

2018 Issue No. 17
28 March 2018

Tax Alert – Canada

Ontario budget 2018-19

EY Tax Alerts cover significant tax news, developments and changes in legislation that affect Canadian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor or EY Law advisor.

“[W]e have a balanced budget in 2017-18... we are now projecting a surplus of over \$600 million in this fiscal year.

“[We] project a deficit of \$6.7 billion next year... less than 1% of GDP.

“We have maintained a competitive tax rate for businesses – the lowest in Canada and competitive with neighbouring US states.

“[The budget] keeps us on our path for building Ontario’s economy.... boosting growth, creating more jobs and expanding access for all.”

*Ontario Finance Minister Charles Sousa
2018-19 budget speech*

On 28 March 2018, Ontario Finance Minister Charles Sousa tabled the province’s fiscal 2018-19 budget. The budget contains several tax measures affecting individuals and corporations, including the elimination of the high-income surtax from the calculation of total Ontario personal income tax.

As set out in Table A, the minister anticipates a surplus of \$642 million for 2017-18. One year ago, the minister projected a return to a balanced budget beginning in 2017-18. However, in this budget, the minister is projecting deficits for each of the next three years. Measured in relation to the size of the economy, the Ontario accumulated deficit is expected to decline to 22.7% of gross domestic product (GDP) by 2020-21.



In 2017, Ontario's real GDP grew by an estimated 2.7%. The government projects real GDP growth of 2.2% in 2018, 1.8% in 2019, 1.9% in 2020 and 1.7% in 2021.

Table A: Projections of Ontario budgetary deficit

	2017-18 (\$ billions)	2018-19 (\$ billions)	2019-20 (\$ billions)	2020-21 (\$billions)
Revenue outlook	150.1	152.5	157.6	163.8
Program expense outlook	(137.5)	(145.9)	(150.4)	(155.8)
	12.6	6.6	7.2	8.0
Interest on debt	(12.0)	(12.5)	(13.1)	(13.8)
Reserve	(0.0)	(0.7)	(0.7)	(0.7)
Surplus/(Deficit)	0.6	(6.7)	(6.6)	(6.5)
Accumulated deficit	192.4	199.2	205.8	212.3
% of GDP	23.2%	23.1%	22.9%	22.7%

Numbers may not add due to rounding.

Following is a brief summary of the key tax measures.

Business tax measures

Corporate tax rates

No changes are proposed to the corporate tax rates or the \$500,000 small-business limit.

Ontario's 2018 corporate tax rates are summarized in Table B.

Table B: Corporate tax rates

	2018		2019
	ON	Federal and ON combined	Federal and ON combined
Small-business tax rate *,**	3.50%	13.50%	12.50%
Manufacturing and processing tax rate	10.00%	25.00%	25.00%
General corporate tax rate	11.50%	26.50%	26.50%

* The small-business rate is prorated based on a 31 December year-end.

** On 24 October 2017, the federal government tabled a notice of ways and means motion to implement reductions in the small-business corporate income tax rate, which were announced on 16 October 2017. The federal small-business rate is reduced from 10.5% to 10.0% effective 1 January 2018 and will be further reduced to 9.0% effective 1 January 2019.

New small-business limit grind

Currently, the Ontario \$500,000 small-business limit on active business income is phased out on a straight-line basis for Canadian-controlled private corporations (CCPCs) and associated corporations that have between \$10 million and \$15 million of taxable capital employed in Canada.

Ontario intends to parallel a 2018 federal budget proposal that provides an additional phase-out, or grind, of the \$500,000 small-business limit. For taxation years beginning after 2018, the small-business limit will be phased out on a straight-line basis for CCPCs (and associated corporations) earning between \$50,000 and \$150,000 of passive investment income in the taxation year (a small-business limit reduction of \$5 for every \$1 of passive investment

income in excess of \$50,000). The effective CCPC small-business limit will be the lower of the limit determined on the basis of taxable capital and the limit determined on the basis of passive investment income.

Other business tax measures

Ontario Research and Development Tax Credit (ORDTC): The government proposes to enhance the non-refundable ORDTC by increasing the credit rate from 3.5% to 5.5%, applicable to eligible research and development (R&D) expenditures exceeding \$1 million in a taxation year and incurred on or after 28 March 2018. The enhanced tax credit rate will be prorated for taxation years straddling 28 March 2018. The \$1 million threshold will be prorated for short taxation years.

The 5.5% credit rate will not be available for businesses where eligible R&D expenditures in the current taxation year are less than 90% of eligible R&D expenditures in the prior year. Eligible expenditures in short taxation years will be increased to the full-year equivalent. For the purpose of determining a prior taxation year's eligible expenditures, where a corporation amalgamates with or is wound up into another corporation, each predecessor corporation's eligible expenditures will be deemed to be transferred to the successor.

Ontario Innovation Tax Credit (OITC): Ontario is proposing to enhance the 8% refundable OITC for eligible expenditures incurred on or after 28 March 2018. Specifically, if a corporation qualifies for the OITC and has a ratio of R&D expenditures to gross revenues that is:

- ▶ 10% or less, the corporation may continue to claim the OITC at the current credit rate of 8%.
- ▶ Between 10% and 20%, the corporation will be able to claim an enhanced OITC rate that will increase from 8% to 12% on a straight-line basis.
- ▶ 20% or greater, the corporation will be able to claim the OITC at a rate of 12%.

For the purpose of determining this ratio, both R&D expenditures and gross revenues must be attributable to Ontario operations. Amounts attributable to Ontario operations of associated corporations will be aggregated.

The enhanced rates will be pro-rated for taxation years straddling 28 March 2018.

Ontario Interactive Digital Media Tax Credit (OIDMTC): Ontario will extend OIDMTC eligibility to film and television websites purchased or licensed by a broadcaster and embedded in the broadcaster's website. This amendment will apply to websites that host content relating to film, television or internet productions that have not received a certificate of eligibility or letter of ineligibility before 1 November 2017.

Commercialization of intellectual property: Ontario is reviewing various tax incentives implemented in other jurisdictions for the purpose of encouraging the commercialization of intellectual property. These include measures such as preferential corporate income tax rates (i.e., patent boxes), tax refunds, tax deductions and exemptions. Ontario intends to develop a provincial incentive after reviewing these options for effectiveness and feasibility.

Currently, the Ontario tax exemption for commercialization provides a 10-year corporate income “tax holiday” for corporations that:

- ▶ Were incorporated between 24 March 2008 and 25 March 2012.
- ▶ Are in the business of commercializing intellectual property developed by qualifying Canadian universities, colleges and research institutes.

Microbrewers and small beer manufacturers: Ontario proposes to amend the small beer manufacturer’s tax credit and the definition of microbrewer in the *Alcohol and Gaming Regulation and Public Protection Act, 1996* to encourage the growth of small beer manufacturers and microbrewers. These changes will be made retroactive to 1 March 2018.

Personal tax

Personal income tax rates

The minister proposes to eliminate the surtax and make consequential adjustments to personal tax rates and brackets, effective 1 January 2018. Ontario’s surtax is calculated on Ontario basic income tax and is, effectively, a tax on a tax.

For 2018, a 20% surtax rate would apply to Ontario income tax between \$4,638 and \$5,936, and a 56% surtax rate would apply to Ontario income tax in excess of \$5,936.

Although the proposal to eliminate the surtax will simplify the personal income tax system, the proposed statutory rates will still approximate the existing marginal tax rates (that incorporate the surtax) as outlined in Table C.

Table C: 2018 pre-budget and proposed rates

Pre-budget bracket	Pre-budget rate	Pre-budget rate with surtax	Proposed bracket	Proposed rate
\$0 to \$42,960	5.05%	5.05%	\$0 to \$42,960	5.05%
\$42,961 to \$85,923	9.15%	9.15%, or 10.98%, or 14.27%	\$42,961 to \$71,500	9.15%
			\$71,501 to \$82,000	11.00%
			\$82,001 to \$92,000	13.50%
\$85,924 to \$150,000	11.16%	17.41%	\$92,001 to \$150,000	17.50%
\$150,001 to \$220,000	12.16%	18.97%	\$150,001 to \$220,000	19.00%
Above \$220,000	13.16%	20.53%	Above \$220,000	20.53%

For taxable income in excess of \$150,000, the 2018 combined federal-Ontario personal income tax rates are outlined in Table D.

Table D: Combined 2018 federal and Ontario personal tax rates

Bracket	Ordinary income*		Eligible dividends		Non-eligible dividends	
	Current	Proposed	Current	Proposed	Current	Proposed
\$150,001 to \$205,842	47.97%	48.00%	31.67%	31.71%	40.39%	40.42%
\$205,843 to \$220,000	51.97%	52.00%	37.19%	37.23%	45.03%	45.06%
Above \$220,000	53.53%	53.53%	39.34%	39.34%	46.84%	46.84%

*The rate on capital gains is one-half the ordinary income tax rate.

Ontario charitable donation tax credit

The current Ontario charitable donation tax credit (OCDTC) rate is 5.05% on the first \$200 in eligible donations and 11.16% for eligible donations in excess of \$200. However, the impact of the surtax calculation effectively increases the OCDTC rate up to a maximum of 17.41% for surtax payers. The budget proposes to increase the OCDTC rate to 17.5% for all taxpayers for eligible donations in excess of \$200, effective 1 January 2018.

Paralleling federal measures

Income sprinkling

The federal government recently introduced measures to extend the tax on split income rules (which applies the top marginal federal personal income tax rate of 33%) to include certain adult family members receiving income or realizing taxable capital gains directly from family businesses carried on by private corporations, or indirectly through trusts or partnerships (the so-called income sprinkling rules). The proposed rules are designed to limit income splitting among family members. Prior to the introduction of these measures, the tax on split income applied only to minor children.

The Ontario budget announced that it will automatically parallel these measures once the federal proposals are enacted. Therefore, the top Ontario rate of 20.53% will apply to split income received by an adult family member.

Financial institutions

Ontario announced that it will automatically parallel measures announced in the 2018 federal budget, upon their enactment, to amend the synthetic equity arrangement and securities lending arrangement rules in order to target sophisticated financial instruments and structured share repurchase transactions by certain Canadian financial institutions to realize artificial tax losses.

Other tax measures

Taxation of cannabis products

Ontario confirmed it will enter into an agreement with the federal government regarding the collection and sharing of cannabis duties. Under this agreement, it will receive 75% of the federal excise tax collected on cannabis intended for sale in the province.

Ontario also indicated that the full 13% HST will apply to off-reserve purchases of recreational cannabis by status Indians when it is legalized. This is consistent with the current practice for off-reserve purchases of alcohol and tobacco. However, a status Indian who is registered to obtain medical cannabis from a licensed producer will remain eligible for a rebate of the 8% provincial portion of the HST for purchases that are delivered off-reserve.

Employer health (payroll) tax

In order to better target the payroll tax exemption, Ontario is proposing to apply the eligibility criteria for the small-business deduction to the payroll tax exemption. Therefore, the exemption will be available only to employers that are individuals, charities, not-for-profit organizations, private trusts and partnerships, or CCPCs.

Ontario will also amend the *Employer Health Tax Act* by incorporating federal anti-avoidance rules relating to the multiplication of the small-business deduction. Ontario will also determine the payroll tax rate for associated employers in a way that is consistent with the application of the exemption threshold for such employers.

The applicable legislative amendments, if enacted, will take effect on 1 January 2019. Ontario will provide a period for public consultation before introducing legislation for the anti-avoidance measures.

Land transfer tax

To ease land transfer tax compliance, Ontario plans to draft a new regulation that will allow land transfer tax arising from certain unregistered dispositions of a beneficial interest in land through certain 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.

Tobacco tax

In accordance with measures announced in Ontario's 2017-18 budget to increase the tobacco tax rate by \$10 per carton over a period of three years, the province will increase its tobacco tax from 16.475¢ to 18.475¢ per cigarette and per gram of tobacco products other than cigars, effective 12:01 a.m. on 29 March 2018. These changes are equivalent to \$4 per carton of cigarettes. Ontario intends to further increase the tobacco tax rate by an additional \$4 per carton of cigarettes in 2019.

Ontario also announced it will amend the Tobacco Tax Act to introduce new compliance measures, such as adding penalty and offence provisions for failing to notify the ministry prior to destroying raw leaf tobacco.

Underground Economy Initiative re Electronic Sales Suppression

Ontario will enact the *Revenue Integrity Act, 2018* to address the practice of electronic sales suppression. This legislation will require every person who carries on a prescribed business in Ontario to record and report sales transaction information using an electronic cash register. The minister may use this information in connection with the administration and enforcement of Ontario tax laws and may disclose it to the CRA to assist in the administration and

enforcement of certain federal tax laws. The legislation also allows the minister to impose administrative penalties against persons who contravene certain provisions or fail to comply with a compliance order.

The *Revenue Integrity Act, 2018* will take effect upon proclamation.

Recently enacted tax measures

The 2018 budget summarized the following measures announced in the Ontario 2017 fall economic statement and enacted on 14 December 2017:

- ▶ The reduction to the Ontario small-business tax rate from 4.5% to 3.5%, effective 1 January 2018
- ▶ Transforming the Ontario Apprenticeship Training tax credit into the new Graduated Apprenticeship Grant for employers
- ▶ Introduction of the refundable Ontario Seniors' Public Transit tax credit, equal to 15% of eligible public transit expenses

Learn more

For more information, please contact your EY or EY Law advisor or one of the following professionals:

Toronto

Karen Atkinson

+1 416 943 2172 | karen.e.atkinson@ca.ey.com

Neil Moore

+1 416 932 6239 | neil.moore@ca.ey.com

Ottawa

Ian Sherman

+1 613 598 4335 | ian.m.sherman@ca.ey.com

London

John Sliskovic

+1 519 646 5532 | john.t.sliskovic@ca.ey.com

Kitchener

Cynthia McIntyre

+1 519 581 5455 | cynthia.m.mcIntyre@ca.ey.com

And for up-to-date information on the federal, provincial and territorial budgets, visit ey.com/ca/Budget.

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization and may refer to one or more of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

About EY's Tax Services

EY's tax professionals across Canada provide you with deep technical knowledge, both global and local, combined with practical, commercial and industry experience. We offer a range of tax-saving services backed by in-depth industry knowledge. Our talented people, consistent methodologies and unwavering commitment to quality service help you build the strong compliance and reporting foundations and sustainable tax strategies that help your business achieve its potential. It's how we make a difference.

For more information, visit ey.com/ca/tax.

About EY Law LLP

EY Law LLP is a national law firm affiliated with EY in Canada, specializing in tax law services, business immigration services and business law services.

For more information, visit eylaw.ca.

About EY Law's Tax Law Services

EY Law has one of the largest practices dedicated to tax planning and tax controversy in the country. EY Law has experience in all areas of tax, including corporate tax, human capital, international tax, transaction tax, sales tax, customs and excise.

For more information, visit <http://www.eylaw.ca/taxlaw>

© 2018 Ernst & Young LLP. All Rights Reserved.

A member firm of Ernst & Young Global Limited.

This publication contains information in summary form, current as of the date of publication, and is intended for general guidance only. It should not be regarded as comprehensive or a substitute for professional advice. Before taking any particular course of action, contact EY or another professional advisor to discuss these matters in the context of your particular circumstances. We accept no responsibility for any loss or damage occasioned by your reliance on information contained in this publication.