Fire Your Tax Preparer

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An occasional discussion of financial issues appearing in *Lifeline*, the newsletter and forum for California's emergency room physicians. For prior articles in this series, see www.lingane.com/tax/newsletr.htm.

The tax returns of most physicians are less complex than the central nervous system and general tax treatises, like IRS Publication 17, are easier to understand than Van Huijzen's monograph. Consumer tax software is easy to use, reasonably comprehensive and inexpensive. Fire your tax preparer because you don't need him.

Even though you could prepare your own returns most of the time, it makes sense to have someone review your work when you are confronted with an unusual situation or if the tax dollars are significant. After all, you would call upon another physician for advice when the patient's symptoms are unusual or significant. In other words, fire your preparer and hire a tax adviser.

An adviser is highly recommended if you are responsible for an estate or trust. California sets a high standard for fiduciaries and it makes sense to transfer this responsibility to an adviser if you are a novice investor or if there might be discord among the beneficiaries or if you have "other things to think about."

You probably look for technical competence, follow-through, personable manner and reasonable fees when choosing a medical adviser. These same criteria apply when choosing a tax adviser.

Technical Competence. You would never choose a medical adviser solely because they are a licensed physician. Licensure as tax adviser is a minimum requirement and you will need to infer competence from other indicators.

Has the individual earned professional certifications beyond the minimum? Are they active in professional organizations? Do they speak before professional organizations? Do their ideas appear in print?

Everyone makes mistakes. Competent advisers have a quality review system to catch as many mistakes as possible. Quality review is a special issue for solo practitioners because they work alone. But choosing an adviser from a large firm does not guarantee quality any more than choosing a physician from a large practice.

Human nature being what it is, a new adviser has an incentive to identify deficiencies in prior work. Our point is that there is value in occasionally having an independent assessment of your adviser's work product. Fire your adviser if there are quality concerns.

Just as a history and physical are often essential to a proper diagnosis, competent advisers begin with a comprehensive interview. Fire your adviser if they don't ask a lot of questions.

Will the adviser be able to assist if you are audited? Generally speaking, this means choosing an adviser who is admitted to practice before the Internal Revenue Service. That is, choose an Enrolled Agent, a Certified Public Accountant or an attorney. If your troubles might become a criminal matter, choose an attorney.

Medicine has evolved into subspecialties because medicine is too broad for everyone to be competent in everything. In the same vein, be wary of an adviser who is not upfront about their limitations.

Service and Fees. Insurers tell us that the less humble are sued more often than the less competent. An adviser's bedside manner may mean more to your overall satisfaction than does their technical competence.

An elderly woman asked Peter to review her return. The tax liability was correct. Although the person who prepared this return was technically competent, and the fee very modest, he was unsatisfactory because he did not explain why the tax was larger than in prior years.

If you are a neatness freak, you may not get along with an adviser whose office resembles a war zone. If you are computer phobic, you won't be happy with an adviser who only communicates by e-mail. If you are a numbers person, don't choose an advisor who thinks in pictures.

There is no reliable relationship between price and quality. County Health Departments provide routine medical services at attractive prices. The national tax preparation chains provide routine tax services at attractive prices.

When a firm competes on price, there is an incentive to have large numbers of customers, to hire seasonal employees and to eliminate all but the most essential services.

"Concierge medicine" has a very different business model. Because prices are high, there is an incentive to provide superior service lest customers be tempted to wander. The Palo Alto Medical Foundation, for example, advertises that their physicians return telephone calls promptly and that there is Internet access in the waiting rooms and fresh croissants after a fasting blood sugar.

Most of us prefer good service without five star fees. If you were seeking a comfortable hotel at a reasonable rate, you would likely avoid the name brand establishments in the prime locations. A similar strategy should help you find a reasonably priced, service oriented adviser.

Fees are generally negotiable so ask for an estimate upfront or, better yet, for a fixed price. Find out what is included in the fee. There may, or may not, be an extra charge if you call with questions, for example.

What if the tax authorities inquiry about the return? Service oriented firms tend to bundle the response to routine documentation inquiries into their pricing structure. All firms should amend the returns for free if they made an error or did not conduct a comprehensive interview.

Gene went elsewhere when his tax preparer wanted twice the fee to prepare Gene's return and that of his fiancée. Charging a double fee suggests that this firm competes on price. If the firm had had more slack in their pricing algorithm, the second return might have been discounted, just as the return for a customer's child might be prepared for a nominal fee.

Proactive Tax Planning. The tax liability is usually determined as the tax rate times gross income less deductions.

Tax Liability = Tax Rate times (Income less Deductions)

The incremental federal and California tax could be as high as 42% of each extra dollar. However, the tax liability is generally less than 42% of total income because of the deductions and because some income is tax-exempt.

Some individuals have so much tax-exempt income and so many deductions that their tax liability as determined by the usual formula is a lot less than 42% of total income. The purpose of the alternate minimum tax is to insure that federal and California tax paid by high income individuals is a significant portion of their total income.

The alternate minimum tax on high income individuals is, conceptually, the difference between the tax determined as about a third of total income and the tax determined by the usual formula.

In some situations, alternate minimum tax means paying more tax today but paying less tax in future years. In other situations, alternate minimum tax means paying more tax, period. It may be possible to avoid extra tax by controlling the timing of income or deductions.

Consider the physician who is selling their practice. Although capital gains are taxed at the same rate for both regular and alternate tax purposes, there can be extra tax when capital gains are high in relation to other income. A physician will likely pay extra tax if they realize a million dollar gain whereas they would likely pay no extra tax if the gain were spread over several years by an installment sale.

This example illustrates that proactive planning can often reduce alternate minimum tax to a manageable nuisance. Indeed, proactive planning is essential when someone has significant assets or income.

The disasters we hear about usually occur because there was no adviser or the adviser was not knowledgeable or the adviser was not consulted until after the triggering event.

Fire your adviser if they don't insist that you call them before deciding your wedding date, creating a pension plan, making large gifts or selling your practice.

Our next discussion will address the purchase of a first home. We invite your suggestions for future articles.

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