



# Tax Time

*Taking the terror out of taxes*

*When it comes to taxes, you don't want to take any chances. Our tried-and-true tips from tax professionals will help you get through tax season with a minimum of drama.*

It's that time of year — tax season! There's nothing like working hard for your money... and then turning a good portion of it over to good ol' Uncle Sam. Taxes are no fun to pay, and even less fun to file. But there's no avoiding them. Horror stories abound, of liens placed on bank accounts, assets being seized, menacing agents pounding on the door demanding payment. And of course, in all these stories, the IRS looms in the foreground, snarling and gnashing its greedy teeth, preying on innocent, tax-paying citizens.

Makes you want to hide under your blanket.

**I**n actuality, tax season is pretty straightforward for most of us: a visit to a tax preparer, some forms filled out, supporting evidence submitted... and you're done. But what happens when you think you're all clear and then find out you're not? Or when a letter from the IRS arrives in your mailbox informing you that you've been selected for audit?

I could scare you with some of the stories I've read. About the woman, for example, who opened her door to find two IRS agents demanding money, out of the blue. Or the man who claims he was slapped with a lien of \$110,000, with no prior notice.

But I won't. The tax professionals I've spoken with emphasize that the veracity of such tales is dubious. They also say that people can be quick to publicize their "horror stories" while withholding certain pertinent information... like the fact that they ignored a year's worth of notices before the IRS took serious action.

There are instances, however, where people *do* find themselves in sticky situations. The accountants, tax

attorneys, and financial planners who contributed to this piece were eager to share their knowledge and advice, to help the uninformed individual (me) navigate through potential tax pitfalls.

### Lesson One: Hire a Tax Professional!

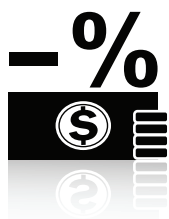
There's a reason why people hire accountants to file their tax returns. It's true that they charge, like all professionals; but they are well worth their fees. Some people learn that the hard way.

Yaakov was careful with his

Each year he'd fill out and file his own tax returns, taking care to ensure that his calculations were as accurate as possible. He had no need for an accountant, as far as he could tell. Over the course of his career he'd saved... let's see... \$250 x 20 years... why, that's \$5,000!

A wise decision, he figured — until the day he received a tax notice in the mail. In a state of panic, he nearly flew over to the office of an accountant he knew, who quickly got to work on his behalf. Ultimately, Yaakov realized he'd made a grave mistake.

No, this isn't a horror story; he didn't owe the IRS thousands of dollars that he



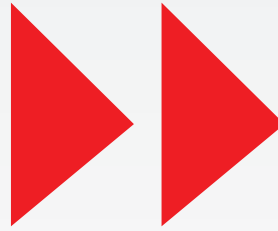
*Hire a tax professional to manage your return. The money you shell out may very well turn out to be the best investment you've made all year.*

money, and with good reason. He loved his job, but as far as financial benefits, it certainly was not the most lucrative choice. He was also careful about paying taxes.

didn't have. On the contrary: it turned out that the IRS owed him money — \$15,000 for overpayment over the last three years. Even worse, he'd actually overpaid by well

## Did you know?

Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming all have no individual income tax. On the other hand, New Jersey and New York have the highest tax burdens in the entire nation, followed closely by Connecticut and Maryland.



over \$100,000 in total, throughout the duration of his career, but due to the statute of limitations, he was only able to recoup a tenth of that amount.

This is, unfortunately, a true story. Lesson learned: Hire a tax professional to manage your return. The money you shell out may very well turn out to be the best investment you've made all year. In addition to his extensive knowledge about tax deductions and credits that you may never have even heard of (see sidebar), he is well versed in the complexities of the ever-changing and confusing tax laws.

Tax preparation software will not replace the services of an accountant, whose knowledge will serve to maximize your potential for both deductions and accuracy. This type of product is a tool, like a calculator. But it will not yield you the best possible return.

When hiring an accountant, seek out a Certified Public Accountant (CPA). And don't just go with anyone. Check out his references, experience, and certification to ensure that he is a real professional. Find out if he has handled audits in the past. Some CPAs are also tax attorneys, which means they can appear on your behalf before the IRS, and handle the legal issues that arise when you're chosen for audit, or deal with the dreaded liens or other withholding of assets. When you employ the use of a tax lawyer, you are also protected by attorney-client privilege.

*“The IRS is generally reasonable to deal with. They are also eager to close your case. If you work with them legitimately, they'll work with you.”*

### A Case of Stolen Identity

You've probably heard a lot of talk about identity fraud. You may even have received one of those scam emails purportedly from a friend's address, stating something like, “I'm stuck in Cairo without my wallet! Can you wire me \$3,000 immediately?” Tax returns have become a means of perpetuating fraud for identity thieves, in the hopes that they will receive tax refunds and credits that are due to others. The following story has not yet reached a resolution. And hold onto your hat: It happened to... an accountant.

Filing income tax was no big deal for Sam. He was an accountant, after all. Numbers to him were like, well, words are to me. In 2010 he submitted his return electronically — simple and fast, right? Wrong. His return was rejected. He was informed that a return had already been filed under his social security number. What was going on?

Using his prowess as an accountant, Sam downloaded the IRS transcripts of the return that had been filed. Whoever had decided to assume Sam's identity was

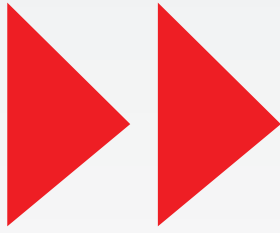


pretty thorough — and eerily well versed in his basic information. The address that had been provided was one digit off from Sam's actual home address, which explained why he'd never received any notices. Much of the information was obviously incorrect, such as Sam's single status and lack of dependents — in addition to his actual earnings and expenses.

Sam duly filed a police report and notified his credit bureau; a fraud alert was imposed on his profile. He then contacted the IRS, submitting a paper return with his legitimate information. The IRS summarily sent him a letter — the first to his actual address in over a year. Instead of a \$12,000 refund (which, incidentally, was made by direct deposit to some scam artist's bank account), Sam was informed that he now owed \$30,000 in taxes, due to his “dual incomes.” Their argument was that he'd failed to respond to their multiple notices, which had been mailed to the wrong address, the one listed on the fraudulent return. Currently, with the issue still unresolved, Sam is preparing for his next step: tax court.

“Identity theft is a huge problem,” says Steven Goldburd, tax partner at





Goldburd & McCone. “There is a lot of Earned Income Credit (a tax credit issued to low-to-moderate income taxpayers) fraud. With e-filing, which can be done from virtually anywhere in the world, it’s hard to verify the veracity of refund and credit claims. By the time you file your return, those checks have been issued — and it’s too late.”

Too many people know this already. The National Taxpayer Advocate, an IRS watchdog group, reports an increase of 650% in tax identity theft cases since 2008. In the 2012 fiscal year alone, the group fielded 55,000 requests for assistance.

Goldburd warns people of email scams stemming from addresses such as irsinfo.com. These emails may claim that your return has been rejected, or ask you to fill out a tax refund form, for example. Any emails purportedly stemming from the IRS are scams. The IRS will never contact taxpayers via email to obtain forms or information. If

## Taxpayer Relief

The new tax laws mostly mean bad news to individuals who fall into the highest income-tax bracket. It’s not all gloom and doom, though, as Efroim Fasten, CPA and partner at Fasten & Co., pointed out: “The Alternative Minimum Tax (an income tax imposed by the federal government to ensure a minimal level of payment, regardless of exemptions) was created in 1969 and was imposed using a straight calculation — one which remained unchanged for years. It was never adjusted for inflation, so although it was intended for wealthy taxpayers, as inflation affected the dollar, middle-class families were affected by the tax as well.

“The newly enacted American Taxpayer Relief Act finally indexed the original rate to inflation, changing the threshold for the AMT to include higher levels of income, and saving middle-class families from having to pay a tax intended for the truly wealthy.” Like all tax matters, the new AMT regulations are far from simple; however, any good news amid the disastrous “fiscal cliff” coverage deserves a sidebar all its own.

## Negotiating With the IRS

Is it ever possible to negotiate with the IRS? Judah Kupfer had this to say:

“At the government’s discretion, there is the possibility of entering into an ‘offer in compromise,’ allowing the taxpayer to settle for an amount that is less than he or she owes. The IRS will only enter such an agreement if there is doubt as to whether the assessed liability is correct, or if there is doubt as to its collectability, as is the case when the taxpayer owes more than he can pay based on his assets and future income. A special hardship or illness may also yield an offer in compromise.

“Before the IRS will reach an agreement, it will evaluate the taxpayer’s assets and the value of his income over the next 60 months and offer a payment plan. Bear in mind that penalties and interest continue to accrue until a settlement is reached — thus, if the offer in compromise is not accepted, the taxpayer will owe more in penalties and interest for the time the offer was pending.

“Other possibilities include entering into an installment agreement, to be able to pay the tax liability in monthly installments; requesting a temporary delay in collections if the IRS finds that the taxpayer can’t pay; and if all else fails, the taxpayer may make a Request for Taxpayer Advocate Service Assistance, where the IRS will try to mediate the issue.”

## *An IRS watchdog group reported an increase of 650% in tax identity theft cases since 2008.*

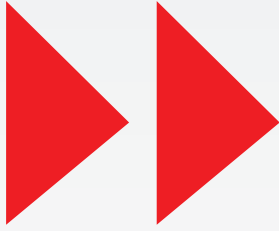


you receive a fraudulent email, the IRS recommends that you forward it to them, and immediately delete it.

The IRS recommends a number of precautions to avoid identity theft,

including protecting your computer with firewalls and anti-virus software, regularly checking your credit report, and protecting your financial information. But ultimately, with savvy

and frighteningly calculating identity thieves on the prowl, often scamming large numbers of victims at once, there is sometimes no way to avoid the problem.



In Sam's case, he was made aware of his status as a victim of tax-identity fraud as soon as he found out that a tax return had already been filed under his social security number. Other indications are if you receive notice of collection or balance due, although you did not file taxes, or if IRS records indicate that you worked for an employer you've never heard of.

The course of action Sam took following his discovery is appropriate. As soon as you believe you are the victim of fraud, contact the IRS. Be aware that no refund will be issued to you until the problem is resolved, which may be an arduous and lengthy process... as Sam can tell you.

### Selected for Audit... Why Me?

I know I said I wouldn't share horror stories, but I ran this one by an attorney to get his thoughts, and am sharing the story with his go-ahead.

In 2009, the *Seattle Times* reported the story of Rachel Porcaro, a single mom of two boys. Porcaro was selected for audit in 2008, when the IRS claimed that her reported income of \$18,892 was not enough to support her family. Their skepticism was based on their assessment of the median income of Rachel's neighborhood, and their determination that she must have been hiding income.

After a battle with the IRS, her two previous tax returns were determined to be deficient as well, and Porcaro was ordered to pay \$16,000 — an amount she, a hair cutter for Supercuts,



couldn't remotely afford.

This was only part of her story, which subsequently became pretty

## Tax Deductions You May Not Be Aware Of

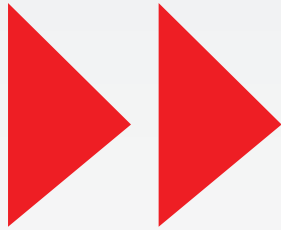
Avrumi Tabak, CPA, offered the following deductions, which many people might miss:

- **Educator Expenses** of up to \$250. Teachers, if you buy prizes for your class, or spend up to that amount on your classroom, you can include your expenses as an above-the-line deduction.
- **Dependent Care Expenses**, if both spouses work, can actually include **day camp**, allowing you to deduct a percentage of up to \$3000 per child, for a total of up to \$6000.
- **Energy Efficient Home Improvements**, including hot water heaters, boilers, windows, doors, and other replacements that meet Energy Star program requirements, may yield a deduction. There are rules and requirements that must be met, but if you've made improvements to your home, this is one deduction worth looking into.
- **Higher Education Expenses**. There are three different ways you can claim this one, but bear in mind that there are options. A tax professional will help figure out which will yield the highest deduction or credit for you.
- **Insolvency on Debt Forgiveness**. This one may be all too appropriate in today's financial climate. Canceled debts are generally considered taxable income — but there are exceptions, for example, when your liabilities are greater than your assets at the time of debt forgiveness.
- **New York State Volunteers** such as Hatzolah members or EMS volunteers are eligible for a \$200 refundable credit on their New York State tax return.

Refael Eckstein offered one more: **Long Term Care Insurance**, which offers favorable deductions on both the state and federal levels. He also took the time to explain the difference between a tax deduction and a tax credit. **Tax deduction** will lower your taxes by reducing your taxable income. Of the amount you list as a deduction, a percentage will be deducted, which means that if you're in the 30% tax bracket, a \$1000 deduction will result in \$300 off your taxes. A **tax credit** is applied once you've calculated your income, and reduces the amount of tax you are required to pay, dollar for dollar. A \$1000 credit will reduce your taxes by \$1000.

*With the national average of charitable contributions falling somewhere between 3% and 5%, the average from family who gives the required amount to ma'aser is already above that level.*

messy. My question on this part of her ordeal was: Is this a likely scenario? Can the IRS come to the determination



that you can't possibly subsist on the amount of money you claim to have earned, when that is, in fact, the case?

"Great example," says Steven Goldburd. "The IRS will open an audit if your return raises questions. They do have a standard estimate of what should be paid for certain line items, although the numbers are not exact. If you're living in a neighborhood in which the average standard of living would require you to earn \$60,000 a year based on the average local cost of rent, food, and utilities, but you only

## Possible Red Flags on Your Return

There are various ways the IRS chooses whom to audit, says Judah Kupfer, a lawyer who advises on many issues of compliance, including tax law. Most returns are pulled for audit using a secret algorithm called the Discriminate Income Formula, which electronically processes many factors and chooses returns it deems have a higher risk of non-compliance. Some returns possess red flags, such as a sharp change in income from a prior year. Returns that possess itemized deductions, claim certain credits, and have income not otherwise reported on a W-2 or 1099 are more subject to abuse and are thus at a higher risk for audit, he says. Publicized earnings, such as winning the lottery, or being reported by a disgruntled employee or a former spouse can certainly do the trick as well.

Avrumi Tabak offered these possibilities as well, although he concurred that there is no definite means of predicting the chances of an audit:

- **Unreported Reportable Income.** If you forgot that you had taxable income, such as money put aside in a CD that earned interest, or a short-term job you forgot about, the IRS might be made aware of it through other sources, such as the bank, or your employer. A discrepancy between that information and the amount you claim to have earned might generate an audit, so be vigilant about reporting your earnings.
- **Excess Charitable Contributions.** With the national average of charitable contributions falling somewhere between 3% and 5%, the average *frum*

*continued on page 32*

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claim \$30,000 to \$40,000 in earnings, that might open an audit. The IRS will know, for example, that a family of your size will need about \$1,500 a month for rent, at least \$1,500 for kosher food, in addition to the clothing and other expenses that you incur each month. If you claim to only earn a portion of that, where is the rest coming from?”

“I see many tax returns that just make no sense,” agrees Efroim Fasten, CPA, partner at Fasten & Co. “If you’re going to report earnings that make no sense, it’ll raise a red flag within the IRS.” The IRS will use its powers of deduction to determine if your return is a logical one. There are some legitimate claims that may also prompt an audit, although no one knows exactly how the IRS makes its determinations.

Charitable contributions may raise questions, says Fasten, especially in *frum* households, where the percentage of donations will generally be significantly higher than in the average American household.

Most audits start out as desk audits, and they may not be full audits either. Sometimes the IRS will question just one line item — such as charity — requesting proof for the amount you claim.

Don’t panic if you receive notice of an audit, says Fasten. And don’t try to handle it yourself. Make sure you hire a competent professional to handle your case. Have as much proof as possible to back you up, in the forms of receipts, records, and logs. “The IRS is generally reasonable to deal with,” assures Fasten. “They are also eager to close your case. If you work with them legitimately, they’ll work with you.”

### Oh, No: I Overpaid!

It is a happy day when you realize that the IRS owes you money. But what if you realize that *after* you’ve filed your claim?

Your husband calls you from his

*continued from page 31*

family who gives the required amount to *maaser* is already above that level. While there are no sure-fire predictions, keep in mind that high percentages of charitable giving may lead to a line audit, even if the amount contributed is perfectly legitimate. Save all your receipts and be prepared to justify the amount you claim to have given.

- **Home Office Deductions** can sometimes raise questions, as they are easy to falsely claim. As in all cases, if the amount you claim is legitimate and provable, don’t worry — but be careful.
- **Schedule C.** Self-employed individuals are under closer scrutiny than salaried employees. Keep logs of your automobile expenses, including mileage, and have records of meetings held in locations such as restaurants.
- **Cash-Intensive Industries**, such as wig salons or restaurants, are also watched carefully. Business owners in industries such as these should have clear records of their earnings.
- **Out-of-Range Expenses.** A high mortgage interest deduction combined with a not-so-high income, for example, might raise a red flag.

The general rule of thumb when filing a tax return is to use common sense. Don’t claim figures that just don’t make sense logically. Be factual, legitimate, and be ready to prove yourself if selected for audit.

accountant’s office. “What’s the baby’s social security number? I’m adding him on as a dependent.” One minute: That baby should have been added last year. Turns out, he wasn’t. Sound the alarms! That means you paid more in taxes than you should have! What do you do now?

A scenario like this is not uncommon. And lucky for you, you have three years from the date you filed your original return to file an amendment. You (well, your tax preparer) will need to prepare a new 1040 and summarize your revisions on another form called the 1040x.

A word of warning: It is a common belief among tax professionals that an amended tax return will have a greater chance of an audit. If you are saving a significant amount of money, and your claim is legitimate, go for it. But be as vigilant as possible when making your calculations, make sure there are no errors, and include any supporting documentation.

If you realize that you’ve *underpaid* your taxes, follow the same procedure. Do not ignore your findings. The IRS is thorough and you don’t want to suffer any consequences.

In any case, whenever you notice an error in a return you’ve already filed, wait for your refund check to arrive before filing an amendment. Sometimes these errors will be automatically adjusted, and those changes may be reflected in your refund check.

### Do IRAs Save on Taxes?

Sorry, no stories here. But IRAs are an important topic to cover, since their tax benefits can be confusing.

Here’s what Refael Eckstein, financial planner at Brooklyn Financial Group, has to say: “When you open a traditional IRA, you’re putting money aside on which you do not have to pay taxes... yet. That tax payment is deferred until you are ready to withdraw the funds from your IRA, which might be years from now (some



withdrawals before age 59½ will result in a 10% penalty in addition to the taxes). You can list the contribution to your IRA as a deduction, subject to limitations; however, understand that you will eventually be paying taxes on that amount, as well as on any earnings that have been generated.

“Keep in mind that you can’t accurately calculate the exact amount of those eventual taxes. For one thing, as time passes, you may have entered a different tax bracket. Most people believe they will be in a lower tax bracket at retirement, but that’s not always the case, especially if you acquired more income-producing assets or generated other higher passive income. Additionally, no one can predict what the tax law will be at that time, especially as it relates to qualified money such as IRAs.”

An IRA is one of the best and easiest tax deductions to be used, says

Eckstein, but make sure your motivation goes beyond the tax incentive. And make sure that you are well educated with all the facts before you open one.

New laws coming into effect are designed to put a damper on many investments, he cautions. One new law imposes a 3.8% separate surtax on any net investment income for married people filing jointly earning over \$250,000. (Distributions from IRA accounts are not considered net investment income for purposes of the 3.8% surtax; however, IRA distributions will increase your income level for purposes of determining if you are subject to the surtax).

“In today’s environment, people should try to concentrate on tax-deferred and tax-favored products,” Eckstein concludes. Annuity and life

insurance are examples of tax-deferred and tax-favored products, according to current law.

### In Conclusion: Stick to Your Day Job

The best piece of advice I can give you is the first one I offered. Yes, taxes can be messy. And they are tricky. So leave them for the professionals.

Your job as a taxpayer is to be as accurate as possible regarding your tax return. Don’t be greedy. Save your receipts. Be prepared in case you are selected for audit with logs and records. In any case, as we contend with the annual burden of income tax, I wish us all a nice, fat refund check, and a smooth and uneventful tax season.

And be nice to the accountants out there. **B**



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