PROFESSIONAL ENGLISH by M. Belogash

UNIT 14 TAX ACCOUNTING

14.1 Getting started.

Financial tax accounting is a branch of accounting that helps to keep financial records of the company's transactions. This is usually done by an accountant who follows standard guidelines to record transactions and summarizes data for financial statements. Financial Tax Accounting is the recording, interpretation and reporting of financial transactions. Every business has to keep a proper record of financial tax accounting, which is a branch of accounting.

Discuss the following points:

1. Why do you think tax accounting has become an important specialty throughout the world?
2. Why do you think businessmen depend on the advice of tax accountants and lawyers?

14.2 Look through the following vocabulary notes which will help you understand the text and discuss the topic.

specialty	специализация, специальность
interpretation	толкование, интерпретация
individuals and organizations	физические и юридические лица
to compute	подсчитывать, начислять
tax liability	фискальные/налоговые обязательства
complete forms	заполнить бланк/анкету
due	подлежащий уплате, причитающийся
tax filing	налоговая декларация
to impose/levy a tax	устанавливать налог
tax-return forms	бланк налоговой декларации
a tax code	налоговый кодекс

Internal Revenue Code (IRC)	Закон о внутреннем налогообложении (США)
charities	благотворительные организации
retirement plans	пенсионная программа
community	сообщество, объединение
tax exempt	освобожденный от уплаты налогов
payroll taxes	налоги, удерживаемые с зарплаты
estate taxes	налог на передачу имущества по наследству
excise taxes	акцизы
an implementing agency	исполнительный орган
Internal Revenue Service	Федеральная налоговая служба США
taxable base	налоговая база, облагаемый налогом доход
marginal tax rate	предельная ставка налога
tax incidence	распределение налогов по группам обложения
proportional tax	налог, взимаемый по единой ставке (пропорциональный)
progressive tax	прогрессивный налог
regressive tax	регрессивный налог
worldwide income	совокупный доход
jurisdiction	подведомственность органа власти, юрисдикция
capital gains	прирост капитала
a tax saving	налоговая экономия
postponement	перенос, отсрочка
income-taxes expense account	счет «Расходы по налогу на прибыль»
estimated-income-taxes payable account	счет «оцененная задолженность по налогам на прибыль»
accrual method	метод начисления
cash method	кассовый метод
double taxation	двойное налогообложение

14.3 Reading

The Basics Tax Accounting

Individuals and organizations have to pay financial taxes whether it is a corporation, sole proprietorship or partnership. They are required to compute their tax liability, complete the necessary forms, and pay taxes due. Proper record and accurate tax filing will help in maintaining proper reputation of businesses otherwise poor records will result in overpaying of financial taxes. That means record keeping will directly affect the financial part of the business. Many features of the American system, both in the imposition and collection of taxes, have been adopted by other countries. The specialty of tax accounting has developed into one of the most important branches of accounting throughout the world. This is the branch of accounting that involves determining correct liability for taxes and preparing the necessary tax-return forms.

The biggest reason why you should hire an accountant to do your taxes is their expertise. A tax accountant must have a perfect knowledge of the tax code of his or her country. US federal tax laws are extremely complex. Besides, many tax laws in the states differ from the federal regulations.

Federal tax law begins with the Internal Revenue Code (IRC), enacted by Congress in Title 26 of the United States Code (26 U.S.C.). The Tax Code provides regulations for individuals, businesses, charities and non-profits, government entities, retirement plans community, and tax exempt bond community. It is organized topically, into subtitles and sections, covering income tax, payroll taxes, estate taxes, gift taxes and excise taxes; as well as procedure and administration. Its implementing agency is the Internal Revenue Service. The 1954 Code imposed a progressive tax with 24 income brackets applying to tax rates ranging from 20% to 91%. A progressive tax is a tax by which the tax rate increases as the taxable base amount increases. "Progressive" describes a distribution effect on income or expenditure, referring to the way the rate progresses from low to high, where the average tax rate is less than the marginal tax rate. It can be applied to individual taxes or to a tax system as a whole; a year, multi-year, or lifetime. Progressive taxes attempt to reduce the tax incidence of people with a lower ability-to-pay, as they shift the incidence increasingly to those with a higher ability-to-pay. The opposite of a progressive tax is a regressive tax, where the relative tax rate or burden increases as an individual's ability to pay it decreases. In between is a proportional tax, where the tax rate is fixed as the amount subject to taxation increases.

In the United States, a tax is imposed on income by the Federal, most states, and many local governments. The income tax is determined by applying a tax rate, which may increase as income increases, to taxable income as defined. Individuals and corporations are directly taxable, and estates and trusts may be taxable on undistributed income. Partnerships are not taxed, but their partners are taxed on their shares of partnership income. Residents and citizens are taxed on worldwide income, while nonresidents are taxed only on income within the jurisdiction. Several types of credits reduce tax, and some types of credits may exceed tax before credits. An alternative tax applies at the Federal and some state levels.

Taxable income is total income less allowable deductions. A deduction is an expense that can be subtracted, or deducted, from income prior to paying taxes. Tax deductions are used as incentives for certain kinds of economic behavior. Most business expenses are deductible. Individuals may also deduct a personal allowance (exemption) and certain personal expenses, including home mortgage interest, state taxes, contributions to charity, and some other items. Some deductions are subject to limits. A corporation is not allowed a deduction for the dividends it pays out when its taxable income is computed. This results in double taxation of the corporate income.

Capital gains are fully taxable, and capital losses reduce taxable income only to the extent of gains. Individuals currently pay a lower rate of tax on capital gains and certain corporate dividends.

The major concern of a business is to decrease the tax liability to the lowest level. It may be made possible by various provisions in the tax laws that offer methods of handling particular transactions or accounting procedures. One alternative may thus have a significant tax advantage over another, resulting in either a tax saving or a postponement of the tax liability. Among the potentially significant decisions are the form of business under which to organize, whether or not to set up multiple corporations, and which accounting methods should be used to deal with inventory and depreciation.

The basic accounting procedure for computing income taxes is relatively simple. The final estimated tax liability is charged to the income-taxes expense account and is deducted on the income statement. The liability is credited to the estimated-income-taxes payable account and is then classified as a current liability on the statement of financial position.

14.4 Comprehension

14.4.1 Answer the questions using the active vocabulary and Unit 14 Glossary.

1. What are individuals and corporations required to compute?
2. Why do you think overpaying of financial taxes is undesirable?
3. What does tax accounting involve?
4. What do you know about Internal Revenue Code?
5. What entities does it provide regulations for?
6. What is its implementing agency?
7. What is the difference between the progressive tax, regressive tax and proportional tax?
8. Why does the progressive tax reduce tax incidence?
9. What three types of government levy taxes in the US?
10. What is a taxable income?
11. What is a deduction? How does it encourage certain kinds of economic behavior? Give your own examples.
12. Why is the corporate income taxed twice?
13. What is the major aim of a business’s tax accounting policy?
14. Why is the postponement of the tax liability an advantage for the business?
15. Describe the accounting procedure for computing income taxes.

14.4.3 Mark these statements T(true) or F(false) according to the information in the Text and Unit 14 Glossary. If they are false say why.

1. Only individual citizens, not businesses, pay income taxes in the US.
2. The Federal government is the only level of government in the United States that can levy a tax.
3. Many larger corporations in the US pay more than 50% of their net income to federal and state governments in the form of taxes.
4. No form of organization or method of handling transactions can give a tax advantage.
5. A corporation enjoys certain nontax advantages over individual proprietorships or partnerships, such as limited liability, continuity of existence, and ease of raising capital.
6. The owners of individual proprietorships and partnerships show income from their businesses on their individual tax returns.
7. In a progressive income tax, all earnings are taxed at the same percentage rate.
8. Corporations may claim a tax deduction for dividends they pay out to stockholders.
9. There is no tax advantage to a small-business type of corporation.
10. There is never any accounting problem that results from differences in the amount of taxable income and the amount reported on financial statements.
11. Capital gain is the profit resulting from the sale of a capital asset such as land or capital stock.
12. The Tax Code provides regulations for individuals, businesses, government entities, retirement tax exempt community.
13. Individuals and corporations may be taxable on undistributed income.
14. Partnerships and their partners are taxed on their shares of partnership income.
15. Capital losses reduce taxable income only to the extent of gains.

14.5 Language practice

14.5.1 Match the English terms in the left-hand column with the definition in the right-hand column.

1	Tax accounting	A	A tax on the sale or use of specific products or transactions.
2	Accrual method of accounting	B	An event that affects the resources of a business.
3	Common law	C	Income tax rate paid on the last dollar of income earned.
4	Deferred expense	D	Levying of tax by two or more jurisdictions on the same declared income (in the case of income taxes), asset (in the case of capital taxes), or financial transaction (in the case of sales taxes).
5	Dependency exemption	E	Cash received that the business has not earned yet. It is a liability until earned because if the business does not earn it the business will have to pay it back.
6	Direct tax	F	Balance Sheet
7	Excise tax	G	A system whereby revenue is recognized and recorded when earned (rather than when received) and expenses are recognized and recorded when incurred (rather than when paid).
8	Marginal tax rate	H	A failure to pay or a deliberate underpayment of taxes.
9	Sales tax	I	A tax by which the tax rate increases as the taxable base amount increases.
10	Social security tax	J	A tax that cannot be shifted to others, such as the federal income tax.
11	Deferred revenues	K	Law made by judges in individual cases, rather than by the legislature.
12	Tax evasion	L	Variable tax dollars that you can subtract, or deduct, from your gross income.
13	Transaction	M	Amount that taxpayers can claim for their eligible dependents.

14	Deduction	N	A prepayment on an expense, recorded as an asset until such time as the expense actually occurs. It is an asset because you have a right to a refund unless you incur the expense.
15	Double taxation	O	Accounting process that focuses on tax issues.
16	Statement of financial position	P	Provides benefits for retired workers and their dependents as well as for the disabled and their dependents.
17	Progressive tax	Q	A tax on retail products based on a set percentage of retail cost.

14.5.2 Complete the following texts using the suitable words or phrases from the box.

A	payable	**E**	deferred
B	expenses payable	**F**	levied
C	Balance Sheet	**G**	accounting
D	calculation	**H**	tax liability

When it comes to income tax ____(1)____ it is important to understand some of the terms like ____(2)____, Income Statement, Illustrations because on the basis of these we calculate income tax.

- **Balance sheet:** The tax which gets ____(3)____ is calculated using the Balance Sheet, deferred tax asset is recognized after each period for the decrease in future income taxes ____(4)____ in the Balance Sheet.

- **Income Statement:** income tax ____(5)____ at each period may increase or decrease depending upon the changes taking place in deferred ____(6)____ and the deferred tax asset.

- **Illustration:** It is more over a calculation of income on which tax is ____(7)____. This involves lots of mathematical ____(8)____ and formulae.

14.5.3 Complete the text. Replace the Russian words and phrases by the English equivalents.

Financial ***налоговый учет*** is the recording, ***интерпретация*** and reporting of ***финансовых операций***. Every business has ***вести записи*** of financial tax accounting, which is ***наиболее эффективно*** done ***под строгим контролем*** of Tax Accounting manager. A manager is one who has specialization in ***управление налогами*** and with his ***знания и опыт*** he does it at his best, while doing so the manager also ***заставляет помощника работать должным образом*** guiding and mentoring to весь персонал.

14.5.4 ***Text for discussion.***

a. Look up the dictionary or Unit 14 Glossary for the meaning and pronunciation of the following words and word-combinations and use them to discuss the problems outlined in the text.

Cash method; accrual method; qualification; beneficial method; inventory; spendable capital.

b. Briefly scan the text and outline the list of major points.

c. Read the text more carefully and comment on the following items:

- the individual features of both methods of tax accounting;
- the advantages and disadvantages of both types.

2 Types of Tax Accounting

As of the 2008 fiscal year, there are only a few different ways to compile tax accounting information, but 2 main methods. The acceptable ways of submitting information are the cash method, accrual method, or a combination of both. Depending on qualification, these different methods can be chosen by a company according to timing of transactions such as credits and debits. If qualified for either method, the company will look at the advantages and disadvantages of each method and choose the most beneficial method. There are two parameters that a business must not qualify for to have the ability to choose their tax accounting method. A business must use the accrual method if the sales are over $5 million or there is inventory stockpiled that will either be sold to the public or used to make products sold to the public.

The **accrual method**, or accrual basis, of tax accounting records sales and purchases as the order is processed. In this method, physically receiving or paying money is not the time of recording. When a sale is made or a job is completed the credits or debits are recorded, regardless of the money actually changing hands or not. This method is simpler when large contracts are signed, but the payment plan may last several years. One disadvantage would be that even though the books show a large capital, the actual funds are not in the account.

The **cash method**, or cash basis, of tax accounting is simply recording transactions as the money is exchanged. This method is more accurate and gives a better feel for how much spendable capital a business has to use. Depending on the set-up of the business procedure, the cash method takes a little more discipline in book keeping. Unlike the accrual method that records the transaction as the order is processed in the office, in cash accounting the payment must be recorded directly after payment is taken. The cash method can also leave a window for fraud or theft, whereas accrual accounting has checks and balances to make sure the correct amount of payment is applied for each order.

14.6 Render the passage in English using the English equivalents of the italicized phrases given in Russian. Express the main idea of the passage in one sentence.

Налоговый учёт — система обобщения информации для определения *налоговой базы по налогу* **(taxable income)** на основе данных первичных документов, сгруппированных в соответствии с порядком, предусмотренным Налоговым кодексом Российской Федерации.

Цель налогового учета - формирование полной и достоверной информации об учете для целей налогообложения всех хозяйственных операций на предприятии. Систему налогового учета организации выбирают самостоятельно, порядок его ведения устанавливается каждой организацией в учетной политике для целей налогообложения, утверждаемой соответствующим *приказом руководителя* **(official order)**.

Налоговый учет возможно организовать следующим образом: бухгалтерский учет фактов хозяйственной деятельности осуществляется в обычном порядке работниками бухгалтерской службы, а налоговый учет – работниками службы, специально созданной для этой цели.

Unit 14 Glossary

TAX ACCOUNTING: tax accounting is the accounting process that focuses on tax issues - including filing tax returns and planning for future tax responsibilities - as opposed to the preparation of financial statements. Tax accounting is a specialized field of accounting where accountants focus on the preparation of tax returns as well as tax planning for future taxable years. Principles of tax accounting differ from the UK's Generally Accepted Accounting Practices. Tax law varies immensely from country to country, as well as between different regions and even cities. Therefore it is important to consider having your accountant prepare or oversee your tax accounting records. It is the planning of business strategies based on tax consequences and avoidance.

401(k) plan: A tax-deferred retirement plan designed to encourage long-term retirement savings. Some companies provide contributions as an employee benefit.

ABILITY TO PAY: A concept of tax fairness that states that people with different amounts of wealth or different amounts of income should pay tax at different rates. Wealth includes assets such as houses, cars, stocks, bonds, and bank accounts. Income includes wages, interest and dividends, and other payments.

ACCELERATION: A contract clause that requires payment of the full amount of the debt owed if a payment is missed or another triggering event (such as bankruptcy of the debtor) occurs. This type of clause often appears in promissory notes or loan agreements.

ACCOUNT: A category that stores information on like items. There are assets, liabilities, capital accounts, revenues and expenses.

ACCOUNTING: Recording and summarizing business transactions to provide useful information.

ACCOUNTING CYCLE: Transactions occur, are recorded, are summarized, and then put into the form of financial statements.
ACCOUNTING EQUATION: Assets - Liabilities = Owner's equity (capital, net worth, stockholder's equity).

ACCOUNTS PAYABLE: Amount owed, generally to suppliers.

ACCOUNTING PERIOD: The period for which the financial statements are prepared.

ACCOUHTS RECEIVABLE: Amounts the business is expecting from its customers based on credit sales that have already occurred.

ACCRUAL BASIS OF ACCOUTING: A system whereby revenue is recognized and recorded when earned (rather than when received) and expenses are recognized and recorded when incurred (rather than when paid).

ACCRUED EXPENSES: Expenses that have been incurred but not yet paid.

ACCUMULATED DEPRECIATION: The depreciation expense accumulated against the buildings and equipment on the books.

ADDENDUM: An attachment or exhibit to a written document, such as a contract.

ADDITIONAL PAID IN CAPITAL: Capital paid in by the owners in addition to that paid for capital stock.

ADJUSTED BASIS: The net cost of an asset after adjusting for various tax-related items.

ADJUSTED GROSS INCOME: Gross income reduced by certain amounts, such as a deductible IRA contribution or student loan interest

ADJUSTING ENTRY: A bookkeeping entry that does not arise from the cash receipts and disbursements. These entries are made at the end of the period for which the financial statement is prepared.

ADJUSTMENTS TO INCOME: Certain expenses which directly reduce your total income rather than relying on itemizing your deductions. Benefit, they help you even if you use the standard deduction.

ADVANCE EARNED INCOME CREDIT PAYMENT: Payments of part of your Earned Income Tax Credit received via your paycheck.

AGENT: A person granted the authority to act on behalf of another person or entity, known as the "principal." The actions and decisions of the agent can be binding on the principal.

AGING OF ACCOUNTS RECEIVABLE OR PAYABLE: Breaking the receivables or payables out into those due within 30 days, 60 days, 90 days, etc. Helpful for determining if they are being received or paid in a timely fashion.

ALIMONY: Money received or paid to a former spouse under a divorce decree or separation instrument.

ALLOCATIONS: In cost accounting, the method for assigning costs to products or departments.

ALLOWANCE FOR DOUBTFUL ACCOUNTS: A set-aside out of accounts receivable for amounts expected not to be received. Used in situations where a fairly uniform amount of credit sales are not collected. This allows a steady recognition of bad debts even when we don't know which receivables will not be collected. As receivables are determined to be uncollectible they are charged off against the allowance.

ALTERNATIVE MINIMUM TAX: A separate method for calculating your income taxes. You are responsible for paying the higher of the AMT or the regular tax. If your AMT tax is higher, you add the difference between the AMT and the regular tax on your 1040 line 44.

AMORTIZATION: The bookkeeping write-off of intangible assets over their useful life.
ANNUITY: A type of tax-deferred retirement plan.

APPEAL: To call for a review of an IRS or legal decision.

APPRECIATION: The increase in the value of an asset.

APPROPRIATED RETAINED EARNINGS: A set-aside of the retained earnings of a company for a particular purpose. This could be for a contingent liability such as a lawsuit, for expansion, or for any other purpose deemed appropriate by the management. It signifies retained earnings that are not available to be paid to the stockholder's in the form of dividends.

ARBITRATION: A form of alternative dispute resolution in which a neutral 3rd party (an arbitrator) considers the competing parties arguments/evidence and renders a decision or award. Arbitration can be binding or nonbinding.

ARCHER MSAs: Tax-deductible savings accounts to save for medical expenses.

AT RISK RULES: Losses from a business operation are limited to the amount of money you can actually lose in the business.

AT-WILL EMPLOYMENT: The policy allowing employers or employees to end an employment relationship at any time for any reason -- or for no reason at all. In some states, the law may place practical limits on this policy.

AUDITING: It is performance of specified procedures necessary for Certified Public Accountants to form an opinion as to whether the financial statements present fairly the operations of the business.

AUDITOR'S REPORT: The letter in which the CPA sets forth an opinion, along with the financial statements and notes to the financial statements.

AVERAGE DAYS IN RECEIVABLES: The number of days it generally takes to collect accounts receivable.
BALANCE SHEET: The financial statement that represents the assets, liabilities and capital position at a specific date.

BANKRUPTCY: A condition in which a business cannot meet its debt obligations and petitions a federal district court for either reorganization of its debts (Chapter 11) or liquidation of its assets (Chapter 7). In the action the property of a debtor is taken over by a receiver or trustee in bankruptcy for the benefit of the creditors. The action may be voluntary or involuntary.

BEGINNING INVENTORY: The items held for sale by the company, expressed at the lower of their cost or the market value.

BONDS: Securities issued by the U.S. government, corporations, federal agencies, or state or local municipalities. Bonds are sometimes further classified as follows:
1. Corporate Bonds - Debt instruments issued by corporations, as distinct from ones issued by a government agency, typically interest-bearing with a fixed maturity.
2. High-Yield Bonds - A bond that has a rating of BB or lower and pays a higher yield to compensate for the greater credit risk.
3. Long-Term Government Bonds - Securities issued by the US government and debt issues of federal agencies having a maturity of 10 years or more.
4. Mortgage-Backed Bonds - Securities backed by mortgages issued by FMLMC and FNMA or guaranteed by GNMA. Investors receive payments out of the interest and principal on the underlying mortgages.

5. Municipal Bonds - Debt obligation of a state or local government entity. The funds may support general government needs or fund special projects. The interest on these bonds is typically exempt from federal income taxes, and most state and local taxes.

BONUS: Compensation received by an employee for services performed. A bonus is given in addition to an employee's usual compensation.

BOOK VALUE: Historical cost of an asset less the depreciation accumulated against it.
BREACH OF CONTRACT: A violation of or failure to perform according to the terms and conditions of an agreement.

BUSINESS: A continuous and regular activity that has income or profit as its primary purpose.

BUSINESS ENTITIES: A group of people organized for some profitable or charitable purpose.

BUSINESS USE OF HOME: Employees who work out of their home or independent contractors with a home office may be able to deduct part of their household expenses on their tax return.

CAFETERIA PLAN: An employee benefit plan where employees use pretax salary or wages to create their own customized benefits package. Employees may be able to take cash (which becomes taxable) for unused credits or convert more pretax dollars to pay for more benefits. Also known as a flexible benefits plan.

CANCELLATION FEE: A fee for breaking a contract. Many cellular phone service contracts impose a cancellation fee for ending the contract before the end of its term.

CAPITAL: The owner's rights against the assets of the business...the owner's share.

CAPITAL EXPENDITURES: Business spending on additional plant equipment and inventory.

CAPITAL GAIN DISTRIBUTIONS: Distributions from a mutual fund of capital gains on investments they have sold off.

CAPITAL GAINS: A capital gain is the difference between what you paid for an investment and what you received when you sold that investment for more than your cost.

CAPITAL LEASE: A lease that actually represents the purchase of the asset. A lease is generally deemed a capital or financing lease when the item can be purchased at the end of the lease for 10% or less of the value.

CAPITAL LOSSES: A capital loss is the difference between what you paid for an investment and what you received when you sold that investment for less than your cost.

CAPITALIZE: Record as an asset rather than an expense. For example, labor is capitalized when it is direct labor incurred in the manufacture of inventory. It is recorded as part of the inventory...which is an asset.

CAPITAL STOCK: Stock purchased by the stockholders representing their ownership interest in the company.

CASH EQUIVALENTS: Investments of high liquidity and safety with a known market value and a very short-term maturity. Examples include Treasury bills and money market funds.

CASH BASIS OF ACCOUNTING: Revenue is recognized when received (rather than when earned) and expenses are recognized when paid (rather than when incurred).

CASH DISBURSEMENTS JOURNAL: A record in which cash disbursements (checks) are recorded.

CASH DISCOUNT: An incentive offered by the seller to encourage a buyer to pay within a stipulated time. For example, if the terms are 1%/10/net 30, the buyer may deduct 1 percent from the amount of the invoice (if paid with 10 days); otherwise the full amount is due within 30 days.

CASH FLOW: An accounting presentation showing how much of the cash generated by a business remains after both expenses (including interest) and principal repayment on loans are paid. A projected cash flow statement indicates whether the business will have cash to pay its expenses, loans, and make a profit. Cash flows can be calculated for any given period of time, normally done on a monthly basis or yearly basis.
CASH FLOW STATEMENT: Also called Statement of Cash flows, it indicates the sources and uses of cash flow by three categories: Operations, Investing and Financing. It is one of the three statements required by Generally Accepted Accounting Principles (GAAP).

CASH OVER OR SHORT: An account representing the difference between what cash should be based on recorded sales and expenses and the actual amount of cash. This is common in a retail, cash register situation. In fact, the absence of cash short can be a warning sign for embezzlement.

CERTIFICATES OF DEPOSIT: Interest-bearing debt instruments issued by banks with maturities from a few weeks to several years.

CERTIFIED PUBLIC ACCOUNTANT: A CPA is a professional accountant licensed by the state. Best for corporate accounting, tax audits, and business consulting.

CHART OF ACCOUNTS: The list of accounts used by a particular entity. These will include assets, liabilities, capital accounts, revenues and expenses.

CHILD TAX CREDIT: You may take a tax credit if you have dependent children.

CITIZEN OR RESIDENT TEST: Assuming all other dependency tests are met, the citizen or resident test allows taxpayers to claim a dependency exemption for persons who are U.S. citizens for some part of the year or who live in the United States, Canada, or Mexico for some part of the year.

CLOSING ENTRIES: Entries made at the end of the accounting period to close the temporary revenue and expense accounts to the capital section. Remember, Assets = Liabilities + Capital. Capital is increased by revenues and decreased by expenses. Another way to say the same thing, capital is increased by net income and decreased by net loss.

COLLATERAL: Something of value pledged to support the repayment of an obligation or loan. Examples include real estate and certificates of deposit.

COMMON LAW: Law made by judges in individual cases, rather than by the legislature.

COMMUNITY PROPERTY STATES: Married persons are considered to own their property, assets, and income jointly.

COMPULSORY PAYROLL TAX: An automatic tax collected from employers and employees to finance specific programs.

CONTRIBUTED CAPITAL: Capital contributed by the owners over and above what they paid for capital stock.

COPYRIGHT: An exclusive ownership interest in an artistic or literary work. The term "literary work" includes computer software and other information stored in electronic form. Copyright is often noted by the following example: "Copyright© 2003 by Linda Keith CPA."

CORPORATION: A business entity that has a legal life separate from its owners. It provides its owners and shareholders with certain rights and privileges, including protection from personal liability, if proper steps are followed. Corporations may take a number of forms, depending on the goals and objectives of the founders. Types include C, S and nonprofit corporations. Corporations are regarded as "persons" in the eyes of the law and may thus sue and be sued, own property, borrow money and hire employees.

CORRECTIVE DISTRIBUTIONS: If you contribute more money to your 401k or IRA than you were supposed to, the plan administrator will send you a check for your excess contributions.

COST OF GOODS SOLD: The cost of the inventory sold ...including raw materials, direct labor and overhead for a manufacturing company.

CREDIT ACCOUNTS: The right side of an accounting transaction. "Debits are next to the window ...credits next to the door." Liabilities and capital run credit balances on the balance sheet. Revenue runs a credit balance.

CREDIT RATING: A formal evaluation of an individual or a company´s credit history and capability of repaying debt.

CREDIT SCORE: A statistical summary of the individual pieces of information on a credit report. A credit score predicts how likely it is that a company or individual will repay debts. Lenders use credit scores to determine whether to extend credit and at what interest rate. Also called a risk score.

C CORPORATION: A corporation where the entity is taxed separately from its owners under subchapter C of the Internal Revenue Code.

DAMAGES: A cash compensation ordered by a court or arbitrator to offset losses or suffering caused by another´s fault or negligence. Damages are a typical request made of a court or arbitrator when persons sue for breach of contract or tort.

DAYS IN INVENTORY: The number of days it generally takes to sell an item that has been added to inventory.

DAYS IN RECEIVABLES: The number of days it generally takes to collect accounts receivable.

DOING BUSINESS AS: A situation in which a business owner operates a company under a different name than the one under which it is incorporated. The owner typically must file a fictitious name statement or similar document with the appropriate county or state agency.

DEBENTURE: Debt instrument evidencing the holder's right to receive interest and principal installments from the debtor.
DEBIT: The left side of an accounting transaction. "Debits are next to the window ...credits next to the door." Assets run a debit balance as do expenses.

DEED OF TRUST: A document that, when properly delivered, transfers a security interest in real property.

DEFAULTS: The nonpayment of principal and/or interest on the due date as provided by the terms and conditions of a promissory note or loan agreement.

DEFERRED EXPENSE: A prepayment on an expense, recorded as an asset until such time as the expense actually occurs. It is an asset because you have a right to a refund unless you incur the expense.

DEFERRED INCOME TAXES: The income taxes that should be paid according to the financial statements, even though using the tax rules, the taxable income is less than the income per books. It represents a timing difference. Eventually, the taxes will have to be paid.

DEFERRED REVENUES: Cash received that the business has not earned yet. It is a liability until earned because if the business does not earn it the business will have to pay it back.

DEFICIT: A negative. When referencing the federal deficit, the result of the government taking in less money than it spends.

DEPENDENCY EXEMPTION: Amount that taxpayers can claim for their eligible dependents. Each exemption reduces the income subject to tax. The exemption amount is a set amount that changes from year to year.

DEPENDENT: A person, other than the taxpayer or spouse, who entitles the taxpayer to claim a dependency exemption. A dependent is someone you take care of. Claiming a person as a dependent on your tax return will increase your personal exemptions, and may help you qualify for other tax benefits. You can claim a dependent on your tax return if you meet five criteria.
DEPLETION: The bookkeeping write off of natural resources, representing the fact that they are being used up.

DEPRECIATION: The bookkeeping write-off of tangible assets such as buildings and equipment, to spread their acquisition cost over their useful life. Land is never depreciated.

DIRECT CHARGE-OFF: The write-off of bad debts as they actually occur, rather than regularly recognizing it through an allowance for bad debts. This is appropriate when bad debts are not frequent or are not very predictable.

DIRECT DEPOSIT: This allows tax refunds to be deposited directly to the taxpayer's bank account. Direct Deposit is a fast, simple, safe, secure way to get a tax refund. The taxpayer must have an established checking or savings account to qualify for Direct Deposit.

DIRECT TAX: A tax that cannot be shifted to others, such as the federal income tax.

DISABILITY BENEFITS: Benefits paid to an employee who cannot work because of disability, usually limited to what is not covered by workers compensation. Disability benefits are usually a percentage of the employee´s prior income and generally run for a limited time.

DISCLOSURE: Releasing your tax return information to a third-party. Disclosure may be authorized or unauthorized. Unauthorized disclosure is a crime.

DIVIDENDS: Payment to the stockholders out of retained earnings (the accumulated profits of the company).

DOUBLE-ENTRY SYSTEM: The debit and credit system of accounting that results in the accounts being in balance. Designed to avoid or catch errors.

EARNED INCOME: Includes wages, salaries, tips, includible in gross income, and net earnings from self-employment earnings.

EARNED INCOME CREDIT: A tax credit for certain people who work, meet certain requirements, and have earned income under a specified limit.

EBITDA: Earnings before interest, taxes, depreciation, and amortization.

EMPLOYEE: Works for an employer. Employers can control when, where, and how the employee performs the work. Significant for how and where the compensation is reported on the tax return.

EMPLOYER ID NUMBER (EIN): An identification number assigned to businesses for taxpaying purposes by the IRS or state taxing authorities. An Employer ID Number is required for partnerships, corporations, and trusts, and it may be required for sole proprietorships that have employees. Also called a Federal ID Number or Taxpayer ID Number.

ENDING INVENTORY: The items held for sale but still owned by the business at the end of the period.

ENROLLED AGENT: A tax professional who has passed an IRS test covering all aspects of taxation.

ENTITY: 1) A person or group of people who are subject to the tax laws. 2) The business unit for which we are accounting ...generally a corporation, partnership or sole proprietorship.

ENTREPRENEUR: One who assumes the financial risk of the initiation, operation, and management of a given business undertaking.

EQUITY: An ownership interest in a business. Owner's rights against the assets...the owner's share. For example, stock in a corporation represents equity in the corporation.

EQUITY FINANCING: The provision of funds for capital or operating expenses in exchange for capital stock, stock purchase warrants, and/or options in the business financed, without any guaranteed return, but with the opportunity to share in the company's profits.

ESOP (EMPLOYEE STOCK OWNERSHIP PLAN): A retirement-type plan in which a trust holds stock in the employees´ names. Employees receive cash from the stock only when they leave the company or perhaps when the company is sold.

ESTATES AND TRUSTS: Estates report income after an individual person has died. A trust is created by an individual person to protect or to preserve the person's assets, and to distribute income to beneficiaries.

EXCISE TAX: A tax on the sale or use of specific products or transactions.

EXEMPT (from withholding): Free from withholding of federal income tax. A person must meet certain income, tax liability, and dependency criteria. This does not exempt a person from other kinds of tax withholding, such as the Social Security tax.

EXEMPT EMPLOYEE: Employees who are not bound to overtime regulations and minimum wage laws. Who is exempt depends on level of responsibility or professional status.

EXEMPTION: Amount that taxpayers can claim for themselves, their spouses, and eligible dependents. There are two types of exemptions-personal and dependency. Each exemption reduces the income subject to tax. The exemption amount is a set amount that changes from year to year.

EXTRAORDINARY ITEMS: Items that are not part of usual operations of the business. They are reported after operating income so that operating income can be compared year-to-year and to other similar companies. Examples are gain/loss on sale of assets or business casualty losses.

FAIR MARKET VALUE: The price that would be negotiated between a willing buyer and willing seller, neither under compunction to buy or sell.

FEDERAL INCOME TAX: The federal government levies a tax on personal income. The federal income tax provides for national programs such as defense, foreign affairs, law enforcement, and interest on the national debt.

FICA (FEDERAL INSURANCE CONTRIBUTIONS ACT): Provides benefits for retired workers and their dependents as well as for disabled workers and their dependents. Also known as the Social Security tax.

FILING SYTATUS: Determines the rate at which income is taxed. The five filing statuses are: single, married filing a joint return, married filing a separate return, head of household, and qualifying widow(er) with dependent child.

FIRST – IN FIRST – OUT (FIFO): A method of counting inventory that assumes the first items purchased are the first items sold. If prices are increasing, FIFO will result in a higher balance in inventory and lower cost of goods sold (therefore higher net income) compared to LIFO.

FORM W – 4: Form W-4 is used to figure the right amount of federal income tax to have withheld from your paycheck.

FULL DISCLOSURE: The concept that financial statements and their notes should include all information reasonably expected to be relevant to the user's understanding.

GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP): The concepts and guidelines followed by Certified Public Accountants in preparing financial information and promulgated by such bodies as the Financial Accounting Standards Board. The purpose of GAAP is to provide meaningful information to end-users of financial statements and other financial information.

GOODWILL: An intangible asset that represents the excess of the purchase price of a business over the fair market value of its tangible assets (equipment and inventory). Goodwill arises at the point in time that the company is purchased and often represents the reputation of the company, value of the location and licenses or patents that might be held by the company.

GROSS INCOME: Money, goods, services, and property a person receives that must be reported on a tax return. Includes unemployment compensation and certain scholarships. It does not include welfare benefits and nontaxable Social Security benefits.

GROSS MARGIN: Sales minus cost of goods sold. (Also called gross profit)

GROSS PROFIT: Sales minus cost of goods sold. (Also called gross margin)

GROSS PROFIT METHOD: A method of estimating inventories for interim financial statements by using the percentage gross profit to sales from the last year-end statement. This allows an interim statement without taking a physical inventory.

HEAD OF HOUSEHOLD FILING STATUS: You must meet the following requirements: 1. You are unmarried or considered unmarried on the last day of the year. 2. You paid more than half the cost of keeping up a home for the year. 3. A qualifying person lived with you in the home for more than half the year (except temporary absences, such as school). However, your dependent parent does not have to live with you. A foster child must live with you all year.

HISTORICAL COST: Acquisition cost of assets as opposed to fair market value or liquidation value. We use historical cost for assets because it is verifiable, objective and timely.

HOME OFFICE: Employees who work out of their home or business owners who have a home office may be able to deduct part of their household expenses on their tax return.

INCOME FROM OPERATIONS: Net income from operating activities before other income and expenses, extraordinary items or income taxes. Helpful for comparing one year to another or one company to another.

INCOME STATEMENT: The statement that represents Sales - Expenses = Profits.

INDEPENDENT CONTRACTOR: Performs services for others. The recipients of the services do not control the means or methods the independent contractor uses to accomplish the work. The recipients do control the results of the work; they decide whether the work is acceptable. Independent contractors are self-employed.

INDIRECT TAX: A tax that can be shifted to others, such as business property taxes.

INVENTORY COSTS: These include the purchase price of the inventory as well as shipping, storage and other inventory related expenses.

INVENTORY TURNOVER: The number of times in a year that the inventory is sold or clears out. An inventory turnover of 4 times would mean that inventory is held for an average of about 90 days or three months. (Three months x 4 = one year.)

INVESTMENT INCOME: Includes taxable and tax-exempt interest, dividends, capital gains net income, certain rent and royalty income, and net passive activity income.

LAST – IN FIRST – OUT (LIFO): A method of inventory valuation in which the last item purchased is considered the first item sold. If inventory costs are increasing, this method results in a lower ending inventory, higher cost of good sold and lower net income compared to FIFO.

LEASEHOLD IMPROVEMENTS: Improvements to a building that the business leases rather than owns. Often leasehold improvements are amortized over the life of the lease.
LEVERAGE: The extent to which debt has been used by the company to finance growth or operations.

LIQUIDATION VALUE: The amount the business could get for the asset if they must sell it in a hurry.

LIQUIDITY: Having enough funds to pay bills when due plus a comfortable cushion.

LOWER-OF-COST-OR-MARKET: The amount at which inventory or marketable securities is listed on the balance sheet.

LUXURY TAX: A tax paid on expensive goods and services considered by the government to be nonessential.

MARGINAL TAX RATE: The marginal tax rate is the income tax rate paid on the last dollar of income earned.

MARRIED FILING JOINTLY FILING STATUS: You are married and both you and your spouse agree to file a joint return. (On a joint return, you report your combined income and deduct your combined allowable expenses.)

MARRIED FILING SEPARATE FILING STATUS: You must be married. This method may benefit you if you want to be responsible only for your own tax or if this method results in less tax than a joint return. If you and your spouse don't agree to file a joint return, you have to use this filing status.

MEDICARE TAX: Used to provide medical benefits for certain individuals when they reach age 65. Workers, retired workers, and the spouses of workers and retired workers are eligible to receive

Medicare benefits upon reaching age 65. Significant for lenders as all wages are taxed for Medicare purposes. Therefore if the lender has the W-2 you can determine the full wages to which the borrower was entitled before 401-k etc.

MIXED COST: Useful for financial analysis, a cost that has both a fixed and a variable component. Example: Rent in a shopping mall that is a set amount plus a percentage of sales.

NET INCOME: Sales - costs.

OPERATING CYCLE: The time it takes to pay for inventory, sell it, and collect the receivable. In other words, to start with cash and end up with cash.

OPERATING EXPENSES: Expenses that relate to normal operations of the business. This does not include loss on disposal of assets, casualty losses or interest expense.

OPERATING INCOME: Net income from operating activities before other income and expenses, extraordinary items or income taxes. Helpful for comparing one year to another or one company to another.

OPERATING LEASE: A lease that allows temporary use of the asset for a fee, as opposed to a financing lease in which the business will own the item at the end of the lease for a nominal amount.

ORGANIZATION COSTS: The start-up costs of a business. Often can be added back as nonrecurring for projecting cash flow.

OTHER INCOME AND EXPENSES: Items that are not part of the normal operations of a business. These include gain/loss on disposal of assets, interest income and interest expense.

OWNER’S EQUITY: Assets - liabilities = owner's equity. The owner's share in the assets.

PAID IN CAPITAL: Capital paid in by the owners in addition to that paid for capital stock.

PARTNER"S EQUITY: The ownership position of a partner (owner) in a partnership.

PERSONAL EXEMPTION: Can be claimed for the taxpayer and spouse. Each personal exemption reduces the income subject to tax by the exemption amount.

PREPAID EXPENSES: Expenses that are paid in advance. They are recorded as an asset because they represent a right to something in the future. A good example is prepaid insurance. If a full year of insurance was recorded in the month paid, that month's statement would show too high of an expense, and in the rest of the statements for the year the expense would be understated. Prepaid expenses are only used when recording the full amount in the period paid would materially misstate income. These are often listed in current assets because they will be used up (expire) within twelve months. Analysts often subtract them from current assets prior to calculating liquidity ratios.

PRIOR PERIOD ADJUSTMENTS: Adjustments directly to retained earnings for items that should have been reported in prior periods. Thus retained earnings can be corrected without misstating the current period income and expenses.
PROFIT MARGIN: Net income divided by sales. The percentage of each sales dollar resulting in profit.

PROPERTY PLANT AND EQUIPMENT: Another term for Fixed or Long-term assets. It is not a literal description of what the company owns. For example, they may not own a plant.

PROPERTY TAXES: Taxes on property, especially real estate, but also can be on boats, automobiles (often paid along with license fees), recreational vehicles, and business inventories.

QUALIFYING PERSON: For the tax credit for child and dependent care expenses, a qualifying person is a child, dependent, or spouse who meets specific requirements. The taxpayer must furnish more than half the cost of maintaining a home that is also the home of the qualifying person. A qualifying child must be under age 13; the taxpayer must claim a dependency exemption for the child. (There is an exception for children of divorced or separated parents.) A qualifying dependent, or a person who could be claimed as a dependent if his or her gross income was less than the exemption amount, must be physically or mentally incapable of self-care. A qualifying spouse must be physically or mentally incapable of self-care.

QUALIFYING WIDOW(ER) FILING STATUS: If your spouse died in 2004, you can use married filing jointly as your filing status for 2004 if you otherwise qualify to use that status. The year of death is the last year for which you can file jointly with your described spouse. You may be eligible to use qualifying widow(er) with dependent child as your filing status for 2 years following the year of death of your spouse. For example, if your spouse died in 2004, and you have not remarried, you may be able to use this filing status for 2005 and 2006. This filing status entitles you to use joint return tax rates and the highest standard deduction amount (if you don't itemize deductions). This status does not entitle you to file a joint return.

REFUND: Amount government returns due to overpayment. State tax refunds are reported as taxable income only if the borrower took a deduction for the actual amount paid in the previous year.

RECEIVABLE TURNOVER: Number of times a year that receivables are collected. Twelve times would relate to 30 days in receivables. If you have a credit sales figure, you can calculate receivable turnover and days in receivables, then compare to their credit policy. If the policy is 2/10, net 30 and the days in receivables is 45, they are not collecting their receivables as agreed.

RELEVANT: The accounting concept that items that will make a difference to end users should be disclosed adequately.

RELEVANT RANGE: The reasonably expected range of activity. Used to determine if a cost is fixed or variable within the 'relevant range'.

RETAINED EARNINGS: The accumulated net profits of the business from the beginning, less capital returned to the shareholders in the form of dividends. If the company has been running a loss then retained 'earnings' will be negative. You can think of this as 'accumulated losses'. Remember that assets are shown at historical cost. A negative retained earnings on the books could actually be positive "equity" if the assets have appreciated in value (i.e. buildings or land).

REVENUES: Total dollars in the door.

REVERSING ENTRIES: An accounting term indicating journal entries necessary to back out beginning receivables and payables and enter the ending receivables and payables. These adjusting entries are used in accrual accounting.

SALARY: Compensation received by an employee for services performed. A salary is a fixed sum paid for a specific period of time worked, such as weekly or monthly.

SALES TAX: A tax on retail products based on a set percentage of retail cost.

SELF-EMPLOYMENT TAX: Similar to Social Security and Medicare taxes. The self-employment tax rate is 15.3 percent of self-employment profit including from a sole proprietorship, LLC or partnership. The self-employment tax is calculated on Schedule SE. The self-employment tax is reported on Form 1040.

SINGLE FILING STATUS: If on the last day of the year, you are unmarried or legally separated from your spouse under a divorce or separate maintenance decree and you do not qualify for another filing status.

SIN TAX: A tax on goods such as tobacco and alcohol.

SOCIAL SECURITY TAX: Provides benefits for retired workers and their dependents as well as for the disabled and their dependents. Also known as the "Federal Insurance Contributions Act" (FICA) tax.

SOLE PROPRIETORSHIP: A business owned by a single individual (sole proprietor). There is no legal distinction between the business and its owner, even though we account for them as separate entities.

SOLVENCY: Do assets exceed liabilities?

STANDARD DEDUCTION: Reduces the income subject to tax and varies depending on filing status, age, blindness, and dependency. This is a minimum adjustment. The taxpayer can itemize deductions if s/he can document more than the standard amount.

STATEMENT OF CASH FLOWS: The third financial statement required by Generally Accepted Accounting Principles (GAAP), it shows sources and uses of cash flow in three categories: Operations, Investing, and Financing.

STOCKHOLDER"S EQUITY: The corporate shareholder's rights against the assets of the company ...their share. This includes capital stock, paid in capital and retained earnings.

SUPPORT: For dependency test purposes, support includes food, clothing, shelter, education, medical and dental care, recreation, and transportation. It also includes welfare, food stamps, and housing provided by the state. Support includes all income, taxable and nontaxable.

TARIFF: A tax on products imported from foreign countries.

TAX CODE: The official body of tax laws and regulations.

TAX CREDIT: A dollar-for-dollar reduction in the tax. Can be deducted directly from taxes owed.

TAX EVASION: A failure to pay or a deliberate underpayment of taxes. This is to be distinguished from tax 'avoidance' which is the legitimate avoidance of taxes by taking legal deductions and credits in an aggressive manner.

TAX-EXEMPT INTEREST INCOME: Interest income that is not subject to income tax. Tax-exempt interest income is earned from bonds issued by states, cities, or counties and the District of Columbia.

TAXPAYER ID NUMBER: An identification number assigned to businesses for taxpaying purposes by the IRS or state taxing authorities. An Employer ID Number is required for partnerships, corporations, and trusts, and it may be required for sole proprietorships that have employees. Also called a Federal ID Number or Employer ID Number.

TIMELINESS: The accounting concept that accounting information should be provided within a time frame that allows users to act on it. One of the reasons for the historical cost basis for assets is that it would not be possible to provide fair market values of assets on a timely basis each month.

TIP INCOME: Money and goods received for services performed by food servers, baggage handlers, and others. Tips go beyond the stated amount of the bill and are given voluntarily. Taxpayers are required to report and pay taxes on their tips.

TRANSACTION: An event that affects the resources of a business.

TREASURY NOTES (T – NOTES): Negotiable debt obligations of the US government with maturities of 1 to 10 years.

TREASURY STOCK: Stock bought back by the corporation.

TRIAL BALANCE: An accounting step to determine that the asset and liability balances compare to other sources to ensure the integrity of the statements. Example: the cash balance would be compared to a reconciled bank statement. This used to be, literally, a step to be sure the total debits and total credits matched after manually entering transactions in the 'books'. Thus it was a trial balance.

TURNOVER: The number of times accounts receivable are collected or inventory sold in a year. Provides an indication of efficiency in the business.

UNCOLLECTIBLE ACCOUNTS: Accounts receivable balances that are not expected to be collected either because of their age or other information available about the customer.

WAGES: Compensation received by employees for services performed. Usually, wages are computed by multiplying an hourly pay rate by the number of hours worked.

WITHHOLDING: Funds that employers withhold from employees paychecks. This money is deposited for the government. (It will be credited against the employees' tax liability when they file their returns.) Employers withhold money for federal income taxes, Social Security taxes and state and local income taxes in some states and localities. Other entities may also withhold based on federal tax rules.

WORKING CAPITAL: Current assets (those assets expected to be turned into cash within a year) minus current liabilities (those debts that have to be paid within the year). If positive, this provides the cushion to handle unexpected events and to grow the company.