



Insight into the

# ONTARIO BUDGET OF MARCH 28, 2018

# 2018 Ontario Budget

## Introduction

Ontario's Finance Minister Charles Sousa tabled the 2018 Ontario Budget on March 28, 2017. The Government is projecting a surplus of \$0.6 billion for 2017-18 and deficits of \$6.7 billion for 2018-19 and \$6.6 billion for 2019-20.

The Budget eliminates the Ontario surtax on personal income tax, creates new personal tax brackets and provides for changes to charitable donation tax credits. There are no changes to corporate tax rates, although the Budget does provide changes to various business tax credits. Ontario has also announced its intention to parallel certain recent federal tax measures.

## Personal Tax Measures

### *Personal Income Tax Rates*

The most significant change affecting individuals in Ontario is the proposed elimination of the surtax on personal income tax which causes the highest Ontario tax bracket to reach a top marginal rate of 20.53% (calculated as the top Ontario tax rate of 13.16% increased by the top surtax rate of 56%). The surtax dates back to a time when the Ontario personal tax was calculated as a percentage of the federal personal tax. The surtax allowed the province to charge a higher effective tax rate on higher income levels even though there was no control over the level of the income brackets for the provincial personal tax calculation. As the Ontario personal tax is now calculated as a percentage of taxable income and Ontario sets its own income brackets, there is no longer a need for the surtax to be part of the calculation.

At first glance, this may sound like a tax reduction, but, of course, that is not the intended result. What is proposed is for the income brackets to be restructured to ensure that the potential revenue lost due to the elimination of the surtax is more than offset by new tax rates applied to varying income levels. There are currently five pre-surtax rates that are proposed to be replaced with seven no-surtax rates in which the new rates incorporate the two surtax rates of 20% and 36%. The current and proposed income brackets and rates are outlined in the following tables.

<b>Current Personal Tax Brackets and Rates</b>	
<b><u>Tax Brackets</u></b>	<b><u>Tax Rates</u></b>
\$0 - \$42,960	5.05%
\$42,960 - \$85,923	9.15% - 14.27% (including surtax)
\$85,923 - \$150,000	17.41% (including surtax)
\$150,000 - \$220,000	18.97% (including surtax)
\$220,000 +	20.53% (including surtax)

<b>Proposed Personal Tax Brackets and Rates</b>	
<b><u>Tax Brackets</u></b>	<b><u>Tax Rates</u></b>
\$0 - \$42,960	5.05%
\$42,960 - \$71,500	9.15%
\$71,500 - \$82,000	11.00%
\$82,000 - \$92,000	13.50%
\$92,000 - \$150,000	17.50%
\$150,000 - \$220,000	19.00%
\$220,000 +	20.53%

While there are slight nuances to the changes in the middle income brackets, note that the top marginal rate applied to taxable income in excess of \$220,000 does not change. As such, the combined federal and provincial top marginal tax rates for 2018 (as compared to 2017) are:

Type of Income	<b>2018</b>	<b>2017</b>
Salary and other income	53.53%	53.53%
Capital gains	26.76%	26.76%
Eligible dividends	39.34%	39.34%
Non-eligible dividends	46.84%	45.30%

The increase in the top marginal tax rate on non-eligible dividends comes from a previously announced change in the federal and provincial dividend tax credit to reflect the reduction in the federal and Ontario small business tax rate.

***Impact on Non-refundable Tax Credits***

The Budget explains that the new tax rate system is much fairer in terms of providing equality of non-refundable tax credits and is intended to be much more transparent and to simplify the tax calculations. Individuals subject to the surtax receive an advantage since non-refundable tax credits reduce the tax base upon which the surtax is calculated; this is where the more significant personal tax increase arises. The Budget elaborates that those individuals subject to the

combined 56% surtax receive benefits above other individuals since the value of the tax credits is effectively increased by the same 56%. The overall impact is that individuals previously subject to the surtax will experience an increase in their provincial income tax due to lower tax credit rates.

For example, the value of the basic personal amount, which is \$10,354 (with the credit amount applied at the lowest tax bracket rate of 5.05%) for 2018, changes as follows:

	<u>Current</u>	<u>Proposed</u>
Individual not subject to surtax	\$ 523	\$ 523
Individual subject to 20% surtax	\$ 627	\$ 523
Individual subject to 56% surtax	\$ 816	\$ 523

To illustrate the overall impact, the Budget assesses the proposed changes to an individual with taxable income of \$95,000. Under the current system, basic provincial tax would be \$6,417 plus surtax of \$529 for a total of \$6,946. Under the proposed system, while there would be no surtax, the basic provincial tax would be \$7,114, or \$168 more tax. The numbers are based upon the individual claiming the basic personal, Canada Pension Plan and Employment Insurance amounts. The proposals recognize that the 56% surtax generally begins to apply at taxable income of \$89,134 given the limited non-refundable tax credits claimed.

Taxable Income of \$95,000	<u>Current</u>	<u>Proposed</u>	<u>Difference</u>
Basic provincial tax	\$ 6,417	\$ 7,114	\$ 697
Surtax	<u>\$ 529</u>	<u>\$ Nil</u>	<u>\$ (529)</u>
Total Income tax	<u>\$ 6,946</u>	<u>\$ 7,114</u>	<u>\$ 168</u>

The Budget’s selection of a mid-level taxable income with limited credits leads one to conclude that where income levels reach the highest marginal tax brackets as with additional tax credits such as medical expenses, the provincial income tax increase will be much greater than illustrated. The Budget adds that on average, 8.6 million individuals would be unaffected, 1.8 million will pay \$200 more on average and 680,000 will see their provincial taxes decrease by \$130 on average. The government explains that the tax rate changes will result in an additional \$275 million in 2018-19 which will help fund their “key initiatives” although recognizing that deficits will continue until 2024.

### ***Charitable Donation Tax Credit***

One potentially detrimental factor of the tax rate changes is the potential impact on the value of charitable donations. To ensure that the level of support for charitable donations is maintained, the Budget proposes to adjust the charitable donation tax credit rates. The rate on the first \$200 will remain unchanged at 5.05%, while the rate on donations in excess of \$200 will increase from 11.16% to 17.5%. The following table demonstrates the impact of the change based on a donation of \$2,000:

	<u>Current</u>	<u>Proposed</u>
Individual not subject to surtax	\$ 211	\$ 325
Individual subject to 20% surtax	\$ 253	\$ 325
Individual subject to 56% surtax	\$ 329	\$ 325

The Budget anticipates that the elimination of the interaction of the donation credit with the surtax, together with the donation credit rate change will result in an additional \$85 million in tax relief.

### **Businesses Tax Measures**

#### ***Corporate Income Tax Rates***

The Budget proposes no changes to corporate income tax rates. The combined federal and Ontario corporate tax rates for the 2018 calendar year are therefore:

<u>Type of Income</u>	<u>Ontario</u>	<u>Federal</u>	<u>Combined</u>
Small business income	3.5%	10%	13.5%
General	11.5%	15%	26.5%
Manufacturing & Processing	10%	15%	25%
Investment income	11.5%	38.67%	50.17%

In late 2017, both the federal and Ontario governments announced reductions in the small business tax rate effective January 1, 2018 (federal from 10.5% to 10% and Ontario from 4.5% to 3.5%).

### ***Ontario Research and Development Tax Credit***

The Ontario Research and Development Tax Credit (ORDTC) is a 3.5% non-refundable tax credit on eligible R&D expenditures. The Budget proposes that companies that qualify for the ORDTC will be eligible for an enhanced credit at a rate of 5.5% on eligible expenditures over \$1 million in a taxation year, effective for expenditures incurred on or after March 28, 2018. This \$1 million threshold would be prorated for short taxation years.

In order to qualify for the enhanced tax credit rate, eligible R&D expenditures in the current year must be at least 90% of the prior year's eligible R&D expenditures.

The enhanced tax credit rate will be prorated for taxation years straddling March 28, 2018.

### ***Ontario Innovation Tax Credit***

The Ontario Innovation Tax Credit (OITC) is an 8% refundable tax credit on eligible R&D expenditures. For eligible R&D expenditures incurred on or after March 28, 2018 by a company that qualifies for the OITC, the Budget proposes to introduce graduated tax credit rates as follows:

- 8%, if the company's R&D expenditures are 10% or less of its gross revenue;
- Between 8% - 12%, if the company's R&D expenditures are between 10% - 20% of its gross revenue. The OITC rate would increase on a straight-line basis within this range; and
- 12%, if the company's R&D expenditures are at least 20% of its gross revenue.

For purposes of this calculation, gross revenue and eligible R&D expenditures must be attributable to Ontario operations and would also take into account gross revenue and eligible R&D expenditures attributable to Ontario operations of associated corporations.

The enhanced tax credit rates will be prorated for taxation years straddling March 28, 2018.

### ***Commercialization of Intellectual Property***

The Budget notes that a number of countries offer various tax incentives to help retain the economic and social benefits from intellectual property. These incentives include patent boxes (preferential corporate tax rates), refunds of taxes paid, tax deductions and exemptions. Ontario has indicated that it is reviewing these incentives and will develop an appropriate incentive program.

### ***Ontario Interactive Digital Media Tax Credit***

The Budget proposes to extend the eligibility for the Ontario Interactive Digital Media Tax Credit to film and television websites purchased or licensed by a broadcaster and embedded in the broadcaster's website. This change will apply to websites that host content related to film, television or internet productions that have not received either a certificate of eligibility or a letter of ineligibility before November 1, 2017.

### ***Paralleling Federal Measures***

The Budget confirms that Ontario will introduce parallel measures to the following recent federal tax measures:

- The extension of the tax on split income (TOSI) provisions to adult family members in certain situations;
- The introduction of an additional phase-out mechanism for the small business deduction limit based on an associated corporate group's level of investment income earned in the preceding taxation year; and
- Proposed amendments to rules dealing with "synthetic equity arrangements" and "securities lending arrangements", as well as stop-loss rules applicable to share repurchase transactions.

The Budget also noted the creation of a group of expert tax advisors tasked with identifying tax loopholes and sophisticated tax planning schemes, which was originally announced in the 2017 Ontario Budget.

## **Other Measures**

### ***Employer Health Tax Measures***

The Budget proposes to limit the eligibility for the Employer Health Tax Exemption so that only employers who would meet the eligibility criteria for the federal Small Business Deduction would be entitled to claim the EHT exemption. Furthermore, the Budget proposes to implement measures that would restrict associated employers' ability to access multiple EHT exemptions.

These measures, if passed, will take effect January 1, 2019.

### ***Measures Related to Cannabis***

The Budget states that Ontario intends to enter into an agreement with the federal government under which Ontario would receive 75% of the federal excise duty collected on cannabis intended for sale in the province.

The Budget also states that the Ontario First Nations Point of Sale rebate available to Status Indians in respect of most goods purchased off-reserve will not apply to off-reserve purchases of recreational cannabis once legalized.

### ***Land Transfer Tax***

The Budget proposes changes intended to ease the administrative burden associated with paying land transfer tax arising from certain transactions involving certain types of partnerships and trusts. The proposal involves a new regulation which will change the payment due date from the current date which is within 30 days of the disposition to a date which is 30 days after the end of the calendar quarter in which the disposition occurred.

### ***Combatting the Underground Economy***

The Ontario government has restated its commitment to fight the underground economy. Specifically, Ontario plans to introduce legislation addressing electronic sales suppression which involves the manipulation of point-of-sale systems for the purposes of underreporting income.

Another focus of the Ontario government is in respect of unregulated tobacco sales. The Ontario government proposes additional measures intended to reduce the availability of unregulated tobacco and ensure compliance with tobacco laws in Ontario.

### ***Tobacco Tax***

Ontario's tobacco tax is set to increase from 16.475 cents to 18.475 cents per cigarette and per gram of tobacco products other than cigars. This change is set to take effect after March 28, 2018. The government is also planning an additional increase in 2019 of \$4 per carton of cigarettes.