Economic spotlight

Introduction to Corporate Income Tax in Alberta

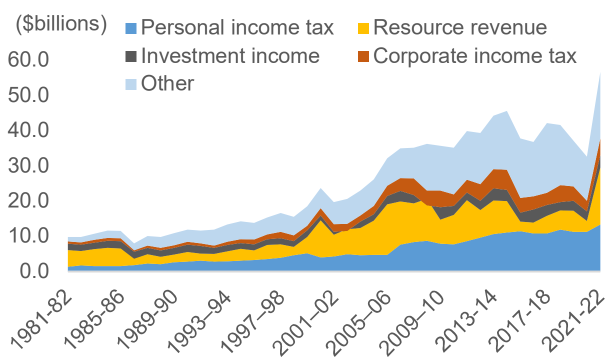
This Economic Spotlight gives an overview of corporate income tax (CIT) in Alberta—a snapshot of CIT administration, in-year patterns in CIT payments and some economic trends underlying the provincial CIT paid by leading Alberta industries.

Major own-source revenue

CIT is a significant source of revenue in the province that helps pay for important services that Albertans rely on. CIT revenue is the fourth largest single own-source[1] revenue stream in Alberta, following resource revenue, personal income tax and investment income (Chart 1). It accounted for $4.7 billion in fiscal year 2021-22, over 8% of Alberta's own-source revenue.

CHART 1: CIT MAJOR SOURCE OF REVENUE IN ALBERTA

Own-source revenue composition in Alberta, 1981-82 through 2021-22



Source: Alberta Treasury Board and Finance

Tax administration

In general, incorporated businesses with a permanent establishment (e.g., a fixed place of business such as an office, branch, mine, oil well or farm) in Alberta at any time in a taxation year are required to pay Alberta income tax in accordance with the provisions of the *Alberta Corporate Tax Act* (the Act). The Act establishes tax rates and methodology for calculating taxes owing and provides the administrative rules, including enforcement provisions, related to tax collection.

[1] Own-source revenue is generated in the province and not received as transfers from other levels of government.

In Canada, both the federal and provincial corporate tax systems are self-assessing—each taxpayer is responsible for preparing, calculating and reporting their own tax liability. Federal income tax returns are filed with the Canada Revenue Agency (CRA), which administers the federal tax system. CRA also administers provincial CIT for all provinces and territories pursuant to a series of tax collection agreements, except Alberta and Quebec. Alberta's CIT is administered by the Tax and Revenue Administration Division (TRA) of Treasury Board and Finance.

Taxable income and its allocation

Taxable income is the base used to calculate the amount of tax a business owes in a given tax year. Generally, it is determined by subtracting expenses and other deductions from gross income. The provincial calculation of taxable income generally parallels the federal calculation. However, Alberta businesses may claim discretionary deductions (e.g., losses, capital cost allowance, and charitable donations) differently when computing taxable income for federal and Alberta purposes.

A corporation with permanent establishments only in Alberta must allocate 100% of its taxable income to the province. However, an Alberta corporation with permanent establishments in other provinces pays CIT in Alberta on the taxable income reasonably attributable to the province. A general income allocation formula applies to most corporations, but special formulas apply for corporations that operate in certain sectors.

Tax credits and deductions

Tax credits and tax deductions both decrease the amount of tax a corporation pays, but they do so in different ways. A tax credit is a dollar-for-dollar reduction in the amount the company owes, while a tax deduction reduces the company's taxable income, leading to a lower tax bill.

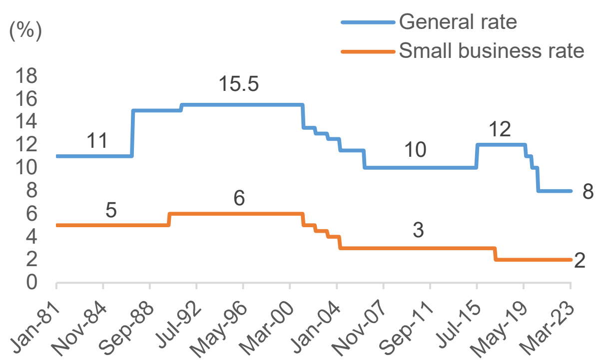
Alberta offers a limited number of targeted tax credits—such as the Agri-Processing Investment Tax Credit, Innovation Employment Grant, and Film and Television Tax Credit. Tax credits can be non-refundable (i.e., can only be used to reduce Alberta taxes payable) or refundable (i.e., a grant delivered through the tax system, which can be claimed even when no taxes are payable).

Tax rates

As of July 2020, Alberta's general corporate income tax rate is 8% and, since January 2017, the small business rate has been 2%. Both rates are the lowest since observations began in 1981 (Chart 2). Smaller privately held corporations (i.e., not publicly traded) generally pay CIT at the small business rate on up to $500,000 of their annual active[2] business income. This $500,000 amount is referred to as the small business threshold and is shared between associated corporations. Passive income and income over the small business threshold is taxed at the general corporate tax rate.

CHART 2: TAX RATES ARE AT HISTORICAL MINIMUM

CIT rates in Alberta



Source: Alberta Treasury Board and Finance

Over recent years, about 85% of the corporations that pay Alberta taxes have benefitted from the small business tax rate. The other 15% of corporations are taxed only at the general rate. Despite this ratio, corporations taxed at the general rate are the principal driver of private investment and economic activity in the province, accounting for about 90% of Alberta's CIT paid.

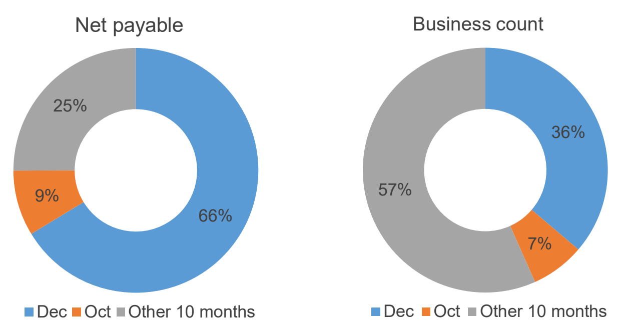
Taxation year

Under Alberta's tax legislation, corporations are required to use the same taxation year as used for federal purposes. A newly incorporated business may choose any date as its taxation year-end. The first year-end must be no later than 53 weeks from the incorporation date, and subsequent year-ends can be no more than 53 weeks apart. Once established and accepted, a year-end cannot be changed without permission from the CRA.

In 2021, 36% of businesses that filed tax returns in Alberta had a tax year-end in December. Most of these businesses were in the Oil and Gas Extraction sector, which contributed 66% of the total tax owing that year. For financial corporations (7% of the total business count in 2021), the tax year ends in October. Financial institutions were responsible for 9% of the total tax payable in Alberta in 2021. The other 57% of corporations, owing 25% of the total tax payable, had tax years that ended in any other month but October and December (Chart 3).

CHART 3: CORPORATIONS THAT CONTRIBUTE OVER HALF OF CIT HAVE DECEMBER YEAR-END

Net payable and count by year-end month, % of respective totals



Source: Alberta Treasury Board and Finance

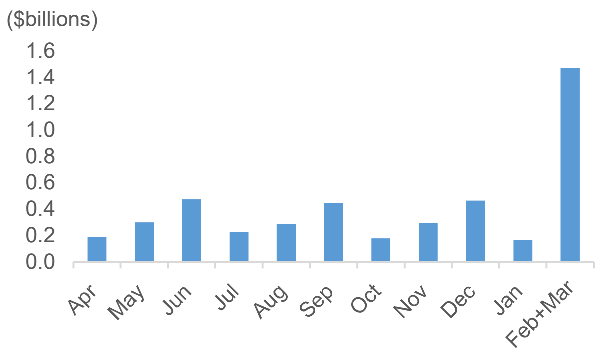
[2] Income specifically derived from active business operations is considered to be active business income and is eligible for the small business rate in Alberta. Passive income or other non-active business income is always subject to the general corporate tax rate.

Cash receipts peak in February and March

Knowledge of the corporate year-end month helps shed light on in-year CIT cash trends. Throughout the tax year, corporations are generally required to make monthly payments, known as installments, based on their estimate of taxes owing for the year. The balance of the tax payable is due on or before the end of the second month following the taxation year-end for all businesses, except Canadian-controlled private corporations (CCPCs). Some CCPCs are exempt from paying installments throughout the taxation year and are instead permitted to defer the total of their tax payments to the end of the third month following the taxation year-end. More than half of the annual tax payable in Alberta comes from businesses with a December year-end. Therefore, the reconciliation of outstanding tax owing falls onto either February or March, explaining the large spike in gross cash receipts at the end of each fiscal year (Chart 4). In addition to the February/March spike, quarter-end increases in cash coincide with some sectors, particularly Oil and Gas Extraction, adjusting their installments at the end of each quarter (June, September and December).

CHART 4: OUTSTANDING BALANCES PUSH CASH HIGHER IN FEBRUARY AND MARCH

Gross CIT cash receipts, average of 2000-01 through 2021-22



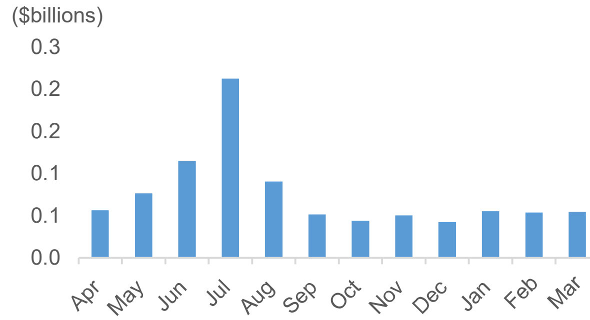
Source: Alberta Treasury Board and Finance

Refunds spike in July

Businesses must file Alberta tax returns with TRA within six months from the end of their taxation year. As a result, refunds are usually strong in summer months, particularly in July (Chart 5). Failure to submit tax returns on time results in a late-filing penalty, which is based on the amount of tax owing on the filing due date.

CHART 5: CIT REFUNDS PEAK IN JULY

CIT refunds, average of 2000-01 through 2021-22



Source: Alberta Treasury Board and Finance

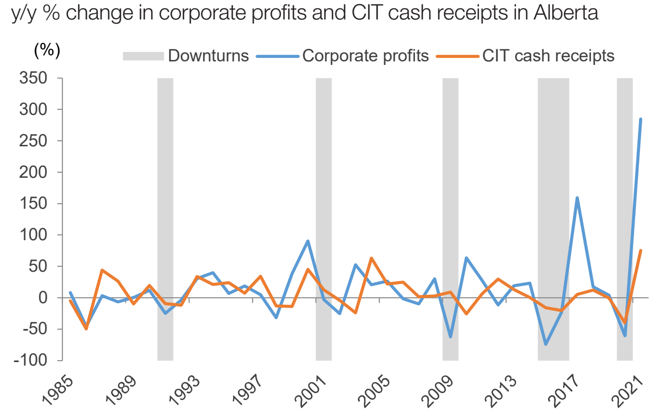
CIT cash follows economic cycles and is highly volatile

Over the long run, growth in Alberta's CIT cash tracks growth in the provincial nominal gross domestic product (GDP). Between 2000 and 2021, CIT cash grew at an average compound annual rate of 3.8%, which is slightly behind, but largely in line with, an average compound annual growth rate of 4.5% for nominal GDP.

Corporate profits, which comprise the corporate income tax base, is the most volatile component of GDP. Ferede (2013) found that Alberta's CIT base is about four times as volatile as provincial GDP. This makes CIT cash receipts highly sensitive to economic cycles (Chart 6). Corporate profits dropped 60% in 2020 compared to the pre-pandemic 2019, whereas CIT cash receipts declined by only 40% over the same period. When the economy bounced back in 2021 and profits rose by about 285% year-over-year (y/y), CIT receipts improved by a more moderate 75% y/y.

CHART 6: ALBERTA'S CIT CASH RECEIPTS ARE HIGHLY VOLATILE

y/y % change in corporate profits and CIT cash receipts in Alberta



Sources: Alberta Treasury Board and Finance, Statistics Canada and Haver Analytics

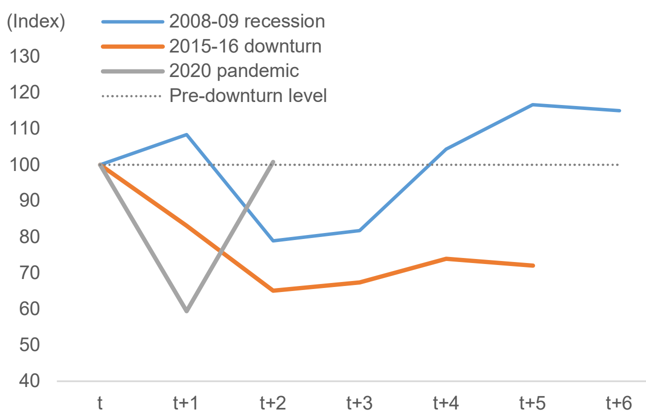
In addition to corporate profits being highly responsive to changes in economic activity, businesses are allowed to claim operating losses incurred in the current tax year against past and/or future corporate tax owing.

Operational losses reduce CIT payable

The use of losses for tax purposes reduces CIT revenue and delays its recovery to pre-downturn levels. Over the three fiscal years following the 2015-16 downturn, CIT cash receipts, measured in 2002 dollars, grew at a compound annual growth rate of 6.5% per year, which was much lower than the average annual growth for the three fiscal years following the 2009 recession (+15%) (Chart 7).

CHART 7: OPERATIONAL LOSSES INCURRED IN 2015-16 ERASED SOME FUTURE CIT REVENUE IN ALBERTA

CIT cash receipts in CDN$2002, indexed to pre-downturn year

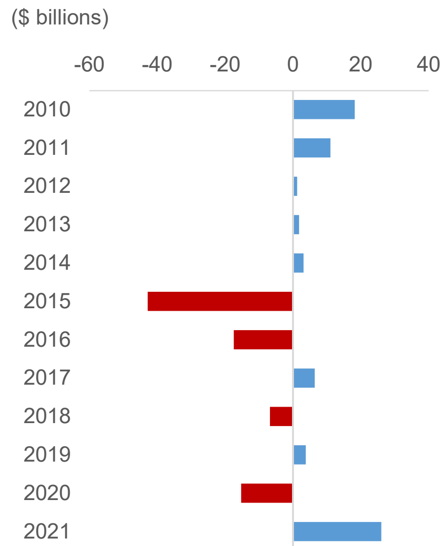


Sources: Alberta Treasury Board and Finance, Statistics Canada and Haver Analytics

There were two primary reasons for the slower recovery in CIT payments. Firstly, Alberta experienced a more gradual economic recovery after the 2015-16 downturn, compared with a strong economic rebound following the 2008-09 recession. In 2011, two years after the recession trough, Alberta's nominal GDP had recovered to and exceeded the pre-recession (2008) level. In 2021, six years after the 2015-16 downturn, nominal GDP remained 0.6% below the 2014 level. Secondly, operating losses incurred by Alberta corporations in a given tax year are allowed to be applied against past and/or future taxable income to reduce corporate income tax payable. During the 2015-16 downturn, oil and gas extraction companies operating in Canada accumulated an unprecedented amount of losses (Chart 8) that significantly slowed the recovery in CIT revenue in the following years. While a decline in future taxable income as a result of carried forward losses is harder to estimate, Alberta Treasury Board and Finance approximates that corporate income tax refunds related to the carried back losses peaked in 2017-18 and began shrinking until the pandemic in early 2020.

CHART 8: LARGE LOSSES IN ENERGY SECTOR IN 2015-16

Operating profit (+)/loss (-), Oil & Gas Extraction, Canada, 2010-2021



Source: Statistics Canada

In 2020, the dual shock of the COVID-19 pandemic and the collapse in oil prices resulted in another increase in operating losses reported by oil and gas extraction companies operating in Canada, although significantly below the magnitude of the 2015-16 losses. Despite elevated losses claimed for tax purposes in 2021, a strong rebound of the Alberta economy helped CIT revenue recover to pre-pandemic levels in the 2021-22 fiscal year (Chart 7).

Largest industry contributors of CIT in Alberta

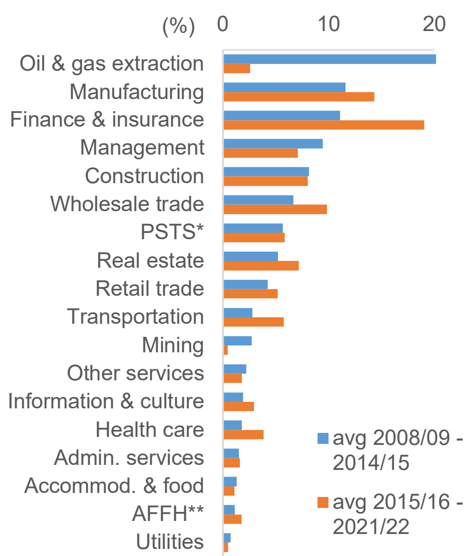
Historically, ten business sectors have been the largest contributors of corporate income tax revenue in Alberta—oil & gas extraction, manufacturing, finance and insurance, management of companies, construction, wholesale trade, professional, scientific & technical services, real estate, retail trade and transportation & warehousing (Chart 9).

Tax contribution of Oil & Gas Extraction dropped after 2014

After the West Texas Intermediate (WTI) oil price collapsed from an annual average of US$93 per barrel (bbl) in 2014 to US$43 per bbl in 2016 and remained depressed for the next four years, CIT payments from oil & gas extraction companies plummeted (Chart 9). The average share of oil & gas extraction in total CIT receipts was about 20% between fiscal years 2008-09 and 2014-15. It then dropped to about 2.5% between fiscal years 2015-16 and 2021-22 on the back of weak energy production and investment.

CHART 9: CIT PAYMENTS FROM ENERGY SECTOR DECLINED AFTER THE 2014 OIL PRICE DROP

CIT cash receipts for major industries, % of total



Source: Alberta Treasury Board and Finance; *Professional, scientific and technical services, **Agriculture, forestry, fishing and hunting

Food, wood and chemical products dominate payments in Manufacturing

For the manufacturing industry in Alberta, CIT payments are dominated by the food (311[3]), wood product (321) and chemical manufacturing (325) sub-sectors. Payments from food product manufacturing are driven by meat product manufacturing (with most of the Canadian beef processing concentrated in Alberta), followed by the grain & oilseed milling subsector. Receipts from wood product manufacturing generally move in line with the price of lumber and other wood products. Tax receipts from chemical manufacturing appear to be driven by the value of chemical manufacturing shipments in Alberta.

Commercial banks drive tax receipts from Finance & Insurance

CIT receipts from commercial banks and other financial institutions involved in depository credit intermediation (5221) have historically led payments from finance & insurance. As no major commercial banks are headquartered in Alberta, the share of the provincial GDP for finance & insurance in the national total is correlated with Alberta's share of the national population.

Holding companies define Management of Companies

The management of companies sector in Alberta is dominated by holding companies. A holding company, in contrast to an operating one, does not produce goods or services, but controls interest in the securities of other corporations. It may present some advantages for tax planning purposes.

Small enterprises dominate Construction and PSTS

Specialty trade contractors (238), particularly building equipment contractors, have historically led CIT payments in construction, followed closely by construction of buildings (236) and heavy & civil engineering construction (237). Both construction and professional, scientific & technical services (PSTS) in Alberta are characterized by a large number of companies that are subject to the small business tax rate. The architectural, engineering & related services (5413) sub-sector, which largely supports the oil patch, has led CIT receipts in PSTS, followed by computer systems design & related services (5415).

[3] Numbers in brackets represent North American Industry Classification System (NAICS).

Economic and construction activity bolster tax receipts from Wholesale Trade

The machinery, equipment & supplies merchant wholesalers (417) and building materials (416) sub-sectors have historically led CIT payments for the wholesale trade industry. These two sub-industries import from other provinces, most frequently Ontario, and pay taxes on the value-added created in Alberta, including wholesale margins. A pickup in economic and construction activity tends to boost tax payments from wholesale trade, assuming no major cost escalation.

Real estate rental shapes industry

Rentals of residential and non-residential real estate (531) drive CIT receipts within the real estate & rental & leasing industry in Alberta. Within the rental & leasing services (532) sub-sector, commercial & industrial machinery & equipment rental & leasing (5324) is the largest CIT contributor.

Motor vehicle dealers drive tax payments from Retail Trade

CIT receipts from retail trade are dominated by payments from the motor vehicle & parts dealers (441), food & beverage stores (445) and the general merchandise stores (452) sub-sectors. The value of retail trade in these respective sub-industries bolsters CIT payments.

Pipeline, rail and truck transportation dominate industry in Alberta

The pipeline (486), rail (482) and truck (484) transportation sub-sectors have generally led CIT payments for Alberta's transportation & warehousing industry. Both pipeline throughput and tolls define revenue in the pipeline transportation sub-sector. Revenue in rail transportation is a function of rail traffic within the Western Division. According to Statistics Canada, about half of revenue in Alberta's trucking industry is determined by domestic movements within the province. Although the trucking industry in Canada is dominated by small businesses, large and medium carriers are generally the most profitable.

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Alberta