Tax Bulletin

May 2004

Ontario Government Releases Inaugural Budget

On May 18, 2004, Ontario Finance Minister Greg Sorbara presented the new provincial government's first budget to the Ontario Legislature (the "**Budget**"). Finance Minister Sorbara was faced with the daunting task of balancing the need for fiscal prudence with the government's recent electoral pledge to increase public funding for health care and education.

The Budget proposes to increase public spending over the next four years on a range of public services. A host of tax changes, including the introduction of a new health care premium, will also be enacted to support the government's new spending commitments and to help gradually eliminate the government's deficit.

The highlights of the Budget include the following:

Proposed Tax Changes

Introduction of the Ontario Health Premium

The Budget proposes the introduction of a new "Ontario Health Premium" (the "**OHP**") to be levied on individuals resident in Ontario. The OHP will be levied based on an individual's taxable income at the following rates:

	Proposed Premium (per Individual)	
Taxable Income[1]	**2004 Taxation Year**	**2005 and Subsequent Taxation Years**
up to $20,000	$0	$0
$20,000 - $36,000	$150	$300
$36,000 - $48,000	$225	$450
$48,000 - $72,000	$300	$600
$72,000 - $200,000	$375	$750
more than $200,000	$450	$900

Since the OHP is expected to be enacted through an amendment to the provincial *Income Tax Act*, standard income tax withholding and instalment rules will apply to the collection of the new premium. **Accordingly, beginning on July 1, 2004, employers will be required to ensure that a prescribed portion of the OHP is withheld from every employee's paycheque.**

Trusts and non-resident taxpayers will not be required to pay the OHP.

[1] It is worthy of note that a complicated formula will apply to determine the OHP payable by an individual whose taxable income falls within the first $600 of any of the prescribed income brackets.

>>>

Gradual Elimination of the Provincial Capital Tax

In 2003, the former Progressive Conservative government of Ontario announced that it intended to eliminate the Ontario capital tax by 2008. While the current Liberal government has chosen not to adopt the previous government's agenda, the government did announce that it intends to gradually eliminate both the general capital tax and the capital tax imposed on financial institutions by 2012.

The elimination of the provincial capital tax will take place in two phases. During the first phase, the $5 million deduction that corporate taxpayers may claim when computing their taxable paid-up capital will be increased by $2.5 million each year until the allowable deduction reaches $15 million on January 1, 2008. Thereafter, capital tax rates will gradually be reduced, beginning on January 1, 2009, until they are completely eliminated on January 1, 2012. The following table details the government's strategy for eliminating the Ontario capital tax:

			Financial Institutions		
				Taxable Capital Above $400 Million	
	Deduction ($ Millions)	Regular Corporations (%)	First $400 Million of Taxable Capital (%)	Non-Deposit Taking (%)	Deposit Taking (%)
Current	5	0.300	0.600	0.720	0.900
January 1, 2005	7.5	0.300	0.660	0.720	0.900
January 1, 2006	10.0	0.300	0.600	0.720	0.900
January 1, 2007	12.5	0.300	0.600	0.720	0.900
January 1, 2008	15	0.300	0.600	0.720	0.900
January 1, 2009	15	0.225	0.450	0.540	0.675
January 1, 2010	15	0.150	0.300	0.360	0.450
January 1, 2011	15	0.075	0.150	0.180	0.225
January 1, 2012	Eliminated				

Changes to the Employer Health Tax Act (the "EHTA")

The Budget proposes to simplify the computation and remittance of Employer Health Tax ("**EHT**"). Employers are currently required to remit EHT on the 15th day of each month on the basis of an estimate on their prior month's payroll. However, beginning on January 1, 2005, EHT instalments will be computed on the basis of an employer's actual payroll for a previous month and will be due on the 15th day of the following month. To facilitate the transition to the new EHT instalment regime, employers will not be required to remit EHT in January 2005. Rather, the first EHT instalment for 2005 will be due on February 15, 2005, computed on the basis of remuneration paid to employees in January 2005.

To promote compliance, the Budget also proposes to increase the penalties levied on employers that fail to file EHT returns on a timely basis. In cases where EHT is outstanding, late-filing penalties of up to 17% of the EHT owing by an employer may be imposed. Late-filing penalties of up to 50% of outstanding EHT will be imposed on repeat late-filers.

Finally, additional amendments to the EHTA will be introduced to clarify how employee remuneration is to be computed for the purposes of the EHTA. Legislative changes will also be introduced to counteract a recent judicial decision that held that Ontario-based professional sports teams are not required to pay EHT on salaries paid to athletes and other employees in respect of games played outside of Ontario.

Tobacco Tax Increases

Effective May 19, 2004, the Budget proposes to increase tobacco tax rates to 11.1 cents per cigarette, tobacco stick, or gram of cut tobacco (resulting in a tax increase of $2.50 per carton of cigarettes). Increased fines and penalties will also be instituted to deal with the potential proliferation of unregulated contraband tobacco and the unauthorized distribution of tobacco products.

Alcohol Tax Increases

Effective June 21, 2004, the Budget proposes to increase the provincial levy on spirits, wine, and beer as follows:

- The provincial levy on spirits will increase by 25 cents per litre;
- The provincial levy on wine coolers and spirit coolers will increase by 9 cents per litre;
- The provincial levy on wine will increase by 12 cents per litre; and
- The brewer's basic provincial fee will increase by 4.5 cents per litre.

Introduction of the Apprenticeship Training Tax Credit ("ATTC")

The Budget proposes the introduction of an ATTC that will allow businesses to claim a 25 percent refundable tax credit in respect of "eligible expenditures" made to secure the services of apprentices.[2]

Under the proposed ATTC program, employers will be eligible for a tax credit of up to $5,000 per year per "eligible apprentice" to a maximum of $15,000 over the first 36 months of an apprenticeship.

Eligible expenditures will consist of salaries and wages paid to an eligible apprentice between May 18, 2004 and January 1, 2011. To qualify as an eligible apprentice, an individual must be in the first 36 months of an apprenticeship training program in respect of a qualifying skilled trade and have commenced employment before January 1, 2008. Qualifying skilled trades will include designated construction, industrial, and motive power trades, as well as the service trades eligible under the present apprenticeship component of the Co-operative Education Tax Credit ("**CETC**").

The CETC will continue to be available for qualifying apprenticeships until the end of 2004. In addition, a number of transitional rules are proposed to integrate certain aspects of the CETC with the ATTC. For certain apprenticeships that straddle May 18, 2004, salaries paid before May 19, 2004 will qualify for the CETC, while amounts paid after May 18, 2004 will qualify for the ATTC.

Ontario Film and Television Tax Credit ("OFTTC")

The Budget proposes to enhance the current OFTTC for productions commencing principal photography after March 27, 2003 by providing that qualifying labour expenditures will not be reduced by equity investments made by Canadian Government film agencies. In addition, the OFTTC will also be amended to parallel certain enhancements to the federal Canadian Film or Video Production Tax Credit announced on November 14, 2003.

---

[2] The allowable ATTC will rise to 30 percent for businesses with total payroll costs not exceeding $400,000.

Retail Sales Tax Changes

Transfer of Assets

The Budget announced the intended modernization of the Retail Sales Tax ("**RST**") rules governing the exempt transfer of assets between related corporations. Rules governing the transfer of assets between partnerships and their principals will also be introduced in a form comparable to those that will apply to related corporations. Draft regulations setting out the proposed rules will be posted on the Ministry of Finance's website (http://www.gov.on.ca/MBS/english/government/taxes.html) in the coming months.

Purchase Exemption Certificate ("PEC") Simplification

The Budget proposes to reduce the red tape and compliance costs borne by vendors and taxpayers when claiming an exemption from RST on commercial purchases. Specifically, PEC's will no longer require a signature, a list of exempt items, or an expiry date.

Property Tax Changes

Assessment Cycle

The Ontario government introduced the Current Value Assessment ("**CVA**") system in 1998 with a view to ensuring consistency in property assessments across the province. Under the existing CVA system, properties in Ontario are currently scheduled to be assessed annually based on their market value as of June 30th of the previous year.

Unfortunately, it has become apparent that the existing CVA system does not provide sufficient time for the Municipal Property Assessment Corporation to prepare accurate assessments of all properties in Ontario or for taxpayers to review the newly assessed values of their properties.

In light of growing concerns, the government intends to introduce legislation to alter the frequency of property valuations. Under the new reforms proposed to take effect in 2006, reassessments will be based on property values as of January 1st of the preceding taxation year, six months earlier than the current valuation date of June 30th.

To facilitate the proposed changes, the government intends to cancel the scheduled property reassessment that would have been conducted for the 2005 taxation year. Instead, property assessments in 2005 will be based on the same valuations used in 2004 (i.e., property values as at June 30, 2003).

Assessment Averaging

Property tax reforms enacted in 1997 included a plan for property tax assessments to be based on property values averaged over several years. Assessment averaging is designed to help smooth out large year-over-year property tax fluctuations that result from dramatic short-term changes in property values.

In light of recent administrative concerns, the Budget proposes to defer the implementation of assessment averaging. The government will instead proceed with analysis and consultation on alternative assessment stabilization measures.

Limitation of Property Tax Increases

The introduction of CVA was accompanied by the establishment of a mandatory tax-capping program designed to mitigate the impact of CVA on owners of commercial, industrial, and multi-residential properties. The government intends to introduce legislation, effective as of 2005, to provide municipalities with a number of options to modify the tax-capping program, thereby expediting the full transition to the CVA regime.

Resource Allowance Retained

The federal government announced that it has decided to replace the 25% resource allowance with a deduction for Crown royalties and mining taxes paid, effective for taxation years ending after December 31, 2002. Under the federal plan, Crown royalties and charges will become fully deductible and the resource allowance will be completely eliminated by 2007.

The Ontario government has chosen not to follow the federal government's lead in the reform of mining taxation and will instead maintain the resource allowance and the non-deductibility of Crown royalties and mining taxes, retroactive to the commencement of the federal change.

Tax Credits and Incentives Eliminated

The Budget proposes to eliminate the following tax credits and incentives:

- *The Ontario Home Ownership Savings Plan*: No new plans may be registered and no new contributions may be made to existing plans after May 18, 2004. Existing plans will expire on December 31, 2005;
- *Educational Technology Tax Incentive*: Donations, sales, or licences after December 31, 2004 will no longer qualify for the incentive;
- *Workplace Accessibility Tax Incentive*: Expires December 31, 2004;
- *Workplace Child Care Tax Incentive*: Expires December 31, 2004;
- *Graduate Transitions Tax Credit*: Expires December 31, 2004;
- *Ontario Research Employee Stock Option Credit*: Expires at the end of the 2004 taxation year; and
- *Electricity Supply and Conservation Incentives*: The government intends to repeal the 10-year corporate income tax holiday and the 10-year property tax holiday, effective November 26, 2002. The government also will not implement either the corporate income tax deduction for self-generation announced in the 2003 Ontario Budget or the immediate 100 percent corporate income tax write-off for electrical energy-efficient equipment announced in November 2002.

Capital Tax Technical Amendments

In response to a recent judicial decision, the provincial government announced that it will amend the definition of "current accounts payable" appearing in the *Corporations Tax Act* to clarify that the term only captures amounts payable to suppliers for goods and services and not amounts owed to other types of creditors or liabilities incurred in connection with the purchase or trading of shares, bonds or other securities.

Concordance of Federal and Ontario Tax Legislation

The Budget proposes several measures designed to parallel the changes to the federal income tax regime announced in the March 23, 2004 federal budget, which include:

- The extension of the carry-forward period for business losses from 7 to 10 years;
- An increase in the capital cost allowance rate for computer equipment from 30% to 45% and for data network infrastructure equipment from 20% to 30%;
- The limitation of the deductibility of fines and penalties, patronage dividends, and unused charitable donations; and
- The amendment of the general anti-avoidance and affiliated person rules.

Additional Proposed Legislative Measures

Introduction of Limited Liability for Trust Unitholders

The Budget proposes the enactment of the *Trust Beneficiaries' Liability Act* to clarify that investors in publicly traded trusts will not be liable for the activities of the trust.

Changes to the Labour-Sponsored Investment Fund Regime

Labour-sponsored investment funds ("**LSIFs**") have traditionally represented a significant source of venture capital for emerging businesses in Ontario. In recent years, several LSIFs have failed to raise sufficient capital to serve as viable long-term funds. The Budget proposes to place a moratorium on the registration of new LSIFs effective immediately. The Budget also proposes to eliminate certain investment restrictions that have hampered LSIFs in the past and to streamline the computation of the LSIF tax credit by aligning the method of computation with the formula employed in computing the applicable federal tax credit.

Residential Rent Increases Restricted

The Budget proposes to amend the *Tenant Protection Act* so that residential rents may generally only be increased by a prescribed inflation factor commencing in 2005. Landlords are currently permitted to increase residential rents by an inflation factor plus two percent.

Fee Increases

The Budget proposes to increase a number of common service fees. For example, effective September 1, 2004, the fee to renew a driver's license will increase from $50 to $75. Other public service fees to be increased include various civil and small claims court filing charges.

Health Coverage Limitations

The Budget proposes to discontinue public payment for certain health services, including chiropractic services, certain physiotherapy services and optometry assessments for those between the ages of 20 and 64.

Balanced Budget Legislation

The *Balanced Budget Act* ("**BBA**") was enacted in 1999 by the former Progressive Conservative government. Under the BBA, the failure of a sitting government to balance its budget results in a 25 percent reduction in ministers' compensation in the first year of the deficit and a 50 percent reduction for all subsequent years in which the provincial budget remains unbalanced.

The Budget proposes to replace the BBA with the *Fiscal Transparency and Accountability Act* ("**FTAA**"). The FTAA will:

- Provide a new framework for the conduct of fiscal policy; and
- Set out transparency requirements for budgets and related publications.

While the government will accept the salary sanctions imposed by the BBA in respect of the 2004-2005 fiscal year, comparable sanctions will not be imposed under the FTAA.

The foregoing provides only an overview. Readers are cautioned against making any decisions based on this material alone. Rather, a qualified lawyer should be consulted.

For further information, please contact any member of the McMillan Binch Tax Group listed below:

Michael Friedman	416.865.7914	michael.friedman@mcmillanbinch.com
Mary-Ann E. Haney	416.865.7293	mary.ann.haney@mcmillanbinch.com
Mark Lobsinger	416.865.7107	mark.lobsinger@mcmillanbinch.com
Todd A. Miller	416.865.7058	todd.miller@mcmillanbinch.com
Ryan Morris	416.865.7180	ryan.morris@mcmillanbinch.com
Laura Stoddard	416.865.7277	laura.stoddard@mcmillanbinch.com
Michael Templeton	416.865.7837	michael.templeton@mcmillanbinch.com
Richard B. Thomas	416.865.7179	richard.thomas@mcmillanbinch.com
David Wentzell	416.865.7036	david.wentzell@mcmillanbinch.com
Mickey M. Yaksich	416.865.7097	mickey.yaksich@mcmillanbinch.com

McMillan Binch LLP

Telephone: 416.865.7000
Facsimile: 416.865.7048
Web: www.mcmillanbinch.com

BCE Place, Suite 4400, Bay Wellington Tower, 181 Bay Street, Toronto, Ontario, Canada M5J 2T3