



Tax Return Analysis: The Basics By Linda Keith, CPA

Here are some great tips for tackling the most complicated tax returns...or the simple ones. These ideas work equally well for a business or personal return.

One step at a time...

No matter how many pages to a tax return, or how many types of income, you just tackle it one step at a time.

If it is a personal return, first you deal with wages. Do they still have the job? If you are short on qualifying cashflow, what are their true wages before voluntary deductions for 401K contributions or dependent care programs? Do they have unreimbursed employee business expenses that are significant and recurring?

Decide what to do about wages, before you worry about the three Partnerships, four LLCs and two S Corporations they also have.

Keep at it, one step at a time, and then combine your conclusions about the various cashflow sources they have to see what the total is.

Keep your train of thought...

Have you ever worked several minutes or even hours on a task and when you got the answer it looked way to familiar? You did it yesterday or before lunch and just did it again!

Or you have just about got your mind wrapped around this tax return when you are interrupted by two phone calls and someone coming up to your desk. You look back down and it's as if you had never seen this return!

Or maybe worst of all, you're reviewing your work with a senior lender and you discover you completely missed an important schedule in the return.

Develop some techniques to keep your train of thought when interrupted and to keep track of where you are. And no, I am not talking about coming in early or taking work home!

Many lenders like to do the parts they know or are most interested in first. But if you skip around in the return you can easily get lost. I use a **road trip** approach. We have a free online tutorial on this at www.LindaKeithCPA.com.

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Linda Keith CPA is a nationally recognized authority on Cashflow Analysis of Tax Returns. She helps lenders say "yes" to good loans through on-site, open-enrollment and online training and resources. Contact her at www.LindaKeithCPA.com or 888-441-1569.

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Here is how it works:

- Work your way down the front page of the tax return.
- When a number comes from another schedule (Line 12 Sole Proprietorship, Schedule C) you take a side trip.
- When you are done with that schedule, head back to the main highway.

Lenders in my tax return analysis training workshops refer to this as 'Canada to Mexico'. If you're heading down the west coast by car, you don't visit Washington State's Mt St Helens first, then Napa Valley in California, then back up to the Oregon Coast before going on to Mexico City .

Take things in order. With 'Canada to Mexico', when you are interrupted you can draw a light mark below the line you were working on and easily find your way back.

I suggest you put checkmarks on the lower left corner of every tax return page you have finished with. Finished does not mean there are no questions, just that any relevant questions are written down.

Asking questions so you get what you need...

Do you often get follow-up information from your borrower that is not even close to what you asked for? It's like you weren't even on the same phone conversation! Here is what I suggest you include when you write a question:

- *What is the source of the question?*
 - A question about a contract receivable will have the source 'B1' since you'll first have encountered it as interest income on Schedule B, Line 1.
- *Next...who is the question for?*
 - You may have questions for the borrower, an underwriter and a more experienced lender. You don't want to ask the wrong person the question.
- *Then the question...which has three elements.*
 - First, what in the tax return triggered the question?
 - For example, on that contract receivable you may write "\$650 Interest Income from Joe Clark." That way you, and your borrower, are clued into what you are asking about.
 - Second, what do you need to know?
 - In the case of the contract you'd ask "How much are the payments and how much longer will they continue?"
 - Third, what will you do with the answer?

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- It is much easier to decide what to do next while you have your train of thought.
- If you run your questions for the borrower past a more experienced lender, they will also see what you plan to do with the answer and have a chance to correct it if you are wrong.
- *Next...what documentation do you need?*
 - In this case, probably a copy of the contract. Sometimes it is a signed lease or a divorce decree. Write it down so you'll remember to ask for it.

Before you call to ask your borrower questions, review the list of questions again. Now that you have an idea whether they are going to squeak by or are qualifying easily, you may find that some of the questions are no longer material or you answered them yourself along the way.

Number your questions as you write them and put the question number where the answer will go in your cashflow worksheet. When you get the answer it is easy to see where to put it. And you have a visible clue on each in-progress worksheet that there is still a question outstanding.

Get help...

Most loan officers come into a position that requires analysis of a tax return without formal training in this area. And yet, this is not an easy skill to master. Ask questions of senior lenders. Get printed or worksheet resources and live or online training. Be sure it is from a reputable source knowledgeable about tax return analysis, about lending and about how to teach so people can learn.

You'll soon be using tax returns as another tool in your tool box to strengthen the borrower relationship and determine if your borrower qualifies. Make good loans. Make more loans.

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