

BUDGET

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May 11, 2005

ONTARIO BUDGET SPEECH OF MAY 11, 2005

- Tax measures
- Economic Viewpoint

INFORMATION BULLETIN



Desjardins
Fédération des caisses
du Québec

Office of the Vice-president, Tax Service
Office of the Vice-president, Economic Studies



May 11, 2005

TAX MEASURES

Ontario's Minister of Finance Greg Sorbara tabled his 2005-2006 budget this afternoon. The budget includes significant investments in postsecondary education and training, namely in universities, colleges and training programs.

The Ontario government recognizes that it was able to bring down the deficit because of a stronger than anticipated economic performance. The revenues, especially those from corporate income tax, were higher than anticipated.

There are only a few tax measures announced in this budget that features no new taxes or tax increases.

Highlights

Measures affecting Desjardins – Businesses

- Review of the Credit Unions and Caisses Populaires Act of 1994
- Accord with Québec on pension plans
- Creation of a common securities regulator

Measures affecting individuals

- Grants for students
- Ontario property tax and sales tax credits for seniors
- Concordance with measures announced in the 2005 federal budget

Measures affecting businesses

- Refundable tax credits
- Retail sales tax simplified calculation for small software businesses
- Professional corporations

MEASURES AFFECTING DESJARDINS - BUSINESSES

The scope of the following topics addressed by the Minister of Finance is broader than just taxes and can affect Desjardins.

Review of the Credit Unions and Caisses Populaires Act of 1994

The government is indicating that it is proceeding with the review of the Credit Union and Caisses Populaires Act of 1994. The government points out that it is co-operating with this sector and determining the amendments to be brought to the Act to modernize its regulations and allow caisses populaires and credit unions to better serve their customers and be more competitive in the financial services marketplace. The government reaffirms its intention to introduce amendments to the Act by next year.

Accord with Québec on pension plans

The government is also proposing to update pensions legislation to facilitate the effective administration of multijurisdictional and jointly sponsored pension plans. Ontario intends to introduce amendments to implement an accord being

discussed between Ontario and Quebec on common pension standards for employment pension plans with members in both provinces. With the assistance of the Canadian Association of Pension Supervisory Authorities (CAPSA), the proposed Ontario-Quebec pension accord is expected to serve as a template for an expanded Canadian agreement, thus simplifying pension regulation for employers with employees working in more than one jurisdiction.

Creation of a common securities regulator

The Ontario government points out that Canada is the only developed nation without some form of national securities regulator. Ontario is recommending the creation of such a body to increase the competitiveness and efficiency of the equity markets in Canada. This body would ease the regulatory burden of businesses, ensure a consistent application of the legislation and better protect investors.

MEASURES AFFECTING INDIVIDUALS

Grants for students

The government is announcing a new tuition grant in co-operation with the federal government and the Canada Millennium Scholarship Foundation that will provide up to \$6,000 to first-year dependent students in postsecondary studies. An assistance of up to \$3,000 will also be provided to second-year dependent students in postsecondary studies.

Ontario Property and Sales Tax Credit for seniors

The property tax and sales tax credits for seniors in Ontario are designed to offer additional assistance to low-income seniors who own or rent their homes. The property tax credit for seniors is \$625 and the maximum advantage resulting from these two credits is \$1,125. Under the current tax regulation, these tax credits as they apply to a couple decrease when the family income is higher than \$22,000.

The government proposes to increase the income threshold for senior couples in 2005 to ensure that those couples receiving the guaranteed minimum level of income support retain their full Ontario Property and Sales Tax Credits benefit.

Concordance with measures announced in the 2005 federal budget

This budget proposes to parallel, with any necessary modifications, a number of measures announced in the 2005 federal budget, subject to the passage of federal legislation:

- Increase of \$5,000 to \$10,000 for medical expenses paid for a dependent;
- Introduction of a tax credit for eligible adoption expenses limited to \$10,000;
- Enhancements to the tax credits for disabled persons and medical expenses.

MEASURES AFFECTING BUSINESSES

Refundable tax credits

Several refundable tax credits are available in Ontario to promote some industries. The budget proposes to increase, enhance or make the following credits more accessible: Ontario Film and Television tax credit, Ontario Production Services tax credit, Ontario Computer Animation and Special Effects tax credit, Ontario Interactive Digital Media tax credit, Ontario Sound Recording tax credit and Ontario Book Publishing tax credit. Some of the changes have already been announced on December 21, 2004.

Retail sales tax simplified calculation for small software businesses

Retail sales tax applies to non-custom computer software and certain software services. The budget is proposing a pilot project consisting of an optional method of tax calculation for contracts involving

both taxable and non-taxable services that would allow businesses to use a blended tax rate applied to the total contract price. This measure would be beneficial for small software businesses because it would simplify the tax calculation and collection process.

Professional corporations

In 2001, the right to incorporate was extended to all regulated professionals. Under existing provisions, non-members of a profession cannot own shares in a professional corporation. Recent negotiations with the Ontario Medical Association have resulted in the government's commitment to extend the share structure of physician professional corporations to include non-voting shares for family members. The government is also proposing to implement this change for dentists who operate their practices through a professional corporation.

Ontario Budget 2005

May 11, 2005

Analysis of Ontario's 2005 budget

A budget of continuity for the liberals



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Highlights

Minister of Finance Greg Sorbara tabled the second budget of the McGuinty government today. It includes a consolidation of the measures taken last year as well as greater efforts to gradually eliminate the structural budget deficit developing for several years.

- The Ontario government's total expenditures should increase by 4.2% in 2005-2006 while total revenues will expand by 5.9%. Revenues should grow at a quicker pace and help absorb part of the structural deficit created over recent years when expenditures often outgrew revenues.
- The budget plan anticipates a \$2.8B deficit in 2005-2006, an amount that includes a prudence reserve of \$1B. Bear in mind that the budget deficit stood at \$5.5B in 2003-2004 and at \$3B in 2004-2005. The Ministry of Finance also anticipates that the budget deficit should continue to be absorbed gradually. So, fiscal balance will be reached in fiscal 2008-2009. Note however that a prudence reserve of \$1.5B is also set aside for fiscal 2006-2007 to 2008-2009.
- The debt that totals the accumulated deficits should keep on inching up over the next three budget years. Reaching fiscal balance in 2008-2009, should however allow the government to put a cap on the debt at \$133.9B. The accumulated-debt-to-GDP ratio should keep on decreasing somewhat over the next quarters and reach 21.5% in 2008-2009, versus 24.6% in 2004-2005 and 24.2% in 2005-2006.
- The Ontario government is planning to strengthen its investments and promote early childhood education. The amounts earmarked for elementary and secondary school education will also be increased during the next three years, in line with the plan announced in last year's budget.
- The 2005-2006 budget also announces an action plan for colleges, universities and training programs. This multi-year plan should total \$6.2B, i.e., a 39% increase between year 2004-2005 and 2009-2010.
- Several initiatives for Ontario's health care system were proposed today and will add to the measures already announced in last year's budget. The goal of these new expenditures is to maintain the health of Ontarians, decrease wait times, upgrade the infrastructure of the health care system and enhance its efficiency and accountability.
- The government has agreed to implement a \$30B five-year infrastructure investment plan.

Summary of budgetary transactions*

(In millions of \$)	2001-2002	2002-2003	2003-2004	2004-2005	2005-2006f	2006-2007f	2007-2008f	2008-2009f
Total revenues	66,534	68,891	68,400	77,137	81,687	84,800	88,500	92,200
Ann. var. in %	0.4	3.5	-0.7	12.8	5.9	3.8	4.4	4.2
Total expenditures	66,159	68,774	73,883	80,130	83,483	85,700	88,500	90,700
Ann. var. in %	2.7	4.0	7.4	8.5	4.2	2.7	3.3	2.5
Reserves	---	---	---	---	1,000	1,500	1,500	1,500
Surplus/(Deficit)	375	117	-5,483	-2,993	-2,796	-2,400	-1,500	0
Net debt	132,121	132,647	138,557	142,228	146,017	149,700	152,600	153,800
Accumulated deficit	132,121	118,705	124,188	127,181	129,977	132,400	133,900	133,900
Program spending as a % of GDP	11.9	11.9	12.6	13.1	13.2	13.0	12.8	12.5
Total expenses as a % of GDP	14.6	14.3	14.9	15.5	15.5	15.2	14.9	14.5
Surplus/(deficit) as a % of GDP	0.1	0.0	-1.1	-0.6	-0.5	-0.4	-0.3	0.0
Net debt as a % of GDP	29.1	27.7	28.0	27.5	27.1	26.6	25.8	24.7
Accumulated deficit as a % of GDP	29.1	24.8	25.1	24.6	24.2	23.5	22.6	21.5

Note: Totals do not always match the sum of all items.

* These figures do not take into account the recent announcement concerning federal transfer increases.

Sources : Ministry of Finance of Ontario and Desjardins, Economic Studies

f: forecasts

Conservative economic assumptions

It is encouraging to note that the fiscal outlook of the McGuinty budget is based on conservative economic assumptions. After a 2.6% increase of Ontario's real GDP in 2004, the Ministry of Finance is anticipating growth of only 2% in 2005 and a slightly higher 2.8% the following year. These estimates are lower than the average estimates of the private sector and our own, which anticipate that growth will reach 2.5% this year and 3.5% next year.

The appreciation of the Canadian dollar, the increase in oil prices and slower economic growth in the United States will put a damper on Ontario's economy this year. These developments will lead to another decline in Ontario's trade surplus. Businesses will have to keep adapting to the difficult environment, which will lead to slow job growth in 2005.

The Ministry of Finance is also anticipating a significant slow-down in consumer spending in 2005, which is different from our scenario and is the main explanation for the disparity between estimates. We are also more optimistic for next year when, as opposed to the Ontario government, we anticipate that external trade will increase. Moderate price increases over the next few years will mean that the GDP deflator and the consumer price index will increase by around 2% over the next few years.

The financial assumptions of the budget are similar to our own estimates. Interest rates should remain very low in 2005. The yield of the federal government's ten-year bonds will be around 4.5% this year before inching up slightly over 5% next year. Following the surge in the past two years, the Canadian dollar will level off at just under \$0.85 US in 2005 and 2006.

Economic and Financial Forecasts

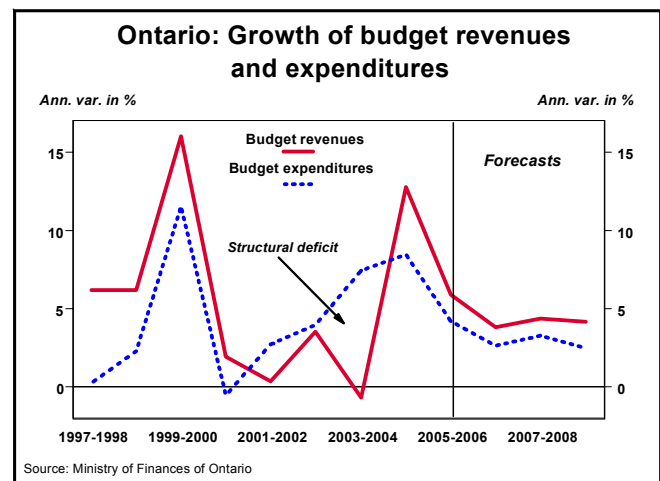
	2004 Budget	2005r Budget	Mouvement Desjardins	2006r Budget	Mouvement Desjardins
Ontario nominal GDP in %	4,7	3,9	4,6	4,6	5,2
Ontario real GDP in %	2,6	2,0	2,5	2,8	3,5
CPI inflation	1,9	2,1	2,0	1,9	2,1
Canadian Treasury bonds in %					
- 3 months	2,2	2,6	2,8	3,4	3,3
Canadian bonds in %					
- 10 years	4,6	4,6	4,4	5,2	5,1
Canadian dollar (US\$/CAN\$)	76,8	82,8	82,0	83,5e	84,5

Sources : Ministry of Finance of Ontario and Desjardins, Economic Studies

e: estimates; f: forecasts

A budget of continuity

Minister Sorbara's second budget should not bring many surprises since most of the fiscal measures that it proposes are in fact the continuation of various programs introduced in the McGuinty government's first budget. The fiscal plan is staying the course on eliminating the budget deficit, although it postpones reaching this goal by one year, in comparison with what had been announced in last year's budget (in 2008-2009 rather than in 2007-2008). Bear in mind that Minister Sorbara inherited a structural deficit from the previous government, brought on by expenses outgrowing revenues for several years. A situation of this nature is relatively difficult to offset. It required a significant turnaround in Ontario's public finances. With revenues outgrowing expenditures over the next fiscal years, the McGuinty government should however be in a position to absorb the structural deficit by 2008-2009.



Note also that Ontario's Ministry of Finance is maintaining a prudence reserve for the next fiscal years, i.e., \$1B in 2005-2006 and \$1.5B in the following years. The relevance of such reserves can however be questioned given the current situation of Ontario's public finances. Of course, one cannot say no to a good thing with such reserves, where and when the budget anticipates a budget balance or surplus. The reserves allow the budget balance to be maintained despite the ups and downs of economic conditions. However, the situation of Ontario's public finances is different since a budget deficit is again anticipated for the next few years. In this situation, the reserves artificially weigh down on the deficits and paint a darker picture of the budget situation. If Minister Sorbara had not introduced these reserves, the anticipated budget deficit would only be \$1.8B and fiscal balance would be reached by 2007-2008.