

Time to Start Organizing Your Deductions

A deduction is an expenditure that will reduce your taxable income. There are two kinds of deductions: adjustments to income and itemized deductions. The adjustments to income are the better of the two, as they reduce adjusted gross income, or "AGI." Itemized deductions reduce your taxable income.

First, we will look at some adjustments to income.

Educator expenses apply to K – 12th grade educators, and are limited to \$250 of documented supplies per qualified taxpayer. Expenses exceeding \$250 can be taken as a miscellaneous itemized deduction.

A health savings account is an account set up exclusively for paying the qualified medical expenses of the account beneficiary or the beneficiary's spouse or dependents.

Moving expenses include qualified out-of-pocket expenses or an employer reimbursement that was included in your W-2 form. If you received a non-taxable reimbursement, you cannot deduct the expenses.

Self-employment tax. If you are a sole-proprietor, active partner or have miscellaneous income subject to self-employment tax, you can deduct half of the self-employment tax.

Self-employed pension plans. You can deduct all qualified contributions to self-employed SEP, SIMPLE, and qualified plans.

Self-employed health insurance deduction. For this deduction you must be a sole proprietor or an active partner with net business income or a more than 2% shareholder of an S-corporation. The deduction is limited to net profit. Qualified long-term care insurance premiums, subject to age limitations, are also deductible.

Penalty on early withdrawal of savings is deductible and you will find this fee on your form 1099-INT. These penalties are typically incurred when you cash in a CD prematurely.

Alimony paid is deductible, but you must include the Social Security number of the recipient.

IRA deduction. Report only deductible traditional IRA contributions. Roth IRA contributions are not deductible.

Student loan interest. Up to \$2,500 of the interest paid on a qualified student loan is deductible. There are income limitations. You will receive Form 1098-E from the entity to which you paid the student loan interest.

Tuition and fees deduction. Up to \$4,000 of higher education tuition and fees can be deducted by taxpayers with an AGI under \$80,000 if single, or \$160,000 if married filing jointly.

Itemized Deductions

Medical expenses in excess of 10% of AGI are deductible as itemized deductions. If you or your spouse is age 65 or older by year end, you may deduct medical expenses in excess of 7.5% of AGI. Medical expenses are deductible in the year paid.

Taxes. State and local income taxes as well as real estate taxes for all property owned are deductible in the year paid. Most income taxes paid to a foreign country or US possession are either deductible as an itemized deduction or can be taken as a credit against tax.

Mortgage interest paid is deductible, with limitations. Mortgage interest is deductible on up to two homes with a combined secured acquisition debt of \$1.1 million (home equity debt is generally limited to \$100,000). Points on the purchase or a refinance to make major improvements are deductible, but they may need to be amortized over the life of the loan.

Charitable contributions must have written substantiation. If less than \$250 is given at one time, the bank draft is sufficient. If the gift is \$250 or greater, a written acknowledgement of receipt from the charity is required. In most situations, the charitable deduction is limited to 50% of AGI. Non-cash contributions are limited to the fair market value of the items contributed, if they are used items.

Casualty and theft losses are subject to a \$100 deduction and a reduction of 10% of AGI per casualty loss. A casualty is damage, destruction, or loss of property resulting from an identifiable event that is sudden, unexpected, or unusual.

Miscellaneous deductions are subject to a reduction of 2% of AGI. They include expenses for generating and protecting income, job-related expenses, and unreimbursed employee business expenses.

Other miscellaneous deductions are deductions that are not subject to the 2% of AGI reduction. Some examples are gambling losses up to the amount of gambling winnings, and special job-related expenses of the disabled.

Be sure to let your tax advisor know if you feel you could be eligible for any of these deductions.

As an enrolled agent (EA), your tax professional must take many hours of continuing education each year to stay up-to-date on the constant changes to the tax code. He or she had to pass a stringent three-part exam, or have relevant experience as a former IRS employee in order to qualify for the EA license. It's reassuring to know that your tax advisor is an EA: licensed by the US Department of the Treasury, with unlimited rights of representation before the IRS.