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
• 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
• 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% X credit X 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% x 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

• 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:
  \[
  \text{Foreign-source TI} \times \text{U.S. tax before credit} \\
  \text{Worldwide TI}
  \]
  = 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

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
• 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 X 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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