11 Tax Breaks for the Middle Class

Tax breaks aren't just for the rich. There are plenty of them that are only available to middle- and low-income Americans.

If you believe that tax breaks are only available for hedge fund managers and companies with offshore subsidiaries, you're probably paying too much to the IRS. The fact is that l**awmakers have enacted dozens of tax incentives targeted at middle- and lower-class families.** If you're not taking full advantage of them, it's probably because you're not aware of them.

Take a look at these 11 tax breaks for ordinary Americans and make sure you're not missing out. Some of these deductions and credits can literally save you thousands of dollars. That's a nice chunk of change that you don't want to pass up.

1. Zero Tax on Capital Gains

For most people, long-term capital gains (and qualified dividends) are taxed at 15% or 20%—a bargain by historical standards.

That's why some people get so exercised about a rule that allows hedge-fund managers to pay tax at the capital-gains rate rather than at rates for ordinary income, which top out at 37%.

But investors with lower taxable incomes pay no tax at all on their capital gains and dividends. That could be a boon to retirees, who have a higher standard deduction than younger taxpayers and who are not taxed on some or all their Social Security benefits, and the unemployed, who may have had to tap their investments to make ends meet.

To take advantage of the 0% capital-gains rate on your 2020 tax return, your taxable income can't exceed $40,000 if you are single; or $80,000 if you are married filing jointly in that year. Note that this is taxable income. That's what's left after you subtract itemized deductions or the standard deduction from your adjusted gross income. For 2021 returns, the 0% rate for long-term gains and qualified dividends applies for taxpayers with taxable income under $40,400 on single returns and $80,800 on joint returns.

2. Get Paid (More) for Working

The government provides an incentive for people to work: The **Earned Income Tax Credit.**

For 2020 tax returns, the maximum EITC ranges from $538 to $6,660 depending on your income and how many children you have. (For 2021 returns, the range will be $543 to $6,728.) This program, originally conceived in the 1970s, has been expanded several times, and some states (and even municipalities) have created their own versions.

Part of what makes it popular: When the federal EITC exceeds the amount of taxes owed, it results in a tax refund—a check back to you. In essence, you're no longer a taxpayer. But, you have to act to claim the credit by filing—a step many don't take.

The income limits on this program are fairly low. If you have no kids, for example, your 2020 earned income and adjusted gross income (AGI) must each be less than $15,820 for singles and $21,710 for joint filers. (For 2021, those income limits rise to $15,980 and $21,920, respectively.) If you have three or more kids and are married, though, your 2020 earned income and AGI can be as high as $56,844 ($57,414 in 2021). The exceptions are considerable—more complicated than we can list here—but the Center for Budget and Policy Priorities has a handy online calculator to help you determine eligibility.

3. Breaks for Saving for Retirement

Anyone with earned income (meaning income from work rather than investments) can contribute to a traditional IRA, but not everyone who contributes can claim a tax deduction. That's a no-no for the rich if they're covered by a retirement plan at work.

Here's how the deduction rules operate for traditional IRAs: First, there's a limit on how much you can contribute each year—$6,000 for 2020 ($7,000 if you'll be at least 50 years old by the end of the year) or 100% of your earned income, whichever is less. The limits are the same for 2021.

If you're not enrolled in a 401(k), 403(b) or another workplace retirement plan, including pension plans, you can deduct your IRA deposits no matter how high your income. But if you're enrolled in such a plan, the right to the IRA deduction is phased out as 2020 income rises to $65,000 and $75,000 for singles and between $104,000 and $124,000 for couples. (For 2021, the deduction phases out for income between $66,000 and $76,000 for singles and $105,000 to $125,000 for couples.) The limits only apply if one spouse participates in an employer plan. If neither does, there are no income limits for taking a deduction.

Spouses with little or no earned income can also make an IRA contribution of up to $6,000 ($7,000 if 50 or older) as long as the other spouse has sufficient earned income to cover both contributions. (The 2021 values are also $6,000 and $7,000.) For 2020, the contribution is tax-deductible as long as income doesn't exceed $196,000 on a joint return. You can take a partial tax deduction if your combined income is between $196,000 and $206,000. (For 2021, the contribution is tax-deductible as long as income doesn't exceed $198,000 on a joint return; you can take a partial tax deduction if your combined income is between $198,000 and $208,000.)

4. Save and Be Credited

If you are single and have 2020 adjusted gross income of $32,500 or less, or you are married and have AGI of $65,000 or less, you can make out even better on a retirement contribution through the **Saver's Tax Credit**. (The income limits rise to $33,000 for singles and $66,000 for couples in 2021.)

The credit is a potential bonanza for part-time workers who fall within the income limits. You can claim a tax credit worth 10%, 20% or 50% of the first $2,000 ($4,000 for joint filers) you put in—that means a credit of up to $1,000 ($2,000 for joint filers). The lower your income, the higher the percentage you get back via the credit. Contributions to a workplace plan, such as a 401(k) or 403(b), as well as contributions to a traditional, Roth or SEP IRA, are eligible for this credit.

People with disabilities who have an ABLE account can also take advantage of the Saver's Credit. Contributions to these accounts qualify for the credit, so long as they're from the designated beneficiary.

Some key exceptions: Taxpayers under age 18, full-time students and those claimed as dependents on their parents' returns are not eligible, regardless of their income.

And here's the beauty of a credit compared with a deduction: While deductions reduce the amount of your income that can be taxed, credits reduce the amount of tax you owe—dollar for dollar. You'll need to submit [IRS Form 8880].

5. Your Child, Your Credit

With a new baby also comes a **$2,000 child tax credit to lower- and middle-income earners,** and this is a gift that keeps on giving every year until your dependent son or daughter turns 17.

You get the full $2,000 credit no matter when during the year the child was born (which is why people make gags about rushing deliveries as the New Year approaches).

Unlike a deduction that reduces the amount of income the government gets to tax, a credit reduces your tax bill dollar for dollar. So the $2,000-per-child credit will reduce your tax bill by $2,000. The credit begins to disappear as income rises above $400,000 on joint returns and above $200,000 on single and head-of-household returns—although there's no limit to how many kids you may claim on a return, as long as they qualify. And for some lower-income taxpayers, the credit is "refundable" (up to $1,400 per qualifying child), meaning that if it's worth more than your income tax liability, the IRS will issue you a check for the difference, as with the EITC.

6. Get Credit for That Child's Care

You may also qualify for a tax credit that will reduce the cost of childcare. If your children are younger than 13, you're eligible for a 20% to 35% credit for up to $3,000 in child-care expenses for one child or $6,000 for two or more. The percentage decreases as income increases. Eligible expenses include the cost of a nanny, preschool, before- or after-school care and summer day camp.

Another way to reduce child-care expenses is to participate in your employer's **flexible spending account for dependent-care expenses.** With these accounts, money is deducted from your gross salary before income, Social Security and Medicare taxes. **You can contribute up to $5,000 per year.**

You can't claim the child-care credit for expenses covered by a flexible spending account. In general, families that earn more than $43,000 will save more with a flexible spending account, says Laurie Ziegler, an enrolled agent in Saukville, Wis. However, even then, you may be able to use the child-care credit to offset expenses not covered by your flex account. If you paid for the care of two or more children and contributed the maximum, you can use the dependent-care credit to cover up to an additional $1,000 in child-care costs.

7. Get Credit for Dependents (When They're No Longer Kids)

If you claim someone other than a child as a dependent (say, an elderly parent or a kid off to college), you can get a $500 tax credit for each of them.

Like the child-care credit, the **Credit for Other Dependents** begins to disappear as income rises above $400,000 on joint returns and above $200,000 on single and head-of-household returns—although there's no limit to how many dependents you may claim on a return, as long as they qualify. Whom can you claim as a dependent? It, well, depends, but the IRS has a helpful tool to guide you through the qualifications.

8. American Opportunity Credit

This tax credit is available for up to **$2,500 of college tuition and related expenses** (but not room and board) paid during the year. The full credit is available to individuals whose modified adjusted gross income is $80,000 or less ($160,000 or less for married couples filing a joint return). Single taxpayers with MAGI above $90,000 and married couples with MAGI above $180,000 are ineligible for the credit.

The American Opportunity Credit covers all four years of college. And if the credit exceeds your tax liability (whether derived from the regular income tax or the alternative minimum tax), up to 40% of it is refundable. For example, suppose you owe $1,900 in federal taxes and qualify for the full credit. The nonrefundable portion of the credit will reduce your tax bill to $400, and the first $400 of the refundable portion will lower your bill to zero. You'll receive the remaining $600 as a tax refund.

9. Lifetime Learning Credit

If you want to get additional education—for virtually any reason and at virtually any school—**you can tap the Lifetime Learning Credit.** The credit is calculated as 20% of up to $10,000 of qualified expenses, so you can get back as much as $2,000 per year.

For 2020, the income limits for the Lifetime Learning Credit are $69,000 if single and $138,000 if married ($69,000 and $139,000 for 2021), and you can't claim both this credit and the American Opportunity Credit for the same student in the same year. Also, no double dipping allowed: Expenses paid with funds from other tax-favored tuition programs, such as a Coverdell ESA, don't count when figuring either credit.

10. More Education Breaks for Middles

If neither the American Opportunity Credit nor the Lifetime Learning Credit works for you, there are still other ways the government offers favorable tax treatment for learning—and limits the breaks to the middle class and below.

For example, if you paid college tuition for yourself, your spouse or a dependent, you may be able to deduct up to $4,000 in college tuition and fees. To qualify for the full deduction, your adjusted gross income must be $130,000 or less if married filing jointly ($65,000 or less if single). You can deduct up to $2,000 in tuition and fees if your joint income was $160,000 or less ($80,000 or less if single). There is no deduction if you earn more than that. You don't need to itemize to qualify. (Unless Congress extends it, this deduction expires at the end of 2020.)

Did you take out a student loan? **You can deduct up to $2,500 of interest paid on the loan each year,** so long as your 2020 modified adjusted gross income (MAGI) is less than $85,000 ($170,000 if filing a joint return). The deduction starts to phase out at a MAGI of $70,000 (for singles) and $140,000 (for joint filers). (The income thresholds are the same for 2021.) The former student can deduct this even if it's actually Mom and Dad who are paying the bill.

Finally, interest on savings bonds is usually subject to federal income tax. However, **interest on Series EE and I bonds issued after 1989 can be tax-free** when used to pay for qualified education expenses, if you meet certain requirements. This benefit phases out gradually as your 2020 MAGI rises between $123,550 to $153,550 for joint filers and from $82,350 to $97,350 for singles. (For 2021, the phase-out range is from $124,800 to $154,800 for joint filers and from $83,200 to $98,200 for singles.) Important note: If you're using savings bonds to pay for a child's education, the bonds must be in your name to qualify for the exclusion. Savings bonds in the child's name aren't eligible.

11. Charitable Deduction for Non-Itemizers

For 2020 only, there's a new "above-the-line" deduction for up to $300 for cash donations to charity. Donations to donor advised funds and certain organizations that support charities don't qualify for this tax break.

Normally, you have to itemize on Schedule A to get a deduction for charitable donations. In this case, though, it's the other way around—if you itemize, you can't take this new deduction. Generally, most people who itemize have higher incomes. So, this tax break is for middle- and lower-income Americans who claim the standard deduction, instead.

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