

MSP
#5**The IRS Harms Victims of Return Preparer Misconduct by Failing to Resolve Their Accounts Fully****RESPONSIBLE OFFICIALS**

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DEFINITION OF PROBLEM

Tax return preparers sometimes alter return information without their clients' knowledge or consent in an attempt to obtain improperly inflated refunds or to divert refunds for their personal benefit. Often, the refunds are directed to an account in the preparer's control, leaving the taxpayer with no monetary benefit from the fraudulent filing but having to deal with the IRS in the aftermath. This type of misconduct creates significant challenges for the IRS, harms innocent taxpayers, and undermines trust in our tax system.

We have seen four primary fact patterns in the return preparer fraud cases that have come to the Taxpayer Advocate Service:

1. **Unauthorized filing.** A taxpayer visits a return preparer, but for some reason decides not to use this preparer and never authorizes a return filing. Later, the taxpayer attempts to file a return electronically (on his or her own, or through a different preparer), but the IRS rejects the return. The taxpayer then learns the IRS has already processed a return submitted by the first preparer, who directed the refund to an account not belonging to or under the control of the taxpayer.
2. **Altered return information — no additional refund due to taxpayer.** The taxpayer visits a preparer and authorizes him or her to file a return. The taxpayer reviews and approves for filing a copy of the "final return," but the preparer later alters it to increase the refund. The taxpayer receives the refund expected, while the preparer direct-deposits the excess to a different bank account.¹ The taxpayer later learns of the return preparer fraud and files a correct original return, but account issues remain.
3. **Altered return information — additional refund due to taxpayer.** Similar to (2), but the taxpayer only receives a portion² (or none³) of the refund he or she expected.

¹ In some cases, the taxpayer receives the funds directly from the IRS by direct deposit; in other cases, the preparer has the entire amount (the taxpayer's correct refund plus the inflated refund) direct-deposited to the preparer, and then issues the taxpayer a check.

² For example, suppose the taxpayer is entitled to a \$500 refund. The preparer alters the data so the refund amount is \$1,000. The preparer splits the refund to direct \$600 to the preparer and \$400 to the taxpayer, who does not receive the full refund to which he is entitled (\$100 shortfall).

³ For example, suppose the taxpayer is entitled to a \$900 refund. The preparer alters the tax data so that the amount is \$1,900. The preparer splits the refund to direct \$1,000 to the preparer and \$900 to the taxpayer. The IRS stores only the information from the first bank account listed on Form 8888, *Allocation of Refund*. The refund is held for some reason beyond the first cycle when the split account information from Form 8888 is still in the system, so the refund is not split and the entire \$1,900 refund is direct-deposited into the first account listed on Form 8888, which is the preparer's account.

4. **Misrouted direct deposit.** The taxpayer visits a preparer and authorizes a return filing. The taxpayer reviews and approves for filing a copy of the “final” return, but subsequently, the preparer alters the bank routing and account numbers; the return is otherwise accurate. The taxpayer never receives a refund, and learns the return filed by the preparer contained altered bank routing and account numbers.

Since 2000, the IRS has received the benefit of four separate legal opinions from its Office of Chief Counsel addressing return preparer misconduct.⁴ Yet the IRS has declined to develop guidance to its employees on how to issue a replacement refund to victims, despite such guidance from its own Chief Counsel. Under current procedures, when the IRS is made aware of the return preparer misconduct, it is willing to “back out” the altered return filed by the preparer and process the correct original return once it is obtained from the taxpayer.⁵ However, the IRS will not provide full relief to these victims by issuing a second refund in cases where the preparer absconded with the initial refund that the IRS issued when the falsified return was filed. Instead, victims of return preparer fraud are advised that because this is a civil matter between the taxpayer and the preparer, they should pursue recovery of their tax refunds from the return preparer without the assistance of the IRS. The IRS appears to be emphasizing budgetary concerns over legal principles.

According to former Commissioner Shulman, “e-file ensures people can file accurately and get refunds quickly” and “IRS e-file is now the norm, not the exception.”⁶ Clearly, the IRS is pushing taxpayers to e-file and use direct deposit. Yet we note that had the taxpayer requested a paper refund check, and it was improperly negotiated by the return preparer, the IRS could reissue a check to the taxpayer upon a timely filed claim.⁷ The IRS should not treat similarly-situated taxpayers differently. Here, the group of taxpayers who are doing what the IRS has pushed them to do — namely, using return preparers (rather than using IRS-provided resources such as the Taxpayer Assistance Centers to file) and selecting the direct deposit option — are being treated unfairly.⁸ Even as the IRS promotes electronic filing and payments, its policy of not issuing refunds to victims of return preparer misconduct creates a disincentive for taxpayers to e-file and request a direct-deposited refund.

Because of the IRS’s refusal to develop procedures, the National Taxpayer Advocate issued guidance to TAS employees in May 2012,⁹ directing Local Taxpayer Advocates to

⁴ See Field Service Advice 200038005 (June 6, 2000); IRS Office of Chief Counsel Memorandum, *Horse’s Tax Service*, PMTA 2011-13 (May 12, 2003); IRS Office of Chief Counsel Memorandum, *Refunds Improperly Directed to a Preparer*, POSTN-145098-08 (Dec. 17, 2008); IRS Office of Chief Counsel Memorandum, *Tax Return Preparer’s Alteration of a Return*, PMTA 2011-20 (June 27, 2011).

⁵ See *Interim Guidance on Return Preparer Misconduct (For Memphis Accounts Management ONLY)*, WI-21-0812-02 (Sept. 6, 2012).

⁶ IRS, IR-2011-4, *IRS e-file Launches Today; Most Taxpayers Can File Immediately* (Jan. 14, 2011).

⁷ See IRM 21.4.2.4.15.3.1, *Check Forgery Insurance Fund (CFIF)* (Oct. 1, 2006).

⁸ For an in-depth discussion of the IRS’s failure to provide all taxpayers with a free method to preparer and e-file their individual returns, see Most Serious Problem: *The IRS Is Striving to Meet Taxpayers’ Increasing Demand for Online Services, Yet More Need to Be Done*, *infra*.

⁹ See *Interim Guidance for Preparing Taxpayer Assistance Orders (TAOs) to Accounts Management Involving Return Preparer Fraud*, TAS-13-0512-017 (May 23, 2012).

The IRS Harms Victims of Return Preparer Misconduct by Failing to Resolve Their Accounts Fully

issue Taxpayer Assistance Orders (TAOs) on return preparer fraud cases.¹⁰ In FY 2012, TAS issued 58 TAOs on these cases, of which 26 are elevated to the National Taxpayer Advocate — an unprecedented number on any issue. The average adjusted gross income (AGI) of the taxpayers involved in the elevated TAOs was less than \$32,000. The refund sought by these taxpayers constituted, on average, 28 percent of their AGI. As of October 25, 2012, these cases were open in TAS for an average of 327 days (11 months) — and are still open!¹¹

ANALYSIS OF PROBLEM

Background

Under our current tax system, taxpayers are required by law to self-assess taxes and interact with the IRS. Given the complexity of the tax law, preparing and filing returns is a significant undertaking for many taxpayers. In fact, more than 80 percent of American households use paid preparers or tax software to help them prepare and file their tax returns.¹² With fewer Taxpayer Assistance Center resources available to help taxpayers prepare and file their returns, many feel pressure to enlist the services of a return preparer to meet their statutorily-mandated tax filing requirement.¹³

In response to the variety and prevalence of return preparer fraud, the IRS issued an alert on March 2, 2012, warning taxpayers about these schemes:¹⁴

- Fictitious claims for refunds or rebates based on false statements of entitlement to tax credits.
- Unfamiliar for-profit tax services selling refund and credit schemes to church members.
- Internet solicitations that direct taxpayers to toll-free numbers and then solicit Social Security numbers.
- Homemade flyers and brochures implying credits or refunds are available without proof of eligibility.
- Offers of free money with no documentation required.
- Promises of refunds for “Low Income — No Documents Tax Returns.”

¹⁰ Internal Revenue Code (IRC) § 7811 authorizes the National Taxpayer Advocate to issue a Taxpayer Assistance Order upon a determination that a taxpayer is suffering or about to suffer a significant hardship as a result of the manner in which the internal revenue laws are being administered by the Secretary.

¹¹ TAS analysis of 26 return preparer fraud cases elevated to the National Taxpayer Advocate level as of October 25, 2012. Some averages were calculated with as few as 22 cases because not all data was available.

¹² IRS, IR-2010-1, *IRS Proposes New Registration, Testing and Continuing Education Requirements for Tax Return Preparers Not Already Subject to Oversight* (Jan. 4, 2010).

¹³ See Most Serious Problem: *The IRS Lacks a Servicewide Strategy that Identifies Effective and Efficient Means of Delivering Face-to-Face Taxpayer Services*, *infra*.

¹⁴ IRS, IR-2012-29, *Tax Scam Warning: Beware of Phony Refund Scheme Abusing Popular College Tax Credit; Senior Citizens, Working Families and Church Members Are Targets* (Mar. 2, 2012).

- Claims for the expired Economic Recovery Credit Program or for economic stimulus payments.
- Unsolicited offers to prepare a return and split the refund.
- Unfamiliar return preparation firms soliciting business from cities outside of the normal business or commuting area.

As tax preparers develop more ways to benefit from fraudulent returns, the list will undoubtedly continue to grow. There is certainly some overlap between identity theft and traditional refund fraud cases; some fact patterns encompass characteristics of more than one type of fraud.¹⁵ For purposes of this discussion, we will focus on cases that fall into these four scenarios (described in detail in the problem statement):

1. Unauthorized filing;
2. Altered return information — additional refund due to taxpayer;
3. Altered return information — no additional refund due to taxpayer; and
4. Misrouted direct deposit.

IRS Guidance on Return Preparer Misconduct Is Incomplete

In July 2011, the National Taxpayer Advocate brought the issue of return preparer misconduct to IRS leadership's attention by elevating a series of TAOs to the Commissioner of the Wage and Investment (W&I) division. These TAOs, originally issued to the W&I Accounts Management (AM) function in December 2010, involved four taxpayers defrauded by the same preparer. Although the IRS has been aware of the need to provide relief to victims of return preparer misconduct since at least 2000, it had no such procedure in place at the time these TAOs were elevated.¹⁶

The National Taxpayer Advocate issued a Proposed Taxpayer Advocate Directive (TAD) to the Commissioner of W&I on June 13, 2011, to address this systemic issue.¹⁷ This Proposed TAD directed W&I to establish procedures for adjusting the taxpayer accounts in instances where a preparer alters the return without the taxpayer's knowledge or consent. After receiving an unsatisfactory response to concerns raised about this matter in the Proposed TAD and the 2011 Annual Report to Congress,¹⁸ the National Taxpayer Advocate issued a TAD to the W&I and Small Business/Self-Employed (SB/SE) division commissioners on

¹⁵ See Most Serious Problem: *The IRS Has Failed to Provide Effective and Timely Assistance to Victims of Identity Theft*, *supra*; Most Serious Problem: *Despite Some Improvements, The IRS Continues to Harm Taxpayers by Unreasonably Delaying Processing of Refunds that Trigger Systemic Filters*, *infra*.

¹⁶ See Field Service Advice 200038005 (June 6, 2000).

¹⁷ 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).

¹⁸ See National Taxpayer Advocate 2011 Annual Report to Congress 59-60.

The IRS Harms Victims of Return Preparer Misconduct by Failing to Resolve Their Accounts Fully

January 12, 2012.¹⁹ This directive included suggestions for how the IRS could unwind the victims' accounts. While both commissioners have acknowledged their intent to comply with the substance of the TAD, they appealed the TAD in an effort to extend the time allowed to comply with the actions, even though the IRS already had over 12 years to develop procedures to assist these victims of fraud.

It took W&I until June 26, 2012, to provide its Accounts Management employees with interim guidance on resolving return preparer misconduct cases — and even then, the information was incomplete.²⁰ The National Taxpayer Advocate objected to the issuance of guidance on the grounds that it did not address many of the common fact patterns in our cases; for example, it does not provide procedures for scenarios 3 and 4 above.

In scenario 3, once the victim notifies the IRS of the misconduct, the IRS will ask the taxpayer to submit a correct return as intended to be filed and then will remove the altered return information from the taxpayer's account. However, the IRS will not issue the refund the taxpayer is due. Instead, the IRS informs the victim that preparer misconduct is a civil matter to be settled without its assistance. AM employees are instructed to suspend action on the case pending Chief Counsel guidance.

On October 17, 2012, the National Taxpayer Advocate issued a Proposed TAD to the W&I Commissioner, seeking procedures for issuing replacement refunds for victims of return preparer fraud.²¹ Among other things, the Proposed TAD directed that W&I:

- Develop procedures to issue refunds to taxpayers who have had their direct deposit routing information altered by a third party without the taxpayer's consent; and
- Provide relief to taxpayers victimized by another individual who has prepared their return and committed fraud, even if the other individual does not fall within the definition of a "tax return preparer" receiving compensation (*e.g.*, family member, friend, neighbor, clergy).

The IRS Should Not Treat Similarly-Situated Taxpayers Differently

The IRS is pushing taxpayers to electronic filing, to both improve the accuracy of return processing and reduce costs.²² Yet when taxpayers who are trying to comply with their obligations are victimized by return preparer misconduct, they are often left to deal with the aftermath with little help from the IRS. If the taxpayer requested a refund using *direct deposit*, the IRS will not reissue the refund to the taxpayer, even if the taxpayer has documented that he or she was a victim of return preparer misconduct. Instead, the IRS views

¹⁹ See 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).

²⁰ See Servicewide Electronic Research Program (SERP) Alert 12A0417, *Memphis AM ONLY - Return Preparer Misconduct Interim Guidance* (June 26, 2012). This guidance was later incorporated into an interim guidance memorandum from the Director of AM on September 6, 2012.

²¹ See Proposed Taxpayer Advocate Directive 2012-5, *Establish procedures for issuing a replacement refund for victims of return preparer misconduct* (Oct. 17, 2012).

²² IRS, IR-2011-4, *IRS e-file Launches Today; Most Taxpayers Can File Immediately* (Jan. 14, 2011).

this as a civil matter between the victim and the return preparer or bank. In contrast, if a third party fraudulently endorses a victim's *paper refund check*, the FMS will investigate and may reissue a check to the taxpayer.²³

The Check Forgery Insurance Fund (CFIF) legislation merely established a fund; it did not create a new authority for the IRS to replace fraudulently negotiated checks. This authority had always existed, so the designation of a source of funding is irrelevant to the discussion of whether the IRS should issue replacement funds to a taxpayer that never received the initial refund. In the case of a stolen direct deposit, the IRS Office of Chief Counsel previously has advised that, “the Service is legally permitted to reissue the refund to the taxpayer.”²⁴ Therefore, we believe the IRS can and should establish a process by which a taxpayer can show that whoever wrongfully altered the bank account number on a return was not an authorized agent, and upon confirmation of these facts, the IRS should pay the refund to the taxpayer — regardless of whether the taxpayer requested a direct deposit or a check.

An Unauthorized Tax Return Should Not Be Treated as a Legitimate Return of the Taxpayer.

In *Beard v. Commissioner*,²⁵ involving a taxpayer who altered a Form 1040, *U.S. Individual Income Tax Return*, the Tax Court applied a four-part test to determine whether a document filed with the IRS qualifies as a “return” for tax purposes. Those requirements are that the document:

1. Purport to be a return;
2. Be signed under penalties of perjury;
3. Contain sufficient data to permit a tax to be calculated; and
4. Evince an honest and genuine endeavor to satisfy the requirements of tax law.

Beard has become the generally accepted test for determining the validity of a tax return.

The signature requirement derives from IRC § 6065, which states that generally, any return, declaration, statement, or other document required under any provision of the internal revenue laws or regulations shall contain or be verified by a written declaration that it is made under penalties of perjury. This requirement authenticates the signed document and verifies its truthfulness.

In a typical return preparer misconduct case scenario, the preparer alters some information on the return after the taxpayer has authorized a prior version. The return submitted by the return preparer was not reviewed, authorized, or signed by the taxpayer under penalties

²³ See IRM 21.4.2.4.15.3.1, *Check Forgery Insurance Fund* (CFIF) (Oct. 1, 2006).

²⁴ FSA 200038005 (June 6, 2000); see also 31 C.F.R. § 210.4(a)(1) (indicating that an agency that accepts an ACH authorization shall verify “the validity of the recipient’s signature”).

²⁵ 82 T.C. 766, 777-78 (1984), *aff’d per curiam*, 793 F.2d 139 (6th Cir. 1986).

The IRS Harms Victims of Return Preparer Misconduct by Failing to Resolve Their Accounts Fully

of perjury. It is not a valid return, as it fails the signature requirement of the *Beard* test, and thus should not be processed as a return of the taxpayer. However, under current procedures, the IRS considers this type of unsigned return to be an “authorized” return and will not issue a refund to a victim of return preparer fraud.

Relevant Chief Counsel Advice Permits the IRS to Issue Refunds to Victims of Return Preparer Misconduct.

Return preparer misconduct is not a new phenomenon. While W&I only recently issued partial guidance to its employees on how to assist victims, the IRS Office of Chief Counsel has provided advice on such situations dating as far back as 2000. These opinions provide the IRS ample advice to permit it to reissue refunds to victims of preparer misconduct in scenarios 3 and 4 described above.

In 2000, Chief Counsel issued advice addressing a situation where a taxpayer used the Volunteer Income Tax Assistance (VITA) program to file her return electronically, and the VITA volunteer subsequently changed the bank routing and account numbers to direct the refund into the account of a third party.²⁶ The Office of Chief Counsel concluded that there is “no legal impediment to reissuing a direct deposit refund” and noted that situations in which direct deposits are stolen are closely analogous to the stolen refund check situation, where there is a process for issuing a replacement.²⁷

In 2003, Chief Counsel again addressed a situation where an e-filed 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.²⁸ In this 2003 memorandum, the Office of Chief Counsel analyzed the four-part test in *Beard*, and concluded that when the taxpayer is unaware of the alterations to the return, and the version that the taxpayer reviewed and approved is not what the preparer filed, the taxpayer did not sign that return under penalties of perjury. Consequently, the return filed by the preparer is a nullity and any assessment on the IRS’s books and records relating to that return is invalid. Counsel advised that the taxpayer should file an *original* return (not an amended return) so the IRS can then adjust the taxpayer’s Master File account to reflect the correct tax information.

In 2008, the Office of Chief Counsel once again looked at a situation where a refund was improperly directed to a preparer.²⁹ The memorandum makes 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. The memorandum further advised that the IRS could bring an erroneous refund suit against the preparer to recover the amounts improperly obtained.

²⁶ 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.

²⁷ See IRM 21.4.2.4.15.3.1, *Check Forgery Insurance Fund (CFIF)* (Oct. 1, 2006).

²⁸ See IRS Office of Chief Counsel Memorandum, *Horse’s Tax Service*, PMTA 2011-13 (May 12, 2003).

²⁹ See IRS Office of Chief Counsel Memorandum, *Refunds Improperly Directed to a Preparer*, POSTN-145098-08 (Dec. 17, 2008).

In 2011, the Office of Chief Counsel was again asked whether a return was valid if it was altered by a preparer to inflate income, deduction, credits, or withholding without the taxpayer's consent.³⁰ Again using the *Beard* analysis, Counsel concluded, “[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.”

In short: since 2000, the IRS has received four legal opinions from its Office of Chief Counsel addressing return preparer misconduct. Two of the opinions indicate that if a purported return fails the *Beard* test, it is a nullity.³¹ Three of the opinions indicate that nullified returns should be backed out of the taxpayer’s account.³² And one of the opinions clearly indicates that there is no legal impediment to issuing the taxpayer his or her correct refund when he or she has not received it due to fraudulent misconduct by a preparer.³³ Thus, when reading all four opinions together, the IRS has received ample advice to permit it to reissue refunds to victims of return preparer misconduct in scenarios 3 and 4 described above.

Current Guidance Does Not Fully Address The Impact of Return Preparer Misconduct.

Under current guidance, when the IRS is made aware of the return preparer misconduct, it is willing to reverse the entries from the altered return filed by the preparer (*i.e.*, treat it as a nullity) and process the correct original return.³⁴ However, the IRS has declined to issue a replacement refund to victims, despite the guidance from the Office of Chief Counsel (discussed above).

The IRS draws a distinction between taxpayers who never authorized a preparer to file a return and those who authorized a filing but did not authorize the particular return the preparer filed. In the first situation, the guidance instructs AM employees to “Follow steps in *Accounts Resolution Initial Steps*” and issue a manual refund if the taxpayer did not receive the full refund.³⁵ The IRS considers this situation analogous to identity theft, where a third party steals a taxpayer’s information and files a return claiming a refund. In the second situation, if the taxpayer is seeking a refund from the IRS, AM is instructed to suspend action on the case pending Chief Counsel guidance. The IRS considers the return filed to be “invalid” but not “unauthorized.”

³⁰ See IRS Office of Chief Counsel Memorandum, *Tax Return Preparer’s Alteration of a Return*, PMTA 2011-20 (June 27, 2011).

³¹ See IRS Office of Chief Counsel Memorandum, *Horse’s Tax Service*, PMTA 2011-13 (May 12, 2003); IRS Office of Chief Counsel Memorandum, *Tax Return Preparer’s Alteration of a Return*, PMTA 2011-20 (June 27, 2011).

³² See IRS Office of Chief Counsel Memorandum, *Horse’s Tax Service*, PMTA 2011-13 (May 12, 2003); IRS Office of Chief Counsel Memorandum, *Refunds Improperly Directed to a Preparer*, POSTN-145098-08 (Dec. 17, 2008); IRS Office of Chief Counsel Memorandum, *Tax Return Preparer’s Alteration of a Return*, PMTA 2011-20 (June 27, 2011).

³³ See Field Service Advice 200038005 (June 6, 2000).

³⁴ See *Interim Guidance on Return Preparer Misconduct (For Memphis Accounts Management ONLY)*, WI-21-0812-02 (Sept. 6, 2012).

³⁵ *Id.*

The IRS Harms Victims of Return Preparer Misconduct by Failing to Resolve Their Accounts Fully

There should be no distinction between these two situations. In both instances, the return preparer filed a tax return that the taxpayer did not authorize. In many cases, the taxpayer is given a copy of the correct, authorized return, but the preparer later alters that return and files a fraudulent version. The fact that a taxpayer authorized the return preparer to file “a” return does not mean that the taxpayer authorized “the” return that was actually filed.

Well-established principles of agency law state that if an agent acts outside of the scope of the agency relationship, then this is an unauthorized act and thus not an action of the principal, unless later ratified (*i.e.*, approved) by the principal.³⁶ A return preparer altering portions of the tax return without the taxpayer’s consent is an agent acting outside of the scope of the agency relationship — meaning the return as filed is not a valid return of the taxpayer and should be backed out of the victim’s account. The IRS’s current guidance ignores longstanding principles of agency law and leaves taxpayers with little recourse to recover their stolen direct deposit tax refunds.

Further, it seems intellectually dishonest for the IRS to treat the initial, altered return as a nullity when it does not require a payment to the taxpayer, yet refuse to fully process the taxpayer’s correct original return when it requires an additional payment of a refund to the taxpayer. The IRS is willing to go halfway and back out the nullified return, but is unwilling to abide by the notion that the first return filed was not the return of the taxpayer when it is asked to issue a second refund. It is as though the IRS is employing a budgetary approach to legal and policy issues.

In an analogous situation, the IRS does make taxpayers whole by issuing a refund after initially processing a nullity. In this regard, when an identity thief files a tax return with falsified information purporting to be the taxpayer, the IRS initially processes the return and pays the refund to the thief. Later, when the victim provides sufficient documentation establishing the identity theft, the IRS moves the nullity to a temporary tax identification number (an IRSN) and accepts the correct original return from the victim. If a refund is associated with the return, the IRS pays it to the victim, regardless of whether it already paid a refund to the thief.

It makes little sense from a policy standpoint to treat victims of return preparer misconduct more harshly than victims of identity theft, when neither victim had any culpability. To be clear, we are not advocating that the IRS agree to hold the taxpayer harmless if there is any evidence that the taxpayer colluded with the return preparer to scam the government. However, the National Taxpayer Advocate disagrees wholeheartedly with the notion that by bringing the return preparer into the equation, the taxpayer automatically is assigned some degree of culpability.

³⁶ See American Law Institute, Restatement (Third) of Agency § 6.05 (2006).

Altering the Bank Routing and Account Numbers Is Tantamount to Altering the Tax Return.

IRS procedures state that when the preparer altered the direct deposit information (rather than items of income, deduction, credits, etc.), AM should suspend action on the case pending Chief Counsel guidance.³⁷ The National Taxpayer Advocate does not believe the IRS should make a distinction on the basis of the *type of information* altered by the preparer. There appears to be no legal basis for arbitrarily deciding that the bank routing and account information is not material to, or part of, the tax return. In fact, to the taxpayer, the instructions on where to send the refund may be the most important part of the return. Seldom would a taxpayer authorize the filing of a return knowingly directing the refund to an account controlled by an unrelated third party who will abscond with the funds. As discussed above, the Office of Chief Counsel concluded in 2000 that the IRS can issue a second refund in a case where the bank routing and account numbers are altered by a third party.³⁸ To avoid further harm to taxpayers, the National Taxpayer Advocate requests that the IRS guidance incorporate this advice.

Taxpayers Must Be Able to Substantiate Return Preparer Misconduct.

The National Taxpayer Advocate recognizes that the IRS is concerned about the practical and financial effect of issuing refunds to victims after already paying out a refund with the altered return. Some taxpayers will certainly attempt to game the system, perhaps by colluding with a return preparer. We appreciate the need for the IRS to request documentation supporting the return preparer misconduct. It may be difficult for some taxpayers to meet the burden of proof the IRS requires. However, many are able to do so easily — some taxpayers have gone as far as file a police report against the return preparer. For years, the National Taxpayer Advocate has recommended that the IRS conduct a comprehensive consumer protection campaign, educating taxpayers about the need to get a copy of their tax return that is signed by their paid preparer.³⁹ The IRS's failure to conduct such a campaign robs taxpayers of their most persuasive evidence in the event of return preparer fraud.

The National Taxpayer Advocate urges the IRS to separate the problems of proof from its analysis of legal and policy issues. For taxpayers who provide sufficient documentation to support their claims, the IRS must quickly issue the refunds to which they are entitled and should not further victimize such taxpayers by depriving them of their tax refunds.

³⁷ See *Interim Guidance on Return Preparer Misconduct (For Memphis Accounts Management ONLY)*, WI-21-0812-02 (Sept. 6, 2012).

³⁸ Field Service Advice 200038005 (June 6, 2000).

³⁹ See National Taxpayer Advocate 2011 Annual Report to Congress 431-432; National Taxpayer Advocate 2009 Annual Report to Congress 41-69; National Taxpayer Advocate 2008 Annual Report to Congress 503-512; National Taxpayer Advocate 2006 Annual Report to Congress 197-221; National Taxpayer Advocate 2005 Annual Report to Congress 223-237; National Taxpayer Advocate 2004 Annual Report to Congress 67-88; National Taxpayer Advocate 2003 Annual Report to Congress 270-301; National Taxpayer Advocate 2002 Annual Report to Congress 216-230; *Fraud in Income Tax Return Preparation*, Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways and Means, 109th Cong. (2005) (statement of Nina E. Olson, National Taxpayer Advocate).

Scope of “Return Preparer Fraud” Should Be Expanded.

As mentioned above, taxpayers frequently 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 neighbors, co-workers, clergy, or family friends who may offer to help in filing their tax returns. Under current guidance, the IRS will not provide relief to taxpayers defrauded by preparers who are not in the business of preparing returns. As a result, many taxpayers who have been victimized by such 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 preparer, the IRS should instead focus on whether the taxpayer authorized the filing of the return that was submitted. We fully recognize the IRS’s concern that some taxpayers with a non-business relationship with their return preparer may not truly be innocent victims of fraud. We do not suggest that the IRS relax its requirement that the taxpayer support his or her assertion that the return preparer filed an unauthorized return with appropriate documentation. But once the IRS is convinced that the return submitted was not the one authorized by the taxpayer, it does not matter whether the preparer was in the business of preparing tax returns.

Regulation of Return Preparers Should Give Taxpayers a Greater Level of Confidence in Choosing Trustworthy Practitioners.

The IRS began regulating return preparers in the 2012 filing season. Unenrolled preparers who prepare Form 1040 series returns must now take a competency test administered by the IRS Return Preparer Office.⁴⁰ Creating a class of certified return preparers is a very positive step toward combatting fraud.

In conjunction with the regular training and testing, a comprehensive communications plan targeting the most vulnerable taxpayers (*e.g.*, the elderly, those who speak English as a second language or are low income, college students) would be a worthwhile investment. By educating taxpayers on how to choose a qualified return preparer, the IRS can attempt to steer taxpayers away from the less scrupulous preparers. As noted above, the IRS should also remind taxpayers that a paid preparer is required to sign the tax return and provide the taxpayer with a copy of that signed tax return. These documents are the taxpayer’s best defense against return preparer fraud, and the IRS’s failure to educate taxpayers about how to protect themselves is, in the National Taxpayer Advocate’s opinion, a gross dereliction of the government’s duty to promote and protect the interests of its taxpayers.

⁴⁰ The Return Preparer Office develops the questions, but the IRS selects a vendor to administer the test nationwide.

CONCLUSION

Return preparer misconduct is a growing problem for the IRS. Return preparer misconduct ties up IRS resources, drains the public fisc, and harms taxpayers. The IRS must do all it can to deter return preparer misconduct and develop comprehensive procedures to assist victims.

When a return preparer diverts a taxpayer's refund using an altered bank routing number and obtains the funds using direct deposit, the IRS will not issue a refund to the taxpayer. Instead, the IRS's position is that this is a civil matter between the victim and the return preparer or bank. At a time when the IRS is pushing taxpayers to electronic filing, its refusal to issue replacement refunds to those who requested direct deposit payment while agreeing to issue a replacement paper check is illogical and bad for tax administration.

Even as the IRS promotes electronic filing and payments, its policy of not issuing refunds to victims of return preparer misconduct creates a disincentive for taxpayers to e-file and request a direct deposited refund. In essence, the message the IRS is sending to taxpayer is this: Prepare and file your tax returns using a return preparer because it is almost impossible to keep up with the increasingly complex tax law, and utilize e-file and direct deposit to keep processing costs down and human errors to a minimum, but if the return preparer you choose is dishonest and absconds with your tax refund, you are on your own.

The National Taxpayer Advocate preliminarily recommends that the IRS:

1. Develop comprehensive guidance providing full relief to victims of return preparer misconduct.
2. Conduct outreach and seek authorization to use appropriated funding for a comprehensive consumer safety information campaign for taxpayers, targeting the most vulnerable segments of the taxpayer population.

IRS COMMENTS

The IRS acknowledges that the perpetration of fraud by a tax return preparer is a very serious issue and one that presents unique challenges and difficult legal questions for the IRS. In addition, the issues have changed over time with new types of fraud developing as we work through this process. These types of cases are intensely factual in nature and involve varying forms of interaction between the IRS and taxpayers as well as third party return preparers. As a result, there are many new and varying factual situations to analyze, some of which have raised novel legal questions for our consideration. For these reasons, careful and thoughtful processing of these cases has taken longer than expected. We know that some taxpayers have been waiting a longer time than we would normally consider appropriate for resolution of their cases, and we hope that this will not continue going forward. As a steward of federal tax dollars, the IRS must ensure that legal requirements are satisfied before the government makes payments to taxpayers whose refunds may have been stolen

The IRS Harms Victims of Return Preparer Misconduct by Failing to Resolve Their Accounts Fully

by a third party. The IRS is attempting to strike a balance in this area so that federal tax dollars are used appropriately.

The circumstances surrounding preparer fraud have been evolving. The IRS has devoted considerable time and resources in 2011 and 2012 toward the resolution of many of these issues. In April 2012, the IRS issued Servicewide Electronic Research Program (SERP) Alert 12A0238, *Contacts Regarding Specific Return Preparer Complaint Issues*, which provided internal guidance to assist taxpayers who contact the IRS claiming they have been victims of preparer fraud or misconduct. In conjunction with this new guidance, the IRS created a new form, Form 14157-A, *Tax Return Preparer Fraud or Misconduct Affidavit*, for taxpayers to use along with a Form 14157, *Return Preparer Complaint*, to submit their complaint and request account adjustments.

The IRS established a special unit in Memphis for Accounts Management to receive claims. Internal guidance to process claims was issued on those scenarios for which all legal issues have been resolved. On June 26, 2012, the IRS issued SERP Alert 12A0417, *Memphis AM ONLY-Return Preparer Misconduct Interim Guidance*. This SERP Alert, and subsequent internal guidance issued on September 6, 2012, provide internal guidance on how to resolve cases in which the taxpayer visits a return preparer but does not authorize that return preparer to file a tax return on their behalf. The guidance also addresses cases where the taxpayer authorized a tax preparer to file a tax return but the return is subsequently altered by the preparer without the consent of the taxpayer, provided the preparer did not misdirect a tax refund due and owing to the taxpayer. The IRS also issued guidance to Collection employees and posted it to the Technical Digest for all SB/SE compliance employees in July 2012.

The unresolved issues raised more recently present new and varying factual situations that need further legal analysis. Most of the remaining cases involve a third-party preparer, who has been authorized to file a tax return, but misappropriated tax refunds that were due and owing to the taxpayer. We have been actively coordinating with the Operating Divisions and Counsel to reach resolution. As a result, these types of cases are on hold awaiting guidance we expect to be forthcoming.

The National Taxpayer Advocate has recommended that the IRS conduct outreach and seek authorization to use appropriated funding for a comprehensive consumer safety information campaign for taxpayers, targeting the most vulnerable segments of the taxpayer population. The IRS website currently provides information to taxpayers on how to choose a Tax Return Preparer. See Tax Topic 254 on IRS.gov. It cautions taxpayers about unscrupulous preparers and provides a link regarding how to choose a tax preparer and how to interact with that preparer to avoid fraud (See hyperlink to IRS Tax Tip 2011-106). This page also provides a link to information on reporting suspected fraud (See “Where Do You Report Suspected Fraud?”). We agree that further education and outreach would be beneficial and will leverage our resources by engaging our partners and stakeholders.

In addition, the Return Preparer Office is continuing to phase in a multi-year plan that began in 2010 to regulate the paid preparer industry. Future steps of the plan include a public database of authorized preparers and a taxpayer education campaign. The database, which is scheduled to launch in 2013, will include a public listing of those individuals who are registered with the IRS, have met minimum competency and suitability requirements, and have appropriate credentials for preparing individual income tax returns for compensation. The taxpayer education campaign will include public service announcements and outreach and education about how to choose a paid preparer, including the types of credentials paid preparers should have, and how to use the database to find or check the credentials of a preparer.

Taxpayer Advocate Service Comments

The National Taxpayer Advocate understands that the IRS has been placed in the difficult position of protecting the public fisc while processing over 140 million individual tax returns annually. We also recognize the IRS's desire to get a firm grasp of its legal obligations before developing procedures. However, the National Taxpayer Advocate believes that the IRS has already received sufficient guidance from the Office of Chief Counsel to proceed to make whole these victims of return preparer fraud.

Contrary to the IRS's assertion that "there are many new and varying factual situations to analyze," the IRS has known for at least 12 years — *more than a decade* — that some tax preparers have perpetrated fraud on their clients, including diversion of refunds. Since 2000, the IRS Office of Chief Counsel has issued several opinions that address similar situations. We have summarized the relevant conclusions, and believe that based on this guidance, the IRS is legally permitted to take all of the actions we have recommended.

The IRS has had 12 years to develop procedures to (1) back out the return information contained in the invalid or unauthorized return, (2) stop any collection action associated with a refund that the taxpayer never received, (3) process the taxpayer's true return, and (4) issue the proper refund to the taxpayer. While the IRS has finally developed interim procedures to address the first three steps, it stopped short of establishing a method of delivering refunds to the victims of preparer fraud — which is the most important aspect of case resolution from the victims' perspective. We do not believe that the IRS needs further guidance in order to assist the growing number of victims of return preparer fraud.

The IRS's inexcusable delay in acting on these cases and issuing guidance is inflicting real harm on real taxpayers. These are not mere cases where "some taxpayers have been waiting a longer time than we would normally consider appropriate for resolution of their cases" nor do they require such "careful and thoughtful processing" as to take over a decade to issue guidance. As we noted above, in FY 2012, TAS issued 58 TAOs on these cases,

of which 26 are elevated to the National Taxpayer Advocate. The average adjusted gross income (AGI) of the taxpayers involved in these 26 TAOs was less than \$32,000, and the refund sought by these taxpayers constituted, on average, 28 percent of their AGI. In the face of these numbers, IRS inaction is callous.

As we go to press with this report, the total number of TAOs involving preparer fraud that have been elevated to the National Taxpayer Advocate is 60. To date, the Commissioner of the Wage and Investment Division has appealed ten of these TAOs, and the National Taxpayer Advocate is sustaining these TAOs to the Acting Commissioner of Internal Revenue. In each of these cases, the National Taxpayer Advocate has presented to the IRS significant documentary evidence of the preparer's actions and the harm sustained by the taxpayer, and laid out a road map of what corrective actions the IRS should take to remedy that harm. In these cases, there are few difficult policy calls to be made. A fraud has been committed, similar to what occurs when paper refund checks are misappropriated, and the IRS has the legal authority to make the taxpayer whole and seek restitution from the perpetrator. Never before has the National Taxpayer Advocate had to fight so hard for such a simple, basic issue of justice and fairness for taxpayers who were simply trying to comply with their tax filing obligations.

The IRS's ongoing failure to conduct a vigorous and extensive outreach and education campaign about preparer selection and protection against preparer fraud is unacceptable. Since 2002, the National Taxpayer Advocate has recommended that the IRS actively inform taxpayers who use paid preparers to ask for and obtain a copy of their returns, signed by that preparer, as required by law.⁴¹ The IRS's own research demonstrates that the taxpayer populations most vulnerable to this type of fraud either do not have regular access to the Internet or do not actively use it for this type of information.⁴² Thus, by failing to conduct an active and direct marketing campaign targeted to the most vulnerable populations and by merely putting cautionary information on its website, the IRS facilitates the very fraud that it should be warning against.

In October 2012, the National Taxpayer Advocate issued a proposed Taxpayer Advocate Directive (TAD) to the W&I Commissioner requesting that the IRS establish procedures for issuing refunds to victims of return preparer fraud, a copy of which immediately follows

⁴¹ See National Taxpayer Advocate 2002 Annual Report to Congress 216-230 (Legislative Recommendation: *Regulation of Federal Tax Return Preparers*).

⁴² See generally Most Serious Problem: *The IRS Lacks a Servicewide Strategy that Identifies Effective and Efficient Means of Delivering Face-to-Face Taxpayer Services*, *infra*. See also Kathryn Zickuhr, Pew Internet, *Generations and Their Gadgets* (Feb. 2011), <http://www.pewinternet.org/Reports/2011/Generations-and-gadgets.aspx>; Kathryn Zickuhr, Aaron Smith, Pew Internet, *Digital Differences* (Apr. 2012), <http://www.pewinternet.org/Reports/2012/Digital-differences.aspx>; IRS Oversight Board, *2006 Service Channels Survey*; IRS, *2006 Market Segment Survey, Many Unprotected from Fraudulent Tax Preparers*, <http://press-room.lawyers.com/Many-Unprotected-from-Fraudulent-Tax-Preparers.html>.

this discussion.⁴³ The division responded by saying it is meeting with senior leadership and Counsel in an attempt to reach resolution. Because the IRS has refused to develop such procedures, even though it has known since 2000 about the problems that return preparer fraud can thrust upon taxpayers, the National Taxpayer Advocate will issue a formal TAD in January 2013 directing the IRS to develop such procedures.

Recommendations

1. Develop comprehensive guidance providing full relief to victims of return preparer misconduct, including the issuance of a refund.
2. Conduct direct outreach and seek authorization to use appropriated funding for a comprehensive consumer safety information campaign for taxpayers, targeting the most vulnerable segments of the taxpayer population.

⁴³ See Proposed Taxpayer Advocate Directive 2012-5, *Establish procedures for issuing a replacement refund for victims of return preparer misconduct* (Oct. 17, 2012). 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. 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). 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.



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: October 31, 2012

MEMORANDUM FOR Peggy Bogadi, Commissioner
Wage and Investment Division

FROM: Nina E. Olson /s/
National Taxpayer Advocate

SUBJECT: Proposed Taxpayer Advocate Directive 2012-5 (*Establish procedures for issuing a replacement refund for victims of return preparer misconduct*)

PROPOSED 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.¹ 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. This Proposed TAD serves as a formal alert that I will issue a TAD if the IRS does not take the following concrete actions:

- 1) within 30 days of the date of this Proposed TAD, develop procedures to issue refunds to victims of return preparer fraud who are due a refund after they file a correct original return;
- 2) within 30 days of the date of this Proposed TAD, develop procedures to issue refunds to taxpayers who have had their direct deposit routing information altered by a third party without the taxpayer's consent;
- 3) within 30 days of the date of this Proposed TAD, provide relief to taxpayers victimized because another individual has prepared their return and committed fraud,

¹ 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).

even if the other individual does not fall within the definition of a “tax return preparer” receiving compensation (*e.g.*, family member, friend, neighbor, clergy.);²

- 4) within 60 days of the date of this Proposed TAD, in consultation with the National Taxpayer Advocate, issue interim guidance to reflect these changes in procedures; and
- 5) within 90 days of the date of this Proposed TAD, in consultation with the National Taxpayer Advocate, revise the IRM to reflect these changes in procedures.

Please provide a written response to this Proposed TAD on or before October 26, 2012.

I. ISSUES

My office is seeing an increasing number of return preparer misconduct cases. Often, victims are individuals who are facing economic hardship and are in dire need of their tax refunds. 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 held responsible for the actions of these return preparers.³

Among our return preparer misconduct cases, there are four common scenarios.

- (1) Unauthorized filing:
 - Taxpayer (TP) visits a return preparer, but for whatever reason decides not to use this preparer and never authorizes a return filing;
 - Later, TP attempts to file a return electronically (either on his/her own, or with assistance from a different preparer), but the IRS rejects the return;
 - TP learns that the IRS has already processed a return submitted by the first preparer, who directed the refund to an account not belonging to, or under the control of, TP; and
 - TP subsequently files a correct original return.
- (2) Altered return information — no additional refund due to TP:
 - TP visits a return preparer and authorizes a return filing;
 - TP reviews and approves for filing a copy of the “final return,” but subsequently, the preparer alters portions of this return to increase the refund amount;

² It is my understanding that the IRS has refused to provide relief to a taxpayer victimized by someone who prepared the taxpayer’s return who was not in the business of preparing returns.

³ 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. (statement of Nina E. Olson, National Taxpayer Advocate).

The IRS Harms Victims of Return Preparer Misconduct by Failing to Resolve Their Accounts Fully

- TP receives the refund amount expected, and the preparer directs the excess amount via direct deposit to different bank routing and account numbers⁴; and
 - TP later learns of the return preparer fraud and files a correct original return.
- (3) Altered return information — additional refund due to TP:
- Similar to (2), but TP only receives a portion⁵ (or none⁶) of the refund amount he was expecting.
- (4) Misrouted direct deposit:
- TP visits a return preparer and authorizes a return filing;
 - TP reviews and approves for filing a copy of the “final” return, but subsequently, the preparer alters the bank routing and account numbers; the return is otherwise accurate; and
 - TP never receives a refund, and learns that the return filed by the preparer contained altered bank routing and account numbers.

On June 26, 2012, Accounts Management (AM) issued interim guidance to its employees on resolving return preparer misconduct cases.⁷ When my staff and I were asked to review a draft of the guidance, I objected to AM issuing this guidance, as it does not address some of the common fact patterns we see in our return preparer misconduct cases. For example, it does not provide procedures for scenarios 3 and 4 described above.

In scenario 3, once the victim notifies the IRS of the return preparer misconduct, the IRS will back out the altered return information from the taxpayer’s account and ask the victim to submit a correct original return. Although a refund is due, the IRS will not issue a refund to the taxpayer. Instead, the IRS informs the victim that preparer misconduct is a civil matter to be settled without its assistance. AM employees are instructed to suspend action on the case pending Chief Counsel guidance.

⁴ In some cases, the taxpayer receives the amount directly from the IRS via direct deposit; in other cases, the preparer has the entire refund amount (taxpayer’s correct refund plus the inflated refund) direct deposited to the preparer, and then issues the taxpayer a check.

⁵ For example, suppose TP is entitled to a \$500 refund. The preparer alters the tax data so that the refund amount is \$1,000. The preparer splits the refund on Form 8888, \$600 to the preparer, \$400 to TP. TP has not received the full refund amount to which he is entitled (\$100 shortfall).

⁶ For example, suppose TP is entitled to a \$900 refund. The preparer alters the tax data so that the refund amount is \$1,900. The preparer splits the refund on Form 8888, \$1,000 to the preparer, \$900 to TP. IMF stores only the information from the first bank account listed on Form 8888. The refund is held for some reason beyond the first cycle when the split account information from Form 8888 is still in the system, so a split refund does not occur, and the entire \$1,900 refund is direct-deposited into the first bank account listed on Form 8888, which in this example is the preparer’s bank account.

⁷ See SERP Alert 12A0417, *Memphis AM ONLY - Return Preparer Misconduct Interim Guidance* (June 26, 2012). This guidance was later incorporated into an interim guidance memorandum from the Director of AM on September 6, 2012. See *Interim Guidance on Return Preparer Misconduct (For Memphis Accounts Management ONLY)*, WI-21-0812-02 (Sept. 6, 2012).

In contrast, if a third party fraudulently endorses a victim's paper refund check, the IRS has procedures to re-issue a check to the taxpayer upon a timely filed claim.⁸ However, if the return preparer diverts a victim's refund using altered bank routing and account numbers and obtains the funds using direct deposit (scenario 4), the IRS will not issue a refund to the taxpayer. Instead, the IRS's position is that it is a civil matter between the victim and the return preparer or bank.

II. PROCEDURAL HISTORY

TAS has previously discussed in depth the problems taxpayers encounter when they are the victims of return preparer misconduct. On January 12, 2012, I issued a TAD that covered the issue thoroughly.⁹ In response to the TAD, on June 26, 2012, the Wage and Investment division (W&I) issued guidance that partially addressed my concerns, but failed to adequately provide relief for all victims of return preparer misconduct.¹⁰

III. ANALYSIS

Pursuant to the Beard Test, an Unsigned Return Is Not a Valid Return.

*Beard v. Commissioner*¹¹ involved a taxpayer who altered a Form 1040, U.S. Individual Income Tax Return. In *Beard*, the Tax Court applied a four-part test to determine whether a document filed with the IRS qualifies as a "return" for tax purposes. Those requirements are that the document: (1) purport to be a return; (2) be signed under penalties of perjury; (3) contain sufficient data to permit a tax to be calculated; and (4) evince an honest and genuine endeavor to satisfy the requirements of tax law. *Beard* has become the generally accepted test for determining the validity of a tax return.

The signature requirement derives from IRC § 6065, which states that generally, any return, declaration, statement, or other document required to be made under any provision of the internal revenue laws or regulations shall contain or be verified by a written declaration that it is made under penalties of perjury. This requirement authenticates the signed document and verifies its truthfulness.

In a typical return preparer misconduct case scenario, the preparer alters some information on the tax return after the taxpayer has authorized a prior version of the return. The return submitted by the return preparer was not reviewed, authorized, or signed by the taxpayer

⁸ See IRM 21.4.2.4.15.3.1, Check Forgery Insurance Fund (CFIF) (Oct. 1, 2006).

⁹ 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).

¹⁰ See SERP Alert 12A0417, *Memphis AM ONLY - Return Preparer Misconduct Interim Guidance* (June 26, 2012). This guidance was later incorporated into an interim guidance memorandum from the Director of AM on September 6, 2012. See *Interim Guidance on Return Preparer Misconduct (For Memphis Accounts Management ONLY)*, WI-21-0812-02 (Sept. 6, 2012).

¹¹ 82 T.C. 766, 777-78 (1984), *aff'd per curiam*, 793 F.2d 139 (6th Cir. 1986).

The IRS Harms Victims of Return Preparer Misconduct by Failing to Resolve Their Accounts Fully

under penalties of perjury. It is not a valid return, as it fails the signature requirement of the *Beard* test.

Relevant Chief Counsel Advice Permits the IRS to Issue Refunds to Victims of Return Preparer Misconduct.

Return preparer misconduct is not a new phenomenon that the IRS is just now facing. While W&I only recently issued partial guidance to its employees on how to assist victims of return preparer misconduct, the IRS Office of Chief Counsel has provided advice on such situations dating as far back as 2000.

In 2000, the Office of Chief Counsel issued advice addressing a situation where a taxpayer used the Volunteer Income Tax Assistance (VITA) program to electronically file her tax return, and the VITA volunteer subsequently changed the bank routing and account numbers, with the result that the taxpayer's refund was directed into the account of a third party.¹² The Office of Chief Counsel concluded that there is "no legal impediment to reissuing a direct deposit refund." The Office of Chief Counsel noted that situations in which direct deposits are stolen are closely analogous to the stolen refund check situation, where there is a process for issuing a replacement refund check.¹³

In 2003, the Office of Chief 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.¹⁴ In this 2003 memorandum, the Office of Chief Counsel analyzed the four-part test set forth in *Beard*, and concluded that when the taxpayer is unaware of the alterations to the return and the version that the taxpayer reviewed and approved is not what the preparer filed with the IRS, the taxpayer did not sign that return under penalties of perjury. Consequently, the return filed by the preparer is a nullity and any assessment on the IRS's books and records relating to that return is invalid. Counsel advised that the taxpayer should file an *original* return (not an amended return) so that the IRS can then adjust the taxpayer's Master File account to reflect the correct tax information.

In 2008, the Office of Chief Counsel once again looked at a situation where a refund was improperly directed to a preparer.¹⁵ The memorandum makes 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. The memorandum further advised that the IRS could bring an erroneous refund suit against the preparer to recover the amounts improperly obtained.

¹² 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.

¹³ *Id.* See also IRM 21.4.2.4.15.3.1, Check Forgery Insurance Fund (CFIF) (Oct. 1, 2006).

¹⁴ See IRS Office of Chief Counsel Memorandum, *Horse's Tax Service*, PMTA 2011-13 (May 12, 2003).

¹⁵ See IRS Office of Chief Counsel Memorandum, *Refunds Improperly Directed to a Preparer*, POSTN-145098-08 (Dec. 17, 2008).

In 2011, the Office of Chief Counsel was again asked whether a return that was altered by a return preparer to inflate items of income, deduction, credits, or withholding without the taxpayer's consent was a valid tax return.¹⁶ Again utilizing the *Beard* analysis, Counsel concluded 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.”

Since 2000, the IRS has received four legal opinions from its Office of Chief Counsel addressing return preparer misconduct. Two of the opinions indicate that if a purported return fails the *Beard* test, it is a nullity. Three of the opinions indicate that nullified returns should be backed out of the taxpayer’s account. And one of the opinions clearly indicates that there is no legal impediment to issuing the taxpayer his or her correct refund when he or she hasn’t received it due to fraudulent misconduct by a return preparer. Thus, when reading all four opinions together, the IRS has received ample advice to permit it to reissue refunds to victims of return preparer misconduct in scenarios 3 and 4 described above.

Current Guidance Does Not Fully Address Impact of Return Preparer Misconduct.

Under current guidance,¹⁷ when the IRS is made aware of the return preparer misconduct, it is willing to back out the altered return filed by the preparer (*i.e.*, treat it as a nullity) and process the correct original return once it is obtained from the taxpayer. However, the IRS has declined to issue a replacement refund to victims, despite the guidance it has received from the Office of Chief Counsel (discussed above).

The IRS makes a distinction between (1) taxpayers who never authorized a return preparer to file a return, and (2) taxpayers who authorized a return preparer to file a return but did not authorize the particular return filed by the return preparer. In the first situation, the interim guidance instructs AM employees to “Follow steps in *Accounts Resolution Initial Steps*” and issue a manual refund if the taxpayer did not receive the full refund.¹⁸ My understanding is that the IRS considers this situation to be analogous to identity theft where a third party steals a taxpayer’s information and files a return claiming a refund. In the second situation, if the taxpayer is seeking a refund from the IRS, AM is instructed to suspend action on the case pending Chief Counsel guidance. The IRS considers the return filed to be “invalid” but not “unauthorized.”

There should be no distinction between these two situations. In both instances, the return preparer filed a tax return that the taxpayer did not authorize. In many cases, the taxpayer is given a copy of the correct return that he or she authorized the return preparer to file, but the return preparer alters information on the return and ends up filing a different

¹⁶ See IRS Office of Chief Counsel Memorandum, *Tax Return Preparer’s Alteration of a Return*, PMTA 2011-20 (June 27, 2011)

¹⁷ See *Interim Guidance on Return Preparer Misconduct (For Memphis Accounts Management ONLY)*, WI-21-0812-02 (Sept. 6, 2012).

¹⁸ *Id.*

The IRS Harms Victims of Return Preparer Misconduct by Failing to Resolve Their Accounts Fully

version of the return. The fact that a taxpayer authorized the return preparer to file “a” return does not mean that the taxpayer authorized “the” return that was actually filed.

Well-established principles of agency law state that if an agent acts outside of the scope of the agency relationship, then it is an unauthorized act and thus not an action of the principal, unless later ratified by the principal.¹⁹ A return preparer altering portions of the tax return without the taxpayer’s consent is an agent acting outside of the scope of the agency relationship — meaning the return as filed is not a valid return of the taxpayer and should be nullified. The taxpayer should be given the opportunity to file a valid return and receive the full refund associated with that return. The interim guidance ignores longstanding principles of agency law and leaves taxpayers with little recourse to recover their stolen direct deposit tax refunds.

The IRS may argue that it reasonably relied upon the apparent authority of the return preparer, and acted to its detriment in processing the refund. I agree that the doctrine of apparent authority is necessary to protect a helpless third party. But I would hardly characterize the IRS as a helpless party in such a transaction; *the taxpayer is the party that requires protection*. Under our current tax system, taxpayers are required by law to self-assess taxes and interact with the IRS. Given the complexity of the tax law, preparing and filing returns is a significant undertaking for many taxpayers. In fact, more than 80 percent of American households use paid preparers or tax software to help them prepare and file their tax returns.²⁰ With less Taxpayer Assistance Center resources available to help taxpayers prepare and file their tax returns, many feel pressure to enlist the services of a return preparer to meet their statutorily-mandated tax filing requirement. The filing of one’s taxes is an entirely different situation than the typical contractual relationship under which apparent authority is exercised.

Further, it seems intellectually dishonest for the IRS to treat the initial, altered return as a nullity when it does not require a payment to the taxpayer, yet refuse to fully process the taxpayer’s correct original return when it requires an additional payment of a refund to the taxpayer. The IRS is willing to go halfway and back out the nullified return, but it is unwilling to abide by the notion that the first return filed was not the return of the taxpayer when it is asked to issue a second refund. I have not been provided an adequate explanation to support this decision. It is as though the IRS is employing a budgetary approach to legal and policy issues.

In an analogous situation, the IRS does make taxpayers whole by issuing a refund after initially processing a nullity. In this regard, when an identity thief files a tax return with falsified information purporting to be the taxpayer, the IRS initially processes the return and pays out the refund to the identity thief. Later, when the identity theft victim provides

¹⁹ See American Law Institute, Restatement (Third) of Agency § 6.05 (2006).

²⁰ IRS, IR-2010-1, *IRS Proposes New Registration, Testing and Continuing Education Requirements for Tax Return Preparers Not Already Subject to Oversight* (Jan. 4, 2010).

sufficient documentation establishing the identity theft, the IRS moves the nullity to a temporary tax identification number (an IRSN) and accepts the correct original return from the victim. If there is a refund associated with the return, the IRS pays the refund to the identity theft victim, regardless of whether it paid a refund to the identity thief initially.

It makes little sense from a policy standpoint to treat victims of return preparer misconduct more harshly than victims of identity theft, when neither victim had any culpability in the refund misconduct scam. To be clear, I am not advocating that the IRS agree to hold the taxpayer harmless if there is any evidence that the taxpayer colluded with the return preparer to scam the government. However, I disagree wholeheartedly with the notion that by bringing the return preparer into the equation, the taxpayer automatically is assigned some degree of culpability.

Altering the Bank Routing and Account Numbers Is Tantamount to Altering the Tax Return.

The interim guidance on return preparer misconduct provides that in situations where the preparer altered the direct deposit information (rather than items of income, deduction, credits, etc.), AM should suspend action on the case pending Chief Counsel guidance. I do not believe there should be a distinction made on the basis of the *type of information* altered on the return by the return preparer. I see no legal basis for arbitrarily deciding that the bank routing and account information is not material to, or part of, the tax return. In fact, to the taxpayer, the instructions on where the refund payment is to be sent may be the most important part of the tax return. No taxpayer would authorize the filing of a return knowingly directing the refund to an account controlled by a third party over which the taxpayer has no control. As discussed above, the Office of Chief Counsel issued advice in 2000 concluding that the IRS is permitted to issue a second refund in a case where the bank routing and account numbers are altered by a third party on a taxpayer's return.²¹ To avoid further harm to taxpayers, I request that the IRS guidance incorporate this advice.

I note that had the return preparer diverted a victim's refund by requesting a paper refund check, the IRS has procedures to re-issue a check to the taxpayer upon a timely filed claim.²² The Financial Management Service, upon determining that the taxpayer was not involved in the negotiation of the check, will issue a replacement to the taxpayer and charge the Check Forgery Insurance Fund (CFIF).²³ The CFIF is a revolving fund created by a statute that specifically refers to a "check," with longstanding rules and regulations that do not contemplate electronic payments.²⁴

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 IRM 21.4.2.4.15.3.1, *Check Forgery Insurance Fund (CFIF)* (Oct. 1, 2006).

²³ A settlement check is a replacement check based on the Form 1133 claim issued by FMS to replace the original check. IRM 21.4.2.4.13 (Dec. 20, 2010).

²⁴ Congress established the CFIF by law in 1941, before the advent of electronic checks. Pub. L. No. 77-310, 55 Stat. 777 (Nov. 21, 1941). While unrelated regulations provide for electronic checks, the CFIF regulations and rules contemplate forgery of signatures on paper.

The IRS Harms Victims of Return Preparer Misconduct by Failing to Resolve Their Accounts Fully

The CFIF legislation merely established a fund; it did not create a new authority for the IRS to replace fraudulently negotiated checks. This authority had always existed, so the designation of a source of funding is irrelevant to the discussion of whether the IRS should issue replacement funds to a taxpayer that never received the initial refund. In the case of a stolen direct deposit, the IRS Office of Chief Counsel previously has advised that, “the Service is legally permitted to reissue the refund to the taxpayer.”²⁵ Therefore, I believe the IRS can and should establish a process by which a taxpayer can show that whoever wrongfully altered the bank account number on a return was not an authorized agent, and upon confirmation of these facts, the IRS should pay the refund to the taxpayer — regardless of whether the refund was requested via direct deposit or by check.

Taxpayers Must Be Able to Substantiate the Occurrence of Return Preparer Misconduct.

I recognize that the IRS is concerned about the practical and financial effect of issuing refunds to victims after already paying out a refund initially with the altered return. There will certainly be taxpayers attempting to game the system, perhaps by colluding with a return preparer. I appreciate the need for the IRS to request documentation substantiating the return preparer misconduct. It may be difficult for some taxpayers to meet the burden of proof the IRS requires. However, many are able to easily — some taxpayers have gone as far as file a police report against the return preparer.

I urge the IRS to separate the problems of proof from its analysis of legal and policy issues. For those taxpayers who are able to provide sufficient documentation supporting their claim, the IRS must act quickly to issue the refunds to which they are entitled. We should not further victimize such taxpayers by depriving them of their tax refunds.

Scope of “Return Preparer Fraud” 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 that 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. As a result, many taxpayers who have been 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 preparer may not

²⁵ FSA 200038005 (June 6, 2000); see also 31 C.F.R. § 210.4(a)(1) (indicating that an agency that accepts an ACH authorization shall verify “the validity of the recipient’s signature”).

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. But 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.

IV. CONCLUSION

According to Commissioner Shulman, “e-file ensures people can file accurately and get refunds quickly” and “IRS e-file is now the norm, not the exception.”²⁶ At a time when the IRS is pushing taxpayers to electronic filing, as a way to both improve the accuracy and reduce the costs of return processing, its refusal to issue replacement refunds to those who requested direct deposit payment while agreeing to issue a replacement paper check is illogical and bad for tax administration.

When taxpayers who are trying to comply with their tax filing obligations are victimized by return preparer misconduct, such victims are often left to deal with the aftermath with little help from the IRS. I suspect that victims of return preparer misconduct take little solace in the fact that, as the IRS is quick to suggest, they might be able to track down the return preparer and file a civil suit to obtain their tax refund money. Even as the IRS promotes electronic filing and payments, its policy of not issuing refunds to victims of return preparer misconduct creates a disincentive for taxpayers to e-file and request a direct deposited refund.

V. REQUESTED ACTIONS

For these reasons, I am issuing this Proposed 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 request that you:

- 1) within 30 days of the date of this Proposed TAD, develop procedures to issue refunds to victims of return preparer fraud who are due a refund after they file a correct original return;
- 2) within 30 days of the date of this Proposed TAD, develop procedures to issue refunds to taxpayers who have had their direct deposit routing information altered by a third party without the taxpayer’s consent;
- 3) within 30 days of the date of this Proposed TAD, provide relief to taxpayers victimized because another individual has prepared their return and committed fraud,

²⁶ IRS, IR-2011-4, *IRS e-file Launches Today; Most Taxpayers Can File Immediately* (Jan. 14, 2011).

The IRS Harms Victims of Return Preparer Misconduct by Failing to Resolve Their Accounts Fully

even if the other individual does not fall within the definition of a “tax return preparer” receiving compensation (*e.g.*, family member, friend, neighbor, clergy.);

- 4) within 60 days of the date of this Proposed TAD, in consultation with the National Taxpayer Advocate, issue interim guidance to reflect these changes in procedures; and
- 5) within 90 days of the date of this Proposed TAD, in consultation with the National Taxpayer Advocate, revise the IRM to reflect these changes in procedures.

Attachments:

- (1) 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)
- (2) SERP Alert 12Ao417, *Memphis AM ONLY - Return Preparer Misconduct Interim Guidance* (June 26, 2012)
- (3) *Interim Guidance on Return Preparer Misconduct (For Memphis Accounts Management ONLY)*, WI-21-0812-02 (Sept. 6, 2012).
- (4) IRS Office of Chief Counsel Memorandum, *Tax Return Preparer’s Alteration of a Return*, PMTA 2011-20 (June 27, 2011)
- (5) IRS Office of Chief Counsel Memorandum, *Refunds Improperly Directed to a Preparer*, POSTN-145098-08 (Dec. 17, 2008)
- (6) IRS Office of Chief Counsel Memorandum, *Horse’s Tax Service*, PMTA 2011-13 (May 12, 2003)
- (7) Field Service Advice 200038005 (June 6, 2000)

cc: w/ attachments: Steve Miller, Deputy Commissioner, Services and Enforcement