**Chapter Five**

**Itemized Deductions and Other Incentives**

**Learning Objective 5.1 Medical Expenses**

Medical expenses are the first itemized deductions on the Schedule A.

* Includes amounts paid for the taxpayer, spouse or dependents.
* Prescription medications, visits to doctors, dentists and hospitals, medical insurance premiums, lodging and transportation expenses for medical care, hearing aids, dentures, eyeglasses and contact lenses.
  + Decreased by any insurance reimbursements.
  + The deductible amount is the amount greater than 10% of AGI for taxpayers under age 65 at year-end. The 7.5% threshold remains in effect through 2016 for taxpayers who reach the age of 65 by year-end.
    - MFJ only one taxpayer must be 65

**Learning Objective 5.2 Taxes**

Certain state, local and foreign taxes paid during the year are deductible.

* May deduct state and local income taxes paid during the year.
  + Taxpayer may elect to deduct either state/local sales tax or state income tax.
* Real estate taxes are deductible.
* Personal property taxes based on the value of the property (ad valorem) are deductible.

**Learning Objective 5.3 Interest**

* Interest paid on a qualified residence deductible on up to $1,000,000 primary mortgage and $100,000 home equity debt
  + Private Mortgage Interest (PMI) for taxpayers with AGI of $100,000 or less.
  + Points deductible
* Investment interest and certain interest associated with a passive activities are deductible
  + The investment interest deduction is limited to the net investment income of the taxpayer.
* Consumer interest (such as the interest on credit cards) is *not deductible.*
* Education loan interest is limited to $2,500 and phased-out if an individual taxpayer’s modified AGI > $65,000 and for married taxpayers with modified AGI >$130,000

**Learning Objective 5.4 Contributions**

Taxpayers may deduct charitable contributions of either cash or property

* The IRS maintains a list of organizations that are considered to be charitable.
* If property is donated, the deduction is equal to the fair market value of the property.
* The limit of contributions to public charities and private foundations is 50%of AGI.
* Other contribution limits are established for long-term capital gain property.
  + The amount over the contribution limit may be carried forward for five years.
* Taxpayers should keep all receipts, cancelled checks or other proof of contributions.
  + Complete Form 8283 if the individual made a contribution of property over $500. For large gifts of property ($5,000+), must obtain/submit an appraisal.

**Learning Objective 5.5 Casualty and Theft Losses**

Taxpayers are allowed deductions for losses due to casualties or thefts.

* A casualty is defined as a *complete or partial destruction of property* resulting from an identifiable event of a sudden, unexpected, or unusual nature
  + Most casualties are natural occurrences, such as damages caused by floods or storms.
  + For damages to be considered casualties, the condition must be *unusual* for the area.
  + Deductions for theft losses occur in the year the theft is discovered, not when the theft actually occurred.
* There are 2 ways to establish the amount of losses.
  + Rule A allows a loss based on the decrease in fair market value of the property.
  + Rule B limits the deduction to the adjusted basis of the property.
    - A $100 floor per occurrence limits the overall amount of the deduction.
    - Then, total loss must exceed 10% of AGI.
    - There are different rules based upon whether the property is used for business or personal purposes.

**Learning Objective 5.6 Miscellaneous Deductions**

Taxpayers are allowed to take several miscellaneous deductions.

* Either limited by 2% of AGI or are not limited.
  + Those limited by 2% of AGI include unreimbursed employee business expenses and employee business expenses reimbursed under a nonaccountable plan, investment expenses and other expenses such as tax preparation fee, union dues, job hunting expenses, and professional subscriptions.
  + Those not limited by the 2% include certain estate taxes, amortizable bond premiums, unrecovered annuity costs at death, handicapped “impairment related work expenses” and gambling losses to extent of gambling winnings.

**Learning Objective 5.7 Classification of Deductions-Employees**

Business expense incurred by an employee in performing services for employer are miscellaneous itemized deductions, subject to the 2% of AGI

* File Form 2106 or 2106-EZ
* Or – if reimbursement is not included in gross income because the employee business expense is under an accountable plan, then no deduction on 2106

**Learning Objective 5.8 Educational Incentives**

Qualified Tuition Programs (QTP) allow taxpayers to buy in-kind tuition credits for qualified higher education expenses or to contribute to an account

* Qualified higher education expenses include tuition, fees, books, supplies, and equipment required for the enrollment or attendance at an eligible education intuition.
  + No income limit on the amount of contributions to the QTP
  + Contributions are *not* tax deductible.
  + The contributions are considered gifts and thus subject to gift tax rules.
* Distributions from QTPs may be taken in the same year as an education credit (Chapter 6), as long as the amount distributed is not used to calculate the credit.

Educational savings accounts (ESAs) are established to pay for qualified higher education expenses.

* The maximum annual contribution to these plans is $2,000.
* Contributions can be made until the designated beneficiary reaches 18.
* Can’t contribute to an ESA in the same year a contribution is made to a QTP
* Contributions to ESAs are phased out between AGI of $95,000 and $110,000 (S) and $190,000 and $220,000 (MFJ)
  + Contributions must be made by April 15 of the following tax year.

**Learning Objective 5.9 Phase-Out of Itemized Deductions and Exemptions for High-Income Taxpayers**

Taxpayers with AGI over certain threshold amounts are subject to both itemized deduction and exemption phase-outs.

* The thresholds are: single - $259,400, head of household - $285,350, married filing joint - $311,300, and married filing separately - $155,650.
* Itemized deductions are reduced by the lesser of 3% of the excess of AGI over the threshold amount or 80% of itemized deductions
  + *Note:* Medical expenses, investment interest expense, casualty and theft losses, and gambling losses to the extent of gambling winnings *are not subject to phase-out*.
* Personal and dependency exemptions are reduced by 2% for each $2,500 ($1,250 – married filing separately) or fraction thereof by which AGI exceeds the threshold amount.