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Ontario 2012 budget proposals – tax accounting implications of the corporate tax rate freeze

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Executive Summary

Bill 55 that is currently in the Ontario Legislative Assembly does not contain any corporate tax rate legislation. It is expected that the Bill to amend the corporate tax rates will legislatively remove the scheduled corporate tax rate decreases rather than delay the tax rate decreases. The Ontario Assembly is scheduled to adjourn for the summer on June 14 or 15, 2012. Until the corporate tax rate freeze is legislated, companies are required to continue to account for the currently scheduled corporate tax rate reductions in Q2, 2012 (for calendar year reporters). We are closely monitoring the legislative proceedings and will report upon the outcome when the Legislative Assembly adjourns.

Legislative Proceedings

The 2012 Ontario budget signaled the intention of the minority government to achieve a balanced budget through a variety of measures. One measure announced in the budget speech was to freeze the basic corporate rate of income tax at 11.5%.

The basic corporate rate of tax in Ontario is 11.5%[1] for days in a taxation year after June 30, 2011 and before July 1, 2012. This rate was scheduled to decrease to 11%[2] for days in a taxation year after June 30, 2012 and before July 1, 2013, with a further decrease to 10%[3] for days in a taxation year after July 1, 2013.

The government proposes to freeze the corporate rate of tax at its current rate of 11.5% until there is a balanced budget. Due to restrictions imposed by Ontario's Taxpayer Protection Act, 1999[4], which contains a provision that prevents the Minister from increasing taxes or establishing new taxes without a referendum authorizing the changes, the proposed rate freeze will require two statutory amendments. First, the Taxpayer Protection Balanced Budget Act, 1999 will be amended to pave the way for the tax increase/freeze; this amendment is contained in Bill 55[5]. Second, the

[1] Paragraph 29(2)(c) of the Taxation Act, 2007.
[2] Paragraph 29(2)(d) of the Taxation Act, 2007.
[3] Paragraph 29(2)(e) of the Taxation Act, 2007.
[4] Subsection 2(1) the Taxpayer Protection Act, 1999. reads as follows:

2(1) A member of the Executive Council shall not include in a bill a provision that increases, or permits the increase of, a tax rate under a designated tax statute or that establishes a new tax unless,

(a) A referendum concerning the increase or the new tax is held under this Act before the bill is introduced in the Assembly; and
(b) The referendum authorizes the increase of the new tax.

[5] Section 1 of Schedule 67of Bill 55 amends section 2 of the Taxpayer Protection Act, 1999 by adding the following provisions:

Taxation Act, 2007 will be amended to provide for the rate increase/freeze. The second statutory amendment cannot occur until the first statutory amendment receives Royal Assent.

It is noteworthy that schedule 67 of Bill 55 indicates that the corporate tax rate freeze will result in the elimination, not the deferral, of the further decreases in the corporate tax rate to 10%. The decrease in tax rates will not be reinstated until such time as "in the Minister's opinion" the provincial finances have returned to a surplus position. As a result, future decreases in the corporate tax rate will have to be legislated at the discretion of the Minister of Finance.

Tax accounting implications

The changes to the Taxpayer Protection Act, 1999 contained in Bill 55 do not provide for a legislated deferral of the corporate tax rate reductions. When the Bill to implement the corporate tax rate freeze is introduced in the Legislative Assembly and passed into law, clients with permanent establishments in Ontario will be subject to a tax rate increase in fiscal 2012 on their current earnings and a tax rate increase impacting their deferred taxes. If the Ontario government introduces a Bill to effect the corporate income tax rate change in June 2012 and this Bill receives third reading during June 2012, then for IFRS purposes, the tax accounting impacts would likely need to be recognized in Q2 for calendar year companies. If this Bill also receives Royal Assent during June 2012, then for US GAAP purposes, the tax accounting impacts would need to be recognized in Q2,

Interim period implications

Interim period accounting for IFRS and US GAAP requires the estimation of an average annual effective tax rate ("AETR") to determine tax expense, which is then adjusted for discrete items to arrive at the total tax expense for the interim period. Under IFRS, IAS 34 Appendix B12-B16 provides the guidance that requires a company, to the extent practical, to determine the AETR by jurisdiction or categories of income. When a tax rate change is substantively enacted during an interim period and it changes the applicable tax rate to current earnings, the AETR should be re-estimated to take into account the change in the tax rate. For deferred taxes, the change in the tax rate requires the deferred taxes to be re-determined. For IFRS purposes, this change in deferred taxes may be included in the AETR or recorded as a discrete item in accordance with the company's policy.

For US GAAP purposes, ASC 740-270-25-5 requires the change in a tax law to be reflected in the computation of the global[6] AETR in the first interim period that includes the enactment date of the new legislation. Thus, a new computation of the global AETR is required in order to determine the impact of the new tax rate for the current interim period. However, ASC 740-270-25-5 mandates that the effect of a change in tax laws or rates on a deferred tax liability or asset not be apportioned among interim periods through an adjustment of the global AETR. For US GAAP purposes, the full impact of the change in tax laws or rates on the deferred tax balance should be fully recognized as a discrete item in the interim period the change in tax laws became enacted.

Exception, 2012

(8) Subsection (1) does not apply to a bill that receives First Reading in 2012 and that amends subsection 29 (2) of the Taxation Act, 2007 to provide that a corporation's basic rate of tax for a taxation year ending after June 30, 2012 is 11.5 per cent.

Statement to the Assembly

(9) If a bill described in subsection (8) is enacted, the Minister of Finance shall provide a statement to the Assembly after the end of the first fiscal year ending after March 31, 2013 for which the Minister is of the opinion, based on information contained in the public accounts, that the Province's expenditures do not exceed its revenues.

Same

(10) The statement under subsection (9) shall indicate when, in the opinion of the Minister, it may be reasonable for a bill to be introduced that amends the Taxation Act, 2007 to provide for a reduction of a corporation's basic rate of tax for a taxation year.

[6] US GAAP in ASC 740-270-30-5 requires a company to compute the AETR on a global consolidated basis rather than upon a jurisdictional or source of income basis.

Current Status of Legislation

On June 4, 2012, Bill 55 was carried through Second Reading in the Legislative Assembly and is currently being debated in the Standing Committee on Finance and Economic Affairs. The Committee is currently scheduled to debate Bill 55 until June 13, 2012. The Legislative Assembly is then scheduled to have Bill 55 read for the third time and passed (with Royal Assent) on June 14 or 15. A Bill to amend the Taxation Act, 2007 could then be introduced in the Legislative Assembly immediately thereafter with rapid passage possible, However, with the Legislative Assembly currently scheduled to adjourn for the summer on June 15, 2012, it is not clear that the Taxation Act, 2007 will be amended prior to June 30, 2012,

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