

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

### Present Law

The IRS currently 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. 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 in order to prepare returns as part of the Volunteer Income Tax Assistance and Tax Counseling for the Elderly programs. But the majority of preparers are non-credentialed.

### Reasons for Change

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 attorneys, doctors, financial planners, actuaries, appraisers, contractors, motor vehicle operators, and even barbers and beauticians to obtain licenses or certifications, and in most cases, they are required to pass a competency test first. 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, the 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 10 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>35</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>36</sup>

**Treasurer Inspector General for Tax Administration (TIGTA).**<sup>37</sup> 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 the 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 returns involving EITC claims, *none* of the preparers exercised appropriate due diligence as required under IRC § 6695(g).

35 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).

36 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).

37 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).

**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>38</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>39</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 of the amount claimed on the return.<sup>40</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>41</sup> and on one occasion, the full Senate approved it by unanimous consent.<sup>42</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>43</sup>

In 2009, the Commissioner of Internal Revenue concluded that the IRS had the authority under section 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>44</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 legislation.<sup>45</sup>

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 House, Congresswoman Black and former Congressman Becerra, both members of the Ways and Means Committee, have sponsored authorizing legislation.<sup>46</sup> In the Senate, Senators Wyden and Cardin sponsored legislation, and Chairman

38 Statement of Jamie Woodward, Acting Commissioner, New York Dept. of Taxation and Finance, before IRS Tax Return Preparer Review Public Forum (Sept. 2, 2009), [http://ftp.irs.gov/pub/irs-utl/ny\\_department\\_of\\_tax\\_statement.pdf](http://ftp.irs.gov/pub/irs-utl/ny_department_of_tax_statement.pdf) (last visited Oct. 18, 2009).

39 *Id.*; see Tom Herman, *New York Sting Nabs Tax Preparers*, WSJ (Nov. 26, 2008).

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

41 H.R. 1528 (incorporating S. 882), 108th Cong. § 141 (2004); S. 1321 (incorporating S. 832), 109th Cong. § 203 (2006).

42 H.R. 1528 (incorporating S. 882), 108th Cong. § 141 (2004).

43 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).

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

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

46 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). Cong. Becerra has since retired from Congress.

Hatch included language to authorize minimum standards as part of a larger bill designed to combat identity theft and refund fraud.<sup>47</sup>

Despite broad, bipartisan support for preparer standards, the American Institute of CPAs (AICPA) has opposed the bill<sup>48</sup> and, to date, the legislation has not advanced. The National Taxpayer Advocate believes the AICPA's concerns are partly misplaced and partly easy to address. Its main concern is about “marketplace confusion” — a sense that uninformed taxpayers will not be able to distinguish between a preparer who passes a simple competency test and a CPA with extensive training and knowledge, potentially leading some taxpayers who otherwise would engage the services of a CPA to go to a non-credentialed preparer instead.

First, we are not convinced taxpayers will generally be confused. Members of other organizations, notably the National Association of Enrolled Agents (NAEA), also hold credentials that could be “devalued” by marketplace confusion, yet the NAEA has made the calculation that enhanced preparer oversight would be beneficial. Second, to the extent some taxpayers may be confused, we agree that the IRS can and should take additional steps to clarify the differences among categories of preparers to assist the public in making informed decisions. Third, we note that the most significant requirements of the oversight rules the IRS adopted — passing a competency test and taking annual continuing education courses — do not apply to CPAs, attorneys, or enrolled agents. The burden of passing the competency test and satisfying new continuing education requirements would fall exclusively on non-credentialed preparers.

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 this plan, 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 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 would help to raise ethical norms as well.

### Recommendation

Amend title 31, section 330 of the U.S. Code to authorize the Secretary to establish minimum standards for federal tax return preparers.

47 See 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).

48 Letter from Chair, AICPA Tax Executive Committee to the Chairman and Ranking Member of the Senate Committee on Finance (Sept. 15, 2015) (opposing the provision in Chairman Hatch's mark that would authorize preparer oversight); Letter from Chair, AICPA Tax Executive Committee to the Chairman and Ranking Member of the House Committee on Ways and Means (Dec. 4, 2015) (opposing Congresswoman Black's bill).