

Tax Deductions for Professionals

17th 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
Pass-Through Tax Deduction.....	8
Professionals Who Lose Money	8
What Is an NOL?	8
NOLs for 2017 and Earlier	9
NOLs for 2018 Through 2020.....	9
NOLs for 2021 and Later.....	10
Annual Dollar Limit on NOL Deduction	10
Claiming an NOL Refund	10
Review Questions.....	11
Review Answers	12
Chapter 2 – Choice of Business Entity.....	13
Learning Objectives	13
Introduction.....	13
Types of Business Entities	13
Sole Proprietorship	13
Limited Liability Company (LLC).....	14
Limited Liability Partnership (LLP).....	15
Corporation.....	15
Partnership	16
Limiting Your Liability	17
What Is Liability?.....	17
Liability for Professional Malpractice	18
Liability for Business Debts	18
Other Types of Liability	19
The Role of Insurance.....	20
The Four Ways Business Entities Are Taxed.....	20
Tax Treatment Choices.....	21
Sole Proprietorship Taxation	21
Partnership Taxation.....	22
S Corporation Taxation	22
C Corporation Taxation.....	23
Comparing Tax Treatments.....	23
Tax Deductions.....	24
Tax Rates.....	24
Owners' Employment Status.....	28

Table of Contents

Fringe Benefits	30
Allocating Profits and Losses	31
Deducting Business Losses	31
Retaining Earnings in Your Business	32
State Taxes	34
Should You Change Your Business Entity or Tax Treatment?	34
The Cost of Converting to Another Business Form	35
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
Operating Expenses Paid With Paycheck Protection Program Loans	44
Forgiven PPP Loans are Tax Free	44
Deductions for Expenses Paid with Forgiven PPP Loans	45
Tax Reporting.....	45
Review Questions.....	46
Review Answers	47
Chapter 4 – The Pass-Through Tax Deduction	49
Learning Objectives	49
Introduction.....	49
You Must Have a Pass-Through Business	49
You Must Have Qualified Business Income.....	50
You Must Have Taxable Income	50
Deduction for Taxable Income Up to \$164,900 (\$329,800 if Married).....	51
Deduction for Income Above \$164,900 (\$329,800 if Married)	51
Are You a Specified Service Business?.....	51
Deduction for Specified Service Business Owners (Income Above \$164,900/\$329,800	53
Deduction for Nonservice Businesses (Income Above \$164,900/\$329,800).....	54
Taking the Pass-Through Deduction	54
Strategies to Maximize the Pass-Through Deduction.....	55
Keep Service Business Income Below \$214,900/\$429,800 Threshold	55
Form an S Corporation and Pay Yourself W-2 Wages	55
Separating Out Nonservice Income?.....	56
File a Separate Return.....	56
Review Questions.....	58
Review Answers	59
Chapter 5 – Car and Local Travel Expenses	61
Learning Objectives	61
Introduction.....	61
Deductible Local Transportation Expenses.....	61
Travel Must Be for Business	61
Commuting Is Not Deductible.....	62
The Standard Mileage Rate	63
How the Standard Mileage Rate Works.....	64
When You Can Use the Standard Mileage Rate	64

Table of Contents

The Actual Expense Method	65
How the Actual Expense Method Works	65
Record-Keeping Requirements	66
Vehicle Depreciation Deductions	66
Leasing a Car	69
Other Local Transportation Expenses	70
Reporting Transportation Expenses on Schedule C	70
When Clients Reimburse You	71
Professionals With Business Entities	71
Using Your Own Car	71
Using a Company Car	72
Review Questions	74
Review Answers	76
Chapter 6 – Long-Distance Travel Expenses	79
Learning Objectives	79
Introduction	79
What Is Business Travel?	79
Where Is Your Tax Home?	80
Your Trip Must Be for Business	81
What Travel Expenses Are Deductible	82
Traveling First Class or Steerage	83
Taking People With You	83
How Much You Can Deduct	84
Travel Within the United States	84
Travel Outside the United States	84
Conventions	86
Travel by Ship	86
Calculating Time Spent on Business	87
Limits on Meal Expense Deduction	87
Maximizing Your Business Travel Deductions	89
Plan Ahead	89
Make a Paper Trail	89
Maximize Your Business Days	90
Take Advantage of the Sandwich Day Rule	90
Travel Expenses Reimbursed by Clients	91
Review Questions	92
Review Answers	93
Chapter 7 – The Home Office Deduction	95
Learning Objectives	95
Introduction	95
Qualifying for the Home Office Deduction	95
Three Threshold Requirements	95
One of Five Additional Requirements	96
Special Requirement for Employees	99
Calculating the Home Office Deduction	100
How Much of Your Home Is Used for Business?	100
What Expenses Can You Deduct?	101
Simplified Home Office Deduction Method	104
How the Simple Method Works	105
Is the Simplified Method a Good Deal?	106
How to Deduct Home Office Expenses	106
Sole Proprietors	106
LLCs, LLPs, and Partnerships	106
Review Questions	108
Review Answers	109

Table of Contents

Chapter 8 – Deductions for Outside Offices	111
Learning Objectives	111
Introduction.....	111
If You Rent Your Office	111
Timing of Deductions	111
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	113
Bonus Depreciation	114
Depreciation Deductions.....	114
Interest Deductions.....	115
Property Taxes	115
If You Lease a Building to Your Practice	116
Review Questions.....	117
Review Answers	118
Chapter 9 – Deducting Long-Term Assets	119
Learning Objectives	119
Introduction.....	119
What Is a Long-Term Asset?.....	119
Special Rules for Deducting Inexpensive Property	120
The De Minimis Safe Harbor	120
Deducting Long-Term Personal Property: Bonus Depreciation, Section 179, Regular Depreciation ..	124
Property Eligible to Deduct.....	124
Mixed-Use Property	125
When to Take Your Deduction	125
How Much You Can Deduct	126
Disposing of Long-Term Property.....	126
Listed Property	126
Bonus Depreciation	127
Property That Qualifies for Bonus Depreciation	127
Calculating the Bonus Amount	127
Class-Wide Requirement	128
Opting Out of the Bonus.....	128
Bonus Depreciation Percentages	128
Section 179 Expensing	129
Deducting Repairs and Improvements.....	129
Regular Depreciation	130
When to Use Regular Depreciation	130
How Regular Depreciation Works	131
First-Year Depreciation	131
Depreciation Methods	132
How to Deduct Listed Property.....	133
Computer Software	133
Deducting Real Property.....	133
Land	134
Buildings.....	134
Building Improvements	134
Intangible Assets	135
Tax Reporting and Record Keeping	136
Leasing Long-Term Assets	137
Leasing Versus Purchasing.....	137
Review Questions.....	139
Review Answers	140

Table of Contents

Chapter 10 – Start-Up Expenses	141
Learning Objectives	141
Introduction.....	141
What Are Start-Up Expenses?	141
Starting a New Practice.....	141
Common Start-Up Expenses.....	141
Costs That Are Not Start-Up Expenses	142
Buying an Existing Practice.....	143
Expanding an Existing Practice.....	143
When Does a Professional Practice Begin?	144
How to Deduct Start-Up Expenses	144
Who Gets Start-Up Deductions	145
If Your Practice Doesn't Last 15 Years	145
Organizational Expenses	145
Review Questions.....	147
Review Answers	148
Chapter 11 – Medical Expenses	149
Learning Objectives	149
Introduction.....	149
The Affordable Care Act (ACA).....	149
Federal Individual Health Insurance Mandate Terminated	149
ACA Health Insurance Rules.....	150
State Health Insurance Exchanges	150
Open Enrollment Periods	151
Health Insurance Premium Tax Credits.....	152
The Personal Deduction for Medical Expenses	152
Self-Employed Health Insurance Deduction	153
Business Income Limitation.....	154
Designating Your Plan Sponsor	154
No Other Health Insurance Coverage	154
Tax Reporting	154
Deducting Health Insurance as an Employee Fringe Benefit	155
Deducting Health Insurance Costs Paid on Behalf of Employees.....	155
Sole Proprietors, LLCs, S Corporations, Partnerships, and LLPs.....	155
C Corporations	156
Employing Your Spouse.....	156
Tax Credits for Employee Health Insurance	157
Sick and Family Leave Tax Credits for the Self-Employed.....	157
Credits for April 1, 2021 Through September 30, 2021	158
Credits for April 1, 2020 Through March 31, 2021	158
Adopting a Health Reimbursement Arrangement.....	159
Spousal Health Reimbursement Accounts.....	159
What Expenses May Be Reimbursed?	160
How to Establish a Spousal HRA	160
Sample Spousal HRA.....	160
Individual Coverage HRAs (ICHRAs)	161
Qualified Small Employer HRAs (QSEHRAs).....	162
Health Savings Accounts	164
What Are Health Savings Accounts?	164
Establishing an HSA.....	164
Making Contributions to Your HSA.....	165
Deducting HSA Contributions.....	166
Withdrawing HSA Funds	166
Are HSAs a Good Deal?	167
HSAs for Employees.....	168
Tax Reporting for HSAs	169

Table of Contents

Review Questions	170
Review Answers	171
Chapter 12 – Inventory	173
Learning Objectives	173
Introduction.....	173
What Is Inventory?.....	173
Supplies Are Not Inventory	174
Incidental Supplies.....	174
Deducting Inventory Costs	175
Nonincidental Materials and Supplies Deduction	175
Books and Records Deduction for Inventory.....	175
Maintaining an Inventory.....	176
Review Questions.....	177
Review Answers	178
Chapter 13 – More Deductions.....	179
Learning Objectives	179
Introduction.....	179
Advertising.....	179
Goodwill Advertising	179
Giveaway Items	180
Website Development and Maintenance	180
Permanent Signs	180
Business Bad Debts.....	180
Three Requirements for Deduction.....	181
Applying the Rules.....	182
Casualty Losses	184
Amount of Deduction	184
Charitable Contributions.....	186
Contributions of Money.....	186
Contributions of Property	186
Contributions of Services	187
Clothing.....	187
Disabled Access Tax Credit.....	188
Use of Credit by Health Care Providers.....	188
Amount of Credit.....	188
License Fees, Dues, and Subscriptions.....	188
Education Expenses	189
Entering a New Profession.....	189
Minimum Educational Requirements	189
Traveling for Education	190
Entertainment and Meals	190
Entertainment	190
Meals.....	190
Gifts.....	192
Insurance for Your Practice.....	193
Homeowners’ Insurance for Your Home Office.....	193
Car Insurance	193
Interest on Business Loans.....	193
Home Offices.....	194
Car Loans.....	194
Loans to Buy a Practice	194
Loans From Relatives and Friends.....	194
Interest You Can’t Deduct.....	194
Limitation on Deducting Interest by Larger Businesses.....	195
Keeping Track of Borrowed Money	195

Table of Contents

Legal and Professional Services	195
Buying Long-Term Property	195
Starting a Practice	196
Accounting Fees	196
Taxes	196
Income Taxes	196
Self-Employment Taxes	196
Employment Taxes	196
Sales Taxes	197
Real Property Taxes	197
Other Taxes	197
Review Questions	199
Review Answers	200
Chapter 14 – Hiring Employees and Independent Contractors	201
Learning Objectives	201
Introduction	201
Employees Versus Independent Contractors	201
Tax Deductions and Credits for Employee Pay and Benefits	203
Employee Pay	203
Payroll Taxes	204
State Payroll Taxes	205
Employee Fringe Benefits	206
Employee Retention Credit	206
Payroll Tax Credits for COVID-19 Sick and Family Leave	208
Reimbursing Employees	210
Reimbursement Under an Accountable Plan	210
No Deduction for Unreimbursed Employee Expenses	211
Employing Your Family	211
Employing Your Children	212
Employing Your Spouse	213
Rules to Follow When Employing Your Family	213
Tax Deductions When You Hire Independent Contractors	214
No Deductions for ICs' Taxes	215
Paying Independent Contractors' Expenses	215
Review Questions	217
Review Answers	218
Chapter 15 – Professionals Who Incorporate	219
Learning Objectives	219
Introduction	219
Automatic Employee Status	219
Paying Yourself	220
The Tax Treatment of Compensation Versus Distributions	220
C Corporations and the Advantages of Employee Compensation	221
S Corporations and the Advantages of Corporate Distributions	224
Employee Fringe Benefits	226
Qualified Fringe Benefits	226
Types of Fringe Benefits	227
Tax-Free Benefits for S Corporation Employees	229
Benefits That Are Not Tax Deductible	230
Shareholder Loans	230
Only Bona Fide Loans Are Recognized by the IRS	230
Below-Market Loans	231
Review Questions	232
Review Answers	233

Table of Contents

Chapter 16 – How You Pay Business Expenses	235
Learning Objectives	235
Introduction.....	235
Your Practice Pays	235
Tax Treatment	236
Documentation Requirements.....	236
Using Personal Funds to Pay for Business Expenses.....	237
LLCs, Partnerships, and LLPs.....	237
Corporations.....	239
Your Client Reimburses You	240
Accountable Plans	241
What Is an Accountable Plan?	241
Time Limit to Make Adequate Accounting	241
Payments Not Made Under an Accountable Plan	242
Review Questions.....	243
Review Answers	244
Chapter 17 – IRS Audits	245
Learning Objectives	245
Introduction.....	245
Anatomy of an Audit.....	245
How Small Business Owners Get in Trouble With the IRS.....	245
Records Available to Auditors	245
Tax Shelters, Scams, and Schemes.....	246
Tax Shelters	246
Tax Scams and Schemes	247
Review Questions.....	249
Review Answers	250
Chapter 18 – Record Keeping and Accounting.....	251
Learning Objectives	251
Introduction.....	251
Recording Your Expenses	251
Your Accounting System.....	251
Documenting Your Deductions.....	252
What Supporting Documents Do You Need?.....	252
Automobile Mileage and Expense Records	254
Travel and Gift Expenses.....	256
Listed Property	258
How Long to Keep Your Records	258
What If You Don't Have Proper Tax Records?.....	258
Accounting Methods	259
Cash Method	259
Accrual Method.....	260
Tax Years.....	260
Review Questions.....	262
Review Answers	263
Glossary.....	265
Index	269