Increases to Alberta Tax Rates

Kim G C Moody FCPA, FCA, TEP and Kenneth Keung CA, CPA (CO, USA), CFP, LLB, MTAX, TEP
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For better or worse, on June 18, 2015, Alberta's newly elected NDP provincial government released Bill 2, which immediately received First Reading in the Legislature and passed. Even though the Bill is still not law, it will undoubtedly pass into law soon. Bill 2 contains corporate and personal tax increases that are, quite frankly, shocking. While "shocking" may not be a correct description, especially since the NDP had campaigned on the tax increases that are contained in the Bill, many Alberta tax practitioners, like us, are still shocked that such abrupt increases are actually going to see the light of day.

Premier Notley has recently cranked up the rhetoric surrounding her new government's tax policies. For example, she has called Alberta's flat tax an "unfortunate experiment". Even the name of Bill 2 – *"An Act to Restore Fairness to Public Revenue"* – is telling. It is clear that the new provincial NDP government plans to implement its ideological tax platform and we are concerned that the policy foundations may negatively affect Alberta's resource, technology, innovation and entrepreneurial sectors. Although it is tempting to provide a rebuttal to some of the recent rhetoric and policy implementation – especially given that all of the practitioners in our firm are students of tax policy –, this short article is not the proper forum to debate tax policy or ideologies.

The table below illustrates the relevant tax changes contained in Bill 2 that will be phased in over a two year period. For the personal tax changes, the table reflects the highest marginal rate that will become applicable for Alberta resident individuals whose income is in excess of $300,000. However, personal income tax rate increases will actually be applicable to anyone who has income in excess of $125,000. Such increases are phased in over four graduated rate brackets that reach the maximum for income in excess of $300,000.

Combined federal and provincial personal tax (based on Alberta proposed legislation)

	2014	**2015**	**2016**
Ordinary income	39.00%	40.25%	44.00%
Capital gains	19.50%	20.13%	22.00%
Eligible dividends	19.29%	21.02%	26.19%
Non-eligible dividends	29.36%	30.84%	35.72%

Combined federal and provincial corporate tax (based on Alberta proposed legislation)

	2014	**2015**	**2016**
General rate income	25.00%	26.00%	27.00%
CCPC – active business income	14.00%	14.00%	13.50%

These tax rate increases are significant. While we are big believers that tax should never "wag the tail of the dog", it is clear that the dog will be "ruffed-up" by these tax rate increases. A wide range of planning matters will be impacted – even "vanilla" planning, such as owner-manager remuneration, to complex planning, such as capital deployment for businesses. Entrepreneurs and owner-manager businesses should carefully consider the following non-exhaustive list of tax considerations in light of the proposed tax increases in Alberta:

1. Owner-manager remuneration planning – are income splitting strategies available to combat the personal tax rate increases? Are there additional deferral strategies that should be considered?

2. Dividend payments – can dividend payments be deferred in order to avoid the increased personal tax rates? Alternatively, should dividend payments be accelerated into 2015 to avoid the significant jump in rates for 2016?

3. Investment income earned within a corporation – investment income earned by a Canadian-Controlled Private Corporation ("**CCPC**") is subject to the refundable tax regime whereby an additional level of corporate tax is levied, but is refundable to the extent that sufficient taxable dividends are paid to the CCPC shareholders. Such a system is designed to provide tax integration between a CCPC and its shareholders with respect to certain types of investment income. After 2015, tax integration in Alberta with respect to investment income earned by a CCPC which is ultimately paid out to its shareholders will no longer be achieved. The incremental cost of using a CCPC to earn investment income and pay such amounts out to its shareholders will approximate to 5%. This is a very significant penalty, and careful planning will need to be done. For example, it may make sense to have the CCPC incur the corporate refundable tax and not pay out sufficient taxable dividends to its shareholders to trigger the corporate refund. This strategy will increase the balance of the corporate refundable tax account (known as the "refundable dividend tax on hand" account), which may present future planning opportunities.

4. Retention of corporate profits that are entitled to the small business tax rate of 14% will provide an even greater deferral than in the past. For example, for 2014, the deferral of retaining corporate profits subject to the small business rate of 14% provided a deferral of 25% when compared to the highest personal tax rate of 39%, that otherwise would have been payable by the shareholder if that profit was paid out as a salary/bonus. Beginning in 2016, this deferral will be 30% (44% highest personal tax rate less 14% corporate rate).
5. For corporate profits subject to the ordinary rate of 25% in 2014, such deferral was 14%. For 2016 forward, the deferral will be 17% (44% highest personal tax rate less 27% corporate rate). Accordingly, to the extent the corporation's shareholders do not require distributions, consideration should be given to retaining such corporate profits to take advantage of the illustrated deferrals. Retention of such general corporate profits will have the effect of building up the "general rate income pool" or "GRIP". Again, the increased GRIP may present future planning opportunities.

6. However, the deferrals discussed in #4 and #5 above only apply to those corporations that will not be carrying on a "personal services business" ("**PSB**"). We have previously written about PSBs and you can get more information here and here. The tax cost for a corporation carrying on a PSB will be an additional 2% as of January 1, 2016. On a flow-through basis, the total tax burden of a PSB structure will be approximately 55% after 2015 (compared to approximately 50% prior to 2015). Caution!

7. The increased rate structure will make it more expensive to die in Alberta. Accordingly, post-

mortem planning for entrepreneurs holding shares of private corporations, while always important to avoid double taxation, will now be even more important. For post-mortem planning after 2015, on a pure tax rate basis, a “pipeline” strategy is preferable so as to obtain capital gains rates of 22.0% as opposed to a subsection 164(6) strategy, which will result in taxable dividend rates of 26.19% or 35.72%. Of course, considerations other than tax rates will need to be taken into account when implementing a post-mortem plan.

8. For the sale of a business, the old “chestnut” of “sale of shares” or “sale of assets” will need to be revisited closely in light of the recent tax rate changes.

9. For certain US citizens resident in Alberta, such persons may now find themselves paying excess Canadian tax which will not be fully utilized as a US foreign tax credit. Similarly, US persons who are non-residents of Canada will need to carefully consider the additional Canadian tax on their Canadian source income from Alberta, which may be in excess of the US tax on such income.

10. For individuals who are considering becoming a non-resident of Canada, such people will be subject to an increased “departure tax” of a maximum of 22% on the appreciation of certain assets (deemed disposed of immediately prior to such a person becoming a non-resident of Canada) after 2015 compared to the 2014 maximum of 19.5%.

11. The so-called “kiddie tax” – which applies when a minor receives certain types of passive income or capital gains will become more punitive – attracting a rate of 44.0% post-2015 compared to 39% pre-2015. This makes careful planning even more important when implementing income splitting plans for Alberta taxpayers.

12. Previously, Alberta was a destination of choice for certain Canadians who would deploy capital by way of a trust that would be resident in the province. Such Alberta “provincial rate shopping” plans will be less attractive or eliminated in many cases.

As mentioned, the above list is non-exhaustive. Notwithstanding, the tax landscape in Alberta is certainly different and affected persons should pay careful attention.