



# Module 5: DEDUCTIONS

# 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

# In this module...

- [The Tax Computation](#)
- [Standard Deduction](#)
- [Itemized Deductions](#)



# 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 1 + 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
- Cash charitable contributions
- 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



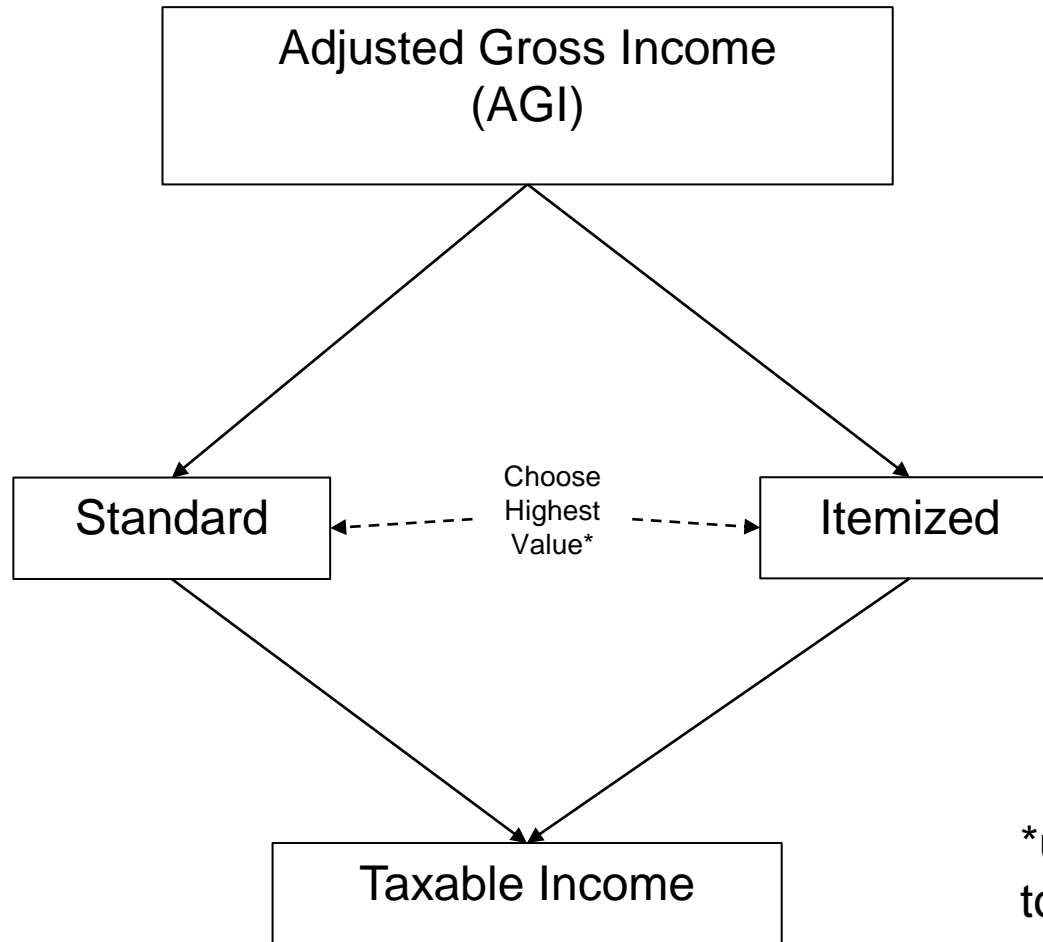
# Deductions



# 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 (2021 returns)

Filing Status	Standard Deduction Amount
Single and MFS	\$12,550
MFJ and Qualifying Widow(er)	\$25,100
Head of Household	\$18,800

- Additional standard deduction for 65+ and blind
  - Filing Status: MFJ, Qualifying Widow(er) or MFS → \$1,350 for each taxpayer
  - Filing Status: Single or Head of Household → \$1,700
- 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



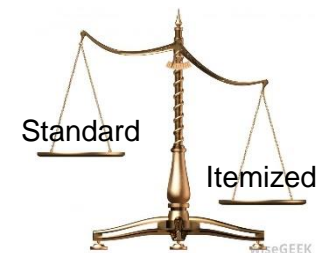
# Itemized Deductions

# 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 one paid (state & local income taxes & property taxes)
  - Home mortgage interest & points one paid,
  - Gifts to charity
  - Certain miscellaneous deductions.
    - Can include gambling losses and casualty and theft losses
      - Check to make sure these are in scope!
- New for TY2020 and TY2021: There is a \$300 credit for charitable giving that taxpayers can claim even if they are not itemizing!

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 1<sup>st</sup> and 2<sup>nd</sup> 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.
- In TY2020 and TY2021, always enter cash donations to charity because the taxpayer may take an adjustment even when not itemizing.

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!

## Knowledge Check

Additional Resources:

- Publication 4012

Up Next...

**Module 6: Non-refundable Credits**