

RESEARCH BRIEF • JANUARY 2025

Optimal Income Tax Deductions for Mixed Business and Personal Expenditures

Based on BFI Working Paper No. 2024-156, “[Optimal Income Tax Deductions for Mixed Business and Personal Expenditures](#),” by Jacob Goldin, University of Chicago; Sebastian Koehne, Kiel University; and Nicholas Lawson, Dalhousie University

The optimal tax deduction for mixed-purpose expenditures should be proportional to the extent that the expense serves an income-generating function versus a consumption function.

Business expenses are typically tax deductible, while personal expenses are not. But what happens when an expense serves both purposes? For instance, a small business owner might purchase a car used for both professional and personal activities or book an airplane ticket that combines a customer meeting with a family visit. This gray area has long challenged tax policy. As UChicago economist Henry Simons noted in 1938, “There is here an essential and insuperable difficulty, even in principle.”

In practice, tax rules governing mixed-purpose expenditures are complex and inconsistent. In the United States, some such expenses are fully deductible (e.g., flying business class to meet a client), others are entirely non-deductible (e.g., buying a suit to wear at work), and some are only partially deductible (e.g., business meals, capped at 50%). In certain cases, deductibility depends on subjective factors, such as the taxpayer’s primary

intent for the expense (e.g., travel costs) or how the expense is used in practice (e.g., home offices).

This paper examines the optimal taxation of mixed-purpose expenditures. Building on theoretical tax models, the authors explore how much of these expenses should be deductible based on their dual roles in generating income and providing personal benefits. They argue that mixed-purpose goods justify the use of different tax rates for different types of expenses, and outline how such distinctions should be implemented in tax policy. Key findings include:

- Under an optimal tax system, expenses solely for generating income should be fully deductible, while purely personal expenses should not be deductible. Mixed-purpose expenses should be partially deductible based on the proportion related to income generation. As expenses resemble business inputs more

closely, the deductible share should increase; the more they resemble personal consumption, the smaller the deduction.

- The optimal deduction rate for mixed-purpose goods should account for differences in income levels, as the ratio of income-generating to consumption benefits may vary across taxpayers. This can be implemented through income-sensitive phase-ins and phase-outs of deductions, a common feature of existing tax systems.
- Deduction rates should be determined by marginal benefits—the additional benefits derived from extra spending—rather than average benefits. For example, while a basic phone plan may largely support work, upgrading for premium features like a high-quality camera is primarily consumption-driven and should have a low or zero deduction rate.
- For goods that provide personal utility but reduce income, the optimal policy involves a “negative deduction rate,” effectively adding a portion of the expense to taxable income to reflect its impact on earning capacity.

This research provides a framework for designing income tax deductions for mixed-purpose expenditures. The findings have significant implications for tax design: they justify partial deductions for hybrid goods and propose adjustments based on taxpayer income, marginal benefits, and administrative constraints. Furthermore, the study opens new avenues for considering “negative deductions” for goods that diminish productivity, offering a novel perspective on addressing behaviors that harm economic output.

READ THE WORKING PAPER

NO. 2024-156 · DECEMBER 2024

Optimal Income Tax Deductions for Mixed Business and Personal Expenditures

bfi.uchicago.edu/working-papers/optimal-income-tax-deductions-for-mixed-business-and-personal-expenditures

ABOUT OUR SCHOLAR



Jacob Goldin

*Richard M. Lipton Professor of Tax Law,
The Law School*

