

## More Than a ‘Mere’ Preparer: Loving and Return Preparation

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Nina E. Olson is the national taxpayer advocate (NTA). The views expressed herein are solely those of the NTA. The NTA is appointed by the Treasury secretary and reports to the IRS commissioner. However, the

NTA presents an independent taxpayer perspective that does not necessarily reflect the position of the IRS, Treasury, or the Office of Management and Budget.

Each year, tens of millions of taxpayers hire paid practitioners to prepare their Form 1040-series returns because of the overwhelming complexity of the tax code and the amount of money at stake. That has led to significant concerns about incompetent and unscrupulous preparers and their negative impact on taxpayers and compliance. The IRS and Treasury had developed and substantially implemented standards governing preparers when, in *Loving v. IRS*, a U.S. district court found that Treasury lacked the authority to issue the regulations. The government has appealed the case to the D.C. Circuit. The NTA believes that the district court’s decision in *Loving* is based in part on an outdated understanding of return preparation and filing. This report makes the case for preparer regulation generally, explains where the district court erred, and illustrates how problems in today’s tax system are directly analogous to the problem Congress sought to address in its original grant of regulatory authority to Treasury.

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The IRS collects more than 90 percent of all federal revenue (\$2.52 trillion in fiscal 2012). The

largest portion comes from the individual income tax. Taxpayers recently have been filing about 145 million Form 1040-series individual income tax returns each year.<sup>1</sup> Most of these taxpayers, filing nearly 80 million returns, pay a preparer to prepare their returns for them.

Taxpayers hire preparers because the tax code is hideously complex, return preparation is anything but straightforward, and a lot of money is on the line. The tax code provides tax breaks that total more than \$1 trillion a year, and many of those breaks are claimed on tax returns.<sup>2</sup> Congress has enacted numerous refundable tax credits, in lieu of direct spending programs, as a way of delivering social and economic benefits to taxpayers. For individual taxpayers claiming refundable credits, the Form 1040-series return constitutes a claim for the pertinent federal benefit — it is no different from an advance application for veterans’ benefits or food stamps. Many other taxpayers claim tax benefits that are inherently subject to dispute. For example, a taxpayer who donates clothing, furniture, or a work of art will use the return to assert a fair market value that is deducted from the taxpayer’s income. The return (including required attachments) establishes the taxpayer’s case for claiming this benefit, and the IRS often will scrutinize and dispute the claimed valuation.

Against this backdrop, significant concerns have been raised about incompetent and unscrupulous preparers and their negative impact on taxpayers and tax compliance. If a preparer makes inflated claims that the IRS later rejects, or fails to claim

<sup>1</sup>2012 IRS Data Book, at 4 (Mar. 25, 2013), Table 2, col. 2 (including late-filed returns for prior tax years).

<sup>2</sup>Approximately one-quarter of government spending has consisted of tax expenditures. See National Taxpayer Advocate 2010 Annual Report to Congress, vol. 2, section 6, at 101-104 (Dec. 31, 2010) (“Research Study: Evaluate the Administration of Tax Expenditures”) (hereinafter “NTA report”); Congressional Research Service, “Tax Expenditures: Compendium of Background Material on Individual Provisions,” S. Print 112-45 (Dec. 2012) (prepared for the Senate Budget Committee). The Congressional Budget Act of 1974 defines a tax expenditure as “a special exclusion, exemption, or deduction from gross income or which provide[s] a special credit, a preferential rate of tax, or a deferral of tax liability.” P.L. 93-344, section 3(3). “Tax expenditures are similar to spending programs in their impact on the deficit; and like spending, are established to achieve specific national objectives.” S. Rep. No. 103-58, at 27 (1993).

benefits to which the taxpayer is entitled, the taxpayer suffers. If a preparer makes inflated claims that the IRS does not detect, federal revenue collection suffers. And until recently, anyone could hang a shingle and prepare a return without having to register with the IRS, demonstrate competency in return preparation, or remain current on the many changes Congress makes to the tax code every year.<sup>3</sup>

Because of my concerns about return accuracy and ethical standards in the return preparation industry, I recommended in my 2002 NTA report the adoption of rules to regulate unenrolled return preparers by requiring registration, testing, and continuing education.<sup>4</sup> In 2006 and 2008, the Government Accountability Office and the Treasury Inspector General for Tax Administration conducted studies in which auditors posed as taxpayers and visited preparers for help in preparing returns. The results dramatically substantiated my concerns.

GAO auditors made 19 visits to several national return preparation chains in a large metropolitan area. They presented two carefully designed fact patterns during their visits. Among the GAO's findings:

- The return preparation chains made errors on all 19 returns.
- The computed tax liabilities ranged from unwarranted excess refunds of nearly \$2,000 per return (on five returns) to overpayments of tax of more than \$1,500 (on two returns).
- Preparers failed to ask where the auditor's child lived or ignored the auditor's answer to the question in five of 10 applicable cases and

consequently prepared returns claiming ineligible children for purposes of the earned income tax credit.

- In 10 out of 19 cases, preparers failed to report cash side income. Several preparers even advised the GAO "taxpayers" that reporting certain income was unnecessary because the IRS would have no way of knowing about it.<sup>5</sup>

TIGTA auditors visited 12 commercial chains and 16 small, independently owned tax return preparation offices in a large metropolitan area. Among TIGTA's findings:

- 61 percent of the returns were prepared incorrectly;
- if the incorrect returns had been filed, the net effect would have been \$12,828 in understated taxes, or an average net understatement of \$755 per return;
- none of the seven preparers working with fact patterns involving EITC claims exercised appropriate due diligence; and
- 65 percent of the inaccurate returns contained mistakes or omissions deemed to be caused by human error or misinterpretation of the tax laws, while 35 percent contained misstatements or omissions that TIGTA deemed willful or reckless.<sup>6</sup>

Most organizations representing established preparers supported my call for minimum industry standards.<sup>7</sup> In 2009 the IRS conducted an extensive review of the issue and announced plans to implement industry standards.<sup>8</sup> Treasury issued regulations to implement those standards,<sup>9</sup> and the new system had been substantially implemented when three preparers filed suit in district court alleging that Treasury lacked the authority to issue the regulations. The district court held in favor of the plaintiffs, and the government has appealed the case, *Loving v. IRS*,<sup>10</sup> to the D.C. Circuit.

<sup>3</sup>We recently reported that there have been 4,680 changes to the IRC since 2001, an average of more than one a day. 2012 NTA report, at 6 (Dec. 31, 2012) ("Most Serious Problem: The Complexity of the Tax Code").

<sup>4</sup>My concerns actually predate the 2002 annual report. As the executive director and founder of the Community Tax Law Project, a low-income taxpayer clinic, I testified before the House Ways and Means Oversight Subcommittee and the Senate Finance Committee in 1997 and 1998, respectively, about the problems facing low-income taxpayers. In my response to questions for the record from then-Finance Committee Chair William Roth, I specifically discussed the need for better oversight of unregulated preparers:

Finally, unscrupulous, untrained, or unregulated return preparers are a real problem for this [low-income] population. Even the measures targeting due diligence are only effective if the preparer signs the return. In many low income communities today, inexpensive but unqualified preparers are setting up low income taxpayers for future audits.

IRS restructuring hearings on H.R. 2676: Senate Finance Committee hearing, 105th Cong., at 337 (1998).

<sup>5</sup>Government Accountability Office, "Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors," GAO-06-563T (2006).

<sup>6</sup>Treasury Inspector General for Tax Administration, "Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors," No. 2008-40-171 (Sept. 3, 2008).

<sup>7</sup>In 2005, for example, the House Ways and Means Oversight Subcommittee held a hearing at which representatives of the following five organizations testified in support of regulating return preparers: 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," House Ways and Means Oversight Subcommittee hearing, 109th Cong. (July 30, 2005).

<sup>8</sup>See IRS Publication 4832, *Return Preparer Review* (Dec. 2009).

<sup>9</sup>Reg. section 1.6109-2; 31 C.F.R. part 10.

<sup>10</sup>*Loving v. IRS*, 2013 U.S. Dist. (D.D.C. 2013), LEXIS 7980.

In this report, I will make the case for preparer regulation generally and explain why I think the district court erred in explaining the nature of tax return preparation. In so doing, I will discuss the changes that have taken place within the return preparation industry over the last few decades as a result of the ready availability of return preparation software, refundable credits, and refund-based loans; the significance of the tax return and tax return preparers in our self-assessment system; the role of the tax return in making claims against the government; the legislative history of Treasury's authority to regulate the conduct of representatives; and how the problems associated with refund claims in today's tax system are directly analogous to the problem Congress sought to address in the original 1884 grant of regulatory authority to Treasury.

### Preparer Standards Needed

In 1975, when I first opened my practice as an unenrolled tax return preparer, knowledge of the tax laws was a barrier to entry into the profession. For the average preparer, there was no tax software to walk you through the issues you should consider in advising your client. You had to read the tax laws, the regulations, the publications, and the instructions. Thus, in 1975, the year the EITC was enacted<sup>11</sup> and the year before Congress enacted many preparer penalties,<sup>12</sup> opening and maintaining a tax return preparation practice required a significant investment of time, energy, skill, and knowledge.

Not so today. With the ubiquitous availability of tax return preparation software packages, for as little as \$119.95 anyone can hold herself out as a tax return preparer.<sup>13</sup> Of the roughly 79 million individual income tax returns prepared by paid preparers in tax year 2011, more than half were completed

by unregulated return preparers.<sup>14</sup> There are no longer any barriers to entry to becoming a return preparer.

The daily news is replete with the consequences of this low bar. The availability of e-filing and the magnitude and frequency of claims for refundable tax credits have combined to make tax return preparation a lucrative business for many. The complexity of eligibility requirements and the application process discourages taxpayers from preparing their own returns. Taxpayers who are the beneficiaries of these credits are often the least educated and least financially sophisticated in the United States today.<sup>15</sup> Thus, they become easy targets for marketing schemes of unregulated and unqualified so-called return preparers whose real

<sup>14</sup>The following table shows the breakdown of prepared returns by type of preparer:

Attorney	889,499
Certified acceptance agent	270,776
Certified public accountant	22,473,361
Enrolled agent	8,916,953
Enrolled actuary	30,963
Enrolled retirement plan agent	5,357
State regulated tax preparer	3,347,118
Unregulated preparer	42,154,527
<b>Total</b>	<b>78,088,554</b>

IRS Compliance Data Warehouse, Individual Returns Transaction File and Return Preparers and Providers Database (tax year 2011). The category labeled "Unregulated Preparer" reflects returns prepared by individuals with preparer tax identification numbers who did not list a profession when registering with the IRS. Also, IRS records show about 1 million returns as paid preparer returns that did not have a PTIN match in the Return Preparers and Providers Database.

<sup>15</sup>The demographics of the taxpayer population seeking return assistance have shifted significantly. In tax year 1976, the first year the EITC was available, only 6 million low-income returns claimed the EITC, accounting for \$1.2 billion. By tax year 2011, preliminary data show 27.4 million returns claiming the EITC, accounting for \$62.1 billion. In 1981, five years after the enactment of preparer penalties, 41 percent of the 94.8 million individual returns were signed by preparers. The median adjusted gross income for tax year 1981 returns with a paid-preparer signature was between \$15,000 and \$20,000, or \$37,119 and \$49,492 in 2011 dollars. In tax year 2011, 55 percent of the 142 million individual returns were prepared by paid preparers, and the median AGI of those returns dropped to \$34,079, reflecting a shift toward lower-income taxpayers.

<sup>11</sup>See Tax Reduction Act of 1975, section 204 (enacting the EITC).

<sup>12</sup>See Tax Reform Act of 1976, section 1203(b)(1).

<sup>13</sup>Results of Google search for "professional tax preparation software price" (Apr. 30, 2013).



interest in the tax return process is to push high-interest loans (formerly refund anticipation loans, and now in the form of “pay-stub” loans) and charge high fees. The amicus brief of the National Consumer Law Center and the National Community Tax Coalition in *Loving* contains many examples of the virtual absence of professionalism and competency in this component of the unregulated tax return preparation world.<sup>16</sup>

It was this environment that led me, in my 2002 NTA report, to propose that Congress regulate unenrolled return preparers by requiring registration, testing, continuing education, and certification.<sup>17</sup> And it was just this type of world that led many of the largest return preparation firms to support that proposal in order to distinguish themselves from the proliferation of return preparers who were showing up at check-cashing places, pawnshops, used car dealerships, furniture stores, and anywhere else you could receive a refund anticipation loan to apply immediately to purchases. 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 service related to tax returns (I’m not sure what precisely the ad is promoting).<sup>18</sup> The second is a slideshow of photographs taken by local taxpayer advocates in 2010 showing the variety of businesses touting return preparation services.<sup>19</sup>

### Preparers Act as Representatives

The filing of a tax return is not merely a ministerial act. The taxpayer is taking a position before the federal government regarding her items of income, expenses, and eligibility for government benefits that are administered through the tax code.

If you hold yourself out to the public as a tax return preparer, you are not a mere scrivener. You are in the business of advising and assisting your client, the taxpayer, on the treatment of her items of

income and expense under the tax code, and on her eligibility for government benefits that are delivered through the tax code. It is *your* judgment and *your* knowledge that enable you to make that entry on the return on behalf of the taxpayer. Your clients pay you for your knowledge and skills because they are uncomfortable navigating the complexity of the tax laws by themselves. You are not an automaton — or you shouldn’t be.

The district court’s decision in *Loving* is based in part on an outdated understanding of the tax return preparation and filing process. As I explain below, the Internal Revenue Code has become the favored vehicle for delivering major social and economic programs. Indeed, that reality led me to recommend in my 2010 annual report to Congress that the IRS revise its mission statement to reflect its two lines of business: revenue collection and benefits administration.<sup>20</sup> Regardless of whether the mission statement is revised, however, the tax return is the vehicle under this dual system by which a taxpayer presents her case — that is, makes a claim — for these substantial benefits.

The IRS itself has been slow to recognize this change, particularly regarding the role of preparers in the new paradigm of tax administration. In its responses to my various recommendations over the years, the IRS has given several rationales for not stepping immediately into a regulatory role. Ultimately, that policy call was based on concerns about allocation of scarce IRS resources rather than on any limitations of IRS authority.<sup>21</sup> The IRS’s public statements were confirmed by my private conversations with senior IRS and Treasury officials during that period.

The evolution of the IRS and Treasury position, from the willingness to defer to state regulation of a federal activity, to the conviction that the IRS *must* step into a regulatory role, was largely driven by the IRS’s belated recognition of its benefits administration function. To be an effective tax administrator in the 21st century, the IRS would have to focus on revenue protection, thereby shifting much of its compliance activity into the return filing environment. Once the IRS turned its attention to the errors, omissions, and outright fraud that occur in return filing, it began by both logic and necessity to focus on the role of preparers.<sup>22</sup>

<sup>16</sup>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. 2013).

<sup>17</sup>2002 NTA report, at 216-230 (Dec. 31, 2002) (“Legislative Recommendation: Regulation of Federal Tax Return Preparers”). As with many of the legislative recommendations I have proposed over the years, I suggested legislative action because the IRS, for various reasons discussed in the text, was unwilling to act administratively at that time. I had not concluded that the IRS lacked the authority to act.

<sup>18</sup>Available at <http://www.youtube.com/watch?v=W00BmbrIvHk&sns=em> (Southern King Taxes promotional video).

<sup>19</sup>Taxpayer Advocate Service (TAS), “Tax Preparation Sites Across the United States: A Random Selection of Services Marketed to U.S. Taxpayers” (Mar. 10, 2010), available at <http://www.taxpayeradvocate.irs.gov/preparervideo>.

<sup>20</sup>2010 NTA report, *supra* note 2, at 15-27 (“Most Serious Problem: The IRS Mission Statement Does Not Reflect the Agency’s Increasing Responsibilities for Administering Social Benefits Programs”).

<sup>21</sup>See, e.g., 2003 NTA report, at 296-301 (Dec. 31, 2003); 2004 NTA report, at 82-88 (Dec. 31, 2004).

<sup>22</sup>On September 25 and 26, 2007, the IRS held a servicewide return preparer summit during which representatives across the

(Footnote continued on next page.)

So what is that role, exactly? The plaintiffs in *Loving* would have us believe that “a ‘tax return preparer’ is no more the ‘representative’ of a taxpayer whose tax return he or she has prepared than a mechanic who repairs a car is the ‘representative’ of the car owner.”<sup>23</sup> Further, they insist that “preparing a tax return (or claim for refund) for compensation is nothing like presenting a ‘case’” and that a return is “informational and non-adversarial.”<sup>24</sup>

The district court framed the issue before it thusly: “This case turns on whether certain tax-return preparers are representatives who practice before the IRS, and thus are properly subject to the new IRS regulations.”<sup>25</sup>

Answering this question in the negative, the court reasoned as follows:

Section 330(a)(2) [of title 31], like section 330(a)(1), . . . tell[s] us what the representatives do — what their “practice” is, in the words of both subsections: representatives “advise and assist persons in presenting their cases.” . . . Filing a tax return would never, in normal usage, be described as “presenting a case.” At the time of filing, the taxpayer has no dispute with the IRS; there is no “case” to present. This definition makes sense only in connection with those who assist taxpayers in the examination and appeals stages of the process.<sup>26</sup>

As the court noted early in its opinion, “Before probing that question, however, it helps to know something about the IRS adjudication process.”<sup>27</sup> I wholeheartedly agree. And as I will show in the following pages, a complete understanding of 21st-century IRS tax administration and “adjudication processes” requires an acknowledgment that under today’s normal usage, tax return filing is almost always “presenting a case” and that return preparers are representatives before the IRS when they advise and assist taxpayers in making their claims to the IRS and Treasury. The definition of representative must keep up with the programs and policies Congress has chosen to administer through today’s tax code.

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organization analyzed the weaknesses of the existing return preparer initiatives as well as recommendations for improvement. The goal of the 2007 summit was to begin work on a comprehensive and cross-functional IRS return preparer strategy. E-mail on behalf of director, Exam Policy, IRS Small Business/Self-Employed Division (Aug. 28, 2007).

<sup>23</sup>Plaintiffs’ motion for summary judgment at 25, *Loving v. IRS*, Civil Case No. 1:12-cv-00385-JEB, Doc. 12 (D.D.C. Sept. 28, 2012).

<sup>24</sup>*Id.* at 29.

<sup>25</sup>*Loving*, 2013 U.S. Dist. LEXIS 7980 at \*2.

<sup>26</sup>*Id.* at \*18.

<sup>27</sup>*Id.* at \*2.

### Claims Against the Government

Under our self-assessment system, tax return filing has always been a somewhat adversarial act because the taxpayer holds all the information and gets to decide (at her own risk) how much she will tell the tax agency. While information reporting has shifted the balance on income items, including wages, interest, dividends, and some miscellaneous payments, cash income and applications for government benefits provided through the tax system almost guarantee that every return has an error in it — some inadvertent, some intentional. Significantly, IRS data indicate that income underreporting — estimated at \$376 billion for tax year 2006 — is the single largest component of the gross tax gap.<sup>28</sup> The net misreporting percentage — generally, the percentage of an amount due that was not reported<sup>29</sup> — is a measure that provides us some idea of the inherently adversarial nature of today’s return filing system. For sole proprietorship income, the net misreporting percentage is estimated at 57 percent (meaning, in essence, that sole proprietors report less than half of their net income).<sup>30</sup> For EITC claims, the percentage is between 21 and 25 percent.<sup>31</sup>

Unlike in 1884 (when the original statutory grant was enacted) or 1976 (when Congress enacted various civil preparer penalties) or 1982 (when the 1884 statute was “stylistically” rewritten), return preparers today are the intermediaries between taxpayers and their government for most individual and business taxpayers. As noted above, most individual taxpayers pay tax return preparers for assistance and advice in preparing their returns. Preparer usage is particularly high among self-employed taxpayers, with 72 percent of the self-employed paying for return preparation.<sup>32</sup>

Tax law has evolved so that competently advising a taxpayer and accurately preparing even the simplest return require an extraordinary exercise of

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<sup>28</sup>See IRS, “Tax Gap for Tax Year 2006: Overview” (Jan. 6, 2012).

<sup>29</sup>The IRS has defined the net misreporting percentage as “the net misreported amount of income as a ratio of the true amount.” *Id.*

<sup>30</sup>IR-2006-28, “IRS Updates Tax Gap Estimates” (Feb. 14, 2006). The IRS did not update its estimate of the net misreporting percentage for sole proprietors in a more recent study of the tax gap.

<sup>31</sup>The most recent projection is based on a tax year 2008 reporting compliance study that estimated the level of improper overclaims for fiscal 2012 to range from \$11.6 billion to \$13.6 billion and 21 percent (lower bound) to 24.6 percent (upper bound) of approximately \$55.4 billion in total program payments. See Treasury, “Agency Financial Report Fiscal Year 2012,” at 204 (Nov. 15, 2012).

<sup>32</sup>IRS Compliance Data Warehouse, Individual Returns Transaction File (Tax Year 2011).

judgment and knowledge by the return preparer. The code provisions applying to family status are as complex as those relating to depreciation of business property or passive activity losses. I noted in 2001 that the code had six different definitions of child.<sup>33</sup> While legislation in 2004 made uniform several of those definitions,<sup>34</sup> we still have at least two — qualifying child and qualifying relative — that require the taxpayer and her adviser to analyze the relationship and residency of the child and the taxpayer as well as local law to determine whether the relationship is in violation thereof. Today, taxpayers and their preparers must determine the taxpayer's filing status (married filing jointly, married filing separately, head of household, or single), her dependency exemptions, and the related credits (child tax credit and additional child tax credit, child and dependent care credit, and adoption credit) and her eligibility for the EITC. As I discussed in my 2012 annual report to Congress, the definition of whether a taxpayer is married under section 7703(b) is mind-boggling.<sup>35</sup> And good luck to you if you happen to live in a community property state or have entered into a domestic partnership or same-sex marriage.<sup>36</sup>

Consider another example of the complexity of our tax code and the analysis required by a taxpayer (or preparer) to take a position on her return. Almost 4.2 million taxpayers received a Form 1099-C in tax year 2011.<sup>37</sup> Those taxpayers must navigate through a 26-page publication and two worksheets to determine whether the income from debt cancellation (resulting from abandonment of property, foreclosure, or write-off by the creditor) is

taxable.<sup>38</sup> The answer to that question depends in part on whether the debt is recourse or nonrecourse, and attributable to qualified principal residence indebtedness or qualified farm indebtedness, and on whether and to what extent the taxpayer was insolvent at the time of debt cancellation.<sup>39</sup> Those terms and concepts are not exactly part of the average taxpayer's daily vocabulary or expertise. Nevertheless, the position taken by the taxpayer on her return constitutes the opening volley in making her case regarding cancellation of debt income. In tax year 2011, preparers advised and assisted taxpayers in making their case on 66 percent of the returns associated with cancellation of debt income.<sup>40</sup>

Yet the plaintiffs in *Loving* contend that “merely preparing and filing a tax return or claim for refund for a paying customer is not an act of representation, nor is it advising or assisting any person in presenting any case.”<sup>41</sup> That statement fundamentally misrepresents what occurs in 21st-century tax administration.

Remember that we are talking about tax returns here — perhaps the most important communication a U.S. citizen or other taxpayer makes with the U.S. government each year. The act of advising and assisting in the preparation of that submission cannot be dumbed down or rendered insignificant simply by applying the word “mere” before it.

Before the advent of refundable credits, filing an income tax return generally brought finality to your annual conversation with the federal government.

<sup>33</sup>See 2001 NTA report, at 11-13 (Dec. 31, 2001) (“Most Serious Problem: Multiple Definitions of ‘Qualifying Child’”) and 78-100 (“Key Legislative Recommendation: Uniform Definition of a Qualifying Child”).

<sup>34</sup>Working Families Relief Tax Act of 2004, section 201 (amending section 152).

<sup>35</sup>2012 NTA report, *supra* note 3, at 513-520 (“Legislative Recommendation: Amend IRC Section 7703(b) to Remove the Household Maintenance Requirement and to Permit Taxpayers Living Apart on the Last Day of the Tax Year Who Have Legally Binding Separation Agreements to Be Considered ‘Not Married’”).

<sup>36</sup>2012 NTA report, *supra* note 3, at 449-455 (“Status Update: Federal Tax Questions Continue to Trouble Domestic Partners and Same-Sex Spouses”); 2010 NTA report, *supra* note 2, at 211, 215 (“Most Serious Problem: State Domestic Partnership Laws Present Unanswered Federal Tax Questions”); 2005 NTA report, at 407-432 (Dec. 31, 2005) (“Key Legislative Recommendation: Another Marriage Penalty: Taxing the Wrong Spouse”); 2001 NTA report, *supra* note 33, at 128-145 (“Key Legislative Recommendation: Joint and Several Liability”).

<sup>37</sup>IRS Compliance Data Warehouse, Information Returns Master File (Tax Year 2011).

<sup>38</sup>See IRS Publication 4681, *Canceled Debts, Foreclosures, Repossessions, and Abandonments* (2012). The publication contains separate worksheets covering the insolvency and foreclosure exceptions.

<sup>39</sup>See generally section 108.

<sup>40</sup>This includes primary or secondary taxpayers who received a Form 1099 in tax year 2011 and used a paid preparer. IRS Compliance Data Warehouse, Information Returns Master File and Individual Returns Transaction File (Tax Year 2011). As one observer has noted:

The tax gap data shows [sic] that a large portion of the underpayment rate relates to issues where there is not the same opportunity for creative tax advice to exploit ambiguities through engineering artificial losses or deferring the receipt of income . . . but rather relates to, for example, relatively unambiguous legal matters dependent on the accurate presentation of essential facts and practitioner understanding of complex but fairly unambiguous legal rules.

2007 NTA report, vol. 2, at 47-48 (Dec. 31, 2007) (Leslie Book, *Study of the Role of Preparers in Relation to Taxpayer Compliance With the Internal Revenue Laws*). See also 2008 NTA report, vol. 2, at 74-116 (Dec. 31, 2008) (Book, *The Need to Increase Preparer Responsibility, Visibility and Competence*).

<sup>41</sup>Complaint for declaratory and injunctive relief at 12, *Loving v. IRS*, Case 1:12-cv-00385-JEB, Doc. 1 (D.D.C. Mar. 13, 2012).



In the early 1990s, the average audit rate for individuals was 1 percent.<sup>42</sup> With the expansion of the EITC in 1993<sup>43</sup> and the proliferation of tax expenditures and refundable credits in the following decades, the act of filing an income tax return for many taxpayers has become only the beginning of a prolonged conversation with the IRS, much of which takes place in an adversarial framework outside the audit or collection process. Today, in fact, most controversy “cases” arise outside the traditional examination and collection contexts.

How can that be, you might ask? Well, as I wrote in my blog last year about real versus unreal audits, the traditional audit rate of individual taxpayers is still only about 1.11 percent.<sup>44</sup> But that low rate masks how busy the IRS really is. After you add in what I call unreal audits — compliance activity the IRS doesn’t call an audit but sure feels like an audit to the taxpayer — the individual audit rate is about 7.4 percent.<sup>45</sup> And much of that activity occurs in the context of return filing and processing.

Since 1976, when preparer penalties were enacted, Congress has expanded the scope of math error authority and summary assessments under section 6213(g). Today, there are 16 provisions that authorize the IRS to summarily assess items reported on the return, without any advance notice to the taxpayer whatsoever, and the IRS does this as part of processing a return submitted by the taxpayer.<sup>46</sup> Only if the taxpayer (or other person) objects will the IRS actually commence what we call deficiency procedures — namely, abate the summary assessment and institute an audit that results in a notice of deficiency, giving the taxpayer the

right to go to the Tax Court.<sup>47</sup> For the 2012 filing season, the IRS issued 2,042,458 math error notices for individual returns.<sup>48</sup> About 10 percent of the amounts assessed were later abated.<sup>49</sup> Virtually all the math error notices were issued as part of IRS return processing, and most of the abatements were issued during the filing season or shortly thereafter.<sup>50</sup>

In addition to the expansion of math error authority and the corresponding increase in these filing season cases, the IRS has developed a new program designed to identify and address questionable returns and refund fraud before a refund is issued. The focus of the IRS today is on revenue protection and pre-refund screening.

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<sup>47</sup>In simplest terms, a deficiency is the tax in excess of the tax shown on a return (or as previously adjusted). See section 6211. When the IRS determines a deficiency (except deficiencies determined as a result of correcting a mathematical or clerical error on the taxpayer’s return), the deficiency procedures outlined in sections 6211-6216 must be followed. A notice of deficiency, also called a statutory notice of deficiency or 90-day letter, is the legal notice in which the IRS determines the taxpayer’s tax deficiency. See section 6212. The notice of deficiency contains the amount of the deficiency, a statement showing how the deficiency was computed, and an explanation of the adjustments. See Internal Revenue Manual section 4.8.9.2 (June 14, 2011). It informs the taxpayer of the right to petition the Tax Court to dispute the deficiency and also notifies the taxpayer of the right to contact a local office of the Taxpayer Advocate Service. Section 6212(a). The taxpayer has only 90 days (150 days if the notice is addressed to a person outside the United States) to petition the Tax Court. If the taxpayer petitions the Tax Court, the IRS is prohibited from assessing any deficiency until the Tax Court decision becomes final, and for 60 days thereafter. Sections 6213(a) and 6503(a)(1).

<sup>48</sup>2012 IRS Data Book, *supra* note 1, Table 15, “Math Errors on Individual Income Tax Returns.”

<sup>49</sup>This amount was determined by comparing additional refund amounts actually paid to taxpayers with refund amounts disallowed during return processing for tax year 2011. IRS Compliance Data Warehouse, Individual Returns Transaction File and Individual Master File (2011).

<sup>50</sup>For a detailed discussion of IRS math error authority and the problems associated with its implementation, see 2011 NTA report, at 74-92 (Dec. 31, 2011) (“Most Serious Problem: Expansion of Math Error Authority and Lack of Notice Clarity Create Unnecessary Burden and Jeopardize Taxpayer Rights”); *id.* at 524-530 (“Legislative Recommendation: Mandate That the IRS, in Conjunction With the National Taxpayer Advocate, Review Any Proposed Expanded Math Error Authority to Protect Taxpayer Rights”); see also 2012 NTA report, *supra* note 3, vol. 2, at 113-144 (“TAS Research: Math Errors Committed on Individual Tax Returns: A Review of Math Errors Issued for Claimed Dependents”); 2006 NTA report, at 311 (Dec. 31, 2006); 2003 NTA report, *supra* note 21, at 113; 2002 NTA report, *supra* note 17, at 186; 2001 NTA report, *supra* note 33, at 33. See also “Improper Payments in the Administration of Refundable Tax Credits,” House Ways and Means Oversight Subcommittee hearing, 112th Cong. (2011) (statement of Olson); “Complexity and the Tax Gap: Making Tax Compliance Easier and Collecting What’s Due,” Senate Finance Committee hearing, 112th Cong. (2011) (statement of Olson).

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<sup>42</sup>In fiscal 1991, 112,303,900 individual returns were filed and 1,123,522 were audited, resulting in an audit rate of 1 percent. IRS 1991 annual report, Table 11, at 24 (“Returns Filed, Examination Coverage” (1991)).

<sup>43</sup>See Omnibus Budget Reconciliation Act of 1993, section 13131. Note that the EITC was also expanded in 2001 and then again in 2009. See Economic Growth and Tax Relief Reconciliation Act of 2001, section 303; American Recovery and Reinvestment Act of 2009, section 1002. For tax year 2012, the maximum amount of EITC a taxpayer could claim was \$5,891. See IRS Publication 596, *Earned Income Credit* (2012), Appdx. at 42.

<sup>44</sup>Nina E. Olson, “What’s an Audit, Anyway?” NTA blog (Jan. 25, 2012), available at <http://www.taxpayeradvocate.irs.gov/Blog/Whats-an-Audit-Anyway>.

<sup>45</sup>In fiscal 2010, the IRS examined 1,414,664 individual taxpayers under procedures that technically constitute “audits” (what I call “real audits”). During that same period, it conducted “unreal audits” (consisting of automated substitute for return, automated underreporter, and math error) on some 9,215,841 individual taxpayers. Olson, *supra* note 44.

<sup>46</sup>Under section 6213(b) and (g), the IRS is authorized to make summary assessments of tax to correct arithmetic mistakes and the like. Paragraphs (A) through (P) of section 6213(g)(2) provide the definition of math and clerical error.

Under this revenue-protection approach to return processing, once a return claiming a refund is electronically submitted to the IRS (or converted from paper into an electronic format), it passes through a series of databases and filters before a refund is issued. For example, the Error Resolution System provides for the correction of errors associated with input submissions, and it issues correspondence and math error notices. Refund returns then go through other filters, including the Dependent Database, Questionable Refund Program, Duplicate Direct Deposit Database, Duplicate Taxpayer Identification Number, and other pre-refund filters and cluster rules for the identification of fraudulent returns or identity theft.<sup>51</sup>

At this point, the return, still swimming upstream, may be determined “unpostable” and will either go to various units for perfection — which in some instances may require communication with the taxpayer — or be sent to the Generalized Unpostable Framework. Once returns are accepted for posting, those returns claiming refunds pass through the Electronic Fraud Detection System (EFDS) filters, designed to identify returns that have a high risk of containing fraudulent information. Any returns identified by these filters are held until the income and withholding can be verified or, if unverifiable, until income and withholding are adjusted to amounts the IRS can verify.

Even after successfully navigating this obstacle course, our poor little refund return is still not done. Having applied all these filters and business rules to identify potential items that require an audit for verification, the IRS then selects the highest-risk returns and holds any potential refund until an audit can be completed. Only after a return completes all of these stages — any one of which can trip up and delay return processing — will the IRS issue a refund to the taxpayer.

Thus, in the 2012 filing season, the IRS selected tax returns associated with 1.46 million Forms W-2 and other information reporting documents for pre-refund verification.<sup>52</sup> Moreover, it issued almost 364,000 EITC math error notices<sup>53</sup> and conducted more than 358,000 pre-refund EITC audits.<sup>54</sup> In the 2011 and 2012 filing seasons, 90 percent of indi-

vidual income tax returns submitting claims for the adoption credit under section 36C<sup>55</sup> were subject to delay and reviewed. The IRS audited 71 percent of adoption credit claims in 2011<sup>56</sup> and 69 percent in 2012,<sup>57</sup> with the average correspondence audit for adoption credit cases taking 126 days in fiscal 2012.<sup>58</sup> For the first-time home buyer credit, in the 2008, 2009, and 2010 tax years during which the credit could be claimed,<sup>59</sup> almost 200,000 claims were delayed for an average of 150 days during the audit process.<sup>60</sup>

This filing season, 12.3 million returns had potential errors identified during processing — meaning they were sent to “error resolution,” and some taxpayers may have to present additional information to get their returns processed.<sup>61</sup> And then there is identity theft, about which I have written and testified extensively.<sup>62</sup> About 2.4 million returns

<sup>55</sup>For tax years 2010 and 2011, section 23 was redesignated as section 36C.

<sup>56</sup>This percentage reflects audits commenced through October 10, 2012 — cycle 42. IRS Wage and Investment Division response to TAS information request (Nov. 19, 2012).

<sup>57</sup>IRS production report, “Adoption Credit Compliance Filters Report Through Cycle 2012-38” (through Sept. 14, 2012). Includes late-filed 2010 returns as well as 2011 returns. “IRS 7-Day Response to NTA Report Most Serious Problem Draft” (Nov. 29, 2012).

<sup>58</sup>This was up from 83 days in fiscal 2011. IRS Compliance Data Warehouse, AIMS, Project codes 0355, 1067, and 0981 for fiscal 2011 and 2012 (Nov. 2012).

<sup>59</sup>There are special benefits for members of the military and some other federal employees. Thus, an eligible taxpayer must buy, or enter into a binding contract to buy, a principal residence on or before April 30, 2011. If a binding contract is entered into by that date, the taxpayer has until June 30, 2011, to close on the purchase. See IRS, “First-Time Homebuyer Credit: Members of the Military and Certain Other Federal Employees,” available at <http://www.irs.gov/uac/First-Time-Homebuyer-Credit-Members-of-the-Military-and-Certain-Other-Federal-Employees>.

<sup>60</sup>IRS Compliance Data Warehouse, Audit Information Management System Closed Case Database (for tax year 2008, 2009, and 2010 returns with source code 8 and claiming the first-time home buyer’s credit according to the Individual Returns Transaction File).

<sup>61</sup>IRS, submission processing miscellaneous monitoring report, Headquarters (week ending Apr. 26, 2013).

<sup>62</sup>“Tax Fraud, Tax ID Theft and Tax Reform: Moving Forward With Solutions,” Senate Finance Committee hearing, 113th Cong. (Apr. 16, 2013) (statement of Nina E. Olson); 2012 NTA report, *supra* note 3, at 42-67 (“Most Serious Problem: The IRS Has Failed to Provide Effective and Timely Assistance to Victims of Identity Theft”); 2011 NTA report, *supra* note 50, at 48-73 (“Most Serious Problem: Tax-Related Identity Theft Continues to Impose Significant Burdens on Taxpayers and the IRS”); 2009 NTA report, at 307-317 (Dec. 31, 2009) (“Status Update: IRS’s Identity Theft Procedures Require Fine-Tuning”); 2008 NTA report, *supra* note 40, at 79-94 (“Most Serious Problem: IRS Process Improvements to Assist Victims of Identity Theft”); 2007 NTA report, *supra* note 40, at 96-115 (“Most Serious Problem: Identity Theft Procedures”); 2005 NTA report, *supra* note 36, at 180-191 (“Most Serious Problem: Identity Theft”); 2004 NTA

(Footnote continued on next page.)

<sup>51</sup>Refund returns also pass through the EFDS filters, which are designed to identify returns that have a high risk of containing fraudulent information.

<sup>52</sup>IRS Wage and Investment Division response to TAS information request (Nov. 19, 2012).

<sup>53</sup>2012 IRS Data Book, *supra* note 1, Table 15, “Math Errors on Individual Income Tax Returns.”

<sup>54</sup>IRS Compliance Data Warehouse, Audit Information Management System Closed Case Database (Tax Year 2011) (data on EITC pre-refund audits).



were delayed and reviewed during the 2012 filing season.<sup>63</sup> Moreover, at the end of fiscal 2012, the IRS had an open inventory of nearly 650,000 identity theft cases in which the victims' returns had not yet been processed.<sup>64</sup>

This scrutiny and activity take place in the filing season after the return is submitted but before the return is accepted into the system — and completely outside the traditional audit environment. And of course, preparers call the IRS constantly inquiring about the status of these returns. In short, they have cases before the IRS and they are advocating on behalf of their clients' claims.

The discussion above amply demonstrates that in the 21st century, the act of "merely" preparing and filing a tax return is not so "mere" after all. It is the first step in what for millions of U.S. taxpayers every year will become a formal controversy, before any audit or collection activity has begun and before the accrual of specific due process rights such as Tax Court review or collection due process hearings.

#### Preparer Regs Keep With Congressional Intent

Today's tax system, with its industry of preparers, closely resembles the circumstances in 1884 when Congress sought to impose order on the process of filing claims before Treasury. The *Loving* plaintiffs correctly note in their motion for summary judgment that the 1884 statute was enacted "in response to mounting complaints about misconduct by unscrupulous attorneys and claims agents who represent military pensioners, persons with claims for lost horses, and others with claims for compensation from the federal government."<sup>65</sup> As the congressional record shows, at that time "attorneys and other agents . . . competed to solicit claimants, and even the rights to their claims, sometimes in less-than-scrupulous ways."<sup>66</sup> One congressman, in making the case for greater consumer protection, said:

While there are some very reputable gentlemen engaged in the business, who charge reasonable fees, there are many who are very

report, *supra* note 21, at 133-136 ("Most Serious Problem: Inconsistent Campus Procedures").

<sup>63</sup>IRS, "Refund Fraud and ID Theft Global Report" (Jan. 15, 2013) (including data through Dec. 31, 2012). The IRS held 2,359,160 returns for review for potential identity theft.

<sup>64</sup>As of September 30, 2012, the IRS had almost 650,000 identity theft cases in inventory agencywide. See IRS Identity Theft Advisory Council, "Identity Theft Status Update" (Oct. 24, 2012). The actual number is 646,950.

<sup>65</sup>Plaintiffs' motion for summary judgment, *supra* note 23, at 3.

<sup>66</sup>*Id.* at 32.

disreputable, and who have been guilty of bad practices, and have victimized many a poor soldier who was unable to take care of himself. . . . The object of this proviso is to protect soldiers against such practices.<sup>67</sup>

Note how closely that language tracks what I have written in my annual reports and congressional testimony, describing the tax universe in which we find ourselves today.<sup>68</sup> While it is true that we no longer have "other agents" "advising and assisting" taxpayers on making their claims to Treasury for lost or stolen horses, we do have other agents advising and assisting taxpayers on making claims to Treasury (through the IRS) for earnings supplements for the working poor (EITC), for first-time home buyers, for adoption assistance, and soon, for subsidies for affordable health insurance premiums.<sup>69</sup> While it is true that in 1884 someone had to physically present your claim for a horse, in 2013 we use e-filing, and less frequently the mail, to present the above-mentioned claims to Treasury.

Here is the original 1884 statutory text, in part:

The Secretary of the Treasury may prescribe rules and regulations governing the recognition of agents, attorneys, or other persons representing claimants before his Department, and may require of such persons, agents and attorneys, before being recognized as representatives of claimants, that they shall show that they are of good character and in good repute, possessed of the necessary qualifications to enable them to render such claimants valuable service, and otherwise competent to advise and assist such claimants in the presentation of their cases.<sup>70</sup>

In 1982<sup>71</sup> Congress changed the 1884 statute to read as follows:

<sup>67</sup>Statement of Rep. Richard Townshend, 48 *Cong. Rec.* H5219 (June 16, 1884), quoted in plaintiffs' motion for summary judgment, *supra* note 23, at 33.

<sup>68</sup>"Tax Fraud, Tax ID Theft and Tax Reform," *supra* note 62, at 23-26. See also "Regulation of Federal Tax Return Preparers," House Ways and Means Oversight Subcommittee hearing, 109th Cong. 4 (July 20, 2005) (statement of Nina E. Olson). I noted:

The current situation allows serious and competent unenrolled preparers to be tarred with the misdeeds of unscrupulous or incompetent unenrolled preparers, and it leads to taxpayer confusion about who one should turn to for help. Is "buyer beware" really an appropriate or sensible standard for the federal tax return preparation market?

<sup>69</sup>Sections 32 (EITC), 36C (first-time home buyer credit), 23 (credit for adoption expenses), and 36B (premium assistance tax credit).

<sup>70</sup>Act of July 7, 1884, ch. 334.

<sup>71</sup>P.L. No. 97-258, 96 Stat. 877 (1982).

**Table 1. Taxpayers Claiming Refundable Credits, Claim Amounts, and Preparer Usage: Tax Years 2010 and 2011<sup>a</sup>**

Tax Credit	Tax Year	Number of Taxpayers	Average Claim (dollars)	Total Claims (dollars in thousands)	Preparer Returns (percentage)
EITC	2011	27,362,193	\$2,270	\$62,119,975	59.3%
Additional child tax credit	2011	20,616,435	\$1,347	\$27,771,740	65.0%
First-time home buyer credit	2010	373,880	\$6,893	\$2,577	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%

<sup>a</sup>IRS Compliance Data Warehouse, Individual Returns Transaction File and Individual Master File (Tax Years 2010 and 2011).

(a) Subject to section 500 of title 5, the Secretary of the Treasury may —

(1) regulate the practice of representatives of persons before the Department of the Treasury; and

(2) before admitting a representative to practice, require that the 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.

As the plaintiffs in *Loving* note, however, those changes were made for stylistic purposes, as part of a larger effort to simplify the U.S. Code by using one word where several previously served<sup>72</sup>:

In 1982, “when the Act of 1884 was recodified . . . Congress explicitly stated that it was simplifying the language without making any substantive changes in meaning.” Poole, 1984 U.S. Dist. LEXIS 15351, at \*5 (citing H.R. Rep. No. 651, 97th Cong., 2d Sess. 19 (1982)). Among the 1982 changes, “the words ‘representatives of persons’ [were] substituted for ‘agents, attorneys, or other persons representing claimants before his department’ to eliminate unnecessary words.”<sup>73</sup>

The emphasis on the word “claimants” in conjunction with “cases” in the original statute is

<sup>72</sup>Plaintiffs’ motion for summary judgment, *supra* note 23, at 4.

<sup>73</sup>*Id.* at 34. The House report accompanying the 1982 codification of title 31 contains the following statement of purpose at the outset: “The purpose of the bill is to restate in comprehensive form, without substantive change, certain general and permanent laws related to Money and Finance and to enact those laws as Title 31, United States Code.” H.R. Rep. No. 97-651, at 1 (1982).

highly significant. By submitting a tax return reflecting an overpayment, a taxpayer presents a case for money to be returned by the federal government. In this regard, reg. section 301.6402-3(a)(1) provides the general rule that a claim for credit or refund shall be made on the appropriate income tax return. Moreover, a “properly executed individual, fiduciary, or corporation original income tax return . . . shall constitute a *claim* for refund or credit within the meaning of section 6402 . . . for the amount of the overpayment disclosed by such return.”<sup>74</sup> The IRS has reiterated that a “return shall be a *claim* for refund if it contains a statement setting forth the amount determined as an overpayment and advising that such amount shall be refunded to the taxpayer.”<sup>75</sup> Even if the taxpayer owes no tax, because of the magnitude of refundable credits available today, a taxpayer can still end up with an overpayment.<sup>76</sup> Any such overpayment can be refunded only if a timely *claim* is presented to the federal government.<sup>77</sup>

Today, more than 80 percent of individual income tax returns are actually claims for refund under section 6402.<sup>78</sup> Moreover, nearly 80 percent of returns prepared by preparers claimed a refund.<sup>79</sup>

<sup>74</sup>Reg. section 301.6402-3(a)(5) (emphasis added). See also *McIlvaine v. United States*, 23 Cl. Ct. 439, 442 (1991) (“an original income tax return that identifies the amount of overpayment is considered to be a refund claim”); *Reinhart v. United States*, 2004 U.S. Dist. LEXIS 24989 at \*4 (W.D. Tex. 2004) (“a valid Form 1040 can constitute a claim for refund”).

<sup>75</sup>Rev. Rul. 76-511, 1976-2 C.B. 428 (emphasis added).

<sup>76</sup>See *Sorenson v. Secretary of the Treasury*, 475 U.S. 851, 855 (1986) (“An individual who is entitled to [a refundable credit] that exceeds the amount of tax he owes thereby receives the difference as if he had overpaid his tax in that amount”).

<sup>77</sup>See section 6511(b)(1).

<sup>78</sup>For tax year 2011, the IRS received 142,424,022 individual returns, of which 114,511,777 (80.4 percent) claimed refunds. IRS Compliance Data Warehouse, Individual Returns Transaction File (Tax Year 2011).

<sup>79</sup>For tax year 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 (Tax Year 2011).

In the last few decades, Congress has shown a predilection for administering social and other benefit programs through the tax code. The Congressional Budget Office has pointed out that specific major tax expenditures alone equal about one-third of 2012 federal revenues<sup>80</sup>; in all, the hundreds of tax expenditure provisions totaled more than \$1 trillion in fiscal 2012.<sup>81</sup> While some tax expenditures reduce a taxpayer's tax liability (for example, the home mortgage interest deduction), others are refundable — that is, they involve a payout of funds even when there is no tax liability. Table 1 shows that the number of returns on which taxpayers make their case to claim a refundable federal benefit is substantial. Moreover, 22.3 million taxpayers filing returns claiming refundable tax benefits paid a preparer to help in making the claim — and most of those preparers fall into the category of “other persons” under the 1884 statute.<sup>82</sup>

As in 1884, taxpayers/claimants receive advice and assistance from preparers and other persons in order to present their claims to Treasury for payment. The abuses Congress sought to regulate in 1884 are of the same type we see today regarding claims made on tax returns. Thus, while the plaintiffs in *Loving* argue that the new regulations under 31 U.S.C. section 330 are a sweeping new licensing scheme, I would argue that they are not a radical departure from their 1884 statutory roots and are fully consistent with the origins and reasons for the original statutory authorization.

Moreover, existing penalties for preparer misconduct certainly serve a purpose that is not in conflict with the new professional regulations. Penalties are applied after the fact to specific instances of misconduct. Thus, a penalty for negligence will be assessed against a preparer on a case-by-case basis, and the elements of negligence must be proved for each case. A testing and continuing education regime is prophylactic — by establishing these standards and requiring preparers to meet them before preparing any returns, the government can ensure that the preparer has a minimum level of competency and professionalism so that future negligence will be minimized. I fail to see any conflict between those two approaches.

<sup>80</sup>See CBO, “Tax Expenditures Have a Major Impact on the Federal Budget” (Feb. 3, 2012).

<sup>81</sup>See CRS, *supra* note 2, at 1 and 11; see also Joint Committee on Taxation, “Estimates of Federal Tax Expenditures for FY 2012-17,” JCS-1-13 (Feb. 1, 2013).

<sup>82</sup>IRS, Compliance Data Warehouse, Individual Returns Transaction File and Individual Master File (Tax Year 2011); Return Preparers and Providers Database (Tax Year 2011).

### Clear Authority to Regulate Return Preparers

The outcome of *Loving* rests on the reviewing court's application of the two-step *Chevron* analysis.<sup>83</sup> Under *Chevron*, the court must ask if Congress's intent in enacting the statute giving rise to the challenged government action — here, the regulation — is clear (*Chevron* step one): “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.”<sup>84</sup> 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” (*Chevron* step two).<sup>85</sup>

Regarding *Chevron* step one: As the preparers challenging the regulation have stated, the 1884 statute and its successors authorize Treasury to regulate persons who are advising and assisting with the presentation of claims and cases before the government. The reality of 21st-century tax administration is that most cases involving claims before Treasury arise at the time of filing an income tax return on which that claim is made, not after the fact in the traditional audit environment. Thus, preparers are clearly involved in the making and representation of these claims. In light of the complexity of the tax code, especially refundable credits, which constitute more than 36 percent of annual refund claims,<sup>86</sup> preparers cannot say they are not “advising and assisting claimants” in the preparation of their clients' claims. Taxpayers are going to preparers in droves because they need their expertise. It seems to me that today's tax administration and the role of preparers are analogous to the state of affairs that Congress sought to regulate back in 1884. Thus, I believe a court could conclude that the statute at issue here is unambiguous in support of the government's authority to regulate paid return preparers.

Regarding *Chevron* step two: If the language of the statute is found to be ambiguous, then for the reasons I have discussed above, the government's scheme to regulate return preparers is a permissible and reasonable approach to solving a serious problem in tax administration.<sup>87</sup>

<sup>83</sup>*Chevron U.S.A. Inc. v. Natural Resources Defense Council Inc.*, 467 U.S. 837 (1984).

<sup>84</sup>*Id.* at 842-843.

<sup>85</sup>*Id.* at 843.

<sup>86</sup>IRS Compliance Data Warehouse, Individual Returns Transaction File and Individual Master File (Tax Year 2011).

<sup>87</sup>The government's extensive efforts to study the problem, hear the concerns of the public, and respond to those concerns, including issuing proposed regulations for notice and comment,

(Footnote continued on next page.)



## COMMENTARY / SPECIAL REPORT

Either way, I believe Treasury and the IRS possess the regulatory authority to implement the scheme I first proposed in 2002. That is a good thing for taxpayers, for tax administration, and for all of us as citizens, because it will retrieve the profession and practice of tax return preparation from the swamp to which it has descended during the last two decades.

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are well documented and meet the analysis required by *Chevron* step two. For an extensive discussion of the IRS's efforts to solicit public comments through three public hearings and formal notice and comment periods for proposed guidance, see IRS Publication 4832, *supra* note 8, at 25-32.

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