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# Understanding Personal Tax Credits

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Have you ever thought that you're paying too much income tax? You may be, if you're not claiming all of the tax credits for which you are eligible when you file your federal tax return. These credits may significantly reduce your tax liability.

## What is a tax credit?

A tax credit is a dollar-for-dollar reduction of your tax liability. Generally, after you've calculated your federal taxable income and worked out how much tax you owe, you can subtract the amount of any tax credit for which you are eligible from your tax obligation. In some cases, if your tax credits exceed your tax liability, you will be able to claim the difference as a refund.

## What is the difference between a tax deduction and a tax credit?

A tax deduction reduces your taxable income, so that when you calculate your tax liability, you're doing so against a lower amount. Essentially, your tax obligation is reduced by the same percentage as your tax rate.

Here's an example. If you're in the 22 percent marginal tax bracket and you have \$1,000 in tax deductions, your tax liability will be reduced by \$220. That reduction would be greater if you were in a higher tax bracket.

A tax credit, on the other hand, is constant. A tax credit of \$100 will reduce your tax liability by \$100, regardless of your tax bracket. Here's a quick summary of some of the main personal federal tax credits that may be available to you.

## Child and dependent care credit

If you're working or looking for work, and you need to pay someone to look after your child or other qualifying individual, you may be eligible for the child and dependent care credit. Depending on your adjusted gross income, you may be able to claim up to 35 percent of the qualifying expenses that you pay to provide care for a dependent child under the age of 13, a disabled spouse, or a disabled dependent. A dollar limit applies to the amount of work-related expenses you can use to figure the credit. This limit is \$3,000 for one qualifying person, or \$6,000 for two or more qualifying persons.

For more information, see IRS Publication 503.

## Child tax credit

The child tax credit provides tax relief for parents and others who have dependent children. If you're eligible, you may be entitled to take a credit of up to \$2,000 per child. A qualifying child is typically a child, grandchild, stepchild, or foster child under the age of 17 who lives with you for more than half the year and provides less than half of his or her own support.

The child tax credit begins to phase out if your modified adjusted gross income (MAGI) exceeds a certain level (\$400,000 for

married persons filing jointly, \$200,000 in any other case).

For more information, see IRS Publication 972.

### Earned income credit

The earned income credit benefits working taxpayers who have low income. You can apply for it only if you work, either as an employee or in your own business, and you have earned income during the tax year. The amount of the credit is based on your adjusted gross income, your filing status, and the number of qualifying children you have.

For more information, see IRS Publication 596.

### Education credits

There are two tax credits that you may qualify for if you, your spouse, or your children are attending an eligible educational institution: the American Opportunity tax credit (formerly known as the Hope credit) and the Lifetime Learning credit. Whether you can claim one of these credits (they can't both be claimed in the same year for the same student) depends on your educational status, your modified adjusted gross income (MAGI), and the amount of qualified tuition and related expenses you pay in a given year.

The American Opportunity credit is worth a maximum of \$2,500 per year and is available for each student in the household who is in the first four years of undergraduate education (provided the student is attending at least half-time). The Lifetime Learning credit is worth a maximum of \$2,000 per year and is more widely available — students who are attending college or graduate school (even less than half-time), taking continuing education courses, or pursuing courses connected to hobbies and other interests may be eligible for this credit. However, the Lifetime Learning credit is limited to \$2,000 per tax return per year, regardless of how many students in the family may qualify.

To qualify for the full Lifetime Learning credit, your MAGI must be below \$80,000 (in 2021, \$59,000 in 2020) if you're a single filer and \$160,000 (in 2021, \$118,000 in 2020) if you're a joint filer. Single filers with a MAGI between \$80,000 and \$90,000 and joint filers with a MAGI between \$160,000 and \$180,000 can claim a partial credit in 2021.

To qualify for the full American Opportunity credit, your MAGI must be below \$80,000 if you're a single filer and \$160,000 if you're a joint filer. Single filers with a MAGI between \$80,000 and \$90,000 and joint filers with a MAGI between \$160,000 and \$180,000 can claim a partial credit. (The same dollar limits applied for the 2020 tax year.)

For more information, see IRS Publication 970.

### Other tax credits

You may also be eligible for other federal tax credits, including the credits listed below:

- Adoption tax credit
- Tax credit for the elderly or the disabled
- Foreign tax credit
- Tax credit for IRA and retirement plan contributions (the retirement savings contribution, or "savers" credit)
- Health insurance premium assistance credit

If you would like more information on personal tax credits, contact your tax advisor or log on to the IRS website at [www.irs.gov](http://www.irs.gov).

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