KRAMER, JENSEN & BAGBY LLC
CERTIFIED PUBLIC ACCOUNTANTS

Kramer, Jensen & Bagby, LLC | 7430 E. Caley Ave. Suite 300E, Centennial, CO 80111
T 303-741-2253 | F 855-330-4215 | aaronb@kramerjensen.com | **kramerjensen.com**

Newsletter May 2024

Is It Better to Have a Tax Credit or a Deduction?

Article Highlights:

- Itemized Deductions
- Above-the-Line Deductions
- Business Deductions
- Asset-Sale Deductions
- Refundable Credits
- Nonrefundable Credits
- Carryover Credits
- Business Tax Credits

Tax Deductions – In one way or another, tax deductions reduce the taxable portion of an individual's income, which thus reduces the tax on that income.

Itemized Deductions – When taxpayers think of deductions, they typically think of the itemized deductions that are claimed on Schedule A. This is the only way to deduct personal expenses such as medical costs, state and local tax payments, investment and home-mortgage interest, charitable contributions, disaster-casualty losses, and various rarely encountered expenses. In some cases, itemized deductions are limited. For instance, medical expenses are only deductible to the extent they exceed 7.5% of the taxpayer's adjusted gross income (AGI). Similarly, state, and local tax payments (including those for income, sales, and property taxes) are capped at $10,000. On top of that, itemization only reduces taxable income to the extent that the total of the itemized deductions exceeds the standard deduction. When the sum does not exceed the standard deduction, the itemized deductible expenses provide no tax benefits at all.

In 2018 a law change nearly doubled the standard deduction amount, and each year since then only about 10% of taxpayers itemize their deductions because they find using their standard deduction provides a better tax benefit. The enhanced standard deduction is annually adjusted for inflation but only applies through tax year 2025 (unless extended by Congress). The standard deduction amounts for 2023 and 2024 are:

BASIC STANDARD DEDUCTION		
Filing Status	**2023**	**2024**
Single & Married Separate	$13,850	$14,600
Married Joint & Qualifying Surviving Spouse	$27,700	$29,200
Head of Household	$20,800	$21,900

Each taxpayer aged 65 and older, or blind, is allowed an **additional standard deduction amount**. When filing a joint return, the extra amount applies to each spouse who is at least 65 or blind. A taxpayer (or spouse) who meets the age requirement and is also blind, is entitled to double the extra amount. The additional amounts are:

- For 2023: $1,850 for single and head of household status; $1,500 for married (either joint or separate) and qualifying surviving spouse.
- For 2024: $1,950 for single and head of household status; $1,550 for married (either joint or separate) and qualifying surviving spouse.

Above-the-Line Deductions – Certain deductions reduce income even when a taxpayer is not itemizing. These are commonly called above-the-line deductions because, when applied, they reduce the income figure that is used to calculate AGI. Hence, the IRS titles these deductions “adjustments to income.” Their benefits apply regardless of whether the taxpayer uses itemized deductions. Above-the-line deductions include educators’ expenses; contributions to health savings accounts and traditional IRAs; deductible alimony payments (only for pre-2019 divorce agreements); and student-loan interest. Most of these deductions have annual maximums. In addition, several above-the-line deductions apply only to self-employed individuals. These are for self-employed health insurance costs, 50% of the self-employment tax, and contributions to certain types of retirement plans. Other, more obscure, above-the-line deductions are listed on **Form 1040, Schedule 1**.

Business Deductions – Taxpayers who operate noncorporate businesses can deduct from their business income expenses that they incur when operating their businesses. These deductions (which cover advertising fees, employee wages, office-supply costs, etc.) are used to reduce profits, which in turn reduces taxable income and, ultimately, income tax. In addition, most self-employed taxpayers pay Social Security and Medicare taxes on their net business income, so any reduction in their business profits also reduces their Medicare taxes and possibly their Social Security taxes.

While not deductible from business income and not an above-the-line deduction, an individual taxpayer may be able to deduct up to 20% of their “net qualified business income” (QBI) from a trade or business (including income from a pass-through entity such as a partnership or S corporation) when figuring their taxable income. This deduction is limited to 20% of taxable income, calculated before the QBI deduction, minus net capital gain.

Asset-Sale Deductions – An individual who sells an asset is allowed to deduct that asset’s cost from the sale price to determine the taxable profit. Good recordkeeping is helpful here because the original expense may have been incurred years prior, even though it is only deductible when the asset is sold. For example, any improvements that an individual makes to a home over years of ownership are not deductible until the home is sold. At that point, the individual can reduce the taxable gain from the sale by counting the improvements as part of the home’s cost.

Tax Credits – Tax credits come in several varieties, and the amount of benefit can vary:

Refundable Credits – A refundable credit offsets current tax liability; it is so called because any amount of unused credit is refunded to the taxpayer. Refundable credits include the Earned Income Tax Credit, the Additional Child Tax Credit, and the Premium Tax Credit (net of any advances received), as well as the American Opportunity Tax Credit (an education credit that is 40% refundable). As a matter of general interest, these credits are subject to significant filing fraud because of their refundability. The IRS also considers prepayments such as income tax withholding and estimated tax payments to be refundable credits.

Nonrefundable Credits – A nonrefundable credit only offsets tax liability; any unused amount is lost (unless it can be carried over to another year; see below). Over time, Congress has become more generous with credits; some credits that are not refundable may carry over for a given period. Nonrefundable credits (not a complete list) include the Saver’s Credit, Child and Dependent Care Credit, Lifetime Learning Credit, Residential Clean Energy Credit, Energy Efficient Home Improvement Credit, and Clean Vehicle Credit.

- **Exception**: For purchases in 2024 or later of vehicles eligible for the Clean Vehicle Credit taxpayers may elect to have the credit transferred to the dealer from whom they purchase the EV. The dealer will then lower the cost of the vehicle by the credit amount or require a reduced down payment. Effectively the taxpayer will be claiming the credit at the time of the purchase rather than waiting until filing their tax return for the purchase year and claiming the nonrefundable credit on it. If a taxpayer successfully transfers the credit to the dealer when purchasing the vehicle, and the amount of credit transferred exceeds the income tax on the taxpayer's return for the year of the purchase, the IRS has ruled that the taxpayer is not required to pay back the excess credit.

Carryover Credits – For some nonrefundable credits, any unused current-year credit can be carried over to the next tax year (or for a longer period) until the carryover amount is used up against a future year's tax. These credits include the Adoption Credit (which can carry over for up to five years) and the Residential Clean Energy Credit.

Business-Tax Credits – Numerous business-tax credits are available; however, they are grouped into the General Business Tax Credit, which is nonrefundable, but which carries forward for twenty years and back for one year. (This allows a business owner to amend the prior year's return to claim the credit.)

If you have questions related to how you might benefit from tax credits or deductions, please call this office.

Tax Facts about Claiming Tax Benefits for Childcare Expenses

Article Highlights:

- Credit For Childcare
- Credit Percentage
- Child Qualifications
- Employment-Related Expense
- Taxpayer Earnings Limits
- Full-Time-Student or Disabled Spouse
- Qualifying Care
- Other Facts and Issues
- Tactic for Maximizing Credit

Many parents who work or are actively looking for work must arrange for care of their children after the school day ends, on weekends when they get called in to work, and during school vacations. If you are in this situation, and your children requiring care are under 13 years of age (or any age if handicapped), you may qualify for a tax credit that can reduce your federal income taxes and help offset the cost of care for children. Don't confuse this credit with the Child Tax Credit; they are two separate credits with different requirements. This article is about the Child and Dependent Care Credit.

Basic Facts about Claiming the Childcare Credit

The Child and Dependent Care Credit [**http://www.irs.gov/taxtopics/tc602.html**] is available for expenses you incur that enable you to work or actively look for work. You must claim the qualifying child for whom you pay care expenses as your dependent to qualify to claim the credit, but there is an exception for divorced or separated parents (not discussed in this article).

The credit is the percentage of actual care expenses. It can be as high as 35% for lower income taxpayers but is never less than 20% for higher income taxpayers. The table illustrates credit percentages at various levels of adjusted gross income (AGI).

AGI Over	But Not Over	Applicable Percent	AGI Over	But Not Over	Applicable Percent
0	15,000	35	29,000	31,000	27
15,000	17,000	34	31,000	33,000	26
17,000	19,000	33	33,000	35,000	25
19,000	21,000	32	35,000	37,000	24
21,000	23,000	31	37,000	39,000	23
23,000	25,000	30	39,000	41,000	22
25,000	27,000	29	41,000	43,000	21
27,000	29,000	28	43,000	No Limit	20

For an expense to qualify for the credit, it must be needed for you and your spouse, if you are married, to work or be looking for work, and it must be for the care of your child, stepchild, foster child, brother, sister or stepsibling (or a descendant of any of these) who is under age 13, lives in your home for more than half the year and does not provide more than half of his or her own support for the year. Married couples must file jointly, and both spouses must work or be looking for work (or one spouse must be a full-time student or disabled) to claim the credit.

The qualifying expenses are limited to the income you or your spouse, if married, earn from work, using the figure for whoever earns less. However, under certain conditions, when one spouse has no actual earned income and that spouse is a full-time student or disabled, that spouse is considered to have a monthly income of $250 (if the couple has one qualifying child) or $500 (two or more qualifying children). This means the income limitation is essentially removed for a spouse who is a student or disabled.

The qualifying expenses can't exceed $3,000 per year if you have one qualifying child, while the limit is $6,000 per year for two or more qualifying persons. This limit does not need to be divided equally. For example, if you have paid and incurred $2,500 of qualified expenses for the care of one child and $3,500 for the care of another child, you can use the total, $6,000, to figure the credit. The credit is computed as a percentage of your qualifying expenses from the table above—in most cases, 20%. If the expenses exceed your work earnings, use the earnings to figure the credit. Dependent care benefits received through your employer will also affect the computation of the credit and could result in no credit being allowed.

- **Example**: Al and Janice both work, each with earned income more than $40,000 per year. Janice has a part-time job, and her work hours coincide with the school hours of their 11-year-old daughter, Susan. However, during the summer vacation period, they place Susan in a day camp program that costs $4,000. Since the expense limitation for one child is $3,000, their child credit would be $600 (20% of $3,000).

The credit reduces a taxpayer's tax bill dollar for dollar. Thus, in the above example, Al and Janice pay $600 less in taxes by virtue of the credit. However, the credit can only offset tax, and any excess is not refundable. The credit cannot be used to reduce self-employment tax or certain other taxes.

Here are some other facts and issues about the tax credit:

1. **Day Camps** – The costs of a day camp generally count as expenses toward the child and dependent care credit. A day camp or similar program may qualify even if the camp specializes in a particular activity, such as soccer or computers. The rule (see #4 below) that a dependent care center must comply with applicable state and local laws also applies to a day camp where more than six persons are cared for in return for a fee.
2. **Overnight Camp or Tutoring** – No portion of the cost of an overnight camp or a tutoring program is a qualified expense.
3. **School Expenses** – Only school expenses for a child below the level of kindergarten will qualify for the credit. But expenses paid for before- and after-school care of a child in kindergarten, or a higher grade are eligible, up until the child turns 13.
4. **Day Care Facility** – The expenses paid to the day care center qualify. If the day care

center cares for more than six persons, it must comply with applicable state and local laws.

5. **In-Home Care** – If your childcare provider is a "sitter" at your home, the sitter is considered your employee, and you may need to pay payroll taxes and file payroll returns.
6. **Records Required** – To claim the credit on your tax return, you will need to provide the care provider's name, address, and tax ID number. No credit is allowed without that information, except the tax ID number is not needed if the provider is a tax-exempt organization such as a church or school. You may run across care providers who are reluctant to provide their ID numbers because they don't plan on reporting their income and paying their taxes. Just remember, without the ID number, you cannot claim the credit. Be sure to obtain the required information before you pay the provider.
7. **ID Number Required -** You must include the name and taxpayer identification number (generally, the social security number) of each child or other qualifying person for whom you paid care expenses.
8. **State Childcare Credit** – Some states also allow a similar credit on the state income tax return. If your state is one of those, additional information, such as the care provider's phone number, may be required.
9. **Disabled Spouse -** This credit is also available if you are working and care for a spouse who is physically or mentally incapable of self-care.
10. **Ineligible Care Provider** – You can't include as eligible care expenses amounts you paid to a person that is your spouse, the parent of your qualifying individual if your qualifying individual is your child and under age 13, your child who is under the age of 19, or a dependent whom you or your spouse may claim on your return.
11. **Volunteer Work -** If you do unpaid volunteer work or work for a nominal salary, amounts you pay to a childcare provider while you volunteer are not eligible expenses for the childcare credit.

Tactic for Maximizing the Childcare Credit When Both Spouses are Involved in an Unincorporated Business

When both spouses in a married couple are jointly involved in the operation of an unincorporated business (generally a Schedule C), it is common – but incorrect – for all that business's income to be reported as just one spouse's income, even when they both work in the business.

In such cases, the spouse not taking credit for his or her portion of the earned income loses out on the chance to accumulate his or her own eligibility for Social Security benefits. In addition, and as noted above, to claim a child care credit, both spouses on a joint return must have earned income (or imputed income if one of the spouses is a full-time student or is disabled), so unless the spouse not including a portion of the income from the joint business has another source of earned income, the couple will not be allowed a child care credit.

There are ways to remedy this situation, however. One option is to file a partnership return for the activity, in which case each spouse will receive a K-1 form that reports his or her share of the net profit. An approach that avoids the necessity of filing a partnership return, and that is probably less complicated, is a qualified joint-venture election, in which each spouse elects to file a separate Schedule C for his or her respective share of the business. This gives them both self-employed income for the purposes of the self-employment tax and for claiming the childcare credit.

A qualified joint venture refers to any joint venture involving the conduct of a trade or business if:

1. The only members of the joint venture are husband and wife,
2. Both spouses materially participate in the trade or business, and
3. Both spouses elect to apply this rule.

Generally, to meet the material participation requirement, each spouse will have to participate in the activity for 500 hours or more during the tax year.

Note, however, that a business owned and operated by spouses through a limited liability company (LLC) does not qualify for the qualified joint venture election.
If the net income from the business exceeds the annual cap on income subject to the Social Security tax, the combined self-employment tax for the spouses with split Schedule Cs will

exceed what a single spouse would have paid if he or she had filed a single Schedule C.

An additional benefit when filing split Schedule Cs is the opportunity for both spouses to participate in IRAs and self-employed retirement plans.

For more information about how the childcare credit may affect your circumstances, please call this office.

Proving Noncash Charitable Contributions

Article Highlights:

- Noncash Charitable Contributions
- Establishing Donation Value
- Fair Market Value
- Documentation Requirements
- Appraisal Requirements

Tax legislation passed in late 2017 nearly doubled the standard deduction for years 2018 through 2025, and now about 90% of individuals filing a tax return are taking advantage of the higher standard amount and are not itemizing their deductions. For the 10% of filers still itemizing, one of the most common tax-deductible charitable contributions that can be claimed is the donation of household goods and used clothing to qualified charities.

The major complication of this type of contribution is establishing the dollar value of the item contributed as of the date of the contribution. According to the tax code, this is the fair market value (FMV), which is defined as the value that a willing buyer would pay a willing seller for the item.

FMV is not always easily determined and varies significantly based upon the condition of the item donated. For example, compare the condition of an article of clothing you purchased and only wore once to that of one that has been worn many times. The almost new one certainly will be worth more, but if the hardly worn item had been purchased a few years ago and had become grossly out of style, the more extensively used piece of clothing could be worth more. In either case, the clothing article is still a used item, so its value cannot be anywhere near as high as the original cost. Determining this value is not an exact science. The IRS recognizes this issue and, in some cases, requires the value to be established by a qualified appraiser.

Remember that when establishing FMV, any value you claim can be challenged by the IRS in an audit and that the burden of proof is with you (the taxpayer), not with the IRS. For substantial noncash donations, it might be appropriate for you to visit a local charity's thrift shop or even a consignment store to get an idea of the FMV of used items. Online research may be another way of determining the value if you can find a comparable item for sale. But be careful when using items being auctioned, since the starting price may not be the same as the final sale price.

The next big issue is documenting your contribution. Many taxpayers believe that the doorknob hanger left by the charity's pickup driver is sufficient proof of a donation. Unfortunately, that is not the case, as a United States Tax Court case (Kunkel T.C. Memo 2015-71) pointed out. In that case, the court denied the taxpayer's charitable contributions, which were based solely upon doorknob hangers left by the drivers who picked up the donated items for the charities. The court stated that "these doorknob hangers are undated; they are not specific to petitioners; they do not describe the property contributed; and they contain none of the other required information."

The IRS requires the following documentation for noncash contributions based on the total value of the donation:

- Deductions of Less Than $250 - When claiming a noncash contribution with a value under $250, you must keep a receipt from the charitable organization that shows:

    1. The name of the charitable organization,

2. The date and location of the charitable contribution, and
3. A reasonably detailed description of the property.

- **Note:** You are not required to have a receipt if it is impractical to get one (for example, if you left the property at a charity's unattended drop site).

- **Deductions of At Least $250 But Not More Than $500** - If you claim a deduction of at least $250 but not more than $500 for a noncash charitable contribution, you'll need to keep an acknowledgment of the contribution from the qualified organization. If the deduction includes more than one contribution of $250 or more, either a separate acknowledgment for each donation or a single acknowledgment that shows the total contribution is required. The acknowledgment(s) must be written and must include:

1. The name of the charitable organization,
2. The date and location of the charitable contribution,
3. A reasonably detailed description of any property contributed (but not necessarily its value), and
4. Whether the qualified organization gave you any goods or services because of the contribution (other than certain token items and membership benefits).

If the charitable organization provided you goods and/or services, the acknowledgement must include a description and a good faith estimate of the value of those goods or services. If the only benefit received was an intangible religious benefit (such as admission to a religious ceremony) that generally is not sold in a commercial transaction outside the donative context, the acknowledgment must say so, and in this case, the acknowledgment does not need to describe or estimate the value of the benefit.

- **Deductions Over $500 But Not Over $5,000 -** To claim a deduction over $500 but not over $5,000 for a noncash charitable contribution, you must attach a completed IRS Form 8283 to your income tax return and must have the same acknowledgement and written records that are required for contributions of at least $250 but not more than $500 (as described above). In addition, the records must also include:

1. How you obtained the property (for example, purchase, gift, bequest, inheritance, or exchange),
2. The approximate date you acquired the property or—if you created, produced, or manufactured the property—the approximate date when the property was substantially completed, and
3. The cost or other basis, and any adjustments to this basis, for property held for less than 12 months and (if available) the cost or other basis for property held for 12 months or more (this requirement, however, does not apply to publicly traded securities).

If you have a reasonable case for not being able to provide information on either the date the property was obtained or the cost basis of the property, you can attach a statement of explanation to the return.

- Deductions Over $5,000 – These donations require time-sensitive appraisals by a "qualified appraiser" in addition to other documentation. When contemplating such a donation, please call this office for further guidance about the documentation and forms that will be needed.

Caution: The value of similar items of property that are donated in the same year must be combined when determining what level of documentation is needed. Similar items of property are items of the same generic category or type, such as coin collections, paintings, books, clothing, jewelry, privately traded stock, land, and buildings. For example, say you donated $5,300 of used furniture to 3 different charitable organizations during the year (a bedroom set valued at $800, a dining set worth $1,000, and living room furniture worth $3,500). Because the value of the donations of similar property (furniture) exceeds $5,000, you would need to obtain an appraisal of the furniture to satisfy the substantiation requirements—even if you donated the furniture to different organizations and at different times during the year. The IRS has strict rules as to who is considered a qualified appraiser and the timing of when the appraisal is to be done.

To help you document some of these noncash contributions, you can download a fillable **Noncash Charitable Contribution Statement**. The statement includes an area for the charity's agent to verify the contribution and a check box denoting whether the qualified organization provided any goods or services because of the contribution. Although not specifically blessed by the IRS, this statement includes everything needed for noncash contributions of up to $500—provided, of course, that you and the charitable organization's representative accurately complete the form.

Do not include items of de minimis value, such as undergarments and socks in the deductible amount of your contribution, as they specifically are not allowed.

Please call this office with any questions about documenting or valuing your noncash contributions.

Thank you for selecting our firm for your tax and accounting needs. We appreciate the confidence you have shown in us, and we remain ready to assist you at any time.

Aaron Bagby
Kramer, Jensen & Bagby, LLC

VISIT OUR WEBSITE

SPREAD THE WORD
SHARE THIS EMAIL

Kramer, Jensen & Bagby, LLC
aaronb@kramerjensen.com

Share This Email as Webpage

KEEP UP ON THE LATEST
SIGN UP FOR OUR EMAILS