COMMON DEDUCTIONS

FOR BUSINESS OWNERS

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ACCOUNTING • TAX • PAYROLL • ADVISORY

ADVERTISING

These expenses are incurred to promote a business, such as newspaper ads, flyers (including the cost of distributing them), television and radio promotions and business cards. The cost of business gifts to current or prospective customers is deductible up to a maximum of **$25 per customer per year.**

BAD DEBTS FROM SALES OR SERVICES

Customer accounts receivable and notes receivable that are definitely known to be worthless are business bad debts and are deductible if the income was included in gross income. Generally, only accrual method business owners have a bad debt deduction. A cash method business owner is not entitled to claim a deduction for business bad debts because the sale was never included in income.

COMMISSIONS AND FEES

Referral fees or occasional amounts paid to individuals who are not employees or independent contractors may be deductible. This does not include commissions paid to employees.

CONTRACT LABOR

Payments that are paid to independent contractors (non-employees) for services rendered are deductible. If you pay more than $600 in a year for services, you then need to issue a Form 1099 to that provider as required by the IRS. (Pay close attention to the rules for classifying a worker as employee vs independent contractor). It's important that you request a complete **Form W-9** from contractors before making any payments. This will allow you to have a smooth process to issue Form-1099MISC if necessary at year-end. Also, payments for rent require a Form-1099 to be issued.

EMPLOYEE BENEFIT PROGRAMS

Contributions to employee benefit programs include those to education, recreation, health and welfare programs.

INSURANCE

Premiums paid to protect the business against losses are deductible as an operating expense. Current or prior-year premiums may be deducted in the year paid for a cash-basis business owner. Whether the cash or accrual method of accounting is used, advance payments may be deducted only in the year to which they apply. Types of insurance for which premiums are deductible include fire, theft, flood, merchandise and inventory, credit, public liability, workers' compensation, business interruption, errors and omissions, disability (for employees), malpractice, display window and product liability.

LEGAL AND PROFESSIONAL SERVICES

Costs for legal and professional services such as attorney, accounting, and tax preparation fees that are ordinary and necessary to the operation of the business are deductible.

MEALS AND ENTERTAINMENT

The Tax Cuts and Jobs Act has made significant changes to the deductibility of business meals and entertainment starting in 2018.

FULLY DEDUCTIBLE MEALS

Here are some common examples of 100% deductible meals expenses:

- A company-wide holiday party
- Department gatherings and outings that include refreshments that primarily benefit employees other than who are highly compensated.
- Food and drinks provided free of charge for the public during seminars or other events
- Items sold to customers
- Food included as taxable compensation to employees and included on the W-2

50% DEDUCTIBLE MEALS

Here are some of the most common 50% deductible meals expenses:

- A meal with a client where work is discussed (that isn't lavish)
- Employee meals at a conference, above and beyond the ticket price
- Employee meals while traveling (**here's how the IRS defines "travel"**)
- Treating a few employees to a meal (but if it's at least half of all employees, it's 100 percent deductible)
- Food for a board meeting
- Snacks and Beverages provided at the office
- Refreshments or meals brought to the office for employees working overtime
- Meals provided for the convenience of the employer (non deductible after 2025)

If the business meal costs over $75, you are required to keep receipts or other documentation for meal expenses. If the meal is under $75, the IRS does not require that you keep these documents, but it's still a good idea to keep them. Regardless of the cost of the meal, you will need to keep a detailed record that includes the following information:

- The date
- Total amount, including tax and tip
- The name of the restaurant/place
- Details of the occasion (who is in attendance, including titles and business names, and how the meal relates to business purposes)

SO WHAT'S NON-DEDUCTIBLE?

- Most work-related meal purchases you can think of are either 100 or 50 percent deductible. But there are a few exceptions. For example, if you pay for your clients' night out but you don't actually go with them, it's nondeductible. The same applies to a client meal at a restaurant where you invite friends or spouses—the cost of your friends is nondeductible (but you can write off half the client bill).
- And of course, with the Tax Cuts and Jobs Act, client entertainment is also nondeductible—no more golf games or courtside tickets. Additionally, membership dues for clubs organized for
- business, pleasure, recreation or other social purposes are also non deductible.

MORTGAGE INTEREST

The interest portion of mortgage payments on property used in the business is deductible. Note: If the small business is located in the proprietor's home, the business portion of mortgage interest is not included here but is part of the business-use-of-home deduction. There are strict requirements on home offices; make sure you understand the restrictions.

OFFICE EXPENSE

Office expenses are the costs of consumable office supplies such as pads, pens, pencils, order books, receipt books, supplies for equipment (for example, cash registers, computers, and copiers), postage and record books and related supplies.

OTHER INTEREST

Other interest includes all interest on business indebtedness for which the business owner did not receive a Form 1098. This includes finance charges on credit card purchases made for business purposes, interest paid on installment sale purchases and other types of loans for the business.

PAYROLL TAXES

Employment taxes that a business must pay on behalf of its employees are deductible, including:

- Social security tax of 6.2 percent on each employee's wages up to $90,000.
- Medicare tax of 1.45 percent on each employee's wages.
- **Federal Unemployment Tax (FUTA)** ranging from 0.8 percent up to 6.2 percent on each employee's wages up to $7,000.
- State unemployment tax, which varies by state.

PENSION AND PROFIT-SHARING PLANS

Amounts paid by the business as employer contributions to a pension, profit-sharing, or annuity plan for employees are deductible.

RENT OR LEASE

Rent or lease payments of business property are deductible in the tax year for which the rent is due.

REPAIRS AND MAINTENANCE

Repairs and maintenance includes amounts necessary to maintain property in an ordinary, efficient operating condition, such as labor, supplies, the yearly portion of the cost of service contracts, and other items incidental to the repair. It is important to distinguish between repair expenses and improvement expenses because an improvement must be depreciated. A capital expenditure increases the value of the asset, the productivity of the asset, prolongs the asset's useful life, or adapts it to a different use.

SUPPLIES

Any supply items necessary to the proprietor's business are tax deductible, including gift wrapping materials, cleaning or maintenance supplies, and maintenance of a watchdog on business property or electronic security systems.

TAXES AND LICENSES

Licenses, such as occupation, liquor, chauffeur, building, and regulatory fees paid annually to state or local governments in connection with the business are deductible.

Taxes that are directly attributable to the trade or business are deductible, including:

- Real estate tax imposed on business property. (Real estate taxes paid on a personal residence with a qualified home office are deducted as business-use-of-home expenses.)
- Any state or local tax on gross income (as distinguished from net income) directly attributable to a trade or business.
- Personal property taxes imposed on property used in a trade or business other than those for vehicles.
- Sales taxes imposed on sales of property or services at retail and measured by gross sales price or gross receipts. If this tax is collected from the buyer, the amount must be included in gross receipts. Note: Sales taxes paid on supplies or depreciable properties are added to the cost basis of the property.
- Compensating use taxes that are generally imposed on the use, storage, or consumption of an item brought in from another taxing jurisdiction.
- Federal highway use tax.
- Payroll taxes.

TRAVEL

Expenses incurred while you or your employees are away from home on business may be deductible. An individual is away from home if he or she is required to be away from his or her tax home substantially longer than for an ordinary day's work and he or she needs to get sleep or rest to meet the demands of the work while away from home. The tax home is the entire city or general area in which an individual regularly works, no matter where he or she lives. Deductible travel expenses include:

- The cost of airplane, train, bus travel or car and truck expenses for traveling between the tax home and the destination.
- The cost of local transportation, including bus, taxi, or limousine fares, while working at the destination location.
- The cost of renting a car at the destination location.
- The cost of sending baggage or shipping samples or display materials to the temporary work location.
- The cost of lodging and related tips, cleaning, laundry, telephone, and fax expenses.

It's important that you keep good records from travel expenses. Write down notes regarding meetings, events, time spent on work activities, etc.

UTILITIES

The utilities deduction includes charges for **electricity**, **gas**, **telephone**, **water**, and **sewer** on business property. The cost of basic local telephone service (including taxes) for the first telephone line in the home is not deductible. The cost of an additional line added for business purposes is deductible as are any long distance charges incurred for the small business. If you have a Home Office only a percentage of your utilities is deductible including Internet Service and Cell Phone use.

WAGES

To be deductible, compensation must be an ordinary and necessary expense of carrying on the business, reasonable in amount, for personal services actually rendered, and actually paid or incurred during the tax year. Gross salaries, wages, or other compensation paid to relatives (including the business owner's spouse and children) are deductible provided all these requirements are met. The actual cost of meals and lodging furnished to employees is deductible as compensation paid regardless of whether the value is taxable to the employee. The value of meals and lodging furnished for the employer's convenience is not included in the employee's gross wages. If furnished as additional employment incentives, the value is included in wages.

OTHER EXPENSES

Examples of tax deductions that might be listed as other expenses are:

- Bank service charges (including the service charge for accepting credit cards).
- Dues to trade or professional organizations.
- Subscriptions to publications.
- Trash removal fees.
- Laundry and cleaning expenses for uniforms.
- The cost of food consumed by day-care recipients (other than the provider's dependents) in a daycare.

UNIFORMS

You can deduct the cost and upkeep of work clothes and uniforms if you must wear them as a condition of your employment and the clothes are not suitable for everyday wear. The IRS says the clothing must be specifically required by your employer and is not suitable for taking the place of your regular clothing. If the clothes can be worn as everyday clothes, even when you don't, then it is not a possible deduction.

CLOTHING DEDUCTION REQUIREMENTS

In order to deduct the cost of purchasing work clothing and the expense of cleaning them, your employer must expressly require that you wear the clothing at work as a condition of your employment. However, this requirement is not sufficient by itself to claim the deduction. The IRS also requires that the clothing have no use to you outside of your employment, meaning it's not appropriate for personal wear. For example, if you work as a waiter in a restaurant and the owner requires you to wear a white shirt with black pants at all times, you are unable to claim the deduction since you can make use of a white shirt or black pants when not waiting tables. However, if the white shirts your employer requires you to purchase feature the restaurant's logo, you can then deduct their cost, but not the pants.

PROTECTIVE CLOTHING

If you work in a profession that is inherently dangerous, such as construction, steam fitting and oil field work, purchasing protective clothing to wear on the job is essential, and in many cases required. Deductible protective clothing can include hard hats, construction boots, fire-retardant outerwear and any other article of clothing that protects against the common health hazards of your profession.

SPECIAL UNIFORMS

Many employers design special uniforms that certain employees must wear every time they come to work, such as airline flight attendants and employees of fast-food chains. In the event your employer doesn't reimburse you for the expense of purchasing these uniforms and doesn't provide an allowance for their cleaning, you can include all uniform-related expenses in your work-clothing deduction.

ITEMIZING WORK CLOTHES

You must deduct the cost of work clothes on Schedule A as itemized deductions. However, you shouldn't itemize just because your work clothes and uniforms are deductible. Instead, you must evaluate whether the sum of all expenses you are eligible to itemize exceeds the standard deduction you can claim for your filing status. Only when itemizing yields a larger deduction should you choose to file Schedule A and deduct your work clothes. Moreover, you should also be aware that the IRS requires you to report the clothing expenses as a miscellaneous expense subject to the 2-percent adjusted gross income (AGI) floor. This means that you must reduce the total of all miscellaneous expenses, including your work clothes, by 2 percent of your AGI.

START-UP EXPENSES

When someone begins a start-up business, he or she often incurs expenses just to get the business up and running. As part of the **American Jobs Creation Act**, taxpayers can deduct up to $5,000 of start-up costs and $5,000 of organizational expenses incurred in the first year of their small business. Start-up expenses are the costs the business owner has for setting up an active trade or business. If these costs meet the following tests, they may be recovered through a process known as **amortization**:

Examples of costs that may qualify as start-up expenses include the following:

- A survey of potential markets.
- Analysis of available facilities, labor, supplies, etc.
- Advertisements for the opening of the business.
- Salaries and wages for trainee-employees and their instructors.
- Travel and other necessary costs for securing prospective distributors, suppliers, or customers. and fees for executives and consultants and for other professional services.

Start-up expenses do not include deductible interest, taxes, or research and experimental costs. Expenses not deductible within the first year can be amortized over 15 years.

CAR AND TRUCK EXPENSES

- If the car is owned by the business, insurance, title and loan documents must be in the name of the business. If this is the case, the personal use of the car has to be calculated and included in the employee/owner W2.
- If the car is in the name of the owner or employee, the business will reimburse the business use of the car.

ACTUAL EXPENSES

A business owner who uses the actual expense method will claim the business portion of the actual expenses paid to run the vehicle. Actual expenses include the cost of **gas**, **oil**, **insurance**, **tires**, **licenses**, **repairs**, **garage rent**, and **cleaning**. If the car is rented, the lease or rent amount can also be a tax deduction (within limitations). If the business owner owns the car, he or she may claim a depreciation tax deduction.

OPTIONAL METHOD (STANDARD MILEAGE RATE)

The second method is known as the optional, or **standard mileage rate**, method. Business owners who own or lease their cars and who don't operate a fleet of vehicles for their businesses are eligible for this method.

The standard mileage rate changes every year. Check **this link** to know the current rate. Business owners should take this into account when calculating their income and expenses or paying the expenses of employees.

ADDITIONAL EXPENSES

The standard mileage rate is considered to cover most of the ordinary expenses listed under the actual method. However, certain expenses may be claimed using either method. These expenses include:

PARKING FEES AND TOLLS

The cost of parking fees and tolls are tax-deductible when incurred while operating a vehicle for business purposes. For example, if you park your vehicle at a client's business and have to pay a fee, you can deduct its cost. You cannot, however, deduct the cost of fees paid to park a car at your own place of business.

It is important to mention that no matter which method; you need to track your business miles and your personal miles to be able to deduct it.

ACTUAL EXPENSES DEPRECIATION

Depreciation is the annual tax deduction allowed to recover the cost or other basis of business property with a useful life of more than one year. Generally, assets placed in service after 1986 are depreciated using the **Modified Accelerated Cost Recovery System, MACRS**. The term "MACRS" essentially refers to two different depreciation systems, the **General Depreciation System** and the **Alternative Depreciation System.**

The General Depreciation System is the most common and applies the depreciation rate against the asset. The Alternative Depreciation System is different in that the depreciation is deducted over longer periods of time. This system is generally used for listed property where the business use drops to below 50 percent and for situations where the General Depreciation System cannot be applied. But it doesn't apply if the standard tax deduction is claimed.

MILEAGE LOG

To be able to reimburse employees or owners for business use of car, or if the car belong sot the business, in any case, miles driven need to be tracked, personal and business, to calulate the percentage of business use. This is a requirement, if no supporting evidence for personal and business use there is no deduction available.

IRS COMPLIANCE LOGS that you need to have written down the following for each trip:

1. The date/time of trip
2. The total mileage of the trip
3. The beginning and ending addresses of the trip
4. And the business purpose. (this is the most commonly miss part that causes many people to lose an audit)

There are many apps available to track your miles, and you can also keep a paper record.

If you are using Quickbooks Online, they now have Mileage included in your monthly subscription. Another good one is MILEQ. If you are interested in getting this app you can get a discount using this promo code to get a 20% discount KNAV874A

OFFICE IN HOME

If you use part of your home exclusively and regularly for business you might be able to deduct a percentage of the expenses related to the home in your business tax return. There are specific requirements to be able to classify a space in the home as Home Office. Once you verify that you meet all the requirements, you'll be able to deduct **rent**, **mortgage interest**, **repairs and maintenance**, **utilities**, **internet**, and more, as long as it is just related to your home office.

CELL PHONE

You can only deduct the percentage of business use of your personal cell phone.

NON-DEDUCTIBLE EXPENSES

You need to know there are also expenses that are never deductible, like penalties and fees.

Also, for all the expenses we discuss in this paper to be deductible you need to keep good records, receipts (digital is fine), and any supporting document that will help prove the expense is ordinary and necessary.

This is especially true for Meals, Travel, Business use of car, and Business use of Home. All of these expenses need detailed explanations and supporting documents, reasons for the meal or travel, what was discussed during the meal, with whom, etc.

DO NOT MIX BUSINESS WITH PERSONAL TRANSACTIONS!

Your business books are not the place to keep track of your personal transactions. You need to have separate bank accounts and credit cards for your business.

Mingling your personal spending with your business operations can lead to mistakes, like claiming deductions you didn't deserve, or claiming a higher amount of business expenses than you actually had.

If you are sloppy with your deductions, this can lead to higher scrutiny from the IRS - or even an IRS tax audit, which can result in additional fees or fines depending on the nature of the oversight.

Another consequence of not separating your personal and business funds could come in the form of a lawsuit directed toward your company. Your business is supposed to exist as a **separate legal entity**, which helps protect your personal assets from lawsuits against your company.

But if you are combining your business and personal finances, this weakens your case for being considered "separate" from your business. By clouding that issue, you could open you up to significant risks.

In the event of a lawsuit and a judgment against your business, creditors might argue that you and your business are one and the same, since you share a bank account and pass funds back and forth fluidly.

By trying to "save money" mixing your business and personal finances, you might end up being personally liable for a devastating judgment in a lawsuit. **Don't take that risk!**