Maximize Your Tax Deductions

Wonder whether it will pay to itemize your deductions?
If you feel pressured at tax time, you may be tempted to settle for the standard deductions and exemptions, rather than going through all the work of itemizing your deductions. But if you don't explore itemizing, you may end up paying more taxes than you really owe. Should you itemize?

To figure out whether itemizing would be profitable for you, consider some of the factors that affect what you can deduct, such as home ownership, taxes, charitable donations, medical expenses, and miscellaneous expenses. Compare your potential deduction with the standard deduction you're entitled to:

- Standard deduction for single taxpayers - $4,750
- Standard deduction for married taxpayers filing a joint return - $9,550
- Standard deduction for head of household taxpayers - $7,000

If you're 65 or older or blind, you get to increase the standard deduction by this additional amount:

Single or Head of Household:	65 or older or blind	$1,150
	65 or older and blind	$2,300
Married or Widower	One spouse 65 or older or blind	$950
	One spouse 65 or older and blind	$1,900
	Both spouses 65 or older or blind	$1,900
	Both spouses 65 or older and blind	$3,800

Now that you know how much your standard deduction would be, consider how well you will do with itemized deductions, in these areas:

- If you own a home
- If you do not own a home
- Charitable donations
- Medical expenses
- Miscellaneous deductions

If You Own a Home

Many taxpayers take the standard deduction rather than itemizing their deductions, even though some taxpayers with mortgages or home equity loans could have saved money by itemizing. If you have a mortgage or home equity loan on your home, fill out Schedule A to see if your itemized deductions are larger than the standard deduction to which you're entitled.

In January, your mortgage lender should provide the amount of mortgage interest you paid during the previous year. Look for Form 1098, Mortgage Interest Statement. If you paid points as part of the financing for your home, the points will also be shown on that form. **Tip:** Mortgage lenders sometimes attach Form 1098 to your December or January mortgage bill.

Here's a quick rule of thumb. Compare your mortgage interest (plus any points paid on the purchase of your residence) with your standard deduction.

Caution: Points paid on the refinancing of your mortgage are not fully deductible in the year paid. Instead, they must be deducted over the life of the loan. For more information, consult IRS Publication 936, Home Mortgage Interest Deduction.

If the interest you paid on your mortgage is larger than the applicable standard deduction, you should itemize your deductions.

If your interest is lower than the standard deduction that applies to you, add the real estate taxes you paid on your home to the interest amount you also paid and compare again. Your real estate taxes are also deductible.

- Many lenders provide a year-end tax summary that includes any real estate taxes and insurance paid through impound accounts. The real estate taxes are deductible, but homeowner's insurance and homeowner's association fees are not.
- If your real estate taxes aren't paid through an escrow account, review your property tax bills and cancelled checks and add up what you paid. You can't deduct any penalties you paid for late payment of property taxes: you can only deduct the actual taxes assessed and paid.

If You Don’t Own a Home

If you don't own a home, look at the income taxes that you paid to your state, and to your city or county, if applicable. Income taxes you pay to these governments are usually deductible. If you have a sizeable amount of these taxes withheld from your paycheck, add up the state and city taxes shown in boxes 17 and 19 on your W-2s and compare the total to your standard deduction.

If you made estimated tax payments to your state or local government, be sure to total those along with any money you sent with your 2003 state and local tax returns in April of 2004. You can also deduct overpayment amounts. If you had an overpayment on your 2003 state or local tax return and asked the government to apply it to your 2004 taxes instead of requesting a refund check, the amount that you overpaid is deductible.

Charitable Donations

You can deduct charitable donations only if you itemize your deductions. Add up the money you donated to organizations like the Red Cross, churches, synagogues, mosques, and other nonprofit organizations. If you donated things like clothes, furniture, appliances, or vehicles, you need to determine the cash value of those items. One way is to find out what your local thrift shop is charging for similarly used items or you could use a software program like ItsDeductible that does this work for you. ItsDeductible determines and assigns actual fair market valuation to thousand of commonly donated items ensuring that you maximize your tax savings.

Make sure you use good judgment and that you don't overvalue your donations.

Medical Expenses

Some of your medical expenses are also deductible as long as your total medical expenses exceed 7-1/2% of your income. For example, if your income for 2003 is $40,000, you can deduct only the amount of your medical costs that exceed $3,000 ($40,000 times 7-1/2%). If your total medical bills were $3,000 or less, you can't qualify for the deduction. Before you go through all of your doctors' bills and prescription receipts, do a quick calculation based on your income to make sure your time will be well spent.

Deductible medical expenses include doctors' and dentists' fees, chiropractors' fees, lab fees, contact lenses, glasses, prescription drugs and medical supplies.

- For a complete list, see Medical Expenses Checklist.
- If you have a question about a particular medical expense, consult: IRS Publication 502, *Medical and Dental Expenses*.

Caution: If you have medical insurance, make sure that you don't deduct the medical costs that were either paid or reimbursed by your insurance company.

You can deduct the premiums you pay for health insurance coverage, unless your employer pays for your coverage through a payroll deduction using pre-tax dollars. If so, you've already received a tax benefit for your premium payments, so don't deduct those premiums on your return. Consult your employer's benefits department if you're not sure.

Miscellaneous Deductions

Most of the remaining deductions are subject to a limitation similar to the one for medical expenses.

1. Review the miscellaneous deductions listed below.
2. Add up the ones you can take.
3. Calculate 2% of your adjusted gross income.
4. Compare the two figures.

If the total of miscellaneous deductions is larger than 2% of your adjusted gross income, subtract the 2% figure from your total miscellaneous deductions. The difference is the amount you can actually deduct on your return.

If the total of miscellaneous deductions is less than 2% of your adjusted gross income, you can't deduct any of these items.

Examples of miscellaneous expenses that you could deduct include:

- Dues you pay to a union or a professional organization in connection with your employment
- Subscriptions to magazines and other publications that are related to your work
- Business liability insurance premiums
- The cost of protective work clothing, such as hard hats or safety shoes and glasses, and the cost of uniforms you're required to wear to work
- Tools and supplies used in your work
- Medical examinations required by an employer
- Tuition for classes that maintain or improve the skills required for your present job
- Expenses you incur while looking for a job in the same line of work you normally do (examples: resume' costs, career counseling, and employment agency fees)
- Depreciation on your computer or cellular phone, but only for the part of the time you use your equipment to keep track of your taxable investments (stocks, bonds, mutual funds) or as part of your job, if required by your employer

- The fees you're charged by your financial institution to maintain your IRA account, but only if you pay them from funds outside of your IRA account (if your financial institution just deducts the maintenance fees directly from your IRA, you can't deduct them)
- Safe deposit box rental fees, if you use the box to store stocks, bonds, or other investment-related documents (if you just store jewelry and other personal items there, the fees aren't deductible)
- What you pay to get your taxes done, whether it's by a professional or with tax preparation software. You can also deduct the cost of any books or publications that help you with preparing your return, and, if you file your return electronically, you can deduct any costs associated with that process
- Legal fees that you pay to protect your taxable income, or to produce your taxable income (This includes fees for legal assistance for helping you keep your job, for tax planning or investment counseling, or for handling an audit of your tax return. Legal fees for divorces aren't deductible, except for any portion specifically related to helping you collect alimony payments or for advice about the taxability of your alimony. You can only deduct legal fees that you pay in your efforts to collect income that's taxable to you.)

There are many other expenses that you can deduct. For example, if you're involved in estates, trusts, and investments, or if you have significant job-related expenses, it's worth your time to investigate a bit further. For more information, see IRS Publication 529, *Miscellaneous Deductions*.

Another way to find more deductions is to use tax preparation software. Tax preparation software such as TurboTax can help you decide whether you should itemize your deductions. Simply enter all of your information when prompted, and let the program determine if it's better for you to itemize or take the standard deduction.