1999 Income Tax School

SCHEDULE C

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1. UPDATE ON I.R.C. §105(B) HEALTH INSURANCE PLANS FOR SPOUSES (EMPLOYEE TAX-FREE FRINGE BENEFIT)

GENERAL INFORMATION

On March 29, 1999, the IRS addressed this issue by issuing an **ISP (Industry Specialization Program) Coordinated Issue Paper.** (UIL 162.35-02). Coordinated Issue Papers provide IRS national office guidance to IRS enforcement personnel on technical tax issues. The opinions and views contained in an ISP Coordinated Issue Paper are generally followed by IRS examiners. The following reflects the position of the IRS as expressed in the Coordinated Issue Paper.

Facts. Glenn is a self-employed CPA who has three employees: Cynthia, Aaron, and his spouse, Anita. Cynthia, the receptionist/bookkeeper, and Aaron, an aspiring CPA, work full-time. Anita works full-time during the filing season and part-time (two days a week) after June 15.

To provide tax-free fringe benefits to Cynthia and Aaron beginning July 1, 1999, Glenn is considering adopting a major medical group health insurance plan. Glenn will pay the premiums for his three employees.

Question 1. *What are the key factors for Glenn to consider regarding the premiums he intends to pay for his spouse, Anita?*

Answer 1. The most important consideration is whether Anita is Glenn's **bona fide common-law employee.** In addition, her **total compensation** (including the employer paid insurance cost) must be **reasonable.** Following are the facts regarding Anita's employment.

- She does receive a W-2 Form.
- She has been employed by Glenn for over five years. (**Note.** No minimum service is required.)
- Glenn's attorney prepared an employment contract, which both Glenn and Anita signed. The contract is dated January 1, 1994. The contract lists Anita's duties, her rate of pay, when she is to be paid, etc. The employment contract is amended every year, mainly to increase Anita's hourly pay.
- Anita is paid every two weeks by check.
- Appropriate employment taxes are withheld.
- Anita's compensation is in line with that of Cynthia and Aaron.

Answer 1 Conclusion. Anita is definitely a common-law employee of her spouse, Glenn. Her compensation appears to be reasonable.

Question 2. *Who should be shown as the insured party on Anita's group health policy, or does it matter?*

Answer 2. The Coordinated Issue Paper makes it very clear **that the insured party on the policy must be Anita, not Glenn.** If the insured party on the policy is Glenn rather than Anita, the amount of the premium Glenn pays is **not deductible on Glenn's 1999 Schedule C.** Rather, the amount of the premium will qualify for the 60% self-employed health insurance deduction on line 28 on the joint 1999 Form 1040.

Question 3. *Are there other factors that Glenn must consider before adopting the major medical group insurance plan?*

Answer 3. Yes. Another important decision Glenn must make is whether to impose a **length-of-service requirement** to existing as well as potential new employees. All three of Glenn's employees have worked for him since at least January 1, 1996 (more than three years as of July 1, 1999). Glenn anticipates that as his CPA practice grows, he may have to hire additional employees. Given these facts, it may be wise for Glenn to provide for a **three-year waiting period** in order for an employee to be eligible to participate in the group plan.

If Glenn decides to adopt a three-year waiting period provision, his three current employees, including Anita, will be eligible to participate in the group plan on July 1, 1999.

Question 4. *Is there a requirement in the Internal Revenue Code or regulations that Glenn's major medical group insurance plan be in writing?*

Answer 4. No, but it is recommended that it be a written plan, especially if a waiting-period requirement is imposed.

Practitioner Caution. The use of an outside plan administrator may be advisable to ensure compliance with all applicable rules and regulations.

Question 5. *If Glenn wants to cover Anita and exclude his two other employees in the new group plan, may he do so?*

Answer 5. Yes, an **insured health plan** (as opposed to a self-insured medical reimbursement plan) may cover only one employee while omitting other employees [Treas. Reg. §1.105-5(a)]. **There are no nondiscrimination restrictions for employer-provided insured health plans.** The employer may provide the insurance coverage to one or more employees and provide different coverage to different employees.

Practitioner Caution. Discrimination rules **do apply** to **self-insured medical reimbursement plans.**

Note. One of Glenn's goals in considering the major medical group insurance plan is to satisfy his two full-time employees, Cynthia and Aaron. The job market is tight, and Glenn wants to show Cynthia and Aaron that he appreciates their work. He wants to reward them and prevent them from leaving his employment. So Glenn will ***not*** adopt a plan that covers ***only*** Anita and ***excludes*** Cynthia and Aaron.

Question 6 Facts. Assume that Glenn adopts a written major medical group insurance plan effective July 1, 1999. He covers his three employees. Anita's policy is in her name; she is the insured. Anita's policy covers her and her family members' (including Glenn's) medical expenses. Glenn paid total premiums of $4,000 in 1999.

Question 6. *Where should Glenn deduct the $4,000 insurance expense on his 1999 Schedule C?*

Answer 6. On line 14, "Employee benefit programs." The $4,000 should not be deducted on line 15, "Insurance expense."

Question 7. *Are the premiums shown on the 1999 Forms W-2 of the three employees?*

Answer 7. No. They are a tax-free fringe benefit [I.R.C.§ 105(b)].

Practitioner Note. An employer may either purchase health insurance for covered employees or establish a plan that reimburses employees for individually purchased health insurance. If the employer chooses a **reimbursement plan,** the spouse-employee should write his or her check for the insurance premium from a **personal account.** The reimbursement from the employer should be made by a check from the business account or a separate business account established solely for employee medical reimbursements.

In a different ISP Coordinated Issue Paper, UIL 105.06-05, the IRS concluded the following regarding payments or reimbursements made by an employer under a **self-insured** health plan **prior** to the adoption of the medical reimbursement plan:

- The employer reimbursements are **not** excludable by the employee under I.R.C. §105(b). Rather, these preadoption reimbursements must be included as income in box 1 of the employee's W-2 form.
- The preadoption reimbursements **may be deducted** by the employer as an ordinary and necessary business expense under I.R.C. §162(a).

Note. See the discussion of the IRS Coordinated Issue Paper in the Fringe Benefits section of the What's New chapter.

2. THE EFFECT OF THE ACCOUNTABLE PLAN RULES ON SELF-EMPLOYED INDIVIDUALS

The **accountable plan** rules allow an employer to exclude business expense reimbursements from an employee's income (the reimbursed amounts will **not** be included on the W-2 Form) (Treas. Reg. §1.62-2). **The accountable plan rules generally do not apply to self-employed individuals.** However, two provisions of the accountable plan rules **do apply** to self-employed individuals:

1. The **standard meal allowance** (also called **per diem substantiation method**) for meals and incidental expenses (M&IE).
2. The **exclusion from income** rules for **reimbursements from customers to clients for travel, entertainment, or gift expenses** incurred on behalf of the customer or client.

EXAMPLE

Carrie is a self-employed consultant whose home office is in Lincoln, Nebraska. Her clients are located in various midwestern cities. She performed services for a client in Dubuque, Iowa, for the week of July 26 through July 30, 1999.

Carrie drove her business auto to Dubuque on Monday, July 26, leaving Lincoln at 7:00 a.m. on July 26 and arriving in Dubuque at 2:00 p.m. She incurred lodging in Dubuque on Monday through Thursday nights. She left Dubuque at 2:00 p.m. on Friday, July 30, and arrived in Lincoln at 10:00 pm.

Chart of Carrie's Expenses for the Week of July 26–30

Day	Actual Meal Expense		Lodging Expense
Monday	$ 19.75	(incl. tip)	$56.75
Tuesday	24.30	(incl. tip)	56.75
Wednesday	17.10	(incl. tip)	56.75
Thursday	28.40	(incl. tip)	56.75
Friday	30.45	(incl. tip)	0
Total	**$120.00**		**$227.00**

Scenario 1. Carrie receives no reimbursement from the client for any travel or transportation expenses.

Question 1A. *What amount of meals expense is Carrie entitled to deduct on her 1999 Schedule C for this week?*

Answer 1A. The CONUS (continental U.S.) standard meal allowance amount for 1999 is $30.00 per day for meals and incidental expenses. Dubuque is **not a high-cost metropolitan area** in 1999. Therefore, the CONUS rate of $30 per day applies. Carrie has three options:

She can deduct 50% of the actual expense figure of $120, **or** she can deduct 50% of the amount allowed under one of the two standard meal allowance methods.

Option 1: Actual cost method. Under this method, Carrie's meal deduction for the week will be $60 (50% of $120).

Option 2: Standard meal allowance method 1. This method is used by federal employees. It prorates the per diem amount **for the first and last days** of travel at **75%.**

Day	Standard Meal Allowance	
Monday	$ 22.50	(75% of $30—partial travel day)
Tuesday	30.00	(full travel day)
Wednesday	30.00	(full travel day)
Thursday	30.00	(full travel day)
Friday	22.50	(75% of $30—partial travel day)
Total	**$135.00 × 50%, or a $68 deduction**	

Option 3: Standard meal allowance method 2. This method allows taxpayers to prorate the per diem rate for **partial travel days using any consistent method in accordance with reasonable business practice.**

> **Note.** See Rev. Proc. 98-64 in the What's New chapter for details.

According to IRS Publication 463, *Travel, Entertainment, Gift, and Car Expenses* (for use in preparing 1998 Returns), Carrie can "use any method that she applies consistently and that is in accordance with reasonable business practice." For example, she could claim **five days of the standard meal allowance even though a federal employee would be limited to 4½ days.**

Under this method, Carrie's **deduction** for the week will be **$75** (50% of five days @ $30 per day, or 50% of $150).

Question 1B. *If you prepared Carrie's 1999 return, what amount of meal expenses should you deduct for this week?*

Answer 1B. The maximum amount allowed by option 3, which is $75.

Question 1C. *Would the dollar figures in Answer 1B differ if Carrie's client had been in Des Moines, Iowa, rather than Dubuque, Iowa?*

Answer 1C. Yes. There are three **high-cost metropolitan** Iowa areas for 1999. They are Des Moines, Davenport/Bettendorf, and Cedar Rapids. For 1999, the standard M&EI allowance for these three metropolitan areas is $34 rather than $30. If Carrie's client had been in one of these three cities, $34 per day would be substituted for $30 in the option 2 and option 3 computations above.

Question 1D. *What amount of lodging expense will Carrie be entitled to deduct on her 1999 Schedule C for this week?*

Answer 1D. The actual amount of $227. Self-employed individuals **cannot** use a standard or per diem lodging allowance to compute deductible lodging expenses.

Scenario 2. Carrie's contract with her client contained the following clauses:

- She is to be paid $100 per hour for every hour of consulting services performed.
- She is to be paid $50 per hour for every hour of travel she spends in performing the consulting services.
- She is required to substantiate to the client all travel and transportation expenses incurred in performing the consulting services. Those expense items include actual meals, lodging, and mileage. Once the expenses are substantiated, the client is to reimburse Carrie for her actual meals (including tips), lodging, and auto expense computed at the post–March 1999 standard mileage rate of 31 cents.

Carrie's client paid her the following for the week she performed consulting services in Dubuque:

Consulting fee (37 hours @ $100 per hour)		$3,700
Travel time fee (15 hours @ $50 per hour)		750
Travel and transportation reimbursement:		
Actual meals	$120	
Actual lodging	227	
Mileage @ 31¢	272	619
Amount of check Carrie received from client		**$5,069**

Question 2A. *What amount is Carrie required to report as income on her 1999 Schedule C?*

Answer 2A. $4,450 (the $3,700 consulting fee plus the $750 travel time fee).

Question 2B. *May Carrie exclude the $619 travel and transportation reimbursement she received from her client?*

Answer 2B. Yes. [Treas. Reg. §1.274-5T(h)].

Question 2C. *Will Carrie's client have to send her a 1999 Form 1099-MISC?*

Answer 2C. Yes.

Question 2D. *What amount will be shown in box 7 (Nonemployee Compensation) of the 1999 Form 1099-MISC?*

Answer 2D. $4,450. See the completed Form 1099-MISC below.

☐ CORRECTED (if checked)

PAYER'S name, street address, city, state, ZIP code, and telephone no. *ABC Corp.* *32 Industrial Parkway* *Dubque, IA 52004*	**1** Rents \$ **2** Royalties \$ **3** Other income \$	OMB No. 1545-0115 **1999** Form **1099-MISC**	**Miscellaneous Income**
PAYER'S Federal identification number *38 1000000* / RECIPIENT'S identification number *111 11 1111*	**4 Federal income tax withheld** \$	**5** Fishing boat proceeds \$	**Copy B** **For Recipient**
RECIPIENT'S name *Carrie Young*	**6** Medical and health care payments \$	**7** Nonemployee compensation \$ *4,450.00*	This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.
Street address (including apt. no.) *1202 Liberty Lane*	**8** Substitute payments in lieu of dividends or interest \$	**9** Payer made direct sales of \$5,000 or more of consumer products to a buyer (recipient) for resale ▶ ☐	
City, state, and ZIP code *Lincoln, NE 68508*	**10** Crop insurance proceeds \$	**11** State income tax withheld \$	
Account number (optional)	**12** State/Payer's state number	**13** \$	

Form **1099-MISC** (Keep for your records.) Department of the Treasury - Internal Revenue Service

Question 2E. *How much of Carrie's $5,069 total payment will be deductible by the client on the client's 1999 business schedule?*

Answer 2E. $5,009 ($5,069 less $60, which is 50% of the $120 reimbursement for Carrie's substantiated meals expense).

3. UNIFORM CAPITALIZATION RULES

Code §263A, the uniform capitalization rules, was included as part of the 1986 Tax Reform Act. The rules apply to certain inventory costs paid or incurred after 1986. This issue is a concise review of these rules.

Under I.R.C. §263A, many costs, both direct and indirect, that a taxpayer incurs are not currently deductible. Instead, the costs currently incurred and paid are deductible in a later year when the inventory to which these costs were allocated is **sold,** or, in the case of a constructed asset, in later years through cost recovery deductions. In either situation, the uniform capitalization rules require a matching of revenue and expense on a year-by-year basis.

WHO IS REQUIRED TO USE I.R.C. §263A?

Code §263A must be used by a taxpayer who:

1. Produces real property or tangible personal property for use in a trade or business or an activity engaged in for profit (**for example,** the construction of an office building by a taxpayer for use in his or her trade or business).
2. Produces real property or tangible personal property for sale to customers [**for example,** a home builder or a boat builder (manufacture for resale) falls into this classification].
3. Acquires property for resale (**for example,** a hardware store that purchases merchandise for resale).

Under the uniform capitalization rules, direct costs and an allocable part of most indirect costs incurred due to production or resale activities must be capitalized. In effect, certain expenses incurred during the year must be included in the basis of property manufactured (or included in inventory costs) rather than deducted as a current expense. These costs are recovered later through depreciation, amortization, or costs of goods sold when the property is sold, used, or otherwise disposed of.

COSTS SUBJECT TO THE UNIFORM CAPITALIZATION RULES

Direct Costs—Producers. Producers must capitalize **direct labor and direct materials** into the cost of the finished product. Direct labor includes all elements of compensation **other than** employee benefit costs. Direct materials include both materials that become part of the finished product and materials consumed in the manufacturing process.

Direct Costs—Resellers. Resellers must capitalize the **total costs** of acquiring the property for resale. These include freight-in and any other necessary charges.

> **Note.** The uniform capitalization rules apply **only** to resellers of personal property if their average annual gross receipts for the three preceding tax years **exceed** $10 million.

Indirect Costs—Producers and Resellers. Indirect costs that must be capitalized include the following:

1. Indirect labor costs
2. Officer's compensation
3. Pension and other related costs
4. Employee benefit expenses
5. Indirect material costs
6. Purchasing costs
7. Handling costs
8. Storage costs (off-site)
9. Cost recovery (depreciation)
10. Depletion
11. Rent
12. Taxes, if they relate to labor, materials, supplies, equipment, land, or facilities
13. Insurance
14. Utilities
15. Repairs and maintenance
16. Engineering and design costs
17. Spoilage
18. Tools and equipment
19. Quality control
20. Bidding costs
21. Licensing and franchise costs
22. Certain interest (applies to producers only)
23. Certain service costs

COST ALLOCATION METHODS

Taxpayers are permitted to use various cost allocation methods to allocate direct and indirect costs to **property produced** and **property acquired for resale,** provided that the methods selected are reasonable. Permitted methods include the following:

1. **Specific identification.** This method traces costs to a function, department, or activity.
2. **Burden rate:** This method allocates an appropriate amount of indirect costs to property produced or property acquired for resale using predetermined rates that approximate the actual amount of indirect costs.
3. **Standard cost.** This method allocates an appropriate amount of direct and indirect costs to property produced or property acquired by the taxpayer through the use of preestablished standard allowances **without reference to costs actually incurred.**
4. **Reasonable allocation.** In addition to the three methods listed above, any other method can be used if it reasonably allocates direct and indirect costs among units of property produced or property acquired for resale. A method is deemed "reasonable" if:

a. The allocations **do not differ significantly** from the allocations resulting from the first three methods listed above,

b. The allocation method is **used consistently,** and

c. The allocation method **does not circumvent** the uniform capitalization rules.

Simplified Cost Allocation Methods for Producers. In addition to the four cost allocation methods identified above, the IRS has authorized several **simplified methods** for producers. They include:

1. The **simplified service cost method,** which can be used to allocate general and administrative expenses (referred to as **mixed service costs**) to production activities.
2. The **simplified production method,** which can be used to allocate the I.R.C. §263A costs between ending inventory and cost of goods sold.

Simplified Cost Allocation Method for Resellers. Resellers include retailers, wholesalers, and distributors. They may use the **simplified resale method** to arrive at the I.R.C. §263A costs that must be capitalized and included in ending inventory.

Example 1. Midwest Feed, a C corporation, produces hog feed, which it sells to distributors. The company is subject to I.R.C. §263A. It uses the **reasonable allocation** method based on a ratio of ending inventory to purchases. The following analysis details the I.R.C. §263A calculation and its effects.

Total purchases	$762,765
Ending inventory (not including I.R.C. §263A costs)	$111,827
Percentage of regular inventory to purchases	15% (rounded)

I.R.C. §263A Indirect Costs	Total Cost	I.R.C. §263A Cost Allocation
Officer's salaries	$10,200	$ 1,530
Salaries	101,167	15,175
Payroll taxes	9,804	1,471
Supplies	13,500	2,025
Rent	2,100	315
Insurance	27,059	4,059
Utilities	12,152	1,823
Depreciation	23,940	3,590
	$199,922	**$29,988**

Results. Each expense shown above must be reduced by the amount allocated to I.R.C. §263A costs. The total of the I.R.C. §263A allocated cost, $29,988, is then **added** to ending inventory as follows:

Ending inventory before I.R.C. §263A allocation	$111,827
I.R.C. §263A cost allocation	29,988
Ending inventory	$141,815

The cost of goods sold, Schedule A, Form 1120, would be completed as follows:

Schedule A	Cost of Goods Sold (see page 15 of the instructions)		
1	Inventory at beginning of year	1	213,852
2	Purchases	2	762,765
3	Cost of labor	3	
4	Additional section 263A costs *(attach schedule)*	4	29,988
5	Other costs *(attach schedule)*	5	
6	**Total.** Add lines 1 through 5	6	1,006,605
7	Inventory at end of year	7	141,815
8	**Cost of goods sold.** Subtract line 7 from line 6. Enter here and on page 1, line 2	8	864,790
9a	Check all methods used for valuing closing inventory:		

Officers' compensation, Schedule E, Form 1120, would be completed as follows:

Schedule E **Compensation of Officers** (See instructions for line 12, page 1.)

Note: *Complete Schedule E only if total receipts (line 1a plus lines 4 through 10 on page 1, Form 1120) are $500,000 or more.*

	(a) Name of officer	(b) Social security number	(c) Percent of time devoted to business	Percent of corporation stock owned (d) Common	(e) Preferred	(f) Amount of compensation
1	Sam Phillips	123-45-6789	100 %	100 %	%	10,200
			%	%	%	
			%	%	%	
			%	%	%	
			%	%	%	
2	Total compensation of officers					10,200
3	Compensation of officers claimed on Schedule A and elsewhere on return					1,530
4	Subtract line 3 from line 2. Enter the result here and on line 12, page 1					8,670

Indirect costs that **do not** have to be capitalized include:

1. Selling and distribution costs
2. Research and development costs
3. I.R.C. §179 costs
4. I.R.C. §165 losses
5. Cost recovery (depreciation) on idle equipment and facilities
6. Income taxes
7. Strike expenses
8. Warranty and product liability costs
9. On-site storage costs
10. Unsuccessful bidding expenses
11. Certain service costs

EXEMPT COSTS

The uniform capitalization rules do not apply to some expenses. They include:

1. Property produced that is not for use in the taxpayer's trade, business, or activity conducted for profit (**for example**, property produced for personal use)
2. Costs paid or incurred by an individual (other than as an employee) or a qualified employee-owner of a corporation who is a writer, photographer, or artist
3. Costs incurred under a long-term contract
4. Research and development expenses allowable as a deduction under I.R.C. §174

The following examples highlight the effects of the I.R.C. §263A uniform capitalization rules.

Example 2. Jane Beardsley is a home builder who constructs an average of 18 homes each year. To ensure a sufficient number of building sites for future construction, Jane purchased 40 acres of farmland to improve and subdivide into residential lots. Jane's plans include underground water, sewer, and electric; concrete curbing and sidewalks; and asphalt streets.

Jane is subject to the uniform capitalization rules because she produces real property for sale to customers. As a result, Jane must capitalize all direct costs (labor and materials) and certain indirect costs into the cost of each lot or home sold. Each lot or home would have in its basis the allocable share of land costs, improvement costs, and construction period interest and taxes.

Example 3. JBS, Inc. manufactures pleasure boats for sale to the public. During the winter months the company is at peak production in order to have sufficient inventory for the spring selling season. JBS rents several **off-site warehouses** for storing boats prior to shipment to their dealers in the spring. The annual rent for these off-site warehouses is $120,000.

JBS is subject to the uniform capitalization rules because it produces tangible personal property for sale to customers. In addition to all direct labor and material costs, certain indirect costs must be capitalized into the costs of the boats. Included in these indirect costs is the **cost of off-site storage of inventory.** JBS **cannot** deduct the $120,000 as rent expense; instead, the amount must be allocated to the total cost of boats sold and deducted as the boats are actually sold.

Example 4. José Cardinal operates a hardware store as a sole proprietor. His gross sales have averaged $1,800,000 annually for the last three years. José's ending inventory of resale items averages $400,000.

José is **not** required to use the uniform capitalization rules of I.R.C. §263A because his average annual gross receipts for the three preceding tax years does not exceed $10 million. All of José's direct and indirect costs are fully deductible in the year paid or incurred, depending on his method of accounting.

4. BUSINESS AUTO EXPENSE ISSUES

RECENT TAX LAW CHANGES

Rev. Proc. 99-14 contains the 1999 inflation-adjusted "luxury auto" depreciation dollar limits and the inclusion amount for leased autos. For autos **first placed in service in 1999,** the MACRS limits are as follows:

Year	Limit (Assuming 100% Business Use)
1999 (first tax year)	$3,060 ($100 less than for autos first placed in service in 1998)
2000 (second tax year)	$5,000 (same as for autos first placed in service in 1998)
2001 (third tax year)	$2,950 (same as for autos first placed in service in 1998)
2002 and later tax years (fourth and later years)	$1,775 (same as for autos first placed in service in 1998)

Example 1. Nicole bought a business auto on June 1, 1999, for $42,000. It was used 75% for her newly established Schedule C consulting business. She financed the purchase and paid $2,000 of interest in

1999. If she uses the **actual cost method** for her 1999 business auto expenses, the **maximum** MACRS deduction she can claim is the **lesser** of:

1. Business cost of $31,500 ($42,000 × 75%) × 20% (the first-year 200% DB MACRS rate)	$6,300
2. 75% of the first-year limit ($3,060 × 75%)	2,295

The first-year limit applies to Nicole. **Her 1999 MACRS deduction is limited to $2,295.** The first-year limit of $3,060 applies to the **total** of the MACRS deduction and the I.R.C. §179 deduction elected (if any).

Practitioner Note. Instead of using actual costs for the auto acquired in 1999, Nicole may benefit by using the **standard mileage rate** for her 1999 business miles. The rate is 32.5 cents per business mile for miles through March 31, 1999, and 31 cents for business miles beginning April 1, 1999. Since Nicole brought the auto in June, her rate will be 31 cents.

Example 2. Assume the same facts as in Example 1 except that Nicole chooses to use the **standard mileage rate** for her 23,200 business miles. Since Nicole is self-employed, she may deduct $1,500 ($2,000 × 75%) on line 16 (Interest) on her 1999 Schedule C in addition to the standard mileage rate deduction.

Computation of Nicole's 1999 Schedule C auto expenses:

23,200 business miles x 31¢	$7,192
Interest on car loan ($2,000 x 75%)	1,500

Partially completed Parts II (Expenses) and IV (Information on Your Vehicle) of her 1999 Schedule C follow.

Part II **Expenses.** Enter expenses for business use of your home **only** on line 30.

8 Advertising	**8**		**19** Pension and profit-sharing plans	**19**	
9 Bad debts from sales or services (see page C-3)	**9**		**20** Rent or lease (see page C-5):		
10 Car and truck expenses (see page C-3)	**10**	*7,192*	**a** Vehicles, machinery, and equipment	**20a**	
11 Commissions and fees	**11**		**b** Other business property	**20b**	
12 Depletion	**12**		**21** Repairs and maintenance	**21**	
13 Depreciation and section 179 expense deduction (not included in Part III) (see page C-4)	**13**		**22** Supplies (not included in Part III)	**22**	
14 Employee benefit programs (other than on line 19)	**14**		**23** Taxes and licenses	**23**	
15 Insurance (other than health)	**15**		**24** Travel, meals, and entertainment:		
16 Interest:			**a** Travel	**24a**	
a Mortgage (paid to banks, etc.)	**16a**		**b** Meals and entertainment		
b Other	**16b**	*1,500*	**c** Enter 50% of line 24b subject to limitations (see page C-6)		
17 Legal and professional services	**17**		**d** Subtract line 24c from line 24b	**24d**	
18 Office expense	**18**		**25** Utilities	**25**	
			26 Wages (less employment credits)	**26**	
			27 Other expenses (from line 48 on page 2)	**27**	

Part IV **Information on Your Vehicle.** Complete this part **ONLY** if you are claiming car or truck expenses on line 10 and are not required to file Form 4562 for this business. See the instructions for line 13 on page C-4 to find out if you must file.

43 When did you place your vehicle in service for business purposes? (month, day, year) ▶ *06* / *01* / *99* .

44 Of the total number of miles you drove your vehicle during 1999, enter the number of miles you used your vehicle for:

a Business *23,200* **b** Commuting ______ **c** Other *7,733*

45 Do you (or your spouse) have another vehicle available for personal use? . . . ☐ **Yes** ☒ **No**

46 Was your vehicle available for use during off-duty hours? . . . ☒ **Yes** ☐ **No**

47a Do you have evidence to support your deduction? . . . ☒ **Yes** ☐ **No**

b If "Yes," is the evidence written? . . . ☒ **Yes** ☐ **No**

Practitioner Caution. Employees who use either the standard mileage rate or actual expenses to compute their auto expenses on Form 2106 **cannot** deduct any interest on a car loan. This prohibition applies even if the auto is used 100% for employee business purposes. The interest is treated as **personal interest** and is not deductible.

Example 3. Nicole leased a business auto on June 1, 1999, which she used 75% for her Schedule C consulting business. The fair market value of the auto was $42,500. Her lease payments were $700 a month for 36 months. She used the car for 214 days in 1999.

The **inclusion amount** is not added to Nicole's 1999 income. Rather, it is subtracted from and thus reduces her otherwise deductible lease payment on her 1999 Schedule C.

Computation of Nicole's 1999 inclusion amount:

Fair market value of auto on first day of lease	$42,000
Inclusion amount for cars first leased in 1999 [Appendix B-1 in IRS Publication 463, *Travel, Entertainment, Gift and Car Expenses* (for use in preparing 1999 returns)]	176
Note. See the Depreciation/Amortization section of the What's New chapter for the $176 figure.	
Nicole's inclusion amount [$176 × 214/365 (proration) × 75% (business use)]	**77**

Computation of Nicole's 1999 Schedule C lease deduction:

$700 x 7 months of lease payments x 75% business use	$3,675
Less: Inclusion amount	(77)
Nicole's 1999 lease deduction if she uses actual expenses to compute her leased auto expenses	**$3,598**

The $3,598 will be deducted on line 20a (Rent or lease–vehicles, machinery, and equipment) on her 1999 Schedule C.

Practitioner Note. Even though Nicole leased the auto, she may use the standard mileage rate to compute her 1999 auto expenses. Rev. Proc. 97-58 permits this for 1998 and later years, even if the lease began before 1998. If Nicole uses the standard mileage rate on her leased auto for 1999, she must continue to use it for the remainder of her 36-month lease term. The standard mileage rate may yield a larger 1999 deduction for Nicole than the actual expense method.