The top 21 small business tax deductions in 2020

• Advertising • Car and truck expenses • Commissions and fees • Contract labor • Depletion • Depreciation and section 179 expense deduction • Employee benefit programs • Insurance • Interest • Legal and professional services	• Office expense • Pension and profit-sharing plans • Rent or lease • Repairs and maintenance • Supplies • Taxes and licenses • Travel • Meals • Utilities • Wages Paid • Home Office Business Deductions

Advertising:

The cost of advertising your business is fully deductible, these expenses usually include:

- Business Logo Designs
- Business cards and brochures
- TV, Radio and Print ads
- Website enhancements
- Google Ads
- Social Media Ads
- Participating in events that promote your business

Most business owners do not know that Branded Promotional Products can also be considered advertising expenses, you can maximize your potential for business tax deductions by using a branded product when gifting items to customers and clients.

Car and truck expenses:

If you use your vehicle for business, there are two methods to maximize your Business Tax Deductions in this area. You can either take the Actual Expenses associated with operating your car or truck or take the Standard Mileage rate.

A few things to consider before looking at the benefits and drawbacks of each method. If you use the standard mileage rate to calculate your Car and Truck Expenses, you must choose it in the first year you use the vehicle for business purposes. This gives you the ability to then choose to use the standard mileage rate or switch to actual expenses in future years. However, if you choose to use actual expenses for the vehicle, you can't switch to the standard mileage rate in future years. Therefore, it is important to evaluate what method works best for you.

- **The Actual Expense Method:** You are basically deducting the costs of maintaining and operating that vehicle including oil changes, fuel, repairs, insurance cost, and registration fees. In addition, with this method, you also get to depreciate the vehicle based on the percentage of business use.
- **The Standard Mileage Rate Method:** You get to deduct a flat $ 0.58 per business mile, you are not allowed to deduct any expenses related to the vehicle including maintenance, insurance, and repairs. If you decide to take the Standard Mileage Rate you are also not allowed to take any depreciation on the vehicle. The key to using the Standard Mileage is to keep good records of your business mileage, in the past, this was done manually using a mileage log. However, we often suggest our clients use MileIQ which makes the capturing of Business Miles very simple and automated. MileIQ also allows you to capture Charitable and Medical Miles which can be deducted on the personal side.

A question we received often is: Which method is best for me? This is difficult to say without running a comparison between the Standard and Actual Method. If you are a new business, you might want to consult with your accountant to help you make that determination.

Commissions and fees:

You can deduct the dollar amounts of commissions you paid for the following:

- Finder's Fees
- Sales Commissions
- Referral Fees
- Other Commissions to third parties

It is critical for you to issue a 1099-Misc. if you paid an independent contractor or a freelancer more than $ 600. Why is it so important to issue a 1099-Misc? Because if you don't, the IRS can disqualify any amounts you entered in this category. Therefore, it is important to make sure you issue a 1099-Misc when needed in order to avoid losing important Business Tax Deductions. There are many online providers that can file a 1099-Misc. or, you can have your Accountant issue these on your behalf.

Contract labor:

Like Commissions and Fees, Contract Labor costs represent payments you made to persons or businesses that are not your employees for services performed in your business. For example, if you hire a virtual assistant to help you stay organized in the business. Usually, a virtual assistant is considered a contractor and any payments can be fully deducted as a business expense. For this category, the same criteria for issuing a 1099-Misc. applies, if you paid an independent contractor more than $ 600 you should issue a 1099-Misc. by January 31st of each year for the prior fiscal year.

You should also review our article on Understanding Employee vs. Contractor Designation and the dangers of misclassification.

Depletion:

This is one of those uncommon Small Business Tax Deductions you might not be aware of. Depletion usually applies to businesses in the mining, drilling, quarrying stone or timber industry. This deduction allows you to account for the reduction of the natural resource available to you in the business. There are many complexities associated with the type of business and depletion method you must use therefore; we highly suggest you work with an Accountant that is proficient in depletions in order to ensure you are maximizing your business tax deductions.

Depreciation and section 179 expense deduction:

Depreciation allows you each year to expense a portion of the costs associated with the purchase of business assets like:

- Furniture
- Buildings
- Equipment
- Signage
- Vehicle
- Machinery

Being able to depreciate a business asset as much as possible, allows you to reduce your Taxable Income. Therefore, it is important to really take advantage of any potential strategy available to maximize your depreciation. A few ideas could be:

- **The De Minimis Safe Harbor Election**, which allows you to immediately expense any assets of $ 2,500 or less. We love this election because with the Safe Harbor you don't have to record the cost of an asset that is less than $ 2,500 in the Balance Sheet, instead, you can record this as an expense directly in the Income Statement. For example, if you buy a $ 700 office desk, by making this election you can just list that purchase under office expenses rather than listing it as an Asset. This is one of those elections that must be done on a yearly basis, you can learn more about this election at the IRS Website.
- **Section 179** also allows you to write off the entire cost of the business asset in one single year without having to depreciate it over time. Section 179 does come with limits, currently, the total amount that you can write off is $1,000,000 in assets, if the assets purchased during the year don't exceed $2,500,000. Therefore, Section 179 has a very generous threshold that most small businesses can use to maximize their Business Deductions. You can learn more about this option on the Section 179
- **Bonus Depreciation** can also be used to immediately deduct the purchase of an asset. The Tax Cuts and Jobs Act increased the bonus depreciation percentage from 50 percent to 100 percent for those assets that have a depreciable life of 20 years or less. Also, assets for film, television and live theatrical productions, also became eligible for Bonus Depreciation.
- **Cost Segregation** can be a very powerful strategy. This is a more advanced Tax Planning strategy that requires careful consideration. Cost Segregation is basically the process of identifying components of an asset that might have a shorter life span which can be depreciated faster. For example, let's say you own an $ 800,000 office building. Since this is a commercial building you are only allowed to depreciate the $ 800,000 building cost of a period of 39 years. Therefore, you can only depreciate $ 20,513 a year ($800,000 / 39

years). With cost segregation, you can, however, identify that the electrical will estimate to last only 10 years before it will need to be replaced. Let's say the electrical is worth $ 50,000. You can now depreciate that component of the building faster over a period of 10 years rather than 39 years as part of the entire building. In this case, on a yearly basis you get to depreciate $ 5,000 for the electrical ($ 50,000 / 10 years) + $ 19,231 ($ 750,000 / 39 years) for the rest of the building. This gives you a new total depreciation of $ 24,231 compared to $ 20,513 if you just depreciated the entire building as a single unit. A few notes of caution, in order to use the Cost Segregation strategy, a full study needs to occur, a professional specialized in this area must be hired to complete this study. Therefore, there is a cost to implement this strategy. However, the tax savings could be huge compared to the fees paid to have this study completed.

The bottom line is that Small Businesses have options available to reduce taxable income using depreciation. Always consult with your Accountant to evaluate the best strategy.

Employee benefit programs:

You can deduct the dollar amount of benefits programs paid by the business on behalf of your employees for the following:

- Health Insurance Premiums
- Dependent Care Programs
- Group-term life insurance

Keep in mind that these are costs the business pays for employees, you cannot deduct contributions you made on your behalf as a self-employed. Not everything is lost however, Health Insurance Premiums paid by the business on your behalf, can be deducted in a different section of your Individual Tax Returns.

Insurance:

Make sure you are maximizing your Small Business Tax Deductions by capturing all expenses paid for insurance costs in order to run your business, this can include Workers Compensation, Errors & Omissions, Insurance of business-owned vehicles, and property insurance.

For the purpose of this section, we are going to ignore for now the Insurance costs on your Home Office, we will discuss this in the Home Office section. One common error that could result in having important insurance expenses disqualified during an IRS audit, is having insurance in your own personal name rather than the business. Make sure you are keeping everything consistent. If a business asset is titled in the name of the business, then make sure the policy reflects the business name.

Interest:

Interest paid on Revolving Credit Cards, loans, and other debt can be deducted as a business expense. Make sure the account is in the name of the business in order to avoid a potential disqualification by the IRS.

Legal and professional services:

The fees to your Accountant that helps you maintain your financial records in pristine condition are fully deductible, make sure you are using your business account in order to pay for these professional services so that you can deduct them. Other Professional services can include, hiring an attorney to obtain a patent on a product, or registering a trademark. Perhaps your attorney helped you setup your Articles of Organization for your business, all these expenses can prove to be a powerful deduction that can greatly reduce your tax liability.

Office expense:

Office supplies and postage can be often overlooked as powerful Business Tax deductions, make sure you are using a dedicated account to purchase these items. Also, make sure to keep either a paper or digital copy of your receipts. If you use cloud accounting software like Xero, you can easily capture images of your receipts and upload them to your accounting records. In the event of an audit, you can easily share these images with the IRS without having to keep paper receipts.

Pension and profit-sharing plans:

A powerful way to retain top talent within your organization is to keep your employees happy. One way to do this is to offer contributions by the business on behalf of your employee for retirement plans like SEP, SIMPLE and SARSEP plans. Not only will you reward your employees for their hard work, but you can also use these contributions in order to obtain a powerful Business Tax Deduction.

Keep in mind not to include contributions made by the business on your behalf, these are usually deducted in a separate section of your Personal Income Tax Returns.

Rent or lease:

If you are renting an office space or perhaps leasing a vehicle, you can use these expenses to obtain a business deduction directly reducing your taxable income. Don't forget to include rents and leases of machinery or equipment in this category. Make sure you are keeping clear business records by retaining the lease contacts in order to substantiate these expenses should you ever be audited.

Repairs and maintenance:

Business assets like machinery and office equipment, are often placed under enormous stress. Sometimes you need to maintain or repair these assets, and in the process, you can use these expenses as a business deduction.

One overlooked area, are repairs and maintenance to your own home office. Don't use personal funds to repaint your home office, this can be easily classified as a repair and maintenance that can be deducted as a business expense.

Supplies:

What constitutes a supply? Books you purchase to assist you in your day to day business, professional instruments or minor tools, these can all be used as business deductions. Make sure you use a business account to pay for these supplies and have accounted for these expenses in your accounting platform.

Taxes and licenses:

Most businesses must pay State or Local taxes on Personal Business Assets, licenses and regulatory fees including annual compliance reporting in order to keep their business entity in good standing. All these expenses can be deducted from your business income.

Regarding Annual Compliance, generally, Business Entities like LLCs, S Corporations, C Corporations, and Limited Partnership have specific State reporting requirements that must be met. For example, most states require that you file an annual report and pay a fee. Unfortunately, the State often will proactively cancel your business entity if you forget to file an Annual Report. Consider a Company Maintenance Program that can help you maintain your business entity in good standing.

Travel:

If you are away from home for business reasons, you get to deduct all expenses for lodging and transportation. You cannot deduct travel expenses for your spouse or dependent as a business expense except if they are employees of the business. Therefore, a common overlooked strategy is not to hire your spouse or child as an employee of your business.

Another important thing to remember is that you cannot deduct expenses for attending conventions, seminars or meetings outside the North America area unless the meeting is directly connected to your business. There are several strategies and pitfalls that need to be considered with travel, therefore, carefully consult with your Trusted Advisor to make sure this category of small business tax deductions is fully optimized.

Meals:

This is an area of the tax code that was significantly impacted by the implementation of the Tax Cuts and Jobs Act of 2018. In the past, the category of Meals and Entertainments was all lumped together however, the new tax law removed as a deductible expense anything related to Entertainment.

Things like night clubs and country club dues were all removed. There is however a loophole in the tax code that allows you to reimburse country club dues for an employee if, you can show that these dues have helped generate new business and increased revenue.

On the meals side, you are only allowed to deduct fifty percent of meals and beverage costs however, in the event of an audit, you must show the IRS that these expenses were:

- Ordinary and necessary for the business
- that you discussed business during your lunch or dinner and
- the expenses were not lavish or extravagant

It is always a good idea to write Who You Met and Why you Met them right on the receipt or bill before scanning it into your accounting software. This will help solidify the case that these expenses were truly related to your business activity.

Utilities:

You can easily deduct all utility expenses associated with your business including phone and internet service. But what happens when the bill is not in the name of the business? This happens quite often when a business owner is using a personal cell phone to conduct business, or perhaps is using a home office and the Internet Service is in their personal name. In that case, you can use a percentage of the total amount of the utility bill.

If you use your personal cell phone for business, review your business calls over a period of three months and compare them with the total personal calls you have made during that time period. Document your findings and then use that average for the entire year.

Wages Paid:

Any wages paid to employees for their services in your business should be compiled as a business deduction. While there is nothing earth shattering about this statement, many times we see business owners using incorrect totals for this category. Often business owners deduct the Net Payroll paid to employees, which is not accurate, you should be deducting Gross Wages Paid. Employer Payroll Taxes should be aggregated in the Taxes section discussed earlier.

Make sure you are balancing and reconciling each payroll run with the funds that are debited from your account. If you have unpaid wages, perhaps an employee does not cash a check, you are often required to turn over that amount to the State. Payroll compliance and reporting must be handled carefully, errors in this category can result in massive penalties that can cripple your business. Therefore, consider outsourcing your payroll process to companies like Gusto which provide outstanding payroll services, HR and Benefits services for Small Businesses across the United States. Gusto offers unlimited payrolls with a simple and transparent pricing model; we highly recommend them for all of your payroll needs.

Home Office Business Deductions:

In the past, business owners have always been reluctant to take advantage of the Home Office Deduction. The rumor was that if you deducted your Home Office you were at a higher risk to be audited. However, according to a recent study conducted by the US Census more than five percent of Americans are now working from home. Therefore, if documented correctly, the Home Office can be a powerful Small Business Tax Deduction you should consider.

Just like the Vehicle expenses, there are two methods to deduct your Home Office:

- **The Simplified Method**, where you can deduct $ 5 per square foot for your home used exclusively for business purposes, you can deduct a maximum of 300 square feet or a total of $ 1,500
- **The Standard Method** instead, is used to deduct a portion of the utilities, rent, property taxes, landscaping services and repairs based on the percentage of your home used for business

While on the surface the Standard Method appears to be a better scenario, there are some important pitfalls to consider including depreciation recapture that can result in future taxes. Therefore, it is important to discuss these options with your Accountant.

In order to audit-proof your home office deduction you need to make sure you pass two important tests:

1. Exclusive use of a space, in order to pass this test, you need to make sure that a portion of your home is truly set up as an office. Working from your couch in the dining room is not going to be acceptable in the event of an audit. Make sure a room of your home is set up as an office, avoid having a bed in your home office that could give the IRS leverage to disqualify your Home Office Deduction. Make sure you take pictures of your home office and retain it with your business documents in the event of an audit.
2. Principal place of business, meaning that you spend a significant amount of time in your home office conducting business. You can still qualify for the Home Office Deduction even if you do have an actual office you work from. Lawyers, for example, will often work a vast majority of their time from their home office rather than the office used to meet with clients.

If you can meet these two basic tests, you should be able to easily qualify for this powerful Small Business Tax Deduction.

Final Thoughts:

The tax code can be complex and even the most basic deduction can have special rules and nuances that need to be evaluated for your individual tax situation. Therefore, always work with a trusted Accountant that can guide you through the intricacies of our Tax Code and make sure you are taking advantage of all of your Small Business Tax Deductions.