Budget EXPRESS

May 2, 2013

ONTARIO BUDGET SPEECH

- **Tax Measures**

  Again, very few tax measures…

- **Budget Analysis**

  A balanced budget by 2017–2018

Desjardins

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Charles Sousa, Ontario's Minister of Finance, today tabled his government's 2013 Budget. This budget contains very few tax measures. Of primary interest is a restructuring of the Employer Health Tax, which includes an increase in the exemption, as well as the complete elimination of the exemption for large employers. Of note is the fact that Ms. Wynne's government is a minority government, meaning that it is not certain that these measures will be implemented.

MEASURES AFFECTING DESJARDINS

Employer Health Tax

The Employer Health Tax (EHT) is paid by employers, based on their Ontario payrolls. All private-sector employers, regardless of size, are exempt from paying the EHT on the first $400,000 of their Ontario payrolls each year.

The government proposes to increase this exemption to provide greater EHT relief for small employers. Beginning January 1, 2014, the exemption would be increased from $400,000 to $450,000, and then adjusted every five years based on the Ontario Consumer Price Index.

However, to better target the EHT exemption, beginning January 1, 2014, the exemption would be eliminated for private-sector employers (including groups of associated employers) with annual Ontario payrolls over $5 million.

MEASURES AFFECTING BUSINESSES

Capital Cost Allowance for Manufacturing and Processing Machinery and Equipment

Ontario will parallel the 2013 federal budget proposal to extend the accelerated CCA for manufacturing and processing machinery and equipment acquired in 2014 or 2015. The deduction will be subject to the rule that limits the CCA deduction to one-half of the amount that would otherwise be permitted in the year the asset is acquired.

Apprenticeship Training Tax Credit

The Apprenticeship Training Tax Credit (ATTC) provides businesses with a 35 to 45 per cent refundable tax credit on the salaries and wages paid to eligible apprentices in designated trades.

As a result of this budget, effective for expenditures incurred after March 31, 2014, information technology contact centre technical support agents will no longer be eligible for the ATTC.

Reducing Tax Avoidance and Combatting the Underground Economy

The Ontario government plans to collaborate with the federal government in the fight against tax avoidance and the underground economy. The Ontario government will be proposing legislation to introduce new disclosure rules for aggressive tax avoidance transactions. These measures would require taxpayers to report aggressive tax avoidance transactions that attempt to avoid Ontario tax.

Also, the Ontario government wants the federal government to ensure that corporations do not engage in transactions that attempt to avoid provincial tax through the shifting of profits or losses across provincial borders.

MEASURES AFFECTING INDIVIDUALS

Trillium Benefit

In the 2011 Budget, the government introduced the Ontario Trillium Benefit (OTB), which combined the Ontario Sales Tax Credit, Ontario Energy and Property Tax Credit and Northern Ontario Energy Credit into one payment.

The OTB is paid in monthly instalments throughout the year. The government proposes to modify the OTB so that, beginning in 2014, each recipient would have the choice to receive their benefit in a single payment at the end of the benefit year. However, entitlements of $360 or less per year will be paid in a single payment at the beginning of the year.

Non-eligible Dividends

The Ontario government plans to adopt the same measure as the federal government with respect to the treatment of non-eligible dividends, that is, the gross-up will change from 25% to 18% for dividends paid after 2013. For now, the Ontario credit rate on this type of dividend remains at 4.5%.

Involontary Separation

The government plans to introduce amendments to clarify that the involuntary separation provisions for spouses and common-law partners who live apart for medical reasons would not apply for the purposes of the Ontario Sales Tax Credit.

Pooled Registered Pension Plans (PRPPs)

Following the legislative changes made by the federal government to foster the establishment of PRPPs, the Ontario government will hold consultations to determine how PRPPs should be implemented as a retirement savings option before it tables any legislation.

HARMONIZATION WITH OTHER FEDERAL BUDGET MEASURES

Ontario will adopt some of these measures and their effective dates once federal legislative and regulatory changes have been approved:

- the lifetime capital gains exemption on qualified small business shares and qualified farm or fishing property;
- restricted farm losses;
- the deduction for safety deposit boxes;
- corporate and trust loss trading;
- mining expenses;
- accelerated CCA for clean energy generation equipment;
- character conversion transactions and leveraged life insurance arrangements.

May 2, 2013

ONTARIO: 2013 BUDGET

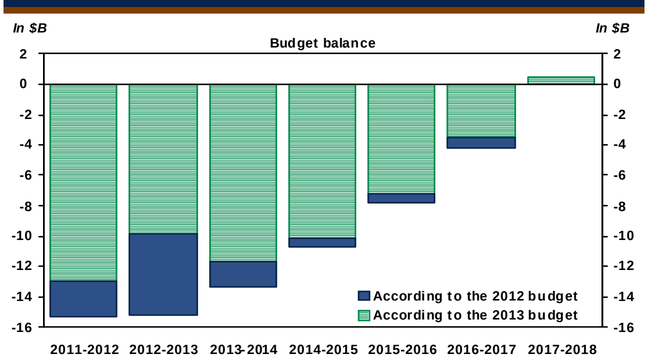
A balanced budget by 2017–2018

The government of Ontario is projecting a budget deficit of $11.7B for 2013–2014, over $1B less than anticipated. Program spending is forecast to grow by 3% throughout the year with revenue increasing by 2.3%. If efforts to control spending continue, a zero deficit will be achieved in four years. This target is ambitious but feasible, considering that the 2012–2013 deficit was nearly $5B below projected results.

CONTROLLING SPENDING IS KEY

The Ontario government's new financial projections have altered very little from last year's budget, and the goal of a balanced budget in the 2017–2018 fiscal year has not changed. To achieve this, the government will need to maintain a very slow growth rate in program spending. Spending in health, education, child services and social services will certainly grow more rapidly, while spending in other sectors will have to decrease. The expected increase in budget revenues in 2013–2014 is somewhat limited, as the province continues to deal with recent difficulties in economic growth. The next fiscal year is expected to deliver improvements, as Ontario starts benefitting from a sustained U.S. economic recovery and an end to the European recession. At the final tally, a budget deficit of $11.7B is projected for 2013–2014, with a gradual reduction leading to its elimination in 2017–2018. Note that Ontario government forecasts continue to incorporate a reserve of between $1.0B and $1.5B, which is prudent given the persistent high levels of uncertainty.

Budget deficits will be lower than expected



Sources: Ontario Ministry of Finance and Desjardins, Economic Studies

For the year ended March 31, 2013, the projected budget deficit is now $9.8B, which is $5.0B less than the amount forecast in last year's budget. This improvement is the result of lower program spending (including one-time savings incurred by reducing school board liabilities associated with reimbursing accumulated sick days and retirement gratuities), as well as increased revenues, particularly from corporate taxes. Unfortunately, the government has not taken advantage of this improvement to further reduce the budget deficits projected for upcoming fiscal years. The return to a deficit of more than $10.0B in 2013–2014 seems inevitable given the Ontario economy's recent troubles and the marked acceleration in program spending after the major sacrifices made in 2012–2013.

GROWTH SHOULD ACCELERATE AFTER A DIFFICULT YEAR-END

In addition to tabling the 2013 budget, the Ministry of Finance also published the province's economic accounts today. Ontario's real GDP grew by only 0.2% (annualized rate) in the fourth quarter of 2012, after a gain of only 0.3% in the previous quarter. Ontario's economy has therefore

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grown more slowly than the Canadian average since mid-2012. Ontario's real GDP posted a gain of 1.6% for all of 2012, compared with Canada's at 1.8%. Domestic demand in the province grew at nearly half the rate of the country as a whole. Non-residential investment is weaker in the province, and the decline in government investment is more pronounced. This is not surprising given the magnitude of Ontario's budget deficit.

The Ministry of Finance is predicting real GDP growth of 1.5% in 2013, a lower projection than what was forecast in the last budget. This is dependent on Ontario's economic growth accelerating at the start of 2013. However, the latest results from the economic indicators tend to back this hypothesis. For example, the volume of merchandise exports Canada-wide jumped 8.7% in the first quarter of 2013. The Ministry of Finance expects the real GDP to increase 2.3% in 2014 and 2.4% in 2015, and those predictions are similar to our most recent forecasts.

THE WORST SEEMS TO BE BEHIND US

Last year, the Ontario government targeted the wages of teachers, civil servants and other public sector employees, which represent more than half its expenditures. It also implemented further spending cuts. This strategy seems to have had a major positive impact on the 2012–2013 deficit.

Of course, achieving a zero deficit in 2017–2018 will only be possible by reining in growth in program spending as much as possible. This would preclude the introduction of new programs or additional spending. It is therefore not surprising that this budget contains few new measures and focuses instead on improving existing systems and programs. A government effort to solve the major problems faced by Ontario's auto insurance system is one example. The government intends to lower premiums for motorists by 15% through various legislative measures to reduce fraud and improve transparency. These actions will likely prove popular while avoiding substantial budgetary implications.

The only new program that will receive any significant new money ($295M over two years) will be the comprehensive Youth Jobs Strategy, which will support initiatives to boost employment prospects, entrepreneurship and innovation among young people. Roughly $100M will also be allocated to a new fund dedicated solely to municipal roads and bridges and other essential infrastructure. This money will go exclusively to small and rural municipalities. With this budget, the government also initiated some reforms to the social assistance program to help more beneficiaries find jobs and improve their financial security.

Some of the budget's other measures will impact income levels. For example, small businesses will be offered greater health tax relief. Lastly, the government will also extend the accelerated capital cost allowance for manufacturing or processing machinery and equipment until 2015.

Table 1
Summary statement of transactions

	Actual	*Projections*					
In $B	2011-2012	2012-2013	2013-2014	2014-2015	2015-2016	2016-2017	2017-2018
Total revenues	**109.8**	**114.2**	**116.8**	**120.5**	**124.9**	**130.1**	**134.4**
- Variation (%)	2.4	4.0	2.3	3.2	3.7	4.2	3.3
Program spending	**-112.7**	**-113.6**	**-117.0**	**-118.3**	**-118.8**	**-118.8**	**-118.0**
- Variation (%)	0.9	0.8	3.0	1.1	0.4	0.0	-0.7
Debt charges	**-10.1**	**-10.4**	**-10.6**	**-11.1**	**-12.2**	**-13.4**	**-14.5**
- Variation (%)	6.4	3.2	1.9	4.7	9.9	9.8	8.2
Total expenses	**-122.7**	**-124.0**	**-127.6**	**-129.5**	**-131.0**	**-132.1**	**-132.4**
- Variation (%)	1.3	1.0	2.9	1.5	1.2	0.8	0.2
Reserve	---	---	-1.0	-1.2	-1.2	-1.5	-1.5
Budgetary balance	**-13.0**	**-9.8**	**-11.7**	**-10.1**	**-7.2**	**-3.5**	**0.5**
Net debt	**235.6**	**252.8**	**272.8**	**290.1**	**303.9**	**n.d.**	**n.d.**
- In % of GDP	36.0	37.5	39.3	40.2	40.4	39.8	38.8

n.a.: unavailable
Sources: Ontario Ministry of Finances and Desjardins, Economic Studies

Table 2
Economic and financial forecasts

Variation in %	2012 Budget 2012	2012 Budget 2013	2013f Budget 2012	2013f Budget 2013	2014f Budget 2012	2014f Budget 2013
Real GDP	1.7	1.6	2.2	1.5	2.4	2.3
Nominal GDP	3.4	2.9	4.1	3.0	4.2	4.1
Employment	0.9	0.8	1.3	1.2	1.5	1.4
U.S. real GDP	2.3	2.2	2.6	2.1	3.0	2.7
Canadian dollar (US¢)	98.0	100.1	101.0	98.0	102.5	99.5
Treasury bills – 3-month (%)	0.9	0.9	1.4	1.0	2.4	1.2
Federal bonds – 10-year (%)	2.2	1.9	2.8	2.0	3.8	2.6

f: forecasts
Source: Ontario Ministry of Finances

STAYING THE COURSE

The budget presented today should not provoke any strong reactions, which is no doubt a concern for this minority government. The Ministry of Finance continues to move toward the goals it set last year and it has laid out a clear path to those objectives. Taxpayers and businesses will not see their tax burden increase. No new large, costly programs were announced, with the possible exception of the Youth Jobs Strategy, which, it must be said, is a worthy cause. The promised 15% reduction in auto insurance premiums should prove popular.