

D. IRS Steps to Create a Voluntary Program for Tax Return Preparer Standards in Light of the *Loving* Decision Are Well Intentioned, But the Absence of a Meaningful Competency Examination Limits the Program's Value and Could Mislead Taxpayers

In the wake of an appellate court's decision in the *Loving v. Internal Revenue Service* case,⁶ the IRS has announced plans to create a voluntary continuing education (CE) program for unenrolled preparers as an interim step to protect taxpayers during the 2015 filing season.⁷ The IRS has acknowledged that a voluntary CE program is not an ideal solution and does not accomplish the same goals as the mandatory program in place before *Loving*.⁸ Nonetheless, the agency is moving ahead with this voluntary program.⁹ The IRS has said it "continues to believe regulation of paid tax return preparers is important for the proper functioning of the U.S. tax system," and accordingly, it urges Congress to provide the agency with the authority to impose mandatory testing and CE requirements.¹⁰

The National Taxpayer Advocate is particularly concerned about the low income taxpayer population, which is especially vulnerable to incompetent or unscrupulous unenrolled preparers.

The National Taxpayer Advocate agrees that the only effective way to increase competency throughout the return preparer profession is for Congress to provide the IRS with the authority to implement a mandatory program substantially similar to the one already in place before *Loving*. Since 2002, we have recommended the enactment of preparer standards as a taxpayer protection measure. The National Taxpayer Advocate is particularly concerned about the low income taxpayer population, which is especially vulnerable to incompetent or unscrupulous unenrolled preparers. For tax year (TY) 2012, over 76 percent of the preparers preparing Earned Income Tax Credit (EITC) returns, where the taxpayers are by definition low income, were unenrolled.¹¹

Unless and until legislation is passed authorizing the IRS to re-institute mandatory preparer standards, the IRS must act within the scope of its existing authority. In our 2013 Annual Report, we recommended that the IRS implement a voluntary examination and continuing education certificate program identical in most respects to the mandatory

6 *Loving v. IRS*, 742 F.3d 1013 (D.C. Cir. 2014) (Upholding the District Court's decision to enjoin the IRS's enforcement of the testing and CE requirements).

7 IRS, *New IRS Filing Season Program Unveiled for Tax Return Preparers: Voluntary Program to Focus on Continuing Education for Unenrolled Preparers*, IR-2014-75 (June 26, 2014); *Protecting Taxpayers from Incompetent and Unethical Return Preparers Hearing Before the S. Comm. On Finance 4* (April 8, 2014) (statement of John Koskinen, Commissioner, IRS).

8 Letter from John Koskinen, IRS Commissioner to Lonnie Gary, President, NAEA, dated June 6, 2014.

9 Rev. Proc. 2014-42, 2014-29 IRB 1 (released June 30, 2014).

10 IRS, *New IRS Filing Season Program Unveiled for Tax Return Preparers: Voluntary Program to Focus on Continuing Education for Unenrolled Preparers*, IR-2014-75 (June 26, 2014); *Protecting Taxpayers from Incompetent and Unethical Return Preparers Hearing Before the S. Comm. On Finance 4* (April 8, 2014) (statement of John Koskinen, Commissioner, IRS).

11 IRS, Compliance Data Warehouse, Individual Returns Transaction File; IRS, Individual Master File (net of transactions 764, 765, and 768); IRS, Return Preparers and Providers Database (through Nov. 2013). Note that the amounts paid out by the IRS may have been subsequently disallowed in post-refund audits.

program the IRS previously developed.¹² The IRS’s recently-announced voluntary program is a step in the right direction, but it is missing one of the most important components – competency testing. The IRS has committed to “assess the feasibility of administering a uniform voluntary examination in future years in order to ensure basic return preparer competency.” We applaud the IRS for taking these interim measures, but we are concerned that the voluntary program does not require unenrolled preparers to pass a competency test in order to be listed in the IRS database. As a consequence, some taxpayers may erroneously assume that preparers listed in the database have been determined by the IRS to meet basic competency standards. For this reason, the database should clearly explain the different credentials and authorities for each type of preparer listed in the database.

Minimum Competency Standards Are Necessary to Protect Taxpayers.

Preparers play a critical role in the tax system, which relies heavily on voluntary compliance. In tax year (TY) 2012, for example, taxpayers filed about 142 million 1040-series individual returns,¹³ with slightly over 79 million taxpayers using paid preparers.¹⁴ More than half (almost 43 million) of these returns were prepared by preparers unregulated by the IRS.¹⁵ Furthermore, a significant number of low income taxpayers use unenrolled preparers. As the below table shows, approximately 75 percent of the preparers who prepared TY 2010 through TY 2012 returns claiming the EITC were unenrolled.

FIGURE II.6, PREPARATION OF EITC CLAIMS BY UNENROLLED PREPARERS IN TY 2010-2012¹⁶

Tax Year	EITC Paid	Count	Total Preparers	Unenrolled Preparers	Percent Unenrolled
2010	\$58,573,186,452	27,627,852	16,464,493	12,430,967	75.5%
2011	\$61,109,934,146	27,816,576	16,549,166	12,198,085	73.7%
2012	\$62,981,818,983	27,081,228	15,132,562	11,523,814	76.2%

12 National Taxpayer Advocate 2013 Annual Report to Congress 61-74.

13 The TY 2012 returns were prepared in 2013. For tax year 2012, the IRS received 141.9 million individual income tax returns. IRS Compliance Data Warehouse, Individual Returns Transaction File, TY 2012 (filed through Dec. 2013).

14 IRS Compliance Data Warehouse, Individual Returns Transaction File and Return Preparers and Providers Database, TY 2012 (filed through Dec. 2013).

15 For a more detailed discussion of this data and its import,see Nina E. Olson, *More Than a ‘Mere’ Preparer: Loving and Return Preparation*, 2013 TNT 92-31, Tax Analysts Tax Notes Today (May 13, 2013). IRS Compliance Data Warehouse, Individual Returns Transaction File and Return Preparers and Providers Database, TY 2011 (filed through Mar. 2013). The category “unregulated preparer” reflects returns prepared by individuals with preparer tax identification numbers who did not list a profession when registering with the IRS. IRS Compliance Data Warehouse, Individual Returns Transaction File and Return Preparers and Providers Database, TY 2012 (filed through Dec. 2013). IRS records show about one million returns as paid preparer returns that did not have a Preparer Tax Identification Number (PTIN) match in the Return Preparers and Providers Database.

16 IRS, Compliance Data Warehouse, Individual Returns Transaction File; IRS, Individual Master File (net of transactions 764, 765, and 768); IRS, Return Preparers and Providers Database (through Nov. 2013). Note that the amounts paid out by the IRS may have been subsequently disallowed in post-refund audits.

Despite the data showing high usage of unenrolled preparers among the low income taxpayer population, there are currently no standards for hanging out a shingle and preparing returns. There is considerable evidence that a significant number of preparers either simply lack the knowledge and ability to prepare accurate returns or seek to exploit taxpayers. The Government Accountability Office (GAO), the Treasury Inspector General for Tax Administration (TIGTA), and others have conducted undercover “shopping visits,” in which auditors posed as taxpayers and visited preparers for help in preparing returns. The results of such shopping visits have consistently substantiated the National Taxpayer Advocate’s longstanding concerns, finding that a significant percentage of visited preparers prepared inaccurate returns (requiring taxpayers to pay thousands of dollars more than they owe or causing taxpayers to substantially understate tax), failed to perform sufficient due diligence, and even took positions that they knew were not supportable.¹⁷

There is Broad Support for a Preparer Oversight Program with Minimum Competency Standards.

To protect taxpayers from preparer incompetence and misconduct, the National Taxpayer Advocate has recommended since 2002 that Congress create minimum standards for the return preparation industry. Our proposed oversight program includes the following four key components for the IRS:

1. Require return preparers to register with the IRS to promote accountability;
2. Require unenrolled preparers to pass a one-time “entrance” examination to ensure basic competency in return preparation;
3. Require unenrolled preparers to satisfy annual continuing education requirements to ensure they keep up to date with the many frequent tax law changes; and
4. In conjunction with the oversight of preparers, conduct a comprehensive education campaign to enable taxpayers to protect themselves. This would include the creation of a publicly accessible and searchable database of registered preparers that taxpayers can use to determine whether a preparer has met the standards of the profession.¹⁸

17 Government Accountability Office, GAO-06-563T, *Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors* 5, 23 (Apr. 4, 2006) (Finding preparers made significant mistakes on 17 of the 19 returns prepared for GAO employees posing as taxpayers. In 17 instances, the preparers computed the wrong refund amounts, with variations of several thousand dollars. In ten of the 19 cases, preparers failed to report cash side income. In five cases, the prepared returns reflected unwarranted excess refunds of nearly \$2,000, and in two cases, the prepared returns would have caused the taxpayer to overpay by more than \$1,500); TIGTA, Ref. No. 2008-40-171, *Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors* 2 (Sept. 3, 2008) (Finding preparers made mistakes on 17 of the 28 returns prepared for TIGTA employees posing as taxpayers, including six willful or reckless errors. If the incorrect returns had been filed, the net effect would have been \$12,828 in understated taxes, or an average net understatement per return of \$755.). See also, Brief of National Consumer Law Center and National Community Tax Coalition, as *amici curiae*, supporting Defendants-Appellants, *Loving v. IRS*, No. 13-5061 (D.C. Cir. filed Apr. 5, 2013) (Doc. #1429234); National Consumer Law Center, *Riddled Returns: How Errors and Fraud by Paid Tax Preparers Put Consumers at Risk and What States Can Do* (Nov. 2013), available at <http://www.nclc.org/issues/riddled-returns.html> (last visited Apr. 2, 2014).

18 National Taxpayer Advocate 2013 Annual Report to Congress 61-74; 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).

Despite bipartisan support and Senate passage of such a proposal, Congress has taken no final action.¹⁹ Beginning in 2009, the IRS decided to implement standards on its own. In January 2010, the IRS published a study of federal tax return preparers that in most important respects reflected the proposals of the National Taxpayer Advocate.²⁰ The IRS subsequently issued regulations requiring all preparers to register with the IRS by obtaining a preparer tax identification number (PTIN),²¹ and requiring certain preparers to meet testing and continuing education standards. Unenrolled preparers would obtain the designation “registered tax return preparer” if they satisfied the program requirements.²²

In light of the *Loving* decision, we once again find ourselves in the position where anyone can hold himself out as a “preparer” with no tax law knowledge or experience required.

Implementation began with the 2011 filing season, when the IRS required paid return preparers to obtain PTINs.²³ The IRS launched the registered tax return preparer competency test in November 2011 with a deadline to take the test by December 31, 2013. The continuing education requirement began during the 2012 calendar year.²⁴

However, the IRS’s efforts to impose standards came to a sudden halt in January 2013 when, in *Loving v. Internal Revenue Service*, the U.S. District Court for the District of Columbia enjoined the IRS from further enforcing the testing and continuing education components. The court made clear that its decision did not invalidate the registration (PTIN) requirement.²⁵ The U.S. Court of Appeals for the District of Columbia Circuit upheld the district court’s decision.²⁶

After *Loving*: The IRS’s New Voluntary Program is a Temporary Measure But Does Not Include the Necessary Competency Testing Component.

The return preparer oversight program developed by the IRS before *Loving* was well planned after extensive consultation with stakeholder groups. In light of the *Loving* decision, we once again find ourselves in the position where anyone can hold himself out as a “preparer” with no tax law knowledge or experience required. Therefore, the National Taxpayer Advocate urges Congress to enact legislation granting the Treasury Department and the IRS the authority to establish minimum preparer standards by implementing exactly the program it had in place.

19 S. 1219, § 4, 110th Cong. (2007); H.R. 5716, § 4, 110th Cong. (2008); S. 3215, §202, 111th Cong. (2010). We are also pleased that the Senate Finance Committee has produced bipartisan support for the preparer due diligence provision in the proposed Preserving America’s Transit and Highways Act of 2014. The provision requires paid tax return preparers who prepare American Opportunity Tax Credit returns to meet due diligence requirements. Joint Committee on Taxation, *Description of the Chairman’s Modification to the “Preserving America’s Transit and Highways Act of 2014”* 7-11 (June 25, 2014).

20 IRS Publication 4832, *Return Preparer Review* (Dec. 2009).

21 Treas. Reg. § 1.6109-2(d).

22 31 C.F.R. §§ 10.4(c) (testing) and 10.6(e) (continuing education).

23 See IRS News Release, IR-2010-106, *IRS Begins Notifying Tax Return Preparers on PTIN Renewals* (Oct. 25, 2010).

24 IRS News Release, IR-2011-111, *IRS Moves to Next Phase of Return Preparer Initiative; New Competency Test to Begin* (Nov. 22, 2011).

25 920 F. Supp. 2d 108 (D.D.C. 2013), clarifying 917 F. Supp. 2d 67 (D.D.C. 2013).

26 *Loving v. IRS*, 742 F.3d 1013 (D.C. Cir. 2014).

Until Congress passes legislation, the IRS must act within the scope of existing authority. While the IRS has enhanced its ability to track preparers through registration and the issuance of PTINs, after *Loving* it retains no meaningful oversight of preparers. In our 2013 Annual Report to Congress, the National Taxpayer Advocate recommended that the IRS take four interim administrative steps to ensure that taxpayers receive competent and ethical preparation, regardless of what type of preparer they choose:²⁷

1. Offer unenrolled preparers the opportunity to distinguish themselves by earning a voluntary examination and continuing education certificate;
2. Restrict the ability of unenrolled preparers to represent taxpayers in audits of returns they prepare unless they earn the certificate;
3. Restrict the ability to name an unenrolled preparer as a Third Party Designee on Form 1040; and
4. Mount a consumer protection campaign that educates taxpayers about the need to select competent preparers who can demonstrate competency.

The IRS Announces a Voluntary Continuing Education Program Without an Examination Component.

In response to *Loving*, the IRS has developed a new voluntary program, called the Annual Filing Season Program.²⁸ Commissioner Koskinen has stated that the “voluntary program is not the ideal solution. But until legislation is enacted, we think we have the responsibility to taxpayers and to our tax system to keep moving forward with our efforts to improve service to taxpayers.”²⁹

The new program will provide unenrolled preparers the opportunity to earn a “Record of Completion” when they voluntarily complete 18 hours of IRS-approved instruction, including:

- A six-hour “refresher” course in basic tax filing issues and updates;
- Two hours of ethics; and
- Ten hours of other federal tax law topics.³⁰

27 National Taxpayer Advocate 2013 Annual Report to Congress 61-74.

28 Rev. Proc. 2014-42, 2014-29 IRB 1 (released June 30, 2014).

29 *New IRS Filing Season Program Unveiled for Tax Return Preparers: Voluntary Program to Focus on Continuing Education for Unenrolled Preparers*, IR-2014-75 (June 26, 2014); Kelly Phillips Erb, *IRS Announces New Tax Preparer Program to Mixed Reactions*, Forbes.com (June 27, 2014).

30 The required hours will be prorated during the first year of the program. To earn the Record of Completion for the 2015 filing season, a return preparer would need to take the six-hour refresher course, two hours of ethics and three hours of other federal tax law topics. IRS, *New IRS Filing Season Program Unveiled for Tax Return Preparers: Voluntary Program to Focus on Continuing Education for Unenrolled Preparers*, IR-2014-75 (June 26, 2014). The American Institute of Certified Accountants has questioned whether the IRS has statutory authority to develop this program. Letter to Hon. John A. Koskinen, Commissioner of Internal Revenue Service from William E. Balhoff and Barry C. Melancon, American Institute of CPAs, dated June 24, 2014. In response, IRS Commissioner Koskinen has stated, “the IRS has vetted the program and they believe that the program complies with the existing statutes.” Kelly Phillips Erb, *IRS Announces New Tax Preparer Program to Mixed Reactions*, Forbes.com (June 27, 2014).

Preparers who earn the Record of Completion will be included in a publicly accessible and searchable preparer database on IRS.gov, along with attorneys, certified public accountants, enrolled agents, enrolled retirement plan agents, and enrolled actuaries who are registered with the IRS.

The new program will not require preparers to pass an IRS-administered competency test to earn a voluntary Record of Completion. The terms of the new voluntary program do require uncredentialed preparers to pass a knowledge-based comprehension test at the end of the refresher continuing education (CE) course in order to obtain course credit. However, this CE-based comprehension test merely assesses whether the CE participant gained a basic understanding of the limited amount of material presented during the class. In addition, each CE provider will develop and administer its own test, so the subject matter tested, the level of difficulty of the test, and the CE provider's diligence in ensuring the test-taker completes the test on his own will vary from course to course. In no way will this CE-based comprehension substitute for a uniform, comprehensive competency examination designed to measure whether a preparer possesses basic knowledge of tax return preparation generally.

We fully recognize that the IRS is working within tight time constraints and had a limited capability to develop and implement a program to be in place for the 2015 filing season. Moreover, we are pleased that the IRS recognizes the importance of a competency examination. For the 2016 filing season and beyond, we believe it is imperative that taxpayers know which unenrolled preparers have demonstrated minimum competency by taking an IRS-administered examination. We applaud the IRS for its commitment to "assess the feasibility of administering a uniform voluntary examination in future years to ensure basic return preparer competency," and we will work with the IRS Return Preparer Office toward that end.³¹

The New Voluntary Program Appropriately Restricts Representation Rights.

As part of the Annual Filing Season Program, the IRS plans to also restrict the representation rights of unenrolled preparers who do not earn the voluntary Record of Completion. Currently, unenrolled preparers can engage in limited practice before the IRS, representing taxpayers before revenue agents, customer service representatives, or similar officers and employees of the IRS (including the Taxpayer Advocate Service) during an examination if they signed the tax return or claim for refund for the tax period under examination.³² These preparers cannot, however, represent taxpayers before Appeals or Collection.³³ Under the new program, unenrolled preparers who do not earn the voluntary Record of

31 IRS, *New IRS Filing Season Program Unveiled for Tax Return Preparers: Voluntary Program to Focus on Continuing Education for Unenrolled Preparers*, IR-2014-75 (June 26, 2014).

32 Section 10.7 of Circular 230 (31 C.F.R. § 10.7) was amended before *Loving* to remove the authorization for unenrolled, unlicensed individuals to represent before the agency on returns they signed. However, Notice 2011-6, 2011-3 I.R.B. 315 provided interim authority for these individuals to represent in this context during "the transition years" of the return preparer program.

33 31 C.F.R. § 10.3(f)(3).

Completion will not be able to represent taxpayers before the IRS during an examination of a return that they signed or prepared after the end of 2015.³⁴ The National Taxpayer Advocate made a similar recommendation in the 2013 annual report and believes that the IRS has taken a major step to protect taxpayers.³⁵ Representing a taxpayer before Examination requires a certain level of knowledge, competence and skill, the absence of which can have a significant economic impact on the taxpayer.

The Outreach and Education Component of the Return Preparer Program is Crucial for Taxpayer Protection.

Regardless of how the IRS addresses the testing component of the voluntary program, it is crucial that the IRS take a proactive role in a public awareness campaign to educate taxpayers on the various preparer designations available. The development and marketing of a publicly accessible and searchable preparer database, listing all preparers who have obtained valid PTINs with their basic information such as location, contact information, and credentials or qualifications, will provide taxpayers with important information. The database should also allow the user to scroll over and obtain a basic description of the preparer credential or qualification along with any associated limitations on representation, such as the inability to represent taxpayers in Collection or Appeals.

The IRS has announced it will develop a preparer database for the 2015 filing season. Unenrolled preparers who have not obtained the voluntary Record of Completion will not be included in the database.³⁶ We commend the IRS for committing to develop the preparer database by the next filing season, but as discussed above, we are concerned that the database will include preparers who earned the Record of Completion but have not demonstrated competency by passing an IRS-approved examination. By including these untested preparers in the public database on the IRS official website, the IRS risks misleading taxpayers, who could erroneously assume that all preparers in the database have been determined by the IRS to be qualified to prepare returns. For this reason, the database should clearly note the different credentials and authorities for each of the included preparer types (attorneys, certified public accountants, enrolled agents, enrolled retirement plan agents, enrolled actuaries, and unenrolled preparers). In that way, taxpayers will understand that unenrolled preparers have not passed an IRS-given competency examination but have completed 18 hours of continuing education.

Fiscal Year 2015 Actions

In FY 2015, TAS will take the following actions to protect taxpayers and promote the establishment of minimum competency standards in the return preparer industry:

34 Rev. Proc. 2014-42, 2014-29 IRB 1 (released June 30, 2014); IRS, *New IRS Filing Season Program Unveiled for Tax Return Preparers: Voluntary Program to Focus on Continuing Education for Unenrolled Preparers*, IR-2014-75 (June 26, 2014).

35 National Taxpayer Advocate 2013 Annual Report to Congress 61-74.

36 IRS, *New IRS Filing Season Program Unveiled for Tax Return Preparers: Voluntary Program to Focus on Continuing Education for Unenrolled Preparers*, IR-2014-75 (June 26, 2014).

- Continue to recommend that Congress authorize the IRS to establish minimum standards for tax return preparers;
- Work with the IRS Return Preparer Office (RPO) to assess the feasibility of the IRS developing and offering a true competency examination prior to the 2016 filing season;
- Work with RPO on the design and information included in the searchable database;
- Develop outreach and education materials for TAS's Local Taxpayer Advocates to include in their grassroots outreach work; and
- Work with the IRS Communications and Liaison Office (C&L) on the outreach campaign to the general public.