

# 2009 Ontario Budget Analysis

## Tax Reform Dominates 2009 Budget Plan

March 26, 2009

Today, Ontario's Finance Minister Dwight Duncan delivered a budget that fundamentally changes Ontario's tax structure. In addition to a commitment to harmonize the province's Retail Sales Tax (RST) with the Federal Goods and Services Tax (GST), the government outlined significant and largely unexpected cuts to Corporate and Personal Income Tax rates.

The Budget also confirmed recent announcements relating to the Government's poverty agenda (increase in child benefits and capital funding for existing and new affordable housing units) as well as the commitment to stimulate the economy with a \$27.5 billion infrastructure infusion, topped up by the federal contribution of \$5 billion.

Overall, the plan provides for a massive \$11 billion increase in spending at the same time that revenues are falling. This is a major political gamble by the McGuinty government, which is dependent on four key assumptions:

- 1) That a period of dramatic economic challenge is the right time to make structural changes to enhance long-term competitiveness.
- 2) That the public and stakeholders will continue to support the world-wide consensus on government intervention as a necessary response to the financial cataclysm.
- 3) That people will believe that tax harmonization is revenue neutral and will leave them personally whole or better off; and
- 4) That an economic turnaround within two years will allow for the start of a reduction in the deficit over time.

### At a glance:

- Deficit: 2008/2009 - \$3.9 billion                      2009/2010 - \$14.1 billion

Even in their own projections, the government does not expect to show a balanced budget until at least 2015-16.

- GDP projection: A 2.5% reduction in 2009 and 2.3 % increase in 2010
- Total Spending: Increases from \$97.3 billion in 2008/09 to almost \$109 billion in 2009/10

## **10.6 Billion in Temporary and Permanent Tax Relief Over 3 Years**

### **Tax changes for individuals:**

- Reducing Ontario's lowest tax bracket from 6.5% to 5.5%, a reduction of 17.5%
- Creation of a permanent value added sales tax credit of up to \$260 annually for every adult and child
- Every eligible family with an income of under \$160,000 will be entitled to \$1,000 over two fiscal years and payable in three separate payments

### **Corporate Tax Cuts Effective July 1, 2010:**

- General Corporate Income Tax rate reduction to 12 % (a 14.3% reduction) and then reduced to 10% in 2013 (a further 16.7% reduction)
- Ontario's manufacturing and processing rate will be reduced to 10% representing a 16.7% cut
- 18% cut to the corporate tax rate for small business taking the rate from 5.5% to 4.5%
- Extending the write-off for new machines and equipment and providing a 100% write off for new computers for small businesses

### **Tax Harmonization:**

Without doubt the most controversial component of today's budget will be the decision by the McGuinty government to harmonize the provincial Retail Sales Tax (RST) with the federal Goods and Services Tax (GST) creating a single sales tax of 13 per cent as of July 1, 2010.

This is a gamble for the provincial Liberals who risk not only alienating their political base but also energizing their opponents on both sides of the political spectrum.

By all accounts this was a decision driven by the Premier himself.

McGuinty, who is known to repeatedly tell his caucus, cabinet and senior advisors that "doing the right thing is always good politics", is counting on the strong support of the Ontario Chamber of Commerce and other business groups to get his message out that this tough decision is the right one for Ontario's future competitiveness.

Put simply, what this realigning of Ontario's tax system does is shift a significant piece of the overall tax burden from business to consumers. For consumers, not only will the basket of goods that are taxed increase but, for the first time, there will be new provincial taxes on services. For business, the new tax will be a pass-through cost not an actual cost, creating significant savings as current RST taxes had to be paid on every product purchased by a company with no ability to get that money back.

The theory for those supporting the tax change is that it will improve Ontario's competitiveness by driving down business costs which businesses will ultimately pass through to consumers in the form of lower prices.

While many will question the wisdom of announcing new consumption taxes in the middle of a deep recession, McGuinty is said to have believed the greater risk to his government was a perception that they were sitting on their hands during this period of economic turmoil.

While much of the media coverage before the budget focused on the potential impact of the new tax on products which were exempted from the PST, the government moved to eliminate its vulnerability by announcing that many of those exemptions would continue. Specific exemptions announced today include:

- children's clothing and footwear
- diapers
- feminine hygiene products
- books
- children's car seats and boosters, and
- new homes costing less than \$400,000 (with partial tax rebates for new homes between \$400,000 and \$500,000)

The government has committed to ensuring transfer partners such as hospitals and municipalities do not incur additional costs as the result of harmonization.

What didn't receive much of a public airing in the trial balloons before the Budget was the fact that harmonization means additional taxes on services. For the first time today many Ontarians will be learning that there will be a new 8% provincial tax on services such as plumbing, carpentry, real estate commissions, or accounting and legal fees.

The government also moved to soften the potential blow to consumers by announcing a one-time compensation of \$1,000 – in three equal payments over 12 months – to families with annual incomes of less than \$160,000.

This move, while politically necessary, could ultimately backfire on the government as it is an admission that consumer's costs (read "taxes") are going up, and going up by a lot. History shows that no one believes a politician when they say tax changes will be revenue neutral. No doubt there will be people in the coffee shops across Ontario tomorrow complaining: "if they say it is going to cost me \$1,000 than it's really \$2,000".

Perhaps the best example of the impact how these new costs can add up and hit consumers was provided by the Toronto Real Estate Board who estimated that the new tax on services will add \$2,037 to the purchase of a \$360,000 home as closing costs on all homes, including realtor fees, legal services and home inspections, will climb because they are not currently subject to provincial sales taxes.

It was once said there were only two things that are certain, death and taxes. After this budget there are likely two new certainties to add to the list:

1. Over the next few weeks and months all politicians will be carefully watching the public's reaction; and
2. Dozens of industry groups will soon be knocking on government's door to make the case for their exemption before the budget bill becomes law and the opportunity disappears.

## **Infrastructure Investments**

As leaked in the past few days, the government plans to significantly increase infrastructure spending over the next two years. The \$27.5 billion in provincial commitments over two years compares is approximately \$11 billion more than over the past two years, and is further topped up by \$5 billion in federal money.

Reflecting Minister Dwight Duncan's prior statements about the importance of infrastructure for immediate job stimulus, the Budget claims these expenditures will result in more than 300,000 jobs over the two year period.

The Budget tables provide breakdown by sector, showing major increases for health and education. Some of this has been nominally assigned already with federal provincial announcements, notably close to \$1 billion for housing initiatives and \$780 million for post-secondary capital. Other areas which might have seen relatively constant or even declining capital spending, such as water and waste water infrastructure, will undoubtedly receive additional funding from the almost \$7 billion in short term stimulus funding over two years, according to Finance officials, all of which will subsequently be allocated by sector.

The table does not include amortization costs for previous capital commitments as they come online, which are reflected under each Ministry's operating Budget.

There will be significant jockeying by stakeholders such as municipalities, hospitals, universities and cultural agencies for appropriate shares of the capital money over the coming months. Clients with obvious infrastructure interests will need to be active in fighting for their interests.

A copy of the Provincial Budget and relevant supporting documentation is available at:

**<http://ontariobudget.ca/>**

For specific questions or additional information please do not hesitate to contact Counsel Public Affairs at **416-920-0716**.