Work from home rent tax deduction

While homeowners receive many opportunities to claim deductions and credits on their tax returns, renting affords few comparable opportunities. Few circumstances exist that permit renters to deduct rent payments from their tax returns, so it is best to understand when such opportunities are legitimate versus when they are illegal. If you use part of the home you rent as a home office, you may be able to deduct part of your rent payment as a business expense. First, your home office must be used regularly and exclusively for business to qualify. Then you calculate the percentage of your home that is the home office, multiply that percentage by your annual rent payments, and the result is the total you may deduct from your federal tax return if you itemize. Rental income — income made from renting out a property — may not be deducted from your federal tax return. In fact, it is considered taxable income, and you must report it to the IRS. However, expenses for the rental, such as improvements or renovation costs, may be deducted from the rental's reported income as a tax break. Certain states, like Massachusetts, permit taxpayers to deduct a percentage of their rent payments from their state tax returns. Massachusetts permits 50 percent of total rent paid to a maximum of $3,000 for the tax year. Other states like California provide renters a credit on their state taxes for up to $120 depending on your filing status and income for that tax year. Each state has its own laws on renter's credits and deductions as well as individual requirements for eligibility. For federal taxes, if you are simply renting an apartment for a place to live, there is nothing in the Internal Revenue Services tax code that permits deducting your rent from your income tax return. In fact, doing so will most likely trigger an audit, which could result in owing the IRS fines and penalties for falsely claiming an invalid rent deduction. Tax deductions lower your taxable income, which reduces the amount of income tax you’re required to pay. Most tax deductions are expenses that you pay either to generate income or provide a social good, such as raising a family. The federal government also grants a blanket standard deduction that is available to nearly all taxpayers, even if they don’t incur specific expenses that would qualify as itemized deductions. Read on to learn all about how standard and itemized tax deductions work, how they differ from tax credits and what you can do to maximize your tax deductions. Read: How To Itemize Deductions Like a Tax Pro To jump ahead to a specific section of this article, click one of these links: What Does Tax-Deductible Mean? The U.S. tax system can be a bit convoluted, and if you’re trying to learn every single aspect about filing taxes, you’ll find yourself deep in a rabbit hole. The good news is that in its broadest form, the American tax system is relatively straightforward. Simply tally up all of the income you earned during the year, whether from wages and salary or investments, and then deduct the amounts the government allows. The result will be your taxable income, which determines how much you have to pay. Those amounts that the government allows you to deduct from your gross income are known as tax-deductible items. Learn: Only 18% of Americans Believe Their Tax Dollars Are Being Spent the Right Way [Back to top] How Do Tax Deductions Work? Tax deductions fall into two broad categories: standard deductions and itemized deductions. As a taxpayer, you get to choose which type of deduction you want to take. You’re allowed to choose whichever option gives you the largest total deduction. [Back to top] Standard Deductions The standard deduction is granted to most taxpayers. It’s almost always the simpler choice to take, but it may or may not provide you with the largest total deduction. The size of the standard deduction varies based on your filing status, and it’s subject to change annually. Here are the standard deduction amounts for tax years 2019 and 2020, categorized by filing status: Standard Deduction for Tax Years 2020 and 2021 Filing Status Deduction for Tax Year 2020 Deduction for Tax Year 2021 Single $12,400 $12,550 Married, filing jointly $24,800 $25,100 Married, filing separately $12,400 $12,550 Head of Household $18,650 $18,800 For tax year 2020, this means that married couples filing jointly can automatically deduct $24,800 from their gross income to help determine their taxable income. If you feel like you have additional deductions that would exceed $24,800, you should consider itemizing your deductions. [Back to top] Itemized Deductions Itemized deductions are individual deductions that apply to many taxpayers. Common itemized deductions include state and local income taxes, charitable contributions, mortgage interest and medical expenses in excess of 10% of your adjusted gross income. Individually, these deductions might not exceed the standard deduction, but when combined, they can be much higher for some taxpayers. Unlike the standard deduction, however, you’ll have to qualify for each itemized deduction on its own merit. Taking a look at IRS Form 1040 may make deductions easier to understand. If you look at the front page of Form 1040, you’ll see your tax entries follow a logical flow. The first few lines tally up your income, and then after a few adjustments, you’re left with your adjusted gross income on line 8b. From there, you’ll subtract either your standard deduction or the total of your itemized deductions to arrive at your taxable income on line 11b, right at the bottom of the page. This is the best way to visualize how deductions work — in black and white, right on Form 1040. Learn More: What Are Itemized Deductions and How Do They Work? [Back to top] When To Claim the Standard Deduction Generally speaking, the standard deduction is much easier to claim than itemized deductions. Many itemized deductions apply primarily to wealthy taxpayers, meaning the average American may not qualify. In 2018, the Tax Cuts and Jobs Act nearly doubled the standard deduction and eliminated many itemized deductions. This further pushed more Americans toward taking the standard deduction. In fact, according to a September 2018 estimate from the Tax Foundation, about 88% of American households were expected to file for the standard deduction for the tax year of 2018, based on information provided by the Joint Committee on Taxation. The bottom line is that you should always claim whichever deduction gives you the greatest tax savings. For most Americans, particularly after the passage of the Tax Cuts and Jobs Act, this means taking the standard deduction. [Back to top] When To Claim Itemized Deductions Claiming itemized deductions is, by definition, more labor-intensive than just taking the standard deduction. In addition to researching which deductions may apply to you, you’ll need to have documentation on hand to properly claim each deduction. Additionally, the total amount of your itemized deductions has to exceed the standard deduction amount to make it a tax-wise move. With the near-doubling of the standard deduction for the tax year of 2018, filing itemized deductions no longer makes sense for many taxpayers. At the end of the day, however, it’s all just a big calculation. If your itemized deductions do indeed exceed your standard deduction, you’re better off tax-wise claiming your itemized deductions. Learn More: 10 Tax Loopholes That Could Save You Thousands [Back to top] What Is the Difference Between Tax Deductions and Tax Credits? Tax credits can also lower the amount of tax you owe, but tax credits are different from tax deductions in that tax credits are applied to your return after your tax is calculated. Unlike tax deductions, which reduce the amount of your taxable income, tax credits reduce the amount of your actual tax, which works out better financially. When you’re in the 24% tax bracket, for example, a $1,000 deduction will reduce your tax by $240. A $1,000 tax credit, on the other hand, will reduce your tax by $1,000, regardless of your tax bracket. Common tax credits include the earned income credit, the child tax credit and the premium tax credit associated with the Affordable Care Act. There are two types of tax credits: refundable and nonrefundable. A nonrefundable tax credit will only reduce the amount of tax you owe to zero; any excess credit you have earned will be lost. A refundable tax credit will actually pay out a refund to you if it exceeds the amount of tax you owe. For example, imagine you owe $600 in taxes, but you qualify for a $1,000 tax credit. If the credit is nonrefundable, you’ll be able to use $600 of that credit, offsetting your net tax to zero. If the credit is refundable, you’ll be able to use the entire $1,000. The first $600 of the credit will zero out your tax liability, and the remaining $400 will be paid out to you as a tax refund. [Back to top] How To Maximize Your Tax Deductions To maximize your tax deductions, start by computing your tax with the standard deduction. Then, pore over the list of itemized tax deductions to determine which ones might apply to you, and in what amount. The key to maximizing your tax deductions is to use every available legal tax deduction to your advantage. Tax filing can be complicated, and you might want to consult a tax advisor to be sure you don’t overlook any tax deductions. Using tax software can be another great way to help make sure you don’t overlook any itemized deductions. Although common deductions like the mortgage interest deduction are well-known, some deductions, like gambling losses (up to the amount of gambling winnings), can be overlooked. High-earning taxpayers should also be aware that some deductions might be reduced; for tax year 2020, the phase-out level for the child tax credit begins at an AGI of $200,000 for single filers and $400,000 for joint filers. See: Commonly Missed Tax Deductions [Back to top] So, What Is a Tax Deduction? A tax deduction is simply a legal way to lower the amount of your taxable income, which translates into a lower tax bill. Itemizing deductions can get complicated, and may require the use of a tax advisor, but it can pay off for many taxpayers — especially those in the higher income brackets. However, the truth is that a majority of taxpayers take the standard deduction, which is already at quite a high level. Thus, for the average taxpayer, the choice between standard and itemized deductions may not be as complicated as it seems. Find out more on how much money you would have if you never paid taxes. [Back to top] More From GOBankingRates