

(Tax deduction vs. tax credit)

A tax deduction reduces your income that then lowers the tax you pay.

A tax deduction saves you the amount of the deduction multiplied by your tax rate (your tax bracket). A tax deduction is used BEFORE calculating your taxes.

Example: Your adjusted gross income is \$25,000 and you make a charitable contribution of \$1,000. Your taxable income (line 43) is \$24,000 and you would use the tax tables for this amount.

Tax Table: \$782.50 + 15% between \$7,825 and \$31,850. People say that you are in the 15% tax bracket.

Tax owed for \$25,000: $\$782.50 + .15(\$25,000 - 7,825) = \$3,358.75$

Tax owed for \$24,000: $\$782.50 + .15(\$24,000 - 7,825) = \$3,208.75$

If you are taxed at a 15% tax rate (you are in the 15% tax bracket) then you save \$150 on your taxes. You save 15% of the charitable contribution.

A tax credit reduces your taxes dollar for dollar. It is used AFTER you have figured out how much tax you owe.

Example: Your adjusted gross income is \$25,000 and you earn a tax credit of \$1,000. Your taxable income (line 43) is \$25,000 and you would use the tax tables for this amount.

Tax owed for \$25,000: $\$782.50 + .15(\$25,000 - 7,825) = \$3,358.75$

Apply tax credit: $\$3,358.75 - 1,000 = 2,358.75$ tax owed.

The credit is applied to the tax you owe and reduces it \$1,000. You save \$1,000 on your taxes. You save 100% of the amount.

a) Calculate your taxes if you are filing married filing jointly, have Adjusted Gross Income of \$75,000 and receive a tax DEDUCTION of \$2,500?

b) Calculate your taxes if you are filing married filing jointly, have Adjusted Gross Income of \$75,000 and receive a tax CREDIT of \$2,500?

	<u>Deduction</u>	<u>Credit</u>
Adjusted Gross Income	75,000	75,000
Deduction (reduces income)	<u>-2,500</u>	<u>0</u>
Taxable Income	<u>72,500</u>	<u>75,000</u>
Taxes owed	10,972.50	11,597.50
Tax credit (reduces taxes)	<u>0</u>	<u>-2,500</u>
Taxes owed	<u>10,972.50</u>	<u>9,097.50</u>

- a) Calculate your taxes if you are filing single, have Adjusted Gross Income of \$83,000 and receive a tax DEDUCTION of \$4,300?

- b) Calculate your taxes if you are filing single, have Adjusted Gross Income of \$83,000 and receive a tax CREDIT of \$4,300?

	<u>Deduction</u>	<u>Credit</u>
Adjusted Gross Income	83000	83000
Deduction (reduces income)	-4300	0
Taxable Income	<u>78700</u>	<u>83000</u>
Taxes owed	16146.75	17350.75
Tax credit (reduces taxes)	0	<u>-4300.00</u>
Taxes owed	<u>16146.75</u>	<u>13050.75</u>

Explain the difference between a tax deduction and tax credit. Write a problem using a tax deduction and solve.

Use the same information and solve the problem using the same amount as a tax credit.