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On March 26, 2009, the Honourable Dwight Duncan, the Liberal Minister of Finance, delivered the government's 2009 Ontario Budget. While there has already been considerable backlash from the public over the proposed move to a single, value-added sales tax, many corporations will benefit from the measure. In addition, the Budget included both corporate and personal income tax measures. If these changes are passed, the owner-managed business will need to reconsider whether or not bonusing down taxable income to the small business deduction limit is the most tax efficient strategy.

Sales Tax Reform

The 2009 Ontario Budget proposes comprehensive changes, commencing July 1, 2010, to the Ontario Sales Tax collection system by harmonizing the Ontario Retail Sales Tax (RST) with the Federal Goods and Services Tax (GST). The Harmonized Sales Tax (HST) will apply at a rate of 13% (5% Federal plus 8% Ontario) to goods and services currently subject to the GST. The new measures include a proposed exemption of the 8% portion of the HST for books, children's clothing and footwear, diapers, children's car seats and car boosters seats, and feminine hygiene products. These items were previously exempt from RST.

HST housing rebates will be available for newly constructed homes under \$400,000 with proportional rebates for new homes valued between \$400,000 and \$500,000.

The Harmonized Sales Tax will mean that consumers will now pay HST on most goods and services purchased in Ontario; however, businesses selling taxable or zero-rated goods and services will be entitled to claim an Investment Tax Credit (ITC) (i.e. a refund) equal to the 13% HST paid in the course of their commercial activities. The HST ITC process will be identical to the current system in place for GST.

Small Business Transition Credit

To assist with the changes to point-of-sale and accounting systems, the 2009 Ontario Budget proposes to make a "one-time" transitional credit available to businesses with less than \$2 million in annual revenues from taxable sales. The credit, of up to \$1,000, will be based on the total taxable revenues in the first fiscal quarter commencing after June 30, 2010.

Ontario Sales Tax Transition Benefit

Single individuals, aged 18 and over, living in Ontario, with net income of less than \$80,000 and who file a tax return will be eligible for a \$300 benefit. The benefit will be paid in three \$100 amounts in June 2010, December 2010 and June 2011. The benefit will be phased-out when an individual has income between \$80,000 and \$82,000.

Families, including single parents, will be entitled to a maximum benefit of \$1,000 where family net income is less than \$160,000. Again, to be eligible, an Ontario tax return must be filed in 2009 and 2010. The benefit will be payable in three installments and will be phased-out when a family's income is between \$160,000 and \$166,700.

Additional information concerning the new sales tax harmonization initiative will be forthcoming as the implementation date approaches.

Corporate Income Tax Measures

Reducing Corporate Income Tax Rates

The 2009 Ontario Budget proposes to reduce corporate income tax rates. The current general corporate income tax rate in Ontario of 14% will be cut to 12% effective July 1, 2010, 11.5% effective July 1, 2011, 11% effective July 1, 2012 and 10% effective July 1, 2013.

The corporate income tax rate on manufacturing and processing income will be reduced from 12% to 10% and the corporate income tax rate on the first \$500,000 of active business income of a Canadian-controlled private corporation will drop from 5.5% to 4.5%. Both of these tax rate reduction measures will take effect on July 1, 2010.

In addition, the Budget proposes to eliminate the Small Business Deduction Surtax. The surtax currently applies when an associated group of companies' taxable income is greater than \$500,000. Where taxable income is between \$500,000 and \$1,500,000, an additional 4.25% surtax is levied on a corporation's active business income. Most companies bonus down their taxable income to \$500,000 to avoid this surtax. However, commencing July 1, 2010, owner-managed companies will need to rethink their bonusing down strategies in light of the fact that the surtax will now be eliminated.

The combined Federal and Ontario corporate income tax rates for December 31st fiscal years 2009 through 2014 will be as follows:

	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>
Active Business Income < \$500,000	16.50%	16.00%	15.50%	15.50%	15.50%	15.50%
Active Business Income > \$500,000 (Note 1)	33.00%	31.00%	28.25%	26.25%	25.50%	25.00%
Manufacturing and Processing Income (Note 2)	31.00%	29.00%	26.50%	25.00%	25.00%	25.00%
Investment Income	48.67%	47.66%	46.41%	45.92%	45.16%	44.67%

Note 1 - the surtax will add 4.25% to the rate in 2009 and 2.1% in 2010 where taxable income is between \$500,000 – \$1,500,000

Note 2 - the surtax will add 3.25% to the rate in 2009 and 1.61% in 2010 where taxable income is between \$500,000 – \$1,500,000

If a company's fiscal year-end straddles December 31st, the tax rates will be prorated.

Ontario Innovation Tax Credit (OITC)

The OITC provides companies who carry on Scientific Research and Experimental Development activities a 10% refundable tax credit. The OITC is currently phased-out when the taxable income of the company and its associated group exceeds \$400,000. The credit is fully phased-out when taxable income reaches \$700,000. The 2009 Budget proposes to extend the taxable income phase-out range to between \$500,000 and \$800,000. The effective date of the amendments will coincide with the Federal Investment Tax Credit measures introduced in the 2009 Federal Budget and will be applicable when the previous taxation year of a corporation ends after 2008.

Other Corporate Tax Measures

- The 2009 Ontario Budget proposes to parallel the Federal Budget changes with respect to the temporary accelerated CCA for computers (100%; no half year rule) and manufacturing and processing equipment (50% straight-line);
- For eligible expenditures after March 26, 2009, the Apprenticeship Training Tax Credit will be increased to 35% (40% for small businesses) on salaries and wages paid during the first 48 months of an apprenticeship program (currently 36 months) for a maximum benefit of \$10,000 per annum. In addition, this previously temporary credit will now be made permanent;
- For eligible expenditures after March 26, 2009, the Co-op Education Tax Credit will be increased to 25% (30% for small businesses) and the maximum credit per work placement will be increased from \$1,000 to \$3,000;
- The Budget proposes to expand the Ontario Book Publishing Tax Credit to include qualifying expenditures incurred regardless of the number of books previously published by a Canadian author in an eligible category, and all direct expenses that reasonably relate to publishing an electronic version of an eligible book;
- The Corporate Minimum Tax (CMT) rate is proposed to decrease from 4% to 2.7% for taxation years ending after June 30, 2010 and will only apply when a corporation or an associated group has \$50 million in total assets and \$100 million in total revenues;
- Eligible Ontario political contributions for taxation years ending after December 31, 2008 will be converted into a non-refundable tax credit.

Personal Income Tax Measures

Reducing Personal Income Tax Rates

The Ontario Budget proposes to reduce the lowest personal income tax rate, effective January 1, 2010, from 6.05% to 5.05%. This rate will apply on taxable income between \$0 and \$36,848 (to be indexed for inflation). The Ontario non-refundable tax credits that were previously calculated at the 6.05% rate will be calculated at the 5.05% rate commencing January 1, 2010. The thresholds at which the Ontario surtax currently applies will be reduced and the surtax rates will remain at 20% and 36%.

Dividend Tax Rates

As a result of the proposed reductions to the corporate income tax rates, the Ontario Budget proposes to effectively increase the personal income tax rates on eligible and non-eligible dividends by reducing the applicable dividend tax credit. The combined Federal and Ontario personal income tax rates on dividends at the highest marginal tax rate will be:

	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
Eligible Dividends	23.06%	26.57%	28.19%	29.54%
Non-eligible Dividends	31.34%	32.57%	32.57%	32.57%

Other Personal Tax Measures

- The current combined Ontario Sales Tax Credit and Property Tax Credit will be replaced with two new separate credits. The new Ontario Sales Tax Credit will be refundable, paid quarterly and the maximum annual benefit will be \$260, subject to a 4% reduction based on income. The new Property Tax Credit will be similar to the existing credit with the exception that a 2% reduction will apply where income exceeds \$20,000 for a single person and \$25,000 for families;
- The Budget proposes to provide relief to seniors in the form of a grant where the individual owns a home and in the form of increases to the income thresholds at which the new Ontario Sales Tax Credit and Property Tax Credit are ground down;
- Individuals will be given increased access to locked-in Life Income Funds (LIFs) and Locked-in Retirement Income Funds (LRIFs).

For more information, please contact the tax department at Cunningham LLP

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