

Article for “Ask SCORE” Column in Business Section of the Rochester Post Bulletin

This week’s topic: Management

Word Count: 877

Writer: Dean Swanson, Past Chairperson of SCORE SE Minnesota Chapter

Publish date: October 13, 2010

Management

Ask SCORE

Getting a Handle on Business Expenses

Keeping track of business expenses can be a frustrating and sometimes confusing task for a small business. Start up and existing businesses, alike need to pay attention to this aspect of managing their operation because it is the basis for evaluating the ongoing status of the business and paying taxes properly. Today’s column will address some of the general issues around this topic that I have experienced recently in our SCORE client interactions and seminars. I encourage each business to work with their business Accountant for the specifics of this topic and also to use the IRS publications.

It may sound redundant, but let us start from the beginning. What is a business expense? These are the various costs incurred in the process of carrying on a trade or business operation. These costs are usually deductible if the business is operated to make a profit.

The most common question is what can I deduct from my business income. In order for an expense to be deductible, it 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.

Having stated that broad, general definition one must consider carefully how the various costs are treated in your accounting system to establish accurate data upon which to make decisions and also to base your tax liabilities. For example, 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. Some of your manufacturing expenses may be included in figuring the cost of goods sold. 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.

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, three types of costs that you will need to capitalize are: Business start-up costs, Business assets, and Improvements. Again, see your accountant about electing to deduct or amortize certain business start-up costs.

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. But make sure you have written rationale for this calculation.

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.

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 can include the following (but each have specific rules...see your Accountant and tax person for these):

- ✓ 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 IRS Publication 535, Business Expenses.

If you need to review your business expenses, contact SCORE, mentors to America's Small businesses. They provide free, confidential counseling as well as informational seminars. For example, next Tuesday evening's SCORE seminar will be taught by CPA Diane Lund on the topic of Planning for Business Accounting and Taxes and is offered through Rochester Community Education. .

Dean L. Swanson
South East Minnesota SCORE
c/o Rochester Area Chamber of Commerce
220 South Broadway, Suite 100
Rochester, MN 55904
*Dean is a volunteer SCORE Counselor.
