Yuma Business Direct

YUMA COUNTY'S BUSINESS VOICE

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PATHWAYS TO PROFIT

Deciphering those terms on your taxes

The new year is upon us and as we close our books for 2005 and review the year's financials, our thoughts turn to taxes. Understanding what those terms on your returns mean may actually save you money on your taxes.

BY LEAH THISS

I recently spoke with local tax preparer Perry Knaub, president of PDK Business Solutions (www.pdktax.com), about this and he agreed.

"I'm proud to be an American taxpayer, but I'd be just as proud to pay half as much," he told me. "Therefore, in my practice I feel personally involved in helping my clients find as many deductions, exemptions and credits possible. Now when I start mentioning terms such as these, I start to see the 'deer in the headlights' look!"

The 1040 tax return for individuals is divided into several sections and the deductions, credits and exemptions are calculated on the first section on page two of the 1040 Tax and Credits.

Here is a brief explanation for each of the three ways the government allows all of us to pay less tax:

➤ Deductions — Whether our income is as an employee or self-employed person, we can deduct or reduce how much of our income is taxed. The IRS will give all taxpayers a standard or regular amount that can be deducted from taxable income. For a single person for the 2005 tax year, it is $5,000 or $10,000 for a married couple.

If a taxpayer thinks they can list or "itemize" more than those allowable (such as mortgage interest, charitable contributions, real estate, personal taxes, etc.) they can choose to do so.

➤ Exemptions — Each taxpayer can "exempt" his or herself of $3,200 of taxable income. The biggest misunderstanding we've seen concerning this function happens when a child gets their first job. The child naturally wants to claim his/herself and take the exemption (and get the refund check). However, many times the parents are in a higher tax-bracket and it would benefit them more if they were able to claim the child as a dependant — and get the exemption.

Many times it does not make a difference if the offspring claim themselves if they didn't make more than $5,000. In these cases, we have to "amend" the child's tax return to reverse this and then file the parents' return a few weeks later. This gives the IRS time to get the records adjusted and the parents can then claim the child's exemption as a dependant.

➤ Credits — A credit is a reduction of the tax actually owed, where a deduction only reduces the amount of the income you are taxed on. Therefore, a credit is much better.

Credits can include child tax credit (worth up to $1,000 for each qualifying dependant), education credits, credits for dependant and child care, retirement savings, adoption, etc.

Probably the most important to low-income taxpayers is the earned-income credit, and there is a complicated formula used to calculate this. Without having any tax withheld, it is possible for a refund of more than $4,000 to be given under this credit.

By understanding each of these key terms, you are in a better position to take advantage of all the tax breaks to which you are entitled.

Uncle Sam has another set of rules that allow us to pay less tax as a small business. My next column will have tips on preparing your sole proprietor Schedule C.

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Business owner needs grasp of taxes

BY LEAH THISS

With April 15 looming around the corner, I thought it would be a good time to talk about taxes. In my last column, I provided definitions for key terms you see on your tax return each year.

For Part 2, I promised to share tips on preparing the sole proprietor Schedule C.

Tax laws can be very daunting. Once again I turned to local tax preparer Perry Knaub, president of PDK Business Solutions (www.pdktax.com), to share his expertise on the topic.

He explained that starting and running a business requires the owner to be good at many things besides his craft. Accounting and taxes are no exception.

After all, it is to no avail to make a ton of money doing what you love to do, then have half of it taken away by the IRS when hit with disallowed deductions and credits because you have not kept adequate records.

As a business owner, you need to have a strong grasp of tax laws and accounting or hire someone who does. Even if you bring in the experts, you should make it a point to understand your tax return before you sign it.

Here are a few tips for the sole proprietor who will be filing an IRS Schedule C Profit and Loss From Business:

➤ Set up a separate checking account and put all of your income into it. Pay for all business expenses from this account. If a taxpayer takes cash and doesn't put it into the account and doesn't include it in the gross receipts, this is tax evasion.

Perhaps this could go on indefinitely, but one day during an audit by the IRS or the state, the auditors can tell if the income being reported is enough to support the taxpayer's lifestyle.

➤ Add up expenses and income at least once a month to see if you're profitable. A business can show a loss generally for the first three years without being challenged by IRS, but must show good reason for continued losses, such as how equipment purchases and other expenditures will help the business achieve profitability.

➤ You can set up a home office to run all or part of your business, such as planning, ordering supplies and keeping records. The office must be exclusively used for the business, although a part of the room may be for personal use if there is a clear division of business and personal space.

Keep a log of the business use, such as clients who come and go and/or hours worked in the office each week. Take pictures of the office and keep this in the file for each year the office is used. It's tough to prove that you had a home office if you move or change the use of the room.

A percentage of the utilities, mortgage interest, property taxes, rent, depreciation of the home, etc. can be deducted based on methods developed by the IRS.

➤ Keep a mileage log for each vehicle used in the business. If your spouse is helping you in the business and uses a vehicle, hire him or her as an employee, set up an "accountable plan" and reimburse them each month for up to 43.5 cents a mile for their business usage. This is deductible to the business and not income to the employee.

If you are going to the store to buy supplies for the family and buy something for the business, record it in the log as the purpose of purchasing supplies for the business. It is all about documenting the business purpose for all activities and corresponding odometer readings.

These can be easily recorded in a log book that costs a buck from an office supply store and is the Bible to the IRS.

In short, keep your business and personal funds separate, know what expenses you can and cannot deduct and document as much as possible.

A tip for 2006 — maintaining accurate accounting records throughout the year will make tax time less taxing.

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