

II. Areas of Focus

A. The IRS Harms Taxpayers by Refusing to Issue Refunds to Some Victims of Return Preparer Fraud

Return preparer misconduct occurs when a preparer alters tax return information without the taxpayer's knowledge or consent in an attempt to obtain improperly inflated refunds, or to divert refunds for the preparer's personal benefit. Often a taxpayer becomes aware of the misconduct only after the IRS:

- Reviews or audits the return;
- Removes the incorrect deductions, withholding, or credits;
- Holds the taxpayer liable for the resulting increased tax assessment; and
- In some cases, refuses to issue the taxpayer the correct refund after the preparer has misappropriated the taxpayer's refund check or direct deposit.

Return preparer misconduct creates significant challenges for the IRS, harms innocent taxpayers, and undermines trust in our tax system.¹ Despite the National Taxpayer Advocate's issuance of 17 Taxpayer Assistance Orders to the Commissioner of Internal Revenue on this matter (through April 2013), the IRS continues to refuse to issue replacement refunds in cases where preparers have stolen a taxpayer's refund, which leaves the victimized taxpayers little hope of ever getting their money.

Preparer misconduct is not a new phenomenon. The IRS has known for well over a decade about the problems that this type of fraud can thrust upon taxpayers. The IRS has since 2000 received the benefit of several Chief Counsel opinions addressing return preparer misconduct.² When read together, these opinions authorize the IRS to:

Chief Counsel has issued multiple opinions addressing return preparer misconduct



The IRS has addressed two:

- The falsified return can be deemed a "nullity," and
- The true return can be accepted and processed

However, to date the IRS has refused to authorize the issuance of a refund to victims of preparer misconduct

¹ See National Taxpayer Advocate 2012 Annual Report to Congress 68-83 (Most Serious Problem: *The IRS Harms Victims of Return Preparer Misconduct by Failing to Resolve Their Accounts Fully*); Nina E. Olson, *More Than a 'Mere' Preparer: Loving and Return Preparation*, Tax Notes 767 (May 13, 2013).

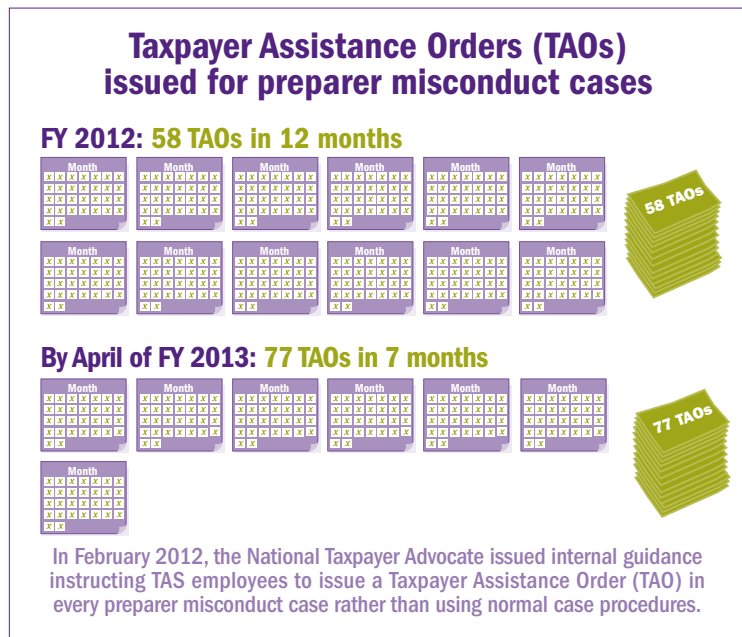
² See Field Service Advice 200038005 (June 6, 2000); IRS Office of Chief Counsel Memorandum, *Horse's Tax Service*, PMTA 2011-13 (May 12, 2003); IRS Office of Chief Counsel Memorandum, *Tax Return Preparer's Alteration of a Return*, PMTA 2011-20 (June 27, 2011).

1. Deem the first, falsified return a “nullity;”
2. Accept and process the second, true return submitted by the taxpayer after discovering the preparer misconduct; and
3. Issue a refund to the taxpayer.

While the IRS has developed interim procedures to address the first two steps, to date it has refused to authorize the issuance of a refund to a victim of preparer misconduct.³ Instead, the procedures instruct employees to suspend action on such cases pending further guidance.

In February 2012, the National Taxpayer Advocate issued internal guidance instructing TAS employees to issue a Taxpayer Assistance Order (TAO) in every preparer misconduct case rather than using normal case procedures.⁴ TAS issued 58 TAOs related to return preparer misconduct in fiscal year (FY) 2012, which constituted 13.4 percent of all TAOs issued that year.⁵ Through April, TAS has already issued another 77 TAOs involving return preparer misconduct in FY 2013.

As of May 31, 2013, the National Taxpayer Advocate has elevated 21 return preparer misconduct TAOs to either the Commissioner of W&I or the Commissioner of Internal Revenue or his successor. In eight of these cases (38 percent), the taxpayer had filed a police report against the preparer, with four of the preparers arrested for fraud (19 percent). The average refund sought in these cases is \$2,901. From the date these taxpayers came to TAS, they have waited an average of 540 days (through May 31, 2013), and have yet to receive the refunds to which they are entitled.



3 See *Interim Guidance on Return Preparer Misconduct (For Memphis Accounts Management ONLY)*, WI-21-0812-02 (Sept. 6, 2012).

4 See *Interim Guidance on Advocating for Taxpayers When a Return Preparer Appears to Have Committed Fraud*, TAS-13-0212-008 (Feb. 7, 2012).

5 TAS issued 434 TAOs in FY 2012.

The IRS has not complied with actions ordered in any of these TAOs, as it is “weighing” policy considerations. The former Acting Commissioner did not provide any response to the National Taxpayer Advocate regarding why he did not provide relief to these taxpayers, nor did he articulate what “policy considerations” he was weighing.

From the National Taxpayer Advocate’s perspective, the policy considerations in making the victims whole clearly outweigh other considerations. Consider the following:

- If a non-preparer takes a taxpayer’s refund because of a falsified return, the IRS considers the taxpayer a victim of identity theft and *will* issue a replacement refund.
- If a taxpayer’s paper check is stolen, the government will issue a replacement refund check.⁶
- If a return preparer changes a taxpayers return so a direct deposit refund goes to the preparer instead of the taxpayer, the IRS *will not* issue a replacement refund.

With the increasing complexity of the tax code and IRS forms, and the reduced availability of return preparation assistance in IRS Taxpayer Assistance Centers (TACs), a substantial number of taxpayers rely on paid professionals to assist with their filing obligations.

Replacement refunds for refund fraud victims

Refund fraud perpetrated by stranger (ID theft)



Taxpayer gets replacement refund

Preparer fraud that includes theft of paper check



Taxpayer gets replacement refund

Preparer fraud that includes misrouted direct deposit



Taxpayer does NOT get replacement refund

Low income taxpayers, such as those who qualify for the Earned Income Tax Credit (EITC), are particularly vulnerable to predatory practices. In tax year 2011, 59.3 percent of EITC filers relied upon paid preparers.⁷ Taxpayers who are trying to comply with the law and who have demonstrated that they are not complicit in the fraud perpetrated by the preparer, should be made whole by the IRS.

In FY 2014, TAS will:

- Issue appropriate guidance to TAS employees on how to advocate for victims of return preparer misconduct when IRS procedures do not fully unwind the harm suffered by the victims;

⁶ See IRM 21.4.2.4.15.3.1 (Oct. 1, 2006).

⁷ Nina E. Olson, *More Than a 'Mere' Preparer: Loving and Return Preparation*, Tax Notes 767 (May 13, 2013).

- Continue to elevate return preparer misconduct TAOs to the highest levels of the IRS until the IRS adopts a policy that provides relief to these taxpayers; and
- Educate internal and external stakeholders (including Congress) on the impact on taxpayers of the IRS's refusal to develop procedures to make victims of return preparer misconduct whole.