

# Adding in business deductions

SCHEDULE A (Form 1040)		Itemized Deductions		OMB No. 1545-0074	
Department of the Treasury Internal Revenue Service (99)		- Attach to Form 1040. - See instructions for Schedule A (Form 1040).		2006 Attachment Sequence No. 07	
Name(s) shown on Form 1040 <b>JOHN SAILOR</b>			Your social security number 123-45-6665		
<b>Medical and Dental Expenses</b>					
Caution: Do not include expenses reimbursed or paid by others.					
1	Medical and dental expenses (see instructions)	1			
2	Enter amount from Form 1040, line 38	2			
3	Multiply line 2 by 7.5% (.075)	3			
4	Subtract line 3 from line 1. If line 3 is more than line 1, enter -0-	4			
<b>Taxes You Paid</b>					
5	State and local income taxes	5	3,750.		
6	Real estate taxes (see instructions)	6			
7	Personal property taxes	7			
8	Other taxes. List type and amount	8	311.	311.	
AUTO EXCISE					
9	Add lines 5 through 8	9			4,061.
<b>Interest You Paid</b>					
10	Home mtg interest and points reported to you on Form 1098	10			
11	Home mortgage interest not reported to you on Form 1098. If paid to the person from whom you bought the home, see instructions and show that person's name, identifying number, and address	11			
<b>Note.</b> Personal interest is not deductible.					
12	Points not reported to you on Form 1098. See instrs for appt rules	12			
13	Investment interest. Attach Form 4952 if required. (See instrs.)	13			
14	Add lines 10 through 13	14			
<b>Gifts to Charity</b>					
15	Gifts by cash or check. If you made any gift of \$250 or more, see instrs	15	360.		
16	Other than by cash or check. If any gift of \$250 or more, see instructions. You must attach Form 5283 if over \$500.	16			
17	Carryover from prior year	17			
18	Add lines 15 through 17	18			360.
<b>Casualty and Theft Losses</b>					
19	Casualty or theft loss(es). Attach Form 4684. (See instructions.)	19			
<b>Job Expenses and Certain Miscellaneous Deductions</b>					
20	Unreimbursed employee expenses — job travel, union dues, job education, etc. Attach Form 2106 or 2106-EZ, if required. (See instructions.)	20			
See Statement		20	6,743.	6,743.	
21	Tax preparation fees	21		270.	
22	Other expenses — investment, safe deposit box, etc. List type and amount	22			
23	Add lines 20 through 22	23		7,013.	
24	Enter amount from Form 1040, line 38	24	75,620.		
25	Multiply line 24 by 2% (.02)	25		1,512.	
26	Subtract line 25 from line 23. If line 25 is more than line 23, enter -0-	26			5,501.
<b>Other Miscellaneous Deductions</b>					
27	Other — from list in the instructions. List type and amount	27			
<b>Total Itemized Deductions</b>					
28	Is Form 1040, line 38, over \$150,000 (over \$75,250 if married filing separately)?	28			
<input checked="" type="checkbox"/> No. Your deduction is not limited. Add the amounts in the far right column for lines 4 through 27. Also, enter this amount on Form 1040, line 40.				9,922.	
<input type="checkbox"/> Yes. Your deduction may be limited. See instructions for the amount to enter.					
29	If you elect to itemize deductions even though they are less than your standard deduction, check here	29			

For an employee, business deductions are itemized deductions. They are added to other itemized deductions with the intent of exceeding your standard deduction (\$5,150 for our example). What are itemized deductions? State taxes paid (or sales taxes), rarely medical, property taxes, charitable contributions, certain attorney's fees, business expenses, mortgage interest, gambling losses (only extending towards winnings) etc. They eventually go from Schedule A (left) to Form 1040. This article isn't intended to discuss specific deductions, rather their effect on your tax return.

Some deductions can be added together (property tax, charity, interest), while others are subject to additional restrictions. Medical deductions, for example, must exceed 7.5% of Adjusted Gross Income (AGI) before they are included in your itemized deductions. In our case, John would need \$5,672 in medical expenses to meet that 7.5% limit. If John had \$5,673 in medical deductions, \$1 would count towards his itemized deductions. This is why I usually tell clients if they can make it up the stairs to my office, they probably don't have enough medical deductions to qualify.

Your name: **JOHN SAILOR** Occupation in which you incurred expenses: **MERCHANT MARINER** Social security number: **123-45-6665**

- You May Use This Form Only if All of the Following Apply.**
- You are an employee deducting ordinary and necessary expenses attributable to your job. An ordinary expense is one that is common and accepted in your field of trade, business, or profession. A necessary expense is one that is helpful and appropriate for your business. An expense does not have to be required to be considered necessary.
  - You do not get reimbursed by your employer for any expenses (amounts your employer included in box 1 of your Form W-2 are not considered reimbursements for this purpose).
  - If you are claiming vehicle expense, you are using the standard mileage rate for 2006.

**Caution:** You can use the standard mileage rate for 2006 only if: (a) you owned the vehicle and used the standard mileage rate for the first year you placed the vehicle in service, or (b) you leased the vehicle and used the standard mileage rate for the portion of the lease period after 1997.

**Part I Figure Your Expenses**

1	Vehicle expense using the standard mileage rate. Complete Part II and multiply line 8a by 44.5¢ (.445)	1	
2	Parking fees, tolls, and transportation, including train, bus, etc. that did not involve overnight travel or commuting to and from work	2	
3	Travel expense while away from home overnight, including lodging, airplane, car rental, etc. Do not include meals and entertainment	3	3,121.
4	Business expenses not included on lines 1 through 3. Do not include meals and entertainment	4	
5	Meals and entertainment expenses: \$ _____ x 50% (.50) (Employees subject to Department of Transportation (DOT) hours of service limits: Multiply meal expenses incurred while away from home on business by 75% (.75) instead of 50%. For details, see instructions.)	5	
6	Total expenses. Add lines 1 through 5. Enter here and on Schedule A (Form 1040), line 20 (or on Schedule A (Form 1040NR), line 9). (Armed Forces reservists, fee-basis state or local government officials, qualified performing artists, and individuals with disabilities: See the instructions for special rules on where to enter this amount.)	6	3,121.

**Part II Information on Your Vehicle.** Complete this part only if you are claiming vehicle expense on line 1.

7 When did you place your vehicle in service for business use? (month, day, year) \_\_\_\_\_

8 Of the total number of miles you drove your vehicle during 2006, enter the number of miles you used your vehicle for:  
a Business \_\_\_\_\_ b Commuting (see instr.) \_\_\_\_\_ c Other \_\_\_\_\_

9 Do you (or your spouse) have another vehicle available for personal use?  Yes  No

10 Was your vehicle available for personal use during off-duty hours?  Yes  No

11a Do you have evidence to support your deduction?  Yes  No

b If "Yes," is the evidence written?  Yes  No

BAA For Paperwork Reduction Act Notice, see separate instructions. Form 2106-EZ (2006)

**Schedule A Miscellaneous Itemized Deductions Statement 2006**  
Lines 20, 22, 27 Attach to return (after all IRS forms) Statement

Name(s) Shown on Return: **JOHN SAILOR** Social Security Number: **123-45-6665**

**Employee Business Expenses – Subject to 2% Limitation**

1	Unreimbursed employee expenses from Form 2106	1	3,121.
2	Excluded expenses from Form 2555	2	
3a	Qualified Educator Expenses	3a	
b	Above the line Educator Expenses: (from Form 1040, line 23A)	3b	
c	Excess Educator Expenses (line 3a less line 3b)	3c	
4	Union and professional dues	4	2,636.
5	Professional subscriptions	5	27.
6	Uniforms and protective clothing	6	328.
7	Job search costs	7	
8	Other: LUGGAGE FOR WORK CELL REQUIRED FOR WORK	8	119. 512.
9	Total unreimbursed employee business expenses (combine lines 1 - 8)	9	6,743.

**Miscellaneous Expenses – Subject to 2% Limitation** Investment Expense ↓

10	Depreciation and amortization deductions	10	
11	Casualty/theft losses of property used in services as an employee	11	
12	REMIC expenses, from Schedule E	12	
13	Investment expenses related to interest and dividend income	13	
14	Deductions related to portfolio income, miscellaneous deductions, and excess deductions on termination, from Schedule(s) K-1	14	
15	Miscellaneous deductions excluded on Form 2555	15	
16	Investment counsel and advisory fees	16	
17	Certain attorney and accounting fees	17	
18	Safe deposit box rental fees	18	
19	IRA custodial fees	19	
20	Loss incurred from total distribution of all traditional IRAs	20	
21	Loss incurred from total distribution of all Roth IRAs	21	
22	Other:	22	
23	Total miscellaneous expenses (combine lines 10 through 22)	23	

**Other Miscellaneous Deductions – Not Subject to 2% Limitation**

24	Deductions related to portfolio income, from Schedule(s) K-1	24	
25	Federal estate tax paid on decedent's income reported on this return	25	
26	Miscellaneous deductions excluded on Form 2555	26	
27	Impairment-related expenses of a handicapped employee, from Form 2106	27	
28	Amortizable bond premiums on bonds acquired before 10/23/86	28	
29	Gambling losses (to the extent of gambling income)	29	
30	Casualty/theft losses of income-producing property	30	
31	Other miscellaneous deductions:	31	
32	Total other miscellaneous deductions (combine lines 24 through 31)	32	

Business deductions are subjected to a 2% limitation. Deductions exceeding 2% of AGI (Schedule A, line 25) are included in your itemized deductions. All deductions that exceed the 2% limitation are included in your itemized deductions.

In John's case, he has \$7,013 in business expenses (Schedule A, Line 23), yielding a \$5,501 itemized deduction (Schedule A, Line 26). Effectively, 2% of John's adjusted gross income is subtracted from his total business deductions.

John has other itemized deductions as well. John made estimated payments towards his Massachusetts state tax due (Schedule A, Line 5), Paid excise taxes on his truck (Schedule A, Line 8), and made charitable contributions (Schedule A, Line 18).

John's total itemized deductions are \$9,922. Since this amount exceeds John's standard deduction of \$5,150, he will itemize.

What's the bottom line?

John's tax is now \$12,151. That's \$1,200 less than his first return. John's business deductions decreased his tax by \$1,200.

From a tax perspective, John is lucky to live in Massachusetts. If John lived in New Hampshire (no sales or income tax), his business deductions wouldn't have been as helpful (\$938 less helpful to be specific). Granted,

state sales and income tax deductions aren't better than not paying any tax at all, but they do affect the big tax picture. Different planning tools need to be implemented depending on the mariner's state of residence.

### **Individual Summary**

Gross Income – \$75,620  
Taxable Gross Income - \$75,620  
Adjusted Gross Income – \$75,620  
Standard/Itemized Deduction – \$9,922  
Tax – \$12,151

Original Tax - \$13,351  
Percent Difference – 9%

### **Overall Summary (the overall summary includes tax tips from our prior articles)**

Gross Income – \$75,620  
Taxable Gross Income - \$70,620  
Adjusted Gross Income – \$70,620  
Standard/Itemized Deduction – \$9,922  
Tax – \$10,876

Original Tax - \$13,351  
Percent Difference (tax savings) – 19%

### **Business Deduction Tip**

Now we can see how we effectively “burn” deductions in order to make them count. Our itemized deductions need to *exceed* our standard deduction. All the deductions used in exceeding the standard are comparatively lost. Also all the deductions used in exceeding the 2% floor that business deductions must exceed are effectively lost as well.

It makes sense then to take more in one year.

Example – Jake makes \$100,000. He lives in New Hampshire so he doesn't have state taxes to deduct. He made a \$500 charitable contribution. His business deductions are as follows –

Incidental Expenses - \$2,400  
Union Dues - \$1,100  
Job Search Expenses - \$2,800  
Tax Preparation Fees - \$270

Total Deductions - \$6,570

Subtract 2% of AGI - (\$2,000)

Allowable Business Deduction - \$4,570

Add in Charitable Contributions - \$500

**Total Itemized Deductions - \$5,070**

Isn't the standard deduction \$5,150? This means that Jake will take the standard deduction because it exceeds itemized deductions. All of those business deductions were in lost.

What if Jake had incorporated some tax planning?

- Jake needed a new laptop for work. If he had bought before the year ended he could have added in its' value of \$1,100.
- Jake still hadn't paid off his initiation fee for the union. He if had done this, he could have added in another \$1,600

If he had done these two things, his itemized deductions would have totaled \$7,770, exceeding the standard deduction by \$2,620.

With his income, Jakes marginal tax rate (MTR) "this is the rate his next dollar will be taxed at" is 28%. This means plan B produces tax savings of \$734. That's money in your pocket. That's tax planning!