MARCH 2018

2018 ONTARIO BUDGET REPORT

On March 28, 2018, the Honourable Charles Sousa presented his seventh budget as Minister of Finance ahead of the upcoming election on June 7, 2018. This budget focuses on:

1. Healthcare
2. Childcare
3. Seniors

Currently, Ontario has a surplus of $600 million forecasted for 2017-18, but it's anticipated there will be a deficit of $6.7 billion in 2018-19 followed by deficits of $6.6 billion and $6.5 billion in each of the following fiscal years.

The Ontario government promised to invest in new programs and expand on the following initiatives:

1. **Healthcare** — The government will introduce a new Drug and Dental Program in summer of 2019. It will reimburse 80 percent, up to a maximum of $400 per single person, $600 per couple and $700 for a family of four, of eligible prescription drug and dental expenses each year for those without benefits through their employer or not covered by OHIP+ or other government programs.
2. **Childcare** — The budget allocated more spending for childcare by introducing free preschool childcare for children aged two-and-a-half until they're eligible for kindergarten, which will begin in 2020.
3. **Seniors** — Ontario will introduce a Healthy Home Program starting in 2019-20, which will provide a benefit to offset the cost of home maintenance for eligible households led by seniors 75 and over. The budget also proposes providing seniors with more access to home and community healthcare services through a $650 million investment over three years.

The following is a summary of the more important tax measures of interest to our clients.

HIGHLIGHTS

- Surplus of $600 million now forecast for 2017-18
- Deficit of $6.7 billion for 2018-19
- Elimination of personal surtax and adjustments to personal tax brackets and rates for 2018
- Phase out of small business limit for passive investment income

ONTARIO BUDGET PROJECTIONS (in billions $)			
	Original Forecast 2017/2018	Revised Forecast 2017/2018	Projected 2018/2019
Revenue	141.7	150.1	152.4
Program Expense	(129.5)	(137.5)	(145.9)
Interest on Debt	(11.6)	(12.0)	(12.5)
Reserve	(0.6)	(0.0)	(0.7)
Surplus (Deficit)	0.0	0.6	(6.7)

BUSINESS TAX MEASURES

The Small Business Limit

In Ontario, the small business deduction reduces the general corporate tax rate for Canadian-controlled private corporations (CCPCs) and associated corporations, on up to $500,000 of qualifying active business income. The $500,000 business limit is phased out on a straight-line basis for CCPCs (and associated corporations) that have between $10 million and $15 million of taxable capital employed in Canada.

The federal government proposed a measure in its 2018 budget to reduce the tax deferral benefit of earning passive investment income in a private corporation. This proposed measure will restrict access to the small business limit of CCPCs that earn between $50,000 and $150,000 of passive investment income (as specifically defined in the federal proposals). Based on the proposals, the federal small business limit would be reduced by $5 for every $1 of investment income above the $50,000 threshold and will be eliminated when investment income reaches $150,000. Note that it is generally investment income earned in the previous taxation year that impacts the calculation for the relevant taxation year.

Under the federal proposals, the business limit of a corporation would be the lower of the business limit determined on the basis of taxable capital and the business limit determined on the basis of passive investment income. This measure is effective for taxation years beginning after 2018.

The Ontario government proposes to parallel this federal measure on passive investment income.

The Ontario Research and Development Tax Credit

The Ontario Research and Development Tax Credit (ORDTC) will be enhanced to encourage large companies to continuously invest in Research and Development (R&D). Currently, the ORDTC is a 3.5 percent non-refundable tax credit on eligible R&D expenditures. The government proposes to provide an enhanced rate of 5.5 percent on expenditures over $1 million in a taxation year to those companies that qualify for the ORDTC. The $1 million threshold will be prorated for short taxation years. This enhancement will be effective for eligible R&D expenditures incurred on or after March 28, 2018. In addition, the enhanced tax credit rate will be prorated for taxation years straddling March 28, 2018.

There will be an additional requirement to determine eligibility. The enhanced credit rate will only be available where eligible R&D expenditures in the current taxation year are equal to or greater than 90 percent of eligible R&D expenditures in the prior taxation year. For purposes of this calculation, specific rules will account for short taxation years, amalgamations and wind-ups.

The Ontario Innovation Tax Credit

The government proposes to enhance the Ontario Innovation Tax Credit (OITC) to encourage small companies to make R&D investments. Currently, the OITC is an 8 percent refundable credit for small to medium-sized companies on eligible R&D expenditures. The budget proposes to enhance the credit rate where the ratio of R&D expenditures to gross revenue meets certain targets. Under the proposals, the rate structure would apply as follows:

- With a ratio of 10 percent or less, the company would remain eligible for the OITC at the 8 percent rate.
- Where the ratio is between 10 and 20 percent, the company would be eligible for an enhanced rate that would increase from 8 to 12 percent on a straight-line basis as the ratio increases from 10 to 20 percent.
- Where the ratio is 20 percent or higher, the company would be eligible for the OITC at a 12 percent rate.

For purposes of determining the ratio, the gross revenues and R&D expenditures must be attributable to Ontario operations. Those amounts attributable to Ontario operations of associated corporations would be aggregated.

This proposed enhancement will be effective for eligible R&D expenditures incurred on or after March 28, 2018. As well, the rate enhancement will be prorated for taxation years straddling March 28, 2018.

The Commercialization of Intellectual Property

A number of countries have implemented tax incentives such as patent boxes (i.e., preferential corporate income tax rates), refunds of taxes paid, tax deductions and exemptions to retain the economic and social benefits from intellectual property. The government has indicated that a review of all of these initiatives is being undertaken to determine effectiveness and feasibility, and an incentive will be developed that works best for Ontario.

Ontario Interactive Digital Media Tax Credit

Eligibility for the Ontario Interactive Digital Media Tax Credit will be extended to film and television websites purchased or licensed by a broadcaster and embedded in the broadcaster's website. The amendment would apply to websites that host content related to film, television or Internet productions that have not received either a certificate of eligibility or letter of ineligibility before November 1, 2017.

PERSONAL TAX MEASURES

Personal Income Tax – Rate Structure

The government is proposing to eliminate the surtax and make adjustments to Ontario's Personal Income Tax (PIT) brackets and rates for the 2018 taxation year. While the top marginal PIT rate of 20.53 percent will be maintained, the government contends that Ontario's PIT revenue would increase by $275 million in 2018-19. If passed, changes to PIT withholdings would start on July 1, 2018.

The proposed changes would create seven statutory PIT rates applied directly to taxable income. Currently, Ontario has five statutory PIT rates plus two surtax rates calculated separately. Specifically, surtax is calculated based on preliminary Ontario tax — that is, Basic Ontario Tax (statutory tax rates applied to taxable income) after non-refundable tax credits. A 20 percent surtax rate applies to Ontario tax between $4,638 and $5,936, and a surtax rate of 56 percent applies to Ontario tax greater than $5,936. Where an individual claims only the basic personal amount, the 20 percent surtax begins to apply at taxable income of $75,653; the 56 percent surtax rate begins to apply at $89,134.

The following table demonstrates the impact of the surtax on Ontario's statutory PIT rates as compared to the proposed 2018 structure.

<table>
<tr><th colspan="2">Current and Proposed 2018 Ontario PIT Rates and Brackets</th></tr>
<tr><th>Current (Including Impact of Surtax)</th><th>Proposed (No Surtax)</th></tr>
<tr><td>5.05% (no surtax)
$0 to $42,960</td><td>5.05%
$0 to $42,960</td></tr>
<tr><td rowspan="3">9.15% (no surtax)
or
10.98% (includes 20% surtax)
or
14.27% (includes 56% surtax)
$42,960 to $85,923</td><td>9.15%
$42,960 to $71,500</td></tr>
<tr><td>11%
$71,500 to $82,000</td></tr>
<tr><td rowspan="2">13.5%
$82,000 to $92,000</td></tr>
<tr><td rowspan="2">17.41% (includes 56% surtax)
$85,923 to $150,000</td></tr>
<tr><td>17.5%
$92,000 to $150,000</td></tr>
<tr><td>18.97% (includes 56% surtax)
$150,000 to $220,000</td><td>19%
$150,000 to $220,000</td></tr>
<tr><td>20.53% (includes 56% surtax)
greater than $220,000</td><td>20.53%
greater than $220,000</td></tr>
</table>

Ontario Charitable Donations Tax Credit

The budget proposes to increase the rate of the non-refundable Ontario Charitable Donations Tax Credit (OCDTC), which provides relief to taxpayers who make eligible charitable donations. Currently, an OCDTC rate of 5.05 percent applies to the first $200 in donations and a rate of 11.6 percent applies for donations that exceed $200. The government is proposing to increase the OCDTC rate to 17.5 percent for all taxpayers for eligible donations exceeding $200. The first $200 of donations would continue to be eligible for an OCDTC rate of 5.05 percent.

OTHER MEASURES

Employer Health Tax

In the 2017 budget, the government announced its intention to review Employer Heath Tax (EHT) relief targeted to smaller employers. Further to that announcement, this year's budget proposes the following measures to better target the EHT exemption.

- The eligibility criteria for the small business deduction will be followed for the EHT exemption. Therefore, the exemption would only be available to individuals, charities, not-for-profit organizations, private trusts and partnerships, and CCPCs.
- Federal anti-avoidance rules related to the multiplication of the SBD will be incorporated into the *Employer Health Tax Act*. As part of implementation, the EHT rate for associated employers would be determined in a way that is consistent with the application of the EHT exemption threshold for these employers.

These proposed changes would be effective January 1, 2019, if legislation is passed. Note that there will be an opportunity for public comment before the legislation for the anti-avoidance changes is introduced.

Land Transfer Tax Reporting Requirements for Certain Dispositions

The government plans to introduce a new regulation that will allow land transfer tax arising from certain unregistered dispositions of a beneficial interest in land through certain types of partnerships and trusts to be payable 30 days after the end of the calendar quarter in which the disposition occurred, rather than within 30 days of the disposition. As well, the Ministry of Finance plans to post guidance on its website regarding the minimum information and documents that an authorized representative of a partnership or trust should provide when submitting a consolidated quarterly filing. The government will continue to review issues raised in previous consultations.

Property Tax

Non-profit Child Care Services in Schools — An amendment will be proposed to the *Assessment Act* to provide a tax exemption to non-profit child care facilities that lease space in otherwise tax-exempt properties.

Airports — Airport authorities in Ontario make payments in lieu of property tax (PILT) based on the number of passengers that travel through the airports annually. The government is planning to conduct a review of the current approach used to calculate PILT as passenger rates have not changed since they were introduced in 2001.

Property Assessments — To strengthen the Advance Disclosure process for complex and specialized business properties, the budget proposes that an earlier valuation date be used as the basis for property assessments. For the next assessment update taking place in the 2021 taxation year, assessments would be based on a valuation date of January 1, 2019. The government also plans to introduce amendments in fall 2018 to provide a framework for addressing non-compliance.

Tobacco Tax

Continuing with increases as announced in the 2017 budget, tobacco tax will increase from 16.475 cents to 18.475 cents per cigarette and per gram of tobacco products other than cigars, effective March 29, 2018. These changes are equivalent to $4 per carton of cigarettes. The government plans to further increase the tobacco tax rate by an additional $4 per carton of cigarettes in 2019. Wholesalers of tobacco products who are not collectors of tobacco tax are required to take an inventory of all tobacco products (except cigars) that they hold at the end of day, March 28, 2018, and remit the additional tax on the inventory to the Ministry of Finance.

Measures Related to Cannabis

Ontario Portion of the Federal Excise Duty — Ontario intends to enter into an agreement with the federal government under which Ontario would receive 75 percent of the federal excise duty collected on cannabis intended for sale in the province.

First Nations HST Point-of-Sale Rebate — It is the Ontario government's intention for the full HST to apply to off-reserve purchases of recreational cannabis once legalized. Medical cannabis will continue to be eligible for a rebate of 8 percent for purchases that are delivered off-reserve.

HOW ONTARIO COMPARES

The following chart compares top personal and corporate tax rates and sales taxes for all provinces and territories, as announced to March 28, 2018.

	Top 2018 Personal Rates %	2018 Corporate Rates			2018 Provincial Sales Tax %
		General %	M&P %	Small Business %	
B.C.	49.80	27.00	27.00	12.00	7.00
Alta.	48.00	27.00	27.00	12.00	-
Sask.	47.50	27.00	25.00	12.00	6.00
Man.	50.40	27.00	27.00	10.00	8.00
Ont.	***53.53***	***26.50***	***25.00***	***13.50***	***8.00***(4)
Qué.	53.31	26.70	26.70	17.00(1)	9.975(5)
N.B.	53.30	29.00	29.00	13.00(2)	10.00(4)
N.S.	54.00	31.00	31.00	13.00	10.00(4)
P.E.I.	51.37	31.00	31.00	14.50	10.00(4)
N.L.	51.30	30.00	30.00	13.00	10.00(4)
Yukon	48.00	27.00	17.50	12.00(3)	-
N.W.T.	47.05	26.50	26.50	14.00	-
Nunavut	44.50	27.00	27.00	14.00	-

(1) Effective March 28, 2018, the small business rate declined from 18%. Québec provides a rate reduction from the small business rate for eligible manufacturing small and medium-sized enterprises (SMEs). Where certain conditions are met, the maximum reduction available is 3% (4% prior to March 28, 2018), for a combined rate of 14%. Note that a lesser reduction from the small business rate may be available to certain manufacturing SMEs where some, but not all conditions are met.

(2) The small business tax rate will decrease to 12.5% effective April 1, 2018.

(3) The tax rate for M&P profits eligible for the small business deduction is 11.5%.

(4) As part of the HST (combined rates are 15% in New Brunswick, Nova Scotia, Prince Edward Island and Newfoundland & Labrador and 13% in Ontario).

(5) The QST system is harmonized with the GST, though two separate tax systems remain — the GST and the amended QST. The combined rate is 14.975%.

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