

Business Expenses

This memorandum is intended to provide a general, informal overview of some common expenses that may arise in the ordinary course of operating a business. It is not intended to be exhaustive, and other expenses not discussed here may also be deductible depending on the specific facts and circumstances of your business. Because business expense rules can be nuanced and subject to change, this memo should not be relied upon as authoritative guidance. Clients are encouraged to review IRS Publication 334, Tax Guide for Small Business, for a more comprehensive and authoritative discussion of business expense administration and deductibility.

“What am I allowed to deduct”? This is the most common question I am asked as an accountant, in short to be deductible, a business expense must be both ordinary and necessary. An ordinary expense is one that is common and accepted in your trade or business. A necessary expense is one that is helpful and appropriate for your trade or business.

A common example I give to my clients in the maritime industry is that of a dive watch. A dive watch is an ordinary and necessary tool of a captain that scuba dives with charter guests. When purchasing the watch, a Captain has the option to buy a \$40 Casio or a \$400 Seiko, both watches are necessary however the Casio might be considered ordinary. The same may also be said for hotel stays as well. If you are traveling away from home on business and have the option to stay at a Four Season’s resort or a Hampton Inn the IRS may disallow the travel to the resort as unnecessary especially if a lower cost option was available.

Keep in mind that just because you believe an expenditure is tax deductible does not mean that the IRS will agree. IRS court cases are full of examples in which the tax court has one interpretation of what is “ordinary and necessary” and the taxpayer has a different view as to what is “ordinary and necessary”. When in doubt I encourage taxpayers to reach out to their accountant to discuss.

Below is a list and description of the most common business expenses you may incur.

Automobile

If a vehicle is used exclusively for business purposes, then generally you may deduct the entire cost of operating the vehicle. However, the standards of “exclusive use” are hard to meet. It’s more likely that your vehicle is used for both personal and business and you will, therefore, need to determine what vehicle expenses are business related.

Generally, travel between two business destinations is considered a deductible operation of the vehicle. This can mean travel from your home office to the post office to deliver mail or the supply store to purchase office supplies. This also may include travel from one client’s location to another client’s location and back to your place of business.

Please note that “commuting miles” are not deductible. Commuting miles are travel from your home to your regular place of business on a daily basis. For example if you live in West Palm Beach and drive every day to your office in Fort Lauderdale those miles are not deductible however once you are at your Fort Lauderdale office the business related travel you incur may be deductible.

Generally, travel deductions using a vehicle are calculated by mileage. It is the taxpayer’s responsibility to keep a mileage log recording the business related use of the vehicle and a record of the business purpose of the trip. Mileage logs are now simpler to maintain using apps on mobile devices. Please note that even if the vehicle is being depreciated it is still the taxpayers responsibility to maintain a mileage log.

Please review the following scenarios to determine which best describes your situation:

Scenario 1—the business vehicle is owned/titled to the business:

In this scenario you will pay for all vehicle related expenses out of the business bank account or using the business credit/debit card, these expenses include fuel, repairs, maintenance, insurance, auto loan payment. With regards to the loan payment, many clients are surprised to hear that we are not deducting the loan payment on their tax return. Please keep in mind that paying back a loan is not deductible just as receiving the loan funds to purchase the vehicle is not included as income. In order to deduct the cost of the vehicle the IRS allows the taxpayer to depreciate the vehicle over a certain period of time.

Scenario 2—the vehicle is owned personally and used for business activities.

When the vehicle is titled to the taxpayer personally the taxpayer must keep a mileage log to record business usage of the vehicle. The taxpayer will then submit an expense reimbursement to the company using the standard IRS reimbursement rate. If the taxpayer travels 1,000 miles in the month of June and the IRS reimbursement rate is 56 cents per mile the business will cut a check to the tax payer personally for \$560.

For a vehicle expense worksheet, please visit our website at avmaraccounting.com and go to the “tax organizer” tab. For more questions regarding vehicle deductions, please contact me directly.

Bank Fees

Bank Fees are relatively simple to record, most fees are directly debited from your business bank account making it easy for us the accountant to spot and deduct when preparing your year end tax return.

Communications

Cell Phone and internet bills are often categorized as “communications”. You will want to pay these costs out of your corporate bank account so long as the account is in your business name. When the cell phone account is in your personal name you will want to have your company reimburse you for the portion of usage that is business related.

Please see the section below for more information on an “accountable plan” for reimbursements procedures. If any portion of your communications costs are personal in nature please notify us at the end of the year and we will allocate the personal portion accordingly.

Dues and Subscriptions

Expenses incurred for dues and subscriptions commonly include the costs for trade associations, the fee to keep your company active with the State, subscriptions for publications directly related to the production of income. As with all business related expenses, pay for these expenses out of your business bank account or with your business debit/credit card.

Education

To be deductible, your expenses must be for education that (1) maintains or improves your job skills, or (2) is required by your employer or by law to keep your salary, status or job. However, even if the education meets either of these tests, the education cannot be part of a program that will qualify you for a new trade or business, or needed to meet the minimal educational requirements of your trade or business.

Although the education must relate to your present work, educational expenses incurred during temporary absence from your job may be deductible. However, after your temporary absence, you must return to the same kind of work. Usually, absence from work for one year or less is considered temporary.

Expenses that can be deducted include:

- Tuition, books, supplies, lab fees, and similar items
- Certain transportation and travel costs, and
- Other educational expenses, such as the cost of research and typing

Since many of our clients are in the maritime/yachting industry I often see a deduction for MPT (Maritime Professional Training). The cost of taking courses at MPT may be considered a business related expense if you are already in the yachting related field but if you are new to the industry and are taking these courses to enter the yachting industry the costs will probably not be deductible.

As with all business related expenses, pay for your qualified education expenses out of your business bank account or with your business debit/credit card.

Equipment and Tools

Tools and equipment you purchase necessary to conduct trade or business are deductible in most cases. As with all business related expenses, pay for your qualified equipment and tool expenses out of your business bank account or with your business debit/credit card.

Health Insurance

Health insurance may be deductible depending on your entity type and how the policy is established and reported (especially for S-Corp shareholders). Additionally, you generally cannot claim the self-employed health insurance deduction for any month you were eligible to participate in an employer-subsidized plan through your employer or your spouse's employer

Liability Insurance

Business liability insurance is considered a business expense, as with all business related expenses, pay for your qualified insurance expense out of your business bank account.

Meals and Entertainment

ENTERTAINMENT 2018- Please note that as of January 1st 2018 most business entertainment is no longer deductible. This includes but is not limited to sporting events, concerts, country club dues and any other deduction that may be considered "entertainment".

Please note when I refer to meals in this section I am referring to meals as a form of entertainment, travel meals will be discussed in the section under "travel".

Office Expense and Supplies

Supplies and office expenses typically include paper for your printer, staples, toner, etc. Since most of these expenses are purchased at places like Office Depot it is important that you keep the receipts for these purchases. An IRS auditor may see a charge to your credit card from "Office Depot" however they will not know what you purchased, as with all business related expenses, pay for your qualified insurance expense out of your business bank account.

Officer Compensation – Salary to Shareholder

It is important to remember that you are an employee of your Corporation/LLC, as a result the IRS requires that the corporation pay its owner/employee a “reasonable salary”. “Reasonable Salary” is a subjective term, typically what the IRS is looking for is to make sure the “wage/salary” your corporation pays to you as an employee is comparable to other “wages/salaries” in the same profession. A common example that the IRS illustrates is that of a doctor or attorney that does business as an S Corporation. In this example the S Corporation has a net income of \$500,000 after deducting all expenses, the doctor or attorney then pays themselves a wage/ salary of \$10,000 for the year. What that doctor or attorney is doing is they are paying full federal income tax on both the salary and the net income of the company HOWEVER they are only paying Social Security and Medicare on the \$10,000 salary. If that doctor or lawyer were to be audited by the Internal Revenue Service the IRS would probably analyze what the average doctor or lawyer earns working as an employee... maybe they determine that the average doctor earns about \$90,000 per year, in this example they IRS would reassess social security and Medicare tax on the salary that they feel is “reasonable”.

Reasonable compensation is a very important topic, if you ever have any questions regarding compensation to shareholder please contact me to discuss.

Travel

With any travel expenses that you plan to write-off, you will need to be able to prove that the travel was directly related to your business, such as a product convention meeting with a client, or in the case of many of our clients travel related to the yacht they work on.

Flight costs typically aren't a problem, even if you always fly first class. It's the limo from the airport to the hotel that would be cause for concern. Travel meals are sometimes deductible at a rate of 50% of the bill. If you are taking client to dinner, you will need to be able to show that you discussed business at the meal.

This is where a journal or electronic log really comes in handy. When traveling on business, be sure to document your daily events, like which clients you spoke to, where and when you met and what you discussed. Should your business ever be audited, the IRS will require you to produce such a journal.

Family vacations are not a tax deduction, unless your family members are part of your business. You have to justify that by holding business meetings by all parties attending a

business convention while on the trip. If you go to the Bahamas and lay on the beach all five days, chances are you really shouldn't try to write that off.

As with all business related expenses, pay for your qualified travel costs out of your business bank account or use your business debit/credit card. Meals are only 50% deductible, this is an allocation we make at the end of the year when we prepare your tax return. Generally travel meals are incurred when you are more than 24 hours away from your home and a meal is not being provided to you.

International travel does have it's own rules and we encourage clients to contact our office to review how best to take advantage of traveling outside the United States.

Uniforms

You may deduct the cost and upkeep of work clothes if the following two requirements are met.

- You must wear them as a condition of your employment.
- The clothes are not suitable for everyday wear.



It is not enough that you wear distinctive clothing. The clothing must be specifically required by your employer. Nor is it enough that you do not, in fact, wear your work clothes away from work. The clothing must not be suitable for taking the place of your regular clothing.

Examples of workers who may be able to deduct the cost and upkeep of work clothes are: delivery workers, firefighters, health care workers, law enforcement officers, letter carriers, professional athletes, and transportation workers (air, rail, bus, etc.).

Musicians and entertainers can deduct the cost of theatrical clothing and accessories that are not suitable for everyday wear.

However, work clothing consisting of white cap, white shirt or white jacket, white bib overalls, and standard work shoes, which a painter is required by his union to wear on the job, is not distinctive in character or in the nature of a uniform. Similarly, the costs of buying and maintaining blue work clothes worn by a welder at the request of a foreman are not deductible.

Protective clothing. You can deduct the cost of protective clothing required in your work, such as safety shoes or boots, safety glasses, hard hats, and work gloves.

Examples of workers who may be required to wear safety items are: carpenters, cement workers, chemical workers, electricians, fishing boat crew members, machinists, oil field workers, pipe fitters, steamfitters, and truck drivers.

As with all business related expenses, pay for your qualified uniform costs out of your business bank account or use your business debit/credit card.

Misc./Other

The expenses mentioned above are some of the more common expenses that you will incur, there will always be misc/other expenses that don't always fit into a specific category. In those cases, we encourage clients to contact our office to discuss. In any

FLORIDA SALES TAX

During the course of business taxpayers may engage in services that are subject to the collection of sales tax. While labor for your service is typically not subject to sales tax, once you add a tangible product to your labor the entire invoice including the labor may become liable to collect and remit sales tax. To illustrate this point please see the example below:

Example:

If you hire a plumber to fix a leaky faucet and the extent of their service is to tighten the faucet with a wrench the plumbers labor for fixing the faucet would generally not be subject to sales tax.

If during that same house call the plumber determines that the faucet is in need of a "washer" or some other tangible item the plumber must charge you sales tax on the entire invoice including the cost of the labor.

Many of our clients in the maritime industry will provide "yacht management" services to boat owners. In many cases the engagement starts out as a labor project in which the captain is only charging the client for his or her labor not subject to sales tax. As time goes on these projects sometimes evolve into providing minor repairs or picking up supplies for the vessel in which the captain will simply invoice the owner for the labor and supplies. If you engage in such a transaction, it is possible you have exposure for collecting sales tax on the entire invoice and remitting that sales tax to the State of Florida. Even if you already paid sales tax on this product when you purchased it from the vendor the sales tax may be due again after it is added to your labor on the same invoice.

We sometimes recommend that clients avoid purchasing supplies on behalf of the vessel owner and instead have the owner purchase the product or provisions themselves. While

these arrangements are sometimes unavoidable it is important that the taxpayer understand the tax ramifications of these types of transactions.

Another point of exposure is when a client purchases product from out of state and does not pay sales tax on this transaction. Just because the vendor does not charge sales tax does not mean the client is not responsible for self-assessing the sales tax and remitting the tax.

For a more detailed analysis of Florida Sales Tax please visit the Department of Revenue website at floridarevenue.com. Please note these examples only contemplate services provided in the State of Florida. Also, please note our office does not file Florida Sales Tax reports unless specifically engaged by the client.

ACCOUNTABLE PLAN

An “Accountable Plan”, under IRC Section 1.62-2 (C)(2) allows a business to reimburse an employee for expenses incurred and connected with the performance of duties for the business provided proper substantiation is followed.

For those doing business through their LLC or S Corporation the temptation to take short cuts and pay business expenses through a personal credit card or bank account is all too convenient. As we enter a new era of IRS enforcement it is a good time to remind taxpayers to not comingle your personal identity with that of your S Corporation or LLC. Paying your personal credit card out of your business account or routinely using a personal credit card to pay for business related expenses may be considered inappropriate by an IRS auditor.

Another common scenario is having a cell phone plan under your personal name and then paying the invoice out of your business bank account. Also paying car insurance that is under your personal name out of the business bank account and claiming the automobile deduction. While monthly cell phone invoices and car insurance premiums are legitimate business expenses they should be processed in a manner that will be respected by an IRS auditor.

Automobile expense may create one of the largest deductions that a small business might incur. Regardless of whether your automobile is titled to your company you will want to keep track of your business mileage. Keeping track of business miles incurred will help substantiate the portion of your vehicle that is used for business. If your vehicle is not titled to your business you may reimburse yourself for the business use of your personal automobile. If the standard mileage rate is 62 cents per mile and you average 1,000 business miles per month you will submit an expense reimbursement request to your company for \$620 at the end of the month. Your company will then reimburse you personally for the personal use of your vehicle. The business will record the expense and the reimbursement will not count as income to yourself.

Automobile insurance is another expense in which the policy is in your personal name and a portion of which is used for business. Your mileage log will help substantiate the business use of your personal automobile. If you are using your vehicle for 50% business your company would reimburse you for 50% of our auto insurance.

Under an “accountable plan” you the employee will prepare an expense reimbursement worksheet. This worksheet will list all of the expenses you paid for using your personal bank and credit card. The receipts should be attached to this worksheet and submitted to the business. The business will then reimburse the employee for those out-of-pocket expenses. The process of having your corporation reimburse yourself can be made easier if you are using a payroll tax software. For clients using GUSTO there is an option to include a nontaxable reimbursement to your normal payroll or you may run an off cycle payroll specifically for an employee reimbursement.

For more information regarding automobile expenses please review IRS Publication 463 at irs.gov.

In order to adopt an “accountable reimbursement plan” you will want to memorialize your intention in your corporate minutes. After that is done you will submit to your company an employee reimbursement form on a regular basis and then your company will reimburse you for expenditures you paid for personally. These reimbursements will then be deducted on the business and not included as income on your personal tax return.

An accountable plan must satisfy the following three conditions:

- the expenses covered under the plan must have a business connection;
- the plan must require employees to substantiate the covered expenses; and
- the plan must require employees who receive advances to return any amounts in excess of their substantiated expenses (Reg. §1.62-2(c)(2)).

If you would like a sample “employee reimbursement form” or an accountable plan adoption memo please contact our office.

For more information regarding an employee reimbursements under an “accountable plan” please see IRS Publications 15, 463 and 529 at irs.gov

The tax advice in this writing is not intended, and cannot be used by you, to avoid any penalties the service may impose as a result of taking any position in this writing we conclude is more likely than not to be resolved in your favor. For a more detailed analysis of business income and expenses we encourage clients to visit the IRS website at irs.gov.