

Tax Credits vs. Tax Deductions

Definitions:

- **Taxable income** is the income level at which the individual(s) will be taxed.
- **Tax liability** is the amount of tax an individual pays on their income.
- A **tax deduction** reduces the individual(s) taxable income. This leads to an indirect reduction in taxes.
- A **tax credit** on the other hand directly reduces the individual(s) tax liability.

Let's look at an example to help illustrate the difference between these two terms.

Lets assume that an individual is in the 25% tax bracket. A \$500.00 **tax deduction** will decrease the individual(s) **taxable income** by \$500.00 and so they will not have to pay tax on this \$500.00. Since they normally would have paid tax on 25% of this income, they will now save that 25%, which is equal to \$125.00. So in this case the individual pays \$125.00 less in tax.

On the other hand a tax credit would save the individual a full \$500.00 in taxes. It is easy to see that a tax credit is almost always more preferable than a tax deduction.

Arizona offers many tax credits to individuals. One that is very beneficial is the school tax credit. This **credit** gives individuals the opportunity to donate up to \$250.00 to the public school of their choice and directly reduce their state **tax liability** by the same amount. Money used to pay for your child's sports or band expenses, can be counted towards the donation. In essence, the donation doesn't really cost a dime. There are a few restrictions to this **credit**, but it is beneficial to the majority of individuals.

If you have any questions about this tax credit, any other tax issues or tax planning questions, please feel free to give The Ruboyianes Company a call.