

Tax Deductions for Professionals

12th Edition

Stephen Fishman, J.D.

Table of Contents

Introduction	1
Chapter 1 – Tax Deduction Basics.....	3
Learning Objectives	3
Introduction.....	3
How Tax Deductions Work.....	3
Types of Tax Deductions	3
You Pay Taxes Only on Your Profits	4
You Must Have a Legal Basis for Your Deductions.....	4
The Value of a Tax Deduction.....	4
Federal and State Income Taxes	5
Social Security and Medicare Taxes	5
Total Tax Savings	6
What Professionals Can Deduct.....	6
Start-Up Expenses.....	7
Operating Expenses	7
Capital Expenses	7
Inventory.....	8
Review Questions.....	9
Review Answers	10
Chapter 2 – Choice of Business Entity.....	11
Learning Objectives	11
Introduction.....	11
Types of Business Entities	11
Sole Proprietorship	11
Limited Liability Company (LLC).....	12
Limited Liability Partnership (LLP).....	13
Corporation.....	13
Partnership	14
Limiting Your Liability	15
What Is Liability?.....	15
Liability for Professional Malpractice	16
Liability for Business Debts	16
Other Types of Liability	17
The Role of Insurance.....	18
The Four Ways Business Entities Are Taxed.....	18
Tax Treatment Choices.....	19
Sole Proprietorship Taxation	19
Partnership Taxation.....	20
S Corporation Taxation	20
C Corporation Taxation.....	21
Comparing Tax Treatments.....	22
Tax Deductions.....	22
Tax Rates	22
Owners' Employment Status.....	26
Fringe Benefits	29
Allocating Profits and Losses	29
Deducting Business Losses	30
Retaining Earnings in Your Business	31
State Taxes	33
IRS Audit Rates	33
Should You Change Your Business Entity or Tax Treatment?.....	34
The Cost of Converting to Another Business Form.....	34

Table of Contents

Changing Your Tax Treatment	36
Automatic Conversion of Your Business Entity	37
Review Questions	38
Review Answers	39
Chapter 3 – Operating Expenses	41
Learning Objectives	41
Introduction.....	41
Requirements for Deducting Operating Expenses	41
Ordinary and Necessary	41
Current Expense.....	42
Business Related.....	42
Reasonable	43
Operating Expenses That Are Not Deductible	44
Tax Reporting.....	44
Review Questions.....	45
Review Answers	46
Chapter 4 – Meal and Entertainment Expenses	47
Learning Objectives	47
Introduction.....	47
What Is Business Entertainment?	47
Activities That Aren’t Entertainment.....	47
Meals Can Be Travel or Entertainment.....	48
Who Can Be Entertained? ?.....	48
Deducting Entertainment Expenses	48
Business Discussions Before or After Entertainment	49
Business Discussions During Meals.....	49
Entertaining at Home	50
Entertainment in Clearly Business Settings	50
Calculating Your Deduction.....	50
Expenses Must Be Reasonable	51
Going “Dutch”	51
Expenses You Can’t Deduct	51
Entertainment Tickets	52
Meals for Employees	52
Expenses Reimbursed by Clients.....	53
Review Questions.....	54
Review Answers	55
Chapter 5 – Car and Local Travel Expenses	57
Learning Objectives	57
Introduction.....	57
Deductible Local Transportation Expenses.....	57
Travel Must Be for Business	57
Commuting Is Not Deductible.....	58
The Standard Mileage Rate	59
How the Standard Mileage Rate Works.....	60
When You Can Use the Standard Mileage Rate.....	60
The Actual Expense Method	61
How the Actual Expense Method Works.....	61
Record-Keeping Requirements	62
Vehicle Depreciation Deductions.....	62
Leasing a Car	66
Other Local Transportation Expenses	67
Reporting Transportation Expenses on Schedule C	67
When Clients Reimburse You	67

Table of Contents

Professionals With Business Entities.....	68
Using Your Own Car.....	68
Using a Company Car.....	69
Review Questions.....	71
Review Answers.....	73
Chapter 6 – Long-Distance Travel Expenses.....	75
Learning Objectives.....	75
Introduction.....	75
What Is Business Travel?.....	75
Where Is Your Tax Home?.....	76
Your Trip Must Be for Business.....	77
What Travel Expenses Are Deductible.....	78
Traveling First Class or Steerage.....	79
Taking People With You.....	79
How Much You Can Deduct.....	80
Travel Within the United States.....	80
Travel Outside the United States.....	80
Conventions.....	82
Travel by Ship.....	82
Calculating Time Spent on Business.....	83
50% Limit on Meal Expenses.....	83
Maximizing Your Business Travel Deductions.....	85
Plan Ahead.....	85
Make a Paper Trail.....	85
Maximize Your Business Days.....	85
Take Advantage of the Sandwich Day Rule.....	86
Travel Expenses Reimbursed by Clients.....	86
Review Questions.....	88
Review Answers.....	89
Chapter 7 – The Home Office Deduction.....	91
Learning Objectives.....	91
Introduction.....	91
Qualifying for the Home Office Deduction.....	91
Three Threshold Requirements.....	91
One of Five Additional Requirements.....	94
Special Requirement for Employees.....	97
Calculating the Home Office Deduction.....	98
How Much of Your Home Is Used for Business?.....	98
What Expenses Can You Deduct?.....	99
Simplified Home Office Deduction Method.....	103
How the Simple Method Works.....	104
Is the Simplified Method a Good Deal?.....	104
How to Deduct Home Office Expenses.....	105
Sole Proprietors.....	105
LLCs, LLPs, and Partnerships.....	105
Corporations.....	106
Audit-Proofing Your Home Office Deduction.....	107
Review Questions.....	109
Review Answers.....	110
Chapter 8 – Deductions for Outside Offices.....	111
Learning Objectives.....	111
Introduction.....	111
If You Rent Your Office.....	111
Timing of Deductions.....	111

Table of Contents

Improvements and Repairs	112
Cost of Modifying a Lease	113
Cost of Canceling a Lease	113
If You Own Your Office	113
Operating Expenses	113
Improvements and Repairs	113
Section 179 Expensing	114
Depreciation Deductions	114
Loss for Replaced Structural Components	116
Interest Deductions	116
Property Taxes	117
Tax Incentives for Improving Access for the Disabled	117
Energy Efficiency Deduction	118
If You Lease a Building to Your Practice	119
Review Questions	120
Review Answers	121
Chapter 9 – Deducting Long-Term Assets	123
Learning Objectives	123
Introduction	123
What Is a Long-Term Asset?	123
Repairs Versus Improvements: The New IRS Regulations	124
Routine Maintenance Safe Harbor	125
Improvements to Real Property?	126
How Do the Rules Affect Prior Years?	126
Methods for Deducting Business Assets	126
Rules for Deducting Any Long-Term Asset	128
What Property Is Eligible	128
Real Versus Personal Property	128
Mixed-Use Property	128
Listed Property	129
When Depreciation Starts and Ends	129
How Much You Can Deduct	129
Disposing of Long-Term Assets	130
Section 179 Deductions	131
Property You Can Deduct	131
Calculating Your Deduction	132
Recapture Under Section 179	134
Bonus Depreciation	134
Property That Qualifies for Bonus Depreciation	135
Placed-in-Service Date	135
Class-Wide Requirement	135
Calculating the Bonus Amount	135
Opting Out of the Bonus	136
Deducting Inexpensive Property	136
Property Costing \$2,500 or Less: The De Minimis Safe Harbor	137
Maximum De Minimis Amount	137
Deducting Materials and Supplies	139
Regular Depreciation	140
When to Use Regular Depreciation	140
When You Can't Use Section 179	140
When You Can't Use Bonus Depreciation	141
Depreciation Period	141
First-Year Depreciation	141
Depreciation Methods	142
How to Deduct Listed Property	145
Real Property	146

Table of Contents

Tax Reporting and Record Keeping for Section 179 and Depreciation.....	147
Leasing Long-Term Assets	149
Leasing Versus Purchasing.....	149
Leases Versus Installment Purchases.....	149
Review Questions.....	151
Review Answers	152
Chapter 10 – Start-Up Expenses.....	153
Learning Objectives	153
Introduction.....	153
What Are Start-Up Expenses?	153
Starting a New Practice.....	153
Common Start-Up Expenses.....	153
Costs That Are Not Start-Up Expenses	154
Buying an Existing Practice.....	155
Expanding an Existing Practice	155
When Does a Professional Practice Begin?	156
How to Deduct Start-Up Expenses	156
Who Gets Start-Up Deductions	157
If Your Practice Doesn't Last 15 Years	157
Organizational Expenses	157
Review Questions.....	159
Review Answers	160
Chapter 11 – Medical Expenses.....	161
Learning Objectives	161
Introduction.....	161
The Affordable Care Act (Obamacare).....	161
Health Insurance Mandate	161
Obamacare Health Insurance Rules.....	163
State Health Insurance Exchanges	163
Open Enrollment Periods	164
Health Insurance Premium Assistance Credits.....	165
The Personal Deduction for Medical Expenses	165
Self-Employed Health Insurance Deduction	166
Business Income Limitation.....	166
Designating Your Plan Sponsor	167
No Other Health Insurance Coverage	167
Tax Reporting.....	167
Deducting Health Insurance as an Employee Fringe Benefit	168
Deducting Health Insurance Costs Paid on Behalf of Employees.....	168
Sole Proprietors, LLCs, S Corporations, Partnerships, and LLPs.....	169
C Corporations	169
Employing Your Spouse.....	170
Tax Credits for Employee Health Insurance	171
Requirement #1: You Must Have Employees	171
Requirement #2: Your Employee Compensation Must Average Less Than \$51,800	171
Requirement #3: You Must Obtain Health Insurance through State SHOP Exchange	171
Requirement #4: You Must Pay at Least 50% of Employee Health Insurance Premiums	172
Amount of the Credit.....	172
Unused Credit Amounts.....	172
Adopting a Health Reimbursement Arrangement.....	172
What Is a Health Reimbursement Arrangement?.....	172
Impact of Obamacare on HRAs.....	174
What Expenses May Be Reimbursed?	174
How to Establish an HRA.....	174
Sample HRA.....	174
Complying With Annual Reporting and Fee Requirements	175
Health Savings Accounts	176

Table of Contents

What Are Health Savings Accounts?	176
Establishing an HSA	176
Making Contributions to Your HSA	178
Deducting HSA Contributions	178
Withdrawing HSA Funds	179
Are HSAs a Good Deal?	180
HSAs for Employees	180
Tax Reporting for HSAs	181
Review Questions	182
Review Answers	183
Chapter 12 – Retirement Deductions	185
Learning Objectives	185
Introduction	185
Why You Need a Retirement Plan (or Plans)	185
Tax Deduction	186
Tax Deferral	186
Types of Retirement Plans	188
Individual IRAs	188
Employer IRAs	188
Tax-Qualified Plans	188
Nonqualified Plans	188
Individual Retirement Accounts—IRAs	189
Traditional IRAs	189
Roth IRAs	190
IRAs for Businesses	191
SEP-IRAs	191
SIMPLE IRAs	192
Qualified Retirement Plans	193
Defined Benefit Plans	194
Defined Contribution Plans	194
Keogh Plans	194
Setting Up a Keogh Plan	194
Profit-Sharing Plans	195
Money Purchase Plans	195
Withdrawing Your Money	195
Solo 401(k) Plans	195
Roth 401(k) Plans	196
Review Questions	197
Review Answers	198
Chapter 13 – Inventory	199
Learning Objectives	199
Introduction	199
What Is Inventory?	199
Supplies Are Not Inventory	200
Incidental Supplies	200
Do You Have to Carry an Inventory?	201
Deducting Inventory Costs	201
Computing the Cost of Goods Sold	201
Determining the Value of Inventory	202
IRS Reporting	202
Review Questions	204
Review Answers	205
Chapter 14 – More Deductions	207
Learning Objectives	207
Introduction	207
Advertising	207

Table of Contents

Goodwill Advertising	207
Giveaway Items	208
Website Development and Maintenance	208
Permanent Signs	208
Business Bad Debts.....	208
Three Requirements for Deduction.....	209
Applying the Rules.....	210
Casualty Losses	212
Amount of Deduction	212
Special Rules for Losses Related to Federally Declared Disasters	213
Charitable Contributions.....	213
Contributions of Money	213
Contributions of Property	213
Contributions of Services	214
Clothing	214
Disabled Access Tax Credit.....	215
Use of Credit by Health Care Providers.....	215
Amount of Credit.....	215
License Fees, Dues, and Subscriptions.....	215
Education Expenses	216
Entering a New Profession.....	216
Minimum Educational Requirements	216
Traveling for Education	217
Gifts.....	217
Insurance for Your Practice.....	217
Homeowners' Insurance for Your Home Office.....	218
Car Insurance	218
Interest on Business Loans.....	218
Home Offices.....	218
Car Loans.....	218
Loans to Buy a Practice	219
Loans From Relatives and Friends.....	219
Interest You Can't Deduct.....	219
Keeping Track of Borrowed Money	219
Legal and Professional Services	219
Buying Long-Term Property	220
Starting a Practice	220
Accounting Fees.....	220
Taxes	220
Income Taxes.....	220
Self-Employment Taxes.....	220
Employment Taxes	220
Sales Taxes.....	221
Real Property Taxes	221
Other Taxes.....	222
Domestic Production Activities	222
Activities That Qualify for the Deduction	222
Amount of Deduction	222
Limits on the Deduction.....	223
Review Questions.....	224
Review Answers	225
Chapter 15 – Hiring Employees and Independent Contractors	227
Learning Objectives	227
Introduction.....	227
Employees Versus Independent Contractors.....	227
Tax Deductions for Employee Pay and Benefits	229
Employee Pay	229

Table of Contents

Payroll Taxes.....	230
State Payroll Taxes.....	231
Employee Fringe Benefits.....	232
Reimbursing Employees.....	232
Reimbursement Under an Accountable Plan.....	233
Unreimbursed Employee Expenses.....	233
Employing Your Family.....	234
Employing Your Children.....	234
Employing Your Spouse.....	235
Rules to Follow When Employing Your Family.....	236
Tax Deductions When You Hire Independent Contractors.....	238
No Deductions for ICs' Taxes.....	238
Paying Independent Contractors' Expenses.....	239
Review Questions.....	240
Review Answers.....	241
Chapter 16 – Professionals Who Incorporate.....	243
Learning Objectives.....	243
Introduction.....	243
Automatic Employee Status.....	243
Paying Yourself.....	244
The Tax Treatment of Compensation Versus Distributions.....	244
C Corporations and the Advantages of Employee Compensation.....	245
S Corporations and the Advantages of Corporate Distributions.....	248
Employee Fringe Benefits.....	250
Qualified Fringe Benefits.....	250
Types of Fringe Benefits.....	251
Benefits That Are Not Tax Deductible.....	254
Shareholder Loans.....	254
Only Bona Fide Loans Are Recognized by the IRS.....	255
Below-Market Loans.....	255
Review Questions.....	256
Review Answers.....	257
Chapter 17 – How You Pay Business Expenses.....	259
Learning Objectives.....	259
Introduction.....	259
Your Practice Pays.....	259
Tax Treatment.....	259
Documentation Requirements.....	260
Using Personal Funds to Pay for Business Expenses.....	260
LLCs, Partnerships, and LLPs.....	260
Corporations.....	262
Your Client Reimburses You.....	264
Accountable Plans.....	265
What Is an Accountable Plan?.....	265
Time Limit to Make Adequate Accounting.....	265
Payments Not Made Under an Accountable Plan.....	266
Review Questions.....	267
Review Answers.....	268
Chapter 18 – Staying Out of Trouble With the IRS.....	269
Learning Objectives.....	269
Introduction.....	269
Anatomy of an Audit.....	269
How Small Business Owners Get in Trouble With the IRS.....	269
Records Available to Auditors.....	269

Table of Contents

The IRS: Clear and Present Danger or Phantom Menace?.....	270
How Tax Returns Are Selected for Audits.....	270
DIF Scores	270
IRS Income Matching Program	271
Groups Targeted for Audit.....	272
Tips and Referrals	272
Tax Shelters, Scams, and Schemes.....	272
Tax Shelters	272
Tax Scams and Schemes	273
Tips for Avoiding an Audit	274
Review Questions.....	276
Review Answers	277
Chapter 19 – Record Keeping and Accounting.....	279
Learning Objectives	279
Introduction.....	279
Recording Your Expenses	279
Your Accounting System.....	279
Documenting Your Deductions.....	280
What Supporting Documents Do You Need?.....	280
Automobile Mileage and Expense Records	283
Entertainment, Meal, Travel, and Gift Expenses	285
Listed Property	288
How Long to Keep Your Records	289
What If You Don't Have Proper Tax Records?.....	290
Accounting Methods	290
Cash Method	291
Accrual Method.....	292
Tax Years.....	294
Review Questions.....	295
Review Answers	296
Chapter 20 – Help Beyond This Book.....	297
Learning Objectives	297
Introduction.....	297
Information From the IRS.....	297
IRS Website	297
IRS Booklets and Downloads.....	297
IRS Telephone Information	297
Online Learning Resources.....	297
Other Online Tax Resources.....	298
Publications for the Nonexpert	298
Review Questions.....	300
Review Answers	301
Glossary.....	303
Index	307