

Chapter 11

Tax Credits

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Refundable vs Nonrefundable Credits (slide 1 of 2)

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

Refundable vs Nonrefundable Credits (slide 2 of 2)

- Nonrefundable credits
 - Credit can only be used to offset tax liability
 - If credit exceeds tax liability, excess is lost
 - Exception: some nonrefundable credits have carryover provisions for excess

General Business Credit

- Comprised of a number of business credits combined into one amount
- 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 1 year, then forward 20 years

Rehabilitation Expenditure Credit

(slide 1 of 3)

- Credit is a percentage of expenditures made to substantially rehabilitate industrial and commercial buildings and certified historic structures
- Credit rate
 - 20% for nonresidential and residential certified historic structures
 - 10% for other structures originally placed into service before 1936

Rehabilitation Expenditure Credit

(slide 2 of 3)

- To qualify for credit, building must be *substantially rehabilitated* meaning qualified rehab expenditures exceed the greater of:
 - The adjusted basis of the property before the rehab expenditures, or
 - \$5,000
- Qualified rehab expenditures do not include the cost of the building and related facilities or cost of enlarging existing building

Rehabilitation Expenditure Credit

(slide 3 of 3)

- Basis in structure is reduced by the credit amount
- Subject to recapture if rehabilitated property held less than 5 years or ceases to be qualifying property

Business Energy Credit

- Credit equal to 10% of expenditures on solar energy and geothermal property

Work Opportunity Tax Credit

(slide 1 of 2)

- Applies to first 12 months of wages paid to individuals falling within target groups and starting work before 12/31/03
 - Credit limited to a percentage of first \$6,000 wages paid per employee
 - 40% if employee has completed at least 400 hours of service to employer
 - 25% if at least 120 hours of service
 - Deduction for wages is reduced by credit amount

Work Opportunity Tax Credit

(slide 2 of 2)

- Targeted individuals generally subject to high rates of unemployment, including
 - Qualified ex-felons, high-risk youths, food stamp recipients, veterans, summer youth employees, and certain welfare recipients
 - Summer youth employees: Only first \$3,000 of wages paid for work during 90-day period between May 1 and September 15 qualify for credit

Welfare-to-Work Credit

(slide 1 of 2)

- Applies to first 24 months of wages paid to individuals who have been long-term recipients of family assistance welfare benefits
- Long-term is at least an 18 month period ending on hiring date

Welfare-to-Work Credit

(slide 2 of 2)

- Maximum credit is a percentage of first \$10,000 qualified wages paid in first and second year of employment
 - 35% in first year
 - 50% in second year
- Maximum credit per qualified employee is \$8,500
 - Deduction for wages is reduced by credit amount

Research Activities Credit

(slide 1 of 4)

- Comprised of two parts
 - Incremental research activities credit, and
 - Basic research credit
- Both credits are a percentage of qualified R&E expenditures in excess of specified base amounts

Research Activities Credit

(slide 2 of 4)

- Incremental research activities credit
 - Credit amount = 20% x (qualified expenditures - base amount)
- Expenditures qualify if research relates to discovery of technological info intended for use in developing a new or improved business component for taxpayer
 - Expenditures qualify fully if research done in-house
 - Only 65% qualify if research conducted by outside party (under contract)

Research Activities Credit

(slide 3 of 4)

- Tax treatment of R&E expenditures
 - Full credit and reduce expense deduction by credit amount
 - Full expense deduction and reduce credit by $(100\% \times \text{credit} \times \text{max. corp. tax rate})$
 - Full credit and capitalize and amortize over 60 months or more
 - Amount capitalized is reduced by credit if credit exceeds allowable deduction

Research Activities Credit

(slide 4 of 4)

- Basic research credit
 - Additional 20% credit is allowed on basic research payments in excess of a base amount
 - Only payments made by June 30, 2004 qualify

Low-income Housing Credit

- Credit is issued on a nationwide allocation program
- Credit amount
 - Based on qualified basis of the property which is dependent on the number of units rented to low-income tenants
 - Credit is allowed over a 10-year period
 - Subject to potential recapture

Disabled Access Credit

- Credit available for eligible access expenditures made by small businesses
- Credit amount
 - 50% x expenditures that exceed \$250 but not in excess of \$10,250
 - Thus, max. credit is \$5,000
 - Basis in asset is reduced by credit amount

Credit For Pension Plan Startup Costs

- Small businesses can claim nonrefundable tax credit for admin costs of establishing and maintaining a qualified retirement plan
 - Small business has < 100 employees and wages of at least \$5,000
- Credit amount = 50% of qualified startup costs limited to max credit of \$500 per year for 3 years
 - Deduction for startup costs is reduced by amount of credit

Credit For Employer-Provided Child Care (slide 1 of 2)

- Employers can claim a credit for providing child care facilities to their employees during normal working hours
 - Limited to \$150,000 per year
- Credit amount:
 - 25% of qualified child care expenses
 - 10% of qualified child care resource and referral services

Credit For Employer-Provided Child Care (slide 2 of 2)

- Deductible qualifying expenses must be reduced by the credit amount
- Basis of qualifying property must be reduced by credit amount
- Credit may be subject to recapture if child care facility ceases to be used for qualifying purpose within 10 years of being placed in service

Earned Income Credit

(slide 1 of 3)

- General qualifications for credit
 - Must have earned income from being an employee or self-employed, and
 - Must have a qualifying child
 - Exception: credit is available for some taxpayers having no children
 - Qualifying child must meet relationship, residency, and age tests

Earned Income Credit

(slide 2 of 3)

- Credit amount (2003 tax year)
 - Applicable percentage rate x earned income
 - Rate and maximum amount of earned income determined by number of qualifying children
 - Phase-out of credit begins when earned income (or AGI) exceeds \$14,730 with qualifying child for MFJ
 - Use IRS tables to calculate exact credit amount

Earned Income Credit

(slide 3 of 3)

- Credit for taxpayers having no children
 - Taxpayers aged 25 through 64
- Credit amount for couple filing jointly with no qualifying children (2003 tax year)
 - $7.65\% \times$ earned income (up to \$4,990)
 - Phase-out of credit begins when earned income (or AGI) exceeds \$7,240

Credit for Elderly or Disabled Taxpayers (slide 1 of 2)

- General qualifications
 - Age 65 or older, or
 - Under age 65 and permanently and totally disabled

Credit for Elderly or Disabled Taxpayers (slide 2 of 2)

- Credit amount
 - Maximum credit = \$1,125
 - Amount reduced for taxpayers with Social Security benefits or AGI in excess of specified amounts
 - IRS will calculate credit for taxpayer if necessary

Foreign Tax Credit

(slide 1 of 2)

- Credit applies to both individuals and corporations that pay foreign income taxes
- Instead of claiming a credit, a deduction may be claimed for the taxes paid

Foreign Tax Credit

(slide 2 of 2)

- Amount of the credit can be limited by the overall limitation:

$$\frac{\text{Foreign-source TI}}{\text{Worldwide TI}} \times \text{U.S. tax before credit} = \text{Overall FTC limitation}$$

Adoption Expenses Credit

(slide 1 of 2)

- Credit for qualified adoption expenses incurred in adoption of eligible child
 - Examples of expenses: adoption fees, court costs, attorney fees
- Maximum credit is \$10,160
 - Credit is phased-out ratably for modified AGI between \$152,390 and \$192,390

Adoption Expenses Credit

(slide 2 of 2)

- 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
- Married taxpayers must file jointly to claim

Child Tax Credit

(slide 1 of 2)

- Credit amount is \$600 per child
- Eligible children are:
 - Under age 17,
 - US citizen, and
 - Claimed as dependent on taxpayer's tax return

Child Tax Credit

(slide 2 of 2)

- 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

Child and Dependent Care Credit

(slide 1 of 4)

- General qualifications for credit
 - Must have employment related care costs for a
 - Dependent under age 13, or
 - Handicapped dependent or spouse

Child and Dependent Care Credit

(slide 2 of 4)

- Credit amount
 - Eligible care costs x applicable percentage
 - Applicable percentage ranges from 20% to 35% depending on AGI
- Married taxpayers must file a joint return to obtain credit

Child and Dependent Care Credit

(slide 3 of 4)

- Eligible care costs defined
 - 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 actual costs or \$3,000 for one qualified individual, and \$6,000 for two or more qualified individuals

Child and Dependent Care Credit

(slide 4 of 4)

- Earned income limitation
 - Amount of eligible care costs cannot exceed lower of taxpayer's or spouse's earned income
 - Full-time student or disabled taxpayer or spouse are deemed to have earned income up to maximum per month limits

Education Tax Credits

(slide 1 of 4)

- 2 education tax credits are available
 - Hope scholarship credit
 - Lifetime learning credit
- Both nonrefundable credits are available for qualifying tuition and related expenses
 - Room, board, and book costs are ineligible for the credits

Education Tax Credits

(slide 2 of 4)

- Maximum credits
 - Hope scholarship credit maximum per eligible student is \$1,500 per year for first 2 years of postsecondary education
 - 100% of first \$1,000 of qualifying expenses plus 50% of next \$1,000 of qualifying expenses
 - Lifetime learning credit maximum per taxpayer is 20% of qualifying expenses (up to \$10,000 per year in 2003)
 - Cannot be claimed in same year the Hope credit is claimed

Education Tax Credits

(slide 3 of 4)

- Eligible individuals include:
 - Taxpayer,
 - Spouse, and
 - Taxpayer's dependent
- To be eligible for Hope credit, student must take at least 1/2 of full-time course load
 - No such requirement for lifetime learning credit

Education Tax Credits

(slide 4 of 4)

- Income limitations
 - Both education credits are combined and phased out for AGI of \$83,000 to \$103,000 for married filing jointly and \$41,000 to \$51,000 for others
 - 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)
 - May claim credit and exclude from gross income amounts distributed from a Coverdell Education Savings Account in same tax year but not for same expenses

Credit For Certain Retirement Plan Contributions

- Credit was enacted to encourage low and middle income taxpayers to contribute to qualified retirement plans
- Eligible contributions of up to \$2,000 qualify
- Credit rate depends on level of AGI and filing status
 - Maximum credit is \$1,000 ($\$2,000 \times 50\%$)
- To qualify, must be at least 18 years old and not a dependent of another taxpayer or a full-time student

If you have any comments or suggestions concerning this PowerPoint Presentation for West's Federal Taxation, please contact:

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