Recap and Analysis of Alberta Corporate Income Tax Cut

Background

In June 2020, Alberta Premier Jason Kenney announced the acceleration of planned corporate income tax (CIT) cuts, slashing the province's statutory general rate to 8% from 10%.[1] Implementing the *Job Creation Tax Cut Act* 1.5 years ahead of schedule has sent a clear message to businesses trying to make decisions amidst a fog of uncertainty. The provincial portion of the province's small business rate (SBR) will remain unchanged at 2%. This action is part of a larger effort to stimulate an economy battered by the COVID-19 pandemic, a global economic contraction, and a collapse in energy prices. Alberta is also increasing its spending on infrastructure projects, establishing a new investment agency, and introducing incentives for industry. This naturally prompts important questions about Saskatchewan's own tax competitiveness, as our CIT rate remains unchanged at 12%. This recap and analysis was informed by existing research available in the public domain and information gleaned from an email correspondence with a senior official at the Saskatchewan Ministry of Finance.

Alberta CIT Facts

- **According to government estimates, the cut will create 50,000 jobs by 2022, attract $4 billion in investment annually starting in 2023, and boost GDP by $13 billion.**
- **The Government of Alberta estimates that it will lose $300 - $500 million in CIT revenue from existing businesses and is projecting a deficit of $20 billion for this year.**
- **Alberta's 8% general CIT rate will be about 30% lower than the next lowest province (11.5% in Ontario) and lower than 44 US states.**

Recap and Analysis

Alberta's move to cut its CIT is part of a larger trend that has taken place across Canada over the past two decades around reducing federal and provincial statutory CIT rates,

[1] Note: Alberta's CIT reduction to 8% was done in lieu of introducing accelerated depreciation adopted by the federal government in fall 2018. According to the Saskatchewan Ministry of Finance, Saskatchewan was required to adopt the federal measure, having an estimated value of $200 million in tax savings for Saskatchewan businesses over a four-year period. Alberta and Quebec are the only provinces in Canada that administer their own CIT systems, Businesses in Alberta and Quebec must complete and file provincial tax returns and adhere to separate audit, compliance, and collection requirements. In contrast, Saskatchewan businesses do not have to file a separate provincial tax return or maintain a parallel set of tax records.

broadening the tax base, and improving the neutrality of taxes. Because CITs are an extremely costly way to raise revenue compared to other forms of taxation, cutting CITs are a good place to start since they will have positive effects over the long run on both business investment and wage earners.[2] Alberta's tax plan is indicative of the province's return to a low rate, broad-based, and market-based approach to taxation. To do this, Alberta is eliminating a suite of tax credits, including the Scientific Research & Experimental Development Tax Credit, the Alberta Innovation Tax Credit, the Capital Investment Tax Credit, and the Interactive Digital Media Tax Credit. In contrast, Saskatchewan's approach historically has been less market-based and relies more on the state trying to promote tax competitiveness through the use of targeted tax incentives for key sectors of the economy that have growth potential and/or are sensitive to tax policy changes.[3]

Alberta Treasury Board and Finance estimates that 100,000 firms annually will benefit from the *Job Creation Tax Cut* versus only 1,600 firms that would benefit from the suite of boutique tax credits referenced earlier.[4] Alberta's decision to lower its general CIT rate from 12% to 8% while keeping SBR at 2% serves to reduce the percentage point spread between the two rates, thus reducing the disincentive for smaller firms to scale up, grow, and hire more workers.

Prior to the CIT cut, Alberta already had a tax advantage over Saskatchewan. Alberta estimates that businesses and households in Alberta would pay an additional $15 billion in taxes for 2020-21 if it had the same tax system as Saskatchewan.[5] In addition to Alberta now having a CIT rate four percentage points lower than Saskatchewan, Alberta households and businesses currently do not pay a provincial sales tax (PST), a payroll tax, a surtax, a corporate capital tax, or health premiums. And while Saskatchewan households and firms do not pay provincial payroll taxes, health premiums, or a surtax, they do pay a 6% PST (unrecoverable for businesses) and a maximum 4% corporate capital tax levied on the assets (not income) of large financial institutions.

Both provinces have a competitive 10% provincial manufacturing and processing (M&P) CIT rate[6] and a 2% SBR. On personal income taxes, both Alberta and Saskatchewan have

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[2] McKenzie, Kenneth. "Altering the Tax Mix in Alberta." University of Calgary School Public Policy Publications 12, no. 25 (September 2019): 1.

[3] Note: Saskatchewan currently offers a suite of targeted tax incentives for the following sectors: manufacturing and processing, research and development, agriculture (including value-added), energy and resources, as well as incentives for First Nation and Metis entities. Click here for a comprehensive list of offerings.

[4] Government of Alberta. Budget 2020: Fiscal Plan 2020-23. Edmonton, AB. Alberta Treasury Board and Finance. 2020. 171.

[5] Ibid. 169.

[6] Note: In addition to offering M&P profits tax reduction, Saskatchewan also offers an M&P Investment Tax Credit and an M&P Export Tax Incentive (extended to 2022 in Provincial Budget 2020). According to the Saskatchewan Ministry of Finance, the M&P Investment Tax Credit notionally offsets the PST on capital acquisitions.

similar combined federal-provincial top marginal rates at 48% and 47.50% respectively. Saskatchewan's higher provincial CIT rate, unrecoverable PST, and corporate capital tax when taken together, mainly account for its tax disadvantage relative to Alberta. Harmonizing the PST with the federal GST alone would go a long way in significantly reducing taxes on capital in Saskatchewan.

A 2020 study by Philip Bazel and Jack Mintz comparing *marginal effective tax rates* (METR)[7] interprovincially found that Alberta has a decisive tax advantage on Saskatchewan on key measures.[8] Comparing Alberta and Saskatchewan on METR by industry, Alberta's aggregate METR of 12% is below the Canadian average of 14.9%, while Saskatchewan's aggregate METR of 20.5% is 8.5 percentage points above Alberta and 5.6 percentage points above the Canadian average (see Appendix I - Table 2).[9] The Bazel and Mintz study found that Saskatchewan imposes the third highest METR among provinces on capital.

A 2020 study by the C.D Howe institute assessing business tax burdens across Canada's major cities and provinces using 2019 tax rates also found that Saskatchewan had the 3rd highest METR on general corporate capital investment (excluding municipal taxes) in Canada by province. Only British Columbia and Manitoba had higher METRs at 32.9% and 32.1% respectively. In this study, Saskatchewan's METR was 4.7 percentage points higher than the group average, whereas Alberta's METR was 4.1 percentage points lower than the group average.[10] While the aggregate METR calculations in the C.D. Howe study for Alberta and Saskatchewan at 19.2% and 28% respectively differ from the Bazel and Mintz study, both studies reached very similar conclusions about Saskatchewan's relatively high aggregate METR and Alberta's existing tax advantage over Saskatchewan.[11]

When the C.D. Howe study looked closer at the individual taxes (federal CITs, provincial CITs, unrecoverable provincial retail sales taxes, provincial land transfer taxes, and provincial business property taxes) that comprise each province's aggregate METR, for

[7] Note: The METR is an estimate of the level of taxation on incremental business investment that accounts for federal and provincial statutory CIT rates, as well as other measures like investment tax credits and deductions, such as capital cost allowances (depreciation). The METR also considers other taxes paid by corporations, such as capital taxes and unrecoverable sales taxes paid on capital purchases (e.g.PST). It is important to note here that METRs involve a series of assumptions and complex calculations, can vary by sector, and are further impacted by the application of tax incentives. Business property taxes (BPTs) have historically been excluded from widely published METR estimates. Including BPTs in METR calculations would provide a more accurate estimate of the tax burden on businesses.

[8] Note: The METR findings in the Bazel and Mintz study assume a fully implemented Alberta CIT rate of 8%.

[9] Bezel, Philip, and Jack Mintz. "The 2019 Tax Competitiveness Report: Canada's Investment and Growth Challenges." *University of Calgary School of Public Policy Publications* 13, no. 1 (March 2020): 18.

[10] Found, Adam and Peter Tomlinson. "Business Tax Burdens in Canada's Major Cities: The 2019 Report Card." C.D. Howe Institute (April 2020): 11.

[11] Ibid.

Saskatchewan the breakdown based on percentage point values from highest to lowest were provincial retail sales taxes (8.4), federal CITs (8.2), provincial business property taxes (5.8), provincial CITs (5.3), and provincial land transfer taxes (0.3). For Alberta, the individual taxes that comprised its already lower aggregate METR from highest to lowest were federal CITs (8.4), provincial CITs (6.2), and business property taxes (4.6). Alberta's aggregate METR figure did not contain a breakdown for either provincial retail sales taxes or provincial land transfer taxes because Alberta does not levy a PST or a land transfer tax.[12]

Looking at METR by asset (buildings, M&E, land, inventory), for each asset class, Saskatchewan has a higher METR than Alberta, but Saskatchewan's METR on M&E alone is 21.5% compared to Alberta's 6.3% (see Appendix I - Table 3).[13] The result is that certain activities like construction, retail trade, wholesale trade, and communications are far more heavily taxed in Saskatchewan than in Alberta. As alluded to earlier, this is mainly because the PST is unrecoverable and is levied on machinery and equipment (M&E) purchases.[14] Alberta and Saskatchewan do have the lowest and second lowest METRs on the *cost of doing business* measure (taxes on both capital and labour) among provinces for 2019 at 26% and 26.3% respectively.[15]

Alberta's decision to lower its CIT to 8% will likely lead to behavioural changes by firms in two ways. Because Alberta now has the lowest CIT in Canada, businesses operating in multiple provinces (including Alberta) will now have a strong incentive to shift their profits away from higher tax provinces to lower tax provinces like Alberta, since those profits will be taxed at a lower rate. This makes sense intuitively as all else being equal, multi-province firms will typically have a higher level of capital mobility than single-province firms.[16] Using a local example to further illustrate this point, Alberta's lower CIT rate could incentivize Saskatchewan firms with operations both here and in Alberta to shift more of their income to Alberta in order to reduce their overall tax bill. Over time (three to ten years), firms may consider relocating existing jobs and assigning incremental investment capital to lower tax jurisdictions like Alberta.

Conversely, firms will also have a strong incentive to shift debt to higher tax provinces, since the value of deducting those expenses will be higher. Taken together, this leads to firms using interest deductions in a higher tax province to fund capital investments in a lower tax province, ultimately eroding the tax base of the higher tax province over time.[17]

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[12] Ibid.

[13] Ibid.

[14] Note: The issues associated with the PST are well known to the SCC and were discussed extensively in our 2019 report, *Beyond 2020: A Blueprint for Saskatchewan Business Competitiveness*.

[15] Ibid. 21.

[16] McKenzie, Kenneth. "Altering the Tax Mix in Alberta." 16.

[17] Ibid.

The Saskatchewan Ministry of Finance states that the impact of Alberta's CIT cut on Saskatchewan will depend on other factors than just the tax rate cut alone, including the impact of federal accelerated depreciation, a firm's profitability, and the ease at which it can shift taxable income and investment to Alberta. Behaviour will likely vary by sector. For example, a firm operating a pipeline is likely to encounter more difficulty in reallocating its taxable income to Alberta compared to a financial services firm.

Conclusions

Alberta's recent move to cut its CIT rate 1.5 years ahead of schedule is a good reminder of the importance of maintaining an attractive investment climate for business. Alberta's recent tax cut could serve as a catalyst for the Saskatchewan business community to not only look more closely at and possibly advocate for reductions in the provincial CIT, but to also advocate for reforms to other taxes - namely PST/GST harmonization, as well as reducing and/or eliminating the corporate capital tax. Finally, it is worth emphasizing again that in addition to taxes, other factors like growth in product demand, commodity prices, availability of raw material and skilled workers, affordable utilities, infrastructure, regulations, and even political uncertainty can also affect business investment decisions. Chambers of commerce and industry groups in Saskatchewan should use the insights outlined in this analysis to prompt a larger discussion about tax competitiveness within their own organizations.

Appendix I

Table 1: Comparing Alberta and Saskatchewan Corporate Income Tax Rates on Active Business Income (for all rates announced up to July 1, 2020)

	Small Business Rate (SBR) (generally up to $500,000)	Manufacturing & Processing (M&P) Profits	General Corporate Rate (not eligible for SBR and non-M&P income)
Federal rate (%)	9.00[18]	15.00	15.00 (net)[19]
Provincial Rates (%)	AB (2.00) SK (2.00)	AB (10.00) SK (10.00)	AB (8.00) SK (12.00)
Combined Federal-Provincial Rates (%)	-	-	-
Saskatchewan	11.00 (up to $500,000) 17.00 (from $500,000 - $600,000)[20]	25.00	27.00

[18] Note: The federal small business rate was reduced from 10% to 9% effective January 1, 2019.

[19] Note: a federal general rate reduction of 13% applies to the base federal rate of 28% for active business income not eligible for other incentives.

[20] Note: The federal small business limit is $500,000. Saskatchewan increased its small business limit to $600,000 effective January 1, 2018. The federal small business rate is reduced if taxable capital employed in Canada exceeds $10 million in the preceding tax year and is eliminated altogether when it exceeds $15 million.

Alberta	11.00	25.00	23.00

Source: Adapted from "Corporate Income Tax Rates for Active Business Income 2020" by Ernst and Young.

Table 2: Aggregate Marginal Effective Tax Rates (METR) by Province

	2018 Pre-Fiscal[21] Update	2019 Post-Fiscal Update	Alberta Tax Cut Full Implementation
Canada (average)	19.2%	15.3%	**14.9%**[22]
Newfoundland	12.8%	7.4%	7.4%
PEI	15.4%	10.3%	10.3%
Nova Scotia	17.8%	12.7%	12.7%
New Brunswick	14.8%	9.8%	9.8%
Quebec	14.3%	10.6%	10.6%
Ontario	18.3%	13.9%	13.9%
Manitoba	27.0%	23.7%	23.7%
Saskatchewan	23.9%	20.5%	**20.5%**
Alberta	18.5%	14.5%	**11.9%**
British Columbia	27.6%	24.3%	24.3%

Source: McKenzie, Kenneth. "Altering the Tax Mix in Alberta," University of Calgary School Public Policy Publications 12, no. 25 (September 2019): 14.

Table 3: METR by Asset and Province: 2019

2019	Buildings	M&E	Land	Inventory	Aggregate
CAN	19.1%	8.5%	11.0%	24.2%	**14.9%**
NFLD	11.7%	-12.0%[23]	12.9%	27.9%	7.7%

[21] Note: The fall 2018 fiscal update announced the availability of accelerated depreciation for equipment purchases from November 21, 2018 - December 31, 2023. The adoption by provinces of accelerated depreciation in 2019 served to lower aggregate METRs (in the short-term) across the board. While accelerated depreciation does lower METRs across the board, it does so at the expense of reducing tax neutrality by favouring shorter-lived investments in certain sectors (e.g. manufacturing and clean energy). The 2020 C.D. Howe Institute study referenced earlier in this report found that accelerated depreciation had little to no impact on 97% of corporate capital investment and only led to an average METR decrease of 1.3 percentage points. It is also inapplicable to non-depreciable capital, such as land and inventories, and has a largely minor effect on the acceleration for buildings.

[22] Note: Land transfer taxes are excluded in the Canada. If land transfer taxes were included, the aggregate METR for Canada would be 15.5%.

[23] Note: The METR on M&E for the four Atlantic provinces (NFLD, PEI, NS, NB) and Quebec (Gaspe Peninsula) is negative mainly because accelerated depreciation at the federal level, combined with the federal Atlantic

PEI	18.4%	-14.4%	13.5%	28.6%	10.7%
NS	18.7%	-2.0%	13.5%	28.7%	13.0%
NB	15.7%	-6.2%	12.4%	27.0%	10.1%
QC	18.2%	-5.1%	11.2%	24.7%	10.8%
ON	18.5%	5.7%	11.0%	24.1%	14.0%
MB	21.1%	25.7%	11.4%	25.0%	22.3%
SK	21.3%	21.5%	11.1%	24.2%	**20.5%**
AB	16.2%	6.3%	9.4%	21.3%	**12.0%**
BC	25.0%	27.9%	11.4%	25.1%	24.3%

Source: Bezel, Philip, and Jack Mintz. "The 2019 Tax Competitiveness Report: Canada's Investment and Growth Challenges." University of Calgary School of Public Policy Publications 13, no. 1 (March 2020): 18.

Investment Tax Credit (primarily benefiting agriculture, forestry and manufacturing) are so generous that when taken together, marginal investment in these assets shelters tax paid on other assets.