

TAX TALK

2007 ONTARIO BUDGET HIGHLIGHTS

On Thursday, March 22, 2007, Ontario's Minister of Finance, Greg Sorbara, presented the 2007 Budget. Set out below are highlights of the budget that we believe to be of most interest to you.

ECONOMIC OVERVIEW

	2006/ 2007 ¹ (\$billion)	2007/ 2008 ² (\$billion)	Growth (%)
Revenue	89.1	91.5	2.7
Expenditure			
Public debt interest	8.8	9.1	3.4
Other ³	80.0	82.8	3.5
Surplus (Deficit)	0.3	(0.4)	-
Net Provincial Debt ⁴	143.0	145.3	1.6

	2006 (%)	2007 ¹ (%)	2008 ² (%)
Inflation	1.8	1.3	1.9
Unemployment rate	6.3	6.3	6.2
Real Growth in GDP	1.3	1.6	2.8

The estimated surplus of \$0.3 billion for 2006/2007 exceeded the forecasted deficit of \$2.4 billion in the previous budget.

Gross revenues exceeded budgeted amounts by \$3.4 billion, largely due to higher tax revenues from individual and corporate taxpayers of \$2.2 billion.

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 province's strengthening economy.

¹ Estimate, for the fiscal year ending March 31, 2007.

² Forecast, for the fiscal year ending March 31, 2008.

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

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

The deficit of \$0.4 billion forecasted for 2007/2008 includes a contingency reserve of \$0.8 billion, i.e., without the reserve there would be a surplus of \$0.4 billion.

The government plans to increase spending in 2007/2008, particularly on health and long-term care, education and training, and children and youth services.

Growth in the economy was slower than expected for 2006 at 1.3%, but is projected to improve to be 1.6% in 2007 and 2.8% in 2008. A weakening Canadian dollar, moderating oil prices, stable interest rates and improving U.S. demand are factors which are projected to 'fuel' economic growth in Ontario for 2008.

PERSONAL TAX MEASURES

Personal Income Tax Rates

The 2007 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 \$120,886.

The income tax brackets⁵ and combined federal and Ontario marginal tax rates (excluding the Ontario Health Premium) for 2007 are as follows:

Taxable Income	Federal Rate %	Ontario Rate %	Total %
\$ 8,930 to \$ 35,487	15.50	6.05	21.55
\$ 35,488 to \$ 37,177	15.50	9.15	24.65
\$ 37,178 to \$ 62,488	22.00	9.15	31.15
\$ 62,489 to \$ 70,975	22.00	10.98	32.98
\$ 70,976 to \$ 73,624	22.00	13.39	35.39
\$ 73,625 to \$ 74,356	22.00	17.41	39.41
\$ 74,357 to \$120,886	26.00	17.41	43.41
\$120,887 and over	29.00	17.41	46.41

⁵ In general, the tax brackets are indexed for inflation to protect taxpayers from automatic tax increases that would otherwise result.

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-tiered⁶ and is calculated as a percentage of basic Ontario tax in excess of specified amounts.

The following table⁷ provides the top marginal tax rates for an Ontario taxpayer for 2007 and future years on regular income, dividends and capital gains.

Type of Income	(%)
Regular Income ⁸	46.41
Ineligible Dividends	31.34
Eligible Dividends ⁹	24.64
Capital Gain	23.21

Minimum Wage

The minimum hourly wage will be increased by 75 cents annually commencing March 31, 2008 reaching \$10.25 on March 31, 2010.

Ontario Child Benefit

The Government intends to revamp the system of providing financial assistance to low-income families with children. The New Ontario Child Benefit will be combined with the Ontario Child Care Supplement for Working Families. It will be phased in, commencing July 2007 with a lump sum payment of up to \$250 per child under 18, which will be reduced by 3.4% of family net income over \$20,000.

Effective July 2008, there will be monthly payments for each child under 18 with maximum annualized payments per child of:

July 2008 – June 2009	\$ 600
July 2009 – June 2010	\$ 805
July 2010 – June 2011	\$ 900
July 2011 – June 2012	\$1,100

After July 1, 2008, the benefit will be reduced by 8% of family net income in excess of \$20,000.

⁶ 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).

⁷ These 2007 tax rates generally apply when taxable income exceeds \$120,886. These rates do not include the Ontario Health Premium; the maximum premium of \$900 applies when income taxable income reaches \$200,600.

⁸ For example, salary, pension, interest, and business income.

⁹ See discussion on Ontario's response to the federal proposal to change the taxation of dividend income.

Pension Income Splitting

On October 31, 2006, the federal government announced its intention to allow a recipient of qualifying pension income¹⁰ to transfer (for tax purposes) up to half of the amount received to his or her spouse (or common-law partner), starting with the 2007 taxation year. The budget proposes that Ontario parallel this measure, contingent on the federal legislation receiving Royal Assent.

Property and Sales Tax Credits for Seniors

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 income threshold for 2007 for senior couples over the current \$23,090 to reflect the change to the guaranteed income supplement amount for 2007.

Locked-In Retirement Accounts

The budget proposes changes to locked-in retirement accounts, effective January 2008, at the earliest. The intention is to give seniors, with locked-in retirement savings transferred from employer pension plans, increased flexibility in planning their retirement income.

Proposed is the establishment of a new Life Income Fund (LIF) to replace the existing Life Income Funds and Locked-In Retirement Income Funds eliminating mandatory annuity purchase requirements. In addition, the retiree will have the right to an optional one-time unlocking of up to 25% of the locked-in funds.

Enhanced Dividend Tax Credit

In November 2006, legislation was passed to provide enhanced Ontario dividend tax credits to parallel federal legislation.

For eligible dividends, the tax rate is to decrease over a five year period starting in 2006. Under the phase-in, the top tax rate on eligible dividends is (or will be) 25.09% for 2006, 24.64% for 2007, 23.96% for 2008, 23.06% for 2009 and 22.38% for 2010.¹¹

¹⁰ Qualifying pension income includes most types of retirement income received on a periodic basis, but does not include Canada Pension Plan (CPP) and Old Age Security pension amounts. Spouses have already been able to "share" CPP benefits to achieve income splitting. To share CPP benefits, an application must be made to Services Canada.

¹¹ 2008 to 2010 rates assume no future change to the tax rates on dividends.

For ineligible dividends, the Ontario dividend tax credit of 5.13% of the grossed-up dividend will not change. Consequently, the maximum tax on ineligible dividends in Ontario remains at 31.34%.

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, 2007 year end

Active Business Income:	Federal Rate * %	Ontario Rate %	Total Rate %
up to \$400,000	13.12	5.50	18.62
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

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 \$400,000. The claw-back applies between \$400,000 and \$1,128,519 of income. 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.

Harmonization of Ontario and Federal Proposals

In October 2006, the Ontario and Federal governments agreed to transfer the administration of Ontario corporate income tax to the Federal government for taxation years ending after 2008. A condition of this agreement is for Ontario to eliminate its deduction of the portion of the federal investment tax credit related to scientific research and experimental development (SR&ED) in Ontario. This deduction was replaced by the Ontario Research and Development Tax Credit.

This non-refundable credit will be 4.5% of eligible expenditures and will be applicable for taxation years ending after 2008. The current 10% Ontario Innovation Tax Credit remains.

Elimination of Capital Tax

As previously announced, effective January 1, 2007, the current capital tax rate of 0.3% was reduced to 0.285% and will be further reduced to 0.225% by 2009, and then eliminated by July 1, 2010. The exemptions and rates are summarized in the following table:

Year	Exemption (\$Millions)	Rate %
Before 2007	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	0.015
July 1, 2010	eliminated	

Corporate Minimum Tax (CMT)

Corporate minimum tax credits and losses currently carry forward for 10 years. The budget proposes to extend the carry-forward period to 20 years to parallel the carry-forward period for non-capital losses. This measure is applicable for credits and losses arising in taxation years ending after March 22, 2007. Corporate minimum tax credits from earlier years still unused at the beginning of a corporation's first taxation year ending after 2008 will have their carry-forward period extended by 10 years to the proposed 20 year carry-forward period.

Recent changes to Canadian accounting standards require corporations to report certain assets at fair market value rather than historical cost. These changes will require any gain or loss accruing on such assets to be recognized in net income for that period. The budget proposes to amend the CMT rules so that income for CMT purposes would be calculated without reference to any unrealized gains and losses. These measures would be effective for taxation years ending after March 22, 2007.

Expanding the Apprenticeship Training Tax Credit

Under current legislation, a 25% to 30% refundable tax credit is available to employers of eligible apprentices on their salaries and wages in the first three years of the apprenticeship program, provided that the apprentice commences employment before January 1, 2008. The budget proposes to extend the credit to salaries and wages paid before January 1, 2015 in respect of apprentices who commence employment before January 1, 2012.

Under the budget proposals, the following skilled trades will also be eligible for the credit; entertainment industry power technician, process operator - power, tractor-trailer commercial driver, exterior insulated finish systems mechanic, information technology call centre inside sales agent and information technology call centre customer care agent.

Extending the Ontario Production Services Tax Credit

The Ontario Production Services Tax Credit was temporarily increased to 18% from 11% in 2005. The increased rate was to have expired March 31, 2007. The budget proposes to extend the higher 18% rate increase to March 31, 2008.

Simplifying the Ontario Computer Animation and Special Effects Tax Credit

In order to simplify the claims process, the budget proposes that, for productions commencing after March 22, 2007, a wholly-owned subsidiary will be able to file for the 20% refundable credit for the labour costs of its parent company incurred in respect of productions of the subsidiary.

RETAIL SALES TAX (RST) AND OTHER TAXES***Tax Credit for Fuel Conservation***

The budget proposes that vendors leasing vehicles eligible for the fuel conservation tax credit will be allowed to deduct the credit from their RST remittances.

Rebate for Clean Home Energy Systems

The temporary RST rebate for residential purchases of solar, wind, micro hydro-electric and geothermal energy systems is being extended to purchases made before January 1, 2010.

Exemption for Destination Marketing Fees

To support the hotel and tourism industry, the government proposes to extend the RST exemption for destination marketing fees. Any destination marketing fees billed on or before June 30, 2008 would qualify for exemption from the 5% RST on accommodations.

Business Property Taxes

In an effort to reduce the Business Education Taxes (BET) rate, an initial ceiling rate for the education portion of property taxes of 2.5% for commercial property and 3.0% for industrial property will be introduced, starting in 2008. Ontario will reduce the ceiling rate for Business Education Taxes (BET) over the next 7 years. By 2014, the ceiling BET rate will be 1.6% for both commercial and industrial properties.

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)

Please visit our website at www.mgca.com.