%	41%	38%
<b>Federal Enhanced DTC</b>	18.97%	18.97%	17.97%	16.44%	15.02%
<b>Ontario Enhanced DTC</b>	7.0%	7.4%	7.7%	7.7%	7.7%

The following table shows the tax rates applicable to eligible dividends received by an Ontario individual in the highest income tax bracket based on the 2008 federal and Ontario budget announcements:

	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012 and Beyond</b>
<b>Eligible Dividend Received</b>	24.64%	23.96%	23.06%	23.65%	25.33%	26.74%

### **Senior Homeowners' Property Tax Grant**

The Budget proposes to provide a new property tax grant (the "Grant") to seniors with low and moderate incomes who own their own homes, commencing in 2009. The maximum annual Grant for 2009 will amount to the lesser of \$250 and the amount of municipal education and property taxes paid in the year, and will increase in 2010 and subsequent years to the lesser of \$500 and the amount of municipal education and property taxes paid in the year.

Eligibility for the Grant for a particular calendar year will be based on the prior year net income reported by the individual, or if married, the couple's combined net income. Therefore, in order to qualify for the Grant, the single senior or senior couple must file their annual personal income tax return(s).

For a single senior, the Grant will be partially phased-out where his/her income exceeds \$35,000, and will be completely phased-out at an income level of \$50,000. For a senior couple, the Grant will be partially phased-out where their combined income exceeds \$45,000, and will be completely phased-out at an income level of \$60,000.

### **Increase in the Ontario Property and Sales Tax Credit (“OPSTC”) Income Threshold for Senior Couples**

The Budget proposes to increase the OPSTC income threshold for senior couples, which is currently \$23,820 for 2007, in order to ensure that senior couples receiving the guaranteed minimum level of income from Old Age Security (“OAS”) and Guaranteed Income Supplements (“GIS”) will continue to benefit fully from the OPSTC. The new threshold amount will be announced when the federal government finalizes the OAS and GIS amounts for 2008.

### **Tax-Free Savings Account (“TFSA”)**

The 2008 federal budget proposed that, beginning in 2009, individuals 18 years of age or older will be able to contribute up to \$5,000 annually to a TFSA. Contributions will not be tax-deductible, but capital gains and investment income earned within the account, and withdrawals therefrom, will be completely tax-free. The Budget proposes to adopt the federal proposal for Ontario personal income tax purposes.

### **Concordance with 2008 Federal Budget Proposals**

The Budget indicates that Ontario will adopt the following other significant changes proposed in the 2008 federal budget, if passed into law:

- i) Extension of the maximum contribution period and the maximum lifespan of Registered Education Savings Plans (“RESP”), as well as increasing the age limit for family plans, beginning in the 2008 taxation year.
- ii) Extension of the capital gains exemption for capital gains realized upon the exchange of certain unlisted securities for publicly traded securities, where the publicly traded securities are then donated, after February 26, 2008, to a registered charity or other qualified donee.
- iii) Extension of the capital gains exemption for the donation of publicly listed securities to private charitable foundations.

## **ONTARIO RETAIL SALES TAX (“RST”) MEASURES**

### **RST Exemption for Destination Marketing Fees**

The Budget proposes that the temporary RST exemption for destination marketing fees on accommodations be extended to fees billed on or before June 30, 2010. The eligibility rules will remain unchanged.

**RST Exemption for ENERGY STAR® Household Appliances and Light Bulbs**

A temporary RST exemption exists for purchases of qualifying new ENERGY STAR household appliances and light bulbs between July 20, 2007 and July 19, 2008. Qualifying household appliances include non-commercial refrigerators, dishwashers, washers (including inseparable washer-dryer combinations), freezers, dehumidifiers, room air conditioners, light bulbs and decorative light strings. The Budget proposes to extend this temporary exemption to include qualifying appliances purchased, rented or leased on or before August 31, 2009, and delivered on or before September 30, 2009, and to include qualifying light bulbs purchased on or before August 31, 2009.

**RST Exemption for Bicycles and Related Safety Equipment**

The temporary RST exemption for purchases of new or used bicycles and related bicycle safety equipment costing \$1,000 or less will be extended to include purchases made on or before December 31, 2010.

**Purchases of Containers and other Packaging, Storage and Shipping Items**

The Budget proposes amendments to the Retail Sales Tax Act, effective May 7, 1997, in order to legislate Ontario's longstanding requirement for persons to pay RST on purchases of containers and other packaging, storage and shipping items that are intended to be returned for reuse in the packaging, storage or shipping of goods. The proposed amendments would also legislate Ontario's longstanding requirement for persons to pay RST on containers and other items that are provided for promotional purposes.

**OTHER MEASURES****Land Transfer Tax ("LTT")**

Currently, transfers of farmland between family members and transfers into a family farm corporation are exempt from LTT. The Budget proposes to expand the exemption to apply to transfers of farmland after March 25, 2008 from family farm corporations to individual family members.

**Property Tax System**

The 2007 Ontario budget introduced a Four-Year Current Value Assessment system whereby (a) property values will be reestablished on January 1, 2008 and every fourth year thereafter, and (b) a mandatory four-year phase-in of property tax increases will apply to residential, farm and managed forest properties. Based on consultations with municipal and business representatives, the Budget proposes to expand the mandatory four-year phase-in of property tax increases to all property classes, including commercial, industrial and multi-residential properties.

**OTHER ITEM OF INTEREST****Single Administration and Harmonization of Ontario Corporate Income Tax**

Under the new single corporate income tax administration, Ontario will parallel the federal definition of taxable income. Therefore, the computation of federal taxable income will apply for Ontario tax purposes. Where tax deductions are based on balances in tax pools (such as undepreciated capital cost allowance balances and loss carryovers), it will be necessary to adjust the Ontario balances to bring them into alignment with federal tax pool balances.

Commencing with taxation years ending after December 31, 2008, federal tax attributes will be adopted for Ontario tax purposes. The taxpayer's federal tax attributes will be compared to the aggregate Ontario tax attributes, so that the taxpayer will have either an overall transitional gain (equal to the amount by which the aggregate federal tax attributes exceed the aggregate Ontario tax attributes) or an overall transitional loss (equal to the amount by which the aggregate Ontario tax attributes exceed the aggregate federal tax attributes).

The tax attributes to be changed to federal amounts, giving rise to an overall transitional gain or loss, include the following:

- Undepreciated capital cost
- Undeducted charitable contributions
- Cumulative eligible capital
- SR&ED pool
- Cumulative Canadian exploration expense, cumulative Canadian development expense and cumulative Canadian oil and gas property expense
- Non-capital loss and net capital loss carryforwards
- The sum of the adjusted cost bases for each partnership interest owned
- The sum of various income reserves, including a reserve under paragraph 20(1)(n) of the Income Tax Act in respect of the sale of income property
- 50% of capital gain reserves.

Ontario tax will be computed on the overall transitional gain or loss as follows:

$$\begin{array}{rcccl} \text{Overall transitional} & & \text{Ontario general corporate} & & \text{Percentage of income} \\ \text{gain or loss} & \times & \text{tax rate (now 14\%)} & \times & \text{allocable to Ontario} \end{array}$$

The Ontario tax applicable to an overall tax gain is referred to as a “transitional tax debit” and the Ontario tax applicable to an overall tax loss is referred to as a “transitional tax credit”. A taxpayer is generally required to add its transitional tax debit, or deduct its transitional tax credit, from its Ontario income tax in five equal annual amounts commencing with taxation years ending after 2008.

Transitional tax credits are not refundable, but can be carried forward to subsequent years within the five-year transitional period. Any transitional tax credits unused at the end of this period will expire.

The new single administration will also include the integration of audits (other than sales tax audits), the processing of objections and appeals, and the provision of rulings and technical interpretations, commencing April 3, 2008.

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To discuss the impact of the Budget on you and your business, please contact your advisor at Goldfarb, Shulman, Patel & Co. LLP.

## COMBINED FEDERAL AND ONTARIO CORPORATE TAX RATES

The Budget does not change the Ontario corporate tax rates. The following combined federal and Ontario tax rates continue to apply to corporations subject to Ontario tax:

		2007	2008	2009	2010	2011	2012
Small business rate on active income up to \$400,000 <sup>1</sup>	Federal	13.12%	11.00%	11.00%	11.00%	11.00%	11.00%
	Ontario	<u>5.50%</u>	<u>5.50%</u>	<u>5.50%</u>	<u>5.50%</u>	<u>5.50%</u>	<u>5.50%</u>
		18.62%	16.50%	16.50%	16.50%	16.50%	16.50%
Small business rate on active income between \$400,000 and \$500,000 <sup>2</sup>	Federal	22.12%	19.50%	19.00%	18.00%	16.50%	15.00%
	Ontario	<u>5.50%</u>	<u>5.50%</u>	<u>5.50%</u>	<u>5.50%</u>	<u>5.50%</u>	<u>5.50%</u>
		27.62%	25.00%	24.50%	23.50%	22.00%	20.50%
General rate (active income not eligible for the small business rate)	Federal	22.12%	19.50%	19.00%	18.00%	16.50%	15.00%
	Ontario	<u>14.00%</u>	<u>14.00%</u>	<u>14.00%</u>	<u>14.00%</u>	<u>14.00%</u>	<u>14.00%</u>
		36.12%	33.50%	33.00%	32.00%	30.50%	29.00%
Manufacturing & processing rate (active income not eligible for the small business rate)	Federal	22.12%	19.50%	19.00%	18.00%	16.50%	15.00%
	Ontario	<u>12.00%</u>	<u>12.00%</u>	<u>12.00%</u>	<u>12.00%</u>	<u>12.00%</u>	<u>12.00%</u>
		34.12%	31.50%	31.00%	30.00%	28.50%	27.00%
Investment income (other than dividend income from taxable Canadian corporations) <sup>3</sup>	Federal	35.79%	34.67%	34.67%	34.67%	34.67%	34.67%
	Ontario	<u>14.00%</u>	<u>14.00%</u>	<u>14.00%</u>	<u>14.00%</u>	<u>14.00%</u>	<u>14.00%</u>
		49.79%	48.67%	48.67%	48.67%	48.67%	48.67%

<sup>1</sup> These rates do not take into account the effect of the clawback of the Ontario small business deduction. The clawback applies where taxable income of the corporation and those corporations associated with it, falls between \$500,000 and \$1,500,000. The Ontario clawback rate is 4.25%.

In addition, the table does not take into account that a corporation's business limit for federal tax purposes is clawed back where the corporation, together with any associated corporations, had taxable capital, as computed for federal Large Corporation Tax purposes, in excess of \$10 million in the preceding year.

The rates are presented on a calendar-year basis. Where a corporation's fiscal year straddles two calendar years, its corporate income tax rate will be pro-rated for the number of days in its fiscal year that falls into each calendar year.

<sup>2</sup> On December 13, 2007, Ontario Finance Minister Dwight Duncan announced a proposed increase in the Ontario small business deduction threshold to \$500,000, effective retroactively to January 1, 2007, which has not yet passed into law.

<sup>3</sup> These rates apply to investment income earned by a CCPC, and include refundable dividend tax of 26.67%.