

Legislative Recommendation #3**Authorize the IRS to Establish Minimum Competency Standards for Federal Tax Return Preparers****SUMMARY**

- *Problem:* The majority of paid tax return preparers are non-credentialed, and some have no training or experience. Taxpayers are harmed when incompetent tax return preparers make errors that cause them to pay too much tax, deprive them of receiving certain tax benefits, or subject them to IRS tax adjustments and penalties for understating their tax.
- *Solution:* Require paid non-credentialed tax return preparers to pass a basic competency test, meet specified standards of conduct, and take annual continuing education courses about federal tax laws and procedures impacting federal tax return preparation.

PRESENT LAW

Federal law imposes no competency or licensing requirements on paid tax return preparers. Credentialed individuals who may prepare tax returns, including attorneys, certified public accountants (CPAs), and enrolled agents (EAs), are generally required to pass competency tests and take continuing education courses (including an ethics component). Volunteers who prepare tax returns as part of the Volunteer Income Tax Assistance and Tax Counseling for the Elderly programs also must pass competency tests. However, the vast majority of paid preparers are non-credentialed and are not required to pass competency tests, take any courses in tax return preparation, or follow prescribed standards of conduct.

REASONS FOR CHANGE

In recent years, the IRS has received over 160 million individual income tax returns annually, and paid tax return preparers prepare the majority of these returns. Both taxpayers and the tax system depend heavily on the ability of preparers to prepare accurate tax returns. Yet numerous studies have found that non-credentialed tax return preparers routinely prepare inaccurate returns, which harms taxpayers and the public fisc.

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

The following studies illustrate the extent – and adverse consequences – of inaccurate return preparation by unenrolled tax return preparers:

Government Accountability Office (GAO). In 2006, GAO auditors posing as taxpayers made 19 visits to several national tax return preparation chains in a large metropolitan area. Using two carefully designed fact patterns, they sought assistance in preparing tax returns. On 17 of 19 returns, preparers computed the wrong refund amounts with variations of several thousand dollars. In five cases, the prepared returns reflected unwarranted excess refunds of nearly \$2,000. In two cases, the prepared returns would have caused the taxpayer to overpay by more than \$1,500 (*e.g.*, by not claiming all deductions or other tax benefits for which the taxpayer qualified). In five out of ten cases in which the Earned Income Tax Credit (EITC) was claimed, preparers

failed to ask where the auditor's child lived or ignored the auditor's answer and prepared returns claiming ineligible children. In 10 of 19 cases, business income was not reported.¹

The GAO conducted a similar study in 2014. It again found that preparers computed the wrong tax liability on 17 of the 19 returns.²

Treasury Inspector General for Tax Administration (TIGTA). In 2008, TIGTA auditors posing as taxpayers visited 12 commercial chains and 16 small, independently owned tax return preparation offices in a large metropolitan area. All preparers visited by TIGTA were non-credentialed. Of 28 returns prepared, 61 percent were prepared incorrectly. The average net understatement was \$755 per return. Of seven returns involving EITC claims, none of the non-credentialed preparers exercised due diligence as required under IRC § 6695(g).³

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 remarks made at an IRS Public Forum, the Acting Commissioner of the New York Department of Taxation and Finance stated that investigators found “an epidemic of unethical and criminal behavior.”⁴ At one point, the Department reported that it had found fraud on about 40 percent of its visits, and it had made over 20 arrests and secured 13 convictions.⁵

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 overclaims averaged between 33 percent and 40 percent.⁶

In 2002, before these studies were published, the National Taxpayer Advocate recommended that Congress authorize the IRS to conduct preparer oversight. 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.⁷

1 GAO, GAO-06-563T, *Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors* (2006).

2 GAO, GAO-14-467T, *Paid Tax Return Preparers: In a Limited Study, Preparers Made Significant Errors* (2014).

3 TIGTA, Ref. No. 2008-40-171, *Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors* (2008).

4 Jamie Woodward, Acting Commissioner, New York Dept. of Taxation and Finance, Remarks at the IRS Tax Return Preparer Review Public Forum (Sept. 2, 2009).

5 *Id.* See also Tom Herman, *New York Sting Nabs Tax Preparers*, WALL ST. J. (Nov. 26, 2008).

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

7 Tax Administration Good Government Act, H.R. 1528, 108th Cong. § 141 (2004) (incorporating Tax Administration Good Government Act, S. 882); Telephone Excise Tax Repeal and Taxpayer Protection and Assistance Act of 2006, S. 1321, 109th Cong. § 203 (2006) (incorporating Taxpayer Protection and Assistance Act of 2005, S. 832).

On one occasion, the full Senate approved the legislation by unanimous consent.⁸ 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.⁹ Several of the same organizations reiterated that support as recently as last year.¹⁰

In 2009, the Commissioner of Internal Revenue concluded that the IRS had the authority under § 330 of Title 31 of the U.S. Code to regulate tax return preparation as “practice” before the IRS. The IRS initiated extensive hearings and discussions with stakeholder groups to receive comments and develop a system within which all parties believed they could operate.¹¹ The IRS, together with the Treasury Department, implemented the program in 2011. However, it was terminated two years later after a U.S. district court upheld a challenge to the IRS’s authority under 31 U.S.C. § 330 to regulate tax return preparation. The court concluded that “mere” tax return preparation did not constitute “practice” before the IRS.¹²

The IRS subsequently created a voluntary “Annual Filing Season Program.” Non-credentialed preparers who participate must meet specific requirements, including taking 18 hours of continuing education each year, which includes an examined tax refresher course. If they meet the requirements, the IRS provides them with a “Record of Completion” that they presumably can use in their marketing to attract potential clients.¹³ The D.C. Circuit has upheld the IRS’s authority to implement this program.¹⁴ However, the program is less rigorous than the one the IRS implemented in 2011, and most non-credentialed preparers do not participate. This voluntary program does not satisfy the objectives of a comprehensive regime.

Since the 2011 program was invalidated, House and Senate members have introduced legislation to provide the IRS with the statutory authority to establish and enforce minimum standards. In the Senate, Senators Portman and Cardin sponsored bipartisan authorizing legislation in 2018,¹⁵ and Senators Wyden and Cardin sponsored similar legislation in 2019.¹⁶ In the House, Congressman Panetta and Congressman Rice sponsored bipartisan authorizing legislation in 2021.¹⁷ In 2015, former Congresswoman Black and former Congressman Becerra, both members of the Ways and Means Committee, sponsored similar legislation.¹⁸ Consistent with the position of both the Obama and Trump Administrations, the Department of the Treasury included a legislative proposal in its fiscal year 2023 revenue proposals to provide the Secretary with explicit authority to regulate all paid preparers of federal tax returns by establishing mandatory minimum competency standards.¹⁹

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

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

10 William Hoffman, *Tax Groups and Conservatives Gird for Battle Over Preparer Regs*, TAX NOTES TODAY, (Aug. 2, 2021) (discussion of organizations supporting Taxpayer Protection and Proficiency Act).

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

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

13 Rev. Proc. 2014-42, 2014-29 I.R.B. 192.

14 *AICPA v. IRS*, 746 Fed. App'x 1 (D.C. Cir. 2018).

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

16 Taxpayer Protection and Preparer Proficiency Act of 2019, S. 1192, 116th Cong. (2019).

17 Taxpayer Protection and Preparer Proficiency Act of 2021, H.R. 4184, 117th Cong. (2021).

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

19 Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2023 Revenue Proposals* 83-86 (Mar. 2022), <https://home.treasury.gov/system/files/131/General-Explanations-FY2023.pdf>.

The IRS's Taxpayer Experience Strategy provides an additional reason for establishing preparer standards.²⁰ The IRS envisions giving preparers access to taxpayer information through online accounts. While there are considerable benefits to this plan, there are also significant security risks, including identity theft and other fraud. As the examples above demonstrate, the absence of standards for tax return preparers exacerbates unethical behavior, including fraud. These risks would be mitigated by the adoption of minimum standards for tax return preparers.

Some have argued that requiring preparers to pass a competency test and take annual continuing education courses would address competence but would not ensure preparers conduct themselves ethically. The National Taxpayer Advocate agrees that tax law competency and ethical conduct are distinct issues. However, we believe preparer standards would raise both competency and ethical conduct levels. A preparer who invests in learning enough about tax return preparation to pass a competency test and takes annual continuing education courses would demonstrate a commitment to return preparation as a profession. The preparer would be a vested partner in the tax system and would have more to lose if he or she is found to have engaged in misconduct, just like attorneys, CPAs, EAs, and other credentialed preparers. If tax return preparation is characterized as “practice” before the IRS – as the 2011 plan did – the Office of Professional Responsibility would have oversight authority over preparers and could impose sanctions in cases of unethical conduct.

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

RECOMMENDATION

- Amend Title 31, § 330 of the U.S. Code to authorize the Secretary to establish minimum standards for paid federal tax return preparers.²¹

²⁰ IRS Pub. 5426, Taxpayer First Act Report to Congress 42-45 (Jan. 2021).

²¹ For legislative language generally consistent with this recommendation, see Taxpayer Protection and Preparer Proficiency Act of 2019, S. 1192 & H.R. 3330, 116th Cong. (2019) and other bills cited herein.