

**Ontario
Budget
Commentary**

May 18, 2004

INTRODUCTION

Ontario Finance Minister Greg Sorbara delivered his first Budget on May 18, 2004. As widely expected, health care was a major focus of the Budget and the result is the re-introduction of health care premiums. Unlike the previous system, the health care premiums will now be imposed under the personal income tax system.

Numerous other tax changes are proposed to assist the Government in its attempt to address the current deficit.

PERSONAL TAX MEASURES Ontario Health Premium

The Budget proposes the introduction of a new health care premium commencing in the 2004 taxation year. Individuals whose taxable income is less than \$20,000 will be exempt from this premium cost.

The applicable taxable income levels and maximum associated premium costs are as follows:

<u>Taxable Income</u>	<u>2004</u>	<u>2005</u>
\$20,000 to \$36,000	\$150	\$300
\$36,000 to \$48,000	\$225	\$450
\$48,000 to \$72,000	\$300	\$600
\$72,000 to \$200,000	\$375	\$750
more than \$200,000	\$450	\$900

Since the first premium level would be phased in at six per cent of taxable income over \$20,000, the full premium for this level will be payable at taxable income of \$25,000. For the second and subsequent premium levels, the full premium will be payable based on 25 per cent of the first \$600 in that range.

Consequently, the full premiums would be payable for each applicable premium level at taxable incomes of \$36,600, \$48,600, \$72,600 and \$200,600 respectively.

This new health care premium applies to individuals who are residents of Ontario on the last day of the taxation year. Trusts would be exempt from the premium. The taxable income reported in the final Ontario tax return will be utilized for individuals who die or emigrate from Canada during the year.

Source deduction withholdings with respect to this premium will commence July 1, 2004. Individuals who make income tax instalment payments should include the applicable premium cost in their total tax cost in determining the applicable amount of quarterly tax instalment payments. The actual premium cost will be determined in the individual's annual income tax return.

Enrichment of Property Tax Credit

The underlying basic property tax credit amount for lower income seniors will be increased from \$500 to \$625 commencing with the 2004 taxation year. Consequently, the maximum benefit available for the property and sales tax credits for seniors will be increased from \$1,000 to \$1,125.

Ontario Tax Reduction

The Ontario tax reduction for lower income taxpayers is being amended, for the 2004 and subsequent taxation years, so that this tax reduction is calculated before claiming foreign tax credits.

Ontario Home Ownership Savings Plan

No new plans will be registered and no new contributions to existing plans will be eligible for the program after May 18, 2004. Existing plans are available for home purchases until December 31, 2005. In addition, the withdrawal of funds from existing plans after 2005 will not be subject to recovery of tax credits or penalties.

Ontario Research Employee Stock Option Credit and Employer Health Tax

Individuals will not be able to claim this tax credit after December 31, 2004 on stock option benefits or capital gains arising from eligible options. In addition, all stock option benefits arising on or after May 18, 2004 will be subject to EHT.

Personal Tax Rates

The Budget proposed no changes to personal tax rates. However, in November 2003, it was announced that personal tax rates would remain at 2003 levels.

CORPORATE TAX MEASURES

Income Tax Rates

The Budget left corporate income tax rates unchanged. However, in November 2003, the new government proposed in the Fiscal Responsibility Act that the rates effective January 1, 2004, would be as follows:

Small Business Tax Rate	General Corporate Tax Rate	Rate for M&P, Farming, Fishing, Mining, Logging
5.5 %	14.0 %	12.0 %

The same Act accelerated to \$400,000 the threshold for income eligible for the small business rate, also effective January 1, 2004.

Capital Cost Allowance (CCA) Enhancements

The Budget proposes to parallel the CCA changes announced in the 2004 Federal budget. Those changes are to increase the CCA rate from 30% to 45% for computer equipment, and an increase from 20% to 30% for data network infrastructure equipment. These changes are effective for acquisitions after March 22, 2004.

Capital Tax

It had been the prior government's intention to eliminate capital tax by 2008, although no schedule had been determined. The current Budget contains a timetable for both the elimination of capital tax by January 1, 2012, and a gradual reduction in rates until then.

The tables on the next page set out the government's proposed plan to eliminate the capital tax:

Regular Corporations		
	Deduction (\$Millions)	Rate (%)
Current	5	0.300
January 1, 2005	7.5	0.300
January 1, 2006	10.0	0.300
January 1, 2007	12.5	0.300
January 1, 2008	15	0.300
January 1, 2009	15	0.225
January 1, 2010	15	0.150
January 1, 2011	15	0.075
January 1, 2012	Eliminated	

Financial Institutions			
	First \$400 Million of Taxable Capital (%)	Taxable Capital Above \$400 Million	
		Non-Deposit Taking (%)	Deposit Taking (%)
Current	0.600	0.720	0.900
January 1, 2005	0.600	0.720	0.900
January 1, 2006	0.600	0.720	0.900
January 1, 2007	0.600	0.720	0.900
January 1, 2008	0.600	0.720	0.900
January 1, 2009	0.450	0.540	0.675
January 1, 2010	0.300	0.360	0.450
January 1, 2011	0.150	0.180	0.225
January 1, 2012	Eliminated		

Although the capital tax is proposed to be eliminated by 2012, the government wants to protect the current capital tax base. Therefore, amendments are proposed to the definition of "current accounts payable" in response to a recent court decision. Effective for taxation years ending after today's Budget, the definition would be amended to confirm that it applies only to amounts payable to the supplier for purchases of goods and services and not amounts owed to a creditor (e.g., a finance company).

The proposal would also clarify that liabilities incurred in connection with the purchase or trading of shares, bonds or other securities are not considered

current accounts payable and are therefore included in taxable capital. This measure is effective for taxation years ending after May 19, 1993.

Employer Health Tax (EHT)

The government announced its intention to appeal the April 27, 2004 judgment of the Ontario Superior Court of Justice that ruled that Ontario-based professional sports teams should not pay EHT with respect to the portion of salaries paid for games played outside Ontario. For greater certainty, it is proposed, retroactive to January 1, 1990, that EHT be payable on all remuneration in cases where a person reports to a permanent establishment in Ontario.

The definition of remuneration for purposes of EHT is being clarified to ensure that it continues to include all taxable benefits and allowances received by an individual pursuant to sections 5, 6 or 7 of the Income Tax Act. This measure is also retroactive to January 1, 1990.

The Budget proposes to simplify the process for paying EHT. Currently, instalment payments for a particular month are required on the 15th of that month, using an estimate based on the prior month's payroll. Instead, payments will be made on the 15th day of the following month based on the actual payroll for that prior month. This proposal will be effective January 1, 2005. Therefore, the first instalment for 2005 will be due February 15, 2005, based on January 2005 payroll.

Penalties for late-filed EHT returns will be increased to be consistent with late-filing penalties under the Corporations Tax Act. The increases will apply for taxation years ending after May 18, 2004.

Apprenticeship Training Tax Credit (ATTC)

The Budget introduces the ATTC, which is intended to encourage the hiring of apprentices in targeted skilled trades. Construction, motive power, industrial and services trades are included. Qualifying service trades are those eligible under the apprenticeship component of the Co-operative Education Tax Credit. Both corporations and unincorporated businesses will be eligible for a 25 per cent refundable tax credit on eligible expenses incurred with respect to eligible apprentices. The rate will be 30 per cent for businesses with total payroll of \$400,000 or less.

The credit is capped at \$5,000 per year per eligible apprentice to a maximum of \$15,000 over the first 36 months of apprenticeship. The \$5,000 maximum annual credit will be pro-rated for the number of days that the apprentice is employed with that employer during the year.

Eligible apprentices are those in their first 36 months of an apprenticeship training program in a qualified skilled trade on or after May 19, 2004 and who have commenced employment before January 1, 2008. Eligible expenditures are salaries and wages paid to an eligible apprentice after May 18, 2004 and

before January 1, 2011. The government intends to consult with interested parties prior to December 31, 2007 to determine whether or not the ATTC should be extended.

Co-operative Education Tax Credit (CETC)

The CETC is a refundable tax credit to employers on salaries and wages paid to students and apprentices in qualifying work placements. Certain changes are proposed to the CETC, consequential on the introduction of the Apprenticeship Training Tax Credit.

The CETC will continue to be available for qualifying co-op placements which are not apprenticeships. There will be transitional rules for apprenticeships where the first 36 months straddle May 18, 2004. Essentially, salaries paid before May 19, 2004 will qualify for the CETC and those after will qualify for the ATTC.

For apprenticeships not in their first 36 months and for certain work placements in non co-op approved fields of study, no credit will be available for salaries and wages paid after December 31, 2004. Such employment commencing after October 25, 2004 will not qualify.

Ontario Film and Television Tax Credit (OFTTC)

Ontario-based, Canadian-controlled production companies are currently eligible for a 20 per cent refundable tax credit on Ontario labour expenditures for film and television productions. The Budget proposes to enhance this credit.

Qualifying labour expenditures will no longer be reduced by equity investments from Canadian government film agencies, effective for productions commencing principal photography after March 27, 2003.

Qualifying labour expenditures will now be able to be incurred as early as two years before the commencement of principal photography. In addition, a production will no longer be disqualified where a person other than the production company holds an interest therein, unless the production or investors are associated with a tax shelter. These changes parallel federal changes introduced November 14, 2003 and are effective on the same dates, generally November 14, 2003.

Other Credits

The Budget proposes to eliminate the Workplace Accessibility Tax Incentive, the Workplace Child Care Tax Incentive and the Graduate Transitions Tax Credit (GTTC) for expenditures made after December 31, 2004. For the GTTC, employment must commence on or before July 5, 2004 to qualify.

Donations, sales or licences after December 31, 2004 will not qualify for the Educational Technology Tax Incentive. For licences granted before January 1, 2005, no amount is available for deduction or credit after December 31, 2004.

Resource Allowance

For Federal purposes, the 25 per cent resource allowance was replaced by a

deduction for Crown royalties and mining taxes paid. These measures are effective for taxation years ending after December 31, 2002. Ontario will not adopt these measures, but rather will retain the 25 per cent resource allowance and will reinstate the non-deductibility of crown royalties and mining taxes retroactive to the introduction of the Federal changes.

OTHER MEASURES

Federal Concordance

Ontario will implement measures to parallel the following measures introduced in the Federal budget of March 23, 2004:

- Increasing the carry forward period for non-capital losses from seven to ten years.
- Limiting the deductibility of fines and penalties, patronage dividends and unused charitable donations.
- Amending the general anti-avoidance rule and the affiliated persons rules.
- It is also proposed that the associated corporations rule for the purposes of the \$2 million expenditure limit relating to the refundable portion of the federal investment tax credit for qualifying scientific research and experimental development expenditures would also apply to the Ontario Innovation Tax Credit.

Ontario Commercialization Investment Funds (OCIF)

Ontario Commercialization Investment Funds would be established to raise capital from institutional, corporate, and accredited investors for purposes of making capital available to eligible publicly funded research institutes for the commercialization of intellectual property derived from scientific research. An OCIF must be sponsored by a research institute that qualifies under the Ontario Business-Research Institute Tax Credit. Such institutions include universities, colleges of applied arts and technology, Centres of Excellence and hospital research institutes in Ontario. Each institute would be permitted to sponsor only one OCIF. Certain other conditions must be satisfied in order to qualify.

Each investor would be required to purchase at least \$25,000. A grant equal to 30 per cent of eligible investments made in a year, to the extent that the investments are supported by new capital raised by the OCIF, would be provided to the OCIF after it invests in seed-stage businesses whose primary asset is intellectual property. The grant would be payable once a year upon application by the OCIF.

The grants would support up to \$30 million of capital raised by OCIFs per year if that capital is fully invested in eligible investments. Restrictions would be placed on the number of registrations of capitalized OCIFs per year and on the annual amount of grant available to each OCIF.

Registration of new OCIFs will be allowed until the end of 2006; no new grants will be available after 2008.

An OCIF will not be permitted to pay dividends or redeem any shares within four years after issuance of its shares.

Labour Sponsored Investment Funds (LSIF)

The LSIF program has been operating since 1991. As a result of their growth, the capital available to LSIFs is spread among too many LSIFs and many of the existing funds are too small to be viable long-term investors.

Accordingly, the province is implementing a moratorium on new LSIF registrations as of the date of this Budget. Existing LSIFs will be permitted to continue operations and raise capital while consultations are undertaken to determine appropriate changes to the program.

Certain changes are being suggested to the existing program, such as:

- Introducing rules to permit the amalgamation of LSIFs through asset purchases.
- Amending the investment requirements that LSIFs must offset 70 per cent of realized losses deducted from investment requirements with a maximum of 70 per cent of realized gains.
- LSIFs will be permitted to invest up to 25 per cent of their investments in a year in publicly listed companies,

based on the greater of either their current or previous years' investments.

- LSIFs will also be allowed to control investee companies, be permitted to choose either August 31 or December 31 as the date on which their investment requirement would be determined (for research oriented investment funds only), change the calculation of the provincial LSIF tax credit to conform to the federal methodology, and will not be required to count investments in holding companies against their investment requirements.

Waiver Provisions

Legislative provisions currently exist under the Corporations Tax Act and Employer Health Tax Act to codify the Minister of Finance's policy of accepting waivers from taxpayers in instances where the period for taxes owing is about to become statute-barred. To ensure consistency in the acceptance of waivers, amendments will be made to the Fuel Tax Act, Gasoline Tax Act, Land Transfer Tax Act, Retail Sales Tax Act and Tobacco Tax Act.

Dissolution of Corporate Charters for Unpaid Tax Debts

The Business Corporations Act will be amended to allow for the dissolution of corporations and the withholding of clearance certificates for revivals, transfers of assets or dissolutions where tax debts are owed to the Minister of Finance. The proposed amendments will apply to the Employer Health Tax Act,

Fuel Tax Act, Gasoline Tax Act, Land Transfer Tax Act, Retail Sales Tax Act and Tobacco Tax Act.

Returns and Payments by Alternative Channels

Amendments will be proposed to ensure that electronic services can be accommodated across all statutes. The Ministry of Finance will implement an automated online service system to expedite gasoline tax refunds to reserve gasoline retailers for tax-exempt sales to First Nations individuals.

RETAIL SALES TAX (RST)

Exemption For Destination Marketing Fees

A temporary exemption from the 5% RST accommodations tax will apply to Destination Marketing Fees billed after May 18, 2004 and before May 19, 2005.

Rebate For Residential Renewable Energy Systems

The renewable energy RST rebate will be extended to include wind energy systems, micro-hydroelectric systems and geothermal heating cooling systems for residential premises. The rebate is available for purchases made after March 27, 2003 and before November 26, 2007.

Transfer of Assets Between Related Corporations and Partnerships

In the fall of this year, the Ministry of Finance will release draft regulations to modernize the rules for the RST exempt transfer of assets between related

corporations as well as between partnerships and their principals. This measure will be effective on the release date of the draft regulations.

Elimination of the RST Rebate for Vehicles Used to Transport Persons with Permanent Physical Disabilities

Effective for purchases on or after May 19, 2004, the rebate of RST paid on motor vehicles to transport persons with physical disabilities is eliminated. Rebates remain available on purchases and leases of qualifying vehicles entered into before May 19, 2004 provided delivery takes place on or before July 31, 2004.

The RST exemption on related equipment (e.g., disabled hand controls, wheelchair lifts, ramps and tie-downs) installed in vehicles will remain in place.

To compensate for the loss of this rebate, funding for the Home and Vehicle Modification Program administered by the Ministry of Community Services will be increased by \$10 million per year. This additional funding exceeds the \$8 million in savings the current rebate is estimated to provide.

Purchase Exemption Certificates (PECs)

The government proposes changes to simplify the use of RST PECs. These changes are designed to reduce red tape and compliance costs for vendors and taxpayers when claiming an exemption from RST on purchases. PECs will no longer require a signature, a list of exempt items or an expiry date. As well,

farmers would be allowed to use farm association identification cards in lieu of PECs.

Tobacco Taxes

Effective May 19, 2004 taxes on cigarettes will increase by 11.1 cents per cigarette. Similar tax increases will be imposed on other tobacco products.

Taxes on Spirits, Wine and Beer

The volume levy applied to spirits, wine and coolers is increased for purchases made on or after June 21, 2004. This increase will be 25 cents per litre bottle of spirits, 12 cents per litre bottle of wine and 9 cents per litre of coolers. The brewers' basic fee will increase by 4.5 cents per litre of beer. Similar fee increases will be imposed on microbreweries and brew pubs.

PROPERTY TAXES

The Budget proposed the following changes to the property tax system:

- Legislation to implement a new assessment cycle for the 2006 and subsequent taxation years will be introduced. This new cycle will result in reassessments being based on property values as of January 1 of the preceding year, which is six months earlier than the current valuation date of June 30. This change is intended to provide additional time to for the Municipal Property Assessment Corporation to prepare assessments and taxpayers additional time to review such assessments.

In order to facilitate the transition to this new assessment date, it is proposed that the reassessment that would have been conducted for 2005 will be cancelled. Property assessments for the 2005 taxation year would be based on valuations undertaken on June 30, 2003, the valuation base for the 2004 year. Annual assessments will be undertaken thereafter.

- Legislation deferring the implementation of assessment averaging will be introduced. Assessment averaging was introduced in the property tax reform legislation enacted in 1997 and was intended to commence in 2005. The government plans to undertake consultation and analysis of alternative assessment stabilization measures for residential and business properties for 2006 and subsequent taxation years.
- When current value assessment was implemented in 1998, a capping mechanism was introduced that required municipalities to limit annual assessment-related tax increases on affected properties to five per cent of the previous year's taxes. Proposed legislation will provide municipalities with a range of options to modify this capping

program in order to increase progress towards the full implementation of the current value assessment mechanism. These proposals, which are intended to be available for 2005 and subsequent taxation years, would permit municipalities the option of phasing in current value assessment in several ways.

- Starting in 2005, regulations relating to conservation and ecologically sensitive land, and the property tax exemption system relating thereto, will be amended to enhance the eligibility criteria for the conservation land property tax exemption program for lands with natural and environmental significance owned by conservation authorities and conservation land trusts.
- A new financing device will be available to help municipalities provide support for the cleanup of "brownfield" sites.
- Consultation with northern communities will be undertaken in 2004-2005 to determine the best way to implement improvements to the provincial land tax.

NOTICE TO READERS

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The ICAO wishes to gratefully acknowledge the contribution of those listed below in the preparation of this Ontario Budget commentary.

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