



October 2024

Three Possible Ways to Deduct Your Dog or Cat

Dogs, cats, and other household pets are expensive. Owners spend an average of \$1,270 to \$2,800 a year to own a dog. Can you ever deduct these costs from your taxes?

The expenses for a family pet that provides you only with love and companionship are never deductible. They are purely personal expenses.

But it is possible to deduct the expenses for a dog, a cat, or another animal if it qualifies as a

- medical expense
- business expense, or
- charitable deduction.

The costs of buying, training, and maintaining a dog or another animal qualify as deductible medical expenses if you

- use the animal primarily for medical care, and
- would not have paid the expenses but for the disease or illness involved.

Medical deductions are allowed for service animals trained to aid their owners with a disability. Examples include guide dogs for people who are blind or have low

vision, or dogs trained to carry items for people with physical disabilities.

You can also deduct as a medical expense emotional support animals, such as dogs, cats, or other animals that help people suffering from mental or emotional disabilities. Emotional support animals are more challenging to deduct than service animals because they can seem little different from regular pets. The animal should be prescribed (or at least recommended) by a licensed healthcare provider as part of a mental health treatment plan.

You can deduct dogs and other animals as a business expense if they serve a legitimate business purpose. For example, you can deduct a guard dog used for security at your business location. The guard dog should be trained and should be an appropriate breed for guarding purposes, such as a Rottweiler, German shepherd, or Doberman pinscher. Don't try to deduct a small dog like a Chihuahua as a guard dog!

Cats have achieved business-deductible status when used for pest control at a business location.

If you foster dogs, cats, or other animals in your home, you may be able to take a charitable deduction for the reasonable expenses you pay out of your own pocket, such as pet food expenses and veterinary bills. You may not deduct the value of the time you spend fostering animals or the value of donating space in your home for this purpose.

To qualify for this charitable deduction, you cannot foster animals on your own. You must do so on behalf of a Section 501(c)(3) charitable organization. You must

also obtain a written acknowledgment from the charity if your expenses exceed \$250.

Got IRS Penalties? Know the Rules, Pay Nothing

If the IRS has recently claimed that you owe a penalty for late filing, late payment, or missed employment tax deposits, pause before making any payment. You may not have to pay that penalty at all.

The IRS often imposes steep penalties for filing tax returns late, failing to pay taxes on time, or not depositing employment taxes correctly. However, several strategies can help you get those penalties removed—and in some cases, even refunded if you have already paid them.

Common IRS Penalties and Their Impact

Some of the most common penalties include:

- **Late filing penalty.** For individual or C corporation returns, this can be up to 5 percent of the unpaid tax for each month the return is late, maxing out at 25 percent. Partnerships and S corporations can incur penalties of \$245 per partner or shareholder per month.
- **Late payment penalty.** This penalty is generally 0.5 percent of the unpaid tax per month, maxing out at 25 percent.
- **Penalty for failure to deposit employment taxes.** This penalty ranges from 2 percent to 10 percent, depending on how late the deposit was.

Strategies for Relief

Here are a few ways to potentially avoid or reduce these penalties:

First-time abate. If this is your first time receiving a penalty—or your first time in over three years—you may be eligible for a “first-time abate.” This is one of the easiest and most common ways to remove a penalty. It applies to failure-to-file, failure-to-pay, and failure-to-deposit penalties. As long as your tax compliance history is clean, you may qualify.

Partnership relief. If your business is a partnership with 10 or fewer partners, and if all partners filed their tax items on time, you may be eligible for relief under Revenue Procedure 84-35. This is a little-known but effective option.

Reasonable cause. If neither of the first two options applies, you can request penalty relief by showing that there was a reasonable cause for your late filing or payment. This could include illness, a natural disaster, or other significant life events that impacted your ability to meet IRS deadlines.

Next Steps

If you believe any of the penalties you’re facing may qualify for relief, you may be able to remove those penalties with a simple phone call. Using the right approach and trigger words when speaking to the IRS can make all the difference.

If you have already paid the penalties, you can use IRS Form 843 to file for a refund if you do so within three years of filing the return or within two years of paying the penalty.

Know the Three Ways the Tax Law Treats Personal Property Rentals

Here are some key points about renting personal property, which includes equipment, vehicles, and furniture. The tax treatment differs from real estate

rentals, and how you classify the rental activity will affect how you report income, expenses, and potential self-employment tax.

Classification of Personal Property Rentals

The tax code treats personal property rentals in three ways:

- 1. Business.** If your primary purpose is to earn income and the activity is continuous, it is considered a business. You must report the income on Schedule C, subject to self-employment tax.
- 2. For-profit activity.** If the rental is profit-motivated but sporadic, it's a for-profit activity. You report the income on Schedule 1. There's no self-employment tax.
- 3. Not-for-profit activity.** If the rental activity is primarily for personal reasons (e.g., for recreation), it is considered not-for-profit. You report the income on Schedule 1, but cannot deduct expenses related to the activity.

Renting to Your Own Business

If you rent personal property to your own business, the tax implications depend on the business structure.

Sole proprietorship or single-member LLC.

Rentals between you and your business are not taxable events.

Corporation, partnership, or multi-member LLC. Renting to your business is a taxable event. The business can deduct rental payments, and you report the income on your tax return. For C corporations, this can help avoid double taxation, as rent payments are taxed only once as income to you.

Self-Rental Rule

The “self-rental” rule applies to renting personal property to a business in which you materially participate. The rule works like this:

- If the rental activity produces net income, it is characterized as non-passive income, meaning you can't deduct passive losses against this income.
- If the rental activity creates a loss, the loss continues as a passive loss, which you can offset only with passive income.

Key point. Self-rental gives you the worst of both worlds—passive classifications.

Grouping

You can avoid the self-rental rules with the grouping election. You may group your property rental with your business when the group forms an appropriate economic unit and

- the rental activity is insubstantial relative to the business activity, or vice versa, or
- each owner of the business activity has the same proportionate ownership interest in the rental activity.

Caution 1. The tax code prohibits grouping real and personal property rentals.

Exception. If you rent the business building or office unit to your business and such rental includes furnished offices, the prohibition on combining activities does not apply. You can group with the business activity under the grouping rules above.

Caution 2. The self-rental grouping election does not work with a C corporation