

# Prorating Taxes

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## Taxes Paid in Advance or Arrears?

- Most taxes are paid semi annually
- Most counties require taxes paid in arrears
  - In 2010 we are paying 2009 taxes
  - At closing, we collect the Seller's portion by debiting the cost and give it to (credit) buyer
- A couple counties require taxes paid in advance
  - In 2010 we are paying 2010 taxes
  - Here we refund (credit) Seller, and collect Buyer's portion by debiting the Buyer for the end of the year

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## Prorate Taxes Paid In Arrears

- Seller may owe for all of the prior year and a portion of the current year.
- Assume taxes are owed in the amount of \$3,600 for 2009 and we are closing on May 15, 2010
- Seller must pay all of 2009, and the closer collects all of that to pay.
- BUT, the 2010 portion will be given to the Buyer to pay in 2011

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## Arrears Computations

$\$3,600 \div 365 = \$9.8630$  per day  
May 15 is the 135<sup>th</sup> day of the year

$$135 \times \$9.8630 = \$1,331.51$$

Seller owes a total of 2009 taxes and prorated amount for 2010 of:

$$\$3,600 + \$1,331.51 = \$4,931.51$$

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## Arrears Ledger Entries

- Seller: (think cost to the Seller)
  - Debit **\$4,931.51**  
(or depending on your form two debits one of \$3,600 and another of \$1,331.51)
- Buyer: (think reduces amount they bring to closing)
  - Credit **\$1,331.51**
- Trust or Balance: (to pay 2009 taxes immediately)
  - Credit **\$3,600.00**

**Debits Equal Credits**

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## Hint for Tests

- If this same example would appear on the test, don't panic.
  - First make sure are taxes paid in advance or arrears, or does it even matter according to the question?
    - It may say "taxes for the year in the amount of \$3600 are owing for 2009, closing May 15, 2010"
- Quick solution:  $\$3600 \div 12 = \$300$  per month
- May 15 = 4 and 1/2 months or about \$1,350
- Seller owes approximately  $\$3600 + \$1,350 = \$4,950$
- If you have an amount that is close that is probably right

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## Taxes Paid in Advance

- Be sure you understand the question. How much is actually paid in advance.
- With taxes paid in advance, there shouldn't be prior year owing, so we're only concerned about 2010 taxes.
- How much has been paid in advance, maybe all year, maybe only a portion. In either case find out from the question how much has been prepaid.

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## Paid in Advance Example (cont)

- In this case, the Seller has paid the entire year's portion of \$3,600 in advance.
- Seller needs to be refunded their unused taxes  
$$\$3,600 \div 365 = \$9.8630 \text{ per day}$$

May 15 leaves 230 days in the year

$$\$9.8630 \times 230 = \$2,268.49$$

Buyer reimburses that amount to Seller

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## Advance Ledger Entries

- Buyer: (reimbursing Seller is a cost or debit to buyer)
  - Debit           \$2,268.49
- Seller: (think increasing the amount they take home)
  - Credit                         \$2,268.49
- Balance or Trust:
  - Because this is money that will be immediately be transferred, it will not pass through the Trust account.

Debits equal Credits

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## Taxes In Summary

- Seller owes taxes through May 15 (135 days)
- Buyer owes taxes from May 15 (230 days)
- $\$3,600 \div 365 = \$9.8630$  per day
- Seller's portion:  $135 \times \$9.8630 = \$1,331.51$
- Buyer's portion:  $230 \times \$9.8630 = \$2,268.49$
- If taxes unpaid, Seller owes their portion
- If taxes prepaid, Buyer owes their portion

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