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2009 Ontario Budget Good for Technology Business

- > More SR&ED Cash from the Ontario Innovation Tax Credit (OITC)
- > Massive Enhancement to the Ontario Interactive Digital Media Tax Credit (OIDMTC)

On March 26th, 2009, Finance Minister Dwight Duncan delivered the province's 2009 Budget to the Ontario Legislature. The budget included several important business-related measures; two of which, OITC and OIDMTC; are of particular interest to companies in the technology sector.

OITC Enhancements

Ontario companies eligible to receive benefits from Canada through the SR&ED tax credit program are eligible to receive an additional 10% benefit from the Ontario Innovation Tax Credit. While the OITC benefit is essentially "automatic" on expenditures that attract the SR&ED benefit from Canada, there is one important difference between the two: While Canada provides a 35% cash refund only to Canadian Controlled Private Corporations (others get a 20% ITC), OITC provides the same 10% cash refund benefit on up to \$3M of SR&ED eligible expenditures to all companies regardless of ownership. This distinction is particularly relevant in tough economic times; when many companies lack sufficient taxable income to use ITCs.

Ontario Budget 2009 proposes to change the OITC rules such that for taxation year ends after 26-Feb-2008, eligibility for the 10% cash refund benefit will be accessible by a wider range of companies. Generally these changes parallel similar enhancements to the Canada SR&ED benefit in the 2009 federal budget. As noted above, OITC eligibility is not affected by ownership, however it is affected by taxable income and taxable capital.

Under existing legislation, a company becomes non-eligible for OITC in tax years after 26-Feb-2008 when either its taxable income hits \$700K or its taxable capital exceeds \$50M. The \$3M expenditure limit; and hence the "effective" benefit rate; is ground down starting at taxable income over \$400K and taxable capital over \$25M.


Budget 2009 proposes to change both the taxable income thresholds such that for tax years after 26-Feb-2008, OITC eligibility is not eliminated until taxable income hits \$800K and the effective benefit rate is fully preserved at 10% for up to \$500K of taxable income. Budget 2009 makes no change to the taxable capital thresholds.

From a tax planning standpoint, the proposed change to the taxable income thresholds, means that more income can be left in the company, where it is taxable at a lower rate than it would be in the hands of shareholders, to whom it would otherwise have been “bonused out” to keep the company’s income below the lower limit of the taxable income threshold.

Comparison of OITC Impacts per Budget 2009		
	<i>Existing</i>	<i>Budget 2009</i>
Case A: \$1M SR&ED expenditure \$500K Taxable Income \$10M Taxable Capital	\$66.6K cash benefit 7% effective benefit rate	\$100K cash benefit 10% effective benefit rate
Case B: \$1M SR&ED expenditure \$600K Taxable Income \$15M Taxable Capital	\$33.3K cash benefit 3% effective benefit rate	\$66.6K cash benefit 7% effective benefit rate
Case C: \$1M SR&ED expenditure \$600K Taxable Income \$50M Taxable Capital	\$0K cash benefit 0% effective benefit rate	\$0K cash benefit 0% effective benefit rate
Case D: \$3M SR&ED expenditure \$600K Taxable Income \$15M Taxable Capital	\$100K cash benefit 3% effective benefit rate	\$200K cash benefit 7% effective benefit rate
Case E: \$3M SR&ED expenditure \$600K Taxable Income \$45M Taxable Capital	\$37.5K cash benefit 1% effective benefit rate	\$37.5K cash benefit 1% effective benefit rate

Ontario Interactive Digital Media Tax Credit (OIDMTC)

The OIDMTC tax credit pays a cash-refund benefit for expenditures incurred by an Ontario company (but not a partnership or an individual) in the creation and marketing of an interactive digital media product the primary purpose of which is to educate, inform, or entertain. The product must achieve that purpose by presenting information using at least two of the following: (i) text, (ii) sound or (iii) images. The multimedia information content must be delivered electronically embedded in a product; e.g. a kiosk, cell phone or PDA; published on a CD ROM, or transmitted via Internet technologies such as HTML, JAVA etc.



OIDMTC has been available in various forms since 1998, with several improvements since then. Originally it was primarily utilized by game developers and makers or electronic gaming kiosks; e.g. VLT's, casino gaming machines etc. However, more recently it is increasingly used by companies involved in developing rich-media applications for cell phones and PDA's including Blackberries and iPhones.

In general, OIDMTC covers payments to persons who are engaged in creating multi-media content; i.e. artists; versus those creating the foundation technology; i.e. engineers, technicians; who would more likely be eligible for SR&ED. Such persons would likely be using software tools such as: Adobe Dimension, Adobe After Effects, Discreet Kinetix 3D Studio Max, Macromedia Flash / Dreamweaver, Sonic Foundry, Adobe Photoshop, Incite Video Editor etc.

Under existing rules, the OIDMTC benefit for companies that develop and sell their own products is calculated at 25% of eligible expenditures for all corporations and 30%, for certain qualifying small corporations. For companies that develop products for sale by others, the benefit is calculated at a rate of 25%.

In either case, to qualify for OIDMTC, the product must be developed all or substantially all; 90% or greater; in Ontario.

Existing rules define eligible expenditures as 100% of T4 wages paid to employees, 50% of amounts paid to arm's length subcontractors and up to \$100,000 of certain marketing costs paid out in periods not greater than 24 months before and 12 months after the release of the product.

Ontario Budget 2009 proposes several significant changes to the OIDMTC rules that greatly enhance the benefit rate and make more expenditure eligible.

First off, the benefit rate is to increase to 40% for all corporations that develop and sell their own products, regardless of size. For companies that develop products for others, the rate increases from 25% to 35%.

Second, 100% of amounts paid to arm's length subcontractors that are attributable to wages paid by that subcontractor, will be eligible, as compared to the current 50%.

Finally, game developers that expend at least \$1M on the purchase of eligible fee-for-service labour on a subcontracted basis from an Ontario company in a three year period, are to be exempt from the requirements to:

- A) Develop all or substantially all of the product in Ontario OR
- B) Deal with only "arm's length" subcontractors, meaning that the game developer can form a subsidiary company in Ontario that it controls to do to the work.

For more information on this topic, contact:

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About Scitax...

Scitax Advisory Partners is a professional services firm with specialist expertise in Scientific Research and Experimental Development (SR&ED) tax credits.

We offer a team of senior technical consultants all of whom have ten or more years experience in the SR&ED field. All Scitax technical consultants have engineering or science backgrounds and at least twenty years industry experience in their particular field prior to consulting.

Our primary function is to produce a technical submission package that most effectively communicates your SR&ED claim to CRA in a way that highlights eligibility and expedites processing. We assist you in identifying and preparing all required documentation including project technical descriptions, cost schedules, and everything else your tax preparer needs to file the claim. Once your claim is filed, Scitax will advocate for you with CRA and help you negotiate fair settlement of your claim.

While we normally work with our client's existing tax advisors, our affiliated firm Cadesky and Associates can provide a full package of tax services if required.



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