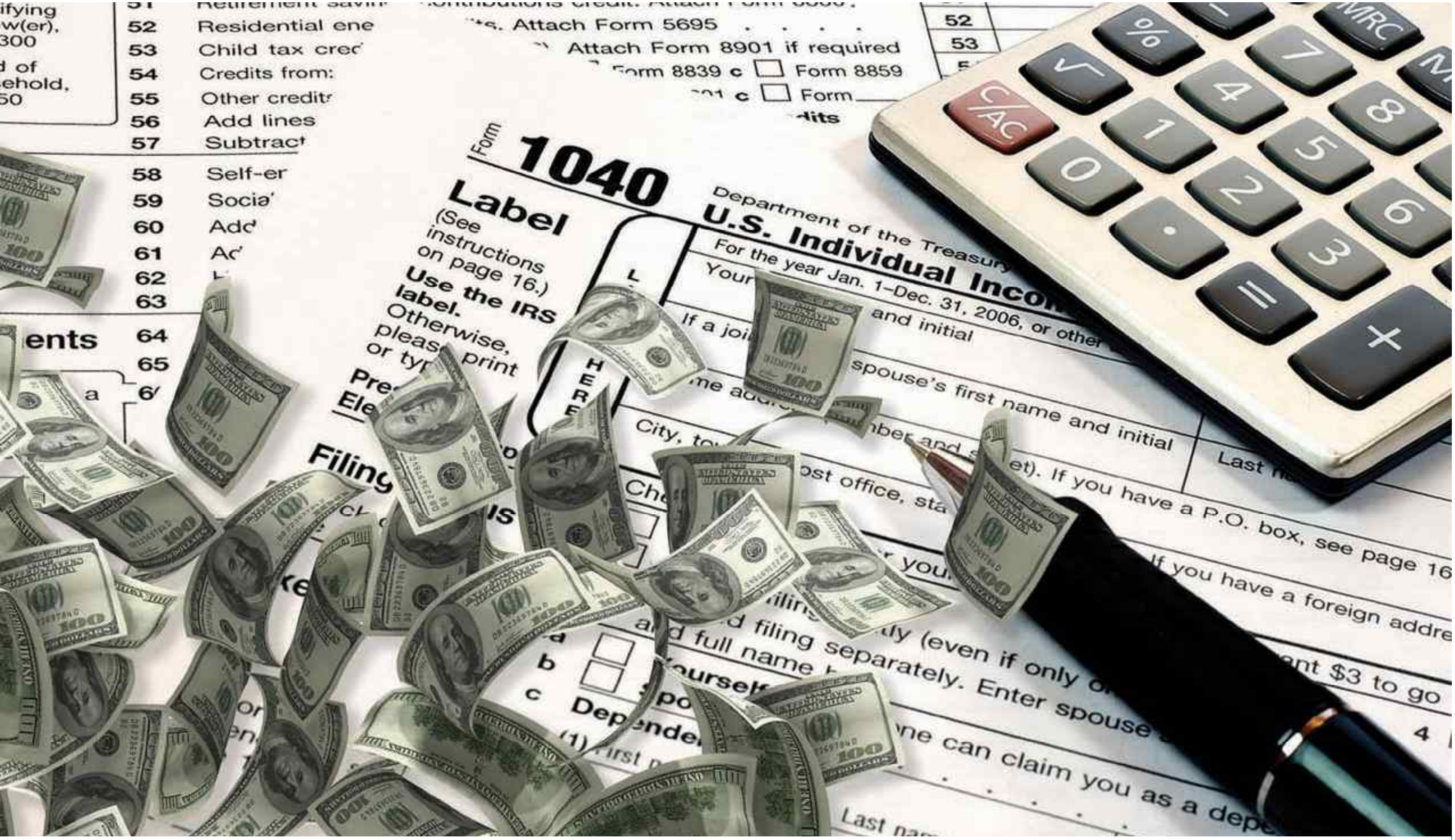

Flexible Tax Reality

by Mark E. Battersby

Today, with the 2007 tax year ended for most pressure cleaning contractors, equipment dealers, and suppliers, all that can be done for the operation's tax returns is to make the most of the existing tax rules—all the while keeping an eye on the pressure cleaning operation's potential tax bill for 2008. That means making the most of already completed transactions and doing so in a manner that will not adversely affect or reduce next year's tax deductions. It might also mean changing your mind about already filed tax returns.

It may surprise many contractors, dealers, and suppliers to learn that the tax deadlines imposed by our lawmakers are flexible. While moves made to structure transactions for the most favorable impact on the annual tax bill are limited, postponing the filing of the tax returns reporting those transactions or changing your mind on already reported transactions is permitted.

Money Now, Returns Later

It goes without saying that Uncle Sam, in the form of the Internal Revenue Service, wants its money sooner rather than later. That means pre-paying an estimated tax bill, usually in four quarterly installments. It also means fully paying the expected tax bill on or before the deadline, either March 15 or April 15 for most businesses and individuals using a calendar year.

Even with the strict pre-payment rules, extensions of time to make those payments are often granted for specific groups of taxpayers, usually those suffering from a natural disaster or unusual circumstances. Under special circumstances, the payment of tax can be extended for a reasonable period, not longer than six months.

In the past, contractors and other business owners could use Form 4868, "Automatic Extension of Time to File a U.S. Individual Tax Return," for a four-month extension. An additional two-month election was often available by filing another form (Form 2688) along with an explanation about the need for an additional extension.

Today, using Form 4868 a contractor, dealer, or supplier can obtain an automatic, six-month extension of time in which to file their personal tax returns. Naturally, a proper estimate of tax liability is required.

Incorporated pressure cleaning businesses may obtain the automatic six-month extension of time to file income tax returns by submitting Form 7004, "Application for Automatic Six-Month Extension of Time to File Certain Business, Income Tax, Information, and other Returns." Form 7004, is also used to obtain a six-month

extension for filing some excise, income, information and other returns.

The automatic six-month extension of time to file also applies to the returns of pass-through entities such as partnerships, S corporations, and limited liability companies (LLCs). Remember, however, the Form 7004 does not extend the time for payment of tax.

After Filing

Once the tax returns have been filed, if a pressure cleaning business owner determines the operation's tax bill is incorrect, changes can be made on an amended tax return. That's right, you can change your mind about many of the income, credits, or deductions on an already-filed tax return.

The IRS reports surprisingly few taxpayers amend their tax returns to report additional income. Correcting or amending any return because of errors, omissions, mistakes, or overlooked deductions—as well as to report additional income—are encouraged.

A pressure cleaning business—or its owner—can change their mind about previously reported income or deductions. They must do so within a period of three years from the time the tax return was filed, or within two years from the time the tax was fully paid, whichever is later. Should the refund claim involve the deductibility of bad debts or worthless securities, the period is seven years.

Individuals, sole proprietors, etc., use Form 1040X. A corporation that filed Form 1120 uses Form 1120X to file an amended return.

Potential Upside/Downside

Why would anyone want to change or amend his or her already-filed tax returns? First, the IRS assures everyone that changing your mind about previously reported deductions or income will not increase the likelihood of an audit. Secondly, it might be because it was discovered that either the first-year write-off or accelerated depreciation method produced a deduction that would be more valuable in a later year when, hopefully, the taxable income those deductions would offset would be greater.

Write-Off Write-Offs

In another area, perhaps professional fees were claimed incorrectly. Fees paid to those all-important lawyers, tax professionals, or consultants, are, generally, deducted in the year incurred. If that work clearly relates to future years, however, the expense is deducted over the life of the benefit received from the lawyer or other professional.

Yet another area in which confusion exists involves deciding whether a pressure cleaning contractor or business owner is an employee of his or her own business. On several occasions, the courts have ruled a shareholder who provides substantial services to his or her incorporated business—even an S corporation—is an employee. That means withholding of payroll taxes is required of even the smallest business.

In the area of fringe benefits, retirement plans, and the like, the majority of shareholder/owners, partners, and principals are employees, entitled to reap all rewards offered by the business. Naturally, those benefit programs cannot discriminate in favor of the owner/shareholder. With the IRS targeting these programs, amending the tax return might be a wise, pre-emptive move.

Write-Off Basics

A pressure cleaning operation whether doing business as a corporation, an individual, or a partnership is permitted to deduct (from gross income) all of the ordinary and necessary expenses of carrying on the business that are paid or incurred in the tax year. Those deductible expenses usually fall within two broad categories: an immediate expense deduction or a capital expense, an expenditure that adds to the value of or useful life of property, usually deducted by means of depreciation, amortization, or depletion.

Remember, however, a large, immediate tax deduction might not be the proper strategy for your business. A pressure cleaning operation with little or no taxable income would obviously opt for smaller write-offs, saving the bulk of those deductions for later, hopefully more profitable years, when the deductions would be more valuable. After a banner year, on the other hand, making the most of all available tax deductions could put the contractor, owner, or his or her business in a lower tax bracket. Fortunately, there are legitimate strategies that can be used now, prior to the filing of the annual tax return.

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Simply ignoring the tax deduction for depreciation does not work. That depreciation write-off might not be of much use on this year's tax return but it cannot be saved for the next year. The rules clearly say "allowed or allowable" whether computing the amount of gain or loss or the book value of an asset.

At the other end of the equation, the depreciation deduction can be reduced if the pressure cleaning business takes advantage of a unique—and newly increased—first-year deduction for newly acquired property. That so-called "Section 179" first year write-off permits a portion of qualified equipment and business asset expenditures to be expensed, or immediately written-off, rather than depreciated over a number of years.

Small Business Expensing

Ever since 2003, and running through 2010, a pressure cleaning business may make, revoke, or change a depreciation deduction, even the Section 179 first-year expensing election without IRS consent on an amended tax return.

Last summer's tax law changes extended and expanded the Section 179, enhanced first-year expensing provisions through 2010. It provided an immediate 2007 increase in the expensing limit from $112,000 to $125,000, with phase-out levels from $450,000 to $500,000. That $125,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds $500,000. Both the $125,000 and $500,000 amounts have been indexed for inflation in 2008 and thereafter.

Timing Is All

Obviously, the best time to think about tax strategies is during the course of the tax year. For long-term tax savings, however, the tax bracket should be consistent year-after-year. If income is up this year but expected to be down next year, postponing asset sales or other unusual transactions might produce a noticeably smaller tax bill.

Postponing income or profitable transactions until next year when they might not be quite as likely to put the pressure cleaning business—or its owner—into a higher tax bracket, is often a legitimate tax-saving strategy. Although the IRS may occasionally disagree, the courts strongly back every taxpayer's right to choose the course of action that will result in the lowest legal tax liability.

Today, thanks to an extended period of time in which tax returns can be filed and an even longer period in which to change or amend already-filed tax returns, the so-called "tax season" has become a year-round event. After all, what better time to guarantee that all deductions have been claimed while simultaneously incorporating overlooked or ignored tax strategies into the 2008 tax plans for you and your pressure cleaning business than right now? CT