BDO

BDO Dunwoody LLP
Chartered Accountants
and Advisors

Ontario Budget Report

March 26, 2009

Highlights

- *PST to be Harmonized with the GST Effective July 1, 2010*
- *Significant Corporate Tax Reductions Announced*
- *CMT Eliminated for Small and Mid-sized Corporations*
- *Corporate Small Business Deduction Clawback Eliminated*
- *Income Tax Rate Reduced for Lowest Tax Bracket*

"Confronting the Challenge Building Our Economic Future"

On March 26, 2009, the Honourable Dwight Duncan presented his second budget since becoming Finance Minister on a full-time basis. This budget will be historic due to the financial crisis and the announcement that Ontario will harmonize the provincial retail sales tax with the federal Goods and Services Tax (GST).

From an economic perspective, the budget has been designed to stimulate the slumping economy. The original forecast for a balanced budget for the 2008-09 fiscal year (after providing for an $800 million reserve) is now projected to be a deficit of $3.9 billion. A much larger deficit of $14.1 billion is projected for the 2009-10 fiscal year. The budget documents confirmed the government's intention to spend $32.5 billion over the next two years on new infrastructure. Another $1 billion will be spent on new business initiatives focusing on research, technology and the environment. The government also announced that significant changes will be made to Ontario pension regulations relating to funding relief and modernization.

In what will no doubt become the most controversial announcement in this year's budget, the Ontario government has announced that it will harmonize the provincial sales tax (PST) with the GST on July 1, 2010. Although this has already caused a great deal of discussion among consumers, it is important to note that this change will provide significant benefits to most businesses. Unlike the GST, many businesses pay PST on business inputs without the ability to recover the PST. Under the new harmonized sales tax system, input tax credits will be available which will ensure that PST does not become a hidden cost.

Another important benefit of harmonization will be the reduction of the paperwork burden for those businesses that now collect both PST and GST. Once the two taxes are harmonized, a single sales tax will be charged and paid to the Canada Revenue Agency (CRA). In addition, there will be combined sales tax returns and businesses will no longer be audited by two levels of government.

The Finance Minister promised that sales tax harmonization will be fiscally neutral overall. The additional sales tax revenue will help to fund a significant corporate tax reduction package. General personal income tax relief was also provided, aimed at lower income Ontarians.

The following summarizes the tax measures included in today's budget that are of the most interest to our clients.

Ontario Budget Projections *(in billions $)*			
	Original Forecast 2008/09	**Revised Forecast 2008/09**	**Projected 2009/10**
Revenue	96.9	93.4	96.0
Program Expense	(87.2)	(88.4)	(99.6)
Interest on Debt	(8.9)	(8.9)	(9.3)
Reserve	(0.8)	-	(1.2)
Surplus (Deficit)	-	(3.9)	(14.1)

PST/GST Harmonization

General Implications

Ontario will join Québec, Nova Scotia, New Brunswick and Newfoundland & Labrador which previously harmonized their sales tax systems with the federal GST. Under the plan announced today, Ontario's share of the new harmonized tax will be collected by the CRA. The combined tax rate will be 13% (5% federal/ 8% Ontario). The harmonized tax will generally follow the same rules as the federal GST (although some exceptions are noted below). In particular, the small supplier threshold will be $30,000 ($50,000 for public service bodies).

Although many details will follow in the coming months, the process for gearing up for the July 1, 2010 conversion will be similar to what businesses have faced with the two recent GST reductions. In terms of sales, businesses will need to convert their systems on July 1, 2010 so the new harmonized tax is collected. Expenses will need to be segregated between pre and post implementation amounts so that the business can accurately measure which expenses will qualify for an input tax credit (ITC) under the new system.

Businesses should review planned expenditures as the conversion date approaches and determine whether these expenditures are subject to PST that can't be recovered. If possible, these expenditures should be incurred after June 2010 so that the provincial component of the tax paid qualifies for an ITC. Consumers on the other hand will no doubt be reviewing expenditures that will become subject to the provincial component of the harmonized tax, so that these goods or services are bought before the harmonized tax comes into effect.

Ontario Exemptions

Under the agreement reached with the federal government, the Ontario government will be allowed to set a limited number of consumer point of sale exemptions on items such as children's clothing and shoes, children's car seats, diapers, feminine hygiene products and books.

Phase-in of Input Tax Credits for Larger Businesses

Although the ability to claim ITCs will be a key component of the new system, ITCs will be restricted during the first 5 years of the new system for financial institutions and businesses with taxable sales in excess of $10 million annually, and after that, full ITCs will be implemented over 3 years. These restrictions will apply to ITCs related to:

- Energy (except for energy used for farming or the production of goods for sale);
- Telecommunication costs, other than internet access or toll-free numbers;
- Road vehicles weighing less than 3,000 kilograms and related fuel; and
- Food, beverages and entertainment.

New Housing Rebate

Under the new tax system, a new housing rebate will be provided. A 75% rebate of Ontario tax will be provided for new homes priced under $400,000. The rebate will be reduced for homes priced between $400,000 and $500,000. No rebate will be allowed for homes priced over $500,000. Resale homes would not be subject to the harmonized tax.

Public Service Body Rebates

Although details were not provided, rebates similar to those allowed under the GST system will be provided and will be designed to ensure the impact of sales tax harmonization will be fiscally neutral for each public service sector.

Small Business Transition Credit

To help reduce the compliance cost of the move to the new system for small businesses, a credit of between $300 and $1,000 will be allowed for the first reporting period after harmonization (a small business will generally be one that has annual taxable revenue of less than $2 million).

Miscellaneous Rules

Ontario will retain a sales tax that will apply on the transfer of private vehicles. In addition, alcohol fees, levies and charges will be increased to make up for the fact that the sales tax on alcohol will fall to 8%.

Rebates for Individuals

To help defray the cost of the conversion to the harmonized sales tax system, the Ontario government will provide rebates to certain taxpayers/families as set out in the chart below. Personal tax returns for 2009 and 2010 must be filed to qualify for the payments, which will be sent directly to taxpayers.

Ontario Sales Tax Transition Benefit

	Single Individuals		Single Parents or Couples	
Month of Payment	Maximum Benefit	Phase Out Range (5% of income)	Maximum Benefit	Phase Out Range (5% of income)
Jun. 2010	$100	$80,000 - $82,000	$330	$160,000-$166,600
Dec. 2010	100	$80,000 - $82,000	$335	$160,000-$166,700
Jun. 2011	100	$80,000 - $82,000	$335	$160,000-$166,700
Total	$300		$1,000	

Personal Tax Changes

Personal Tax Reductions

The budget proposes a personal tax rate cut by decreasing the tax rate on the lowest tax bracket from 6.05% to 5.05%, effective January 1, 2010. With the proposed rate reduction, the calculation of the non-refundable tax credits will be adjusted so that credit amounts will be multiplied by 5.05%. Consequential adjustments will also be made to the calculation of Ontario minimum tax.

Unfortunately, personal tax will be increased for individuals subject to Ontario’s two-tiered surtax. The tax threshold at which the 20% surtax applies will be reduced from $4,257 for 2009 to $3,978 for 2010, and the tax threshold at which the 36% surtax applies will be reduced from $5,370 to $5,091 for 2010.

Dividend Tax Credit Reduced

With proposed reductions to the corporate income tax rates (discussed below), changes will be made to reduce dividend tax credit rates in order to maintain the integration of Ontario’s corporate and personal income tax systems. The dividend tax credit rate on eligible dividends (as a percentage of the taxable amount of dividends) is currently set at 7.4% for 2009 and 7.7% for 2010. Effective January 1, 2010, the rate will be reduced to 6.4%. The dividend tax credit rate for ineligible dividends is currently 5.13% for 2009 and 2010. Effective January 1, 2010, the rate will be reduced to 4.5%.

Sales Tax and Property Tax Relief

To better target tax relief, it is proposed that the current combined sales and property tax credits be replaced with two new tax credits: the Ontario Sales Tax Credit (OSTC) and the Ontario Property Tax Credit (OPTC).

Currently, low to middle income individuals and families receive sales tax relief for sales tax paid in the previous year once their current year income tax return is processed. The budget proposes to provide more timely assistance by introducing a new ongoing sales tax credit with advance payments. The new sales tax credit would be refundable and paid quarterly starting in July 2010, when the new sales tax comes into effect.

The new OSTC would provide up to $260 for each adult and each child. The credit would be reduced by 4% of adjusted family net income over $20,000 for single people and over $25,000 for families. The maximum benefit and thresholds will be indexed for inflation.

The new refundable OPTC for low to middle income homeowners and tenants will maintain existing benefits while extending property tax relief to more individuals. The credit will continue to be based on occupancy costs. It will be provided for occupancy costs up to $250 for non-seniors and $625 for seniors, plus 10% of occupancy costs up to a maximum of $900 for non-seniors and $1,025 for seniors. The credit will be reduced by 2% of adjusted family net income in excess of $20,000 for single individuals and $25,000 for families. The amounts and thresholds will be indexed for inflation. Eligible senior homeowners will continue to receive assistance through the Ontario Senior Homeowners' Property Tax Grant.

Tax-Free Savings Accounts

Beginning January 1, 2009, a new savings plan – the Tax-Free Savings Account (TFSA) – became available to all Canadians. The government has proposed changes related to TFSAs that will allow for beneficiary designations of TFSAs outside of a will, similar to RRSPs. This will allow TFSAs to pass to designated beneficiaries without being subject to probate tax, which will simplify estate matters and reduce costs.

Increased Access to Locked-in Accounts

Amendments have been proposed to enhance access to locked-in funds by increasing the rate of unlocking permitted from 25% to 50% on purchase from new Life Income Funds (LIFs), effective January 1, 2010. It has also been proposed to temporarily waive financial hardship application withdrawal fees for Ontario locked-in accounts for two years, effective for applications approved on or after April 1, 2009.

Corporate Income Tax Changes

Corporate Tax Reform

With increased sales tax revenue, the government was provided with room to significantly reduce corporate income tax and to finally deal with two major corporate tax irritants – the Small Business Deduction Surtax (or clawback) and the Corporate Minimum Tax. These changes are summarized below.

Corporate Income Tax

Corporate income tax rates will be reduced beginning on July 1, 2010. The details are set out in the chart below. In addition to the reduction in tax rates, the Small Business Deduction Surtax will be eliminated with an effective date of July 1, 2010. This will allow incorporated businesses to reinvest corporate profits in excess of the $500,000 small business limit without losing the benefit of the small business deduction. Under the current rules, tax is charged on taxable income in excess of $500,000 at 4.25% until the benefit of the small business deduction has been eliminated. These changes will be prorated for taxation years straddling the effective dates.

Ontario Corporate Income Tax Reductions				
Effective Date	General Rate	M & P Rate	Small Business Rate	Small Business Deduction Surtax
Current	14%	12%	5.5%	4.25%
July 1, 2010	12%	10%	4.5%	Eliminated
July 1, 2011	11.5%	10%	4.5%	Eliminated
July 1, 2012	11%	10%	4.5%	Eliminated
July 1, 2013	10%	10%	4.5%	Eliminated

Corporate Minimum Tax

There was more good news relating to the Corporate Minimum Tax (CMT). First, corporations (or an associated group) with total assets of less than $50 million or total revenue of less than $100 million will no longer be subject to the CMT. In addition, for those corporations that are still subject to the CMT, the CMT rate will be reduced from 4% to 2.7%. Both changes will be effective for taxation years ending after June 30, 2010 (the CMT rate reduction will be prorated for taxation years straddling this date).

Political Tax Credit

With the harmonization of the collection of federal and Ontario corporate income taxes, the Ontario political contribution tax deduction will be converted into a non-refundable tax credit. This change will apply to taxation years ending after 2008.

Other Changes for Business

Ontario Innovation Tax Credit (OITC)

The OITC is a refundable tax credit for small and medium-sized corporations performing eligible scientific research and experimental development in Ontario. The government will parallel the enhancements to the federal Investment Tax Credit announced in the 2009 federal budget, extending the OITC to more corporations. The current taxable income phase-out range of $400,000 to $700,000 will be changed to a phase-out range of $500,000 to $800,000. The effective date of the changes and phase-in rules will parallel the federal amendments.

Ontario Film and Television Tax Credit (OFTTC)

The OFTTC is a refundable tax credit available to qualifying corporations for labour expenditures related to certified domestic film and television productions in Ontario. In 2007, the credit rate was temporarily increased to 35% from 30% effective for the period January 1, 2008 to December 31, 2009. As announced earlier this year, the government will make the enhanced 35% rate permanent.

Ontario Production Services Tax Credit (OPSTC)

The OPSTC is a refundable tax credit available to qualifying corporations for labour expenditures related to qualifying foreign film and television production services and non-certified domestic film and television productions in Ontario. The credit rate was increased to 25% from 18% effective for the period January 1, 2008 to December 31, 2009. The government will make the enhanced 25% rate permanent, as announced earlier this year.

Ontario Interactive Digital Media Tax Credit (OIDMTC)

The OIDMTC is a refundable tax credit available to qualifying corporations for expenditures related to the creation, marketing and distribution of eligible interactive digital media products. The budget proposes the following permanent enhancements to the credit, effective for qualifying expenditures incurred after March 26, 2009:

- The rates will be increased to 40% for qualifying corporations, regardless of size, that develop and market their own eligible products, and to 35% for qualifying corporations that develop eligible products under a fee-for-service arrangement.
- The credit will be expanded to allow corporations to claim 100% of the amount paid to eligible arm's-length contractors that is attributable to the salaries and wages of the contractor's employees.
- The credit will be extended to digital media game developers that incur a minimum $1 million of eligible labour expenditures over a 36-month period for fee-for-service work done in Ontario in respect of an eligible product. Corporations that meet the minimum limit would not be required to be at arm's-length with the purchaser corporation, or to develop all, or substantially all, of the eligible product.

Ontario Computer Animation and Special Effects Tax Credit (OCASETC)

The OCASETC is a refundable tax credit available to qualifying corporations for eligible labour expenditures related to digital animation and special effects in qualifying film and television productions. The following enhancements were announced, effective for qualifying expenditures incurred after March 26, 2009:

- Eligible labour expenditures will be increased from 50% to 100% of amounts paid to arm's-length unincorporated individuals and partnerships providing freelance services.
- Eligible labour expenditures will be expanded to include 100% of amounts paid to arm's-length incorporated individuals providing freelance services. In this case, incorporated individuals cannot claim the credit directly.
- The requirement that an eligible animation or visual effect be created primarily with digital technologies will be relaxed.

Ontario Book Publishing Tax Credit (OBPTC)

The OBPTC is a refundable tax credit available for qualifying expenditures related to publishing and promoting the first three books by a Canadian author in an eligible category of writing. Eligibility will be expanded for qualifying expenditures incurred after March 26, 2009, by eliminating the three book limit and allowing direct expenses that reasonably relate to publishing an electronic version of an eligible book.

Co-operative Education Tax Credit (CETC)

The CETC is a refundable credit available to businesses that employ post-secondary students enrolled in qualifying co-operative education programs at eligible educational institutions. Effective for eligible expenditures incurred after March 26, 2009, the CETC rate will be increased from 10% to 25% and the enhanced 15% rate for small businesses will be increased to 30%. As well, the maximum tax credit will be increased from $1,000 to $3,000 per work placement.

Apprenticeship Training Tax Credit (ATTC)

The ATTC is a refundable tax credit for businesses on the salaries and wages paid to eligible apprentices in designated construction, industrial, motive power and service trades. The ATTC will be made a permanent tax credit and enhancements have been announced, effective for expenditures incurred after March 26, 2009. The ATTC rate will be increased from 25% to 35% and the enhanced 30% rate for small businesses will be increased to 45%. The annual maximum credit will be increased from $5,000 to $10,000. The ATTC will be extended to include salaries and wages paid during the first 48 months (increased from the first 36 months) of an apprenticeship program.

How Ontario Compares

The following chart compares top personal and corporate tax rates and sales taxes for all provinces and territories, as announced to March 26, 2009.

	Top 2009 Personal Rates %	**2009 Corporate Rates**			**Retail Sales Tax %**
		General %	**M&P %**	**Small Business %**	
BC	43.70	30.0	30.0	13.5	7.0
Alta.	39.00	29.0	29.0	14.0	-
Sask.	44.00	31.0	29.0	15.5	5.0
Man.	46.40	32.0 (1)	32.0 (1)	12.0	7.0
Ont.	***46.41***	***33.0***	***31.0***	***16.5***	***8.0***
Qué.	48.22	30.9	30.9	19.0	7.5 (4)
NB	46.00	32.0 (1)	32.0 (1)	16.0	8.0 (5)
NS	48.25	35.0	35.0	16.0	8.0 (5)
PEI	47.37	35.0	35.0	14.2 (2)	10.0 (4)
Nfld.	44.50	33.0	24.0	16.0	8.0 (5)
Yukon	42.40	34.0	21.5	15.0 (3)	-
NWT	43.05	30.5	30.5	15.0	-
Nunavut	40.50	31.0	31.0	15.0	-

(1) The general business and M&P rates will be reduced to 31.0% on July 1, 2009.
(2) The small business rate will be reduced to 13.1% on April 1, 2009.
(3) The tax rate for M&P profits eligible for the small business deduction is 13.5%.
(4) Provincial sales tax applies on GST. Effective combined rate is 12.875% in Québec and 15.5% in PEI.
(5) As part of the HST (combined rate is 13% with GST).