

Section 3: Deductions and Credits

3.1 Itemized Deductions

1. Medical and Dental Expenses
2. Various taxes (e.g., state income, personal property, real estate)
3. Interest expense (e.g., mortgage interest, investment interest, tracing rules, points)
4. Charitable Contributions

Part 1 Itemized Deductions

- 5. Non business Casualty and Theft Losses
- 6. Miscellaneous Itemized Deductions
- 7. Employee Travel, Transportation and Entertainment Expenses
- 8. Other Employee Expenses
- 9. AGI Limitations
- 10. Allowed Itemized Deductions for Form 1040-NR

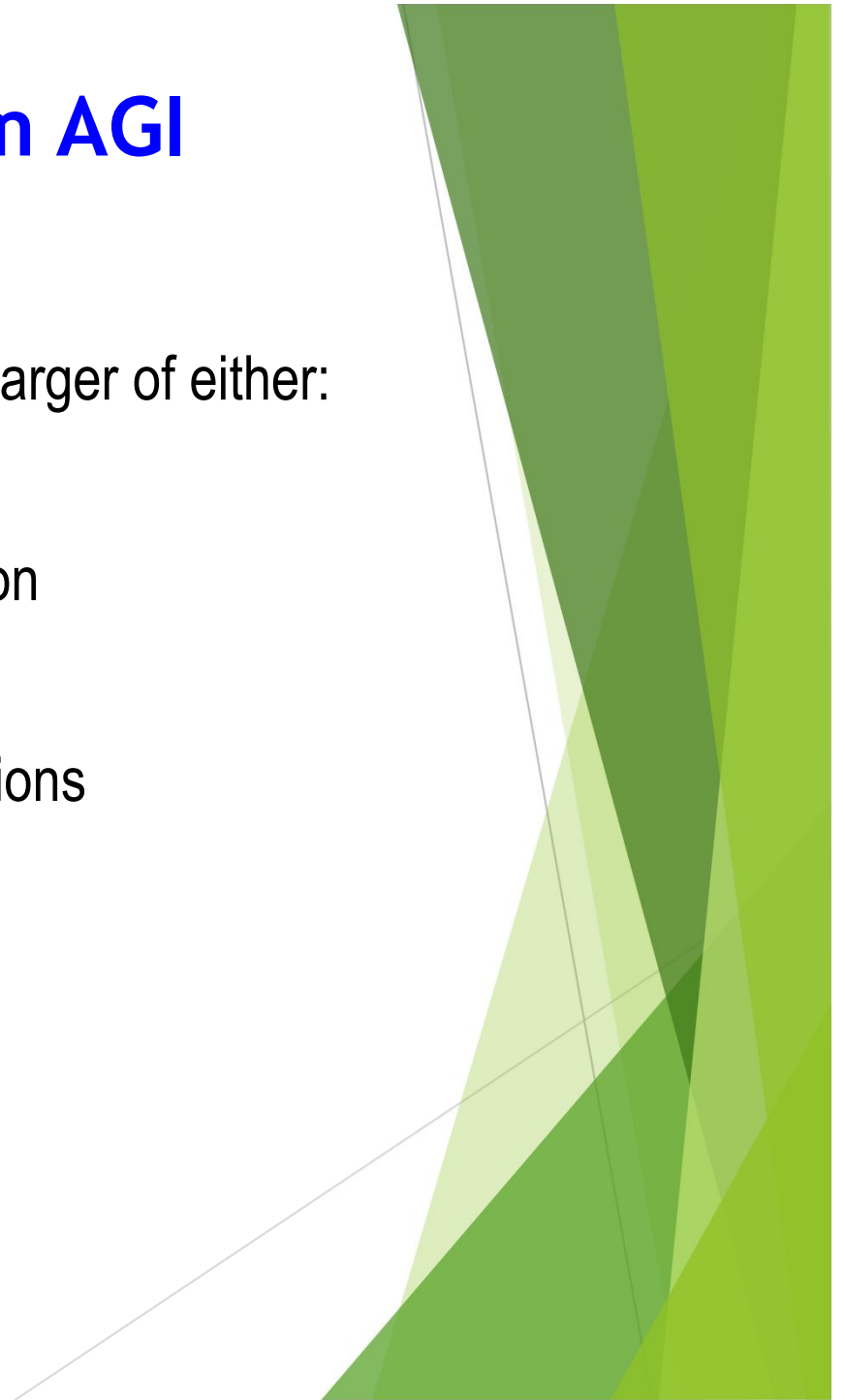
Deductions from AGI

Individual taxpayers may deduct the larger of either:

A standard deduction

or

Total itemized deductions



Deductions From AGI

The standard deduction is the sum of two components:

- ▶ *Basic* standard deduction- The amount allowed is based on taxpayer's filing status
- ▶ Additional standard deductions- Available for taxpayers who are
 - ▶ Age 65 or over, and/or Blind
 - ▶ Two additional standard deductions are allowed for a taxpayer who is age 65 or over and blind
 - ▶ Amount allowed depends on filing status

Standard Deductions

Is Based on filing status

- ▶ Taxpayers who are over 64 years of age receive extra amounts, as do blind taxpayers

Standard deduction amounts:

| | 2018 | 2019 |
|------------------------------|----------|----------|
| ▶ Single | \$12,000 | \$12,200 |
| ▶ Married, filing jointly | \$24,000 | \$24,400 |
| ▶ Married, filing separately | \$12,000 | \$12,200 |
| ▶ Head of Household | \$18,000 | \$18,350 |
| ▶ Surviving spouse | \$24,000 | \$24,400 |

Itemized Deductions

Through legislative grace, there are 6 categories of personal expenses individual taxpayers may deduct:

- ▶ Medical
- ▶ Taxes
- ▶ Interest
- ▶ Charitable Contributions
- ▶ Casualty Losses
- ▶ Miscellaneous

Adjusted Gross Income (AGI)

AGI is an important subtotal

- ▶ Serves as the basis for computing percentage limitations on certain itemized deductions such as
 - ▶ Medical expenses
 - ▶ Charitable contributions
 - ▶ Certain casualty losses
- ▶ E.g., For taxpayers under age 65, medical expenses are deductible only to the extent they exceed 10% of AGI
 - ▶ This limitation might be described as a 10% “floor” under the medical expense deduction

Deductions From AGI

Deductions *from* AGI include:

The greater of:

- ▶ Itemized deductions, or
- ▶ The standard deduction

And

- ▶ Personal and dependency exemptions

Deductions From AGI

This is a partial list of itemized deductions:

- ▶ Medical expenses in excess of 10% of AGI
- ▶ Certain taxes and interest
- ▶ Charitable contributions
- ▶ Casualty Losses in excess of 10% of AGI
- ▶ Deductions for expenses related to
 - ▶ The production or collection of income, and
 - ▶ The management of property held for the production of income
 - ▶ Certain miscellaneous itemized deductions in excess of 2% of AGI

1. Medical and Dental Expenses

- ▶ Unreimbursed medical expenses of the taxpayer and medical dependents are deductible
 - ▶ Medical dependents need not meet the gross income and the joint return tests
 - ▶ Costs include premiums for health and accident insurance and transportation at 19 cents per mile
 - ▶ Deduction is limited to the excess of total costs over 10% of AGI (7.5% for taxpayers 65 and older through 2016)

2. Taxes

The Following payments are deductible:

- ▶ Amounts paid for either sales taxes or state and local income taxes are deductible
- ▶ Amounts paid for real estate and other personal property taxes are deductible
 - ▶ No payments for federal taxes are allowed
 - ▶ Property taxes must be based on value

3. Qualified Mortgage Interest

- ▶ Qualified home mortgage interest is deductible
 - ▶ Debt must be secured by a principal residence
 - ▶ *Qualified* interest is interest paid for Home owners. Taxpayers can deduct interest expenses on up to:
 - ▶ \$750,000 of mortgage debt for couples Married Filing Joint
 - ▶ \$375,000 for taxpayers Filing Separate from income taxes.
 - ▶ However, taxpayers will forego the standard deduction.
 - ▶ Home must have been purchased after December 15, 2017

3. Qualified Mortgage Interest – Points

Points on a qualified mortgage are deductible if paid to acquire financing:

- ▶ Must be stated as a % of the loan value
- ▶ Deductible currently if paid on acquisition debt
 - ▶ If for refinancing, amortize over the life of the loan

1.3 Investment Interest

- ▶ Deduction for investment interest is limited to the amount of *net investment income*
- ▶ Investment Income – Investment Expenses = Net Investment Income
 - ▶ Investment income = portfolio income plus gross income and gains from investment assets
 - ▶ Investment expenses include all ordinary and necessary expenses directly connected to the production of the investment income other than tax-exempt investment income.

1.4 Charitable Contributions

Deduction amount for property depends on the type of property given:

Ordinary income property or short-term capital gain property

- ▶ Deduction is the lesser of the property's
 - ▶ FMV, or
 - ▶ adjusted basis
- ▶ Deduction amount for long-term capital gain property is FMV

1.4 Charitable Contributions

Limitations

- ▶ **Overall** deduction cannot exceed 60% of AGI
- ▶ Deduction for **long-term capital gain** property cannot exceed 30% of AGI
 - ▶ If the taxpayer elects to deduct the adjusted basis rather than FMV, the 60% limit is used
- ▶ Contributions to non-operating private foundations are subject to additional limits

1.5 Casualty Losses

- ▶ Loss is the lesser of
 - ▶ Property's adjusted basis, or
 - ▶ Decline in the value of the property (repair cost)
- ▶ Loss is reduced by
 - ▶ Insurance proceeds received,
 - ▶ \$100 per event (Administrative convenience), and
 - ▶ 10% of AGI per year

6 Miscellaneous Deductions

Various other expenses are combined as miscellaneous itemized deductions and are either fully deductible or partially deductible

6 Miscellaneous Deductions

Partially deductible (to the extent the total of this group of expenses exceeds 2% of AGI):

- ▶ Unreimbursed employee expenses
- ▶ Investment expenses other than interest
- ▶ Hobby-related expenses

6 Miscellaneous Deductions Fully Deductible

- ▶ Fully Deductible:
 - ▶ Gambling losses to the extent of gambling winnings,
 - ▶ Impairment-related-work expenses of disabled taxpayers, and
 - ▶ Unrecovered capital from a terminated annuity

Phase-out of Itemized Deductions and Exemptions

- ▶ High-income taxpayers must reduce their allowable itemized deductions and exemptions if their AGI is above a threshold amount
 - ▶ Threshold amounts are based on filing status and are the same for both itemized deductions and exemptions

Phase-out of Itemized Deductions

Taxpayers are subject to a limit on itemized deductions if the AGI is more than:

- ▶ \$ 313,000 Married Filing Joint or Qualifying Widow (er)
- ▶ \$ 287,550 Head of Household
- ▶ \$ 261,500 Single,
- ▶ \$156,900 Married Filing Separately

Section 3 Deductions and Credits

3.1 Itemized Deductions

7. Employee travel, transportation and entertainment expenses



Employee travel, transportation and entertainment expenses

Travel

Travel expenses are the ordinary and necessary expenses of traveling away from home for your business, profession or job. Generally, employees deduct these expenses by using Form 2106, *Employee Business Expenses*, or Form 2106-EZ, *Unreimbursed Employee Business Expenses*, and Form 1040, Schedule A, *Itemized Deductions*. You cannot deduct expenses that are lavish or extravagant or that are for personal purposes.

You are traveling away from home if your duties require you to be away from the general area of your tax home for a period substantially longer than an ordinary day's work, and you need to get sleep or rest to meet the demands of your work while away.

Employee travel, transportation and entertainment expenses

Generally, your tax home is the entire city or general area where your main place of business or work is located, regardless of where you maintain your family home. For example, you live with your family in Chicago but work in Milwaukee where you stay in a hotel and eat in restaurants. You return to Chicago every weekend. You may not deduct any of your travel, meals or lodging in Milwaukee because that is your tax home. Your travel on weekends to your family home in Chicago is not for your work, so these expenses are also not deductible. If you regularly work in more than one place, your tax home is the general area where your main place of business or work is located.

Employee travel, transportation and entertainment expenses

In determining your main place of business, take into account the length of time you normally need to spend at each location for business purposes, the degree of business activity in each area, and the relative significance of the financial return from each area. However, the most important consideration is the length of time you spend at each location.

You can deduct travel expenses paid or incurred in connection with a temporary work assignment away from home. However, you cannot deduct travel expenses paid in connection with an indefinite work assignment. Any work assignment in excess of one year is considered indefinite. Also, you may not deduct travel expenses at a work location if you realistically expect that you will work there for more than one year, whether or not you actually work there that long. If you realistically expect to work at a temporary location for one year or less, and the expectation changes so that at some point you realistically expect to work there for more than one year, travel expenses become nondeductible when your expectation changes.

Employee travel, transportation and entertainment expenses

Transportation

If you use your car in your job or business and you use it only for that purpose, you may deduct its entire cost of operation (subject to limits discussed later). However, if you use the car for both business and personal purposes, you may deduct only the cost of its business use.

You can generally figure the amount of your deductible car expense by using one of two methods: the **standard mileage rate** method or the **actual expense** method. If you qualify to use both methods, you may want to figure your deduction both ways before choosing a method to see which one gives you a larger deduction.

For the current **standard mileage rate**, refer to [Publication 463](#), *Travel, Entertainment, Gift, and Car Expenses*, or search standard mileage rates on [IRS.gov](#). If you use the standard mileage rate, you can add to your deduction any parking fees and tolls incurred for business purposes.

Employee travel, transportation and entertainment expenses

Entertainment

Business entertainment expenses and business gift expenses may be deductible but subject to certain limits. For information on business entertainment expenses, refer to [Topic 512](#). For additional information on business expenses, refer to [Publication 463](#), *Travel, Entertainment, Gift, and Car Expenses*.

You must keep records to prove the expenses you deduct. For general information on recordkeeping, refer to [Topic 305](#).

If your employer reimbursed you or gave you an advance or allowance for your employee business expenses that is treated as paid under an accountable plan, the payment should not appear as income on your [Form W-2](#), *Wage and Tax Statement*. You do not include the payment in your income, and you may not deduct any of the reimbursed amounts.

Entertainment

To be an accountable plan, your employer's reimbursement or allowance arrangement must include all three of the following rules:

You must have paid or incurred expenses that are deductible while performing services as an employee

You must adequately account to your employer for these expenses within a reasonable time period, and

You must return any excess reimbursement or allowance within a reasonable time period

These rules are discussed in greater detail in [Publication 463](#), *Travel, Entertainment, Gift, and Car Expenses*.

If your employer's reimbursement arrangement does not meet all three requirements, the payments you receive should be included in the wages shown on your [Form W-2](#)

Entertainment

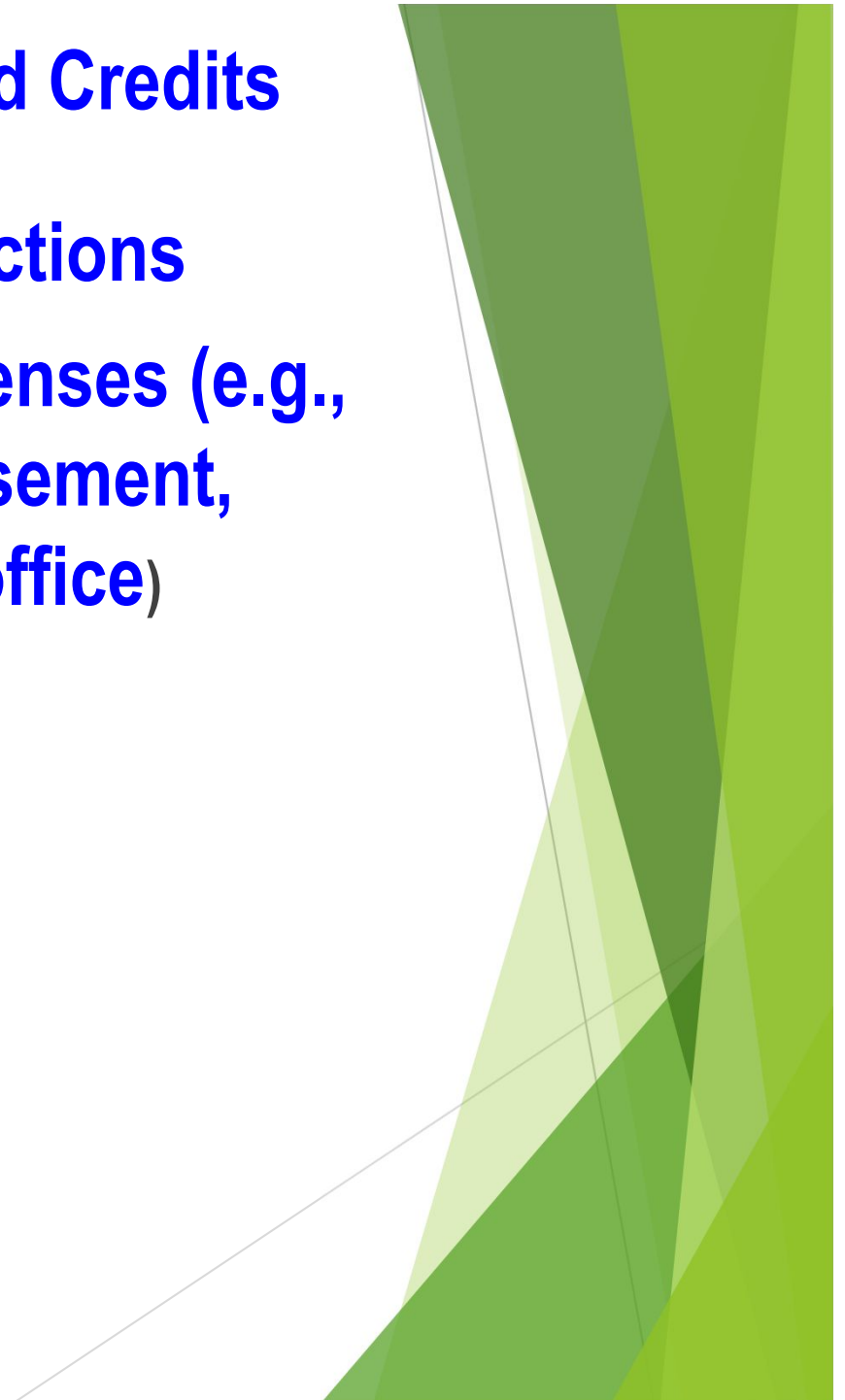
You must report the payments as income, and you must complete [Form 2106](#) , *Employee Business Expenses*, or [Form 2106-EZ](#) , *Unreimbursed Employee Business Expenses*, and itemize your deductions to deduct your expenses. See [Publication 463](#) for detailed information on your employer's reporting requirement for business expenses and how you are required to report these expenses on your tax return.

If your employer reimbursed you for travel or transportation under an accountable plan but at a per diem or mileage rate that exceeds the federal rate, your employer should include the excess in the wages on your Form W-2. Box 12 of your Form W-2 should report the amount up to the allowance. If your actual expenses exceed the federal rate, you may

Section 3 Deductions and Credits

3.1 Itemized Deductions

**8. Other employee expenses (e.g.,
education, reimbursement,
eligibility, home office)**



8. Other employee expenses (e.g., education, reimbursement, eligibility, home office)

Education

You may be able to deduct work-related educational expenses paid during the year as an itemized deduction on Form 1040, Schedule A, *Itemized Deductions*. To be deductible, your expenses must be for education that (1) maintains or improves your job skills or (2) that your employer or a law requires to keep your salary, status or job. However, even if the education meets either of these tests, the education cannot be part of a program that will qualify you for a new trade or business or that you need to meet the minimal educational requirements of your trade or business.

Education

Although the education must relate to your present work, educational expenses incurred during temporary absence from your job may be deductible. After your temporary absence, you must return to the same kind of work. Usually, absence from work for one year or less is considered temporary. Expenses that you can deduct include:

Tuition, books, supplies, lab fees, and similar items

Certain transportation and travel costs, and

Other educational expenses, such as the cost of research and typing

Business Use of Home

Whether you are self-employed or are an employee, you may be able to deduct certain expenses for the part of your home you use for business.

To deduct expenses for business use of the home, you must use part of your home as one of the following:

Exclusively and regularly as your principal place of business for your trade or business

- ▶ Exclusively and regularly as a place where you meet and deal with your patients, clients, or customers in the normal course of your trade or business; or
- ▶ A separate structure used exclusively and regularly in connection with your trade or business that is not attached to your home
- ▶ On a regular basis for certain storage use
- ▶ For rental use
- ▶ As a daycare facility

Business Use of Home

If the exclusive-use requirement applies, you cannot deduct business expenses for any part of your home that you use both for personal and business purposes. For example, if you are an attorney and use the den of your home to write legal briefs and for personal purposes, you may not deduct any business use of your home expenses. Further, under the principal place of business test, you must determine that your home is the principal place of your trade or business after considering where you perform your most important business activities and where you spend most of your business activity time, in order to deduct expenses for the business use of your home. Additionally, a portion of your home may qualify as your principal place of business if you use it for the administrative or management activities of your trade or business and you have no other fixed location where you conduct substantial administrative and management activities for that trade or business. An employee may only deduct business use of the home expenses when he or she uses the business part of the home regularly and exclusively and for the employer's convenience.

Section 3: Deductions and Credits

3.1 Itemized Deductions

9. AGI Limitations



9. AGI Limitations

Itemized Deductions versus Standard Deduction. Itemized deductions are deducted *from* AGI if they exceed the taxpayer's standard deduction. If itemized deductions do not exceed the standard deduction, they are “lost” because they do not produce a tax benefit. If you have deductible expenses that qualify as miscellaneous itemized deductions, you can deduct certain of those expenses only to the extent that they exceed 2% of your adjusted gross income. For an explanation of deductible and nondeductible expenses, refer to [Publication 529](#), *Miscellaneous Deductions*.

There are three types of expenses that are subject to the 2% limit: unreimbursed employee expenses, tax preparation fees and certain other expenses.

9. AGI Limitations

Certain unreimbursed employee expenses are deductible as miscellaneous itemized deductions on [Form 1040, Schedule A](#), *Itemized Deductions*, or Schedule A in [Form 1040NR](#), *U.S. Nonresident Alien Income Tax Return*. To be deductible, the expense must be:

- ▶ Paid or incurred in the tax year
- ▶ For carrying on your trade or business of being an employee, and
- ▶ Ordinary and necessary

You can deduct other expenses subject to the 2% limit that you pay to:

- ▶ Produce or collect taxable income that must be included in your gross income,
- ▶ Manage, conserve, or maintain property held for producing such income, or
- ▶ Determine, contest, pay, or claim a refund of any tax.

You can deduct expenses you pay for the purposes in (1) and (2) above only if they are reasonable and closely related to these purposes.

Section 3: Deductions and Credits

3.1 Itemized Deductions

10. Allowed itemized deductions for Form 1040-NR



Allowed Itemized Deductions For Form 1040-NR

Generally, you apply the 2% limit after you apply any other deduction limit. For example, you apply the 50% (or 80%) limit on business-related meals and entertainment (discussed under [Travel, Transportation, Meals, Entertainment, Gifts, and Local Lodging](#)) before you apply the 2% limit.

- ▶ Deductions subject to the 2% limit are discussed in the following three categories.
- ▶ Unreimbursed employee expenses (Schedule A (Form 1040), line 21 or Schedule A (Form 1040NR), line 7).
- ▶ Tax preparation fees (Schedule A (Form 1040), line 22 or Schedule A (Form 1040NR), line 8).
- ▶ Other expenses (Schedule A (Form 1040), line 23 or Schedule A (Form 1040NR), line 9).