

# 8 Business Deductions

## ■ Tab 8 Contents ■

Per Diem Rates—Continental U.S. (CONUS)	8-1
NOL Default Rules	8-1
Common Elections	8-1
QBID—2025 Threshold Amounts and Phase-In Ranges	8-1
Amortization	8-1
Per Diem Rates	8-2
Per Diem Rates/High-Low Method	8-3
Truckers/Transportation Industry Chart	8-4
Business Deductions	8-4
Energy Efficient Commercial Buildings Deduction	8-6
Meals, Entertainment, Travel, and Lodging	8-9
Entertainment	8-9
Meals	8-9
Travel and Lodging	8-10
Accountable/Nonaccountable Plans	8-11
Reporting Reimbursements	8-12
Per Diem	8-12
Inventory/Cost of Goods Sold	8-13
Uniform Capitalization (UNICAP) Rules	8-14
Small Business Inventory Exception	8-15
Qualified Business Income Deduction (QBID)—IRC §199A	8-15
Qualified Business Income Deduction (QBID) Flowchart	8-16
Net Operating Loss (NOL)	8-20
Start-Up/Organizational Costs	8-22
Deduction/Amortization	8-22
Accounting Periods and Methods	8-23
Cash Method	8-23
Accrual Method	8-24
Change in Accounting Method	8-25
Accounting Periods	8-26

## Per Diem Rates—Continental U.S. (CONUS)

Effective:	10/1/25–9/30/26	10/1/24–9/30/25
M&IE	\$68	\$68
Lodging	\$110	\$110

For higher localities, see *Per Diem Rates*, page 8-2.

## NOL Default Rules (page 8-20)

Tax Year	Carryback Period	Carryforward Period	Taxable Income % Limit
Pre-2018	Varies by year <sup>1</sup>	20 years	100%
2018 – 2020	5-year <sup>1,2</sup>	Unlimited <sup>3</sup>	80% <sup>4</sup>
2021 and after	Not allowed <sup>2</sup>	Unlimited <sup>3</sup>	80%

<sup>1</sup> Election to waive carryback period allowed.

<sup>2</sup> 2 years for farm losses. See *Net Operating Losses on Farms*, Tab 5.

<sup>3</sup> Until loss is used up or taxpayer dies.

<sup>4</sup> 100% for losses utilized in tax years before 2021; 80% thereafter.

**Note:** When computing a taxpayer's NOL, the 20% qualified business income deduction (QBID) is not taken into account. See *Qualified Business Income Deduction (QBID)—IRC §199A*, page 8-15.

## ■ New for 2025 ■

- **Qualified business income deduction (QBID).** The threshold amounts and phase-in ranges have increased for the QBID. See *QBID—2025 Threshold Amounts and Phase-In Ranges*, below.
- **Research and experimental costs.** For tax years beginning after 2024, domestic research and experimental costs can be deducted. See *Research and Experimental Costs*, page 8-8.

## Common Elections

- Election to capitalize carrying charges, page 8-6.
- Election to amortize domestic research and experimental costs, page 8-8.
- Election to forgo reducing capitalized research expenses by reducing the research credit, page 8-8.
- Election to waive NOL carryback period, page 8-21.
- Elections to deduct, amortize, or capitalize start-up or organizational costs, page 8-22.
- Electing a tax year other than a calendar year, page 8-26.

## QBID—2025 Threshold Amounts and Phase-In Ranges (page 8-16)

	Single, HOH, QSS	MFJ	MFS
Threshold Amount	\$197,300	\$394,600	\$197,300
Phase-In Range	\$197,301 to \$247,300	\$394,601 to \$494,600	\$197,301 to \$247,300
Full Limitation Applies*	\$247,301	\$494,601	\$247,301

\* For specified service trade or business (SSTB), no QBID allowed.

## Amortization

A business deduction for amortization is first reported on Part VI, Form 4562, *Depreciation and Amortization*. The deductible amount is then carried to the "other expenses" line on the tax return.

	Period	IRC Code Section
Circulation expenditures*	3-years	59(e)
Research and experimental costs—		
inside the U.S.	5 years**	174A
Research and experimental costs—		
outside the U.S.	15 years	174
Intangible drilling costs*	60-months	59(e)
Mining development costs*	10-years	59(e)
Mining exploration costs*	10-years	59(e)
Pollution control facilities	60-months	169
Cost of acquiring a lease	lease term	178
Reforestation expenditures	84-months	194
Business start-up costs	180-months	195
Goodwill and other intangibles	15-years	197
Corporate organizational costs	180-months	248
Partnership organizational costs	180-months	709

\* Optional write-off method [IRC §59(e)]. No AMT adjustment required.

\*\* By election only. For tax years beginning after 2024, domestic research and experimental costs can be deducted. See *Research and Experimental Costs*, page 8-8.

## Per Diem Rates (page 8-12)

**Standard rates.** The standard per diem rates for travel within the Continental United States (CONUS) are:

- Effective October 1, 2025, \$68 for meals and incidental expenses (M&IE) and \$110 for lodging.
- Effective October 1, 2024, \$68 for M&IE and \$110 for lodging.

The following chart identifies key locations that allow a higher M&IE rate than the standard CONUS rates.

**Accountable plan lodging.** A lookup tool for lodging rates by location for employer reimbursements under an accountable plan is available at [www.gsa.gov/travel-resources](http://www.gsa.gov/travel-resources).

**Transition rules.** Taxpayers may continue to use the rates in effect for the first nine months of the year, instead of the rates updated on October 1, for the last three months of the year. The use of calendar year rates or fiscal year rates must be done consistently.

**Alaska and Hawaii.** Alaska and Hawaii per diem rates are established by the Department of Defense, see [www.travel.dod.mil/Travel-Transportation-Rates/Per-Diem/Per-Diem-Rate-Lookup/](http://www.travel.dod.mil/Travel-Transportation-Rates/Per-Diem/Per-Diem-Rate-Lookup/)

**Receipts.** For deduction purposes, when using the per diem rates, receipts are not required for M&IE but receipts are required for lodging. No lodging per diem is allowed for a business deduction, only actual expenses.

**Note:** The following chart identifies key locations that allow a higher M&IE rate. The counties encompassing these localities are typically included in the higher rate. Cities not listed below may be located in a listed county. Go to [www.gsa.gov/perdiem](http://www.gsa.gov/perdiem) to check the rate for a specific location.

Effective Date:	10/1/24	10/1/25	Effective Date:	10/1/24	10/1/25	Effective Date:	10/1/24	10/1/25	Effective Date:	10/1/24	10/1/25	Effective Date:	10/1/24	10/1/25
Location	M&IE	M&IE	Location	M&IE	M&IE	Location	M&IE	M&IE	Location	M&IE	M&IE	Location	M&IE	M&IE
Standard CONUS			Santa Cruz .....	\$86	\$86	<b>District of Columbia</b>			<b>Idaho</b>			<b>Massachusetts</b>		
Rate applies to all destinations not specifically listed ..	\$68	\$68	Santa Monica.....	\$92	\$92	Washington DC			Boise .....	\$86	\$86	Andover.....	\$80	\$80
<b>Alabama</b>			Santa Rosa .....	\$86	\$86	(also cities of			Coeur d'Alene .....	\$74	\$74	Boston/Cambridge ...	\$92	\$92
Birmingham .....	\$80	\$80	South Lake Tahoe .....	\$86	\$86	Alexandria/Fairfax/			Sun Valley/Ketchum..	\$80	\$80	Burlington/Woburn ..	\$86	\$86
Gulf Shores.....	\$74	\$74	Stockton.....	\$74	\$74	Falls Church			<b>Illinois</b>			Falmouth.....	\$86	\$86
Huntsville.....	\$74	\$74	Sunnyvale/Palo Alto/			and counties of			Bolingbrook/			Hyannis .....	\$92	\$92
Mobile.....	\$74	\$74	San Jose.....	\$92	\$92	Arlington/Fairfax			Romeoville/			Martha's Vineyard....	\$92	\$92
<b>Arizona</b>			Tahoe City.....	\$86	\$86	in Virginia and			Lemont .....	\$74	\$74	Nantucket.....	\$92	\$92
Grand Canyon/			Truckee .....	\$86	\$86	the counties of			Chicago.....	\$92	\$92	Northampton.....	\$80	\$80
Flagstaff.....	\$80	\$80	Ventura County.....	\$86	\$86	Montgomery/			East St. Louis/			Pittsfield .....	\$86	\$86
Kayenta.....	\$74	\$74	Visalia .....	\$80	\$80	Prince George's in			O'Fallon/Fairview			Plymouth/Taunton/		
Phoenix/Scottsdale..	\$86	\$86	West Sacramento/			Maryland).....	\$92	\$92	Heights .....	\$86	\$86	New Bedford .....	\$80	\$80
Sedona.....	\$92	\$92	Davis.....	\$80	\$80	<b>Florida</b>			Oak Brook Terrace...	\$80	\$80	Quincy.....	\$80	\$80
Tucson .....	\$80	\$80	Yosemite National			Boca Raton/Delray			<b>Indiana</b>			Springfield .....	\$74	\$74
<b>California</b>			Park .....	\$86	\$86	Beach/Jupiter.....	\$86	\$86	Bloomington.....	\$74	\$74	Worcester .....	\$80	\$80
Antioch/Brentwood/			<b>Colorado</b>			Bradenton.....	\$80	\$80	Indianapolis/Carmel..	\$80	\$80	<b>Michigan</b>		
Concord.....	\$86	\$86	Aspen .....	\$92	\$92	Cocoa Beach .....	\$74	\$74	Lafayette/West			Ann Arbor.....	\$80	\$80
Bakersfield/			Boulder/Broomfield..	\$80	\$80	Daytona Beach.....	\$80	\$80	Lafayette.....	\$74	\$74	Detroit.....	\$74	\$74
Ridgecrest.....	\$74	\$74	Colorado Springs.....	\$86	\$86	Fort Lauderdale .....	\$86	\$86	<b>Iowa</b>			Grand Rapids .....	\$80	\$80
Barstow/Ontario/			Cortez .....	\$74	\$74	Fort Myers .....	\$80	\$80	Dallas County.....	\$80	\$80	Holland.....	\$74	\$74
Victorville.....	\$86	\$86	Crested Butte/			Fort Walton Beach/			Des Moines.....	\$80	\$80	Mackinac Island .....	\$86	\$86
Death Valley.....	\$80	\$80	Gunnison .....	\$86	\$86	De Funiak Springs..	\$86	\$86	<b>Kansas</b>			Midland.....	\$74	\$74
Edwards AFB .....	\$86	\$86	Denver/Aurora .....	\$92	\$92	Gulf Breeze .....	\$74	\$74	Kansas City/			Petoskey.....	\$86	\$86
Eureka/Arcata/			Douglas County .....	\$80	\$80	Key West.....	\$86	\$86	Overland Park.....	\$80	\$80	Pontiac/		
McKinleyville.....	\$86	\$86	Durango .....	\$80	\$80	Miami.....	\$92	\$92	Auburn Hills.....	\$80	\$80	Auburn Hills.....	\$80	\$80
Fresno .....	\$86	\$86	Fort Collins/			Naples.....	\$80	\$80	Traverse City .....	\$80	\$80	<b>Minnesota</b>		
Los Angeles .....	\$86	\$86	Loveland.....	\$80	\$80	Orlando .....	\$80	\$80	<b>Missouri</b>			Duluth .....	\$86	\$86
Mammoth Lakes.....	\$86	\$86	Grand Lake .....	\$86	\$86	Panama City.....	\$80	\$80	Kansas City.....	\$80	\$80	Minneapolis/St. Paul..	\$92	\$92
Mill Valley/San			Montrose.....	\$74	\$74	Pensacola.....	\$74	\$74	St. Louis.....	\$86	\$86	Rochester.....	\$80	\$80
Rafael/Novato.....	\$92	\$92	Silverthorne/			Punta Gorda.....	\$74	\$74	<b>Montana</b>			<b>Missouri</b>		
Monterey.....	\$92	\$92	Breckenridge.....	\$92	\$92	Sarasota.....	\$86	\$86	Big Sky/West			Kansas City.....	\$80	\$80
Napa .....	\$92	\$92	Steamboat Springs...	\$92	\$92	Sebring.....	\$74	\$74	Yellowstone/			St. Louis.....	\$86	\$86
Oakhurst.....	\$80	\$80	Telluride .....	\$92	\$92	St. Augustine.....	\$80	\$80	Gardiner.....	\$80	\$80	<b>Nebraska</b>		
Oakland.....	\$92	\$92	Vail .....	\$92	\$92	Stuart.....	\$80	\$80	Helena .....	\$74	\$74	Omaha .....	\$80	\$80
Orange County.....	\$86	\$86	<b>Connecticut</b>			Tallahassee.....	\$80	\$80	Kalispell/Whitefish...	\$80	\$80	<b>Nevada</b>		
Palm Springs.....	\$86	\$86	Bridgeport/Danbury .	\$86	\$86	Tampa/			Missoula.....	\$74	\$74	Incline Village/Reno/		
Point Arena/Gualala..	\$86	\$86	Hartford.....	\$80	\$80	St. Petersburg.....	\$80	\$80	Sparks.....	\$80	\$80	Sparks.....	\$80	\$80
Sacramento .....	\$86	\$86	New Haven.....	\$80	\$80	Vero Beach.....	\$74	\$74	Las Vegas.....	\$86	\$86	<b>Nebraska</b>		
San Diego .....	\$86	\$86	New London/			<b>Georgia</b>			<b>Nebraska</b>			Omaha .....	\$80	\$80
San Francisco .....	\$92	\$92	Groton .....	\$86	\$86	Athens .....	\$74	\$74	<b>Nevada</b>			<b>Nebraska</b>		
San Luis Obispo.....	\$86	\$86	<b>Delaware</b>			Atlanta .....	\$86	\$86	Incline Village/Reno/			Omaha .....	\$80	\$80
San Mateo/Foster			Lewes .....	\$74	\$74	Augusta.....	\$74	\$74	Sparks.....	\$80	\$80	<b>Nebraska</b>		
City/Belmont.....	\$86	\$86	Wilmington .....	\$74	\$74	Jekyll Island/			Las Vegas.....	\$86	\$86	Omaha .....	\$80	\$80
Santa Barbara.....	\$92	\$92				Brunswick.....	\$86	\$86	<b>Nebraska</b>			<b>Nebraska</b>		
						Marietta.....	\$74	\$74	Omaha .....	\$80	\$80	Omaha .....	\$80	\$80
						Savannah .....	\$80	\$80	<b>Nebraska</b>			<b>Nebraska</b>		
									Omaha .....	\$80	\$80	Omaha .....	\$80	\$80
									<b>Nebraska</b>			<b>Nebraska</b>		
									Omaha .....	\$80	\$80	Omaha .....	\$80	\$80
									<b>Nebraska</b>			<b>Nebraska</b>		
									Omaha .....	\$80	\$80	Omaha .....	\$80	\$80
									<b>Nebraska</b>			<b>Nebraska</b>		
									Omaha .....	\$80	\$80	Omaha .....	\$80	\$80
									<b>Nebraska</b>			<b>Nebraska</b>		
									Omaha .....	\$80	\$80	Omaha .....	\$80	\$80
									<b>Nebraska</b>			<b>Nebraska</b>		
									Omaha .....	\$80	\$80	Omaha .....	\$80	\$80
									<b>Nebraska</b>			<b>Nebraska</b>		
									Omaha .....	\$80	\$80	Omaha .....	\$80	\$80
									<b>Nebraska</b>			<b>Nebraska</b>		
									Omaha .....	\$80	\$80	Omaha .....	\$80	\$80
									<b>Nebraska</b>			<b>Nebraska</b>		
									Omaha .....	\$80	\$80	Omaha .....	\$80	\$80
									<b>Nebraska</b>			<b>Nebraska</b>		
									Omaha .....	\$80	\$80	Omaha .....	\$80	\$80
									<b>Nebraska</b>			<b>Nebraska</b>		
									Omaha .....	\$80	\$80	Omaha .....	\$80	\$80
									<b>Nebraska</b>			<b>Nebraska</b>		
									Omaha .....	\$80	\$80	Omaha .....	\$80	\$80
									<b>Nebraska</b>			<b>Nebraska</b>		
									Omaha .....	\$80	\$80	Omaha .....	\$80	\$80
									<b>Nebraska</b>			<b>Nebraska</b>		
									Omaha .....	\$80	\$80	Omaha .....	\$80	\$80
									<b>Nebraska</b>			<b>Nebraska</b>		
									Omaha .....	\$80	\$80	Omaha .....	\$80	\$80
									<b>Nebraska</b>			<b>Nebraska</b>		
									Omaha .....	\$80	\$80	Omaha .....	\$80	\$80
									<b>Nebraska</b>			<b>Nebraska</b>		
									Omaha .....	\$80	\$80	Omaha .....	\$80	\$80
									<b>Nebraska</b>			<b>Nebraska</b>		
									Omaha .....	\$80	\$80	Omaha .....	\$80	\$80
									<b>Nebraska</b>			<b>Nebraska</b>		
									Omaha .....	\$80	\$80	Omaha .....	\$80	\$80
									<b>Nebraska</b>			<b>Nebraska</b>		
									Omaha .....	\$80	\$80	Omaha .....	\$80	\$80
									<b>Nebraska</b>			<b>Nebraska</b>		
									Omaha .....	\$80	\$80	Omaha .....	\$80	\$80
									<b>Nebraska</b>			<b>Nebraska</b>		
									Omaha .....	\$80	\$80	Omaha .....	\$80	\$80
									<b>Nebraska</b>			<b>Nebraska</b>		
									Omaha .....	\$80	\$80	Omaha .....	\$80	\$80
									<b>Nebraska</b>			<b>Nebraska</b>		
									Omaha .....	\$80	\$80	Omaha .....	\$80	\$80
									<b>Nebraska</b>			<b>Nebraska</b>		
									Omaha .....	\$80	\$80	Omaha .....	\$80	\$80
									<b>Nebraska</b>			<b>Nebraska</b>		
									Omaha .....	\$80	\$80	Omaha .....	\$80	\$80
									<b>Nebraska</b>			<b>Nebraska</b>		
									Omaha .....	\$80	\$80	Omaha .....	\$80	\$80
									<b>Nebraska</b>			<b>Nebraska</b>		
									Omaha .....	\$80	\$80	Omaha .....	\$80	\$80

## Per Diem Rates

Effective Date:	10/1/24	10/1/25	Effective Date:	10/1/24	10/1/25	Effective Date:	10/1/24	10/1/25	Effective Date:	10/1/24	10/1/25	Effective Date:	10/1/24	10/1/25
Location	M&IE	M&IE	Location	M&IE	M&IE	Location	M&IE	M&IE	Location	M&IE	M&IE	Location	M&IE	M&IE
<b>New Hampshire</b>			Niagara Falls.....	\$80	\$80	<b>Oregon</b>			<b>Tennessee</b>			Roanoke .....	\$74	\$74
Concord.....	\$74	\$74	Nyack/Palisades.....	\$80	\$80	Beaverton.....	\$80	\$80	Brentwood/Franklin..	\$86	\$86	Virginia Beach.....	\$74	\$74
Conway.....	\$80	\$80	Poughkeepsie .....	\$80	\$80	Bend .....	\$86	\$86	Chattanooga .....	\$74	\$74	Williamsburg/James		
Durham .....	\$74	\$74	Riverhead/			Clackamas.....	\$80	\$80	Knoxville.....	\$74	\$74	City and York		
Laconia .....	\$74	\$74	Ronkonkoma/			Eugene/Florence .....	\$80	\$80	Memphis .....	\$74	\$74	Counties .....	\$80	\$80
Lebanon/Lincoln/			Melville.....	\$86	\$86	Lincoln City.....	\$92	\$92	Nashville .....	\$86	\$86	<b>Washington</b>		
West Lebanon .....	\$74	\$74	Rochester.....	\$80	\$80	Portland.....	\$86	\$86	Everett/Lynnwood....	\$86	\$86	Ocean Shores .....	\$86	\$86
Manchester .....	\$74	\$74	Saratoga Springs/			Seaside .....	\$86	\$86	Olympia/Tumwater...	\$80	\$80	Port Angeles/Port		
Portsmouth.....	\$74	\$74	Schenectady .....	\$80	\$80	<b>Pennsylvania</b>			Arlington/Fort Worth/			Townsend .....	\$92	\$92
<b>New Jersey</b>			Syracuse/Oswego....	\$80	\$80	Allentown/Easton/			Grapevine .....	\$80	\$80	Richland/Pasco .....	\$86	\$86
Cherry Hill/			Tarrytown/White			Bethlehem.....	\$74	\$74	Austin .....	\$80	\$80	Seattle .....	\$92	\$92
Moorestown.....	\$80	\$80	Plains/New			Bucks County.....	\$80	\$80	Dallas.....	\$80	\$80	Spokane .....	\$86	\$86
Eatontown/Freehold.	\$86	\$86	Rochelle .....	\$92	\$92	Chester/Radnor/			Galveston.....	\$74	\$74	Tacoma .....	\$86	\$86
Edison/Piscataway...	\$80	\$80	Troy.....	\$80	\$80	Essington .....	\$80	\$80	Houston.....	\$80	\$80	Vancouver .....	\$86	\$86
Flemington .....	\$80	\$80	West Point.....	\$80	\$80	Harrisburg .....	\$74	\$74	Midland/Odessa .....	\$74	\$74	<b>Washington DC</b>		
Newark .....	\$86	\$86	<b>North Carolina</b>			Hershey.....	\$80	\$80	Pecos.....	\$74	\$74	See District of		
Parsippany.....	\$80	\$80	Asheville.....	\$80	\$80	Lancaster .....	\$74	\$74	Plano .....	\$80	\$80	Columbia.		
Princeton/Trenton....	\$86	\$86	Atlantic Beach/			Malvern/Frazer/			San Antonio .....	\$74	\$74	<b>Wisconsin</b>		
Somerset .....	\$80	\$80	Morehead City.....	\$74	\$74	Montgomery County..	\$80	\$80	South Padre Island...	\$74	\$74	Madison .....	\$80	\$80
Springfield/Cranford/			Chapel Hill .....	\$80	\$80	Philadelphia .....	\$92	\$92	<b>Utah</b>			Milwaukee.....	\$80	\$80
New Providence ...	\$80	\$80	Charlotte.....	\$80	\$80	Pittsburgh.....	\$80	\$80	Moab .....	\$86	\$86	Sturgeon Bay .....	\$80	\$80
Tom's River.....	\$74	\$74	Durham .....	\$74	\$74	Reading.....	\$74	\$74	Park City.....	\$92	\$92	<b>Wyoming</b>		
<b>New Mexico</b>			Greensboro.....	\$74	\$74	State College.....	\$74	\$74	Provo .....	\$74	\$74	Cody .....	\$74	\$74
Albuquerque .....	\$80	\$80	Kill Devil Hills .....	\$74	\$74	<b>Rhode Island</b>			Salt Lake City .....	\$80	\$80	Jackson/Pinedale ...	\$92	\$92
Carlsbad.....	\$74	\$74	Raleigh.....	\$74	\$74	Jamestown/			<b>Vermont</b>					
Santa Fe.....	\$80	\$80	Wilmington .....	\$74	\$74	Middletown/			Burlington.....	\$86	\$86			
Taos.....	\$74	\$74	<b>Ohio</b>			Newport .....	\$80	\$80	Manchester .....	\$86	\$86			
<b>New York</b>			Cincinnati .....	\$86	\$86	Providence/Bristol ...	\$80	\$80	Montpelier.....	\$74	\$74			
Albany.....	\$86	\$86	Cleveland.....	\$80	\$80	<b>South Carolina</b>			Stowe .....	\$86	\$86			
Binghamton .....	\$74	\$74	Columbus.....	\$80	\$80	Charleston .....	\$92	\$92	White River					
Buffalo .....	\$80	\$80	Dayton/Fairborn.....	\$74	\$74	Columbia .....	\$74	\$74	Junction .....	\$86	\$86			
Floral Park/Garden			Hamilton.....	\$74	\$74	Hilton Head.....	\$80	\$80	<b>Virginia</b>					
City/Great Neck ....	\$86	\$86	<b>Oklahoma</b>			Myrtle Beach .....	\$74	\$74	Alexandria/Fairfax/					
Glens Falls .....	\$86	\$86	Oklahoma City .....	\$80	\$80	<b>South Dakota</b>			Falls Church .....	\$92	\$92			
Ithaca .....	\$80	\$80				Deadwood/Spearfish	\$80	\$80	Arlington/Fairfax					
Kingston .....	\$86	\$86				Hot Springs.....	\$74	\$74	Counties .....	\$92	\$92			
Lake Placid .....	\$86	\$86				Rapid City .....	\$74	\$74	Charlottesville .....	\$80	\$80			
New York City.....	\$92	\$92							Loudoun County.....	\$80	\$80			
									Richmond .....	\$80	\$80			

## Per Diem Rates/High-Low Method

The high-low substantiation method can be used by employers to pay employees a per diem travel allowance (hotels, meals, and incidentals) instead of using various rates that apply at different locations.

- Only two rates apply in the Continental United States (CONUS).
- Used by employers, not by self-employed taxpayers.
- Reimbursements within the limits are considered substantiated.

Effective Date	High-Cost Localities		Low-Cost Localities	
	Total Travel	Meals Only	Total Travel	Meals Only
Oct. 1, 2025	\$319	\$86	\$225	\$74
Oct. 1, 2024	\$319	\$86	\$225	\$74

Also see *Truckers/Transportation Industry Chart*, page 8-4.

**High-cost localities.** The following areas are considered high-cost localities for purposes of the high-low substantiation method of per diem reimbursement by employers on or after October 1, 2025. Localities not listed are subject to the low-cost rate. (Notice 2025-54)

**Alabama**  
Gulf Shores  
(June 1 – July 31)

**Arizona**  
Phoenix/Scottsdale  
(Feb. 1 – Mar. 31)  
Sedona  
(Oct. 1 – Dec. 31,  
Mar. 1 – Sept. 30)

**California**  
Los Angeles  
Mammoth Lakes  
(Dec. 1 – Mar. 31)  
Monterey  
Napa  
(Oct. 1 – Nov. 30,  
Feb. 1 – Sept. 30)  
Palm Springs  
(Oct. 1 – Apr. 30)

San Diego  
San Francisco  
San Luis Obispo  
(June 1 – July 31)  
Santa Barbara  
Santa Monica  
South Lake Tahoe  
(Dec. 1 – Mar. 31)  
Sunnyvale/Palo Alto/San  
Jose  
Yosemite National Park  
(Jan. 1 – Apr. 30)

**Colorado**  
Aspen  
Denver/Aurora  
(Oct. 1 – Oct. 31,  
Apr. 1 – Sept. 30)  
Silverthorne/  
Breckenridge  
(Dec. 1 – Mar. 31)

Steamboat Springs  
(Dec. 1 – Mar. 31)  
Telluride  
Vail

**Delaware**  
Lewes  
(June 1 – Aug. 31)

**District of Columbia**  
Washington D.C. (also  
the cities of Alexandria,  
Falls Church, and  
Fairfax, and the  
counties of Arlington  
and Fairfax, in Virginia;  
and the counties of  
Montgomery and Prince  
George's in Maryland)  
(See also Maryland and  
Virginia)

*continued on next page*

<b>Florida</b> Boca Raton/Delray Beach/Jupiter (Jan. 1 – Apr. 30) Bradenton (Feb. 1 – Mar. 31) Cocoa Beach (Feb. 1 – Mar. 31) Fort Lauderdale (Jan. 1 – Apr. 30) Fort Meyers (Jan. 1 – Mar. 31) Fort Walton Beach/DeFuniak Springs (June 1 – July 31) Gulf Breeze (June 1 – July 31) Key West Miami (Dec. 1 – May 31) Naples (Dec. 1 – Apr. 30) Panama City (June 1 – July 31) Sarasota (Feb. 1 – Apr. 30) Sebring (Feb. 1 – Mar. 31) Stuart (Feb. 1 – Mar. 31) Tampa/St. Petersburg (Feb. 1 – Apr. 30) Vero Beach (Dec. 1 – Apr. 30)	<b>Kennebunk/Kittery/Sanford</b> (July 1 – Aug. 31) <b>Portland</b> (Oct. 1 – Oct. 31, June 1 – Sept. 30)	<b>Maryland</b> Ocean City (June 1 – Aug. 31) Washington, DC Metro Area	<b>Massachusetts</b> Boston/Cambridge Falmouth (July 1 – Aug. 31) Hyannis (July 1 – Aug. 31) Martha's Vineyard Nantucket (June 1 – Sept. 30)	<b>Michigan</b> Mackinac Island (July 1 – Aug. 31) Petoskey (June 1 – Aug. 31) Traverse City (July 1 – Aug. 31)	<b>Minnesota</b> Duluth (Oct. 1 – Oct. 31, June 1 – Sept. 30)	<b>Montana</b> Big Sky/West Yellowstone/Gardiner (June 1 – Sept. 30) Kalispell/Whitefish (July 1 – Sept. 30)	<b>New Jersey</b> Toms River (July 1 – Aug. 31)	<b>New York</b> Glens Falls (July 1 – Aug. 31) Lake Placid (July 1 – Aug. 31) New York City (Oct. 1 – Dec. 31, Mar. 1 – Sept. 30) Saratoga Springs/Schenectady (July 1 – Aug. 31)	<b>North Carolina</b> Kill Devil Hills (June 1 – Aug. 31)
---	--	---	---	--	--	--	--	---	--

<b>Oregon</b> Bend (June 1 – Aug. 31) Eugene/Florence (June 1 – July 31) Seaside (July 1 – Aug. 31)	<b>Pennsylvania</b> Hershey (June 1 – Aug. 31) Philadelphia (Oct. 1 – Nov. 30, Apr. 1 – Sept. 30)	<b>Rhode Island</b> Jamestown/Middletown/Newport (Oct. 1 – Oct. 31, June 1 – Sept. 30)	<b>South Carolina</b> Charleston Hilton Head (Mar. 1 – Aug. 31)	<b>Tennessee</b> Nashville	<b>Utah</b> Moab (Oct. 1 – Oct. 31, Mar. 1 – June 30, Sept. 1 – Sept. 30) Park City	<b>Vermont</b> Burlington (Oct. 1 – Oct. 31, May 1 – Sept. 30) Manchester (Oct. 1 – Oct. 31, Aug. 1 – Sept. 30) Montpelier (Oct. 1 – Oct. 31, Aug. 1 – Sept. 30)	<b>Virginia</b> Virginia Beach (June 1 – Aug. 31) Wallops Island (July 1 – Aug. 31) Washington, DC Metro Area	<b>Washington</b> Port Angeles/Port Townsend (July 1 – Aug. 31) Seattle	<b>Wyoming</b> Jackson/Pinedale
--	---	---	--	-------------------------------	---	---	--	---	------------------------------------

## Business Deductions

### Cross References

- IRS Pub. 334, *Tax Guide for Small Business*
- IRS Pub. 529, *Miscellaneous Deductions*
- IRS Pub. 583, *Starting a Business and Keeping Records*
- IRC §162, *Trade or business expenses*

### Related Topics

- Repayments, Tab 3
- Sole Proprietorships and Farmers, Tab 5
- Rental, Passive, and At-Risk, Tab 7
- Depreciation and Amortization (Form 4562), page 9-2
- Automobiles and Listed Property, Tab 10
- Employee Business Expense for S Corporation Shareholder, Tab 19
- Unreimbursed Partnership Expenses, Tab 20

### Ordinary and Necessary Business Expenses

A deductible business expense must be both ordinary and necessary.

**Ordinary.** An ordinary expense is an expense that is common and accepted in the taxpayer's line of work.

**Necessary.** A necessary expense is an expense that is helpful and appropriate for the taxpayer's trade or business.

An expense need not be required in order to be considered necessary. Facts and circumstances must be considered to determine whether an expense is ordinary and necessary.

**Deductibility.** Even though an expense may be ordinary and necessary, the cost might not be deductible, or might not be deductible in the year paid. See the following sections for information about deductibility of certain expenses.

- *Depreciation and Amortization (Form 4562)*, page 9-2.
- *Inventory/Cost of Goods Sold*, page 8-13.

**Court Case:** A television news anchor claimed employee business deductions for clothing, make-up, grooming, and self-defense classes as well as subscriptions to cable television and various newspapers and magazines. The IRS denied the clothing deduction on the grounds that the clothing was suitable for everyday personal wear, even though it was not of the style that the taxpayer would typically wear. The other expenses were not ordinary and necessary business expenses because they were inherently personal expenses. The Tax Court agreed with the IRS. (*Hamper*, T.C. Summary 2011-17)

**Non deductible expenses.** Generally, no deduction is allowed for:

- Bribes, kickbacks, and other illegal payments.
- Charitable contributions. [May be deductible on Schedule A (Form 1040)]
- Demolition expenses or losses.
- Dues to business, social, athletic, luncheon, sporting, airline, and hotel clubs.
- Entertainment expenses.
- Improvements to real or tangible personal property.
- Lobbying expenses.
- Penalties and fines paid to or at the direction of a governmental entity for broken laws.
- Personal, living, and family expenses.
- Political contributions.
- Settlements, payments, or attorney's fees related to sexual harassment or abuse if such settlement or payment is subject to a nondisclosure agreement.

## Truckers/Transportation Industry Chart

For workers subject to the U.S. Department of Transportation "hours of service" rules, a deduction of 80% for meals is allowed (compared to the general 50% limitation). This can include individuals working on an airline, barge, bus, ship, train, or truck. In addition to a higher limit for deducting meals, transportation workers also have their own special standard meals and incidental expenses (M&IE) rates.

<i>Effective:</i>	10/1/25–9/30/26	10/1/24–9/30/25
<b>M&amp;IE Continental U.S. (CONUS)</b> .....	\$80	\$80
<b>M&amp;IE, outside Continental U.S. (OCONUS)</b> .....	\$86	\$86

**Tax home.** Generally, the tax home is the regular place of business or post of duty. For truckers, this could be the main terminal. See *Tax home*, page 8-10.

## Employee Business Expenses (Form 2106)

Taxpayers cannot deduct unreimbursed employee expenses unless they are one of the following employees.

- Armed Forces reservist.
- Qualified performing artist.
- Fee-based state or local government official.
- Employee with impairment-related work expenses.

Individuals in these categories with job-related business expenses must complete Form 2106, *Employee Business Expenses*. Reservists, performing artists, and fee-based government officials can claim the expenses as an adjustment to income on Schedule 1 (Form 1040), *Additional Income and Adjustments to Income*. Employees with impairment-related work expenses deduct qualified expenses on Schedule A (Form 1040), *Itemized Deductions*.

**Reservists.** Reservists include members of Army, Navy, Marine Corps, Air Force, or Coast Guard Reserve; the Army or Air National Guard of the United States; or the Reserve Corps of the Public Health Service.

**Qualified expenses.** The taxpayer must travel more than 100 miles away from home in connection with performance of services as a reservist. The amount of expenses deductible as an adjustment is limited to the regular federal per diem rate (for lodging, meals, and incidental expenses) and the standard mileage rate (for car expenses), plus any parking fees, ferry fees, and tolls.

**Qualified performing artists.** A qualified performing artist is an individual who:

- Performed services in the performing arts as an employee for at least two employers during the year,
- Received from at least two of those employers wages of \$200 or more per employer,
- Had allowable business expenses attributable to the performing arts of more than 10% of gross income from the performing arts, and
- AGI is \$16,000 or less before deducting expenses as a performing artist.

**Fee-basis official.** A fee-basis official is an employee of a state or political subdivision of a state and who is compensated, in whole or in part, on a fee basis.

**Impairment-related work expenses.** Impairment-related work expenses are the allowable expenses of an individual with physical or mental disabilities for attendant care and other expenses at his or her place of employment that enable the employee to work.

## Limits on Business Deductions

A business can deduct legitimate expenses even if the expenses exceed income from the activity. Such losses may produce a net operating loss for the taxpayer. See *Net Operating Loss (NOL)*, page 8-20. The following rules may limit the deductible amount of business losses.

- Excess business loss limitation. See *Excess Business Loss Limitation*, Tab 5.
- Hobby loss rules. See *Hobby Loss Rules*, Tab 5.
- Passive activities. See *Passive Activity Losses*, Tab 7.
- At-risk limits. See *At-Risk Rules*, Tab 7.
- Accrual method of accounting. See *Accrual Method*, page 8-24.

## Services in Trade

If the taxpayer provides services as compensation for a business expense, the deductible amount is limited to out-of-pocket costs. The taxpayer cannot deduct the value of his or her services. Also, there is no wage deduction available for amounts withdrawn from a business by a sole proprietor.

## Bad Debts

A bad debt occurs when a taxpayer is owed money that cannot be collected. A bad debt is either a business bad debt or a non-business bad debt. For nonbusiness bad debts, see *Nonbusiness bad debt*, Tab 6.

To be deductible, the amount owed to the taxpayer must have already been included in the taxpayer's income. For example, a cash method taxpayer cannot deduct uncollectible accounts receivable because they have not been included in income.

**Business bad debt.** Examples of business bad debts include:

- Uncollectible accounts receivable if income has already been reported as income under the accrual accounting method.
- Loans to clients and suppliers that become worthless.
- The payment of debts attributable to an insolvent partner of the taxpayer.
- Business loan guarantees if there was a reasonable business consideration for making the guarantee, and the taxpayer has a legal duty to pay the debt.

---

**Court Case:** The taxpayer was the co-founder, president, and major shareholder in an S corporation that was in the business of making loans. Apart from these business activities, the taxpayer loaned substantial sums from his personal account. One of these personal account loans resulted in a bad debt. The IRS claimed that although the taxpayer was in the business of lending, the bad debt from making a personal property loan was outside the scope of the business. The Tax Court ruled that the taxpayer's behavior in connection with the loan was consistent with his general business practices and that the loan was proximately connected to his trade or business of lending money. (*Bercy*, T.C. Memo. 2019-118)

---

**How to deduct a business bad debt.** A business bad debt is deductible on the business tax return of the taxpayer using one of two methods.

- 1) The specific charge-off method limits the deduction to the amount charged off on the business books during the tax year.
  - Debts can be charged off incrementally as they become partly worthless or all at once when the entire debt becomes worthless.
  - The taxpayer cannot deduct any part of a debt after the year it becomes totally worthless.
- 2) Taxpayers who use an accrual method of accounting may qualify for the nonaccrual-experience method of deducting business bad debts. For more information, see Reg. §1.448-3.

**Claiming a previously omitted bad debt deduction.** If the taxpayer did not deduct a bad debt on the original return in the year it became worthless, a claim for credit or refund can be filed.

## Claiming Previously Omitted Bad Debts

<i>If the bad debt was:</i>	<i>The claim must be filed by the later of:</i>
Totally worthless	<ul style="list-style-type: none"><li>• Seven years from the original due date, not including extensions, or</li><li>• Two years from the date the tax was paid.</li></ul>
Partly worthless	<ul style="list-style-type: none"><li>• Three years from the date the original return was filed, or</li><li>• Two years from the date the tax was paid.</li></ul>

## Capital Costs

Capital costs are costs that are considered a part of an investment in a business, such as start-up and organizational costs, the cost of purchasing tangible or intangible business property, and improvements to business assets. Capital costs are added to the basis of property and are deducted through depreciation, amortization, depletion, or the cost of goods sold deduction. Certain capital costs, such as the cost of land, are not depreciable and

must remain as part of the investment in the business property until sold. Also see *Repairs and Improvements*, page 9-11.

## Election to Capitalize Carrying Charges

Carrying charges include taxes and interest paid to carry or develop real property, or costs to carry, transport, or install personal property. An election is available to capitalize carrying charges instead of claiming a current deduction, increasing the basis of the property. The election may be advantageous if the taxpayer expects to be in a higher tax bracket when the property is placed in service or sold. The election is made on a year-by-year basis. (Reg. §1.266-1)

**Making the election.** The election to capitalize carrying charges is made by attaching a statement to an original tax return for the year the election is to be effective. The statement should indicate which charges the taxpayer is electing to capitalize. If the return is timely filed without the election, the taxpayer can make the election on an amended return filed within six months of the original due date (not including extensions). On an amended return, write "Filed pursuant to section 301.9100-2" on the attached statement.

## Cell Phones

Employers may deduct, as a nontaxable fringe benefit, the cost of cell phones provided or reimbursed to employees for non-compensatory business reasons, such as the employer's need to contact the employee at all times for work-related emergencies. Providing a cell phone to reward an employee or promote good will is not a noncompensatory reason. (Notice 2011-72)

See *Employer-Provided Cell Phones*, page 22-4.

Self-employed taxpayers may deduct the cost of business-use cell phones. If the taxpayer has no other telephone, costs must be allocated between business and personal use.

## Demolition Expenses

Amounts paid to demolish a structure are not deductible as a current expense. They must be added to the cost basis of the land where the demolished structure was located. Any loss for the remaining undepreciated basis of the demolished structure is not recognized until the property is disposed of.

## Education Expenses

Ordinary and necessary expenses paid for the cost of the education and training of a taxpayer's employees are generally deductible. A taxpayer can also deduct the cost of his or her own education (including certain related travel) related to his or her trade or business. The taxpayer must be able to show the education maintains or improves skills required in his or her trade or business, or that it is required by law or regulations, for keeping his or her license to practice, status, or job.

For example, an attorney can deduct the cost of attending Continuing Legal Education (CLE) classes that are required by the state bar association to maintain his or her license to practice law.

Education expenses incurred to meet the minimum requirements of a present trade or business, or those that qualify the taxpayer for a new trade or business, are not deductible. This is true even if the education maintains or improves skills presently required in the taxpayer's business.

## Energy Efficient Commercial Buildings Deduction

The deduction for an energy efficient commercial building is available to:

- Owners of qualified commercial buildings, and
- Designers of energy efficient commercial building property (EECBP) or energy efficient building retrofit property (EEBRP) installed in buildings owned by specified tax-exempt entities.

**OBBBA** The deduction expires for property construction that begins after June 30, 2026 (taxpayers must recover costs through depreciation). Expensing under the special depreciation rules would still be allowed if the property is qualified production property. See *Qualified Production Property (QPP)*, page 9-11.

**EECBP.** EECBP must be installed on or in a building located in the U.S. and within the scope of specified standards. To qualify, the property must be:

- Depreciable or amortizable.
- Installed as a part of interior lighting systems, the heating, cooling, ventilation, and hot water systems, or the building envelope.
- Certified as being installed as part of a plan to reduce the total annual energy and power costs for the above systems by 25% or more in comparison to a reference building.

**EEBRP.** EEBRP must be installed on or in qualified building located in the U.S. as part of the interior lighting systems, the heating, cooling, ventilation, and hot water systems, or the building envelope. To qualify, the property must be:

- Depreciable or amortizable.
- Originally placed in service not less than five years before the establishment of a qualified retrofit plan for the building.
- Certified as meeting certain energy savings requirements.

**Deduction amount.** The deduction for EECBP is the lesser of:

- The cost of the installed property, or
- The savings per square foot calculated as:
  - \$0.50 per square foot for a building with 25% energy savings,
  - Plus \$0.02 per square foot for each percentage point of energy savings above 25%,
  - Up to a maximum of \$1.00 per square foot for a building with 50% energy savings.
  - Savings per square foot may be reduced for deductions claimed in previous years.

The deduction is similar to the Section 179 deduction which allows the taxpayer to write off the entire cost of qualified property in one year rather than depreciate the cost over a number of years.

**Prevailing wage and apprenticeship bonus.** If prevailing wages are paid and apprenticeship requirements are met, an increased maximum deduction applies. The maximum amount increases to five times the savings per square foot amount.

**Claiming the deduction.** Form 7205, *Energy Efficient Commercial Buildings Deduction*, is used to claim the deduction. The amount calculated is transferred to the appropriate line on Schedule C (Form 1040), or Forms 1041, 1065, 1120, or 1120-S. For more information, see the instructions for Form 7205 and IRC section 179D.

## Gifts

Deductible business gifts for customers and clients are limited to \$25 per individual per year [IRC §274(b)]. Items of small value, such as pens imprinted with the business name, costing \$4 or less, are not included in the \$25 limit.

## Insurance

Insurance premiums (e.g., hazard, medical, liability, malpractice, etc.) paid for a trade or business are generally deductible.

**Nondeductible insurance premiums include:**

- Amounts paid into a self-insurance reserve fund even if the taxpayer cannot get business insurance coverage for certain business risks.
- Loss of earnings policy that pays for the taxpayer's lost earnings due to sickness or disability. However, premiums for overhead

insurance that pays for business overhead expenses during long periods of disability caused by the taxpayer's injury or sickness are deductible.

- Life insurance and annuities if the taxpayer is directly or indirectly a beneficiary of the policy.
- Insurance to secure a loan.

## Intangible Drilling Costs

Costs of developing oil, gas, or geothermal wells may be deducted currently by election, or capitalized and recovered through depreciation or depletion. An AMT adjustment is required if costs are not amortized over 60 months. See *Depletion*, page 9-17.

## Life Insurance

No deduction is allowed by a taxpayer for life insurance premiums if the taxpayer is the beneficiary of the policy. (Reg. §1.264-1)

If an employer is providing the cost of life insurance as a fringe benefit for employees, the cost is deductible if it is reasonable compensation to the employee. See *Group Term Life Insurance*, page 22-5.

## Marijuana Sales

The sale of marijuana for medical or recreational purposes is legal in many states. However, it is classified as a Schedule I controlled substance under federal law, and considered illegal for federal income tax purposes. No deduction or credit is allowed for any amount paid during the year in carrying on a trade or business if such trade or business consists of trafficking in controlled substances (IRC §280E). Even though gross income from the sale of marijuana is taxable under federal law, related business deductions are not allowed.

**Exception:** The only exception to this rule is the deduction for the cost of goods sold. Since the cost of goods sold is taken into consideration in the calculation of gross income, the direct costs of producing or purchasing the marijuana are allowed in calculating taxable income, while operational type expenses are not deductible (CCA 201504011). See *Cost of Goods Sold (COGS)*, page 8-13.

---

**Court Case:** A California medical-marijuana dispensary deducted business expenses and adjusted for indirect cost of goods sold (COGS) per UNICAP rules for producers. The IRS determined that the taxpayer's sole trade or business was trafficking in a controlled substance and as a result business expenses are not deductible. The court agreed with the IRS and held that the taxpayer could not deduct the ordinary and necessary business expenses of an illegal trade or business. (*Harborside Health Center*, 151 T.C. No. 11)

---

## Penalties and Fines

Penalties incurred for late performance or nonperformance of a contract, for example missing a deadline under a construction contract, are generally deductible.

Generally, no deduction is allowed for fines and penalties paid to a governmental or specified nongovernmental entity for the violation of any law, except in the following situations.

- Amounts that constitute restitution.
- Amounts paid to come into compliance with the law.
- Amounts paid or incurred as the result of certain court orders in which no government or nongovernmental agency is a party.
- Amounts paid or incurred for taxes due.

No deduction is allowed for the restitution amount or amount paid to come into compliance with the law unless the amounts are specifically identified in the settlement agreement or court order. Also, any amounts paid or incurred as reimbursement to a government for the costs of investigation or litigation are not deductible. [IRC §162(f)]

## Professional Fees

Professional fees paid to get initial licensing are not deductible. Examples include the cost of obtaining an accounting certificate for the initial right to practice accounting, bar exam fees for the initial admission to the bar, and medical license fees paid to get initial licensing. Amounts paid each year to state or local governments for licenses and regulatory fees for an existing trade or business are deductible. Expenses incurred to maintain professional skills during a period when the professional has indefinitely suspended practice are not deductible. (Rev. Rul. 77-32)

## Recoveries

If an expense is later recovered in the same tax year, such as a rebate or credit for a returned item, the recovery is treated as a reduction in the expense deduction for that category of expense. If an expense that was deducted in one tax year is later recovered in a different tax year, the recovery is included in income in the year of recovery, unless the expense did not reduce tax in the year it was originally deducted.

## Rent or Lease

Rent is any amount paid for the use of property not owned by the taxpayer. The following rules apply to rent or lease payments.

- Rent is deductible as a current expense if the taxpayer does not receive equity or title to the property being rented.
- If an amount is paid to cancel a business lease, the amount is deductible as rent.
- A rental deduction for unreasonable rent is not allowed. Ordinarily, the issue of unreasonableness arises only if the taxpayer and lessor are related. Rent is not unreasonable just because it is computed as a percentage of gross sales.
- If rent is paid in advance, deduct only the amount that applies to the use of the rented property during the year. The rest of the rent payment is deductible over the period to which it applies.
- If the taxpayer is leasing business property, the taxpayer can treat taxes paid on the property as deductible rent.
- The cost of getting a lease is amortized over the term of the lease.

**Conditional sales contract.** If rent or lease payments are in fact made under a conditional sales contract, the payments are not deductible as rent. Instead, the payments are considered to be part of the purchase price of the asset, and the cost of purchasing the asset is recovered through depreciation.

---

**Court Case:** A taxpayer was leasing a hotel. The hotel was in need of improvements the taxpayer could not afford. An agreement was reached between the taxpayer and the lessor to credit the cost of improvements against rent. In the year the taxpayer received a credit for the cost of improvements, the taxpayer deducted the costs as rent. The IRS disallowed the deductions claiming that the cost of the improvements should not be treated as rent. The court concluded that the improvements were substitutes for rent, the lease had economic substance, and the taxpayer's treatment of the improvements was a clear reflection of income. (*Hopkins Partners*, T.C. Memo. 2009-107)

---

## Repairs and Improvements

Incidental repairs and maintenance of property are not capital expenditures. A taxpayer can generally deduct the cost of repairing business property in the same way as any other business expense. However, if a taxpayer improves depreciable property, the improvement is treated as separate depreciable property. Improvement means an addition to or partial replacement of property that results in a betterment of the unit of property, restores the unit of property, or adapts the unit of property to a new use. For clarification of the differences between repairs and improvements

and certain safe harbors and elections available, see *Repairs and Improvements*, page 9-11.

## Research and Experimental Costs

**OBBBA Domestic research deduction.** For tax years beginning after 2024, a deduction is allowed for any domestic research or experimental expenditures paid or incurred during the tax year.

**Elect to amortize.** A taxpayer may elect to amortize domestic research or experimental expenditures ratably over 60 months.

**Foreign research amortization.** Research conducted outside the U.S. requires a 15-year amortization.

**Coordination with the Credit for Increasing Research Activities.** If the amount of the research credit exceeds the amount allowable as a deduction for the tax year, the excess credit reduces the amount that can be amortized for those expenses. For more information, see *Credit for Increasing Research Activities (Form 6765)*, Tab 31.

**Election of reduced research credit.** A taxpayer may elect to forgo reducing capitalized research expenses by reducing the research credit instead. The election must be made not later than the time for filing the tax return (including extensions) for the tax year. Once made, the election is irrevocable. [IRC §280C(c)(2)(C)]

**OBBBA Prior year expenditures.** Taxpayers may elect to deduct domestic research and experimental expenditures that were paid or incurred after December 31, 2021. The election must be made by July 4, 2026 and requires the taxpayer to file an amended return for each year affected by the election. The election is treated as a change in accounting method for purposes of IRC section 481.

**OBBBA Expenses charged to capital account.** Taxpayers may also elect to deduct in full the unamortized amount of any expenses paid or incurred in tax years beginning after 2021 and before 2025 which were charged to a capital account. The deduction under this election is deducted ratably over the 2-year tax period beginning with the 2025 tax year. This election is also treated as a change in accounting method for purposes of IRC section 481.

## Wages

See the following pages for information about wages.

- Sole proprietorships, see *Line 26. Wages*, Tab 5.
- C corporations, see *Shareholder Wages*, Tab 18.
- S corporations, see *Reasonable Compensation*, Tab 19.
- Partnerships, see *Guaranteed Payments*, Tab 20.
- Employer compliance, see *Payroll and Labor Laws*, Tab 23.

## Other Business Deductions

<i>Expense</i>	<i>Page Reference</i>
Amortization	<i>Amortization</i> , page 8-1, and <i>Intangible Assets</i> , page 9-13.
Attorney fees	<i>Line 17. Legal and professional services</i> , Tab 5.
Auto expenses	<i>Automobiles and Listed Property</i> , Tab 10.
Awards	<i>Achievement Awards (IRC §74(c))</i> , page 22-3.
Casualty and theft losses	<i>Business and income-producing property</i> , Tab 4.
Charitable contributions*	<i>Charitable Contributions</i> , Tab 4.
Commissions and fees	<i>Independent Contractor vs. Employee</i> , Tab 5.

*continued in next column*

<i>Other Business Deductions continued</i>	
<i>Expense</i>	<i>Page Reference</i>
Computer software	<i>Recovering the Cost of Computer Software</i> , page 9-14.
Contract labor	<i>Line 11. Contract labor</i> , Tab 5.
Covenant not-to-compete	<i>Intangible Assets</i> , page 9-13.
Depletion	<i>Depletion</i> , page 9-17.
Depreciation	<i>Depreciation</i> , Tab 9.
Employee benefit plans	<i>Employee Fringe Benefits</i> , page 22-2.
Franchise costs	<i>Intangible Assets</i> , page 9-13.
Fringe Benefits	<i>Employee Fringe Benefits</i> , page 22-2.
Goodwill	<i>Intangible Assets</i> , page 9-13.
Health insurance	<i>Self-employed health insurance deduction</i> , Tab 5, and <i>Health Benefits (IRC §105 and IRC §106)</i> , page 22-6.
Hobby expenses	<i>Hobby Loss Rules</i> , Tab 5.
Improvements	<i>Repairs and Improvements</i> , page 9-11.
Intangible assets	<i>Intangible Assets</i> , page 9-13.
Interest expense	<i>Interest Tracing Rules (Allocation of Interest)</i> , Tab 4.
Investment expenses	<i>Classifying Investors and Traders</i> , Tab 6.
License fees	<i>Line 23. Taxes and licenses</i> , Tab 5.
Lobbying expenses	<i>Expenses Not Allowed on Schedule C (Form 1040)</i> , Tab 5.
Office-in-home expenses	<i>Business Use of Home</i> , Tab 5.
Pension and profit-sharing plans	<i>Small Business Retirement</i> , Tab 29.
Parts	<i>Repairs and Improvements</i> , page 9-11.
Payroll taxes	<i>Payroll and Labor Laws</i> , Tab 23.
Political contributions	<i>Expenses Not Allowed on Schedule C (Form 1040)</i> , Tab 5.
Qualified improvement property	<i>Qualified Improvement Property (QIP)</i> , page 9-11.
Repairs	<i>Repairs and Improvements</i> , page 9-11.
Retirement plans	<i>Small Business Retirement</i> , Tab 29.
Sick leave pay	<i>Supplemental Wages</i> , page 23-9.
Soil and water conservation expenses	<i>Soil and Water Conservation Expenses</i> , Tab 5.
Tax preparation fees	<i>Line 17. Legal and professional services</i> , Tab 5.
Taxes and licenses	<i>Line 23. Taxes and licenses</i> , Tab 5.
Telephone	<i>Telephone</i> , Tab 5.

\* Corporations other than S corporations can deduct charitable contributions on their tax return. Sole proprietors, S corporation shareholders, and partners in a partnership may be able to deduct charitable contributions on Schedule A (Form 1040).

# Meals, Entertainment, Travel, and Lodging

## Cross References

- Form 2106, *Employee Business Expenses*
- IRS Pub. 463, *Travel, Gift, and Car Expenses*
- IRC §162, *Trade or business expenses*
- IRC §274, *Disallowance of certain entertainment, etc., expenses*

## Related Topics

- Schedule C Recordkeeping and Substantiation Rules, Tab 5
- Automobiles and Listed Property, Tab 10

## Substantiating Meals, Travel, and Lodging

Special rules apply for substantiation of expenses for meals, travel, and lodging. The taxpayer must maintain records that include:

- The amount of the expense,
- The time and place of travel,
- The business purpose of the expense, and
- The business relationship between the taxpayer and persons provided meals.

**Self-employed taxpayers.** Per diem rates for meals can only be used as a standard deduction by a self-employed taxpayer while traveling in place of actual receipts.

**Employer reimbursements.** Per diem rates can be used by an employer to reimburse an employee for travel and meals in place of actual receipts. The employee still must give documentary evidence of the business expenses to the employer. See *Per Diem Rates*, page 8-2.

**Lodging.** An employer may use per diem rates to substantiate an employee reimbursement for travel and meals. However, self-employed individuals must use actual receipts to substantiate a deduction for lodging.

**Traveling exceptions.** Documentary evidence is not needed if any of the following conditions apply.

- The expense, other than lodging, is less than \$75.
- The taxpayer has meals or lodging expenses while traveling away from home that he or she accounts for to the employer under an accountable plan and the per diem allowance method, that includes meals and/or lodging, is used.
- The taxpayer has a transportation expense for which a receipt is not readily available.

## Entertainment

No deduction is allowed with respect to:

- An activity generally considered to be entertainment, amusement, or recreation,
- Membership dues with respect to any club organized for business, pleasure, recreation or other social purposes, or
- A facility or portion thereof used in connection with any of the above items.

**Entertainment.** Entertainment includes any activity generally considered to provide entertainment, amusement, or recreation. Examples include entertaining guests at nightclubs, at social, athletic, and sporting clubs, at theaters, at sporting events, on yachts, or on hunting, fishing, vacation, and similar trips. Entertainment also may include meeting personal, living, or family needs of individuals, such as providing meals, a hotel suite, or a car to customers or their families.

**Membership dues.** A taxpayer cannot deduct membership dues for any club organized for business, pleasure, recreation, or other social purpose. This includes country clubs, golf and athletic clubs, airline and hotel clubs, and clubs operated to provide meals under conditions favorable to business discussion.

**Exceptions:** The following expenses are still 100% deductible:

- Entertainment treated as compensation.
- Recreational expenses for employees (e.g., holiday party).
- Expenses related to attending business meetings or conventions of certain exempt organizations such as business leagues, chambers of commerce, or professional associations.
- Entertainment sold to customers.

## Meals

Meals are generally deductible if incurred while traveling on business or if provided to a client, customer, or employee. See *Deducting meals provided to others*, page 8-10. The deduction for local meals is calculated by using actual costs while the deduction for meals while out of town is calculated by using actual costs or the standard meal allowance. See *Per Diem Rates*, page 8-2, and *Per Diem Rates/High-Low Method*, page 8-3.

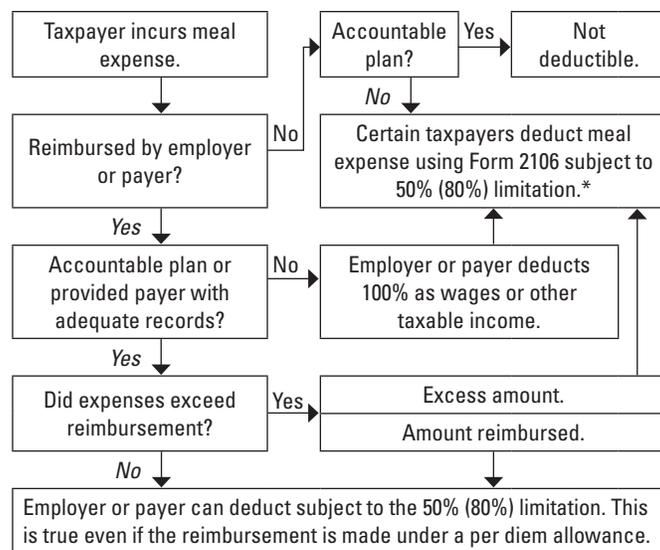
**50% limitation.** A deduction for meals is generally limited to 50% of the expense, which includes delivery fees, taxes and tips relating to a meal. [IRC §274(n)]

**Transportation industry.** Workers subject to the U.S. Department of Transportation "hours of service" rules may take an 80% deduction for meals instead of being limited to 50%. See *Truckers/Transportation Industry Chart*, page 8-4.

**Full deduction.** The 50% limit on the deduction for meals does not apply in the following situations. [IRC §274(n)(2)]

- Meal expenses of an employee reimbursed by the employer under an accountable plan. In this case the employer is subject to the 50% limit.
- Meal expenses reimbursed to a self-employed person who provides adequate records of the expenses to the customer or client (payer). The customer or client is subject to the 50% limit.
- Meals provided to the general public for promotional purposes.
- Meals sold to the public, such as a restaurant providing meals to customers.
- Meals required by federal law to be provided to crew members of certain commercial vessels (but not luxury water transportation vessels), or provided on an oil or gas platform or drilling rig.

### 50% Limitation on Meals (80% for Transportation Workers)



\* Form 2106, *Employee Business Expense*, is available only to specific taxpayers. See *Employee Business Expenses (Form 2106)*, page 8-5.

**Reimbursed meals.** Meal expenses incurred by one party performing services for another party under a reimbursement or other expense allowance arrangement are subject to the 50% limitation for one of the parties, but not both. [Reg. §1.274-2(f)(2)(iv)]

### **Two-party reimbursement arrangements:**

- **Employee.** Any party that reimburses an employee is a payer and incurs the expense if the payment is not treated as compensation to the employee. The payer may or may not be the employer.
- **Independent contractor.** The deduction limitation applies to the client or customer and not the independent contractor if there is a written agreement that specifies the client or customer will reimburse the independent contractor for expenses subject to the limitation and the independent contractor provides adequate accounting of those expenses to the client or customer. Alternatively, the parties may enter into an express agreement identifying the party that is subject to the deduction limitation.

**Multiple-party reimbursement arrangements.** Multiple-party reimbursement arrangements are separately analyzed as a series of two-party reimbursement arrangements. The limitation applies to the party that receives an accounting and that ultimately pays the expense.

**Deducting meals provided to others.** Business meals are generally deductible if the taxpayer (or an employee) is present and the food or beverages are not considered lavish or extravagant. The meals may be provided to a current or potential business customer, client, consultant, or similar business contact. However, if a group of business acquaintances takes turns picking up each other's meal checks without regard to whether any business purposes are served, no member of the group can deduct any part of the expense. Any allowed expense must be both ordinary and necessary. See *Ordinary and Necessary Business Expenses*, page 8-4.

**Separating costs.** Food and beverages that are provided during entertainment events are deductible if purchased separately from the entertainment, or if the cost of the food and beverages is stated separately from the cost of the entertainment on one or more bills, invoices, or receipts. However, the entertainment disallowance rule may not be circumvented through inflating the amount charged for food and beverages.

---

**Example:** Aaron invites Brad, a business contact, to a baseball game. Aaron purchases tickets for himself and Brad to attend the game. While at the game, Aaron buys hot dogs and drinks for himself and Brad. The cost of the baseball game tickets is a nondeductible entertainment expense. Aaron may deduct 50% the cost of the hot dogs and drinks, which are purchased separately from the game tickets, as a deductible business meal expense.

---

**Example:** Chris invites Dan, a business contact, to a basketball game. Chris purchases tickets for himself and Dan to attend the game in a suite, where they have access to food and beverages. The cost of the basketball game tickets, as stated on the invoice, includes the food and beverages. The cost of the game tickets is a nondeductible entertainment expense. The cost of the food and beverages, which is not purchased separately from the game tickets, and is not stated separately on the invoice, is also a nondeductible entertainment expense. Therefore, Chris may not deduct any of the expenses associated with the basketball game.

**Firefighter meals.** Firefighters may be required to live and work 24-hour shifts during which they are not permitted to leave the fire station for meals. Various rulings have been issued on the subject.

- When the fire department requires its firefighter-employees to make payments into a common meal fund as a condition of employment, the expense was deductible. (*Sibla*, 9th Cir., January 7, 1980)
- When payments into a common meal fund are voluntary, the expense for meals is a nondeductible personal expense. (*Swagler*, T.C. Summary 2004-63)

The deduction for miscellaneous itemized deductions subject to the 2% AGI limit is no longer allowed, which makes most employee meal expenses not deductible.

## **Travel and Lodging**

Travel expenses are ordinary and necessary expenses incurred by a taxpayer while on temporary travel away from his or her tax home for business purposes. For business use of a vehicle, see *Business Autos*, page 10-2. Deductible expenses include, but are not limited to:

- Air, train, bus, taxi, or car travel between the taxpayer's home and the business destination.
- Use of a car for business use while at the business destination.
- Transportation (including tips) between the airport or train station and a hotel, between the hotel and a business location, and between business locations or customers.
- Meals, lodging, dry cleaning, and laundry, including tips.
- Other ordinary and necessary expenses related to the business travel.

**Away from home.** A taxpayer travels away from his or her tax home if:

- The taxpayer's business duties require an absence from home that is substantially longer than a day's work, and
- The taxpayer needs to sleep or rest to meet the demands of work while away from home. Merely napping in a car does not meet the rest requirement. However, absence for an entire day or from dusk until dawn is not required as long as relief from duty is long enough to allow for necessary sleep and rest.

**Local lodging expense exception.** There is a safe harbor for local lodging at business meetings and conferences. Local lodging will qualify as deductible ordinary business expenses if all the following conditions are met. (Reg. §1.162-32)

- The lodging is necessary for the individual to participate fully in, or be available for, a bona fide business meeting, conference, training activity, or other business function,
- The lodging does not exceed five calendar days and does not recur more than once per calendar quarter,
- If the individual is an employee, the employer requires the employee to remain at the activity or function overnight, and
- The lodging is not lavish or extravagant and does not provide any significant element of personal pleasure, recreation, or benefit.

Employer-paid qualified lodging is deductible by the employer and excluded from the employee's income as a working condition fringe benefit under IRC section 132. See *Employee Fringe Benefits*, page 22-2.

**Tax home.** In order to decide whether the taxpayer travels away from home, his or her tax home must first be determined. The taxpayer's tax home is generally his or her regular place of business or duty post, regardless of the location of the family residence. The taxpayer's tax home includes the entire city or general area in which the taxpayer's business is located.

**More than one place of business.** If there is more than one regular place of business, the taxpayer's tax home is the main place of business. If the nature of the work means there is no regular or main place of business, the following three factors help determine the taxpayer's tax home.

- 1) Business is conducted in the area of a main home and the taxpayer uses that home for lodging while doing business in the area.
- 2) The taxpayer's living expenses at a main home are duplicated when business requires the taxpayer to be away from that home.
- 3) The taxpayer has not abandoned the area in which both his or her historical place of lodging and claimed main home are located, or the taxpayer's family member lives at the main home, or the taxpayer often uses that home for lodging.

If all three factors are satisfied, the taxpayer's tax home is where the taxpayer regularly lives. If two factors are satisfied, other

circumstances must be considered. If only one factor is satisfied, the taxpayer is an itinerant (transient) worker.

**Itinerant (transient) workers.** An itinerant worker has neither a regular place of business nor a regular place to live. An itinerant worker's tax home is wherever there is work. No travel expenses can be deducted because the taxpayer is never considered to be traveling away from his or her tax home.

**Tax home different than personal residence.** If a taxpayer's regular place to live is different than his or her tax home, traveling between the tax home and the place of residence is not deductible travel expense.

---

**Court Case:** A taxpayer working as a barge mate took a position in New York but maintained residence in Jacksonville, Florida. The employer paid travel expenses from New York to other work locations. The taxpayer took deductions for travel from Jacksonville to New York for work assignments. The IRS contended, and the court agreed, that the taxpayer's residence in Florida was a personal choice and the travel deductions from Jacksonville to New York were disallowed. (*Canterbury*, T.C. Summary 2009-118)

---

**Temporary travel.** The determination of whether a job location is temporary or indefinite is made when work at the location begins.

**Temporary assignment.** An assignment in a single location is generally considered temporary if it is expected to last (and does last) for one year or less. The taxpayer's tax home does not change. The taxpayer is considered to be away from his or her tax home for the whole period, and qualifying travel expenses are deductible.

**Indefinite assignment.** An assignment in a single location is generally considered indefinite if it is realistically expected to last for more than one year, whether or not it actually lasts for more than one year. If the assignment is for an indefinite period of time, the job location becomes the taxpayer's tax home, and travel expenses are not deductible.

---

**Example:** Joe lives in Minneapolis and travels to Fresno for business expected to last nine months. After eight months, he is asked to remain another seven months. His living expenses in Fresno for the first eight months are deductible as travel expenses. Once it was determined that he would remain another seven months (more than one year from the start), his Fresno living expenses are no longer considered deductible travel expenses.

---

**Court Cases:** Laid-off airline mechanics in Minneapolis were allowed to bump less senior mechanics in other cities and take their positions. The airline gave no end date for the new positions and did not require any services from the mechanics in Minneapolis. The Tax Court disallowed travel expenses. A taxpayer must generally have some business justification to maintain the first residence to be entitled to deduct expenses incurred while temporarily away from that home. (T.C. Memos. 2007-148 through 2007-153)

---

The Seventh Circuit Court of Appeals affirmed the Tax Court's decision stating that in order to deduct travel expenses, the taxpayer must have a business reason rather than a personal reason to be living in two places. (*David A. Wilbert*, 7th Cir., January 21, 2009)

---

**Temporary trips home on weekends and holidays.** If a taxpayer goes back to his or her tax home from a temporary assignment on days off, the taxpayer is not considered away from his or her tax home, and those living expenses are not deductible. However, travel costs from the temporary place of work to the taxpayer's tax home are deductible travel expenses, up to the amount it would have cost to remain at the temporary place of work.

**Business or personal?** If a trip is primarily for business, business-related travel expenses are deductible, including the costs of getting to and from the business destination. If a trip is primarily personal, none of the cost of getting to and from the destination

is deductible. However, any direct business costs while at the destination are deductible.

---

**Example:** Mary lives in Atlanta and takes a business trip to New Orleans. On her way home, she stops in Mobile to visit her parents. She spent \$2,670 for the nine days she was away from home for travel, meals, lodging, and other travel expenses. If she had not stopped in Mobile, she would have been gone only six days and only spent \$2,520. She can deduct \$2,520 for her trip, including the round-trip transportation to and from New Orleans.

---

**Author's Comment:** Round-trip transportation to a business destination within the United States is all or nothing. If the trip is primarily for business, it is 100% deductible. If the trip is primarily personal, none of it is deductible. For example, a taxpayer that spends 20% of his personal vacation on business cannot take 20% of the round-trip airline ticket as a deduction.

---

**Travel primarily for business outside the United States.** The all or nothing rule does not apply when business travel is outside the United States. The deductible amount of a round-trip travel expense is prorated by the number of days on business to the total number of days of travel. Transportation days, days the taxpayer's presence is required, days spent on business, and certain weekends and holidays all count as business days for this purpose. However, if the trip is primarily for personal reasons, none of the travel is deductible, except for the direct costs related to business such as business seminar registration fees. For exceptions to the travel expense proration requirement see IRS Pub. 463, *Travel, Gift, and Car Expenses*.

**Travel as a form of education.** Travel as a form of education generally is not deductible. [IRC §274(m)(2)]

**Travel for investment purposes.** Travel expenses, including meals, are deductible if in connection with investment and other income-producing property.

**Medical and charitable travel.** The standard meal allowance may not be used in connection with travel for medical or charitable purposes. See *Lodging Expenses for Medical Care*, Tab 4, and *Volunteer Expenses*, Tab 4.

**Luxury water travel.** A deduction for business travel by ocean liner, cruise ship, or other form of luxury water transportation is limited to twice the highest federal per diem rate allowable at the time of travel. For an exception, see *Cruise ship conventions*, below.

**Conventions.** Travel expenses for a convention connected with a trade or business are deductible. If the convention is for investment, political, social, or other purpose unrelated to business, the travel expenses are not deductible.

**Cruise ship conventions.** The deduction limit for attending a business convention on a cruise ship is limited to \$2,000 per year.

## Accountable/Nonaccountable Plans

**Reimbursements.** An employer may reimburse an employee for travel and meal expenses incurred while performing services for the employer. The tax treatment of the reimbursement, including per diem allowances, depends on whether the employer has an accountable plan or a nonaccountable plan.

If expenses are reimbursed under an accountable plan, the employer deducts the amount allowable as travel and meal expense, subject to limits, and the reimbursement is excluded from the employee's income.

If the expenses are reimbursed under a nonaccountable plan, the employer reports the reimbursement as taxable wages to the employee on Form W-2 and takes a wage expense deduction. Certain employees may be allowed to deduct the reimbursed

expenses on Form 2106, *Employee Business Expenses*. See *Employee Business Expenses (Form 2106)*, page 8-5.

**Accountable plan.** To qualify as an accountable plan, employees must:

- 1) Have paid or incurred deductible expenses while performing services as an employee,
- 2) Adequately account to the employer for these expenses within a reasonable period of time, and
- 3) Return any excess reimbursement or allowance within a reasonable period of time.

An arrangement under which the employer advances money to the employees is treated as meeting (3), above, only if the following requirements are also met.

- The advance is reasonably calculated not to exceed the amount of anticipated expenses.
- The employer makes the advance within a reasonable period of time.

For examples of ways in which an accountable plan may be inadvertently turned into a nonaccountable plan, see Revenue Ruling 2012-25.

**Did You Know?** If a reimbursement arrangement provides for meal expenses in excess of the federal per diem rate, there must be a mechanism in place to track the actual expenses for purposes of returning the excess to the employer. If such a mechanism is not in place, the reimbursement is treated as made under a nonaccountable plan, and the entire amount is included in the employee's taxable wages, not just the amount in excess of the per diem rate.

**Reasonable period of time.** Facts and circumstances determine what is reasonable in a given situation. Actions that take place within the following list will be treated as taking place within a reasonable period of time.

- The employer reimburses an expense within 30 days of the time the employee incurred the expense.
- The employee adequately accounts for the expense within 60 days after the expense was paid or incurred.
- The employee returns any excess reimbursement within 120 days after the expense was paid or incurred.
- The employer gives the employee a periodic statement, at least quarterly, that asks the employee to either return or adequately account for outstanding advances, and the employee complies within 120 days of the date of the statement.

**Reimbursement not requested.** When an employee has a right to reimbursement for expenses related to his or her status as an

employee but fails to claim reimbursement, the expenses are not deductible since they are not considered necessary expenses.

**Court Case:** The taxpayer's job involved extensive traveling in a two state area. His employer had a policy under which employees were eligible for reimbursement of all types of non-vehicle business expenses. The taxpayer did not submit any expenses for reimbursement from his employer. Instead, he deducted the expenses as unreimbursed business expenses on his tax return. The court noted that it was not necessary for the taxpayer to remain unreimbursed for the expenses.

To the extent the expenses could have been reimbursed, the court disallowed the taxpayers claimed deductions. (*Stidham*, T.C. Summary 2012-61)

**Nonaccountable plan.** Any form of reimbursement that does not meet the accountable plan rules is a nonaccountable plan. All amounts paid, or treated as paid under a nonaccountable plan, are reported as wages on Form W-2. The payments are subject to income tax withholding, Social Security, Medicare, and federal unemployment taxes.

See *Reporting Reimbursements*, below.

## Per Diem

Per diem is a fixed amount of reimbursement paid to employees for daily lodging, meals and incidental expenses incurred during business-related travel. Under an accountable plan, a per diem satisfies the adequate accounting requirements for the amount of expenses only if all of the following are met.

- The expenses are limited to ordinary and necessary business expenses,
  - The reimbursement is not more than the federal rate,
  - Employees must still prove the time, date, place, and business purposes of the expenses within a reasonable period of time, and
  - The employee is not related to the employer.
- See *Related to employer*, page 8-13.

**Federal rate.** The federal rate uses one of the following.

- The regular federal per diem rate is the highest amount paid to federal employees away from home on travel. Rates vary by location. See *Per Diem Rates*, page 8-2.
- The standard meal allowance is the meal and incidental expenses (M&IE) portion of the federal per diem rate. This is the only allowance permitted when the employer pays for or reimburses actual lodging expense or when the employee is not

## Reporting Reimbursements

(See *Accountable/Nonaccountable Plans*, page 8-11.)

<i>If the type of reimbursement, or other expense allowance is under:</i>	<i>Then the employer reports on Form W-2:</i>	<i>And the employee reports on Form 2106, Employee Business Expenses:*</i>
<b>An accountable plan with:</b>		
Actual expense reimbursement with adequate accounting made and excess returned.	No amount.	No amount.
Actual expense reimbursement with adequate accounting and return of excess both required but excess not returned.	The excess amount as wages in box 1, box 3, and box 5.	No amount.
Per diem or mileage allowance up to the federal rate with adequate accounting made and excess returned.	No amount.	All expenses and reimbursements only if excess expenses are claimed. Otherwise form is not filed.
<b>A nonaccountable plan with:</b> Either adequate accounting or return of excess, or both, not required by plan.	The entire amount as wages in box 1, box 3, and box 5.	The amount that can be substantiated as a business deduction.
<b>No reimbursement plan.</b>	The entire amount as wages in box 1, box 3, and box 5.	The amount that can be substantiated as a business deduction.

\***Form 2106, Employee Business Expenses.** Only Armed Forces reservists, qualified performing artists, fee-basis state or local government officials, and employees with impairment-related work expenses may file Form 2106 to claim any unreimbursed employee business expenses.

reasonably believed to have incurred any lodging expense. See *Per Diem Rates*, page 8-2.

- The high-low method simplifies the regular per diem rate method by specifying only two reimbursement rates. See *Per Diem Rates/High-Low Method*, page 8-3.

**Outside contiguous U.S.** The Department of Defense establishes per diem rates for Alaska, Hawaii, Puerto Rico, American Samoa, Guam, Midway, the Northern Mariana Islands, the U.S. Virgin Islands, Wake Island and other non-foreign areas outside the contiguous United States. The Department of State establishes per diem rates for all other foreign areas. To access per diem rates for non-foreign areas outside the continental United States go to [www.travel.dod.mil/Travel-Transportation-Rates/Per-Diem/Per-Diem-Rate-Lookup/](http://www.travel.dod.mil/Travel-Transportation-Rates/Per-Diem/Per-Diem-Rate-Lookup/). Access per diem rates for all other foreign areas at [www.state.gov/travelers/](http://www.state.gov/travelers/).

**No standard deduction for lodging.** The per diem rates for lodging are used only to determine the amount of employer reimbursement that meets the accountable plan rules, not for calculating deductions.

- Self-employed taxpayers and certain employees who are not reimbursed by their employer cannot use the per diem rates for lodging to determine a deduction for unreimbursed lodging expenses but must instead use the actual expense method.
- Self-employed taxpayers and certain employees can use the per diem rates for meals to determine a deduction for unreimbursed meal expenses.

**Independent contractors and clients.** A client may provide an allowance to or reimburse an independent contractor for travel, meal, or gift expenses incurred on the client's behalf.

- The tax treatment of such payments depends on whether the independent contractor has adequately accounted to the client.
- Reporting actual expense constitutes adequate accounting.
- The independent contractor must keep adequate records whether the expenses are presented to the client or not.

Independent Contractor's Return	Client's Tax Return, if a Business
<i>If adequate accounting has been made, then...</i>	
Reimbursements and allowances are not included in self-employment income, and no deduction is taken for associated expenses.	Reimbursements and allowances may be deductible, subject to 50% limitation on meals. Do not include on Form 1099-NEC.*
<i>If adequate accounting has not been made, then ...</i>	
Include reimbursements and allowances in self-employment income. Deduct qualified expenses, subject to 50% limitation on meals.	Deduct reimbursements and allowances in full as payments for services. Include on Form 1099-NEC, if required.*

\* See *Form 1099-NEC, Nonemployee Compensation*, page 23-7.

**Travel on first and last day of trip.** The per diem rate for meals is for a full 24-hour day of travel and must be prorated on the first and last day of a trip. The standard meal allowance can be prorated using either of the following methods. (Rev. Proc. 2019-48)

- Three-fourths of the standard meal allowance for the day of departure and the day of return, or
- Prorate the standard meal allowance using any method that is consistent and within reasonable business practice.

**Related to employer.** If the employee is related to the employer, the employee must be able to prove expenses to the IRS even if expenses have been adequately accounted to the employer under a per diem or car allowance plan and any excess reimbursement returned. An employee is related to his or her employer if:

- The employer is the employee's brother, sister, half brother, half sister, spouse, ancestor, or lineal descendant,
- The employer is a corporation and the employee directly or indirectly owns 10% or more in value of the stock, or

- Certain relationships, such as grantor, fiduciary, or beneficiary, exist between the employee, a trust, and the employer.

## Paying Expenses of an Employer

If the expense paid by an employee is that of the employer and not the employee, the expense is not deductible. This could be the case where a taxpayer is both the shareholder and employee of his or her corporation. The shareholder-employee may pay a corporate expense, such as office rent, out of personal funds when the corporate checkbook is low on funds. Since the expense is a liability of the corporation and not the employee, the expense is not deductible by the employee because it is not an ordinary and necessary business expense (*Brody*, T.C. Summary 2004-149).

See *Unreimbursed Partnership Expenses*, Tab 20.

## Inventory / Cost of Goods Sold

### Cross References

- IRS Pub. 334, *Tax Guide for Small Business*
- IRS Pub. 538, *Accounting Periods and Methods*
- IRC §263A, *Capitalization and inclusion in inventory costs of certain expenses*
- IRC §471, *General rule for inventories*

### Related Topics

- Farm Inventory, Tab 5
- Uniform Capitalization Rules for Farmers, Tab 5

### Inventory

Accounting for inventory is necessary to clearly show income when the production, purchase, or sale of merchandise is an income-producing factor. If a taxpayer must account for an inventory, the accrual method of accounting must be used, unless one of the exceptions applies. See *Small Business Inventory Exception*, page 8-15.

### Cost of Goods Sold (COGS)

If a business manufactures products or purchases them for resale, some expenses are included in calculating cost of goods sold. Expenses includable in cost of goods sold are not deductible until the item is sold, unless the taxpayer meets the small business exemption. The following are examples of expenses that go into calculating cost of goods sold.

- The cost of merchandise and products that are resold to customers.
- Raw materials and supplies that physically become part of a product, including the cost of having them shipped to the taxpayer, but not the cost of shipping the finished product to customers.
- The cost of storing the products until sold.
- Direct labor costs, including contributions to retirement plans, for workers who produce the products (manufacturing business), but not the cost of labor in a wholesale or retail business (buying and selling products).
- Indirect costs such as factory overhead expenses if the taxpayer is subject to UNICAP. See *Uniform Capitalization (UNICAP) Rules*, page 8-14).

**Computing COGS.** The basic equation to determine the cost of goods sold is as follows.

$$\begin{aligned} & \text{Beginning inventory} \\ & \text{Plus ..... Purchases, cost of labor, and materials and supplies} \\ & \text{Minus ..... Ending inventory} \\ & \text{Equals .... Cost of goods sold} \end{aligned}$$

**Example:** Wayne is a sole proprietor in the business of selling customized t-shirts. His beginning inventory value is \$5,500. During the year he purchased \$6,000 of additional inventory. His inventory value at the end of the year is \$4,300, see *Valuing inventory*, below. The deduction for cost of goods sold is computed as follows and reported on Part III of Wayne's Schedule C (Form 1040).

Beginning Inventory .....	\$5,500
Plus Purchases.....	6,000
Minus Ending Inventory.....	(4,300)
Cost of Goods Sold .....	\$7,200

## Inventory Methods

Inventory methods have two broad purposes, (1) identifying inventory items, and (2) valuing inventory. The most common method of identifying inventory is the specific identification method where the specific items are tracked, and the most common method of valuing inventory is the cost method. For information on other methods, see IRS Pub. 538, *Accounting Periods and Methods*.

**Identifying inventory items.** Use one of the following methods to identify items in inventory.

- Specific identification method when the taxpayer can identify and match the actual cost of specific inventory items.
- First-in first-out (FIFO) method.
- Last-in first-out (LIFO) method. IRS approval is required and may be applied for with Form 970, *Application To Use LIFO Inventory Method*.

**Valuing inventory.** Various methods can be used to value inventory.

**Cost method.** The cost method values ending inventory with the invoice cost of items purchased during the year, the inventory price of merchandise on hand at the beginning of the year, plus other direct and indirect costs that are to be added to inventory. The FIFO cost method takes the invoice price of similar items most recently purchased and applies that price to the quantity of items on hand at the end of the year.

**Lower of cost or market method.** The lower of cost or market method compares the market value of each item on hand at the time inventory is taken with its original cost. The lower of the two is the value used to compute cost of goods sold. Note that the lower the value of inventory at the end of the year, the higher the deduction for cost of goods sold.

**Example:** Under the lower of cost or market method, the following items would be valued at \$600 in closing inventory.

Item	Cost	Market	Lower
R .....	\$300	\$500	\$300
S .....	200	100	100
T .....	450	200	200
Totals .....	\$950	\$800	\$600

**Retail method.** Under the retail method, the total retail selling price of goods on hand at the end of the tax year in each class of goods is reduced to approximate cost by using an average markup expressed as a percentage of the total selling price. See *Retail Method* in IRS Pub. 538, *Accounting Periods and Methods*.

**Goods that cannot be sold.** Goods that cannot be sold at normal prices or are unusable because of damage, imperfections, shop wear, changes in style, odd or broken lots, or other similar causes should be valued at their bona fide selling price minus direct cost of disposition no matter which method is used to value the rest of the inventory.

**Loss of inventory.** A casualty or theft loss for inventory that is shoplifted, broken, spoiled, or otherwise lost during the year is taken through the increase in the cost of goods sold deduction, which is calculated by properly reporting opening and closing inventories. An additional deduction for a casualty or theft loss is not allowed. Any insurance or other reimbursement received for the lost inventory is reported as taxable income.

**Materials and supplies.** If items that would otherwise be required to be included in inventory are treated as materials and supplies, the cost is deductible in the year the inventory item is sold, or the year the materials and supplies are paid for, whichever is later.

For special rules that apply to farm supplies, see *Prepaid farm supplies*, Tab 5.

**Author's Comment:** An accurate inventory should be taken frequently not only for tax purposes, but also for management purposes. The value of inventory must be considered when evaluating the financial success or failure of a business. Also, in the event of a casualty such as fire or flood, an accurate inventory can prove the value of inventory loss for insurance purposes.

## Uniform Capitalization (UNICAP) Rules

Under the UNICAP rules of IRC section 263A, a business must capitalize the direct costs and part of the indirect costs for production or resale activities. For purposes of calculating the cost of inventory, a business subject to UNICAP must add a portion of indirect costs to the direct costs that make up inventory. These costs are then recovered through the cost of goods sold deduction rather than as a current deduction.

**Activities subject to UNICAP rules.** An activity subject to UNICAP is any trade or business that:

- Produces real or tangible personal property, or
- Acquires property for resale with average annual gross receipts for the three previous taxable years of more than \$31 million (2025).

**Producing property.** A taxpayer produces property if he or she constructs, builds, installs, manufactures, develops, improves, creates, raises, or grows the property. Property produced for the taxpayer under a contract is treated as produced by the taxpayer to the extent the taxpayer makes payments or incurs costs in connection with the property.

**Tangible personal property.** Tangible personal property includes films, sound recordings, video tapes, books, artwork, photographs, or similar property containing words, ideas, concepts, images, or sounds. Freelance authors, photographers, and artists are exempt from the rules if qualified.

**Exceptions.** The UNICAP rules do not apply to resellers of personal property with average gross receipts of \$31 million (2025) or less for the three prior tax years. For other exceptions to the UNICAP rules see IRC section 263A and Regulation section 1.263A-1(b).

**Qualified creative expenses exception.** Qualified expenses are expenses that are paid or incurred by a freelance (self-employed) writer, photographer, or artist whose personal efforts create (or can reasonably be expected to create) certain properties. These expenses do not include expenses related to printing, photographic plates, motion picture films, video tapes, or similar items.

**Inventories.** If the taxpayer must adopt the UNICAP rules, revalue the items or costs included in the beginning inventory for the year of change as if the capitalization rules had been in effect for all prior periods. When revaluing inventory costs, capitalization rules apply to all inventory costs accumulated in prior periods. The adjustment required under IRC section 481(a) is the difference between the original value of the inventory and the revalued inventory.

Taxpayers that must capitalize costs for production and resale activities are required to make this change. If the change is for the first tax year the taxpayer is subject to the UNICAP rules, it is an automatic change of accounting method that does not need IRS approval. All other years require IRS approval to make the change.

### Small Business Inventory Exception

Any taxpayer (other than a tax shelter) that meets the gross receipts test may elect not to keep an inventory [Reg. §1.471-1(b)]. See *Gross receipts test*, page 8-23. The taxpayer must still use a method of accounting for inventory that clearly reflects income. A small business taxpayer can account for inventory by:

- Treating the inventory as non-incidentals materials and supplies (NIMS),
- Conforming to its treatment of inventory in an applicable financial statement (AFS), or
- If it does not have an AFS, using the method of accounting used in its books and records that are prepared according to the taxpayer's accounting procedures. **Note:** If a taxpayer includes inventory in any internal or external record, inventory must be valued using the accrual method to determine the cost of goods sold.

**Treatment as NIMS.** Costs of inventory are recovered only in the tax year in which the inventory is used or consumed or the tax year in which the taxpayer pays for or incurs the cost of the inventory, whichever is later. Inventory is considered used or consumed in the year it is provided to the customer.

**Applicable financial statement (AFS).** An AFS is defined in order of priority, as a statement 1) prepared in accordance with generally accepted accounting principles (GAAP), 2) certified as prepared in accordance with international financial reporting standards (IFRS), or 3) filed with the federal government, a state government, or self-regulating organization.

**Change of accounting method.** An eligible small business taxpayer that wishes to change its method of accounting for inventories may need to file Form 3115, *Application for Change in Accounting Method* (Rev. Proc. 2022-9 and Rev. Proc. 2022-14). See *Change in Accounting Method*, page 8-25.

## Qualified Business Income Deduction (QBID)—IRC §199A

### Cross References

- Form 8995, *Qualified Business Income Deduction Simplified Computation*
- Form 8995-A, *Qualified Business Income Deduction*
- IRC §199A, *Qualified business income*
- Reg §1.199A-1 through -6
- Rev. Proc. 2019-38

### Related Topics

- Sole Proprietorships and Farmers, Tab 5
- S Corporations, Tab 19
- Partnerships and LLCs, Tab 20

### Qualified Business Income Deduction (QBID)

Eligible taxpayers may be able to deduct:

- 1) Up to 20% of qualified business income from a domestic business operated as a sole proprietorship, or through a partnership, S corporation, trust or estate, plus
- 2) Up to 20% of combined qualified real estate investment trust (REIT) dividends and qualified publicly traded partnership (PTP) income.

The sum of the two above amounts is referred to as the combined qualified business income amount. Generally, the QBID is the lesser of the combined qualified business income amount, and an amount equal to 20% of taxable income minus the taxpayer's net capital gain.

The QBID is claimed on Form 1040, and can be taken in addition to the standard deduction or itemized deductions.

**Note:** Income earned through a C corporation or by providing services as an employee is not eligible for the QBID.

**Partnerships and S corporations.** Partnerships and S corporations cannot take the QBID at the entity level. However, all partnerships and S corporations report each partner's or shareholder's share of qualified business income, Form W-2 wages paid by the business, unadjusted basis immediately after acquisition (UBIA) of qualified property, qualified REIT dividends, and qualified PTP income on Schedule K-1 so that a partner or shareholder may calculate his or her QBID.

**Trusts and estates.** For more information, see *Qualified business income deduction (QBID)*, page 21-17.

**Limitations.** There is a limitation, based on Form W-2 wages paid by the business and the unadjusted basis immediately after acquisition (UBIA) of qualified business property, that is phased in when the taxpayer's taxable income (computed without regard to the deduction) exceeds the threshold amount. See *Threshold Amount*, page 8-16.

In this case, the deduction is limited to the greater of 50% of the Form W-2 wages paid by the business, or the sum of 25% of the Form W-2 wages paid by the business plus 2.5% of the UBIA of all qualified property of the business. See *Calculation of QBID*, page 8-18. Additionally, when a taxpayer's taxable income exceeds the top of the phase-in range, the QBID is disallowed with respect to specified service trades or businesses. See *Specified Service Trade or Business (SSTB)*, page 8-17.

**Self-employment (SE) tax and net investment income tax.** The QBID does not reduce net earnings from self-employment or net investment income for determining the net investment income tax. [Reg. §1.199A-1(e)(3)]

Therefore, both the self-employment tax and the net investment income tax are calculated as though there is no QBID. For more information, see *Self-Employment Tax*, Tab 5, and *Net Investment Income Tax*, page 6-4.

**Basis in partnership or S corporation.** The QBID is applied at the partner or shareholder level in the case of a partnership or S corporation. The QBID has no effect on the adjusted basis of the partner's interest in the partnership, the adjusted basis of a shareholder's stock in an S corporation, or the S corporation's accumulated adjustments account. See *S Corporations*, Tab 19, and *Partnerships and LLCs*, Tab 20.

**Understatement penalty.** There is a 20% accuracy-related penalty for taxpayers who substantially understate their tax. Generally, the understatement is substantial if the amount of the tax exceeds the greater of 10% of the tax required to be shown on the return for the tax year or \$5,000. However, any taxpayer who claims the QBID is subject to a lower 5% threshold to determine substantial understatement. [IRC §6662(d)(C)]

### Qualified Trades or Businesses

A taxpayer's qualified trades and businesses include his or her trades or businesses for which the taxpayer is allowed a deduction for ordinary and necessary business expenses.

**Exceptions:** Trade or business does not include the following.

- Trades or businesses conducted through a C corporation,
- Wages earned as an employee, and
- Specified service trades or businesses for taxpayers with taxable income above the threshold amounts. See *QBID—2025 Threshold Amounts and Phase-In Ranges* chart, next column.

**Note:** If the taxpayer was treated as an employee for federal employment tax purposes by the person to whom he or she provided services, but now is treated as an independent contractor by that person and the taxpayer is providing substantially the same services directly or indirectly to that person (or a related person), the taxpayer is considered to be in the trade or business of performing services as an employee for purposes of determining his or her QBID for the 3-year period after ceasing to be an employee.

A taxpayer may rebut this presumption on notice from the IRS by providing records such as contract or partnership agreements that corroborate his or her status as a nonemployee.

**Rental activities.** In general, income from rental real property held for investment purposes and reported on Schedule E (Form 1040) is not eligible for the QBID. However, an investor may be eligible for the QBID if he or she is operating the activity as a real estate business.

**Safe harbor.** A safe harbor is available for a rental real estate enterprise to be treated as a trade or business solely for purposes of the QBID. Individuals, partnerships, and S corporations may use this safe harbor. (Rev. Proc. 2019-38).

For more information, see *Qualified Business Income Deduction (QBID)—IRC §199A*, page 7-3.

## Threshold Amount

Qualified business income is subject to limitations for individuals with taxable income exceeding the threshold amount. Taxpayers above the threshold amount must apply a limitation, which reduces the QBID. See *Qualified Business Income Deduction (QBID) Flowchart*, below.

The threshold amount is indexed each year for inflation. A taxpayer under the threshold amount does not apply any limitation.

## QBID—2025 Threshold Amounts and Phase-In Ranges

	Single, HOH, QSS	MFJ	MFS
Threshold Amount	\$197,300	\$394,600	\$197,300
Phase-In Range	\$197,301 to \$247,300	\$394,601 to \$494,600	\$197,301 to \$247,300
Full Limitation Applies*	\$247,301	\$494,601	\$247,301

\* For specified service trade or business (SSTB), no QBID allowed.

**Example:** Rory (single) has taxable income of \$125,000 and qualified business income of \$50,000. His taxable income is under the threshold amount (\$197,300) so no limitation applies and his QBID is \$10,000 (\$50,000 × 20%).

**OBBBA** Beginning 2026, the phaseout range increases to \$75,000 (\$150,000 for MFJ) and a new minimum QBID of \$400 applies. For more information, see *What's New*, Tab 1.

**Threshold limitation.** Limitations include the reduction or exclusion of the QBID for an SSTB and limitations based on the Form W-2 wages of a trade or business, or a combination of the Form W-2 wages and the unadjusted basis immediately after acquisition (UBIA) of qualified property.

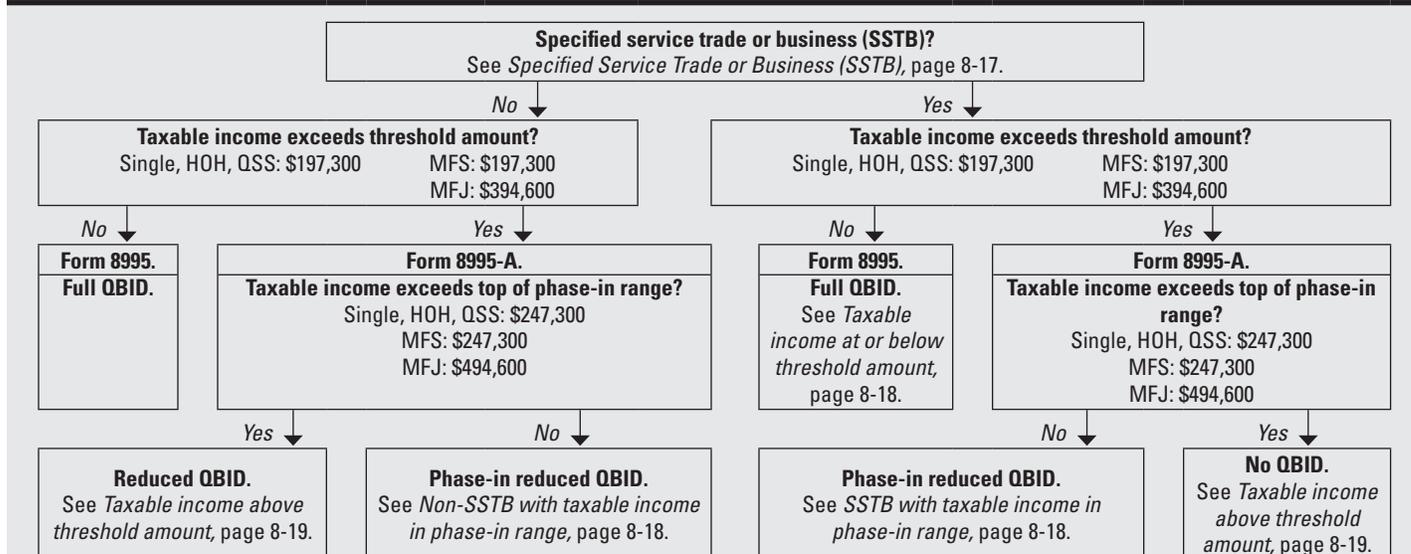
**Example:** Ben and Julie (MFJ) have taxable income of \$400,000 and qualified business income of \$150,000. Their taxable income is within the phase-in range so their QBID will be reduced. See *Calculation of QBID*, page 8-18.

**Aggregating trades or businesses.** An individual or relevant pass-through entity (RPE) may be engaged in more than one trade or business. Generally, each trade or business is a separate trade or business for purposes of applying the qualified business income limitations. However, individuals and RPE's are allowed, but not required, to aggregate trades and businesses, treating the aggregate as a single trade or business for purpose of applying the QBID limitations. Trades or businesses may be aggregated only if an individual or RPE can demonstrate that the following requirements are met.

- The taxpayer or a group of persons directly or indirectly own 50% or more of each trade or business for a majority of the tax year, including the last day of the tax year, and all trades or businesses use the same tax year end,

*continued on next page*

## Qualified Business Income Deduction (QBID) Flowchart<sup>1</sup>



<sup>1</sup> Applicable to a taxpayer who owns all or a part of a sole proprietorship, S corporation, partnership, trust, or estate. For more information, see *Qualified Business Income Deduction (QBID)*, page 8-15 and *Agricultural and Horticultural Cooperatives*, page 8-19.

- None of the trades or business are an SSTB, and
- The trades or businesses meet at least two of the following factors:
  - They provide products, property, or services that are the same or customarily offered together.
  - They share facilities or share significant centralized business elements.
  - They are operated in coordination with, or reliance upon, one or more of the businesses in the aggregated group.

*Required annual disclosure.* Schedule B (Form 8995-A), *Aggregation of Business Operations*, must be completed and attached to the tax return each year.

**Netting of qualified business income (QBI).** The regulations use a netting approach when there is negative QBI from one trade or business. If an individual has QBI of less than zero from one trade or business, but has overall QBI greater than zero when all of the individual's trades or businesses are taken together, then the individual must offset the net income in each trade or business that produced net income with the net loss from each trade or business that produced net losses before the individual applies the limitations based on Form W-2 wages and UBIA of qualified property. The individual must apportion the net loss among the trades or businesses with positive QBI in proportion to the relative amounts of QBI in such trades or businesses. Use Schedule C (Form 8995-A), *Loss Netting and Carryforward*, to compute loss netting and carryforward.

Then, for purposes of applying the limitation based on Form W-2 wages and UBIA of qualified property, the net gain or income with respect to each trade or business (as offset by the apportioned losses) is the taxpayer's QBI with respect to that trade or business. The Form W-2 wages and UBIA of qualified property from the trades or businesses which produced negative QBI are not taken into account and are not carried over into the subsequent year under the carryover rules. [Reg. §1.199A-1(d)(2)(iii)(A)]

### Specified Service Trade or Business (SSTB)

SSTBs are generally excluded from the definition of qualified trade or business. An SSTB is any trade or business providing services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any other trade or business where the taxpayer receives fees, compensation, or other income for endorsing products or services, for the use of the taxpayer's image, likeness, name, signature, voice, trademark, or any other symbols associated with the taxpayer's identity, or for appearing at an event or on radio, television, or another media format.

In addition, the trades or businesses of investing and investment management, trading or dealing in securities, partnership interests, or commodities are SSTBs.

**Note:** An SSTB specifically excludes architects and engineers. Services within the fields of architecture and engineering are not treated as consulting services. [Reg. §1.199A-5(b)(2)(vii)]

**Exceptions:** If taxable income is less than or equal to the threshold amount, the taxpayer's SSTB is treated as a qualified trade or business. If taxable income is within the phase-in range, an applicable percentage of the taxpayer's SSTB is treated as a qualified trade or business. See *QBID—2025 Threshold Amounts and Phase-In Ranges* chart, page 8-16.

### Qualified Business Income (QBI)

QBI includes items of income, gain, deduction, and loss from a taxpayer's trades or businesses, including income from partnerships (other than PTPs), S corporations, sole proprietorships, and certain estates and trusts that are included or allowed in determining taxable income for the year. Consider all items that are related to the trade or business, including, but not limited to, unreimbursed partnership expenses, business interest expense, deductible part of self-employment tax, self-employed health insurance deduction, and contributions to qualified retirement plans. QBI does not include any of the following.

- Items that are not properly included in income.
- Income that is not effectively connected with the conduct of a trade or business within the United States.
- Investment items such as capital gains or losses, dividends, or interest income not properly allocable to a trade or business.
- Wage income (except statutory employees).
- Foreign income that is not effectively connected with the conduct of business within the United States. For more information, go to [www.irs.gov/ECI](http://www.irs.gov/ECI).
- Commodities transactions or foreign currency gains or losses.
- Income, loss, or deductions from notional principal contracts.
- Annuities (unless received in connection with the trade or business).
- Reasonable compensation from an S corporation.
- Guaranteed payments.
- Payments received by a partner for services other than in a capacity as a partner.
- Qualified REIT dividends.
- Qualified PTP income.

**Note:** A taxpayer's QBI does not include any losses or deductions disallowed under the basis, at-risk, passive loss, the excess business loss limitations, as they are not included or allowed in determining taxable income for the year. Instead, these losses are taken into account in the tax year they are included in determining taxable income.

**Previously suspended losses.** Previously disallowed losses or deductions that are suspended and carried over to the current year must be taken into account for purposes of computing QBI in the current year.

The losses continue their status as either items of QBI or non-QBI for all subsequent years. Therefore, a taxpayer must track each category of loss or deduction (e.g., suspended losses under at-risk or passive activity rules, or a partner's or shareholder's share of partnership or S corporation losses in excess of his or her basis) from year to year until the loss is included in taxable income. Each category's portion of loss allowed in calculating taxable income is treated as qualified business net loss carryforward [line 3, Form 8995, or line 2, Schedule C (Form 8995-A)] in calculating the current year's QBID.

**Worksheet to track suspended losses or deductions.** A worksheet is provided in the instructions for Form 8995 to track and compute previously disallowed losses or deductions to be included in a qualified business income deduction for the year allowed. For more information, see the instructions for Form 8995.

**REIT dividends and PTP income.** Qualified REIT dividends include any dividend received from a real estate investment trust (REIT) that is not a capital gain dividend or qualified dividend. This amount is reported on line 5, Form 1099-DIV. The dividend may have to be corrected if the REIT was not held for at least 45 days during the period surrounding the ex-dividend date. Qualified PTP income or loss includes the taxpayer's share of qualified items of income, gain, deduction, and loss from a publicly traded partnership (PTP). It may also include gain or loss recognized on

the disposition of the taxpayer's partnership interest that is not treated as a capital gain or loss.

**Note:** Most REIT/PTP income is not subject to taxable income based phaseout rules, however PTP income generated by an SSTB may be limited to the applicable percentage or excluded if taxable income exceeds the threshold amount.

## Calculation of QBID

**Taxable income at or below threshold amount.** The QBID for taxpayers with taxable income at or below the threshold amount is equal to the lesser of:

- The combined QBI amount, or
- 20% of the excess, if any, of the taxpayer's taxable income minus the taxpayer's net capital gain (net long-term capital gain minus net short-term capital loss).

**Combined QBI amount.** The combined QBI amount is 20% of total QBI from all qualified trades or businesses of the taxpayer (QBI component), plus 20% of the taxpayer's combined qualified REIT dividends and qualified PTP income (REIT/PTP component).

**Note:** This limitation applies to all taxpayers at all income levels when taxable income is less than the combined QBI amount.

**Carryover.** If total QBI is less than zero, the taxpayer has a qualified business net loss for the year and does not qualify for the QBID unless he or she has qualified REIT dividends or qualified PTP income. The negative total QBI is carried forward to the next tax year and treated as negative QBI from a separate trade or business. This carryover is only applicable to the QBID.

**Form 8995, Qualified Business Income Deduction Simplified Computation.** Form 8995 is used to compute a taxpayer's QBID if the taxpayer:

- Has QBI, qualified REIT dividends, or qualified PTP income or loss, and
- Has 2025 taxable income before the QBID less than or equal to \$197,300 (Single, HOH, QSS, estate or trust), \$197,300 (MFS), \$394,600 (MFJ), and
- Is not a patron in a specified agricultural or horticultural cooperative.

Otherwise, use Form 8995-A to compute the taxpayer's QBID. See *Form 8995-A, Qualified Business Income Deduction*, page 8-19.

**Non-SSTB with taxable income in phase-in range.** The QBID for non-SSTB with taxable income in the phase-in range equals:

- 20% of QBI, less,
- An amount equal to the percentage multiplied by the excess amount.

**Phase-in percentage.** The percentage for MFJ is:  

$$\frac{(\text{Taxable income} - \$394,600)}{\$100,000}$$

The percentage for MFS is:  

$$\frac{(\text{Taxable income} - \$197,300)}{\$50,000}$$

The percentage for Single, HOH, QSS, estates and trusts, is:  

$$\frac{(\text{Taxable income} - \$197,300)}{\$50,000}$$

**Excess amount.** The excess amount is the amount by which 20% of QBI exceeds the greater of:

- 50% of Form W-2 wages paid by the business, or
- 25% of Form W-2 wages paid by the business plus 2.5% of the unadjusted basis immediately after acquisition (UBIA) of qualified property of the business.

**Form W-2 wages.** For purposes of the QBID limitation, Form W-2 wages include all compensation paid to employees during the calendar year ending during the taxpayer's tax year including:

- Total wages subject to withholding, but not including Form 1099 compensation.
- Elective deferrals.
- Deferred compensation.
- Designated Roth contributions.

The Form W-2 wages limitation applies separately for each trade or business. In the case of Form W-2 wages that are allocable to more than one trade or business, the portion of the Form W-2 wages allocable to each trade or business is determined to be in the same proportion to total Form W-2 wages as the deductions associated with those wages are allocated among the particular trades or businesses.

**Unadjusted basis (UBIA) of qualified property.** UBIA is the basis on the placed-in-service date. Qualified property includes tangible property subject to depreciation, held and used in the production of QBI, by the trade or business during and at the close of the tax year, for which the depreciable period has not ended before the close of the tax year.

The depreciable period ends on the later of 10 years after the property is first placed in service by the trade or business, or the last day of the last full year in the applicable recovery period.

**Property transferred to increase QBID.** Property is not qualified property if the property is acquired within 60 days of the end of the tax year and disposed of within 120 days without having been used in a trade or business for at least 45 days prior to disposition, unless the taxpayer demonstrates that the principal purpose of the acquisition and disposition was a purpose other than increasing the QBID. [Reg. §1.199A-2(c)(1)(iv)]

**Example:** Joe and Beth file jointly with taxable income of \$454,600 and QBI of \$300,000. Joe's engineering business (non-SSTB) paid Form W-2 wages of \$40,000 and the UBIA of his business property is \$0. Initially, his QBID would be \$60,000 (\$300,000 × 20%), however, because they are above the threshold amount, his deduction is limited. Joe's QBID is \$36,000, computed as follows:

Excess amount	\$40,000
\$60,000 (20% of \$300,000 QBI) minus \$20,000 (50% of \$40,000 W-2 wages).	
Phase-in percentage	60%
$\frac{(\$454,600 \text{ taxable income} - \$394,600 \text{ threshold amount})}{\$100,000}$	
QBID	\$36,000
\$60,000 (20% of \$300,000 QBI) minus \$24,000 (60% phase-in percentage times \$40,000 excess amount).	

**SSTB with taxable income in phase-in range.** The QBID for SSTB with taxable income in the threshold phase-in range is calculated as follows.

- The applicable percentage is first applied to QBI, Form W-2 wages, and UBIA of qualified property. For definitions, see *Form W-2 wages*, previous column, and *Unadjusted basis (UBIA) of qualified property*, above.
- The QBID is then:
  - 20% of QBI, less,
  - An amount equal to the percentage multiplied by the excess amount. See *Excess amount*, previous column.

**Applicable percentage.** Applicable percentage means 100% reduced, but not below zero, by the phase-in percentage.

Applicable Percentage		
MFJ	MFS	Single, HOH, QSS, Estates and Trusts
$100\% - \frac{(\text{Taxable income} - \$394,600)}{\$100,000}$	$100\% - \frac{(\text{Taxable income} - \$197,300)}{\$50,000}$	$100\% - \frac{(\text{Taxable income} - \$197,300)}{\$50,000}$

**Example:** Bob and Shirley file jointly with taxable income of \$454,600 and QBI from Shirley's accounting business (SSTB) of \$300,000. Shirley's SSTB paid Form W-2 wages of \$40,000 and the UBIA of her business property is \$0. Initially, her QBID would be \$60,000 ( $\$300,000 \times 20\%$ ), however, because they are above the threshold amount, her deduction is limited. Shirley's QBID is \$14,400, computed as follows:

*Applicable percentage*

$$100\% - \frac{(\$454,600 \text{ taxable income} - \$394,600 \text{ MFJ threshold})}{\$100,000} = 40\%$$

*Excess amount* ..... \$16,000

$$\text{Reduced QBI} = \$300,000 \text{ QBI} \times 40\% = \$120,000$$

$$\text{Reduced W-2 wages} = \$40,000 \text{ W-2 wages} \times 40\% = 16,000$$

$$\begin{aligned} \text{Excess amount} &= 20\% \text{ reduced QBI minus } 50\% \text{ reduced wages} \\ &= (\$120,000 \times 20\%) - (\$16,000 \times 50\%) \\ &= \$24,000 - \$8,000 \\ &= \$16,000 \end{aligned}$$

*Phase-in percentage* ..... 60%

$$\frac{(\$454,600 \text{ taxable income} - \$394,600 \text{ threshold amount})}{\$100,000}$$

*QBID* ..... \$14,400

$$= 20\% \text{ reduced QBI minus excess amount multiplied by phase-in percentage}$$

$$= (\$120,000 \times 20\%) - (\$16,000 \times 60\%)$$

$$= \$24,000 - \$9,600$$

$$= \$14,400$$

**Taxable income above threshold amount.** For an SSTB, if taxable income is above the threshold amount, no QBID is allowed.

For a non-SSTB, the QBID for each qualified trade or business is the lesser of:

- 20% of QBI, or
- The greater of:
  - 50% of Form W-2 wages paid by the business, or
  - The sum of 25% of Form W-2 wages paid by the business plus 2.5% of the UBIA of qualified property of the business.

**Example:** Lowell operates a sole proprietorship that sells candles. His qualified business income for 2025 is \$200,000 and his taxable income is \$250,000. Lowell has employees and paid total wages of \$40,000 for the year. Lowell does not have any qualifying property. Initially, Lowell's qualified business income deduction would be \$40,000 ( $\$200,000 \times 20\%$ ), however, because he is above the threshold amount, his deduction will be limited by the wages limitation. For 2025, Lowell's QBID is limited to \$20,000 ( $\$40,000 \text{ wages} \times 50\% = \$20,000$ ).

**Example:** Mike operates a sole proprietorship that makes beef jerky. His qualified business income for 2025 was \$180,000 and his taxable income is \$250,000. The business bought a new high-tech large-capacity dehydrator for \$100,000 and placed the dehydrator in service in 2025. Mike has one employee and paid total wages of \$20,000 for the year.

Initially, Mike's QBID would be \$36,000 ( $\$180,000 \times 20\%$ ), however, because he is above the threshold amount, his deduction is limited. Mike's QBID is limited to \$10,000, which is the lesser of:

- \$36,000 = 20% of his qualified business income, or
- \$10,000 = Form W-2 wages/UBIA property limit, which is the greater of:
  - \$10,000 = 50% of W-2 wages ( $\$20,000 \times 50\%$ ), or
  - \$7,500 = sum of 25% W-2 wages ( $\$20,000 \times 25\% = \$5,000$ ), plus 2.5% UBIA ( $\$100,000 \times 2.5\% = \$2,500$ )

**Form 8995-A, Qualified Business Income Deduction.** Form 8995-A is used to compute a taxpayer's QBID if the taxpayer:

- Has QBI, qualified REIT dividends, or qualified PTP income or loss, and
- Has 2025 taxable income before the QBID of more than \$197,300 (Single, HOH, QSS, estates or trusts), \$197,300 (MFS), \$394,600 (MFJ), or
- Is a patron in a specified agricultural or horticultural cooperative.

Otherwise, use Form 8995 to compute the taxpayer's QBID. See *Form 8995, Qualified Business Income Deduction Simplified Computation*, page 8-18.

Before completing Form 8995-A, a taxpayer may need to complete Schedules A, B, C, and D, as applicable.

**Schedule A (Form 8995-A), Specified Service Trades or Businesses.** Part I is completed if the taxpayer's trade or business is an SSTB and his or her taxable income is within the phase-in range. The applicable percentages of qualified business income (or loss), Form W-2 wages, and UBIA of qualified property are calculated in this part and transferred to Part II, Form 8995-A.

Part II is completed if the taxpayer has income from a PTP and his or her taxable income is within the phase-in range. The applicable percentage of qualified PTP income (or loss) is calculated in this part and transferred to Part IV, Form 8995-A.

**Schedule B (Form 8995-A), Aggregation of Business Operations.** Information required to aggregate businesses is entered to this schedule and transferred to Form 8995-A.

**Schedule C (Form 8995-A), Loss Netting and Carryforward.** Amounts for losses carried forward from previous years, and the income and losses from the current year are used to calculate the current year qualified business net (loss) carryforward (if any).

**Note:** If the taxpayer has an overall net loss for the year, he or she does not qualify for a QBID in the current year.

**Schedule D (Form 8995-A), Special Rules for Patrons of Agricultural or Horticultural Cooperatives.** See *Agricultural and Horticultural Cooperatives*, below.

## Agricultural and Horticultural Cooperatives

Cooperatives are C corporations and therefore not eligible for the QBID. However, specified agricultural and horticultural cooperatives (and their patrons) are eligible for a domestic production activities deduction (DPAD) equal to 9% of the lesser of the specified cooperative's qualified production activities income (QPAI), or taxable income. [IRC §199A(g)]

A specified agricultural or horticultural cooperative is an organization subject to income tax rules for cooperatives which is engaged in the:

- Manufacturing, production, growth, or extraction (MPGE) in whole or significant part of any agricultural or horticultural product, or
- In the marketing of agricultural or horticultural products that their patrons have MPGE in whole or significant part.

**Limitations.** The deduction for specified cooperatives is:

- Subject to a 3% reduction if it has oil-related QPAI.
- Limited to 50% of its Form W-2 wages.

**Patrons.** A specified cooperative may pass all, some, or none of its DPAD under IRC section 199A(g) to patrons, and reduce its deduction by the amount passed through. An eligible patron is allowed to deduct the passed through amount (on line 38, Form 8995-A) as long as the deduction does not exceed the patron's taxable income minus his or her QBID. A specified cooperative must provide the necessary information to its patrons on Form 1099-PATR or an attachment.

**Form 1099-PATR, Taxable Distributions Received From Cooperatives.** The taxpayer's share of patronage dividends and similar payments on Form 1099-PATR are not automatically included in QBI. Payments may be included in QBI to the extent they are:

- Related to the taxpayer's trade or business,
- Reported to the taxpayer by the cooperative as qualified income items on an attachment to Form 1099-PATR, and
- Not payments reported as from an SSTB (unless the taxpayer's taxable income is at or below the threshold).

Taxpayers that receive qualified payments from a specified cooperative must reduce QBI by the patron reduction. [IRC §199A(b)(7)]

**Patron reduction.** Patrons that receive qualified payments must reduce their QBI component by the lesser of 9% of QBI properly allocable to qualified payments from a specified cooperative, or 50% of Form W-2 wages allocable to qualified payments. The patron reduction is computed on Schedule D (Form 8995-A).

## Net Operating Loss (NOL)

### Cross References

- Form 172, *Net Operating Losses (NOLs)*
- Form 1040-X, *Amended U.S. Individual Income Tax Return*
- Form 1045, *Application for Tentative Refund*
- IRS Pub. 536, *Net Operating Losses (NOLs) for Individuals, Estates, and Trusts*
- IRC §172, *Net operating loss deduction*

### Related Topics

- Net Operating Losses on Farms, Tab 5
- Corporate Net Operating Loss (NOL), Tab 18

### NOL Carryback and Carryforward

**Default rule.** For an NOL occurring in any tax year beginning after December 31, 2020:

- The NOL deduction is limited to 80% of taxable income.
- The option to carry back an NOL is disallowed for most taxpayers.
- An NOL carryforward is adjusted to take into account the 80% of taxable income limitation.
- An NOL may be carried forward indefinitely.

Exceptions apply to certain farming losses and NOLs of insurance companies other than life insurance companies.

#### NOL Default Rules

Tax Year	Carryback Period	Carryforward Period	Taxable Income % Limit
Pre-2018	Varies by year <sup>1</sup>	20 years	100%
2018 – 2020	5-year <sup>1,2</sup>	Unlimited <sup>3</sup>	80% <sup>4</sup>
2021 and after	Not allowed <sup>2</sup>	Unlimited <sup>3</sup>	80%

<sup>1</sup> Election to waive carryback period allowed.

<sup>2</sup> 2 years for farm losses. See *Net Operating Losses on Farms*, Tab 5.

<sup>3</sup> Until loss is used up or taxpayer dies.

<sup>4</sup> 100% for losses utilized in tax years before 2021; 80% thereafter.

**Applicable law.** The computation of an NOL for any tax year is determined by the law in effect for the tax year in which it originates. The amount of deduction allowed for any NOL carried back or carried forward is determined by the law in effect for the year to which the NOL is carried.

**Business loss limitation.** NOLs arising in tax years after 2020 are limited by the excess business loss limitation rule, so an NOL generally will not exceed \$313,000 (\$626,000 MFJ) for 2025. See *Excess Business Loss Limitation*, Tab 5.

**NOL deduction.** The NOL deduction is listed as a negative amount on line 8a, Schedule 1 (Form 1040), *Additional Income and Adjustments to Income*. Attach Form 172, *Net Operating Losses (NOLs)*, showing how the NOL deduction was calculated. If more than one NOL is deducted in the same year, attach Form 172 for each NOL. See *Form 172, Net Operating Losses (NOLs)*, page 8-21.

- If the NOL is being carried back, use Form 1045, *Application for Tentative Refund*, or Form 1040-X, *Amended U.S. Individual Income Tax Return*, to report recalculated tax. Attach a Form 172 for each NOL to Form 1045 or Form 1040-X if it applies for the computation of the NOL.
- If the NOL is being carried forward, attach Form 172 to the return showing the computation for each NOL being carried to that year. See *How to Calculate an NOL Carryover*, page 8-21.

**Did You Know?** An NOL carryback or carryforward does not become part of the calculation for:

- An NOL in the carryback or carryforward year.
- Self-employment tax for the carryback or carryforward year.
- Additional Medicare tax in the carryback or carryforward year.

### What is a Net Operating Loss (NOL)?

An individual, estate, or trust may have an NOL if deductions for the year exceed gross income. NOLs are caused by losses from the following:

- Trades or businesses (Schedules C and F losses, or Schedule K-1 losses from partnerships or S corporations),
- Casualty and theft losses resulting from a federally-declared disaster, and
- Rental property (Schedule E).

**Individual NOL.** An individual may have an NOL if adjusted gross income (AGI) minus the standard deduction or itemized deductions is a negative amount, and the negative amount is due to business deductions exceeding business income.

**Estate or trust NOL.** An estate or trust may have an NOL if the taxable income line on Form 1041, *U.S. Income Tax Return for Estates and Trusts*, is a negative amount, and the negative amount is due to business deductions exceeding business income.

**Individual alternative tax net operating loss (ATNOL).** An ATNOL for a loss year is the excess of deductions allowed for calculating alternative minimum taxable income (AMTI) over the income included in AMTI. The ATNOL deduction is limited to 90% of AMTI without regard to the ATNOL. See the instructions for Form 6251, *Alternative Minimum Tax—Individuals*.

### How to Calculate an NOL

First, complete the tax return for the current year. The taxpayer may have an NOL if a negative amount results from:

- An individual's AGI minus his or her standard deduction or itemized deductions.
- An estate's or trust's combined taxable income, charitable deduction, income distribution deduction, and exemption amount (Form 1041).

Next, determine whether the taxpayer has an NOL and its amount. In general, the following items are not allowed when computing an NOL.

- Capital losses in excess of capital gains.
- The section 1202 exclusion of the gain from the sale or exchange of qualified small business stock.
- Nonbusiness deductions in excess of nonbusiness income.
- The NOL deduction.
- The qualified business income deduction (IRC §199A).

In addition, business and nonbusiness income and deductions must be separated.

After completing the allocation to separate business and nonbusiness income and deductions from business income and deductions, use the amounts to fill in Form 172, *Net Operating Losses (NOLs)*.

**Example:** Glenn, single, has a retail music business and has the following income and deductions on his 2025 Form 1040.

Income	
Wages from part-time job.....	\$1,225
Interest on savings.....	425
Net long-term capital gain on sale of real estate used in business.....	2,000
<b>Glenn's total income</b> .....	<b>\$3,650</b>
Deductions	
Net loss from business.....	\$5,000
Net short-term capital loss on sale of stock.....	1,000
Standard deduction.....	15,750
<b>Glenn's total deductions</b> .....	<b>\$21,750</b>

Glenn's deductions exceed his income by \$18,100 (\$21,750 – \$3,650). To determine if he has an NOL, the following deductions are not allowed.

Nonbusiness net short-term capital loss.....	\$1,000
Nonbusiness deductions (\$15,750 standard deduction) minus nonbusiness income (\$425 interest income).....	15,325
<b>Total adjustments to net loss</b> .....	<b>\$16,325</b>

Glenn's NOL for 2025 is computed as follows:

Glenn's total 2025 income .....	\$3,650
Less:	
Glenn's original 2025 total deductions .....	21,750
Reduced by the disallowed items.....	(16,325)
<b>Glenn's NOL for 2025</b> .....	<b>(\$1,775)</b>

## How to Use an NOL

Once an NOL has been calculated for the year, it is used to offset income from another tax year. The current default rules require the NOL to be carried forward, except for certain farming businesses and insurance companies.

For default carryback and carryforward rules, see *NOL Default Rules* chart, page 8-20.

**Election to waive carryback period.** For tax years prior to 2021, a taxpayer could elect not to carry the NOL back and to carry the NOL forward only by making an irrevocable election to waive the carryback period.

**Estimated tax in carryforward year.** An NOL carryforward can reduce the amount of estimated taxes due in the current year.

**Change in marital status.** If a taxpayer and spouse were not married to each other in all years involved in calculating NOL carryforwards, only the spouse who had the loss can take the NOL deduction. If a joint return is filed for the NOL year, the NOL deduction is limited to the income of that spouse.

**Change in filing status.** Special rules apply for computing the NOL carryovers of married people whose filing status changes for any tax year involved in computing an NOL carryback or carryover.

**Separate to joint return.** If the taxpayer and spouse file a joint return for a carryforward year, but file separate returns for any of the tax years involved in calculating the NOL carryover, treat the separate carryover as joint.

**Joint to separate returns.** If the taxpayer and spouse file separate returns for a carryforward year, but filed a joint return for any or all of the tax years involved in calculating the NOL carryover, compute each of the carryovers separately.

## How to Calculate an NOL Carryover

If the NOL is more than taxable income for the year to which it was carried (computed before deducting the NOL), there may be an NOL carryover. Certain modifications must be made to taxable income to determine how much NOL will be used up in that year and how much may be carried over to the next tax year. The carryover is the excess of the NOL deduction over modified taxable income for the carryforward year. If the NOL deduction includes more than one NOL, apply the NOLs against modified taxable income in the same order they were incurred, starting with the earliest.

**Form 172, Net Operating Losses (NOLs).** Form 172 is used by individuals, estates, and trusts to compute the amount of a current NOL and the amount of any unused NOL available for carrying forward or any unused NOL available for carrying back (allowed only to certain farmers and certain insurance companies).

If carrying forward an NOL to a tax year after the NOL year, list the NOL deduction as a negative amount on Schedule 1 (Form 1040) for the year to which the NOL is carried. Estates and trusts, include an NOL deduction on Form 1041.

Attach a Form 172 for each NOL to Form 1040 or Form 1041.

### Form 1045, Application for Tentative Refund.

Form 1045 is used by individuals, estates, and trusts to apply for a quick tax refund resulting from:

- The carryback of an NOL.
- The carryback of an unused general business credit,
- The carryback of a net section 1256 contracts loss, or
- An overpayment of tax due to a claim of right adjustment under IRC section 1341(b)(1).

**Note:** Individuals, estates, and trusts that carry NOLs back to years in which they have an IRC section 965(a) inclusion may not use Form 1045. Use an amended return for such claim.

**Modified taxable income.** Modified taxable income is the amount calculated on line 9, Part II, Form 172.

1) Do not claim any of the following:

- An NOL deduction for the NOL carryover being calculated or for any later NOL.
- A deduction for capital losses in excess of capital gains or any section 1202 exclusion claimed.

2) Recalculate any item affected by the amount of AGI after making the changes in (1) above, and certain other changes to AGI that result from (1). This includes income and deductions used to determine AGI (for example, IRA deductions), as well as certain itemized deductions. To calculate a charitable contribution deduction, do not include deductions for NOL carrybacks in the change in (1) but do include deductions for NOL carryforwards from tax years before the NOL year.

Taxable income as modified cannot be less than zero.

## Start-Up/Organizational Costs

### Cross References

- IRS Pub. 583, *Starting a Business and Keeping Records*
- IRC §195, *Start-up expenditures*
- IRC §248, *Organizational expenditures*
- IRC §709, *Treatment of organization and syndication fees*

### Related Topics

- Intangible Assets, page 9-13
- Start-Up Costs and Organizational Costs, Tab 18
- Where to Report Income and Expenses (Form 1065) chart, page 20-2

---

### Start-Up and Organizational Cost Deduction Limits

---

Start-up costs.....	\$5,000*
Organizational costs.....	\$5,000*

\* Reduced dollar-for-dollar when total costs exceed \$50,000. Limits apply separately. Any remaining costs must be amortized.

---

### Capital Expenses

Start-up costs and organizational costs are generally capital expenses. Capital expenses are generally not deductible and are added to the taxpayer's basis in the business. If the expenses are not otherwise recoverable through depreciation, amortization, depletion, or the cost of goods sold deduction, the expenses are recovered at the time the business is sold.

### Start-Up Costs

Start-up costs are amounts that would be deductible by an existing business that are paid or incurred in connection with:

- Investigating the creation or acquisition of an active trade or business,
- Creating an active trade or business, or
- Any activity engaged in for profit and for the production of income before the day on which the active trade or business begins, in anticipation of such activity becoming an active trade or business.

Start-up costs include:

- Analysis or survey of potential markets, products, labor supply, transportation facilities, etc.
- Expenses incurred while investigating the purchase of a business.
- Training wages for employees who will work in the business.
- Travel and other necessary costs for securing prospective distributors, suppliers, or customers.
- Cost of professional services, such as executives and consultants.
- Minor or incidental repairs and maintenance costs paid before a rental property is offered to rent.
- Research fees paid to analyze demographics, traffic patterns, and economic conditions of a neighborhood for potential rental property.
- Cost of investigating ways to create a successful residential rental business, including research on potential real estate markets.

**Business start date.** The business start date determines whether operating expenses are deductible in the current tax year or whether the expenses must be capitalized. For example, before a retail store opens its doors to customers, wages paid for employee training are capitalized start-up costs subject to amortization limits. After the business opens, the wages are deductible as current operating expenses.

---

**Court Case:** The taxpayer owned a health food business for which the IRS denied business expense deductions on the basis that the expenses constituted start-up expenses rather than business expenses. Numerous email conversations, cost analyses, online educational articles, bank records, credit card statements, and canceled checks in evidence demonstrated that the company remained in the start-up phase throughout the years in question. The Tax Court supported the IRS' position that the expenses in question should be properly treated as start-up expenses. (*Yapp*, T.C. Memo. 2018-147)

---

**Author's Comment:** Determining the business start date is not always as clear as a retail store's grand opening. In *Glotov vs. Commissioner*, (T.C. Memo. 2007-147), the Tax Court made the determination based on whether "the business is functioning as a going concern and performing the activities for which it was organized." Note that a business can be a going concern even if it has not yet produced any sales revenue.

---

**Purchase of a business.** Costs directly associated with purchasing a business are capital expenses and cannot be amortized.

---

**Example:** In June, Jenny hired an accounting firm to perform financial projections to investigate the potential purchase of Heidi's Convenience Store. In October, Jenny signed a purchase agreement with Heidi's Convenience Store. The accounting firm continued to provide services after the purchase agreement was signed. The costs to investigate the business before Jenny signed a purchase agreement are amortizable start-up costs. The costs for services after that time related to the attempt to purchase the business must be capitalized, added to the basis of the business, and cannot be amortized as start-up costs. When Jenny opens the doors as the new owner, the business start date has occurred, and future accounting costs will be deductible as operating costs.

---

### Organizational Costs

Business organizational costs are amounts paid or incurred to create a corporation or partnership business entity.

See *Organizational costs*, Tab 18, for information on corporate organizational costs, and *Organizational costs*, Tab 20, for information on partnership organizational costs.

### Deduction/Amortization

**Amortization.** Under the general rule, a taxpayer may elect to amortize start-up costs and organizational costs over a term of 180 months, starting with the month the active trade or business begins.

**Deduction.** A taxpayer may elect to deduct up to \$5,000 in start-up costs and/or up to \$5,000 in organizational costs in the year the business begins. The deduction is phased out dollar-for-dollar when start-up costs (or organizational costs) exceed \$50,000.

---

**Example:** Armando opened the doors to the public for his new restaurant in April 2025. Start-up costs paid between November 2024, when he first started planning for the restaurant, and April 2025, when final preparations were complete, total \$14,000. The first \$5,000 of start-up costs is currently deductible in 2025. The remaining \$9,000 is amortized over 180 months starting April 2025.

---

### Making the Election

The election to either amortize or capitalize start-up or organizational costs is irrevocable and applies to all start-up and organizational costs that are related to the trade or business. (Reg. §1.195-1 and Reg. §1.248-1)

**Electing the deduction.** The election to currently deduct up to \$5,000 of start-up or organizational costs (or both) is made by claiming the deduction for the tax year in which the trade or business begins. The election is irrevocable.

- The tax return must be timely-filed, including extensions.
- No separate statement is required for making this election.

**Electing to amortize (deemed election).** The election to amortize start-up or organizational costs (or both) is made by filing Form 4562, *Depreciation and Amortization*, with the applicable timely-filed (including extensions) tax return for the tax year in which the trade or business begins.

**Note:** A statement is not required to make the election.

**Electing to capitalize (affirmative election).** A taxpayer may choose to forgo the deemed election to amortize start-up costs and organizational costs by affirmatively electing to capitalize these costs on a timely filed income tax return (including extensions) for the year in which the active trade or business begins.

**Correcting an omitted election.** An election that was omitted on a timely-filed return (including extensions) can still be made by filing an amended return within six months of the original due date of the return (excluding extensions).

---

**Author's Comment:** A taxpayer filing a past-due late return with start-up and/or organizational costs must capitalize the expenses and can recover them only upon the sale of the business.

---

## What if the Business Never Starts?

**Individuals.** If an individual attempts to go into business and is not successful in starting the business, the expenses incurred in trying to establish the business fall into two categories.

- Costs incurred before making a decision to acquire or begin a specific business are personal and nondeductible. They include any costs incurred during a general search for, or preliminary investigation of, a business or investment possibility.
- Costs incurred in an attempt to acquire or begin a specific business are capital expenses and can be deducted as a capital loss.

**Corporations.** If a corporation attempts to go into a new trade or business and is not successful, all investigatory costs are deductible as a loss. The cost of any assets acquired during the unsuccessful attempt at going into business is part of the basis in the assets. Such costs are recovered when the assets are disposed of.

## Accounting Periods and Methods

### Cross References

- Form 3115, *Application for Change in Accounting Method*
- IRS Pub. 538, *Accounting Periods and Methods*
- IRC §448, *Limitation on use of cash method of accounting*
- IRC §460, *Special rules for long-term contracts*
- IRC §471, *General rule for inventories*
- IRC §481, *Adjustments required by changes in method of accounting*
- Rev. Proc. 2025-23

### Related Topics

- Farm Accounting Methods, Tab 5
- Installment Sales, Tab 6

### Accounting Methods

An accounting method is a set of rules used to determine when income and expenses are reported. The accounting method is chosen when the first tax return is filed. Approval from the IRS

is required if the taxpayer wants to later change the accounting method. See *Change in Accounting Method*, page 8-25.

The same individual can use different accounting methods for different businesses provided each business maintains complete and separate sets of books and records.

### Cash Method

The cash method is the most common method of accounting. However, if a business produces, purchases, or sells merchandise, the business must account for an inventory and generally use the accrual method for sales and purchases. See *Small Business Inventory Exception*, page 8-15.

**Income.** Under the cash method, income is reported when the taxpayer actually or constructively receives the income.

**Constructive receipt.** Income is constructively received when an amount is credited to the taxpayer's account or made available to the taxpayer without restriction. The taxpayer does not need to have possession of the income. If someone is authorized to be an agent and receive income for the taxpayer, the taxpayer is considered to have received it when the agent received it. Income is not constructively received if control or its receipt is subject to substantial restrictions or limitations.

Holding a check or postponing taking possession of similar property from one tax year to another does not postpone constructive receipt.

---

**Example:** Ken is an excavator and reports income and expenses under the cash method. On December 26, 2025, he receives a check in the mail for services performed in September 2025. Ken deposits the check into his business checking account on January 6, 2026. The income is includible on his 2025 tax return.

---

**Expenses.** Business expenses are deducted in the tax year they are actually paid, even if they were incurred in an earlier year. See *Prepaid Expenses*, page 8-25.

**Small business taxpayers.** The cash method of accounting may be used by taxpayers, other than tax shelters, that satisfy the gross receipts test. The cash method is allowed regardless of whether the purchase, production, or sale of merchandise is an income-producing factor.

**Gross receipts test.** The gross receipts test allows taxpayers with average annual gross receipts that do not exceed \$31 million (2025) for the three prior tax-year period to use the cash method. Average annual gross receipts are calculated by taking the prior year gross receipts plus the gross receipts from the two preceding tax years and dividing the total by three. If an entity was not in existence for the entire three-year period, the gross receipts test is applied on the basis of the period during which such entity (or trade or business) was in existence.

**Farming corporation.** Any farming C corporations (and farming partnerships with a C corporation partner) that meet the gross receipts test may use the cash method of accounting. A farming business means the trade or business of farming, including operating a nursery or sod farm, or the raising or harvesting of trees bearing fruit, nuts, or other crops, timber, or ornamental trees.

**Personal service corporations (PSC) and other pass-through entities.** Qualified PSCs (services in the fields of health, veterinary services, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting), partnerships without C corporation partners, S corporations, and other pass-through entities are allowed to use the cash method without regard to whether they meet the gross receipts test, as long as the use of such method clearly reflects income.

**Excluded entities.** The following entities cannot use the cash method of accounting.

- A C corporation (other than an S corporation) with average annual gross receipts exceeding the gross receipts test.
- A partnership with a corporation (other than an S corporation) as a partner, with average annual gross receipts exceeding the gross receipts test.
- A tax shelter. [IRC §448(d)(3)]

If a corporation that was allowed to use the cash method in a prior year fails to meet the average annual gross receipts test for the current year, the corporation must change to an accrual method of accounting for the current year.

Additionally, if an S corporation that was permitted to use the cash method of accounting converts to a C corporation that is required to use the accrual method of accounting, the conversion would result in a change of accounting method. See *Change in Accounting Method*, page 8-25.

## Accrual Method

Under the accrual method of accounting, a taxpayer generally reports income in the year earned and deducts or capitalizes expenses in the year incurred. The purpose of the accrual method is to match income and related expenses in the same year.

---

**Example:** Gloria owns a floral shop. Most customers use a credit card or cash to purchase products. On occasion, local business customers will call her to order flowers to be delivered. Gloria bills these customers for their orders. She purchases the flowers from a wholesaler on credit. In order to match the income earned on the sale with the cost of purchasing the flowers, Gloria reports her income and expenses under the accrual method of accounting. She claims a deduction for the cost of the flowers at the same time she reports the sale as income.

---

**Income.** Include in income, gross income for the tax year in which all events that fix the taxpayer's right to receive the income have occurred, and the taxpayer can determine the amount with reasonable accuracy. Report the amount included in gross income on the earliest of the following dates.

- When the payment is received.
- When the income amount is due to the taxpayer.
- When the taxpayer earns the income.
- When the title has passed.

---

**Example:** Mike is an accrual basis taxpayer and sells inventory on December 28, 2025. He bills the customer in the first week of January 2026 but does not receive payment until February 2026. Mike reports the income earned as 2025 income.

---

**Advance payment for services.** Accrual method taxpayers include payment for future services in income when the payment is received.

- If the advance payment is for services to be performed by the end of the next tax year, the taxpayer can elect to postpone reporting the income until the next tax year (but not beyond the next tax year).
- Income cannot be postponed if any part of the service is to be performed beyond the next tax year or at some unspecified future date that may be beyond the next tax year.
- Prepaid income from a guarantee or warranty contract and prepaid rent cannot be postponed.

**Advance payment for goods.** For advance payments for sales of goods held primarily for sale to customers, income is generally reported in the year received. A special election is available to postpone reporting income. For more information, see IRS Pub. 538, *Accounting Periods and Methods*.

**Expenses.** Business expenses are deducted or capitalized when both of the following apply.

- All events have occurred that fix the fact of liability, and the liability can be determined with reasonable accuracy.
- Economic performance has occurred.

**Economic performance.** If an expense is for property or services provided to the business, or for use of property, economic performance occurs as the property or services are provided or the property is used. If the expense is for property or services the business provides to others, economic performance occurs as the business provides the property or services.

---

**Example:** In December 2025, Clint's Plumbing Company did some repair work at Amy's Store and sent her a bill for \$150. Amy paid it by check in January 2026. If Amy uses the accrual method of accounting, she deducts the \$150 on her 2025 tax return because all events occurred to fix the fact of liability, the liability can be determined, and economic performance occurred in that year. If Amy uses the cash method of accounting, she deducts the expense on her 2026 tax return.

---

**Employee compensation.** Economic performance occurs as an employee renders service to the employer. However, deductions for compensation or other benefits paid to an employee in a year subsequent to economic performance are subject to the rules governing deferred compensation, deferred benefits, and funded welfare benefit plans. See *Retirement, Social Security, and Medicare*, Tab 13, and *Employee Benefits*, Tab 22.

**Related party rules.** If an expense is paid to a related person who uses the cash method of accounting, the expense is not deductible until actually paid to the related person.

**Payments by accrual basis partnership to cash basis partner.** A partnership that uses an accrual method of accounting can not deduct any business expense owed to a cash basis partner until the amount is paid. However, this rule does not apply to guaranteed payments made to a partner, which are generally deductible when accrued.

---

**Court Case:** The taxpayers were sole shareholders of two S corporations, making the two entities related parties. From 1998 through 2004 the accrual method S corporation deducted accounts payable to the cash method S corporation as the liability became fixed. The cash basis S corporation included the payments in income when it actually received the payments. The taxpayers and IRS agreed that the taxpayers overstated their deduction for the tax years 1998 through 2004.

The taxpayers disagreed with the ability of the IRS to assess any income tax deficiencies for tax years 1998 through 2002, because at the time of the audit, those years were beyond the 3-year statute of limitations. The IRS argued that the disallowance was an accounting method change under IRC section 481 and upwardly adjusted the 2004 income of the accrual method S corporation by the prior years disallowed deductions. The Circuit Court of Appeals affirmed the Tax Court judgment and agreed with the IRS. As such, IRC section 481 allowed the IRS to make an income adjustment to the 2004 tax year based upon disallowed deductions from tax years beyond the 3-year statute of limitations. (*Bosamia*, 5th Cir., October 24, 2011)

---

**Author's Comment:** This case illustrates that when the IRS determines a taxpayer has been using an improper method of accounting, the IRS can go back more than the 3-year statute of limitations to make an IRC section 481 adjustment. See *Statutes of Limitations*, page 15-3.

---

## Hybrid Method

A taxpayer can use any combination of cash, accrual, and special methods of accounting if the combination clearly reflects income, and it is used consistently. A common hybrid method uses the accrual method for purchases and sales and the cash method for services and operating expenses. The following restrictions apply to the hybrid method.

- If an inventory is necessary to account for income, the accrual method must be used for purchases and sales, unless the exception applies. See *Small Business Inventory Exception*, page 8-15.
- If the cash method is used to report income, the cash method must be used for related expenses.
- If the accrual method is used to report expenses, the accrual method must be used for related income.
- Any hybrid combination method that includes the cash method is treated as the cash method for purposes of the limitations upon using the cash method of accounting.

## Long-Term Construction Contracts

**Percentage-of-completion method.** This method may be required if a contract for building, installing, constructing, or manufacturing will not be completed within the taxable year in which the contract is entered into. Under the percentage-of-completion method, the taxpayer reports income based upon the percentage of the contract that is completed during the tax year. The percentage of completion for each year is determined by comparing contract costs incurred before the end of the tax year with the estimated total contract cost. (IRC §460)

**Home construction contractors.** Home construction contractors are not subject to the percentage-of-completion method.

**OBBBA** For contracts entered into in tax years beginning after July 4, 2025, the exception to the percentage-of-completion method for long-term home construction contracts is expanded to include residential construction contracts.

**Other construction contractors.** Other construction contractors are not subject to the percentage-of-completion method if estimated completion of the construction contract is within two years, and the taxpayer meets the gross receipts test [IRC §460(e)(1)]. See *Gross receipts test*, page 8-23.

**Completed contract method.** The taxpayer reports all income and deducts all costs of a long-term contract in the year in which the contract is completed. Costs not allocated to the contract are deducted in the year in which they are paid or incurred. Various rules apply in allocating costs and determining when a contract is considered to be completed. [Reg. §1.460-4(d)]

## Prepaid Expenses

In general, an expense cannot be deducted if paid in advance. This is true for both the cash and accrual methods. Examples include prepaid interest and prepaid insurance premiums. The prepaid expense is treated as an asset with a useful life extending beyond the current year to the year the expense is incurred.

**Twelve-month rule exception.** The prepaid expense rule does not apply to amounts paid to create certain rights or benefits for the taxpayer that do not extend beyond the earlier of the following.

- 12 months after the right or benefit begins, or
- The end of the tax year after the tax year in which payment is made.

---

**Example:** Jeff pays an auto insurance policy premium for his business truck on October 25, 2025, for 12 months insurance coverage beginning October 2025 and ending October 2026. Even though most of the insurance coverage is for 2026, the 12-month rule allows Jeff to deduct all of the premium in 2025.

---

Also see *Prepaid Farm Expenses*, Tab 5.

## Change in Accounting Method

**Initial selection of accounting method.** An accounting method is chosen on the first tax return, generally without requiring IRS approval.

**Exception:** See *Identifying inventory items*, page 8-14.

**Change of accounting method.** IRS approval is required to make a change in accounting method once a method has been established.

- File Form 3115, *Application for Change in Accounting Method*, whether the change is automatic, requested, or required. For example, if a cash method corporation no longer qualifies to use the cash method because of the average gross receipts restriction, the corporation must file Form 3115.
- A positive IRC section 481(a) adjustment is generally taken over four years (year of change and next three years).
- A negative IRC section 481(a) adjustment is generally taken over one year (year of change).
- Revenue Procedure 2025-23 provides detailed information about automatic changes in accounting methods.
- For changes made to correct depreciation errors, see *Correcting Depreciation Errors*, page 9-15.
- The correction of a math or tax computation error is not a change in accounting method.

**Automatic change.** An automatic change means the taxpayer will receive automatic IRS consent for the accounting method change. A taxpayer who timely files for an accounting method change generally receives audit protection, which means that the IRS will not require the taxpayer to change its method of accounting for the same item for a taxable year prior to the year of change.

**When to file Form 3115, Application for Change in Accounting Method.** Different rules apply to automatic and non-automatic change requests.

**Automatic change requests.** Unless instructed otherwise:

- Attach the original Form 3115 to the filer's timely filed federal income tax return for the year of the change (including extensions).
- File a copy of the signed Form 3115 to the address in the chart, page 8-26, no earlier than the first day of the year of change and no later than the date the original is filed with the federal income tax return for the year of the change.

The IRS does not acknowledge receipt of automatic change requests.

**Non-automatic change requests.** File Form 3115 during the year for which the change is requested, unless otherwise provided by published guidance. File the form as early as possible during the year of change to provide adequate time for the IRS to respond prior to the due date of the filer's return for the year of change.

The IRS normally sends acknowledgement of receipt within 60 days of receiving the form.

## Address Chart for Form 3115

	<b>Automatic change request (Form 3115 copy)</b>	<b>Non-automatic change request</b>
Deliver by mail	Internal Revenue Service Ogden, UT 84201 M/S 6111	Internal Revenue Service Attn: CC:PA:LPD:TSS P.O. Box 7604 Benjamin Franklin Station Washington, DC 20044
Deliver by private delivery service	Internal Revenue Service 1973 N Rulon White Blvd Ogden, UT 84201 Attn: M/S 6111	Internal Revenue Service Attn: CC:PA:LPD:TSS Room 5336 1111 Constitution Ave NW Washington, DC 20224

## Accounting Periods

Most taxpayers file using a calendar tax year. In certain situations, it may be appropriate for a taxpayer to use a fiscal year rather than a calendar year. The first and/or last year of a partnership or a corporation is usually a short tax year.

**Calendar tax year.** A calendar tax year is 12 consecutive months beginning January 1 and ending December 31.

- All taxpayers are allowed to use a calendar tax year.
- Taxpayers are required to use a calendar year if they keep no books, have no annual accounting period, or are otherwise required to use a calendar year by a provision in the IRC or regulations.

**Fiscal tax year.** A fiscal tax year is 12 consecutive months ending on the last day of any month except December.

- Individuals, C corporations, and estates can elect a fiscal tax year.
- Partnerships, S corporations, and PSCs may qualify for a fiscal tax year under certain conditions.
- A trust must use a calendar tax year unless a grantor trust filing Form 1041 has a grantor that uses a fiscal year. See *Grantor Trusts*, page 21-20.

**52–53 week tax year.** A 52–53 week tax year is a fiscal year that varies from 52 to 53 weeks. The year always ends on the same day of the week. The last day of the year must always end on:

- Whatever date this same day of the week last occurs in a calendar month, or
- Whatever date this same day of the week falls that is nearest to the last day of the calendar month.

For example, a tax year that always ends on the last Monday in August ends on August 25 for 2025. However, a tax year that always ends on the Monday nearest to the end of August ends on September 1 for 2025.

**Short tax year.** A short tax year is any tax year less than 12 months. A short tax year may be required when the taxpayer:

- Is not in existence for an entire tax year, such as the first or last year of a partnership, corporation, estate, or trust, or
- Elects to change the accounting period.

**Example:** Carla formed a corporation that began operations on July 22, 2025, with a calendar year end of December 31, 2025. Carla must file a return for her corporation for the short period from July 22, 2025 through December 31, 2025.

**Death of individual.** When an individual dies, a tax return must be filed for the decedent by the 15th day of the 4th month after the close of the individual's regular tax year. The decedent's final return will be a short period tax return that begins on January 1, and ends on the date of death. In the case of a decedent who dies on December 31, the last day of the regular tax year, a full calendar-year tax return is required.

**Calculating tax in a short tax year.** There are two separate rules for calculating tax in a short tax year.

- If a short tax year is the result of an individual or entity not being in existence for the entire year, the tax is calculated as if the individual or the entity were in existence for the entire year. For example, an individual that died on January 10, 2025, qualifies for a full standard deduction for tax year 2025 even though the individual was alive for only 11 days during the year.

**Exception:** Depreciation for an asset placed in service during a short tax year must be calculated under the short tax year rules. See *Short Tax Year Depreciation*, page 9-6.

- If a short tax year is the result of an individual or entity electing to change from a calendar tax year to a fiscal tax year, or vice versa, special rules require the annualizing of income before applying the tax rate schedules. For more information, see IRS Pub. 538, *Accounting Periods and Methods*.

**Required tax year.** A required tax year is a tax year required under the Internal Revenue Code or the Treasury Regulations.

**Individuals.** Generally, individuals must adopt the calendar year as their tax year. An individual can adopt a fiscal year if the individual maintains his or her books and records on the basis of the adopted fiscal year.

**Partnerships.** See *Required tax year for partnerships*, Tab 20.

**S Corporations and personal service corporations (PSCs).** See *Required Tax Year for S Corporations and PSCs*, Tab 19.

**Electing a tax year other than a calendar year.** The form to use for electing a fiscal tax year depends on when the election is made and under which tax provision.

**Form 1128, Application to Adopt, Change, or Retain a Tax Year.** Individuals, existing partnerships, S corporations, and PSCs file Form 1128 to adopt, change, or retain a tax year. Form 1128 is not filed by entities electing a tax year under IRC section 444.

**Form 8716, Election to Have a Tax year Other Than a Required Tax Year.** Existing partnerships, S corporations, and PSCs electing under IRC section 444 to have a tax year other than a required tax year must use Form 8716,

**Form 2553, Election by a Small Business Corporation.** Qualifying business entities may elect a tax year other than a calendar year when electing S corporation treatment on Form 2553.

**Improper tax year.** Taxpayers that have adopted an improper tax year must change to a proper tax year. To change to a proper tax year, do one of the following.

- If requesting a change to a calendar tax year, file an amended income tax return based on a calendar tax year that corrects the most recently filed tax return that was filed on the basis of an improper tax year. Attach a completed Form 1128 to the amended tax return. Write "FILED UNDER REV. PROC. 85-15" at the top of Form 1128 and file the forms with the Internal Revenue Service Center where the original return was filed.
- If requesting a change to a fiscal tax year, file Form 1128 in accordance with the form instructions to request IRS approval.