Deloitte LLP
Brookfield Place
181 Bay Street
Suite 1400
Toronto ON M5J 2V1
Canada

Tel: 416-643-8753
Fax: 416-601-6703
www.deloitte.ca

April 5, 2013

The Honourable Charles Sousa
Minister of Finance
c/o Budget Secretariat
Frost Building North, 3rd Floor
95 Grosvenor Street
Toronto, ON
M7A 1Z1

Dear Minister Sousa,

Budget 2013: An opportunity to enhance prosperity through increased economic competitiveness

Budget 2013 is an opportunity for the Government of Ontario to continue its commitment to enhance economic prosperity. Our key recommendations for Budget 2013 focus on improving Ontario's productivity. These recommendations can be summarized in five broad categories:

1. Foster innovation and foreign investment through improvements to the research and development (R&D) tax program
2. Support a "start-up economy" with an angel tax credit
3. Attract and retain the world's most talented people
4. Follow through with planned corporate tax rate reductions
5. Enhance the HST program

We applaud the Government for its continued focus on ways to reduce Ontario's deficit. Important steps have already been taken to better position Ontario to face the domestic challenges of the deficit and also international challenges such as the slow global economic recovery in Europe and the United States. These steps include initiating the report by The Commission on Reform of Ontario's Public Services, chaired by Don Drummond, to help Ontario reduce spending and eliminate the deficit, reducing corporate tax rates and adopting the harmonized sales tax (HST).

Ontario's productivity challenge

We believe that sustained economic growth in Ontario is impeded by its lagging productivity. In comparison with its North American peers, Ontario's GDP per capita in 2010 was $7,900 below the median of 16 North American jurisdictions, and while the gap decreased to $7,500 in 2011, Ontario continued to rank14th. Of this gap, Ontario is estimated to have a $900 work effort advantage, but this advantage is offset by lower productivity of $8,400.[1] As discussed in our 2011 report, *The future of*

[1] Ontario, Task Force on Competitiveness, Productivity and Economic Progress, "*A push for growth: The time is now*" Ninth Annual Report (Toronto: Institute of Competitiveness and Prosperity, November 2012), page 15.

productivity: An eight-step game plan for Canada, we believe that there is a window of opportunity to address these issues and, thereby, significantly improve productivity.

In shaping our recommendations for Budget 2013, we observe in our 2012 report, *The future of productivity: Clear choices for a competitive Canada*, that high-growth firms are the engine of productivity in Canada. Thus, a key priority for the Government in formulating its tax policies should be to ensure that such policies support growth businesses of all size, type, sector and location.

DELOITTE'S BUDGET 2013 RECOMMENDATIONS

1. Foster business innovation and foreign investment through improvements to the R&D tax program

While innovation drives both productivity and ultimately employment, Canada's historic leadership in encouraging innovation is under threat. With the competition for attracting global R&D investments intensifying, it is critical for Canada and the provinces to improve their R&D tax incentive regimes to remain competitive. In 1996, only 12 OECD countries offered R&D tax incentives; today, 22 OECD countries offer such incentives, with Germany, Sweden and several others considering the same. In addition, France, the United Kingdom and other countries have dramatically improved their programs.[2]

To encourage foreign investment, as we have recommended to the federal government, we recommend the expansion of refundable R&D investment tax credits (ITCs) to all businesses, rather than only certain small companies. A number of Canadian provinces with which Ontario competes for corporate R&D spending already have this policy - with Alberta, Manitoba and Saskatchewan being the most recent provinces to extend refundable R&D tax credits to all businesses. Not only are Canadian provinces extending refundability to all businesses but several countries such as France and the United Kingdom have or will be introducing similar regimes.

For many U.S.-based multinational corporations, refundability means the difference between the incentives being a permanent tax savings or a tax deferral, which can be a powerful distinction in perceived value.[3]

Currently, Ontario offers the Ontario innovation tax credit (OITC) as a refundable credit that is available only to small corporations. In addition, Ontario provides a non-refundable credit, the Ontario R&D tax credit, to all corporations. However, as this credit is non-refundable, companies only receive the benefit of the credits in years in which they have a tax liability. Long-term planning is made difficult for these organizations as many operate in cyclical industries and cannot predict the years in which they will have sufficient corporate tax liability to benefit from the R&D tax credits. Allowing these credits to be refundable would appropriately reward the risks inherent in carrying out R&D in Ontario, sending a strong message to foreign companies seeking new investment opportunities.

---

[2] Natan Aronshtam and Joanne Hausch, "Innovation and the SR&ED Program." 2010 Conference Report. Canadian Tax Foundation.

[3] Canadian companies that are subsidiaries of U.S. parent companies and perform R&D in Canada benefit from SR&ED ITCs only as a timing difference, as a non-refundable tax credit only reduces the underlying tax payable. Although they benefit from the Canadian SR&ED tax incentives reducing their Canadian taxes payable, ultimately a parent company's U.S. tax increases when funds are repatriated from Canada to the United States due to the U.S. foreign tax credit rules. In contrast, a refundable tax credit is treated as a reduction of cost in the U.S., increasing net income before taxes and, thus, creating a permanent tax savings.

Not only do we believe that Ontario should allow the Ontario R&D tax credit to be refundable but also we think that Ontario has room to increase the Ontario R&D tax credit rate. Currently, the rate - at 4.5 per cent - is significantly lower than the rate offered in most of the other provinces.[4]

Enhancing the Ontario government's support for innovation through its R&D tax incentive program is an important step that will allow Ontario to be a leader in innovation, in both the knowledge economy and in new technologies designed to exploit energy and resources.

2. Support a "start-up economy" with an angel tax credit

Knowledge-based industries will contribute significantly to Ontario's productivity and economic growth. Ontario has an opportunity to claim global leadership in industries such as life sciences, alternate energy, clean technology, digital media and other areas of technology and innovation.

We are happy to observe that the Government has recognized that support for financing is essential by indicating its intent to introduce an angel tax credit for individual investors as well as incentives for setting up Ontario-based venture capital funds. It is our view that Ontario must support home-grown enterprises with world-class potential through such incentives. We recommend that priority be given to an angel tax credit as it is the logical starting point for the renewal of Ontario's innovation initiative and it is the incentive that may have the greatest impact on growing our economy.

Since 2003, British Columbia has successfully provided a provincial angel tax credit as part of its Equity Capital Program. This program was implemented to help create new businesses and expand existing ones. Based on an evaluation of that program in 2010, the angel tax credit is estimated to generate $1.41 in provincial consumption and income taxes for every dollar of credit claimed.[5] British Columbia's experience suggests that the introduction of a provincial angel tax credit would not result in any long term cost to the provincial government.

3. Attract and retain the world's most talented people

A key focus must be on attracting and retaining individuals who are most likely to drive innovation in the economy and improve Ontario's productivity. Accordingly, we encourage the Government to focus on enhancing the competitiveness of the personal tax regime and the Opportunities Ontario: Provincial Nominee Program.

Review personal tax rates

In order to be competitive vis-a-vis the other provinces and territories in attracting and retaining talented individuals, Ontario's personal tax rates should be competitive. Currently, this may not be the case – the top marginal rate, for example, is among the highest in the country. We believe that it is in Ontario's interest to ensure that the personal tax regime encourages individuals to live and work in Ontario.

---

[4] Most provinces, other than Quebec, provide an R&D tax credit rate of 10% or 15% of eligible SR&ED expenditures. Quebec's basic R&D tax credit is 17.5% of R&D salaries.
[5] Thomas Hellerman and Paul Schure, "An Evaluation of the Venture Capital Program in British Columbia" British Columbia: Ministry of Small Business, Technology, and Economic Development. 2010.

Improve Opportunities Ontario: Provincial Nominee Program

We commend the Government for developing an immigration strategy that is focused on attracting highly skilled workers and their families, supporting diverse communities and growing a globally-connected economy, as outlined in the November 2012 report, *A new direction: Ontario's immigration strategy*. Increased immigration to Ontario by individuals who are educated, productive and innovative will improve the ability of Ontario enterprises to compete globally and will enhance government revenues from corporate and personal taxation.

2011 census figures indicate that immigration to Ontario has declined significantly since the last census period. While immigration to Canada has remained constant, Ontario's share has shrunk. This decline, if left unchecked, will undoubtedly have a negative impact on Ontario's economic prosperity. In our view, the Government must respond by improving the Provincial Nominee Program, both in respect of the investor nominee program as well as the foreign worker nominee program. One approach could be to lower the $3,000,000 investment requirement for foreign investors. In order to attract more foreign workers, the Government should also review the minimum threshold criteria for eligible companies in Ontario. As well, consideration should be given to a temporary foreign worker program for qualifying corporations. Finally, the Government should also consider harmonizing the wage requirements (i.e., allowing flexibility with respect to the prevailing wage) under the Provincial Nominee Program with those allowed for Labour Market Opinions (LMO) by Human Resources and Skills Development Canada. This ensures that any foreign workers on an LMO-based work permit will qualify for nomination under the Provincial Nominee Program.

4. Follow through with planned future corporate tax rate reductions

The 2012 budget froze the general corporate income tax rate at 11.5%. Under the Tax Plan for Jobs and Growth, Ontario's general corporate income tax rate has decreased from 14% in 2009 to 11.5% and was scheduled to fall to 11% on July 1, 2012 and to 10% on July 1, 2013. These corporate income tax rate reductions will resume in 2017-18 at which time a balanced budget is projected. It is estimated that this measure will save almost $1.5 billion over the next three years. As businesses need certainty in regard to key factors that will impact them, the delay in the planned reductions is unfortunate but not unreasonable given the short-term need to balance the budget. However, it is very important that the government follow through with the planned reduction once the budget is balanced.

5. Enhance the HST program

As noted above and in prior years, we applaud the Government's implementation of the HST. This was an important step to reduce Ontario's administrative costs, make Ontario more competitive, encourage new investment, and improve productivity. In fact, Ontario's adoption of the HST was noted by Forbes in ranking Canada as the number one country for business.[6]

We encourage the Government to continue to evolve the HST program by addressing areas in need of improvement. One such area is the requirement for businesses to recapture input tax credits (RITC requirement) in respect of the provincial component of the HST for certain expenses. It is our view that the RITC requirement should be eliminated as it goes against the very principle of the benefits of a value added tax like the HST. A second area of improvement is the continued application of the provincial sales tax (PST) to certain property and casualty insurance. Insurers now incur additional tax costs with the HST

[6] Badenhausen, Kurt. "*The Best Countries for Business*" Forbes.com, October 3, 2011.

due to the broadening of the tax base as compared to the PST. Once the 8% PST is added to the premiums, the result is tax on tax. We feel that this makes for poor tax policy and increases the cost of insurance for both insurers and the insured. We therefore recommend the repeal of the PST on insurance.

****

Deloitte is committed to playing a key role in shaping Ontario's future. We trust that our policy recommendations will provide helpful guidance as you move forward with Budget 2013. We would be happy to meet with you personally or with anyone you suggest from the Ministry of Finance to discuss any of these matters further.

Yours truly,

Heather L. Evans
Managing Partner, Tax
Deloitte LLP

Albert Baker, FCPA, FCA
Tax Policy Leader
Deloitte LLP

Copy to:

Steve Orsini
Deputy Minister
Ontario Ministry of Finance

Pat Deutscher
ADM Office of Economic Policy
Ontario Ministry of Finance