THE TOP 25 TAX DEDUCTIONS YOUR BUSINESS CAN TAKE — AND 5 YOU CAN’T
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You're responsible for hiring employees, paying bills, and selling your products and services.

You're also responsible for paying taxes. It's probably not on anyone's list of favorite things to do; paying taxes can be stressful to new business owners — but it doesn't have to be. The IRS offers a long list of legitimate tax deductions that can help small business owners reduce their taxable income, resulting in a smaller tax payment.

These tax deductions are expenses you incur over the course of doing business and can range from the copier paper you purchase to the premium you pay for your employees' health insurance. Each time you take a deduction for these expenses, it lowers your taxable income and your tax bill. That's why it's so important to learn what deductions are available to you as well as what deductions you can never take.

Remember, your accounting method can also affect what deductions you can take for the year. For example, if you're using the cash method, any tax-deductible expense you paid during the calendar year can be deducted. But if you're using the accrual method, you'll need to deduct expenses based on the date the expense was initiated.

For example, you call an electrician in December to fix some faulty wiring at your business. The electrician later sends you a bill for $500, which you pay in January. If you're using the accrual method, you can deduct the $500 in 2019, because work was completed in December of that year, even though it wasn't paid. However, if you're using the cash method, you'll have to wait until 2020 to deduct the expense.
TOP 25 TAX DEDUCTIONS

Our list of the top 25 tax deductions includes the most common deductions small business owners can take. Not all these deductions are available for all businesses, so it's always a good idea to check with a CPA or accounting professional to see which deductions your business is eligible for.

And remember, when taking any deduction, be sure you have the records in place to back it up. Accounting software can keep track of your expenses, but you have to have the paperwork to back up any deductions you take.

1. QUALIFIED BUSINESS INCOME DEDUCTION (QBI)

Part of the Tax Cuts and Jobs Act of 2018, this relatively recent addition to the tax code is a major bonus for the self-employed, including sole proprietors, partnerships, or S corporations. The QBI helps offset pass-through income, offering up to 20% deduction. This can be a major bonus for self-employed workers who pay taxes at the individual tax rate.

For example, if your business has a pre-tax income of $50,000 in 2019, and you fall into one of the self-employed or small business structures listed above, you could deduct 20%, or $10,000, before income tax is calculated. There are caps to what you can earn, with the deduction phasing out at $157,000 for single filers or $315,000 for those filing a joint return.

2. STARTING A BUSINESS

If you're still in the planning phase of starting a business, you likely can deduct some costs. It can get a little tricky because it depends on whether you end up actually starting a business. If you do end up with a legitimate business, you can deduct up to $5,000 for both startup and organizational costs incurred during the first year of your business as long as total startup costs are less than $50,000. The deduction must be taken in the year the business officially started, and any costs exceeding the deduction taken would need to be amortized.

If you end up not going into business, some of your expenses may still be deductible. However, standard costs such as general research, preliminary investigations, or possible investment costs are considered personal and are nondeductible.

3. CONTRACT LABOR

If you regularly hire freelancers or contractors in your business, their costs are deductible. Remember to send a 1099-MISC form to any freelancer you hire, and collect a W-9 from any contractor or freelancer before issuing a check so you know exactly where to send that 1099.

4. TRAVEL EXPENSES

Travel expenses are tax deductible if they are deemed necessary and they take you away from your regular business operations. Deductible travel expenses may include the following:

- Travel by vehicle, plane, train, or bus
- Parking and tolls
• Lodging
• Taxis or other means of transportation

Whether you or an employee travels, it’s helpful to keep a log of all expenses incurred during travel.

### 5. EMPLOYEE BENEFIT PROGRAMS

You can deduct the cost of various benefit programs you offer your employees. These programs can include:

• Health plans
• Accident plans
• Adoption assistance
• Educational assistance
• Life insurance coverage

Usually, you can deduct the entire amount you spend on any of these employee benefit programs on your tax return. The only exception is that you cannot deduct the cost of life insurance for yourself or anyone with a financial interest in your business.

### 6. FRINGE BENEFITS

Fringe benefits are considered a form of payment for services rendered and are generally deductible. Fringe benefits include:

• Vehicle usage
• Meals and lodging
• Discounts on services
• Air travel expenses

For self-employed individuals who use Schedule C to file their taxes, handling fringe benefits is fairly straightforward. It becomes more complicated for corporations.

### 7. REIMBURSEMENT OF BUSINESS EXPENSES

If you advance funds or reimburse employees for business-related expenses, these expenses are deductible. However, remember the 50% deduction for meals still stands, so even if you reimburse your employees 100% for their meal expenses while traveling, your business can...
still only deduct 50% of that expense. The IRS has various rules in place for per diems and reimbursement rates. For more information on per diems and other allowable travel-related deductions, check out Publication 535: Business Expenses.

8. VEHICLE EXPENSES

If you own a vehicle used exclusively for business, you can deduct all related expenses. If the car is used for both personal and business reasons, you'll have to calculate related expenses based on the number of business miles driven. There are two ways you can deduct vehicle expenses, so you'll have to choose the method that works best for your business.

- **Actual car expenses**: This method works best if the car is used exclusively for business. You have the option to calculate and deduct expenses based on usage, but you'll first have to figure out the percentage of time (or miles) the car is used for business reasons.

- **Standard mileage rate**: If you're already tracking mileage for business, consider taking the standard mileage rate deduction, which in 2020 is $0.575 per mile.

9. EMPLOYEE PAY

Any wages you pay your employees are considered deductible if they meet both of these tests:

- The pay must be reasonable.
- It must be for services rendered.

Regular payroll, commissions, and payments made before services are performed are all considered deductible. Employee awards are also deductible up to $400 per award, or $1,600 for all awards in a tax year.

10. EDUCATION EXPENSES

If you have a qualified educational assistance program, you can deduct the payments made to an educational institution or the amount reimbursed to your employees. Be sure you have a program in place before taking educational expenses as a deduction.

11. CONTINUING EDUCATION

Your employees aren't the only ones that can benefit from continuing their education. Any expenses you incur to further your education are tax deductible as well. These include:

- Any courses or classes that relate to your current line of work.
• Trade publications

• Seminars or webinars that are related to your current line of work

12. RENT
If you rent an office or other space for your business, you can deduct the rental cost. Remember that if you pay your rent in advance, you can only deduct the rent that is related to the current tax year. For example, if you sign a lease in August to rent a property for $1,000 a month, and you prepay for the entire 12 months, you can only deduct rental expenses for August through December, with the rest deductible in the following year.

If you rent a home or apartment that you use partially for business, you may deduct a portion of the rent (that will be addressed later in this list).

13. INTEREST
Do you pay mortgage interest on a property purchased for your business? If so, that interest is deductible. As always, it’s best to check with your accountant, because there are cases when interest should be added to the cost basis of the property through capitalization.

14. MISCELLANEOUS TAXES
As a business owner, income tax isn’t the only tax you’ll be paying. Fortunately, many of those other taxes, such as real estate and property taxes, are deductible. Your share of employment taxes — such as FICA, FUTA, and state unemployment tax — is deductible, too.

15. INSURANCE
Usually, the cost of premiums for insurance related to your business is deductible. This could include:
• Property insurance
• Insurance that covers business losses from bad debt
• Group health insurance
• Liability insurance
• Malpractice insurance
• Workers’ compensation insurance
• Vehicle insurance (only if not using standard mileage expense on the vehicle)

Excluded in the regular deduction are premiums for indirect cost items such as premiums for a plant or production facility, machinery, equipment, materials produced, or property acquired for resale. You also cannot deduct premium costs for any life insurance policy for which you are a beneficiary.

16. BAD DEBT

If you’ve been in business for any length of time, you know bad debt is part of doing business. While there are ways to reduce the debt you have, if you offer your customers credit, you’ll likely have some bad debt you need to write off.

Luckily, the IRS allows you to do just that using one of two methods:

• The specific charge-off method
• The nonaccrual-experience method

If you claim a bad debt deduction on your tax return and later get paid for the debt, the amount you received must be included in your gross income for the year in which you received the payment.

17. MEALS AND ENTERTAINMENT

Even if you reimburse your employees 100% for their meal expenses, you can still only deduct 50% of the meal expense on your tax return. There are exclusions to the 50% rule that you should know:

• Advertising and goodwill: For example, if your restaurant provides free meals to first responders in the community, 100% of that cost is deductible.

• Sales of meals and/or entertainment: If you’re in business to sell meals to the public or provide entertainment, the cost of the meals and entertainment is 100% deductible.

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**Tax Withholding and Estimated Tax**

- **SCHEDULE D** (Form 1040)
- **Capital Gains and Losses—Generally Assets Held One Year or Less**

**Part I**

- Short-Term Capital Gains and Losses
- Complete if you round off cents to nearest dollar
- Proceeds (basis x 1,000)
- Cost (or other basis)
• **Company-wide events:** Food and beverage expenses for your annual picnic are not subject to the 50% rule, making them 100% deductible.

### 18. ADVERTISING EXPENSES

If you do any advertising for your business, you can generally deduct the expenses paid as long as they are directly related to your business activities. Lobbying expenses or other amounts paid to influence legislation are not deductible.

### 19. CLUB DUES AND MEMBERSHIP FEES

Generally, club dues for country clubs and athletic clubs are not deductible. However, the IRS makes an exception for certain types of clubs, including:

- Business leagues
- Chambers of commerce
- Civic organizations
- Real estate boards
- Trade associations
- Professional organizations
- Boards of trade

If you belong to one of these organizations, those dues and membership fees would be tax deductible.

### 20. INTERNET-RELATED EXPENSES

If you’re in business today, you need to have internet access, so it makes sense that internet-related expenses would be deductible. These include standard expenses such as domain registration fees, monthly connection fees, and webmaster consulting, if necessary.

### 21. LEGAL AND PROFESSIONAL FEES

Any fees you pay to an accountant or an attorney that are considered ordinary and necessary are deductible as a business expense. Be careful to exclude personal expenses when taking these deductions.

*Doing business often means being connected to a variety of resources.* Source: bandt.com.au.
22. UTILITIES

Utility costs for heat, power, telephone service, water, and sewer are fully deductible. Utilities must be calculated differently if using a home office.

23. SUPPLIES AND MATERIALS

Miscellaneous supplies and materials not included in your regular inventory totals can be deducted, as can items like the cost of books, equipment, and professional instruments used in your business. Keep in mind these are typically short-term costs, not items normally depreciated. Think of things like paper supplies, envelopes, stamps, printer cartridges, etc.

24. DEPRECIATION

Any time you purchase big-ticket items such as furniture, computers, and equipment, the costs are typically spread across the item’s useful years using depreciation. However, the IRS provides several options for writing off the cost of these assets:

- **De minimis safe harbor election**: The de minimis safe harbor election allows small businesses to expense assets costing less than $2,500.

- **Section 179**: The Section 179 deduction has a cap of $1 million, including new and used business property. The Section 179 deduction can only be used up to your taxable income, but any unused deduction can be carried forward and used on the following year’s return.

- **Bonus depreciation**: Bonus depreciation allows you to deduct the full cost of machinery, computers, appliances, furniture, and equipment.

For more information on depreciation, check out Publication 946 from the IRS. Depreciation is a complex topic, even for experienced accountants, so consult with a professional if you have any questions or concerns.

25. HOME OFFICE DEDUCTION

Although this deduction has been the subject of much controversy in recent years, don’t let the naysayers scare you away from taking the home office deduction if you qualify for it. The IRS has two basic requirements for claiming a home office deduction:

- Regular and exclusive use

- Principal place of business

This simply means that the part of your house you’re including as a deduction must be used exclusively for your business. That means no office at the kitchen table. It must also be your principal place of business.

When calculating your home office deduction, you can claim both direct and indirect costs if your home qualifies. There’s a lot of information to absorb on this one, so check out Publication 587: Business Use of Your Home for further details.
WHAT YOU CAN’T DEDUCT

With all of these great business deductions available, why resort to some questionable ones? For some reason, every year, someone, somewhere decides that their daughter’s wedding qualifies as a legitimate business expense.

These examples get an A for creativity, but received a big, fat NO from the IRS:

• Someone claimed a deduction of more than $14,000 to remove carpeting from a home because the occupant claimed she was allergic.

• A taxpayer claimed the cost of constructing a fallout shelter as a medical expense since having the shelter nearby would reduce his stress and anxiety.

• Mileage to your favorite restaurant to eat lunch (by yourself) is not a deductible expense, as one office worker discovered. Even if the food is really, really good.
On that note, here are five expenses that are never considered deductible.

1. **POLITICAL CONTRIBUTIONS**

   Give to the candidate of your choice, but don’t expect the contribution to be tax deductible. Indirect expenses such as advertising in a politically-funded publication, admission to a dinner, program, gala, concert, or any other event directly related to a specific political party or candidate are not deductible.

2. **LOBBYING EXPENSES**

   Like political contributions, lobbying expenses are also not tax deductible. Lobbying expenses can include any or all of the following:
   
   • Attempting to influence legislation
   • Attempting to influence the general public about elections or other related matters
   • Communicating with officials to influence their actions

3. **PERSONAL EXPENSES**

   There are a ton of these, none of which are considered business deductions.
   
   • Home repairs
   • Home security systems (unless you work from your home)
   • Personal living expenses
   • Pet registration fees
   • Club dues
   • Burial and funeral expenses
   • Lost or misplaced cash

4. **CLOTHING FOR WORK**

   If you’re required to wear a uniform for work, the uniform cost is deductible. All other clothing expenses for work are not. So, even if you’re required to wear a suit to work every day, the cost is coming out of your pocket with no help from the IRS.

5. **ILLEGAL ACTIVITY**

   While this shouldn’t come as a shock, it bears repeating that the IRS does not allow you to deduct expenses related to illegal activity, which includes bribes and kickbacks. On a side note, if you have any sexual harassment claims you recently paid, those aren’t deductible either.
POSSIBLE COVID-19 IMPACT

In some ways, COVID-19 has already affected the 2020 tax year, specifically regarding estimated tax deadlines, which were pushed to July 15 this year, along with the 2019 filing deadline.

Payroll Protection Program (PPP) recipients may also be affected if their loan is ultimately forgiven. Earlier this year, the IRS released a notice clarifying how the forgiven portion of the PPP loan will be handled. For example, if you pay business expenses such as payroll, mortgage interest, or rent using the PPP loan, and that loan is forgiven, any expenses paid for with that loan will not be considered a deductible expense. Nothing is finalized, though, and there’s a lot of time for things to change before 2020 taxes are due.

For Economic Injury Disaster Loan (EIDL) recipients, if you only received the loan, there are no tax repercussions, but if you also received a grant, that money is considered taxable income and needs to be included in 2020 income totals.

There are sure to be plenty of additions and changes to taxes due to the COVID-19 impact in the coming months. Keep your eye out for them, and check with your tax professional to see if any of them will affect your business.
YOU DON’T HAVE TO DO IT ALL BY YOURSELF

Small business owners are typically take-charge people used to jumping in the ring to get things done. But with taxes, don’t think you have to do this all by yourself.

Yes, there are a ton of great tax preparation software programs out there designed for small business owners, and often, those programs will be sufficient. But if you’re just starting out, have no idea how to prepare taxes, or don’t even know what a deduction is, the best thing you can do for your business is to consult a tax professional.

CPAs aren’t just for Fortune 500 companies. There are a ton of CPA firms that specialize in small businesses and can help you understand tax implications for 2020 and beyond — and maybe even save you some money in the process.

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