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2008 Ontario Budget Commentary

March 25, 2008

INTRODUCTION

Finance Minister Dwight Duncan today delivered Ontario's 2008 Budget. There were no new personal or corporate income taxes announced in the Budget.

The Budget is projecting a surplus of \$600 million for the 2007-08 fiscal year. The majority of surplus funds are to be used for funding skills training and municipal infrastructure. There is also a provision for full-time university and college students to receive a "Textbook and Technology Grant". The grant will start this fall at \$150 per student and will increase to \$225 in 2009 and \$300 in 2010 and future years.

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

PERSONAL TAXES

Tax Rates

The Budget proposes no changes to personal income tax rates.

Tax Treatment of Dividends

Changes were announced in the 2008 Federal Budget to the taxation of eligible dividends. These changes reduce the gross-up applying to eligible dividends commencing in 2010. This Budget proposes to maintain the previously announced increases to the Ontario dividend tax credit rate on grossed-up eligible dividends to 7.4% in 2009 and 7.7% in 2010 and subsequent years.

Combining the Federal and Ontario changes, top marginal rates for eligible dividends in Ontario are as follows:

Year	Federal	Ontario	Total
2008	14.6%	9.4%	24.0%
2009	14.6	8.5	23.1
2010	15.9	7.8	23.7
2011	17.7	7.6	25.3
2012	19.3	7.4	26.7

Tax-Free Savings Account

The 2008 Federal Budget introduced a Tax-Free Savings Account (TFSA), effective for 2009. Under this proposal, individuals will be able to contribute up to \$5,000 annually to a TFSA and investment income and capital gains earned on these funds will be tax-free. Contributions will not be tax deductible and withdrawals will be tax-free. Unused contribution limit carries forward and the contribution limit is re-established when withdrawals are made. Ontario will automatically adopt the Federal proposal on Royal Assent of the enabling Federal legislation.

Property and Sales Tax Credits and Grants for Seniors

The Budget introduces a property tax grant for low and moderate income seniors who own their own homes, effective for 2009 and subsequent years. This grant is in addition to the current refundable property tax credit. The maximum grant will be \$250 for 2009 and \$500 thereafter. The grant application will be part of income tax returns. For single seniors, the full grant will be available where income is \$35,000 or less and property taxes are at least \$500. A reduced grant will be available for income between \$35,000 and \$50,000 and totally eliminated where income exceeds \$50,000. For married taxpayers, the thresholds are \$45,000 and \$60,000 of combined income.

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 threshold for 2008 for senior couples over the current \$23,820. The increased income threshold will be set so that those receiving the guaranteed minimum level of income from governments will not have their credit reduced. The threshold will be determined once the Federal government finalizes Old Age Security and Guaranteed Income Supplement amounts for 2008.

CORPORATE TAXES

Tax Rates

The Budget proposes no changes to corporate income tax rates.

Tax Exemption for Commercialization

The Budget proposes a 10-year corporate income and minimum tax holiday for new corporations that commercialize intellectual property developed by qualifying Canadian colleges, universities and research institutes. New corporations will be those established after March 24, 2008 and before March 25, 2012 that are incorporated in Canada and derive all or substantially all of their income from eligible commercialization activities carried on in Ontario. Such activities will include the development of prototypes and the marketing and manufacturing of products related to the intellectual property. It is intended that the tax holiday apply to what are considered priority areas such as bio-economy/clean technologies, advanced health technologies and telecommunications, computer and digital technologies.

This proposal exempts the corporation only from Ontario corporate tax. It is hoped that the Federal government will parallel this proposal.

Reduction and Elimination of the Ontario Capital Tax

A plan to eliminate Ontario's capital tax by 2012 was implemented in 2004. The 2007 Ontario Budget announced the elimination of the capital tax effective July 1, 2010. As previously implemented, the capital deduction was increased to \$12.5 million from \$10 million January 1, 2007 and to \$15 million January 1, 2008. No further changes to the capital deduction are proposed by this Budget. The capital tax rate was previously reduced to .285% from .3% January 1, 2007, to .225% January 1, 2009, to .15% effective January 1, 2010 and to nil J

July 1, 2010. The Budget confirms the announcement in the 2007 Economic Outlook and Fiscal Review of a reduction in the capital tax rate to .225% retroactive to January 1, 2007, two years earlier than originally intended. The rate and capital deduction are prorated for taxation years straddling these effective dates. Where a corporation's tax return was filed and assessed using the higher rate, a reassessment reducing the capital tax should be automatically generated.

The 2007 Economic Outlook and Fiscal Review announced the elimination of the capital tax for manufacturing and resource activities, effective January 1, 2008. The Budget not only confirms this measure but also announces that the elimination will be retroactive to January 1, 2007. For taxation years straddling January 1, 2007, the elimination will be pro-rated.

There will be complete elimination of the capital tax for corporations for which salaries and wages relating to manufacturing and processing, mining, logging, farming or fishing activities in Ontario represent at least 50% of their total salaries and wages in Ontario. Where such salaries and wages are more than 20% but less than 50% of total Ontario salaries and wages, there will be a proportionate reduction as opposed to full elimination of the capital tax.

The elimination for 2007 applies if the corporation or a successor has employees reporting to a permanent establishment in Ontario on March 25, 2008. Where a corporation's tax return was filed and assessed without reflecting the elimination, a reassessment may or may not be automatically generated, depending on the corporation's particular situation. Procedures for claiming a capital tax refund have not yet been determined.

Enhancement of the Ontario Innovation Tax Credit

The Ontario Innovation Tax Credit (OITC) is a refundable 10% tax credit on qualifying scientific research and experimental development expenditures incurred in Ontario and is available to small and medium-sized corporations. The Budget proposes to enhance the credit by paralleling changes made in the 2008 Federal Budget.

The expenditure limit for expenditures qualifying for the OITC will be increased to \$3 million from \$2 million. The OITC is currently subject to a graduated phase-out where taxable income exceeds \$400,000 and is fully eliminated at \$600,000 of taxable income. The Budget proposes to increase the upper threshold to \$700,000 of taxable income.

It is intended that the effective date of these changes parallel that of the Federal amendments. The Federal amendments are generally proposed to be effective for taxation years ending on or after February 26, 2008 with pro-rations for taxation years that straddle that date.

Enhancement of the Ontario Interactive Digital Media Tax Credit

The Ontario Interactive Digital Media Tax Credit is a refundable credit available to corporations engaging in the creation, marketing and distribution of interactive digital media products in Ontario. The credit is 30% of qualifying expenditures for smaller corporations that develop and market their own products and 20% for larger corporations. The 30% rate for smaller corporations was to end on December 31, 2009.

The Budget proposes to extend the smaller corporation 30% rate to qualifying expenditures incurred before January 1, 2012. For larger corporations, the credit rate will be increased to 25% for fee-for-service work qualifying expenditures incurred after March 25, 2008 and before January 1, 2012. Currently, eligible labour expenditures must be incurred within a two-year period ending with completion of product development. The Budget proposes to extend this to a three-year period for products completed after March 25, 2008.

CONCORDANCE WITH FEDERAL MEASURES

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

- Accelerated capital cost allowance for certain manufacturing and processing equipment;
- Expanded eligibility for enhanced capital cost allowance on clean energy generation assets;
- Capital cost allowance rate changes for carbon dioxide pipelines, and related pumping and compression equipment;
- Increased capital cost allowance rates for railway locomotives;
- Changes to Registered Education Savings Plans;
- Increases to the Northern Residents Deduction;
- Expansion of the list of qualifying medical expenses for individual taxpayers;
- Nil capital gains inclusion rate on the donation of securities to private foundations and of certain non-traded securities to all registered charities;
- Quarterly tax instalments for small corporations; and
- Increases to corporate tax instalment thresholds.

RETAIL SALES TAX (RST)

Exemption for Newspapers

The Budget confirms the announcement in December 2007 to extend the RST exemption on newspapers, retroactively to January 1, 2000, to publications with smaller circulation or less frequent publishing schedules, such as community and ethnic newspapers.

Destination Marketing Fees

The current exemption from RST for destination marketing fees is extended by the Budget to fees billed on or before June 30, 2010. This exemption was to have expired June 30, 2008.

Live Theatre Admissions

There is currently a temporary exemption from RST on admissions to live theatres of not more than 3,200 seats that present live performances. The Budget proposes to make this exemption permanent effective April 1, 2008.

Exemption for Energy Star Items

The temporary exemption from RST for qualifying purchases of new Energy Star household appliances and light bulbs was scheduled to expire July 19, 2008. The Budget proposes to extend the exemption to qualifying appliances purchased, rented or leased on or before August 31, 2009 and delivered on or before September 30, 2009 and qualifying light bulbs purchased on or before August 31, 2009.

Exemption for Bicycles and Related Safety Equipment

Purchases of new or used bicycles costing \$1,000 or less as well as related safety equipment such as helmets are eligible for a RST exemption that was scheduled to expire November 30, 2008. The Budget proposes to extend the exemption to purchases made on or before December 31, 2010.

Exemption for Nicotine Replacement Therapies

There is currently a temporary exemption from RST for qualifying purchases of non-prescription nicotine replacement therapies which was to expire on August 12, 2008. The Budget proposes to make this exemption permanent.

Containers, Packaging and Shipping Items

In response to a recent court decision, the Budget proposes to amend the Retail Sales Tax Act, with effect from May 7, 1997, to confirm that RST applies on purchases of containers, packaging, storage and shipping items that are intended to be returned for reuse. The amendment will also confirm that RST is applicable on purchases of containers and other items that are provided as a promotional distribution.

PROPERTY TAXES

The 2007 Budget announced reductions in the Business Education Tax over the seven-year period 2008 to 2014. The Budget proposes to accelerate the reduction for certain northern areas so that the full reduction is realized by 2010.

The 2007 Budget introduced a four-year reassessment cycle and mandatory phase-in of assessment increases for residential properties. The Budget extends this regime to all property classes, including commercial, industrial and multi-residential.

A review will be conducted of the property tax treatment of long-term care homes to clarify eligibility of their exemption.

TOBACCO TAX ACT

The Budget introduces the following measures to strengthen enforcement against the illegal manufacture and distribution of tobacco products:

- Require purchasers or importers of cigarette-making machinery to be registered as manufacturers under the Act;
- Increase abilities to seize tobacco products from persons found in violation of the Act; and
- Add minimum penalties to existing tax-based penalties for persons found to be in violation of the Act.

LAND TRANSFER TAX

Family Transfers of Farm Property

Currently, transfers of qualifying farmland between family members and to family farm corporations are exempt from land transfer tax. The Budget proposes to extend the exemption to transfers of farmland from family farm corporations to individual family members effective for transfers after March 25, 2008.