**Chapter Six**

**Credits and Special Taxes**

**Learning Objective 6.1 Child Tax Credit**

If taxpayers have children under age 17 that are U.S. citizens and claimed as dependents on the taxpayer’s return, a credit is offered based on the number of children.

* Maximum credit is $1,000 per child
* Phase out once AGI reaches $110,000 (MFJ), $55,000 (MFS) and $75,000 (S) or (HOH)
* Credit is nonrefundable
* Also additional child tax credit

**Learning Objective 6.2 Earned Income Credit**

The Earned Income Credit (EIC) is for qualifying individuals with income below certain levels – meant to assist working poor

* Unique because can result in refund
* Based on AGI of taxpayer and the number of qualifying children
* The taxpayer must meet 7 rules to qualify for the EIC, including a limit on investment income (can’t make more than $3,400)
  + If the taxpayer doesn’t have a qualifying child, 4 additional rules must be met to qualify for a greatly reduced EIC
  + To be eligible for credit with no qualifying children must be over 25 and under 65 and not claimed as dependent by another taxpayer

**Learning Objective 6.3 Child and Dependent Care Credit**

Taxpayers are allowed a credit for the care of their children and certain other dependents.

* To be eligible, the taxpayer must maintain a household for a child whose age is 13 or under, or a dependent or spouse of any age who is incapable of self-care
* Credit is based on AGI and qualified expenses
  + Qualified expenses include amounts paid to enable taxpayer and spouse to be employed
  + Must include the name, address, and TIN# of the person or organization providing care
  + Allowable credit is available at different percentages of the qualifying expense, depending upon AGI (see table in text)
  + The maximum credit allowed is $3,000 for one dependent and $6,000 for two+
* Full-time students with little/no income ‘deemed’ to have $250/month or $500/month for two or more depends for purposes of calculating credit

**Learning Objective 6.4 The Affordable Care Act (ACA)**

The ACA was passed in 2010

* Significant provisions implemented over time
* For 2016, most of the reporting requirements are in place and ACA compliance enforced

Individual Shared Responsibility

* The individual shared responsibility provision is a “penalty tax” for failing to carry health insurance at a minimum level (MEC)
* Requires a taxpayer and family to have a minimum essential coverage level (MEC) or an exemption from the MEC
* Failure to carry the MEC causes the taxpayer to pay an additional tax when filing their annual federal tax return

Premium Tax Credit

Eligible taxpayers may receive a tax credit intended to lower the cost of health care. To be eligible taxpayers must meet all of the following:

* Health insurance is purchased through one of the state exchanges or the federal exchange
* The taxpayer is not eligible for coverage through an employer or government plan
* The taxpayer’s income falls below certain levels
* The taxpayer does not file Married Filing Separately except under very limited conditions
* The taxpayer cannot be claimed as a dependent by another

The credit is calculated using specific tax tables similar to those used to calculate EIC

* If qualified, the credit can be obtained at two different times

(1) Up front - at time of enrollment

or

(2) At the end of the year when the annual federal tax return is filed

**Learning Objective 6.5 Education Tax Credits**

Taxpayers who are paying for higher education have two credits potentially available:

The *American Opportunity Tax Credit (AOTC)* and the *lifetime learning credit.*

***AOTC***

* Credit is for tuition. Fees, supplies, books - but not for room and board.
* The AOTC is 100% of the first $2,000 of tuition, fees, books and course materials paid and 25% of the next $2,000 (maximum credit of $2,500) per student
  + AOTC is 40% refundable, so can reduce the liability to below zero
  + A student must be taking one-half the normal course load and cannot be convicted of a federal or state drug felony.
  + Available for the first 4 years of post-secondary education.
  + The phase-out for AOTC is between $160,000-$180,000 (MFJ) and $80,000-$90,000 (all others).

***LLC***

* The lifetime learning credit (LLC) is a nonrefundable credit of 20% of tuition and fees up to $10,000 (maximum credit of $2,000) per year.
* The phase-out for LLC is $111,000-$131,000 (MFJ) and $55,000-$65,000 (all others)

Students cannot claim both credits in the same year, but if more than one student is eligible for the credits, both credits can be claimed, as appropriate, for each student.

**Learning Objective 6.6 Foreign Tax Credit**

U.S. taxpayers are allowed a credit for the taxes paid to other countries.

* The purpose is to eliminate double taxation.
* Taxpayer can take credit – amount of taxes paid to foreign governments
  + “Overall” limitation on amount of credit, based on ratio of

*Net foreign income/US taxable income x US tax liability*

* Unused foreign tax credits can be carried back one year or carried forward ten years
* Commonly seen on foreign taxes withheld on dividends from foreign stock investments.

**Learning Objective 6.7 Adoption Expenses**

Individuals are allowed a credit for qualified adoption expense equal to $13,460 credit per adopted child.

* Phase-outs apply
* Qualified adoption expenses include reasonable and necessary adoption fees, court costs, attorney fees and other expenses directly related to and the principal purpose of which is for the taxpayer’s legal adoption of an eligible child.

**Learning Objective 6.8 Energy Credits**

To encourage the use of energy-efficient products, there are two major energy credits available in 2016.

* *Plug-in electric vehicle credit* applies to the purchase of plug-in electric vehicles and the credits range between $2,500 and $7,500 depending on the weight of the vehicle and the kilowatt hour of traction battery capacity.
* *The Residential Energy-Efficient Property (REEP) credit* is expected to increase the number of solar and wind energy installations in the coming years.
  + Taxpayers may claim a credit of 30% of amount paid for
    - qualified solar electric property (property which uses solar power to generate electricity in a home)
    - qualified solar water-heating property
    - qualified small wind energy property
    - qualified geothermal heat pump property.
  + May be claimed for both principal residences and vacation homes.

**Learning Objective 6.9 The Individual Alternative Minimum Tax (AMT)**

The IRS Service has created a minimum tax to insure that every taxpayer with economic income pays at least some amount of income tax.

* 2016 AMT rates are 26% on the first $186,300 ($93,150 – MFS) plus 28% on the amounts above $186,300.
* AMT is based on taxable income plus or minus certain adjustments, adding the amount of “tax preferences” and subtracting an exemption allowance based on tax filing status.
  + For 2016, the AMT exemption allowance is $83,800 (MFJ), $53,900 (S and HOH) and $41,900 (MFS) with phase-outs for high income taxpayers.

**Learning Objective 6.10 Unearned Income of Minor Children and Certain Students**

Many taxpayers have found that putting income-earning assets in the names of children lowers tax liability.

* Tax Reform Act of 1986 limits the benefit of shifting income to minor children.
* Children under 18 years must pay at parents highest marginal rate - “parental rate”
* Parents may also elect to include a child’s gross income their tax return, thereby eliminating the need to file a return for the child.
  + File on Form 8615
  + To make this election, the child’s gross income must:
    - be from interest and dividends only
    - the gross income is more than $1,050 but less than $10,500 and
    - no estimated tax has been paid in the name of the child

**Learning Objective 6.11 Community Property**

Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin are community property states.

* In Alaska spouses *may* elect to treat income as community income.
* Property owned before marriage, or property received as inheritance, is separate property.
* All other property is assumed to be community property and FIT must be allocated to each spouse.
* In community property states, income from salary and wages is generally treated as having been earned one-half by each spouse.

A special provision is allowed when married spouses residing in a community property state do not live together.

* A spouse will be taxed only on his or her actual earnings from personal services when

1) they live apart the entire year

2) they do not file a joint return, and

3) no portion of earned income is transferred between spouses.

* Same-sex couples’ legally married under state law will now be required to file as married
  + Community property states that recognize same-sex marriages also extend community property rights.