

Tax Deductions that No Dog Should Bark At

By Geoffrey Goudy



It's that time of year and I know what you want. My April and July 2005 articles painted some broad strokes regarding operational requirements and suggestions. Now we'll go into greater detail, plus some industry-specific items of note.

Any proposed income tax deduction must meet three tests:

1. Is it documented?
2. Is it business related?
3. Is it reasonable?

Documentation can take on many forms, but more is better—detailed receipt, method of payment, and corresponding third-party bank or credit card statement. This is most critical for travel and entertainment expenditures, without which, the Internal Revenue Service can justifiably disallow by Federal statute.

The next hurdle is to determine whether the expense relates to actual business activity. First, did the expenditure arise from revenue generation? If so, allocate accordingly under direct costs. If not, determine whether the expenditure could be considered an indirect cost under one of three categories: selling and marketing, facilities and equipment, or general and administrative. Regardless of deductibility, note on each receipt the nature of the expense and why the expense was incurred.

The key to deductibility of an indirect expenditure is reasonableness: A sort of “gut-feel” test. Would a prudent taxpayer take the deduction? In other words, would an independent arbitrator after hearing your argument for deductibility and reviewing the documented facts and circumstances conclude that the expenditure is fair and reasonable and thus, deductible? I know, sounds a bit like legalese from a tax accountant.

The following three examples should help outline the process. Let's use the case of the canine veterinarian bills:

A. Seminar Presenter—This individual owns a dog, shows the dog, and uses the dog to test courses prepared for seminars. The “healthy” canine companion is necessary

to assist with analyzing different techniques for the same sequence, determining potential handler pitfalls, and preserving or emboldening the presenter's reputation. Think “training and education” as the dog is critical to the success of a career. Thus, the facts and circumstances point toward the deductibility of incurred veterinarian bills:

B. Trial Judge—This individual owns a dog, shows the dog, and uses the dog to test trial-prepared courses. The “healthy” canine companion is necessary to assist with staying current with judging and handling techniques, studying course layout angles, generating new course ideas, and the judge's reputation. Think “research and design” as the dog is critical to the success of a career. Thus, the facts and circumstances point toward the deductibility of incurred veterinarian bills.

C. Dog Show Photographer—This individual owns a dog, shows the dog, and uses the dog for test shots and brochures. The “healthy” canine companion is necessary to improve action photography skills and develop unique angles and backdrops. Think “marketing and selling” as the dog is critical to the success of a career. Thus, the facts and circumstances point toward the deductibility of incurred veterinarian bills.

Examples A and B are relatively black and white, especially when you consider that often these individuals are hired based on their skills in handling a canine on an agility course. With this in mind, Example C appears to be awfully gray. While the above scenario of deducting canine-related expenditures may be defensible in the early years of operation, it may not be as the photography business matures. Is it the quality of the photographs or how well you handle your dog that determines your reputation and sells your photos? Were you a paid photographer before you entered the canine sport industry? How often do you use your canine to improve your photography timing? You must ask yourself honestly, “Just how critical is dog ownership to the success of the business?”



Additionally, Example A can be applied to training school instructors and paid handlers while several other ancillary canine product vendors fall under Example C, such as training aids, equipment, and t-shirt sales. And as described in the subscriber question/answer section within my July 2005 article, canine expenditures for these businesses will likely not be deductible. In all cases, you must ask yourself as you tabulate office expenses, equipment costs, and vehicle charges: “What would an independent arbitrator say?”

I hope these three examples clear up the murky tax landscape for those earning money in the canine agility industry. The chart included here explains some common, yet relatively complex tax deduction areas. I also advise that you re-read both 2005 articles before you begin preparing your own 2005 income tax return, especially if you intend to file Schedule C-EZ or have business receipts less than \$25,000. As there are no two dogs alike, no two business income tax return situations are similar. So actively engage your financial advisor as questions or concerns arise. Remember, your dog jumps through hoops, shouldn't your accountant? 🐾

A question from my October 2005 article, “Club Treasurer—To Be or Not To Be?”

Our club traded \$720 worth of event entries to an individual for trial secretary duties. Are we required to issue a 1099 to her?

Yes. While no cash traded hands, this barter transaction between the club and an individual taxpayer should be reported to the Internal Revenue Service. The trial secretary earned compensation for services rendered in excess of \$600 and chose payment in the form of “free” entries, which had a specified monetary value. Form 1099-MISC, not 1099-B, is the appropriate filing. Don't forget to also prepare Form 1096.

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Three Critical Tax Deduction Areas

Capital Assets—long-lived acquisitions

1. Use separate categories:
 - Transportation Equipment (vehicles and trailers)
 - Office Equipment (computers and furniture)
 - Machinery and Equipment (lawnmowers and agility items)
 - Property Improvements (permanent fencing and storage sheds)
 - Buildings (arenas and training centers)
2. Definition of repairs and maintenance:
Expenditures that keep an asset in operating condition and do not add value to or extend the useful life of the property.
3. Section 179 deductibility:
 - a. Individual with Schedule C: Allowed to deduct and create business loss if taxpayer is also employed and received W-2 wages.
 - b. Individual with multiple pass-through entities (S Corps and LLCs): Must net amounts together and cannot deduct more than \$102,000. However, any excess is carried over to subsequent year.
4. Internal Revenue Service has explicitly approved the use of \$500 floor for capital asset treatment. Thus, acquisitions costing less than \$500 can be expensed as incurred rather than depreciated over time.

Vehicle Expenditures

Two computation options (Schedule C):

1. Standard Mileage Rate: 40.5 cents per mile (January-August 2005) and 48.5 cents per mile (September-December 2005) for all business miles driven.
2. Actual Cost: In theory, business owns vehicle and applicable business use percentage is multiplied against total vehicle costs. These costs include fuel, insurance, repairs and maintenance, registration, and depreciation expense, which is computed separately on Form 4562.

Travel, Meals, and Entertainment

Allocation options (Schedule C):

1. Unreimbursed travel costs
 - a. Report on Schedule C, Part II, Line 24 or
 - b. Report within other listed expense categories: Hosted seminar costs, competitive event costs, and so on.
2. Always report unreimbursed meal and entertainment costs on Line 24b as amount is subject to 50% limitation.
3. Reimbursed travel, meals and entertainment costs: Report receipt in income and corresponding expense under cost of goods sold. Therefore, meal and entertainment costs are deducted dollar for dollar and accordingly, not subject to limitation.