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Male Speaker 1

In this episode, we'll discuss tax credits. We're going to speak with Eiji Yoshikawa, author of *Lower Taxes in Seven Easy Steps*. In a previous episode, we talked to Eiji about tax deductions. Many people are confused as to the difference between a credit and a deduction.

Here's how it works. Let's say you're in the 28% tax category. If you had \$1,000 tax deduction, you would deduct that from your taxable income, and then you determine your taxes. The result of deducting \$1,000 is that you would save \$280 in taxes. But if you had \$1,000 tax credit, you could deduct that directly from your taxes. So, you would save \$1,000 in taxes. So, \$1000 tax credit is always going to be more valuable—maybe three or four times more valuable—as a \$1000 tax deduction. It all depends on your tax rate.

We asked Eiji Yoshikawa what could a typical family do to maximize their tax credits? What's available to your average tax paying family member?

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Male Speaker 2

Well, if they had a baby, bought a hybrid car, added new insulation to their home, installed a solar water heater in their home, incurred child care expenses so that they could both work, and took night classes at a local college, they could have reduced their taxes by approximately \$6,000 to \$7,000.

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Male Speaker 1

It's been reported that the average tax credit for a hybrid car is \$2,000. We asked Eiji if that was accurate.

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Male Speaker 2

Not necessarily \$2,000. That depends on the type of car and its fuel consumption statistics. In addition, another factor complicates things. Congress didn't want to allow too many tax credits for hybrids. So, once a hybrid manufacturer sells 60,000 vehicles, the credit will be phased out over the following 15 months for all hybrids produced by that company. You can find phase-out times and percentages in my book and at the IRS website.

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Male Speaker 1

That brings up another point. Tax credits come and go. Some tax credits have been around for years and are more or less permanent – for example, the child care credit; the low-income housing credit, for example. Others have been created more recently and have scheduled phase-out dates. Congress can and often does extend credits that are scheduled to end. Some credits like research and experimentation, work opportunity, and welfare to work credits have been extended one year at a time for several years. However, there is no guarantee that Congress will extend a tax credit. So, it's always wise to act before the expiration date if you want to use a tax credit that is scheduled to expire.

As Eiji pointed out, there are various tax credits for homeowners, and as he indicates in his book, fuel efficiency is the primary target here. Among the credits, there are great breaks for homeowners who put fuel efficient windows, roofing, insulation, and heating and cooling systems. However, there are some rules you'll have to follow. Homeowners must buy these energy efficient products during 2006 and 2007. The total combined credit you can get for all tax years is \$500, and no more than \$200 of the credit can be for windows.

The other thing to keep in mind is you get the credit only if the items you buy meet the energy efficiency specifications established by law, and a lot of these specifications are quite stringent. For example, an electric heat pump water heater qualifies for the credit only if its energy efficiency is over twice as great as the current federal standard. Make sure the product you want to buy qualifies; don't take a salesperson's word for it. Also, more generous credits are available to homeowners who install solar water heating or electric power systems in their homes.

Eiji Yoshikawa also mentioned that there is a tax credit for having a child. That tax credit was created for low- and middle-income taxpayers. We asked Eiji about the requirements.

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Male Speaker 2

It is subject to an income threshold and the amount of credit you can take each year goes down as your income approaches that threshold amount. For example, a married couple filing jointly with one qualifying child gets no child tax credit if their adjusted gross income exceeds \$130,000.

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We asked Eiji Yoshikawa what about tax credits for couples who adopt children?

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Male Speaker 2

Yes. There is a tax credit for people who adopt children. The credit is equal to 100% of adoption expenses up to an annual ceiling. The ceiling was \$10,960 per child in 2006.