



TAXWATCH

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Getting through the tax maze

Five reasons why itemizing your deductions may not make sense

By [Eva Rosenberg](#), MarketWatch

LOS ANGELES (MarketWatch) -- The tax code is so needlessly complex, trying to thread your way through the maze can cause migraines.

Readers have been asking me why they're forced to jump through tax hoops, instead of being able to deal with things in a straightforward manner.

If you're going to get the deduction anyway, why do you need a mound of paperwork to build a framework for the inevitable deduction?

You'll have to ask Congress. In the meantime, using itemized deductions has five major pitfalls:

Tax programs for tough jobs

Tax-preparation Web sites such as TurboTax Online, H&R Block Online and TaxACT will help you figure your options in a year that will see many significant changes in tax policy.

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1. To use medical expenses, they have to be more than 7.5% of your adjusted gross income. That is the last line on page one of your Form 1040 (the long form).
2. To deduct employee business expenses, investment expenses and other miscellaneous expenses, they

must be more than 2% of your AGI.

3. Your itemized deductions should be more than your standard deduction before you use one dime of expenses (in 2008, that's \$10,900 for couples, \$5,450 singles and \$8,000 for head-of-household filers).
4. As your income reaches \$159,950 (\$79,975 for married-filing-separately), your itemized deductions face a phase-out.
5. Even if you manage to jump over the first four pits, you may fall prey to the alternative minimum tax, and find most of your deductions aren't worth a thing.

Who can still itemize

Looking at all these things that stop you from being able to itemize, you may wonder who in the world can use a Schedule A? These days, pretty much the only taxpayers who can itemize are those who have mortgages with high balances, those whose incomes are in the high six figures or above, with a heavy state tax burden, or the very ill, with no medical insurance.

After all, if you refinanced two years ago into a \$150,000 mortgage with a 5% interest rate, your mortgage interest is less than \$7,500. With property taxes of \$2,500, and auto registration fees of \$500, a married couple is still under the standard deduction threshold.

Plus, for 2008, taxpayers can take an additional standard deduction based on state or local real-estate taxes paid, up to \$500 for single and \$1,000 for married-filing-jointly filers, or one for net disaster losses suffered from a federally declared disaster.

Next year, even fewer taxpayers will need to itemize, since they will be able to take deductions or credits that are available to people who pay education expenses, buy new cars and/or have children.

Deducting medical expenses

Of course, people look for every dollar they can find to cut their taxes.

For instance, Terry is an officer stationed at Fort Riley, Kan. He's been too busy doing tours of duty in Iraq to pay close attention to the nuances of tax deductions. But having read our "February To-Do" article, he perked up and asked TaxMama® if he may deduct the dental insurance premiums he's been paying for his wife for the last several years. [See story on tax to-do's.](#)

That's a good question. For many employees, it's likely your medical and dental insurance payments are deducted from your paycheck before taxes are assessed against your income. If that's the case, you can't take a medical deduction for these payments. However, if the premiums were paid from taxed dollars, those costs would be well worth looking at.

To use medical deductions at all, you need to be able to overcome two pitfalls listed earlier. That is, the expenses must exceed 7.5% of AGI, and they must top the standard deduction. Even if your income is only \$35,000, your medical expenses would have to be more than \$2,625 before you could deduct a dime.

While it's worth looking into all your various small medical charges, take into account your own income and deduction status before you go to all that work. In the previous article, the taxpayer was someone who had over \$20,000 worth of medical and dental insurance premiums. That's almost guaranteed to generate a deduction, right?

Health insurance deductions can be found on pension pay stubs, too. Sometimes, the medical insurance payment directly reduces the taxable portion of the pension. When it does, you don't have a medical deduction.

Why aren't all medical insurance payments pre-tax?

Some smaller employers don't establish pre-tax medical insurance deduction programs, thinking they are too expensive for the company. In fact, most payroll services offer relatively inexpensive premium-only plans (POPs), which allows employees to pay their medical premiums before taxes are deducted from their paychecks. The costs are a bit higher for flexible spending accounts (FSAs) that allow employees to set aside part of their wages to cover out-of-pocket medical expenses.

Giving this benefit to employees is like giving them a raise without taking money out of the employer's pocket. Let's face it, when the medical premiums for a family run \$3,000 to \$10,000 per year or more, the tax savings to an employee can be as much as \$800 to \$3,500 per year. (Take into account federal and state income taxes, FICA and Medicare taxes, which are not paid on these dollars. True! Unlike retirement contributions, flexible spending dollars come off the top, before FICA/Medicare.)

The employer benefits, too. By taking \$3,000 to \$10,000 off the top of the employee's wages, the employer saves \$300 to \$1,000 per employee in taxes, workers compensation costs and other payroll-related expenses. That's a terrific tax savings, more than covering the administration costs. The employer has not paid a dime of the medical insurance premiums. They've just jumped through some hoops and used the tax laws.

Times are tough. The various tax incentives for employers and employees to use, like MSAs, HSAs and other alphabet soup plans, are often too complicated for the average employee to figure out. Why not just arrange for all medical expenses to be deducted from wages using a POP and/or flexible spending plan? It's like giving your employees a raise without costing you a dime!

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