

Your Business **TAX** Guide

They offer the moon; you land behind bars

Tax time brings out schemes and scams: Here are some you should watch out for

Beacon Journal staff report

It often feels bad enough having to pay taxes, especially if you have to write a check instead of getting a refund.

But you'll feel even worse if you fall for a tax scam that promises to save you money but instead forces you to pay hefty fines or even go to jail.

Each year the IRS releases its "Dirty Dozen" top tax scams. Here is the latest available list, which probably will be updated soon:

Trust misuse. Promoters urge taxpayers to transfer assets into trusts, promising reduction of income subject to tax, deductions for personal expenses and reduced estate or gift taxes. Some trusts do not deliver the promised tax benefits.

Frivolous arguments. Promoters make outlandish claims: that the Sixteenth Amendment concerning congressional power to levy and collect income taxes was never ratified; that wages are not income; that filing a return and paying taxes are merely voluntary; and that being required to file Form 1040 violates the Fifth Amendment right against self-incrimination or the Fourth Amendment right to privacy. Such arguments are false and have been thrown out of court.

Return preparer fraud. Dishonest return preparers skim part of their clients' refunds and charge inflated fees. They attract clients by promising large refunds. The taxpayer is ultimately responsible for the return's accuracy.

Credit counseling agencies. Be careful with credit-counseling organizations that say they can fix credit ratings, push debt-payment agreements or charge high fees, monthly service charges or mandatory "contributions" that may add to debt.

"Claim of right" doctrine. In this scheme, a taxpayer files a return and attempts to take a deduction equal to the entire amount of his or her wages. The promoter advises the taxpayer to label the deduction as "a necessary expense for the production of income" or "compensation for personal services actually rendered."

"No gain" deduction. Similar to "claim of right," filers attempt to eliminate their entire adjusted gross income (AGI) by deducting it on Schedule A. The filer lists his or her AGI under the Schedule A section labeled "Other miscellaneous

deductions" and attaches a statement to the return, referring to court documents and including the words "no gain realized."

Corporation sole. Participants apply for incorporation under the pretext of being a "bishop" or "overseer" of a one-person, phony religious organization or society with the idea that this entitles the individual to exemption from federal income taxes as a nonprofit, religious organization.

Identity theft. In one case, those perpetrating the fraud sent bank customers fictitious correspondence and IRS forms in an attempt to trick them into disclosing personal financial data.

Abusive tax preparers have used clients' Social Security numbers and other information to file false tax returns without the clients' knowledge.

Sometimes scammers pose as the IRS.

The IRS does not use e-mail to contact taxpayers. Call 800-829-1040 to confirm whether a contact is from the IRS.

Abuse of charitable organizations and deductions. A tax-exempt organization is used to improperly shield income or assets from taxation. This can occur when a taxpayer moves assets or income to a tax-exempt supporting organization or donor-advised fund but maintains control over the assets or income.

Offshore transactions. People continue to try to avoid U.S. taxes by illegally hiding income in offshore bank and brokerage accounts or using offshore credit cards, wire transfers, foreign trusts, employee leasing schemes, private annuities or life insurance.

Zero return. Promoters instruct taxpayers to enter all zeros on their federal income tax

filings. In a twist on this scheme, filers enter zero income, report their withholding and then write "nunc pro tunc" - Latin for "now for then" - on the return.

Employment tax evasion. Employers are instructed not to withhold federal income tax or other employment taxes from wages paid to their employees. Such advice has been refuted in court. Employees who have nothing withheld from their wages are still responsible for payment of their personal taxes.

Older scams linger. The IRS removed four scams from the Dirty Dozen in 2005: slavery reparations, improper home-based businesses, the Americans with Disabilities Act and sharing dependents for the Earned Income Tax Credit. Still, old scams can resurface or evolve. And new tax scams or schemes routinely pop up, especially around tax time. People who suspect tax fraud can call the IRS at 800-829-0433.

Questions and answers on health savings plans

Bush wants them expanded; here are things to know

By Marilyn Geewax
Cox News Service

WASHINGTON:

President Bush wants Congress to expand health savings accounts to "help people afford the insurance coverage they need." Here are answers to questions about the little-understood accounts.

Q: What is an HSA?

A: Health savings accounts let people put aside money tax-free that can be used to pay health expenses. The accounts must be paired with high-deductible health insurance policies.

Q: Don't these accounts already exist?

A: Yes, HSAs were created in 2003. To qualify for tax breaks under the current rules, the insurance deductible - the amount you must spend in a year before coverage begins - must be at least \$1,050 for an individual, or \$2,100 for a family.

Users of HSAs pay no tax on the money they deposit into the accounts or on any investment gains. Withdrawals also are tax-free if they are used to cover medical expenses.

Q: Can the money be used for any kind of medical expense?

A: The money can be used for any expense that the Internal Revenue Service considers a qualified medical expense. Examples of ineligible expenses are cosmetic surgery and health club dues. If you use HSA funds for an ineligible expense, you'll pay tax on the ineligible amount and any interest earned on the amount.

Q: What happens to the money if I have no medical expenses one

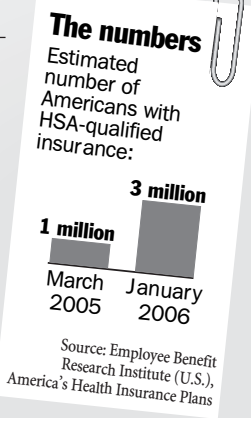
The HSA debate

Pros and cons of health savings accounts, tax-advantaged accounts tied to high-deductible medical insurance plans:

Advantages: High-deductible plans should have lower monthly premiums; money in savings accounts can be invested, grows tax-free and can be withdrawn tax-free to pay medical expenses

Drawbacks: Out-of-pocket medical costs can be as high as \$10,500 a year for a family, depending on the plan's deductible; contributing to the HSA takes discipline and may strain your budget; shopping for competitively priced health care may be hard

Who may benefit? Healthy workers with high incomes



Knight Ridder Tribune

year?

A: The money carries over to the next year and continues to accrue earnings. If you die, the remaining money passes to your heirs.

Q: My employer provides health insurance. Should I think about starting an HSA as well?

A: Generally, people with health insurance that does not have a high deductible are not eligible for HSAs. But some employers' plans are designed to include HSAs.

Q: How does the president want to change the program?

A: He wants to increase the tax breaks to make the program more attractive. For example, he would let HSA users pay their insurance premiums with money in their accounts. That would boost the tax advantage because, under current rules, many people pay premiums with after-tax dollars.

In addition, Bush wants to increase the amount of money that one could deposit each year into an HSA, making the accounts more appealing to people with high medical expenses. Under existing law, the deposit limit is equal to the

insurance deductible or a fixed cap, whichever is lower. This year, the caps are set at \$2,700 for an individual or \$5,450 for a family.

Q: Does anyone oppose expanding tax breaks for health care?

A: Yes, a number of health care advocates and labor groups say Bush's plan does little to address the problem of making medical care more affordable for the unemployed or lower-income people who can't afford a high deductible.

Q: Who supports Bush's plan?

A: Many employers, health insurers and financial institutions support HSAs, saying they give individuals more control over their health care dollars.

Q: How many people have HSAs?

A: The White House estimates that 3 million Americans have HSAs. It estimates the number will reach 14 million by 2010. But if Congress expands the tax breaks, that year's figure could be 21 million.

CAT

Costs for businesses more than expected

Continued from Page D1

Businesses with under \$150,000 in gross receipts should be exempt and will not even have to register for the CAT.

American Winds, which operates a flight school at Akron Fulton International Airport, is among the Ohio businesses that had to register for the CAT. President Michael Kolomichuk said dealing with the new Ohio tax was no big deal.

"Our accountants handled all that," he said with a laugh. Kolomichuk said while the tax reform measures are supposed to save businesses money, "I don't believe it for a minute. Invariably it doesn't save the employer any money."

He and others have to trust

that the government that collects the taxes spends the money wisely, he said. "If they don't, shame on them. They've let us down."

Kyle Jackson, assistant state director for the National Federation of Independent Business in Ohio, said he expects the state will continue to make adjustments to the tax package.

"From a small business perspective, the jury is still out," Jackson said. Many small business owners remain unsure about who has to pay or how the process works, he said.

It's also costing small business owners more money than many thought, he said. Many of the National Federation of Independent Business' members have found that in addition to paying a \$150 CAT tax, they have to pay an accounting firm an additional \$150 to do all the paperwork, in effect creating a \$300 tax, he said.

"It's a big change from the way people are used to paying taxes," Jackson said. "The law is

changing and it is difficult for people to keep up with the changes," said Paula DiVencenzo, an accountant at the Akron firm Bober, Markey, Fedorovich & Co.

The tax reform measures mean it is more important than ever for small businesses to keep good records, DiVencenzo said.

Laura Culp, director of taxation services at Akron accounting firm Brockman, Coats, Gedelian & Co., said her firm spent a lot of time last year helping clients with the tax reform measures.

"It went, for the most part, smoothly," she said. But many small businesses may still be working on their 2005 year-end accounting, she said.

Anyone who could not get exact finances by the Friday deadline could file an estimated tax return, she said. That will give them until May 10 to refine their numbers and file taxes again, she said.

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Hurricane victims may seek tax help

Professionals ready for influx of returns

By David Twiddy
Associated Press

KANSAS CITY, MO.:

Almost five months after Hurricane Katrina chased Yolonda Prevost from her East New Orleans neighborhood to her sister's place in Kansas City, she spends her days trying to get back home - searching for apartments and arranging for repairs to her drowned house.

The last thing Prevost wants to worry about is her taxes.

Taxpayers like Prevost are a big question mark this year as tax preparers gear up.

Some in the industry predict the hurricanes will cause an influx of new clients as victims and those who contributed to recovery efforts wrestle with the myriad exemptions and refund programs put into place after hurricanes Katrina, Rita and Wilma.

"I'm too overwhelmed with what's going on," Prevost said, adding that she planned to return to Louisiana soon to retrieve any financial records she can and take them to a

nearby H&R Block office.

"It will be interesting to see how it works out with a lost house and three lost cars and a lost job," said Prevost, 51, a former Delgado Community College employee.

John Hewitt, chief executive of Virginia Beach, Va.-based Liberty Tax Service, estimated his company will add a quarter-million returns to the one million returns it filed last year, partly because of the crush of Katrina-related returns.

Others say the complexity of returns will skyrocket.

"The spreading out of clients that we experienced from the New Orleans area is probably a negative net because it's hard to know exactly where those folks are and ensuring that we have the staff to serve them well (where they end up)," said H&R Block Inc. CEO Mark Ernst at a recent analyst meeting.

The Internal Revenue Service this year expects taxpayers to file 134.9 million individual income returns, a 1.6 percent increase from 2005. The IRS won't guess how many returns will be affected by the hurricanes but said it expected many returns would be delayed until next year.

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