Itemized Deductions, Standard Deduction, and Exemptions

Itemized and Standard Deductions

Itemized deductions are deducted if total itemized deductions exceed a taxpayer's standard deduction amount. The standard deduction amount is based on filing status. The greater of itemized deductions or the standard deduction amount is subtracted from adjusted gross income in arriving at taxable income. The standard deduction amounts are adjusted annually for inflation. For 2018 the standard deduction amounts are:

Married filing jointly - $24,000

Married filing separately - $12,000

Head of household - $18,000

Single - $12,000

An additional standard deduction is allowed for taxpayers over the age of 65, blind, or both 65 and blind. The additional standard deduction in 2018 is $1,600 for single taxpayers and $1,300 for married taxpayers.

When married taxpayers file separate tax returns, both spouses must either itemize deductions or use the standard deduction amount. This rule is to prevent taxpayers from receiving larger deductions than would be available if a joint return was filed.

The standard deduction amount for a taxpayer who is a dependent of another taxpayer is limited to the greater of $1050 or earned income (generally wages) plus $350. The standard deduction amount for a dependent can never be more than the amount listed above.

The death of a taxpayer does not affect the standard deduction amount. A taxpayer is entitled to a full standard deduction regardless of the date of death.

Certain taxpayers may not claim the standard deduction amount. They are as follows:

1) Married individuals filing separate returns and whose spouse itemizes.

2) Nonresident aliens - these individuals must claim itemized deductions even if they are less than the standard deduction amount.

Exemptions

[1] In General

Under the Tax Cuts and Jobs Act (P.L. 115-97), the value of the dependency exemption was reduced to zero and replaced with a larger standard deduction. While the Act eliminated the tax savings related to the dependency exemption deduction, the rules related to the parent eligible to claim the deduction remain in place. The eligibility to claim a dependency exemption is important in determining who may claim benefits such as the child tax credit.

The value of the deduction for personal and dependency exemptions is zero for the tax years 2018-2025. The reduction of the exemption amount to zero does not alter the operation of other provisions of the Internal Revenue Code that refer to an allowed deduction under. Example: A taxpayer is allowed a child tax credit for each qualifying child even though the value of the allowed deduction has been reduced to zero.

Two sets of general rules govern the allowance of dependency exemptions. They are 1) qualifying children and 2) qualifying relatives. In addition, unrelated individuals may qualify the taxpayer for a dependency exemption if certain tests are met as discussed below.

[2] Dependency Exemptions and Qualifying Child Rules

Taxpayers are allowed a deduction (valued at zero for the tax years 2018 through 2025) for each child where the qualifying child rules are met. Five requirements must be met before a taxpayer is entitled to claim a child, stepchild, adopted child, or foster child as a dependent. They are as follows:

1. A dependent must be a citizen of the United States; a resident of the United States, Canada, or Mexico; or a child adopted by a United States citizen and living with the citizen in a foreign country,
2. A child must have as a principal residence the taxpayer's residence for more than one-half of the tax year,
3. A dependent must not provide over one-half of his or her support during the tax year,
4. A dependent must be under the age of 19, under the age of 24 if the child is a full-time student, or any child who is permanently and totally disabled, and
5. A dependent may not file a joint return with a spouse unless the only purpose for filing the return is to obtain a refund.

A special rule applies to the dependency exemption for children of divorced or separated parents. The general rule is that the parent that has custody of a child for more than one-half of the tax year is entitled to a dependency exemption deduction (valued at zero for tax years 2018 through 2025). The custodial parent may grant (or may be required to transfer as part of a divorce settlement) the dependency exemption to the non-custodial parent if a release is signed on IRS Form 8332 by the custodial parent and the following information conditions are met:

1. The parents were legally separated, divorced, or lived apart during the entire last six months of the tax year,
2. One or both parents combined provided more than one-half of the child's support during the tax year, and
3. One or both parents had custody for more than one-half of the tax year.

Dependency Exemptions and Qualifying Relative

A tax credit of $500 is available for each dependent who is not a qualifying child. Tax credits will be discussed later in the semester.

Generally, five requirements must be met before a taxpayer is entitled to claim a relative or unrelated person as a dependent. They are as follows:

1. A dependent must be a citizen of the United States, or a resident of the United States, Canada, or Mexico.

2. A dependent must be a person listed under relatives of a taxpayer on page 3-7. Individuals who lived with the taxpayer for the entire year are also included in the list (these individuals are referred to as qualifying nonrelatives).

3. A taxpayer must furnish more than 50 percent of the support of the dependent. Support does not include luxury items.

4. A dependent must have gross income of less than the exemption amount ($4,150 for 2018).

5. A dependent may not file a joint return with a spouse unless the only purpose for filing the return is to obtain a refund.

If two or more persons provide more than one-half of the support of a person, then any person providing more than 10 percent of the support may claim a dependency exemption. Only one taxpayer may claim a dependency exemption with regards to a particular person in any given year. An exemption cannot be split between taxpayers. While the dependency exemption is currently valued at $0, supporting an individual will result in a $500 tax credit if all of the qualifying relative rules (referenced above) are met.