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## STANDARD DEDUCTION OR ITEMIZATION

Each year, when you file your income tax return, you can choose between itemizing or claiming the standard deduction. Itemizing allows you to deduct your actual allowable expenses while the standard deduction provides a flat amount (For 2006, the standard deduction is $10,300 for married couples filing jointly and $5,150 for singles and married couples filing separately. It's $7,500 for heads of households.) to be deducted from your adjusted gross income. In some cases, the standard deduction can consist of two parts, the basic standard deduction, and an additional standard deduction amount for age, blindness, or both.

A large percentage of taxpayers pay more in taxes than they need to because they take the standard deduction while itemizing could reduce their tax liability. The best way to determine which method saves the most tax dollars is to run the numbers. You can use Schedule A of form 1040 to list all your deductible expenses and compare the total to the standard deduction for your filing status. If your actual itemized expenses exceed the standard deduction, you'll save money by itemizing.

The choice between the standard deduction and itemizing involves a number of factors:

- A comparison between the available standard deduction and allowable itemized deductions-the larger number is generally advantageous.
- Even if a taxpayer's itemized deductions are less than the amount of her/his standard deduction, s/he can elect to itemize deductions on her/his federal tax return if the tax benefit of being able to itemize deductions on her/his state tax return is greater than the tax benefit s/he loses on federal return by not taking the standard deduction.
- Whether or not the taxpayer has or is willing to maintain the records required to substantiate the itemized deductions.
- If the total itemized deductions and the standard deduction are very close in value, whether the taxpayer would prefer to take the standard deduction to reduce the risk of change upon IRS audit. (The standard deduction amount cannot be changed upon audit unless the taxpayer's filing status changes).
- Whether the taxpayer is otherwise eligible to file a shorter tax form (like 1040EZ or 1040 A) and would prefer not to prepare (or pay to have prepared) the more complicated 1040 form and the associated Schedule for itemized deduction.

### TAXPAYERS WHO CANNOT TAKE STANDARD DEDUCTION

There are certain persons who cannot take the standard deduction and must itemize. These include:

- Married persons filing separately, whose spouse itemizes deductions. (But you can agree to both itemize or both take the standard deduction, whichever way results in a lower overall tax for the two of you.)
- A taxpayer filing a tax return for a short year, because of a change in the annual accounting period.
- Persons who were nonresident or dual-status alien at some time during the year.

## TYPES OF ITEMIZED EXPENSES

There are seven ***main categories of itemized expenses*** that you can deduct on your taxes:

» Medical and dental expenses
» Taxes
» Interest expense
» Charitable contributions
» Casualty and theft losses. » Miscellaneous Deductions.
» Car Expenses and other Business Expenses
» Work related Education expenses

You can deduct only certain amounts of some types of itemized deductions. The amount you can deduct is based on different limits, depending on the type of itemized deduction. Most of the limits are figured using a percentage of your adjusted gross income (AGI). For example, your miscellaneous itemized deductions must be greater than 2% of your adjusted gross income before you get a tax benefit for any of those expenses. This type of percentage limit is called a floor, because you have to come up to the floor before you can start deducting any of the expenses.

## DOUBLE ITEMIZING

Taxpayers have the advantage of alternating between itemization and standard deduction from year to year to derive the maximum tax benefit.

Taxpayers who choose itemization may "double itemize" or "bunch up" their deductions as IRS recognizes expenses in the year you pay them. For example, to double itemize the year 2006, some bills (say, your property tax bill, Charitable contributions bill etc.) received near the end of 2005 are not paid until the year 2006 begins, and some other bills due in 2007 are prepaid in the year 2006.

Itemizing every other year and "bunching" your deductions can help you take deductions above and beyond the standard deduction that you would have lost otherwise. Double itemizing often works best for taxpayers who do not have a home mortgage payment. To see if double itemizing is right for you, you may have to take steps before the year-end to take maximum advantage of this technique. **Note that** the points paid on the refinancing of your mortgage are not fully deductible in the year paid. Instead, they must be deducted over the life of the loan. Therefore, one should look at each issue on a case-by-case basis.

## AMENDED RETURNS

If you discover you could have saved by itemizing deductions and are willing to tackle your taxes again, file an amended return on Form 1040X. It will let you negate your original standard deduction and list all the money-saving deductions you should have taken.

Generally, tax returns must be amended within three years of the original filing deadline. If you want to amend your 2003 return (which was due April 15, 2004), you have until April 16, 2007 (Because April 15 is a Sunday). To get your rightful dollar back money, you must file an amended return for each affected tax year.

## PHASE-OUT RULES

If your AGI exceeds certain amounts, your total allowable itemized deductions may be reduced. However, limit on itemized deductions for high-income taxpayers will begin phasing out in 2006. For tax years beginning after 2009, the itemized limit will be fully repealed.

## CONCLUSION

As with all tax issues, deciding whether to take the standard deduction or itemize isn't so simple. If you have a fairly simple financial life, standard deduction is usually the best choice, as it requires no calculations or supporting documentation. For instance, if you make $40,000-$45000 as an employee of a company, rent a residence and don't have any major medical bills or losses, standard deduction is probably going to save you more money than itemizing. Nevertheless, you can never be sure until you take a stab at itemizing your deductions in a rough draft of a tax return.

You go through your records and identify every possible deduction. These deductions are then subtracted from your adjusted gross income to arrive at a final figure from which tax is determined using the tax tables. Normally, you almost always want to itemize if you own a home, have significant medical bills, can claim a tax credit or suffered some type of major loss. There are other situations where itemizing makes sense, but this gives you an idea.

For a simple financial situation, claiming the standard deduction and for a bit more complicated one, itemizing may be the right answer.

Now is the excellent time to assess your tax situation and strategies for 2006 and beyond!

*Important note:* Many exceptions, definitions, and special rules in the law have been paraphrased, simplified, and/or omitted. Readers should not take specific action based on this summary without first consulting the statute and regulations or seeking advice from a qualified professional.

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