

# TaxTalk

## 2009 ONTARIO BUDGET HIGHLIGHTS

On Thursday, March 26, 2009, Ontario's Minister of Finance, Dwight Duncan, presented the 2009 Budget. Set out below are highlights of the Budget that we believe to be of most interest to you.

### ECONOMIC OVERVIEW

	2008/ 2009 <sup>1</sup> (\$billion)	2009/ 2010 <sup>2</sup> (\$billion)	Growth (%)
Revenue	93.4	96.0	-
Expenditure			
Public debt interest	8.9	9.3	0.04
Other <sup>3</sup>	88.4	100.8	0.14
Surplus (Deficit)	(3.9)	(14.1)	
Net Provincial Debt <sup>4</sup>	149.4	169.8	

	2008 (%)	2009 <sup>1</sup> (%)	2010 <sup>2</sup> (%)
Inflation	2.3	0.4	1.9
Unemployment rate	6.1	8.8	8.9
Real Growth in GDP	(0.4)	(2.5)	2.3

As anticipated the Budget proposes to harmonize Ontario's current 8% Retail Sales Tax and the federal 5% Goods and Services Tax (GST) tax to create a single 13% value added sales tax, to be effective July 1, 2010.

The Budget proposes minor tax rate changes for individuals while increasing the tax rate on both eligible and non-eligible dividends starting in 2010. For corporations there are tax cuts in the general, manufacturing and processing and small business tax rates as well as the elimination of the small business deduction surtax (clawback). These corporate proposals are to be effective July 1, 2010.

<sup>1</sup> Estimate, for the fiscal year ending March 31, 2009.

<sup>2</sup> Forecast, for the fiscal year ending March 31, 2010.

<sup>3</sup> Includes contingency reserve of \$1.2 billion in 2009/2010.

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

In a slumping economy, the Budget is projecting a deficit of \$3.9 billion for the 2008/2009 fiscal year. A much larger deficit of \$14.1 billion is projected for 2009/2010, with \$32.5 billion of spending over the next two years to be directed mainly to infrastructure.

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

### PERSONAL TAX MEASURES

#### Personal Income Tax Rates

The 2009 Budget does not introduce any new tax rate changes, but does propose a reduction to the lowest tax rate to be effective in 2010. The top marginal rate for individuals remains at 46.41% for 2009. This rate starts to apply when taxable income exceeds \$126,264.

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 2009.

Taxable Income	Federal Rate %	Ontario Rate %	Total %
\$ 10,320 to \$ 36,848	15.00	6.05	21.05
\$ 36,849 to \$ 40,726	15.00	9.15	24.15
\$ 40,727 to \$ 64,886	22.00	9.15	31.15
\$ 64,887 to \$ 73,698	22.00	10.98	32.98
\$ 73,699 to \$ 76,440	22.00	13.39	35.39
\$ 76,441 to \$ 81,452	22.00	17.41	39.41
\$ 81,453 to \$126,264	26.00	17.41	43.41
\$126,265 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>5</sup> and is calculated as a percentage of basic Ontario tax in excess of specified amounts.

<sup>5</sup> For 2009, the first-tier surtax is 20% of Ontario tax in excess of \$4,257 (applies when taxable income exceeds \$64,886); and the second-tier surtax of 36% of Ontario tax over \$5,370 (applies when taxable income exceeds \$76,440).

The Budget proposes that, *effective January 1, 2010*, the lowest Ontario marginal tax rate is to be reduced to 5.05% from 6.05%. The lowest rate currently applies to the first \$36,848 of taxable income. This threshold is indexed annually.

As indicated above, Ontario levies a two-tier personal surtax, the first tier at 20% of Ontario income tax in excess of a base amount and the second tier at 36% of Ontario income tax in excess of a higher base amount. The Budget proposes to reduce both of these base amounts for 2010. Currently, the threshold amounts are \$4,257 for the first tier and \$5,370 for the second tier. It is proposed that, for 2010, these thresholds become \$3,978 and \$5,091 respectively.

Personal non-refundable credits claimed against Ontario tax payable are computed by applying the lowest marginal rate to a base amount for each credit. Accordingly, for 2010 and subsequent years, these credits will be computed at 5.05%.

#### ***Tax Treatment of Dividends***

The Budget proposes to reduce the Ontario general corporate tax rate, *effective July 1, 2010*. As a result of this change, the Budget also proposes to reduce the Ontario dividend tax credit on eligible dividends<sup>6</sup> effective January 1, 2010 from a previously introduced rate of 7.7% to 6.4% of the “grossed-up” dividend.

Combining the federal rates with the Ontario changes, top marginal rates for eligible dividends in Ontario will be as follows:

Year	Federal	Ontario	Total
	%	%	%
2009	14.6	8.5	23.1
2010	15.9	10.7	26.6
2011	17.7	10.5	28.2
2012	19.3	10.3	29.6

The Budget also proposes to reduce the Ontario small business corporate tax rate, again *effective July 1, 2010*. As a result of this change, the Budget also proposes to reduce the Ontario dividend tax credit on non-eligible dividends (essentially those paid out of income taxed at small business rates) effective January 1, 2010 from 5.13% to 4.5% of the “grossed-up” dividend.

<sup>6</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.

Combining the federal rates with the Ontario changes, top marginal rates for non-eligible dividends in Ontario will be as follows:

Year	Federal	Ontario	Total
	%	%	%
2009	19.6	11.7	31.3
2010 and subsequent years	19.6	13.0	32.6

#### ***Property and Sales Tax Credits***

The Budget proposes to increase the provincial tax relief by replacing the existing combined property tax and sales tax credits with two new credits, effective for the 2010 tax year.

The Ontario Sales Tax Credit (OSTC) will provide for a maximum of \$260 for each adult and child while the new Ontario Property Tax Credit (OPTC) will provide for a maximum of \$900 for non-seniors and \$1,025 for seniors.

#### ***Property Tax Grant for Seniors***

The 2009 Budget confirms that the maximum grant will be \$500 for 2010 and subsequent years.

#### ***Tax-Free Savings Accounts (TFSA)***

Individuals are able to contribute up to \$5,000 annually to a TFSA and investment income and capital gains earned on these funds is tax-free. The Budget proposes to change the Succession Law Reform Act to allow direct beneficiary designations on TFSAs, similar to those for Registered Retirement Savings Plans and life insurance. The impact of this proposal is to allow TFSAs to pass outside a will thereby avoiding Estate Administration Tax or probate.

#### ***Locked-in Pension Accounts***

Enhanced access to locked-in funds will be provided by changes to the Pension Act that will allow 50% unlocking (increased from 25%) on purchase from new Life Income Funds (LIF), effective January 1, 2010. Existing LIF and Locked-in Retirement Income Fund owners will be able to unlock an additional 25% of their accounts in order to bring them on side with the new rules. In addition, there will be a temporary two-year waiver of financial hardship application withdrawal fees for applications approved on or after April 1, 2009.

## BUSINESS TAX MEASURES

### Corporate Tax Rates

This Budget introduces no changes to corporate income tax rates for 2009, but does propose reductions to corporate rates to be effective in 2010.

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, in 2009:

For 2009 - December 31 year end

Active Business Income	Federal Rate %	Ontario Rate %	Total Rate %
up to \$500,000	11.00	5.50	16.50
from \$500,001 to \$1,500,000*	19.00	18.25	37.25
> \$1,500,000	19.00	14.00	33.00
> \$1,500,000 with M&P **	19.00	12.00	31.00

\* includes clawback of Ontario small business deduction

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

For corporations that claim the Ontario small business deduction (SBD), a surtax (clawback) is levied to reduce the benefit of the SBD where corporate income exceeds \$500,000. The clawback increases the tax rate on active business income between \$500,000 and \$1.5 million by 4.25% from 33.0% to 37.25%, as indicated in the table above.

The Budget proposes to reduce the general corporate income tax rate over a three year period, *effective July 1, 2010*. In addition, the small business deduction surtax or clawback, currently at 4.25%, will be eliminated as of that date. Where the corporate taxation year straddles the effective date, rates will be pro-rated. As a result of these proposals, Ontario corporate income tax rates will be as follows:

	General %	M&P %	Small Business %	SBD Surtax %
Current	14.0	12.0	5.5	4.25
July 1, 2010	12.0	10.0	4.5	Eliminated
July 1, 2011	11.5	10.0	4.5	Eliminated
July 1, 2012	11.0	10.0	4.5	Eliminated
July 1, 2013	10.0	10.0	4.5	Eliminated

Taking into account proposed or scheduled reductions to federal corporate tax rates, total federal and Ontario corporate rates will be as follows:

	General %	M&P %	Small Business %
Current	33.0*	31.0	16.5
July 1, 2010	30.0	28.0	15.5
July 1, 2011	28.0	26.5	15.5
July 1, 2012	26.0	25.0	15.5
July 1, 2013	25.0	25.0	15.5

\* 37.25% with Ontario clawback

### Corporate Minimum Tax (CMT)

The Budget proposes two changes to CMT. CMT is currently calculated as the excess of 4% of adjusted accounting net income over "regular" income tax. The CMT rate is to be reduced to 2.7% effective for taxation years ending after June 30, 2010.

Currently, CMT does not apply to a corporation or an associated group of corporations with total assets under \$5 million and annual gross revenues under \$10 million. For taxation years ending after June 30, 2010, these limits will be raised to \$50 million and \$100 million, respectively.

### Reduction and Elimination of the Ontario Capital Tax

This budget does not change the previously announced capital tax rates. As a recap, capital tax was eliminated on January 1, 2007 for some of the corporations in the manufacturing and resource industries and will be eliminated for all corporations as of July 1, 2010.

The exemption and rates are prorated for taxation years straddling the effective dates and are summarized in the following table:

Year	Exemption (\$Millions)	Current/Expected Rate %
January 1, 2008	15	0.225
January 1, 2009	15	0.225
January 1, 2010	15	0.150
July 1, 2010	Eliminated	

### ***Ontario Innovation Tax Credit (OITC)***

The OITC is a refundable 10% tax credit on qualifying scientific research and experimental development (SR&ED) expenditures incurred in Ontario and is available to small and medium-sized corporations. The OITC is currently subject to a graduated phase-out when taxable income exceeds \$400,000 and is fully eliminated at \$700,000 of taxable income. The Budget proposes to increase these thresholds to \$500,000 and \$800,000 respectively. It is intended that the timing of these changes parallel that of the federal amendments announced in the 2009 federal Budget. Accordingly, the new thresholds will be effective for taxation years ending after 2009 with a pro ration for taxation years that straddle December 31, 2009.

### ***Apprenticeship Training Tax Credit (ATTC)***

The ATTC is a refundable credit available to employers of eligible apprentices in qualifying trades. The credit is 25% (30% rate for small businesses) of salaries and wages paid during the first 36 months of apprenticeship to a maximum annual credit of \$5,000. The ATTC is available for apprentices that begin their apprenticeship program before January 1, 2012 and for salaries and wages paid before January 1, 2015. For expenditures incurred after March 26, 2009, the Budget proposes to increase the rates to 35% and 45% respectively and the annual maximum is to be increased to \$10,000.

### ***Other Tax Credits to Corporations***

#### ***Ontario Interactive Digital Media Tax Credit (OIDMTC)***

Effective for qualifying expenditures incurred after March 26, 2009, the Budget proposes to:

- increase<sup>7</sup> the credit to 40% for qualifying corporations that develop and market their own eligible products and 35% for qualifying corporations that develop eligible products under fee-for-service arrangements.
- expand qualifying expenditures to include 100% (rather than 50%) of amounts paid to eligible arm's length contractors.

<sup>7</sup> The credit rate currently is 30% for qualifying corporations and 25% for larger corporations. The new rates do not vary based on the corporation's size.

### ***Ontario Computer Animation and Special Effects Tax Credit (OCASETC)***

The Budget proposes to enhance this credit for qualifying expenditures incurred after March 26, 2009 to 100% of amounts paid to arm's length parties, including incorporated individuals.

### ***Ontario Book Publishing Tax Credit (OBPTC)***

For expenditures incurred after March 26, 2009, the Budget expands the eligibility by eliminating the first three books limitation and extending the credit to certain expenses.

### ***Co-operative Education Tax Credit (CETC)***

For expenditures incurred after March 26, 2009 the rate is to be increased from 10% to 25% (from 15% to 30% for small businesses) and the maximum per placement is to be increased to \$3,000.

### ***Ontario Film and Television Tax Credit (OFTTC)***

The Budget confirms that the rate will remain at 35%.<sup>8</sup> This was previously announced on February 20, 2009.

### ***Ontario Production Services Tax Credit (OPSTC)***

The Budget confirms that the rate will remain at 25%.<sup>9</sup> This was previously announced on February 20, 2009.

### ***Political Contributions***

The Budget confirms an announcement made on December 30, 2008 that legislation will be introduced to replace the current corporate deduction for Ontario political contributions with a non-refundable credit effective for taxation years ending after December 31, 2008.

<sup>8</sup> The rate was scheduled to drop back to 30% after December 31, 2009.

<sup>9</sup> The rate was scheduled to drop back to 18% after December 31, 2009.

## SALES TAX HARMONIZATION

### *General*

It is proposed that *commencing July 1, 2010* Ontario will introduce a value-added tax. This tax will be combined with the federal Goods and Services Tax (GST) to create a single sales tax to be administered by the Canada Revenue Agency. The new Ontario value-added tax will replace the existing Ontario Retail Sales Tax (RST).

The single combined value-added tax will have a 13% rate representing a 5% federal portion and 8% Ontario portion (the same rate as the current RST). The single sales tax will be largely consistent with the GST.

It is expected that the conversion to a broader-based value added consumption tax will create increased Ontario government revenues. The change will provide benefits to most businesses, as they will be able to claim input tax credits to recover the tax paid – under the current RST system, businesses that pay RST on business inputs cannot recover it, so the RST becomes a hidden part of the price charged. Also, harmonization will reduce the paperwork burden for businesses that collect both GST and RST.

The single sales tax will apply to a wide range of goods and services but will not be charged on items such as basic groceries, prescription drugs and medical devices. Businesses making taxable or zero-rated sales will generally be able to claim input tax credits for the single sales tax paid on their purchases. As part of this sales tax reform process, Ontario is to receive \$4.3 billion in cash transfer payments from the federal government to promote economic growth and support transition to the single sales tax.

### *Sales Tax Transition Benefits for Individuals*

To assist individuals during the introduction of the single sales tax, benefits will be payable to eligible Ontario income tax filers aged 18 and over. A single person with no children and income of less than \$80,000 will receive \$300 in 3 instalments payable June 2010, December 2010 and June 2011. Single parents or couples with combined income of \$160,000 or less will receive \$1,000 in 3 instalments payable June 2010, December 2010 and June 2011.

### *Sales Tax Transition Support for Small Business*

Effective March 31, 2010 the vendors' compensation currently paid under the RST will be eliminated. To assist small businesses in transitioning to the single sales tax, a credit will be provided. The credit will be based on taxable sales in the first full quarter commencing after June 30, 2010.

- businesses with taxable revenues of \$15,000 or less will receive a \$300 credit,
- businesses with taxable revenues between \$15,000 and \$50,000 will receive a credit of 2% of taxable revenue, and
- businesses with taxable revenues between \$50,000 and \$500,000 will receive a credit of \$1,000.

### *Temporarily Restricted Input Tax Credit (ITC)*

Restricted ITCs will be imposed on large businesses with annual taxable sales in excess of \$10 million and on financial institutions. The restriction will apply only to the provincial portion of the single sales tax and will be in place for the first 5 years and then will be phased out over the following 3 years. Purchases subject to the ITC restriction include certain energy charges, certain telecommunication services, road vehicles less than 3,000 kilograms, food, beverages and entertainment.

### *Rebates for Public Service Bodies*

Similar to the federal GST, rebates will be available for the provincial portion of the single sales tax. These rebates are generally available to municipalities, universities/colleges, school boards, hospitals, charities and qualifying non-profit organizations.

### *Point-of-Sale Exemptions*

To provide targeted tax relief, point-of-sale rebates will be introduced for the provincial portion of the single sales tax on the following items: books, children's clothing and footwear, children's car seats, diapers, and feminine hygiene products.

***New Housing Rebate***

To ensure that new homes priced under \$400,000 do not attract additional sales tax, a rebate will be available equal to 75% of the provincial component of the single sales tax (i.e. 6%). This rebate will be phased out for homes priced between \$400,000 and \$500,000 with no rebate available for those priced over \$500,000. Resale home purchases will not be subject to the single sales tax.

***Insurance Premiums***

Insurance premiums currently subject to the RST will also be subject to the 8% provincial portion of the single sales tax.

***Alcohol Sales***

RST is currently applied on purchases of alcoholic beverages at rates of 10% or 12%. Under the single sales tax these rates will fall to 8%. To ensure that existing revenues are maintained, alcohol fees, levies and charges will be adjusted upward to offset the sales tax rate reduction.

***Private Transfers of Motor Vehicles***

After implementation of the single sales tax, Ontario will retain a sales tax on private transfers of automobiles to maintain a level playing field between used vehicles sold through dealerships and private sales.

***Hotel Rooms and Other Transient Accommodation***

The RST currently applies at a rate of 5% on charges for hotel rooms and other transient accommodation. Under the single sales tax system such charges will be subject to the full 13% thereby increasing the provincial sales taxes applied to 8%.

**CONCORDANCE WITH FEDERAL MEASURES**

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

- 100 % accelerated capital cost allowance rate with no half-year rule for eligible computers and software acquired after January 27, 2009 and before February 2011.
- 50% straight-line accelerated capital cost allowance rate for manufacturing and processing machinery and equipment acquired in 2010 and 2011.
- Increase of the RRSP Homebuyer's Plan withdrawal limit to \$25,000 from \$20,000 effective for withdrawals after January 27, 2009.
- Carryback of post-death decreases in value of Registered Retirement Savings Plans and Registered Retirement Income Funds to offset the year-of-death income inclusion for the deceased, effective for deaths after 2008.

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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