

## #4 AUTHORIZE THE IRS TO ESTABLISH MINIMUM COMPETENCY STANDARDS FOR FEDERAL TAX RETURN PREPARERS

### Present Law

Current law imposes no competency or licensing requirements on tax return preparers. Attorneys, certified public accountants (CPAs), and enrolled agents are required to take courses and pass competency tests. Volunteers are required to pass competency tests as part of the Volunteer Income Tax Assistance and Tax Counseling for the Elderly programs. But most preparers are non-credentialed and are not required to pass any competency tests or take any courses in tax return preparation.

### Reasons for Change

The IRS receives more than 150 million federal income tax returns every year, and the majority are prepared by paid tax return preparers. For that reason, both taxpayers and the tax system depend heavily on the ability of preparers to prepare accurate tax returns. Yet numerous studies have found that non-credentialed tax return preparers routinely prepare inaccurate returns, which has the effect of harming taxpayers, the public fisc, or both.

To protect the public, federal and state laws generally require lawyers, doctors, financial planners, actuaries, appraisers, contractors, motor vehicle operators, and even barbers and beauticians to obtain licenses or certifications, and in most of these cases, they are required to pass competency tests. Taxpayers and the tax system would benefit from requiring minimum standards of tax return preparers as well.

The following studies illustrate the extent of inaccurate return preparation:

**Government Accountability Office (GAO).** In 2006, GAO auditors posing as taxpayers made 19 visits to several national tax return preparation chains in a large metropolitan area. Using two carefully designed fact patterns, they sought assistance in preparing tax returns. On 17 of 19 returns, preparers computed the wrong refund amounts, with variations of several thousand dollars. In five cases, the prepared returns reflected unwarranted excess refunds of nearly \$2,000. In two cases, the prepared returns would have caused the taxpayer to overpay by more than \$1,500. In five out of ten cases in which the Earned Income Tax Credit (EITC) was claimed, preparers failed to ask where the auditor's child lived or ignored the auditor's answer to the question, and consequently prepared returns claiming ineligible children.<sup>13</sup>

The GAO conducted a similar study in 2014. It again found that preparers computed the wrong tax liability on 17 of the 19 returns they prepared.<sup>14</sup>

**Treasurer Inspector General for Tax Administration (TIGTA).** In 2008, TIGTA auditors posing as taxpayers visited 12 commercial chains and 16 small, independently owned tax return preparation offices in a large metropolitan area. All preparers visited by TIGTA were non-credentialed. Of 28 returns prepared, 61 percent were prepared incorrectly. The average net understatement was \$755 per return. Of seven

13 Government Accountability Office (GAO), GAO-06-563T, *Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors* (Apr. 4, 2006) (statement of Michael Brostek, Director - Strategic Issues, Before the Committee on Finance, U.S. Senate).

14 GAO, GAO-14-467T, *Paid Tax Return Preparers: In a Limited Study, Preparers Made Significant Errors* (Apr. 8, 2014) (statement of James R. McTigue, Jr., Director - Strategic Issues, Before the Committee on Finance, U.S. Senate).

returns involving EITC claims, *none* of the preparers exercised appropriate due diligence as required under IRC § 6695(g).<sup>15</sup>

**New York State Department of Taxation and Finance.** During 2008 and 2009, agents conducted nearly 200 targeted covert visits in which they posed as taxpayers and sought assistance in preparing income or sales tax returns. In testimony at an IRS Public Forum, the Acting Commissioner of the New York Department of Taxation and Finance testified that investigators found “an epidemic of unethical and criminal behavior.”<sup>16</sup> At one point, the Department reported that it had found fraud on about 40 percent of its visits, and it had made more than 20 arrests and secured 13 convictions.<sup>17</sup>

**IRS Study on EITC Noncompliance.** The IRS conducted a study to estimate compliance with EITC requirements during the 2006-2008 period. Among the findings of the study, unaffiliated unenrolled preparers (*i.e.*, non-credentialed preparers who are not affiliated with a national tax return preparation firm) were responsible for “the highest frequency and percentage of EITC overclaims.” The study found that half of the EITC returns prepared by unaffiliated unenrolled preparers contained overclaims, and the overclaim averaged between 33 percent and 40 percent.<sup>18</sup>

In 2002, before these studies were published, the National Taxpayer Advocate began recommending that Congress authorize the IRS to conduct preparer oversight based on her experience in private practice. Her proposal received widespread support from stakeholders and Members of Congress. The Senate Committee on Finance twice approved legislation authorizing preparer oversight on a bipartisan basis under the leadership of Chairman Grassley and Ranking Member Baucus,<sup>19</sup> and on one occasion, the full Senate approved it by unanimous consent.<sup>20</sup> In 2005, the House Ways and Means Subcommittee on Oversight held a hearing at which representatives of five outside organizations expressed general support for preparer oversight.<sup>21</sup>

In 2009, the Commissioner of Internal Revenue concluded that the IRS had the authority under § 330 of Title 31 of the U.S. Code to impose minimum standards without statutory authorization. The IRS initiated an extensive series of hearings and discussions with stakeholder groups to receive comments and develop a system within which all parties believed they could operate.<sup>22</sup> The IRS began to implement the program in 2011, but it was terminated after a U.S. District Court rejected the IRS’s legal position, concluding it does not have the authority to impose preparer standards without statutory authorization.<sup>23</sup>

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

16 Statement of Jamie Woodward, Acting Commissioner, New York Dept. of Taxation and Finance, before IRS Tax Return Preparer Review Public Forum (Sept. 2, 2009).

17 *Id.*; see Tom Herman, *New York Sting Nabs Tax Preparers*, Wall Street Journal (Nov. 26, 2008).

18 IRS Pub. 5162, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 24-26 (Aug. 2014).

19 Tax Administration Good Government Act, H.R. 1528 (incorporating Tax Administration Good Government Act, S. 882), 108th Cong. § 141 (2004); Telephone Excise Tax Repeal Act, S. 1321 (incorporating Taxpayer Protection and Assistance Act, S. 832), 109th Cong. § 203 (2006).

20 Tax Administration Good Government Act, H.R. 1528 (incorporating Tax Administration Good Government Act, S. 882), 108th Cong. § 141 (2004).

21 The organizations were the American Bar Association, the American Institute of Certified Public Accountants (AICPA), the National Association of Enrolled Agents, the National Society of Accountants, and the National Association of Tax Professionals. See *Fraud in Income Tax Return Preparation: Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways & Means*, 109th Cong. (2005).

22 See IRS Pub. 4832, *Return Preparer Review* (Dec. 2009).

23 *Loving v. IRS*, 917 F. Supp. 2d 67 (D.D.C. 2013), *aff'd*, 742 F.3d 1013 (D.C. Cir. 2014).

Since that time, Members of the House and Senate have introduced legislation that would provide the IRS with the statutory authorization to establish and enforce minimum standards. In the Senate, Senators Portman and Cardin sponsored authorizing legislation in 2018.<sup>24</sup> Previously, Senators Wyden and Cardin sponsored authorizing legislation, and Chairman Hatch included language to authorize minimum standards as part of a larger bill designed to combat identity theft and refund fraud.<sup>25</sup> In the House, Congresswoman Black and former Congressman Becerra, both members of the Ways and Means Committee, have sponsored authorizing legislation.<sup>26</sup>

The IRS's evolving "Future State" plan provides an important additional basis for establishing preparer standards. The IRS envisions giving preparers access to taxpayer information through online accounts. The security risks of this plan are significant, and if the IRS proceeds with it, steps must be taken to mitigate the risks. Minimum standards for preparers are one important step. Some have argued that requiring preparers to pass a competency test and take annual continuing education courses would address only the issue of competence and would not ensure preparers conduct themselves ethically. The National Taxpayer Advocate agrees that competency and ethical conduct are distinct issues. However, we think preparer standards would serve to raise ethical conduct as well as competency levels. A preparer who learns enough about tax return preparation to pass a competency test and takes annual continuing education courses would be demonstrating a commitment to return preparation as a profession. As such, the preparer would be more likely to understand and feel like a part of the tax system and would have more to lose if he or she is found to have engaged in misconduct.

In sum, the GAO, TIGTA, and other compliance studies described above suggest that tax returns prepared by non-credentialed preparers are often inaccurate. Minimum standards would directly improve preparer competency levels and are likely to raise ethical norms as well.

### Recommendation

Amend Title 31, § 330 of the U.S. Code to authorize the Secretary to establish minimum standards for federal tax return preparers.<sup>27</sup>

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24 Protecting Taxpayers Act, S. 3278, 115th Cong. § 202 (2018).

25 See Taxpayer Protection and Preparer Proficiency Act, S. 137, 114th Cong. (2015); J. Comm. on Tax'n, *Description of the Chairman's Mark of a Bill to Prevent Identity Theft and Tax Refund Fraud*, JCX-108-15, at 16-21 (2015).

26 See Tax Return Preparer Competency Act, H.R. 4141, 114th Cong. § 2 (2015) (Cong. Black) and Taxpayer Rights Act of 2015, H.R. 4128, 114th Cong. § 202 (2015) (Cong. Becerra).

27 For legislative language generally consistent with this recommendation, see Taxpayer Protection and Preparer Proficiency Act, S. 137, 114th Cong. (2015) and other bills cited herein.