

Tax-Saving Strategies

Although Miquel and Anna chose to use the standard deduction, other tax payers may use another option called “itemizing”. The standard deduction is just that: the same for everyone. However, not everyone has the same income or possible deductions.

Itemizing can be a better option for those who have total deductions greater than the standard amount. The Internal Revenue Service provides special income tax forms, called Form 1040, Schedule A, that allows individuals to list each of their deductions. Some of these deductions include the interest paid on a home mortgage or other real estate, medical expenses, some educational expenses, certain work-related expenses, child care expenses, and funds put into retirement accounts.

While paying personal income tax is part of having a paycheck, following are some most common strategies you can use to reduce your tax burden and increase your take home pay.

Lowering your taxable income. If your employer provides benefits such as health insurance or a retirement account, you may be required to make a percentage of the payment for them. Those payments are deducted from your gross income and may be used to reduce your overall taxable income. In other words, you may subtract those payments from your gross income and use the reduced amount to calculate your taxes.

Maximizing your retirement account. Many employers offer a 401(k) or other similar retirement plan for their employees. In most cases, they will match whatever amount you pay into that account each month, up to a certain percentage of your income. The payments you make into that retirement account is subtracted from your taxable income. The more you put into the retirement plan, the more your taxable income is reduced. Imagine saving on taxes and also getting your employer to help pay for your retirement!

Opening an IRA. An IRA is the short name for an Individual Retirement Account at banks and other financial institutions. Depending upon your income, you may be able to use the payments made to your IRA as a tax deduction.

Keeping good financial records. Some of the purchases or donations you make during the year may also be used as tax deductions. These include charitable and religious contributions, special shoes or uniforms, medical expenses, child care, and a variety of others. Using these expenses as deductions may help you save money on your income taxes. However, you need to maintain accurate records of your donations and expenses to take advantage of these deductions.

Depending upon your situation, you may eventually want someone else to prepare your taxes. Using a tax preparer is strictly a matter of choice. Some find it is easier to rely on others who stay up-to-date on changes in tax laws and available deductions while others use updated software packages to guide them. Whether using a tax preparer or doing them yourself, keeping good records will help make paying the right amount of taxes much easier.

Questions

- a. What is the difference between the standard deduction and itemizing?

- b. Why would some taxpayers prefer to itemize instead of using the standard deduction?

- c. What are some of the common expenses that people can itemize on their taxes?