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Canadian Tax Alert

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The Drummond Report: Tough decisions ahead for Ontario

On February 15, 2012, The Commission on the Reform of Ontario's Public Services ("the Commission"), chaired by Don Drummond, released **its report** ("Drummond Report") outlining a list of 362 recommendations to help Ontario reduce spending and eliminate the deficit. This Report suggests that Ontario's current deficit of $16.2 billion is likely to expand to $30.2 billion unless the recommendations outlined in the report are implemented.

Key tax recommendations

Although the mandate precluded the Commission from recommending any increases in taxes, the Drummond Report provided a number of tax-related recommendations aimed at creating stronger, more productive organizations and improving the integrity of the tax system through better administration and enforcement. Specific recommendations include:

- Wind down all current direct business support programs and current refundable corporate income tax credits in 2012-13 and then reintroduce only the effective and efficient ones under a new funding model that places the funds for both direct and indirect business support programs, including refundable tax credits into a single funding envelope
- Limit the Ontario small business deduction to small Canadian-controlled private corporations, as practiced federally and in all other provinces
- Eliminate the Ontario resource tax credit and review the mining tax system
- Apply a four-year sunset rule to all future business support programs
- Coordinate efforts with the federal government to combat aggressive interprovincial and international tax avoidance activities
- Work with the federal government and other provinces to explore options for the taxation of corporate groups to ensure a fair allocation of losses and income across Canada
- Replace taxes on items such as gasoline, diesel, tobacco, beer, and wine that are tied to a good's volume with taxes tied to the good's value
- Push the federal government for a greater provincial role in immigrant selection and also advocate for an expanded Provincial Nominee Program

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Recommendations for achieving fiscal balance

Despite its mandate restraints, the Drummond Report did include a suggestion that tax rates be increased in order to raise Ontario's revenue to meet spending growth. To avoid tax rate increases, the Report recommends that spending only increase by 0.8% per year rather than the 1.4% set out in the *2011 Budget*. If Ontario wants program spending to grow beyond the Report's suggested 0.8 per cent, the Report suggests that it may be necessary to increase all taxes to generate adequate revenue; according to the Report, the most economically neutral way to raise the required revenue would be to focus on raising consumption taxes, such as the harmonized sales tax (HST).

Deloitte's view

We agree with the Ontario government's decision to appoint the Commission to find inefficiencies and improve the value of Ontario public services. In addition to the reduction of corporate tax rates (scheduled to be further reduced to 11% on July 1, 2012 and to 10% on July 1, 2013) and adoption of the HST, this review is an important step to better position Ontario to face the challenges of the deficit, slowing global growth, and sovereign-debt issues in Europe and the United States.

We commend the Commission's desire to improve Ontario's lagging productivity; this focus is critical to the future economic prosperity of Ontario as discussed in our Report **The future of productivity: An eight step game plan for Canada**. In our **pre-budget submission** to Dwight Duncan, Ontario Minister of Finance, Deloitte's recommendations for Budget 2012, which focus on improving Ontario's productivity, fall into four broad categories:

- **Foster innovation through improvements to the research and development (R&D) tax program**

  The Ontario research and development (R&D) tax program should be improved by allowing refundability of the Ontario R&D tax credit. Refundability would appropriately reward the risks inherent in carrying out R&D in Ontario, and would help attract foreign companies seeking global investment opportunities.

  Deloitte believes that Ontario must have broad-based tax incentives for all industries and these should be complemented by grants directed at specific sectors or industries. Certainty is critical to businesses and refundability is key, especially in this challenging economic time.

- **Support a "start-up economy" with improved financing support**

  Consistent with the Ontario government's election promise, we believe that an angel tax credit should be introduced. This would help build an environment that fosters innovation and entrepreneurship, leading to job creation and economic growth.

- **Attract and retain the world's most talented people**

  We encourage the government to focus on improving the competitiveness of the personal tax regime and implementing immigration policies to attract and retain productive individuals in Ontario who have the requisite skills to support Ontario's future economic prosperity. We believe that personal tax rates should be lowered gradually over a period of five to 10 years. As recommended in the Drummond Report, we also believe that the Provincial Nominee Program should be expanded.

- **Enhance the HST program**

  We applaud the government for adopting the HST and we encourage the government to continue to evolve the HST program by addressing areas in need of improvement. These areas include eliminating the requirement for businesses to recapture input tax credits and the continued application of the provincial sales tax to certain property and casualty insurance.

Deloitte believes that, with the right tax policy in these areas, Ontario can have a more productive and globally competitive economy.

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