

## FOUNDATIONS SERIES

# Baratelli Foundations: Tax Deductions Reference

## Business Deductions for US Small Business, Self-Employed, and Single-Member LLCs

*For: small business owners, freelancers, single-member LLCs, growing businesses with employees*

The US tax code allows businesses to deduct expenses that are **ordinary and necessary** to operate. That single phrase — from IRC Section 162 — is the foundation of every business deduction in this guide. The work is in the application: knowing which expenses qualify, what documentation is required, where the limits sit, and where the most common audit-bait categories live. This guide walks the major categories with practitioner-mentor neutrality — what the rules actually say, the documentation you need, and where to be careful. **Tax law changes constantly**; thresholds and rules cited here reflect 2026 guidance and the publisher's best understanding at the date of publication. Always verify current figures with the IRS and consult a CPA or EA for your specific situation.

**Educational disclaimer.** This guide is published by Baratelli Institute for general educational purposes only. Nothing here constitutes accounting, tax, legal, or investment advice. Numbers, thresholds, and rules cited reflect the publisher's understanding at the date of publication and are subject to change; always consult current primary sources and a qualified professional before acting on any specific matter. The author and Baratelli Institute disclaim any liability arising from use of this material.

**Important.** This guide is general reference, not a tax return position. Every position depends on facts and circumstances; consult a CPA before filing. OBBBA-affected provisions have inconsistent effective dates. Confirm the effective date for your filing year before relying on any figure in this guide. The figures, thresholds, and statutory positions cited reflect U.S. federal tax law as of the date of publication and may have changed since; tax law is amended frequently — including by post-2025 legislation such as the One Big Beautiful Bill Act (OBBBA) — and individual circumstances vary materially. Before relying on any deduction discussed here, verify the current figure with the IRS at [irs.gov](https://www.irs.gov) and consult a CPA, EA, or tax attorney for your specific situation. Baratelli Institute does not prepare tax returns and does not provide individualized tax advice; nothing in this guide creates an advisor-client relationship.

	Topic	What's Covered
<b>Section 1</b>	<b>The Basics</b>	Ordinary & necessary; burden of proof; Cohan; documentation
<b>Section 2</b>	<b>Vehicle and Auto</b>	Standard mileage vs actual; commuting vs business
<b>Section 3</b>	<b>Home Office</b>	Regular & exclusive use; simplified vs actual; recapture
<b>Section 4</b>	<b>Meals and Entertainment</b>	50% meals; 100% exceptions; entertainment disallowed
<b>Section 5</b>	<b>Travel</b>	Overnight rule; transportation, lodging, per diem; mixed
<b>Section 6</b>	<b>Depreciation &amp; Capital</b>	Sec 179; bonus; de minimis; MACRS; recapture
<b>Section 7</b>	<b>Retirement Plans</b>	SEP-IRA, SIMPLE, Solo 401(k), 401(k); OBBBA changes
<b>Section 8</b>	<b>Health Insurance</b>	Self-employed health; HSAs; S-corp owner W-2 dance
<b>Section 9</b>	<b>Wages &amp; Owner Comp</b>	Reasonable comp; guaranteed payments; 1099 vs W-2
<b>Section 10</b>	<b>Professional Services</b>	Legal, accounting, software, education, QBI implications
<b>Section 11</b>	<b>Bad Debts, Theft, Casualty</b>	When and how to claim losses
<b>Section 12</b>	<b>Disallowed / Limited</b>	Entertainment, club dues, political, fines, lobbying
<b>Section 13</b>	<b>Documentation Checklist</b>	Per deduction: what receipt/log/contract you need

## Section 1 - The Basics: Ordinary and Necessary

*Section 162: the load-bearing phrase behind every business deduction*

**IRC Section 162(a)** allows a deduction for 'all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.' That sentence does the work for every deduction discussed in this guide. **Ordinary** means common and accepted in your trade. **Necessary** means helpful and appropriate for the business — not indispensable. The burden of proof is on the taxpayer to substantiate every deduction claimed. Adequate records and contemporaneous documentation are the difference between a sustained deduction and a disallowed one.

### #01 Ordinary and Necessary - the Section 162 Standard

Courts have applied this two-part test for decades. **Ordinary** means an expense common in your line of business; you do not need to incur it every year, but it must be the kind of expense someone in your trade would normally incur. **Necessary** means appropriate and helpful in carrying on the business. The expense need not be required — just useful.

**Key Insight:** *The narrower the connection to your trade, the better. A web designer's Adobe Creative Cloud subscription is plainly ordinary and necessary. The same designer's bass-fishing-pole purchase is not - unless the bass-fishing pole is being used in a paid client photo shoot.*

### #02 Burden of Proof and the Cohan Rule

The taxpayer bears the burden of proving each deduction. Adequate records are documentary (receipts, invoices, bank statements, written logs) and contemporaneous (created at or near the time of the expense). Under the **Cohan rule** (from a 1930 Second Circuit decision), if a taxpayer can establish that an expense was incurred but cannot prove the exact amount, the court may estimate a reasonable amount — but the court is not required to, and Cohan does NOT apply to categories where the Code mandates strict substantiation: travel, meals, vehicle, business gifts, and listed property (see IRC Section 274(d)).

**Key Insight:** *The Cohan rule is a backstop, not a strategy. The categories Section 274(d) excludes - travel, meals, vehicle, gifts, listed property - are exactly the categories where weak documentation hurts most. Build documentation discipline at the time of the transaction.*

### #03 Documentation Discipline

A defensible deduction has four traceable artifacts: **amount** (what was spent), **time** (when), **place** (where), and **business purpose** (why). Digital receipts in a folder or in QBO with notes meet all four. The single most common audit-bait pattern is a charge on a bank or credit card statement with no supporting documentation behind it.

Documentation Element	Acceptable Forms
Amount	Receipt, invoice, bank/CC statement
Time	Date on receipt; entry in calendar
Place	Receipt address; calendar; mileage log
Business purpose	Note on receipt or in software; meeting note in calendar

**Key Insight:** A two-line note typed when you upload the receipt - who you met or what you were doing - takes 10 seconds and is the difference between sustained and disallowed.

## Section 2 - Vehicle and Auto Deductions

*Standard mileage vs actual expenses; commuting vs business*

Business vehicle use is one of the most-claimed and most-audited deductions. Two methods are available and you must choose one per vehicle per year (with some rules about switching). Commuting between home and your regular place of business is NEVER deductible — that is personal. Business miles are: client visits, supply runs, business errands, travel between work sites.

### #04 Standard Mileage Method

Multiply business miles driven by the IRS standard mileage rate. The 2026 IRS standard business mileage rate is **72.5 cents per mile** (IRS Notice 2026-10). This rate captures fuel, maintenance, insurance, registration, and depreciation in a single per-mile figure. You may also deduct business-related parking and tolls separately. *Effective tax year: 2026 (IRS Notice 2026-10; figure changes annually — verify at IRS.gov for your filing year).*

#### Standard Mileage Deduction

$$\text{Deduction} = \text{Business Miles} \times \text{IRS Standard Mileage Rate}$$

**Key Insight:** *If you plan to use standard mileage long-term, you must choose it in the first year the vehicle is placed in service. You can later switch to actual expenses, but switching from actual to standard is limited.*

### #05 Actual Expense Method

Track all operating costs (fuel, oil, maintenance, repairs, insurance, registration, lease payments OR depreciation if owned) and deduct the business-use percentage. Business-use percentage = business miles divided by total miles for the year. Actual usually wins for expensive vehicles, lease arrangements, or vehicles with heavy operating cost.

Cost Element	Notes
Fuel	All grades; do NOT use per-mile fuel allowance
Maintenance & repairs	Oil, tires, service, mechanical
Insurance	Auto premium for the vehicle
Registration & fees	State/local registration; license
Lease payments	If leased - subject to luxury auto limits
Depreciation	If owned - subject to luxury auto limits
Parking & tolls	Business-related; deductible separately

**Key Insight:** If your business-use percentage is 60% and total actual costs were \$10,000, your deduction is \$6,000. Mileage log integrity drives the business-use percentage - if you cannot prove the miles, you cannot defend the percentage.

### #06 Mileage Log Discipline

A defensible mileage log records, for each business trip: date, starting odometer or starting location, ending odometer or ending location, business purpose, and miles. Several apps (MileIQ, QuickBooks Self-Employed, Stride, Hurdlr, others) auto-track miles via phone GPS and let you classify trips daily. The IRS expects contemporaneous logs; reconstructed-after-the-fact logs are vulnerable in audit.

BUSINESS MILES	PERSONAL MILES
DEDUCTIBLE: client visits, supply runs, between-office travel, off-site work, business errands, networking events.	NOT DEDUCTIBLE: commute from home to regular workplace, personal errands, family travel, post-work side trips.

**Key Insight:** If your home is your principal place of business (qualifying home office), then trips from home to clients ARE business miles - because the trip is between work locations. This is one of the biggest practical benefits of a qualifying home office.

## Section 3 - Home Office Deduction

*Regular and exclusive use; simplified method vs actual method; recapture*

The home office deduction (IRC Section 280A) is available to self-employed taxpayers and to employees in narrow circumstances (post-TCJA, unreimbursed employee business expenses are not deductible for federal purposes through 2025, with OBBBA changes affecting later years; confirm at IRS.gov for your filing year). For self-employed taxpayers (Schedule C, partnership, S-corp owner), the home office can be a meaningful deduction. The threshold tests are strict.

### #07 The Two-Part Test - Regular and Exclusive Use

**Regular use:** the space is used for business on a continuing basis (not occasionally). **Exclusive use:** the space is used ONLY for business - no personal use, not even occasionally. The space must also be the principal place of business (or used to meet clients in the normal course of business, or be a separate structure). A dining-room table that doubles as a desk fails the exclusive-use test.

**Key Insight:** A spare bedroom converted to an office passes. A corner of the living room with a desk fails - the rest of the room is personal space. The IRS is strict on the exclusivity test.

### #08 Simplified Method (Safe Harbor)

The simplified method allows **\$5 per square foot**, capped at **300 square feet** (so maximum \$1,500 per year). No depreciation; no recapture on sale of home. Take 5 minutes to compute. Best for small home offices and taxpayers who do not want recordkeeping or recapture exposure.

#### Simplified Home Office

$$\text{Deduction} = \text{Square Footage (max 300)} \times \$5/\text{sqft}$$

**Key Insight:** If your actual home-office expenses are more than \$1,500 a year (high-cost area, large office), actual method wins on dollars - but adds recapture exposure on sale. Many practitioners default to simplified for a small office, actual for a substantial one.

**#09 Actual Method**

Compute the business-use percentage (business sqft divided by total home sqft) and apply it to actual home expenses: utilities, insurance, mortgage interest, property tax, repairs, depreciation. Direct expenses (entirely for the office - like painting just the office) are 100% deductible; indirect expenses (whole-home expenses) are deductible at the business-use %.

SIMPLIFIED	ACTUAL
USE SIMPLIFIED when: office is small (under 200 sqft), actual costs are modest, you want to avoid recapture on home sale.	USE ACTUAL when: office is large, you have high home costs (HCOL area), you accept recapture exposure for larger current deduction.

**Key Insight:** Home office depreciation under the actual method creates a depreciation recapture obligation when you sell your home - the portion of gain attributable to depreciation taken is taxed at ordinary rates (capped at 25%). The simplified method avoids this entirely.

## Section 4 - Meals and Entertainment

*50% meals; 100% exceptions are narrow; entertainment generally disallowed*

TCJA (effective 2018) eliminated the entertainment deduction. Most entertainment expenses are now non-deductible regardless of business purpose. Meals remain partially deductible at 50%, with narrow 100% exceptions. The brief 100% meals deduction enacted for 2021-2022 has expired; as of 2026 the standard business-meals rate is 50%.

### #10 The 50% Meals Rule

Business meals are 50% deductible when: (1) the expense is ordinary and necessary, (2) the meal is not lavish or extravagant, (3) the taxpayer (or an employee) is present, and (4) there is a valid business purpose with a current or prospective business contact. Documentation must capture amount, time, place, business purpose, and the business relationship of the person dined with.

**Key Insight:** *Standalone food at an entertainment event (concert, sporting event) can still be 50% deductible IF separately stated on the bill. The entertainment portion (tickets) is not deductible; the meal portion is, at 50%.*

## #11 The 100% Meals - Narrow Exceptions

A small set of meals remain 100% deductible: (1) meals at company-wide employee events (holiday party, summer picnic), (2) meals included in employee compensation as a taxable fringe (W-2 wages), (3) certain meals at conferences sold to attendees as part of the registration fee, (4) meals provided to the general public for advertising or goodwill purposes. The employer-provided 'meals on premises for the convenience of employer' deduction was reduced from 100% to 50% by TCJA and, under the OBBBA, is generally non-deductible beginning in 2026. *Effective tax year: 2026 (employer-convenience meals 0%; OBBBA-confirmed; tax years beginning after December 31, 2025).*

Meal Type	Deductibility
Client / prospect meal (typical)	50%
Employee travel meal	50%
Company-wide employee event (holiday party)	100%
Meal taxable to employee (W-2 fringe)	100% (it's wages)
Meals on premises for employer convenience	50% through 2025; 0% beginning 2026 (OBBBA)
Snacks in break room	50% through 2025; 0% beginning 2026 (OBBBA)

**Key Insight:** Always keep itemized receipts for meals. A credit-card-slip-only is the IRS's least favorite documentation; an itemized receipt PLUS a note of who attended and why is the best.

## #12 Entertainment - Generally NOT Deductible

Sporting event tickets, theater tickets, concerts, golf outings, club memberships used for entertainment: not deductible. Even when there is a clear business purpose. The TCJA disallowance is structural. Two narrow carve-outs survive: (1) the cost of food/drinks at an entertainment event if separately stated and otherwise qualifying as a 50% meal; (2) entertainment included as compensation to an employee (taxable as W-2).

ALWAYS	USUALLY (if...)	RARELY	NEVER
Employee holiday party (100%)	Client meal with documented purpose (50%)	Stadium suite catering separately stated (food portion 50%)	Sports tickets, theater tickets, golf greens fees

**Key Insight:** The pre-2018 'directly related' and 'associated with' entertainment categories no longer exist for federal deduction. State conformity varies; check your state.

## Section 5 - Travel

*Overnight rule; transportation; lodging; per diem; mixed business / personal*

Travel is deductible when the taxpayer is **away from home** in the pursuit of a trade or business. 'Away from home' has a technical meaning: you must be away from your tax home long enough to require sleep or rest (essentially overnight). Same-day trips to a nearby city are transportation, not travel.

### #13 Transportation - Getting There and Back

Airfare, train, rental car, taxi, rideshare, mileage on personal vehicle: 100% deductible when the trip is primarily for business. 'Primarily' is judged by days spent on business vs personal.

BUSINESS TRIP	PERSONAL TRIP
<p>PRIMARILY BUSINESS: &gt; 50% of days are business; all transportation is 100% deductible.</p>	<p>PRIMARILY PERSONAL: &lt; 50% of days are business; transportation is NOT deductible (lodging/meals only on business days).</p>

**Key Insight:** *Travel-day count: the day you depart and the day you return both count as business days if the purpose is business. Weekend days in between business meetings count as business days if staying over saves money or makes business sense.*

### #14 Lodging

Lodging is 100% deductible for business nights (away from tax home). Personal nights extended for vacation are not deductible. Keep folio receipts; the credit-card charge alone is not enough.

**Key Insight:** *If a spouse or family member travels with you, only your portion of lodging is deductible. When the hotel charges the same room rate single or double, your portion is 100%; when a double-occupancy rate applies, deduct the single-rate equivalent.*

## #15 Meals on Travel and the Per Diem Option

Meals while traveling on business are subject to the same 50% rule. As an alternative to tracking actual meal expenses, taxpayers may use the IRS standard per-diem (M&IE - meals and incidental expenses) for the locality. Self-employed taxpayers may only use the per diem for meals, not lodging. The federal per-diem rates are published by GSA and updated annually.

**Key Insight:** *Per diem simplifies documentation but you still need to substantiate time, place, and business purpose. The per diem replaces the receipt requirement for amount, not for everything.*

## #16 Mixing Business and Personal Travel

Common scenario: business trip to a destination, extended weekend for sightseeing. Allocate carefully. Business-day expenses are deductible; personal-day expenses are not. Airfare is fully deductible if the primary purpose was business. Per-day expenses (lodging, meals) are deducted only on business days.

**Key Insight:** *If a spouse travels with you, document whether the spouse is a bona fide employee with a business purpose for the trip (rare); otherwise the spouse's travel costs are not deductible. A 'bona fide employee' requires real work and W-2 compensation, not a paperwork title.*

## Section 6 - Depreciation and Capital Items

*Section 179, bonus depreciation, de minimis safe harbor, MACRS*

When you buy property that lasts more than a year, you generally cannot deduct the full cost in the year of purchase - you must capitalize and depreciate it. Several elections accelerate depreciation: Section 179 expensing, bonus depreciation, and the de minimis safe harbor for small-dollar items. The interplay matters and the limits are indexed annually - confirm at IRS.gov for your filing year.

### #17 Section 179 Expensing

Section 179 lets a taxpayer fully expense qualifying property in the year placed in service, up to an annual limit. For 2026 the Section 179 deduction limit is **\$2.56 million**, with the phase-out beginning at **\$4.09 million** of qualifying property placed in service (full phase-out at \$6.65 million). Section 179 cannot create a loss; the deduction is limited to taxable business income. *Effective tax year: 2026 (Section 179, IRC §179(b)(1); \$2.56M limit / \$4.09M phase-out threshold; thresholds adjust annually for inflation — verify at IRS.gov).*

#### Section 179 (Mechanics)

**Sec 179 deduction = Lesser of (1) Cost of Qualified Property and (2) Annual Limit, capped at Business Taxable Income.**

**Key Insight:** *Section 179 applies to tangible personal property used in business (equipment, machinery, office furniture, certain software, qualified improvement property for nonresidential real property). Real estate generally does NOT qualify (with the QIP exception).*

### #18 Bonus Depreciation

Bonus depreciation lets a taxpayer immediately deduct a percentage of the cost of qualifying property. After 100% bonus (2017-2022), TCJA's scheduled phase-down ran 80% (2023), 60% (2024), and 40% (early 2025). The One Big Beautiful Bill Act (OBBBA), enacted July 2025, **restored 100% bonus depreciation for qualifying property acquired and placed in service after January 19, 2025**, and made the 100% rate permanent. Bonus depreciation, unlike Section 179, CAN create a loss. *Effective tax year: property placed in service after January 19, 2025 (OBBBA-permanent; IRC §168(k)).*

**Key Insight:** *Section 179 vs bonus depreciation: 179 is elective and limited by taxable income; bonus is automatic (election to opt OUT) and can create a loss. Many practitioners use Section 179 first for selected assets, then bonus for the rest.*

### #19 De Minimis Safe Harbor

Under the tangible property regulations, taxpayers may elect to expense items below a per-item threshold: **\$2,500 per item** for taxpayers without an Applicable Financial Statement (AFS), **\$5,000 per item** with AFS. The election is made annually on the return. The safe harbor lets you expense laptops, small tools, office furniture without capitalizing - dramatically simplifying recordkeeping.

**Key Insight:** The de minimis election is annual and applies to all qualifying property. You must have a written accounting policy at the beginning of the tax year stating the expensing threshold. Without the written policy in place, the election is challenged in audit.

### #20 MACRS - Modified Accelerated Cost Recovery System

When property does not qualify for Section 179 or bonus depreciation, or when these are not elected, MACRS applies. MACRS assigns property to a class life (5-year, 7-year, 15-year, 27.5-year for residential rental, 39-year for nonresidential real property) and prescribes depreciation tables. The half-year convention is standard; the mid-quarter convention applies if >40% of asset additions occur in Q4.

Asset Class	Recovery Period	Examples
3-year	3-year	Certain tools, short-life equipment
5-year	5-year	Vehicles, computers, office equipment
7-year	7-year	Office furniture, most machinery
15-year	15-year	Land improvements, QIP
27.5-year	27.5-year	Residential rental real property
39-year	39-year	Nonresidential real property

**Key Insight:** The right answer for new assets is almost always: take 179 up to the limit, then take bonus on the rest, then let MACRS handle whatever bonus does not cover. Confirm current-year limits with your CPA.

## #21 Depreciation Recapture on Sale

When you sell depreciated property, the gain attributable to depreciation already taken is **recaptured** and taxed at ordinary rates (capped at the maximum ordinary rate or 25% for Section 1250 real property). This is one of the most-missed consequences of accelerated depreciation - you got a bigger deduction up front but the gain on sale is taxed harder.

**Key Insight:** *When you sell business property, work backwards: how much depreciation did you take, what is the remaining basis, what is the sale price, what is the gain, what portion is ordinary (recapture) and what is capital? A CPA earns their fee on this calculation.*

### CROSS-REFERENCE | From Foundations: Journal Entries Reference

Depreciation, Section 179, and bonus depreciation are recorded via journal entries (see entries #21-#23 in Foundations: Journal Entries Reference). Book depreciation per GAAP often differs from tax depreciation - the difference creates a deferred tax asset or liability tracked outside the COA. See Foundations: Accounting Reference for the book-vs-tax mechanics.

## Section 7 - Retirement Plan Contributions

*SEP-IRA, SIMPLE-IRA, Solo 401(k), traditional 401(k); the employer-side deduction*

Retirement plan contributions are one of the most tax-advantaged deductions available to small business owners. The right plan depends on whether you have employees, how much you want to contribute, and how much administrative complexity you can tolerate. **The One Big Beautiful Bill Act (OBBBA) and SECURE 2.0 have modified contribution limits and rules effective through 2026 - confirm at IRS.gov for your filing year.**

### #22 SEP-IRA - Simplest for Solos with Few or No Employees

Simplified Employee Pension IRA. Employer-only contributions; no employee deferral. Contribution limit: lesser of 25% of compensation (20% for self-employed after self-employment-tax adjustment) and the annual 415(c) limit (**\$72,000 for 2026**). Easy to set up, no annual Form 5500 required for solo plans. Drawback: if you hire employees, you must contribute the same percentage of comp for all eligible employees. *Effective tax year: 2026 (IRC §415(c); limit adjusts annually for inflation — verify at IRS.gov).*

**Key Insight:** *SEP-IRA is ideal for a high-income solo who wants to contribute the maximum with minimum admin. Once you add eligible employees, the equal-percentage requirement makes it expensive fast.*

### #23 SIMPLE-IRA - Small Employer Plan

Savings Incentive Match Plan for Employees. Employee deferral up to an annual limit (**\$17,000 for 2026**; catch-up adds for 50+), employer match of 3% (or 2% nonelective for all eligible employees). Available to employers with 100 or fewer employees. Lower limits than 401(k) but minimal admin. *Effective tax year: 2026 (IRC §408(p); deferral limit adjusts annually for inflation — verify at IRS.gov).*

**Key Insight:** *SIMPLE-IRA is the standard small-employer plan. You cannot run a SIMPLE-IRA and a Solo 401(k) in the same year for the same business - the two are mutually exclusive.*

### #24 Solo 401(k) - High Limits for True Solo / Spousal Businesses

For self-employed individuals (and a spouse working in the business) with no other employees. Combines employee deferral (**\$24,500 for 2026**) and employer profit-sharing (up to 25% of compensation), capped at the annual 415(c) limit (**\$72,000 for 2026**). Catch-up for 50+ adds further. Roth option available. Once you hire a non-spouse employee, the Solo 401(k) ends. *Effective tax year: 2026 (IRC §402(g) elective deferral \$24,500; IRC §415(c) overall cap \$72,000; both adjust annually for inflation — verify at IRS.gov).*

**Key Insight:** The Solo 401(k) is the highest-contribution single-participant plan. Many solos compare SEP vs Solo 401(k) - Solo 401(k) almost always wins at moderate-to-high income because the employee deferral piece is a percentage-free \$24,500 (2026).

### #25 Traditional 401(k) - For Growing Companies

Standard employer-sponsored 401(k). Employee deferral with optional employer match or profit-sharing. Subject to nondiscrimination testing unless the plan adopts safe-harbor provisions (safe-harbor 401(k) avoids most testing in exchange for required employer contributions). Annual Form 5500 required. The right choice for businesses with W-2 employees.

Plan	Best For	Employer Deduction	Admin Burden
SEP-IRA	Solo or family-only	Up to 25% of comp (cap \$72K, 2026)	Low
SIMPLE-IRA	100 or fewer EEs	Match 3% or 2% nonelective	Low
Solo 401(k)	Solo + spouse only	EE \$24.5K + 25% PS (cap \$72K, 2026)	Low-medium
Traditional 401(k)	Growing W-2 workforce	Match / PS as plan designed	Medium-high

**Key Insight:** The Setting Every Community Up for Retirement Enhancement Act (SECURE 2.0) and OBBBA changed many rules: auto-enrollment requirements for new 401(k) plans, expanded catch-up rules, Starter 401(k) safe harbor. Confirm what applies to your plan year.

## #26 Contribution Deadlines

Employer contributions can generally be made up to the due date of the business tax return (including extensions). Employee 401(k) deferrals must be deposited promptly during the year. SEP-IRA contributions can be made up to the tax-return due date including extensions, even after year-end.

**Key Insight:** *If you extend your business tax return to October 15, your employer contribution to the SEP or 401(k) profit-sharing can be made through that extended deadline. Useful for cashflow planning at year-end.*

## Section 8 - Health Insurance and Medical

*Self-employed health insurance deduction; HSAs; S-corp owner W-2 dance*

Health insurance and medical expenses sit in their own corner of the tax code. The self-employed health insurance deduction is an above-the-line deduction. HSA contributions are deductible at the individual level. S-corp owner-employees navigate a specific W-2 procedure to retain the deduction.

### #27 Self-Employed Health Insurance Deduction

Self-employed taxpayers (Schedule C, partnership, or S-corp owners holding more than 2% of shares) may deduct premiums for health, dental, and qualifying long-term-care insurance for themselves, spouse, dependents, and children under age 27. The deduction is taken above the line (Schedule 1) and is limited to earned income from the business. Premiums cannot be deducted if the taxpayer is eligible for employer-subsidized coverage from another employer (including a spouse's employer).

**Key Insight:** *The self-employed health insurance deduction reduces AGI and therefore can unlock other AGI-sensitive items (IRA contributions, Roth conversions, education credits).*

### #28 HSA Contributions

Health Savings Accounts pair with high-deductible health plans (HDHPs). 2025 contribution limits: **\$4,300 self-only / \$8,550 family** (catch-up \$1,000 for 55+). **Verify 2026 figures.** Contributions are deductible (above the line). Distributions for qualifying medical expenses are tax-free. HSAs can be a powerful retirement-medical-savings tool when funded for many years. *Effective tax year: 2025 limits cited; 2026 HSA contribution and HDHP-threshold limits adjust annually under IRC §223 — verify the 2026 figures at IRS.gov before funding.*

**Key Insight:** *The HDHP minimum deductible and out-of-pocket-maximum thresholds adjust annually. Confirm your plan meets HDHP requirements or your HSA contribution may be disqualified.*

### #29 S-Corp Owner-Employee - The W-2 Dance

An S-corp's >2% shareholder cannot deduct health insurance as a business expense at the S-corp level in the usual sense. The procedure: (1) S-corp pays the premium, (2) S-corp reports the premium as wages on the owner's W-2 (subject to income tax but NOT FICA), (3) the owner takes the self-employed health insurance deduction on Schedule 1 (Form 1040). This 'wash' result preserves the deduction for the owner.

**Key Insight:** *Missing the W-2 step is one of the most common S-corp errors. If premiums are paid by the S-corp but not reported on the W-2, the IRS position is that NO deduction is allowed. Get the W-2 step right at year-end.*

## Section 9 - Wages and Owner Compensation

*Reasonable comp for S-corp owners; W-2 wages vs guaranteed payments; 1099 contractor rules*

Wages paid to employees are deductible. The question is who counts as an employee, what counts as reasonable compensation, and where the line sits between W-2 wages and other forms of owner compensation. Misclassification (employee vs contractor) and unreasonably low S-corp comp are two of the most common audit issues.

### #30 Reasonable Compensation - S-Corp Owners

S-corp owners who work in the business must take 'reasonable compensation' as W-2 wages before distributions. The S-corp deducts the wages (and pays payroll taxes on them). Distributions are NOT subject to FICA. The temptation is to pay zero wages and take everything as distributions; the IRS audits this and recharacterizes shortfalls as wages plus penalties.

ALWAYS	USUALLY (if...)	RARELY	NEVER
W-2 wages paid for actual work performed	Compensation in line with comparable industry / role / region data	Compensation set below comparable-comp data without justification	Zero wages while taking large distributions and doing actual work

**Key Insight:** Reasonable comp is determined by what comparable workers earn for similar work, in similar regions, in similar roles. Document the determination at year-end (industry data, comparable salary databases, role descriptions) and keep the file.

### #31 Guaranteed Payments to Partners (Partnership / Multi-Member LLC)

A partnership cannot pay W-2 wages to a partner. Instead, partners receive guaranteed payments (deductible by the partnership, ordinary income to the partner, subject to SE tax on the partner's return). The partnership's deduction reduces partnership ordinary income; the recipient partner reports the guaranteed payment as ordinary income.

**Key Insight:** Many founders form an LLC taxed as partnership not realizing they cannot take W-2 wages. If W-2 wage structure is important (for retirement plan eligibility, mortgage qualification, Solo 401(k) deferrals), structure as S-corp instead.

### #32 1099 Contractor vs W-2 Employee

The classification depends on the degree of control the business exerts over how, when, and where the work is performed. The IRS uses a three-category framework: (1) behavioral control, (2) financial control, (3) relationship type. Misclassification can trigger payroll-tax back-assessment plus penalties. State law (especially CA AB5 and the ABC test in many states) is often stricter than federal.

CONTRACTOR	EMPLOYEE
1099 CONTRACTOR: independent business, works for multiple clients, controls own schedule and methods, supplies own tools, paid per project.	W-2 EMPLOYEE: works set hours, directed by employer, uses employer's tools, integrated into business operations, paid hourly or salary.

**Key Insight:** When in doubt, the conservative answer is W-2. Misclassification penalties have grown steadily. State-level enforcement (CA, NJ, MA, others) is aggressive. Many states use the ABC test which is much stricter than the federal test.

### #33 Payroll Taxes - The Employer Side

Employer-side payroll taxes are deductible business expenses: 6.2% Social Security (on wages up to the annual base, **\$184,500 for 2026**), 1.45% Medicare (uncapped), FUTA (effective 0.6% on first \$7,000), state unemployment (rates vary). Employee-side withholding is NOT a business deduction (it is the employee's tax, withheld and remitted). *Effective tax year: 2026 (Social Security wage base per SSA cost-of-living adjustment; adjusts annually).*

**Key Insight:** Set up a separate payroll-tax liability account in QBO. When you pay the IRS for the combined payroll-tax deposit, it splits between the employee withholding (clearing a liability) and the employer's portion (clearing a different liability). Mixing these is the #1 payroll categorization mistake.

## Section 10 - Professional Services and Subscriptions

*Legal, accounting, consulting, software, education; QBI implications*

Most professional services are straightforward 'ordinary and necessary' deductions. A few categories have nuances - capitalization vs expense, education that crosses into a new field, and the Qualified Business Income (QBI) deduction's interaction with Specified Service Trade or Business (SSTB) classification.

### #34 Legal, Accounting, Consulting

Generally deductible when ordinary and necessary. Two exceptions to current expensing: (1) costs of acquiring an asset (legal fees to acquire real estate add to basis), (2) costs of starting a business (organizational and start-up costs are amortized, with a first-year election to expense up to \$5,000 each, phased out above \$50,000).

**Key Insight:** *Legal fees for personal matters (divorce, personal injury, estate planning) are not deductible against business income, even if you pay them through the business. Keep personal legal fees personal.*

### #35 Software Subscriptions

SaaS subscriptions used in the business (productivity, accounting, CRM, design, hosting) are 100% deductible when paid for the current period of use. Multi-year prepaid subscriptions are generally amortized over the period of use, though the de minimis safe harbor and the 12-month rule provide simplification for shorter prepaids.

**Key Insight:** *Software paid through a personal credit card and not reimbursed by the business is harder to defend. Get business subscriptions on a business credit card or set up a clean monthly expense report and reimbursement procedure.*

### #36 Education and Training

Education that maintains or improves skills in your current trade or business is deductible. Education that qualifies you for a new trade or profession is NOT deductible. Bar review courses, first-year CPA exam costs, and degree programs that change career are non-deductible. Continuing professional education and skills updates for your existing role are deductible.

MAINTAINS SKILLS	NEW TRADE
<p>DEDUCTIBLE: CLE, CPE, conference fees, books, skills-update workshops, certifications maintaining your current trade.</p>	<p>NOT DEDUCTIBLE: education preparing for new profession, first license / certification to enter new field, MBA pivoting career.</p>

**Key Insight:** The 'qualifies you for a new trade' standard is a bright line. A practicing CPA's tax-update CPE is deductible; that same CPA's law-school tuition is not. The new-trade rule does not consider economic reality; it considers credential gained.

### #37 QBI and the SSTB Limitation

The Qualified Business Income deduction (Section 199A) allows pass-through owners to deduct up to 20% of qualified business income. **Originally scheduled to sunset after 2025, the QBI deduction was made permanent by the One Big Beautiful Bill Act (OBBBA), enacted July 2025, for tax years beginning after December 31, 2025.** Specified Service Trades or Businesses (SSTBs - law, accounting, health, consulting, financial services, athletics, brokerage, and any business whose principal asset is the reputation or skill of one or more employees) face full phase-out of the QBI deduction once taxable income exceeds the upper threshold. *Effective tax year: tax years beginning after December 31, 2025 (OBBBA-permanent; IRC §199A).*

**Key Insight:** If you operate an SSTB and your income is near the QBI phase-out, retirement plan contributions can be doubly valuable - they both reduce current tax AND keep QBI-eligible income below the SSTB phase-out.

## Section 11 - Bad Debts, Theft, and Casualty Losses

*When and how to claim losses*

Losses can be deductible but the categories have specific timing and documentation requirements. Bad debts must be partially or wholly worthless. Theft and casualty losses for businesses are still deductible (the TCJA limitation applies to PERSONAL casualty losses, not business).

### #38 Business Bad Debts

A business bad debt is deductible when it becomes wholly or partially worthless. The taxpayer must have previously included the amount in income (for accrual taxpayers, this is automatic when the receivable was booked). Cash-basis taxpayers generally cannot deduct an uncollected receivable because they never recognized the income.

**Key Insight:** To support a bad-debt deduction, document collection efforts: dunning letters, collection-agency engagement, debtor bankruptcy filings, dissolution evidence. A receivable written off in your books without evidence of worthlessness is vulnerable.

### #39 Theft Losses (Business)

Business theft losses are deductible in the year the theft is discovered. The deduction is the lesser of the property's adjusted basis or the decline in fair market value, minus any insurance recovery. Document the theft: police report, insurance claim, internal investigation.

**Key Insight:** Embezzlement is a theft loss when discovered. The discovery year - not the year the embezzlement occurred - is the deduction year.

### #40 Casualty Losses (Business)

Business casualty losses (sudden, unexpected damage from fire, storm, accident, vandalism) are deductible. The deduction is the lesser of adjusted basis or decline in FMV, minus insurance recovery. The TCJA's 10%-of-AGI floor and disaster-area limitation apply only to personal casualty losses, NOT to business casualty losses.

**Key Insight:** For federally declared disaster areas, special elections allow taxpayers to claim the loss on the PRIOR-year return (carryback) instead of the current year. Useful for cashflow when the loss occurs in a low-income year.

## Section 12 - Common Disallowed or Limited Items

*Entertainment, club dues, political contributions, fines, lobbying*

Several common business expenditures are not deductible regardless of business connection. Knowing the disallowed list saves audit-trail headaches.

### #41 The Disallowed Categories

These items are categorically not deductible (or sharply limited) under current law.

Category	Treatment	Authority
Entertainment (general)	Not deductible	TCJA Sec 274(a)(1)
Club dues (any club)	Not deductible	Sec 274(a)(3)
Political contributions	Not deductible	Sec 162(e)
Lobbying (most)	Not deductible	Sec 162(e)
Fines and penalties (government)	Not deductible	Sec 162(f)
Illegal payments / bribes	Not deductible	Sec 162(c)
Personal expenses	Not deductible	Sec 262
Capital expenditures	Capitalized, not expensed	Sec 263
Excess executive comp (\$1M+ public)	Limited	Sec 162(m)
Excess employee comp (public co)	Section 280G parachute	Sec 280G

**Key Insight:** The fines-and-penalties disallowance includes traffic tickets (employee driving on business), parking violations, regulatory fines. The cost of remediation paid to fix a violation may be deductible; the fine itself is not.

## Section 13 - Documentation Checklist

*Per deduction: what receipt, log, or contract you need*

Below is the documentation expected for each major deduction category. The exact form varies, but the four elements - amount, time, place, business purpose - must be traceable. The 'extra' column lists category-specific items the IRS expects to see.

Category	Standard Docs	Category-Specific
Vehicle (standard mileage)	Mileage log	Date, miles, destination, business purpose per trip
Vehicle (actual)	All receipts + mileage log	Insurance, fuel, maintenance, depreciation schedule
Home office (simplified)	Square footage measurement	Photo / floor plan documenting exclusive-use area
Home office (actual)	All home-cost receipts + photos	Utilities, insurance, mortgage interest, property tax, depreciation
Meals (50%)	Itemized receipt + note	Names of attendees + business purpose noted at the time
Travel	Itinerary + receipts	Hotel folio, transportation receipts, business agenda
Section 179 / Bonus	Invoice + placed-in-service date	Detail of asset class, location, business-use %
MACRS depreciation	Asset schedule	Cost, date, class life, convention, accumulated depreciation
Retirement contributions	Plan documents + statements	Plan adoption agreement, contribution confirmations, W-2
Self-employed health ins	1095 or policy + payment records	Premium receipts, eligibility documentation
S-corp owner health (W-2 wash)	W-2 box 1 + box 14 'S corp 2% health'	W-2 reporting + Schedule 1 deduction
1099 contractors	W-9 + 1099-NEC + invoices	Contract or engagement letter; W-9 collected before payment
Bad debt write-off	Documentation of worthlessness	Collection letters, agency reports, bankruptcy filings
Casualty / theft	Police report + insurance claim	Photos, appraisals, insurance recovery records

**CROSS-REFERENCE | From Foundations: Journal Entries Reference**

Many tax-deductible categories require specific book entries that mirror the tax treatment - depreciation (entries #21-#23), accrued payroll and payroll taxes (entries #16-#20), bad debt (entries #6-#7). Book treatment can differ from tax treatment (book vs tax timing differences); see Foundations: Accounting Reference for how book-basis differs from tax-basis and where the differences are tracked.

**Educational disclaimer.** This guide is published by Baratelli Institute for general educational purposes only. Nothing here constitutes accounting, tax, legal, or investment advice. Numbers, thresholds, and rules cited reflect the publisher's understanding at the date of publication and are subject to change; always consult current primary sources and a qualified professional before acting on any specific matter. The author and Baratelli Institute disclaim any liability arising from use of this material.

**Important. This guide is educational reference material, not return-position advice.** Tax law changes constantly; the figures and rules cited reflect 2026 guidance to the best of the publisher's knowledge at publication. Specific limits and rates — mileage, Section 179, retirement contributions, FICA bases, QBI thresholds, bonus depreciation rates — are updated by the IRS and Congress and may differ from those cited here. **OBBBA-affected provisions have inconsistent effective dates; confirm the effective date for your filing year before relying on any figure.** Before filing or relying on any deduction strategy described in this guide, **consult a qualified CPA, Enrolled Agent, or tax attorney for your specific situation.** Baratelli Institute does not prepare tax returns and does not provide individualized tax advice; nothing in this guide creates an advisor-client relationship.

**NEXT STEP***From Foundations to Flagship***PRIMARY PATH****Tax Strategy Decoded (full practitioner depth)**

Foundations: Tax Deductions covers what is deductible. Tax Strategy Decoded covers what to DO about it - the planning vs compliance distinction. Entity selection, S-corp election timing, retirement plan design, real-estate planning (cost segregation, 1031, opportunity zones), state-tax SALT-cap workarounds, charitable strategies, multi-year tax planning, and the practitioner workflow that turns annual compliance into multi-year strategy. If this guide answered 'what can I deduct?', Tax Strategy Decoded answers 'what should I be doing differently across the next five years?'

**ALSO CONSIDER****Business Buyer's Guide**

If you are evaluating a target's tax positions during diligence - inside a search-fund acquisition, a strategic deal, or a private-equity platform investment - the Business Buyer's Guide walks through tax diligence: open audit risks, prior-year position quality, Section 382 NOL limitations, transfer pricing, sales-tax exposure, and the tax-structuring decisions that close the deal.

Visit [www.baratelliinstitute.com](http://www.baratelliinstitute.com) for the full library. *Mentoring at Scale.*