

Small Business Tax Deductions

14th Edition

Stephen Fishman, J.D.

Table of Contents

Chapter 1 – Tax Deduction Basics	1
Learning Objectives	1
Introduction.....	1
How Tax Deductions Work.....	1
Types of Tax Deductions	1
You Only Pay Taxes on Your Business Profits	2
You Must Have a Legal Basis for Your Deductions.....	2
You Must Be in Business to Claim Business Deductions	2
How Businesses Are Taxed	2
Basic Business Forms	3
Tax Treatment	3
Spouses Who Co-Own a Business.....	5
The Value of a Tax Deduction.....	6
Federal and State Income Taxes	7
Self-Employment Taxes.....	7
Total Tax Savings	8
What Businesses Can Deduct.....	8
Start-Up Expenses.....	9
Operating Expenses	9
Capital Expenses.....	9
Inventory.....	10
Businesses That Lose Money	11
Figuring a Net Operating Loss	11
Carrying a Loss Back.....	11
Carrying a Loss Forward.....	11
Review Questions.....	13
Review Answers	14
Chapter 2 – Are You Really in Business?	15
Learning Objectives	15
Introduction.....	15
What Is a Business?	15
Profit Test.....	15
Behavior Test	16
Tax Consequences of Being a Hobbyist.....	19
Income-Producing Activities.....	20
Tax Consequences of Income-Producing Activities	20
Review Questions.....	22
Review Answers	23
Chapter 3 – Start-Up Expenses	25
Learning Objectives	25
Introduction.....	25
What Are Start-Up Expenses?	25
Starting a New Business	25
Common Start-Up Expenses.....	25
Costs That Are Not Start-Up Expenses	26
Buying an Existing Business	27
Expanding an Existing Business	27
When Does a Business Begin?.....	28
Retail Businesses	28
Manufacturers.....	28
Knowledge Workers.....	28
Service Providers.....	28

Table of Contents

An Existing Business	28
Claiming the Deduction.....	29
If Your Business Doesn't Last 15 Years	29
Organizational Expenses	29
Review Questions.....	31
Review Answers	32
Chapter 4 – Business Operating Expenses.....	33
Learning Objectives	33
Introduction.....	33
Requirements for Deducting Operating Expenses	33
Ordinary and Necessary	33
Current Expense.....	35
Business-Related.....	36
Reasonable	37
Operating Expenses That Are Not Deductible	38
Tax Reporting.....	38
Review Questions.....	39
Review Answers	40
Chapter 5 – Deducting Long-Term Assets	41
Learning Objectives	41
Introduction.....	41
What Is a Long-Term Asset?.....	41
Repairs Versus Improvements: The New IRS Regulations	42
Routine Maintenance Safe Harbor	43
Real Property Improvements.....	44
Methods for Deducting Business Assets	44
Deducting Inexpensive Property.....	45
The De Minimis Safe Harbor.....	45
The Materials and Supplies Deduction.....	48
Rules for Deducting Any Long-Term Asset.....	48
What Property Is Eligible.....	48
Real Versus Personal Property	49
Mixed-Use Property	49
Listed Property	50
When Depreciation Starts and Ends.....	50
How Much You Can Deduct	50
Disposing of Long-Term Assets	51
Section 179	51
Property You Can Deduct.....	52
Calculating Your Deduction.....	53
Recapture Under Section 179.....	55
Bonus Depreciation	56
How It Works	56
Property that Qualifies for Bonus Depreciation	57
Placed In Service Date	57
Class-Wide Requirement	57
Calculating the Bonus Amount	57
Opting Out of the Bonus.....	57
Regular Depreciation	58
When to Use Regular Depreciation	58
Depreciation Period	59
First-Year Depreciation.....	59
Depreciation Methods.....	60
Depreciation Rules for Listed property.....	61
Real Property.....	61

Table of Contents

Intangible Assets	62
Natural Resources	62
Depreciation Recapture	63
Tax Reporting and Record Keeping	63
Leasing Long-Term Assets	64
Leasing Versus Purchasing.....	64
Leases Versus Installment Purchases.....	65
Review Questions.....	67
Review Answers	68
Chapter 6 – Inventory	69
Learning Objectives	69
Introduction.....	69
What Is Inventory?	69
Supplies Are Not Inventory	69
Incidental Supplies.....	70
Long-Term Assets	70
Deducting Inventory Costs	71
Computing the Cost of Goods Sold	71
IRS Reporting for Cost of Goods Sold.....	71
Maintaining an Inventory	72
When You Provide Services and Sell Merchandise	72
Supplies for Providing a Service.....	73
Determining the Value of Inventory	73
Review Questions.....	74
Review Answers	75
Chapter 7 – Office Expenses.....	77
Learning Objectives	77
Introduction.....	77
Qualifying for the Home Office Deduction.....	77
Threshold Requirement: Regular and Exclusive Business Use	79
Additional Requirements.....	80
Storing Inventory or Product Samples at Home	83
Corporation Employees.....	83
Calculating the Home Office Deduction.....	84
How Much of Your Home Is Used for Business?	84
What Expenses Can You Deduct?	85
Simplified Home Office Deduction Method	89
How the Simple Method Works	89
Is the Simplified Method a Good Deal?	90
IRS Reporting Requirements	91
Sole Proprietors.....	91
LLCs and Partnerships	91
Corporations.....	91
Deducting an Outside Office or Workplace.....	91
Renting an Outside Workplace.....	91
Buying an Outside Workplace	94
Review Questions.....	95
Review Answers	96
Chapter 8 – Car and Local Travel Expenses	97
Learning Objectives	97
Introduction.....	97
Deductible Local Transportation Expenses.....	97
Travel Must Be for Business	97
Commuting Is Not Deductible.....	98

Table of Contents

The Standard Mileage Rate	102
How the Standard Mileage Rate Works.....	103
Requirements to Use the Standard Mileage Rate.....	103
The Actual Expense Method	104
How the Actual Expense Method Works.....	105
Record-Keeping Requirements	105
Vehicle Depreciation Deductions.....	106
Leasing a Car	110
Other Local Transportation Expenses	110
When Clients or Customers Reimburse You	110
Reporting Transportation Expenses on Schedule C	111
Corporations, LLCs, and Partnerships.....	111
Using Your Own Car.....	112
Using a Company Car.....	113
Review Questions.....	114
Review Answers	115
Chapter 9 – Business Travel	117
Learning Objectives	117
Introduction.....	117
What Is Business Travel?	117
Where Is Your Tax Home?.....	118
Your Trip Must Be for Business.....	120
What Travel Expenses Are Deductible	121
Traveling First Class or Steerage	122
Taking People With You.....	122
How Much You Can Deduct.....	122
Travel Within the United States	122
Travel Outside the United States.....	123
Conventions	125
Travel by Ship.....	125
Calculating Time Spent on Business	125
50% Limit on Meal Expenses	126
Maximizing Your Business Travel Deductions	128
Plan Ahead.....	128
Make a Paper Trail	128
Maximize Your Business Days	128
Take Advantage of the Sandwich Day Rule.....	129
How to Deduct Travel Expenses	129
Sole Proprietors.....	129
Partnerships and LLCs	129
Corporations.....	130
Travel Expenses Reimbursed by Clients or Customers	130
Review Questions.....	131
Review Answers	132
Chapter 10 – Meal and Entertainment Expenses	133
Learning Objectives	133
Introduction.....	133
What Is Business Entertainment?	133
Activities That Aren't Entertainment.....	133
Meals Can Be Travel or Entertainment.....	134
Who You Can Entertain	134
Deducting Entertainment Expenses	134
Business Discussions Before or After Entertainment.....	135
Business Discussions During Meals.....	135
Entertaining at Home	136

Table of Contents

Entertainment in Clear Business Settings.....	136
Calculating Your Deduction.....	136
Expenses Must Be Reasonable	137
Going “Dutch”	137
Expenses You Can’t Deduct	137
Entertainment Tickets	138
Reimbursed Expenses.....	139
Meals for Employees	139
Reporting Entertainment Expenses on Your Tax Return.....	139
Sole Proprietors.....	140
Partnerships, LLCs, and LLPs.....	140
Corporations.....	140
Review Questions.....	141
Review Answers	142
Chapter 11 – Hiring Workers.....	143
Learning Objectives	143
Introduction.....	143
Employees Versus Independent Contractors.....	143
Tax Deductions for Employee Pay and Benefits.....	145
Employee Pay	145
Payroll Taxes.....	147
Employee Fringe Benefits.....	149
Reimbursing Employees for Business-Related Expenditures.....	150
Accountable Plans	150
Unaccountable Plans.....	152
Unreimbursed Employee Expenses	152
Employing Your Family or Yourself	152
Employing Your Children	153
Employing Your Spouse.....	154
Rules to Follow When Employing Your Family	154
Employing Yourself.....	155
Tax Deductions When You Hire Independent Contractors.....	156
No Deductions for IC’s Taxes.....	157
Paying Independent Contractors’ Expenses	157
Review Questions.....	159
Review Answers	160
Chapter 12 – Retirement Deductions.....	161
Learning Objectives	161
Introduction.....	161
Why You Need a Retirement Plan (or Plans).....	161
Tax Deduction	162
Tax Deferral.....	162
Individual Retirement Accounts—IRAs.....	163
Traditional IRAs	164
Roth IRAs.....	164
Employer IRAs.....	165
SEP-IRAs	165
SIMPLE IRAs.....	166
Keogh Plans.....	166
Types of Keogh Plans.....	166
Setting Up a Keogh Plan.....	167
Solo 401(k) Plans	167
Review Questions.....	169
Review Answers	170

Table of Contents

Chapter 13 – Medical Expenses **171**

 Learning Objectives 171

 Introduction..... 171

 The Affordable Care Act (Obamacare) 171

 Health Insurance Mandate 171

 Obamacare Health Insurance Rules..... 173

 State Health Insurance Exchanges 173

 Open Enrollment Periods 174

 Health Insurance Premium Assistance Credits 174

 The Personal Deduction for Medical Expenses 175

 Deducting Health Insurance Costs 175

 Personal Income Tax Deduction for the Self-Employed 176

 Deducting Health Insurance as a Business Expense 177

 Tax Credits for Employee Health Insurance 179

 Adopting a Health Reimbursement Arrangement..... 180

 Spousal Health Reimbursement Accounts..... 182

 HRAs for Businesses With Multiple Employees 183

 Complying with Annual Reporting and Fee Requirements 184

 Health Savings Accounts 184

 What Are Health Savings Accounts? 184

 Establishing Your HSA..... 185

 Making Contributions to Your HSA 186

 Deducting HSA Contributions..... 187

 Withdrawing HSA Funds 187

 HSAs for Employees..... 188

 Tax Reporting for HSAs 189

 Review Questions 190

 Review Answers 191

Chapter 14 – Additional Deductions **193**

 Learning Objectives 193

 Introduction..... 193

 Advertising..... 193

 Goodwill Advertising 193

 Giveaway Items 194

 Website Development and Maintenance 194

 Permanent Signs 194

 Business Bad Debts..... 194

 Three Requirements to Deduct Bad Debts 195

 Types of Bad Debts 196

 Casualty Losses 198

 Amount of Deduction 198

 Damage to Your Home Office 199

 Tax Reporting 199

 Charitable Contributions..... 199

 Contributions by Proprietors, LLCs, Partnerships, and S Corporations 199

 Clothing 200

 Dues and Subscriptions 200

 Education Expenses 201

 Starting a New Business 201

 Minimum Educational Requirements 201

 Traveling for Education 202

 Gifts..... 202

 Insurance for Your Business 203

 Homeowners’ Insurance for Your Home Office..... 203

 Car Insurance 203

 Interest on Business Loans..... 203

Table of Contents

Home Offices.....	204
Car Loans.....	204
Loans to Buy a Business.....	204
Loans From Relatives and Friends.....	204
Interest You Can't Deduct.....	204
Legal and Professional Services.....	205
Buying Long-Term Property.....	205
Starting a Business.....	205
Accounting Fees.....	205
Taxes and Licenses.....	206
Income Taxes.....	206
Self-Employment Taxes.....	206
Employment Taxes.....	206
Sales Taxes.....	206
Real Property Taxes.....	207
Other Taxes.....	207
License Fees.....	208
Review Questions.....	209
Review Answers.....	210
Chapter 15 – Record Keeping and Accounting.....	211
Learning Objectives.....	211
Introduction.....	211
What Records Do You Need?.....	211
Business Checkbook and Credit Cards.....	211
Calendar or Appointment Book.....	212
Records of Your Business Income and Expenses.....	214
Tracking Your Business Expenses.....	215
Supporting Documents.....	216
Records Required for Specific Expenses.....	219
Automobile Mileage and Expense Records.....	219
Entertainment, Meal, Travel, and Gift Expenses.....	221
Listed Property.....	224
How Long to Keep Records.....	224
What If You Don't Have Proper Tax Records?.....	225
Accounting Methods.....	225
Cash Method.....	226
Accrual Method.....	227
Which Is Better: Accrual or Cash Method Accounting?.....	228
Tax Years.....	229
Review Questions.....	230
Review Answers.....	231
Chapter 16 – Staying Out of Trouble with the IRS.....	233
Learning Objectives.....	233
Introduction.....	233
What Every Business Owner Needs to Know About the IRS.....	233
Anatomy of an Audit.....	233
The IRS: Clear and Present Danger or Phantom Menace?.....	234
You Are a Prime IRS Target.....	235
How Tax Returns Are Selected for Audits.....	235
Eight Tips for Avoiding an Audit.....	237
Tip #1: Be Neat, Thorough, and Exact.....	237
Tip #2: Don't File Early.....	237
Tip #3: Form a Business Entity.....	237
Tip #4: Explain Items the IRS Will Question.....	237
Tip #5: Avoid Ambiguous or General Expenses.....	238

Table of Contents

Tip #6: Report All of Your Income	238
Tip #7: Watch Your Income-to-Deduction Ratio.....	238
Tip #8: Beware of Abnormally Large Deductions	238
Review Questions.....	239
Review Answers	240
Glossary.....	241
Index	245