

Business
Expense
Deductions
for US Tax: An
Overview



What are Business Expenses?

Business expenses are costs that are incurred to carry out the day-to-day activities of a business.

A business expense must be **'ordinary and necessary'** in order to be deductible.

Ordinary Expense

is anything that is "common and accepted" to a specific trade or business.

Necessary expense

is anything that is "helpful and appropriate," but not indispensable.

For Example

Employee
Compensation

Rent

401K
Retirement
Plan

Taxes

Interest

Insurance

What are Deductible and Non-deductible expenses?

Deductible expenses

These are the expenses which a business can subtract from its income before computing the taxable income.

A deductible expense reduces the tax liability. The expense may be fully deductible or partially deductible.

For example:

- Advertising
- Contract labor
- Equipment Rentals
- Insurance
- Taxes

Non-deductible expenses

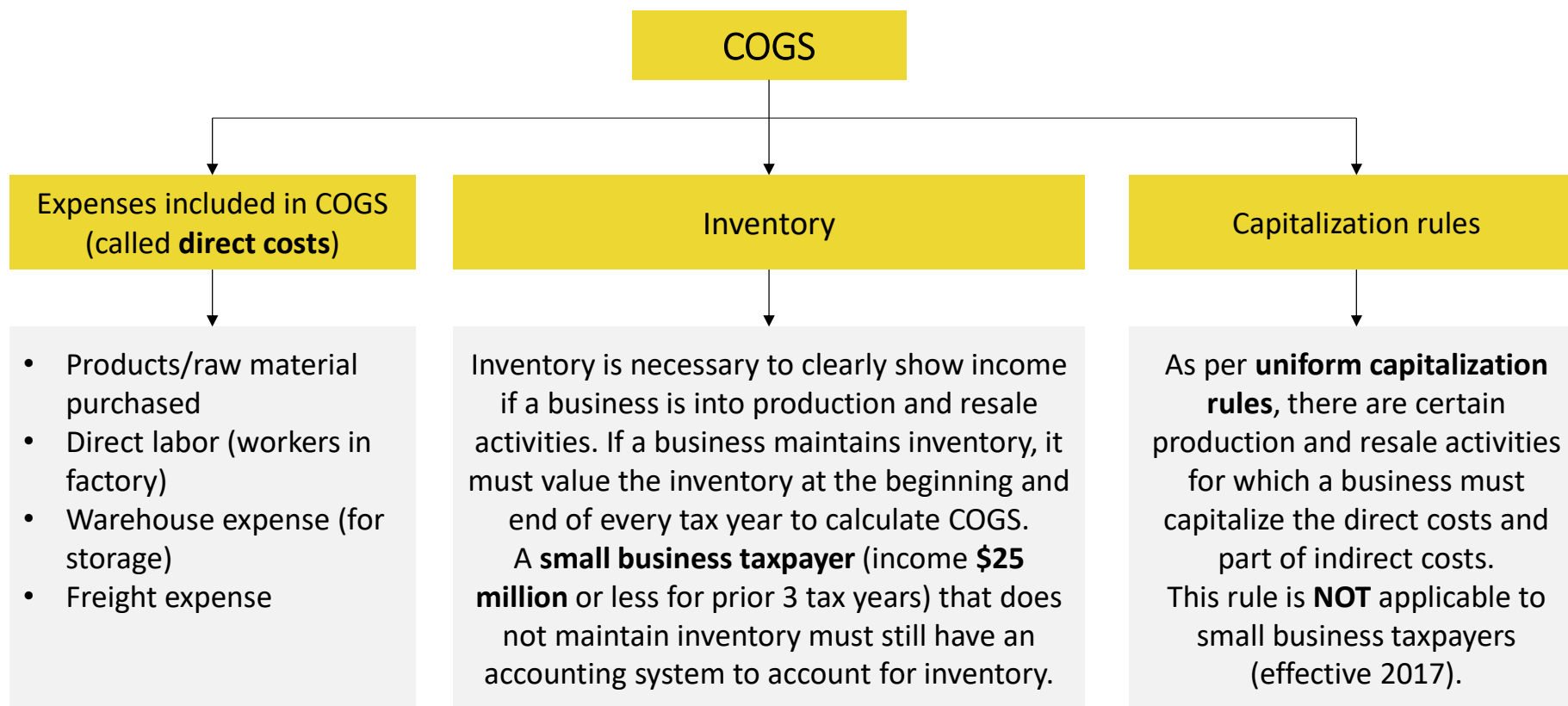
These are those expenses that **CANNOT** be subtracted from a business's income while computing the taxable income.

For example:

- Penalties
- Lobbying expense
- Political contributions
- Bribes
- Demolition expense/loss

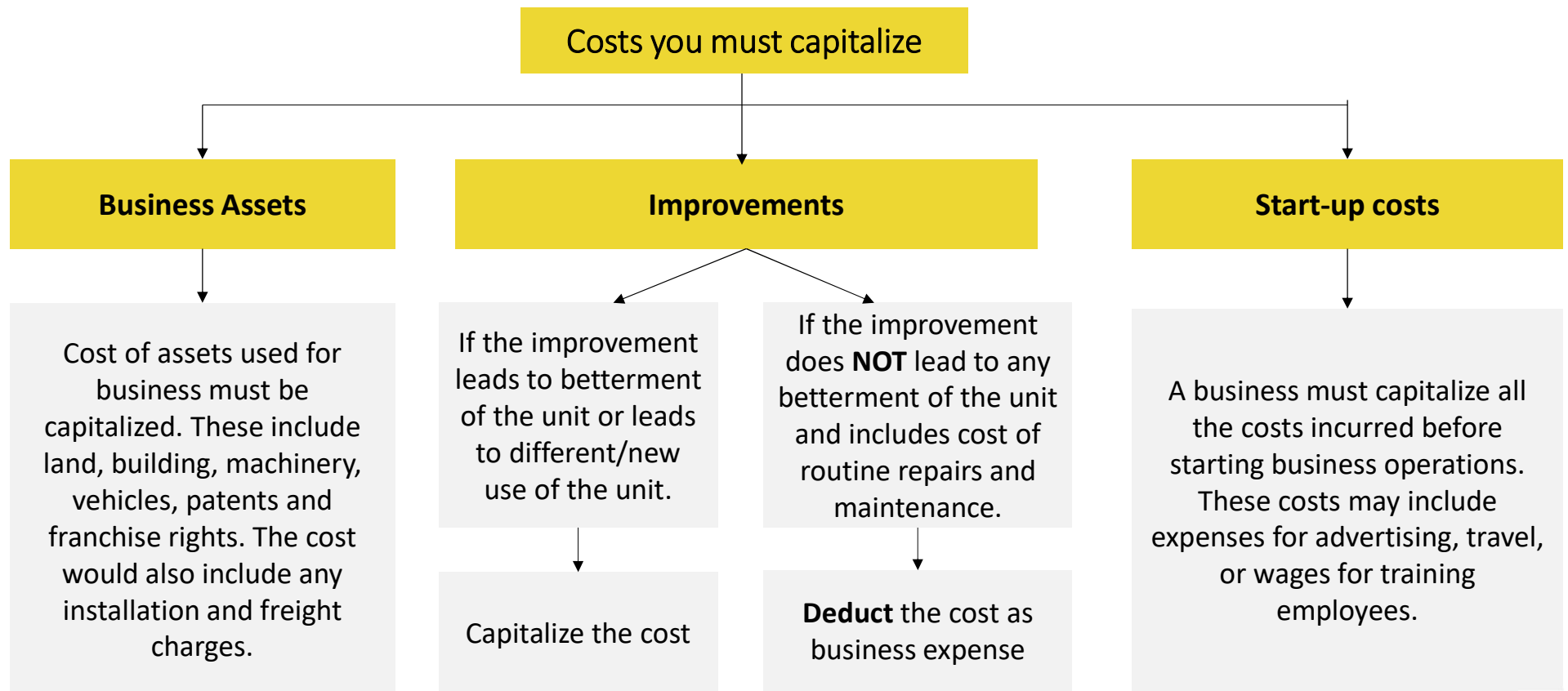
Cost of Goods Sold

If a business manufactures products or purchases products for resale, it can deduct the cost of goods sold (COGS) from the business income.

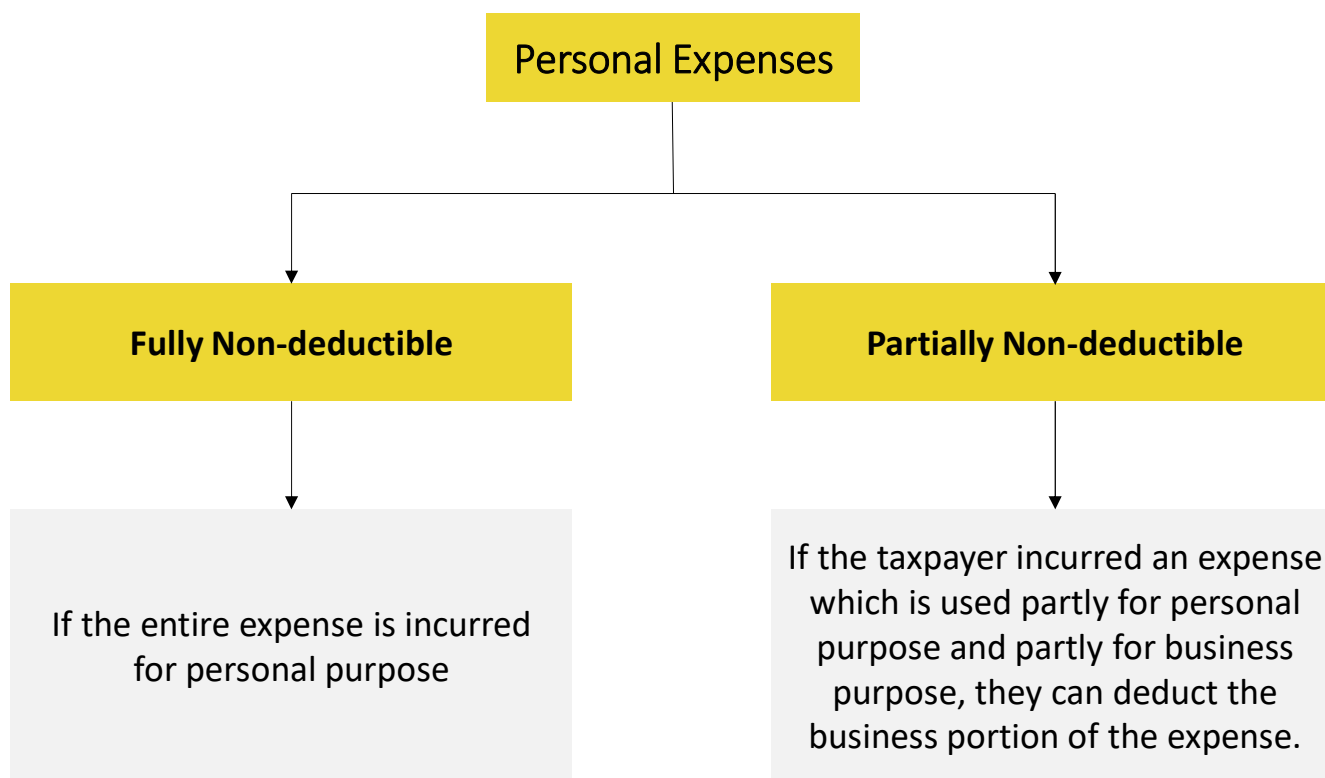


Capital Expenses

There are certain costs that a business must capitalize instead of deducting.

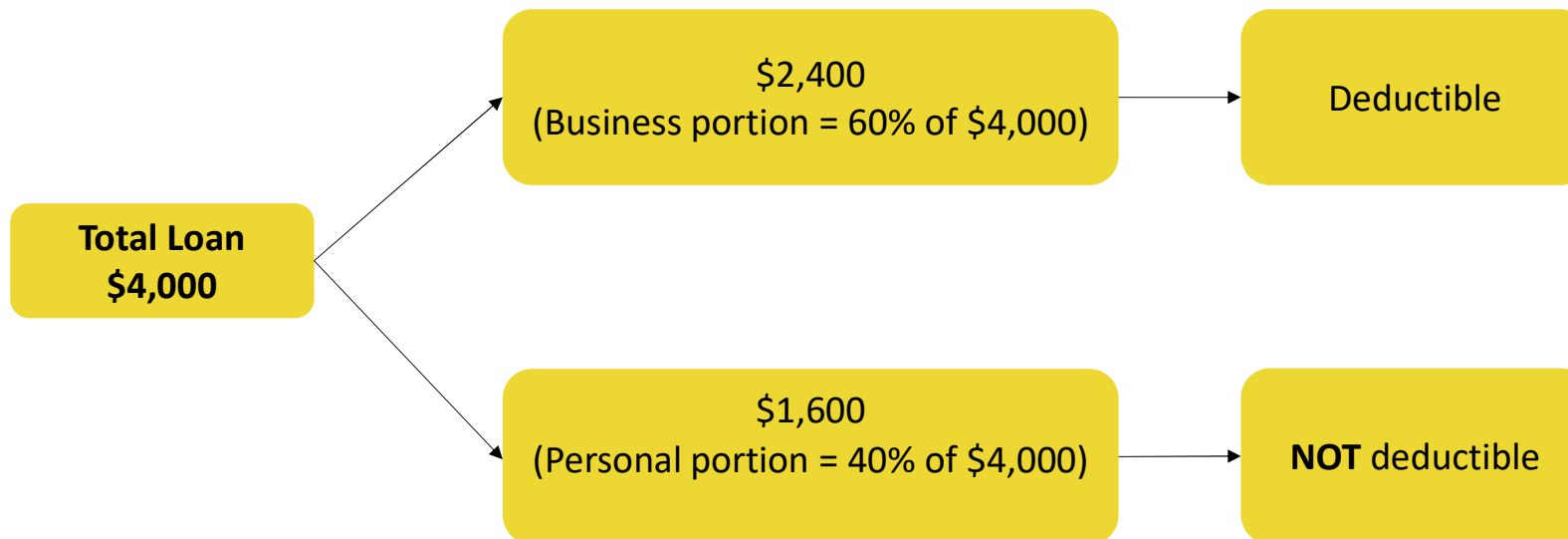


Personal Expenses - Fully and partially non-deductible

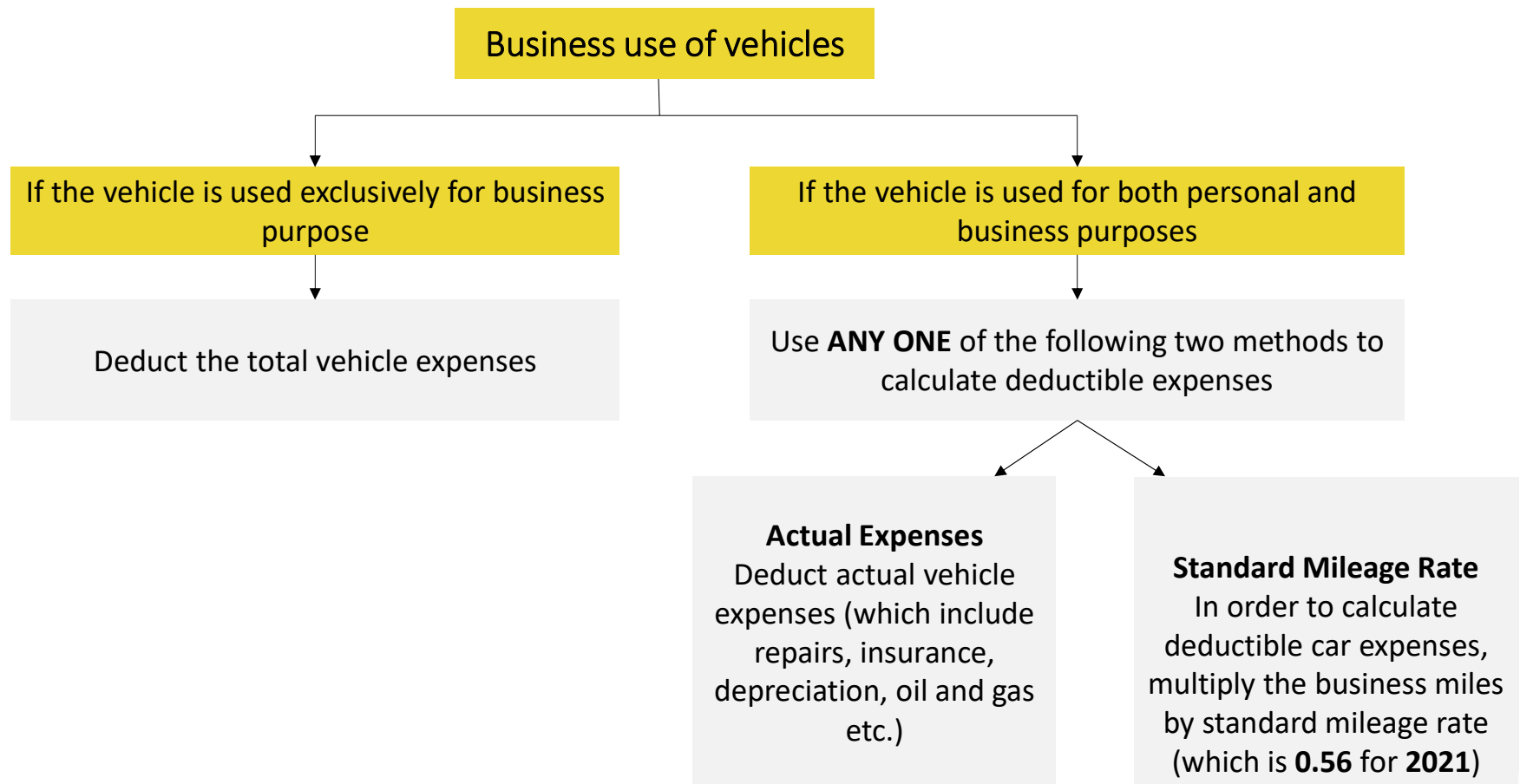


Personal v/s Business expense example

For example, a taxpayer took a short-term loan of \$4,000. They utilized 60% of the loan for purchasing raw materials for the business and 40% for personal use.



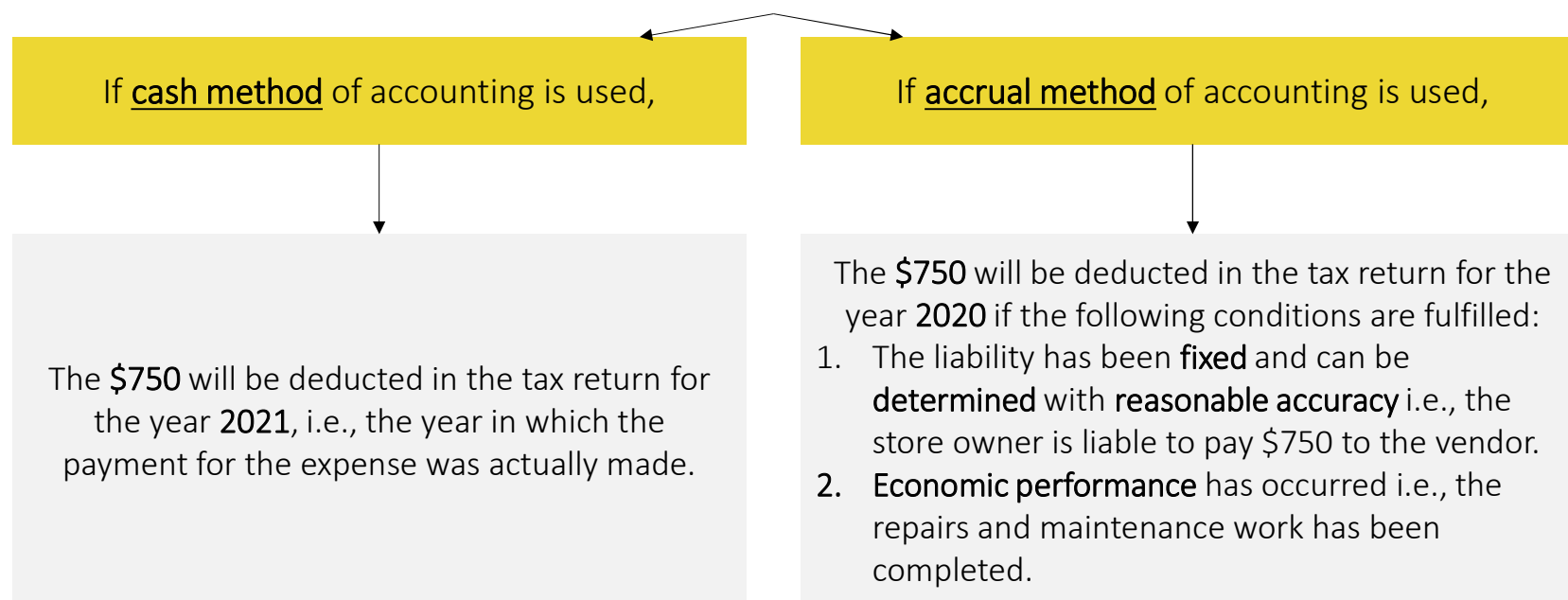
Personal v/s Business expense - Business use of vehicle

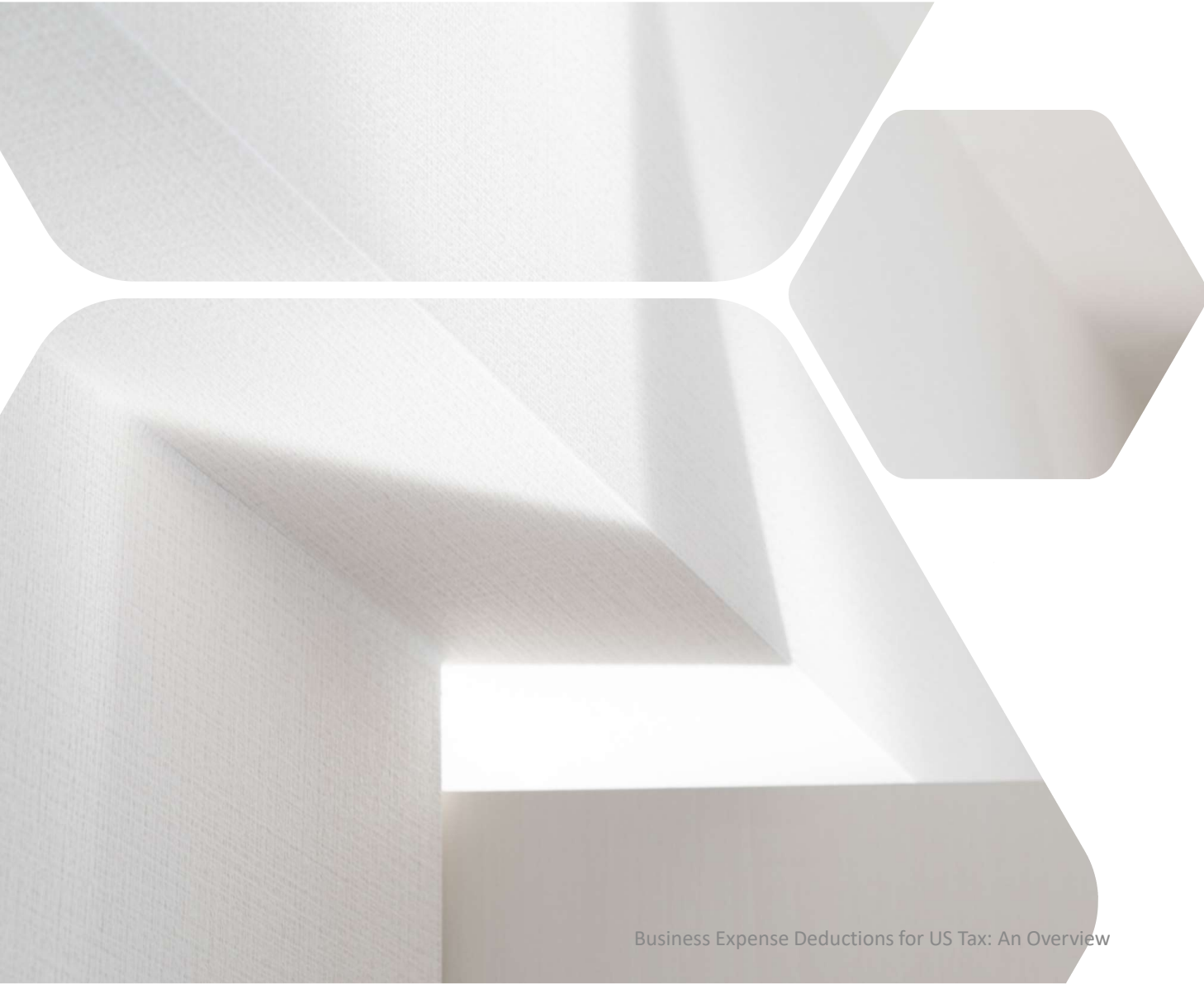


When can you deduct an expense?

The accounting method used by a business determines when an expense is deductible.

Let's say a grocery store owner gets some repairs and maintenance work done for their store in December 2020. The vendor sends a bill of \$750. The store owner pays the bill by check on January 20, 2021. The tax treatment of the expense will be as follows:





Thank You.

