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Taxpayers Learn . . . Self Tax-Preparation Can Be Costly

Two different taxpayers; two similar results...just how much does professional tax preparation differ from what you can do yourself? Can a professional really save you enough tax liability to be worth the cost? Let's see.

Ms. G, after using software to complete her income taxes, felt sick to learn that in addition to the \$31,000 she had already paid in estimated taxes, she owed an additional \$12,000. At the urging of a friend, she visited the friend's tax professional. **That advice saved Ms. G \$14,000!** How?

Ms. G had sold a rental house with a large capital gain. After examining the return and asking several questions, the tax professional uncovered several software errors. The tax software had:

- Doubled her W-2 income;
- Not properly allocated the basis, selling expenses, or the sales price to the land and the building;
- Had not asked understandable questions about the settlement statement on the sale of the real estate; and
- Did not properly place the sale of the land and building on Form 4797.
- Missed several itemized deductions by not asking the right questions;
- Didn't probe enough to properly calculate basis and depreciation of a recent acquisition that was to be rental property;
- Incorrectly calculated the alternative minimum tax (AMT);

By reworking the return, correcting the errors, and using Schedule A instead of using a standard deduction, the tax pro was able to remove the AMT tax (a \$7,000 savings) and reduce the regular income tax. Rather than writing a check to the IRS for \$12,000, Ms. G received a **refund from the IRS of \$2,000 – a savings of \$14,000.**

A second taxpayer, Mr. B, saw a tax professional on the advice of his brother. He had sold a limited partnership interest and needed assistance reporting the sale (and its

explanation) on the tax return. Mr. B had completed his income tax return by hand using manual calculations. He and his wife had sold their personal residence and many belongings to move to a continuing care retirement community. He was unaware that the retirement community's entrance fee, as well as the monthly fee, had a "medical expense" component in it – of over \$65,000!

Believing that he did not have enough in deductions to qualify, Mr. B had not prepared a Schedule A to itemize even though he had enough deductions with just the medical expense! He could also claim real estate taxes, charitable contributions, the balance of the medical expenses (prescriptions, doctors, etc.), expense from a settlement statement, and dividends that were previously identified incorrectly (qualified/nonqualified). By using records from several years, the tax professional was able to reduce the capital gain on the sale of the taxpayers land. You can imagine that Mr. B was smiling when, instead of paying the IRS just under \$1,000, he was getting a **refund of nearly \$7,000 – a savings of almost \$8,000.**

Here is what Ms. G and Mr. B had in common:

- Both felt competent to prepare their own tax returns, yet given the complexity of tax return preparation, both lacked knowledge beyond salaries, retirement income, dividends, and interest.
- Ms. G was confused as to how to input data for the sale of her rental property and how to use Schedule A deductions instead of the defaulting standard deduction. Without being asked probing questions such as those a tax professional would ask, she missed out.
- Mr. B was unaware that part of the retirement community's fee was partially for lifetime medical support. Without the knowledge of a tax professional, he missed many additional eligible tax deductions.

There is no equal to having the assistance of a trained professional who asks probing questions and applies specialized knowledge to achieve the maximum refund or minimum balance due on behalf of his or her clients.