Standard Deduction and Tax Computation

Introduction

This is the first of eight lessons covering the Tax and Credits section of the taxpayer's return. After completing this lesson on standard deductions and the Itemized Deductions lesson, you will be able to subtract the appropriate deduction from the taxpayer's adjusted gross income (AGI) to figure their taxable income.

Some taxpayers may need to use the standard deduction worksheet in the Form 1040 Instructions.

Objectives

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

- Determine the standard deduction amount for most taxpayers
- Determine the standard deduction amount for taxpayers claimed as dependents
- Identify how taxable income and income tax are computed and reported

What do I need?

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

Optional:

- ☐ Publication 501
- ☐ Form 1040-SR

What are deductions?

Deductions are subtractions from a taxpayer's AGI. They reduce the amount of income that is taxed. Most taxpayers have a choice of taking a standard deduction or itemizing their deductions. When taxpayers have a choice, they should use the type of deduction that results in the lower tax. Use the interview techniques and tools discussed in earlier lessons to assist you in determining if the standard deduction will result in the largest possible deduction for the taxpayer.

What is a standard deduction?

A standard deduction for most taxpayers is a set dollar amount based on the taxpayer's filing status. An increased standard deduction is available to taxpayers who are 65 or older or blind. There are limitations on the standard deduction for taxpayers who can be claimed as a dependent on someone else's return. The Volunteer Resource Guide, Tab F, Deductions, includes references for calculating the standard deduction.

example

James, 44, and Sara, 39, are filing a joint return. Neither is blind, and neither can be claimed as a dependent. They decided not to itemize their deductions. They will use the married filing jointly standard deduction amount. Their standard deduction is computed using the Standard Deduction Chart for Most People in the Volunteer Resource Guide.

What is an itemized deduction?

Itemized deductions allow taxpayers to reduce their taxable income based on specific personal expenses. If the total itemized deductions are greater than the standard deduction, it will result in a lower taxable income and lower tax. In general, taxpayers benefit from itemizing deductions if they have mortgage interest, very large unreimbursed medical or dental expenses when compared to their income, or other large expenses such as charitable contributions. Itemized deductions will be covered in the next lesson.

Who cannot take the standard deduction?

Some taxpayers cannot take the standard deduction and must itemize. During the interview, find out if the taxpayer is:

- Filing as Married Filing Separately and the spouse itemizes
- A nonresident or dual-status alien during the year (and not married to a U.S. citizen or resident at the end of the year)
- Filing a return for a short tax year due to a change in the annual accounting period

If any of these situations apply, the taxpayer must itemize personal deductions and complete Schedule A.

> example
>
> Chase files as Married Filing Separately. Her spouse, Grant, will be itemizing his deductions. Chase cannot use the standard deduction; she will have to itemize her deductions.

Tax Software Hint: The standard deduction is automatically calculated based on entries in the Basic Information section.

How does age or blindness affect the standard deduction?

The standard deduction is higher if the taxpayer or spouse is 65 or older, and if one or both are blind. This information is reported in the check boxes located on Form 1040 or Form 1040-SR. The more check boxes marked, the higher the standard deduction. Be sure to verify the taxpayer's and spouse's age and level of blindness as described below.

Tax Software Hint: The Age 65 or older boxes are automatically checked. For software entries, go to the Volunteer Resource Guide, Tab B, Starting a Return and Filing Status.

> example
>
> Sherman is 73 years old and blind. He files as Single using Form 1040. Because Sherman is over 65 and blind, check the appropriate boxes on Form 1040 or Form 1040-SR.

Who qualifies as 65 or older?

Taxpayers are entitled to a higher standard deduction if they are 65 or older at the end of the year. They are considered to be 65 on the day before their 65th birthday. In other words, a person born on January 1 is considered to be 65 on December 31 of the previous year.

The standard deduction for decedents is the same as if they had lived the entire year; however, if taxpayers die before their 65th birthday, the higher standard deduction does not apply.

> example
>
> Armando died on November 24. He would have been 65 if he had reached his birthday on December 12 of that same year. He does not qualify for a higher standard deduction for being 65 because he died before reaching his 65th birthday.

Who qualifies as blind?

Taxpayers are entitled to a higher standard deduction if they are considered blind on the last day of the year and they do not itemize their deductions. A taxpayer who is not totally blind must have a certified statement from an eye doctor (ophthalmologist or optometrist) that:

- The taxpayer cannot see better than 20/200 in the better eye with glasses or contact lenses or
- The field of vision is not more than 20 degrees

If the eye condition is not likely to improve beyond these limits, the statement should include that fact. Taxpayers should keep the statement for their records.

TIP If vision can be corrected beyond those limits only by contact lenses *and* the taxpayer can only wear the lenses briefly because of pain, infection, or ulcers, the taxpayer can take the higher standard deduction for blindness.

What if only one spouse is over 65 or blind?

Taxpayers can take the higher standard deduction if one spouse is 65 or older, or blind, and if:

- The taxpayer files a joint return, or
- The taxpayer files a separate return and can claim an exemption for the spouse because the spouse had no gross income and an exemption for the spouse could not be claimed by another taxpayer

What is the standard deduction based on age or blindness?

The standard deduction for taxpayers who are 65 or older or are blind increases for each box checked for age or blindness. This amount can also be computed using the Standard Deduction Chart in the Volunteer Resource Guide, Tab F, Deductions.

CAUTION These amounts do not apply if the taxpayer (or spouse if Married Filing Jointly) can be claimed as a dependent on someone else's return.

example

Tim is 67 and is filing as Single. He is not blind and he cannot be claimed as a dependent on someone else's return. His standard deduction is computed using the chart in the Volunteer Resource Guide, Tab F, Deductions.

example

Kevin and Jane are both 60, and Jane is blind. They are filing as Married Filing Jointly. Neither can be claimed as a dependent on someone else's return. They are entitled to the regular standard deduction for married filing jointly plus an additional amount for being blind.

EXERCISES

Use the Standard Deduction Chart in the Volunteer Resource Guide, Tab F, Deductions to complete the following exercises. Answers are at the end of the lesson summary.

Question 1: Roderick is 64 and blind. Can he claim an additional deduction? ☐ Yes ☐ No

Question 2: Leticia died in May just before reaching her 65th birthday. Does she qualify as age 65?
☐ Yes ☐ No

What about individuals who can be claimed as dependents?

The standard deduction is generally lower for an individual who can be claimed as a dependent by another taxpayer. Taxpayers who can be claimed as a dependent must use the Standard Deduction for Dependents Worksheet to determine their standard deduction. The worksheet can be found in the Volunteer Resource Guide, Tab F, Deductions.

Tax Software Hint: A dependent's standard deduction will be automatically calculated, as long as the box indicating they can be claimed as a dependent by another taxpayer has been checked. For software entries, go to the Volunteer Resource Guide, Tab B, Starting a Return and Filing Status.

example

Janet is single, 22, a full-time student, and not blind. Her parents claimed her as a dependent on their current year tax return. She has no itemized deductions, so she will compute her standard deduction using the Standard Deduction Worksheets for Dependents.

How do I determine which deduction is best for the taxpayer?

If taxpayers are not required to itemize, they should take the higher of the standard deduction or the itemized expenses deduction. In general, taxpayers will benefit from itemizing their deductions if they have mortgage interest, qualified charitable contributions, or if unreimbursed medical/dental expenses are large compared to their income. During the interview, ask the taxpayer if any of the following were applicable during the tax year:

- Large out-of-pocket medical and dental expenses
- State and local income taxes, real estate taxes, personal property taxes, and/or state and local general sales tax
- Mortgage interest
- Gifts to charity
- Certain other miscellaneous deductions

If the taxpayer's expenses qualify, itemizing may be a better choice.

Tax Software Hint: The taxpayer's standard deduction is automatically calculated and displayed on page 2 of the Form 1040 screen. The software automatically selects the deduction method that gives the taxpayer the best result, but only if Schedule A information is entered. For software entries, go to the Volunteer Resource Guide, Tab F, Deductions.

How are taxable income and tax determined?

Tax is based on the amount of taxable income, which is generally determined by the taxpayer's AGI, and the standard deduction or itemized deductions. Taxable income is determined by subtracting from the AGI:

- Standard or itemized deductions
- Deduction for qualified business income (QBI)

TIP A separate worksheet is used to calculate the tax (instead of the tax tables) for taxpayers with certain types of income, such as capital gains, qualifying dividends, or foreign earned income.

Tax Software Hint: Tax is automatically calculated based on previous entries. It is important to enter all income, deduction, and credit information correctly for the tax to be computed accurately. The tax software also calculates the standard deduction amount and applies any limitations in determining the tax.

TIP Please see the Affordable Care Act (ACA) lesson contained in this publication for additional information on calculating the Excess Advanced Premium Tax Credit.

What is the tax for certain children who have unearned income (Kiddie Tax)?

For children under age 18 and certain older children, unearned income over a certain amount is taxed using the tax rates applicable to trusts and estates. For this purpose, “unearned income” includes all taxable income other than earned income, such as taxable interest, ordinary dividends, capital gains, rents, royalties, etc. It also includes taxable Social Security benefits, pension and annuity income, taxable scholarship and fellowship grants not reported on Form W-2, unemployment compensation, alimony, and income received as the beneficiary of a trust. If the child’s unearned income is more than the ceiling amount, and the child is required to file a tax return, Form 8615, Tax for Certain Children Who Have Unearned Income, must be used to figure the child’s tax. (See the Volunteer Resource Guide for the ceiling amount.)

example

Morgan (age 19) is a full-time student and earned $2,000 working at the local mall. She also had $1,100 of interest income. She received a scholarship of $4,000. Her tuition and fees for the year were $4,000. She decides to include $4,000 of the scholarship as income on her return allowing her education expenses to be used for one of the education credits. Since Morgan included the scholarship as income on her return, she will be required to complete Form 8615 to figure her tax because the $4,000 scholarship income is unearned income for the Kiddie Tax and more than ceiling amount.

When must Form 8615 be filed?

Form 8615 must be filed for the child if all the following are true:

1. The child's unearned income was more than the ceiling amount.
2. The child is required to file a return for the tax year.
3. The child either:
    - Was under age 18 at the end of the year,
    - Was age 18 at the end of the year and did not have earned income that was more than half of his or her support, or
    - Was a full-time student at least age 19 and under age 24 at the end of the tax year and did not have earned income that was more than half of the child's support.
4. At least one of the child's parents was alive at the end of the tax year.
5. The child does not file a joint return for the tax year.

What is the deduction for qualified business income (QBI)?

For taxable years beginning after December 31, 2017 and before January 1, 2026, there is a deduction for "pass through" businesses. Sole proprietors are categorized as "pass through" businesses.

- A sole proprietor will be able to take up to 20% of qualified business income (QBI) as a deduction on the tax return

- The calculations on Schedule C and Schedule SE are not affected by the deduction
- Taxable income is not reduced below zero by the 20% deduction
- The 20% deduction is limited for higher incomes
- The deduction will also be limited for specified service trades or businesses when the applicable threshold is exceeded

For taxable income that does not exceed the applicable threshold amount the QBI deduction is the lesser of:

- 20% of qualified business income (for example, it is the net profit reported on a Schedule C) or
- 20% of taxable income (equals adjusted gross income minus the applicable standard or itemized deduction) minus net capital gains and qualified dividends. See Form 1040 instructions for details.

Qualified business income is reduced by the deductible part of the self-employment tax, the self-employment health insurance deduction, and by contributions to certain qualified retirement plans (not traditional IRA deductions).

Taxpayers with income over the threshold amount should be referred to a professional tax preparer.

Summary

You should be able to identify those who can take the standard deduction, and how the deduction is affected by their filing status, age, blindness and status as a dependent. All of this will make it easier for you to help taxpayers understand how their deduction is computed and how it affects their tax.

You should also understand that the tax computation is based on taxable income. The tax may be further reduced by tax credits to be covered in an upcoming lesson.

Students that opt to include scholarships in income that exceed the unearned income ceiling amount may be required to complete Form 8615 to compute the tax. This is in scope, but limited to students who include unearned income such as scholarships/grants as income on the return.

Taxpayers who are considered sole proprietors may take up to 20% of their qualified business income as a deduction on the return. Taxpayers with qualifying REIT dividends may also be eligible for the QBI deduction.

You are now ready to work with itemized deductions in the next lesson.

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: *Yes. Roderick is entitled to an additional standard deduction amount for blindness.*

Answer 2: *No*

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:
  - Name and address of the organization
  - Date and location of the contribution
  - 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