

Undoing Alberta's Personal Income Tax Hikes

Tegan Hill and Nathaniel Li



Summary

- As recently as 2014, Alberta had a single 10 percent personal and corporate income tax rate. As a result, it had the lowest top statutory combined federal and provincial/state personal income tax rate and business income tax rate in North America. This was a powerful advantage that made Alberta an attractive place to start a business, work, and invest.
- In 2015, however, the provincial NDP government replaced the single personal income tax rate of 10 percent with a five-bracket system including a top marginal rate of 15 percent. It also increased Alberta's 10 percent CIT rate to 12 percent. While the CIT rate has since been reduced to 8 percent, Alberta now has the 10th highest PIT rate in North America.
- It is important for the province to undo the personal income tax hikes, and return to a single rate PIT system at a lower rate of 8 percent to match the CIT rate. This would help restore Alberta's position as a low tax jurisdiction with a top combined PIT rate among the 15 lowest in North America. Crucially, it would improve Alberta's standing among energy jurisdictions, among which it competes for talent and investment.
- If these changes were introduced via a flat tax system, Alberta could improve tax efficiency, reduce administration and compliance costs, all while avoiding negative incentives for work, savings, and investment.
- Finally, reducing Alberta's PIT system to a single rate of 8 percent would lead to tax savings for Albertans across income groups. For perspective, taxpayers affected by the changes would save \$1,573, on average, in 2023.

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Introduction

As recently as 2014, Alberta had a single 10 percent personal and corporate income tax rate. As a result, it had the lowest top statutory combined federal and provincial/state personal income tax rate and business income tax rate in North America. Paired with having no provincial sales tax, this powerful tax advantage made Alberta an incredibly attractive place to start a business, work, and invest. With the election of the provincial NDP government in 2015, however, Alberta lost its tax advantage. Specifically, the Notley government replaced the single personal income tax rate of 10 percent with a five-bracket system—including a top marginal rate of 15 percent—and increased Alberta's 10 percent CIT rate to 12 percent.

While the corporate income tax increases have since been undone, higher personal income tax rates remain. The intention of this bulletin is to assess the potential to improve Alberta's personal income tax competitiveness and generate savings for Albertans by undoing the NDP tax hikes and replacing the provincial PIT system with a lower single rate of 8 percent.

Why low tax rates matter

A significant body of research finds that high marginal tax rates—the tax rate that applies to the next dollar earned—discourage economic growth by reducing after-tax income from engaging in productive activities like work, savings, investment, and entrepreneurship (Palacios and Harischandra, 2008). For example, Padovano and Galli (2001;2002) analyzed 23 member countries of the Organisation for Economic Co-operation and Development (OECD) from 1951 to 1990, and found that high marginal tax rates tend to be negatively correlated with long-term economic growth. Romer and

Romer (2010) found that increasing taxes by the equivalent of 1 percent of gross domestic product was associated with an approximate 2.5 to 3 percent decrease in real economic growth.

High marginal PIT rates have a particularly strong impact on productive activity, as a consequence of reducing the after-tax returns from employment and additional work (Ferede, 2019; Ferede and Dahlby, 2016). For instance, Davis and Henrekson (2004) examined 16 industrialized countries in the 1990s and found that a tax rate increase of 12.8 percentage points¹ led to a 4.9 percentage point decline in total employment. In contrast, reducing and maintaining low personal income tax rates help stimulate productive activity (Palacios and Harischandra, 2008). For example, Cardia et al. (2003) found that a decrease of 10 percentage points in marginal tax rates increased weekly hours worked by 9.9 percent in Canada and up to 18.0 percent in the United States. Research also suggests that tax rates play an important role in attracting highly skilled labour. For instance, Akcigit, Baslandze, and Stantcheva (2015) identify “superstar” inventors from 1977 to 2000 and find that their tendency towards international migration was significantly influenced by the effective top marginal tax rate. Overall, Dahlby and Ferede (2012) estimate that the cost to society (the “marginal cost of public funds”) from raising one dollar of personal income tax in Alberta is \$1.44.

In sum, reducing tax rates can help encourage work, investment, and entrepreneurship in Alberta—key pillars to support strong economic growth.

Improving Alberta's PIT tax competitiveness

As recently as 2014, Alberta had the lowest top statutory combined federal and provincial/state personal income tax (PIT) and corporate income tax (CIT) rate in north America. Paired with having

1 Specifically, a unit standard deviation tax difference of 12.8 percentage points.

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no provincial sales tax, this tax advantage helped Alberta attract talent and investment that fuelled economic growth.

In 2015, however, the newly elected provincial NDP government increased both corporate and personal tax rates. The provincial income tax system was changed from a single rate of 10 percent to a five-bracket system including top marginal rate of 15 percent.² Moreover, in 2016, Canada's federal government created a new top PIT rate of 33 percent—four percentage points higher than the previous top rate of 29 percent—which would be on top of the provincial tax-rate increase. On corporate income taxes, the provincial rate increased from 10 percent to 12 percent. While the CIT rate increased in Alberta, the federal top CIT rate in the United States was reduced from 35 to 21 percent. As a result of these changes, Alberta moved from having the lowest top statutory combined federal and provincial/state personal income tax (PIT) and corporate income tax (CIT) rate in North America, to having one of the highest top statutory combined PIT rates, ranking middle of the pack on CIT competitiveness (Eisen and Hill, 2020).

The subsequent premier understood the importance of low tax rates for economic growth. Jason Kenney of the United Conservative Party reduced the CIT rate to 8 percent in 2020, two percentage points below the CIT rate (10 percent) that Alberta had prior to the NDP tax increases. As such, Alberta's CIT rate is now the lowest in Canada and lower than 44 U.S. states. However, higher personal income tax rates remain.³

The next logical step is to undo the personal income tax hikes and return to a single rate personal income tax system, this time at a lower rate of 8 percent to once again match the CIT rate (a discussion of the benefits of this approach follows later). Figure 1 compares Alberta's current top combined (federal state/provincial) personal income tax rate, and Alberta's top combined PIT rate if the province returned to a single 8 percent rate, to all Canadian provinces and U.S. states in 2023, and shows how Alberta's tax competitiveness could improve. It focuses on the top marginal tax rate both for simplicity and because research suggests that the behavioral response to high PIT rates is significantly greater at higher incomes (Milligan and Smart, 2019).

As shown, Alberta is tied with Hawaii for the tenth highest top personal income tax rate in North America at 48.00 percent. While it is lower than other Canadian provinces excluding Saskatchewan (47.50 percent), it is higher than every U.S. state excluding only California (50.30 percent). In contrast, if Alberta's top PIT rate was reduced to 8.00 percent, it would be the lowest in Canada by 6.50 percentage points, and among the 15 lowest top combined PIT rates in North America at 41.00 percent.⁴

It is useful to take a closer look at Alberta's current top combined rate compared to a subset of energy producing jurisdictions with which Alberta directly competes for investment and talent. As shown in figure 2, Alberta's top combined PIT rate is lower than Newfoundland and Labrador (54.80 percent),

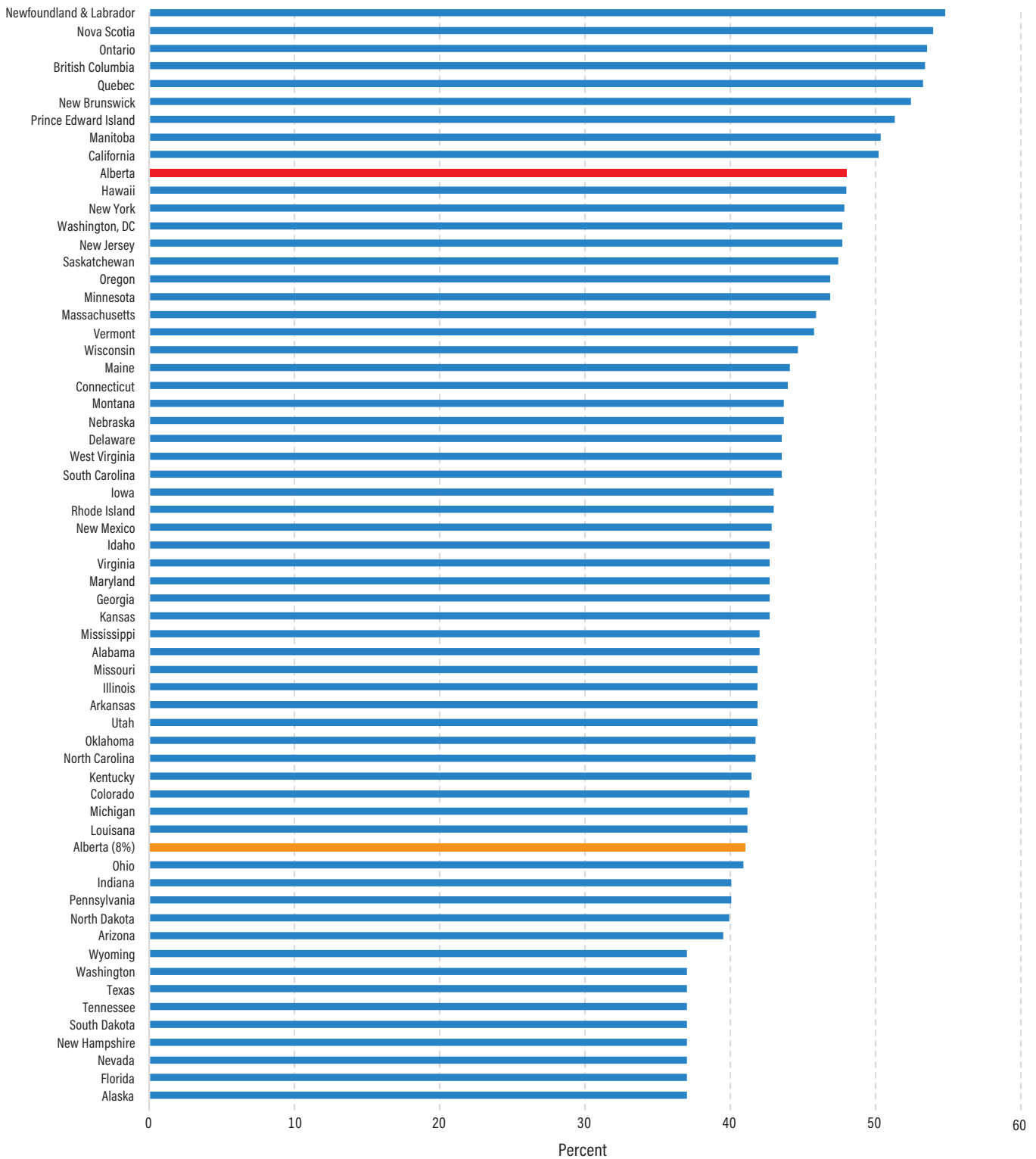
2 In 2024, Albertans will face a 10 percent marginal provincial personal income tax rate on income up to \$148,269, a 12 percent marginal personal income tax rate on income over \$148,269 and up to \$177,922, a 13 percent rate on income over \$177,922 up to \$237,230, a 14 percent rate on income over \$237,230 and up to \$355,845, and a 15 percent rate on income over \$355,845.

3 The Smith government has committed to creating a new 8 percent tax bracket on personal income below \$60,000 (United Conservatives, 2023), however, this would be insufficient to undue the NDP tax increases.

4 While this study focuses, on undoing NDP tax hikes so as to fully restore Alberta's previous tax advantage—given federal, provincial and U.S. tax policy changes—the province would need to adopt a 4.00 percent personal income tax rate to be tied with U.S. states for the lowest top combined rate. To match the lowest top combined rate at Alberta's top income threshold (\$341,502), which is significantly lower than the top thresholds in the U.S., the province would need to adopt a 2.00 percent personal income tax rate.

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Figure 1: Top Combined Marginal Personal Income Tax Rates in Canadian Provinces and US States, 2023

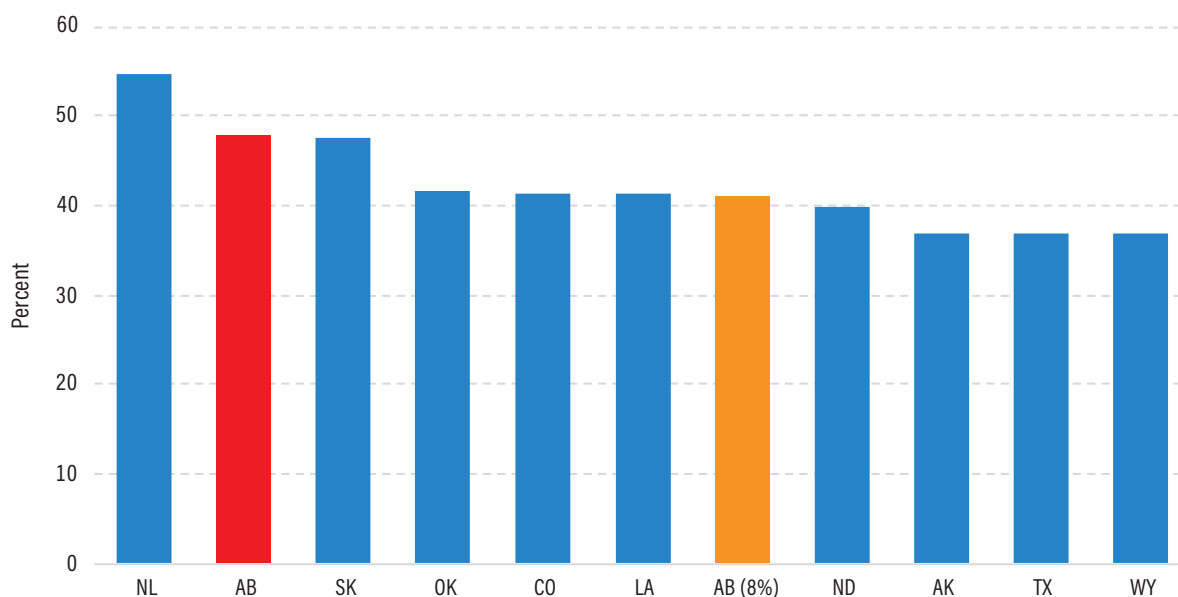


Note: Personal income tax rates include surtaxes where applicable. Quebec's tax rate is adjusted for the federal abatement. Local income taxes are excluded for US states.

Sources: Durante (2023); Vermeer (2023); CRA (2023); Revenu Quebec (2023); calculations by authors.

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Figure 2: Top Combined Marginal Personal Income Tax Rate, Energy Producing States/Provinces, 2023



Sources: Durante (2023); Vermeer (2023); CRA (2023); calculations by authors.

but higher than eight other peer jurisdictions in 2023. It is significantly higher than all U.S. jurisdictions with the gap ranging from 6.25 percentage points above Oklahoma's top combined PIT rate to 11.00 percentage points above Alaska, Texas, and Wyoming, which have no state personal income tax. As shown, if Alberta's PIT system was reduced to a single rate of 8.00 percent it would be much more closely aligned with peer jurisdictions with a top combined (federal/provincial) PIT rate of 41.00 percent.

It is also important to recognize that Alberta's top rate applies at a much lower level of income than in U.S. energy producing jurisdictions. As shown in Table 1, Alberta's threshold for the top combined PIT rate is \$341,502 (CAD) in 2023. By comparison, the top rate in competing U.S. jurisdictions applies at \$780,295 (CAD). Newfoundland and Labrador is the only subnational jurisdiction in this group of energy producing states/provinces that has a higher

top combined personal income tax rate, which applies at \$1,059,000 (CAD).

While the focus thus far has been on the top combined PIT rate, Albertans at a wide range of income levels face significantly higher marginal tax rates than comparable individuals in most U.S. jurisdictions. Table 2 compares tax rates at various levels of income in energy jurisdictions in Canada and the United States.

An Albertan with \$50,000 in annual taxable income⁵, for instance, faces a combined marginal tax rate of 25.00 percent, while the combined rate in select U.S. jurisdictions ranges from 12.00 to 16.75 percent, a gap of between 8.25 to 13.00. The gap becomes smaller but continues to exist at \$75,000 and \$100,000, ranging between 3.75 and 8.50 percentage points. At a combined marginal tax rate of \$150,000 Albertans face a marginal PIT rate between 9.25 and 14.00 percentage points higher than in U.S. energy

5 Taxable income is the amount used to determine how much federal and provincial income tax individuals will pay.

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Table 1: Threshold for combined top federal provincial/state personal marginal personal income tax rate, energy producing states/provinces, 2023

Province/State	Threshold for Top Marginal Tax Rate
Alberta	341,502
Saskatchewan	235,675
Newfoundland & Labrador	1,059,000
Alaska	780,295
Colorado	780,295
Louisiana	780,295
North Dakota	780,295
Oklahoma	780,295
Texas	780,295
Wyoming	780,295

Note: The 2023 exchange rate for converting US dollars to Canadian dollars in 2023 is 1.3497, which is recoded by the Bank of Canada. At this rate, the threshold of US\$ 578,125 is CA\$780,295.

Sources: Durante (2023); Vermeer (2023); CRA (2023).

jurisdictions, and at \$200,000 that gap goes up to between 13.25 and 18.00 percentage points. Finally, Albertans at \$350,000 face a marginal combined tax rate between 8.25 and 13.00 percentage points higher than energy U.S. jurisdictions.

In other words, with respect to the taxation of personal income, skilled workers are less incentivized to work in Alberta. Further, the disincentive for productive economic activity is larger at any income level above \$50,000 when compared to U.S. energy jurisdictions. As shown in table 2, if the 5-bracket PIT system was returned to a single rate system at 8.00 percent, this disincentive would be reduced throughout the income distribution. For instance, the gap between the combined marginal tax rates of Alberta and U.S. energy jurisdictions at \$75,000 and \$100,000 would be reduced to as little as 1.75 percentage points. At a combined marginal tax rate of \$350,000 the gap would be narrowed to between 1.25 and 6.00 percentage points.

Replacing the 5-bracket PIT system with a single rate of 8 percent would lead to tax savings for Albertans across income groups. Table 3 shows the potential savings per Albertan taxpayers by income group on average. As shown, taxpayers affected by the tax changes (approximately 2.3 million Albertans) will save on average \$1,573 per year. Put simply, establishing an 8.00 percent PIT rate would keep more money in the pockets of Albertans.

Table 2: Combined marginal tax rates at various income levels, 2023

Province/State	Marginal tax rate (%) at \$50,000	Marginal tax rate (%) at \$75,000	Marginal tax rate (%) at \$100,000	Marginal tax rate (%) at \$150,000	Marginal tax rate (%) at \$200,000	Marginal tax rate (%) at \$350,000
Alberta	25.00	30.50	30.50	38.00	42.00	48.00
Alberta (8%)	23.00	28.50	28.50	34.00	37.00	41.00
Saskatchewan	27.50	33.00	33.00	40.50	43.50	47.50
Newfoundland & Labrador	29.50	35.00	36.30	43.80	46.80	53.80
Alaska	12.00	22.00	22.00	24.00	24.00	35.00
Colorado	16.40	26.40	26.40	28.40	28.40	39.40
Louisiana	15.50	26.25	26.25	28.25	28.25	39.25
North Dakota	13.10	24.04	24.04	26.27	26.27	37.64
Oklahoma	16.75	26.75	26.75	28.75	28.75	39.75
Texas	12.00	22.00	22.00	24.00	24.00	35.00
Wyoming	12.00	22.00	22.00	24.00	24.00	35.00

Note: The 2023 exchange rate for converting US dollars to Canadian dollars in 2023 is 1.3497, which is recoded by the Bank of Canada. At this rate, a threshold of CAD\$50,000 is US\$37,045; CAD\$75,000 is US\$55,568; etc.

Sources: Durante (2023); Vermeer (2023); CRA (2023); Bank of Canada (2023); calculations by authors.

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Table 3: Average change in provincial tax burden for individuals affected by tax change, by taxable income group, Alberta, 2023

Taxable Income Range	Number of individuals (000s)	Change in value	Percentage change
Under 50,000	804	-247	-21.1%
50,001 - 75,000	629	-666	-21.0%
75,001 - 100,000	423	-1,179	-21.0%
100,001 - 150,000	298	-1,807	-21.2%
150,001 - 300,000	158	-4,811	-28.6%
Above 300,000	38	-33,438	-46.6%
All Incomes	2,350	-1,573	-27.9%

Note: 42% of individuals in the lowest income group earnings 0 to \$50,000 did not see a reduction in PIT because they pay 0 or negligible tax.

Source: Calculations by authors based on Statistics Canada's SPSPD/M (version 30.0).

While it is beyond the scope of this paper to analyze the implications for government revenue, it is important to note that this tax change may be more fiscally feasible than one might think. Based on Budget 2023, the revenue raised from all provincial personal income tax brackets above \$142,292 (the top of the 10 percent bracket) amounts to \$1.199 billion in 2023/24.⁶ Moreover, all taxable income subject to the 10 percent rate yields \$1.287 billion per percentage point. Based on this data, in total, reducing Alberta's multi-bracket PIT system to a single rate of 8 percent would lead to a total mechanical loss of \$3.773 billion ($\$1.199 + \1.289×2) in 2023/24.⁷ For perspective, that is equivalent to 5.1 percent of total provincial government revenue in 2023/24. Moreover, factoring in the behavioral affect from lowered taxes—increased work, savings, and investment—it could dramatically reduce the amount of

revenue lost. Indeed, Milligan and Smart (2019) estimate that personal income tax elasticity is quite large, which implies that the tax base could significantly expand when the top tax rate falls, leading to economic and fiscal gains. Finally, there are several options to cover the lost personal income tax revenue, including modest spending restraint, replacing the federal consumer carbon tax with a made-in-Alberta approach⁸, or introducing 3-4 percent provincial sales tax⁹.

A flat tax system

To truly improve Alberta's tax system, the province would implement a flat tax. Replacing Alberta's multi-bracket personal income tax system with a single rate of 8 percent—matching the 8 percent CIT rate—is just one step towards this. A truly

6 See page 131 of the 2023 Budget.

7 An analysis by Ferede (2021) also suggests that personal income tax reductions would have a relatively minor impact on government revenue in the context of potential economic benefits it could bring. Specifically, Ferede finds that a gradual tax reduction that returns the province to the pre-2015 single rate of 10 percent would lead to a revenue loss for the provincial government of just \$16 million in the first year (based on 2022/23) after factoring in the direct positive economic benefits from the tax rate reduction. The revenue loss would rise to roughly \$1.36 billion at the end of the fourth year (2025/26) again, after factoring in direct economic benefits.

8 See Mintz (2023) for more information.

9 It is estimated that each percentage point of a provincial sales tax raises over \$1 billion annually (Bazel and Mintz, 2013). A provincial sales tax would also allow Alberta to reach a larger tax base by tapping into revenue from non-Albertan visitors.

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integrated flat tax system would not only apply a uniform tax rate to all sources of income, including personal and corporate; it would eliminate credits, deductions, and exemptions which complicate the system and distort economic decisions. Tax credits, deductions, and exemptions can reduce the cost of investments in certain areas, implicitly increasing the relative cost of investment in others. As a result, resources may go to areas where they are not necessarily most productive, leading to a less efficient allocation of resources than if these tax incentives did not exist. In other words, tax incentives can artificially change the relative attractiveness of goods and services leading to sub-optimal allocation. A flat tax system would not only improve tax efficiency by reducing these tax-based economic distortions, it would also reduce administration costs (expenses by governments due to tax collection and enforcement regulations) and compliance costs (expenses incurred by individuals and businesses to comply with tax regulations).¹⁰

A flat tax system would also help avoid negative incentives that come with a progressive marginal tax system. Put simply, Albertans are currently taxed at higher rates as their income increases, which can discourage additional work, savings, and

investment. A flat tax system would maintain progressivity as the proportion of taxes paid would still increase with income, but minimize the disincentive to work more and earn more (increasing savings and investment) because Albertans would face the same tax rate regardless of how their income increases. In sum, flat tax systems encourage stronger economic growth, higher tax revenues, and overall a more robust economy (Clemens, Emes and Scott, 2003; Basham and Mitchell, 2008).

Conclusion

After the NDP government's personal and corporate income tax rate hikes in 2015, Alberta lost a powerful tax advantage that helped attract entrepreneurs, investors, businesses, and workers—the fuel for economic growth. The corporate income tax rate has since been reduced, and the clear next step is to undo the personal income tax increases. To accomplish this, the provincial government would replace the current multi-bracket personal income tax system with a flat PIT rate matching the CIT rate of 8 percent. As the evidence suggests, this change could help stimulate economic growth while leaving more money in the pockets of Albertans.

¹⁰ Tax administration and compliance costs Canadians billions of dollars annually. For more information see Vaillancourt and Clemens (2008).

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Acknowledgments

The authors would like to express appreciation to the anonymous reviewers of this paper. Any remaining errors or omissions are the sole responsibility of the authors. As the researchers have worked independently, the views and conclusions expressed in this paper do not necessarily reflect those of the Board of Directors of the Fraser Institute, the staff, or supporters.

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ISSN 2291-8620

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