

B. Return Preparer Fraud: A Sad Story

Background

Unscrupulous tax return preparers sometimes alter taxpayers' returns by inflating income, deductions, credits, or withholding without their clients' knowledge or consent. They then pocket the entire refund, or the difference between the revised refund amount and the amount the taxpayer expected, by diverting all or part of the direct deposit refund to a bank account under the preparer's control.

To recap: since 2000, the IRS has received four legal opinions from its Office of Chief Counsel that, when read together, permit the IRS to (1) disregard the altered return filed by the preparer, (2) accept an unaltered return signed by the taxpayer, and (3) issue a refund to the victim even if a payment had already been made to the preparer. Chief Counsel recently reaffirmed to the National Taxpayer Advocate and the IRS Commissioner that the IRS is not prohibited from issuing refunds to victims of preparer fraud. Yet in all this time, the IRS has chosen not to take the actions necessary to assist victims of preparer fraud.

In some cases, the taxpayer has a copy of the legitimate (unaltered) return, receives the refund he or she was expecting, and has no reason to suspect fraud. In many situations, the taxpayer learns of the fraud only after the IRS discovers the taxpayer's return is incorrect and attempts to recover the excess refund (paid to the preparer) from the taxpayer through levies or refund offsets.

In situations where the preparer diverted even the legitimate portion of the refund to his own account, victimized taxpayers have little hope of obtaining their refunds from the preparer, who may have closed up shop and disappeared.

Despite Being Aware of This Issue Since 2000, the IRS Has Not Yet Developed Procedures to Fully Unwind the Harm to Victims of Preparer Fraud.

Return preparer fraud is not a novel issue. The IRS has known about this problem and its severe impact on victims for many years. The IRS Office of Chief Counsel ("Counsel") has provided advice on such situations dating as far back as 2000, when it concluded that there is "no legal impediment to reissuing a direct deposit refund" to a taxpayer whose return was altered after visiting a Volunteer Income Tax Assistance site.¹

In 2003, Counsel again addressed a situation where an electronically filed tax return was altered without the taxpayer's knowledge, and declared that a return altered by a preparer after the victim has verified the accuracy of the return is a "nullity" and, therefore, invalid.² In 2008, Counsel once again looked at a situation where a refund was improperly directed to a preparer and made clear that the IRS "can and should" adjust each affected taxpayer's account for any refund

¹ Field Service Advice 200038005 (June 6, 2000). While Field Service Advice is not binding and may not be cited as precedent, it does allow us some insight on how similar situations may be analyzed.

² See IRS Office of Chief Counsel Memorandum, *Horse's Tax Service*, PMTA 2011-13 (May 12, 2003).

(or portion of one) illegally obtained by the preparer.³ In 2011, Counsel reiterated that “[a] tax return signed by a taxpayer that is altered by a tax return preparer without the taxpayer’s knowledge and submitted to the IRS by the preparer is not a valid tax return.”⁴

To recap: since 2000, the IRS has received four legal opinions from its Office of Chief Counsel that, when read together, permit the IRS to (1) disregard the altered return filed by the preparer, (2) accept an unaltered return signed by the taxpayer, and (3) issue a refund to the victim even if a payment had already been made to the preparer. Chief Counsel recently reaffirmed to the National Taxpayer Advocate and the IRS Commissioner that the IRS is not prohibited from issuing refunds to victims of preparer fraud.

Yet in all this time, the IRS has chosen not to take the actions necessary to assist victims of preparer fraud. Current IRS procedures instruct Accounts Management employees to suspend preparer fraud cases, “pending Counsel guidance” – even though Counsel has stated that there is no legal prohibition for the IRS to issue such refunds.⁵ It is one thing if the government is unaware of a problem, but when it learns of one (as far back as 2000) and receives advice from its Counsel on how it can unwind the harm, the fact that it drags its feet and throws up so many obstacles makes it an act of intent and commission. It is embarrassing that the IRS has acted so callously toward victims of preparer fraud who were trying to comply with the law, and who have demonstrated that they were not complicit in fraud. These taxpayers deserve better.

TAS Has Been Unable to Obtain Complete Relief for Victims of Preparer Fraud.

Beginning in fiscal year (FY) 2011, TAS started tracking preparer fraud cases using a special code. As shown below, TAS has continued to work a substantial number of cases in which taxpayers are harmed by return preparer fraud or misconduct.

As of May 31, 2014, TAS had 316 return preparer fraud cases in inventory.⁶ Since 2013, the National Taxpayer Advocate has elevated 25 Taxpayer Assistance Orders (TAOs) on this issue to Acting Commissioners Steven Miller and Danny Werfel from January through September 2013.⁷ These victims are typically low income taxpayers, with a median adjusted gross income of \$17,548 and a median refund claim of \$2,511.⁸ Some of the victims who have come to TAS for help have been waiting for refunds since they filed 2008 tax

3 See IRS Office of Chief Counsel Memorandum, *Refunds Improperly Directed to a Preparer*, POSTN-145098-08 (Dec. 17, 2008).

4 See IRS Office of Chief Counsel Memorandum, *Tax Return Preparer’s Alteration of a Return*, PMTA 2011-20 (June 27, 2011).

5 See Director, Accounts Management, *Interim Guidance on Return Preparer Misconduct (For Memphis Accounts Management ONLY)*, WI-21-0813-02 (Aug. 5, 2013).

6 Data obtained from TAMIS (June 25, 2014). The current inventory of preparer fraud cases include unresolved cases received in prior FYs.

7 As of June 9, 2014, 113 TAOs involving return preparer misconduct have been elevated to the National Taxpayer Advocate. These elevated TAOs are included as part of the TAOs issued noted in Figure II.3. The National Taxpayer Advocate has decided not to elevate these TAOs to the Commissioner at this time, pending the IRS development of procedures to implement the Commissioner’s decision to issue refunds to victims of preparer misconduct who are able to meet certain substantiation requirements, discussed below.

8 National Taxpayer Advocate 2013 Annual Report to Congress 96.

returns.⁹ On December 20, 2013, Deputy Commissioner for Services and Enforcement John Dalrymple rescinded *en masse* the 24 TAOs elevated to the Acting Commissioners which requested the IRS issue a refund to the victim of preparer fraud (one of the 25 TAOs elevated involved a victim who was not seeking a refund from the IRS). As a result, none of the victims of preparer fraud for whom TAS has issued TAOs have received refunds.

FIGURE II.3, TAS PREPARER FRAUD CASES¹⁰



The National Taxpayer Advocate Has Worked Tirelessly to Convince IRS Leadership to Develop Procedures to Make Victims of Preparer Fraud Whole.

While working to help these individual taxpayers, we have also been pursuing this issue from a systemic perspective. Since 2011, the National Taxpayer Advocate has raised and discussed this issue with four Commissioners (two acting) and has directed the IRS to develop procedures to remedy this problem via two proposed Taxpayer Advocate Directives (TADs)¹¹ and a TAD (see timeline).¹² The National Taxpayer Advocate has also covered the subject extensively in the last two Annual Reports to Congress.¹³

⁹ See, e.g., TAMIS case numbers 4757753, 5269873, and 5361465.

¹⁰ Data obtained from TAMIS June 25, 2014. The current inventory of preparer fraud cases include unresolved cases in prior FYs.

¹¹ See IRM 13.2.1.6.1.2, *Proposed TAD* (July 16, 2009).

¹² Pursuant to Delegation Order No. 13-3, the National Taxpayer Advocate has the authority to issue a TAD “to mandate administrative or procedural changes to improve the operation of a functional process or to grant relief to groups of taxpayers (or all taxpayers) when implementation will protect the rights of taxpayers, prevent undue burden, ensure equitable treatment, or provide an essential service to taxpayers.” IRM 1.2.50.4, Delegation Order 13-3 (formerly DO-250, Rev. 1), *Authority to Issue Taxpayer Advocate Directives* (Jan. 17, 2001). See also IRM 13.2.1.6, *Taxpayer Advocate Directives* (July 16, 2009).

¹³ See, e.g., National Taxpayer Advocate 2013 Annual Report to Congress 94-102; National Taxpayer Advocate 2012 Annual Report to Congress 68-94.

Commissioner Koskinen Has Decided That the IRS Will Issue Refunds to Victims of Preparer Fraud Who Provide a Copy of a Police Report.

In recent discussions with the National Taxpayer Advocate, Commissioner Koskinen decided that the IRS will issue refunds to victims of preparer fraud who can show that they were not

complicit in the preparer's fraud. Under the Commissioner's approach, the victim will be required to provide a copy of an incident report filed with local law enforcement (*i.e.*, a police report) before the IRS issues a replacement refund, to alleviate the IRS's concern about collusion between the preparer and taxpayer. While the Commissioner's decision to require a police report to accompany all claims of preparer fraud will not provide relief to all victims, it constitutes a major step forward. Moreover, having a bright line rule will make it easier for IRS employees to process these claims.

Since 2011, the National Taxpayer Advocate has raised and discussed this issue with four Commissioners (two acting) and has directed the IRS to develop procedures to remedy this problem via two proposed Taxpayer Advocate Directives (TADs) and two TADs.

While the National Taxpayer Advocate is pleased with the Commissioner's decision, she remains concerned about victims of preparer fraud who will be unable to obtain a police report. Some will not be able to obtain the report because the particular police department does not accept incident reports related to tax fraud, or refuses to accept a report for an incident that occurred several years ago (as stated earlier, some of our cases relate to 2008 tax returns). Additionally, some taxpayers who have ques-

tionable immigration status may be hesitant to go to the police for fear of being reported to immigration authorities. TAS is developing interim guidance on how Local Taxpayer Advocates can continue to advocate for such victims on a case-by-case basis by providing alternate documentation to alleviate the IRS's concern about possible collusion.

The IRS Chief Financial Officer has raised some concerns regarding the proper accounting entries that need to be made for such refunds. While these are legitimate concerns, the National Taxpayer Advocate wants these issues resolved immediately so that refunds are not further delayed. Recognizing that some victims waiting for refunds from their 2008 tax returns, the National Taxpayer Advocate has issued yet another TAD ordering the IRS to finalize procedures in time to start issuing refunds by October 1, 2014 (see Taxpayer Advocate Directive 2014-1, *infra*). If the IRS does not have procedures in place by October 1, 2014, the National Taxpayer Advocate will sustain and forward all pending return preparer fraud TAOs to the Deputy Commissioner for Services and Enforcement. If they remain unresolved, she will elevate them to the Commissioner of Internal Revenue. In her Annual Report to Congress, she will report to Congress on all TAOs on which the IRS has failed to act in accordance with her order.

For the remainder of FY 2014 and FY 2015, TAS will:

- Work with the Wage & Investment division to develop guidance on when it is appropriate to issue refunds to victims of preparer fraud;
- Meet with the Chief Financial Officer's staff to work through concerns related to financial reporting and accounting for such refunds;
- Update guidance to TAS employees on how to advocate for victims of return preparer fraud and what documentation should be submitted to the IRS; and
- If necessary, continue to elevate return preparer fraud TAOs to the highest levels of the IRS.

FIGURE II.4, NATIONAL TAXPAYER ADVOCATE'S ELEVATION OF PREPARER FRAUD ISSUE

<p>The following chronology sets forth the procedural history of the National Taxpayer Advocate's involvement in elevating the preparer fraud issue.</p>	
2010	
December 2010	Nashville Local Taxpayer Advocate (LTA) issues TAOs to Accounts Management on behalf of four taxpayers who had been victimized by the same unscrupulous preparer.
2011	
June 13, 2011	NTA issues Proposed TAD 2011-1 to the W&I Commissioner, directing W&I to establish procedures for adjusting taxpayer accounts in instances where a preparer alters the return without the taxpayer's knowledge or consent.
July 6, 2011	NTA and Deputy NTA meet with W&I Commissioner Rick Byrd to discuss the concerns raised in Proposed TAD 2011-1.
December 31, 2011	NTA highlights return preparer fraud issue in 2011 Annual Report to Congress.
2012	
January 12, 2012	NTA issues TAD 2012-1 to the W&I and SB/SE division commissioners, directing them to establish procedures to assist victims of preparer fraud.
February 3, 2012	W&I Commissioner Peggy Bogadi appeals TAD 2012-1, indicating that W&I intends to comply with the substance of the TAD, but that it was not feasible to comply with the established timelines.
March 20, 2012	NTA testifies before Senate Committee on Finance, Subcommittee on Fiscal Responsibility and Economic Growth, regarding preparer fraud.
May 8, 2012	NTA testifies before House Committee on Ways and Means, Subcommittees on Oversight and Social Security, regarding preparer fraud.
June 5, 2012	SB/SE issues interim guidance to its employees regarding collection activity in cases where the taxpayer has been victimized by a tax return preparer.
June 25, 2012	Special Counsel to the NTA requests a legal opinion from the subject matter experts in the Office of Chief Counsel, specifically asking whether the IRS has the legal authority to issue a "second" refund.
June 26, 2012	W&I issues interim guidance to its employees that only partially addresses the problem, and does not address the "second" refund issue.
June 28, 2012	NTA testifies before House Committee on the Judiciary, Subcommittee on Crime, Terrorism, and Homeland Security, regarding preparer fraud.
October 17, 2012	NTA issues Proposed TAD 2012-5 specifically directing the W&I Commissioner to develop procedures to issue refunds to victims of return preparer fraud who are due a refund after they file a correct original return.
November 6, 2012	W&I Commissioner Peggy Bogadi responds to Proposed TAD 2012-5, indicating that "We are working to resolve the open issues related to Preparer Misconduct. There are several meetings set up with Counsel, staff and senior leadership in an effort to reach resolution."

December 5, 2012	NTA meets with W&I Commissioner Peggy Bogadi and W&I Counsel to discuss what legal barriers, if any, preclude the IRS from issuing refunds to victims of preparer fraud.
December 13, 2012	NTA meets with Acting Commissioner Steven Miller regarding preparer fraud.
December 31, 2012	NTA includes MSP entitled <i>The IRS Harms Victims of Return Preparer Misconduct by Failing to Resolve Their Accounts Fully</i> in 2012 Annual Report to Congress.
2013	
January 24- September 17, 2013	NTA elevates a total of 25 preparer fraud TAOs to Acting Commissioners Steven Miller and Danny Werfel.
June 19, 2013	NTA has one-on-one meeting with Acting Commissioner Werfel in which they discussed return preparer fraud issues.
September 13, 2013	Office of Chief Counsel provides an options paper to Acting Deputy Commissioner for Services and Enforcement (DCSE) Heather Maloy outlining the various legally permissible options available to resolve return preparer fraud cases.
September 18, 2013	At Acting Commissioner Werfel's request, NTA meets with DCSE Dalrymple, the Associate Chief Counsel (Procedure and Administration), the Commissioner of W&I, and the Director of the Return Preparer Office, among others, regarding preparer fraud.
October 23, 2013	NTA holds meeting with Acting Commissioner Werfel in which they discussed return preparer fraud issues.
November 5, 2013	Deputy Chief Counsel (Operations) sends email to NTA confirming that "the IRS has authority to make the refunds."
December 18, 2013	NTA meets with Acting Commissioner Werfel and DCSE Dalrymple regarding preparer fraud.
December 20, 2013	Deputy Commissioner for Services and Enforcement John Dalrymple rescinded en masse the 24 TAOs elevated to the Acting Commissioners that requested the IRS issue a refund to the victim of preparer fraud (one of the 25 TAOs elevated involved a victim who was not seeking a refund from the IRS.)
December 31, 2013	NTA includes MSP entitled <i>The IRS Still Refuses to Issue Refunds to Victims of Return Preparer Misconduct Despite Ample Guidance Allowing the Payment of Such Refunds</i> in 2013 Annual Report to Congress.
2014	
January 22, 2014	NTA meets with Commissioner Koskinen to elevate preparer fraud issues.
March 14, 2014	NTA meets with Commissioner Koskinen, DCSE Dalrymple, and Chief Counsel to discuss preparer fraud issues; Commissioner Koskinen decides that the IRS will issue refunds to victims of preparer fraud who provide a police report and meet the other substantiation requirements.
May 28, 2014	NTA meets with the Chief Financial Officer (CFO), Deputy CFO, and W&I Commissioner to discuss concerns over the proper accounting of proposed payouts to victims of preparer fraud.



YOUR VOICE AT THE IRS



THE OFFICE OF THE TAXPAYER ADVOCATE OPERATES INDEPENDENTLY OF ANY OTHER IRS OFFICE AND REPORTS DIRECTLY TO CONGRESS THROUGH THE NATIONAL TAXPAYER ADVOCATE.

Response Due: July 15, 2014

Actions Completed By: September 30, 2014

June 30, 2014

MEMORANDUM FOR John M. Dalrymple, Deputy Commissioner for Services and Enforcement
Peggy Sherry, Deputy Commissioner for Operations Support

FROM: Nina E. Olson, National Taxpayer Advocate

SUBJECT: Taxpayer Advocate Directive 2014-1, Establish Procedures for Issuing a Replacement Refund for Victims of Return Preparer Misconduct

TAXPAYER ADVOCATE DIRECTIVE

Delegation Order No. 13-3 grants the National Taxpayer Advocate the authority to issue a Taxpayer Advocate Directive (TAD). A TAD may be issued to (1) mandate administrative or procedural changes to improve the operation of a functional process, or (2) grant relief to groups of taxpayers (or all taxpayers) when its implementation will protect the rights of taxpayers, prevent undue burden, ensure equitable treatment, or provide an essential service to taxpayers.¹⁴

Internal Revenue Manual (IRM) 13.2.1.6.1 (July 16, 2009) provides that in advance of issuing a TAD, the National Taxpayer Advocate attempts to work with and communicate with the owners of the process in order to correct the problem. I issued Proposed TAD 2012-5 to the Commissioner of the Wage and Investment Division (W&I) on October 17, 2012. This Proposed TAD directed W&I to, among other things, develop procedures to issue refunds to victims of return preparer fraud who are due a refund after they file a correct original return. On November 6, 2012, the W&I Commissioner responded to the Proposed TAD,

14 Pursuant to Delegation Order No. 13-3, the National Taxpayer Advocate has the authority to issue a TAD "to mandate administrative or procedural changes to improve the operation of a functional process or to grant relief to groups of taxpayers (or all taxpayers) when implementation will protect the rights of taxpayers, prevent undue burden, ensure equitable treatment, or provide an essential service to taxpayers." Internal Revenue Manual (IRM) 1.2.50.4, Delegation Order 13-3 (formerly DO-250, Rev. 1), *Authority to Issue Taxpayer Advocate Directives* (Jan. 17, 2001). See also IRM 13.2.1.6, *Taxpayer Advocate Directives* (July 16, 2009).

indicating that W&I is “working to resolve the open issues related to Preparer Misconduct.” I have also included this issue as a Most Serious Problem in my most recent Annual Report to Congress, with specific recommendations.¹⁵ As detailed more fully below, the issues related to preparer misconduct have been outstanding for several years; I now direct you to take the following actions:

1. By September 30, 2014, issue interim guidance memoranda (IGM) that modify existing IGM to:
 - a. authorize the release of refunds to victims of preparer misconduct who submit a police report (in addition to existing documentation requirements); and
 - b. eliminate the requirement that a perpetrator involved in the misconduct be “in the business of preparing returns for consideration” in order for the victim to be provided relief;
2. By September 30, 2014, establish procedures to:
 - a. pay refunds to victims of preparer misconduct who have met the requirements of the IGM; and
 - b. move the original refund to separate account for tracking and financial audit purposes.
3. By September 30, 2014, finalize the recommendations made by the team, comprised of representatives from W&I, CFO, TAS, Counsel, CI, PGLD, SB/SE, and RPO, as to what actions can be taken to recover the fraudulent refund paid to preparers; and
4. By October 1, 2014, commence issuing refunds to taxpayers who have met the requirements of the IGM for establishing return preparer fraud.

Please provide a written response to this TAD on or before July 15, 2014, or file an appeal of this TAD to the Commissioner of Internal Revenue ten (10) calendar days of the date on this TAD.¹⁶

I. Issues

Unscrupulous preparers sometimes prey on unsuspecting taxpayers by altering return information without their clients’ knowledge or divert refunds for their personal benefit. Often, victims are individuals who are facing economic hardship and are in dire need of their refunds. In situations where the preparer diverted even the legitimate portion of the refund to his own account, victimized taxpayers have little hope of obtaining their refunds from the preparer, who may have closed up shop and disappeared.

¹⁵ National Taxpayer Advocate 2013 Annual Report to Congress 94-102 (Most Serious Problem: *The IRS Still Refuses to Issue Refunds to Victims of Return Preparer Misconduct Despite Ample Guidance Allowing the Payment of Such Refunds*).

¹⁶ IRM 13.2.1.6.2(1), *TAD Appeal Process* (July 16, 2009).

I have written extensively about the need for the IRS to develop procedures to ensure that the tax accounts of the victims are appropriately adjusted and that the victims are not denied refunds they are legally entitled to because of the illegal actions of these return preparers.¹⁷

II. Procedural History

On December 16, 2010, we issued the first of many Taxpayer Assistance Orders (TAOs) on behalf of victims of preparer fraud. When no systemic changes were made, I began to elevate this issue to senior IRS leadership through TADs and Proposed TADs. Since 2011, I have raised and discussed this issue with four Commissioners (two acting), urging the IRS to make these vulnerable taxpayers whole, just as the IRS works to make identity theft victims whole. Attachment 1 provides a detailed chronology of my office's extensive involvement in elevating this issue.

The National Taxpayer Advocate elevated a total of 25 of these preparer misconduct TAOs to Acting Commissioners Steven Miller and Danny Werfel from January through September 2013. These victims are typically low income taxpayers, with a median adjusted gross income of \$17,548 and a median refund claim of \$2,511.¹⁸ Some of the victims who have come to TAS for help have been waiting for refunds since they filed 2008 tax returns.¹⁹ On December 20, 2013, Deputy Commissioner for Services and Enforcement John Dalrymple rescinded these 25 preparer misconduct TAOs. As a result, none of the victims of preparer misconduct for whom TAS has issued TAOs have received refunds.

As of May 31, 2014, TAS had 316 return preparer fraud cases in inventory.²⁰ As of June 9, 2014, TAS Local Taxpayer Advocates have elevated 113 TAOs involving preparer misconduct to the National Taxpayer Advocate.

III. Analysis

Return preparer fraud is not a novel issue. The IRS has known about this problem and its severe impact on victims for many years. The IRS Office of Chief Counsel ("Counsel") has provided advice on such situations dating as far back as 2000, when it concluded that there

17 See Proposed Taxpayer Advocate Directive 2011-1, *Establish procedures for adjusting the taxpayer's account in instances where a tax return preparer altered the return without the taxpayer's knowledge or consent, and the preparer obtained a fraudulent refund* (June 13, 2011); National Taxpayer Advocate 2011 Annual Report to Congress 59-60; Taxpayer Advocate Directive 2012-1, *Establish procedures for adjusting the taxpayer's account in instances where a tax return preparer altered the return without the taxpayer's knowledge or consent, and the preparer obtained a fraudulent refund* (Jan. 12, 2012); *Identity Theft and Income Tax Preparation Fraud*, Hearing Before the House Judiciary Committee, Subcommittee on Crime, Terrorism, and Homeland Security, 112th Cong. (June 28, 2012) (statement of Nina E. Olson, National Taxpayer Advocate); Proposed Taxpayer Advocate Directive 2012-5, *Establish procedures for issuing a replacement refund for victims of return preparer misconduct* (Oct. 17, 2012); 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*); National Taxpayer Advocate 2013 Annual Report to Congress 94-102 (Most Serious Problem: *The IRS Still Refuses to Issue Refunds to Victims of Return Preparer Misconduct Despite Ample Guidance Allowing the Payment of Such Refunds*).

18 National Taxpayer Advocate 2013 Annual Report to Congress 96.

19 See, e.g., Taxpayer Advocate Management Information System (TAMIS) case numbers 4757753, 5269873, and 5361465.

20 Data obtained from TAMIS (June 25, 2014). The current inventory of preparer fraud cases include unresolved cases received in prior FYs.

is “no legal impediment to reissuing a direct deposit refund” to a taxpayer whose return was altered after visiting a Volunteer Income Tax Assistance site.²¹

In 2003, Counsel again addressed a situation where an electronically filed tax return was altered without the taxpayer’s knowledge, and declared that a return altered by a preparer after the victim has verified the accuracy of the return is a “nullity” and, therefore, invalid.²² In 2008, Counsel once again looked at a situation where a refund was improperly directed to a preparer and made clear that the IRS “can and should” adjust each affected taxpayer’s account for any refund (or portion of one) illegally obtained by the preparer.²³ In 2011, Counsel reiterated that “[a] tax return signed by a taxpayer that is altered by a tax return preparer without the taxpayer’s knowledge and submitted to the IRS by the preparer is not a valid tax return.”²⁴

To recap: since 2000, the IRS has received four legal opinions from its Office of Chief Counsel that, when read together, permit the IRS to (1) disregard the altered return filed by the preparer, (2) accept an unaltered return signed by the taxpayer, and (3) issue a refund to the victim even if a payment had already been made to the preparer. The Deputy Chief Counsel (Operations) recently reaffirmed this position, both orally and in writing, to the National Taxpayer Advocate and the IRS Commissioner.

The Commissioner Has Agreed the IRS Will Release Refunds to Victims of Preparer Misconduct Who Have Provided Certain Documentation, Including a Police Report

Recent discussions with Commissioner Koskinen have been encouraging. The Commissioner has agreed the IRS will issue refunds to victims of preparer fraud if the victims can show that they were not complicit in the preparer’s fraud. To alleviate the IRS’s concern about collusion between the preparer and taxpayer, the victim will be required to provide a copy of an incident report filed with local law enforcement (i.e., a police report) before the IRS issues a replacement refund.

Some taxpayers will be unable to obtain a police report, perhaps because the particular police department does not accept incident reports related to tax fraud, or refuses to accept a report for an incident that occurred several years ago (as noted earlier, some of our cases relate to 2008 tax returns). Additionally, some taxpayers who have questionable immigration status may be hesitant to go to the police for fear of being reported to immigration authorities. While the Commissioner’s decision to require a police report to accompany all claims of preparer fraud will not provide relief to all victims, it constitutes a major step forward. Moreover, having a bright line rule will make it easier for IRS employees to process

21 Field Service Advice 200038005 (June 6, 2000). While Field Service Advice is not binding and may not be cited as precedent, it does allow us some insight on how similar situations may be analyzed.

22 See IRS Office of Chief Counsel Memorandum, *Horse’s Tax Service*, PMTA 2011-13 (May 12, 2003).

23 See IRS Office of Chief Counsel Memorandum, *Refunds Improperly Directed to a Preparer*, POSTN-145098-08 (Dec. 17, 2008).

24 See IRS Office of Chief Counsel Memorandum, *Tax Return Preparer’s Alteration of a Return*, PMTA 2011-20 (June 27, 2011).

these claims. The focus of this Taxpayer Advocate Directive is to ensure that the IRS moves forward with all due speed in implementing the Commissioner's decision.

The IRS Needs to Develop Procedures to Implement the New Policy

For taxpayers able to provide sufficient documentation supporting their claims, the IRS must act quickly to issue the refunds to which they are entitled. We should not further victimize such taxpayers, some of whom are awaiting refunds from their 2008 tax returns, by making them wait any longer.

Therefore, given that (1) there are no outstanding legal considerations preventing the IRS from issuing refunds to victims of preparer misconduct, and (2) the Commissioner has agreed that the IRS should issue refunds to victims who have substantiated the preparer misconduct by filing a police report, the IRS should move forward to develop guidance implementing this policy decision.

Definition of "Return Preparer" in This Context Should Be Expanded

As I mentioned above, taxpayers often use the services of return preparers to comply with their federal tax obligations. Often, these return preparers are professionals who are licensed and regulated. However, some taxpayers rely upon the services of neighbors, co-workers, clergy, or family friends who may offer to assist in filing their tax returns. Under current guidance, the IRS will not provide relief to taxpayers who have been defrauded by tax return preparers who are not "in the business of preparing returns for consideration."²⁵ As a result, many taxpayers victimized by return preparers who are not in the business of preparing returns will not receive assistance from the IRS.

Rather than inquiring about the relationship between the taxpayer and the return preparer, the IRS should instead focus on whether the taxpayer authorized the filing of the particular return that was submitted for processing. I fully recognize the IRS's concern that some taxpayers with a non-business relationship with their return preparers may not truly be innocent victims of fraud. I do not suggest that the IRS relax its requirement that the taxpayer support with appropriate documentation his or her assertion that the particular return filed by the return preparer was an unauthorized return. However, once the IRS is convinced that the return submitted by the return preparer was not the one authorized by the taxpayer, it matters not whether the return preparer was in the business of preparing tax returns. Moreover, the additional requirement that the taxpayer obtain a police report with respect to theft of a tax refund will guard against any concerns about collusion between the taxpayer and the preparer. If a taxpayer is willing to report his friend, neighbor, or relative to the police, the IRS's risk will be minimal.

25 See *Interim Guidance on Return Preparer Misconduct (For Memphis Accounts Management ONLY)* 8, WI-21-0813-02 (Aug. 5, 2013).

IV. Requested Actions

Because the IRS has a history of delay and failure to act with respect to this issue, and has not provided me with a timeline for implementation of the Commissioner's decision to issue refunds to victims of return preparer fraud, I am issuing this TAD to protect the rights of taxpayers and prevent undue burden. In light of the significant harm taxpayers are suffering as a result of the IRS's inability to develop a process for providing relief to these victims, I direct you to take the following actions:

1. By September 30, 2014, issue interim guidance memoranda (IGM) that modify existing IGM to:
 - a. authorize the release of refunds to victims of preparer misconduct who submit a police report (in addition to existing documentation requirements); and
 - b. eliminate the requirement that a perpetrator involved in the misconduct be "in the business of preparing returns for consideration" in order for the victim to be provided relief;
2. By September 30, 2014, establish procedures to:
 - a. pay refunds to victims of preparer misconduct who have met the requirements of the IGM; and
 - b. move the original refund to separate account for tracking and financial audit purposes.
3. By September 30, 2014, finalize the recommendations made by the team, comprised of representatives from W&I, CFO, TAS, Counsel, CI, PGLD, SB/SE, and RPO, as to what actions can be taken to recover the fraudulent refund paid to preparers; and
4. By October 1, 2014, commence issuing refunds to taxpayers who have met the requirements of the IGM for establishing return preparer fraud.

Attachments:

1. Timeline of the National Taxpayer Advocate's involvement in elevating the preparer fraud issue
2. Proposed Taxpayer Advocate Directive 2012-5 (*Establish procedures for issuing a replacement refund for victims of return preparer misconduct*)
3. Taxpayer Advocate Directive 2012-1 (*Establish procedures for adjusting the taxpayer's account in instances where a tax return preparer altered the return without the taxpayer's knowledge or consent, and the preparer obtained a fraudulent refund*) (Jan. 12, 2012)
4. National Taxpayer Advocate 2013 Annual Report to Congress 94-102 (Most Serious Problem: *The IRS Still Refuses to Issue Refunds to Victims of Return Preparer Misconduct Despite Ample Guidance Allowing the Payment of Such Refunds*)
5. *Interim Guidance on Return Preparer Misconduct (For Memphis Accounts Management ONLY)*, WI-21-0813-02 (Aug. 5, 2013)

cc: with attachments: John A. Koskinen, Commissioner of Internal Revenue