

# THE TAX PROFESSIONAL

FROM VETERAN TAX PRO ROBERT D FLACH



January 2016

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## MORTGAGE INTEREST GUIDE - REPRINT RIGHTS

In my opinion the area of the Tax Code where proper documentation and strict adherence to the law is perhaps the **most overlooked** (or actually ignored) is the deduction for mortgage interest - both on Schedule A and Form 6251.

Taxpayers are required to keep separate track of acquisition debt and home equity debt, to make sure that the deduction on Schedule A does not include interest on debt principal that exceed the statutory maximums, and to determine what interest deduction to add back on Form 6251 when calculating Alternative Minimum Taxable Income. However, I firmly believe that 99.5% of taxpayers do not do this. I do not know of any taxpayer who does. And I expect that the majority of tax preparers do not do this for their clients.

I have created a MORTGAGE INTEREST GUIDE as part of my "[Dollar Store](#)" of tax guides. In this guide I explain the various types of mortgage debt and the deduction limitations, and go into detail on how refinancing an acquisition debt mortgage can result in home equity debt.

**I include in this guide two worksheets - one for Acquisition Debt Activity and one for Home Equity Debt activity - and provide a detailed example of how to use the worksheets.**

My MORTGAGE INTEREST GUIDE is a great way for tax preparers to introduce new homeowners to the rules and responsibilities for deducting mortgage interest. You can give this guide to clients who have just purchased a new home, or offer it as a free "gift" to new homeowners in your town as a part of a marketing and promotion program to get new clients.

And the debt activity worksheets in the guide are excellent tools for use in your practice if you choose to maintain the documentation for your clients.

I am offering limited "reprint rights" for my Mortgage Interest Guide to my fellow tax professionals to purchase and use for just such purposes. The cost of the limited license and right to reprint the Mortgage Interest Guide is **only \$14.95**.

The reprint rights are for use in **your own practice only - for free distribution to current or potential clients**. You cannot use the reprint rights to sell the guide to the public.

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## THE WANDERING TAX PRO

I have been preparing 1040s for taxpayers in all walks of life since February of 1972, and I have also been writing the popular tax blog THE WANDERING TAX PRO consistently (except for an annual tax season hiatus) since June of 2001.

THE WANDERING TAX PRO contains up-to-the-minute advice, information, resources, and commentary on federal and NJ state income taxes, updates on federal and state tax legislation, IRS and NJ Division of Taxation rulings and regulations, and federal and NJ tax court decisions, insights and observations on operating a 1040 tax preparation practice, information on other online tax planning and preparation resources, and other interesting "stuff".

Visit me regularly at <http://wanderingtaxpro.blogspot.com>.



## WHAT ABOUT BOB?

Greetings! My name is Robert D Flach. I have been preparing 1040s for individuals in all walks of life since 1972. I am the Editor and Publisher of THE TAX PROFESSIONAL.

My first encounter with income taxes came when I was a freshman at a local Jesuit college. I had taken the first half of Accounting 101, but had not taken any tax classes. I had no experience with any aspect of income taxes. I had never even prepared my own simple returns.

My uncle's tax professional, James P. Gill, who had a storefront office near a metropolitan transportation hub, hired college students during the tax season as "apprentice" preparers. During his annual visit to have his return prepared, on February 12, 1972 (he would always go on Lincoln's birthday), my uncle happened to mention that I had taken my first accounting course and that I was helping him with the books for the non-profit organization he ran. Jim told my uncle to send me in to see about a job – and the rest is history!

On my first visit to the office Jim took me to a desk in the outer office. He gave me a copy of a client's previous year's tax return and a briefcase full of papers that constituted the current year's tax "stuff", and told me to "jump in and swim".

If I had a question I would ask JP, who would take the time to explain the answer or send me to find the answer in his CCH tax library. So I was self-taught via on-the-job training. I learned how to prepare income tax returns in the very best way possible – by preparing income tax returns. Back then there was no software – so I learned by preparing returns manually. I firmly believe the best way to learn how to prepare returns is by preparing them manually.

In my 40+ years as a tax preparer I have never prepared a 1040, or any other federal tax return, using tax preparation software. When asked what software I use I simply point to my brain.

The closest I came to using software was during my brief tenure as a "para-professional" for the then big-eight CPA firm of Deloitte Haskins + Sells back in the late 1970s. I would fill-in an "input sheet" for a Form 1040 which was generated using Computax. My reaction back then was that by the time I finished filling in the input sheet I could have actually completed the return manually.

I attended an education session in San Antonio some years ago, conducted by legendary veteran tax pro and CPE instructor, and former director of the IRS Office of National Public Liaison, Beanna Whitlock. Beanna asked the participants if anyone still prepared 1040s manually. Of course my hand was the only one that went up. Beanna said she wanted to shake my hand - because I was the only one in the room who really knew how to prepare 1040s!

I am an "unenrolled" preparer. I am neither a CPA nor an EA. I have never had any desire to audit financial statements, so I did not become a CPA. And I have never had any desire to represent taxpayers before the IRS, so I did not become an EA.

Over the last 25 years I have written extensively about federal income tax planning and preparation for the average middle class taxpayer. I have been writing the popular tax blog THE WANDERING TAX PRO consistently, except for an annual tax season hiatus, since July of 2001.

I currently live in Wayne County, PA, and work out of a "home office" in my condo. I plan to continue to prepare 1040s until I can say I have been doing so for 50 years. I am attempting to wind down my practice by "thinning the herd" during my last years, and I do not accept any new 1040 clients.



## **EDITORIAL:** **WE NEED AN INDEPENDENT TAX PREPARER CREDENTIAL**

As we all know the U.S. District Court shut down the Internal Revenue Service attempt at regulating all "previously unenrolled" paid tax return preparers, and did away with the Registered Tax Return Preparer designation that would eventually be required of all such individuals who wanted to prepare federal tax returns for compensation. The IRS decided not to appeal the decision.

Do we really need the IRS to require federal "licensing" of paid tax return preparers?

The service already regulates preparers, both those permitted to "practice" before the IRS, like CPAs, attorneys and Enrolled Agents, as well as the "previously unenrolled" preparers who would have become RTPs, via Circular 230. There have been "preparer penalties" for many years now.

Paid preparers are required to sign and enter their "identification number" (originally their Social Security number) on all tax returns that they prepare for a fee. In the late 1990s the IRS created the Preparer Tax Identification Number, or PTIN, as an alternative to the Social Security number to help prevent identity theft. The court case kept in place the requirement for all paid preparers to register with the IRS and receive a PTIN -- so the service has the central registry of paid tax preparers that it needed.

I have been preparing 1040s for individuals in all walks of life since February of 1972. Prior to the initiation of the IRS regulation regime, for as long as I have been in the business and the years before, anyone could prepare a federal income tax return for a fee. There were absolutely no requirements. And the federal income tax system has managed to survive for almost 100 years.

Basically a tax preparer is someone who assists a taxpayer to prepare a required federal form. The 1040 (or 1040A) is a federal form, not unlike a census form or a federal student financial aid form (albeit more complicated). The taxpayer is responsible for all the information reported on the form -- the preparer provides guidance to the taxpayer on what is required to be reported and how to record it on the return.

The IRS argues that their required licensing of paid preparers would reduce tax fraud. This is not true. Regardless of any required licensing program, crooked taxpayers will always find crooked or unethical preparers, "underground" or otherwise, and crooked or unethical preparers will always find willing or naive taxpayers. Licensing and regulation of CPAs did not prevent Enron.

There is no real "need" to require federal "licensing" of paid tax return preparers. But there is a problem that needs to be addressed.

The problem is that any Tom, Dick or Harriet can hang out a shingle as a "tax preparer," regardless of education or ability. The situation got worse with the introduction of tax preparation software. Any Tom, Dick or Harriet, with absolutely no training, experience or knowledge, can simply purchase a tax preparation software package and try to pass themselves off as a "tax professional."

Without some kind of accepted certification program the taxpaying public has no way of knowing if a person who says that they are a professional tax preparer has any training or experience in, or actual knowledge of, preparing tax returns (except for individuals who have the initials EA after their name).

The answer would be some kind of voluntary "certification program" where a tax preparer could receive a universally accepted professional designation based on testing or credentials and maintained by required annual continuing professional education in federal taxation. The taxpaying public would then know that a preparer possessing this designation has proven basic competence in preparing 1040s and remains current in tax law.

The IRS already has such a program that designates preparers as EAs. However, this designation includes the ability to “practice” before the IRS and, as such, the enrollment examination is very extensive and includes issues of taxpayer representation. Many preparers, like myself, are happy just preparing returns and are not interested in taxpayer representation.

What is needed is a voluntary lower-level designation related to preparation only – like the Registered Tax Return Preparer (RTRP) designation. You could look at it like this: The RTRP-like designation is like an undergraduate degree and the EA is like a Master’s. But the IRS did not go this route. Instead it created a useless voluntary continuing education Annual Filing Season Program (AFSP) that provides tax preparers with a “Record of Completion” instead of an actual initialed credential or designation.

But the IRS is not the best choice to administer a voluntary certification program. In the case of all other professions, like CPAs, attorneys, architects and medical doctors, the maintenance of the professional certification designation is done by an independent industry-based organization such as the American Institute of CPAs, the American Bar Association, the American Institute of Architects, and the American Medical Association.

And so for professional tax preparers, any voluntary certification program, which issues a, for example, “Certified Tax Preparer” credential should be administered by an independent industry-based organization like a “National Institute of Certified Tax Return Preparers.”

There have been many attempts at voluntary certification of tax return preparers -- creating a designation for tax preparers (Certified Tax Professional, Chartered Tax Preparer, etc.) -- over the years. But none have been successful because they were offered by individual membership or CPE organizations and were not universally accepted by the industry.

Such an institute would be an independent, nonprofit organization established solely for the purpose of issuing, maintaining and promoting the tax-preparation designation. Its governing board will consist of a representative (perhaps the executive director or board president) of the National Association of Tax Professionals, the National Society of Tax Professionals, the National Society of Accountants, and perhaps the AICPA and/or the American Bar Association, and any other appropriate tax-related membership organization, and at least two independent “previously unenrolled” practicing tax professionals.

In order to receive the designation, a candidate must possess a valid PTIN and pass a competency test on federal 1040 tax law. A “grandfathering exemption” from this test would be allowed for:

- Tax professionals who have been consistently preparing federal income tax returns on at least a half-time basis (during the traditional tax filing season) for at least five full years and who have successfully completed a total of 48 hours of continuing professional education in federal taxation in the three-year period (36 months) prior to applying for the designation.
- Tax professionals who have passed the IRS-sponsored competency test and been designated as an RTRP under the IRS tax return preparer regulation regime.
- Tax professionals who have been licensed or certified to prepare income tax returns under a required state program that includes a competency test.
- Individuals who have successfully completed a certificate or certification program in federal income taxation offered by an accredited educational institution or a qualified membership organization that includes testing.

The “grandfathering period” would last for two or three years following the initiation of the certification program. Tax preparers who want to take advantage of the grandfathering exemption from testing would need to apply for the designation during this period.

Participants would need to renew their designation every three years by submitting proof of completion of a total of 48 hours of CPE in federal taxation during the three-year period, with at least fifteen hours each year. The 48 hours must include four hours of "tax updates" per year and one hour of "ethics updates" within the three-year period.

Qualified CPE providers would include accredited educational institutions and organizations/companies accepted by the National Registry of CPE Sponsors. The overseeing organization would not need to separately approve CPE providers.

CPAs and attorneys would be welcome to apply for voluntary certification under this program as a way to acknowledge and identify their knowledge of and currency in 1040 preparation.

With the institution of such a voluntary certification program, taxpayers will be able to identify true "tax professionals" from among the choices they are faced with. More accurate and competent returns will be prepared. And competent, ethical "previously unenrolled" tax preparers will receive the recognition and respect that they deserve. Everyone benefits -- the taxpaying public, the IRS and the tax preparation industry.

As an alternative to creating a new organization, which would be a difficult task, and a new credential we can look to the already existing Accreditation Council for Accountancy and Taxation, created and currently administered by the "other" NSA (National Society of Accountants), and its Accredited Tax Preparer (ATP) and Accredited Tax Advisor (ATA) credentials. The ATP is for basic 1040 preparers and the ATA is for practitioners who handle more sophisticated tax planning issues, including ownership of closely held businesses, qualified retirement plans and complex estates.

An ATA must maintain 72 hours of CPE during each three-year cycle or 24 CPE hours per year, similar to the EA, and an ATA must maintain 90 hours during each three-year cycle or 30 hours per year. The 72 and 90 hours must include 4 hours of ethics preaching – which is a bit better than the annual 2-hour requirement of the ATSP. These CPE requirements are in excess of the ATSP 18 hours per year, so these credentials clearly meet the alleged purpose of the ATSP - giving "unenrolled return preparers a way to stay to up-to-date on tax laws and changes".

Preparers with ACAT credentials are exempt from the annual 6 hour federal tax filing season refresher course and corresponding annual test requirement of the AFSP, so the IRS obviously "recognizes" these credentials as being valid "proof" of competence and currency in tax return preparation.

The initial competency examination component of the ACAT tax credentials should satisfy National Taxpayer Advocate Nina Olsen. Her support of the IRS voluntary program was tentative; she felt the program should include an initial competency test requirement.

The ACAT would need to sever its direct link to the NSA to become a truly independent organization and add representatives of the other legitimate tax preparer membership organizations to its Board of Trustees and be publicly "recognized" by these other organizations, and the IRS, as "the" voluntary non-"practice" tax preparer credential.

What do you think?

My **THE NEW SCHEDULE C NOTEBOOK** is a collection of advice, information and resources for Schedule C filers. It is a great resource for someone thinking about starting a sideline business as well as the veteran small businessperson. Purchase of this book includes my compilation of special forms, logs, schedules and worksheets for the self-employed to use to help document Schedule C tax deductions and to help organize and gather the tax information needed to give to their tax professional. Go to <http://robertdfiach.blogspot.com/p/the-schedule-cnotebook-anew-special.html> for more information.



## **TRIPLE-CHECK ALL TAX RETURNS!**

As a tax professional you have the obligation and responsibility to make sure all returns you prepare are correct.

Any tax preparer – regardless of training, experience, or “initials” – can make a mistake. Even I have made mistakes on 1040s I have prepared over the years.

The mistake can be mathematic or involve the proper application of tax law or regulation.

A tax preparer can unintentionally omit reporting or entering income or deductions from an information return or client worksheet.

A tax preparer can unknowingly understate or overstate taxable income or legitimate deductions. A tax return is prepared based on information supplied by the taxpayer, and this information can be, purposefully or not, faulty.

Over the years I have found that tax preparers who use tax preparation software – which I expect is now about 99% of all tax pros (I am truly one of the last of the dinosaurs) – tend to become lazy when it comes to checking software-generated tax returns.

There is nothing to guarantee that a tax return generated using tax preparation software package is correct, mathematically or otherwise.

I triple check all finished returns before giving them to the client. This should not be limited to returns prepared manually. Tax returns generated by software must also be triple checked in the same manner.

Here is what I do -

I run three series of adding machine tapes – verifying net taxable income three different ways.

The first is a tape adding and subtracting, as appropriate, the numbers on pages 1 and 2 of the Form 1040.

I next run a continuous tape of all the numbers on all the forms and schedules in the return – Schedules A, B, C, D, and E and so on – and any unattached worksheets used to determine entries on the 1040 in the order the information appears on Page 1 and 2.

For example, I would add the wages and other income numbers of Page 1 (that are not carried forward from an internal form or schedule or unattached worksheet) and the individual entries from each internal form and schedule and unattached worksheet that are carried over to Page 1, subtract the adjustments to income in the same way (using the individual entries from any internal forms and schedules and unattached worksheets), subtract either the individual components of the Standard Deduction or the individual items from Schedule A, including any individual items of deduction or adjustment from unattached worksheets, and each personal exemption individually.

The total from both of these first two sets of adding machine tapes should be exactly the same. If they are not I go back and check the additions and subtractions of individual items on each of the internal forms and schedules and unattached worksheets to verify the carryforward numbers.

I run the last tape directly from the original source documents of the information reported on the return – W-2s, 1099s, K-1s, 1098s, bills and receipts, and any worksheets either prepared by myself or provided

by the client. Here I use the complete dollars and cents for each item. The total of this tape should be within a couple of dollars (and change) of the totals on the first two – considering there would be a minor rounding adjustment.

In the case of a Schedule D with a loss, where the total of all the individual items results in a net loss in excess of the \$3,000 allowable maximum, I first run separate tapes of the Schedule D items – both from the return and the source documents – to verify the net capital loss and then use the \$3,000 loss deduction in each of the 3 “triple-check” tapes. I would also do the same with Schedule E if a passive loss is limited.

Once the net taxable income has been verified I double check the actual tax calculation, using the number on the tax return and the net taxable income from the third adding machine tape process.

This triple check process is not as time consuming as it may seem from the explanation.



## WANDERING THE WEB ONLINE RESOURCES FOR TAX PROS

<http://costbasis.com>  
[www.bigcharts.com](http://www.bigcharts.com)

One of the biggest time wasters during the tax filing season is trying to determine the cost basis of stock sold by a client – especially stock that has split often since its original purchase, or was acquired via spin-off or merger.

Costbasis.com will help you determine the tax basis of securities sold, and show how to account for those stock spinoffs, mergers, splits, split-offs, rights, and class action claim checks. I have so far used it to look up two stocks that had been acquired via merger, and found it very helpful.

You can use BigCharts.com to find the price of any listed stock or mutual fund on any exchange for any given date. Go to “Historical Quotes”, enter the ticker symbol of the stock and the date of death, or the business day closest to the date of death, to get a price quote. It will also identify any subsequent splits.

Cost basis information, calculators, worksheets can also often be found in the Shareholder Services sections of company websites.



## JOINT OR SEPARATE – THAT IS THE QUESTION

Many tax preparers will automatically prepare a joint return for a married couple – assuming that this is the better filing status. But I say that tax professionals should almost always do a comparative analysis to compare filing joint to filing separately before preparing the returns of married taxpayers.

Whenever you find yourself faced with choices on a tax return you should review each option and do separate tax calculations to see which one will result in the lowest overall federal, state, and local tax. You will need to calculate three (3) sets of federal, state, and local tax liabilities, one for a joint return and one each for the husband and wife's separate returns. You must also determine if the Alternative Minimum Tax applies to any of the 3 returns and do the appropriate calculations if it does.

One reason to consider filing separate returns is because the "marriage penalty" is alive and well and thriving in the federal Tax Code.

Because of the way the tax rate schedules are constructed, dual-income married couples generally pay more federal and state income tax than they would if they were filing as two Single taxpayers. This is known as the "marriage penalty". George W's early tax cuts attempted to address the problem, and did provide a fix for lower income taxpayers who do not itemize. But it remains a real issue for most middle and upper middle- class taxpayers.

You may be able to reduce this "penalty" by electing to file as Married Filing Separately.

Before I go any further I must point out that you will not be able to take advantage of some tax benefits, or you will receive a reduced benefit, if you file separate 1040s.

In most cases if you file separately you cannot claim –

- the American Opportunity or Lifetime Learning Education Credit,
- the Credit for Adoption Expenses,
- the Credit for Child and Dependent Care Expenses,
- the Earned Income Credit,
- the Credit for the Elderly or Disabled,
- the adjustments to income for tuition and fees, student loan interest, or a spousal IRA.
- a loss on rental property
- the exclusion from income savings bond interest used for qualified educational expenses.

And -

- A greater amount of your Social Security benefits may be taxed.
- The maximum net loss deduction is limited to \$1,500 for each spouse.
- One spouse's passive loss cannot be used to reduce or wipe out the other spouse's passive income.

If the husband and wife lived apart for the entire year, or in certain cases for the last 6 months of the year, they will be able to file separately and still receive the full tax benefit for some of the items listed above.

When itemizing on Schedule A you must reduce medical expenses by 10% (or 7½%) of Adjusted Gross Income and most miscellaneous deductions by 2% of AGI. If one spouse has excessive deductions in

either category applying the % exclusion to the separate AGI should produce greater separate deductions.

Let's say a couple, both spouses under age 65, had \$8,000 in deductible medical expenses, \$6,000 of which was for dental work for the wife and \$2,000 was for glasses and doctor bills for the husband. Their combined AGI is \$100,000, of which \$60,000 applies to the husband and \$40,000 to the wife. If they filed a joint return, and could itemize, they would get no deduction for medical expenses (\$8,000 less \$10,000). If they filed separately, the husband could not deduct any medical expenses, as 10% of his AGI (\$6,000) is more than his \$2,000 in medical bills. But the wife can deduct \$2,000 (\$6,000 less \$4,000). By filing separately they get to deduct \$2,000 more in medical expenses.

If the husband was an outside salesman and had \$2,500 in net unreimbursed "employee business expenses" and the wife was a secretary with no job-related expenses, and they paid \$100 in tax preparation fees for a joint return, they would be able to deduct \$600 in miscellaneous expenses on a joint return (\$2,600 less \$2,000). On a separate return the wife would have no miscellaneous deduction, but the husband could deduct \$1,350 (\$2,550 less \$1,200) - \$750 more than on a joint return.

If one spouse claims itemized deductions on a separate return the other spouse must also itemize. One spouse cannot itemize and the other claim the standard deduction.

If increased medical or miscellaneous deductions are not an issue, you will generally receive the greatest combined federal and state tax savings from filing separate returns if the individual taxable incomes of the spouses are relatively equal. As the spread between the two separate incomes increases the net tax savings will decrease until eventually filing separately will produce a higher net combined tax liability.

Unfortunately, you cannot file an amended return to change your filing status from joint to separate after the initial due date for that return has passed. If you file a joint 2015 Form 1040 in February of 2016 you can change to separate in March, but you cannot change to separate after April 18th.

When filing separate returns, each spouse will report as income his/her wages and net earnings from self-employment, the income (interest, dividends, capital gains, rents) from separately-held assets (bank accounts, investments, rental property), and one-half of the income from jointly-held property.

There is an exception for married couples living in "community property" states (Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin). In such states each spouse usually must report one-half of the total "community income" (income from community property and wages for services of either spouse) unless the couple lived apart (i.e. maintained separate residences) for the entire year.

Each spouse can deduct only those expenses that he/she has actually paid, and for which he/she is legally responsible. Expenses paid from separate funds (i.e. the wife's separate checking account) are considered to be paid by that spouse, while expenses paid from joint funds (a joint checking account) are considered to be paid equally by each spouse, unless they can prove otherwise.

The wife makes a \$500 charitable contribution from her separate checking account. She can claim the entire \$500. The couple makes monthly contributions of \$100 to their church from a joint checking account. Each spouse can deduct \$600.

Medical expenses are deducted by the spouse that makes the payment, regardless of which family member incurred the medical costs. A wife can deduct medical bills for her husband that she paid from her separate checking account, even if she is not legally responsible to do so.

If real estate is owned by only one spouse (vacation property owned by the wife), only that spouse can deduct the related property taxes, and only if that spouse has actually paid the taxes. Property tax paid on jointly-owned real estate is deducted under the guidelines discussed above.

Mortgage interest is only deductible by a person who is legally liable for that mortgage. For a mortgage on jointly-held property, where both names are on the mortgage, each spouse can deduct the amount of interest that he/she has actually paid, using the guidelines discussed above.

When it comes to claiming dependent children, either spouse can claim a child as long as they both agree. A couple with three children can decide that the husband will claim one child and the wife two, or that the wife will claim all three.

In the case of spouses who live apart during at least the last six months of the year, the "custodial" parent will get the dependency exemption, unless that parent releases his/her claim to the exemption on Form 8332. In some cases the custodial parent may also be able to file as Head of Household.

Another reason to file separately, even if the initial combined separate tax liabilities, before claiming any credits, is more than the corresponding liability on a joint return, is to take maximum advantage of the Child Tax Credit. The credit is up to \$1,000 for each dependent child under age 17, and is phased-out as MAGI exceeds \$110,000 for a married couple filing jointly and \$55,000 for separate filers. While one would think the spouse with the greater net taxable income should claim the dependency deduction for the couple's children, it is the lower earning spouse who should claim the children under age 17 to maximize the allowable Child Tax Credit.

John has a MAGI of \$76,000 and Mary has a MAGI of \$54,000. They have one dependent child under age 17. On a joint return, with a combined MAGI of \$130,000, they would not be entitled to any Child Tax Credit. If John claimed the child as a dependent he would not be entitled to any Child Tax Credit. But Mary will get the maximum \$1,000 credit if she claims the child on her separate return. If John and Mary have more than one applicable dependent the credit allowed would be reduced via phase-out on a joint return or if John claimed the children, but Mary would still get the maximum \$1,000 credit per child.

Having the lower income spouse claim dependents on a separate return is also usually "more better" when it comes to calculating the Alternative Minimum Tax.

## CLASSIFIED ADS



THE TAX PROFESSIONAL will accept classified ads for publication. The Publisher reserves the right to refuse any submission. The cost of an ad is a minimum \$10.00 for up to 50 words, and 20 cents per each additional word. The same ad run in all four quarterly issues is \$30.00 plus 60 cents per each word in excess of 50 paid in advance.

Send your ad copy and payment (payable to Taxes and Accounting, Inc) to -

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POST OFFICE BOX A  
HAWLEY PA 18428



## NOSTALGIA CORNER:

### MY FIRST 1040

Most people remember their first love. I remember with fondness the first Form 1040 I prepared as a paid tax preparer – which for me is really the same thing. My first 1040 was the 1971 model.

On Page 1 of the 1971 Form 1040 one would indicate name, address and Social Security numbers of the filer(s). In the case of a return for a married couple the names were listed as “Richard and Mary Taxpayer” on one line instead of a separate line for the name of each spouse. The filing status was checked and exemptions were claimed. The taxpayer and spouse could each claim an additional exemption for being 65 or over and blind. The names, but not Social Security numbers, of dependent children were listed, with no indication of whether they “lived with you” or “did not live with you”. The names, but again not Social Security numbers, of “other” dependents were listed on Page 2 of the 1040.

Income was reported on Lines 12 through 18 on Page 1, with lines for wages, dividends (no designation of “qualified”), interest (taxable only – no reporting of tax-exempt interest), and “income other than wages, dividends and interest”, the sub-total, total “adjustments to income” and Adjusted Gross Income. The Line for dividends include (a) for gross dividends and (b) for an exclusion amount. If gross dividends and/or total interest exceeded \$100 one would have to complete and attach Schedule B

The net tax liability was reported on Lines 19 through 23. Federal Income Tax withheld, Estimated Tax Payments, and “Other payments” were deducted and a balance due or refund was indicated.

Line 31 of the Form 1040, and not Schedule B, was where the taxpayer was asked about foreign accounts.

Page 2 of the Form 1040 consisted of Part I where other dependents were listed, along with relationship, months live in taxpayer’s home, did dependent have income of \$675 or more, amount taxpayer furnished toward support, and amount furnished by all others, including the dependent, but not the dependent(s)’ Social Security number(s).

Specific items of income, adjustments to income, credits, other taxes, other payments, and the actual Tax Computation were reported on Lines 34 through 64 in Parts II through VII.

Social Security, Railroad Retirement, and Unemployment benefits were totally exempt from federal income tax. One could use the “3-year” rule for recovering employee contributions to determine the taxable portion of pensions and annuities. This was calculated on Part I of Schedule E.

Adjustments to income included –

- \* “sick pay”,
- \* Moving expense,
- \* Employee business expense, and
- \* Payments as a self-employed person to a retirement plan, etc.

The only credits indicated on the 1040 were –

- \* Retirement income credit,
- \* Investment credit, and
- \* Foreign tax credit.

The personal exemption amount was \$675. Tax could be calculated by "using Tax Rate Schedule X, Y or Z, or if applicable, the alternative tax from Schedule D, Income Averaging from Schedule G, or maximum tax from Form 4726". Other taxes included a line for "Minimum tax", not yet alternative.

On Schedule A –

\* Medical and dental expenses were reduced by 3% of Adjusted Gross Income (this was the only item on the Form 1040 that was reduced based on AGI),

\* Taxes included state and local gasoline tax (from gas tax tables), general sales tax (from sales tax tables) and (not or) state and local income tax, with an additional deduction allowed for sales tax paid on "major purchases",

\* Contributions were deductible pretty much as they are now, except there was no strict requirement for documentation,

\* Interest expense included not only home mortgage interest (fully deductible – no principle restrictions) but also interest on installment purchases and credit cards, and

\* Miscellaneous deductions were not reduced by a % of AGI; certain employee business expense, as mentioned earlier, were deductible as an "above-the-line" adjustment to income.

Schedule D allowed for a 50% deduction for net long-term capital gain – only half of such gains were included in AGI. So if net long-term capital gain (or net combined long-term and short-term gain if smaller) was \$10,000, only \$5,000 was reported as income on Page 2 of Form 1040. The maximum net capital loss deduction was \$1,000.

The starting tax rate was 14% and the top was 70%, although the rate for "earned income" such as wages was capped at 50% - hence the "Maximum Tax" calculated on Form 4726.

The 1971 standard deduction was \$1,050 for both a single person and a married couple. The standard deduction was originally 10% of AGI up to a maximum of \$1,000. It wasn't until 1975 that the standard deduction for married was more than that for single.

Obviously the 1971 tax returns were prepared by hand. We didn't even have photocopies back then (at least where I worked). The returns were written, or sometimes typed, on 3-copy carbonized forms purchased from Accountants Supply House in Valley Stream, New York State.

So tax rates were higher back then – but there were a lot more deductions allowed. And one could also use either Income Averaging or 10-Year Averaging to cut thousands off a large tax bill.

Do you think the Tax Code is better now or back then?

**If an IRS auditor and a lawyer were both drowning and you could only save one what would you do? Go to lunch or read the paper?**

**If Thomas Jefferson thought taxation without representation was bad, he should see how it is with representation.**

**A tax loophole is something that benefits the other guy. If it benefits you, it is tax reform.**

<b>Adjusted Gross Income</b>	23	Educator expenses	23
	24	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ	24
	25	Health savings account deduction. Attach Form 8889	25
	26	Moving expenses. Attach Form 3903	26
	27	Deductible part of self-employment tax. Attach Schedule SE	27
	28	Self-employed SEP, SIMPLE, and qualified plans	28
	29	Self-employed health insurance deduction	29
	30	Penalty on early withdrawal of savings	30
	31a	Alimony paid. In Recipient's 55% <span style="float:right">▶</span>	31a
	32	IRA deduction	32
	33	Student loan interest deduction	33
	34	Tuition and fees. Attach Form 8917	34
	35	Domestic production activities deduction. Attach Form 990	35
	36	Add lines 23 through 35	36
	37	Subtract line 30 from line 22. This is your adjusted gross income <span style="float:right">▶</span>	37

**THE MOST IMPORTANT NUMBER**  
**ON YOUR TAX RETURN**

Here is a refresher of something you are probably already aware of, taken from my book of timeless tax advice **WON'T YOU TAKE THIS ADVICE I GIVE YOU LIKE A BROTHER.**

Most taxpayers concentrate on ways to reduce their "taxable income". However, it is your "Adjusted Gross Income", or AGI, that is the most important number on your tax return.

Adjusted Gross Income is the net total of the various categories of income (Lines 7 through 21 on the Form 1040) less a variety of "adjustments to income" (Line 23 through 35). It is the last number on Page 1 of your Form 1040, or 1040A.

The "adjustments to income" are considered deductions "above the line", as are deductions that reduce the components of "total income" (Line 22). The "line" is your AGI. Deductions "below the line" include the Standard Deduction, Personal Exemptions, and itemized deductions. These deductions reduce Taxable Income, but not Adjusted Gross Income.

Why is AGI so important? Many tax deductions and credits are reduced, phased-out, or altogether eliminated based on your AGI, or in some cases a "Modified" AGI (no gift from this MAGI), and several items of income are increased, and some deductible losses are reduced, as this number grows.

A "below the line" deduction of \$1,000 on Schedule A will reduce your tax liability by the amount of your marginal tax rate. For a taxpayer in the 25% bracket an additional \$1,000 in itemized deductions will reduce the tax liability by \$250. But an "above the line" deduction of \$1,000 can reduce the tax liability by substantially more than \$250 because of the potential for increased deductions and credits and reduced taxable income.

The Tax Reform Act of 1986 started the ball rolling by limiting the allowable rental loss deduction for taxpayers with an AGI in excess of \$100,000 and phasing-out the amount of IRA contributions that could be deducted based on an AGI threshold. The Budget Reconciliation Act of 1990, the Taxpayer Relief Act of 1997, the many tax Acts passed under George W Bush, and the tax breaks added during President Obama's tenure all continued the trend of limiting credits and deductions based on AGI.

Items that are affected by your AGI (or MAGI) include -

- the taxable portion of interest on US Savings Bonds used to pay for education,
- losses from rental real estate activities with active participation,
- the taxable portion of Social Security and Railroad Retirement benefits,
- deductible traditional and spousal IRA contributions,
- the ability to contribute to a ROTH IRA,
- student loan interest,
- the deduction for tuition and fees,
- medical and dental expenses,
- charitable contributions,
- casualty and theft losses,
- job and investment expenses, tax preparation costs, and other "miscellaneous" deductions,
- total Itemized Deductions,

- the deduction for personal exemptions,
- the dreaded Alternative Minimum Tax (AMT),
- the Credit for Child and Dependent Care Expenses,
- the Credit for the Elderly or Disabled,
- the American Opportunity and Lifetime Learning education credits,
- the Retirement Savings Contributions Credit,
- the Child Tax Credit,
- the Adoption Credit,
- the Earned Income Credit,
- Coverdell Education Savings Account contributions, and
- the safe harbor amount for quarterly estimated tax payments.

Each of the items listed above have a separate set of AGI thresholds. For some items the amount for joint filers is twice that for unmarried taxpayers; for others it is not. In some cases married taxpayers filing separate returns are not allowed the deduction or credit at all; in others the threshold for separate filers is half that for joint filers.

The reason for the reduction, phase-out, or elimination of deductions and credits based on AGI or MAGI is so that our elected officials in Washington can raise our taxes without actually raising tax rates.

The elder Bush pledged, "Read my lips – no new taxes". While the actual tax rates were not increased, the tax liability of higher income taxpayers did grow via the "back door" because of the PEP and Pease reductions of the personal exemption deduction and itemized deductions based on AGI.

While qualifying dividends, capital gain distributions and long-term capital gains are taxed separately at a lower rate, both for the regular tax and the AMT, these items of income are included in your AGI, as well as your Alternative Minimum Taxable Income (AMTI), and can reduce or eliminate the various deductions and credits affected by AGI, and cause you to become a victim of, or increase, the AMT. So in reality this income can be taxed at more than the "advertised" maximum rates of 0%, 15%, and 20%.

An increase in AGI increases AMTI, and can reduce the AMT exemption allowance. So the AMT tax cost of additional income is not necessarily 26% or 28%, the AMT tax rates, but could be 32.5% or 35%! And conversely a reduction in AGI can save 32.5% or 35%.

Because of the way the taxable portion of Social Security and Railroad Retirement benefits is calculated, for every additional \$1.00 of AGI you could be taxed on as much as \$1.85. For a taxpayer in the 15% federal tax bracket who finds himself in this situation a \$1,000 increase in AGI could increase the tax liability by \$278, or \$463 for a taxpayer in the 25% bracket. And conversely a reduction of \$1,000 in AGI can reduce tax liability by \$278 or \$463.

A reduction in AGI of as little as \$5 could reduce your tax liability by at least \$500! Now that the infamous "tax extenders" have been once again extended, married taxpayers filing a joint return can deduct up to \$4,000 in qualified tuition and fees as an "adjustment to income" if their MAGI is \$130,000 or less (\$65,000 for single and head of household filers). The deduction is reduced to \$2,000 for MAGI over \$130,000 or \$65,000. If MAGI exceeds \$160,000 (\$80,000 for single and head of household filers) no deduction is allowed. Reducing MAGI from \$160,002 to \$159,997 could allow for an additional \$2,000 "above the line" tax deduction, which reduces tax liability by \$500 for taxpayers in the 25% bracket. But the actual tax liability could be reduced even further if the taxpayers are claiming other deductions and credits that are affected by AGI.

There are several moves a taxpayer can make before the end of the year to reduce AGI:

Maximize "pre-tax" contributions to your 401(k), 403(b) or other pension or deferred compensation plans, including any "catch-up" contributions for taxpayers age 50 or older.

Maximize the amount of wages set aside in an employer-sponsored "pre-tax" medical expense or dependent care flexible spending account.

Postpone the receipt of a year-end bonus until next year.

Postpone billing clients until January, accelerate or prepay business expenses at year-end, and maximize retirement plan contributions if you are self-employed.

Accelerate or prepay expenses at year-end if you own rental property.

Sell investments as a loss to take advantage of the maximum \$3,000 net capital loss deduction.

Invest in tax-free municipal bonds or tax-deferred US Savings Bonds instead of bank CDs (be aware that tax exempt interest is included in the calculation of taxable Social Security and Railroad Retirement benefits).

But opportunities to reduce AGI do not end when the ball drops on One Times Square and the New Year is rung in. There are options available to taxpayers and tax preparers during the preparation of the return that can substantially reduce the tax liability.

Instead of deducting the total fee for tax preparation as a "miscellaneous" deduction on Schedule A, where it must be reduced by 2% of AGI and is often lost altogether, allocate a portion of the fee, if applicable, to Schedule C, Schedule E, and/or Schedule F. Taxpayers who are self-employed can deduct the portion of their tax preparation expense allocable to business-form preparation as a self-employed business expense on their Schedule C, allocable to rental income form preparation as a rental expenses on their Schedule E, and allocable to business form preparation as a self-employed farming expense on their Schedule F. Ask your Tax professional for an itemized bill that shows the portion of your tax preparation fee allocated to preparing a Schedule C, Schedule E, Schedule F, and any other related business tax forms and worksheets.

Claim actual expenses for a home office on Schedule C, instead of using the optional "simplified method", and turn a portion of the "below the line" deduction for real estate taxes and mortgage interest to "above the line" deductions. While a home office cannot generally be used to create a loss on Schedule C, you can generate a net loss to the extent of the business use percentage of real estate taxes and qualified mortgage interest.

Maximize deductible contributions to a traditional IRA and a self-employed SEP-IRA, including any allowable catch-up contributions. You have until April 18th to make the IRA contribution and up to as late as October 17th to make the SEP-IRA contribution if you request an automatic extension (October 15, 2016 is a Saturday).

Married couples should consider filing separate returns. See the above article JOINT VS SEPARATE – THIS IS THE QUESTION.

So whether doing year-end tax planning or preparing returns think AGI!

As a veteran tax professional I am often asked by friends, family, clients, readers, and cocktail party guests, "What is your best tax advice?" As an answer I have written a compilation of my best tax to share wisdom accumulated from my 40+ years of preparing 1040s which I have titled "**WON'T YOU**

**TAKE THIS ADVICE I HAND YOU LIKE A BROTHER"**

The cost of this book is only \$7.95. NATP members pay only \$5.96 – a 25% discount.

Click [here](#) for more information on this book.

# Rant!



## IF I HAD MY DRUTHERS

I am sure we all have a "wish list" for clients – a list of things we wish they would do. Here is mine -

(1) I wish that when a client receives a letter or notice from the Internal Revenue Service, or a state tax authority, about a tax return I prepared they would put it in the mail to me, fax it to me, or include it as an attachment in an email to me IMMEDIATELY.

I still have some clients who insist on trying to call me first to tell me that they got a notice from the IRS. This is a total waste of time. My telephone answering machine is turned off during the "regular" year –

it is only on during the tax filing season (January 15 to April 15).

And what would happen if they did manage to reach me by telephone? They would tell me that they got a notice from the IRS or the NJ Division of Taxation or whoever and I would tell them to mail, fax or email it to me!

Here is an example. A client tried repeatedly to call me with no success. So he told his mother to try to call me, which she did for a week or so, again without success. The mother mailed me a note saying that her son was trying to get in touch with me. I mailed a note to the son, along with a self-addressed envelope, telling him to mail me the notice.

The notice, which was from the NJ Division of Taxation, was dated October 1st. I received the notice in the mail from the client, finally, on November 10th. Look at how much time was wasted!

And I do have clients who just pay the balance due on the notice without consulting with me first. I have found that 2/3 to 3/4 of all notices are wrong – and that notices from the NJ Division of Taxation are more likely wrong than those from Uncle Sam.

(2) I wish clients would keep track of the cost basis of all their investments and give the information to me at tax time when they have sold investments.

Or at the very least tell - not ask – their brokers to provide them with – or send directly to me - a detailed Profit and Loss Statement showing dates of purchase and cost basis for every investment sold during the tax year.

Some clients do it right. They set up a file folder for each investment at purchase and put the original purchase confirmation in the file.

If dividends are reinvested they put the annual DRP statements in the file each year. If the investment spins-off or merges or whatever they put any related correspondence, notices and statements in the file.

If they purchase real estate they put the Closing/Settlement Statement in the file along with any receipts for expenses involved in the purchase that were not paid through the closing. They also place any receipts for capital improvements in the file each year.

If they receive an investment (including real estate) by gift they ask the giver to provide them with the cost basis of the investment gifted. If they inherit an investment (including real estate) they ask the Executor of the estate to provide them with the market value or appraised value on the date of death that was used in filing the federal estate, if required, and/or state inheritance tax return or filing.

When the investment is sold they put the sale confirmation, or Closing Statement, in the file and give me the file folder with their tax "stuff".

To be honest, I would prefer a Profit and Loss Statement from the broker, to save me the time of actually determining the gain or loss on each investment. However, the individual file folder system discussed above would provide more complete and accurate information.

While the new 1099-B reporting requirements have been a big help, the mandatory cost basis reporting only applies to recently purchased securities.

(3) I wish clients would provide me with specific numbers for deductions they are claiming – instead of telling me "claim the maximum" or "whatever I am allowed" or "same as last year".

The maximum is what you actually paid. You are allowed what you actually paid. It is very rare that an expense or number of miles driven for an activity is exactly the same as it was the previous year.

I need clients to tell me "\$1023.50" or "\$20.00 per week for 50 weeks" or "4638 miles"!

Each year I include in my January client mailing worksheets that apply to specific clients' individual situations – for medical expenses, charitable contributions, rental income and expenses, employee business expenses, etc. I wish clients would fill them out completely and accurately – or provide me with a detailed listing of deductions in any other format.

When clients do not give me the proper information and I have to email or write to them this wastes valuable time and delays the completion of the return.

I want to make sure my clients take advantage of all the deductions and credits to which they are entitled – but I can only do this if I am given complete and accurate information.

(4) I wish clients would make and keep a photocopy of all their Form W-2s for the year before sending me their "stuff" – as I clearly instruct in my annual January client mailing.

Each year during the season I get two or three frantic calls or emails asking me to fax photocopies of the W-2s to a bank, mortgage company or to the client. This is not a big thing, but anything that takes time away from actual 1040 preparation during this time is bad.

(5) My invoices all clearly state "payment due upon receipt". This means once the invoice is received, and not "30 days net". I wish my clients would sit down and write my check, and put it in the mail, as soon as they have finished reviewing the finished returns

This is only the beginnings of my client "wish list". I could probably fill several more pages.

So what is on your client "wish list"?

**I welcome, and solicit, the thoughts and comments of my fellow tax professionals on the topics discussed here in THE TAX PROFESSIONAL.**

**Please email your thoughts and comments to me at [rdftaxpro@yahoo.com](mailto:rdftaxpro@yahoo.com) with "THE TAX PROFESSIONAL LETTER TO THE EDITOR" in the subject line.**

## **THE TWELVE DAYS OF TAX SEASON**

On the first day of tax season my client gave to me a Closing Statement for the purchase of a home.

On the second day of tax season my client gave to me 2 W-2 forms.

On the third day of tax season my client gave to me 3 mortgage statements.

On the fourth day of tax season my client gave to me 4 Salvation Army receipts.

On the fifth day of tax season my client gave to me 5 Form K-1s.

On the sixth day of tax season my client gave to me 6 1099s for dividends.

On the seventh day of tax season my client gave to me 7 cancelled checks.

On the eighth day of tax season my client gave to me 8 useless items.

On the ninth day of tax season my client gave to me 9 medical bills.

On the tenth day of tax season my client gave to me 10 stock sale confirms.

On the eleventh day of tax season my client gave to me 11 employee business expenses.

On the twelfth day of tax season my client got from me a finished tax return, 11 employee business expenses, 10 stock sale confirms, 9 medical bills, 8 useless items, 7 cancelled checks, 6 1099s for dividends, 5 Form K-1s, 4 Salvation Army receipts, 3 mortgage statements, 2 W-2 forms, and a Closing Statement for the purchase of a home.

And, of course, on the thirteenth day of tax season the client gave to me a corrected Consolidated 1099 from Wells Fargo Advisors!

### **TAX PRO PRACTICE TIPS**

Each issue I will provide a special tax practice tip or idea. Here is one to help cover your arse:

Place a personalized stamp or mark on all original documents you have viewed, and returned to the client, in the course of preparing an income tax return. This way a client can't say he gave you information that you failed to include on the return if he is audited and tries to claim "I told my tax preparer, but he forgot to report it".

For example - enter your initials followed by a sequential number and an arbitrarily chosen non-sequential capital letter (1C, 2T, 3W, 4M, 5F) with a colored pen on each item. The letter "F", or whatever other letter you chose, indicates the last document viewed in the sequence. So even the most devious client cannot sneak in a 6th item.

If you have a tax practice tip you would like to share with your fellow tax professionals email me at [rdftaxpro@yahoo.com](mailto:rdftaxpro@yahoo.com) with "Tax Pro Practice Tip" in the subject line.

# TAX PROFESSIONAL FORMS, SCHEDULES, WORKSHEETS, AND CLIENT MEMOS

I have been preparing 1040s since 1972. Over the years I have developed a collection of forms, schedules and worksheets that have proven very helpful in my practice. I offer this compilation, with some sample client handouts, to you for **only \$7.95!**

Some forms are given to clients to help them provide me with the information I need to prepare their returns. Some are used as "memos" to the client's copy and my office file copy to back-up items reported on the returns. Others are used as attachments to the returns.

Please be aware that this is copyrighted material and is for your internal use only.

The package will be sent as a "word document" email attachment, so you may edit and revise them to personalize them to your firm, customize them be more relevant to your particular practice, clients or specific professions, or update for annual COLAs or tax law changes.

Here is some of what is included in the package:

Supplement to Schedule A  
Medical Expense Worksheet  
Medical Mileage Worksheet  
Medical Expenses – Out of Pocket Analysis  
Acquisition Debt Worksheet  
Home Equity Debt Worksheet  
Charitable Contribution Listing  
Charitable Contribution Record  
Charitable Mileage Record  
Contribution Worksheet  
Employee Business Expenses  
Employee Business Expenses – Police Officer  
Conventions, Conference and Education  
Miscellaneous Expenses #1  
Miscellaneous Expenses #2  
Summary of Casino Gambling Activity Log  
  
Alternative Minimum Tax Worksheet  
Does Not Have To File  
Joint Vs Separate Analysis  
Statement of Dividend Income  
Statement of Pension Income – in "landscape"  
format- sent separately  
Form 1040 Comparative Analysis

Allocation of Expenses  
Automobile Expense Worksheet  
Auto Mileage Log  
Business Expenses of a Freelance Writer  
Business Travel Record  
Computer Use Log  
Election to Deduct Organization Expenses  
Employee Expense Report  
Employee Time Card  
Home Office Deduction Worksheet  
Cell Phone Log  
  
Owner-Occupied Multi-Unit Rental Property  
Statement of Rental Income and Expenses  
Statement of Rental Income and Expenses –  
Vacation Property  
Multi Family Building  
  
CLIENT MEMOS  
  
What I Need to Prepare Your 2015 Tax Returns  
Client Finished Return Memo  
Engagement Letter

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Comments and suggestions for future topics -

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Thanks!

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