



# TD Economics

## Special Report

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### ONTARIO FOLLOWS LEAD OF FEDERAL GOVERNMENT IN CUTTING TAXES ON DIVIDEND INCOME

This morning, the Ontario government announced that it will be following the lead of the federal government and some other provinces – notably Quebec and Manitoba – in lowering taxation of eligible dividend income. The cuts by Ontario, along with its federal counterpart, will greatly reduce – but not fully eliminate – the problem of “double taxation” of dividend income in the province and assist in levelling the playing field on taxation between corporate dividends and trusts. In addition, Ontario’s moves will put even more pressure on other provinces to respond in kind in order to prevent losing competitive ground in the race to attract investment.

In its 2006 budget, the federal Conservative government promised to act upon the Liberal’s intention to raise the gross up factor from 1.25 to 1.45 and the federal dividend tax credit from 13.33 to 19 per cent, effective in 2006. Since the budget also committed to lower the federal general corporate income tax to 19 per cent by 2010, the tax credit would be sufficient to offset federal corporate income taxes paid by the end of the decade, hence eliminating double taxation at the federal level. The pressure has since shifted to the provinces to follow suit in raising their credits. So far, Quebec and Manitoba have responded with increases in their dividend tax credits, while British Columbia and Nova Scotia committed to moving but have not yet specified details. In the 2006 budget season, the other provinces chose to await the design of federal legislation before announcing their intent. The Ontario government has acted today.

The below example provided by the government reveals how the proposed change today will impact provin-

Current & Proposed Tax Treatment of Eligible Dividends		
	Large Corporations	
	Current	Proposed
A. Income	100	100
B. Corporate income tax	(31)*	(31)*
C. Amount distributed to investor	69	69
<b>Canadian Taxable Individual Investor</b>		
D. Amount included in income	86	100
E. Personal income tax (46.4%** of D)	40	46
F. Federal and Ontario dividend tax credit	(18)	(31)
G. Net personal income tax (E - F)	22	15
H. Total tax paid (B + G)	<b>53</b>	<b>46</b>
*Combined federal-Ontario corporate income tax rate for mfg., processing, farming, fishing, logging, and mining in 2010, including proposed federal corporate tax rate reductions; **Top federal-Ontario personal income tax rate; Source: Ontario Ministry of Finance		

cial dividend taxes for a high income earner. The government is proposing to provide a 7.7 per cent non-refundable tax credit on eligible dividends phased in between 2006 and 2010. Keep in mind that Ontario tax earners in the highest bracket are subject to a surtax of 56 per cent on income in excess of \$72,000. Hence, for those earners, the effective dividend tax credit is actually 12 per cent (7.7 per cent plus 56 per cent of 7.7). Adding this \$12 to the \$19 tax credit provided at the federal level yields the total credit of \$31 for each \$100 in dividend income.

Today’s announcement was supported by Ontario’s better-than-expected fiscal performance in 2006-07. In its first-quarter update, the government estimated that its deficit on a planning basis is poised to come in at \$1.9 billion this fiscal year compared to a budget estimate of \$2.4 billion. The cost of the dividend tax reduction is roughly \$40 million this year and \$110 million when fully implemented in 2010.

Not all of the problem of “double taxation” of dividends in Ontario will be eliminated as a result of today’s announced move. For example, when fully phased in, the credit will offset Ontario’s 12 per cent corporate income tax rate for manufacturing, processing, farming, fishing, logging and mining income for individuals subject to the top marginal tax rate. However, for these high-income investors earning dividend income from other eligible business areas, which are subject to the general provincial corporate income tax rate of 14 per cent provincial corporate income tax rate, there will still remain an element of double taxation. This is similar to the situation in Manitoba, where the new dividend tax credit of 11 per cent falls short of the general corporate income tax rate of 14 per cent. In

contrast, Quebec has said that it will raise its dividend tax credit to 11.9 per cent, which will match its CIT rate in 2009. However, since its rate is currently 9.9 per cent, Quebec will achieve “over integration” of the personal and corporate tax systems for the next few years. So, while Ontario (and Manitoba) did not go quite as far as Quebec, today’s proposal represents a step in the right direction. Following up this announcement with a commitment to reduce the general corporate income tax rate would move this province further down the path of removing the distortion while at the same time improving the overall investment climate.

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