CardRatings' 2021 guide to credit cards and taxes

It's tax season and whether you're a tax accountant, a tax preparer or a champion at-home tax filer, you're dealing with all the typical forms and boxes and calculators and questions.

Many people, too, are dealing with questions about how credit cards relate to taxes. What is taxable when it comes to credit card rewards? Is it OK to pay your taxes with your credit card? Plus, what else do you need to know to comply? This guide to taxes and credit cards should help answer those questions.

Are credit card rewards taxable?

One of the key advantages of credit cards is the ability to earn rewards. Whether you're saving points for travel discounts, earning miles, or earning cash back deals, deciding which credit card rewards fit best into your lifestyle often helps you determine which type of card to use. However, sometimes these rewards you're earning need to be reported to the IRS. And sometimes they don't. Let's break it down:

If you earned credit card rewards by spending money, there's no need to report them. The IRS will treat them as a discount if you earn rewards in a cash-back program. Compare it to clipping coupons – they help you save money and you don't have to report it to the IRS. When you earn credit card rewards for spending money with your credit card it's a rebate. You're saving, not earning.

"The IRS typically views credit cards are rebates. This means that, in general, you don't have to report your credit card rewards as income on your taxes," says Chris Abrams, founder of Abrams Insurance Solutions. "Most rewards are not taxable because they require you to spend money to receive them. You don't have to report cash back rewards, signup bonuses and travel rewards even though they resulted in financial gain."

There are, however, some cases where you do need to report credit card rewards to the IRS.

For example, if you're intrigued by Petal® 2 "Cash Back, No Fees" Visa® Credit Card, which, for a limited time offers $50 for card approval (see full terms), you would need to report that bonus as income since it isn't tied in any way to spending. The same rule applies when receiving a bonus for opening a checking account with a particular bank or receiving a bonus for adding an authorized user to your credit card account or a earning a referral bonus from someone else applying for a credit card via your recommendation and referral link.

"You will need to report credit card rewards if you didn't spend money to get them," said Mason Miranda, credit industry specialist with Credit Card Insider. "Some credit card sign-up bonuses which don't require spending are considered taxable, but this is relatively rare."

If you receive a form 1099 from your credit card issuer, you'll want to take an even harder look at whether you need to report the rewards as income. Receiving the form doesn't automatically mean you'll need to report the rewards as income, but it's a good reminder to check into it.

When in doubt, ask your tax professional. You don't want to assume all your rewards automatically don't apply as taxable income.

"Though cumbersome, it's best to take your time and research what you should report," added Miranda. "Consult an accountant to learn how to approach your taxes in your specific situation."

Things get a little more complicated when dealing with credit card rewards on a business card, according to Abrams. Business credit card rewards are not taxable, but if you use rewards to pay for business expenses it can increase your tax liability because these cards come with different rules.

"If you pay for a business expense partially in rewards, you should deduct the rewards portion of the payment from your tax write-off," Abrams said. "This can be pretty tedious, so it's best to just avoid writing off items purchased in part with rewards."

Can I pay my taxes on a credit card?

There are pros and cons to using your credit card to pay your taxes.

As we discussed in the previous section, you can earn rewards if you pay your taxes with a credit card. That cash-back bonus when spending a certain amount within so many months could be an incentive. If you're looking to earn airline miles, paying your taxes with your credit card can help you do that as well. But there will be a transaction fee any time you pay taxes with a credit card, whether you're making estimated tax payments or just paying an annual bill.

Therefore, you need to decide if increasing what you owe is worth it.

For his part, Miranda recommends when it comes to credit cards and your taxes, you should avoid using a credit card if you can.

"Though it's possible, fees will often accompany your payment, which can negate any rewards you would receive for using a credit card," he said.

The IRS has three companies to choose from for processing paying your taxes with a credit card, and those fees for 2021 range from 1.96% to 1.99%.

There are a maximum number of card payments allowed depending on the type of payments you are making and how often you can make them. The IRS has this table you can refer to to see your options. You can't, however, use card or cash payment methods to make Federal Tax Deposits.

When should you consider using a card to pay your taxes?

Below are a couple of reasons to go ahead and use a credit card to pay your taxes.

1. You're working on earning a lucrative signup bonus and the spending threshold is higher than what you'll be able to meet with other spending. Furthermore, consider the value of the signup bonus and whether the rewards you stand to earn are worth more than the roughly 2% fee you'll pay for the transaction.

2. You have a lengthy 0% APR offer on a card and need some extra time to pay your full tax bill. In this situation, remember first that the IRS has payment plans available if you aren't able to pay your taxes in full. Qualified taxpayers can apply for an installment plan to pay off their balance over time through these plans. A short-term payment plan (120 days or less) has no setup fee but includes accrued penalties and interest until the tax owed balance is paid in full. Longer-term payment plans have setup fees ranging from $31-$149, along with those accrued penalties and interest until the balance is paid in full.

Before deciding to pay with an intro 0% APR credit card, check to ensure that the fee you'll pay to make your payment is LESS than the penalties and fees you would pay to use one of the IRS payment plan options mentioned above. Furthermore, and importantly, if you're paying with a 0% APR offer card, make yourself a plan so that you pay off your full credit card balance before the 0% period ends; otherwise, the interest charges will likely end up costing more than the IRS payment plan fees and penalties.

We've rounded up a few cards below that could be good options for paying your taxes if this is the direction you choose to go.

Credit cards, taxes and your business

Credit cards themselves are helpful for separating business from personal expenses and make it easier to see your monthly expenses in one place come tax time, but they could present a few additional questions related to credit card rewards and your taxes.

The rewards themselves likely aren't taxable, but remember that you can't deduct expenses paid for with credit card rewards.

"You need to be aware, as a business owner, of everything your business credit card is used for," said Jake Hill, chief executive officer at DebtHammer. "If you plan to count those purchases as a deduction, you'll need to verify that they were necessary for your business."

When it comes to rewards earned via a business credit card, as with a personal credit card the rewards themselves are in most cases considered a rebate and aren't necessary to report to the IRS as income. Once again, if you earned rewards that weren't tied to a specific purchase, you might need to report those as business income.

The major consideration with business credit cards and rewards comes down to how you report business deductions. If you used credit card rewards to buy your flight for business trip, you can't then claim that flight as a business expense deduction.

Even with that consideration, having a credit card dedicated to your business can still be a good way to stay organized when it comes to expenses and spending and not mixing business with personal, a wise choice in general.

"If you used a personal credit card to make business-related purchases with the intention of earning points or cashback [sic] rewards, and then were reimbursed for the purchases by your employer (but kept the points) there is a chance that the IRS might view that as abusing the system," says Joshua Zimmerman, managing partner at Westwood Tax & Consulting LLC.

A business credit card also makes record keeping a lot easier when tax time comes along. Having a dedicated business credit card helps you easily see your overhead and helps with the itemization of deductions. Plus you can easily export your monthly and year-end statements making it easier when doing your annual tax return.

What credit cards are best for paying taxes?

If you are going to pay your taxes with your credit card, you want to choose the one that makes the most sense for you. While we, in general, don't recommend using a card to pay your taxes, we know there are situations when it could make sense for you. For that reason, we've rounded up these cards as our favorite options:

Chase Sapphire Preferred® Card

- Bonus: Earn 60,000 bonus points after you spend $4,000 on purchases in the first three months of account opening. Additionally, earn up to $50 in statement credits toward grocery store purchases within the first year of account opening.
- Rewards: Chase Sapphire Preferred offers premium dining and travel rewards. Cardholders can earn 2X points on dining including eligible delivery services, takeout and dining out and travel.
- Annual Fee: $95
- Credit Needed: Excellent, Good
- **Why is this a good choice for tax payments?** We recommend this card for tax payments only if you're working to earn the signup bonus. That's because those 60,000 bonus points are worth $750 when redeemed through the Chase Ultimate Rewards® portal and potentially more than that if you transfer to one of the several travel loyalty partners. For comparison, a 1.96% fee on a $4,000 tax bill is just $78.40, well under the value of that signup bonus.

Discover it® Cash Back

- Bonus: Discover will match all the cash back rewards new cardholders earn during their first year as a cardholder.
- Intro 0% APR Offer: 0% intro APR on purchases (and balance transfers) for the first 14 months (then, 11.99% - 22.99% Variable APR) *See Rates and Fees*
- Rewards: Earn 5% cash back on up to $1,500 spent in categories that rotate quarterly (activation required); earn 1% cash back on other purchases and on bonus category purchases after reaching the quarterly spending cap.
- Annual Fee: $0
- Credit Needed: Excellent, Good
- **Why is this a good choice for tax payments?** This option is all about the intro 0% offer and the bonus. The 14 months of 0% intro APR on purchases means you can take 14 months to pay off your tax bill without incurring fees and penalties from the IRS. Furthermore, the matching cash back earned at the end of your first year as a cardholder means that the transaction fee (let's assume it's 1.96% again) for paying the bill will be fully offset.

Capital One Venture Rewards Credit Card

- Bonus: New cardholders earn 60,000 bonus miles when they spend at least $3,000 within three months of enrollment.
- Rewards: Earn unlimited 2 miles per $1 on all purchases.
- Annual Fee: $95
- Credit Needed: Excellent, Good
- **Why is this a good choice for tax payments?** In this case, the regular rewards would offset a 1.96% fee, but you want to do better than just break even. Therefore, once again, this is about earning the bonus. If the regular rewards offset the fee, the bonus earned will be entirely "profit," if you will.

Ink Business Preferred® Credit Card

- Bonus: New card members can earn 100,000 bonus points after spending $15,000 on purchases in the first three months of opening an account. That's $1,000 cash back or $1,250 toward travel rewards when redeemed through Chase Ultimate Rewards®.
- Rewards: Cardholders earn three points per $1 on the first $150,000 spent in shipping purchases; advertising purchases made with social media sites and search engines; on internet, cable and phone services; and on travel annually. They also earn unlimited one point per $1 spent on all other purchases. Additionally, cardholders earn 25% more in travel redemption points through Chase Ultimate Rewards®.
- Annual Fee: $95
- Credit Needed: Excellent, Good
- **Why is this a good choice for tax payments?** That signup bonus is huge, but that spending threshold is daunting. A good-sized tax bill could go a long way toward meeting that $15,000 spend to earn 100,000 points. Given that you only have three months to meet that spend and earn the bonus, a large single transaction might be just what you're looking for.

Should you use a tax refund to pay down credit card debt?

We've talked a lot about paying taxes with a credit card and the implications of rewards on your tax bill, but what if you expect to get a tax refund? How does a credit card play into that scenario.

Here are a couple of things to consider as it relates to a tax refund and your credit cards:

1. Do you have an outstanding balance on a credit card? If so, using your tax refund to pay that off (or even just pay it down) could be an excellent use of those funds. Paying off credit card debt as soon as possible will save you money on interest payments and could improve your credit score by reducing your credit utilization and showing good payment habits.

2. Are you in the market for a new credit card with an excellent signup bonus offer? If so, using your tax refund to make a big purchase and meet the spending threshold to earn a bonus on a new card could pay off big time. Obviously, you shouldn't buy things you don't need just to earn a bonus, but having that tax refund cushion might allow you to make a number of purchases close together so you can meet that spending requirement and still fully pay off your balance.

In any case, taxes can be complicated, even without considering credit card rewards or payment options. It's always going to be best to consult a tax professional if you have any questions about your unique tax situation.

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