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 10 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 nonrefundable 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 3 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.

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 2 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 2015, a nonrefundable credit of up to $13,400 may be claimed for qualified adoption expenses. The credit is phased out ratably for taxpayers with MAGI over $201,010 and no credit is allowed for taxpayers with MAGI over $241,010 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 2016, the credit allowed is $13,460 and phased out ratably for taxpayers with MAGI over $201,920 and completely phased out at $241,920.

Residential Energy Property Credit

The tax credit allowed for the cost of qualifying improvements that meet certain energy efficient standards had been extended through December 31, 2016 as a result of PATH.

A tax credit was allowed for the cost of qualifying improvements that met certain energy efficient standards. The credit is equal to the sum of:

- 10% of amounts paid or incurred for energy efficient building envelope components plus
- Specified dollar amounts for the purchase of residential energy property.

The credit is limited to $500 ($200 for windows) minus the credits claimed in previous years.

Residential Energy Efficient Property Credit

A tax credit is 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 applies to expenditures for the following qualified energy equipment installed before 2017:

- Solar electric property expenditure, such as for photovoltaic cells,
- Solar water heaters,
- Small wind energy property,
- Geothermal heat pump property, and
- Fuel cell property.

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.

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 3 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, and the credit can be utilized by certain small businesses against the employer's payroll tax liability.

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, 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 December 21, 2019, as a result of PATH. 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).