

Is the Federal Government your favorite Charity? If not, don't pay more tax than you have to.

Most Americans correctly report their income because the amounts are clearly reported to them on forms such as W-2s and 1099s, but many Americans do not correctly report their deductions, because, with minor exceptions such as mortgage interest, the items are not clearly reported to them. Below are the seven most common reasons why Americans overpay their Federal income tax:

Dependency Exemptions: In addition to yourselves, you may be entitled to a dependency exemption (\$3,000 per person) and a dependent care credit for another person who is dependent on you for support whether or not that person is related to you. Both are subject to income limitations, but if you support another person, you should determine if you qualify.

Medical Expense: To the extent your total medical expenses exceed 7.5% of your adjusted gross income (AGI), you are entitled to a deduction. Medical expense may, depending on the circumstances, include: home improvements, acupuncture, weight loss programs, alcohol treatment, eye surgery, artificial limbs, artificial teeth, whirlpools, smoking cessation programs.

Educational Expenses: Teachers are entitled to deduct up to \$250 for classroom material and students are entitled to deduct up to \$3,000 of tuition in computing their AGIs (subject to limitations). You can also deduct student loan interest (up to \$2,500) and take tax credits for tuition payments.

Mortgage Interest: In addition to a deduction for interest on the primary loan secured by your home, you can deduct the interest on a home equity loan of up to \$100,000 regardless of how you spent the loan proceeds. Additionally, the interest on your second home (or possibly boat) can be deducted.

Retirement Plan Contributions: The Federal Government will supplement your retirement planning by entitling you to deduct contributions to qualified retirement plans. A myriad of types of plans exist and the limitations on contributions are confusing and complicated, but it is often worth working through the maze and deducting a contribution to a qualified plan.

Charitable Contributions: The Federal Government rewards you for contributing those old clothes, furniture, tools, and toys by permitting a deduction. There are limitations on contribution deductions based on your AGI, but because they are 20%, 30%, and 50% of AGI and the fact that unused deductions can be carried forward for five years, most contribution save tax. Mistakes are often made in calculating the amount of the contribution deductions, but the most common mistakes are neglecting to consider activities for which you are entitled to a deduction. For example, you are entitled to a deduction for the miles driven toting those boy scouts around and expenses supporting their activities.

Calculation of Basis: Calculating basis in property sold is relatively easy if you purchased one lot of stock and later sold it, but things get considerably more complicated if you purchased different lots at different times at different prices and participated in a dividend reinvestment plan. In such cases, many taxpayers understate their basis and pay more income tax than necessary. Taxpayers also understate their bases in real estate by failing to consider expenses such as closing costs at the times of purchase and sale, a new porch, custom window treatments, and the costs of fixing up property prior to sale. Such mistakes will not cause additional income tax if the property sold is a primary residence and the gain is less the exclusion amount (\$500,000 per couple), but it may cause substantial additional income which may be taxed at ordinary income tax rates in the case of the sale of a rental property.

Tax evasion is illegal, but tax avoidance is not. The objective is to pay only the amount of tax that you are legally obligated to pay, unless of course the Federal Government is your favorite charity.

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