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Certified Public Accountants

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Here's the Tax Beat broadcast for September 9

Subject Line: Could Chris Rock Be Wrong?

Just off Exit 68 of Interstate 84 in Tolland, Connecticut, there used to be a place called the Electric Blue. For three decades it was one of the state's premier gentlemen's clubs. (Not a high bar.) A man named Kenneth Denning ran it through a holding company nominally owned by his wife.

In March 2023, federal agents and state police raided the Blue. Prosecutors were shocked, *shocked*, to discover the dancers weren't only dancing. Denning and his staff encouraged customers to buy considerably more than a lap dance in the private rooms, and the house took a cut of every transaction. Chris Rock spent a whole track in 1999 warning young men there's no sex in the champagne room. At the Blue, prosecutors say, that was less a rule than a sales objection to overcome. Investigators watched the cash for two weeks, extrapolated across three tax years, and came up with roughly \$3 million in receipts that never made it onto a return. In total, the government accused him of hiding \$5.7 million.

Here's the part that should make every business owner sit up. Denning and his bookkeeper built spreadsheets of the club's income and handed them to the club's tax preparer. The spreadsheets weren't fake, exactly. They were just incomplete. The crew even had a name for the pile of cash they left off: "Kenny's money."

The tax code is crystal clear here. Section 61 defines gross income as income "from whatever source derived," and courts have spent a century clarifying that "whatever" means *whatever*. Al Capone learned it the hard way in 1931. There's a spot for illegal income on Schedule 1, and IRS Publication 17 politely instructs you to report income from your illegal activities.

The good news is, the IRS understands the old adage that it takes money to make money. So you can deduct the cost of running your illegal business. Ordinary and necessary expenses stay ordinary and necessary even when the business is a crime. What the IRS won't do is let you keep quiet about the revenue.

Back in Connecticut, Denning pled guilty in May to five felonies: conspiracy to promote prostitution, conspiracy to defraud the IRS, conspiracy to commit money laundering, and two counts of spending the proceeds. Maximum exposure, 45 years. He agreed to forfeit more than \$1.5 million and pay \$700,000 in restitution — \$550,000 to the IRS and \$150,000 to the Small Business Administration for a pandemic relief loan he wasn't entitled to. (Ordinary fraud as a side hustle?)

Then, last week, his lawyers asked the judge for no prison time at all, on the theory that he'd already paid. That argument has a hole in it roughly the size of Connecticut. Paying tax you already legally owed isn't generosity on Denning's part. It's arithmetic finally catching up with him. Judges tend to notice the difference.

The real lesson here isn't about the club, it's about the spreadsheet. Denning had a bookkeeper, a tax preparer, and thirty years of cash flow, and he pointed all three at hiding money instead of keeping it legally. The code is stuffed with legal ways to cut the bill on a cash-heavy business — entity structure, retirement plans that shelter six figures a year, cost segregation on the building, payroll for family members who actually work, accountable plans for the expenses you're already paying out of pocket. Every one of them works better than a second set of books, and every one survives an audit.

Sadly, we can't help you get into the champagne room. And we won't help you keep a second set of books. But we're very good with the first one. So call us and we'll find the money you're already allowed to keep!

Kevin

