



Client Not Taken

Imagine making \$250,000 a year in your business. Your business pays all of your business and household bills, including car payments. In other words, your business covers every aspect of your living expenses. Also, you never have to pay a nickel in FICA, federal taxes or state income taxes. You also get a refund every year in the form of the EIC. Sounds like the American dream.

I had these people come to my office for an appointment. It seems that their old CPA disappeared off of the face of the earth and they needed someone to work on their current year's tax returns.

As will all new clients, we requested that they bring in the last two years returns, which one of the owners did.

As I was reviewing the returns I started asking questions. The S-Corporation was zeroed out each year (this is typical advice of some practitioners). The owner(s) wait until the end of the year to take a salary to have the tax payments as withholding to avoid late payment penalties.

There was no corresponding income on the 1040 for wages, but there were salary expenses recorded on the 1120-S. There were no employees and there were no W-2's to be found among the business paperwork.

I asked why their property taxes and mortgage interest were on their business return. They stated that their CPA was very clever and that they themselves were the owners of the home, but the business rented their residence from them as an office.

When I asked why there was no rental income on their Schedule E or why the home was not being depreciated, they had no explanation. The business had registered rental expenses on the 1120-S.

Then I asked if the business was taking the mortgage interest expense and the property taxes, why were they also on their Schedule A?

They had never noticed this before.

I asked if they had backup for the charitable deductions, cash and non-cash donations. They stated that there were some available.

On the business, there was a large expense on the other expense line. But there was no corresponding schedule to spell out the detailed items in the total amount. The client had no records or kept any so they had no idea.

There were some other income items on the 1040, but for the two years I was looking at, the Schedule A greatly exceeded the Adjusted Gross Income (AGI) on the return.

After I pointed this all out to the prospective client, I informed them that I believed that their CPA was forced to shut down by the IRS (the Service has been cracking down on fraudulent preparers). Maybe they have not been

able to locate him because he was forced to shut down. I suggested that it was in their best interests to file amended returns and accurately reflect the income and expenses of their business and personal returns.

They stated that they needed to discuss with their spouse and would like me to explain this all to them the next day. They left the prior year forms in my office.

I attempted to call the Chairmen of the Ethics Committee of the ICPAS. I felt I needed to know where I stood from a liability perspective with these people. They came back early the next morning before I was able to discuss the issue with the Ethics Chairman.

I outlined all of my findings to the spouse, explaining that I believed that they had submitted fraudulent returns. They stated they had only followed the advice of their CPA. I pointed out on the form that they were responsible for the returns accuracy.

I also stated that it was unlikely that they had actually qualified for the Earned Income Credit (EIC), which is where the real fraud occurred. This is an abused area that the IRS has been utilizing a great deal of energy in addressing fraud. I encouraged them to consider amending as far back as feasible. If they started the process themselves, it would look better than waiting for the IRS to come after them.

When they asked how much their liability would be I explained that if they truly were at break-even, they would only have to refund the EIC fraudulently acquired. They were getting \$8,000-9,000 a year and they did not want to pay this back.

They had discussed it among themselves the day before. They took all of their documents, stated that they were going to talk to their attorney for additional options and left. Luckily, I made no copies of the forms. I talked to the Ethics Chairman and since I had no copies of the forms, I made the proper recommendations. They felt I had done my due diligence from a liability standpoint.

I later heard that they found another tax preparer to do only the current return. That preparer suggested that they form a new company, forget about the past company and just move forward.

But the reality, as every business owner knows, that this is an impossible dream. If you are successful you will need to pay some form of taxes. There are ways of legally minimizing your tax liability, but you also have to use common sense. If you make money and can live an upper middle class lifestyle, it is unlikely that you won't have to pay taxes and qualify for the EIC. It just is not possible unless you are perpetuating fraud.