

TaxTalk

2003 ONTARIO BUDGET HIGHLIGHTS

On Thursday, March 27, 2003, the Honourable Janet Ecker, Ontario's new Minister of Finance, presented the 2003 Budget.

Set out below are highlights of the budget that we believe to be of most interest to our clients.

ECONOMIC OVERVIEW

	2002/ 2003 ¹ (\$billion)	2003/ 2004 ² (\$billion)	Growth (%)
Revenue	66.4	71.6	7.8
Expenditure			
Public debt interest	8.8	8.7	(1.1)
Other ³	<u>57.1</u>	<u>62.9</u>	10.2
Surplus	<u>0.5</u>	<u>0.0</u>	-
Net Provincial Debt	109.7	109.7	(0.0)

	2002 (%)	2003 ¹ (%)	2004 ² (%)
Inflation	2.0	3.0	2.0
Unemployment rate	7.1	6.3 – 6.5	5.5 – 6.0
Real Growth in GDP	3.8	3.0	3.6

In its 2002 budget, the surplus was forecast to be nil, including a contingency reserve of \$1 billion, i.e. the 'real' surplus forecast was \$1 billion. Interim figures estimate a surplus of \$524 million, which indicates that \$476 million of the \$1 billion contingency reserve was absorbed.

For 2003/2004, a balanced budget is again presented, which again includes a contingency reserve of \$1 billion.

¹ Estimate, for the fiscal year ending March 31, 2003.

² Forecast, for the fiscal year ending March 31, 2004.

³ Includes contingency reserve of \$1 billion in 2003/2004.

To the extent that it is not required, any excess reserve will be available to reduce the provincial debt.

Although the Ontario economy continues to feel the effects of the sluggish US economy and the events of September 11, it remains relatively strong. The economy grew by 3.8% in 2002, which was better than the forecasted growth of 3.1%. Ontario's real GDP growth, averaged over the last 6 years, has surpassed Canada's as a whole. Growth is forecast to decline to 3.0% in 2003, reflecting the impact of the Iraq situation and the slowdown in the U.S. economy.

Personal tax cuts that were delayed in the 2002 budget have been reinstated. Previously announced proposals to reduce corporate taxes remain intact.

Spending is to increase in certain areas, including increases of \$1.9 billion for health care, \$500 million for elementary and secondary education and \$200 million for post-secondary education. The anticipated economic growth is expected to provide the requisite revenues to fund these increases in spending – revenues are forecast to increase by \$5.2 billion in 2003/2004.

As a provincial election is anticipated, whether or not the proposals of this budget will be enacted could ultimately depend on the election result.

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PERSONAL TAX MEASURES

The 2001 budget contained proposals to:

- reduce tax rates for taxpayers in the low and middle-income brackets, over a two-year period in 2002 and 2003
- eliminate the first tier of the Ontario surtax, effective January 1, 2003
- provide an education tax credit for independent school tuition fees, starting at 10% in 2002 and rising by 10% per year to a maximum of 50% in 2006

In its 2002 budget, citing economic uncertainty, the government did **not** implement the planned changes to these three items for 2003. Instead, the 2002 budget deferred the planned changes for 2003 arising from the 2001 budget to 2004.

This 2003 budget revives the tax rate reductions – it contains proposals to reduce tax rates, eliminate the first tier of the surtax for 2004, and restore the education tax credit phase-in to its original timetable outlined in the 2001 budget.

Personal Income Tax Rate Reductions

The budget does not introduce any new tax rate changes. However, it reinstates the final phase of personal tax cuts for taxpayers in the low and middle-income brackets announced in the 2001 budget. The 2004 tax rates will be lower than the 2003 rates for some taxpayers; however, the highest Ontario tax rate will remain unchanged at 11.16%.

Surtax

The effect of the Ontario surtax is to increase the top marginal tax rate from 40.16% to 46.41%; that is, the surtax can increase the marginal tax rate by as much as 6.25%.

Ontario's surtax is two-tiered⁴ and is calculated as a percentage of basic Ontario tax in excess of specified amounts. The first tier of the surtax is scheduled to be eliminated for 2004 (as indicated above, the 2001 budget proposed to eliminate the first tier in 2003, but this was deferred to 2004).

⁴ For 2003, the first-tier surtax is 20% of Ontario tax in excess of \$3,747 (starts to apply when taxable income exceeds \$59,000); and the second-tier surtax is 36% of Ontario tax over \$4,727 (starts to apply when taxable income exceeds \$69,000).

For 2004, it is proposed that the second-tier surtax be calculated as 56%⁵ of Ontario income tax in excess of \$4,727⁶. For 2005, the budget proposes to increase the Ontario tax threshold so that the surtax would not apply to individuals with taxable income of less than about \$75,000.

Based on these changes, the income tax brackets and combined Federal and Ontario tax rates (including all surtaxes) for 2003 and 2004 are as follows:

2003			
Taxable Income (Ontario Brackets)	Federal Rate %	Ontario Rate %	Total %
\$ 7,817 to \$ 32,435	16.00	6.05	22.05
\$ 32,436 to \$ 57,110	22.00	9.15	31.15
\$ 57,111 to \$ 64,870	22.00	10.98	32.98
\$ 64,871 to \$ 67,290	26.00	13.39	39.39
\$ 67,291 to \$104,648	26.00	17.41	43.41
\$ 104,649 and over	29.00	17.41	46.41

Proposed for 2004			
Taxable Income (Ontario Brackets) ⁷	Federal Rate %	Ontario Rate %	Total %
\$ 7,817 to \$ 32,435	16.00	5.65	21.65
\$ 32,436 to \$ 64,870	22.00	8.85	30.85
\$ 64,871 to \$ 69,040	26.00	11.16	37.16
\$ 69,041 to \$104,648	26.00	17.41	43.41
\$ 104,649 and over	29.00	17.41	46.41

The following table provides the top marginal tax rates for an Ontario taxpayer for the years 2000 to 2004 on regular income, dividends and capital gains.

Type of Income	2000 (%)	2001 to 2004 (%)
Regular Income ⁸	47.86	46.41
Dividends	32.32	31.34
Capital Gain ⁹	23.93	23.21

These rates generally apply when taxable income exceeds \$104,648 in 2003 (this income threshold is to be indexed annually for inflation).

⁵ The 56% surtax rate is equal to the current 20% + 36% two-tiered rate.

⁶ To be indexed for inflation.

⁷ The income amounts are the 2003 levels. These amounts will be indexed for inflation in 2004.

⁸ For example salary, pension and interest income.

⁹ During 2000, the capital gains inclusion rate was reduced from 75% to 66 2/3% and then to the current 50%. The rate of 23.93% for 2000 is based on the 50% inclusion rate.

Education Tax Credit for Independent Schools¹⁰

The budget proposes to restore the implementation schedule for this credit as originally proposed in the 2001 budget. For 2002, the tax credit is 10%. It is proposed that the tax credit rate will be 20% for 2003, 30% for 2004, 40% for 2005 and 50% for 2006 and subsequent years.

The maximum tuition fee eligible for the credit is \$7,000 for children aged 6 and over and \$3,500 for children under the age of 6.

Ontario Tax Reduction

The Ontario tax reduction eliminates or reduces Ontario tax for taxpayers with low to moderate income levels, i.e. those with income under \$13,800. Effective January 1, 2004, the budget proposes to increase the basic amount from \$181 to \$197, plus an increase for inflation.

Enhanced Tax Credits for the Disabled

Increases to Ontario non-refundable credits from 2002 to 2003 are proposed as follows:

- Disability credit from \$6,316 to \$6,637
- Disability credit supplement for severely disabled children from \$3,684 to \$6,637
- Caregiver credit from \$3,684 to \$6,637
- Infirm dependent credit from \$3,684 to \$6,637

It is also proposed to increase the income thresholds for both the caregiver credit and the infirm dependant credit so that more taxpayers will qualify for these credits.

Ontario Child Care Supplement for Working Families

The budget proposes to increase the income threshold at which benefits from the Ontario Child Care Supplement for Working Families begin to be reduced, from \$20,000 to \$20,750. This benefit will continue to be reduced by 8% of family net income in excess of \$20,750.

BUSINESS TAX MEASURES

Corporate Tax rates

The 2001 budget proposed corporate tax rate reductions for the general corporate tax rate¹¹ and the tax rate on income from manufacturing and processing. The 2002

¹⁰ The credit is available for qualifying kindergarten, elementary and secondary school tuition fees paid to independent schools in Ontario.

¹¹ The general corporate tax rate applies to income that is *not eligible* for the small business tax rate.

budget delayed these reductions by one year; as such, the proposed corporate income tax rates are as follows.¹²

Ontario Rates Only	General Corporate Rate (%)	M&P* Rate (%)
January 1, 2003	12.5	11.0
Proposed tax rates		
January 1, 2004	11.0	10.0
January 1, 2005	9.5	9.0
January 1, 2006	8.0	8.0

* Manufacturing and Processing Profits

All tax rate decreases are to be effective January 1 of each year, with a proration in rates for taxation years that straddle January 1.

Previously announced reductions in the small business tax rate and the timetable for the increase to \$400,000 with respect to income eligible for the small business rate remain unchanged and will be fully implemented by January 1, 2005.

The following table provides the scheduled rate and income threshold amounts for "small" businesses.

Ontario Rates Only	Small Business Tax Rate (%)	Income Eligible for Small Business Rate	Income Level when Small Business Rate is Eliminated
January 1, 2003	5.5	\$320,000	\$800,000
January 1, 2004	5.0	360,000	900,000
January 1, 2005	4.0	400,000	1,000,000

The following table compares the combined federal and Ontario corporate tax rates, for a company with a December year-end, giving effect to proposed federal tax rate reductions. As indicated, the high tax rate is scheduled to decrease substantially from 38.62% in 2002 to 30.12% in 2006.

Combined Federal and Ontario Corporate Income Tax Rates for Active Business Income			
Year	M & P (%)	Other Business Income	
		High Rate (%)	Low rate (%)
2002	33.12	38.62	19.12
2003	33.12	36.62	18.62
2004	32.12	33.12	18.12
2005	31.12	31.62	17.12
2006	30.12	30.12	17.12

¹² There is no change in the tax rates and income thresholds from the amounts presented in the 2002 budget, i.e. this budget 'stays the course' with respect to corporate income taxes.

Capital Tax

The budget proposes to reduce capital tax rates and **eliminate capital tax** altogether by 2008. The current capital tax rate of 0.3% of taxable capital¹³ will be reduced by 10% to 0.27% starting January 1, 2004. The timeline for elimination is consistent with the federal government's proposal in its 2003 federal budget to eliminate the federal large corporations (capital) tax by 2008. However, whereas the federal capital tax is to be reduced / eliminated in stages, there is no indication on how quickly the Ontario capital tax is to be phased out.

Apprenticeship Tax Credit

The budget proposes a new **refundable** tax credit for corporations and unincorporated businesses on salaries and wages paid to apprentices in a qualifying skilled trade. Skilled trades include several job categories in various industrial, service, construction and motive power trades. The rate of the credit will be based on annual payroll costs. The employer will be eligible for a maximum credit of \$250 a month to a maximum of \$6,000 per apprentice over a 24-month employment period.

Labour Sponsored and Community Small Business Investment Funds

The budget proposes several changes to the Labour Sponsored Investment Fund (LSIF) and Community Small Business Investment Fund (CSBIF) rules to make it easier for small and medium sized businesses to access capital.

Administration and Enforcement

Ontario's major tax statutes require taxpayers to voluntarily file tax returns, accurately report their tax liabilities and pay the taxes they owe. The budget

¹³ The first \$5 million of taxable capital is exempt for all corporations.

proposes to undertake aggressive action to ensure that all corporations file their requisite tax returns. By April 30, 2003, notices will be issued to all corporations in default of filing, requiring immediate filing of appropriate documents. Failure to respond to this notice could ultimately result in the corporation's dissolution and possible prosecution of the directors.

OTHER TAX MEASURES

Property Tax Relief for Seniors

To help seniors to stay in their homes, the budget proposes to provide them with property tax relief. Seniors who own or rent their homes will be eligible for a credit that reimburses their full residential education portion of the property tax, starting in respect to their property tax after July 1, 2003. An application form will be required, with the first refunds being issued in 2004.

Land Transfer Tax (LTT) Exemptions

The budget proposes to exempt certain life leases from LTT. Life leases are a form of housing for seniors, whereby the owner of the life lease has the exclusive right to occupy the residential dwelling for life. The budget also proposes to exempt transfers of farmland between family members from LTT, effective for qualifying transfers after March 27, 2003.

Ontario Retail Sales Tax

The budget proposes several measures to enhance retail sales tax rebates in several areas such as: capital investments by charities, solar and other renewable energy projects, and alternative fuel vehicles.

It also proposes changes to the retail sales tax purchase exemption certificate (PEC) system, so that PECs will have no expiry date and will no longer require a signature or a list of exempt items.

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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