

# TAXTALK

## 2006 ONTARIO BUDGET HIGHLIGHTS

*If you or any of your colleagues would prefer to receive an electronic copy of TaxTalk in PDF format instead of a paper copy, please send an email to [taxtalk@mgca.com](mailto:taxtalk@mgca.com)  
To review previous issues of our TaxTalk, please visit our website at [www.mgca.com](http://www.mgca.com)*

On Thursday, March 23, 2006, Ontario's Minister of Finance, Dwight Duncan, presented the 2006 Budget. Set out below are highlights of the budget that we believe to be of most interest to our clients.

### ECONOMIC OVERVIEW

	2005/ 2006 <sup>1</sup> (\$billion)	2006/ 2007 <sup>2</sup> (\$billion)	Growth (%)
Revenue	83.9	85.7	2.1
Expenditure			
Public debt interest	9.1	9.4	3.3
Other <sup>3</sup>	<u>76.2</u>	<u>78.7</u>	3.3
Deficit	<u>1.4</u>	<u>2.4</u>	
Net Provincial Debt	143.0	147.0	2.7

	2005 (%)	2006 <sup>1</sup> (%)	2007 <sup>2</sup> (%)
Inflation	2.2	2.1	1.8
Unemployment rate	6.6	6.3	6.2
Real Growth in GDP	2.7	2.3	2.5

The estimated deficit of \$1.4 billion for 2005/2006 is less than the forecasted deficit of \$2.8 billion in the previous budget. This reduced deficit is largely due to higher tax revenues from individual and corporate taxpayers.

The budget has no significant personal or corporate income tax rate changes or new taxes; however provincial tax revenues are forecasted to increase as a result of the increase in the province's average annual growth rate.

A deficit of \$2.4 billion is forecast for 2006/2007. However, this amount includes a contingency reserve of \$1.0 billion. The government plans to increase spending by \$1.9 billion in 2006/2007, particularly on health care, education, training and infrastructure projects.

Growth in the economy was 2.7% for 2005, and is expected to remain moderate (2.3 % increase for 2006 and 2.5% increase for 2007). A strong Canadian dollar, elevated oil prices and higher interest rates are factors that are expected to keep the economic growth at these moderate levels.

### Personal Tax Measures

#### *Personal Income Tax Rates*

The 2006 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 \$118,285.

<sup>1</sup> Estimate, for the fiscal year ending March 31, 2006.

<sup>2</sup> Forecast, for the fiscal year ending March 31, 2007.

<sup>3</sup> Includes contingency reserve of \$1 billion in 2006/2007.

The income tax brackets and combined federal and Ontario marginal tax rates (excluding the Ontario Health Premium) for 2006 and future years are as follows:

#### 2006 and Future Years

Taxable Income (Ontario Brackets) <sup>4</sup>	Federal Rate %	Ontario Rate %	Total %
\$ 8,377 to \$ 34,758	16.00 <sup>5</sup>	6.05	22.05
\$ 34,759 to \$ 36,378	16.00 <sup>5</sup>	9.15	25.15
\$ 36,379 to \$ 61,205	22.00	9.15	31.15
\$ 61,206 to \$ 69,516	22.00	10.98	32.98
\$ 69,517 to \$ 72,113	22.00	13.39	35.39
\$ 72,114 to \$ 72,757	22.00	17.41	39.41
\$ 72,758 to \$118,285	26.00	17.41	43.41
\$118,286 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.

The following table<sup>7</sup> provides the top marginal tax rates (excluding the Ontario Health Premium) for an Ontario taxpayer for 2006 and future years on regular income, dividends and capital gains.

<sup>4</sup> In general, the tax brackets are indexed for inflation to protect taxpayers from automatic tax increases that would otherwise result.

<sup>5</sup> Under proposed legislation, this rate was to be reduced to 15%. However, the new federal government has indicated that this rate will remain at 16%.

<sup>6</sup> For 2006, the first-tier surtax is 20% of Ontario tax in excess of \$4,016 (applies when taxable income exceeds \$61,205); and the second-tier surtax is 36% of Ontario tax over \$5,066 (applies when taxable income exceeds \$72,113).

<sup>7</sup> These tax rates generally apply when taxable income exceeds \$118,285 in 2006 (this income threshold is to be indexed annually for inflation). These rates do not include the Ontario Health Premium; the maximum premium of \$900 applies when taxable income reaches \$200,600.

Type of Income	(%)
Regular Income <sup>8</sup>	46.41
Dividends <sup>9</sup>	31.34
Capital Gain	23.21

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

Lower-income seniors are eligible for the Ontario Property and Sales Tax Credit. However, benefits are reduced once a couple's income exceeds a set threshold; for 2005, this threshold was \$22,250. The budget proposes to increase the income threshold<sup>10</sup> for 2006. The new level will be determined when the federal government finalizes Old Age Security (OAS) and Guaranteed Income Supplement) GIS amounts for 2006.

#### Business Tax Measures

##### Corporate Tax Rates

This budget introduces no changes to corporate income tax rates.

The following table summarizes corporate tax rates with respect to active business income (ABI) earned by a Canadian-controlled private corporation (CCPC) in Ontario:

##### Based on a December 31, 2006 year end

Income For ABI:	Federal Rate * %	Ontario Rate %	Total Rate %
up to \$300,000	13.12	5.50	18.62
from \$300,001 to \$400,000	22.12	5.50	27.62
from \$400,001 to \$1,128,519**	22.12	18.67	40.79
> \$1,128,519	22.12	14.00	36.12
> \$1,128,519 with M&P ***	22.12	12.00	34.12

\*including federal surtax of 1.12%

\*\*includes claw-back of Ontario small business deduction

\*\*\*M & P – manufacturing and processing tax credit

<sup>8</sup> For example: salary, pension, interest and business income.

<sup>9</sup> See discussion on Ontario's response to the Federal proposal to change the taxation of dividend income.

<sup>10</sup> The proposed 2006 income threshold will allow seniors who receive the minimum level of income guaranteed by the federal and Ontario governments to fully benefit from the Ontario Property and Sales Tax Credit.

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 certain levels. For 2006, the range of income where the claw-back applies continues to be between \$400,000 and \$1,128,519. The effect of the claw-back is to increase the Ontario corporate rate from 14% to 18.67% on corporate active business income in this range, as indicated in the chart above.

### **Capital Tax Reductions**

Effective January 1, 2007, the current capital tax rate of 0.3% will be reduced to 0.285% and then to 0.225% in 2009. A further annual reduction, based upon a previous budget, of 0.075% of the capital tax rate, will commence January 1, 2010, until the tax is eliminated in 2012<sup>11</sup>.

Pursuant to previous budgets, the capital tax exemption will increase in increments of \$2.5 million. The following table summarizes exemptions and rates for the current and future years:

Year	Exemption (\$Millions)	Rate %
2005	7.5	0.3
January 1, 2006	10.0	0.3
January 1, 2007	12.5	0.285
January 1, 2008	15	0.285
January 1, 2009	15	0.225
January 1, 2010	15	0.150
January 1, 2011	15	0.075
January 1, 2012	15	0.000

It should be noted that the previous federal government planned to eliminate the federal large corporations (capital) tax by 2008.

<sup>11</sup> The government indicated in this budget that it intends to eliminate capital tax earlier (by 2010), but only if the Province's fiscal position allows it.

### **Harmonization of Ontario and Federal Proposals**

Ontario proposes to parallel certain federal measures introduced in November 2005<sup>12</sup>. Ontario will implement the proposals only if they are implemented federally. Two proposals of general interest are:

- To extend the non-capital loss carry-forward period from 10 to 20 years, for losses incurred in taxation years ending after 2005.
- To parallel the capital cost allowance provisions relating to co-generation systems that use "black liquor", a byproduct of the paper-making process.

### **Federal Plan to Reduce Income Tax on Certain Dividends**

On November 23, 2005, the previous federal government proposed changes<sup>12</sup> to the taxation of dividend income. This proposal is designed to reduce the income taxes paid on **eligible** dividend income from Canadian resident corporations.

If enacted, the proposed federal tax reduction will apply to dividends **paid after 2005** by CCPCs,<sup>13</sup> to the extent that the CCPC's income is:

- not investment income (other than dividends from public companies); and
- subject to the federal general corporate income tax rate (i.e., the income is active business income not subject to the federal small business rate, generally active business income exceeding \$300,000).

Since critical details of the federal proposal are unavailable at this time, **Ontario** has indicated that it will review the federal legislation if and when it is re-introduced and will respond at that time.

<sup>12</sup> The proposed legislation needs to be reintroduced by the new federal government. Whether this will be done is unknown at this time.

<sup>13</sup> As proposed, the tax reduction will also apply to dividends paid after 2005 by public corporations; and other corporations that are not CCPCs, that are resident in Canada and are subject to the federal general corporate income tax rate (i.e., 22.12% in 2006).

If Ontario parallels the federal proposals, the top combined federal and Ontario personal income tax rate on qualifying dividends is expected to drop from 31.34% to 19.59%, an aggregate decrease of 11.75%. If Ontario does not parallel the federal provisions, the top combined federal and Ontario personal income tax rate on qualifying dividends will drop from 31.34% to 26.26%, an aggregate decrease of 5.08%.

### ***Tax Credits***

As previously announced, the 18% tax credit rate for the Ontario Production Services Tax Credit will be extended by one year, to March 31, 2007.

Effective for expenditures incurred after March 23, 2006 and before January 1, 2010, it is proposed that the Ontario Interactive Digital Media Tax Credit be increased from 20% to 30% for corporations that qualify under the existing provisions.

### ***Corporate Tax Collection Agreement***

Legislation will be proposed to permit an integration of federal and Ontario tax audits, furthering Ontario's collaboration with the Canada Revenue Agency in reducing corporate tax compliance costs for taxpayers.

## **OTHER TAX MEASURES**

### ***Ontario Retail Sales Tax – Various***

The budget proposes the following retail sales tax measures to:

- extend the temporary retail sales tax exemption for destination marketing fees to fees billed on or before June 30, 2007;

- double the maximum retail sales tax rebate for hybrid electric vehicles from \$1,000 to \$2,000 for vehicles delivered to purchasers after March 23, 2006; and
- amend the Retail Sales Tax Act to ensure that outstanding taxes may be collected from a vendor of a business even after a clearance certificate has been issued under the Bulk Sales Act.

### ***Land Transfer Tax***

The Land Transfer Tax Act provides for deferral and cancellation of tax for **unregistered** transfers of land between affiliated corporations, subject to certain conditions. To counter court interpretations that have resulted in certain **registered** transfers being viewed as exempt, the Act will be amended to reinforce the original intent of the provision to apply only to **unregistered** transfers.

### ***Mining Tax Act Fines and Penalties***

The government intends to restrict the deductibility of fines and penalties in the computation of tax payable under the Mining Tax Act, effective for fines and penalties imposed after March 23, 2006.

### ***Labour-Sponsored Investment Funds (LSIF)***

As previously announced, the Labour-Sponsored Investment Funds (LSIF) tax credit is being phased out at the end of 2010.

### ***Employment Health Tax***

The instalment base for remitting Employer Health Tax (EHT) has recently changed from an estimated payroll to an actual payroll, virtually eliminating any overpayments or underpayments of tax for a year.

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.

Offices      10 Bay Street, Suite 600  
(Bay Street and Queen's Quay)  
Toronto, Ontario M5J 2R8  
Phone: 416-362-0515  
Fax: 416-362-0539

8501 Mississauga Road, Suite 100  
(Steeles Avenue and Mississauga Road)  
Brampton, Ontario L6Y 5G8  
Phone: 905-451-4788  
Fax: 905-451-3299

TaxTalk is prepared by our Tax Group ([taxtalk@mgca.com](mailto:taxtalk@mgca.com))

Please visit our website at [www.mgca.com](http://www.mgca.com).