

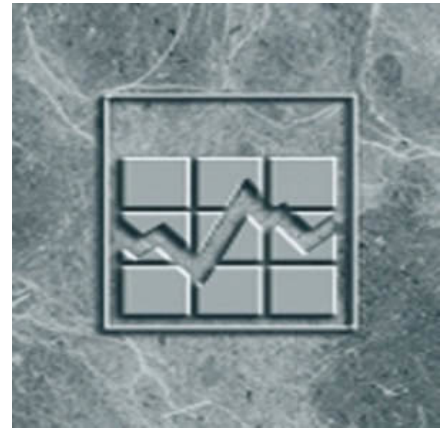
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Effective Income Tax and Transfer Rates: Technical Reference Note

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Effective Income Tax and Transfer Rates: Technical Reference Note

Abstract

In 2018, Statistics Canada released two new data tables with estimates of effective tax and transfer rates for individual tax filers and census families. These estimates are derived from the Longitudinal Administrative Databank. This publication provides a detailed description of the methods used to derive the estimates of effective tax and transfer rates.

1. Introduction

Table 11-10-0054-01 provides individual taxation statistics, including effective tax and transfer rates, the total amount of taxes paid and government transfers received, and the proportion of Canadian tax filers that pay tax or receive government transfers.

The statistics are derived using the Longitudinal Administrative Databank (LAD), which is a 20% random sample of Canadian tax filers drawn from the T1 Family File (T1FF). Estimates available in Table 11-10-0054-01 cover the period from 1992 to the most recent reference year available.

The primary purpose of these estimates is to give an indication of the size of the largest government tax and transfer programs relative to individual incomes. The table provides information on the percentage of individual incomes that come from major cash transfer programs and how much is paid in major income and payroll taxes. Tax and transfer rates are available for both the federal and provincial governments and also include rates for contributions to CPP/QPP and EI.

This document provides technical details underlying the statistics found in table 11-10-0054-01 with reference to the LAD variables used in the calculations. Section 2 describes the sample selection criteria that underlay the estimates. Section 3 provides information on the definitions of taxes, transfers, and modified total income. Section 4 presents the specifications used to derive the statistics. Section 5 provides descriptions of the categorical variables used to report the statistics. Section 6 describes the details regarding family taxation statistics found in table 11-10-0058-01. Finally, the Annex provides more detailed information on the derivation of total income and each tax and transfer measure included in the table.

2. Sample Selection

Since not all individuals file income tax returns and a small portion of filers die every year, statistics contained in this table should be interpreted in the context of living tax filers, not the entire population. The sample is restricted to persons who were at least 18 years old and filed a tax return and resided inside Canada.

Exclusions:

1. Persons under 18 are excluded from the sample. Only 5% of persons under 18 file a tax return and less than one-fifth of those individuals pay federal tax.
2. Deceased filers and persons with a deceased spouse are excluded from the sample. These individuals can have deemed dispositions that do not reflect their usual income and taxation patterns.
3. Non-residents are removed from the sample as their income and taxation patterns do not reflect that of a typical Canadian. This includes individuals with a foreign postal code or a code designated for deployed military or embassy personnel.

3. Variable Definitions

This section provides background information on the tax, transfer, and income variables that underlay the estimates. In addition to information on how each variable is derived, the section documents the LAD variables that are used in the derivations.

Income and taxation information available in the LAD are derived largely from information available in T1 personal income tax return (T1) and its various schedules provided by the Canada Revenue Agency (CRA). Where certain income and taxation information is not available in the T1, it is derived during T1FF processing. Detailed information on the LAD variables used to derive each variable are provided in the Annex.

3.1 Federal Income Tax

Federal income tax is derived from net federal tax on line 420 of the T1. The Yukon federal refundable First Nations abatement and the Quebec abatement are subtracted from net federal tax. This adjustment is done to accurately reflect the federal tax burden for tax filers that reside in Quebec and self-governing Yukon First Nations.

In the case of the Quebec abatement, it is an amount that tax filers in Quebec receive upon filing their Federal income tax returns. It reflects the fact that the government of Quebec finances (through its provincial income tax system) some public goods that are in other provinces, provided by the Federal government. The federal government then, returns a portion of federal tax to residents in Quebec in lieu of certain public goods.

The Yukon First Nations abatement operates a bit differently. For members of the Yukon First Nations, a portion of their Federal income tax is transferred to the First Nations. There is no direct return of federal tax paid to the tax filer. As such, further adjustments are made to provincial income tax in regards to the Federal refundable First Nations abatement. See Section 3.2 for more information.

See Table 1 in the annex for more detailed information on the calculation of federal income tax.

3.2 Provincial Income Tax

Provincial income tax is derived from line 428 of the T1. For members of the Yukon First Nations, the federal refundable First Nations abatement is added to net provincial tax. This adjustment is done to accurately capture the territorial tax burden for tax filers that reside in a self-governing Yukon First Nation.

Although the Yukon First Nations are autonomous from the Yukon government, all personal income tax amounts transferred to the Yukon First Nations are combined with the Yukon government tax for the purposes of measuring the overall territorial tax burden. Similar to the Federal First Nations Abatement discussed in Section 3.1, a portion of the tax collected by the Yukon government is transferred to the Yukon First Nations. The amount of the transfer is included in line 428 of the T1 and thus no re-allocation is required. The amount of the Federal First Nations abatement however, needs to be added to the Yukon tax in order to capture the inter-governmental transfer from the Federal to the combined Yukon/First Nations tax.

Quebec does not have a tax collection agreement with the CRA and thus provincial income tax for that province is not outlined on the federal tax return. However, Quebec tax is estimated during T1FF processing and is thus included in the provincial income tax variable on LAD.

See Table 2 in the annex for more detailed information on the calculation of provincial income tax.

3.3 Federal Payroll Tax

Federal payroll tax includes employee contributions to the Canada/Quebec Pension Plan (CPP/QPP) and the Employment Insurance (EI) program. Contributions to CPP/QPP and EI payable on self-employment earnings include the total contribution (i.e. the employee portion and the employer portion).

Where CPP/QPP contribution overpayments have been made, they are subtracted from CPP/QPP contributions. Similarly, where EI repayments are required, they are subtracted from EI contributions.

See Table 3 in the annex for more detailed information on the calculation of the federal payroll tax.

3.4 Federal Cash Transfer Payments

Federal cash transfer payments include transfers such as the federal Goods and Services Tax Credit, federal child benefits, Old Age Security and the Guaranteed Income Supplement, Canada/Quebec Pension Plan benefits, Employment Insurance, and the Working Income Tax Benefit. Where social benefits have had to be repaid, the repayment is subtracted from federal cash transfer payments.

The calculations underlying federal cash transfer payments reflect program changes over time. For instance, federal child benefits include the Federal Family Allowance and the Child Tax Benefit in 1992 but are replaced by the Canada Child Tax Benefit beginning in 1993. Federal child benefits also include the Universal Child Care Benefit upon its introduction in 2006 until its termination in 2016.

See Table 4 in the annex for more detailed information on the calculation of the federal cash transfer payments.

3.5 Provincial Cash Transfer Payments

Provincial cash transfer payments include Social Assistance, Workers Compensation, provincial family benefits, provincial seniors' supplements, and provincial refundable tax credits such as the Ontario Trillium Benefit and the Quebec Solidarity Tax Credit.

Provincial family benefits include, for example, the Quebec Family Allowance (1994 to present), Family Benefits for British Columbia (1996 to present) and starting in 1998, family benefit amounts are included for Nova Scotia, Ontario, Saskatchewan and the Northwest. These amounts are not available in the personal income tax records obtained from the CRA but are derived in T1FF processing.

Provincial refundable tax credits include amounts found on the T1 as well as various provincial credits that are not reported on the T1 tax return but are derived during T1FF processing. These credits include for example, amounts such as Quebec Solidarity Tax Credit and components of the Ontario Trillium Benefit.

Provincial senior supplements are also calculated during T1FF processing as these amounts are also not reported on the T1. These supplements include for example, the British Columbia Senior's Supplement, the New Brunswick Low Income Senior's Benefit, and the Ontario Guaranteed Annual Income System payments for seniors.

See Table 5 in the annex for more detailed information on the calculation of the provincial cash transfer payments.

3.6 Modified Total Income

The income used for calculating effective rates and creating income groups for individual filers in this table is referred to as modified total income and is defined as total income (employment income, investment and pension income, government transfers, and other income such as scholarships, retiring allowances, and alimony) plus capital gains and registered retirement savings plan withdrawals made by persons under 65, less social benefits repayments. Further adjustments to allocate elected split-pension amounts to the spouse claiming the amount are also made.

The objective of measuring income for the purpose of calculating an effective tax rate is to include all income that an individual receives during the year. In order to meet this objective, the measure of income used here differs from Statistics Canada's standard definition of total income in three important ways:

1. Modified total income includes actual capital gains, which falls outside of the standard definition of income as defined by the Canberra Group on income measurement.¹ However, since some portion of capital gains are subject to income tax, they affect the size of an individual's personal income tax burden. Moreover, the funds received from capital gains are financial resources that an individual receives during the year. As such, the definition of income employed for the purpose of measuring the burden of taxation includes the actual amount of capital gains received in the year.
Note that modified total income also includes actual dividends received as opposed to taxable dividends as reported on the T1. This is also true to Statistics Canada's standard definition of income.

1. Capital gains are excluded as a regular source of income because they are irregular.

2. RRSP withdrawals by persons under 65 are not included in the standard definition of income because they are viewed as a wealth withdrawal rather than income. However, since these amounts are subject to income tax, they are included in income for the purpose of measuring the burden of tax.
3. Pension income splitting is a tax reduction strategy available to married or common-law couples where at least one partner receives income from a private pension. The transferor can elect to transfer a portion of their pension to their spouse, who declares the amount as income on their tax return. The transferor is then able to reduce their own tax owing by deducting the amount of the transfer from their income. The arrangement (as intended by the policy) results in a lower tax burden for the combined income of the couple.

When measuring income according to the standard definition employed at Statistics Canada, the impact of the policy is more difficult to measure at the individual level. This is because the full pension amount is recognized as belonging to the transferor and no split amounts are allotted to the transferee. In this situation, the overall impact of the shifting arrangement on individual tax rates is inconsistent with what would result when tax rates are measured using the combined income of the couple. In effort to better reflect the overall impact of the arrangement at the individual level, pension income splitting amounts are allocated to the transferee and the transferred amounts are excluded from income of the transferor.

The true impact of pension income splitting is best measured at the family level – where the overall burden of tax faced by couples does indeed fall as a result of income splitting. Data table 11-10-0058-01 will allow for analysis of tax and transfer policies that are targeted at the family level.

UCCB repayments for previous years are netted out of modified total income. There are two reasons for this. First, they represent a financial burden that the individual is required to pay back to the government, thereby reducing their disposable income in the current year. Second, these repayment amounts are accounted for in the calculation of tax payable in the current year. This is essentially a reimbursement for previous tax owing on the income at the time of receipt. Failing to remove this amount from income would understate the relative burden of tax in the current year.

Adjustments are also made in relation to certain RRSP income and pension and superannuation amounts.

- Income shown on a T4RSP slip on the death of a spouse or common-law partner is reported as RRSP income the T1 (line 129), even when those amounts are transferred to an RRSP. These amounts are subtracted from RRSP income when calculating modified total income.
- Annuity, PRPP, and RRIF payments received on the death of a spouse are reported as pension and superannuation income on the T1 (line 115). These amounts are subtracted from pension income in cases where they are transferred to an RRSP.
- Amounts such as retiring allowances that are transferred to an RRSP are subtracted from other income as reported on the T1 (line 130).
- Home Buyer's Plan shortfall amounts (the difference between the repayment amount due for a given year and the repayment amount the HBP participant actually pays) are reported as RRSP income on the T1 (line 129). These amounts are subtracted from RRSP income for the purposes of measuring modified total income.

See Table 6 in the annex for more detailed information on the calculation of modified total income.

4. Statistics

All effective tax or transfer statistics available in Data Table 11-10-0054-01 are based on the ratio of taxes (or transfers) paid to total income for each individual tax filer in the sample. The denominator is always modified total income and the numerator is the selected type of tax or transfer. Unless otherwise stated, these rates are bounded between 0 and 100.

$$(1) \quad \textit{Effective Rate}_{ji} = \max \left(0, \min \left(100, \frac{T_{ji}}{\textit{Modified Total Income}_i} * 100 \right) \right)$$

Where T_{ji} is the amount of tax or transfer j for tax filer i and *Modified Total Income_i* for tax filer i is as defined in Section 3.6.

Effective tax rates are top-coded at 100% to mitigate the impact of outliers with rates of taxation greater than 100%. While such instances are rare, it is possible that a person may have income of \$100 but due to their circumstances, will have paid \$200 in taxes and thus have a rate of taxation of 200%. Rather than removing these records, all tax rates are top-coded to 100%. In practice, the number of cases in which the combined federal and provincial income tax results in a rate greater than 100 is negligible in any given year between 1992 and 2016.

The calculation differs slightly for the combined federal and provincial income tax with federal payroll tax net of federal and provincial transfers. In that case, the effective tax rate is top-coded to 100 but allowed to be less than zero. In cases where an individual receives more in government transfers than they pay in tax, the effective rate will be negative.

$$(2) \quad \text{Effective Tax Rate net of Transfers}_i = \max\left(100, \frac{T_{FPP,i} - T_{FPT,i}}{\text{Modified Total Income}_i} * 100\right)$$

Where $T_{FPP,i}$ is the combined federal and provincial income tax and federal payroll tax for tax filer i and $T_{FPT,i}$ are combined federal and provincial cash transfer payments for tax filer i .

4.1 Mean effective rate

Statistics that report the mean effective rate for a selected tax or transfer are calculated by taking the average effective rate of all individual tax filers in the given dimension or level of geography.

$$(3) \quad \text{Mean Effective Rate}_j = \frac{\sum_{i=1}^N \text{Effective Rate}_{ji}}{N}$$

Where *Effective Rate_{ji}* is the effective rate of tax or transfer j for tax filer i and N is the total number of tax filers in the given dimension.

4.2 Percentile rates

Statistics that report percentile rates are derived from the distribution of effective rates faced by each individual. The 50th percentile rate for instance reports the effective rate (for a selected tax or transfer type) for which half of individuals in a given dimension or level of geography fall below and half fall above.

4.3 Categorical distribution of effective rates

Statistics that report the number of persons with an effective rate falling into a given category (e.g. rate of 0.1% to 5%) are counts of the number of individuals that have an effective rate within that range.

Statistics that report the number of tax filers with a rate of zero are equivalent to statistics that report the number of tax filers with zero. The number of tax filers with an effective rate of less than zero applies only to the net of transfer rate as these are the only rates that can be negative.

5. Categorical Variables

Lower threshold of modified total income group

A modified total income threshold is used to classify tax filers into their respective income groups. The thresholds reported in Data Table 11-10-0054-01 refer to the lower bound of each income group. For example, tax filers in the percentile 6 to 10 income group have incomes that are equal to or greater than the threshold for that group but less than the threshold for the percentile 11 to 15 income group.

Age Group

Tax filers are grouped together according to their age on December 31 as computed from their birth date.

Province

Province in these tables refers to the province of residence of the tax filer and not the province of taxation. In some cases an individual may reside in a province that is different from their province of taxation.

6. Family Taxation Statistics

In addition to individual taxation statistics presented in table 11-10-0054-01, table 11-10-0058-01 provides census family taxation statistics, including effective tax and transfer rates, the total amount of taxes paid and government transfers received, and the proportion of Canadian census families that pay tax or receive government transfers.

The primary purpose of these estimates is to give an indication of the size of the largest government tax and transfer programs relative to family incomes. The table provides information on the percentage of family incomes that come from major cash transfer programs and how much is paid in major income and payroll taxes. Tax and transfer rates are available for both the federal and provincial governments and also include rates for contributions to CPP/QPP and EI.

The mean effective tax rates in this table are calculated as the average ratio of total taxes paid by the tax filer's family to modified total income of the tax filer's family. The mean effective transfer rate in these tables is calculated as the average ratio of transfers received by the tax filer's family to the modified total income of the tax filer's family. The mean effective net tax rate in these tables is calculated as the average ratio of taxes paid by the tax filer's family, less all transfers received by the tax filer's family, to modified total income of the tax filer's family.

The rates are calculated for each tax filer and then averaged across all tax filers. A family weight is applied to each filer such that the resulting estimate is approximately equivalent to a family tax rate calculated across census families rather than individuals. The denominator is always modified total family income and the numerator is the selected type of tax or transfer. Unless otherwise stated, effective tax rates are bounded between 0 and 100.

A modified total family income threshold is used to classify tax filers into their respective family income groups. The thresholds reported in Data Table 11-10-0058-01 refer to the lower-bound of each income group. For example, tax filers in the percentile 6 to 10 income group have family incomes that are equal to or greater than the threshold for that group but less than the threshold for the percentile 11 to 15 income group.

Tax filers are grouped together according to their census family type. A census family can be either a married couple (with or without children), a common-law couple (with or without children) or a lone parent family. Note that children in census families can be of any age as long as they live in the same dwelling as their parents.

Province in the census family table refers to the province of residence of the tax filer and not the province of taxation. In some cases an individual may reside in a province that is different from their province of taxation.

Table 1
Federal Income Tax^{1,2}

Variable	Description	Source	Years
NFTXC	Net federal tax	T1 line 420	1992 to Present
ABQUE	Refundable Quebec abatement	T1 line 440	1992 to Present
YKFNAB	Federal refundable First Nations abatement	2008-2009 (derived from YT432 lines 8 and 9) 2010-present (T1 line 441)	2008 to present Unavailable 1999 to 2007 ³

1. To ensure micro data consistency, federal income tax is bottom-coded to zero. In any given year, this affects only 0.26% of records where a Quebec or First Nations abatement is subtracted from net federal tax.

2. $Federal\ Income\ Tax_i = \max(0, NFTXC_i - ABQUE_i - YKFNAB_i)$

3. Due to limitations in the information obtained from the CRA for some years, data for the Federal First Nations abatement are not available in the earlier years of the program.

Table 2
Provincial Income Tax¹

Variable	Description	Source	Years
NPTXC	Net provincial tax	T1 line 428	1992 to present
YKFNAB	Federal refundable First Nations abatement	T1 line 441	2008 to present Unavailable 1999 to 2007 ²

1. $Provincial\ Income\ Tax_i = NPTXC_i + YKFNAB_i$

2. Data for the Federal First Nations abatement are not available in the earlier years of the program.

Table 3
Federal Payroll Tax^{1,2}

Variable	Description	Source	Years
CQPPD	CPP/QPP contributions through employment and self-employment earnings	Calculated by CRA	1992 to present
CPPRF	CPP overpayment	T1 line 448	1992 to present
T4EIC	Employment insurance premiums from T4 slips	T1 line 312	1992 to present
EICRP	Employment insurance repayment	T1FF Derived	1992 to present
EIPSEIC	Employment insurance premiums on self-employment and other eligible earnings	Schedule 1 line 317	2010 to present

1. To ensure micro data consistency, federal payroll tax is bottom-coded to zero. This affects no more than 1.0% of records in any given year. In these cases, CPP/QPP and EI overpayments reported on the T1 exceed CPP/QPP and EI contributions.

2. $Federal\ Payroll\ Tax_i = \max(0, CQPPD_i - CPPRF_i) + \max(0, T4EIC_i - EICRP_i + EIPSEIC_i)$

Table 4
Federal Cash Transfer Payments^{1,2}

Variable	Description	Source	Years
GHSTC	Goods and services tax credit	T1FF Derived	1992 to present
EINS	Employment Insurance benefit	T1 line 119	1992 to present
WITB	Working Income Tax Benefit	T1 line 453	2007 to present
RDSP	Registered Disability Savings Plan	T1 line 125	2008 to present
CTBI	Canada Child Tax Benefit	T1FF Derived, CCTB file	1993 to present
CTC	Child Tax Credit	T1 line 444	1992
FABEN	Federal Family Allowance ³	T1 line 118	1992
UCCB	Universal Child Care Benefit	T1 line 117	2006 to 2016
RCFTCC	Refundable children's fitness tax credit	T1 line 459	2015 to 2016
CQPP	Canada/Quebec Pension Plan	T1 line 114	1992 to present
NFSL	Net Federal Supplements (Guaranteed Income Supplement and Spouse's Allowance)	T1 line 146	1992 to present
OASP	Old Age Security Pension	T1 line 113	1992 to present
RSBCL	Social benefits repayment	T1 line 235	1992 to present

1. To ensure micro data consistency, federal cash transfers are bottom-coded to zero. Cash transfers can be negative if social benefits repayments as reported on the T1 exceed total federal cash transfers, which is very rare.

2. $Federal\ Cash\ Transfer\ Payments_t = \max(0, EINS_t + GHSTC_t + WITB_t + RDSP_t + CTBI_t + CTC_t + FABEN_t + UCCB_t + RCFTCC_t + NFSL_t + OASP_t + CQPP_t - RSBCL_t)$

3. Prior to the introduction of the Canada Child Tax Benefit in 1993, the variable FABEN captured the federal family allowance and is thus included in the calculation of federal cash transfer payments in the 1992 reference year. From 1994 onward, the variable FABEN captures provincial family benefits.

Table 5
Provincial Cash Transfer Payments^{1,2}

Variable	Description	Source	Years
SASPY	Social Assistance	T1 line 235	1992 to present
WKCPY	Workers' Compensation	T1 line 144	1992 to present
FABEN	Provincial family benefits ³	T1FF Derived	1994 to present
YKFN	Yukon, First Nations tax credit	YT479 line 6386	2008 to present Unavailable 1999 to 2007
PTXC	Provincial refundable tax credits. Note: this variable also includes provincial senior's supplements.	T1 line 479 plus derived amounts	1992 to present

1. For members of the Yukon First Nations, total provincial refundable tax credits (PTXC) taken from line 479 of the T1 includes the amount of the Yukon First Nations tax credit. This amount does not reflect income received by the tax filer. Rather, it is an element of the accounting transaction that facilitates for the transfer of a portion of the income tax paid to the Yukon government over to the Yukon First Nations. This amount is thus netted out of provincial cash transfers.

To ensure micro data consistency, provincial refundable tax credits were bottom-coded to zero. This only affects records where the Yukon First Nations tax credit exceeds overall provincial refundable credits overall, which is rare.

2. $Provincial\ Cash\ Transfer\ Payments_t = SASPY_t + WKCPY_t + FABEN_t + \max(0, PTXC_t - YKFN_t)$

3. The variable FABEN is included as a provincial family benefit from 1994 onward. Prior to 1993, this variable captured the federal family allowance.

Table 6
Modified total income^{1,2}

Variable	Description	Source	Years
T4E	Earnings per T4 slip	T1 line 104	1992 to present
EXIND	Exempt employment income for persons with Indian status	TD-IN form	1999 to present Missing 1992 to 1998 ³
OEI	Other employment income	T1 line 104	1992 to present
SEI	Self-employment income	T1 lines 135 to 143	1992 to present
SOP4A	Pension and superannuation income	T1 line 115	1992 to present
ALMI	Alimony or support income	T1 line 128	1992 to 1996
TALIR	Total amount of spousal and child support payments received	T1 line 156	1997 to present
OI	Other Income	T1 line 130	1992 to present
INVI	Interest and other investment income	T1 line 121	1992 to present
LTPi	Limited partnership income	T1 line 122	1992 to present
RNET	Net rental income	T1 line 126	1992 to present
XDIV	Dividends	T1FF Derived	1992 to present
CLKGX	Net capital gains	T1FF Derived	1992 to present
T4RSP	RRSP income	T1 line 129	1992 to present
UCCBR	Universal childcare benefit repayment	T1 line 213	2007 to 2016
ESPAD	Elected split pension amount deduction	T1 line 201	2007 to present
ESPA	Elected split pension amount	T1 line 116	2007 to present
Federal Cash Transfer Payments	See Table 4		1992 to present
Provincial Cash Transfer Payments	See Table 5		1992 to present

1. All negative income values (e.g. self-employment income, investment income, and capital gains) are bottom-coded to zero prior to the aggregation of all sources into total modified income. Modified total income as calculated is also bottom-coded to zero to ensure microdata consistency in cases where UCCB repayments exceed modified total income as calculated (these occurrences are rare).

Note that RRSP income is measured using the variable T4RSP rather than RRSP (RRSP income for persons 65 and over) to capture all RRSP income, including withdrawals by persons under 65.

2. $Modified\ Total\ Income_i = \max(0, T4E_i + EXIND_i + OEI_i + SEI_i + SOP4A_i + ALMI_i + TALIR_i + OI_i + INVI_i + LTPi_i + RNET_i + XDIV_i + ESPA_i - ESPAD_i + CLKGX_i + T4RSP_i + Federal\ Cash\ Transfer\ Payments_i + Provincial\ Cash\ Transfer\ Payments_i - UCCBR_i)$

3. Due to limitations in the information acquired from the CRA in some years, data for the exempt employment income for persons with Indian status are not available in all years.