

**WRITTEN STATEMENT OF
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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 RALs have largely been abolished in the last few years but have been replaced by pay-stub loans, Refund Anticipation Checks (RACs), and the like.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=W00BmbrlvHk&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/taxpreplic.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/preparervideo>.

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.

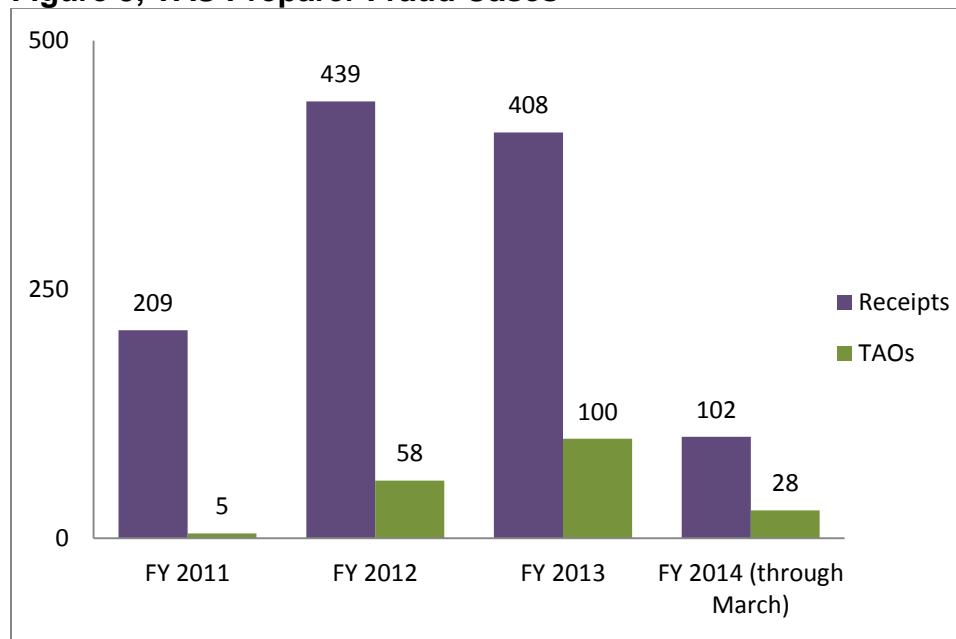
The Taxpayer Advocate Service started issuing Taxpayer Assistance Orders (TAOs)⁷⁰ on preparer fraud cases in 2010. One Local Taxpayer Advocate (LTA) office opened

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.