

Small Business Tax Deductions

19th 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	3
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	8
What Businesses Can Deduct.....	9
Start-Up Expenses.....	9
Operating Expenses	9
Capital Expenses.....	10
Pass-Through Tax Deduction.....	10
Inventory.....	10
Businesses That Lose Money	11
What Is an NOL?	11
NOLs for 2017 and Earlier	11
NOLs for 2018 Through 2020.....	11
NOLs for 2021 and Later.....	12
Annual Dollar Limit on NOL Deduction	12
Claiming an NOL Refund	12
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
Review Questions.....	20
Review Answers	21
Chapter 3 – Start-Up Expenses.....	23
Learning Objectives	23
Introduction.....	23
What Are Start-Up Expenses?	23
Starting a New Business	23
Common Start-Up Expenses.....	24
Costs That Are Not Start-Up Expenses	24
Buying an Existing Business	25
Expanding an Existing Business	25
When Does a Business Begin?	26
Retail Businesses	26
Manufacturers.....	26

Table of Contents

Knowledge Workers.....	26
Service Providers.....	26
An Existing Business	26
Claiming the Deduction.....	27
If Your Business Doesn't Last 15 Years	27
Organizational Expenses	27
Review Questions.....	29
Review Answers	30
Chapter 4 – Business Operating Expenses.....	31
Learning Objectives	31
Introduction.....	31
Requirements for Deducting Operating Expenses	31
Ordinary and Necessary	31
Current Expense.....	33
Business Related.....	33
Reasonable	34
Operating Expenses That Are Not Deductible	35
Operating Expenses Paid with Paycheck Protection Program Loans.....	36
Forgiven PPP Loans Are Tax Free.....	36
Deductions for Expenses Paid with Forgiven PPP Loans	36
Tax Reporting	36
Review Questions.....	37
Review Answers	38
Chapter 5 – Deducting Long-Term Assets	39
Learning Objectives	39
Introduction.....	39
What Is a Long-Term Asset?.....	39
Deducting Inexpensive Property: The De Minimis Safe Harbor and Materials and Supplies	
Deduction	40
The De Minimis Safe Harbor	40
The Materials and Supplies Deduction	43
Deducting Long-Term Personal Property: Bonus Depreciation, Section 179, Regular Depreciation	44
Property Eligible to Deduct.....	44
Mixed-Use Property	45
When to Take Your Deduction	45
How Much You Can Deduct.....	46
Disposing of Long-Term Property.....	46
Listed Property	46
Bonus Depreciation	47
Property That Qualifies for Bonus Depreciation	47
Calculating the Bonus Amount.....	47
Class-Wide Requirement	48
Opting Out of the Bonus.....	48
Bonus Depreciation Percentages	48
Section 179 Expensing	49
Deducting Repairs and Improvements.....	49
Regular Depreciation	50
When to Use Regular Depreciation	50
How Regular Depreciation Works	51
First-Year Depreciation	52
Depreciation Methods	52
Depreciation Rules for Listed property.....	53
Deducting Real Property	53
Land	53
Buildings.....	53

Table of Contents

Building Improvements	54
Intangible Assets	55
Tax Reporting and Record Keeping	56
Leasing Long-Term Assets	56
Review Questions	58
Review Answers	59
Chapter 6 – Inventory	61
Learning Objectives	61
Introduction	61
What Is Inventory?	61
Supplies Are Not Inventory	61
Incidental Supplies	61
Long-Term Assets	62
Deducting Inventory Costs	62
Nonincidental Materials and Supplies Deduction	62
Books and Records Deduction for Inventory	63
Maintaining an Inventory	64
Review Questions	65
Review Answers	66
Chapter 7 – Office Expenses	67
Learning Objectives	67
Introduction	67
Qualifying for the Home Office Deduction	67
Threshold Requirement: Regular and Exclusive Business Use	69
Additional Requirements	70
Corporation Employees	73
Calculating the Home Office Deduction	74
How Much of Your Home Is Used for Business?	74
What Expenses Can You Deduct?	75
Simplified Home Office Deduction Method	78
How the Simple Method Works	79
Is the Simplified Method a Good Deal?	80
IRS Reporting Requirements	80
Sole Proprietors	80
LLCs and Partnerships	80
Deducting an Outside Office or Workplace	80
Renting an Outside Workplace	80
Buying an Outside Workplace	83
Review Questions	84
Review Answers	85
Chapter 8 – Car and Local Travel Expenses	87
Learning Objectives	87
Introduction	87
Deductible Local Transportation Expenses	87
Travel Must Be for Business	87
Commuting Is Not Deductible	88
The Standard Mileage Rate	92
How the Standard Mileage Rate Works	93
Requirements to Use the Standard Mileage Rate	93
The Actual Expense Method	94
How the Actual Expense Method Works	94
Record-Keeping Requirements	95
Vehicle Depreciation Deductions	95
Leasing a Car	100
Other Local Transportation Expenses	101

Table of Contents

When Clients or Customers Reimburse You	101
Reporting Transportation Expenses on Schedule C	101
Corporations, LLCs, and Partnerships.....	102
Using Your Own Car	102
Using a Company Car.....	103
Review Questions.....	105
Review Answers	106
Chapter 9 – Business Travel.....	107
Learning Objectives	107
Introduction.....	107
What Is Business Travel?	107
Where Is Your Tax Home?.....	108
Your Trip Must Be for Business.....	110
What Travel Expenses Are Deductible	111
Traveling First Class or Steerage	112
Taking People with You	112
How Much You Can Deduct.....	112
Travel Within the United States.....	112
Travel Outside the United States.....	113
Conventions	114
Travel by Ship.....	115
Calculating Time Spent on Business.....	115
Limits on Meal Expense Deduction	116
Maximizing Your Business Travel Deductions	118
Plan Ahead	118
Make a Paper Trail	118
Maximize Your Business Days.....	118
Take Advantage of the Sandwich Day Rule.....	119
How to Deduct Travel Expenses	119
Sole Proprietors	119
Partnerships and LLCs	119
Corporations	120
Travel Expenses Reimbursed by Clients or Customers	120
Review Questions.....	121
Review Answers	122
Chapter 10 – The Pass-Through Tax Deduction	123
Learning Objectives	123
Introduction.....	123
You Must Have a Pass-Through Business	123
You Must Have Qualified Business Income	124
You Must Have Taxable Income	124
Deduction for Taxable Income Up to \$170,050 (\$340,100 if Married).....	125
Deduction for Income Above \$170,050 (\$340,100 if Married)	125
Are You a Specified Service Business?.....	125
Deduction for Nonservice Businesses (Income Above \$170,050/\$340,100).....	126
Deduction for Specified Service Business Owners (Income Above \$170,050/\$340,100).....	128
Taking the Pass-Through Deduction	128
Strategies to Maximize the Pass-Through Deduction.....	129
Keep Service Business Income Below the \$220,050/\$440,100 Threshold	129
Separating Out Nonservice Income?.....	129
Form an S Corporation	130
Combine Multiple Nonservice Businesses	130
File a Separate Return.....	131
Review Questions.....	132
Review Answers	133

Table of Contents

Chapter 11 – Hiring Workers.....	135
Learning Objectives	135
Introduction.....	135
Employees Versus Independent Contractors.....	135
Tax Deductions and Credits for Employee Pay and Benefits	137
Employee Pay	137
Payroll Taxes.....	139
Employee Fringe Benefits	141
COVID-Related Employer Tax Credits	142
Reimbursing Employees for Business-Related Expenditures.....	143
Accountable Plans	143
Unaccountable Plans	145
No Deduction for Unreimbursed Employee Expenses	145
Employing Your Family or Yourself	146
Employing Your Children	146
Employing Your Spouse.....	147
Rules to Follow When Employing Your Family	147
Employing Yourself.....	148
Tax Deductions When You Hire Independent Contractors	149
No Deductions for an IC's Taxes.....	150
Paying Independent Contractors' Expenses	150
Review Questions.....	151
Review Answers	152
Chapter 12 – Retirement Deductions.....	153
Learning Objectives	153
Introduction.....	153
Why You Need a Retirement Plan (or Plans).....	153
Tax Deduction	154
Tax Deferral.....	154
Individual Retirement Accounts—IRAs.....	155
Traditional IRAs	155
Roth IRAs.....	156
Employer IRAs.....	157
SEP-IRAs	157
SIMPLE IRAs.....	158
Keogh Plans	158
Types of Keogh Plans	158
Setting Up a Keogh Plan.....	158
Solo 401(k) Plans	159
Review Questions.....	161
Review Answers	162
Chapter 13 – Medical Expenses.....	163
Learning Objectives	163
Introduction.....	163
The Affordable Care Act (ACA)	163
Federal Individual Health Insurance Mandate Terminated	163
The Employer Mandate.....	164
ACA Health Insurance Rules.....	164
State Health Insurance Exchanges	164
Open Enrollment Periods	165
Health Insurance Premium Tax Credits	166
The Personal Deduction for Medical Expenses	166
Deducting Health Insurance Costs	167
Personal Income Tax Deduction for the Self-Employed	167
Deducting Health Insurance as a Business Expense	168

Table of Contents

Sick Leave and Family Leave Tax Credits for the Self-Employed	171
Tax Credits for Employee Health Insurance	171
Adopting a Health Reimbursement Arrangement	171
Spousal Health Reimbursement Arrangements	172
Individual Coverage HRAs (ICHRAs)	175
Qualified Small Employer HRAs (QSEHRAs)	176
Health Savings Accounts	177
What Are Health Savings Accounts?	177
Establishing Your HSA	177
Making Contributions to Your HSA	178
Deducting HSA Contributions	179
Withdrawing HSA Funds	179
HSAs for Employees	180
Tax Reporting for HSAs	181
Review Questions	182
Review Answers	183
Chapter 14 – Additional Deductions	185
Learning Objectives	185
Introduction	185
Advertising	185
Goodwill Advertising	185
Giveaway Items	186
Website Development and Maintenance	186
Permanent Signs	186
Business Bad Debts	186
Three Requirements to Deduct Bad Debts	187
Types of Bad Debts	188
Casualty Losses	190
Amount of Deduction	190
Damage to Your Home Office	191
Tax Reporting	192
Charitable Contributions	192
Contributions by Sole Proprietors, LLCs, Partnerships, and S Corporations	192
Clothing	193
Dues and Subscriptions	194
Education Expenses	194
Starting a New Business	195
Minimum Educational Requirements	195
Traveling for Education	195
Entertainment and Meals	195
Entertainment	196
Meals	196
Gifts	198
Insurance for Your Business	199
Homeowners' Insurance for Your Home Office	199
Car Insurance	199
Interest on Business Loans	199
Home Offices	200
Car Loans	200
Loans to Buy a Business	200
Loans from Relatives and Friends	200
Interest You Can't Deduct	200
Limitation on Deducting Interest by Larger Businesses	201
Legal and Professional Services	201
Buying Long-Term Property	202
Starting a Business	202

Table of Contents

Accounting Fees	202
Taxes and Licenses	202
Income Taxes	202
Self-Employment Taxes	202
Employment Taxes	203
Sales Taxes	203
Real Property Taxes	204
Other Taxes	204
License Fees	205
Review Questions	206
Review Answers	207
Chapter 15 – Using Cryptocurrency in Your Business	209
Learning Objectives	209
Introduction	209
What Is Cryptocurrency?	209
Why You Might Want to Use Cryptocurrency in Your Business	209
Tax Treatment of Cryptocurrency	210
Accepting Cryptocurrency as Payment for Services	210
Accepting Cryptocurrency as Payment for Goods	210
Using Cryptocurrency to Pay for Business Expenses	211
Paying Independent Contractors with Cryptocurrency	211
Paying Employees with Cryptocurrency	211
IRS Reporting of Cryptocurrency Transactions	212
Record Keeping for Cryptocurrency Transactions	212
Accounting for Cryptocurrency Transactions	212
How to Report Cryptocurrency Revenue to the IRS	213
Cryptocurrency Tax Treatment Guide	213
Review Questions	215
Review Answers	216
Chapter 16 – Record Keeping and Accounting	217
Learning Objectives	217
Introduction	217
What Records Do You Need?	217
Business Checkbook and Credit Cards	217
Records of Your Business Income and Expenses	218
Tracking Your Business Expenses	220
Supporting Documents	221
Records Required for Specific Expenses	223
Automobile Mileage and Expense Records	224
Travel and Gift Expenses	226
Listed Property	227
How Long to Keep Records	227
What if You Don't Have Proper Tax Records?	228
Accounting Methods	228
Cash Method	229
Accrual Method	230
Tax Years	230
Review Questions	232
Review Answers	233
Chapter 17 – Staying Out of Trouble with the IRS	235
Learning Objectives	235
Introduction	235
What Every Business Owner Needs to Know About the IRS	235
Anatomy of an Audit	235

Table of Contents

The IRS: Clear and Present Danger or Phantom Menace?.....	236
You Are a Prime IRS Target.....	237
How Tax Returns Are Selected for Audits.....	237
Nine Tips for Avoiding an Audit	239
Tip #1: Be Thorough and Exact.....	239
Tip #2: Don't File Early.....	239
Tip #3: File Electronically	239
Tip #4: Form a Business Entity.....	239
Tip #5: Explain Items the IRS Will Question	239
Tip #6: Avoid Ambiguous or General Expenses.....	240
Tip #7: Report All of Your Income	240
Tip #8: Watch Your Income-to-Deduction Ratio.....	240
Tip #9: Beware of Abnormally Large Deductions	240
Review Questions.....	241
Review Answers	242
Glossary.....	243
Index	247