

Larry's Tax Law

## **NBA Star Kevin Durant Files a Lawsuit Against His CPA**

By Larry Brant on 3.14.14 | Posted in Tax Laws

According to an article published by Kristi Eaton of the Associated Press (“AP”) on February 20, 2014, NBA star Kevin Durant filed a lawsuit against his former accountant, Joel Lynn Elliott, CPA, for alleged mistakes made in the preparation of income tax returns. As a result of the mistakes, Durant alleges he will have to amend certain income tax returns, pay additional taxes, and possibly be subjected to penalties.

The lawsuit, filed in California, where CPA Elliott practices accounting, alleges that the accountant made numerous errors in the preparation of Kevin Durant’s income tax returns, including deducting as business expenses the costs of personal travel and the costs of a personal chef. According to the AP, the complaint provides with respect to the travel expenses: “In preparing a client’s tax returns, a reasonable prudent accountant would have conducted a basic inquiry and sought documentation to confirm that each travel expense for which a deduction was recorded was truly business related.”

As a general proposition, if a tax return preparer gives a client incorrect advice about the deductibility of certain expenses or mistakenly includes non-deductible expenses on the client’s tax return, what are the client’s damages? The taxes, the interest on the underpayment of taxes, the penalties and/or the cost to amend the tax return? If the client ends up engaging a new preparer to amend his or her tax return, and pays the tax, interest on the underpayment of taxes and penalties, it seems logical the preparer could be liable for the cost of amending the returns and the penalties. The client owes the tax; nothing the preparer did likely changes that conclusion. Unless the client would have refrained from incurring the non-deductible expenses in the first place had he or she been given a correct recitation of the tax laws, how can the preparer be liable for the tax? Interest is a bit trickier. Since the client got the use of the money (from the time the taxes were originally due until actually paid), one can argue the preparer is not liable for the interest. Assuming the preparer gave incorrect advice or mistakenly included non-deductible expenses on the client’s tax return, he or she will likely be liable for the cost of amending the tax return and the penalties. Obviously, there may be facts that would cause a court to rule differently.

Mr. Durant is seeking damages from CPA Elliott totaling \$600,000. Stay tuned for the outcome of this case!

**The moral to this story is simple:** While an accountant is not required to audit the client's business activities, the accountant must act with reasonable diligence. Section 10.22(a)(1) of Circular 230 specifically requires that a practitioner exercise "due diligence" in preparing tax returns. Consequently, tax preparers should:

- Make sure the tax preparation organizer clearly states that: **(i)** the accountant is not responsible for auditing the client's business activities; **(ii)** the client represents the business expense items contained in his or her books and records are ordinary, necessary, and reasonable; and **(iii)** the client represents that he or she has reasonable documentation to support the amount of the expenses and that the expenses were actually incurred in the normal course of business.
- If the preparer knows or has reason to know an expense item listed as a business expense is in reality a personal expense or was not actually incurred, the preparer should not include the expense on the income tax return. Advise the client that the expense is non-deductible. If the client still wants you to deduct the costs of his or her vacation travel or personal chef, just say no!
- If the preparer suspects a client is classifying personal expenses as business expenses, the preparer should terminate the relationship and memorialize the termination in a disengagement letter. The risks to the preparer are significant. They include, in addition to a lawsuit initiated by the client for allegedly failing to advise him or her that the expenses were not deductible, tax preparer penalties, sanctions and/or disbarment.

Due to the possible publicity, CPA Elliott may be facing more than Kevin Durant's lawsuit. While it is not a sure thing, he could be subjected to an investigation by his local board of accountancy and/or the Office of Professional Responsibility. This case should serve as a reminder—tax preparers cannot put their heads in the sand! While preparers are not required to audit their clients, they must act prudently and with reasonable care in the preparation of tax returns.

**Tags:** Income Tax Returns, Kevin Durant, Tax Return Preparer