



Not all “business” expenses are tax deductible

With 2025 in the rear view mirror and the tax filing deadline on the road ahead, it's a good time for businesses to start gathering information about their deductible expenses for 2025. But what's deductible (and what's not) might not be as clear-cut as you think.

Most business deductions aren't specifically listed in the Internal Revenue Code (IRC). The general rule is what's stated in the first sentence of IRC Section 162, that you can write off “all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.” In addition, you must be able to substantiate the expenses.

Ordinary and necessary

In general, an expense is *ordinary* if it's considered common or customary in the particular trade or business. For example, a landscaping company's costs for fuel and routine maintenance on its lawn equipment would typically qualify as ordinary expenses because such costs are customary for that type of business.

A *necessary* expense is defined as one that's helpful or appropriate. For instance, a retail store that invests in security cameras may be able to operate without them, but the expense is helpful for reducing theft and protecting employees and customers.

To be deductible, an expense must be *both* ordinary *and* necessary. An ordinary expense may be unnecessary because the amount isn't reasonable in relation to the business purpose. For example, let's say a construction business upgrades to premium, top-of-the-line tools when standard professional-grade tools already meet job requirements. Tool purchases are ordinary, but excessive upgrades may be unreasonable and, thus, unnecessary.

Cases in point

The IRS and courts don't always agree with taxpayers about what qualifies as a deductible business expense. Often substantiation is the primary issue. Sometimes the question hinges not on the expense itself, but on whether the taxpayer was actually operating a trade or business.

For example, the U.S. Tax Court denied deductions claimed by an engineering firm owner for the value of his own time spent developing a program. Self-performed labor isn't "paid or incurred," the court noted. Therefore, it's not deductible. The court disallowed other deductions due to insufficient records and lack of a clear business purpose.

In another case, a taxpayer engaged in real estate activities. His business expense deductions were denied by the Tax Court. The court ruled that the activities didn't constitute an active trade or business. Instead, the real estate was held for investment purposes. In addition, the deductions weren't substantiated because adequate records weren't kept. The taxpayer appealed. The U.S. Court of Appeals for the Ninth Circuit agreed with the Tax Court. The court ruled the taxpayer "failed to provide sufficient evidence of his claimed deductions."

What can you deduct for 2025?

Determining the deductibility of business expenses can be complicated, and proper substantiation is critical. We can help you determine what you can deduct on your 2025 tax return.