

Alberta Provincial Dividend Tax Rates - A Subtle Gift

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June 17, 2019

On May 28, 2019, the newly installed Alberta government introduced [Bill 3](#) to the legislature. Bill 3 proposes to reduce the Alberta corporate tax rate from its existing 12% rate by 4% as follows:

- On July 1, 2019, a reduction of 1% to 11%;
- On January 1, 2020, a further reduction of 1% to 10%;
- On January 1, 2021, a further reduction of 1% to 9%; and
- On January 1, 2022, a final reduction of 1% to 8%.

No changes are proposed to the Alberta small business corporate tax rate (currently 2%).

As background, the federal government – as part of the July 18, 2017 private corporation tax proposals and its related fallout – promised to reduce the small business corporate tax rate by 2% (1% reduction effective January 1, 2018 and a further 1% reduction effective January 1, 2019).

A quick reminder. Canada's tax system purposely deploys the integration principle. In other words, the legal form through which the income is earned (for example, in corporate form or personally) should not matter: the overall taxation load should be roughly the same. For example, if income is earned corporately, then the extraction of any after-tax surplus to the personal shareholder and the underlying corporate tax - should be roughly equal to what the overall tax would have been had that income been earned personally. Across the country, the integration principle is alive and well although the results are not perfect. In most provinces, earning income through a corporation and then distributing the after-tax surplus as a taxable dividend yields a less desirable effective tax rate when compared to simply earning the income personally.

One last reminder. In 2006, the federal government introduced the concept of "eligible" and "non-eligible" dividends. Eligible dividends – subject to detailed rules in the Income Tax Act – are paid out of the General Rate Income Pool ("GRIP"). Overly simplified, GRIP is the after-tax corporate surplus remaining in the private corporation after paying the general corporate tax rate. Non-eligible dividends are generally dividends paid out of a Canadian-controlled private corporation ("CCPC") when such income has been subject to a preferential tax rate. The most common example is where the CCPC has paid the small business tax rate on the first \$500,000 of profits as a result of claiming the small business deduction. Such surplus distributions are considered non-eligible dividends and subjected to higher personal tax rates compared to eligible dividends (since eligible dividends are paid from surplus that was subjected to corporate tax rates which are higher than the small business rates). Regardless of whether the dividends received by the ultimate personal shareholder are eligible or non-eligible, the integration principle is intended to apply.

Given such corporate tax rate reductions, one would therefore expect amendments to the federal and provincial tax legislation to ensure that integration is maintained. The federal government introduced and passed legislation in 2018 to ensure that result. However, given Bill 3 introduced by the Alberta

government, we expected consequential amendments to the provincial personal tax rates on dividends. Such amendments were released on June 13, 2019 by way of [Bill 10](#).

However, the results to the amendments were not quite what we expected. Given the reduction in Alberta general corporate rates, we expected to see an increase in the Alberta eligible dividend rates. Surprisingly, there are no proposed amendments to such rates. This ultimately means that the cost of removing such surplus is not as expensive as it should be if integration was to be maintained. Not doing so would appear to us to be a purposeful tax decrease to shareholders of corporations that earn income that is subject to the general corporate rate. In laymen's term, it might be viewed as a minor tax decrease to investors of large corporations (public corporations and private corporations earning over \$500,000 per annum). In fact, by 2022, Alberta will achieve over-integration for corporate income subject to general corporate rates, whereby incorporating results in a net tax savings on a fully distributed basis for such corporate income. This is a rarity amongst the Canadian provinces and territories and is rather remarkable because earning income corporately already comes with another significant advantage: tax deferral of up to 37% by simply delaying the distribution of corporate surplus.

For non-eligible dividend rates, we have already seen an increase to the federal non-eligible dividend rates for 2019 given the federal decrease to the small business tax rate for 2019. For Alberta, because Alberta calculates its tax on the grossed-up dividends (and there was a companion amendment federally in 2019 to the federal gross-up), Bill 10 amends the Alberta dividend tax credit to essentially nullify the impact of the federal gross-up change. Accordingly, the resulting Alberta tax rate on non-eligible dividends remains roughly the same as 2018. A collateral benefit resulting from the change to the Alberta dividend tax credit for non-eligible dividend is that it reduces the traditional penalty for earning investment income corporately through a CCPC versus personally from currently 5.55% to 3.54% by 2022.

For a numerical illustration of the integrated tax regime in Alberta from 2017-2020, please review our [document](#). The resulting corporate tax rates and personal tax rates on dividends across the country – courtesy of our friends from Tax Templates Inc. - are displayed [here](#).

These Alberta amendments to the technical mechanisms behind dividend taxation are not flashy and do not attract much attention, but they quietly lessen the tax burden for Alberta private business owners – and that's something to cheer for in this Alberta economy.

Federal and Alberta Tax Integration Tables for 2017 to 2020, Reflecting Changes Proposed by Alberta Bill 3 and Bill 10

Non-Eligible Dividends (small business rate income, Dec 31 year-end) - effective tax rates (ETR)

	2017		2018		2019		2020		
	Federal	Alberta	Federal	Alberta	Federal	Alberta	Federal	Alberta	
Corporate income	\$ 100.00	\$ 100.00	\$ 100.00	\$ 100.00	\$ 100.00	\$ 100.00	\$ 100.00	\$ 100.00	
Corporate tax rate	10.5%	2.0%	10.0%	2.0%	9.0%	2.0%	9.0%	2.0%	
Corporate tax	\$ 10.50	\$ 2.00	\$ 10.00	\$ 2.00	\$ 9.00	\$ 2.00	\$ 9.00	\$ 2.00	
<i>Funds available for distribution</i>		\$ 87.50		\$ 88.00		\$ 89.00		\$ 89.00	
Dividend amount	\$ 87.50	\$ 87.50	\$ 88.00	\$ 88.00	\$ 89.00	\$ 89.00	\$ 89.00	\$ 89.00	
Gross-up rate	17%	17%	16%	16%	15%	15%	15%	15%	
Gross-up	\$ 14.88	\$ 14.88	\$ 14.08	\$ 14.08	\$ 13.35	\$ 13.35	\$ 13.35	\$ 13.35	
Taxable dividend	\$ 102.38	\$ 102.38	\$ 102.08	\$ 102.08	\$ 102.35	\$ 102.35	\$ 102.35	\$ 102.35	
Personal tax rate	33%	15%	33%	15%	33%	15%	33%	15%	
Personal tax before dividend tax credit	\$ 33.78	\$ 15.36	\$ 33.69	\$ 15.31	\$ 33.78	\$ 15.35	\$ 33.78	\$ 15.35	
Dividend credit rate	21/29	54/359	8/11	69/440	9/13	149/890	9/13	149/890	
Dividend tax credit	\$ (10.77)	\$ (2.24)	\$ (10.24)	\$ (2.21)	\$ (9.24)	\$ (2.24)	\$ (9.24)	\$ (2.24)	
Personal tax	\$ 23.01	\$ 13.12	\$ 23.45	\$ 13.10	\$ 24.53	\$ 13.12	\$ 24.53	\$ 13.12	
Personal ETR on dividend	26.30%	14.99%	26.64%	14.89%	27.57%	14.74%	27.57%	14.74%	42.30%
ETR on \$100 of corporate income	33.51%	15.12%	33.45%	15.10%	33.53%	15.12%	33.53%	15.12%	48.65%

Notes:

- As can be seen from the combined 'ETR on \$100 of corporate income', the integrated tax rate for corporate income entitled to small business tax rate is slightly higher than the top personal marginal tax rate of 48% for all the years. For example, in 2019, the integrated ETR of 48.65% means that there is a 0.65% penalty for earning such income corporately versus personally. The Alberta tax changes do not change this.
- The reduction of federal small business tax rates provide additional opportunity for tax deferral (by delaying dividend payments), but does not reduce overall integrated tax results (between 48.55% to 48.65%).
- Reduction in the gross-up rate from 17% (2017) to 16% (2018) and finally to 15% (2019), necessitated corresponding increases in Alberta dividend tax credit rates in order to maintain roughly the same Alberta integrated tax rate (between 15.10% to 15.12%).

Non-Eligible Dividends (investment income, assuming full 'refundable dividend tax on hand' or RDTOH refund, Dec 31 year-end) - ETR

	2017		2018		2019		2020		
	Federal	Alberta	Federal	Alberta	Federal	Alberta	Federal	Alberta	
Corporate income	\$ 100.00	\$ 100.00	\$ 100.00	\$ 100.00	\$ 100.00	\$ 100.00	\$ 100.00	\$ 100.00	
Corporate tax rate	8.0%	12.0%	8.0%	12.0%	8.0%	11.5%	8.0%	10.0%	
Corporate tax	\$ 8.00	\$ 12.00	\$ 8.00	\$ 12.00	\$ 8.00	\$ 11.50	\$ 8.00	\$ 10.00	
<i>Funds available for distribution</i>		\$ 80.00		\$ 80.00		\$ 80.50		\$ 82.00	
Dividend amount	\$ 80.00	\$ 80.00	\$ 80.00	\$ 80.00	\$ 80.50	\$ 80.50	\$ 82.00	\$ 82.00	
Gross-up rate	17%	17%	16%	16%	15%	15%	15%	15%	
Gross-up	\$ 13.60	\$ 13.60	\$ 12.80	\$ 12.80	\$ 12.08	\$ 12.08	\$ 12.30	\$ 12.30	
Taxable dividend	\$ 93.60	\$ 93.60	\$ 92.80	\$ 92.80	\$ 92.58	\$ 92.58	\$ 94.30	\$ 94.30	
Personal tax rate	33%	15%	33%	15%	33%	15%	33%	15%	
Personal tax before dividend tax credit	\$ 30.89	\$ 14.04	\$ 30.62	\$ 13.92	\$ 30.55	\$ 13.89	\$ 31.12	\$ 14.15	
Dividend credit rate	21/29	54/359	8/11	69/440	9/13	149/890	9/13	149/890	
Dividend tax credit	\$ (9.85)	\$ (2.05)	\$ (9.31)	\$ (2.01)	\$ (8.36)	\$ (2.02)	\$ (8.52)	\$ (2.06)	
Personal tax	\$ 21.04	\$ 11.99	\$ 21.31	\$ 11.91	\$ 22.19	\$ 11.86	\$ 22.60	\$ 12.09	
Personal ETR on dividend	26.30%	14.99%	26.64%	14.89%	27.57%	14.74%	27.57%	14.74%	42.30%
ETR on \$100 of corporate income	29.04%	23.99%	29.31%	23.91%	30.19%	23.36%	30.60%	22.09%	52.69%

Notes:

As can be seen from the combined 'ETR on \$100 of corporate income', the integrated tax rate for corporate investment income significantly higher than the top personal marginal tax rate of 48% for all years. The reason is that while the federal and provincial combined corporate tax rate (after the RDTOH is fully recovered) is lower compared to the combined general corporate tax rate, it is still substantially higher than the combined rate on small business income. However, gross-up and dividend tax credit mechanism for non-eligible dividends is the same regardless of whether the underlying income has been subject to the small business tax rate or the investment tax rate. As a result, there is a significant disadvantage (or under-integration) in earning investment income in a Canadian-controlled private corporation. For example, in 2019, the integrated ETR of 53.55% means that there is a whopping 5.55% penalty for earning such income corporately versus personally. To make matters worse, there is close to no tax deferral with corporate investment income due to the refundable dividend tax regime (not illustrated here). The silver lining here is that the corporate tax rate reduction introduced by Alberta will reduce this penalty: in 2020, the penalty for investing corporately is reduced to 4.69%. By 2022 (not illustrated here), the penalty shrinks to a still-formidable 3.54%. Therefore, if effective tax rate is the sole motivating factor and there is no other factors to consider (e.g. funds are already in the corporate system to start with, liability protection offered by corporations), it is generally better to make investments personally rather than in a Canadian-controlled private corporation.

Eligible Dividends (general corporate rate income, Dec 31 year-end) - ETR

	2017		2018		2019		2020		
	Federal	Alberta	Federal	Alberta	Federal	Alberta	Federal	Alberta	
Corporate income	\$ 100.00	\$ 100.00	\$ 100.00	\$ 100.00	\$ 100.00	\$ 100.00	\$ 100.00	\$ 100.00	
Corporate tax rate	15.0%	12.0%	15.0%	12.0%	15.0%	11.5%	15.0%	10.0%	
Corporate tax	\$ 15.00	\$ 12.00	\$ 15.00	\$ 12.00	\$ 15.00	\$ 11.50	\$ 15.00	\$ 10.00	
<i>Funds available for distribution</i>		\$ 73.00		\$ 73.00		\$ 73.50		\$ 75.00	
Dividend amount	\$ 73.00	\$ 73.00	\$ 73.00	\$ 73.00	\$ 73.50	\$ 73.50	\$ 75.00	\$ 75.00	
Gross-up rate	38%	38%	38%	38%	38%	38%	38%	38%	
Gross-up	\$ 27.74	\$ 27.74	\$ 27.74	\$ 27.74	\$ 27.93	\$ 27.93	\$ 28.50	\$ 28.50	
Taxable dividend	\$ 100.74	\$ 100.74	\$ 100.74	\$ 100.74	\$ 101.43	\$ 101.43	\$ 103.50	\$ 103.50	
Personal tax rate	33%	15%	33%	15%	33%	15%	33%	15%	
Personal tax before dividend tax credit	\$ 33.24	\$ 15.11	\$ 33.24	\$ 15.11	\$ 33.47	\$ 15.21	\$ 34.16	\$ 15.53	
Dividend credit rate	6/11	69/190	6/11	69/190	6/11	69/190	6/11	69/190	
Dividend tax credit	\$ (15.13)	\$ (10.07)	\$ (15.13)	\$ (10.07)	\$ (15.23)	\$ (10.14)	\$ (15.55)	\$ (10.35)	
Personal tax	\$ 18.11	\$ 5.04	\$ 18.11	\$ 5.04	\$ 18.24	\$ 5.07	\$ 18.61	\$ 5.18	
Personal ETR on dividend	24.81%	6.90%	24.81%	6.90%	24.81%	6.90%	24.81%	6.90%	31.71%
ETR on \$100 of corporate income	33.11%	17.04%	33.11%	17.04%	33.24%	16.57%	33.61%	15.18%	48.78%

Notes:

As can be seen from the combined 'ETR on \$100 of corporate income', the integrated tax rate for corporate income entitled to general corporate tax rate is modestly higher than the top personal marginal tax rate of 48%, particularly for years prior to 2020. For example, in 2017 and 2018, the integrated ETR of 50.15% means that there is a 2.15% penalty for earning such income corporately versus personally. The Alberta tax changes significantly narrows this penalty in 2019 and 2020, due to Alberta reducing the corporate tax rates but maintaining the dividend tax credit rate constant. The result is that in 2019, the integrated tax rate for general corporate rate income falls below 50% to 49.81%, and in 2020 it falls to 48.78% (only 0.78% penalty over earning the income personally). Although not displayed here, further Alberta corporate tax rate reductions in 2021 and 2022 will ultimately reduce the integrated tax rate to 47.4%, which is below the personal tax rate and is a rarity amongst the Canadian provinces and territories.

Courtesy of Tax Templates Inc.					
2019 Maximum Combined Personal Rates					
Jurisdiction	Eligible dividends	Other than eligible dividends	Capital gains	Other income	
AB	31.71%	42.30%	24.00%	48.00%	Note 1
BC	31.44%	44.63%	24.90%	49.80%	
MB	37.78%	46.67%	25.20%	50.40%	
NB	33.51%	47.75%	26.65%	53.30%	
NL	42.61%	44.59%	25.65%	51.30%	
NS	41.58%	48.28%	27.00%	54.00%	
NT	28.33%	36.82%	23.52%	47.05%	
NU	33.08%	37.79%	22.25%	44.50%	
ON	39.34%	47.40%	26.76%	53.53%	
PE	34.22%	45.22%	25.68%	51.37%	
SK	29.64%	40.37%	23.75%	47.50%	
YT	28.93%	42.17%	24.00%	48.00%	
QC	40.00%	46.25%	26.65%	53.31%	
Note 1					
AB - Other than eligible dividends rate of 42.30% reflects the Bill 10 increase to the other than eligible dividend tax credit rate under paragraph 21(j.2)(i) of the Alberta Personal Income Tax Act.					
2019 Federal and Provincial/Territorial Tax Rates					
Jurisdiction	SBD limit	Up to SBD limit	M&P rate	General rate	
Federal	500,000	9.00%	15.00%	15.00%	
AB	500,000	2.00%	11% - 12%	11% - 12%	Note 2
BC	500,000	2.00%	12.00%	12.00%	
MB	500,000 -		12.00%	12.00%	
NB	500,000	2.50%	14.00%	14.00%	
NL	500,000	3.00%	15.00%	15.00%	
NS	500,000	3.00%	16.00%	16.00%	
NT	500,000	4.00%	11.50%	11.50%	
NU	500,000	4.00%	12.00%	12.00%	
ON	500,000	3.50%	10.00%	11.50%	
PE	500,000	3.50%	16.00%	16.00%	
SK	600,000	2.00%	10.00%	12.00%	
YT	500,000	2.00%	1.50%-2.50%	12.00%	
QC	500,000	6.00%	4.00%-11.60%	11.60%	
Note 2					
AB - Bill 3 (Job Creation Tax Cut) reduces the Alberta corporate tax rate from 12% to 11% effective July 1, 2019.					
The AB corporate tax rates will be further reduced by 1% each year until 2022, ending at a general corporate rate of 8%.					