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Tax Tips for American Musicians

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As both a professional musician and a tax professional, I have been on both sides of the desk at tax time. Throughout the many years I have been preparing tax returns for, as well as consulting on, tax issues with musicians nationwide, I have often encountered many of the same questions. What can I deduct? What do I report? What records should I keep? Below are answers to some of the most commonly asked questions I receive every year:

Q: Can musicians paid as employees still deduct any business expenses?

A: The new Tax Cuts & Jobs Act that went into law in 2017 completely disallows all *employee* business expense deductions at the Federal level. This means any expenses incurred as an employee or for the production of W-2 income are no longer currently deductible for anyone, including musicians. This law is in effect up until 2025. This *really* hurts W-2 employees who buy expensive equipment, pay to have it maintained, and have thousands of dollars in work dues or agent/manager commissions.

Please note that while Employee Business Expenses are not allowed on the Federal level, some states, such as New York, California, and Pennsylvania still allow them. It may be worth checking to see if you have enough to make a difference on your state return, if your state allows these deductions.

Q: Can we still deduct our business expenses if we are self-employed?

A: Absolutely. All ordinary and necessary expenses you incur to generate self-employment (1099) income are still deductible in full, with the exception of business meals, which are 100% deductible for 2022 only, then 50% after.

Q. What if I have expenses for both W-2 and for 1099 income?

A. Here's the good news and the tricky part: Some, and perhaps even many, expenses incurred by musicians inevitably can generate both W-2 *and* 1099 income. For instance, your lessons/education, research, instruments, repairs, wardrobe, home office, etc., are often beneficial to your status as both an employee as well as a self-employed musician. Therefore, such expenses can be allocated to your income from self-employment and therefore still be deducted—some in full, and some proportionately. A good tax preparer familiar with the industry will know what to do here.

Q. I heard that deducting your home office is an audit flag. Is this true?

A. This is an old rumor. In tax audits from the 1980s, the IRS found that most people who claimed a home office deduction did not really understand how to properly calculate it, so in 1990 they introduced the new Home Office Form 8829. This form shows exactly how to calculate the home office, and it is attached to your tax return. Since then, I haven't heard of anyone being audited because they deducted a home office (unless they tried to deduct most of or all of their home).

Something else you should know: Your chances are of getting audited are even greater if you have no home office but have a lot of local transportation expenses. Here's why: The IRS allows a deduction for transportation expenses between job locations, or travel to job locations out of town or outside of your regular work area, but traveling to and from jobs *within your regular metropolitan area* are considered non-deductible "commuting expenses," and commuting to work is never deductible. If you can prove that you qualify for a legitimate Home Office deduction, then you can deduct your transportation from your home office to any other work location where you are self-employed and not an employee. This will qualify as deductible "transportation between jobs." Therefore, the IRS may flag a return with high transportation expenses and no home office, because they might suspect the taxpayer is writing off non-deductible commuting expenses.

Q. What other transportation can I deduct?

A. In addition to travel to jobs out of town, jobs outside of your normal work area, and transportation from job to job (including travel from your home office to another job location), you can also deduct travel to rehearsals, music stores, business meetings, auditions, lessons, classes, showcases, and other non-paid performances that are likely to result in work or valuable exposure.

Q. What if I use my car or truck for gigs? How do I keep records of this?

A. You should track all miles driven for business reasons, including all the reasons given in the paragraph above. One easy way to do this is with a good mileage app such as "Mile IQ," "Mile Tracker," or "Trip Cubby." Such apps are easy to use, and the apps can even email you a spreadsheet with a record of every business trip you made and how many miles it was. Such a record is exactly what the IRS would want to see to substantiate the use of your car or truck for business.

Q. What about gas and other expenses like repairs and insurance?

A. For 2023, the IRS allows an automatic 65.5 cents per mile as a tax deduction. You may also use your mileage records to determine a deductible percentage of your actual expenses such as gas, insurance, repairs, and the cost of your car. Choosing which of these two ways to deduct your auto for business is best discussed with a tax professional familiar with your business. One can often be far better in the long run than the other, depending on many factors such as how long you plan on keeping the same car or how many miles per year you drive.

Q. Can I deduct the cost of making my own CD, or master? I heard the IRS actually has a special rule for this?

A. Yes, there is a special rule for this and a special procedure that must be followed. You must make what is called the "Safe Harbor" election on your tax return to amortize the production expenses over three years. If you fail to make this election and are audited, the IRS will take away your deduction and make you use a very complicated "units of production" method of depreciation. This method could provide hardly any deduction in the year you make the recording, and a much smaller deduction every year after that, for a really long time.

Electing the "safe harbor" will provide you with the huge write-off of 50% of the costs in the first year, and 25% for the next two years after that. Make sure that you have guidance from someone who is thoroughly familiar with this procedure and knows the code section well.

Q. I took a gig overseas and they want to withhold foreign taxes in all the countries I'm performing in. Can I get those taxes back when I file?

A. While you cannot get those taxes refunded, you have two choices. You can either claim the "Foreign Tax Credit" on your US tax return, resulting in either a full or partial credit for the foreign taxes withheld, or if you have at least 45 days before the gig, you can apply to the IRS to get a Form 6166 "Certification of US Tax Residency" and submit it to the payer in advance. This form takes about 45 days to get, it is signed and stamped by the IRS, and it shows that you are a US Resident Taxpayer, and you will pay taxes to the US on your foreign income. If that country, like most countries do, has a tax treaty with the US, in most cases it will waive the income tax withholding requirement. Just make sure that you set aside some of that gig income for the US taxes (and State/city taxes) you'll owe on it when you eventually file your US tax return.

Q. I received a per diem and/or expense reimbursement, can I still deduct expenses I paid with that per diem/expense reimbursement?

A. There are two kinds of per diems or reimbursements: tax free and taxable. If you receive a tax-free per diem or tax-free reimbursement for any expenses such as meals, travel, or hotel, then you cannot deduct those reimbursed expenses. It is very important to check if the per diem or expense reimbursement is included on your 1099 as taxable income. If it is taxable, then you definitely *can* deduct those reimbursed expenses to avoid being taxed on the reimbursement. As always, make sure you have records of everything.

It is very important to note that one of the first things they now ask for in an audit, is a letter from anyone who hired you for a tour or out of town gig saying whether or not they paid you a per diem or reimbursed you for any travel expenses.

A comprehensive list of tax deductions for musicians can be found here: https://musictax.com/client-worksheets/

Q. Do I have to report gig income if I didn't get a 1099 for it and nobody reported it?

A. The first thing that your examiner will ask for in an audit is your bank statements. If you don't provide them, they will be subpoenaed directly from your bank(s). The examiner will add up all of your bank deposits and if they are more than you reported on your tax return, they will presume the difference is unreported income unless you can prove otherwise. Failure to report all of your income will definitely cost you negligence penalties plus interest, and they will look at other years to see if this is a pattern. If you file a fraudulent tax return, you run the risk of the IRS launching a criminal investigation.

Q. How long should I save my tax records & receipts?

A. The IRS can normally go back three years from the date you filed your tax return or the actual due date, whichever is later. However, in cases of large misstatements of income or expenses they can go back six years. Best advice is to save all of your records for six years after the date you filed your return or the actual due date, whichever is later. Save copies of your tax returns for at least 10 years, if not longer.

Q. What is the easiest way for a musician to keep records of self-employment income and expenses?

A. Best advice is to open a separate checking account, either a business account or simply another account that you call your "business account." Also get a separate or a business credit card. Any W-2 income with taxes withheld should be deposited in your regular bank account, but any income where taxes are not withheld should be deposited in your business account. All business expenses should be paid either from the business account or the business credit card. Definitely keep receipts for all of these business expenses, but put them in an envelope or box because you won't need them unless you're audited.

When tax time comes, all of your expenses will be on the 12 bank statements and 12 credit card statements, making it very easy to categorize and add them up using a spreadsheet. No more unfolding and sifting through hard-to-read receipts! Likewise, your self-employment income will be easy to determine by just adding up your deposits. Note that anytime you put your own money into the business account, you do not count this as income. In fact, when you put you own money into your business account, end the amount in one cent (for example: $500.01) This way, when you go to add up your income, any amount that ends in one cent you will know not to count as income.

Q. Should I form an LLC or a Corporation? Is there any tax savings?

A. A single person LLC files taxes the same way as any other self-employed person, so there is virtually no difference except for the Limited Liability. However, there is no limited liability if the LLC is not formed correctly and run like a true LLC, meaning ALL business income & expenses must go thru the LLC bank account.

Forming a Corporation is easy to do but a pain to maintain. An extra Corporate tax return must be filed, and the owner(s) by law must be put on 'payroll' with taxes withheld from each paycheck. The corporation must pay into unemployment for each owner/shareholder and in some states or instances a worker's comp policy may be required. Add this to the stringent bookkeeping requirements and unless you're earning enough to pay for all the added costs, it may not be worth it. What you may save in taxes could easily be eaten up by the extra payroll and accounting costs.There *are* instances however, when business expenses that you would be ineligible for as an employee could be paid by and deducted by your corporation if your employer would agree to pay your corporation instead of paying you as an employee, providing it was permissible by union bylaws.

Before forming any business entity such as an LLC or Corporation, a consultation with a good tax person that knows your profession can save you money and headache down the road.

Q. Is there any tax advantage to forming a Delaware LLC or a Delaware Corporation?

A. There is no tax advantage… in fact, it will cost you more in the long run. This is because you are also legally required to register your company in the state where you do most of your business and where your main office is, so you'll be paying annual fees to two states. You will have to have to have a 'registered agent' in Delaware which also has an annual fee. With no tax savings for all that, what's the point? Also check out the new BOI filing requirement!!!

Also, beginning in 2024 there is a new ***very serious filing requirement*** for all new as well as existing LLC's and Corporations called the BOI filing. This must be done by the company and is NOT a tax filing! Penalties for not filing your BOI online can be up to $10,000 plus imprisonment.

Q. When should I worry about sending out 1099 Forms to other musicians and vendors I've paid? What are the penalties for not doing this?

A. When you pay an individual or a company $600 or more for services rendered to you for business purposes, you must send them a Form 1099-NEC and file a copy with the IRS. The only exception is if the company you paid is a corporation or is taxed as a corporation, however, law firms must get a 1099 even if they are incorporated. The best way to find out if you are paying a corporation is to have your payee fill out and sign Form W-9 and return it to you.

The easiest and cheapest way to issue and file your 1099s is through a website called "efilemyforms.com" where they actually mail them out for you and e-file them with the IRS. If you are paying other musicians, accompanists, band members, arrangers, sound technicians, etc., you should have everyone fill out and sign Form W-9 (Google Form W-9 for a copy) and return it to you *before* you ever pay them. If you don't then you may be scrambling to get their info in January as the filing deadline closes in.

The new penalties for failure to 1099s when required are now between $310 and $630 *per* 1099 not filed when required. The due date to file these forms is January 31. The new late penalties are $60 per 1099 for being up to 30 days late, $120 per 1099 for over 30 days late up to August 1, and if you file them after August 1 the late penalty is $310 per 1099. Willfully not filing them at all brings a penalty of $630 per 1099 not filed! AND, don't think that if you choose to not claim the payments as a deduction that you'll escape the penalty. As long as you made the payments, a 1099 must be filed whether or not you choose to deduct them.

In closing, remember that a good tax professional never actually costs you anything in the long run, but running afoul of the tax laws or not taking advantage of every tax break available can be costly. If we could, I and colleagues I regularly speak with would tell you about all the times we've had a musician bring his or her self-prepared tax returns to us for review, only to find opportunities that were lost because it was too late to go back and amend those returns and make retroactive elections that would have saved them much more than they would have paid a professional.

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