TAXES

9 wackiest tax deductions

By Jay MacDonald • Bankrate.com

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Did you hear the one about the instant "nephew"? The $35,000 in dance lessons? The new definition of office paperwork?

That's right, it's time for the fourth installment of Bankrate's "9 wackiest tax deductions," our homage to the endlessly creative ways some taxpayers dream up to try to limbo under the tax code.

In our first installment, taxpayers tried to write off everything from sperm donations to an arsonist's fee. Our second installment found clever filers trying to deduct a "love shack," doggie day care and a pimped-out Amish buggy. Round three featured otherwise law-abiding Americans trying to write off a $50,000 wedding as a business expense and claim everyone in New York City as a dependent!

This year's best cocktail stories -- culled from certified public accountants nationwide, some of whom requested to remain nameless -- naturally comes with a disclaimer: *Do not try this at home*. Or in the home office, for that matter.

As audacious as these stories might be, rest assured that the Internal Revenue Service is not amused when taxpayers fail to file, misfile, underreport income or otherwise attempt to avoid taxes.

Ready for some laughs? Behold Bankrate's 9 wackiest tax write-offs, 2009 edition.

Creative accounting

Here's our annual homage to taxpayers who try to limbo under the tax code.

9 craziest write-offs

1. Paper-thin home office deduction

CPAs sometimes feel they've opened a Pandora's box when they introduce newly self-employed clients to the wonderland of home office deductions: Give 'em an inch and ... well, you wind up like one Arizona accountant whose client exhibited an unusual amount of tax swagger.

The client asked for a home office deduction for the toilet paper he bought for his house. No word on the nature of his business.

2. Hell hath no fury...

Walt Hatter, CPA at Hatter & Associates in Fort Worth, has seen some generous Texans in his day, but none compare to the woman who literally gave it all away.

The client, whose income was in the $40,000 range, brought in noncash charitable receipts from donations made to various charities. The donation total came to roughly the same dollar amount as her income.

Hatter was about to nominate her for sainthood -- until he heard the rest of the story.

"She had gotten a divorce; her husband had cheated on her and just never came back," Hatter says. "He called her up and said he would send a moving van to divide their assets. So, she loaded up everything he would want -- two or three sets of golf clubs and all the furniture, including some of his family antiques -- and took it all to Goodwill. She even had photos of all the stuff!"

It fell to Hatter to inform her that she could only deduct up to 50 percent of her adjusted gross income.

"We wound up with something like $15,000 in contributions," he says. "I just knew that that return was going to get audited, but it never did."

3. At least it wasn't 'Travel & Entertainment'

Sometimes business owners will try to slide a fast one by the IRS by classifying a business deduction in a category where the dollar signs might not raise an eyebrow.

One such fastball didn't pass the eyebrow test with this Oklahoma accountant, however.

"We were reviewing a business client's accounting entries and noted a check for over $2,000 written to a gynecologist. It was classified on the business books as 'repairs and maintenance.'"

4. Bubble bath credit

Taxpayers sometimes get into hot water by deducting their spas and swimming pools, either as medical deductions or, more boldly, as business expenses.

"We had a woman who tried to deduct her tricked-out Jacuzzi hot tub due to medical reasons," says Elizabeth Dittrick of Dittrick and Associates in Cleveland. "That can be a legitimate expense -- but not the underwater speakers, the mood lighting and the in-tub stereo. So we ended up deducting a portion of it but removed the sound and lightshow. She did use it for medical reasons; she had arthritis and had a note from her doctor."

It was going to be a bit longer swim for one New Jersey accountant's client.

"A taxpayer wanted to write off a $100,000 swimming pool for medical reasons," says the accountant. "Swimming, he explained quite seriously, relaxed him so he could earn more money, which in turn would be taxable."

Uh ... no.

5. Beautify your return

Ah, nature! So peaceful, so inspiring, so ... *deductible?*

It can be, at least according to Allyson Baumeister, CPA at Sanford, Baumeister & Frazier in Forth Worth.

"I had a lady client who didn't like some of her really mature trees, they didn't fit into her new landscaping theme," she says. "So, she dug them out and donated them to charity."

"She had to get somebody to appraise the value of the trees, but the IRS allowed it," says Baumeister.

6. Unmarried, filing weirdly

Common-law marriages can create tax complications, as Hatter found out when two young, single clients who had been living together for a number of years decided to file jointly as a married couple.

"You can do that in Texas by meeting certain criteria, living together for so long," Hatter says. "The problem is, when you decide that you don't want to live together anymore, it creates all sorts of problems with the IRS."

That's because once a couple files jointly, everything thereafter is keyed off of the male partner's Social Security number.

"You don't have to go through a divorce per se; it just takes a little letter-writing campaign to the IRS to get it fixed," Hatter says.

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7. Dancing with the IRS

Who doesn't get a little carried away with the grace and fluidity of ballroom dancing? But according to a Tucson, Ariz., CPA, some dance moves fail to charm the taxman.

The accountant's client was an elderly woman who had once been a university professor. When her doctor suggested she take up dancing to improve her arthritic hips, she enrolled at the Arthur Murray Dance Studio.

"The first year, she brought in her tax data and wanted to deduct over $8,000 in dance lessons," the accountant says. "I got her to have her doctor write a letter and I believe I did deduct it the first year."

Ah, but you know how infectious ballroom dancing can be.

"The second year, she brought in receipts totaling over $35,000 for dance lessons and another $18,000 for gowns and expenses to travel on cruises for herself and her 'instructor' from this dance studio; he was in his 20s and she was about 85 by this time," the accountant says. "I was appalled and obviously did not deduct these expenses as medical -- although I was temped to call it a theft loss."

The accountant notified adult protective services, which launched an investigation of the situation. Her client died before it was completed.

8. Of guard cats and canine contractors

Taxpayers become pretty creative when it comes to devising ways to deduct their pets on their tax returns. In this series alone, we've featured one pet lover who claimed his dog as a dependent, another who attempted to write off the dog food for his "home security system," and yet another who claimed Fido as a landscaping subcontractor.

Ed Mendlowitz, CPA at WithumSmith+Brown in New Brunswick, N.J., has heard it so much that he actually devised a tongue-in-cheek response:

"When I have a client ask me if they can deduct their cat or dog, I usually inquire in a very serious tone about their pet's age and whether the cat or dog is a full-time student. Parrots and other long-lived animals, by contrast, may qualify for elderly benefits."

9. Costly adoption

A Kissimmee, Fla., CPA inherited the case of a 65-year-old woman who took in a 20-something student renter and handyman. She liked the lad so much she decided to welcome him into her family -- at least on her taxes.

The woman's original accountant never questioned the deduction, which incidentally enabled the woman to not claim the rental income from her new "nephew."

"There are guidelines CPAs use to determine whether or not a relative by blood, marriage or adoption is considered a dependent," the Kissimmee CPA says. "In this case, the young man was none of the above. She was confusing emotional attachment with an actual factual definition."

Long story short, the IRS caught on three years later and slapped Mom with $5,000 in back taxes and a $2,000 penalty for failing to disclose income.

The Kissimmee CPA came to the rescue, filed amended returns and eventually reclaimed part of the excess taken by the IRS.

Ironically, because the renter had remodeled part of her home, Mom could have offset that expense against the rental income and ended up with a better and legitimate deduction than claiming him as a dependent.

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