Itemized Deductions

Introduction

This lesson will assist you in determining if a taxpayer should itemize deductions. Generally, taxpayers should itemize if their total allowable deductions are higher than the standard deduction amount.

Objectives

At the end of this lesson, using your resource materials, you will be able to:

- Determine if a taxpayer should itemize deductions
- Determine the type of expenses that qualify as itemized deductions
- Accurately report itemized deductions on Schedule A, Itemized Deductions
- Explain the recordkeeping requirements for claiming charitable contributions

What do I need?

- ☐ Form 13614-C
- ☐ Publication 4012
- ☐ Publication 17
- ☐ Form 1040
- ☐ Schedule A

Optional:

- ☐ Publication 502
- ☐ Publication 526
- ☐ Publication 529
- ☐ Publication 530
- ☐ Publication 936

What are itemized deductions?

Itemized deductions are subtractions from a taxpayer's Adjusted Gross Income (AGI) that reduce the amount of income that is taxed. Most taxpayers have a choice of taking a standard deduction or itemizing deductions. Taxpayers should use the type of deduction that results in the lowest tax.

Who must itemize?

Taxpayers who have a standard deduction of zero should itemize their deductions. Taxpayers who normally fall within this category are:

- Married, filing a separate return, and their spouse is itemizing
- Filing a return for a short tax year due to a change in the annual accounting period
- Considered to be nonresident aliens or dual status aliens during the year (and not married to a U.S. citizen or resident at the end of the tax year)

How do I decide if a taxpayer should itemize deductions?

In general, taxpayers who have mortgage interest or a very large amount of unreimbursed medical/dental expenses compared to their income would benefit from itemizing their deductions.

Use the Interview Tips – Itemized Deductions in the Volunteer Resource Guide, Tab F, Deductions, to determine if itemizing deductions would be more beneficial for the taxpayer. If you think the taxpayer may benefit from itemizing, enter the qualified expenses on Schedule A. The tax software will automatically select the larger of itemized versus standard deduction.

Itemized deductions include amounts paid for qualified:

- Medical and dental expenses
- Certain taxes paid
- Mortgage interest
- Gifts to charity
- Casualty and theft losses (only losses derived from federally declared disaster areas are allowed)
- Certain miscellaneous deductions

CAUTION Casualty and theft losses are outside the scope of the VITA/TCE programs. Refer taxpayers with these losses to a professional tax preparer.

TIP For taxpayers using the Married Filing Separately status, if one spouse itemizes, the other must also itemize (even if their itemized deduction amount is zero).

What medical and dental expenses are deductible?

Taxpayers can deduct only the amount of unreimbursed medical and dental expenses that exceeds the applicable percentage of their Adjusted Gross Income (AGI). Volunteers should refer to the Volunteer Resource Guide for the applicable percentage for the tax year.

TIP The standard mileage rate allowed for out-of-pocket expenses for a car when used for medical reasons can be found in Publication 17. Taxpayers can also deduct parking fees and tolls.

Whose expenses are covered?

Qualified medical and dental expenses paid by the taxpayer during the tax year can be included for:

- The taxpayer
- The taxpayer's spouse
- Dependents claimed at the time the medical services were provided or at the time the expenses were paid
- Individuals who could be the taxpayer's dependent except:
  - They do not meet the gross income test, or
  - They do not meet the joint return test, or
  - The taxpayers, or their spouse if filing jointly, could be claimed as a dependent on someone else's return

TIP If a child of divorced or separated parents is claimed as a dependent on either parent's return, each parent may deduct the medical expenses that they individually paid for the child.

Tax Software Hint: For software entries, go to the Volunteer Resource Guide, Tab F, Deductions.

Review Whose Medical Expenses Can You Include? in the Medical and Dental Expenses chapter of Publication 17.

example

Stewart and Carmen are divorced. Their son, Raymond, lives with Carmen, who claims him as a dependent. Carmen paid for and deducted Raymond's standard medical and dental bills. Stewart deducted the emergency bill he paid when Raymond broke his arm.

What types of expenses are covered?

Refer to the Volunteer Resource Guide or Publication 17 for the medical and dental expenses checklist, and Publication 502, Medical and Dental Expenses, for more information on medical, dental, and other expenses. Be sure the expenses were not paid with pretax dollars or reimbursed by an insurance company.

TIP Premiums for long-term care insurance are deductible up to a limit amount based on the age of the insured.

CAUTION Retired public safety officers cannot include as medical expenses any health or long-term care premiums they elected to have paid with tax-free distributions from their retirement plan.

TIP If you and a taxpayer disagree as to whether a particular expense is deductible, discuss the issue with the Site Coordinator. The taxpayer may be correct, but you should not deduct an expense unless you are sure it is deductible.

EXERCISES

Answers are at the end of the lesson summary.

Question 1: Bill and Kathy Ferris file a joint return. They paid the medical and dental bills listed below. The total of Bill and Kathy's qualified medical expenses is $_______.

Medical Expenses	Amount	Deductible
Unreimbursed doctors' bills	$500	?
Unreimbursed orthodontist bill for braces	$1,200	?
Hospital insurance premiums	$300	?
Life insurance premiums	$500	?
Unreimbursed prescription medicines	$100	?
Vitamins	$70	?
Hospital bill (before insurance company's reimbursement of $1,000)	$2,000	?
Smoking-cessation program	$150	?
Total	$4,820	?

TIP Taxpayers may only deduct unreimbursed medical expenses. They may not deduct medical insurance premiums paid with pretax dollars or reimbursed by an insurance company. For taxpayers who receive the premium tax credit (PTC), only the premiums paid out of pocket by the taxpayer and not covered by the PTC, may be used as a medical expense when itemizing deductions.

For example, if the taxpayer's insurance policy premium was $12,000 and they received a PTC of $10,000, they would only be able to deduct the $2,000 premiums paid out of pocket by the taxpayer as a medical expense deduction, subject to the appropriate applicable adjusted gross income threshold for itemized medical expenses. Taxpayers also deduct the excess APTC they have to repay on the return or reduce their deduction for any additional net PTC they claim on the return.

What taxes may be deductible?

Taxpayers can deduct certain taxes if they itemize. To be deductible, the tax must have been imposed on and paid by the taxpayer during the current tax year. Taxes that are deductible include:

- State and local income taxes – This includes withheld taxes, estimated tax payments, or other tax payments (such as a prior year state or local income tax refund that the taxpayer chose to credit to their estimated tax for the following year).
- Sales taxes – It may be possible to deduct sales taxes in lieu of state and local income taxes (from the optional sales tax tables or actual sales tax paid). Taxpayers who use the tables may be able to add the state and local general sales taxes paid on certain specified items to the tax table amounts. See the Schedule A instructions for details on the specific items.

TIP Taxpayers may deduct either sales tax or state and local income tax, but not both.

- Real estate taxes
  - State and local real estate taxes based on the assessed value of the taxpayer's real property, such as the taxpayer's house or land, are deductible.
  - Taxes based on other than the assessed value of the property may be deductible in certain circumstances if they are levied:
    - For the general public welfare
    - By a proper taxing authority
    - At a similar rate
    - On owners of all properties in the taxing authority's jurisdiction
  - Real estate taxes, which are generally reported on Form 1098, Mortgage Interest Statement, or a similar statement from the mortgage holder, are deductible. If the taxes are not paid through the mortgage company, the taxpayer should have a record of what was paid during the year.
  - Some real estate taxes are not deductible, including taxes for local benefits and improvements that tend to increase the value of the property, itemized charges for services, transfer taxes, rent increases due to higher real estate taxes, and homeowners' association fees.

CAUTION Real estate taxes reported on Form 1098 may include nondeductible amounts. Use the interview techniques with taxpayers to determine if nondeductible amounts such as sanitation pickup and water fees are included in their Form 1098. These items should not be included on Schedule A.

Which taxes are not deductible?

Not all taxes are deductible and some items aren't actually classified as taxes. Some examples include employment taxes, federal income taxes, and license fees. No deduction is allowed for foreign property taxes unless it relates to a trade or business or for the production of income.

How do I handle taxes that are deductible?

Deductible taxes are reported on Form 1040, Schedule A in the Taxes You Paid section. The aggregate deduction for state, foreign income, local income (or sales taxes in lieu of income taxes), and property taxes is limited to $10,000 ($5,000 if Married Filing Separately) per return.

State and local income taxes or state and local sales taxes

Include tax withheld, estimated tax payments to a state or local government, and tax payments for an earlier year paid during the current tax year. Do *not* include penalties or interest. Enter both the state and local income taxes and the state and local sales taxes. The software will use the greater amount.

TIP The total deduction for state and local income, sales, and property taxes is limited to a combined, total deduction of $10,000 ($5,000 if Married Filing Separately). Any state and local taxes paid above this amount cannot be deducted.

Foreign income taxes

Generally, income taxes that were paid to a foreign country can be taken as an itemized deduction on Schedule A, or as a credit against U.S. income tax on Form 1040. More information will be provided on this credit in subsequent lessons. You should compare claiming the foreign taxes paid as a nonrefundable credit to taking it as an itemized deduction and use whichever results in the lowest tax.

TIP See the Taxes chapter in Publication 17 for more information.

Tax Software Hint: For software entries, go to the Volunteer Resource Guide, Tab F, Deductions.

EXERCISES (continued)

Question 2: Which of the following taxes are deductible on Schedule A?

A. Federal income tax

B. State, local, and foreign income tax and real estate tax

C. Tax on alcohol and tobacco

D. Foreign sales tax

Question 3: For a tax to be deductible, a tax must be ____. (Select all that apply.)

A. Imposed during the tax year

B. Imposed on the taxpayer

C. Paid during the tax year

D. Paid by the taxpayer

How do I handle interest paid?

Certain types of interest payments qualify as itemized deductions. Home mortgage interest, points (paid as a form of interest), and investment interest can be deducted on Schedule A. Investment interest is outside the scope of the VITA/TCE programs and should be referred to a professional tax preparer.

Home Mortgage Interest

Generally, home mortgage interest is any interest paid on a loan, line of credit, or home equity loan secured by the taxpayer's home. The deduction for home equity mortgage interest is not allowed unless it was used to build, buy, or substantially improve the taxpayer's qualified residence. The flow chart *Is My Home Mortgage Interest Fully Deductible?* in Publication 17 will help you determine if interest paid by the taxpayer should be included on Schedule A.

TIP Members of the clergy and military can deduct qualified mortgage interest even if they receive a nontaxable housing allowance.

Generally, the total amount of home mortgage interest paid by a taxpayer is shown on Form 1098, Mortgage Interest Statement. Only taxpayers who are legally liable for the debt can deduct the interest in the year it is paid. Remember that taxpayers may have more than one mortgage or may have refinanced during the year and may have multiple Mortgage Interest Statements.

TIP See the Legislative Extender's lesson contained in this publication for information regarding qualified mortgage insurance premiums.

TIP A taxpayer may be able to deduct interest on a main home **and** a second home. A home can be a house, cooperative apartment, condominium, mobile home, house trailer, or houseboat that has sleeping, cooking, and toilet facilities.

Review "Home Mortgage Interest" in Publication 17, Interest Expense chapter, for details on determining deductible amounts of mortgage interest.

Any interest (including original issue discount) accrued on a reverse mortgage is not deductible until the loan is paid in full. See Publication 17 for more details.

example

From 1991 through 1998, Alfredo and Cindy Kendall obtained home equity loans totaling $91,000. Alfredo and Cindy used the loans to pay off gambling debts, overdue credit payments, and some nondeductible medical expenses.

The current balance of Alfredo and Cindy's home equity loan is $72,000. The fair market value of their home is $230,000, and they carry $30,000 of outstanding acquisition debt (the amount used to buy, build, or improve their home).

If Alfredo and Cindy file a joint return, they cannot deduct the interest on their loans because the total of these loans was not used to build, buy, or improve the taxpayer's qualified residence.

What are points?

Points are the charges paid by a borrower and/or seller to a lender to secure a loan. They are also called:

- Loan origination fees (including VA and FHA fees)
- Maximum loan charges
- Premium charges
- Loan discount points
- Prepaid interest

When are points deductible?

Only points paid as a form of interest (for the use of money) can be deducted on Schedule A. Generally, points must be spread over the life of the mortgage. However, if the loan is used to buy or build a taxpayer's main home, the taxpayer may be able to deduct the entire amount in the year paid. See the Interest Expense chapter of Publication 17 for more information.

Points paid to refinance a mortgage are generally not deductible in full the year they were paid, unless the points were paid in connection with the improvement of a main home and certain other conditions are met.

Beware of certain charges that some lenders call points. Points paid for specific services, such as appraisal fees, preparation fees, VA funding fees or notary fees, are *not* interest and are *not* deductible.

TIP Use the flow chart in the Interest Expense chapter of Publication 17 to help determine if points are fully deductible.

What types of interest are *not* deductible?

Interest that *cannot* be deducted includes:

- Interest on car loans where the car is used for nonbusiness purposes
- Other personal loans
- Credit investigation fees
- Loan fees for services needed to get a loan
- Interest on a debt the taxpayer is not legally obligated to pay
- Finance charges for nonbusiness credit card purchases

EXERCISES (continued)

Question 4: Joe and Angela file a joint return. During the year, they made the interest payments listed below. The total of Joe and Angela's fully deductible interest for the tax year is $__________.

Interest Payments	Amount	Deductible
Qualified interest on their home mortgage, reported on Form 1098	$2,180	?
Credit card interest	$400	?
Points paid to refinance their mortgage for a better interest rate (None of the points qualify as interest.)	$1,500	?
Interest on a car loan	$2,000	?
Total	$6,080	?

How do I handle gifts to charity?

A charitable contribution is a donation or gift to a **qualified organization**, which may be deductible if the taxpayer itemizes. Cash, check, and noncash contributions should be reported on Schedule A on either the Gifts by cash or check line or the Other than by cash or check line, respectively. Deductions may be taken for contributions to:

- Organizations that operate exclusively for religious, charitable, educational, scientific, or literary purposes
- Organizations that work to prevent cruelty to children or animals
- Organizations that foster national or international amateur sports competition if they do not provide athletic facilities or equipment
- War veterans' organizations
- Certain nonprofit cemetery companies or corporations

- The United States, or any state, the District of Columbia, a U.S. possession (including Puerto Rico), a political subdivision of a state or U.S. possession, or an Indian tribal government or any of its subdivisions that perform substantial government functions

TIP To be deductible, contributions must be made to a qualifying organization, not an individual.

TIP Qualified organizations are listed in Publication 78, Cumulative List of Organizations. An online version is offered to help taxpayers efficiently search organizations that are eligible to receive tax-deductible charitable contributions.

To find out if the organization is a qualified charity, go to www.irs.gov.

Deductible items include:

- Monetary donations
- Dues, fees, and assessments paid to qualified organizations above the value of benefits received
- Fair market value of used clothing, furniture, and other items in good condition
- Cost and upkeep of uniforms that have no general use but must be worn while performing services donated to a charitable organization
- Unreimbursed transportation expenses that relate directly to the services the taxpayer provided for the organization
- Part of a contribution above the fair market value for items received such as merchandise and tickets to charity balls or sporting events
- Transportation expenses, including bus fare, parking fees, tolls, and either the cost of gas and oil or the standard mileage deduction may be taken. See Publication 4012 for the standard mileage deduction for charitable contributions.

Form 1098-C, Contributions of Motor Vehicles, Boats and Airplanes, is out of scope. Taxpayers who have made these contributions should be referred to a professional tax preparer.

Which gifts to charity are *not* deductible?

Contributions to the following types of organizations are *not* deductible:

- Business organizations, such as the Chamber of Commerce
- Civic leagues and associations
- Political organizations and candidates
- Social clubs
- Foreign organizations
- Homeowners' associations
- Communist organizations

Amounts that may *not* be deducted include:

- Cost of raffle, bingo, or lottery tickets
- Tuition
- Value of a person's time or service
- Blood donated to a blood bank or Red Cross

- Car depreciation, insurance, general repairs, or maintenance
- Direct contributions to an individual
- Sickness or burial expenses for members of a fraternal society
- Part of a contribution that benefits the taxpayer, such as the fair market value of a meal eaten at a charity dinner

example

Susan ran a 10K organized by the Chamber of Commerce to benefit a qualified charitable organization. She paid the race organizers a $30 entry fee and received a "free" T-shirt and pancake breakfast after the race.

Susan did not make a contribution to the qualifying organization. She paid the Chamber of Commerce, which allotted funds to the benefiting organization. Therefore, none of Susan's entry fee is tax deductible. If the race had been organized by the qualifying organization itself, part of her entry fee may have been deductible.

What limits apply to charitable deductions?

Taxpayers whose charitable contributions total more than 20% of their AGI may be able to deduct only a percentage of their contributions and must carry over the remainder to a later tax year. The percentage varies depending on the type of gift and the type of charitable organization. More information on these limitations is available in Publication 17. Individuals affected by limits on charitable deductions should be referred to a professional tax preparer.

What records should the taxpayer keep for charitable contributions?

Taxpayers must keep records to verify the cash and noncash contributions they make during the year. Advise taxpayers that they cannot deduct a cash contribution, regardless of the amount, unless one of the following records of the contribution is kept:

- A credit card statement or a bank record, such as a canceled check, a bank copy of a canceled check, or a bank statement containing the name of the charity, the date, and the amount
- A written communication from the charity, which must include the name of the charity, date of the contribution, and amount of the contribution

Out-of-pocket expenses related to donated services

For unreimbursed expenses related to donated services, the taxpayer must have:

- Adequate records of the expenses
- Organization's written acknowledgment and description of the taxpayer's services for unreimbursed expenses of more than $250

Only out-of-pocket expenses that are directly related to the donated services can be deducted. The value of time or services donated cannot be deducted. See Publication 17, Contributions chapter, for the rules applicable to out-of-pocket expenses incurred when rendering services to a qualifying organization.

What records should the taxpayer keep for noncash contribution deductions?

TIP Deductions are not allowed for the charitable contribution of clothing and household items if the items are not in good used condition or better.

Noncash contributions less than $250

For any single contribution of less than $250, the taxpayer must keep:

- A receipt or other written communication from the organization or the taxpayer's own reliable written records for each item, showing:
  –
  – Reasonably detailed description of the donated property
  – Fair market value of the donated property

TIP If the taxpayer is donating capital gain property or property that was previously depreciated, refer them to a professional tax preparer.

Noncash contributions of at least $250 but not more than $500

For any single contribution of at least $250 and not more than $500, the taxpayer must have all the documentation described for noncash contributions less than $250. In addition, the organization's written acknowledgment must state whether the taxpayer received any goods or services in return and a description and good faith estimate of any such items.

Noncash contributions of more than $500

Taxpayers with more than $500 in total noncash contributions must file Form 8283, Noncash Charitable Contribution, and should be referred to a professional tax preparer.

EXERCISES (continued)

Question 5: Julia made the following contributions last year:

- $600 to St. Martin's Church (The church gave her a letter verifying the amount.)
- $32 to Girl Scouts (not for cookies!)
- $40 to a family whose house burned
- $50 for lottery tickets at a fundraiser
- $100 for playing bingo at her church

The amount that Julia can claim as deductible monetary contributions is $________.

What about casualty and theft losses?

Only casualty losses derived from federally declared disaster areas are allowed after 2017. All other losses are not allowed except to the extent of casualty gains. Taxpayers with deductible casualty and theft losses should be referred to a professional tax preparer.

What miscellaneous expenses are deductible?

Examples of miscellaneous itemized deductions include:

- Gambling losses to the extent of gambling winnings (taxpayers must have a record of their losses)
- Work-related expenses for disabled individuals that enables them to work, such as attendant care services at their workplace

TIP All itemized deductions subject to the 2% of AGI limitation are not allowed through the end of 2025. This includes employee business expenses.

CAUTION Gambling losses in excess of winnings are not deductible. The full amount of winnings must be reported as income and the losses (up to the amount of winnings) can be claimed as an itemized deduction.

EXERCISES (continued)

Question 6: Philip had the expenses shown below. What is the total of Philip's qualified miscellaneous itemized expenses? $_______.

Expense	Amount	Deductible
Income tax preparation fee	$100	**?**
Safe deposit box rental (to store bonds)	$75	**?**
Life insurance premiums	$300	?
Credit card convenience fee for income tax payment	$70	**?**
Loss on sale of personal home	$1,800	?
Investment journals and newsletters	$250	**?**
Investment expenses	$200	**?**
Attorney fees for preparation of a will	$100	?
Total	$2,895	**?**

Summary

Medical and Dental Expenses

Unreimbursed medical and dental expenses that exceed the applicable percentage of the taxpayer's AGI are deductible; they are reported on lines 1 through 4 of Schedule A.

Qualified medical and dental expenses are those paid during the tax year for the taxpayer, spouse, and dependents.

Taxes

Deductible taxes are reported on Schedule A and include the following:

- State and local income taxes, or state and local general sales taxes
- State or local real estate taxes
- Personal property taxes

These taxes are subject to an aggregate limitation of $10,000 ($5,000 if Married Filing Separately). Note: Taxes paid as part of a trade or business or for the production of income are not subject to the aggregate $10,000 limit.

Interest

Deductible interest is reported on Schedule A.

Generally, the taxpayer receives Form 1098, Mortgage Interest Statement, which shows the total amount of interest paid. To be deductible, the interest must be paid by the taxpayer during the tax year. Only taxpayers who are legally liable for the debt can deduct the interest.

Only points paid as a form of interest (for the use of money) can be deducted on Schedule A. Generally, points must be spread over the life of the mortgage. However, if the loan is used to buy or build a taxpayer's main home, and certain other conditions are met, the taxpayer may be able to deduct the entire amount in the year paid.

Gifts to Charity

Qualified charitable contributions are reported on Schedule A.

The contributions to **qualifying organizations** that taxpayers can deduct include:

- Monetary donations
- Dues, fees, and assessments paid to qualified organizations above the value of benefits received
- Fair market value of used clothing and furniture at the time of donation
- Cost and upkeep of uniforms that have no general use but must be worn while performing donated services for a charitable organization
- Unreimbursed transportation expenses or out of pocket expenses that relate directly to the services the taxpayer provided for the qualifying organization
- Part of a contribution above the fair market value for items received such as merchandise and tickets to charity balls or sporting events

CAUTION Taxpayers are required to keep receipts and records of all their contributions.

Miscellaneous Deductions

Only gambling losses to the extent of gambling winnings and certain other items are in scope as miscellaneous deductions.

What situations are out of scope for the VITA/TCE programs?

The following is out of scope for this lesson. While this list may not be all inclusive, it is provided for your awareness only.

- Casualty and theft losses
- Investment interest
- Form 1098-C, Contributions of Motor Vehicles, Boats and Airplanes
- Taxpayers affected by limits on charitable deductions
- Taxpayers that file Form 8283 to report noncash contributions of more than $500
- If the taxpayer is donating property that was previously depreciated
- If the taxpayer is donating capital gain property such as appreciated stock or artwork
- Repayment of income of $3,000 or more. Note there is also a credit that may be better – see Publication 525, Taxable and Nontaxable Income
- Loss or termination of an annuity by a deceased annuitant – see Publication 575, Pension and Annuity Income

TAX LAW APPLICATION

To gain a better understanding of the tax law, complete the comprehensive problem or practice exercise(s) for your course of study on TaxSlayer

For practice using the tax preparation software, complete the scenarios using the Practice Lab on L&LT.

EXERCISE ANSWERS

Answer 1: *The total of qualified medical and dental expenses is $3,250, which does not include life insurance premiums, vitamins, or reimbursed hospital expenses.*

Answer 2: *B. State, local, foreign income tax, and real estate taxes are all deductible on Schedule A.*

Answer 3: *B, C, and D. Taxpayers cannot deduct a tax they did not owe, did not pay, or that they paid during another year. However, the tax may have been imposed in a prior year.*

Answer 4: *$2,180. The only interest that is fully deductible for the tax year is Joe and Angela's home mortgage interest. The points they paid to refinance are not deductible because they don't qualify as interest, and the other interest paid was personal interest and is not deductible.*

Answer 5: *The amount that Julia can claim as deductible cash contributions is $632 (donations to her church and to the Girl Scouts). Bingo, lottery tickets, and donations to individuals in need are not deductible.*

Answer 6: *Zero. None of these expenses are qualified miscellaneous itemized deductions.*

Notes