Tax Deductions and Credits to Consider for Tax Season 2021

The closest things to "magic words" when it comes to taxes are *deductions* and *credits*. Both help you keep more money in your pocket instead of Uncle Sam's, but they do so in slightly different ways!

Tax deductions help lower how much of your income is subject to federal income taxes. Some deductions are only available if you choose to itemize your deductions, while others are still available even if you decide to take the standard deduction.

Meanwhile, tax credits lower your actual tax bill dollar for dollar, and there are two types of credits: *refundable* and *nonrefundable*. If a credit is greater than the amount you owe and it's a refundable credit, the difference is paid to you as a refund. Score! But if it's a nonrefundable credit, your tax bill will be reduced to zero, but you won't get a refund. That's still great!

Here are some deductions and credits you might be able to claim on your 2020 tax return:

1. Charitable Deductions

If you like to give like no one else, we have some great news! In an effort to encourage more charitable giving, the CARES Act allows you to deduct up to **100%** of their adjusted gross income (AGI), which is your total income minus other deductions you have already taken, in qualified charitable donations if you plan to itemize their deductions.[3]

What if you're taking the standard deduction? Well, the CARES Act added a new "above-the-line" deduction that will help you write off up to $300 of charitable contributions you made in cash.[4]

2. Medical Deductions

If you spent a lot of time in the hospital or found yourself with some hefty medical bills last year, you might be able to find at least some tax relief.

You can deduct any medical expenses above **7.5%** of your adjusted gross income (AGI), which is your total income minus other deductions you have already taken.[5] For example, if your AGI was $100,000, you can deduct out-of-pocket medical expenses *above* $7,500 in 2020. But you have to itemize your deductions in order to write off those expenses on your tax return.

3. Business Deductions

If you're self-employed, there are a bunch of deductions you can claim on your tax return—including travel expenses and the home office deduction if you use a part of your home to conduct business.[6]

But if you're one of the millions of workers who were sent home to work remotely, you won't be able to claim the home office deduction since it's reserved for self-employed individuals *only.* Sorry!

4. Earned Income Tax Credit

The EITC is a refundable credit designed to help out low- and middle-income workers (workers earning up to **$56,844** during the 2020 tax year might be eligible).[7] Depending on your income, your filing status and how many children you have, the credit could save you anywhere from a few hundred to a few thousand dollars on your taxes. But here's a crazy stat: About one out of five taxpayers who are eligible either don't claim the benefit on their taxes or don't file a tax return at all.[8] Don't let that be you!

5. Child Tax Credit

Got kids? Families can **claim up to $2,000** per qualified child with this tax credit (the income limits for this credit are $200,000 for single parents and $400,000 for married couples). And since this is a refundable credit, your family can receive up to $1,400 per child as a refund.[9]

And there are plenty of other deductions and credits that might be up for grabs depending on your situation! If you don't want to miss out on any tax savings, you'll want to work with a tax advisor who can make sure you're not leaving any deductions or credits on the table.

The Coronavirus and Your Taxes

Oh, so you thought you were done with the coronavirus now that it's 2021? Unfortunately, the coronavirus (and the government's response to it) has created a ripple effect that will be felt when you sit down to file your taxes for last year. Here are some things to keep in mind:

Stimulus Checks

As part of the Coronavirus Aid, Relief, and Economic Security (CARES) Act's $2 trillion relief package, the government sent up to $1,200 in the form of a stimulus check to millions of Americans shortly after the pandemic shut most of the country down.[10]

The good news is your stimulus check **will *not* count** as taxable income. Instead, it's being treated like a refundable tax credit for 2020. Translation:

Your stimulus check is sort of like an advance on money you would have received anyway as part of your tax refund in 2021.

Paycheck Protection Program (PPP) Loans

The CARES Act also tried to help struggling small business owners stay afloat by offering them Paycheck Protection Program (PPP) loans. As long as these loans were used on certain business expenses—payroll, rent or interest on mortgage payments, and utilities, to name a few—these loans were designed to be "forgiven."[11]

But heads up, small business owners: The IRS says that any expenses you paid with money from those PPP loans *cannot* be deducted from your taxable income.[12] Plus, you'll have to get your loan forgiveness application approved by the Small Business Administration before you're off the hook for the amount you borrowed. But since the SBA is processing the applications for $525 billion in loans given to 5.2 million borrowers at the speed of a sloth wearing ankle weights, we don't recommend holding your breath.[13]

Unemployment Benefits

Many Americans found themselves out of work (at least temporarily) after the pandemic shut down a large part of the economy and turned to unemployment insurance for help. Those who received unemployment benefits **will need to pay income taxes** on that money.[14]

If you chose *not* to have taxes withheld from your benefits when you signed up, then you'll either have to pay quarterly estimated taxes or set aside enough money from your unemployment benefits to pay your taxes come Tax Day.

Educational Expenses: 529 Plans and ESAs

Any money you take out of a 529 plan or Educational Savings Account (ESA) *must* be used for qualified educational expenses in order to be tax-free. Makes sense. But a lot of schools went remote or cancelled classes this year—which means your college might have refunded some or all of your 529 or ESA money. If that's the case, you have 60 days to put the money back in the account or use it to cover other educational expenses. If you didn't, you might have to pay income taxes and a withdrawal penalty.[15]

There are also a couple of new ways you can use 529 plans in 2020 without having to pay any taxes. First, you can now use 529 plans to pay for the costs of certain apprenticeship programs—including fees, books and supplies. And second, you can also use money from a 529 plan to pay off up to $10,000 in student loan debt (that's $10,000 *total*—not annually) without having to pay any penalties or taxes.[16]

Retirement Plans: 401(k)s, IRAs and More

There were *a lot* of changes to retirement plans in 2020—and some of those changes could impact your tax bill this year. Let's tackle each of those major changes:

- The CARES Act allows folks **under age 59 1/2** to take up to $100,000 out of their **401(k)s and IRAs** up until the end of 2020 without having to pay an early withdrawal penalty.[17] But first, taking money out of your retirement accounts before retirement is a *terrible* idea—penalty or not. Second, the money you take out of tax-deferred retirement accounts like a traditional 401(k) or IRA will be taxed as ordinary income, so get ready to pay taxes on any withdrawals you make.

- If you own a traditional IRA, you *have* to take money out of your account once you reach a certain age. Those withdrawals are called **required minimum distributions (RMDs)**. The good news is the SECURE Act pushed back the age for RMDs from traditional IRAs from 70 1/2 to 72 (if your 70th birthday was July 1, 2019 or later).[18] On top of that, the CARES Act allows seniors to skip RMDs altogether in 2020 without penalty. That's huge, because it could lead to significant tax savings for retirees with those accounts since the money that's taken out of a traditional IRA counts as taxable income.

- The SECURE Act also allows owners of **traditional IRAs** to keep putting money in their accounts **past age 70 1/2** starting in 2020.[19] Since the money you put into a traditional IRA is tax deductible, you could lower how much of your income is taxed this year. Just remember: You will have to pay taxes on that money whenever you take it out.