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REAL ESTATE 411

Some of the Most Overlooked Tax Deductions

Here are 13 lucky breaks that could be yours.

Every year, the IRS reports the most common blunders that taxpayers make on their returns. Every year, at or near the top of the "oops" list is forgetting to enter their Social Security number correctly on the tax form, or forgetting it entirely!

No doubt about it: The opportunity to make mistakes is almost unlimited, and missed deductions can be the most costly. Tax time is a dangerous time and it can be easy to miss a trick and pay too much. In the IRS and professional tax auditing circles, it is a known fact that millions of taxpayers overpay their taxes every year by overlooking just one of the money-savers listed below:

1. State sales taxes. Although all taxpayers have a shot at this write-off, which has recently been extended through 2011, 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. But the tables aren't the last word. If you purchased a vehicle, boat or airplane, you get to add the state sales tax you paid to the amount shown in the IRS tables for your state, to the extent that the sales-tax rate you paid doesn't exceed the state's general sales-tax rate.

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

2. Reinvested dividends. This isn't really a tax deduction, but it is an important subtraction that can save you a bundle. And this is the break that a lot of taxpayers miss.

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 you receive them 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.

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 good works. 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 2010, remember to deduct 14 cents per mile.

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 also don't get the interest deduction since they were not liable on the debt.

5. Job-hunting costs. If you're among the millions of unemployed Americans who were looking for a job in 2010, keep track of your job-search expenses. 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, but only to the extent that the total of your total miscellaneous itemized deductions 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. Moving expenses to take your first job. As we just mentioned, job-hunting expenses incurred while looking for your first job are not deductible. But, moving expenses to get to that position 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, including 16 ½ cents per mile for driving your own vehicle for a 2010 move, plus parking fees and tolls.

7. Health insurance deduction to reduce self-employment tax. Business owners have always been allowed to deduct health insurance premiums for themselves and their family in computing adjusted gross income on the front page of Form 1040. For 2010, they can also deduct the cost of those health insurance premiums in calculating self-employment tax on Schedule SE.

The IRS has hidden this write-off on line 3 of Schedule SE. On that line, you are told to add your self-employment income from lines 1 and 2, subtract the amount claimed on line 29 of Form 1040 (your health insurance premiums) and enter the net amount on line 3. Since the write-off is not on a separate line and is not clearly identified, it will be far too easy for many self-employed persons to miss unless you are fully aware of this tax break and are looking for it.

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.

If you pay your child-care bills through a reimbursement account at work, it's easy to overlook the child-care credit. 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. State tax paid last spring. Did you owe tax when you filed your 2009 state income tax return in the spring of 2010? Then, for goodness' sake, remember to include that amount in your state-tax deduction on your 2010 return, along with state income taxes withheld from your paychecks or paid via quarterly estimated payments.

10. 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 a mortgage, though, you have to deduct the points over the life of the 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 in one fell swoop all of the 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.

11. American Opportunity Credit. This tax credit, which has been extended through 2012, 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 (regular and AMT), it is partially refundable.

12. Making Work Pay credit. You've probably been enjoying the fruits of this credit via reduced payroll tax withholding throughout the year. But to lock in your savings–by reducing your tax bill by $400 if you're single or $800 if you're married and file a joint return–you'll need to actually claim the credit on your 2010 tax return—and you'll use Schedule M to do so. The credit is equal to 6.2% of your earned income, capped at $400 or $800. For single filers, it starts phasing out at $75,000 of adjusted gross income and dries up at $95,000. The phase-out zone for couples is $150,000 to $190,000.

13. Credit for energy-saving home improvements. You can claim a tax credit equal to 30% of the cost of energy-saving home improvements up to a maximum of $1,500. This cap applies to both 2009 and 2010 combined, so if you claimed the maximum $1,500 in 2009, you don't get another crack at it for 2010. The credit applies to biomass fuel stoves, qualifying skylights, windows and outside doors, and high-efficiency furnaces, water heaters and central air conditioners. For 2011, this credit goes back to pre-2009 limits (for example, $500 maximum credit for all years with no more than $200 for windows).

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.

Be informed and ready this year when you file your taxes and do check with a tax professional on your status before you get started. For more information on current tax credits and allowable deductions visit www.irs.gov.

Source: Kevin McCormally, http://www.kiplinger.com/features/archives/the-mostoverlooked-tax-deductions.html