

## BUSINESS INCOME AND EXPENSES



Self-employed individuals must file a Schedule C with their tax return to declare their net profit or loss for their business. Schedule C is separated into two parts; Part I reports your income, and Part II reports your expenses.



### **SCHEDULE C, PART I – INCOME**

To calculate your gross income, you need your gross receipts or sales, any returns and allowances, and the cost to make the goods sold.

First, you reduce your gross receipts or sales by any returns and allowances. A sales return occurs when a buyer sends a product back to a seller for a partial or full refund. An allowance is a retroactive discount a customer receives when they contact a company about a minor but noticeable defect with its product. Both are subtracted from a company's gross sales to calculate gross profit. After you calculate your gross profit, add any other income (such as bad debts recovered, interest, prizes and awards related to your trade or business, etc.) and that will generate your gross income for the business.



### **SCHEDULE C, PART II – EXPENSES**

To calculate your net profit or loss, you need to deduct your expenses from your gross income. Expenses must be considered ordinary and necessary business expenses in order to be deducted. The most common expenses include the following:

#### **1. Car and Truck Expense**

You can deduct the actual expenses of operating your car or truck (gasoline, oil, repairs, insurance, license plates, etc.) or take the standard mileage rate (0.56/mile). Normally, the business mileage deduction will generate a greater expense for the business. When using this method you track your mileage, parking, and toll costs not your gas purchases or vehicle expenses.

There are three types of mileage:

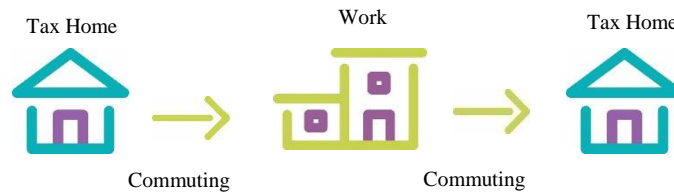
- Commuting – mileage from home to a work site or returning from a work site to home.
- Business – mileage is from one work site to another work site. **This is the only mileage that is deductible.**
- Personal – mileage not related to work.

TIP: If you travel from a regular job (W-2 situation) to a self-employment work site to perform tasks, or vice versa, this is considered business mileage.

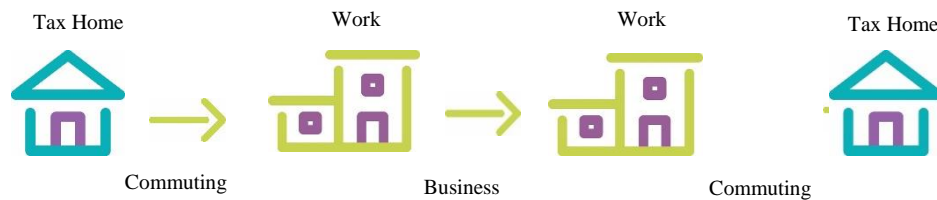
What type of mileage should you track? This will depend. Let's look at two scenarios:

- A. This first scenario depicts business mileage for a self-employed taxpayer with a "tax home" (the term "tax home" refers to your main place of business regardless

of where you maintain your family home). When the taxpayer leaves the tax home to go to a job site then returns to the tax home all are commuting miles and not deductible.



- B. The second scenario is a workday for the same self-employed taxpayer with another stop on the way. This example shows deductible business mileage; the trip from the first work site to the second work site. In addition, if you stop at a store to pick up job supplies then travel to a job site, the trip from the store to the job site is business mileage.



## 2. Depreciation (see IRS Publication 946 for further information)

Depreciation is the annual deduction allowed to recover the cost, or other basis of business or investment property having a useful life substantially beyond the tax year. Depreciation starts when you first use the property in your business or to produce income, and it ends when you take the property out of service, deduct all your depreciable cost, or other basis, or no longer use the property in your business, or to produce income.

There are two main methods of depreciation: The Modified Accelerated Cost Recovery System and the Section 179 deduction. The method for depreciating most tangible property, that is property you can see or touch, is the Modified Accelerated Cost Recovery System. It's commonly referred to by its initials, MACRS and pronounced, "makers."

**Example:** Shawn bought and placed a used pickup in service for \$15,000 on March 5, 2022. The pickup has a 5-year class life. His depreciation deduction for each year is computed in the following table (see Pub. 946 Table A-1):

Year	Cost x MACRS %	Depreciation
2022	\$15,000 x 20%	\$3,000
2023	\$15,000 x 32%	\$4,800
2024	\$15,000 x 19.2%	\$2,880
2025	\$15,000 x 11.52%	\$1,728
2026	\$15,000 x 11.52%	\$1,728
2027	\$15,000 x 5.76%	\$864
<b>Total</b>		<b>\$15,000</b>

## 3. Travel, Meals, and Entertainment (see IRS Publication 535 for further information)

Taxpayers may deduct 50% of the cost of business meals if the taxpayer or an employee of the taxpayer is present, and the food or beverages are not considered lavish or extravagant. The meals may be provided to a current or potential business customer,

client, consultant, or similar business contact. Food and beverages that are provided during entertainment events will not be considered entertainment if purchased separately from the event.

For the meals and entertainment expenses, enter your total deductible business meal and entertainment expenses. This includes expenses for meals while traveling away from home for business and for meals that are business-related entertainment.

TIP: Instead of basing your deduction on the actual cost of your meals while on business travel away from home, you can use the standard meal allowance for your daily meals and incidental expenses. Under this method, you deduct a specified amount, depending on where you travel, instead of keeping records of your actual meal expenses. You must keep records, however, to prove the time, place, and business purpose of your travel. The standard meal allowance is the federal M&IE; that is, the meals and incidental expenses rate.

**Example: Jim invites Steve to a business lunch to negotiate a new deal on the cost of widgets. The total bill at the end of the lunch is \$65.00. Since this was not a lavish or extravagant lunch, Jim can deduct 50% of the expenses associated with lunch, or \$32.50.**

For the travel part of Travel, Meals, and Entertainment, enter your expenses for lodging and transportation connected with overnight travel for business while away from your tax home. These expenses may include airplane, train, or bus ticket, fares in a taxi, baggage and shipping fees, rental car, cleaning, tips, etc.

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