

Deducting Sales Taxes

Many people may be paying too much in taxes because they are overlooking a valuable break enacted late in 2004.

A recent Treasury Department report says numerous taxpayers who could have benefited from deducting state and local sales taxes didn't do so on their federal income-tax returns for 2004, which were filed last year. The provision allows millions of people to choose to deduct either their state and local income taxes or their sales taxes.

This deduction is particularly important for people who live in states with no state income tax, such as Florida, Texas, Washington and Nevada. But it also can benefit many people in other states who pay relatively low state and local income taxes. To be eligible, taxpayers must itemize instead of taking the standard deduction.

Taxpayers have a choice of how to calculate the deduction. They can use their actual receipts, or they can figure the amount using Internal Revenue Service tables, plus the actual taxes they paid on motor vehicles, boats and certain other items.

The Treasury Department report found more than 33 million tax returns for 2004 with itemized deductions. Of those returns, there were about 1.1 million, or 3%, on which the taxpayer could have claimed -- but didn't -- either a state income-tax or a sales-tax deduction. Taxpayers living in states without a state income tax were four times more likely to omit the sales-tax deduction than taxpayers living elsewhere. Taxpayers living in those states filed nearly 5.1 million returns with itemized deductions -- and more than 465,000 of those returns, or 9%, didn't claim the sales-tax deduction.

One reason for this is probably the late passage of the legislation. This prevented the instructions and other key details from being included in the IRS's Form 1040 instructions for the 2004 tax year. Instead, taxpayers were referred to a separate IRS publication for details.

The IRS has revised its instructions for 2005 to include state sales-tax tables and other details. The agency recently issued a fact sheet (FS-2006-9) summarizing the deduction, available on its web site.

But even that may not solve the problem. For example, some people who live in places that impose state or local income taxes may erroneously assume they're always better off taking the deduction for income taxes. Many people who pay very little state or local income tax may be better off claiming the sales-tax deduction -- especially if they made big-ticket purchases such as a car or boat.

You can't deduct state or local income taxes, or general sales taxes, in calculating the alternative minimum tax.

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Before sending off your return this year, double-check to see whether you're eligible for this deduction and whether it makes sense to claim it. Some people also should take a fresh look at their return for 2004 and file an amended return if they were eligible for the deduction and would have benefited by claiming it.

The provision's fate is up in the air. When Congress approved it in 2004, it made it effective only for the 2004 and 2005 tax years. But now many lawmakers want to extend it.