



Deductions For Business Owners

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SUMMARY

Within the day-to-day life of your small business, you will incur ordinary and necessary expenses that you can deduct when filing your taxes.

So what does that mean?

"Ordinary" means they are common and accepted in the general industry in which the business owner is working. "Necessary" means they are appropriate and required in operating your small business. Keep reading for more information on specific expenses you can deduct as a business owner.

DEDUCTIONS

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.

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.

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CONTRACT LABOR

Payments that are paid to independent contractors (non-employees) for services rendered are deductible.

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.

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.

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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.

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.

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.

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.

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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 system.

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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 property 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.

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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.

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.

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MEALS

Ordinary and necessary meals for current or prospective customer or client. Generally, only 50% of the cost of furnishing meals to employees is deductible.

The expenses can't be lavish or extravagant, and the tax deduction is generally limited to 50% of the expenses incurred.

The cost of business gifts to current or prospective customers is deductible up to a maximum of \$25 per customer per year.

Tickets to shows, sporting events, or "fun" activities given to clients to promote business are considered entertainment and non-deductible. If the business owner accompanies the customer to the event, the cost of the tickets is non-deductible as an entertainment expense.

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.

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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 day care.

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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.

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.

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.

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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.

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CAR AND TRUCK EXPENSES

A business owner who uses his or her automobile or reimburses an employee for using an automobile has two methods available for claiming car and truck expenses. The two methods are actual expenses or the optional method.

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.

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 business-use percentage of finance charges paid on the purchase of the vehicle. The business-use percentage of personal property taxes on the vehicle.

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