

Alberta and the use of Alberta trusts – the next tax haven?

Finance Minister, Jim Flaherty, recently announced his intention to “scrutinize offshore tax havens and significant tax avoidance by some Canadians”. It is clearly the Department of Finance’s objective to crackdown on Canadians who try to shelter income outside of Canada thereby avoiding domestic income taxes. However, one doesn’t need to look outside the borders of our country to find an opportunity to shift income to lower taxed jurisdictions. Here in Canada, the province of Alberta has a significantly lower personal income tax rate than Ontario. For taxpayers in the highest marginal personal income tax bracket, the tax rate on ordinary income (e.g. employment income and interest income) and dividends is more than 7% lower in Alberta than it is in Ontario. This presents a tax planning opportunity if an Ontario taxpayer can shift income and have it taxed in Alberta.

Short of selling the house and being a resident of Alberta on December 31st, a taxpayer can take advantage of the lower tax rate in Alberta if an Alberta trust is established. For example, if an Ontario resident taxpayer earns \$100,000 in interest and dividends annually, the taxpayer will end up paying approximately \$46,000 in personal income taxes. If that income is earned through an Alberta trust, the total taxes paid would be approximately \$39,000 – a savings of \$7,000.

An Alberta trust can also subscribe for shares of a corporation and earn dividends at a lower rate. For example, ABC Inc. is a private Canadian company which pays annual dividends of \$500,000. If the dividends are received by an individual shareholder, the taxes on that dividend would be approximately \$125,000 (assuming the dividends are paid out of income that has been subject to the general corporate tax rate and the government’s proposed “eligible dividends” legislation is passed as drafted). However, if the dividend was received by an Alberta trust, the total taxes would be approximately \$91,000 – a savings of \$34,000.

Similarly, if ABC Inc. is an investment company which has paid income tax in Canada on its investment income but has not paid out dividends to its shareholder(s) thereby creating a large “refundable dividend tax on hand” balance, transferring the shares of the investment company to an Alberta trust may result in a recovery of corporate tax at 31% when a dividend is paid, but only a payment of tax at 24% at the shareholder level- again, a net savings of 7% (note: the transfer of shares to the trust may result in a capital gain for the shareholder, see below).

Before a taxpayer establishes an Alberta trust, they must consider a few matters. First, the trustees of an Alberta trust must reside in Alberta. Generally, if the taxpayer does not know any Albertan residents they can choose an Alberta law firm or financial institution to act as trustee. Second, if property with an accrued gain is transferred to the Alberta trust, the transfer will likely cause a gain to be realized for tax purposes. If an individual is older than 65 years of age though and is comfortable with only the taxpayer and his or her spouse having entitlement to the income and capital from the trust during their lifetime, any realized gain on the transfer of property to the trust can be avoided by way of a tax-free rollover. Third, the taxpayer must consider the costs of establishing and maintaining an Alberta trust. Most independent trustees charge a fee. Finally, each province has a General Anti-Avoidance Rule (GAAR) which they can invoke. There is little guidance on what type of inter-provincial tax planning is considered offensive such that a province would apply its GAAR.

An Alberta trust is also a great way to avoid probate fees on certain assets since a trust's assets are not subject to probate and can assist in reducing or eliminating the "clawback" of Old Age Security payments. In certain circumstances an Alberta trust can provide a great estate and tax planning opportunity. Please contact the tax department at Cunningham LLP for more information.