

General Adjustments to Ontario Income Tax Payable

References: Sections 41, 41.1, 43 and subsection 51(4)

Application

This bulletin replaces portions of Information Bulletins 2748 and 2738 originally published October 1994 and February 1986, respectively.

The bulletin is provided as a guide to taxpayers and is not intended as a substitute for the relevant legislation. Any references to legislation are to the provisions of the Corporations Tax Act (Ontario) (CTA) and its Regulations, unless otherwise noted.

Introduction

1. Ontario offers various tax incentives to different types of corporations in order to encourage and promote certain specific economic activities within the province. While some of these incentives are deductions from income (e.g., the Ontario current cost adjustment for pollution control equipment), most are in the form of tax credits against Ontario income tax payable. This bulletin describes some general tax credits offered to broad categories of corporations.

Incentive Deduction for Small Business Corporations (IDSBC)

IDSBC - Section 41

2. It is generally recognized that small, private corporations do not have the same access to capital markets that large, public corporations do. Therefore, in order to assist small corporations to retain their capital, section 41 offers the IDSBC to “Canadian-controlled private corporations” (CCPCs).
3. Though structured as a deduction from income tax payable, the impact of the IDSBC is to effectively reduce the income tax rate of a CCPC, on its active business income, thereby allowing the corporation to retain a larger portion of its income for business expansion purposes. The IDSBC applies only to income below the minimum threshold amount, as shown in Table 2.

IDSBC Rates

IDSBC Rates -
Table 1

4. Table 1 shows the general income tax and the IDSBC rates for 2001 to 2004:

Applicable Period (*)	General Income Tax Rates	IDSBC Rates	Net CCPC Income Tax Rates
January 1, 2001 and before October 1, 2001	14.0 %	7.5 %	6.5 %
After September 30, 2001 and before January 1, 2003	12.5 %	6.5 %	6.0 %
2003 calendar year	12.5 %	7.0 %	5.5 %
2004 and thereafter	14.0 %	8.5 %	5.5 %

(*) For taxation years straddling these dates, the general income tax and IDSBC rates are pro-rated on a daily basis.

Surtax on CCPC's

Surtax -
Section 41.1

5. Section 41.1 imposes a surtax to claw back the low tax rate benefit of the IDSBC from more profitable CCPCs. The surtax equals a specified percentage of the excess of a corporation's taxable income over the minimum threshold amount, not exceeding the IDSBC claimed. The IDSBC will be fully clawed back whenever taxable income reaches the maximum threshold amount. These thresholds and rates are shown in Table 2.

Associated
Corporations

6. When a CCPC is a member of an associated group of corporations, the taxable incomes of all of those corporations must be considered in calculating the surtax payable. This measure prevents the group from effectively "splitting" its collective taxable income amongst all of the group members with each one benefiting from the full IDSBC rate.

Associated
Group Limits -
Amounts
Included

7. Under subsection 41.1(1), the income threshold limits for surtax purposes include the taxable income of each associated corporation for the last taxation year which ends on or before the last day of the corporation's taxation year. Under paragraph 41.1(2)3, where an associated corporation has more than one taxation year ending within the corporation's taxation year, the total amount of the taxable income for each of those taxation years is prorated by the ratio of 365 to the total number of days in those taxation years.

Short Taxation
Years

8. Pursuant to paragraph 41.1(2)1, where the taxation year of a corporation or an associated corporation is less than 51 weeks, the taxable income of those years must be multiplied by the ratio of 365 to the number of days in the taxation year, in order to consider the income on an annualized basis.

Surtax Rates and Income Threshold Limits - Table 2

9. Table 2 shows the threshold amounts and the surtax rates for the years 2001 to 2004:

Applicable Period (*)	Threshold Amounts (*)		Surtax Rates
	Minimum	Maximum	
January 1, 2001 and before October 1, 2001	\$ 240,000	\$ 600,000	5.000 %
After September 30, 2001 and before January 1, 2003	\$ 280,000	\$ 700,000	4.333 %
2003 calendar year	\$ 320,000	\$ 800,000	4.667 %
2004 and thereafter	\$ 400,000	\$ 1,128,519	4.667 %

(*) For taxation years straddling these dates, the threshold amounts and surtax rates are pro-rated on a daily basis.

Surtax Formula

10. The surtax is determined by the following formula:

$S = R \times A \times B / T$, where

S is the amount of surtax payable for the taxation year,

R is the surtax rate per Table 2,

A is the amount subject to surtax (which cannot be less than nil), calculated as:

- the taxable income of the corporation for the taxation year, plus
- the taxable income of each corporation with which the corporation was associated at any time during the taxation year, minus
- T,

B is the least of amounts determined under paragraphs 125(1)(a), (b) and (c) of the *Income Tax Act (Canada)* (ITA) for the taxation year, for the purpose of the federal small business deduction, multiplied by the Ontario small business allocation factor. The Ontario small business allocation factor, as defined in subsection 41(4), is the ratio that the corporation's taxable income earned in Ontario is to the total amount of taxable income earned in provinces of Canada, and

T is the minimum Threshold Amount per Table 2.

Surtax Example

11. Consider the following facts for a small business corporation:

- (a) Ontario taxable income = \$350,000
- (b) Taxable income of associated corporation = \$ 75,000
- (c) Canadian active business income (paragraph 125(1)(a) of the ITA) = \$ 300,000
- (d) Federal taxable income, less adjustment for foreign tax credit (paragraph 125(1)(b) of the ITA) = \$ 350,000
- (e) Business limit for the year (subsection 41(3.2) of the CTA) = \$ 280,000
- (f) Ontario small business allocation factor (subsection 41(4) of the CTA) = 75%
- (g) Year end is December 31, 2002

Surtax Example
(continued)

IDSBC claim allowed	
$(75\% \times \$280,000^*) \times 6.5\% = \$210,000 \times 6.5\% =$	<u>\$ 13,650</u>
* the least of (c), (d) and (e), above	
Calculation of surtax	
Ontario taxable income	\$ 350,000
Add: Taxable income of associated corporation	<u>75,000</u>
Aggregate of taxable incomes	425,000
Less: Low threshold of Business Limit for 2002	<u>280,000</u>
Difference: Amount subject to surtax	<u>\$ 145,000</u>
SURTAX PAYABLE:	
$S = 4.333\% \times \$145,000 \times \$210,000 / \$280,000 =$	<u>\$ 4,712</u>

Manufacturing and Processing Profits Credit (M&P)

M & P Credit -
Section 43

12. All corporations actively engaged in certain qualifying business activities in Canada, are eligible to claim the M&P tax credit against income tax otherwise payable. These activities include manufacturing and processing (as referred to in section 125.1 of the ITA and regulation 5202 of the ITA), as well as farming, fishing, logging, and mining (all as referred to in subsection 505(3) of Regulation 183 of the CTA). The credit is calculated by multiplying the applicable M&P credit rate (shown in Table 3, below) times the lesser of:
- the amount of Eligible Canadian Profits (ECP) that exceeds its "Adjusted Ontario small business income", and
 - adjusted taxable income.

M&P Credit
Table 3

13. Table 3 shows the general income tax rate and M&P credit rate for 2001 to 2004.

Applicable Period (*)	General Income Tax	M&P Credit Rate	Net Income Tax Rate
January 1, 2001 and before October 1, 2001	14.0 %	2.0 %	12.0 %
After September 30, 2001 and before January 1, 2004	12.5 %	1.5 %	11.0 %
2004 and thereafter	14.0 %	2.0 %	12.0 %

(*) For taxation years straddling these dates, the general income tax and M&P credit rates are pro-rated on a daily basis.

Eligible Canadian Profits (ECP)

14. For each type of qualifying active business listed in paragraph 12, above, its ECP are determined by the following formula:

$$\text{ECP} = \frac{\text{MC} + \text{ML}}{\text{C} + \text{L}} \times \text{ADJUBI}, \text{ where}$$

ADJUBI is “adjusted business income”

C is “cost of capital”

L is “cost of labour”

MC is “cost of manufacturing and processing capital”

ML is “cost of manufacturing and processing labour”

All of these terms are defined in Regulation 5202 of the ITA, but are modified for farming, fishing, logging and mining under section 505 of Regulation 183 of the CTA. ADJUBI is calculated per the federal definition, however using relevant Ontario amounts, where they differ from the corresponding federal values, in the computation of active business income.

Small M&P Active Business Income

15. Where a corporation has active business income, from non-M&P sources, which does not exceed 20% of its total active business income and that total does not exceed \$ 250,000, then all of the corporation’s active business income will qualify as ECP, by virtue of subsection 505(2) of Regulation 183. This provision is made to reduce the administrative requirements of small manufacturing corporations in making their M&P claims.

Adjusted Ontario Small Business Income

16. Adjusted Ontario small business income is defined in subsection 43(4). It can generally be described as the amount of income on which the IDSBC has been claimed, but not clawed back by the surtax on CCPCs.

Adjusted Taxable Income

17. For purposes of eligibility for the M&P Profits Credit, discussed in paragraph 12, above, “adjusted taxable income” is the maximum income eligible for the credit. It is computed as Ontario taxable income less:
- Adjusted Ontario small business income
 - the portion of taxable income earned in a foreign jurisdiction, and
 - the excess of investment income over net capital losses.

Additional Tax Deduction for Credit Unions

Additional Deduction - Subsection 51(4)

18. Subsection 51(4) allows credit unions a special deduction from income tax otherwise payable, designed to reduce their overall income tax rate to the same net rate paid by small business corporations which claim the IDSBC. This additional deduction from tax is calculated using the following formula:

$R \times (T - A)$, where

R is the IDSBC rate per Table 1, (except that the 7.5% rate is effective from May 1, 2000, not January 1, 2001)

T is the lesser of

Additional
Deduction -
Subsection
51(4)
(continued)

- taxable income, and
 - 4/3 of its “maximum cumulative reserve” at the year-end, less its “preferred rate amount” for the preceding taxation year. (These terms are defined in section 137 of the ITA.), and
- A is the “Adjusted Ontario small business income”

For More
Information

For further information, please contact DeskAudit, general tax enquiries

- Pickering (905) 837-3888 (905) 837-3889
- Français (905) 837-3907
- Toll-free 1-866-805-7702 ext. 3888; Français poste 3907
- Fax (905) 837-3800

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