TALES FROM THE CRYPT
APRIL 2007

John Donofrio of Donofrio Inc. has emerged from the *"Tax Cave," a* top secret location that he walls himself in during the months leading up to tax day. (Rumor has it; he has not showered or shaved in three months.) John is here to enlighten/scare us with another installment of *Tales from the Crypt*.

I just had a new client come to my office for the first time to have her 2006 tax return prepared. This individual unfortunately had her previous years tax return prepared by none other than H&R Block. Due diligence and in this case, common sense, calls for me to review prior years tax returns in order to prepare the current years correctly as well as diffuse any time bombs left by carelessness or ignorance. Also, their are certain items that can be deductible on this year's return such as state taxes paid with the prior year tax return due date and items such as state tax refunds that need to be included as income on your federal tax return.

This new client of mine happened to be retired with a conservative preservation of capital outlook in regards to her investments. Her portfolio consisted of NYS/NYC municipal bonds, which for all practical purposes are tax free to the federal government, NYS and NYC (triple tax free)**. Two of the principal reasons for the purchase and ownership of municipal bonds are tax free income and preservation of capital. Because of this, municipal bonds typically pay less interest for that tax benefit.

My client was entitled to the triple tax-free benefit that NYS/NYC municipal bonds provide. However, the geniuses at H&R Block thought differently. After reviewing her tax return for 2005, I saw that the federal return correctly showed the tax exempt interest, however, after reviewing her state return I was shocked to discover that all of her NYS/NYC municipal bond interest was added back in to her NYS tax return. By adding back the interest to her state return, H&R Block had my client paying over $5,000 in unnecessary taxes to the powers that be in Albany for tax year 2005.

The incompetent H&R Block rep did not even look at her brokerage statements to see where the tax exempt interest derived from. If she had municipal interest other than NYS/NYC then I understand adding it back to her NYS return; however, that was not the case in this situation. My client had the rep call on a three way and he asked me what was wrong with the return for 2005. I indicated to the rep that she had all NYS/NYC municipal bond interest and her consolidated 1099 statement indicated such. I informed him that he caused her to pay an additional $5000 in taxes.

His response... *"My bad."*

We are all human and everyone is entitled to mistakes; however, this case was Accounting 101. The bottom line is with a tax code that is nine million words and growing, there is also a growing unlikelihood that you will find a competent tax-advisor whose experience and education is a six–week crash course.

This was not an error of omission. It was an error of ignorance.

Anyway...we amended the return and my client is awaiting the taxes she paid out incorrectly for 2005. The reality is that if she didn't walk into my office, she would be paying an additional $5000 this year as well. If you have any questions regarding this years or prior years returns please do not hesitate to contact me at (718) 921-1818.

**Understand that certain municipal interest derived from private activity is added back for alternative minimum tax purposes. The scope of the private activity bond interest is a lot more involved for this article; however, year end consolidated 1099 will indicate the amount of interest from a private activity.