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Maximizing your Itemized Deductions (Schedule A)
Under the New Tax Law

The new tax law, "the Tax Jobs and Cuts Act of 2017" will bring significant changes to most of our 2018 income tax returns. The most evident change affecting taxpayers is to **itemized deductions**. For years, itemized deductions (Schedule A) were used to promote social agendas. Individuals in "high-tax states", who pay a larger proportion of taxes than those living in "lower-tax states", were allowed to deduct their state income taxes, as a sort of revenue sharing. If your state didn't have an income tax, you were able to deduct your sales tax. To promote home ownership, mortgage interest and real estate taxes were allowed to be deducted. To promote more accurate income tax submissions, some could deduct tax preparation fees. And to promote better savings and investing, some could deduct investment expenses.

Now, there are many changes to the new tax law. Last year, I included a new worksheet with your 2017 tax return called the "Tax Return Impact Summary". This 2-page document took your 2017 tax return information and presented what the same items would be under the new tax law. If you missed this, it is a good idea to go back and find it in the 2017 tax papers we gave you. Many will discover that under the new tax law, it's more advantageous to use the standard deduction than to itemize. The **changes to standardized deduction** amounts follow:

	Standard Deductions	
	Tax Year **2017**	Tax Year **2018**
Married Filing Jointly (MFJ)	$12,700	$24,000
Married Filing Single (MFS)	$6,350	$12,000
Single taxpayer	$6,500	$12,000
Head of Household (HOH)	$9,350	$18,000

State and local taxes: With increases in the standard deduction for 2018, the amount of itemized deductions you can claim has decreased. The first major change is in the **state and local tax deduction** (SALT). In previous years, if you paid state, local, sales or real estate taxes, you could deduct them on your federal tax return. Beginning in 2018, however, there is a limit of $10,000 in total deductions, regardless of the type, that you can take on your tax return. It is bad news for states with high taxes like California or New York, and for states with high real estate tax like Illinois. In addition, property taxes in foreign countries are no longer deductible.

Mortgage interest was an already complicated area, although many people didn't realize it. When you bought your home with a mortgage, you had initial mortgage indebtedness. As you paid down the loan, your mortgage indebtedness decreased accordingly. What most people didn't realize was that increasing mortgage indebtedness didn't increase the amount of mortgage interest you could deduct if the additional loan was not to buy, build or improve your primary residence. So, if you pulled out an additional $150,000 from your home through a mortgage, and didn't use it to buy, build or improve your home, the additional mortgage interest was non-deductible. The IRS didn't like all that non-deductible mortgage interest people were claiming on their tax returns, so they changed the information reported on your Mortgage Interest Statement - Form 1098-int. Now the form includes the original date the mortgage was opened, and the beginning and ending mortgage balance. This area is now under scrutiny. You better believe that the IRS will use that information to track down all that non-deductible mortgage interest.

In addition to the mortgage interest rules discussed above, the 2018 tax law reduces the amount of total mortgage interest that you can deduct from $1,000,000 in 2017 to $750,000 in 2018. But don't worry if you have an older loan balance above $750,000 but below $1,000,000: you are grandfathered in as long as the mortgage was in effect before December 17, 2017.

Home equity loans didn't get the same treatment under the new tax law. Beginning 2018, unless the Home Equity loan was used to buy, build or improve your primary residence, you cannot deduct the interest regardless of when the loan originated. So while it seemed like a good idea to take out a Home Equity loan to pay off credit cards, student, auto loans or travel, beginning in the 2018 tax year, the interest on Home equity loans for purposes other than primary home improvement cannot be deducted. Period.

2% Miscellaneous Deduction: is the last major change to itemized deductions. Are you a salesperson expected to pay for your own transportation, business supplies, and entertaining/feeding your clients? Do you pay Union dues or incur expenses to find a new job? If so, you are going to lose the deductibility of these expenses. There are also no more deductions for payments made to investment advisors to manage your money, or paid to a tax preparer to file your income taxes. These expenses are not deductible under the new tax law.

What hasn't changed? You can still deduct **unreimbursed medical expense and insurance that** is greater than 7.5% of your Adjusted Gross Income (AGI). Medical expenses do not include expenses "good" for your general health, such as vitamins and gym memberships. A good rule of thumb is that if an item is prescribed by a doctor, it is probably deductible. You can still deduct your **charitable expenses**, as long as you meet the documentation rules. The IRS has even increased the amount you can deduct to certain charities from 50% to 60% of your AGI.

Other things have not change, yet, like **Letter Audits** (i.e., non-office audits). The IRS continues to hone its computer programs to help match outside documentation to the information in your tax return in an effort to identify inconsistencies in income or deductions on tax returns. With decreased IRS personnel, this activity will continue to present an ongoing management challenge.

Every year I hear, "Mark, my neighbor has been deducting blank, blank or blank for years, and whenever I ask you, you say NO!" I don't get enjoyment out of saying no, although my kids would argue otherwise. What I will tell you is that your neighbors have never been audited on the issue. You pay me to keep you out of trouble, not get you into it. I can promise you would not thank me when you have to pay 10, 20, 30% or more in penalties and interest. But now you say, "Mark, you're saying the same thing. It's all been

NO, NO and more NO on the new tax law! When are you going to show me how to maximize my itemized deductions?" The answer is now!

It's going to be harder and harder to itemize your deductions, so you just need to be smarter on how you do it. The IRS predicts that the percentage of people who itemize will decrease from 30% to approximately 15%. Here are some deduction suggestions:

1) **Mortgage Interest Deductibility for Your Business:** Let's say you want to buy a rental or business property, or lend money to your business, but you have no other assets than your home. By using a 10T Election, we can allocate the additional mortgage interest to that activity.

2) **Charitable Deductions:** If you customarily give two or three thousand dollars a year to charities, you will lose the deduction if you take the increased standard deduction instead of itemizing. If you have money you can put aside, you could donate a lump sum into a charitable fund, (like Fidelity Charitable Trust) and itemize the deduction for the entire lump sum amount this year. You can then request the fund to pay out to your choice charities over several years. For instance, let's say you have $10,000 in a low interest bearing account that is not essential in an emergency. You can donate that $10,000 this year to Fidelity Charitable, take the entire deduction this year, but tell Fidelity to pay it out over a number of charities over a number of years.

3) **Business Expenses Deduction:** If you are a salesperson who pays for your own expenses out of pocket, and depends on the Schedule A deduction to offset your wages, ask your employer to set up an Accountable Plan, so that they reimburse you for the expenses you pay. That way, it's not taxable to you. It can help your employer as well: Your employer can lower your income by offsetting the reimbursed expenses and save money on employment taxes and Workman's Comp. You get reimbursed for your expenses tax free. Your income is lower, and your employer has deductible expenses. It's a win-win situation.

4) **Tax Preparation Fee** We can allocate your tax preparation fee to other Schedules on your tax return- such as Schedules C, E, or F, so you don't lose all the deductions for our fee.

These suggestions are subject to some complicated tax rules, and may not work for everyone. So before you do anything, contact this office. We strive to stay on top of the many changes to the tax code which can affect you. Hopefully, you can use the information in this letter to evaluate your personal situation and help you gather what you need for our tax appointment. If you have any questions, you can ask me in person or drop me an email. Don't forget to make your tax appointments early.

Thank you for the opportunity to serve you!

Sincerely,

Mark R. Villano
Certified Public Accountant