

10 Things Tax Preparers Won't Tell You

Below is an excerpt from the book *"1,001 Things They Won't Tell You,"* which was published in May 2009 and highlights popular columns from SmartMoney's long-running "10 Things" feature.

1. "A big name doesn't always mean better service."

Roughly 135 million Americans file tax returns, and of those, two thirds pay for help. While solo acts like CPAs and so-called enrolled agents have plenty of clients, almost 20 percent of taxpayers go through a big franchise like H&R Block, Jackson Hewitt, or Liberty Tax Service to get their refund—in 2007 costing an average \$2,255 per return. Problem is, tax preparation and advice depend on the preparer, and in a system of franchises, that means thousands of seasonal employees and limited quality control.



The results can be dangerous. When staffers from the Government Accountability Office (GAO) went undercover to get returns done by the big chains, they found “nearly all of the returns prepared for us were incorrect to some degree,” according to the report. Worse yet, recently filed lawsuits allege that the owners of 125 Jackson Hewitt franchises cost the government \$70 million in tax fraud and created an environment “in which fraudulent tax-return preparation is encouraged and flourishes,” according to the Department of Justice. Jackson Hewitt says it stands behind its compliance procedures as well as its nationally standardized educational curriculum.

2. "You wouldn't believe what I get away with."

As of 2008, complaints about tax preparers, including allegations of inaccuracies and returns that weren't filed on time, were up 80 percent in five years, says the Council of Better Business Bureaus. But when it comes to the IRS policing problem preparers, “the lifeguard is asleep,” complains Sen. Chuck Grassley (R-Iowa), who took the agency to task for inaction in 2007. (The IRS had no comment.) Less than 1.5 percent of returns get audited, and while that may pacify nervous taxpayers, audits are the primary way to catch bad tax pros. The GAO found that a year after it reported poor preparers by name to the IRS, the agency had failed to audit a single one.



Professional organizations, like the American Institute of Certified Public Accountants (AICPA) and the National Association of Enrolled Agents, pack even less of a wallop because they often wait for the IRS to act. Then the AICPA will strip membership and report bad accountants to the relevant state-licensing group, says Tom Ochenschlager, the association's VP of taxation. How to find out if your CPA has been disciplined? Visit the agency's website at www.aicpa.org/TheCPALetter.

3. "You might be better off without me."

Maybe you're hiring a tax preparer because you've got better things to do with your weekend or numbers make you dizzy—more power to you. But if you're hiring a pro because you think he's smarter than you, think again. On average, tax preparers make more mistakes, and costlier ones, than Josie Taxpayer does. According to a study of IRS data, 56 percent of professionally prepared returns showed significant errors, compared with 47 percent of those done by the taxpayer. And audited taxpayers who used preparers owed an average of \$363, while those who filed themselves owed \$185.



Of course, tax preparers often see more-difficult returns, which could lead to more errors. But the bottom line? “For one W-2, mortgage interest, and a couple of kids, TurboTax is just fine,” says Kerry Kerstetter, an Arkansas CPA. If, on the other hand, you're attaching a schedule for self-employment income or capital losses, consider getting help. And even then, if a return is made complicated by a one-time event—say, the birth of a child or the acquisition of a rental property— you might need only one year's worth of advice. “If nothing changes, you should be able to copy it from year to year,” says Ochenschlager.

4. "What are my qualifications? Well, I'm real good at Sudoku."

Every April, Sen. Grassley calls IRS officials before the Finance Committee to grill them on taxpayer protection. He's increasingly concerned about unethical, unlicensed tax preparers and what he calls “sharks in the water.” “Anyone can call himself a tax preparer,” Grassley laments. Many do. There's no mandatory



national licensing, and Oregon and California are the only states that require tax pros to take a test. That means as many as 600,000 tax preparers are unregulated, according to the National Taxpayer Advocate, the taxpayer assistance wing of the IRS. Some may set up shop in a local real estate office, but many work for the big chains.



Translation: There's no universal standard for qualification. Licensed preparers, who are usually CPAs or enrolled agents, are tested and must meet ongoing education requirements. Unlicensed preparers do neither. In general that's fine—no harm, no foul. But in the worst-case scenario—say, a tricky audit—only a pro with a license (or a lawyer) can represent you before the IRS.

5. "If it's February, you're already too late."

A savvy tax pro may be able to cut your tax bill or juice your refund. But don't expect to find one come Feb. 1. From that point through April, tax pros are generally too busy to talk to new clients. So if you don't already have a preparer lined up by the time you actually have your W-2s in hand, "you're not going to get good service," says Frank Degan, an enrolled agent in Setauket, N.Y. "In the fall, though, tax preparers will give you their full attention." That means you should be talking to tax preparers in October and November. They'll have time to answer questions, look over your old returns, and suggest changes.



Not only that, but talking to a tax pro in the fall means you still have time to plan. If you wait until you have all your W-2s, you've locked in all your income for the year. But in the fall a good preparer can help you figure out ways to manipulate your income by increasing your 401(k) contributions, deferring a bonus until the new year, or taking taxable losses. Wait until spring, and a professional can help you make small decisions, like whether to itemize or think about different deductions, says Bob Scharin, an analyst with Thomson Tax and Accounting, but you've lost most of your flexibility.

6. "You hired me, but your return is being done by some guy in Peoria."

Some accounting firms have begun outsourcing return preparation, says Rich Brody, a University of New Mexico accounting professor. That means your data might be sent out of state or to a local H&R Block, since the chain contracts with CPA firms to do returns. Either way, your accountant isn't obliged to tell you, as long as your account is being outsourced domestically. (The IRS ruled in January 2008 that tax preparers are required to tell clients if their return is being prepared outside the U.S.) "It's very scary," Brody says.



Indeed, transmitting Social Security numbers, names, addresses, birth dates, and account numbers electronically makes some people uneasy. For while the origins of identity theft are often hard to pinpoint, says Beth Givens, director of the Privacy Rights Clearinghouse, returns contain so much "in one bright, shiny package—that's a great gift to the identity thief."

The number of outsourced returns is still small, but they're becoming increasingly common. An overseas company can process a return overnight for as little as \$50, much less than a CPA's hourly rate. CCH, an organization that provides such services, estimates that 240,000 returns will have been outsourced in 2008—up 20 percent from 2007.

7. "Taxes, shmaxes—let me see what else I can sell you."

The real money in tax preparation has nothing to do with 1040 forms and W-2s. For the big-chain preparers, as well as your local accountant, the register really lights up only when they persuade you to take a loan, open a retirement account, or buy insurance. Chances are you don't need what they're selling, but the sales pitch may blur the issue. GAO staffers reported that when they visited the bigchain tax preparers, loans were described as "options" or "bank products"; on one visit a customer was asked to sign a loan application without being told what it was.



Worse, these extras can do more harm to consumers than good: More than 80 percent of those who opened an "Express IRA" at H&R Block, for example, paid more in fees than they earned in interest, according to a lawsuit filed by the New York attorney general. (H&R Block says most Express IRA accounts opened between 2001 and 2005 have yielded "positive net tax savings benefits and interest earnings," even as the company "has lost money operating this program.") CPAs, too, are in the sales game, ever since the AICPA allowed members to sell insurance products. When commissions can be \$20,000, says Terry DeMuth, an insurance wholesaler in California, "it's easy to get greedy."

8. "If I screw up, I'll pay up."

Worried about an audit? H&R Block and Jackson Hewitt are happy to ease your mind—for a price. Both offer the option of buying a souped-up guarantee that promises to cover any back taxes you owe, plus interest, fees, and penalties. Here's what they don't say: You don't need the extra protection. If it turns out you owe back taxes, the big chains' basic (read: free) guarantee already covers fines, penalties, and interest. Many CPAs and enrolled agents will do the same;



they often have insurance for that very purpose. Just be sure to ask about it before one does your return.



But what about the back taxes? True, they could amount to a bigger expense than the fines and penalties, which may be why some chains can sell that extra guarantee. But H&R Block and Jackson Hewitt will cover you only up to \$5,000 and exclude the most complicated returns. If you're tempted, know there may be an unintended consequence: If someone pays your taxes, the IRS considers that taxable income. In other words, if you buy the guarantee and H&R Block ends up paying your back taxes, expect to get a 1099 next January.

9. "Tax preparation is an art, not a science."

A recent law tightened penalties for tax preparers who play fast and loose with the tax code, taking far-fetched positions because they know 99 percent of returns never get audited. That said, for anyone with a complicated or unusual financial life, there's still lots of wiggle room, says Kerstetter, the CPA: "It's about 10 percent black, 10 percent white, and everything else is in the middle."



Chances are good you have room to maneuver if you have income in a category the tax code treats flexibly—you're selfemployed, for example, or own rental property. Ditto if you've earned big capital gains or incurred high or unusual medical expenses. In short, Kerstetter says, if you're attaching a schedule to your return, a good tax preparer will pay for himself.

Now, that may mean raising a red flag with the IRS, and a good preparer should explain if he's taking risky positions, says Fred Giertz, of the National Tax Association. If you can't stomach the specter of an audit, you'll want a pro to err on the side of caution. And think twice before paying someone to look for loopholes if your income picture is relatively simple. "If you've got one W-2, you don't need someone fancy," says Kerstetter. "There's not a lot we can do for you."

10. "You could find a much better deal if you'd only shop around."

There's no standard price for doing taxes. Some preparers charge by the hour, others by the form; either way the cost depends on where you live, the complexity of your situation, and the qualifications of your tax pro. Consider this: The average H&R Block customer pays about \$150; a CPA may charge 15 times that. Jay Adkisson, a California lawyer who specializes in helping people protect their assets, says, "People rely too much on word of mouth; they don't shop prices." If they did, they might be surprised. A licensed local pro may not cost much more than a national chain. Nadine Smith, an enrolled agent in Florida, charges by the form, and a simple return could cost just \$200—not much more than what you might pay at a big chain.



Even among franchises, prices vary. The return that cost \$90 to prepare at one big store was more than three times that amount at another, according to the GAO study. To be fair, it may be hard to know what your return will cost before the preparer actually spends time on it. Ask for estimates using last year's return—that'll give you a point of comparison to find the best price.

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