tax credits

There are many credits available to reduce your federal tax liability, but all are subject to complex limitations based on income and whether or not you are subject to the alternative minimum tax.

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TAX CREDIT OVERVIEW

The following is a discussion of the credits that impact most taxpayers:

Foreign Tax Credit

The U.S. taxes its residents on their worldwide income including foreign-sourced income which may be also subject to tax in foreign jurisdictions. To avoid double taxation, subject to certain limitations, the U.S. allows its residents either a credit or deduction for taxes imposed by foreign countries and possessions of the U.S. In general, a credit is more advantageous as it is a dollar-for-dollar offset to the taxpayer's U.S. income tax liability, whereas a deduction is a reduction to income subject to tax. There are limits on the amount of foreign tax credits an individual may be able to take in a particular year. There is a separate calculation of foreign tax credits allowed each year which could result in a difference between your regular and AMT foreign tax credit allowed. Any foreign tax credits not fully utilized in the current year due to limitations may be carried back one year and forward ten years. The most common forms of income that result in the payment of foreign taxes include dividends paid by foreign corporations and business income earned by foreign pass-through entities. It is very common to incur foreign taxes through securities that are held in your investment accounts or from an underlying ownership interest in a partnership or other pass-through entity that has an investment in a foreign entity.

Child Tax Credit

A nonrefundable child tax credit of $1,000 per qualifying child is available to offset your tax liability.

Qualifying children are defined as:

- A son, daughter, stepson, stepdaughter, or a descendant of such child; a brother, sister, stepbrother, stepsister, or a descendant of such relative.

- A child who has not attained the age of 17 by the end of the tax year and who is either a U.S. citizen or national, or a resident of the U.S.

However, the child tax credit is not available to many taxpayers since it begins to phase out when MAGI reaches $110,000 for joint filers, $55,000 for married filing separately and $75,000 for unmarried individuals, head of household and qualifying widowers. The credit is reduced by $50 for every $1,000, or fraction thereof, of MAGI above the threshold amount.

Should the credit be disallowed, an additional child tax credit may be allowed. Individuals are eligible for a refundable child tax credit equal to the lesser of the unclaimed portion of the non-refundable credit amount or 15% of their earned income in excess of $3,000.

The earned income limitation is set at $3,000. For taxpayers with three or more qualifying children, the refundable credit will be equal to the lesser of the credit that would have been allowed without the tax limit and the excess of the taxpayer's social security taxes for the year over the taxpayer's earned income credit for the year. The credit is allowed up to the $1,000 per child credit amount, if the allowable child tax credit exceeds the total tax liability, taking into account the AMT.

The earned income threshold of $3,000 is made permanent by PATH.

The child tax credit is temporarily expanded after 2017 by increasing the credit amount for each qualifying child to $2,000, increasing the phase-out threshold to $400,000 if married filing jointly ($200,000 for other taxpayers), and providing a $500 nonrefundable credit for each dependent who is not a qualifying child. The refundable portion of the credit (additional child tax credit) is limited to $1,400 per qualifying child, but is indexed for inflation and the earned income threshold is reduced to $2,500. These provisions are effective for tax years 2018 through 2025.

Child and Dependent Care Credit

If you pay someone to take care of your children or other qualifying persons so that you and your spouse can work or go to school, then you qualify to take the credit for child and dependent care expenses. Qualifying expenses include expenses paid for household services and for the care of a qualifying individual. A qualifying individual can include a dependent who was under age 13 at the close of the tax year or a dependent who was physically or mentally incapable of self-care and who had lived with you for more than half of the year.

The maximum amount of dependent care expense on which you can calculate the credit is $3,000 for one qualifying individual or $6,000 for two or more qualifying individuals. The amount of the dependent care expenses eligible for a credit must be reduced by any payments received through an employer-provided dependent care assistance program. The amount of the allowable credit is based on your AGI, with the applicable credit percentage ranging from 20% to 35%. The 35% credit is for lower income taxpayers. Once your AGI exceeds $43,000, the maximum rate allowed is 20%.

These percentages entitle you to a credit of $600/$1,200 and $1,050/$2,100, respectively, based on the number of qualifying individuals.

American Opportunity and Lifetime Learning Credits
There are two education-related credits: the American Opportunity Credit ("AOC"), which is a modified Hope Credit, and the Lifetime Learning Credit. These credits are available to individuals who incurred tuition expenses pursuing college or graduate degrees or vocational training. The AOC allows taxpayers a maximum credit per eligible student of $2,500. The Lifetime Learning Credit allows a taxpayer to take a maximum credit of $2,000 per taxpayer. A more detailed discussion of these credits can be found in the chapter on education incentives.

PATH has made the American Opportunity tax credit permanent.

Adoption Credit
For 2017, a nonrefundable credit of up to $13,570 may be claimed for qualified adoption expenses. The credit is phased out ratably for taxpayers with MAGI over $203,540 and no credit is allowed for taxpayers with MAGI over $243,540 or higher. Qualified adoption expenses include reasonable and necessary adoption fees, court costs, attorney fees and other expenses which are directly related to the legal adoption of an eligible child. An eligible child is an individual who has not attained the age of 18 at the time of the adoption or who is physically or mentally incapable of caring for himself or herself. A credit for the adoption of a special needs child is allowed regardless of the actual qualified expenses.

For U.S. adoptions, you may be able to claim the credit before the adoption is finalized and if you adopt a special needs child you may qualify for the full amount of the credit.

For 2018, the credit allowed is $13,840 and phased out ratably for taxpayers with MAGI over $207,580 and completely phased out at $247,580.

Residential Energy Property Credit
The Bipartisan Budget Act of 2018 extends through 2017 the credit for purchases of nonbusiness energy property. The provision allows a credit of 10% of the amount paid or incurred for qualified energy improvements, up to $500.

Residential Energy Efficient Property Credit
The Bipartisan Budget Act of 2018 extends the residential energy efficient property credit allowed up to 30% of the cost of qualified energy property and the credit for each half kilowatt of capacity of fuel cell property is limited to $500. This credit applied to expenditures for the following qualified energy equipment installed and placed in service through December 31, 2021:

- Small wind energy property,
- Geothermal heat pump property, and
- Fuel cell property.

The credit for solar electric property and solar water heating property, however, is available for property placed in service through December 31, 2021, based on an applicable percentage. The applicable percentages are:

- In the case of property placed in service after December 31, 2016, and before January 1, 2020, 30%.
- In the case of property placed in service after December 31, 2019, and before January 1, 2021, 26%.
- In the case of property placed in service after December 31, 2020, and before January 1, 2022, 22%.

Qualified Plug-In Electric Drive Motor Vehicle Credit
The maximum tax credit allowed for individuals who purchase plug-in electric vehicles is $7,500, and if the vehicle did not have battery capacity of at least 5 kilowatt hours, the minimum credit of $2,500 applied.

To qualify as a plug-in electric drive vehicle, the vehicle must:

- be made by a manufacturer,
- be acquired for use or lease but not resale,
- have its original use commencing with the taxpayer,
- be treated as a motor vehicle for purposes of Title II of the Clean Air Act,
- have a gross vehicle weight rating of not more than 14,000 pounds,
- be propelled to a significant degree by an electric motor that draws electricity from a battery with a capacity of not less than 4 kilowatt hours and that is capable of being recharged from an external source of electricity.

The credit begins to phase-out after 200,000 vehicles have been sold for use in the United States. The phase-out period begins with the second calendar quarter following the calendar quarter in which the 200,000th unit is sold. For the first two quarters of the phaseout period, the credit is cut to 50% of the full credit amount. The credit is cut to 25% for the third and fourth quarters of the phase-out period. Thereafter, no credit is allowed.

No qualified plug-in electric drive motor vehicle credit is allowed for property used predominantly outside of the United States.

The Bipartisan Budget Act of 2018 extends the credit for two-wheeled plug-in electric vehicles acquired before January 1, 2018, known as the golf-cart credit. This is a 10% credit for two-wheeled plug-in electric vehicles (capped at $2,500).

Qualified Research Credit

This is a credit for expenditures paid or incurred for research that was technological in nature and whose application was for use in developing a new or improved business component. This credit is made permanent as a result of PATH. In general, the credit was equal to 14% of the qualified research expenditures incurred that exceeds 50% of the average qualified research expenses for the three prior years. In addition, for taxable years beginning after December 31, 2015, eligible small businesses ($50 million or less in gross receipts) may claim the credit against AMT liability.

Further, the credit against the employers' payroll tax liabilities is available for certain businesses (gross receipts of $5 million or less and no gross receipts for any taxable year before the five years ending with the tax year). So, for a 2017 return, a business is not eligible if it generated gross receipts prior to 2013.

AMT Credit

If you pay the AMT in one year, you may be entitled to a tax credit against your regular tax in a subsequent year. You qualify for an AMT credit if any of your AMT liability is derived from "deferral items" such as depreciation adjustments and the tax preference on the exercise of ISOs. See the chapter on the AMT for a more detailed discussion.

Work Opportunity Credit

The work opportunity tax credit is a federal tax credit available to employers for hiring individuals from certain target groups who have consistently faced significant barriers to employment through taxable years beginning on or before January 1, 2020. The credit is based on qualified wages paid to the employee for the first year of employment. In general, qualified wages are capped at $6,000. The credit is 25% of the qualified first-year wages for those employed at least 120 hours but fewer than 400 hours and 40% for those employed 400 hours or more.

PATH also extends the credit beginning in 2016 to apply to employers who hire qualified long-term unemployed individuals (those unemployed for 27 weeks or more).

Due Diligence Checklist

Paid preparers will be required to complete and attach Form 8867 to the return in those cases where the Earned Income Credit, the Child Tax Credit and additional Child Tax Credit, and the American Opportunity Credit are utilized. Preparers will be required to maintain copies of the documents that were relied upon to determine eligibility of the qualifying taxpayer.