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.