

## Typical Small Business Deductions

The following is a list of typical small business expenses that can be claimed as deductions on your tax return. To be eligible for a tax deduction, the expense must be **ordinary** (common and accepted in the tax payer's line of work) and **necessary** (helpful and appropriate for work). For each of these expenses, it is recommended that you keep detailed records that are updated at the time of the expense. A software program, such as QuickBooks, can ease the burden of the record keeping.

- **Home Office**
  - Summary: If you use part of your home for business, you may be able to deduct expenses for the business use of your home. These expenses may include mortgage interest, insurance, utilities, repairs, and depreciation.
  - To Qualify: The portion of your home must be used regularly and exclusively for conducting business. It also must be your principal place of business – you can NOT have another office that you work from on a daily basis.
  - The Cons: If you take this deduction on a house that you own, you will later need to recapture the depreciation. This means that if you took the depreciation deduction on your house for \$5,000 over a 5 year period, you would have to pay taxes on \$5,000 when you sell the house. Further, if you take any of the home office expenses (mortgage interest, insurance, utilities, etc.), the IRS assumes you took the depreciation deduction and will require you to recapture that amount.
  - More Information: <http://www.irs.gov/businesses/small/article/0,,id=204169,00.html>
- **Office Supplies**
  - Keep any receipts. These are usually fairly straight forward deductions.
  - The office supplies include furniture, although you may elect to depreciate it over a seven year period. To take the full deduction up front, you would elect to use the Section 179 expense.
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- **Automobile Expenses**
  - Summary: You are allowed to choose one of the following options for your automobile expenses:
    - Standard mileage deduction: For this deduction, you simply multiply the IRS's standard mileage rate (\$0.55 in 2012) by your business miles driven. You then add any parking fees or tolls that you paid to that total.
    - Actual Expenses: For this deduction, you will track your business and personal miles driven and keep your gas/maintenance/other receipts. You will then determine a percentage of business use for the car. You multiply the business mile percentage by the actual expenses to determine your tax deduction. This method of expense tracking is typically advantageous for newer cars or large SUV's, due to the amount of depreciation.
  - To Qualify: Keep good records of the miles driven for business use. Ideally, you will have a log that lists the miles of the trip, the date, and the purpose of the trip.
  - The Cons: When using the actual expense method, there is a cutoff line at 50% for the business use miles. If you are over 50%, then you can take the section 179 expense deduction and a special first year deduction. If you are going to be anywhere close,

make sure that you get over the 50% business miles mark. There is one other issue to be aware of when using the actual expense method with greater than 50% business miles - If you meet the 50% business use test in the first year, but fail to meet the test in later years, you will need to recapture the deduction you previously took.

- **Computers & Cell Phones**
  - Summary: Self-employed taxpayers may deduct the cost of business-use computers or cell phones. If the taxpayer has no other computer or telephone, costs must be allocated between business and personal use.
  - <http://www.irs.gov/businesses/small/article/0,,id=230307,00.html#2043>
- **Meals, Entertainment, and Gifts**
  - Summary: You can deduct ordinary and necessary expenses to entertain a client, customer, or employee if the expenses meet the directly-related test or the associated test.
    - Directly-related test: Entertainment took place in a clear business setting; **or** The main purpose of entertainment was the active conduct of business, **and** you did engage in business with the person during the entertainment period, **and** you had more than a general expectation of getting income or some other specific business benefit.
    - Associated Test: Entertainment is associated with your trade or business **and** Entertainment directly precedes or follows a substantial business discussion.
  - You can generally deduct 50% of the cost of the meals or entertainment.
  - The Cons: The IRS will likely look closely at these expenses if you are audited. Be sure to keep track of receipts and the business purpose for the expense.
  - More Information:  
[http://www.irs.gov/publications/p334/ch08.html#en\\_US\\_2010\\_publink100025380](http://www.irs.gov/publications/p334/ch08.html#en_US_2010_publink100025380)
- **Travel**
  - Summary: You can deduct travel expenses when your work takes you away from your tax home for substantially longer than a day's work. You can deduct the cost of transportation, lodging, meals (typically 50%), tips, dry cleaning, and other necessary expenses. Also, you can frequently avoid some of the record keeping and increase your deduction by using the per diem rate on meals and lodging.
  - Special note: These deductions apply to business seminars and training.
  - More information:  
[http://www.irs.gov/publications/p334/ch08.html#en\\_US\\_2010\\_publink100025380](http://www.irs.gov/publications/p334/ch08.html#en_US_2010_publink100025380)
- **Insurance Premiums**
  - Summary: If you are self-employed and paying for your own health insurance premiums, then the costs are 100% deductible.
  - To qualify: The deduction can't be more than your business' net profit. It is also not allowed if you were eligible for other health care coverage, such as an employed spouse's medical plan.
    - A sole proprietor can meet this requirement by purchasing the health insurance coverage under his or her personal name.
    - A 2% shareholder in an S corporation may qualify for the selfemployed health insurance deduction if his or her premium was paid directly by the S



Tel: 303-517-6342  
EMail: [info@twohillsaccounting.com](mailto:info@twohillsaccounting.com)  
Web: [www.twohillsaccounting.com](http://www.twohillsaccounting.com)

corporation, or if he or she made the premium payments and furnished proof of payment to the S corporation for reimbursement in the current tax year

- The health insurance can be purchased in the name of the 2% shareholder and not in the name of the corporation if the following are true.
  - The payments are made or reimbursed by the S corporation in the current tax year, and
  - The payments are included in the W-2 gross income for the 2% shareholder-employee in the current year, and
  - The 2% shareholder-employee reports the payments or reimbursement as gross income on his or her personal tax return.
- More Information:  
[http://www.irs.gov/publications/p535/ch06.html#en\\_US\\_2010\\_publink1000208843](http://www.irs.gov/publications/p535/ch06.html#en_US_2010_publink1000208843)
- **Retirement Contributions**
  - Summary: SEP-IRA or Keogh contributions are tax deductible.

For more information or assistance with implementing these deductions on your taxes, contact Two Hills at 303-517-6342.