



## HOW INCOME TAX WORKS

You pay federal and provincial tax. Tax is a fee the government charges on income, property, and sales. The money goes to finance government programs and other costs. [+ read full definition](#) on the income you earn. You are required to report your total income to the Canada Revenue Agency (CRA) when you file your tax return. The tax you pay is based on your taxable income. Taxable income is the amount of income you have to pay tax on, after tax credits and deductions. [+ read full definition](#). The rate of tax increases as your taxable income increases and exceeds certain amounts, called tax brackets. You can reduce your taxable income and the taxes you pay by taking advantage of deductions and credits.

The government sets the tax rates and brackets. They may change from year to year. Find out the [current tax rates](#).

### Sources of income

Your total income is all of your different sources of income, including:

- employment income
- dividends
- interest
- taxable capital gains
- business or professional income.

### ***Some sources of income aren't taxed***

For example, you don't pay tax on life insurance. Life insurance pays cash to your family or other beneficiary after your death. This can give them income and help pay your funeral and other final costs. [+ read full definition](#) proceeds following someone's death, most gifts and lottery winnings. Learn more about which sources of income [aren't taxed](#).

### Deductions and credits – what's the difference?

- **Tax deduction** – reduces your total income to arrive at your net income for tax purposes. Examples: RRSP contributions, childcare expenses, union and professional dues. Further deductions, such as capital losses of prior years, reduce your net income to arrive at taxable income – the basis for calculating the taxes you owe.
- **Tax credit** – is a specific amount of money that is deducted from the amount of tax you owe – not from the amount of income you earn. The amount of the tax credit – and the tax savings – is the same whether you owe \$1,000 or \$10,000 in taxes.

Learn more about [what you can deduct](#).

If you're in a higher tax bracketTax bracket The rate at which you pay tax, based on your income level.+ [read full definition](#), a deduction will be worth more in terms of tax savings than if you are in a lower bracket.

## **2 TYPES OF TAX CREDITS:**

1. **Non-refundable tax credits** – can only be used against tax that you would otherwise owe. Examples: basic personal amount, medical expenses, charitable donations, disability amount and the caregiver amount. If the total of these credits is greater than the tax you owe, you won't receive a refund for the difference.
2. **Refundable tax credits** – The government will pay you the refundable tax credits you qualify for, whether you owe tax or not. To claim them, you must file a tax return. Examples: GST/HST credits, and the working income tax benefit.

### **Take action**

Tax credits and deductions lower the amount of tax you have to pay.

Claim all the credits and deductions you're entitled to.