

**MSP
#7****RETURN PREPARER OVERSIGHT: The IRS Lacks a Coordinated Approach to Its Oversight of Return Preparers and Does Not Analyze the Impact of Penalties Imposed on Preparers****RESPONSIBLE OFFICIALS**

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TAXPAYER RIGHTS IMPACTED¹

- *The Right to Quality Service*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

The IRS is tasked with collecting taxes and administering the Internal Revenue Code (IRC). In calendar year 2018, the IRS processed over 150 million individual tax returns, with almost 80 million taxpayers relying on paid preparers.² More than half of these returns were submitted by return preparers who are unregulated by the IRS.³ Unenrolled preparers—those generally not subject to IRS regulation—account for over half of all preparers.⁴

It is a necessary part of the IRS's duties to ensure that preparers are competent and accountable, since return preparers play such a critical role in tax administration and ensuring tax compliance. The public needs a way to differentiate between professional, competent, and experienced preparers, and their incompetent or unscrupulous counterparts. The National Taxpayer Advocate has written extensively on the need to protect taxpayers from non-compliant return preparers.⁵

1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the Internal Revenue Code (IRC). See IRC § 7803(a)(3).

2 Compliance Data Warehouse (CDW), *Return Preparers and Providers database Preparer Tax Identification Number (PTIN) table and the Individual Return Transaction File (IRTF) Entity file* (data updated Sept. 30, 2018 for both databases).

3 *Id.*

4 *Id.*

5 See National Taxpayer Advocate 2015 Annual Report to Congress 261-283 (Most Serious Problem: *The IRS's EITC Return Preparer Strategy Does Not Adequately Address the Role of Preparers in EITC Noncompliance*); National Taxpayer Advocate 2013 Annual Report to Congress 61-74 (Most Serious Problem: *Taxpayers and Tax Administration Remains Vulnerable to Incompetent and Unscrupulous Return Preparers While the IRS Is Enjoined From Continuing Its Efforts to Effectively Regulate Unenrolled Preparers*); National Taxpayer Advocate 2009 Annual Report to Congress 41-69 (Most Serious Problem: *The IRS Lacks a Servicewide Return Preparer Strategy*); National Taxpayer Advocate 2006 Annual Report to Congress 197-221 (Most Serious Problem: *Oversight of Unenrolled Return Preparers*); National Taxpayer Advocate 2005 Annual Report to Congress 223-237 (Most Serious Problem: *Regulation of Electronic Return Originators*); National Taxpayer Advocate 2004 Annual Report to Congress 67-88 (Most Serious Problem: *Oversight of Unenrolled Return Preparers*); National Taxpayer Advocate 2003 Annual Report to Congress 270-301 (Legislative Recommendation: *Federal Tax Return Preparers: Oversight and Compliance*); National Taxpayer Advocate 2002 Annual Report to Congress 216-230 (Legislative Recommendation: *Regulation of Federal Tax Return Preparers*).

The case for IRS oversight of the return preparation industry is clear. When an attorney is hired, there is some level of confidence that the attorney is competent. One could verify that the attorney has passed a bar exam and meets the continuing legal education and professional responsibility requirements of his or her state's bar association. When one visits a hair salon, the hair stylist will have a certificate displayed, which attests to the fact that the stylist has undergone the training necessary to obtain the license. In contrast, there is no such guarantee that an unenrolled tax return preparer has passed any exam, continues to engage in ongoing education, or meets any other minimum standard of competency to prepare federal tax returns.

If anyone can hang out a shingle as a “tax return preparer” with no minimum competency requirements or oversight, problems with return accuracy will abound. The Government Accountability Office (GAO) confirmed this by having its auditors pose as taxpayers visiting tax return preparation chains (which had a minimum of ten locations). Only two out of the 19 randomly selected preparers calculated the correct amount of refund in a GAO study.⁶ The National Consumer Law Center has conducted similar “mystery shopper visits” with similar results.⁷

The IRS had started to implement a program to impose minimum competency requirements on the unenrolled tax preparation profession. However, in 2013, the District Court for the District of Columbia enjoined the IRS from regulating tax return preparers via testing and continuing education requirements.⁸ In 2014, the U.S. Court of Appeals for the District of Columbia upheld the decision, meaning that the IRS will need to fulfill its oversight responsibility within the confines of the current law.

Even with the courts enjoining the IRS from testing and certifying tax return preparers, the National Taxpayer Advocate believes that the IRS still has a vital role to play in protecting taxpayers' *rights to quality service* and *to a fair and just tax system*. The court decision does not absolve the IRS of the responsibility to protect taxpayers.

Specifically, the IRS should:

- Establish a truly cross-functional team to develop and communicate a coordinated strategy to effectively provide oversight of return preparers;
- Conduct in-depth analysis of the impact of penalty assessments on preparers' behavior in subsequent years, and publish the findings;
- Assert a more active role in the voluntary certification process, including designing an examination and developing training materials; and
- Ensure that any references to the directory of Federal Tax Return Preparers are not misleading.

6 Government Accountability Office (GAO), GAO-14-467T, *PAID TAX RETURN PREPARERS: In a Limited Study, Preparers Made Significant Errors* (Apr. 8, 2014).

7 See National Consumer Law Center (NCLC), *Riddled Returns: How Errors and Fraud by Paid Tax Preparers Put Consumers at Risk and What States Can Do* (Mar. 2014), www.nclc.org/images/pdf/pr-reports/report-riddled-returns.pdf.

8 *Loving v. Internal Revenue Service*, 917 F. Supp. 2d 67 (D.D.C. 2018), *aff'd*, 742 F.3d 1013 (D.C. Cir. 2014).

ANALYSIS OF PROBLEM

Background

There are several types of tax return preparers. Attorneys, Certified Public Accountants (CPAs), and Enrolled Agents (EAs) have passed examinations to demonstrate their knowledge and proficiency. Furthermore, they must comply with applicable continuing education requirements for their jurisdiction. These tax professionals have unlimited representation rights before the IRS and may represent their clients on any matters including examinations, collection issues, and appeals.

Unenrolled preparers are individuals other than an attorney, CPA, EA, enrolled retirement plan agent, or enrolled actuary who prepares and signs a taxpayer's return as the paid preparer (or who prepares a return but is not required to sign the return). For tax returns filed after December 31, 2015, unenrolled preparers who have completed the IRS's Annual Filing Season Program (AFSP)⁹ for both the year the tax return was filed *and* for the year(s) in which the representation occurs, have limited representation rights.¹⁰ They may represent clients whose returns they have prepared, but only before Revenue Agents, Customer Service Representatives, and similar IRS employees; they may not represent clients before Appeals or Collections officers.¹¹

Unenrolled preparers who have not received the AFSP Record of Completion do not have the right to represent taxpayers. If the unenrolled preparer checked the box as a third party designee on the Form 1040, the preparer may speak to the IRS to provide more information about an item on the tax return, but may not execute closing agreements, extend the statutory period for tax assessments or collection of tax, execute waivers, or sign any document on behalf of a taxpayer.¹²

Anyone who prepares federal tax returns for compensation is required to have a valid preparer tax identification number (PTIN).¹³ Tax preparers are required to include their PTIN on and sign any returns they prepare. However, some "ghost" tax preparers file tax returns on their clients' behalf without any indication that the taxpayer used a paid tax preparer to complete the return.

Figure 1.7.1 shows the number of individual tax returns prepared for tax year (TY) 2017 by type of preparer. Unenrolled preparers (including those who completed the voluntary AFSP) account for more than half of the nearly 77 million individual tax returns prepared by a preparer.

9 The Annual Filing Season Program is a voluntary program designed to encourage non-credentialed tax return preparers to participate in continuing education courses. To obtain an Annual Filing Season Program Record of Completion, a return preparer must obtain 18 hours of continuing education (including a six-credit hour Annual Federal Tax Refresher course that covers filing season issues and tax law updates) from an IRS-approved continuing education provider. In addition to completing the appropriate continuing education courses, the return preparer must also renew his or her preparer tax identification number (PTIN) for the upcoming year. IRS, *Frequently Asked Questions: Annual Filing Season Program*, <https://www.irs.gov/tax-professionals/frequently-asked-questions-annual-filing-season-program> (last visited Dec. 6, 2018).

10 Rev. Proc. 2014-42, *Annual Filing Season Program* § 6, 2014-29 I.R.B. 192 (2014).

11 See Internal Revenue Manual (IRM) 21.3.7.5.6(3), *Unenrolled Return Preparer (Level H) Representative Research, Rejections and Processing* (Sept. 13, 2017).

12 See Instructions to 2018 Form 1040 (Dec. 10, 2018); IRS Pub. 947, *Practice Before the IRS and Power of Attorney 4* (Rev. Feb. 2018).

13 See Treas. Reg. § 1.6109-2.

FIGURE 1.7.1, Volume of Tax Year 2017 Individual Tax Returns by Preparer Type¹⁴

	Number of Returns								
	Form 1040	Form 1040 with Schedule C	Form 1040A	Form 1040EZ	Form 1040 A/EZ with Schedule EIC	Form 1040 with Schedules C & EIC	Form 1040 with Schedule F	Form 1040 with Schedules F & EIC	Total
Unenrolled Preparer (Unenrolled Prep)	16,634,128	4,456,328	4,480,376	3,260,274	6,949,731	3,035,224	391,237	45,492	39,252,790
Attorney (ATTY)	589,182	180,644	44,916	27,869	31,529	20,109	32,312	2,401	928,962
Certified Acceptance Agent (CAA)	202,595	70,389	67,025	45,944	79,889	44,393	1,868	207	512,310
Certified Public Accountant (CPA)	14,784,869	5,010,256	698,486	486,295	671,680	549,718	601,204	35,088	22,837,596
Enrolled Agent (EA)	5,273,359	1,546,780	863,847	547,327	733,998	382,294	149,137	13,257	9,509,999
Enrolled Actuary	5,688	2,210	1,203	1,063	2,320	2,003	82	8	14,577
Enrolled Retirement Plan Agent (ERPA)	357	104	87	31	167	30	-	1	777
State Regulated Tax Preparer (SRTP)	1,736,864	500,310	404,694	244,619	506,970	255,470	9,080	964	3,658,971
Total	39,227,042	11,767,021	6,560,634	4,613,422	8,976,284	4,289,241	1,184,920	97,418	76,715,982

A recent poll conducted by the Consumer Federation of America indicates strong support for reform of the tax preparer industry. Eighty-six percent of respondents support the requirement that paid tax preparers pass a competency test. Sixty-eight percent of respondents believe that either the federal government or their state government should require paid tax preparers to be licensed.¹⁵ Only seven states (California, Connecticut, Illinois, Maryland, Nevada, New York, and Oregon) currently impose minimum competency standards for unenrolled preparers.¹⁶

Legal Framework

On January 18, 2013, the U.S. District Court for D.C. enjoined the IRS from enforcing regulatory requirements for registered tax return preparers.¹⁷ As a result of this decision in *Loving vs. Internal Revenue Service*, the IRS is not able to mandate that unenrolled tax return preparers complete competency testing or secure continuing education. (This holding does not apply to attorneys, CPAs, or EAs, who are already subject to continuing education requirements imposed by their licensing agencies.)

The *Loving* decision was upheld by the U.S. Court of Appeals for the District of Columbia Circuit on February 11, 2014. The IRS has not further appealed the decision to the Supreme Court. Various bills

14 CDW, *Return Preparers and Providers database PTIN table and the IRTF Entity file* (data updated Sept. 30, 2018 for both databases).

15 See Consumer Federation of America, *Second National Poll Indicates Strong Support for Reform of Paid Tax Preparer Industry* (Mar. 22, 2017), <https://www.nclc.org/images/pdf/taxes/pr-paid-tax-preparer-industry.pdf>.

16 Don't Mess with Taxes, *Seven States that Regulate Paid Tax Preparers* (July 11, 2018), <https://www.dontmesswithtaxes.com/2018/07/7-states-that-regulate-paid-tax-preparers.html>.

17 *Loving v. Internal Revenue Service*, 917 F. Supp. 2d 67 (D.D.C. 2018), *aff'd*, 742 F.3d 1013 (D.C. Cir. 2014).

have been proposed that would require tax return preparers to take a competency exam, attend continuing education classes, and submit to a background check.¹⁸ However, Congress has not enacted any.

The IRS Should Establish a Truly Cross-Functional Team to Develop and Communicate a Coordinated Strategy to Effectively Provide Oversight of Return Preparers

Although the IRS unilaterally cannot mandate return preparers pass competency tests or undergo continuing education, there is still a need for the IRS to provide a certain level of oversight. Taxpayers need to feel confident that they can rely on return preparers. Rather than designating one centralized Commissioner-level office to coordinate oversight of return preparers, the IRS has spread this responsibility over multiple offices across several organizations.

The Return Preparer Office (RPO) oversees preparer registration and renewal programs, is engaged in general outreach and education, and administers the Annual Filing Season Program. The RPO does not engage in disciplinary proceedings related to return preparers.

The Office of Professional Responsibility (OPR) was established as the governing body responsible for interpreting and applying Treasury Department Circular 230, *Regulations Governing Practice before the Internal Revenue Service*. OPR's stated mission is to "interpret and apply the standards of practice for tax professionals in a fair and equitable manner," and its goals include increasing awareness of the Circular 230 standards of practice through outreach activities, as well as investigating cases where practitioners have run afoul of Circular 230. Attorneys, CPAs, and EAs are among the tax professionals subject to Circular 230. OPR lacks the authority to provide oversight of non-Circular 230 practitioners; however, participants in the AFSP must consent to the Circular 230 obligations. The OPR may take disciplinary action (including against unenrolled agents who have obtained limited representation rights by virtue of completing the AFSP) who are involved in "disreputable conduct."¹⁹

The Wage and Investment (W&I) division's Return Integrity and Compliance Services (RICS) function has developed a Refundable Credits Return Preparer Strategy Guide and Procedures. RICS acknowledges that refundable credit noncompliance among return preparers is problematic for the IRS. For example, more than three-quarters of returns allowed in processing the earned income tax credit (EITC) are prepared by unenrolled preparers.²⁰ Accordingly, W&I's strategy to prevent and reduce improper payments of refundable credits includes strengthening relationships with return preparers, educating them about the credits, and enforcing the preparer due diligence requirements.²¹

18 See Protecting Taxpayers Act, S. 3278, 115th Cong. (referred to S. Comm. on Finance July 26, 2018); Tax Return Preparer Competency Act, H.R. 4141, 114th Cong. (referred to the H. Comm. on Ways and Means Dec. 1, 2015).

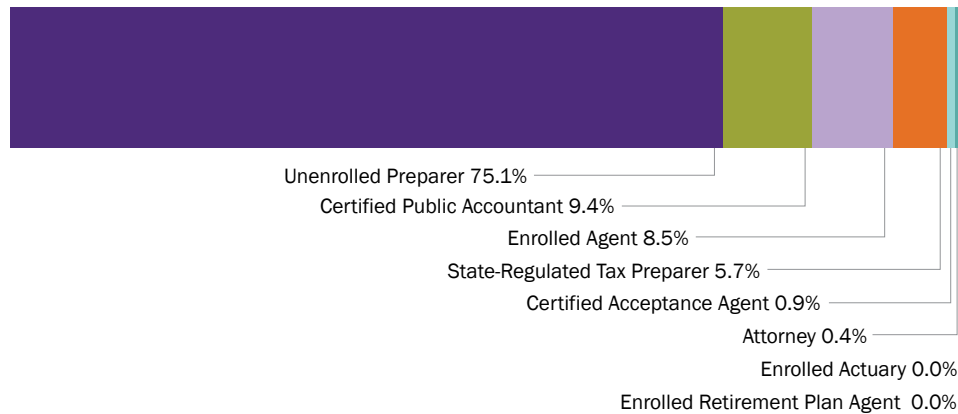
19 IRS Pub. 947, *Practice Before the IRS and Power of Attorney 4*, 7 (Rev. Feb. 2018).

20 CDW, *Return Preparers and Providers database PTIN table and the IRTF Entity file* (data updated Sept. 30, 2018, for both databases).

21 See National Taxpayer Advocate 2015 Annual Report to Congress 261-283 (Most Serious Problem: *The IRS's EITC Return Preparer Strategy Does Not Adequately Address the Role of Preparers in EITC Noncompliance*). The preparer due diligence requirements are set forth in Treas. Reg. 1.6695-2. A preparer must (1) complete and submit Form 8867, (2) use worksheets or other method to compute credits, (3) have no knowledge that any information used by the preparer is incorrect, and (4) retain records. See below for additional discussion about preparer penalties.

FIGURE 1.7.2²²

Earned Income Tax Credit Returns Filed by Profession (Tax Year 2018)



Small Business and Self-Employed (SB/SE) oversees the Return Preparer Program (RPP). Under the RPP, the IRS can open program action cases (PACs), which are “preparer investigations where clients of questionable preparers are examined to determine whether preparer penalties and/or injunctive actions against the preparers are warranted.”²³

The Criminal Investigation (CI) division administers an Abusive Return Preparer Program. Under this program, CI pursues return preparers for criminal offenses related to the preparation and filing of false income tax returns. Corrupt return preparers who claim inflated personal or business expenses, false deductions, excessive exemptions, or unallowable tax credits may be referred to the Department of Justice for injunctions from preparing taxes, or even criminal sanctions.²⁴

There is a risk that the IRS is not achieving effective oversight with so many different offices and programs in place to oversee return preparers. The IRS’s internal procedures reference a “National Headquarters Return Preparer Strategy,” but no further information about such a strategy is contained in the Internal Revenue Manual (IRM).²⁵ The SB/SE Examination Program Letter for fiscal year 2018 contained a goal to develop a servicewide return preparer strategy.²⁶

22 CDW, *Return Preparers and Providers database PTIN table and the IRTF Entity file* (data updated Sept. 30, 2018, for both databases).

23 IRM 4.1.10.3, *Program Action Cases Overview (PAC)* (Jan. 14, 2011).

24 IRS, *Criminal Investigation 2018 Annual Report* 9. In fiscal year (FY) 2018, there were 224 investigations initiated from the Abusive Return Preparer Program, with 170 indictments (148 of which received sentencing). IRS, *Criminal Investigation 2018 Annual Report* 124.

25 See IRM 4.1.1.6.20.1, *Return Preparer Coordinator (RPC)* (Oct. 25, 2017) (“The area Return Preparer Coordinator (RPC) will be responsible for planning and coordinating the implementation of area and National Headquarters Return Preparer Strategy.”); IRM 4.1.10.1, *Overview of the Return Preparer Program* (Jan. 14, 2011) (“The Area Return Preparer Coordinator (RPC) will be responsible for planning and coordinating the implementation of the Area and the National Headquarters Return Preparer Strategy.”).

26 Small Business/Self-Employed (SB/SE), *FY 2018 SB/SE Examination Program Letter* 7 (“Exam will lead a collaborative effort involving multiple compliance organizations (e.g., Wage & Investment (W&I), CI, Return Preparer Office (RPO)) to develop a comprehensive, Servicewide strategy incorporating the full range of educational, civil and criminal enforcement and judicial actions to ensure we use our limited resources in the most efficient and effective manner to address preparer non-compliance.”).

In May 2018, the IRS convened a cross-functional team tasked with developing a coordinated servicewide return preparer strategy.²⁷ The cross-functional team included representatives from SB/SE (Exam and Collection), Communications, Criminal Investigation, Research, Applied Analytics, and Statistics, W&I, Governmental Liaison, Large Business and International, Return Preparer Office, Office of Professional Responsibility, SB/SE Research, Office of Servicewide Penalties, and Chief Counsel. TAS was not invited to participate on this team. To make this a truly cross-functional team, the National Taxpayer Advocate believes that representatives from TAS, the voice of the taxpayer inside the IRS, must be included.

In developing the return preparer strategy, this team should take on a tiered approach. Rather than immediately resorting to penalties and sanctions, the team should consider the impact of education and soft notices on preparers. The IRS has some efforts with respect to soft notices, but the work is not coordinated or strategically planned.²⁸ If the IRS does not currently have good data on this, the team should work with the Research function to gather the data needed. The team is still conducting analysis; to date, no recommendations have been made.²⁹

Once the IRS has developed a coordinated return preparer strategy, the next challenge is to figure out the best way to spread this message. For populations where taxpayers are especially vulnerable to unscrupulous and opportunistic preparers, the IRS needs to ensure its strategy is communicated. The IRS will need to take a multi-faceted approach, working with partners such as the Volunteer Income Tax Assistance sites and the Low Income Taxpayer Clinics, with consumer rights groups, and with local churches and other community groups. IRS employees need to be on the ground in these communities, partnering with the various groups listed above. In addition, the IRS can explore developing creative public service announcements for TV and radio, as well as tapping into non-traditional social media outlets.³⁰ The Nationwide Tax Forums could be one way to communicate the strategy, but there is much more the IRS may do to reach unenrolled preparers.

The IRS Should Conduct In-Depth Analysis on the Impact of Penalty Assessments on Preparers' Behavior in Subsequent Years, and Publish the Findings

The tax code provides for several different types of preparer penalties. Section 6694 imposes two types of penalties for understatement of taxpayer's liability by tax return preparer:

- Understatement due to **unreasonable position** (IRC § 6694(a)); penalty is the greater of \$1,000 or 50 percent of the income derived by the preparer with respect to the return or claim for refund.
- Understatement due to **willful or reckless conduct** (IRC § 6694(b)); penalty is the greater of \$5,000 or 50 percent of the income derived by the preparer with respect to the return or claim for refund.

27 IRS response to TAS information request (Nov. 29, 2018).

28 For a more detailed discussion, see National Taxpayer Advocate 2016 Annual Report to Congress 261-283 (Most Serious Problem: *The IRS's EITC Return Preparer Strategy Does Not Adequately Address the Role of Preparers in EITC Noncompliance*).

29 IRS response to TAS information request (Nov. 29, 2018).

30 See National Taxpayer Advocate 2016 Annual Report to Congress 261-283 (Most Serious Problem: *The IRS's EITC Return Preparer Strategy Does Not Adequately Address the Role of Preparers in EITC Noncompliance*) for some specific recommendations on conducting effective outreach for the IRS's EITC return preparer strategy.

Section 6695 imposes a host of other assessable penalties with respect to the preparation of tax returns, including:

- Failure to furnish copy to taxpayer (IRC § 6695(a));
- Failure to sign return (IRC § 6695(b));
- Failure to furnish identification number (IRC § 6695(c));
- Failure to retain copy or list (IRC § 6695(d)); and
- Failure to comply with due diligence requirements with respect to eligibility for the EITC (IRC § 6695(g)).

FIGURE 1.7.3, IRC §§ 6694 and 6695 Penalties Assessed (FYs 2015–2018)³¹

	FY 2015	FY 2016	FY 2017	FY 2018
Number of IRC §§ 6694 and 6695 Penalties Assessed	3,624	2,582	2,107	2,292

As Figure 1.7.3 shows, the IRS has assessed penalties for preparer misconduct very sparingly, considering that the GAO found errors in returns filed by 17 of 19 paid preparers in its limited sample, and estimated that tax returns filed by paid preparers had a 60 percent error rate.³² A recent report issued by the Treasury Inspector General for Tax Administration (TIGTA) found that just 15 percent of referrals to a return preparer coordinator resulted in a PAC investigation, and 41 percent of PAC investigations were closed without penalty assessments.³³ The IRM provides a list of factors that should be considered when determining if a PAC investigation should be opened.³⁴ Even in situations where the IRS determines that a PAC is not warranted, the IRS should consider whether there is value in sending out a letter. An example of using a soft touch to influence behavior is the issuance of a letter notifying a preparer that a complaint has been received.

The goal of W&I's Refundable Credits Return Preparer Strategy is to reduce overclaims of EITC and other refundable credits through education and compliance treatments. One of the treatment streams consists of auditing paid preparers who claim EITC and other credits for compliance with their IRC § 6695(g) due diligence requirements.³⁵

31 CDW, *IMF Transaction History File* (data compiled Dec. 2018). This included assessments from Master File Tax (MFT) 13 and MFT 55.

32 GAO, GAO-14-467T, *Paid Tax Return Preparers: In a Limited Study, Preparers Made Significant Errors* 9 (Apr. 8, 2014).

33 Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2018-30-042, *The Internal Revenue Service Lacks a Coordinated Strategy to Address Unregulated Return Preparer Misconduct* 11 (July 25, 2018).

34 Factors for consideration of Program Action Case (PAC) action include, but are not limited to:

- ◆ The egregious nature of the questionable conduct—*i.e.*, does the preparer engage in a widespread practice of making material errors and/or demonstrate intentional misconduct.
- ◆ The number of client taxpayers affected by the preparer's conduct.
- ◆ The available resources of the examination groups receiving the PAC examinations.
- ◆ The type(s) of returns involved (*i.e.*, 1040) and the tax years available.
- ◆ The dollar amounts and materiality of potential adjustments.
- ◆ Prior compliance activities — *i.e.* preparer penalties previously asserted, Earned Income Tax Credit (EITC)/Electronic Return Originator (ERO) visitations, and/or RPO compliance letters.

IRM 4.1.10.3.2, *PAC Development Factors* (Dec. 13, 2016).

35 IRS response to TAS information request (Aug. 13, 2018).

FIGURE 1.7.4, IRC § 6695(g) Due Diligence Audits³⁶

FY	Audits Assigned	Surveyed	Discontinued	No Change	Penalties Proposed
2014	747	0 (0%)	21 (3%)	130 (17%)	596 (80%)
2015	1,001	0 (0%)	46 (5%)	145 (14%)	810 (81%)
2016	1,180	8 (1%)	47 (4%)	203 (17%)	922 (78%)
2017	787	0 (0%)	24 (3%)	119 (15%)	644 (82%)
2018	803	0 (0%)	27 (3%)	122 (15%)	654 (81%)

SB/SE conducts these due diligence audits (also known as “site visits”) before and during the filing season. During a due diligence audit, the examiner will interview the preparer and review at least 25 returns, looking at the preparer’s due diligence records, checklists, worksheets, copies of client provided documents, etc.³⁷ Preparers can face a penalty of \$500 (indexed for inflation) for failing to meet the due diligence requirements. Interestingly, the IRS reports that 96 percent of its due diligence audits are conducted on unenrolled agents.³⁸

In theory, consistent assessment of such penalties will help encourage accountability and change behavior.³⁹ After the IRS has assessed penalties against a preparer, it should track the impact on subsequent behavior by reviewing tax returns filed by preparers who have been assessed penalties, and publish the findings. TAS research studies have demonstrated no change audits result in *decreased* compliance in future years; the no change rates of preparer due diligence audits shown above raise similar concerns.⁴⁰

The IRS has not had great success in collecting the penalties assessed. Part of the problem is that these liabilities are processed just like any other taxpayer liability within the Collection function. In the past, the Collection Program Letter prioritized the collection of preparer penalties. However, the collection of these penalties is no longer included as a priority.⁴¹ As a result of limited IRS resources and the low prioritization by Collection in actively working preparer penalty assessments, TIGTA noted that the IRS collected just 15 percent of the penalties assessed against individual return preparers from calendar year (CY) 2012 to CY 2015.⁴²

36 EITC Preparer Treatment Delivery Tool (Dec. 12, 2018). The actual audits are conducted by SB/SE.

37 IRS, *Auditing for Due Diligence Compliance*, <https://www.eitc.irs.gov/tax-preparer-toolkit/preparer-compliance-focused-and-tiered/auditing-for-due-diligence-compliance> (last visited Dec. 6, 2018).

38 IRS response to TAS information request (Aug. 2, 2018).

39 Although there is scholarly debate on how much of a deterrent effect penalties actually have on tax compliance. See Michael Doran, *Tax Penalties and Tax Compliance*, 46 HARV. J. ON LEGIS. 111-161 (2009). See also Research Study: *Do Taxpayers Respond to the Substantial Understatement Penalty? Analysis of Bunching Below the Substantial Understatement Penalty Threshold*, *infra*.

40 Erik Hoelzl, Erich Kirchler, and Ingrid Wahl, *Enforced Versus Voluntary Tax Compliance: The “Slippery Slope” Framework*, 29 J. ECON. PSYCHOL. 218-219 (2008).

41 The FY 2013, FY 2014, and FY 2015 Program Letters for Collection included the collection of tax return preparer penalties as a priority. The FY 2016 and FY 2017 Program Letters did not list collection of tax return preparer penalties as a priority.

42 TIGTA, Ref. No. 2018-30-042, *The Internal Revenue Service Lacks a Coordinated Strategy to Address Unregulated Return Preparer Misconduct* 15 (July 25, 2018).

As a result of limited IRS resources and the low prioritization by Collection in actively working preparer penalty assessments, Treasury Inspector General for Tax Administration (TIGTA) noted that the IRS collected just 15 percent of the penalties assessed against individual return preparers from calendar year (CY) 2012 to CY 2015.

In addition to assessing penalties for preparer misconduct, the IRS may apply sanctions against unscrupulous preparers. The Secretary of the Treasury may (after notice and opportunity for a proceeding) suspend, disbar from practice, or censure representatives who are incompetent, are disreputable, violate regulations, or willfully and knowingly mislead or threaten the person being represented (or a prospective person to be represented).⁴³ In the first six months of CY 2018, the IRS reported only one disbarment, 34 suspensions, and zero censures.⁴⁴

FIGURE 1.7.5, OPR Disciplinary Actions, CY 2015 to CY 2018 (through June)⁴⁵

	CY 2015	CY 2016	CY 2017	CY 2018 (through June)
Disbarment	2	2	1	1
Suspension	61	57	46	34
Censure	0	3	1	0
Total OPR Case Receipts	905	894	2,018	2,018

In extreme cases, return preparers (enrolled or unenrolled) may be enjoined from preparing tax returns. Such a process requires coordination between SB/SE Exam, CI, IRS Office of Chief Counsel, and the Department of Justice.⁴⁶ Perhaps because an injunction against a return preparer requires a great deal of coordination, the IRS rarely imposes such sanctions.⁴⁷

The IRS Should Assert a More Active Role in the Voluntary Certification Process, Including Designing an Examination and Developing Training Materials

While it is true that the courts have enjoined the IRS from requiring testing and certification of tax return preparers, the IRS still has the responsibility to protect taxpayers.

As discussed above, the IRS already administers the AFSP, the voluntary certification program for unenrolled preparers. Currently, the IRS does not administer the knowledge-based comprehension test that participants must pass to obtain the AFSP Record of Completion. Rather, participants are referred

43 31 U.S.C. § 330.

44 Note that the Office of Professional Responsibility has oversight responsibility over Circular 230 tax professionals; it does not have jurisdiction over unenrolled preparers.

45 IRS, *OPR's Case Dispositions*, <https://www.irs.gov/tax-professionals/oprs-case-dispositions> (last visited Dec. 21, 2018).

46 IRM 4.32.2.2, *Overview of Abusive Transactions (AT) Program* (June 4, 2018); IRM 4.32.2.3, *Abusive Transactions Defined* (June 4, 2018).

47 In calendar year 2016, only 70 preparers were enjoined from preparing returns. TIGTA, Ref. No. 2018-30-042, *The Internal Revenue Service Lacks a Coordinated Strategy to Address Unregulated Return Preparer Misconduct* 16 (July 25, 2018).

to a list of continuing education providers who are responsible for the development and administration of the comprehension test. However, the National Taxpayer Advocate believes that because it owns this program, the IRS and the IRS alone should design the test that is administered to program participants.⁴⁸ This would ensure that the content covers the issues the IRS finds to be problematic.

One idea the IRS can consider as it develops its overall return preparer strategy is to tie in continuing education training to the abatement of preparer penalties. For example, if an unenrolled preparer is assessed a \$500 penalty at the conclusion of a due diligence audit, the IRS may be able to encourage that preparer to take a voluntary continuing education course by offering to abate all or a portion of the penalty upon passing the test.

The IRS Should Ensure that Any References to the Directory of Federal Tax Return Preparers Are Not Misleading

The IRS maintains a public directory of federal tax return preparers to help taxpayers find return preparers with certain credentials and qualifications. This searchable and sortable database includes the name, city, state, and ZIP Code of preparers with valid PTINs—including attorneys, CPAs, EAs, enrolled retirement plan agents, and enrolled actuaries. The database also includes a list of participants who have completed the AFSP for that year.

While this database can be helpful to taxpayers, the IRS should be cautious in how it references the Directory of Federal Tax Return Preparers in its communication with taxpayers. For example, in the Appeals Letter 3808, *Docketed Acknowledgment and Conference (to Petitioner)*, taxpayers are referred to the Directory of Federal Tax Return Preparers, although (1) many return preparers listed in the directory may not be authorized to represent taxpayers (if they are not attorneys, CPAs, or EAs), and (2) even a registered return preparer (*i.e.*, one who participates in the AFSP) who prepared and signed the taxpayer's return may only be authorized under Circular 230 to provide limited representation with regard to an examination of that return and are specifically prohibited from otherwise representing the taxpayer.⁴⁹ It is misleading and potentially harmful for the IRS to reference the Directory of Federal Tax Return Preparers without adequately explaining the potential limited representation authorities of such preparers.

Although the IRS is prohibited from requiring unregulated preparers to undergo testing, this does not mean that preparers cannot obtain certification voluntarily, as a way of differentiating themselves from their competition. The IRS can lead the effort in the development and review of training material used by third-party certification programs.

48 Continuing education providers could continue to administer the test, and the IRS can partner with these providers in designing the test, but the IRS alone should direct and design the content.

49 IRS, Circular 230, §10.3(f).

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Invite representatives from TAS to the cross-functional team that was established to develop a coordinated strategy to provide effective oversight of return preparers.
2. Develop a comprehensive plan to communicate the coordinated return preparer strategy to Circular 230 preparers and unenrolled preparers.
3. Develop a community-based, grassroots communication strategy for educating vulnerable taxpayer populations about how to select a competent return preparer and the risk of return preparer fraud.
4. Conduct analysis on the impact of penalty assessments and no change audits on preparers' behavior in subsequent years, and publish the findings.
5. Revise letters and notices (including Appeals Letter 3808) that reference the Directory of Federal Tax Return Preparers to ensure that appropriate caveats are clearly articulated.