FAMILY LAW PRACTICE TIPS ISSUE No. 7

Topic: **"Tax Deductions v. Tax Credits"**
Opinion by: **Justice Doug Campbell**

Date: December 12, 2014
See Also: Issue No. 4: "Marginal Rates of Income Tax Signified
Issue No. 5: "The Marginal Rates Chart"

This memorandum was prepared by Justice Doug Campbell in reply to the request of ACJ O'Neil as outlined in his Notice to the Bar dated November 6, 2014. It represents Justice Campbell's personal viewpoint and may or may not require some adjustment to conform to the preferences or practices of individual Judges. That will be left up to the Judge and the lawyer, if any, involved. Readers who make use of the within material do so therefore at their own discretion and subject to their own judgment.

Formulation: 1) A Tax **deduction** is a ***subtraction from taxable Income***; and
2) A Tax **Credit** is a ***subtraction from Tax.***
3) A **refundable tax credit** or **a tax benefit** is to be distinguished.

Discussion:

The above-noted differences between a tax deduction and tax credit have a significant impact on the amount of income tax saved by the taxpayer as a result of these being applicable.

Very often, a separation or divorce triggers new tax deductions for one or both of the spouses that were previously unavailable to them.

Because a tax deduction is a subtraction from taxable income, it necessarily results in a saving of tax in an amount that is a function of that Taxpayer's top Marginal Rate: *Different Taxpayers will save Tax in different amounts.* It follows that an understanding of "marginal rates" and the knowledge of the particular taxpayer's top marginal rate will allow for a very quick and easy calculation of the tax being saved by virtue of that deduction (or owed by that income inclusion).

By way of example, a tax deduction for Spousal Support in the amount of $5000 will save $2500 of tax for a Taxpayer who has a top marginal rate tax bracket; but it will only save $1,250 for a Taxpayer whose top Marginal Rate is 25%[1]

To the contrary, because a tax credit is a subtraction from tax payable, it results in a saving of tax in a "dollar for dollar" amount. Therefore, its impact is not affected by the marginal rate of the Taxpayer. *Generally speaking, every taxpayer will save the same amount of tax from claiming a particular* ***tax credit*.**

[1] This assumes that such taxpayers have at least $5,000 of income in that mentioned top marginal tax bracket.

The credit is generally based on the lowest Combined Federal/Provincial tax rate, which is currently 25% in Nova Scotia. All taxpayers in Nova Scotia will save Tax equal to 25% of the tax credit, regardless of their top Marginal Rate.

(An exception is the Divided Tax Credit and the medical and charitable tax credits.)

To restate this concept by way of an example, the tuition transferrable and education amount is $5000 (maximum). The tax credit is a balance of $1,250 (5,000 x 25%). This tax credit will be subtracted directly from the tax otherwise payable by the Taxpayer; therefore, this $1250 tax credit will save the taxpayer $1250. His marginal rate is irrelevant.

It is beyond the scope of this memorandum to identify the various criteria for eligibility for each particular tax deduction and tax credit. Eligibility is therefore assumed.

The following items are the most common Tax deductions (as of 2013):

1) Periodic Spousal Support (not Child Support)
2) (Employment) Pension Plan Contributions;
3) RRSP Contributions;
4) Pension Split with Spouse;
5) Union Dues, etc.;
6) Daycare Expenses (limited by age of the child and otherwise);
7) Disability Support;
8) Business Investment Losses;
9) Certain Moving Expenses.

The following are the most common Tax Credits:

1) Personal Amount;
2) Spouse Amount (Common Law);
3) Age Amount;
4) Eligible Dependent Amount;
5) CPP Contributions;
6) EI Premiums;
7) Pension Income Amount;
8) Caregiver Amount;
9) Disability Amount;
10) Recreation for Children;
11) Tuition and Education amounts;
12) Tuition and Education Amounts Transferred from a child;
13) Medical Expenses (above a particular threshold); and
14) Charitable Donations (amounts above a certain threshold save tax at more than 25%).

To be distinguished from all of the above are those items referred to as "refundable tax credits" or "tax benefits". These are amounts paid by Canada Revenue Agency even when there is no tax payable[2]. In short, the taxpayer receives money from CRA. The GST tax credit is an example of the former and the Universal Child Care Benefit ("UCCB ") is an example of the latter.

[2] By contrast, at tax deduction is only available to the extent that there is an equivalent amount of **income** to offset that deduction. Also, a tax credit is only available to the extent that there is **tax payable** in an equivalent amount to offset that credit.