

Why You Shouldn't Pay Taxes With a Credit Card

Think you'll outsmart Uncle Sam by earning rewards miles or points? Not so fast.

Sorry, credit card processing fees will likely wipe out any rewards miles, points or cash back.

Rewards junkies are always looking for a way to pile up more miles or points without getting on an airplane.

The good news is that there are plenty of great ways to do that. Applying for a credit card with a big sign-up bonus is maybe the best example, but is hardly the only way. Dining in the right restaurants can get you extra points, too, as can buying items through a card issuer's shopping portal. There are seemingly as many ways to boost your miles as there are cardholders seeking to boost them.

However, that doesn't mean every way to grab more rewards is a wise move. Take, for example, paying your taxes with a credit card.

What a great idea! I have enough money to pay for my taxes, but why not just pay for it on my credit card and pocket the extra miles?

It's simple: The math usually doesn't work.

Here's why ...

Most rewards credit cards give one point per dollar spent. Yes, those multipliers can be far higher in certain cases, especially when rotating bonus categories are involved. However, one point per dollar – in other words, a 1 percent return – is typical in the industry. That's all well and good until you notice that the typical convenience charge for paying taxes with your credit card ranges from 1.87 percent to as high as 3.93 percent.

Paying 3 percent to get a return of 1 percent?

You don't have to be an accountant to understand why that's a bad deal. Overpaying to get rewards is seldom a good idea. It's the same trap that awaits people who want to pay college tuition with a credit card. The convenience fee that you'll be stuck with will typically turn a sweet, alluring deal into a money-losing proposition.

Can it ever work?

That doesn't mean paying for taxes with a credit card can never make sense. Again, it's all about the math.

The Internal Revenue Service lists four payment processors through which you can pay via credit card when you file electronically and then three other payment processors that let you pay your taxes via credit card over the phone. The phone-based options have the lowest convenience fees, ranging from 1.87 percent to 2.25 percent.

If you have a cash back card that gives you 2 percent back on every purchase – the Citi Double Cash card, for example – and you opt to pay your taxes via the processor that charges the 1.87 percent fee, the math actually works in your favor, albeit narrowly. You'd pay 1.87 percent to get 2 percent back, turning a 0.13 percent profit. In real money terms, if you were paying a \$5,000 tax bill with your credit card, you'd pay a \$93.50 convenience fee in order to earn \$100 worth of rewards – a \$6.50 profit. It's not going to make you rich, obviously, but it is a profit nonetheless.

The plan isn't foolproof, however. If you can't pay the balance off immediately, there's a good chance that all of your profit will be eaten up quickly by interest charges.

Is it possible to write off the processing fee?

In the long run, it might even be possible to boost your profit a bit further by writing off some of your processing fee. The credit card processing fee can be included as a miscellaneous deduction on Schedule A. According to the IRS, miscellaneous deductions include: tax preparation fees; unreimbursed employee expenses, like costs involved in searching for a new job; and other expenses, such as credit or debit card conveniences fees.

It's not quite as simple as it may sound, though. In order to write off miscellaneous deductions, the total amount of those deductions must total at least 2 percent of your adjusted gross income – and you can only deduct the amount exceeding that 2 percent. Here's an example:

- Say your AGI was \$75,000 in 2015, and your miscellaneous deductions total \$1,800.
- You would be eligible for a write-off, since \$1,800 is more than 2 percent of \$75,000. (Two percent of \$75,000 is \$1,500.)
- However, since you're only able to deduct the amount of deductions exceeding 2 percent, the amount that you'd be able to deduct would be only \$300.

So unless you have a really large tax bill or a lot of other potential miscellaneous deductions to include, it is probably best to not count on writing off that fee.

The Bottom Line

For most Americans, paying taxes with a credit card isn't wise, simply because of the math. It just doesn't make sense to pay a 2.5 or 3 percent convenience fee in order to get a reward of 1 percent back.

If, however, you're willing to take the time to use the least expensive credit card processing option offered by the IRS *and* you can pay for it with a card that rewards you with at least 2 percent on purchases *and* you're absolutely, positively, beyond-a-shadow-of-a-doubt sure that you can pay the entire bill off immediately without paying your credit card issuer any interest, you might be able to make a profit by paying your taxes with a credit card.

That profit would be tiny, though – about one-tenth of 1 percent. Knowing that, you're probably better off choosing another way to pay Uncle Sam and focusing your rewards efforts on more lucrative goals.

<http://money.usnews.com/money/blogs/my-money/articles/2016-02-08/why-you-shouldnt-pay-taxes-with-a-credit-card>