

Understanding Tax Credits for Individuals: Your Guide to Tax Savings

Tax credits provide dollar-for-dollar reductions in your tax bill, making them one of the most valuable tax benefits available. Understanding how these credits work can help you maximize your tax savings.

What Are Tax Credits?

Tax credits reduce the amount of income tax you owe, unlike deductions which reduce your taxable income. For example, a \$1,000 tax credit reduces your tax bill by exactly \$1,000, regardless of your tax bracket.

Nonrefundable vs. Refundable Credits:

Nonrefundable credits can reduce your tax liability to zero but cannot generate a refund. If the credit exceeds the tax you owe, the excess is lost. Refundable credits, however, can result in a refund even if you have no tax liability.

Key Nonrefundable Credits:

Education Credits:

The American Opportunity Credit provides up to \$2,500 per eligible student for the first four years of postsecondary education, calculated as 100% of the first \$2,000 plus 25% of the next \$2,000 of qualifying expenses. The Lifetime Learning Credit offers up to \$2,000 per tax return (20% of the first \$10,000 of qualifying expenses) for all years of postsecondary education. Both credits are claimed on Form 8863, though you cannot claim both for the same student in the same year.

Family-Related Credits:

The Child Tax Credit benefits taxpayers with qualifying dependents under age 17. The Credit for Other Dependents covers qualifying dependents who don't meet Child Tax Credit requirements. The Child and Dependent Care Expenses Credit (Form 2441) helps taxpayers who pay for daycare so they can work or attend school.

Energy and Vehicle Credits:

Several energy-related credits expire in 2025 or 2026. The Residential Clean Energy Credit (Form 5695) covers solar, wind, geothermal, or fuel cell property installed at a residence and expires December 31, 2025. The Energy Efficient Home Improvement Credit also expires December 31, 2025. The Clean Vehicle Credit for new plug-in electric vehicles expires September 30, 2025.

Retirement Savings:

The Retirement Savings Contributions Credit (Saver's Credit) on Form 8880 benefits low and middle income taxpayers who contribute to retirement plans.

This information is provided to you by Arrowhead Tax Service. We make every effort to provide honest and accurate tax information. Please use your discretion before making any decisions based on the information provided, every tax situation is different. If you have any questions, please visit our office or call us at 937-543-5770.