HBLA

CERTIFIED PUBLIC ACCOUNTANTS INC.

From the desk of Vic Hausmaninger, CEO

# THE 18 MOST FREQUENTLY OVERLOOKED TAX DEDUCTIONS

***When we have the privilege of discussing tax services with prospective clients, one of the first things we do is to review prior returns for possible omissions / errors. We are always amazed to see how many we locate – enabling us, in many cases, to file amended returns and get refunds. Set forth below is a list of the most common ones. For those of you receiving our e-mail newsletter ValueLine who prepare your own tax returns or have them prepared by others, you may want to just check to make sure that you don't overlook one or more of the following:***

**1. Reinvested dividends**

This isn't really a tax deduction, but it is an important subtraction that can save you a bundle. If, like most investors, your mutual fund dividends are automatically used to buy extra shares, remember that each reinvestment increases your tax basis in the fund. That, in turn, reduces the taxable capital gain (or increases the tax-saving loss) when you redeem shares. Forgetting to include the reinvested dividends in your basis results in double taxation of the dividends -- once when they are paid out and immediately reinvested in more shares and later when they're included in the proceeds of the sale. Don't make that costly mistake. If you're not sure what your basis is, ask the fund for help.

**2. State sales taxes**

Although all taxpayers have a shot at this write-off, it makes sense primarily for those who live in states that do not impose an income tax. You must choose between deducting state and local income taxes or state and local sales taxes. For most citizens of income-tax states, the income tax is a bigger burden than the sales tax, so the income-tax deduction is a better deal.

The IRS has tables that show how much residents of various states can deduct, based on their income and state and local sales tax rates. But the tables aren't the last word. If you purchased a vehicle, boat or airplane, you get to add the sales tax you paid to the amount shown in the IRS table for your state.

The same goes for any homebuilding materials you purchased. These add-on items are easy to overlook, but big-ticket items could make the sales-tax deduction a better deal even if you live in a state with an income tax. The IRS has a calculator on its Web site to help you figure the deduction.

**3. Out-of-pocket charitable contributions**
It's hard to overlook the big charitable gifts you made during the year, by check or payroll deduction (check your December pay stub).

But the little things add up, too, and you can write off out-of-pocket costs incurred while doing work for a charity. For example, ingredients for casseroles you prepare for a nonprofit organization's soup kitchen and stamps you buy for your school's fundraising mailing count as a charitable contribution. Keep your receipts and if your contribution totals more than $250, you'll need an acknowledgement from the charity documenting the services you provided. If you drove your car for charity in 2011, remember to deduct 14 cents per mile plus parking and tolls paid in your philanthropic journeys.

**4. Student-loan interest paid by Mom and Dad**
Generally, you can only deduct mortgage or student-loan interest if you are legally required to repay the debt. But if parents pay back a child's student loans, the IRS treats the money as if it was given to the child, who then paid the debt. So, a child who's not claimed as a dependent can qualify to deduct up to $2,500 of student-loan interest paid by Mom and Dad. And he or she doesn't have to itemize to use this money-saver. Mom and Dad can't claim the interest deduction even though they actually foot the bill since they are not liable for the debt.

**5. Job-hunting costs**
If you're among the millions of unemployed Americans who were looking for a job in 2011, we hope you kept track of your job-search expenses ... or can reconstruct them. If you're looking for a position in the same line of work, you can deduct job-hunting costs as miscellaneous expenses if you itemize. Such expenses can be written off only to the extent that your total miscellaneous expenses exceed 2% of your adjusted gross income. Job-hunting expenses incurred while looking for your first job don't qualify. Deductible job-search costs include, but aren't limited to:

- Food, lodging and transportation if your search takes you away from home overnight
- Cab fares
- Employment agency fees
- Costs of printing resumes, business cards, postage, and advertising

**6. The cost of moving for your first job**
Although job-hunting expenses are not deductible when looking for your first job, moving expenses to get to that job are. And you get this write-off even if you don't itemize.
To qualify for the deduction, your first job must be at least 50 miles away from your old home. If you qualify, you can deduct the cost of getting yourself and your household goods to the new area. If you drove your own car, your mileage write-off depends on when during 2011 you moved. For moves from January 1 through the end of June, the standard mileage rate is 19 cents a mile; for moves during the second half of the year, a  23.5 cents a mile rate applies. In either case, boost your deduction by any amount you paid for parking and tolls.

**7. Deduction of Medicare premiums for the self-employed**

Folks who continue to run their own businesses after qualifying for Medicare can deduct the premiums they pay for Medicare Part B and Medicare Part D and the cost of supplemental Medicare (medigap) policies. This deduction is available whether or not you itemize and is not subject the 7.5% of AGI test that applies to itemized medical expenses. One caveat: You can't claim this deduction if you are eligible to be covered under an employer-subsidized health plan offered by your employer (if you have a job as well as your business) or your spouse's employer.

**8. Child-care credit**

A credit is so much better than a deduction; it reduces your tax bill dollar for dollar. So missing one is even more painful than missing a deduction that simply reduces the amount of income that's subject to tax.

You can qualify for a tax credit worth between 20% and 35% of what you pay for child care while you work. But if your boss offers a child care reimbursement account – which allows you to pay for the child care with pre-tax dollars – that might be a better deal. If you qualify for a 20% credit but are in the 25% tax bracket, for example, the reimbursement plan is the way to go. (In any case, only expenses for the care of children under age 13 count.)

You can't double dip. Expenses paid through a plan can't also be used to generate the tax credit. But get this: Although only $5,000 in expenses can be paid through a tax-favored reimbursement account, up to $6,000 for the care of two or more children can qualify for the credit. So, if you run the maximum through a plan at work but spend even more for work-related child care, you can claim the credit on as much as $1,000 of additional expenses. That would cut your tax bill by at least $200.

**9. Estate tax on income in respect of a decedent**

This sounds complicated, but it can save you a lot of money if you inherited an IRA from someone whose estate was big enough to be subject to the federal estate tax.

Basically, you get an income-tax deduction for the amount of estate tax paid on the IRA assets you received. Let's say you inherited a $100,000 IRA, and the fact that the money was included in your benefactor's estate added $45,000 to the estate-tax bill. You get to deduct that $45,000 on your tax returns as you withdraw the money from the IRA. If you withdraw $50,000 in one year, for example, you get to claim a $22,500 itemized deduction on Schedule A. That would save you $6,300 in the 28% bracket.

**10. State tax paid last spring**

Did you owe tax when you filed your 2010 state income tax return in the spring of 2011? Then remember to include that amount in your state-tax deduction on your 2011 federal return, along with state income taxes withheld from your paychecks or paid via quarterly estimated payments.

**11. Refinancing points**
When you buy a house, you get to deduct in one fell swoop the points paid to get your mortgage. When you refinance, though, you have to deduct the points on the new loan over the life of that loan. That means you can deduct 1/30th of the points a year if it's a 30-year mortgage. That's $33 a year for each $1,000 of points you paid -- not much, maybe, but don't throw it away.

Even more important, in the year you pay off the loan -- because you sell the house or refinance again -- you get to deduct all as-yet-“undeducted” points. There's one exception to this sweet rule: If you refinance a refinanced loan with the same lender, you add the points paid on the latest deal to the leftovers from the previous refinancing -- and deduct that amount gradually over the life of the new loan.

**12. American Opportunity Credit**
This tax credit is available for up to $2,500 of college tuition and related expenses paid during the year. The full credit is available to individuals whose modified adjusted gross income is $80,000 or less ($160,000 or less for married couples filing a joint return). The credit is phased out for taxpayers with incomes above those levels. This credit is juicier than the old Hope credit – it has higher income limits and bigger tax breaks, and it covers all four years of college. And if the credit exceeds your tax liability, it can trigger a refund. (Most credits can reduce your tax to $0, but not get you a check from the IRS.)

**13. Deduct those blasted baggage fees**
In recent years airlines have been driving passengers batty with extra fees for baggage and for making changes in their travel plans. Altogether, such fees add up to billions of dollars each year. If you get burned, maybe Uncle Sam will help ease the pain. If you're self-employed and travelling on business, be sure to add those cost to your deductible travel expenses.

**14. Credit for energy-saving home improvements**
Although this credit has been scaled back, it still exists and might save you some money if you made energy-saving home improvements during 2011. The credit is worth 10% of the cost of qualifying energy savers including new windows and insulation. The maximum credit is $500 and, if you claimed this credit in the past, you're probably out of luck now. That $500 is the maximum credit allowed on all tax returns from 2006 to 2011.

There's also no dollar limit on the separate credit for homeowners who install qualified residential alternative energy equipment, such as solar hot water heaters, geothermal heat pumps and wind turbines. Your credit can be 30% of the total cost (including labor) of such systems installed through 2016.

**15. Additional bonus depreciation**
Business owners can write off 100% of the cost of qualified assets placed in service during 2011. This break applies only to new assets with recovery periods of 20 years or less, such as computers, machinery, equipment, land improvements and farm buildings. So don't miss out on this big tax benefit if you placed business assets in service during 2011.

**16. Break on the sale of demutualized stock**
Taxpayers won an important court battle with the IRS over the issue of demutualized stock. That's stock that a life insurance policyholder receives when the insurer switches from being a mutual company owned by policyholders to a stock company owned by stockholders. The IRS's longstanding position was that such stock had no tax basis, so that when the shares were sold, the taxpayer owed tax on 100% of the proceeds of the sale. But after a long legal struggle, a federal court ruled in 2009 that the IRS was wrong. The court didn't say what the basis of the stock should be, but many experts think it's whatever the shares were worth when they were distributed to policyholders. If you sold stock in 2011 that you received in a demutualization, be sure to claim a basis to hold down your tax bill.

**17. Home-buyer credit**
Most people think this credit expired in 2010 ... and it did for most homeowners. But, there's a special rule for members of the uniformed armed services, the foreign service or the intelligence community who were on extended duty outside the United States at least 90 days during the period after December 31, 2008, and ending before May 1, 2010. If you qualify and you bought a home before May 1, 2011, you may qualify for a tax credit worth $8,000 (for home buyers who didn't own a home in the three years leading up to the purchase of a new home) or $6,500 (for longtime homeowners who continuously owned a home for at least five of the eight years leading up to the purchase of a new home). The credit gradually disappears and is phased out for taxpayers with adjusted gross incomes between $125,000 and $145,000 (for singles) and $225,000 and $245,000 (for married couples who file jointly).

**18. Other labor related tax credits**
There are also a number of Federal and California tax credits that were enacted the last couple of years to stimulate the economy through encouraging the hiring of employees. They are available for all businesses but there are qualifications for employers and employees to be able to benefit from those credits. However, if a business qualifies, taxes can be reduced significantly. Three of these credits are: Federal Hire Retention Credit; Federal Small Business Health Care Credit; and California New Jobs Credit. Be sure to review your unique situation to see if you might qualify for one or more of those credits.

Please contact us if we can be of assistance to you with your 2011 tax return filings.

Sincerely,

Vic


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