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30 Last-Minute Tax Tips

The deadline is fast approaching—but don't file your return until you've grabbed every last break. Here's a guide.

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Are you ready for tax day?

First, some good news: This year's deadlines are unusually late. Because April 15 coincided with a District of Columbia holiday, 2010 tax payments are due Monday, April 18. The deadline for those with six-month filing extensions is Oct. 17.

Now for some bad news: Audits on wealthier taxpayers are likely to rise, and refund amounts are merely holding steady. As of mid-March, just over half of all 140 million-plus individual returns had been filed, slightly behind the total for last year, and the average refund continued to be about $3,000.

If you are racing to meet the April 18 deadline, here are some last-minute tips gathered from a broad array of tax preparers. We have identified eight deductions that many people overlook, eight audit triggers, six common mistakes, five reminders for investors and three ways to cut your tax bill right now. Plus, we offer a heads-up on the perils of offshore accounts.

8 Overlooked Deductions of Credits

1. State-tax refunds for AMT taxpayers. Taxpayers often forget that state tax refunds aren't taxable to those who owe alternative minimum tax, or AMT, for the same tax year, as long as the amount of the refund is less than the amount of state income tax disallowed under AMT.

2. Charitable donations, Part I. Donors may not deduct labor or time, but they may deduct expenses such as mileage, uniforms and even the cost of taking some underprivileged youths to sports events or movies. Board members or chosen representatives also may deduct unreimbursed expenses for attending a conference or meeting. For details, see IRS publication 526.

3. Charitable donations, Part II. Employees who give to charities via payroll deductions at work frequently forget to include them on their personal return. "The number is on the W-2 and there's no letter," says Melissa Labant, an expert with the American Institute of CPAs.

4. Health-insurance premiums for the self-employed. For 2010 only, people who are self-employed and have deductible health-insurance premiums may also deduct them against Social Security taxes on Schedule SE. For 2010 and after, these same taxpayers may deduct premiums for a child under age 27 at the end of the year, even if the child isn't a dependent for tax purposes.

5. Medical expenses. The disallowance equal to 7.5% of adjusted gross income is a high hurdle, but those who qualify shouldn't overlook all possible expenses, listed in IRS publication 502.

Ms. Labant advises married couples to consider filing separately if one partner has high medical bills. "This is one of the only times that filing separately can lower the total tax bill," she says.
6. Sales-tax deduction in lieu of income taxes. This provision, which Congress has extended through 2011, allows itemized deductions for state and local sales tax instead of state and local income taxes. Taking this is a no-brainer in states without an income tax, and it may work for others if state income taxes are relatively low but a taxpayer had big-ticket purchases such as a car, boat or engagement ring, according to H&R Block's Tax Institute.
7. Moving expenses. Taxpayers who moved more than 50 miles for work and stayed employed may often deduct reasonable moving expenses. No itemization is necessary. See IRS publication 521.
8. Domestic Production Deduction. This generous benefit for having a qualified business in the U.S. can be claimed by sole proprietors, partnerships and corporations; it can even apply to farmers. It is easy to miss, says Chris Hesse, a CPA with LarsonAllen LLP in Minneapolis, "because no checks are written and tax-prep software may be unaware of it."
8 Audit Triggers
1. Mortgage-interest deduction over $50,000. Taxpayers are allowed to deduct interest on qualified loans up to $1 million (plus $100,000 of home-equity debt, and $50,000 is roughly equal to the annual interest on a $1 million loan at 5%. "Clients with larger payments are sometimes too busy to refinance," says David Lifson of Crowe Horwath CPAs in New York, "but they are likely to hear from the IRS."
2. Large charitable contributions, especially of noncash items. Taxpayers must have proof for every dollar of donation deductions, and sometimes appraisals as well. The rules are in IRS publications 526 and 561.
3. Schedule C business losses more than two years in a row. Because these losses are deductible against other income such as wages or interest, losses in three or more consecutive years arouse the IRS's suspicion that they are nondeductible "hobby losses." A small profit raises taxes very little and diverts attention, says Robert Gard of Gard & LaFreniere, an Atlanta-area CPA firm.
4. Home-buyer tax credit. Congress has passed three versions of this stimulus beginning in 2008, and research by official watchdogs showed substantial fraud in the initial one. Later versions require taxpayers to provide documents proving they qualify for the break.

5. Rental real estate, especially with losses. A perennial red flag, especially if the taxpayer claims to be a real-estate professional, because the losses are then deductible against ordinary income. The IRS will be even more suspicious if the wages and professional activities are performed by a single person or one partner of a couple, because professional status often requires a 750 hour-a-year commitment, says James Guarino of Moody, Famiglietti & Andronico, a Boston-area accounting firm.

6. Payouts to subchapter S owners who earn little or no compensation. Owners of closely held businesses using the subchapter S format sometimes pay themselves in dividends and lowball their wages in order to minimize the 15.3% payroll tax. It is a difficult area for the IRS to police, but those who take too little compensation are asking for IRS attention, Mr. Gard says. One rule of thumb: The ratio of pay to profits should be 70% or higher, say tax experts.
7. Large deductions in relation to income, especially for business travel and entertainment. What is too large? That is hard to say, and the IRS zealously guards its audit formulas. For T&E rules, see IRS publication 463.

8. Home office—maybe. Years ago, the IRS was famous for challenging home-office deductions, but has backed off lately, say some experts. "It doesn't seem to be a hot item," Ms. Labant says. The rules are in IRS publication 587.

6 Common Errors

1. Overstating charitable deductions. If you attend a charity event, you may deduct only a portion of the ticket cost, which is usually stated in a letter from the charity. This is true even if you don't attend, unless you donate the ticket back to the charity beforehand.

2. Deducting mortgage "points" incorrectly. Mortgage fees are fully deductible upfront only for the first mortgage on a house. Points on refinancings must be amortized and deducted over the life of the loan.

3. Overlooking the "kiddie" tax. Children up to age 23 often owe tax at their parent's rate on investment income over $1,900. Information from the parent(s)' return is required to complete the child's, so it should be finished first. For details, see IRS publication 929.

4. Missing the Making Work Pay credit. Last year was the final one for this refundable, dollar-for-dollar credit of up to $400 for an individual or $800 for married couples earning less than $190,000 (single: $95,000). Although withholding was adjusted to reflect this credit, taxpayers also need to file Schedule M to claim it.

5. Omitting small interest payments. Banks and other institutions don't have to provide a 1099 form for amounts less than $10, but they still are taxable income. Why do such small amounts matter? An IRS computer may note the discrepancy, and "any unreported income makes the IRS nervous and can lead to more questions," says Ms. Labant of the AICPA.

6. Roth conversions and filing extensions. Taxpayers who did 2010 conversions of regular IRAs to Roth accounts have until Oct. 17, 2011, to reverse them. Thus it may make sense to get a six-month filing extension for the return, because if you already have filed and decide to reverse the conversion, then you will have to file an amended tax return.

5 Tips for Investors

1. "Wash" sales. Taxpayers can't take long-term capital losses on stock sales if they also buy shares 30 days before or after the sale. Exercising stock options counts as a purchase.

2. Dividends. Only "qualified" dividends get a top tax rate of 15%; others are taxed at ordinary income rates. Fortunately most dividends of stocks held longer than two months count as qualified, but check broker reports to make sure.

3. Losses. Long-term capital losses (those on investments held longer than a year) can be used to shelter an equal amount of long-term or sometimes short-term gains. Up to $3,000 of excess can then be deducted against ordinary income per year, and what's left beyond that can carry forward indefinitely.

4. Employee stock. Be careful with shares that originated as stock options, restricted stock, or employee stock. Andrew Mattson of Mohler, Nixon & Williams in Campbell, Calif., says a discount is recorded on the employee's W-2 form that should raise cost basis and lower taxes when the stock is sold. But this adjustment is often overlooked, he says: "We see this in Silicon Valley all the time."

5. Incentive stock options. The tax treatment of these options can be advantageous but also is tricky. Expert help is a good idea, because there are alternative-minimum-tax consequences both on exercise and sale.

3 Ways to Cut Your Tax Bill Now

1. Regular IRA. You may deduct contributions to a regular IRA made by April 18. For who is eligible, see IRS publication 590. Taxpayers 50 and older can put in a bit more.

2. SEP IRA and other pension plans. Unlike with regular IRAs, deductible contributions may be made up to Oct. 17 for those with filing extensions.

3. Health Savings Accounts (HSAs). You may deduct up to $6,150 per family ($3,050 single) for an HSA if you had a qualifying high-deductible health plan in 2010. Contributions are due by April 18.