

## Additional Information – Common Business Deductions

### Automobile Expenses

We follow the federal guidelines on automobile expenses. A business deduction is only allowed when you use your car for business purposes. Deductible car expenses may include: travel from one workplace to another, business trips to visit customers/attend business meetings away from your regular workplace, or travel to temporary workplaces.

We allow two methods to determine your business car expenses:

- 1) Actual expenses – Car operating expenses (e.g., gas, oil, repairs, license fees, insurance, depreciation, etc.) for the entire year multiplied by the percentage of time you used the car for business purposes.
- 2) Standard mileage rate – A more simplified method in which you multiply the business miles and the applicable published federal mileage rate.

We require that you keep adequate records showing the date, amount, place, and essential character of the expense to substantiate your deduction(s).

### Business Start-up Costs

As a new business, you can generally deduct up to \$5,000\* of start-up expenses (e.g., salaries, marketing, market analysis, etc.) and \$5,000\* of organizational costs (e.g., legal services, fees paid to the state to incorporate).

### Home Office Expenses

In order to claim a home office expense, you must ensure that the area of your home is used regularly and exclusively for business purposes. If this test is met, then you would claim any direct expenses that are used exclusively for the business (e.g., computer, supplies, etc.). For indirect expenses, you would compute the percentage of your home that is being used for business purposes and apply the percentage against any indirect expenses (e.g., utilities, insurance, and depreciation). IRS Publication 587, *Business Use of Your Home*, has more information about home offices.

### Travel, Meals, and Entertainment Expenses

First, the expense must be considered ordinary and necessary for your business. Secondly, the expense must be primarily for business purposes (e.g., travel to a new client's office). The IRS provides detailed guidance about these types of expenses in IRS Publication 463, *Travel, Entertainment, Gift, and Car Expenses*. We follow IRS guidelines.

### Bonus Depreciation

In California, you can elect to deduct up to \$25,000\* of the costs incurred during the year for the acquisition of personal property used in your business.

*\* These amounts are subject to phase-out.*

### Client Gifts

We allow a deduction of up to \$25 for each recipient of a gift.

### Employee Pay

You can generally deduct the pay you give your employees for the services they perform for your business.

### Contact Us

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STATE OF CALIFORNIA  
Franchise Tax Board

# Business Expenses

Common Business Expenses for the  
Business Owner and Highlights of the  
Federal/State Differences

We detail the most common business expenses in this publication. Use this publication together with the federal publications we reference here. Although there are many forms of business ownership that have business expenses, this publication focuses on sole proprietorships. Business expense deductions allowed to be taken by other business entities may be subject to different rules.



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## Common Business Expenses

Whether you are forming a new business or you are a current business owner, claiming all the expenses you are entitled to makes smart business sense. In addition, deducting business expenses can potentially lower the overall tax liability of your business. Business expenses are the costs of carrying on a trade or business, and they are usually deductible if the business is operated to make a profit.

The Franchise Tax Board (FTB) generally follows federal law on many common business expenses. The attached comparison chart details some common business expenses that may be deductible for income tax purposes. The chart also shows how the Internal Revenue Service (IRS) and FTB treat each type of expense.

The IRS allows a business expense deduction if the expense is both **ordinary** and **necessary**. An **ordinary** expense is defined as an expense that is “common and accepted” in your trade or business. A **necessary** expense is defined as an expense that is “helpful and appropriate” for your trade or business. An expense does not have to be indispensable to be considered necessary.

Your business may also generate expenses that tie into the cost of goods sold if you manufacture a product or if you have capital expenses for fixed assets you purchased. This publication’s focus is on the common business expenses that may be deductible for income tax purposes.

As a general rule, a taxpayer must maintain adequate records or other sufficient evidence to substantiate expenses claimed. Additional evidence is required for some expenditures or use, such as, travel, entertainment, gifts, and auto expenses.

## Federal/State Comparison Chart for Typical Business Expenses

| Expense Type                             | Federal Treatment (IRS)  | California Treatment (FTB)  | Additional Guidance  |
|--|--|---|--|
| Advertising                              | Actual costs   | Same as federal   | IRS Pub. 535, <i>Business Expenses</i>   |
| Business Bad Debt                        | Bad debt may be partly or totally worthless  | Same as federal   | IRS Pub. 535   |
| Car                                      | Actual car expenses or standard mileage rate (current published federal mileage rate). You <b>must</b> maintain adequate written records to substantiate these expenses. (Internal Revenue Code 274) | Same as federal   | IRS Pub. 463, <i>Travel, Entertainment, Gift, and Car Expenses</i>   |
| Charitable Contributions                 | Up to 50%, 30%, or 20% of adjusted gross income depending on the contribution and organization. You <b>must</b> have the proper documentation.   | Same as federal   | IRS Pub. 526, <i>Charitable Contributions</i>  |
| Depreciation                             | Various methods; Modified Accelerated Cost Recovery System to depreciate <b>most</b> property  | Generally same as federal, but California does not conform to the federal rules regarding special or bonus depreciation. Differences may also occur for other less common reasons. Please refer to FTB Pub. 1001, <i>Supplemental Guidelines to California Adjustments</i> , for more information about differences between California and federal law. Use form FTB 3885A, <i>Depreciation and Amortization Adjustments</i> , when reporting a difference. | Federal – IRS Pub. 946, <i>How to Depreciate Property</i> State – Revenue and Taxation Code (R&TC) Section 17250, FTB Pub. 1001, and FTB 3885A |
| Entertainment                            | Generally, not allowed   | Must meet one of two tests (the “Directly related test” or the “Associated test”) and deductions are limited to 50% of unreimbursed expenses. You must have the proper documentation.   | IRS Pub. 463   |
| Gifts                                    | Limited to \$25 per gift for each recipient. You <b>must</b> have the proper documentation.  | Same as federal   | IRS Pub. 463   |
| Home Office                              | Deduction is allowed based on the percentage of the home that is used “exclusively and regularly” for business purposes and meets one of three IRS qualifications                                    | Same as federal   | IRS Pub. 587, <i>Business Use of Your Home</i>   |
| Insurance                                | Actual costs   | Same as federal   | IRS Pub. 535   |
| Legal and Professional Fees              | Actual costs   | Same as federal   | IRS Pub. 535   |
| Personal Property “Section 179 Election” | Deduction subject to a dollar limit and business income limit  | Allowable deduction on first year property up to \$25,000 (phased out for asset values over \$200,000)  | Federal – IRS Pub. 946 State – R&TC Section 17255  |
| Rent                                     | Actual costs   | Same as federal   | IRS Pub. 535   |
| Salaries                                 | Actual costs   | Same as federal   | IRS Pub. 535   |
| Start-up Costs                           | May elect to deduct up to \$5,000* of start-up costs in the year a business begins, phase-out of \$50,000  | Same as federal   | IRS Pub. 535   |
| Supplies and Materials                   | Actual costs that are consumed and used during tax year  | Same as federal   | IRS Pub. 535   |
| Taxes                                    | Taxes paid, in the year you pay them, to federal, state, and local authorities (no deduction allowed for federal income taxes paid)  | No deduction allowed for taxes measured by income or profits (federal and state)  | IRS Pub. 535   |
| Travel                                   | Actual costs   | Same as federal   | IRS Pub. 463   |
| Utilities                                | Actual costs   | Same as federal   | IRS Pub. 535   |

\* These amounts are subject to phase-out.