Module 7: REFUNDABLE CREDITS

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By the end of this module you will…

- Understand how refundable tax credits impact a taxpayer's return

- Understand the eligibility requirements and required forms for these refundable tax credits:
  - Earned Income Tax Credit
  - Additional Child Tax Credit
  - Premium Tax Credit

Refundable tax credits

Refundable Tax Credits

- A refundable tax credit is considered a payment made by the taxpayer.

- Refundable credits can reduce the tax liability to zero, pay for other taxes, and amounts greater than income tax are paid to the taxpayer as a refund.

- Taxpayers with no income tax who are eligible for refundable tax credits should file a return even if they are not required to file.

Refundable Tax Credit Example

- Jeremy has federal income tax of $2,600.
- Jeremy can claim a $2,000 nonrefundable Child Tax Credit and a $1,500 refundable Earned Income Tax Credit.
- The total amount of credits Jeremy qualifies for ($3,500) is higher than Jeremy's income tax ($2,600).
- Jeremy can claim the full amount of the Child Tax Credit, which reduces his tax liability.
- Jeremy can also claim the full amount of the Earned Income Tax Credit, which reduces his tax liability to $0 and pays the remaining $900 as a refund.

Additional Child Tax Credit

Additional Child Tax Credit

- Taxpayers who cannot use the maximum nonrefundable Child Tax Credit, may be able to claim the refundable Additional Child Tax Credit.
  - The Child Tax Credit is worth up to $2,000 per qualifying child as a nonrefundable credit.

- The Additional Child Tax Credit has a maximum value of $1,600 per qualifying child.

- Qualifications for the Additional Child Tax Credit and the definition of a qualifying child match the qualifications for the Child Tax Credit (covered in Module 6 Nonrefundable Credits).

- To claim the Additional Child Tax Credit, taxpayers must have more than $2,500 in earned income or have three or more qualifying children.

- To claim the credit, use Form 8812. This form collects information about income, tax liability, and the number of eligible children to figure the Child Tax Credit and Additional Child Tax Credit.

Earned Income Tax Credit (EITC)

Earned Income Tax Credit (EITC)

- The EITC is a tax benefit that can serve as a financial supplement for taxpayers with low to moderate incomes, particularly those individuals with children.
- The two main factors when calculating the EITC are income and family size.
- To claim the credit, use Schedule EIC. This form collects information about income and the number of eligible children to figure the amount of the credit.
  - Filers without qualifying children can claim the credit without Schedule EIC and report the credit directly on Form 1040.

EITC Maximum Credit

- The **maximum** amount of credit for the 2024 Tax Year is:
  - $7,830 with three or more children
  - $6,960 with two children
  - $4,213 with one child
  - $632 with no children

How a Taxpayer Qualifies for the EITC

In order to qualify for the Earned Income Tax Credit, an individual must meet all the following criteria:

- Have earned income in the tax year
- Been a citizen of the U.S. or a resident alien for the entire duration of the tax year
- Have a valid Social Security number for yourself, your spouse, and any qualifying child by the due date of your 2024 return (including extensions).
- Investment income cannot exceed $11,600.
- The taxpayer cannot use the MFS filing status (unless the taxpayer lived apart from their spouse for the last 6 months of the year and they have a qualifying child for the credit).
- The taxpayer cannot file Form 2555 – related to foreign income
- If no qualifying children:
  - For earlier tax years the individual must be at least 25 but less than 65
  - Can't be a dependent of another person
  - Can't be a qualifying child of another person
  - Must have lived in the United States more than half of the year

EITC Income Limts

For the 2023 tax year, the Earned Income and Adjusted Gross Income must not exceed the following thresholds.

- $59,899 ($66,819 married filing jointly) with three or more qualifying children;
- $55,768 ($62,688 married filing jointly) with two qualifying children;
- $49,084 ($56,004 married filing jointly) with one qualifying child;
- $18,591 ($25,591 married filing jointly) with no qualifying children

Qualifying Child Rules

Relationship

- The following will satisfy the relationship requirement.
  - Your son, daughter, adopted child, stepchild, foster child or a descendant of any of the previously stated relationships (e.g., your grandchild).
  - Your brother, sister, half brother, half sister, step brother, step sister or a descendant of any of them (e.g., a niece or nephew).

Age

- At the end of the filing year, your child was younger than you and younger than 19.
- At the end of the filing year, your child was younger than you, younger than 24 and a full-time student.
  - These dependents are still eligible for EITC – requires additional action in the tax software.
- At the end of the filing year, your child was any age and permanently and totally disabled.

Residency

- Your child must have lived with you for more than half of the year.

Joint Return

- The child can't file a joint return for the year

What Qualifies as Earned Income

- Earned Income is income you received from work.

- Income that is generated from interest, rental income, investment dividends, unemployment, worker's compensation and pensions will **not** count as earned income.

- The IRS defines the following as earned income:
  - Income earned as an employee (Form W-2)
  - Net Earnings from operating a business (Form 1099-NEC, 1099-K, and cash)
  - Union strike benefits qualify

Knowledge Check

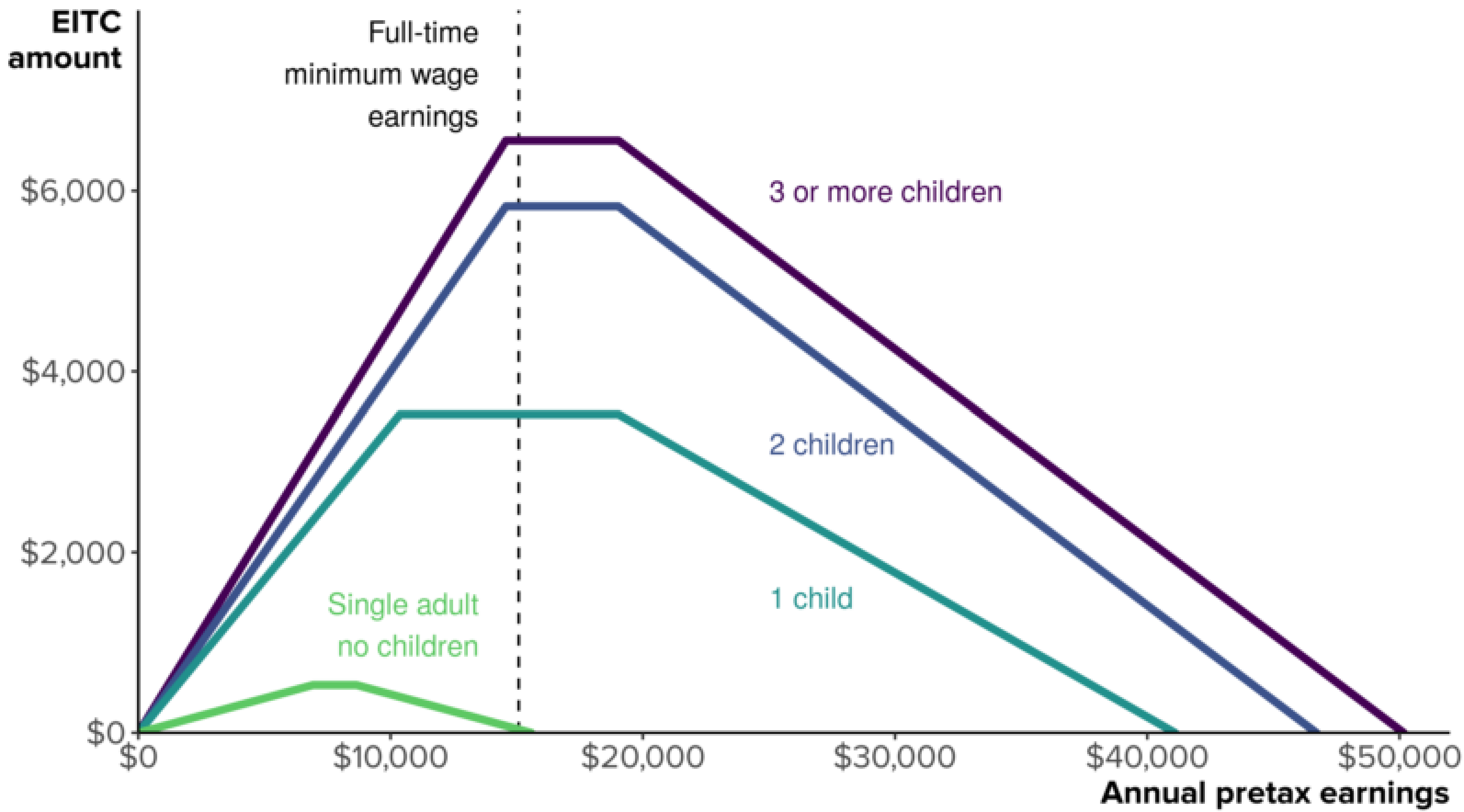
- David and Daniella Dunn are married and wish to file a joint return.
- David and Daniella earned $58,050 in combined wages, and they sold $8,500 worth of telephone company stock they inherited from David's mother, Ellen, to help them purchase a larger vehicle.
- They have eight-year-old triplets, Bryan, Brendon, and Brent.

Are they eligible to receive the Earned Income Tax Credit?

Answer: No, they are not eligible.

- Their investment income is below $11,000, so that's not the problem.
- Their earned income is $58,050, which is well below the earned income threshold for a married couple with three children, so that's not it.
- However, their earned income, when combined with their investment income, gives them an adjusted gross income (AGI) that exceeds the income limits required to claim EITC, even with three children.

EITC Bell Curve



Premium Tax Credit

Premium Tax Credit (PTC)

- The PTC is a refundable credit that certain taxpayers may receive to help them pay for health insurance through the Affordable Care Act (ACA).
- Advanced certification is required to prepare returns with this credit.
- Insurance is purchased either from the federal Health Insurance Marketplace or a state-based exchange.
- Qualified taxpayers receive subsidies to help them pay for their insurance; these subsidies are sent directly to the insurance provider, unless the taxpayer chooses to receive the assistance as a tax credit when filing the year's tax return, which rarely happens. The typical process is as follows:
  - The taxpayer signs up for insurance through the ACA Healthcare Marketplace or a state-based exchange, and estimates their total income for the coming year.
  - The Marketplace or exchange figures the amount of premium assistance the taxpayer should receive based on that estimate.
  - At tax filing time, taxpayers must reconcile their actual income with the estimate they made when they initially registered for health insurance.
  - If the taxpayer made less money than they expected, they may receive additional Premium Tax Credits that would have been paid to the insurer if the estimate had been on point.
  - If the taxpayer made more money than expected, the taxpayer may have to repay some or all of the premium assistance they received.

Who qualifies for the PTC?

- To qualify for the premium tax credit:
  - The taxpayer must not be eligible for employer-sponsored health coverage, coverage through a family member's employer sponsored coverage, or government provided coverage such as Medicare, Tricare, or CHIP.
  - The taxpayer must purchase health coverage either from a state-based exchange, or from the federally facilitated Marketplace in states that do not have their own exchanges.
  - The taxpayer's income should be between 100% and 400% of the federal poverty guideline amounts determined for their region and tax family size. See Publication 4012 for exact figures.
  - Taxpayers cannot be married filing separately, unless an exception for spousal abuse or abandonment applies.

Notes:

1. Taxpayers whose income is no more than 400% of their federal poverty guideline may not have to repay all of the premium tax credit this year.
2. When figuring the income used to calculate this credit, tax exempt interest and dividends and nontaxable social security are included. Also, choosing the Lump Sum Benefit Worksheet for reducing taxable social security does not affect the premium tax credit; for PTC purposes, all social security benefits received in the year, including those paid for prior years, are included in the income calculation.

Figuring the PTC

- The taxpayer should have one or more forms 1095-A showing, among other information:
  - Who is covered by the insurance policy
  - The cost of the taxpayer's insurance policy
  - The second lowest cost silver plan amount (used in figuring the correct amount of premium assistance)
  - The amount of premium assistance that has already been paid, and
  - The months that the person was insured.

- Form 8962 is used to figure the credit. It captures the information from Form 1095-A, and includes calculations to determine the amount of the credit the taxpayer should have received, and it figures the amount that needs to be repaid if excess assistance was provided throughout the year.

- If a Form 1095-A appears to be unusual, such as an amount being missing in Column A for a month, or if you have multiple forms 1095-A, see Publication 4012 for guidance on handling these and other unusual situations.

Caution: If a taxpayer's 1095-A includes the name of a covered individual who is not on the tax return you are preparing, or if the taxpayer has gotten married during the tax year and wishes to elect to use the alternative calculation for year of marriage, the return is out of scope.