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2003 ONTARIO BUDGET

BUDGET HIGHLIGHTS

The Ontario Finance Minister, Janet Ecker, delivered her second Ontario budget (the “Budget”) on March 27, 2003. While the Budget proposes no new corporate or personal income tax rate changes, previously announced multi-year corporate income tax rate reductions will continue as currently scheduled. Furthermore, no changes were announced to the time frame over which the amount of income eligible for the small business deduction will increase to \$400,000. The government expects that lower corporate income taxes will encourage economic growth. The government also recognizes that capital tax hurts Ontario businesses, reduces jobs, and is a disincentive to the ownership of capital in Ontario; accordingly, the Budget proposes to eliminate the Ontario capital tax within a five-year time frame.

In summary, the Budget proposes to:

- Phase out the Ontario capital tax over the same five-year period as the federal capital tax is set to be eliminated (as announced in the 2003 Federal budget), commencing with a 10% reduction (from 0.30% to 0.27% of taxable capital) in the Ontario capital tax rate in 2004.
- Introduce a refundable Apprenticeship Tax Credit of 10% (15% for certain small businesses) of eligible payroll costs for apprentices in an qualifying skilled trade, such as manufacturing or construction.
- Eliminate the Ontario surtax for individuals with taxable income of less than \$75,000.
- Restore the implementation schedule of the Equity in Education Tax Credit for certain private school tuition fees.
- Enhance various personal tax credits, including disability, caregiver, infirm dependant and disability credit supplement for children with severe disabilities.
- Provide home property tax relief for seniors.

The government also announced that they intend to actively pursue all corporations who have failed to file Ontario tax returns or Exempt from Filing declarations.

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The following sections outline the major tax initiatives.

Corporate Tax Measures

Capital Tax Elimination

Effective January 1, 2004, the Budget proposes to reduce the capital tax rate by 10%, from 0.30% to 0.27%. The capital tax exemption continues to allow a deduction from taxable paid-up capital of \$5 million, which must be shared by associated corporations based on their relative taxable capital.

Apprenticeship Tax Credit (“ATC”)

The Budget proposes to introduce a refundable tax credit for corporations and unincorporated businesses in Ontario for salaries and wages paid after March 27, 2003 to an apprentice in a qualifying skilled trade. The credit will be 10% (15% for businesses with total payroll costs of less than \$400,000) of the eligible expenditures. The maximum monthly credit will be \$250 per apprentice, to a maximum of \$6,000 over a 24-month employment period.

Qualifying skilled trades will include designated construction and industrial trades, as well as the leading-edge technology trades eligible under the present apprenticeship component of the Co-operative Education Tax Credit (“CETC”). Rules will be introduced to provide a transition to this proposed new credit for existing apprenticeships under the CETC.

Skilled trades qualifying for the ATC will include, but will not be limited to, the following:

Construction Trades

- ◆ Plumber
- ◆ Sheet metal worker
- ◆ Electrician
- ◆ Refrigeration & air conditioning mechanic
- ◆ Brick and stone mason
- ◆ General carpenter
- ◆ Ironworker

Services Trades

- ◆ Electronic service technician
- ◆ Micro-electronics manufacturer
- ◆ Network cabling specialist
- ◆ Information technology support analyst

Industrial Trades

- ◆ General machinist
- ◆ Tool and die maker
- ◆ Machine tool design
- ◆ Industrial electrician
- ◆ Mould designer
- ◆ Mould maker
- ◆ Industrial mechanic (millwright)
- ◆ Industrial instrument mechanic
- ◆ Industrial electrical technician
- ◆ Precision metal fabricator

Motive Power Trades

- ◆ Fuel & electrical systems technician
- ◆ Motive power machinist

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Income Tax Incentive for Self-Generated Electricity

The Budget proposes to provide an *additional* 100% deduction to Ontario corporations for the cost of qualifying assets used to generate electricity for their own use from alternative or renewable energy sources. The deduction will be in addition to the write-off of such assets allowed under the capital cost allowance system. The deduction will apply to electrical generating facilities, where construction commences after November 25, 2002 and is completed before January 1, 2008. Corporations eligible for this incentive will not be eligible for the 10-year income tax holiday for new electricity generation.

Ontario Film and Television Tax Credit (“OFTTC”)

To promote the film and television production industry in Ontario, the Budget proposes that, for productions commencing principal photography after March 27, 2003, Ontario labour expenditures that are eligible for the 20% refundable OFTTC will not be reduced by equity investments from government agencies.

Personal Tax Measures

Ontario Surtax on Individuals

The Budget proposes to increase the tax threshold at which the Ontario surtax will begin to apply. Effective January 1, 2005, the tax threshold will increase to \$5,240, from \$4,727 (to be adjusted for inflation) in 2004. This has the effect of increasing the level of income at which the surtax applies from approximately \$ 69,000 to \$ 75,000. The impact to affected taxpayers will be a maximum tax saving of approximately \$ 290.

Combined Federal and Ontario Personal Tax Rates

The following combined federal and Ontario personal income tax rates will apply from 2003 to 2005:

<u>Taxable Income Brackets (1)</u>	<u>Calendar Year</u>		
	<u>2003</u>	<u>2004</u>	<u>2005</u>
\$0 to \$32,183	22.05%	21.65%	21.65%
\$32,184 to \$57,028	31.15%	30.85%	30.85%
\$57,029 to \$64,368	32.98%	30.85%	30.85%
\$64,369 to \$67,131	39.39%	37.16%	37.16%

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<u>Taxable Income Brackets (1)</u>	<u>Calendar Year</u>		
	<u>2003</u>	<u>2004</u>	<u>2005</u>
\$67,132 to \$68,870	43.41%	37.16%	37.16%
\$68,871 to \$75,000	43.41%	43.41%	37.16%
\$75,001 to \$104,648	43.41%	43.41%	43.41%
Over \$104,648	46.41%	46.41%	46.41%

(1) The income brackets shown above reflect all applicable taxes and surtaxes, and do not include any personal tax credits. This chart shows the primary 2003 federal and Ontario tax brackets, which will be indexed for inflation after 2003.

Equity in Education Tax Credit

The Budget proposes to reinstate the refundable education tax credit provided in respect of kindergarten, elementary and secondary tuition fees at independent schools in Ontario, that was first proposed in the Ontario 2001 budget. The Ontario 2002 budget proposed to delay the rate increase by one year from its original announcement. The Budget proposes to restore the original implementation schedule for the refundable education tax credit. The maximum tuition fees eligible for the annual credit are \$7,000 per child age six years and over, and \$3,500 per child under the age of six years.

This tax credit will be phased in over a five-year period as follows:

<u>Taxation Year</u>	<u>Tax Credit Rate</u>	<u>Maximum Credit (per child age 6 or over)</u>	<u>Maximum Credit (per child under age 6)</u>
2002	10%	\$ 700	\$ 350
2003	20%	1,400	700
2004	30%	2,100	1,050
2005	40%	2,800	1,400
2006 and subsequent taxation years	50%	3,500	1,750

Improved Tax Support for People with Disabilities and for Family Caregivers

Effective January 1, 2003, in order to assist the disabled and their caregivers in dealing with their expenses, the Budget proposes to:

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- (i) Increase the disability credit, the caregiver credit, the infirm dependant credit and the disability supplement for children with severe disabilities to \$6,637.
- (ii) Expand the caregiver credit and the infirm dependant credit to include spouses or common-law partners who are dependent by reason of a mental or physical infirmity, and to provide financial support to more caregivers living apart from dependent relatives.
- (iii) Increase the income level, before which the caregiver credit or infirm dependant credit will be reduced, from \$8,922 to \$13,050. These credits will be eliminated for income in excess of \$19,687 from the present \$16,290 level of income.

Retail Sales Tax ("RST")

RST Rebate for Alternative Heating and Cooling Systems

The five-year RST rebate for solar energy systems will be expanded to include wind energy systems, micro-hydroelectric systems and geothermal heating/cooling systems purchased for residential premises after March 27, 2003 and before November 26, 2007.

RST Rebate for Alternative Fuel Vehicles

The RST rebate on qualifying alternative fuel vehicles delivered to purchasers after March 27, 2003 will be doubled, to a maximum of \$2,000.

Rebate for RST Paid by Registered Charity on Building Materials

Currently, registered charities may apply for a rebate of the RST paid on materials incorporated into buildings that they own or lease under a long-term lease. This rebate will be extended to registered charities that enter into an agreement to construct a facility that they will lease on a long-term basis immediately upon completion. In order to qualify, the building must be transferred to the charity immediately following substantial completion, the building must be leased to the charity for at least 20 years, and the charity must have the right to acquire the building for nil or nominal consideration at the end of the lease. The rebate would apply to contracts entered into after March 27, 2003, with a partial rebate available for contracts entered into on or before March 27, 2003.

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Consultation Regarding RST System for Certain Heavy Commercial Vehicles

In addition, the Ontario government will consult with the trucking industry on the merits of extending the modified RST system for multi-jurisdictional vehicles to all heavy commercial vehicles.

Land Transfer Tax (“LTT”)

Exempting Life Leases from LTT

The Budget proposes that life lease transactions between a registered charity or a non-profit organization and a purchaser be exempt from LTT, retroactive to the application of land transfer tax to unregistered dispositions of land.

Transfers of Farmland between Family Members

The Budget proposes to expand the current exemption from LTT applicable to transfers of farmland into a family farm corporation, to include transfers of farmland between family members, effective for qualifying transfers after March 27, 2003.

Property Tax

Ontario Home Property Tax Relief for Seniors Program

The Budget proposes a new tax credit for senior homeowners and renters, that will reimburse them for the full amount of residential education property tax. The credit will apply in respect of property tax paid (whether directly or indirectly through their monthly rent) after July 1, 2003. Seniors will be required to complete an application and will be reimbursed beginning in 2004.

Property Assessment and Classification Review

As a result of the government’s review of property assessment and classification issues and public feedback thereon, various measures are proposed to streamline administration and enhance the fairness and flexibility of the property tax system.

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Managed Forests Property Class

To provide municipalities with more flexibility, commencing in 2003, the Budget proposes to enable upper-tier and single-tier municipalities to reduce the municipal portion of the tax rate on the managed forests property class below 25% of the residential tax rate. To help promote greater land stewardship planning and to recognize the diversity of the forest landscape, effective for 2004 taxation years, the eligibility criteria for the managed forests property class would be expanded to allow natural areas that cannot support tree growth, such as marshes or rock facings, to be included in the managed forests property class along with eligible forested areas. In addition, certain administrative requirements will be simplified.

Assessment Quality Measures

The Minister of Finance has the authority to establish “policies, procedures and standards” for the provision of assessment services by the Municipal Property Assessment Corporation (“MPAC”). It is proposed that the Assessment Act be amended to enable the Minister of Finance to prescribe additional information that must be included on the assessment roll.

Assessment Averaging Review

In 1998, the Province introduced current value assessment (“CVA”), together with transitional mandatory limits on annual property tax increases. As part of the original CVA system, the government planned to introduce an assessment averaging mechanism that would take effect in 2005. A review and public consultation are to be undertaken, to determine whether the introduction of assessment averaging scheduled to take effect in 2005 should be deferred.

Other Measures

Labour Sponsored Investment Funds (“LSIF”)

In order to promote greater access to capital for a greater number of businesses, the Budget proposes the following changes:

- (i) To permit an LSIF to invest up to 25% of its investments in a year in publicly listed companies (as compared to the current 15% limit).
- (ii) To increase the maximum asset size of an eligible small business to \$6 million.
- (iii) To pursue joint action with the federal government to increase the investment size limit of an LSIF from the current \$15 million level to \$18 million. The asset size of companies in which LSIFs will be permitted to invest is also intended to be increased, from its current \$50 million level to \$60 million.

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Community Small Business Investment Fund (“CSBIF”)

The CSBIF program was designed to promote greater access to investment capital for growing businesses with \$1 million or less in assets. In 2003, the following changes to the CSBIF program are proposed:

- (i) To extend the registration deadlines of a CSBIF until December 31, 2004.
- (ii) To increase the investment incentive available to individuals and corporations from a maximum of 15% to a maximum of 30%. The investment incentive available would be 15% at the time of investment in a CSBIF, and 15% when the CSBIF invests in small businesses, with an overall maximum credit of \$150,000 per taxpayer.
- (iii) To remove the requirement for a CSBIF to obtain an investment from a financial institution or an LSIF prior to registration.

Administrative Matters

Corporate Tax Administration

The Ontario government announced that, by April 30, 2003, notices will be issued to all corporations in default of filing their corporate tax returns, requiring the immediate filing of the appropriate documents. Failure to respond to this notice could ultimately result in the corporation’s dissolution and the prosecution of the directors of the corporation under the Provincial Offences Act for failure to file a tax return. Late-filing penalties will also be imposed, where applicable.

The Ontario Business Corporations Act will be amended to allow for the dissolution of a corporation, and to withhold clearance certificates for revivals, transfers of assets or dissolutions, where tax debts are owing to the Ministry of Finance for Employer Health Tax (“EHT”), RST, LTT, gasoline tax or tobacco tax.

RST Administration

Businesses that are RST registrants are required to obtain purchase exemption certificates (“PECs”) from customers who are able to purchase goods or services on an RST exempt basis, otherwise RST must be charged. The Regulations to the RST Act will be amended to no longer require PECs to have a signature, a list of exempt items, or an expiry date. In addition, in order to simplify the purchase of eligible farm-related supplies, equipment and building materials, it is proposed that qualifying farmers use a farmer identification card instead of a PEC.

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The Budget also proposes to amend the RST Act, in order to provide the authority for the Minister of Finance to obtain a waiver from taxpayers in instances where the period for taxes owing is about to become statute-barred.

EHT Administration

It is intended that the Ministry of Finance will send an annual information package to employers with payroll between \$300,000 and \$400,000, in order to advise them of their potential EHT obligations should their payroll exceed \$400,000 in the future.

Support for Ontario's Wine Marketing

The Province will extend for five years its Ontario Wine Industry marketing support program, which matches the Ontario wine producers' and retailers' funding for marketing, advertising and tourism initiatives.

Recent Development

Payment Under a Non-competition Agreement ("NCA")

With our June 17, 2002 summary of the Ontario Budget, we provided a summary of some cases which we believed may be of interest to our readers. One such case was the decision of the Tax Court of Canada ("TCC") in *Tod T. Manrell v. The Queen*. The issue in the Manrell case was whether an NCA payment was taxable as a capital gain under the Income Tax Act of Canada (the "Act"). In order to succeed on this point, the Crown had to demonstrate that an NCA payment constituted "property" as defined in the Act. The definition indicates that property ... "includes a right of any kind whatever". Given this definition, the TCC agreed with the Crown, having stated that, while the right to compete may not be property under common law, the definition under the Act was broad enough to include rights that do not necessarily have the usual characteristics of property, such as a right to compete.

Mr. Manrell appealed the TCC decision to the Federal Court of Appeal ("FCA"). On March 11, 2003, the FCA released its decision. In a unanimous decision, the FCA ruled in favor of Mr. Manrell by finding that the NCA was a non-taxable receipt.

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The FCA rejected the Minister's arguments for the following reasons:

- a) The ordinary definition of "property" must have or entail some exclusive right to make a claim against someone else. A general right to do something that anyone can do, or a right that belongs to everyone, is not the "property" of anyone. All that Mr. Manrell gave up when he signed the NCA was the right that is shared by everyone, namely the right to carry on a business. Hence, Mr. Manrell did not dispose of property within the ordinary meaning of the word.
- b) After reviewing the legislative history of the term "property" within the context of the Act and its predecessor versions, the FCA concluded that this term was not intended to encompass a non-exclusive, commonly held right to carry on a business.
- c) After reviewing previous case law, the FCA concluded that "property" does not include everything of value, such as a human or constitutional right, and even though "a right of any kind whatever", like "property", has a broad meaning, it is not a word of infinite meaning. In fact, the FCA noted that in the history of tax jurisprudence in Canada, there has not been a single case in which the word "property" has been held to include a right that is not or does not entail an exclusive and legally enforceable claim.

According to the FCA, before signing the NCA, Mr. Manrell could carry on or compete with the companies that he sold. That right, however, did not give him a claim against anyone else, nor the ability to stop anyone else from starting the same business. By signing the NCA, Mr. Manrell became obliged not to undertake activities that he could have undertaken before. The right that Mr. Manrell gave up was a right to carry on a business that is shared by everyone. Since this is a non-exclusive general right, the FCA concluded that it does not fall within the statutory definition of "property" under the Act, and hence, was not taxable as a capital gain.

This case may result in future legislative amendments to the Act to make an NCA receipt taxable, or it may be appealed to the Supreme Court of Canada by the Crown. **In the meantime, however, it may be appropriate for an individual selling shares of a privately-held business to negotiate a reasonable NCA payment with the purchaser.**

Caution: An NCA payment received by an individual, in connection with the sale of a business as a sole proprietor or as a partner, would not be afforded the same beneficial tax treatment as was decided in the Manrell case. In such an event, advance tax planning may be warranted. Should this situation arise, we urge you to contact us.

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

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Combined Federal and Ontario Corporate Tax Rates

The combined federal and Ontario rates applicable to corporations subject to Ontario tax remain unchanged as follows:

Type of Income	Calendar Year				
	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
Active Small Business Income (“SBI”) up to \$ 200,000	19.12%	18.62%	18.12%	17.12%	17.12%
Active SBI \$ 200,001 to \$ 225,000	28.12%	18.62%	18.12%	17.12%	17.12%
Active SBI \$ 225,001 to \$ 250,000	28.12%	27.62%	18.12%	17.12%	17.12%
Active SBI \$ 250,001 to \$ 275,000	28.12%	27.62%	27.12%	17.12%	17.12%
Active SBI \$ 275,001 to \$ 280,000	28.12%	27.62%	27.12%	26.12%	17.12%
Active SBI \$ 280,001 to \$ 300,000	34.62%	27.62%	27.12%	26.12%	17.12%
Active SBI \$ 300,001 to \$ 320,000	38.62%	29.62%	27.12%	26.12%	26.12%
Active SBI \$ 320,001 to \$ 360,000	38.62%	36.62%	27.12%	26.12%	26.12%
Active SBI \$ 360,001 to \$ 400,000	38.62%	36.62%	33.12%	26.12%	26.12%
General Income	38.62%	36.62%	33.12%	31.62%	30.12%
Manufacturing & Processing Income	33.12%	33.12%	32.12%	31.12%	30.12%
CCPC Investment Income	48.29%	48.29%	46.79%	45.29%	43.79%

The rates shown reflect the tax rates on the band of income specified. The rates do not include the impact of the claw back of the small business deduction, where applicable.

All tax rate reductions will be prorated for taxation years straddling the effective dates.