

**PROTECTING TAXPAYERS FROM INCOMPETENT
AND UNETHICAL RETURN PREPARERS**

HEARING
BEFORE THE
COMMITTEE ON FINANCE
UNITED STATES SENATE
ONE HUNDRED THIRTEENTH CONGRESS
SECOND SESSION

APRIL 8, 2014



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PROTECTING TAXPAYERS FROM INCOMPETENT AND UNETHICAL RETURN PREPARERS

TUESDAY, APRIL 8, 2014

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:08 a.m., in room SD-215, Dirksen Senate Office Building, Hon. Ron Wyden (chairman of the committee) presiding.

Present: Senators Cantwell, Carper, Cardin, Brown, Casey, Hatch, Grassley, Crapo, Roberts, Thune, Burr, and Isakson.

Also present: Democratic Staff: Michael Evans, General Counsel; Anne Cammack, Senior Tax Counsel; Joshua Sheinkman, Staff Director; Todd Metcalf, Chief Tax Counsel; Maureen Downes, Detailee; and Juan Machado, Professional Staff Member. Republican Staff: Chris Campbell, Staff Director; Shawn Novak, Senior Accountant and Tax Advisor; Jim Lyons, Tax Counsel; and Preston Rutledge, Tax Counsel.

OPENING STATEMENT OF HON. RON WYDEN, A U.S. SENATOR FROM OREGON, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. The Finance Committee will come to order.

There is just a week to go before the April 15th deadline for filing taxes, and millions of Americans are spending a good portion of the spring struggling to fill out tax forms and digging through piles of receipts in a painful annual ritual. The complexity of the tax code creates an environment where confusion and errors flourish. And the Congress is not blameless on this issue, and that is one reason, in my view, why it is time to rewrite the tax code and make filing your taxes easier in America.

For many Americans, maybe even a majority, nothing will have a bigger impact on their pocketbooks all year long. The great majority of Americans want to get it right, but because the tax code is so byzantine and so complicated, and so overgrown, nearly 80 million Americans pay for help preparing their tax return. And what is especially alarming is that most of those paid tax return preparers do not have to meet any standards—any standards—for competence in order to prepare somebody else's tax return.

Earlier this year, because of the baffling outcome of that Federal Appeals Court case called *Loving v. IRS*, protection for American taxpayers against incompetence and fraud among tax preparers has taken a significant blow. As too often seems to be the case in

situations like this, the most vulnerable people in America are going to bear the brunt of the effects of this decision. These are often people who are struggling from paycheck to paycheck, counting down the days until their refund comes through to help them make ends meet. They could be seniors or working families who qualify for the Earned Income Tax Credit, or they could be immigrants proud to pay taxes in their new country who just want to make sure they are following the rules of a tax code that is hard for anybody to understand.

Here is my bottom line. For the second time in 8 years, the Government Accountability Office has done an independent inquiry and proven that the absence of meaningful oversight of much of the tax preparer industry is harming too many citizens who can least afford it. The problems they run into could be as simple as a typo or a miscalculation on a form, but they could also be much worse.

In some egregious cases, preparers calculate a taxpayer's refund in person and skip the line that shows who did the work. Then, after the taxpayer leaves, the preparer falsifies the math to boost the refund, files the return, and pockets the difference. And worst of all, unless the taxpayer can prove what happened, they are on the hook for the money when the IRS finds out.

Witnesses today are going to share some more eye-opening stories, and we are eager to get their thoughts on what the government can do to come up with more sensible policies here. The most important step is to restore standards to protect the American taxpayer.

Now, I am proud to say my home State of Oregon gets this issue right. Tax preparers at home study, pass an exam, and keep up with the changing landscape of the tax code in order to maintain their licenses. And Oregon's standards work. The Government Accountability Office took a look at the system a few years ago and found that tax returns from Oregon were 72 percent likelier to be accurate than returns from the rest of the country. That puts fewer Oregonians at the mercy of unscrupulous preparers and reduces the risk of a dreaded audit.

Now, there are ways for Congress to help in this arena. For example, I strongly believe that comprehensive tax reform must simplify the tax code and make filing easier. That must be a priority.

When the Finance Committee passed the EXPIRE Act last week, practically every Senator here on the dais agreed it is time to end stop-and-go policies and give Americans more certainty about their taxes. The bipartisan tax reform plan I worked on with Senators Begich and Coats, as well as former Senator Gregg, would make filing much quicker and more simple for millions of taxpayers by tripling the standard deduction. That would eliminate the need for more than 80 percent of taxpayers to itemize deductions. Then they could easily prepare their own returns and never fall risk to tax preparers' ineptitude or misconduct.

Now, Senator Nelson of the committee has led our charge to protect taxpayers from identity theft, and Senator Cardin has also fought very hard for taxpayer rights. They and other Senators have valuable ideas on how to solve the challenge, and that is the point of today's hearing: to look at a variety of approaches to protect the American taxpayer and the integrity of our tax system.

As long as the code is so overgrown and so complicated that most Americans have to seek out help to file, they should not have to worry about crooked or incompetent preparers. It is that simple.*

As I wrap up, I would like to thank both our panels of witnesses for being here today. As always, Senator Hatch and I plan to work on this issue in a bipartisan way. You saw that, again, last week.

[The prepared statement of Chairman Wyden appears in the appendix.]

The CHAIRMAN. Senator Hatch, we welcome your comments.

**OPENING STATEMENT OF HON. ORRIN G. HATCH,
A U.S. SENATOR FROM UTAH**

Senator HATCH. Thank you, Mr. Chairman, for holding this timely hearing. As we all know, the day for individuals to complete and file their annual income tax returns is 1 week away, and, at this point in the year, millions of Americans face a number of difficulties in trying to comply with that deadline.

The sheer complexity of our tax system requires the majority of Americans to seek the services of a paid preparer in order to navigate through and comply with the tax code. Of the 142 million income tax returns filed by individuals last year, nearly 80 million, as the distinguished chairman has said, or roughly 56 percent, were prepared by a paid preparer.

Our income tax system relies heavily on good faith, voluntary compliance, which, in turn, requires the services of paid preparers who are both competent and ethical. The IRS attempted to implement regulations in 2011 that, for the first time, imposed both ethical and competency standards on any person who sought to prepare tax returns for compensation. The D.C. Circuit Court of Appeals, however, has since prevented IRS from enforcing those regulations when it upheld the *Loving* decision on appeal, as mentioned by our chairman.

Among the approaches to solving the problem of incompetent and unethical paid preparers that we will hear about today is government regulation. However, there are other approaches worthy of thoughtful consideration. One approach is comprehensive tax reform that results in a much simpler and straightforward tax system, with fewer compliance and administrative burdens.

A less complex tax system that allows for simpler compliance rules will reduce taxpayer and preparer errors—certainly errors associated with complexity—decrease the need for complex tax filings, and eliminate opportunities to cheat the system through unethical behavior. It is my belief that the best way to protect tax filers from incompetent and unethical tax preparers is to implement a fair and simple tax system that dramatically reduces their dependence on paid return preparers. Until we get there, we need to minimize the damage that incompetent and unethical return preparers can cause, and I look forward to hearing about different ideas on how to accomplish this worthy goal during today's hearing.

*For more information, see also, "Present Law and Background Related to the Regulation of Conduct of Paid Tax Return Preparers," Joint Committee on Taxation staff report, April 4, 2014 (JCX-34-14), <https://www.jct.gov/publications.html?func=startdown&id=4580>.

Of course, with the IRS Commissioner testifying before us today, there are other matters that deserve the committee's attention. For example, there is the ongoing investigation into the IRS's targeting of conservative groups during the 2010 and 2012 campaign seasons.

Four congressional committees, including the Finance Committee, are currently looking into this matter. And up to now, the IRS officials have, with some exceptions, been cooperating. That is why it was disheartening to hear that 2 weeks ago, Commissioner Koskinen apparently tried to spin what had gone on at the IRS, claiming that no one had used the word, quote, "targeting" to describe what happened.

The fact is that the Treasury Inspector General for Tax Administration, or TIGTA, Russell George, used the word "targeting" in his May 2013 report to describe the allegations; and, in testimony before Congress, he stated that the allegation had proven to be true.

Furthermore, Commissioner Koskinen himself described the activities as "targeting" during his confirmation hearings before this committee. I want to remind you of that, although I really appreciate you being here today, more than you know.

Now, this may seem like we are engaging in semantics, but the words we use here are important. If the administration, rather than acknowledging what went on at the IRS and trying to fix it, is going to engage in word play to minimize what happened, we are going to continue to have difficulties as we try to resolve these important issues.

Even the *Washington Post* fact checker said it is "silly and counterproductive" to deny that the phrase "targeting" describes what happened, awarding the Commissioner 3 Pinocchios for saying otherwise. On top of that, we have the regulatory effort at the IRS that appears to be designed to further marginalize these same conservative groups. I am talking, of course, about the proposed regulations governing the political activities of 501(c)(4) organizations.

People in organizations across the political spectrum have rightly condemned these proposed regulations, because they undermine free speech and the ability of American citizens to participate in the political process. The IRS had a record number of public comments filed in response to the proposal from all points on the political spectrum, and, from what I gather, they were almost uniformly negative.

This regulation, if given the force of law, would effectively silence grassroots organizations by categorizing a number of routine and long-accepted activities as political, and it would ensure that a number of the administration's critics remain on the sidelines of the political debate, and that could work both ways in the future. And I do not want it to work both ways.

This proposal is particularly disturbing given what has already gone on at the IRS with the targeting scandal. Now, last week, Commissioner Koskinen publicly stated that the regulation is not likely to be finalized this year. To me, that is not good enough. These regulations should go away entirely, and Commissioner Koskinen has the power to make that happen.

Throughout the public debate over this proposal, little has been said of the role of the IRS Commissioner in approving the final reg-

ulation. However, as was confirmed by Secretary Lew in his recent appearance before this committee, the IRS Commissioner has the authority to unilaterally prevent these regulations from taking effect. That being the case, any effort to deflect responsibility in a different direction would appear to me to be futile.

Now, as you can see, Mr. Chairman, we have a number of issues to discuss today, and I look forward to a robust and informative hearing. So I want to thank you for this.

The CHAIRMAN. Thank you, Senator Hatch.

[The prepared statement of Senator Hatch appears in the appendix.]

The CHAIRMAN. Our hearing today is going to consist of two panels. Our first panel includes two government witnesses from the IRS. Our second panel will include the Government Accountability Office and a cross-section of individuals who are knowledgeable about tax preparation.

I would note that we have eight witnesses, and, to that end, we hope that all of you are going to limit your testimony to 5 minutes.

Our first witness is the Honorable John Koskinen, Commissioner of the Internal Revenue Service. Our second witness is Ms. Nina Olson, the National Taxpayer Advocate of the IRS.

Thank you both for coming. Your prepared statements are going to automatically be made a part of the record.

Why don't you start, Commissioner?

**STATEMENT OF HON. JOHN A. KOSKINEN, COMMISSIONER,
INTERNAL REVENUE SERVICE, WASHINGTON, DC**

Commissioner KOSKINEN. Thank you. Chairman Wyden, Ranking Member Hatch, and members of the committee, thank you for the opportunity to discuss IRS regulation of paid return preparers.

The tax return preparer community is a key ally in our efforts to fulfill our dual mission of taxpayer service and tax compliance. Each year, paid preparers are called upon to complete about 80 million returns, as noted earlier, about 56 percent of total individual income tax returns filed.

Preparers make the IRS's job easier by helping their clients properly report their taxes and pay what they owe. At the same time, the level of oversight of paid return preparers has traditionally been uneven, at best. While attorneys, enrolled agents, and CPAs must meet mandated professional competency requirements, they make up only about 40 percent of the universe of paid tax return preparers. That has left another 60 percent preparing returns with little or no Federal oversight.

Although a few States, including the State of Oregon, as noted, have begun regulating unlicensed preparers, most of the tax professional community favors Federal oversight to avoid the possibility of a patchwork of conflicting State requirements.

While a majority of return preparers are competent and operate with the highest ethical standards, there are those who do engage in fraud. Others do not have enough training and are not equipped to do an adequate job of preparing tax returns. To ensure that return preparers are competent and adhere to professional standards, the IRS launched the Tax Return Preparer Initiative in 2010. Under this initiative, individuals must register with the IRS if they

prepare all or a substantial portion of any Federal tax return or refund claim for compensation.

The initiative also required paid preparers who are not CPAs, attorneys, or enrolled agents to pass a competency exam and complete annual continuing education requirements related to tax law and professional conduct.

The IRS also extended the ethical rules found in regulations, commonly known as Treasury Department Circular 230, to all paid preparers. This allows us to suspend, or otherwise discipline, tax return preparers who engage in unethical or disreputable conduct. Since 2010, more than a million individuals have registered with the IRS and obtained a Preparer Tax Identification Number, or PTIN. As of last month, approximately 677,000 return preparers were active in our tax professional database.

Preparers must use their PTIN as the identifying number on returns they prepare for compensation, and they must renew their PTINs annually. Along with regulation of return preparers, the IRS also has a comprehensive compliance and enforcement strategy. With regard to these efforts, it is important to note that the registration requirement gives the IRS a better line of sight into the return preparer community than ever before. The information we obtain through the registration process helps us do more to analyze trends, spot anomalies, and potentially to detect fraud.

The IRS announced the testing phase of its return preparer program in November of 2011. The test was designed to cover preparation of Form 1040 and its related schedules. Through 2012, about 84,000 tests were given, and about 62,000 preparers received a passing grade, for a pass rate of about 74 percent. This, obviously, means that 26 percent were unable to pass the exam.

The 15-hour annual education requirement consisted of 10 hours of Federal tax law topics, 3 hours of tax law updates, and 2 hours of ethics or professional conduct. A lawsuit against the return preparer program, as noted, resulted in a court decision that invalidated the testing and education requirements in January of 2013. An appellate court recently upheld that decision. The IRS is continuing to assess the appeals court decision while consideration is given to options for appeal.

It is true that preparer registration alone does help in identifying the paid preparer community, analyzing trends, and determining a general level of taxpayer service. But competency testing and continuing education may put us on a path to ensuring that all tax return preparers provide the appropriate level of service to taxpayers. We believe that this level of service will translate into improved overall tax compliance and certainly, with that, more effective tax administration.

Therefore, we urge Congress to pass the proposal in the administration's fiscal year 2015 budget that would explicitly authorize the IRS to regulate all tax return preparers. This would let us resume mandatory testing and continuing education. In the meantime, we are taking a close look at the possibility of an interim step involving a program of voluntary continuing education.

Before moving forward on this idea, we will solicit feedback from a wide range of external stakeholders as to whether such an interim step would be useful and appropriate. But the better solution

would be for Congress to grant us explicit authority to provide better oversight of tax preparers.

This concludes my testimony, and I would be happy to take your questions.

The CHAIRMAN. Thank you, Mr. Koskinen.

[The prepared statement of Commissioner Koskinen appears in the appendix.]

The CHAIRMAN. Ms. Olson?

**STATEMENT OF NINA E. OLSON, NATIONAL TAXPAYER
ADVOCATE, INTERNAL REVENUE SERVICE, WASHINGTON, DC**

Ms. OLSON. Chairman Wyden, Ranking Member Hatch, and members of the committee, thank you for holding today's hearing on a subject I consider among the most important for U.S. taxpayers.

Nearly 150 million individual taxpayers file tax returns every year, many jointly with their spouses. Because the tax code is so complex, the significant majority of taxpayers pay preparers to complete their returns for them. Unfortunately, many taxpayers have no easy way to determine whether the preparer they are hiring can do the job.

In recent years, around 80 percent of tax filers have received tax refunds. The average refund amount is a little under \$3,000 per return, and it is often higher for low-income taxpayers who receive refundable tax credits. Therefore, the work a preparer does can have a significant financial impact on the taxpayer.

Other financial professionals whose work affects the financial lives of their clients are widely regulated. Yet, anyone can hang out a shingle as a tax return preparer, with no knowledge, no skill, and no experience required. I know this well, because I began my career in tax administration in 1975, when I myself hung out a shingle as an unenrolled return preparer. At that time, however, there were no widely available return preparation software packages. To do my job, I had no choice but to study and learn tax law, rules, regulations, and publications. Because one actually had to know something about the tax law to be a return preparer, taxpayers had some assurance of the preparer's competency.

Today, there is no such assurance. Three transformational changes have taken place in the return preparation field. First, the advent of return preparation software has eliminated barriers to entry into the profession. Second, the enactment of refundable credits has expanded the taxpayer base to include low-income individuals. Third, preparers have financial incentive to inflate refunds and cross-market non-tax goods and services, like pay-stub loans. In fact, in many tax season advertisements today, it is difficult to discern the connection between the service offered—get money quick—and the act of tax preparation.

As a result of seeing firsthand the radical change in the industry and its impact on vulnerable taxpayers, as National Taxpayer Advocate, in 2002, I recommended that Congress enact a program to register, test, and certify these preparers. I also recommended that Congress authorize greater preparer penalties and strengthen due diligence requirements. But there is an important distinction between these approaches.

While penalties and due diligence requirements are a vital component of any oversight regime, these actions occur only after the taxpayer has been harmed. Prevention is less costly and more effective. Accordingly, Congress should clarify that the IRS has the authority to establish minimum standards for the unenrolled preparer population and to test and require continuing education of these preparers.

The only credible argument I have heard against establishing preparer standards is that the cost will ultimately be passed on to the consumer. But the per-taxpayer cost of the program the IRS was implementing before the *Loving* decision seemed very reasonable as compared with the far more significant cost the GAO's and other "shopping visits" have found, where preparer errors caused some taxpayers to overpay their tax by thousands of dollars, and other taxpayers to underpay their tax by thousands of dollars and then likely face IRS enforcement action down the road.

In the absence of clear legislative authority, I believe the IRS should do the following: first, offer unenrolled return preparers the opportunity to earn a voluntary examination and continuing education certificate; second, restrict the ability of unenrolled preparers to represent taxpayers in audits of returns they prepared unless they earn that certificate; third, mount a consumer protection campaign that educates taxpayers about the need to select preparers who can demonstrate competency and reminds taxpayers to obtain a copy of their tax return with the preparer's signature on it.

Finally, the IRS should develop a publicly accessible and searchable preparer database to include all preparers who register with the IRS. After all, the best enforcement and consumer protection strategy is to have an informed and educated consumer base—in this instance, the taxpayers, who need to have some clear-cut way of knowing which preparers meet minimum levels of competency and which are not willing to make the effort. That is why having a mandatory "certified preparer" designation, along with enrolled agents, CPAs, and attorneys, is so important. It is a bright line that the taxpayers can understand.

Thank you.

The CHAIRMAN. Ms. Olson, thank you.

[The prepared statement of Ms. Olson appears in the appendix.]

The CHAIRMAN. Colleagues, we will all take 5-minute rounds at this point.

Let me start with you, Ms. Olson, if I could. You are the National Taxpayer Advocate. In other words, it is your job to go to bat for the kind of people whom we are seeing getting fleeced around the country.

I was particularly struck—and I would like you to amplify a bit on it—when you said that there are actually new incentives and new opportunities for the unscrupulous tax preparer to, in effect, rip people off. Could you describe that in a little more detail?

Ms. OLSON. Well, there are several ways we see this. One is that entities that would not normally be involved in the profession of return preparation use the ability to give advance loans on the refund itself to cross-market goods, whether it is cars that the client could purchase with a down payment, but at the very highest inter-

est rates, or just simply the loan product itself, like the pay-stub loans.

The other thing we are seeing is really out-and-out fraud, where, as was described in your statement, preparers will take the taxpayer's return after the taxpayer has approved it or, in some instances, the taxpayer has not approved it, but the preparer will inflate items on the return and pocket the refund. And then the taxpayer later finds out about this when the IRS is contacting them and saying "You owe us taxes," and that causes the taxpayer to be engaged in a long, extended conversation with the IRS.

By that point, the preparer is long gone. You cannot find that preparer.

The CHAIRMAN. I appreciate your clarifying that, because I did not think the standards were adequate even before we saw taxpayers bumping up against the kinds of problems that you are talking about. And I appreciate your demonstrating that it is usually the case that the unscrupulous are always one or two steps ahead of efforts, particularly voluntary efforts, to deal with the problem.

Now I gather, so we are clear on this point, that the *Loving* decision, in your view, has created new problems in effect, in terms of protecting taxpayers; is that right?

Ms. OLSON. Absolutely. The *Loving* decision, first of all, my reading of it is, it did not go to the fact of whether regulation is desirable or not. It addressed whether the IRS has the authority to regulate the return preparer under the current law. And right now there is an injunction in place against the IRS being able to implement the exam and the continuing education requirements, and that is a significant obstacle. We can register tax preparers, but we cannot test them, require them to be tested, or require them to take continuing education in order to do returns.

The CHAIRMAN. How limited are the tools that are left given the *Loving* decision? Because my sense is that there are some tools that are left, but they are pretty narrow and they really do not go to the heart of what you have been talking about, which is protection against the unscrupulous preparer.

I share the view that there are many, if not the majority, of preparers who are very honest and reputable, but it sure looks like some new opportunities, some new trap doors, have been created for those who are unscrupulous.

Tell us, given the decision in the *Loving* case, how restricted the tools are for the IRS to deal with the unscrupulous preparer.

Ms. OLSON. Well, right now, the IRS has penalties that it can apply against preparers that it identifies as unscrupulous. It requires, in the Earned Income Tax Credit arena, for preparers to complete due diligence certifications, sort of questions that they have to ask the taxpayer, and certify that they have done so.

We have the ability to seek injunctive relief against some unscrupulous preparers, working with the Department of Justice. But this is a situation where the IRS cannot audit itself out of this situation. It cannot audit or apply penalties or even do injunctions with 1.2 million preparers.

It cannot get the kind of competence that we need to engender by doing one-on-one audits. You need a much broader approach.

And more importantly, taxpayers need the designation so that they have a bright line, so that they can say, "Yes, this is someone who has demonstrated competency, and this is someone I should go to." If you go to someone other than that, all bets are off whether that person is competent. That is a very important distinction that audits will not get you.

The CHAIRMAN. I appreciate that, and I especially appreciate that last point, because, in effect, what you are saying is, we need a system that up front makes it clear to those who need these services where the, as you call it, bright lines are and where you ought to go to get the kind of consumer protection you need.

The alternative to that, what we are stuck with, in effect, post the *Loving* decision, is essentially reactive kind of tools where you are playing catch-up ball. Is that a fair appraisal?

Ms. OLSON. Yes. And the taxpayer has already experienced the harm rather than being able to prevent the harm.

The CHAIRMAN. It is very helpful to have your views today. Senator Hatch?

Senator HATCH. Well, thank you, Mr. Chairman.

Let me just ask both of you. What is the IRS doing to educate the public about how to select a competent and ethical return preparer, and what else should it do to educate the public on this issue and make it easier to confirm the competence and ethical standards of a particular preparer?

You have alluded to answers to this, but I would like to have a little bit more.

Commissioner KOSKINEN. As part of our outreach to taxpayers, we provide, on a regular basis throughout the year, a wide range of information and advice to taxpayers, trying to assist them in their attempts to figure out how much they owe and how to pay it. So we advise people they should be careful who their tax preparer is. They should check them out. But as noted, there is no way we can provide any minimum standard guarantee for tax preparers.

So all we can do for taxpayers, which is what we do, is say, you should be careful; you should make sure you know who the tax preparer is and what their background and experience are. But for the average taxpayer, that is a very difficult thing to do. There are no listings, there is no way for them to figure out who are those who have studied and have a minimum level of competence and who do not.

So our view has been, if you had a way of giving that information to the taxpayer, then the free market would be more intelligently applied. People would be able to say, "All right. If I am going to a tax preparer who has not received the minimum standards, I am taking a bigger chance than if I go to a tax preparer who actually has passed the IRS examination." But at this point, we cannot give them that additional information. So we simply have to tell them, be careful with your preparer, but that is not particularly helpful to the average taxpayer.

Ms. OLSON. There is one thing that my office did, which is, we created a poster last year in this environment to warn taxpayers to obtain two things to protect themselves, and they are: preparers

are required to give you a copy of your return that is signed by the preparer *and* has their PTIN number on it.

So I think if there is one piece of information in this environment, without setting standards, it would be for taxpayers to at least get that, because then if the preparer alters the return afterwards, you, one, have the name and identifying number of the preparer, and, two, you can show that there really was fraud committed, and that is a very important piece of information for us to have when that happens.

Senator HATCH. That is good.

Mr. Commissioner, when you were confirmed by this committee, one of my charges to you was that you needed to restore public confidence in the IRS, and you affirmed it was your intent to make that a top priority. However, there have been several recent incidents which underscore the degree to which the public still may have reason to not trust the IRS.

Between the furor over the IRS's proposed rulemaking for 501(c)(4)s, which received over 150,000 comments, most of which were negative, and recent concerns raised by my colleagues on the House side about whether or not your agency is fully cooperating with producing documents related to the ongoing IRS political targeting investigation, I am concerned that it is no longer such a priority.

The American people deserve to have an IRS which is free from political bias, and, of course, we have to hold you accountable as members of Congress, and I personally am holding you accountable for ensuring that, under your watch, no such bias is or will be present, and I believe you believe that and intend to do that.

To that end, can you tell me what steps you have taken to begin restoring that trust and how my colleagues and I can be assured that you are continuing to make this a top priority?

Commissioner KOSKINEN. Thank you, Senator. It is and always has been and will continue to be a priority of mine and the agency's.

With regard to the production of documents for the tax writing committees, the House Ways and Means Committee and this committee, we have had no complaints about the volume of material we have now provided, well over 700,000 pages of information. We do not have to redact it. So, as we work through it, we are simply giving you everything we can find.

We have worked closely with your staff and with the Ways and Means Committee staff to identify additional information that you may need, and we are providing that material in volume. We hopefully are nearing closure on that. We have provided you all the information about the determinations process that we have.

The discussion has been, and the concern has been, with those committees that do not have the authority to see taxpayer information, where we have to review every single page and redact any information related to individual taxpayers before we can provide that information. But we are continually providing information. Since the hearing I had before the House Oversight Committee, we have provided them, by the end of this week, another 50,000 pages of redacted information.

No one has a greater interest than me personally, within the IRS, to have these investigations come to a close. As I have said from the start, whenever we get a final report from someone, we will look at the facts as they are found, and we will consider what additional actions need to be taken, if any. We have already accepted all of the Inspector General's recommendations. And then we will move forward, because I do think it is important for every taxpayer to be confident that no matter who they are, what their organization, what their political beliefs, who they voted for in the last election, when they deal with the IRS, they will be treated fairly, in an evenhanded way, and they will be treated the same way everyone else is treated as we go forward.

Senator HATCH. That is good.

Thank you, Mr. Chairman.

The CHAIRMAN. I thank my colleague.

I would only say—it is Senator Casey's turn—I would just say that I do not see any evidence that protecting taxpayers from unscrupulous preparers is a partisan issue, and that is what we are focused on here today, and we have a lot of heavy lifting to do.

We will go to Senator Casey next.

Senator CASEY. Mr. Chairman, thank you very much. Before I pose some questions for our witnesses, I wanted to address an issue that has been raised a number of times, including this morning. This is the 501(c)(4) issue, the processing of those.

We did our subcommittee assignments recently, and I was just appointed the new chair of the Subcommittee on Taxation and IRS Oversight. So I, like folks in both parties on this committee, am committed to making sure that any kind of abusive practice that is engaged in is not repeated and is rooted out and exposed.

The committee, Mr. Chairman, I guess, undertook an investigation, which has been a bipartisan investigation, into the issue. The investigation included interviews with individuals who are impacted, as well as IRS employees.

Mr. Chairman, it is my understanding that the committee staff has essentially completed the investigation and is prepared to release its findings and conclusions. So, Mr. Chairman, I would welcome the prompt release of the conclusions of that bipartisan investigation and look forward to working with you on the issue, as well as other members.

The CHAIRMAN. Thank you, Senator Casey. Certainly, that investigation was well underway when Chairman Baucus chaired the committee. Senator Hatch has been very constructive in terms of working with me.

This is the only bipartisan investigation that is taking place into these issues, and I am very hopeful that we will have that report ready for members quickly.

Senator CASEY. Thanks very much.

Commissioner, I wanted to start with you. I know that your team has identified some tax scams on a so-called "dirty dozen" list, and there are two issues that I have worked on that are related to this, the kind of abuse of data or information. One is the Death Master File, preventing that from being used for fraudulent purposes, as well as working with the Social Security Administration to prevent criminals from stealing Social Security checks.

I guess more broadly, on this issue of scams and preventing them, what would you hope that we could do here in the Congress, starting here in the Senate and the Senate Finance Committee, to better help the IRS protect taxpayers? I am assuming that it would be some form of the items that you outlined on pages 6 and 7 of your testimony.

Commissioner KOSKINEN. Right. I appreciate the question. Obviously, the Taxpayer Advocate and I are here supporting congressional efforts to give us the authority to set minimum standards for tax preparers—a reasonable amount.

As I say, most tax preparers are competent, they are educated, and they do a good job. What we are worried about is those on the periphery who either do not have enough information to adequately prepare a return or, worse, are figuring out various ways to defraud taxpayers either by high fees, by taking all or a portion of their refunds, or by channeling them, as the Taxpayer Advocate said, into other activities which may or may not be in the taxpayer's interest.

We also are proposing, with regard to identity theft and refund fraud generally, that the Congress give us authority to get W-2 information by the end of January. Right now, what has happened is—we are sort of the victims of our own progress.

In the old days, you used to get your IRS refund months later, and, in the meantime, we would have gotten all of the third-party information. Now, with electronic filing and the tremendous progress the IRS and its employees have made, when you file your return, we say we will get you a refund within 21 days. So we have leapfrogged the receipt by the IRS of the third-party information. So a critical part of that information for us would be to have third-party information and W-2 identifiers earlier so we could check refund applications to ensure that at least there is some comparison before issuing refunds.

The action the Congress already took to close the Death Master File has been very helpful, although there are still people who have access to it. We are concerned across the board with the ease of theft of Social Security numbers in the public sector. No one has ever stolen Social Security numbers from the IRS database, but they use the Social Security number to file a false return.

Senator CASEY. I appreciate that.

Ms. Olson?

Ms. OLSON. I think one thing that is an emerging trend that I have just been briefed on is the theft of Social Security numbers from preparers themselves, hacking into preparer databases. And that is very disturbing, because you do get the wage information. So, even if we have the wage information, we cannot necessarily tell that that is a bad return.

The IRS right now is doing a pilot to see if you can match the name on the return, where the deposit is supposed to be made into an account, with the name on the account itself, the bank account itself, and that is having some mixed results. But there may be things on that end where you can work with the financial institutions to do greater security—are these dollars supposed to go into there? And I know that the IRS is considering limiting how many

refunds can be made into a particular account. So that would be a very easy fix.

Again, these criminals are—you are truly talking about scams. These are opportunistic criminals. They are going to do whatever is easiest, and the more you can create barriers for them committing fraud, the more they will look somewhere else. They will not necessarily go away permanently, but they will go somewhere else.

Senator CASEY. Thank you very much.

The CHAIRMAN. Thank you, Senator Casey.

Senator Roberts?

Senator ROBERTS. Mr. Koskinen, when you visited with me last year prior to your confirmation, sir, you told me that you thought it was your role to clean up the IRS and get the agency back on track in regard to the processing of exemption applications and the implementation of the Affordable Health Care Act, both monumental tasks indeed. You said that your longer-term goal, however, was to restore the IRS's reputation and integrity on these and other functions.

I have some confidence that you are going to be able to do that. However, prior to your confirmation, you said that the IRS was targeting certain groups during the exemption application process, thereby trampling on their First Amendment rights.

It seems to me that there is a common-sense step that you need to take, and you should take it today—stop all action on the proposed 501(c)(4) regulations until the House Ways and Means Committee, this committee, and everyone knows what went on, who was involved, what the implication of all of this is, and how we can address the issues raised and hold people accountable. That is why I have joined with Senator Flake from Arizona and 40 of my colleagues to offer legislation to stop the IRS from proceeding with the new rules until we have answers.

Here is the deal. We have Code of Federal Regulations title 26. I am sure you are familiar with it. Internal Revenue rules take various forms. The most important rules are issued as regulations, and the Treasury decisions are prescribed by the Commissioner and approved by the Secretary or his delegate. Other rules may be issued with the signature of the Commissioner or the signature of any other official to whom authority has been delegated. Regulations and Treasury decisions are prepared in the Office of the Chief Counsel after approval by the Commissioner.

Here is the deal. Our constituents informed us, with some degree of outrage, that there is an IRS fox in the First Amendment chicken house. The response by the IRS: "Yes, we know that. We are writing regulations that will tell the fox to behave himself." But that makes no sense. We are investigating why the fox was even in the First Amendment chicken house in the first place.

So I have some suggestions. First, why do we not get the damn fox out of the First Amendment chicken house? Second, why not waive the regulations until we get our investigations done, at least until we can find out who put the fox in the chicken house in the first place and how and hold them accountable?

Why can we not stop on these regulations until we are done with our investigation?

Commissioner KOSKINEN. Having worked on my uncle's farm in Minnesota, I have a little bit of familiarity with foxes and hen-houses, but let me just respond to the point.

As I have said for some time, actually in my earlier testimony in February, especially since the volume of comments since then has gone up, the chances of our finishing any regulation before the end of the year are very slim, if not nonexistent.

Our hope has been that, in fact, one or more of the six investigations that have been going on now since last year will be completed well in advance of that. So I think, in terms of the goal of not having a regulation until we have some investigations done, I think that unless the investigations are going to go on into next year, somebody will issue at least one, and hopefully this committee, perhaps others, will issue their report sometime in the next 3 or 4 months, which will be well in advance of any time that we would have a chance of completing this regulation.

With regard to the regulation, as I have said in the past, not having been around when it was originally formulated, my commitment and dedication is that any regulation that is ultimately issued should be fair to everybody, should be clear, and it should be easy to administer.

And we are going to carefully review the 150,000-plus comments that have been made. We have just started the review, so I am not quite sure how everybody knows whether they are positive or negative, but clearly the regulation has attracted a lot of interest.

And as I have said, by the time we hold a public hearing, in all likelihood, re-propose any regulation that we would be considering and get more public comments, it is going to be well toward the end of this year. And as I say, my hope would be at least one of the six investigations will have been done by then, if not more, and we are committed to reviewing the findings of those investigative reports and taking any additional action that is necessary to put this behind us.

Senator ROBERTS. My time is about up. I want to thank you for that word "committed." So you are unequivocally committed to this committee and you are committing to this committee that 501(c)(4) proposed regulations will not be finalized this year?

Commissioner KOSKINEN. I think what I have said is that the chances of it being finalized before the end of the year, not before the election, before the end of the year, are slim.

We are not rushing to get them done. We are actually being—

Senator ROBERTS. There is an expression that the chances of something happening in Dodge City, KS are slim and none, and slim left town. So why do we not just say "none" this year and, more especially, until the investigations are done? Why can't we do that?

Commissioner KOSKINEN. We could do that, and I think probably that it is a slim chance and it is fairly likely. What I can easily commit to is, we will not be anywhere near completing these regulations before somebody has completed an investigation, because I am confident—

Senator ROBERTS. I hope you share these regs with us as we go through this, because there are an awful lot of people—

The CHAIRMAN. The Senator's time has expired.

Senator ROBERTS [continuing]. Who are outraged by this.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Grassley?

Senator GRASSLEY. Mr. Koskinen, I wrote to you and Secretary Lew on February the 20th. I asked about the administration's decision to delay the employer mandate until 2017 for businesses with 50 to 99 employees. That category of businesses is not specified in the health care law at all.

In order to qualify for the delay, you require employers to certify that they did not lay off employees to get below the 100-employee threshold. This certification seems like unnecessary information, unless you think the employer mandate will cause businesses to lay people off.

(A) Do you think that businesses will lay off their employees in order to avoid paying penalties under the health care law, and, if not, why are you requiring the certification? And (B), what is the legal justification for a new category of businesses with 50 to 99 employees in the certification process?

Commissioner KOSKINEN. Senator, as you know, tax policy issues like this are all the domain of the Treasury Department. Those decisions were made by the Treasury Department. I did not participate in those.

As a general matter, I do not think that companies, with regard to health care issues, are going to willy-nilly lay off their employees. I think most companies are dedicated to their workforce and to developing them.

But the question in terms of on what basis those decisions were made, is really a question that has to be addressed to the Treasury Department.

Senator GRASSLEY. But you have to sign off on them.

Commissioner KOSKINEN. All Treasury regulations are issued by Treasury and the IRS, but the policy issues behind questions like this are decided by the Treasury Department. The Chief Counsel's Office actually reports directly to the Treasury Department.

Senator GRASSLEY. Well, I requested a response from you and Secretary Lew by March the 7th. So then, when can I expect such a response? And I assume you can be an Aaron for making sure that this gets done.

Commissioner KOSKINEN. I will clearly commit that I do not know why the delay, other than the fact that any response gets cleared by a complicated process. But my commitment to this committee and you and all of you has been that we will reply promptly to any letter we get from you, and I will assure you that I will get you a prompt response from our side. I cannot tell you when the Treasury Department will respond, but we should respond to you promptly.

Senator GRASSLEY. Well, you surely talk to Secretary Lew, and he made the same promise that you made: when he comes before the committee, he is going to answer our questions. And I do not know why people say they will answer our questions if they will not.

Well, anyway, let us go on to the second question. Mr. Koskinen, just last week, I wrote to you concerning the nonprofit hospital reforms that I authored and were enacted in 2010. These reforms im-

posed new requirements on nonprofit hospitals to hold them accountable for their tax-exempt status.

To date, key legal guidance needed to ensure compliance with the law does not appear to be finalized. What has been the delay in finalizing regulations in this area, and when we can expect final regulations?

Commissioner KOSKINEN. A series of regulations and proposals have been drafted pursuant to that statute. And in January of this year, Treasury provided, with the IRS jointly, guidance to hospitals that they could rely on the existing proposed regulations that are out there.

We expect that the final regulations will be issued before the summer is out. But the hospitals have already been advised that they can rely upon the earlier regulations or proposals that are out there.

Senator GRASSLEY. The 2010 nonprofit hospital reforms also required the IRS and the Department of Health and Human Services to collect information on nonprofit hospitals and report to Congress every year. An annual report should have been issued to Congress for fiscal year 2012, but Congress never received any report. Congress has yet to receive a final report for fiscal year 2013.

A 2012 report by the Inspector General of Treasury recommended that the IRS enter into a memorandum of understanding with HHS in order to better coordinate the collection and sharing of the information for the report. The IRS agreed with the Inspector General's recommendations, and, as I understand it, the memorandum of understanding has not been finalized.

What is the status of the memorandum between IRS and HHS? When would you expect it to be finalized? Why has there not been an annual report, as required by law, and when can Congress expect the 2013 report?

Commissioner KOSKINEN. We have been working cooperatively with HHS. We expect not a memorandum of understanding, but written, final confirmation from them about the process we are going to use going forward.

The problem with timing is, it takes 2 to 3 years for all of the data to be filed. So the 2011 data has now been made public by HHS. We expect to provide it jointly, because our data is going to measure with theirs. The hospitals all asked for us to use apples-to-apples data.

So this summer we will be issuing to the Congress a report for 2011, because that is the timing in which we actually get the final data. And then every year thereafter, we will provide that report on an annual basis jointly with HHS.

So the data for 2011 is already public from HHS's side. We are collecting then for the same time period, calendar 2011, putting the data together, and every year it will be late because of the time the hospitals have to file all of that data. But as a regular matter, starting this summer, you will get annually the data required.

The CHAIRMAN. Thank you, Senator Grassley.

Senator Thune is next.

Senator THUNE. Thank you, Mr. Chairman. I want to thank you and Senator Hatch for holding this hearing.

I think all Americans expect the IRS to administer our tax laws in an impartial manner, and they expect the tax preparers to act in a competent and ethical manner too. And so the concerns that have been brought to light by the GAO in its recent study are very troubling, and I am pleased the committee is examining this issue in order to determine if legislative action is necessary to ensure that Americans are protected from unscrupulous and incompetent tax return preparers.

I do want to, Mr. Koskinen, give you an opportunity—I want to turn to something that has been mentioned here by my colleagues and has been discussed of late, and give you an opportunity to correct the record.

Last week, the *Washington Post* fact checker, Glenn Kessler, awarded you three Pinocchios for your statement that the Treasury Inspector General for Tax Administration, Russell George, had not used the term “targeting” when referring to how the IRS has treated conservative social welfare groups. The *Post* article noted that Mr. George specifically stated in his testimony to Congress that the IRS targeted specific groups—I am quoting now—“applying for tax-exempt status. It delayed processing of these groups’ applications and requested unnecessary information, as well as subjected these groups to special scrutiny.”

Given that *Post* article and the confusion around recent statements that you have made on this topic, I want to give you an opportunity to correct the record. And the question, I guess, specifically, is, do you agree that the Treasury Inspector General for Tax Administration has found that certain conservative groups were targeted for extra scrutiny by the IRS?

Commissioner KOSKINEN. I appreciate the opportunity to correct the record. It has been intriguing to me that it has become this big issue, a tempest in the teapot. What I said in my testimony, which seems to have triggered this, was that the Inspector General’s report last May, in his findings, said that he found that inappropriate criteria were used to select applications for further review. It was in response to a question about the findings of the IG, and my point was the IG’s finding in the report said it was improper criteria.

Thereafter, I have—and a couple of times since then—made it clear the IG clearly in his testimony to Congress used the word “targeting.” He talked about targeting beforehand. My only point was in response to a question in which I was asked if the Inspector General’s finding was “targeted.” I said his actual finding said “improper criteria.”

But one man’s improper criteria is another man’s targeting. How it got to be this big an issue I do not know, because clearly the issue is, however you describe it, it should not have happened. It should not happen going forward in the future.

We are committed. We have already taken all of the IG’s recommendations and accepted them. We are committed that, as I say, when people, not only for (c)(4) applications, but in any relationship with the IRS—we are going to continue to audit people. Some will be Democrats, some will be Republicans; some will go to church, some will not.

When you hear from us, it is only because of something in your tax return. People need to be confident that that is our commitment, that is our general approach to these issues, and that is how we are going to behave going forward.

Senator THUNE. Just as a follow-up to that, the *Post* article also referenced your use of the term “targeting” and posed this question. The basic question was, was the phrase so toxic that it was wiped from the lexicon once you arrived at the IRS?

And I guess I would just ask, since your confirmation as Commissioner, has anyone in the administration, within the IRS, the Treasury, the White House, anyplace like that, pressured you or counseled you against using the terms “target” or “targeting” in reference to the matter that we are talking about?

Commissioner KOSKINEN. No one in the administration. The only concern I have heard—I have been to 20 offices at the IRS now, and I have listened to and met with over 8,000 employees. Several of the employees have objected to the use of the term “targeting,” but nobody in the White House, nobody in the Treasury, nobody in the administration, has asked me not to use the word.

Senator THUNE. Thank you.

Mr. Chairman, I want to just—I have about a minute left here—focus on what I believe is a major driver of more and more Americans seeking tax preparation assistance, and that is the incredible complexity of the tax code.

As you know, much of the Affordable Care Act is administered through the tax code, which means that when uninsured Americans file their taxes, they are going to need to figure out whether they qualify for the subsidies, how much they can receive, whether it makes more financial and medical sense to get coverage or to pay the penalty for violating the law.

The question is, doesn’t the Affordable Care Act create a lot of new complexity issues on top of those that we already have, making it even more difficult and driving even more Americans to tax preparers when it comes to getting their returns in on time? And do you believe that most tax preparers are adequately prepared to handle the complexities arising from the Affordable Care Act?

Commissioner KOSKINEN. I think we are going to have a lot of questions by preparers and taxpayers about the Affordable Care Act.

The vast majority of Americans are going to be unaffected by it. They are going to check off a box that says they have insurance, they have Medicare, and they will not be affected. But for the people who are in that area, who are applying for insurance, getting advanced premium credits, there are going to be questions asked.

One of our concerns is to make sure we are prepared to answer those questions.

Senator THUNE. Ms. Olson, quickly, on that, do you have a comment?

Ms. OLSON. I think that there is certainly a great deal of complexity in the Affordable Care Act. I would note that I am watching very carefully and closely how the IRS is approaching that also, on the compliance side, what they do if somebody owes money as a result of the ACA.

But there is one thing about the Affordable Care Act that is very important. We are going to get a lot of information from third parties, which will allow us to identify inaccurate claims during the filing season. As the Commissioner earlier alluded, it is very important for us to get W-2 and 1099 information early in order to avoid all this fraud and errors in the regular tax system.

So there is an actual added benefit in the Affordable Care Act that we do not have with the rest of the filing system that would be really good to have in the rest of the filing system.

Senator THUNE. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Thune.

I very much appreciate your also highlighting the complexity of the code, because the Congress is not blameless here. Virtually every session, some other group comes up, usually with a good cause, and what happens here on the Finance Committee is, we just add it to the code. There have been something like 15,000 changes. It comes to maybe one or two for every working day in recent years.

So that is right at the heart of tax reform, and I look forward to working with my colleague.

Senator Isakson is next.

Senator ISAKSON. Thank you, Mr. Chairman. I concur with your opening statement, talking about how tax simplification is the key to this, and I think it is the key.

There is another key that I use to determine what Georgians are interested in, and that is how long I have to stay in the narthex after church to answer questions and what that subject is about. Yesterday, given the proximity to April 15th, everything was about the IRS. Listening to Senator Casey's statement, I think I heard that we are close to having conclusions from our bipartisan investigation. Is that correct?

The CHAIRMAN. I will let Senator Hatch chime in here, but I believe so. Certainly, the staffs have been talking.

Senator Hatch has been very constructive, given the fact that this is the only bipartisan investigation into this, and, obviously, there were errors made. There is no question about that. It is important that we wrap this up, but I am very hopeful that we can do that quickly.

Senator Hatch, would you like to add to that?

Senator HATCH. Well, we are trying to wrap this up as quickly as we can. It has been slow. We still have not gotten a number of documents that we still have to get, but I agree with the distinguished chairman that we are working in a bipartisan manner and hopefully we can conclude this within the relatively near future—at least I hope so.

The CHAIRMAN. Commissioner, can we have some clarity on that point?

I understand you have sent us a letter indicating that you have made available all the documents for purposes of this investigation. Is that right? I do not have the letter with me.

Commissioner KOSKINEN. Yes. We, 3 weeks ago, said we had provided you all the documents we had about the determinations process, which was the subject of the Inspector General's report.

Since then, we have had requests for additional information, not about the determinations process, but about any involvement by Lois Lerner in the exam process, the appeals process, and the regulatory process, and we are completing the provision to you of all of that additional information as well.

But for the base issue of the determinations issue that the IG raised, you have all of the documents we could find.

The CHAIRMAN. We are intruding on Senator Isakson's time, and I will let Senator Hatch have the last word here.

Senator HATCH. They said they had given us most of the documents, and then we found out that they had not. So we just got a new set of documents last week.

We are appreciative of the cooperation. We still have not gotten into the Treasury documents as much as we would like to, although we are starting. All I can say is, we are trying to do the very best we can to conclude this investigation, and hopefully we will in the near future.

The CHAIRMAN. We are committed to getting this done, Commissioner. We are going to get it done in a bipartisan way, and I want to assure you that we will be following up with you quickly on any remaining questions. But I knew that, as of a couple of weeks ago, you had given us everything we asked for, and that strikes me as indicative of your cooperation.

This is not going to be imputed to Senator Isakson's time. So let us make sure that—

Commissioner KOSKINEN. In that case, let me just say I appreciate that. We have had good working relationships with the staffs of the majority and the minority, and we are committed to continuing to work with you. Whatever you need, we are anxious to get it to you.

The CHAIRMAN. Very good.

Senator Isakson, we are going to roll the clock back so you can have your full 5 minutes.

Senator ISAKSON. Well, I asked the question, and I am glad you all went into the detail to answer the question, because, in a voluntary compliance-dependent system, which ours is, the confidence the American people have in the Internal Revenue Service is the key to voluntary compliance.

I think the quicker we can get to all the answers, whatever those answers are, the better off all of us are. I want to thank Commissioner Koskinen for the visit he paid to Atlanta 3 or 4 months ago and his including me in that visit.

I would just comment, having run a business before and watched a department manager or a business head motivate employees, if your performance in Atlanta was typical of what you do when you visit other offices around the country, I think the confidence of the IRS employees and the IRS will go up, because I was very impressed.

Commissioner KOSKINEN. Thank you.

Senator ISAKSON. Ms. Olson made a statement about financial incentives to inflate numbers in tax returns for the preparer to take advantage and pocket the difference. How do they pocket the difference?

Ms. OLSON. Well, one of the ways that you see is, if you can get a larger tax refund for your customer, and you are actually preparing returns in a car dealership or in a furniture rental place or in any number of other kinds of entities that are selling products unrelated to tax, then you can give a loan advancing funds so that the taxpayer can apply those inflated refunds to purchasing a product.

And what we are seeing in some instances—and I used to see this in the low-income taxpayer clinic I ran when I represented taxpayers—is we see this in a vehicle purchase, where a taxpayer would use the loan on an inflated refund to purchase an automobile. The IRS would then disallow that refund.

The taxpayer would be unable to make the ongoing payments on this higher-dollar vehicle that they really could not afford. They owed the refund back to the IRS, and the car would ultimately be repossessed, and then the taxpayer would end up with cancellation of debt income for the next year, which was taxable.

Commissioner KOSKINEN. Another, more direct way of fraud is, the preparer puts his bank account down as the bank account to which the refund should go, and it is all done electronically. Then the preparer can either take out a big fee before he provides the refund to the taxpayer, can keep some of the refund, or may keep it all. And there is no way for us—because it is all done electronically, when he puts down his bank account—to keep the refund from going to his bank account rather than the taxpayer's. A lot of those taxpayers do not have bank accounts.

Senator ISAKSON. In either case, that is a fraud against the taxpayer.

Commissioner KOSKINEN. Fraud against the taxpayer.

Senator ISAKSON. Which brings me to the question I wanted to ask about IRS's Free File program. You talked about low-income taxpayers being the ones who are most often abused in something like that.

Has Free File helped? Because it seems like electronic technology would help prevent people from padding deductions or padding income.

Ms. OLSON. Well, I think that the issue is, many of these taxpayers who are most vulnerable do not have computer literacy, the level of computer literacy, that would enable them to do that.

In some of the walk-in sites that the IRS has and at some of the Volunteer Income Tax Assistance sites, they are actually trying to get taxpayers to sit down, and they walk them through. You can prepare—they have computer terminals. You can go and prepare your own return, and, if you can learn it once, maybe next year you can do it yourself. But there is a very high learning curve.

I think one thing that can help is if we can get this W-2/1099 information in advance, then maybe the IRS can pour that into, whether it is commercial software or into Free File or into the free fillable forms that we have as part of the consortium, if you could pour some of the data in, that might make it easier for taxpayers to then say, "Okay, and I have these dependents," et cetera, and prepare their own returns. But it is a big lift for this population.

Senator ISAKSON. This is my last question, and I appreciate the time, Mr. Chairman.

When you catch an unenrolled preparer in a fraud, under the *Loving* decision, you do not have any standing to do anything to that person, but can you refer them to the Justice Department for prosecution or investigation?

Commissioner KOSKINEN. Yes, and we do that. Whenever we find either systemic fraud or fraud that is a violation of law, we can refer it for prosecution. As the Taxpayer Advocate noted, that is after the fact, after the taxpayer has been abused, and we cannot prosecute every case. We do not have the resources to either catch everybody who has defrauded their clients or to prosecute them all, but they are at risk.

If they commit fraud in the filing of their returns for their clients, if they violate the law, they are at risk of prosecution. The question is whether we can catch enough of them to make a difference.

Senator ISAKSON. Well, if CMS does a good job of trying to enforce against fraud in Medicare and Medicaid by making highly visible profiles of anybody they catch defrauding the government, the same thing might be beneficial for the IRS as well.

Commissioner KOSKINEN. We give as much visibility as we can to the prosecutions we get and to the sentences we get, but there are still a lot of people figuring out that they are playing roulette. And assuming that, at the levels they are operating, it will be hard to find them, and the question is whether there will be enough resources to prosecute them.

Senator ISAKSON. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Isakson.

Among the good points that you just made, I think there really ought to be more inquiry into Free File to actually see what its strengths and limits are. I have heard, for example, questions about whether they can do State returns and these kinds of matters. So I want to work closely with you on it.

Senator Burr?

Senator BURR. Commissioner, welcome. Senator Coburn and I have shared some correspondence with you in the last 2 weeks. You have responded. I thank you for that very timely response.

Let me refresh your memory. This was in relation to the Chicago District of the NLRB's decision as it relates to the Northwestern Football Players and their potential unionization.

We said to you that our interpretation of section 117 of the Internal Revenue Code was, in fact, exactly what your tax experts said, that there was an exclusion specifically stated in there for scholarships, educational scholarships, that made those exempt from ordinary income.

But the statute goes on to note one exception, and I will quote it. It says section 117, and I quote, "shall not apply to that portion of any amounts received which represents payment for services by the student required as a condition for receiving the qualified scholarship," meaning if the individual received a scholarship, a portion or the portion that represented a payment for service was no longer tax-exempt.

I got a very detailed letter back from you basically stating the first part, which is about section 117 and the exclusion for scholarships, and you made a very specific statement in here that the

NLRB definition of an employee for labor law does not control whether the individual is an employee for the purposes of Federal tax. In other words, scholarships are governed by IRS code, and this is going to raise a big question, because nowhere did your letter note the disqualifying thing found in the tax code, which is providing a service.

Now, let me just state for my colleagues, the NLRB decision said these students are employees. The suit was brought by Northwestern football players because they said, "We are under the control of the university. They tell us when to go to practice, when to go to a game. They control. Therefore, we should have the opportunity to bargain with them because we are employees."

The NLRB made a determination that they were employees, and they referred to section 2.3 of the National Labor Relations Act. Let me just quote from the NLRB decision.

"The Act provides, in relevant part, that the term 'employee' shall include any employee. The Supreme Court has held that by applying this broad definition of an employee, it is necessary to consider the common law definition of an employee. Under the common law definition, an employee is a person who performs services for another under a contract of hire, subject to the others' control or right of control, and in return for payment."

Now, let me just suggest to you that, if that does not meet the exclusionary part of section 117, I really do not understand it. And I understand your point here that labor law does not dictate tax law.

So let me point then to tax law. In Revenue Ruling 77-263, which discusses section 117 and the tax law treatment of athletic scholarships, the IRS states this clearly: "Any amount paid or allowed to or on behalf of an individual to enable an individual to pursue studies or research is not considered to be an amount received as a scholarship or a fellowship grant for the purposes of section 117, if such amount represents compensation for past, present, or future employment services or for services that are subject to," and I underline, "direction or supervision of a grantor or if such studies or research are primarily for the benefit of the grantor. Any of these conditions will negate the existence of a scholarship or fellowship grant as defined in the regulation."

So the body of tax law is pretty clear on this question, Mr. Commissioner. Bargained-for payments cannot be excluded from income as athletic scholarships. Again, the players were seeking to unionize in the Northwestern case, and they make the argument that they are employees and that the scholarships they receive from the university are compensation for services rendered. The NLRB has agreed with the players that they are employees and that their scholarships are compensation for services rendered.

Let me just ask you, how can the IRS ignore tax law and the facts in the answer that they prepared for you to send me?

Commissioner KOSKINEN. Well, first of all, it would be interesting to see what the NLRB final decision is as that issue from the regional office goes forward.

Senator BURR. If it goes as currently written, are those scholarships taxable?

Commissioner KOSKINEN. Well, the revenue ruling you are talking about talks about and tries to distinguish, obviously, graduate students who teach, who do research, who get paid, and that issue.

Obviously, interesting discussions are going on in the NCAA about whether, in fact, student athletes should get stipends, so whether they should, in fact, be paid in addition to their scholarships. The principle thus far has been that all of these students are student athletes, that the scholarship allows them to attend college and to participate in athletics, and that historically has been the rule applied.

To the extent that the circumstances change significantly—and that is why I say it will be interesting to see where this goes—then, obviously, we will take another look at what the definition of compensation is, what the definition of scholarships are, and what the situation is. But thus far, the people who have looked at it, the experts in the IRS, have ruled that nothing has changed thus far that would cause us to make a—

Senator BURR. Commissioner, let me ask. Just from the explanation and what I read of tax law, where have I missed it that it is clearly stated there, that if they are supervised, if they perform a service required by that entity that controls them, this is no longer considered a scholarship?

I think that you are reinterpreting what the tax law says and—

Commissioner KOSKINEN. What I am saying is, historically, what football players do today is no different than what they did 5, 10, or 20 years ago, and they have always been treated as if those were scholarships.

To the extent that the nature of the compensation changes, then we would take a look at it. But nothing in terms of what a student athlete does has changed, even as a result of that NLRB decision.

The CHAIRMAN. Senator Burr, I just think we have to move on. We have a lot of additional witnesses. Is that acceptable to you? Do you have anything else you need to do? You are way over.

Senator BURR. Let me just say, Mr. Chairman, it concerns me that we might look at it in the future, because we either follow the statute that is in the law, which I think is very clear, or we do not, and I am not sure the IRS statute is open for interpretation when it is as clear as it is. You would have to change a lot of words there to suggest that this does not fit the determination that the labor law makes.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Brown?

Senator BROWN. Thank you, Mr. Chairman.

I appreciate Senator Burr bringing up such an interesting issue of what happens at Northwestern with these players, and I might add, I have met with a couple of them, and they are definitely not asking for compensation.

I know Senator Burr did not say that, but it is about concussions, and it is about a kid who gets hurt and loses his scholarship because he is of no use to the university then and may not have his health care provided for.

I remember a suspension some years ago of a major player at a university in my State. The suspension did not take effect until

after the bowl games because of the revenue he represented to the university, the NCAA, and ESPN. So, even though he deserved suspension, he did not deserve it until after he would play that ballgame that would bring in that revenue. So I think we have a lot of discussions ahead of us on this.

Senator BURR. If I could say to my good—

The CHAIRMAN. Colleagues, we have quite a number of witnesses on the second panel. We are just going to have to continue on the question of fraud by tax preparers.

Senator Brown?

Senator BROWN. Thank you, Mr. Chairman. And it will be that.

There has not been much said—well, nobody on this panel has talked about the Earned Income Tax Credit. I cannot stay for the second panel. I do know one of the witnesses on the second panel will have much to say about the Earned Income Tax Credit.

My view is, if we are going to look at the EITC—which President Reagan, as you know, called the best poverty program going in America—couple it with the Child Tax Credit and what that means. I know Ms. Olson has been outspoken about that. If we are going to look at EITC as being subject to too much fraud, and we always should be vigilant, to be sure, we might be just as focused on carried interest and blocker corporations and accounts in the Cayman Islands.

But let me ask Ms. Olson. There was a TIGTA report that found higher rates of improper payments for EITC. They also estimate that between 20 percent to 22 percent of eligible workers are not claiming EITC.

For many of us, in our States, we put real time and real staff, real personal staff and real staff time, into getting people to sign up, to know about it, to be aware of it.

First, two questions, Ms. Olson. What do we do to maintain and enhance the EITC and the Child Tax Credit while reducing the error rate and increasing enrollment? And second, in Professor Barrick's written testimony, he states that despite the fact that EITC and the Child Tax Credit lift millions of families out of poverty, he says the risk of fraud is so great that it should be addressed by eliminating both credits.

So comment on both of those, if you would, Ms. Olson.

Ms. OLSON. I think that the IRS has some research, some very good research, from its random audits of EITC taxpayers that really demonstrates that the sources of error are very great. And it is a complicated statute, so you have those kinds of errors, and then you do have fraud, for all the reasons we have talked about here, including the vulnerability of the population.

The population also changes one-third every year. So it is very hard to have a learning curve where you are teaching people. They are leaving the EITC and coming into the EITC in great numbers.

I have proposed in other testimony multiple ways of addressing the errors, including both education and redesigning the statute a little bit to combine the family-related credits and dependency exemptions and child credit into a larger family credit that would be refundable, and then a worker credit, because that makes the overall dollar amount a little less for each provision and a little less attractive for fraud.

But the main point I really want to make about this is that the EITC has very low administration costs for such a large social benefit program. Where its costs are are in the compliance and error and fraud rate, and we do not know what is fraud and we do not know what is error.

Other benefit programs have very high administration costs and not as high error costs. That is because they have a lot of front-end application process. We do not. You file on an income tax return. That is very inexpensive. We have the costs at the back end.

But what the EITC has that no other benefit program has is a high participation rate. We have 75 to 80 percent of the eligible taxpayers getting that money. It is higher than any other benefit program that the United States administers to that population, to my knowledge.

So, if you really want to look at the effectiveness and the efficacy of the EITC, yes, we have a higher error rate, but we have low cost and we have a high participation rate, as opposed to the programs that have low error rates but very high administration costs and low participation rates.

I think if you look at it holistically, yes, we have to get down our error rates—and I have made really substantive proposals on how to do that—but as an effective program, it is very good, in my personal opinion, and my professional opinion too.

Commissioner KOSKINEN. Yes. I agree with the Taxpayer Advocate. We have had two big meetings with everybody who has ever thought about this program. We have tried a lot of different things.

I think the error rate, 20 percent to 22 percent, and the amount of payment made in error—it is not all fraud, as the Taxpayer Advocate said—are untenable. It is a great program, and, as I have told everybody, we have to make it clear to the public that we understand it is a problem, it is a serious problem that we care about, and, in fact, we are going to do something about it.

One of the things we need, and we have asked the Congress this time around for, is authority for what is called “correctable error authority.” We, if we find and know there is a problem in a return, cannot change that return, unless it is just simple math errors, without an audit and contacting the taxpayer. Correctable error authority would allow us, when we know there is an error in the return, to make the change, then advise the taxpayer. The taxpayer could appeal and come back to us. But it would allow us to eliminate some of the improper payments at the front end rather than requiring us to have an audit each time.

The CHAIRMAN. My colleague’s time has expired.

Senator Carper?

Senator CARPER. Thanks, Mr. Chairman.

Commissioner Koskinen, Ms. Olson, it is very nice to see you both. Thank you so much for your service and for being with us today.

I just want to say, Mr. Chairman, I am delighted we are having this hearing, and I commend you and Senator Hatch for holding it.

My colleagues hear me say from time to time that there are three things we need to do for deficit reduction if we are serious about it. We have seen the deficit come down from about \$1.4 trillion in 2009; last year it was only \$680 billion. This year it is ex-

pected to come in at about \$550 billion, then drop a little bit more, and then start going back up again.

But if we are serious about deficit reduction, we need to do three things. One is entitlement reform, save these programs for our kids, save some money, so it does not savage old people or poor people. Number two, we need tax reform that actually brings down our top corporate rates to something that is more competitive with the rest of the world and also generates some revenues for deficit reduction. The third thing we need to do is look at everything we do in government and ask this question: how do we get a better result for less money? And this falls right into that bailiwick.

GAO has spent a lot of time in recent years looking at this and how we make sure, in terms of other revenue that is coming into the Treasury, that taxpayers are paying a fair and reasonable amount, but others are not being unduly burdened because some of our neighbors are not doing their fair share. And this hearing puts a real spotlight on one of the ways that we could better ensure that everybody is paying their fair share. So I am delighted we are having this hearing.

The investigations by the GAO and by the Treasury Inspector General have revealed serious problems with tax return preparation by preparers who are not CPAs or who are not attorneys or otherwise credentialed, and, as we know, this poses serious problems for tax administration, particularly for highly complex tax provisions like the EITC. You indicate it is pretty easy to fill out the form, the tax form to apply for it, but the actual compliance of it is quite a different matter.

In light of the recent circuit court decision, it looks like legislation is necessary to allow the IRS to adequately regulate the tax preparers. In the meantime, I support IRS's efforts to create a voluntary certification program for preparers. And let me ask this question.

Do you believe that offering voluntary certification will offer enough opportunity for return preparers to distinguish themselves so that many preparers will participate?

Commissioner KOSKINEN. Go ahead.

Ms. OLSON. I think that if we couple that voluntary certification with some conditions—for example, right now, unenrolled return preparers can represent taxpayers in audits before the IRS for returns that they prepare, and that is a rule that we have promulgated. We should change that rule to only grant that ability to people who have taken the test and demonstrated competency and continuing education.

They can also write their name on the return and say, "You can call us if there are questions about the return," and we should restrict that to certified preparers. So that gives a leg-up to those people who are taking the time out to do that voluntary testing and continuing education. They can say, "We can do these things," whereas other people cannot.

It will not work if we do not have a comprehensive education campaign. We have to make it the Good Housekeeping Seal of Approval, that you have a clear choice. You go to someone, an attorney, a CPA, an enrolled agent, or a certified preparer, or all bets are off.

Senator CARPER. How could we help in this regard, other than passing legislation, which I would like to see us do, but how can we help short of that? There may be nothing, but there may be something.

Commissioner KOSKINEN. This hearing is very valuable to give visibility to the issue to try, as we do, to get taxpayers to be careful when they select a preparer, to try to determine what their background is and their competency.

Again, the government and the IRS have a great interest in competent preparers, because the errors that are provided, or the fraud that is created when it is not done well, create a tremendous burden on the system, as well as a question of whether we are getting adequate compliance.

So I think a voluntary program, which we are considering, would be a step forward, but it is still going to leave people on the periphery, if for whatever reason they decide they are not going to register and take the exams and demonstrate competence, to produce erroneous returns that we then have to deal with and have to contact taxpayers about.

Ultimately, it is not as if it is sort of six of one and half a dozen of the other. From our standpoint, it is critical that taxpayers get proper advice and that we get as many accurate tax returns as we can so that we do not fritter away resources chasing people who had no business filling out that return in the first place.

Senator CARPER. Mr. Chairman, my time has expired. I am going to be submitting a question for the record, because I thought Senator Thune asked a question that is worth highlighting and returning to about a substantial portion of the Affordable Care Act being implemented through the tax system. So you will get a question from me on that.

But thank you so much. It is great to see you both.

The CHAIRMAN. I appreciate my colleague bringing up this voluntary compliance issue. My concern about voluntary compliance is it really does not deal with the scofflaws. We know that the majority of preparers are scrupulous and honest. The problem is what to do about the outliers, and those are the people who are not going to be exactly tripping over themselves to comply with the voluntary compliance point. But we are going to discuss that, and we are going to discuss all of the options here for dealing with this problem.

Senator Cantwell?

Senator CANTWELL. Thank you, Mr. Chairman. And following on that note, one of the options, I believe, is continuing to make things simpler from a technology perspective.

So some of my colleagues have brought up the Free File program, which is a public-private partnership between the IRS and commercial tax software companies that offer free Federal tax preparation. And since its inception, it has saved over 30 million taxpayers in helping them with their filings, and it has also saved the Federal Government something like \$91 million by making it easier, obviously, on the processing costs.

So one of the things that I kind of disagree with you a little bit on, Ms. Olson, is, I am sure there are a lot of people who make less than \$58,000 who know how to use Word or Excel or various soft-

ware programs. This is about continuing to make the complexity of the tax code simple so that the administration of it is simpler too.

So I wanted to talk to you about what else we can do to continue to advance the use of technology and help taxpayers file efficiently, because I have certainly heard stories within my own office of young people using an online version, and paying a little bit for that, and then going the next year, thinking they were going to get some great advice from somebody, and all they are doing is sitting across from somebody who knows barely more than they do, but is charging them 2 times or 3 times the rate.

So to me, I think we need to make the tax code simpler, make it easier for people to file, make the code easier to understand so that people know exactly what they are doing. Is that not the direction that we should be going?

Ms. OLSON. Absolutely. I have made the complexity of the tax code the number-one most serious problem for taxpayers many times in my annual report to the Congress.

I was an unenrolled return preparer and then an attorney who prepared returns for many clients, and I was baffled why people would not do some of the returns that they were bringing to me. There is this nervousness factor that they are going to make a mistake, that they missed something, and I think that is driving people of all income levels to return preparers.

The Free File usage has not been robust in terms of the numbers of taxpayers, even though it covers a large population, and I think some of that is that some taxpayers like to buy the tax software products to get all the other bells and whistles that are on those products, incorporating them with their accounting programs, et cetera. Others want to go to return preparers, like I said before, because they do not want to make a mistake and they just do not trust themselves, even with the software.

I think the IRS publicizes the Free File or the free fillable forms. I will come back to something I said earlier. I think it is very important for the IRS to be able to get W-2 and 1099 data early in the filing season, as early as possible, so we can make it available to taxpayers, so they can download it into their software programs that they may purchase, so preparers can download it into their programs, and so that people can download it into Free File or free fillable forms and get a little further along and that is accurate information then.

You avoid keystroking errors and things like that and that missed W-2 that got sent to a wrong address. That would be the big technology push, and Congress could do something about this by setting some goals for the IRS to move forward in this.

Congress set goals for the IRS to get into electronic filing, and, even though it did not hit the goal on time, it became a rationale, it became a goal, and the IRS organized itself around achieving that. And I think to get to this next electronic umph with getting the third-party information reporting timely, being able to help taxpayers, but, also, protect against fraud—

Senator CANTWELL. I think software developers have to focus all their attention on making it intuitive, and I think there is some intuitiveness we could probably put into the tax code explanations. And so we will certainly take you up on that offer.

I also wanted to ask, quickly, because we have, obviously, suffered this devastating loss in the Oso, Darrington mud slide area of our State, and so we have been looking at all of this as it relates to disaster relief, and you certainly have seen a lot of these incidents with Sandy.

Do you think that we need to look at this issue of what is available to communities? It seems like we are so almost rifle-shot, and then here is a community where you have lost your house. In a lot of instances, you still have to pay on your mortgage even though your house has been totally wiped out.

How do we help these communities?

Ms. OLSON. We have made some recommendations in the past about disasters that did not quite qualify for presidentially declared disasters, and I will commit to working with your office about some of that. And I also think your idea about some of the mortgage relief and debt relief and things, so you do not trigger taxable events because you cannot pay these things, that is very important. I would be more than happy to look into that.

Senator CANTWELL. Thank you.

The CHAIRMAN. Thank you, Ms. Olson, both of you. This was very helpful in terms of the technology issue. There is no one in the Senate who is more tech-savvy than Senator Cantwell. So we are going to follow up on these two issues and on the mortgage point in terms of trying to protect people from tax increases when they get debt relief. That is part of the extenders, as a result largely of Senator Stabenow.

At this point, I think we have completed our first round.

I would like to introduce our second panel, and we will have Senator Hatch introduce Dr. John Barrick, associate professor at Brigham Young University.

Thank you both very much. You have spent a lot of time at the witness table, and we thank you for your expertise and your patience.

Now for our second panel. I would like to introduce the first witness, Mr. James McTigue, Director of Strategic Issues from the Government Accountability Office. Mr. Wayne McElrath is Director of Investigative Services and will answer any questions that members have after Mr. McTigue provides his testimony.

Our next witness is Mr. William Cobb, the president and CEO of H&R Block.

Our third witness is Ms. Janis Salisbury, the chair of the Oregon Board of Tax Practitioners. Ms. Salisbury, we know that you have tax clients waiting for you at home in Oregon, so we thank you for coming.

Senator Hatch will introduce Dr. John Barrick momentarily.

Our fifth witness will be Ms. Chi Chi Wu, staff attorney at the National Consumer Law Center.

Our final witness will be Mr. Dan Alban, attorney for the Institute of Justice.

Let us now have Senator Hatch introduce Dr. John Barrick, associate professor, Brigham Young.

Senator HATCH. I would like to welcome Professor John Barrick from the School of Accountancy in the Marriott College of Business

at Brigham Young University, which is a very highly rated business school.

Professor Barrick is a leading academic expert in taxation. In addition, he has a wealth of practical experience. His highlights include 2 years of tax experience with the bipartisan Joint Committee on Taxation and 4 years as a tax consultant with Price-Waterhouse.

John's family is with him here today. And we welcome you all here, and we are very happy to have you here helping us to understand these issues.

The CHAIRMAN. Thank you very much, Senator Hatch.

We thank all of our witnesses for coming.

In order to give members of the committee time to ask questions, we would ask that you limit your testimony to 5 minutes. Your prepared statements are going to automatically be part of the record.

Why don't you start, Mr. McTigue?

STATEMENT OF JAMES R. McTIGUE, JR., DIRECTOR, STRATEGIC ISSUES, GOVERNMENT ACCOUNTABILITY OFFICE, WASHINGTON, DC

Mr. McTIGUE. Thank you, Mr. Chairman and members of the committee. I am pleased to be here today to discuss the quality of services provided by paid tax preparers.

Millions of taxpayers rely on paid preparers to provide them with accurate and fully compliant tax returns. The IRS has long recognized that paid preparers' actions have an enormous impact on its ability to administer tax laws effectively and collect the revenue that funds the government. Despite the importance of paid preparers in our tax system, IRS's authority to regulate paid preparers is limited to certain preparers, as you have heard, such as attorneys and certified public accountants. The majority of preparers, 55 percent, are known as unenrolled preparers and are not regulated by IRS. In 2010, IRS initiated steps to regulate unenrolled preparers, but the courts ruled that IRS lacked the authority.

In order to gain some insight into how unenrolled preparers actually perform, we developed two scenarios based on common tax issues. We call these scenarios our waitress scenario and our mechanic scenario. In our waitress scenario, our undercover investigator posed as a single mother who received wage income and unreported cash income from tips. She had one child who lived with her during the year and qualified for the Earned Income Tax Credit and one who did not. In our second scenario, a mechanic and his wife derived the majority of their income from his wages, but also had some side income from repair work and child care. They had three children who lived at home; one attended college.

As you can see from the board on my right and figure 3 in my written statement, in 19 visits to randomly selected commercial paid preparers, refund errors ranged from \$52 lower to \$3,700 higher than they should have been. In only two instances did the paid preparer calculate the correct refund amount.

In the waitress scenario, preparers made two key errors; first, not reporting all the cash tip income and, second, claiming both children as being eligible to receive the Earned Income Tax Credit. The clustering of the bars illustrates that different preparers made

the same errors. For example, four preparers did not claim the cash tip income, which overstated the waitress' refund by \$654. One preparer told our investigator that if she reported the tip income, it would be a red flag, and her employer would be audited. Three preparers made both errors, which resulted in refunds that were overstated by more than \$3,700. In one case, the preparer told our investigator that she could claim her second child if no one else did, even though the child did not live with her for more than half of the year.

In the mechanic scenario, not reporting cash income also resulted in refunds that were overstated by \$3,000. One preparer told our investigator that if the side income was reported, his tax preparation fee would go up and his refund would go down. Two preparers went as far as to show our investigator how his refund would change if the side income was reported.

Clearly, taxpayers were not well-served by the preparers that we visited. But as the next board on my right illustrates, figure 6 in the written statement, they paid a lot of money for the services, and fees varied widely. For example, with the mechanic scenario, fees ranged from about \$300 to \$600. Alarming, the average fee for the waitress scenario was nearly \$300, more than 80 percent of her weekly pay.

Often, the paid preparers either did not provide an estimate of the fees up front or the actual fees charged were higher. Higher fees, however, do not translate into more accurate returns. In fact, the fee charged for the correct mechanic return was one of the lowest at \$311. When our investigators inquired about the high fees, we heard a range of responses like, we charge more in the morning than the afternoon, we charge more early in the tax season than later, and the Earned Income Tax Credit form is one of the most expensive.

Although our findings are anecdotal, GAO's analysis of IRS's national research program data reveals that preparer-filed returns showed an estimated 60-percent error rate compared to an estimated 50-percent for self-prepared returns. Errors on paid preparer returns were similar to those encountered during our visits. For example, preparer-filed returns claiming the Earned Income Tax Credit had an estimated error rate of 51 percent.

Undoubtedly, many paid preparers do their best to provide clients with returns that are accurate and fully compliant. However, poor performance can result in taxpayers being audited, having to pay back taxes and interest, and possibly even penalties.

In 2008, when GAO looked at States that regulate paid preparers, we found that returns filed by paid preparers in Oregon, which has the most stringent requirements of any State, were more likely to be accurate than comparable returns filed by preparers in the rest of the country.

Given the importance of paid preparers in our voluntary tax system, we are recommending that, if Congress agrees significant preparer errors exist, it should consider granting IRS the authority to regulate unenrolled tax preparers.

This concludes my statement, and I would be happy to answer any questions.

Thank you.

The CHAIRMAN. Thank you very much.
[The prepared statement of Mr. McTigue appears in the appendix.]

The CHAIRMAN. Mr. Cobb, I think you will be next.

Mr. McElrath, would you like to add to that?

Mr. McELRATH. No. I have nothing to add.

The CHAIRMAN. Very good.

Mr. Cobb?

**STATEMENT OF WILLIAM COBB, PRESIDENT AND CEO,
H&R BLOCK, KANSAS CITY, MO**

Mr. COBB. Chairman Wyden, Ranking Member Hatch, and the distinguished members of the committee, thank you for inviting H&R Block. We are pleased to participate in this important discussion about protecting consumers from incompetent and unethical preparers.

As the world's largest consumer tax services provider, competent, ethical tax return preparation is something we take very seriously. Last year, we filed more than 22 million U.S. individual income tax returns, about 15 million returns in our more than 10,000 offices, and another 7 million through our do-it-yourself software offerings.

We know a lot about consumer views on taxes and know what it takes to maintain expertise in this always-changing tax landscape. In order to protect taxpayers from incompetent and unethical tax return preparers, there are two key items that must be addressed: first, minimum standards for tax return preparers, and, second, consistent fraud prevention measures across all tax preparation methods.

First, we support legislation that sets standards for professional tax return preparers. The most obvious way to address incompetent and unethical tax return preparers is to establish a set of minimum standards. Standards provide an objective measure for both consumers and tax preparers to measure and monitor the overall competency, expertise, and performance of tax return preparers.

This is critical, because the ultimate goal is to help taxpayers file more complete and accurate returns. Equally important is the reduction of both fraudulent tax returns and the improper payment rate of the Earned Income Tax Credit. More than 80 million people file an individual income tax return with the help of a tax return preparer every year. Consumers need an objective way to know that the person they turn to for one of the biggest financial transactions of their year is competent and meets standards necessary to accurately prepare tax returns.

Taxpayers themselves agree. A recent national survey that we commissioned found that 9 out of 10 consumers support requiring professional tax preparers to meet minimum training standards. As this initiative moves forward, the U.S. Treasury Department and IRS must leverage the lessons learned from the prior registered tax preparer program and partner with private industry to create an effective and cost-efficient program.

The components of the program must include tax preparer registration, demonstrated competency, continuing education, and background screening. At the end of the day, requiring return pre-

parers to meet minimum standards and stay current with the tax code is not about granting the IRS additional authority that it should not have or to advance anti-competitive pursuits. It is about protecting the 60 percent of consumers who get help with their taxes every year. This is why we require our H&R Block tax preparers to meet stringent education and competency standards: 75 hours of tax law and return preparation education, plus 35 hours of skills training in their first year, then annually, another 15 hours of continuing education and 20 hours of skills training.

The second key item that must be addressed is implementing consistent fraud prevention measures across all tax preparation methods. The steps designed to prevent EITC fraud in the paid preparer channel are notably absent in the do-it-yourself channel. Specifically, for the 40 percent of taxpayers who do their own taxes using do-it-yourself software, such as H&R Block's, they are not required to provide the same information and documentation to substantiate their eligibility for this refundable credit.

Congress must close such obvious gaps not only for EITC, but for all refundable credits. With an EITC improper payment rate persisting at 20 percent or higher, this is an obvious opportunity that can and should be seized immediately.

Consumers are not concerned about answering more questions. In the same survey I mentioned before, a significant majority of taxpayers expressed a willingness to do more to help combat tax fraud, such as answering more questions on their returns or even waiting a little longer for their refund.

Government, the tax preparers, software developers, and taxpayers each play a significant role in the tax filing process. Taxpayers are willing to do their part as long as it is administered consistently for all. Additionally, this difference in standards creates a loophole for ghost preparers who do not want to comply with the paid preparer requirements. They simply use a do-it-yourself product. IRS should set standards for tax software to ferret out ghost preparers.

Before I close, let me take a moment, Mr. Chairman, to acknowledge your interest in streamlining the tax code and the tax filing process. We would be pleased to share our consumer tax expertise on these issues with you and your staff.

The Tax Institute at H&R Block, comprised of enrolled agents, tax attorneys, CPAs, and former IRS officials, analyzes proposed legislation and regulations with an eye on how they will affect consumers. And in doing this analysis, the Tax Institute has access to the real world expertise of our 70,000 tax professionals who are on the front line with consumers.

In conclusion, we urge Congress to listen to consumers and move to enact minimum standards for return preparers and implement consistent anti-fraud measures for taxpayers. These standards are essential for protecting consumers, combating fraud, and reducing improper payments.

Until Congress can enact minimum standards for return preparers, we recommend that Treasury and IRS implement a voluntary certification program as supported by IRS Commissioner Koskinen and the National Taxpayer Advocate.

Thank you for the time, and I look forward to working together to implement these common-sense measures.

The CHAIRMAN. Mr. Cobb, thank you.

[The prepared statement of Mr. Cobb appears in the appendix.]

The CHAIRMAN. Ms. Salisbury, welcome. You made a long trek at a busy time of the year, and I know you have some late nights ahead of you, so we really appreciate your coming.

**STATEMENT OF JANIS SALISBURY, CHAIR, OREGON BOARD
OF TAX PRACTITIONERS, OREGON CITY, OR**

Ms. SALISBURY. Thank you. Chairman Wyden, Ranking Member Hatch, and distinguished members of the committee, my name is Janis Salisbury. I am an IRS enrolled agent and a licensed tax consultant in Oregon. For the past 6 years, I have served the State of Oregon as a member of the Board of Tax Practitioners and have served on that board for the last 2 years as chair.

I am pleased to be here to discuss with the committee the actions that Oregon has taken to protect taxpayers from incompetent and unethical tax return preparers, and to recommend that Congress provide the IRS with the authority to require individuals to demonstrate minimum competency in tax return preparation, either by passing a State board examination or for the individual to pass an IRS examination, and then to impose continuing education requirements after passage of such examination.

The primary reason Oregon felt it necessary to develop its own paid preparer regulatory program 40 years ago is the same today as it was then. Initial training and registration is essential before anyone can even begin preparing your tax returns. Oregon's track record proves this.

In 1972, Oregon determined that people engaging in tax return preparation should be licensed and be required to obtain continuing education relating to the tax return preparer occupation. The Board of Tax Practitioners currently regulates tax return preparers in Oregon. Oregon requires paid preparers who are not already licensed by the State as CPAs or attorneys to obtain a State license to prepare tax returns.

To become a licensed tax preparer, a person must have a high school diploma or the equivalent, complete 80 hours of approved qualified education, pass a State-administered examination, and then pay a registration fee at application. Annual renewal by licensees requires proof of at least 30 hours of continuing education.

According to a report to this committee prepared by the GAO in August of 2008, Federal tax returns for the year 2001 filed in Oregon were more likely to be accurate than returns filed anywhere in the rest of the country. Specifically, the GAO found that the odds that a return prepared by an Oregon paid preparer was accurate were about 72 percent higher than the odds for a comparable return filed by paid preparers in the rest of the country.

Oregon has been a leader in requiring the licensing of tax return preparers for over 40 years, and the results noted by the GAO show the excellent results of Oregon's regulations. Accordingly, the Oregon State Board of Tax Practitioners urges the Congress to enact legislation similar to Oregon's legislation, which would re-

quire individuals to demonstrate competency in the preparation of tax returns and satisfy continuing education requirements.

We suggest that such competency be demonstrated by passing a written examination approved by a State board of accountancy or a board of law examiners or a State entity, such as the Oregon Board of Tax Practitioners, or by the IRS. The passage of an examination recognized by a State, such as Oregon, to show competency in tax return preparation must be considered to demonstrate tax competency for Federal tax return preparers, in order to recognize efforts that have been undertaken at the State level and to avoid duplicate and unnecessary testing.

We commend the Senate Finance Committee for holding this hearing and considering this important legislation. Thank you for the opportunity to be with you, and please let me know if you have any questions. I am very willing to answer.

The CHAIRMAN. Thank you. That is very helpful, and we will have some questions in a moment.

[The prepared statement of Ms. Salisbury appears in the appendix.]

The CHAIRMAN. Professor Barrick?

**STATEMENT OF JOHN BARRICK, Ph.D., ASSOCIATE
PROFESSOR, BRIGHAM YOUNG UNIVERSITY, PROVO, UT**

Dr. BARRICK. Chairman Wyden, Ranking Member Hatch, and members of the committee, thank you for inviting me to participate in this hearing. Protecting taxpayers from incompetent and unethical tax return preparers is an important topic.

To illustrate the problem, I would like to share a former colleague and classmate's recent experience with a taxpayer who previously received return preparation services from a ghost preparer.

A new client comes to visit a CPA and indicates that he has a tax problem. The client never attended college, is a single father, has two young children, ages 4 and 6, and is facing uncertain economic times. During the previous year, he engaged a tax return preparer who claimed that he could get him an \$8,000 refund at the cost of \$800 or 10 percent of the refund due.

The return preparer did not sign the return nor did he provide reliable preparer contact information. As promised, the client did receive an \$8,000 refund and began spending it. However, a short time later, the client received an IRS notice denying the three American opportunity credits that were claimed, one for himself and each of his two young children. The money had to be returned.

Who was to blame? Both the client and the tax preparer knowingly submitted or had opportunity to know that the return claimed false information.

The client is now worse off than before. He owes the full amount of the refund, plus he is out the \$800 return preparation fee. The preparer is a ghost, not to be found, \$800 richer than before.

All of us at this hearing would like to prevent this type of behavior from happening again. But how can we best do that?

First, our tax system is both necessary to raise revenue and complex, as has been noted today. With 6.1 billion hours spent complying with the law and the code having over 4 million words and

containing 4,600 changes since 2001, this complexity has led to the need for tax return preparers.

There are three main problems associated with regulations: the inability to regulate the most unscrupulous and unethical, the inability to impose ethics on return preparers, and the creation of winners and losers within the industry. I firmly believe that the current regulatory framework is insufficient to address these limitations, and I will make several recommendations that the Congress and the IRS could follow to better protect these taxpayers.

First, voluntary disclosure. We live in a free society. Let the markets decide. Create incentives for the return preparers to voluntarily register. Attorneys, CPAs, and enrolled agents already do this. If the IRS chooses to endorse or certify a new class of return preparers with only 15 hours of education, the IRS will provide a seal of approval and a false sense of security to taxpayers. I do not recommend this latter approach.

Second, eliminate or limit refundable credits. The growth of refundable credits in the income tax system encourages unethical behavior by taxpayers, ghost preparers, and others wishing to defraud the Federal Government. The Earned Income Tax Credit, Child Tax Credit, and education credits are refundable. The new credits provided by the Affordable Care Act will double the amount of refundable credits available by the income tax system. Prior research has shown that financial incentives do matter, that current law encourages and creates incentives for fraud. To the unscrupulous and unethical, this is easy money.

Third, enforce existing return preparer laws. In 2005, the IRS Criminal Investigation Division stated that the IRS currently has numerous tools available to address return preparer fraud. If the IRS already has ample statutorily authorized tools, why do they need regulations to address this issue? Encourage the IRS to use the existing tools.

Fourth, educate taxpayers. Taxpayers are ultimately responsible for their returns. They have an obligation to put forth a good effort. If something promised to you by anyone sounds too good to be true, it probably is. Buyers beware. Taxpayer education can be an effective tool that the IRS has historically used successfully.

In conclusion, the tax law is large and complex. For these reasons, the majority of taxpayers seek out return preparers to help them. But there are ghosts that attempt to defraud the income tax system.

Rather than regulate, please take the previous steps that I have mentioned. The most important protection for taxpayers would be a simpler income tax system, as suggested by Chairman Wyden today. I would encourage the committee to continue to pursue meaningful reform.

Thank you for giving me the time and opportunity to speak.

The CHAIRMAN. Thank you, Dr. Barrick.

[The prepared statement of Dr. Barrick appears in the appendix.]

The CHAIRMAN. Ms. Wu?

**STATEMENT OF CHI CHI WU, STAFF ATTORNEY, NATIONAL
CONSUMER LAW CENTER, BOSTON, MA**

Ms. WU. Chairman Wyden, Ranking Member Hatch, and members of the committee, thank you for inviting me here today. My name is Chi Chi Wu. I am a staff attorney at the National Consumer Law Center.

Mr. Chairman, thank you for holding this hearing on the need to protect taxpayers from incompetent and unethical tax preparers. This is a consumer protection issue, as well as a revenue protection issue. Simply put, there needs to be licensing and competency standards for paid tax preparers. Either Congress needs to give IRS the authority, or the States need to enact such laws. Indeed, mindful of the difficulty in getting Federal legislation passed, we at NCLC have issued a model act to encourage States to adopt such laws.

I have worked at the intersection of taxpayer and consumer rights for over a decade. When I began this work, I assumed, as do many Americans, that tax preparers were licensed professionals with certain educational credentials. After all, the tax return is the most important financial transaction during the year for many Americans, and it would only make sense that the preparers in whom consumers place their trust and their sensitive financial information would be required to take some courses and pass a test.

To my surprise, the exact opposite was true. Preparers are essentially unregulated in 46 States. Contrast this with other professions that do require licensing in all or most States, such as hairdressers or landscape architects.

The lack of regulation for tax preparers has resulted in an environment that breeds incompetence and fraud. One indication is the existence of fringe preparers, tax preparation offered by businesses such as payday lenders, pawn shops, check cashers, used car dealers, jewelry shops, even liquor stores and a “rent-a-wheel” business.

This, of course, raises questions. How accurate are tax returns prepared by used car dealers? One can imagine that the incentive for accuracy might take a back seat to the desire to sell a car by using a tax refund as a down payment.

Unfortunately, the problems go beyond that. In 2008, we conducted mystery shopper testing, the original purpose of which was to investigate disclosures concerning refund anticipation loans. To our surprise, what we found were serious tax errors and fraud in four out of the 17 tests we conducted, or nearly 25 percent. One example involved a preparer who did not know how to handle a Form 1099-D. To quote, “The preparer said that there was a problem she did not know how to handle. The problem was that there was a \$5,000”—that is a fictional number—“dividend that we must pay taxes on. With the dividend, our return would only return \$100. If she were to ignore it, then we would receive \$3,000 in returns. She then called her ‘tax people,’ who told her we do not need to report the dividend and just ignore it.”

In 2010, we conducted another round of testing and found incompetence and fraud in six out of 19 tests, or about 30 percent. One example involved a preparer who, when realizing the tester would only receive a \$1,000 refund and would owe State taxes, began making up deductions.

To quote, “The tester does not attend church, but the preparer included a \$2,000 church donation. The preparer also deducted the cost of work clothes and laundry, even showed the tester that her Federal refund would increase to \$3,000 from about \$1,000. The preparer also tried to convince the tester to make up a dependent, as she does not have any, showing her that her refund would go to \$5,000 if she did. The preparer also tried to qualify her for the EITC, even though she is not eligible. Finally, the tax preparer deducted \$400 in 2008 tax preparation costs, even after the tester told the preparer she did not pay for tax preparation last year.”

Unfortunately, these test results are not isolated and unique. Similar testing, including the testing announced by the GAO today, has found equal or greater levels of fraud or incompetence. Looking at the totality, we can see these problems are not limited to a handful of bad apples. Thus, bringing enforcement actions on a one-by-one basis is simply inadequate.

For example, a recent lawsuit by the Department of Justice against Instant Tax Service might be considered a success because it shut down that chain, but it probably cost the government tens or even hundreds of thousands of dollars in staff time by IRS personnel and DOJ lawyers.

There are simply not enough resources to go after all the bad actors. Furthermore, we disagree with the notion that preparer regulation could harm taxpayers because preparers will raise their fee to cover the cost of education and testing.

First, the interest of consumers in obtaining competent, accurate, and ethical tax preparation far outweighs any increased marginal cost. After all, an erroneous return could put the taxpayer at risk of an IRS audit or even criminal sanctions.

Second, we believe that preparer regulation will not actually even create significantly greater costs. Preparer compliance costs are minimal. For example, prior to the *Loving* decision, the IRS had planned to charge less than \$120 for the exam. These costs are dwarfed by the hundreds of dollars in fees that some paid preparers charge for a single return, as we heard from the GAO today, and as our testing revealed—\$400 to \$500 in some cases.

And the DOJ’s lawsuit against Instant Tax Service revealed that that chain typically charged about \$550 for as little as 15 minutes worth of work. Preparer regulation has more potential to lower costs than increase them by improving transparency and reducing abuses.

Thank you for the opportunity to testify, and I look forward to your questions.

The CHAIRMAN. Thank you very much, Ms. Wu.

[The prepared statement of Ms. Wu appears in the appendix.]

The CHAIRMAN. Mr. Alban, welcome.

**STATEMENT OF DAN ALBAN, ATTORNEY,
INSTITUTE FOR JUSTICE, ARLINGTON, VA**

Mr. ALBAN. Thank you, Chairman Wyden and Ranking Member Hatch, and other members of the committee.

Congress should not give the IRS additional power over tax preparers by forcing them to get an IRS license before they can assist taxpayers with their tax returns. Tax preparers are already regu-

lated by numerous Federal statutory requirements imposing both civil and criminal penalties for everything from failing to keep a list of the returns they prepared for the past 3 years to actual tax fraud. Tax preparers are also required to register with the IRS to obtain an individualized number, known as a PTIN, that they must include on every return they prepare, so that the IRS can track and analyze their returns. These tools already provide the IRS with what it needs to identify, track, and penalize the few bad apples without unnecessarily burdening the vast majority of law-abiding preparers.

I have three main critiques of preparer licensing as bad public policy, followed by a few recommended solutions that are superior to licensing.

First, preparer licensing is protectionist and anticompetitive. Rather than protecting consumers, licensing regulations can protect large incumbents and industry insiders from competition, by erecting costly barriers to entry. Indeed, several financial analysts have concluded that the largest firms, such as H&R Block, stand to benefit the most from licensing preparers.

Unsurprisingly, the IRS licensing regulations were a product of lobbying by powerful special interests. H&R Block, Jackson Hewitt, and Intuit, the makers of TurboTax, all actively supported licensing, while other industry insiders, such as the American Institute of CPAs, obtained special exemptions for their members. Former H&R Block CEO Mark Ernst even oversaw the drafting of the regulations at IRS.

Of course, mom-and-pop preparers generally do not have the resources to send lobbyists to Washington, DC to represent their interests. At the same time, licensing burdens usually fall hardest on the little guys who do not have the same financial resources and cannot benefit from economies of scale. Licensing was expected to push out tens of thousands of independent preparers, possibly as much as 10 percent to 20 percent of all preparers. Most of those who would have been put out of business were seasonal mom-and-pop preparers, like my client, 81-year-old Elmer Kilian, of Eagle, WI, who hangs a shingle outside his house every tax season and has been preparing tax returns for over 30 years on his dining room table.

Second, consumers would be harmed by preparer licensing, which raises prices and reduces choices. Licensing reduces competition, which is bad for consumers. Between reduced competition and increased regulatory compliance costs, licensing is expected to artificially drive up the prices consumers pay for tax preparation.

Licensing also reduces consumer choices and interferes with consumer autonomy over personal finances. Many taxpayers will not only be left with fewer options, but will be forced to pick a new preparer if licensing drives their current preparer out of business. Instead, taxpayers, not the IRS, should be the ones who get to decide who prepares their taxes.

Licensing may also result in other unintended consequences that harm consumers. Higher prices and fewer choices may push unqualified taxpayers to prepare their own returns. It will also likely boost the number of unregistered ghost preparers who do not sign

the returns they prepare and are, thus, very difficult for the IRS to monitor.

Third, preparer licensing offers a false promise and fails to deliver. As an initial matter, licensing regulations cannot do much about fraud prevention that is not already achieved by the PTIN registration combined with existing criminal penalties. Dishonest preparers can take exams and sit through continuing education courses just as well as honest preparers.

Moreover, licensing and IRS-mandated training are largely ineffective. For example, IRS-trained and certified preparers in the VITA volunteer program were found by TIGTA to have a 61-percent error rate in 2011. Similarly high error rates have been found over the years in TIGTA studies of IRS employees answering just a single tax question.

Likewise, an IRS study found that licensed California preparers had the third-highest error rates in the country for 2 years in a row, despite the State's long-standing licensing program. That is because the real problem is not competency, but tax code complexity.

As the National Taxpayer Advocate explained last May, tax code complexity almost guarantees that every return has an error in it, some inadvertent, some intentional. Thus, licensing will not prevent tax preparers from making errors. It will simply limit who is licensed to make those errors.

Licensing should be rejected because better solutions for these problems already exist. First, voluntary certification is far superior to mandatory licensing. It allows both consumers and preparers to decide if they value certification and permits them to opt in or opt out.

Second, the best way to reduce errors is to reduce complexity. Simplify the tax code to reduce error rates.

And, third, the IRS already has the legal and technical tools it needs to identify, track, and penalizes the few bad apples. Enforcement of these existing laws is far preferable because, unlike licensing, it does not impose substantial costs on the vast majority of law-abiding tax preparers.

Thank you.

The CHAIRMAN. Thank you, Mr. Alban. And all of you have been very helpful.

[The prepared statement of Mr. Alban appears in the appendix.]

The CHAIRMAN. I want to see what I can do to draw out some key questions.

Mr. Alban, as I understand it, is particularly concerned about the small practitioner, and I certainly understand why small businesses can be frustrated with needless government red tape and bureaucracy. My understanding, however, here, Ms. Salisbury, is that you are a small practitioner. Are there not two practitioners at your firm?

Ms. SALISBURY. Yes. There are a total of four. Two are CPAs and two are licensed tax consultants.

The CHAIRMAN. So I think that would certainly qualify you as a small practitioner.

Do you all feel, apropos of Mr. Alban's point, that somehow this disadvantages you against Mr. Cobb? Because it looks to me like

both of you passed a competency test. That does not look to me like a disadvantage to a small practitioner.

Ms. SALISBURY. Well, the numbers prove it is not in Oregon and in California. In Oregon, with our licensing, and as recently as 2011—these are the most recent facts I have—nearly 84 percent of the practitioners in Oregon are not employed by H&R Block, Jackson Hewitt, or Liberty Tax Service, the three big companies in Oregon. And in California, it is nearly 89 percent.

So it disproves that small practitioners will be affected, and both of those States have some form of registration for practitioners.

Mr. COBB. Mr. Chairman, if I may add, quickly, forty percent of our system is small business people. We have 1,670 franchisees, many of whom are like Ms. Salisbury, have one or two offices, and really they are small businesses.

The CHAIRMAN. So now that we have at least addressed, to some extent, this question of whether small practitioners are disadvantaged by having some minimum standards, I want to ask you, Ms. Salisbury—we have had our system for decades, and we Oregonians are pretty outspoken souls.

I can tell you, I have been on the Finance Committee now since 2005, and I have not had anybody who is a practitioner come and say, “Oh, my goodness, Ron, it is going to be bureaucratic water torture if we have the kind of thing that you have in Oregon.” We pass a competency test. We undertake 30 hours per year of continuing education, audit preparation, and sanctions for those who are not competent.

We have done this for decades. Nobody is marching in the streets, nobody is picketing. There is no sign of unhappiness. Is that a fair appraisal of what we have had? And then, of course, the results have been documented by the Government Accountability Office, which you have referred to as well. We have superior results with this kind of system, and I think Oregonians would agree that appropriate oversight is missing today, which is the minimum competency standard.

Is that a fair assessment?

Ms. SALISBURY. Very much so, very fair.

The CHAIRMAN. What lessons can the IRS learn from Oregon’s experience over these decades? I heard discussion from Mr. Alban about the cost. I have not heard complaints about Oregon’s cost or things of this nature. Are there other lessons here from the standpoint of Oregon’s experience for the IRS?

Ms. SALISBURY. Well, the costs in Oregon are very affordable. Probably the most expensive cost is education, but because we require education, we have a lot of resources in the State that provide cost-effective education.

Rather than spending \$200 or \$300 or \$400 for a day of education, you can get education through other resources, not as expensive. So education is not an issue. The registration fees are very affordable for even a small business. I had a larger business in years past and paid those fees for my employees and still managed to keep my head above water with the business. So it is not a concern.

We have wondered why it has taken the Nation so long to be—

The CHAIRMAN. We are always too logical for the rest of the country.

One other question, if I might, for you, Mr. McTigue. One of the things that concerns me about some of these questions with respect to having minimum competence and the like is, those who are opposed say we already have these tough standards, and it seems to me what you all have found is that that is not the case.

What we basically have is reactive, after the fact, when the harm is done to people who just want to get every single dollar back that they are owed. Is that a fair characterization?

Mr. MCTIGUE. Yes, Mr. Chairman, that is a fair characterization. As you stated, the majority of tools and actions that the IRS can take are after the fact, after the refunds have gone out, after the paid preparer has disappeared in some cases, and it is the taxpayer who is left explaining, dealing with the back taxes, having to pay back interest and penalties, whereas up-front regulation has the potential to prevent some of these return errors.

The CHAIRMAN. My time has expired. I just appreciate the fact that you have done this second independent inquiry. People can question the value of one independent inquiry. I would not, because I have watched the professionalism of your office over the years, but you have now found it twice.

I also know, because you are quite scrupulous in documenting the facts, you said, "Look, we have looked at 19 sites," but as you know, there have been other analyses which are pretty much in line with yours.

So we have a lot of heavy lifting to do to fix this, and we are going to be working with all of you.

Senator HATCH?

Senator HATCH. Thank you, Mr. Chairman.

I want to thank all of you for being here. Each of you has presented us with the various perspectives that I think will benefit the committee and hopefully the IRS as well.

Dr. Barrick, let me just ask you a question. Credentialed preparers, such as attorneys, CPAs, and enrolled agents, have long been regulated and subject to professional standards of competence and ethical conduct. Is there clear evidence that returns prepared by these credentialed preparers are less prone to error than those returns that are prepared by now-unregulated preparers or even ghost preparers?

Dr. BARRICK. I am unaware of specific evidence that shows that credentialed preparers in those specifically mentioned groups are fundamentally different. However, I do not have full access to the data that the GAO or TIGTA or others have used.

As an academic, though, I am always willing to help them design more statistically reliable and more educated studies examining these important questions.

Senator HATCH. Thank you.

Mr. McTigue, let me ask you this. Software developments and increasing computer literacy have made it easier for many people to prepare and, of course, file their own tax returns. In fact, the percentage of self-prepared returns has been increasing in recent years.

Is this trend one that is improving or degrading the overall quality of tax compliance?

Mr. MCTIGUE. Senator Hatch, that is an issue that we did not look at in this study. But when we did look at data from IRS's national research program database on error rates for preparer-filed returns versus self-prepared returns, and we did see a significant difference. Returns prepared by paid preparers had an error rate of 60 percent versus 50 percent for self-prepared returns.

Senator HATCH. Let me throw this one out. When a tax filer stops using the services of a paid preparer and instead uses software to self-prepare their own return, do we know or have any statistics or any evidence—do we know what happens to the quality of their tax filings?

Mr. MCTIGUE. The data that IRS collects through random audits—the most recent national research program audit covered tax years 2006 through 2009—estimates error rates for both paid preparers and self-prepared returns, both in the aggregate and, also, for specific tax issues or line items. For example, for the Earned Income Tax Credit, the estimates showed that returns prepared by paid preparers had an error rate of 51 percent versus 44 percent for self-prepared returns.

Senator HATCH. Now, some have expressed concern that regulation will drive unethical preparers underground, turning them into what have been referred to here as ghost preparers who are very difficult to discover and shut down. How big is this problem of ghost preparers, and is the problem getting worse? What is being done to address that particular problem?

Mr. MCTIGUE. I am not aware of any data that exists, either IRS data or otherwise, that goes to the scope of that problem. Again, GAO feels that some basic level of regulation can help provide consumers with assurance that the people whom they are using to prepare their tax returns meet certain qualifications, and they have a certain level of assurance that their tax returns will be as compliant as they expect.

Senator HATCH. Well, I want to thank all of you. H&R Block certainly does a great job, as do others.

I would like, Mr. Chairman, to put this Intuit letter into the record.

The CHAIRMAN. Without objection, so ordered.

[The letter appears in the appendix on p. 129.]

Senator HATCH. Thank you. Thank you all for being here.

The CHAIRMAN. Senator Casey?

Senator CASEY. Thank you, Mr. Chairman. I only have time for one question, and I know the panel will not necessarily be upset about that.

But, Mr. Cobb, I wanted to ask you a question that relates to your testimony. On page 12, you summarize what the so-called VITA folks have to go through, the Voluntary Income Tax Assistance folks, in their minimum standards.

We all would agree, I think, that that is especially important. Those kinds of standards are especially important to vulnerable populations, folks who are easily misled or often isolated and who have to depend upon someone whom they come into contact with who might mislead them.

I would assume that when we talk about kind of basic minimum standards here, that you would hope that everyone would have an opportunity to be served by an individual who goes through the minimum standards that would be comparable to your Appendix D, which were the requirements that these so-called volunteer tax preparers go through. Is that generally accurate?

Mr. COBB. Yes. That is generally accurate, Senator. For our people, we have continuing education every year. For people who start out wanting to be a tax preparer for us, it is over 100 hours of training, and 75 hours of it is income tax training, including ethical training. We also do skills training.

For continuing education, we average around 35 hours—15 hours of income tax training plus 20 hours of skills training. For anyone, even if you have been a tax preparer for 30 years, you have to come in and get that. And we can adjust the hours, depending upon what the statute is. But, generally, we agree with your point.

Senator CASEY. And what is set forth in this appendix, these requirements that you just outlined, you would think that those would be the best direction that the Federal Government should move in? In other words, how do you effectuate this as a matter of national policy for all taxpayers to benefit from?

Mr. COBB. And again, I think Ms. Salisbury—I think we have a great model. The chairman has certainly pointed out with pride what Oregon does. I think that is a model to be built off of.

I think the research we have done shows that this is—you have heard all day about fraud and various cases that people have cited. I think that we have a standard which has been implemented for a number of years in Oregon. We have the test in the market, if you will. We do a lot of training.

So I think the outline is there to put the national policy in place. Plus, you have clients, consumers, who in our research are saying, “Of course, I want to know that the person sitting across from me has certain standards.”

Usually, people in my position are not in front of a committee like this asking for more regulation. I do not imagine you would find that very often. What we want is a level playing field. What we want to do is protect consumers; this is not about anticompetitive behavior. This is about going up against people who are just looking out for themselves. You have heard the horror stories about tax preparers in a furniture store or somewhere else saying, “How big is your refund,” to make loans to people based on that amount.

We do not do refund anticipation loans. We just want to clean up this industry.

Senator CASEY. Thank you very much.

The CHAIRMAN. Thank you, Senator Casey.

I want to thank all of our witnesses for their participation.

Members of the committee are going to have until the close of business on Friday, April 11 to submit questions for the record.

I just want to make a short statement and then give the last word to Senator Hatch on this topic.

Last week, in this room, on a bipartisan basis, our committee committed to dealing with what are called the tax extenders. There are a number of provisions that expired, that will expire this year and next year, and we indicated this was going to be the last time

this committee did this. We called the proposal the EXPIRE Act because it was meant to expire. That is it, turn the lights out on it.

So really, with this hearing, we begin the effort at overhauling the tax system and particularly making it simpler, doing it in a bipartisan way, so that Americans this time of year do not feel like they are going through bureaucratic water torture to comply with the tax rules.

You have given us some very helpful suggestions here. Senator Hatch and I will be working together on this in a bipartisan way. The challenge is to figure out, with our colleagues on both sides of the aisle, the appropriate oversight of preparers.

The two of us are going to talk about it, and then we will inform members of our proposal. But, clearly, what we have learned today, starting with the GAO, is this problem persists. You have documented it a second time. It is consistent not just with your analyses, but with others.

Nina Olson, the independent Taxpayer Advocate, said not only does the problem exist now, but there are incentives for additional opportunities for the unscrupulous—who are, fortunately, a minority—to fleece our people, and very often those are the most vulnerable, those are the low-income. So that ought to concern us.

Then, Ms. Salisbury, we are really glad that you came, because you have shown once again that Oregonians know that there is a better way. We do not just sit around and say, “Oh, this is wrong, and that is wrong.” We roll up our sleeves, and we come up with solutions.

So you all have been very helpful to us, and I just want you to know I am going to work very closely with Senator Hatch on comprehensive tax reform, and on appropriate oversight with respect to tax preparers.

I want to give my friend and colleague the last word here.

Senator HATCH. Thank you, Mr. Chairman.

I am grateful to all of you for being here, and all I can say is that, the more I look into this, the more I worry about the problems that are involved.

On the other hand, there are a lot of good people in this industry who are trying to do what is right and who do do what is right. So we have to look at this very carefully. I do not want another great big bureaucratic institution to make it even more expensive to file tax returns. I have certain feelings for your libertarian approach toward tax preparers as well.

So I am grateful that you all took time to come and see us here, helping us to understand this better, and hopefully you will continue to weigh in and give us your ideas on how we might do a better job here.

Thanks so much.

The CHAIRMAN. The committee is adjourned.

[Whereupon, at 12:34 p.m., the hearing was concluded.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Testimony of Dan Alban
Attorney at the Institute for Justice
Arlington, Virginia

Before the United States Senate
Committee on Finance

Thank you, Mr. Chairman and members of this Committee.

Congress should not give the IRS additional power over tax preparers by forcing them to get an IRS license before they can assist taxpayers with their tax returns.

Tax preparers are already regulated by numerous federal statutory requirements imposing both civil and criminal penalties for everything from failing to keep a list of the returns they've prepared for the past three years to actual tax fraud.¹ Tax preparers are also required to register with the IRS to obtain an individualized number known as a PTIN that they must include on every return they prepare so that the IRS can track and analyze their returns.² These tools already provide the IRS with what it needs to identify, track, and penalize the few bad apples without unnecessarily burdening the vast majority of law-abiding preparers.³

I have three main critiques of preparer licensing as bad public policy, followed by a few recommended solutions that are superior to licensing.

First, preparer licensing is protectionist and anti-competitive.

In the 1950s, only one in 20 U.S. workers needed the government's permission to pursue their chosen occupation; today that figure stands at almost one in three.⁴ But rather than protecting consumers, licensing regulations can protect large incumbents and industry insiders from competition by erecting costly barriers to entry.⁵ Indeed, several financial analysts have concluded that the largest firms, such as H&R Block, stand to benefit the most from licensing tax-return preparers.⁶

Unsurprisingly, the now-invalidated IRS licensing regulations were a product of lobbying by powerful special interests.⁷ As *The Wall Street Journal* noted: "Cheering the new regulations are big tax preparers like H&R Block, who are only too happy to see the feds swoop in to put their mom-and-pop seasonal competitors out of business."⁸ H&R Block, Jackson-Hewitt, Intuit (the makers of TurboTax), and the National Association of Enrolled Agents all actively supported licensing,⁹ while other industry insiders, such as the American Institute of CPAs, obtained special exemptions for their members.¹⁰ Former H&R Block CEO Mark Ernst even oversaw the drafting of the regulations while he was deputy commissioner at the IRS.¹¹ Of course, mom-and-pop preparers generally don't have the resources to send lobbyists to Washington, DC to represent their interests.

At the same time, licensing burdens usually fall hardest on the little guys, who don't have the same financial resources and can't benefit from economies of scale. *The Economist* explained that the IRS licensing regulations "threaten to crush . . . small, local" tax preparers and are "likely to push mom and pop into another line of work."¹² Indeed, the IRS's own estimates indicate that compliance with their licensing regulations would have cost about 6-7 million man hours annually, plus hundreds of millions of dollars in out-of-pocket expenses.¹³ That was expected to push out tens of thousands of independent preparers, possibly 10-20% of all preparers.¹⁴ Most of those who would have been put out of business were seasonal mom-and-pop preparers like my client, 81-year-old Elmer Kilian, of Eagle, Wisconsin, who hangs a shingle outside his house every tax season and has been preparing tax returns for his neighbors for over thirty years on his dining room table.¹⁵

In fact, IRS data released last summer shows a dramatic drop in the number of tax preparers in recent years—a sudden loss of more than 200,000 preparers from 2010 to 2012—following the recent imposition of a series of burdensome IRS regulations on preparers (the e-file mandate and the Return Preparer Initiative, which included both the PTIN registration requirement and RTRP licensing).¹⁶

These recent IRS figures indicate that small preparers are being driven out of the market at a much higher rate than other preparers:

- Preparers who prepared between one and twenty returns decreased from 66% of all preparers in 2004, to 58% of all preparers in 2010, to just 46% of all preparers in 2012.¹⁷
- Meanwhile, preparers who prepared over 100 returns increased from 17% of all preparers in 2004, to 22% of all preparers in 2010, to 30% of all preparers in 2012.¹⁸
- There has been a sharp uptick in the average number of returns prepared per preparer, even though the total number of returns prepared has remained relatively constant.¹⁹

This data indicates substantial industry consolidation as small preparers are squeezed out of the market by the cost of compliance with burdensome regulations. Licensing will only further exacerbate this problem.

Second, consumers would be harmed by preparer licensing, which raises prices and reduces choices.

Licensing reduces competition in the tax preparation market, which is bad for consumers. Between reduced competition and increased regulatory compliance costs, licensing is expected to artificially drive up the prices consumers pay for tax preparation.²⁰

Licensing also reduces consumer choices and interferes with consumer autonomy over personal finances. Many taxpayers will not only be left with fewer options, but will be deprived of their first preference and forced to pick a new preparer if licensing forces their current preparer out of business. Instead, taxpayers—not the IRS—should be the ones who get to decide who prepares their taxes.

Licensing may also result in other unintended consequences that harm consumers. Higher prices and fewer choices may push unqualified taxpayers to prepare their own returns, potentially *increasing* error rates.²¹ It will also likely boost the number of unregistered, black-market “ghost” preparers who do not sign the returns they prepare and are thus very difficult for the IRS to monitor, much less regulate.²²

Third, preparer licensing offers a false promise and fails to deliver.

As an initial matter, licensing regulations cannot do much about fraud prevention that isn’t already achieved by the PTIN registration combined with existing criminal penalties. Dishonest preparers can take exams and sit through continuing education courses just as well as honest preparers.

Moreover, licensing and IRS-mandated training are largely ineffective. For example, IRS trained-and-certified preparers in the VITA volunteer program were found by the Treasury Inspector General for Tax Administration (TIGTA) to have a 61% error rate in 2011.²³ Similarly high error rates have been found over the years in TIGTA studies of IRS employees answering just a single tax question.²⁴ Likewise, in California, one of just four states that licenses tax preparers, an IRS study found that California preparers had the third highest error rates in the country for two years in a row despite the state’s longstanding licensing program.²⁵

That's because the real problem is not competency, but tax code complexity.²⁶ The sheer complexity of the federal tax code makes it notoriously difficult to prepare tax returns without any errors. As of 2013, the size of the federal tax code has grown to nearly 74,000 printed pages.²⁷ There are a large number of variables that must be considered in preparing even a "simple" 1040EZ tax return.²⁸ Even highly competent individuals make errors in interpreting the tax code, or hire a preparer to avoid making the mistakes themselves. Secretary of Treasury Tim Geithner famously made numerous errors in preparing his own tax returns.²⁹ Former IRS Commissioner Douglas Shulman admitted that he does not prepare his own taxes, stating: "I find the tax code complex so I use a preparer."³⁰ Federal courts also rule with some frequency that the IRS itself has incorrectly interpreted tax law.³¹

In other words, as the National Taxpayer Advocate conceded in an article last May, the complexity of our current tax system "almost guarantee[s] that every return has an error in it—some inadvertent, some intentional."³² Thus, licensing will not prevent tax preparers from making errors; it will simply limit who is licensed to make those errors.

It is therefore inappropriate to justify the licensing of paid preparers by simply citing error rates on tax returns prepared by paid preparers without any frame of reference. The IRS has previously relied on two "shopping visit" studies done by the Government Accountability Office (GAO) and TIGTA which purport to show a high error rate on returns by paid tax preparers.³³ But both studies contain disclaimers that the small and non-representative sample of preparers studied—just 19 and 28 preparers, respectively—prevents drawing any generalized conclusions.³⁴ These limited studies also failed to include a control sample of tax returns prepared by attorneys, CPAs, or enrolled agents (who were exempted from the IRS licensing regulations).³⁵ In addition, the GAO study only visited the offices of major tax preparation chains, not independent preparers.³⁶

The "handful of mystery shopper tests" cited by the National Consumer Law Center (NCLC) suffer from many of the same flaws – they are all very small (involving fewer than 20 preparers, and sometimes 10 or fewer), non-representative, and non-randomized.³⁷ They were also conducted by acknowledged "advocacy groups," not neutral parties or social scientists, and the NCLC seems to have particular antipathy for what they call "fringe preparers," which they describe as including "businesses that are historically associated with the exploitation of consumers" and "business[es] that specialize[] in goods and services other than tax preparation."³⁸ This appears to be in some tension with the (very limited) findings of the GAO study about error rates at chain preparers.³⁹ Moreover, given the seasonal nature of tax preparation, it is understandable why someone who operates a tax preparation business might want to diversify their business; no sinister motives are necessary. Also, as with the GAO and TIGTA studies, there is no control group studied to provide context for the results.

Finally, licensing should be rejected because better solutions for these problems already exist:

1. Voluntary certification is far superior to mandatory licensing. It allows both consumers and preparers to decide if they value certification and permits them to opt in or opt out.
2. The best way to reduce errors is to reduce complexity – simplify the tax code to reduce error rates.
3. The IRS already has the legal and technical tools it needs to identify, track, and penalize the few bad apples. Enforcement of these existing laws is far preferable because, unlike licensing, it does not impose substantial costs on the vast majority of law-abiding tax preparers.

Thank you.

Dan Alban is a public interest attorney at the *Institute for Justice*, where he focuses on litigating cutting-edge constitutional cases that defend economic liberty, free speech, and private property rights. He is the lead attorney in *Loving v. IRS*, a successful federal challenge to the IRS's attempt to unilaterally impose a sweeping new licensing scheme on tax-return preparers without Congressional authorization.

¹ See, e.g., 26 U.S.C. §§ 6694, 6695, 6700, 6701, 6702, 6707A, 6713, 7201, 7206, 7207, 7213, 7216, 7407.

² See, e.g., Internal Revenue Service, *PTIN Requirements for Tax Return Preparers*, last updated March 10, 2014, at <http://www.irs.gov/Tax-Professionals/PTIN-Requirements-for-Tax-Return-Preparers>.

³ IRS enforcement statistics indicate that this is indeed a problem of just a few bad apples. Out of about 700,000 tax return preparers, the IRS initiated criminal investigations against just 309 preparers in Fiscal Year 2013, securing 207 convictions. See Internal Revenue Service, *Statistical Data - Abusive Return Preparers*, last updated Oct. 23, 2013, at <http://www.irs.gov/uac/Statistical-Data-Abusive-Return-Preparers>.

⁴ Morris M. Kleiner & Alan B. Krueger, *The Prevalence and Effects of Occupational Licensing*, British Journal of Industrial Relations, 48(4), 676–687 (2010), available at http://www.hhh.umn.edu/people/mkleiner/pdf/Prevalence_of_Occupational_Lisc.pdf (documenting dramatic growth of occupational licensing over the past 50 years and finding that, in 2010, “about 29 per cent of the [American] workforce is required to obtain a licence from either the federal, state or local government to work for pay.”)

⁵ See Dick M. Carpenter II et al., Institute for Justice, *License to Work* at 6 & notes 2-5, May 2012, available at <http://www.ij.org/licensetowork> (summarizing extensive social science research, which “provides little evidence that government licenses protect public health and safety or improve the quality of products or services” but instead “indicates that occupational licenses increase consumer costs and reduce opportunities for workers, particularly minorities, those with less education and older workers who may want to switch careers.”) (endnotes omitted).

⁶ See, e.g., Ryan J. Donmoyer, *H&R Block, Jackson Hewitt Must Register With U.S. IRS*, Bloomberg, Jan. 4, 2010, available at <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=amNva7FXtukM> (“UBS AG analysts Andrew Fones and Margaret O’Connor issued a report that said the IRS initiative will help H&R Block by preventing small preparers from entering the market and driving others out of it.”); Patrick Temple-West & Kim Dixon, *IRS Rescinds Rules, Puts Tax Preparers in Disarray*, Reuters, Jan. 22, 2013, available at <http://www.reuters.com/article/2013/01/22/us-usa-tax-preparer-idUSBRE90L15W20130122> (quoting an investment analyst as stating that the district court ruling in *Loving v. IRS*, which enjoined enforcement of the IRS licensing regulations, could “hurt institutional tax-preparation providers such as H&R Block and Jackson-Hewitt by reopening the market to small competitors that the IRS program had been expected to squeeze out.”)

⁷ See, e.g., Timothy P. Carney, *Little Guys Fight H&R Block’s Regulatory Robbery*, Washington Examiner, March 13, 2012, available at <http://washingtonexaminer.com/little-guys-fight-hr-blocks-regulatory-robbery/article/1175506> (“H&R Block isn’t just a passive beneficiary of this regulation—it was an active supporter. In July, once the IRS announced it was considering these rules, H&R Block hired the Podesta Group to lobby on the matter.”).

⁸ *H&R Blockheads: The IRS Wants to Save You From Your Rogue Tax Accountant*, Wall St. J., Jan. 7, 2010, available at <http://online.wsj.com/news/articles/SB10001424052748703436504574640572196836150> (Also noting that, “Kathryn Fulton, senior vice president for government relations, told the Washington Post the company was glad to support rules that meant H&R Block ‘won’t be competing against people who aren’t regulated and don’t have the same standards as we do.’”).

⁹ See *id.*; Timothy P. Carney, *H&R Block, TurboTax, and Obama’s IRS Lose in Effort to Regulate Small Tax Preparers Out of Business*, Washington Examiner, Feb. 11, 2013, available at <http://washingtonexaminer.com/tim-carney-hr-block-turbotax-and-obamas-irs-lose-in-effort-to-regulate-small-tax-preparers-out-of-business/article/2521169>; Timothy P. Carney, *Big Tax-Prep Companies Welcome IRS Regulation*, Washington Examiner, Jan. 8, 2010, available at <http://washingtonexaminer.com/timothy-p-carney-big-tax-prep-companies-welcome-irs-regulation/article/33049>; Ryan J. Donmoyer, *H&R Block, Jackson Hewitt Must Register With U.S. IRS*,

Bloomberg, Jan. 4, 2010, available at <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=amNva7FXtukM>.

¹⁰ *CPA-Supervised Nonsigning Preparers Exempted From Exam, Continuing Education*, Journal of Accountancy, March 2011, available at <http://www.journalofaccountancy.com/Issues/2011/Mar/NonsigningPreparers.htm> ("In Notice 2011-6, the IRS carved out an AICPA-advocated exception from the competency examination and continuing education requirements" for unlicensed preparers who are supervised by attorneys, CPAs, or enrolled agents at a "law firm, CPA firm, or other recognized firm."); see also Internal Revenue Service, Notice 2011-6, available at <http://www.irs.gov/pub/irs-drop/n-11-06.pdf>.

¹¹ See Timothy P. Carney, *H&R Block, TurboTax, and Obama's IRS Lose in Effort to Regulate Small Tax Preparers Out of Business*, Washington Examiner, Feb. 11, 2013, available at <http://washingtonexaminer.com/tim-carney-hr-block-turbotax-and-obamas-irs-lose-in-effort-to-regulate-small-tax-preparers-out-of-business/article/2521169>; Timothy P. Carney, *Revolving Door Spins at Obama's IRS*, Washington Examiner, Jan. 15, 2010, available at <http://washingtonexaminer.com/timothy-p.-carney-revolving-door-spins-at-obamas-irs/article/33018>.

¹² *Guides Through the Swamp: A Big Shake-up for America's Tax-preparation Industry*, The Economist, May 24, 2012, available at <http://www.economist.com/node/21551052>.

¹³ See 76 Fed. Reg. 32,295-97 (stating partial IRS estimates for compliance costs). Total compliance costs can be calculated using the total number of tax preparers subject to the IRS licensing regulations – estimated by the IRS to be between 300,000 and 350,000 – and basic arithmetic. See, e.g., Appellees' Response Brief to Government's Motion for Stay Pending Appeal at 19-20, *Loving v. IRS*, No. 13-5061, (D.C. Cir. March 8, 2013), available at http://ij.org/images/pdf_folder/economic_liberty/irs_tax_preparers/response_to_govt_mfs_3-8-13.pdf, and the accompanying declaration (on file with the author, but available by request) providing the details of the calculations.

¹⁴ Roger Russell, *Tax Preparer Shortage on the Way*, Accounting Today, September 7, 2012, available at <http://www.accountingtoday.com/news/tax-preparer-shortage-63903-1.html> (quoting industry expert Chuck McCabe of the Income Tax School: "The new requirements will cause an exodus of tax preparers, who will stop practicing rather than take the test and complete annual education . . . A high percentage of the industry's most experienced tax preparers, are elderly and rather than take the exam, many will retire."); *Guides Through the Swamp: A Big Shake-up for America's Tax-preparation Industry*, The Economist, May 24, 2012, available at <http://www.economist.com/node/21551052> ("Scott Schneeberger, an analyst at Oppenheimer, a research and investment firm, guesses that as many as a fifth of the 100,000 independent preparers may quit the industry between 2011 and 2012."); Eric Kroh, *Shortage of Tax Return Preparers Feared in Face of New Requirements*, Tax Analysts, Dec. 2012 (citing prediction that 10-20% of tax preparers will leave the tax preparation business because of the new regulations); Joe Kristan, *Tax Roundup, 12/24/2012: The Coming Preparer Crash, Tax Update Blog*, Dec. 24, 2012, <http://rothcpa.com/2012/12/tax-roundup-12242012-the-coming-preparer-crash-also-a-modest-fiscal-cliff-proposal/> ("It's likely the population of authorized return preparers will crash. That will increase demand for the big national tax preparation franchises. . .").

¹⁵ Institute for Justice, *Loving v. IRS Litigation Backgrounder*, last updated March 2012, available at <http://www.ij.org/irs-tax-preparers-backgrounder>. For more information about Mr. Kilian or the two other courageous independent preparers who challenged the IRS licensing regulations, see www.ij.org/IRS.

¹⁶ Patrick Langetieg et al., Internal Revenue Service, *Return Preparer Industry Analysis: Presentation to the IRS-TPC Research Conference* at 4, June 20, 2013, available at <http://www.taxpolicycenter.org/events/upload/1-2-Vigil.pdf> (showing steepening decline in number of preparers from over one million preparers in 2010 to less than 800,000 preparers in 2012).

¹⁷ *Id.* at 6.

¹⁸ *Id.*

¹⁹ *Id.* at 5 (showing sharp uptick in average number of returns per preparer from less than 80 in 2010 to well over 100 in 2012, while the number of prepared returns remains relatively constant).

²⁰ See *H&R Blockheads: The IRS Wants to Save You From Your Rogue Tax Accountant*, Wall St. J., Jan. 7, 2010, available at <http://online.wsj.com/news/articles/SB10001424052748703436504574640572196836150> (“With fewer tax preparers in the market, H&R Block will find it easier to raise prices.”); Roger Russell, *Tax Preparer Shortage on the Way*, Accounting Today, September 7, 2012, available at <http://www.accountingtoday.com/news/tax-preparer-shortage-63903-1.html> (noting that industry expert Chuck McCabe of the Income Tax School “expects that the shortage of preparers may also drive up compensation for preparers, resulting in higher prices for tax preparation services” and describing the IRS licensing regulations as creating a “bidding war” for tax preparation services due to “a shortage of qualified preparers”); Joe Kristan, *Tax Roundup, 12/24/2012: The Coming Preparer Crash*, Tax Update Blog, Dec. 24, 2012, <http://rothcpa.com/2012/12/tax-roundup-12242012-the-coming-preparer-crash-also-a-modest-fiscal-cliff-proposal/> (“A reduction in preparer supply will increase prices.”); see also Jonnelle Marte, *Tax Prep Gets Pricier*, Wall St. J. MarketWatch, Jan. 25, 2013, available at http://articles.marketwatch.com/2013-01-25/finance/36538398_1_tax-preparer-melissa-labant-tax-return (noting 6% increase in prices from previous year, stating that “experts expect those costs to keep rising this tax season” and observing that “[t]ax preparers may also charge more for their services if they face higher costs”).

²¹ See, e.g., Joe Kristan, *Tax Roundup, 12/24/2012: The Coming Preparer Crash*, Tax Update Blog, Dec. 24, 2012, <http://rothcpa.com/2012/12/tax-roundup-12242012-the-coming-preparer-crash-also-a-modest-fiscal-cliff-proposal/> (noting that increased tax preparation prices due to IRS licensing regulations “will cause some taxpayers on the margin to prepare their own returns, and some to stop filing altogether.”).

²² See, e.g., Kelly Phillips Erb, *Black Market Tax Preparers Continue to Defy IRS*, Forbes, Nov. 18, 2013, available at <http://www.forbes.com/sites/kellyphillipserb/2013/11/18/black-market-tax-preparers-continue-to-defy-irs/>.

²³ Treasury Inspector General for Tax Administration, *Accuracy of Tax Returns, the Quality Assurance Processes, and Security of Taxpayer Information Remain Problems for the Volunteer Program* at 6, Reference No. 2011-40-094, Aug. 26, 2011, available at <http://www.treasury.gov/tigta/auditreports/2011reports/201140094fr.pdf>.

²⁴ *Guides Through the Swamp: A Big Shake-up for America's Tax-preparation Industry*, The Economist, May 24, 2012, available at <http://www.economist.com/node/21551052> (“The big-brand preparers make lots of mistakes, too, according to the Government Accountability Office, an official watchdog. So do IRS staff: a 2003 study found they flubbed most of the questions of investigators posing as taxpayers.”); Kevin Cork, *Audit Finds Poor Service at the IRS*, NBC News, April 13, 2005, available at http://www.msnbc.msn.com/id/7492730/ns/nightly_news/t/audit-finds-poor-service-irs/ (finding variance in error rates among answers provided by IRS employees depending on how they were contacted by taxpayers, including a 36% error rate in questions answered by email and a 33% error rate in questions asked in person at an IRS help center); Mary Dalrymple, *IRS Can't Do the Math*, Associated Press, Sept. 3, 2003, available at <http://www.cbsnews.com/news/irs-cant-do-the-math/> (finding that “[l]ess than half, or 45 percent, of the questions were answered correctly and completely” in survey of answers provided to tax questions by IRS employees). This is a longstanding problem. See, e.g., Gary Klott, *Taxpayers Often Getting Bad Advice from I.R.S.*, N.Y. Times, April 9, 1987, available at <http://www.nytimes.com/1987/04/09/business/taxpayers-often-getting-bad-advice-from-irs.html> (1987 article noting 37% error rate in answers provided by IRS employees on the agency's toll-free telephone line in response to “basic” questions).

²⁵ See Kim M. Bloomquist et al., Internal Revenue Service, *Evaluating Preparation Accuracy of Tax Practitioners: A Bootstrap Approach* at 81-82 & Table 4, The IRS Research Bulletin, 2007, available at <http://www.irs.gov/pub/irs-soi/07resconfbloom.pdf> (measuring “potential AUR discrepancy” as a proxy for likely error rates).

²⁶ *Guides Through the Swamp: A Big Shake-up for America's Tax-preparation Industry*, The Economist, May 24, 2012, available at <http://www.economist.com/node/21551052> (“... America's tax code seems designed to make it hurt as much as possible. It contains 3.8m words, and was changed 579 times in 2010 alone. . . . The obvious solution would be to simplify the tax code. The IRS's National Taxpayer Advocate begs Congress every year to do exactly this.”).

²⁷ See CCH, *Federal Tax Law Keeps Piling Up: As illustrated by pages in the CCH Standard Federal Tax Reporter*, Release (22), 2013, at <http://www.cch.com/taxlawpileup.pdf>.

²⁸ Even reducing the relatively basic Form 1040EZ to a set of executable, rules-based decisions for use in a software program is quite complex. See, e.g., *Preparing a Tax Return Using Executable Decisions (Decision1040EZ): Tutorial*, Open Rules, Inc., Dec. 2011, available at <http://openrules.com/pdf/Tutorial.Decision1040EZ.pdf>.

²⁹ Kathy Kristof, *Was Timothy Geithner Mistaken or Misleading?*, L.A. Times, Jan. 15, 2009, available at <http://articles.latimes.com/2009/jan/15/nation/na-taxes15>.

³⁰ Bob Cusack, *IRS Commissioner Doesn't File His Own Taxes*, The Hill's Blog Briefing Room, Jan. 10, 2010, at <http://thehill.com/blogs/blog-briefing-room/news/75119-irs-commissioner-doesnt-file-his-own-taxes>.

³¹ See, e.g., Laura Sanders, *IRS Loses a Gift-Tax Battle*, Wall St. J., Sept. 16, 2011, available at <http://online.wsj.com/article/SB10001424053111904491704576570980775431732.html>; I.R.S. *Loses Tax Case Against Lay of Enron*, N.Y. Times, Aug. 29, 2011, available at <http://www.nytimes.com/2011/08/30/business/irs-loses-tax-case-against-lay-of-enron.html>; Doug Batey, *The IRS Again Loses in Attempt to Limit the Deductibility of LLC Losses*, LLC Law Monitor, March 8, 2010, at <http://www.llclawmonitor.com/tags/newell-v-commissioner/>.

³² Nina E. Olson, *More Than a 'Mere' Preparer: Loving and Return Preparation*, Tax Notes, May 13, 2013, at 771, available at http://www.taxpayeradvocate.irs.gov/userfiles/file/nta_taxnotes_lovingcase.pdf.

³³ Internal Revenue Service, *Return Preparer Review* at 13-17, Publication 4832 (Rev. 12-2009), Dec. 2009, available at <http://www.irs.gov/pub/irs-pdf/p4832.pdf>.

³⁴ Government Accountability Office, *Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors* ("GAO Paid Preparer Limited Study") at 3, 29, GAO-06-563T, April 4, 2006, available at www.gao.gov/new.items/d06563t.pdf ("Our 19 site visits cannot be used to generalize our findings to the retail tax preparation community . . . Our limited review and the problems we found do not permit observations about the quality of the work of paid tax preparers in general."); Treasury Inspector General for Tax Administration, *Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors* ("TIGTA Paid Preparer Limited Sample") at 4, Reference No. 2008-40-171, Sept. 3, 2008, available at www.ustreas.gov/tigta/auditreports/2008reports/200840171fr.pdf ("Because we selected a non-representative sample of preparers from one large metropolitan city for this review, it is not possible to generalize the results of our work and draw conclusions about all preparers.").

³⁵ GAO Paid Preparer Limited Study at 3 ("We did not visit any law firms [or] CPA firms."); TIGTA Paid Preparer Limited Sample at 2 ("The preparers [studied] were unlicensed and unenrolled. That is, they were not practitioners (attorneys, certified public accountants, enrolled agents, or enrolled actuaries).").

³⁶ GAO Paid Preparer Limited Study at 3 ("We had tax returns prepared for us at 19 outlets of several commercial chain preparers . . . We did not visit any . . . single-office tax return preparation businesses.").

³⁷ Chi Chi Wu, National Consumer Law Center, *Riddled Returns: How Errors and Fraud by Paid Tax Preparers Put Consumers at Risk and What States Can Do* at 4, updated March 12, 2014, available at <http://www.nclc.org/images/pdf/pr-reports/report-riddled-returns.pdf>.

³⁸ *Id.* at 4-6.

³⁹ GAO Paid Preparer Limited Study at 14 ("All 19 of our visits to tax return preparers affiliated with chains showed problems.").

**Supplemental Statement of Dan Alban
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**Before the United States Senate
Committee on Finance**

Thank you, Chairman Wyden, ranking member Hatch, and the members of this Committee, for the opportunity to present this supplemental statement in response to claims made at the April 8, 2014 hearing about Oregon's tax-preparer licensing scheme. The testimony presented painted far too rosy a picture of tax-preparer licensing in Oregon.

Summary

The available evidence indicates that Oregon's licensing scheme has created a chronic shortage of tax-return preparers, which has driven up the cost of tax-preparation for consumers, and significantly more taxpayers prepare their own returns in Oregon than in other states, likely because of the shortage of tax preparers and higher costs of tax preparation caused by the licensing scheme.

In addition, despite what was stated at the April 8 hearing, H&R Block does have an outsized influence on tax preparation in Oregon. Even using the data from PTIN applications relied on by A higher percentage of tax preparers in Oregon are H&R Block preparers than the nationwide average, and over half of new tax-preparer licensees each year are graduates of the H&R Block Tax School (which only trains preparers who have agreed to work at H&R Block).

Finally, Oregon's tax-preparer licensing scheme is no panacea. The 2008 Government Accountability Office ("GAO") study admits that Oregon's above-average performance on estimates of tax-return error rates cannot be attributed to the tax-preparer licensing scheme (and found that California, which also licenses preparers, had a below-average performance on estimates of tax-return error rates). In fact, Oregon's above-average performance is partly attributable to the above-average performance of self-prepared returns in Oregon, which speaks well of the ability of Oregonians to prepare their own tax returns, but cannot be attributed to Oregon's licensing scheme. The GAO study also notes that seven other states—Colorado, Iowa, New Mexico, Ohio, Pennsylvania, West Virginia, and Wisconsin—also had more accurate returns than the national average, even though those states do not license preparers. And even under the GAO's most optimistic estimates, returns prepared by Oregon-licensed preparers still have a 33% error rate.

Supplemental Statement

For a regulatory regime that some are urging Congress to impose on a nationwide scale, there is surprisingly little evidence available about the effects of Oregon's tax-preparer licensing scheme. The limited data that is available is largely summarized in two reports: an August 2008 GAO Report ("GAO Report")¹ and a 2012 peer-reviewed "white paper" report by April Gutierrez of the Pacific Northwest Tax School ("PNTS Report")², an organization which provides training and continuing education programs for preparers in Oregon and California. The full GAO Report and excerpts from the PNTS Report were included in the written testimony submitted by Janis Salisbury, Chair of the Oregon State Board of Tax Practitioners.

These reports indicate the following:

1. **Tax-preparer licensing has created a chronic shortage of tax preparers in Oregon, and is expected to do the same nationally if a similar licensing scheme is imposed nationwide.**

As the PNTS Report explains: “National licensing will likely create a shortage of tax preparers if Oregon’s history is an example of what to expect. There is a general consensus among tax service owners in Oregon that there is a chronic shortage of licensed tax preparers.”³

Not only is there a shortage among currently licensed preparers, but there is also a shortage of new licensees, particularly independent licensees who are not obligated to work for a national chain:

Since most students who graduate from a school offered by one of the three national chains will be recruited to work for the company with which they completed their education, **independent tax services are left with a very small pool of graduating students** from which they can recruit each year. Independent tax schools and colleges within the State of Oregon were able to produce an **average total of only 118 new licensees annually**. . . . these new licensees merely replace existing tax preparers and do not result in a net increase in number of tax preparers available to work for independent tax services.⁴ (emphasis added).

In fact, the number of Oregon tax preparers appears to be on the decline. The number of licensed preparers has declined over 6.6% from 2008 to 2011, dropping from 3,993 preparers to just 3,729.⁵

2. **As a result of the shortage of licensed tax preparers, Oregon-licensed tax preparers charge consumers notably higher fees than tax preparers in other states.**

As the GAO Report acknowledges: “Regulation of preparers can also have the effect of increasing the price of tax preparation services by reducing the supply of paid preparers.”⁶ That has evidently proven true in Oregon, as the PNTS Report admits:

The average wage paid to Oregon tax preparers is **higher than for the rest of the country**. The average wage paid to a first year tax preparer in Oregon is well above the state minimum wage with first-year tax preparers generally commanding \$10-\$14 per hour. Tax service businesses pass on higher payroll costs to consumers in the form of increased tax preparation fees. **Average tax preparation fees in Oregon are generally high when compared to other states.**⁷

These higher costs for tax-preparation services are very likely due to the chronic shortage of preparers caused by the barriers to entry imposed by the licensing scheme. As the GAO Report noted: “It is possible that the Oregon regulatory regime has had the effect of reducing the supply of paid preparers, leading to an increase in the price charged for the service.”⁸

3. **Oregon has significantly more self-prepared returns than other states, likely due to the shortage of licensed tax preparers and the resulting higher costs of tax-return preparation.**

Oregon taxpayers prepare their own returns at a significantly higher rate than the rest of the country. That is likely because of the shortage of tax preparers and the higher fees charged, as the GAO Report notes:

NRP data show that taxpayers in Oregon are somewhat less likely to use a paid preparer than taxpayers in the rest of the country and even less likely to use paid preparers than taxpayers in California. NRP data show that about 58 percent of individual taxpayers used paid preparers nationally, while only 49 percent of Oregon taxpayers did so. . . . It is possible that the Oregon regulatory regime has had the effect of reducing the supply of paid preparers, leading to an increase in the price charged for the service.⁹

4. Oregon's licensing scheme is protectionist and anti-competitive, needlessly imposing more substantial barriers to entry than the practice of law.

a. Barriers to entry include a minimum two-year apprenticeship requirement.

Oregon has a two-tiered licensing scheme that imposes a protectionist apprenticeship requirement. It effectively requires newly licensed tax-preparers to work for preparers with a higher form of license for at least two tax seasons:

A Licensed Tax Preparer (LTP) license is awarded to individuals who successfully complete an approved 80-hour course and pass the LTP exam. **LTPs are viewed as mere apprentices who must work under the supervision of a Licensed Tax Consultant (LTC).** Licensed Tax Consultants are individuals who have achieved a minimum of 780 hours [increased to 1100 hours in July 2012] of tax preparation experience over a **minimum of two tax seasons** and who have also passed a second, higher-level exam, called the LTC exam. **First-year LTPs may not work alone in any tax office,** and an LTC must physically be present in every office for a minimum of 50% of the time any office is open.¹⁰

The GAO found that this requirement was “[p]otentially more important” than Oregon’s already substantial direct compliance costs for raising the price of tax-return preparation services, noting further that:

... LTCs may not supervise more than two offices. This means that there can be a substantial bar to the opening of a new tax preparation business if the owner cannot find and recruit an LTC. We were told by a representative of a tax preparation chain that he had experienced difficulty in opening a new rural office because he could not find an LTC to supervise LTPs.¹¹

This is a higher barrier to entry than the practice of law, which has no such apprenticeship requirement for those who pass the bar exam.

b. Barriers to entry include licensing exams that are more difficult to pass than the Oregon State Bar exam.

Oregon’s tax-preparer licensing exams are also needlessly difficult; in fact, they are harder to pass than the Oregon State Bar. The 2010 LTP exam had a 65% pass rate, while the 2010 LTC exam had a 30% pass rate.¹² It is not clear whether there is any comparative data indicating whether LTCs have any lower error rates on tax returns than LTPs. Even the entry-level LTP exam passage rate is lower than the average passage rate for the Oregon State Bar exam, and the LTC exam passage rate is well less than half the average bar exam passage rate.¹³

Among the indications that the LTC exam is designed to be needlessly difficult, rather than to test relevant return-preparation skills is the fact that the LTC exam is a “closed book” five-hour exam,¹⁴ even

though tax-return preparation is never “closed book.” Both exams are also done on paper,¹⁵ even though the vast majority of tax-return preparers use commercial software to assist them in preparing returns. To even sit for the LTC exam, preparers “must have a minimum of 780 hours [increased to 1100 hours in July 2012] of work experience completed over two – five years.”¹⁶

All of this serves to needlessly impose very substantial barriers to entry that reduce competition, leading to a shortage of licensed tax-preparers and increased fees for tax-preparation services, all to the detriment of taxpayer/consumers, a majority of whom prepare their own returns instead.

5. H&R Block has an outsized influence in Oregon that is only going to increase in the future.

The data in the PNTS report indicates that there is a higher percentage of H&R Block Preparers in Oregon than in other states.¹⁷ However, the methodology used by the PNTS Report likely dramatically *undercounts* the number of preparers from H&R Block and the other national chains because it relies solely on self-reporting of an employer’s name in response to an “optional” question on the PTIN application form.¹⁸ As the PNTS Report admits, over 80% of preparers in every group studied “identified themselves as employed by other firms or did not identify their employers.”¹⁹

Thus, the number of preparers who do identify their employer as H&R Block or another chain preparer on the optional PTIN question only serves as the *bare minimum* number of chain preparers, but not the actual figure, as the PNTS report suggests. And even this bare minimum methodology identifies that there is a larger proportion of H&R Block tax preparers in Oregon than in other states.²⁰

Perhaps more importantly, H&R Block dominates education for tax-preparer licenses in Oregon. As the PNTS report admits, “[m]ore than half of new licensees [each year] are graduates of H&R Block’s tax school.”²¹ It further explains that:

The largest tax school in Oregon and nationally is H&R Block. More than half of new Oregon licensees graduated from classroom courses offered by the company. However, **H&R Block prohibits competitors from sending employees to its school**, thus the largest and most widely available school is not a resource available to the majority of tax preparers²²

As the PNTS report further acknowledges: “Economies of scale give the three national chains a distinct advantage over smaller private schools and colleges since course curriculums are developed, updated and marketed by the national chains for use by all franchisees nationwide.”²³

When a majority of preparers are educated and employed by H&R Block, the percentage of chain preparers in Oregon is only likely to increase over time, particularly given the decline in the total number of licensed preparers.

6. Oregon’s licensing scheme is hardly a panacea.

The GAO Report admits that the data it presents is “not sufficient to prove that Oregon’s regulatory regime leads to some increased tax return accuracy.”²⁴ Indeed, Oregon is not alone in having above-average accuracy rates on tax returns prepared by paid preparers. The GAO report acknowledges that: “States besides Oregon with a statistically significant likelihood of having paid preparer returns that were more accurate than the national average, controlling for other factors, were Colorado, Iowa, New Mexico, Ohio, Pennsylvania, West Virginia, and Wisconsin.”²⁵ None of these other states have tax-preparer licensing regulations. Meanwhile, California had below-average accuracy on paid preparer returns,

despite a longstanding licensing scheme for tax-return preparers (one of only two in the nation at the time of the study.)²⁶

Self-prepared returns also contributed to Oregon's high accuracy rate, even though they are unlikely to have been caused by Oregon's tax-preparer licensing scheme. The GAO report also found that, "Oregon's 2001 federal returns were on average about \$250 dollars more accurate than returns in the rest of the country" when self-prepared returns were included.²⁷

For all of the above reasons, Congress should not attempt to follow Oregon's model by giving the IRS additional power over tax preparers by forcing tax preparers to complete onerous licensing requirements in order to get IRS permission before they can assist taxpayers with their tax returns.

Thank you.

Dan Alban is a public interest attorney at the Institute for Justice, where he focuses on litigating cutting-edge constitutional cases that defend economic liberty, free speech, and private property rights. He is the lead attorney in Loving v. IRS, a successful federal challenge to the IRS's attempt to unilaterally impose a sweeping new licensing scheme on tax-return preparers without Congressional authorization.

¹ Government Accountability Office, *Tax Preparers: Oregon's Regulatory Regime May Lead to Improved Federal Tax Return Accuracy and Provides a Possible Model for National Regulation* ("GAO Report"), GAO-08-781, Aug. 15, 2008, available at <http://www.gao.gov/products/GAO-08-781>.

² April Gutierrez, Pacific Northwest Tax School, *IRS Registered Tax Preparer (RTRP) Regulations: Challenges and Opportunities For the Tax Preparation Industry* ("PNTS Report"), Jan. 3, 2012, available at http://pnwtaxschool.com/sites/default/files/documents/white_paper_-_rtrp_regulations_1.3.12_1.pdf.

³ PNTS Report at 14.

⁴ PNTS Report at 25-26.

⁵ PNTS Report at 25.

⁶ GAO Report at 21 (noting also that "[i]n Oregon, however, direct costs to become a paid preparer and to maintain licensed status are somewhat higher [than California].")

⁷ PNTS Report at 19 (emphasis added).

⁸ GAO Report at 22.

⁹ GAO Report at 22.

¹⁰ PNTS Report at 5.

¹¹ GAO Report at 21.

¹² PNTS Report at 6.

¹³ Oregon State Bar, *Bar Exam Information*, “Exam Results,” at <https://www.osbar.org/admissions/examresults.html> (indicating a bar passage rate of 66% in February 2014, 75% in July 2013, and a passage rate of 70% or above in every July bar exam from 2005 to the present).

¹⁴ PNTS Report at 17.

¹⁵ PNTS Report at 17-18.

¹⁶ PNTS Report at 6.

¹⁷ PNTS Report at 13, Table 1.

¹⁸ Compare PNTS Report at 12 & n.21 with Internal Revenue Service, *Form W-12*, “IRS Paid Preparer Tax Identification Number (PTIN) Application and Renewal, Rev. January 2013, available at <http://www.irs.gov/pub/irs-pdf/fw12.pdf> (Question 14 states: “Enter the business name and website address (optional)”).

¹⁹ PNTS Report at 12 (emphasis added).

²⁰ PNTS Report at 13, Table 1.

²¹ PNTS Report at 15.

²² PNTS Report at 15 (emphasis in original).

²³ PNTS Report at 25.

²⁴ GAO Report at 3.

²⁵ GAO Report at 17 n.34.

²⁶ GAO Report at 3.

²⁷ GAO Report at 3-4 (noting that this figure “[i]nclude[s] both self-prepared and paid prepared returns.”

Statement of

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**Before the
Senate Committee on Finance**

Protecting Taxpayers from Incompetent and Unethical Return Preparers

April 8, 2014

Chairman Wyden, Ranking Member Hatch, and Members of the Committee: Thank you for inviting me to participate in this hearing. I appreciate this opportunity to address this important topic: protecting taxpayers from incompetent and unethical tax return preparers. My name is John Barrick. I am an Associate Professor of Accounting at Brigham Young University in Provo, Utah. In addition, I was an Accountant on the staff of the Joint Committee on Taxation during the 110th and 111th Congresses. I am a member of the American Taxation Association and a Certified Public Accountant ("CPA"). I am a sole proprietor and return preparer for two S-corporations and their primary shareholders. I am speaking for myself alone. My views should not be attributed to any of the organizations with which I am affiliated.

As a CPA and return preparer, I am affected by the preparer tax identification number (PTIN) program. There are financial and administrative costs that I bear from this new program.¹ As a CPA, I am exempt from the federal return preparer regulations because I am already subject to Circular 230 and a continuing education requirement. I am unaware of any benefits that my clients or I receive through these programs.

¹ The financial burden includes the \$64.25 initial fee and a \$63.00 recurring annual fee. The administrative burden includes time to register, maintenance of a PTIN personal identification number (PIN), and the inconvenience of junk mail and email as a result of my registration (due to the IRS distributing/posting the information provided from all PTIN users). The IRS website discloses that PTIN holders are subject to the Freedom of Information Act (FOIA). <http://www.irs.gov/Tax-Professionals/PTIN-Information-and-the-Freedom-of-Information-Act> (accessed April 1, 2014).

Protecting Taxpayers from Unscrupulous and Unethical Return Preparers

I would like to share one taxpayer's recent experience with an unscrupulous and unethical return preparer that will clearly illustrate the problem we are trying to prevent today:

A new client comes to visit a CPA, who is a former colleague and classmate of mine. The client indicates that he has a tax problem. By way of background, the client is a high-school graduate who never attended college, is a lower income, single father with custody of two young boys, and is currently facing tough economic times. During the previous year he engaged a tax return preparer, at the cost of \$800, who helped him prepare a return that claimed an \$8,000 tax refund. The return preparer did not sign the return, did not provide the client with a copy of the return, nor provide reliable preparer-contact information. The client received a check for the \$8,000, and began spending it. A short time later the client received a notice from the IRS denying the three American Opportunity Credits claimed (one for himself and each of his two young boys). The money has to be returned. Who is to blame? Both the client and tax preparer knowingly submitted a return that claimed false information. The client is now worse off than before filing the false return: he owes the full amount of the refund (\$8,000) plus the \$800 fee to the unscrupulous tax preparer. The tax preparer is not to be found, \$800 richer than before.

All of us at this hearing would like to prevent this type of behavior from happening. Return preparer regulation should be allowed if we can protect taxpayers from incompetent and unethical return preparers, and if the benefits of regulation outweigh the costs.² However, if regulation cannot protect taxpayers from these types of incompetent and unethical preparers, or if the costs of regulation exceed the benefits received, then you must find alternatives. I firmly believe that the regulatory framework in this case is insufficient to protect these taxpayers, and I will make several recommendations that Congress and the IRS could follow to better protect these taxpayers.

Why is this question important?

"Taxes are the price we pay for a civilized society" — Oliver Wendell Holmes

The U.S. tax system is designed to: 1) finance public projects; 2) redistribute wealth; and (3) encourage a variety of economic activities that are deemed to be in the public interest (Scholes and Wolfson, 1992). Because of these competing interests and the technical nature of the tax law the Internal Revenue Code (Code) is complex. Besides, the U.S. income tax system is a voluntary system, taxpayers' attitudes and perceptions of the tax system affect compliance. Yin (2012) stated that: "In the United States, the principal goal of (*personal income tax*) PIT administration has been to promote true, *voluntary* compliance on the part of taxpayers, where

² According to Temple-West (2014), the Obama administration has asked Congress to empower the IRS with authority to regulate federal return preparers.

they internalize their societal obligations to report accurately and pay their full tax liabilities.” The Tax Foundation (2009) asked taxpayers the question: “Do you consider the amount of federal income tax you have to pay as...?” In 2009, fifty-six percent (56%) of taxpayers felt the amount federal income tax was “too high” while only two percent (2%) felt the amount was “too low” (see Figure 1). This attitude likely reflects the 2006 estimated tax gap of \$385 billion (IRS 2012).

Figure 1

Q600 Do you consider the amount of federal income tax you have to pay as...?				
	2009	2007	2006	2005
Unweighted Base	2,002	2,012	2,017	2,013
Too high	56%	58%	59%	55%
About right	33%	31%	30%	33%
Too low	2%	2%	1%	2%
Not sure	10%	10%	9%	10%

“The hardest thing in the world to understand is the income tax” — Albert Einstein³

The Taxpayer Advocate (2012) reported that taxpayers spent 6.1 billion hours complying with the law. The Code is over 4 million words long, and contains 4,680 changes since 2001. This complexity often leads to taxpayer dissatisfaction. For example, the Tax Foundation (2009) asked taxpayers the following question: “How complex do you think the federal income tax is”? Eighty-five percent (85%) of taxpayers felt the federal income tax was either “very complex” or “somewhat complex” (see Figure 2).

Figure 2

Q630 How complex do you think the current federal income tax is?				
	2009	2007	2006	2005
Unweighted Base	2,002	2,012	2,017	2,013
TOP 2 BOX (NET)	85%	83%	80%	81%
(4) Very complex	52%	50%	48%	46%
(3) Somewhat complex	32%	33%	32%	35%
BOTTOM 2 BOX (NET)	9%	11%	10%	11%
(2) Not too complex	8%	10%	9%	9%
(1) Not complex at all	1%	2%	1%	2%
Not sure	6%	5%	10%	8%

³ This quote was attributed to Leo Mattersdorf, who was Mr. Einstein’s tax preparer.
<http://quoteinvestigator.com/2011/03/07/einstein-income-taxes/> (last accessed April 1, 2014).

Because of this complexity, taxpayers hire return preparers to reduce the informational asymmetry between them and tax administrators. The GAO (2011) has said that paid return preparers are a cornerstone of our tax system — this is due to the oft-cited statistics that they help about sixty percent (60%) of taxpayers to file their returns. Higher-income taxpayers typically hire attorneys or CPAs to help them minimize taxes and meet their compliance obligations. “Over and over again courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced exactions, not voluntary contributions.” *Commissioner v. Newman*, 159 F.2d 848, 851 (2d Cir. 1947). Lower-income taxpayers often hire less-sophisticated or less-educated preparers and are more likely to be served by incompetent or unethical return preparers.

Regulation

Are there problems with income tax compliance? Yes. Are there some return preparers that lack the requisite knowledge and skills needed for compliance? Yes. Are there some unscrupulous and unethical return preparers? Yes. Are there some unscrupulous and unethical taxpayers? Yes. Are there some taxpayers that lack the requisite knowledge and skills needed for compliance? Yes. There has been a substantial amount of academic research on the topics of taxpayer compliance and effects of tax professionals on the tax compliance process.⁴

There are three primary problems that lead to tax compliance errors: 1) lack of knowledge, 2) lapses in ethical judgment, and 3) inadequate review processes or supervision. Preparer knowledge is addressed by the regulations through a certification examination and continuing professional education. Ethics are addressed through the application of Circular 230 to registered preparers. Review processes and supervision are areas where a diversity of practice exists and there are varying levels of quality as a result.

“The classical theory of government regulation is that society has problems and the government through reason can thoughtfully address them. But what is the problem the IRS is trying to solve with the regulations? There is no indication that paid preparers are incompetent, certainly not on a scale that would require government intervention. Why not let the market solve the competency issue? A crooked return preparer will be penalized by the IRS. But a preparer who leads his clients to audit will be out of business. And, to the extent it matters, there is no indication that paid preparers are less ethical than anyone else” (Brunori 2012).

⁴ Academics have done numerous studies exploring taxpayer behavior and tax professionals' roles in that process. For a review of taxpayer compliance literature see Taxpayer Advocate (2007), a commissioned study by M. Kornhauser. For a review of tax professional judgment and decision making see Roberts (1998). Additionally, the lack of tax compliance data from the IRS and made available to researchers has hampered tax compliance research in the United States relative to similar research being done in countries like Germany and Sweden. While there are concerns about taxpayer privacy, the IRS could make data available that would facilitate a better understanding to today's environment rather than drawing inferences that may be unlikely to generalize to the current environment.

Problems with Regulation

There are three main problems associated with or limits on regulation: 1) the inability to regulate the most unscrupulous and unethical preparers, 2) inability to impose ethics on either registered or unregistered preparers, and 3) the creation of winners and losers in the return preparation industry.

Ghost preparers

I will use the term “ghost preparers” to refer to the most unscrupulous and unethical return preparers. Ghost preparers prepare, but do not sign returns. The preparer I referred to in my earlier story is a good example of a ghost preparer. Ghost preparers don’t sign returns to avoid the unethical behavior being traced to him or her. These preparers charge inordinately large fees, often based on a percentage of the client’s fraudulent refund, quickly collect their fee, and then disappear before they are caught. These ghost preparers refuse to register because they want to hide in the shadows. How many ghost preparers are there? Tolan (2012) estimates there are between 88,000 and 388,000 paid preparers that failed to register. However, this presupposes that ghost preparers previously signed a tax return. The true number of ghost preparers is unknown, but this preparer group imposes the highest cost on taxpayers and is the least likely to be regulated. The only way to deal with ghost preparers is through the Criminal Investigation division of the IRS or other law enforcement methods. Regulation imposes costs on registered tax preparers and their clients without affecting ghost preparers who are outside the law.

Ethical Judgments

There are two small-sample studies that find errors made by return preparers. The first was conducted by the GAO (2009). In tests of chain preparers, the GAO found that 10 of 19 preparers failed to report business income. They excluded income that was not subject to the IRS matching program. Additionally, these same preparers claimed the Earned Income Tax Credit (EITC) for an ineligible child in five out of 10 applicable cases. These errors occurred by not asking about where a child lived or by ignoring the GAO’s answer to the question. In both situations, the preparers made ethical lapses. The second study was conducted by Treasury Inspector General for Tax Administration (TIGTA) in 2008. The TIGTA study examined 28 unenrolled preparers: 12 from commercial chains and 16 from smaller independent firms. The study found that 17 preparers calculated the wrong tax and six of these preparers acted willfully or negligently — demonstrated lapses in ethical judgment. While information is illuminating, the study doesn’t provide information on the distribution of these ethical lapses between the chain preparers and independent firms. How did the regulations improve the behavior of these previously unregulated preparers? Is there any evidence that these preparers’ ethical lapses would be improved by being subject to Circular 230?

Bauman and Mantzke (2004, 54-55) state that: “By all indications, it appears that [the] U.S. tax system is at least somewhat impaired by problems caused by (*federal tax return preparers*) FTRPs. However, evaluating proposals for increased regulation is hampered by the lack of

systematic evidence of the extent of the problem and the effectiveness of existing regulation. As such, it is not clear that increased regulation is the answer.”

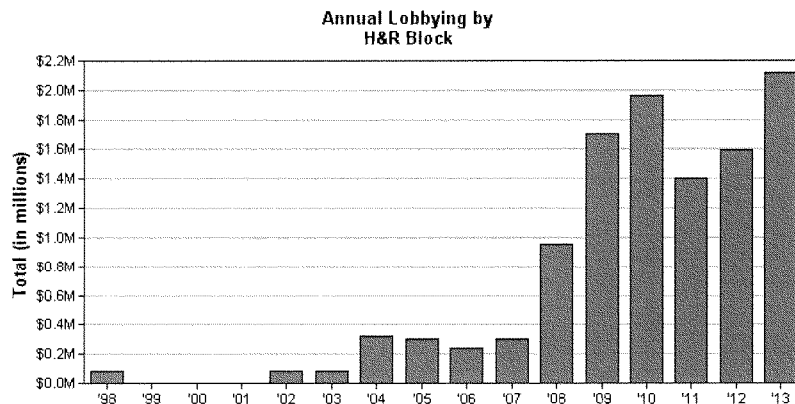
My personal interaction with return preparers from all levels of the industry, particularly those return preparers directly affected by the regulations, indicates that they are generally competent and conscientious. My intuition tells me that the regulations are unlikely to eliminate or deter unscrupulous and unethical preparers who aren’t competent and conscientious.

Winners and Losers

Regulation clearly creates winners and losers among the previously unenrolled portion of the return preparation industry. A host of commentators have rightly pointed out that many of the small independent return preparers are disadvantaged. For example, Brunori (2014) states that: “The big proponents of regulating preparers are H&R Block, Jackson Hewitt, and the other large tax return preparation services. No one will ever convince me that big preparers have the public’s interest at heart. They merely want to limit or eliminate all the competition.”

The Lobbying Disclosure Act data bears this assertion out. Figure 3 was obtained from the Center for Responsive Politics’ Opensecrets.org database. The large increase in lobbying expenditures coincides with the government interest and discussion of return preparer regulation.

Figure 3



While I do not fully understand the economics of the large-scale commercial return preparation businesses, many of these businesses are presumed to make significant profits off of ancillary services, such as refund anticipation loans, which are now referred to as “refund anticipation checks.”

Alternatives to Regulation

I would like to thank Nina Olson, the National Taxpayer Advocate, for her and her staff's tireless efforts to help taxpayers. In the 2013 Taxpayer Advocate Report she recommends a six-part strategy. I highly recommend the first five points and urge you to carefully consider the sixth item:

Accordingly, the National Taxpayer Advocate urges the IRS to develop a six-part strategy to protect taxpayers in the event that *Loving* is upheld on appeal. Specifically, the strategy should include the following components:

1. Offer unenrolled preparers the opportunity to earn a voluntary examination and continuing education certificate.
2. Restrict the ability of unenrolled preparers to represent taxpayers in audits of returns they prepared unless they earn the voluntary examination and continuing education certificate.
3. Restrict the ability to name an unenrolled preparer as a Third Party Designee on Form 1040.
4. Mount a consumer protection campaign that educates taxpayers about the need to select competent preparers who can demonstrate competency.
5. Develop a research driven and Service-wide preparer compliance strategy similar in nature to the EITC preparer compliance strategy.
6. Recommend that Congress revise 31 U.S.C. § 330(a)(2) to clarify that the IRS has the authority to regulate unenrolled preparers.

Building off of her work, I suggest four strategies that I believe will improve the protections afforded to taxpayers from incompetent and unethical return preparers: 1) voluntary disclosure, 2) eliminate or limit refundable credits, 3) enforce existing return preparer laws, and 4) educate taxpayers.

Voluntary disclosure

We live in a free society; let the markets decide whether return preparer certification is a good thing. Licensed attorneys and CPAs are gainfully employed because their professional designations are valued by taxpayers. I recommend combining the Taxpayer Advocate's items one through three. Create incentives for return preparers to voluntarily register. Allow them to represent taxpayers before the IRS in audits and be designated on a taxpayer's Form 1040. These are items that taxpayers value. Also educate taxpayers about the advantages of using a registered return preparer.

Eliminate or Limit Refundable Credits

The growth of refundable credits in the income tax system encourages unscrupulous and unethical behavior by taxpayers, ghost preparers, and others wishing to defraud the federal government. "The availability of e-filing and the magnitude and frequency of claims for refundable tax credits have combined to make tax return preparation a lucrative business for many" (Olson, p 769). The former Commissioners make this point in the amicus brief: "Most

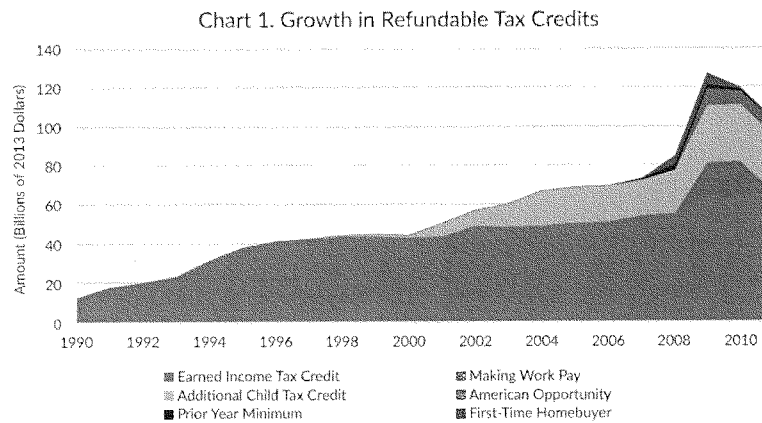
significantly, Congress has decided to administer an increasingly wide variety of government assistance programs through the federal income tax system, including assistance for low income families, health care, education, and homebuyers. In each instance, preparing and filing a tax return is the sole means by which taxpayers are able to present to Treasury their qualification for these programs and to obtain the financial assistance intended by Congress.”

Currently, the Internal Revenue Code includes the following refundable credits:

- earned income credit (§ 32);
- child tax credit (made partially refundable under § 24(d)(1));
- education credits (made partially refundable under § 25(i)(5));
- health insurance cost credit (§ 35);
- first-time homebuyer credit (§ 36) available from 2008-2011;
- making work pay credit (§ 36A) available in 2009 and 2010; and
- adoption expense credit (§ 36C, re-codified as § 23).

Figure 4 illustrates the historical growth of refundable credits claimed by taxpayers (Tax Foundation 2014).

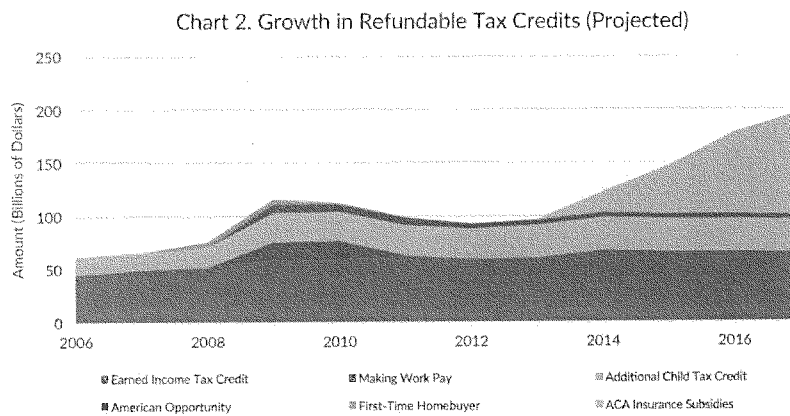
Figure 4



Source: IRS Statistics of Income, 1990-2011

Figure 5 projects the future growth of refundable credits (Tax Foundation 2014).

Figure 5



“The primary purpose of the Internal Revenue Service is to collect revenue. Refundable tax credits represent a form of mission creep, in which the IRS dispenses revenue instead of collecting it. Recent acts of Congress, particularly ARRA and the ACA, have dramatically increased the scope and breadth of these credits. As the ACA subsidies come online, the total expenditures associated with refundable tax credits will surpass \$200 billion” (Tax Foundation, 2014).

Outside of Washington there is very little understanding of why the Code is used for programs such as EITC, Low Income Housing Credit, etc. Congress can both authorize and fund a program through the Code with the single stroke of a pen, while doing so outside of the Code requires both an authorization to create the program as well as an appropriation bill to fund the program. This legislative loophole has led to a significant increase in refundable credits, and resulting opportunities for abuse.

The Joint Committee on Taxation (2013) shows the distribution of these refundable credits across taxpayers. Figure 6 indicates that taxpayers with taxable income below \$30,000 have a negative tax liability (refunds) created through refundable credits.

Figure 6

Table 2.--Distribution by Income Class of All Returns, Taxable Returns, Itemized Returns, and Tax Liability at 2012 Rates, 2012 Law, and 2012 Income Levels [1]

[Money amounts in millions of dollars, returns in thousands]

Income Class [2]	All Returns [3]	Taxable Returns	Itemized Returns	Tax Liability
Below \$10,000	17,878	12	418	-\$8,110
\$10,000 to \$20,000	17,418	4,168	760	-24,672
\$20,000 to \$30,000	18,526	6,328	1,360	-14,085
\$30,000 to \$40,000	15,862	7,928	2,310	144
\$40,000 to \$50,000	14,182	9,051	3,230	13,582
\$50,000 to \$75,000	26,339	20,123	8,583	72,802
\$75,000 to \$100,000	16,618	15,414	7,860	91,859
\$100,000 to \$200,000	22,735	22,412	16,522	293,676
\$200,000 and over	6,321	6,281	5,882	561,492
Total	155,879	91,717	46,925	\$986,688

[1] Tax law as in effect on December 31, 2011, is applied to the 2011 level and sources of income and their distribution among taxpayers.

[2] The income concept used to place tax returns into classes is adjusted gross income ("AGI") plus: (a) tax-exempt interest, (b) employer contributions for health plans and life insurance, (c) employer share of FICA tax, (d) workers' compensation, (e) nontaxable Social Security benefits, (f) insurance value of Medicare benefits, (g) alternative minimum tax preference items, and (h) excluded income of U.S. citizens living abroad.

[3] Includes filing and non-filing units. Filing units include all taxable and nontaxable returns. Non-filing units include individuals with income that is exempt from Federal income taxation (e.g., transfer payments, interest from tax-exempt bonds, etc.). Excludes individuals who are dependents of other taxpayers and taxpayers with negative income.

NOTE--Details may not add to totals due to rounding.

Source: Joint Committee on Taxation

Financial incentives do matter; the current tax law creates incentives for fraud. To the unscrupulous and unethical this is easy money.

Enforce Existing Return Preparer Laws

The Taxpayer Advocate finds the IRS negligent for its failure to take action against return preparers. This is echoed by an earlier testimony from the Chief of the Criminal Investigation Division: "The IRS currently has numerous tools available to address return preparer fraud and to educate the public. Effective application of these tools requires strong support of the IRS enforcement mission during this critical building stage. Some of the key tools include the Criminal Investigation Fraud Detection Centers, which deploy expert intelligence analysts who look at sophisticated data mining and data analysis tools and identify unscrupulous return preparers as well as defining the scope of their schemes. Numerous civil and criminal penalties can be deployed once return preparer schemes are identified and examined. The parallel investigative process permits a civil injunction to be issued, which allows us to stop fraudulent conduct in its tracks. Finally, we have no aggressive education and outreach program geared specifically to this problem which targets both law-abiding taxpayers and the preparer community. (IRS 2005)"

The IRS has seldom made use of its existing statutorily authorized tools for regulating tax return preparers, such as the tax return preparer penalty.

The IRS already has ample statutorily-authorized tools to apply against incompetent or unethical tax-return preparers. Furthermore, the regulations will be ineffective in eliminating the most incompetent and unethical return preparers.

Educate Taxpayers

Taxpayers are ultimately responsible for their own tax return. They have an obligation to put forth a good faith effort. If something promised you by anyone sounds too good to be true, it usually is; buyers beware. Taxpayer education can be an effective tool. Previously, the IRS has used taxpayer education favorably:

The IRS indicated that more than 80,000 tax returns were filed in 2001 seeking fictitious slavery tax credits totaling \$2.7 billion. The IRS estimated that \$30 million was mistakenly paid out in slave reparations in 2000 and part of 2001. However, the Service reports a significant drop in reparation claims attributable to stepped-up scrutiny of tax returns and an aggressive media campaign targeting scam artists promising to secure these phony tax credits for taxpayers. (Bauman and Mantzke, 2004, p. 58).

In addition to educating taxpayers about their own responsibility, you should recommend that the IRS follow the Taxpayer Advocate's item 4: "Mount a consumer protection campaign that educates taxpayers about the need to select competent preparers who can demonstrate competency."

Final Recommendations

"Licensing is effective only if accompanied by strictly enforced standards of performance and integrity. We see no realistic way of IRS's doing this. It has been estimated that there are over 200,000 preparers. Actually, no one knows. In any case, the administration of examinations and the conduct of character investigations for such a large number of individuals is beyond any resources we are likely to get for the job." . . . Statement made by former IRS Commissioner Johnnie M. Walters before the Legal and Monetary Affairs Subcommittee of the House Committee on Government Operations on April 13, 1972.

The tax law is large and complex. For these reasons, the majority of taxpayers seek the help of return providers. Regulation will not deter the most unscrupulous and unethical return providers. They are ghost preparers that attempt to defraud the income tax system. Nor will regulation increase return preparers' ethics without enforcement. Regulation clearly creates winners and losers; those who lobby for rent-seeking activities.

Don't allow states to regulate out-of-state tax return preparers. There are enough taxpayers that are required to file in multiple jurisdictions that it makes it difficult, if not impossible, for return preparers to provide the help they require.

Rather than regulate, please take steps to protect taxpayers from unscrupulous and unethical taxpayers: encourage voluntary disclosure, eliminate refundable credits, enforce existing return preparer laws, and educate taxpayers. However, if you must regulate, exclude those who are

already regulated, including attorneys, CPAs, and enrolled agents. If you must regulate, in addition to knowledge you must make sure that ethics are in place. In training future CPAs, we always start with a foundation of ethics.

Thank you for giving me the opportunity to think about how to help protect taxpayers from unscrupulous and unethical return preparers. I will be happy to answer your questions. I would also be happy to continue this discussion with you or your staffs on tax return preparer regulation, tax reform, or any other topic that you or they might request.

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**STATEMENT OF WILLIAM C. COBB
PRESIDENT & CEO OF H&R BLOCK
BEFORE THE SENATE FINANCE COMMITTEE
HEARING ON "PROTECTING TAXPAYERS FROM INCOMPETENT AND UNETHICAL RETURN PREPARERS"
APRIL 8, 2014**

Thank you for inviting H&R Block to participate in this important discussion about protecting taxpayers from incompetent and unethical return preparers.

H&R Block is the world's largest tax services provider, having prepared more than 600 million tax returns by and through retail locations and digital solutions since 1955. Last year, we filed more than 22 million U.S. individual income tax returns — about 15 million returns in our more than 10,000 offices and another 7 million through our do-it-yourself software offerings.

H&R Block has approximately 10,000 offices in the United States about 11,000 worldwide, with about 40% ownership by small business owners through our franchise program. Our company-owned and franchise offices are located in all 50 states, Puerto Rico and other U.S. territories, and on U.S. military bases around the world. An H&R Block branded retail office is located within 5 miles of most Americans.

H&R Block also has tax offices on 100 U.S. military bases around the world and continues to grow. Forty-three percent of active, reserve and retired service members used H&R Block for tax preparation in 2012. More than 1,300 military spouses took H&R Block's Income Tax Course for free, which enables them to pursue careers as H&R Block tax preparers.

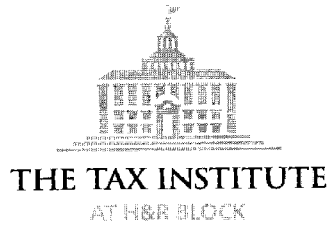
H&R Block employs more than 70,000 highly trained tax professionals across the country and 80,000 professionals worldwide. A typical client is served by an H&R Block tax professional with more than a decade of experience and hundreds of hours of training. Our tax professionals progress through a 14-level certification program, culminating in master tax advisor status. To be re-hired, H&R tax professionals must complete at least 15 hours of continuing education annually. H&R Block's tax professionals are trained on systems, policies and procedures that require an additional 35 hours of education annually.

Our tax professionals have access to The Tax Institute at H&R Block. The Tax Institute provides nonpartisan information and analysis on the real world implications of tax policies affecting the individual taxpayer. The Institute's experts include CPAs, Enrolled Agents, tax attorneys and former IRS officials. Building off more than 10 years of research and analysis from a specialized tax research group at H&R Block, the company launched The Tax Institute in 2007.

For the record, Mr. Chairman, I'd like to submit two studies prepared by the Tax Institute at H&R Block — one on the importance of return preparer standards and the other on a consumer fraud survey they conducted in conjunction with ORC International.

We appreciate the chance to testify, Mr. Chairman, and would be happy to respond to your questions.

One H&R Block Way, Kansas City, MO 64105



Tax Return Preparer Standards:

An Important Tool to Improve Tax Return Accuracy,

Combat Fraud, & Protect Consumers

April 2014

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ABOUT THE TAX INSTITUTE AT H&R BLOCK

The Tax Institute at H&R Block is the go-to source for objective insights on federal and state tax laws affecting the individual. It provides nonpartisan information and analysis on the real world implications of tax policies and proposals to policymakers, journalists, experts and tax preparers. The Institute's experts include CPAs, Enrolled Agents, tax attorneys and former IRS agents. Building off more than 10 years of research and analysis from a specialized tax research group at H&R Block, the company launched The Tax Institute in 2007.

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I. Executive Summary

For many consumers, filing their tax return may be their most important financial transaction of the year. Almost 60 percent of the approximately 142 million consumers who file an individual income tax return with the Internal Revenue Service (IRS) seek the assistance of a compensated tax return preparer. Yet, the majority of tax return preparers are not subject to minimum testing or education standards nor are they subject to oversight by either the federal government or most states.

The IRS's most recent statistics on federal tax return preparers indicate that there are almost 680,000 compensated tax return preparers, but only about 40 percent of these preparers have professional credentials. The other 60 percent of compensated return preparers, or almost 400,000 preparers, generally are not subject to minimum testing or education standards, exceptions being those operating in California, Maryland, New York, and Oregon which have implemented standards.

Requiring such minimum standards for and oversight of compensated tax return preparers has been debated and discussed for many years. Various stakeholders have expressed support for such standards and oversight. These stakeholders include nonprofit consumer advocacy organizations, practitioner groups, the IRS Taxpayer Advocate, state agencies, and Members of Congress.

Minimum education and testing standards for and oversight of compensated tax return preparers will result in better service and protection for consumers. This is because such standards and oversight increase overall competency, knowledge, and expertise of compensated tax return preparers and may also reduce the filing of fraudulent tax returns. In addition, they may also help to reduce the EITC improper payment rate, which appears largely to be caused by the complex eligibility rules.

The IRS attempted to implement a program to oversee non-credentialed compensated tax return preparers by issuing regulations. However, the IRS's authority to implement this program was challenged in court and the courts—both the trial court in 2013 and the appellate court in 2014—ruled against the IRS, holding that Congress must first provide the IRS with authority for such a program.

The appellate court's decision focused on whether the IRS had the *authority* to implement its program and not whether the IRS *should* oversee compensated tax return preparers. In fact, the opinion stated that such a program might "be wise as a policy matter."

The permanent injunction against the IRS's program creates a situation where the majority of consumers are receiving assistance from compensated return preparers who are not subject to any minimum testing or education standards. This is an interesting result since even the volunteers who prepare returns through the IRS-funded Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly programs are subject to minimum testing and education standards.

At H&R Block, our purpose is to look at life through the lens of tax and find ways to help. We are anchored in a set of values summed up as, "we do the right thing." H&R Block has supported efforts to better serve and protect consumers through minimum standards for and oversight of all tax return preparers. Simply put, we believe the "right thing" to do is to protect consumers from potentially incompetent or unscrupulous tax preparers. Our company has long required very stringent standards for tax return preparers working at our offices. See Appendix A for a description of such standards.

In this paper, we

- provide an overview of consumer use of compensated tax return preparers;
- provide an overview of current federal standards and penalties for return preparers;
- explain why additional federal standards and oversight are needed;
- highlight stakeholder support for such additional standards and oversight; and,
- present both legislative and non-legislative recommendations for such standards and oversight.

II. Overview of Consumer Use of Compensated Tax Return Preparers

As Figure 1 below indicates, according to IRS data, for the past five tax years, the ratio of consumers seeking the assistance of a compensated tax return preparer versus those who self-prepare has remained close to 60 percent.

Figure 1: IRS Data Showing Trends in Return Preparation Method Overall¹

Tax Season	2008	2009	2010	2011	2012
Paid-Preparer	86,515,114 (58%)	82,817,612 (60%)	81,040,615 (60%)	81,527,629 (59%)	82,192,985 (58%)
Self-Prepared	61,820,528 (42%)	55,149,802 (40%)	54,726,080 (40%)	56,659,609 (41%)	59,256,931 (42%)

The IRS, through its requirements for who must obtain a Preparer Tax Identification Number (PTIN), essentially defines a compensated tax return preparer as “all enrolled agents as well as all tax return preparers who are compensated for preparing, or assisting in the preparation of, all or substantially all of any U.S. federal tax return, claim for refund, or other tax form submitted to the IRS,” with certain forms excepted.² Volunteers, friends, or family members who assist with tax preparation are not required to obtain PTINs as they are not compensated.

The 670,000 current PTIN holders reported by the IRS³ does not accurately reflect the total number of compensated tax return preparers as it does not include “ghost preparers.” While there is not an official definition for a ghost preparer, a ghost preparer is generally understood to be a preparer who receives compensation for assisting in the preparation of a tax return, but does not sign the tax return as a preparer. Since “ghost preparers” do not have PTINs, they are extremely difficult to track for enforcement purposes.

¹ I.R.S. Pub. 4822, *Taxpayer Filing Attribute Report*, <http://www.irs.ustreas.gov/pub/irs-prior/p4822-2010.pdf> (Apr. 2011) and http://www.irs.ustreas.gov/pub/irs-utl/Pub_4822_Sept_2013.pdf (Rev. Jan. 2013).

² I.R.S. Frequently Asked Questions: Do I Need a PTIN? <http://www.irs.gov/Tax-Professionals/Frequently-Asked-Questions-Do-I-Need-a-PTIN%3F> (last visited Mar. 18, 2014).

³ I.R.S. Return Preparer Office Federal Tax Return Preparer Statistics, <http://www.irs.gov/Tax-Professionals/Return-Preparer-Office-Federal-Tax-Return-Preparer-Statistics> (last visited April 4, 2014).

As of April 1, 2014, the IRS indicates that, of the almost 680,000 PTIN holders, only about 40 percent, or 290,000, of these preparers have professional credentials.⁴ The remaining 60 percent, or 390,000, are generally not subject to any minimum testing or education standards. However, the IRS statistics do not break down PTIN holders by state, so it is unclear how many compensated return preparers are in states that have imposed such minimum standards. An estimate of preparers subject to minimum standards in Oregon, California, Maryland and New York are, respectively, 4,000, 80,000, 3,900, and 40,000.⁵

In her most recent annual report to Congress, National Taxpayer Advocate Nina Olson indicates that, for tax year 2011 returns, 42 million consumers used a tax return preparer that was either non-credentialed or not subject to state oversight and minimum standards.⁶ That is roughly half the number of consumers who used a compensated tax return preparer for tax year 2011.

Ms. Olson estimates that consumers who claim the Earned Income Tax Credit (EITC) use non-credentialed, compensated tax return preparers in greater numbers than non-EITC filers. The report indicates, “over 76 percent of preparers who prepared returns claiming EITC were [non-credentialed].”⁷

III. Overview of Federal Preparer and e-file Rules and Penalties

Current rules and penalties include preparer registration requirements, the electronic filing (*e-file*) mandate and related Electronic Return Originator (ERO) rules, Internal Revenue Code Preparer Penalties, and Treasury Circular 230 rules.

a. Compensated Return Preparer Registration

The IRS has long required compensated tax return preparers to sign the tax return in addition to the taxpayer. Until the year 2000 tax season, tax return preparers were required to sign by providing their Social Security Numbers (SSN). Due to privacy considerations, the IRS implemented the PTIN program for the year 2000 tax season as an alternative to providing SSNs.⁸ From tax season 2000 through tax season 2010, return preparers could use either their SSN or a PTIN.

⁴ *Id.* Credentialed preparers include attorneys, certified public accountants, enrolled actuaries, enrolled agents, and enrolled retirement plan agents.

⁵ Or. Board of Tax Practitioners, *General Information Booklet for Tax Consultant & Tax Preparer Applicants*, at 2 (Sept. 2013) http://www.oregon.gov/OBTP/docs/form/gen_info.pdf; Ca. Tax Educ. Council Press Release, *New Law Targets Questionable Tax Preparers* (Dec. 30, 2013) <http://www.ctec.org/preparer/content.aspx?contentid=29> (follow “New Law Targets Questionable Tax Preparers” hyperlink); Md. Dept. of Labor, Licensing and Regulation, Public Meeting Minutes (Nov. 2013) <http://dllr.maryland.gov/license/min/taxprepmin.shtml>; N.Y. State Dept. of Tax’n and Fin. Press Release, *Governor Cuomo Announces New Regulations to Protect Consumers Who Hire Tax Preparers* (Mar. 3, 2014) <http://www.governor.ny.gov/press/03032014-new-regulations-tax-preparers>.

⁶ National Taxpayer Advocate, 2013 Annual Report to Congress, Vol. I, at 61 (citing I.R.S., Compliance Data Warehouse, Individual Returns Transaction File and Return Preparer and Provider Database, TY 2011)[hereinafter NTA 2013 Annual Report]; The total number of returns prepared by unregulated preparers also includes returns that had a PTIN that could not be matched in the Return Preparers and Providers database.

⁷ NTA 2013 Annual Report, *supra* note 6, at 65.

⁸ I.R.S. News Release IR-1999-72 (Aug. 24, 1999) <http://www.irs.gov/pub/irs-news/ir-99-72.pdf>.

As part of the IRS's Registered Tax Return Preparer (RTRP) program, beginning January 1, 2011, the IRS mandated that all compensated tax return preparers use a PTIN.⁹ After the trial court enjoined the IRS from implementing the RTRP program,¹⁰ the IRS sought clarification on whether it was also enjoined from mandating PTINs. As a result, the court modified its order on February 1, 2013 to clarify that IRS could continue to require PTINs.¹¹

When applying for a PTIN, registrants must attest to any felony convictions in the past ten years and to being in full compliance with federal tax laws. A felony conviction will not necessarily disqualify an applicant from receiving a PTIN, but "crimes related to federal tax matters and also those involving dishonesty or a breach of trust will be considered grounds for denial or termination of a PTIN." Full compliance with federal tax laws includes filing all individual and business returns that are due (or having requested an extension) and paying or making payment arrangements for all taxes due.¹² However, IRS published guidance does not indicate that non-filing or non-payment of taxes is a bar to preparing returns.

b. Electronic Filing (e-file) Mandate

In the IRS Restructuring and Reform Act of 1998, Congress required that IRS achieve an 80 percent *e-file* rate by 2007,¹³ a goal which IRS achieved regarding individual income tax returns in 2012.¹⁴ For tax season 2013, the *e-file* rate for individual tax returns was approximately 83 percent.¹⁵

In 2009, the Worker, Homeownership, and Business Assistance Act amended Internal Revenue Code (IRC) section 6011 to mandate that all specified tax return preparers must electronically file all income tax returns.¹⁶ A specified tax return preparer is any tax return preparer (or a preparer's firm in aggregate) that reasonably expects to file more than 10 individual income tax returns during such calendar year.¹⁷ Prior to this amendment to section 6011, the threshold for mandated *e-filing* was 250 returns.¹⁸

To electronically file returns, specified preparers must apply for and obtain an Electronic Filing Identification Number (EFIN) from the IRS. As part of the application for an EFIN, preparers who were not certified or licensed, i.e. not an attorney, certified public accountant, or enrolled agent, must provide fingerprints to the IRS and pass a suitability check.

⁹ 26 C.F.R. § 1.6109-2 (2014).

¹⁰ *Loving v. IRS*, 917 F. Supp. 2d 67 (D.D.C. Jan. 18, 2013).

¹¹ *Loving v. IRS*, 920 F. Supp. 2d 108 (D.D.C. 2013).

¹² I.R.S., Instructions for Form W-12, *IRS Paid Preparer Tax Identification Number (PTIN) Application and Renewal*, at 2, (Rev. Jan. 2013).

¹³ H.R. 2676, 105th Cong. § 2001 (codified at 26 U.S.C. § 6011 note) (1998).

¹⁴ I.R.S. Oversight Board, Electronic Filing 2012 Annual Report to Congress, at 5 (Dec. 2012)

<http://www.treasury.gov/irsob/reports/2013/IRSOB~E-File%20Report%202012.pdf>.

¹⁵ I.R.S. News Release IR-2013-94 (Dec. 4, 2013) <http://www.irs.gov/uac/More-than-122-million>Returns-eFiled-in-2013>.

¹⁶ H.R. 3548, 111th Cong. § 17 (codified at I.R.C. § 6011) (2009).

¹⁷ *Id.*

¹⁸ Omnibus Budget Reconciliation Act of 1989, H.R. 3299, 101st Cong. § 7713 (1989).

This may include a criminal background check, a credit history check, a tax compliance check, and a check for prior non-compliance with IRS *e-file* requirements.¹⁹

c. Electronic Return Originator Oversight and Penalties

An ERO is an authorized IRS *e-file* Provider that originates the electronic submission of a return to the IRS.²⁰ An ERO must apply for and obtain an EFIN and is therefore subject to a suitability and background check.

An ERO must, as part of its responsibility to safeguard the IRS *e-file* program, diligently identify, prevent, and report fraud and abuse of the IRS *e-file* program. EROs are required to confirm taxpayer identities and Taxpayer Identification Numbers (TINs), monitor for altered taxpayer information documents, and exercise due diligence in the preparation of returns involving the Earned Income Tax Credit (EITC).²¹

An ERO is not a return preparer if his or her services are limited to “typing, reproduction, or other mechanical assistance in the preparation of a return or claim for refund.”²² If an ERO, intermediate service provider, transmitter, or software product alters the return in a way other than “mechanical assistance,” penalties that apply to an income tax return preparer can apply.²³

The following types of penalties can be applied to an ERO:

1. **Level One Infractions.** Violations that have little or no impact on the integrity of the *e-file* program or the quality of electronically filed returns are subject to a letter of reprimand.²⁴ IRS reviews each Level One infraction case based on its own specific facts and circumstances. An example of a Level One infraction is when “[t]here is a history of defaulted installment agreement, but issues were addressed or self-corrected with no reasonable cause or explanation.”²⁵
2. **Level Two Infractions.** Violations that “have an adverse impact upon the quality of electronically filed returns, or on IRS *e-file*,” including continued level one infractions after the *e-file* provider has been notified of the infraction may result in restricted participation or suspension from the *e-file* program for the remainder of the calendar year plus the next calendar year.²⁶ An ERO could be subject to a Level Two infraction if he or she, among other conduct, is incarcerated, defaults on an installment agreement without reasonable cause or explanation, or is missing two tax returns from the last six years without reasonable cause or explanation.²⁷

¹⁹ I.R.S. Pub. 3112, *IRS e-file Application and Participation*, at 8 (Rev. May. 2013) [hereinafter *I.R.S. e-file Application*].

²⁰ *I.R.S. e-file Application*, *supra* note 19, at 5.

²¹ I.R.S. Pub. 1345, *Handbook for Authorized I.R.S. e-File Providers of Individual Tax Returns*, at 16-18 (Rev. Mar. 2009) [hereinafter *Handbook for e-File Providers*].

²² *Handbook for e-File Providers*, *supra* note 21, at 48.

²³ *Id.* at 49.

²⁴ *I.R.S. e-file Application*, *supra* note 19, at 27.

²⁵ I.R.S. Internal Revenue Manual 3.42.10.23.11.1, *Levels of Infraction – Level One* (Rev. Oct. 1, 2012).

²⁶ *I.R.S. e-file Application*, *supra* note 19, at 27.

²⁷ I.R.S. Internal Revenue Manual 3.42.10.23.11.2, *Levels of Infraction – Level Two* (Rev. Oct. 1, 2012).

3. **Level Three Infractions.** Violations that “have a significant adverse impact on the quality of electronically filed returns or on IRS e-file,” including continued level two infractions after the e-file provider has been notified of the infraction may result in suspension for the remainder of the calendar year plus the next two calendar years.²⁸ A Level Three infraction may involve fraud, disreputable conduct, criminal conduct, or non compliance with Form 8453, *U.S. Individual Income Tax Transmittal for an IRS e-file Return*.²⁹ Fraudulent or criminal conduct may result in expulsion.

In addition to the possible application of return preparer penalties, an ERO may be suspended or barred from submitting returns. Suspension or expulsion can occur prior to review of level three infractions.³⁰

d. Internal Revenue Code Preparer Penalties

Although many penalties apply primarily to taxpayers, several IRC penalties apply specifically to paid preparers. Codified penalties apply to all compensated return preparers, including those who are not credentialed.

Under IRC section 6694, preparers may be subject to penalties for understatement of income on a taxpayer’s return. If understatement on a taxpayer’s return was based on an unreasonable position, the penalty is the greater of \$1,000 or 50 percent of the income derived by the preparer with respect to the return or claim. If the understatement was due to willful or reckless conduct, the penalty is \$5,000 or the amount of income derived by the preparer with respect to the return or claim for refund, whichever is greater.³¹

IRC section 6109(a)(4) requires compensated tax return preparers to sign and provide their PTIN on any return or claim for refund that they prepare. If a preparer fails to sign or provide his or her PTIN on a return or claim for refund he or she may be subject to a \$50 penalty for each failure, capped at \$25,000 per year.³²

Other preparer penalties range from a \$50 penalty for failing to provide a copy of the return to the taxpayer to fines and imprisonment for fraudulent activity. For a complete listing of preparer penalties under the IRC, see Appendix B.

e. Treasury Circular 230 Oversight

Treasury Circular 230 (Circ. 230) contains rules that govern attorneys, certified public accountants, enrolled agents, and other persons who represent clients in matters before the IRS. Circ. 230 includes rules relating to the authority to practice before the IRS, the duties and restrictions relating to such practice, and the sanctions for violating the regulations.

²⁸ *I.R.S. e-file Application*, *supra* note 19, at 27.

²⁹ I.R.S. Internal Revenue Manual 3.42.10.23.11.3, *Levels of Infraction – Level Three* (Rev. Aug. 28, 2013).

³⁰ *I.R.S. e-file Application*, *supra* note 19, at 27.

³¹ I.R.C. §§ 6694(a)-(b) (2014).

³² I.R.C. §§ 6695(b)-(c) (2014).

The enabling legislation for Circ. 230 regulations appears in title 31, United States Code, section 330, which, among other authority, grants the Treasury the power to, “regulate the practice of representatives of persons before the Department of Treasury.”

According to Circ. 230:

*Practice before the IRS comprehends all matters connected with a presentation to the Internal Revenue Service . . . relating to a client’s rights, privileges, or liabilities under laws or regulations administered by the Internal Revenue Service. Such presentations include . . . preparing documents; filing documents; corresponding and communicating with the Internal Revenue Service . . . and representing a client at conferences, hearings and meetings.*³³

The IRS Office of Professional Responsibility (OPR) enforces regulations governing practice before the IRS.³⁴ Under Circ. 230, OPR may suspend, disbar, or censure individuals subject to Circ. 230 for disreputable conduct or for failure to comply with the practice requirements.³⁵

As part of the IRS’s implementation of the RTRP program, Circ. 230 was modified in 2011 to include Registered Tax Return Preparers.³⁶ However, given the appellate court’s ruling in the *Loving* case that practice before Treasury does not include tax return preparation,³⁷ it is reasonable to assume that Circ. 230 will be modified again to remove the inclusion of Registered Tax Return Preparers.

IV. Why Additional Federal Standards & Oversight Are Needed

The tools available to the IRS are not sufficient to improve tax return accuracy, combat fraud and protect consumers. For example, the EFIN and ERO requirements, are clearly are not deterring fraudulent tax return preparers as the majority of those returns filed by the preparers subject to DOJ enforcement action are also participating in *e-file*.

In addition,

- Studies suggest that preparers may file returns with errors;
- Studies and enforcement efforts indicate that consumers are victims of fraudulent return preparers;
- The complexity of tax laws and the frequency of changes to it suggest that minimum standards should be imperative;
- Requiring such standards and informing consumers about them would empower consumers;
- Consumers who use credentialed preparers or volunteer preparers may be better served and protected than the majority of consumers who use non-credentialed preparers; and
- A patchwork of state laws and regulations, while preferable in absence of any standards, may be burdensome and confusing to consumers

³³ 31 C.F.R. § 10.2 (a)(4) (Jul. 1, 2013).

³⁴ 31 C.F.R. § 10.1 (a)(1) (Jul. 1, 2013).

³⁵ 31 C.F.R. § 10.50 (a) (Jul. 1, 2013).

³⁶ 31 C.F.R. § 10.0 (a) (Jul. 1, 2011).

³⁷ *Loving v. I.R.S.*, No. 13-5061 (D.D.C. Feb. 11, 2014).

a. Studies Suggest Preparers May File Returns with Errors

For more than a decade, various stakeholders have completed studies and issued reports on the conduct of compensated tax return preparers as well as volunteer preparers. These stakeholders include the Government Accountability Office (GAO), the Treasury Inspector General for Tax Administration (TIGTA), and consumer advocacy nonprofit groups. See Appendix C for a list of such reports.

In general, these stakeholders “mystery shopped” compensated tax return preparers, including both independent preparers and those employed by chain tax preparation companies, by posing as consumers seeking to have tax returns prepared. The sample sizes are generally small and their non-representative nature precludes results from being generalized across all preparers. However, the results suggest that tax preparers frequently make errors in preparing tax returns and that the errors could both be favorable or unfavorable to the consumer.

Examples of errors and lack of knowledge include:

- Failing to include income, sometimes even when the consumer has declared income;
- Failing to utilize all deductions and credits for which a consumer may be eligible; and
- Inability to properly report or complete certain schedules and forms.

In general, while these studies provide valuable anecdotes of preparer misconduct, they do not provide a comprehensive review of return preparers. The studies are not based on statistically valid, geographically balanced samples of return preparers and do not properly weigh independent preparers versus those employed by retail offices. They also do not include a comparison and analysis of preparers subject to minimum standards, either as a result of state laws or as a condition of employment or volunteer eligibility, versus those that are not.

b. Studies & Enforcement Efforts Indicate that Consumers are Victims of Fraudulent Return Preparers

The studies referenced *supra* IV.a, as well as Ms. Olson’s 2012 Annual report to Congress, also indicate that some tax return preparers clearly engage in fraudulent behavior.

Examples of fraud from the studies referenced above include:

- Advising consumers not to report income;
- Intentionally claiming or inflating frivolous or unsubstantiated expenses; and,
- Filing a return without authorization from the consumer and directing refunds to the preparer’s accounts.

Examples from Ms. Olson's report include:

- Altering a tax return to inflate the refund after the consumer authorizes filing and retaining the excess refund; and
- Altering direct deposit bank account information after consumer authorizes e-filing so that consumer receives no refund.³⁸

In her 2013 report to Congress, Ms. Olson also reported on the harm experienced by consumers whose refunds are delayed due to preparer fraud. As of December 16, 2013, some of the 107 preparer fraud victims that enlisted the help of the Taxpayer Advocate Services (TAS) were still waiting for refunds from their 2008 tax returns. Other victims, "have been waiting an average of more than two years to receive their refunds."³⁹

Information about preparer fraud is also available from the the United States Department of Justice's Tax Division (DOJ) ongoing enforcement efforts.⁴⁰ DOJ has shut down hundreds of fraudulent tax return preparers in more than a decade of enforcement.⁴¹

DOJ's efforts have targeted both national and regional retail offices as well as independent preparers. Examples of enforcement against retail offices include Mo' Money Taxes, a Memphis, Tennessee-based firm with 300 offices in 18 states, ITS Financial LLC, the national franchisor of Instant Tax Service, which had hundreds of offices in 34 states, and a rogue Jackson Hewitt franchisee who owned, in whole or in part, five corporations that operated 125 offices.⁴²

The actions against these individuals and corporations largely stemmed from the fact that the preparers were trained and encouraged to file fraudulent and incorrect returns, as well as sell deceptive loan products.

³⁸ National Taxpayer Advocate, 2012 Annual Report to Congress, Vol. I, at 68-69 (Dec. 31, 2012).

³⁹ NTA 2013 Annual Report, *supra* note 6, at 94-102.

⁴⁰ U.S. Dep't of Justice News Release, *Justice Department Highlights Ongoing Efforts to Protect the Public and Shut Down Fraudulent Tax Return Preparers and Promoters Nationwide* (Feb. 11, 2014) <http://www.justice.gov/opa/pr/2014/February/14-tax-145.html>.

⁴¹ See U.S. DOJ Tax Division Press Releases for 2001-2014, <http://www.justice.gov/tax/taxpress2001.htm>.

⁴² U.S. DOJ Press Release, *Tennessee Federal Court Bars the Owners of Mo' Money Taxes from Owning, Operating, Licensing or Franchising a Tax Return Preparation Business and Preparing Tax Returns for Others* (Sept. 18, 2013) <http://www.justice.gov/opa/pr/2013/September/13-tax-1042.html>; U.S. DOJ Press Release, *Federal Court in Ohio Shuts Down Nation's Fourth-Largest Tax-Preparation Firm and Bars CEO from Tax-Preparation Business* (Nov. 7, 2013) <http://www.justice.gov/opa/pr/2013/November/13-tax-1196.html>; U.S. DOJ Press Release, *U.S. Government Sues Jackson Hewitt Tax Preparation Franchises in Four States, Alleging Pervasive Fraud* (Apr. 3, 2007) <http://www.justice.gov/tax/txdv07215.htm>.

DOJ enforcement efforts against independent preparers include similar issues. In cases where courts shut down or imprisoned fraudulent preparers, the courts found examples of preparer misconduct that resulted in understated federal tax liabilities for consumers included:

1. Selling other people's identifying information to consumers to then be claimed as dependents on those consumers' tax returns;⁴³
2. Urging a consumer to lie to an IRS agent to forestall an IRS audit;⁴⁴
3. Creating wholly fictitious business income and expenses;⁴⁵
4. Claiming the First Time Home Buyer Credit for taxpayers who did not purchase homes;⁴⁶
5. Inflating deductions for legitimate businesses to claim losses for otherwise profitable enterprises;⁴⁷
6. Fabricating and inflating charitable deductions;⁴⁸ and
7. Claiming false and exaggerated education credits.⁴⁹

c. It is Too Easy to Be a Tax Return Preparer

Arguably, the lack of minimum standards for, and oversight of return preparers empowers individuals and business to become compensated tax return preparers with relative ease and minimal costs. NCLC highlights the issue of "fringe preparers":

*Fringe preparers include businesses that are historically associated with the exploitation of consumers, such as payday loan stores, check cashers, and used car dealers. Some retailers, such as jewelry and furniture stores, also act as fringe preparers. Many of these preparers encourage clients to use their tax refunds for large purchases.*⁵⁰

⁴³ U.S. Dep't of Justice News Release, *Former Georgia Tax Return Preparers Sentenced for Tax Fraud* (Aug. 9, 2013) <http://www.justice.gov/tax/2013/txdv13902.htm>.

⁴⁴ U.S. Dep't of Justice News Release, *Texas Tax Preparer is Permanently Barred from Tax Preparation for Allegedly Falsifying Returns for Overseas Customers and Impeding Audits* (Aug. 23, 2013) <http://www.justice.gov/tax/2013/txdv13955.htm>.

⁴⁵ U.S. Dep't of Justice News Release, *Former Washington D.C.-Area Accountant Sentenced to Prison for Tax Fraud* (Dec. 11, 2013) <http://www.justice.gov/tax/2013/txdv131309.htm>.

⁴⁶ U.S. Dep't of Justice News Release, *Federal Court Shuts Down Atlanta-Area Tax Preparer* (Dec. 11, 2013) <http://www.justice.gov/tax/2013/txdv131306.htm>.

⁴⁷ *Id.*

⁴⁸ U.S. Dep't of Justice News Release, *Federal Court Bars Kansas City, Mo., Man from Preparing Tax Returns for Others* (Sept. 26, 2013) <http://www.justice.gov/tax/2013/txdv131084.htm>.

⁴⁹ U.S. Dep't of Justice News Release, *Federal Court Permanently Bars Texas Tax Preparer from Preparing Tax Returns for Others* (Sept. 4, 2013) <http://www.justice.gov/tax/2013/txdv13990.htm>.

⁵⁰ Chi Chi Wu, National Consumer Law Center, *Riddled Returns: How Errors and Fraud by Paid Tax Preparers Put Consumers at Risk and What States Can Do*, at 4 (2014).

This lack of standards and oversight is in stark contrast to many other professions, including hairdressers. “In 46 states, there are more regulatory requirements for hairdressers than tax preparers.”⁵¹

Given that the filing of a tax return may be a consumer’s most significant financial transaction every year, a more relevant comparison may be other financial services providers. For example, stock brokers and certified public accountants are respectively subject to standards governed by the Securities and Exchange Commission or state boards of accountancy.

The complexity of federal, state, and local tax laws and regulations, as well as the sensitive financial information divulged to a tax return preparer, suggests that it would be reasonable for consumers utilizing compensated tax return preparation to expect those preparers to meet some minimum standard.

In addition to the lack of minimum standards and oversight, the wide-spread availability of relatively low-cost tax return preparation software allows any individual with a computer to become a compensated tax return preparer. For tax year 2011, of the 82,192,985 million returns filed by paid preparers, only 875,567 (or 1 percent) of those returns were filed on paper without using any software.⁵²

Most tax return preparation software uses plain-English interview questions and data entry to facilitate the preparation of a tax return. This may cultivate dependence by software users as it eliminates the need for tax return preparers to understand the tax law driving those interview questions. NCLC points out the fact that one software provider’s marketing strategy is to highlight that no tax experience is required to use their software.⁵³

Tax Max, a software provider that markets to car dealers, in response to the frequently asked question “I have no tax experience at all. Will I be able to participate in this program?” states:

*Yes. There is no experience required, and our web-based program was designed for use by someone who knows nothing about taxes. Also, our customer packets have a checklist inside to walk you through the whole process.*⁵⁴

Requiring some minimum standards for tax return preparers, such as testing and continuing education, may reduce the number of tax return preparers who are incompetent, or lack knowledge and expertise of the tax laws, including fringe preparers. In addition, the implementation of minimum standards could help alleviate the effect of dependence on software.

⁵¹ Wu, *supra* note 50, at 3 (citing Bureau of Labor Statistics, U.S. Dept. of Labor, *Occupational Outlook Handbook*, Barbers, Hairdressers, and Cosmetologists, <http://www.bls.gov/ooh/personal-care-and-service/barbers-hairdressers-and-cosmetologists.htm>) (last visited March 18, 2014).

⁵² I.R.S. Pub. 4822, *Taxpayer Filing Attribute Report*, http://www.irs.ustreas.gov/pub/irs-utl/Pub_4822_Sept_2013.pdf (Rev. Jan. 2013).

⁵³ Wu, *supra* note 50, at 5.

⁵⁴ Tax Max, Tax Refund Services, <https://www.taxmax.com/TRSTaxMax/FAQ.aspx> (last visited March 16, 2014).

d. Consumers Should Be Empowered to Identify Potentially Fraudulent Preparers before They Become Victims

The IRS's annual press release on the "Dirty Dozen" tax scams for 2014 includes return preparer fraud.⁵⁵ In a concurrent release, the IRS issues tips on "How to Choose a Tax Preparer."⁵⁶ The following language is an excerpt from a bullet point in the latter release titled "Check the preparer's history":

Check with the Better Business Bureau to see if the preparer has a questionable history. Check for disciplinary actions and for the status of their licenses. For enrolled agents, check with the IRS Office of Enrollment. (Enrolled agents are licensed by the IRS and are specifically trained in federal tax planning, preparation and representation.) For certified public accountants, check with the state board of accountancy. For attorneys, check with the state bar association.

While such third party resources can provide some comfort to consumers who utilize credentialed compensated tax return preparers, the tens of millions who use non-credentialed preparers are not afforded the same resources. Some consumers may not think to check with the Better Business Bureau, or if they do, they may not be able to obtain relevant information because many preparers listed are not rated, and businesses are not required to seek accreditation from the Better Business Bureau.

Requiring compensated return preparers to meet minimum standards and then educating consumers about such standards would empower consumers to become informed about their return preparer.

e. Consumers Who Use Volunteer Preparers Are Better Served & Protected

VITA preparers are subject to minimum standards in the form of annual training and testing. Each year, volunteer preparers must complete Volunteer Standards of Conduct, intake and interview awareness, and quality review training. Volunteer preparers must also pass an annual, four-hour competency examination with a score of 80 percent or higher. VITA provides its volunteers with optional education both in person and online through the third party vendor Link and Learn Taxes. This training contains problems and exercises as well as practice returns using tax software.⁵⁷ For a summary of requirements for VITA certification, see Appendix D.

Arguably, compensated tax return preparers should be subject to at least the same standards as VITA volunteers.

⁵⁵ I.R.S. News Release IR-2014-16 (Feb. 19, 2014), <http://www.irs.gov/uac/Newsroom/IRS-Releases-the-%E2%80%9CDirty-Dozen%E2%80%9D-Tax-Scams-for-2014;-Identity-Theft,-Phone-Scams-Lead-List>.

⁵⁶ I.R.S. News Release FS-2014-5 (Feb. 2014) <http://www.irs.gov/uac/Newsroom/IRS-Offers-Advice-on-How-to-Choose-a-Tax-Preparer>.

⁵⁷ I.R.S. Pub. 4012, *VITA/TCE Volunteer Resource Guide* (Rev. Oct. 2013); I.R.S. Pub. 4961, *Volunteer Standards of Conduct – Ethics Training* (Rev. Oct. 2013); VITA/TCE Central website, <https://www.linklearn certification.com>; I.R.S. Volunteer Training Resources, <http://www.irs.gov/Individuals/Volunteer-Training-Resources>.

f. Fifty State Strategy Could Be More Confusing and Burdensome for Consumers

At the state level, four states require minimum standards for and oversee compensated preparers: Oregon and California began oversight of paid preparers effective in the 1970s⁵⁸, and Maryland and New York began overseeing them more recently, in 2008⁵⁹ and 2010,⁶⁰ respectively.

While state standards and enforcement of those standards would better protect consumers in the absence of any standards, a state-focused strategy could create more confusion and burden. It is unclear whether and how a consumer would be aware of a preparer's state certification if he or she moves between states or lives and works in different states with different standards. For example, a consumer who lives in New Jersey but works in New York City may need to file both New Jersey and New York returns. If the consumer chooses a return preparer in New Jersey, he or she may not be aware that the preparer may need to meet New York standards in order to prepare the consumer's New York return.

In addition, it is unclear whether states with no income tax would require standards for federal income tax returns. Currently, the IRS lists nine states as having no income tax.⁶¹ Interestingly, Florida, one of those nine, is one of the largest sources of fraudulent returns.⁶²

V. Stakeholder Support for Additional Standards and Oversight

The President's budget for fiscal year 2015 includes a legislative proposal to provide Treasury with the authority to set minimum standards for return preparers.⁶³ In addition, there has been longstanding support for such standards and oversight of paid preparers from various stakeholders including consumer advocates, the National Taxpayer Advocate, Members of Congress, and even consumers themselves. Many of these stakeholders participated in the IRS's Return Preparer Review conducted in 2009.

⁵⁸ Government Accountability Office, GAO-08-781, *Oregon's Regulatory Regime May Lead to Improved Federal Tax Return Accuracy and Provides for a Possible Model for National Regulation*, at 9 (2008); *Cal. SB 229* (Figueroa, Stats. 2005, Ch. 658) (In 1997, the State legislature transferred responsibility for registering individuals as tax preparers, certifying the education of tax preparers, approving tax schools, and educating California taxpayers on the selection of tax professionals from the California Department of Consumer Affairs to The California Tax Education Council, a non-profit corporation).

⁵⁹ Md. Individual Tax Preparers Act, 2008 MD S 817, ch. 623, § 3.

⁶⁰ N.Y. L. 2009, c. 59, Part VV, § 2 (as amended by L. 2009, c. 503, Part F, § 1; L. 2010, c. 242, § 1; L. 2012, c. 488, § 1).

⁶¹ I.R.S. States Without a State Income Tax, <http://www.irs.gov/uac/States-Without-a-State-Income-Tax> (last visited Apr. 4, 2014).

⁶² U.S. Dep't of Justice News Release, *25 Defendants Charged in Separate Schemes that Resulted in Thousands of Identities Stolen and Millions of Dollars in Identity Theft Tax Filings* (April 3, 2014) <http://www.justice.gov/usao/fls/PressReleases/140403-01.html>.

⁶³ Office of Mgmt. and Budget, Fiscal Year 2015 Budget of the U.S. Gov't, at 193 (2014) <http://www.whitehouse.gov/sites/default/files/omb/budget/fy2015/assets/budget.pdf>.

a. Support from Consumer Advocates

National Taxpayer Advocate, Nina Olson, has been advocating for oversight and minimum standards of paid preparers as a consumer protection measure since 2002, claiming that return preparer fraud “creates significant challenges for the IRS, harms innocent taxpayers, and undermines trust in our tax system.”⁶⁴ According to Olson, minimum standards and oversight would reduce preparer-facilitated noncompliance because it would ensure preparers are, “competent, visible, and accountable.”⁶⁵

The National Consumer Law Center (NCLC) also supports oversight and minimum standards for preparers and has proposed a Model Act for states to adopt.⁶⁶ Key components of the Model Act include:

- Minimum formal education requirement of a high school diploma or equivalent;
- Registration with the designated state agency unless exempt;
- Completing 60 hours of entry-level education;
- Passing a basic competency examination;
- 15 hours of continuing education per year; and
- A background check.

The Model Act also would require preparers to provide a standardized disclosure of fees to improve transparency with tax preparation fees.

b. Congressional Support

Members of Congress have introduced numerous bills, one as recently as 2013, to give the IRS express authority to oversee and require minimum standards for tax return preparers. See Appendix E for a summary of these bills.

Former New Mexico Senator Jeff Bingaman’s introductory remarks for the Taxpayer Protection and Assistance Act of 2005 sheds light on his opinion of minimum standards for and oversight of preparers:

*For those taxpayers who use a paid tax practitioner, compliance with the tax laws hinges on the practitioners competence and ethical standards. The IRS’s lack of oversight over such practitioners therefore contributes to noncompliance. Further, improving the accuracy of tax returns at the front end of the process should reduce government burden and intrusion on taxpayers through enforcement.*⁶⁷

⁶⁴ National Taxpayer Advocate, 2002 Annual Report to Congress, at 216-230; NTA 2013 Annual Report, *supra* note 6, at 61-74, 94.

⁶⁵ NTA 2013 Annual Report, *supra* note 6, at 61.

⁶⁶ Wu, *supra* note 50, at 20.

⁶⁷ 109 Cong. Rec. S.4102 (2005) (statement of Sen. Bingaman for S. 832, later incorporated into S. 1321).

More recently, the Senate Committee on Finance Staff expressed support for providing the IRS with clear statutory authority to oversee compensated tax return preparers. Providing such authority was included as a tool to reduce the tax gap in one of the Staff's tax reform discussion drafts.⁶⁸

c. Consumer Support

The IRS Oversight Board released the 2013 Taxpayer Attitude Survey on February 18, 2014. The survey of 1,000 male and female U.S. adults indicated that 96 percent of all taxpayers believe it is either very or somewhat important that preparers be required to meet minimum standards, including 80 percent which said it was very important.⁶⁹

In addition, The Tax Institute at H&R Block worked with ORC International to field a national survey to gauge consumer awareness and attitudes on tax fraud. An overwhelming majority of respondents, over 86 percent, expressed support for requiring tax return preparers to meet minimum standards.⁷⁰

d. Internal Revenue Service Return Preparer Review

IRS included in its strategic plan for years 2009 through 2013 the objective of "[ensuring] that all tax practitioners, tax preparers, and other third parties in the tax system adhere to professional standards and follow the law."⁷¹ To achieve this objective, IRS launched a comprehensive six-month study of the paid tax return preparer industry.⁷² The IRS issued a report on its findings: Pub. 4832, *Return Preparer Review* (Review).

In conducting the Review, the IRS sought input from internal and external stakeholders through three public forums, written comments, and meetings with advisory groups.⁷³ As the Review indicates, there was overwhelming support for minimum standards for and oversight of preparers, and the proposals in the Review were the basis of the Registered Tax Return Preparer (RTRP) program.⁷⁴

⁶⁸ Staff of Senate Comm. on Fin., 113th Cong., *Simplifying the Tax System for Families and Businesses*, at 3 (Mar. 21, 2013).

<http://www.finance.senate.gov/imo/media/doc/032113%20Tax%20Administration%20Options%20Paper%20for%20Member%20Meeting%20.pdf>.

⁶⁹ I.R.S. Oversight Board, *2013 Taxpayer Attitude Survey*, Figure 12, at 10 (Feb. 18, 2014).

⁷⁰ The Tax Institute at H&R Block, *Consumer Tax Fraud: Sources & Solutions*, at 4 (2014).

⁷¹ I.R.S. Pub. 3744, *2009-2013 I.R.S. Strategic Plan*, at 23-24 (Rev. Apr. 2009), <http://www.irs.gov/pub/irs-pdf/p3744.pdf>.

⁷² I.R.S. Pub. 4832, *Return Preparer Review*, at 32 (2009) <http://www.irs.gov/pub/irs-pdf/p4832.pdf> [hereinafter *Return Preparer Review*].

⁷³ *Return Preparer Review*, *supra* note 72, at 25-26.

⁷⁴ See *Id.* Review participants that supported a framework of minimum standards and oversight included the U.S. Government Accountability Office (GAO), Treasury Inspector General for Tax Administration (TIGTA), National Association of Enrolled Agents (NAEA), American Institute of Certified Public Accountants (AICPA), American Bar Association (ABA), National Society of Accountants (NSA), National Association of Tax Professionals (NATP), National Community Tax Coalition (NCTC), Center on Budget and Policy Priorities (CBPP), American Association of Retired Persons (AARP), Consumer Federation of America (CFA), Community Tax Law Project (CTLP), Oregon State

VI. Elements of Federal Legislation

H&R Block supports legislation that would set minimum standards for compensated tax return preparers. Such legislation should incorporate the standards contemplated by the IRS in its RTRP program, including codifying the registration requirement, as well as provisions to minimize burden on return preparers.

The core components of the proposal include:

- Registration;
- Testing with reasonable exceptions for experienced professionals;
- Continuing education;
- Background screening;
- Limiting fees charged to preparers to implement the program (limited to IRS's costs for administering annual registration and examination);
- Certification of non-Treasury programs;
- Nonmonetary penalties for noncompliance; and
- Annual reports to Congress.

a. Registration

Being able to identify compensated return preparers is the first—and critical—step in combating incorrect and fraudulent returns. Registration should increase visibility and provide data on return preparers. In its 2009 Return Preparer Review, the IRS indicated that it did not know the precise number of tax return preparers. However, it estimated that there were between 900,000 and 1.2 million compensated tax return preparers.⁷⁵ For tax season 2014, the actual number is closer to 670,000.⁷⁶

Although the U.S. Court of Appeals for the District of Columbia affirmed the IRS's ability to maintain the PTIN component of the RTRP program,⁷⁷ codifying the requirement will protect against future challenges. For example, in addition to the injunction requested in the *Loving* case, another preparer challenged the PTIN requirement and associated user fee.⁷⁸

It is important to note that registration alone will not lead to better service or protections for consumers. Examination, continuing education and background screenings must also accompany registration. However, more stringent enforcement actions may be necessary to address ghost preparers as they are not likely to register.

Board of Tax Practitioners, California Franchise Tax Board, California Tax Education Council (CTEC), Comptroller of Maryland Revenue Administration Division, and New York Department of Taxation and Finance.

⁷⁵ *Return Preparer Review*, *supra* note 72, at 1.

⁷⁶ I.R.S., Return Preparer Office Federal Tax Return Statistics, <http://www.irs.gov/Tax-Professionals/Return-Preparer-Office-Federal-Tax-Return-Preparer-Statistics> (last visited March 18, 2014).

⁷⁷ *Loving v. IRS*, 920 F. Supp. 2d 108 (D.D.C. Feb. 1, 2013).

⁷⁸ *Brannen v. U.S.*, 682 F. 3d 1316 (11th Cir. 2012) (holding that the regulation imposing a user fee to obtain a PTIN was correctly established in accordance with I.R.C. § 9701).

Most, if not all, consumer tax return preparation software for self-preparers contains restrictions on the use of its software in its End User Licensing Agreement (EULA). Because software companies' data and statistics would likely identify ghost preparers more quickly and efficiently than the IRS, the IRS should study ways in which they might be able to partner with software companies to identify ghost preparers.

b. Examination

An entry-level examination is a hallmark of many standard-setting organizations and government programs and should be a reasonable requirement for compensated tax return preparers. Under the IRS's RTRP program, the number of testing sites available to return preparers was extremely limited, and the fee to take the examination was \$116.

This limited availability of test administration sites imposed a significant burden on some preparers. For example, one H&R Block franchisee located on a Hawaiian island incurred costs in excess of \$21,000 in travel costs and examination fees to fly his 51 tax return preparers to the main island since a testing site was not available on the island where the office was situated (an average of over \$400 per preparer to take the examination, not including PTIN registration and continuing education fees).

To minimize burden and maximize the number of compensated return preparers available to consumers, an online testing option should be made available. In addition, in order to maximize testing accessibility, Treasury should also consider designating existing third party testing service providers and their examinations. This should include allowing compensated preparers to access the VITA Basic certification examination, for a fee, online through third-party vendor Link and Learn, as well as on paper at participating VITA sites.

Since third party providers would not be government contractors, utilizing such providers for examinations program should not be subject to government procurement rules or budgetary constraints. Rather, designation of existing tax testing service providers and their examinations would be similar to procedures that were developed for certifying continuing education providers under the RTRP program.

The IRS's RTRP examination was a multiple choice test. It is worth noting that a multiple choice test may not be an effective method to test competence. Instead, a test that requires completion of a tax return based on scenarios that include mock information returns and other documents may identify gaps in knowledge or competence more accurately.

Any new examination requirement, regardless of method, would mean thousands of competent and experienced tax return preparers would be subject to examination fees and possibly expenses for traveling to a testing site. To incentivize these preparers to remain preparers and to ensure consumers are afforded as many options as possible, Treasury should "grandfather" or provide reasonable exceptions to the examination for competent and experienced preparers.

In addition, the thousands of preparers who passed the examination the IRS implemented as part of its RTRP program should be exempt from any new examination requirements.

c. Continuing Tax Education

Continuing education is a critical component of any framework of minimum standards for tax return preparers, as registration and examination procedures in of themselves may not reduce the error rate by incompetent or negligent preparers or deter fraudulent return preparers. Given the complexity of and frequent changes made to the Internal Revenue Code as well as the rules and regulations governing tax law, continuing education requirements could encourage preparers to remain current on and expand their knowledge of tax laws.

Continuing education requirements would also serve as a vehicle for educating preparers on properly claiming credits and deductions. This could help ensure that consumers receive all credits and deductions to which they are entitled while also reducing the amount of credits and deductions improperly claimed. Specifically, continuing education could be used to educate preparers on EITC requirements in order to reduce improper EITC claims resulting from complexity.

To that end, it should be reasonable to require a minimum continuing education curriculum of no less than 15 hours including a minimum of two hours of instruction on professional ethics and IRS procedures as well as at least three hours on federal tax law updates. Unlike testing services, there are hundreds of continuing education providers, including the National Association of Enrolled Agents (NAEA), American Institute of Certified Public Accountants (AICPA), and National Association of Tax Professionals (NATP).⁷⁹ Access to VITA's Link & Learn program, for a fee, should also be an option.

d. Background Screening

Another challenge with IRS's implementation of the RTRP program was its implementation of a background screening process. Under the RTRP program, a preparer was to be subject to digital fingerprinting to facilitate a background check of the preparer.

However, the results of the background check would not have been shared with the registrant or the registrant's employer. In addition, employers of paid preparers were not permitted to supply a background check in lieu of this requirement, nor were they able to use a single, certifiable source to provide background checks for both parties. This caused unnecessary burden and costs to those employers of compensated return preparers who had their own background screening procedures.

In order to minimize burden and reduce costs to return preparers, Treasury should adhere to a uniform set of guidelines, such as those prescribed by the National Association of Professional Background Screeners (NAPBS). In addition, similar to certifying third party examination and continuing education providers, Treasury should certify the background screening procedures used by employers of return preparers as long as they are consistent with NAPBS standards.

⁷⁹ I.R.S., Approved Continuing Education Providers, <https://ssl.kinsail.com/partners/irs/publicListing.asp#> (last visited Mar. 18, 2014).

e. Limitation on Fees

Under the IRS's RTRP program, the IRS incurred significant—and unnecessary—costs to implement and administer both the registration system and examination. These costs were passed on to return preparers who were charged both registration and examination fees.

While it is reasonable for return preparers to bear some of the costs of registration and examination as is common with other professional certifications, high costs may discourage individuals and businesses from being tax return preparers and discourage, not promote, compliance with the standards. Charges for compensated tax return preparers should be limited to the costs of administering and implementing a registration and examination system.

f. Certification of Non-Treasury Programs

Registration, examination, and continuing education costs should be viewed holistically with the understanding that compensated tax return preparers are likely to pass these costs along to their clients as part of their tax preparation fees. As discussed above, certifying third party service providers, particularly for examination and background screening services, should reduce the government's costs for implementing standards and oversight of return preparers. Additionally, such certification should also reduce return preparer costs which would minimize additional costs to consumers.

g. Enforcement & Oversight: Penalties for Noncompliance

If the chief objective of setting minimum standards for compensated tax return preparers is to better serve and protect consumers, some enforcement of those standards and oversight is required. Without it, consumers may incorrectly assume that the preparer they have chosen is in compliance. A lack of enforcement may also lead compliant preparers to lose confidence in the system, thus decreasing the incentive to comply. These concerns were also presented by most commenters during the IRS Return Preparer Review process.⁸⁰

Suspension of eligibility to prepare tax returns is consistent with IRS's current sanctions for EROs. As with current ERO rules, such suspension ultimately harms the consumer if the consumer does not become aware of such suspension until after a return is attempted to be filed with the IRS but rejected due to suspension of the preparer.

The IRS proposed "to recommend that period of limitations under section 6696(d) for assessing a penalty under sections 6694(a), 6695 and 6695A be extended."⁸¹ However, the IRS did not recommend any new penalties or an increase in penalty amounts until it had an opportunity to study whether additional penalties were needed.⁸² Since it does not seem that the IRS had sufficient opportunity to study this, proposed legislation should not include any new monetary penalties or increases to existing penalties.

⁸⁰ *Return Preparer Review*, *supra* note 72, at 37.

⁸¹ *Return Preparer Review*, *supra* note 72, at 38.

⁸² *Id.*

h. Annual Report to Congress

In order to monitor the effectiveness of these provisions in reducing errors, improving accuracy and combating fraud, it is important that appropriate metrics for success are determined and shared with Congress and the general public. This provision requires GAO to assist the IRS in determining those metrics and issuing an annual report to publish results.

As discussed above, one of the major flaws of past mystery shopping and investigative audits of return preparers is that sample sizes were not always statistically valid. In addition, some studies only included chain preparers. Metrics for review of implementation and enforcement of these standards should provide for statistically valid samples of both chain and independent tax return preparers as well as volunteer preparers and credentialed versus non-credentialed preparers, including those subject to state standards.

As a result, the annual report should contain the results of an annual, statistically valid review of all return preparers, both compensated and volunteer. It should also contain the results of annual IRS preparer education and enforcement efforts.

Finally, the report should contain data on taxpayer migration between paid return preparation and self-preparation. In the past, the IRS published this information in its *Taxpayer Attribute Report*. However, it appears due to budget cuts the IRS will no longer be publishing this report.

VII. Non-Legislative Recommendations

a. Implement Voluntary Standards Until Legislation Is Enacted

In her 2013 annual report to Congress, the National Taxpayer Advocate proposed a voluntary examination and continuing education certificate for non-credentialed⁸³ preparers as part of a six-part strategy to protect consumers.⁸⁴ In order to incentivize voluntary compliance, non-credentialed preparers would then be prohibited from representing taxpayers in audits of returns they prepared if they did not meet the voluntary examination and continuing education requirements and from being named as a Third Party Designee on the Form 1040.⁸⁵

In addition, the NTA recommends that IRS “mount a consumer protection campaign to educate taxpayers about the need to select competent preparers who can demonstrate competency” and “develop a research-driven, Servicewide preparer compliance strategy.”⁸⁶

In the wake of the recent court decision enjoining the IRS from implementing the RTRP program, IRS Commissioner, John Koskinen, has voiced support for a voluntary certification program.⁸⁷

⁸³ While the National Taxpayer Advocate uses the term “unenrolled,” the term “non-credentialed” is used here to be consistent with Return Preparer Office Federal Tax Return Statistics, *supra* note 76.

⁸⁴ NTA 2013 Annual Report, *supra* note 6, at 62.

⁸⁵ *Id.*

⁸⁶ NTA 2013 Annual Report, *supra* note 6, at 62.

A voluntary program could be quickly implemented. The PTIN registration program is now well established. As part of its RTRP program, the IRS planned “to introduce a searchable database of tax return preparers who have met the required standards on its website after the initial registration and examination period have been completed.”⁸⁸ The IRS should maintain such a database for those preparers it designates as having met the voluntary standards and ensure easy access to the public. However, IRS should take necessary precautions to protect the privacy of the tax return preparers listed in the database.

The key components left to implement would be the examination, continuing education and background screening procedures. As argued above, because the IRS already certifies third party continuing education providers, it should be able to certify third party testing and background screening providers without the significant additional costs of developing and implementing its own testing and background screening procedures. In addition, a low cost alternative for the examination as well as continuing education would be to allow compensated preparers to take the VITA Basic certification examination for a fee through Link and Learn Taxes online or at VITA sites that offer examinations.

The success of a voluntary program will hinge on IRS’s education and outreach efforts to consumers. The IRS currently conducts limited direct-to-consumer outreach through its annual “Dirty Dozen” and “How to Select a Return Preparer” press releases. Should a voluntary program be implemented, however, IRS should conduct, “the extensive public awareness campaign,” that it originally contemplated would, “utilize a full range of social media, public service announcements and paid advertising, if authorized, to provide taxpayers with information on what standards the IRS requires of tax return preparers and how they can determine whether their tax return preparer has met these standards.”⁸⁹

b. Conduct Education & Outreach to Return Preparers

As discussed above, the current range of tools in IRS’s toolbox is very limited, with tax code penalties being limited to those situations where preparer error resulted in a consumer understating his or her tax liability by understating income or overstating deductions or credits. However, many of the errors identified by GAO, TIGTA, and consumer advocate groups related to mistakes and omissions that may have been favorable to the taxpayer (and unfavorable to the IRS).⁹⁰

The current tax reform debate includes discussions on using the tax code to improve income mobility or reduce income inequality.⁹¹ There is general consensus that certain tax deductions and credits do just that, especially the EITC.

⁸⁷ Greater Washington Society of CPAs, *IRS’s New Commissioner Favors Voluntary Tax Preparer Certification* (Jan. 6, 2014) http://www.gwscpa.org/news/313-irss_new_commissioner_favors_voluntary_tax_preparer_certification.

⁸⁸ *Return Preparer Review*, *supra* note 72, at 41.

⁸⁹ *Return Preparer Review*, *supra* note 72, at 41.

⁹⁰ See reports listed in Appendix C.

⁹¹ See *A Progress Report on the War on Poverty: Expanding Economic Opportunity*. Hearing Before the H. Comm. on the Budget, 113th Cong. (Jan. 28, 2014).

However, while there are proposals to expand or restructure the EITC, there does not appear to be much attention paid to the fact that the EITC is not claimed by all of those who are eligible to claim it. The same is likely true for other deductions and credits.

While it is possible—and likely—that some individuals may affirmatively choose not to claim certain deductions or credits, the mystery shopping visits indicate that errors and omissions may occur due to incompetence, lack of preparer knowledge or fraud. The IRS already has implemented a rigorous education and outreach campaign for compensated tax return preparers focused on improper claims of refundable credits, particularly the EITC and the American Opportunity Tax Credit.

In order to reduce errors and omissions, particularly those favorable to consumers, IRS should conduct an education and outreach campaign similar to the one implemented for refundable credits.

c. Convene Working Group to Determine Standards for Tax Return Preparation Software

When the IRS launched its Return Preparer Review in 2009, it reported that, “for 2007 and 2008, over 80 percent of all federal income tax returns were prepared by paid tax return preparers or by taxpayers using consumer tax preparation software.”⁹² Recent IRS data, provided in Figure 2 below, indicates that figure is now closer to 94 percent.

Figure 2. IRS Data Showing Tax Year 2011 Taxpayer Filing Trends⁹³

	Paid Preparer	Self-Prepared	Total	
e-filed	74,992,044	43,827,647	118,819,691	84.00%
v-coded	6,325,374	7,575,052	13,900,426	9.83%
paper not v-coded	875,567	7,854,232	8,729,799	6.17%
			141,449,916	

For the 2009 filing season, consumers self-prepared and *e-filed* 32 million returns using consumer tax preparation software and compensated return preparers used commercial tax preparation software to prepare and *e-file* 61.8 million returns.⁹⁴ For tax season 2013, those numbers are 45,247,000 and 77,268,000 respectively.⁹⁵

⁹² *Return Preparer Review*, *supra* note 72, at 1.

⁹³ I.R.S., Pub. 4822, *Taxpayer Attribute Report*, http://www.irs.ustreas.gov/pub/irs-utl/Pub_4822_Sept_2013.pdf (Rev. Jan. 2013).

⁹⁴ *Return Preparer Review*, *supra* note 72, at 9.

⁹⁵ I.R.S., 2014 and Prior Year Filing Season Statistics, <http://www.irs.gov/uac/2014-and-Prior-Year-Filing-Season-Statistics> (follow “12/27/13” hyperlink).

As discussed above, mistakes and omissions that could be considered to have been caused by human error or misrepresentation or misunderstanding of the tax laws may be due in part to advances in tax preparation software. Recognizing the need, “to assess the risks of a high level dependence on consumer and commercial tax preparation software,” the IRS indicated that it planned to form a task force to “explore the possibility of establishing industry standards.”⁹⁶ The task force was supposed to, “seek the input of industry representatives, state governments, and other impacted stakeholders.”⁹⁷

Given the high rate of use of software both by consumers who self-prepare and file their own returns and by compensated tax return preparation, establishing standards for tax return preparation software seems imperative. Convening a task force or working group should be the first step and this should be done without any further delay.

⁹⁶ *Return Preparer Review*, *supra* note 72, at 39.

⁹⁷ *Id.*

Appendix A
H&R Block Standards and Certification⁹⁸

To become an H&R Block tax professional, graduation from high school or an equivalent degree is required in Delaware, Maryland, New Jersey, Ohio and Texas. If a tax professional is under 18, the signature of a parent or guardian is required.

H&R Block tax professionals are required to have a valid Federal Preparer Tax Identification Number (PTIN).

H&R Block tax professionals are required to complete a minimum of 15 hours of continuing education courses, plus any additional hours required under state law.⁹⁹ The minimum continuing education required consists of:

- 10 hours on federal tax law,
- 3 hours on federal tax law updates, and
- 2 hours on ethics.

Continuing education courses may be taken through any IRS-approved CE provider or through the H&R Block Tax Training School (TTS). H&R Block Tax Professionals may take as many TTS courses as desired during the remainder of the year for an annual enrollment fee of \$20. To earn continuing education credit, tax professionals must complete the course, take the course examination, and obtain a minimum score of 80 percent.

First-Year Tax Professionals

To be hired as an H&R Block tax professional, individuals must pass either entry-level education or entry-level testing. First-year tax professionals must complete 35 hours of paid skills training once hired.

Entry Level Education

In most states, new preparers must complete a 75-hour Income Tax Course (ITC).¹⁰⁰ The ITC includes a blend of 42 hours of instructor-led classroom sessions, 21 hours of web-based training, and 12 hours of software practice designed to teach tax professionals the technical knowledge and ethical standards to prepare income tax returns. The course is designed to teach tax theory and law, how to conduct a thorough client interview, how to offer tax advice and explanations to clients, and preparation of tax returns using software.

⁹⁸ As independent business owners, H&R Block franchisees may require their return preparers to meet different standards.

⁹⁹ California tax professionals must complete an additional five hours of continuing education courses on California tax law. Oregon tax professionals must complete at least 30 hours of continuing education each year. Maryland tax professionals must complete at least 16 hours of continuing education every two years, including at least 4 hours of Maryland tax-related subjects.

¹⁰⁰ In Oregon and California, the ITC consists of 81 and 87.5 hours of instruction, respectively.

Participants may not miss or fail to complete more than eight hours of any instructor-led or practice sessions. Participants must complete all of the 21 hours of required web-based training.

Course fees vary based upon location and range from \$199 to \$299. In most cases, course fees include books and materials; however in some states the cost of books and materials is separate.

ITC participants must pass the course with a cumulative minimum score of 70 percent and score 70 percent or above on the final ITC examination to successfully complete the course. A participant's cumulative score is determined by the following in addition to the final examination:

- Four open-book, multiple choice quizzes where the user works through a tax return problem using software to arrive at the correct answer,
- Three graded reviews of practice returns completed on paper, and
- An open-book, cumulative midterm examination including a practice tax return completed on paper.

The midterm and final examinations are weighted. The comprehensive, open-book final examination consists of 20 multiple-choice questions and requires the participant to complete a tax return using H&R Block software based on a set of facts and tax documents. The return involves, among other topics, dependency rules, self-employment income, adjustments, credits, rental real estate, various investment transactions, and itemized deductions. The midterm and final examinations

ITC participants must complete three additional hours of continuing education courses on federal tax law updates after completing the course but are not required to complete additional ethics and federal tax law continuing education, which are covered in the ITC.

Entry Level Testing

In lieu of the ITC, experienced tax return preparers may pass H&R Block's Tax Knowledge Assessment (TKA) with a score of 80 percent or higher. The TKA is a 90 minute, open book examination consisting of 50 multiple choice questions. Preparers are limited to three attempts to achieve a passing score. There is no fee required to take the TKA.

The TKA includes questions on the following topics:

- Filing requirements
- Filing status
- Itemized deductions
- Credits and Earned Income Tax Credit
- Military Returns

Tax professionals that pass the TKA must complete the minimum 15 continuing education hours described above. Tax professionals that pass the TKA must also successfully complete the Introduction to Tax Preparation course which covers the software application and tax interview skills. The Introduction to Tax Preparation course is paid training available only to individuals who have passed the TKA.

Prior-Year Tax Professionals

Tax professionals that worked for H&R Block in a previous year, or prior-year tax professionals, are required to complete 15 hours of continuing education courses, plus any additional hours required under state law. Course fees for continuing education total \$20.

Prior-year tax professionals are required to take at a minimum, the following amounts of continuing education:

- 10 hours on federal tax law,
- 3 hours on federal tax law updates, and
- 2 hours on ethics.

Prior-year tax professionals must complete 20 hours of paid skills training each year.

Certification

H&R Block strongly encourages its tax professionals to exceed minimum standards by offering a Certification Advancement Program and a Specialty Certification Program. H&R Block offers courses at no additional fee designed to teach the knowledge and skills needed to pass each certification examinations and specialty certification examination.

Certification Advancement Program

The Certification Advancement Program is designed to increase a tax professional's tax expertise. Franchise associates must pass either the ITC or TKA to be eligible to participate in the Certification Advancement Program. H&R Block offers 14 certification levels:

- Tax Associate
- Tax Specialist I-III
- Tax Advisor I-IV
- Senior Tax Advisor I-V
- Master Tax Advisor

The first certification level, Tax Associate, is obtained by meeting the minimum standards described above. Tax professionals may achieve higher certification levels by passing an examination at the succeeding certification level. Tax professionals may not skip certification levels. The highest certification level, Master Tax Advisor, requires the individual to be certified under Circular 230 as an enrolled agent.

Certification level examinations consist of 50 multiple choice questions that include completion of relevant forms and schedules using tax preparation software. The examinations are open book and open resources. There is no time limit on the examinations, but must be administered in a tax office or training center.

Specialty Certification Program

The Specialty Certification Program is designed to enhance a tax professional's tax knowledge in a specific area of expertise. Before an individual is classified as a specialist, he or she must pass an assessment demonstrating his or her tax theory knowledge and software application skills around the topic.

Specialty certifications are valid for three years from the date the examination is passed and are available in the following areas of expertise:

- Small Business
- Retirements
- Military
- Investment

Circular 230 Professionals

Circular 230 Professionals, including Enrolled Agents, certified public accountants, and attorneys, have specific requirements under their licensing authority. Maintaining a current license requires these professionals to meet the continuing education requirements and all other requirements of the licensing authority. Circular 230 Professionals exempt from the H&R Block annual enrollment fee, but must submit proof of their professional designation (a copy of the license and proof of payment) to H&R Block's Operations Center of Excellence.

Appendix B
Paid Preparer Penalties in the Internal Revenue Code

Code §	Description	Penalty	Abatement/Exception
6694(a)	Understatement of tax liability due to unreasonable position. Position not disclosed or no reasonable basis for position.	Greater of \$1,000 or 50 percent of the income derived (or to be derived) by the tax return preparer.	Reasonable cause and preparer acted in good faith.
6694(b)	Willful or reckless conduct, understatement of taxpayer's tax liability.	Greater of \$5,000 or 50 percent of the income derived (or to be derived) by the tax return preparer.	Penalty is reduced to extent a penalty is paid under § 6694(a).
6695(a)	Failure to furnish a completed copy of a return or claim to the taxpayer. (IRC § 6107(a))	\$50 per failure, not to exceed \$25,000 per calendar year.	Reasonable cause. No willful neglect.
6695(b)	Failure to sign return.	\$50 per failure, not to exceed \$25,000 per calendar year.	Reasonable cause. No willful neglect.
6695(c)	Failure to comply with requirement to furnish identifying number as outlined in § 6109(a)(4)) (4) Furnishing identifying number of tax return preparer Any return or claim for refund prepared by a tax return preparer shall bear such identifying number for securing proper identification of such preparer, his employer, or both, as may be prescribed. For purposes of this paragraph, the terms "return" and "claim for refund" have the respective meanings given to such terms by section 6696(e).	\$50 per failure, not to exceed \$25,000 per calendar year.	Reasonable cause. No willful neglect.
6695(d)	Failure to retain a copy of the tax return. (IRC § 6107(b))	\$50 per failure, not to exceed \$25,000 per calendar year.	Reasonable cause. No willful neglect.
6695(e)	Failure to file correct information returns. (IRC § 6060)	\$50 per failure, not to exceed \$25,000 per calendar year.	Reasonable cause. No willful neglect.
6695(f)	Negotiation of check.	\$500 per check.	Deposit of check into account held for benefit of the taxpayer.
6695(g)	Failure to be diligent in determining eligibility for Earned Income Tax Credit (EITC).	\$500 per failure.	Considering all the facts and circumstances, the preparer's normal office procedures are reasonably designed and

			routinely followed to ensure compliance and the failure was isolated and inadvertent.
6696(d)	Periods of limitation	Provides a 3 year statute of limitations from date of filing for penalties under §§ 6694(a) and 6695 Provides that there is no statute of limitations for a penalty under § 6694(b)	
6700	Promoting a tax shelter.	Lesser of \$1,000 or 100 percent of the gross income derived (or to be derived) from the activity. 50% of gross income if related to a statement regarding allowability of a tax benefit that the preparer knows or has reason to know is false or fraudulent as to any material matter.	Reasonable basis and made in good faith.
6701	Aiding and abetting the understatement of tax liability.	\$1,000 (\$10,000 for corporate returns or documents).	Burden of proof is on the IRS.
6713	Improper disclosure or use of information furnished for or in connection with tax prep.	\$250 per disclosure or use, not to exceed \$10,000 in any calendar year.	Same as exceptions for §7216.
7206	Fraud and false statements.	Misdemeanor—up to \$100,000 (\$500,000 for corporations), 3 years imprisonment, or both.	
7207	Fraudulent returns, statements, or other documents.	Misdemeanor—up to \$10,000 (\$50,000 for corporations), 1 year imprisonment, or both.	
7216	Improper disclosure or use of tax return information	Misdemeanor—up to \$1,000, 1 year imprisonment, or both.	Does not apply if disclosure is allowed under any other provision or pursuant to a court order.
7407	Action to enjoin tax return preparers.	Federal district court can enjoin individual from engaging in certain proscribed conduct, or in extreme cases, from acting as a tax return preparer.	
7408	Action to enjoin specified conduct related to tax shelters and reportable transactions.	Federal district court can enjoin individual from engaging in certain proscribed conduct.	

Appendix C
Mystery Shopping Reports

Government Accountability Office, GAO-06-563T, *Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors* (Apr. 4, 2006) <http://www.gao.gov/new.items/d06563t.pdf>

Treasury Inspector General for Tax Administration Ref. No. 2008-40-171, *Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors* (Sept. 3, 2008) <http://www.treasury.gov/tigta/auditreports/2008reports/200840171fr.pdf>

Chi Chi Wu, et al., National Consumer Law Center, Community Reinvestment Association of NC, and Community Legal Services of Philadelphia, *Tax Preparers Take a Bite Out of Refunds: Mystery Shopper Test Exposes Refund Anticipation Loan Abuses in Durham and Philadelphia* (Apr. 2008) http://www.nclc.org/images/pdf/high_cost_small_loans/ral/shopper_report.pdf

Chi Chi Wu, et al., National Consumer Law Center, Arkansans Against Abusive Payday Lending, New Economy Project (formerly NEDAP), Community Reinvestment Association of NC, *Tax Preparers Out of Compliance: Mystery Shopper Testing Exposes Violations of Refund Anticipation Loan Laws in Arkansas, New York and North Carolina* (Apr. 2010) http://www.nclc.org/images/pdf/high_cost_small_loans/ral/mystery_ral_report.pdf

Chi Chi Wu, et al., NCLC, New Economy Project (formerly NEDAP), Community Reinvestment Association of NC, *Tax Time 2011: Mystery Shopper Testing in New York and North Carolina Finds Continuing Problems with Tax Preparers* (Apr. 2011) <http://www.nclc.org/images/pdf/pr-reports/report-mystery-ral-shopper-2011.pdf>

First Nations Development Institute, *Tax Time Troubles: Mystery Shopper Testing Exposes Poor Quality Tax Preparation and Refund Anticipation Check Abuses* (May 4, 2011) <http://www.nmlegis.gov/lcs/handouts/IAC%20092412%20FNDI%20Taxtime%20Mystery%20Shopper.pdf>

First Nations Development Institute, *More Tax Time Troubles: Mystery Shopper Testing Exposes Refund Anticipation Loans in Reservation Border Towns* (2012) <http://www.nmlegis.gov/lcs/handouts/IAC%20092412%20FNDI%20Taxtime%20V3.pdf>

Treasury Inspector General for Tax Administration Ref. No. 2013-40-110, *Inconsistent Adherence to Quality Requirements Continues to Affect the Accuracy of Some Tax Returns Prepared at Volunteer Sites* (Sept. 16, 2013) <http://www.treasury.gov/tigta/auditreports/2013reports/201340110fr.pdf>

Appendix D
Volunteer Income Tax Assistance Minimum Standards

VITA, TCE, and LITC volunteers are specifically excluded from the definition of “tax return preparer” under Treasury Regulations § 301.7701-15(f)(ii-vii).

VITA/TCE Volunteer Requirements

- All volunteers must be 18 years old, but no prerequisite education is necessary
- All volunteers (whether paid or unpaid workers) must complete Volunteer Standards of Conduct (VSC) Training and pass the VSC test with a score of 80 percent or higher
- All Tax Return Preparers, Quality Reviewers, Instructors, and Site Coordinators must complete the Intake/Interview & Quality Review training
- Annual Certification Examination
 - Tax Return Preparers and Quality Reviewers must achieve an 80 percent score on the Basic or Advanced certification examination annually (see Table 1 below for Basic and Advanced certification competencies)
 - Basic Certification
 - 30-question, open book multiple choice test
 - Estimated completion time: 4 hours
 - Covers wage earner type returns
 - Includes EITC training
 - Advanced Certification
 - 40-question, open book multiple choice test
 - Estimated completion time: 4 hours
 - Includes the Basic topics, as well as pensions, self-employment, and other topics
 - Optional Certification Courses/Examinations
 - Health Savings Accounts – requires Basic certification
 - Military – requires Advanced certification
 - International – requires Advanced certification
 - Cancellation of Debt – requires Advanced certification
- Training
 - Not required to take certification examinations
 - All training may be taken in either a classroom setting or online through a third party vendor’s Link & Learn Taxes
 - Training includes comprehensive problems and practice exercises and an online practice lab to complete exercises, practice returns, and test scenarios using tax software
- Tax Preparers must have:
 - At least Basic Certification
 - A designated or peer-to-peer reviewer review 100 percent of the returns they prepare
- Quality Reviewers must have:
 - At least Basic Certification, or higher based on the complexity of the return
 - Three years tax preparation experience

Appendix E
U.S. Congressional Legislation

1. **Low Income Taxpayer Protection Act of 2001, S. 802**, 107th Cong.
Sponsor: Jeff Bingaman (D-NM)
Introduced and referred to Senate Finance Committee Apr. 30, 2001

Sec. 2. Regulation of Income Tax Return Preparers and Refund Anticipation Loan Providers
2. **Low Income Taxpayer Protection Act of 2003, S. 685**, 108th Cong.
Sponsor: Jeff Bingaman (D-NM)
Cosponsors: Daniel Akaka (D-HI)
Introduced and referred to Senate Finance Committee Mar. 21, 2003

Sec. 2. Regulation of Income Tax Return Preparers and Refund Anticipation Loan Providers
3. **Tax Administration Good Government Act, H.R. 1528**, 109th Cong.
Incorporating *Tax Administration Good Government Act*, S. 882
Sponsor: Rob Portman (R-OH)
Introduced and referred to Ways and Means Committee Apr. 1, 2003
Reported by Ways and Means Committee Apr. 3, 2003
Passed House June 19, 2003
Included into S.882 (no. 4 infra) May 19, 2004

Sec. 141. Regulation of Federal Income Tax Return Preparers and Refund Anticipation Loan Providers, and Payroll Agents
4. **Tax Administration Good Government Act, S. 882**, 108th Cong. (incorporated no. 3 above)
Sponsor: Max Baucus (D-MT)
Cosponsors: Charles "Chuck" Grassley (R-IA), Orrin Hatch (R-UT), Dianne Feinstein (D-CA), John "Jay" Rockefeller IV (D-WV), Gordon Smith (R-OR), John Breaux (D-LA)
Introduced and referred to Senate Finance Committee April 10, 2003
Reported by Senate Finance Committee Feb. 02, 2004
Incorporated H.R. 1528 (no. 3 supra) May 19, 2004
Passed Senate with changes May 19, 2004
Differences were never resolved

Sec. 141. Regulation of Federal Income Tax Return Preparers and Refund Anticipation Loan Providers, and Payroll Agents
5. **Low Income Taxpayer Protection Act of 2004, H.R. 3983**, 108th Cong. (re-introduction of no. 2 supra)
Sponsor: Xavier Becerra (D-CA 31st)
Cosponsors: Sherrod Brown (D-OH 13th), Jonas "Martin" Frost (D-TX 24th), James "Jim" McGovern (D-MA 3rd)
Introduced and referred to House Ways and Means Committee Mar. 17, 2004

Sec. 2. Regulation of Income Tax Return Preparers and Refund Anticipation Loan Providers

6. **Taxpayer Protection and Assistance Act of 2005**, S. 832, 109th Cong.
 Sponsor: Jeff Bingaman (D-NM)
 Cosponsors: Daniel Akaka (D-HI), Max Baucus (D-MT), Charles “Chuck” Grassley (R-IA), Mark Pryor (D-AR), Charles “Chuck” Schumer (D-NY), Gordon Smith (R-OR), James “Jim” Talent (R-MO), John Kerry (D-MA), Richard Durbin (D-IL), Joseph Lieberman (D-CT), Diane Feinstein (D-CA)
 Introduced and referred to Senate Finance Committee Apr. 18, 2005
 Included into S. 1321 (no. 7 infra) June 28, 2006

Sec. 4. Regulation of income tax return preparers

Sec. 5. Contract authority for examinations of preparers

7. **Telephone Excise Tax Repeal Act of 2005**, S. 1321, 109th Cong. (incorporated no. 6 supra)
 Sponsor: Rick Santorum (R-PA)
 Michael Crapo (R-ID), Charles “Chuck” Hagel (R-NE), Gordon Smith (R-OR), John Ensign (R-NV), George Allen (R-VA), Thomas Coburn (R-OK), John Thune (R-SD), Saxby Chambliss (R-GA), Wayne Allard (R-CO), Jefferson “Jeff” Sessions (R-AL), Thad Cochran (R-MS), John “Johnny” Isakson (R-GA), Larry Craig (R-ID), Orrin Hatch (R-UT), Samuel “Sam” Brownback (R-KS), James “Jim” Talent (R-MO), Jon Kyl (R-AZ)
 Introduced and referred to Senate Finance Committee June 28, 2005
 Reported by Senate Finance Committee June 28, 2006
 Senate Finance Committee report, Sept. 15, 2006

Sec. 203. Regulation of Federal tax return preparers

Sec. 204. Contract authority for examinations of preparers

8. **Taxpayer Protection and Assistance Act of 2007**, S. 1219, 110th Cong. (re-introduction of no. 6 supra)
 Sponsor: Jeff Bingaman (D-NM)
 Cosponsors: Daniel Akaka (D-HI), Richard Durbin (D-IL), John Kerry (D-MA), Joseph Lieberman (I-CT), Gordon Smith (R-OR), Charles “Chuck” Schumer (D-NY), Mark Pryor (D-AR)
 Introduced and referred to Senate Finance Committee Apr. 25, 2007

Sec. 4. Regulation of Federal Tax Return Preparers

Sec. 5. Contract authority for examination of preparers

9. **Taxpayer Bill of Rights Act of 2008**, H.R. 5716, 110th Cong.
 Sponsor: Xavier Becerra (D-CA 31st)
 Cosponsors: Lloyd Doggett (D-TX 25th), Bill Pascrell (D-NJ 8th), Fortney “Pete” Stark (D-CA 13th), Charles “Charlie” Gonzalez (D-TX 20th), John Lewis (D-GA 5th), John Conyers (D-MI 14th), Janice “Jan” Schakowsky (D-IL 9th), Mazie Hirono (D-HI 2nd), Eddie Johnson (D-TX 30th), Neil Abercrombie (D-HI 1st), Corrine Brown (D-FL 3rd), Jim McDermott (D-WA 7th)
 Introduced and referred to House Ways and Means Apr. 8, 2008

Sec. 4. Regulation of Federal Tax Return Preparers

Sec. 6. Preparer Penalties with respect to preparation of returns and other submissions

- 10. Taxpayer Bill of Rights Act of 2010, S. 3215 and H.R. 5047, 111th Cong.** (re-introduction of no. 9 supra)
- S. 3215 Sponsor: Jeff Bingaman (D-NM)
- S. 3215 Cosponsors: Daniel Akaka (D-HI), Sherrod Brown (D-OH), Christopher Dodd (D-CT), Richard Durbin (D-IL), John Kerry (D-MA), Joseph Lieberman (D-CT), Robert “Bob” Menéndez (D-NJ), Jeff Merkley (D-OR), Mark Pryor (D-AR), Charles “Chuck” Schumer (D-NY), Tom Udall (D-NM), Thomas Carper (D-DE)
- H.R. 5047 Sponsor: Xavier Becerra (D-CA 31st)
- S. 3215 introduced and referred to Senate Finance Committee Apr. 15, 2010
- H.R. 5047 introduced and referred to House Ways and Means Committee Apr. 15, 2010.

Sec. 202. Regulation of Federal income tax return preparers

Sec. 204. Preparer penalties with respect to preparation of returns and other submissions

- 11. Taxpayer Bill of Rights Act of 2012, S. 3355 and H.R. 6050, 112th Cong.** (re-introduction of no. 10 supra)
- S. 3355 Sponsor: Jeff Bingaman (D-NM)
- S. 3355 Cosponsors: Daniel Akaka (D-HI), Sherrod Brown (D-OH), Richard Durbin (D-IL), John Kerry (D-MA), Joseph Lieberman (D-CT), Robert “Bob” Menéndez (D-NJ), Mark Pryor (D-AR), Tom Udall (D-NM), Thomas Carper (D-DE)
- H.R. 6050 Sponsor: Xavier Becerra (D-CA 31st)
- H.R. 6050 Cosponsors: Timothy Bishop (D-NY 1st), Corrine Brown (D-FL 3rd), Bob Filner (D-CA 51st), Michael “Mike” Honda (D-CA 15), John Lewis (D-GA 5th), Jim McDermott (D-WA 7th), Eleanor Norton (D-DC 0), Charles “Charlie” Rangel (D-NY 15th), Fortney “Pete” Stark (D-CA 13th), Janice “Jan” Schakowsky (D-IL 9th)
- S. 3355 introduced and referred to Senate Finance Committee June 28, 2012
- H.R. 6050 introduced and referred to House Ways and Means Committee June 28, 2012

Sec. 202. Regulation of Federal income tax return preparers

Sec. 204. Preparer penalties with respect to preparation of returns and other submissions

- 12. Taxpayer Protection and Preparer Fraud Prevention Act of 2013, H.R. 1570, 113th Cong.**
- Sponsor: Cedric Richmond (D-LA 2nd)
- Introduced and referred to House Ways and Means Committee Apr. 15, 2013

Sec. 2. Regulation of tax return preparers

Sec. 3. Authority to impose a fee for licensing

Appendix F
Minimum Standards Comparison

	NCLC State Legislative Proposal	VITA/TCE	Oregon	California	Maryland	New York
Registration	Biannual registration	Annual Certification	Annual Registration	Annual Registration	Biannual Registration	Annual Registration
Minimum Education	60-hour basic income tax law course High school diploma or GED	Income tax course	80-hour basic income tax law course High school diploma or GED	60-hour qualifying education course	High school diploma or GED	High school diploma or GED
Entry Level Testing	Yes	Yes	Yes ¹⁰¹	No	Yes ¹⁰²	Yes ¹⁰³
Continuing Education	15 hours annually	N/A	30 hours annually	20 hours annually	16 hours biannually	4 or 16 hours annually ¹⁰⁴
Background Check	No	Not required ¹⁰⁵	No	No	No	No
Credentialed Preparer Exemption	Yes	No	Yes	Yes	Yes	Yes

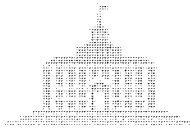
¹⁰¹ Two exams are offered depending on level of certification.

¹⁰² Maryland does not require registrants to pass an exam before December 31, 2014.

¹⁰³ Commercial Tax Return Preparers (generally, a preparer who prepares 10 or more New York State returns for a fee) will be required to pass a New York State Competency exam by the third calendar year after the exam is made available.

¹⁰⁴ First-year registrants with less than three years of experience must complete 16 hours. All other registrants must complete four hours.

¹⁰⁵ Some sponsoring organizations may perform background checks on their volunteers.



THE TAX INSTITUTE

AT H&R BLOCK

Consumer Tax Fraud: Sources & Solutions

Survey Findings

March 2014

ABOUT THE TAX INSTITUTE AT H&R BLOCK

The Tax Institute at H&R Block is the go-to source for objective insights on federal and state tax laws affecting the individual. It provides nonpartisan information and analysis on the real world implications of tax policies and proposals to policymakers, journalists, experts and tax preparers. The Institute's experts include CPAs, Enrolled Agents, tax attorneys and former IRS agents. Building off more than 10 years of research and analysis from a specialized tax research group at H&R Block, the company launched The Tax Institute in 2007.

ABOUT THIS REPORT

This report presents the findings of a telephone survey conducted among a dual national probability sample of 1,005 adults comprising 505 men and 500 women 18 years of age and older, living in the continental United States. Results have a margin of error $\pm 3.1\%$ at the 95% confidence level. Interviewing for this combined landline and cell phone survey was completed during the period October 31-November 3, 2013 by ORC International. The national sample was weighted to ensure the results reflect the general population.

Additional Methodology Notes:

Figure 1: Percentages may not add to 100% due to rounding.

Figure 2: Percentages do not add to 100% because respondents were asked to select up to two options.

Figure 3: Percentages do not add to 100% because respondents were asked to select multiple options.

Figure 4: Represents percent of who said they strongly or somewhat support each statement.

CONTACT INFORMATION

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Letter to our readers:

The U.S. tax law is thousands of pages long, focused on credits, penalties and obtuse rules and regulations, which we at H&R Block decipher and interpret for our clients. For individuals and families, these tax laws manifest themselves on a much more personal level. To many the regulations may just be words and numbers on a page. To most people however, the tax law is a complex web of rules and forms to navigate each spring – holding with it hope and sometimes dismay. For most taxpayers their annual tax filing, whether they receive a refund or make a payment, is often the largest financial transaction they experience during the year. It has a significant effect on their financial outlook and is a deeply personal experience.

Because of the size of the typical tax refund – which is approximately \$2,700 according to IRS data – more and more taxpayers find themselves under assault from increasingly sophisticated thieves who file false tax returns under their names. Add this to the growing rate of credit card fraud and compromised Social Security numbers, consumers now have the added worry of someone stealing their tax refund. Even Attorney General Eric Holder is not immune to this as he found himself nearly the victim of tax fraud when two men tried to file a fraudulent tax return under his name this March. Those who have experienced this know full well the litany of paperwork, calls, ID checks and more that it takes to right such a wrong.

Tax fraud and improper payments – which consist of payments made due to deliberate fraud, confusion around complex rules, and basic math errors – are examples of several disturbing trends contributing to a rising level of waste, fraud and abuse in the overall U.S. tax system. Estimates of lost revenue are in the hundreds of billions of dollars. While the IRS Oversight Board has asked consumers how they feel about cheating, no one has asked the question “what can be done to address this?”

The discussion surrounding this problem, and how to solve it, mostly has been limited to tax wonks, policy experts and industry players. Until now. The Tax Institute at H&R Block worked with ORC International to field a national survey to help understand public appetite for grappling with this issue. The results were reassuring and encouraging. In sum, survey results suggest that consumers:

- Are willing to do more to help combat tax fraud;
- Acknowledge that the IRS, Congress, professional tax preparers, the makers of tax preparation software and taxpayers themselves are accountable for addressing fraudulent tax filings;
- Support requiring professional tax preparers to meet minimum training standards;
- Strongly back holding do-it-yourself software to minimum standards.

These results are heartening – consumers are willing to take simple, yet important steps, to preserve the integrity of our tax filing system, which relies largely on voluntary compliance. With billions of dollars lost to fraud and improper payments every year, we – consumers, the IRS and Congress – have the opportunity and frankly the responsibility to address this costly and unnecessary waste.

K. Pickering

Kathy Pickering, Executive Director
The Tax Institute at H&R Block

SURVEY FINDINGS

Executive Summary

The Tax Institute at H&R Block commissioned a national survey to measure consumer awareness and attitudes on the issue of tax fraud and prevention. The survey found that:

1. **Taxpayers are willing to do more to help combat tax fraud.** A large majority are willing to take a variety of actions to prevent fraud, whether answering more specific questions in their IRS filings, waiting a little longer for a refund or requiring consistent questions for all filers.
2. **Consumers recognize that there is joint responsibility.** They agreed that it is incumbent on the IRS, Congress, professional tax preparers, the makers of DIY tax preparation software and taxpayers themselves to address fraudulent tax filings.
3. **Consumers support requiring professional tax preparers to meet minimum training standards.** This reinforces the fact that consumers want to know the person they turn to for one of their biggest financial transactions of their year meets consistent and minimum standards for expertise.
4. **Taxpayers who use DIY software/websites are strongly supportive of requiring minimum standards for those software/websites and requiring consistency in forms and documentation across all tax preparation methods.** Consumers indicated that creating this type of parity across all tax preparation platforms is important.

The survey found that U.S. consumers believe that falsely reporting dependents (48%) and income (45%) are the most frequent drivers of fraudulent income tax returns, more so than using a stolen identity to file a false claim (31%), falsifying tax breaks (26%) or tax credits (27%).

86% of consumers support requiring professional tax preparers to meet minimum training standards.

80% of consumers support requiring do-it-yourself (DIY) tax preparation software/websites meet minimum standards.

86% of consumers support requiring that the tax forms and documentation are the same whether using either a professional tax preparer or a do-it-yourself software/website.

61% of consumers would be willing to wait a little longer for their refund to help combat tax fraud; this willingness did not vary across income levels.

94% of consumers using DIY tax preparation software/websites support requiring that tax forms and documentation be the same for professional tax preparers and DIY software.

71% of consumers using DIY tax preparation software/websites would be willing to provide additional documentation with their return to help combat tax fraud.

69% of consumers using DIY tax preparation software/websites would be willing to answer additional questions on their return in an effort to battle tax fraud.

Detailed Findings

Consumer Awareness

U.S. consumers believe that falsely reporting dependents and income are the most frequent drivers of fraudulent income tax returns.

- U.S. consumers are most likely to think that falsifying dependents (48%) and falsifying income (45%) are the most likely to lead to fraudulent returns. Those were higher than using a stolen identity to claim a false refund (31%) and falsifying tax breaks (26%) and tax credits (27%).
 - Consumers who say falsifying income most often leads to a fraudulent return are likely to be:
 - Male (50%)
 - Those who have accidentally made false statements on their tax return (67%)
 - Those who have made mistakes on their tax return that the IRS didn't catch (68%)
 - Consumers who say falsifying dependents most often leads to a fraudulent return are more likely to be:
 - Generation Xers, between the ages 35-44 (58%)

Consumer Attitudes

Overall, consumers have favorable perceptions of tax preparers, particularly those that are regulated.

- They are significantly more likely to believe that fraudulent tax returns are generated from do-it-yourself (DIY) tax preparation software/websites (54%), compared to any tax preparers (36%).
- Only 1 in 10 (9%) think fraudulent tax returns are most likely to originate with specifically regulated professional tax preparers, and this is consistent across men and women.
 - Even users of DIY software are significantly less likely to blame regulated professional tax preparers than they do tax preparation software/websites when it comes to the sources of fraud
 - Only 9% of DIY software users attribute fraudulent returns to regulated professional preparers, while 48% say DIY software is the reason.

There is a tremendous amount of consumer support for minimum standards for both tax preparers and DIY software.

- 86% support requiring professional tax preparers to meet minimum training standards while almost as many support requiring DIY tax preparation software/websites to meet minimum standards (80%).
- More than four out of five (86%) also believe in requiring that tax forms and documentation to be the same when using a professional tax preparer or DIY software.
 - Support is even higher among the users of DIY software, with 94% expressing support for requiring that tax forms and documentation to be the same for professional tax preparers and DIY software.
 - Consumers in the highest household income tier (\$100K or more) are more likely to support stricter regulations, with 95% in favor of minimum training standards for professional tax preparers, and 95% also in favor of minimum standards for DIY software. In addition, 94% of those higher income consumers believe that that tax forms and documentation requirements should be the same for both in-person and DIY preparation.

Consumer Actions

Consumers say individual taxpayers themselves, along with the IRS, are most responsible for reducing tax fraud.

- Consumers are most likely to say the IRS is responsible for reducing tax fraud (41%) over Congress (20%), professional tax preparers (20%) and makers of DIY tax preparation software (17%).
- However, over one-third (37%) believe individual taxpayers are most responsible.
 - Women (23%) are just slightly more likely than men (16%) to put the responsibility on professional tax preparers.

General consumers are willing to do more to help combat fraud.

- Nearly all consumers (93%) are willing to take at least one action when preparing their income tax return in an effort to combat tax fraud. To do so, about two out three said they would:
 - Use a professional tax preparer regulated by the IRS (68%).
 - Provide additional documentation with their return (67%).
 - Answer additional questions on their return (65%).
 - Answer questions to confirm their identity when using do-it-yourself (DIY) tax preparation software or websites (64%).
 - Wait a little longer for the refund (61%).
 - This number did not vary dramatically by income level, with 62% of those making under \$35,000 saying they would wait, 59% of \$35,000-\$50,000, 61% of \$50,000-\$75,000, 63% of \$75,000-\$100,000, and 67% of those making more than \$100,000.
- Women (74%) are more likely than men (62%) to say they'd use a professional tax preparer regulated by the IRS to combat tax fraud.
- Millennials (18-34) (82%) are more likely than other generations to be willing to provide additional information on their returns.
- Those who have stretched the truth when preparing their tax return themselves or know someone who has tend to be more likely to be willing to wait a little longer for a refund (73% vs. 61% of general consumers) and answer questions to confirm their identity when using DIY sites (73% compared to 64% of general consumers) in an effort to combat fraud.

While consumers who prefer DIY software to prepare their taxes are not necessarily willing to give up their independence to combat tax fraud, these DIYers are open to requiring minimum standards for their software.

- Less than half (41%) of consumers using DIY software to prepare their taxes are willing to use a professional tax preparer regulated by the IRS to help combat tax fraud.
- However, nearly all (91%) of these DIY software preparers support requiring that the sites meet minimum standards.
- Specifically, a large majority of consumers using DIY software are willing to answer questions to confirm their identity when using the websites (84%), provide additional documentation with their return (71%) or answer additional questions on their return (69%) in an effort to battle tax fraud.

Keep in mind though, consumers who prepare their taxes completely by hand show the most resistance in taking actions that combat tax fraud.

- To combat tax fraud, those who complete their taxes on their own, completely by hand, are less likely to be inclined to provide additional documentation on their returns (57% compared to 67% of general consumers).
- This segment also holds professional tax preparers in a less favorable light.
 - They are more likely to believe fraudulent tax returns originated with tax preparers (47% vs. 36% of general consumers).
 - They are also less willing to use a professional tax preparer regulated by the IRS (53% vs. 68% of general consumers) in battling tax fraud.

FIGURES

Figure 1: When asked where consumers thought fraudulent returns were most likely to originate, the survey found:

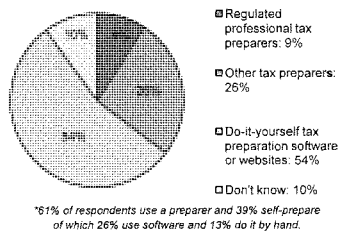


Figure 2: When asked who consumers think is most responsible for reducing tax fraud, the survey found:

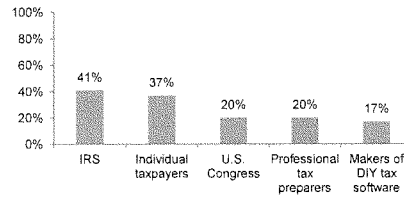


Figure 3: When asked what consumers were willing to do when preparing their income tax returns to help combat tax fraud, the survey found:

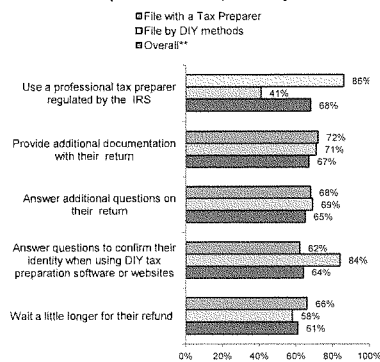
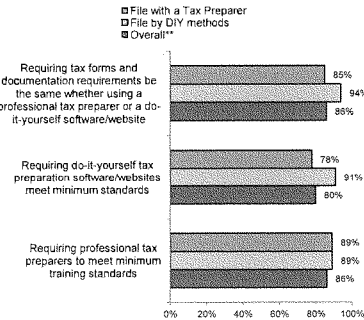


Figure 4: When asked whether they supported each of these statements, the survey found consumers supported:



** Overall includes all consumers: those who prepare entirely by hand, use DIY software/websites, use a professional preparer, work with a family/friend or do not prepare the taxes each year.

SURVEY QUESTIONS

1. Which of following do you think most often leads to a fraudulent income tax return? Choose top two.
 - Using a stolen identity to claim a false refund
 - Falsifying tax breaks
 - Falsifying tax credits
 - Falsifying income
 - Falsifying dependents
 - Don't know
2. To help combat tax fraud, which, if any, of the following are you willing to do when preparing your income tax return? Select all that apply.
 - Wait a little longer for your refund
 - Answer additional questions on your return
 - Provide additional documentation with your return
 - Use a professional tax preparer that is regulated by the Internal Revenue Service (IRS)
 - Answer questions to confirm your identity when using do-it-yourself tax preparation software/website
 - None of the above
 - Don't know
3. Where do you think fraudulent tax returns are most likely to originate?
 - Regulated professional tax preparers
 - Other tax preparers
 - Do-it-yourself tax preparation software/websites
 - Don't know
4. Who is most responsible for reducing tax fraud? Select up to two responses.
 - U.S. Congress
 - Professional tax preparers
 - Internal Revenue Service (IRS)
 - Individual tax-payer
 - Makers of do-it-yourself tax preparation software/websites
 - None of the above
 - Don't know
5. Which of following do you think most often leads to a fraudulent income tax return? Choose top two.
 - Using a stolen identity to claim a false refund
 - Falsifying tax breaks
 - Falsifying tax credits
 - Falsifying income
 - Falsifying dependents
 - Don't know

6. How much do you support each of the following?
- Strongly support
 - Somewhat support
 - Don't support at all
 - Requiring professional tax preparers to meet minimum training standards
 - Requiring do-it-yourself tax preparation software/websites meet minimum standards
 - Requiring that the tax forms and documentation requirements are the same when using either a professional tax preparer or a do-it-yourself software/website
7. Which of the following statements are true for you? Please select all that apply.
- You have stretched the truth on my tax return
 - You know someone who has stretched the truth on their tax return
 - You have been a victim of identity theft
 - You know someone who has been a victim of identity theft
 - You have accidentally made false statements on my tax return
 - You have had to pay a fine for making an error on my tax return
 - You have made mistakes on your tax return that the Internal Revenue Service (IRS) did not catch.
 - None of the above
 - Don't know
8. Which of the following describes how you prepare and file your United States income tax return each year? Please select all that apply.
- You prepare your tax return completely by hand, on my own – no software, websites, or help from a professional, family member, or friend
 - You use a do-it-yourself tax preparation software/website
 - You use a professional tax preparer
 - You work with a friend or family member
 - Other, specify
 - You do not currently prepare and/or file my taxes each year
 - Don't know

**STATEMENT OF HON. ORRIN G. HATCH, RANKING MEMBER
U.S. SENATE COMMITTEE ON FINANCE HEARING OF APRIL 8, 2014
PROTECTING TAXPAYERS FROM INCOMPETENT AND
UNETHICAL RETURN PREPARERS**

WASHINGTON – U.S. Senator Orrin Hatch (R-Utah), Ranking Member of the Senate Finance Committee, today delivered the following opening statement at a committee hearing examining effective ways to protect taxpayers from incompetent and unethical tax preparers:

As we all know, the due date for individuals to complete and file their annual income tax returns is one week away. And, at this point in the year, millions of Americans face a number of difficulties in trying to comply with that deadline.

The sheer complexity of our tax system requires the majority of Americans to seek the services of a paid preparer in order to navigate through and comply with the tax code. Of the 142 million income tax returns filed by individuals last year, nearly 80 million – or roughly 56 percent – were prepared by a paid preparer.

Our income tax system relies heavily on good faith voluntary compliance, which, in turn, requires the services of paid preparers that are both competent and ethical.

The IRS attempted to implement regulations in 2011 that, for the first time, imposed both ethical and competency standards on any person who sought to prepare tax returns for compensation. The D.C. Circuit Court of Appeals, however, has since prevented IRS from enforcing those regulations when it upheld the Loving decision on appeal.

Among the approaches to solving the problem of incompetent and unethical paid preparers that we will hear about today is government regulation. However, there are other approaches worthy of thoughtful consideration.

One approach is comprehensive tax reform that results in a much simpler and straightforward tax system with fewer compliance and administrative burdens. A less complex tax system that allows for simpler compliance rules will reduce taxpayer and preparer errors associated with complexity, decrease the need for complex tax filings, and eliminate opportunities to cheat the system through unethical behavior.

It is my belief that the best way to protect tax filers from incompetent and unethical tax preparers is to implement a fair and simple tax system that dramatically reduces their dependence on paid return preparers.

Until we get there, we need to minimize the damage that incompetent and unethical return preparers can cause. I look forward to hearing about different ideas on how to accomplish this worthy goal during today's hearing.

Of course, with the IRS Commissioner testifying before us today, there are other matters that deserve the committee's attention.

For example, there is the ongoing investigation into the IRS's targeting of conservative groups during the 2010 and 2012 campaign seasons. Four congressional committees, including the Finance Committee, are currently looking into this matter. And, up to now, IRS officials have, with some exceptions, been cooperating.

That's why it was disheartening to hear that, two weeks ago, Commissioner Koskinen apparently tried to spin what had gone on at the IRS, claiming that no one had used the word "targeting" to describe what happened.

The fact is that the Treasury Inspector General for Tax Administration (TIGTA) Russell George used the word "targeting" in his May 2013 report to describe the allegations, and, in testimony before Congress, he stated that the allegation had proven to be true.

Furthermore, Commissioner Koskinen himself described the activities as "targeting" during his confirmation hearings before this committee.

Now, this may seem like we're engaging in semantics, but the words we use here are important. If the administration, rather than acknowledging what went on at the IRS and trying to fix it, is going to engage in word-play to minimize what happened, we are going to continue to have difficulties as we try to resolve these issues.

Even the Washington Post fact checker said it is "silly and counterproductive" to deny that the phrase targeting describes what happened, awarding the Commissioner Three Pinocchios for saying otherwise.

On top of that, we have the regulatory effort at the IRS that appears to be designed to further marginalize these same conservative groups. I'm talking, of course, about the proposed regulations governing the political activities of 501(c)(4) organizations.

People and organizations across the political spectrum have rightly condemned these proposed regulations because they undermine free speech and the ability of American citizens to participate in the political process. The IRS had a record number of public comments filed in response to the proposal from all points on the political spectrum. And, from what I gather, they were almost uniformly negative.

This regulation, if given the force of law, would effectively silence grassroots organizations by categorizing a number of routine and long-accepted activities as political. And, it would ensure that a number of the administration's critics remain on the sidelines of the political debate.

This proposal is particularly disturbing given what has already gone on at the IRS with the targeting scandal.

Now, last week, Commissioner Koskinen publicly stated that the regulations are not likely to be finalized this year. But, that's not good enough. These regulations should go away entirely. And Commissioner Koskinen has the power to make that happen.

Throughout the public debate over this proposal, little has been said of the role of the IRS Commissioner in approving the final regulation.

However, as was confirmed by Secretary Lew in his recent appearance before this committee, the IRS Commissioner has the authority to unilaterally prevent these regulations from taking effect. That being the case, any effort to deflect responsibility in a different direction is futile.

As you can see, Mr. Chairman, we have a number of issues to discuss today. I look forward to a robust and informative hearing.

Thank you.

###

Brad Smith
President & CEO

2700 Coast Avenue
Mountain View, CA 94043

intuit

April 4, 2014

The Honorable Ron Wyden
Chairman,
Committee on Finance
United States Senate
Washington, DC 20510

The Honorable Orrin Hatch
Ranking Member,
Committee on Finance
United States Senate
Washington, DC 20510

Dear Chairman Wyden and Ranking Member Hatch,

I am writing on behalf of Intuit, the maker of TurboTax, to express our strong support for your objective of simplifying the tax code for the average American, a key component not only of basic tax reform, but also for strengthening the safety, integrity, effectiveness and fairness of the U.S. income tax system.

We have advocated for tax simplification reform for a decade, because while technology innovation has, and will continue to, deliver simplicity and burden reduction for taxpayer, the extreme complexity of the tax system today has become a risk to more than just the burden of compliance. Complexity works at cross-purposes to assurance of the integrity, safety and fairness of the tax system itself.

I testified before the House Ways and Means Committee in 2005 and called for tax simplification for the average taxpayer. We offered the suggestion then, based on our taxpayer experience, that streamlining and simplifying today's myriad of tax incentives for education and retirement, as one example of reform, could make a meaningful difference for the average taxpayer. There are other such practical examples, including sorting out the multiple conflicting definitions of common tax terms in different provisions of the Code, such as the definition of *dependent child*. Such complexity creates confusion and makes tax compliance unnecessarily difficult for the average family. But we believe tax simplification reform is important as well to strengthen the integrity and effectiveness of the tax system in ways that would reduce both inadvertent error and the opportunities for intentional fraud. Tax simplification reform would benefit both the tax system and the taxpayer.

Simplification reform can also bring closer the day that data-driven innovation can deliver a *10 minute tax return* for the average American taxpayer, slashing compliance burden. The private sector technology industry, including Intuit, has already delivered critical inventions and innovations that bring that goal within reach today. But American ingenuity can do more. And tax simplification reform can help.

But simplification alone is not enough to fully strengthen and improve our tax system. We also believe that oversight and regulation of the tax industry is important to the public interest. We testified before the IRS in 2009 in support of a sound and thoughtful strategy for providing return preparer oversight, but at that time we also called for a parallel oversight initiative that would provide standards-based regulation of the software sector of the tax industry.

A dozen years ago IRS Commissioner Charles Rossotti – with the partnership and support of many in Congress and on this Committee -- created an unprecedented public-private partnership initiative called the IRS Free File Program, which provides private sector donation of online tax preparation products and services to lower and middle income taxpayers at no cost to either the Government or the individual taxpayer. In more recent years the Free File Program was expanded, due to Senator Schumer's leadership, to include an electronic fillable forms utility that can be used by all taxpayers, again at no cost to the public purse or to the individual user. And importantly, these free online tax software services must all meet the standards-based rules and requirements that were established with the IRS to govern their Free File Program.

We have urged that the standards-based rules that IRS uses to govern Free File could point the way to a similar strategy model that could be applied to the tax products and services of the technology industry more broadly. We continue to believe this is a proposal that merits adoption by the IRS in furtherance of the public interest.

We would welcome the opportunity to work with the Committee to explore these concepts more fully, for both tax simplification reform and industry oversight, and to consider the most effective ways to advance their adoption. The tax system will be sounder and work better as a result. But we think there is still more that can be done to strengthen tax system integrity.

The tax association, the American Coalition for Taxpayer Rights, ACTR, has proposed a series of technology measures which, taken together, could significantly tighten safeguards against identity theft and refund fraud in our tax system. Intuit testified on behalf of the Association before this Committee two years ago on this subject. The fact is that IRS and the Justice Department are already hard at work to stop criminals and safeguard honest taxpayers, and the industry is cooperative and supportive of these critically important law enforcement efforts. But there is even more that could be done to further strengthen the effort, as the ACTR association has urged, with the Government drawing on the best advice of the technology experts in the industry, and ACTR has shared these recommendations with IRS and the DOJ over time. We recognize that IRS is resource constrained, but would strongly urge that they prioritize those recommendations as quickly as possible and advance them to the implementation stage.

Thank you for the opportunity to offer these thoughts and suggestions for the Committee's consideration in your ongoing work, and in your Hearing this week. There is much work to be done in all of these areas of reform and improvement, and we want to support and assist the Committee in its vitally important work.

Sincerely,



Brad Smith
President and CEO,
Intuit

cc: Members of the U.S. Senate Committee on Finance

**WRITTEN TESTIMONY OF
JOHN A. KOSKINEN
COMMISSIONER
INTERNAL REVENUE SERVICE
BEFORE THE
SENATE FINANCE COMMITTEE
ON REGULATION OF TAX RETURN PREPARERS
APRIL 8, 2014**

I. Introduction

Chairman Wyden, Ranking Member Hatch and Members of the Committee, thank you for the opportunity to appear before you today to discuss IRS regulation of paid tax return preparers and our related compliance activities.

I am honored to serve as IRS Commissioner and to have the opportunity to lead this agency and its dedicated employees, because I believe that the success of the IRS is vital for this country. The agency collects about \$2.9 trillion each year, which is more than 90 percent of the revenue collected by the federal government. Because the activities of the IRS touch virtually every American, we are particularly focused on providing taxpayer service to help people understand and meet their tax responsibilities, while ensuring enforcement of the tax laws.

The tax return preparer community is a key ally in our efforts to fulfill our dual mission of providing taxpayer service and ensuring tax compliance. We view our relationship with tax professionals as a partnership, one that has enabled a system that interacts with hundreds of millions of taxpayers to nimbly adjust to new tax laws, speed the average time for refunds, and encourage the voluntary compliance of taxpayers.

Return preparers are a vital link between the IRS and taxpayers, especially given that the vast majority of people seek help in doing their taxes. Each year, paid preparers are called upon by taxpayers to complete about 80 million returns, or about 56 percent of the total individual income tax returns filed, while another 34 percent of taxpayers use tax preparation software, for a total of 90 percent who seek some form of assistance. Competent preparers make our job easier by helping their clients properly report their taxes and pay what they owe.

Given the crucial role that return preparers play in our tax system, the IRS believes it is critical to ensure a basic competency level for tax return preparers and to focus our enforcement efforts on identifying and stopping unscrupulous preparers.

II. The IRS' Return Preparer Initiative

In years past, taxpayers typically prepared their own income tax returns. Over the past two decades or more, however, the increasing complexity of tax law and growing taxpayer confusion over how to comply with the tax code have led to a substantial increase in the number of taxpayers who seek assistance in preparing and filing their taxes.

At the same time, the level of oversight of paid return preparers has traditionally been uneven at best. While attorneys, Enrolled Agents (EAs), and Certified Public Accounts (CPAs) must meet mandated professional competency requirements, they make up only about 40 percent of the universe of paid tax return preparers. That has left another 60 percent preparing returns with little or no federal oversight. Although a few states have begun regulating unlicensed preparers, most of the tax professional community favors federal oversight to avoid the possibility of a patchwork of conflicting state requirements.

Although the majority of return preparers are competent and operate with the highest ethical standards, the Government Accountability Office (GAO), the Treasury Inspector General for Tax Administration (TIGTA), and the IRS' own research all suggest that our tax system and a large number of taxpayers may be poorly served by return preparers who engage in fraud. In addition, some unlicensed preparers have received insufficient training and are not equipped to do an adequate job of preparing returns for taxpayers who seek their help.

Given the substantial reliance of taxpayers on paid return preparers and the concern about unlicensed and unregulated preparers, the IRS in 2009 undertook a review of the return preparer industry. As a result of that review, the IRS in 2009 issued a report, Publication 4832, *Return Preparer Review*, and in 2010 launched the Tax Return Preparer Initiative. The initiative was designed to ensure that all preparers of individual income tax returns have a minimum level of competency and adhere to professional standards, with an overarching objective of better service to taxpayers and increased compliance. The IRS wants return preparers to be competent and ethical in order to prepare the most accurate returns possible, and we also owe it to compliant tax preparers to make sure that everyone can operate on a level playing field.

Under the initiative, the IRS began phasing in a multipronged strategy. This strategy included requiring individuals to obtain a Preparer Tax Identification Number (PTIN) from the IRS if they prepare all, or a substantial portion of, any federal tax return or refund claim for compensation. The initiative also required all paid preparers of individual income tax returns who are not CPAs, attorneys or EAs to pass a competency exam and complete annual continuing education requirements related to tax law and professional conduct.

In addition to the requirement to obtain a PTIN, the IRS extended the ethical rules found in regulations reprinted as Treasury Department Circular 230 – which historically had only applied to attorneys, CPAs, and EAs practicing before the IRS – to all paid preparers, in order to allow the IRS to suspend or otherwise discipline tax return preparers who engage in unethical or disreputable conduct.

Taken together, the return preparer initiative was designed to reduce the number of inaccurate and fraudulent returns prepared by paid preparers, help the IRS discipline unscrupulous preparers, and improve service to taxpayers so they are better able to comply with filing requirements.

Since September 2010, more than a million individuals have obtained a PTIN. As of mid-March 2014, approximately 677,000 return preparers are active in our tax professional database. All preparers must use their PTINs as the identifying number on returns they prepare for compensation, and they must renew their PTINs annually. The IRS just completed the PTIN renewal season for Calendar Year 2014.

The IRS announced the testing phase of its return preparer program in November 2011. At the time, the agency said that it was requiring all preparers of individual income tax returns with a valid PTIN who were not CPAs, EAs, or attorneys to take the test, with a deadline of December 31, 2013 for passing it. The test was designed to cover preparation of Form 1040 and its related schedules. Preparers who passed the test, held a valid PTIN, and completed 15 hours of continuing education each year would be given a new designation – Registered Tax Return Preparer. The 15-hour annual education requirement consisted of 10 hours of federal tax law topics, three hours of tax law updates, and two hours of ethics and/or professional conduct.

Through 2012, about 84,100 tests were given with about 62,300 preparers receiving a passing grade, for a pass rate of 74 percent. But the phased implementation of the return preparer program stalled in January 2013 when the U.S. District Court for the District of Columbia issued an injunction in the case of *Loving vs. IRS* that prevented the agency from enforcing the regulatory requirements for competency testing and continuing education. The court said that the IRS lacked statutory authority to impose those requirements on return preparers. The court later clarified that the injunction did not apply to the requirement that all paid return preparers obtain a PTIN, acknowledging that the IRS has that authority under section 6109 of the Internal Revenue Code.

Further action in the case occurred on February 11, 2014, when the U.S. Court of Appeals for the District of Columbia Circuit upheld the lower court's decision. The IRS is continuing to assess the scope and impact of the Court's decision while consideration is given to options for appeal.

The IRS, meanwhile, continues to believe that the regulation of paid return preparers is important for the proper functioning of the U.S. tax system. To that end, the President's Fiscal Year (FY) 2015 Budget includes a proposal to explicitly authorize the IRS to regulate all paid tax return preparers. In explaining the reason for this proposal, the Treasury Department noted that the regulation of paid preparers, in conjunction with diligent enforcement, will help promote high quality services from tax return preparers, improve voluntary compliance, and foster taxpayer confidence in the fairness of the tax system. Treasury also noted the harms caused by incompetent and dishonest preparers to the tax system, including increased collection costs, reduced revenues, the burden placed on taxpayers by the submission of incorrect returns on their behalf, and a reduction in taxpayers' confidence in the integrity of the tax system.

Following the court decision, the IRS remains concerned about protecting taxpayers and ensuring they receive quality assistance in preparing their tax returns. While we urge Congress to quickly enact the proposal described in the President's Budget, we are taking a close look at the possibility of an interim step involving a program of voluntary continuing education.

The idea of a voluntary program is under consideration because we believe it is important to maintain the momentum for regulation and oversight of unregulated preparers that has built up over the last five years, and to lessen the risks to taxpayers resulting from the lack of federal education requirements. Before moving forward on this idea, however, we will solicit feedback from a wide range of external stakeholders as to whether such an interim step would be useful and appropriate.

III. Return Preparer Compliance Activities

In addition to regulating return preparers, the IRS' preparer initiative also includes a comprehensive compliance and enforcement strategy, as well as extensive outreach and education activity. Components of the strategy include due diligence visits, preparer investigations, notices, and injunctions. In addition, the IRS sponsors educational programs, offered at little or no cost to recipients, which cover both substantive tax law and the preparer's obligations under Circular 230.

With regard to our compliance efforts, it is important to note that the PTIN requirement gives the IRS an important and better line of sight into the return preparer community than ever before. PTINs allow the IRS to collect more-accurate data on who is preparing returns, the volume and types of returns being prepared and the qualifications of those doing return preparation. Thus, the information obtained through the PTIN process helps us do more to analyze trends and spot anomalies, so that we have a much better understanding of the

return preparer community as a whole, and can design appropriate compliance and educational activities in response to the data we collect.

As part of our compliance strategy, the IRS' Criminal Investigation (CI) division works closely with the Department of Justice to pursue civil or criminal actions against unscrupulous return preparers. In FY 2013, CI initiated 309 investigations of tax fraud related to return preparer fraud and recommended 281 cases for prosecution. Indictments for cases involving return preparer fraud totaled 233 in 2013 with 186 individuals sentenced, and an average time to be served at 27 months.

Our compliance efforts also involve helping preparers understand their responsibilities. During FY 2013, the IRS continued to educate and inform return preparers on tax law compliance in a number of ways. These include making visits to more than 3,000 return preparers around the country and addressing preparers who were found to have made egregious errors through a variety of methods to ensure appropriate penalties and/or sanctions were imposed. Educational seminars offered through the IRS Nationwide Tax Forums, the Small Business/Self-Employed Stakeholder Liaison function, and the Office of Professional Responsibility reach tens of thousands of tax professionals annually in an effort to prevent preparer error and misconduct before it occurs.

A major focus of our return preparer compliance strategy involves preparers who prepare large numbers of returns containing claims for the Earned Income Tax Credit (EITC). This focus enhances our efforts to reduce EITC improper payments, because it is estimated that about 60 percent of EITC returns are prepared by paid tax return preparers.

Compliance activities conducted as part of our EITC-focused paid preparer effort have included: Field examiner audits of EITC preparers to determine whether they are performing due diligence to ensure that individuals claiming the EITC are in fact eligible for the credit; so-called "knock-and-talk visits" made by CI agents to EITC preparers to educate them on EITC rules and due diligence requirements; and undercover shopping visits to return preparers suspected of engaging in fraud.

Additionally, the IRS has expanded its traditional treatment of EITC preparers to test a new early-intervention component. Beginning in 2012, the IRS has used data analytics - including an innovative "test and learn" approach - to significantly reduce improper payments associated with the EITC and other refundable credits.

Using this approach, a small data-driven pilot in 2012 identified a group of tax return preparers with a history of submitting incorrect or potentially fraudulent tax returns falsely claiming the EITC. We then designed and implemented interventions with these preparers to stop improper claims. The interventions

included letters, calls and site visits to selected preparers, both before and during tax filing season to allow preparers to immediately adjust their practices. These efforts reduced improper EITC payments in 2012 by an estimated \$198 million for returns prepared by preparers who received the interventions.

An expanded preparer pilot in 2013 protected an additional \$590 million in revenue from being paid out improperly. The 2013 pilot program included a wider group of preparers and a broader set of interventions. In 2014, we have continued these interventions before and during the filing season.

In addition to providing the IRS with the legislative authority to regulate paid tax return preparers and any other individual who for compensation prepares or assists in the preparation of documents relating to federal tax liabilities for submission to the IRS, Congress can help us further enhance our compliance efforts in general and with regard to return preparers in particular, by passing the following legislative proposals contained in the President's FY 2015 Budget:

- **Preparer penalty.** Under current law, the penalty imposed on preparers for understatement of tax on a federal return due to an unreasonable position taken on the return is the greater of \$1,000 or 50 percent of the income derived by the preparer from preparation of the return. A separate penalty can be imposed if the understatement is due to the preparer's willful or reckless conduct. That penalty is the greater of \$5,000 or 50 percent of the income derived by the preparer from preparation of the return. The Administration's proposal would increase the penalty in cases of willful or reckless misconduct to the greater of \$5,000 or 75 percent of the income derived by the preparer (instead of 50 percent). Treasury has said this proposal is necessary because in many cases, 50 percent of income derived by the preparer is far greater than the fixed dollar penalties imposed, so that, under the present penalty regime, preparers who engaged in reckless or willful conduct would end up paying the same dollar penalty as preparers whose conduct did not rise to that level.
- **Correctible error authority.** The IRS has limited statutory authority to identify certain computation or other irregularities on returns and automatically adjust the return for a taxpayer. These upfront systemic processing checks, also known as "math error authority," protect approximately \$320 million in improper EITC payments annually. At various times, Congress has expanded this limited authority on a case-by-case basis to cover specific newly enacted tax code amendments. The Administration's proposal would replace the existing specific grants of this authority with more general authority covering computational errors and incorrect use of IRS tables. Further, the proposal would expand IRS' authority by creating a new category of "correctible errors," allowing the IRS to fix errors in several specific situations, such as when a taxpayer's information does not match the data in government databases.

- **Due diligence.** Return preparers who prepare tax returns on which the EITC is claimed must meet a number of due diligence requirements to ensure their clients are in fact eligible to receive this credit. In addition to asking questions designed to determine eligibility, the preparer must complete a due diligence checklist (Form 8867) for each client, and file the checklist with the client's return. The Administration's proposal would extend the due diligence requirements to all federal income tax returns claiming the Child Tax Credit (CTC) and the Additional Child Tax Credit. The existing checklist would be modified to take into account differences between the EITC and CTC.

IV. Conclusion

Thank you again for the opportunity to discuss IRS regulation of tax return preparers as well as preparer compliance activities. Our activities in relation to return preparers are critical to maintaining the integrity of our tax system. While the preparer registration requirement is an important advance in our ability to ensure that all return preparers provide the proper level of service to taxpayers, the testing and continuing education components of our return preparer initiative are critical to making even more progress in this area. I again urge Congress to quickly approve the Administration's proposal granting the IRS explicit statutory authority to regulate all paid tax return preparers, which will allow us to resume implementation of testing and continuing education requirements for certain return preparers. This concludes my testimony, and I would be happy to take your questions.



United States Government Accountability Office

Testimony
Before the Committee on Finance,
U.S. Senate

For Release on Delivery
Expected at 10:00 a.m. EDT
Tuesday, April 8, 2014

PAID TAX RETURN PREPARERS

In a Limited Study, Preparers Made Significant Errors

Statement of James R. McTigue, Jr., Director
Strategic Issues

GAO Highlights

Highlights of GAO-14-467T, a testimony before the Committee on Finance, U.S. Senate

Why GAO Did This Study

For tax year 2011, an estimated 56 percent of about 145 million individual tax returns were completed by a paid preparer. IRS has long recognized that preparers' actions have an enormous effect on its ability to administer tax laws effectively and collect revenue that funds the government. Likewise, many taxpayers rely on preparers to provide them with accurate, complete, and fully compliant tax returns.

GAO was asked to review the oversight and quality of paid preparers. This testimony examines (1) how preparers are regulated by IRS and (2) the characteristics of tax returns completed by preparers based on products GAO issued from April 2006 through August 2008 and work conducted from November 2013 to April 2014. GAO reviewed laws, regulations and other guidance and interviewed IRS officials. GAO analyzed IRS Statistics of Income data from tax year 2011, the most recent data available, and the NRP database, which broadly tracks compliance. To gain insight on the quality of service provided, GAO conducted 19 undercover site visits to commercial preparers in a metropolitan area. Criteria to select the metropolitan area included whether the state regulates preparers and levies an income tax.

What GAO Recommends

If Congress agrees that significant preparer errors exist, it should consider legislation granting IRS the authority to regulate paid tax preparers. Technical comments from IRS were incorporated into this report.

View GAO-14-467T. For more information, contact James R. McTigue, Jr. at (202) 512-9110 or mcmtigue@gao.gov.

April 2014

PAID TAX RETURN PREPARERS

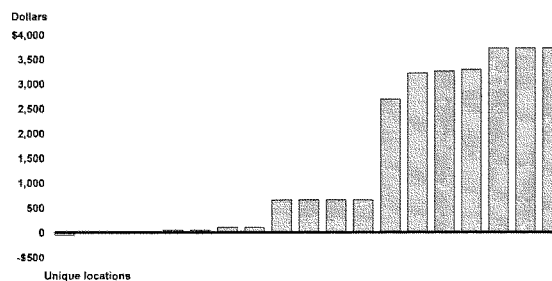
In a Limited Study, Preparers Made Significant Errors

What GAO Found

The Internal Revenue Service's (IRS) authority to regulate the practice of representatives before IRS is limited to certain preparers, such as attorneys and certified public accountants. Unenrolled preparers—those generally not subject to IRS regulation—accounted for 55 percent of all preparers as of March 2014. In 2010, IRS initiated steps to regulate unenrolled preparers through testing and education requirements; however, the courts ruled that IRS lacked the authority.

GAO found significant preparer errors during undercover site visits to 19 randomly selected preparers—a sample which cannot be generalized. Refund errors in the site visits varied from giving the taxpayer \$52 less to \$3,718 more than the correct refund amount. Only 2 of 19 preparers calculated the correct refund amount.

Refund Amounts Over or Under the Correct Amount



Source: GAO analysis.

The quality and accuracy of tax preparation varied. Seventeen of 19 preparers completed the correct type of tax return. However, common errors included

- not reporting non-Form W-2 income (e.g., cash tips) in 12 of 19 site visits;
- claiming an ineligible child for the Earned Income Tax Credit in 3 of 10 site visits where applicable;
- not asking the required eligibility questions for the American Opportunity Tax Credit; and
- not providing an accurate preparer tax identification number.

These findings are consistent with the results of GAO's analysis of IRS's National Research Program (NRP) database. GAO analysis of NRP data from tax years 2006 through 2009 showed that both individuals and preparers make errors on tax returns. Errors are estimated based on a sample of returns, which IRS audits to identify misreporting on tax returns. Tax returns prepared by preparers had a higher estimated percent of errors—60 percent—than self-prepared returns—50 percent. Errors refer to changes either to the tax due or refund amount.

United States Government Accountability Office

Chairman Wyden, Ranking Member Hatch and Members of the Committee:

I am pleased to be here today to discuss the quality of services provided by paid preparers. Paid preparers play an integral role in our voluntary tax system. Millions of taxpayers rely on paid preparers to provide them with accurate, complete, and fully compliant tax returns. The Internal Revenue Service (IRS) has long recognized that paid preparers' actions have an enormous impact on its ability to administer tax laws effectively and collect the revenue that funds the government, including minimizing the estimated \$385 billion net tax gap.¹ In tax year 2011—the most recent data available—paid preparers completed approximately 56 percent of all individual tax returns filed. A large segment of the preparer industry is not subject to testing or education requirements.

In 2006, we reported to this Committee on the results of an investigation where we identified mistakes in 19 out of 19 of our visits to paid preparers working in commercial preparer offices.² Some of the mistakes were significant, either exposing taxpayers to serious IRS enforcement action or resulting in unwarranted refunds of up to \$2,000. At the request of this Committee, we once again went undercover in February of this year and once again found significant errors that I will highlight today.

My statement today is based on reports issued from April 2006 through August 2008 and work recently completed at the request of the Committee.³ Our objectives were to (1) examine how paid preparers are regulated by IRS and applicable states (i.e., states that regulate paid preparers) and (2) evaluate characteristics of tax returns completed by paid preparers.

¹The net tax gap is the difference between taxes owed and taxes paid after accounting for IRS enforcement actions. The amount listed above is for tax year 2006, the most recent IRS tax gap estimate.

²See GAO, *Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors*, GAO-06-563T (Washington, D.C.: Apr. 4, 2006).

³See GAO, *Tax Preparers: Oregon's Regulatory Regime May Lead to Improved Federal Tax Return Accuracy and Provides a Possible Model for National Regulation*, GAO-08-781 (Washington, D.C.: Aug. 15, 2008).

In preparing this statement, we did the following work from November 2013 through April 2014:

- We reviewed laws, regulations, and other guidance and interviewed IRS officials.
- We analyzed IRS's Statistics of Income (SOI) individual taxpayer database for tax year 2011, when the most recent data were available, to determine income levels of taxpayers that used paid preparers and characteristics of the tax returns that these taxpayers filed.
- We had tax returns prepared for us at 19 randomly selected locations of several commercial preparers throughout a major metropolitan area. We chose the major metropolitan area based on criteria such as (1) location in a state that does not regulate paid preparers, (2) presence of multiple commercial preparers, and (3) location in a state that does not levy an income tax. Our investigators posed as taxpayers and asked paid preparers to prepare, but allow us to file, our federal tax returns under one of two scenarios, as described later in this testimony. The two tax scenarios incorporated a range of commonly used IRS forms and lines on the Form 1040. Because our 19 site visits are limited in size, results cannot be used to generalize our findings to the retail tax preparation industry. We visited commercial paid preparers with 10 or more locations. We did not visit any law firms, Certified Public Accountant (CPA) firms, or single-office tax return preparation businesses.
- We developed correct tax returns for each scenario with input from tax experts. Specifically, we consulted with the Joint Committee on Taxation to ensure the responses prepared for each scenario were accurate and consistent with the tax code.⁴ For each of the 19 visits, we then compared the tax returns produced by the paid preparers with those we prepared. To minimize any potential for paid preparers to have legitimately different results from our returns, we provided guidance to our investigators for answering the preparers' questions consistently with the facts we used in preparing our mock returns.

⁴The Joint Committee on Taxation is a nonpartisan committee of the U.S. Congress. Its professional staff consists of economists, attorneys, and accountants, who assist Members of the majority and minority parties in both houses of Congress. The Committee is a respected source of expertise on tax legislation.

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- We analyzed IRS's National Research Program (NRP) database, which broadly tracks compliance, for tax year 2006 through tax year 2009 (the most recent years available) to compare the estimated compliance found on returns completed by paid preparers and those that were not.⁵

We conducted all of our work in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Our investigative work was conducted from January through February 2014 in accordance with standards prescribed by the Council of the Inspectors General on Integrity and Efficiency. During our investigation, we conducted 19 undercover site visits.

We provided IRS with a draft of this statement and officials provided us with technical comments which we incorporated.

IRS's Authority to Regulate Paid Preparers Is Limited, Although Use of Preparers is High

A paid preparer is simply anyone who is paid to prepare, assist in preparing, or review a taxpayer's tax return. In this statement, we refer to two categories of paid preparers—tax practitioners and unenrolled preparers. CPAs, attorneys, and enrolled agents are tax practitioners.⁶ Tax practitioners differ from unenrolled preparers in that they can practice before IRS, which includes the right to represent a taxpayer before IRS, prepare and file documents with IRS for the taxpayer, and correspond and communicate with IRS.⁷ We use the term unenrolled preparer to

⁵IRS uses NRP data to, among other things, analyze taxpayer compliance, assess the effectiveness of compliance programs and treatments in use by IRS, and develop workload selection formulas.

⁶Tax practitioners also include Enrolled Retirement Plan Agents and Enrolled Actuaries.

⁷In limited circumstances, unenrolled preparers who sign a return may act as the taxpayer's representative if accompanied by the taxpayer, or by filing a written authorization from the taxpayer. This representation is limited to practice before examining officers in certain examination divisions, and may only encompass matters concerning the tax liability of the taxpayer for the year covered by the return. See IRS Publication 470 (Rev. Proc. 81-38).

describe the remainder of the paid preparer population. In most states, anyone can be an unenrolled preparer regardless of education, experience, or other standards.

Tax practitioners are subject to standards of practice under the Department of Treasury Circular No. 230.⁸ Enrolled agents are generally required to pass a three-part examination and complete annual continuing education, while attorneys and CPAs are licensed by states but are still subject to Circular 230 standards of practice if they practice before IRS. Generally, unenrolled preparers are not subject to these requirements.

In April 2006, we made a recommendation to IRS to conduct research on the extent to which paid preparers meet their responsibility to file accurate and complete tax returns.⁹ To address this recommendation, IRS conducted a study of the quality of paid preparers and issued a report recommending increased oversight of paid preparers.¹⁰

Recommendations included (1) mandatory registration, (2) competency testing and continuing education, and (3) holding all paid preparers—including unenrolled preparers—to Circular 230 standards of practice. IRS implemented each recommendation through regulations issued in September 2010 and June 2011. The June 2011 regulations amended Circular 230 and established a new class of practitioners called “registered tax return preparers.” IRS intended for these new requirements to support tax professionals, increase confidence in the tax system, and increase taxpayer compliance.

Prior to the deadline for unenrolled preparers to pass a competency exam or complete continuing education credits, a complaint was filed in the U.S. District Court for the District of Columbia (District Court) challenging IRS’s authority to regulate preparers under Circular 230.¹¹ In January 2013, the District Court concluded that IRS lacked the statutory authority to regulate all paid preparers, and ruled that IRS could not continue implementing its

⁸Department of the Treasury, *Regulations Governing Practice before the Internal Revenue Service*, Circular No. 230.

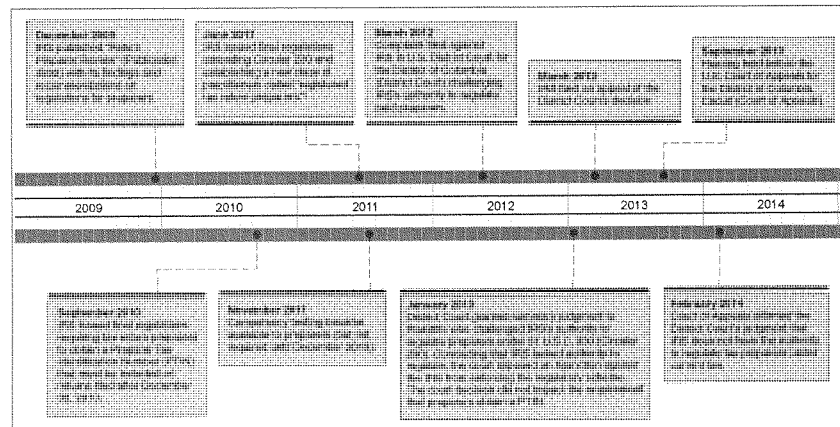
⁹GAO-06-563T.

¹⁰Internal Revenue Service, *Return Preparer Review*, IRS Publication 4832 (December 2009).

¹¹According to IRS officials, approximately 84,148 competency exams were taken prior to the District Court’s decision.

new testing and continuing professional education requirements. IRS appealed the order, but it was affirmed in February 2014 by the U.S. Court of Appeals for the District of Columbia Circuit. Figure 1 provides a summary timeline of IRS's implementation of paid preparer requirements and legal proceedings.¹² The President's Fiscal Year 2015 budget, released in March 2014, included a proposal to explicitly provide the Secretary of the Treasury and IRS with the authority to regulate all paid preparers.

Figure 1: Timeline of IRS Paid Preparer Regulations



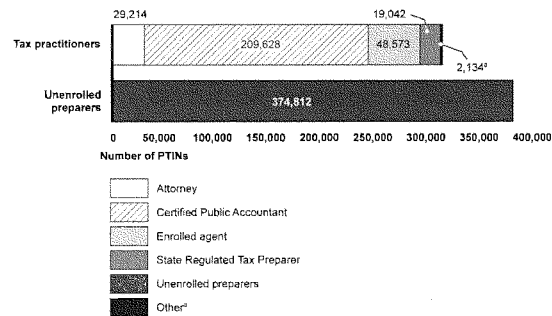
Source: GAO review of laws and regulations.

Note: *Certain paid preparers became registered tax return preparers under an IRS program that IRS is no longer able to enforce due to a District Court injunction. We refer to this group as unenrolled preparers.

¹²Loving v. IRS, 917 F. Supp. 2d 67 (D.D.C. 2013), *aff'd* 742 F.3d 1013 (D.C. Cir. 2014).

Although the District Court determined that IRS does not have the authority to regulate unenrolled preparers, the decision did not affect the requirement that all paid preparers obtain a Preparer Tax Identification Number (PTIN) and renew their PTIN annually.¹³ As of March 16, 2014, approximately 676,000 paid preparers have registered or renewed their PTINs.¹⁴ As shown in figure 2, the two largest categories of PTIN registrations and renewals are unenrolled preparers—55 percent—and CPAs—31 percent.

Figure 2: Number of Preparer Tax Identification Numbers (PTINs) by Type of Paid Preparer for Processing Year 2014



Source: IRS, Tax Professional PTIN System (TPPS). Data as of March 16, 2014.

Notes: Paid preparers may have more than one credential.

*Other category includes Enrolled Retirement Plan Agents, Certifying Acceptance Agents, and Enrolled Actuaries.

Four States Regulate Paid Preparers, but Requirements Vary

Currently, Oregon, Maryland, California, and New York regulate paid preparers. Both Oregon and California began to regulate paid preparers in the 1970s, while Maryland and New York's programs were

¹³Unlike the majority of the paid preparer regulations, IRS has the statutory authority to require that tax return preparers obtain a PTIN under 26 U.S.C. § 6109.

¹⁴This number represents most of the paid preparers who are expected to register this year and is consistent with the number of registrations in 2012 and 2013.

implemented more recently. Further, the programs themselves involve different types of requirements for paid preparers as illustrated in table 1.

Table 1: Comparison of State-Level Paid Preparer Requirements

Requirements	Oregon	Maryland	California	New York
Registration	Yes	Yes	Yes	Yes
Qualifying education	Yes	Yes ^a	Yes	No
Continuing education	Yes	Yes	Yes	No
Testing	Yes	Yes ^b	No ^c	No
Date of implementation	1973	2008	1974	2009

Source: GAO review of state laws.

Notes: ^aQualifying education requirements in Maryland do not require prior tax education.

^bPaid preparers in Maryland do not have to pass a qualifying test until after December 31, 2014.

^cPaid preparers in California who take self-study courses for qualifying education must pass a final exam as a means for evaluating successful completion of the course.

In August 2008—prior to Maryland and New York implementing paid preparer requirements—we reported on state-level paid preparer requirements in California and Oregon.¹⁵ Specifically, we reported that both California and Oregon have requirements that paid preparers must meet before preparing returns; of the two states, Oregon has more stringent requirements.

According to our analysis of IRS tax year 2001 NRP data, Oregon returns were more likely to be accurate while California returns were less likely to be accurate compared to the rest of the country after controlling for other factors likely to affect accuracy. Specifically, in August 2008, we found that the odds that a return filed by an Oregon paid preparer was accurate were 72 percent higher than the odds for a comparable return filed by a paid preparer in the rest of the country.¹⁶

¹⁵See GAO-08-781.

¹⁶These results are consistent with, but do not prove, that Oregon's regulations lead to some increased tax return accuracy.

**Use of Paid Preparers
Varied by Complexity of
Tax Return, but Often
Resulted in Larger
Refunds**

According to IRS's SOI data, an estimated 81.2 million or 56 percent of approximately 145 million individual tax returns filed for tax year 2011 were completed by a paid preparer. Estimated use of paid preparers was fairly evenly distributed across income levels, and as table 2 shows, taxpayers with more complex returns used preparers the most. For example, preparers were more commonly used by taxpayers who filed the Form 1040 as opposed to the 1040EZ or 1040A and those claiming itemized deductions or the Earned Income Tax Credit (EITC).

Table 2: Individual Taxpayers' Estimated Use of Paid Preparers, by Various Groupings, Tax Year 2011

Taxpayer grouping and subgrouping	Estimate (percent)
Adjusted gross income levels	
\$0–20,000	54
20,001–40,000	54
40,001–60,000	56
60,001–80,000	59
80,001–100,000	58
Over 100,000	63
All adjusted gross income levels	56
Type of return	
Form 1040EZ	41
Form 1040A	50
Form 1040	63
Filing status	
Single	50
Head of household	61
Married filing jointly	62
Type of deductions	
Standard	53
Itemized	63
Earned Income Tax Credit	
Not claimed	55
Claimed	59

Source: GAO analysis of SOI data for tax year 2011.

Note: All percentage estimates have 95 percent confidence intervals that are within 10 percentage points of the estimate itself, and all numerical estimates other than percentages have 95 percent confidence intervals that are within 10 percent of the estimate itself.

Across all income levels taxpayers who used paid preparers had a higher median refund than those who prepared their own returns at statistically significant levels, as shown in table 3. Specifically, individual taxpayers who used a paid preparer had an estimated median tax refund across all adjusted gross income levels that was 36 percent greater than taxpayers who prepared their own return.

Table 3: Estimated Median Refunds on Returns Filed by Individual Taxpayers Using Paid Preparers and Those Preparing Their Own Returns, Tax Year 2011

Income level	Preparing own return	Using a paid preparer
\$0-20,000	\$1,499	\$2,125
20,001-40,000	857	1,114
40,001-60,000	1,606	2,184
60,001-80,000	1,949	2,213
80,001-100,000	2,208	2,700
Over 100,000	2,499	2,971
All adjusted gross income levels	3,143	4,277

Source: GAO analysis of IRS SOI data for tax year 2011.

Note: All percentage estimates have 95 percent confidence intervals that are within 10 percentage points of the estimate itself, and all numerical estimates other than percentages have 95 percent confidence intervals that are within 10 percent of the estimate itself.

Limited Investigation and IRS Data Reveal Significant Errors in Returns Prepared by Paid Preparers

Taxpayers rely on paid preparers to provide them with accurate, complete, and fully compliant tax returns; however, tax returns prepared for us in the course of our investigation often varied widely from what we determined the returns should and should not include, sometimes with significant consequences. Many of the problems we identified would put preparers, taxpayers, or both at risk of IRS enforcement actions. The NRP's review of tax returns from 2006 through 2009 also found many errors on returns prepared by paid preparers, and some of those errors were more common on paid prepared returns than on self-prepared returns.

Nineteen Site Visits Revealed Significant Paid Preparer Errors

Nearly all of the returns prepared for our undercover investigators were incorrect to some degree, and several of the preparers gave us incorrect tax advice, particularly when it came to reporting non-Form W-2 income and the EITC. Only 2 of 19 tax returns showed the correct refund amount. While some errors had fairly small tax consequences, others had very

large consequences resulting in the overstatement of refunds from \$654 to \$3,718.

Our undercover investigators visited 19 randomly selected tax preparer offices—a non-generalizeable sample—to have taxes prepared. We developed two taxpayer scenarios based on common tax issues that we refer to as our “Waitress Scenario” and our “Mechanic Scenario.” Key characteristics of each scenario are summarized in table 4.

Table 4: Key Characteristics of Taxpayer Scenarios

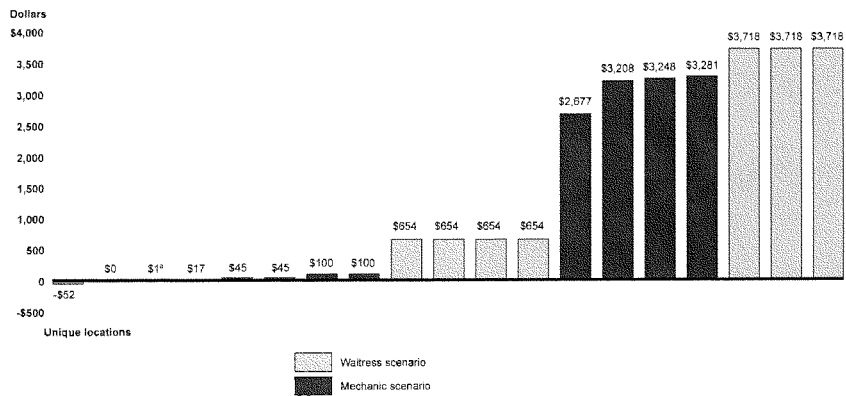
Waitress scenario	Mechanic scenario
<ul style="list-style-type: none"> Single mother whose occupation is a waitress with cash and noncash tips. One child who lived with her during 2013 and one child who did not—both under 15 years of age. Deductions include student loan interest. Eligible to claim the Earned Income Tax Credit (EITC). This scenario was used in 10 site visits. 	<ul style="list-style-type: none"> Married couple filing jointly; husband is a mechanic and his wife is a homemaker. Three children live at home aged 7, 15 and 20. Itemized deductions include mortgage interest, state sales tax, and charitable gifts. Both husband and wife have non-Form W-2 business income, including mileage reimbursement. This scenario was used in 9 site visits.

Source: GAO analysis.

Errors in Tax Preparation Resulted in Inaccurate Refund Amounts

Refund amounts derived by the 19 preparers who prepared tax returns based on our two scenarios varied greatly. For our waitress scenario, the correct refund amount was \$3,804, however, refund amounts on returns prepared for our undercover investigators ranged from \$3,752 to \$7,522. Similarly, the correct refund amount for the mechanic scenario was \$2,351; however, refunds ranged from \$2,351 to \$5,632. Paid preparer errors generated during our 19 non-generalizeable visits resulted in refund amounts that varied from giving the taxpayer \$52 less to \$3,718 more than the correct amount. Of the 19 paid preparers we visited, 2 determined the correct refund amount: one correct tax return was prepared for the waitress scenario and one for the mechanic scenario. An additional 4 paid preparers calculated tax returns within \$52 of the correct refund amount. On the remaining 13 tax returns—7 for the waitress scenario and 6 for the mechanic scenario—preparers overestimated the total refund by \$100 or more. Figure 3 shows the amount of the refund over and under the correct refund amount.

Figure 3: Refund Amounts Over or Under Correct Amount



Source: GAO analysis.

Notes: *We determined that the tax return with an estimated refund amount of \$1 over the correct amount was calculated correctly. The difference is attributable to a rounding error.

In some instances, paid preparers made similar errors across multiple site visits. For example, on the waitress return paid preparers made two of the same errors: (1) not claiming the unreported cash tips and (2) claiming both children as eligible to receive the EITC. These errors resulted in clusters of overstated refunds. In four site visits, paid preparers not claiming unreported cash tips resulted in a refund amount overstated by \$654. In three site visits, paid preparers made both errors, which resulted in a refund amount overstated by \$3,718. In the mechanic scenario, paid preparers that did not include side income resulted in tax refunds that ranged from \$2,677 to \$3,281 above the correct refund amount.

Quality and Accuracy of
Tax Preparation Varied
Based on the Scenario
and Specific Form or
Line Number

A majority of the 19 paid preparers we visited made errors on common tax return issues; on some lines of the tax return most paid preparers were correct. Some of the most significant errors involved paid preparers (1) not reporting non-Form W-2 income, such as unreported cash tips, in 12 of 19 site visits; (2) claiming an ineligible child for the EITC in 3 of 10 site visits; and (3) not asking the required eligibility questions for the American Opportunity Tax Credit. Such errors could lead taxpayers to underpay their taxes and may expose them to IRS enforcement actions. By contrast, in some instances the majority of preparers took the right course of action. For example, 17 of 19 paid preparers completed the correct type of tax return and 18 of 19 preparers correctly determined whether to itemize or claim the standard deduction. Our results are summarized in figure 4.

Form or Line Number	Results
Type of tax return	●●●●●●●●●●●●●●●●
Ordinary dividends, Qualified dividends, and Capital gains (Lines 9a-b, and Line 13)	●●●●●●●●●●●●●●●●
Total income (Line 22)	●●●●●●●●●●●●●●●●
Itemized or standard deduction (Line 40)	●●●●●●●●●●●●●●●●
Credit for child and dependent care expenses—Form 2441 (Line 48)	●●●●●●●●●●●●●●●●
Student loan interest deduction (Line 33)	●●●●●●●●●●●●●●●●
State and local general sales tax (Schedule A—Line 5b)	●●●●●●●●●●●●●●●●
Unreported Social Security and Medicare tax—Form 4137 (Line 57)	●●●●●●●●●●●●●●●●
Earned Income Credit (Line 54a)	●●●●●●●●●●●●●●●●
American Opportunity Tax Credit—Form 8863 (Line 66)	●●●●●●●●●●●●●●●●
Refund amount (Line 74a)	●●●●●●●●●●●●●●●●

Waitress scenario

- Completed correctly
- Completed incorrectly
- Not completed

Mechanic scenario

- Completed correctly
- Completed incorrectly
- Not completed

Source: GAO analysis.

Type of tax return. Paid preparers completed the correct type of tax return—the Form 1040—for 17 of 19 site visits. Two paid preparers incorrectly completed the Form 1040A for the waitress scenario. The Form 1040A should not have been used because the waitress received tip income that was not reported to her employer.¹⁷

¹⁷According to IRS guidance, Form 1040 and Form 4137 must be used if tip income not reported to the employer is \$20 or more in any month.

Dividend and capital gains income. Preparers recorded the income correctly on 8 of 9 returns. The mechanic received qualified and ordinary dividends, and capital gains from a mutual fund that were reinvested into the fund. This income was documented on a third party reporting form; the Form 1099-DIV. According to IRS guidance, a Form 1099-DIV must be filed for any person who receives dividends of \$10 or more, including for funds that are reinvested.

Mechanic Scenario, Site Visit #1

One paid preparer who did not accurately record the investment income said that it was not necessary to include income that was reinvested in a mutual fund.

Total income. Of the 10 waitress returns prepared for us, 3 included the unreported cash tip income. However, only one of the three returns included the correct amount of tip income. Total income for the waitress scenario should include income documented on the Form W-2, as well as the amount of unreported cash tip income offered by our investigator to the paid preparer during the site visit. The two returns that did not include the correct amount of tip income included lesser amounts.

Waitress Scenario, Site Visit #5

In response to the investigator mentioning her unreported cash tip income, one paid preparer told her that she not included on the Form W-2 do not need to be reported.

Total income for the mechanic return should include non-Form W-2 business income—resulting from mechanic work and babysitting conducted outside of a formal employment arrangement—and income from ordinary dividends and capital gains. Of the 9 mechanic returns prepared for us, 4 returns included both the business income and the investment income. However, only 3 returns included the correct amounts of business and investment income.¹⁸

Incorrectly reporting income often resulted in cascading errors on other lines of the tax return. Tax returns that did not include side income had errors in credits that are calculated based on income. For

¹⁸The mechanic tax return should have included a Schedule C, Profit or Loss from Business. The income also required a Schedule SE for self-employment taxes.

example, if a paid preparer did not report side income in the mechanic scenario, the resulting total income would make the mechanic eligible for the EITC when he otherwise would not be eligible. Similarly, because two paid preparers incorrectly chose not to include unreported tip income for the waitress, they selected the wrong type of tax return, the Form 1040A.

Mechanic Scenario, See Vigns #2 and #9
Two paid preparers demonstrated what the refund amount would be if the side income were reported compared to if it were not reported. Both preparers did not record the side income.

Itemized or standard deduction. All but one of the 19 returns correctly recorded the most advantageous deduction for the two scenarios. According to IRS guidance, taxpayers should itemize deductions when the amount of their deductible expenses is greater than the standard deduction amount. For the waitress scenario, the most advantageous deduction would be the standard deduction for head of household, and for the mechanic scenario, the itemized deductions were more advantageous. One paid preparer chose to use the standard deduction for the mechanic, even though it was approximately \$3,000 less than the total amount of the itemized deductions we included in the scenario.

Child-care expenses. All 19 paid preparers did not record child-care expenses because neither the waitress nor mechanic was eligible to receive the credit. While none of the paid preparers recorded the credit, the reasons the preparers cited were often incorrect. According to IRS guidance, a taxpayer must attempt to collect the Social Security number of his or her child-care provider, but if unsuccessful, can report that fact to IRS and still claim the credit. For the waitress scenario, the reason that she was ineligible to claim the child-care expenses was that she did not attempt to get her child-care provider's Social Security number. Upon learning that she did not have the Social Security number of the provider, several of the paid preparers did not enter her child care expenses on her return.

IRS guidance states that qualified child-care expenses only include amounts paid while the taxpayer worked or looked for work. The mechanic and his wife were not eligible for the credit because the child-care expenses were incurred for running errands, and not so that either parent could work. Again, many tax preparers said that the reason the credit could not be claimed was because the mechanic did

not have the child-care provider's Social Security number, not because he was otherwise ineligible.

Student loan interest. Eight of 10 paid preparers correctly included the deduction for student loan interest. The waitress's Form 1098-E shows the interest the lender received from the taxpayer on qualified student loans. A taxpayer receives a Form 1098-E if student loan interest of \$600 or more is paid during the year.

Sales tax deduction. Seven of 9 preparers recorded sales tax as a deduction on the mechanic's tax return, however not all chose the most advantageous amount. According to IRS guidance, taxpayers who itemize deductions can choose whether to deduct local income taxes or sales taxes. Because the mechanic lived in a state that did not have income tax, sales tax should have been deducted. Of the 7 paid preparers that deducted sales taxes, only 2 recorded the amount that was most advantageous to the taxpayer. IRS provides an online calculator to help taxpayers estimate the amount of sales taxes they likely paid in a year. To determine this estimate, taxpayers input basic information such as ZIP code and annual income in the calculator. Five preparers chose amounts that were lower than the amount the calculator estimated.

Social Security and Medicare tax on unreported tips. Two of 10 paid preparers completed the Form 4137 and reported the amount of taxes owed on the tip income. Because the waitress received unreported cash tips, the amount of taxes owed on the unreported cash tip income should be calculated using the Form 4137.¹⁹ However, one of the preparers included a lesser amount of tip income when performing the calculation, resulting in a smaller amount of taxes owed. Another preparer reported the tip income by incorrectly completing a Schedule C, Profit or Loss from Business, and a Schedule SE for self-employment taxes.

Earned Income Tax Credit. The EITC on line 64a was another area where paid preparers made mistakes that resulted in a significant overstatement of the refund. Of the 10 returns prepared for the waitress, 3 reported two children on the Schedule EIC, instead of the

¹⁹Form 4137, Social Security and Medicare Tax on Unreported Tip Income.

one child who lived with the taxpayer in 2013 and was eligible for the EITC.²⁰

Waitress Scenario, Site Visit #4
One paid preparer questioned the investigator on the amount of time her other child lived with her. The investigator responded that the other child stayed with her on weekends. The paid preparer discussed the investigator's response with the office manager and then stated that she can claim the child for the EITC if no one else does, which was not correct.

American Opportunity Tax Credit. All 9 paid preparers correctly chose the American Opportunity Tax Credit for the mechanic scenario. The mechanic had a 20-year-old son attending a community college and paid for both his tuition and books. According to IRS guidance, to be eligible for this credit, a student must meet certain requirements including full-time enrollment at least half the year and no felony drug offense convictions. Although we instructed the investigator to respond to paid preparer inquiries such that his son met these requirements, some paid preparers did not ask the required questions to determine eligibility.

Improper Conduct May Subject Preparers to Internal Revenue Code Penalties

All paid preparers are subject to certain requirements in the Internal Revenue Code (IRC) and may be subject to penalties for non-compliance. For example, the IRC imposes monetary penalties on paid preparers who understate a taxpayer's tax liability due to willful or reckless conduct. As shown in figure 5, in 12 of 19 cases, paid preparers did not record additional side income not reported on Form W-2's and may be subject to this penalty. The IRC also requires that paid preparers sign the tax return and furnish an identifying number. In 3 of 19 cases, preparers did not meet the signature requirement. In addition, 3 preparers used a PTIN that did not belong to them and one used a fake PTIN.

Additionally, 3 of 10 preparers in our study may be subject to a penalty for not meeting due diligence requirements when determining if both of the

²⁰IRS estimated that for fiscal year 2013 the level of improper overclaims for the EITC range from \$13.3 to \$15.6 billion of approximately \$60.3 billion in total program payments. The projection of estimated overclaims for fiscal year 2013 is based on tax year 2009 reporting compliance study. See Department of Treasury, *Fiscal Year 2013 Agency Financial Report*, December 16, 2013.

waitress's children qualified for the EITC. When considering the EITC, paid preparers must meet four due diligence requirements. Generally, if paid preparers file EITC claims, they must (1) ask all the questions to get the information required on Form 8867, Paid Preparers' Earned Income Credit Checklist; (2) compute the amount of the credit using the EITC worksheet from the Form 1040 instructions or a similar document; (3) ask additional questions when the information the client gives the preparer seems incorrect, inconsistent, or incomplete; and (4) keep a copy of Form 8867, the EITC worksheets, and other records used to compute the credit.

Figure 5: Selected Internal Revenue Code Penalties

Internal Revenue Code	Violation	Penalty	Findings
IRC § 6011(a)	Failure to include taxable income	\$500 or 2% percent of income, whichever is less	12 of 19 preparers did not include taxable income and may be subject to this violation.
IRC § 6015(a)	Failure to provide a copy of the return to the taxpayer	\$50 per failure	3 of 19 preparers did not sign the return and may be subject to this violation.
IRC § 6011(b)	Failure to sign the return	\$50 per failure	4 of 19 preparers did not provide correct PTINS and may be subject to this violation.
IRC § 6011(c)	Failure to provide a copy of the return to the taxpayer	\$50 per failure	
IRC § 6011(d)	Failure to provide a copy of the return to the taxpayer	\$50 per failure	
IRC § 6011(e)	Failure to provide a copy of the return to the taxpayer	\$500 per failure	3 of 19 preparers did not exercise due diligence and may be subject to this violation.

Source: GAO analysis and Internal Revenue Code.

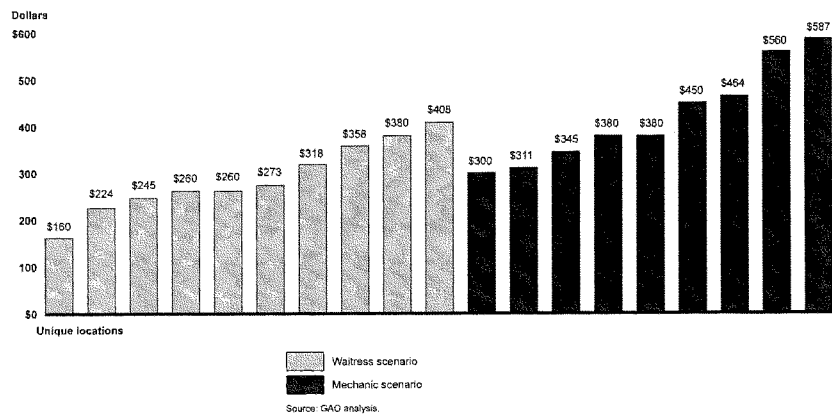
Because the returns we had prepared were not real returns and were not filed, penalties would not apply. However, we plan to refer the matters we encountered to IRS so that any appropriate follow-up actions can be taken.

**Fees Charged for
Tax Preparation Varied
Widely Across Paid
Preparer Site Visits**

The fees charged for tax preparation services varied widely across the 19 visits, sometimes between offices affiliated with the same chain. Often, paid preparers either did not provide an estimate of the fees upfront or the estimate was less than the actual fees charged. In several instances, upon completion of the tax return, the preparer initially charged one fee, then offered a reduced amount. Figure 6 shows the fees charged by each of the 19 paid preparers we visited for each scenario. For the waitress scenario, the final fees charged for tax preparation ranged from \$160 to \$408. For the mechanic scenario, the final fees charged for tax preparation ranged from \$300 to \$587. For the two correct tax returns that were prepared, the final fee charged was \$260 for the waitress scenario and \$311 for the mechanic scenario. Some paid preparers provided receipts that listed total charges that were higher than the "discounted" amount ultimately charged. For example, one preparer estimated the cost of services to be \$794, but then charged the taxpayer \$300.

Paid preparers provided various reasons for the amount of the tax preparation fee, including, (1) the EITC form is the most expensive form to file, (2) the pricing and fees are at their peak from mid-January through February and then go down, and (3) there is a price difference depending if the tax return is completed in the morning or the evening.

Figure 6: Fees Charged for Tax Preparation Services



IRS Data Suggest Errors on Paid Preparer Returns Were Similar to Those Generated During Our Site Visits

As in our limited investigation, our estimates from NRP data suggest that tax returns prepared by paid preparers contained a significant number of errors.²¹ As shown in table 5, returns prepared by a paid preparer showed a higher estimated error rate—60 percent—than returns prepared by the taxpayer—50 percent. Errors in this context changed either the tax due or the amount to be refunded. As noted before, it is important to remember that paid preparers are used more often on more complicated returns than on simpler ones, although we were unable to gauge the full extent to which this might be true. Furthermore, errors on a return prepared by a paid preparer do not necessarily mean the errors were the preparer's

²¹IRS NRP data for tax years 2006 through 2009.

fault; the taxpayer may be to blame. Preparers depend upon the information provided by the taxpayer.

Table 5: Estimated Percentage of Individual Returns with Errors

Preparer type	Estimate (percent)
Prepared by a paid preparer ^a	60
Prepared by the taxpayer	50
All returns	55

Source: GAO analysis of IRS NRP data tax years 2006 through 2009.

Notes: All percentage estimates have 95 percent confidence intervals that are within 10 percentage points of the estimate itself, and all numerical estimates other than percentages have 95 percent confidence intervals that are within 10 percent of the estimate itself.

^aAnalysis of paid preparer returns includes both tax practitioners, such as CPAs, attorneys and enrolled agents and unenrolled preparers.

In addition to different rates of errors on paid preparer filed returns and self-prepared returns, the amount taxpayers owed IRS also differed. Specifically, the estimated median amount owed to IRS was higher for paid preparer filed returns. For instance, as shown in table 6, it is estimated that taxpayers using a paid preparer owed a median of \$354 to IRS, compared with \$169 for taxpayers preparing their own return.

Table 6: Estimated Median Additional Taxes Owed on Individual Returns

Preparer type	Estimate	Lower bound	Upper bound
Prepared by a paid preparer ^a	\$354	\$337	\$377
Prepared by the taxpayer	169	155	184
All returns	263	245	281

Source: GAO analysis of IRS NRP data for tax years 2006 through 2009.

Notes: All percentage estimates have 95 percent confidence intervals that are within 10 percentage points of the estimate itself, and all numerical estimates other than percentages have 95 percent confidence intervals that are within 10 percent of the estimate itself.

^aAnalysis of paid preparer returns includes both tax practitioners, such as CPAs, attorneys and enrolled agents and unenrolled preparers.

NRP estimates show that both individuals and paid preparers make errors on specific forms and lines of Form 1040, some of which we experienced in our undercover visits. Table 7 shows that in many instances, returns completed by a paid preparer are estimated to have a greater percentage of errors compared to self-prepared returns. For example, of returns

prepared by a paid preparer, 51 percent have an error on the EITC line compared to 44 percent of self-prepared tax returns. In total, for five line items we analyzed, the difference in the percent of errors on returns prepared by a paid preparer was statistically greater than the percent of errors on self-prepared returns. These line items include (1) the itemized or standard deduction, (2) business income, (3) total income, (4) the EITC, and (5) the refund amount. Differences between the percent of returns with errors on the student loan interest deduction line, the unreported Social Security and Medicare tax on tips line, and the education credit line were not statistically significant when comparing returns done by a paid preparer to those that were self-prepared.

Table 7: Estimated Percentages of Individual Returns Containing Specific Line Items with Errors

Form 1040 line item	Self-prepared returns (percent)	Returns done by a paid preparer ^a (percent)
Itemized or standard deduction	28	38
Business income (or loss) from Schedule C or C-EZ	73	77
Total income	36	44
Student loan interest deduction	30	34
Unreported Social Security and Medicare tax on tips	51	52
Earned Income Tax Credit	44	51
Education credit	43	45
Refund amount	50	60

Source: GAO analysis of IRS NRP data for tax years 2006 through 2009.

Notes: All percentage estimates have 95 percent confidence intervals that are within 10 percentage points of the estimate itself, and all numerical estimates other than percentages have 95 percent confidence intervals that are within 10 percent of the estimate itself.

^aAnalysis of paid preparer returns includes both tax practitioners, such as CPAs, attorneys and enrolled agents and unenrolled preparers.

Conclusions

Over half of all taxpayers rely on the expertise of a paid preparer to provide advice and help them meet their tax obligations. IRS regards paid preparers as a critical link between taxpayers and the government. Consequently, paid preparers are in a position to have a significant impact on the federal government's ability to collect revenue and minimize the estimated \$385 billion tax gap. As of March 2014, 55 percent of paid tax preparers are unenrolled preparers, not regulated by

IRS. Undoubtedly, many paid preparers do their best to provide their clients with tax returns that are both fully compliant with the tax law and cause them to neither overpay nor underpay their federal income taxes. However, IRS data, which more broadly track compliance, show preparers made serious errors, similar to the findings from our site visits. The higher level of accuracy of Oregon's tax returns compared to the rest of the country suggests that a robust regulatory regime involving paid preparer registration, qualifying education, testing, and continuing education may help facilitate improved tax compliance. The courts determined that IRS does not have sufficient authority to regulate unenrolled preparers. In March 2014, the administration proposed that the Treasury and IRS be granted the explicit authority to regulate all paid preparers. Providing IRS with the necessary authority for increased oversight of the paid preparer community will help promote high-quality services from paid preparers, will improve voluntary compliance, and will foster taxpayer confidence in the fairness of the tax system.

Matter for Congressional Consideration

If Congress agrees that significant paid preparer errors exist, it should consider legislation granting IRS the authority to regulate paid tax preparers.

Chairman Wyden, Ranking Member Hatch, and Members of the Committee, this concludes my statement. I would be pleased to respond to any questions that you may have.

Contacts and Acknowledgments

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**WRITTEN STATEMENT OF
NINA E. OLSON
NATIONAL TAXPAYER ADVOCATE**

BEFORE THE

**COMMITTEE ON FINANCE
UNITED STATES SENATE**

HEARING ON

**"PROTECTING TAXPAYERS FROM INCOMPETENT AND UNETHICAL RETURN
PREPARERS"**

APRIL 8, 2014

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Chairman Wyden, Ranking Member Hatch, and distinguished Members of the Committee:

Thank you for inviting me to testify about the status of federal tax return preparation in the United States.¹ Given the critical role that preparers play in tax compliance, I believe it is in the best interest of taxpayers and tax administration to establish minimum standards for the profession.

I say this based on my longstanding and personal involvement with this issue. Shortly after I graduated from college in the mid-1970s, I hung out a shingle and held myself out as a return preparer. I had been a Fine Arts major, so to say the least, I was not a tax expert. But in that period, tax software was not yet widely available, so an individual wanting to prepare tax returns had to learn the basics. I took this endeavor seriously, and ultimately, I believe I did a good job for my clients. Even then, however, taxpayers would have been better served if return preparers were required to demonstrate basic competency in tax return preparation.

Today, because of changes in technology, the need for standards is much greater. With the advent of tax preparation software and the "Q&A" format, a person can hold himself out as a return preparer with almost no knowledge or skill by simply sitting with a taxpayer and working through the software's prompts. As many undercover "shopping visits" to return preparers have found, preparing returns with software and little knowledge typically does not produce accurate results.

At the same time, the development of e-file and direct deposit has vastly expanded the pool of preparers to include persons who are marketing return preparation as a tool to sell other products and services. Refund Anticipations Loans (RALs) for many years were offered to lure customers in order to sell other products. For example, a car dealership would prepare returns and offer customers RALs so the customer could make a down payment on a car or truck. This created an incentive for preparers to inflate refunds so the taxpayer would have more money available to make a larger down payment or buy a more expensive vehicle. RALs have largely been abolished in the last few years but have been replaced by pay-stub loans, Refund Anticipation Checks (RACs), and the like. The utilization of tax preparation as a tool to sell other products and services has not gone away.

¹ The views expressed herein are solely those of the National Taxpayer Advocate. The National Taxpayer Advocate is appointed by the Secretary of the Treasury and reports to the Commissioner of Internal Revenue. However, the National Taxpayer Advocate presents an independent taxpayer perspective that does not necessarily reflect the position of the IRS, the Treasury Department, or the Office of Management and Budget. Congressional testimony requested from the National Taxpayer Advocate is not submitted to the IRS, the Treasury Department, or the Office of Management and Budget for prior approval. However, we have provided courtesy copies of this statement to both the IRS and the Treasury Department in advance of this hearing.

After being an unenrolled, unregulated return preparer for more than a decade, I decided to go to law school. I continued to prepare returns, and when I graduated, I founded a Low Income Taxpayer Clinic (LITC). There, I represented taxpayers who had gotten into trouble with the IRS, and I saw first-hand the challenges that await taxpayers who have used incompetent preparers. It is generally the taxpayer – not the preparer – who is left holding the bag when the IRS determines more taxes, plus interest and penalties, are due.

In tax year (TY) 2012, 56 percent of 142 million individual taxpayers paid preparers to complete their returns for them. Very simply, the absence of minimum competency standards for return preparers leaves these taxpayers vulnerable to inadvertent errors that could cause them to overpay their tax – or to underpay their tax and face IRS collection action. It also leaves some taxpayers open to unscrupulous preparers, many of whom would be weeded out if the return preparation industry were professionalized.

At present, we require volunteers who help prepare returns for elderly, disabled, and low income taxpayers through the VITA and TCE programs to pass a competency test. Yet we ask nothing of hundreds of thousands of persons who make their living off tax preparation. That makes little sense to me.

In my testimony, I will elaborate on these and other issues, as follows:

1. **The tax preparation industry has changed substantially over recent decades.** The industry has changed significantly since 1976 when Congress enacted the penalty provisions in Internal Revenue Code (IRC) §§ 6694 and 6695. The changes are the result, for the most part, of three factors: the advent of commercial preparation software; the expansion of the taxpayer base to include low income persons through enactment of refundable credits; and the financial incentives to inflate refunds and cross-market products and services.
2. **Preparers play a crucial role in tax administration and their services amount to more than “mere ministerial acts.”** Federal tax return preparers are not mere scriveners of a taxpayer’s information. The tax return functions as a report of financial information and even as an application for benefits. Accordingly, in many instances, the preparation of a tax return amounts to presenting a taxpayer’s case when preparers advise and assist taxpayers in making their claims to the IRS.
3. **There is an urgent need for uniform standards to professionalize the tax return preparation industry.** Since 2002, I have proposed that the IRS develop a program to register, test, and certify unenrolled preparers. I also recommended increased penalties and due diligence requirements as well as a public awareness campaign. My proposals received widespread support. In 2009, the IRS developed its return preparer program. In early 2013, however,

the U.S. District Court in *Loving v. Internal Revenue Service* enjoined the IRS from implementing the testing and education components of the program.² Now we are left with no meaningful federal oversight, and varying levels of standards in several states.

4. **Without meaningful federal oversight, taxpayers remain vulnerable to incompetent and unscrupulous preparers.** Until the IRS has authority to establish minimum standards for the profession, taxpayers will remain vulnerable to incompetence and misconduct. Several "mystery shopping visit" programs over the years have uncovered significant noncompliance and unethical behavior. My office has also seen a substantial number of cases involving return preparer fraud.
5. **Without a preventive testing and education regime, the IRS is forced to take a reactive approach to return preparer oversight.** The IRS currently has Title 26 penalties and sanctions under Circular 230 at its disposal. However, these enforcement measures only allow the IRS to intervene after harm to a taxpayer has occurred. The establishment of minimum standards would professionalize the industry, protect taxpayers by ensuring that preparers are competent in the tax laws, and likely weed out a majority of unprofessional or unethical individuals.
6. **Congress should revise 31 U.S.C. § 330(a)(2) to make clear that the IRS has the authority to regulate unenrolled preparers.** I recommend that Congress amend 31 U.S.C. § 330(a)(2) to clarify that the IRS has the authority to impose testing and continuing education requirements on unenrolled preparers. The provision should provide enough flexibility to enable the IRS to react to any unanticipated changes in the return preparation industry. The provision should be written broadly enough to encompass submissions of other documents that pertain to or arise from the tax liability, such as financial statements and offers in compromise.³
7. **In the absence of clear legislative authority to establish testing and continuing education requirements on unenrolled preparers, the IRS should take administrative measures to protect taxpayers from preparer incompetence and misconduct.** To protect taxpayers from harm in the absence of minimum standards for unenrolled preparers, the IRS should: (1) offer preparers the opportunity to earn a voluntary examination and continuing education certificate; (2) restrict the ability of unenrolled preparers to represent taxpayers in audits of returns they prepared unless they have obtained a certificate; (3) restrict the ability to name unenrolled preparers as third-party designees unless they have obtained a certificate; and (4) mount a consumer

² 917 F. Supp. 2d 67 (D.D.C. Jan. 18, 2013), *aff'd* 742 F.3d 1013 (D.C. Cir. Feb. 11, 2014).

³ IRC § 7122.

protection campaign educating taxpayers about how to select competent preparers.

8. **The IRS has agreed to develop procedures to issue refunds due to victims of return preparer fraud.** My office has seen a significant number of cases where the preparer alters the taxpayer's return by inflating income, deductions, credits, or withholding without the client's knowledge or consent and pockets the difference or perhaps the entire refund by diverting all or a portion of the refund to a bank account under the preparer's control. After several years of issuing Taxpayer Assistance Orders (TAOs) and negotiating with the IRS, I am pleased that the IRS has agreed to issue refunds to victims of preparer fraud upon receiving sufficient documentation to alleviate any concerns about collusion.

- I. **The tax preparation industry has changed substantially over recent decades.**

The return preparation industry has changed substantially since 1976, when Congress first enacted requirements for preparers to sign returns and provide copies to taxpayers along with the penalty provisions of IRC §§ 6694 and 6695.⁴ When I began my career in tax administration as an unenrolled return preparer in 1975, there were no widely-available commercial return preparation software packages. To do my job, I had no choice but to study and learn tax law, rules, regulations, and publications. Because one had to actually know something about the tax law to be a return preparer, taxpayers had some assurance of the preparer's competency.

Today, by comparison, there is no such assurance of competence. Three important changes have taken place in the tax preparation arena as described below:

- A. **The advent of return preparation software has eliminated barriers to entry in the profession.**

The advent of affordable commercial return preparation software eliminated barriers to entry into the industry. As noted above, before return preparation software became available, knowledge of the tax laws was a prerequisite. But once tax preparation software became widely available and reasonably priced, anyone could sit down and walk through the entire process without any previous knowledge or experience. While there are clear benefits to commercial software, *e.g.*, fewer omissions and transcription errors (and for the taxpayer user, the benefit of the question-and-answer format), there is no doubt that software has opened the doors to enable anyone, with good or ill intent, to present himself or herself as a return preparer.

⁴ See Tax Reform Act of 1976, Pub. L. No. 94-455, § 1203.

B. The enactment of refundable credits has expanded the preparer customer base to include low income individuals.

Beginning in 1975 with the Earned Income Tax Credit (EITC), Congress has enacted numerous refundable tax credits, in lieu of direct spending programs, as a way of delivering social and economic benefits to taxpayers. The delivery of refundable credits through the tax system has brought into the system low income and other vulnerable taxpayers who would not otherwise need to file or who would file very simple returns without the need for tax preparation. As the chart below illustrates, a substantial percentage of refundable-credit recipients used paid preparers in TYs 2011 and 2010.

Figure 1, Taxpayers Claiming Refundable Credits, Claim Amounts, and Preparer Usage: Tax Years 2010 and 2011⁵

Tax Credit	Tax Year	Number of Taxpayers	Average Claim (\$)	Total Claims (\$ in thousands)	Preparer Returns (%)
EITC	2011	27,362,193	\$2,270	\$62,119,975	59.3%
Additional child tax credit	2011	20,616,435	\$1,347	\$27,771,740	65.0%
First-Time Homebuyer credit	2010	373,880	\$6,893	\$2,577,155	53.8%
Adoption credit	2011	55,794	\$13,474	\$760,365	60.1%
Making Work Pay credit	2010	106,381,764	\$514	\$54,784,234	53.6%
American Opportunity tax credit	2011	12,525,776	\$899	\$11,266,488	55.9%

Furthermore, many of the taxpayers who claim refundable credits use unenrolled preparers. As Figure 2 demonstrates, approximately 75 percent of the preparers who prepared TY 2010 through TY 2012 returns claiming the EITC were unenrolled.

⁵ IRS Compliance Data Warehouse (CDW), Individual Returns Transaction File and Individual Master File, TY 2010 and TY 2011 (returns filed through Mar. 2013).

Figure 2, Preparation of EITC Claims by Unenrolled Preparers:, Tax Years 2010 - 2012⁶

Tax Year	EITC Paid	Count	Total Preparers	Unenrolled Preparers	Percent Unenrolled
2010	\$58,573,186,452	27,627,852	16,464,493	12,430,967	75.5%
2011	\$61,109,934,146	27,816,576	16,549,166	12,198,085	73.7%
2012	62,981,818,983	27,081,228	15,132,562	11,523,814	76.2%

C. Preparers have a financial incentive to inflate refunds and cross-market products and services.

The increasingly complex nature of tax returns filed by low and middle income taxpayers, driven in part by refundable and nonrefundable credits, has given rise to disturbing incentives in the tax preparation industry. Taxpayers' reliance on or expectations to receive quick and sizeable refunds have created a financial incentive for new players to enter the return preparation industry and market ancillary products. For example, preparers and associated financial institutions may charge high fees for commercial refund delivery products such as RACs or pay-stub loans.⁷ Moreover, the tax preparation field has increasingly become a vehicle for cross-marketing non-tax goods and services.

Individuals and businesses now offer return preparation services not just as their primary service as in the past, but as a service ancillary to their primary line of business. These "preparers" then encourage their preparation clients to spend their tax refunds on products or services offered in their primary line of business, such as car or truck sales, furniture rentals, mortgage refinancing with a related financial institution – or even dog

⁶ IRS, Compliance Data Warehouse, Individual Returns Transaction File; IRS, Individual Master File (net of transactions 764, 765, and 768); IRS, Return Preparers and Providers Database (through Nov. 2013). Note that the amounts paid out by the IRS may have been subsequently disallowed in post-refund audits.

⁷ A RAC is a non-loan commercial product that creates a temporary bank account to receive the taxpayer's direct-deposited tax refund. The taxpayer subsequently receives the refund after deduction of fees incurred during the preparation process. A pay-stub loan is a pre-filing season short-term loan based on the taxpayer's anticipated tax refund as calculated by using numbers reported on the taxpayer's most recent pay stub.

grooming services.⁸ In fact, in many advertisements today, it is difficult to discern the connection between the service offered (“get money quick!”) and the act of tax preparation.⁹

II. Preparers play a crucial role in tax administration and their services amount to more than “mere ministerial acts.”

Preparers play a critical role in the tax system, which relies heavily on voluntary compliance. In TY 2012, for example, taxpayers filed about 142 million 1040-series individual returns,¹⁰ with slightly over 79 million taxpayers using paid preparers.¹¹ More than half (almost 43 million) of these returns were prepared by preparers unregulated by the IRS.¹²

There is a general misunderstanding of the role tax preparers play in the tax system, particularly in light of the complexity of and the increased delivery of refundable credits through the Code.¹³ However, the filing of a tax return is not merely a ministerial act. The taxpayer is taking a position before the federal government regarding items of income, expenses, and eligibility for government benefits administered by the IRS. A preparer is not merely the taxpayer's scrivener. Taxpayers pay preparers for their

⁸ Taxpayer Advocate Service, *Tax Preparation Sites Across the United States: A Random Selection of Services Marketed to U.S. Taxpayers*, available at <http://www.taxpayeradvocate.irs.gov/preparervideo> (last visited Apr. 2, 2014).

⁹ For an example, see <http://www.youtube.com/watch?v=W00BmbrivHk&sns=em> (Southern King Taxes promotional video) (last viewed Mar. 31, 2014).

¹⁰ The TY 2012 returns were prepared in 2013. For tax year 2012, the IRS received 1.9 million individual income tax returns. IRS Compliance Data Warehouse, Individual Returns Transaction File, TY 2012 (returns filed through Dec. 2013).

¹¹ IRS Compliance Data Warehouse, Individual Returns Transaction File and Return Preparers and Providers Database, TY 2012 (filed through Dec. 2013).

¹² For a more detailed discussion of this data and its import, see Nina E. Olson, *More Than a 'Mere' Preparer: Loving and Return Preparation*, 2013 TNT 92-31, Tax Analysts Tax Notes Today (May 13, 2013). IRS Compliance Data Warehouse, Individual Returns Transaction File and Return Preparers and Providers Database, TY 2011 (returns filed through Mar. 2013). The category “unregulated preparer” reflects returns prepared by individuals with preparer tax identification numbers who did not list a profession when registering with the IRS. IRS Compliance Data Warehouse, Individual Returns Transaction File and Return Preparers and Providers Database, TY 2012 (returns filed through Dec. 2013). IRS records show about one million returns as paid preparer returns that did not have a Preparer Tax Identification Number (PTIN) match in the Return Preparers and Providers Database.

¹³ For a more detailed discussion, see Nina E. Olson, *More Than a 'Mere' Preparer: Loving and Return Preparation*, 2013 TNT 92-31, Tax Analysts Tax Notes Today (May 13, 2013). In the article, I make the case for preparer regulation generally, illustrating how problems in today's tax system are directly analogous to the problem Congress sought to address in its original grant of regulatory authority to Treasury.

knowledge and skills because they are uncomfortable navigating the complexity of the tax laws themselves.¹⁴

Tax return filing is almost always “presenting a case” for deductions, credits, and exclusions claimed on the return. Preparers participate in presenting that case to the IRS when they advise and assist taxpayers in making their claims to the IRS and Treasury.¹⁵ Almost 80 percent of individual income tax returns are actually claims for refund under IRC § 6402, and over 75 percent of those refund returns are prepared by preparers.¹⁶

In addition, IRC § 6695(g) imposes due diligence requirements for paid preparers of individual income tax returns claiming the EITC and a penalty of \$500 for each failure to comply with the requirements. The associated regulations require the preparer to complete and submit Form 8867, *Paid Preparer's Earned Income Credit Checklist*, which includes a series of questions to determine the taxpayer's eligibility as well as the preparer's affirmative acknowledgement that he or she complied with the due diligence requirements. The preparer must also complete an EITC worksheet and comply with recordkeeping and knowledge requirements.¹⁷

The due diligence requirements result in the preparer anticipating and preparing for an IRS challenge to the taxpayer's eligibility for EITC by answering certain questions, verifying to the IRS that he or she asked the taxpayer certain questions, and retaining documentation probative of eligibility.

The act of filing is also the first step for millions of U.S. taxpayers every year in what will become a formal tax controversy. For example, in the 2013 filing season, the IRS identified potential errors in approximately 18.9 million returns during processing, then sent them to “error resolution,” and required some of the taxpayers to present additional

¹⁴ See also Brief of Former Commissioners of Internal Revenue as amici curiae, supporting defendants-appellants, *Loving v. IRS*, No. 13-5061 (D.C. Cir. filed Apr. 5, 2013).

¹⁵ See Lawrence B. Gibbs, *Loving v. IRS: Treasury Has the Authority to Regulate Unregulated Commercial Preparers*, 2013 TNT 203-50, *Tax Analysts Tax Notes Today* (Oct. 21, 2013). In the article, former IRS Commissioner Gibbs argues in favor of the government's position and states that the preparation of a return is the presentation of a case. Moreover, the article analogizes the preparation of a return to the preparation of a will, which is undeniably considered representation despite the absence of a principal-agent relationship.

¹⁶ For TY 2012, the IRS received 141,900,553 individual income tax returns, of which 112,850,465 (79.5 percent) claimed refunds. IRS Compliance Data Warehouse, Individual Returns Transaction File, TY 2012 (returns filed through Dec. 2013). For TY 2012, preparers prepared 79,201,197 individual returns, of which 60,867,933 (76.9 percent) claimed refunds. IRS Compliance Data Warehouse, Individual Returns Transaction File, TY 2012 (returns filed through Dec. 2013).

¹⁷ Treas. Reg. § 1.6695-2. For tax returns and claims for refund for tax years ending on or after Dec. 31, 2011, preparers are required to submit Form 8867, with the taxpayer's return. T.D. 9570. This recent revision is consistent with my 2003 recommendations. National Taxpayer Advocate 2003 Annual Report to Congress 270-302. Under the knowledge requirement, the preparer must have no knowledge that any of the information used to determine the taxpayer's eligibility for the EITC is incorrect.

information.¹⁸ Further, the IRS issued over 270,000 math error notices, disallowing dependency exemptions and tax credits tied to dependents for tax year 2012.¹⁹

III. There is an urgent need for uniform standards to professionalize the tax return preparation industry.

Before I became the National Taxpayer Advocate in 2001, I was an unenrolled preparer for 16 years and the founder, director, and attorney of an LITC for eight years. At the clinic, I represented taxpayers in IRS disputes that more often than not arose from incompetent or questionable return preparation and advice. As a result of seeing firsthand the radical changes in the industry since I first entered practice and the impact this industry has on vulnerable taxpayers, I have formally advocated for return preparer oversight since 2002. As National Taxpayer Advocate, I wrote the following in that year's Annual Report to Congress:

Taxpayers must be confident that federal tax preparers meet basic standards of expertise and competence, and that these standards are maintained over time. Taxpayers would be better served, and compliance would likely be improved, if tax preparers were required to meet minimum standards of competency.

Currently there are no national standards that a person is required to satisfy before presenting him- or herself as a federal tax preparer and selling tax preparation services to the public. Anyone, regardless of his or her training, experience, skill, or knowledge, is able to prepare federal tax returns for others for a fee.²⁰

To address the lack of meaningful IRS oversight over unenrolled preparers, I have continually advocated for a program to register, test, and certify these preparers, as well as imposition of increased preparer penalties and improved due diligence requirements. I have also recommended that the IRS mount a comprehensive education campaign to inform taxpayers how to choose a competent preparer and remind them to obtain a copy of the tax return with the preparer's signature.²¹

¹⁸ IRS, Submission Processing Miscellaneous Monitoring Report, Headquarters, ERS (IMF/BMF) 2013 vs. 2012 (week ending Sept. 27, 2013).

¹⁹ Individual Returns Transaction File (IRTF) tax module table from CDW tax year 2012 (transaction codes 604, 605, and 743) (Oct. 2013). For a detailed description of the path a return takes from submission to assessment and refund issuance, and all the possible controversies arising from that path, see Nina E. Olson, *More Than a 'Mere' Preparer: Loving and Return Preparation*, 2013 TNT 92-31, Tax Analysts Tax Notes Today (May 13, 2013).

²⁰ National Taxpayer Advocate 2002 Annual Report to Congress 216.

²¹ National Taxpayer Advocate 2013 Annual Report to Congress 61-74. National Taxpayer Advocate 2009 Annual Report to Congress 41-69; National Taxpayer Advocate 2008 Annual Report to Congress 503-512; National Taxpayer Advocate 2006 Annual Report to Congress 197-221; National Taxpayer Advocate 2005 Annual Report to Congress 223-237; National Taxpayer Advocate 2004 Annual Report to

Our recommendations have received widespread support. Most organizations representing established preparers supported my call for minimum industry standards. The Senate Finance Committee has twice approved legislation to regulate federal tax return preparers (once under Democratic leadership and once under Republican leadership).²² The first time, the full Senate approved the legislation.²³ In the House, the Ways and Means Subcommittee on Oversight held a hearing in 2005 at which representatives of five outside organizations testified in support of regulating return preparers.²⁴ However, the House of Representatives has not considered this legislation. More recently, several bills included proposals to regulate preparers, including S. 1219, the Taxpayer Protection and Assistance Act of 2007, H.R. 5716, the Taxpayer Bill of Rights Act of 2008, and S. 3215, the Taxpayer Bill of Rights of 2010.²⁵ All of these bills would have required preparers to have the knowledge and skills to prepare accurate returns.²⁶

Beginning in 2009, the IRS sought on its own to establish minimum competency standards for the tax preparation industry. In January 2010, the IRS published a study of federal tax return preparers that in most important respects reflected my proposal.²⁷ As a result of the study, the IRS issued regulations requiring all preparers to register with the IRS by obtaining a preparer tax identification number (PTIN).²⁸ The IRS also required certain preparers to meet testing and continuing education standards. Unenrolled preparers would obtain the designation "registered tax return preparer" if they satisfied the program requirements.²⁹

Congress 67-88; National Taxpayer Advocate 2003 Annual Report to Congress 270-301; National Taxpayer Advocate 2002 Annual Report to Congress 216-230; *Fraud in Income Tax Return Preparation: Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways and Means*, 109th Cong. (2005) (statement of Nina E. Olson, National Taxpayer Advocate).

²² H.R. 1528 (incorporating S. 882) (108th Cong.); S. 1321 (incorporating S. 832) (109th Cong.).

²³ H.R. 1528 (incorporating S. 882) (108th Cong.).

²⁴ The organizations were the American Bar Association, the American Institute of Certified Public Accountants, the National Association of Enrolled Agents, the National Society of Accountants, and the National Association of Tax Professionals. See *Fraud in Income Tax Return Preparation: Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways and Means*, 109th Cong. (2005).

²⁵ S. 1219, § 4, 110th Cong. (2007); H.R. 5716, § 4, 110th Cong. (2008); S. 3215, § 202, 111th Cong. (2010).

²⁶ See also Government Accountability Office (GAO), GAO-08-781, *Oregon's Regulatory Regime May Lead to Improved Federal Tax Return Accuracy and Provides a Possible Model for National Regulation* (Aug. 15, 2008).

²⁷ IRS Publication 4832, *Return Preparer Review* (Dec. 2009).

²⁸ Treas. Reg. § 1.6109-2(d).

²⁹ 31 C.F.R. §§ 10.4(c) (testing) and 10.6(e) (continuing education).

Implementation began with the 2011 filing season, when the IRS required paid return preparers to obtain PTINs.³⁰ The IRS launched the registered tax return preparer competency test in November 2011 with a deadline to take the test by December 31, 2013. The continuing education requirement began during the 2012 calendar year.³¹

The IRS's efforts to impose standards came to a sudden halt when, in *Loving v. Internal Revenue Service*,³² the U.S. District Court for the District of Columbia enjoined the IRS from further enforcing the testing and continuing education components of the program. The court made clear that its decision did not invalidate the registration requirement. The U.S. Court of Appeals for the District of Columbia Circuit upheld the district court's decision.³³ Therefore, while the IRS has enhanced its ability to track preparers through registration and PTINs, there remains no meaningful IRS oversight of preparers. We once again find ourselves in the position where anyone can hold himself out as a "preparer" with no tax law knowledge or experience required.

In the absence of national standards, several states have addressed the need to protect taxpayers by establishing varying levels of standards on the profession. Specifically, the following four states have implemented oversight programs:

California. In California, to become a "registered tax preparer," an individual must take an initial 60-hour "qualifying education course," purchase a \$5,000 tax preparer bond, obtain a PTIN from the IRS, submit an application to the California Tax Education Council (CTEC), and pay a \$25 fee. Registered tax preparers must renew their licenses annually and satisfy a minimum of 20 hours continuing education from a CTEC-approved provider, which must include 15 hours of federal tax curriculum (of which two hours cover ethics) and five hours of California tax curriculum.³⁴

Oregon. In Oregon, there are two separate tracks to become a preparer. A licensed tax preparer works under the supervision of a licensed tax consultant. Each track has separate requirements, but if an individual wants to begin a career as a licensed tax consultant, he or she needs to complete 80 hours of basic tax law education, complete 15 hours of continuing education in personal income tax, and pass a state-developed examination with at least a 75 percent grade. To renew each year, the licensees must attest to completion of 30 hours of tax law and tax preparation continuing education.³⁵

³⁰ See IRS News Release, IR-2010-106, *IRS Begins Notifying Tax Return Preparers on PTIN Renewals* (Oct. 25, 2010).

³¹ IRS News Release, IR-2011-111, *IRS Moves to Next Phase of Return Preparer Initiative; New Competency Test to Begin* (Nov. 22, 2011).

³² 917 F. Supp. 2d 67 (D.D.C. Jan. 18, 2013).

³³ *Loving v. I.R.S.*, 742 F.3d 1013 (D.C. Cir. Feb. 11, 2014).

³⁴ For more details on California requirements, see https://www.ftb.ca.gov/professionals/registered_tax_preparers.shtml.

³⁵ For more information on Oregon's requirements, see http://www.oregon.gov/OBTP/pages/becoming_licensed.aspx.

Maryland. Maryland requires applicants to obtain an IRS PTIN, pay a \$100 registration fee, and pass a state-developed test. Registered tax preparers must renew on a bi-annual basis and satisfy 16 hours of continuing education, of which four hours cover Maryland taxation.³⁶

New York. New York's program requires a \$100 registration fee for anyone who expects to preparer ten or more New York State returns, but registration is denied if the individual is delinquent in child support payments. Registered tax return preparers with less than three years' experience must complete 16 hours of continuing education each year. Those with more than three years of experience must complete four hours of continuing education.³⁷

The National Consumer Law Center (NCLC) is also leading a movement to develop a "Model Individual Tax Preparation Regulation Act."³⁸ NCLC encourages states to adopt the provisions of the Model Act to implement their own preparer oversight programs.³⁹

While we believe there is a need for minimum standards and a Model Act would provide more consistency among the states, I am concerned that the Model Act allows the states to develop their own competency exams. I understand that the state-specific sections of the tests would differ, but it is unclear whether the federal tax law and ethics sections of the test would be consistent among the states. I hesitate supporting a program that would result in examinations on *federal* tax law with varying levels of difficulty and content among the states. With multiple state tests, some will not be calibrated to the appropriate level of difficulty (challenging enough to ensure competency but not so challenging as to exclude capable preparers from federal tax practice). Varying state requirements would also pose challenges to preparers with clients in many states.

IV. Without meaningful federal oversight, taxpayers remain vulnerable to incompetent and unscrupulous preparers.

Without meaningful federal oversight, we will continue to see a proliferation of return preparers showing up at check-cashing businesses, pawnshops, used car dealerships, furniture stores, etc. Anyone who doubts we have devolved into the Wild, Wild West of tax return preparation should view two videos. The first is an advertisement for some

³⁶ For more information on Maryland's requirements, see <http://dlr.maryland.gov/license/taxprep/taxprepic.shtml>.

³⁷ For more information on New York's requirements, see <http://www.tax.ny.gov/tp/reg/tpregmore.htm>.

³⁸ Chi Chi Wu, National Consumer Law Center (NCLC), Model Individual Tax Preparer Regulation Act (Rev. Nov. 2013).

³⁹ NCLC, *Report Documents How Lack of Regulation Results in Widespread Problems with Paid Tax Preparers: Urges States to Require Basic Standards* (Mar. 12, 2014).

type of services related to tax returns – we aren't exactly sure what.⁴⁰ The second is a slideshow of photographs taken by Local Taxpayer Advocates in 2010 showing the variety of businesses touting tax preparation services.⁴¹ In addition, the amicus brief of the National Consumer Law Center and the National Community Tax Coalition in *Loving* contains many examples of the virtual absence of professionalism and competency in the tax preparation field.⁴²

Over the years, the need for oversight has been clearly demonstrated through the results of several “mystery shopping visit” programs. The following organizations have conducted research through shopping visits to preparers and have uncovered significant noncompliance:

Government Accountability Office

In 2006, Government Accountability Office (GAO) auditors posing as taxpayers made 19 visits to several national tax preparation chains in a large metropolitan area. Using two carefully designed fact patterns, they sought assistance in preparing tax returns. Among the results:⁴³

- The tax preparation chains made errors on all 19 returns.
- In 17 instances, the preparers computed the wrong refund amounts, with variations of several thousand dollars. In five cases, the prepared returns reflected unwarranted excess refunds of nearly \$2,000, and in two cases, the prepared returns would have caused the taxpayers to overpay by more than \$1,500.
- Preparers failed to ask where the auditor's child lived or ignored the auditor's answer to the question in five of ten applicable cases, and consequently prepared returns claiming ineligible children for purposes of the EITC.

⁴⁰ <http://www.youtube.com/watch?v=W00BmbrlvHk&sns=em> (Southern King Taxes promotional video) (last visited Mar. 31, 2014).

⁴¹ Taxpayer Advocate Service, *Tax Preparation Sites Across the United States: A Random Selection of Services Marketed to U.S. Taxpayers*, available at <http://www.taxpayeradvocate.irs.gov/preparevideo>.

⁴² Brief of National Consumer Law Center and National Community Tax Coalition, as amici curiae, supporting Defendants-Appellants, *Loving v. IRS*, No. 13-5061 (D.C. Cir. filed Apr. 5, 2013) (Doc. #1429234). See also National Consumer Law Center, *Riddled Returns: How Errors and Fraud by Paid Tax Preparers Put Consumers at Risk and What States Can Do* (Nov. 2013), available at <http://www.nclc.org/issues/riddled-returns.html>.

⁴³ GAO, GAO-06-563T, *Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors* 2 (Apr. 4, 2006) (statement of Michael Brostek, Director - Strategic Issues, Before the Committee on Finance, U.S. Senate).

- In ten of the 19 cases, preparers failed to report cash side income. Several preparers even advised the GAO “taxpayers” that reporting certain income was unnecessary because the IRS would have no way of knowing about it.
- In ten cases, shoppers were entitled to a credit for child care expenses, yet no preparer claimed the credit.
- In two of nine cases, preparers claimed the standard deduction where itemizing deductions would have been more advantageous.
- In four of the 19 cases, the preparer did not sign the return.

Treasury Inspector General for Tax Administration

In 2008, Treasury Inspector General for Tax Administration (TIGTA) auditors posing as taxpayers visited 12 commercial chains and 16 small, independently owned tax return preparation offices in a large metropolitan area. All of the preparers visited were unlicensed and unenrolled. Among the results:⁴⁴

- Of the 28 returns prepared, 61 percent were prepared incorrectly.
- If the incorrect returns had been filed, the net effect would have been \$12,828 in understated taxes, or an average net understatement per return of \$755.
- None of the seven preparers working with fact patterns involving EITC claims exercised appropriate due diligence.
- Sixty-five percent of the inaccurate returns contained mistakes or omissions deemed to be caused by human error and/or misinterpretation of the tax laws.
- Thirty-five percent of the inaccurate returns contained misstatements or omissions that TIGTA deemed willful or reckless.
- All of the business returns were prepared inaccurately.
- In five out of 28 cases, the preparer did not sign the return.

New York State Department of Taxation and Finance

Over a 20-month period ending in 2009, New York State Department of Taxation and Finance agents conducted nearly 200 targeted covert visits in which they posed as

⁴⁴ TIGTA, Ref. No. 2008-40-171, *Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors* (Sept. 3, 2008).

taxpayers and sought assistance in preparing income or sales tax returns.⁴⁵ In testimony at an IRS Public Forum, the Acting Commissioner of the New York Department of Taxation and Finance testified that investigators found “an epidemic of unethical and criminal behavior.” At one point, the Department reported that it had found fraud on about 40 percent of its visits.⁴⁶

Impact Alabama

In January 2009, Impact Alabama, an Alabama nonprofit agency sent 13 volunteers to Alabama tax preparation services, including both small seasonal firms and large national operations. All of the 13 returns prepared contained errors. Most of the mistakes involved the right to claim EITC by divorced parents sharing custody of children, a very complex and fact-specific legal inquiry.⁴⁷

Community Legal Services of Philadelphia and Community Reinvestment Association of North Carolina

Community Legal Services of Philadelphia and Community Reinvestment Association of North Carolina also conducted visits to study preparers marketing refund anticipation loans (RALs). The summary of the report findings noted, “[o]ne of the most disturbing test results involved the quality of tax preparation. Several of the preparers made serious errors that significantly affected tax liability.”⁴⁸

New York City Department of Consumer Affairs

In January 2009, New York City Department of Consumer Affairs (DCA) inspectors examined more than 430 tax preparation businesses and issued more than 1,200 notices of violations to 150 businesses. Top violations included deceptively advertising RALs. DCA targeted businesses charged with violations in the previous year as well as neighborhoods with high concentrations of EITC claims. Together, the compliance visits and assessed penalties increased the compliance rate from 56 percent to 65 percent.⁴⁹

⁴⁵ Statement of Jamie Woodward, Acting Commissioner, New York Dept. of Taxation and Finance, before IRS Tax Return Preparer Review Public Forum (Sept. 2, 2009).

⁴⁶ See Tom Herman, New York Sting Nabs Tax Preparers, Wall Street Journal (Nov. 26, 2008).

⁴⁷ Russell Hubbard, Tax Preparers Cheating Customers, Government, Alabama Nonprofit Finds, Birmingham News (Jan. 23, 2009).

⁴⁸ National Community Law Center, *Tax Preparers Take a Bite out of Refunds: Mystery Shopper Test Exposes Refund Anticipation Loan Abuses in Durham and Philadelphia* (Apr. 2008).

⁴⁹ New York City Department of Consumer Affairs, Press Release, NYC Department of Consumer Affairs Announces Citywide Enforcement Sweep of Income Tax Preparers (Feb. 5, 2009).

National Consumer Law Center

In 2010 and 2011, the NCLC reported the results two series of mystery shopping visits. In 2010, three advocacy groups in Arkansas, New York, and North Carolina conducted 19 shopping visits.⁵⁰ While the focus of the visits was to test compliance with RAL laws in those states, the groups also looked for other preparation abuses or noncompliance with the tax laws.

The 2010 visits showed that a significant number of testers were the victims of poor quality tax preparation or outright fraud. The most disturbing example was a preparer in New York who, when realizing the tester would only receive a \$1,000 federal refund with the standard deduction and would owe state taxes, began making up deductions. A preparer in Arkansas repeatedly suggested to a tester that she not include income from a second job, even though it had been reported to the IRS on a Form 1099. Another tester was forced to file an amended return and repay \$822 to the IRS due to a preparer's mistakes. Even worse, one preparer filed a return without the tester's permission.⁵¹

In 2011, NCLC reported on nine mystery shopping visits conducted by consumer groups in New York City and Durham, North Carolina. During the visits, four of the nine testers were victims of incompetent preparation or were encouraged to engage in tax fraud.⁵²

Finally, over the past several years, the need for minimum standards has become even more apparent at the Taxpayer Advocate Service. As discussed in a subsequent section of this testimony, we recently have seen many misconduct cases in which the return preparers have altered return information on electronically filed returns without their clients' knowledge or consent in an attempt to obtain improperly inflated refunds or divert refunds for their personal benefit.⁵³

⁵⁰ NCLC, *Riddled Returns: How Errors and Fraud by Paid Tax Preparers Put Consumers at Risk and What States Can Do* (updated March 2014).

⁵¹ NCLC, *Tax Preparers Out of Compliance: Mystery Shopper Testing Exposes Violations of Refund Anticipation Loan Laws in Arkansas, New York and North Carolina* (Apr. 2010).

⁵² Chi Chi Wu, *et al.*, NCLC, New Economy Project (formerly NEDAP), Community Reinvestment Association of N.C., *Tax Time 2011: Mystery Shopper Testing in New York and North Carolina Finds Continuing Problems with Tax Preparers* (Apr. 2011). Nineteen persons were recruited to make visits in three states (nine in Arkansas, seven in New York, and three in North Carolina).

⁵³ For a more detailed description of return preparer misconduct and IRS procedures to assist victims of the misconduct, see National Taxpayer Advocate 2013 Annual Report to Congress 94-102 (Most Serious Problem: *The IRS Still Refuses to Issue Refunds to Victims of Return Preparer Fraud, Despite Ample Guidance Allowing the Payment of Such Refunds*); National Taxpayer Advocate Fiscal Year 2014 Objectives Report to Congress 1-4; National Taxpayer Advocate 2012 Annual Report to Congress 68-94 (Most Serious Problem: *The IRS Harms Victims of Return Preparer Misconduct by Failing to Resolve Their Accounts Fully*).

V. Without a preventive testing and education regime, the IRS is forced to take a reactive approach to return preparer oversight.

The IRS has a wide array of enforcement tools to encourage compliance among return preparers. It can assess Title 26 penalties as well as impose sanctions under Circular 230 (under Title 31), which is generally enforced by the Office of Professional Responsibility.⁵⁴ While enforcement initiatives are a vital component of any oversight regime, IRS enforcement actions occur only after the taxpayer has already been harmed. Prevention is less costly from all perspectives. Therefore, I believe prophylactic measures are the most effective and deserve the highest priority.

The most effective preventive approach is to ensure that the preparers are competent in the tax laws. Return preparers should demonstrate their competency before they even begin to prepare taxpayers' returns. A competency test would ensure that the preparers have basic tax law knowledge, the necessary skills to complete tax forms, and the ability to find information in the tax form instructions, publications, and other IRS guidance. In addition, because the tax laws continually evolve, annual continuing education (CE) requirements are key to ensuring that preparers stay informed on the latest tax law changes.

I believe the inclusion of ethics topics in both the competency exam and CE requirements is crucial to professionalize the industry and prevent significant harm to taxpayers. There is evidence that ethics education requirements positively influence professional behavior. For example, in the years following the 2005 implementation of a four-hour biennial mandatory ethics update for all licensed certified public accountants (CPAs) in Texas, the Texas State Board of Accountancy (TSBPA) saw a significant decline in ethics disciplinary actions taken against CPA licensees.⁵⁵ By "professionalizing" the industry, we will likely weed out many and potentially most unethical individuals.

While testing and CE requirements are important components of any oversight program, I acknowledge that such requirements come with costs. However, I believe the additional costs imposed on the impacted preparer population are reasonable in light of the benefits to taxpayers. Before the IRS was enjoined from administering the test and the CE components of its return preparer program, preparers were required to pay a \$116 fee to take the competency exam. The CE fees varied by provider, ranging from under \$50 for home study courses to several hundred dollars for classroom courses to satisfy the annual 15-hour requirement.⁵⁶

⁵⁴ See IRC §§ 6694, 6695, and 6713; 31 C.F.R. § 10.50.

⁵⁵ Kathy Hurtt and C. William Thomas, *Ethics Education for CPAs in Texas: Is It Working?* Today's CPA (July/Aug. 2011).

⁵⁶ For a list of IRS-approved CE providers and their offerings, see <http://www.irs.gov/Tax-Professionals/FAQs:-Registered-Tax-Return-Preparer-Continuing-Education-Requirements>.

Further, it makes no practical sense that the IRS requires volunteer preparers in the Volunteer Income Tax Assistance and Tax Counseling for the Elderly (VITA/TCE) program to pass a competency test before preparing returns while those who make their living preparing returns have no comparable requirement. Volunteers in VITA/TCE must pass at least the basic level "Link & Learn Taxes" e-course and an associated certification examination before they are eligible to prepare returns within their certification level.⁵⁷

VI. Congress should revise 31 U.S.C. § 330(a)(2) to make clear that the IRS has the authority to regulate unenrolled preparers.

To professionalize the return preparation industry and protect taxpayers from incompetent and unscrupulous unenrolled preparers, I recommend that Congress revise 31 U.S.C. § 330(a)(2) to clarify that the IRS has the authority to establish minimum standards for the unenrolled preparer population. Specifically, Congress should modify 31 U.S.C. § 330(a)(2)(C) and (D) to clarify that the IRS can require a preparer to demonstrate the qualifications necessary to prepare and file returns, and that presenting a case to the IRS includes the preparation and filing of returns. Congress should revise the statute to enable the IRS to reinstate the previous structure and associated guidance, but the language should provide enough flexibility to enable the IRS to modify its approach as the profession evolves in unanticipated ways.

I also believe this is an opportunity to ensure that the statute clearly encompasses the submission of other documents that determine tax liability, such as financial statements and offers in compromise. The IRS should have the authority to oversee "offer mills" that troll lien filings at local recorder offices for the sole purpose of selling their high-priced services to the taxpayers, often by making misleading or deceptive promises that the taxpayers will wind up paying cents on the dollar.⁵⁸

⁵⁷ For more information about Link & Learn Taxes e-courses and certifications, see <http://apps.irs.gov/app/vita/index.jsp?level=basic>.

⁵⁸ See National Taxpayer Advocate 2009 Annual Report to Congress 207 (recommending that the IRS require preparers of offers in compromise to sign the forms to enable the IRS to track such preparers). Several of the largest "tax resolution" businesses in the United States have gone out of business after being sued by federal and state law enforcement agencies, including American Tax Relief, J.K. Harris & Company LLC, The Law Offices of Roni Lynn Deutch, and TaxMasters.

VII. In the absence of clear legislative authority to establish testing and continuing education requirements on unenrolled preparers, the IRS should take administrative measures to protect taxpayers from preparer incompetence and misconduct.

Given the demonstrated need for minimum standards for preparers, it is imperative that the IRS act to protect taxpayers from the harm that arises in the current environment. I recommend that the IRS take the following four administrative steps to ensure that taxpayers receive competent and ethical preparation, regardless of the type of tax return preparer they choose:

1. Offer unenrolled preparers the opportunity to earn a voluntary examination and continuing education certificate.
2. Restrict the ability of unenrolled preparers to represent taxpayers in audits of returns they prepared unless they earn the voluntary examination and continuing education certificate.
3. Restrict the ability to name an unenrolled preparer as a Third Party Designee on Form 1040.
4. Mount a consumer protection campaign that educates taxpayers about the need to select competent preparers who can demonstrate competency.

A. Offer unenrolled preparers the opportunity to earn a voluntary examination and continuing education certificate.

The IRS should offer paid unenrolled preparers the opportunity to *voluntarily* distinguish themselves from untrained preparers. This would involve providing a certificate to preparers who pass an IRS-developed examination and satisfy continuing education criteria similar to those previously implemented. This approach may involve contracting with third parties to administer the examination and continuing education once the IRS follows the appropriate rulemaking processes.

B. Restrict the ability of unenrolled preparers to represent taxpayers in audits of returns they prepare unless they earn an examination and continuing education certificate.

Currently, unenrolled preparers are allowed to engage in limited practice before the IRS, representing taxpayers before revenue agents, customer service representatives, or similar officers and employees of the IRS (including TAS) during an audit if they signed the tax return or claim for refund for the tax period under examination.⁵⁹ These preparers cannot, however, represent taxpayers before Appeals or Collection.⁶⁰

⁵⁹ Section 10.7 of Circular 230 (31 C.F.R. § 10.7) was amended before *Loving* to remove the authorization for unenrolled, unlicensed individuals to represent taxpayers before the agency on returns

When Treasury granted unenrolled preparers this limited practice authority, the role of a tax preparer required skill and knowledge of tax laws. Revenue Procedure 81-38 provides that the preparer of the return is expected to recognize questions, issues and factual situations of such difficulty that are beyond one's experience and to suggest to the taxpayer that the taxpayer should seek assistance from someone more experienced.⁶¹ As noted above, however, commercial preparation and filing software enables anyone to prepare a return without any training in the tax law, which means the preparer often may have no capacity to explain the position taken. Thus, return preparation by an untrained individual with commercial software does not equip that individual to assist the taxpayer competently in the examination.

Representing a taxpayer in an audit requires a certain level of knowledge, competence, and skill, the absence of which can have a significant financial impact on the taxpayer. Without testing and education requirements, I believe it is in the best interest of taxpayers to restrict the authority granted to unenrolled return preparers to conduct limited practice before the IRS. Unenrolled preparers may not possess the skill and knowledge to represent taxpayers at any level before the IRS and may cause the taxpayers more harm than good.

To ensure that taxpayers have knowledgeable and skilled representation, the IRS should condition the authority for an unenrolled preparer to represent his or her preparation clients in audits on passing a competency test and satisfying annual continuing education requirements. This approach does not impinge on a preparer's ability to prepare a return. Even the plaintiffs in *Loving* raised no objection to the IRS regulating practitioners who choose to represent taxpayers during an examination.⁶²

If, as the *Loving* plaintiffs state, these unenrolled preparers are "merely" preparing returns – being scriveners – then, absent passing a test and satisfying continuing education requirements to demonstrate competency, they should not be permitted to represent taxpayers in audits of returns. Therefore, I recommend revising all guidance to ensure that only competent unenrolled preparers have the authority to represent taxpayers under audit with respect to returns they have prepared.

they signed. However, Notice 2011-6, 2011-3 I.R.B. 315, provided interim authority for these individuals to represent taxpayers in this context during "the transition years" of the return preparer program. It is the opinion of the Office of Professional Responsibility (OPR) that this anticipated temporary authority should be amended to remove this privilege. OPR response to TAS information request 5 (Oct. 31, 2013).

⁶⁰ 31 C.F.R. § 10.3(f)(3).

⁶¹ See Rev. Proc. 81-38, 1981-2 C.B. 592.

⁶² *Loving v. IRS*, 917 F. Supp. 2d 67, 71 (D.D.C. Jan. 18, 2013).

C. Restrict the ability to name unenrolled preparers as third party designees on Form 1040 unless they have earned an examination and continuing education certificate.

Form 1040 includes a section for "Third Party Designee" where the taxpayer can check a box to designate a person who has the authority to discuss the return with the IRS. The Office of Professional Responsibility (OPR) has indicated that it is contemplating prohibiting taxpayers from designating an unenrolled preparer as the Third Party Designee.⁶³ I support OPR in these efforts.⁶⁴ In addition, OPR is considering excepting from such prohibition those preparers who are licensed by the IRS or a state licensing body.⁶⁵ I believe OPR's position merits serious consideration.

D. The IRS should mount a consumer education campaign to educate taxpayers about the need to select competent preparers.

Consistent with my longstanding position that the IRS should mount a comprehensive taxpayer awareness campaign, I believe it is more important than ever that the IRS increase its outreach and education about choosing a preparer, with particular emphasis on the populations at most risk, such as low income, elderly, and disabled taxpayers. Until the IRS is once again permitted to fully administer a program establishing minimum competency standards, taxpayers must proactively protect themselves when hiring preparers, and the IRS should make every effort to provide them with the information they need to do so. In fact, the IRS stopped providing return preparation services at Taxpayer Assistance Centers (TACs) during the 2014 filing season.⁶⁶ Therefore, low income, elderly, and disabled taxpayers have one less avenue to receive reliable tax preparation services at no cost, making this information campaign even more important to protect those most vulnerable taxpayers. TAS has already developed communications instructing taxpayers to do the following:

- a. Ask the preparer directly about his or her qualifications and experience level in preparing tax returns. The preparer should convince the taxpayer that he or she possesses sufficient knowledge of relevant tax law – not merely completion of return preparation software training or an "ability" to obtain large refunds for taxpayers. Further, the taxpayer should check with the Better Business Bureau or the state consumer protection website for any complaints or ongoing investigations against the preparer or the firm.⁶⁷

⁶³ OPR response to TAS information request 5 (Oct. 31, 2013).

⁶⁴ However, the prohibition should clearly exclude persons not in the business of preparing returns, such as parents preparing their child's return.

⁶⁵ OPR response to TAS information request 5 (Oct. 31, 2013).

⁶⁶ W&I response to TAS information request (Dec. 20, 2013). The IRS will refer taxpayers who visit the TACs for tax preparation to the nearest volunteer site for tax return preparation.

⁶⁷ We also recommend that any future communications clearly state that the taxpayer should not select a preparer based on the size of the promised refund.

- b. Make sure the preparer signs the return and fills in his or her Preparer Tax Identification Number or Employer Identification Number where indicated on the tax forms.
- c. Obtain a copy of the return signed by the preparer and keep the copy in case of any problem with the return.⁶⁸
- d. Ask the preparer for a business card or brochure and place it in their tax file with a copy of the invoice for the preparation services.

In my 2009 Annual Report, I also recommended that the IRS develop a preparer database to include all preparers who register with the IRS. While the database would be useful to tax administrators and practitioners, the main focus of my recommendation is to empower taxpayers to protect themselves in their search for competent and ethical preparers. The database should be accessible and searchable by the public and include such information as the preparer's contact information, whether the preparer is in good standing, the preparer's designation, and any final determinations on disciplinary actions.⁶⁹ State licensing agencies make this information available for other types of practitioners. The IRS should follow suit.

Once the database is well-developed and marketed properly, the IRS could modify its approach over time and consider abating penalties for taxpayers who did their due diligence in return preparer selection. Those taxpayers who chose preparers who are not included in the database or who are listed as not in good standing assume the risk and may even be considered negligent.

The best enforcement and consumer protection strategy is to have an informed and educated consumer base – in this instance, taxpayers. Whether regulation is voluntary or mandatory, taxpayers need to have some clear-cut way of knowing which preparers meet minimum levels of competency and which are not willing to make the effort. That is why having a “certified preparer” designation, along with enrolled agents, CPAs, and attorneys, is so important – it is a bright line that taxpayers can understand.

It is true that there will always be preparers who will work “underground” – and some formerly “above-ground” preparers will go underground with the advent of testing and education requirements. However, a comprehensive consumer education strategy, conducted year-in and year-out, will arm taxpayers with the knowledge of whom they can trust as preparers and how they can report misconduct when it occurs. Without the

⁶⁸ The Taxpayer Advocate Service developed a poster (IRS Publication 5074, *Protect Your Refund*) and distributed copies to all local taxpayer advocate offices, W&I TACs, and LITC offices. The communication instructs the taxpayer to require the preparer to include the preparer's name and address on the return.

⁶⁹ National Taxpayer Advocate 2009 Annual Report to Congress 58.

bright line of certified (as opposed to unenrolled) preparers, this education campaign is much more complicated and difficult.

VIII. The IRS has agreed to develop procedures to issue refunds to victims of return preparer fraud.

Sometimes, unscrupulous preparers alter taxpayers' returns by inflating income, deductions, credits, or withholding without their clients' knowledge or consent, and pocket the entire refund or the difference between the revised refund amount and the amount expected by the taxpayer by diverting all or a portion of the direct deposit refund to a bank account under the control of the preparer. The following are examples of how a return preparer could commit fraud without the taxpayer's knowledge:

- First, provide a copy of the legitimate tax return to the taxpayer.
- Then, without the taxpayer's knowledge, alter the return to reflect additional withholding, credits, or deductions, resulting in an increased refund.
- Next, file the altered return with the IRS.
- Finally, request that the refund be split between two bank accounts – with the correct amount going to the taxpayer and the inflated portion of the refund going directly into the return preparer's bank account.

In such cases, the taxpayer has a copy of the legitimate return, receives the refund he or she was expecting, and has no reason to suspect fraud. The taxpayer may learn of the fraud only after the IRS discovers the taxpayer's return is incorrect and attempts to recover the excess refund (paid to the preparer) from the taxpayer through levies or refund offsets.

In the situations where the preparer diverted even the legitimate portion of the refund to his own account, taxpayers victimized have little hope of obtaining their refunds from the preparer, who may have closed up shop. While there may be no legal impediment for the IRS issuing such refunds to victims of preparer fraud, it has been reluctant to do so. I do not believe that taxpayers who are trying to comply with the law, and who have demonstrated that they were not complicit in the fraud, should not be left holding the bag.

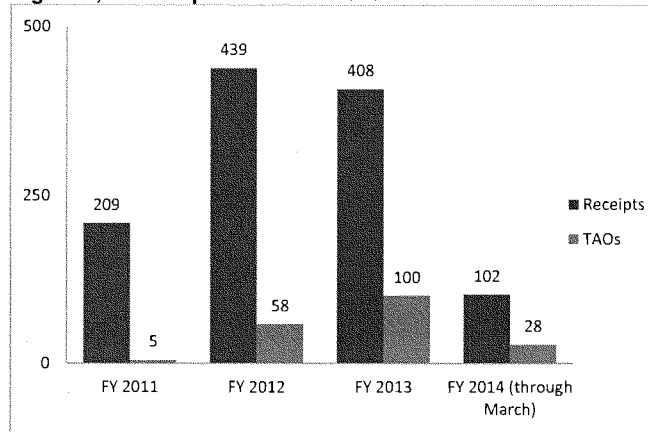
The Taxpayer Advocate Service started issuing Taxpayer Assistance Orders (TAOs)⁷⁰ on preparer fraud cases in 2010. One Local Taxpayer Advocate (LTA) office opened

⁷⁰ Pursuant to IRC § 7811, the National Taxpayer Advocate may issue a taxpayer assistance order ordering the IRS to cease, take, or refrain from taking certain actions as described more fully in the statute. The order may be modified or rescinded only by the Commissioner or Deputy Commissioner or the National Taxpayer Advocate (or her delegate).

cases for four taxpayers who had been victimized by the same unscrupulous preparer. Despite the IRS's concurrence that the returns it processed were not the returns signed by the taxpayers, the IRS refused to adjust the taxpayers' accounts to remove the fabricated income or credits because it did not have procedures in place to do so. In December 2010, the LTA issued TAOs to the IRS's Accounts Management function (AM) in these four cases. In March 2012 – over 18 months after the taxpayers first came to TAS for help – AM finally took the requested actions for these four taxpayers. However, at that time, the IRS had not issued guidance to its employees on how to work preparer fraud cases.

Beginning in fiscal year (FY) 2011, TAS started tracking preparer fraud cases using a special code. As shown below, TAS has continued to work a substantial number of cases in which taxpayers are harmed by return preparer fraud or misconduct.

Figure 3, TAS Preparer Fraud Cases



As of March 21, 2014, the Taxpayer Advocate Service had 267 return preparer fraud cases in our inventory.⁷¹ The IRS does not track preparer fraud cases, so I cannot report on the volume of preparer fraud cases IRS-wide. I recommend that the IRS develop a marker to track preparer fraud cases, as it does for identity theft cases.

Over the past two years, I have elevated 25 Taxpayer Assistance Orders on this issue to the Commissioner. These victims are typically low income taxpayers, with a median adjusted gross income of \$17,548 and a median refund claim of \$2,511. These 25 taxpayers have been waiting an average of more than two years to receive their

⁷¹ Data obtained from the Taxpayer Advocate Management Information System (TAMIS) (Mar. 26, 2014). The current inventory of preparer fraud cases includes unresolved cases received in prior fiscal years.

refunds! Some of the victims who have come to TAS for help have been waiting for refunds ever since they filed 2008 tax returns.⁷²

Simultaneous with TAS's casework activity, we have also been pursuing this issue from a systemic perspective. Since 2011, I have raised and discussed this issue with four Commissioners (two acting). I have issued two Taxpayer Advocate Directives (TADs)⁷³ and one Proposed TAD.⁷⁴ I have also covered the subject extensively in my last two Annual Reports to Congress.⁷⁵

I recognize that return preparer fraud is a complicated issue, and there has been much internal debate regarding the appropriate IRS response. Return preparer fraud is similar to identity theft in that both crimes delay refunds and cause account problems, but the IRS deals with the victims in substantially different ways. Over the years, the IRS has developed procedures that ultimately unwind the harm to victims of identity theft. The IRS has procedures to "back out" the return filed by the perpetrator, process the legitimate return, and pay the associated refund claim, if applicable.⁷⁶

In contrast, the IRS has not developed procedures that would fully unwind the harm suffered by victims of preparer fraud. In June 2012, the IRS issued interim guidance to its employees on how to handle certain preparer fraud cases.⁷⁷ However, this guidance was not comprehensive, as it failed to provide relief for a large category of victims. For example, the IRS agreed to remove the fraudulent tax return information from the victim's account and process the correct return of the victim, but it did not instruct its employees to issue a replacement refund – which, from the taxpayer's perspective, is the most important step of return processing.

In my most recent report to Congress, I urged the IRS leadership to make these vulnerable taxpayers whole, just as the IRS works to make identity theft victims whole. I proposed a framework of analysis that takes into account mitigation, restitution, and

⁷² See, e.g., TAMIS case numbers 4757753, 5269873, and 5361465.

⁷³ Pursuant to Delegation Order No. 13-3, the National Taxpayer Advocate has the authority to issue a TAD "to mandate administrative or procedural changes to improve the operation of a functional process or to grant relief to groups of taxpayers (or all taxpayers) when implementation will protect the rights of taxpayers, prevent undue burden, ensure equitable treatment, or provide an essential service to taxpayers." IRM 1.2.50.4, Delegation Order 13-3 (formerly DO-250, Rev. 1), *Authority to Issue Taxpayer Advocate Directives* (Jan. 17, 2001). See also IRM 13.2.1.6, *Taxpayer Advocate Directives* (July 16, 2009).

⁷⁴ See IRM 13.2.1.6.1.2, *Proposed TAD* (July 16, 2009).

⁷⁵ See, e.g., National Taxpayer Advocate 2013 Annual Report to Congress 94-102; National Taxpayer Advocate 2012 Annual Report to Congress 68-94.

⁷⁶ See generally IRM 21.6.2, *Individual Tax Returns, Adjusting TIN-Related Problems* (Oct. 1, 2013).

⁷⁷ See Director, Accounts Management, *Interim Guidance on Return Preparer Misconduct (For Memphis Accounts Management ONLY)*, WI-21-0813-02 (Aug. 5, 2013).

substantiation that the IRS can use in deciding when to issue refunds to purported victims of preparer fraud.

I am pleased to report that my most recent discussions with Commissioner Koskinen and his staff have been encouraging. The Commissioner agreed that the IRS needs to provide complete relief by issuing refunds to victims of preparer fraud who can show that they were not complicit in the preparer's fraud. To alleviate the IRS's concern about collusion between the preparer and taxpayer, the victim will be required to provide a copy of an incident report filed with local law enforcement (*i.e.*, a police report) before the IRS issues a replacement refund.

I note that there will be some taxpayers who are unable to obtain a police report. Perhaps the particular police department does not accept incident reports related to tax fraud, or refuses to accept a report for an incident that occurred several years ago (as noted earlier, some of our cases relate to 2008 tax returns). Additionally, some taxpayers who have questionable immigration status may be hesitant to go to the police for fear of being reported to immigration authorities. While the Commissioner's decision to require a police report to accompany all claims of preparer fraud will not provide relief to all victims, I believe it constitutes a major step forward. Moreover, having a bright line rule will make it easier for IRS employees to process these claims.

In light of the Commissioner's preferred approach, the IRS should develop appropriate guidance for IRS employees as soon as possible. With many of these victims waiting more than two years already, we should do what we can to get them their refunds as quickly as possible. I am pleased to report that the Wage & Investment Division leadership has agreed to work closely with TAS to promptly issue guidance.

IX. Conclusion

Until the IRS is authorized to require the testing and continuing education components of the return preparer program, taxpayers will continue to be vulnerable to incompetent and unscrupulous preparers. I encourage Congress to amend 31 U.S.C. §§ 330(a)(2) to clarify that the IRS has authority to establish testing and continuing education requirements for the unenrolled preparer population. By instituting minimum standards on the profession, the IRS will be able to take a preventive approach instead of a reactive one and will be able to protect taxpayers from harm before it occurs. The IRS and the Taxpayer Advocate Service can also assist taxpayers by educating them about the various precautions they can take to prevent becoming a victim. Further, the IRS can restrict the ability of unenrolled preparers to represent taxpayers in audits or be named as Third Party Designees unless they establish minimum competence by obtaining a voluntary testing and continuing education certificate.

I believe that consumer education is the best defense against preparer misconduct. The IRS should begin taking steps immediately to create a comprehensive consumer education strategy. If conducted year-in and year-out, this strategy will arm taxpayers with the knowledge to make wise selections of competent preparers and report

misconduct when it occurs. However, without the bright line of certified (as opposed to unenrolled) preparers, this education campaign becomes much more complicated and difficult.

SENATE COMMITTEE ON FINANCE
HEARING
“Protecting Taxpayers from Incompetent and
Unethical Return Preparers”

April 8, 2014

Representation by
The Oregon State Board of Tax Practitioners

Janis Salisbury
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Letter from Oregon Board recommending amendments to US Code
Section 330

Closing statement (*Opinion by Circuit Judge Kavanaugh*)

SENATE COMMITTEE ON FINANCE HEARING

"Protecting Taxpayers from Incompetent and Unethical Preparers"

April 8, 2014

Testimony by Janis Salisbury, EA, LTC; Chair of the Oregon Board of Tax Practitioners

Thank you Chairman Wyden, Ranking Member Hatch, and members of the committee for the opportunity to speak to you about the protection of taxpaying consumers and the regulation of tax practitioners. Your interest in this issue that affects every taxpaying American is greatly appreciated.

I am Janis Salisbury, an IRS enrolled agent and a licensed tax consultant in Oregon. I also have a degree in Education which I have utilized to the fullest in tax law training at IRS; basic tax preparer's classes in Oregon and tax preparation continuing education classes. I have worked in the tax industry for over 38 years. For the past six years I have served the State of Oregon as a member of the Board of Tax Practitioners with the last two years as Board Chair. We oversee nearly 4000 licensees (licensed tax preparers and licensed tax consultants). Needless to say I understand the extremely important need for continuing education in the tax industry. But that is only part of the picture.

We recommend that Congress emulate Oregon's regulation of tax return preparers and provide the IRS with the authority to require individuals to demonstrate minimum competency in tax return preparation either by passage of a state board examination or by an IRS examination and to impose continuing education requirements after passage of such examination.

Initial training and registration is essential before anyone can even begin preparing your tax returns. Oregon's track record proves that. You will find details of Oregon's story in my written statement.

The primary reason Oregon felt it necessary to develop its own paid preparer regulatory program 40 years ago is the same today as it was then – Oregon determined that people engaging in tax return preparation should be competent to perform the task.

Oregon requires paid preparers, who are not already licensed by the state as CPAs or attorneys, to obtain a state license to prepare tax returns. To become a licensed tax preparer, a person must have a high school diploma or the equivalent, complete 80 hours of approved qualifying education, pass a state administered examination and pay a registration fee. Annual renewal by licensees requires proof of least 30 hours of continuing education.

According to a report to this Committee prepared by the Government Accountability Office in August 2008, federal tax returns for the year 2001 filed in Oregon were more likely to be accurate than returns filed anywhere in the rest of the country. Specifically, the GAO found that the odds that a return prepared by an Oregon paid preparer was accurate were about 72 percent higher than the odds for a comparable return filed by paid preparers in the rest of the country.

Oregon has been a leader in requiring the licensing of tax return preparers for over 40 years and the results noted by the GAO show the excellent results of Oregon's regulations. Accordingly, the Oregon State Board of Tax Practitioners urges the Congress to enact legislation, similar to Oregon's legislation, which would require individuals to demonstrate competency in the preparation of tax returns and satisfy continuing education requirements. We suggest that such competency be demonstrated by a written examination approved by a state licensing board or board of law examiners,

a state entity such as the Oregon Board of Tax Practitioners, or by the IRS. The passage of an examination recognized by a state, such as Oregon, to show competency in tax return preparation must be considered to demonstrate tax competency for federal tax return preparers in order to recognize efforts that have been undertaken at the state level and to avoid duplicate and unnecessary testing.

To further illustrate that I am speaking for more than myself, several comments and writings from Oregon licensees, supportive organizations, and the GAO are enclosed. This includes a suggested code section wording to facilitate the IRS regulation of tax practitioners nationwide. Oregon practitioners have proven competency through basic education, two levels of exams and ongoing education requirements.

What was the primary reason Oregon felt it necessary to develop its own paid preparer regulatory program 40 years ago?

In 1972, an IRS shopping test in which IRS agents posed as taxpayers was performed. A newspaper article appeared nationwide stating that 97% of tax practitioners were either incompetent or dishonest. Many tax practitioners disliked the disparaging publicity and negative reflection on the tax preparation industry. They decided to take action.

1. Who do we regulate?

- Any person who prepares or advises or assists in the preparation of personal income tax returns for another and for valuable consideration or advertises in Oregon to do so. (ORS 673.615)
- Excludes:
 - i. CPA or PA and their employees.
 - ii. Attorneys at law and their employees.
 - iii. Full or part-time employees of a business who prepare the income tax return for that business.
 - iv. Tax practitioners who prepare or advise or assist with the preparation of Oregon income tax returns while outside Oregon.

2. Licensing requirements

For Licensed Tax Preparer:

- Meet the qualifications of an 80 hour Basic Preparer's class or equivalent to qualify to take the preparer's exam.
- Pass the board administered exam – minimum 75% test score.
- Complete tax preparer initial application and pay appropriate fees.

For Licensed Tax Consultant:

- Meet the qualifications to take the consultant exam consisting of working in the tax preparation industry for a specific amount of time
- Pass the board administered exam – minimum 75% test score.
- Complete the tax consultant application and pay appropriate fees.

- If an enrolled agent moves into Oregon, they must pass the State only portion of the Licensed Tax Consultant exam

3. Ongoing qualifications –

- Obtain minimum of 30 hours of continuing education each year.
- Maintain professional standards and state ethics.
- File annual licensing renewal form and pay appropriate fees.

4. What was done right?

- Created two levels of licensure.
- Board is currently self-supporting.
- The Board receives **NO** state general fund dollars.
- Regulation is at the local level.

5. How do we ensure tax practitioner compliance?

- Enforcement staff researches all consumer complaints and other possible violations of the laws and rules governing tax preparation
- Some complaints may proceed to a hearing before an Administrative Law Judge
- Civil penalties, based on a set matrix for consistence charges, may be assessed and/or a person's license may be suspended or revoked.
- Depending on circumstances the Board may work with other agencies to assess criminal charges

Recommendations to increase taxpayer compliance and ensure uniform and high ethical standards of conduct for tax preparers nationally:

- Competency must be proven - Oregon's model of 2 levels has been extremely successful.
- Continuing Education Requirements.
- Compliance.
- Code of professional conduct.
- Consumer education.
- Coordinated by local jurisdictions.

OREGON BOARD OF TAX PRACTITIONERS

MISSION STATEMENT

THE BOARD OF TAX PRACTITIONERS PROTECTS OREGON CONSUMERS BY ENSURING OREGON TAX PRACTITIONERS ARE COMPETENT AND ETHICAL IN THEIR PROFESSIONAL ACTIVITIES.

OREGON BOARD of TAX PRACTITIONERS

HISTORY

In 1972, because of an IRS shopping test in which IRS agents posed as taxpayers, a newspaper article appeared nationwide stating that 97% of the tax preparers were either incompetent or dishonest. The Article received widespread publicity and resulted in a group of eight tax preparers in Oregon holding meetings and discussions. The disliked the fact that the disparaging publicity reflected on the entire tax preparation history, including the conscientious practitioners. These discussions resulted in the formation of the Association of Tax Consultants (ATC), consisting of approximately 30 people.

The group concluded that to upgrade their profession, people engaging in tax return preparation should be licensed and required to obtain education relating to this occupation. They felt this was the only way to attain true professionalism.

The ATC put together a workable program. They hired a lobbyist who, together with the Deputy of Legislative Council, came up with the Tax Service Examiners Law, which was patterned after the Real Estate Law at that time.

The law created a State Board of Tax Service Examiners and placed the Board under the umbrella of the Department of Commerce. The Board was to consist of five members; each member must have been actively engaged in tax consulting for a minimum of five years. The Board became operative on October 5, 1973, ninety days after the adjournment of the 1973 session. The law required all persons who would be preparing, advising, or assisting in the preparation of personal income tax returns be licensed as January 1, 1974.

A "grandfather" clause allowed any tax preparer who was engaged in the business of tax preparation during the 1973 tax season to become licensed without examination if they applied on or before January 1, 1974. The designations were to be tax consultant or associated consultants who were qualified as tax consultants but worked for another consultant, preparers, and businesses.

The Board staff originally consisted of an Administrator and an office support secretary.

Completion of a 60 hour Basic income tax class was required before sitting for the preparer's exam. Without any teaching material available the members of the newly formed Board joined developed with the help of the Department of Education a class text. With annual updates that same text, quiz, and class exam materials were used for over 25 years.

A proposed Code of Ethics was developed in October 1973 and finalized in 1974. Rule development continued during this same period.

The Oregon state Board of Tax Service Examiners was authorized with the passage of the first state with a licensing law to regulate income tax preparation by those individuals who are not certified public accountants, licensed public accountants, or attorneys.

Oregon Revised Statutes [ORS 673-605 to 673-735 (*Appendix 11*)] authorizes the Board to regulate the practice of preparing personal income tax returns for the protection of consumers and to enhance the quality of such work. There are currently two levels of licensure: Licensed Tax Preparer and Licensed Tax Consultant. The Board is a policy-making board rather than strictly an advisory board.

The law allows the Board general powers to determine qualifications of tax practitioners (within statutory guidelines), administer examinations and issue licenses. They are also allowed to investigate and act on complaints against licensees, penalize unlicensed practitioner, formulate a Code of Professional Conduct, which licensees are required to follow, and “exercise general supervision over tax consultant and tax preparer practice.”

As the Board became better known, complaints from taxpayers against licensees and non-licensees began to come in. In October of 1974, a Field Examiner’s position description and recruitment announcement was presented, hiring in 1975.

By January 1975 there were 1,123 consultants and 666 preparers that had been grandfathered into the program. Examinee counts to that date were 239 taking the consultant’s exam and 634 taking the preparer’s exam resulting in 246 passing.

In 1977, Elinor Blundell, Board administrator, testified before the California Assembly Committee on Labor, Employment, and Consumer Affairs. Among many things, she discussed the fact that, prior to licensing, there had been almost no tax classes available to practitioners. Once licensing was in place, classes and seminars were being held through colleges, tax businesses, and tax organizations such as Oregon Association of Tax Consultants, and the Oregon Society of Tax Consultants. She pointed out that continuing education appeared to be paying off due to higher quality tax preparation.

John Lobdell, Director of Oregon Department of Revenue, wrote, “My observation of Oregon’s tax service examination program is that it has substantially improved the quality of tax returns prepared by Oregon’s tax practitioners. The effects of your requirements for continuing education are evident not only in the return preparation but in the manner in which tax practitioners represent their clients before the Department of Revenue.”

After a decade, the number on the Board increased by two members and became a seven member Board that consisted of six licensed tax consultants and one public member. Also in 1983, enrolled agents were required to take the state-only exam to become licensed by the Tax Board before they could work as tax practitioners in Oregon.

Unlicensed activity has resulted in the majority of the civil penalties issued during the years. The Board has made notable efforts in educating the public to seek licensed practitioners to prepare their personal income taxes. It was often found that the unlicensed individual usually caused financial harm to the taxpayer usually due to lack of training.

The Board has encouraged consumers to seek a Licensed Tax Preparer and/or Licensed Tax Consultant by using press releases and distributing brochures. After unlicensed practitioner cases have been resolved, the Board has used press releases to notify consumers to avoid these individuals, and encourage them to seek Licensed Tax Preparers and/or Licensed Tax Consultants.

The relationships between the Board, Oregon Department of Revenue, and the Internal Revenue Service continue to help provide compliance and reduce unlicensed activity, thus improving services to the public.

The following is from the Oregon Board of Tax Practitioners website:

“The Tax Board issues two types of licenses. The Licensed Tax Preparer is an apprenticeship license that enables a person to lawfully prepare personal income tax returns in Oregon under the supervision of a Licensed Tax Consultant. The Licensed Tax Consultant is a higher competency license obtained through testing and experience to the point that a licensee may prepare taxes as a self-employed, independent or supervising tax practitioner. There is a business registration which is required for offices preparing personal income tax returns, however a business registration does not cover the individual actually performing the work (the practitioner). All income tax preparation businesses must be registered and must have a licensed tax consultant providing services and/or supervising licensed tax preparers.

The Tax Board is funded solely from fees derived from the licensees and other miscellaneous services.

The Tax Board carries out its mission through four programs; Licensing, Examination and Education, Compliance Enforcement/Consumer Awareness, and Administration.

The Licensing Program provides licenses to those people who have demonstrated their competence and ethical standards established by the Board.

The Examination and Education Program develops and administers competency examinations to new applicants to ensure their comprehension of the state and federal tax code prior to issuing them a license. An applicant must answer 75% of the questions correctly to become licensed. The program also monitors the continuing education requirements by reviewing and approving courses that will enhance the licensee's knowledge of the tax law. Each applicant is required to complete an 80-hour basic tax course covering state and federal tax laws. Licensees are required to complete a minimum of 30 hours continuing education as a prerequisite to renewing their license each year.

The Compliance Enforcement Program researches all complaints and possible violations of the laws and rules governing tax preparation. Many complaints proceed to a hearing before an Administrative Law Judge. After careful consideration of the facts surrounding a complaint, civil penalties may be assessed, and a person's license may be suspended or revoked. The Tax Board may also require restitution to consumers harmed by tax preparation fraud. In serious cases, the Board may work with other agencies to assess criminal charges.”

**2013 Calendar Year
Compliance Report**

Reported by Monica J. Walker

Complaints reported from January 1, 2013, through December 27, 2013

General statistics

164 Total complaints as follows:

16 Open investigations
11 Pending Investigations
17 Mediated
120 Closed

Out of these totals:

*28 Complaints which resulted in Board action taken**

2 Complaints the Board gave an authorization to take action on if evidence is found/gained

17 Complaints in which licensees were educated into compliance

**Complaints in which enough evidence was collected to verify violations took place and the Board took action on, i.e. Complaints which are now considered Cases. Action = Notice of Intent, followed by a Final Order/Settlement Agreement.*

General counts/information on complaints:

84 Unlicensed/unregistered activity
39 Competency/Services
20 Advertising
19 DC/RC/supervision requirements
18 Other entities
16 Return of records
9 Failure to file a return
8 Fraudulent activity
6 Failure to notify of changes to information
6 Confidentiality
3 CE audit requirements
1 Signature requirements
1 Posting of fee schedules
1 Failure to comply w/Child Support Enforcement Program

**2012 Calendar Year
Compliance Report**

Reported by Monica J. Walker

Complaints reported from January 1, 2012, through December 31, 2012.

General statistics

159 Total complaints as follows:

25 Open investigations
11 Pending Investigations
13 Mediated
110 Closed

Out of these totals:

*24 Complaints which resulted in Board action taken**

15 Complaints the Board has given an authorization to take action on (if evidence is found/gained)

19 Complaints in which licensees were educated into compliance

**Complaints in which enough evidence was collected to verify violations took place and the Board took action on, i.e. Complaints which are now considered Cases. Action = Notice of Intent, followed by a Final Order/Settlement Agreement.*

General counts/information on complaints:

64 Unlicensed/unregistered activity
37 Advertising
24 Other entities
23 Competency/Services
16 Return of records
14 DC/RC/supervision requirements
11 Fraudulent activity
5 Failure to notify of changes to information
5 Failure to file a return
2 Confidentiality
2 CE audit requirements
1 Signature requirements
0 Posting of fee schedules

3218 SE Pringle Rd #120
Salem, OR 97302
Contact: Monica J. Walker
(503) 378-4860

**Oregon State Board of
Tax Practitioners**

PRESS RELEASE

To: News Media
From: Oregon State Board of Tax Practitioners
Date: April 10, 2009
Re: Cease and Desist Order Issued Against Carol M. Jones for Unlicensed Tax Preparation

Oregon State Board of Tax Practitioners announced that legal action against an unlicensed Lane County tax preparer should serve as a warning to consumers: many of her customers are now being audited for receiving excessive tax refunds.

The Board on Thursday issued a Cease and Desist Order against Carol M. Jones of Lowell for continuing to break the law for preparing personal income taxes for a fee without a license.

In 2007, Jones violated the law 534 times by preparing, advising or assisting in the preparation of personal income tax returns for about 450 people.

Last November, the Board assessed \$68,879.40 in costs and civil penalties against Jones for operating without a license.

Despite the order, Jones has continued to prepare personal income tax returns.

As a result of the returns filed by Jones, many of these taxpayers are being audited by the Oregon Department of Revenue. These taxpayers are responsible for the underpayment of tax, interest, and penalties that may be imposed by the Department of Revenue. Many of the folks for whom Carol Jones prepared returns have already spent the refunds received.

The Board encourages all taxpayers to use a licensed tax professional to protect themselves against costly errors as well as to ensure that the person preparing their taxes meet minimum qualifications for competency and adhere to professional and ethical standards. Anyone wishing to review the license status of an individual or who has a complaint about the preparation of their personal income tax return(s) should contact the Board at (503) 378-4034 or refer to the Board's Web site at www.oregon.gov/OTPB.

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**Oregon State Board of
Tax Practitioners**

PRESS RELEASE

To: News Media and Interested Parties
From: Oregon State Board of Tax Practitioners
Date: January 29, 2009
Re: Consumer Alert – Verify Your Tax Professional's Credentials

Would you hand your Social Security card or your checkbook to a stranger? How about your wage stubs? If you don't know your tax preparer is a legitimate, licensed professional with a good track record, why should you give them your confidential financial information? Unfortunately, every year many citizens are the victims of fraudulent tax preparation by unlicensed people.

Oregon law requires every person who prepares, assists, or advises in personal income tax matters for another for payment in any form to be licensed. The Board of Tax Practitioners urges all consumers to protect themselves by checking for their practitioner's license. The Board's mission is to protect the consumer by ensuring Oregon tax professionals are competent and ethical in their professional activities.

Tax Board licensees must first pass a basic level tax course and prove their competency by passing an examination. There are two types of licenses. The Licensed Tax Preparer is an apprenticeship level that permits a person to work under the supervision of a Tax Consultant or Certified Public Accountant. Tax Consultants must have sufficient experience and must pass a higher level examination demonstrating their ability to work without supervision. All licensees must take continuing education courses to remain knowledgeable of the latest law changes and tax information. They must also continue to follow an ethical code of conduct that is outlined in Oregon Rule and Statute.

Consumers can protect themselves by following these basic tips when working with a tax professional:

- Check first to make certain the person and business is licensed for tax preparation. Every tax season, tax businesses "spring-up" overnight. Some take their clients' money and information only to disappear the next day. If you do not see a current license posted, protect yourself by: 1) Looking up the name of the tax practitioner on the Board's Web site at www.oregon.gov/OTPB; OR 2) Calling the Tax Board at (503) 378-4034.
- Never sign a blank return. The person preparing your return should sign the returns in the preparer's signature block and give you a copy of that return.
- The person should return to you all of your supporting documentation, such as W-2s, receipts, and other information.
- Do not pay a percentage of your refund for the fee. Practitioners should have a published fee schedule and tax preparation fees should be listed separately from other professional services provided.
- Do not allow your refund to be mailed to the person preparing your taxes. And, if you owe taxes, you should make the payment directly to the IRS or the Department of Revenue. Refund Anticipation Loans are legal if they are made through third party financial institutions.
- Be especially cautious if the person or business handling your return is sending your information to another location for preparation.

For further information on the licensing of tax professionals and how to protect yourself this tax season:

- 1) View the Oregon Board of Tax Practitioners' Web site at: www.oregon.gov/OTPB
- 2) Contact the Oregon Board of Tax Practitioners at: (503) 378-4034

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**Oregon State Board of
Tax Practitioners**

PRESS RELEASE

To: News Media
From: Oregon State Board of Tax Practitioners
Date: February 23, 2010
Re: Unlicensed Tax Preparers

Unlicensed tax preparers break law; defraud taxpayers

Unlicensed income-tax preparers often target people looking for bargains and big refunds, according to Ron Wagner, Director of the Oregon Board of Tax – and that can include the elderly, college students and non-English-speaking residents.

"Unlicensed tax practitioners commonly invent deductions and manipulate numbers to get clients bigger refunds than the law allows," said Wagner. "When they're caught, all the returns they've prepared are audited, and the taxpayers who used their services can find themselves repaying years' worth of back taxes and refunds, interest and penalties."

"Taxpayers open themselves up for identity theft when they give their Social Security numbers and personal financial information to unlicensed tax practitioners," said Wagner. "You should always make sure that anyone you pay to do your taxes signs your return and lists their license number."

Taxpayers can avoid such troubles by ensuring that their tax practitioner is licensed, as required by Oregon law. Licenses must be displayed in tax practitioners' places of business. If the license is not posted, or to make sure a license is valid, visit the [Licensee Look-Up](http://www.oregon.gov/OTPB) on the Oregon Board of Tax Practitioners Web site, www.oregon.gov/OTPB, or call the Board, 503-378-4034.

The Oregon Board of Tax Practitioners accepts and follows up on complaints about unlicensed income-tax preparers and consultants.

In addition to tax preparers and consultants, others are legally authorized to prepare taxes for compensation:

- CPAs or public accountants and their employees overseen by the Oregon Board of Accountancy
- Lawyers and their employees

Anyone may prepare another's taxes at no charge.

There are about 4,000 tax preparers and tax consultants in Oregon licensed by the Oregon Board of Tax Practitioners, which has played a role in consumer protection since its creation in 1973 by the state legislature. The Board is funded by licensee fees and services; it is not a General Fund agency.

###

COMMENTS

MICHAEL ADDINGTON, EA, LTC

Board member, Oregon Board of Tax Practitioners

The following are excerpts from an article Michael recently wrote for the *Tax Board Bulletin*:

“We’ve come a long way baby.” How fortunate we are to be “practicing” as tax professionals in Oregon. We have structure and guidance, unlike any other state in the country. Believe it—Oregon stands alone and the statistics prove it!! (See GAO Report to the Committee on Finance, GAO-08-781) Our structure includes administrative rules, statutes, an apprentice program, and the Oregon Board of Tax Practitioners (OBTP). The Board is the glue that holds it all together. Can you believe it? October 5, 2013 will be the 40th anniversary of the Oregon Tax Board. Cause for celebration? If there is not going to be a party, then let me take this opportunity to thank all previous and current Board members for their service and guidance.

As the new national IRS licensing and regulation program evolves, I hope the IRS does not overlook the direct correlation between experience, consumer protection, and reducing the “tax gap.” The recent report by the Taxpayer Advocate Service, Fiscal Year 2014 Objectives Report to Congress, reinforces the need for “qualifications and experience” when searching for a competent tax preparer. (www.taxpayeradvocate@irs.gov) As a Board member, licensee, and Enrolled Agent in Oregon, I am ecstatic to see a comprehensive program being implemented nationally. What Oregon has been doing successfully for almost 40 years is finally catching on.”

GAO

United States Government Accountability Office

Report to the Committee on Finance,
U.S. Senate

August 2008

TAX PREPARERS

Oregon's Regulatory Regime May Lead to Improved Federal Tax Return Accuracy and Provides a Possible Model for National Regulation



GAO-08-781

G A O
Accountability-Integrity-Reliability
Highlights

Highlights of GAO-08-781, a report to the
Committee on Finance, U.S. Senate

Why GAO Did This Study

Millions of taxpayers use paid tax return preparers and many of these paid preparers are not subject to any qualification requirements. Paid preparers in California and Oregon are exceptions in that these states have set paid preparer qualification standards. Additionally, two bills before Congress would require national paid preparer regulations.

To help Congress better understand the potential costs and revenue effects of regulating paid preparers, GAO was asked to study (1) how IRS, California, Oregon, and other states regulate paid preparers, (2) how the accuracy of federal tax returns from California and Oregon compare to other returns, and (3) state-level costs and benefits of the California and Oregon programs and insights they provide for a possible national program. GAO analyzed IRS research data on tax return accuracy; interviewed IRS officials, state administrators, and preparer community representatives; and reviewed relevant documents.

What GAO Recommends

If Congress judges that the Oregon paid preparer regulations account for even a modest portion of the higher accuracy of Oregon federal tax returns at a reasonable cost, it should consider adopting a similar regime nationwide. If Congress enacts paid preparer legislation, it should also require IRS to evaluate its effectiveness. IRS provided technical comments on a draft of this report which were incorporated.

To view the full product, including the scope and methodology, click on GAO-08-781. For more information, contact Michael Brostek at (202) 512-9110 or brostekm@gao.gov.

August 2008

TAX PREPARERS

Oregon's Regulatory Regime May Lead to Improved Federal Tax Return Accuracy and Provides a Possible Model for National Regulation

What GAO Found

No federal registration, education, or testing requirements apply to all paid preparers before they can prepare tax returns. California and Oregon have requirements that preparers must meet before preparing returns in those states. California paid preparers who are not attorneys, certified public accountants, enrolled agents (or employed by one of these types of tax practitioners) must complete an education requirement, obtain a bond, pay a fee, and register. In following years, they must complete continuing education requirements, and renew their registration. Oregon has similar, but more stringent requirements. Oregon has a two-tiered licensing system, with an education requirement and examination for Licensed Tax Preparers and work experience and a second examination for Licensed Tax Consultants. Oregon exempts certified public accountants and their employees, as well as attorneys, from these requirements. Oregon requires enrolled agents to take a shorter version of the consultant examination. Fifty-four percent of Oregon applicants passed the state's basic examination. Recently, Maryland enacted legislation to regulate paid preparers and at least three other states have similar pending legislation.

According to GAO's analysis of the Internal Revenue Service's (IRS) tax year 2001 National Research Program data, Oregon returns were more likely to be accurate while California returns were less likely to be accurate compared to the rest of the country after controlling for other factors likely to affect accuracy. In dollar terms, the average Oregon return required approximately \$250 less of a change in tax liability than the average return in the rest of the country. For Oregon's 1.56 million individual tax filers, this equates to over \$390 million more in federal income taxes paid in Oregon than would have been paid if the returns were as accurate as similar returns in the rest of the country. These results are consistent with, but do not prove, that Oregon's regulations lead to some increased tax return accuracy. GAO's analysis could not account for all factors that might affect the accuracy of these tax returns. Because some states without preparer regulation also had tax returns that, on average, were more accurate than the national average, some portion of the increased accuracy of Oregon returns likely is due to other factors.

The California and Oregon programs' costs varied with differences in the programs' scope. Both programs' administrative costs are funded primarily from program fees. California's costs were about \$29 per preparer and Oregon's about \$123. GAO estimates that the total annual cost of the ongoing Oregon program, including state costs and the cost to preparers for their time and expense in acquiring required education, likely is about \$6 million. Officials in both states believe program benefits like reducing the number of incompetent preparers outweigh costs, although neither state had data on benefits. IRS officials said that a national program's costs likely would depend on the program's objectives and features.

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Abbreviations

CPA	Certified Public Accountant
CRTP	CTEC Registered Tax Preparer
CTEC	California Tax Education Council
EIC	Earned Income Credit
FTB	Franchise Tax Board
IRS	Internal Revenue Service
LTC	Licensed Tax Consultant
LTP	Licensed Tax Preparer
NRP	National Research Program
OBTP	Oregon Board of Tax Practitioners
OPR	Office of Professional Responsibility

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United States Government Accountability Office
Washington, DC 20548

August 15, 2008

The Honorable Max Baucus
Chairman
The Honorable Charles Grassley
Ranking Member
Committee on Finance
United States Senate

Nearly 78 million of the 127 million individual income tax returns filed during the 2006 filing season were prepared by paid tax return preparers.¹ Paid preparers are such an important part of the federal tax administration system that the Internal Revenue Service (IRS) sometimes refers to them as "partners." However, we testified in 2006 on the serious errors that paid preparers can make—errors that cause taxpayers to underpay their taxes, exposing themselves to IRS enforcement action, or that lead taxpayers to not take advantage of available credits or deductions and, as a result, they end up paying too much.² Tax return preparers may be self employed or may work in a variety of business settings, including large companies, franchises, and small businesses. Most paid preparers are not subject to any education, testing, or registration requirements. Two states, California and Oregon, are exceptions in that for many years they have had their own requirements that apply to paid preparers working in their states.

To help Congress better understand the potential costs and revenue effects of establishing regulation at a federal level for all paid preparers, you asked us to answer the following questions: (1) How do IRS, California, Oregon, and other states regulate paid preparers? (2) Using available IRS data, how does the accuracy of federal tax returns in California and Oregon compare to that of returns in the rest of the country, after accounting for other factors that might influence accuracy? (3) What are the state-level costs and benefits of the paid preparer programs in California and Oregon and what insights do they provide for

¹GAO, *Tax Administration: 2007 Filing Season Continues Trend of Improvement, but Opportunities to Reduce Costs and Increase Compliance Should be Evaluated*, GAO-08-38 (Washington, D.C.: Nov. 15, 2007).

²GAO, *Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors*, GAO-06-563T (Washington, D.C.: Apr. 4, 2006).

possible benefits if Congress were to enact national paid preparer registration or licensing requirements?

To answer these questions, we reviewed relevant documents from California, Oregon, and IRS, including budget and legislative material. We interviewed California and Oregon state program administrators and paid preparer industry representatives in those states and nationwide. We also searched legal databases for examples of newly enacted paid preparer laws in other states and pending legislation. We also interviewed IRS officials to discuss the implications of using the California or Oregon regulatory regimes as possible models for federal-level paid preparer legislation. To compare tax return accuracy, we analyzed data from the National Research Program (NRP), an IRS study of reporting compliance for a random sample of individual tax returns filed for tax year 2001.³ In most cases, the returns were audited to determine whether income, expenses, and other items were reported accurately by the taxpayers. We determined that the data used to characterize tax return accuracy differences between California, Oregon, and the rest of the country and to describe the costs of the two state programs were sufficiently reliable for the purposes of this report; we determined this after assessing the reliability of NRP data, reviewing California and Oregon financial reports, and interviewing state program administrators. We conducted this performance audit from September 2007 through July 2008 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. For a more detailed discussion of our scope and methodology, see appendix I.

Results in Brief

Oregon has more requirements for paid tax return preparers than California, and both states have more paid tax return preparer requirements than the federal government. Only a few federal laws apply to all paid preparers and these laws concern tax preparer conduct rather than qualification requirements. Only a small portion of paid preparers—

³The results of the 2001 NRP are the most recent IRS compliance research data available.

enrolled agents⁴—have any federal registration, testing, or fee requirements. California paid preparers who are not attorneys, certified public accountants (CPA), enrolled agents (or employed by one of these types of tax practitioners) must complete 60 hours of qualifying education, obtain a surety bond, register with the California Tax Education Council (CTEC), and pay a fee to become a CTEC Registered Tax Preparer (CRTP), and they must complete 20 hours of continuing education and reregister in each subsequent year. Paid preparers who fail to register can be fined up to \$5,000. Oregon has a two-tiered licensing program. Oregon requires prospective paid preparers to complete 80 hours of qualifying education, pass a state-administered examination, register, and pay a fee to be initially certified as a Licensed Tax Preparer (LTP), and they must complete 30 hours of continuing education and pay a fee to reregister in each subsequent year. Oregon also requires that all LTPs work under the supervision of a Licensed Tax Consultant (LTC), CPA, or attorney. To become an LTC, a preparer must meet specific work experience requirements and pass a second, more advanced examination. Oregon can impose fines of up to \$5,000 per return for unlicensed tax return preparation and for certain conduct on the part of LTPs and LTCs. The Oregon tests are notable in that they have low passing rates—54 percent for the LTP examination and 30 percent for the LTC examination. In May 2008, Maryland enacted legislation to regulate paid preparers and at least three other states have pending legislation to regulate paid preparers.

When controlling for other factors likely to affect tax return accuracy, our analysis of IRS data showed that tax year 2001 federal tax returns filed in Oregon were more likely to be accurate than returns in the rest of the country, which is consistent with but not sufficient to prove that Oregon's regulatory regime leads to some increased tax return accuracy. On average, returns filed in California were less likely to be accurate than returns filed in the rest of the country.⁵ This indicates that California's paid preparer regulatory regime may not improve the likelihood that returns are accurate, relative to the rest of the country. Including both self-prepared and paid prepared returns, Oregon's 2001 federal returns were on

⁴Enrolled agents are allowed to represent a taxpayer before the IRS, to prepare and file documents with the IRS for the taxpayer, and to correspond and communicate with the IRS. Individuals can become enrolled agents by passing a 3-part examination. IRS waives the examination requirement for people with specific prior work experience at IRS.

⁵We categorize a return as "accurate" if the IRS examination found that it required a change of tax liability of less than \$100 in absolute value.

average about \$250 dollars more accurate than returns in the rest of the country. With about 1.56 million individual tax filers in Oregon in 2001, this translates into over \$390 million more in income taxes paid in Oregon than would have been paid if Oregon returns were prepared at the level of accuracy seen on similar returns in the rest of the country. While some portion of this difference might be due to preparer regulations, we cannot rule out that other factors may influence accuracy, such as whether Oregon paid preparers were more likely to be attorneys or accountants than were paid preparers elsewhere in the country. Also, we cannot compare the before and after effects of either state's regulatory regime. Furthermore, some states without paid preparer regulation also had tax returns that, on average, were more accurate than the national average. Consequently, we cannot rule out the possibility that Oregon or California returns were no more or less likely to be accurate than they would have been without regulation of paid preparers.

The costs and benefits of the California and Oregon programs vary in terms of scope and point to factors that would have implications for any proposed national paid preparer regulatory program. In both programs, direct administration costs are funded principally through fees with no direct cost to the states. California's program is focused on ensuring that paid preparers have received required education and its cost is relatively low, with direct costs of about \$29 per CRTF per year, according to our analysis of the CTEC budget. Oregon's per paid preparer costs are higher than California's—about \$123 per LTC and per LTP, according to our analysis of the Oregon Board of Tax Practitioners (OBTP) budget. Oregon's higher cost per preparer is partly because the Oregon program includes testing and also because Oregon's costs are spread among far fewer paid preparers than California's. Nevertheless, we conservatively estimate that the total cost of the Oregon program—including both fees paid to the state and the time and expense that preparers incur to comply with Oregon's education requirements—was about \$6 million in 2007. If only a small portion of the increased revenue that we found in Oregon is attributable to the Oregon regulatory regime, the regime would compare favorably to IRS's overall efforts to increase reporting accuracy. Program administrators and preparer community representatives we spoke to in both states said they believe that the programs are beneficial because they reduce the number of incompetent paid preparers, professionalize the industry, and have benefits that outweigh the costs, although neither state has conducted research into this latter question. Costs and benefits of paid preparer regulation at the federal level would similarly be driven by program features—the more a program would be expected to accomplish, the more it would likely cost to design, implement, and administer.

If Congress judges that the Oregon paid preparer regulatory regime is likely to account for at least a modest portion of the higher accuracy of Oregon federal tax returns and could be implemented nationwide at a favorable cost compared to the potential benefits of improved accuracy, it should consider adopting a similar regime nationwide. In light of the uncertainty about the extent to which Oregon's regime improves tax return accuracy, if Congress enacts national paid preparer legislation, it should also require IRS to evaluate its effectiveness.

We provided the Commissioner of Internal Revenue with a draft of this report for review and comment and IRS provided technical comments which we incorporated. The Commissioner's letter is reprinted in appendix II.

Background

A paid tax return preparer is anyone who is paid to prepare, assist in preparing, or review a taxpayer's tax return.⁶ In this report, we refer to two categories of paid preparers—tax practitioners and unenrolled preparers. CPAs, attorneys, and enrolled agents are tax practitioners. Tax practitioners can practice before IRS; practicing before IRS includes the right to represent a taxpayer before the IRS, to prepare and file documents with IRS for the taxpayer, and to correspond and communicate with IRS. Individuals can become enrolled agents by passing a 3-part examination; IRS waives the examination requirement for people with specific prior work experience at IRS. Department of the Treasury Circular 230, *Regulations Governing the Practice of Attorneys, Certified Public Accountants, Enrolled Agents, Enrolled Actuaries, and Appraisers before the Internal Revenue Service*, applies to tax practitioners and governs their duties, restrictions, sanctions, and disciplinary proceedings. IRS's Office of Professional Responsibility (OPR) has responsibility for administering and enforcing Treasury Circular 230. We use the term unenrolled preparer to describe the remainder of the paid preparer population. In most states, anyone can be an unenrolled preparer regardless of education, experience, or other standards.⁷

Paid preparers are a critical part of the nation's tax administration system because of the wide variety of services they offer and their unique relationship with taxpayers. Paid preparers may combine several taxpayer

⁶See 26 U.S.C. § 7701(a)(36).

⁷Regulation of unenrolled preparers is the principal focus of this report.

services, including help understanding tax obligations, answering tax law questions, and providing tax forms and publications, return preparation, and electronic filing. IRS regards tax professionals as a critical link between taxpayers and the government. For example, IRS has a section of its Web site dedicated to providing information directly to tax professionals. IRS also sponsors the Nationwide Tax Forums, annual conferences in several cities every year to provide tax education to paid preparers. The Web site of the National Association of Tax Professionals also points out the shared responsibility of paid preparers to represent their clients while respecting the law, listing among its professional standards one that says "Should the client insist upon [an] item being stated on the return incorrectly, the member should withdraw and refuse to prepare the return."

The number of active paid preparers is unknown. In 1999, IRS estimated there were up to 1.2 million paid preparers, but IRS officials acknowledge that the actual number could be significantly higher or lower. The total number of active paid preparers is unknown because only a small portion of all paid preparers—enrolled agents—are licensed directly by IRS to practice before the IRS. As of June 2008, about 43,000 tax preparers were actively enrolled to practice before the IRS.⁸ IRS officials said that the number of new enrolled agent applications and the number of people taking the examination have declined in recent years. They noted that these declines followed increases in enrolled agent application and examination fees.⁹ Similarly, the number of attorneys and accountants who make tax return preparation a part of their practice is unknown.

Millions of tax returns prepared by paid preparers have serious compliance problems, which often leave taxpayers owing or overpaying by hundreds or thousands of dollars. As we have previously reported,¹⁰ IRS's tax year 2001 NRP data indicate that tax returns prepared by paid preparers had a higher error rate—56 percent—than returns prepared by

⁸Enrolled agents must complete 72 hours of continuing education and renew their registration every 3 years.

⁹IRS officials said that the number of applications for enrollment was 3,108 in fiscal year 2006 and 1,916 in fiscal year 2007. In fiscal year 2005 and 2006, there were over 11,000 candidates taking the examinations per year and 5,847 did so in fiscal year 2007. Enrollment fees increased from \$80 to \$125 in fiscal year 2007. Total examination fees increased from \$55 to \$201 in 2006.

¹⁰GAO, *Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors*, GAO-06-563T (Washington, D.C.: Apr. 4, 2006).

taxpayers—47 percent.¹¹ In 2002, we estimated that on as many as 2.2 million tax returns, taxpayers claimed the standard deduction when their potential itemized deductions were greater, and that about half of these taxpayers had returns prepared by another person.¹² In 2005, we reported that many tax returns included claims for one of three available postsecondary education tax preferences that resulted in higher overall tax liability than if one of the other preferences had been taken, and that over half of these returns were prepared by paid preparers.¹³ However, the fact that errors were made on a return done by a paid preparer does not necessarily mean the errors were the preparer's fault; the taxpayer may be to blame. The preparer must depend on the information provided by the taxpayer.

On the other hand, some mistakes are clearly the fault of the preparer. In 2006 we reported on the results of an investigation where we identified mistakes in 19 out of 19 visits to paid preparers working in preparer chain offices. Some of the mistakes were significant, either exposing the taxpayers to serious IRS enforcement action or costing taxpayers over \$1,500 in overpaid taxes.¹⁴ In 2007, the Department of Justice took action against corporations operating franchises of a major tax preparation chain. The government complaints alleged that the franchisee corporations created and fostered a business environment "in which fraudulent tax return preparation is encouraged and flourishes."¹⁵ The corporations that owned the franchises agreed to sell the franchises to

¹¹All percentage estimates from the NRP files have margins of error of plus or minus 5 percentage points or less, unless otherwise noted. All numerical estimates other than percentages have margins of error of plus or minus 5 percent or less of the value of those numerical estimates, unless otherwise noted.

¹²GAO, *Tax Deductions: Further Estimates of Taxpayers Who May Have Overpaid Federal Taxes by Not Itemizing*, GAO-02-509 (Washington, D.C.: Mar. 29, 2002).

¹³GAO, *Student Aid and Postsecondary Tax Preferences: Limited Research Exists on Effectiveness of Tools to Assist Students and Families through Title IV Student Aid and Tax Preferences*, GAO-05-684 (Washington, D.C.: July 29, 2005).

¹⁴GAO, *Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors*, GAO-06-563T (Washington, D.C.: Apr. 4, 2006).

¹⁵Department of Justice, *U.S. Government Sues Jackson Hewitt Tax Preparation Franchises in Four States, Alleging Pervasive Fraud* (Apr. 3, 2007), available at <http://www.usdoj.gov/tax/txtv07215.htm>.

new owners and to be permanently barred from preparing federal income tax returns.¹⁶

When mistakes or deliberate noncompliance by paid preparers result in taxpayers underreporting their tax liabilities, it adds to the tax gap. The net tax gap is an estimate of the difference between the taxes owed—including individual income, corporate income, employment, estate, and excise taxes—and what was eventually paid for a specific year. IRS most recently estimated the net tax gap to be \$290 billion in 2001.

In March 2008, we recommended that IRS develop a plan to require a single identification number for paid preparers, including assessing the feasibility of options, their benefits and costs, as well as their usefulness for enforcement and research, on paid preparer behavior.¹⁷ Also, as of July 2008 there were similar bills pending before Congress calling for national paid preparer regulation. Senate Bill 1219 and House of Representatives Bill 5716 would require members of the current community of unenrolled paid preparers to pass an initial qualifying examination and meet continuing annual education requirements. Support for legislation such as this can be found in the National Taxpayer Advocate's 2002 and 2003 Annual Reports to Congress, which recommended Congress create a designation called a "Federal Tax Return Preparer," defined as someone other than an attorney, CPA, or enrolled agent, who prepares more than five federal tax returns in a calendar year and satisfies registration, examination, and certification requirements.¹⁸

¹⁶Department of Justice, *Corporations That Owned Jackson Hewitt Franchises in Three States Agree to be Barred from Tax Return Preparation* (Sept. 28, 2007), available at <http://www.usdoj.gov/tax/txdv07779.htm>.

¹⁷GAO, *Internal Revenue Service: Fiscal Year 2009 Budget Request and Interim Performance Results of IRS's 2008 Tax Filing Season*, GAO-08-567 (Washington, D.C.: Mar. 13, 2008).

¹⁸The National Taxpayer Advocate, *National Taxpayer Advocate—FY 2002 Annual Report to Congress* (Washington, D.C.: Dec. 31, 2002) and *National Taxpayer Advocate—2003 Annual Report to Congress* (Washington, D.C.: Dec. 31, 2003).

IRS, California, and Oregon Differ Significantly in How Each Regulates Paid Tax Preparers

Only a few Internal Revenue Code provisions apply to all paid preparers and only a small portion of paid preparers—enrolled agents—have any federal registration, testing, or fee requirements. All paid preparers are subject to a few Code provisions and may be penalized if they fail to follow them. For example, the Internal Revenue Code imposes monetary penalties on paid preparers who (1) understate a taxpayer's liability due to a position that fails to meet the applicable legal standard, (2) fail to provide a copy of the return to the taxpayer, or (3) fail to identify themselves on the returns they prepare. Additionally, for returns that include the Earned Income Credit (EIC), paid preparers must ask specific questions to determine a taxpayer's eligibility for the credit. Also, all paid preparers who choose to file electronically are subject to IRS Electronic Return Originator rules.

Both California and Oregon began to regulate paid preparers in the 1970s. California's program was first administered by the state's Department of Consumer Affairs, and legislation transferred oversight responsibility to CTEC in 1997. Oregon's program was established by the 1973 Oregon Legislative Assembly after representatives of the state's paid preparer community recommended that the legislature regulate the profession. According to a preparer involved at the time, the Oregon Legislative Assembly was responding to a report that there were many dishonest or incompetent paid preparers working in the state.

The main features of California's paid preparer program are qualifying and continuing education and registration. To become a CRTP, individuals initially register with CTEC by completing a 60-hour qualifying education course, purchasing a \$5,000 surety bond, completing an application, and paying a \$25 registration fee. CTEC may waive some of the qualifying education requirements for individuals with 2 recent years experience in the preparation of personal income tax returns.¹⁰ In each subsequent year, CRTPs must complete 20 hours of continuing education, ensure their bond remains in full force, submit a renewal application, and pay a \$25 renewal fee. As of June 6, 2008, 41,755 paid preparers were registered with CTEC.

¹⁰The 2 years of experience can be time spent preparing tax returns in another state or while working for an attorney, CPA, or enrolled agent. It may not include time preparing tax returns in violation of the registration requirement.

CPAs, attorneys, enrolled agents, and employees of any of these types of tax practitioners are exempt and not required to register.²⁰

California does not require prospective CRTPs to pass a criminal background check or to report past criminal convictions or current legal issues. This means that prior questionable or illegal conduct is not known to program administrators. Moreover, CTEC does not have the authority to deny a preparer's registration application based on known illegal conduct, nor does the California Code include provisions for refusing to renew a CRTP's registration as long as the CRTP meets the continuing education requirement and pays the annual registration fee.

The 60-hour qualifying education requirement is intended to ensure paid preparers have a basic knowledge of federal and California tax laws. According to the CTEC policy manual, the intent of the annual continuing education requirement is to enhance the paid preparer's skill in tax matters above the basic knowledge they have already acquired. CTEC approves an education provider's curriculum based on an independent review of one of the prospective provider's courses at least once every 3 years.

People who are not one of the types of exempt tax practitioners who prepare tax returns in California without becoming CRTPs can be fined. Under a Memorandum of Understanding between CTEC and the California Franchise Tax Board (FTB),²¹ the FTB is reimbursed by CTEC for providing staff to identify unregistered tax preparers. In 2007, FTB provided one full-time and one part-time employee and CTEC reimbursed FTB \$270,000. Persons suspected of illegally preparing tax returns are first issued penalty letters and encouraged to become registered. If they do not register within 90 days, the FTB can levy fines of up to \$5,000. An FTB official said that between July 1, 2005, and June 30, 2006, FTB identified 77 individuals as unregistered.²² Many of these persons were identified by the

²⁰Trust company and financial institution employees functioning within the scope of their employment are also exempt from the registration requirements.

²¹The California FTB is responsible for administering the state's personal income and corporate tax.

²²Of the 77 individuals identified, 56 registered within the 90-day period and were not fined. The other 21 were fined \$2,500. Of the 21 who were fined, 11 registered in the next year and were not subject to any additional penalties. Six of the 21 did not register and were issued the \$5,000 penalty. The remaining 4 were no longer preparing returns.

2 FTB staff members who visited the Los Angeles and San Francisco Bay areas—where there are large numbers of paid preparer offices—met with paid preparers, and asked to see evidence of registration. Noncompliant paid preparers have also been identified through complaints sent to CTEC and passed along to FTB.

Oregon requires paid preparers who are not already licensed by the state as CPAs or attorneys, or working for a CPA, to obtain a state license to prepare tax returns.²³ Enrolled agents—practitioners licensed by Treasury—must also obtain an Oregon license, but they are subject to fewer qualifying requirements than other individuals who are seeking an LTC license. The state board that administers the program—the Oregon Board of Tax Practitioners—issues two levels of paid preparer licenses: the Licensed Tax Preparer (LTP) license and the Licensed Tax Consultant (LTC) license.²⁴ To become an LTP, a person must have a high school diploma or the equivalent, complete 80 hours of approved qualifying education, pass a state-administered examination with a score of 75 percent or better, and pay an \$80 registration fee. To continue as an LTP in following years, individuals must annually renew their license by completing 30 hours of approved continuing education and paying an \$80 renewal fee. An LTP in Oregon may only prepare tax returns for Oregon residents under the supervision of an LTC, CPA, or attorney.²⁵ A person can become an LTC after working as a tax preparer for a minimum of 780 hours during 2 of the prior 5 years, completing a minimum of 15 hours of continuing education within 1 year of submitting an application, and passing a more advanced examination with a score of 75 percent or better.²⁶

²³Public accountants and their employees, employees of businesses who prepare only their businesses' tax returns, fiduciaries and their employees while acting on behalf of estates, and employees of governmental agencies while performing official duties are also exempt from Oregon's licensing requirements.

²⁴Tax preparation businesses operating in Oregon must also register with OBTP. As of February 1, 2008, the annual tax preparation business registration fee was \$110.

²⁵The laws applicable to paid preparers do not apply to attorneys, CPAs, and the employees of CPAs. However, an LTP working under the supervision of a CPA or attorney must still follow the applicable paid preparer laws because the LTP has chosen to be licensed by the OBTP.

²⁶Continuing education may be accepted for up to 260 hours of work experience at the rate of 1 hour of education for 5 hours of work experience provided the course is tax related, taken within 1 year of applying to become an LTC, and credit for the course is not claimed to fulfill continuing education requirements for a license renewal.

LTPs and LTCs must disclose on their initial license and license renewal applications if they have been convicted of a crime or are under indictment for criminal offenses involving dishonesty, fraud, or deception. According to the Oregon statute, OBTP can consider the circumstances in particular cases and still approve an application when the applicant has disclosed a legal issue.

Many applicants do not pass the LTP or LTC examinations. For instance, from March 1, 2006, to February 28, 2007, 54 percent of test takers passed the LTP examination and 30 percent passed the LTC examination.²⁷ The OBTP updates both examinations yearly. The examinations cover specific Oregon and federal personal income tax laws as well as tax theory and practice. The LTC examination also includes questions on corporation and partnership income as they relate to personal income tax returns. The examination questions pertain to approximately 75 percent federal and 25 percent state law. IRS enrolled agents in Oregon who wish to become LTCs must pass a shorter version of the LTC examination that is limited to Oregon state laws. The intent of Oregon's education and examination requirement is to ensure paid preparers comprehend the state and federal tax codes. OBTP reports that in March 2008, 3,993 paid preparers held one of these two licenses—1,916 LTPs and 2,077 LTCs.

The Oregon statute includes fines for preparing tax returns without a license. Each return prepared can generate a separate fine, so the total penalty for working as an unlicensed preparer can be very large. OBTP also has the authority to assess civil penalties of up to \$5,000, or suspend or revoke the license of LTCs and LTPs who engage in fraudulent or illegal conduct, or who violate other provisions of the Oregon statutes or OBTP rules. Additionally, the board may order restitution to consumers harmed by tax preparation fraud. From March 2001 to November 2007, OBTP took disciplinary action 48 times, with fines totaling about \$2 million. The largest fine for one individual was in April 2002 for \$805,700. Only a fraction of fines are eventually collected however—while about \$867,000 in fines were levied from July 2005 through June 2007, about \$69,000 in fines and \$6,000 in interest was collected during the same period. Persons penalized by the OBTP can appeal these decisions and OBTP has an

²⁷ All passing rate figures are for the 12-month period beginning March 1, 2006. The 30 percent passing rate for the LTC examination is an overall figure for both the full examination and the state-law-only portion of the examination given to enrolled agents. The passing rate for the full LTC examination is 25 percent and the state-law-only portion is 71 percent.

arrangement with the Oregon Office of Administrative Hearings to provide an administrative law judge to hear these cases. Individuals can also appeal their cases to the Oregon Court of Appeals.

Both California and Oregon use their registered or licensed paid preparer lists to contact preparers to remind them about requirements and to inform them about changes to the tax code or other matters they should know about. However, neither state uses their preparer information to track paid preparer accuracy or for enforcement purposes. California does not require CRTPs to include their CTEC registration number on either the state or federal tax returns that they prepare. Oregon requires LTCs and LTPs to include their license number on both types of returns, but officials told us that this requirement is not consistently followed as some licensees incorrectly put down their Preparer Tax Identification Number, Social Security Number, or an employer's Employer Identification Number. Consequently, neither state has a reliable means to track or analyze returns prepared by registered or licensed paid preparers in their states. Table 1 illustrates some of the highlights of the California and Oregon regulatory programs.

Table 1: Overview of the California and Oregon Paid Tax Preparer Programs

Requirement	California	Oregon	
		Licensed Tax Preparer (LTP)	Licensed Tax Consultant (LTC)
Experience	May consider work experience in lieu of education.	None	Prior experience as an LTP or submit petition form of all past tax preparation experience.
Education	Complete a 60-hour qualifying education course.	(1) Hold a high school diploma or pass equivalency exam. (2) Complete 80 hours of qualifying education.	If currently an LTP, complete at least 15 hours of continuing education. Otherwise, complete 80 hours of education on income tax law.
Examination	None	Pass exam with a score of at least 75 percent.	Pass exam with a score of at least 75 percent. Enrolled agents take only the sections of the LTC examination focused on Oregon laws.
Exempted individuals	CPAs, attorneys, enrolled agents, and anyone employed by them. Trust company and financial institution employees functioning within the scope of their employment.	CPAs, public accountants, and their employees; attorneys; employees of businesses who prepare only their businesses' tax returns; fiduciaries and their employees while acting on behalf of estates; and employees of governmental agencies while performing official duties.	

Requirement	California	Oregon	
		Licensed Tax Preparer (LTP)	Licensed Tax Consultant (LTC)
Is criminal background relevant to registration or licensing?	No	Yes. OBTP makes case-by-case decisions.	
Other	Purchase a \$5,000 surety bond.	Must be 18 years old.	
Fees	\$25 (initial registration and annual renewal).	\$80 (initial issuance or renewal).	\$95 (initial issuance and renewal), \$65 (if currently an LTP).
Renewal	Annual. Complete 20 hours of continuing education and ensure bond remains in force.	Annual. Complete 30 hours of continuing education.	
Penalties for failing to register	Unregistered individuals may be fined \$2,500, but fine may be waived if they register within 90 days. If they fail to comply, the fine may be increased to \$5,000.	Civil penalties range from \$50 to \$5,000 per violation.	

Sources: California and Oregon paid preparer regulatory programs.

In May 2008, Maryland also enacted paid preparer legislation that will require tax preparers to pass an examination, pay a registration fee, and subsequently comply with continuing education requirements. Also, New York, Oklahoma, and Arkansas all have legislation pending that would create tax preparer programs. All three pending bills create an oversight regime, which would include tax preparer registration and education requirements, both initial and continuing.²⁸

The Oklahoma and Arkansas bills require that preparers pass an examination to register. Arkansas's pending legislation closely models the Oregon regime, with requirements for both preparers and consultants. New York's pending legislation is similar to California's paid preparer program, requiring preparers to maintain surety bonds but having no provision for preparer testing. The enacted Maryland program and the pending legislation in New York and Oklahoma exempt CPAs, attorneys and their employees, and enrolled agents from the requirements. The Arkansas bill would exempt CPAs and attorneys and their employees, and would require enrolled agents to pass a test only on Arkansas tax law

²⁸We limited our search for enacted laws and pending legislation to those concerning paid preparer qualifications and did not search for pending or enacted legislation concerning paid preparer conduct. Also, our search may not have identified all recent activity in states aside from the states we found.

issues.²⁹ Table 2 provides an overview comparison of the California and Oregon requirements with the Maryland requirements and the pending legislation in the other states.

Table 2: Comparison of State-Level Paid Preparer Requirements and Pending Legislation

	California	Oregon	Maryland	Arkansas (pending legislation)	New York (pending legislation)	Oklahoma (pending legislation)
Registration	Yes	Yes	Yes	Yes	Yes	Yes
Qualifying education	Yes	Yes	No	Yes	Yes	Yes
Testing	No	Yes	Yes	Yes	No	Yes
Continuing education	Yes	Yes	Yes	Yes	Yes	Yes

Sources: GAO review of state laws and pending legislation.

IRS officials noted that continued growth in the number of different paid preparer registration or licensing regimes in different states could become a problem if the requirements differ from state to state. The officials described this as primarily a problem for the tax preparation industry in that a variety of regulatory regimes across many different states could make it complicated, for example, for paid preparers to move their practice from one state to another or for a tax preparation chain to move employees or expand their operations.

Oregon's Regulatory Regime May Lead to More Accurate Federal Tax Returns

When controlling for other factors likely to affect tax return accuracy, our analysis of IRS data showed that tax year 2001 federal tax returns filed in Oregon were more likely to be accurate than returns in the rest of the country, which is consistent with but not sufficient to prove that Oregon's regulatory regime improves tax return accuracy. Relative to the rest of the country, Oregon paid preparer returns had a greater likelihood of being accurate and California paid preparer returns were less likely to be accurate. Specifically, we found that the odds that a return filed by an Oregon paid preparer was accurate were about 72 percent higher than the odds for a comparable return filed by a paid preparer in the rest of the country. Conversely, the odds that a paid preparer return in California was accurate were about 22 percent lower than for paid preparer returns in the

²⁹The United States territory of Guam also has a tax preparer program that requires all paid preparers to pass an examination, register with Guam's Department of Revenue and Taxation, and maintain a surety bond.

rest of the country.³⁰ This indicates that California's paid preparer regulatory regime may not improve the likelihood that returns are accurate, relative to the rest of the country. Our analysis controlled for factors such as the complexity of tax returns in comparing California and Oregon to the rest of the country. However, our analysis cannot rule out the possibility that factors for which we could not control affected the accuracy of tax returns in either state.

To determine the relative likelihood that Oregon and California returns were accurate, we used multivariate logistic regression to compare the odds of return accuracy in these states compared to odds in the rest of the country, controlling for other characteristics that might influence return accuracy.³¹ To make these accuracy comparisons, we used data from IRS's NRP, which assessed the accuracy of individual tax returns from tax year 2001. We defined a return as accurate if it required less than \$100 absolute value in changes.³²

As an illustration of the differences among paid preparer returns in California and Oregon, we computed the probability of accuracy for a medium complexity, form 1040, *U.S. Individual Income Tax Return*, for a taxpayer with income over \$100,000. While a return with these characteristics prepared by a paid preparer in Oregon would have a 74 percent probability of being accurate, a similar return prepared by a paid preparer in California would have a 55 percent probability of being accurate.

In addition to having a higher likelihood of accuracy than the rest of the country, on the average Oregon 2001 federal tax return—regardless of whether it was self prepared or from a paid preparer—auditors identified a

³⁰The bounds of our estimates for how Oregon compared to the rest of the country are relatively wide. For example, the 95 percent confidence interval for our model among paid preparer returns suggests that the odds of accuracy among Oregon returns are higher than those for returns in the rest of the country by somewhere between 5 percent to 181 percent.

³¹The odds of accuracy are defined as the percentage of returns that are accurate over the percentage that are inaccurate in each category. The ratio of odds for one group (e.g., Oregon) to another group (the rest of the country) helps to illustrate the relative likelihood of accuracy. For an illustration of how odds ratios are calculated, see appendix I.

³²We also tested alternative dependent variables such as liability changes over \$10 in value and whether the net value of line item adjustments exceeded \$99. The results were largely consistent with our model using the \$100 liability threshold change.

smaller increase in taxes owed.³³ In Oregon, the average return required approximately \$250 less of a change in tax liability than the average return in the rest of the country. Our \$250 estimate is conservative in that it does not incorporate the limited number of cases with relatively large liability changes. With about 1.56 million individual tax filers in Oregon in 2001, this translates into over \$390 million more in income taxes paid in Oregon than would have been paid if Oregon returns were prepared at the level of accuracy seen on similar returns in the rest of the country. The average tax liability change in California was higher than the average in the rest of the country by approximately \$90.

Although the differences we observed in the states' regulatory programs and in how likely California and Oregon returns were to be accurate compared to the rest of the country are consistent with the Oregon regime leading to some improved federal tax return accuracy, the analysis cannot rule out that the regime did not have such an effect. We could not control for other factors that may influence accuracy, such as whether Oregon paid preparers were more likely to be attorneys or CPAs than preparers elsewhere in the country. Also, data are not available on return accuracy prior to the existence of each state's program, so we cannot compare the before and after effects of the regimes. Before and after data might have shown, for instance, whether the California regime leads to improved tax return accuracy compared to what it otherwise would have been even though California's returns in 2001 were less accurate, on average, than returns in the rest of the country. Also, we considered the accuracy of tax returns in other states and found that some states without paid preparer laws had more accurate tax returns than the national average, after controlling for the factors in our model.³⁴ This indicates that regulation over paid preparers alone does not explain the differences that we found. Further, to the extent that the Oregon regime does improve tax return accuracy, our methodology does not identify whether any part of the

³³Computing accuracy for all Oregon returns takes into account that if the Oregon paid preparer regime decreases the likelihood of noncompliance for paid prepared returns, those wishing to be noncompliant might switch to preparing their own returns. Because Oregon self-prepared returns were no less accurate than returns elsewhere in the country, even if this switching occurred it likely would not completely offset the increased accuracy of paid prepared returns.

³⁴States besides Oregon with a statistically significant likelihood of having paid preparer returns that were more accurate than the national average, controlling for other factors, were Colorado, Iowa, New Mexico, Ohio, Pennsylvania, West Virginia, and Wisconsin.

regime is most important to that result. Our methodology only takes into account the entire regimes as implemented in Oregon and California.

Costs and Benefits of the California and Oregon Programs Provide Some Guidance for a National Program

Both California and Oregon support their programs almost entirely through fees, with state program costs averaging about \$29 and \$123 per year, respectively, per registered paid preparer. In addition to the fees charged to paid preparers, the preparers or their employers bear other costs, such as those associated with taking courses on tax law and return preparation. Program administrators and preparer community representatives in both states said that there are intangible benefits from their regulatory regimes, although there are no studies quantifying outcomes in either place. The California and Oregon paid preparer registration programs include differing design features, such as on testing applicants and how much enforcement is deemed desirable, that show, not surprisingly, that more extensive programs cost more.

California's Less Extensive Program Costs Less Than Oregon's

California's paid preparer program is more limited in scope than Oregon's, and has lower direct administration costs per registered preparer. Because neither state provides funding for the programs above the fees collected, the entire cost of both programs are borne directly or indirectly by the regulated paid preparer communities.

As noted previously, California's program primarily requires unenrolled preparers to register with the state and meet minimum education requirements. The total direct budgeted cost of the California program was about \$1.2 million in fiscal year 2007, with most of the funding coming from the \$25 registration fees that CRTPs must pay, with additional funds coming from late registration fees and other income such as fees paid by education providers that apply to be approved as CTEC education providers.³⁵ CTEC's total budget in 2007 was \$1.2 million and CTEC reported 41,755 CRTPs in June 2008, so the cost per CRTP was about \$29. According to CTEC officials, no funds from state tax revenues are used to pay for administering or enforcing California's paid preparer laws.

Like California, Oregon also registers preparers and seeks to ensure that paid preparers meet minimum education requirements, but it also tests prospective LTPs and LTCs, adding to the administration cost of the

³⁵CTEC's fiscal year operates from July 1 to June 30.

Oregon program. In 2008, prospective LTPs pay \$50 and prospective LTCs pay \$85 to take the examinations. Also as of 2008, LTPs pay \$80 and LTCs pay \$95 to obtain their initial license and in each subsequent year to renew their license. The registration fee for a new LTC who had been an LTP is \$65. OBTP also collects fines and penalties from both unlicensed tax return preparers and licensed paid preparers who violate Oregon laws—averaging about \$38,000 per year in the 2005 through 2007 period. OBTP's administrative expenses amounted to about \$490,000 in 2007—divided by the 3,993 LTCs and LTPs OBTP reported in March 2008, this is about \$123 per licensee.³⁰ According to OBTP officials, OBTP's operating funds come from the fees and fines described above and none come from the state's general revenues.

Administrative functions of CTEC and OBTP include communicating with paid preparers and the public at large about their regulations, informing the paid preparer community about tax law and processing changes, evaluating education providers, recordkeeping related to registration and licensing, maintaining a Web site that taxpayers can use to find a paid preparer or check that a particular paid preparer is properly registered or licensed, and working with the state legislature and the rest of the state government. Some of the difference in the administrative cost per registered or licensed preparer between the two states may be attributed to economies of scale in the registration of paid preparers that California has relative to Oregon. While California's direct operating budget is about twice the size of Oregon's, the number of preparers that it registers is more than 10 times greater.

Enforcement-related expenses take up a share of the CTEC and OBTP budgets. In California, CTEC paid the FTB \$270,000 in fiscal year 2007 to conduct enforcement targeted at identifying unregistered preparers and either bringing them into compliance or fining them. CTEC is not involved in imposing fines on unregistered preparers and has no means of taking enforcement action against a CRTP for misconduct, and it has never incurred litigation expenses associated with someone appealing a CTEC decision. In Oregon, the OBTP has a full-time investigator on its staff and directly imposes fines on both licensed and unlicensed paid preparers for misconduct. As discussed previously, these fines can be appealed, so OBTP arranges with the Oregon Office of Administrative Hearings for an administrative law judge to hear cases, and reimburses the Oregon

³⁰ OBTP's biennial fiscal years 2005 through 2007 budget was about \$980,000.

Attorney General's Office for counsel to handle legal aspects of disputed cases. In 2007, OBTP expenses for its investigator and costs related to litigation were about \$93,000.³⁷

The regulatory programs in the two states impose additional costs beyond the direct administration expenses found in the CTEC and OBTP budgets. In both states, prospective paid preparers must meet qualifying education requirements and the financial and time costs of obtaining this education are directly borne by either the individual or his or her employer. We contacted frequently used education providers in both states and found costs were typically in the \$200 to \$300 range, although one was \$614. According to paid preparers we spoke to, the cost of obtaining continuing education was sometimes fairly low, especially when continuing education was obtained through participation in professional associations. In some associations, monthly meetings usually include a presentation that qualifies for continuing education credit. Other preparers, however, may choose to travel to conferences or training sessions, such as an IRS Nationwide Tax Forum, to obtain their continuing education over just a few days. The registration fee for the IRS forums is fairly low—\$179 for early registration in 2008. Out-of-town travel, when necessary, adds to the cost of obtaining required continuing education. Continuing education can also be obtained from state-approved education providers in both classroom settings and over the Internet.

Because results for the Oregon regime are consistent with some positive effect on federal tax return accuracy, the cost of that regime is of particular interest. We conservatively estimated the total costs associated with Oregon's regulation to be about \$6 million in 2007. This estimate includes the regime's direct administrative costs as well as an estimate of the cost of licensees obtaining qualifying and continuing education from education providers, the value of the time they spend in those classes and studying outside of class, and the same education-related costs for all unsuccessful test takers. This estimate is conservative because it counts preparer education time and expense for all licensees, including enrolled agents, who have continuing education requirements under that program, and employees of tax preparation chains that require similar education for all of their preparers. Appendix I describes how we made our estimate.

³⁷This includes about \$29,000 in legal fees billed to OBTP by the Oregon Department of Justice. According to OBTP, these were mostly associated with enforcement actions, but also included some non-enforcement-related matters.

IRS has developed rough measures of return on investment in terms of tax revenue that it assesses from uncovering noncompliance. Generally, IRS cites an average return on investment for enforcement of 4:1, that is, IRS estimates that it collects \$4 in revenue for every \$1 of funding.³⁸ For the Oregon paid preparer regulatory regime to be considered a reasonably cost-effective tax administration policy by this standard, it would have to account for only a small share of the \$390 million in higher federal tax revenue we estimated came in from Oregon compared to the rest of the country.³⁹ It is important to note that the 4:1 IRS average return is based on administrative spending and such expenses are less than 10 percent of our approximately \$6 million annual total cost estimate for the Oregon program.

Regulation of preparers can also have the effect of increasing the price of tax preparation services by reducing the supply of paid preparers. A California tax preparer association representative said that the costs to obtain and maintain CRTP status are fairly low and likely do not have much of an impact on prices consumers pay, and that the requirements to become a paid preparer are not so great that the number of paid preparers in the state is being held lower than it would be without any regulation. In Oregon, however, direct costs to become a paid preparer and to maintain licensed status are somewhat higher. Potentially more important, however, is the requirement that LTPs only work in offices supervised by an LTC, attorney, or CPA, and that LTCs may not supervise more than two offices. This means that there can be a substantial bar to the opening of a new tax preparation business if the owner cannot find and recruit an LTC. We were told by a representative of a tax preparation chain that he had experienced difficulty in opening a new rural office because he could not find an LTC to supervise LTPs. However, since there are somewhat more LTCs in Oregon than LTPs, such problems may be limited.⁴⁰

Data that could be used to analyze prices charged by paid preparers in California or Oregon, or to compare prices charged in those states with the

³⁸GAO, *Tax Compliance: Multiple Approaches Are Needed to Reduce the Tax Gap*, GAO-07-488T (Washington, D.C.: Feb. 16, 2007).

³⁹At \$6 million in total cost, the Oregon regulatory regime would have to account for only about 6 percent (\$23.4 million) of the \$390 million in higher federal tax return accuracy to compare favorably to IRS's estimated overall 4:1 return on investment.

⁴⁰An alternative to finding an LTC to supervise LTPs is to hire a CPA. Any individual employed by a CPA in Oregon may prepare tax returns, whether an LTP or not.

rest of the country, are not available. NRP data, however, provide a related point of comparison on the use of paid preparers. NRP data show that taxpayers in Oregon are somewhat less likely to use a paid preparer than taxpayers in the rest of the country and even less likely to use paid preparers than taxpayers in California. NRP data show that about 58 percent of individual taxpayers used paid preparers nationally, while only 49 percent of Oregon taxpayers did so. About 64 percent of California tax returns were prepared by paid preparers. It is possible that the Oregon regulatory regime has had the effect of reducing the supply of paid preparers, leading to an increase in the price charged for the service.

**California and Oregon
Officials Consider Their
Programs to Be Beneficial**

Program administrators and preparer community representatives in both California and Oregon described their programs as having benefits that outweigh their costs. Officials in both states also said they believe that paid prepared tax returns are more accurate due to their paid preparer regulatory regimes. However, neither California nor Oregon program administrators have analyzed tax returns to see if this is the case. Representatives also noted that registration facilitates communication with paid preparers that are registered or licensed, so notifying them about, for example, recent changes in tax rules or forms, can be done fairly easily.

Program administrators and paid preparer community representatives in California and Oregon also told us education requirements likely reduce the number of incompetent paid preparers and have led to a more professional tax preparation industry. California and Oregon program administrators also said that consumers benefit from the ability to go online and verify whether a paid preparer is registered or licensed. Both state programs also give taxpayers the ability to seek restitution when wronged by a paid preparer.⁴¹

A benefit of the Oregon program is that prospective preparers who cannot pass the state examination are not allowed to prepare tax returns in that state. As noted previously, the Oregon LTP examination has only a 54 percent passing rate. This means that many people who want to become paid preparers but lack the knowledge and skills necessary to

⁴¹CRTP clients in California can make claims against the surety bonds that CRTPs are required to obtain. LTP and LTC clients can make complaints to OBTP, and OBTP can order restitution along with fines and penalties.

pass the Oregon exam are not legally preparing tax returns. People in every other state with a similar desire to become a paid preparer—and a similar lack of skill—are presumably preparing tax returns.

Occupational licensing of other professions has been shown to have costs and benefits to the consumer.⁴² As with other markets for services, licensing paid preparers might be expected to have several potential effects depending on how licensing requirements are designed. Depending on the level of education or expertise required to obtain a license, some preparers who become licensed may acquire additional knowledge, which helps them better prepare returns or expand their expertise to additional types of returns. In Oregon, officials said that they believe unlicensed tax preparers cost the consumer money when they prepare incorrect or inaccurate tax returns. Occupational licensing of other professions suggests that taxpayers may be willing to pay more to have their returns prepared by registered or licensed paid preparers if the regulatory requirements (i.e., education requirements) provide greater assurance of a higher quality prepared return. Consumers who continue to use these paid preparers may benefit as a result and some taxpayers who previously self-prepared their own returns may switch to a licensed or registered preparer because of additional assurance of quality service. On the other hand, if the licensing requirements cause some preparers to no longer offer services, prices may rise and some taxpayers may switch to self-preparation.

Implications for a National Regulatory Program

The California and Oregon paid preparer regulation programs provide reference points for national policymakers when considering a national paid preparer regulatory regime. In both cases, program costs are driven by the scope of the program. As with the differences we identified in California and Oregon, a more extensive national program will likely cost more to administer than a less extensive one.

An additional point of comparison for policymakers considering a potential national paid preparer program is IRS's enrolled agent program. Enrolled agents are paid preparers who are permitted to represent their

⁴²Morris M. Kleiner, *Licensing Occupations: Ensuring Quality or Restricting Competition*, W.E. Upjohn Institute (Kalamazoo, Michigan, 2006) summarizes the results of several studies on the effects of licensing on quality of service, prices, and earnings for workers in different service markets, including teachers, dentists, lawyers, and optometrists.

clients in matters before IRS. Enrolled agents have to either pass a 3-part examination covering individual income taxes, business taxes and representation, and practices and procedures, or have specific IRS experience.⁴³ During the period May 2007 through April 2008, the overall passing rate for the three parts of the examination was 48 percent.⁴⁴ Prospective enrolled agents also have to meet continuing education requirements and pay a \$125 registration fee every 3 years. One area in which the enrolled agent program parallels the two state programs we studied is that the examination is handled through a contract that is of no direct cost to the government. A private company developed the tests and administers them at sites around the country and it is compensated entirely through fees of about \$100 that test takers pay to take each part of the 3-part examination. Most of the test taking fee is retained by the contractor, but \$11 is remitted to IRS. Applicants are also required to allow IRS to conduct a background check.⁴⁵

IRS officials in OPR said that the more a national program is expected to accomplish, the more expensive it will likely be to design, implement, and administer.⁴⁶ Enforcement is a key consideration, as even the fairly modest enforcement efforts in the two states we reviewed took up 19 percent of total administrative costs in Oregon and 23 percent in California. IRS officials said that more extensive enforcement nationwide could be very costly. IRS officials said they have not developed specific costs for a national regime, in part because they are uncertain which of the many potential elements the program would include.

⁴³An enrolled agent applicant who is requesting enrollment based on former employment with IRS must have had (1) a minimum of 5 years continuous employment with IRS during which the applicant must have been regularly engaged in applying and interpreting the provisions of the Internal Revenue Code and the regulations relating to income, estate, gift, employment, or excise taxes, or (2) an aggregate of 10 or more years of employment in positions involving the application and interpretation of the provisions of the Internal Revenue Code, at least 3 of which occurred within the 5 years preceding the date of application.

⁴⁴Between May 2007 and April 2008, 1,856 of 4,844 attempts (38 percent) at Part 1 of the examination were successful, as were 1,558 of 3,438 attempts (45 percent) at Part 2, and 1,777 of 2,591 attempts at Part 3 (69 percent).

⁴⁵IRS data do not permit comparison of return accuracy by type of paid preparer.

⁴⁶OPR establishes and enforces standards of competence, integrity, and conduct for enrolled agents, attorneys, CPAs, and other individuals and groups covered by IRS Circular 230.

Conclusions

The California and Oregon regulatory regimes point to the feasibility of a nationwide regulatory regime involving paid preparer education, registration, and, as in Oregon's case, testing. Both states have enacted registration and other requirements while funding the administration of their programs through relatively modest fees paid by paid preparers, similar to the way that IRS sees to the testing of enrolled agents. A key benefit from the Oregon approach is the apparent rigor of its qualifying examinations. Just under half of the people who take the Oregon LTP examination fail to pass. These people are not legally preparing tax returns in Oregon today, at least not until they are able to pass the examination. Paid preparers with an equivalent lack of demonstrated ability may well be working as paid preparers in other states.

Available data do not conclusively support or refute the idea that adopting some or all of the California or Oregon program elements at the national level would improve the accuracy of paid prepared returns or reduce the tax gap. However, the more stringent requirements of the Oregon regime along with our modeling results suggest that an Oregon-style approach to paid preparer regulation may be beneficial. The higher level of accuracy found on Oregon returns meant \$390 million more in income taxes paid in Oregon than would have been paid if Oregon returns were as accurate as returns everywhere else. The cost of the Oregon program is quite small in comparison, about \$490,000 per year in administrative expenses and an estimated total of about \$6 million after including the time and expense associated with paid preparers meeting their education and testing requirements. If only a small share of the increased revenue is attributable to the Oregon regulatory regime, it would compare favorably to IRS's overall efforts to increase reporting accuracy. With over half of individual taxpayers using paid preparers, it may be possible to make meaningful progress towards narrowing the tax gap by requiring all paid preparers to demonstrate competence before being allowed to prepare other people's tax returns.

However, because the extent, if any, to which the Oregon regulatory regime improves federal tax return accuracy, is uncertain, if a similar regulatory regime is adopted at the federal level, its effect on tax return accuracy should be assessed. Because IRS has resumed periodic studies of tax return accuracy, such a study could compare accuracy of returns before and after implementation of a federal regime.

**Matter for
Congressional
Consideration**

If Congress judges that the Oregon paid preparer regulatory regime is likely to account for at least a modest portion of the higher accuracy of Oregon federal tax returns and could be implemented nationwide at a favorable cost compared to the potential benefits of improved accuracy, it should consider adopting a similar regime nationwide. In light of the uncertainty about the extent to which Oregon's regime improves tax return accuracy, if Congress enacts national paid preparer legislation, it should also require IRS to evaluate its effectiveness.

Agency Comments

In a letter commenting on a draft of this report dated August 1, 2008, the Commissioner of Internal Revenue noted the important role that paid preparers play in supporting a fair, efficient, and effective system of tax administration. His letter also notes IRS's strategy of working with paid preparers and curbing abuses by unscrupulous preparers. IRS also provided technical comments which we incorporated. The Commissioner's letter is included in appendix II.

As agreed with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days after its date. At that time, we will send copies of this report to the Secretary of the Treasury, the Commissioner of Internal Revenue, and other interested parties. This report is available at no charge on GAO's Web site at <http://www.gao.gov>.

If you or your staff have any questions about this report, please contact me at (202) 512-9110 or brostekm@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in appendix III.



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Appendix I: Objectives, Scope, and Methodology

Our objectives were to answer the following questions: (1) How do IRS, California, Oregon, and other states regulate paid preparers? (2) Using available IRS data, how does the accuracy of federal tax returns in California and Oregon compare to that of returns in the rest of the country, after accounting for other factors that might influence accuracy? (3) What are the state-level costs and benefits of the paid preparer programs in California and Oregon and what insights do they provide for possible benefits if Congress were to enact national paid preparer registration or licensing requirements?

To answer the first and third objectives we conducted a literature review of both the California and Oregon paid preparer programs, including a review of applicable laws and budget documents. We also interviewed state program administrators from the California Tax Education Council and the Oregon Board of Tax Practitioners (OBTP); officials from the California Franchise Tax Board and the Oregon Department of Revenue; and leaders in each state's paid preparer community, and reviewed documents provided to us by them. At the federal level, we reviewed appropriate legislation concerning the regulation of paid preparers, interviewed IRS officials, primarily from the Office of Professional Responsibility, and reviewed documents related to the enrolled agent program. We also interviewed and obtained data from an official from Prometric, the company IRS contracted with to develop and administer the enrolled agent examinations. We interviewed the National Taxpayer Advocate and members of her staff concerning her prior recommendations to regulate paid preparers. We also met with a representative from the National Association of Enrolled Agents to understand their perspective on a more expansive national regulatory regime. Finally, we conducted a literature review of professional occupational regulation to understand the potential effects of occupational regulation on the paid preparer profession. In identifying nonfederal paid preparer regulation programs, we limited our review to state governments and requirements concerning qualification, registration, or licensing of paid preparers and we did not consider possible county or city regulations, or laws dealing with paid tax return preparer conduct.

For the discussion of costs and benefits from the Oregon program in the third objective, we also used information from the OBTP about program costs and the number of new and returning licensees in 2007. We obtained information from education providers about the fees that they charge for basic and continuing education. We also used the U.S. Bureau of Labor Statistics national average hourly wage for paid tax return preparers—\$16.78 in 2007—the value of the time spent obtaining the education. Using

this information, we developed an estimate of the total cost of the Oregon program. In considering costs to include, we included higher-end estimates where possible to ensure that our estimate of the total cost of the Oregon program was conservative. For example, we did not consider the fact that many Oregon licensees are employed by a national tax preparation chain that requires its paid preparers to receive initial and continuing education, so they would be obtaining that education regardless of the Oregon laws.

To answer the second objective, we analyzed data from IRS's National Research Program (NRP). The NRP contains detailed tax and audit data from approximately 47,000 randomly selected tax year 2001 returns, and includes extensive compliance data including line-by-line estimates of accuracy.¹ Unlike other compliance-related data sets, NRP data are generalizable to the population of individual taxpayers throughout the U.S. While NRP was not designed for specific state-level analysis, in conjunction with IRS's NRP officials, we agreed on the types of analysis that the data would support and which variables could be used.

Our analysis comprised four main steps, each of which is explained in more detail below. We first examined the odds that returns from different locations and using different preparation types were accurate. Next, we considered the relative likelihood that a return was accurate, prior to controlling for other factors. Additionally, recognizing that Oregon and California differ from the rest of the country in terms of factors potentially related to a return's accuracy, we developed multivariate statistical models to assess whether returns from these states were more or less likely than returns from other states to require liability changes of \$100 or more in absolute value after controlling for other factors. We also assessed differences in the accuracy of self-prepared tax returns. Finally, we estimated potential cost savings using multivariate regression analysis to assess the size of average tax liability changes for Oregon or California returns relative to the returns in the rest of the United States, controlling for other factors.²

¹More accurate returns that result in higher revenues collected than less accurate returns are the measure of societal benefit that we considered for purposes of this report.

²We define tax liability as taxes owed after accounting for the Earned Income Credit and the additional child tax credit.

In creating our statistical models, we examined a variety of variables on the basis of previous research, our reports, and recommendations from NRP personnel. Our final model included measures of the complexity of the return,³ including whether it was for a sole proprietor or claimed the Earned Income Credit (EIC). We also included the examination class of the return,⁴ taxpayer adjusted gross income in quartiles, whether the return was e-filed, filing status, and a proxy for a state's aggregate level of English proficiency.⁵ All models were calculated using sampling weights and robust estimation to account for differential variation among returns in distinct sampling strata.

Logistic Regression

Table 3 illustrates differences in likelihood that returns from different locations and using different preparation types were accurate. Column A of table 3 shows that, prior to controlling for other factors, 54 percent of California returns and 71 percent of Oregon returns were accurate compared to 64 percent of returns in the rest of the United States. On average, 58 percent of paid preparer returns were accurate, compared to 70 percent of self-prepared returns. The lower half of table 3 illustrates the combined effect of location and preparation status. Prior to controlling for other factors, 49 percent of California paid preparer returns and 67 percent of Oregon paid preparer returns were accurate, compared to 59 percent of paid preparer returns in the rest of the country. Similarly, without controlling for other factors, 63 percent of California self-prepared returns and 75 percent of Oregon self-prepared returns were accurate, compared to 71 percent of self-prepared returns in the rest of the country. The odds within each category, shown in column C, compare the proportion of returns that were accurate to the proportion of returns that were not accurate.

³Our measure of complexity is a three-point scale based on research presented by John Guyton, Karen Masken, and Mark Mazur at the 2007 National Tax Association Conference on Taxation.

⁴The examination class is defined by the income reported on the return and, for sole proprietors or farm owners, the gross receipts of the return.

⁵All models were calculated using sampling weights and robust estimation to account for potential correlation between returns in the same sampling stratum. We used likelihood ratio tests and Akaike's Information Criterion when deciding on a final model specification.

Appendix I: Objectives, Scope, and Methodology

Table 3: Percentages, Odds, and Odds Ratios for Return Accuracy, before and after Controlling for Other Factors

		Percentage of accurate returns (A)	Percentage of nonaccurate returns (B)	Odds of accuracy C = (A / B)	Unadjusted odds ratio prior to controlling for other factors (D)	Adjusted odds ratio controlling for other factors (E)
Location	California (average)	54.1	45.9	1.18	.66 ^a	.81 ^a
	Oregon (average)	71.0	29.0	2.45	1.37 ^a	1.54 ^a
	Rest of U.S.	64.2	35.8	1.79	^b	^b
Preparation type	Paid preparer (ave)	58.0	42.0	1.38	.58 ^a	.89 ^a
	Self prepared (ave)	70.3	29.7	2.37	^b	^b
Location by preparation type						
Paid Preparer Returns	California paid preparer	49.4	50.6	.98	.67 ^a	.78 ^a
	Oregon paid preparer	67.1	32.9	2.04	1.41	1.72 ^a
	Rest of U.S. paid preparer	59.2	40.8	1.45	^b	^b
Self-prepared returns	California self-prepared	62.5	37.5	1.67	.68 ^a	.85
	Oregon self-prepared	74.6	25.2	2.97	1.21	1.29
	Rest of U.S. self-prepared	71.1	28.9	2.46	^b	

Sources: GAO analysis of IRS's NRP data.

^aIndicates statistical significance at the 95 percent confidence level. The NRP sample is only one of an infinite number of samples that could have been selected to represent the population of taxpayers in the U.S. Statistical significance at the 95 percent level indicates that there is less than a 5 percent chance we would have gotten a result of this magnitude if there were no actual difference between the group of interest and the reference category in the population.

^bIndicates referent category of self-prepared returns and/or returns in the rest of the United States.

For the next step, we used odds ratios to compare the relative likelihood that returns from different locations or of different preparation types were accurate. The unadjusted odds ratio in column D compares the odds of return accuracy in each specific subgroup to a reference group, prior to

controlling for other factors. An odds ratio of 1 illustrates that on average, returns for the two groups have the same odds of being accurate, while odds ratios above 1 indicate a higher likelihood of accuracy and odds ratios below 1 indicate a lower likelihood of accuracy. Column D of table 3 illustrates that, prior to controlling for other factors, California returns on average had lower odds of accuracy than returns in the rest of the country, by a factor of .66 (34 percent lower). Conversely, Oregon returns on average had higher odds of accuracy than the rest of the country, by a factor of 1.37 (37 percent), before we account for other factors that might influence accuracy. This pattern holds when we compare returns using different preparation methods to similarly prepared returns. For example, California paid preparer returns have odds of accuracy approximately 33 percent lower than paid preparer returns in the rest of the country, and Oregon paid preparer returns have odds that are 41 percent higher than similarly prepared returns in the rest of the country, before controlling for other factors.

These unadjusted odds do not control for other factors that might differentiate between returns in Oregon and California compared to those in the rest of the country. However, descriptive data reveal that the characteristics of returns filed in California and Oregon differ from the characteristics of returns filed in the U.S. as a whole. For example, a greater proportion of Oregon and California residents file sole proprietor returns than in the U.S., on average.

To control for potential differences that might influence the likelihood of filing an accurate return, we used multivariate logistic regression. These models enabled us to compare the adjusted odds of accuracy for returns from Oregon or California with returns in the rest of the country, holding constant the effect of other factors that could affect accuracy. Column E in the upper half of table 3 shows that the odds of accuracy for an average Oregon return were still higher when compared to the rest of the country, and the odds of accuracy for a California return were still lower, after controlling for other factors. Additionally, paid preparer returns, on average, had lower odds of accuracy than self-prepared returns, controlling for other factors including location. As we note previously, not all mistakes on paid prepared tax returns are the fault of the paid preparer.

The results for all returns in the upper half of table 3 treat location and preparation type as distinct factors, without considering potential interaction between location and preparation type. To ensure that these estimates did not mask compliance differences between paid preparer and self-prepared returns and to assess the potential impact of regulation on

the population directly affected by the regime (paid preparers), we also examined self-prepared and paid preparer returns separately (see the lower half of table 3). These models reveal pronounced effects among paid preparers, after controlling for other factors. Among paid preparer returns, Oregon returns had odds of accuracy 72 percent higher, and California returns had odds of accuracy 22 percent lower, than comparable paid preparer returns in the rest of the country. While self-prepared returns in California had lower odds of accuracy than self-prepared returns in the rest of the country, and Oregon returns had higher odds of accuracy after controlling for other factors, these results were not statistically significant at the 95 percent level.

Our estimates of the impact of location on the likelihood that a return was accurate had fairly wide confidence intervals. One reason for this is due to our inability to incorporate the full range of individual or state-level factors that might influence the likelihood of compliance, such as whether a paid prepared return was prepared by an attorney or CPA. Additionally, the NRP sample was designed for purposes other than to compare states, which resulted in wider confidence bounds than would a sample designed specifically for state-level estimates.⁶

Our analyses identified several factors other than location that influenced the likelihood that a return would require less than \$100 in liability changes, both among returns in general and the subpopulation of paid preparer returns. For example, the odds that a return claiming the EIC was accurate were less than half those of returns that did not claim the EIC in all models.⁷ Similarly, sole proprietor returns (those individual returns that had an attached Schedule C, *Profit or Loss from Business*) had lower odds of being accurate than other returns. Additionally, returns with a filing status of “married, filing separately” were significantly less likely to be accurate than returns in any other filing status. Overall, 1040 forms with total positive incomes of less than \$100,000 had higher odds of accuracy

⁶The design effect, which compares the effect of a complicated sample design compared to a simple random sample, helps to illustrate the impact of the NRP sampling design on state-level estimates. These design effects indicate that standard errors for estimates of the effect of being in California and Oregon were more than 2 ¼ times what we would expect to see from a random sample. Large standard errors make it more difficult to detect statistical significance.

⁷Controlling for other factors, paid preparer returns claiming the EIC had odds of accuracy 76 percent lower than that of non-EIC paid preparer returns, whereas self-prepared returns claiming the EIC had odds 68 percent lower than those of non-EIC self-prepared returns.

compared to form 1040 returns with total positive income of \$100,000 or above. Conversely, among forms with total positive income of \$100,000, forms 1040F, *Profit or Loss from Farming*, and 1040C, *U.S. Departing Alien Income Tax Return*, were less likely to be accurate. In general, e-filed returns had slightly lower odds of accuracy than paper returns.

In addition to our main logistic regression model, we conducted a series of alternative analyses to examine the impact of location and paid preparer status with additional control factors and alternative dependent variables, and found results generally consistent with the models presented in table 3. These included several models with and without various aggregate state factors (such as per capita income and whether a state had an income tax), with alternative measures of complexity (including one based on the number of schedules filed), and with a dummy variable for returns that were software generated but not e-filed.⁸ Finally, we examined alternative dependent variables, including tax liability changes prior to EIC and additional child credits, and the net sum of dollar values of line item adjustments for each return. These additional analyses give us confidence that our results are robust to a variety of model specifications and different definitions of accuracy.

Cost Savings

To identify potential cost savings from an Oregon-style regulatory regime, we used multivariate linear analysis to assess the size of average tax liability changes among all returns, controlling for other factors. We conducted diagnostic analysis to identify and exclude outliers and potentially high-leverage cases—individual cases that have the potential to disproportionately affect our estimate when compared to other cases. Our estimate of savings is thus conservative when compared to an analysis that includes all cases, as it does not incorporate the savings generated by a limited number of cases with relatively large liability changes. After controlling for the other factors described, we found that the average return in Oregon required significantly lower changes in tax liability than returns in California or the rest of the country. The average Oregon return required tax liability increases that were approximately \$250 lower than comparable returns in the rest of the country. In contrast, the average California return required tax liability increases that were approximately

⁸ We could not find written IRS guidance on how to interpret the flag for computer-generated returns. Although IRS staff confirmed that the flag was distinct from the e-filing code, we found some overlap in the NRP data. The variable did not consistently improve model fit when added to the model described above.

Appendix I: Objectives, Scope, and
Methodology

\$90 higher than returns in the rest of the country, controlling for other characteristics.

We conducted this performance audit from September 2007 through July 2008 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: Comments from the Internal Revenue Service



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

August 1, 2008

Mr. Michael Brostek
Director, Tax Issues
U.S. Government Accountability Office (GAO)
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Brostek:

Thank you for giving us the opportunity to comment on the draft Government Accountability Office (GAO) report titled "Tax Preparers: Oregon's Regulatory Regime May Lead to Improved Federal Tax Return Accuracy and Provides a Possible Model for National Regulations" (GAO-08-781).

According to Internal Revenue Service (IRS) data, the majority of individual taxpayers used a return preparer in 2006. The IRS recognizes the critical role of these preparers in supporting a fair, efficient, and effective system of tax administration. Our strategy is to enhance service to and collaboration with return preparers; ensure coordinated and consistent oversight to curb abuses by unscrupulous preparers; and identify and provide new tools to preparers.

If you have any questions, or would like to discuss in more detail, please contact me or Michael Chesman, Director, Office of Professional Responsibility, at (202) 927-3397.

Sincerely,

Douglas H. Shulman

Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact

Michael Brostek, (202) 512-9110 or brostekm@gao.gov

Acknowledgments

In addition to the contact person named above, David Lewis, Assistant Director; Crystal Bernard; Amy Bowser; James Cook; John Mingus; Ed Nannenhorn; Karen O'Connor; and Anna Maria Ortiz made key contributions to this report.

IRS Registered Tax Preparer (RTRP) Regulations: Challenges and Opportunities For the Tax Preparation Industry

Written by: April Gutierrez, B.A., E.A., L.T.C.
Published: January 3, 2012
Category: Tax Education
Target Audience: Tax Return Preparers, CPAs, Enrolled Agents

Executive Summary

The IRS is implementing new tax preparer regulations that will impose significant restrictions on tax preparers and tax preparation businesses. The regulations are modeled in part on more stringent licensing laws that have governed Oregon tax preparers for the past 38 years. This white paper offers an authoritative perspective on how the tax preparation industry has successfully adapted to government oversight within the State of Oregon. It describes how tax preparers and businesses throughout the country can work to accommodate and even benefit from the new IRS regulations with analyses of the following subjects:

- How tax preparers will be impacted by new IRS regulations,
- How tax preparers will be able to obtain adequate levels of education to successfully pass mandatory examinations,
- How tax preparers and tax preparation businesses can successfully operate within a regulatory environment,
- How independent tax preparation businesses compete with national chains for qualified tax preparers and whether

- How the costs of providing tax preparation services may be affected,
- A listing of education providers, including a comparison of costs, delivery methods and curriculums,
- How costs of IRS compliance compare with costs of compliance already paid by approximately 49,000 tax preparers in Oregon and California, and
- Factors to consider when selecting a tax education provider.

A new era has begun for the tax preparation industry. The IRS is regulating paid tax preparers for the first time in history through a mandatory registration process and the creation of a new designation, "Registered Tax Return Preparer" (RTRP). The RTRP designation is a credential that will be awarded to certain tax preparers who must pass a mandatory competency test, complete 15 hours of continuing education (CE) annually, and pass a background check.¹

By the end of 2013, more than 350,000 tax preparers will be

In 2008, the General Accounting Office (GAO) reported that the IRS's tax year 2001 "NRP data indicate that tax returns prepared by paid preparers had a higher error rate—56%—than returns prepared by taxpayers—47%²."

2 GAO Report, "Tax Preparers, Oregon Regulatory Regime May Lead to Improved Federal Tax Return Accuracy And Provides a Possible Model for National Regulation", Special Report to Committee on Finance, US Senate, GAO, August 15th, 2008, Page 1

required to demonstrate competence in individual tax law by passing the RTRP test.⁴ Tax preparers who pass this test will be awarded the designation of Registered Tax Return Preparer. The benefits associated with RTRP designation include:

1. The ability to legally prepare tax returns for compensation,
2. A recognizable credential which will be promoted by the IRS via public awareness campaigns.
3. Increased ability on the part of the IRS to crackdown on incompetent and unqualified tax preparers which will weed out unfair competition.
4. Increased earnings for tax preparers and tax preparation businesses that will no longer need to compete with fly-by-night tax preparation outfits which undermine the integrity of the industry.

While some tax preparers have complained that the new regulations are too arduous and difficult to meet, considerable benefits will come for those tax preparers who are able to embrace the new standards. This paper focuses on the challenges and opportunities that will be presented to tax preparers and businesses within the new regulatory environment. It will also describe how quality tax education programs will play a vital role in the future success of tax preparers and tax preparation businesses by:

1. Preparing tax preparers for the RTRP competency test,
2. Developing and improving professional tax preparation skills, and
3. Meeting the mandatory annual continuing education requirements.

GAO Report

19 out of 19 tax returns prepared at the offices of national tax chains had errors.

In 2006 the GAO reported on the results of an investigation where it identified mistakes in 19 out of 19 visits to paid preparers working in preparer chain offices. "All 19 of our visits to tax return preparers affiliated with chains showed problems.

Nearly all of the returns prepared for us were incorrect to some degree, and several of the preparers gave us very bad tax advice, particularly when it came to reporting non-W-2 business income. Only 2 of 19 tax returns showed the correct refund amount, and in both of those visits the paid preparer made mistakes that did not affect the final refund amount."

⁴ Retrieved 19 December 2011 from <http://www.irs.gov/pub/irs-news/ir-11-111.pdf>

While the IRS is not requiring tax preparers to complete education programs prior to taking the IRS competency test, it is predicted that most tax preparers will not be able to pass the test without first completing a comprehensive study program in basic tax law. This conclusion is based upon historical data collected in the State of Oregon which has imposed mandatory testing requirements on tax preparers since 1973. Based on the topics and weighting of the IRS exam,⁵ it is anticipated the test may be at least as rigorous as Oregon's test and Oregon preparers achieve average pass rates of just 65% after completing 80 hours of mandatory education in basic tax law from an approved education provider.⁶ It is readily predictable that tax preparers who have not completed a comprehensive study program will achieve much lower pass rates.

Background

In August 2008, the General Accounting Office (GAO) published the results of its investigation into the tax preparation industry in a report to the US Senate Committee on Finance titled, "*Tax Preparers: Oregon's Regulatory Regime May Lead to Improved Federal Tax Return Accuracy and Provides a Possible Model for National Regulation*".

The GAO report examined the costs and benefits associated with regulating paid tax preparers. It investigated and compared tax preparers in the states of Oregon and California with tax preparers in the rest of the country. According to GAO's analysis of the Internal Revenue Service's (IRS) tax year 2001 National Research Program data, "*Oregon returns were more likely to be accurate while California returns were less likely to be accurate*".

⁵ Retrieved 19 December 2011 from <http://www.irs.gov/pub/irs-ut/rptests/specifications.pdf> or <http://www.pnwtaxschool.com/licensing-laws/irs-preparer-exams>

⁶ Retrieved 19 December 2011 from <http://www.oregon.gov/CBTP/examinations.shtml>, Examination Statistics, lower center of page for 2008, 2009, 2010. Statewide and individual school pass rates are included in the reports.



Oregon

John A. Kitzhaber, M.D., Governor

State Board of Tax Practitioners

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February 20, 2014

The Honorable Ron Wyden
Chairman, Senate Finance Committee
United States Senate
Washington, DC 20510

Dear Chairman Wyden:

On behalf of the Oregon Board of Tax Practitioners charged with protecting Oregon consumers by ensuring Oregon tax practitioners are competent and ethical in their professional activities, and representing over 4000 licensed practitioners, we write in support of the National Society of Accountants' recommended amendments to 31 U.S.C. Section 330. In particular section (f):

A tax return preparer will satisfy the requirements of (a)(2)(D) if such person had demonstrated competence in Federal tax return preparation by written examination approved by the Internal Revenue Service, a state board of accountancy, a state board of tax practitioners, or a state bar licensing agency.

The Board is very appreciative of the time and perseverance in crafting this legislation and thanks you and your staff for meeting with the National Society of Accountants to discuss these essential amendments.

Construction of Section (f) points directly at the Oregon Board of Tax Practitioner's examination and professional standards. The Board updates and administers licensing examinations throughout the year. Examination consultants retained by the Board regularly review exam questions and develop new ones. All questions used on the examinations receive *at least* five reviews for clarity and legal accuracy prior to their use in annual examinations.

Exams cover personal income tax, law, theory and practice. The consultant exam may include questions on corporation or partnership income tax as it relates to personal income-tax returns. Preparer and consultant exam questions contain true-and-false, multiple-choice questions and scenario-based mini-problems. In both preparer and consultant exams, approximately 75 percent of the questions will be on federal law and 25 percent on state law.

In addition, each applicant is required to complete an 80-hour basic tax course covering state and federal tax laws. Licensees are required to complete a minimum of 30 hours continuing education as a prerequisite to renewing their license each year.

The Board looks forward to working with you and the Finance Committee as you finalize permanent language for these amendments. We are happy to discuss this letter with you and answer any other questions. We can be reached at tax.bd@state.or.us.

Sincerely,

Janis Salisbury, Licensed Tax Consultant, Enrolled Agent
Board Chair
Oregon Board of Tax Practitioners

MISSION: The Board of Tax Practitioners protects consumers by insuring that Oregon tax professionals are competent and ethical in their professional activities

31 U.S. Code § 330 – Practice before the Department

- (a) Subject to section 500 of title 5, the Secretary of the Treasury may –
- (1) regulate the practice of representatives of persons before the Department of the Treasury; and
 - (2) before admitting a representative to practice, require that the representative demonstrate –
 - (A) good character;
 - (B) good reputation;
 - (C) necessary qualifications to enable the representative to provide to persons valuable service; and
 - (D) competency to advise and assist persons in presenting their cases.
- (b) After notice and opportunity for a proceeding, the Secretary may suspend or disbar from practice before the Department, or censure, a representative who –
- (1) is incompetent;
 - (2) is disreputable;
 - (3) violates regulations prescribed under this section; or
 - (4) with intent to defraud, willfully and knowingly misleads or threatens the person being represented or a prospective person to be represented.

The Secretary may impose a monetary penalty on any representative described in the preceding sentence. If the representative was acting on behalf of an employer or any firm or other entity in connection with the conduct giving rise to such penalty, the Secretary may impose a monetary penalty on such employer, firm, or entity if it knew, or reasonably should have known, of such conduct. Such penalty shall not exceed the gross income derived (or to be derived) from the

conduct giving rise to the penalty and may be in addition to, or in lieu of, any suspension, disbarment, or censure of the representative.

- (c) After notice and opportunity for a hearing to any appraiser, the Secretary may –
 - (1) provide that appraisals by such appraiser shall not have any probative effect in any administrative proceeding before the Department of Treasury or the Internal Revenue Service, and
 - (2) bar such appraiser from presenting evidence or testimony in any such proceeding.
- (d) Nothing in this section or in any other provision of law shall be construed to limit the authority of the Secretary of the Treasury to impose standards applicable to the rendering of written advice with respect to any entity, transaction plan or arrangement, or other plan or arrangement, which is of a type which the Secretary determines as having a potential for tax avoidance or evasion.

31 U.S.C. §330 is amended by adding the following subsections –

(e) The term "representative" includes a tax return preparer who prepares for compensation, or who employs one or more persons to prepare for compensation, any return of tax imposed by Title 26. For purposes of the preceding sentence, the preparation of a substantial portion of a return or claim for refund shall be treated as if it were the preparation of such return or claim for refund.

(f) A tax return preparer will satisfy the requirements of (a)(2)(D) if such person has demonstrated competence in Federal tax return preparation by written examination approved by the Internal Revenue Service, a state board of accountancy, a state board of tax practitioners, or a state bar licensing agency.

Opinion for the Court filed by Circuit Judge Kavanaugh

United States Court of Appeals

For the District of Columbia Circuit

No. 13-5061

Sabina Loving, Et Al., Appellees

v.

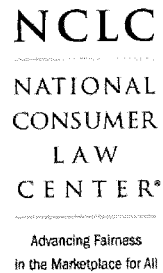
Internal Revenue Service, Et Al., Appellants

Decision filed February 11, 2014

Exert

“It might be that allowing the IRS to regulate tax-return preparers more stringently would be wise as a policy matter.

But that is a decision for Congress and the President to make if they wish by enacting new legislation.”



**Testimony before the
U.S. SENATE COMMITTEE ON FINANCE**

regarding

“Protecting Taxpayers from Incompetent and Unethical Return Preparers”

April 8, 2014

Chi Chi Wu

Staff Attorney

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Testimony of Chi Chi Wu, National Consumer Law Center

Before the U.S. Senate Committee on Finance

regarding

“Protecting Taxpayers from Incompetent and Unethical Return Preparers”

April 8, 2014

INTRODUCTION

Mr. Chairman, Ranking Member Hatch, and Members of the Subcommittee, thank you for inviting me here today. My name is Chi Chi Wu, I am a Staff Attorney at the National Consumer Law Center, and I offer my testimony on behalf of our low income clients.¹

Mr. Chairman, thank you for holding this hearing on the need to protect taxpayers from incompetent and unethical tax preparers. This issue is critically important, not just for taxpayers as consumers of preparation services, but also to protect the integrity of the tax system and the coffers of the United States Treasury. Simply put, there needs to be licensing and competency standards for paid tax preparers. Either Congress needs to give the Internal Revenue Service the authority to regulate paid preparers, or the states need to enact such laws. Indeed, mindful of the difficulty in getting federal legislation passed, we at NCLC have issued a model act to encourage states to adopt such laws.

¹ The National Consumer Law Center is a nonprofit organization specializing in consumer issues on behalf of low-income people. We work with thousands of legal services, government and private attorneys, as well as community groups and organizations, from all states who represent low-income and elderly individuals on consumer issues. NCLC has worked on tax-related consumer protection issues for over a decade, including issuing twelve annual reports on the problems posed by tax refund anticipation loans and other tax-time financial products. This testimony was written by Chi Chi Wu of NCLC, with assistance from Carolyn Carter of NCLC and David Rothstein, Director of Resource Development & Public Affairs, NHS of Greater Cleveland.

THE SUPRISING LACK OF MINIMUM STANDARDS FOR PAID TAX PREPARERS

I have worked on issues at the intersection of taxpayer and consumer rights for over a decade, and it still astounds me that paid tax preparers are essentially unregulated in forty-six states. When I began this work, I assumed – as do most Americans – that tax preparers were licensed professionals with certain educational credentials, and that they needed some sort of accounting degree or specialized training to prepare tax returns. After all, the tax return is the most important financial transaction during the year for many Americans, and it would only make sense that the preparers in whom Americans place their trust and their sensitive financial information would be required to take some courses and pass a test.

To my surprise, the exact opposite was true – with the exception of a handful of states,² paid preparers are not governed by any minimum educational standards, competency testing, or continuing education requirements. While there are some preparers who are certified public accountants or credentialed by the IRS as enrolled agents, the great majority do not have such qualifications. Ironically, the only tax preparers apart from CPAs and enrolled agents subject to testing and regulatory oversight are the unpaid volunteers at Volunteer Income Tax Assistance sites. Contrast this with other professions that do require licensing in all or most states, such as hairdressers³ and landscape architects.⁴

To its credit, the IRS did attempt to institute minimum competency requirements and was on the verge of implementing them, when a federal judge struck down the agency's regulations,

² These states are California, Maryland, New York, and Oregon.

³ Bureau of Labor Statistics, U.S. Department of Labor, Occupational Outlook Handbook (2014-15 Edition), Barbers, Hairdressers, and Cosmetologists, *available at* www.bls.gov/ooh/personal-care-and-service/barbers-hairdressers-and-cosmetologists.htm (visited March 31, 2014) (noting that all states require hairdressers to be licensed).

⁴ *Id.*, Landscape Architects, *available at* www.bls.gov/ooh/architecture-and-engineering/landscape-architects.htm (visited March 31, 2014).

a decision that was upheld just this past February by the Court of Appeals for the D.C. Circuit.⁵ Note that the Court of Appeals invalidated the IRS's regulations because it believed the agency did not have the statutory authority to issue them, not because the Court believed the regulations to be a bad idea. In fact, the Court stated "[i]t might be that allowing the IRS to regulate tax-return preparers more stringently would be wise as a policy matter."⁶ Thus, Congress could easily fix this problem with a single sentence giving the IRS authority, and the IRS already would have many of the elements in place to implement a program.

LACK OF REGULATION LEADS TO INCOMPETENCE AND FRAUD

The lack of regulation for tax preparers has resulted in an environment that breeds incompetence and fraud. One indication of these problems is the existence of "fringe preparers" – tax preparation offered by businesses such as payday lenders, pawn shops, check cashers, used car dealers, jewelry shops, furniture stores – even liquor stores and a "rent-a-wheel" business.⁷ We have noted examples of all these businesses engaged in tax preparation, sometimes encouraging their customers use the refunds to buy their goods. This of course raises questions about the quality and competency of tax preparation from such businesses – how accurate are tax returns prepared by used car dealers? One can imagine that the incentive for accuracy might take a back seat to a desire to sell a car by using the taxpayer's refund as a down payment.

Unfortunately, the problems with incompetence and fraud go beyond just fringe preparers. In 2008, several consumer and advocacy groups, including NCLC, conducted mystery

⁵ *Loving v. I.R.S.*, 742 F.3d 1013 (D.C. Cir. Feb. 11, 2014).

⁶ *Id.* at 1022. In addition, five former IRS Commissioners, appointed by both Democratic and Republican Presidents, filed an amicus brief in this case expressing support for the IRS's preparer regulation program.

⁷ Chi Chi Wu, National Consumer Law Center, RALs, Tax Fraud, and Fringe Preparers (Feb. 2009), at 17-18, available at www.nclc.org/images/pdf/high_cost_small_loans/ral/2009-ral-appendix.pdf.

shopper testing of a number of different types of tax preparers.⁸ Our original purpose for these tests was to determine whether preparers were properly making disclosures concerning refund anticipation loans (RALs)⁹ and refund anticipation checks (RACs).¹⁰ To our surprise, what we found were serious tax errors and fraud. This occurred in four out of the 17 tests we conducted — or nearly 25% of the tests. One example of incompetence involved a preparer in Durham, N.C. who did not know how to handle an IRS Form 1099-D, issued to report dividend income:

After sitting in the office for an hour or so, [the preparer] said that there was a problem that she did not know how to handle. The problem was that there was a \$5000 [fictional number] “dividend” that we must pay taxes on. With the dividend, our return would only return \$100. If she was to “ignore” it, then we would receive \$3000 in returns. She then called her “tax people,” [who] told her that we do not need to report the dividends and just ignore it.¹¹

Essentially, this preparer was advising the tester to commit tax fraud.

In 2010, we conducted another round of testing, and found incompetence or fraud in six of 19 tests — or about 30%. One example involved a tester in New York City who described how the preparer, when realizing the tester would receive only a \$1,000 federal refund and would owe state taxes, began making up deductions:

⁸ Chi Chi Wu, National Consumer Law Center, Riddled Returns: How Errors and Fraud by Paid Tax Preparers Put Consumers at Risk and What States Can Do (updated Mar. 2014), at 6-7, available at www.nclc.org/issues/riddled-returns.html [hereinafter “Riddled Returns”].

⁹ A refund anticipation loan (RAL) is a short term loan secured by and repaid from the proceeds of a consumer’s tax refund. RAL lending was dramatically curtailed as a result of regulatory actions by federal banking regulators and the IRS. Currently, RALs are only available from a limited number of non-banks.

¹⁰ A refund anticipation check (RAC) is a bank product involving temporary bank account. The temporary account is used to receive a direct deposit of the consumer’s refund from the IRS. After the refund is received, the bank deducts a fee for the RAC, as well as the tax preparation fee. The remainder is issued to the consumer in the form of a paper check, prepaid debit card, or a direct deposit to the consumer’s own bank account.

¹¹ Riddled Returns at 6.

[The tester] reported that the tax preparer tried to entice her to commit tax fraud by showing her how much her federal refund would increase if she took deductions in excess of the standard deduction. [The tester] does not attend church, but the tax preparer included a \$2,000 church donation. The preparer also deducted the cost of work clothes and laundry, then showed [the tester] that her federal refund would increase to \$3,000 from about \$1,000. The preparer also tried to convince [the tester] to make up a dependent as she does not have any — showing her that her refund would go up to \$5,000 if she did so. The preparer also tried to qualify her for EITC even though she is not eligible. Finally, the tax preparer deducted \$400 in 2008 tax preparation costs even after [the tester] told the preparer that she did not pay for tax preparation last year.¹²

A third round of limited testing in 2011 similarly revealed errors or fraud in four out of the nine tests, or 44%.¹³

Unfortunately, our test results were not isolated or unique. As discussed in our report *Riddled Returns*, attached, similar testing by other advocacy groups, by the Government Accountability Office, and by the Treasury Inspector General for Tax Administration have found equal or even greater levels of fraud and incompetence.¹⁴ Looking at the totality of all these tests, we can see that these problems are not limited to a handful of bad apples. There is a substantial level of incompetence and corruption in the tax preparation industry.

REGULATION IS NEEDED TO HELP CONSUMERS

Protecting individual taxpayers and the federal and state treasuries from this fraud and abuse demands some basic fundamental standards. It calls for establishing minimum qualifications for the practitioners who handle consumers' most sensitive information. It is only

¹² Riddled Returns at 7-8.

¹³ Riddled Returns at 9-10.

¹⁴ Riddled Returns at 10-15.

common sense to require paid tax preparers to obtain basic training, pass competency exams, and seek continuing education to stay current on our ever-changing tax laws.

Given the widespread level of incompetence and fraud, bringing enforcement actions on a one-by-one basis is simply inadequate as a response. For example, the lawsuit by U.S. Department of Justice (DOJ) against Instant Tax Service involved a multi-year investigation that revealed an “astonishing array of repeated fraudulent and deceptive conduct.”¹⁵ While it might be ultimately considered a success because it shut down that chain, the case probably cost the government tens or even hundreds of thousands of dollars in staff time by IRS personnel and DOJ lawyers – and there are allegations that the principals of Instant Tax might be continuing to operate under a new structure.¹⁶ There are simply not enough resources to go after all of the bad actors. While it would get rid of a few of them, relying on enforcement alone is akin to treating just a skin lesion when the related disease has invaded a patient’s entire body.

Regulating tax preparers is urgently needed to protect both taxpayers and the U.S. Treasury. Furthermore, we disagree with notion that preparer regulation could harm taxpayers because preparers will raise their fees to cover the cost of education and testing. First, the interests of consumers in obtaining competent, accurate and ethical tax preparation assistance far outweighs any increased marginal cost. After all, an erroneous return can put the taxpayer at risk of an IRS audit or even criminal sanctions. Second, we believe that regulation will not actually even create significantly greater costs to consumers. Preparers’ compliance costs are minimal – for example, prior to the adverse court decision, the IRS had planned to charge less than \$120 for its exam.¹⁷ These costs are dwarfed by the hundreds of dollars in fees that some paid preparers

¹⁵ *United States v. ITS Fin., LLC*, 2013 WL 5947222, *1 (S.D. Ohio Nov. 6, 2013).

¹⁶ Adam Rust, *Instant Tax to Dodge DOJ Order*, Bank Talk blog, Nov. 20, 2103, at <http://banktalk.org/content/instant-tax-dodge-doj-order> (visited Mar. 2014).

¹⁷ IRS, *Registered Tax Return Preparer Test - Candidate Information Bulletin*, Apr. 16, 2012, at 2-3.

charge for a single tax return. Our mystery shopper tests uncovered tax preparation fees of \$400 or \$500 in some cases,¹⁸ and the DOJ's lawsuit against Instant Tax Service revealed that that chain typically charged about \$550, for as little as 15 minutes of work.¹⁹

It is worth noting that tax preparation fees are entirely non-transparent. This is one of the few services for which consumers typically cannot obtain a price before they incur the service. Tax preparers assert that they charge by the tax forms required in preparing a particular return, and cannot predict which forms will be generated until they actually finish the preparation process. Thus, consumers cannot obtain quotes to comparison shop.²⁰ This lack of transparency is responsible in part for the very high, and possibly inflated, tax preparation fees. Thus, preparer regulation has more potential to lower costs than to increase them, by improving transparency and reducing abuses.

Finally, competent and ethical tax preparers will benefit from regulation. Basic standards are important to protecting the integrity of an industry. Paid preparers who are honest and ethical, investing in training and education, are hurt when their competitors cut corners, commit outright fraud, and give tax preparation a bad name.

Thank you for the opportunity to testify, and I look forward to your questions.

¹⁸ Riddled Returns at 18 (Table 18).

¹⁹ *United States v. ITS Fin., LLC*, 2013 WL 5947222 (S.D. Ohio Nov. 6, 2013), ¶¶ 329, 349-350.

²⁰ See David Rothstein, Policy Matters Ohio, Improving Tax Preparation With a Model Fee Disclosure Box, June 2013, available at www.policymattersohio.org/wp-content/uploads/2013/06/FeeDisclosure_Jun2013.pdf.

RIDDLED RETURNS

HOW ERRORS AND FRAUD BY PAID TAX PREPARERS PUT CONSUMERS AT RISK AND WHAT STATES CAN DO

Amount You Owe 74

Third Party Designee

Sign Here

Joint return? See page 17. Keep a copy for your records.

Under penalties of perjury, I believe they are true, correct, and complete.

Your signature

Spouse's signature, if a joint filer

Paid Preparer's Use Only

Preparer's signature

Firm's name (or yours if self-employed), address, and ZIP code

Updated March 2014

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NATIONAL
CONSUMER
LAW
CENTER

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ABOUT THE AUTHOR

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ABOUT THE NATIONAL CONSUMER LAW CENTER

Since 1969, the nonprofit National Consumer Law Center® (NCLC®) has used its expertise in consumer law and energy policy to work for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the United States. NCLC's expertise includes policy analysis and advocacy; consumer law and energy publications; litigation; expert witness services, and training and advice for advocates. NCLC works with nonprofit and legal services organizations, private attorneys, policymakers, and federal and state government and courts across the nation to stop exploitive practices, help financially stressed families build and retain wealth, and advance economic fairness.

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EXECUTIVE SUMMARY

A tax return is one of the most critical financial events for many consumers during the year. Over half of these consumers rely on paid tax preparers, putting their financial lives in the hands of these practitioners. Yet there is no regulation for most tax preparers in the vast majority of states. There are no minimum educational, training, competency, or other standards. In 46 states, there are more regulatory requirements for hairdressers than tax preparers.

Because of this lack of regulation, incompetence and abuses by tax preparers have flourished over the years. Mystery shopper testing by consumer groups, other advocacy organizations, and government agencies has found frequent examples of this incompetency and outright fraud — a disturbingly high number, given the limited number of tests conducted. Some of the examples uncovered in this testing were:

- Intentional omission of income;
- Falsifying information to make the taxpayer eligible for various credits and deductions, such as charitable deductions, job-related or business expenses, and the Earned Income Tax Credit (EITC);
- Inability to properly deal with education-related credits and income;
- Misclassifying filing status; and
- Data entry errors resulting in incorrect refunds.

These numerous examples of fraud and incompetence, comprising a significant percentage of the preparers tested, shows that this problem is not isolated or the case of a few bad actors. Instead, it is an endemic problem and regulation is urgently needed to protect both taxpayers and public treasuries.

Another problem faced by taxpayers is the inability to comparison shop or predict how much tax preparation will cost them, because many tax preparers claim they cannot give a quote or give inaccurate ones. As a result of this lack of transparency, consumers face tax preparation fees that are very high, and sometimes inflated — up to \$400 or \$500 in some cases.

The IRS attempted to address fraud and improve preparer competency by developing a system to regulate tax preparers. However, in early 2013, this effort was blocked by a federal court, which invalidated the regulations as exceeding the IRS's statutory authority. This decision was upheld in February 2014 by the D.C. Court of Appeals. Thus, it is up to Congress or the states to institute a system of preparer regulation.

To assist states toward this goal, this report includes the **Model Individual Tax Preparer Regulation Act**, which a state legislature can enact for the regulation of tax preparers, based in large part on three of the four existing state laws, as well as the IRS regulations.

The Model Act requires paid tax preparers to:

- Obtain a registration unless they fit into one of the handful of exceptions,
- Pass a basic competency exam,
- Have 60 hours of initial education and 15 hours per year of continuing education, and
- Provide a standardized disclosure of their fees.

For consumers, an incorrectly prepared tax return can lead to dire economic consequences or even criminal sanctions. This is especially true for low-income EITC recipients, of whom over 60% — or 16 million families — pay for tax preparation. For these consumers, especially EITC recipients, their refund is the single largest sum of money that they will receive during the entire year. Passage of the Model Act will allow these consumers to be confident that the tax preparer that they rely upon has the basic skills and knowledge needed to prepare their tax returns correctly.

A. Startling Lack of Regulation for Tax Preparers

For many individuals, filing a tax return is the most critical financial interaction they have with the federal government during the year. An incorrectly prepared return can lead to dire economic consequences or even criminal sanctions. And for many consumers, especially recipients of the Earned Income Tax Credit (EITC), their tax refund is the single largest sum of money that they will receive during the entire year.

Over half of these consumers rely on paid tax preparers, putting their financial lives in the hands of these practitioners. This is especially true for low-income EITC recipients, of whom over 60% — or 16 million families — pay for tax preparation.¹

Yet for many decades, there was no regulation for these critical actors in the vast majority of states, with only a handful of exceptions.² There were no minimum educational, training, competency, or other standards for the businesses that could determine the consumer's financial fate for the coming year. While some tax preparers are licensed as certified public accountants or credentialed by the IRS as enrolled agents, the vast majority do not have such qualifications. Indeed, the only tax preparers apart from CPAs and enrolled agents subject to testing and regulatory oversight are the unpaid volunteers at Volunteer Income Tax Assistance sites.³

In 46 states, there are more regulatory requirements for hairdressers than tax preparers.

In 46 states, there are more regulatory requirements for hairdressers than tax preparers.⁴ Yet the impact of a bad haircut is far less damaging than an inaccurate tax return.

In 2011, the IRS attempted to address this issue by developing a system to regulate tax return preparers. The IRS regulations required preparers to register with the IRS, take a competency

¹ Data from IRS Stakeholder Partnerships, Education & Communication (SPEC) Return Information Database for Tax Year 2010 (Returns Filed in 2011) (Jan. 2013). In general, over half of taxpayers (56%) use a paid tax preparer. *Id.*

² The exceptions are California, Maryland, New York, and Oregon. See Cal. Bus. & Prof. Code §§ 22250 to 22259; Md. Code §§ 21-101 to 21-502; N.Y. Comp. Codes R. & Reg. tit. 20, pt. 2600 (Dec. 2013), and Or. Rev. Stat. §§ 673.605 to 673.740. In addition, some states require registration of persons that offer RALs. See National Consumer Law Center, *Model Refund Anticipation Loan Act*, Appendix A (Dec. 2008) (summary of state RAL laws), available at <http://www.nclc.org/ralmmodel>.

³ VITA sites have long followed fundamental training and certification requirements. See IRS, Pub. 1084 - IRS Volunteer Site Coordinator's Handbook 29 (Oct. 2012) (requiring that all "[v]olunteer preparers must pass at least the basic certification test. A minimum score of 80% is required for each certification test").

⁴ Bureau of Labor Statistics, U.S. Department of Labor, *Occupational Outlook Handbook, 2012-13 Edition*, Barbers, Hairdressers, and Cosmetologists, available at www.bls.gov/ooh/personal-care-and-service/barbers-hairdressers-and-cosmetologists.htm (visited July 22, 2013) (noting that all states require hairdressers to be licensed).

examination, and stay current with tax law developments through continuing education.⁵ However, the IRS effort was blocked on January 18, 2013, when the federal district court for the District of Columbia issued a surprising decision invalidating the regulations as exceeding the agency's statutory authority.⁶ In February 2014, the D.C. Court of Appeals upheld the lower court's ruling.⁷

This report discusses the need for preparer regulation to protect both taxpayers and the public treasury. It details the massive amount of fraud and incompetence uncovered by just a handful of mystery shopper tests by consumer groups, advocacy organizations, and government agencies. These repeated examples of fraud and incompetence, comprising a significant percentage of the preparers tested, shows that this problem is not isolated or the case of a few bad actors. Instead, it is an endemic problem that must be addressed by systemic reform, that is, comprehensive regulation of tax preparers.

B. Nature of the Tax Preparation Industry

The tax preparation industry consists of three larger commercial chains (H&R Block, Jackson Hewitt, and Liberty Tax Service), a number of smaller chains, and many thousands of small or solo independent preparers.⁸ There is a wide range of independent preparers, from licensed professionals – such as attorneys, enrolled agents, and certified public accountants – to businesses that primarily deal in another line of goods and services.

Among the last group, there is a segment that is highly problematic – the fringe preparer. Fringe preparers include businesses that are historically associated with the exploitation of consumers, such as payday loan stores, check cashers, and used car dealers. Some retailers, such as jewelry and furniture stores, also act as fringe tax preparers. Many of these preparers encourage clients to use their tax refunds for large purchases.

In June 2008, the Government Accountability Office (GAO) conducted mystery shopper testing that focused on identifying types of businesses where financial products related to tax refunds, such as refund anticipation loans (RALs)⁹ were marketed.¹⁰ Of the 27 paid preparers subject to testing, 13 were located in businesses that target low-income consumers, such as check cashers,

⁵ Internal Revenue Service, Regulations Governing Practice Before the Internal Revenue Service, 76 Fed. Reg. 32,286 (June 3, 2011).

⁶ *Loving v. I.R.S.*, 920 F. Supp. 2d 108 (D.D.C. 2013).

⁷ *Loving v. I.R.S.*, ---F.3d ---, 2014 WL 519224 (D.C. Cir. Feb. 11, 2014).

⁸ See Chi Chi Wu and Jean Ann Fox, NCLC and Consumer Federation of America, *RALs, Tax Fraud, And Fringe Preparers* 11 (Feb. 2009), available at http://www.nclc.org/images/pdf/high_cost_small_loans/ral/2009-ral-appendix.pdf.

⁹ See note 14 for an explanation of what a refund anticipation loan is.

¹⁰ Government Accountability Office, *Refund Anticipation Loans*, GAO-08-800R, June 5, 2008, available at <http://www.gao.gov/new.items/d08800r.pdf>.

payday loan vendors, rent-to-own stores, and pawn shops. Nine of the preparers in the GAO study offered incentives to encourage tax customers to spend their refunds on the businesses' primary goods and services. For example, an auto dealer told GAO investigators that if they didn't have enough money for the down payment on a car, they could get their taxes done by its tax preparer and use the refund as a down payment. Another preparer operated out of a shoe store, and offered a free pair of shoes with tax preparation.

A fundamental problem with fringe preparers is the questionable quality of tax preparation by a business that specializes in goods and services other than tax preparation. The mystery shopper tests discussed later in this report found several instances of incompetent tax preparation by fringe preparers. One particular example was an Alabama small loan company that prepared a tester's return to show a \$6,247 refund when the tester actually owed \$112 to the IRS.¹¹

There are even third-party vendors that specialize in providing software and back office support to businesses that want to prepare taxes "on the side" to boost sales in their primary line of business. One example is Tax Max, which specifically caters to used car dealers. Tax Max advertises that it is "the leading tax consultant in the industry with a portfolio of over 3000 car dealerships nationwide."¹² Tax Max informs car dealers that "[t]here is no experience required, and our web-based program was designed for use by someone who knows nothing about taxes."¹³

C. Abuses Uncovered by Mystery Shopper Testing

Due to the lack of regulation, abuses by tax preparers have flourished over the years. Mystery shopper testing by consumer and other advocacy groups has found frequent examples of incompetency and fraud by tax preparers – a disturbingly high number, given the limited number of tests conducted. Regulation, whether by the federal or state government, is urgently needed to prevent incompetence and fraud by ensuring that paid preparers meet minimum standards.

Some of the types of incompetence and fraud uncovered in this testing were:

- Intentional omission of income;
- Falsifying information to make the taxpayer eligible for various credits and deductions, such as charitable deductions, job-related expenses, Schedule C business expenses, and the EITC;

¹¹ Impact Alabama, *Impact Alabama Undercover Investigation of Commercial Tax Preparers in Alabama Results and Analysis*, Jan. 2009.

¹² Tax Max, About Us, at <https://www.taxmax.com/TRSTaxMax/AboutUs.aspx>.

¹³ Tax Max, FAQ, at <https://www.taxmax.com/TRSTaxMax/FAQ.aspx>

- Inability to properly deal with education-related credits and income;
- Misclassifying filing status; and
- Data entry errors resulting in incorrect refunds.

1. 2008 Mystery Shopper Testing

In 2008, advocacy groups conducted 17 mystery shopper tests of paid tax preparers in Durham, North Carolina and Philadelphia, Pennsylvania.¹⁴ Testers were instructed to have their returns prepared and to obtain RALs from commercial preparers. The original intent of the testing was to determine whether tax preparers were properly making disclosures concerning refund anticipation loans (RAL)¹⁵ and refund anticipation checks (RACs).¹⁶ Unfortunately, the testing also uncovered instances of serious tax errors and fraud in 4 out of 17 tests — or nearly 25%.

The worst example involved a preparer at a small loan company in Durham, where the tester withdrew because of the seriousness of the incompetence. According to this tester:

After sitting in the office for an hour or so, [the preparer] said that there was a problem that she did not know how to handle. The problem was that there was a \$5000 [fictional number] "dividend" that we must pay taxes on. With the dividend, our return would only return \$100. If she was to "ignore" it, then we would receive \$3000 in returns. She then called her "tax people," [who] told her that we do not need to report the dividends and just ignore it.¹⁷

Mystery shopper testing by consumer and other advocacy groups has found frequent examples of incompetency and fraud by tax preparers — a disturbingly high number, given the limited number of tests conducted.

Essentially, this preparer gave the tester advice to commit tax fraud. This tester concluded: "My experience with [the independent preparer] has been a scary one. I say that mainly because the

¹⁴ Chi Chi Wu, et al., NCLC, Community Reinvestment Association of NC, and Community Legal Services of Philadelphia, *Tax Preparers Take a Bite Out of Refunds: Mystery Shopper Test Exposes Refund Anticipation Loan Abuses in Durham and Philadelphia* (Apr. 2008), available at www.nclc.org/images/pdf/high_cost_small_loans/ral/shopper_report.pdf [hereinafter "2008 Mystery Shopper Testing Report"].

¹⁵ A refund anticipation loan (RAL) is a short term loans secured by and repaid from the proceeds of a consumer's tax refund. RAL lending was dramatically curtailed as a result of regulatory actions by federal banking regulators and the IRS. Currently, RALs are only available from a limited number of non-banks, who cannot make the loans on the same scale.

¹⁶ A refund anticipation check (RAC) is a bank product involving temporary bank account. The temporary account is used to receive a direct deposit of the consumer's refund from the IRS. After the refund is received, the bank deducts a fee for the RAC, as well as the tax preparation fee. The remainder is issued to the consumer in the form of a paper check, prepaid debit card, or a direct deposit to the consumer's own bank account.

¹⁷ 2008 Mystery Shopper Testing Report at 9.

lack of confidence in the preparer's ability to competently complete our return even though she was generally nice."¹⁸

In Philadelphia, a Jackson Hewitt preparer failed to include \$3,500 in unemployment income in the return of a married couple who were testers. This omission resulted in a refund that was \$600 greater than the couple was entitled to, and required them to file an amended return. This preparer also had never seen a mortgage interest Form 1098 and didn't know how to deal with it.

An independent preparer in Philadelphia made numerous errors in dealing with education-related tax credits. Among other mistakes, the preparer incorrectly treated a taxable education award as though it were an exempt scholarship, resulting in an additional tax liability of \$66 and a loss of \$134 worth of Earned Income Tax Credit. The tester was also forced to file an amended return.

At least two of the preparers in this 2008 testing were businesses that primarily sold other goods or services. One preparer was a small loan lender/payday lender, and the other preparer was in a store that primarily operated as a gift shop.

2. 2010 Mystery Shopper Testing

In 2010, consumer groups conducted 19 mystery shopper tests in Arkansas, New York City, and Durham, North Carolina.¹⁹ As in the 2008 testing, several testers became the victims of incompetent tax preparation or outright fraud – at least 6 out of the 19 testers, or over 30%.

A very disturbing example came from a tester in New York City who described how the preparer, when realizing the tester would receive only a \$1,000 federal refund and would owe state taxes, began making up deductions:

[The tester] reported that the tax preparer tried to entice her to commit tax fraud by showing her how much her federal refund would increase if she took deductions in excess of the standard deduction. [The tester] does not attend church, but the tax preparer included a \$2,000 church donation. The preparer also deducted the cost of work clothes and laundry, then showed [the tester] that her federal refund would increase to \$3,000 from about \$1,000. The preparer also tried to convince [the tester] to make up a dependent as she does not have any – showing her that her refund would go up to \$5,000

¹⁸ *Id.* at 10.

¹⁹ Chi Chi Wu, et al., National Consumer Law Center, Arkansans Against Abusive Payday Lending, New Economy Project (formerly NEDAP), Community Reinvestment Association of NC, *Tax Preparers Out of Compliance: Mystery Shopper Testing Exposes Violations of Refund Anticipation Loan Laws in Arkansas, New York and North Carolina* (Apr. 2010), available at www.nclc.org/images/pdf/high_cost_small_loans/ral/mystery_ral_report.pdf [hereinafter "2010 Mystery Shopper Testing Report"].

if she did so. The preparer also tried to qualify her for EITC even though she is not eligible. Finally, the tax preparer deducted \$400 in 2008 tax preparation costs even after [the tester] told the preparer that she did not pay for tax preparation last year.²⁰

Another example of attempted tax fraud by a preparer came from a tester in Arkansas who described how:

[The preparer] took the forms I had completed and requested my W2's which I gave them to him. He mistakenly thought that my 1099 was my tithing statement from my church. I told him it was my salary from my second job. He entered the amount and stated that I would be really disappointed if I knew the difference in my refund now that I have this additional income reported. I asked what was the difference, he stated I went from around \$30?? [i.e. \$3,000] To only \$15?? [i.e., \$1,500]. He wanted to know if I still wanted to report the additional income. I told him yes, I did because this income has already been reported to the IRS. Since I have been working this part time job, my refund has been less and I even have to pay State Taxes sometimes. He then told me how much I will owe the state for taxes. He again asked me if I was sure I wanted to report this. I told him again, yes, I do. I need to keep it clean. He said he had to ask because some people don't want them to report additional income because it lowers their refund amount. So he has to do what the customers tell him to do.²¹

Other testers reported either fraud or incompetent preparation, including:

- A tester in New York reported that a Jackson Hewitt preparer advised her not to include \$300 in income for which the tester had not received a 1099 form.
- A tester who went to a small chain in Arkansas later had her tax return reviewed by a Volunteer Income Tax Assistance (VITA) volunteer. The VITA preparer found numerous errors, resulting in the tester being required to file an amended return and to reimburse the IRS \$822.

Another example of preparer abuse came from a complaint in North Carolina against Freedom Tax Services, an independent preparer. This consumer could not participate in the testing. Why? Freedom Tax Services had already prepared her taxes without her permission, after she had given them her documents merely to get an estimate of the tax preparation fees.

Finally, there were several violations of requirements for tax preparers to provide certain documents to the taxpayers. The IRS Code requires preparers to provide a copy of the tax return to the taxpayer no later than the time that the taxpayer signs it.²² Yet 3 of the 19 preparers did not provide a complete copy of the tax return at the time of filing, but instead withheld the copies until the refund was received and the preparer was paid from the refund.

²⁰ *Id.* at 3.

²¹ *Id.* at 3-4.

²² I.R.C. § 6107(a).

3. 2011 Mystery Shopper Testing

In 2011, consumer groups conducted nine mystery shopper tests in New York City and Durham, North Carolina.²³ As in the earlier rounds of testing, several testers were the victims of incompetent tax preparation or were encouraged to engage in tax fraud — at least four out of the nine testers, or a whopping 44%.

A very disturbing example in the 2011 testing came from a New York City tester who went to a Liberty Tax office. The tester described how the preparer could not initially process a 1099 form that she had received for a credit card debt that was settled:

His boss came over to assist the tax preparer with the 1099. [The tester] asked if the 1099 would change her tax refund, and the preparer answered that they would “fix it.” The tax preparer and his boss proceeded to ask her a number of questions including: did she have money in the bank, valuables like jewelry, a 401k or other investments, or other debts. [The tester] answered that she had a 401k at work, some money in the bank as she recently deposited a substantial check for one of her daughters, and that she had about \$10,000 in combined credit card and student loan debt. She asked how they would “fix it.” The preparer responded that they needed to make it look like she had other debts that prevented her from affording the credit card debt that was forgiven (to make her look deserving of the forgiveness, was [the tester’s] understanding), and that she had no assets to sell. The preparer and his boss filled out a worksheet with her answers to their questions, but they did not provide her with a copy.²⁴

In addition, this preparer improperly claimed the EITC for one of the tester’s daughters. Finally, the tester observed that the preparer reported on a form that the tester did not know the location of her children’s father. However, the preparer never asked that question and the tester did know where her children’s father was.²⁵

Another example involved a Jackson Hewitt preparer in New York City who gave questionable advice to a tester who owed money to the IRS. The preparer told the tester that she “needed to get a kid” in order to get a bigger tax refund.

A third tester reported that she informed the preparer that she was no longer a student but the preparer incorrectly claimed the New York State tuition credit. The tester also reported that the

²³ Chi Chi Wu, et al., NCLC, New Economy Project (formerly NEDAP), Community Reinvestment Association of NC, *Tax Time 2011: Mystery Shopper Testing in New York and North Carolina Finds Continuing Problems with Tax Preparers* (Apr. 2011), available at www.nclc.org/images/pdf/pr-reports/report-mystery-ral-shopper-2011.pdf [hereinafter “2011 Mystery Shopper Testing Report”].

²⁴ *Id.* at 3.

²⁵ This was probably a follow-up question to “Can anyone else claim this child?,” which is asked by IRS Form 8867, the checklist for the EITC. This information would be listed in the tax preparer’s internal notes, not on the actual tax return.

preparer incorrectly inputted student loan interest, misspelled her address, and pressured her to sign the return without explaining the paperwork.

In North Carolina, a Jackson Hewitt preparer erroneously failed to claim Head of Household status for a tester. As a result, the tester's refund was smaller by \$269 for her federal refund and \$84 for her state refund, and she was forced to file an amended return.

4. 2011 First Nations Development Institute (FNDI) Mystery Shopper Testing

First Nations Development Institute (FNDI) is an organization focused on strengthening American Indian economies to support healthy Native communities. Two of its key areas of work are combating predatory lending and promoting financial education. FNDI conducted 12 mystery shopper tests in New Mexico, all in communities with high Native American populations and located near reservations.²⁶ In this testing, 10 of the 12 taxpayers encountered problems with inaccurate, illegal, or unprofessional behavior. In 7 cases, the tax preparation process was stopped or changed to avoid having the paid preparer file an inaccurate tax return.

One of the worst errors was a preparer's failure to include unemployment insurance benefits as taxable income. This omission incorrectly qualified the taxpayer for the EITC, which could have significant ramifications. If the IRS caught the omission of the unemployment income, the refund would be lowered and the EITC would be denied. A taxpayer can be disallowed from taking the EITC for 10 years if the credit is claimed but the taxpayer is later determined ineligible. This taxpayer was required to file an amended return. This same preparer lacked the knowledge to properly handle dividend income. This preparer also told the tester: "Oh, they are just forms. If I get \$4,000, I am not going to ask a lot of questions. I just want it!"²⁷

Two preparers failed to report qualified student grant funds as taxable income. Both preparers became confused about Form 1098-T, which reports scholarships, grants, and tuition payments from higher education institutions. In the case of the first tester, her scholarship amount exceeded the qualified expenses and therefore the tester was required to report some income from the scholarship. The preparer for the first tester asked her supervisor what to do, and the supervisor incorrectly responded that the tester didn't have to report the income.

The second tester had a 1098-T that listed \$662.65 in line 4 (adjustment from prior year). The preparer became confused and stated, "Technically I think I'm supposed to subtract \$662.65 from \$2,235, but I'm not sure. We can probably just leave it out because it's highly unlikely that IRS can track it."²⁸ Before completing the return she addressed the issue again, asking the taxpayer for permission to just ignore the \$662.65.

²⁶ Sarah Dewees and Shawn Spruce, First Nations Development Inst., *Tax Time Troubles: Mystery Shopper Testing Exposes Poor Quality Tax Preparation and Refund Anticipation Check Abuses*, Apr. 15, 2011, available at www.nmlegis.gov/lcs/handouts/IAC%20092412%20FNDI%20Taxtime%20Mystery%20Shopper.pdf.

²⁷ *Id.* at 22.

²⁸ *Id.* at 7.

Another tax preparer indicated she used her own bank account to receive direct deposits of taxpayers' refunds, which is prohibited under the IRS Code. I.R.C. § 6695(f). A tester asked this preparer what she did if someone could not afford to pay upfront. The preparer responded: "I just put my account number and routing number on the return and write the client a check when their refund comes in. I take my fee out before I write the check."²⁹

One tax preparer encouraged tax fraud by making up frivolous expenses for the Schedule A form. This preparer included numerous expenses for which taxpayers do not usually qualify for a deduction, *i.e.* clothing expenses, personal cell phones (calculated for 99% business use), and numerous commuter expenses that the taxpayer was not eligible to claim. She asked questions such as, "about how much did you spend on clothing?" and then recorded answers without asking for records of expenses. This same preparer told the tester, who was a tribal member, that he did not have to pay state income tax on income earned from employment not on his reservation, which was incorrect under New Mexico law.³⁰

Other problems included preparers who:

- Showed a lack of knowledge regarding how to properly file a Schedule C business return.
- Told a tester that federal employees do not pay Social Security taxes because they have a good retirement plan (this has not been the case since 1984).
- Didn't know how to handle paperwork associated with a rollover of a Roth IRA.

Finally, 5 of the 12 preparers did not provide a copy of the tax return to the testers at the time of signing, in violation of I.R.C. § 6107(a).

5. 2012 First Nations Development Institute (FDNI) Mystery Shopper Testing

In 2012, FDNI conducted 10 mystery shopper tests in communities near Native American reservations in New Mexico.³¹ Once again, this testing revealed poor quality service provided by tax preparers. Nine of the 10 testers encountered some issue when filing their taxes. FDNI concluded "[w]hile our sample of participants was small, the frequency of these errors calls into question how many Native American taxpayers, and moreover, how many taxpayers across the country are being overcharged and underserved by paid tax preparers."³²

²⁹ *Id.* at 10.

³⁰ *Id.*

³¹ Benjamin Marks, et al., First Nations Development Institute, *More Tax Time Troubles: Mystery Shopper Testing Exposes Refund Anticipation Loans in Reservation Border Towns*, 2012, available at www.nmlegis.gov/lcs/handouts/IAC%20092412%20FNDI%20Taxtime%20V3.pdf

³² *Id.* at 3.

In one example, an inexperienced preparer miscalculated the total refund for the tester. A FDNI staffer who accompanied the tester noted:

Unfortunately, I had completely assumed the preparer correctly listed the daughter as a dependent because she asked so many questions, so I didn't catch the omission until reviewing the return later. I ended up having to write a whole new paper return, changing the filing status to Head of Household and listing the daughter as a dependent. This raised the refund from \$55 to \$70... missing a dependent standing next to a taxpayer across your desk is probably inexcusable.³³

Since all of the testers were Native American, they potentially qualified for the New Mexico state exemption for this community. Yet several preparers skipped over this step. In one case — in which the tester was eligible for this exemption yet the preparer missed it — the tester had \$571 of state withholding from which she might have received some refund.

Finally, 6 of the 10 preparers did not provide a copy of the tax return to the testers at the time of signing, in violation of I.R.C. § 6107(a).

6. *Impact Alabama Testing*

Impact Alabama conducted mystery shopper tests of 13 tax preparers.³⁴ Testers described themselves to preparers as parents with one or two children who lived with them less than six months of the year, which would make them ineligible for the EITC.

The testing by Impact Alabama found that 11 of the 13 preparers nonetheless incorrectly claimed the EITC. In addition, 10 preparers did not report income from other jobs such as babysitting; nine preparers did not report interest income; and 11 allowed testers to claim “head of household” status without being qualified for it.

None of the testers should have qualified for refunds, yet each preparer calculated a refund ranging from \$65 to \$6,247. Five preparers calculated a refund of \$6,247 for a taxpayer who actually owed \$112 to the IRS. These five preparers included a fringe preparer (a finance company), a Mo' Money Taxes outlet, and three other independent preparers.

7. *Testing by the Treasury Inspector General for Tax Administration (TIGTA)*

In 2008, TIGTA testers conducted mystery testing of 28 paid preparers — 12 commercial chains and 16 independent preparers.³⁵ The TIGTA testers found that just 11 of the 28 preparers

³³ Id. at 17.

³⁴ Impact Alabama, *Impact Alabama Undercover Investigation of Commercial Tax Preparers in Alabama Results and Analysis*, Jan. 2009.

prepared an accurate tax return. The other 17 preparers prepared the returns incorrectly. Of these 17 preparers, 6 of 17 preparers produced returns that contained misstatements and omissions TIGTA considered to have been willful or reckless. These six preparers engaged in conduct such as adding or increasing deductions without the testers' permission — in some situations after the testers had questioned whether they were entitled to receive the deductions.

Examples included:

- When informed by the tester that s/he paid for babysitter expenses in cash, the preparer increased the child care expenses beyond what the tester stated s/he paid. In addition, the preparer instructed the tester to tell the babysitter to file a Schedule C with the inflated amount and deduct expenses for operating a home business equal to the inflated amount. The preparer also offered to change the expenses back to the original (real) amount if the babysitter did not agree to change his or her records. The preparer's actions increased the tester's refund by more than \$325.
- A tester completed an information worksheet showing children living in the home for less than one-half of the year. The preparer stated that he or she was going to show on the tax return that the children lived in the home with the tester for a full 12 months. The decision erroneously changed the tester's filing status from Single to Head of Household, increased the dependency exemptions, and qualified the tester for the Child Tax Credit and the EITC. The net effect was to increase the refund from \$100 to approximately \$6,000.
- Even though a tester informed the preparer s/he had no charitable contributions, the preparer included contributions on the return and did not inform the tester that they were being added. The preparer also added a deduction for property tax for a car without the tester's assertion or documentation. The effect was a refund of more than \$200, when the refund should have been less than \$140.

8. *Testing by the Government Accountability Office (GAO)*

In 2006, the GAO conducted mystery shopper tests of 19 paid preparers.³⁵ The GAO found errors in 17 out of the 19 tests, including preparers not reporting business income in 10 of 19 cases and claiming an ineligible child for the EITC in 5 out of the 10 applicable cases. These errors led to inflated refunds exceeding \$1,000 in 6 out of the 19 test cases.

³⁵ Treasury Inspector General for Tax Administration, *Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors*, Reference Number: 2008-40-171, Sept. 3, 2008, available at www.ustreas.gov/tigta/auditreports/2008reports/200840171fr.pdf.

³⁶ Government Accountability Office, *Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors*, GAO-06-563T, April 4, 2006, available at www.gao.gov/new.items/d06563t.pdf.

D. Abuses Uncovered by Government Enforcement Actions

Enforcement actions by the federal and state regulators have found numerous instances of fraud committed by preparers. Some of the most prominent actions include:

1. *U.S. Department of Justice (USDOJ) v. Jackson Hewitt*

A particularly notable tax fraud case was the civil enforcement action in April 2007 brought by the United States Department of Justice (USDOJ) against five Jackson Hewitt franchisees that operated 125 offices.³⁷ The USDOJ brought the civil enforcement action against the five Hewitt franchisees for preparing fraudulent tax returns that falsely claimed \$70 million in tax refunds. The USDOJ alleged that the owners and managers of these franchisees created and fostered an environment in which fraudulent tax return preparation was encouraged and flourished. Examples of fraud alleged by the USDOJ include filing false returns claiming refunds based on phony W-2 forms; using fabricated businesses and business expenses on returns to claim bogus deductions; claiming fuel tax credits in absurd amounts for customers clearly not entitled to any such credits; and massive fraud related to EITC claims.

2. *USDOJ v. Instant Tax Service*

The USDOJ filed a lawsuit against the owner of the tax preparation chain Instant Tax Service in March 2012.³⁸ The complaint alleged that Instant Tax franchisees intentionally prepared fraudulent tax returns to maximize customers' refunds in order to extract large tax preparation fees from these refunds. The USDOJ also alleged that Instant Tax Service issued guidance documents that encouraged franchisees "to lie to the IRS in the event of an audit."³⁹ The complaint states that the estimated tax losses from the allegedly fraudulent returns prepared in 2011 at Instant Tax locations in five cities exceeded \$16 million. After a two-week trial, a federal judge issued a permanent injunction banning Instant Tax Service and its owner, Fesum Ogbazion, from operating or being involved with any business related to tax preparation.⁴⁰

3. *Illinois v. Mo' Money Taxes*

The Illinois Attorney General's Office sued Mo' Money Taxes for filing tax returns without consumers' authorization, filing erroneous tax returns, and charging undisclosed and exorbitant

³⁷ See Complaint, *United States v. Smart Tax of Georgia, Inc.*, 1:07CV-0747 (N.D. Ga. Apr. 2, 2007); Complaint, *United States v. Smart Tax Inc.*, 07C-1802 (N.D. Ill. Apr. 2, 2007); Complaint, *United States v. Sofar, Inc.*, Civ. No. 2:07-cv-11460 (E.D. Mich. Apr. 2, 2007); Complaint, *United States v. Smart Tax of North Carolina, Inc.*, Civ. No. 5:07-cv-00125-FL (E.D.N.C. Apr. 2, 2007). All of the complaints are available at <http://www.usdoj.gov/tax/txdv07215.htm>.

³⁸ Complaint, *United States v. Fesum Ogbazion*, Civil No. 3:12-cv-95 (S.D. Ohio. Mar. 28, 2012).

³⁹ *Id.* at ¶¶ 27-28.

⁴⁰ *United States v. ITS Fin., LLC*, 2013 WL 5947222 (S.D. Ohio Nov. 6, 2013).

fees for tax preparation.⁴¹ The complaint alleged that Mo' Money used offers of RALs to lure consumers into providing their personal information, and signing a form that – unbeknownst to the consumer – gave Mo' Money the right to file tax returns on their behalf. Mo' Money would then file the consumers' tax returns and automatically deduct hundreds of dollars in undisclosed fees from their refunds – as much as \$700 per person. Many of these returns included incorrect information.

4. Chicago Department of Business Affairs and Consumer Protection

Investigators from this Chicago agency went undercover to investigate hundreds of tax preparers. They found more than 80 percent of the preparers investigated were in violation of new City ordinances governing them.⁴² One common violation was the failure to give consumers a required "Taxpayer Bill of Rights" and disclosure forms listing their services, the price for each service, and an estimate of the total charges. (The CBS news story also cites the case of a Chicago consumer whose return was filed by a tax preparer who did not have authorization to do so, and was even expressly told by the consumer not to file his return).

5. New York Department of Taxation and Finance

A 2008 sting operation by this New York state agency found evidence of fraud among about 40 percent of the 85 tax preparers it visited.⁴³ According to a news article about the sting, state officials were startled by the brazen nature of the fraud. In one case, a preparer told an undercover investigator: "I did not declare your full gross income from your business because you will pay a lot of taxes."⁴⁴

E. Tax Preparation Fees

Another problem faced by taxpayers is the lack of transparency around tax preparation fees. Tax preparation is one of the few consumer services in the United States for which consumers often cannot obtain a price for the services before they incur them. Many tax preparers assert that they charge by the form and cannot predict which forms will be generated until they actually

Mystery shopper testing has documented tax preparation fees up to \$500.

⁴¹ See Complaint, *People v. Mo' Money Tax Service*, Civil Ac. No. 12CH09136 (Cook Cty Cir. Ct. Mar. 14, 2012).

⁴² Pam Zekman, "2 Investigators: Tax Preparers May Be Ripping You Off", CBS Chicago, Feb 4, 2013, available at <http://chicago.cbslocal.com/2013/02/04/2-investigators-tax-preparers-violating-city-consumer-laws/>.

⁴³ See Press Release, New York Department of Taxation and Finance, "Wall Street Journal Story Highlights Department's Efforts To Expose Crooked Tax Preparers", Dec. 4, 2008.

⁴⁴ See Tom Herman, "New York Sting Nabs Tax Preparers", *Wall Street Journal*, Nov. 26, 2008.

finish the tax preparation. Thus, consumers cannot comparison shop or predict how much tax preparation will cost them.⁴⁵

As a result of this lack of transparency, low-income consumers face tax preparation fees that are already very high, and, in many instances, inflated. Mystery shopper testing has documented preparation fees up to \$400 or \$500. There are numerous examples of preparers giving low-ball estimates on preparation fees or even refusing to provide testers with a quote.⁴⁶ The U.S. Department of Justice's lawsuit against Instant Tax Service is the latest example of these types of abuses. The USDOJ alleged that:

Collectively, Instant Tax Service's tax preparation and junk fees⁴⁷ typically average more than \$400–\$500, and sometimes run as high as \$1,000 for as little as 15 minutes of tax return preparation. Because Instant Tax Service deliberately targets low-income taxpayers, these unconscionably high fees often pose a significant financial hardship for their customers Frequently, franchisees also fail to disclose all fees, or they tell customers that they charge one amount for fees and then later increase the fees without the customer's knowledge or consent.⁴⁸

The Illinois Attorney General's lawsuit against Mo' Money Taxes is another example of abuses in tax preparation fees.

Mo' Money Taxes advertised that the cost of their services would be between \$150 and \$350....In fact, Mo' Money Taxes charged consumers between \$480 and \$550 to prepare and file their returns, and charged them additional fees totaling \$178 for processing the returns....As a result, consumers were typically charged over \$700 in fees for preparing, filing, and processing their tax return.⁴⁹

The ability to deduct tax preparation fees from a tax-time financial product, such as a refund anticipation check (RAC) or refund anticipation loan (RAL), compounds this problem, as it makes taxpayers less sensitive to the price of preparation. Normally, a merchant's refusal to provide price information might discourage a consumer from buying a product. However, since the fee is deducted from the financial product, consumers may not be as sensitive to this

⁴⁵ See David Rothstein, Policy Matters Ohio, Improving Tax Preparation With a Model Fee Disclosure Box, June 2013, available at www.policymattersohio.org/wp-content/uploads/2013/06/FeeDisclosure_Jun2013.pdf; Chi Chi Wu and Jean Ann Fox, NCLC and Consumer Federation of America, *The Party's Over for Quickie Tax Loans: But Traps Remain for Unwary Taxpayers*, 14-16 (Feb. 2012), available at <http://www.nclc.org/images/pdf/pr-reports/report-ral-2012.pdf>.

⁴⁶ See *id.* at 17.

⁴⁷ These "junk fees" were the add-on fees often associated with refund anticipation checks and loans, such as "data and document storage," "administrative," "e-filing," "service bureau," "transmission," or "processing" fees.

⁴⁸ Complaint, *United States v. Fesum Ogbazion*, Civil No. 3:12-cv-95 (S.D. Ohio, Mar. 28, 2012), ¶¶ 33-34.

⁴⁹ Complaint, *People v. Mo' Money Tax Service*, Civil Ac. No. 12CH09136 (Cook Cty Cir. Ct. Mar. 14, 2012), ¶¶ 79-81.

lack of pricing information. Furthermore, mystery shopper testing has found that the tax preparation fee is often lumped together with the fee for the RAC/RAL and other junk fees, so that it is impossible to tell how much a consumer paid for each item.⁵⁰ Some tax preparers subjected to mystery shopper testing were even reluctant to provide a breakdown of the fees when asked.⁵¹

Clearly, there is a need for reforms in the disclosure of tax preparation fees. As part of any tax preparer regulation, preparers should be required to provide a clear, simple disclosure of tax preparation fees to consumers before beginning the process of tax preparation. This disclosure should be in a tabular format, similar to the disclosure table that accompanies credit card applications and solicitations.

⁵⁰ See 2011 Mystery Shopper Testing Report at 5-6; 2010 Mystery Shopper Testing Report at 9; See also Sara Dewees, First Nations Development Institute, *Tax Time Troubles: Mystery Shopper Testing Exposes Poor Quality Tax Preparation and Refund Anticipation Check Abuses*, Apr. 15, 2011, at 14, 24.

⁵¹ See 2011 Mystery Shopper Testing Report at 5; 2010 Mystery Shopper Testing Report at 9.

The following table provides examples of the different tax preparation fees documented by mystery shopper studies and other sources.

Table of Tax Preparation Fees

Source	Location	Range of Tax Prep Fee	Range of Total Fees (inc. RALs, RACs and Related Fees)
US Dept of Justice v. Instant Tax Serv. (2012)	Multiple states	----	\$400 – over \$1000
Illinois AG v. Mo' Money Taxes (2012)	Illinois	\$480 - \$550	\$658 - \$728
Consumer Groups 2008 Testing	North Carolina (Durham)	\$75 - \$355	\$75 – \$502
	Pennsylvania (Philadelphia)	\$60 - \$298	\$148 - \$487
Consumer Groups 2010 Testing	Arkansas	\$79 - \$396	\$224 - \$487
	North Carolina (Durham)	\$195 - \$275	\$343 - \$388
	New York (New York City)	\$40 - \$443	\$40 - \$497
Consumer Groups 2011 Testing	North Carolina (Durham)	\$64 - \$320	\$69 - \$466
	New York (New York City)	\$143 - \$540	\$100 - \$570
First Nations Dev. Inst. 2011 Testing	New Mexico (towns bordering Native American reservations)	\$48 - \$308	Same
First Nations Dev. Inst. 2012 Testing	New Mexico (towns bordering Native American reservations)	\$55 - \$1,318	Same
Treasury Inspector General(2008)	Not disclosed	\$60 - \$402	-----

F. Why Regulation Is Needed and Enforcement Actions Alone Are Not Adequate

The massive amount of fraud, incompetence, and abuse in the tax preparation industry is astounding. Just a handful of limited mystery shopper tests have consistently uncovered numerous instances of these problems, indicating that such problems are widespread and common in the tax preparation industry. This is not an anomaly or a handful of bad apples. There is an enormous level of incompetence and corruption across the entire industry. The IRS regularly ranks “preparer fraud” highly among its “Dirty Dozen Tax Scams.”⁵²

Bringing enforcement actions on a one-by-one basis is simply inadequate as a response to this problem. While it would get rid of a few bad actors, relying on enforcement alone ignores tens of thousands of other violators. It is akin to only treating a skin lesion when the related disease has invaded a patient’s entire body.

Protecting individual taxpayers and the federal and state treasuries from this massive fraud and abuse demands some basic fundamental standards. It calls for establishing baseline considerations for the practitioners who handle consumers’ most sensitive information. It is only common sense to require commercial preparers to obtain basic training, pass competency exams, and seek continuing education to stay current on ever-changing tax laws.

It is only common sense to require commercial preparers to obtain basic training, pass competency exams, and seek continuing education to stay current on ever-changing tax laws.

G. The Model Tax Preparer Regulation Act

To assist states in developing a system to regulate tax preparers, the National Consumer Law Center (NCLC) has developed text for a Model Act for the regulation of tax preparers (see Appendix B). This Model Act is based in large part upon the laws of three of the four states that currently regulate paid tax preparers – Maryland, Oregon, and California⁵³ – as well as the IRS regulations that were invalidated as being outside the IRS’s authority.⁵⁴ It combines the best elements of these laws with some additional provisions for administrative and private relief.

⁵² See, e.g., IRS, *IRS Releases the Dirty Dozen Tax Scams for 2013*, Mar. 26, 2013.

⁵³ The fourth state to regulate tax preparers was New York. New York’s regulations governing preparers were finalized in December 2013, after the Model Act had been already drafted in November 2013.

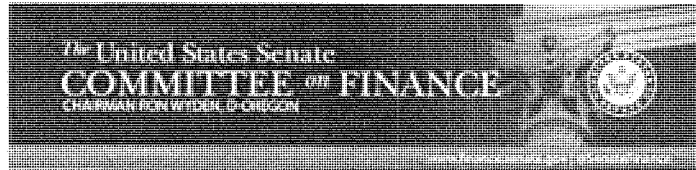
⁵⁴ Note that the D.C. Court of Appeals invalidated the IRS regulations solely on the basis that they were outside the scope of the IRS’s authority as an administrative agency, and not for any deficiencies in the regulations themselves. See *Loving v. I.R.S.*, ---F.3d ---, 2014 WL 519224 (D.C. Cir. Feb. 11, 2014). Obviously, the issue of the scope of administrative authority is not a problem for a state legislature that is enacting a new law.

The Model Act consists of three core components that require all paid tax preparers to:

- Obtain a registration from the designated state agency unless they fit into one of the handful of exceptions, such as certified public accountants.
- Pass a basic competency exam to demonstrate their knowledge of tax law and practice.
- Have 60 hours of initial education and 15 hours per year of continuing education courses on tax law, theory, and practice.

In addition, the Model Act has provisions requiring preparers to provide a standardized disclosure of their fees. This addresses the problem with the opacity of tax preparation fees discussed in section E.

The Model Act can be combined with another model statute available from NCLC that regulates preparers who broker or “facilitate” tax-time financial products, particularly refund anticipation loans and refund anticipation checks. This model statute, the Model Refund Anticipation Loan Act, is available at www.nclc.org/ralmodel.



**Hearing Statement of Chairman Ron Wyden, D-Ore.,
On Protecting American Taxpayers from Incompetent and Unscrupulous Tax Preparers**
As prepared for delivery

There is just a week to go before the April 15 deadline for filing taxes, and millions of Americans are spending a good portion of the spring struggling to fill out tax forms and digging through piles of receipts in a painful annual ritual. The complexity of the tax code creates an environment where confusion and errors flourish. Congress isn't blameless on this issue, and that's one reason why it's time to rewrite the code to make filing easier.

For many Americans, maybe even a majority, nothing will have a bigger impact on their pocketbooks all year long. The great majority of Americans want to get it right, but because the tax code is so byzantine, so complicated and so overgrown, nearly 80 million Americans pay for help preparing their tax return.

Here's the alarming thing: most of those paid tax return preparers don't have to meet any standards for competence in order to prepare someone else's return.

Earlier this year, because of the baffling outcome of a federal appeals court case called *Loving v. IRS*, protection for American taxpayers against incompetence and fraud among tax preparers has taken a significant blow.

As often seems to be the case in situations like this, the most vulnerable people in America will bear the brunt of the effects of this decision. They're often people struggling from paycheck to paycheck, counting down the days until their refund comes through to help them make ends meet. They could be seniors or working families who qualify for the Earned Income Tax Credit. Or they could be immigrants proud to pay taxes in their new country who want to make sure they're following the rules of a tax code that's hard for anyone to understand.

For the second time in eight years, the Government Accountability Office has done an independent inquiry and proven that the absence of meaningful oversight of much of the tax preparer industry is harming too many citizens who can least afford it. The problems they run into could be as simple as a typo or a miscalculation on a form, but they can also be much worse.

In some egregious cases, preparers calculate a taxpayer's refund in person and skip the line that shows who did the work. Then after the taxpayer leaves, the preparer falsifies the math to boost the refund, files the return and pockets the difference. And worst of all, unless the taxpayer can prove what happened, they're on the hook for the money when the IRS finds out.

The witnesses here today are going to share some more eye-opening stories, and I'm eager to get their thoughts on how the government can help. The most important thing is to restore standards to protect American taxpayers.

I'm proud to say my home state gets this issue right. Tax preparers in Oregon study, pass an exam and keep up with the changing landscape of the tax code in order to maintain their licenses, and those standards work. The GAO took a look at the system a few years ago and found that tax returns from Oregon were 72 percent likelier to be accurate than returns from the rest of the country. That puts fewer Oregonians at the mercy of unscrupulous preparers and reduces the risk of the dreaded audit.

There are ways for Congress to help in this arena. For example, I'm a firm believer that comprehensive tax reform can simplify the code and make filing an easier process. When the Finance Committee passed the EXPIRE Act last week, practically every Senator on the dais agreed it's time to end stop-and-go policies and give Americans more certainty about their taxes.

The bipartisan income tax reform plan I worked on with Senators Begich and Coats, as well as former Senator Judd Gregg, would make filing a much quicker and simpler process for millions of taxpayers by tripling the standard deduction. Because that would eliminate the need for more than 80 percent of taxpayers to itemize deductions, they could easily prepare their own returns and never risk falling prey to tax preparers' ineptitude or misconduct.

Senator Nelson has led the charge to protect taxpayers from identity theft, and few people have fought harder for taxpayer rights than Senator Cardin. They've got a lot of valuable ideas that can help solve this challenge, and I look forward to continuing the conversation and building on their excellent work to protect the American taxpayer and the integrity of the tax system.

As long as the U.S. tax code is so overgrown and complicated that most Americans have to seek out help to file, they shouldn't have to worry about crooked or incompetent tax preparers. It's that simple.

And as I wrap up, I'd like to thank both our panels of witnesses for being here today. I'm looking forward to hearing your stories and your ideas of how the government can do a better job of protecting taxpayers.

###

COMMUNICATIONS

Date: April 10, 2014


The United States Senate
Committee of Finance
Honorable Chairman Ron Wyden
Washington, DC 20510

I, Manuel Gonzalez, a tax preparer with the PTIN No. [REDACTED], doing business at 1230 Simpson RD. Kissimmee FL 34744, Tel. (407) 910-4738 support a bill to empower the IRS to regulate tax return preparers more stringently. As you are probably aware, the IRS lost a federal appeal in a legal battle over its effort to institute competency exams and other new regulations for as many as 700,000 paid tax preparers. The plaintiffs argued that "Congress never gave the IRS the power to license tax preparers, and the IRS cannot give itself that authority."

However, according to a study conducted by the Government Accountability Office, "Paid tax preparers fill out 60 percent of all U.S. tax returns... The GAO has found significant problems over the years in the quality of work done by them. In one 2006 study, the GAO took tax returns to 19 different commercial tax preparers, and 17 of 19 incorrectly calculated the taxes due." Therefore, is very important for the IRS to have more authority to regulate tax return preparers, to require continuing education, and to impose the competency test.

I urge you to support legislation like HR 1570 by the Representative Cedric Richmond or any other bill, which would provide for the regulation of tax return preparers. Such legislation is necessary to protect taxpayers and to ensure the capacity and integrity of tax return preparers. I am proud for passing the competency test, issued by IRS early in 2012. After the Internal Revenue Service increased the requirements of continuing education and passing the exam for renewing the PTIN, I am a better Tax Preparer for having done so. I can offer better services to my clients and they can feel safe knowing that I am accredited by a legitimate organization. I am proud to have a certificate on my wall from the IRS stating: Manuel Gonzalez: REGISTERED TAX RETURN PREPARER.

Sincerely,


REGISTERED TAX RETURN PREPARER
Manuel.gonzalez0527@gmail.com
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April 6, 2014
Senate Committee on Finance
Attn. Editorial and Document Section
Rm. SD-219
Dirksen Senate Office Bldg.
Washington, DC 20510-6200

Title and Date of Hearing: Protecting Taxpayers from Incompetent and Unethical Return Preparers; Tuesday April 8, 2014 10:00AM 215 Dirksen Senate Office Building

Honorable Members of the Senate Committee, Witnesses and Panel Members

Thank you for holding these hearings. As President of an IRS and NASBA qualified provider of continuing education that deals extensively with the very group of unlicensed individuals about which the committee is meeting, we find that American citizens are being overwhelmed by criminal, incompetent and unlicensed preparers. Our audiences are composed of about 50% CPAs, 20% EAs and 30% unlicensed preparers and we speak with over 10,000 professionals annually in all 50 states, so we actually feel better qualified to address this issue than anyone on the panel except the IRS. (We also wonder where are the panel members from any national association of tax preparers?)

In every city, in every seminar, on every class day we hear dozens of stories about people preparing returns without signing them, illegally using tax software multiple times without signing returns, accepting cash for payment without signature and multiple other complaints from those of us in the tax preparation industry who do try to do the right thing. This appalling situation has been brought about because of lack of national licensing, lack of public awareness and lack of prosecution against the software thieves and the software providers that allow it. In most states you need a license to shoe a horse, cut hair or unclog a toilet but no license is needed to prepare Federal income tax returns. What a ridiculous situation, particularly when Congress continues to expand the tax code and return preparation is becoming nearly impossible even for experienced professionals. One of my most common jokes is that to stop the ridiculousness of the tax code individuals elected to Congress should be required to do their own tax return, by hand, correctly, under penalty of death and yet we don't even have a competency exam for tax preparers to enforce this edict!

A few states such as Oregon and California have seen the need to step in with licensing requirements, and since we speak regularly in Oregon we see a much higher level of competence and compliance in Oregon than in most states. The Federal government needs to establish as rapidly as possible a similar national licensing and competency-testing requirement. Frankly there is already one in place with the Enrolled Agents exam so new testing would not even need to be designed, just allow a short grandfathering period of 2-3 years for all individuals to become licensed through taking an existing and accepted proof of adequate and timely tax knowledge.


As one of probably 10 or fewer individuals in the United States who is a licensed CPA (Indiana 1980), a licensed IRS enrolled agent (2011) and a registered tax return preparer (2012 before Loving!) I have a personal input here that can be provided that is beyond reproach. I have taken all the licensing tests and passed them. I strongly believe that no one should be exempt from testing to do tax returns including CPAs, attorneys or unlicensed individuals because this group has not had to prove tax-specific competence in their professional licensing exams, nor have they ever had to comply with annual tax specific continuing education. CPAs will argue that the CPA exam has tax questions on it-I agree, but it is not a tax specific exam. Attorneys will argue that they know the law, yet they have never had to prove tax specific knowledge. Unlicensed

individuals are just that-they have never proven anything in a competency testing manner. And no member of this group has any requirement to stay current in their tax knowledge!

No one should be allowed to grandfather in because of experience.

I urge you to protect America's citizens and add a national licensing requirement and provide the IRS with adequate funding to go after the criminals, fools and idiots who are illegally and incompetently "preparing" tax returns.

Thank you.


Robert Jennings CPA, EA, RTRP
President
Jennings Advisory Group, LLC, *dba TaxSpeaker*
4403 Hamburg Pike
Jeffersonville, IN 47130

WRITTEN STATEMENT OF

LUIS PARRA, EA

President of LATINO ASSOCIATION OF TAX PREPARERS, INC.

(LATAX)

HEARING ON

PROTECTING TAXPAYERS FROM INCOMPETENT

AND UNETHICAL RETURN PREPARERS

BEFORE THE

UNITED STATES SENATE COMMITTEE ON FINANCE

APRIL 8, 2014

I. INTRODUCTION

Chairman Ron Wyden, Ranking Member Orrin G. Hatch, and Members of the Committee, thank you for the opportunity to submit my opinion on Protecting Taxpayers from Incompetent and Unethical Return Preparers.

I am honored to provide this statement in behalf of our Latino tax preparer's community.

For the last five years our organization has been behind the proposal of the Internal Revenue Service (IRS) to regulate the tax preparers in the country; we have sponsored several events in conjunction with the IRS to promote the registered tax return preparer (RTRP).

Today we want further to show our support for this initiative in your Committee.

II. NEED FOR A LEGAL TAX PREPARER REGISTRATION

This issue is really a national issue. The reason for this affirmation is because this issue affect millions of taxpayers.

Around the country we are aware that we have very good tax professionals that are dedicated and responsible with the taxpayers and the laws and regulations of our tax system; but we also know that we have some really bad tax professionals.

All tax preparers (except those regulated: CPA, Enrolled Agent, and Lawyers) are working inside the system without any professional regulations; after the court decision last January, the IRS cannot take any action against tax preparers. The IRS cannot require education and cannot single out the tax preparers that ignore the rules and regulations of our Internal Revenue Code.

It is a necessity to regulate all tax preparers in our country.

Abusive tax preparers are charging ridiculous fees, not signing the tax returns, inflating deductions and credits, sending the returns by paper, and disappearing out of the office after April 15.

Our members in LATAX are suffering from this practice: we pay rent, employment tax and annual registration fees (in the federal and some states). We

run ethical and correct businesses around the country, but we cannot compete against the unscrupulous tax preparers working in bedrooms and basements.

Around the country most professions (barbers, beauty salons, car repair shops, massage centers, plumbers, electricians, and more) require a professional license; why not for Tax Preparers? We have more confidential and financial information compared to everyone else; we help taxpayers get through the most important financial event every year.

Why must bad tax preparers serve the taxpayers?

Now is the time to legislate a regulation for all tax preparers in the country; an effective and proper rule run by the IRS.

You can hear the voices pleading Congress to act now. Nina Olson, National Taxpayer Advocate, has addressed Congress several times regarding this issue. Other professional organizations support this initiative, and several other consumer groups had advocated for it.

The Committee can join the Hon. Cedric Richmond (D) for Louisiana, who drafted the bill H.R. 1750 with the title "Taxpayer Protection and Preparer Fraud Prevention Act" last year; unfortunately the bill is resting on his desk waiting for sponsors.

This Committee has the chance to propel legislation to allow the IRS to regulate the tax preparers, including requirements for testing, education and annual registration.

III. CONCLUSION

Chairman Ron Wyden, Ranking Member Orrin G. Hatch, and Members of the Committee, thank you again for the opportunity to submit my opinion on Protecting Taxpayers from Incompetent and Unethical Return Preparers.

Our LATAX members are waiting for the right decision regarding this issue from your committee. Again, we truly believe that this is a national issue that is needed to improve our tax system.

IV. ABOUT LATAX

Latino Association of Tax Preparers, Inc. (LATAX) is a not for profit business organization incorporated November 14, 2005 under the New York State law and recognized by the Internal Revenue Service under the section 501(c)(6) of the Internal Revenue Code.

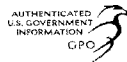
The mission of the LATAX is *"To promote the services provided for the Latino and Hispanic tax professionals around the United States based on the integrity, honesty, skill, preparation and follow-up of the laws and regulations."*

Objectives & Purposes:

- 1. To promote a service of excellence to the community from the Latino and Hispanic professional tax preparers in the United States.*
- 2. To protect, support and help the business services for the Latino and Hispanic professional tax preparers of the United States.*
- 3. To become an active voice of support for the Latino and Hispanic professional tax preparers in the United States.*
- 4. To promote respect, integrity, quality, image and confidentiality between all Latino and Hispanic professional tax preparers and their customers.*

2038 DAVIDSON AVE.
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I

113TH CONGRESS
1ST SESSION

H. R. 1570

To amend title 31, United States Code, to provide for the regulation of
tax return preparers.

IN THE HOUSE OF REPRESENTATIVES

APRIL 15, 2013

Mr. RICHMOND introduced the following bill; which was referred to the
Committee on Ways and Means

A BILL

To amend title 31, United States Code, to provide for the
regulation of tax return preparers.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 SECTION 1. SHORT TITLE.

4 This Act may be cited as the “Taxpayer Protection
5 and Preparer Fraud Prevention Act of 2013”.

6 SEC. 2. REGULATION OF TAX RETURN PREPARERS.

7 (a) IN GENERAL.—Section 330 of title 31, United
8 States Code, is amended by adding at the end the fol-
9 lowing new subsection:

10 “(e)(1) The Secretary of the Treasury may—

1 “(A) regulate tax return preparers who do not
2 practice as representatives of persons before the De-
3 partment of the Treasury; and

4 “(B) before licensing or certifying a person as
5 a tax return preparer, require that the person dem-
6 onstrate—

7 “(i) good character;

8 “(ii) good reputation;

9 “(iii) necessary qualifications to enable the
10 person to provide to persons valuable service;
11 and

12 “(iv) competency to perform the functions
13 of a tax return preparer.

14 “(2) For purposes of this section, the term ‘tax re-
15 turn preparer’ has the meaning given such term by section
16 7701(a)(36) of the Internal Revenue Code of 1986.”.

17 (b) DISCIPLINARY PROCEDURES.—Subsection (b) of
18 section 330 of title 31 of such Code is amended—

19 (1) by inserting “or tax return preparer” after
20 “representative” each place it appears, and

21 (2) by inserting before the period at the end of
22 paragraph (4) the following: “, or for whom a return
23 or claim for refund is being or is to be prepared”.

1 (c) EFFECTIVE DATE.—The amendments made by
2 this section shall take effect on the date of the enactment
3 of this Act.

4 **SEC. 3. AUTHORITY TO IMPOSE A FEE FOR LICENSING.**

5 (a) IN GENERAL.—Subsection (a) of section 7528 of
6 the Internal Revenue Code of 1986 is amended—

7 (1) by inserting “other similar requests, and”
8 at the end of paragraph (1), and

9 (2) by amending paragraph (2) to read as fol-
10 lows:

11 “(2) regulating representatives and tax return
12 preparers under section 330 of title 31, United
13 States Code.”.

14 (b) AVERAGE FEE REQUIREMENT.—Paragraph (3)
15 of section 7528(b) of such Code is amended by adding at
16 the end the following flush sentence: “The fees charged
17 pursuant to the regulation of representatives and tax re-
18 turn preparers shall be reasonable, as determined by the
19 Secretary.”.

20 (c) EFFECTIVE DATE.—The amendments made by
21 this section shall apply with respect to returns for taxable
22 years ending after the date of the enactment of this Act.

○

April 16, 2014

Senate Committee on Finance
Attn. Editorial and Document Section
RM SD-219
Dirksen Senate Office Building
Washington, DC 20510-6200
FAX: 202-228-0554

RE: Hearing on Protecting Taxpayers from Incompetent and Unethical Return Preparers, April 8, 2014

Dear Finance Committee:

As members of the Maryland State Board of Individual Tax Preparers, we are writing to show our support of the IRS regulation of tax preparers.

We support this regulation after working with taxpayers who have been subject to the effects of bad preparers. Many taxpayers have lost refunds due them or have suffered the difficult penalties and interest imposed by the IRS when a preparer incorrectly provides a higher refund than they are entitled to receive. Many of these issues stem from inexperience of the preparers. Some of the more heinous issues stem from the intentional actions of a preparer to acquire a higher refund for the client. This is often done so the preparer is able to keep a client or charge higher fees.

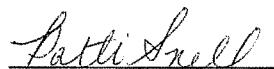
Regulating preparers will better ensure preparers are skilled in their craft and reduce the number of mistakes on returns. It will hopefully weed out those preparers who intentionally file incorrect returns. If a preparer makes the effort to complete an exam to be certified, they are less likely to risk that certification with unscrupulous actions.

At a minimum it would be helpful to reinstate the RTRP test issued by the IRS to be taken voluntarily. At present, taxpayers do not have a method of finding qualified preparers. Taxpayers who complete the RTRP could use it to distinguish themselves as being skilled in tax preparation.


The states are taking more interest in the regulation of preparers. If the IRS does not take the lead, preparers may be required to take multiple state tests so they are able to prepare returns for clients of different states. Maryland is in the process of drafting its exam. Its testing requirement was originally met by preparers who took the RTRP exam. It is now forced to draft its own exam and if other states adopt an exam requirement, preparers will need to take multiple exams to practice or be prohibited from preparing in other states.

We are excited with the interest the US Senate and the IRS have shown in regulating preparers. Please contact us for any support you may need in working on this matter.

Respectfully,



Patricia Snell, CPA
Chair, Maryland State Board of Tax Preparers



F. Robert Bader, Esq., EA
Vice Chair, Maryland State Board of Tax Preparers
Baltimore CASH Campaign
217 E. Redwood Street
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**Statement for the Record
National Association of Enrolled Agents
Senate Finance Committee
April 8, 2014**

"...most people would be astounded to find out that while their barber or manicurist is licensed, their preparer may not be. Comparing the downside of a bad hair cut to incorrect tax return makes it clear it is time to establish federal standards to ensure basic competency and ethical behavior."

Francis X. Degen, EA, Past President, NAEA
US House of Representatives, Ways and Means Committee
July 20, 2005

The question of return preparer oversight is not a new one. As long ago as 1995, the Commissioner's Advisory Groupⁱ recommended amending Circular 230 to prescribe rules for the registration of commercial tax return preparers. The National Association of Enrolled Agents (NAEA), the principal organization representing the interests of the 49,000 enrolled agents (EAs) across the country, has been advocating for years that oversight is essential to protect taxpayers, to protect the federal treasury, and to level the playing field for the professional tax preparation industry.

To that end, NAEA has supported efforts—legislative, administrative, or both—to provide oversight to the widely unregulated tax preparer community. Our philosophy is simple: Americans who pay a "professional" ought to receive a professional-quality tax return. As the committee reviews testimony at the close of the 2014 filing season, many Americans unfortunately cannot be reasonably assured that a given paid preparer will indeed produce a professional-quality, accurate return. We believe that is wrong.

Those engaged in this conversation understand all too well that *Loving v. IRS* is not a judgment on the merits of IRS' oversight program. We side with those who believe such a program necessary, and we believe the agency performed admirably in establishing its oversight program. What was probably most noteworthy is what the agency didn't do: huddle behind closed doors and hammer out a program unburdened by business realities. Instead, IRS reached out in a meaningful fashion—early and often—when creating its oversight program. While we did not agree with all the decisionsⁱⁱ, we believe the Service listened to the concerns of all and made principled decisions. Stakeholders got their say; stakeholders did not necessarily get their way.

Notwithstanding *Loving*, the problem IRS attempted to address—taxpayers harmed by incompetent or unethical preparers—is real and ongoing. Members write frequently to regale us with stories of unbelievable positions so-called professionals have taken on returns. One example just to prove the point: an unenrolled preparer placed a taxpayer's long-term rental property on a Schedule C (rather than Schedule E). Adding insult to injury, the preparer proceeded to lard up the return with illegitimate employee

business expenses (suits, for instance) for the taxpayer's physician spouse and completely unsubstantiated credits on the Form 1040 line for 'other credits.'

We believe we find ourselves at a fork in the road; Congressional action will determine whether we have thoughtful, reasonably swift, and relatively unobtrusive policy for the long run or whether we have a chaotic, patchwork, and unpredictable policy.

In the interest of long run stability, NAEA believes taxpayers and the tax administration system are best protected by national standards for all paid return preparers and oversight of the entire community. During this debate, NAEA has consistently urged policymakers to consider some basic principles for reform:

- **Competency:** Taxpayers would have a reasonable expectation of competency if preparers are subject to initial testing, annual continuing education requirements, background checks, and strong ethical standards. The absence of an initial competency test could place taxpayers in a worse position than currently exists, as taxpayers will assume a preparer holding a federal license has at least demonstrated minimal competenceⁱⁱⁱ.
- **Consolidation:** Any program should build on the existing regulatory framework and consolidate enforcement and administration at the federal level (under the Office of Professional Responsibility and the Return Preparer Office, respectively). This structure creates a variety of benefits: a single ethics code; coordinated exams that would allow for advancement within the profession; and, standardized continuing education requirements all administered under the already existing system.

Consolidation within the agency should ensure uniformity of standards and enforcement for all return preparers and necessary privacy for taxpayer data. It also prevents the cost, redundancy, and confusion that would come from 50 different state requirements with 50 different standards.

- **Resources:** A successful program is predicated on adequate resources for administration, promotion and enforcement. Promotion is noteworthy because IRS needs to reach the tax professional community^{iv} as well as taxpayers at large. It is not unreasonable or unusual for professionals to pay for their licenses—attorneys pay for their licenses, certified public accountants pay for theirs, and EAs pay for theirs, too. IRS should retain all registration fees for program administration and promotion.

The reality, though, is that post-Loving, the agency is not in a position to implement such a program. We urge Congress to clarify that IRS has the authority to run a return preparer oversight program—and in fact always has had that authority. We strongly recommend Congress clarify IRS' authority in such a fashion that IRS need not rebuild a program from scratch. Starting from square one would be expensive—and wastefully so

considering the thoughtfulness and inclusiveness of the original process. We have waited long enough for a system that works for taxpayers and for the profession, and re-fighting old battles is not a recipe to move forward quickly and efficiently.

In the interim, though, we have two concerns. The first is that IRS will not simply revert to *status quo ante*, but institute a new voluntary program. We oppose a new voluntary program.

The desire to create a new program is understandable, as the agency believes (rightly, in our opinion) it must take some action to protect the federal treasury and to protect taxpayers. And a newly created voluntary program will find some supporters, particularly among those philosophically opposed to providing the agency with new authority and/or philosophically opposed to regulation.

We are concerned that creating a new voluntary program (either out of the remains of the registered tax return preparer program or otherwise) would be counterproductive. Creating multiple voluntary credentials—some of which might not even be created by the agency—will confuse the marketplace. How is a taxpayer to distinguish between a legacy Circular 230 practitioner, other IRS-created (or recognized) credentials, and something as simple as a PTIN or EFIN? Further, and just as troubling, we are concerned that a new voluntary program, particularly one that recognized a panoply of state-created or state recognized tests, would dilute standards and leave confused taxpayers in a worse circumstance than they are currently.

Should the agency decide to institute a voluntary program while awaiting Congressional action, we ask policymakers to keep in mind that IRS has for decades had a voluntary program in place—in which attorneys, certified public accountants, and enrolled agents have of their own accord subjected themselves to high and stringent standards. The agency at this moment has within its grasp rigorous Circular 230 practice standards and should at the very least fully exploit the tools at its disposal as it attempts to drain the swamp of incompetent and unethical paid preparers.

Should the agency want to promote competency in a voluntary program, it has the means in its hands. Enrolled agents are less widely known than their legacy Circular 230 brethren, but the program has practical, attractive features. It is egalitarian, owing to its low barriers to entry (neither college education nor an apprenticeship program is required). The multi-part EA test is available right now—any other test would need to be run through competitive bidding. Further, enrolled agents are widely recognized by state taxation authorities.

This leads us to our second concern: a proliferation of state regulatory programs. The longer federal policymakers take to create a program, the more likely individual states will create regulatory programs of their own. Such an approach has great potential to be patchwork, with the inevitable result that a return preparer in Ohio would find herself subject to different requirements for Kentucky, for Indiana, for Michigan, and so on. Given the high incidence of interstate tax return preparation, this patchwork would be a nightmare administratively and, no doubt, unnecessarily expensive and bureaucratic.

Finally, we suggest neither a state-centered approach to credentialing nor accepting tests recognized by individual states make much sense for a federal power established specifically under the U.S. Constitution.

NAEA thanks Senator Wyden and Senator Hatch for this timely hearing. We have for well over a decade been deeply involved in raising awareness of the dangers of incompetent and unethical paid tax return preparers. These bad actors harm individual taxpayers, undermine the tax preparation industry, corrode the tax administration system, and erode the treasury. Federal policymakers can—and should—take vigorous steps to shore up such a significant system. After all, the National Taxpayer Advocate states in her most recent NTA Report to Congress: "For tax year (TY) 2011, taxpayers filed about 142 million 1040-series individual returns, with nearly 79 million using paid preparers. More than half (over 42 million) of these returns were prepared by preparers who are unregulated by IRS."

We urge Congress to grant IRS authority to re-start its return preparer oversight program and to do so as quickly as possible. We have lived in the wild West long enough to know that we can—and should—do better. While we have already discussed this issue with both of your staffs, we stand ready to engage in the conversation more broadly and look forward to assisting in drafting whatever legislation is necessary to reestablish minimum tax return preparer standards.

ⁱ The Commissioner's Advisory Group is predecessor to the current IRS Advisory Committee, commonly referred to by its acronym IRSAC.

ⁱⁱ For instance, we believe limited practice—representation on returns completed by a paid preparer—should have been eliminated and we believe that those who have demonstrated basic competency should not have been permitted to prepare complex returns.

ⁱⁱⁱ Not only the 679,749 individuals with current Preparer Tax Identification Numbers (see IRS website for [statistics](#)), but also those who prepare returns but do not know of any preparer requirements.

^{iv} A PTIN is a preparer tax identification number and is required of all paid return preparers, though the PTIN does not require any competency or continuing education. Similarly, an EFIN is an electronic filing identification number and it is provided to those who are permitted to file electronically, though EFIN holders have neither demonstrated competency nor been required to take continuing education.



National Association
of Tax Professionals

NATP Comments:

Effective Regulation of Tax Return Preparers

Presented to:

Senate Finance Committee
April 8, 2014

Background

The National Association of Tax Professionals (NATP) is honored to submit this commentary on the regulation of tax return preparers to the Senate Finance Committee. NATP appreciates the opportunity to register its observations and concerns regarding the regulation of tax return preparers and the status of the tax preparation industry as a whole.

NATP is a nonprofit professional association that is committed to the integrity of the tax administration system and the application of tax laws and regulations by providing education, research and information to tax professionals. For over 34 years, we have existed to serve professionals who work in all areas of tax practice. We provide our members with over 200 tax education offerings in more than 100 locations throughout the United States. In 2013, NATP issued 155,250 CPEs through live nationwide workshops, webinars, and self-study programs. In addition, our 39 Chapters and National headquarters serve the public through regular news releases, client brochures and newsletters, and a designated taxpayer website. Our Chapters provide significant member involvement in local and state communities. Our headquarters with 56 employees is located in Appleton, Wisconsin.

NATP lends tremendous influence to 12 million taxpayers' decisions about compliance through its educated membership of over 23,000 tax professionals. NATP's membership is a diverse group comprised of attorneys, CPAs, EAs, CFPs, BBAs, MBAs, PhDs, as well as Associate degrees, accountants, part-time professionals and those who have entered the profession as a second career. NATP is an "industry-specific" association as opposed to a "credential-specific" association. We therefore have no bias for any one group of tax professionals over another. Approximately half of our members are "credentialed," which is a term used by the IRS to primarily designate attorneys, CPAs and EAs. Accordingly, roughly half of our members are directly affected by the proposed regulation of tax professionals. Approximately 82% of these non-credentialed professionals have post-high school degrees.

We believe we are uniquely qualified to speak to the status of tax return preparers because of the wide cross-section of tax professionals in the industry that comprises our membership. NATP has, from the beginning, been of the belief that nothing but good can come from raising the bar and enhancing professional knowledge and competence in complying with our complex tax code.

Preparer Regulation

In 2004, NATP sent an informal survey to its members asking for input regarding the national licensing or registration of tax preparers. Based on the feedback, the majority of those who responded would support some form of licensing or registration. Of those that showed support for licensing or registration, many agreed that it was time for practitioners to register and demonstrate reasonable competency, although an overly burdensome program would not serve the best interests of the industry. The basic opinions remain today despite the Loving case outcome.

NATP has always supported "raising the bar" through careful and thoughtful regulation of all paid tax return preparers. The effectiveness of tax administration, in part, relies on the consistent quality of work being done on tax returns and staying up-to-date on tax law through continuing education. Both are necessary competencies to do accurate tax work. We would

hope the IRS will continue to pursue pathways toward a higher standard for all tax professionals.

At the onset of the Return Preparer Review initiative, NATP submitted comments effectively suggesting that the IRS take a slow, careful approach when determining their desired outcomes. Our society and the business environment have become so complex that, despite repeated efforts on behalf of Congress and the regulatory agencies, the process of computing and reporting accurate tax liabilities on the part of citizens has also become complex. Licensing and/or registration is a step toward ensuring that taxpayers receive professional and credible services from currently unlicensed paid tax preparers. Any proposal to regulate paid preparers should ensure that they sign the returns they prepare, stand behind their work, continue their education to stay current on tax laws and regulations, and maintain the highest ethical conduct while servicing taxpayers.

Despite any regulatory regime, there is a strong likelihood that unscrupulous and unethical tax return preparers who are not already licensed or regulated will simply "go underground" when/if any regulation is put into place. During the 2014 filing season, statistics revealed that there was approximately a 6% increase in the number of self-prepared returns. While it's not possible to know with certainty what percentage of these returns were actually prepared by non-signing "ghost" preparers, we can assume that many of them most likely were. In its effort to make tax return filing easy and economical for the American public, Congress and the IRS have unintentionally fostered an environment where such dishonest and unprincipled people can readily have free and easy access to software and electronic filing capability. At a minimum, those issues must be tackled from a compliance and enforcement standpoint.

There should be some way to easily identify qualified tax return preparers and inform the public of who is authorized to prepare their tax returns. Taxpayers must have a clear understanding of where to go for professional service in getting their returns completed. The American public deserves that. Terminology used to identify such preparers must be clear to the public, clear to the tax administration system and clear to the tax preparation community. Any government marketing effort to educate the public regarding newly licensed preparers must distinguish them so as not to confuse the public with existing credentials already in use such as Certified Public Accountant, Enrolled Agent, and attorney.

NATP is concerned that the tax administration system will be harmed by a loss of capable preparers that provide for the current compliance enjoyed by the system. We believe that many of the problems above can be alleviated with reasonable, economic tweaks in the process going forward. We recommend the following:

1. Provide the IRS with the regulatory authority and the budgetary resources to effectively administer a program regulating tax preparers.
2. Carefully review and revise Circular 230 to remove the specific restraint of trade provision in Section 10.3(f)(3). Preparers should not be put in a position of having to refer their clients to competitors for advice in the course of planning, emergencies or any other instance in which taxpayers need help with compliance. At a minimum, change the wording to reflect that all paid tax return preparers may give advice in their practice before the IRS, but that such advice will not be considered confidential or privileged as such communication has meaning under IRC §7525.

3. The IRS should exercise more caution in implementing any program until better information can be obtained through matching PTINs and EFINs with problem returns.
4. Build a program model that can keep small business preparers in place thereby assuring jobs and livelihoods that can provide for healthy competition and therefore better serve the taxpayer and the tax administration system.

Conclusion

We would hope that, as regulation of paid preparers is once again debated, direction would be given the Treasury to keep the licensing process efficient, fair and economical. We would also hope that any legislation would provide the Commissioner of the IRS with the resources needed to enforce already existing laws enacted to stamp out unethical and unscrupulous behavior within our tax system. We point out that this behavior is also demonstrated by some taxpayers – those prone to “shop” the tax professional community to see who will provide them with the best tax result or highest refund.

Thank you for this opportunity to express our thoughts regarding what we consider to be important issues regarding the regulation of paid tax return preparers. We are available to share our unbiased knowledge on issues of tax administration from the perspective of both Circular 230 and non-Circular 230 tax professionals.

NATIONAL SOCIETY OF ACCOUNTANTS

**WRITTEN STATEMENT OF THE
NATIONAL SOCIETY OF ACCOUNTANTS**

**SUBMITTED FOR THE
SENATE COMMITTEE ON FINANCE HEARING ON
PROTECTING TAXPAYERS FROM INCOMPETENT AND UNETHICAL
RETURN PREPARERS**

April 8, 2014

Written Statement of National Society of Accountants

Submitted for the
Senate Committee on Finance Hearing on

Protecting Taxpayers from Incompetent and Unethical
Return Preparers

National Society of Accountants ("NSA") is pleased to provide its view on the regulation of tax return preparers. NSA and its affiliate, the Accreditation Council for Accountancy and Taxation ("ACAT") strongly recommend that Congress provide the Internal Revenue Service ("IRS") with the authority to require individuals to demonstrate competency in tax return preparation by passing a bar examination, an examination approved by a state board of accountancy, a state board approved examination testing tax return preparer competency, or an IRS examination.

Background

ACAT was established in 1973 as a non-profit independent testing, accrediting and monitoring organization. ACAT offers an Accredited Tax Return Preparer Credential to independent practitioners who specialize in providing tax return preparation services to individuals and small to mid-size businesses after the passage of a written examination testing competency in tax return preparation. In addition, ACAT offers an Accredited Tax Advisor Credential to independent practitioners who specialize in providing financial, accounting and taxation services to individuals and small to mid-size businesses after the passage of a written examination testing competency in accounting and finance as well as competency in tax return preparation. ACAT is affiliated with the National Society of Accountants headquartered in Alexandria, Virginia. The ACAT tax return preparer examination is part of the ACAT Accredited Tax Advisor examination approved by the boards of accountancy in Iowa, Minnesota, and Delaware. The ACAT tax return preparer examination covers all of the technical

knowledge and ethics topics that are tested in the IRS enrolled agent examination and that should be covered in any competency examination that is required under a tax return preparer certification program administered by the Treasury Department or IRS.

Paid tax return preparers have voluntarily studied for and taken the ACAT tax return preparer examination for almost 40 years in order to differentiate themselves from other tax return preparers in states that do not require tax return preparer competency testing.

ACAT's tax return preparer examination also has been certified by the National Commission for Certifying Agencies (the "NCAA"). NCAA certification assures that the ACAT tax return preparer examination is developed, administered, scored, and reported according to generally accepted standards for the testing of professional competency.

Since 1973, ACAT has provided the certification of tax return preparer competency on a voluntary basis to individuals throughout the United States. As noted above, the ACAT Accredited Tax Advisor examination, which includes the ACAT tax return preparer examination, has been approved by the state boards of accountancy in Iowa, Minnesota and Delaware to show competency in tax return preparation under their respective accounting certification programs.

In 2010, the IRS determined that it had the authority to regulate paid tax return preparers and instituted a regulatory scheme requiring preparer registration, competency testing, and continuing education. Certain individuals who had taken and passed an examination recognized for regulatory purposes by a state – certified public accountants and attorneys – were exempted from the testing requirement because passage of the state approved examination demonstrated tax competency. However, the IRS did not exempt from this new testing requirement other individuals who had taken and passed a state-recognized examination that demonstrated competency in tax matters. For example, the IRS required individuals who had passed the tax preparer examination given by the state of Oregon to also pass the IRS competency examination. Similarly, the IRS required individuals to take the competency examination even if they had

taken and passed the test in taxation offered by ACAT which is recognized to demonstrate tax competency for regulatory purposes in Delaware, Iowa and Minnesota.

In 2013, the U.S. District Court for the District of Columbia ruled in *Loving v. Commissioner* that the IRS did not have the statutory authority to require preparers to take a competency examination or require continuing education and issued a permanent injunction preventing the IRS from further implementing or enforcing its preparer testing requirements.

Legislative Proposal to Regulate Tax Return Preparers

Congress is now considering granting the IRS the authority to regulate tax return preparers and NSA strongly supports competency testing for tax return preparers. As noted above, for almost 40 years ACAT has been providing credentials to individuals passing the ACAT tax return preparer examination acknowledging their competency in tax matters, and the ACAT tax return preparer examination is recognized to show competency in tax return preparation by three¹ of the four² states that regulate tax return preparers. In any legislative approach granting the IRS the authority to require testing and continuing education of tax return preparers, preparers who have taken and passed an examination recognized by a state to show competency in tax matters must be exempted from the IRS testing requirement in order to uniformly recognize state tax competency determinations and avoid subjecting individuals to duplicate and unnecessary testing.

Under the regulations the IRS had issued setting forth the requirements that an individual must satisfy to be deemed competent in tax matters for purposes of preparing federal tax returns, attorneys and CPAs who have passed a state examination were deemed competent to file tax

¹ Passage of the ACAT examination is recognized by Delaware, Iowa and Minnesota to demonstrate tax competency.

² Oregon developed its own competency test in 1973, the same year ACAT began credentialing tax return preparers.

returns in any state. However, the IRS ignored the fact that some states issue credentials or licenses to professionals, other than attorneys and CPAs, after the passage of an examination recognized by such state that demonstrates competency in tax matters, e.g., the ACAT examination for Minnesota registered accounting practitioners.

Other states offer no such credentials but residents of such states may take tests recognized by other states, e.g., the ACAT examination recognized in Iowa, to demonstrate tax competency to the public. The passage of an examination, other than a bar or CPA examination, recognized by a state to show competency in tax matters, must be considered to demonstrate tax competency for federal tax return preparers in order to uniformly recognize state tax competency determinations and avoid subjecting individuals to duplicate and unnecessary testing.

Legislation requiring federal tax return preparers to demonstrate competency in tax matters should be enacted and provide that such competency will be shown if an individual passes a written examination demonstrating competence in tax return preparation approved by a state board of accountancy, a board of law examiners, a state entity such as the Oregon Board of Tax Practitioners, or the IRS. To accomplish this we suggest that 31 U.S.C. § 330, which regulates the conduct of persons representing others before the IRS, be amended by adding the following new subsection –

(e) The term "representative" includes a tax return preparer who prepares for compensation, or who employs one or more persons to prepare for compensation, any return of tax imposed by Title 26. For purposes of the preceding sentence, the preparation of a substantial portion of a return or claim for refund shall be treated as if it were the preparation of such return or claim for refund.

(f) A tax return preparer will satisfy the requirements of (a)(2)(D) if such person has demonstrated competence in Federal tax return preparation by written

examination approved by the Internal Revenue Service, a state board of accountancy, a state board of tax practitioners, or a state bar licensing agency.

Conclusion

Congress should require that paid tax return preparers must show competency. We recommend that 31 U.S.C. § 330 be amended to provide the IRS with the authority to regulate tax return preparers and allow competency to be demonstrated by the passage of a written examination approved by a state board of accountancy, a state board of tax practitioners, a state bar licensing agency, or by the IRS. The passage of an examination approved by a state to show competency in tax return preparation must be considered to demonstrate tax competency for federal tax return preparers in order to recognize efforts that have been made by the states and to avoid duplicate testing for individuals who have already shown competency.

WRITTEN STATEMENT OF

**DONALD T. WILLIAMSON
PROFESSOR OF TAXATION
HOWARD S. DVORKIN FACULTY FELLOW
EXECUTIVE DIRECTOR, KOGOD TAX CENTER
AMERICAN UNIVERSITY
WASHINGTON, D.C.**

AND

**JAMES GALE
PROFESSOR OF ACCOUNTING
NORTHERN VIRGINIA COMMUNITY COLLEGE
FAIRFAX, VIRGINIA**

COMMITTEE ON FINANCE

UNITED STATES SENATE

HEARING ON

**“PROTECTING TAXPAYERS FROM INCOMPETENT AND UNETHICAL
RETURN PREPARERS”**

APRIL 8, 2014

TO: Committee on Finance, U.S. Senate

FROM: Donald Williamson, Professor of Taxation, American University
James Gale, Professor of Accounting, Northern Virginia Community College

RE: Statement for Hearing on "Protecting Taxpayers From Incompetent and Unethical Return Preparers," April 8, 2014

We are professors of taxation and accounting with private tax return preparation practices and substantial experience conducting continuing professional education seminars for the community of practitioners that the IRS is requesting authority to regulate. While generally suspicious of proposals to increase government regulation of our profession, we believe the complexity of the law coupled with the negligent and outright fraudulent actions of unlicensed practitioners call for the registration, testing and continuing education requirements proposed by the IRS.

Our prior published comments on the Loving case set out our views that the IRS never had authority to regulate all practitioners and it is regrettable that the IRS belatedly seeks formal Congressional action.¹ It is equally unfortunate that this regulatory effort may be the result of lobbying efforts by large tax return preparation corporations that seek to snuff out competitors leading inevitably to higher fees being imposed on the public for the preparation of their returns. Nevertheless, it is our opinion that regulation is needed to protect the public. However, as Congress crafts legislation, we request that the following be considered:

1. **Grandfathering Current Preparers**

To transition to the new requirements and address the objections that registration is unnecessary for many experienced practitioners, the new legislation should exempt from testing any preparer who upon application demonstrates he or she was in the business of tax return preparation for the year prior to enactment of the legislation. However, to obtain licensure, such practitioners would still be required to attend continuing professional education classes. Exemption from testing will ease the anxiety of many

¹See, Williamson & Gale, "Loving and the End of RTRPs," Tax Notes, April 21, 2014; Williamson & Gale, "RTRPs and Their 'Practice' Before the IRS," Tax Notes, April 8, 2013.

otherwise competent and experienced professionals who may not have taken a multiple-choice examination since high school. At the same time such individuals will still be required to meet annual continuing professional education requirements to update their preparation skills and technical tax knowledge.

2. **Set Limits or Establish Oversight Authority on Testing and Registration Fees**

Because of concern that the charging of fees to receive and maintain licensing will erect barriers to entry that will only serve the interest of large corporate tax return preparers, congressional authorization permitting regulation should establish a fee schedule or create legislative oversight for entry into and maintenance of the right to practice. Since the purpose of licensure is the protection of the public rather than the raising of government revenue, such charges should in some way be tied to the cost of the maintenance of the program.

3. **Penalties on Taxpayers for Using Unlicensed Preparers**

All agree that licensing tax return preparers will not eliminate fraud and may only result in “ghost” preparers who do not sign returns but still charge fees. To combat abuses that will inevitably grow if all preparers signing returns for compensation must be licensed, an assessable penalty should be imposed on the taxpayer for engaging an unlicensed preparer. Preparers would be required to show their clients proof that they are licensed. In addition, the individual income tax return should require taxpayers to attest that they have examined documentation that the preparer is licensed.

4. **Require Attorneys and CPAs to Also Pass an Examination and Meet Specific Continuing Professional Education Requirements in Taxation**

Attorneys are generally not required to take a tax course in law school and the undergraduate curriculum of most business schools require accounting majors to take only one tax course. Even if an attorney or CPA took a tax course in school, the subjects covered in such courses were unlikely to include discussion of the earned income credit or other matters relevant to low-income Americans.

Couple this lack of formal training with the fact that most attorneys and CPAs do not practice in the area of taxation at all, these individuals are as unprepared to grapple with the nuisance of the earned income tax credit as any of the practitioners whom the IRS wishes to now regulate. Therefore, simple equity calls for attorneys and CPAs who wish to prepare an individual income tax return for compensation be subject to the same standards and levels of demonstrated competency as enrolled agents. As the recent scandals involving the promotion of tax shelters show, attorneys and CPAs can be as fraudulent and unethical as any store-front practitioner claiming a refundable credit on Form 1040. In short, the bar exam of all fifty states and the Uniform CPA examination do not test the skills needed to prepare tax returns for low-income Americans. If the IRS is asking experienced and knowledgeable practitioners who have prepared thousands of such returns to take a test demonstrating their skills, the same should be asked of attorneys and CPAs who have no experience or knowledge of tax issues affecting the general public.

In conclusion, the irony of advocating the grant of more regulatory authority to the IRS when it is embroiled in scandal involving the abuse of its authority is not lost upon us. Nevertheless, the growth of fraudulent and unethical tax return preparation in a world of refundable tax credits that the IRS is powerless to effectively administer without abandoning its commitment to electronic filing is also not lost upon us. Regrettably, therefore, we choose more regulation.

Thank you for this opportunity to make these comments and suggestions.

