Canadian tax law uses the concepts of income and taxable income. Income means income from all sources inside or outside Canada and includes income for the year from businesses, property, offices and employments. Since January 1, 1972, it has also included half of any capital gains.

In computing income, an individual must include benefits from employment, fees, commissions, dividends, annuities, pension benefits, interest, alimony and maintenance payments. Also included are unemployment insurance benefits, family allowance payments, scholarships in excess of $500, benefits under a disability insurance plan to which his employer contributes and other miscellaneous items of income. A number of items are expressly excluded from income, including certain war service disability pensions, social assistance payments, compensation for an injury or death under provincial worker compensation acts and family income security payments.

Half of capital gains is included in income. Taxable capital gains are determined by deducting capital losses from capital gains and dividing by two. In the event that losses exceed capital gains, $2,000 of allowable capital losses may be deducted from other income. Capital gains or losses relate to disposition of property. Other gains or losses, for example, resulting from a lottery or gambling, are not included. The sale of personal property at a price not exceeding $1,000 and the sale of a home do not give rise to a capital gain or loss.

Certain amounts are deductible in computing income. These include contributions to a registered employees pension plan, premiums to a registered retirement savings plan, premiums under the unemployment insurance program, alimony payments and union dues. A taxpayer 18 years of age or over who does not own a house or whose spouse does not own one may deduct contributions up to $1,000 a year to a lifetime maximum of $10,000 to a registered home-ownership savings plan. The proceeds of such plans will be taxable when they are paid to the taxpayer unless they are applied by him to the purchase of a home. An employee may deduct 3% of salary or wages up to a maximum of $250 a year to cover expenses of earning his income. No receipts or details of actual expenditures are necessary to claim this deduction. Expenses of meals and lodging while away from home are deductible by employees who have to travel as they perform their work, such as employees who work on trains or who drive trucks. When a mother has her children cared for in order that she may work, she may deduct this expense subject to certain limitations. Expenses of moving to a new work location are deductible from income earned in the new location. Students attending universities, colleges or certain other certified educational institutions in Canada may deduct their tuition fees.

An individual carrying on a business may deduct business expenses. These include wages, rents, depreciation (called capital cost allowances), municipal taxes, interest on borrowed money, reserves for doubtful debts, contributions to pension plans or profit-sharing plans for his employees, and bad debts.

The amount of the guaranteed income supplement, which is a payment made to individuals over age 65 who have little or no income in addition to their old age pension, is also deductible. Individuals who have incurred business losses in other years may deduct these in computing taxable income. A taxpayer is able to deduct up to $1,000 of Canadian investment income from interest, dividends or capital gains. In addition, a taxpayer who is 65 or over is able to deduct up to $1,000 of his pension income including amounts he receives from pension plans and from annuities under registered retirement savings plans and deferred profit sharing plans. A taxpayer under 65 may deduct up to $1,000 of qualified pension income. This includes amounts received from a pension plan or as a consequence of the death of a spouse.

Having computed income, an individual calculates taxable income by subtracting certain exemptions and deductions. Before 1974 the levels of exemptions and deductions were fixed from time to time by Parliament. The introduction in the 1974 taxation year of a mechanism for indexing personal income tax results in automatic adjustments each year to reflect the inflation rate in the levels of exemptions and deductions. The adjusted personal exemptions and deductions for each year are based on such factors as married or single status, dependent children, other dependents,