There are various items that get subtracted off, when one is calculating personal income tax liabilities : a "basic personal amount", contributions to RRSP's, charitable donations, some expenses of earning income (for self–employed people) and so on.

There are really two ways in which we can have taxes reduced for these expenses. One way is by **deducting** the item from the income. That is the way that RRSP contributions and tax–deductible expenses of earning income are treated. So if a person puts \$1000 in an RRSP during the tax year *, she deducts \$1000 from her income when computing her taxable income for the year. How much does she save on her year 2015 taxes by putting the \$1000 into the RRSP? It depends on her marginal rate. If her marginal tax rate were 29 percent, then her 2015 federal income taxes would have been reduced by \$290 by the contribution. If her marginal rate were 15 percent, then the contribution would only reduce her federal income tax bill by \$150.

So the actual dollar value of a tax deduction, in terms of the decrease in the taxes payable, depends on the person's marginal tax rate.** The higher your marginal rate, the more valuable the deduction.

The second way in which taxes can be reduced by these items is for a flat amount to be subtracted from one's taxes owing. For example, this is the way that the "basic personal amount" is treated, as well as support for dependent children and charitable contributions. This way is referred to as a tax **credit**. For example, how much are a person's federal income tax liabilities reduced by her charitable donations? There is a formula on the tax return : take 15 percent of your first \$200 in charitable donations, plus 29 percent of any donations in excess of \$200. Now take that amount, and subtract it from your taxes owing.

So how much would a charitable donation of \$1000 reduce your taxes? It depends on what other donations you have made. If this is your only charitable donation, if will result in a tax credit of 262 dollars ($(0.15)(200) + (0.29)(1000 - 200) = 262$). If you actually had made more than 200 dollars in donations already, then the \$1000 donation would reduce your federal taxes by \$290. With a tax credit, the amount by which your taxes payable decrease depends on the size of the donation, on the size of your other donations, but *not* on your own personal tax bracket. If two people made identical levels of charitable donations during the year, and one person's income was \$25,000 (in the bottom, 15 percent bracket), while the other's was \$150,000 (in the top, 29 percent bracket), then they both would get the same tax credit.****

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* which extends to the end of the following February for RRSP contributions

** Of course, the deduction could "straddle" two tax brackets. A person might have taxable income which was \$400 above the bottom of the 29 percent tax bracket (\$138,586 in 2015), if she did not contribute to her RRSP. Then if she contributed more than \$400, she would be knocked down into the next tax bracket down, the 26 percent bracket. So if she contributed \$1000, the reduction in her taxes would be $(0.29)(400) + (0.26)(600) = 272$ dollars.

**** One qualification here : nearly all the tax credits in the Canadian personal income tax, So the difference between tax deductions and tax credits is that tax deductions are subtracted off income before the tax is calculated, so that they reduce taxable income. That means that the amount that the deduction reduces taxes payable depends on the marginal tax rate. Tax credits are subtracted off from the taxes payable, after taxable income has been calculated. What you see is what you get ; the amount taxes are reduced is the amount of the tax credit.

Which would you prefer? That depends. If a person is in a 15 percent marginal bracket, then she should be indifferent between a tax deduction of $100, and a tax credit of $15. Both reduce her actual federal taxes payable by $15. However, if her marginal rate were greater than 15 percent, then she would prefer the tax deduction, since it will save her more than $15.

In a sense, tax credits are more "progressive" than tax deductions, since the value of a given tax deduction goes up with a person's income. In Canada, tax deductions used to be the norm in the personal income tax. In 1987, many of the tax deductions were changed to tax credits. That change did benefit low–income people relative to higher–income people (although the dollar amounts of these relative changes in benefits were not huge). Some tax deductions remain. Most of the ones that remain can be justified, for example, by the Haig–Simons definition of income. Expenses of earning income should be subtracted from income, before the tax is calculated, according to Haig–Simons principles.

For example, suppose that person A and person B both are self–employed, making high–quality acoustic guitars. Person A buys the wood herself, for $200 (per guitar), builds the guitars, and sells them for $1000 each. Person B has the customers buy the wood themselves, and then charges them $800 to build the guitar. Each person nets $800 per guitar from her work. A reasonable requirement for our tax system is that the tax liabilities of these two people not differ (at least if they sell the same number of guitars, and are in the same tax bracket). If person A can deduct her expenses of $200 from her gross income, then the tax system will treat person A and person B the same. If instead we replaced the tax deduction with a tax credit, say of $40, then the tax system no longer treats them the same. If they are both in a 15 percent bracket, the system treats A better, and if they are both in a 29 percent bracket, then the system treats B better. I want a system which treats them both the same, if they are in the same bracket, no matter what that bracket is. So I want a deduction, rather than a credit, for the expenses of earning income.

including the tax credit for charitable donations, are **non–refundable** tax credits. That means that you don't get any money back from CRA, even if your tax credits are bigger than your taxable income. So someone whose income is so low that the tax credits would make her income negative, will get less benefit from these credits than will people making more money.