



Deducting Business Expenses

Business expenses are the cost of carrying on a trade or business. These expenses are usually deductible if the business operates to make a profit.

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Note: If you do not carry on the activity to make a profit, you must report all of the gross income (without deductions) from the activity on Form 1040, line 21. Special limits apply to what expenses for a not-for-profit activity are deductible; for detailed information, refer to [Publication 535, Business Expenses](#).

What Can I Deduct?

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. 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.

Cost of Goods Sold

If your business manufactures products or purchases them for resale, you generally must value inventory at the beginning and end of each tax year to determine your cost of goods sold unless you are a small business taxpayer (defined below). Some of your expenses may be included in figuring the cost of

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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 unless you are a small business taxpayer (defined below). Indirect costs include rent, interest, taxes, storage, purchasing, processing, repackaging, handling, and administrative costs.

Small business taxpayer. Effective for tax years beginning after 12/31/2017, a small business taxpayer is a taxpayer that (a) has average annual gross receipts of \$25 million or less for the 3 prior tax years and (b) is not a tax shelter (as defined in section 448(d)(3)). See section 471(c) and section 263A(i).

If you are small business taxpayer, you can adopt or change your accounting method to account for inventories (i) in the same manner as materials and supplies that are non-incidental, or (ii) conform to your treatment of inventories in an applicable financial statement (as defined in section 451(b)(3)), or if the taxpayer does not have an applicable financial statement, the method of accounting used in the taxpayer's books and records prepared in accordance with the taxpayer's accounting procedures. See section 471(c)(1).

For additional information, refer to the chapter on Cost of Goods Sold, [Publication 334, Tax Guide for Small Businesses](#) and the chapter on Inventories, [Publication 538, Accounting Periods and Methods](#).

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 costs (See the note below)
- Business assets
- Improvements

Note: You can elect to deduct or amortize certain business start-up costs. Refer to chapters 7 and 8 of [Publication 535, Business Expenses](#).

Personal versus Business Expenses

Generally, you cannot deduct personal, living, or family expenses. However, if you have an expense 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. Refer to chapter 4 of [Publication 535, Business Expenses](#), for information on deducting interest and the allocation rules.

Business Use of Your Home

If you use part of your home for business, you may be able to deduct expenses for the business use of your home. These expenses may include mortgage interest, insurance, utilities, repairs, and depreciation. Refer to [Home Office Deduction](#) and [Publication 587, Business Use of Your Home](#), for more information.

Business Use of Your Car

If you use your car in your business, you can deduct car expenses. If you use your car for both business and personal purposes, you must divide your expenses based on actual mileage. Refer to [Publication 463, Travel, Entertainment, Gift, and Car Expenses](#). For a list of current and prior year mileage rates see the [Standard Mileage Rates](#).

Other Types of Business 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 is any amount you pay for the use of property you do not own. In general, 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.
- **Interest** - Business interest expense is an amount charged for the use of money you borrowed for business activities.
- **Taxes** - You can deduct various federal, state, local, and foreign taxes directly attributable to your trade or business as business expenses.

- **Insurance** - Generally, you can deduct the ordinary and necessary cost of insurance as a business expense, if it is for your trade, business, or profession.

This list is not all inclusive of the types of business expenses that you can deduct. For additional information, refer to [Publication 535, Business Expenses](#).

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