Publication 334

Tax Guide for Small Business

(For Individuals Who UseSchedule C)

For use in preparing

2023 Returns

Volume 3 of 4

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Businesses that sell services. You do not have to figure the cost of goods sold if the sale of merchandise is not an income-producing factor for your business. Your gross profit is the same as your net receipts (gross receipts minus any refunds, rebates, or other allowances). Most professions and businesses that sell services rather than products can figure gross profit directly from net receipts in this way.

Illustration. This illustration of the gross profit section of the income statement of a retail business shows how gross profit is figured.

Income Statement Year Ended December 31, 2023

Gross receipts....................	$400,000
Minus: Returns and allowances.....	14,940
Net receipts...........................	$385,060

Minus: Cost of goods sold...........	288,140
Gross profit............................	**$96,920**

The cost of goods sold for this business is figured as follows.

Inventory at beginning of year...		$37,845
Plus: Purchases...	$285,900	
Minus: Items withdrawn for personal use....	2,650	283,250
Goods available for sale............		$321,095
Minus: Inventory at end of year..		32,955
Cost of goods sold................		**$288,140**

Items To Check

Consider the following items before figuring your gross profit.

Gross receipts. At the end of each business day, make sure your records balance with your actual cash and credit receipts for the day. You may find it helpful to use cash registers to keep track of receipts. You should also use a proper invoicing system and keep a separate bank account for your business.

Sales tax collected. Check to make sure your records show the correct sales tax collected.

If you collect state and local sales taxes imposed on you as the seller of goods or services from the buyer, you must include the amount collected in gross receipts.

If you are required to collect state and local taxes imposed on the buyer and turn them over to state or local governments, you generally do not include these amounts in income.

Inventory at beginning of year. Compare this figure with last year's ending inventory. The two amounts should usually be the same.

Purchases. If you take any inventory items for your personal use (use them yourself, provide them to your family, or give them as personal gifts, etc.), be sure to remove them from the cost of goods sold. For details on how to adjust cost of goods sold, see *Merchandise withdrawn from sale* in chapter 6.

Inventory at end of year. Check to make sure your procedures for taking inventory are adequate. These procedures should ensure all items have been included in inventory and proper pricing techniques have been used.

Use inventory forms and adding machine tapes as the only evidence for your inventory. Inventory forms are available at office supply stores. These forms have columns for recording the description, quantity, unit price, and value of each inventory item. Each page has space to record who made the physical count, who priced the items, who made the extensions, and who proofread the calculations. These forms will help you confirm that the total inventory is accurate. They will also provide you with a permanent record to support its validity.

Inventories are discussed in chapter 2.

Testing Gross Profit Accuracy

If you are in a retail or wholesale business, you can check the accuracy of your gross profit figure. First, divide gross profit by net receipts. The resulting percentage measures the average spread between the merchandise cost of goods sold and the selling price.

Next, compare this percentage to your markup policy. Little or no difference between these two percentages shows that your gross profit figure is accurate. A large difference between these percentages may show that you did not accurately figure sales, purchases, inventory, or other items of cost. You should determine the reason for the difference.

Example. You operate a retail business. On the average, you mark up your merchandise so that you will realize a gross profit of $33^1/3$% on its sales. The net receipts (gross receipts minus returns and allowances) shown on your income statement are $300,000. Your cost of goods sold is $200,000. This results in a gross profit of $100,000 ($300,000 − $200,000). To test the accuracy of this year's results, you divide gross profit ($100,000) by net receipts ($300,000). The resulting $33^1/3$% confirms your markup percentage of $33^1/3$%.

Additions to Gross Profit

If your business has income from a source other than its regular business operations, enter the income on line 6 of Schedule C and add it to gross profit. The result is gross business income. Some examples include income from an interest-bearing checking account, income from scrap sales, income from certain fuel tax credits and refunds, and amounts recovered from bad debts.

8.

Business Expenses

Introduction

You can deduct the costs of operating your business. These costs are known as business expenses. These are costs you do not have to capitalize or include in the cost of goods sold but can deduct in the current year.

To be deductible, a business expense must be both ordinary and necessary. An ordinary expense is one that is common and accepted in your field of business. A necessary expense is one that is helpful and appropriate for your business. An expense does not have to be indispensable to be considered necessary.

For more information about the general rules for deducting business expenses, see section 162 and its regulations.

If you have an expense that is partly for business and partly personal, separate the personal part from the business part. The personal part is not deductible.

Useful Items

You may want to see:

Publication

- ☐ **463** Travel, Gift, and Car Expenses
- ☐ **946** How To Depreciate Property

See chapter 12 for information about getting publications and forms.

Bad Debts

If someone owes you money you cannot collect, you have a bad debt. There are two kinds of bad debts—business bad debts and nonbusiness bad debts.

A business bad debt is generally one that comes from operating your trade or business. You may be able to deduct business bad debts as an expense on your business tax return.

Business bad debt. A business bad debt is a loss from the worthlessness of a debt that was either of the following.

1. Created or acquired in your business.
2. Closely related to your business when it became partly or totally worthless.

A debt is closely related to your business if your primary motive for incurring the debt is a business reason.

Business bad debts are mainly the result of credit sales to customers. They can also be the result of loans to suppliers, clients, employees, or distributors. Goods and services that customers have not paid for are shown in your books as either accounts receivable or notes receivable. If you are unable to collect any part of these accounts or notes receivable, the uncollectible part is a business bad debt.

CAUTION *You can take a bad debt deduction for these accounts and notes receivable only if the amount you were owed was included in your gross income either for the year the deduction is claimed or for a prior year.*

Accrual method. If you use an accrual method of accounting, you normally report income as you earn it. You can take a bad debt deduction for an uncollectible receivable if you have included the uncollectible amount in income.

Cash method. If you use the cash method of accounting, you normally report income when you receive payment. You cannot take a bad debt deduction for amounts owed to you that you have not received and cannot collect if you never included those amounts in income.

More information. For more information about business bad debts, see section 166 and its regulations.

Nonbusiness bad debts. All other bad debts are nonbusiness bad debts and are deductible as short-term capital losses on Form 8949 and Schedule D (Form 1040). For more information on nonbusiness bad debts, see section 166 and its regulations.

Car and Truck Expenses

If you use your car or truck in your business, you may be able to deduct the costs of operating and maintaining your vehicle. You may also be able to deduct other costs of local transportation and traveling away from home overnight on business.

Local transportation expenses. Local transportation expenses include the ordinary and necessary costs of all the following.

- Getting from one workplace to another in the course of your business or profession when you are traveling within the city or general area that is your tax home. Tax home is defined later.
- Visiting clients or customers.
- Going to a business meeting away from your regular workplace.
- Getting from your home to a temporary workplace when you have one or more regular places of work. These temporary workplaces can be either within the area of your tax home or outside that area.

Local business transportation does not include expenses you have while traveling away from home overnight. Those expenses are deductible as travel expenses and are discussed later under *Travel and Meals*.

However, if you use your car while traveling away from home overnight, use the rules in this section to figure your car expense deduction.

Generally, your tax home is your regular place of business, regardless of where you maintain your family home. It includes the entire city or general area in which your business or work is located.

Example. You operate a printing business out of rented office space. You use your van to deliver completed jobs to your customers. You can deduct the cost of round-trip transportation between your customers and your print shop.

CAUTION *You cannot deduct the costs of driving your car or truck between your home and your main or regular workplace. These costs are personal commuting expenses.*

Office in the home. Your workplace can be your home if you have an office in your home that qualifies as your principal place of business. For more information, see *Business Use of Your Home*, later.

Example. You are a graphic designer. You operate your business out of your home. Your home qualifies as your principal place of business. You occasionally have to drive to your clients to deliver your completed work. You can deduct the cost of the round-trip transportation between your home and your clients.

Methods for Deducting Car and Truck Expenses

For local transportation or overnight travel by car or truck, you can generally use one of the following methods to figure your expenses.

- Standard mileage rate.
- Actual expenses.

Standard mileage rate. You may be able to use the standard mileage rate to figure the deductible costs of operating your car, van, pickup, or panel truck for business purposes. The business standard mileage rate for 2023 is 65.5 cents a mile.

CAUTION *If you choose to use the standard mileage rate for a year, you cannot deduct your actual expenses for that year except for business-related parking fees and tolls.*

Choosing the standard mileage rate. If you want to use the standard mileage rate for a car or truck you own, you must choose to use it in the first year the car is available for use in your business. In later years, you can choose to use either the standard mileage rate or actual expenses.

If you choose to use the standard mileage rate for a car you lease, you must use it for the entire lease period (including renewals).

Standard mileage rate not allowed. You cannot use the standard mileage rate if you:

1. Operate five or more cars at the same time;
2. Claimed a depreciation deduction using any method other than straight line, for example, ACRS or MACRS;
3. Claimed a section 179 deduction on the car;
4. Claimed the special depreciation allowance on the car;
5. Claimed actual car expenses for a car you leased; or
6. Are a rural mail carrier who received a qualified reimbursement.

Parking fees and tolls. In addition to using the standard mileage rate, you can deduct any business-related parking fees and tolls. (Parking fees you pay to park your car at your place of work are nondeductible commuting expenses.)

Actual expenses. If you do not choose to use the standard mileage rate, you may be able to deduct your actual car or truck expenses.

If you qualify to use both methods, figure your deduction both ways to see which gives you a larger deduction.

Actual car expenses include the costs of the following items.

Depreciation	Lease payments	Registration
Garage rent	Licenses	Repairs
Gas	Oil	Tires
Insurance	Parking fees	Tolls

If you use your vehicle for both business and personal purposes, you must divide your expenses between business and personal use. You can divide your expenses based on the miles driven for each purpose.

Example. You are the sole proprietor of a flower shop. You drove your van 20,000 miles during the year. 16,000 miles were for delivering flowers to customers and 4,000 miles were for personal use (including commuting miles). You can claim only 80% (16,000 ÷ 20,000) of the cost of operating your van as a business expense.

More information. For more information about the rules for claiming car and truck expenses, see Pub. 463.

Reimbursing Your Employees for Expenses

You can generally deduct the amount you reimburse your employees for car and truck expenses. The reimbursement you deduct and the manner in which you deduct it depend in part on whether you reimburse the expenses under an accountable plan or a nonaccountable plan. For details, see Pub. 15. That publication explains accountable and nonaccountable plans and tells you whether to report the reimbursement on your employee's Form W-2.

Depreciation

If property you acquire to use in your business is expected to last more than 1 year, you generally cannot deduct the entire cost as a business expense in the year you acquire it. You must spread the cost over more than 1 tax year and deduct part of it each year on Schedule C. This method of deducting the cost of business property is called depreciation.

The following is a brief overview. You will find more information about depreciation in Pub. 946.

What property can be depreciated? You can depreciate property if it meets all the following requirements.

- It must be property you own.
- It must be used in business or held to produce income. You can never depreciate inventory (explained in chapter 2) because it is not held for use in your business.
- It must have a useful life that extends substantially beyond the year it is placed in service.
- It must have a determinable useful life, which means that it must be something that wears out, decays, gets used up, becomes obsolete, or loses its value from natural causes. You can never depreciate the cost of land because land does not wear out, become obsolete, or get used up.

- It must not be excepted property. This includes property placed in service and disposed of in the same year.

Repairs. In general, you do not depreciate the costs of repairs or maintenance if they do not improve your property. Instead, you deduct these amounts on line 21 of Schedule C. Improvements are amounts paid for betterments to your property, restorations of your property, or work that adapts your property to a new or different use.

Election to capitalize repair and maintenance costs that do not improve your property. You can make an election to treat certain repairs or replacements in your trade or business as improvements subject to depreciation. This election is available if you treat these amounts as capital expenditures on your books and records regularly used in computing your income and expenses.

Depreciation method. The method for depreciating most business and investment property placed in service after 1986 is called the Modified Accelerated Cost Recovery System (MACRS). MACRS is discussed in detail in Pub. 946.

Section 179 deduction. You can elect to deduct a limited amount of the cost of certain depreciable property in the year you place the property in service. This deduction is known as the section 179 deduction. The maximum amount you can elect to deduct during 2023 is generally $1,160,000 (higher limits apply to certain property).

This limit is generally reduced by the amount by which the cost of the property placed in service during the tax year exceeds $2,890,000. The total amount of depreciation (including the section 179 deduction) you can take for a passenger automobile you use in your business and first place in service in 2023 is $12,200 ($20,200 if you take the special depreciation allowance for qualified passenger automobiles placed in service in

2023). Special rules apply to trucks and vans. For more information, see Pub. 946. It explains what property qualifies for the deduction, what limits apply to the deduction, and when and how to recapture the deduction.

CAUTION

Your section 179 election for the cost of any sport utility vehicle (SUV) and certain other vehicles is limited to $28,900. For more information, see the Instructions for Form 4562 or Pub. 946.

Listed property. You must follow special rules and recordkeeping requirements when depreciating listed property. Listed property includes any of the following.

- Most passenger automobiles.
- Most other property used for transportation.
- Any property of a type generally used for entertainment, recreation, or amusement.

For more information about listed property, see Pub. 946.

Form 4562. Use Form 4562, Depreciation and Amortization, if you are claiming any of the following.

- Depreciation on property placed in service during the current tax year.
- A section 179 deduction.
- Depreciation on any listed property (regardless of when it was placed in service).

Employees' Pay

You can generally deduct on Schedule C the pay you give your employees for the services they perform for your business. The pay may be in cash, property, or services.

To be deductible, your employees' pay must be an ordinary and necessary expense and you must pay or incur it in the tax year. In addition, the pay must meet both the following tests.

- The pay must be reasonable.
- The pay must be for services performed.

You cannot deduct your own salary or any personal withdrawals you make from your business. As a sole proprietor, you are not an employee of the business.

Kinds of pay. Some of the ways you may provide pay to your employees are listed below.

- Awards.
- Bonuses.
- Education expenses.
- Fringe benefits (discussed later).
- Loans or advances you do not expect the employee to repay if they are for personal services actually performed.

- Property you transfer to an employee as payment for services.
- Reimbursements for employee business expenses.
- Sick pay.
- Vacation pay.

Fringe benefits. A fringe benefit is a form of pay for the performance of services. The following are examples of fringe benefits.

- Benefits under qualified employee benefit programs.
- Meals and lodging.
- The use of a car.
- Flights on airplanes.
- Discounts on property or services.

Employee benefit programs include the following.

- Accident and health plans.
- Adoption assistance.
- Cafeteria plans.
- Dependent care assistance.
- Educational assistance.
- Group-term life insurance coverage.
- Welfare benefit funds.

You can generally deduct the cost of fringe benefits you provide on your Schedule C in whatever category the cost falls. For example, if you allow an employee to use a car or other property you lease, deduct the cost of the lease as a rent or lease expense. If you own the property, include your deduction for its cost or other basis as a section 179 deduction or a depreciation deduction.

You may be able to exclude all or part of the fringe benefits you provide from your employees' wages. For more information about fringe benefits and the exclusion of benefits, see Pub. 15-B.

Insurance

You can generally deduct premiums you pay for the following kinds of insurance related to your business.

1. Fire, theft, flood, or similar insurance.
2. Credit insurance that covers losses from business bad debts.
3. Group hospitalization and medical insurance for employees, including long-term care insurance.
4. Liability insurance.
5. Malpractice insurance that covers your personal liability for professional negligence resulting in injury or damage to patients or clients.

6. Workers' compensation insurance set by state law that covers any claims for bodily injuries or job-related diseases suffered by employees in your business, regardless of fault.

7. Contributions to a state unemployment insurance fund are deductible as taxes if they are considered taxes under state law.

8. Overhead insurance that pays for business overhead expenses you have during long periods of disability caused by your injury or sickness.

9. Car and other vehicle insurance that covers vehicles used in your business for liability, damages, and other losses. If you operate a vehicle partly for personal use, deduct only the part of the insurance premium that applies to the business use of the vehicle. If you use the standard mileage rate to

figure your car expenses, you cannot deduct any car insurance premiums.

10. Life insurance covering your employees if you are not directly or indirectly the beneficiary under the contract.

11. Business interruption insurance that pays for lost profits if your business is shut down due to a fire or other cause.

Nondeductible premiums. You cannot deduct premiums on the following kinds of insurance.

1. Self-insurance reserve funds. You cannot deduct amounts credited to a reserve set up for self-insurance. This applies even if you cannot get business insurance coverage for certain business risks. However, your actual losses may be deductible. For more information, see Pub. 547.

2. Loss of earnings. You cannot deduct premiums for a policy that pays for your lost earnings due to sickness or disability. However, see item 8 in the previous list.

3. Certain life insurance and annuities.

    a. For contracts issued before June 9, 1997, you cannot deduct the premiums on a life insurance policy covering you, an employee, or any person with a financial interest in your business if you are directly or indirectly a beneficiary of the policy. You are included among possible beneficiaries of the policy if the policy owner is obligated to repay a loan from you using the proceeds of the policy. A person has a financial interest in your business if the person is an owner or part owner of the business or has lent money to the business.

b. For contracts issued after June 8, 1997, you generally cannot deduct the premiums on any life insurance policy, endowment contract, or annuity contract if you are directly or indirectly a beneficiary. The disallowance applies without regard to whom the policy covers.

4. Insurance to secure a loan. If you take out a policy on your life or on the life of another person with a financial interest in your business to get or protect a business loan, you cannot deduct the premiums as a business expense. Nor can you deduct the premiums as interest on business loans or as an expense of financing loans. In the event of death, the proceeds of the policy are not taxed as

income even if they are used to liquidate the debt.

Self-employed health insurance deduction. You may be able to deduct the amount you paid for medical and dental insurance and qualified long-term care insurance for you and your family.

How to figure the deduction. Generally, you can use the worksheet in the Instructions for Form 1040 to figure your deduction. However, if any of the following apply, you must use Form(s) 7206.

- You have more than one source of income subject to SE tax.
- You file Form 2555 (relating to foreign earned income).
- You are using amounts paid for qualified long-term care insurance to figure the deduction.

See Form 8962 and its separate instructions and use Pub. 974 if the insurance plan established, or considered to be established, under your business was obtained through the Health Insurance Marketplace and you are claiming the premium tax credit.

Prepayment. You cannot deduct expenses in advance, even if you pay them in advance. This rule applies to any expense paid far enough in advance to, in effect, create an asset with a useful life extending substantially beyond the end of the current tax year.

Example. In 2023, you signed a 3-year insurance contract. Even though you paid the premiums for 2023, 2024, and 2025 when you signed the contract, you can only deduct the premium for 2023 on your 2023 tax return. You can deduct in 2024 and 2025 the premiums allocable to those years.

Interest

You can generally deduct as a business expense some or all interest you pay or accrue during the tax year on debts related to your business. Interest relates to your business if you use the proceeds of the loan for a business expense. It does not matter what type of property secures the loan. You can deduct interest on a debt only if you meet all of the following requirements.

- You are legally liable for that debt.
- Both you and the lender intend that the debt be repaid.
- You and the lender have a true debtor-creditor relationship.

Certain taxpayers are required to limit their business interest expense deduction. See the Instructions for Form 8990 to determine whether you are required to limit your business interest expense deduction, who is required to file Form 8990, and how certain businesses may elect out of the business interest expense limitation.

You cannot deduct on Schedule C the interest you paid on personal loans. If a loan is part business and part personal, you must divide the interest between the personal part and the business part.

Example. In 2023, you paid $600 interest on a car loan. During 2023, you used the car 60% for business and 40% for personal purposes. You are claiming actual expenses on the car. You can only deduct $360 (60% (0.60) × $600) for 2023 on Schedule C. The remaining interest of $240 is a nondeductible personal expense.

More information. Additional items to consider are shown below.

- How to allocate interest between personal and business use.
- Limitation on business interest.

- When to deduct interest.
- The rules for a below-market interest rate loan. (This is generally a loan on which no interest is charged or on which interest is charged at a rate below the applicable federal rate.)

Legal and Professional Fees

Legal and professional fees, such as fees charged by accountants, that are ordinary and necessary expenses directly related to operating your business are deductible on Schedule C. However, you usually cannot deduct legal fees you pay to acquire business assets. Add them to the basis of the property.

If the fees include payments for work of a personal nature (such as making a will), you can take a business deduction only for the part of the fee related to your business.

Tax preparation fees. You can deduct on Schedule C the cost of preparing that part of your tax return relating to your business as a sole proprietor or statutory employee.

You can also deduct on Schedule C the amount you pay or incur in resolving asserted tax deficiencies for your business as a sole proprietor or statutory employee.

Pension Plans

You can set up and maintain the following small business retirement plans for yourself and your employees.

- SEP (Simplified Employee Pension) plans.
- SIMPLE (Savings Incentive Match Plan for Employees) plans.
- Qualified plans (including Keogh or H.R. 10 plans).

SEP, SIMPLE, and qualified plans offer you and your employees a tax-favored way to save for retirement. You can deduct contributions you make to the plan for your employees on line 19 of Schedule C. If you are a sole proprietor, you can deduct contributions you make to the plan for yourself on line 16 of Schedule 1 (Form 1040). You can also deduct trustees' fees if contributions to the plan do not cover them. Earnings on the contributions are generally tax free until you or your employees receive distributions from the plan. You may also be able to claim a tax credit if you begin a new qualified defined benefit or defined contribution plan (including a 401(k) plan), SIMPLE plan, or SEP plan. For details on this credit and credits for auto-enrollment and military spouse participation, see Form 8881 and its separate instructions.

Under certain plans, employees can have you contribute limited amounts of their before-tax pay to a plan. These amounts (and earnings on them) are generally tax free until your employees receive distributions from the plan.

For more information on retirement plans for small business, see Pub. 560.

Pub. 590-A, Contributions to Individual Retirement Arrangements (IRAs), discusses other tax-favored ways to save for 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 a business expense only if the rent is for property you use in your business. If you have or will receive equity in or title to the property, you cannot deduct the rent.

Unreasonable rent. You cannot take a rental deduction for unreasonable rents. Ordinarily, the issue of reasonableness arises only if you and the lessor are related. Rent paid to a related person is reasonable if it is the same amount you would pay to a stranger for use of the same property. Rent is not unreasonable just because it is figured as a percentage of gross receipts.

Related persons include members of your immediate family, including siblings (either whole or half), your spouse, ancestors, and lineal descendants. For a list of the other related persons, see section 267 of the Internal Revenue Code.

Rent on your home. If you rent your home and use part of it as your place of business, you may be able to deduct the rent you pay for that part. You must meet the requirements for business use of your home. For more information, see *Business Use of Your Home*, later.

Rent paid in advance. Generally, rent paid in your business is deductible in the year paid or accrued. If you pay rent in advance, you can deduct only the amount that applies to your use of the rented property during the tax year. You can deduct the rest of your payment only over the period to which it applies.

Taxes

You can deduct on Schedule C various federal, state, local, and foreign taxes directly attributable to your business.

Income taxes. You can deduct on Schedule C a state tax on gross income (as distinguished from net income) directly attributable to your business. You can deduct other state and local income taxes on Schedule A (Form 1040) if you itemize your deductions. Do not deduct federal income tax.

Employment taxes. You can deduct the social security, Medicare, and FUTA taxes you paid out of your own funds as an employer. Employment taxes are discussed briefly in chapter 1. You can also deduct payments you made as an employer to a state unemployment compensation fund or to a state disability benefit fund. Deduct these payments as taxes.

SE tax. You can deduct one-half of your SE tax on line 15 of Schedule 1 (Form 1040). SE tax is discussed in chapter 1 and chapter 10.

Personal property tax. You can deduct on Schedule C any tax imposed by a state or local government on personal property used in your business.

You can also deduct registration fees for the right to use property within a state or local area.

Example. You and your spouse drove your car 7,000 business miles out of a total of 10,000 miles. You and your spouse had to pay $25 for your annual state license tags and $20 for your city registration sticker. You and your spouse also paid $235 in city personal property tax on the car, for a total of $280. You and your spouse are claiming your actual car expenses. Because you and your spouse used the car 70% for business, you and your spouse can deduct 70% of the $280, or $196, as a business expense.

Real estate taxes. You can deduct on Schedule C the real estate taxes you pay on your business property. Deductible real estate taxes are any state, local, or foreign taxes on real estate levied for the general public welfare. The taxing authority must assess these taxes uniformly at a like rate on all real property under its jurisdiction, and the proceeds must be for general community or governmental purposes.

Sales tax. Treat any sales tax you pay on a service or on the purchase or use of property as part of the cost of the service or property. If the service or the cost or use of the property is a deductible business expense, you can deduct the tax as part of that service or cost. If the property is merchandise bought for resale, the sales tax is part of the cost of the merchandise. If the property is depreciable, add the sales tax to the basis for depreciation. For information on the basis of property, see Pub. 551.

Do not deduct state and local sales taxes imposed on the buyer that you must collect and pay over to the state or local government. Do not include these taxes in gross receipts or sales.

Excise taxes. You can deduct on Schedule C all excise taxes that are ordinary and necessary expenses of carrying on your business. Excise taxes are discussed briefly in chapter 1.

Fuel taxes. Taxes on gasoline, diesel fuel, and other motor fuels you use in your business are usually included as part of the cost of the fuel. Do not deduct these taxes as a separate item.

You may be entitled to a credit or refund for federal excise tax you paid on fuels used for certain purposes. For more information, see Pub. 510.

Travel and Meals

This section briefly explains the kinds of travel and meal expenses you can deduct on Schedule C.

Travel expenses. These are the ordinary and necessary expenses of traveling away from home for your business. You are traveling away from home if both the following conditions are met.

1. Your duties require you to be away from the general area of your tax home (defined later) substantially longer than an ordinary day's work.
2. You need to get sleep or rest to meet the demands of your work while away from home.

Generally, your **tax home** is your regular place of business, regardless of where you maintain your family home. It includes the entire city or general area in which your business is located. See Pub. 463 for more information.

The following is a brief discussion of the expenses you can deduct.

Transportation. You can deduct the cost of travel by airplane, train, bus, or car between your home and your business destination.

Taxi, commuter bus, and limousine. You can deduct fares for these and other types of transportation between the airport or station and your hotel, or between the hotel and your work location away from home.

Baggage and shipping. You can deduct the cost of sending baggage and sample or display material between your regular and temporary work locations.

Car or truck. You can deduct the costs of operating and maintaining your vehicle when traveling away from home on business. You can deduct actual expenses or the standard mileage rate (discussed earlier under *Car and Truck Expenses*), as well as business-related tolls and parking. If you rent a car while away from home on business, you can deduct only the business-use portion of the expenses.

Meals and lodging. You can deduct the cost of meals and lodging if your business trip is overnight or long enough that you need to stop for sleep or rest to properly perform your duties. You can use actual expenses or the standard meal allowance to calculate your deduction. In most cases, you can deduct only 50% of your meal expenses. See Pub. 463 for additional information.

Cleaning. You can deduct the costs of dry cleaning and laundry while on your business trip.

Telephone. You can deduct the cost of business calls while on your business trip, including business communication by fax machine or other communication devices.

Tips. You can deduct the tips you pay for any expense in this list.

More information. For more information about travel expenses, see Pub. 463.

Reimbursing your employees for expenses. You can generally deduct the amount you reimburse your employees for travel and meal expenses. The reimbursement you deduct and the manner in which you deduct it depend in part on whether you reimburse the expenses under an accountable plan or a nonaccountable plan. For details, see Pub. 15. That publication explains accountable and nonaccountable plans and tells you whether to report the reimbursement on your employee's Form W-2.

Business Use of Your Home

To deduct expenses related to the part of your home used for business, you must meet specific requirements. Even then, your deduction may be limited.

To qualify to claim expenses for business use of your home, you must meet the following tests.

1. Your use of the business part of your home must be:

    a. Exclusive (however, see *Exceptions to exclusive use*, later),

    b. Regular, and

    c. For your business.

2. The business part of your home must be:

    a. Your principal place of business (defined later);

b. A place where you meet or deal with patients, clients, or customers in the normal course of your business; or

c. A separate structure (not attached to your home) you use in connection with your business.

Exclusive use. To qualify under the exclusive use test, you must use a specific area of your home only for your trade or business. The area used for business can be a room or other separately identifiable space. The space does not need to be marked off by a permanent partition.

You do not meet the requirements of the exclusive use test if you use the area in question both for business and for personal purposes.

Example. You are an attorney and use a den in your home to write legal briefs and prepare clients' tax returns. Your family also uses the den for recreation. The den is not used exclusively in your profession, so you cannot claim a business deduction for its use.

Exceptions to exclusive use. You do not have to meet the exclusive use test to the extent you use part of your home in either of the following ways.

1. For the storage of inventory or product samples.
2. As a daycare facility.

For an explanation of these exceptions, see Pub. 587, Business Use of Your Home.

Regular use. To qualify under the regular use test, you must use a specific area of your home for business on a continuing basis. You do not meet the test if your business use of the area is only occasional or incidental, even if you do not use that area for any other purpose.

Principal place of business. You can have more than one business location, including your home, for a single trade or business. To qualify to deduct the expenses for the business use of your home under the principal place of business test, your home must be your principal place of business for that business. To determine your principal place of business, you must consider all the facts and circumstances.

Your home office will qualify as your principal place of business for deducting expenses for its use if you meet the following requirements.

- You use it exclusively and regularly for administrative or management activities of your business.
- You have no other fixed location where you conduct substantial administrative or management activities of your business.

Alternatively, if you use your home exclusively and regularly for your business, but your home office does not qualify as your principal place of business based on the previous rules, you determine your principal place of business based on the following factors.

- The relative importance of the activities performed at each location.
- If the relative importance factor does not determine your principal place of business, you can also consider the time spent at each location.

If, after considering your business locations, your home cannot be identified as your principal place of business, you cannot deduct home office expenses. However, for other ways to qualify to deduct home office expenses, see Pub. 587.

Deduction limit. If your gross income from the business use of your home equals or exceeds your total business expenses (including depreciation), you can deduct all your business expenses related to the use of your home. If your gross income from the business use is less than your total business expenses, your deduction for certain expenses for the business use of your home is limited.

Your deduction of otherwise nondeductible expenses, such as insurance, utilities, and depreciation (with depreciation taken last), allocable to the business is limited to the gross income from the business use of your home minus the sum of the following.

1. The business part of expenses you could deduct even if you did not use your home for business (such as mortgage interest, real estate taxes, and casualty and theft losses that

are allowable as itemized deductions on Schedule A (Form 1040)).

2. The business expenses that relate to the business activity in the home (for example, business phone, supplies, and depreciation on equipment), but not to the use of the home itself.

Do not include in (2) above your deduction for one-half of your SE tax.

Use **Form 8829**, Expenses for Business Use of Your Home, to figure your deduction.

Simplified method. The IRS provides a simplified method to determine your expenses for business use of your home. The simplified method is an alternative to calculating and substantiating actual expenses. In most cases, you will figure your deduction by multiplying $5 by the area of your home used for a qualified business use. The area you use to figure your deduction is limited to 300 square feet. For more information, see the Instructions for

Schedule C.

More information. For more information on deducting expenses for the business use of your home, see Pub. 587.

De Minimis Safe Harbor for Tangible Property

Generally, you must capitalize costs to acquire or produce real or tangible personal property used in your trade or business, such as buildings, equipment, or furniture. However, if you elect to use the de minimis safe harbor for tangible property, you may deduct de minimis amounts paid to acquire or produce certain tangible property if these amounts are deducted by you for financial accounting purposes or in keeping your books and records.

If you have an applicable financial statement, you may use this safe harbor to deduct amounts paid for tangible property up to $5,000 per item or invoice. If you do not have an applicable financial statement, you may use the de minimis safe harbor to deduct amounts paid for tangible property up to $2,500 per item or invoice.

Amounts qualifying under this de minimis safe harbor should be included as other expenses in Part V of Schedule C.

More information. For details on making this election and requirements for using the de minimis safe harbor for tangible property, see *Tangible Property Regulations*.

Other Expenses You Can Deduct

You may also be able to deduct the following expenses.

- Advertising.
- Bank fees.

- Donations to business organizations.
- Education expenses.
- Impairment-related expenses.
- Interview expense allowances.
- Licenses and regulatory fees.
- Moving machinery.
- Outplacement services.
- Penalties and fines you pay for late performance or nonperformance of a contract.
- Repairs and maintenance to real or tangible personal property.
- Repayments of income.
- Supplies and materials.
- Utilities.

Expenses You Cannot Deduct

You usually cannot deduct the following as business expenses.

- Bribes and kickbacks.
- Charitable contributions.
- Demolition expenses or losses.
- Dues to business, social, athletic, luncheon, sporting, airline, and hotel clubs.
- Entertainment expenses.
- Improvements to real or tangible personal property.

Improvements are amounts paid for betterments to

your property, restorations of your property, or work that adapts your property to a new or different use.

- Lobbying expenses.

- Penalties and fines you pay to a governmental agency or instrumentality because you broke the law.
- Personal, living, and family expenses.
- Political contributions.
- Settlements or payments related to sexual harassment or sexual abuse if such settlement or payment is subject to a nondisclosure agreement. You also cannot deduct attorney fees related to such settlement or payment.

9.

Figuring Net Profit or Loss

Introduction

After figuring your business income and expenses, you are ready to figure the net profit or net loss from your business. You do this by subtracting business expenses from business income. If your expenses are less than your income, the difference is net profit and becomes part of your income on line 3 of Schedule 1 (Form 1040). If your expenses are more than your income, the difference is a net loss. You can usually deduct it from gross income on line 3 of Schedule 1 (Form 1040). But in some situations your loss is limited. This chapter briefly explains three of those situations. Other situations that may limit your loss are explained in the instructions for Schedule C, line G and line 32.

If you have more than one business, you must figure your net profit or loss for each business on a separate Schedule C.

Excess business loss limitation. Your loss from a trade or business may be limited. Use Form 461 to determine the amount of your excess business loss, if any. Your excess business loss will be included as income on line 8p of Schedule 1 (Form 1040) and treated as an NOL that you must carry forward and deduct in a subsequent year.

For more information about the excess business loss limitation, see Form 461 and its instructions.

Net Operating Losses (NOLs)

If your deductions for the year are more than your income for the year, you may have an NOL. You can use an NOL by deducting it from your income in another year or years.

Examples of typical losses that may produce an NOL include, but are not limited to, losses incurred from the following.

- Your trade or business.
- A casualty or theft resulting from a federally declared disaster.
- Moving expenses.
- Rental property.

A loss from operating a business is the most common reason for an NOL.

For details about NOLs, see Pub. 536. It explains how to figure an NOL, when to use it, how to claim an NOL deduction, and how to figure an NOL carryover.

Not-for-Profit Activities

If you do not carry on your business to make a profit, there is a limit on the deductions you can take. You cannot use a loss from the activity to offset other income. Activities you do as a hobby, or mainly for sport or recreation, come under this limit.

For details about not-for-profit activities, see *Hobby or business: here's what to know about that side hustle*.

10.

Self-Employment (SE) Tax

The SE tax rules apply no matter how old you are and even if you are already receiving social security and Medicare benefits.

Who Must Pay SE Tax?

Generally, you must pay SE tax and file Schedule SE (Form 1040) if your net earnings from self-employment were $400 or more. Use Schedule SE to figure net earnings from self-employment.

Sole proprietor or independent contractor. If you are self-employed as a sole proprietor or independent contractor, you generally use Schedule C (Form 1040) to figure your earnings subject to SE tax.

SE tax rate. The 2023 SE tax rate on net earnings is 15.3% (12.4% social security tax plus 2.9% Medicare tax).

Maximum earnings subject to SE tax. Only the first $160,200 of your combined wages, tips, and net earnings in 2023 is subject to any combination of the 12.4% social security part of SE tax, social security tax, or the Tier 1 part of railroad retirement tax.

All of your combined wages, tips, and net earnings in 2023 are subject to any combination of the 2.9% Medicare part of SE tax, Medicare tax, or Medicare part of railroad retirement tax.

If your wages and tips are subject to either social security tax or the Tier 1 part of railroad retirement tax, or both, and total at least $160,200, do not pay the 12.4% social security part of the SE tax on any of your net earnings. However, you must pay the 2.9%

Medicare part of the SE tax on all your net earnings.

Additional Medicare Tax. A 0.9% Additional Medicare Tax may apply to you if your net earnings from self-employment exceed a threshold amount (based on your filing status). For more information, see *Self-Employment (SE) Tax* in chapter 1, and Form 8959 and its instructions.

Special Rules and Exceptions

Aliens. Generally, resident aliens must pay SE tax under the same rules that apply to U.S. citizens. Nonresident aliens are not subject to SE tax unless an international social security agreement (also known as a totalization agreement) in effect determines that they are covered under the U.S. social security system. However, residents of the U.S. Virgin Islands, Puerto Rico, Guam, the Commonwealth of the Northern Mariana Islands, or American Samoa are subject to SE tax, as they are considered U.S. residents for SE tax purposes. For more information on aliens, see Pub. 519, U.S. Tax Guide for Aliens.

Child employed by parent. You are not subject to SE tax if you are under age 18 and you are working for your father or mother.

Church employee. If you work for a church or a qualified church-controlled organization (other than as a minister, member of a religious order, or Christian Science practitioner) that elected an exemption from social security and Medicare taxes, you are subject to SE tax if you receive $108.28 or more in wages from the church or organization. For more information, see Pub. 517, Social Security and Other Information for Members of the Clergy and Religious Workers.

Fishing crew member. If you are a member of the crew on a boat that catches fish or other aquatic life, your earnings are subject to SE tax if all the following conditions apply.

1. You do not get any pay for the work except your share of the catch or a share of the proceeds from the sale of the catch, unless the pay meets all the following conditions.
   a. The pay is not more than $100 per trip.
   b. The pay is received only if there is a minimum catch.
   c. The pay is solely for additional duties (such as mate, engineer, or cook) for which additional cash pay is traditional in the fishing industry.
2. You get a share of the catch or a share of the proceeds from the sale of the catch.

3. Your share depends on the amount of the catch.

4. The boat's operating crew normally numbers fewer than 10 individuals. (An operating crew is considered as normally made up of fewer than 10 if the average size of the crew on trips made during the last 4 calendar quarters is fewer than 10.)

Notary public. Fees you receive for services you perform as a notary public are reported on Schedule C but are not subject to SE tax (see the Instructions for Schedule SE (Form 1040)).

State or local government employee. You are subject to SE tax if you are an employee of a state or local government, are paid solely on a fee basis, and your services are not covered under a federal-state social security agreement.

Foreign government or international organization employee. You are subject to SE tax if both the following conditions are true.

1. You are a U.S. citizen employed in the United States, Puerto Rico, Guam, American Samoa, the Commonwealth of the Northern Mariana Islands, or the U.S. Virgin Islands by:

    a. A foreign government,

    b. A wholly owned agency of a foreign government, or

    c. An international organization.

2. Your employer is not required to withhold social security and Medicare taxes from your wages.

U.S. citizen or resident alien residing abroad. If you are a self-employed U.S. citizen or resident alien living outside the United States, in most cases you must pay SE tax. Foreign earnings from self-employment can't be reduced by your foreign earned income exclusion when computing self-employment tax.

Exception. The United States has social security agreements with many countries to eliminate double taxation under two social security systems. Under these agreements, you must generally only pay social security and Medicare taxes to the country in which you live. The country to which you must pay the tax will issue a certificate that serves as proof of exemption from social security tax in the other country.

For more information, see the Instructions for Schedule SE (Form 1040).

More Than One Business

If you have earnings subject to SE tax from more than one trade, business, or profession, you must combine the net profit (or loss) from each to determine your total earnings subject to SE tax. A loss from one business reduces your profit from another business.

Community Property Income

If any of the income from a trade or business, other than a partnership, is community property income under state law, it is included in the earnings subject to SE tax of the spouse carrying on the trade or business.

Gain or Loss

Do not include in earnings subject to SE tax a gain or loss from the disposition of property that is neither stock in trade nor held primarily for sale to customers. It does not matter whether the disposition is a sale, an exchange, or an involuntary conversion.

Lost Income Payments

If you are self-employed and reduce or stop your business activities, any payment you receive from insurance or other sources for the lost business income is included in earnings subject to SE tax. If you are not working when you receive the payment, it still relates to your business and is included in earnings subject to SE tax, even though your business is temporarily inactive.

Figuring Earnings Subject to SE Tax

Methods for Figuring Net Earnings

There are three ways to figure net earnings from self-employment.

1. The regular method.
2. The nonfarm optional method.
3. The farm optional method.

You must use the regular method to the extent you do not use one or both of the optional methods.

Why use an optional method? You may want to use the optional methods (discussed later) when you have a loss or a small net profit and any one of the following applies.

- You want to receive credit for social security benefit coverage.
- You incurred child or dependent care expenses for which you could claim a credit. (An optional method may increase your earned income, which could increase your credit.)
- You are entitled to the earned income credit. (An optional method may increase your earned income, which could increase your credit.)
- You are entitled to the additional child tax credit. (An optional method may increase your earned income, which could increase your credit.)

Effects of using an optional method. Using an optional method could increase your SE tax. Paying more SE tax could result in your getting higher benefits when you retire.

Using the optional methods may also decrease your AGI due to the deduction for one-half of SE tax on Form 1040 or 1040-SR, which may affect your eligibility for credits, deductions, or other items that are subject to an AGI limit. Figure your AGI with and without using the optional methods to see if the optional methods will benefit you.

If you use either or both optional methods, you must figure and pay the SE tax due under these methods even if you would have had a smaller tax or no tax using the regular method.

The optional methods may be used only to figure your SE tax. To figure your income tax, include your actual earnings in gross income, regardless of which method you use to determine SE tax.

Regular Method

To figure net earnings using the regular method, multiply your self-employment earnings by 92.35% (0.9235). For your net earnings figured using the regular method, see line 4a of your Schedule SE (Form 1040).

Net earnings figured using the regular method are also called actual net earnings.

Nonfarm Optional Method

Use the nonfarm optional method only for earnings that do not come from farming. You may use this method if you meet all the following tests.

1. You are self-employed on a regular basis. This means that your actual net earnings from self-employment were $400 or more in at least 2 of the 3 tax years before the one for which you use this method. For this purpose, the prior-year net earnings can be from either farm or nonfarm earnings or both.

2. You have used this method less than 5 years. (There is a 5-year lifetime

limit.) The years do not have to be one after another.

3. Your net nonfarm profits were:

   a. Less than $7,103, and

   b. Less than 72.189% of your gross nonfarm income.

Net nonfarm profit. Net nonfarm profit is generally the total of the amounts from:

- Line 31 of Schedule C (Form 1040); and
- Box 14, code A, of Schedule K-1 (Form 1065) (from nonfarm partnerships).

However, you may need to adjust the amount reported on Schedule K-1 if you are a general partner or if it is a loss.

Gross nonfarm income. Your gross nonfarm income is generally the total of the amounts from:

- Line 7 of Schedule C (Form 1040); and

- Box 14, code C, of Schedule K-1 (Form 1065) (from nonfarm partnerships).

Figuring Nonfarm Net Earnings

If you meet the three tests explained earlier, use the following table to figure your nonfarm net earnings from self-employment under the nonfarm optional method.

Table 10-1. **Figuring Nonfarm Net Earnings**

IF your gross nonfarm income is...	THEN your net earnings are equal to...
$9,840 or less	two-thirds of your gross nonfarm income.
more than $9,840	$7,103.

Optional net earnings less than actual net earnings. You cannot use this method to report an amount less than your actual nonfarm net earnings from self-employment. Your actual nonfarm net earnings are your nonfarm net earnings figured using the regular method, explained earlier.

Gross nonfarm income of $9,840 or less. The following examples illustrate how to figure net earnings when gross nonfarm income is $9,840 or less.

Example 1. Net nonfarm profit less than $7,103 and less than 72.189% of gross nonfarm income. You run a craft business. Your actual net earnings from self-employment were $800 in 2021 and $900 in 2022. You meet the test for being self-employed on a regular basis. You have used the nonfarm optional method less than 5 years. Your gross income and net profit in 2023 are as follows.

Gross nonfarm income.................	$5,400
Net nonfarm profit......................	$1,200

Your actual net earnings for 2023 are $1,108 ($1,200 × 0.9235). Because your net profit is less than $7,103 and less than 72.189% of your gross income, you can use the nonfarm optional method to figure net earnings of $3,600 ($^2/3$ × $5,400). Because these net earnings are higher than your actual net earnings, you can report net earnings of $3,600 for 2023.

Example 2. Net nonfarm profit less than $7,103 but not less than 72.189% of gross nonfarm income. Assume that in *Example 1* your gross income is $1,200 and your net profit is $900. You must use the regular method to figure your net earnings. You cannot use the nonfarm optional method because your net profit is not less than 72.189% of your gross income.

Example 3. Net loss from a nonfarm business. Assume that in *Example 1* you have a net loss of $700. You can use the nonfarm optional method and report $3,600 ($^2/3$ × $5,400) as your net earnings.

Example 4. Nonfarm net earnings less than $400. Assume that in *Example 1* you have gross income of $525 and a net profit of $175. In this situation, you would not pay any SE tax under either the regular method or the nonfarm optional method because your net earnings under both methods are less than $400.

Gross nonfarm income of more than $9,840. The following examples illustrate how to figure net earnings when gross nonfarm income is more than $9,840.

Example 1. Net nonfarm profit less than $7,103 and less than 72.189% of gross nonfarm income. You run an appliance repair shop. Your actual net earnings from self-employment were $10,500 in 2021 and

$9,500 in 2022. You meet the test for being self-employed on a regular basis. You have used the nonfarm optional method less than 5 years. Your gross income and net profit in 2023 are as follows.

Gross nonfarm income.................	$12,000
Net nonfarm profit......................	$1,200

Your actual net earnings for 2023 are $1,108 ($1,200 × 0.9235). Because your net profit is less than $7,103 and less than 72.189% of your gross income, you can use the nonfarm optional method to figure net earnings of $6,560. Because these net earnings are higher than your actual net earnings, you can report net earnings of $6,560 for 2023.

Example 2. Net nonfarm profit not less than $7,103. Assume that in *Example 1* your net profit is $8,900. You must use the regular method. You cannot use the nonfarm optional method because your net nonfarm profit is not less than $7,103.

Example 3. Net loss from a nonfarm business. Assume that in *Example 1* you have a net loss of $700. You can use the nonfarm optional method and report $6,560 as your net earnings from self-employment.

Farm Optional Method

Use the farm optional method only for earnings from a farming business. See Pub. 225 for information about this method.

Using Both Optional Methods

If you have both farm and nonfarm earnings, you may be able to use both optional methods to determine your net earnings from self-employment.

To figure your net earnings using both optional methods, you must do the following.

- Figure your farm and nonfarm net earnings separately under each method.

Do not combine farm earnings with nonfarm earnings to figure your net earnings under either method.

- Add the net earnings figured under each method to arrive at your total net earnings from self-employment.

You can report less than your total actual farm and nonfarm net earnings but not less than actual nonfarm net

earnings. If you use both optional methods, you can report no more than $6,560 as your combined net earnings from self-employment.

Example. You are a self-employed farmer. You also operate a retail grocery store. Your gross income, actual net earnings from self-employment, and optional farm and optional nonfarm net earnings from self-employment are shown in Table 10-2.

Table 10-2. **Example—Farm and Nonfarm Earnings**

Income and Earnings	**Farm**	**Nonfarm**
Gross income	$4,500	$6,000
Actual net earnings	$900	$500
Optional net earnings (2/3 of gross income)	$3,000	$4,000

Table 10-3 shows four methods or combinations of methods you can use to figure net earnings from self-employment using the farm and nonfarm gross income and actual net earnings shown in Table 10-2.

- Method 1. Using the regular method for both farm and nonfarm income.
- Method 2. Using the optional method for farm income and the regular method for nonfarm income.

- Method 3. Using the regular method for farm income and the optional method for nonfarm income.
- Method 4. Using the optional method for both farm and nonfarm income.

Note. Actual net earnings are the same as net earnings figured using the regular method.

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