

This Month:

- ◆ Cash Accounting Method
- ◆ Business Telephone Deductions
- ◆ Cash Donations
- ◆ Shareholder Loans to S Corp
- ◆ Meals Deductible at 100%

Deductions for Business Use of Telephone



Taxpayers who use a home telephone for business purposes may deduct any charges incurred beyond the monthly base rate,

such as business long distance phone calls. The base rate including taxes for the first phone line into the home is not deductible; the cost of a business-only second line is deductible.

Business calls made while traveling away from home are a deductible item. This includes any business communication by devices such as a fax machine.

Cellular phones that are used for business purposes can give rise to a depreciation deduction. However, if the phone does not have more than 50% business use, depreciation deductions are limited and the Section 179 expense deduction is not allowed.

More Taxpayers Can Use Cash Method of Accounting

Generally, if you engaged in a trade or business in which the production, purchase, or sale of merchandise was an income-producing factor, you must take inventories into account at the beginning and end of your tax year.

However, if your average annual gross receipts for the 3 prior tax years are \$1 million or less and you are an eligible taxpayer who adopts or changes to the cash method of accounting, you will not be required to account for inventories.

If your business has been in existence for less than three years, average gross receipts are determined over the tax years it has been in existence (including annualized amounts for short years). For this purpose, gross receipts are defined as all amounts from the trade or business required to be recognized under your current method of accounting. These amounts include total sales (net of returns and allowances), all amounts received from services, interest, dividends, and rents. You do not have to include taxes that are legally imposed on the purchaser and are merely collected and remitted on their behalf.

If you are not required to account for inventories and do not want to do so, you must treat inventory in the same manner as cost of materials and supplies that are not incidental. Under this rule, inventory costs for raw materials purchased for resale are deductible in the year the finished goods or merchandise are sold (or, if later, the year you paid for the raw materials or merchandise).

If you want to change to the cash method of accounting, you must file Form 3115, *Application for Change in Accounting Method*. You may also have to make an adjustment to prevent amounts of income or expense from being duplicated or omitted. This is called a section 481(a) adjustment, which is taken into account over a period not to exceed 4 years.



Cash Donations

Currently, taxpayers must retain written substantiation on any gift of cash in order to deduct the contribution. If less than \$250, either a canceled check or account statement, or written acknowledgement from the charity is sufficient to substantiate the donation. For cash contributions of \$250 or more, written acknowledgement is required; a cancelled check is not sufficient.

If the charity provides goods or services of more than a nominal value in exchange for a donation of \$75 or more, the charity must give the donor a “good faith estimate” of the fair market value of the goods or services provided. Regardless of amount of donation, the charitable deduction is limited to the amount of the donation less the FMV of the goods or services received in return.

Taxpayers must reduce cash donations by the value of tickets received for charitable events even if they do not attend the event. No deductible charitable portion exists if the ticket price includes a raffle ticket entitling the individual to win a valuable prize.

Donors have until the due date of the tax return to obtain written substantiation from charities.

Meals Deductible at 100%

Although most business-related meal and entertainment expenses are currently only 50% deductible, a number of expenses are 100% deductible. The following can be deducted in full:



- Birthday and holiday gifts, other than cash;
- Donuts, coffee, and soft drinks;
- Fruit given due to illness, family emergency, or exceptional performance;
- Occasional cocktail parties, group meals, or picnics for employees and their guests;
- Meals billed to a customer;
- Food used as samples;
- Meals provided to employees under the “convenience of the employer” rules.

When meals are reimbursed, the percentage limitation applies to the person making the reimbursement.

Shareholder Loans to S Corp

Securing a loan for use in an S corporation often requires a shareholder guarantee. If the loan is not properly structured, the shareholder’s ability to deduct losses from the S corporation may be limited. The amount of losses an S corporation shareholder can take is limited to the adjusted basis of the shareholder’s stock, plus any direct loans the shareholder makes to the corporation. Losses cannot be deducted against a loan made directly from the lender to the S corporation – even if it is guaranteed by the shareholder.

To assure the ability to deduct losses, the shareholder should take out a personal loan for the amount needed, and, in turn, make a direct shareholder-to-corporation loan. Shareholder loans should be evidenced by an enforceable note with reasonable repayment terms in order for the loan to be viewed by the IRS as bona fide debt.

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Padgett Business Services is dedicated to meeting the tax, government compliance, profit & financial reporting and payroll needs of businesses with fewer than 20 employees in the retail and service sector of the economy. This publication suggests general business planning concepts that may be appropriate in certain situations. It is designed to provide complete and accurate information to the reader. However, because of the complexities of the tax law and the necessity of determining whether the material discussed herein is appropriate to your business, it is important you seek advice from your Padgett office before implementing any of the concepts suggested in this newsletter.

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