1 St. Clair Ave. East, Suite 900 Toronto, Canada M4T 2V7 Tel: 416-923-0809 Fax: 416-923-1549 www.alpertlawfirm.ca

THE MAY 18, 2004 ONTARIO BUDGET

This issue of the Legal Business Report provides current information to the clients of Alpert Law Firm on important tax changes outlined in the May 18, 2004 Ontario Budget. Although these proposals are likely to be implemented in their present form, these provisions are not yet law and the final legislation should be reviewed before initiating any transaction. Alpert Law Firm is experienced in providing legal representation on behalf of its clients in connection with tax, corporate and estate planning matters.

A. MEASURES AFFECTING INDIVIDUALS

1. Ontario Health Premium

The 2004 Ontario budget announced the introduction of a New Ontario Health Premium. Bill 106, Budget Measures Act, 2004 (No.2) which contains the proposal to implement this health premium, received its first reading on June 21, 2004.

This premium will be payable by individuals, who are residents of Ontario on the last day of the taxation year, with a taxable income exceeding $20,000. Individuals who earn less than $20,000, trusts, and non-resident taxpayers are exempt from this liability. The premiums, which range from $300 to $900, are to vary according to the individual's taxable income. Note that while the premiums would be effective as of July 1, 2004, in order to phase in this new measure, the premiums payable in 2004 would be only half the amount payable in subsequent taxation years. The premiums are proposed as follows:

Taxable Income	Proposed Premiums	
	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

1 St. Clair Ave. East, Suite 900 Toronto, Canada M4T 2V7 Tel: 416-923-0809 Fax: 416-923-1549 www.alpertlawfirm.ca

Note that for each income bracket, premium levels would be phased in over the income range.

For individuals with income between $20,000 and $36,000 the premium is calculated at 6% of the lesser of $5,000, and the individual's taxable income in excess of $20,000. For individuals who have a taxable income between $36,000 and $48,000, the premium is calculated as $300 plus 6% of the lesser of $2,500 and the individuals taxable income in excess of $36,000. For those with a taxable income between $48,000 and $72,000, the premium is calculated as $450 plus 25% of the lesser of $600 and the amount the individual's taxable income in excess of $48,000. For individuals with a taxable income between $72,000 and $200,000 the premium is calculated as $600, plus 25% of the individual's taxable income in excess of $72,000. For individuals with a taxable income of above $200,000, the premium is $750 plus 25% of the individuals taxable income in excess of $200,000.

Also, unlike private health premiums, the new premiums will not be eligible for the medical expense tax credit.

2. Personal Income Tax Cuts

The 2004 Ontario Budget proposed no new personal income tax cuts. Reductions proposed by the former Ontario Government have been cancelled. As a result, for the year 2004, the top personal marginal tax rates (i.e. rates of tax which apply to taxable income of above $113,804) for an Ontario resident will remain unchanged from 2003. The top combined federal and provincial rates of tax are as follows:

Top Personal Tax Rates	2004
Ordinary Income	46.41%
Dividends	31.34%
Capital Gains	21.20%

3. Property Tax Relief for Seniors

The 2004 Ontario Budget proposed to increase the property and sales tax credit for seniors, effective January 1, 2004. The basic property tax credit for seniors is to be increased from $500 to $625. As such, the maximum benefit available for the property and sale credits for seniors is also to be increased by $125 to $1,125.

1 St. Clair Ave. East, Suite 900 Toronto, Canada M4T 2V7 Tel: 416-923-0809 Fax: 416-923-1549 www.alpertlawfirm.ca

B. MEASURES AFFECTING BUSINESSES

1. Corporate Tax Rates

The 2004 Ontario Budget did not modify the corporate tax rates beyond the changes announced by the Government on November 24, 2003. Such changes included: (i) an increase of Ontario's general corporate tax rate; (ii) an increase of Ontario's manufacturing and processing (M&P) tax rate; and (iii) an increase of the small business phase-out range. As such the corporate tax rates for 2004 are as follows:

		2004
General Corporate Tax		14%
Manufacturing and Processing Rate		12%
Small Business Rate		5.5%
Small Business phase-out range	Lower threshold	$400,000
	Upper threshold	$1,128,519

Note, that small businesses are entitled to the 5.5% small business rate if the taxable income of their associated corporations fit within the small business phase-out range (i.e. their taxable income is between $400,000 and $1,128,519). If their taxable income is below this range then a surtax claws back the small business deduction, and if their taxable income exceeds this range then the deduction is completely eliminated.

2. Elimination of the Capital Tax

The 2003 Budget had proposed to gradually eliminate Ontario's capital taxes, which currently apply to corporations with taxable capital over $5,000,000. The capital tax was planned to be eliminated by January 1, 2008. The recent 2004 Ontario Budget has proposed to delay this elimination of capital taxes using *two* approaches: (i) gradually reducing capital tax rates until its eventual elimination; and (ii) gradually increasing the current $5,000,000 capital tax deduction to $15,000,000.

1 St. Clair Ave. East, Suite 900 Toronto, Canada M4T 2V7 Tel: 416-923-0809 Fax: 416-923-1549 www.alpertlawfirm.ca

(a) Capital Tax Rate

The 2004 Ontario Budget proposed to reduce capital tax rates by a fixed amount starting January 1, 2009 until its complete removal by January 1, 2012. The Government proposed to eliminate the capital tax as follows:

Year	Capital Tax for Regular Corporations (%)
2004 (current)	0.300
Jan. 1, 2005	0.300
Jan. 1, 2006	0.300
Jan. 1, 2007	0.300
Jan. 1, 2008	0.300
Jan. 1, 2009	0.225
Jan. 1, 2010	0.150
Jan. 1, 2011	0.075
Jan. 1, 2012	0.000

Note that there are separate provisions that deal with the gradual elimination of capital taxes for financial institutions.

(b) Capital Tax Deduction

The 2004 Ontario Budget also proposed to increase the current $5,000,000 capital tax deduction to $15,000,000 by January 1, 2008. The Government proposed to increase the capital tax deduction in increments as follows:

Year	Capital Tax Deduction ($ Millions)
2004 (current)	5
Jan. 1, 2005	7.5
Jan. 1, 2006	10.0
Jan. 1, 2007	12.5
Jan. 1, 2008	15
Jan. 1, 2009	15
Jan. 1, 2010	15
Jan. 1, 2011	15

Jan. 1, 2012	15

3. Capital Tax Definition

The 2004 Ontario Budget amended the definition of "current accounts payable" for capital tax purposes, resulting in the following:

(i) For taxation years ending after May 18th, 2004, the definition of 'current accounts payable' will be amended to confirm that is applies only to amounts payable to a supplier for purchases of goods and service; and

(ii) For taxation years ending after May 19th, 1993, the definition of 'current accounts payable' will be amended to clarify that it does not include liabilities incurred in connection with the purchase or trading of shares, bonds, or other securities.

4. Changes to Employer Health Tax (EHT)

The 2004 Ontario Budget has proposed a number of changes to the Employer Health Tax (EHT).

(a) EHT Instalments

To simplify the process of making EHT instalments, monthly instalments will be based on the current months payroll, instead of an estimation based on the prior month's payroll. Instalments will still be due on the 15th day of the following month. To ease the transition to the new system, while the change will commence as of January 1, 2005, employers will not be required to remit an instalment until February 15, 2005, based on the January's remuneration.

(b) Late-filing Penalties Increased

The 2004 Ontario Budget proposed an increase in penalties for late-filed EHT return, effective for taxation years ending after May 18, 2004. The increase in penalties will be raised to be consistent with late-filing penalties levied under the *Corporations Tax Act.* As such, if EHT is owing, late-filing penalties of up to 17% of the tax, will be imposed. For repeat offenders, the rate of late-filing penalties can escalate up to 50% of the tax owing.

1 St. Clair Ave. East, Suite 900 Toronto, Canada M4T 2V7 Tel: 416-923-0809 Fax: 416-923-1549 www.alpertlawfirm.ca

(c) Taxable Benefits and EHT

The Ontario Budget proposed that amendments would be introduced to clarify that all amounts included in the income of an employee by way of section 5, 6, or 7 of the *Income Tax Act* (ITA) are taxable for income tax purposes. Note that these amounts include automobile benefits and benefits in respect to employee group term life insurance and low-interest employee loans. This change will be effective retroactively to January 1, 1990.

(d) Permanent Establishment in Ontario

The Ontario Budget proposed that amendments would be introduced to clarify that, as long as a person reports for work at a permanent establishment in Ontario, all of that employee's remuneration is subject to EHT. This amendment would be retroactive as of January 1, 1990. Note that this amendment overrules an Ontario Superior Court of Justice decision that held that Ontario-based professional sports terms were not liable for EHT with respect to the salaries paid for games played outside Ontario.

5. Retail Sales Tax (RST) Measures

The 2004 Ontario Budget proposes various measures in relation to the Retail Sales Tax (RST) which include:

(i) Destination marketing fees billed after May 18, 2004 and before May 19, 2005 will receive an exemption from the 5% RST accommodations tax;

(ii) The RST rebate for solar energy systems will be expanded to include wind energy systems, micro-electric systems and geothermal heating/cooling systems for residential premises for purchases made after March 27, 2003 and before November 26, 2007; and

(iii) Various proposals aimed at (a) modernizing the RST rules relating to exempt transfer of assets between related corporations and (b) regulating the rules for the transfer of assets between partnerships and their principals and making such rules consistent with the rules for related corporations. Note that draft legislation setting out these proposals will be

1 St. Clair Ave. East, Suite 900 Toronto, Canada M4T 2V7 Tel: 416-923-0809 Fax: 416-923-1549 www.alpertlawfirm.ca

posted on the Ministry of Finance's Web site for industry comment, with a goal of finalizing the proposals in the fall of 2004.

6. Apprenticeship Training Tax Credit (ATTC)

The 2004 Ontario Budget proposed a new Apprenticeship Training Tax Credit (ATTC), applicable to the hiring of apprentices in certain skilled trades. The ATTC will provide corporations and incorporated businesses with a refundable tax credit of 25% (or 30% for businesses with total payrolls of under $400,000) of eligible expenditures incurred with respect to qualifying apprentices. The tax credit however is capped at $5,000 per eligible apprentice per year to a maximum of $15,000 over the first 36 months of the apprenticeship.

Eligible expenditures are salaries and wages paid to eligible apprentices after May 18, 2004 and before January 1, 2011. An eligible apprentice must be employed in a qualifying skilled trade, which includes industrial and motive power trades, designated construction trades, and service trades eligible under the apprenticeship component of the Co-Operative Education tax credit (CETC).

7. Ontario Film and Television Tax Credit (OFTTC)

The Ontario Budget proposes to enhance the Ontario Film and Television Tax Credit (OFTTC) so that eligible labour expenditures would not be reduced by equity investments from Canadian government film agencies. This tax credit would be retroactively effective for productions commencing after March 27, 2003. Also the Budget announced that several other measures would be adopted to parallel the federal Canadian Film and Video Production Tax Credit changes announced on November 14, 2003.

C. OTHER MEASURES

1. Publicly Traded Trusts and Investor Liability

The Ontario Budget proposes the introduction of legislation to clarify that investors in publicly traded trusts will not be liable for the activities of the trust. The technical specifics of legislation were not indicated in the budget, but the measure is likely to resemble legislation introduced in Alberta.

2. Federal Concordance

Ontario proposes to parallel the following federal measures announced in the 2004 Federal budget:

- The extension of the carry-forward period from seven to ten years for business losses and credits arising after March 22, 2004.
- The limitations on the deductibility of fines and penalties, patronage dividends and unused charitable donations.
- The amendments to the General Anti-Avoidance Rule and the Affiliated Persons Rules.
- The relaxation of the associated corporations rules, for the purpose of applying the Ontario Innovation Tax Credit.
- The measure to increase the Capital Cost Allowance (CCA) rates for Information and Communication Technology (ICT) ICT assets. Specifically, Ontario will follow the 2004 federal initiative to increase the CCA rate for computer equipment from 30% to 45% and increase the CCA rate for data network infrastructure equipment from 20% to 30%. The Ontario changes will in effect after March 22, 2004.

3. Property Tax

A number of changes were proposed by the 2004 Ontario Budget in respect to the property tax system, to be implemented for the 2005 taxation year. The proposals include the following measures:

(i) changes to the legislation that allow municipalities greater flexibility in regards to the tax capping program and the application of graduated tax rates at the optional property class level;

(ii) the setting of a new assessment cycle, as of January 2006, in which reassessments will be based on property values as of January 1 of the year preceding the taxation year (instead of the current valuation date of June 30, six months earlier); and

(iii) changes that delay the 1997 property tax reform legislation that included a plan for assessments to be based on averaged property value starting 2005. Specifically, the Budget proposes to delay the implementation of assessment averaging for residential and business properties by one year, until 2006.

3. Waiver Provisions under Various Acts

The Ontario Budget announced that amendments will be proposed *to Fuel Tax Act*, *Gasoline Tax Act*, *Land Transfer Tax Act*, *Retail Sales Tax Act and Tobacco Tax Act* to Codify the Minister of Finance's policy of accepting waivers from taxpayers where the assessment period for taxes owing is about to become statute barred.

4. Qualifying Environmental Trusts

The 2004 Ontario Budget proposed an increase tax rate of 14% for Qualifying environmental trusts, retroactive to January 1, 2004.

5. Increased Access to Capital Initiatives

In a move to encourage investments in the venture capital market, the 2004 Ontario Budget proposed a new initiative: Ontario Commercialization Investment Funds (OCIFs). OCIFs are intended to raise capital from various investors and provided that certain criteria are met then OCIFs will be eligible for a grant equal to 30% of their eligible investments.

6. Elimination of Certain Tax Credits and Incentives

The Budget also eliminated a number of pre-existing tax credits and incentives:

- Educational Technology Tax Incentive no longer applies to donations, sales, and licences entered into after December 31, 2004.

1 St. Clair Ave. East, Suite 900 Toronto, Canada M4T 2V7 Tel: 416-923-0809 Fax: 416-923-1549 www.alpertlawfirm.ca

- Ontario Research Employee Stock Option Credit cannot be claimed after 2004, and EHT exemption for stock option benefits for scientific research and experimental development (SR&ED) employers will be eliminated as of May 18, 2004

- Graduate Transition Tax Credits, the Workplace Accessibility Tax Incentive, and the Workplace Child Care Tax Incentive have all been eliminated with respect to expenditures.

- Ontario Home Ownership Savings Plans expires December 31, 2005 and no new plans will be given for contributions made after May 18, 2004.

- Certain electricity supply and conservation incentives have been narrowed: the Corporate income tax deduction for self-generation and 100% corporate income tax write-off for electrical energy-efficient equipment will not be implemented; and the 10-year corporate tax holiday and 10-year property tax holiday has been eliminated retroactively to November 26,2002.

This issue of the Legal Business Report is designed to provide information of a general nature only and is not intended to provide professional legal advice. The information contained in this Legal Business Report should not be acted upon without further consultation with professional advisers.

If you require assistance with the May 18, 2004 Ontario Budget or need other tax, corporate and estate planning advice, please contact Howard Alpert directly at (416) 923-0809.