

Ontario Budget Commentary

March 23, 2006

Introduction

Premier Dalton McGuinty's government tabled its third provincial Budget on Thursday, March 23, 2006. The Budget did not contain any significant tax initiatives and focused primarily on investing in Ontario's transportation infrastructure and education and health care initiatives. This Budget stays on track with the government's prior commitment to eliminating the deficit.

The Budget projects an interim deficit of \$1.4 billion for 2005/6, a 75% reduction from the \$5.5 billion deficit of 2003/4. The government reiterated its commitment to balance the budget by 2008/9, at the latest. However, the projected deficit for 2006/7 is \$2.4 billion.

As expected, the Budget contains no new taxes or tax increases. The following summarizes the tax-related measures included in the Budget.

Personal Income Taxes

Enhanced Dividend Tax Credits

In November 2005, the Federal government proposed changes to the taxation of dividend income, including establishing a second dividend tax credit. This change was proposed in response to what was perceived to be a favourable tax treatment accorded to distributions from income trusts.

Essential details of the Federal measures are not yet available. Ontario has indicated that it will review the Federal

legislation introducing this change when it is released and will respond at that time.

Ontario Property and Sales Tax Credits for Seniors

Since their introduction in 1992, the Ontario government has been enriching the refundable Ontario Property and Sales Tax Credits for qualifying seniors. The Budget proposes to again increase the income threshold above the current \$22,250 for senior couples in 2006. The new threshold will be determined when the Federal government finalizes Old Age Security and Guaranteed Income Supplement amounts for 2006. Although the precise amount of the new threshold is not known at this time, it is expected that about 695,000 senior couples would benefit from these credits in 2006.

Corporate Income Taxes

Extending the Carryforward Period for Non-Capital Losses

Ontario is proposing to parallel the Federal government's 2005 measure to increase the carryforward period for non-capital losses from 10 to 20 years. Implementation of this change is dependent upon implementation of the Federal changes.

Accelerated Reduction of the Ontario Capital Tax

In 2004, a plan to eliminate Ontario's capital tax by 2012 was implemented. As part of the government's initiatives to promote new investment, economic



growth, and job creation, the Budget proposes to accelerate the capital tax rate cut. Effective January 1, 2007, every corporation still subject to the capital tax would have its rate cut by 5%. The intention is now to eliminate the capital tax by 2010, two years earlier than originally announced, subject to favourable fiscal conditions.

The new reduction/elimination schedule is:

Effective January 1, 2007, the capital tax deduction increases to \$12.5 million, and the rate decreases to .285% for regular corporations. Effective January 1, 2008, the capital tax deduction increases to \$15 million for all years up to the year of its elimination. The rate will decrease to .225% in 2009. If economic conditions prevent the elimination of this tax in 2010, the rate will decrease to .15% in 2010, .075% in 2011 and nil in 2012.

Enhancing the Ontario Production Services Tax Credit

The Ontario Production Services Tax Credit is available to Ontario-based corporations for both foreign-based and domestic productions not claimed under the Ontario Film and Television Tax Credit program. This credit was temporarily increased from 11% to 18% in 2005. The Budget proposes to extend this increased rate until March 31, 2007.

Expanding the Ontario Interactive Digital Media Tax Credits

The Ontario Interactive Digital Media Tax Credit is a 20% refundable tax credit for eligible expenditures incurred

by qualifying corporations whose annual gross revenues do not exceed \$20 million, and whose total assets do not exceed \$10 million. This credit is to be increased to 30%. This measure is intended to assist smaller multimedia companies in the development and marketing of interactive digital media products.

Expanded eligibility is also proposed. A 20% credit will be made available to multimedia developers who exceed the size test described above and to fee-for-service work done in Ontario. The amount of the credit available for fee-for-service work will be based on the salaries and wages incurred in Ontario by a corporation that develops all or substantially all of an eligible product under contract with an arm's length party.

Both these measures are effective for expenditures incurred after March 23, 2006 and before 2010.

Expenses Relating to Issuing Shares, Options, and Other Interests

Ontario proposes to parallel proposed Federal legislation that would limit the expenses that a taxpayer can deduct in respect of certain transactions, such as the issuance of shares, to the amount of the cash outlay incurred.

Corporate Tax Collection Agreement

In 2004, the Federal and Ontario governments agreed to explore collaborative means of delivering public services. As a result, a process for the integration of the collection and



processing systems for the two governments' respective taxes was commenced. Legislation will be introduced which, if enacted, would authorize Ontario to enter into a corporate income tax collection agreement with the Federal government. This legislation would permit an early integration of Federal and Ontario tax audits enabling the Canada Revenue Agency to audit Ontario's corporate taxes for taxation years ending before the commencement of a corporate tax collection agreement.

Retail Sales Tax

Retail Sales Tax Rebate on Hybrid Vehicles

The maximum Retail Sales Tax rebate for qualifying hybrid electric vehicles will be doubled from \$1,000 to \$2,000 for vehicles delivered to purchasers after March 23, 2006. These rebates are scheduled to be eliminated on March 31, 2012, subject to discussions with relevant stakeholders on the rebate's effectiveness.

The maximum rebate for alternative fuel vehicles, other than hybrid vehicles, remains unchanged.

Clearance Certificates

Clearance certificates are required when assets are sold in the course of a sale of a business to which the Bulk Sales Act applies. The certificate is intended to evidence that taxes payable or collectable by the seller have been paid. The Budget proposes to amend the clearance certificate process to ensure

that outstanding taxes may be collected from vendors after a certificate has been issued. This would not affect the protection provided to a purchaser that has obtained a certificate.

Donations of Admission Tickets

Currently, tickets donated by owners or operators of places of amusement to registered charities are exempt from Retail Sales Tax. The Budget proposes to extend this exemption to include complimentary tickets donated after March 23, 2006 to community colleges, schools, universities and other not-for-profit organizations.

Retail Sales Tax Exemption for Destination Marketing Fees

The temporary Retail Sales Tax exemption on destination marketing fees has been extended for an additional year. Destination marketing fees billed on or before June 30, 2007, will qualify for exemption from the 5% Retail Sales Tax on accommodations.

Retail Sales Tax on Computer-Program Related Services

A pilot program to simplify the Retail Sales Tax calculation for small businesses providing computer related services will commence on April 1, 2006.

Land Transfer Tax

The Land Transfer Tax Act permits the deferral and cancellation of tax for unregistered transfers of land between affiliated corporations, unless a transfer



is registered. Court interpretations of these provisions have resulted in certain transfers being viewed as exempt even though they are registered. Proposed amendments to the Land Transfer Tax Act will reconfirm the original intention of this exempting provision.

These amendments include clarification to the term “affiliate”, and specify that the deferred tax would become payable if a document is registered during the deferral period. In addition, if a document is registered after the deferred tax is cancelled, land transfer tax would be payable on the registration based on the earlier, unregistered transfer.

Gasoline Tax Act

Ontario has proposed to remove the exclusion of ethanol from the definition of “gasoline” under the Gasoline Tax Act. Ethanol would then be subject to the same tax treatment as gasoline. This change takes effect January 1, 2007, to coincide with the implementation of the Renewable Fuels Standard provision requiring an average 5% ethanol content in gasoline.

Other Measures

- The Budget confirmed that, as previously announced, the tax credit available on the purchase of Labour-Sponsored Investment Funds will be phased out. Credits will no longer be available on purchases of shares of these funds after the end of the 2010 taxation year.

- The Budget proposes to apply the income tax restriction on deducting fines and penalties to the computation of tax payable under the Mining Tax Act. This measure is effective for fines and penalties imposed after March 23, 2006.
- Amendments will be proposed to the Tobacco Tax Act to strengthen Ontario’s tobacco-related enforcement activities, including expanded information sharing between municipal, provincial and federal counterparts.
- The Federal government has stated its intention to permit a tax deferral on certain patronage dividends received by members of Agricultural Cooperative Corporations. Ontario intends to parallel this deferral plan if the Federal proposals are implemented.
- Ontario also intends to parallel Federal proposals to provide favourable, enhanced capital cost allowance to businesses that invest in “black liquor”. It is a byproduct of the paper-making process and is Canada’s second largest energy source.

