

Do you use credit cards to pay business expenses?

Be sure you're taking the right deduction

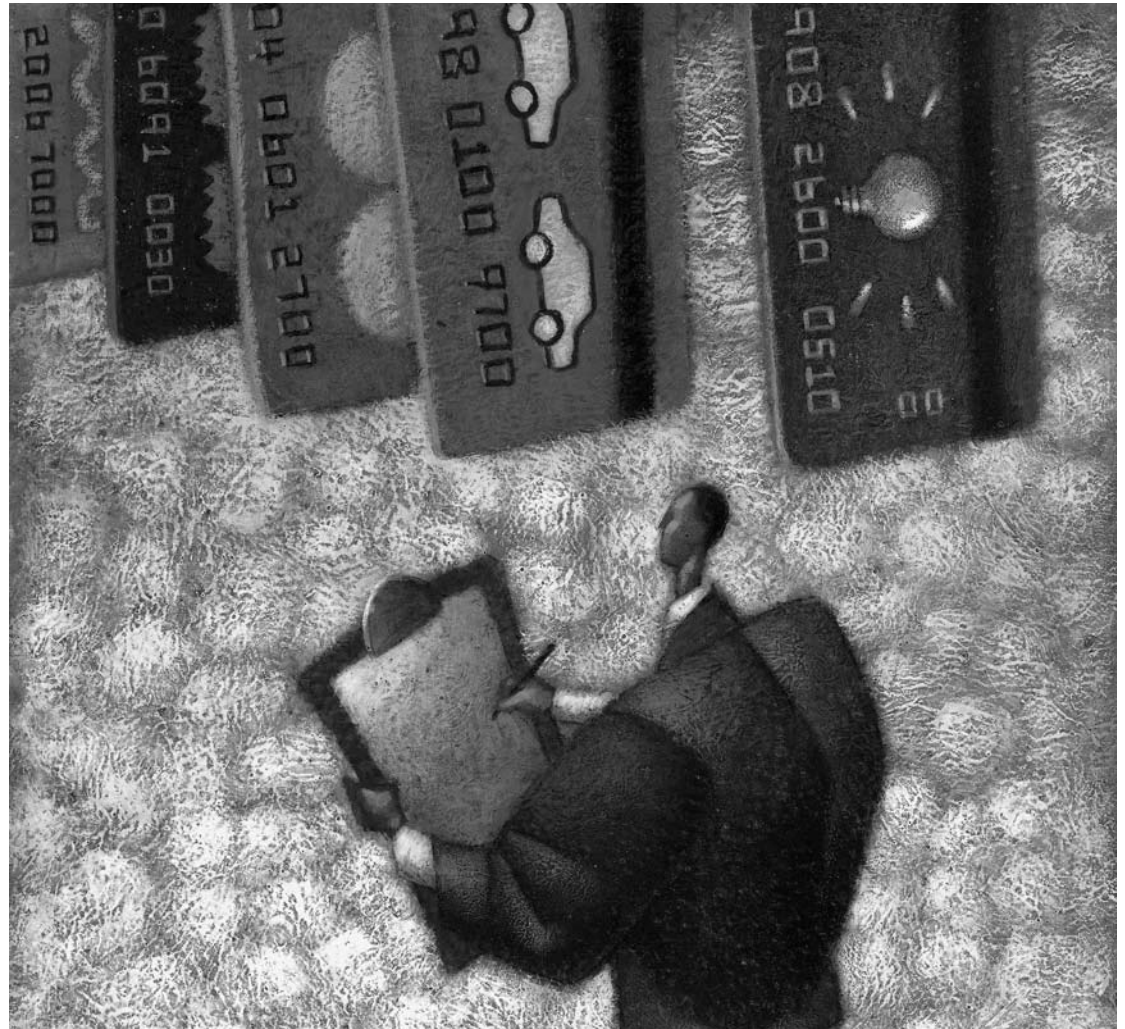
By Norman LeBlanc, CPA

Nearly all small businesses find it convenient, and sometimes necessary, to use credit cards to pay business expenses. This is especially true during the early years of a new business, again during times of growth, and sometimes during times of difficulty.

The trouble spot is the misconception that many taxpayers have about when they should be deducting their credit card activity. A fair number of businesses use the cash basis of accounting. This means they claim income when it is received and expenses when they are paid. The exception to this rule is when business expenses are paid by credit card. The tax code mandates that expenses charged to a credit card must be deducted when charged, regardless of when the credit card is paid. Many businesses track their expenses by looking at the checks they write, so it is not uncommon for business owners to deduct their credit card payments rather than their credit card charges.

Over a short time, this might not be a problem. For instance, when the charges and payments are equal and occur all in the same tax year. The real problem occurs when there are many charges in one year and the subsequent payments are spanning over several years. If the IRS chooses to audit those tax years, it will move the charges to the year they occurred and remove any deduction taken for payments. If the statute of limitations has expired on the year the charges were made you will be faced with losing the payment deduction and not being able to realize the charge deduction.

For example, say you made



charges of \$12,000 in 2004 and paid them off with payments during 2005, 2006 and 2007 of \$4,000 per year. During 2005, 2006 and 2007, you follow your checkbook and unknowingly deduct the \$4,000 in payments. Then the IRS chooses to audit your 2006 and 2007 tax returns. During the audit, they disallow the credit card payments because a deduction is allowed only for charges. You were entitled to take the \$12,000 of charges in 2004 but since the statute of limitations has expired

you can't change the 2004 tax return. You are now faced with not getting a deduction at all.

If you think you may have accidentally deducted payments instead of charges in past years, an amended return can be filed to correct this situation and allow you to get the proper deduction. For most taxpayers, the most recent year that is still open for amendment is 2005; but hurry, the statute for some corporate taxpayers expired March 15 and for some individuals it's as soon as April 15. **e**

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