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PRODUCT & SERVICE GUIDE

5 Outrageous, But Legitimate, Income Tax Deductions

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Jan. 24, 2016



As tax professionals, we all have stories to tell about the dubious items our clients want to “write off” on their tax returns – and after many years of hearing the same questions, many of our answers are quite well-rehearsed. But what about those *outrageous* deductions we are asked about a little less frequently? While we know it’s possible for our clients to meet the rules for deducting, say, a boat or a swimming pool, are we prepared for the conversation?

The 400K Yacht

Your new client runs a “boat chartering” business, but his prior year tax returns show losses for the business year after year. He insists on writing off the boat again this year. What do you do?

Whether or not a boat qualifies as a business asset will depend on a number of facts and circumstances that are used by the IRS to determine if a business is a business or in fact a hobby. That part will be easy for you. But when you’ve gone through the nine factors with your client and determined that perhaps the charter “business” is really a hobby, you may be able to surprise and delight your client by explaining the rules for deducting mortgage interest on a second home – at which point you can run through the list of requirements to see if he qualifies to claim his boat interest as interest on a second home.

The general rule for the deduction is that you may claim mortgage interest on your main home and a second home. As long as the boat has a kitchen, sleeping quarters and a bathroom, the interest may be claimed as home mortgage interest, up to the limits. If your client is not already claiming a second home, he can take the deduction for the interest paid on his boat. But if he falls under the Alternative Minimum Tax, unfortunately the boat interest will not be allowed under the AMT rules.

The 100K MBA

It may seem outrageous for that millennial MBA student to be able to claim the full amount of her business school tuition as an employee business expense, but believe it or not, the deduction is often allowed. It’s not at all easy to get the deduction through in an audit, but if your client has the right situation and documentation, it’s almost a lock.

There are three decisive factors that are used by the IRS to determine whether an MBA qualifies as a business expense deduction. First, your client must already be established in her job or business. Second, the purpose of the education must be to

maintain or improve your client's skills in her current job or business, and third, the education cannot qualify your client for a new trade or business.

The factor that usually makes or breaks the case in an audit is the taxpayer's current job. If their position, responsibilities and title are the same as when they began the MBA program, there's a very good chance you will be able to make a strong case for your client.

Though it's almost always an audit trigger, the amount of the deduction is worth it if your client's position is solid. If the requirements for the employee business education expense deduction are not met, your client may be able to claim either the Lifetime Learning Credit or the Tuition and Fees Deduction for higher education expenses. But while the maximum your client could potentially receive with either of these would be in the \$2k range, your client could enjoy tax benefits in the tens of thousands of dollars with the employee business expense deduction.

The \$30K Swimming Pool

Your client says he should be able to deduct the expenses for installing his new swimming pool as a medical expense because his doctor told him to swim laps every day. Sounds outrageous, but in fact, the IRS and Tax Court have approved swimming pool expense deductions for taxpayers whose doctors have prescribed regular swimming for the treatment of a medical condition, such as arthritis or emphysema. The extent to which the pool is used by others living in the home for recreational purposes will be a major factor in determining its deductibility. The primary purpose of the pool must be for the alleviation of a medical condition.

With a swimming pool it's important to remember that only the amount that exceeds the amount of the increase in the property's value resulting from the pool installation is deductible. And on top of that, only the amount over 10% of income is allowed for the medical expense deduction – or 7.5% if your client is 65 or older (through 2016).

The \$25K Gender Reassignment Surgery

Your formerly male but now female client wants to deduct the \$25,000 he spent on gender reassignment surgery. While in the past this would have been disallowed by the IRS, all of that changed with the decision on *O'Donnabhain v. Commissioner of Internal Revenue*. In this 2010 case, the Tax Court judges decided in favor of plaintiff Rhiannon O'Donnabhain, ruling that medical treatment for gender identity disorder

qualifies as medical care under the Internal Revenue Code — and is therefore deductible.

In order to prove your client’s case, you will need letters from doctors stating that the treatment and surgeries were part of the medically necessary treatment for gender identity disorder. And while the Tax Court disallowed the expenses for breast augmentation in the O’Donnabhain case, it is possible to make a strong argument for these as well. In a case we handled at [TaxAudit.com](https://www.TaxAudit.com), our member was able to provide letters from her doctors citing “evidence of clinically significant distress or impairment in social, occupational, or other important areas of functioning,” which made the breast augmentation surgeries part of the medically necessary treatment of her gender identity disorder — and therefore deductible.

The \$12K in Pet Expenses

When the feline fancier who is passionate about rescuing cats arrives at your office door with a box of receipts for her cat food, litter and veterinary bills, your initial instinct might be to tell her that pet expenses are not allowed – because in most situations that would be true. But if she meets a certain set of criteria she may be able to claim them as a charitable contribution.

First, your client will need to prove that her activities are directly connected with an approved charity. Next, she must demonstrate that her expenses are connected with and solely attributable to her charitable activities. And finally, she will need to provide the required documentation needed to properly substantiate the expenses that are connected to the charitable work.

One of our responsibilities as tax professionals is educating our clients about the rules for deductions. Explaining why they are or are not eligible for a specific deduction is something we expect to do during every client meeting we have. Keeping up to date with the latest tax legislation and Tax Court decisions — and reading articles like this one — will help to ensure we are ready for whatever outrageous question comes our way.

[More articles by Dave Du Val, EA.](#)

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