How To Make The Tax Code Work For You

By May 20, 2022, over 145 million taxpayers had dutifully filed their federal income tax returns. And they all made decisions about deductions and credits – whether or not they realized it.[1]

When you take the time to learn more about how it works, you may be able to put the tax code to work for you. A good place to start is with two important tax concepts: credits and deductions.

Keep in mind that the information in this material is not intended as tax or legal advice. It may not be used for the purpose of avoiding any federal tax penalties. Please consult legal or tax professionals for specific information regarding your individual situation.

Credits

As tax credits are usually subtracted, dollar for dollar, from the actual tax liability, they potentially have greater leverage in reducing your tax burden than deductions. Tax credits typically have phase-out limits, so consider consulting a legal or tax professional for specific information regarding your individual situation.

Here are a few tax credits that you may be eligible for:

- The Child Tax Credit is a federal tax credit for families with dependent children under age 17. The maximum credit is $2,000 per qualifying child, depending on your income level.[2]
- The American Opportunity Credit provides a tax credit of up to $2,500 per eligible student for tuition costs for four years of post-high-school education.[3]
- Those who have to pay someone to care for a child (under 13) or other dependent may be able to claim a tax credit for those qualifying expenses. The Child and Dependent Care Credit provides up to $4,000 for one qualifying individual or up to $8,000 for two or more qualifying individuals.[4]

Deductions

Deductions are subtracted from your income before your taxes are calculated, and thus, may reduce the amount of money on which you are taxed, and by extension, your eventual tax liability. Like tax credits, deductions typically have phase-out limits, so consider consulting a legal or tax professional for specific information regarding your individual situation.

Here are a few examples of deductions:

- Under certain limitations, contributions made to qualifying charitable organizations are deductible. In addition to cash contributions, you can potentially deduct the fair market value of any property you donate. And you may be able to write off out-of-pocket costs incurred while doing work for a charity.[5]
- If certain qualifications are met, you may be able to deduct the mortgage interest you pay on a loan secured for you primary or secondary residence.[6]
- Amounts set aside for retirement through a qualified retirement plan, such as an Individual Retirement Account, may be deducted. The contribution limit is $6,500, and if you are 50 or older, the limit is $7,500.[7]
- In most circumstances, once you reach age 73, you must begin taking required minimum distributions from a Traditional Individual Retirement Account (IRA) or qualified retirement plan. Withdrawals are taxed as ordinary income and, if taken before age 59½, may be subject to a 10% federal income tax penalty.
- You may be able to deduct the amount of your medical and dental expenses that exceed 7.5% percent of your adjusted gross income.[8]

Understanding credits and deductions is a critical building block to making the tax code work for you. But remember, the information in this article is not intended as tax or legal advice. And it may not be used for the purpose of avoiding any federal tax penalties.

FOOTNOTES

[1] IRS.gov, 2022
[2] Investopedia.com, June 24, 2022
[3] IRS.gov, 2023
[4] IRS.gov, 2023
[5] Investopedia.com, September 8, 2022
[6] Investopedia.com, November 30, 2022
[7] Investopedia.com, November 8, 2022
[8] IRS.gov, 2023

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