

Chapter 8

Deductions: Employee and Self-Employed-Related Expenses

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Employee vs. Self-Employed

(slide 1 of 2)

- Business expenses for self-employed persons are deductible FOR AGI
- Business expenses for employees are generally deductible FROM AGI subject to 2% of AGI floor

Employee vs. Self-Employed

(slide 2 of 2)

- Person is classified as an employee if:
 - Another controls details of how work is performed
 - Can be discharged without creating legal liability to another
 - Another furnishes tools or the place of work
 - Income based on time spent rather than task performed

Employee Expenses

- Fall into one of the following categories:
 - Transportation
 - Travel
 - Moving
 - Education
 - Entertainment
 - Other

Transportation Expenses

(slide 1 of 2)

- Transportation expense defined
 - Very limited, only from job site to job site and commuting to temporary work place
 - Commuting from home to work and back is nondeductible
 - Exceptions:
 - Additional costs incurred to transport heavy tools
 - Employees with more than one job

Transportation Expenses

(slide 2 of 2)

- Amount deductible
 - Actual expenses
 - Must keep adequate records of all expenses and depreciation is limited, or
 - Automatic mileage method
 - 36 cents per mile for business miles for 2003
 - Adjustment to basis of auto is required for depreciation considered allowed
 - Plus parking, tolls, etc.
 - Adequate documentation of mileage required

Travel Expenses (slide 1 of 2)

- Travel expense defined
 - Expenses while “away from tax home” on business
 - Includes transportation, lodging, 50% meals, and miscellaneous expenses

Travel Expenses (slide 2 of 2)

- “Away from home” requirement
 - Need not be a 24-hour period but must be longer than ordinary work day and taxpayer will need to rest during release time
 - Being “away” should be a temporary situation (not in excess of 1 year)
 - “Tax Home” generally means business location, post, or station of the taxpayer

Restrictions on Travel Expenses

(slide 1 of 2)

- Convention travel expenses
 - No deduction for travel unless directly related to taxpayer's trade or business
 - Example: Doctor attending out-of-town seminar on estate planning would not have deductible travel expenses

Restrictions on Travel Expenses

(slide 2 of 2)

- Education travel expenses
 - Travel as a form of education is not deductible
 - Example: Spanish language professor traveling to Spain to work on the language would not have deductible travel expenses
 - Example: Spanish history professor traveling to Spain to study historical documents available only in Spanish museums would have deductible travel expenses

Combined Business/Pleasure Travel

(slide 1 of 4)

- Only actual expenses for business are deductible
 - Meals, lodging and other expenses must be allocated between business and personal days
- Deductibility of transportation costs depends on whether the trip is domestic or foreign

Combined Business/Pleasure Travel

(slide 2 of 4)

- For domestic travel
 - If primary purpose of trip is business, transportation is deductible in full
 - If primary purpose is pleasure, no deduction for transportation allowed, but other expenses (e.g., lodging) associated with business days are deductible

Combined Business/Pleasure Travel

(slide 3 of 4)

- For foreign travel
 - Transportation expenses must be allocated between business and personal unless:
 - Trip is 7 days or less,
 - Less than 25% of time was for personal purposes, or
 - Taxpayer had no substantial control over arrangements for the trip

Combined Business/Pleasure Travel

(slide 4 of 4)

- Travel days are considered business days
- Weekends, legal holidays and intervening days are business days if both the preceding and succeeding days are business days
- If trip is primarily for pleasure, no transportation expenses are deductible

Moving Expenses

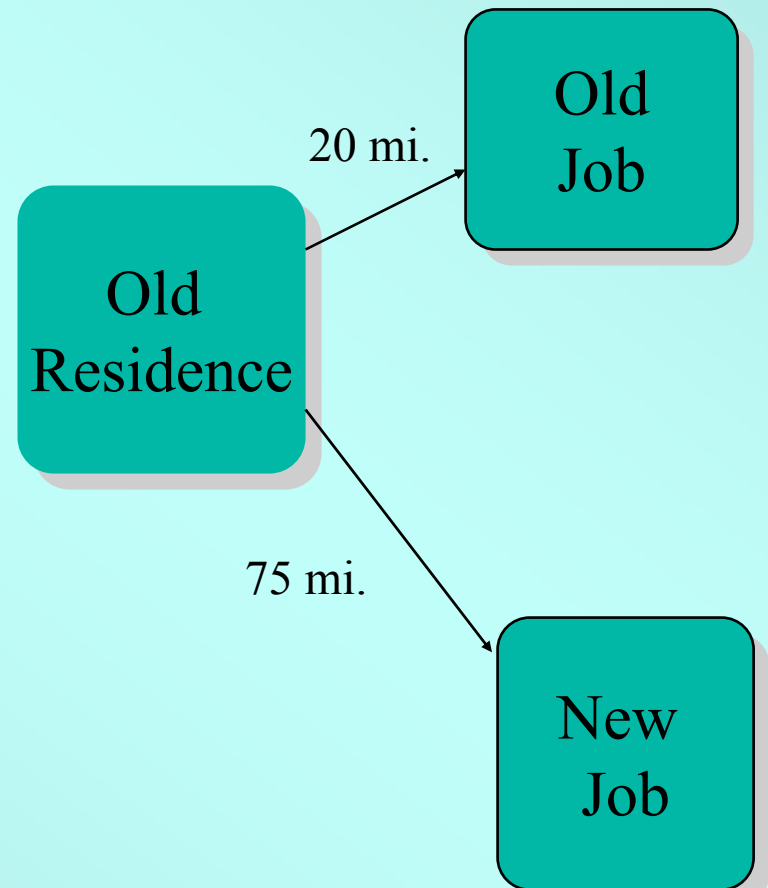
- Deductible for moves in connection with the commencement of work at a new principal place of work
- Two tests must be met for moving expenses to be deductible
 - Distance test
 - Time test

Distance Test

- Distance from old home to new job must be at least 50 miles farther than from old home to old job
- New home location not relevant for decision

Example of Distance Test

- Gail lived 20 miles from her old job
- Gail's new job is 75 miles from her old home
- Gail meets the distance test



Time Test (slide 1 of 2)

- Taxpayer must be full-time employee for 39 of the 52 weeks following the move, or
- Self-employed must work in new location for 78 of the 104 weeks following the move
 - 39 of the weeks must be in the first 12 months
- Test waived if die, disabled, discharged, or transferred

Time Test (slide 2 of 2)

- If time test not met during taxable year, two alternatives:
 - Take the deduction in year moved. If test is not met in following year, either:
 - Include the amount deducted in gross income in the following year, or
 - File amended return for year of move
 - Alternatively, wait until time test is met and then file amended return for year of move

Deductible Moving Expenses

- Expenses of moving household goods and personal effects to new location
- Expenses of travel for family to new location
 - Actual auto costs (not depreciation) or mileage rate of \$.12 per mile
 - Meals are not deductible as moving expense

Tax Treatment of Moving Expenses

- Unreimbursed moving expenses are deductible *For AGI*
- Reimbursement or payment by employer:
 - For qualified moving expenses, amount is excluded from gross income, but no deduction for related expenses
 - For nonqualified moving expenses, amount is included in gross income and no deduction is allowed

Education Expenses (slide 1 of 3)

- Education expenses are deductible if they are incurred:
 - To maintain or improve existing skills, or
 - To meet the requirements of the employer, profession, licensing, or state law

Education Expenses (slide 2 of 3)

- Education expenses are not deductible if they are incurred:
 - To meet minimum educational standards for existing job, or
 - To qualify taxpayer for new trade or business

Education Expenses (slide 3 of 3)

- Education expenses include:
 - Tuition
 - Books
 - Supplies
 - Transportation
 - Travel (including lodging and 50% meals)

Deduction For Qualified Tuition and Related Expenses (slide 1 of 2)

- Starting in 2002, a deduction is allowed for qualified tuition and related expenses
- For 2003, maximum deduction allowed is \$3,000
- No deduction is allowed if AGI exceeds:

Single	\$ 65,000
Married	\$130,000

Deduction For Qualified Tuition and Related Expenses (slide 2 of 2)

- Qualified tuition and related expenses include whatever is required for enrollment
 - Usually, student activity fees, books, room and board are not included
- Expenses need not be work related
- Deduction is not available for married persons filing separately

Entertainment Expenses

(slide 1 of 2)

- Deductions are very restricted due to abuse possibilities
 - Amount allowed
 - 50% meals and entertainment
 - 100% of transportation costs
 - Amounts cannot be lavish or extravagant
 - Beginning in 1998, the 50% cutback for meals is eased for certain, very limited, types of employees

Entertainment Expenses

(slide 2 of 2)

- Entertainment expenses are classified as either:
 - *Directly related to business*
 - Actual business meeting or discussion occurs during meal or entertainment
 - *Associated with business*
 - Meal or entertainment that directly precedes or follows business meeting or discussion

Restrictions on Entertainment Expenses (slide 1 of 3)

- Club dues
 - Generally not deductible
 - Exception: Clubs formed for public services and community volunteerism (e.g., Kiwanis, Rotary)
 - Business entertainment expenses incurred at club are still deductible (50%)

Restrictions on Entertainment Expenses (slide 2 of 3)

- Ticket purchases for entertainment
 - Amounts paid in excess of face value of ticket are not deductible
 - Limitation on deductibility of luxury skybox expenditures

Restrictions on Entertainment Expenses (slide 3 of 3)

- Business gifts
 - Business gifts of tangible personalty with a value of \$25 or less per person per year are deductible
 - If the value is \$4 or less (e.g., pen with company name) then not subject to \$25 limit
- Gifts to employers or superiors are not deductible

Office in the Home

(slide 1 of 3)

- Deductibility is very restricted due to abuse possibilities
 - Office must be used exclusively and on a regular basis as:
 - The principal place of business, or
 - A place of business used by clients, patients, or customers
 - For employees, office must also be for the convenience of the employer

Office in the Home

(slide 2 of 3)

- What constitutes “principal place of business”?
 - Home office qualifies as a principal place of business if:
 - Taxpayer conducts admin. and mgmt. activities in the home office, and
 - There is no other fixed location where taxpayer conducts these activities
 - Effective for tax years beginning after 12-31-98

Office in the Home

(slide 3 of 3)

- Office in the home expenses cannot cause net loss from the business activity
 - Office in home deduction limited to business gross income in excess of other business expenses (ordering rules apply)
 - Excess is carried forward (subject to limit)
 - Form 8829 is used to report office in home expenses

Other Employee Expenses

- A partial list of other employee expenses that are deductible includes:
 - Special clothing (uniforms)
 - Union dues
 - Professional expenses
 - Job hunting in same profession

Classification of Employee Expenses (slide 1 of 2)

- Depends on whether they are reimbursed and, if reimbursed, under what type of plan

Classification of Employee Expenses (slide 2 of 2)

- Employers can have three types of reimbursement plans
 - Accountable
 - Nonaccountable
 - No reimbursement is given

Accountable Plan (slide 1 of 2)

- Plan must require adequate accounting to the employer for expense reimbursed, and
- Any excess reimbursements must be returned to the employer

Accountable Plan (slide 2 of 2)

- Adequate accounting is
 - Submitting a record, with receipts, to the employer, or
 - Using a per diem allowance that is not more than the Federal per diem rate
- Employee reports no income and takes no deduction to the extent of the reimbursed expenses

Substantiation for Expenditures

(slide 1 of 2)

- No deduction allowed for an expense if the taxpayer does not have adequate records for the expense
 - Therefore, taxpayers need to have good records for employee or self-employed expenses
 - In some cases, use of per diem allowance will be deemed substantiation

Substantiation for Expenditures

(slide 2 of 2)

- Records should include:
 - Business relationship with other persons involved (who)
 - Type of expense (what)
 - Time of expense (when)
 - Place of expense (where)
 - Purpose of expense (why)
 - Amount of expense (how much)

Nonaccountable Plan

- Plan that does not require adequate accounting or return of excess reimbursement or both
 - Reimbursed amounts received under this plan are included in gross income
 - Expenses are deductible FROM AGI as miscellaneous itemized deductions subject to the 2% AGI limitation

Unreimbursed Employee Expenses

- Expenses are deductible FROM AGI as miscellaneous itemized deductions subject to the 2% AGI limitation

Miscellaneous Deductions

- Miscellaneous itemized deductions subject to the 2% AGI limitation
 - Certain miscellaneous expenses must be added together and the amount in excess of 2% of taxpayer's AGI is deductible FROM AGI (i.e., itemized deduction reported on Sch. A)

Examples of Miscellaneous Deductions Subject to 2% Floor

- Most reimbursed expenses under a nonaccountable plan
- Unreimbursed employee expenses
- Section 212 expenses not related to rents and royalties
- Tax return preparation fee
- Hobby expenses
- Investment expenses (except interest and taxes)

Computing 2% of AGI Limitation (slide 1 of 4)

- Example 1

Taxpayer, a single individual, provides the following information for 2003:

\$30,000 AGI

\$ 3,500 deductible interest expense and taxes paid

\$ 1,500 employee business expenses, and

\$ 500 tax return preparation fee

Computing 2% of AGI Limitation (slide 2 of 4)

- Example 1 (cont'd)

Interest and taxes		\$3,500
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Misc. expenses:

Employee bus. exp.	\$1,500	
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Tax return prep.	<u>500</u>	
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Total	\$2,000	
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Less 2% AGI	<u>600</u>	<u>1,400</u>
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Itemized deductions		\$4,900
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Computing 2% of AGI Limitation (slide 3 of 4)

- Example 2

Assume the same facts as in Example 1, except that the taxpayer has only \$200 of employee business expenses

Computing 2% of AGI Limitation (slide 4 of 4)

- Example 2 (cont'd)

Interest and taxes		\$ 3,500
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Misc. expenses:

Employee bus. exp.	\$200	
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Tax return prep.	<u>500</u>	
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Total	\$700	
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Less 2% AGI	<u>600</u>	<u>100</u>
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Itemized deductions		\$ 3,600
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Take standard deduction		\$ 4,750
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If you have any comments or suggestions concerning this PowerPoint Presentation for West's Federal Taxation, please contact:

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