Schedule A – Itemized Deductions

Office of Income Taxation Communications & Training Branch

2009 Tax Year

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Contents:

Each year, when filing their individual income tax returns, most taxpayers claim the standard deduction. The standard deduction is the specified amount by which a taxpayer is entitled to reduce their adjusted gross income before calculating the tax liability on their return. The amount of the standard deduction is adjusted annually for inflation and usually varies depending upon a taxpayer's filing status. However, for those individuals who have high medical expenses, home mortgage interest, taxes paid, charitable contributions or unreimbursed employee expenses, the government allows them to itemize these expenses to help lower their tax liability. An itemized deduction, in accordance with IRS regulations, is an incurred expense which reduces an individual's taxable income and is typically claimed on Schedule A. There are many federal and state laws/statutes that dictate what specific expenses can be reported as itemized deductions, as well as imposing certain limitations that may impact the amount of the deductions being claimed. The purpose of this material is to look at some of these important issues in depth and to examine how Kentucky treats claiming itemized deductions on the individual income tax return.

STANDARD DEDUCTION VS. ITEMIZED DEDUCTIONS

Most taxpayers have a choice of either taking the standard deduction or itemizing their deductions on Schedule A. If you have a choice, it is recommended that you use the method that is most advantageous to your tax situation (i.e. whatever method that gives you the lowest tax).

Itemizing deductions on your tax return often depends on how much was spent for certain expenses in the previous year. Money paid for medical care, mortgage interest, taxes, charitable contributions, casualty losses and miscellaneous deductions can help reduce your taxable income. If the total amount spent on these categories is greater than your standard deduction, you can usually benefit by itemizing deductions on your return.

For the federal return, the standard deduction amounts are based on your filing status and are subject to inflation adjustments each year. For the 2009 tax year, they are:

- $5,700 for Single
- $11,400 for Married Filing Jointly
- $8,350 for Head of Household
- $5,700 for Married Filing Separately
- $11,400 for Qualifying Widow(er)

For taxpayers filing a Kentucky Individual income tax return, the standard deduction amounts for 2009 tax year are:

- $2,190 for Single or Married Filing Jointly or Married Filing Separately
- $2,190 per taxpayer for Married Filing Separately on a Combined Return

These amounts are also subject to inflation adjustments each year.

Note: Some taxpayers are not eligible for the standard deduction on the federal return. They include nonresident aliens, dual-status aliens and individuals who file returns for periods of less than 12 months due to a change in accounting periods. These individuals must itemize their deductions on the federal return. However, this stipulation does NOT apply to the Kentucky return.

Federal Form(s) 1040-EZ / 740-EZ

Taxpayers that file a federal return using the federal Form 1040-EZ must claim the standard deduction. They cannot claim itemized deductions as they would not have an opportunity to complete a Schedule A. The same principle is also true of taxpayers that file a Kentucky return using the Form 740-EZ.

Married Filing Separately

When a married couple files separate returns and one spouse itemizes deductions, the other spouse cannot claim the standard deduction and should also itemize their deductions. The issue of how filing status impacts itemized deductions will be discussed in detail later in the material.

RECORD KEEPING

Why Keep Records?

There are many reasons to keep records. In addition to tax purposes, you may need to keep records for insurance purposes or to apply for a loan. Good records will help you:

- Identify sources of income. You may receive money or property from a variety of sources. Your records can identify these sources of income. You may also need this information to separate business from nonbusiness income and taxable from nontaxable income.
- Keep track of expenses. You may forget an expense unless you record it when it occurs. You can use your records to identify expenses for which you can claim a

deduction. This will help you determine if you can itemize deductions on your tax return.

- Keep track of the basis of property. You need to keep records that show the basis of your property. This includes the original cost or other basis of the property and any improvements you made.
- Prepare tax returns. You need records to prepare your tax return. Good records help you to file quickly and accurately.
- Support items reported on tax returns. You must keep accurate records in case the IRS or Kentucky Department of Revenue has a question about an item on your return. If your tax return is audited, you may be asked to explain the items reported. Good records will help you explain any item and arrive at the correct tax with a minimum of effort. If you do not have records, you may have to spend time gathering statements and receipts from various sources. If you cannot produce the correct documents, you may have to pay additional tax and be subject to penalties.

What Kind of Records Should Be Kept?

Besides keeping general financial documents, it is important to keep any type of income statements (i.e. pay stubs, W-2 forms, records of tips earned, investment income statements, bank and brokerage statements, and 1099 forms), as well as receipts and/or documentation to verify any deduction claimed on your tax return, including itemized deductions such as medical expenses, charitable contributions, and unreimbursed job expenses.

Organizing Your Records

Organizing your financial records takes an investment in time, especially if your records are scattered. It is an investment you will be glad you made when you can find a cancelled check to prove a disputed bill or a medical receipt without hours of searching.

When organizing your records, it is a good idea to keep them in order by date and by category. Organizing your receipts, pay stubs, and various financial forms as the year goes along will make it easier to file your tax return. Another organizing tip is to use a folder, envelope or binder to keep all of your records for the tax year together and then store these yearly files in a safe place for easy access.

Good record keeping is a must for tracking and verifying expenses. The best records show who you paid and when, how much you paid and what the expense was for. Receipts and canceled checks are good evidence for a deduction, as well as credit card slips and statements. Appointment books, calendars and informal expense logs are all good supplementary records; they can show where you were on a given day, who you saw and what you spent.

How Long Should You Keep Records?

The IRS has a statute of limitations of three (3) years to go back and audit tax returns; whereas the Kentucky Department of Revenue can go back up to four (4) years. As such, you should keep your records for a minimum of four (4) years. However, in certain tax situations it is recommended to keep records for longer than a minimum of four (4) years. Finally, even though you may not need to keep these records for tax purposes, in some cases you may wish to maintain them for proof to creditors or for use in insurance claims.

Tip: The taxpayer should have complete and accurate records to verify all itemized deductions claimed on Schedule A. In the event of an audit by the IRS or the Kentucky Department of Revenue, the burden of proof is on the taxpayer to verify anything that is claimed on the tax return. As such, the basic rule of thumb is quite simple - if you do not have the documentation, then do not claim the deduction.

For further information on record keeping, please see IRS Publication 552 – *Recordkeeping for Individuals*.

DIFFERENCES BETWEEN FEDERAL and STATE RETURNS

When discussing itemized deductions and completing a Schedule A, it is important to recognize that there are a few basic differences between the Federal Schedule A and the Kentucky Schedule A. Some of these differences include:

Medical Expenses – Insurance

One of the biggest differences between the Federal Schedule A and the Kentucky Schedule A is that health insurance premiums are included as part of the medical and dental expense deduction on the Federal return (whereas it is a separate deduction claimed on Schedule M of the Kentucky return). This particular issue will be discussed in detail in the following chapter.

State Income Taxes Paid

Another difference is that the IRS allows the taxpayer to claim a deduction for State & Local Income Taxes paid or General Sales Tax paid (whichever amount is greater). This deduction would be claimed on Line 5 of the Federal Schedule A.

In contrast, on the Kentucky Schedule A, the taxpayer is only allowed to deduct the amount of Local Income Taxes paid (on Line 4). State Income Taxes paid would not be allowed as a deduction on a state return.

New Vehicle Sales and Use Tax Deduction

The American Recovery and Reinvestment Act of 2009 allowed for taxpayers to claim sales & use tax paid on the purchase of a new motor vehicle (after Feb. 16, 2009) as a deduction on their Federal income tax return. This deduction can be claimed using one of two methods:

- Itemizers would claim it on Line 7 of the Schedule A.
- Those claiming the standard deduction. You can complete a Schedule L (new for 2009 tax year) and add the amount of sales & use tax paid to your standard deduction.

Helpful Tax Tip:
When choosing between taking the standard deduction or itemizing deductions on Schedule A, you do not have to make the same choice for both the Federal and Kentucky income tax returns. In fact, it is very common for taxpayers to claim the standard deduction on the Federal return, but itemize their deductions on the Kentucky return.

Due to the fact that Kentucky is still under the Internal Revenue Code of 12/31/2006 and has not adopted this legislation, taxpayers cannot claim sales & use tax paid on the purchase of a new motor vehicle on their Kentucky return. Line 7 of the Kentucky Schedule A is instead used to claim Other Taxes.

Schedule L

As previously mentioned, Schedule L was a new form introduced by the IRS for the 2009 tax year that allows taxpayers choosing not to itemize their deductions to claim the standard deduction, but still add the sales tax paid on a new vehicle bought in the previous year, as well as real estate taxes paid on a primary residence. However, this form is only filed as part of the Federal income tax return and does not apply to Kentucky.

Chapter 1: Medical and Dental Expenses

SCHEDULE A
Form 740
42A740-A
Department of Revenue

KENTUCKY ITEMIZED DEDUCTIONS
➤ **See instructions.**
➤ **Attach to Form 740.**

2009

Enter name(s) as shown on Form 740, page 1. | Your Social Security Number

Medical and Dental Expenses	**Do not include expenses reimbursed or paid by others.**		
	1. Medical and dental expenses 1		
	2. Enter 7.5% (.075) of the amount from Form 740, line 9 2		
	3. **Total medical and dental.** Subtract line 2 from line 1. If zero or less, enter -0- .... ➤ 3		00
Taxes	4. Local income taxes (do not include state income tax) 4		
	5. Real estate taxes 5		
Note: Sales and use taxes and new motor vehicle taxes are not deductible.	6. Personal property taxes 6		
	7. Other taxes (list) ________ 7		
	8. **Total taxes.** Add lines 4 through 7. Enter here .... ➤ 8		00
Interest Expense	9. Home mortgage interest and points reported to you on federal Form 1098 9		
Note: Personal interest is not deductible.	10. Home mortgage interest not reported to you on federal Form 1098 (if paid to an individual, show that person's name, identifying number and address) ________ 10		
	See instructions for lines 11 and 12.		
	11. Points not reported to you on federal Form 1098 11		
	12. Qualified mortgage insurance premiums 12		
	13. Investment interest (attach federal Form 4952 if required) 13		
	14. **Total interest.** Add lines 9 through 13. Enter here .... ➤ 14		00
Contributions *Note: For any contribution of $250 or more, see instructions.*	15. Contributions by cash or check 15		
	16. Other than cash or check (attach federal Form 8283 if over $500) 16		
	17. Artistic charitable contributions deduction (attach copy of appraisal) 17		
	18. Carryover from prior year 18		
	19. **Total contributions.** Add lines 15 through 18. Enter here .... ➤ 19		00
Casualty and Theft Losses	20. Enter amount from attached federal Form 4684, Section A, line 16 20		
	21. Enter 10% (.10) of the amount from Form 740, line 9 21		
	22. **Total casualty or theft loss(es).** Subtract line 21 from line 20. If zero or less, enter -0- .... ➤ 22		00
Job Expenses and Most Other Miscellaneous Deductions	23. Unreimbursed employee expenses—job travel, union dues, job education, etc. (attach Form 2106 or 2106-EZ if applicable) list ________ 23		
	24. Tax preparation fees 24		
	25. Other (investment, safe deposit box, etc.) list ________ 25		
	26. Add the amounts on lines 23, 24 and 25. Enter here 26		
	27. Enter 2% (.02) of the amount from Form 740, line 9 27		
	28. **Total.** Subtract line 27 from line 26. If zero or less, enter -0- .... ➤ 28		00
Other Miscellaneous Deductions	29. Other (see instructions) ________ .... ➤ 29		00
Total Itemized Deductions	30. Add lines 3, 8, 14, 19, 22, 28 and 29. Enter here .... ➤ 30		00

★ If single or married filing jointly and your income for Form 740, Column B does not exceed $166,800, enter total itemized deductions on Form 740, line 10, Column B.
★ All others go to page 2.

With the continuing rising costs of healthcare, more and more taxpayers find themselves in a position to claim medical and dental expenses as an itemized deduction on Schedule A. This chapter will focus on some of the important issues related to medical and dental expenses including what is and is not allowable as a medical expense deduction, as well as limitations based on income.

WHOSE MEDICAL EXPENSES CAN YOU INCLUDE as an ITEMIZED DEDUCTION?

You can generally include the medical and dental expenses of the taxpayer, the taxpayer's spouse and any dependents claimed on the tax return. To include your spouse's expenses, you must have been married either at the time your spouse received the medical services or at the time you paid the medical expenses. The same basic principle also applies when claiming the medical expenses of a dependent. A person generally qualifies as your dependent for the purposes of the medical expense deduction <u>if</u> both of the following requirements are met:

1. The person was a qualifying child or a qualifying relative, and
2. The person was a U.S. citizen or national, or a resident of the United States, Canada or Mexico.

There are different rules for decedents and for individuals who are the subject of multiple support agreements. For more information on these particular issues, see IRS Publication 502.

WHAT QUALIFIES as a MEDICAL EXPENSE?

As a general rule, medical expenses are the costs of diagnosis, cure, mitigation, treatment, or prevention of disease, and the costs for treatments affecting any part or function of the body. These expenses include payments for legal medical services rendered by physicians, surgeons, dentists, and other medical practitioners. They include the costs of equipment, supplies, and diagnostic devices needed for these purposes. The following are some additional rules that apply to medical expenses:

- They must be primarily for the purpose of alleviating or preventing a physical or mental defect or illness;

- They do not include expenses that are merely beneficial to general health, such as vitamins or a vacation;

- They can include the premiums paid for insurance that covers expenses of medical care, and the amounts for transportation to obtain medical care;

- They can also include amounts paid for qualified long-term care services and limited amounts paid for any qualified long-term care insurance contract;

- They can include all physician prescribed drugs and therapies for the purpose of treating medical conditions;

- In many cases, the necessity of care or medicines must be determined by a licensed physician or medical practitioner.

Tip: Medical and dental expenses are only deductible during the year they are paid; regardless of when the services were actually provided. For example, if a taxpayer visits the doctor's office late in December of 2009, their insurance company is billed first and the taxpayer does not pay the balance due until January of 2010, the expense would be claimed on the 2010 tax return.

AGI LIMITATIONS

You can only deduct on Schedule A the amount of your medical and dental expenses that exceeds 7.5% of your Adjusted Gross Income (AGI). This essentially means you must subtract 7.5% of your AGI from your total medical expenses in order to determine your allowable medical expense deduction.

Example A: Your filing status is "single," you have no dependents and your AGI is $40,000; 7.5% of which is $3,000. You paid medical expenses in the amount of $2,000 for 2009 tax year. You cannot deduct any of your medical expenses because they do not exceed 7.5% of your AGI.

Example B: Your filing status is "married, filing joint," you have two kids and your combined AGI is $60,000; 7.5% of which is $4,500. Your family paid $6,200 in total medical expenses for the 2009 tax year. Your allowable medical expense deduction for 2009 would be $1,700.

WHAT MEDICAL EXPENSES ARE DEDUCTIBLE?

There is a wide range of medical expenses that are potentially deductible if you itemize expenses on Schedule A. The following is a list of some of the items that you can include when figuring your medical expense deduction.

Note: This list does not include all possible medical expenses. To determine if an expense not listed can be included in figuring your medical expense deduction, please see the "What Qualifies as a Medical Expense" section earlier in the material.

Abortion

You can include in medical expenses the amount you pay for a legal abortion.

Acupuncture

You can include in medical expenses the amount you pay for acupuncture.

Ambulance

You can include in medical expenses amounts you pay for ambulance service.

Artificial Limb or Prosthesis

You can include in medical expenses the amount you pay for an artificial limb or prosthetic device.

Birth Control Pills

You can include in medical expenses the amount you pay for birth control pills prescribed by a doctor.

Body Scan

You can include in medical expenses the cost of an electronic body scan.

Braille Books or Magazines

You can include in medical expenses the part of the cost of Braille books or magazines for use by a visually impaired person that is more than the cost of regular printed editions.

Breast Reconstruction Surgery

You can include in medical expenses the amounts you pay for breast reconstruction surgery following a mastectomy for cancer.

Car

You can include in medical expenses the cost of special hand controls and other special equipment installed in a car for the use of a person with a disability. You can also include the difference between the cost of a regular car and a car specially designed to hold a wheelchair.

Chiropractor

You can include in medical expenses fees you pay to a chiropractor for medical care.

Dental Treatment

You can include in medical expenses the amounts you pay for the prevention and alleviation of dental disease. Preventive treatment includes the services of a dental hygienist or dentist for such procedures as teeth cleaning, the application of sealants, and fluoride treatments to prevent tooth decay. Treatment to alleviate dental disease including services of a dentist for procedures such as x-rays, fillings, braces, extractions, dentures, artificial teeth, and other dental ailments. However, teeth whitening procedures are not includible.

Diagnostic Devices

You can include in medical expenses the cost of devices used in diagnosing and treating illness and disease.

Example: You have diabetes and use a blood sugar test kit to monitor your blood sugar level. You can include the cost of the blood sugar test kit in your medical expenses.

Disabled Dependent Care Expenses

Some disabled dependent care expenses may qualify as either medical expenses or work-related expenses for purposes of taking a credit for dependent care. You can choose to apply them either way as long as you do not use the same expenses to claim both a credit and a medical expense deduction.

Drug or Alcohol Addiction, Treatment of

You can include in medical expenses amounts you pay for an inpatient's treatment at a therapeutic center for drug or alcohol addiction. This includes meals and lodging at the center during treatment.

You can also include in medical expenses amounts you pay for transportation to and from Alcoholics Anonymous meetings in your community if the attendance is pursuant to medical advice that membership in Alcoholics Anonymous is necessary for the treatment of a disease involving the excessive use of alcoholic liquors.

Drugs and Medicines

You can include in medical expenses amounts you pay for prescribed drugs and medicines. A prescribed drug is one that requires a prescription by a doctor for its use by an individual. However, generally over-the-counter drugs, such as aspirin, cold remedies and other medicines, even if prescribed by a doctor are not deductible, with the exception of insulin. You also cannot include in your medical expenses the cost of a prescribed drug brought in (or ordered shipped) from another country.

Eye Care

You can include in medical expenses amounts you pay for visiting an ophthalmologist or an optometrist, including fees paid for eye examinations.

<u>Eyeglasses and Contact Lenses</u>

You can include in medical expenses amounts you pay for eyeglasses and contact lenses needed for medical reasons. You can also include the cost of equipment and materials required for using contact lenses, such as saline solution and enzyme cleaner.

<u>Eye Surgery/Vision Correction Surgery</u>

You can include in medical expenses the amount you pay for eye surgery to treat defective vision, such as laser eye surgery or radial keratotomy.

Fertility Enhancement

You can include in medical expenses the cost of the following procedures to overcome an inability to have children:

- Procedures such as in vitro fertilization (including temporary storage of eggs or sperm).
- Surgery, including an operation to reverse prior surgery that prevented the person operated on from having children.

Guide Dog or Other Service Animal

You can include in medical expenses the costs of buying, training, and maintaining a guide dog or other service animal to assist a visually-impaired or hearing-impaired person, or a person with other physical disabilities.

Hearing Aids

You can include in medical expenses the cost of a hearing aid and the batteries you buy to operate it.

Home Health Care and/or Nursing Services

You can include in medical expenses wages and other amounts you pay for nursing services. The services need not be performed by a nurse as long as the services are of a kind generally performed by a nurse. This includes services connected with caring for the patient's condition, such as giving medication or changing dressings, as well as bathing and grooming the patient. These services can be provided in your home or another care facility.

Generally, only the amount spent for nursing services is a medical expense. If the attendant also provides personal and household services, amounts paid to the attendant must be divided between the amount of time spent performing household and personal services and the amount of time spent for nursing services. However, certain maintenance or personal care services provided for qualified long-term care can be included in medical expenses.

Additionally, certain expenses for household services or for the care of a qualifying individual incurred to allow you to work may qualify for the child and dependent care credit. See IRS Publication 503, *Child and Dependent Care Expenses*.

You can also include in medical expenses part of the amount you pay for that attendant's meals. Divide the food expense among the household members to find the cost of the attendant's food. Then divide that cost in the same manner as in the preceding paragraph. If you had to pay additional amounts for household upkeep because of the attendant, you can include the extra amounts with your medical expenses. This includes extra rent or utilities you pay because you moved to a larger apartment to provide space for the attendant.

<u>Employment Taxes</u>

You can include as a medical expense social security tax, FUTA, Medicare tax, and state employment taxes you pay for an attendant who provides medical care. If the attendant also provides personal and household services, you can include as a medical expense only the amount of employment taxes paid for medical services as explained earlier. For information on employment tax responsibilities of household employers, see IRS Publication 926, *Household Employer's Tax Guide*.

Home Improvements

You can include in medical expenses amounts you pay for special equipment installed in a home, or for improvements, if their main purpose is medical care for you, your spouse, or your dependent. The cost of permanent improvements that increase the value of your property may be partly included as a medical expense. The cost of the improvement is reduced by the increase in the value of your property. The difference is a medical expense. If the value of your property is not increased by the improvement, the entire cost is included as a medical expense.

Certain improvements made to accommodate a home to your disabled condition, or that of your spouse or your dependents living with you, do not usually increase the value of the home and the cost can be included in full as medical expenses. These improvements include, but are not limited to, the following items:

- Constructing entrance or exit ramps for your home;
- Widening doorways at entrances or exits to your home;
- Widening or otherwise modifying hallways and interior doorways;
- Installing railings, support bars, or other modifications to bathrooms;
- Lowering or modifying kitchen cabinets and equipment;
- Moving or modifying electrical outlets and fixtures;
- Installing porch lifts and other forms of lifts (but elevators generally add value to the house);
- Modifying fire alarms, smoke detectors, and other warning systems;
- Modifying stairways;
- Adding handrails or grab bars anywhere (whether or not in bathrooms);
- Modifying hardware on doors;
- Modifying areas in front of entrance and exit doorways;
- Grading the ground to provide access to the residence.

Only reasonable costs to accommodate a home for a person’s disabled condition are considered medical care. Additional costs for personal motives, such as for architectural or aesthetic reasons, are not medical expenses.

Hospital Services

You can include in medical expenses amounts you pay for the cost of inpatient care at a hospital or similar institution if a principal reason for being there is to receive medical care. This includes amounts paid for meals and lodging.

Intellectually and Developmentally Disabled, Special Home for

You can include in medical expenses the cost of keeping a person who is intellectually and developmentally disabled (mentally retarded) in a special home, not the home of a relative, on the recommendation of a psychiatrist to help the person adjust from life in a mental hospital to community living.

Laboratory Fees

You can include in medical expenses the amounts you pay for laboratory fees that are part of medical care.

Lead-Based Paint Removal

You can include in medical expenses the cost of removing lead-based paints from surfaces in your home to prevent a child who has or had lead poisoning from eating the paint. These surfaces must be in poor repair (peeling or cracking) or within the child's reach. The cost of repainting the scraped area is not a medical expense.

If, instead of removing the paint, you cover the area with wallboard or paneling, treat these items as capital expenses. See "Home Improvements," earlier. Do not include the cost of painting the wallboard as a medical expense.

Legal Fees

You can include in medical expenses legal fees you paid that are necessary to authorize treatment for mental illness. However, you cannot include in medical expenses fees for the management of a guardianship estate, fees for conducting the affairs of the person being treated, or other fees that are not necessary for medical care.

Long-Term Care

You can include in medical expenses amounts paid for qualified long-term care services and premiums paid for qualified long-term care insurance contracts.

<u>Qualified Long-Term Care Services</u>

Qualified long-term care services are necessary diagnostic, preventive, therapeutic, curing, treating, mitigating, rehabilitative services, and maintenance and personal care services (defined later) that are:

(a) Required by a chronically ill individual, and

(b) Provided pursuant to a plan of care prescribed by a licensed health care practitioner.

Chronically Ill Individual

An individual is chronically ill if, within the previous 12 months, a licensed health care practitioner has certified that the individual meets either of the following descriptions:

(a) He or she is unable to perform at least two activities of daily living without substantial assistance from another individual for at least 90 days, due to a loss of functional capacity. Activities of daily living are eating, toileting, transferring, bathing, dressing, and continence, or

(b) He or she requires substantial supervision to be protected from threats to health and safety due to severe cognitive impairment.

Maintenance and Personal Care Services

Maintenance or personal care services is care which has as its primary purpose the providing of a chronically ill individual with needed assistance with his or her disabilities (including protection from threats to health and safety due to severe cognitive impairment).

Qualified Long-Term Care Insurance Contracts

A qualified long-term care insurance contract is an insurance contract that provides only coverage of qualified long-term care services. The contract must:

1. Be guaranteed renewable,
2. Not provide for a cash surrender value or other money that can be paid, assigned, pledged, or borrowed,
3. Provide that refunds, other than refunds on the death of the insured or complete surrender or cancellation of the contract, and dividends under the contract must be used only to reduce future premiums or increase future benefits, and
4. Generally not pay or reimburse expenses incurred for services or items that would be reimbursed under Medicare, except where Medicare is a secondary payer, or the contract makes per diem or other periodic payments without regard to expenses.

The amount of qualified long-term care premiums you can include is limited for federal purposes. For specific amounts that you include as medical expenses please refer to the instructions for Schedule A or IRS Publication 502.

Medical Conferences

You can include in medical expenses amounts paid for admission and transportation to a medical conference if the medical conference concerns the chronic illness of yourself, your spouse, or your dependent. The costs of the medical conference must be primarily for and necessary to the medical care of you, your spouse, or your dependent. The majority of the time spent at the conference must be spent attending sessions on medical information. Please note: The cost of meals and lodging while attending the conference is <u>not</u> deductible as a medical expense.

Medical Information Plan

You can include in medical expenses amounts paid to a plan that keeps medical information in a computer data bank and retrieves and furnishes the information upon request to an attending physician.

Medical Supplies

You can include in medical expenses the cost of medical supplies such as bandages, splints and crutches.

Nursing Home

You can include in medical expenses the cost of medical care in a nursing home, home for the aged or similar institution, for yourself, your spouse, or your dependents. This includes the cost of meals and lodging in the home if a principal reason for being there is to get medical care.

Do not include the cost of meals and lodging if the reason for being in the home is personal. You can, however, include in medical expenses the part of the cost that is for medical or nursing care.

Organ Donors and Transplants

You can include any expenses you pay for the medical care you receive because you are a donor in connection with the donating of an organ. This includes transportation.

Osteopath

You can include in medical expenses amounts you pay to an osteopath for medical care.

Oxygen

You can include in medical expenses amounts you pay for oxygen and oxygen equipment to relieve breathing problems caused by a medical condition.

Physical Examination

You can include in medical expenses the amount you pay for an annual physical examination and diagnostic tests by a physician. You do not have to be ill at the time of the examination. Example: Joe goes to see Dr. Williams for his annual check-up. Dr. Williams does a physical examination and has some lab tests done. Joe can include the cost of the exam and lab tests in his medical expenses, if his insurance does not cover the cost.

Physical Therapy

You can include in medical expenses amounts you pay for physical therapy received as medical treatment.

Pregnancy Test Kit

You can include in medical expenses the amount you pay to purchase a pregnancy test kit to determine if you are pregnant.

Psychiatric Care

You can include in medical expenses amounts you pay for psychiatric care. This includes the cost of supporting a mentally ill dependent at a specially equipped medical center where the dependent receives medical care.

Psychologist

You can include in medical expenses amounts you pay to a psychologist for medical care.

Special Education

You can include in medical expenses fees you pay on a doctor's recommendation for a child's tutoring by a teacher who is specially trained and qualified to work with children who have learning disabilities caused by mental or physical impairments, including nervous system disorders.

You can include in medical expenses the cost (tuition, meals, and lodging) of attending a school that furnishes special education to help a child to overcome learning disabilities. A doctor must recommend that the child attend the school. Overcoming the learning disabilities must be a principal reason for attending the school, and any ordinary education received must be incidental to the special education provided. Special education includes:

- Teaching Braille to a visually impaired person,
- Teaching lip reading to a hearing-impaired person, or
- Giving remedial language training to correct a condition caused by a birth defect.

You cannot include in medical expenses the cost of sending a problem child to a school where the course of study and the disciplinary methods have a beneficial effect on the child's attitude if the availability of medical care in the school is not a principal reason for sending the student there.

Sterilization

You can include in medical expenses the cost of a legal sterilization (a legally performed operation to make a person unable to have children).

Stop-Smoking Programs

You can include in medical expenses amounts you pay for a program to stop smoking. However, you cannot include in medical expenses amounts you pay for drugs that do not require a prescription, such as over-the-counter nicotine gum or patches, that are designed to help stop smoking.

Surgery/Operations

You can include in medical expenses amounts you pay for legal operations that are not for unnecessary cosmetic surgery.

Telephone

You can include in medical expenses the cost of special telephone equipment that lets a hearing-impaired person communicate over a regular telephone. This includes teletypewriter (TTY) and telecommunications device for the deaf (TDD) equipment. You can also include the cost of repairing the equipment.

Television

You can include in medical expenses the cost of equipment that displays the audio part of television programs as subtitles for hearing-impaired persons. This may be the cost of an adapter that attaches to a regular set. It also may be the part of the cost of a specially equipped television that exceeds the cost of the same model regular television set.

Vasectomy

You can include in medical expenses the amount you pay for a vasectomy.

Weight-Loss Program

You can include in medical expenses amounts you pay to lose weight if it is a treatment for a specific disease diagnosed by a physician (such as obesity, hypertension, or heart disease). This includes fees you pay for membership in a weight reduction group as well as fees for attendance at periodic meetings. You cannot include membership dues in a gym, health club, or spa as medical expenses, but you can include separate fees charged there for weight loss activities.

Wheelchair

You can include in medical expenses amounts you pay for an autoette or a wheelchair used mainly for the relief of sickness or disability, and not just to provide transportation to and from work. The cost of operating and maintaining the autoette or wheelchair is also a medical expense.

Wig

You can include in medical expenses the cost of a wig purchased upon the advice of a physician for the mental health of a patient who has lost all of his or her hair from disease.

X-ray

You can include in medical expenses amounts you pay for X-rays for medical reasons.

Question: Whitey Finnegan recently paid $2000 to have the Lasik procedure performed on both of his eyes. Is this considered a medical expense that is deductible on Schedule A?

Answer: Yes. Because the Lasik procedure is considered a vision correction surgery to treat defective vision, it is allowable as a medical expense.

INSURANCE PREMIUMS

You can include in medical expenses amounts you pay for insurance premiums for policies that help cover the cost of medical care. Medical care policies can provide payment for treatment that includes:

- Hospitalization, physician services, surgeries and X-rays,
- Prescription medicine and drugs (also insulin),
- Dental care,
- Eye care and replacement of lost or damaged contact lenses, and
- Long-term care (subject to additional limitations).

If you have a policy that also provides payments for something other than medical care, you can include the premiums for the medical care part of the policy if the charge for the medical part is reasonable. The cost of the medical part must be separately stated in the insurance contract or given to you in a separate statement.

Tip: Remember that health and long-term care insurance premiums are deductible as a medical expense only on the *Federal* Schedule A (and they are limited 7.5% of your AGI). On the Kentucky Individual Income tax return, health and long-term care insurance premiums are a separate deduction (and fully deductible) on Schedule M. However, please note that health insurance premiums paid for with pre-tax dollars are not deductible under any circumstances.

Health Maintenance Organization (HMO)

You can include in medical expenses amounts you pay to entitle you, your spouse, or a dependent to receive medical care from a health maintenance organization. These amounts are treated as medical insurance premiums.

Medicare Part A

If you are covered under social security (or if you are a government employee who paid Medicare tax), you are automatically enrolled in Medicare A. The payroll tax paid for Medicare A is typically not considered a medical expense. If you are not covered under Social Security or were not a government employee who paid Medicare tax, you can voluntarily enroll in Medicare Part A. In this situation you can include the premiums you paid for Medicare Part A as a medical expense.

Medicare Part B

Medicare Part B is a supplemental medical insurance. Premiums that you pay for Medicare Part B are deductible as a medical expense. If you applied for Medicare Part B at age 65, or after you became disabled, you can include in medical expenses the monthly premiums that you paid. If you were over age 65 or disabled when you first enrolled check the information you received from the Social Security Administration to find out your monthly premium.

Medicare Part D

Medicare Part D is a voluntary prescription drug insurance program for persons with Medicare Part A or B. You can include as a medical expense any premiums you pay for Medicare Part D.

Unused Sick Leave Used to Pay Premiums

You must include in gross income cash payments you receive at the time of retirement for unused sick leave. You also must include in gross income the value of unused sick leave that, at your option, your employer applies to the cost of your continuing participation in your employer's health plan after you retire. You can include this cost of continuing participation in the health plan as a medical expense.

If you participate in a health plan where your employer automatically applies the value of unused sick leave to the cost of your continuing participation in the health plan (and you do not have the option to receive cash), do not include the value of the unused sick leave in gross income. You cannot include this cost of continuing participation in that health plan as a medical expense.

Self-Employed Health Insurance Premiums

There is an exception for health insurance premiums paid by self-employed individuals. The self-employed actually do not have to itemize their deductions on the Federal return to claim health insurance premiums. 100% of their premiums would be claimed as an above-the-line deduction on Line 29 of the federal Form 1040. On the state return, this amount would be added back on Line 2 of the Kentucky Schedule M and then typically subtracted again on Line 14 of Kentucky Schedule M. (This, of course, prevents the taxpayer from claiming the two different deductions for the same expense or "double-dipping" on the state return.)

Insurance Premiums You Cannot Include

You cannot include in medical expenses the premiums you paid for the following:

- Life insurance policies;
- Policies providing payment for loss of earnings;
- Policies for loss of life, limb, sight, etc.;
- Policies that pay you a guaranteed amount each week for a stated number of weeks if you are hospitalized for sickness or injury;
- The part of your car insurance that provides medical insurance coverage for all persons injured in or by your car because the part of the premium providing insurance for you, your spouse, and your dependents is not stated separately from the part of the premium providing insurance for medical care for others; or
- Health or long-term care insurance, if you elected to pay these premiums with tax-free distributions from a retirement plan made directly to the insurance provider and these distributions would otherwise have been included in income.

Taxes imposed by any governmental unit, such as Medicare taxes, are not considered insurance premiums and therefore are not deductible.

MEALS, LODGING, and TRANSPORTATION

You can also include in medical expenses amounts you pay for meals, lodging and transportation under certain circumstances.

Meals

You can include in medical expenses the cost of meals at a hospital or similar institution if a principal reason for being there is to get medical care. However, you cannot include in medical expenses the cost of meals that are not part of inpatient care.

Lodging

You can include in medical expenses the cost of lodging at a hospital or similar institution if a principal reason for being there is to receive medical care.

You may also be able to include in medical expenses the cost of lodging not provided in a hospital or similar institution. You can include the cost of such lodging while away from home if all of the following requirements are met:

- The lodging is primarily for and essential to medical care,
- The medical care is provided by a doctor in a licensed hospital or in a medical care facility related to, or the equivalent of, a licensed hospital,
- The lodging is not lavish or extravagant under the circumstances, and

- There is no significant element of personal pleasure, recreation, or vacation in the travel away from home.

The amount you include in medical expenses for lodging cannot be more than $50 per night for each person. You can include lodging for a person traveling with the person receiving the medical care. For example, if a parent is traveling with a sick child, up to $100 per night can be included as a medical expense for lodging.

Transportation

You can include in medical expenses amounts paid for transportation primarily for and essential to receiving medical care. You can include:

- Bus, taxi, train, or plane fares or ambulance service;
- Transportation expenses of a parent who must go with a child who needs medical care;
- Transportation expenses of a nurse or other person who can give injections, medications, or other treatment required by a patient who is traveling to get medical care and is unable to travel alone; and
- Transportation expenses for regular visits to see a mentally ill dependent, if these visits are recommended as a part of treatment.

You can also include out-of-pocket expenses, such as the cost of gas and oil, when you use a car for medical reasons. However, you cannot include depreciation, insurance, general repair, or maintenance expenses.

If you do not want to use your actual car expenses, you can use the standard medical mileage rate instead. For the 2009 tax year, the standard medical mileage rate was 24 cents a mile.

Finally, you can also include the cost of parking fees and tolls. You can add these fees and tolls to your medical expenses whether you choose to use actual car expenses or use the standard mileage rate.

Example: Reggie Lisowski drove 1,900 miles for medical reasons during the year. He spent $220 for gas, $30 for oil, and $55 for tolls and parking. He wants to calculate the amount that he can include in medical expenses both ways to determine which method gives him the greater deduction.

Reggie figures the actual expenses first. He adds the $220 for gas, the $30 for oil, and the $55 for tolls and parking for a total of $305.

He then calculates the standard mileage amount. He multiplies the 1,900 miles by 24 cents a mile for a total of $456. He then adds the $55 for tolls and parking for a total of $511.

Reggie will include the $511 of car expenses with his other medical expenses for the year because the $511 is greater than the $305 that he figured using actual expenses.

WHAT MEDICAL EXPENSES ARE NOT ALLOWABLE?

The following is a list of some items that you cannot include in figuring your medical expense deduction claimed on Schedule A. The items are listed in alphabetical order.

Baby Sitting, Childcare, and Nursing Services for a Normal, Healthy Baby

You cannot include in medical expenses amounts you pay for the care of children, even if the expenses enable you, your spouse, or the dependent to get medical or dental treatment. Also, any expense allowed as a childcare credit cannot be treated as an expense paid for medical care.

Controlled Substances

You cannot include in medical expenses amounts you pay for controlled substances (such as marijuana, laetrile, etc.), in violation of federal law.

Cosmetic Surgery

Generally, you cannot include in medical expenses the amount you pay for unnecessary cosmetic surgery. This includes any procedure that is directed at improving the patient's appearance and does not meaningfully promote the proper function of the body or prevent or treat illness or disease. You generally cannot include in medical expenses the amount you pay for procedures such as face lifts, hair transplants, hair removal (electrolysis), and liposuction.

You can include in medical expenses the amount you pay for cosmetic surgery if it is necessary to improve a deformity arising from, or directly related to, a congenital abnormality, a personal injury resulting from an accident or trauma, or a disfiguring disease. For example, an individual undergoes surgery that removes a breast as part of treatment for cancer. She pays a surgeon to reconstruct the breast. The surgery to reconstruct the breast corrects a deformity directly related to the disease. The cost of the surgery is includible in her medical expenses.

Dancing or Swimming Lessons

You cannot include the cost of dancing or swimming lessons, etc., even if they are recommended by a doctor, if the sole purpose is only for the improvement of general health.

Diaper Service

You cannot include in medical expenses the amount you pay for diapers or diaper services, unless they are needed to relieve the effects of a particular disease.

Flexible Spending Account

You cannot include in medical expenses amounts for which you are fully reimbursed by your flexible spending account if you contribute a part of your income on a pre-tax basis to pay for the qualified benefit.

Funeral Expenses

You cannot include in medical expenses amounts you pay for funerals.

Future Medical Care

Generally, you cannot include in medical expenses current payments for medical care (including medical insurance) to be provided substantially beyond the end of the year.

Gender Reassignment Surgery

You cannot include the cost of gender reassignment surgery (i.e. sex-change operation) because it does not fit the narrow definition of allowable cosmetic procedures intended to correct disfigurement arising from a disease, accident, or congenital abnormality.

Health Club Dues

You cannot include in medical expenses health club dues or amounts paid to improve one’s general health or to relieve physical or mental discomfort not related to a particular medical condition.

You cannot include in medical expenses the cost of membership in any club organized for business, pleasure, recreation, or other social purpose.

Health Coverage Tax Credit (HCTC)

You cannot include in medical expenses amounts you pay for health insurance that you use in figuring your health coverage tax credit. The HCTC is a refundable credit provided on the federal return that pays 80 percent of health insurance premiums for eligible taxpayers and their qualified family members.

Health Reimbursement Arrangement (HRA)

If you have medical expenses that are reimbursed by a health reimbursement arrangement, you cannot include those expenses in your medical expenses. This is because an HRA is funded solely by an employer.

Health Savings Accounts (HSA)

You cannot include in medical expenses any payment or distribution for medical expenses out of a health savings account. Contributions to health savings accounts are deducted separately. See IRS Publication 969.

Household Help

You cannot include in medical expenses the cost of household help, even if such help is recommended by a doctor. This is a personal expense that is not deductible. However, you may be able to include certain expenses paid to a person providing nursing-type services. For more information, see "Nursing Services," earlier under What Medical Expenses Are Includible. Also, certain maintenance or personal care services provided for qualified long-term care can be included in medical expenses. For more information, see "Long-Term Care," earlier under What Medical Expenses Are Includible.

Illegal Operations and Treatments

You cannot include in medical expenses amounts you pay for illegal operations, treatments, or controlled substances whether rendered or prescribed by licensed or unlicensed practitioners.

Marijuana

You cannot include the cost of purchasing marijuana or cannabis for medicinal purposes, even if prescribed by a doctor in a state allowing the prescription.

Maternity Clothes

You cannot include in medical expenses amounts you pay for maternity clothes.

Medical Savings Account (MSA)

You cannot include in medical expenses amounts you contribute to an Archer MSA. You cannot include expenses you pay for with a tax-free distribution from your Archer MSA. You also cannot use other funds equal to the amount of the distribution and include the expenses. For more information on Archer MSAs, see IRS Publication 969.

Medicines and Drugs from Other Countries

In general, you cannot include in your medical expenses the cost of a prescribed drug brought in (or ordered shipped) from another country. You can only include the cost of a drug that was imported legally. For example, you can include the cost of a prescribed drug the Food and Drug Administration announces can be legally imported by individuals.

You can include the cost of a prescribed drug you purchase and consume in another country if the drug is legal in both the other country and the United States.

Nonprescription Drugs and Medicines

Except for insulin, you cannot include in medical expenses amounts you pay for a drug that is not prescribed. Example: Your doctor recommends that you take aspirin. Because aspirin is a drug that does not require a physician’s prescription, you cannot include its cost in your medical expenses.

Nutritional Supplements

You cannot include in medical expenses the cost of nutritional supplements, vitamins, herbal supplements, “natural medicines,” etc. unless they are recommended by a medical practitioner as treatment for a specific medical condition diagnosed by a physician. Otherwise, these items are taken to maintain your ordinary good health, and are not for medical care.

Personal Use Items

You cannot include in medical expenses the cost of an item ordinarily used for personal, living, or family purposes unless it is used primarily to prevent or alleviate a physical or mental defect or illness. For example, the cost of a toothbrush and toothpaste is a nondeductible personal expense.

In order to accommodate an individual with a physical defect, you may have to purchase an item ordinarily used as a personal, living, or family item in a special form.

You can include the excess of the cost of the item in a special form over the cost of the item in normal form as a medical expense. For example, Charlie is visually impaired and must special order Braille books or magazines from a company on the internet. He is allowed to deduct the part of the cost that is more than the cost of regular printed editions.

Teeth Whitening

You cannot include in medical expenses amounts paid to whiten teeth. See "Cosmetic Surgery," earlier.

Trips

You cannot include in medical expenses a trip or vacation taken merely for a change in environment, improvement of morale, or general improvement of health, even if the trip is made on the advice of a doctor. The expenses for the trip must be primarily for and essential to receiving medical care.

Veterinary Fees

You generally cannot include veterinary fees in your medical expenses. The exception is the costs of buying, training, and maintaining a guide dog or other service animal to assist a visually-impaired or hearing-impaired person, or a person with other physical disabilities.

Weight-Loss Program

You cannot include in medical expenses the cost of a weight-loss program if the purpose of the weight loss is the improvement of appearance, general health, or sense of well-being. You cannot include amounts you pay to lose weight unless the weight loss is a treatment for a specific disease diagnosed by a physician (such as obesity, hypertension, or heart disease). If the weight-loss treatment is not for a specific disease diagnosed by a physician, you cannot include either the fees you pay for membership in a weight reduction group or fees for attendance at periodic meetings. Also, you cannot include membership dues in a gym, health club, or spa.

You cannot include the cost of diet food or beverages in medical expenses because the diet food and beverages substitute for what is normally consumed to satisfy nutritional needs.

Question: Chastity Starling is a popular movie actress that recently had nose reduction surgery performed. Can she claim the expenses from the surgery as a medical expense on Schedule A?

Answer: No. Because nose reduction surgery is a cosmetic procedure used to improve a patient's appearance, it is considered an elective surgery and not medically necessary. Therefore, it is not deductible as a medical expense.

The following chart gives an "at-a-glance" look at what is includible and what is not includible for medical/dental expenses deduction on Schedule A. This is not intended to be a comprehensive list, just an overview. For more detailed information, see IRS Publication 502.

Figure 1.1 – Medical and Dental Expenses Checklist (See IRS Publication 502 for more detailed information.)

You Can Include:	**You Cannot Include:**
• Bandages • Birth control pills prescribed by your doctor • Body scan • Capital expenses for equipment or improvements to your home needed for medical care (see the worksheet in IRS Publication 502) • Diagnostic devices • Expenses of an organ donor • Eye surgery- to promote the correct function of the eye • Fertility enhancement, certain procedures • Guide dogs or other animals aiding the blind, deaf, and disabled • Hospital service fees (lab work, therapy, nursing services, surgery, etc.) • Lead-based paint removal • Legal abortion • Legal operation to prevent having children such as a vasectomy or tubal ligation • Long-term care contracts, qualified • Meals and lodging provided by a hospital during medical treatment • Medical service fees (from doctors, dentists, surgeons, specialists, and other medical practitioners • Medicare Part D premiums • Medical and hospital insurance premiums • Oxygen equipment and oxygen • Part of life-care fee paid to retirement home designated for medical care. • Physical examination • Pregnancy test kit • Prescription medicine and insulin (prescribed by a doctor) • Psychiatric and psychological treatment • Social security tax, Medicare tax, FUTA, and state employment tax for worker providing medical care (see "Wages for nursing services" below) • Special items (artificial limbs, false teeth, eye glasses, contact lenses, hearing aids, crutches, wheelchair, etc.) • Special education for mentally or physically disabled persons • Stop-smoking programs • Transportation for needed medical care • Treatment at a drug or alcohol center (includes meals and lodging provided by the center) • Wages for nursing services • Weight-loss, certain expenses for obesity	• Babysitting and childcare • Bottled water • Contributions to Archer MSAs (see IRS Publication 969) • Diaper service • Expenses for your general health (even if following your doctor's advice) such as— —Health club dues —Household help (even if recommended by a doctor) —Social activities, such as dancing or swimming lessons —Trip for general health improvement • Flexible spending account reimbursements for medical expenses (if contributions were on a pre-tax basis) • Funeral, burial, or cremation expenses • Health savings account payments for medical expenses • Illegal operation or treatment • Life insurance or income protection policies, or policies providing payment for loss of life, limb, sight, etc. • Maternity clothes • Medical insurance included in a car insurance policy covering all persons injured in or by your car • Medicine you buy without a prescription • Nursing care for a healthy baby • Prescription drugs you brought in (or ordered, shipped) from another country, in most cases • Nutritional supplements, vitamins, herbal supplements, "natural medicines," etc., unless recommended by a medical practitioner as a treatment for a specific medical condition diagnosed by a physician • Surgery for purely cosmetic reasons • Toothpaste, toiletries, cosmetics, etc. • Teeth whitening • Weight-loss expenses not for the treatment of obesity or other disease

Chapter 2: Deductible Taxes

SCHEDULE A
Form 740
42A740-A
Department of Revenue

KENTUCKY ITEMIZED DEDUCTIONS
➤ **See instructions.**
➤ **Attach to Form 740.**

2009

Enter name(s) as shown on Form 740, page 1. | Your Social Security Number

Section	Line	No.	Amount
Medical and Dental Expenses	**Do not include expenses reimbursed or paid by others.**		
	1. Medical and dental expenses	1	
	2. Enter 7.5% (.075) of the amount from Form 740, line 9	2	
	3. **Total medical and dental.** Subtract line 2 from line 1. If zero or less, enter -0-	➤ 3	00
Taxes	4. Local income taxes (do not include state income tax)	4	
Note: Sales and use taxes and new motor vehicle taxes are not deductible.	5. Real estate taxes	5	
	6. Personal property taxes	6	
	7. Other taxes (list) ____________	7	
	8. **Total taxes.** Add lines 4 through 7. Enter here	➤ 8	00
Interest Expense	9. Home mortgage interest and points reported to you on federal Form 1098	9	
Note: Personal interest is not deductible.	10. Home mortgage interest not reported to you on federal Form 1098 (if paid to an individual, show that person's name, identifying number and address) ____________	10	
	See instructions for lines 11 and 12.		
	11. Points not reported to you on federal Form 1098	11	
	12. Qualified mortgage insurance premiums	12	
	13. Investment interest (attach federal Form 4952 if required)	13	
	14. **Total interest.** Add lines 9 through 13. Enter here	➤ 14	00
Contributions	15. Contributions by cash or check	15	
Note: For any contribution of $250 or more, see instructions.	16. Other than cash or check (attach federal Form 8283 if over $500)	16	
	17. Artistic charitable contributions deduction (attach copy of appraisal)	17	
	18. Carryover from prior year	18	
	19. **Total contributions.** Add lines 15 through 18. Enter here	➤ 19	00
Casualty and Theft Losses	20. Enter amount from attached federal Form 4684, Section A, line 16	20	
	21. Enter 10% (.10) of the amount from Form 740, line 9	21	
	22. **Total casualty or theft loss(es).** Subtract line 21 from line 20. If zero or less, enter -0-	➤ 22	00
Job Expenses and Most Other Miscellaneous Deductions	23. Unreimbursed employee expenses—job travel, union dues, job education, etc. (attach Form 2106 or 2106-EZ if applicable) list ____________	23	
	24. Tax preparation fees	24	
	25. Other (investment, safe deposit box, etc.) list ____________	25	
	26. Add the amounts on lines 23, 24 and 25. Enter here	26	
	27. Enter 2% (.02) of the amount from Form 740, line 9	27	
	28. **Total.** Subtract line 27 from line 26. If zero or less, enter -0-	➤ 28	00
Other Miscellaneous Deductions	29. Other (see instructions) ____________	➤ 29	00
Total Itemized Deductions	30. Add lines 3, 8, 14, 19, 22, 28 and 29. Enter here	➤ 30	00

★ If single or married filing jointly and your income for Form 740, Column B does not exceed $166,800, enter total itemized deductions on Form 740, line 10, Column B.
★ All others go to page 2.

If you choose to itemize deductions, various taxes may qualify as deductions and others may not. There are rules and conditions that govern the allowance of taxes as an itemized deduction. Paragraph 1021 of the Master Tax Guide explains deductible taxes as "taxes not directly connected with a trade or business or with property held for production of rents or royalties may be deducted only as an itemized deduction on Schedule A". Additional information about the deductibility of taxes may also be found in the Master Tax Guide.

Note: Due to differences in Federal and Kentucky law, allowable taxes claimed on Schedule A may be different for federal and Kentucky purposes. In other words, when reviewing Schedule A, it is not a given that the deductions claimed for Taxes will be the same for federal and Kentucky purposes.

WHO CAN DEDUCT TAXES?

Taxes are deductible only by the person who paid them. For example, taxes paid on a child's property are not deductible by the parent, because they are not the parent's obligation, or by the child, because the child did not pay them, unless the parent paid on the child's behalf (the child treats the amount as a gift).

WHEN ARE TAXES DEDUCTED?

Cash-basis taxpayers deduct taxes in the year they are paid. For the vast majority of taxpayers this would be based on the calendar year the tax was paid. Accrual-basis taxpayers deduct taxes in the year they are accrued. If taxes were claimed in the incorrect year, then an amended return must be filed to make corrections.

WHAT TAXES MAY BE DEDUCTED?

In 2009, <u>for federal purposes,</u> allowable taxes paid include:

- State and local income taxes <u>or</u> state and local general sales tax
- Real estate taxes
- New motor vehicle taxes
- State and local personal property taxes
- Other taxes (see note below)

In 2009, <u>for Kentucky purposes,</u> allowable taxes paid include:

- Local income taxes
- Real estate taxes
- Personal property taxes
- Other taxes (see note below)

Note: For federal purposes, "other taxes" often represent Foreign Income Tax Paid. Over the years this deduction has been allowed for Kentucky some years and some years not, depending on the law in effect. For 2009, Foreign Income Tax Paid is not allowed as a Kentucky itemized deduction.

FEDERAL ALLOWABLE TAXES PAID

For federal purposes only, allowable taxes paid that may be claimed on the federal Schedule A are detailed in the material that follows.

STATE and LOCAL INCOME TAXES

- State and local income taxes withheld from your salary during 2009. Form(s) W-2 will show these amounts. Forms W-2G, 1099-G, 1099-R, and 1099-MISC may also show state and local income taxes withheld.
- State and local income taxes paid in 2009 for a prior year, such as taxes paid with your 2008 state or local income tax return. Do not include penalties or interest.
- State and local estimated tax payments made during 2009, including any part of a prior year refund that you chose to have credited to your 2009 state or local income taxes.
- Mandatory contributions you made to the California, New Jersey, or New York Non-occupational Disability Benefit Fund, Rhode Island Temporary Disability Benefit Fund, or Washington State Supplemental Workmen's Compensation Fund.
- Mandatory contributions to the Alaska, New Jersey, or Pennsylvania state unemployment fund.

Do not reduce your deduction by either of the following:

- State or local income tax refund or credit you expect to receive for 2009, or
- Refund of, or credit for, prior year state and local income taxes you actually received in 2009. Instead, see the instructions for federal Form 1040, line 10.

STATE and LOCAL GENERAL SALES TAXES

In lieu of claiming state and local income tax you may instead elect to claim state and local sales tax paid. However, you may not claim both income and sales tax on your Schedule A. If you elect to deduct state and local general sales taxes you can use either your actual expenses or the optional sales tax tables.

ACTUAL EXPENSES

Generally, you can deduct the actual state and local general sales taxes (including compensating use taxes) you paid in 2009 if the tax rate was the same as the general sales tax rate. However, sales taxes on food, clothing, medical supplies, and motor vehicles are deductible as a general sales tax even if the tax rate was less than the general sales tax rate. If you paid sales tax on a motor vehicle at a rate higher than the general sales tax rate, you can deduct only the amount of tax that you would have paid at the general sales tax rate on that vehicle. Motor vehicles include cars, motorcycles, motor homes, recreational vehicles, sport utility vehicles, trucks, vans, and off-road vehicles. Also include any state and local general sales taxes paid for a leased motor vehicle. Do not include sales taxes paid on items used in your trade or business.

REFUND of GENERAL SALES TAXES

If you received a refund of state or local general sales taxes in 2009 for amounts paid in 2009, reduce your actual 2009 state and local general sales taxes by this amount. If you received a refund of state or local general sales taxes in 2009 for prior year purchases, do not reduce your 2009 state and local general sales taxes by this amount. But if you deducted your actual state and local general sales taxes in the earlier year and the deduction reduced your tax, you may have to include the refund in income on federal Form 1040, line 21. See *Recoveries* in IRS Publication 525 for details.

OPTIONAL SALES TAX TABLES

Instead of using your actual expenses, you can use the tables provided by the IRS to figure your state and local general sales tax deduction. You may also be able to add the state and local general sales taxes paid on certain specified items.

To figure your state and local general sales tax deduction using the tables, complete the worksheet or use the 2009 Sales Tax Deduction Calculator on the IRS website. To use the 2009 Sales Tax Deduction Calculator, go to www.irs.gov and enter "Sales tax deduction calculator" in the search box.

If your filing status is married filing separately, both you and your spouse elect to deduct sales taxes, and your spouse elects to use the optional sales tax tables, you also must use the tables to figure your state and local general sales tax deduction.

REAL ESTATE TAXES

Include taxes (state, local, or foreign) you paid on real estate you own that was not used for business, but only if the taxes are based on the assessed value of the property. Also, the assessment must be made uniformly on property throughout the community, and the proceeds must be used for general community or governmental purposes. IRS Publication 530 explains the deductions homeowners can take.

Do not include the following amounts as real estate tax paid:

- Itemized charges for services to specific property or persons (for example, a $20 monthly charge per house for trash collection, a $5 charge for every 1,000 gallons of water consumed, or a flat charge for mowing a lawn that had grown higher than permitted under a local ordinance).
- Charges for improvements that tend to increase the value of your property (for example, an assessment to build a new sidewalk).
- The cost of a property improvement is added to the basis of the property. However, a charge is deductible if it is used only to maintain an existing public facility in service (for example, a charge to repair an existing sidewalk, and any interest included in that charge).

If your mortgage payments include your real estate taxes, you can deduct only the amount the mortgage company actually paid to the taxing authority in 2009.

If you sold your home in 2009, any real estate tax charged to the buyer should be shown on your settlement statement and in box 5 of any Form 1099-S you received. This amount is considered a refund of real estate taxes. See "Refunds and rebates," below. Any real estate taxes you paid at closing should be shown on your settlement statement.

You must look at your real estate tax bill to decide if any nondeductible itemized charges, such as those listed above, are included in the bill. If your taxing authority (or lender) does not furnish a copy of your real estate tax bill, request a copy to verify your deductions.

Taxpayer Tip: Many financial institutions furnish a substitute Form 1098 that reflects the amount of money paid for interest, taxes and insurance. These substitute forms will serve to verify your deductions.

REFUNDS and REBATES

If you received a refund or rebate in 2009 of real estate taxes you paid in 2009, reduce your deduction by the amount of the refund or rebate. If you received a refund or rebate in 2009 of real estate taxes you paid in an earlier year, do not reduce your deduction by this amount. Instead, you must include the refund or rebate in income on federal Form 1040, line 21, if you deducted the real estate taxes in the earlier year and the deduction reduced your tax. See *Recoveries* in IRS Publication 525 for details on how to figure the amount to include in income.

NEW MOTOR VEHICLE TAXES

If you elected to deduct state and local general sales taxes, you cannot deduct new motor vehicle taxes.

You may be able to deduct state and local sales and excise taxes (or certain other taxes or fees in a state without a sales tax) paid after February 16, 2009, for the purchase of any new motor vehicle(s). To figure the amount you can deduct, you will need to complete the Worksheet for Line 7 on the back of Schedule A.

A new motor vehicle is any of the following:

- A passenger automobile or light truck that is self propelled, designed to transport people or property on a street or highway, and the gross vehicle weight rating of the vehicle is not more than 8,500 pounds.
- A motorcycle with a gross vehicle weight rating of not more than 8,500 pounds.
- A motor home

The original use of the vehicle must begin with you.

OTHER TAXES

If you had any other deductible tax, list the type and amount of tax on the Other Taxes line. Total the taxes entered. Include on this line:

- State and local personal property taxes you paid, if the taxes were based on value alone and were imposed on a yearly basis; and
- Income tax you paid to a foreign country or U.S. possession.

Taxpayer Tip: It may be to your advantage to take a credit for the foreign tax paid instead of a deduction on your federal return. For 2009, Kentucky does not allow a deduction or a credit for foreign taxes paid.

KENTUCKY ALLOWABLE TAXES PAID

Local Income Taxes

Report the total amount of local occupational (payroll) tax paid. In some instances tax may be paid to more than one locality. These amounts should be supported by W-2 wage statements. Do not include state or federal income taxes paid or withheld; they are not deductible.

Real Estate Taxes

Report the amount of local and state property taxes you paid on real estate owned by you. Do not report real estate taxes here that were paid in connection with a business or profession and have been deducted on
Schedule C, E or F.

Personal Property Taxes

Report your personal property taxes paid on automobiles, intangible property (accounts receivable, bonds, etc.) or other personal property.

Other Taxes

Report any other taxes that are deductible. Do not deduct on Schedule A taxes paid in connection with a business or profession which are deductible on Schedule C, E or F.

WHAT TAXES MAY NOT BE DEDUCTED?

FEDERAL Taxes You May NOT Deduct

- Federal income and most excise taxes
- Social Security, Medicare, federal unemployment (FUTA), and railroad retirement (RRTA) taxes
- Customs duties
- Federal estate and gift taxes
- Certain state and local taxes, including:
    - tax on gasoline
    - car inspection fees
    - assessments for sidewalks or other property improvements
    - tax you paid for someone else, and
    - license fees (marriage, driver's, dog, etc.)

KENTUCKY Taxes You May NOT Deduct

- Foreign income taxes paid
- Sales and use taxes
- New motor vehicle taxes
- Usage taxes on motor vehicles
- State or federal income taxes
- State or federal inheritance or estate taxes
- State gasoline taxes

- Federal excise taxes on your personal expenditures, such as taxes on theater admissions, furs, jewelry, cosmetics, tires, telephone service, airplane tickets, etc.
- Federal Social Security taxes
- Hunting, fishing or dog licenses
- Auto inspection fees
- Auto license fees
- Cigarette or liquor taxes
- Taxes paid by you for another person
- Motorboat registration fees
- Driver's license fees
- Sewer assessments
- School taxes based on electric, water, sewer, gas and telephone bills
- Local or state insurance premiums taxes or surcharges

SUMMARY

A variety of taxes qualify as itemized deductions that will lower your tax liability. Additionally, other taxes, such as self-employment tax, may be claimed elsewhere on your return. However, in order to be deducted, the following tests must be met:

- The tax must be imposed on you
- The tax must be paid by you
- The tax must be paid during your tax year

Remember that tax law changes from year to year. Therefore, allowable deductions may also change and you must factor in differences between federal and state law to accurately claim the proper deduction for taxes paid.

Figure 2.1

Are These Taxes Deductible for 2009?

Tax Types	Kentucky	Federal
Ad valorem tax	Y	Y
Auto inspection fees	N	N
Auto license fees	N	N
Cigarette or liquor taxes	N	N
Employee contributions to private or voluntary disability plans	N	N
Federal excise taxes on your personal expenditures (taxes on theater admissions, furs, jewelry, cosmetics, tires, telephone service, airplane tickets, etc.)	N	N
Federal income taxes	N	N
Federal social security taxes	N	N
Fee and charges that are **NOT** expenses of your trade or business or of producing income, such as fees for driver's licenses or charges for water bills.	N	N
Fees and charges that **are** expenses of your trade or business or of producing income	Y	Y
Foreign income taxes paid	N	Y
Foreign real estate taxes	Y	Y
Homeowners association charges	N	N
Hunting, fishing, and dog licenses	N	N
Local income taxes	Y	Y
Local or state insurance premiums, taxes, or surcharges	N	N
Motorboat registration fees	N	N
New motor vehicle taxes	N	Y
Occupational taxes	Y	Y
One-half of self-employment tax paid	Y	Y
Personal Property Taxes	Y	Y
Rent increase due to higher real estate taxes	N	N
Sales and use taxes (special rules apply)	N	Y
School taxes based on electric, water, sewer, gas, and telephone bills	N	N
Sewer assessments	N	N
State and local personal property taxes	Y	Y
State and local real estate taxes	Y	Y
State and local sales taxes and federal excise taxes	N	N
State gasoline taxes	N	N
State income taxes	N	Y
State or federal inheritance taxes (beneficiary rules apply)	N	N
Taxes for local benefits (with exceptions)	N	N
Taxes on property producing rent or royalty income	Y	Y
Taxes paid by you for another person	N	N
Taxes that are expenses of your trade or business or of producing income	Y	Y
Tenant's share of real estate taxes paid by cooperative housing corporation	Y	Y
Trash and garbage pick-up fees (with exceptions)	N	N
Usage taxes on motor vehicles	N	N

Chapter 3: Interest Expense

SCHEDULE A
Form 740
42A740-A
Department of Revenue

KENTUCKY ITEMIZED DEDUCTIONS
➤ See instructions.
➤ Attach to Form 740.

2009

Enter name(s) as shown on Form 740, page 1. | Your Social Security Number

Section	Line		
Medical and Dental Expenses	**Do not include expenses reimbursed or paid by others.**		
	1. Medical and dental expenses 1		
	2. Enter 7.5% (.075) of the amount from Form 740, line 9 2		
	3. **Total medical and dental.** Subtract line 2 from line 1. If zero or less, enter -0- .... ➤ 3		00
Taxes	4. Local income taxes (do not include state income tax) 4		
Note: Sales and use taxes and new motor vehicle taxes are not deductible.	5. Real estate taxes 5		
	6. Personal property taxes 6		
	7. Other taxes (list) ________ 7		
	8. **Total taxes.** Add lines 4 through 7. Enter here .... ➤ 8		00
Interest Expense	9. Home mortgage interest and points reported to you on federal Form 1098 9		
Note: Personal interest is not deductible.	10. Home mortgage interest not reported to you on federal Form 1098 (if paid to an individual, show that person's name, identifying number and address) ________ 10		
	See instructions for lines 11 and 12.		
	11. Points not reported to you on federal Form 1098 11		
	12. Qualified mortgage insurance premiums 12		
	13. Investment interest (attach federal Form 4952 if required) 13		
	14. **Total interest.** Add lines 9 through 13. Enter here .... ➤ 14		00
Contributions	15. Contributions by cash or check 15		
Note: For any contribution of $250 or more, see instructions.	16. Other than cash or check (attach federal Form 8283 if over $500) 16		
	17. Artistic charitable contributions deduction (attach copy of appraisal) 17		
	18. Carryover from prior year 18		
	19. **Total contributions.** Add lines 15 through 18. Enter here .... ➤ 19		00
Casualty and Theft Losses	20. Enter amount from attached federal Form 4684, Section A, line 16 20		
	21. Enter 10% (.10) of the amount from Form 740, line 9 21		
	22. **Total casualty or theft loss(es).** Subtract line 21 from line 20. If zero or less, enter -0- .... ➤ 22		00
Job Expenses and Most Other Miscellaneous Deductions	23. Unreimbursed employee expenses—job travel, union dues, job education, etc. (attach Form 2106 or 2106-EZ if applicable) list ________ 23		
	24. Tax preparation fees 24		
	25. Other (investment, safe deposit box, etc.) list ________ 25		
	26. Add the amounts on lines 23, 24 and 25. Enter here 26		
	27. Enter 2% (.02) of the amount from Form 740, line 9 27		
	28. **Total.** Subtract line 27 from line 26. If zero or less, enter -0- .... ➤ 28		00
Other Miscellaneous Deductions	29. Other (see instructions) ________ .... ➤ 29		00
Total Itemized Deductions	30. Add lines 3, 8, 14, 19, 22, 28 and 29. Enter here .... ➤ 30		00

★ If single or married filing jointly and your income for Form 740, Column B does not exceed $166,800, enter total itemized deductions on Form 740, line 10, Column B.
★ All others go to page 2.

KENTUCKY TAX TREATMENT

In general, other than differences between Kentucky and federal law and the IRC tax code in effect for the tax year involved, tax treatment of interest expense is reported the same for Kentucky and federal purposes.

Note: For tax purposes interest may refer to either an expense or an item of income. Interest expense may or may not qualify as a tax deduction, whereas interest income may or may not be a taxable event depending upon the tax treatment for state and federal purposes.

Interest expense may be defined as the amount you pay to borrow money. Depending upon the type of interest expense, the deduction may be claimed on your return as an itemized deduction or as a business deduction. Expenses that qualify as an allowable itemized deduction for interest expense on Schedule A include the following:

- Home mortgage interest
- Qualified mortgage insurance premiums
- Investment interest

HOME MORTGAGE INTEREST

Generally, home mortgage interest is any interest you pay on a loan secured by your home (main home or a second home). The loan may be a mortgage to buy your home, build your home, a second mortgage, a line of credit, or a home equity loan. A main or second home includes a condominium or cooperative unit, houseboat, mobile home, or house trailer that has sleeping, cooking, and toilet facilities.

Note: Interest on debt secured by a residence other than your main or second home may still be deductible, but only if you use the proceeds for investment or business purposes.

You can deduct home mortgage interest if all the following conditions are met:

- You file federal Form 1040 and itemize deductions on Schedule A,
- You are legally liable for the loan,
- There is a true debtor-creditor relationship between you and the lender, and
- The mortgage is a secured debt on a qualified home in which you have an ownership interest. (Generally, your mortgage is a secured debt if you put your home up as collateral to protect the interest of the lender. The term “qualified home” means your main home or second home.

You cannot deduct interest you pay for someone else if you are not legally liable to pay it. Both you and the lender must intend that the loan be repaid.

AMOUNT DEDUCTIBLE

How much you can deduct on your tax return for a given tax year depends on the date of the mortgage, the amount of the mortgage, and how you use the mortgage proceeds. In most cases, you can deduct all of your home mortgage interest.

FULLY DEDUCTIBLE INTEREST

If all of your mortgages fit into one or more of the following three categories at all times during the year, you can deduct all of the interest on those mortgages. (If any one mortgage fits into more than one category, add the debt that fits in each category to your other debt in the same category.)

The three categories are as follows:

1. Mortgages you took out on or before October 13, 1987 (called grandfathered debt)
2. Mortgages you took out after October 13, 1987, to buy, build, or improve your home (called home acquisition debt), but only if throughout 2009 these mortgages plus any grandfathered debt totaled $1 million or less ($500,000 or less if married filing separately)
3. Mortgages you took out after October 13, 1987, other than to buy, build, or improve your home (called home equity debt), but only if throughout 2009 these mortgages totaled $100,000 or less ($50,000 or less if married filing separately) and totaled no more than the fair market value of your home reduced by (1) and (2)

The dollar limits for the second and third categories apply to the combined mortgages on your main home and second home.

LIMITS on DEDUCTION

You cannot fully deduct interest on a mortgage that does not fit into any of the three categories listed above. If this applies to your situation, see IRS Publication 936 to determine the amount of interest you can deduct.

SPECIAL SITUATIONS

Certain items may be included as home mortgage interest and others may not be included. There are also special situations that may affect your deduction. The following information applies to these situations.

Late Payment Charge on Mortgage Payment

You can deduct as home mortgage interest a late payment charge if it was not for a specific service performed in connection with your mortgage loan.

Mortgage Prepayment Penalty

If you pay off your home mortgage early, you may have to pay a penalty. You can deduct that penalty as home mortgage interest provided the penalty is not for a specific service performed or cost incurred in connection with your mortgage loan.

Home Construction Loans

Interest on a home construction loan for your principal or second residence may be fully deductible from the time construction begins for a period of up to 24 months while construction takes place. Within the 24 month period, the loan is considered acquisition debt subject to the $1 million ceiling. If construction lasts more than 24 months, interest after the 24 month period is treated as nondeductible personal interest.

Sale of Home

If you sell your home, you can deduct your home mortgage interest (subject to any limits that apply) paid up to, but not including, the date of sale.

Example: Jack and Jill Hill sold their home on May 7. Through April 30, they made home mortgage interest payments of $1,220. The settlement sheet for the sale of the home showed $50 interest for the 6-day period in May up to, but not including, the date of sale. Their mortgage interest deduction is $1,270 ($1,220 plus $50).

Prepaid Interest

If you pay interest in advance for a period that goes beyond the end of the tax year, you must spread this interest over the tax years to which it applies. You can deduct in each year only the interest that qualifies as home mortgage interest for that year. However, there is an exception that applies to points, discussed later.

Mortgage Interest Credit

You may be able to claim a mortgage interest credit if you were issued a mortgage credit certificate (MCC) by a state or local government. Compute the credit on federal Form 8396, Mortgage Interest Credit. If you take this credit, you must reduce your mortgage interest deduction by the amount of the credit.

Ministers' and Military Housing Allowance

If you are a minister or a member of the uniformed services and receive a housing allowance that is not taxable, you can still deduct your home mortgage interest.

Mortgage Assistance Payments

If you qualify for mortgage assistance payments for lower-income families under section 235 of the National Housing Act, part or all of the interest on your mortgage may be paid for you. You cannot deduct the interest that is paid for you. Do not include these mortgage assistance payments in your income. Also, do not use these payments to reduce other deductions, such as real estate taxes.

Interest Paid after House Destroyed

If your principal residence or second home is destroyed and the land is sold within a reasonable period of time following the destruction, the IRS treats the property as a residence for purposes of deducting interest payments on the mortgage during the period between the destruction of the residence and the sale of the property. If the residence is rebuilt and occupied within a reasonable length of time, the interest payments on the property will be deductible.

Cooperative and Condominium Apartments

If you are a tenant-stockholder of a cooperative apartment, you may deduct your portion of interest paid by the cooperative on its debts, provided you do not pay interest on more than two residences. This includes your pro rata share of points of the cooperative on its mortgage covering the cooperative. If you own an apartment in a condominium you may deduct your mortgage interest. Condominium owners are also subject to the two-residence limit.

Divorced or Separated Individuals

If a divorce or separation agreement requires you or your spouse or former spouse to pay home mortgage interest on a home owned by both of you, the payment of interest may be alimony.

Redeemable Ground Rents

If you make annual or periodic rental payments on a redeemable ground rent, you can deduct them as mortgage interest. Payments made to end the lease and to buy the lessor's entire interest in the land are not deductible as mortgage interest. For more information, see IRS Publication 936.

Nonredeemable Ground Rents

Payments on a nonredeemable ground rent are not mortgage interest. You can deduct them as rent if they are a business expense or if they are for rental property.

Reverse Mortgages

A reverse mortgage is a loan where the lender pays you (in a lump sum, a monthly advance, a line of credit, or a combination of all three) while you continue to live in your home. With a reverse mortgage, you retain title to your home. Depending on the plan, your reverse mortgage becomes due with interest when you move, sell your home, reach the end of a pre-selected loan period, or die. Because reverse mortgages are considered loan advances and not income, the amount you receive is not taxable. Any interest (including original issue discount) accrued on a reverse mortgage is not deductible until the loan is paid in full. Your deduction may be limited because a reverse mortgage loan generally is subject to the limit on Home Equity Debt discussed in IRS Publication 936.

Rental Payments

If you live in a house before final settlement on the purchase, any payments you make for that period are rent and not interest. This is true even if the settlement papers call them interest. You cannot deduct these payments as home mortgage interest.

Mortgage Proceeds Invested in Tax-Exempt Securities

You cannot deduct the home mortgage interest on grandfathered debt or home equity debt if you used the proceeds of the mortgage to buy securities or certificates that produce tax-free income.

Refunds of Interest

If you receive a refund of interest in the same tax year you paid it, you must reduce your interest expense by the amount refunded to you. If you receive a refund of interest you deducted in an earlier year, you generally must include the refund in income in the year you receive it. However, you need to include it only up to the amount of the deduction that reduced your tax in the earlier year. This is true whether the interest overcharge was refunded to you or was used to reduce the outstanding principal on your mortgage. If you received a refund of interest you overpaid in an earlier year, you generally will receive a federal Form 1098, Mortgage Interest Statement, showing the refund in box 3.

Refinancing

When you refinance a mortgage on a first or second home for the same amount as the remaining principal balance on the old loan, there is no change in the tax treatment of interest. In other words, subject to limits, it is fully deductible. However, if you refinance for more than the existing balance, the deductibility of the interest on the excess amount depends upon how you use the funds and the amount of refinancing. If the excess amount is used to buy, build, or substantially improve your first or second home, then it is considered home acquisition debt. Interest paid on loans in excess of home acquisition and home equity debt ceilings is generally treated as nondeductible personal interest unless the proceeds are used for business or investment purposes.

POINTS

The term "points" is used to describe certain charges paid, or treated as paid, by a borrower to obtain a home mortgage. Points may also be called loan origination fees, maximum loan charges, loan discount, or discount points.

A borrower is treated as paying any points that a home seller pays for the borrower's mortgage. See "Points paid by the seller," later.

General Rule

You generally cannot deduct the full amount of points in the year paid. Because they are prepaid interest, you generally deduct them ratably over the life (term) of the mortgage.

DEDUCTION ALLOWED RATABLY

If you do not meet the tests listed under "Deduction Allowed in Year Paid," which is discussed later, the loan is not a home improvement loan, or you choose not to deduct your points in full in the year paid, you can deduct the points ratably (equally) over the life of the loan if you meet all the following tests:

1. You use the cash method of accounting. This means you report income in the year you receive it and deduct expenses in the year you pay them. Most individuals use this method,
2. Your loan is secured by a home. (The home does not need to be your main home.)
3. Your loan period is not more than 30 years,
4. If your loan period is more than 10 years, the terms of your loan are the same as other loans offered in your area for the same or longer period, and
5. Either your loan amount is $250,000 or less, or the number of points is <u>not more</u> than:

a. Four, if your loan period is 15 years or less, or

b. Six, if your loan period is more than 15 years.

DEDUCTION ALLOWED in YEAR PAID

You can fully deduct points in the year paid if you meet all the following tests:

1. Your loan is secured by your main home. (Your main home is the one you ordinarily live in most of the time.)
2. Paying points is an established business practice in the area where the loan was made.
3. The points paid were not more than the points generally charged in that area.
4. You use the cash method of accounting. This means you report income in the year you receive it and deduct expenses in the year you pay them.
5. The points were not paid in place of amounts that ordinarily are stated separately on the settlement statement, such as appraisal fees, inspection fees, title fees, attorney fees, and property taxes.
6. The funds you provided at or before closing, plus any points the seller paid, were at least as much as the points charged. The funds you provided do not have to have been applied to the points. They can include a down payment, an escrow deposit, earnest money, and other funds you paid at or before closing for any purpose. You cannot have borrowed these funds from your lender or mortgage broker.
7. You use your loan to buy or build your main home.
8. The points were computed as a percentage of the principal amount of the mortgage, and
9. The amount is clearly shown on the settlement statement (such as the Settlement Statement, Form HUD-1) as points charged for the mortgage. The points may be shown as paid from either your funds or the seller's.

Note: If you meet all of these tests, you can choose to either fully deduct the points in the year paid, or deduct them over the life of the loan.

Home Improvement Loan

You can also fully deduct in the year paid points paid on a loan to improve your main home, if tests one through six above are met.

Second Home

You cannot fully deduct in the year paid points you pay on loans secured by your second home. You can deduct these points only over the life of the loan.

Refinancing

Generally, points you pay to refinance a mortgage are not deductible in full in the year you pay them. This is true even if the new mortgage is secured by your main home.

However, if you use part of the refinanced mortgage proceeds to improve your main home and you meet the first six tests listed under "Deduction Allowed in Year Paid," you can fully deduct the part of the points related to the improvement in the year you paid them with your own funds. You can deduct the rest of the points over the life of the loan.

SPECIAL SITUATIONS

The following section describes certain special situations that may affect your deduction of points.

Original Issue Discount

If you do not qualify to either deduct the points in the year paid or deduct them ratably over the life of the loan, or if you choose not to use either of these methods, the points reduce the issue price of the loan. This reduction results in original issue discount, which is discussed in IRS Publication 535.

Amounts Charged for Services

Amounts charged by the lender for specific services connected to the loan are <u>not</u> considered interest. Examples of these charges are:

- Appraisal fees,
- Notary fees, and
- Preparation costs for the mortgage note or deed of trust.

You cannot deduct these amounts as points either in the year paid or over the life of the mortgage.

Points Paid by the Seller

The term “points” includes loan placement fees that the seller pays to the lender to arrange financing for the buyer.

Treatment by Seller

The seller cannot deduct these fees as interest. But they are a selling expense that reduces the amount realized by the seller.

Treatment by Buyer

The buyer reduces the basis of the home by the amount of the seller-paid points and treats the points as if he or she had paid them. If all the tests under "Deduction Allowed in Year Paid," earlier, are met, the buyer can deduct the points in the year paid. If any of those tests are not met, the buyer deducts the points over the life of the loan.

Funds Provided Are Less than Points

If you meet all the tests in "Deduction Allowed in Year Paid," earlier, except that the funds you provided were less than the points charged to you (test six), you can deduct the points in the year paid, up to the amount of funds you provided. In addition, you can deduct any points paid by the seller.

Example 1: When you took out a $100,000 mortgage loan to buy your home in December, you were charged one point ($1,000). You meet all the tests for deducting points in the year paid, except the only funds you provided were a $750 down payment. Of the $1,000 charged for points, you can deduct $750 in the year paid. You spread the remaining $250 over the life of the mortgage.

Example 2: The facts are the same as in Example 1, except that the person who sold you your home also paid one point ($1,000) to help you get your mortgage. In the year paid, you can deduct $1,750 ($750 of the amount you were charged plus the $1,000 paid by the seller). You spread the remaining $250 over the life of the mortgage. You must reduce the basis of your home by the $1,000 paid by the seller.

Excess Points

If you meet all the tests in "Deduction Allowed in Year Paid," earlier, except that the points paid were more than generally paid in your area (test three), you deduct in the year paid only the points that are generally charged. You must spread any additional points over the life of the mortgage.

Mortgage Ending Early

If you spread your deduction for points over the life of the mortgage, you can deduct any remaining balance in the year the mortgage ends. However, if you refinance the mortgage with the same lender, you cannot deduct any remaining balance of spread points. Instead, deduct the remaining balance over the term of the new loan. A mortgage may end early due to a prepayment, refinancing, foreclosure, or similar event.

Example: Patrick paid $3,000 in points in 1998 that he had to spread out over the 15-year life of the mortgage. He deducts $200 points per year. Through 2008, Patrick has deducted $2,200 of the points. Patrick prepaid his mortgage in full in 2009. He can deduct the remaining $800 of points in 2009.

Limits on Deduction

You cannot fully deduct points paid on a mortgage unless the mortgage fits into one of the categories listed earlier under "Fully deductible interest." See IRS Publication 936 for additional information.

QUALIFIED MORTGAGE INSURANCE PREMIUMS

Mortgage Insurance Premiums

You can treat amounts you paid during 2009 for qualified mortgage insurance as home mortgage interest. The insurance must be in connection with home acquisition debt and the insurance contract must have been issued after 2006.

Qualified Mortgage Insurance

Qualified mortgage insurance is mortgage insurance provided by the Department of Veterans Affairs, the Federal Housing Administration, or the Rural Housing Service, and private mortgage insurance (as defined in section 2 of the Homeowners Protection Act of 1998 as in effect on December 20, 2006).

Mortgage insurance provided by the Department of Veterans Affairs is commonly known as a funding fee. If provided by the Rural Housing Service, it is commonly known as a guarantee fee. These fees can be deducted fully in 2009 if the mortgage insurance contract was issued in 2009.

Special Rules for Prepaid Mortgage Insurance

Generally, if you paid premiums for qualified mortgage insurance that are allocable to periods after the close of the tax year, such premiums are treated as paid in the period to which they are allocated. You must allocate the premiums over the shorter of the stated term of the mortgage or 84 months, beginning with the month the insurance was obtained. No deduction is allowed for the unamortized balance if the mortgage is satisfied before its term. This paragraph does not apply to qualified mortgage insurance provided by the Department of Veterans Affairs or the Rural Housing Service.

Example: Ryan purchased a home in May of 2009 and financed the home with a 15-year mortgage. Ryan also prepaid all of the $9,240 in private mortgage insurance required at the time of closing in May. Since the $9,240 in private mortgage insurance is allocable to periods after 2009, Ryan must allocate the $9,240 over the shorter of the life of the mortgage or 84 months. Ryan's adjusted gross income (AGI) for 2009 is $76,000. Ryan can deduct $880 ($9,240 ÷ 84 x 8 months) for qualified mortgage insurance premiums in 2009. For 2010, Ryan can deduct $1,320 ($9,240 ÷ 84 x 12 months) if his AGI is $100,000 or less.

In this example, the mortgage insurance premiums are allocated over 84 months, which is shorter than the life of the mortgage of 15 years (180 months).

Limit on Deduction

If your adjusted gross income on federal Form 1040, line 38, is more than $100,000 ($50,000 if your filing status is married filing separately), the amount of your mortgage insurance premiums that are otherwise deductible is reduced and may be eliminated. See Line 13 in the instructions for Schedule A and complete the Qualified Mortgage Insurance Premiums Deduction Worksheet to figure the amount you can deduct. If your adjusted gross income is more than $109,000 ($54,500 if married filing separately), you cannot deduct your mortgage insurance premiums.

Federal Form 1098, Mortgage Interest Statement

If you paid $600 or more of mortgage interest (including certain points and mortgage insurance premiums) during the year on any one mortgage, you generally will receive a federal Form 1098 or a similar statement from the mortgage holder. You will receive the statement if you pay interest to a person (including a financial institution or a cooperative housing corporation) in the course of that person's trade or business. A governmental unit is a person for purposes of furnishing the statement.

The statement for each year should be sent to you by January 31 of the following year. A copy of this form will also be sent to the IRS.

The statement will show the total interest you paid during the year, any mortgage insurance premiums you paid, and if you purchased a main home during the year, it also will show the deductible points paid during the year, including seller-paid points. However, it should not show any interest that was paid for you by a government agency.

As a general rule, federal Form 1098 will include only points that you can fully deduct in the year paid. However, certain points not included on federal Form 1098 also may be deductible, either in the year paid or over the life of the loan.

Prepaid Interest on Federal Form 1098

If you prepaid interest in 2009 that accrued in full by January 15, 2010, this prepaid interest may be included in box 1 of federal Form 1098. However, you cannot deduct the prepaid amount for January 2010 in 2009. You will have to figure the interest that accrued for 2010 and subtract it from the amount in box 1. You will include the interest for January 2010 with the other interest you pay for 2010.

Refunded Interest

If you received a refund of mortgage interest you overpaid in an earlier year, you generally will receive a federal Form 1098 showing the refund in box 3. See "Refunds of interest," earlier.

Mortgage Insurance Premiums

The amount of mortgage insurance premiums you paid during 2009 may be shown in box 4 of federal Form 1098.

INVESTMENT INTEREST

This section discusses interest expenses you may be able to deduct as an investor.

If you borrow money to buy property you hold for investment, the interest you pay is investment interest. You can deduct investment interest subject to the limit discussed later. However, you cannot deduct interest you incurred to produce tax-exempt income. Nor can you deduct interest expenses on straddles.

Investment interest does not include any qualified home mortgage interest or any interest taken into account in computing income or loss from a passive activity.

Investment Property

Property held for investment includes property that produces interest, dividends, annuities, or royalties not derived in the ordinary course of a trade or business. It also includes property that produces gain or loss (not derived in the ordinary course of a trade or business) from the sale or trade of property producing these types of income or held for investment (other than interest in a passive activity). Investment property also includes an interest in a trade or business activity in which you did not materially participate (other than a passive activity).

Partners, Shareholders, and Beneficiaries

To determine your investment interest, combine your share of investment interest from a partnership, S corporation, estate, or trust with your other investment interest.

Allocation of Interest Expense

If you borrow money for business or personal purposes as well as for investment, you must allocate the debt among those purposes. Only the interest expense on the part of the debt used for investment purposes is treated as investment interest. The allocation is not affected by the use of property that secures the debt.

Limit on Deduction

Generally, your deduction for investment interest expense is limited to the amount of your net investment income.

You can carry over the amount of investment interest that you could not deduct because of this limit to the next tax year. The interest carried over is treated as investment interest paid or accrued in that next year.

You can carry over disallowed investment interest to the next tax year even if it is more than your taxable income in the year the interest was paid or accrued.

Net Investment Income

Determine the amount of your net investment income by subtracting your investment expenses (other than interest expense) from your investment income.

Investment Income

This generally includes your gross income from property held for investment such as interest, dividends, annuities, and royalties. Investment income does not include Alaska Permanent Fund dividends. It also does not include qualified dividends or net capital gain unless you choose to include them.

Choosing to Include Qualified Dividends

Investment income generally does not include qualified dividends. However, you can choose to include all or part of your qualified dividends in investment income. You make this choice by completing federal Form 4952.

If you choose to include any amount of your qualified dividends in investment income, you must reduce your qualified dividends that are eligible for the lower capital gains tax rates by the same amount.

Choosing to Include Net Capital Gain

Investment income generally does not include net capital gain from disposing of investment property (including capital gain distributions from mutual funds). However, you can choose to include all or part of your net capital gain in investment income. You make this choice by completing federal Form 4952. If you choose to include any amount of your net capital gain in investment income, you must reduce your net capital gain that is eligible for the lower capital gains tax rates by the same amount.

Investment Income of Child Reported on Parent's Return

Investment income includes the part of your child's interest and dividend income that you choose to report on your return. If the child does not have qualified dividends, Alaska Permanent Fund dividends, or capital gain distributions, this is the amount on line 6 of federal Form 8814, Parents' Election to Report Child's Interest and Dividends.

Child's Qualified Dividends

If part of the amount you report is your child's qualified dividends, that part (which is reported on federal Form 1040, line 9b) generally does not count as investment income. However, you can choose to include all or part of it in investment income, as explained under "Choosing to include qualified dividends," earlier.

Your investment income also includes the amount on federal Form 8814, line 12, (or, if applicable, the reduced amount figured next under "Child's Alaska Permanent Fund" dividends).

Child's Alaska Permanent Fund dividends

If part of the amount you report is your child's Alaska Permanent Fund dividends, that part does not count as investment income. In figuring the amount of your child's income that you can consider your investment income, start with the amount on federal Form 8814, line 6. Multiply that amount by a percentage that is equal to the Alaska Permanent Fund dividends divided by the total amount on federal Form 8814, line 4. Subtract the result from the amount on federal Form 8814, line 12.

Child's Capital Gain Distributions

If part of the amount you report is your child's capital gain distributions, that part (which is reported on federal Schedule D or federal Form 1040) generally does not count as investment income. However, you can choose to include all or part of it in investment income, as explained in "Choosing to include net capital gain," earlier.

Your investment income also includes the amount on federal Form 8814, line 12 (or, if applicable, the reduced amount figured under "Child's Alaska Permanent Fund dividends," earlier).

Investment Expenses

Investment expenses are your allowed deductions (other than interest expense) directly connected with the production of investment income. Investment expenses that are included as a miscellaneous itemized deduction on Schedule A, are allowable deductions after applying the 2% limit that applies to miscellaneous itemized deductions. Use the smaller of:

- The investment expenses included on Schedule A, line 23, or
- The amount on Schedule A, line 27.

Losses from Passive Activities

Income or expenses that you used in computing income or loss from a passive activity are not included in determining your investment income or investment expenses (including investment interest expense). See IRS Publication 925, for information about passive activities.

Use federal Form 4952, Investment Interest Expense Deduction, to figure your deduction for investment interest.

Exception to use of federal Form 4952: You do not have to complete federal Form 4952 or attach it to your return if you meet all of the following tests.

- Your investment interest expense is not more than your investment income from interest and ordinary dividends minus any qualified dividends,
- You do not have any other deductible investment expenses, and
- You have no carryover of investment interest expense from 2008.

If you meet all of these tests, you can deduct all of your investment interest.

NONDEDUCTIBLE INTEREST EXPENSES

Some interest payments are not deductible. Certain expenses similar to interest also are not deductible. Nondeductible expenses include the following items: Personal interest

- Service charges
- Annual fees for credit cards
- Loan fees
- Credit investigation fees
- Interest to purchase or carry tax-exempt securities

Taxpayer Tip: An individual who wishes to help someone by paying off a debt should not pay the money directly to the creditor. Instead, they should give the money to the debtor, who can then deduct the allowable interest portion of the payment to the creditor.

Fines and Penalties

You cannot deduct fines and penalties paid to a government for violations of law, regardless of their nature.

Personal Interest

Personal interest is not deductible. Personal interest is any interest that is not home mortgage interest, investment interest, business interest, or other deductible interest. It includes the following items:

- Interest on car loans (unless you use the car for business)
- Interest on federal, state, or local income tax
- Finance charges on credit cards, retail installment contracts, and revolving charge accounts incurred for personal expenses
- Late payment charges by a public utility

Allocation of Interest

If you use the proceeds of a loan for more than one purpose (for example, personal and business) you must allocate the interest on the loan to each use. However, you do not have to allocate home mortgage interest if it is fully deductible, regardless of how the funds are used. You allocate interest (other than fully deductible home mortgage interest) on a loan in the same way as the loan itself is allocated.

Similarly, if you are the payer of record on a mortgage on which there are other borrowers entitled to a deduction for the interest shown on the federal Form 1098 you received, deduct only your share of the interest on Schedule A, line 10. You should let each of the other borrowers know what his or her share is.

Note: It is important to keep separate accounts for business, personal, and investment borrowing. For example, if you borrow for investment purposes, keep the proceeds of the loan in a separate account.

Mortgage Proceeds Used for Business or Investment

If your home mortgage interest deduction is limited, but all or part of the mortgage proceeds were used for business, investment, or other deductible activities it must be allocated.

Investment Interest

Deduct investment interest, subject to certain limits discussed in IRS Publication 550, on Schedule A, line 14.

Amortization of Bond Premium

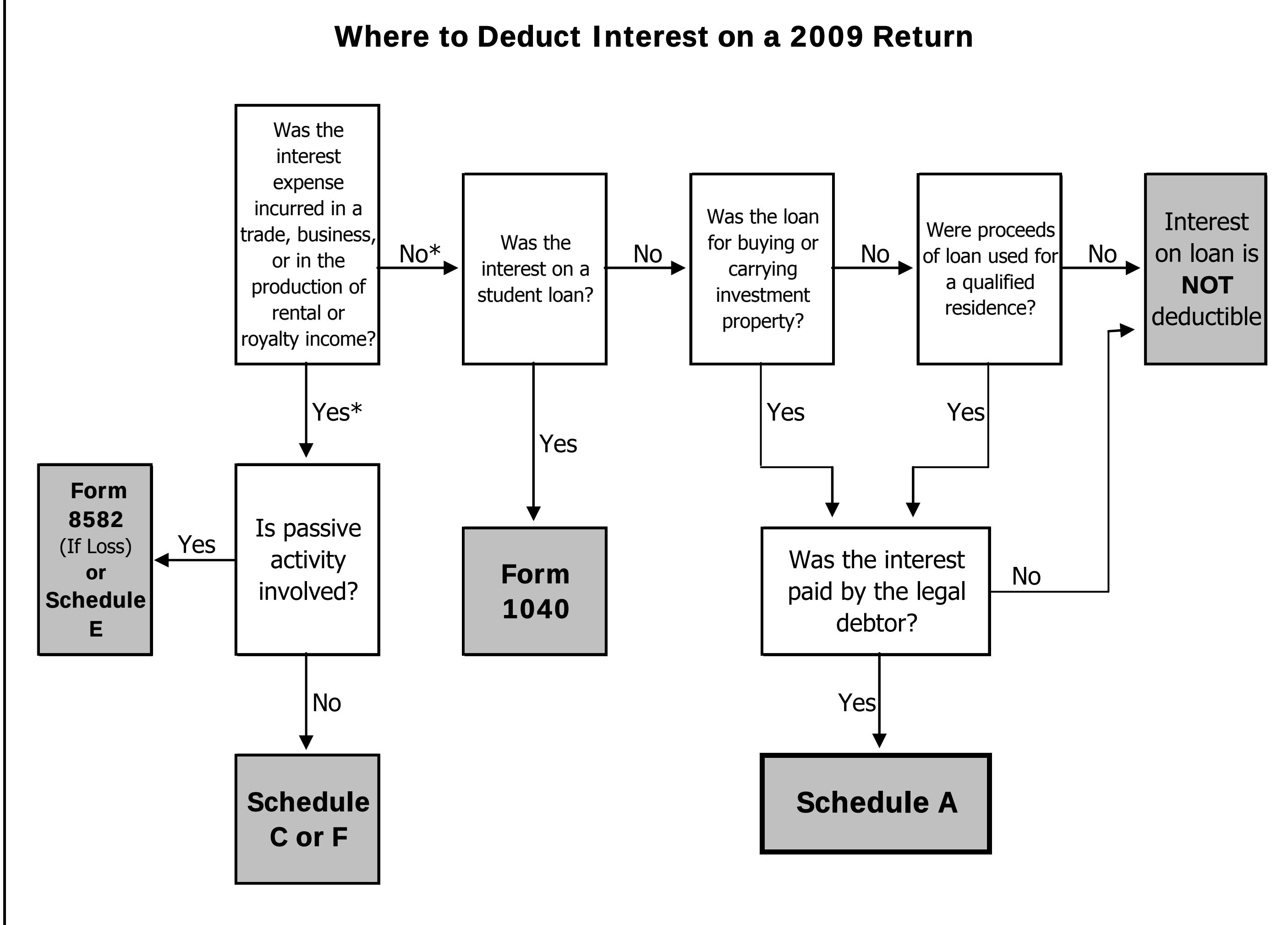
There are various ways to treat the premium you pay to buy taxable bonds. See *Bond Premium Amortization* in IRS Publication 550.

Income-Producing Rental or Royalty Interest

Deduct interest on a loan for income-producing rental or royalty property that is not used in your business in Part I of Schedule E.

Example: You rent out part of your home and borrow money to make repairs. You can deduct only the interest payment for the rented part in Part I of Schedule E. Deduct the rest of the interest payment on Schedule A if it is deductible home mortgage interest.

Figure 3.1



* If proceeds were used for both business and personal use, the interest must be allocated.

Chapter 4: Charitable Contributions

SCHEDULE A
Form 740
42A740-A
Department of Revenue

KENTUCKY ITEMIZED DEDUCTIONS
➤ **See instructions.**
➤ **Attach to Form 740.**

2009

Enter name(s) as shown on Form 740, page 1. | Your Social Security Number

Section	Line		
Medical and Dental Expenses	**Do not include expenses reimbursed or paid by others.**		
	1. Medical and dental expenses 1		
	2. Enter 7.5% (.075) of the amount from Form 740, line 9 2		
	3. **Total medical and dental.** Subtract line 2 from line 1. If zero or less, enter -0- .... ➤ 3		00
Taxes *Note: Sales and use taxes and new motor vehicle taxes are not deductible.*	4. Local income taxes (do not include state income tax) 4		
	5. Real estate taxes 5		
	6. Personal property taxes 6		
	7. Other taxes (list) ____ 7		
	8. **Total taxes.** Add lines 4 through 7. Enter here .... ➤ 8		00
Interest Expense *Note: Personal interest is not deductible.*	9. Home mortgage interest and points reported to you on federal Form 1098 9		
	10. Home mortgage interest not reported to you on federal Form 1098 (if paid to an individual, show that person's name, identifying number and address) ____ 10		
	See instructions for lines 11 and 12.		
	11. Points not reported to you on federal Form 1098 11		
	12. Qualified mortgage insurance premiums 12		
	13. Investment interest (attach federal Form 4952 if required) 13		
	14. **Total interest.** Add lines 9 through 13. Enter here .... ➤ 14		00
Contributions *Note: For any contribution of $250 or more, see instructions.*	15. Contributions by cash or check 15		
	16. Other than cash or check (attach federal Form 8283 if over $500) 16		
	17. Artistic charitable contributions deduction (attach copy of appraisal) 17		
	18. Carryover from prior year 18		
	19. **Total contributions.** Add lines 15 through 18. Enter here .... ➤ 19		00
Casualty and Theft Losses	20. Enter amount from attached federal Form 4684, Section A, line 16 20		
	21. Enter 10% (.10) of the amount from Form 740, line 9 21		
	22. **Total casualty or theft loss(es).** Subtract line 21 from line 20. If zero or less, enter -0- .... ➤ 22		00
Job Expenses and Most Other Miscellaneous Deductions	23. Unreimbursed employee expenses—job travel, union dues, job education, etc. (attach Form 2106 or 2106-EZ if applicable) list ____ 23		
	24. Tax preparation fees 24		
	25. Other (investment, safe deposit box, etc.) list ____ 25		
	26. Add the amounts on lines 23, 24 and 25. Enter here 26		
	27. Enter 2% (.02) of the amount from Form 740, line 9 27		
	28. **Total.** Subtract line 27 from line 26. If zero or less, enter -0- .... ➤ 28		00
Other Miscellaneous Deductions	29. Other (see instructions) ____ .... ➤ 29		00
Total Itemized Deductions	30. Add lines 3, 8, 14, 19, 22, 28 and 29. Enter here .... ➤ 30		00

★ If single or married filing jointly and your income for Form 740, Column B does not exceed $166,800, enter total itemized deductions on Form 740, line 10, Column B.
★ All others go to page 2.

By giving a charitable gift or donation to your favorite charity, you may be able to receive a significant tax benefit. Donating to a qualified charitable organization can help reduce your taxable income and ultimately lower your tax bill on your individual income tax return. However, you can only claim charitable contributions as a deduction if you itemized deductions on Schedule A.

Charitable contributions are actually the third largest itemized deduction claimed on Schedule A behind Home Mortgage Interest and State & Local Taxes Paid. This chapter will focus on some of the important issues related to charitable contributions including determining what is and is not considered an allowable deduction, how to substantiate the deductions being claimed, as well as certain limitations and carryover rules based on income.

DEFINITION of CHARITABLE CONTRIBUTION

"A charitable contribution is a donation or gift to, or for the use of, a qualified organization. It is voluntary and is made without getting, or expecting to get, anything of equal value," per IRS Publication 526

ORGANIZATIONS QUALIFYING for DEDUCTIBLE CONTRIBUTIONS

Generally, taxpayers can deduct any contributions of money or property made to a qualified organization. According to IRS regulations, only the five following types of organizations can be considered qualified organizations.

1. A community chest, corporation, trust, fund, or foundation organized or created in or under the laws of the United States, any state, the District of Columbia, or any possession of the United States (including Puerto Rico). It must be organized and operated only for one or more of the following purposes:
    a. Religious
    b. Charitable
    c. Educational
    d. Scientific
    e. Literary
    f. The prevention of cruelty to children or animals

   Certain organizations that foster national or international amateur sports competition also qualify.

2. War veterans' organizations, including posts, auxiliaries, trusts, or foundations, organized in the United States or any of its possessions.

3. Domestic fraternal societies, orders, and associations operating under the lodge system. *(**Note**: Your contribution to this type of organization is deductible only if it is to be used solely for charitable, religious, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals.)*

4. Certain nonprofit cemetery companies or corporations. *(**Note**: Your contribution to this type of organization is not deductible if it can be used for the care of a specific lot or mausoleum crypt.)*

5. The United States or any state, the District of Columbia, a U.S. possession (including Puerto Rico), a political subdivision of a state or U.S. possession, or an Indian tribal government or any of its subdivisions that perform substantial government functions. *(**Note**: To be deductible, your contribution to this type of organization must be made solely for public purposes.)*

If you are unsure if a charitable organization is approved by the IRS to receive deductible contributions, ask the organization about its tax status, or check the IRS list of tax-exempt organizations (IRS Publication 78).

Figure 4.1 Examples of Charitable Contributions – A Quick Reference Guide
Use the following lists for a quick check of contributions you can or cannot deduct on Schedule A. See the rest of this chapter for more information and additional rules and limits that may apply.

Deductible as Charitable Contributions	**Not Deductible as Charitable Contributions**
Money or property you give to: • Churches, synagogues, temples, mosques, and other religious organizations • Federal, state, and local governments, if your contribution is solely for public purposes (for example, a gift to reduce the public debt) • Nonprofit schools and hospitals • Public parks and recreation facilities • Salvation Army, Red Cross, CARE, Goodwill Industries, United Way, Boy Scouts, Girl Scouts, Boys and Girls Club of America, etc. • War veterans groups • Charitable organizations listed in IRS Publication 78 • Expenses paid for a student living with you, sponsored by a qualified organization • Out-of-pocket expenses when you serve a qualified organization as a volunteer	Money or property you give to: • Civic leagues, social and sports clubs, labor unions, and chambers of commerce • Foreign organizations (except certain Canadian, Israeli, and Mexican charities) • Groups that are run for personal profit • Groups whose purpose is to lobby for law changes • Homeowners' associations • Individuals • Political groups or candidates for public office • Cost of raffle, bingo, or lottery tickets • Dues, fees, or bills paid to country clubs, lodges, fraternal orders, or similar groups • Tuition • Value of your time or services • Value of blood given to a blood bank

CONTRIBUTIONS by CASH or CHECK

Cash contributions include any amounts paid by cash, check, electronic funds transfer, credit card or payroll deduction. They also include out-of-pocket expenses incurred while donating services to an organization or charity (this topic will be covered in-depth later in the chapter).

For cash donations of any amount, your deduction may be disallowed if you do not have one of the following to substantiate your contribution:

1. A bank record that shows the name of the qualified organization, the date of the contribution, and the amount of the contribution. Bank records may include:

    a. A canceled check,
    b. A bank or credit union statement, or
    c. A credit card statement.

2. A receipt (or a letter or other written communication) from the qualified organization showing the name of the organization, the date of the contribution, and the amount of the contribution.

3. Payroll deduction records (see following for more details).

If you make a contribution by payroll deduction, then you must keep:

1. A pay stub, Form W-2, or other document furnished by your employer that shows the date and amount of the contribution, <u>and</u>

2. A pledge card or other document prepared by or for the qualified organization that shows the name of the organization.

For cash donations of $250 or more, you must receive a written acknowledgement from the qualified organization that indicates whether you received goods or services in return for your donation. A cancelled check is not sufficient evidence for a cash donation of $250 or more. If you made more than one donation of $250 or more, you must have either separate acknowledgement for each or one acknowledgement that lists each individual contribution, as well as the date of each contribution and also shows your total contribution.

NONCASH CONTRIBUTIONS

Noncash contributions are contributions of tangible property. If a taxpayer contributes tangible property to a qualified organization, the amount of the taxpayer's charitable contribution for deduction purposes is generally the fair market value of the property at the time of the contribution. However, if the property has increased in value, then you may have to make some adjustments to the amount of your deduction.

Depending on the value of the noncash contributions, you may need to provide some or all of the following records to substantiate your contribution:

- The name of the qualified charitable organization
- The date and location of the charitable contribution
- A reasonable detailed description of the property being donated
- An appraisal showing fair market value of the property and the appraisal method
- Any required reductions to the fair market value. See IRS Publication 526 for more details

Also, any taxpayer claiming a deduction for noncash charitable contributions must complete and attach a federal Form 8283, if the total amount of the contribution(s) exceeds $500. Finally, if the value of the donated property exceeds $5,000, then you must also complete Section B of federal Form 8283, which requires an appraisal by a qualified appraiser.

<u>Clothing and Household Items</u>

Any donated clothing and/or household items to a qualified charitable organization are not deductible unless the donated items are in "good" or better condition. This means that the taxpayer needs to keep accurate records and be prepared to verify the value and condition of any donated items. There is one exception to this rule: if a single donated item is not in at least good condition, but is nevertheless, worth more than $500, it is deductible, so long as a qualified appraisal is obtained at the time of donation.

Tip: A taxpayer that makes several donations of clothing and/or household items would be well-advised to take a digital photograph of each item and keep the memory card with their tax records as insurance in the event of an audit.

For the purpose of this discussion, "household items" includes furniture, electronics, appliances, linens and other similar items. However, the term does not include food, paintings, antiques, other art objects, jewelry, gems or collections.

Generally, the fair market value of used clothing and household goods is far less than its original cost. For used clothing, you should claim as the value the price that potential buyers of used items actually pay in used clothing stores, such as consignment or thrift shops. For determining the value of household goods, see IRS Publication 561 for more information.

Cars, Other Motor Vehicles, Boats and Airplanes

> **Fair Market Value –** The price at which property would change hands between a willing buyer and a willing seller, neither having to buy or sell, and both having reasonable knowledge of all relevant facts.

The following rules apply to the donation of any qualified vehicle. A qualified vehicle is:

- A car or motor vehicle manufactured mainly for use on public streets, road or highways,
- A boat, or
- An airplane.

If you donate a qualified vehicle to a qualified organization and the claimed value of the vehicle is greater than $500, then you must attach Copy B of federal Form 1098-C to your income tax return. You should receive the federal Form 1098-C from the qualified organization within 30-days of the sale of the vehicle. Your deduction is generally limited to the lesser of the gross sales proceeds received by the organization on a sale of the vehicle –or– the vehicle's fair market value on the date of the contribution (provided the FMV is not more than your cost basis).

There are two exceptions to the rules just described for donated vehicles with a value of greater than $500.

1. If the qualified organization makes a significant intervening use of or material improvement to the vehicle before transferring it, you generally can deduct the vehicle's fair market value at the time of the contribution.
2. If the qualified organization gives the vehicle, or sells it for a price well below fair market value, to a needy individual to further the organization's charitable purpose, you generally can deduct the vehicle's fair market value at the time of the contribution. (This exception does not apply if the organization sells the vehicle at auction. In that case, you cannot deduct the vehicle's fair market value.)

Finally, if the qualified organization sells the donated vehicle (other than a sale to a needy person in furtherance of the charitable purposes) without significant intervening use or material improvement, and the gross sale proceeds are $500 or less, then you can deduct the lesser of $500 or the vehicle's fair market value on the date of the contribution (provided the FMV is not more than your cost basis), even if the fair market value exceeds the gross sales proceeds.

Example: Karl F. Benz donated a 2001 Nissan Sentra with over 200,000 miles to the Salvation Army, which in turn sold the vehicle at a public auction. The gross sales proceeds for the vehicle were only $475. However the fair market value of the vehicle was actually $750. Mr. Benz is allowed to claim the fair market value (provided the FMV can be substantiated) as a charitable deduction, but is limited to $500.

Giving Property that has Increased in Value

If you contribute property with a fair market value that is more than your basis in it, you may have to reduce the fair market value by the amount of appreciation (i.e. increase in value) when you figure your charitable contribution deduction. Your basis in property is generally what you paid for it.

Different rules apply to figuring your deduction, depending on whether the property is:

- Ordinary income property, or
- Capital gain property.

Property is considered "ordinary income property" if its sale at fair market value on the date it was contributed would have resulted in ordinary income or in short-term capital gain. Examples of ordinary income property include: inventory, works of art or manuscripts created by the donor, and capital assets held short-term – one (1) year or less.

The amount you can deduct for a contribution of ordinary income property is its fair market value minus the amount that would be ordinary income or short-term capital gain if you sold the property for its fair market value. Generally, this rule limits the deduction to your basis in the property.

Property is considered "capital gain property" if its sale at fair market value on the date of the contribution would have resulted in long-term capital gain. Examples include: personal property, stocks and other capital assets held long-term – more than one (1) year, as well as certain real property and depreciable property used in your trade or business and, generally, held more than one (1) year. When figuring your deduction for a gift of capital gain property, you generally can use the fair market value of the gift.

On the other hand, if you contribute property that has decreased in value – i.e. the fair market value is less than your basis in it – your deduction is then limited to its fair market value. You cannot claim a deduction for the difference between the property's basis and its fair market value.

VOLUNTEER SERVICES and OUT-of-POCKET EXPENSES

The value of time or services rendered to any organization or charity on a volunteer basis is not deductible. However, some out-of-pocket expenses related to those donated services may be considered deductible, provided the expenses are unreimbursed, directly connected with the services you rendered, and are not personal, living or family expenses.

The following are some examples of out-of-pocket expenses that you can include:

- Cost and upkeep of uniforms required to be worn while volunteering (note: the uniform must not be suitable for every-day wear)
- Transportation expenses incurred (the standard automobile charitable mileage rate for 2009 tax year was 14 cents per mile)
- Expenses (travel, meals, lodging, etc.) incurred while attending a qualified organization's convention as a delegate or officer of the organization (no expenses are deductible for attending in an unofficial capacity)

Finally, please note that you cannot deduct child care expenses as a charitable contribution, even if they are necessary so you can do volunteer work for a qualified organization. Further, you also cannot deduct the value of income lost while you work as an unpaid volunteer for a qualified organization.

FOSTER PARENTS

You may be able to deduct as a charitable contribution some of the costs of being a foster parent (foster care provider), if you have no profit motive in providing the foster care and are not, in fact, making a profit. A qualified organization must designate the individuals you take into your home for foster care.

Generally, you can deduct expenses that meet both of the following requirements:

1. They are unreimbursed out-of-pocket expenses to help feed, clothe, and care for the foster child and

2. They must be mainly to benefit the qualified organization.

Example: You cared for a foster child primarily because you wanted to adopt her, not to benefit the agency that placed her in your home. As such, your unreimbursed expenses for food, clothing, etc. to care for the foster child are NOT considered deductible as charitable contributions.

EXPENSES PAID for a STUDENT LIVING with YOU

You may be able to deduct some expenses of having a student live with you as part of an educational program arranged by a charitable organization. You can deduct qualifying expenses for a foreign or American student who meets the following requirements:

1. The student lives in your home under a written agreement between you and a qualified organization as part of a program of the organization to provide educational opportunities for the student;

2. They are not your relative or dependent; and

3. They are a full-time student enrolled in the 12th grade or lower at a school located in the United States.

For any full month when conditions (1) through (3) above are met, you can deduct up to $50 per month for support payments for the student that lives with you. For these purposes, the IRS considers 15 or more days of the calendar month as a full month.

Qualifying expenses that you may be able to deduct include the cost of books, tuition, food, clothing, transportation, medical and dental care, entertainment, and other amounts you actually spend for the well-being of the student. However, no deduction is allowed for depreciation on your home. In addition, general household expenses, such as taxes, insurance, repairs, etc., do not qualify for the deduction.

It is important to note that if you are compensated or reimbursed for any part of the costs of having a student living with you, you cannot deduct any of your costs. However, if you are reimbursed only for an extraordinary or a one-time item – such as a hospital bill or vacation trip – that you paid in advance at the request of the student's parents or the sponsoring organization, you can still deduct your other expenses for the student for which you were not reimbursed.

Finally, you cannot deduct the costs of a foreign student living in your home under a mutual exchange program through which your child will live with a family and attend school in a foreign country.

CONTRIBUTIONS from WHICH the DONOR BENEFITS

A taxpayer who receives any type of benefit as a result of making a charitable contribution to a qualified organization can deduct only the amount of the contribution that exceeds the value of the benefit received.

If you pay more than fair market value to a qualified organization for merchandise, goods or services, including admission to a charity ball, banquet, theatrical performance or athletic event, the amount you pay that is more than the value of the item can be considered a charitable contribution.

Example: Chuck and Sarah Carmichael pay $80 for two tickets to a banquet dinner hosted by their local church to raise funds for Relay For Life. The church provides all contributors with a good-faith statement that says the fair market value of the two dinners is only $30. Therefore, the Carmichaels may claim a $50 deduction on their income tax return if they file "married, filing joint" (or, if filing separately, whoever paid for the tickets may claim the deduction.)

<u>Athletic Events</u>

If you make a donation to a college or university and, as a result, receive as a benefit the right to buy tickets to an athletic event in the athletic stadium of the college or university, then you can only deduct 80% of the remaining amount as a charitable contribution. The cost of the ticket(s), of course, is not deductible.

<u>Token Items or Gifts</u>

If a taxpayer receives a token item or gift – such as a t-shirt, calendar or a coffee mug or other items bearing the organization's name and logo – in return for making a charitable contribution, then the gift item can be ignored in calculating the allowable deduction. The IRS determines the value limit of a token gift prior to each tax year; for 2009, the value limit was the lesser of $9.50 or 2% of the amount of the contribution.

Tip: Purchasing raffle tickets – a common fundraiser among some charitable organizations – can be a gray area. The IRS has deemed that this is a benefit for donors even if they do not win the prize. Although in theory, the amount paid for the raffle ticket would probably exceed the value of the chance to win the prize, the taxpayer would first need to establish the value of the chance of winning. Unfortunately, the taxpayer's unsubstantiated opinion of the chances of winning is generally not sufficient to satisfy the burden of proof. Therefore the amounts paid for chances to participate in raffles do not qualify as a charitable contribution.

WHEN to CLAIM a DEDUCTION

It is important to note that typically a contribution to a qualified charity or organization is deductible in the year in which it is actually paid. Putting a check in the mail to the charity constitutes payment. A contribution made on a credit card is deductible in the year it is charged to your credit card, even if payment to the credit card company is made later in a different year.

Helpful Tax Tip:
On at least two separate occasions in recent history, the IRS has extended the window of opportunity for making charitable cash contributions and claiming them in a specific taxable year. When the tragic Tsunami hit Indonesia on December 26, 2004, the IRS allowed any charitable donations made to the relief efforts in early 2005 to be included in itemized deductions claimed on either the 2004 or 2005 tax return (but not both). In the same way, when the recent devastating earthquakes struck Port-au-Prince, Haiti on January 12, 2010 and Santiago, Chile on February 27, 2010, the IRS allowed taxpayers who made charitable contributions prior to April 15th towards the earthquake relief efforts to actually claim those contributions on either their 2009 or 2010 tax return (but not both).

LIMITATIONS on CHARITABLE CONTRIBUTIONS

Typically, the amount claimed as a deduction for charitable contributions is limited to 50% of your Adjusted Gross Income (AGI) for the year and, in some cases, may be limited to 30% or even 20% of the AGI, depending on the type of property given and the type of organization receiving it.

- 50% Limit – The 50% limit applies to the total of all charitable contributions you make during the year. This means that your deduction for charitable contributions cannot exceed 50% of your adjusted gross income for the year. Generally, the 50% limit is the only limit that applies to gifts to organizations listed below as "50% limit organizations." But there is one exception – a special 30% limit also applies to these gifts if they are gifts of capital gain property for which you figure your deduction using fair market value without reduction for appreciation.

- 50% Limit Organizations – You can generally ask any organization whether it is considered a "50% limit organization" and most will be able to tell you. However, for further clarification, you can always either contact the IRS or check the IRS Publication 78. The following is a partial list of the types of organizations that are 50% limit organizations:
    - Churches and conventions or associations of churches.

  - Educational organizations with a regular faculty and curriculum that normally have a regularly enrolled student body attending classes on site.
  - Hospitals and certain medical research organizations associated with these hospitals.
  - Publicly supported charities.

- 30% Limit – A 30% limit applies to the following gifts:
  - Gifts to all qualified organizations other than 50% limit organizations. This includes gifts to veterans' organizations, fraternal societies, nonprofit cemeteries, and certain private nonoperating foundations.
  - Gifts for the use of any organization. However, if these gifts are of capital gain property, they are subject to the 20% limit, described later, rather than the 30% limit.

- Student living with you – Amounts you spend on behalf of a student living with you are also subject to the 30% limitation. These amounts are considered a contribution for the use of a qualified organization. See "Expenses Paid for Student Living with You," earlier.

- 20% Limit – The 20% limit applies to all gifts of capital gain property to or for the use of qualified organizations (other than gifts of capital gain property to 50% limit organizations).

- Qualified Conservation Contribution – The special 30% limit does not apply to qualified conservation contributions (QCCs). Instead, a 50% limit applies. For qualified farmers and ranchers, QCCs are deductible up to 100% of adjusted gross income. See IRS Publication 526 for more details.

CONTRIBUTION CARRYOVERS

Charitable contributions that you are unable to deduct in the current tax year because they exceed your adjusted-gross-income limits may be carried over to the following tax year. You can claim the excess deduction in each of the next 5 years until it is used up, but not beyond that time. Your total contributions deduction for the year to which you carry your contributions cannot exceed 50% of your adjusted gross income for that year.

For each category of charitable contributions, you may deduct carryover contributions only after deducting all allowable contributions in that category for the current tax year. If you have carryovers from two or more prior years, you would claim the carryover from the earliest year first.

Also, contributions that you carry over are still subject to the same percentage limits in the year to which they are carried. For example, contributions subject to the 20% limit in the year in which they are made are 20% limit contributions in the year to which they are carried.

Example: Milburn Pennybags is a wealthy businessman and philanthropist from the Louisville, KY area. During the 2007 tax year, he made charitable contributions to several nonprofit organizations and charities in the amount of 2 million dollars. However, because his adjusted gross income for 2007 was 3.2 million dollars, he was limited to a charitable contributions deduction of 1.6 million dollars and had a carryover of $400,000. In 2008 tax year, Mr. Moneybags had a reported AGI of 3.6 million dollars and again made 2 million dollars in charitable contributions. As such, he was only allowed to claim a deduction in the amount of 1.8 million dollars; he did not use any of the carryover from 2007 and had an additional carryover from 2008 in the amount of $200,000. Finally, in the 2009 tax year, Mr. Moneybags again donated 2 million dollars to various charities, but his AGI actually exceeded 6 million dollars. As such, he was allowed to claim the entire 2 million dollar deduction, plus the $400,000 carryover from 2007, as well as the $200,000 carryover from 2008, for a total contribution deduction of 2.6 million dollars for 2009 tax year.

Chapter 5: Casualty and Theft Losses

SCHEDULE A
Form 740
42A740-A
Department of Revenue

KENTUCKY ITEMIZED DEDUCTIONS
➤ **See instructions.**
➤ **Attach to Form 740.**

2009

Enter name(s) as shown on Form 740, page 1. | Your Social Security Number

Medical and Dental Expenses	**Do not include expenses reimbursed or paid by others.**		
	1. Medical and dental expenses 1		
	2. Enter 7.5% (.075) of the amount from Form 740, line 9 2		
	3. **Total medical and dental.** Subtract line 2 from line 1. If zero or less, enter -0- .... ➤ 3		00
Taxes	4. Local income taxes (do not include state income tax) 4		
Note: Sales and use taxes and new motor vehicle taxes are not deductible.	5. Real estate taxes 5		
	6. Personal property taxes 6		
	7. Other taxes (list) ____ 7		
	8. **Total taxes.** Add lines 4 through 7. Enter here .... ➤ 8		00
Interest Expense	9. Home mortgage interest and points reported to you on federal Form 1098 9		
Note: Personal interest is not deductible.	10. Home mortgage interest not reported to you on federal Form 1098 (if paid to an individual, show that person's name, identifying number and address) ____ 10		
	See instructions for lines 11 and 12.		
	11. Points not reported to you on federal Form 1098 11		
	12. Qualified mortgage insurance premiums 12		
	13. Investment interest (attach federal Form 4952 if required) 13		
	14. **Total interest.** Add lines 9 through 13. Enter here .... ➤ 14		00
Contributions	15. Contributions by cash or check 15		
Note: For any contribution of $250 or more, see instructions.	16. Other than cash or check (attach federal Form 8283 if over $500) 16		
	17. Artistic charitable contributions deduction (attach copy of appraisal) 17		
	18. Carryover from prior year 18		
	19. **Total contributions.** Add lines 15 through 18. Enter here .... ➤ 19		00
Casualty and Theft Losses	20. Enter amount from attached federal Form 4684, Section A, line 16 20		
	21. Enter 10% (.10) of the amount from Form 740, line 9 21		
	22. **Total casualty or theft loss(es).** Subtract line 21 from line 20. If zero or less, enter -0- .... ➤ 22		00
Job Expenses and Most Other Miscellaneous Deductions	23. Unreimbursed employee expenses—job travel, union dues, job education, etc. (attach Form 2106 or 2106-EZ if applicable) list ____ 23		
	24. Tax preparation fees 24		
	25. Other (investment, safe deposit box, etc.) list ____ 25		
	26. Add the amounts on lines 23, 24 and 25. Enter here 26		
	27. Enter 2% (.02) of the amount from Form 740, line 9 27		
	28. **Total.** Subtract line 27 from line 26. If zero or less, enter -0- .... ➤ 28		00
Other Miscellaneous Deductions	29. Other (see instructions) ____ .... ➤ 29		00
Total Itemized Deductions	30. Add lines 3, 8, 14, 19, 22, 28 and 29. Enter here .... ➤ 30		00

★ If single or married filing jointly and your income for Form 740, Column B does not exceed $166,800, enter total itemized deductions on Form 740, line 10, Column B.
★ All others go to page 2.

If you have been the victim of a theft, accident, fire, flood, or some other casualty during the year, you may be able to deduct some of your unreimbursed losses.

A casualty occurs when your property is damaged as a result of a disaster such as a storm, fire, car accident, or similar event. A theft occurs when someone steals your property.

Casualty and theft losses are treated somewhat differently depending on whether the loss occurred to property used in your trade or business, property used to generate investment income, or property used for personal or family purposes. However, regardless of the type of property, the loss must first be reported on federal Form 4684, *Casualties and Thefts.*

The material covered in this chapter includes the following topics:

- Definitions of casualty, theft, and other losses
- What may be claimed
- How to compute the amount of your gain or loss
- How to treat reimbursements you receive
- Gains and losses
- Federal and Kentucky limitations
- When and how to report a casualty or theft
- Special rules for disaster area losses

CASUALTY DEFINED

A casualty is the damage, destruction, or loss of property resulting from an identifiable event that is sudden, unexpected, or unusual.

- A sudden event is one that is swift, not gradual or progressive.
- An unexpected event is one that is ordinarily unanticipated and unintended.
- An unusual event is one that is not a day-to-day occurrence and that is not typical of the activity in which you were engaged.

THEFT DEFINED

A theft is the taking and removing of money or property with the intent to deprive the owner of it. The taking of property must be illegal under the law of the state where it occurred and it must have been done with criminal intent. You do not need to show a conviction for theft.

OTHER LOSSES

Many other types of losses can qualify to be deducted as a casualty and theft loss. Examples of other losses that might be claimed as a casualty and theft include:

- Losses on business or income-producing property
- Losses on leased property
- Loss of inventory
- Loss on deposits

LOSSES YOU MAY DEDUCT

Deductible casualty losses can result from a number of different causes, including the following:

- Car accidents
- Earthquakes
- Fires
- Floods
- Government-ordered demolition or relocation of a home that is unsafe to use
- Mine cave-ins
- Shipwrecks
- Sonic booms
- Storms, including hurricanes and tornadoes
- Terrorist attacks
- Vandalism
- Volcanic eruptions

Deductible theft losses include the taking of money or property by the following means:

- Blackmail
- Burglary
- Embezzlement
- Extortion
- Kidnapping for ransom
- Larceny
- Robbery

The taking of money or property through fraud or misrepresentation is theft if it is illegal under state or local law. Losses from fraud are deductible. For example, when a contractor disappears after taking a down payment for a repair he never performs, the victim is allowed a deduction.

LOSSES YOU MAY NOT DEDUCT

A casualty loss is not deductible if the damage or destruction is caused by the following:

- Accidentally breaking articles such as glassware or china under normal conditions,
- A fire if you willfully set it, or pay someone else to set it,
- A car accident because of willful negligence or a willful act, such as the result of drunk driving,
- A willful act or willful negligence of someone acting for you caused the accident,
- Progressive deterioration, or
- A family pet.

Loss of property due to damage by a family pet is not deductible as a casualty loss unless the requirements discussed earlier under Casualty are met.

Example: Your antique oriental rug was damaged by your new puppy before it was housebroken. Because the damage was not unexpected and unusual, the loss is not deductible as a casualty loss.

Progressive Deterioration

Loss of property due to progressive deterioration is not deductible as a casualty loss. This is because the damage results from a steadily operating cause or a normal process, rather than from a sudden event. The following are examples of damage due to progressive deterioration:

- The steady weakening of a building due to normal wind and weather conditions
- The deterioration and damage to a water heater that bursts; however, the rust and water damage to rugs and drapes caused by the bursting of a water heater does qualify as a casualty
- Most losses of property caused by droughts
  - To be deductible, a drought-related loss generally must be incurred in a trade or business or in a transaction entered into for profit
- Termite or moth damage
- The damage or destruction of trees, shrubs, or other plants by a fungus, disease, insects, worms, or similar pests

However, a sudden destruction due to an unexpected or unusual infestation of beetles or other insects may result in a casualty loss.

OTHER LOSSES that YOU MAY or MAY NOT DEDUCT

Decline in Market Value of Stock

You cannot deduct as a theft loss the decline in market value of stock acquired on the open market for investment if the decline is caused by disclosure of accounting fraud or other illegal misconduct by the officers or directors of the corporation that issued the stock. However, you can deduct as a capital loss the loss you sustain when you sell or exchange the stock or the stock becomes completely worthless. You report a capital loss on Schedule D.

Mislaid or Lost Property

The simple disappearance of money or property is not a theft. However, an accidental loss or disappearance of property can qualify as a casualty if it results from an identifiable event that is sudden, unexpected, or unusual.

Example: A car door is accidentally slammed on your hand, breaking the setting of your diamond ring. The diamond falls from the ring and is never found. The loss of the diamond is a casualty.

Losses from Ponzi-type investment schemes. The IRS has issued guidance to assist taxpayers who are victims of losses from Ponzi-type investment schemes. Please reference IRS material for additional information.

Loss on Deposits

A loss on deposits can occur when a bank, a credit union, or other financial institution becomes insolvent or bankrupt. If you incurred this type of loss, you can choose one of the following ways to deduct the loss:

- As a casualty loss.
- As an ordinary loss.
- As a nonbusiness bad debt.

Casualty Loss or Ordinary Loss

You can choose to deduct a loss on deposits as a casualty loss or as an ordinary loss for any year in which you can reasonably estimate how much of your deposits you have lost in an insolvent or bankrupt financial institution. The choice generally is made on the return you file for that year and applies to all your losses on deposits for the year in that particular financial institution. If you treat the loss as a casualty or ordinary loss, you cannot treat the same amount of the loss as a nonbusiness bad debt when it actually becomes worthless. However, you can take a nonbusiness bad debt deduction for any amount of loss that is more than the estimated amount you deducted as a casualty or ordinary loss. Once you make the choice, you cannot change it without permission from the Internal Revenue Service.

The maximum amount you can claim is $20,000 ($10,000 if you are married filing separately) reduced by any expected state insurance proceeds. Your loss is subject to the 2%-of-adjusted-gross-income limit. You cannot choose to claim an ordinary loss if any part of the deposit is federally insured.

Nonbusiness Bad Debt

If you do not choose to deduct the loss on deposits as a casualty loss or as an ordinary loss, you must wait until the year the actual loss is determined and deduct the loss as a nonbusiness bad debt in that year.

For more information, see "Special Treatment for Losses on Deposits in Insolvent or Bankrupt Financial Institutions" in the instructions for federal Form 4684.

REQUIRED PROOF

To deduct a casualty or theft loss, you must be able to show that there was a casualty or theft. You also must be able to support the amount you take as a deduction.

For a casualty loss, you should be able to show all the following:

- The type of casualty (car accident, fire, storm, etc.) and when it occurred
- That the loss was a direct result of the casualty
- That you were the owner of the property, or if you leased the property from someone else, that you were contractually liable to the owner for the damage
- Whether a claim for reimbursement exists for which there is a reasonable expectation of recovery

For a theft loss, you should be able to show all the following:

- When you discovered that your property was missing
- That your property was stolen
- That you were the owner of the property
- Whether a claim for reimbursement exists for which there is a reasonable expectation of recovery

It is important that you have records that will prove your deduction. If you do not have the actual records to support your deduction, you may be able to use other satisfactory evidence to support it.

DETERMINING YOUR LOSS

To determine your deduction for a casualty or theft loss, you must first compute the amount of your loss.

Determine the amount of your loss using the following steps:

- Determine your adjusted basis in the property before the casualty or theft
- Determine the decrease in fair market value (FMV) of the property as a result of the casualty or theft
- From the smaller of the amounts you determined in (1) and (2), subtract any insurance or other reimbursement you received or expect to receive

For personal-use property and property used in performing services as an employee, apply the deduction limits, discussed later, to determine the amount of your deductible loss.

Decrease in Fair Market Value

Fair market value (FMV) is the price for which you could sell your property to a willing buyer when neither of you have to sell nor buy and both of you know all the relevant facts. The decrease in FMV used to figure the amount of a casualty or theft loss is the difference between the property's fair market value immediately before and immediately after the casualty or theft.

Stolen Property

The FMV of property immediately after a theft is considered to be zero since you no longer have the property.

Example: Several years ago, you purchased silver dollars at face value for $150. This is your adjusted basis in the property. Your silver dollars were stolen this year. The FMV of the coins was $1,000 just before they were stolen, and insurance did not cover them. Your theft loss is $150.

Recovered Stolen Property

Recovered stolen property is your property that was stolen and later returned to you. If you recovered property after you had already taken a theft loss deduction, you must refigure your loss using the smaller of the property's adjusted basis (explained later) or the decrease in FMV from the time just before it was stolen until the time it was recovered. Use this amount to refigure your total loss for the year in which the loss was deducted.

If your refigured loss is less than the loss you deducted, you generally have to report the difference as income in the recovery year. But report the difference only up to the amount of the loss that reduced your tax. For more information on the amount to report, see *Recoveries* in IRS Publication 525.

Figuring Decrease in FMV — Items to Consider

To figure the decrease in FMV because of a casualty or theft, you generally need a competent appraisal. However, other measures also can be used to establish certain decreases.

Appraisals

An appraisal to determine the difference between the FMV of the property immediately before a casualty or theft and immediately afterwards should be made by a competent appraiser. The appraiser must recognize the effects of any general market decline that may occur along with the casualty. This information is needed to limit any deduction to the actual loss resulting from damage to the property.

Several factors are important in evaluating the accuracy of an appraisal, including the following:

- The appraiser's familiarity with your property before and after the casualty or theft
- The appraiser's knowledge of sales of comparable property in the area
- The appraiser's knowledge of conditions in the area of the casualty
- The appraiser's method of appraisal

Cost of Cleaning Up or Making Repairs

The cost of repairing damaged property is not part of a casualty loss. Neither is the cost of cleaning up after a casualty. But you can use the cost of cleaning up or of making repairs after a casualty as a measure of the decrease in FMV if you meet all the following conditions:

- The repairs are actually made
- The repairs are necessary to bring the property back to its condition before the casualty
- The amount spent for repairs is not excessive
- The repairs take care of the damage only
- The value of the property after the repairs is not, due to the repairs, more than the value of the property before the casualty

Landscaping

The cost of restoring landscaping to its original condition after a casualty may indicate the decrease in FMV. You may be able to measure your loss by what you spend on the following:

- Removing destroyed or damaged trees and shrubs, minus salvage you receive
- Pruning and other measures taken to preserve damaged trees and shrubs
- Replanting to restore the property to its approximate value before the casualty

Automobiles

Books issued by various automobile organizations that list your car may be useful in figuring the value of your car. You can use the books' retail values and modify them by factors such as the mileage and condition of your car to figure its value. The prices are not official, but they may be useful in determining value and suggesting relative prices for comparison with current sales and offerings in your area. If your car is not listed in the books, determine its value from other sources. A dealer's offer for your car as a trade-in on a new car is not usually a measure of its true value.

Basis of Property

The measure of your investment in the property you own is its basis. For property you buy, your basis is usually its cost to you. For property you acquire in some other way, such as inheriting it, receiving it as a gift, or getting it in a nontaxable exchange, you must figure your basis in another way, as explained in IRS Publication 551.

Adjustments to Basis

While you own the property, various events may take place that change your basis. Some events, such as additions or permanent improvements to the property, increase basis. Others, such as earlier casualty losses and depreciation deductions, decrease basis. When you add the increases to the basis and subtract the decreases from the basis, the result is your adjusted basis.

RECOVERIES

If you recover an amount you deducted as a loss in an earlier year, you may have to include the amount recovered in your income for the year of recovery. If any part of the original deduction did not reduce your tax in the earlier year, you do not have to include that part of the recovery in your income. For more information, see *Recoveries* in IRS Publication 525.

INSURANCE and OTHER REIMBURSEMENTS

If you receive an insurance or other type of reimbursement, you must subtract the reimbursement when you figure your loss. You do not have a casualty or theft loss to the extent you are reimbursed.

If you expect to be reimbursed for part or all of your loss, you must subtract the expected reimbursement when you figure your loss. You must reduce your loss even if you do not receive payment until a later tax year.

Failure to File a Claim for Reimbursement

If your property is covered by insurance, you must file a timely insurance claim for reimbursement of your loss. Otherwise, you cannot deduct this loss as a casualty or theft.

The portion of the loss usually not covered by insurance (for example, a deductible) is not subject to this rule.

Example: You have a car insurance policy with a $1,000 deductible. Because your insurance did not cover the first $1,000 of an auto collision, the $1,000 would be deductible (subject to limitations). This is true, even if you do not file an insurance claim, because your insurance policy would never have reimbursed you for the deductible.

TYPES of REIMBURSEMENTS

The most common type of reimbursement is an insurance payment for your stolen or damaged property. Other types of reimbursements are discussed next.

Employer’s Emergency Disaster Fund

If you receive money from your employer’s emergency disaster fund and you must use that money to rehabilitate or replace property on which you are claiming a casualty loss deduction, you must take that money into consideration in computing the casualty loss deduction. Take into consideration only the amount you used to replace your destroyed or damaged property.

Example: Your home was extensively damaged by a tornado. Your loss after reimbursement from your insurance company was $10,000. Your employer set up a disaster relief fund for its employees. Employees receiving money from the fund had to use it to rehabilitate or replace their damaged or destroyed property. You received $4,000 from the fund and spent the entire amount on repairs to your home. In figuring your casualty loss, you must reduce your unreimbursed loss ($10,000) by the $4,000 you received from your employer's fund. Your casualty loss before applying the deduction limits is $6,000.

Insurance Payments for Living Expenses

You do not reduce your casualty loss by insurance payments you receive to cover living expenses in either of the following situations.

- You lose the use of your main home because of a casualty
- Government authorities do not allow you access to your main home because of a casualty or threat of one

Inclusion in Income

If these insurance payments are more than the temporary increase in your living expenses, you must include the excess in your income. However, if the casualty occurs in a federally declared disaster area, none of the insurance payments are taxable.

A temporary increase in your living expenses is the difference between the actual living expenses you and your family incurred during the period you could not use your home and your normal living expenses for that period. Actual living expenses are the reasonable and necessary expenses incurred because of the loss of your main home. Generally, these expenses include the amounts you pay for the following.

- Renting suitable housing
- Transportation
- Food
- Utilities
- Miscellaneous services
- Normal living expenses consist of these same expenses that you would have incurred but did not because of the casualty or the threat of one

Disaster Relief

Food, medical supplies, and other forms of assistance you receive do not reduce your casualty loss, unless they are replacements for lost or destroyed property. Qualified disaster relief payments you receive for expenses you incurred as a result of a federally declared disaster, are not taxable income to you.

Reimbursement Received After Deducting Loss

If you figured your casualty or theft loss using the amount of your expected reimbursement, you may have to adjust your tax return for the tax year in which you get your actual reimbursement, depending on the amount of your reimbursement.

You Are Reimbursed as Expected

If you receive exactly the reimbursement you expected to receive, you do not have to include any of the reimbursement in your income and you cannot deduct any additional loss.

Example: In December 2009, you had a collision while driving your personal car. Repairs to the car cost $950. You had $100 deductible collision insurance. Your insurance company agreed to reimburse you for the rest of the damage.
Because you expected a reimbursement from the insurance company, you did not have a casualty loss deduction in 2009.

Due to limitations on casualty and theft loss, you cannot deduct the $100 you paid as the deductible. When you receive the $850 from the insurance company in 2010, do not report it as income.

Your Actual Reimbursement is Less than Expected

If you later receive less reimbursement than you expected, include that difference as a loss with your other losses (if any) on your return for the year in which you can reasonably expect no more reimbursement.

Your Actual Reimbursement is More than Expected

If you later receive more reimbursement than you expected, after you have claimed a deduction for the loss, you may have to include the extra reimbursement in your income for the year you receive it. However, if any part of the original deduction did not reduce your tax for the earlier year, do not include that part of the reimbursement in your income. You do not refigure your tax for the year you claimed the deduction. See IRS Publication 525 for additional information.

LIMITS on YOUR DEDUCTION

Generally, each personal casualty or theft loss is limited to the excess of the loss over $500 for federal purposes. In addition, the 10%-of-adjusted gross income (AGI) limit continues to apply to the net loss.

New Schedule L for Federal Purposes

If you claim a net disaster loss as part of your standard deduction, you must complete Schedule L and attach it to federal Form 1040.

After you have figured your casualty or theft loss, you must figure how much of the loss you can deduct. The deduction for casualty and theft losses of employee property and personal-use property is limited. A loss on employee property is subject to the 2% rule, discussed next. With certain exceptions, a loss on property you own for your personal use is subject to the $500 and 10% rules, discussed later.

Losses on business property (other than employee property) and income-producing property are not subject to these rules. However, if your casualty or theft loss involved a home you used for business or rented, your deductible loss may be limited. See the instructions for federal Form 4684, Section B. If the casualty or theft loss involved property used in a passive activity, see federal Form 8582, Passive Activity Loss Limitations, and its instructions.

Federal Limitation for 2009

On October 3, 2008, President Obama signed into law the Emergency Economic Stabilization Act of 2008. One provision of this law impacted the calculation of casualty and theft losses. **For 2009 only,** the new law increased the $100 limitation to **$500**.

Kentucky Limitation for 2009

Because Kentucky is under the IRC code of 12/31/06, we have not adopted this law change. Our casualty and theft limitation remains at **$100**.

So for the 2009 tax year, amounts for casualty and theft losses claimed on Schedule A will be different for federal and state purposes.

2% Rule – Miscellaneous Deductions

The casualty and theft loss deduction for employee property, when added to your job expenses and most other miscellaneous itemized deductions on Schedule A must be reduced by 2% of your adjusted gross income. Employee property is property used in performing services as an employee.

$500 Rule – Federal Limitation for 2009

After you have figured your casualty or theft loss on personal-use property, as discussed earlier, you must reduce that loss by $500. This reduction applies to each total casualty or theft loss. It does not matter how many pieces of property are involved in an event. Only a single $500 reduction applies.

Example: You have $750 deductible collision insurance on your car. The car is damaged in a collision. The insurance company pays you for the damage minus the $750 deductible. The amount of the casualty loss is based solely on the deductible. The casualty loss is $250 ($750 - $500) because the first $500 of a casualty loss on personal-use property is not deductible.

Single Event

Generally, events closely related in origin cause a single casualty. It is a single casualty when the damage is from two or more closely related causes, such as wind and flood damage caused by the same storm. A single casualty may also damage two or more pieces of property, such as a hailstorm that damages both your home and your car parked in your driveway.

Example 1: A thunderstorm destroyed your boat. You also lost some boating equipment in the storm. Your loss was $5,000 on the boat and $1,200 on the equipment. Your insurance company reimbursed you $4,500 for the damage to your boat. You had no insurance coverage on the equipment. Your casualty loss is from a single event and the $500 rule applies once. Figure your loss before applying the 10% rule (discussed later) as follows.

	Boat	Equipment
Loss	5,000	1,200
Subtract insurance	4,500	0
Loss after reimbursement	500	1,200
Total loss		**1,700**
Subtract $500		500
Loss before 10% rule		**1,200**

Example 2: Thieves broke into your home in January and stole a ring and a fur coat. You had a loss of $200 on the ring and $700 on the coat. This is a single theft. The $500 rule applies to the total $900 loss.

More than One Loss

If you have more than one casualty or theft loss during your tax year, you must reduce each loss by $500.

Example: Your family car was damaged in an accident in January. Your loss after the insurance reimbursement was $75. In February, your car was damaged in another accident. This time your loss after the insurance reimbursement was $90. Apply the

$500 rule to each separate casualty loss. Since neither accident resulted in a loss of over $500, you are not entitled to any deduction for these accidents.

More than One Person

If two or more individuals (other than a husband and wife filing a joint return) have losses from the same casualty or theft, the $500 rule applies separately to each individual.

Example: A fire damaged your house and also damaged the personal property of your house guest. You must reduce your loss by $500. Your house guest must reduce his or her loss by $500.

Married Taxpayers

If you and your spouse file a joint return, you are treated as one individual in applying the $500 rule. It does not matter whether you own the property jointly or separately.

If you and your spouse have a casualty or theft loss and you file separate returns, each of you must reduce your loss by $500. This is true even if you own the property jointly. If one spouse owns the property, only that spouse can figure a loss deduction on a separate return.

If the casualty or theft loss is on property you own as tenants by the entirety, each of you can figure your deduction on only one-half of the loss on separate returns. Neither of you can figure your deduction on the entire loss on a separate return. Each of you must reduce the loss by $500.

More than One Owner

If two or more individuals (other than a husband and wife filing a joint return) have a loss on property jointly owned, the $500 rule applies separately to each.

10% Rule

You must reduce the total of all your casualty or theft losses on personal-use property by 10% of your adjusted gross income. For 2009, this rule does not apply for federal purposes to a net disaster loss attributable to a federally declared disaster.

Apply the 10% rule after you reduce each loss by $500. If you have both gains and losses from casualties or thefts, see "Gains and Losses," later in this discussion.

Example: In June, you discovered that your house had been burglarized. Your loss after insurance reimbursement was $2,000. Your adjusted gross income for the year you discovered the theft is $29,500. Figure your theft loss as follows.

Loss after insurance	2,000
Subtract $500	500
Loss after $500 rule	1,500
Subtract 10% of $29,500 AGI	2,950
Theft loss deduction	0

You do not have a theft loss deduction because your loss ($1,500) is less than 10% of your adjusted gross income ($2,950).

More than One Loss

If you have more than one casualty or theft loss during your tax year, reduce each loss by any reimbursement and by $500. Then you must reduce the total of all your losses by 10% of your adjusted gross income.

Example: In March, you had an accident that totally destroyed your car. You did not have collision insurance on your car, so you did not receive any insurance reimbursement. Your loss on the car was $1,800. In November, a fire damaged your basement and totally destroyed the furniture, washer, dryer, and other items you had stored there. Your loss on the basement items after reimbursement was $2,100. Your adjusted gross income for the year that the accident and fire occurred is $25,000. Your loss is as follows:

	Car	**Basement**
Loss	1,800	2,100
Subtract $500 per incident	500	500
Loss after $500 rule	1,300	1,600
Total loss		2,900
Subtract 10% of $25,000 AGI		2,500
Casualty loss deduction		**400**

Married taxpayers

If you and your spouse file a joint return, you are treated as one individual in applying the 10% rule. It does not matter if you own the property jointly or separately.

If you file separate returns, the 10% rule applies to each return on which a loss is claimed.

More than One Owner

If two or more individuals (other than husband and wife filing a joint return) have a loss on property that is owned jointly, the 10% rule applies separately to each.

GAINS and LOSSES

If you have casualty or theft gains as well as losses to personal-use property, you must compare your total gains to your total losses. Complete this step after you have reduced each loss by any reimbursements and by $500 (for federal purposes) but before you have reduced the losses by 10% of your adjusted gross income. Do not include gains you choose to postpone. See "Postponement of Gain," later.

Losses More than Gains

If your losses are more than your recognized gains, subtract your gains from your losses and reduce the result by 10% of your adjusted gross income. The rest, if any, is your deductible loss from personal-use property.

Example: Your theft loss after reducing it by reimbursements and by $500 is $2,700. Your casualty gain is $700. Your loss is more than your gain, so you must reduce your $2,000 net loss ($2,700 - $700) by 10% of your adjusted gross income.

Gains More than Losses

If your recognized gains are more than your losses, subtract your losses from your gains. The difference is treated as a capital gain and must be reported on federal Schedule D. The 10% rule does not apply to your gains.

Example: Your theft loss is $600 after reducing it by reimbursements and by $500. Your casualty gain is $1,600. Because your gain is more than your loss, you must report the $1,000 net gain ($1,600 - $600) on federal Schedule D.

FIGURING the DEDUCTION

Generally, you must figure your loss separately for each item stolen, damaged, or destroyed. However, a special rule applies to real property you own for personal use.

Real Property

In figuring a loss to real estate you own for personal use, all improvements (such as buildings and ornamental trees and the land containing the improvements) are considered together.

Example: In June, a fire destroyed your lakeside cottage, which cost $144,800 (including $14,500 for the land) several years ago. (Your land was not damaged.) This was your only casualty or theft loss for the year. The FMV of the property immediately before the fire was $180,000 ($145,000 for the cottage and $35,000 for the land). The FMV immediately after the fire was $35,000 (value of the land). You collected $130,000 from the insurance company.

Your adjusted gross income for the year the fire occurred is $80,000. Your deduction for the casualty loss is $6,300, figured as follows:

Adjusted basis of the entire property (cost in this example)	144,800
FMV of entire property before fire	180,000
FMV of entire property after fire	35,000
Decrease in FMV of entire property (line 2 - line 3)	145,000
Loss (smaller of line 1 or line 4)	144,800
Subtract insurance	130,000
loss after reimbursement	14,800
Subtract $500	500
Loss after $500 rule	14,300
Subtract 10% of $80,000 AGI	8,000
Casualty loss deduction	**6,300**

Personal Property

Personal property is generally any property that is not real property. If your personal property is stolen or is damaged or destroyed by a casualty, you must figure your loss separately for each item of property. Then combine these separate losses to figure the total loss. Reduce the total loss by $500 and 10% of your adjusted gross income to figure the loss deduction.

Example: In August, a storm destroyed your pleasure boat, which cost $18,500. This was your only casualty or theft loss for the year. Its FMV immediately before the storm was $17,000. You had no insurance, but were able to salvage the motor of the boat and sell it for $200. Your adjusted gross income for the year the casualty occurred is $70,000.

Although the motor was sold separately, it is part of the boat and not a separate item of property. You figure your casualty loss deduction as follows.

Adjusted basis (cost in this example)	18,500
FMV before storm	17,000
FMV after storm	200
Decrease in FMV (line 2 - line 3)	16,800
Loss (smaller of line 1 or line 4)	16,800
Subtract insurance	0
Loss after reimbursement	16,800
Subtract $500	500
Loss after $500 rule	16,300
Subtract 10% of $70,000 AGI	7,000
Casualty loss deduction	**9,300**

Both Real and Personal Properties

When a casualty involves both real and personal properties, you must figure the loss separately for each type of property. However, you apply a single $500 reduction to the total loss. Then, you apply the 10% rule to figure the casualty loss deduction.

Example: In July, a hurricane damaged your home, which cost you $164,000 including land. The FMV of the property (both building and land) immediately before the storm was $170,000 and its FMV immediately after the storm was $100,000. Your household furnishings were also damaged. You separately figured the loss on each damaged household item and arrived at a total loss of $600.

You collected $50,000 from the insurance company for the damage to your home, but your household furnishings were not insured. Your adjusted gross income for the year the hurricane occurred is $65,000.

You figure your casualty loss deduction from the hurricane in the following manner:

Adjusted basis of real property (cost in this example)	164,000
FMV of real property before hurricane	170,000
FMV of real property after hurricane	100,000
Decrease in FMV of real property (line 2 - line 3)	70,000
Loss on real property (smaller of line 1 or line 4)	70,000
Subtract insurance	50,000
Loss on real property after reimbursement	20,000
Loss on furnishings	600
Subtract insurance	0
Loss on furnishings after reimbursement	600
Total loss (line 7 plus line 10)	20,600
Subtract $500	500
Loss after $500 rule	20,100
Subtract 10% of $65,000 AGI	6,500
Casualty loss deduction	**13,600**

Property Used Partly for Business and Partly for Personal Purposes

When property is used partly for personal purposes and partly for business or income-producing purposes, the casualty or theft loss deduction must be figured separately for the personal-use portion and for the business or income-producing portion. You must figure each loss separately because the losses attributed to these two uses are figured in two different ways. When figuring each loss, allocate the total cost or basis, the FMV before and after the casualty or theft loss, and the insurance or other reimbursement between the business and personal use of the property. The $500 rule and the 10% rule apply <u>only</u> to the casualty or theft loss on the <u>personal-use</u> portion of the property.

Example: You own a building that you constructed on leased land. You use half of the building for your business and you live in the other half. The cost of the building was $400,000. You made no further improvements or additions to it.

A flood in March damaged the entire building. The FMV of the building was $380,000 immediately before the flood and $320,000 afterwards. Your insurance company reimbursed you $40,000 for the flood damage. Depreciation on the business part of the building before the flood totaled $24,000. Your adjusted gross income for the year the flood occurred is $125,000.

You have a deductible business casualty loss of $10,000. You do not have a deductible personal casualty loss because of the 10% rule.

You figure your loss as follows:

	Business Part	Personal Part
Cost (total $400,000)	200,000	200,000
Subtract depreciation	24,000	0
Adjusted basis	176,000	200,000
FMV before flood (total $380,000)	190,000	190,000
FMV after flood (total $320,000)	160,000	160,000
Decrease in FMV (line 4 - line 5)	30,000	30,000
Loss (smaller of line 3 or line 6)	30,000	30,000
Subtract insurance	20,000	20,000
Loss after reimbursement	10,000	10,000
Subtract $500 on personal-use property	0	500
Loss after $500 rule	10,000	9,500
Subtract 10% of $125,000 AGI on personal-use property	0	12,500
Deductible business loss	10,000	
Deductible personal loss		0

Figuring a Gain

If you receive an insurance payment or other reimbursement that is more than your adjusted basis in the destroyed, damaged, or stolen property, you have a gain from the casualty or theft. Your gain is figured as follows.

- The amount you receive
  Minus
- Your adjusted basis in the property at the time of the casualty or theft

Even if the decrease in FMV of your property is smaller than the adjusted basis of your property, use your adjusted basis to figure the gain.

Amount You Receive

The amount you receive includes any money plus the value of any property you receive minus any expenses you have in obtaining reimbursement. It also includes any reimbursement used to pay off a mortgage or other lien on the damaged, destroyed, or stolen property.

Example: A hurricane destroyed your personal residence and the insurance company awarded you $145,000. You received $140,000 in cash. The remaining $5,000 was paid directly to the holder of a mortgage on the property. The amount you received includes the $5,000 reimbursement paid on the mortgage.

Main Home Destroyed

If you have a gain because your main home was destroyed, you generally can exclude the gain from your income as if you had sold or exchanged your home. You may be able to exclude up to $250,000 of the gain (up to $500,000 if married filing jointly). To exclude a gain, you generally must have owned and lived in the property as your main home for at least 2 years during the 5-year period ending on the date it was destroyed.

Reporting a Gain

You generally must report your gain as income in the year you receive the reimbursement. However, you do not have to report your gain if you meet certain requirements and choose to postpone reporting the gain according to the rules explained under Postponement of Gain, next.

If you have a casualty or theft gain on personal-use property that you choose to postpone reporting and you also have another casualty or theft loss on personal-use property, do not consider the gain you are postponing when figuring your casualty or theft loss deduction.

POSTPONEMENT of GAIN

Do not report a gain if you receive reimbursement in the form of property similar or related in service or use to the destroyed or stolen property. Your basis in the new property is generally the same as your adjusted basis in the property it replaces.

You must ordinarily report the gain on your stolen or destroyed property if you receive money or unlike property as reimbursement. However, you can choose to postpone reporting the gain if you purchase property that is similar or related in service or use to the stolen or destroyed property within a specified replacement period, discussed later. You also can choose to postpone reporting the gain if you purchase a controlling interest (at least 80%) in a corporation owning property that is similar or related in service or use to the property.

If you have a gain on damaged property, you can postpone reporting the gain if you spend the reimbursement to restore the property.

To postpone reporting all the gain, the cost of your replacement property must be at least as much as the reimbursement you receive. If the cost of the replacement property is less than the reimbursement, you must include the gain in your income up to the amount of the unspent reimbursement.

Example: In 1970, you bought an oceanfront cottage for your personal use at a cost of $18,000. You made no further improvements or additions to it. When a storm destroyed the cottage this January, the cottage was worth $250,000. You received $146,000 from the insurance company in March. You had a gain of $128,000 ($146,000 - $18,000).

You spent $144,000 to rebuild the cottage. Since this is less than the insurance proceeds received, you must include $2,000 ($146,000 - $144,000) in your income.

Buying Replacement Property from a Related Person

You cannot postpone reporting a gain from a casualty or theft if you buy the replacement property from a related person. This rule applies to the following taxpayers:

1. C corporations
2. Partnerships in which more than 50% of the capital or profits interest is owned by C corporations
3. All others (including individuals, partnerships — other than those in (2) — and S corporations) if the total realized gain for the tax year on all destroyed or stolen properties on which there are realized gains is more than $100,000

For casualties and thefts described for all others above, gains cannot be offset by any losses when determining whether the total gain is more than $100,000. If the property is owned by a partnership, the $100,000 limit applies to the partnership and each partner. If the property is owned by an S corporation, the $100,000 limit applies to the S corporation and each shareholder.

Related Persons

Under this rule, related persons include, for example, a parent and child, a brother and sister, a corporation and an individual who owns more than 50% of its outstanding stock, and two partnerships in which the same C corporations own more than 50% of the capital or profits interests. For more information on related persons, see *Nondeductible Loss* under *Sales and Exchanges between Related Persons* in IRS Publication 544.

Death of a Taxpayer

If a taxpayer dies after having a gain, but before buying replacement property, the gain must be reported for the year in which the decedent realized the gain. The executor of the estate or the person succeeding to the funds from the casualty or theft cannot postpone reporting the gain by buying replacement property.

Replacement Property

You must buy replacement property for the specific purpose of replacing your destroyed or stolen property. Property you acquire as a gift or inheritance does not qualify.

You do not have to use the same funds you receive as reimbursement for your old property to acquire the replacement property. If you spend the money you receive from the insurance company for other purposes, and borrow money to buy replacement property, you can still postpone reporting the gain if you meet the other requirements.

Owner - User

If you are an owner-user, similar or related in service or use means that replacement property must function in the same way as the property it replaces.

Example: Your home was destroyed by fire and you invested the insurance proceeds in a grocery store. Your replacement property is not similar or related in service or use to the destroyed property. To be similar or related in service or use, your replacement property must also be used by you as your home.

Main Home Replaced

If your gain from the reimbursement you receive because of the destruction of your main home is more than the amount you can exclude from your income (see "Main home destroyed under Figuring a Gain," earlier), you can postpone reporting the excess gain by buying replacement property that is similar or related in service or use.

Basis of Replacement Property

You must reduce the basis of your replacement property (its cost) by the amount of postponed gain. In this way, tax on the gain is postponed until you dispose of the replacement property.

Example: A fire destroyed your rental home that you never lived in. The insurance company reimbursed you $67,000 for the property, which had an adjusted basis of $62,000. You had a gain of $5,000 from the casualty. If you have another rental home constructed at a cost of $110,000 within the replacement period, you can postpone reporting the gain. You will have reinvested all the reimbursement (including your entire gain) in the new rental home. Your basis for the new rental home will be $105,000 ($110,000 cost - $5,000 postponed gain).

Replacement Period

To postpone reporting your gain, you must buy replacement property within a specified period of time. This is the replacement period. The replacement period begins on the date your property was damaged, destroyed, or stolen. The replacement period ends 2 years after the close of the first tax year in which any part of your gain is realized.

Example: You are a calendar year taxpayer. While you were on vacation, a valuable piece of antique furniture that cost $2,200 was stolen from your home. You discovered the theft when you returned home on August 10, 2009. Your insurance company investigated the theft and did not settle your claim until January 4, 2010, when they paid you $3,000. You first realized a gain from the reimbursement for the theft during 2010, so you have until December 31, 2012, to replace the property.

How to Postpone a Gain

You postpone reporting your gain from a casualty or theft by reporting your choice on your tax return for the year you have the gain. You have the gain in the year you receive insurance proceeds or other reimbursements that result in a gain.

If a partnership or a corporation owns the stolen or destroyed property, only the partnership or corporation can choose to postpone reporting the gain.

See IRS Publication 547 for additional information on postponing a gain.

WHEN to REPORT GAINS and LOSSES

Gains

If you receive an insurance or other reimbursement that is more than your adjusted basis in the destroyed or stolen property, you have a gain from the casualty or theft. You must include this gain in your income in the year you receive the reimbursement, unless you choose to postpone reporting the gain as explained earlier.

Losses

Generally, you can deduct a casualty loss that is not reimbursable only in the tax year in which the casualty occurred. This is true even if you do not repair or replace the damaged property until a later year.

You can deduct theft losses that are not reimbursable only in the year you discover your property was stolen.

DISASTER AREA LOSSES

This section discusses the special rules that apply to federally declared disaster area losses. A federally declared disaster is a disaster that occurred in an area declared by the President to be eligible for federal assistance under the Robert T. Stafford Disaster Relief and Emergency Assistance Act. It includes a major disaster or emergency declaration under the Act.

Losses of Personal Use Property

You claim disaster losses of personal use property on federal Form 4684, line 17. A net disaster loss is deductible as an itemized deduction on Schedule A, or as part of the standard deduction on Schedule L for federal purposes.

When to Deduct the Loss

You generally must deduct a casualty loss in the year it occurred. However, if you have a casualty loss from a federally declared disaster that occurred in an area warranting public or individual assistance (or both), you can choose to deduct that loss on your return or amended return for the tax year immediately preceding the tax year in which the disaster happened. If you make this choice, the loss is treated as having occurred in the preceding year.

Example: You are a calendar year taxpayer. A flood damaged your home this June. The flood damaged or destroyed a considerable amount of property in your town. Your town is located in an area designated by FEMA for public or individual assistance (or both). You can choose to deduct the flood loss on your home on last year's tax return.

Main Home in Disaster Area

If your home is located in a federally declared disaster area, you can postpone reporting the gain if you spend the reimbursement to repair or replace your home. Special rules apply to replacement property related to the damage or destruction of your main home (or its contents) if located in these areas. If your main home is located in a federally declared disaster area, the replacement period generally ends 4 years after the close of the first tax year in which any part of your gain is realized.

Example: You are a calendar year taxpayer. A hurricane destroyed your home in September 2009. In December 2009, the insurance company paid you $3,000 more than the adjusted basis of your home. The area in which your home is located is not a federally declared disaster area. You first realized a gain from the reimbursement for the casualty in 2009, so you have until December 31, 2011, to replace the property.

If the area had been declared a federal disaster area, you would have until December 31, 2013, to replace the property.

Home Made Unsafe By Disaster

If your home is located in a federally declared disaster area, your state or local government may order you to tear it down or move it because it is no longer safe to live in because of the disaster. If this happens, treat the loss in value as a casualty loss from a disaster. Your state or local government must issue the order for you to tear down or move the home within 120 days after the area is declared a disaster area.

Unsafe Home

Your home will be considered unsafe only if both of the following apply:

- Your home is substantially more dangerous after the disaster than it was before the disaster
- The danger is from a substantially increased risk of future destruction from the disaster

You do not have a casualty loss if your home is unsafe due to dangerous conditions existing before the disaster. (For example, your house is located in an area known for severe storms.) This is true even if your home is condemned.

Example: Due to a severe storm, the President declared the county you live in a federal disaster area. Although your home has only minor damage from the storm, a month later the county issues a demolition order. This order is based on a finding that your home is unsafe due to nearby mud slides caused by the storm. The loss in your home's value because the mud slides made it unsafe is treated as a casualty loss from a disaster. The loss in value is the difference between your home's FMV immediately before the disaster and immediately after the disaster.

How to Deduct Your Loss in the Preceding Year

If you choose to deduct your loss on your return or amended return for the tax year immediately preceding the tax year in which the disaster happened, include a statement saying that you are making that choice. The statement can be made on the return or can be filed with the return. The statement should specify the date or dates of the disaster and the city, town, county, and state where the damaged or destroyed property was located at the time of the disaster.

Time Limit for Making Choice

You must make this choice to take your casualty loss for the disaster in the preceding year by the later of the following dates.

- The due date (without extensions) for filing your income tax return for the tax year in which the disaster actually occurred.

- The due date (with extensions) for filing the return for the preceding tax year.

Revoking Your Choice

You can revoke your choice within 90 days after making it by returning to the Internal Revenue Service any refund or credit you received from making the choice. However, if you revoke your choice before receiving a refund, you must return the refund within 30 days after receiving it for the revocation to be effective.

Federal Loan Canceled

If part of your federal disaster loan was canceled under the Robert T. Stafford Disaster Relief and Emergency Assistance Act, it is considered to be reimbursement for the loss. The cancellation reduces your casualty loss deduction.

Qualified Disaster Relief Payments

Qualified disaster relief payments are not included in the income of individuals to the extent any expenses compensated by these payments are not otherwise compensated for by insurance or other reimbursement. These payments are not subject to income tax, self-employment tax, or employment taxes (Social Security, Medicare, and federal unemployment taxes). No withholding applies to these payments. Qualified disaster relief payments include payments you receive (regardless of the source) for the following expenses:

- Reasonable and necessary personal, family, living, or funeral expenses incurred as a result of a federally declared disaster,
- Reasonable and necessary expenses incurred for the repair or rehabilitation of a personal residence due to a federally declared disaster. (A personal residence can be a rented residence or one you own,)
- Reasonable and necessary expenses incurred for the repair or replacement of the contents of a personal residence due to a federally declared disaster, and
- Qualified disaster relief payments also include amounts paid to individuals affected by the disaster by a federal, state, or local government in connection with a federally declared disaster.

Qualified disaster relief payments do not include:

- Payments for expenses otherwise paid for by insurance or other reimbursements, or
- Income replacement payments, such as payments of lost wages, lost business income, or unemployment compensation.

Gains

Special rules apply if you choose to postpone reporting gain on property damaged or destroyed in a federally declared disaster area. For more information on these types of gains please reference available IRS material.

Reporting Gains and Losses

How you report gains and losses depends on whether the property was business, income-producing, or personal-use property.

Personal-Use Property

If you have a loss, use both of the following:

- Federal Form 4684
- Schedule A, Itemized Deductions (or federal Form 1040NR, Schedule A, if you are a nonresident alien)

Note: Use Schedule L instead of Schedule A if you are deducting a net disaster loss as part of your standard deduction.

If you have a gain, report it on both of the following:

- Federal Form 4684
- Schedule D, Capital Gains and Losses

Business and Income-Producing Property

Use federal Form 4684 to report your gains and losses. You will also have to report the gains and losses on other forms as explained next.

Property Held One Year or Less

Individuals report losses from income-producing property and property used in performing services as an employee on Schedule A. Gains from business and income-producing property are combined with losses from business property (other than property used in performing services as an employee) and the net gain or loss is reported on federal Form 4797. If you are not otherwise required to file federal Form 4797, only enter the net gain or loss on your tax return on the line identified as from federal Form 4797. Next to that line, enter "federal Form 4684." Partnerships and S corporations should see the federal Form 4684 instructions to find out where to report these gains and losses.

Property Held More than One Year

If your losses from business and income-producing property are more than gains from these types of property, combine your losses from business property (other than property used in performing services as an employee) with total gains from business and income-producing property. Report the net gain or loss as an ordinary gain or loss on federal Form 4797. If you are not otherwise required to file federal Form 4797, only enter the net gain or loss on your tax return on the line identified as from federal Form 4797. Next to that line, enter "federal Form 4684." Individuals deduct any loss of income-producing property and property used in performing services as an employee on Schedule A. Partnerships and S corporations should see federal Form 4684 to find out where to report these gains and losses.

If losses from business and income-producing property are less than or equal to gains from these types of property, report the net amount on federal Form 4797. You may also have to report the gain on federal Schedule D depending on whether you have other transactions.

Depreciable Property

If the damaged or stolen property was depreciable property held more than 1 year, you may have to treat all or part of the gain as ordinary income to the extent of depreciation allowed or allowable. You figure the ordinary income part of the gain in Part III of federal Form 4797. See *Depreciation Recapture* in chapter 3 of IRS Publication 544 for more information about the recapture rule.

Adjustments to Basis

If you have a casualty or theft loss, you must decrease your basis in the property by any insurance or other reimbursement you receive and by any deductible loss. The result is your adjusted basis in the property.

You must increase your basis in the property by the amount you spend on repairs that restore the property to its pre-casualty condition. Do not increase your basis in the property by any qualified disaster mitigation payments (discussed earlier under Disaster Area Losses). See *Adjusted Basis* in IRS Publication 551 for more information on adjustments to basis.

Net Operating Loss

If your casualty or theft loss deduction causes your deductions for the year to be more than your income for the year, you may have a net operating loss (NOL). You can use an NOL to lower your tax in an earlier year, allowing you to get a refund for tax you already paid. Or, you can use it to lower your tax in a later year. For Kentucky purposes, after 2005, you may only carry forward losses.

Chapter 6: Unreimbursed Job Expenses

SCHEDULE A
Form 740
42A740-A
Department of Revenue

KENTUCKY ITEMIZED DEDUCTIONS
➤ **See instructions.**
➤ **Attach to Form 740.**

2009

Enter name(s) as shown on Form 740, page 1. | Your Social Security Number

Section	Line	
Medical and Dental Expenses		**Do not include expenses reimbursed or paid by others.**
	1.	Medical and dental expenses 1
	2.	Enter 7.5% (.075) of the amount from Form 740, line 9 2
	3.	**Total medical and dental.** Subtract line 2 from line 1. If zero or less, enter -0- .... ➤ 3 ... 00
Taxes *Note: Sales and use taxes and new motor vehicle taxes are not deductible.*	4.	Local income taxes (do not include state income tax) 4
	5.	Real estate taxes 5
	6.	Personal property taxes 6
	7.	Other taxes (list) ____ 7
	8.	**Total taxes.** Add lines 4 through 7. Enter here .... ➤ 8 ... 00
Interest Expense *Note: Personal interest is not deductible.*	9.	Home mortgage interest and points reported to you on federal Form 1098 9
	10.	Home mortgage interest not reported to you on federal Form 1098 (if paid to an individual, show that person's name, identifying number and address) ____ 10
		See instructions for lines 11 and 12.
	11.	Points not reported to you on federal Form 1098 11
	12.	Qualified mortgage insurance premiums 12
	13.	Investment interest (attach federal Form 4952 if required) 13
	14.	**Total interest.** Add lines 9 through 13. Enter here .... ➤ 14 ... 00
Contributions *Note: For any contribution of $250 or more, see instructions.*	15.	Contributions by cash or check 15
	16.	Other than cash or check (attach federal Form 8283 if over $500) 16
	17.	Artistic charitable contributions deduction (attach copy of appraisal) 17
	18.	Carryover from prior year 18
	19.	**Total contributions.** Add lines 15 through 18. Enter here .... ➤ 19 ... 00
Casualty and Theft Losses	20.	Enter amount from attached federal Form 4684, Section A, line 16 20
	21.	Enter 10% (.10) of the amount from Form 740, line 9 21
	22.	**Total casualty or theft loss(es).** Subtract line 21 from line 20. If zero or less, enter -0- .... ➤ 22 ... 00
Job Expenses and Most Other Miscellaneous Deductions	23.	Unreimbursed employee expenses—job travel, union dues, job education, etc. (attach Form 2106 or 2106-EZ if applicable) list ____ 23
	24.	Tax preparation fees 24
	25.	Other (investment, safe deposit box, etc.) list ____ 25
	26.	Add the amounts on lines 23, 24 and 25. Enter here 26
	27.	Enter 2% (.02) of the amount from Form 740, line 9 27
	28.	**Total.** Subtract line 27 from line 26. If zero or less, enter -0- .... ➤ 28 ... 00
Other Miscellaneous Deductions	29.	Other (see instructions) ____ .... ➤ 29 ... 00
Total Itemized Deductions	30.	Add lines 3, 8, 14, 19, 22, 28 and 29. Enter here .... ➤ 30 ... 00

★ If single or married filing jointly and your income for Form 740, Column B does not exceed $166,800, enter total itemized deductions on Form 740, line 10, Column B.
★ All others go to page 2.

As an employee, it is possible that you would incur some expenses that are related to your job. If your employer did not pay you back for those expenses, they would be considered unreimbursed job expenses; you may be able to deduct those expenses as miscellaneous deductions on Schedule A. Because they are considered a miscellaneous deduction, you will only be allowed to deduct the amount that is over 2% of your adjusted gross income. In other words, if your AGI was $50,000 you must have expenses of more than $1000 before the expenses are deductible. And even then, only the amount over $1000 can be deducted.

Your expenses must have been required for you to carry out the job for which you were hired and must be ordinary and necessary. This means the item or service is common and accepted in your line of work and is appropriate and helpful to your job. You will need to detail your expenses on federal Form 2106, Employee Business Expenses, or federal Form 2106-EZ, Unreimbursed Employee Business Expenses. All records for these expenses must be kept contemporaneously. This means that the records must be kept as the expense occurs (i.e. receipts, mileage logs) and not be recreated after the fact.

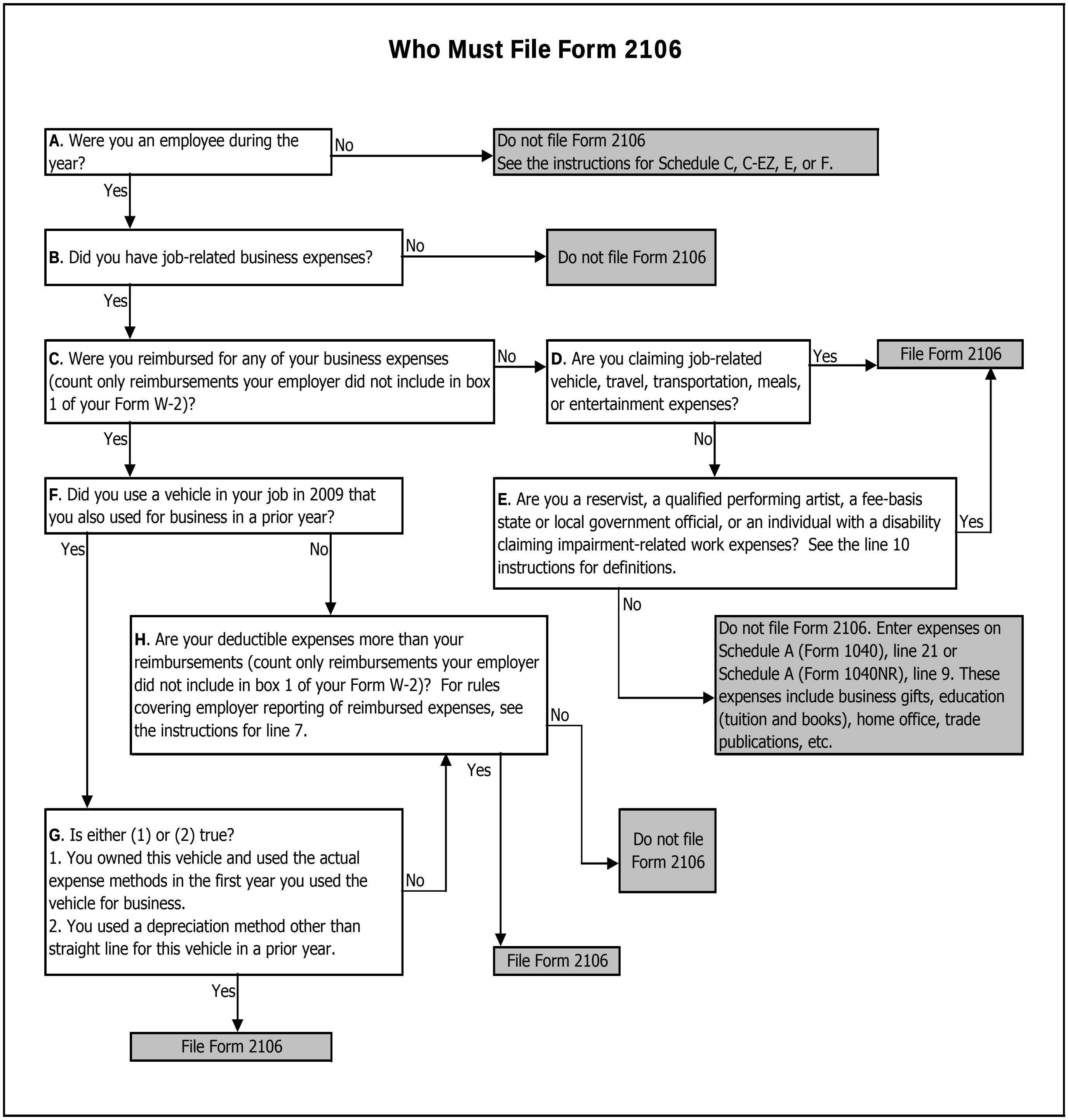
You may be able to deduct the following items as unreimbursed employee expenses. Many of the following items will be discussed in this chapter; however, this is not an all-inclusive list. For a complete listing of unreimbursed job expenses and descriptions, refer to IRS Publication 529.

- Business liability insurance premiums
- Damages paid to a former employer for breach of an employment contract
- Dues to a chamber of commerce or professional society
- Educator expenses that are more than you can deduct as an adjustment to income
- Home office or part of your home used regularly and exclusively in your work
- Legal fees related to your job
- Licenses and regulatory fees
- Malpractice insurance premiums
- Medical examinations required by an employer
- Occupational taxes
- Passport for a business trip
- Repayment of an income aid payment received under an employer’s plan
- Research expenses of a college professor
- Rural mail carriers’ vehicle expenses
- Subscriptions to professional journals and trade magazines related to your work
- Tools and supplies used in your work
- Travel, transportation, meals, entertainment, gifts, and local lodging related to your work
- Union dues and expenses
- Work clothes and uniforms if required and not suitable for everyday use
- Work-related education

FEDERAL FORM 2106

As previously mentioned, federal Form 2106 should be used whenever you are deducting ordinary and necessary expenses for your job. All of the possible deductions in this chapter should be taken on federal Form 2106. Below is a flow chart that will help you decide whether you should utilize that form. For information on how these deductions should be taken on the form, see *Completing Form 2106*, in IRS Publication 463.

Figure 6.1


Who Must File Form 2106
A. Were you an employee during the year?
No
Do not file Form 2106 See the instructions for Schedule C, C-EZ, E, or F.
Yes
B. Did you have job-related business expenses?
No
Do not file Form 2106
Yes
C. Were you reimbursed for any of your business expenses (count only reimbursements your employer did not include in box 1 of your Form W-2)?
No
D. Are you claiming job-related vehicle, travel, transportation, meals, or entertainment expenses?
Yes
File Form 2106
Yes
No
F. Did you use a vehicle in your job in 2009 that you also used for business in a prior year?
E. Are you a reservist, a qualified performing artist, a fee-basis state or local government official, or an individual with a disability claiming impairment-related work expenses? See the line 10 instructions for definitions.
Yes
Yes
No
No
H. Are your deductible expenses more than your reimbursements (count only reimbursements your employer did not include in box 1 of your Form W-2)? For rules covering employer reporting of reimbursed expenses, see the instructions for line 7.
Do not file Form 2106. Enter expenses on Schedule A (Form 1040), line 21 or Schedule A (Form 1040NR), line 9. These expenses include business gifts, education (tuition and books), home office, trade publications, etc.
No
Yes
G. Is either (1) or (2) true?
1. You owned this vehicle and used the actual expense methods in the first year you used the vehicle for business.
2. You used a depreciation method other than straight line for this vehicle in a prior year.
No
Do not file Form 2106
File Form 2106
Yes
File Form 2106

TRAVEL EXPENSES

Although commuting costs are not deductible, some local transportation expenses are. Deductible local transportation expenses include the expenses of going from one workplace (away from your place of residence) to another workplace. If you have an office in your home that you use as your principal place of business for your employer, you may deduct the cost of traveling between your home office and work places associated with your employment.

You may deduct the cost of going between your residence and a temporary work location outside of the metropolitan area where you live and normally work. If you have one or more regular work locations away from your residence, you may also deduct the cost of going between your residence and a temporary work location within your metropolitan area.

Business Related Travel

Travel expenses are the ordinary and necessary expenses of traveling away from home for your business, profession, or job. You cannot deduct expenses that are lavish or extravagant or that are for personal purposes.

You are traveling away from home if your duties require you to be away from the general area of your tax home for a period substantially longer than an ordinary day's work, and you need to get sleep or rest to meet the demands of your work while away.
Generally, your tax home is the entire city or general area where your main place of business or work is located, regardless of where you maintain your family home.

Tax Home

To determine whether you are traveling away from home, you must first determine the location of your tax home. Generally, your tax home is your regular place of business or post of duty, regardless of where you maintain your family home. It includes the entire city or general area in which your business or work is located.

If you have more than one regular place of business, your tax home is your main place of business. If you do not have a regular or a main place of business because of the nature of your work, then your tax home may be the place where you regularly live.

If you do not have a regular or main place of business or post of duty and there is no place where you regularly live, you are considered an itinerant (a transient) and your tax home is wherever you work. As an itinerant, you cannot claim a travel expense deduction because you are never considered to be traveling away from home.

Main Place of Business or Work

If you have more than one place of work, consider the following when determining which one is your main place of business or work:

- The total time you ordinarily spend in each place
- The level of your business activity in each place
- Whether your income from each place is significant or insignificant

Example: You live with your family in Lexington but work in Bowling Green where you stay in a hotel and eat in restaurants. You return to Lexington every weekend. You may not deduct any of your travel, meals, or lodging in Bowling Green because that is your tax home. Your travel on weekends to your family home in Lexington is not for your work, so these expenses are also not deductible. If you regularly work in more than one place, your tax home is the general area where your main place of business or work is located.

In determining your main place of business, take into account the length of time you are normally required to spend at each location for business purposes, the degree of business activity in each area, and the relative significance of the financial return from each area. However, the most important consideration is the length of time spent at each location. Travel expenses paid or incurred in connection with a temporary work assignment away from home are deductible.

However, travel expenses paid in connection with an indefinite work assignment are not deductible. Any work assignment in excess of one year is considered indefinite. Also, you may not deduct travel expenses at a work location if it is realistically expected that you will work there for more than one year, whether or not you actually work there that long. If you realistically expect to work at a temporary location for less than one year, and the expectation changes so that at some point you realistically expect to work there for more than one year, travel expenses become nondeductible when your expectation changes.

You may deduct travel expenses, including meals and lodging, you had in looking for a new job in your present trade or business. You may not deduct these expenses if you had them while looking for work in a new trade or business or while looking for work for the first time. If you are unemployed and there is a substantial break between the time of your past work and you're looking for new work, you may not deduct these expenses, even if the new work is in the same trade or business as your previous work. Travel expenses for conventions are deductible if you can show that your attendance benefits your trade or business. Special rules apply to conventions held outside of the North American area.

Deductible travel expenses while away from home include, but are not limited to, the costs of:

- Travel by airplane, train, bus, or car between your home and your business destination. If you are provided with a ticket or you are riding free as a result of a frequent traveler or similar program, your cost is zero
- Using your car while at your business destination
- Fares for taxis or other types of transportation between the airport or train station and your hotel, the hotel and the work location, and from one customer to another, or from one place of business to another
- Meals and lodging
- Tips you pay for services related to any of these expenses
- Dry cleaning and laundry
- Business calls while on your business trip. This includes business communications by fax machine or other communication devices
- Other similar ordinary and necessary expenses related to your business travel. These expenses might include transportation to and from a business meal, public computer rental fees, etc.

Temporary Assignment or Job

You may regularly work at your tax home and also work at another location. It may not be practical to return to your tax home from this other location at the end of each work day. If your assignment or job away from your main place of work is temporary, your tax home does not change. You are considered to be away from home for the whole period you are away from your main place of work. You can deduct your travel expenses if they otherwise qualify for deduction. Generally, a temporary assignment in a single location is one that is realistically expected to last (and does in fact last) for 1 year or less.

However, if your assignment or job is indefinite, the location of the assignment or job becomes your new tax home and you cannot deduct your travel expenses while there. An assignment or job in a single location is considered indefinite if it is realistically expected to last for more than 1 year, whether or not it actually lasts for more than 1 year.

If your assignment is indefinite, you must include in your income any amounts you receive from your employer for living expenses, even if they are called travel allowances and you account to your employer for them. You may be able to deduct the cost of relocating to your new tax home as a moving expense. See IRS Publication 521 for more information.

Determining Temporary or Indefinite Assignment

You must determine whether your assignment is temporary or indefinite when you start work. If you expect an assignment or job to last for 1 year or less, it is temporary unless there are facts and circumstances that indicate otherwise. An assignment or job that is initially temporary may become indefinite due to changed circumstances. A series of assignments to the same location, all for short periods but that together cover a long period, may be considered an indefinite assignment.

Going Home on Days Off

If you go back to your tax home from a temporary assignment on your days off, you are not considered away from home while you are in your hometown. You cannot deduct the cost of your meals and lodging there. However, you can deduct your travel expenses, including meals and lodging, while traveling between your temporary place of work and your tax home. You can claim these expenses up to the amount it would have cost you to stay at your temporary place of work.

If you keep your hotel room during your visit home, you can deduct the cost of your hotel room. In addition, you can deduct your expenses of returning home up to the amount you would have spent for meals had you stayed at your temporary place of work.

Probationary Work Period

If you take a job that requires you to move, with the understanding that you will keep the job if your work is satisfactory during a probationary period, the job is indefinite. You cannot deduct any of your expenses for meals and lodging during the probationary period.

Deductible Travel Expenses

<u>Meal Allowance</u>

Instead of keeping records of your meal expenses and deducting the actual cost, you can generally use a standard meal allowance, which varies depending on where you travel. The deduction for business meals is generally limited to 50% of the unreimbursed cost.

Generally, you can use the "standard meal allowance" method as an alternative to the actual cost method. It allows you to use a set amount for your daily meals and incidental expenses (M&IE), instead of keeping records of your actual costs. If you use the standard meal allowance, you still must keep records to prove the time, place, and business purpose of your travel.

Incidental Expenses

You can use an optional method (instead of actual cost) for deducting incidental expenses only. The amount of the deduction is $3 a day for the period from January 1 through September 30, 2009, and $5 a day for the period October 1 through December 31, 2009. You can use this method only if you did not pay or incur any meal expenses. You cannot use this method on any day that you use the standard meal allowance.

The term "incidental expenses" means:

- Fees and tips given to porters, baggage carriers, bellhops, hotel maids, stewards or stewardesses and others on ships, and hotel servants in foreign countries,
- Transportation between places of lodging or business and places where meals are taken, if suitable meals can be obtained at the temporary duty site, and
- Mailing costs associated with filing travel vouchers and payment of employer-sponsored charge card billings.

Incidental expenses do not include expenses for laundry, cleaning and pressing of clothing, lodging taxes, or the costs of telegrams or telephone calls.

50% Limit

If you use the standard meal allowance method for meal expenses and you are not reimbursed, you can generally deduct only 50% of the standard meal allowance. If you are reimbursed under an accountable plan and you are deducting amounts that are more than your reimbursements, you can deduct only 50% of the excess amount. There is no optional standard lodging amount similar to the standard meal allowance. Your allowable lodging expense deduction is your actual cost.

Amount of Standard Meal Allowance

The standard meal allowance is the federal M&IE rate. For travel in 2009, the rate for most small localities in the United States is $39 a day for the period January 1 through September 30, 2009, and $46 a day for the period October 1 through December 31, 2009. Most major cities and many other localities in the United States are designated as high-cost areas, qualifying for higher standard meal allowances. These rates are listed in IRS Publication 1542 and can also be found on the IRS Website.

National Guard or Military Reserve Travel

If you are a member of the National Guard or military reserve you may be able to claim a deduction that reduces adjusted gross income rather than an itemized deduction for unreimbursed travel expenses paid in connection with the performance of services as a reservist. To qualify the travel must be overnight and more than 100 miles from your home. Expenses must be ordinary and necessary. This deduction is limited to the regular federal per diem rate (for lodging, meals, and incidental expenses) and the standard mileage rate (for car expenses) plus any parking fees, ferry fees, and tolls. These expenses are claimed on federal Form 2106, or federal Form 2106-EZ and carried to the appropriate line on federal Form 1040. Expenses in excess of the limit can be claimed only as an itemized deduction on Schedule A.

Conventions

You can deduct your travel expenses when you attend a convention if you can show that your attendance benefits your trade or business. You cannot deduct the travel expenses for your family. If the convention is for investment, political, social, or other purposes unrelated to your trade or business, you cannot deduct the expenses.

The convention agenda or program generally shows the purpose of the convention. You can show your attendance at the convention benefits your trade or business by comparing the agenda with the official duties and responsibilities of your position. The agenda does not have to deal specifically with your official duties and responsibilities; it will be enough if the agenda is so related to your position that it shows your attendance was for business purposes.

Cruise Ships

You can deduct up to $2,000 per year of your expenses of attending conventions, seminars, or similar meetings held on cruise ships. All ships that sail are considered cruise ships. You can deduct these expenses only if all of the following requirements are met:

- The convention, seminar, or meeting is directly related to your trade or business
- The cruise ship is a vessel registered in the United States
- All of the cruise ship's ports of call are in the United States or in possessions of the United States
- You attach to your return a written statement signed by you that includes information about:
  - The total days of the trip (not including the days of transportation to and from the cruise ship port),
  - The number of hours each day that you devoted to scheduled business activities, and
  - A program of the scheduled business activities of the meeting
- You attach to your return a written statement signed by an officer of the organization or group sponsoring the meeting that includes:
  - A schedule of the business activities of each day of the meeting, and
  - The number of hours you attended the scheduled business activities

Business Entertainment and Gift Expenses

Entertainment expenses that are both ordinary and necessary in carrying on a trade or business may be deductible if they meet one of the two tests discussed in IRS Publication 463. You must have records to prove the business purpose (under the applicable test) and the amount of each expense, the date and place of the entertainment, and the business relationship of the persons entertained.

Generally, only 50% of food and beverage ("meal") and entertainment expenses are allowed as a deduction. For exceptions to the 50% limitation, refer to IRS Publication 463, *Travel, Entertainment, Gift and Car Expenses*. If you are an employee whose deductible business entertainment expenses are fully sustained and reimbursed under an accountable plan, the reimbursement should not be included in your wages on Form W-2 and you should not deduct the expenses. If you are not reimbursed fully under an accountable plan, your expenses exceed the reimbursement you received under an accountable plan, or you are not reimbursed at all, use federal Form 2106, or federal Form 2106-EZ to report business entertainment expenses.

If the entertainment takes place in a clear business setting and is for your business or work, the expenses are considered directly related to your business or work. The following situations are examples of entertainment in a clear business setting:

- Entertainment in a hospitality room at a convention where business goodwill is created through the display or discussion of business products.
- Entertainment that is mainly a price rebate on the sale of your products (such as a restaurant owner providing an occasional free meal to a loyal customer).
- Entertainment of a clear business nature occurring under circumstances where there is no meaningful personal or social relationship between you and the persons entertained. An example is entertainment of business and civic leaders at the opening of a new hotel or play when the purpose is to get business publicity rather than to create or maintain the goodwill of the persons entertained.

Directly-Related Test

To meet the directly-related test for entertainment expenses (including entertainment-related meals), you must show that:

- The main purpose of the combined business and entertainment was the active conduct of business,
- You did engage in business with the person during the entertainment period, and
- You had more than a general expectation of getting income or some other specific business benefit at some future time.

Business is generally not considered to be the main purpose when business and entertainment are combined on hunting or fishing trips, or on yachts or other pleasure boats. Even if you show that business was the main purpose, you generally cannot deduct the expenses for the use of an entertainment facility. You must consider all the facts, including the nature of the business and the reasons for conducting business during the entertainment. It is not necessary to devote more time to business than to entertainment. However, if the business discussion is only incidental to the entertainment, the entertainment expenses do not meet the directly-related test.

Entertainment expenses generally are not considered directly related if you are not there or in situations where there are substantial distractions that generally prevent you from actively conducting business. The following are examples of situations where there are substantial distractions.

- A meeting or discussion at a nightclub, theater, or sporting event
- A meeting or discussion during what is essentially a social gathering, such as a cocktail party
- A meeting with a group that includes persons who are not business associates at places such as cocktail lounges, country clubs, golf clubs, athletic clubs, or vacation resorts

Associated Test

Even if your expenses do not meet the directly-related test, they may meet the associated test. To meet the associated test for entertainment expenses (including entertainment-related meals), you must show that the entertainment is associated with the active conduct of your trade or business, and directly before or after a substantial business discussion.

Whether a business discussion is substantial depends on the facts of each case. A business discussion will not be considered substantial unless you can show that you actively engaged in the discussion, meeting, negotiation, or other business transaction to get income or some other specific business benefit.

Generally, an expense is associated with the active conduct of your trade or business if you can show that you had a clear business purpose for having the expense. The purpose may be to get new business or to encourage the continuation of an existing business relationship.

The meeting does not have to be for any specified length of time, but you must show that the business discussion was substantial in relation to the meal or entertainment. It is not necessary that you devote more time to business than to entertainment. You do not have to discuss business during the meal or entertainment.

Below is a table that will help in determining if your entertainment expenses are deductible.

Figure 6.2

General Rule	You can deduct ordinary and necessary expenses to entertain a client, customer, or employee if the expenses meet the directly-related test or the associated test.
Definitions	• Entertainment includes any activity generally considered to provide entertainment, amusement, or recreation, and includes meals provided to a customer or client. • An ordinary expense is one that is common and accepted in your trade or business. • A necessary expense is one that is helpful and appropriate.
Tests to be met	Directly-related test • Entertainment took place in a clear business setting, or • Main purpose of entertainment was the active conduct of business, and you did engage in business with the person during the entertainment period, and you had more than a general expectation of getting income or some other specific business benefit.
	Associated test • Entertainment is associated with your trade or business, and • Entertainment directly before or after a substantial business discussion.
Other rules	• You cannot deduct the cost of your meal as an entertainment expense if you are claiming the meal as a travel expense. • You cannot deduct expenses that are lavish or extravagant under the circumstances. • You generally can deduct only 50% of your unreimbursed entertainment expenses.

<u>Directly Before or after Business Discussion</u>

If the entertainment is held on the same day as the business discussion, it is considered to be held directly before or after the business discussion. If the entertainment and the business discussion are not held on the same day, you must consider the facts of each case to see if the associated test is met. The facts to consider are location, date, and duration of the business discussion. If you or your business associates are from out of town, you must also consider the dates of arrival and departure, and the reasons the entertainment and the discussion did not take place on the same day.

Example: A group of business associates comes from out of town to your place of business to hold a substantial business discussion. If you entertain those business guests on the evening before the business discussion, or on the evening of the day following the business discussion, the entertainment generally is considered to be held directly before or after the discussion. The expense meets the associated test.

Meetings at Conventions

You are considered to have a substantial business discussion if you attend meetings at a convention or similar event, or at a trade or business meeting sponsored and conducted by a business or professional organization. However, your reason for attending the convention or meeting must be to further your trade or business. The organization that sponsors the convention or meeting must schedule a program of business activities that is the main activity of the convention or meeting.

50% Limit

In general, you can deduct only 50% of your business-related meal and entertainment expenses. The 50% limit applies to employees or their employers, and to self-employed persons (including independent contractors) or their clients, depending on whether the expenses are reimbursed. The 50% limit applies to business meals or entertainment expenses you have while:

- Traveling away from home (whether eating alone or with others) on business,
- Entertaining customers at your place of business, a restaurant, or other location, or
- Attending a business convention or reception, business meeting, or business luncheon at a club.

Included Expenses

Expenses subject to the 50% limit include:

- Taxes and tips relating to a business meal or entertainment activity,
- Cover charges for admission to a nightclub,
- Rent paid for a room in which you hold a dinner or cocktail party, and
- Amounts paid for parking at a sports arena.

However, the cost of transportation to and from a business meal or a business-related entertainment activity is not subject to the 50% limit. The 50% limit also applies to certain meal and entertainment expenses that are not business related. It applies to meal and entertainment expenses you have for the production of income, including rental or royalty income. It also applies to the cost of meals included in deductible educational expenses.

What Entertainment Expenses Are Deductible?

Entertainment

Entertainment includes any activity generally considered to provide entertainment, amusement, or recreation. Examples include entertaining guests at nightclubs; at social, athletic, and sporting clubs; at theaters; at sporting events; on yachts; or on hunting, fishing, vacation, and similar trips. Entertainment also may include meeting personal, living, or family needs of individuals, such as providing meals, a hotel suite, or a car to customers or their families.

A Meal as a Form of Entertainment

Entertainment includes the cost of a meal you provide to a customer or client, whether the meal is a part of other entertainment or by itself. A meal expense includes the cost of food, beverages, taxes, and tips for the meal. To deduct an entertainment-related meal, you or your employee must be present when the food or beverages are provided.

Note: You cannot claim the cost of your meal both as an entertainment expense and as a travel expense. Also, meals sold in the normal course of your business are not considered entertainment.

Separating Costs

If you have one expense that includes the costs of entertainment, and other services (such as lodging or transportation), you must allocate that expense between the cost of entertainment and the cost of other services. You must have a reasonable basis for making this allocation. For example, you must allocate your expenses if a hotel includes entertainment in its lounge on the same bill with your room charge.

Lavish or Extravagant Expenses

You cannot deduct expenses for entertainment that are lavish or extravagant. An expense is not considered lavish or extravagant if it is reasonable considering the facts and circumstances. Expenses will not be disallowed just because they are more than a fixed dollar amount or take place at deluxe restaurants, hotels, nightclubs, or resorts.

Allocating between Business and Nonbusiness

If you entertain business and nonbusiness individuals at the same event, you must divide your entertainment expenses between business and nonbusiness. You can deduct only the business part. If you cannot establish the part of the expense for each person participating, allocate the expense to each participant on a pro rata basis.

Trade Association Meetings

You can deduct entertainment expenses that are directly related to and necessary for attending business meetings or conventions of certain exempt organizations if the expenses of your attendance are related to your active trade or business. These organizations include business leagues, chambers of commerce, real estate boards, trade associations, and professional associations.

Entertainment Tickets

Generally, you cannot deduct more than the face value of an entertainment ticket, even if you paid a higher price. For example, you cannot deduct service fees you pay to ticket agencies or brokers or any amount over the face value of the tickets you pay to scalpers.

Exception for Events that Benefit Charitable Organizations

Different rules apply when the cost of a ticket to a sports event benefits a charitable organization. You can take into account the full cost you pay for the ticket, even if it is more than the face value, if all of the following conditions apply:

- The event's main purpose is to benefit a qualified charitable organization.
- The entire net proceeds go to the charity.
- The event uses volunteers to perform substantially all the event's work.

What Entertainment Expenses Are Not Deductible?

Club Dues and Membership Fees

You cannot deduct dues (including initiation fees) for membership in any club organized for:

- Business,
- Pleasure,
- Recreation, or
- Other social purpose.

This rule applies to any membership organization if one of its principal purposes is either:

- To conduct entertainment activities for members or their guests, or
- To provide members or their guests with access to entertainment facilities, discussed later.

The purposes and activities of a club, not its name, will determine whether or not you can deduct the dues. You cannot deduct dues paid to:

- Country clubs,
- Golf and athletic clubs,
- Airline clubs,
- Hotel clubs, and
- Clubs operated to provide meals under circumstances generally considered to be conducive to business discussions.

Entertainment Facilities

Generally, you cannot deduct any expense for the use of an entertainment facility. This includes expenses for depreciation and operating costs such as rent, utilities, maintenance, and protection.

An entertainment facility is any property you own, rent, or use for entertainment. Examples include a yacht, hunting lodge, fishing camp, swimming pool, tennis court, bowling alley, car, airplane, apartment, hotel suite, or home in a vacation resort.

Out-of-Pocket Expenses

You can deduct out-of-pocket expenses, such as for food and beverages, catering, gas, and fishing bait that you provided during entertainment at a facility. These are not expenses for the use of an entertainment facility. However, these expenses are subject to the directly-related and associated tests and to the 50% limit, all discussed earlier.

Expenses for Spouses

You generally cannot deduct the cost of entertainment for your spouse or for the spouse of a customer. However, you can deduct these costs if you can show that you had a clear business purpose, rather than a personal or social purpose, for providing the entertainment.

Example: You entertain a customer. The cost is an ordinary and necessary business expense and is allowed under the entertainment rules. The customer's spouse joins you because it is impractical to entertain the customer without the spouse. You can deduct the cost of entertaining the customer's spouse. If your spouse joins the party because the customer's spouse is present, the cost of the entertainment for your spouse is also deductible.

GIFTS

If you give gifts in the course of your trade or business, you can deduct all or part of the cost. The following information explains the limits and rules for deducting the costs of gifts. You can deduct no more than $25 for business gifts you give directly or indirectly to each person during your tax year. A gift to a company that is intended for the eventual personal use or benefit of a particular person or a limited class of people will be considered an indirect gift to that particular person or to the individuals within that class of people who receive the gift.

If you give a gift to a member of a customer's family, the gift is generally considered to be an indirect gift to the customer. This rule does not apply if you have a bona fide, independent business connection with that family member and the gift is not intended for the customer's eventual use.

If you and your spouse both give gifts, both of you are treated as one taxpayer. It does not matter whether you have separate businesses, are separately employed, or whether each of you has an independent connection with the recipient. If a partnership gives gifts, the partnership and the partners are treated as one taxpayer.

Incidental Costs

Incidental costs, such as engraving on jewelry, or packaging, insuring, and mailing, are generally not included in determining the cost of a gift for purposes of the $25 limit. A cost is incidental only if it does not add substantial value to the gift. For example, the cost of gift wrapping is an incidental cost. However, the purchase of an ornamental basket for packaging fruit is not an incidental cost if the value of the basket is substantial compared to the value of the fruit.

Exceptions

The following items are not considered gifts for purposes of the $25 limit:

- An item that costs $4 or less and:
    - Has your name clearly and permanently imprinted on the gift, and
    - Is one of a number of identical items you widely distribute. Examples include pens, desk sets, and plastic bags and cases.
- Signs, display racks, or other promotional material to be used on the business premises of the recipient.

Gift or Entertainment

Any item that might be considered either a gift or entertainment generally will be considered entertainment. However, if you give a customer packaged food or beverages that you intend the customer to use at a later date, treat it as a gift. If you give a customer tickets to a theater performance or sporting event and you do not go with the customer to the performance or event, you have a choice. You can treat the cost of the tickets as either a gift expense or an entertainment expense, whichever is to your advantage.

If you go with the customer to the event, you must treat the cost of the tickets as an entertainment expense. You cannot choose, in this case, to treat the cost of the tickets as a gift expense.

BUSINESS USE of CAR

If you use your car in your job or business and you use it only for that purpose, you may deduct its entire cost of operation. However, if you use the car for both business and personal purposes, you may deduct only the cost of its business use. Transportation expenses do not include expenses you have while traveling away from home overnight.

Transportation expenses include the ordinary and necessary costs of all of the following:

- Getting from one workplace to another in the course of your business or profession when you are traveling within the city or general area that is your tax home.
- Visiting clients or customers.
- Going to a business meeting away from your regular workplace.
- Getting from your home to a temporary workplace when you have one or more regular places of work. These temporary workplaces can be either within the area of your tax home or outside that area.

Parking Fees

Fees you pay to park your car at your place of business are nondeductible commuting expenses. You can, however, deduct business-related parking fees when visiting a customer or client.

Advertising Display on Car

Putting display material that advertises your business on your car does not change the use of your car from personal use to business use. If you use this car for commuting or other personal uses, you still cannot deduct your expenses for those uses.

Car Pools

You cannot deduct the cost of using your car in a nonprofit car pool. Do not include payments you receive from the passengers in your income. These payments are considered reimbursements of your expenses. However, if you operate a car pool for a profit, you must include payments from passengers in your income. You can then deduct your car expenses.

Car Expenses

If you use your car for business purposes, you ordinarily can deduct car expenses. You generally can use one of the two following methods to figure your deductible expenses.

- Standard mileage rate
- Actual car expenses

If you use actual expenses to figure your deduction for a car you lease, there are rules that affect the amount of your lease payments that you can deduct.

If you qualify to use both methods, you may want to figure your deduction both ways to see which gives you a larger deduction.

Actual car expenses include:

- Depreciation
- Licenses
- Gas
- Oil
- Tolls
- Lease payments
- Insurance
- Garage rental
- Parking fees
- Registration fees
- Repairs
- Tires

If you have fully depreciated a car that you still use in your business, you can continue to claim your other actual car expenses.

Business and Personal Use

If you use your car for both business and personal purposes, you must divide your expenses between business and personal use. You can divide your expense based on the miles driven for each purpose.

Example: You are a sales representative for a clothing firm and drive your car 20,000 miles during the year: 12,000 miles for business and 8,000 miles for personal use. You can claim only 60% (12,000 ÷ 20,000) of the cost of operating your car as a business expense.

Employer-Provided Vehicle

If you use a vehicle provided by your employer for business purposes, you can deduct your actual unreimbursed car expenses. You cannot use the standard mileage rate.

Interest on Car Loans

If you are an employee, you cannot deduct any interest paid on a car loan. This interest is treated as personal interest and is not deductible.

Taxes Paid on Your Car

If you are an employee, you can deduct personal property taxes paid on your car if you itemize deductions.

Fines and Collateral

You cannot deduct fines you pay or collateral you forfeit for traffic violations.

Casualty and Theft Losses

If your car is damaged, destroyed, or stolen, you may be able to deduct part of the loss that is not covered by insurance. See IRS Publication 547, *Casualties, Disasters, and Thefts*, for information on deducting a loss on your car.

Depreciation and Section 179 Deductions

Generally, the cost of a car, plus sales tax and improvements, is a capital expense. Because the benefits last longer than 1 year, you generally cannot deduct a capital expense. However, you can recover this cost through the section 179 deduction (the deduction allowed by section 179 of the Internal Revenue Code), special depreciation allowance, and depreciation deductions.

Depreciation allows you to recover the cost over more than 1 year by deducting part of it each year. Generally, there are limits on these deductions. Special rules apply if you use your car 50% or less in your work or business. You can claim a section 179 deduction and use a depreciation method other than straight line only if you do not use the standard mileage rate to figure your business-related car expenses in the year you first place a car in service.

If you claim either a section 179 deduction or use a depreciation method other than straight line in the year you first place a car in service, you cannot use the standard mileage rate on that car in any future year.

Depreciation Limits

There are limits on the amount you can deduct for depreciation of your car, truck, or van. The section 179 deduction and special depreciation allowance are treated as depreciation for purposes of the limits. The maximum amount you can deduct each year depends on the year you place the car in service. For example, if a car was placed in service in 2008/2009 the limit on the first year of section 179 depreciation is $10,960. If you chose not to expense out the costs of depreciation, you should use section 280F depreciation which just uses a standard rate. For section 280F depreciation, the first year limit is $2,960 on cars.

If the depreciation is for a truck or van, the limits are slightly higher. For example, the first year section 179 depreciation of a truck or van placed in service in 2008/2009 is $11,060. For section 280F depreciation, the limit is $3,060.

These limits vary based on year of service and how many years the depreciation is taken. For a full discussion on depreciation of a vehicle used for business purposes, see chapter 4 of IRS Publication 463.

Car Defined

For depreciation purposes, a car is any four-wheeled vehicle (including a truck or van) that is made primarily for use on public streets, roads, and highways. Its unloaded gross vehicle weight must not be more than 6,000 pounds. A car includes any part, component, or other item that is physically attached to it or is usually included in the purchase price.

A car does not include:

- An ambulance, hearse, or combination ambulance-hearse used directly in a business,
- A vehicle used directly in the business of transporting persons or property for pay or hire, or
- A truck or van that is a qualified nonpersonal use vehicle.

Qualified Nonpersonal Use Vehicles

These are vehicles that by their nature are not likely to be used more than a minimal amount for personal purposes. They include trucks and vans that have been specially modified so that they are not likely to be used more than a minimal amount for personal purposes, such as by installation of permanent shelving and painting the vehicle to display advertising or the company's name. Delivery trucks with seating only for the driver, or only for the driver plus a folding jump seat are qualified nonpersonal use vehicles.

Rural Mail Carriers

If you are a rural mail carrier, you may be able to treat the qualified reimbursement you received as your allowable business use of car expense. Because the qualified reimbursement is treated as paid under an accountable plan, your employer should not include the reimbursement in your income. If your vehicle expenses are more than the amount of your reimbursement, you can deduct the unreimbursed expenses as an itemized deduction on Schedule A. You must complete federal Form 2106 and attach it to your return.

If you are a rural mail carrier and received a qualified reimbursement, you cannot use the standard mileage rate.

Five or More Cars

If you own or lease five or more cars that are used for business at the same time, you cannot use the standard mileage rate for the business use of any car. However, you may be able to deduct your actual expenses for operating each of the cars in your business. You are not using five or more cars for business at the same time if you alternate using (use at different times) the cars for business.

Standard Mileage Rate

You may be able to use the standard mileage rate to figure the deductible costs of operating your car for business purposes. For 2009, the standard mileage rate for the cost of operating your car for business use is 55 cents per mile. The following table lists the standard mileage rate during a 16 year period.

Figure 6.3

YEAR	RATE (IN CENTS PER MILE)
1994	29.0
1995	30.0
1996	31.0
1997	31.5
1998	32.5
Jan-Mar 1999	32.5
Apr-Dec 1999	31.0
2000	32.5
2001	34.5
2002	36.5
2003	36.0
2004	37.5
Jan-Aug 2005	40.5
Sep-Dec 2005	48.5
2006	44.5
2007	48.5
Jan-June 2008	50.5
July-Dec 2008	58.5
2009	55.0
2010	50.0

If you use the standard mileage rate for a year, you cannot deduct your actual car expenses for that year. You cannot deduct depreciation, lease payments, maintenance and repairs, gasoline (including gasoline taxes), oil, insurance, or vehicle registration fees.

You generally can use the standard mileage rate whether or not you are reimbursed and whether or not any reimbursement is more or less than the amount figured using the standard mileage rate.

Choosing the Standard Mileage Rate

If you want to use the standard mileage rate for a car you own, you must choose to use it in the first year the car is available for use in your business. Then in later years, you can choose to use either the standard mileage rate or actual expenses. If you want to use the standard mileage rate for a car you lease, you must use it for the entire lease period.

You must make the choice to use the standard mileage rate by the due date (including extensions) of your return. You cannot revoke the choice. However, in later years, you can switch from the standard mileage rate to the actual expenses method. If you change to the actual expenses method in a later year, but before your car is fully depreciated, you have to estimate the remaining useful life of the car and use straight line depreciation.

You cannot use the standard mileage rate if you:

- Use the car for hire (such as a taxi),
- Use five or more cars at the same time (as in fleet operations),
- Claimed a depreciation deduction for the car using any method other than straight line,
- Claimed a section 179 deduction on the car,
- Claimed the special depreciation allowance on the car,
- Claimed actual car expenses after 1997 for a car you leased, or
- Are a rural mail carrier who received a qualified reimbursement.

To use the standard mileage rate, you must own or lease the car; the car must not be used to transport persons or property for compensation or hire, for example as a taxi. You can't operate five or more cars at the same time (fleet operation) and you must not have claimed a depreciation deduction using the Modified Accelerated Cost Recovery System (MACRS) on the car in an earlier year (including any additional first-year depreciation or "bonus depreciation" or any method other than straight-line for its estimated useful life; you must not have claimed a Section 179 deduction or the special depreciation allowance on the car. For further information on depreciation and how it effects deducting the business use of a car, see IRS Publication 463. You must not have claimed actual expenses after 1997 for a car you leased. You cannot use the standard mileage rate if you are a rural mail carrier who received a "qualified reimbursement".

Further, to use the standard mileage rate for a car you own, you must choose to use it in the first year the car is available for use in your business. Then, in later years, you can choose to use the standard mileage rate or actual expenses. However, for a car you lease, you must use the standard mileage rate method for the entire lease period (including renewals). To use the actual expense method, you must determine what it actually costs to operate the car for the portion of the overall use of the car that is business use. Include gas, oil, repairs, tires, insurance, registration fees, licenses, and depreciation (or lease payments) attributable to the portion of the total miles driven that are business miles.

HOME OFFICE

Whether you are self-employed or are an employee, you may be able to deduct certain expenses for the part of your home you use for business despite the general denial of business expense deductions for the home. To deduct expenses for business use of the home, part of your home must be used regularly and exclusively as one of the following:

- The principal place of business for your trade or business,
- The place where you meet and deal with your patients, clients, or customers in the normal course of your trade or business; or

- In connection with your trade or business, if you use a separate structure that is not attached to your home.

You cannot deduct business expenses for any part of your home that you use for both personal and business purposes. For example, if you are an attorney and use the den of your home to write legal briefs and also for personal purposes, you may not deduct any business-use-of-your-home expenses. Further, under the principal-place-of-business test, you must determine that your home is the principal place of your trade or business after considering where your most important activities are performed and most of your time is spent, in order to deduct expenses for the business use of your home.

Generally, you cannot deduct items such as mortgage interest and real estate taxes as business expenses. However, you may be able to deduct expenses related to the business use of part of your home if you meet specific requirements. Even then, your deduction may be limited.

To qualify to deduct expenses for business use of your home, you must use part of your home:

- Exclusively and regularly as your principal place of business,
- Exclusively and regularly as a place where you meet or deal with patients, clients, or customers in the normal course of your trade or business,
- In the case of a separate structure which is not attached to your home, in connection with your trade or business, on a regular basis for certain storage use. For rental use (see IRS Publication 527 for more information), or
- As a daycare facility.

If you are an employee and you use a part of your home for business, you may qualify for a deduction for its business use. You must meet the tests discussed above plus:

- Your business use must be for the convenience of your employer, and
- You must not rent any part of your home to your employer and use the rented portion to perform services as an employee for that employer.

If the use of the home office is merely appropriate and helpful, you cannot deduct expenses for the business use of your home. The chart on the following page visually outlines whether or not business use of your home is deductible.

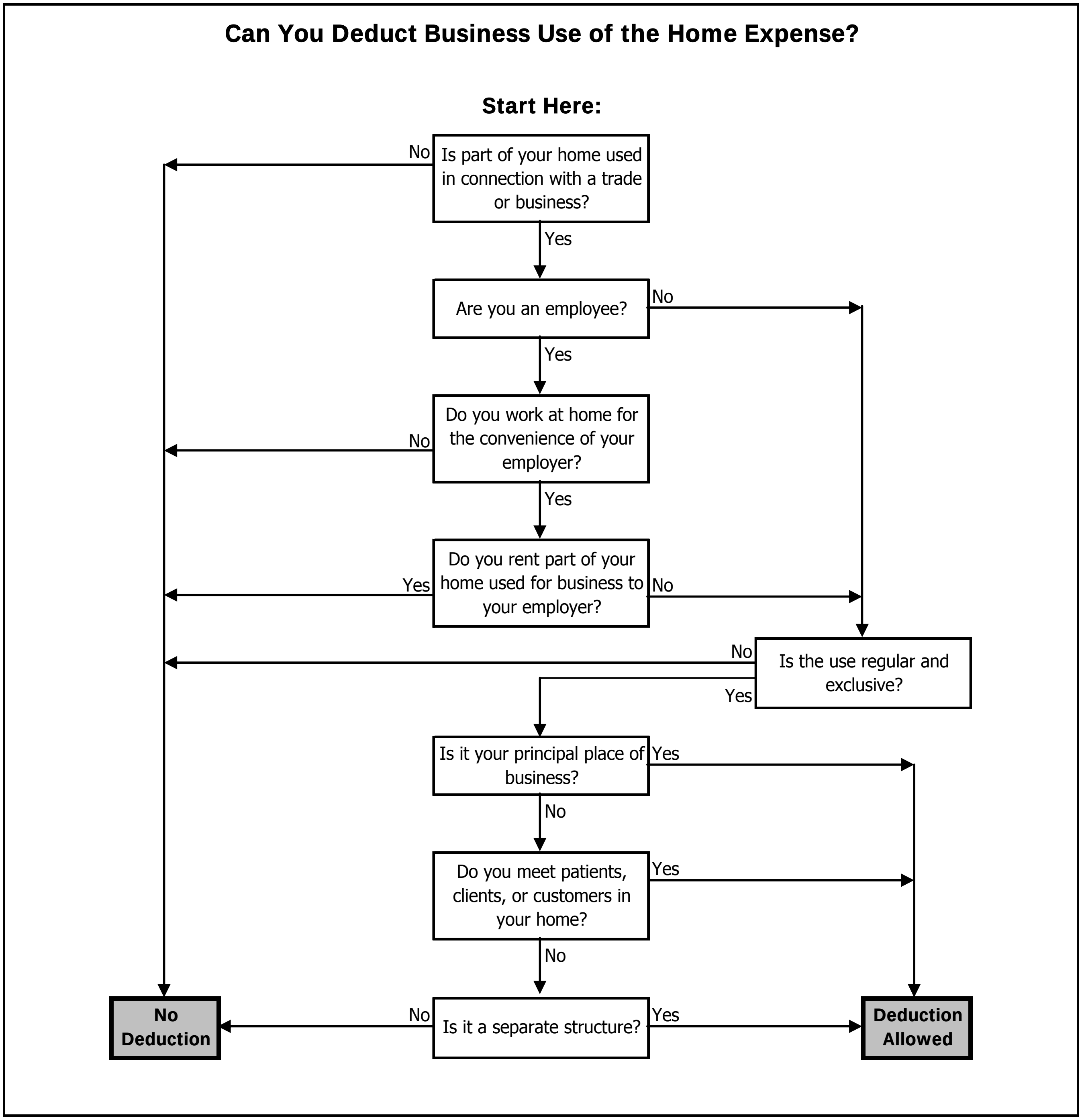
<u>Federal Form 8829</u>

Use federal Form 8829 to figure the allowable expenses for business use of your home on Schedule C (federal Form 1040) and any carryover to 2010 of amounts not deductible in 2009. When using this form, it is important to ensure that you qualify for the deduction based on the above information.

Part IV of federal Form 8829 is used to figure any allowable carryover of expenses that are more than the limit. You do not use federal Form 8829 in the following situations:

• You are claiming expenses for business use of your home as an employee or a partner, or you are claiming these expenses on Schedule F (federal Form 1040). Instead, complete the worksheet in IRS Publication 587
• All of the expenses for business use of your home are properly allocable to inventory costs. Instead, figure these expenses in Schedule C, Part III.

Figure 6.4


Can You Deduct Business Use of the Home Expense?
Start Here:
Is part of your home used in connection with a trade or business?
No
Yes
Are you an employee?
No
Yes
Do you work at home for the convenience of your employer?
No
Yes
Do you rent part of your home used for business to your employer?
Yes
No
Is the use regular and exclusive?
No
Yes
Is it your principal place of business?
Yes
No
Do you meet patients, clients, or customers in your home?
Yes
No
Is it a separate structure?
No
Yes
No Deduction
Deduction Allowed

Exclusive Use

To qualify under the exclusive use test, you must use a specific area of your home only for your trade or business. The area used for business can be a room or other separately identifiable space. The space does not need to be marked off by a permanent partition. You do not meet the requirements of the exclusive use test if you use the area in question both for business and for personal purposes.

Storage of Inventory or Product Samples

If you use part of your home for storage of inventory or product samples, you can deduct expenses for the business use of your home without meeting the exclusive use test. However, you must meet all the following tests:

- You sell products at wholesale or retail as your trade or business,
- You keep the inventory or product samples in your home for use in your trade or business,
- Your home is the only fixed location of your trade or business,
- You use the storage space on a regular basis, and
- The space you use is a separately identifiable space suitable for storage.

Example: Your home is the only fixed location of your business of selling mechanics' tools at retail. You regularly use half of your basement for storage of inventory and product samples. You sometimes use the area for personal purposes. The expenses for the storage space are deductible even though you do not use this part of your basement exclusively for business.

Regular Use

To qualify under the regular use test, you must use a specific area of your home for business on a regular basis. Incidental or occasional business use is not regular use. You must consider all facts and circumstances in determining whether your use is on a regular basis.

Trade or Business Use

To qualify under the trade-or-business-use-test, you must use part of your home in connection with a trade or business. If you use your home for a profit-seeking activity that is not a trade or business, you cannot take a deduction for its business use.

Principal Place of Business

You can have more than one business location, including your home, for a single trade or business. To qualify to deduct the expenses for the business use of your home under the principal place of business test, your home must be your principal place of business for that trade or business. To determine whether your home is your principal place of business, you must consider:

- The relative importance of the activities performed at each place where you conduct business, and
- The amount of time spent at each place where you conduct business.

Your home office will qualify as your principal place of business if you meet the following requirements:

- You use it exclusively and regularly for administrative or management activities of your trade or business, and
- You have no other fixed location where you conduct substantial administrative or management activities of your trade or business.

If, after considering your business locations, your home cannot be identified as your principal place of business, you cannot deduct home office expenses.

Note: As was discussed earlier in this chapter, if your home office qualifies as your principal place of business, you can deduct your daily transportation costs between your home and another work location in the same trade or business.

Deductible expenses for business use of your home include the business portion of real estate taxes, deductible mortgage interest, rent, casualty losses, utilities, insurance, depreciation, maintenance and repairs. You may not deduct expenses for lawn care in general or for painting a room not used for business.

When figuring the amount you can deduct for the business use of your home, you can use the entire amount of expenses attributable solely to the portion of the home used in your business. The amount you can deduct for expenses attributable to the whole house depends on the percentage of your home used for business. To figure this percentage, you may divide the number of square feet used for business by the total square feet in your home. Or, if the rooms are approximately the same size, divide the number of rooms used for business by the total number of rooms in your home. You figure the business portion of your expenses by applying this percentage to the total of each expense. If you are a qualified day-care provider who does not use any area exclusively for day care, your business portion is further limited by the ratio of the number of hours the area is used exclusively for business to the total number of hours the portion was available for any use.

If your gross income from the business use of your home is less than your total business expenses, your deduction for certain expenses for the business use of your home, other than mortgage interest, taxes, casualty losses, and the like is limited. However, those business expenses that cannot be deducted because of the gross income limitation can be carried forward to the next year but will be subject to the deduction limit for that year.

WORK RELATED EDUCATION EXPENSES

You may be able to deduct work–related educational expenses paid during the year as an itemized deduction. To be deductible, your expenses must be for education that (1) maintains or improves your job performance, or (2) is required by your employer or by law to keep your salary, status or job. Also, the education cannot part of a program that will qualify you for a new trade or business. Although the education must relate to your present work, educational expenses incurred during a temporary absence from your job may be deductible. However, after your temporary absence, you must return to the same kind of work. Usually, absence from work for one year or less is considered temporary.

What Expenses Can Be Deducted?

If your education meets the requirements described earlier you can generally deduct your education expenses as business expenses. If you are not self-employed, you can deduct business expenses only if you itemize your deductions. You cannot deduct expenses related to tax-exempt and excluded income.

Deductible Expenses

The following education expenses can be deducted:

- Tuition, books, supplies, lab fees, and similar items
- Certain transportation and travel costs
- Other education expenses, such as costs of research and typing when writing a paper as part of an educational program

Nondeductible Expenses

You cannot deduct personal or capital expenses. For example, you cannot deduct the dollar value of vacation time or annual leave you take to attend classes. This amount is a personal expense.

Unclaimed Reimbursement

If you do not claim reimbursement that you are entitled to receive from your employer, you cannot deduct the expenses that apply to the reimbursement.

Travel as Education

You cannot deduct the cost of travel that in itself constitutes a form of education. For example, a German teacher who travels to Germany to maintain general familiarity with the German language and culture cannot deduct the cost of the trip as an educational expense.

No Double Benefit Allowed

You cannot do either of the following:

- Deduct work-related education expenses as business expenses if you benefit from these expenses under any other provision of the law, for example, as a tuition and fees deduction.
- Deduct work-related education expenses paid with tax-free scholarship, grant, or employer-provided educational assistance.

Adjustments to Qualifying Work-Related Education Expenses

If you pay qualifying work-related education expenses with certain tax-free funds, you cannot claim a deduction for those amounts. You must reduce the qualifying expenses by the amount of any tax-free educational assistance you received.

This includes:

- The tax-free part of scholarships and fellowships,
- Pell grants,
- Employer-provided educational assistance,
- Veterans' educational assistance, and
- Any other nontaxable (tax-free) payments (other than gifts or inheritances) received as educational assistance.

Amounts that do not Reduce Qualifying Work-Related Education Expenses

Do not reduce the qualifying work-related education expenses by amounts paid with funds the student receives as:

- Payment for services, such as wages,
- A loan,

- A gift,
- An inheritance, or
- A withdrawal from the student's personal savings.

Also, do not reduce the qualifying work-related education expenses by any scholarship or fellowship reported as income on the student's return or any scholarship which, by its terms, cannot be applied to qualifying work-related education expenses.

How to Treat Reimbursements

How you treat reimbursements depends on the arrangement you have with your employer. There are two basic types of reimbursement arrangements—accountable plans and nonaccountable plans. You can tell the type of plan you are reimbursed under by the way the reimbursement is reported on your Form W-2.

Note: The following rules about reimbursement arrangements also apply to expense allowances received from your employer.

Accountable Plans

To be considered an accountable plan, your employer's reimbursement arrangement must require you to meet all three of the following rules:

- Your expenses must have a business connection—that is, your expenses must be deductible under the rules for qualifying work-related education explained earlier.
- You must adequately account to your employer for your expenses within a reasonable period of time.
- You must return any reimbursement or allowance in excess of the expenses accounted for within a reasonable period of time.

If you are reimbursed under an accountable plan, your employer should not include any reimbursement in your income in box 1 of your Form W-2.

If your employer included reimbursements in box 1 of your Form W-2 and you meet all three rules for accountable plans, ask your employer for a corrected Form W-2.

Accountable Plan Rules Not Met

Even though you are reimbursed under an accountable plan, some of your expenses may not meet all three rules for accountable plans. Those expenses that fail to meet the three rules are treated as having been reimbursed under a nonaccountable plan (discussed later).

Expenses Equal Reimbursement

Under an accountable plan, if your expenses equal your reimbursement, you do not complete Form 2106 or 2106-EZ. Because your expenses and reimbursements are equal, you do not have a deduction.

Excess Expenses

If your expenses are more than your reimbursement, you can deduct your excess expenses.

Allocating Your Reimbursements for Meals

Because your excess meal expenses are subject to the 50% limit, you must figure them separately from your other expenses. If your employer paid you a single amount to cover both meals and other expenses, you must allocate the reimbursement so that you can figure your excess meal expenses separately. Make the allocation as follows:

1. Divide your meal expenses by your total expenses.
2. Multiply your total reimbursement by the result from (1). This is the allocated reimbursement for your meal expenses.
3. Subtract the amount figured in (2) from your total reimbursement. The difference is the allocated reimbursement for your other expenses of qualifying work-related education.

Example: Your employer paid you an expense allowance of $2,000 under an accountable plan. The allowance was to cover all of your expenses of traveling away from home to take a 2-week training course for work. There was no indication of how much of the reimbursement was for each type of expense. Your actual expenses equal $2,500 ($425 for meals + $700 lodging + $150 transportation expenses + $1,225 for books and tuition).

Using the steps listed above; allocate the reimbursement between the $425 meal expenses and the $2,075 other expenses. Your excess meal expenses are $85 ($425 − $340) and your excess other expenses are $415 ($2,075 − $1,660). After you apply the 50% limit to your meals, you have a deduction for work-related education expenses of $458 [($85 × 50%) + $415].

Nonaccountable Plans

Your employer will combine the amount of any reimbursement or other expense allowance paid to you under a nonaccountable plan with your wages, salary, or other pay and report the total in box 1 of your Form W-2. You can deduct your expenses regardless of whether they are more than, less than, or equal to your reimbursement.

Reimbursements for Nondeductible Expenses

Reimbursements you received for nondeductible expenses are treated as paid under a nonaccountable plan. You must include them in your income. For example, you must include in your income reimbursements your employer gave you for expenses of education that:

- You need to meet the minimum educational requirements for your job, or
- Is part of a program of study that can qualify you for a new trade or business.

For more information on accountable and nonaccountable plans, see chapter 6 of IRS Publication 463.

UNION DUES and EXPENSES

You can deduct dues and initiation fees you pay for union membership. You can also deduct assessments for benefit payments to unemployed union members. However, you cannot deduct the part of the assessments or contributions that provides funds for the payment of sick, accident, or death benefits. Also, you cannot deduct contributions to a pension fund even if the union requires you to make the contributions.

WORK CLOTHES and UNIFORMS

You can deduct the cost and upkeep of work clothes if the following two requirements are met:

- You must wear them as a condition of your employment, and
- The clothes are not suitable for everyday wear.

It is not enough that you wear distinctive clothing. The clothing must be specifically required by your employer. Nor is it enough that you do not, in fact, wear your work clothes away from work. The clothing must not be suitable for taking the place of your regular clothing.

Examples of workers who may be able to deduct the cost and upkeep of work clothes are: delivery workers, firefighters, health care workers, law enforcement officers, letter carriers, professional athletes, and transportation workers (air, rail, bus, etc.).

Musicians and entertainers can deduct the cost of theatrical clothing and accessories that are not suitable for everyday wear. However, work clothing consisting of white cap, white shirt or white jacket, white bib overalls, and standard work shoes, which a painter is required by his union to wear on the job, is not distinctive in character or in the nature of a uniform. Similarly, the costs of buying and maintaining blue work clothes worn by a welder at the request of a foreman are not deductible.

Protective Clothing

You can deduct the cost of protective clothing required in your work, such as safety shoes or boots, safety glasses, hard hats, and work gloves. Examples of workers who may be required to wear safety items are: carpenters, cement workers, chemical workers, electricians, fishing boat crew members, machinists, oil field workers, pipe fitters, steamfitters, and truck drivers.

Military Uniforms

You generally cannot deduct the cost of your uniforms if you are on full-time active duty in the armed forces. However, if you are an armed forces reservist, you can deduct the unreimbursed cost of your uniform if military regulations restrict you from wearing it except while on duty as a reservist. In figuring the deduction, you must reduce the cost by any nontaxable allowance you receive for these expenses.

If local military rules do not allow you to wear fatigue uniforms when you are off duty, you can deduct the amount by which the cost of buying and keeping up these uniforms is more than the uniform allowance you receive. If you are a student at an armed forces academy, you cannot deduct the cost of your uniforms if they replace regular clothing. However, you can deduct the cost of insignia, shoulder boards, and related items. You can deduct the cost of your uniforms if you are a civilian faculty or staff member of a military school.

JOB SEARCH EXPENSES

You can deduct certain expenses you have in looking for a new job in your present occupation, even if you do not get a new job. You cannot deduct these expenses if:

- You are looking for a job in a new occupation,
- There was a substantial break between the ending of your last job and your looking for a new one, or
- You are looking for a job for the first time.

<u>Employment and Outplacement Agency Fees</u>

You can deduct employment and outplacement agency fees you pay in looking for a new job in your present occupation.

Employer Pays You Back

If, in a later year, your employer pays you back for employment agency fees, you must include the amount you receive in your gross income up to the amount of your tax benefit in the earlier year. See IRS Publication 525 for more information.

Employer Pays the Employment Agency

If your employer pays the fees directly to the employment agency and you are not responsible for them, you do not include them in your gross income.

Résumé

You can deduct amounts you spend for preparing and mailing copies of a résumé to prospective employers if you are looking for a new job in your present occupation.

Travel and Transportation Expenses

If you travel to an area and, while there, you look for a new job in your present occupation, you may be able to deduct travel expenses to and from the area. You can deduct the travel expenses if the trip is primarily to look for a new job. The amount of time you spend on personal activity compared to the amount of time you spend in looking for work is important in determining whether the trip is primarily personal or is primarily to look for a new job.

Even if you cannot deduct the travel expenses to and from an area, you can deduct the expenses of looking for a new job in your present occupation while in the area. You can choose to use the standard mileage rate to figure your car expenses. The 2009 rate for business use of a vehicle is 55 cents per mile. See the standard mileage rate chart in the previous chapter as well as IRS Publication 463 for more information on travel and car expenses.

SCHEDULE A
Form 740
42A740-A
Department of Revenue

KENTUCKY ITEMIZED DEDUCTIONS
➤ See instructions.
➤ Attach to Form 740.

2009

Enter name(s) as shown on Form 740, page 1. | Your Social Security Number

Medical and Dental Expenses	**Do not include expenses reimbursed or paid by others.**		
	1. Medical and dental expenses 1		
	2. Enter 7.5% (.075) of the amount from Form 740, line 9 2		
	3. **Total medical and dental.** Subtract line 2 from line 1. If zero or less, enter -0- .... ➤ 3		00
Taxes	4. Local income taxes (do not include state income tax) 4		
	5. Real estate taxes 5		
Note: Sales and use taxes and new motor vehicle taxes are not deductible.	6. Personal property taxes 6		
	7. Other taxes (list) ____ 7		
	8. **Total taxes.** Add lines 4 through 7. Enter here .... ➤ 8		00
Interest Expense	9. Home mortgage interest and points reported to you on federal Form 1098 9		
Note: Personal interest is not deductible.	10. Home mortgage interest not reported to you on federal Form 1098 (if paid to an individual, show that person's name, identifying number and address) ____ 10		
	See instructions for lines 11 and 12.		
	11. Points not reported to you on federal Form 1098 11		
	12. Qualified mortgage insurance premiums 12		
	13. Investment interest (attach federal Form 4952 if required) 13		
	14. **Total interest.** Add lines 9 through 13. Enter here .... ➤ 14		00
Contributions	15. Contributions by cash or check 15		
Note: For any contribution of $250 or more, see instructions.	16. Other than cash or check (attach federal Form 8283 if over $500) 16		
	17. Artistic charitable contributions deduction (attach copy of appraisal) 17		
	18. Carryover from prior year 18		
	19. **Total contributions.** Add lines 15 through 18. Enter here .... ➤ 19		00
Casualty and Theft Losses	20. Enter amount from attached federal Form 4684, Section A, line 16 20		
	21. Enter 10% (.10) of the amount from Form 740, line 9 21		
	22. **Total casualty or theft loss(es).** Subtract line 21 from line 20. If zero or less, enter -0- .... ➤ 22		00
Job Expenses and Most Other Miscellaneous Deductions	23. Unreimbursed employee expenses—job travel, union dues, job education, etc. (attach Form 2106 or 2106-EZ if applicable) list ____ 23		
	24. Tax preparation fees 24		
	25. Other (investment, safe deposit box, etc.) list ____ 25		
	26. Add the amounts on lines 23, 24 and 25. Enter here 26		
	27. Enter 2% (.02) of the amount from Form 740, line 9 27		
	28. **Total.** Subtract line 27 from line 26. If zero or less, enter -0- .... ➤ 28		00
Other Miscellaneous Deductions	29. Other (see instructions) .... ➤ 29		00
Total Itemized Deductions	30. Add lines 3, 8, 14, 19, 22, 28 and 29. Enter here .... ➤ 30		00

★ If single or married filing jointly and your income for Form 740, Column B does not exceed $166,800, enter total itemized deductions on Form 740, line 10, Column B.
★ All others go to page 2.

You can deduct certain expenses as miscellaneous itemized deductions on Schedule A. Just like the unreimbursed job expenses, you can claim the amount of expenses that are more than 2% of your adjusted gross income. You figure your deduction on Schedule A by subtracting 2% of your adjusted gross income from the total amount of these expenses.

Generally, you apply the 2% limit after you apply any other deduction limit. For example, you apply the 50% (or 80%) limit on business-related meals and entertainment (discussed earlier in the unreimbursed job expenses chapter) before you apply the 2% limit.

TAX PREPARATION FEES

You can usually deduct tax preparation fees in the year you pay them. For example, on your 2009 return, you can deduct fees paid in 2009 for preparing your 2008 return. These fees include the cost of tax preparation software programs and tax publications. They also include any fee you paid for electronic filing of your return.

OTHER EXPENSES

You can deduct certain other expenses as miscellaneous itemized deductions subject to the 2%-of-adjusted-gross-income limit. On Schedule A, you can deduct expenses that you pay:

1. To produce or collect income that must be included in your gross income,
2. To manage, conserve, or maintain property held for producing such income, or
3. To determine, contest, pay, or claim a refund of any tax.

You can deduct expenses you pay for the purposes in (1) and (2) above only if they are reasonable and closely related to these purposes. These other expenses include the following items:

- Appraisal fees for a casualty loss or charitable contribution
- Casualty and theft losses from property used in performing services as an employee
- Clerical help and office rent in caring for investments
- Depreciation on home computers used for investments
- Excess deductions (including administrative expenses) allowed a beneficiary on termination of an estate or trust
- Fees to collect interest and dividends
- Hobby expenses, but generally not more than hobby income
- Indirect miscellaneous deductions of pass-through entities
- Investment fees and expenses
- Legal fees related to producing or collecting taxable income or getting tax advice

- Loss on deposits in an insolvent or bankrupt financial institution
- Loss on traditional IRAs or Roth IRAs, when all amounts have been distributed to you
- Repayments of income
- Repayments of social security benefits
- Safe deposit box rental
- Service charges on dividend reinvestment plans
- Tax advice fees
- Trustee's fees for your IRA, if separately billed and paid

Appraisal Fees

You can deduct appraisal fees if you pay them to figure a casualty loss or the fair market value of donated property.

Clerical Help and Office Rent

You can deduct office expenses, such as rent and clerical help, which you have in connection with your investments and collecting the taxable income on them.

Credit or Debit Card Convenience Fees

You can deduct the convenience fee charged by the card processor for paying your income tax (including estimated tax payments) by credit or debit card. The fees are deductible in the year paid. For example, fees charged to payments made in 2009 can be claimed on the 2009 tax return.

Hobby Expenses

You can generally deduct hobby expenses, but only up to the amount of hobby income. A hobby is not a business because it is not carried on to make a profit.

Investment Fees and Expenses

You can deduct investment fees, custodial fees, trust administration fees, and other expenses you paid for managing your investments that produce taxable income.

Legal Expenses

You can usually deduct legal expenses that you incur in attempting to produce or collect taxable income or that you pay in connection with the determination, collection, or refund of any tax. You can also deduct legal expenses that are:

- Related to either doing or keeping your job, such as those you paid to defend yourself against criminal charges arising out of your trade or business,
- For tax advice related to a divorce if the bill specifies how much is for tax advice and it is determined in a reasonable way, or
- To collect taxable alimony.

Loss on Deposits

If you can reasonably estimate the amount of your loss on money you have on deposit in a financial institution that becomes insolvent or bankrupt, you can generally choose to deduct it in the current year even though its exact amount has not been finally determined. Once you make this choice, you cannot change it without IRS approval.
If none of the deposit is federally insured, you can deduct the loss in either of the following ways:

- As a miscellaneous itemized deduction subject to the 2% limit. Write the name of the financial institution and "Insolvent Financial Institution" beside the amount on Schedule A, line 23, or Schedule A (federal Form 1040NR), line 11. This deduction is limited to $20,000 ($10,000 if you are married filing separately) for each financial institution, reduced by any expected state insurance proceeds, or
- As a casualty loss. See the "Casualty and Theft Losses" chapter earlier in this manual.

If any part of the deposit is federally insured, you can deduct the loss only as a casualty loss. You cannot make this choice if you are a 1%-or-more-owner or an officer of the financial institution, or are related to such owner or officer. For a definition of "related," see *Deposit in Insolvent or Bankrupt Financial Institution* in chapter 4 of IRS Publication 550.

Actual Loss Different from Estimated Loss

If you make this choice and your actual loss is less than your estimated loss, you must include the excess in income. See *Recoveries* in IRS Publication 525. If your actual loss is more than your estimated loss, treat the excess loss as explained under the *Choice not made* rule.

Choice Not Made Rule

If you do not make this choice (or if you have an excess actual loss after choosing to deduct your estimated loss), treat your loss (or excess loss) as a nonbusiness bad debt (deductible as a short-term capital loss) in the year its amount is finally determined. See *Nonbusiness Bad Debts* in chapter 4 of IRS Publication 550.

Loss on IRA

If you have a loss on your traditional IRA (or Roth IRA) investment, you can deduct the loss as a miscellaneous itemized deduction subject to the 2% limit, but only when all the amounts in all your traditional IRA (or Roth IRA) accounts have been distributed to you and the total distributions are less than your unrecovered basis. For more information, see IRS Publication 590, *Individual Retirement Arrangements* (IRAs).

Repayments of Income

If you had to repay an amount that you included in income in an earlier year, you may be able to deduct the amount you repaid. If the amount you had to repay was ordinary income of $3,000 or less, the deduction is subject to the 2% limit. If it was more than $3,000, you can establish a claim of right, discussed later in this chapter.

Repayments of Social Security Benefits

If the total of the amounts in box 5 (net benefits for 2009) of all your Forms SSA-1099, Social Security Benefit Statement, and Forms RRB-1099, Payments By the Railroad Retirement Board, is a negative figure (a figure in parentheses), you may be able to take a miscellaneous itemized deduction subject to the 2% limit. The amount you can deduct is the part of the negative figure that represents an amount you included in gross income in an earlier year.

The amount in box 5 of Form SSA-1099 or RRB-1099 is the net amount of your benefits for the year. It will be a negative figure if the amount of benefits you repaid in 2009 (box 4) is more than the gross amount of benefits paid to you in 2009 (box 3).

Note: If the deduction is more than $3,000, you will have to use a special computation to figure your tax. See IRS Publication 915, *Social Security and Equivalent Railroad Retirement Benefits*, for additional information.

Safety Deposit Box Rent

You can deduct safety deposit box rent if you use the box to store taxable income-producing stocks, bonds, or investment-related papers and documents. You cannot deduct the rent if you use the box only for jewelry, other personal items, or tax-exempt securities.

OTHER MISCELLANEOUS ITEMIZED DEDUCTIONS

Deductions Not Subject to the 2% Limit

You can deduct the items listed below as miscellaneous itemized deductions. They are not subject to the 2% limit.

List of Deductions

- Amortizable premium on taxable bonds
- Casualty and theft losses from income-producing property
- Federal estate tax on income in respect of a decedent
- Gambling losses up to the amount of gambling winnings
- Impairment-related work expenses of persons with disabilities
- Losses from Ponzi-type investment schemes
- Repayments of more than $3,000 under a claim of right
- Unrecovered investment in an annuity

Amortizable Premium on Taxable Bonds

In general, if the amount you pay for a bond is greater than its stated principal amount, the excess is bond premium. You can elect to amortize the premium on taxable bonds. The amortization of the premium is generally an offset to interest income on the bond rather than a separate deduction item.

<u>Pre-1998 Election to Amortize Bond Premium</u>

Generally, if you first elected to amortize bond premium before 1998, the above treatment of the premium does not apply to bonds you acquired before 1988.

<u>Bonds Acquired after October 22, 1986, and before 1988</u>

The amortization of the premium on these bonds is investment interest expense subject to the investment interest limit, unless you chose to treat it as an offset to interest income on the bond.

Bonds acquired before October 23, 1986

The amortization of the premium on these bonds is a miscellaneous itemized deduction not subject to the 2% limit.

Deduction for Excess Premium

On certain bonds (such as bonds that pay a variable rate of interest or that provide for an interest-free period), the amount of bond premium allocable to a period may exceed the amount of stated interest allocable to the period. If this occurs, treat the excess as a miscellaneous itemized deduction that is not subject to the 2% limit.

However, the amount deductible is limited to the amount by which your total interest inclusions on the bond in prior periods exceed the total amount you treated as a bond premium deduction on the bond in prior periods. If any of the excess bond premium cannot be deducted because of the limit, this amount is carried forward to the next period and is treated as bond premium allocable to that period.

Federal Estate Tax on Income in Respect of a Decedent

You can deduct the federal estate tax attributable to income in respect of a decedent that you as a beneficiary include in your gross income. Income in respect of the decedent is gross income that the decedent would have received had death not occurred and that was not properly includible in the decedent's final income tax return. See IRS Publication 559 for information about figuring the amount of this deduction.

Gambling Losses Up to the Amount of Gambling Winnings

You must report the full amount of your gambling winnings for the year on federal Form 1040, line 21; for Kentucky purposes, this income will be included as your Federal Adjusted Gross Income. You deduct your gambling losses for the year on Schedule A line 29. You cannot deduct gambling losses that are more than your winnings.

Note: A credit for tax paid to another state on gambling income may be allowed if the income is taxed by both Kentucky and the other state. However, if you have paid tax on gambling income in another state and you claimed an itemized deduction on your Schedule A for losses, the allowable credit may be reduced or eliminated.

You cannot reduce your gambling winnings by your gambling losses and report the difference. You must report the full amount of your winnings as income and claim your losses (up to the amount of winnings) as an itemized deduction. Therefore, your records should show your winnings separately from your losses.

Diary of Winnings and Losses

You must keep an accurate diary or similar record of your losses and winnings. Your diary should contain at least the following information:

- The date and type of your specific wager or wagering activity
- The name and address or location of the gambling establishment
- The names of other persons present with you at the gambling establishment
- The amount(s) you won or lost

Proof of Winnings and Losses

In addition to your diary, you should also have other documentation. You can generally prove your winnings and losses through Form W-2G, Certain Gambling Winnings, federal Form 5754, Statement by Person(s) Receiving Gambling Winnings, wagering tickets, canceled checks, substitute checks, credit records, bank withdrawals, and statements of actual winnings or payment slips provided to you by the gambling establishment.

For specific wagering transactions, you can use the following items to support your winnings and losses. It should be noted that these recordkeeping suggestions are intended as general guidelines to help you establish your winnings and losses. They are not all-inclusive. Your tax liability depends on your particular facts and circumstances.

Keno

Copies of the keno tickets you purchased that were validated by the gambling establishment, copies of your casino credit records, and copies of your casino check cashing records.

Slot machines

A record of the machine number and all winnings by date and time the machine was played.

Table games

The number of the table at which you were playing. Casino credit card data indicating whether the credit was issued in the pit or at the cashier's cage.

Bingo

A record of the number of games played, cost of tickets purchased, and amounts collected on winning tickets. Supplemental records include any receipts from the casino, parlor, etc.

Racing (horse, harness, dog, etc.)

A record of the races, amounts of wagers, amounts collected on winning tickets, and amounts lost on losing tickets. Supplemental records include unredeemed tickets and payment records from the racetrack.

Lotteries

A record of ticket purchases, dates, winnings, and losses. Supplemental records include unredeemed tickets, payment slips, and winnings statements.

Impairment-Related Work Expenses

If you have a physical or mental disability that limits your being employed, or substantially limits one or more of your major life activities, such as performing manual tasks, walking, speaking, breathing, learning, and working, you can deduct your impairment-related work expenses.

Impairment-related work expenses are ordinary and necessary business expenses for attendant care services at your place of work and other expenses in connection with your place of work that are necessary for you to be able to work.

Example: You are blind. You must use a reader to do your work. You use the reader both during your regular working hours at your place of work and outside your regular working hours away from your place of work. The reader's services are only for your work. You can deduct your expenses for the reader as impairment-related work expenses.

Officials Paid on a Fee Basis

If you are a fee-basis official, you can claim your expenses in performing services in that job as an adjustment to income rather than as a miscellaneous itemized deduction. See IRS Publication 463 for more information.

Performing Artists

If you are a qualified performing artist, you can deduct your employee business expenses as an adjustment to income rather than as a miscellaneous itemized deduction. If you are an employee, complete federal Form 2106 or federal Form 2106-EZ. See IRS Publication 463 for more information.

Repayments under Claim of Right

If you had to repay more than $3,000 that you included in your income in an earlier year because at the time you thought you had an unrestricted right to it, you may be able to deduct the amount you repaid, or take a credit against your tax. See *Repayments* in IRS Publication 525 for more information. For Kentucky purposes, you can claim the deduction not subject to the 2% limitation on Miscellaneous Deductions or claim a tax credit on the estimated tax line for the difference caused by the added income on the previous year.

Unrecovered Investment in Annuity

A retiree who contributed to the cost of an annuity can exclude from income a part of each payment received as a tax-free return of the retiree's investment. If the retiree dies before the entire investment is recovered tax free, any unrecovered investment can be deducted on the retiree's final income tax return. See IRS Publication 575, *Pension and Annuity Income*, for more information about the tax treatment of pensions and annuities.

NONDEDUCTIBLE EXPENSES

You cannot deduct the following expenses:

- Adoption expenses
- Broker's commissions that you paid in connection with your IRA or other investment property
- Burial or funeral expenses, including the cost of a cemetery lot
- Campaign expenses
- Capital expenses
- Check-writing fees
- Club dues
- Commuting expenses
- Fees and licenses, such as car licenses, marriage licenses, and dog tags
- Fines and penalties, such as parking tickets
- Health spa expenses
- Hobby losses—but see "Hobby expenses," earlier
- Home repairs, insurance, and rent
- Home security system
- Illegal bribes and kickbacks—see *Bribes and kickbacks* in chapter 11 of IRS Publication 535
- Investment-related seminars

- Life insurance premiums
- Lobbying expenses
- Losses from the sale of your home, furniture, personal car, etc
- Lost or misplaced cash or property
- Lunches with co-workers
- Meals while working late
- Medical expenses as business expenses
- Personal disability insurance premiums
- Personal legal expenses
- Personal, living, or family expenses
- Political contributions
- Professional accreditation fees
- Professional reputation, expenses to improve
- Relief fund contributions
- Residential telephone line
- Stockholders' meeting, expenses of attending
- Tax-exempt income, expenses of earning or collecting
- The value of wages never received or lost vacation time
- Travel expenses for another individual
- Voluntary unemployment benefit fund contributions
- Wristwatches

Adoption Expenses

You cannot deduct the expenses of adopting a child but you may be able to take a credit for those expenses. For details, see federal Form 8839, Qualified Adoption Expenses.

Campaign Expenses

You cannot deduct campaign expenses of a candidate for any office, even if the candidate is running for reelection to the office. These include qualification and registration fees for primary elections.

Legal fees

You cannot deduct legal fees paid to defend charges that arise from participation in a political campaign.

Capital Expenses

You cannot currently deduct amounts paid to buy property that has a useful life substantially beyond the tax year or amounts paid to increase the value or prolong the life of property. If you use such property in your work, you may be able to take a depreciation deduction. See IRS Publication 946. If the property is a car used in your work, also see IRS Publication 463.

Check-Writing Fees on Personal Account

If you have a personal checking account, you cannot deduct fees charged by the bank for the privilege of writing checks, even if the account pays interest.

Club Dues

Generally, you cannot deduct the cost of membership in any club organized for business, pleasure, recreation, or other social purpose. This includes business, social, athletic, luncheon, sporting, airline, hotel, golf, and country clubs. You cannot deduct dues paid to an organization if one of its main purposes is to:

- Conduct entertainment activities for members or their guests, or
- Provide members or their guests with access to entertainment facilities.

Dues paid to airline, hotel, and luncheon clubs are not deductible.

Commuting Expenses

You cannot deduct commuting expenses (the cost of transportation between your home and your main or regular place of work). If you haul tools, instruments, or other items in your car to and from work, you can deduct only the additional cost of hauling the items, such as the rent on a trailer to carry the items.

Fines or Penalties

You cannot deduct fines or penalties you pay to a governmental unit for violating a law. This includes an amount paid in settlement of your actual or potential liability for a fine or penalty (civil or criminal). Fines or penalties include parking tickets, tax penalties, and penalties deducted from teachers' paychecks after an illegal strike.

Health Spa Expenses

You cannot deduct health spa expenses, even if there is a job requirement to stay in excellent physical condition, such as might be required of a law enforcement officer.

Home Security System

You cannot deduct the cost of a home security system as a miscellaneous deduction. However, you may be able to claim a deduction for a home security system as a business expense if you have a home office. See *Home Office* under *Unreimbursed Employee Expenses,* IRS Publication 587.

Investment-Related Seminars

You cannot deduct any expenses for attending a convention, seminar, or similar meeting for investment purposes.

Life Insurance Premiums

You cannot deduct premiums you pay on your life insurance. You may be able to deduct, as alimony, premiums you pay on life insurance policies assigned to your former spouse. See IRS Publication 504, *Divorced or Separated Individuals*, for information on alimony.

Lobbying Expenses

You generally cannot deduct amounts paid or incurred for lobbying expenses. These include expenses to:

1. Influence legislation,
2. Participate, or intervene, in any political campaign for, or against, any candidate for public office,
3. Attempt to influence the general public, or segments of the public, about elections, legislative matters, or referendums, or
4. Communicate directly with covered executive branch officials in any attempt to influence the official actions or positions of those officials.

Lobbying expenses also include any amounts paid or incurred for research, preparation or coordination of any of these activities.

Covered Executive Branch Official

A covered executive branch official, for the purpose of (4) above, is any of the following officials:

- The President
- The Vice President
- Any officer or employee of the White House Office of the Executive Office of the President, and the two most senior level officers of each of the other agencies in the Executive Office
- Any individual serving in a position in Level I of the Executive Schedule under section 5312 of Title 5, United States Code, any other individual designated by

the President as having Cabinet-level status, and any immediate deputy of one of these individuals

Dues Used for Lobbying

If a tax-exempt organization notifies you that part of the dues or other amounts you pay to the organization are used to pay nondeductible lobbying expenses, you cannot deduct that part.

Exceptions

You can deduct certain lobbying expenses if they are ordinary and necessary expenses of carrying on your trade or business.

- You can deduct expenses for attempting to influence the legislation of any local council or similar governing body (local legislation). An Indian tribal government is considered a local council or similar governing body.
- You can deduct in-house expenses for influencing legislation or communicating directly with a covered executive branch official if the expenses for the tax year are not more than $2,000 (not counting overhead expenses).
- If you are a professional lobbyist, you can deduct the expenses you incur in the trade or business of lobbying on behalf of another person. Payments by the other person to you for lobbying activities cannot be deducted.

Lost or Mislaid Cash or Property

You cannot deduct a loss based on the mere disappearance of money or property. However, an accidental loss or disappearance of property can qualify as a casualty if it results from an identifiable event that is sudden, unexpected, or unusual. See IRS Publication 547.

Lunches with Co-Workers

You cannot deduct the expenses of lunches with co-workers, except while traveling away from home on business. See IRS Publication 463 for information on deductible expenses while traveling away from home.

Meals While Working Late

You cannot deduct the cost of meals while working late. However, you may be able to claim a deduction if the cost of the meals is a deductible entertainment expense, or if you are traveling away from home. See IRS Publication 463 for information on deductible entertainment expenses and expenses while traveling away from home.

Personal Legal Expenses

You cannot deduct personal legal expenses such as those for the following:

- Custody of children
- Breach of promise to marry suit
- Civil or criminal charges resulting from a personal relationship
- Damages for personal injury (except certain whistleblower claims and unlawful discrimination claims), for more information about unlawful discrimination claims, see "Deductions Subject to the 2% Limit," earlier
- Preparation of a title (or defense or perfection of a title)
- Preparation of a will
- Property claims or property settlement in a divorce

You cannot deduct these expenses even if a result of the legal proceeding is the loss of income-producing property.

Political Contributions

You cannot deduct contributions made to a political candidate, a campaign committee, or a newsletter fund. Advertisements in convention bulletins and admissions to dinners or programs that benefit a political party or political candidate are not deductible.

Professional Accreditation Fees

You cannot deduct professional accreditation fees such as the following:

- Accounting certificate fees paid for the initial right to practice accounting
- Bar exam fees and incidental expenses in securing initial admission to the bar
- Medical and dental license fees paid to get initial licensing

Professional Reputation

You cannot deduct expenses of radio and TV appearances to increase your personal prestige or establish your professional reputation.

Relief Fund Contributions

You cannot deduct contributions paid to a private plan that pays benefits to any covered employee who cannot work because of any injury or illness not related to the job.

Residential Telephone Service

You cannot deduct any charge (including taxes) for basic local telephone service for the first telephone line to your residence, even if it is used in a trade or business.

Stockholders' Meetings

You cannot deduct transportation and other expenses you pay to attend stockholders' meetings of companies in which you own stock but have no other interest. You cannot deduct these expenses even if you are attending the meeting to get information that would be useful in making further investments.

Tax-Exempt Income Expenses

You cannot deduct expenses to produce tax-exempt income. You cannot deduct interest on a debt incurred or continued to buy or carry tax-exempt securities.
If you have expenses to produce both taxable and tax-exempt income, but you cannot identify the expenses that produce each type of income, you must divide the expenses based on the amount of each type of income to determine the amount that you can deduct.

Example: During the year, you received taxable interest of $4,800 and tax-exempt interest of $1,200. In earning this income, you had total expenses of $500 during the year. You cannot identify the amount of each expense item that is for each income item. Therefore, 80% ($4,800/$6,000) of the expense is for the taxable interest and 20% ($1,200/$6,000) is for the tax-exempt interest. You can deduct, subject to the 2% limit, expenses of $400 (80% of $500).

Travel Expenses for another Individual

You generally cannot deduct travel expenses you pay or incur for a spouse, dependent, or other individual who accompanies you (or your employee) on personal or business travel. See IRS Publication 463 for more information on deductible travel expenses.

Voluntary Unemployment Benefit Fund Contributions

You cannot deduct voluntary unemployment benefit fund contributions you make to a union fund or a private fund. However, you can deduct contributions as taxes if state law requires you to make them to a state unemployment fund that covers you for the loss of wages from unemployment caused by business conditions.

Wristwatches

You cannot deduct the cost of a wristwatch, even if there is a job requirement that you know the correct time to properly perform your duties

DIVIDING DEDUCTIONS between SPOUSES

Only one Schedule A is required to be completed even if spouses are filing separate returns or separately on combined returns, however a copy of that Schedule A must be attached to both spouse's return. The total deductions are prorated based on each spouse's portion of their Kentucky Adjusted Gross Income. A worksheet is provided on page 2 of the Schedule A for this calculation.

Example: A husband and wife have a Kentucky Adjusted Gross Income of $60,000. The wife's portion of the income is $40,000 while the husband's portion is $20,000. The following computation shows how the spouses will divide their total itemized deductions of $7,000.

Wife's Deduction	$40,000 / $60,000	=	66.7% **X** $7,000	=	**$4,669**
Husband's Deduction	$20,000 / $60,000	=	33.3% **X** $7,000	=	**$2,331**

This is the calculation that is done on page 2 of the Schedule A. On that worksheet, this example would look like this:

PART I—DIVIDING DEDUCTIONS BETWEEN SPOUSES

Use this schedule if married filing separately on a combined return.

1.	Total itemized deductions from page 1, line 30	7000
2.	Percent of income (Form 740, line 9, Column A) to total income (Form 740, total of line 9, Columns A and B)	66.70 %
3.	Percent of income (Form 740, line 9, Column B) to total income (Form 740, total of line 9, Columns A and B)	33.30 %
4.	Percent on line 2 times total deductions entered on line 1 (enter here and on Form 740, line 10, Column A)	4,669
5.	Percent on line 3 times total deductions entered on line 1 (enter here and on Form 740, line 10, Column B)	2,331

LIMIT on SCHEDULE A DEDUCTIONS BASED on INCOME

Taxpayers who have an Adjusted Gross Income of greater than $166,800 (for joint or single filers) or $83,400 (for separately on a combined return or separate returns filers) are subject to a limit on their itemized deductions. To calculate this limitation, those taxpayers must complete Part II of the Schedule A found on page 2.

Filing Status Impact on Itemized Deductions

If one spouse itemizes deductions, the other must also itemize; this even applies to taxpayers who are filing separate returns. Filing status should always be considered when a taxpayer chooses to itemize their deductions. As shown in the example below, when filing separately and itemizing, the apportionment of the deductions to each taxpayer can have an impact on how much total deductions are allowed.

Example: Mr. and Mrs. Hamilton itemized their deductions for 2009. Their total itemized deductions amount to $27,300 and their Kentucky Adjusted Gross Incomes are $40,000 for one spouse and $90,000 for the other. The following is a copy of their Schedule A, including the limitation schedule.

SCHEDULE A
Form 740
42A740-A
Department of Revenue

KENTUCKY ITEMIZED DEDUCTIONS
➤ See instructions.
➤ Attach to Form 740.

2009

Enter name(s) as shown on Form 740, page 1. | Your Social Security Number

Section	Line	Line no.	Amount		Total	
Medical and Dental Expenses	**Do not include expenses reimbursed or paid by others.**					
	1. Medical and dental expenses	1	4,000	00		
	2. Enter 7.5% (.075) of the amount from Form 740, line 9	2	9,750	00		
	3. **Total medical and dental.** Subtract line 2 from line 1. If zero or less, enter -0-	➤ 3				00
Taxes *Note: Sales and use taxes and new motor vehicle taxes are not deductible.*	4. Local income taxes (do not include state income tax)	4	2,800	00		
	5. Real estate taxes	5	3,500	00		
	6. Personal property taxes	6	1,500	00		
	7. Other taxes (list)	7		00		
	8. **Total taxes.** Add lines 4 through 7. Enter here	➤ 8			7,800	00
Interest Expense *Note: Personal interest is not deductible.*	9. Home mortgage interest and points reported to you on federal Form 1098	9	12,000	00		
	10. Home mortgage interest not reported to you on federal Form 1098 (if paid to an individual, show that person's name, identifying number and address)	10		00		
	See instructions for lines 11 and 12.					
	11. Points not reported to you on federal Form 1098	11		00		
	12. Qualified mortgage insurance premiums	12		00		
	13. Investment interest (attach federal Form 4952 if required)	13		00		
	14. **Total interest.** Add lines 9 through 13. Enter here	➤ 14			12,000	00
Contributions *Note: For any contribution of $250 or more, see instructions.*	15. Contributions by cash or check	15	4,000	00		
	16. Other than cash or check (attach federal Form 8283 if over $500)	16	300	00		
	17. Artistic charitable contributions deduction (attach copy of appraisal)	17		00		
	18. Carryover from prior year	18		00		
	19. **Total contributions.** Add lines 15 through 18. Enter here	➤ 19			4,300	00
Casualty and Theft Losses	20. Enter amount from attached federal Form 4684, Section A, line 16	20		00		
	21. Enter 10% (.10) of the amount from Form 740, line 9	21		00		
	22. **Total casualty or theft loss(es).** Subtract line 21 from line 20. If zero or less, enter -0-	➤ 22				00
Job Expenses and Most Other Miscellaneous Deductions	23. Unreimbursed employee expenses — job travel, union dues, job education, etc. (attach Form 2106 or 2106-EZ if applicable) list	23	2,200	00		
	24. Tax preparation fees	24	100	00		
	25. Other (investment, safe deposit box, etc.) list Safe Deposit Box, Investment Se	25	500	00		
	26. Add the amounts on lines 23, 24 and 25. Enter here	26	2,800	00		
	27. Enter 2% (.02) of the amount from Form 740, line 9	27	2,600	00		
	28. **Total.** Subtract line 27 from line 26. If zero or less, enter -0-	➤ 28			200	00
Other Miscellaneous Deductions	29. Other (see instructions) Gambling Losses	➤ 29			3,000	00
Total Itemized Deductions	30. Add lines 3, 8, 14, 19, 22, 28 and 29. Enter here	➤ 30			27,300	00

★ If single or married filing jointly and your income for Form 740, Column B does not exceed $166,800, enter total itemized deductions on Form 740, line 10, Column B.

★ All others go to page 2.

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PART II—ITEMIZED DEDUCTIONS LIMITATION SCHEDULE

Complete this schedule only if the adjusted gross income on Form 740, line 9, exceeds $166,800 ($83,400 if married filing separately on a combined return or separate returns).

	A. Spouse	B. Yourself (or Joint)
• If married filing separately on a combined return, **enter in Column A** the percent of income (Form 740, line 9, Column A) to total income (Form 740, total of line 9, Columns A and B); **enter in Column B** the percent of income (Form 740, line 9, Column B) to total income (Form 740, total of line 9, Columns A and B). • If single, married filing a joint return or married filing separate returns, enter 100% in Column B.	31.00 %	69.00 %
1. Multiply the amount on Schedule A, line 30, by the percent of income shown in Columns A and/or B	1. 8,463	1. 18,837
2. Add the amounts on Schedule A, lines 3, 13 and 22, plus any gambling losses included on line 29 and multiply by the percent of income shown in Columns A and/or B	2. 930	2. 2,070
Note: *Be sure your total gambling losses are clearly identified on line 29.*		
3. Subtract the amount on line 2 from the amount on line 1. (If the result is zero, **STOP HERE**; enter the amount from line 1 above on Form 740, line 10.)	3. 7,533	3. 16,767
4. Multiply the amount on line 3 above by 80% (.80)	4. 6,026	4. 13,414
5. Enter the amount from Form 740, line 9	5. 40,000	5. 90,000
6. Enter $166,800 ($83,400 if married filing separately on a combined return or separate returns)	6. 83,400	6. 83,400
7. Subtract the amount on line 6 from the amount on line 5. (If the result is zero or less, **STOP HERE**; enter the amount from line 1 above on Form 740, line 10.)	7.	7. 6,600
8. Multiply the amount on line 7 above by 3% (.03)	8.	8. 198
9. Compare the amounts on lines 4 and 8 above. Enter the **smaller** of the two amounts here	9.	9. 198
10. Divide line 9 by 1.5	10.	10. 132
11. Subtract line 10 from line 9	11.	11. 66
12. Total itemized deductions. Subtract the amount on line 11 from the amount on line 1. Enter the result here and on Form 740, line 10	12. 8,463	12. 18,771

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