

Ministry of Revenue

March 2007

## Corporations Tax Highlights from the 2007 Ontario Budget

6020

### About this Notice

On March 22, 2007, a number of measures relating to the *Corporations Tax Act* and the proposed *Taxation Act, 2006* were announced in the 2007 Ontario Budget. The proposed amendments must be passed by the Legislature and receive Royal Assent to become law. This notice provides general information and is not a substitute for the legislation.

### *Taxation Act, 2006*

Bill 174, the *Strengthening Business through a Simpler Tax System Act, 2006*, if enacted, would implement the *Taxation Act, 2006* which, with certain exceptions, would continue the taxes imposed under the *Corporations Tax Act* and the *Income Tax Act*. Bill 174 was introduced in the Legislature on December 13, 2006 and would be effective for taxation years ending after December 31, 2008. The changes discussed below are proposed to be implemented under the *Corporations Tax Act* for taxation years ending before January 1, 2009 and under the proposed *Taxation Act, 2006* for taxation years ending after December 31, 2008.

### Accelerating Ontario's Capital Tax Elimination

It is proposed to accelerate the elimination of the capital tax from January 1, 2012 to July 1, 2010.

#### Ontario's Proposed Capital Tax Elimination Plan

	Deduction (\$M)	Rates (%)			
		Regular Corporations	Financial Institutions		
			First \$400M of Taxable Capital	Non-Deposit Taking	Deposit Taking
Jan. 1, 2004	5	0.3	0.6	0.72	0.9
Jan. 1, 2005	7.5	0.3	0.6	0.72	0.9
Jan. 1, 2006	10.0	0.3	0.6	0.72	0.9
Jan. 1, 2007 <sup>1</sup>	12.5	0.285	0.57	0.684	0.855
Jan. 1, 2008 <sup>1</sup>	15	0.285	0.57	0.684	0.855
Jan 1, 2009	15	0.225	0.45	0.54	0.675
Jan. 1, 2010	15	0.15	0.3	0.36	0.45
Jul. 1, 2010 <sup>2</sup>	<b>Proposed Accelerated Elimination Date</b>				
Jan. 1, 2011 <sup>3</sup>	15	0.075	0.15	0.18	0.225
Jan. 1, 2012	<b>Legislated Elimination Date</b>				

<sup>1</sup>Rates in the table reflect the five per cent capital tax rate cut announced in the 2006 Ontario Budget and enacted on May 18, 2006.

<sup>2</sup>Capital Tax would be prorated where the taxation year straddles the effective date of the elimination.

<sup>3</sup>Rates in the absence of the accelerated elimination plan proposed in the 2007 Budget.

### Apprenticeship Training Tax Credit (ATTC)

In 2004, the ATTC was introduced to encourage businesses to hire apprentices in certain skilled trades. The ATTC currently provides businesses with a 25 to 30 per cent refundable tax credit on salaries and wages paid to eligible apprentices who commence employment before January 1, 2008. Eligible apprentices must be in their first 36 months of an apprenticeship training program in designated construction, industrial, motive power and service trades.

The Budget proposes to extend the ATTC to eligible apprentices who commence employment before January 1, 2012. Eligible expenditures would be salaries and wages paid prior to January 1, 2015.

In addition, the following six trades will be added to the list of 117 skilled trades that currently qualify for the ATTC:

- entertainment industry power technician
- process operator – power
- tractor-trailer commercial driver
- exterior insulated finish systems mechanic
- information technology call centre inside sales agent
- information technology call centre customer care agent.

The ATTC tax interpretation bulletin will be updated and eligibility for each of these trades will be retroactive to the date that the Ministry of Training, Colleges and Universities introduced the apprenticeship program.

### Ontario Production Services Tax Credit

The Budget proposes to extend the 18 per cent tax credit rate for the Ontario Production Services Tax Credit for one year, until March 31, 2008.

### Ontario Computer Animation and Special Effects Tax Credit

It is proposed to amend the 20 per cent refundable Ontario Computer Animation and Special Effects Tax Credit to allow any wholly owned subsidiary to claim eligible labour expenditures incurred by the parent corporation in respect of the subsidiary's production, effective for productions commencing after March 22, 2007. The conditions for claiming these expenditures would parallel similar rules under the Film and Television Tax Credits.

## Ontario Research and Development Tax Credit

In calculating Ontario taxable income, Ontario currently provides a deduction equal to the portion of the federal investment tax credit (ITC) that relates to qualifying scientific research and experimental development (SR&ED) expenditures undertaken in Ontario. With corporate income tax base harmonization, this incentive will automatically expire for taxation years ending after 2008.

The 2006 Economic Outlook and Fiscal Review proposed to replace this deduction with a 4.5 per cent non-refundable tax credit effective for taxation years ending after 2008.

The Budget outlines additional details of the proposed tax credit:

- An eligible expenditure is an expenditure that:
  - is incurred by a corporation during a taxation year ending after 2008 for SR&ED carried on through an Ontario permanent establishment, and
  - is a qualified SR&ED expenditure for purposes of the federal ITC.
- The new tax credit would be determined after the transitional tax credit and debit, and before the tax credit for Ontario corporate minimum tax.
- A corporation would have the option to waive all or part of its entitlement to the new credit.
- A 20 year carry-forward and three year carry-back would be provided for unused tax credits, although no carry-back to a taxation year that ends before 2009 would be permitted.
- As under the federal ITC rules, partnerships would be entitled to flow the new credit through to active corporate members of a partnership.
- The new credit would be subject to recapture and change-of-control rules similar to those that apply to the federal ITC.
- Continuation rules would be provided to permit unused credits to be carried forward after an amalgamation or winding-up that is subject to subsection 87(1) or 88(1), respectively, of the *Income Tax Act* (Canada).

## Extending the Carry-Forward of Corporate Minimum Tax (CMT) Credits and Losses

It is proposed that the carry-forward period for CMT credits and losses attributable to taxation years ending after March 22, 2007, would be extended from 10 years to 20 years.

For taxation years ending after 2008, it is further proposed that the carry-forward period for CMT credits relating to taxation years ending before March 23, 2007, be extended by 10 years to provide a total 20-year carry-forward. This measure would apply to CMT credits outstanding at the beginning of a corporation's first taxation year ending after 2008.

### Simplifying CMT Compliance and Administration

Corporations are allowed to exclude from their CMT income accounting gains that are deferred on a corporate reorganization for income tax purposes. A gain is deferred until the asset is disposed of in a transaction not involving a corporate reorganization. This deferral also applies to gains arising from the replacement of assets where a deferral is provided for income tax purposes. These rules can be complex and often require taxpayers to track the gains over many years.

The Budget proposes to simplify these rules by exempting from CMT the accounting gains arising from corporate reorganizations or the replacement of assets. In addition, when a transferee disposes of a property that was acquired from a transferor that deferred the CMT gain, the transferee would no longer be liable for CMT on that deferred gain. These measures would apply to a disposition, amalgamation or winding-up completed after March 21, 2007.

Amendments are also proposed to repeal the provisions that allow a flow-through of a subsidiary's CMT losses to a corporation where the subsidiary amalgamates with or is wound up into the corporation. The amendments would permit the corporation to deduct the full accounting loss from the CMT base. This measure would apply to an amalgamation or winding-up completed after March 21, 2007.

### CMT – Unrealized Gains and Losses

The Budget proposes to amend the CMT rules to remove the impact of recent accounting changes respecting unrealized gains and losses. Income for CMT purposes would be calculated without reference to unrealized gains and losses that are not required to be included in computing income for income tax purposes.

Similar adjustments would be made when calculating a corporation's total assets for the purpose of determining whether the corporation qualifies for the CMT exemption for small corporations.

These measures would be effective for taxation years ending after March 22, 2007.

### Special Additional Tax (SAT) on Life Insurers

SAT is a tax paid by life insurance companies. Ontario proposes to introduce a SAT carry-forward credit effective for taxation years ending after 2008. The credit would be equal to the amount of SAT paid for a taxation year ending after 2008.

The credit could be applied in a future taxation year to reduce Ontario income tax payable in excess of the greater of CMT (before deducting the income tax liability for the future year) and SAT (before deducting the income tax and CMT liability for the future year). The SAT credit would have the same carry-forward period of 20 years that is proposed for CMT.

## Adjustments to the Transitional Mechanism for SR&ED

For Ontario and federal corporate income tax purposes, taxpayers typically have tax pools with respect to amounts that can be carried over to another taxation year. Examples are the pools for unclaimed deductions for losses and SR&ED expenditures. Currently, tax pool balances may be different for federal and Ontario purposes. However, upon harmonizing with the federal definition of taxable income, each Ontario tax pool balance will assume its federal value. In many cases, this will require upward and downward adjustments to the Ontario pools, which may result in future Ontario tax gains or losses for corporations. The proposed *Taxation Act, 2006* contains a five-year transitional mechanism that is designed to minimize the Ontario tax gains and losses that would otherwise arise in adopting the federal tax pool balances.

The proposed transitional mechanism first calculates the difference between the aggregate of the federal and Ontario tax pool balances. If the total Ontario balance exceeds the total federal balance, a tax credit is provided to reflect the corporation's Ontario tax loss that arises in moving to the lower total federal balance. Conversely, if the total federal balance exceeds the total Ontario balance, additional Ontario tax is charged to reflect the corporation's Ontario tax gain. The tax credit or additional Ontario tax (i.e., tax debit) is spread out evenly over five years, commencing with the corporation's first taxation year ending after 2008.

The Budget proposes two changes to this mechanism to provide transitional support to R&D companies in Ontario.

As noted above under the Ontario Research and Development Tax Credit, the existing Ontario SR&ED incentive that excludes the portion of the federal ITC relating to Ontario SR&ED from Ontario taxable income expires for taxation years ending after 2008. The existing incentive is delivered in the taxation year in which the assistance provided through federal ITCs is recognized for purposes of the *Income Tax Act* (Canada), which is generally the taxation year following the taxation year in which the corresponding federal ITC is claimed. With this one-year lag and potential delays in claiming federal ITCs, there is a gap between the incentive provided by the new 4.5 per cent tax credit and the existing incentive.

To eliminate this gap, the Budget proposes that the amount of a corporation's relevant federal ITCs earned in taxation years ending before 2009 would be added to the corporation's total Ontario balance, to the extent that those ITCs have not expired for federal purposes; have not been taken into account in the calculation of the existing Ontario incentive; and were not earned prior to the last time that control of the corporation was acquired.

Even with that adjustment, the transitional mechanism can still lead to a tax debit for an SR&ED performer where its federal SR&ED pool balance exceeds its Ontario SR&ED pool balance as of the beginning of its first taxation year ending after 2008. This difference can arise, for example, where a corporation has used federal ITCs, rather than its federal SR&ED pool, to reduce its federal income tax.

To provide additional relief in these circumstances, the Budget proposes that a corporation be allowed to defer tax debits relating to its federal SR&ED pool balance. The

## Adjustments to the Transitional Mechanism for SR&ED (cont'd)

corporation could elect to reduce the amount of its total federal balance by the lesser of two amounts. The first amount would be equal to the excess of its federal SR&ED pool balance over its Ontario SR&ED pool balance, minus the amount of its adjustment for federal ITCs. The second amount would be the amount by which its total federal balance (determined without reference to the election) exceeds its total Ontario balance.

If the electing corporation incurs sufficient ongoing SR&ED, tax debits relating to the reduction in the total federal balance could be deferred by at least seven years as follows:

- For taxation years ending after 2008 and before 2016, a corporation would maintain a cumulative balance of post-2008 SR&ED expenses. For each of those taxation years, the corporation's SR&ED tax deduction would be applied first against that cumulative balance. No tax debit would arise if the SR&ED tax deduction does not exceed the cumulative balance. If a corporation's SR&ED tax deduction exceeds the cumulative balance, the tax debit would be based on the extent to which the SR&ED tax deduction (up to the amount of the reduction in the total federal balance) exceeds the cumulative balance.
- For taxation years ending after 2015, a corporation's tax debit would be based on its SR&ED tax deduction for the year and no longer on its cumulative balance.

## For More Information:

Please contact the Ministry Information Centre between 8:15 am and 5:00 pm toll free from anywhere in Canada.

- English language enquiries 1-800-263-7965
- French language enquiries 1-800-668-5821
- TTY (Teletypewriter) 1-800-263-7776

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