

# Taxes

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*The Congress shall have power to lay and collect taxes on income, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration.*

Sixteenth Amendment, Constitution of the United States

Understanding of taxes is a fundamental skill for the successful operation of a practice. Although professional assistance is necessary to calculate and pay taxes, the important task of tax planning must usually be initiated and performed by the practitioner. This task is more easily conceived and more accurately executed if the practitioner has a basic knowledge of tax law. This chapter addresses the key issues in income tax, business tax, and tax reporting, as they pertain to the practice of optometry.

## INDIVIDUAL INCOME TAX

At the time of the birth of the United States, the English government drew the ire of those in the colonies through the use of an import tariff, the purpose of which was to create a favorable balance of trade (i.e., exports were not subject to the tariff, but imports were charged a duty that was, ultimately, paid by the American consumer). The Boston Tea Party was a result of the perception by the citizens of the colonies that the tariff was unfair. Yet, one of the first acts of the new US Congress was to impose an internal tariff on imports to America! Thus began a widespread system of duties on imports rather than a true tax because of the provisions of the US Constitution, which limited the ability of the federal government to tax the US citizenry. The general taxing power permitted to Congress by the Constitution was that “The Congress shall have power to lay and collect taxes, duties, imports and excises, to pay the debts and provide for the common defense and general welfare of the United States.” But as far as internal revenue was concerned, the only sources of income provided for in the Constitution were as follows:

- Duties, imports, and excise taxes were permitted but could not be higher in one part of the country than in another.
- No direct tax could be levied on the income of individual citizens unless it was applied in proportion to the population of the states, so that each state would have a different tax rate, a cumbersome and impractical system that made the collection of direct taxes a slow and grossly unequal operation.

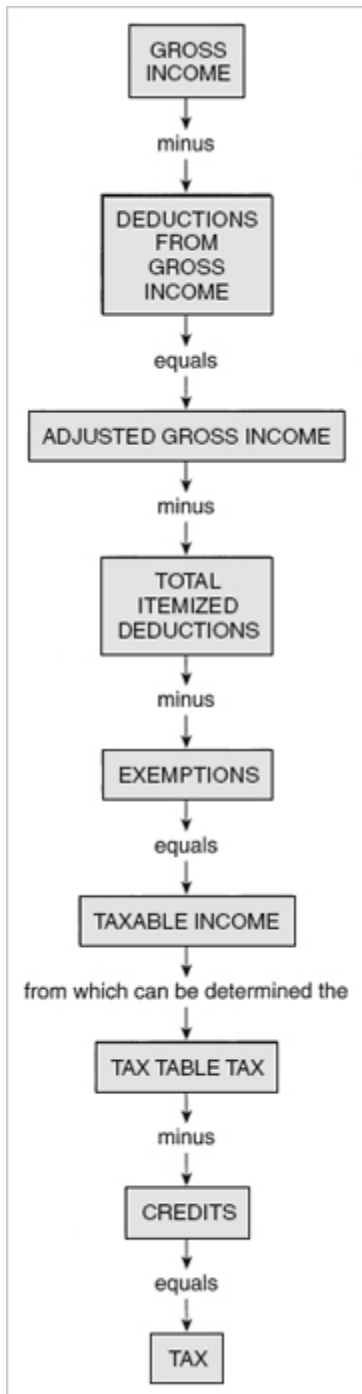
Attempts during the 1800s and early 1900s to impose an income tax met with limited success; the most important development was a 1% tax on income of more than \$5,000 earned by corporations organized for profit. In 1913 the US Congress proposed an amendment to the Constitution that would allow a tax on all incomes without apportionment. Its ratification allowed an income tax to be levied on individual citizens.

The tax consisted of two parts: a normal tax, which was a flat 1% of the net income in excess of the personal exemption, and a surtax that was a progressive tax levied on net incomes in excess of \$20,000 (for which another 1% was collected) up to a maximum of \$500,000 (for which a 6% maximum was imposed). Thus a married man with a net income of \$80,000 in 1913 paid a total tax of \$1,710. Subsequent changes in the rates and system of taxation have created dramatic differences in the tax burden incurred by American citizens; by 1980, this same married man would have to pay an income tax of \$26,914. Of such things is tax reform born, and the result has been decade after decade of unceasing tax reform acts passed by the federal Congress.

In fact, tax reform has become such a favorite pastime of the federal government that tax counsel often must be consulted when significant financial decisions are made. One year’s tax laws rapidly give way to another’s, and the wise optometrist always will seek professional advice before making personal or business decisions that have tax ramifications. Even so, it is necessary for optometrists to possess a reasonable understanding of the tax process. Given the significance of taxes as an item of both personal and business expense, contemporary practitioners can ill afford to live in ignorance of the basic provisions of tax law. Once these fundamental concepts are understood, the process of revision becomes less confusing and the significance of proposed changes more apparent.

## CALCULATION OF INCOME TAX

The tax base to which the income tax rates are applied is called the taxable income. To determine a person’s taxable income (Figure 39-1), the gross income must be calculated, from which



**FIGURE 39-1** Schematic representation of the income taxation process.

allowable *deductions* are subtracted, resulting in an intermediary sum called the *adjusted gross income (AGI)*. The next step is to deduct certain *itemized deductions*, or a *standard deduction* for items that may be claimed. *Exemptions* from income are then subtracted, resulting in the *taxable income*. From this amount the tax table tax can be determined. Finally, *credits* are subtracted from the tax table tax, resulting in the actual tax owed.

Income tax rates for individuals are graduated, which means they increase as the level of taxable income increases. The current tax rates, authorized by federal tax reform in 2003,

consist of six brackets, until further modified by Congress. The stepwise computation of income tax may be found on Internal Revenue Service (IRS) Form 1040: US Individual Income Tax Return (Figure 39-2).

## FILING STATUS

Taxes are reported based on the status of the taxpayer, who has the following five choices:

- Single
- Married filing jointly
- Married filing separate returns
- Head of household
- Qualifying widow/widower with dependent child

The choice of filing status is left to the taxpayer; the tax rates that will be applied to the taxpayer's income are based on the choice made. However, the tax reform act enacted in 2003 altered the tax brackets for the "married filing jointly" category, reducing the tax imposed on individuals choosing this status (and thereby eliminating the so-called marriage "tax penalty").

## GROSS INCOME

Every income tax return begins with gross income, which is defined in the federal tax code as "all income from whatever source derived." This all-inclusive phrase embraces such diverse means of income as compensation for services (including those of an optometrist); business income; gains from the sale or exchange of property; interest; rent; royalties; dividends; annuities; pensions; partnership income; income from an estate or trust; winnings from gambling; alimony; and illegally obtained windfalls such as embezzlement, theft, fraud, and related offenses. Awards, gifts, or prizes may also be taxable.

**Awards:** Cash, a gift certificate, or non-cash merchandise given for meritorious performance, productivity, or other reasons connected with employment, or for non-employees, given in recognition of an accomplishment, achievement or activity that does not require the performance of a service, as well as for other valid business reasons, is reportable and may be taxable. This may include Staff Recognition Awards, Employee of the Month Awards, and awards to boost employee morale.

The award must be reported as employee compensation on the employee's Form W-2 and is subject to federal withholding and FICA taxes. Exceptions include the following:

- A "length of service" award is not reported as taxable if it is not granted to an employee more frequently than every 5 years. A retirement gift generally will not be reported as taxable if given as a "length of service" award and does not exceed \$400 per year per employee.
- Non-cash, de minimis awards are not reported as taxable to an employee unless the award is readily convertible into cash. IRS regulations use the example of holiday gift items with a low fair market value to define "de minimis." Awards of gift certificates of \$100 or less will not be reported as taxable, unless redeemable for cash.

Awards given to non-employees are generally considered reportable as taxable income, regardless of value. Non-cash awards to non-employees that have little intrinsic value are not reportable.

Gifts: Non-cash items of nominal value given to express appreciation or gratitude and not related to job performance, may qualify

as gifts; however, there should be no negotiation in advance for the gift. Cash and gift certificates redeemable for cash, do not qualify as gifts. Gifts less than or equal to \$100 are not reportable to the IRS.

Non-cash gifts may be presented as a token of appreciation to a patient when a valid and documented business purpose exists such as to recognize contributions to the community.

Form **1040** Department of the Treasury—Internal Revenue Service **2008** U.S. Individual Income Tax Return (99) IRS Use Only—Do not write or staple in this space.

For the year Jan. 1–Dec. 31, 2008, or other tax year beginning . . . , 2008, ending . . . , 20 . . . OMB No. 1545-0074

**Label** (See instructions on page 14.) Use the IRS label. Otherwise, please print or type.

Your first name and initial: John G Last name: O'Dee Your social security number: 123 45 6789

If a joint return, spouse's first name and initial: Jane B Last name: O'Dee Spouse's social security number: 987 65 4321

Home address (number and street). If you have a P.O. box, see page 14. Apt. no. 321 Vision Lane

City, town or post office, state, and ZIP code. If you have a foreign address, see page 14. Anytown, ST 12345

Checking a box below will not change your tax or refund.  You  Spouse

**Filing Status**

1  Single 4  Head of household (with qualifying person). (See page 15.) If the qualifying person is a child but not your dependent, enter this child's name here. ▶

2  Married filing jointly (even if only one had income)

3  Married filing separately. Enter spouse's SSN above and full name here. ▶

5  Qualifying widow(er) with dependent child (see page 16)

**Exemptions**

6a  Yourself. If someone can claim you as a dependent, do not check box 6a

b  Spouse

c Dependents:

(1) First name	Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) <input checked="" type="checkbox"/> If qualifying child for child tax credit (see page 17)
<u>Junior</u>	<u>O'Dee</u>	<u>234 56 7890</u>	<u>child</u>	<input checked="" type="checkbox"/>

Boxes checked on 6a and 6b: 2

No. of children on 6c who:  
 • lived with you: 1  
 • did not live with you due to divorce or separation (see page 18): \_\_\_\_\_  
 Dependents on 6c not entered above: \_\_\_\_\_

Add numbers on lines above ▶ 3

d Total number of exemptions claimed 3

**Income**

7	Wages, salaries, tips, etc. Attach Form(s) W-2	7	<u>8000</u>
8a	Taxable interest. Attach Schedule B if required	8a	<u>400</u>
8b	Tax-exempt interest. Do not include on line 8a	8b	
9a	Ordinary dividends. Attach Schedule B if required	9a	
9b	Qualified dividends (see page 21)	9b	
10	Taxable refunds, credits, or offsets of state and local income taxes (see page 22)	10	
11	Alimony received	11	
12	Business income or (loss). Attach Schedule C or C-EZ	12	<u>131,835</u>
13	Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ <input type="checkbox"/>	13	
14	Other gains or (losses). Attach Form 4797	14	
15a	IRA distributions	15a	
15b	Taxable amount (see page 23)	15b	
16a	Pensions and annuities	16a	
16b	Taxable amount (see page 24)	16b	
17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E	17	
18	Farm income or (loss). Attach Schedule F	18	
19	Unemployment compensation	19	
20a	Social security benefits	20a	
20b	Taxable amount (see page 26)	20b	
21	Other income. List type and amount (see page 28)	21	
22	Add the amounts in the far right column for lines 7 through 21. This is your total income ▶	22	<u>140,235</u>

**Adjusted Gross Income**

23	Educator expenses (see page 28)	23	
24	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ	24	
25	Health savings account deduction. Attach Form 8889	25	
26	Moving expenses. Attach Form 3903	26	
27	One-half of self-employment tax. Attach Schedule SE	27	<u>8089</u>
28	Self-employed SEP, SIMPLE, and qualified plans	28	<u>19,700</u>
29	Self-employed health insurance deduction (see page 29)	29	<u>10,500</u>
30	Penalty on early withdrawal of savings	30	
31a	Alimony paid b Recipient's SSN ▶	31a	
32	IRA deduction (see page 30)	32	
33	Student loan interest deduction (see page 33)	33	
34	Tuition and fees deduction. Attach Form 8917	34	
35	Domestic production activities deduction. Attach Form 8903	35	
36	Add lines 23 through 31a and 32 through 35	36	<u>38,289</u>
37	Subtract line 36 from line 22. This is your adjusted gross income ▶	37	<u>101,946</u>

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FIGURE 39-2 Sample Form 1040.

Form 1040 (2008) Page **2**

<b>Tax and Credits</b>	38	Amount from line 37 (adjusted gross income)	38	101,946
	39a	Check <input type="checkbox"/> You were born before January 2, 1944, <input type="checkbox"/> Blind. <input type="checkbox"/> Spouse was born before January 2, 1944, <input type="checkbox"/> Blind. Total boxes checked <b>▶</b> 39a		
	b	If your spouse itemizes on a separate return or you were a dual-status alien, see page 34 and check here <b>▶</b> 39b		
	c	Check if standard deduction includes real estate taxes or disaster loss (see page 34) <b>▶</b> 39c		
<b>Standard Deduction for—</b>	40	Itemized deductions (from Schedule A) or your standard deduction (see left margin)	40	43,500
• People who checked any box on line 39a, 39b, or 39c or who can be claimed as a dependent, see page 34.	41	Subtract line 40 from line 38	41	58,446
• All others:	42	If line 38 is over \$119,975, or you provided housing to a Midwestern displaced individual, see page 36. Otherwise, multiply \$3,500 by the total number of exemptions claimed on line 6d	42	10,500
Single or Married filing separately, \$5,450	43	Taxable income. Subtract line 42 from line 41. If line 42 is more than line 41, enter -0-	43	47,946
Married filing jointly or Qualifying widow(er), \$10,900	44	Tax (see page 36). Check if any tax is from: a <input type="checkbox"/> Form(s) 8814 b <input type="checkbox"/> Form 4972	44	6,386
Head of household, \$8,000	45	Alternative minimum tax (see page 39). Attach Form 6251	45	
	46	Add lines 44 and 45	46	6,386
	47	Foreign tax credit. Attach Form 1116 if required	47	
	48	Credit for child and dependent care expenses. Attach Form 2441	48	
	49	Credit for the elderly or the disabled. Attach Schedule R	49	
	50	Education credits. Attach Form 8863	50	
	51	Retirement savings contributions credit. Attach Form 8880	51	
	52	Child tax credit (see page 42). Attach Form 8901 if required	52	1,000
	53	Credits from Form: a <input type="checkbox"/> 8396 b <input type="checkbox"/> 8839 c <input type="checkbox"/> 5695	53	
	54	Other credits from Form: a <input type="checkbox"/> 3800 b <input type="checkbox"/> 8801 c <input type="checkbox"/>	54	
	55	Add lines 47 through 54. These are your total credits	55	1,000
	56	Subtract line 55 from line 46. If line 55 is more than line 46, enter -0-	56	5,386
<b>Other Taxes</b>	57	Self-employment tax. Attach Schedule SE	57	16,178
	58	Unreported social security and Medicare tax from Form: a <input type="checkbox"/> 4137 b <input type="checkbox"/> 8919	58	
	59	Additional tax on IRAs, other qualified retirement plans, etc. Attach Form 5329 if required	59	
	60	Additional taxes: a <input type="checkbox"/> AEIC payments b <input type="checkbox"/> Household employment taxes. Attach Schedule H	60	
	61	Add lines 56 through 60. This is your total tax	61	21,568
<b>Payments</b>	62	Federal income tax withheld from Forms W-2 and 1099	62	2,000
	63	2008 estimated tax payments and amount applied from 2007 return	63	22,000
	64a	Earned income credit (EIC)	64a	
	b	Nontaxable combat pay election <b>▶</b> 64b		
	65	Excess social security and tier 1 RRTA tax withheld (see page 61)	65	
	66	Additional child tax credit. Attach Form 8812	66	
	67	Amount paid with request for extension to file (see page 61)	67	
	68	Credits from Form: a <input type="checkbox"/> 2439 b <input type="checkbox"/> 4136 c <input type="checkbox"/> 8801 d <input type="checkbox"/> 8885	68	
	69	First-time homebuyer credit. Attach Form 5405	69	
	70	Recovery rebate credit (see worksheet on pages 62 and 63)	70	
	71	Add lines 62 through 70. These are your total payments	71	24,000
<b>Refund</b>	72	If line 71 is more than line 61, subtract line 61 from line 71. This is the amount you overpaid	72	
Direct deposit? See page 63 and fill in 73b, 73c, and 73d, or Form 8888.	73a	Amount of line 72 you want refunded to you. If Form 8888 is attached, check here <b>▶</b> <input type="checkbox"/>	73a	2,436
	b	Routing number		
	c	Account number		
	d	Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings		
	74	Amount of line 72 you want applied to your 2009 estimated tax <b>▶</b>	74	
	75	Amount you owe. Subtract line 71 from line 61. For details on how to pay, see page 65 <b>▶</b>	75	
<b>Amount You Owe</b>	76	Estimated tax penalty (see page 65)	76	
<b>Third Party Designee</b>	Do you want to allow another person to discuss this return with the IRS (see page 66)? <input type="checkbox"/> Yes. Complete the following. <input type="checkbox"/> No			
	Designee's name	Phone no.	Personal identification number (PIN)	
<b>Sign Here</b>	Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.			
Joint return? See page 15. Keep a copy for your records.	Your signature	Date	Your occupation	Daytime phone number
	<i>John O'Dee</i>	4-15-09	Optometrist	( )
	Spouse's signature. If a joint return, both must sign.	Date	Spouse's occupation	
	<i>Jane B. O'Dee</i>	4-15-09		
<b>Paid Preparer's Use Only</b>	Preparer's signature	Date	Check if self-employed <input type="checkbox"/>	Preparer's SSN or PTIN
	Firm's name (or yours if self-employed), address, and ZIP code	EIN	Phone no. ( )	

Form **1040** (2008)

FIGURE 39-2 –Cont'd

Examples of token items would be roses or a gift certificate for a local movie theater.

**Prizes:** Cash or items of value received as a result of a game of chance, drawing or contests of skill, either with or without the purchase of a chance or ticket, are deemed to be

prizes. Federal law requires the reporting of prize winnings to the IRS and to the recipient on a calendar year basis. Federal regulations also require that a specific percentage of the winnings must be withheld under certain conditions. Non-cash winnings are reported at their fair market value.

Other cash and non-cash income that must be reported include:

- Sick pay received from an employer while an employee is ill or injured is taxable, but benefits received under an accident or health insurance policy paid for by the employee are not taxable.
- Medical insurance premiums, if paid for by an employer, are not included in income.
- Vacation allowances are considered to be wages and are included in income.
- Severance pay is taxable as income.
- Moving expense allowances or reimbursements are included in gross income for an employee (but are offset by the expenses incurred); these allowances or reimbursements are not considered wages for purposes of income tax or Social Security withholding.
- Interview expenses paid by an employer or prospective employer are considered to be income but are not subject to income tax or Social Security withholding.

## Exclusions From Income

There are exclusions from income that permit certain types of gross income to escape taxation. These exempt classes of income should not be confused with deductions from gross income. Some of the more important exclusions include the following.

### *Life Insurance Death Proceeds*

The proceeds of life insurance policies, if paid by reason of the death of the insured, are excluded from the gross income of the beneficiary. The manner in which the policy proceeds is paid is of no consequence (i.e., whether in a lump sum or in installments). If the proceeds of a life insurance contract are paid for reasons other than the death of the insured, however, the insured is entitled to recover tax-free only what was paid for the contract.

### *Gifts, Bequests, and Devises*

The amount of cash or the value of property received by gift or inheritance is excluded from gross income. However, income derived from property received by gift is taxable as income to the recipient.

### *Retirement Income*

Social Security benefits are not subject to taxation as gross income.

### *Interest on Government Securities*

State and local bonds produce interest income that is not included as gross income. Obligations of the federal government are subject to federal taxation, and the interest on US Savings Bonds (Series E) is fully taxable.

### *Compensation for Injuries or Sickness*

Compensation awarded for personal rights, such as workers' compensation, damages for personal injury, damages for defamation, and damages for other legal actions intended

to "make the person whole again," are excluded from gross income. A like exclusion is permitted for accident and health benefits (disability income) received under a policy purchased by the policyholder.

### *Employee's Accident and Health Benefit Plans*

Amounts received by an employee as reimbursement for medical care; payments for permanent injuries or loss of bodily function; and to a limited extent, wages or payments in lieu of wages during a period of absence from work as a result of permanent and total disability are excluded from gross income.

### *Employer's Educational Assistance Plans*

Amounts paid by an employer for an employee's education, pursuant to a plan meeting certain requirements, are excluded from gross income. Amounts received that may be excluded include tuition and fees, books, supplies, and equipment. For an educational assistance program to qualify, it must be in writing, limited to providing employees with education assistance, and not discriminatory in favor of certain employees or a certain class of employees.

### *Scholarship and Fellowship Grants*

Scholarships and fellowship grants are tax exempt for degree candidates but only to the extent that amounts are paid for tuition, books, and supplies; room and board and other expenses that are paid by the scholarship or fellowship are not excluded from income.

### *Sale of Primary Residence*

A single homeowner who sells a primary residence that has been lived in for 2 years and realizes a profit may exclude \$250,000 of the gain from the sale; if the sale is by a married couple filing a joint tax return, the exclusion is \$500,000.

## Capital Gains

All gross income will not be taxed the same because there is an important distinction between ordinary income and capital gains. Ordinary income includes money earned as salary, benefits that are subject to taxation, income earned through the providing of services or the sale of products (as in optometry), bonuses, exchanges, and gains realized on the sale of items owned for a year or less. Capital gains are limited only to gains earned on certain assets that are held for more than a year. These assets, which must be owned and used for personal purposes, pleasure, or investment, are termed *capital assets* and include stocks, bonds, homes, household furnishings, coins, stamps, jewelry, art, and similar items. When capital assets are sold for a gain after being held for more than a year, a capital gain is realized.

The tax rate to which these assets are subject varies, depending on the asset, and ranges from 0% to 15%, which is decidedly less than the tax rates for ordinary income, which range from 10% to 35% (Table 39-1). The tax on capital gains is calculated differently than the tax on ordinary income, and the calculation is performed on Schedule D. If there is a capital

TABLE 39-1

**Capital Gains Tax Rates, 2008**

Tax Bracket	2008 Capital Gains Tax
10% or 15%	0%
25%, 28%, 33%, or 35%	15%

Gains realized on the sale of capital assets held for more than a year receive preferential tax treatment. A taxpayer in the 28% tax bracket who sells a capital asset held more than a year for a gain of \$10,000 will pay a tax of \$1,500 rather than \$2,800.

From Internal Revenue Service Publication 17: Your income tax.

loss (e.g., capital assets held for more than a year and sold for a loss), it can be used to offset a capital gain. The computation of these gains can become quite complicated, requiring an accountant's expertise. Capital gains also must be included in gross income and reported on Form 1040.

Once gross income has been determined, the next step is to consider the deductions available to the taxpayer.

## DEDUCTIONS

There are certain expenses that may be subtracted from gross income to arrive at the AGI. Both business and nonbusiness expenses are included, but they are limited in number. As of 2008, these deductions were:

- **Educator expenses.** Eligible educators may deduct qualified expenses paid and not reimbursed (to a maximum of \$250).
- **Contributions to an individual retirement account (IRA).** Contributions to a traditional IRA can be deducted by taxpayers who meet certain qualifications (Chapter 37); contributions to a Roth IRA are not deductible.
- **Student loan interest deduction.** The interest on any loan taken out to pay for qualified higher education expenses incurred by a taxpayer or taxpayer's spouse or dependent may be claimed in part as a deduction. The deduction is limited but gradually has been increased throughout the years (currently, it is \$2,500 maximum), and will be reduced if certain income limits are exceeded.
- **Tuition and fees deduction.** Qualified tuition and fees paid by the taxpayer, spouse, or for dependents may be deducted (up to \$4,000); Form 8917.
- **Health savings accounts (HSAs).** These accounts are a combination of a high-deductible insurance plan and tax-deferred savings account like an IRA. Tax-deductible contributions may be made to the account, the amounts contributed are invested and grow on a tax-deferred basis, and tax-free withdrawals may be made for medical expenses. HSA deductions are calculated on Form 8889. Archer medical savings accounts are similar, and tax deductions for these accounts are figured on Form 8853.
- **Moving expenses.** The cost of moving to another location to start a new job may qualify as a deduction if certain

conditions are met; the most important are that the move be connected with employment, within a year of starting a new job, and that the distance be at least 50 miles (the distance is measured between the old home and the new place of employment). The actual costs of the move may be deducted, but pre-move expenses, temporary living expenses, and expenses for the sale, purchase, or lease of a residence are not deductible. Allowable expenses must be calculated on Form 3903.

- **Self-employment tax.** Self-employed individuals must contribute to Social Security and Medicare, and one-half of the tax paid (which is calculated on Schedule SE for selfemployed practitioners) may be claimed as a deduction.
- **Self-employed health insurance deduction.** The cost of health insurance premiums for a self-employed individual, spouse, and dependents may be deducted. The deduction may be claimed whether the health insurance policy was taken out in the name of the practitioner or by the business (individual proprietorship, partnership, or S Corporation). If a selfemployed individual becomes eligible for benefits under an employer-provided health plan for the individual's spouse, however, the premiums are no longer deductible.
- **Self-employed contributions to a simplified employee pension IRA, Keogh plan, pension plan, or other tax-deductible retirement plan.** Self-employed individuals or partners who participate in tax-deferred retirement plans may deduct their contributions from gross income (see Chapter 37 for a discussion of these plans).
- **Penalties for early withdrawal of savings.** Premature withdrawals of funds from a time savings account or deposit are subject to penalty; the amount paid as a penalty may be deducted as an exclusion from gross income.
- **Alimony.** Alimony and separate maintenance payments are deductible from gross income by the one paying them if the following four criteria are met: they must be made under a written decree or agreement; they must qualify as periodic payments (i.e., payments that are uncertain in amount or for an indefinite period, or for more than 10 years); they must not be specifically designated for the support of minor children; and they must not be in the form of a lump sum or settlement. Child support is not deductible.

These deductions, when subtracted from the gross income, produce the AGI. This amount has relevance to certain expenses that may be claimed when determining itemized deductions, a calculation that is performed on Schedule A. Itemizing deductions is not necessary, however, unless they exceed the standard deduction.

## THE STANDARD DEDUCTION

The lowest bracket for each category of taxpayer (e.g., single, married filing jointly) has a tax of zero; these brackets are referred to as the standard deduction (Box 39-1). Additional deductions are allowed for individuals 65 years of age and older and for individuals who are blind. Thus a single taxpayer who is both 65 and blind could claim two additional deductions, in addition to the standard deduction.

## BOX 39-1

## Standard Deduction, 2008

The standard deduction increases from year to year, but for purposes of illustration the 2008 amounts were:

- \$5,450 for single taxpayers
- \$10,900 for married couples filing jointly
- \$5,450 for married taxpayers filing separately
- \$8,000 for heads of household

In 2008 an additional \$1,350 was allowed for individuals 65 years of age and older (\$1,050 if married filing jointly) and for individuals who were blind. Thus a single taxpayer who was both 65 and blind could claim an additional \$2,700 (\$2,100 if married filing jointly).

From Internal Revenue Service Publication 17: Your income tax.

For purposes of claiming the deduction for blindness, the taxpayer must get a statement certified by the “eye doctor” or “registered optometrist” that verifies either of the following:

- Visual acuity is less than 20/200 in the better eye with glasses or contact lenses
- The field of vision is 20 degrees or less

The statement also must assert that the acuity or field of vision is “not likely to improve.”

Only income in excess of the standard deduction (plus exemptions, to be discussed) is subject to taxation. Any taxpayer may claim the standard deduction, but as income increases, this deduction fails to yield the best tax benefit. This is because taxpayers are permitted to claim certain personal deductions to ascertain whether these itemized deductions provide a better tax benefit than the standard deduction (but the extra deductions for elderly and blind taxpayers cannot be claimed when itemizing). The calculation is performed on Schedule A.

An illustration of how itemized deductions are calculated may be found in Figure 39-3.

## ITEMIZED DEDUCTIONS

There are eight categories of expenses that are commonly incurred by taxpayers and recognized as itemized deductions on Schedule A:

- *Medical, dental, and optometric expenses.* The deduction allowed for these expenses is limited in several respects. First, a taxpayer may not claim a deduction for any expenses for which there was reimbursement by insurance. Second, the deduction is limited to the amount that is in excess of 7.5% of the AGI. For example, if the AGI is \$100,000 and \$8,000 of expenses (unreimbursed by insurance) were incurred, only \$500 would be deductible. Amounts paid for medicine and drugs may be deducted, but drugs are defined as prescription drugs and insulin only. Premiums for health care are included as deductions, as are

transportation costs for health care (as of July 2008, 27 cents a mile and up to \$50 a night for lodging).

- *Taxes.* Certain taxes may be deducted, including state, local, and foreign real property taxes; state and local personal property taxes (e.g., an automobile tag or registration tax); and state, local, and foreign income taxes. State and local general sales taxes may be deducted instead of state and local income taxes; either actual expenses may be claimed or an amount taken from the Optional State Sales Tax Tables (Publication 600) can be used.
- *Interest.* Only limited interest expenses paid by a taxpayer are deductible, with the most important example being mortgage interest payments. (Student loan interest is deductible as an expense to reduce gross income on the first page of Form 1040 and is not claimed on Schedule A).
- *Charitable contributions.* Charitable contributions are allowed for money or property contributed to qualified organizations, which include a state, a possession of the US, or any subdivision of these; a corporation, trust, or other organization that is operated exclusively for religious, charitable, scientific, literary, or educational purposes; posts or organizations of war veterans or an auxiliary unit or society of, or trust or foundation for, any such post or organization; or a domestic fraternal society, order, or association, operating under the lodge system (if the contribution is made for charitable purposes). The amount of a contribution in property other than money is its fair market value at the time of the contribution. To determine this value, consult IRS publication 526, Charitable Contributions.
- *Casualty and theft losses.* A taxpayer may deduct a limited amount for casualty losses to nonbusiness property that are the result of fire, storm, shipwreck, or other casualties not covered by insurance. Such a loss is limited, however, to the extent by which it exceeds 10% of the taxpayer’s AGI. For example, if the AGI were \$100,000 and the loss were \$12,000, the deduction would be limited to \$2,000.
- *Job expenses and most miscellaneous deductions.* For employed individuals, most job-related expenses for which there is no reimbursement by the employer will be claimed in this category. Miscellaneous personal expenses also may be claimed (Box 39-2). These expenses provide a tax deduction, however, only to the extent that they exceed 2% of the taxpayer’s AGI. For example, for an employed optometrist with an AGI of \$50,000, only expenses in excess of \$1,000 would be deductible.
- *Other miscellaneous deductions.* Examples of miscellaneous deductions that may be claimed in the “other” category include gambling losses, casualty and theft losses from income-producing property, and impairment-related work expenses of a disabled individual.

If itemized deductions exceed a certain total (adjusted annually, for 2008, \$79,975 if single and \$159,950 if married filing jointly), they begin to be reduced. Careful recordkeeping is necessary to document Schedule A expenses. Receipts, checks, and other evidence of these expenditures should be retained and stored so that proof of claimed deductions will be readily available should the IRS audit the taxpayer’s return.

SCHEDULES A&B (Form 1040)		Schedule A—Itemized Deductions (Schedule B is on back)		OMB No. 1545-0074 <b>2008</b> Attachment Sequence No. 07		
Department of the Treasury Internal Revenue Service (99)		▶ Attach to Form 1040. ▶ See Instructions for Schedules A&B (Form 1040).				
Name(s) shown on Form 1040 <b>John G &amp; June B O'Dre</b>				Your social security number <b>123 : 45 : 6789</b>		
<b>Medical and Dental Expenses</b>	<b>Caution.</b> Do not include expenses reimbursed or paid by others.					
	1 Medical and dental expenses (see page A-1).	1	4500			
	2 Enter amount from Form 1040, line 38 <b>2   101,946  </b>	2				
	3 Multiply line 2 by 7.5% (.075)	3	7645			
	4 Subtract line 3 from line 1. If line 3 is more than line 1, enter -0-	4			0	
<b>Taxes You Paid</b> (See page A-2.)	5 State and local (check only one box):	5	4000			
	a <input checked="" type="checkbox"/> Income taxes, or					
	b <input type="checkbox"/> General sales taxes					
	6 Real estate taxes (see page A-5)	6	7000			
	7 Personal property taxes	7	500			
	8 Other taxes. List type and amount ▶	8				
	9 Add lines 5 through 8	9				11,500
	<b>Interest You Paid</b> (See page A-5.)	10 Home mortgage interest and points reported to you on Form 1098	10	24,000		
11 Home mortgage interest not reported to you on Form 1098. If paid to the person from whom you bought the home, see page A-6 and show that person's name, identifying no., and address ▶		11				
<b>Note.</b> Personal interest is not deductible.						
12 Points not reported to you on Form 1098. See page A-6 for special rules.		12				
13 Qualified mortgage insurance premiums (see page A-6)		13				
14 Investment interest. Attach Form 4952 if required. (See page A-6.)		14				
15 Add lines 10 through 14	15				24,000	
<b>Gifts to Charity</b> If you made a gift and got a benefit for it, see page A-7.	16 Gifts by cash or check. If you made any gift of \$250 or more, see page A-7	16	5,000			
	17 Other than by cash or check. If any gift of \$250 or more, see page A-8. You must attach Form 8283 if over \$500	17	3,000			
	18 Carryover from prior year	18				
	19 Add lines 16 through 18	19				8,000
<b>Casualty and Theft Losses</b>	20 Casualty or theft loss(es). Attach Form 4684. (See page A-8.)	20			0	
<b>Job Expenses and Certain Miscellaneous Deductions</b> (See page A-9.)	21 Unreimbursed employee expenses—job travel, union dues, job education, etc. Attach Form 2106 or 2106-EZ if required. (See page A-9.) ▶	21				
	22 Tax preparation fees	22	400			
	23 Other expenses—investment, safe deposit box, etc. List type and amount ▶ investment 1,000 box 1.00	23	1,100			
	24 Add lines 21 through 23	24	1,500			
	25 Enter amount from Form 1040, line 38 <b>25   101,946  </b>	25				
	26 Multiply line 25 by 2% (.02)	26	2,038			
27 Subtract line 26 from line 24. If line 26 is more than line 24, enter -0-	27				0	
<b>Other Miscellaneous Deductions</b>	28 Other—from list on page A-10. List type and amount ▶	28			0	
<b>Total Itemized Deductions</b>	29 Is Form 1040, line 38, over \$159,950 (over \$79,975 if married filing separately)? <input type="checkbox"/> No. Your deduction is not limited. Add the amounts in the far right column for lines 4 through 28. Also, enter this amount on Form 1040, line 40. <input type="checkbox"/> Yes. Your deduction may be limited. See page A-10 for the amount to enter.	29				43,500
	30 If you elect to itemize deductions even though they are less than your standard deduction, check here <input type="checkbox"/>	30				

FIGURE 39-3 Sample Schedule A.

EXEMPTIONS

A certain amount of income is deemed to be exempt from taxation. The amount exempt from taxation is based on filing status, with one exemption allowed to each of the following:

- Taxpayer
- Taxpayer's spouse (if filing jointly)
- Each dependent

Therefore a married couple filing jointly with two children would have four exemptions (Box 39-3). Although this

**BOX 39-2**

**Miscellaneous Expenses Deductible on Schedule A**

**EMPLOYEE EXPENSES**

- License fees
- Dues to professional societies
- Employment-related education (i.e., continuing education)
- Expenses of looking for a job in the same field
- Business property insurance premiums
- Malpractice insurance premiums
- Subscriptions to professional journals and magazines
- Profession-related books, CDs, DVDs
- Work clothes or uniforms
- 50% of unreimbursed business-related entertainment or meal expenses
- Business-related travel and transportation expenses in excess of reimbursement by the employer

**PERSONAL EXPENSES**

- Legal and accounting fees
- Fees paid to investment counsel
- Fees paid to the custodian of an IRA
- Custodial fees paid for income-producing property
- Cost of safety deposit box rental
- Cost of tax services, periodicals, or return preparation
- Appraisal fees for establishing a casualty loss or charitable contribution

From Internal Revenue Service Publication 334: Tax guide for small business.

**BOX 39-3**

**Exemptions, 2008**

Exemptions from income are modest in amount and increase slightly each year. Examples for 2008 are as follows:

- \$3,500 for the taxpayer
- \$3,500 for the taxpayer's spouse (if filing jointly)
- \$3,500 for each dependent

For married taxpayers filing jointly with two dependents, the amount to be claimed in 2008 would be 4 × \$3,500, or \$14,000. There is an income test for exemptions, and if a taxpayer's adjusted gross income exceeds the allowable amount, the exemption begins to be reduced. The exemption is phased out completely when the taxpayer's income exceeds an income ceiling.

From Internal Revenue Service Publication 17: Your income tax.

amount is claimed after the standard or itemized deduction has been subtracted from the AGI, the determination of the number of exemptions is made on the first page of Form 1040, under the category "Exemptions."

There is an income test for exemptions, and if a taxpayer's AGI exceeds a ceiling amount, the exemption begins to be reduced.

**COMPUTING THE TAX**

The computation of individual income tax is based on the tax tables prepared by the IRS. The tables are constructed according to the tax status of the taxpayer: single, married couple filing jointly, married person filing separately, head of household, and widow/widower with dependent child.

As of 2008 there were six tax rates: 10%, 15%, 25%, 28%, 33%, and 35%. Each rate applies to a certain bracket of income; these brackets differ for single taxpayers and for married persons filing jointly (Table 39-2). Although the tax rates are only occasionally changed by the US Congress, the income brackets are adjusted annually.

The determination of the tax due from the tax tables does not conclude the tax computation process; once the actual tax is figured, any credits may be deducted.

**TAX CREDITS**

Whereas deductions and exemptions reduce the amount of income that the taxpayer must report for purposes of computing the tax owed, tax credits actually reduce the tax that must be paid, by being deducted dollar-for-dollar from the tax. For example, \$10,000 of tax owed—based on taxable income of \$54,600—would be reduced to \$8,000 by a \$2,000 tax credit. Some credits are nonrefundable (i.e., they cannot be refunded to the extent that they exceed the income tax owed by the taxpayer).

The credits likely to be of most importance to optometrists are the following:

- *Credit for child and dependent care expenses.* A credit may be claimed for expenses incurred to have someone take care of a child younger than 13 years of age or a dependent or spouse who cannot care for himself or herself. As of 2008 the maximum allowable credit was \$3,000 per child or dependent, and the total credit that may be claimed annually was \$6,000. However, because of income limitations, optometrists are likely to be eligible to claim only 20% of the credit (incomes in excess of \$43,000 are limited to 20% of the credit). Computation of the credit is performed on Form 2441.

**TABLE 39-2**

**Income Tax Rates and Brackets, 2008**

Income tax is determined by the income tax rate and the bracket to which it is applied. The brackets vary for single, married filing jointly, and other classifications of taxpayers.

Tax Bracket	Single	Married Filing Jointly
10%	\$0 to \$8,025	\$0 to \$16,050
15%	\$8,026 to \$32,550	\$16,051 to \$65,100
25%	\$32,551 to \$78,850	\$65,101 to \$131,450
28%	\$78,851 to \$164,550	\$131,451 to \$200,300
33%	\$164,551 to \$357,700	\$200,301 to \$357,700
35%	\$357,701 and up	\$357,701 and up

From Internal Revenue Service Publication 17: Your income tax.

- *Credit for the elderly and the disabled.* This credit may be claimed by individuals age 65 and older (younger than 65 if a government retiree) and by individuals who are permanently and totally disabled. The credit is reported on Schedule R.
- *Education credits.* The Hope credit may be claimed for expenses paid for a taxpayer, spouse, or child to enroll in and attend the first 2 years of college or vocational education. The student must be enrolled in a degree-earning program and must carry at least a half-academic load. As of 2008, the allowable credit was up to \$1,800 per student (for 2 years). The lifetime learning credit does not require enrollment in a degree program and permits a credit of up to \$2,000 to be claimed per family (for an unlimited number of years). These credits are not allowed if the AGI exceeds an income ceiling, which differs for single individuals and married persons filing jointly. The credit must be computed on Form 8863.
- *Child tax credit.* A tax credit may be claimed for a child who is a dependent and is younger than 17 years at the end of the tax year. As of 2008, to receive the \$1,000 credit the taxpayer's AGI could not exceed an income ceiling, which differed for taxpayers who were single or married filing jointly.
- *Adoption credit.* A credit may be claimed for expenses incurred in adopting a child. There is a maximum allowable amount, but unused credit may be carried forward for 5 years. There is an income ceiling to claim the credit, which must be figured on Form 8839.

Some credits are refundable and can be refunded to the extent that they exceed the tax owed by the taxpayer, being treated as payments of taxes. These credits generally are not applicable to optometrists.

## SOCIAL SECURITY AND MEDICARE TAX

A self-employed person must also pay the Social Security/Medicare tax—assessed at 15.3% of net income—which represents the self-employed individual's contributions to these programs. The calculation of this tax is performed quarterly and the tax is submitted to the IRS; the total amount due for the year is calculated on Schedule SE and reported on the second page of Form 1040, in the "Other Taxes" section. The amounts submitted quarterly are entered on the "Payments" section of page 2 of Form 1040 and subtracted from the total due for the year.

Employed individuals also have Social Security/Medicare taxes calculated, withheld, and submitted to the IRS quarterly, on Form 941, by the employer. The amount that has been withheld for the year is reported by the employer to the IRS on Form W-2. The taxpayer enters this amount in the "Payments" section on the second page of the taxpayer's Form 1040.

If the amount withheld for income and Social Security/Medicare taxes exceeds the total tax indebtedness calculated on the return, the taxpayer is due a refund. If the amount withheld is less than the total amount owed, the taxpayer must pay the additional sum to the IRS.

## FILING REQUIREMENTS

Taxpayers need not file a return if their gross income is less than the standard deduction plus the personal exemption (Box 39-4). These amounts are relatively modest, and optometrists are certain to exceed them. Individuals' returns must be filed by the 15th day of the fourth calendar month after the close of the taxable year—April 15 for a calendar year. The IRS has an electronic filing system that may be used in lieu of the traditional paper system, the IRS Electronic Federal Tax Payment System, accessible online at [www.eftps.gov/eftps/](http://www.eftps.gov/eftps/).

Dependent children may be required to submit their own tax returns. A child age 19 years or older with earned income (from employment) or unearned income (such as from investments) who can be claimed as a dependent must file a separate return if the unearned income is \$900 or more (as of 2008); the income is taxed at the child's bracket. For a child under 19, a separate return must be filed if the child has earned income in excess of the standard deduction (\$5,450 in 2008) or unearned income in excess of \$900. Although earned income in excess of the deduction is taxed at the child's rate, and unearned income from \$900 to \$1,800 is taxed at the child's rate, unearned income in excess of \$1,800 is taxed at the parents' rate (Table 39-3).

Although taxpayers will be granted an automatic 2-month extension for the filing of income tax returns if they file Form 4868 on or before the due date of the return, they also must pay a tentative estimate of the income tax due at the time of making the extension application. Applications for further extensions of time for filing must be made in writing and will be granted only in hardship cases. There are penalties for failure to file and for failure to pay by the due date. In addition, there is a penalty for substantially understating the tax due (20% of the understated tax), which will be applied if the unpaid amount is more than 10% of the final tax liability or is more than \$5,000, whichever is larger.

Any taxpayer may revise a previous return to claim a refund of taxes or pay additional taxes by filing Form 1040X.

### BOX 39-4

#### Income Levels Not Subject to Tax, 2008

There is a minimum income that is not subject to income taxation. This minimum income level is composed of the following:

- The standard deduction
- The personal exemption

For example, in 2008 the standard deduction for single taxpayers younger than 65 years was \$5,450 and the personal exemption was \$3,500, for a total of \$8,950. Single taxpayers earning less than this amount did not have to file a return. For a married couple younger than 65 years filing jointly in 2008, the total was \$17,900.

From Internal Revenue Service Publication 17:  
Your income tax.

TABLE 39-3

**Child Tax Reporting Requirements, 2008**

Age of Child	Tax Return Required	Unearned Income Tax	Earned Income Tax
Under 19 years of age	Earned income >\$5,450 or unearned income >\$900	Income \$900 to \$1,800 is taxed at child's bracket. Income >\$1,800 is taxed at parent's bracket,	Income >\$5,450 is taxed at child's bracket.
19 years of age or older	Earned or unearned income >\$900	Income >\$900 is taxed at child's bracket.	Income >\$900 is taxed at child's bracket.

From Internal Revenue Service Publication 17: Your income tax.

## PENALTIES

In addition to the penalty for underpaid tax, there is a \$5,000 penalty that may be imposed on frivolous returns. If any part of the deficiency in tax is due to the negligence or intentional disregard of IRS regulations, a penalty of 5% of the total amount of the deficiency is assessed per month, up to a maximum of 25%. If there is fraud, the penalty is 75% of the underpayment due to fraud. Fraud also may be the basis for a criminal action against the taxpayer, which can result in a jail sentence of up to 5 years and a \$10,000 fine. The period within which criminal prosecution may be started is generally 3 years after the commission of the offense but may be longer in some circumstances.

Tax returns are examined by the IRS through several programs. A computer system known as the Discrimination Function System selects most returns that are examined, by evaluating selected entries and giving the return a score, which is then reviewed by IRS personnel. Returns deemed to have the highest probability of error are selected for audit.

Returns also may be analyzed through the Taxpayer Compliance Measurement Program, which is a random selection system that is used to determine correct tax liability and measure and evaluate taxpayer compliance characteristics. Information obtained through Taxpayer Compliance Measurement Program audits is used to update and improve the Discrimination Function System.

## AUDITS

Returns also may be examined directly by IRS personnel by assessing claims for credit or refunds of previously paid taxes or by matching tax documents, such as Form W-2 or 1099. The place and method of examination are determined by the IRS and may be no more than an exchange of correspondence, a more formal hearing at the taxpayer's office, or at the office of the IRS. Most taxpayers represent themselves at these meetings, and many disagreements are settled at this level. If the taxpayer does not agree with the changes proposed by the examiner, the taxpayer may appeal through the IRS or proceed to tax court. See IRS Publication 5: *Appeal Rights and Preparation of Protests for Unagreed Cases*, and Publication 556: *Examination of Returns, Appeal Rights, and Claims for Refund*.

## BUSINESS TAXES

A business is an activity carried on for profit, and for an activity to be considered a business, a profit motive must be involved. An activity is presumed to be engaged in for-profit activities if it produces a profit in any 3 out of 5 consecutive years.

One of the most important decisions made when entering into business is the form of organization to use. Tax considerations are a key aspect of the decision-making process, as each type of business entity offers different tax advantages and disadvantages. Although the individual proprietorship has been the historical backbone of optometry, economic and sociologic factors have combined to make partnerships and group practices grow in popularity. For purposes of illustration, however, the computation of business taxes for an individual proprietor is described in this section. Legal counsel and accounting advisors will be required when beginning a business enterprise to ascertain the appropriate type of organization and tax reporting requirements.

A business must have its own unique identification, and so each business is required to have an employer identification number, which must be provided on all business tax returns. Personal tax returns, with Schedule C (Profit or Loss from Business) attached, must include the individual's Social Security number. If a sole proprietorship is incorporated or merged with another sole proprietorship to form a limited liability company (LLC) or partnership, then a new employer identification number is needed for the resulting corporation, LLC, or partnership. To apply for an employer identification number, Form SS-4, Application for Employer Identification Number, must be completed and submitted to the IRS (Figure 39-4).

When organizing a business, there are three important income-related considerations: books and records, accounting periods, and accounting methods.

### Books and Records

When starting a business, a system of recordkeeping that is suitable for the business should be established. The tax year and the accounting method must be determined because the recordkeeping system must show the income for the accounting period that is the tax year. Computerized bookkeeping is the preferred method to use for financial records (Chapter 20).

<b>Form SS-4</b> (Rev. January 2009) Department of the Treasury Internal Revenue Service		<b>Application for Employer Identification Number</b> (For use by employers, corporations, partnerships, trusts, estates, churches, government agencies, Indian tribal entities, certain individuals, and others.) ▶ See separate instructions for each line. ▶ Keep a copy for your records.		OMB No. 1545-0003 EIN	
Type or print clearly.	1 Legal name of entity (or individual) for whom the EIN is being requested <i>John G O'Dee, O.D.</i>				
	2 Trade name of business (if different from name on line 1)		3 Executor, administrator, trustee, "care of" name		
	4a Mailing address (room, apt., suite no. and street, or P.O. box) <i>123 Eye Street</i>		5a Street address (if different) (Do not enter a P.O. box.)		
	4b City, state, and ZIP code (if foreign, see instructions) <i>Anytown, ST 12345</i>		5b City, state, and ZIP code (if foreign, see instructions)		
	6 County and state where principal business is located <i>County, State</i>				
	7a Name of principal officer, general partner, grantor, owner, or trustor <i>John G O'Dee</i>		7b SSN, ITIN, or EIN <i>123 45 6789</i>		
8a Is this application for a limited liability company (LLC) (or a foreign equivalent)? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No			8b If 8a is "Yes," enter the number of LLC members ▶		
8c If 8a is "Yes," was the LLC organized in the United States? <input type="checkbox"/> Yes <input type="checkbox"/> No					
9a Type of entity (check only one box). Caution. If 8a is "Yes," see the instructions for the correct box to check.					
<input checked="" type="checkbox"/> Sole proprietor (SSN) <i>123 : 45 : 6789</i> <input type="checkbox"/> Partnership <input type="checkbox"/> Corporation (enter form number to be filed) ▶ <input type="checkbox"/> Personal service corporation <input type="checkbox"/> Church or church-controlled organization <input type="checkbox"/> Other nonprofit organization (specify) ▶ <input type="checkbox"/> Other (specify) ▶					
<input type="checkbox"/> Estate (SSN of decedent) <input type="checkbox"/> Plan administrator (TIN) <input type="checkbox"/> Trust (TIN of grantor) <input type="checkbox"/> National Guard <input type="checkbox"/> State/local government <input type="checkbox"/> Farmers' cooperative <input type="checkbox"/> Federal government/military <input type="checkbox"/> REMIC <input type="checkbox"/> Indian tribal governments/enterprises                 Group Exemption Number (GEN) if any ▶					
9b If a corporation, name the state or foreign country (if applicable) where incorporated		State	Foreign country		
10 Reason for applying (check only one box)					
<input checked="" type="checkbox"/> Started new business (specify type) ▶ <i>optometry</i> <input type="checkbox"/> Banking purpose (specify purpose) ▶ <input type="checkbox"/> Changed type of organization (specify new type) ▶ <input type="checkbox"/> Purchased going business <input type="checkbox"/> Created a trust (specify type) ▶ <input type="checkbox"/> Created a pension plan (specify type) ▶					
<input type="checkbox"/> Hired employees (Check the box and see line 13.) <input type="checkbox"/> Compliance with IRS withholding regulations <input type="checkbox"/> Other (specify) ▶					
11 Date business started or acquired (month, day, year). See instructions. <i>1 Jan 2009</i>		12 Closing month of accounting year <i>December</i>			
13 Highest number of employees expected in the next 12 months (enter -0- if none).		14 Do you expect your employment tax liability to be \$1,000 or less in a full calendar year? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No (If you expect to pay \$4,000 or less in total wages in a full calendar year, you can mark "Yes.")			
Agricultural		Household		Other <i>1</i>	
15 First date wages or annuities were paid (month, day, year). Note. If applicant is a withholding agent, enter date income will first be paid to nonresident alien (month, day, year) ▶ <i>January</i>					
16 Check one box that best describes the principal activity of your business.					
<input type="checkbox"/> Construction <input type="checkbox"/> Rental & leasing <input type="checkbox"/> Transportation & warehousing <input checked="" type="checkbox"/> Health care & social assistance <input type="checkbox"/> Wholesale-agent/broker <input type="checkbox"/> Real estate <input type="checkbox"/> Manufacturing <input type="checkbox"/> Finance & insurance <input type="checkbox"/> Accommodation & food service <input type="checkbox"/> Wholesale-other <input type="checkbox"/> Retail <input type="checkbox"/> Other (specify)					
17 Indicate principal line of merchandise sold, specific construction work done, products produced, or services provided. <i>Eye care, ophthalmic products</i>					
18 Has the applicant entity shown on line 1 ever applied for and received an EIN? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No If "Yes," write previous EIN here ▶					
Complete this section only if you want to authorize the named individual to receive the entity's EIN and answer questions about the completion of this form.					
Third Party Designee		Designee's name		Designee's telephone number (include area code)	
				( )	
		Address and ZIP code		Designee's fax number (include area code)	
				( )	
Under penalties of perjury, I declare that I have examined this application, and to the best of my knowledge and belief, it is true, correct, and complete.				Applicant's telephone number (include area code)	
Name and title (type or print clearly) ▶ <i>John G O'Dee, O.D.</i>				(123) 456-7890	
Signature ▶ <i>JG O'Dee</i>				Applicant's fax number (include area code)	
Date ▶ <i>1 Dec 2008</i>				(123) 456-7899	
For Privacy Act and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 15055N Form SS-4 (Rev. 1-2009)					

FIGURE 39-4 Sample Form SS-4.

All business receipts should be deposited in a separate bank account established for that purpose, and all disbursements should be made by check from this account. This permits the documentation of both income and expenses. Checks payable to one's self should be written only when making withdrawals of income from the business for one's own use; checks payable to "cash" should be avoided.

A petty cash fund should be established for minor expenses, and all business expenses paid for by cash should be supported by documents showing their business purpose. To document recordkeeping, the following rules should be observed:

- *Support all entries.* Cancelled checks, paid bills, duplicate deposit slips, and other items that support entries in the practice accounts should be kept in an orderly manner.

- *Keep all records.* Business records should be kept available for review as needed; backup computer records should be scrupulously maintained; these records should be kept for a period that exceeds the statute of limitations for liability and contract actions.
- *Retain copies.* Supporting records for tax returns should be kept until the statute of limitations for tax returns runs out (3 years after the return is due or 2 years from the date the tax is paid, whichever occurs later).
- *Keep comprehensive employee records.* All records on employment taxes (e.g., income tax withholding, Social Security, Medicare, federal unemployment tax) should be kept for at least 4 years after the due date of the return or the date the tax is paid, whichever is later; business records always should contain the employer identification number, copies of the returns filed, and the dates and amounts of tax deposits made. Withholding and submission of employment taxes are described later.

## Accounting Periods

Every taxpayer must calculate taxable income and file a tax return on the basis of an annual accounting period, called a tax year. A tax year usually is 12 consecutive months. It may be a calendar year or a fiscal year; under certain circumstances, it may be less than 12 months, a partial year.

A calendar year is 12 consecutive months ending December 31. A fiscal year is either 12 consecutive months ending on the last day of any month other than December, or a 52- to 53-week year. To report on a fiscal basis, the practice books must be kept on that basis. A short tax year, or partial year, is a tax year of less than 12 months, but a short tax year return is treated as a return for a full tax year. A short tax year usually results when a taxpayer is not in business for an entire tax year. Most optometrists and other small businesses are on a calendar year accounting period.

## Accounting Methods

Taxable income is determined by using a fixed accounting period and a set of rules to decide when and how to report income and deductions. There are two types of accounting methods, cash and accrual, for income and expenses of business activities.

### Cash Method

The cash method of accounting is used by most individuals and many small businesses with no inventories. With the cash method, all items of income actually or constructively received during the year are included in gross income. Both property and services received must be included as income at their fair market value. Constructive receipt of income occurs when an amount is credited to the practice account or made available to the practice without restriction as to the time and manner of payment. For example, an optometrist on the cash method of accounting renders services to a patient on December 31 but does not receive a check as payment until January 1. The payment is income reportable in the year beginning January 1.

### Accrual Method

Under the accrual method all items of income are included in gross income when earned, even though payment may be received in another tax year. All events that fix the right to receive the income must have occurred and the amount must be able to be determined with reasonable accuracy. For example, an optometrist on the accrual method of accounting renders services to a patient December 31 but does not receive payment until January 1. The payment is income reportable in the year ending December 31.

An accountant should be consulted before making any decision as to the most appropriate type of bookkeeping, accounting period, and method of accounting for a given business enterprise.

## BUSINESS ASSETS

Ophthalmic instruments have obvious value to the practice of optometry because they contribute directly to earning the income that supports the practice. Such property is termed a *business asset*.

A business asset can be tangible real estate, such as a building or a parking lot, or tangible personal property, such as furniture or examination room equipment. It also can be intangible property such as goodwill or a covenant not-to-compete.

The amount paid for a business asset usually is a capital expenditure rather than a deductible expense. This distinction has important tax ramifications. The cost of capital expenditures cannot be deducted all at once but rather must be recovered through the use of depreciation or amortization, which permits recovery over a period of years. Some business assets cannot be depreciated or amortized (e.g., land), and the cost of these assets can be recovered only when the asset is sold or otherwise disposed of. A deductible expense, on the other hand, may be claimed in full for the tax year in which it was incurred. Examples of deductible expenses include office supplies, drugs and solutions, and repairs.

A capital expenditure actually is an investment of capital, either to acquire property with a useful life of more than 1 year or to make permanent improvements that increase the value of property or appreciably prolong its life. Thus purchases of equipment, instruments, and other capital assets incur longterm tax ramifications that must be taken into account when the purchases are being considered.

Business assets have to be classified for tax purposes; the tax accounting for a practice must distinguish between the types of capital expenditures because the depreciation period varies for different types of property. The tax ramifications of this classification system also are important when purchasing a practice or the assets of a practice (see Chapter 8).

## TAX BASIS FOR BUSINESS PROPERTY

The tax basis of business property is used to figure the gain or loss from the sale or other disposition of the property. It also is used for determining tax deductions for depreciation or

amortization. When property is purchased, its original basis is the cost. (If the property is received in some other manner, such as by gift or inheritance, then a basis other than cost is used.) If an asset is used for business purposes and depreciation or amortization deductions are claimed by the taxpayer, then these deductions are used to calculate the adjusted basis of the asset. In addition, this information may be needed to determine the taxable income of the taxpayer's business. The adjusted basis also is necessary for determining gain or loss when business property is sold or exchanged. Such transactions are a common part of the decisions made by a small business owner such as an optometrist.

For example, if an optometrist purchases a computer for \$5,000 and uses it for a year, it will have a depreciated value (adjusted basis) of \$4,000. If the optometrist sells it for \$3,000, there will be a \$1,000 loss; if it is sold for \$5,000 there will be a \$1,000 gain.

As this example illustrates, cost serves as a beginning point for basis determination in many cases. Another important aspect of basis is fair market value, which is the price at which property would change hands between a willing buyer and seller.

For example, an automobile used exclusively for business purposes by an optometrist has been depreciated so that it has an adjusted basis of \$13,000, but it has a fair market value of \$14,500. The optometrist decides to trade it for a truck that also has a fair market value of \$14,500. The basis in the truck after the sale is \$13,000, the same as the traded automobile.

If the optometrist decides to trade the truck for a new automobile that has a fair market value of \$15,000, and pays \$1,000 in addition to the trade-in, the basis in the new car becomes \$14,000 (the \$13,000 basis of the old truck plus the \$1,000 cash).

The effect of basis on a contemplated sale or exchange of equipment or other business assets always should be carefully considered. It is important to retain a competent accountant or tax attorney so that advice concerning the tax consequences of a business transaction can be ascertained before entering into the transaction.

Although the preceding examples have used tangible assets for purposes of illustration, intangible assets also have a basis that may be adjusted as required. Typical examples include the following:

- *Goodwill.* The basis of goodwill is its cost when the purchase of a practice is involved.
- *Covenant not-to-compete.* Usually, the basis of a covenant not-to-compete is what is paid for it; if a covenant is part of a sales agreement for the purchase of a practice, its cost must be listed in the contract.
- *Franchise.* The basis of a franchise is its cost.

The determination of basis can become complicated, but each purchase and sale or exchange of a business asset has tax consequences, and nowhere is this more important than in the purchase of a practice: it is not the price paid but the value allocated to the various types of assets being purchased that determines the tax ramifications

## DETERMINING NET PROFIT FROM A BUSINESS

The determination of profit (or loss) for an individual practitioner is calculated on Schedule C (Figure 39-5). Schedule C is divided into two parts: income and deductions. Information concerning the type of business activity being reported and the accounting method (cash or accrual) being used also must be provided. A review of the calculation of income and business deductions for Schedule C is provided to illustrate how income is determined for an optometrist in private practice and to describe the various types of business deductions that typically may be claimed in the practice of optometry.

### INCOME

The principal activity of an optometry practice is to provide personal services. All compensation received for personal services, no matter what the form of payment, must be included in gross income and must be reported in the year received (if on the cash basis) or in the year earned (if on the accrual basis). Such income is ordinary income and is taxable whether earned by a sole proprietor, owner of an LLC, shareholder in a subchapter S corporation, or partner in a general partnership.

For the majority of optometrists there is another source of income: the sale of ophthalmic materials. An optometrist who dispenses eyewear, contact lenses, solutions, ophthalmic devices (such as magnifiers), and similar items must report the income derived from their sale. Thus "goods sold" usually are a significant part of the income earned by an optometrist.

In some states a sales tax is imposed on the sale of ophthalmic materials and other items by optometrists, and the optometrist collects the tax from the patient-purchaser. These taxes should be included as income, but because they must be paid to the state they are also deducted as a business expense, so the net effect is zero.

In addition, business-related gains from dealings in property, bartering of property or services, or distributive shares of partnership income also are "income" that must be reported by an optometrist-taxpayer.

Income from services is reported as "gross receipts and sales" in Part I of Schedule C, as is income from the sale of ophthalmic materials and other items. To determine the profit from the sale of materials, however, the "cost of goods sold" must be known (i.e., from the price paid by patients for these materials, the cost of the materials must be deducted to calculate profit). To make this calculation, inventories must be conducted at the start of the tax year. To arrive at a dollar amount for an inventory, a method for identifying inventory items (such as frames) and a basis for valuing each item in the inventory must be established. Next, the cost of materials, supplies, labor, or other expenses incurred during the tax year must be added to the inventory. From this amount, the value of the inventory at the end of the tax year must be.

<b>SCHEDULE C (Form 1040)</b>		<b>Profit or Loss From Business</b> (Sole Proprietorship)		OMB No. 1545-0074 <b>2008</b> Attachment Sequence No. <b>09</b>	
Department of the Treasury Internal Revenue Service (99)		▶ Partnerships, joint ventures, etc., generally must file Form 1065 or 1065-B. ▶ Attach to Form 1040, 1040NR, or 1041. ▶ See Instructions for Schedule C (Form 1040).			
Name of proprietor <b>John G O'Dee</b>		Social security number (SSN) <b>123 : 45 : 6789</b>			
A Principal business or profession, including product or service (see page C-3 of the instructions) <b>Optometrist</b>		B Enter code from pages C-9, 10, & 11 <b>9290</b>			
C Business name. If no separate business name, leave blank. <b>John G O'Dee, OD</b>		D Employer ID number (EIN), if any <b>87654321</b>			
E Business address (including suite or room no.) ▶ <b>123 Eye Street</b> City, town or post office, state, and ZIP code <b>Anytown, ST 12345</b>					
F Accounting method: (1) <input checked="" type="checkbox"/> Cash (2) <input type="checkbox"/> Accrual (3) <input type="checkbox"/> Other (specify) ▶					
G Did you "materially participate" in the operation of this business during 2008? If "No," see page C-4 for limit on losses <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No					
H If you started or acquired this business during 2008, check here <input type="checkbox"/>					
<b>Part I Income</b>					
1 Gross receipts or sales. <b>Caution.</b> See page C-4 and check the box if: <ul style="list-style-type: none"> <li>• This income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked, or</li> <li>• You are a member of a qualified joint venture reporting only rental real estate income not subject to self-employment tax. Also see page C-4 for limit on losses.</li> </ul>					
				▶ <input type="checkbox"/>	
		1	<b>450,000</b>		
2 Returns and allowances		2			
3 Subtract line 2 from line 1		3	<b>450,000</b>		
4 Cost of goods sold (from line 42 on page 2)		4	<b>135,000</b>		
5 <b>Gross profit.</b> Subtract line 4 from line 3.		5	<b>315,000</b>		
6 Other income, including federal and state gasoline or fuel tax credit or refund (see page C-4).		6			
7 <b>Gross income.</b> Add lines 5 and 6		7	<b>315,000</b>		
<b>Part II Expenses.</b> Enter expenses for business use of your home <b>only</b> on line 30.					
8 Advertising	8	<b>5,000</b>	18 Office expense	18	<b>2,500</b>
9 Car and truck expenses (see page C-5)	9	<b>3,030</b>	19 Pension and profit-sharing plans	19	
10 Commissions and fees	10		20 Rent or lease (see page C-6):	20a	
11 Contract labor (see page C-5)	11		a Vehicles, machinery, and equipment	20b	<b>39,000</b>
12 Depletion	12		b Other business property	21	
13 Depreciation and section 179 expense deduction (not included in Part III) (see page C-5)	13	<b>16,165</b>	22 Repairs and maintenance	22	
14 Employee benefit programs (other than on line 19)	14	<b>14,000</b>	23 Supplies (not included in Part III)	23	<b>11,000</b>
15 Insurance (other than health)	15	<b>5,000</b>	24 Taxes and licenses	24a	<b>3,000</b>
16 Interest:			a Travel	24b	<b>500</b>
a Mortgage (paid to banks, etc.)	16a	<b>7,970</b>	b Deductible meals and entertainment (see page C-7)	25	<b>12,000</b>
b Other	16b		26 Utilities	26	<b>50,000</b>
17 Legal and professional services	17	<b>3,000</b>	27 Wages (less employment credits)	27	
			28 Total expenses before expenses for business use of home. Add lines 8 through 27	28	<b>183,165</b>
			29 Tentative profit or (loss). Subtract line 28 from line 7	29	<b>131,835</b>
			30 Expenses for business use of your home. Attach Form 8829	30	
			31 <b>Net profit or (loss).</b> Subtract line 30 from line 29.	31	<b>131,835</b>
<ul style="list-style-type: none"> <li>• If a profit, enter on both Form 1040, line 12, and Schedule SE, line 2, or on Form 1040NR, line 13 (if you checked the box on line 1, see page C-7). Estates and trusts, enter on Form 1041, line 3.</li> <li>• If a loss, you must go to line 32.</li> </ul>					
32 If you have a loss, check the box that describes your investment in this activity (see page C-8).					
<ul style="list-style-type: none"> <li>• If you checked 32a, enter the loss on both Form 1040, line 12, and Schedule SE, line 2, or on Form 1040NR, line 13 (if you checked the box on line 1, see the line 31 instructions on page C-7). Estates and trusts, enter on Form 1041, line 3.</li> <li>• If you checked 32b, you must attach Form 6198. Your loss may be limited.</li> </ul>					
				32a <input type="checkbox"/> All investment is at risk.	
				32b <input type="checkbox"/> Some investment is not at risk.	
For Paperwork Reduction Act Notice, see page C-9 of the instructions. <span style="float: right;">Cat. No. 11334P Schedule C (Form 1040) 2008</span>					

FIGURE 39-5 Sample Schedule C.

subtracted. The result is the "cost of goods sold," which is the sum entered on Schedule C.

"Returns and allowances" also may be included as income. For example, cash discounts from invoice price may be awarded to an optometrist by an ophthalmic laboratory or frame

manufacturer for the optometrist's good record of prompt payment during the year or for buying in volume. Either of two methods may be used to account for these refunds: they can be deducted directly from the purchases made during the year, or they can credit to a discount income account and



within optometry; necessary expenses are those that are appropriate and helpful in developing and maintaining an optometric practice.

If property is used both for business and for personal purposes (such as an automobile), then it must be determined which part of the expenses are for business and which part are for personal matters. Only the business expenses are deductible.

There are numerous business deductions that may be claimed; the major categories are: salaries, wages, and related payments; rent expense; repairs, improvements, and replacements; bad debts; travel, entertainment, and gift expenses; business interest; insurance premiums; taxes; utility costs; profession-related expenses; and miscellaneous business expenses.

### ***Salaries, Wages, and Related Expenses***

Compensation paid to employees, in its various forms, is deductible as a business expense.

#### ***Salaries***

A sole proprietor (or partner) may not deduct his or her salary or any withdrawal for personal use, but salaries paid to the employees of a sole proprietorship (or partnership) are a deductible business expense; salaries paid by a professional corporation or association to its employees (including optometrists) are similarly deductible.

#### ***Bonuses***

Payment of money or of other items of value are deductible if they are intended as additional compensation rather than as a gift (e.g., a turkey given to an employee as a gift at Christmas).

#### ***Education Expenses***

Tuition expenses paid for employees under a qualified educational assistance program related to their employment are not considered gross income for the employees and are deductible by the business.

#### ***Interview Expense Allowances***

Payments made to prospective employees to compensate them for the costs of an interview are deductible by the business and are not income for the interviewees.

#### ***Moving Expenses***

Payments to employees as an allowance or reimbursement for the cost of moving to a new job site can be deducted if the employee is eligible for a tax deduction for the move.

#### ***Meals and Lodging***

The cost of meals, lodging, and inventoriable items, (i.e., lenses and frames) furnished to employees as part of their compensation, is deductible by the business.

#### ***Fringe Benefits***

There are numerous forms of indirect compensation that may be provided to employees, such as health or accident insurance, life or disability insurance, reimbursement for medical

care, medical savings accounts, reimbursement for business-related use of an automobile, fees for membership in professional organizations, licensure fees, and reimbursement for expenses related to continuing education; these fringe benefits are deductible as business expenses and are not taxable as income for the employee.

#### ***Rent Expense***

If business property is leased, the rental amount generally may be deducted. Certain other expenses also may be deducted as rent.

Rent is the amount that is paid for the use of property that is not owned. In general, rent may be deducted as an expense only if the rent is for property that is used in the practice of optometry. If the renter has or will have equity in or title to the property, the rent is not deductible. If an optometrist leases business property, any taxes that must be paid for or to the lessor may be deducted. If a building is leased and an addition or other permanent improvement is made to it, the optometrist may be able to either depreciate or amortize the improvements.

#### ***Repairs, Improvements, and Replacements***

The cost of repairing, improving, or replacing property used in the practice of optometry is either a deductible expense or a capital expenditure. An expenditure necessary to keep property in a normal and efficient operating condition is a deductible expense. However, if the expenditure adds to the value of the property or significantly increases its life, the cost must be capitalized rather than deducted and recovered through the use of depreciation.

Repairs do not add to the value or the usefulness of property, nor do they appreciably lengthen its life (e.g., repairs to floors, painting). Thus they are deductible expenses and not capital expenditures.

Improvements add to the value of property, lengthen its life, or adapt it to a different use. The cost of an improvement is a capital expenditure. Examples are a new floor, lighting renovations, and altering an office as part of a general restoration plan.

Replacements, such as the amount paid to replace parts of an instrument that only keep it in a normal operating condition, do not add to life and are deductible expenses. A replacement that stops deterioration and adds to the life of the property has to be capitalized and depreciated.

#### ***Bad Debts***

If money is owed but the debt cannot be collected, it is known as a bad debt. Under certain circumstances, the bad debt may qualify as a business deduction. For the debt to qualify, there must be a true creditor-debtor relationship between the creditor and the person who owes the money. Optometrists using the accrual method of accounting report income that is due them as soon as it is earned. Therefore they may take a bad debt deduction when they are unable to collect what is owed. If the bad debt is later recovered, all or in part, it must be reported as income in the year that it is collected. Cash method

optometrists do not report income that is due until payment is received. For this reason, they may not take a bad debt deduction on payments they have not received or cannot collect.

### *Travel, Entertainment, and Gift Expenses*

Important deductions for a business are the travel, entertainment, and gift expenses that are related to the conduct of the business. This is an area that is carefully scrutinized by the IRS, so meticulous recordkeeping, documentation, and planning are essential.

**Travel Expenses.** Travel expenses are those ordinary and necessary expenses of foreign and domestic travel away from home for the practice of optometry. These expenses include meals and lodging, transportation and baggage charges, the cost of maintaining and operating a car, cleaning and laundry expenses, telephone and other communications expenses, and similar costs related to qualified travel, including tips incidental to any of these expenses.

The general rule is that if a trip was entirely for business, then ordinary and necessary travel expenses may be deducted, but if the trip was primarily personal, no travel expenses may be deducted, even if there was some business activity at the destination. If the trip was primarily for business and while at the business destination the trip was extended for vacation or other nonbusiness activities, then the expenses of travel to and from the destination may be deducted. Whether the primary purpose of the trip was business or pleasure, the expenses incurred at the destination that were related to business may be deducted.

Travel expenses that an optometrist incurs in attending an optometric convention or seminar may be deducted. A spouse or other family member accompanying an optometrist on such a trip cannot be included in the deduction unless it can be shown that there is a business purpose and need for the other person's attendance.

Transportation expenses for business purposes may be deducted even though the optometrist is not away from home. Transportation expenses include such items as air, train, bus, and cab fares and the expenses of driving or maintaining a car or other vehicle. Meals and lodging are not considered in computing transportation expenses, and commuting expenses between the home and the usual place of business are not deductible. Special rules involved in the use of an automobile or other vehicle for business purposes are described in a subsequent section of this chapter.

**Business Entertainment.** Business entertainment expenses are deductible only if they are ordinary and necessary expenses of carrying on the practice of optometry and can be documented. This deduction may be taken only if the amounts spent are directly related to or associated with the active conduct of optometry or directly precede or follow a substantial business discussion related to the practice of optometry. Furthermore, only 50% of business-related entertainment expenses may be deducted.

For example, an optometrist wishing to establish a co-operative for the purpose of purchasing spectacle frames at discount may take a prospective member of the co-op to dinner,

at which they discuss the details of such a business association. If the cost of the meal is \$100, the optometrist may deduct \$50 as a business deduction.

Entertainment includes any activity generally considered to provide entertainment, amusement, or recreation. This covers entertaining guests at nightclubs; social, athletic and sporting clubs; theaters; sporting events; on yachts; or hunting, fishing, or vacation trips. It also may include satisfying the personal, living, or family needs of any individuals such as furnishing food and beverages, hotel accommodations, or an automobile. However, expenses cannot be deducted for entertainment that is lavish or extravagant. Dues and fees paid to a club organized for business, pleasure, recreation, or other social purposes are not deductible as a business expense.

**Business Gifts.** Business gifts may be deducted, but the total cost of such gifts made directly or indirectly to any person during the tax year cannot be more than \$25. If a gift is not intended for the eventual personal use or benefit of a particular person or limited class of people, the gift will not be allowed.

The proof necessary to establish travel, entertainment, and business gift expenses should be kept in an account book, diary, statement of expense, or similar record, supported by adequate documentary evidence, that together will support each element of an expense. For example, entries on a desk calendar, not supported by evidence, are not considered to be proper proof.

**Employee Travel Expenses.** Expenses reimbursed to employees for travel expenses are deductible by the business. Employee travel expenses that are unreimbursed by the employer may be claimed only as itemized deductions (under the "miscellaneous" category on Schedule A) to the extent that they exceed 2% of adjusted gross income.

**Employee Entertainment Expenses.** Entertainment expenses reimbursed to employees are deductible. Employee entertainment expenses that are not reimbursed by the employer are deductible, but the deduction is limited to 50% of these costs. They must be claimed on Schedule A and thus may be realized as deductions only to the extent they exceed 2% of adjusted gross income.

### *Interest*

Interest is the charge made for the use of money. All interest paid or accrued in the tax year on a debt that is related to business may be deducted. The interest must be on a debt for which there is a valid obligation to pay a fixed or determinable sum of money.

Generally, the amount agreed on by the lender and the borrower as interest may be deducted when paid or accrued. Examples of deductible interest include the following:

- Interest on business loans used to purchase instruments or equipment (or for other business purposes)
- Mortgages on real property or personal property ("chattel mortgages")
- Interest on loans taken out on insurance policies
- Interest on business-related credit card charges

If a taxpayer uses the cash method of accounting, interest may be deducted only in the year in which it was paid. If the taxpayer uses the accrual method of accounting, the interest may be deducted in the year it accrued.

### Insurance

The cost of insuring a business may be deducted as an expense, but generally the cost of life insurance cannot be deducted. This means that while premiums paid on various types of business insurance policies may be deducted ( Box 39-5 ), premiums on a life insurance policy covering an employer are not deductible (because the employer is directly or indirectly a beneficiary of the policy). Thus a sole proprietor cannot deduct the cost of his or her life insurance policy, and if a partner in a partnership purchases life insurance on the partner's life, naming the other partners as beneficiaries, the premiums are not deductible. However, there are some exceptions. For example, group term life insurance purchased by a professional association or corporation for its employees (including shareholder optometrists) is deductible.

### Taxes

Various taxes imposed by federal, state, local, and foreign governments may be deducted if they are incurred in the ordinary course of business. Federal income, estate, gift, state, inheritance, legacy, and succession taxes are not deductible. Deductible taxes may be categorized as the following.

**Real Property Taxes.** All taxes imposed on real estate that is owned and used for business purposes may be deducted.

**Income Taxes.** State income taxes imposed on a professional corporation are deductible; state income taxes cannot be deducted by an individual proprietor as a business expense (but may be claimed on Schedule A as an itemized deduction).

**Employment Taxes.** If an employer has one or more employees, Social Security and Medicare taxes and federal (or state) unemployment taxes will have to be withheld; the employer's share of the Social Security and Medicare taxes and the federal (or state) unemployment taxes may be claimed as a tax deduction. However, the taxes for Social Security and Medicare

paid by a self-employed taxpayer are only 50% deductible, and this deduction is not claimed on Schedule C.

**Sales Taxes.** State and local sales taxes imposed on the sale of ophthalmic materials and other goods by an optometrist may be deducted if the taxes also were credited as income; if equipment or instruments were purchased and a sales tax was imposed, the tax is considered part of the cost of the items purchased and is depreciated rather than deducted as an expense.

**Other Taxes.** There are other taxes that may be deducted as a business expense, including personal property taxes (e.g., automobiles), gasoline taxes (for vehicles used for business purposes), and corporate franchise taxes. The tax accounting of personal tax items (such as the tax on a home) is performed on Schedule A when itemizing deductions.

### Utility Costs

Utility charges, such as those for heat, light, power, or water expenses for an office; the costs of telephones or telephone services; and Internet access or similar costs, that are incurred for the operation of a business are deductible.

### Profession-Related Expenses

The ordinary and necessary expenses of conducting a private practice can be deducted (Box 39-6) in the year they are incurred.

### Expenses of Looking for a New Job

An individual in an occupation who travels for the purpose of finding employment elsewhere may deduct the expenses of job-seeking trips, including travel costs, meals (limited to 50%), and lodging, even if the trips do not result in an employment offer. The individual must be able to establish, however, that the trips were taken primarily for the purpose of finding employment and have documentation to support this purpose. In determining the purpose of the trip, the amount of time spent on personal activity compared with the amount of time spent looking for employment is the key issue.

#### BOX 39-5

##### Deductible Business Insurance

- Fire, theft, flood, or other casualty insurance
- Merchandise and inventory insurance
- Employees' group hospitalization and medical plans
- Employer's liability insurance
- Malpractice insurance
- Public liability insurance covering liability for bodily injury to persons who are not employees
- Workers' compensation insurance
- State unemployment insurance
- Office overhead insurance
- Employee performance bonds
- Car and other vehicle insurance

From Internal Revenue Service Publication 334: Tax guide for small business.

#### BOX 39-6

##### Deductible Professional Business Expenses

- Membership in professional organizations or societies
- Subscriptions to journals
- Professional texts or books
- Business-related supplies and materials
- Equipment that has a useful life of less than 1 year
- Legal and accounting fees
- Licenses or regulatory fees
- Advertising
- Costs of attending continuing education (but only 50% of expenses for meals is deductible)
- Malpractice insurance
- Property insurance (for professional equipment)

From Internal Revenue Service Publication 334: Tax guide for small business.

## Miscellaneous Business Expenses

There are other types of expenses that may qualify for business deductions. Among these are payments to charitable, religious, educational, or scientific organizations (but the expenses claimed must not be charitable contributions) and the amounts spent to purchase a franchise, trademark, or trade name.

All business expenses are totaled on the “Expenses” section of Schedule C and subtracted from gross business income to provide a tentative profit. For most optometrists, this amount will, in fact, be the net profit, but if a home is used as a business office, certain expenses also may be deducted.

## Expenses for the Business Use of a Home Office

Space in a home may qualify as a deduction if it is used regularly and exclusively for business purposes. The home office must be the following:

- The principal place of business
- Used to meet with patients in the normal course of business

To claim the deduction, the number of square feet used for the office must be determined as a percent of the total square feet of the house. This percentage is then multiplied by the mortgage interest expense, home taxes, insurance, utilities, repairs, maintenance, and allowable depreciation for the home. The calculation is performed on Form 8829.

The total home expenses are subtracted from the tentative profit to yield the net profit for the business. One other deduction that may be included on Schedule C but discussed separately because of its complexity is depreciation.

## DEPRECIATION, AMORTIZATION, AND EXPENSING DEDUCTIONS

Depreciation is one of the most important business deductions available to an optometrist. To a lesser extent, amortization can be used to reduce taxable income as a claimed deduction.

### Depreciation

If business property that has a useful life of more than 1 year is purchased, its cost cannot be deducted as an expense when business income is determined for tax purposes. Instead, the cost must be spread over more than 1 year and deducted a portion at a time. This process is called depreciation and is a means of allowing the recovery of the cost over a period of years.

Depreciable property may be classified as either real or personal. Personal property is anything that is not real estate, whereas real property is the land and anything that is erected on, growing on, or attached to it. The land itself cannot be depreciated, only the structures or other things on it.

Property is depreciable if it meets the following three requirements:

- It must be used in business or held for the production of income.
- It must be something that wears out, decays, gets used up, becomes obsolete, or loses value from natural causes.

- It must be expected to last more than 1 year.

In general, if property does not meet these requirements, it is not depreciable.

Depreciation may only be deducted on property that is used for business purposes or held for the production of income; depreciation cannot be claimed on nonbusiness property such as a car that is used for commuting, vacations, or other nonbusiness activities. If property is used for both business and nonbusiness purposes, however, depreciation may be deducted for business use. Automobiles often are used for both purposes and are eligible for depreciation but only for the percent of use that is related to business.

For example, if an automobile used both for personal reasons and for the practice of optometry is driven 20,000 miles during the year, and 12,000 of these miles are for business purposes, the optometrist is entitled to use 60% (12,000 of 20,000) of the costs of operating the car for purposes of claiming a business deduction.

Depreciable property includes the following:

- Ophthalmic instruments and equipment
- Motor vehicles
- Furniture and furnishings
- Computers and other electronic equipment
- Computer software
- An office building
- Professional libraries
- Repairs or improvements to property that lengthen its life, make it more useful, or increase its value
- Patents and copyrights
- Restrictive covenants
- Franchises

Property that cannot be depreciated includes land, rented property, inventory, goodwill, and trademarks or trade names that already are in existence when purchased.

To calculate depreciation, three things must be known about the property: its basis, the date it was placed in service, and the method of depreciation to be applied.

### Basis

For property that is purchased, the original basis is its cost. Events often will change the basis of a piece of property to a value called the *adjusted basis*. Some events (e.g., permanent repairs or improvements) improve basis; others (e.g., casualty losses) decrease basis. If basis is adjusted, the depreciation deduction also may be affected.

### Date of Service

Property is considered to be placed in service when it is in a condition or state of readiness and availability for a specifically assigned function in a business. Depreciation begins when the property is first ready for service.

### Method of Depreciation

There are several types of depreciation that may be used for business property. Tangible property used by optometrists (automobiles, computers, furniture, instruments, and ophthalmic equipment) must be depreciated under the Modified

Accelerated Cost Recovery System (MACRS) unless another allowable method is elected. Because the MACRS does not include intangible property (goodwill, covenant not-to-compete, and trade names), this type of property must be amortized. A special first-year depreciation deduction for tangible property, the Section 179 deduction, also may be claimed.

## Modified Accelerated Cost Recovery System

In general, the method of depreciation that is used for tangible business property is the MACRS. This system requires that property be depreciated over a 3-, 5-, 7-, 10-, 15-, or 20-year period. There is no distinction made between new and used property; rather, the difference is between classes of assets. The 5- and 7-year periods include the types of assets that are most likely to be found in the practice of optometry (Box 39-7).

Deductions under the MACRS are calculated by multiplying the original basis in the property by a certain percentage that varies from year to year during the recovery period. The annual percentages for 5- and 7-year property are listed in Table 39-4. (It should be noted that the actual write-off periods are 6 and 8 years.)

For example, computers and peripheral equipment purchased for \$5,000 fall under 5-year property, with an original basis of \$5,000. The MACRS deduction for the first year is 20%, or \$1,000; for the second year the depreciation deduction is increased to 32%, or \$1,600. If computer software also is purchased for \$600, it has to be depreciated by the straightline method for 3 years (\$200 a year).

## Amortization

Intangible business assets of most significance to the practice of optometry cannot be depreciated under the MACRS and instead are subject to amortization.

Amortization provides for equal deductions over a period of years. Goodwill and covenants not-to-compete are intangible business assets and must be deducted over 15 years. For example, if \$45,000 of goodwill is part of the purchase price

**TABLE 39-4**

### Annual Percentages for 5- and 7-Year Property Under The Modified Accelerated Cost Recovery System

5-Year Property		7-Year Property	
Year	Percent Deductible	Year	Percent Deductible
1	20.00	1	14.29
2	32.00	2	24.49
3	19.20	3	17.49
4	11.52	4	12.49
5	11.52	5	8.93
6	5.76	6	8.92
		7	8.93
		8	4.46

Data from Internal Revenue Service, Publication 946: How to depreciate property.

of an optometric practice, the purchaser may claim a \$3,000 deduction each year for 15 years.

Patient records, even though they are tangible assets, also are required to be deducted in equal installments over a 15-year period. For example, if patient records are valued at \$60,000 in the purchase of an optometric practice, or for the records alone, the tax deduction allowed the purchaser would be \$4,000 per year for 15 years.

The recovery period for nonresidential real property is 39 years, and if an office building is purchased by an optometrist, the tax deduction for the purchase must be claimed over this period.

## Expensing (Section 179 Deduction)

A taxpayer may choose to treat the cost of depreciable property as an expense rather than as a capital expenditure. If the taxpayer elects to deduct the property as an expense as a Section 179 deduction, a sizable write-off may be claimed in the year the property is placed in service. This deduction may be claimed only once, in the first year of service, and the amount claimed must be subtracted from the basis of the property, thereby reducing the depreciation available in later years. The maximum amount that may be claimed, as of 2008, was \$250,000. (This amount is adjusted annually.) An example illustrating how the Section 179 deduction is calculated is provided in Box 39-8. There are limits on the amount of a Section 179 deduction that can be claimed for automobiles.

## Special Rules for Motor Vehicles

There are special rules that apply to depreciation deductions for automobiles or other motor vehicles used for business purposes. Motor vehicles are termed *listed property*, and although they are considered 5-year property, depreciable under the MACRS, there are special “caps” for write-offs that limit the amount of allowable depreciation. The dollar caps for automobiles are listed in Table 39-5. (For the 2008 tax year, “bonus” depreciation of \$8,000 was permitted for “luxury” vehicles

### BOX 39-7

#### Property Eligible for 5- and 7-Year Recovery Periods Under the Modified Accelerated Cost Recovery System (MACRS)

##### 5-YEAR PROPERTY

Automobiles and other vehicles used for business  
Computers and peripheral equipment  
Office machinery (e.g., calculators)

##### 7-YEAR PROPERTY

Office furniture and fixtures (e.g., desks, chairs, eyeglass display cabinets)  
Ophthalmic equipment and instruments

Data from Internal Revenue Service Publication 946: How to depreciate property.

**BOX 39-8****Use of the Section 179 Deduction**

If \$100,000 of ophthalmic equipment is purchased and put into service in 2008, the optometrist may elect to claim the entire amount as a Section 179 deduction:

- The \$100,000 reduces 2008 taxable income by that amount.
- There is no further depreciation deduction.

Or, the optometrist may elect to claim part of the purchase as a section 179 deduction:

- If \$60,000 is claimed the optometrist's 2008 taxable income is reduced by that amount.
- The second year MACRS depreciation deduction (for 2009) is calculated by reducing the basis by the amount previously deducted (\$100,000 minus \$60,000), and this adjusted basis (\$40,000) is multiplied by 25% (the second-year depreciation for 7-year property), so the MACRS depreciation deduction for the second year is \$10,000.
- Third and subsequent year MACRS depreciation deductions are calculated similarly.

used primarily for business purposes.) The depreciation caps are reduced, however, if the business use of the automobile is less than 100%, which is a certainty for an optometrist.

For example, if a self-employed optometrist buys a \$20,000 automobile that is used 60% for business purposes, the depreciable basis for the first year will be \$12,000 (60% of \$20,000). The first year cap is \$3,060, or 20% of the depreciable basis, whichever is less. The allowable deduction is \$2,400 (20% of \$12,000), which is less than the cap. If a vehicle is purchased for \$40,000, however, and used 60% of the time for business purposes, the depreciable basis is \$24,000 (60% of \$40,000), and the allowable deduction is \$3,060 because 20% of \$24,000 is \$4,800, which is higher than the cap.

If qualified use for business purposes does not exceed 50%, which is likely for an optometrist, then the MACRS cannot be used and the vehicle's depreciable basis must be recovered over 5 years using a straight-line depreciation method, which is

**TABLE 39-5**

**Depreciation Caps for Automobile Deductions Under the Modified Accelerated Cost Recovery System, 2008**

Year	Amount
1st year limit	\$3,060*
2nd year limit	\$4,900
3rd year limit	\$2,950
4th year limit	\$1,775
5th and later year limit	\$1,775

\* For the 2008 tax year, "bonus" depreciation of \$8,000 could be claimed in the first year for "luxury" automobiles used primarily for business purposes. For a vehicle used 100% for business purposes, the first year depreciation total was \$11,060.

Data from Internal Revenue Service Publication 463: Travel, entertainment, gift and car expenses.

similar to amortization. For example, if a vehicle is purchased for \$30,000 and used 25% for business purposes, the basis in the vehicle is \$7,500. The deduction must be claimed in equal amounts over a 5-year period (\$1,500 a year).

If the MACRS is originally claimed for a vehicle and during the recovery period business use decreases to 50% or less, part of the depreciation claimed in prior years is "recaptured," and the taxpayer must switch to a straight-line depreciation thereafter. Recaptured depreciation must be reported as ordinary income.

## Determining Expenses for Business Use of a Motor Vehicle

To obtain an accurate tax write-off, an optometrist should maintain an automobile log that records the miles traveled for business purposes. This mileage must be compared with the total miles traveled to determine the percent of business use. This percent is then applied to the actual costs of operating the vehicle (Box 39-9).

Instead of the actual costs of operating a vehicle, a taxpayer may deduct a flat amount, known as the *standard mileage rate*, based on the miles traveled for business purposes. This rate is changed every year (50½ cents in 2008). In addition to this rate, the taxpayer may include parking fees and tolls, loan interest, and state and local taxes (other than gas tax) that are related to business use of the vehicle. Ordinarily, the standard mileage deduction will not be as large as the write-off for depreciation and actual operating expenses, but for some taxpayers it may be the best option. It should be noted, however, that the standard mileage rate must be chosen in the first year to be claimed in subsequent years.

The calculation of the depreciation deduction is performed on Form 4562 (Figure 39-6). The total depreciation deduction is then transferred to Schedule C, where it is listed as a business expense.

## PAYMENTS TO INDEPENDENT CONTRACTORS

Optometrists regularly employ individuals in private practice. If the individuals are, in fact, *employees*, the optometrist will be required to withhold income, Social Security, and

**BOX 39-9****Actual Costs of Operating a Motor Vehicle**

- Gas, oil and tires
- Repairs
- Insurance
- Depreciation
- Interest on a loan taken out to buy the car
- Taxes
- Licenses and registration
- Garage rent, parking fees and tolls

Data from Internal Revenue Service Publication 463: Travel, entertainment, gift and car expenses.

Medicare taxes from their wages, pay unemployment tax on wages paid to an employee and pay applicable workers' compensation insurance. If the individuals are not employees, however, optometrists do not incur these obligations. These individuals are referred to as *independent contractors* (ICs).

The question as to whether an individual is an employee or an independent contractor is a legal one. It is generally held that an individual who performs services that are subject to the control of the employer—where the employer has the legal right to determine what duties are to be performed and how they are to be performed—is an employee. Whether the

Form <b>4562</b> Department of the Treasury Internal Revenue Service (99)	<b>Depreciation and Amortization</b> <b>(Including Information on Listed Property)</b> ▶ See separate instructions. ▶ Attach to your tax return.	OMB No. 1545-0172 <b>2008</b> Attachment Sequence No. 67								
Name(s) shown on return <u>John G O'Dee</u>		Business or activity to which this form relates <u>Optometry</u>								
		Identifying number <u>123 45 6789</u>								
<b>Part I Election To Expense Certain Property Under Section 179</b> Note: If you have any listed property, complete Part V before you complete Part I.										
1	Maximum amount. See the instructions for a higher limit for certain businesses . . . . .	1 \$250,000								
2	Total cost of section 179 property placed in service (see instructions) . . . . .	2 40,000								
3	Threshold cost of section 179 property before reduction in limitation (see instructions) . . . . .	3 \$800,000								
4	Reduction in limitation. Subtract line 3 from line 2. If zero or less, enter -0- . . . . .	4 0								
5	Dollar limitation for tax year. Subtract line 4 from line 1. If zero or less, enter -0-. If married filing separately, see instructions . . . . .	5 250,000								
<table border="1" style="width:100%; border-collapse: collapse;"> <tr> <th style="width:40%;">(a) Description of property</th> <th style="width:20%;">(b) Cost (business use only)</th> <th style="width:20%;">(c) Elected cost</th> <th style="width:20%;"></th> </tr> <tr> <td>6</td> <td></td> <td></td> <td></td> </tr> </table>			(a) Description of property	(b) Cost (business use only)	(c) Elected cost		6			
(a) Description of property	(b) Cost (business use only)	(c) Elected cost								
6										
7	Listed property. Enter the amount from line 29 . . . . .	7 10,000								
8	Total elected cost of section 179 property. Add amounts in column (c), lines 6 and 7 . . . . .	8 10,000								
9	Tentative deduction. Enter the smaller of line 5 or line 8. . . . .	9 10,000								
10	Carryover of disallowed deduction from line 13 of your 2007 Form 4562 . . . . .	10								
11	Business income limitation. Enter the smaller of business income (not less than zero) or line 5 (see instructions) . . . . .	11 250,000								
12	Section 179 expense deduction. Add lines 9 and 10, but do not enter more than line 11 . . . . .	12 10,000								
13	Carryover of disallowed deduction to 2009. Add lines 9 and 10, less line 12 ▶ . . . . .	13								
Note: Do not use Part II or Part III below for listed property. Instead, use Part V.										
<b>Part II Special Depreciation Allowance and Other Depreciation (Do not include listed property.) (See instructions.)</b>										
14	Special depreciation allowance for qualified property (other than listed property) placed in service during the tax year (see instructions) . . . . .	14								
15	Property subject to section 168(f)(1) election . . . . .	15								
16	Other depreciation (including ACRS) . . . . .	16								
<b>Part III MACRS Depreciation (Do not include listed property.) (See instructions.)</b>										
<b>Section A</b>										
17	MACRS deductions for assets placed in service in tax years beginning before 2008 . . . . .	17								
18	If you are electing to group any assets placed in service during the tax year into one or more general asset accounts, check here ▶ <input type="checkbox"/>									
<b>Section B—Assets Placed in Service During 2008 Tax Year Using the General Depreciation System</b>										
(a)	(b)	(c)	(d)	(e)	(f)	(g)				
Classification of property	Month and year placed in service	Basis for depreciation (business/investment use only—see instructions)	Recovery period	Convention	Method	Depreciation deduction				
19a	3-year property									
b	5-year property									
c	7-year property									
d	10-year property									
e	15-year property									
f	20-year property									
g	25-year property		25 yrs.		S/L					
h	Residential rental property		27.5 yrs.	MM	S/L					
i	Nonresidential real property		27.5 yrs.	MM	S/L					
			39 yrs.	MM	S/L					
				MM	S/L					
<b>Section C—Assets Placed in Service During 2008 Tax Year Using the Alternative Depreciation System</b>										
20a	Class life				S/L					
b	12-year		12 yrs.		S/L					
c	40-year		40 yrs.	MM	S/L					
<b>Part IV Summary (See instructions.)</b>										
21	Listed property. Enter amount from line 28 . . . . .	21 6165								
22	Total. Add amounts from line 12, lines 14 through 17, lines 19 and 20 in column (g), and line 21. Enter here and on the appropriate lines of your return. Partnerships and S corporations—see instr. . . . .	22 16,165								
23	For assets shown above and placed in service during the current year, enter the portion of the basis attributable to section 263A costs . . . . .	23								
For Paperwork Reduction Act Notice, see separate instructions. <span style="float: right;">Cat. No. 12906N Form 4562 (2008)</span>										

FIGURE 39-6 Sample Form 4562.

Form 4562 (2008) Page **2**

**Part V Listed Property** (Include automobiles, certain other vehicles, cellular telephones, certain computers, and property used for entertainment, recreation, or amusement.)  
**Note:** For any vehicle for which you are using the standard mileage rate or deducting lease expense, complete only 24a, 24b, columns (a) through (c) of Section A, all of Section B, and Section C if applicable.

**Section A—Depreciation and Other Information** (Caution: See the instructions for limits for passenger automobiles.)

**24a** Do you have evidence to support the business/investment use claimed?  Yes  No **24b** If "Yes," is the evidence written?  Yes  No

(a) Type of property (list vehicles first)	(b) Date placed in service	(c) Business/investment use percentage	(d) Cost or other basis	(e) Basis for depreciation (business/investment use only)	(f) Recovery period	(g) Method/Convention	(h) Depreciation deduction	(i) Elected section 179 cost
<b>25</b> Special depreciation allowance for qualified listed property placed in service during the tax year and used more than 50% in a qualified business use (see instructions) . . . . . <b>25</b>								
<b>26</b> Property used more than 50% in a qualified business use:								
equipment	1-2008	100%	40,000	30,000	7	200DB	4290	10,000
		%						
		%						
<b>27</b> Property used 50% or less in a qualified business use:								
automobile	1-2008	37%	25,000	9375	5	S/L -	1875	
		%				S/L -		
		%				S/L -		
<b>28</b> Add amounts in column (h), lines 25 through 27. Enter here and on line 21, page 1. . . . . <b>28</b>							6165	
<b>29</b> Add amounts in column (i), line 26. Enter here and on line 7, page 1. . . . . <b>29</b>								10,000

**Section B—Information on Use of Vehicles**  
 Complete this section for vehicles used by a sole proprietor, partner, or other "more than 5% owner," or related person. If you provided vehicles to your employees, first answer the questions in Section C to see if you meet an exception to completing this section for those vehicles.

	(a) Vehicle 1		(b) Vehicle 2		(c) Vehicle 3		(d) Vehicle 4		(e) Vehicle 5		(f) Vehicle 6	
	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No
<b>30</b> Total business/investment miles driven during the year (do not include commuting miles) . . . . .	6,000											
<b>31</b> Total commuting miles driven during the year . . . . .	9,000											
<b>32</b> Total other personal (noncommuting) miles driven . . . . .	1,000											
<b>33</b> Total miles driven during the year. Add lines 30 through 32 . . . . .	16,000											
<b>34</b> Was the vehicle available for personal use during off-duty hours? . . . . .	<input checked="" type="checkbox"/>											
<b>35</b> Was the vehicle used primarily by a more than 5% owner or related person? . . . . .	<input checked="" type="checkbox"/>											
<b>36</b> Is another vehicle available for personal use? . . . . .	<input checked="" type="checkbox"/>											

**Section C—Questions for Employers Who Provide Vehicles for Use by Their Employees**  
 Answer these questions to determine if you meet an exception to completing Section B for vehicles used by employees who are not more than 5% owners or related persons (see instructions).

	Yes	No
<b>37</b> Do you maintain a written policy statement that prohibits all personal use of vehicles, including commuting, by your employees? . . . . .		
<b>38</b> Do you maintain a written policy statement that prohibits personal use of vehicles, except commuting, by your employees? See the instructions for vehicles used by corporate officers, directors, or 1% or more owners . . . . .		
<b>39</b> Do you treat all use of vehicles by employees as personal use? . . . . .		
<b>40</b> Do you provide more than five vehicles to your employees, obtain information from your employees about the use of the vehicles, and retain the information received? . . . . .		
<b>41</b> Do you meet the requirements concerning qualified automobile demonstration use? (See instructions.) <b>Note:</b> If your answer to 37, 38, 39, 40, or 41 is "Yes," do not complete Section B for the covered vehicles.		

**Part VI Amortization**

(a) Description of costs	(b) Date amortization begins	(c) Amortizable amount	(d) Code section	(e) Amortization period or percentage	(f) Amortization for this year
<b>42</b> Amortization of costs that begins during your 2008 tax year (see instructions):					
<b>43</b> Amortization of costs that began before your 2008 tax year. . . . . <b>43</b>					
<b>44</b> Total. Add amounts in column (f). See the instructions for where to report. . . . . <b>44</b>					

Form **4562** (2008)

FIGURE 39-6 –Cont'd

employer chooses to exercise this right is not the determining factor, nor is the description given to the individual (e.g., partner, agent, employee, independent contractor), nor even how the individual is paid (i.e., for full-time or part-time employment). This issue is further complicated with regard to licensed professionals where the IRS recognizes that an optometric

license is required and that the business itself can not provide that license – providing weight to the argument for independent contractor status. The IRS has issued guidelines for identifying independent contractors that are based on three criteria: behavioral control, financial control, and the type of relationship between the parties.

Behavioral control shows whether the employer has a right to direct and control how the employee or independent contractor performs the tasks for which the employee or independent contractor is being paid and assesses the type and degree of instructions and training being provided by the employer.

Financial control describes the extent that the employer controls business aspects of the employee or independent contractor's job (e.g., reimbursement for business expenses, opportunity to invest in the business, availability to provide services to others, method of payment for services, and ability to realize a profit or loss).

The type of relationship shows whether the agreement or contract between the parties is similar to an employment contract, and whether the employer provides employee-type benefits (e.g., insurance, pension plan, vacation or sick pay), and the permanency of the relationship.

These three criteria are weighed as if on a balancing scale – if the scale tips more towards employee status than independent contractor status then the arrangement is probably that of employer and employee. For example, if an employed optometrist does not make professional decisions about patient care or materials, continuing education is paid for by the employer, reimbursement is granted for business-related expenses, the opportunity to work for others is not allowed, liability insurance is purchased by the employer, and the employment can continue indefinitely, the relationship would likely be deemed that of employer and employee.

IRS Form SS-8, Determination of Worker Status for Purposes of Federal Employment, Taxes and Income Tax Withholding, may be filed by either an employer or employee in order to request that the IRS review the facts and circumstances and officially determine the status of an employee. It can take at least 6 months to get a determination.

If an individual is deemed to be an independent contractor, the wages paid to the individual are reported to the IRS on Form 1099, and there usually is no tax withholding. The independent contractor reports these wages on Form 1040 and is responsible for the payment of income and Social Security/Medicare taxes as a self-employed individual. (See Calculating and Paying Income Taxes for Self-Employed Individuals later in this chapter).

## TAX REPORTING

An employer is responsible for the payment of business taxes to federal and state governments. Taxes must be paid for income to the Social Security/Medicare system and the unemployment compensation system. In all but nine jurisdictions, this system is two-tiered, requiring payment to both federal and state governments (only Alaska, Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas, Wyoming, and Washington do not have state income taxes), and the tax reporting itself is “pay as you go,” requiring both quarterly and annual payments from the practitioner. These obligations, which are summarized in Table 39-6, are described in terms of current federal reporting requirements (state obligations are too varied

**TABLE 39-6**

### Federal Tax Reporting Deadlines

You May Be Liable For	If You Are	Use Form	Due On or Before
Income Tax	Sole proprietor	Schedule C (Form 1040)	Same day as Form 1040
	Individual who is a partner, LLC owner, or S corporation shareholder	1040	15th day of 4th month after end of tax year
	Corporation	1120 or 1120-A	15th day of 3rd month after end of tax year
	S corporation	1120S	15th day of 3rd month after end of tax year
Self-employment tax	Sole proprietor or individual who is a partner	Schedule SE (Form 1040)	Same day as Form 1040
Estimated tax	Sole proprietor or individual who is a partner or S corporation shareholder	1040-ES	15th day of 4th, 6th, and 9th months of tax year, and 15th day of 1st month after the end of tax year
	Corporation	1120-W	15th day of 4th, 6th, 9th, and 12th months of tax year
Annual reporting of income	Partnership or LLC	1065	15th day of 4th month after end of tax year
Social security (FICA) tax and the withholding of income tax	Sole proprietor, corporation, LLC, S corporation, or partnership	941 and 8109 (to make deposits)	April 30, July 31, October 31, and January 31
Providing information on Social Security (FICA) tax and the withholding of income tax	Sole proprietor, corporation, LLC, S corporation or partnership	W-2 (to employee) W-2 and W-3 (to the SSA)	January 31 Last day of February
Federal unemployment tax (FUTA)	Sole proprietor, corporation, LLC, S corporation, or partnership	940 and 8109 (to make deposits)	January 31, April 30, July 31, October 31, and January 31, but only if the liability for unpaid tax is more than \$500
Information returns	Sole proprietor, corporation, LLC, S corporation, or partnership transactions with other persons	Form 1099—to the recipient by January 31	For payments to non-employees and to the Internal Revenue Service by February 28

Data from Internal Revenue Service: *Tax guide for small business*, Washington, DC, 2007, US Government Printing Office.

for inclusion). Because tax law is among the most ephemeral legislation enacted by government, current tax information and advice should be regularly obtained to ensure accuracy.

## Tax Reporting for Business Organizations

An optometry practice will be organized to do business as a business entity, and this entity's annual tax reporting will depend on the type of business organization being used—individual proprietorship, general partnership, LLC, professional association or corporation (PA or PC), or S corporation—in accordance with IRS requirements. The business entity will first need to secure a federal tax identification number, which is used for the payment of both federal and state business income taxes; any business tax return or tax deposit, transfer, or payment must include the employer identification number of the entity. This number may be obtained by completing Form SS-4, Application for Employer Identification Number, and submitting it to the IRS (for an example, see Figure 39-4). An employer identification number can also be obtained online by accessing the IRS Website, [www.irs.gov](http://www.irs.gov).

Tax reporting for business organizations varies from the relatively simple (individual proprietor) to the highly complex (corporation).

### *Individual Proprietorship*

If an optometrist practices as an individual proprietor, the business income and allowable deductions are computed on Schedule C. The business profit or loss calculated on this schedule is entered on the optometrist's Form 1040 and used to determine the optometrist's income tax.

### *Partnership*

If an optometrist is in a general partnership, the partnership must determine its income and the distributive share of profit or loss received by the partners on a partnership return, Form 1065. The profit or loss received by the individual partners from the partnership is reported on Schedule K-1, a copy of which is attached to each partner's individual Form 1040. Income tax is not paid by the partnership, only by the partners, who are taxed on the profit or loss they report.

### *Limited Liability Company*

A one-practitioner LLC is considered a sole proprietorship for tax purposes; the LLC pays no tax, but profits are calculated on the practitioner's Schedule C, which is attached to Form 1040. Multiple-owner LLCs are partnerships, and the LLC submits a Form 1065 that reports income and the distribution of profit or loss and provides a Schedule K-1 for each of the owners, who file individual Form 1040s.

### *Professional Association or Corporation*

If an optometrist is a shareholder in a PA or PC, the association or corporation is regarded as a separate, tax-paying entity, which must report all business income and claim all business deductions on Form 1120. The optometrist-shareholder also is the employee of the association or corporation, which

withholds the optometrist's income tax and issues the optometrist a W-2 form at the conclusion of the tax year, just as for any other employee. The optometrist reports this income on Form 1040; claims allowable personal adjustments, exemptions, or deductions; and calculates the additional tax payment or refund. With a PA or PC therefore both the association or corporation and the optometrist may pay income taxes (the "double tax").

### *S Corporation*

Although an S corporation pays no taxes, it must file a return on Form 1120S, reporting income, expenses, and profit or loss distributions to shareholders. Each shareholder receives a Schedule K-1, which reports that individual's share of the S corporation income and is attached to Form 1040.

Although all types of business entities used for the practice of optometry must file tax returns, only a professional association or corporation is actually responsible for the payment of income taxes; for the other types of business organizations the tax return reports the profit or loss earned the optometrist, who pays the tax.

## CALCULATING INCOME TAXES FOR EMPLOYEES

Once an employee identification number is obtained, a Federal Tax Deposit (FTD) coupon book containing preprinted Form 8109 is mailed by the IRS to the business entity. There is a blank coupon, Form 8109-B, which can be used if necessary before the preprinted ones have been received. The IRS automatically sends replacement coupon books periodically. FTD coupons must be used when payroll tax deposits are made. An employer must establish a bank account at an authorized financial institution or a Federal Reserve Bank for these tax deposits and payments. In order to simplify this process business owners frequently contract with payroll services to perform payroll processing, employee tax preparation, payroll tax deposit and filing, online reports and pay statements, general ledger interface, direct deposits, workers' compensation insurance premium management, wage garnishment processing and unemployment compensation management. Examples of full service payroll and employee tax reporting services are Advantage Payroll Services, Automatic Data Processing, Inc. (ADP), Complete Payroll Processing (CPP), and Paychex. Some banks also provide these services, such as Bank of America.

To determine the appropriate withholding of federal, state, and local income taxes, every new employee has to file a Form W-4, Employee's Withholding Allowance Certificate (Figure 39-7). The W-4 form should be completed by the employee on or before the first day of employment.

The W-4 form requires the employee to claim a specific number of "withholding allowances" (this number usually equals the number of exemptions the employee is entitled to). The number of allowances claimed affects the amount of taxes to be withheld and should be changed if the employee has to pay a sizable amount of taxes at the end of the tax year; if the employee receives a sizable tax refund; or if the employee's marital status changes during the year.

### Form W-4 (2009)

**Purpose.** Complete Form W-4 so that your employer can withhold the correct federal income tax from your pay. Consider completing a new Form W-4 each year and when your personal or financial situation changes.

**Exemption from withholding.** If you are exempt, complete only lines 1, 2, 3, 4, and 7 and sign the form to validate it. Your exemption for 2009 expires February 16, 2010. See Pub. 505, Tax Withholding and Estimated Tax.

**Note.** You cannot claim exemption from withholding if (a) your income exceeds \$950 and includes more than \$300 of unearned income (for example, interest and dividends) and (b) another person can claim you as a dependent on their tax return.

**Basic instructions.** If you are not exempt, complete the **Personal Allowances Worksheet** below. The worksheets on page 2 further adjust your withholding allowances based on itemized deductions, certain credits, adjustments to income, or two-earner/multiple job situations.

Complete all worksheets that apply. However, you may claim fewer (or zero) allowances. For regular wages, withholding must be based on allowances you claimed and may not be a flat amount or percentage of wages.

**Head of household.** Generally, you may claim head of household filing status on your tax return only if you are unmarried and pay more than 50% of the costs of keeping up a home for yourself and your dependent(s) or other qualifying individuals. See Pub. 501, Exemptions, Standard Deduction, and Filing Information, for information.

**Tax credits.** You can take projected tax credits into account in figuring your allowable number of withholding allowances. Credits for child or dependent care expenses and the child tax credit may be claimed using the **Personal Allowances Worksheet** below. See Pub. 919, How Do I Adjust My Tax Withholding, for information on converting your other credits into withholding allowances.

**Nonwage income.** If you have a large amount of nonwage income, such as interest or dividends, consider making estimated tax payments using Form 1040-ES, Estimated Tax for Individuals. Otherwise, you may owe additional tax. If you have pension or annuity income, see Pub. 919 to find out if you should adjust your withholding on Form W-4 or W-4P.

**Two earners or multiple jobs.** If you have a working spouse or more than one job, figure the total number of allowances you are entitled to claim on all jobs using worksheets from only one Form W-4. Your withholding usually will be most accurate when all allowances are claimed on the Form W-4 for the highest paying job and zero allowances are claimed on the others. See Pub. 919 for details.

**Nonresident alien.** If you are a nonresident alien, see the Instructions for Form 8233 before completing this Form W-4.

**Check your withholding.** After your Form W-4 takes effect, use Pub. 919 to see how the amount you are having withheld compares to your projected total tax for 2009. See Pub. 919, especially if your earnings exceed \$130,000 (Single) or \$180,000 (Married).

**Personal Allowances Worksheet (Keep for your records.)**

**A** Enter "1" for yourself if no one else can claim you as a dependent . . . . . **A** 1

**B** Enter "1" if:   
 • You are single and have only one job; or   
 • You are married, have only one job, and your spouse does not work; or   
 • Your wages from a second job or your spouse's wages (or the total of both) are \$1,500 or less. . . . . **B** 1

**C** Enter "1" for your spouse. But, you may choose to enter "-0-" if you are married and have either a working spouse or more than one job. (Entering "-0-" may help you avoid having too little tax withheld.) . . . . . **C** 1

**D** Enter number of dependents (other than your spouse or yourself) you will claim on your tax return . . . . . **D** 1

**E** Enter "1" if you will file as head of household on your tax return (see conditions under Head of household above) . . . . . **E** \_\_\_\_\_

**F** Enter "1" if you have at least \$1,800 of child or dependent care expenses for which you plan to claim a credit . . . . . **F** \_\_\_\_\_

**G Child Tax Credit** (including additional child tax credit). See Pub. 972, Child Tax Credit, for more information.   
 • If your total income will be less than \$61,000 (\$90,000 if married), enter "2" for each eligible child; then less "1" if you have three or more eligible children.   
 • If your total income will be between \$61,000 and \$84,000 (\$90,000 and \$119,000 if married), enter "1" for each eligible child plus "1" additional if you have six or more eligible children. . . . . **G** 2

**H** Add lines A through G and enter total here. (Note. This may be different from the number of exemptions you claim on your tax return.) ▶ **H** 6

For accuracy, complete all worksheets that apply.   
 • If you plan to itemize or claim adjustments to income and want to reduce your withholding, see the **Deductions and Adjustments Worksheet** on page 2.   
 • If you have more than one job or are married and you and your spouse both work and the combined earnings from all jobs exceed \$40,000 (\$25,000 if married), see the **Two-Earners/Multiple Jobs Worksheet** on page 2 to avoid having too little tax withheld.   
 • If neither of the above situations applies, stop here and enter the number from line H on line 5 of Form W-4 below.

Cut here and give Form W-4 to your employer. Keep the top part for your records.

---

Form **W-4** **Employee's Withholding Allowance Certificate** OMB No. 1545-0074

Department of the Treasury Internal Revenue Service **2009**

▶ Whether you are entitled to claim a certain number of allowances or exemption from withholding is subject to review by the IRS. Your employer may be required to send a copy of this form to the IRS.

**1** Type or print your first name and middle initial. Last name **2** Your social security number   
 Hardy I Worker 876 : 54 : 3210

Home address (number and street or rural route) **3**  Single  Married  Married, but withhold at higher Single rate.   
 1040 Labor Lane Note. If married, but legally separated, or spouse is a nonresident alien, check the "Single" box.

City or town, state, and ZIP code **4** If your last name differs from that shown on your social security card, check here. You must call 1-800-772-1213 for a replacement card. ▶    
 Anytown, ST 12345

**5** Total number of allowances you are claiming (from line H above or from the applicable worksheet on page 2) **5** 6   
**6** Additional amount, if any, you want withheld from each paycheck **6** \$ 0

**7** I claim exemption from withholding for 2009, and I certify that I meet both of the following conditions for exemption.   
 • Last year I had a right to a refund of all federal income tax withheld because I had no tax liability and   
 • This year I expect a refund of all federal income tax withheld because I expect to have no tax liability.   
 If you meet both conditions, write "Exempt" here ▶ **7** 7

Under penalties of perjury, I declare that I have examined this certificate and to the best of my knowledge and belief, it is true, correct, and complete.

Employee's signature (Form is not valid unless you sign it.) ▶ Hardy I Worker Date ▶ 1 Jan 2009

**8** Employer's name and address (Employer: Complete lines 8 and 10 only if sending to the IRS.) **9** Office code (optional) **10** Employer identification number (EIN)   
 John G O'Dee, 123 Eye Street, Anytown, ST 123 : 45 6789

For Privacy Act and Paperwork Reduction Act Notice, see page 2. Cat. No. 10220Q Form **W-4** (2009)

FIGURE 39-7 Sample W-4 form and instructions for determination of withholding.

Similarly, the employee must fill out a state withholding allowance certificate so that the correct state income tax deduction can be made (unless the state does not tax income). There may be a local income tax to be withheld as well (county or municipal tax).

The employer may need to make deductions from an employee's gross income, such as contributions to a retirement plan (e.g., individual retirement account, 401[k] plan, health insurance plan), and these deductions reduce the income on which taxes must be calculated.

To determine the amount of federal income taxes to be deducted for each employee, Circular E (Publication 15) must be used. Withholding is based on gross wages and is usually calculated by using either the wage bracket or the percentage method. Wage bracket tables for income taxes are included in Circular E; for each wage level and number of allowances claimed, the amount to be withheld is listed. Under the percentage method, the employee's gross wages and number of allowances are used to calculate the withholding, based on the percentages listed in Circular E.

Gross income and tax deductions are reported at the end of the year to the employee (and the IRS) on Form W-2, Wage and Tax Statement (Figure 39-8).

### CALCULATING SOCIAL SECURITY AND MEDICARE TAXES FOR EMPLOYEES

The Federal Insurance Contributions Act (FICA) provides for a federal system of old age, survivors, and disability insurance. This system is financed through Social Security taxes, which are deducted from the employee's wages on a percentage basis, up to a certain maximum income. A similar tax system exists for Medicare, which provides health care benefits to persons 65 years and older and hospital insurance, except there is no maximum income ceiling.

Although the percentage of gross income that must be paid to Social Security and Medicare for an employee is 15.3% of gross

wages, only half is withdrawn from the wages of the employee; an equal percentage must be contributed by the employer.

### Social Security Tax

The percentage that must be paid to Social Security by employees is 6.2%, which is imposed on wages up to an earnings ceiling that changes annually (Table 39-7). If income exceeds the earnings ceiling, no tax is applied to the excess amount. The employer is also required to contribute 6.2% of wages; thus the total that must be paid as Social Security retirement taxes for each employee is 12.4% of the employee's wages, with the employer and employee contributing equally.

### Medicare Tax

Since 1991 a specific percentage of the Social Security tax has been payable to Medicare, 2.9% of gross wages, and as of 1994 there is no earnings ceiling applied to this part of the tax. Employer and employee each contribute 1.45% of gross wages.

For example, if an employee earns \$50,000 in gross income, 12.4% or \$6,200 will be contributed to Social Security and 2.9% or \$1,450 will be contributed to Medicare. The employer and employee will contribute equally, 7.65% or \$3,825, to payment of these taxes.

Although deductions such as contributions to a retirement plan or health insurance plan reduce gross income for purposes

22222		Void <input type="checkbox"/>	Employee's social security number 123-45-6789		For Official Use Only ▶ OMB No. 1545-0008		
b Employer identification number (EIN) 94-1234567			1 Wages, tips, other compensation 133034.36		2 Federal income tax withheld 21603.36		
c Employer's name, address, and ZIP code Hill side Vision Group 1234 California St. San Francisco, CA 94111			3 Social security wages 102000.00		4 Social security tax withheld 6324.00		
			5 Medicare wages and tips 153534.36		6 Medicare tax withheld 2226.25		
			7 Social security tips		8 Allocated tips		
d Control number			9 Advance EIC payment		10 Dependent care benefits		
e Employee's first name and initial Diane B		Last name Goodvision		Suff.		11 Nonqualified plans	
2020 Birch Lane Berkeley, CA 94703			12a See instructions for box 12 C 847.44		12b D 20500.00		
			13 Statutory employee <input type="checkbox"/> Retirement plan <input checked="" type="checkbox"/> Third-party sick pay <input type="checkbox"/>		12c		
			14 Other FSAPA 2313.00 CASDI 693.58		12d		
f Employee's address and ZIP code			15 State Employer's state ID number CA 435-1234-5		16 State wages, tips, etc. 133034.36		
			17 State income tax 7387.99		18 Local wages, tips, etc.		
			19 Local income tax		20 Locality name		

**Form W-2 Wage and Tax Statement 2008** Department of the Treasury—Internal Revenue Service  
 Copy A For Social Security Administration — Send this entire page with Form W-3 to the Social Security Administration; photocopies are not acceptable.  
 For Privacy Act and Paperwork Reduction Act Notice, see back of Copy D. Cat. No. 10134D

**Do Not Cut, Fold, or Staple Forms on This Page — Do Not Cut, Fold, or Staple Forms on This Page**

FIGURE 39-7 Sample W-4 form and instructions for determination of withholding.

TABLE 39-7

**Social Security and Medicare Tax Rates and Earnings Ceilings, 1998-2008**

EMPLOYER OR EMPLOYEE CONTRIBUTIONS*				
	Year	Earning Ceiling For Tax	Tax Rate	Maximum Contributions
Social Security	1998	\$68,400	6.20%	\$4,240
Medicare		No ceiling	1.45%	No limit
Social Security	1999	\$72,600	6.20%	\$4,501
Medicare		No ceiling	1.45%	No limit
Social Security	2000	\$76,200	6.20%	\$4,724
Medicare		No ceiling	1.45%	No limit
Social Security	2001	\$80,400	6.20%	\$4,985
Medicare		No ceiling	1.45%	No limit
Social Security	2002	\$84,900	6.20%	\$5,263
Medicare		No ceiling	1.45%	No limit
Social Security	2003	\$87,000	6.20%	\$5,394
Medicare		No ceiling	1.45%	No limit
Social Security	2004	\$87,900	6.20%	\$5,450
Medicare		No ceiling	1.45%	No limit
Social Security	2005	\$90,000	6.20%	\$5,580
Medicare		No ceiling	1.45%	No limit
Social Security	2006	\$94,200	6.20%	\$5,840
Medicare		No ceiling	1.45%	No limit
Social Security	2007	\$97,500	6.20%	\$6,045
Medicare		No ceiling	1.45%	No limit
Social Security	2008	\$102,000	6.20%	\$6,324
Medicare		No ceiling	1.45%	No limit

\*These payments represent one-half of the annual tax; both employer and employee contribute equal amounts. For example, an employee receiving a salary of \$50,000 would contribute \$3,825 ( $\$50,000 \times 7.65\%$ ), and the employer also would contribute \$3,825. The total paid would be \$7,650.

of income taxation, they do not reduce gross income for purposes of calculating Social Security/Medicare taxation. For example, if an employee had gross income of \$100,000, but contributed \$10,000 to a 401(k) plan, the gross income for purposes of calculating income tax would be lowered to \$90,000. For calculation of Social Security/Medicare taxes, however, there would be no deduction, and 15.3% of \$100,000 would have to be paid, with employer and employee contributing equally.

## DEPOSIT AND PAYMENT OF TAXES FOR EMPLOYEES

Employers are required by law to withhold income and Social Security/Medicare taxes, and a failure to do so on the part of the employer will result in the employer's personal liability for payment. The money withheld for income taxes and for Social Security/Medicare taxes must be deposited periodically in a federal reserve bank. The deposit period for employers who collect less than \$50,000 annually is monthly; for those who collect more than \$50,000 it is semi-weekly (twice a week). Each deposit must be accompanied by FTD coupon, Form 8109. Penalties are applied to late deposits, ranging from 2% of the amount (up to 5 days late) to 10% (more than 15 days late).

The Electronic Federal Tax Payment System can be used to deposit and pay these taxes online.

Withheld taxes must be forwarded to the IRS on a quarterly basis. The federal income and Social Security/Medicare taxes for employees are reported together and sent to the IRS on Form 941, Employer's Quarterly Federal Tax Return (Figure 39-9). This form (and the payment, for which there is a voucher) must be submitted within a month of the end of each calendar quarter, which is April 30, July 31, October 31, and January 31. Penalties are applied for late payments, and interest is charged on the overdue amount. In addition, the employer must give W-2 forms reporting income and Social Security/Medicare tax deductions to employees by January 31 following the end of the tax year. For independent contractors, who usually require no withholding, Form 1099 is used by employers to report the income paid, with copies provided to the IRS and the independent contractor, also by January 31.

## CALCULATING AND PAYING INCOME TAXES FOR SELF-EMPLOYED INDIVIDUALS

Federal income tax reporting for a self-employed individual, such as a sole proprietor, requires quarterly payments to the federal government. The deadlines for payment of these taxes are (for practitioners on a calendar year): April 15, June 15, September 15, and January 15 (Table 39-6). At each quarterly payment, the optometrist must submit the proper amount of income taxes, accompanied by a payment voucher. Failure to make payment, or submission of an improper payment, can result in a penalty. These quarterly tax payments can be made through the IRS Electronic Federal Tax Payment System, which allows access to the history of payments made.

To estimate the income tax due, a practitioner can use Form 1040-ES, Estimated Tax for Individuals, which contains a worksheet that allows self-employed optometrists to estimate their income (and Social Security/Medicare) taxes (Figure 39-10). This worksheet can be recalculated and resubmitted with each quarterly payment.

These quarterly payments are estimates of annual income tax. At the conclusion of the tax year, the optometrist is obligated to calculate the exact amount of income tax owed. For a sole proprietor, the business income and any necessary and ordinary business deductions are listed on Schedule C (Figure 39-5), and the profit or loss so determined is then entered on Form 1040.

After adjustments, exemptions, and deductions are calculated and subtracted, the income tax is determined. The estimated income taxes that have been paid quarterly are then subtracted from the income tax owed, and if the result is less than the amount owed, an additional payment must be made to the IRS. The estimated income payments must have been more than 90% of the final amount due or a penalty may be imposed. If the taxes paid exceed the amount actually owed, the optometrist receives a refund.

State business income tax for individual proprietors usually is determined by the profit or loss calculated on Schedule C.

**Form 941 for 2009: Employer's QUARTERLY Federal Tax Return** 950109  
 (Rev. January 2009) Department of the Treasury — Internal Revenue Service OMB No. 1545-0029

(EIN) Employer identification number   -

Name (not your trade name)

Trade name (if any)

Address

Report for this Quarter of 2009 (Check one.)  
 1: January, February, March  
 2: April, May, June  
 3: July, August, September  
 4: October, November, December

Read the separate instructions before you complete Form 941. Type or print within the boxes.

**Part 1: Answer these questions for this quarter.**

1 Number of employees who received wages, tips, or other compensation for the pay period including: Mar. 12 (Quarter 1), June 12 (Quarter 2), Sept. 12 (Quarter 3), Dec. 12 (Quarter 4) 1

2 Wages, tips, and other compensation 2

3 Income tax withheld from wages, tips, and other compensation 3

4 If no wages, tips, and other compensation are subject to social security or Medicare tax  Check and go to line 6.

5 Taxable social security and Medicare wages and tips:

	Column 1		Column 2
5a Taxable social security wages	<input type="text" value="5775 ."/>	× .124 =	<input type="text" value="716 ."/>
5b Taxable social security tips	<input type="text" value="."/>	× .124 =	<input type="text" value="."/>
5c Taxable Medicare wages & tips	<input type="text" value="5775 ."/>	× .029 =	<input type="text" value="167 ."/>

5d Total social security and Medicare taxes (Column 2, lines 5a + 5b + 5c = line 5d) 5d

6 Total taxes before adjustments (lines 3 + 5d = line 6) 6

7 CURRENT QUARTER'S ADJUSTMENTS, for example, a fractions of cents adjustment. See the instructions.

7a Current quarter's fractions of cents

7b Current quarter's sick pay

7c Current quarter's adjustments for tips and group-term life insurance

7d TOTAL ADJUSTMENTS. Combine all amounts on lines 7a through 7c 7d

8 Total taxes after adjustments. Combine lines 6 and 7d 8

9 Advance earned income credit (EIC) payments made to employees 9

10 Total taxes after adjustment for advance EIC (line 8 - line 9 = line 10) 10

11 Total deposits for this quarter, including overpayment applied from a prior quarter and overpayment applied from Form 941-X or Form 944-X

12a COBRA premium assistance payments (see instructions)

12b Number of individuals provided COBRA premium assistance reported on line 12a

13 Add lines 11 and 12a 13

14 Balance due. If line 10 is more than line 13, write the difference here 14

15 Overpayment. If line 13 is more than line 10, write the difference here

Apply to next return.  
 Send a refund.

▶ You MUST complete both pages of Form 941 and SIGN it. **Next** →


For Privacy Act and Paperwork Reduction Act Notice, see the back of the Payment Voucher. Cat. No. 17001Z Form 941 (Rev. 1-2009)

FIGURE 39-9 Sample Form 941.

The optometrist lists the profit or loss on the state income tax return; computes the allowable adjustments, exemptions and deductions; and determines the tax due. From this amount the optometrist may subtract the quarterly estimated taxes paid to the state government. If payment is less than the income tax

owed, additional payment must be made; if it is more, a refund may be collected.

For a self-employed practitioner, such as an individual proprietor, the payment of income tax is intimately connected to the payment of Social Security/Medicare taxes.

**2009 Estimated Tax Worksheet** Keep for Your Records 

<b>1</b> Adjusted gross income you expect in 2009 (see instructions below)	<b>1</b>		150,000
<b>2</b> • If you plan to itemize deductions, enter the estimated total of your itemized deductions. <b>Caution:</b> If line 1 above is over \$166,800 (\$83,400 if married filing separately), your deduction may be reduced. See Pub. 505 for details. • If you do not plan to itemize deductions, enter your standard deduction from page 1 or Pub. 505, Worksheet 2-3.	<b>2</b>		42,000
<b>3</b> Subtract line 2 from line 1	<b>3</b>		108,000
<b>4</b> Exemptions. Multiply \$3,650 by the number of personal exemptions. <b>Caution:</b> See Pub. 505 to figure the amount to enter if line 1 above is over: \$250,200 if married filing jointly or qualifying widow(er); \$208,500 if head of household; \$166,800 if single; or \$125,100 if married filing separately	<b>4</b>		40,950
<b>5</b> Subtract line 4 from line 3	<b>5</b>		67,050
<b>6</b> <b>Tax.</b> Figure your tax on the amount on line 5 by using the <b>2009 Tax Rate Schedules</b> on page 5. <b>Caution:</b> If you will have qualified dividends or a net capital gain, or expect to claim the foreign earned income exclusion or housing exclusion, see Pub. 505 to figure the tax	<b>6</b>		16,944
<b>7</b> Alternative minimum tax from <b>Form 6251</b>	<b>7</b>		
<b>8</b> Add lines 6 and 7. Add to this amount any other taxes you expect to include in the total on Form 1040, line 44, or Form 1040A, line 28	<b>8</b>		16,944
<b>9</b> Credits (see instructions below). <b>Do not</b> include any income tax withholding on this line	<b>9</b>		1,000
<b>10</b> Subtract line 9 from line 8. If zero or less, enter -0-	<b>10</b>		15,944
<b>11</b> Self-employment tax (see instructions below). Estimate of 2009 net earnings from self-employment \$ <u>100,000</u> ; if <b>\$106,800 or less</b> , multiply the amount by 15.3%; if <b>more than \$106,800</b> , multiply the amount by 2.9%, add \$13,243.20 to the result, and enter the total. <b>Caution:</b> If you also have wages subject to social security tax or the 6.2% portion of tier 1 Railroad Retirement tax, see Pub. 505 to figure the amount to enter	<b>11</b>		15,300
<b>12</b> Other taxes (see instructions below)	<b>12</b>		
<b>13a</b> Add lines 10 through 12	<b>13a</b>		31,244
<b>b</b> Earned income credit, additional child tax credit, and credits from <b>Forms 4136, 5405, 8801 (line 27), and 8885</b>	<b>13b</b>		
<b>c</b> <b>Total 2009 estimated tax.</b> Subtract line 13b from line 13a. If zero or less, enter -0-	<b>13c</b>		31,244
<b>14a</b> Multiply line 13c by 90% (86% % for farmers and fishermen)	<b>14a</b>	28,119	
<b>b</b> Enter the tax shown on your 2008 tax return (110% of that amount if you are not a farmer or fisherman and the adjusted gross income shown on that return is more than \$150,000 or, if married filing separately for 2009, more than \$75,000)	<b>14b</b>	23,500	
<b>c</b> <b>Required annual payment to avoid a penalty.</b> Enter the smaller of line 14a or 14b	<b>14c</b>		23,500
<b>Caution:</b> Generally, if you do not prepay (through income tax withholding and estimated tax payments) at least the amount on line 14c, you may owe a penalty for not paying enough estimated tax. To avoid a penalty, make sure your estimate on line 13c is as accurate as possible. Even if you pay the required annual payment, you may still owe tax when you file your return. If you prefer, you can pay the amount shown on line 13c. For details, see Pub. 505.			
<b>15</b> Income tax withheld and estimated to be withheld during 2009 (including income tax withholding on pensions, annuities, certain deferred income, etc.)	<b>15</b>		4
<b>16a</b> Subtract line 15 from line 14c	<b>16a</b>	23,500	
Is the result zero or less? <input type="checkbox"/> <b>Yes.</b> Stop here. You are not required to make estimated tax payments. <input checked="" type="checkbox"/> <b>No.</b> Go to line 16b.			
<b>b</b> Subtract line 15 from line 13c	<b>16b</b>	31,244	
Is the result less than \$1,000? <input type="checkbox"/> <b>Yes.</b> Stop here. You are not required to make estimated tax payments. <input checked="" type="checkbox"/> <b>No.</b> Go to line 17 to figure your required payment.			
<b>17</b> If the first payment you are required to make is due April 15, 2009, enter ¼ of line 16a (minus any 2008 overpayment that you are applying to this installment) here, and on your estimated tax payment voucher(s) if you are paying by check or money order. <b>(Note: Household employers, see instructions below.)</b>	<b>17</b>		7,811

**Instructions for the 2009 Estimated Tax Worksheet**

**Line 1. Adjusted gross income.** Use your 2008 tax return and instructions as a guide to figuring the adjusted gross income you expect in 2009 (but be sure to consider the items listed under What's New that begins on page 1). For more details on figuring your adjusted gross income, see Expected AGI—Line 1 in chapter 2 of Pub. 505. If you are self-employed, be sure to take into account the deduction for one-half of your self-employment tax (2008 Form 1040, line 27).

**Line 9. Credits.** See the 2008 Form 1040, lines 47 through 54, or Form 1040A, lines 29 through 33, and the related instructions.

**Line 11. Self-employment tax.** If you and your spouse make joint estimated tax payments and you both have self-employment income, figure the self-employment tax for each of you separately. Enter the total on line 11. When figuring your estimate of 2009 net earnings from self-employment, be sure to use only 92.35% (9235) of your total net profit from self-employment.

**Line 12. Other taxes.** Use the instructions for the 2008 Form 1040 to determine if you expect to owe, for 2009, any of the taxes that would have been entered on your 2008 Form 1040, lines 59 (additional tax on early distributions only) and 60, and any write-ins on line 61, or any amount from Form 1040A, line 36. On line 12, enter the total of those taxes, subject to the following two exceptions.

**Exception 1.** Include household employment taxes from box b of Form 1040, line 60, on this line only if:

- You will have federal income tax withheld from wages, pensions, annuities, gambling winnings, or other income, or
- You would be required to make estimated tax payments (to avoid a penalty) even if you did not include household employment taxes when figuring your estimated tax.

If you meet one or both of the above, include in the amount on line 12 the total of your household employment taxes before subtracting advance EIC payments made to your employee(s).

**Exception 2.** Of the amounts for other taxes that may be entered on Form 1040, line 61, do not include on line 12: tax on recapture of a federal mortgage subsidy, uncollected employee social security and Medicare tax or RRTA tax on tips or group-term life insurance, tax on golden parachute payments, look-back interest due under section 167(g) or 460(b), or excise tax on insider stock compensation from an expatriated corporation. These taxes are not required to be paid until the due date of your income tax return (not including extensions).

**Repayment of first-time homebuyer credit.** If you claimed the first-time homebuyer credit for 2008 and the home ceased to be your main home in 2009, you generally must include on line 12 the entire credit you claimed for 2008. This includes situations where you sell the home or convert it to business or rental property. See Form 5405 for exceptions.

**Line 17.** If you are a household employer and you make advance EIC payments to your employee(s), reduce your required estimated tax payment for each period by the amount of advance EIC payments paid during the period.

FIGURE 39-10 Sample Estimated Tax Worksheet from Form 1040-ES.

### CALCULATING AND PAYING SOCIAL SECURITY/MEDICARE TAXES FOR SELF-EMPLOYED INDIVIDUALS

The Social Security/Medicare payments of a self-employed individual practitioner are based on the income or loss reported on Schedule C. This amount must exceed \$400 or no

Social Security/Medicare tax need be paid. If the amount is in excess of \$400, the Social Security/Medicare tax must be calculated on Schedule SE, Self-Employment Tax (Figure 39-11).

As with employees, the total percentage contributed for the Social Security tax is 12.4%, up to the earnings ceiling; the percentage for the Medicare tax is 2.9% but without a ceiling. However, an individual practitioner pays the full 15.3%

**Privacy Act and Paperwork Reduction Act Notice.** We ask for tax return information to carry out the tax laws of the United States. We need it to figure and collect the right amount of tax.

Our legal right to ask for information is Internal Revenue Code sections 6001, 6011, and 6012(a), and their regulations. They say that you must file a return or statement with us for any tax for which you are liable. Your response is mandatory under these sections. Code section 6109 and its regulations say that you must provide your taxpayer identification number on what you file. This is so we know who you are, and can process your return and other papers.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as stated in Code section 6103.

We may disclose the information to the Department of Justice and to other federal agencies, as provided by law. We may disclose it to cities, states, the District of Columbia, and U.S.

commonwealths or possessions to carry out their tax laws. We may also disclose this information to other countries under a tax treaty, to federal and state agencies to enforce federal nontax criminal laws, or to federal law enforcement and intelligence agencies to combat terrorism.

If you do not file a return, do not give the information asked for, or give fraudulent information, you may be charged penalties and be subject to criminal prosecution.

Please keep this notice with your records. It may help you if we ask you for other information. If you have any questions about the rules for filing and giving information, please call or visit any Internal Revenue Service office.

The average time and expenses required to complete and file this form will vary depending on individual circumstances. For the estimated averages, see the instructions for your income tax return.

If you have suggestions for making this package simpler, we would be happy to hear from you. See the instructions for your income tax return.

### 2009 Tax Rate Schedules

**Caution.** Do not use these Tax Rate Schedules to figure your 2008 taxes. Use only to figure your 2009 estimated taxes.

#### Schedule X—Use if your 2009 filing status is Single

If line 5 is:	But not over—	The tax is:	of the amount over—
Over—			
\$0	\$8,350	10%	\$0
8,350	33,950	\$835.00 + 15%	8,350
33,950	82,250	4,675.00 + 25%	33,950
82,250	171,550	16,750.00 + 28%	82,250
171,550	372,950	41,754.00 + 33%	171,550
372,950		108,216.00 + 35%	372,950

#### Schedule Z—Use if your 2009 filing status is Head of household

If line 5 is:	But not over—	The tax is:	of the amount over—
Over—			
\$0	\$11,950	10%	\$0
11,950	45,500	\$1,195.00 + 15%	11,950
45,500	117,450	6,227.50 + 25%	45,500
117,450	190,200	24,215.00 + 28%	117,450
190,200	372,950	44,585.00 + 33%	190,200
372,950		104,892.50 + 35%	372,950

#### Schedule Y-1—Use if your 2009 filing status is Married filing jointly or Qualifying widow(er)

If line 5 is:	But not over—	The tax is:	of the amount over—
Over—			
\$0	\$16,700	10%	\$0
16,700	67,900	\$1,670.00 + 15%	16,700
67,900	137,050	9,350.00 + 25%	67,900
137,050	208,850	26,637.50 + 28%	137,050
208,850	372,950	46,741.50 + 33%	208,850
372,950		100,894.50 + 35%	372,950

#### Schedule Y-2—Use if your 2009 filing status is Married filing separately

If line 5 is:	But not over—	The tax is:	of the amount over—
Over—			
\$0	\$8,350	10%	\$0
8,350	33,950	\$835.00 + 15%	8,350
33,950	68,525	4,675.00 + 25%	33,950
68,525	104,425	13,318.75 + 28%	68,525
104,425	186,475	23,370.75 + 33%	104,425
186,475		50,447.25 + 35%	186,475

Tear off here

Form **1040-ES**  
Department of the Treasury  
Internal Revenue Service

## 2009 Estimated Tax

## Payment Voucher 4

OMB No. 1545-0074

File only if you are making a payment of estimated tax by check or money order. Mail this voucher with your check or money order payable to the "United States Treasury." Write your social security number and "2009 Form 1040-ES" on your check or money order. Do not send cash. Enclose, but do not staple or attach, your payment with this voucher.

Calendar year—Due Jan. 15, 2010

Amount of estimated tax you are paying

by check or money order. Dollars **7811** Cents **00**

Print or type	Your first name and initial <b>John G</b>	Your last name <b>O'Dee</b>	Your social security number <b>123 45 6789</b>
	If joint payment, complete for spouse		
	Spouse's first name and initial <b>June B</b>	Spouse's last name <b>O'Dee</b>	Spouse's social security number <b>987 65 4321</b>
	Address (number, street, and apt. no.) <b>321 Vision Lane</b>		
City, state, and ZIP code. (If a foreign address, enter city, province or state, postal code, and country.) <b>Anytown, ST 12345</b>			

For Privacy Act and Paperwork Reduction Act Notice, see instructions above.

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FIGURE 39-10—Cont'd

of income for Social Security/Medicare (Table 39-8); this payment is allowed as a deduction on the practitioner's Form 1040, but only 50% of the payment may be claimed.

The payment of Social Security/Medicare taxes is made quarterly by self-employed optometrists, along with the income tax payment and voucher, and is based on the estimated tax figured on the worksheet for Form 1040-ES.

At the end of the tax year, Schedule SE is used to calculate the exact amount of Social Security tax owed and that amount is entered on the practitioner's Form 1040. Quarterly payments are deducted from the total tax owed; if less tax has been paid than is owed, the balance must be remitted to the IRS. If more has been paid than is owed, a refund may be collected.

<b>SCHEDULE SE</b> <b>(Form 1040)</b> <small>Department of the Treasury Internal Revenue Service (99)</small>	<b>Self-Employment Tax</b> ▶ Attach to Form 1040. ▶ See instructions for Schedule SE (Form 1040).	OMB No. 1545-0074 <b>2008</b> Attachment Sequence No. 17
Name of person with self-employment income (as shown on Form 1040) John G O'Dee		Social security number of person with self-employment income ▶ 123 : 45 : 6789
<b>Who Must File Schedule SE</b> You must file Schedule SE if: <ul style="list-style-type: none"> <li>You had net earnings from self-employment from <b>other than</b> church employee income (line 4 of Short Schedule SE or line 4c of Long Schedule SE) of \$400 or more, or</li> <li>You had church employee income of \$108.28 or more. Income from services you performed as a minister or a member of a religious order is <b>not</b> church employee income (see page SE-1).</li> </ul> <p><b>Note.</b> Even if you had a loss or a small amount of income from self-employment, it may be to your benefit to file Schedule SE and use either "optional method" in Part II of Long Schedule SE (see page SE-4).</p> <p><b>Exception.</b> If your only self-employment income was from earnings as a minister, member of a religious order, or Christian Science practitioner and you filed Form 4361 and received IRS approval not to be taxed on those earnings, <b>do not</b> file Schedule SE. Instead, write "Exempt—Form 4361" on Form 1040, line 57.</p>		
<b>May I Use Short Schedule SE or Must I Use Long Schedule SE?</b> <b>Note.</b> Use this flowchart <b>only</b> if you must file Schedule SE. If unsure, see <i>Who Must File Schedule SE</i> , above.		
Did you receive wages or tips in 2008?		
No Are you a minister, member of a religious order, or Christian Science practitioner who received IRS approval not to be taxed on earnings from these sources, but you owe self-employment tax on other earnings? No Are you using one of the optional methods to figure your net earnings (see page SE-4)? No Did you receive church employee income reported on Form W-2 of \$108.28 or more? No You may use Short Schedule SE below	Yes Was the total of your wages and tips subject to social security or railroad retirement (Tier 1) tax plus your net earnings from self-employment more than \$102,000? No Did you receive tips subject to social security or Medicare tax that you did not report to your employer? No Did you report any wages on Form 9919, Uncollected Social Security and Medicare Tax on Wages? Yes You must use Long Schedule SE on page 2	
<b>Section A—Short Schedule SE. Caution.</b> Read above to see if you can use Short Schedule SE.		
1a Net farm profit or (loss) from Schedule F, line 36, and farm partnerships, Schedule K-1 (Form 1065), box 14, code A . . . . .	1a	
b If you received social security retirement or disability benefits, enter the amount of Conservation Reserve Program payments included on Schedule F, line 6b, or listed on Schedule K-1 (Form 1065), box 20, code X . . . . .	1b ( )	
2 Net profit or (loss) from Schedule C, line 31; Schedule C-EZ, line 3; Schedule K-1 (Form 1065), box 14, code A (other than farming); and Schedule K-1 (Form 1065-B), box 9, code J1. Ministers and members of religious orders, see page SE-1 for types of income to report on this line. See page SE-3 for other income to report . . . . .	2	131,835
3 Combine lines 1a, 1b, and 2 . . . . .	3	
4 <b>Net earnings from self-employment.</b> Multiply line 3 by 92.35% (.9235). If less than \$400, do not file this schedule; you do not owe self-employment tax . . . . . ▶	4	121,750
5 <b>Self-employment tax.</b> If the amount on line 4 is: • \$102,000 or less, multiply line 4 by 15.3% (.153). Enter the result here and on Form 1040, line 57. • More than \$102,000, multiply line 4 by 2.9% (.029). Then, add \$12,648 to the result. Enter the total here and on Form 1040, line 57 . . . . .	5	16,178
6 <b>Deduction for one-half of self-employment tax.</b> Multiply line 5 by 50% (.5). Enter the result here and on Form 1040, line 27 . . . . .	6	8089
For Paperwork Reduction Act Notice, see Form 1040 instructions. <span style="float: right;">Cat. No. 11358Z Schedule SE (Form 1040) 2008</span>		

FIGURE 39-11 Sample Schedule SE.

## UNEMPLOYMENT TAXES

The federal government, in concert with the states, has devised a system of unemployment compensation for unemployed workers under the Federal Unemployment Tax Act (FUTA).

The system is funded exclusively by employers, and the taxes are paid to both federal and state governments.

The tax is paid for each employee, with the amount being a percentage of the employee's wages, to a stated ceiling. The federal unemployment tax is 6.2% of wages, to a maximum

TABLE 39-8

**Social Security and Medicare Tax Rates and Earnings Ceilings, 1998-2008**

	Year	Self-Employed Contributions*		
		Earning Ceiling For Tax	Tax Rate	Maximum Contributions
Social Security	1998	\$68,400	12.4%	\$8,481
Medicare		No ceiling	2.9%	No limit
Social Security	1999	\$72,600	12.4%	\$9,002
Medicare		No ceiling	2.9%	No limit
Social Security	2000	\$76,200	12.4%	\$9,448
Medicare		No ceiling	2.9%	No limit
Social Security	2001	\$80,400	12.4%	\$9,969
Medicare		No ceiling	2.9%	No limit
Social Security	2002	\$84,900	12.4%	\$10,527
Medicare		No ceiling	2.9%	No limit
Social Security	2003	\$87,000	12.4%	\$10,788
Medicare		No ceiling	2.9%	No limit
Social Security	2004	\$87,900	12.4%	\$10,899
Medicare		No ceiling	2.9%	No limit
Social Security	2005	\$90,000	12.4%	\$11,160
Medicare		No ceiling	2.9%	No limit
Social Security	2006	\$94,200	12.4%	\$11,680
Medicare		No ceiling	2.9%	No limit
Social Security	2007	\$97,500	12.4%	\$12,090
Medicare		No ceiling	2.9%	No limit
Social Security	2008	\$102,000	12.4%	\$12,648
Medicare		No ceiling	2.9%	No limit

\*These payments represent the Social Security and Medicare taxes paid by a self-employed practitioner. For example, an optometrist earning \$100,000 in 2002 contributed \$10,527 ( $\$84,900 \times 12.4\%$ ) to Social Security and \$2,900 ( $\$100,000 \times 2.9\%$ ) to Medicare. The total paid was \$13,427.

of \$7,000. Thus, for an employee earning \$7,000 or more, the employer must contribute \$434. This tax is not taken from the wages of the employee; rather, it is paid exclusively from the earnings of the employer. The federal government allows a credit for unemployment taxes paid by an employer to the state, up to 5.4% of wages. In such a case, the employer must pay to the federal government only the balance; if the employer pays the maximum, 5.4% of wages, to the state, only 0.8% of wages must be paid to the federal government.

The unemployment tax rate varies from state to state. For example, in Alabama the unemployment tax for a new business is 2.7% of the first \$8,000 in wages, which means that the state unemployment tax paid by the employer would be:  $\$8,000 \times 2.7\% = \$216$ , and the unemployment tax paid to the federal government would be \$218 ( $\$434 - \$216$ ).

The federal unemployment tax is applied to all employees during the tax year. If an employee quits and another is hired, the tax must be paid on both employees. For example, if in 1 year, employee A has earned \$7,000 in wages but quits and employee B is hired as a replacement and also earns \$7,000 in wages, the total tax that will have to be paid by the employer is \$868 (\$434 for each employee).

The reporting of federal unemployment taxes is performed on Form 940, Employer's Annual Federal Unemployment Tax Return (Figure 39-12). Payment to a federal reserve bank must be made quarterly, unless the tax owed is less than \$500, in which case the quarterly deposit does not have to be submitted until the amount owed exceeds \$500. Form 940, accompanied by a tax deposit coupon (Form 8109), is submitted with the final payment, which must be sent to the IRS within a month of the end of the tax year (January 31 if the tax year is a calendar year).

State unemployment tax deposits usually must be made on a quarterly basis, and a form must be submitted annually by April 15 if the employer's tax year is a calendar year. The employer receives a business tax deduction for the unemployment tax paid to the state or federal government.

## CONCLUSION

Tax reporting in the United States is an obligation. All organizations must report wage and non-wage payments made in the course of business to the Internal Revenue Service. Tax reporting is continuously growing, as are regulatory requirements established by state and federal government. There are currently more than 30 types of tax returns required by the federal government alone, and they provide the primary crosschecking measure the IRS uses to verify the accuracy of tax returns filed by individual taxpayers.

Each federal return reports a different type of payment or transaction. In addition, each return has its own unique rules on when, what, and the amount to report. The complexity involved in filling out and filing these returns requires optometrists to depend on third party reporting software, payroll processing services, and accountants or lawyers knowledgeable in tax issues. States also have their own forms and reporting requirements.

In an effort to enforce the tax laws and identify unreported and under-reported income, the IRS uses electronic cross-matching of information income tax returns, such as returns submitted by partnerships, limited liability companies, and subchapter S corporations. By reviewing information returns received from the payers of income, the IRS can assess monetary penalties—which can be severe—on businesses and other entities that do not file all of the required returns, or file returns with errors that make it more difficult for the IRS to identify the taxpayers who received the income.

An increasing amount of attention and government enforcement is being focused on tax reporting, as the United States Congress and the federal administration seek ways to close the "tax gap" of over \$300 billion dollars annually that would be collected by the federal government if all income were reported by US individuals and businesses.

It is for these reasons that optometrists should seek professional assistance in filing business and individual tax returns, for very few optometrists have the expertise and time to perform the daunting task of timely, accurate tax reporting.

**Form 940 for 2008: Employer's Annual Federal Unemployment (FUTA) Tax Return** 850108  
 Department of the Treasury — Internal Revenue Service OMB No. 1545-0028

(EIN) Employer identification number   -

Name (not your trade name)

Trade name (if any)

Address    
Number Street City State ZIP code

**Type of Return**  
 (Check all that apply.)  
 a. Amended  
 b. Successor employer  
 c. No payments to employees in 2008  
 d. Final: Business closed or stopped paying wages

Read the separate instructions before you fill out this form. Please type or print within the boxes.

**Part 1: Tell us about your return. If any line does NOT apply, leave it blank.**

1 If you were required to pay your state unemployment tax in ...  
 1a One state only, write the state abbreviation . . . . . 1a    
 - OR -  
 1b More than one state (You are a multi-state employer) . . . . . 1b  Check here. Fill out Schedule A.  
 Skip line 2 for 2008 and go to line 3.  
 2 If you paid wages in a state that is subject to CREDIT REDUCTION . . . . . 2  Check here. Fill out Schedule A (Form 940), Part 2.

**Part 2: Determine your FUTA tax before adjustments for 2008. If any line does NOT apply, leave it blank.**

3 Total payments to all employees . . . . . 3

4 Payments exempt from FUTA tax . . . . . 4   
 Check all that apply: 4a  Fringe benefits 4c  Retirement/Pension 4e  Other  
 4b  Group-term life insurance 4d  Dependent care

5 Total of payments made to each employee in excess of \$7,000 . . . . . 5

6 Subtotal (line 4 + line 5 = line 6) . . . . . 6

7 Total taxable FUTA wages (line 3 - line 6 = line 7) . . . . . 7

8 FUTA tax before adjustments (line 7 × .008 = line 8) . . . . . 8

**Part 3: Determine your adjustments. If any line does NOT apply, leave it blank.**

9 If ALL of the taxable FUTA wages you paid were excluded from state unemployment tax, multiply line 7 by .054 (line 7 × .054 = line 9). Then go to line 12 . . . . . 9

10 If SOME of the taxable FUTA wages you paid were excluded from state unemployment tax, OR you paid ANY state unemployment tax late (after the due date for filing Form 940), fill out the worksheet in the instructions. Enter the amount from line 7 of the worksheet onto line 10 . . . . . 10

Skip line 11 for 2008 and go to line 12.  
 11 If credit reduction applies, enter the amount from line 3 of Schedule A (Form 940) . . . . . 11

**Part 4: Determine your FUTA tax and balance due or overpayment for 2008. If any line does NOT apply, leave it blank.**

12 Total FUTA tax after adjustments (lines 8 + 9 + 10 + 11 = line 12) . . . . . 12

13 FUTA tax deposited for the year, including any payment applied from a prior year . . . . . 13

14 Balance due (If line 12 is more than line 13, enter the difference on line 14.)  
 • If line 14 is more than \$500, you must deposit your tax.  
 • If line 14 is \$500 or less, you may pay with this return. For more information on how to pay, see the separate instructions . . . . . 14

15 Overpayment (If line 13 is more than line 12, enter the difference on line 15 and check a box below.) . . . . . 15   
 Check one:  Apply to next return.  
 Send a refund.

▶ You MUST fill out both pages of this form and SIGN it.

Next →

For Privacy Act and Paperwork Reduction Act Notice, see the back of Form 940-V, Payment Voucher. Cat. No. 112340 Form 940 (2008)

FIGURE 39-12 Sample Form 940.

## BIBLIOGRAPHY

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- Internal Revenue Service Publication 1: *Your rights as a taxpayer*.
- Internal Revenue Service Publication 4: *Student's guide to federal income tax*.
- Internal Revenue Service Publication 5: *Appeal rights and preparation of protests for unagreed cases*.
- Internal Revenue Service Publication 15: *Employer's tax guide (circular E)*.
- Internal Revenue Service Publication 17: *Your income tax*.
- Internal Revenue Service Publication 334: *Tax guide for small business*.
- Internal Revenue Service Publication 463: *Travel, entertainment, gift and car expenses*.
- Internal Revenue Service Publication 505: *Tax withholding and estimated tax*.
- Internal Revenue Service Publication 509: *Tax calendars for 2008*.
- Internal Revenue Service Publication 533: *Self-employment tax*.
- Internal Revenue Service Publication 535: *Business expenses*.
- Internal Revenue Service Publication 538: *Accounting periods and methods*.
- Internal Revenue Service Publication 541: *Partnerships*.
- Internal Revenue Service Publication 542: *Corporations*.
- Internal Revenue Service Publication 544: *Sales and other dispositions of assets*.
- Internal Revenue Service Publication 551: *Basis of assets*.
- Internal Revenue Service Publication 553: *Tax highlights of 2000 tax changes*.
- Internal Revenue Service Publication 553: *Tax highlights of 2001 tax changes*.
- Internal Revenue Service Publication 553: *Tax highlights of 2002 tax changes*.
- Internal Revenue Service Publication 553: *Tax highlights of 2007 tax changes*.
- Internal Revenue Service Publication 556: *Examination of Service returns, appeal rights, and claims for refund*.
- Internal Revenue Service Publication 560: *Retirement plans for small business (SEP, Keogh, and SIMPLE plans)*.
- Internal Revenue Service Publication 583: *Starting a business and keeping records*.
- Internal Revenue Service Publication 587: *Business use of your home*.
- Internal Revenue Service Publication 589: *Tax information on S corporations*.
- Internal Revenue Service Publication 917: *Business use of a car*.
- Internal Revenue Service Publication 929: *Tax rules for children and dependents*.
- Internal Revenue Service Publication 946: *How to depreciate property*.
- Internal Revenue Service Publication 972: *Child tax credit*.
- Internal Revenue Service Publication 1518: *Tax calendar for small business*.
- Internal Revenue Service Publication 1976: *Independent contractor or employee?*.

### Website

[www.irs.gov/formspubs](http://www.irs.gov/formspubs). Website for the Internal Revenue Service, which contains forms and publications that can be downloaded.