Ontario Budget – March 26, 2009

BUDGET OVERVIEW

On March 26, 2009, Ontario Finance Minister Dwight Duncan delivered the 2009 Ontario budget (the "Budget"). The Budget strives to stimulate economic growth through infrastructure spending and tax cuts to individuals and businesses. At the same time, the government is projecting a significant reduction in revenues. The combined effects of these spending initiatives and revenue reductions are projected deficits of $3.9 billion in 2008-09, $14.1 billion in 2009-10, and $12.2 billion in 2010-11. The government projects that the deficits will decline after 2010-11, but will continue until 2015.

The Budget proposes to spend approximately $32.5 billion on building highways, bridges, hospitals, modernizing schools, and fixing municipal buildings, as well as spending increases on job training, "green" businesses, the entertainment industry, and tourism.

The Budget proposes the following significant income and sales tax changes:

- Implement a harmonized sales tax system, which will combine the 8% Ontario sales tax with the 5% federal goods and services tax ("GST") effective July 1, 2010.
- Reduce the Ontario general corporate tax rate from 14% to 10% by July 1, 2013, the corporate small business tax rate from 5.5% to 4.5% effective July 1, 2010, and the manufacturing and processing corporate tax rate from 12% to 10% effective July 1, 2010.
- Eliminate the small business deduction surtax (claw-back) effective July 1, 2010.
- Reduce the number of businesses subject to the corporate minimum tax.
- Reduce the lowest personal Ontario tax rate from 6.05% to 5.05% effective January 1, 2010.
- Modify and enhance the personal property and sales tax credit system.

The highlights of the tax changes announced in the Budget are summarized below.

SALES TAX MEASURES

The Budget proposes that, commencing July 1, 2010, Ontario's Retail Sales Tax ("RST") will be harmonized with the federal GST to create a federally administered harmonized sales tax ("HST"). The HST rate will be 13%, of which the Ontario portion will remain at the current rate of 8%. The HST will generally follow the same tax base and rules as the GST, except for certain items noted below.

As under the present GST system, businesses selling taxable or zero-rated goods and services are generally able to claim input tax credits ("ITCs") to recover the HST paid on purchases used in the course of their commercial activities. On the other hand, businesses selling tax-exempt goods or services are generally unable to claim ITCs.

New Housing Rebate

The Budget proposes to introduce a housing rebate for primary residences in respect of the Ontario component of the HST. The rebate for new primary residences priced under $400,000 would be 75% of the provincial portion of the HST (in effect, 6%), with the rebate amount reduced for homes priced between $400,000 and $500,000. There will be no rebate for homes priced more than $500,000. It should be noted that the HST does not apply to the sale of resale homes.

Point-of-Sale Exemption for Selected Items

Ontario will not collect its portion of the HST (i.e. 8%) on the following items: books, children's clothing and footwear, children's car seats and car booster seats, diapers and feminine hygiene products. As a result, only 5% GST will apply on these items. This measure will not reduce the ability of a vendor to claim full ITCs for the HST paid to purchase such items for resale as part of their business activities.

Temporarily Restricted Input Tax Credits

The Budget proposes that businesses with annual taxable sales in excess of $10 million and financial institutions will be temporarily unable to claim ITCs on energy (except where purchased by farmers or manufacturers), telecommunication services (other than internet access or toll free numbers), road vehicles weighing less than 3,000 kilograms and fuel to power those vehicles, and meals and entertainment. These restrictions will apply only to the provincial portion of the HST, for the first five years of its implementation. Thereafter, full ITCs will be phased in over the subsequent three years.

Maintaining Current Tax Levels on Certain Types of Insurance

RST is currently charged on premiums for certain types of insurance, such as group insurance. Currently, the GST is not charged on insurance, since it is considered an exempt supply. The Budget proposes that Ontario will retain an 8% tax on the same types of insurance currently taxed under the RST system.

Maintaining Current Levels of Revenue from Alcohol Sales

Currently, the RST rate on the sale of alcoholic beverages in licensed establishments and retail stores are 10% and 12%, respectively. The Budget proposes to increase current alcohol fees, levies and charges to compensate for the reduction of such tax to 8% under the HST system.

Private Transfers of Motor Vehicles

To ensure that there is no difference between the sales of used vehicles sold through dealerships and private sales, the Budget proposes that Ontario will retain an 8% sales tax on private transfers of used motor vehicles.

Public Service Bodies

The Budget proposes to provide rebates to municipalities, hospitals, universities, colleges, school boards, charities and other qualifying non-profit organizations, in order to make them economically neutral relative to the amount of RST currently being paid by these entities.

Small Supplier Threshold

As under the current GST system, businesses with total taxable revenues of $30,000 or less in the prior year or $50,000 or less for a public service body, will not be required to register and collect the HST.

Small Business Transition Support

Businesses, other than financial institutions, with annual revenue from taxable sales of less than $2 million, will be eligible for a one-time transition credit, to a maximum of $1,000. The credit will be available in the first full fiscal quarter commencing after June 30, 2010.

RST Compensation

The current RST system provides Ontario vendors compensation for collecting and remitting RST. The elimination of the RST will also result in the elimination of this vendor compensation, for RST returns filed for periods ending after March 31, 2010.

Transitional Provisions

The Budget contained no mention of any transitional provisions to be implemented, in respect of RST paid on purchases made prior to July 1, 2010 (which are therefore not recoverable as an ITC), yet which is incorporated as part of the cost of supplying a good or service, and hence, will factor into the pricing of a good or service supplied after June 30, 2010 which is subject to HST.

BUSINESS TAX MEASURES

Corporate Income Tax Rate Reduction

The Budget proposes to reduce the general, manufacturing and processing (“M&P”), and small business Ontario corporate income tax rates as follows:

	General	M&P	Small Business[1]
Current	14%	12%	5.5%
Effective July 1, 2010	12%	10%	4.5%
Effective July 1, 2011	11.5%	10%	4.5%
Effective July 1, 2012	11%	10%	4.5%
Effective July 1, 2013	10%	10%	4.5%

[1] Small Business means a Canadian-Controlled Private Corporation (“CCPC”) earning active business income primarily in Canada.

The proposed tax rate reductions will be pro-rated for taxation years straddling the effective dates.

As a result of the corporate tax rate reductions, the combined federal and Ontario general corporate tax rate will decrease from 33% in 2009 to 25% by 2013. The combined small business tax rate will decrease from 16.5% in 2009 to 15.5% by 2011. The revised combined federal and Ontario corporate income tax rates are summarized in the last page of this document.

Small Business Deduction Surtax Elimination

The Ontario surtax claws back the Ontario small business deduction claimed by a CCPC where taxable income is in excess of the small business deduction limit. Currently, the surtax of 4.25% applies where the taxable income of a CCPC, when combined with corporations associated with it, falls between $500,000 and $1,500,000. The Budget proposes to completely eliminate the surtax effective July 1, 2010. Once this proposal is implemented, all CCPCs subject to Ontario tax will be able to benefit from the Ontario small business tax rate of 4.5% on their first $500,000 of active business income. The surtax will be pro-rated for taxation years which straddle the effective date.

Corporate Minimum Tax ("CMT")

Currently, the CMT for a corporation is calculated at the amount by which 4% of the adjusted net income exceeds the actual Ontario income tax for a particular year. The CMT may apply where the corporation, together with its associated corporations, has total assets or annual gross revenue in excess $5 million or $10 million, respectively. Effective for taxation years ending after June 30, 2010, the Budget proposes to reduce the CMT rate to 2.7%, and to increase the total assets and revenue thresholds to $50 million and $100 million, respectively.

Ontario Innovation Tax Credit ("OITC")

The OITC is a 10% refundable tax credit, to a maximum amount of $300,000 for small and medium-sized corporations performing scientific research and experimental development ("SR&ED") in Ontario. Currently, the OITC is phased-out where the preceding year's taxable income of a corporation, when combined with those of its associated corporations, is between $400,000 and $700,000, and is completely eliminated at $700,000. The Budget proposes to increase the range to $500,000 and $800,000, to parallel a similar SR&ED proposal announced in the 2009 federal budget. This change will apply where the preceding fiscal year ends after 2008.

Ontario Tax Credits

The Budget proposes to make changes to the following income tax credits:

- Enhance the Apprenticeship Training Tax Credit ("ATTC") for expenditures incurred after March 26, 2009, which would increase the 25% rate to 35% and the enhanced 30% rate for small businesses to 45%, increase the $5,000 annual maximum ATTC to $10,000, extend the ATTC to salaries and wages paid during the first 48 months from 36 months of an apprenticeship program, and make the ATTC a permanent tax incentive.

- Enhance the Co-operative Education Tax Credit rate for eligible expenditures incurred after March 26, 2009 from the 10% rate to 25% and the enhanced 15% rate for small businesses to 30%, as well as increase the maximum tax credit available from $1,000 to $3,000 per work placement.

- Make permanent the 35% Ontario Film and Television Tax Credit rate.

- Make permanent the 25% Ontario Production Services Tax Credit rate.

- Expand the eligibility to the Ontario Computer Animation and Special Effects Tax Credit and Ontario Book Publishing Tax Credit for qualifying expenditures incurred after March 26, 2009.

- Enhance the Ontario Interactive Digital Media Tax Credit ("OIDMTC") for qualifying expenditures incurred after March 26, 2009, which would increase the rate to 40% for qualifying corporations, regardless of size, that develop and market their own eligible products, and to 35% for qualifying corporations that develop eligible products under a fee-for-service arrangement.

- Expand the OIDMTC, effective for qualifying expenditures incurred after March 26, 2009, to allow corporations to claim 100%, from 50%, of the amount paid to eligible arm's-length contractors that is attributable to the salaries and wages of the contractor's employees, and to extend the OIDMTC to more fee-for-service arrangements.

Ontario Political Contributions

The Budget reiterated an earlier announcement to introduce legislation this spring to convert the tax deduction that was available for corporations making eligible Ontario political contributions into a non-refundable tax credit, effective for taxation years ending after December 31, 2008.

PERSONAL TAX MEASURES

Dividend Tax Credit

The dividend tax credit rates for eligible and non-eligible dividends will be reduced effective 2010, due to the proposed reduction in the corporate income tax rates, resulting in increased tax rates on eligible and non-eligible dividends. Commencing January 1, 2010, the dividend tax credit rate will decline on eligible dividends from 7.7% to 6.4% and on non-eligible dividends from 5.13% to 4.5%.

Taking into account these changes, the top marginal rates applying to eligible and non-eligible dividends for Ontario resident individuals will be as follows:

Top Federal and Ontario Combined Marginal Tax Rates for Eligible and Non-Eligible Dividends				
	2009	2010	2011	2012
Eligible dividends	23.06%	26.56%	28.18%	29.54%
Non-Eligible dividends	31.34%	32.57%	32.57%	32.57%

Personal Income Tax Rates

The Budget proposes to reduce the tax rate on the lowest tax bracket from 6.05% to 5.05%, effective January 1, 2010. This change will result in a tax savings of approximately $280 for 2010 for an individual tax filer. Consequential with the change in the aforementioned tax rate, the Budget proposes to reduce the level of taxes upon which the Ontario surtaxes apply for 2010.

Ontario Sales Tax Transition Benefit ("OSTTB")

To ensure a smooth transition to the harmonized sales tax system, the Budget proposes to provide relief to individuals by providing OSTTB payments. The Budget proposes to make such payments to individuals aged 18 and over in each of June 2010, December 2010 and June 2011, to a maximum of $300 for single individuals and $1,000 for single parents or couples.

The benefit will be available where the prior year net income is under $82,000 for single individuals and under $166,700 for families. Since the OSTTB payments are determined based on income, the filing of personal tax returns for 2009 and 2010 are required in order to qualify.

Sales Tax and Property Tax Relief

The Budget proposes to replace the current combined sales and property tax credits for low-income individuals, with two new tax credits: the Ontario Sales Tax Credit and the Ontario Property Tax Credit.

Ontario Sales Tax Credit

The new Ontario Sales Tax Credit will be refundable and paid quarterly commencing July 2010, when the HST comes into effect. The new Ontario Sales Tax Credit will provide annual relief of up to $260 for each adult and child. It will be reduced by 4% of adjusted net income over $20,000 for single individuals and over $25,000 for families. The maximum benefit and thresholds will be indexed for inflation in future calendar years.

Ontario Property Tax Credit

Property tax relief will be available through a refundable Ontario Property Tax Credit. This credit is similar in concept to the present property tax component of the current Ontario Property and Sales Tax Credit, except that it will extend property tax relief to more Ontarians. The maximum credit available to non-seniors and seniors will amount to $900 and $1,025, respectively, and will be based upon property taxes or rent incurred by the individual or family, as applicable. The credit will be reduced by 2% of adjusted net income in excess of $20,000 for single individuals and $25,000 for families.

Similar to the Ontario Sales Tax Credit, the maximum benefit and thresholds will be indexed for inflation. Unlike the Ontario Sales Tax Credit system, however, the Ontario Property Tax Credit will not be paid through quarterly advance payments.

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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 following combined federal and Ontario tax rates apply to corporations subject to Ontario tax having a December 31st fiscal year-end:

		2008	2009	2010	2011	2012	2013	2014
Small business rate on active income up to $400,000[1]	Federal Ontario	11.00% 5.50% 16.50%	11.00% 5.50% 16.50%	11.00% 5.00% 16.00%	11.00% 4.50% 15.50%	11.00% 4.50% 15.50%	11.00% 4.50% 15.50%	11.00% 4.50% 15.50%
Small business rate on active income between $400,000 and $500,000[1]	Federal Ontario	19.50% 5.50% 25.00%	11.00% 5.50% 16.50%	11.00% 5.00% 16.00%	11.00% 4.50% 15.50%	11.00% 4.50% 15.50%	11.00% 4.50% 15.50%	11.00% 4.50% 15.50%
General rate (active income not eligible for the small business rate)	Federal Ontario	19.50% 14.00% 33.50%	19.00% 14.00% 33.00%	18.00% 13.00% 31.00%	16.50% 11.75% 28.25%	15.00% 11.25% 26.25%	15.00% 10.50% 25.50%	15.00% 10.00% 25.00%
Manufacturing & processing rate (active income not eligible for the small business rate)	Federal Ontario	19.50% 12.00% 31.50%	19.00% 12.00% 31.00%	18.00% 11.00% 29.00%	16.50% 10.00% 26.50%	15.00% 10.00% 25.00%	15.00% 10.00% 25.00%	15.00% 10.00% 25.00%
Investment income (other than dividend income from taxable Canadian corporations)[2]	Federal Ontario	34.67% 14.00% 48.67%	34.67% 14.00% 48.67%	34.67% 13.00% 47.67%	34.67% 11.75% 46.42%	34.67% 11.25% 45.92%	34.67% 10.50% 45.17%	34.67% 10.00% 44.67%

[1] These rates do not take into account the effect of the claw-back of the Ontario small business deduction. The claw-back applies where taxable income of the corporation and those corporations associated with it, falls between $500,000 and $1,500,000. The Ontario claw-back rate is 4.25%. The 2009 Ontario budget has proposed to eliminate the claw-back effective July 1, 2010.

In addition, the table does not take into account that some or all of 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 using the former federal Large Corporation Tax rules, in excess of $10 million in the preceding year.

Where a corporation's fiscal year straddles two calendar years, its federal corporate income tax rates will be pro-rated for the number of days in its fiscal year that falls into each calendar year. On the other hand, where a corporation's fiscal year straddles July 1, 2010-2013, its Ontario corporate income tax rates, outlined in the Business Tax Measures section, will be pro-rated for the number of days in its fiscal year that falls before and after July 1.

[2] These rates apply to investment income earned by a CCPC, and include refundable dividend tax of 26.67%.