

### Why Do Businesses Pay Taxes?

Oliver Wendell Holmes, Jr., a Supreme Court Justice in the early 1900s, is credited with the statement, "I like to pay taxes. With them I buy civilization." Few people can claim they like paying taxes, money required by the government to support its various functions. Yet taxation is so important to the nation that it was authorized in the Constitution. Taxes may not "buy civilization," but they do buy government services, from trash pick-up to medical care.

Some tax money returns to business as resources for growth and development. The Small Business Administration (SBA) is a federal agency that provides information, advice, government contracts, and loan guarantees for operations that fall within its size restrictions. It emphasizes underserved business owners, such as women, teens, military veterans, Native Americans, and other minority groups. Subsidies for public transportation make it more affordable and available, help lower-income citizens, and reduce stress on the roads and the environment. The owner of a commercial property may qualify for a low-interest construction loan by including energy-efficient features in the new building. Cities and states subsidize entrepreneurs, too, by creating enterprise zones. An enterprise zone is a geographic area in which businesses receive economic incentives to encourage development there. Entrepreneurs might be awarded grants to improve a property or tax credits for hiring employees. Business also benefits indirectly from government programs. Good roads make ground transportation more efficient. Sports arenas, museums, and tourist attractions bring customers to area merchants. Telecommunication networks use satellites built by the space agency NASA. And think how many businesses owe their existence to the Internet, which was created in the 1960s by the Department of Defense.

### What Taxes Do Businesses Pay?

Paying taxes is a daily reality. They must be included in every sale that is made and paycheck signed. There are many business taxes, some of which many people don't know about. In the eyes of the law, entrepreneurs are responsible for their business's taxes to the IRS. Trying to avoid paying taxes through illegal or deceptive means is called tax evasion and is a federal crime. It's punishable by fine, seizure of property, or even imprisonment.

### Payroll Taxes (FICA)

As you learned earlier, retirement and disability insurance is one of the biggest items in the federal government's budget. The government pays for these by using Payroll taxes, also referred to as FICA. FICA is the acronym for the Federal Insurance Contributions Act, the law that requires employers and employees to share the cost of the federal government's insurance and retirement program through deductions from wages and income.

Although both employers and workers contribute to the tax, the employer is responsible for calculating and sending the payments to the IRS. FICA tax is composed of two separate deductions: a larger one for Social Security and a smaller one for Medicare. They are figured as a percentage of the employee's wages or salary and withheld from each paycheck. The employer's own contribution equals the contribution of the employee.

### Federal Unemployment Tax (FUTA)

Just as payments to Social Security are technically called FICA taxes, payments to fund unemployment insurance are called FUTA, for the Federal Unemployment Tax Act. As the name tells you, the FUTA tax aids workers who have lost a job. It is also a percentage of employee wages; however, unlike FICA taxes, the FUTA tax is paid solely by the employer.

### Consumption Taxes

As a consumer, you're probably well aware that most of the goods and services you buy are taxed. Because these things are used, or consumed, such taxes are called consumption taxes. Lawmakers decide which goods and services are taxed, and at what rate. Business owners who sell these items decide who pays the tax. They either absorb the entire amount themselves or pass some or all of it on to the customer.

The most common consumption tax is a sales tax. Some local and state governments require this, so entrepreneurs may need to calculate taxes for a variety of situations. For example, a state may impose a sales tax on merchandise, such as a frying pan. However, merchandise that is bought to be resold later may be tax-free. So, if a restaurant equipment wholesaler sells a shipment of frying pans to a department store, the

wholesaler wouldn't be liable for sales tax-the department store would be. However, the store would probably not collect a sales tax if it sold the pans to a church for use in its soup kitchen, because sales to nonprofit organizations are usually tax-exempt.

Even figuring the tax on a single product can be complicated. In some states, food products are tax-free. However, a bakery owner might have to collect a tax on a birthday cake based on candles, decorations, and other inedible elements if they make up over half of the cake's retail value.

Additionally, certain items are subject to excise taxes. An excise tax is a tax on a specific product or commercial activity. Federal, state, and local governments often impose excise taxes to control consumption or raise money for a project. A city may have a tax on restaurant sales to pay for a civic center, for instance. Excise taxes on large commercial trucks, diesel fuel, and truck tires help pay for highway maintenance.

Goods that are traded internationally may be subject to tariffs. Some governments impose tariffs on imported goods to protect or strengthen a domestic industry by discouraging foreign competition. Exports may be taxed to encourage producers to satisfy the market at home rather than sell overseas. These taxes are sometimes controversial because they can restrict trade.

### **Business Income Tax**

In many cases, income earned as a business owner is taxed in the same way as income earned as an employee. The business's income is the owner's personal income as well. This is true for sole proprietorships, partnerships, S corporations, and limited liability corporations (LLCs). For this reason, these types of businesses are called pass-through businesses. The main difference, once again, is that the business owner is responsible for calculating and sending in these payments-not once a year, as an employee does, but throughout the year, even as they are earning income.

This is described as paying estimated taxes. Entrepreneurs predict what they will owe in income and payroll taxes and send in their payments each April, June, September, and January. Many business owners estimate conservatively, sending in the smallest amount necessary, to keep more money available for their business. They can also skip a payment if they believe they have no liability for that period. However, they need to be cautious or they may be penalized for underpaying. At year's end, they file a tax return, like any employee, to receive a refund or pay the balance of what they owe on their actual earnings.

For corporations other than S corporations and LLCs, taxation is more complex (and some believe less fair). C corporations are, in effect, taxed twice. First, a corporate income tax is assessed on the business's earnings. Then shareholders pay personal income tax on any corporate dividends received.

### **Property Tax**

Entrepreneurs who own the land or building where their business operates are also subject to an annual commercial property tax. As with personal property, the tax rate for commercial property is set by the local government. Each government sets rates according to its own formula. In some areas, taxes are based on both the property's actual and potential value. Values rise in areas where homebuyers are building and the infrastructure is being improved, for example. In addition, some states assess a tax on personal property used in business, including furniture, fixtures, supplies used for daily operations, and inventory held for sale.

---

## **QUESTIONS**

1. List the broad types of public services that are provided by the government.
2. Name some of the ways in which businesses benefit from government programs.
3. Describe FICA taxes and who pays them
4. Describe the FUTA tax and who pays it.
5. What are the two main types of consumption taxes?
6. What kinds of business property may be subject to property taxes?