



Module 5: DEDUCTIONS

Special thanks to: Desmond Leong and Evelyn Mickles for their contributions to this module.

By the end of this module you will...

- Understand how the tax liability is calculated
- Understand the ways to lower one's taxable income and income taxes
- Understand the difference between the Standard and Itemized Deductions
- Understand how to determine which deduction should be applied to a client's return
- Understand what items/expenses are included with the Itemized Deduction



The Tax Computation

A general overview

The Tax Computation

- Tax filers are not taxed on all of their income
- Taxes are only paid on “**Taxable Income**”

Total Income ≠ Taxable Income

- Total Income – Adjustments = **Adjusted Gross Income**
- Adjusted Gross Income – Deductions = **Taxable Income**
- Taxable income does not mean the income will be taxed – it means the income is reported on the 1040.

Determining Taxable Income

Step 1: Determine “Total Income” (this is not the same as “Taxable Income”)

▪ Total Income = the sum of the following:

- Wages
- Interest
- Dividends
- Capital gains
- Business Income
- Pensions
- Social Security
- Unemployment,
- etc.

Total Income = line 9 = the sum of lines 1z + 2b + 3b + 4b + 5b + 6b + 7 + 8

Determining Taxable Income

Step 2: Reduce **Total Income** to determine **Taxable Income**

▪ There are two income reducing categories:

▪ **Adjustments** (Module 4):

- IRA deductions
- Student Loan Interest
- Self-Employment tax, etc.

Total Income – Adjustments
=
Adjusted Gross Income (AGI)

▪ **Deductions**

- Standard
- Itemized

Adjusted Gross Income – Deductions
=
Taxable Income

Note: Non-refundable credits (Module 6) can also be used to reduce income tax

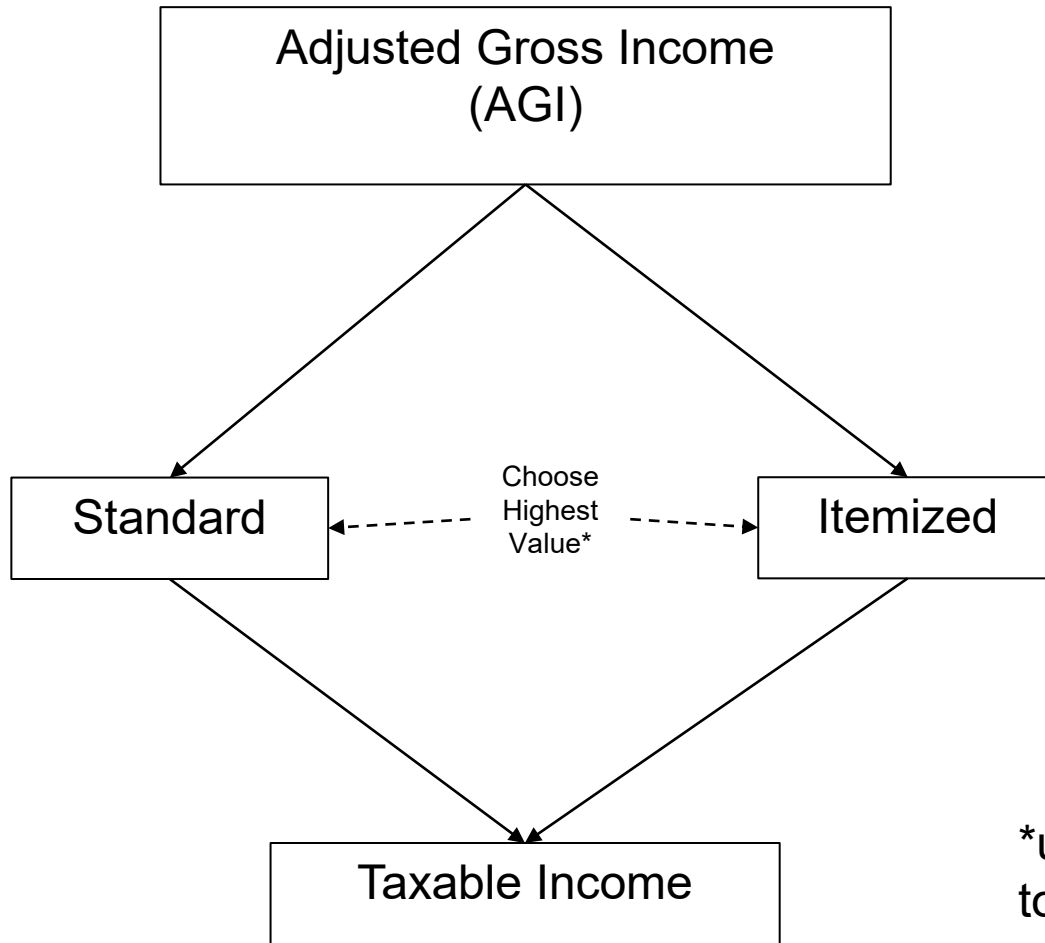


Deductions

Deductions Overview

- **Deductions** are subtracted from the Adjusted Gross Income (AGI) to result in the **Taxable Income**
- This is the value upon which the tax liability is established.
- There are 2 types of Deductions
 - Standard
 - Itemized
- **Only one** of these two can be applied to a return
 - **Use the one with the higher value.... UNLESS** you're required to itemize your deductions!
 - For example, MFS filers may be required to itemize
 - To obtain lowest **Taxable Income** value
- Don't sweat this! You got this!

Deductions → Taxable Income



*unless required to itemize



Standard Deduction

Standard Deduction

- **Standard Deduction** - A dollar amount that reduces the amount of taxable income
 - Varies according to filing status
 - Additional standard deduction for individuals who are blind or age 65 or over
 - You CANNOT take the standard deduction if you itemize deductions
 - Individuals that qualify as someone's dependent generally cannot take the full standard deduction

- **NOTE:** *Not all clients are eligible to take the Standard deduction*
 - *If a married couple is filing separately and one spouse uses Itemized deductions then the other spouse must also use Itemized deductions*
 - *See your 4012 for other less common cases*

Standard Deduction Values (2023 returns)

Filing Status	Standard Deduction Amount
Single and MFS	\$13,850
MFJ and Qualifying Widow(er)	\$27,700
Head of Household	\$10,800

- Additional standard deduction for 65+ and blind
 - Filing Status: MFJ, Qualifying Widow(er) or MFS → \$1,400 for each taxpayer
 - Filing Status: Single or Head of Household → \$1,750
- An individual who qualifies as a dependent: Standard Deduction is the greater of
 - \$1,100 (if all income is unearned income) *OR*
 - sum of \$350 and individual's earned income (up to the standard deduction for their filing status)
 - *OR* the Standard Deduction for their Filing Status **if** earned income is greater than the Standard Deduction



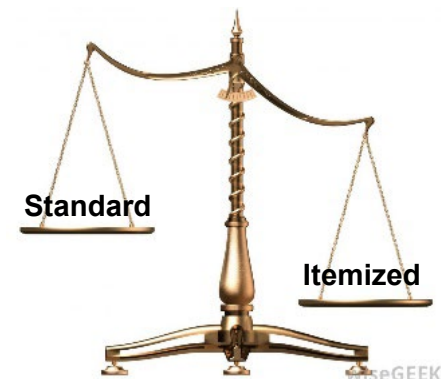
Itemized Deductions

Itemized Deductions – Schedule A

▪ Itemized Deductions

- This will apply to a handful of clients only with the 2017 Tax Law changes
- Itemized deductions generally apply to higher income clients who have a home mortgage
- Individual expenses include:
 - Medical and dental expenses
 - Taxes paid (state & local income taxes, & property taxes)
 - Home mortgage interest & points paid,
 - Gifts to charity
 - Certain miscellaneous deductions.
 - Can include gambling losses and casualty and theft losses
 - Check to make sure these are in scope!

Does the sum of the individual expenses paid by the client result in an amount that is *greater than* the Standard Deduction amount? *If so*, Itemize Deductions and use the sum of the individual expenses to reduce one's taxable income.



Itemized Deduction Expenses

What to include?

▪ Medical

- Expense Amount that is $> 7.5\%$ of AGI
- Include medical & dental expenses paid for all members of the household:
 - Doctor & Dental bills
 - Prescriptions
 - Hospital bills
 - Insurance premiums (health and long-term care) **not** subsidized by employers or covered by the APTC
 - Mental health treatments
 - Transportation for medical treatments
 - And others (see IRS instructions [Schedule A instructions](#))

▪ Taxes

- State sales or income tax (whichever is larger)
 - Note: calculate the sales taxes as it will be likely higher for non-working taxpayers (retired, disabled, etc.)
- Local or foreign income taxes
 - Foreign income taxes are generally out of scope – except those on 1099-INT and 1099-DIV
- Real estate taxes
- Personal property taxes

Beginning with tax year 2018, the total deduction for real estate tax, personal property taxes, and state income tax or sales tax is limited to \$10,000.

Itemized Deduction Expenses

What to include?

- Home mortgage interest (Form 1098)
 - Limited to the 1st and 2nd home **only**
 - Private Mortgage Insurance is back as an interest deduction!
 - For reverse mortgages, no interest until the loan is settled.

- Cash or non-cash donations to a qualified charitable organization
 - Charitable deductions are limited by VITA scope

- Miscellaneous Deductions
 - Gambling losses up to the amount of winnings
 - Be careful not to deduct more gambling losses than reported as gambling winnings! These winnings are reported on W-2G.
 - Most Miscellaneous Deductions, including union dues and investment expenses have been eliminated.
 - Work related expenses are allowed for a Disabled Person only as well.
 - Casualty and Theft Losses are **Out of Scope** for VITA!
 - See your Publication 4012 for the complete list

Interview About Deductions

- Start a discussion about Itemized Deductions with the client using the 13614-C, Part IV.
- Reminder: many clients will have qualifying Itemized Deductions; but may benefit more from the standard deduction. If the client is not making mortgage payments, it's very likely the standard deduction will be more beneficial.
- For TY2022, there is no deduction for cash donations to charity unless the client itemizes.

Yes	No	Unsure	Part IV – Expenses – Last Year, Did You (or Your Spouse) Pay
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	1. (B) Alimony or separate maintenance payments? If yes, do you have the recipient's SSN? <input type="checkbox"/> Yes <input type="checkbox"/> No
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	2. Contributions to a retirement account? <input type="checkbox"/> IRA (A) <input type="checkbox"/> 401K (B) <input type="checkbox"/> Roth IRA (B) <input type="checkbox"/> Other
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	3. (B) College or post secondary educational expenses for yourself, spouse or dependents? (Form 1098-T)
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	4. (A) Deductions: <input type="checkbox"/> Medical & Dental (including insurance premiums) <input type="checkbox"/> Mortgage Interest (Form 1098) <input type="checkbox"/> Taxes (State, Real Estate, Personal Property, Sales) <input type="checkbox"/> Charitable Contributions
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	5. (B) Child or dependent care expenses such as daycare?
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	6. (B) For supplies used as an eligible educator such as a teacher, teacher's aide, counselor, etc.?
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	7. (A) Expenses related to self-employment income or any other income you received?
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	8. (B) Student loan interest? (Form 1098-E)

Re-Cap

- **Taxable Income \neq Total Income**
- Total Income – Adjustments = **Adjusted Gross Income**
- Adjusted Gross Income – Deductions = **Taxable Income**

- There are 2 types of Deductions
 - Standard
 - Itemized

- Only 1 of these two can be applied to a return
 - Standard vs Itemized Deduction
How to choose??
 - Use the one with the higher value...
 - To obtain lowest “Taxable Income” value*
 - *Unless the taxpayer is required to itemized!

- If the sum of the individual expenses paid by the client results in an amount that is *greater than* the Standard deduction amount, Itemize Deductions (Schedule A), using the sum of the individual expenses to reduce taxable income. The software will help calculate for you!