



Tax Tips You Can Use Sept 2008

THE BASIC'S – THE EARNED INCOME TAX CREDIT

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Tax credits are a method our government uses to influence taxpayer behavior. A credit is a reduction of the actual tax that a taxpayer owes. Last month we talked in general about the different types of credits. In the next few months, the articles will discuss some specific credits. This month, the subject is the earned income credit, because it is a credit that may be debated during the presidential campaign.

The earned income credit is different from other credits because it is not first used to lower the income tax due. It is directly considered a payment like the estimated payments or like the withholding that was taken from wages. So it reduces the total tax bill like those other payments and is refunded if not needed to satisfy tax debt.

The earned income credit (EIC) is controversial because the government is giving away money. The credit is meant to give a financial boost to the working poor. The credit is available to very low wage people without children and the amount and wage limit increases with the first child and the second child. The amount of the credit is calculated on a bell curve. At zero wages, there is zero credit; at middle wages, the credit is maximum; and at higher wages the credit decreases to zero. In a practical example, in 2007, if a single mom with two small children made \$3025 wages at her part time job, she would get a credit of \$1210 as a refund from her tax return. If she increased her hours and made \$12000 wages, her credit would be \$4716. If she got a better job and made \$35000 in wages, her credit would be \$1002 and, finally, if she got a promotion and made \$38000 in wages her credit would be zero. The most wages that a taxpayer with no children could make in 2007 and still receive any amount of EIC was \$12590. A single taxpayer with one child had zero EIC at \$33241 and with two children the limit was \$37783 in 2007.

The EIC can be a tremendous boost for a struggling family, but is prone to abuse. One loophole that the IRS closed several years ago was a single taxpayer that would find a non-working companion with several children and claim the companion and the children on his/her return. That would qualify the taxpayer for a big earned income credit because of the children. The IRS now requires the any child used for EIC be a blood relation, adopted child or state directed foster child.

The earned income credit is for working families. The amount of the credit is based on the wages or self-employment income a person earns. Income from investments does not count and can disqualify a taxpayer from the program. Income from disability, pensions or social security does not count. With the size of the credit, one can understand why many people run out to have their taxes done as soon as the W-2 hits the mailbox.

Two other credits that are important for families are the child tax credit and the education credit. Those will be discussed next month.

The fine print is that this article is for information only. Please call Kathy or a tax professional for questions about your individual tax situation. The Jacksonville Tax Lady can be reached at 541-899-7926 or at 610 North Fifth Street.

