

Small Business Tax Deductions

17th 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	2
Tax Treatment	4
Spouses Who Co-Own a Business.....	6
The Value of a Tax Deduction.....	7
Federal and State Income Taxes	7
Self-Employment Taxes.....	8
Total Tax Savings	9
What Businesses Can Deduct.....	9
Start-Up Expenses.....	9
Operating Expenses	10
Capital Expenses.....	10
Pass-Through Tax Deduction.....	10
Inventory.....	10
Review Questions.....	14
Review Answers	15
Chapter 2 – Are You Really in Business?.....	17
Learning Objectives	17
Introduction.....	17
What Is a Business?	17
Profit Test.....	17
Behavior Test	18
Tax Consequences of Being a Hobbyist.....	21
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.....	26
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
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

Table of Contents

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.....	35
Reasonable	37
Operating Expenses That Are Not Deductible	37
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
Deducting Inexpensive Property: The De Minimis Safe Harbor and Materials and Supplies	
Deduction	42
The De Minimis Safe Harbor	42
The Materials and Supplies Deduction	45
Deducting Long-Term Personal Property: Bonus Depreciation, Section 179, Regular Depreciation	46
Property Eligible to Deduct.....	46
Mixed-Use Property	47
When to Take Your Deduction	47
How Much You Can Deduct	47
Disposing of Long-Term Property.....	48
Listed Property	48
Bonus Depreciation	49
Property That Qualifies for Bonus Depreciation	49
Calculating the Bonus Amount	49
Class-Wide Requirement	50
Opting Out of the Bonus.....	50
Bonus Depreciation Percentages	50
Section 179 Expensing	51
Deducting Repairs and Improvements.....	51
Regular Depreciation	52
When to Use Regular Depreciation	52
How Regular Depreciation Works	53
First-Year Depreciation	53
Depreciation Methods	54
Depreciation Rules for Listed property.....	55
Deducting Real Property	55
Land	55
Buildings.....	55
Building Improvements	56
Intangible Assets	57
Tax Reporting and Record Keeping	57
Leasing Long-Term Assets	58
Review Questions.....	60
Review Answers	61
Chapter 6 – Inventory.....	63
Learning Objectives	63
Introduction.....	63
What Is Inventory?.....	63
Supplies Are Not Inventory	63
Incidental Supplies.....	63

Table of Contents

Long-Term Assets	64
Deducting Inventory Costs	64
Nonincidental Materials and Supplies Deduction	64
Books and Records Deduction for Inventory	65
Maintaining an Inventory	65
Review Questions	67
Review Answers	68
Chapter 7 – Office Expenses.....	69
Learning Objectives	69
Introduction.....	69
Qualifying for the Home Office Deduction.....	69
Threshold Requirement: Regular and Exclusive Business Use	71
Additional Requirements.....	72
Storing Inventory or Product Samples at Home	75
Corporation Employees.....	75
Calculating the Home Office Deduction.....	76
How Much of Your Home Is Used for Business?	76
What Expenses Can You Deduct?	77
Simplified Home Office Deduction Method	80
How the Simple Method Works	81
Is the Simplified Method a Good Deal?	82
IRS Reporting Requirements	82
Sole Proprietors	82
LLCs and Partnerships	82
Deducting an Outside Office or Workplace.....	83
Renting an Outside Workplace.....	83
Buying an Outside Workplace	85
Review Questions	86
Review Answers	87
Chapter 8 – Car and Local Travel Expenses	89
Learning Objectives	89
Introduction.....	89
Deductible Local Transportation Expenses.....	89
Travel Must Be for Business	89
Commuting Is Not Deductible.....	90
The Standard Mileage Rate	94
How the Standard Mileage Rate Works.....	95
Requirements to Use the Standard Mileage Rate	95
The Actual Expense Method	96
How the Actual Expense Method Works.....	96
Record-Keeping Requirements	97
Vehicle Depreciation Deductions.....	97
Leasing a Car	102
Other Local Transportation Expenses	103
When Clients or Customers Reimburse You	103
Reporting Transportation Expenses on Schedule C	104
Corporations, LLCs, and Partnerships.....	104
Using Your Own Car	104
Using a Company Car.....	105
Review Questions	107
Review Answers	108
Chapter 9 – Business Travel.....	109
Learning Objectives	109
Introduction.....	109
What Is Business Travel?	109

Table of Contents

Where Is Your Tax Home?.....	110
Your Trip Must Be for Business.....	112
What Travel Expenses Are Deductible.....	113
Traveling First Class or Steerage	114
Taking People With You.....	114
How Much You Can Deduct.....	114
Travel Within the United States.....	114
Travel Outside the United States.....	115
Conventions	116
Travel by Ship.....	117
Calculating Time Spent on Business.....	117
50% Limit on Meal Expenses	118
Maximizing Your Business Travel Deductions.....	119
Plan Ahead.....	120
Make a Paper Trail	120
Maximize Your Business Days.....	120
Take Advantage of the Sandwich Day Rule.....	120
How to Deduct Travel Expenses	121
Sole Proprietors.....	121
Partnerships and LLCs	121
Corporations	121
Travel Expenses Reimbursed by Clients or Customers.....	122
Review Questions.....	123
Review Answers	124
Chapter 10 – The Pass-Through Tax Deduction.....	125
Learning Objectives	125
Introduction.....	125
You Must Have a Pass-Through Business	125
You Must Have Qualified Business Income.....	126
You Must Have Taxable Income	126
Deduction for Taxable Income Up to \$163,300 (\$326,600 if Married).....	127
Deduction for Income Above \$163,300 (\$326,600 if Married)	127
Are You a Specified Service Business?.....	127
Deduction for Non-Service Businesses (Income Above \$163,300/\$326,600).....	128
Deduction for Specified Service Business Owners (Income Above \$163,300/\$326,600).....	130
Taking the Pass-Through Deduction	130
Strategies to Maximize the Pass-Through Deduction.....	131
Keep Service Business Income Below the \$213,300/\$426,600 Threshold	131
Separating Out Nonservice Income?.....	131
Form an S Corporation	132
Combine Multiple Nonservice Businesses	132
File a Separate Return.....	133
Review Questions.....	134
Review Answers	135
Chapter 11 – Hiring Workers.....	137
Learning Objectives	137
Introduction.....	137
Employees Versus Independent Contractors.....	137
Tax Deductions for Employee Pay and Benefits	139
Employee Pay	139
Payroll Taxes.....	141
Employee Fringe Benefits	143
Reimbursing Employees for Business-Related Expenditures.....	145
Accountable Plans	145
Unaccountable Plans	147
No Deduction for Unreimbursed Employee Expenses	148

Table of Contents

Employing Your Family or Yourself	148
Employing Your Children	148
Employing Your Spouse.....	149
Rules to Follow When Employing Your Family	150
Employing Yourself.....	151
Tax Deductions When You Hire Independent Contractors	152
No Deductions for IC's Taxes.....	152
Paying Independent Contractors' Expenses	152
Review Questions.....	154
Review Answers	155
Chapter 12 – Retirement Deductions.....	157
Learning Objectives	157
Introduction.....	157
Why You Need a Retirement Plan (or Plans).....	157
Tax Deduction	158
Tax Deferral.....	158
Individual Retirement Accounts—IRAs.....	159
Traditional IRAs.....	160
Roth IRAs.....	161
Employer IRAs.....	162
SEP-IRAs	162
SIMPLE IRAs.....	162
Keogh Plans	163
Types of Keogh Plans.....	163
Setting Up a Keogh Plan.....	163
Solo 401(k) Plans	164
Review Questions.....	166
Review Answers	167
Chapter 13 – Medical Expenses.....	169
Learning Objectives	169
Introduction.....	169
The Affordable Care Act (ACA)	169
Federal Individual Health Insurance Mandate Terminated	169
The Employer Mandate.....	170
ACA Health Insurance Rules.....	170
State Health Insurance Exchanges	170
Open Enrollment Periods	171
Health Insurance Premium Assistance Credits	172
The Personal Deduction for Medical Expenses	172
Deducting Health Insurance Costs	173
Personal Income Tax Deduction for the Self-Employed	173
Deducting Health Insurance as a Business Expense	174
Sick and Family Leave Tax Credits for the Self-Employed	177
Sick Leave Credit.....	177
Family Leave Credit.....	177
Calculating the Credit.....	177
Claiming the Credit	177
Tax Credits for Employee Health Insurance	178
Adopting a Health Reimbursement Arrangement	178
Spousal Health Reimbursement Accounts.....	178
Individual Coverage HRAs (ICHRAs)	181
Individual Coverage HRAs (ICHRAs)	182
Qualified Small Employer HRAs (QSEHRAs)	183
Health Savings Accounts	184
What Are Health Savings Accounts?	184
Establishing Your HSA.....	184

Table of Contents

Making Contributions to Your HSA.....	185
Deducting HSA Contributions.....	186
Withdrawing HSA Funds.....	187
HSAs for Employees.....	188
Tax Reporting for HSAs	188
Review Questions.....	189
Review Answers	190
Chapter 14 – Additional Deductions.....	191
Learning Objectives	191
Introduction.....	191
Advertising.....	191
Goodwill Advertising	191
Giveaway Items	192
Website Development and Maintenance	192
Permanent Signs	192
Business Bad Debts.....	192
Three Requirements to Deduct Bad Debts	193
Types of Bad Debts	194
Casualty Losses	196
Amount of Deduction	196
Damage to Your Home Office	197
Tax Reporting	197
Charitable Contributions.....	198
Contributions by Sole Proprietors, LLCs, Partnerships, and S Corporations.....	198
Clothing	198
Dues and Subscriptions	199
Education Expenses	199
Starting a New Business	200
Minimum Educational Requirements.....	200
Traveling for Education	200
Entertainment and Meals	200
Entertainment	201
Meals.....	201
Gifts.....	203
Insurance for Your Business	203
Homeowners' Insurance for Your Home Office.....	203
Car Insurance	204
Interest on Business Loans	204
Home Offices.....	204
Car Loans.....	204
Loans to Buy a Business.....	204
Loans From Relatives and Friends.....	205
Interest You Can't Deduct	205
Limitation on Deducting Interest by Larger Businesses.....	205
Legal and Professional Services	206
Buying Long-Term Property	206
Starting a Business	206
Accounting Fees.....	206
Taxes and Licenses	206
Income Taxes	206
Self-Employment Taxes	206
Employment Taxes	207
Sales Taxes.....	207
Real Property Taxes	207
Other Taxes.....	208
License Fees	208
Review Questions.....	209
Review Answers	210

Table of Contents

Chapter 15 – Record Keeping and Accounting	211
Learning Objectives	211
Introduction.....	211
What Records Do You Need?	211
Business Checkbook and Credit Cards	211
Records of Your Business Income and Expenses	212
Tracking Your Business Expenses	214
Supporting Documents	215
Records Required for Specific Expenses	218
Automobile Mileage and Expense Records	218
Travel and Gift Expenses.....	220
Listed Property	221
How Long to Keep Records	222
What If You Don't Have Proper Tax Records?.....	222
Accounting Methods	223
Cash Method	223
Accrual Method.....	224
Tax Years	225
Review Questions.....	226
Review Answers	227
Chapter 16 – Staying Out of Trouble with the IRS	229
Learning Objectives	229
Introduction.....	229
What Every Business Owner Needs to Know About the IRS.....	229
Anatomy of an Audit.....	229
The IRS: Clear and Present Danger or Phantom Menace?.....	230
You Are a Prime IRS Target.....	231
How Tax Returns Are Selected for Audits.....	231
Eight Tips for Avoiding an Audit	233
Tip #1: Be Thorough and Exact.....	233
Tip #2: Don't File Early.....	233
Tip #3: Form a Business Entity.....	233
Tip #4: Explain Items the IRS Will Question	233
Tip #5: Avoid Ambiguous or General Expenses.....	234
Tip #6: Report All of Your Income	234
Tip #7: Watch Your Income-to-Deduction Ratio.....	234
Tip #8: Beware of Abnormally Large Deductions	234
Review Questions.....	235
Review Answers	236
Glossary.....	237
Index	241