

Tax Credits

Chapter 9

Deductions v. Credits

▸ Deductions

- Reduce tax base (income subject to tax)

▸ Credits

- Reduce tax liability
- In a 33% tax bracket, \$1 of credit is worth \$3 of deductions
- Gives equal benefit regardless of marginal tax bracket

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Refundable Credits vs. Nonrefundable Credits

▸ Refundable Credits

- Paid even if the tax liability is less than amount of credit

▸ Nonrefundable Credits

- Can only be used to offset tax liability
- If credit exceeds tax liability, excess is lost
 - Exception: some nonrefundable credits have carryover (back + /or forward) provisions

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Nonrefundable Credits

- ▶ Foreign Tax Credit
- ▶ Credit for Child and Dependent Care
- ▶ Credit for the Elderly or Disabled
- ▶ Education Credits
 - American Opportunity Tax Credit (portion is nonrefundable)
 - Lifetime Learning Credit
- ▶ Retirement Savings Contributions Credit
- ▶ Child Tax Credit

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Nonrefundable Credits

- ▶ Residential Energy Efficient Property Credit
- ▶ Non-business Alternative Motor Vehicle Credit
- ▶ Non-business Alternative Fuel Vehicle Refueling Property Credit
- ▶ General Business Credit

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Tax Issues with Nonrefundable Credits

- ▶ Carryback/forward provisions
 - Foreign Tax Credit: 1 year back, 10 forward
 - Mortgage Interest Credit: 3 yrs forward
 - Adoption Expense Credit: 5 yrs forward
 - Residential Energy Credit: 1 year forward
 - General Business Credit: 5 year back, 20 forward
 - Child Tax Credit: See Additional Child Tax Credit

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Refundable Credits

- ▶ Used to
 - Reduce current tax year liability
 - Generate a refund

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Refundable Credits

- ▶ Federal Income Tax Withheld from Forms W-2 and 1099
- ▶ Estimated Tax Payments
- ▶ Federal Income Tax Refunds Applied from Prior Years
- ▶ Excess Social Security Taxes Withheld
- ▶ Earned Income Credit
- ▶ Additional Child Tax Credit
- ▶ Credit for Tax on Undistributed Capital Gains from:
 - A Mutual Fund
 - A Real Estate Investment Trust (REIT)
- ▶ Health Coverage Tax Credit
- ▶ Credit for Excise Taxes on Gasoline and Special Fuels
- ▶ American Opportunity Tax Credit (portion is refundable)
- ▶ Qualified Adoption Expenses Credit

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Foreign Tax Credit

- ▶ If foreign tax is paid, can claim
 - Foreign Tax Credit
 - Itemized deduction
- ▶ Method selected applies to all foreign taxes paid during the year
- ▶ Limitations
 - No credit for income excluded from US Income
 - No credit for taxes imposed at higher than US rates
- ▶ Carry back 1 year; forward 10 years

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Child & Dependent Care Credit

- ▶ **General Qualifications**
 - Must have employment related care costs for a
 - Dependent under age 13, or
 - Handicapped dependent or spouse
 - Married taxpayers must file a joint return
- ▶ **Credit Amount**
 - Eligible care costs x applicable percentage
 - Applicable percentage ranges from 20% to 35% (See Exhibit 9.3)

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Child & Dependent Care Credit

- ▶ Covers costs for care of qualified individual within taxpayer's home or outside home
 - If outside home, handicapped dependent or spouse must spend at least 8 hours a day within taxpayer's home.
- ▶ Amount of costs that qualify is the lesser of
 - Earned income,
 - Actual costs, or
 - \$3,000 for one qualified individual, and \$6,000 for two or more qualified individuals.

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CDCC Percentage

If AGI is not over	Then the percentage is	If AGI is not over	Then the percentage is
\$15,000	35%	\$31,000	27%
\$17,000	34%	\$33,000	26%
\$19,000	33%	\$35,000	25%
\$21,000	32%	\$37,000	24%
\$23,000	31%	\$39,000	23%
\$25,000	30%	\$41,000	22%
\$27,000	29%	\$43,000	21%
\$29,000	28%	No limit	20%

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Child and Dependent Care Credit

- ▶ Special Rules
 - If spouse is full time student, deemed to earn \$250 per month (or \$500 per month if 2 or more qualifying individuals)

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Credit for Elderly and Disabled

- ▶ General Qualifications
 - Age 65 or older, or
 - Under age 65 and permanently and totally disabled
- ▶ Credit Amount
 - Calculated on Schedule R
 - Amount reduced for taxpayers with Social Security benefits or AGI in excess of specified amounts
 - IRS will figure for taxpayer if necessary

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Education Tax Credits

- ▶ 2 Education Credits:
 - American Opportunity Tax Credit
 - Lifetime Learning Credit
- ▶ Common Elements:
 - Available for qualifying tuition and related expenses
 - Room and board costs are NOT eligible
 - Available for taxpayer, spouse, and dependents
 - Beginning in 2009, course materials (including books, supplies, and equipment needed for a course of study) are considered qualified related expenses

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American Opportunity Tax Credit

- ▶ Maximum per eligible student is \$2,500 (2010 – 2012) per year for first 4 years of postsecondary education.
 - 100% of first \$2,000 of qualifying expenses, plus
 - 25% of next \$2,000 of qualifying expenses
- ▶ Student must
 - Pursue an undergraduate degree or recognized credential
 - Take at least 1/2 of full-time course load

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Lifetime Learning Credit

- Maximum per taxpayer is 20% of qualifying expenses (up to \$10,000 per year)
 - Cannot be claimed in same year the American Opportunity Tax Credit is claimed
- Student must take one or more courses
- Drugs take away your American Opportunity Tax Credit but not your Lifetime Learning Credit

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Income Limits - Education Credits

- ▶ Both education credits are combined and phased out for MAGI of
 - For 2010 – 2012, \$160,000 – \$180,000 for married filing jointly, and
 - For 2010 – 2012, \$80,000 – \$90,000 for others
 - $MAGI = AGI + \text{excluded foreign income} + \text{excluded income from US Possessions}$
- ▶ Taxpayers can't receive a double tax benefit for education expenses
 - Can't claim a credit for amounts otherwise excluded from income (e.g., scholarships and employer-paid education assistance)

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Education Credit Summary

Feature	American Opportunity Tax Credit	Lifetime Learning Credit
Base and Rate	\$2,000 @ 100% plus \$2,000 @ 25% (2010 and 2011)	\$10,000 @ 20%
Maximum Annual Credit	\$2,500 per eligible student (2010 and 2011)	\$2,000 per tax return
General Availability	For the first four years of postsecondary education	For all years of postsecondary education and for courses to acquire or improve job skills
Years Available	Four years per student	Unlimited Number of Years
Degree Requirement	Student must pursue an undergraduate degree or other recognized education credential	Student does not need to pursue a degree or education credential
Half-time Requirement	Student must be enrolled at least half-time for one academic period during the year	Student must take one or more courses
Drug Conviction	No felony drug conviction on student's record	Felony drug conviction rule does not apply

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Retirement Savings Credit

- ▶ Taxpayers with MAGI below certain thresholds receive a credit for retirement savings
 - Fully phased out at:
 - \$57,500 of MAGI for MFJ (2012)
 - \$43,125 of MAGI for HOH (2012)
 - \$28,750 for all others (2012)
 - MAGI includes
 - Excluded foreign income and housing costs
 - Income for residents of American Samoa and Puerto Rico

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Retirement Savings Credit

- ▶ **Qualifications**
 - 18 or older
 - Makes a qualified retirement savings contribution
 - Traditional or Roth IRA
 - Elective Deferrals
- ▶ **Amount of Credit** = Contribution x Percentage
 - See Exhibit 9.6
- ▶ **Maximum Credit**
 - \$1,000 per person per year, or
 - \$2,000 on a joint return

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Child Tax Credit

- ▶ \$1,000 credit per qualifying child
- ▶ Qualifications:
 - Married taxpayers must file jointly
 - Credit amount is \$1,000 per child
 - Eligible children are:
 - Under age 17,
 - U.S. citizen, U.S. national, or resident, and
 - Claimed as dependent on taxpayer's tax return

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Child Tax Credit

- ▶ Credit is phased out by \$50 for each \$1,000 of AGI above specified levels
 - \$110,000 for joint filers
 - \$55,000 for married filing separately
 - \$75,000 for single

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Additional Child Tax Credit

- ▶ Applies if taxpayer could not use all of the available Child Tax Credit
- ▶ Calculated on Form 8812

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Adoption Expenses Credit

- ▶ Credit for qualified adoption expenses incurred in adoption of eligible child
 - Examples of expenses: adoption fees, court costs, attorney fees, travel expenses
- ▶ Maximum credit is \$12,650 for 2012
 - Credit is phased out ratably for modified AGI between \$189,710 – \$229,710 for 2012

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Adoption Expenses Credit

- ▶ Eligible child is one that is
 - Less than 18 years of age, or
 - Physically or mentally handicapped
- ▶ Nonrefundable credit
 - Excess may be carried forward for five years

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Residential Energy Efficient Property Credits

- ▶ Residential Energy Property Credit
 - For 2009 and 2010, combined credit limit of \$1,500 for both tax years
 - Qualifying improvements to taxpayer's existing home
- ▶ Residential Energy Efficient Property Credit
 - Credit is equal to 30% of qualified property
 - Qualified residential alternative energy equipment
 - Note: The credit for qualified fuel cell property is the lesser of: 30%, or \$500 for each half kilowatt of capacity and applies only to the taxpayer's principal residence.

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General Business Credit

- ▶ Comprised of a number (about 30) of nonrefundable business credits combined into one amount (See Exhibit 9.10)
 - Rehabilitation Expenditure Credit
 - Business Energy Credit
 - Work Opportunity Tax Credit
 - Welfare to Work Credit
 - Research Activities Credit
 - Low-Income Housing Credit
 - Disabled Access Credit

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General Business Credit

- ▶ Limited to net income tax reduced by greater of:
 - Tentative minimum tax
 - 25% of net regular tax liability that exceeds \$25,000
- ▶ Unused credit is carried back one year, then forward 20 years

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