Written Comments of Francis X. Degen, EA on behalf of The National Association of Enrolled Agents

Senate Finance Committee
April 4, 2006

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President National Association of Enrolled Agents[i]
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Thank you, Mr. Chairman, Ranking Member Baucus, and members of the Committee on Finance, for asking the National Association of Enrolled Agents to testify before you today on tax return preparation. NAEA is the premier organization representing the interests of the 46,000 enrolled agents across the country. Enrolled agents are the only practitioners in whom the IRS directly attests to competency and ethical behavior. Our organization works to increase the professionalism of our members and the integrity of the tax administration system.

Background

It is a taxpayer's responsibility to file a complete and accurate tax return, as well as to remit taxes due on a timely basis. As you understand, this civic responsibility is not trivial. For a number of reasons, of which tax code complexity and fear of the IRS are two of the more common, taxpayers are increasingly turning to paid preparers for assistance in determining their tax obligations.

At the same time, most taxpayers do not realize that in forty-nine states tax preparers are not required to be licensed. As an enrolled agent, I represent far too many of these taxpayers when the IRS catches up with them after the fact. These non-compliant returns, prepared by unlicensed preparers, generally come in two flavors: the blatantly fraudulent and the merely inaccurate due to gross incompetence. From the taxpayer's perspective, the outcome is identical: tough enforcement actions by the government.

Legislators care about return fraud and incompetence because they undermine the integrity of our voluntary tax system, create resentment in those who file honest tax returns, and contribute to the $300 billion plus gross tax gap. We share those concerns. Further, as federally licensed practitioners, EAs find themselves at a disadvantage when competing in the marketplace against the unscrupulous and find that these bad actors sully the reputation of all licensed tax professionals.

In our testimony today, I would like to present a picture of the problems presented to the tax system by unlicensed return preparers, who in many instances we have found to be unscrupulous or incompetent, and unfortunately in far too many cases both unscrupulous and incompetent. To help remedy this disturbing situation, NAEA urges members of this committee to take action by reporting out Senator Bingaman's bill, S. 832, The Taxpayer Protection and Assistance Act of 2005. I would also like to touch upon an e-filing/e-services concern held commonly by Circular 230 practitioners.

The Problem

While most of the focus for the IRS and policymakers over the last few years has been on large-dollar compliance areas such as corporate tax shelters and non-profit behavior, NAEA members have observed disturbing trends in the world of return preparation for ordinary taxpayers, almost always involving unlicensed preparers.

NAEA is not alone in acknowledging this problem. In her 2003 and 2004 annual reports, National Taxpayer Advocate Nina Olson recommended the establishment of a federal program to regulate unenrolled tax preparers. More pointedly, she noted in her 2003 report that over 55 percent of the 130 million individual taxpayers hired a return preparer. The majority of those preparers did not possess a legitimate license demonstrating competency or ethical standards. The result is startling: Ms. Olson noted that at least 57 percent of EITC earned income overclaims were attributable to returns prepared by unlicensed paid preparers, resulting in billions of dollars in lost revenue to the government.

For our members and all preparers who abide by the highest levels of ethical and competency standards in order to live up to the requirements set by federal regulations, the competitive disadvantages of this situation are stark. Time and time again, when our members are surveyed they relate instances of what we call "preparer shopping" during every tax season. Indeed some taxpayers gather up their tax documents and walk out because someone right down the street has guaranteed them a minimum refund amount: $1,000, $3,000, or even higher. Or the taxpayer wants the preparer to help him or her create phony business or unreimbursed employee business expenses, incorrectly report expenses or income from rental property, or not report "under-the-table" income. The list goes on and on.

Many of our members are aware of specific preparers in their neighborhoods who specialize year-in and year-out in ripping off the Treasury. Many have even complained to the IRS; but because of the lack of resources, the agency appears to focus on practitioners currently regulated under Circular 230. Last year, one of our members commented, "People drive in excess of the speed limit until they notice the cop; then they all observe the speed limit for a while, but when the cop leaves the beat, speeds begin to creep back up." Mr. Chairman, it has been too long since the tax cop has been out circling the neighborhood in his black and white.

While it is easy to focus on fraud, one must not forget that preparer incompetence probably causes as much heartache. We all know the tax code is too complicated. Unfortunately, too many preparers who are open for business today fail to attain adequate training and education or do not make the investment in time and money to keep up with the constantly changing tax code. Mr. Chairman, it is important to place negligence and incompetence on an equal footing with intentional fraud when attempting to understand the magnitude of the non compliance problem among unregulated preparers.

What can be done?

Mr. Chairman, we all acknowledge that the tax code is exceedingly complex. Dramatically simplifying the code would likely reduce some incidences of

noncompliance. However, absent significant simplification, we must deal with the situation as it currently exists.

NAEA strongly endorses the concept of regulating **all** paid return preparers, requiring an initial test for competency, background checks, annual minimum continuing education requirements, and compliance with the current Circular 230 ethical standards. Additionally, the Office of Professional Responsibility needs adequate resources to both enforce the rules and promote all preparers covered by Circular 230.

After many months of working with the practitioner community Senator Bingaman, in concert with the chairman and ranking member of this committee, has developed thoughtful legislation addressing most of these elements. NAEA has endorsed this legislation as the most comprehensive roadmap to address the problem of unregulated preparer noncompliance. We would urge the committee to report out this important piece of legislation as soon as possible because it:

A. Contributes significantly to taxpayer access to competent and ethical tax preparation services.

The legislation requires all paid preparers to pass an IRS initial competency examination testing understanding of basic individual income tax laws and ethical standards. Further, paid preparers would be required to complete annual continuing education and be subject to the ethical standards of Circular 230. These changes would contribute significantly to the use of qualified and ethical individuals preparing returns.

B. Builds on the existing regulatory framework and consolidates enforcement under one entity.

Rather than constructing a parallel regulatory framework and enforcement entity for different groups of paid preparers, the legislation consolidates all persons preparing returns (EAs, lawyers, CPAs, as well as other paid preparers) under the current regulations (Circular 230) and the existing Office of Professional Responsibility. In other words, there would be one ethical code, one set of coordinated exams that would allow for advancement within the profession, and standardized continuing education requirements all administrated under the current regulatory system.

In addition to being cost effective, this consolidation would ensure uniformity of standards and enforcement across all preparers.

C. Ensures adequate resources for administration, promotion, and, most importantly, enforcement.

The legislation would allow OPR to retain all registration fees for administration of the program, including policing all practitioners and preparers under its jurisdiction. Most importantly, the authorization to retain these fees ensures that the office would have adequate resources to investigate and penalize unlicensed individuals. This would go a long way toward discouraging taxpayers from shopping for the "best deal" among preparers and will help shut down many EITC mills across the country.

Additionally, the bill authorizes OPR to retain penalties administered under the program for promotion of all Circular 230 preparers to the general public. This will assist the public in understanding the importance of paying only licensed individuals for tax preparation and will assist the public in understanding the difference between the various groups allowed to do paid preparation.

D. Strikes a correct balance for creating a new tax practice credential.

The legislation recognizes the ramifications of creating a new credential in the world of tax administration. Currently, the general public is presented with three options for individuals who are authorized to practice before the IRS: EAs, lawyers, and CPAs. Circular 230 is very specific as to how these individuals may advertise and generally present themselves to the public. A new credential implying a higher level of authority and competency than merely preparing basic individual tax returns will cause confusion and undermine the general intent of the legislation.

For example, since the passage of the IRS Restructuring and Reform Act, there has been a great deal of confusion as to the credentials and *bona fides* of Electronic Return Originators or EROs. The IRS has issued signage denoting official endorsement of individuals qualifying as EROs, as well as financed a public awareness campaign in support of the program. Anecdotal evidence (the appearance of billboards and bus stop signage) in poorer neighborhoods claiming a government stamp of approval demonstrates the danger of putting out to the public confusing titles or credentials that overstate competency.

Additionally, state regulators would be very leery if not outright hostile toward the creation of a new credential in the accounting/tax preparation marketplace. States regulate the use of credentials and many list a litany of titles (e.g., certified tax consultant, chartered accountant, registered accountant) and abbreviations likely or intended to be confused with CPA that may not be used. After years of conflict, the majority of state boards of accountancy have accepted that a person recognized by IRS as being enrolled may use the enrolled agent name and EA abbreviation. Creating nomenclature that might overstate its intended mission is likely to re-ignite this battle, and at the very least potentially counter the underlying intent of the legislation. Once again, Senator Bingaman's bill strikes the right balance.

e-Filing and e-Services

The e-services product is one of the best and most useful IRS has launched in recent memory. At its heart, e-services is a tool that significantly improves the timeliness and quality of taxpayer representation while at the same time saving IRS thousands of man hours annually. What once took weeks or even months to resolve now can often be handled during one office visit by a distressed taxpayer.

NAEA echoes the Taxpayer Advocate's concerns with respect to the program and remains troubled that the agency continues to predicate e-services access on participation in the e-filing program. The fact remains that many Circular 230 practitioners focus their practices **solely** on representation and therefore cannot meet **any** e-services e-filing prerequisite. While some of those who file current-year returns may on rare occasion have use for it, those who provide representation services find it phenomenally useful.

The Service's refusal to open e-services to all Circular 230 practitioners opens the agency to a criticism I have heard often, namely that while the agency has in place a framework prescribing competency and ethics and holding EAs, attorneys, and CPAs to a higher standard (i.e., Circular 230), the agency consistently fails to support its licensed practitioners.

The IRS web page for e-services illustrates this issue. It states, "e-Services is not available to the general public. Only approved IRS business partners, such as e-filing tax professionals and payers, are eligible to participate in e-services." Adding insult to injury, the site also defines an eligible tax professional as one who is an active participant in the IRS e-file program and e-files five or more accepted individual or business returns in a season. As a result, to the unschooled eye it appears that IRS believes tax professionalism is defined by filing five electronic returns and NOT by the EA license the IRS itself grants or by the licenses granted by state boards of accountancy or state bars.

Clearly, meeting the congressionally-mandated 80 percent e-file participation rate is important for the agency. At the same time, using the e-services program to "incent" e-filing participation without regard to the specialized services of the practitioners it licenses itself (EAs) and the other licenses over which it has most control (attorneys and CPAs) is distressing to NAEA members and appears to be at loggerheads with the Service's commitment to customer service.

Enrolled agents believe excluding enrolled practitioners—particularly those who specialize in representation—from e-services participation compromises good taxpayer service and falsely creates a nexus between two unrelated products. We hope the agency revisits this policy decision and works posthaste to bring all Circular 230 practitioners into the e-services fold.

Closing

In closing Mr. Chairman, we unconditionally endorse Senator Bingaman's bill and stand ready to work with you in passing it expeditiously. As I have said previously while testifying before Congress, most people would be astounded to find that while their barber or manicurist is licensed, their preparer may not be. Comparing the downside of a bad hair cut to an incorrect tax return, it is time to establish federal standards to ensure basic competency and ethical behavior.

Whether due to the complexity of the Internal Revenue Code or due to a healthy fear of the IRS—or simply for convenience—a majority of taxpayers do seek professional assistance in filing their tax returns. It stands to reason that an ethical and competent tax preparer is a taxpayer's best and lowest cost insurance against IRS problems and the Service's best and lowest cost assurance of return compliance.

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[i] The **National Association of Enrolled Agents (NAEA)** is the professional society representing enrolled agents (EAs), which number some 46,000 nationwide. Its 11,000 members are licensed by the U.S. Department of the Treasury to represent taxpayers before all administrative levels of the IRS, including examination, collection, and appeals functions.

While the EA license was created in 1884 and has a long and storied past, today's EAs are the only tax professionals tested by IRS on their knowledge of tax law and regulations. EAs provide tax preparation, representation, tax planning, and other financial services to millions of individual and business taxpayers. EAs adhere to a code of ethics and professional conduct and are required by IRS to take Continuing Professional Education. Like attorneys and CPAs, EAs are governed by Treasury Circular 230 in their practice before the IRS.

Since its founding in 1972, NAEA has been the enrolled agents' primary advocate before Congress and the IRS. NAEA has affiliates and chapters in forty-two states. For additional information about NAEA, please go to our website at www.naea.org.