cutting through complexity

Pending and Proposed Alberta Tax Rates

Dennis J. Auger

October 27, 2015

Alberta CCPC – Integrated Tax Rates, 2014-2019 Inclusive
Assumes Calendar Year and Small Business Deduction

	2014 CCPC				2015 CCPC			
	Business	SBD	Rental	Capital Gain	Business	SBD	Rental	Capital Gain
Corporate tax rate	25.00%	14.00%	44.67%	44.67%	26.00%	14.00%	45.67%	45.67%
Refundable tax rate			26.67%	26.67%			26.67%	26.67%
Personal tax rate	39.00%	39.00%	39.00%	39.00%	40.25%	40.25%	40.25%	40.25%
Proposed rates								
Dividend rate - eligible	19.29%				21.02%			
Proposed rates								
Dividend rate - non-eligible		29.36%	29.36%	29.36%		30.84%	30.84%	30.84%
Proposed rates								
Gross income	100,000	100,000	100,000	100,000	100,000	100,000	100,000	100,000
Less: non-taxable 1/2 of capital gain	-	-	-	(50,000)	-	-	-	(50,000)
	100,000	100,000	100,000	50,000	100,000	100,000	100,000	50,000
Corporate tax	(25,000)	(14,000)	(44,670)	(22,335)	(26,000)	(14,000)	(45,670)	(22,835)
Less: refundable tax	-	-	26,670	13,335	-	-	26,670	13,335
	(25,000)	(14,000)	(18,000)	(9,000)	(26,000)	(14,000)	(19,000)	(9,500)
net cash available for dividends	75,000	86,000	82,000	91,000	74,000	86,000	81,000	90,500

Alberta CCPC – Integrated Tax Rates, 2014-2019 Inclusive
Assumes Calendar Year and Small Business Deduction

	2014 CCPC				2015 CCPC			
	Business	SBD	Rental	Capital Gain	Business	SBD	Rental	Capital Gain
Personal tax								
Eligible dividend	75,000	-	-	-	74,000	-	-	-
Non-eligible dividend	-	86,000	82,000	41,000	-	86,000	81,000	40,500
Capital dividend	-	-	-	50,000	-	-	-	50,000
Tax - eligible dividend	(14,468)	-	-	-	(15,555)	-	-	-
Tax - non-eligible dividend	-	(25,250)	(24,075)	(12,038)	-	(26,522)	(24,980)	(12,490)
Tax - capital dividend	-	-	-	-	-	-	-	-
	(14,468)	(25,250)	(24,075)	(12,038)	(15,555)	(26,522)	(24,980)	(12,490)
Net after -tax	60,533	60,750	57,925	78,962	58,445	59,478	56,020	78,010
Effective tax rate	39.47%	39.25%	42.08%	21.04%	41.55%	40.52%	43.98%	21.99%
Versus earned personally	39.00%	39.00%	39.00%	19.50%	40.25%	40.25%	40.25%	20.13%
Better (worse)	-0.47%	-0.25%	-3.08%	-1.54%	-1.30%	-0.27%	-3.73%	-1.86%

Alberta CCPC – Integrated Tax Rates, 2014-2019 Inclusive
Assumes Calendar Year and Small Business Deduction

	2016 CCPC Business	2016 CCPC SBD	2016 CCPC Rental	2016 CCPC Capital Gain	2017 CCPC Business	2017 CCPC SBD	2017 CCPC Rental	2017 CCPC Capital Gain
Corporate tax rate	27.00%	13.50%	46.67%	46.67%	27.00%	13.00%	46.67%	46.67%
Refundable tax rate			26.67%	26.67%			26.67%	26.67%
Personal tax rate	44.00%	44.00%	44.00%	44.00%	44.00%	44.00%	44.00%	44.00%
Proposed rates	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%
	48.00%	48.00%	48.00%	48.00%	48.00%	48.00%	48.00%	48.00%
Dividend rate - eligible	26.19%				26.19%			
Proposed rates	5.52%				5.52%			
	31.71%				31.71%			
Dividend rate - non-eligible		35.56%	35.56%	35.56%		36.10%	36.10%	36.10%
Proposed rates		4.68%	4.68%	4.68%		4.68%	4.68%	4.68%
		40.24%	40.24%	40.24%		40.78%	40.78%	40.78%
Gross income	100,000	100,000	100,000	100,000	100,000	100,000	100,000	100,000
Less: non-taxable 1/2 of capital gain	-		-	(50,000)	-		-	(50,000)
	100,000	100,000	100,000	50,000	100,000	100,000	100,000	50,000
Corporate tax	(27,000)	(13,500)	(46,670)	(23,335)	(27,000)	(13,000)	(46,670)	(23,335)
Less: refundable tax	-		26,670	13,335	-	-	26,670	13,335
	(27,000)	(13,500)	(20,000)	(10,000)	(27,000)	(13,000)	(20,000)	(10,000)
net cash available for dividends	73,000	86,500	80,000	90,000	73,000	87,000	80,000	90,000

The Conservaties planned to reduce the small business rate to 9% starting in 2016
In conjunction with this they also planned to increase the non-eligible dividend
rate in order to compensate. The Liberals have said they intent to follow this small
business rate reduction. It has been assumed they will also increase the non-eligible
dividend rate in conjunction as the Conservatives planned.

Alberta CCPC – Integrated Tax Rates, 2014-2019 Inclusive
Assumes Calendar Year and Small Business Deduction

	2016 CCPC				2017 CCPC			
	Business	SBD	Rental	Capital Gain	Business	SBD	Rental	Capital Gain
Personal tax								
Eligible dividend	73,000		-	-	73,000		-	-
Non-eligible dividend	-	86,500	80,000	40,000	-	87,000	80,000	40,000
Capital dividend	-		-	50,000	-		-	50,000
Tax - eligible dividend	(23,148)		-	-	(23,148)		-	-
Tax - non-eligible dividend	-	(34,809)	(32,194)	(16,097)	-	(35,480)	(32,625)	(16,313)
Tax - capital dividend	-		-	-	-	-	-	-
	(23,148)	(34,809)	(32,194)	(16,097)	(23,148)	(35,480)	(32,625)	(16,313)
Net after -tax	49,852	51,691	47,806	73,903	49,852	51,520	47,375	73,687
Effective tax rate	50.15%	48.31%	52.19%	26.10%	50.15%	48.48%	52.63%	26.31%
Versus earned personally	48.00%	48.00%	48.00%	24.00%	48.00%	48.00%	48.00%	24.00%
Better (worse)	-2.15%	-0.31%	-4.19%	-2.10%	-2.15%	-0.48%	-4.63%	-2.31%

Alberta CCPC – Integrated Tax Rates, 2014-2019 Inclusive
Assumes Calendar Year and Small Business Deduction

	2018 CCPC Business	2018 CCPC SBD	2018 CCPC Rental	2018 CCPC Capital Gain	2019 CCPC Business	2019 CCPC SBD	2019 CCPC Rental	2019 CCPC Capital Gain
Corporate tax rate	27.00%	12.50%	46.67%	46.67%	27.00%	12.00%	46.67%	46.67%
Refundable tax rate			26.67%	26.67%			26.67%	26.67%
Personal tax rate	44.00%	44.00%	44.00%	44.00%	44.00%	44.00%	44.00%	44.00%
Proposed rates	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%
	48.00%	48.00%	48.00%	48.00%	48.00%	48.00%	48.00%	48.00%
Dividend rate - eligible	26.19%				26.19%			
Proposed rates	5.52%				5.52%			
	31.71%				31.71%			
Dividend rate - non-eligible		36.41%	36.41%	36.41%		36.67%	36.67%	36.67%
Proposed rates		4.64%	4.64%	4.64%		4.60%	4.60%	4.60%
		41.05%	41.05%	41.05%		41.27%	41.27%	41.27%
Gross income	100,000	100,000	100,000	100,000	100,000	100,000	100,000	100,000
Less: non-taxable 1/2 of capital gain	-		-	(50,000)	-	-	-	(50,000)
	100,000	100,000	100,000	50,000	100,000	100,000	100,000	50,000
Corporate tax	(27,000)	(12,500)	(46,670)	(23,335)	(27,000)	(12,000)	(46,670)	(23,335)
Less: refundable tax	-	-	26,670	13,335	-	-	26,670	13,335
	(27,000)	(12,500)	(20,000)	(10,000)	(27,000)	(12,000)	(20,000)	(10,000)
net cash available for dividends	73,000	87,500	80,000	90,000	73,000	88,000	80,000	90,000

The Conservaties planned to reduce the small business rate to 9% starting in 2016 In conjunction with this they also planned to increase the non-eligible dividend rate in order to compensate. The Liberals have said they intent to follow this small business rate reduction. It has been assumed they will also increase the non-eligible dividend rate in conjunction as the Conservatives planned.

Alberta CCPC – Integrated Tax Rates, 2014-2019 Inclusive
Assumes Calendar Year and Small Business Deduction

	2018 CCPC				2019 CCPC			
	Business	SBD	Rental	Capital Gain	Business	SBD	Rental	Capital Gain
Personal tax								
Eligible dividend	73,000		-	-	73,000		-	-
Non-eligible dividend	-	87,500	80,000	40,000	-	88,000	80,000	40,000
Capital dividend	-		-	50,000	-		-	50,000
Tax - eligible dividend	(23,148)		-	-	(23,148)		-	-
Tax - non-eligible dividend	-	(35,915)	(32,836)	(16,418)	-	(36,318)	(33,016)	(16,508)
Tax - capital dividend	-	-	-	-	-	-	-	-
	(23,148)	(35,915)	(32,836)	(16,418)	(23,148)	(36,318)	(33,016)	(16,508)
Net after -tax	49,852	51,585	47,164	73,582	49,852	51,682	46,984	73,492
Effective tax rate	50.15%	48.41%	52.84%	26.42%	50.15%	48.32%	53.02%	26.51%
Versus earned personally	48.00%	48.00%	48.00%	24.00%	48.00%	48.00%	48.00%	24.00%
Better (worse)	-2.15%	-0.41%	-4.84%	-2.42%	-2.15%	-0.32%	-5.02%	-2.51%

Alberta CCPC – Integrated Tax Rates, 2014-2019 Inclusive
Assumes Calendar Year and No Small Business Deduction

	2014 CCPC			2015 CCPC		
	Business	Rental	Capital Gain	Business	Rental	Capital Gain
Corporate tax rate	25.00%	44.67%	44.67%	26.00%	45.67%	45.67%
Refundable tax rate		26.67%	26.67%		26.67%	26.67%
Personal tax rate	39.00%	39.00%	39.00%	40.25%	40.25%	40.25%
Proposed increases						
Dividend rate - eligible	19.29%			21.02%		
Proposed increases						
Dividend rate - non-eligible		29.36%	29.36%		30.84%	30.84%
Proposed increases						
Gross income	100,000	100,000	100,000	100,000	100,000	100,000
Less: non-taxable 1/2 of capital gain	-	-	(50,000)	-	-	(50,000)
	100,000	100,000	50,000	100,000	100,000	50,000
Corporate tax	(25,000)	(44,670)	(22,335)	(26,000)	(45,670)	(22,835)
Less: refundable tax	-	26,670	13,335	-	26,670	13,335
	(25,000)	(18,000)	(9,000)	(26,000)	(19,000)	(9,500)
net cash available for dividends	75,000	82,000	91,000	74,000	81,000	90,500

Alberta CCPC – Integrated Tax Rates, 2014-2019 Inclusive
Assumes Calendar Year and No Small Business Deduction

	2014 CCPC			2015 CCPC		
	Business	Rental	Capital Gain	Business	Rental	Capital Gain
Personal tax						
Eligible dividend	75,000	-	-	74,000	-	-
Non-eligible dividend	-	82,000	41,000	-	81,000	40,500
Capital dividend	-	-	50,000	-	-	50,000
Tax - eligible dividend	(14,468)	-	-	(15,555)	-	-
Tax - non-eligible dividend	-	(24,075)	(12,038)	-	(24,980)	(12,490)
Tax - capital dividend	-	-	-	-	-	-
	(14,468)	(24,075)	(12,038)	(15,555)	(24,980)	(12,490)
Net after -tax	60,533	57,925	78,962	58,445	56,020	78,010
Effective tax rate	39.47%	42.08%	21.04%	41.55%	43.98%	21.99%
Versus earned personally	39.00%	39.00%	19.50%	40.25%	40.25%	20.13%
Better (worse)	-0.47%	-3.08%	-1.54%	-1.30%	-3.73%	-1.86%

Alberta CCPC – Integrated Tax Rates, 2014-2019 Inclusive
Assumes Calendar Year and No Small Business Deduction

	2016 CCPC			2017 CCPC		
	Business	Rental	Capital Gain	Business	Rental	Capital Gain
Corporate tax rate	27.00%	46.67%	46.67%	27.00%	46.67%	46.67%
Refundable tax rate		26.67%	26.67%		26.67%	26.67%
Personal tax rate	44.00%	44.00%	44.00%	44.00%	44.00%	44.00%
Proposed increases	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%
	48.00%	48.00%	48.00%	48.00%	48.00%	48.00%
Dividend rate - eligible	26.19%			26.19%		
Proposed increases	5.52%			5.52%		
	31.71%			31.71%		
Dividend rate - non-eligible		35.56%	35.56%		36.10%	36.10%
Proposed increases		4.68%	4.68%		4.68%	4.68%
		40.24%	40.24%		40.78%	40.78%
Gross income	100,000	100,000	100,000	100,000	100,000	100,000
Less: non-taxable 1/2 of capital gain	-	-	(50,000)	-	-	(50,000)
	100,000	100,000	50,000	100,000	100,000	50,000
Corporate tax	(27,000)	(46,670)	(23,335)	(27,000)	(46,670)	(23,335)
Less: refundable tax	-	26,670	13,335	-	26,670	13,335
	(27,000)	(20,000)	(10,000)	(27,000)	(20,000)	(10,000)
net cash available for dividends	73,000	80,000	90,000	73,000	80,000	90,000

Alberta CCPC – Integrated Tax Rates, 2014-2019 Inclusive
Assumes Calendar Year and No Small Business Deduction

	2016 CCPC			2017 CCPC		
	Business	Rental	Capital Gain	Business	Rental	Capital Gain
Personal tax						
Eligible dividend	73,000	-	-	73,000	-	-
Non-eligible dividend	-	80,000	40,000	-	80,000	40,000
Capital dividend	-	-	50,000	-	-	50,000
Tax - eligible dividend	(23,148)	-	-	(23,148)	-	-
Tax - non-eligible dividend	-	(32,194)	(16,097)	-	(32,625)	(16,313)
Tax - capital dividend	-	-	-	-	-	-
	(23,148)	(32,194)	(16,097)	(23,148)	(32,625)	(16,313)
Net after -tax	49,852	47,806	73,903	49,852	47,375	73,687
Effective tax rate	50.15%	52.19%	26.10%	50.15%	52.63%	26.31%
Versus earned personally	48.00%	48.00%	24.00%	48.00%	48.00%	24.00%
Better (worse)	-2.15%	-4.19%	-2.10%	-2.15%	-4.63%	-2.31%

Includes all the rate increases as per the previous slides +

Proposed Liberal rate increases:		Factor	Real Increase
Regular income	4%	1.00	4.00%
Capital gains	4%	0.50	2.00%
Eligible dividends	4%	1.38	5.52%
Non-eligible dividends	4%	1.17	4.68%

Alberta CCPC – Integrated Tax Rates, 2014-2019 Inclusive
Assumes Calendar Year and No Small Business Deduction

	2018 CCPC Business	2018 CCPC Rental	2018 CCPC Capital Gain	2019 CCPC Business	2019 CCPC Rental	2019 CCPC Capital Gain
Corporate tax rate	27.00%	46.67%	46.67%	27.00%	46.67%	46.67%
Refundable tax rate		26.67%	26.67%		26.67%	26.67%
Personal tax rate	44.00%	44.00%	44.00%	44.00%	44.00%	44.00%
Proposed increases	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%
	48.00%	48.00%	48.00%	48.00%	48.00%	48.00%
Dividend rate - eligible	26.19%			26.19%		
Proposed increases	5.52%			5.52%		
	31.71%			31.71%		
Dividend rate - non-eligible		36.41%	36.41%		36.67%	36.67%
Proposed increases		4.64%	4.64%		4.60%	4.60%
		41.05%	41.05%		41.27%	41.27%
Gross income	100,000	100,000	100,000	100,000	100,000	100,000
Less: non-taxable 1/2 of capital gain	-	-	(50,000)	-	-	(50,000)
	100,000	100,000	50,000	100,000	100,000	50,000
Corporate tax	(27,000)	(46,670)	(23,335)	(27,000)	(46,670)	(23,335)
Less: refundable tax	-	26,670	13,335	-	26,670	13,335
	(27,000)	(20,000)	(10,000)	(27,000)	(20,000)	(10,000)
net cash available for dividends	73,000	80,000	90,000	73,000	80,000	90,000

Alberta CCPC – Integrated Tax Rates, 2014-2019 Inclusive
Assumes Calendar Year and No Small Business Deduction

	2018 CCPC Business	2018 CCPC Rental	2018 CCPC Capital Gain	2019 CCPC Business	2019 CCPC Rental	2019 CCPC Capital Gain
Personal tax						
Eligible dividend	73,000	-	-	73,000	-	-
Non-eligible dividend	-	80,000	40,000	-	80,000	40,000
Capital dividend	-	-	50,000	-	-	50,000
Tax - eligible dividend	(23,148)	-	-	(23,148)	-	-
Tax - non-eligible dividend	-	(32,836)	(16,418)	-	(33,016)	(16,508)
Tax - capital dividend	-	-	-	-	-	-
	(23,148)	(32,836)	(16,418)	(23,148)	(33,016)	(16,508)
Net after -tax	49,852	47,164	73,582	49,852	46,984	73,492
Effective tax rate	50.15%	52.84%	26.42%	50.15%	53.02%	26.51%
Versus earned personally	48.00%	48.00%	24.00%	48.00%	48.00%	24.00%
Better (worse)	-2.15%	-4.84%	-2.42%	-2.15%	-5.02%	-2.51%

Includes all the rate increases as per the previous slides +

Proposed Liberal rate increases:		Factor	2018 Real Increase	Factor	2019 Real Increase
Regular income	4%	1.00	4.00%	1.00	4.00%
Capital gains	4%	0.50	2.00%	0.50	2.00%
Eligible dividends	4%	1.38	5.52%	1.38	5.52%
Non-eligible dividends	4%	1.16	4.64%	1.15	4.60%

Active versus Passive Income for a CCPC

- **There has always been a significant tax deferral opportunity with active income that is not available to passive income.**
- **It is becoming even more pronounced with all rate changes on the personal income, including non-eligible dividends.**
- **With non-eligible dividend rates reaching 40%, some may well decide not to pay a dividend to recover tax @ 33$^{1/3rd}$%**

(or will there be an increase in refundable tax rates in future?)

Active versus Passive Income for a CCPC

- **At what point does earning real property rental income move from being a passive activity to active?**
- **The determination of when some forms of income (rent from real property included) move from passive to active is specifically spelled out in the Income Tax Act**
- **For whatever reason, the somewhat arbitrary "line in the sand" is > 5 full time employees (the ">" doesn't have to be full-time)**
- **There are two ways to achieve this:**

  i. **The "corporation" employs more than 5 full-time employees <u>throughout the year;</u>** or

  ii. **An associated corporation provides those services and it <u>could reasonably be expected that the corporation would require > 5 full time employees if those services had not been provided.</u>**

Active versus Passive Income for a CCPC

The two tests are actually practically quite different

1. The first is a “hard-line” test of simply counting the number of employees in the corporation carrying on the rental business. (either you met the test or you do not)
2. The other is much softer: it “could reasonably be expected that you would need > 5 full-time employees” if those services were not so provided

Active versus Passive Income for a CCPC

<u>Consider</u>

One company with 6 full time employees, all employed by the operating company.

Properties – rent

6 full-time employees

The company clearly meets the first test for active business

But what happens if 1 employee suddenly quits and for a month (or shorter or longer) the company is down to 5 full-time employees for a period of time?

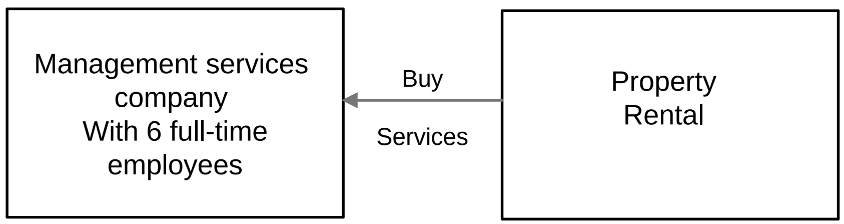
<u>Answer</u>

- **Your taxable income for the year is determined to be passive because you have failed to have > 5 full time employees <u>throughout</u> the year**
- **That's going to cost 20% -25% of the entire year's taxable income.**

Active versus Passive Income for a CCPC

Consider the Alternative

- **You separate the services from the actual operating company by utilizing a Services Company that is associated for tax purposes.**



- **Now consider the same fact pattern as before except this time the Management Services Company is down to 5 full-time employees for a short period of time**
- **Now what is the result?**

Active versus Passive Income for a CCPC

- **The test is:**
  - **"it could reasonably be expected that the operating company would need > 5 full-time employees if it didn't buy those services from an associated company"**
  - **Though the Services Company fell below this threshold, the Services Company's employee count is not the test**
  - **If, to provide the services, 6 full-time people were needed (as indicated by the fact that 6 full-time people were used by the Services Company, even though for a short time it fell below this threshold), then it should be reasonable to expect you would need > 5 full-time people and you should still be considered to earn active income.**

In my view if you are so close to the > 5 full time employees that you have any risk of falling below at any time, the Services Company is the way to go.

Active versus Passive Income for a CCPC

Few key points from this

- **The tax deferral for active business income is becoming more valuable.**
- **The test is a corporate taxpayer-by-taxpayer test**
  - **If properties are held in multiple corporations for liability or other reasons, the test must be applied to each corporation.**
  - **This would tend to favour consolidated holdings, at least for tax purposes.**
- **If the rental company employs the people, it is a straight numbers game; if employed by a services company it becomes a “reasonably expected” test.**
  - **Which you prefer will depend upon your total employee count and risk of dropping below the threshold.**

The Changes to Inter-corporate Dividends

- **I would like to end by talking very generally about the changes coming with respect to inter-corporate dividends.**
- **This has particular relevance to the real estate sector and in particular**
  - **Should you choose to consolidate your holdings because of the active business test just discussed, you may be more inclined to pay dividends to minimize the equity exposed; and**
  - **It's not uncommon to leverage a property and pull the leveraged cash out by way of dividend.**

The Changes to Inter-corporate Dividends

- **There has always been an avoidance provision in the Income Tax Act that will characterize an otherwise tax-free inter-corporate dividend into a capital gain.**
- **But there has always been an "out" from this rule where you are dealing strictly with related parties. Like a parent holding company and a subsidiary operating real estate company.**
- **That exception has been significantly reduced and now dividends, even between a parent and subsidiary, can be caught where:**
  - One of the purposes of the payment is to effect a significant reduction in a capital gain that would otherwise be realized on any share; or
  - One of the purposes of the payment is to effect either: (i) a significant reduction in the fair market value of any share or (ii) a significant increase in the cost for tax purposes of properties held by the corporate recipient of the dividend
- **Arguably one of the reasons for a subsidiary paying a dividend to its parent is to minimize the fair market value of the shares of the subsidiary and therefore the amount you have at-risk.**
- **So these new rules could in theory capture all such subsidiary-to-parent dividends and your tax-free dividend suddenly = capital gain.**

The Changes to Inter-corporate Dividends

There are really two ways to avoid the application of this newly expanded avoidance provision (assuming it's too risky to argue your way out of the purpose test):

1. **Do not exceed the "safe income on hand" of the dividend payer. In simple terms, the safe income on hand is after-tax retained earnings:**
   i. You need to calculate it and it may not be enough where you are leveraging FMV increments.
2. **Structure the dividend instead as a repurchase by the subsidiary of some shares held by the parent:**
   i. The related party exception still applies to deemed dividends arising on share repurchases in lieu of simple dividends (and for tax purposes a share repurchase = a dividend for the most part)
   ii. It may mean going forward we would prefer the parent company to own, say, 10M shares of the subsidiary instead of the customary 100 shares to help facilitate doing multiple repurchases over time.

Thank you

Presentation by Dennis Auger
(403) 691-8385
dauger@kpmg.ca

cutting through complexity