

How Much Tax Refund Are You Entitled To?

By Michael E. Schwartz, CPA, and Karen H. Klink, CPA, Arthur F. Bell, Jr. & Associates, L.L.C.

On May 25, 2006, the Internal Revenue Service (IRS) announced that it would cease collections of a three percent excise tax on long-distance telephone services. The excise tax on local and long-distance telephone calls originated in 1898 as a luxury tax on telephone services to help finance the Spanish-American War. The decision to end the tax on long-distance phone services followed several legal disputes in which five federal appeals courts held that the tax does not apply to long-distance services as they are billed by carriers. In addition to the cessation of tax collection, the IRS is also refunding a portion of taxes previously paid on long-distance telephone services. Refunds will be issued for U.S. excise taxes paid on long-distance telephone services billed for the period after Feb. 28, 2003 and before Aug. 1, 2006. Taxpayers should request this refund on their 2006 tax returns. The telephone tax continues to apply to local-only service, and the IRS is not refunding taxes charged on local-only service.

The Refund Process for Individuals

For taxpayers who choose to use actual amounts paid for the 41 months from March 2003 through July 2006, documentation should be retained in order to substantiate the requested refund amount. In order to minimize the burden, the IRS is offering a simplified alternative for individuals to collect their refund on excise taxes paid on long-distance calls since 2003.

Individuals will have a choice of electing a safe harbor amount or claim the actual tax paid. The standard amounts are \$30 for an individual filing a return with one exemption, \$40 for two exemptions, \$50 for three exemptions, and \$60 for four or more exemptions.

Form 1040 will be changed for tax year 2006 to include a line for requesting the refund or overpayment amount. For individuals not otherwise required to file federal income tax returns, a new Form 1040EZ-T can be filed requesting payment.

If an individual claims the actual tax paid, Form 8913, Credit for Federal Telephone Excise Tax Paid, should be completed and filed with their Form 1040. Form

8913 includes a column for interest, which should be received in addition to the tax. The interest received is reportable taxable interest income. If an individual claims the safe harbor amount, the interest is already included.

The Refund Process for Businesses and Exempt Organizations

Businesses and exempt organizations can determine their refund claim by either using actual amounts paid, or by using a formula to estimate the federal telephone excise tax paid for the 41 months from March 2003 through July 2006.

The formula method provides a less cumbersome option than gathering up to 41 months of old telephone records. Rather than computing the actual amount of excise taxes paid, filers can determine their refund amounts by comparing a telephone bill with a statement date in April 2006 with a statement date in September 2006. To use the formula, businesses and tax-exempt organizations follow these steps:

- Using the April 2006 phone bill (this is the bill with an April 2006 statement date), a taxpayer should divide the total federal telephone excise tax by the total phone bill (including federal telephone excise taxes) to arrive at the percentage of the bill attributable to federal telephone excise tax. The bills from all services and/or services providers (land line, fax, cell, local, long distance, bundled, etc.), should be combined before making this computation. For this purpose, there is no need to separate the taxes paid on long-distance service from those paid on local service. April is a representative month during which the government was still collecting the excise tax on long-distance service.
- Using the September 2006 phone bill, a taxpayer should divide the total federal excise tax by the total phone bill to arrive at the percentage of that bill attributable to federal telephone excise tax. The percentage should be lower because the government was only collecting the federal excise tax on local telephone service.

- Subtract the September percentage from the April percentage to arrive at the percentage that represents the federal long-distance tax. This is the percentage businesses and tax-exempt organizations will use to calculate their refunds.
- Multiply the long-distance tax percentage (determined in step three) by the total phone expenses shown on telephone bills dated after Feb. 28, 2003, and before Aug. 1, 2006.

Under the formula method, the refund is capped at two percent of the total telephone expenses for small business and tax-exempt organizations, defined as those with 250 or fewer employees. The refund is capped at one percent for large business and tax exempt organizations, defined as those with more than 250 employees. The number of employees is determined as of June 12, 2006, which should have been reported on the Form 941, Employer's Quarterly Federal Tax Return, for the second quarter of 2006. Part-time employees are considered the same as full-time employees.

For example, if a business has an April 2006 telephone bill of \$1,000, which includes Federal telephone excise tax of \$28, the tax percentage is 2.8 percent. If the September 2006 bill is \$1,100 including Federal excise tax of \$16.50, the tax percent is 1.5 percent. The taxpayer's long-distance excise tax percentage is therefore 1.3 percent (2.8 percent for April minus 1.5 percent for September). The taxpayer multiplies 1.3 percent by its total phone expenses over the 41-month period to arrive at the amount of its IRS refund. Provided the business has 250 or fewer employees, the entire amount calculated should be allowable. However, if the business has over 250 employees, then the refund is limited to 1% under the formula approach.

If a taxpayer does not have the monthly detail of telephone expenses paid, the estimate can be based on the amounts reported as business-related telephone expense on tax returns for tax years 2003 through 2006. The telephone expense amount for a particular tax year should be pro-rated if part of the year falls outside the refund period (2003 and 2006 for most taxpayers).

The formula approach can be applied even if the business only operated for part of the 41-month period. However, if the business was not operating from April through September 2006, the formula cannot be used.

For sole proprietors filing a Schedule C with their Form 1040, the refund alternatives will vary depending on the gross income reported. Sole proprietors reporting gross income of \$25,000 or less on their Schedule C may use the safe harbor amounts or request a refund based on actual expenses. Sole proprietors reporting more than \$25,000 of gross income have the following choices: (i) use the safe harbor amounts that cover both personal and business expenses, (ii) use the formula for their business expenses and actual for their personal ones, or (iii) use actual amounts for both business and personal. Individual owners of rental property and farmers have similar options.

Businesses, including sole proprietors, corporations and partnerships, along with tax-exempt organizations must complete Form 8913, Credit for Federal Telephone Excise Tax Paid, to request a refund. Trusts and fiduciaries are also considered businesses for the purposes of the refund. Forms 1120, 1065, 990-T and 1041 will be changed for tax year 2006 to include a line for requesting the refund. Interest should be received on the amount refunded, which is calculated and reported on the Form 8913. The interest is reportable taxable interest income. In addition, any part of the refund attributable to tax payments that were deducted as ordinary and necessary business expenses must be included in taxable income.

Summary

The individual safe harbor method and the business formula approaches to determining the amount due to a taxpayer are relatively simple to apply. However, if the actual amount paid is claimed as a refund, more information gathering is required. If you are considering using the actual expense method, you may want to start gathering your phone bills since Feb. 28, 2003. Starting early and maintaining good records should make the tax preparation process smoother. ☉

IRS Circular 230 Disclosure: To ensure compliance with requirements imposed by the IRS, we inform you that any U.S. federal tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.