

Reduction of Corporate Taxation Rates on Investment Income and Introduction of a Refundable Tax Regime

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Background

The current federal regime for the taxation of investment income is predicated on the following principles:

- Taxation of the investment income at base rate of 38 per cent less a federal tax abatement of 10 per cent for income deemed to be earned in a province.
- A special additional tax on investment income of 6.67 per cent.
- This yields a total rate of taxation at the federal level of 34.67 per cent.
- Of this amount, the total federal “refundable tax” on investment income earned by the corporation that is available for addition to the corporation’s Refundable Dividend Tax on Hand (RDTOH) account is 26.67 per cent.
- When dividends from after-tax dollars are paid to the shareholders of the corporation, a refund of \$1 of RDTOH for every \$3 of dividends paid is paid to the corporation.
- There is a reduction of RDTOH available to the extent that the payor corporation has claimed its own dividend refund (on a pro-rata basis).

This approach under federal legislation recognizes that the taxation of investment income corporately reflects an opportunity to defer current income taxation (rather than avoid taxation) in the absence of the additional special tax on investment income. This is mitigated by the existence of the dividend refund mechanism and the incidence of refundable tax to the corporation, as the RDTOH account balance represents an incentive to shareholders to have income taxed in their hands personally in order to receive the dividend refund in the corporation. The result is the reduction of the net tax eligible by the corporation, but under the current approach, reflects a net increase in combined personal and corporate taxation.

The current approach is contrary to the overall objective of the income tax system, which is to ensure that there is no preference by the taxpayer for earning investment income corporately or personally. This objective is referred to as integration. Taxation of \$1 of investment income is said to be perfectly integrated where the after-tax yield to an individual is the same, regardless of whether the income was earned personally or through a corporate investment.

The concept of integration fails in practically every province — investment income is either over-integrated (which means there is a preference for earning investment income corporately) or under-

integrated (which means there is a preference for earning investment income personally). In Alberta, under-integration exists on interest income at a rate of 1.72 per cent and on capital gains at a rate of 0.86 per cent. This propensity for taxpayers to earn investment income personally ostensibly removes opportunities for planning within the provisions of the Income Tax Act that would otherwise be available. This is particularly true with respect to the planning that is available for the segregation of business or creditor risk from investment assets.

In addition, by reason of the rules that would result in “corporate attribution” (or the attribution of investment income to a particular member of a family group that owns shares of an investment company), the ability to income-split with family members is curtailed.

The principal reason why integration does not exist in Alberta is the absence of a comparable system for the taxation of investment income at the provincial level. That is to say that all forms of investment income are taxed corporately at a similar rate of 10 per cent with no mechanism for refund of a portion of the provincial tax when dividends are paid to the shareholders of the Alberta corporation. Accordingly, it is our position that changes to the Alberta Corporate Tax Act should be instituted to immediately restore integration in Alberta.

It is the position of the Edmonton Chamber of Commerce that the minister of Finance institutes such amendments for the following reasons:

- This mechanism would be reasonably easy to implement — all corporations are currently familiar with the federal filing requirements in respect of refundable income tax and provincial requirements would not differ appreciably.
- The implementation of this mechanism would be politically neutral. The overall objective is simply a restoration of integration, rather than the creation of a set of rules that creates a bias toward one class of taxpayers over another. Thus, there would be no perceived benefit to corporate taxpayers in favour of individual taxpayers.

The Edmonton Chamber of Commerce recommends the Government of Alberta:

1. Maintain the current rate of taxation on investment income at the 10-per-cent provincial level.
2. Immediately introduce amendments to the Alberta Corporate Tax Act that would institute a refundable tax mechanism similar to the federal regime whereby:
 - 2.38 per cent of the 10-per-cent provincial corporate tax on investment income is added to a provincial a refundable tax account;
 - A refund of provincial corporate tax is available to the corporate taxpayer at rate of \$1 for every \$35 of dividends paid to shareholders of the corporation; and,
 - A reduction of the dividend refund available to the corporation would be required to the extent an Alberta dividend refund has been received by the payor corporation (on a pro rata basis).