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#5****REGULATION OF RETURN PREPARERS: Taxpayers and Tax Administration Remain Vulnerable to Incompetent and Unscrupulous Return Preparers While the IRS Is Enjoined From Continuing its Efforts to Effectively Regulate Unenrolled Preparers****RESPONSIBLE OFFICIAL**

John Koskinen, Commissioner of Internal Revenue

**DEFINITION OF PROBLEM**

The IRS collects more than 90 percent of all federal revenue (\$2.52 trillion in fiscal year 2012), with the largest portion coming from the individual income tax.<sup>1</sup> For tax year (TY) 2011, taxpayers filed about 142 million 1040-series individual returns,<sup>2</sup> with nearly 79 million taxpayers using paid preparers.<sup>3</sup> More than half (over 42 million) of these returns were prepared by preparers who are unregulated by the IRS.<sup>4</sup>

As preparers play a critical role in tax administration, it is essential that the IRS ensure that they are competent, visible, and accountable. In fact, the IRS was recently implementing a program to impose minimum competency requirements on the tax preparation profession. However, in *Loving v. Internal Revenue Service*, the District Court for the District of Columbia enjoined the IRS from further enforcing the testing and continuing education components of the program.<sup>5</sup> Thus, unless the District Court's ruling is overturned on appeal, U.S. taxpayers will continue to find themselves without meaningful IRS oversight of preparers, where anyone can hang out a shingle as a "tax return preparer" with no knowledge or experience required.

The case for IRS oversight over the return preparation industry is clear. Problems with return accuracy and ethical standards were substantiated by a series of "shopping visits" the Government Accountability Office (GAO) and the Treasury Inspector General for Tax Administration (TIGTA) conducted, where auditors posed as taxpayers and visited tax return preparation businesses.<sup>6</sup> Accordingly, the National

1 2012 IRS Data Book, at 3 (Mar. 25, 2013) (Doc 2013-7103); Table 1, col 2; Department of Treasury, *Budget in Brief: Internal Revenue Service FY 2014* 1.

2 The TY 2011 returns were prepared in 2012. For TY 2011, the IRS received 142,424,022 individual income tax returns. IRS Compliance Data Warehouse, Individual Returns Transaction File, TY 2011 (filed through Mar. 2013).

3 IRS Compliance Data Warehouse, Individual Returns Transaction File and Return Preparers and Providers Database, TY 2011 (filed through Mar. 2013).

4 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 (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 2011 (filed through Mar. 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.

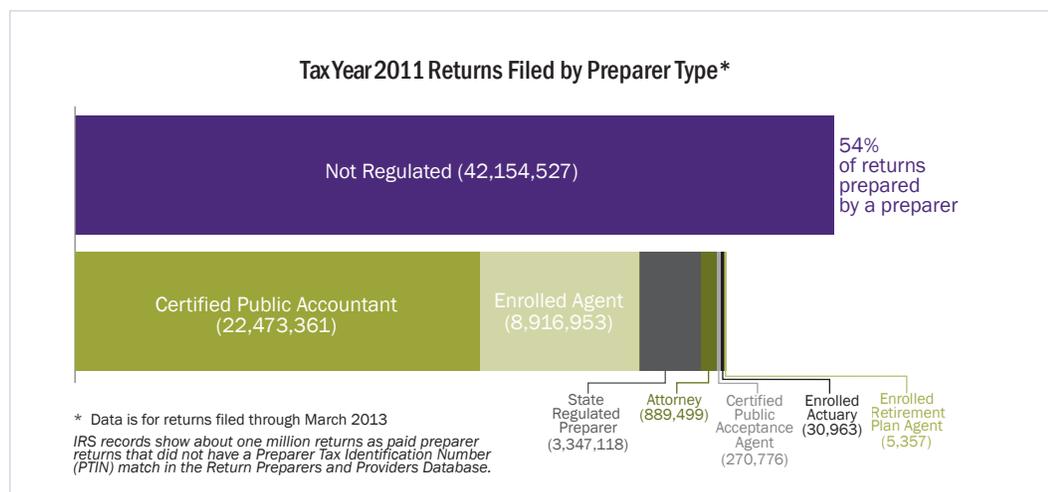
5 111 A.F.T.R.2d (RIA) 589 (D.D.C. Jan. 18, 2013).

6 Government Accountability Office, 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); Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2008-40-171, *Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors* (Sept. 3, 2008).

Taxpayer Advocate continues to recommend that the IRS establish minimum standards for return preparers as an essential consumer protection measure. Minimum standards would also improve professionalism and reduce preparer-facilitated noncompliance.<sup>7</sup>

While the question of regulatory authority is ultimately up to the courts to decide, the IRS has the responsibility to protect taxpayers by pursuing education and enforcement options that are undeniably within its purview. In the event that the courts decide that the IRS does not have authority to impose testing and continuing education requirements on preparers, the National Taxpayer Advocate urges the IRS to implement the following six-part strategy to protect taxpayers from preparer incompetence and misconduct:

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, *U.S. Individual Income Tax Return*.
4. Mount a consumer protection campaign to educate taxpayers about the need to select competent preparers who can demonstrate competency.
5. Develop a research-driven, Servicewide preparer compliance strategy similar in nature to the Earned Income Tax Credit (EITC) preparer compliance strategy.
6. Recommend that Congress revise 31 U.S.C. § 330(a)(2) to clarify that the IRS has the authority to regulate unenrolled preparers.



<sup>7</sup> By statute, the IRS cannot require attorneys and accountants to pass the competency exam or satisfy continuing education requirements to prepare returns. 5 U.S.C §§ 500(b) & (c) grant attorneys and certified public accountants, respectively, the authority to represent clients before federal agencies (upon submitting a written declaration stating that he or she is currently qualified).

## ANALYSIS OF PROBLEM

### Background

#### *The National Taxpayer Advocate Has Long Proposed a Program to Regulate Return Preparers*

Since 2002, the National Taxpayer Advocate has advocated for a system to regulate return preparers. Her proposals included a program to register, test, and certify unenrolled preparers, as well as increased preparer penalties and improved due diligence requirements. The National Taxpayer Advocate has 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.<sup>8</sup>

The National Taxpayer Advocate's recommendations to regulate the return preparer profession received widespread support. Most organizations representing established preparers supported her call for minimum industry standards. For example, in 2005 the House Ways and Means Subcommittee on Oversight held a hearing at which representatives of five outside organizations testified in support of regulating return preparers.<sup>9</sup> Preparer oversight has received similarly broad support from members of Congress. The Senate Finance Committee has twice approved legislation to regulate federal tax return preparers (once under Democratic and once under Republican control).<sup>10</sup> The full Senate also once approved similar legislation.<sup>11</sup> However, the House of Representatives never took up companion measures. More recently, several bills included proposals to regulate preparers — 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.<sup>12</sup> All of these bills would have required preparers to have the knowledge and skills to prepare accurate returns.<sup>13</sup>

#### *IRS Implements Return Preparer Strategy*

In January 2010, the IRS published a study of federal tax return preparers that in most important aspects reflected the proposals made by the National Taxpayer Advocate.<sup>14</sup> 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).<sup>15</sup> The IRS also required certain preparers to meet testing and continuing education standards.<sup>16</sup> Implementation began with the 2011 filing season, when the IRS required paid return preparers to obtain PTINs.<sup>17</sup> The IRS launched the registered tax return preparer competency test in November

8 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 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).

9 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 & Means*, 109th Cong. (2005).

10 H.R. 1528 (incorporating S. 882) (108th Cong.); S. 1321 (incorporating S. 832) (109th Cong.).

11 H.R. 1528 (incorporating S. 882) (108th Cong.).

12 S. 1219, § 4, 110th Cong. (2007); H.R. 5716, § 4, 110th Cong. (2008); S. 3215, §202. 111th Cong. (2010).

13 See also 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).

14 IRS Publication 4832, Return Preparer Review (Dec. 2009).

15 Treas. Reg. § 1.6109-2(d).

16 31 C.F.R. §§ 10.4(c) (testing) and 10.6(e) (continuing education).

17 See IRS News Release, IR-2010-106, *IRS Begins Notifying Tax Return Preparers on PTIN Renewals* (Oct. 25, 2010).

2011 with a deadline to take the test by December 31, 2013. The continuing education requirement began during the 2012 calendar year.<sup>18</sup>

### The District Court Enjoined IRS Preparer Initiatives

In January 2013, after the new return preparer program was substantially in place, a U.S. district court judge in *Loving v. Internal Revenue Service* enjoined the IRS from enforcing the testing and continuing education requirements. The outcome of *Loving* rests on the reviewing court's application of the *Chevron* analysis.<sup>19</sup>

Under *Chevron*, the court must first ask if Congress's intent in enacting the statute giving rise to the challenged government action — here, the regulation — is clear. If so, the court must give full effect to this expressed intent of Congress. Pursuant to 31 U.S.C. § 330(a)(1), Congress granted the Secretary of the Treasury authority to “regulate the practice of representatives of persons before the Department of the Treasury.” The *Chevron* analysis turns on how “practice of representatives” is defined in the context of tax return preparation.

In *Loving*, the District Court reasoned that the statute equates “practice of representatives” to the presentation of a case before the IRS, and held that the mere preparation of a return for submission to the IRS does not amount to “practicing” before the IRS.<sup>20</sup> Thus, the District Court held that the statute unambiguously limits the IRS's authority to regulate the “practice of representatives.” Therefore, under a *Chevron* analysis, 31 U.S.C. § 330(a)(1) does not authorize the Secretary of Treasury to regulate the practice of representatives who prepare federal tax returns on behalf of other persons for filing with, and review by, the IRS.<sup>21</sup> The Justice Department has appealed the District Court's decision.<sup>22</sup>

### The District Court's Decision in *Loving* is Based on an Outdated Understanding.

The National Taxpayer Advocate believes that the District Court decision in *Loving* is based on an outdated understanding of the return preparation function.<sup>23</sup> For purposes of determining what constitutes “practice” before the IRS, the court excluded return preparation because, it reasoned, at the time of filing there is no dispute before the IRS and thus, no “case” to present, as required by 31 U.S.C. § 330(a)(2)

18 IRS News Release, IR-2011-111, *IRS Moves to Next Phase of Return Preparer Initiative; New Competency Test to Begin* (Nov. 22, 2011).

19 *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 842-43 (1984). “If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress” (step one). If, however, the reviewing court determines that the statute is ambiguous or silent regarding Congress's intent, the court must ask whether the agency position “is based on a permissible construction of the statute” (step two).

20 *Loving v. IRS*, 917 F. Supp. 2d 67 (D.D.C. Jan. 18, 2013). The government filed a motion to suspend the injunction pending appeal. The U.S. District Court for the District of Columbia denied the motion but then modified the terms of the injunction to make clear that the IRS is not required to suspend the preparer tax identification number (PTIN) program, and not required to shut down all of its testing and continuing centers. See *Loving*, 111 A.F.T.R.2d (RIA) 702 (D.D.C. Feb. 1, 2013). On February 25, 2013, the government filed a motion for a stay pending appeal. On March 27, 2013, the U.S. District Court for the District of Columbia denied the motion for stay. *Loving*, 111 A.F.T.R.2d (RIA) 1384 (D.D.C. Mar. 27, 2013). Oral argument was held before the Court of Appeals for the D.C. Circuit on September 24, 2013.

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

22 See *Government Files Brief in D.C. Circuit Court in Return Preparer Oversight Case*, 2013 TNT 62-20, Tax Analysts Tax Notes Today (Apr. 3, 2013); *Loving v. IRS*, No. 1:12-cv-00385 (D.D.C. 2013) (USCA Case No. 13-5061). The oral arguments were held at the D.C. Circuit on September 24, 2013. See Matthew R. Madara, *Appeals Judges Turn Skeptical Eye Toward IRS Return Preparer Requirements*, Tax Analysts Tax Notes Today (Sept. 24, 2013).

23 For a more detailed discussion of the National Taxpayer Advocate's views, 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).

(D).<sup>24</sup> 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 that are administered by the IRS. A preparer is not merely the taxpayer's scrivener. Taxpayers pay preparers for their knowledge and skills because they are uncomfortable navigating the complexity of the tax laws by themselves.<sup>25</sup>

Tax return filing is almost always "presenting a case" and return preparers are representatives before the IRS when they advise and assist taxpayers in making their claims to the IRS and Treasury.<sup>26</sup> More than 80 percent of individual income tax returns are actually claims for refund under IRC § 6402, and nearly 80 percent of those refund returns are prepared by preparers.<sup>27</sup>

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*The case for IRS oversight over the return preparation industry is clear.*

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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 regulations thereunder 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.<sup>28</sup>

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 the preparer asked certain questions and retained documentation probative of eligibility. In TY 2012, over 76 percent of preparers who prepared returns claiming EITC were unenrolled.<sup>29</sup> The chart below provides further information on EITC claims and the use of preparers in tax years 2010 through 2012:

24 *Loving v. IRS*, 917 F. Supp. 2d 67, 74 (D.D.C. Jan. 18, 2013). The Secretary of the Treasury has the authority to require that a representative demonstrate:

(A) good character; (B) good reputation; (C) necessary qualifications to enable the representative to provide to persons valuable service; and (D) competency to advise and assist persons in presenting their cases.

31 U.S.C. § 330(a)(2)(A)-(D). In its reply brief, the government argues that the factors listed in § 330(a)(2) are discretionary and therefore not all required to constitute practice before the IRS. See Reply Brief for the Appellants, *Loving v. Internal Revenue Service*, No. 13-5061, page 18 (D.C. Cir. filed June 5, 2013).

25 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).

26 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, the former IRS Commissioner argues in favor of the government's position and provides that the preparation of a return is the presentation of a case. Moreover, the article analogizes the preparation of return to the preparation of a will, which is undeniably considered representation, despite the absence of a principal-agent relationship.

27 For TY 2011, the IRS received 142,424,022 individual income tax returns, of which 114,511,777 (80.4 percent) claimed refunds. IRS Compliance Data Warehouse, Individual Returns Transaction File, TY 2011 (filed through Mar. 2013). For TY 2011, preparers prepared 79,008,158 individual returns, of which 61,680,140 (78.1 percent) claimed refunds. IRS Compliance Data Warehouse, Individual Returns Transaction File, TY 2011 (filed through Mar. 2013).

28 Treas. Reg. § 1.6695-2. For tax returns and claims for refund for tax years ending on or after December 31, 2011, preparers are required to submit Form 8867, with the taxpayer's return. T.D. 9570. This recent revision is consistent with recommendations made by the National Taxpayer Advocate in 2003. National Taxpayer Advocate 2003 Annual Report to Congress 270-302. The knowledge requirement provides that the preparer have no knowledge that any of the information used to determine if a taxpayer is eligible for the EITC is incorrect.

29 IRS, Returns Preparer and Provider Database.

**TABLE 1.5.1, The Preparation of EITC Claims by Unenrolled Preparers in TY 2010-2012<sup>30</sup>**

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%

In addition, 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, causing the IRS to send the returns to “error resolution,” and requiring some of the taxpayers to present additional information.<sup>31</sup> Further, the IRS issued over 270,000 math error notices, disallowing dependency exemptions and tax credits tied to dependents for tax year 2012.<sup>32</sup> The following chart illustrates the use of paid preparers by taxpayers claiming refundable credits in tax years 2010 and 2011.

**TABLE 1.5.2, Taxpayers Claiming Refundable Credits, Claim Amounts, and Preparer Usage: Tax Years 2010 and 2011<sup>33</sup>**

Tax Credit	Tax Year	Number of Taxpayers	Average Claim (dollars)	Total Claims (dollars in thousands)	Preparer Returns (percentage)
Earned Income Tax Credit	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%

### The Availability of Tax Preparation Software Opened Opportunities for Untrained and Even Unscrupulous Return Preparers

Before reasonably priced return preparation software packages became widely available, knowledge of the tax laws was a barrier to entry into the return preparation industry. To gain the competence to prepare a return, preparers needed to read the tax laws, Treasury regulations, IRS publications, and the IRS form instructions, which required a significant investment of time, energy, skill, and knowledge. Once return preparation software became widely available and reasonably priced (as little as \$119.95 for a package),

30 IRS, Compliance Data Warehouse Individual Returns Transaction File; IRS, Individual Master File (net of transactions 764, 765, and 768); IRS, Returns Preparer and Provider Database (through Nov. 2013) (Note that the amounts paid out by the IRS may have been subsequently disallowed in post-refund audits).

31 IRS, Submission Processing Miscellaneous Monitoring Report, Headquarters, ERS (IMF/BMF) 2013 vs. 2012 (week ending Sept. 27, 2013).

32 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).

33 IRS Compliance Data Warehouse (CDW), Individual Returns Transaction File and Individual Master File, TY 2010 and 2011 (through Mar. 2013).

anyone could sit down and have the software walk them through the entire process without any previous knowledge or experience.<sup>34</sup>

The IRS sought to remedy this issue by imposing examination and continuing education requirements on preparers with no previously recognized credentials — unenrolled return preparers. Those preparers could satisfy the IRS's requirements and obtain the designation “registered tax return preparer” if they satisfied the program requirements. However, the current injunction imposed on the IRS by *Loving* prohibits the IRS from administering the testing and education components of the program. Therefore, after *Loving*, once again, anyone can hang up a shingle and be a return preparer.

### **Taxpayers Remain Vulnerable to Incompetent and Unscrupulous Preparers.**

The need for regulation was evident long before the IRS implemented its return preparer program. In 2006 and 2008, GAO and TIGTA, respectively, conducted studies in which auditors posed as taxpayers and visited preparers for help in preparing returns. The results dramatically substantiated the National Taxpayer Advocate's longstanding concerns by suggesting that a high percentage of preparers prepare inaccurate returns, fail to perform sufficient due diligence, and even take positions that they know are not supportable.<sup>35</sup>

Without any regulation, we will continue to see a proliferation of return preparers showing up at check-cashing places, 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 type of services related to tax returns.<sup>36</sup> The second is a slideshow of photographs taken by Local Taxpayer Advocates in 2010 showing the variety of businesses touting tax preparation services.<sup>37</sup> 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.<sup>38</sup>

Finally, over the past several years, the need for regulation of these preparers has become even more apparent at the Taxpayer Advocate Service. We recently have seen many misconduct cases in which the return preparers have altered return information without their clients' knowledge or consent in an attempt to obtain improperly inflated refunds or divert refunds for their personal benefit.<sup>39</sup>

34 Results of Google search “Professional Tax Preparation Software Price” (Apr. 30, 2013).

35 Government Accountability Office, GAO-06-563T, *Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors* 5, 23 (Apr. 4, 2006) (finding preparers made significant mistakes on 17 of the 19 returns prepared for GAO employees posing as taxpayers, including the omission of income on ten); TIGTA, Ref. No. 2008-40-171, *Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors* 2 (Sept. 3, 2008) (finding preparers made mistakes on 17 of the 28 returns prepared for TIGTA employees posing as taxpayers, including six willful or reckless errors).

36 <http://www.youtube.com/watch?v=W00BmbrlvHk&sns=em> (Southern King Taxes promotional video) (last viewed Dec. 10, 2013).

37 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> (Dec. 10, 2013).

38 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> (last visited Dec. 20, 2013).

39 For a more detailed description of return preparer misconduct and IRS procedures to assist victims of the misconduct, see 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*, *supra*; 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*).

### **Development of a Six-Part Return Preparer Strategy Would Protect Taxpayers in the Event the Courts Decide the IRS Does Not Have Regulatory Authority.**

Given the demonstrated need for regulation of unenrolled preparers, and the uncertainty introduced by the *Loving* litigation, it is imperative that the IRS act to protect taxpayers from the harm that arises in the current unregulated environment. In the discussion below, we lay out an approach for ensuring that taxpayers receive competent and ethical preparation, regardless of the type of tax return preparer they choose. Accordingly, the National Taxpayer Advocate urges the IRS to develop a six-part strategy to protect taxpayers in the event that *Loving* is upheld on appeal. Specifically, the strategy should include the following components:

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

#### ***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 passed an IRS-developed examination and satisfy continuing education criteria similar to those previously implemented by the IRS. This may involve contracting with third parties to administer the examination and continuing education once the IRS follows the appropriate rulemaking processes.

#### ***Restrict the Ability of Unenrolled Preparers to Represent Taxpayers in Audits of Returns They Prepared Unless They Earn the 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 the Taxpayer Advocate Service) during an examination if they signed the tax return or claim for refund for the tax period under examination.<sup>40</sup> These preparers cannot, however, represent taxpayers before Appeals or Collection.<sup>41</sup>

<sup>40</sup> 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 before the agency on returns they signed. However, Notice 2011-6, 2011-3 I.R.B. 315 provided interim authority for these individuals to represent 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).

<sup>41</sup> 31 C.F.R. § 10.3(f)(3).

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*Without any regulation, we will continue to see a proliferation of return preparers showing up at check-cashing places, pawnshops, used car dealerships, furniture stores, etc.*

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At the time 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 under audit could assist in the exam by explaining the positions taken.<sup>42</sup> However, as noted above, the advent of commercial preparation and filing software has radically changed the profession by enabling anyone to prepare a return without any training in the tax law. Thus, return preparation by an untrained individual with commercial software does not position that individual to competently assist the taxpayer in the examination.

Representing a taxpayer before Examination requires a certain level of knowledge, competence and skill, the absence of which can have a significant economic impact on the taxpayer. If the courts decide return preparation is not “presenting a case” before the IRS because it is mere preparation, 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 requisite skill and knowledge to represent taxpayers at any level before the IRS.

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 his or her 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 wish to represent taxpayers during an examination.<sup>43</sup> If, as the *Loving* plaintiffs state, these unenrolled preparers are “merely” preparing returns — being scribes — then, absent passing a test and satisfying continuing education requirements to demonstrate competency, they clearly should not be permitted to represent taxpayers in audits of returns.

Therefore, the National Taxpayer Advocate recommends revising all guidance to ensure that only competent unenrolled preparers have the authority to represent taxpayers under exam with respect to returns they have prepared. Accordingly, revisions are necessary to the current guidance provided by:

- Revenue Procedure 81-38;
- Circular 230<sup>44</sup> (any references relating to the authorization for unenrolled preparers to represent taxpayers in audits of returns they have prepared and signed); and
- 26 C.F.R. § 601.502(b)(5)(iii).

***Restrict the Ability to Name an Unenrolled Preparer as a Third Party Designee on Form 1040.***

Form 1040 includes a section for “Third Party Designee” in which 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

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<sup>42</sup> See Rev. Proc. 81-38, 1981-2 C.B. 592.

<sup>43</sup> *Loving v. IRS*, 917 F. Supp. 2d 67, 71 (D.D.C. Jan. 18, 2013).

<sup>44</sup> 31 C.F.R. Part 10.

Responsibility (OPR) is contemplating prohibiting taxpayers from designating an unenrolled preparer as the Third Party Designee.<sup>45</sup> We support OPR in its efforts and believe this issue warrants consideration.<sup>46</sup>

OPR is considering excepting from such prohibition those preparers who are licensed by the IRS or a state licensing body.<sup>47</sup> The National Taxpayer Advocate believes OPR's position merits further investigation.

In addition, it is unclear whether restricting third party designees on Form 1040 would impact the authorization granted to an appointee in Form 8821, *Tax Information Authorization*. If the taxpayer appoints a preparer on Form 8821, the taxpayer does not authorize the appointee to advocate a position with respect to federal tax laws; to execute waivers, consents, or closing agreements; or to otherwise represent the taxpayer before the IRS.<sup>48</sup> In contrast to the Form 8821 designee, the Third Party Designee authorization on the Form 1040 authorizes the designee to both provide information and receive information, which is one step closer to acting as the taxpayer's agent. This issue requires further analysis.

### *Mount a Consumer Education Campaign Educating Taxpayers About the Need to Select Competent Preparers.*

Consistent with the National Taxpayer Advocate's longstanding position that the IRS should mount a comprehensive taxpayer awareness campaign, we 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 the return preparer regulations, the National Taxpayer Advocate believes 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 will cease to provide return preparation services at Taxpayer Assistance Centers (TACs) during the 2014 filing season.<sup>49</sup> Therefore, low income, elderly and disabled taxpayers will have one less avenue to receive reliable tax preparation services at no cost, making this information campaign even more imperative 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 the preparer 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.<sup>50</sup>
- b. Make sure the preparer signs the return and fills in his or her Preparer Tax Identification Number (PTIN) or Employer Identification Number where indicated on the tax forms.

45 OPR response to TAS information request 5 (Oct. 31, 2013).

46 However, the prohibition should clearly exclude persons not in the business of preparing returns, such as parents preparing their child's return.

47 OPR response to TAS information request 5 (Oct. 31, 2013).

48 Instructions, Form 8821, *Tax Information Authorization*.

49 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.

50 The communication should clearly provide that the taxpayer should not select a preparer based on the promised size of the refund.

- c. Obtain a copy of the return signed by the preparer and keep the copy in the event there is a problem with the return.<sup>51</sup>
- d. Ask the preparer for a business card or brochure and place it in the tax file with a copy of the invoice for the preparation services.

*Develop a Research-Driven and Servicewide Return Preparer Compliance Strategy Similar in Nature to the FY 2014 EITC Preparer Compliance Strategy.*

While it cannot impose testing and education requirements on preparers pending litigation, the IRS can increase competency and accountability among preparers by using tools that remain available. For example, the IRS holds annual Nationwide Tax Forums to provide preparers with the latest information on tax administration in general. More than half of those attending the forums are unenrolled preparers.<sup>52</sup> However, instead of increasing its presence at the forums, the IRS has drastically reduced the resources allocated to them.<sup>53</sup> For example, the IRS has cut the case resolution program and focus groups conducted at the forums, which represents lost opportunities for both practitioners and the IRS to interact in a mutually beneficial situation.<sup>54</sup>

Another cost-effective way to reach the unenrolled preparer population is through webinars, podcasts and other social media channels to deliver messages impacting vulnerable taxpayers, such as the EITC due diligence requirements in IRC § 6695(g).<sup>55</sup> The IRS currently focuses preparer education on EITC and other refundable credits. However, it has not changed its overall outreach and education strategy for preparers in response to *Loving*.<sup>56</sup>

In addition to education and outreach, the IRS has a wide array of enforcement tools to encourage compliance among return preparers. The IRS 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.<sup>57</sup> However, the IRS has not altered its compliance strategies in response to the *Loving* opinion.<sup>58</sup> While the National Taxpayer Advocate believes prevention in the form of taxpayer and preparer education and outreach is the most effective way to protect taxpayers, the IRS must enhance its compliance initiatives if it can no longer mandate minimum competency standards.

51 The Taxpayer Advocate Service developed a poster (IRS Publication 5074, *Protect Your Refund*), and distributed copies to all W&I taxpayer assistance centers (TACs) and low income taxpayer clinic (LITC) offices. The communication should instruct the taxpayer to require the preparer to include the preparer's name and address on the return.

52 OPR response to TAS information request 3 (Oct. 31, 2013).

53 IRS National Public Liaison response to TAS information request. The IRS made presentations on EITC at the 2012 and 2013 Tax Forums. W&I response to TAS information request 3 (Oct. 28, 2013). In addition, OPR also presented three levels of training at the Tax Forums in 2013. OPR response to TAS information request (Oct. 31, 2013).

54 See National Taxpayer Advocate Fiscal Year 2014 Objectives Report to Congress 51-53.

55 The IRS held webinars on the topic of EITC due diligence in both English and Spanish in 2012. W&I response to TAS information request 3 (Oct. 28, 2013). The IRS website includes comprehensive information about EITC due diligence requirements for preparers. See <http://www.eitc.irs.gov/rptoolkit/dd/>. OPR has also held webinar broadcasts, phone forums, and various other types of broadcasts, press releases, and face-to-face speaking engagements. OPR response to TAS information request (Oct. 31, 2013). RPO also conducts live webinars, video presentations and uses various social media channels. RPO response to TAS information request (Nov. 12, 2013).

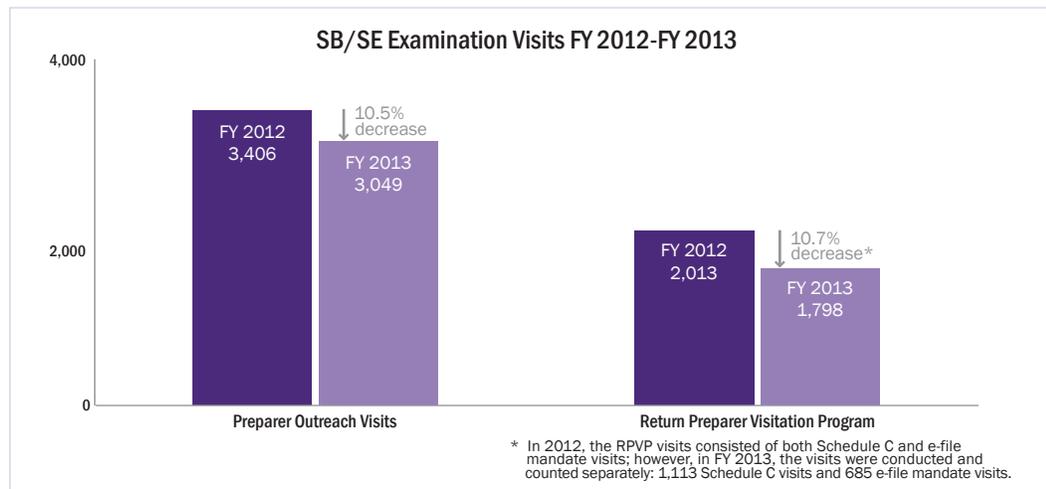
56 W&I response to TAS information request 2 (Oct. 28, 2013) (The IRS did not notify examiners to limit education on its Knock and Talk Visits to just PTIN compliance after *Loving*). RPO has noted that its outreach and education has changed due to *Loving* in that there is a reduction in public speaking requests, and their education is directed more at individual preparers and related to program and tax compliance as well as complaints as opposed to more large preparer groups pre-*Loving*. RPO response to TAS information request (Nov. 12, 2013).

57 See IRC §§ 6694, 6695, 6713 and 31 C.F.R. § 10.50.

58 SB/SE response to TAS information request 2 (Nov. 5, 2013) ("SBSE Examination has not increased scrutiny and enforcement of return preparers in response to the injunction ordered by the District Court in *Loving v. IRS*. We have continued to identify, evaluate and conduct appropriate investigations of questionable return preparers referred to Examination or identified through compliance activity.").

SB/SE Examination conducts preparer outreach visits as directed by the IRS Return Preparer Office (RPO) and W&I's return preparer offices. Total outreach visits decreased by 10.5 percent from FY 2012 to FY 2013. In addition, visits conducted as part of the Return Preparer Visitation Program (RPVP), to address PTIN requirements, e-file requirements, and Schedule C preparation, declined from FY 2012 to FY 2013, by approximately 10.7 percent.<sup>59</sup>

**FIGURE 1.5.3, SB/SE Exam Visits**



In addition to increasing the appropriate assessment and collection of preparer penalties under IRC §§ 6694 and 6695, repeat offenders must also deal with Circular 230 sanctions, which require coordination between various IRS functions. We have learned that the OPR and the Department of Justice have coordinated efforts to make return preparer injunctions a priority. OPR has also taken the position that its enhanced jurisdiction under sections 10.8(a) and (c) of Circular 230 is not impacted by *Loving*, and thus, all PTIN holders are still subject to the ethical standards under Subparts B and C of Circular 230.<sup>60</sup> OPR has also begun initiatives to crack down on preparers taking their fees directly out of taxpayer refunds by improperly setting up a split refund direct deposit using Form 8888, *Allocation of Refund (Including Savings Bond Purchases)*, or directing the refund into a joint bank account in the name of the taxpayer and preparer.<sup>61</sup> These are positive developments that will benefit vulnerable taxpayers.

The National Taxpayer Advocate encourages the IRS to develop a Servicewide Return Preparer Strategy similar in nature to the FY 2014 EITC Return Preparer Strategy. The IRS developed this strategy over

59 SB/SE response to TAS information request (Nov. 5, 2013). SB/SE Exam conducted a total of 3,406 preparer outreach visits in FY 2012 and decreased to 3,049 total visits in FY 2013. The number of planned total return preparer visits in FY 2013 was originally 3,434; however, visitations were reduced due to Hurricane Sandy. SB/SE Exam conducted 2,013 RPVP visits in FY 2012 and then dropped to only 1,798 visits in FY 2013. RPVP visits declined by approximately 10.7 percent from FY 2012 to FY 2013. In 2012, the RPVP visits consisted of both Schedule C and e-file mandate visits; however, in FY 2013 the visits were conducted and counted separately — 1,113 Schedule C visits and 685 e-file mandate visits.

60 OPR response to TAS information request 3 (Oct. 31, 2013). Section 10.8(a) and (c) were added to Cir 230 in the 2011 amendments to insure that ethical oversight of the expanded universe of Circular 230 practitioners was available during the transition period without regard to whether a preparer had tested (or was required to test).

61 Kristin Parillo, *ABA Meeting: OPR and DOJ Coordinating Enforcement Against Return Preparers*, 2013 TNT 185-9, Tax Analysts Tax Notes Today (Sept. 24, 2013); OPR response to TAS information request (Oct. 31, 2013).

several years and based it on findings from a three-year EITC Real Time Return Preparer Test. The IRS has completed two years of the test during 2012 and 2013 and evaluated the effectiveness of several treatment streams both pre-filing season and post filing season, including various letters, phone calls, due diligence visits, knock-and-talk visits, and audits. According to the IRS, evaluation of the results showed that the test protected nearly \$600 million in revenue during the 2013 filing season.<sup>62</sup> The IRS used the findings of the first two years of the test to design the FY 2014 Return Preparer Strategy, which utilizes improved and research-driven selection techniques and assigns progressive treatments based on the preparer's risk of segment.<sup>63</sup> The National Taxpayer Advocate believes that the IRS should build on the experience of this strategy to develop a servicewide return preparer compliance strategy.

***Recommend that Congress Revise 31 U.S.C. § 330(a)(2) to Make Clear That the IRS Has the Authority to Regulate Unenrolled Preparers.***

If *Loving* is upheld on appeal, the National Taxpayer Advocate recommends that Congress revise 31 U.S.C. § 330(a)(2) to clarify that the IRS has the authority to regulate 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. The National Taxpayer Advocate also believes this is an opportunity to ensure that the statute clearly includes the submissions of other documents that determine tax liability, such as financial statements and offers in compromise.<sup>64</sup>

## CONCLUSION

Until the IRS is allowed to resume the implementation of the testing and continuing education components of the return preparer program, taxpayers are vulnerable to incompetent and unscrupulous preparers. The IRS and the Taxpayer Advocate Service can assist taxpayers by educating them about the various precautions they can take to prevent becoming a victim. Without the ability to impose minimum standards on unenrolled return preparers, the IRS's only avenue to address competency issues is through targeted outreach and education to this population. However, the IRS is actually decreasing the amount of resources allocated to the tax forums, which has historically been an effective way to reach unenrolled return preparers. It has also significantly decreased preparer outreach visits. Finally, the IRS has not taken steps to enhance its return preparer compliance strategy in response to the *Loving* decision.

<sup>62</sup> IRS W&I Research Analysis, *Filing Season 2013 EITC Real Time Return Preparer Initial Findings / Recommendations* (Dec. 5, 2013).

<sup>63</sup> FY 2014 EITC Return Preparer Strategy (Dec. 2013).

<sup>64</sup> 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).

## RECOMMENDATIONS

Until the IRS is able to continue implementing the testing and continuing education requirements of the return preparer program, the National Taxpayer Advocate recommends that the IRS develop a six-part servicewide return preparer strategy with the following components:

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