

**Abstract:** Business owners who look at the Internal Revenue Code for a list of deductible business expenses may be surprised to find that there isn't a list of specific deductions. For example, the tax law doesn't explicitly state that a business can deduct office supplies and certain other expenses. Some expenses are detailed in the code, but the general rule is contained in Section 162, which states a business can write off "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business."

## What expenses can't be written off by your business?

If you check the Internal Revenue Code, you may be surprised to find that most business deductions aren't specifically listed there. For example, the tax law doesn't explicitly state that you can deduct office supplies and certain other expenses. Some expenses are detailed in the tax code, but the general rule is contained in the first sentence of Section 162, which states you can write off "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business."

### Basic definitions

In general, an expense is *ordinary* if it's considered common or customary in the particular trade or business. For example, insurance premiums to protect a store would be an ordinary business expense in the retail industry.

A *necessary* expense is one that's helpful or appropriate. For example, a car dealership may purchase an automatic defibrillator. It may not be necessary for the business operation, but it might be helpful if an employee or customer suffers a heart attack. It's possible for an ordinary expense to be *unnecessary* — but, to be deductible, an expense must be ordinary *and* necessary.

A deductible amount must be reasonable in relation to the benefit expected. For example, if you're attempting to land a \$3,000 deal, a \$65 lunch with a potential client should be OK with the IRS. (The Tax Cuts and Jobs Act eliminated most deductions for entertainment expenses but retained a 50% deduction for business meals.)

### Proceed with caution

The deductibility of some expenses is clear, while others are more complicated. Keep careful records to substantiate expenses you plan to deduct. Generally, if an expense seems like it's not normal in your industry — or could be considered personal or extravagant — proceed with caution. Not surprisingly, the IRS and courts don't always agree with taxpayers about what is ordinary and necessary. (See examples in "Relevant U.S. Tax Court cases" below.) Contact us with questions about deductibility.

### Sidebar:

#### Relevant U.S. Tax Court cases

Here are three recent U.S. Tax Court cases in which specific taxpayer deductions were disallowed:

1. A married couple owned an engineering firm. For two tax years, they claimed depreciation of \$76,264 on three vehicles, but didn't provide required details, including each vehicle's ownership, cost and useful life. They claimed \$34,197 in mileage deductions and provided receipts and mileage logs, but the court found they didn't show related business purposes. The court also found the mileage claimed included commuting costs, which can't be written off. The court disallowed these deductions and assessed taxes and penalties. (TC Memo 2023-39)
2. The court ruled that a married couple wasn't entitled to business tax deductions because the husband's consulting company failed to show that it was engaged in a trade or business. In fact, invoices produced by the consulting company predated its incorporation. And the court ruled that even if the expenses were legitimate, they weren't properly substantiated. (TC Memo 2023-80)
3. A physician specializing in gene therapy deducted legal expenses of \$360,295 for two years on Schedule C of his joint tax returns. The court found that most of the legal fees were to defend the husband against personal conduct issues. The court denied the deduction for personal legal expenses but allowed a deduction for \$13,000 for business-related legal expenses. (TC Memo 2023-42)