Snapshots™

NEWCOMERS:
TAX SYSTEM IN CANADA

CANADA'S THREE LEVELS OF GOVERNMENT – FEDERAL, PROVINCIAL AND TERRITORIAL, AND MUNICIPAL – PROVIDE THEIR CITIZENS WITH A WEALTH OF SERVICES AND PROGRAMS.

Governments collect your tax dollars and return them in the form of education, free health care, roads and highways, and numerous other social benefits. In 2013-14, for example, the federal government alone spent $251.2 billion on government-sponsored programs. And about 30% of federal government revenues come from personal income taxes.

Both federal and provincial/territorial governments levy income taxes which, as the name implies, is a tax on your income. They also levy consumption taxes or sales taxes. In Canada, you will encounter the Goods and Services Tax (GST), Provincial Sales Tax (PST) and, in some provinces, the Harmonized Sales Tax (HST).

Goods and Services Tax (GST) and the Harmonized Sales Tax (HST)

Consumption tax, more commonly known as a sales tax, is a tax on your purchases – whether you are shopping for new clothes, dining in a restaurant or buying a mutual fund. When you purchase goods and services in Canada, you add this tax to the cost of your purchase to get the total owing; the tax is generally not included in the price displayed on the sales tag.

Some items are exempt from sales taxes: basic groceries, for example, prescription drugs, child care, health and dental services, rent. Some items are "zero-rated," such as most livestock and agricultural and fishery products. They are subject to sales tax but at a rate of 0%. Everything else is taxable.

The federal government levies a 5% GST. Some provinces also levy a provincial sales tax (PST); the amount varies by province ranging from 7% to 10%. Some provinces have chosen to combine the two taxes into a single tax – the Harmonized Sales Tax or HST – which includes both the provincial and federal portion.

In Ontario, for example, the HST is 13% with 5% going to the federal government and 8% to the province. If you are shopping in British Columbia, however, your sales receipt will show GST and PST separately, at 5% and 7% respectively. Only Alberta has no PST; in Alberta you pay only the 5% GST.

Income Taxes

Who is required to pay income taxes in Canada?
Every resident of Canada is required to file a Canadian income tax return annually. Before filing your tax return, you must determine whether you are a resident, a "deemed" resident or a non-resident of Canada for tax purposes. According to the Canada Revenue Agency (CRA), you are considered a Canadian resident when you have established significant ties in Canada, such as having your permanent residence in Canada or a spouse and/or dependents in Canada. Having significant ties can also include holding Canadian documentation – for example, a Social Insurance Number (SIN) or a provincial health card and/or a driver's licence showing a Canadian address. The CRA may deem you a resident if you spend 183 or more days in Canada in a year; if you maintain significant ties to another country or your country of origin, you may be considered a non-resident.

In Canada, each member of the household – who has income – is responsible for filing his or her own income taxes. You and your spouse, for example, will each file a return. If you have teenaged children who earned income on a part-time job, the child will file a return. And you must file a return, even if you have been in Canada only part of the year; you will file your worldwide income for that part of the year.

To prevent you from paying taxes twice – in Canada and in your country of origin – on the same amount of money, Canada has tax treaties or conventions with more than 90 countries. To find out more, see the Foreign Pensions and Tax Treaties section.

Paying income taxes in Canada

Canada's tax system is unique in many respects and will probably be different from what you are used to in your country of origin. As a resident of Canada, it is your responsibility to pay taxes on the worldwide income you earned during the year and to file your tax return with the government. Income can take many forms: employment income, investment income, commission income, retirement income. You will pay taxes at your income on both the federal level and the provincial/territorial level.

In Canada, the tax system is progressive or graduated, meaning the more money you make, the more income taxes you pay. The amount of your income that you pay in taxes is expressed as a percentage and goes up in steps, or "brackets."

For example, in 2016, if you had a taxable income less than $45,282, you are in the lowest bracket of federal income tax and pay 15% of taxable income. If you made more than $45,282 but less than $90,563, you still pay 15% on the first $45,282, and 20.5% on the next $45,282. And it goes up according to income.

On top of that, you will pay provincial/territorial income taxes. Your province of residence is determined by where you were living on December 31 of that tax year. Even if you lived in Manitoba until September, when you moved to Ontario, you will file Ontario income taxes. Provincial/territorial income rates, likewise, step up in brackets and vary according to the jurisdiction. For the federal and provincial/territorial income tax brackets, go to Canadian income tax rates for Individuals – current and previous years.

So, every year by April 30, you must file your income tax return, the T1 general tax return, for the previous year ended December 31, and the accompanying provincial forms and "schedules." The forms you need will be determined by your situation. You will find the forms and various "guides" and CRA publications online on the CRA website at Forms and publications. You will need the *General Income Tax and Benefit Guide*, your overall guide to your tax return, and may find other guides, such as the *T4040 RRSP and Other Registered Plans for Retirement* and the *T4055 Newcomers to Canada 2013*, useful as well. The return is at General income tax and benefit package, along with the following schedules that might prove useful:

- Schedule 3 – Capital Gains (or Losses)
- Schedule 4 – Statement of Investment Income
- Schedule 5 – Amounts for Spouse or Common–Law Partner and Dependants
- Schedule 6 – Working Income Tax Benefit
- Schedule 7 – RRSP Unused Contributions, Transfers, and HBP or LLP Activities
- Schedule 8 – CPP or QPP Contributions on Self–Employment and Other Earnings – Common to all EXCEPT for QC
- Schedule 8 – CPP or QPP Contributions on Self–Employment and Other Earnings – Version for Quebec (QC) only
- Schedule 9 – Donations and Gifts

If you live in Ontario, for example, you will want the following provincial information and forms:

- Information Sheet – Residents of Ontario
- Provincial Worksheet – Ontario
- Form ON428 – Ontario Tax
- Form ON479 – Ontario Credits
- Form ON–BEN – Application for the Ontario Trillium Benefit and the Ontario Senior Homeowners' Property Tax Grant
- Schedule ON(S2) – Provincial Amounts Transferred From Your Spouse or Common–Law Partner
- Schedule ON(S11) – Provincial Tuition and Education Amounts
- Schedule ON(S12) – Ontario Healthy Homes Renovation Tax Credit

On your tax return, you will report income earned during that year and you are required to pay the taxes owing on that income before April 30. (Depending on a number of factors, you may not owe money but get a refund instead.)

The tax return can be complicated. There are many rules the average Canadian doesn't know or understand. As a result, many Canadians hire tax preparers to do their taxes and, in recent years, numerous computer-based programs (such as U-File) have been developed that make filing your return more manageable. So, do not be afraid to seek professional help when preparing your income taxes. Also, you can use tax-planning strategies to pay the least amount of taxes possible. I can help you implement your plan.

Filing your income taxes within the deadline is important. Miss the deadline and you incur charges and penalties. And failing to file taxes or misrepresenting your income can lead to criminal charges.

Following is a brief overview of the overall structure of the T1. To view an example of the T1 for Ontario, please go to Income Tax and Benefit Return.

Page 1 – Information

This is where you report your name, address, SIN and marital status, including spouse's name and SIN.

Page 2 – Total Income

This is where you report all your sources of income for the past year, including:

- **Employment income**. If you were employed in the past year, you will have received a T4 slip from your employer showing the amount of money you made while working there. If you had more than one employer last year, you will receive a T4 from each employer. Your T4 will also detail the taxes your employer paid on your behalf or any deductions made from your paycheque (more below).

- **Self-employment income**. If you were self-employed in the past year, you will report the amount of income you earned from your business, supported by documentation such as a profit and loss statement.

- **Pension income**. If you are retired, pension income can come from a few sources. You may be getting income from the Canada Pension Plan or, in Quebec, the Quebec Pension Plan, as well as Old Age Security. In that case, you will receive a T4A(P) slip and a T4A(OAS) slip, respectively, from the government. If you have a workplace pension, accumulated over your work career, you report that here as well. In this case, the pension administrator will send you the appropriate slip.

- **Investment income**. This is income earned on your investments and includes dividends from common or preferred shares, interest from bonds or bank accounts, and capital gains (or losses) on investments sold (see the Investing 101 brochure). The financial institution at which your investments are held will provide you with the necessary tax slips and you will complete a separate form providing the details that you will submit with your return.

At the bottom of this page, you will total these amounts of income for your "**total income**."

Page 3 – Net income and taxable income

There are certain deductions and credits that you are allowed to claim that reduce your total income to your "**taxable income**." These items appear at the top of Page 3. The deductions/credits you are most likely to encounter are:

- **Pension contributions**. As an employee, if you are a member of your company's registered pension plan (RPP), your employer will probably have taken regular deductions from your paycheque. Any contributions you made to the plan during the year will then be deducted from your total income. The amount eligible to be deducted will be reported on the T4 slip that you received from your employer.

- **Registered Retirement Savings Plan (RRSP) contributions**. RRSPs are meant to encourage you to set aside funds for your retirement, and to make that option attractive your RRSP contribution is deductible. Your contribution reduces your total income so that, in effect, the money you put into your RRSP is tax-free. This usually translates into a tax refund. And as an added benefit, any income earned by investments inside your RRSP are not taxed until you withdraw funds from your RRSP. You will receive a tax slip from the financial institution where your RRSP is held to support this deduction.

- **Child-care expenses**. If you hired someone to look after a child (or children) who lives with you while you earned income from a job or went to school (under specific conditions), that amount can be deducted, reducing your taxable income.

After these amounts have been deducted from your total income, you will find your "**net income**." At the bottom half of page 3, under your net income, you will find other amounts that may be deducted. However, most taxpayers do not ordinarily qualify for these deductions.

After the amounts described above have all been deducted from total income, what is left is your "**taxable income**" – the amount upon which your taxes payable will be calculated.

Calculation of federal tax

Canada's progressive or graduated tax rate structure is meant to ease the tax burden on those who have lower incomes. So, there are a number of tax credits that are applied to taxable income to reduce the amount of income taxes you pay.

View an example of a schedule 1 form for Ontario.

Schedule 1, Step 1: Federal non-refundable tax credits

There are many credits available and every taxpayer will be eligible for at least some of the credits listed on Step 1 of Schedule 1 of your tax return. The common credits include:

- **Basic personal amount**. Every taxpayer receives what is essentially a tax-free amount. In 2016, it is $11,474. But if you have been in Canada and have Canadian income for only part of the year, you proportion the basic personal amount accordingly. For example, if you have been in Canada for 240 days, you would claim $7,544 (240 x $11,474/365). For more information, see the guide Newcomers to Canada.
- **Canada Pension Plan (CPP) contributions and Employment Insurance (EI) contributions**. If you were employed in the past year, your employer will have deducted contributions to CPP and EI from your paycheques. Those amounts will appear on your T4 slip and you can credit them against your taxable income. If you are self-employed and making contributions, you will fill in those amounts on your tax return.

- **Canada employment amount**. If you were employed in the past year, you can claim the Canada employment amount, a non-refundable tax credit meant to offset work-related expenses such as home computers, uniforms and supplies. (If you were self-employed, you cannot claim the credit.) The amount is the lesser of your employment income up to a maximum of $1,161 in 2016.
- **Medical expenses amount**. Although most medical expenses are covered through your provincial or territorial health programs, certain other expenses you might incur are not. Eligible expenses, such as dentist and chiropractic services, can be included for a credit.
- **Charitable donations**. If you made contributions to an eligible charity you can credit the amount of your donation.

These eligible credits will be multiplied by the federal non-refundable tax credit rate of 15% which determines how much of the credits can be included in the deduction from taxable income. For example, say last year you had $10,000 in eligible credits. If you apply the 15% rate, you will reduce your taxes payable by $1,500.

Note: Almost all credits are non-refundable, which means that you cannot reduce your taxes payable to less than zero.

Schedule 1, Step 2: Tax on federal income

You will enter your taxable income from Page 3 of your T1 general return form on this table and calculate your tax payable.

Schedule 1, Step 3: Net federal tax

Once the tax payable has been calculated in Step 2, it will be reduced by the eligible tax credit amounts calculated at Step 1 of Schedule 1. This is the total tax owing to the federal government, which you will report in your T1 general return form to determine if you owe taxes or should get a federal refund.

Calculation of provincial/territorial tax

Provincial/territorial governments levy income taxes as well. To calculate that amount, you must complete the provincial/territorial return for the jurisdiction in which you lived on December 31 of the tax year for which you are filing. This is similar in structure to the federal return.

This being Canada, the tax rates vary by province. Ontario, for example, levies a 5.05% tax on the first $41,536 and 9.15% on the next $41,536, continuing upward with income. Alberta, on the other hand has a "flat" rate of 10% across the board. You will report the amount calculated on your T1 general return form to determine if you owe taxes or should get a provincial/territorial refund.

Page 4 – Refund or balance owing

On the first line, you will enter the amount of federal taxes calculated. Then, you will add the amount of provincial/territorial taxes to this.

If you were employed in the past year, your employer will have deducted an amount from your paycheques that should cover your income taxes for the year. Your employer will have forwarded that amount to the government. In other words, you have pre-paid your income taxes. The amount your employer withheld from your pay will be found on your T4. This amount will be deducted from the initial amount of tax owing and the resulting figure, if it is positive, will be the actual amount of money you owe to the governments. If that figure is negative, you have paid more taxes than you owe and you will receive a refund.

Case Study: Understanding your Canadian income tax return

Evelyn Wong, 26, is a newcomer to Canada and has worked the past year for Atlas Infotech in Kanata, Ontario. Her husband, Edward, is also a technology worker and has recently secured a job with a medical technology company in the Ottawa area. Evelyn and Edward are wisely watching their money and saving for the time when they can buy a home and start a family. Evelyn has a workplace pension plan and also contributes what she can to an RRSP. She has a small portfolio of interest-bearing investments started for her by her father which she has transferred to Canada. Here is how she filled out her 2016 income tax return.

Page 1: Personal information

Evelyn's name, address, date of birth, marital status and Social Insurance Number (SIN)
Husband's name and SIN

Page 2: Income

Employment income: $75,000, from her employer, Atlas Infotech
Interest income: $5,000
Total income: $80,000

Page 3: Deductions

Registered Retirement Savings Plan (RRSP) contribution: $10,000
Registered Pension Plan (RPP) contribution: $10,000
Total: $20,000
Taxable income: $60,000 ($80,000 minus $20,000)

Schedule 1, Step 1: Federal non-refundable tax credits

Basic personal amount: $11,474
CPP contributions: $2,300
EI contributions: $800
Canada employment amount: $1,161
Total amount: $15,735
Total federal tax credit: $15,735 x 15% (federal non-refundable tax credit rate) = **$2,360**

Schedule 1, Step 2: Federal tax on taxable income:

Evelyn's 2016 taxable income is $60,000. She will apply a tax rate of 15% on the first $45,282 of her income and a tax rate of 20.5% on her remaining income of $14,718. To calculate the amount of federal tax she owes, Evelyn has to complete the second column of the table (taxable income more than $45,282 but less than $90,563) as follows:
Federal tax payable: [($60,000 – $45,282) x 20.5%] + $6,792 = **$9,809**

Schedule 1, Step 3: Net federal tax

Federal tax on taxable income: $9,809
Federal non-refundable tax credit: $2,360
Net federal tax = $9,809 – $2,360 = **$7,449**

Evelyn's federal income tax due for 2016 is $7,449; this amount needs to be reported at the top of page 4 of T1 general return form.

Calculation of provincial or territorial taxes

Step 6. Provincial or territorial tax calculation, Ontario tax form ON428

On the Ontario tax form ON428, Evelyn will calculate the amount of taxes owing to Ontario. We go back to Evelyn's taxable income of $60,000. She will apply a tax rate of 5.05% on the first $41,536 of her income ($2,098) and a rate of 9.15% on her remaining income of $18,464 for $1,690. **Her provincial tax owing will be $3,788** ($2,098 plus $1,690).

Page 4: Calculation of refund or balance owing

Step 7. Refund or balance owing

Federal tax payable: $7,449
Provincial tax payable: $3,788
Total tax payable: $11,237
Tax already paid by her employer through payroll deductions: $13,500
Net tax owing: – $2,263 ($11,237 minus $13,500)

Evelyn will receive a refund of $2,263 from the government.

Evelyn's income taxes are fairly straightforward but, as you can see, preparing your income tax return is a multi-step process. If your return is complicated, don't be afraid to seek out someone who prepares tax returns professionally. I'm always available to answer your questions, if I am unable to do so, I will probably be able to recommend a tax preparer.

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