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*Business Advisor*

*Tax Planning*

*Tax Preparation*

*Retirement Planning*

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ments*

*Personal Financial  
Planning*

## Memberships

American Institute of  
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## Annual Fall Sale

From October 17 through December 15, 2006, my annual fall sale offers a 20% discount on all services except IRS (or other government) audit assistance. So, save on year-end tax planning, getting your computerized accounting up and running before the new year, business consulting, and personal financial planning. Call today to set up your appointment. To take advantage of the discount, you need to pay your invoice within 10 days of billing. (Note: This is *not* the same as the prepayment plan for 2006 tax return preparation, which you will receive in December.)

## Deductibility and Payment of Taxes

Let's start with the basic premise: *Taxes are not deductible unless specifically allowed by the Internal Revenue Code.*

**Business taxes.** Taxes paid in the course of your business are generally deductible, unless you are required to capitalize them under a specific section of the Internal Revenue Code. Here are some of the taxes that can affect businesses:

- **Income taxes:** Businesses are subject to income tax, just as are individuals. State and local income tax is deductible for federal purposes, and in some states federal income tax is deductible on state returns. In the case of pass-through entities (partnerships, LLCs and S corporations) the tax is assessed on the tax returns of the owners.
- **Sales and use taxes:** Sales taxes paid are included as part of the cost of the underlying item. Since use taxes are often paid separately from the underlying item, they would be expensed if the item is expensed, but added to the cost of a capitalized asset. Retail businesses collect sales tax from customers, and pay that over to state and local governments.
- **Property taxes:** These are paid (in Colorado) in the year following the assessment. There are two types: real and personal. You need to file an assessment form for personal property (this is non-real property used in a business or rental activity) if the total value of the property exceeds \$2,500. The annual ownership tax on vehicles is a type of property tax.
- **Excise taxes:** Some businesses, such as trucking companies, pay excise taxes on their equipment. Importers may pay customs duties. That kind of excise tax is deductible. Other kinds of excise taxes (such as on retirement plans) are more in the nature of penalties, and so are not deductible.

*Personal taxes:* There is more variability regarding the deductibility of taxes on personal income tax returns. All the comments regarding business taxes apply to those paid for proprietorships or rental properties.

- *State and local income tax versus Sales Tax (Corrected):* For the past couple of years, taxpayers had the choice of deducting the state/local income tax paid or the sales tax paid. Unless Congress acts to extend the sales tax deduction, it will not be available for 2006..
- *Property tax:* Property tax on real property and ownership tax on vehicles continue to be deductible. If you own vacant land, and you're subject to the Alternative Minimum Tax, you may benefit from not claiming the property tax as a deduction. Instead you can make an election to capitalize the tax (add it to your cost of the land) instead of claiming the deduction. Since taxes aren't deductible for AMT, this preserves the deduction for the time you sell the land.
- *Foreign taxes:* Investors who have investments in mutual funds or stocks that include dividends from foreign companies may have a foreign tax deducted from the dividend. You have two choices regarding the foreign taxes. For most people, taking these as a credit against your federal income tax is the better choice. For small amounts (\$300 per taxpayer), you can just apply the credit against your income tax. Larger amounts are credited after completing Form 1116, a complex two-page form. Any unused credit can be carried back two years and forward 5 years, if those years have foreign income. For a few taxpayers, deducting the taxes as an itemized deduction turns out to be better (subject to being disallowed for AMT purposes).

*Paying income taxes:* To some extent, when you pay your taxes is an economic decision, provided you pay them within a reasonable time after the due date. There are two basic methods: withholding and estimated tax.

- *Withholding of tax:* Most people who work for wages have income taxes automatically withheld from their pay. Now that interest rates are reasonable, it makes sense to arrange your withholding so that the amount of refund you get when you file your tax returns is relatively small. You can file new W-4 forms with your employer to change your withholding any time. If you owe a few hundred, that's even better, since it means you, rather than the government, have had the use of the money. Owners of corporations can be particularly flexible here; they can pay a nominal salary for 11 months of the year, with a big bonus in December, from which all the withholding for the year is taken. Since the tax code assumes that withholding is evenly taken through the year, this avoids underpayment penalties.
- *Estimated tax:* People who have large amounts of income with no withholding need to make estimated tax payments. There are three ways to approach this; the method you use depends on your comfort level with the IRS and the state.
  - Routine: Pay each installment as it comes due, based on the prior year. If you had a particularly high tax bill in the prior year, you may benefit from calculating the actual tax due just before each payment date, since the payments would be lower.
  - Pay late: Pay only at the time the tax return is filed. Incur the "underpayment penalty" as the financing cost of this decision.
  - Pay early: Pay it all at the beginning of the tax year. A good choice for those who don't want to have to remember the payment schedule through the year. Several of my "senior" clients choose this approach

**Promote use of the democratic process in all our activities.**