

THE LION'S SHARE: Corporate profits and taxes in Alberta



Alberta's economy has seen tremendous economic growth, but the lion's share of that growth has been benefiting private corporations. Corporate profits more than doubled their share of the economy from 1989 to 2008, rising from 9.6% to 22.6%. Relatively little of the meteoric rise in profits was captured by corporate taxes as can be seen in Figure 1.

The race to the bottom

At both the federal and provincial levels, corporate tax cuts have been all the rage. Each jurisdiction is attempting to outdo its neighbours in order to attract mobile capital investment. This is a competition no jurisdiction can win as corporate tax and thus government revenues spiral down everywhere.

The combined federal/provincial general corporate income tax rate has fallen from 33.62% in 2005 to 28% today and is set to decline to 25% by 2012. The small business tax has also declined from 30% to 14% (Table 1).

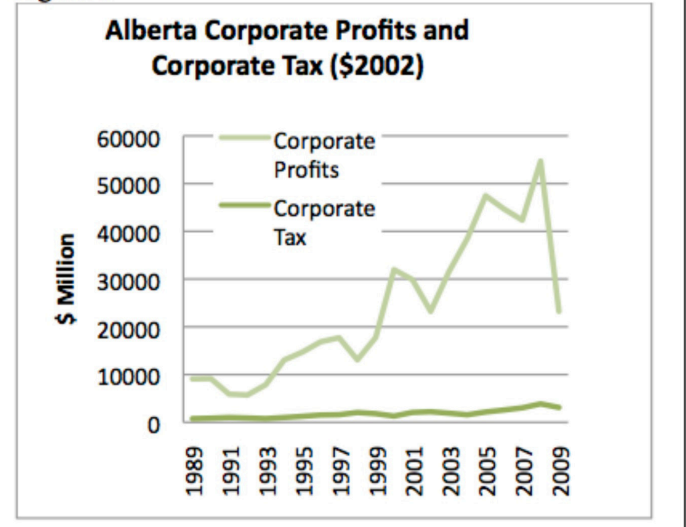
Already Canada has some of the lowest tax rates in the developed world. Canadian corporations will have the lowest tax rate on new business investment in the Group of Seven (G7) by 2011 and the lowest statutory tax rate in the G7 by 2012.¹

Combined Corporate Tax Rate Cuts		
	2012	2005
First \$300,000	14.00%	16.12%
\$300K - \$400K	14.00%	25.12%
\$400K - \$430K	14.00%	33.62%
\$430K - \$460K	14.00%	33.62%
\$460K - \$500K	14.00%	33.62%
excess of \$500K	25.00%	33.62%

Table 1

1. According to KMPG's Guide to International Business Location, 2008, Competitive Alternatives Special Report: Focus on Tax, Canada is second only to Mexico
 2. Many mainstream economists have been clearly advocating spending over tax cuts as economic stimulus. These include: Benjamin Tal, "Capitalizing on the upcoming infrastructure stimulus," Occasional Report #66, CIBC World Markets, January 26, 2009. Matthew D. Shapiro, Joel B. Sherrod, "Did the 2008 Tax Rebates Stimulate Spending?" working paper #14753,

Figure 1



Alberta's Tory government has been leading the nation's race to cut corporate taxes. Between 2001 and 2006, the general corporate income tax rate was reduced from 15.5% to 10%. The small business rate was cut in half, to 3%, and the small business income threshold was doubled to \$400,000.

Tax cuts not best job creator

Direct government spending creates far more jobs per dollar than tax cuts (Table 3). Government spending on health care or infrastructure is more effective at creating jobs because that spending directly employs people who then spend most of their income locally on goods and services, creating more spin-off jobs.² Corporations do not automatically hire workers when they have money, much of that tax cut will be lost to payouts to shareholders (some foreign), debt payment, higher CEO salaries and other non-employment based activities.

National Bureau of Economic Research, Cambridge, MA, March 2009. "Tax refunds to go to debt, investments, suggests poll," Financial Post, Ottawa, March 3, 2009. Glen Hodgson, "Permanent tax cuts are no panacea," Globe and Mail, January 12, 2009.

Lower taxes are not bringing expected higher investment

Corporate tax cuts have also not been particularly effective at stimulating investment. As seen in Figure 1 corporate profits have been at record levels year over year with the exception of the temporary dip in the recession. However, Statistics Canada reports that business fixed capital investment was relatively sluggish during those growth years. Also, TD Bank reported before the recession that the ratio of business investment to profits had fallen to an all time low. If the federal government spent \$6 billion on public infrastructure instead of corporate tax cuts, the total increase in investment would be more than ten times higher.³

Instead of investing, Canada's corporate sector is sitting on a growing pile of cash. The non-financial corporate sector had accumulated \$489 billion in ready cash by the third quarter of 2010.

Corporate taxes capture unpaid rent

Another reason corporate income tax is particularly important in Alberta is to capture economic rent from the use of natural resources that may have slipped through the Alberta's inadequate royalties scheme. This is critical in the context of the wealth being generated and not captured from Alberta's oil and gas industry, much of it by foreign corporations.

Ensuring corporations pay their fair share

The budget for 2010-11 estimated the general corporate tax revenue at \$2.822b at the 10% rate.

3. For a more detailed discussion of the disconnect between corporate taxes and investment, see *Having Their Cake and Eating It Too: Business Profits, Taxes, and Investment in Canada: 1961 Through 2010*, Jim Stanford, Canadian Centre for Policy Alternatives, April 2011.

This means that for each percentage of tax the province is collecting \$282.2 million.⁴ Accordingly, if Alberta raised its general rate to 12% it could raise roughly an additional \$564.4 million per year in corporate tax revenue.

Provincial Corporate Income Tax Rates April 2011		
Province or Territory	Small Business	General rate
Newfoundland and Labrador	5.0%	14.0%
Nova Scotia	5.0%	16.0%
Prince Edward Island	1.0%	16.0%
New Brunswick	5.0%	11.0%
Ontario	4.5%	12.0%
Quebec	8.0%	11.9%
Manitoba	0.0%	12.0%
Saskatchewan	4.5%	12.0%
Alberta	3.0%	10.0%
British Columbia	2.5%	10.5%*

Table 2 shows the corporate tax rates for the provinces and territories of Canada as of April 2011. These rates will change in January 2012. Source: Alberta Canada budget 2010-11, Tax Plan p. 157

Though BC's rate is lower, debate in BC about reinstating it to 12% opens the door for a similar debate in Alberta. This rate would thus be still low enough relative to other provinces that it would not likely be significantly reduced by corporations declaring their revenues elsewhere in Canada, and the US combined tax rates are significantly higher.

Extraordinary profits tax

Alberta could capture significantly more of the corporate profits if it targeted the extraordinary profits being made in the oil and gas sectors. There is a precedent for a higher corporate tax rate for oil and gas. In 2001 the federal government began cutting the corporate income tax rate but left it at the higher rate for resource companies for an additional two years.⁵ The United Kingdom has a higher corporate rate for petroleum companies than for other companies.

4. Government of Alberta, Budget 2010, Striking the Right Balance, Tax Plan, p155.

5. Finance Canada, Budget 2003, p. 185 (table 3.8) as referenced in the CCPA Alternative Federal Budget 201 "Getting the Job Done Right" p. 28.

US corporations pay the difference to the US treasury

The United States does not allow its corporations to avoid taxes by paying them at lower rates in other countries. The US government collects the difference between what those corporations paid in Alberta to the US Treasury rate, meaning that American corporations working in Canada will receive a tax credit for taxes paid (25%) in Canada but will pay rates of 35% at home. Alberta is not attracting American investors with lower taxes, we are just transferring resources to the US Treasury. Estimates are that, depending on the year Alberta has paid between \$1.1 and \$2 billion in taxes to the US Treasury because they were not collected by the Alberta government.⁶

The Health Care Advantage

In the United States any firm of reasonable size has to provide expensive medical insurance to its employees, Canadian firms do not. Corporate taxes should be levied with this discrepancy in mind. This means that Alberta's combined corporate tax rate could be higher than the US rate and still give Canada a competitive advantage over US companies.⁷

Corporations take advantage of loopholes

The above tables showing tax rates show the statutory tax rates. Studies of effective tax rates show that what companies actually pay in tax is considerably lower because of loopholes they take advantage of.

6. Erin Weir, "The Treasury Transfer Effect, Are Canada's corporate tax cuts shifting billions to the U.S. Treasury?", Canadian Centre for Policy Alternatives, 2009.

7. Towers Perrin, High-Performing Companies 1 Again Beat Low Performers on Costs by Double-Digit Percentages — Informing Policy Debate With Insights Into What Works In Health Care, September 24, 2008 http://www.towersperrin.com/tp/showdctmdoc.jsp?url=Master_Brand_2/USA/Press_Releases/2008/20080924/2008_09_24b.htm

GDP and Employment Impact of Federal Fiscal Measures: Final Impact from \$1 Billion Stimulus

Fiscal Measure	GDP Impact (\$bil) ¹	Employment Impact ²
Support to unemployed and low income	\$1.7	18,755
Infrastructure investment	\$1.6	17,652
Housing investment	\$1.5	16,584
Other spending measures	\$1.4	15,445
Personal income tax reductions	\$1.0	11,032
EI premium reductions	\$0.6	6,619
Corporate income tax reductions	\$0.3	3,310

1. Dept. of Finance Canada, *Canada's Economic Action Plan Report #6, Table A.1. p. 142 for 3Q 2010*

2. Assumes average employment-GDP ratio of 11,032 jobs per billion dollars of GDP. 2009 average nominal GDP \$1,527 billion and average employment of 16,849,000 (Source: Statistics Canada CANSIM database). $16,849,000 \text{ divided by } 1,527 = 11,032 \text{ jobs per billion.}$

Table 3

For example, a recent National Bureau of Economic Research paper reported Canada's corporate tax rate to be 7% for domestic firms and 21% for multinational firms, even though the statutory rate was about 36%.⁸ The oil and gas extraction sector paid a real tax rate of 6% of profits in 1999 to 18% in 2008.

Small business rate a giveaway

The incentive created by having a lower small business rate is that larger corporations hive off into smaller units to take advantage of the lower rate. Individuals also incorporate to avoid higher personal income tax rates. Making the rates consistent across corporations regardless of size would create a more effective and fairer regime for progressively capturing both personal and corporate incomes. As long as that rate is paid on profits, small businesses that operate close to the line would not be particularly hard hit by a higher tax rate.

8. Kevin S. Markle, and Douglas A. Shackelford, Cross-country Comparisons of Corporate Income Taxes, Working Paper 16839, National Bureau of Economic Research, Cambridge, MA, February 2011, <http://www.nber.org/papers/w16839>.

9. Majority has spoken - scrap corporate tax cuts, (May 5, 2011) Canadians for Tax Fairness www.taxfairness.ca.

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Public opinion does not favour tax cuts

Public opposition to the corporate tax cuts has been significant and consistent. In January, Leger Marketing found only 10% of respondents favoured the cuts, while 40% supported increased corporate tax rates. In early March, both CP-Harris Decima and Ipsos Reid polls found 59% opposed the cuts. In late March, Forum Research reported more than 60% opposed.⁹ When faced with a choice between social program cuts such as health care and education and tax increases, polling consistently shows the majority support increasing taxes.

It is time to stop the race to the bottom

The corporate tax cuts race to the bottom is a race no one wins. The consequences of this is reduced government revenues -- meaning program and service cuts and deficits. We are seeing this in the provincial budget which has been in a deficit two years running despite serious cuts to programs including education, housing and community supports. Corporate taxes need to be reinstated and raised to the Canadian average.

For more information see:

Fixing What's Broken: Fair and sustainable solutions to Alberta's revenue problems, Parkland Institute June 2, 2011. <http://parklandinstitute.ca>