

Financial Literacy Lesson #3: Deductions from Income Part Two - Income Tax

Income Tax

Income tax is a tax that the federal, provincial, and territorial governments impose on income generated by all businesses and individuals. Income tax is a key source of revenue that the governments use to fund their activities and serve the public.

Individuals file an income tax return every year to determine whether they owe any taxes or are eligible for a tax refund, e.g., they have had too much tax deducted from their earnings. In general, higher income earners will pay tax at a higher rate. The Canada Revenue Agency (CRA) administers tax laws for the federal government and for most provinces and territories.

Individual Income Tax

Individual Income Tax is composed of two parts: **Basic Federal Tax** and **Provincial Tax**.

Basic Federal Tax

Individuals do not pay tax on all of their income. There are various deductions available which taxpayers subtract from their gross income to determine their **taxable income**. For example, if a taxpayer earns \$100 000 in income and qualifies for \$20 000 in tax-exempt deductions, then the taxpayer is only taxed on the remaining \$80 000. As indicated in the previous lesson, tax-exempt deductions include union or professional dues, RPP or RRSP contributions, child care expenses, and others.

The amount of **Federal Tax** due can be calculated from the Federal Tax Rate Table. The bands and rates will vary from year to year and the rate table for 2018 is shown.

Federal Tax Rate Table for Year 2018

2018 Taxable Income	Tax Rate
first \$46 605	15%
over \$46 605 up to \$93 208	20.5%
over \$93 208 up to \$144 489	26%
over \$144 489 up to \$205 842	29%
over \$205 842	33%



Federal Tax is calculated on taxable income and not on gross income.

As an example using the table, for a taxable income of \$47 605, the Federal Tax would be 15% of \$46 605 plus 20.5% of \$1 000.

Once the amount of tax due has been calculated, there are **tax credits** available which will reduce the actual amount of tax which has to be paid.

Tax credits include a **basic personal amount**, CPP contributions, EI premiums, some health and dental expenses, charitable donations, disability credits, and others.

The basic personal amount for the year 2018 is \$11 809.

The amount of tax payable to the Federal Government is called the **Basic Federal Tax** and is given by the following formula:

$$\text{Basic Federal Tax} = \text{Federal Tax} - 15\% \text{ of an Individual's Tax Credits}$$