# Small Business Tax Deductions


# Small Business Tax Deductions

Updated June 12, 2024

Ahh, the good stuff. Yes, you work hard. Yes, you want to get a little extra from your hard work and your business and you want this to be tax-advantaged. We get it. This post will discuss the 185 small business tax deductions you cannot take and explain how to position yourself on allowable business tax deductions. Then we'll get into hot topics such as automobiles, home offices, deducting MBA's, Cohan rule and other fun things. Let's not forget about the Sutter rule, where a doctor tried to make every meal a business meal (spoiler alert: he lost).

**This page is a condensed version of Chapter 11 on Tax Deductions and Fringe Benefits from our book titled Taxpayer's Comprehensive Guide to LLCs and S Corps. It's available in paperback and eBook on Amazon, and as a PDF from ClickBank!**

## Section 199A Business Deduction

Section 199A deduction also known as the **Qualified Business Income deduction** arises from the **Tax Cuts & Jobs Act of 2017**. This is a significant tax break for small business owners, however, there are rules and limits. We have written additional articles that outline what is considered a qualified business for the qualified business income deduction, including the dreaded specified service trade definitions; summed up as "any trade or business where the principal asset is the reputation or skill" of the own. Check out the articles below for more info!

### S corporations remain a critical tax saving tool for two reasons:

1. The usual self-employment tax savings remain intact for all business owners, including specified service trades or businesses.
2. A business owner might need to pay W-2 wages to himself or herself to not be limited by income, and only corporations can pay W-2 wages to owners (in other words, an LLC cannot without an S Corp election).

## 185 Business Tax Deductions You Cannot Take

Similarly to the **185 reasons to not elect S corporation taxation**, there are 185 small business deductions that you cannot take. However, we want to start with the crazy things small business owners try to do since it is such a good springboard for discussion. We aren't trying to limit your tax deductions, nor are we the government's accountant. In other words, we aren't the tax police, but it's our job is to remind you that the tax police exists.

WCG is your advocate, and we can help position you and your business to maximize your small business deductions. Let's get started!

## 100% Cell Phone

These days, most small businesses operate on a cell phone. However, most small business owners also use his or her cell phone as a personal phone as well. The minute you get the "Hey honey… we need milk and eggs" text message to your cell phone, it drops from 100% business use to a mixed use device.

If you attempt to deduct 100% of your cell phone bill as a small business tax deduction, the IRS will claim 0% and then force you to demonstrate why it should be something else. Conversely, if you approach this from a position of being reasonable, it is extremely challenging for the IRS to argue otherwise. What is reasonable?

Anywhere from 50% to 80% is a good jumping off point. Since this is a mixed use expense between personal and business, the cell phone charges should be paid by you personally and then reimbursed by the company for the business use portion through an accountable plan. This in turn makes the reimbursement a tax deduction for the business. For more information on Accountable Plans and how to implement them, **click here**.

## Automobiles

Automobiles will be discussed in nauseating detail later, and there is a decision tree as well to help determine if you should own it personally and get reimbursed or have the business own it. In keeping with the business tax deductions that are disallowed, claiming your only automobile as 100% business use is a tough sell unless you have another automobile. Yeah, the biking to the grocery store is a nice counterargument, but you live in Buffalo, those winters are brutal.

## Home Office Improvements

You cannot spend $30,000, finish your basement, plop your desk in the middle of it and deduct the $30,000 for two reasons:

First, the entire space must be regularly and exclusively used as a home office. This means the theater room must be a conference room, and the wet bar must be the office kitchen. Might be tough in the world of small business tax deductions.

Second, even if the entire basement is designated business use, the $30,000 represents an improvement. Therefore, it must be capitalized as an asset and subsequently depreciated over 39 years. Hey, don't hate the player.

## Food

More bad news. You cannot deduct your business meals unless you fall under one of two situations:

1. You are entertaining a client, prospect, or other business associate (or a small group such as 12), and discussing business matters, or
2. You are away from your tax home where you require substantial rest (such as an overnight trip), and that trip has a business purpose.

So if you cruise through the Starbucks drive-thru and grab your usual triple Grande vanilla breve on the way to your day meeting, no good. However, if you're traveling away from your tax home for a business trip, then spring for the Venti.

Your small business tax deduction is limited to 50% under both circumstances (100% for the 2021 and 2022 tax years). Sure, you've heard of people deducting 100% for all meals, and you've heard of people who say because they're away from home all day on travel, they can deduct their meals as business meals. Stop the madness! Both of these silly things have been struck down a zillion times in tax court, and the people that do this haven't been audited… yet.

For more information, please read our blog post on the recent IRS changes to the **meals tax deduction,** including **Notice 2018-76**.

## Per Diem

Sole proprietors, including single-member LLC owners and partners, are allowed to deduct the federal per diem rate for meals. Lodging can only be deducted using the actual cost of lodging. Where are S corporations? You are not going to like this. Employees of corporations are eligible for per diem allowances, reimbursements and deductions **unless** this same employee owns more than 10% of the corporation.

This means that most S corporation shareholders are hosed, and can only deduct (or get reimbursed) for actual meal costs. **IRS Revenue Procedure 2011-47** has this limitation and **IRS Publication 463** states in part “A per diem allowance satisfies the adequate accounting requirements for the amount of your expenses only if…you are not related to your employer.” You are related to your employer if:

- Your employer is your brother or sister, half brother or half sister, spouse, ancestor, or lineal descendant,
- Your employer is a corporation in which you own, directly or indirectly, more than 10% in value of the outstanding stock, or
- Certain relationships (such as grantor, fiduciary, or beneficiary) exist between you, a trust, and your employer

So the question becomes, if you are an LLC being taxed as an S corporation, are you a corporation where you own stock or a limited liability company where you own a membership interest? We believe these are one and the same in this context. Don’t fret. You can still deduct 50% of your meals when traveling; you just need to use actual expenses and not per diem allowances. Also, keep in mind that the most expensive cities are around $70 per day. You can chew that up, quite literally, at lunch in San Francisco. And even if you could deduct per diem allowances, you still have to apply a 75% limit on the first and last day, so this $70 becomes $52.

### Country Club Dues

Nope. The IRS does not care how many times or how much you entertain or discuss business with your clients, prospects, and business associates at your country club. The membership dues are not an allowed small business tax write-offs. However, the specific out-of-pockets expenses associated with qualifying meals (no entertainment) incurred at your country club are deductible. There are some other devils in the details, but this is the general gist.

Don’t confuse this with other types of dues such as Chamber of Commerce or other professional organizations such as BNI. Those dues are 100% tax-deductible, although there is some scuttle butt about BNI and other networking groups since a portion of the dues are for meals.

### Client Gifts

Yuck, more IRS publications stuff on the way. In **IRS Publication 463**, here is the blurb on client gifts:

> *You can deduct no more than $25 for business gifts you give directly or indirectly to each person during your tax year. A gift to a business that is intended for the eventual personal use or benefit of a particular person or a limited class of people will be considered an indirect gift to that particular person or to the individuals within that class of people who receive the gift.*

### Commuting Expenses

It is unfortunate, but expenses associated with your commute to work are not a small business tax deduction. Tolls and parking are the common ones small business owners attempt to deduct. There is a subtle difference to be aware of: driving from a work location to your client’s place of business is not commuting. Commuting is driving from your home to your office or client’s place of business.

You can solve a lot of problems surrounding commuting expenses by qualifying for a home office. Then your commute is from the bedroom to the home office. And if you shower, then the commute is from the bathroom to the home office. You should probably shower before going out in public. Sure, it lengthens the commute, especially if there is traffic like your spouse, but you’ll be better for it.

### Professional Attire

The tax code is very clear on this. Anything that you can convert to everyday use is considered personal, and therefore not tax-deductible. Many business owners want to deduct dry cleaning expenses or Men’s Warehouse purchases, but they usually cannot. We know you are rocking it in the double-breasted vest without a coat look, but the IRS doesn't have fashion sense, and therefore doesn't care. However, there are some exceptions (of course there are). What if you slap a logo on it? Now we chat about how your everyday attire might be a business uniform and therefore a small business tax deduction.

### Loan Payments

Many businesses have loans, either for automobiles, business equipment or lines of credit. However, having an expense category of "Loan Payment" is a dead giveaway that the business owner doesn't understand that only the interest portion of the loan payment is tax-deductible.

### Zeus and Apollo

Let's say you are a hotshot private investigator driving a red Ferrari 308 GTS in Hawaii. Can you deduct two Dobermans as business expenses? Possibly. We recently worked with a client who is a criminal defense attorney where we demonstrated that the need for security dogs was a bona fide occupational qualification. In other words, the dogs provided security to the criminal defense attorney so he was able to perform his job. Stop laughing, it was L-E-G-I-T. Not because of the creativity, but because of the argument's position.

Another way to look at these obscure examples: the IRS allows you to deduct most things if they eventually lead to the generation of taxable income. Think of investment fees (when those were a thing, but some states still allow the tax deduction). Think of Zeus and Apollo, who allowed the attorney to continue taking on high-risk, high-profit (taxable) defense cases. Here is some more information from our LLC and S Corporations book:

## Reasonable Business Tax Deductions

Small business tax deductions are critical for reducing taxable income. What happens if you are unreasonable? Good question… think of your last argument with someone who was unreasonable. Was that pleasant? Did the argument end up being resolved amicably? Probably not on both counts.

The IRS and tax court are full of humans, and humans respond to unreasonableness in predictable ways. They simply toss out whatever small business tax deduction you are arguing, ask for all kinds of proof, and then look at whatever evidence you've provided with extreme suspicion… a "Yeah… riiiiiggght" salvo.

Don't get us wrong… just because your business tax deduction appears reasonable does not mean you don't have to support it with proper record keeping. You must be able to prove the veracity of the tax deduction if challenged. The button below is a link to a blog post outlining some reasonable and unreasonable positions on small business tax deductions:

## Accountable Plan Reimbursements

Some of the expenses above are mixed use such as home office, cell phone, internet and automobile expenses. These are called mixed-use expenses and are typically personally paid for by you the individual, and then later reimbursed by your business. Please check out the video which explains more.

You can also visit our **Accountable Plan page** which has fancy Excel spreadsheets and examples, and other nonsense.

## Tax Planning with Depreciation Recapture

Please understand that depreciation is a tax deferral system rather than a tax avoidance system. Huh? When you sell or dispose of an asset, you might have to pay tax on the portion that was depreciated.

For example, you buy a $200,000 piece of machinery and use Section 179 depreciation to deduct the entire $200,000 in the first year. Five years later, you sell the equipment for $150,000 because you slapped some new paint on it, and you are a shrewd negotiator with your buyer. You will now have to recognize $150,000 of taxable ordinary income. Yuck. But there is a silver lining- depreciation recapture is taxed at your marginal tax rate up to a maximum of 25% tax rate. So, you could have depreciated your asset during 39.6% marginal tax rate years just to pay it all back at 25%. Bonus. Tax planning is a must! How many times have we mentioned that?

## Small Business Tax Deductions Themes

There are some over-arching themes and concepts for all small business deductions. The business expense must be-

- Ordinary and necessary (IRS Publication 334), **and**
- Paid or recognized in the current tax year, **and**
- Directly related to your business, **and**
- Reasonable, and not lavish or extravagant (IRC Section 162 and IRS Publication 463).

Let's break these down. An ordinary expense is one that is common and accepted in your field of business, trade, or profession. A necessary expense is one that is helpful and appropriate, although not necessarily required, for your business. In **Samp v. Commissioner** (**Tax Court Memo 1981-706**), an insurance agent had a handgun since he traveled to an area with a recent unsolved murder. The tax court responded with:

> "*A handgun simply does not qualify as an ordinary and necessary business expense for an insurance agent, even a bold and brave Wyatt Earp type with a fast draw who is willing to risk injury or death in the service of his clients.*"

You have to appreciate a Wyatt Earp reference from a tax court judge. Ouch. Clean up on aisle Allstate.

**The expense must be paid or recognized in the current year.** Expenses that were paid but not deducted in previous years cannot be "caught up" by deducting them today without amending your prior tax returns (which are easy to do, and should be done if there is money to be had).

## Value of Small Business Tax Deductions

Here is another concept that small business owners miss. **Tax deductions only reduce taxable income.** If you spend $1,000 and your marginal tax rate is 24%, then you only save $240 by spending $1,000. Every December, WCG fields hundreds of phone calls and emails from clients asking if they should buy something to save on taxes. Our response is a simple flowchart:

- Do you need the item you are considering? If No, then stop. Don't buy anything. If yes, then continue to the next question. Don't buy stuff for the tax deductions; buy stuff because it makes operational sense for your business.
- Is the current year's income unusually high, or do you expect to earn more next year?

Without sounding snarky, why would you buy something on December 31 if your tax rate will only increase the following year? Wait 24 hours, buy the cool thing you actually need and get a better yet delayed tax deduction. And if you don't need it, why would you spend money unnecessarily only to get a portion of that back in tax savings? In other words: **keep some small business tax deductions in your pocket for next year**. You don't want to be in a position where you ran out of perfectly good deductions in a year of increased taxable income.

Conversely, if your current taxable income is unusually high, and you expect it to go down next year, then perhaps you should accelerate your timelines for major purchases. WCG can help with the tax modeling and planning.

All too often we hear people at cocktail parties say something silly like "Don't worry, it's a write-off." Remember that money is still leaving your person, and the money you are getting back in the form of a tax deduction is substantially less. Just because it is a "write-off" or a business tax deduction doesn't mean that you are using Monopoly money. Houses are green and hotels are red, but cash is real life.

Tax credits are in contrast to tax deductions. Tax credits such as $7,500 for buying a cool Tesla (when that was available) or $13,810 for adopting a child are a dollar-for-dollar reduction in your tax due. For example, if the computed tax liability is $20,000 and you max out your adoption credit of $13,810 (2018), you will only have a tax liability of $6,190. However, if you spend $13,400 in office furniture you will save taxes based on your marginal tax rate- 24% tax rate equates to $3,216. See the difference?

## Automobile Decision Tree

In deciding whether to own an automobile personally or through your small business, here is a simplified decision tree. It is not a hard and fast set of rules, but will provide some guidance.

- If you buy expensive automobiles, such as $80,000, and drive them 10,000 miles or less, then the business might want to own it.
- If you buy frugal automobiles, such as $30,000, and drive them 15,000 miles or more, then you should own it personally and get reimbursed by your business.
- What about the soft middle? The $60,000 automobile and 12,000 miles? If you cycle through automobiles every 2–3 years, then the business should own it. If you keep automobiles for 5–7 years, then you should own it and get reimbursed.

These are not hard and fast rules. These are rules of thumbs and generalizations. We always caution people who try to split the atom to save some money. At the end of the day, most small business owners do what makes him or her feel most comfortable, and the few bucks that might be left on the table is overshadowed by the lack of anxiety and headache. In other words, is the juice worth the squeeze? Or as Jason says, I love French fries, but I am not running a mile for just one.

Here is some more information from our blog posts and LLC and S Corp book:Also… the Tax Cuts and Jobs Act of 2017 created 100% Bonus Depreciation which means you can now deduct 100% of heavy vehicles using both Section 179 and Section 168. Luxury cars are still limited to $18,000, but the Hummer Loophole is back-

## Multiple Work Locations

You can have multiple work locations. The IRS states that if you use a home office as your primary location for substantial administrative activities, you are allowed to essentially have two work locations. For example, you own a landscaping company, and you have an office in your shop. You perform all your administrative activities such as hiring and firing employees, accounting, balancing your checkbook. You talk to your attorney, chat it up with your Colorado Springs CPAs at WCG, etc. all in your home office. Your office counts as a work location in addition to your office in your shop. Here is the play by play blurb from the IRS:

*"You can have more than one business location, including your home, for a single trade or business. To qualify to deduct the expenses for the business use of your home under the principal place of business test, your home must be your principal place of business for that trade or business. To determine whether your home is your principal place of business, you must consider:*

1. *The relative importance of the activities performed at each place where you conduct business, and*
2. *The amount of time spent at each place where you conduct business.*

*Your home office will qualify as your principal place of business if you meet the following requirements.*

1. *You use it exclusively and regularly for administrative or management activities of your trade or business.*
2. *You have no other fixed location where you conduct substantial administrative or management activities of your trade or business."*

This also works well for the consultant who works out of his or her home office, but also spends a ton of time on site with the client.

Don't forget that commuting miles between your residence and your office are not deductible, but if you have a home office, suddenly these miles become business miles and therefore tax-deductible. Boom! The use of "boom" is apparently out of fashion. Whatever.

Please visit our **Home Office Mini Portal**. You can also read the full **IRS Publication 587** (Business Use of your Home) for more information.

## Business Travel Deduction

Let's start off by saying the IRS despises business travel tax deductions. They view it as a way to rifle personal expenses through the business, and on some levels they are correct. But then again, the rules allow for it under some circumstances. The easiest way to explain business travel as part of small business tax deductions is to run through some examples.

You travel to Tahoe to look at rental properties. None of the expenses associated with this trip are deductible. If and when you purchase a rental property in Tahoe, the expenses associated with your travels will be considered an acquisition cost and added to the basis of the purchased property. Upon sale you will realize the tax benefit of your travels through a smaller capital gain.

You travel to Las Vegas on Tuesday for a conference. At night you take in the sights, attend the conference on Wednesday and return home the same day. Travel is deductible at 100%, hotel is deductible at 100% and meals are deductible at 50% (the normal deduction).

Same Las Vegas trip but you return on Friday, with Tuesday and Wednesday being the only days you attend the conference. Since the business portion of the trip did not exceed half of the overall trip, none of the travel is deductible. However, Tuesday's and possibly Wednesday's hotel and meal costs are deductible.

Same Las Vegs trip, but the conference is from Tuesday to Thursday, and you still return home on Friday. Travel is deductible at 100%, and hotel is deductible at 100% provided you demonstrate that returning home on Thursday was not economically feasible. Meals would follow suit with the hotel but at 50% (the normal deduction).

You travel to Miami on Thursday for a conference that starts Thursday and ends on Friday. You also schedule business meetings on Monday. You do not return home on Saturday since it was not economically feasible. Travel is deductible at 100%, hotel is deductible at 100% (including the Saturday and Sunday stay) and meals are deductible at 50%.

This is a generalization, but you get the idea. There are additional exceptions for travel outside the United States and additional rules about side trips (such as seeing Mom on the way home from a business trip). See your Mom (that's important) we'll worry about the deduction later!

If your spouse and / or children are employed by the S corporation, and have a genuine need for business travel then he or she follows the same rules above. Where business owners get into trouble is the employment part. Your spouse and / or children must have a legitimate position with the company, and a genuine reason for business travel.

Having Junior stuff envelopes is fine, but bringing Junior to a conference on the "evolution of the market economy in the early colonies" probably won't work. Or have Junior attend a seminar where Vickers argues that Gordon Wood "drastically underestimates the impact of social distinctions predicated upon wealth, especially inherited wealth." Gotta love that epic bar scene from Good Will Hunting.

## Business Meal Tax Deductions

Business meals as a tax deduction was in flux because of the butchering of Section 274 in connection with the Tax Cuts and Jobs Act of 2017. However, the IRS released Notice 2018-76 which basically restores 2017 rules for 2018 and going forward. Here is our blog article on it:We chatted about business meals earlier on this page. To reiterate the two themes, you must be either:

- Meeting with a client, prospect, or other business associate (and small groups of the same), and discussing business matters, or
- Away from your tax home where you require substantial rest (such as an overnight trip), and the trip is for business purposes.

Your meals as small business tax deductions are limited to 50% under both circumstances.

The theory on this is straightforward- you have to eat regardless of owning a business or not. In other words, your meal is not contributing directly to the operations or success of your business. The IRS is clever; they don't mind giving you tax deductions today on something that eventually will result in taxable business income through growth and profits in the future.

To deduct a meal as a business expense that was shared with a client, prospect or other business associate, there are two scenarios to consider.

For business discussions during a meal, you must have a clear business goal in mind, the discussion must be substantive beyond casual conversation, and you must have an expectation of income or benefit to your business from the meeting. The meeting's main purpose should be business-related, with the eating of food being incidental or secondary.

You may also deduct, as a small business tax deduction, the cost of meals for business discussions that occurred before or after the meal. For example, after a lengthy day of negotiating a business transaction, you take the associate out for a nice dinner to relax. While eating your dinner, no business discussion takes place. Since these two events are so closely related, the cost of the dinner is deducted as a meals expense. The business discussions before or after the meal must be substantial and closely connected (nexus).

What happens if your spouse tags along to a business meeting over dinner? Or if the client or business associate brings his or her spouse? Do you have to split the bill up between business and non-business participants? No. The IRS considers the spousal attendance to the meeting to be incidental.

Can your spouse be considered a business associate as an employee? Of course. Before you get all excited about trips to Gallagher's in Time Square with your spouse to discuss business, we encourage restraint and reasonableness. If the occasional business discussion occurs during a meal, and the meeting's original intent was business, then this becomes a small business tax deduction at 50%. Position yourself carefully, and yes, your spouse needs to be an employee or shareholder.

You can deduct 100% of the meals you provide your employees in social settings such as parties or picnics, or if the meal is for the convenience of the employer, such as working lunches. This is called **de minimis**, and here is the blurb from the IRS:

> In general, a de minimis benefit is one for which, considering its value and the frequency with which it is provided, is so small as to make accounting for it unreasonable or impractical. De minimis benefits are excluded under **Internal Revenue Code section 132(a)(4)** and include items which are not specifically excluded under other sections of the Code. These include such items as:

- Controlled, occasional employee use of photocopier. ("Bob, making copies.")
- Occasional snacks, coffee, doughnuts, etc. Glazed only.
- Occasional tickets for entertainment events.
- Holiday gifts
- Occasional meal money or transportation expense for working overtime
- Group-term life insurance for employee spouse or dependent with face value not more than $2,000

- Flowers, fruit, books, etc., provided under special circumstances (such as: your 103-year-old grandmother died.)
- Personal use of a cell phone provided by an employer primarily for business purposes. (Don’t even go there on this one!)

In determining whether a benefit is de minimis, you should always consider its frequency and its value. **An essential element of a de minimis benefit is that it is occasional or unusual in frequency.** It also must not be a form of disguised compensation. Therefore, routine dinners with your business partner are not de minimis. It might not qualify for the 50% either unless a business purpose is germane to the meal.

## Small Business Tax Deductions Consultation

Do you have questions about tax deductions? Are you asking for a “friend” who wants to ask, but is afraid? Let’s chat!JTVCd2NnLWNvbnRhY3QtdXMlNUQ=

## Sutter Rule

**The Sutter rule allows the IRS to disallow a portion of your business meals when they consume a large part of your normal living expenses.** In other words, if every meal you eat is a justifiable business meal, it might not matter under the Sutter rule. This rule was created in **Richard Sutter v. Commissioner, 21 Tax Court 170 (1953)**, where Sutter expensed his lunch every day, but the court found that “*the deduction for the cost of lunches was apparently almost entirely payment for petitioner’s own meals when he attended such functions as meetings of the Chamber of Commerce. There is no evidence that these costs were any greater than expenditures which petitioner would have been required to make in any event for his own personal purposes. They must consequently be disallowed*.”

Sutter was audacious; he deducted everything he could think of. It’s a great read.

Again be careful. Business meals are low-hanging fruit for the IRS. We’ve seen thousands of dollars in tax deductions disappear before our eyes during an examination because the client could not demonstrate the business purpose. **For the sake of a potential audit, make sure you keep receipts beyond relying on the credit card statement. In addition, keep a log or journal of the person(s) you met with and the topics of discussion.** Be very specific. Memories fade, so if you intend to reconstruct this evidence upon receipt of your examination notice from the IRS, think twice. IRS agents are no dummies on meals and the associated tax deductions.

## Cohan Rule

Let’s briefly discuss record keeping, and then jump into a famous New York entertainer named Cohan, who ultimately provided a nifty rule that can be used during an IRS audit. To be able to demonstrate business tax-deductions, you need to show the date, the amount, and the person or business you paid. A bank or credit card statement, or canceled check, satisfies this. The second element is the business purpose must be documented either through a logbook, planner, or accounting software. **Proof of payments + business purposes = tax deductions.**

Do you need receipts? Yes and no. For travel, gifts and meal, if the amount is under $75 then you only need to document the event and business purpose in a logbook or planner. However, if you spend $10 at Costco for some paper, then you need proof of payment plus business purpose documentation. Seems a bit onerous and even contradictory, but it is true.

Enter **Cohan vs. Commissioner, 39 F. 2d 540 (2d Cir. 1930)**. Yes, 1930 and we still use it today. **George Cohan** gave us “Yankee Doodle Dandy” and “Give My Regards to Broadway”, and he gave us a small business tax deduction rule. His rule is simple: **you can approximate your business expenses and ultimately your business tax deductions**. What?! No, it is not that simple.

You must have corroborating evidence that demonstrates your expense. For example, as an online accountant, WCG can demonstrate that we prepare so many tax returns which are so many pages in length, and therefore we can approximate our paper costs.**Temp. Regs. Sec. 1.274-5T(c)(3)** also gives latitude to the IRS to allow substantiation of a business expense by other means.

WCG has successfully used the Cohan rule in IRS examinations. We have also implemented it during tax preparation when records are incomplete or missing (i.e., one hot mess). Having said that, using estimates and approximations looks bad. Keep good records, please. Do not rely on the Cohan rule or some treasury regulation to save your butt.

**The Cohan rule or any type of estimation cannot be used for travel, business gifts and meals.** All the good stuff need strict record keeping habits. **Section 274(d) of the U.S. Tax Code** also states that listed property must be substantiated with proper documentation. Listed property includes vehicles, equipment generally used in entertainment such as cameras and stereo equipment, and computers. Seems a bit out dated, but there you go. So, if you are a photographer who drives a car for business while entertaining guests, you will be a master at record keeping.

## Putting Your Kids On Payroll

Should you pay Junior to vacuum? Perhaps. While most parents can't get their kids to clean a counter or put away dishes, perhaps putting kids to work at the office is a good option to add to your small business tax deductions.

There are some minor tax advantages to paying your children; for example, you can pay your child $12,950 in wages, and since the standard deduction is $12,950 (for the 2022 tax year) the child will not have any taxable income. This will not affect your ability to take the tax exemption for your child. If you pay yourself this income through a shareholder distribution, and you are in the 15% tax bracket, you will unnecessarily pay about $885 in income taxes. Your kids are going to take your money anyway — might as well make it tax-advantaged!

You could also pay your child more money, since their tax bracket is probably lower than yours. They can gift up to $16,000 per year back to you (for the 2022 tax year). Almost hard to say with a straight face. Here is some more information from our LLC and S Corporations book, including retirement scenarios:

## Education as a Business Tax Deduction

To be able to deduct education expenses as small business tax deductions, the education must either:

- Maintain or improve skills required in your existing business, or,
- Is required by law or regulation to maintain your professional status through continuing education credits such as attorneys, accountants, real estate agents, mortgage lenders, etc.

So, can you deduct your MBA? Perhaps. In **Lori A. Singleton-Clarke v. Commissioner**, Tax Court Summary Opinion 2009-182, the court ruled in Lori's favor. She was an established nurse, and she went back to school to obtain an MBA in Health Care Management. She was already in charge of quality control from a management perspective, and the MBA did not lead to an additional and discernible skill. Additionally, the court stated that the MBA improved her current work skill as a quality control coordinator. Subtle difference.

## Summary of Small Business Tax Deductions

This resource page is huge, and has a ton of information in it, and may be overwhelming. To reiterate information from the beginning of this hoopla there are some over-arching themes and concepts for all small business deductions. The business expense must be:

- Ordinary and necessary (IRS Publication 334), **and**
- Paid or recognized in the current tax year, **and**
- Directly related to your business, **and**
- Reasonable, and not lavish or extravagant (IRC Section 162 and IRS Publication 463).

We want to give you this table to help summarize the business deductions that are clearly not allowed (black), the ones that clearly are allowed (white), and the gaggle of exceptions (grey). We swim in grey waters with slivers of black and white.

| **Business Expense** | **Deduction?** |
| --- | --- |
| 401k Plan | Get $500 tax credit from IRS for starting one. Great way to defer taxes. We can set this up. The SECURE Act of 2020 boosted the tax benefits as well. |
| Advertising | Yes. |
| Automobiles | Business use only. Use a decision tree to see if you should own it or the business. Depends on price, turnover, miles driven, business use and marginal tax rates. Personal use added to W2 Box 1, 3 and 5 using Lease Value rates in IRS Pub 15-B. |
| Business Travel | All kinds of rules. Mix pleasure with business under some circumstances. |
| Business Meals | 50% if business discussion with client, prospect or associate, or if traveling away from your tax home on business (100% for the 2021 and 2022 tax years). 100% for company social gatherings or convenience of the employer (lunch). |
| Cell Phone | Business use only. Never 100% unless you have a second phone. Reimbursed through Accountable Plan. |
| Client Gifts | Max $25 per recipient per year. |
| Commissions | Yes. |
| Commuting Expenses | No. If you have a home office, then commuting becomes business travel and subsequently Yes. |
| Copier Lease | If the lease can be considered a capital lease, then No. If the lease is an operational lease, then yes. Depends on the facts and circumstances. |
| Country Club Dues | No. Don’t throw the book. Not our fault. Meals at your country club, yes, if there is a business purpose. |
| Defined Benefits Plan | Get $500 tax credit from IRS for starting one. Great way to defer taxes. We can set this up. |
| Education | Only if improves your current work skills or necessary for professional credentials. |
| Food | 50% if business discussion with client, prospect or associate, or if traveling away from your tax home on business (100% for the 2021 and 2022 tax years). 100% for company social gatherings or convenience of the employer (lunch). |
| Golf Outing | No. Seriously. Let it go. |
| Guard Dogs | If you are a high risk defense attorney on the East Coast and need a security detail, then Maybe. Must be a bona fide occupational qualification. |
| Health Savings Accounts | Company contributions, yes. Added to your W2 Box 1. |
| Home Office | If regularly and exclusively used for business, then yes. Multiple locations OK provided home office is primarily used for substantial administrative activities. Reimbursed through Accountable Plan. |
| Insurance | Business liability insurance, yes. Auto insurance, yes if the company owns the car. Health insurance, yes and added to W2 Box 1. Dental insurance, yes and added to W2 Box 1. Eye insurance, yes and added to W2 Box 1. Long Term Care insurance, yes, but limited. Disability insurance, No. Otherwise, your benefits become taxable income. Life insurance, No. Only in C corporations, where the corporation is the owner and beneficiary (no S corp election!). |
| Kids On Payroll | Great way of reducing tax liability for the same amount of cash. Must do it correctly and follow state child labor laws. |
| Legal, Professional Fees | Yes. |
| Merchant Card Fees | Yes. |
| Per Diem | Maybe. If employees own more than 10% of a corporation, then No. Sole proprietors and single member LLCs including partners in partnerships, yes. |

| | |
|---|---|
| Professional Attire | If the clothing is suitable for everyday use, then No. If the clothing is a uniform, then yes. Possible advertising expense. No dry cleaning unless clothing otherwise qualifies. |
| Profit Sharing Plan | Get $500 tax credit from IRS for starting one. Great way to defer taxes. We can set this up. |
| Retirement Plan | Get $500 tax credit from IRS for starting one. Great way to defer taxes. We can set this up. |
| Taxes | Sales tax, yes. Payroll tax, yes for company portion. Estimated tax payments, no. Nice try. |
| Utilities | No, unless you have a separate office location. If using home office, utilities, is a part of the deductible basis. |
| Website | Yes. |

There you go. There are tons of variations, exceptions, rules to follow, interpretations, positioning, and many more modifiers that we can't think of right now. Please contact us if you have any questions or concerns. We love to run through small business tax deductions with owners. And like a good parent, we try to find ways to say yes. Yes, you can go to Johnny's house right after you clean your room. Yes, you can deduct that expense provided you document it this way.

## Co-mingling of Money

We've mentioned this previously, and we'll do it again here.

**Rule #1- Please get a separate checking account for your business, preferably with the same bank as your personal checking account, so transfers (shareholder distributions) are easy.**

**Rule #2- Do not pay for personal expenses or any mixed-use expense with business funds.**

This is bad for several reasons — the IRS hates it. It erodes the corporate veil, which is already dangerously thin since you are a closely held corporation. Lastly, if you need to re-construct your financials because of a QuickBooks disaster or some other disaster, having your business transactions compartmentalized within a bank account makes life better. All money coming in is income. All money going out is an expense or a distribution.

Do you get the feeling that we've said these words before? Like déjà vu? Ever have "vuja de?" It is the feeling that this has never happened before (opposite of déjà vu).

Read Rule #2 again. It is imperative to keep an arms-length perspective on you, the employee, and relationship with the S corporation. If you worked for Google or Ford, you wouldn't be able to get the business to buy your groceries or pay your mortgage directly. Same thing with your business. Here is another quick table to help you out with the "Which debit card should I use?" question.

| **Cash Outflow** | **Checking Account To Use** |
|---|---|
| Car Lease | Personal, unless lease is in business name. |
| Gas for Car | Personal, unless owned / registered by business |
| Estimated Tax Payments | Personal, since an S Corp is a pass-thru entity |
| Cell Phone | Personal, reimbursed through Accountable Plan |
| Home Utilities | Personal, reimbursed through Accountable Plan |
| Home Office Renovations | Personal, possible partial reimbursement |
| DSW, Banana Republic | Personal, but it would be nice |
| Shareholder Distribution | Business |
| Self-Employed Health Insurance | Business |
| Out of Pocket Medical | Personal, unless you have an HRA |
| Accountable Plan Reimbursements | Business |
| 401k Contribution | Business |
| SEP IRA Contribution | Business, but you should use a 401k instead |

# Reducing Taxes

One of our primary focuses at **WCG inc.** is ensuring you are paying the least amount of taxes allowed by law. Some of our other primary focuses are helping you build wealth and leverage the most of your financial worlds for you and your family. However, these focuses or objectives are not isolated; they are very much related to each other and intertwined.

In our Reducing Taxes article, we talk about a lot of the basics, plus some ideas that don't always hit the headlines:

- Borrowing Against Unrealized Gains
- State Deferrals
- Medical C Corp
- Cost Segregation (and the limitations)
- Accrual Accounting (and risk based revenue recognition)
- Donor Advised Fund
- Conservation Easement
- Captive Insurance
- Discounted Roth Conversions

Please click on the button below for the full article-