



Tax Deductions and Tax Credits: What's the Difference?

Two ways to reduce your tax bill—with different results

Tax deductions and tax credits can both reduce your federal income tax, but they work at different stages of the calculation.

- A **tax deduction** reduces the income subject to tax.
- A **tax credit** reduces the tax itself, generally dollar for dollar, subject to eligibility and other limits.

Understanding that distinction helps you estimate what a tax benefit is actually worth. [The IRS explains credits and deductions.](#)

A Simple Comparison

Suppose you qualify for either a \$1,000 deduction or a \$1,000 credit. Their value can be quite different:

Tax benefit	What it reduces	Illustrative tax savings
\$1,000 deduction	Taxable income	\$220 if the entire deduction offsets income taxed at 22%
\$1,000 credit	Tax liability	\$1,000 if you can use the full credit

This simplified example assumes the deduction does not cross tax brackets or affect other benefits. A deduction's value depends on your circumstances; a credit's usable amount depends on its rules.

A deductible purchase is not free. Spending \$1,000 to save \$220 in tax still leaves you with an \$780 expense.

Standard Deduction or Itemized Deductions?

Most individual taxpayers choose between the standard deduction and itemizing allowable expenses.

The **standard deduction** is an amount set by law. It varies with filing status and other factors, and is generally adjusted annually.

Itemized deductions are qualifying expenses reported on Schedule A. Common categories include:

- Eligible medical and dental expenses above the applicable income threshold.
- Certain state and local taxes, subject to limits.
- Qualifying home mortgage interest.
- Eligible charitable contributions, subject to applicable rules.

You generally benefit from whichever allowable deduction is larger. Exceptions apply—for example, some taxpayers cannot claim the standard deduction. Use the rules and amounts for the tax year you are filing. [See the IRS guide to choosing whether to itemize.](#)

Not every expense within a category qualifies. Limits and documentation requirements matter. Keep records throughout the year so you can compare the alternatives accurately. [Consult the Schedule A instructions.](#)

Some Deductions Don't Require Itemizing

Certain deductions, commonly called **adjustments to income** or **above-the-line deductions**, are used to calculate adjusted gross income, or AGI. They come before the standard or itemized deduction.

Depending on eligibility, examples include:

- Deductible traditional IRA contributions.
- Student loan interest.
- Eligible educator expenses.
- Certain health savings account contributions.
- Certain deductions for self-employed taxpayers.

You may qualify for these adjustments even if you take the standard deduction. Each has its own restrictions; contributing to an account or paying an expense does not automatically make it deductible. [The IRS explains AGI and adjustments.](#)

Other deductions may also be available without itemizing under current law. Follow the current return instructions rather than treating Schedule A as the only source of deductions.

Tax Credits Reduce the Tax Calculation Directly

Credits are an important part of many household tax returns. Depending on your circumstances, you may qualify for benefits related to:

- Earned income.
- Children and other dependents.
- Education.
- Child and dependent care.
- Adoption.
- Eligible retirement savings contributions.

Taking the standard deduction does not prevent you from claiming an otherwise available credit. However, income limits, filing status, qualifying expenses, and other requirements can reduce or eliminate eligibility. [Explore the IRS's individual credits and deductions.](#)

Refundable and Nonrefundable Credits Differ

A **nonrefundable credit** can generally reduce the tax it applies against to zero, but its unused amount does not itself become a refund.

For example, if you have \$600 of eligible tax liability and a \$1,000 nonrefundable credit, you can generally use \$600. Any carryforward of the remaining amount depends on that credit's rules.

A **refundable credit** can provide a refund beyond the tax it offsets. Under the same simplified assumptions, a fully refundable \$1,000 credit could offset the \$600 and leave \$400 refundable. Some credits are only partly refundable.

A nonrefundable credit can still increase your refund of taxes already withheld by reducing your liability. "Nonrefundable" describes the credit's unused portion—not whether you can receive any refund at all. [Read the IRS explanation of refundable credits.](#)

Claim What You Qualify For—and Keep the Records

Use current forms and instructions, document eligible expenses, and check whether income limits or other restrictions apply. Some tax benefits cannot use the same expense twice; education benefits are one example where coordination matters. [IRS Publication 970 explains education tax benefits.](#)

If you're unsure, a qualified tax professional can help you compare options and support your claims.

The central distinction is simple: **deductions reduce taxable income; credits reduce tax.** Knowing how each works helps you recognize legitimate savings and avoid expecting more relief than the rules allow.