Deduct It

Deductions, the 2026 Rules, and Why Every Write-Off Is Worth Your Marginal Rate

“Two paychecks, same salary — and one owes thousands more in April. The difference is what they did with the line between gross income and taxable income. Today we move that line.”

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A PREMIUM LESSON · CHARTS · REAL EXAMPLES · ACTION STEPS · GLOSSARY

WHAT YOU WILL MASTER

- Distinguish gross income from taxable income and explain how every deduction lowers the taxable 'waterline' — without putting cash directly in your pocket.
- Choose correctly between the 2026 standard deduction ($16,100 single / $24,150 head of household / $32,200 married filing jointly) and itemizing the big four.
- Stack above-the-line deductions — 401(k), HSA, IRA, student loan interest, half of self-employment tax — on top of whichever path you choose.
- Value any deduction precisely: amount times your marginal rate, including the new 2026 limits (charitable 0.5% floor, 35-cent cap for top-bracket itemizers).
- Apply the owner's toolkit: the 20% QBI deduction with 2026 thresholds, and the pre-tax vs. Roth decision framed by today's bracket versus retirement's.

Gross Is Not Taxable: The Waterline Model

The IRS does not tax everything you earn. It taxes what remains after a list of subtractions — and the entire game of legal tax reduction is knowing that list. Picture your income as water in a tall glass jar with a movable line partway up. Everything above the line gets taxed on the bracket staircase; everything below it, the staircase never sees. Every deduction is a level adjustment: it pushes the line down. Deductions are not money in your pocket and never reduce tax dollar-for-dollar — that is what credits do (next episode). They shrink the income the tax is computed on.

The first and biggest line-mover is automatic. For 2026 the standard deduction is $16,100 for single filers and those married filing separately, $24,150 for heads of household, and $32,200 for married couples filing jointly — no receipts, no proof, no effort. Taxpayers 65 or older (or blind) add $1,650 each if married, $2,050 if unmarried. These amounts were made permanent and enlarged by the 2025 tax law and now index annually, which is exactly why most Americans take the standard deduction: beating those numbers with receipts is hard.

One boundary to keep from Episode 5: deductions move your income tax, not your FICA. The 7.65% payroll slice comes off gross wages before any of this machinery runs (only pre-tax Section 125 premiums and payroll HSA contributions escape it). So a deduction's value lives entirely on the income-tax staircase — which is what makes the next question, 'which staircase step are you on,' the master key of this whole episode.

WORKED EXAMPLE: A SINGLE RENTER EARNING $52,000 (ILLUSTRATIVE)

No mortgage, no big medical bills, modest giving — the standard deduction wins without a contest. Watch the waterline drop before the staircase runs.

Gross income	$52,000
Standard deduction (2026, single)	-$16,100
Taxable income	$35,900
Federal income tax (10% and 12% brackets)	$4,060
Effective rate on gross vs. 12% marginal	7.8%

The Fork: Standard vs. Itemized, 2026 Edition

You may take the standard deduction or itemize on Schedule A — whichever is larger. Itemizing means adding up the big four: (1) state and local taxes (SALT) — income or sales tax plus property tax; (2) home mortgage interest, deductible on up to $750,000 of acquisition debt ($375,000 married filing separately); (3) charitable gifts to qualified organizations; and (4) medical expenses, but only the portion above 7.5% of adjusted gross income. If the total beats your standard deduction, itemize; if not, take the standard and keep your weekend.

The 2026 rules moved two of those four in ways the episode could not capture. SALT: the old $10,000 cap is temporarily gone — for 2026 the limit is $40,400 ($20,200 married filing separately), the 2025 $40,000 cap indexed about 1% per year through 2029. High earners phase back down: above roughly $505,000 of modified AGI the cap shrinks by 30 cents per extra dollar, but never below $10,000 — and in 2030 the cap is scheduled to snap back to $10,000 for everyone. Charitable: starting in 2026 itemizers may deduct only the portion of gifts above 0.5% of AGI (give $2,400 on $110,000 AGI and the first $550 does not count), cash gifts remain capped at 60% of AGI, and appreciated stock held over a year deducts at market value up to 30% of AGI.

Suddenly-itemizing is back for homeowners in higher-tax states: a mortgage plus uncapped-to-$40,400 SALT clears the standard-deduction bar far more often than it did under the $10,000 cap. Run the comparison fresh every year — refinances, property-tax jumps, charitable bunching (stacking two years of gifts into one to clear the floor and the bar), and the 2030 SALT snap-back can each flip the answer.

WORKED EXAMPLE: A SINGLE HOMEOWNER WITH $110,000 AGI (ILLUSTRATIVE)

State income tax $6,200 plus property tax $5,800; mortgage interest $11,200; cash gifts $2,400; medical $4,000 (below the $8,250 floor, so $0 counts). Compare 2026 itemizing to the $16,100 standard deduction.

SALT (fully allowed under the $40,400 cap)	**$12,000**
Mortgage interest	**$11,200**
Charitable after the 0.5% AGI floor ($2,400 - $550)	**$1,850**
Itemized total vs. $16,100 standard	**$25,050**
Extra deduction x 22% marginal rate = tax saved	**$1,969**
Portion of that saving created by the new SALT cap alone	**$440**

→ Under the old $10,000 SALT cap this filer barely itemized; under 2026 rules the same receipts save nearly $2,000. Re-run the fork every year.

★ New for 2026: you no longer need to itemize to deduct charity. Non-itemizers may deduct up to $1,000 of cash gifts ($2,000 married filing jointly) on top of the standard deduction. Keep the receipts either way — the IRS requires a written acknowledgment for any gift of $250 or more.

Above the Line: The Deductions That Stack

One family of deductions ignores the fork entirely. Above-the-line deductions come off gross income before you choose standard or itemized, so they stack on top of either path. The heavyweights for 2026: traditional 401(k) elective deferrals up to $24,500 (plus $8,000 catch-up at 50, or $11,250 at ages 60-63); HSA contributions up to $4,400 self-only or $8,750 family (plus $1,000 at 55) if you carry a qualifying high-deductible plan; traditional IRA contributions up to $7,500 (plus $1,100 at 50, income limits apply if a workplace plan covers you); student loan interest up to $2,500, phasing out between $85,000-$100,000 of modified AGI single ($175,000-$205,000 joint); half

Worth Your Marginal Rate — No More, No Less

A $1,000 deduction is never worth $1,000. It is worth $1,000 times your marginal rate — the rate on your last dollar, from the 2026 staircase: 10%, 12%, 22%, 24%, 32%, 35%, 37% (the 22% step starts at $50,400 of taxable income single / $100,800 joint; the 37% step at $640,600 / $768,700). At a 22% marginal rate, a $1,000 deduction saves $220. At 12%, the same deduction saves $120. This is why deductions excite high earners and often underwhelm modest earners: a founder in the 37% bracket gets $370 per $1,000 of deduction; a teacher in the 12% bracket gets $120 from the identical charitable gift. Know your marginal rate and you can price any deduction in seconds — and notice that a big deduction can straddle down into the next bracket, where its tail is worth the lower rate.

Two 2026-specific refinements sharpen the math at the top. Itemized deductions (not above-the-line, not the standard) are now worth at most 35 cents per dollar for taxpayers in the 37% bracket — a new cap that shaves the top bracket's benefit. And the charitable 0.5%-of-AGI floor means the first slice of giving each year carries no deduction at all for itemizers. Neither changes the core rule; both trim its edges for the highest incomes.

Now the phantoms — the 'deductions' every influencer mentions that most W-2 workers cannot take. Personal credit-card interest: never deductible. Commuting to your regular job: never deductible. The home office: eliminated for W-2 employees by the 2017 law (a suspension the 2025 law made permanent) — it survives only for the self-employed who use space regularly and exclusively for business. And your donated time: the IRS assigns zero deduction value to hours, however skilled; only money, goods, mileage, and out-of-pocket costs for a charity count. Knowing what you cannot deduct is half of knowing what you can.

WORKED EXAMPLE: THE SAME $1,000 CHARITABLE GIFT AT FOUR INCOMES (ILLUSTRATIVE)

Four itemizing donors give the identical $1,000 to the identical charity in 2026. Same generosity, different tax value — priced by each donor's marginal rate (floor and AGI limits already cleared).

12% bracket donor saves	**$120**
22% bracket donor saves	**$220**
32% bracket donor saves	**$320**
37% bracket donor saves (new 35-cent itemized cap)	**$350**
Out-of-pocket generosity in every case	**$1,000**

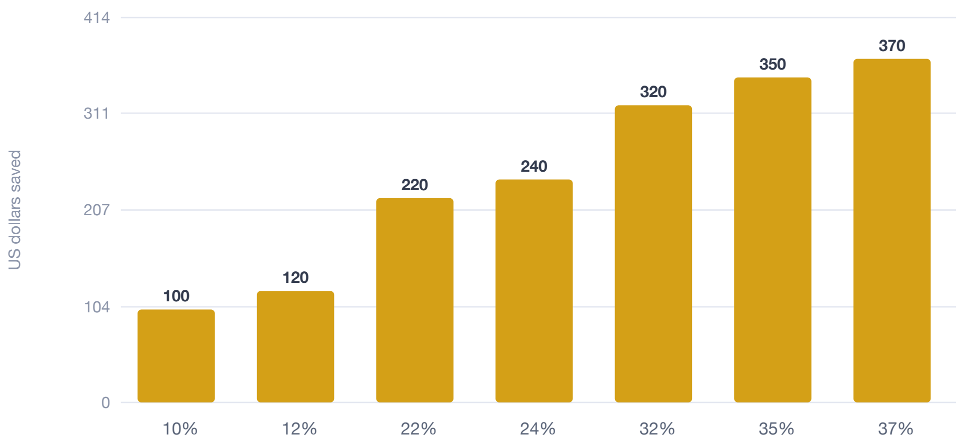
→ Deductions are valued at the rate of the jar the dollars came out of — and 2026 caps the top jar's value at 35 cents.

⚠ Proof beats promises: the IRS can disallow any itemized deduction you cannot substantiate. Keep acknowledgment letters for gifts of $250+, Form 1098 for mortgage interest, and property-tax records. A shoebox works; a folder scanned monthly works better.

The Owner's Corner: QBI, the New 2026 Deductions, and Pre-Tax vs. Roth

If any of your income comes from a business — freelancing, consulting, rentals that rise to a trade or business, an operating company taxed as a pass-through — the qualified business income (QBI) deduction is your extra lane. Now permanent, it deducts up to 20% of qualified pass-through profit without spending a dollar. For 2026 the full deduction applies below $201,750 of taxable income ($403,500 joint); above that, wage-and-property tests and the specified-service phase-out apply across a widened $75,000 / $150,000 range. New for 2026: anyone with at least

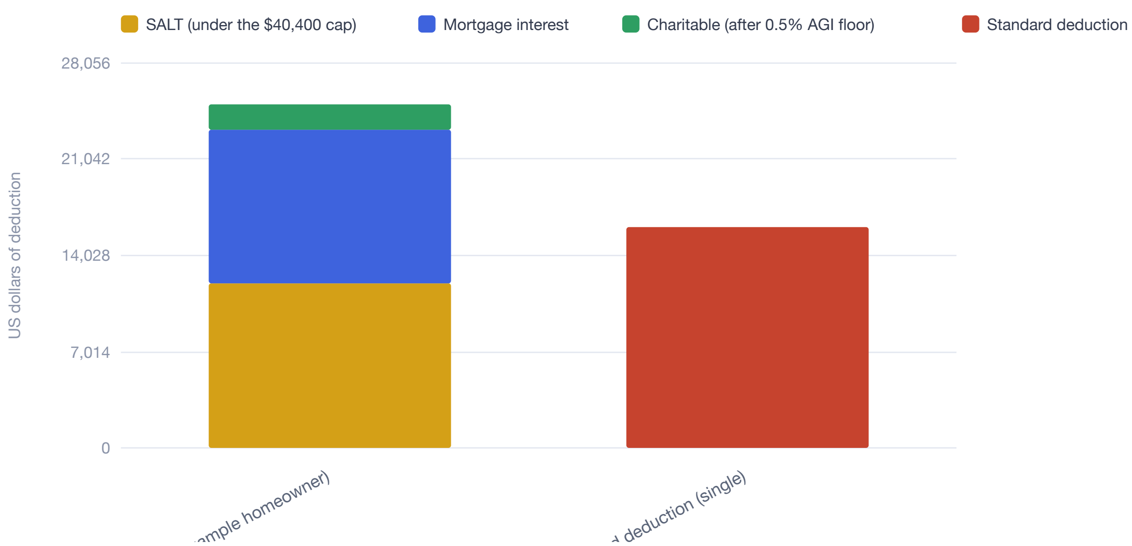
What a $1,000 Deduction Is Actually Worth (2026 marginal rates)



A deduction is worth its amount times your marginal rate — $120 in the 12% bracket, $370 in the 37% (itemized deductions for 37%-bracket filers are further capped at $350 per $1,000 beginning in 2026). Computed illustration from the official 2026 rate tables.

Source: IRS releases tax inflation adjustments for tax year 2026 (IR-2025-103; Rev. Proc. 2025-32 rate tables) · Internal Revenue Service (2025) · https://www.irs.gov/newsroom/irs-releases-tax-inflation-adjustments-for-tax-year-2026-including-amendments-from-the-one-big-beautiful-bill

The 2026 Fork: One Homeowner's Itemized Stack vs. the Standard Deduction



Illustrative single homeowner, $110,000 AGI: the big four stack to $25,050 against the $16,100 standard deduction — an $8,950 edge worth $1,969 at a 22% marginal rate under 2026 rules (SALT cap $40,400; new charitable floor applied).

Source: 2026 Form 1040-ES, What's New (SALT limit, charitable floor, standard deduction) · Internal Revenue Service (2026) · https://www.irs.gov/pub/irs-prior/f1040es--2026.pdf

STORY BREAK

Moving the Waterline

MARCUS
Same salary as my brother. He pays three thousand less.

Suburban kitchen in the evening. Marcus, mid-30s, sits at the table beside a shoebox overflowing with crumpled receipts, holding two envelopes and looking baffled.

1. Same salary as his brother. Very different April.

LEDGER
Deductions lower the waterline. The IRS taxes what remains.

Ledger's oak-paneled study. Ledger, the silver-haired mentor in a vest, stands at his desk sliding a brass marker rod down the side of a tall water-filled glass jar.

MARCUS
So the trick is moving that line down.

2. Deductions do not hand you cash. They lower the line.

LEDGER
A thousand-dollar deduction saves its marginal rate, not a thousand.

Still in the study. Ledger holds up a single gold coin over two glass jars of different fill levels while Marcus leans in, counting on his fingers.

MARCUS
Two hundred twenty at my bracket.

3. Every deduction is priced by your bracket.

MARCUS
Standard or itemized, whichever is bigger. Receipts either way.

Back in the kitchen, morning light. Marcus files papers into a tidy accordion folder while Ledger stands by with an approving nod, teacup in hand.

LEDGER
Now the line moves in your favor.

4. The fork, decided fresh every year.

DO IT NOW

The 30-Minute Deduction Audit

Time: 30-40 minutes · You need: Last year's tax return (Form 1040 with Schedule A if you itemized) · Mortgage Form 1098 and property tax bill, if you own a home · Pay stub showing 401(k) and HSA year-to-date contributions · Calculator or spreadsheet, and one folder (paper or digital) for receipts

1. Find your marginal rate: locate taxable income on last year's return, place it on the 2026 bracket table, and write the rate on the folder — every deduction this year is worth that percentage.
2. Tally your projected big four for 2026: state and local taxes paid (now countable up to $40,400), mortgage interest, planned charitable gifts minus 0.5% of AGI, and medical costs above 7.5% of AGI.
3. Compare that total to your standard deduction ($16,100 / $24,150 / $32,200). Circle the winner — that is your fork for the year, and if charity decides it, consider bunching two years of gifts into one.
4. List your above-the-line room: 401(k) up to $24,500, HSA up to $4,400 / $8,750, IRA up to $7,500, student loan interest up to $2,500 — and half of SE tax if you have 1099 income. Multiply unused room by your marginal rate to see the tax left on the table.
5. Business income? Estimate the QBI deduction: 20% of pass-through profit (after half of SE tax), but no more than 20% of taxable income minus capital gains. Note whether you sit under the $201,750 / $403,500 thresholds.
6. Start the receipts habit today: drop every acknowledgment letter, 1098, and property-tax statement into the folder monthly. Proof, not promises, is what survives an IRS letter.

Check yourself

- [ ] **A deduction and a credit both show $1,000 on paper. Why are they worth different amounts to you?**
  A deduction reduces taxable income, so it saves $1,000 times your marginal rate (e.g., $220 at 22%); a credit cuts the tax bill itself dollar-for-dollar — the full $1,000.

- [ ] **For 2026, when does itemizing beat the standard deduction, and which two rules changed most since the episode's era?**
  Itemize when SALT (now capped at $40,400, phasing down above about $505,000 MAGI), mortgage interest, charity above the new 0.5% AGI floor, and medical over 7.5% of AGI together exceed $16,100 / $24,150 / $32,200. The SALT cap and the charitable floor are the big 2026 changes.

- [ ] **Why do planners call above-the-line deductions the strongest in the code?**
  They stack on top of the standard deduction (no itemizing needed), most also cut state tax, and payroll HSA contributions even skip 7.65% FICA — so each dollar saves at multiple layers.

- [ ] **A standard-deduction freelancer with $74,348 of QBI expected a $14,870 QBI deduction but got $11,650. What happened?**
  The QBI deduction is capped at 20% of taxable income minus net capital gains — 20% of her $58,248 taxable income ($11,650) was smaller than 20% of QBI, so the income ceiling controlled.

WORDS TO KNOW

Gross income
Everything you earn before any subtractions — wages, profit, interest, rents. The jar before the line moves.

Adjusted gross income (AGI)
Gross income minus above-the-line deductions; the base for many floors and phase-outs (charitable 0.5%, medical 7.5%, student loan limits).

Taxable income
AGI minus the standard or itemized deduction (and QBI, if any) — the only number the bracket staircase ever sees.

Standard deduction
The automatic no-receipts deduction: $16,100 single / $24,150 head of household / $32,200 married filing jointly for 2026, plus add-ons at 65 or blind; indexed annually.

Itemized deductions
The Schedule A alternative — SALT, mortgage interest, charity, and excess medical — taken only when their total beats your standard deduction.

Above-the-line deduction
A deduction taken before the standard-vs-itemized fork (401(k), HSA, IRA, student loan interest, half of SE tax), so it stacks with either choice.

Marginal rate
The tax rate on your last dollar of taxable income — and therefore the exact value of each deduction dollar. The 2026 rates run 10% to 37%.

SALT cap
The Schedule A limit on state-and-local tax deductions: $40,400 for 2026 ($20,200 MFS), phasing down 30% above about $505,000 MAGI to a $10,000 floor; scheduled to revert to $10,000 in 2030.

Charitable floor (2026)
Itemizers may deduct only gifts above 0.5% of AGI; non-itemizers may newly deduct up to $1,000 / $2,000 of cash gifts. Written acknowledgment required at $250+.

QBI deduction
Up to 20% of qualified pass-through business income, permanent, with 2026 thresholds of $201,750 / $403,500 taxable income, a widened phase-in, a new $400 minimum, and a 20%-of-taxable-income ceiling.

Traditional vs. Roth
Traditional retirement contributions deduct now at your marginal rate and are taxed later; Roth contributions deduct nothing now and withdraw tax-free later. Pick by comparing today's rate to retirement's.

Substantiation
The proof the IRS requires to keep a deduction — acknowledgment letters, Form 1098, tax bills, logs. No records, no deduction.

SOURCES & MATERIALS USED

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- Revenue Procedure 2025-32 — 2026 rate tables, standard deduction, student loan interest phase-outs, QBI thresholds, educator expenses — Internal Revenue Service (2025). https://www.irs.gov/pub/irs-drop/rp-25-32.pdf
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- Topic No. 506, Charitable Contributions — Internal Revenue Service (2026). https://www.irs.gov/taxtopics/tc506