Top Tax Deductions for Your Small Business

Don't miss these fourteen tax deductions for your small business.

It's simple: The more tax deductions your business can legitimately take, the lower its taxable profit will be. Also, in addition to putting more money into your pocket at the end of the year, the tax code provisions that govern deductions can also yield a personal benefit: a nice car to drive at a small cost, or a combination business trip and vacation. It all depends on paying careful attention to IRS rules on just what is -- and isn't -- deductible.

When you're totaling up your business's expenses at the end of the year, don't overlook these 14 common business deductions.

1. Auto Expenses

If you use your car for business, or your business owns its own vehicle, you can deduct some of the costs of keeping it on the road. Mastering the rules of car expense deductions can be tricky, but well worth your while.

There are two methods of claiming expenses:

- **Actual expense method.** You keep track of and deduct all of your actual business-related expenses.
- **Standard mileage rate method.** You deduct a certain amount (the standard mileage rate) for each mile driven, plus all business-related tolls and parking fees. In 2009, the standard mileage rate is 55 cents per business mile driven. The rate was 50.5 cents per mile for the first half of 2008 and 58.5 cents per mile for the second half of the year.

As a rule, if you use a newer car primarily for business, the actual expense method provides a larger deduction at tax time. If you use the actual expense method, you can also deduct depreciation on the vehicle. To qualify for the standard mileage rate, you must use it the first year you use a car for your business activity. Moreover, you can't use the standard mileage rate if you have claimed accelerated depreciation deductions in prior years, or have taken a Section 179 deduction for the vehicle. (For more on Section 179, see "New Equipment," below.)

If your auto is used for both business and pleasure, only the business portion produces a tax deduction. That means you must keep track of how often you use the vehicle for business and add it all up at the end of the year. Certainly, if you own just one car or truck, no IRS auditor will let you get away with claiming that 100% of its use is related to your business.

2. Expenses of Going Into Business

Once you're running a business, expenses such as advertising, utilities, office supplies, and repairs can be deducted as current business expenses -- but not before you open your doors for business. The costs of getting a business started are capital expenses, $5,000 of which you may deduct the first year you're in business; any remainder must be deducted in equal amounts over the next 15 years.

If you expect your business to make a profit immediately, you may be able to work around this rule by delaying paying some bills until after you're in business, or by doing a small amount of business just to officially start. However, if, like many businesses, you will suffer losses during the first few years of operation, you might be better off taking the deduction over five years, so you'll have some profits to offset.

3. Education Expenses

You can deduct education expenses if they are related to your current business, trade, or occupation. The expense must be to maintain or improve skills required in your present employment, or be required by your employer or as a legal requirement of your job. The cost of education that qualifies you for a new job isn't deductible.

4. Legal and Professional Fees

Fees that you pay to lawyers, tax professionals, or consultants generally can be deducted in the year incurred. However, if the work clearly relates to future years, they must be deducted over the life of the benefit you get from the lawyer or other professional.

Business books, including those that help you do without legal and tax professionals, are fully deductible as a cost of doing business.

5. Bad Debts

If someone stiffs your business, the bad debt may or may not be deductible -- it depends on the kind of product your business sells.

- **Goods.** If your business sells goods, you can deduct the cost of goods that you sell but aren't paid for.
- **Services.** If, however, your business provides services, no deduction is allowed for time you devoted to a client or customer who doesn't pay.

6. Business Entertaining

If you pick up the tab for entertaining present or prospective customers, you may deduct 50% of the cost if it is either:

- directly related to the business and business is discussed at the event -- for example, a catered meeting at your office; or
- associated with the business, and the entertainment takes place immediately before or after a business discussion.

Make notes. On the receipt or bill, always make a note of the specific business purpose -- for example, "Lunch with Joyce Slater of Ace Manufacturing Co. to discuss widget contract."

7. Travel

When you travel for business, you can deduct many expenses, including the cost of plane fare, costs of operating your car, taxis, lodging, meals, shipping business materials, cleaning clothes, telephone calls, faxes, and tips.

What about combining business and pleasure? It's okay, as long as business is the primary purpose of the trip. However, if you take your family along, you can deduct only your own expenses.

8. New Equipment

Some small businesses can write off the full cost of some assets in the year they buy them, rather than capitalizing them -- deducting their cost over a number of years. (See Current vs. Capital Expenses for information on expenses that must be capitalized.)

Section 179 of the Internal Revenue Code allows you to deduct up to $250,000 of the cost of new equipment or other assets in 2008 (scheduled to go down to $128,000 in 2009). This is subject to a phase-out if you place more than $800,000 of equipment in service in 2008 ($510,000 in 2009). Some assets don't qualify for this Section 179 deduction, including real estate, inventory bought for resale, and property bought from a close relative.

There is also a first-year bonus depreciation deduction in effect for 2008 only. This special one-year only deduction allows taxpayers to depreciate 50% of the adjusted basis of qualified property during the first year the property is placed in service. This deduction can be taken in addition to the Section 179 deduction and offers tremendous tax savings on property purchased in 2008.

9. Interest

If you use credit to finance business purchases, the interest and carrying charges are fully tax-deductible. The same is true if you take out a personal loan and use the proceeds for your business. Be sure to keep good records demonstrating that the money was used for your business.

10. Moving Expenses

If you move because of your business or job, you may be able to deduct certain moving costs that would otherwise be non-deductible personal living expenses. To qualify, you must have moved in connection with your business (or job, if you're an employee of your own corporation or someone else's business). The new workplace must be at least 50 miles farther from your old home than your old workplace was. (Technically, moving expenses aren't business expenses; there's a special place to list them on your Form 1040 tax return.)

11. Software

As a general rule, software bought for business use must be depreciated over a 36-month period, but there are some important exceptions:

- Computer software placed in service from January 1, 2003 to December 31, 2010 is eligible for a Section 179 deduction, which means that 100% of the cost of software can be deducted in the year purchased. Starting in 2011, you will no longer be able to use Section 179 to deduct off-the-shelf software.
- When software comes with a computer, and its cost is not separately stated, it's treated as part of the hardware and is depreciated over five years. However, under Section 179, you can write off a whole computer system (including bundled software) in the first year if the total cost is less than a certain amount ($250,000 in 2008; scheduled to go down to $128,000 in 2009). See IRS Publication 946, *How to Depreciate Property*.

12. Charitable Contributions

If your business is a partnership, a limited liability company, or an S corporation (a corporation that has chosen to be taxed like a partnership), your business can make a charitable contribution and pass the deduction through to you, to claim on your individual tax return. If you own a regular (C) corporation, the corporation can deduct the charitable contributions.

If you've got some old computers or office furniture, giving it to a school or nonprofit organization can yield goodwill plus a tax benefit. However, if the equipment has been fully depreciated (written off), you can't claim a deduction.

13. Taxes

Taxes incurred in operating your business are generally deductible. How and when they are deducted depends on the type of tax:

- Sales tax on items you buy for your business's day-to-day operations is deductible as part of the cost of the items; it's not deducted separately. However, tax on a big business asset, such as a car, must be added to the car's cost basis; it isn't deductible entirely in the year the car was bought.
- Excise and fuel taxes are separately deductible expenses.
- If your business pays employment taxes, the employer's share is deductible as a business expense. Self-employment tax is paid by individuals, not their businesses, and so isn't a business expense.

- Federal income tax paid on business income is never deductible. State income tax can be deducted on your federal return as an itemized deduction, not as a business expense.
- Real estate tax on property used for business is deductible, along with any special local assessments for repairs or maintenance. If the assessment is for an improvement -- for example, to build a sidewalk -- it isn't immediately deductible; instead, it is deducted over a period of years.

14. Advertising and Promotion

The cost of ordinary advertising of your goods or services -- business cards, yellow page ads, and so on -- is deductible as a current expense. Promotional costs that create business goodwill -- for example, sponsoring a peewee football team -- are also deductible as long as there is a clear connection between the sponsorship and your business. For example, naming the team the "Southwest Auto Parts Blues" or listing the business name in the program is evidence of the promotion effort.

Easily Overlooked Business Expenses

Here are some additional routine deductions that many business owners miss. Keep your eye out for them.

- audiotapes and videotapes related to business skills
- bank service charges
- business association dues
- business gifts
- business-related magazines and books
- casual labor and tips
- casualty and theft losses
- coffee and beverage service
- commissions
- consultant fees
- credit bureau fees
- office supplies
- online computer services related to business
- parking and meters
- petty cash funds
- postage
- promotion and publicity
- seminars and trade shows
- taxi and bus fare
- telephone calls away from the business

Note: Just because you didn't get a receipt doesn't mean you can't deduct the expense, so keep track of those small items.

Please contact PADGETT BUSINESS SERVICES® for more guidance on interpreting the IRS tax code and for tax, accounting, and payroll services for your small business.

PADGETT BUSINESS SERVICES®, 140 Point Judith Road, Narragansett, RI 02882, 401-783-4500, ext. 2 or email smallbizpro.evans@gmail.com

www.smallbizprosri.com