Royalty Information Briefing #6
- Corporate Income Tax -

Introduction:
Previous briefings in this series[1] describe the world's oil and natural gas fiscal systems as being classified on a continuum from regressive to progressive. Regressive systems have a high portion of the government share from fiscal components such as bonuses, royalties, and rentals and fees. These systems do not respond to changes in project profitability. Progressive systems include fiscal instruments that are based on profitability. These systems are classified generally as profit shares or profits taxes,[2] indicating that the government share changes with the level of profitability.

Other briefings in this series describe Alberta's fiscal system as a hybrid of bonuses, rentals and fees,[3] royalties,[4] and corporate income tax. In the case of royalties, the distinction was made between royalties that are a fixed percentage,[5] royalties where the rate changes based on the level of price and production,[6] and finally royalties that also change based on the level of costs, such as Alberta's oil sands royalty.

The purpose of this briefing is to describe corporate income tax (CIT) and to relate it to the other elements in the overall fiscal system. This is important because all fiscal elements have to be taken into account to determine the government share and a project's economic attractiveness. Important differences in the application of CIT compared to the other fiscal elements are also discussed.

What is corporate income tax?:
Corporate income tax (CIT) is a legislated tax of general application requiring payment to governments by a corporation. CIT is different from the other fiscal instruments such as royalties. One difference is that while royalties, bonuses, rentals and fees, and other special levies applied to the petroleum sector, are specific to a given project, CIT is based on the revenue or income of the entire corporation, not just that of a given project.

Another difference relates to the primary purpose of CIT relative to fiscal instruments specific to the petroleum sector. Taxes are levied by the Crown to permit the treasury to pay for public services such as roads, hospitals, education, police services, and the military. In contrast, royalties are levied as a right of ownership.

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[1] See *Royalty Information Briefing#1 – What are Royalties?,* Alberta Department of Energy, 2007.
[2] The reference to taxes in this context is not to confuse these types of fiscal instruments with corporate income tax, which is also considered a profits tax.
[3] See *Royalty Information Briefing#5 – Bonuses and Land Rental Fees,* Alberta Department of Energy, 2007.
[4] See *Royalty Information Briefing#3 – Royalties: History and Description,* Alberta Department of Energy, 2007.
[5] This system is applied in many jurisdictions, most notably in the United States.
[6] This system applies to conventional oil and natural gas in Alberta.

CIT in Alberta is applied by both the federal and provincial governments through different legislation. Although most details of the calculations are determined under the Federal rules, the provincial tax rate is determined by provincial legislation.

Comparison with other profit taxes:
CIT is referred to as a profits tax, indicating that the tax is based on net revenue after costs have been deducted. Costs include depreciated investments, operating costs, royalties, and special fiscal levies such as the resource rent tax (RRT)[7].

While taxes such as the RRT are considered to be profits taxes, there are a couple of important differences when comparing these profits taxes to CIT. First, CIT applies to the entire corporation whereas the RRT typically applies at the individual project level. Also, for the RRT, all capital costs are deducted when incurred, whereas CIT only allows depreciated costs to be deducted. In the case of CIT, the notion is that allowable costs for tax purposes should be distributed over the useful life of the asset. Capital cost allowance rules specify the rate at which capital assets can be expensed annually for CIT purposes.[8] Finally, RRT and similar special fiscal levies often include some form of uplift on costs.[9] The reasons for such uplift include accounting for a rate of return on investments and for corporation costs that ought to be allocated to a specific project.

In addition to the regular capital cost allowance described above, mining companies in Canada, including both oil sands mining and in situ projects, are able to claim accelerated capital cost allowance on the assets of the particular mine, up to the income from the mine or project. As corporations recover their initial investments sooner, accelerated capital cost allowance reduces the risk associated with the mine or project, thus improving the overall economics of the project. The federal government has announced that it is phasing out the accelerated capital cost allowance for oil sands projects.

In summary, many jurisdictions apply special profits sharing fiscal levies such as the oil sands royalty. Such levies are considered a form of profits tax and in this way are sometimes comparable to CIT, as both are based on net revenue. The important difference however is that CIT is levied on the income of a corporation not just that of a given project.[10]

[7] Alberta's oil sands royalty is a form of resource rent tax. Other jurisdictions applying the RRT include Australia, Newfoundland and Labrador and Nova Scotia in Canada. The reference to tax in the context of RRT is to distinguish between the normal royalty based on gross revenue and a tax which is based on net revenue. The reference to rent is to economic rent, indicating that all costs are allowed, including an allowance of rate of return for alternative investment opportunities.

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[9] The return allowance in Alberta's oil sands royalty is an example of uplift.

[10] Another difference is that the government shares from most other fiscal elements such as rentals and fees, royalties, and profit shares such as the oil sands royalty are additive; these elements however are typically deductions when considering net income in the determination of CIT payable. For example, a tax rate of 36% and a royalty rate of 25% would result in an effective CIT rate of 27% (36% x (100% - 25%) = 27%) and a combined government share of 52% (27% + 25%).

CIT Rates:
CIT rates around the world tend to be comparable over time. For example, the rate in Canada is currently in the range of 32 to 39 percent[11], compared to about 36% in the United States.[12]

[11] Public corporations in Canada pay tax at the general rate. In 2006, the general rate of federal tax was 22.12 percent, comprising a basic rate of 21% and a surtax of 1.12 %. The Federal government announced in Bill C-13 the intention to eliminate the surtax as of January 1, 2008 and to further reduce the general rate from 21% to 19% by January 1, 2010. Provincial rates vary between 10 percent in Alberta and up to 17 percent elsewhere, so combined federal/provincial tax rates on corporate income for 2006 ranged from 32.12 to 39.12 percent.

[12] The CIT rate in the Unites States is a combination of the Federal and State rates. The Federal rate is 35%; however this rate can be reduced to 31.85% under the American Jobs Preservation Act. State rates vary from 0% to 12%, with the average being about 7%. Since, unlike Canada, the State tax is deductible against the Federal tax, the combined U.S. rate would be approximately 36%.