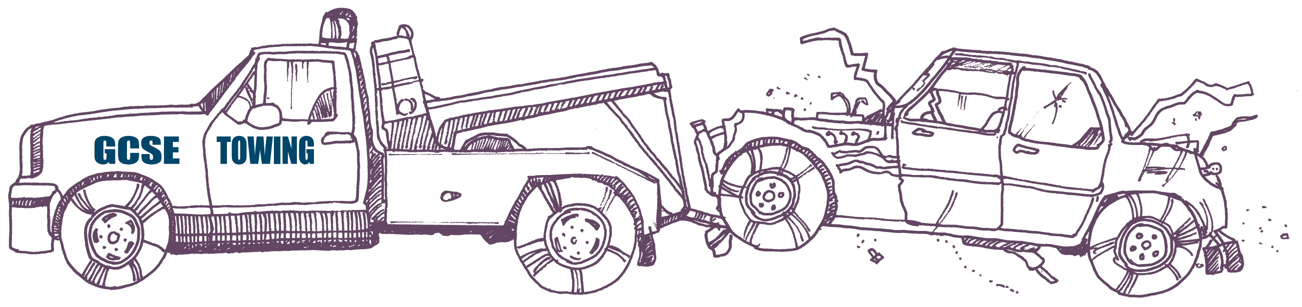
GCSE In Touch *with* Tax

August 2002

The Automobile
From Dealer To Scrap Yard



At GCSE Towing, we can salvage your car as well as your taxes.

It's time to buy a new car. Should your company buy the car or should you buy it personally? Alternatively, should the car be leased, either in a company or personally? Should a company provide an employee with a company car, or reimburse the employee for expenses incurred? The answers are not simple because the tax rules in this area are extremely complicated. Often, there is no easy solution. In fact, generally there is no good solution.

The preceding questions about cars are likely the most often asked of accountants. In the good old days, prior to June 18, 1987, the answers were both simple and "generous". Since that time, the government's policy has generally been: drive what you want, but taxpayers aren't going to help you pay for it.

The tax authorities are interested in ensuring that employees and owner/managers of companies do not enjoy tax-free perks from the company. The result is a set of tax rules which impose tax on any personal use of employer-supplied cars and some car allowances. Further, the tax rules are structured to limit the deduction of costs associated with the ownership of cars which are considered to be "luxurious".

For the sake of simplicity, the balance of this commentary will refer only to employees. Please note that these rules are equally applicable to owner/managers.

What is An Automobile?

Sounds simple. Maybe not. The employer's and the employee's tax consequences depend on whether a car is an "automobile" for tax purposes. In most cases, the answer to the question "what is an automobile?" is obvious.

What's Inside...

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If the vehicle is not an "automobile", then the specific and often harsh rules dealing with employee taxable benefits in the following sections will not apply. Instead, the employee will only be taxed on any benefit which he has actually received as a result of any personal use of an employer-owned or employer-leased car.

If the vehicle is an "automobile", then the deductibility of certain costs associated with the ownership of the automobile are restricted to certain limits. If a car is not an "automobile", the deduction of costs associated with the ownership of the vehicle will be subject to the normal rule that requires that the expense or expenditure is incurred for income-earning purposes.

An automobile is a defined term for tax purposes. It includes any motor vehicle which seats up to 9 people. The exceptions are primarily vehicles used in a business, including:

- An ambulance
- A taxi
- A bus used to transport passengers
- A hearse
- A van or pick-up truck that seats no more than 3 people, and is used primarily for the purpose of transporting goods or equipment in the course of a business (sorry, mom's taxi)
- A van or pick-up truck (regardless of how many passengers it may seat) which is used all or substantially all for the purpose of transporting goods or equipment in the course of a business.

A car which is being sold, leased or rented, and cars used in the funeral business are not "automobiles" for the purpose of determining the deductibility of costs. However, employees who have personal use of such vehicles will be subject to the following rules in determining their taxable benefit.

In the following commentary, we have assumed that the vehicle is considered an automobile, as defined, and use the words automobile, vehicle and car interchangeably.

Should The Car Be Owned/Leased by The Corporation?

Tax Implications to the Employee

Standby Charge Benefit

Having a car **available** for the personal use of an employee, may be costly. Even if personal use of the car is negligible, as long as the employee has access to the car for personal use, the employee will be considered to have received a taxable benefit, calculated based on the actual cost of the car. This is known as a "standby charge" benefit.

The mechanics of determining the amount of the benefit will be discussed in the "Employer-Owned Cars" and "Employer-Leased Cars" sections. Unless the employee qualifies for the reduced standby charge, he/she may be taxed on a substantial percentage of the cost of the car each year. If the employee drives an employer-owned car for more than four years, he/she will be taxed on more than 100% of the cost of the car.

The standby charge benefit is based on the original cost of the car, notwithstanding that the employer may only be able to claim deductions based on a lower amount (see our comments under the *"Luxury Car"* section). An employee driving a five-year-old car will be taxed on the same amount of benefit as an employee who drove the car when it was new. The taxable benefit in the later years may in fact be in excess of the true value of the benefit. As a result, it is generally advisable to sell the car to the employee after a few years at the then lower fair market value.

The standby charge is applicable even if the car is not available for the exclusive use of one employee. If an employer-owned or leased car is available for the personal use of more than one employee, each may be subject to the standby charge benefit. For example, if a husband and wife are both employees of a business, and a car is available for the personal use of both of them, each may be taxed on 24% of the cost of the car each year.

For the above reasons, cars should generally not be owned through a corporation, unless the cars are not used, and are not available for use, for personal purposes. In the case of owner managers, there are circumstances where a corporate owned vehicle is appropriate.

Employer-Owned Car

The standby charge is calculated as 2% of the cost (including any Goods and Services Tax ("GST") or Harmonized Sales Tax ("HST") and provincial sales tax ("PST") paid by the corporation) of the car for each month the car is available for personal use. If a car is available for use for the full year, the employee will be taxed on a benefit equal to 24% of the cost of the car.

For example, Good Employer Corporation purchased a car for $50,000 (taxes included) to be used in the business. An employee, Mr. Bigshot, who was hired on May 1, 2002, uses the car approximately 70% for business, and 30% for commuting between his home and his place of employment, personal errands, etc. The 2002 standby charge benefit will be calculated on the eight months during which the car is available for his use:

$$2\% \times \$50,000 \times 8 = \$8,000$$

In 2003, assuming that the car will be available for use in the whole year, the standby charge benefit will be $12,000 (2% x $50,000 x 12).

These benefits are taxed the same as $8,000 and $12,000 of salary respectively.

Special Standby Charge Benefit for Car Salesmen

An employer has the option of using special rules for employees who are employed principally in selling or leasing cars. The standby charge benefit becomes 1.5% per month of the greater of:
• the average cost of new cars purchased during the year, or
• the average cost of all cars purchased during the year.

Employer-Leased Car

If an employer provides the employee with a leased car, the standby charge is calculated as 2/3rds of the total lease cost during each month the car is available for personal use.

The employer's lease cost includes all amounts (other than insurance) the employer is required to pay to the lessor, even though the employer's lease cost deduction may be restricted (see "Lease Cost" section for further comments). The amounts which are included in lease cost include:

- kilometre charges,
- any charges for repairs and maintenance,
- GST/HST and PST,
- "terminal charges" (i.e., amounts charged at the end of a lease term) less "terminal credits" (i.e., amounts credited at the end of a lease term), and
- a pro-rata portion of any substantial down payment, in excess of first and last month lease payments.

Reduced Standby Charge

The standby charge may be reduced from the amounts determined above, if:

- The employee uses the car all or substantially all for business purposes, and the personal use does not exceed an average of 1,000 kilometres per month; and/or
- The employee pays an amount to the employer for the use of the car.

Generally, the standby charge formula assumes that an employee's personal use of the employer's car is 1,000 kilometres per month, or 12,000 kilometres per year. If an employee is required by the employer to use the car for business, and the car is used all or substantially all (interpreted by the Canada Customs and Revenue Agency as more than 90%) for business, the standby charge is calculated to be a fraction of the standby charge otherwise determined. For example, if the personal mileage during a year is only 5,000 kilometres, the employee will only be taxed on 5/12 of the normal standby charge. To benefit from this reduction, the Canada Customs and Revenue Agency will want to see mileage logs and/or other evidence supporting the personal mileage claimed.

It is important to reiterate that driving between home and your place of business or employment is considered personal.

The standby charge is further reduced by any amounts paid during the year by the employee to reimburse the employer for the use of the car. Any amounts paid by the employee to reimburse the employer for operating expenses will not reduce the standby charge benefit.

Operating Cost Benefit

If an employer also pays operating costs that relate to the personal use by an employee, an additional operating benefit is required to be included in the employee's income. Operating costs do not include parking costs.

Generally, the operating cost benefit is determined by multiplying the total personal kilometres driven in the year by a prescribed amount.

The prescribed amount is 16¢ in 2002. The prescribed amount for car salesmen is 13¢ in 2002.

If the employee uses the car primarily (interpreted by the Canada Customs and Revenue Agency as more than 50%) for business, and the employee notifies the employer in writing before the end of the year, the operating cost benefit may be determined as 1/2 of the amount of the standby charge (before reduction for employee reimbursement).

An employee may reduce the amount of the operating expense benefit if he/she reimburses the employer no later than 45 days after the year-end.

Assume Mr. Bigshot, in the previous example, will drive 15,000 kilometres in 2002, 4,500 (i.e. 30%) of which will be personal mileage. Assume also that Good Employer Corporation will pay $9,000 in operating costs in respect of the car provided to Mr. Bigshot. The normal operating cost benefit will be 4,500 x 16¢ = $720, instead of 30% of the actual operating costs paid by Good Employer Corporation. Mr. Bigshot will not elect to use the alternative method, which would result in a higher operating cost benefit of $4,000 [$8,000 (the previously calculated standby charge benefit) x 1/2]. Mr. Bigshot will be able to eliminate his operating benefit by reimbursing Good Employer Corporation $720 by February 14, 2003.

In order to benefit from this preferential calculation, the employee must maintain a log.

Tax Implications to The Employer

Generally, the comments relating to employer-owned vehicles also apply to vehicles owned by self-employed individuals.

Luxury Cars

Depreciation

Depreciation for tax purposes (referred to as capital cost allowance, or "CCA" for tax purposes) is restricted on so-called luxury cars. CCA on cars which cost no more than the prescribed limit (the limit for automobiles purchased in 2002 is $30,000 plus GST/HST and PST) may be claimed according to normal rules. CCA on cars which cost more than the limit can only be claimed on a cost equal to the limit. Each car which exceeds the limit is separately accounted for in a separate class.

The rules are summarized in the following table.

	Luxury Cars	Other Vehicles
Maximum cost added to CCA class	$30,000 plus GST/HST & PST (in 2002)	Actual cost
CCA rate	15% in year of purchase, 30% declining balance thereafter, and 15% in the year of sale	15% in year of purchase, 30% declining balance thereafter
Recapture or terminal loss in year of disposition	None	Yes, if no assets remaining in the class

When the "luxury car" concept was introduced in 1987, the threshold was $20,000. It had been increased a number of times to its present limit. It is the year of acquisition that determines the limit. No adjustments are made after the car is purchased and the limit increases.

Interest Expense

An employer is permitted to deduct a monthly maximum of $300 (in 2002) in respect of interest incurred on buying a car, whether the car is a "luxury car" or not. This rule may have the effect of restricting the deduction when a corporation buys an expensive car.

The maximum deductible monthly interest is determined by the limit in the year of acquisition and does not vary even if the limit changes.

Lease Costs

For leased cars, the calculation of the maximum deductible lease payments is extremely complex. Generally, for a car leased in 2002, the deduction is limited to the lesser of:

1. the actual lease payments, and
2. $800 (plus GST/HST and PST) per month.

The actual lease payments are reduced if the car's manufacturer's list price ("MLP") is in excess of $35,294 (plus GST/HST and PST), for a lease entered into in 2002. For example, assume that in May 2002, Good Employer Corporation leased instead of buying the $50,000 (taxes included) car in the previous example. It paid $1,000 (including taxes) per month for the lease, for a total of $8,000 for the year. The deductible amount of the lease payments will be calculated as the lesser of the following amounts:

1. $6,494
   - calculated by multiplying the actual lease payments of $8,000 by the following ratio: $34,500/85% of $50,000
2. $7,360
   - the monthly limit of $800 plus taxes of $120 per month, for 8 months

The limits were the same for cars leased in 2001. The limits are lower for cars leased prior to 2001.

	Leased in 1998 and 1999	Leased in 2000
Monthly lease limit	$650 + GST/HST + PST	$700 + GST/HST + PST
MLP limit	$30,588 + GST/HST + PST	$31,765 + GST/HST + PST

There are adjustments which take into account the impact of refundable deposits, and reimbursements receivable on the lease. These rules prevent leases, which, as a result of such deposits and reimbursements, are structured with lower than normal lease payments in order to bypass the luxury car restrictions. The deduction limit calculation is further complicated by the fact that the calculation of allowable lease payments is cumulative over the term of the lease. Payments which are not deductible in one year may be deductible in another year under certain circumstances.

GST/HST

Input Tax Credit ("ITC")

If the employer is registered for the GST or HST, it may be able to recover the tax paid on the purchase of the car through the ITC mechanism, provided that the car is used primarily (i.e. more than 50%) in commercial activities. Where an employee uses an automobile partly for business and partly for personal use, the employee's personal use is considered to be part of the employer's commercial activities for purposes of calculating the employer's input tax credit. This is the case as long as the employee's personal use is less than 90%. If it is 90% or more, no input tax credit is allowed.

If a car is a "luxury car", the maximum ITC which may be claimed is limited to the lower of the actual tax paid and the tax that would have been payable on the maximum depreciable cost (see our comments under the Depreciation section). For example, if Good Employer Corporation paid

$3,043 GST on the car provided to Mr. Bigshot in the previous example, it will be allowed to claim as ITC, the lower of the actual GST of $3,043, or $2,415, [7% of $34,500, ($30,000 plus applicable GST and PST)].

In the case of leased vehicles, the GST/HST paid or payable by an employer on the lease payments is creditable in the normal manner. However, to the extent that the lease costs exceed the maximum lease costs that are deductible (see our previous comments), the ITC on the excess amount is recaptured at the end of the year. No amount is to be recaptured if the employer was denied an ITC (such as when employee personal use is more than 90%).

Remittance re Employee Benefits

The employer is required to remit GST/HST on the standby charge and operating cost benefits which are taxable to the employee.

The amount which is required to be remitted is 6/106 of the amount of standby charge before reimbursements, and 5% of the operating cost benefit before reimbursement. For employers in the HST system, the remittance amounts are 14/114 of the standby charge benefit and 11% of the operating cost benefit.

Should An Employee Use His/Her Own Car For Employer Business?

Tax Implications to the Employee

Tax Free Allowances

An employee may receive tax-free, reasonable allowances for the business use of his/her car. There is no definition of what is reasonable, but the CCRA will generally accept the per-kilometre amounts in the "Tax-Deductible Allowance" section as reasonable.

The following allowances are taxable to the employee:

- *An employee receiving an allowance which is not calculated based on business kilometres travelled;*
- An employee receives both a flat rate allowance and a per-kilometre allowance;
- An employee receiving specific reimbursement for certain expenses (except supplementary business insurance, toll, ferry charges and parking) as well as receiving a per-kilometre allowance.

Administratively, the CCRA will permit an employer to pay a flat rate allowance to an employee during the year, and not consider it to be a taxable allowance, provided that:

- There is a pre-established reasonable per-kilometre allowance rate,
- The flat rate allowances are reasonable,
- The employee must account for the business kilometres he/she has travelled during the year, and the advances received, before the end of the calendar year, and
- Any overpayments must be repaid to the employer, or any underpayments paid to the employee before the end of the calendar year.

Car Expenses

The employee may claim expenses on his/her personal tax return with respect to any business use of his/her car, provided that the following conditions are met:

- The employee does not receive an allowance which is reasonable, and therefore, not included in his/her income during the year,
- He/she is required under the terms of his/her employment contract to pay for his/her own expenses,
- He/she is ordinarily required to travel away from the employer's place of business, and
- The employer completes form T2200, which certifies that the above conditions are met. (See sample form on page 6).

If an employee receives a car allowance which is unreasonable (either too high or too low), he/she may consider including the amount of the allowance in income, and deducting the business portion of both ownership and operating expenses. The restrictions concerning the deductibility of depreciation, interest and lease costs are as outlined in the previous sections dealing with cars owned by employers.

Interest Free/Low Interest Rate Car Loans From The Employer

An employer may assist the employee in buying a car used for business by giving the employee an interest free loan, or a loan with lower than the market rate of interest. The employee must include a taxable benefit in income, calculated by multiplying the outstanding loan balance by a prescribed rate of interest. The taxable benefit is reduced by any interest actually paid by the employee within 30 days after the end of the year.

For example, assume that Ms Top Notch needs a car to travel on her employer's business. On January 1, she receives an interest-free loan of $20,000 from her employer to assist her in buying a car. The quarterly prescribed rates of interest for the year are 6%, 6%, 5% and 5%. Her taxable benefit for the year will be:

Jan - June	20,000 x 181/365 x 6%	$595
Jul - Dec	20,000 x 184/365 x 5%	$504
Taxable benefit for the year		$1,099

The taxable benefit is deemed to be interest paid by the employee. Therefore, the business portion of the deemed interest will also be deductible, if the employee claims car expenses.

Canada Customs and Revenue Agency — Agence des douanes et du revenu du Canada

DECLARATION OF CONDITIONS OF EMPLOYMENT

- You have to complete this form to deduct employment expenses from your income. You complete **Part A**, and your employer completes **Part B**.
- You do not have to file this form with your return. However, you have to keep it in case we ask to see it.
- For more information, see the guide called *Employment Expenses*, or Interpretation Bulletins IT-352, *Employee's Expenses, Including Work Space in Home Expenses*, and IT-522, *Vehicle, Travel and Sales Expenses of Employees*.

Part A – Employee information (to be completed by the employee)

Last name	First name	Social insurance number
Home address	Business address	

Part B – Conditions of employment (to be completed by the employer)

1. Did this employee's contract require the employee to pay his or her own expenses? ☐ Yes ☐ No

2. a) Did you normally require this employee to work away from your place of business, or in different places? ☐ Yes ☐ No
   b) If yes, what was the employee's area of travel? ______________________

3. Indicate the period of employment during the year. **From:** ________ (Year) ________ (Month) **To:** ________ (Year) ________ (Month)

4. a) Did this employee receive an allowance? ☐ Yes ☐ No
   b) If yes, indicate:
   i) the amount received as a fixed allowance, such as a flat monthly allowance. $________
   ii) the per km rate used ________ ($/km), and the amount received. $________
   iii) the amount of the allowance that was included on the employee's T4 slip. $________

5. a) Did this employee receive a repayment of the expenses he or she paid to earn employment income? ☐ Yes ☐ No
   b) If yes, indicate the amount that was:
   i) received upon proof of payment. $________
   ii) charged to the employer, such as credit-card charges. $________
   iii) included on the employee's T4 slip. $________

6. a) Did you require this employee to pay other expenses for which the employee did not receive any allowance or repayment? ☐ Yes ☐ No
   b) If yes, indicate the type(s) of expenses. ______________________

7. a) Did you pay this employee wholly or partly by commissions or similar amounts according to the volume of sales made or contracts negotiated? ☐ Yes ☐ No
   b) If yes, indicate the amount paid, $________ and the type of goods sold or contracts negotiated. ________

8. Did you require this employee to be away for at least 12 hours from the municipality and metropolitan area (if there is one) of your business where the employee normally reported for work? ☐ Yes ☐ No

9. a) Did you require this employee under a contract of employment to:
   - rent an office away from your place of business, or use a portion of his or her home? ☐ Yes ☐ No
   - pay for a substitute or assistant? ☐ Yes ☐ No
   - pay for supplies that the employee used directly in his or her work? ☐ Yes ☐ No

   b) Did you or will you repay this employee for any of the expenses in 9a)? ☐ Yes ☐ No
   c) If yes to 9b), indicate the amount you did or will repay. $________

Employer declaration

I certify that the information provided in Part B is, to the best of my knowledge, true, correct, and complete.

________________ Name of employer (print) ________________ Name and title of authorized person (print)

________ Date ( ) ________ Telephone ________________ Signature of employer or authorized person

T2200 (01) Canada

It is much more difficult for an employee who is also a shareholder to benefit from a loan from the employer. First, there must be evidence that a lender and borrower relationship exists, and the shareholder has not merely appropriated the use of corporate assets. The loan should be documented, either through a written agreement or other evidence such as a corporate resolution setting out the loan, and the terms of its repayment.

Generally, a shareholder (or someone related to the shareholder) who borrows from the corporation will have to include the amount of the loan in his/her income in the year the loan is made, unless the loan is repaid by the company's following year-end. There are certain exceptions, one of which is a car loan made to an employee to buy a car to be used in the performance of his/her duties. To qualify for this exception, the loan must be made as a result of the employer-employee relationship, and not because of the employee's shareholding in the corporation. In addition, there must be bona-fide arrangements for the repayment of the loan within a reasonable amount of time.

If the opportunity to borrow funds is only made available to shareholders or when the terms and conditions attached to loans to employee-shareholders are more favourable than those attached to loans to other employees, the Canada Customs and Revenue Agency will generally consider the loan to have been made to the employee-shareholder in his or her capacity as a shareholder unless the facts clearly indicate otherwise. As a result, the entire amount of the loan may be taxable to the shareholder. A deduction will be allowed to the shareholder when the loan is repaid.

Tax-free allowances paid in excess of the limits are not deductible to the employer. There are no restrictions on deductibility of allowances, if the allowances are taxable to the employee.

Therefore, monthly tax-free car allowances not determined or reconciled to actual business mileage are not deductible to the employer.

GST

Unlike the treatment of other taxable benefits such as the standby charge or the operating cost benefit, the employer is not required to remit a portion of the cash allowance paid to the employee.

GST Rebate

An employee may claim a rebate for the GST/HST paid on automobile expenses deducted on his/her tax return. A rebate is not payable if the employer is not registered for GST/HST purposes, or if the employer is a bank, trust company or other financial institution. An employee is also not eligible for a rebate if he or she received a tax-free allowance in respect of the expense. The employer is required to certify on the rebate application form that at the time the allowance was paid, the employer did not consider the allowance to be reasonable. This ensures that a rebate will not be paid to an employee if the employer is also claiming an ITC on the allowance relating to the expense.

The table on page 8 illustrates the GST rebate.

Tax Implications to The Employer

Tax Deductible Allowances

If an employer provides an employee with a tax-free car allowance, it is only deductible to the employer if it does not exceed the following limits:

The employer is allowed to claim an ITC of 7/107 on reasonable car allowances paid to the employee, without regard to whether the expenses incurred by the employee include any GST paid.

Location Driven	Distance travelled (in km)	Rate Per kilometre 2002
In Yukon, NWT or Nunavut	First 5,000	45 ¢
	Each additional	39 ¢
In other locations	First 5,000	41 ¢
	Each additional	35 ¢

If an employer pays a taxable allowance to the employee (i.e. the allowance is not "reasonable"), the employer will not be allowed an ITC on the amount of allowance paid.

The Final Drive

The preceding comments were relatively complicated because the rules dealing with cars are very complicated. Further, the rules would be considered by most as very restrictive, almost punitive and certainly not generous.

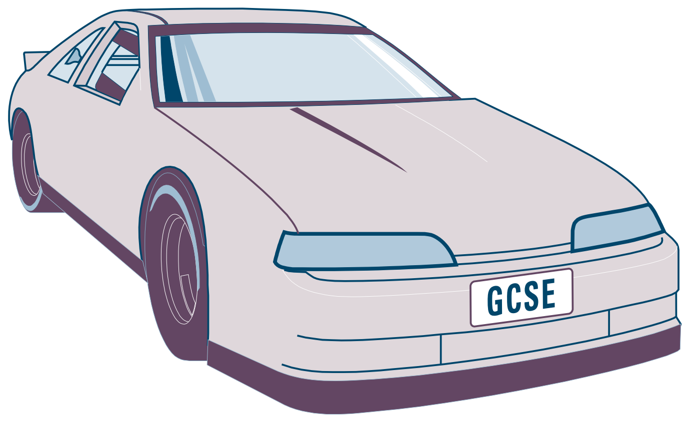
So, whether you are an employee, employer, owner/manager or self-employed individual, next time you ask your accountant about the tax implications surrounding the use of a car, know one simple truth. There is no good answer!

As a vehicle makes its way to its final resting place, the scrap yard, the best answer to all these car related questions is - buy a cheap car and use it exclusively for business. Every other scenario will involve personal versus tax trade offs.

Or as the TTC says in Toronto: Take the Better Way: public transit.

GST Rebate Illustration

	2002 $	2003 $
Automotive Costs (actual total costs)		
Oil and gas	1,070	
Insurance	720	
Interest on bank loan	780	
Reparis and maintenance	650	
	3,220	
Capital cost allowance	3,000	
	6,220	
Less personal portion - say 25%	-1,555	
	4,665	
GST Rebate		
Costs on which GST was paid		
Oil and gas	1,070	
Repairs and maintenance	650	
	1,720	
Capital cost allowance	3,000	
	4,720	
Deductible for income tax - say 75%	3,540	
Rebate 7/107 x 3,540	232	
Impact of GST rebate, filed for 2002, received in 2003		
Income inclusion		
($ 1,070+650) x 75% x 7/107		84
Deduction from capital cost		
$3,000 x 75% x 7/107		147
		232

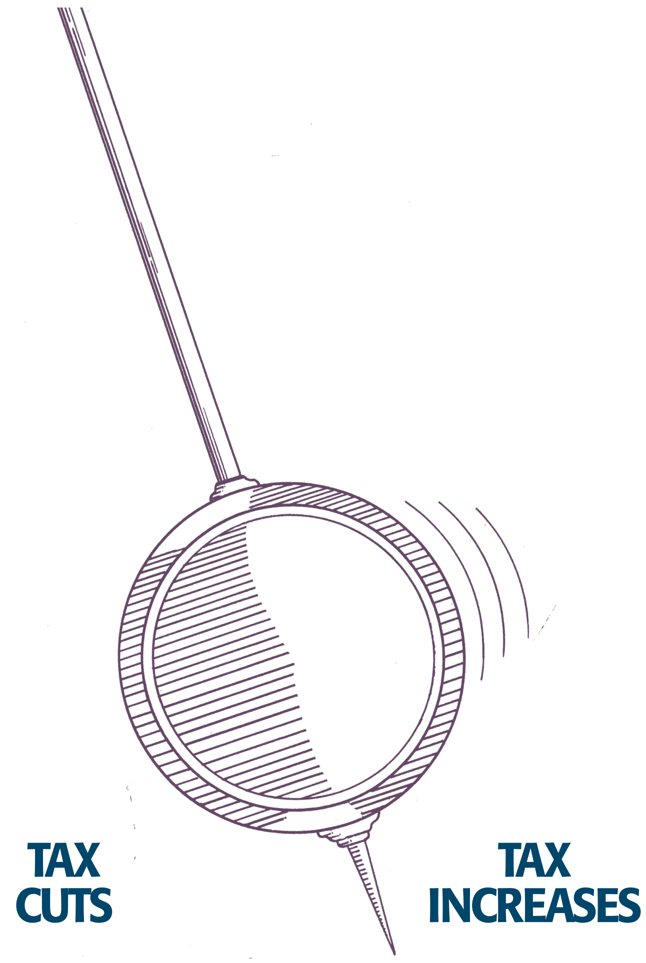


THE 2002 ONTARIO BUDGET:

Has the Pendulum Swung?

After years of successive tax cuts by the Mike Harris Conservative government (aka the common sense revolution) under then Minister of Finance Ernie Eves, the now Ernie Eves Conservative government, under new Minister of Finance Janet Ecker, has chartered a different course. Or, has it?

Citing the economic effects of post-September 11th, the Ontario government has for the most part delayed previously announced tax cuts for one year. These delayed tax cuts constitute a tax increase, notwithstanding a budget surplus for fiscal 2001/2002 and an unexpectedly robust economy.



Although not widely publicized, even the government acknowledges that the delay of the tax cuts constitutes a tax increase. The Ontario Taxpayer Protection Act, 1999 precluded future tax increases, including the delay of announced tax reductions, without first holding a referendum, and receiving voter approval. Included with the budget is an amendment to this Act, which will permit the announced tax changes without going through the referendum process.

This budget proposes to use the revenue from the delayed tax cuts along with some new tax revenue to fund significant increases in spending in health, education and ensuring safe water in Ontario, while still maintaining a balanced budget.

Although we all welcome the increased necessary spending on the social side of the ledger, the theory had been that tax cuts pay for themselves through increased economic activity. Has this government abandoned this theory? Are these tax cuts delayed for one year, as announced, or longer? Has the pendulum begun to swing back?

The budget contained few tax changes. As had been rumoured, personal and certain corporate tax reductions originally scheduled to take place on January 1, 2003 have been postponed until January 1, 2004. Tax rate reductions for small businesses, and the phase out of retail sales tax on automobile insurance premiums and on repairs and replacements made under warranty will proceed as previously announced. The Minister announced that she will seek advice on future tax rate changes, including possibly eliminating the personal income tax surtax and corporate capital taxes.

Personal Tax Changes

Ontario personal tax rates have decreased over the last few years. The low and middle tax rates were scheduled to reduce further on January 1, 2003. The budget proposes to delay the tax rate reduction by one year, and maintain 2002 tax rates in 2003. There are no changes to the highest tax rate.

In the 2001 budget, the government announced that the current two-tiered surtax system would be changed to a single-tier system beginning in 2003. The 2003 surtax rate was scheduled to be 56% of Ontario tax in excess of $4,648 (subject to indexing). This change will also be delayed a year. The surtax rate for 2003 will be 20% of Ontario tax over $3,685 and 56% of Ontario tax over $4,648 (both amounts subject to indexing).

Taxpayers with low income levels are eligible for a basic reduction of their Ontario tax. In 2002, this reduction is $161. In 2003, the reduction is scheduled to be indexed for

Ontario Personal Tax Rates

Taxable income (subject to indexing)	2002	2003 Previously announced	2003 Proposed	2004 Proposed
Up to 31,893	6.05%	5.65%	6.05%	5.65%
31,893 to 63,786	9.15%	8.85%	9.15%	8.85%
Over 63,786	11.16%	11.16%	11.16%	11.16%

inflation. The budget proposes to increase the basic reduction to $178 plus an increase for inflation, effective January 1, 2003.

As a result of the budget proposals, the marginal tax rates (subject to any changes which may be announced in a federal budget) for 2003 will be the same as 2002. The highest combined federal and Ontario marginal tax rate remains 46.41% on ordinary income, 23.2% on capital gains and 31.34% on dividends. Low-income individuals may earn up to approximately $10,840 (about $500 more than in 2002) in 2003 and pay no Ontario income tax. For all taxpayers, there should still be a slight reduction of tax in 2003 as a result of indexation of the tax brackets.

The controversial refundable tax credit for private school fees became effective in 2002. In 2002, the credit is 10% of eligible private school fees. The credit was scheduled to be phased in over five years, increasing 10% per year until 2006, when the credit will be 50%. The 2002 budget delays the scheduled increase of the tax credit to 20% on January 1, 2003 for one year to January 1, 2004. Unlike the announced delays in the other areas, there is no comment in the budget on the timing of the balance of the scheduled increases.

Corporate Tax Changes

Certain corporate income tax rate reductions previously announced will also be delayed by a year. The budget proposes to delay the general rate reduction and the manufacturing and processing tax rate reduction. The rate reduction applicable to small businesses will proceed on schedule. The applicable tax rates are summarized in the table below.

Other Changes

There have been a number of announced technical changes in retail sales tax, property tax, fuel tax, etc. Perhaps the one of most interest is the increase in the tax on tobacco.

Tobacco taxes are increased by 2.5 cents per cigarette and 2.5 cents per gram of cut tobacco. This amounts to $5 per carton of 200 cigarettes. This is in addition to the $3.50 per carton increase in federal excise taxes which was announced on the same day. Both of these tax increases were effective on June 18, 2002.

To combat tax evasion at the retail level, Ontario also proposes to exempt tobacco products from the Retail Sales Tax, and recover the revenues through an equivalent increase in rates under the Tobacco Tax Act. The proposed new Ontario tax rate on cigarettes will be 8.6 cents per cigarette, or $17.20 per carton. The federal excise tax on cigarettes will be 7.925 cents per cigarette, or $15.85 per carton.

Ontario Corporate Tax Rates

Effective Date	General : Previously announced	General : Proposed	Manufacturers Previously announced	Manufacturers Proposed	Small Business : no change
Oct 1, 2001	12.5%	12.5%	11%	11%	6%
January 1, 2003	11%	12.5%	10%	11%	5.5%
January 1, 2004	9.5%	11%	9%	10%	5%
January 1, 2005	8%	9.5%	8%	9%	4%
January 1, 2006	8%	8%	8%	8%	4%

Stayed Tuned

Has the pendulum begun to swing? We'll answer that question next year.

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