TAX Q&A

Are scholarships and grants subject to federal income tax?

That depends on several factors. If you are a candidate for a degree at an educational institution and receive a qualified scholarship or fellowship that you use for tuition, fees, and required expenses (e.g., books, supplies, and equipment), you need not include the scholarship amount in your taxable income. (Note: the IRS has provided specific guidance regarding the definitions of educational institution and degree candidate.) However, if your scholarship includes money for room, board, and other incidentals, those dollars are taxable. If you are not a candidate for a degree, your entire scholarship is taxable. If you receive a grant in exchange for performing required services for the school (e.g., working as a teaching assistant), the amount of the grant is generally taxable. Note: Different rules may apply to tuition reductions and reimbursements.

How long should I keep copies of my tax returns?

Generally, you should keep your tax returns and supporting information (i.e., receipts, W-2 forms, bank statements) for six to seven years. The IRS has three years to audit a return, or two years after you have paid the tax, whichever is later. However, if income was underreported by at least 25%, the IRS can look back six years, and there is no time limit for fraudulent tax returns.

Can I take the credit for the elderly or disabled?

This federal income tax credit is available if you are a qualified individual and your income falls within specified limits. You are a qualified individual if you are either (1) age 65 or older at the end of the tax year or (2) are under age 65 and retired on permanent and total disability. You must also be a U.S. citizen or resident to qualify for the credit. If you are married, you and your spouse must file a joint tax return to qualify. However, if you and your spouse lived apart for the entire year, you have the option of filing either a joint return or separate returns. Qualifying on the basis of age is straightforward. To qualify as disabled, though, you should note that the IRS considers you retired on disability as of the date you stopped working because of your disability. You are considered permanently and totally disabled if (1) you can't engage in any substantial gainful activity due to either your physical or mental condition and (2) the condition has lasted or will last for a continuous period of not less than one year (or is expected to result in death). You should obtain a physician's statement certifying your disability. To qualify for the credit, you must also meet income requirements. Your income and nontaxable Social Security (or other nontaxable pension) must fall below specified amounts that vary with your filing status. For more information, see Schedule R of your Form 1040.

If I prepay next year's taxes this year, can I deduct them this year?

It depends. Sometimes real estate taxes are prepaid. If you are the property owner, you can generally deduct prepaid real estate taxes in the year of the prepayment if (1) you are a cash basis taxpayer, (2) the taxes were assessed in the year they were paid, and (3) you don't live in a jurisdiction where the taxing authority considers prepayment a "deposit." Jurisdictions vary regarding how they treat prepaid tax. Be aware that taxes placed in escrow generally aren't deductible until they are paid to the taxing authority. Remember, the TCJA limits state and local tax deductions on Schedule A to $10,000 per year. It may not benefit you to prepay taxes if you are already over the $10,000 limit.

What is the difference between the child tax credit, the family tax credit, and the child and dependent care tax credit?

These credits are quite different. First, the child tax credit: The purpose of this credit is simply to provide tax relief for parents, working or not, who have qualifying children under the age of 17. A qualifying child may be a dependent child, stepchild, adopted child, sibling, or stepsibling (or descendant of these individuals), or an eligible foster child.

The child must be a U.S. citizen or resident with a valid Social Security Number and must live with you for more than half the year. The family tax credit provides relief for dependents who did not have gross income in excess of certain amounts for that year. Generally, these dependents will be qualifying children who are older than the child tax credit age or qualifying relatives, such as dependent parents, stepparents, grandparents, siblings, aunts, uncles, and in-laws. Your dependent must be a U.S. citizen or resident.

A qualifying dependent is not required to have lived with you, but is someone who received more than half of his or her financial support from you over the year. If you're eligible, you may be able to take a credit on your federal income tax return of up to $2,000 per child for the child tax credit and$500 for the family tax credit.

These credits begin to phase out if your modified adjusted gross income (MAGI) exceeds a certain level. The child and dependent care tax credit offers relief to working people who must pay someone to care for their children or other dependents. You may qualify for a tax credit equal to 20% to 35% of expenses incurred when someone cares for your dependent child (under age 13), your disabled spouse, or your disabled dependent so that you (and your spouse, if married) may work or look for work. The work-related expenses you can use when figuring the credit are limited to $3,000 for one qualifying individual and $6,000 for more than one qualifying individual.

For married persons to qualify for the credit, both spouses must work outside the home, or one must work outside the home while the other is a full-time student, is disabled, or is looking for work (provided that the spouse looking for work has earnings during the year). Married couples must also file a joint income tax return. The credit is also available if you're a single parent or a divorced custodial parent.

What is the earned income credit, and who qualifies for it?

The earned income credit (EIC) is a refundable tax credit available to certain low-income individuals who have earned income, meet adjusted gross income thresholds, and do not have more than a specified amount of disqualified income (excess investment income). If you file a federal tax return and meet all applicable requirements, your income tax (if any) will be reduced, and you might receive a refund.

To qualify for the EIC, you must meet all of the following requirements:

- Must have earned income
- Tax return must cover a full 12 months (unless a short period is filed due to taxpayer's death)
- Filing status cannot be married filing separately

- Cannot be a qualifying child of another taxpayer
- Must not have filed forms related to foreign earned income; and
- Must have no more than $11,600 of disqualified income (stock dividends, rental income, inheritance, etc.);

In addition, special rules will apply to taxpayers who have qualifying children and to taxpayers who do not have qualifying children. If you are eligible to claim the EIC and have at least one qualifying child, you can receive part of your credit in your paycheck during the year, rather than all at once at tax time. This is known as the advance EIC. However, several requirements apply. For more information, consult a tax professional.

Where is my income tax refund?

If you electronically filed your tax return more than four weeks ago, you may want to check on the status of your refund. There is a link on the IRS website, irs.gov, "Get Your Refund Status". Click on this link, and it will walk you through the steps to obtain the status of your refund. To obtain your refund status, you will need your Social Security Number or ITIN, your filing status, and the exact refund amount from your return. Remember, you will typically receive your refund sooner if you choose to have the refund directly deposited into your bank account as opposed to receiving a check in the mail.

Planning for Tax Changes

April is a good time to consider strategies to help you reduce your tax bill. The best way to begin is by pulling out the prior year's tax return, along with your current pay stubs and account statements. Doing a few quick projections will help you estimate your present tax situation and identify any concerns to address while there's still time remaining in the year.

Get your withholding on track

Every employer withholds a certain amount from your paycheck for taxes, and what they withhold is based on information that you give them. With the new tax law, the amount that is being withheld from your paycheck has likely changed. Make sure that amount is reflective of your current tax situation and that you check your withholdings each year. Or you may have other changes in your situation that will cause the current year tax to be more than the prior year. In that case, ask your employer to increase your federal income tax withholding amounts. Changing withholding now can help you avoid possible penalties for under-withholding. On the other hand, if you often get a large refund or expect to see one this year because of a change in your income, you may want to reduce your withholding accordingly. That will put money in your pocket now, and you won't have to wait for your refund check to come next year. See a CPA for assistance with this calculation to ensure you have accounted for potential changes. The W-4 form you fill out to determine taxes withheld from your paycheck had a major overhaul as of 1/1/2020. Most employers and their HR departments will not assist employees with filling out the Form W-4. Contact your CPA for help with this form. The IRS replaced the withholding calculator with its new Tax Withholding Estimator. This can be a helpful tool to review withholding.

Give gifts that give back

If you itemize your deductions, bunch contributions, taxes, etc., into years that allow you to exceed the standard deduction. Consider donating money or property to charity to increase the amount you can deduct on your taxes. If you donate an appreciated asset, you won't have to pay tax on the gain and, in most circumstances, you will be able to take a deduction for the market value of the property. Donating appreciated property, however, is more complex than making cash donations. You will want to see your CPA prior to donating appreciated property to make sure you do not lose any of the tax benefits available.

Postpone the inevitable

To reduce your taxable income during the year, consider maximizing pretax contributions to an employer-sponsored retirement plan, such as a 401(k). You won't be taxed on the contributions you make now, and you may be in a lower tax bracket when you do eventually withdraw the funds and report the income. If you qualify, you might also consider making either a tax-deductible contribution to a traditional IRA or an after-tax contribution to a Roth IRA. In the first instance, a current income tax deduction effectively defers income—and its taxation—to future years. In the second, while there's no current tax deduction allowed, qualifying distributions you take later will be tax-free. You'll generally have until the due date of your federal income tax return to make these contributions.

Contact your CPA before making any major financial decisions

It is too late to do tax planning after a transaction has been completed. When it comes to major business decisions, sales of real property, or investing in a new activity, it is always wise to contact your CPA before you finalize the transaction. This could save you money and prevent you from losing any tax advantages that may be available.