Wealth Management

Income and taxation

Understanding the different types of income and how each is taxed

When it comes to the money you earn or the income you receive, the reality is that it's not all yours to keep. Depending on the type of income, you will generally need to pay some tax.

While taxation is a topic that can often seem complex and confusing, it's helpful to first categorize the main sources of income, and then look at how taxes may apply to each.

Financial education can help set the stage for a lifetime of informed and confident decision-making.

Three main sources of income

1. **Employment**
   - Generally, this is where the majority of income comes from for most people.
   - There are many types of employment (for example, part-time, full-time, self-employed, business ownership, contract).

2. **Unexpected**
   - This is not a guaranteed source of income and should never be relied on as a regular source of funds.
   - Unexpected income could include things like a gift of cash or a lottery win, for example.

3. **Investment**
   - Income that is generated from investing in a product and the growth in value of those investments.
   - This should always be viewed as an additional source of funds
   - Investment products typically include GICs and bonds that generate interest, stocks that generate dividends or capital gains, and mutual funds that can generate all three types of income.

How do taxes come into play?

In general, within Canada, all income is taxable unless the government deems it otherwise. Canada's tax system includes federal income tax, and each province or territory also has its own income tax that gets layered in.

Here's a breakdown of the tax treatment for each main type of income:

Employment

The amount you earn gets taxed at your "average tax rate," which takes into account the graduated tax rates (lower income is taxed at lower rates and higher income is taxed at higher rates).

To find out more about income and taxation or the RBC Wealth Management Financial Literacy program, please contact us today.

When you receive a paycheque, your gross pay represents your pay before deductions and your net pay is your take-home amount, less taxes and other deductions.

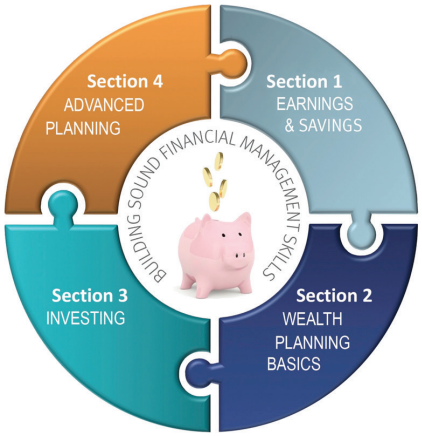
Unexpected

Gifts of cash that you receive and lottery winnings are not taxed in Canada.

Investment

Taxes on investment income vary according to the type of income received. Most investment income can be broken down into interest, dividends and capital gains.

- Interest
  What you earn on cash held in your savings accounts, or in other investments. 100% of this gets taxed at your average tax rate—the same way your employment income does.
- Dividends
  Eligible Canadian dividends are taxed at a lower rate than interest due to special tax rules. Foreign dividends are taxed the same as interest.
- Capital gains
  This is the growth of your stock or investment. Only half of the growth gets taxed at your average tax rate.



Applying your knowledge of income and taxation

Even a basic understanding of different tax treatments will help you save more, and save faster. And, when it comes to your overall wealth planning, taxes are important to consider as part of your financial decision-making.