The Most-Overlooked Tax Deductions

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Every year, the IRS dutifully reports the most common blunders that taxpayers make on their returns. And every year, at or near the top of the "oops" list is forgetting to enter their Social Security number at the top of the tax form — or making a mistake when entering those nine digits.

But think about it for a minute: Do you think that's the most common mistake . . . or simply the easiest to notice?

One thing we know for sure is that the opportunity to make mistakes is almost unlimited, and missed deductions can be the most costly. About 45 million of us itemize on our 1040s — claiming more than $1 trillion worth of deductions. That's right: $1,000,000,000,000, a number rarely spoken out loud until Congress started tying itself up in knots trying to deal with the budget deficit and national debt.

Another 92 million taxpayers claim about $700 billion worth using standard deductions — and some of you who take the easy way out probably shortchange yourselves. (If you turned 65 in 2011, remember that you now deserve a bigger standard deduction than the younger folks.)

Yes, friends, tax time is a dangerous time. It's all too easy to miss a trick and pay too much. Years ago, the fellow who ran the IRS at the time told Kiplinger's Personal Finance magazine that he figured millions of taxpayers overpay their taxes every year by overlooking just one of the money-savers listed below.

State sales taxes

Although all taxpayers have a shot at this write-off, 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, based on their income and state and local sales tax rates. But the tables aren't the last word. If you purchased a vehicle, boat or airplane, you get to add the sales tax you paid to the amount shown in the IRS table for your state.

The same goes for any homebuilding materials you purchased. These add-on items are easy to overlook, but big-ticket items could make the sales-tax deduction a better deal even if you live in a state with an income tax. The IRS has a calculator on its web site to help you figure the deduction.

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 former IRS commissioner Fred Goldberg told Kiplinger's 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 they are paid out and immediately reinvested in more shares 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.

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 work for a charity. 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 2011, remember to deduct 14 cents per mile plus parking and tolls paid in your philanthropic journeys.

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 can’t claim the interest deduction even though they actually foot the bill since they are not liable for the debt.

Job-hunting costs

If you’re among the millions of unemployed Americans who were looking for a job in 2011, we hope you kept track of your job-search expenses . . . or can reconstruct them. 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. Such expenses can be written off only to the extent that your total miscellaneous expenses 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

The cost of moving for your first job

Although job-hunting expenses are not deductible when looking for your first job, moving expenses to get to that job 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. If you drove your own car, your mileage write-off depends on when during 2011 you moved. For moves from January 1 through the end of June, the standard mileage rate is 19 cents a mile; for moves during the second half of the year, a 23.5 cents a mile rate applies. In either case, boost your deduction by any amount you paid for parking and tolls.

Deduction of Medicare premiums for the self-employed

Folks who continue to run their own businesses after qualifying for Medicare can deduct the premiums they pay for Medicare Part B and Medicare Part D and the cost of supplemental Medicare (medigap) policies. This deduction is available whether or not you itemize and is not subject the 7.5% of AGI test that applies to itemized medical expenses. One caveat: You can’t claim this deduction if you are eligible to be covered under an employer-subsidized health plan offered by your employer (if you have a job as well as your business) or your spouse’s employer.

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.

You can qualify for a tax credit worth between 20% and 35% of what you pay for child care while you work. But if your boss offers a child care reimbursement account – which allows you to pay for the child care with pre-tax dollars – that might be a better deal. If you qualify for a 20% credit but are in the 25% tax bracket, for example, the reimbursement plan is the way to go. (In any case, only expenses for the care of children under age 13 count.)

You can't double dip. Expenses paid through a plan can't also be used to generate the tax credit. But get this: 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.

American Opportunity Credit

This tax credit 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, it can trigger a refund. (Most credits can reduce your tax to $0, but not get you a check from the IRS.)

Deduct those blasted baggage fees

In recent years airlines have been driving passengers batty with extra fees for baggage and for making changes in their travel plans. All together, such fees add up to billions of dollars each year. If you get burned, maybe Uncle Sam will help ease the pain. If you're self-employed and traveling on business, be sure to add those cost to your deductible travel expenses.

Credit for energy-saving home improvements

Although this credit has been scaled back, it still exists and might save you some money if you made energy-saving home improvements during 2011. The credit is worth 10% of the cost of qualifying energy savers including new windows and insulation. The maximum credit is $500 and, if you claimed this credit in the past, you're probably out of luck now. That $500 is the maximum credit allowed on all tax returns from 2006 to 2011.

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.
Additional bonus depreciation

Business owners can write off 100% of the cost of qualified assets placed in service during 2011. This break applies only to new assets with recovery periods of 20 years or less, such as computers, machinery, equipment, land improvements and farm buildings. So don't miss out on this big tax benefit if you placed business assets in service during 2011.