

# TAX TALK

## 2008 ONTARIO BUDGET HIGHLIGHTS

On Tuesday, March 25, 2008, Ontario's Minister of Finance, Dwight Duncan, presented the 2008 Budget. Set out below are highlights of the Budget that we believe to be of most interest to you.

### ECONOMIC OVERVIEW

	2007/ 2008 <sup>1</sup> (\$billion)	2008/ 2009 <sup>2</sup> (\$billion)	Growth (%)
Revenue	96.9	96.6	-
Expenditure			
Public debt interest	9.0	8.9	(1.0)
Other <sup>3</sup>	87.0	87.3	0.3
Surplus (Deficit)	<u>0.6</u>	<u>(0.0)</u>	-
Net Provincial Debt <sup>4</sup>	142.8	146.2	2.3

	2007 (%)	2008 <sup>1</sup> (%)	2009 <sup>2</sup> (%)
Inflation	1.8	1.4	1.9
Unemployment rate	6.4	6.6	6.5
Real Growth in GDP	2.1	1.1	2.1

The Budget does not change corporate or personal income tax rates. However, both the federal and Ontario governments introduced tax changes in economic statements that they each presented in the fall of 2007. These proposed changes are reflected in this TaxTalk.

The Budget is projecting a surplus of \$600 million for the 2007-08 fiscal year. The majority of surplus funds are to be used for funding skills training and municipal infrastructure.

There is also a provision for full-time university and college students to receive a "Textbook and Technology Grant". The grant will start this fall at \$150 per student and will increase to \$225 in 2009 and \$300 in 2010 and future years.

<sup>1</sup> Estimate, for the fiscal year ending March 31, 2008.

<sup>2</sup> Forecast, for the fiscal year ending March 31, 2009.

<sup>3</sup> Includes contingency reserve of \$0.8 billion in 2007/2008.

<sup>4</sup> The annual change in the net provincial debt is equal to the surplus/deficit less the projected investment in capital assets.

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

### PERSONAL TAX MEASURES

#### Personal Income Tax Rates

The 2008 Budget does not introduce any new tax rate changes. The top marginal rate for individuals remains at 46.41%. This rate starts to apply when taxable income exceeds \$123,184.

The following table summarizes marginal tax rates (on regular income, i.e., salary, interest, etc.) (excluding the Ontario Health Premium) that apply to the income tax brackets for 2008<sup>5</sup>.

Taxable Income	Federal Rate %	Ontario Rate %	Total %
\$ 9,600 to \$ 36,020	15.00	6.05	21.05
\$ 36,021 to \$ 37,885	15.00	9.15	24.15
\$ 37,886 to \$ 63,421	22.00	9.15	31.15
\$ 63,422 to \$ 72,040	22.00	10.98	32.98
\$ 72,041 to \$ 74,728	22.00	13.39	35.39
\$ 74,728 to \$ 75,769	22.00	17.41	39.41
\$ 75,770 to \$123,184	26.00	17.41	43.41
\$123,185 and over	29.00	17.41	46.41

The table above includes the effect of the Ontario surtax. The surtax increases the top marginal tax rate by 6.25% from 40.16% to 46.41%. Ontario's surtax is two-tiered<sup>6</sup> and is calculated as a percentage of basic Ontario tax in excess of specified amounts.

<sup>5</sup> This table reflects the changes proposed in the federal October 30, 2007 economic statement and the changes proposed in the Ontario December 13, 2007 economic statement.

<sup>6</sup> For 2007, the first-tier surtax is 20% of Ontario tax in excess of \$4,100 (applies when taxable income exceeds \$62,488); and the second-tier surtax of 36% of Ontario tax over \$5,172 (applies when taxable income exceeds \$73,624).

### Tax Treatment of Dividends

Changes to the taxation of eligible dividends were announced in the 2008 federal budget. These changes reduce the gross-up applying to eligible dividends commencing in 2010.

The Budget proposes to maintain the previously announced increases to the Ontario dividend tax credit rate on grossed-up **eligible** dividends<sup>7</sup> to 7.4% in 2009 and 7.7% in 2010 and subsequent years. Combining the federal and Ontario changes, top marginal rates for eligible dividends in Ontario will be as follows:

Year	Federal	Ontario	Total
2008	14.6%	9.4%	24.0%
2009	14.6	8.5	23.1
2010	15.9	7.8	23.7
2011	17.7	7.6	25.3
2012	19.3	7.4	26.7

### Tax-Free Savings Account

The 2008 federal budget introduced a Tax-Free Savings Account (TFSA), effective for 2009. Under this proposal, individuals will be able to contribute up to \$5,000 annually to a TFSA. Investment income and capital gains earned on these funds will be tax-free. Contributions will **not** be tax deductible and withdrawals will not be subject to tax. Any unused contribution limit will carry forward and the contribution limit will be re-established when withdrawals are made. Ontario will automatically adopt the federal proposal on Royal Assent of the enabling federal legislation.

### Property and Sales Tax Credits and Grants for Seniors

The Budget introduces a property tax grant for low and moderate income seniors who own their own homes, effective for 2009 and subsequent years. This grant is in addition to the current refundable property tax credit. The maximum grant will be \$250 for 2009 and \$500 thereafter.

The grant application will be part of the personal income tax return. For single seniors, the full grant will be available where net income is \$35,000 or less and property taxes are at least \$500. A reduced grant will be available where net income is between \$35,000 and

<sup>7</sup> In general, eligible dividends are dividends that are paid from corporate business income that has been taxed at the high corporate federal income tax rate.

\$50,000, and totally eliminated where net income exceeds \$50,000. For married taxpayers, the combined income thresholds are \$45,000 and \$60,000 respectively.

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 (net) income threshold for 2008 for senior couples over the current \$23,820. The increased income threshold will be set so that those receiving the guaranteed minimum level of income from the federal government 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 2008.

### BUSINESS TAX MEASURES

#### Corporate Tax Rates

This Budget introduces no changes to corporate income tax rates. However, corporate rates are scheduled to decrease pursuant to previously enacted announced measures.

The following table summarizes federal and Ontario corporate tax rates, with respect to active business income (ABI) earned by a Canadian controlled private corporation in Ontario, and reflects federal and Ontario tax rate reductions to apply in 2008:

Based on a December 31 year end for 2008<sup>8</sup>

Active Business Income	Federal Rate %	Ontario Rate %	Total Rate %
up to \$400,000	11.00	5.50	16.50
from \$400,001 to \$500,000	19.50	5.50	25.00
from \$500,001 to \$1,500,000*	19.50	18.25	37.75
> \$1,500,000	19.50	14.00	33.50
> \$1,500,000 with M&P**	19.50	12.00	31.50

\* includes clawback of Ontario small business deduction  
 \*\* M & P - manufacturing and processing tax credit

<sup>8</sup> This table reflects the changes proposed in the federal October 30, 2007 economic statement and the changes proposed in the Ontario December 13, 2007 economic statement. In its economic statement, Ontario increased the income threshold for its small business tax rate (5.5%) from \$400,000 to \$500,000, retroactive to January 1, 2007.

For corporations that claim the Ontario small business deduction (SBD), a surtax (claw-back) is levied to reduce the benefit of the SBD where corporate income exceeds \$500,000. The claw-back applies between \$500,000 and \$1,500,000 of income. The effect of the claw-back is to increase the Ontario corporate rate on corporate active business income in this income range, from 14% to 18.25% (combined rate of 37.75%), as indicated in the table above.

### ***Reduction and Elimination of the Ontario Capital Tax***

As previously announced, capital tax rates are scheduled to decrease, while capital tax exemptions are scheduled to increase, before being completely eliminated on July 1, 2010. Specifically, the capital deduction was increased to \$12.5 million from \$10 million effective January 1, 2007 and to \$15 million effective January 1, 2008. No further changes to the capital deduction are proposed by this Budget.

Based on previous announcements, the capital tax rate of .3% was to reduce to .285% effective January 1, 2007, to .225% effective January 1, 2009, to .15% effective January 1, 2010 and to nil effective July 1, 2010.

The Budget confirms the announcement in the 2007 Economic Outlook and Fiscal Review of a reduction in the capital tax rate to .225% retroactive to January 1, 2007, two years earlier than originally intended. The capital tax exemptions and rates are summarized in the following table:

Year	Exemption (\$Millions)	Proposed Rate %	Current Rate %
January 1, 2007	12.5	0.225	0.285
January 1, 2008	15	0.225	0.285
January 1, 2009	15	0.225	0.225
January 1, 2010	15	0.150	0.150
July 1, 2010	Eliminated		

The rate and capital deduction are prorated for taxation years straddling these effective dates. Where a corporation's tax return was filed and assessed using the higher rate, a reassessment reducing the capital tax should be automatically generated.

The 2007 Economic Outlook and Fiscal Review announced the elimination of the capital tax for manufacturing and resource activities, effective January 1, 2008. The Budget not only confirms this measure but also announces that the elimination will be retroactive to January 1, 2007.

For taxation years straddling January 1, 2007, the elimination will be pro-rated.

There will be complete elimination of the capital tax for corporations for which salaries and wages relating to manufacturing and processing, mining, logging, farming or fishing activities in Ontario represent at least 50% of their total salaries and wages in Ontario. Where such salaries and wages are more than 20% but less than 50% of total Ontario salaries and wages, there will be a proportionate reduction as opposed to full elimination of the capital tax.

The elimination of capital tax for 2007 applies if the corporation or a successor has employees reporting to a permanent establishment in Ontario on March 25, 2008.

Where a corporation's tax return was filed and assessed without reflecting the elimination, a reassessment may or may not be automatically generated, depending on the corporation's particular situation. Procedures for claiming a capital tax refund have not yet been established.

### ***Other Corporate Tax Measures***

#### ***Tax Exemption for Commercialization***

The Budget proposes a 10-year corporate income and minimum tax holiday for new corporations that commercialize intellectual property developed by qualifying Canadian colleges, universities and research institutes. Eligible corporations will be those established after March 24, 2008 and before March 25, 2012 that are incorporated in Canada and derive all or substantially all of their income from eligible commercialization activities carried on in Ontario.

Such activities will include the development of prototypes and the marketing and manufacturing of products related to intellectual property. It is intended that the tax holiday apply to what are considered priority areas such as bio-economy/clean technologies, advanced health technologies and telecommunications, computer and digital technologies.

This proposal exempts the corporation only from Ontario corporate tax. It is hoped that the federal government will parallel this proposal.

### *Enhancement of the Ontario Innovation Tax Credit*

The Ontario Innovation Tax Credit (OITC) is a 10% refundable tax credit on qualifying scientific research and experimental development expenditures incurred in Ontario and is available to small and medium-sized corporations. The Budget proposes to enhance the credit by paralleling changes made in the 2008 federal budget.

The limit for expenditures qualifying for the OITC will be increased to \$3 million from \$2 million. The OITC is currently subject to a graduated phase-out where taxable income exceeds \$400,000 and is fully eliminated at \$600,000 of taxable income. The Budget proposes to increase the upper threshold from \$600,000 to \$700,000 of taxable income.

It is intended that the effective date of these changes parallel that of the federal amendments. The federal amendments are generally proposed to be effective for taxation years ending on or after February 26, 2008 with pro-rations for taxation years that straddle that date.

### *Enhancement of the Ontario Interactive Digital Media Tax Credit*

The Ontario Interactive Digital Media Tax Credit is a refundable credit available to corporations engaging in the creation, marketing and distribution of interactive digital media products in Ontario. The credit is 30% of qualifying expenditures for smaller corporations that develop and market their own products and 20% for larger corporations. The 30% rate for smaller corporations was to end on December 31, 2009.

The Budget proposes to extend the time frame for the smaller corporation 30% rate to qualifying expenditures incurred before January 1, 2012. For larger corporations,

the credit rate will be increased to 25% for fee-for-service work qualifying expenditures incurred after March 25, 2008 and before January 1, 2012. Currently, eligible labour expenditures must be incurred within a two-year period ending with completion of product development. The Budget proposes to extend this to a three-year period for products completed after March 25, 2008.

### **CONCORDANCE WITH FEDERAL MEASURES**

The Budget announces the intention of Ontario to adopt the following previously announced federal measures:

- Accelerated capital cost allowance for certain manufacturing and processing equipment;
- Expanded eligibility for enhanced capital cost allowance on clean energy generation assets;
- Capital cost allowance rate changes for carbon dioxide pipelines, and related pumping and compression equipment;
- Increased capital cost allowance rates for railway locomotives;
- Changes to Registered Education Savings Plans;
- Increases to the Northern Residents Deduction;
- Expansion of the list of qualifying medical expenses for individual taxpayers;
- Nil capital gains inclusion rate on the donation of securities to private foundations and of certain non-traded securities to all registered charities;
- Quarterly tax instalments for small Canadian controlled private corporations (i.e. if taxable income in the current or prior year does not exceed \$400,000, and if the company qualified for the low rate of tax in the current or prior year); and
- Increases to corporate tax instalment thresholds from \$1,000 to \$3,000.

A memorandum of this nature cannot be all encompassing and is not intended to replace professional advice. Its purpose is to highlight tax-planning possibilities and identify areas of possible concern. Anyone wishing to discuss the contents or to make any comments or suggestions about this TaxTalk is invited to contact one of our offices.

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