

Deductions and Credits

SBA & H&R Block

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Agenda

- ▶ Deductible items
- ▶ Tax Credits
- ▶ Questions

What Can I Deduct?

- ▶ To be deductible, a business expense must be both ordinary and necessary.
 - ▶ Ordinary = common and accepted in your trade or business.
 - ▶ Necessary = helpful and appropriate for your trade or business.
 - ▶ An expense does not have to be indispensable to be considered necessary.
- ▶ It is important to separate business expenses from the following expenses:
 - ▶ The expenses used to figure the cost of goods sold,
 - ▶ Capital Expenses, and
 - ▶ Personal Expenses.

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
 - ▶ You may deduct \$5,000 the first year you're in business; any remainder must be deducted (amortized) in equal amounts over the next 15 years.

Books/Resource Material and Legal and Professional Fees

- ▶ Business books/ Resource Materials
- ▶ Fees that you pay to lawyers, tax professionals, or consultants generally can be deducted in the year incurred.
 - ▶ You must give your lawyer a 1099 each year no matter how much you pay them
 - ▶ All other consultants 1099 at the end of the year for \$600 over

Insurance

- ▶ More than 1 year, split it up for the years over coverage
 - ▶ Example: 5 year insurance for business. Purchased in January of 2015. 1/5 every year until renewal date.

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.
- ▶ The cost of education that qualifies you for a new job isn't deductible.

Business Assets

- ▶ Assets = Building, machinery, computers, software, (anything that has value that you paid for)
- The way to write off assets:
 - Take a deduction in the year of purchase
 - Depreciation of the asset
- Time your purchase of assets to offset profits
- ▶ Financed assets - write off interest each year
- Assets for Personal use (Listed Property):
 - Computer (60% Business/ 40% personal)
 - Car
 - Document the % of use

Software and Computer

- ▶ As a general rule, software bought for business use can be depreciated over a 36-month period
- ▶ 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.

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.
- ▶ Only interest you can deduct personally is mortgage on your home.
- ▶ Be sure to keep good records demonstrating that the money was used for your business.

Advertising and Promotion

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

Bad Debts

- ▶ If someone stiffes 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.** no deduction is allowed for time you devoted to a client or customer who doesn't pay if you are cash basis but you can on accrual
- Accounting method
 - Cash
 - Accrual, records income as it is earned and expenses as incurred, regardless of when received or paid.
 - Hybrid, a combination of cash and accrual. Often using accrual for income and inventory and cash for everything else.

Cost of Goods Sold

- ▶ If your business manufactures products or purchases them for resale:
 - ▶ Value inventory at the beginning and end of each tax year to determine your cost of goods sold.
- ▶ Some of your expenses may be included in figuring the cost of goods sold.
- ▶ The cost of goods sold is deducted from your gross receipts to figure your gross profit for the year.
- ▶ **If you include an expense in the cost of goods sold, you cannot deduct it again as a business expense.**
- ▶ The following are types of expenses that go into figuring the cost of goods sold.
 - ▶ The cost of products or raw materials, including freight
 - ▶ Storage
 - ▶ Direct labor costs (including contributions to pensions or annuity plans) for workers who produce the products
 - ▶ Factory overhead
 - ▶ Under the uniform capitalization rules, you must capitalize the direct costs and part of the indirect costs for certain production or resale activities.
 - ▶ Indirect costs include rent, interest, taxes, storage, purchasing, processing, repackaging, handling, and administrative costs..

Capital Expenses

- ▶ You must capitalize, rather than deduct, some costs.
- ▶ These costs are a part of your investment in your business and are called capital expenses.
- ▶ Capital expenses are considered assets in your business. In general, there are three types of costs you capitalize.
 - ▶ Business start-up cost
 - ▶ Business assets
 - ▶ Improvements

Personal versus Business Expenses

- ▶ You can expenses for something that is used partly for business and partly for personal purposes
 - ▶ Divide the total cost between the business and personal parts. **You can deduct the business part.**
 - ▶ For example, if you borrow money and use 70% of it for business and the other 30% for a family vacation, you can deduct 70% of the interest as a business expense. The remaining 30% is personal interest and is not deductible.

Employee & Retirement Expenses

- ▶ **Employees' Pay** - You can generally deduct the pay you give your employees for the services they perform for your business.
- ▶ **Retirement Plans** - Retirement plans are savings plans that offer you tax advantages to set aside money for your own, and your employees' retirement.

Rent Expense

- ▶ **Rent Expense** - Rent is any amount you pay for the use of property you do not own.
- ▶ You can deduct rent as an expense only if the rent is for property you use in your trade or business.
- ▶ If you have or will receive equity in or title to the property, the rent is not deductible.

Easily Overlooked Business Expenses

- ▶ 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
- ▶ Health care premiums
- ▶ 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
- ▶ Tolls

Home Office Expenses

► 2 Methods to account for home office:

Actual and Simplified(Safe Harbor)

- Actual = Intensive record keeping but higher deduction possible (keep all receipts!)
- Simplified = Simple calculation based on square footage x \$5 (Max of 300 Sq. ft)
 - Used exclusively for business (not a kids playroom or guestroom)
- IRS does look at it but not a trigger for an audit like it use to be

Auto Deduction:

Actual Expenses vs. Standard mileage rate:

▶ Standard

- Calculate mileage = .575 per mile (2015)
- You must have a mileage log
- You must have the beginning miles and ending miles for the year

▶ Actual Expenses:

- Gas, auto repair, insurance, maintenance, cleaning, tire...etc.

▶ Buying/ Leasing a car for business:

- If a vehicle is used exclusively for business purposes, you may generally deduct the full cost of operating the vehicle
- If you use a vehicle for business on a part-time basis, you will have to allocate your expenses based on your business and personal use.

Business Travel

- ▶ **Keep Receipts** - Meals, lodging, transportation (airline, taxi, train), laundry..etc..
- ▶ Credit Card charges aren't enough without explanation
 - Ex: Seminar and then Disneyland after with family - Write off seminar but not family related travel expenses
 - Ex: Lunch with a client - document who client was, what was discussed, business purpose
 - Just talking to someone on vacation and exchanging business cards, does not make that vacation business travel

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."

Deducting Taxes

- ▶ 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.
- ▶ 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
 - ▶ Example, to build a sidewalk -- it isn't immediately deductible; instead, it is deducted over a period of years.

Schedule C – Part 1 Income

SCHEDULE C (Form 1040)

Department of the Treasury
Internal Revenue Service (99)

Profit or Loss From Business (Sole Proprietorship)

▶ Information about Schedule C and its separate instructions is at www.irs.gov/schedulec.
▶ Attach to Form 1040, 1040NR, or 1041; partnerships generally must file Form 1065.

OMB No. 1545-0074

2014

Attachment
Sequence No. **09**

Name of proprietor		Social security number (SSN)
A	Principal business or profession, including product or service (see instructions)	B Enter code from instructions
C	Business name. If no separate business name, leave blank.	D Employer ID number (EIN), (see instr.)
E	Business address (including suite or room no.) City, town or post office, state, and ZIP code	
F	Accounting method: (1) <input type="checkbox"/> Cash (2) <input type="checkbox"/> Accrual (3) <input type="checkbox"/> Other (specify)	
G	Did you "materially participate" in the operation of this business during 2014? If "No," see instructions for limit on losses	<input type="checkbox"/> Yes <input type="checkbox"/> No
H	If you started or acquired this business during 2014, check here	<input type="checkbox"/>
I	Did you make any payments in 2014 that would require you to file Form(s) 1099? (see instructions)	<input type="checkbox"/> Yes <input type="checkbox"/> No
J	If "Yes," did you or will you file required Forms 1099?	<input type="checkbox"/> Yes <input type="checkbox"/> No

Part I Income

1	Gross receipts or sales. See instructions for line 1 and check the box if this income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked	<input type="checkbox"/>	1		
2	Returns and allowances		2		
3	Subtract line 2 from line 1		3		
4	Cost of goods sold (from line 42)		4		
5	Gross profit. Subtract line 4 from line 3		5		
6	Other income, including federal and state gasoline or fuel tax credit or refund (see instructions)		6		
7	Gross income. Add lines 5 and 6		7		

Schedule C – Part 2 Expenses

Part II Expenses. Enter expenses for business use of your home only on line 30.							
8	Advertising	8		18	Office expense (see instructions)	18	
9	Car and truck expenses (see instructions).	9		19	Pension and profit-sharing plans	19	
10	Commissions and fees	10		20	Rent or lease (see instructions):		
11	Contract labor (see instructions)	11		a	Vehicles, machinery, and equipment	20a	
12	Depletion	12		b	Other business property	20b	
13	Depreciation and section 179 expense deduction (not included in Part III) (see instructions).	13		21	Repairs and maintenance	21	
14	Employee benefit programs (other than on line 19).	14		22	Supplies (not included in Part III)	22	
15	Insurance (other than health)	15		23	Taxes and licenses	23	
16	Interest:			24	Travel, meals, and entertainment:		
a	Mortgage (paid to banks, etc.)	16a		a	Travel	24a	
b	Other	16b		b	Deductible meals and entertainment (see instructions)	24b	
17	Legal and professional services	17		25	Utilities	25	
				26	Wages (less employment credits)	26	
				27a	Other expenses (from line 48)	27a	
				b	Reserved for future use	27b	

Credit Vs. Deduction

- Credits reduce your tax liability (amount you owe to the IRS)
- Deductions reduce your taxable income (amount your taxes are based on)

Healthcare Tax Credit

- ▶ To be eligible, an employer must:
 - ▶ Pay premiums for employee health insurance under a qualifying arrangement;
 - ▶ Have fewer than 25 full-time-equivalent employees (FTEs) for the tax year; and
 - ▶ Pay average annual wages of less than \$50,000 per FTE
 - ▶ The maximum credit is 50% of the employer's contribution toward the employees' health insurance premiums (35% for nonprofits).
 - ▶ The credit is available for a maximum of two years. In addition, employers must obtain the insurance through the Small Business Health Options Program (SHOP)

Alternative Motor Vehicle Credit

- ▶ New diesel, hybrid & electric cars
- ▶ Certified by IRS for the credit
- ▶ Tax credit ranging from \$400 to \$4,000 based on fuel economy.
- ▶ Phase due to manufacturer sales
- ▶ Three criteria to qualify for the hybrid tax credit:
 1. Purchase a qualifying vehicle.
 2. Purchase the vehicle new, not used.
 3. The vehicle must be used for your own personal or business use. The vehicle should not be bought with the intention of re-selling it.
- ▶ Qualifying vehicle must be "placed in service" in during the tax year for which you claim the tax credit.

Credit for Employer Provided Child Care

- ▶ Employers who pay a child care facility to provide child care services to their employees.
 - Employers must make payments directly to a child care facility pursuant to an arrangement or contract between the employer and the child care facility.
 - Payments made to employees as a reimbursement for child care expenses cannot be included in the credit.
 - Amounts taken as a credit cannot also be deducted as an expense.
- ▶ The federal tax credit is equal to 25 percent of the child care expenditures made by the employer. The credit is limited to \$150,000.
- ▶ The credit is limited to 50 percent of the employer's income tax liability for the taxable year, but any credit not used in a tax year can be carried forward for five years.

Questions?