Alberta Provincial Dividend Tax Rates - A Subtle Gift

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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.

For a PDF version of this blog post, including the numerical illustration and the Tax Templates table, please click to download