MSP #3

The IRS Lacks a Servicewide Return Preparer Strategy

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DEFINITION OF PROBLEM

Return preparers are key partners in the tax system because of their essential role in facilitating the preparation of tax returns, protecting taxpayer rights, and influencing tax compliance. The IRS relies on preparers to educate taxpayers about tax laws, facilitate efficient electronic tax filing, and reduce the stress and anxiety often associated with the filing season.[1] About 58 percent of individual taxpayers and most business taxpayers pay preparers to handle their returns.[2] In light of the critical role return preparers play in tax administration, it is essential that the IRS ensure preparers are competent, visible, and accountable.

While the IRS has made significant strides in the return preparer arena, its efforts to date have fallen short in several respects. The National Taxpayer Advocate has repeatedly urged the IRS and Treasury to develop and implement a program to test, register, and certify "unenrolled" preparers.[3] Despite numerous studies finding significant noncompliance among

1 *See* National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, 74-116 (Leslie Book, *The Need to Increase Preparer Responsibility, Visibility and Competence*); National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 44-74 (Leslie Book, *Study of the Role of Preparers in Relation to Taxpayer Compliance with Internal Revenue Laws*).

2 IRS Compliance Data Warehouse, Individual Returns Transaction File, Tax Year 2007 (Aug. 2009).

3 *See* National Taxpayer Advocate Fiscal Year (FY) 2010 Objectives Report to Congress xiii-xv (Area of Emphasis: *TAS Will Continue to Advocate for a More Robust Return Preparer Strategy*); National Taxpayer Advocate 2008 Annual Report to Congress 423-26 (Legislative Recommendation: *The Time Has Come to Regulate Federal Tax Preparers*); National Taxpayer Advocate 2006 Annual Report to Congress 197-221 (Most Serious Problem: *Oversight of Unenrolled Return Preparers*); National Taxpayer Advocate 2005 Annual Report to Congress 223-37 (Most Serious Problem: *Regulation of Electronic Return Originators*); National Taxpayer Advocate 2004 Annual Report to Congress 67-88 (Most Serious Problem: *Oversight of Unenrolled Return Preparers*); National Taxpayer Advocate 2003 Annual Report to Congress 270-301 (Legislative Recommendation: *Federal Tax Return Preparers: Oversight and Compliance*); National Taxpayer Advocate 2002 Annual Report to Congress 216-30 (Legislative Recommendation: *Regulation of Federal Tax Return Preparers*); *see also 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); *Preparing Your Taxes: How Costly Is It?: Hearing Before the S. Comm. On Finance*, 109th Congress (2006) (statement of Nina E. Olson, National Taxpayer Advocate). In her 2003 Annual Report to Congress, the National Taxpayer Advocate further encouraged Congress to enact a more stringent compliance and penalty regime to deter reckless disregard of the rules and/or negligence by paid preparers. National Taxpayer Advocate 2003 Annual Report to Congress 270-301. Based on continual discussions with internal and external stakeholders, the National Taxpayer Advocate's recommendation has evolved since originally proposed. The initial proposal was to require an entrance exam and annual refresher exams thereafter. After discussing the issue with various stakeholder groups, we believe that tax preparers, after passing an entrance exam, should be given the choice of passing periodic refresher exams or taking periodic continuing professional education courses.

return preparers, there is still virtually no federal oversight over unenrolled preparers, who constitute a substantial portion of all preparers.[4] In 2009, the IRS launched a wide-ranging review of return preparer issues with the ultimate goal of delivering recommendations to the Secretary of the Treasury and the President about how to better leverage the preparer community for the overall benefit of the tax system. It is imperative that any resulting strategy be balanced by including both service and enforcement components to ensure that preparers have all the tools they need for optimal compliance and are fully aware of the consequences of their actions.

The National Taxpayer Advocate supports this commendable effort, and our office has been included in the internal IRS working group charged with developing a return preparer strategy. This section of the Annual Report was written before the IRS finalized and submitted its recommendations and is therefore not intended as commentary on the new IRS proposals. Rather, this section describes the National Taxpayer Advocate's assessment of what a comprehensive and effective return preparer strategy should include.

ANALYSIS OF PROBLEM

Background

Use of Preparers by Individuals and Businesses

For tax year (TY) 2007, 58 percent of individual income tax filers used return preparers to meet their filing obligations, and the percentage jumped to 70 percent for those claiming the Earned Income Tax Credit (EITC).[5] Moreover, in TY 2007, 80 percent of small business filers hired return preparers.[6]

Return Preparers Play a Significant Role in the Tax System

IRS research illustrates the significant role return preparers play in tax administration. Research conducted by the Small Business/Self-Employed (SB/SE) Operating Division found taxpayers who switched from preparing their own returns to using a paid preparer in TY 2005 were more likely to:

- File electronically;
- File a more complex return than in the previous year;
- Switch to a new filing status;
- Claim the EITC; and

4 *See* National Taxpayer Advocate 2003 Annual Report to Congress 270-301 (estimating that of the 1.2 million known tax return preparers, approximately 300,000 to 600,000 are not regulated by any licensing entity or subject to minimum competency requirements).

5 IRS Compliance Data Warehouse, Individual Returns Transaction File, Tax Year 2007 (Aug. 2009).

6 IRS, Pacific Consulting Group, *SB/SE Customer Base Report, Covering Tax Year 2008* (Aug. 2009), *available at* http://wsep.ds.irsnet.gov/sites/co/dcse/sbse/sf/ppm/Cust%20Sat/Shared%20Documents/Customer%20Base/Customer%20Base%20REPORTS/Customer%20Base%202008.pdf.

- File a return that falls under the jurisdiction of a different business operating division.[7]

This research does not directly link preparers to taxpayer behavior. It is plausible that the taxpayers who switched did so because of an underlying change in their circumstances. Nonetheless, while this research does not prove that preparers caused taxpayers to change their filing behavior, it suggests that taxpayer filing patterns may be heavily influenced by the use of a preparer.

In FY 2007, the Taxpayer Advocate Service commissioned Professor Leslie Book to conduct a two-part study on the role of return preparers in taxpayer compliance. The first report, published in Volume 2 of the 2007 Annual Report, addressed the role of practitioners in taxpayer decisions to comply with the tax laws, with a focus on sole proprietors and taxpayers claiming EITC. The report noted the significant usage of preparers and the high error rate among those returns.[8] The second part of the study, which was published in Volume 2 of the 2008 Annual Report, proposes legislative and administrative steps that the IRS can take to increase preparer compliance with unambiguous tax law issues. The common themes of the proposals are increasing preparer competence, visibility, and accountability.[9]

In addition, the following organizations have conducted research through "shopping visits" to preparers and have uncovered significant noncompliance:

- **Government Accountability Office (GAO).**[10] In 2006, GAO auditors posing as taxpayers made 19 visits to several national tax preparation chains in a large metropolitan area. Using two carefully designed fact patterns, they sought assistance in preparing tax returns. Among the results:
  - The tax preparation chains made errors on all 19 returns.
  - In 17 instances, the preparers computed the wrong refund amounts, with variations of several thousand dollars. In five cases, the prepared returns reflected unwarranted excess refunds of nearly $2,000, and in two cases, the prepared returns would have caused the taxpayer to overpay by more than $1,500.
  - Preparers failed to ask where the auditor's child lived or ignored the auditor's answer to the question in five of ten applicable cases, and consequently prepared returns claiming ineligible children for purposes of the EITC.
  - In ten out of 19 cases, preparers failed to report cash side income. Several preparers even advised the GAO "taxpayers" that reporting certain income was unnecessary because the IRS would have no way of knowing about it.

7 SB/SE Research, Project STP0095, *Differences in Return Characteristics When Taxpayers Switch from Self-Preparing to Using a Paid Preparer* (Nov. 2008).

8 National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 44-74 (Leslie Book, *Study of the Role of Preparers in Relation to Taxpayer Compliance with Internal Revenue Laws*).

9 *Id.* at 74-116.

10 Government Accountability Office, GAO-06-563T, *Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors* 2 (Apr. 4, 2006) (statement of Michael Brostek, Director - Strategic Issues, Before the Committee on Finance, U.S. Senate).

- In ten cases, shoppers were entitled to a credit for child care expenses, yet no preparer claimed the credit.
- In two out of nine cases, preparers claimed the standard deduction where itemizing deductions would have been more advantageous.
- In four out of 19 cases, the preparer did not sign the return.

- **Treasury Inspector General for Tax Administration (TIGTA).**[11] 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 of the preparers visited by TIGTA were unlicensed and unenrolled. Among the results:
  - Of the 28 returns prepared, 61 percent were prepared incorrectly.
  - If the incorrect tax returns had been filed, the net effect would have been $12,828 in understated taxes, or an average net understatement per return of $755.
  - None of the seven preparers working with fact patterns involving EITC claims exercised appropriate due diligence.
  - Sixty-five percent of the inaccurate returns contained mistakes or omissions deemed to be caused by human error and/or misinterpretation of the tax laws.
  - Thirty-five percent of the inaccurate returns contained misstatements or omissions that TIGTA deemed willful or reckless.
  - All of the business returns were prepared inaccurately.
  - In five out of 28 cases, the preparer did not sign the return.

- **New York State Department of Taxation and Finance.**[12] Over a recent 20-month period, agents conducted nearly 200 targeted covert visits in which they posed as taxpayers and sought assistance in preparing income or sales tax returns. In testimony at an IRS Public Forum, the Acting Commissioner of the New York Department of Taxation and Finance testified that investigators found "an epidemic of unethical and criminal behavior." At one point, the Department reported that it had found fraud on about 40 percent of its visits.[13] To date, the Department has made more than 20 arrests and has secured 13 convictions. The Acting Commissioner testified that the investigation is continuing and more arrests are expected.
- **Impact Alabama.** In January 2009, an Alabama nonprofit agency sent 13 volunteers to Alabama tax preparation services, including both small seasonal firms and large national operations. All of the 13 returns prepared contained errors. Most of the mis-

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

12 Statement of Jamie Woodward, Acting Commissioner, New York Dept. of Taxation and Finance, before IRS Tax Return Preparer Review Public Forum (Sept. 2, 2009), *available at* http://ftp.irs.gov/pub/irs-utl/ny_department_of_tax_statement.pdf (lasted visited Oct. 18, 2009).

13 *See* Tom Herman, *New York Sting Nabs Tax Preparers*, Wall Street Journal (Nov. 26, 2008).

takes involved the right to claim EITC by divorced parents sharing custody of children, a very complex and fact-specific legal inquiry.[14]

- **Community Legal Services of Philadelphia and Community Reinvestment Association of North Carolina.** These two groups conducted visits to study preparers marketing refund anticipation loans (RALs). However, the summary of the report findings noted "[o]ne of the most disturbing test results involved the quality of tax preparation. Several of the preparers made serious errors that significantly affected tax liability."[15]
- **New York City Department of Consumer Affairs.** In January 2009, New York City Department of Consumer Affairs (DCA) inspectors examined more than 430 tax preparation businesses and issued more than 1,200 notices of violations to 150 businesses. Top violations included deceptively advertising RALs. Fines imposed could reach as high as $600,000. This year, DCA increased its inspections of income tax preparers by 43 percent, targeting businesses charged with violations in 2008 as well as neighborhoods with high concentrations of EITC claims. Together, the compliance visits and penalties increased compliance rates from 56 percent to 65 percent. [16]

Despite evidence indicating a correlation between return preparers and taxpayer noncompliance, the IRS has yet to conduct strategic research to determine the various types of preparer noncompliance or the reasons and appropriate treatment for each type of noncompliance.[17]

IRS Focus on Return Preparers: Development of Servicewide Strategy

The IRS has increasingly acknowledged the critical role preparers play in the tax system. The IRS Strategic Plan for 2009-2013 states as an objective: "Ensure that all tax practitioners, tax preparers and other third parties in the tax system adhere to professional standards and follow the law."[18] During FY 2008 and 2009, the IRS also committed to increase return preparer compliance by developing a comprehensive Servicewide Return Preparer Strategy. This initiative, which TAS participated in, was disbanded in 2009 in anticipation of a new high-level review of the IRS's return preparer initiatives.

14 Russell Hubbard, *Tax Preparers Cheating Customers, Government, Alabama Nonprofit Finds*, Birmingham News (Jan. 23, 2009).

15 National Community Law Center, *Tax Preparers Take a Bite out of Refunds: Mystery Shopper Test Exposes Refund Anticipation Loan Abuses in Durham and Philadelphia* (Apr. 2008).

16 New York City Department of Consumer Affairs, Press Release, *NYC Department of Consumer Affairs Announces Citywide Enforcement Sweep of Income Tax Preparers* (Feb. 5, 2009).

17 *See* Karen Masken, Mark Mazur, Joanne Meikle & Roy Nord, IRS Office of Research, Analysis, and Statistics, *Do Products Offering Expedited Refunds Increase Income Tax Non-Compliance?* 15 ("While our analysis indicates that noncompliance is higher among taxpayers using RALs, we cannot conclude that the availability or utilization of RALs causes noncompliance.")

18 IRS, *Strategic Plan 2009-2013, Goal 2, Objective 6*. The strategies to achieve the stated goal include:
- Develop and implement a coordinated preparer plan across the IRS and the preparer community;
- Administer a fair, diligent, and effective system of sanctions and penalties for those who fail to follow the law; and
- Leverage research to identify fraudulent return preparers and other areas of abuse and noncompliance by return preparers.

In June 2009, the IRS announced a comprehensive review of its approach toward return preparers, including the tax return preparation and tax software industry, with a goal of developing recommendations to "better leverage the tax return preparer community in increasing taxpayer compliance and ensuring high ethical standards of conduct for paid tax preparers."[19] TAS actively participated on the review team.

Continuing Need for Servicewide Return Preparer Strategy

The National Taxpayer Advocate commends the IRS for its considerable strides in focusing on return preparer issues. TAS looks forward to continued participation on the team to finalize and implement any resulting recommendations. However, in the interim, we would like to set forth what we believe should be the crucial components of any servicewide return preparer strategy:

- *Ensure Competence.* The strategy should ensure that preparers are competent. To accomplish this goal, the IRS should require unenrolled tax preparers to pass an examination and thereafter to complete periodic continuing professional education (CPE) requirements in connection with a national system to register, test, and certify unenrolled preparers. Equally important, the IRS should provide services, education, and outreach to equip preparers with the tools they need to prepare accurate returns.
- *Increase Visibility.* To adequately oversee preparers, the IRS must improve its ability to track them. This involves requiring all individual preparers to obtain unique identifying numbers as well as conducting a public awareness campaign to inform the taxpaying public about any new preparer requirements.
- *Increase Preparer Accountability.* Preparers should know that their actions have consequences. The IRS should focus additional resources on preparer compliance initiatives. To do so effectively, the IRS should more thoroughly study the causes of preparer noncompliance and the best ways to change this behavior. For example, mystery shopping visits would help the IRS to better grasp the scope and nature of preparer noncompliance as well as deter preparer noncompliance. Cognitive learning initiatives could provide useful information on which to base future preparer education and compliance initiatives. Once the IRS has a better understanding of preparer behaviors and their influence on taxpayer compliance, it can develop a more effective enforcement strategy. The National Taxpayer Advocate believes such a strategy should include increased penalties, soft notices, progressive enforcement techniques, and a streamlined complaint reporting process.

Ensuring Preparer Competence

The IRS can increase preparer competence by supporting minimum entrance requirements for the profession and providing targeted education, outreach, and services to enable

[19] Tax Notes Today, *IRS to Make Recommendations on Regulating Tax Return Preparers by Year's End* (June 5, 2009).

preparers to understand their responsibilities and properly educate and assist taxpayers. Research supports the need to reach preparers early to prevent attitudes of habitual noncompliance from developing. Thus, by dedicating resources to preparer competence early on, the IRS is likely to save significant compliance resources downstream.[20] The IRS provides a wealth of services to preparers, both before and following each tax filing season. However, the services are not part of a consistent, research-driven, servicewide plan, and the IRS does not measure the impact these services have on taxpayer and preparer compliance.[21]

National System to Register, Test, and Certify Preparers

Since 2002, the National Taxpayer Advocate has proposed a plan for the IRS to register, test, and certify unenrolled preparers.[22] Given the role that preparers play in guiding taxpayers through our complex tax laws, it is incumbent on the IRS to register and identify unenrolled preparers and administer a basic examination to ensure at least a minimal level of competency. Requiring preparers to register in a formal program and meet strict requirements could set the stage for preparers to take their preparation and filing responsibilities more seriously.[23] Although the GAO, TIGTA, and other studies cited above are not statistically representative of the full population of prepared returns, they suggest that a sizeable segment of the preparer population prepares inaccurate returns, fails to perform adequate due diligence, and even takes positions that the preparers know are not correct (*e.g.,* encouraging taxpayers to omit items of gross income from their returns or, in some cases, claiming ineligible children for purposes of the EITC). This conduct usually results in understatements of tax (reducing federal tax revenue and potentially subjecting taxpayers to enforcement actions) and sometimes results in overstatements of tax (causing taxpayers to pay more than they owe). Higher competency and ethics standards are therefore necessary both to provide better consumer protection and to improve compliance.

The National Taxpayer Advocate believes examinations should be administered in two tiers: (1) the first tier would address issues that arise on basic 1040 returns and include Schedules C-EZ and (2) the second tier would cover more complex 1040 returns as well as business returns.[24] It is important that the second-level test include business returns beyond the Form 1040 series, as IRS has found significant compliance problems on

20 National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, 77 (Leslie Book, *The Need to Increase Preparer Responsibility, Visibility, and Competence*).

21 *See* IRS, *Return Preparer Strategy: Understanding and Partnering with the Return Preparer Community to Improve Voluntary Tax Compliance* 7-10 (Mar. 31, 2008).

22 *See* note 3, *supra*.

23 National Taxpayer Advocate 2008 Annual Report to Congress, vol. 2, 92 (Leslie Book, *The Need to Increase Preparer Responsibility, Visibility and Competence*).

24 While not statistically representative, the shopping visits recently conducted by TIGTA support the importance of instituting an exam for business returns immediately. All of the business returns were prepared inaccurately in the TIGTA audit, which indicates that business return preparation is a significant and immediate problem. TIGTA, Ref. No. 2008-40-171, *Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors* (Sept. 3, 2008).

S corporation and other business returns as well.[25] Moreover, an ongoing CPE requirement, including an ethics component, would keep preparers current on tax law changes and reinforce difficult concepts that are subject to high rates of error. As discussed below, a public information campaign to educate taxpayers about how to find an appropriate preparer should be an integral part of any system of regulation.

The National Taxpayer Advocate believes that to be effective, registration and testing requirements should apply to any preparer who interacts with a taxpayer and prepares the taxpayer's return. For some purposes, current Treasury regulations distinguish between a preparer who signs a tax return (a "signing tax return preparer") and a preparer who prepares all or a substantial portion of a return but does not sign it (a "nonsigning tax return preparer").[26] In some tax return preparation businesses, multiple preparers meet with taxpayers and prepare their returns, yet a single individual signs all returns. Thus, if the IRS were to regulate solely "signing tax return preparers," many individuals engaged in return preparation would not be subject to the registration, testing, and CPE requirements and the effectiveness of the regulation regime could be substantially undercut. Moreover, an incentive would arise for return preparation businesses to rely more heavily on nonsigning preparers to avoid the costs and burden associated with the registration, testing, and CPE requirements.[27]

It is important to note that the National Taxpayer Advocate believes the IRS should require every preparer to register and obtain a single identification number. However, practitioners covered by Circular 230, which governs "practice" before the IRS,[28] should be exempt from the examination and CPE requirements. These practitioners already face education, examination, and in most cases CPE requirements, while ethical rules prevent them from accepting assignments for which they are not competent.[29]

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25 Based on IRS research, approximately 68 percent of S corporation returns filed for tax year 2004 misreported net corporation income. This amounts to underreported income of approximately $56 billion. Furthermore, approximately 93 percent of S corporation returns were prepared by paid preparers. IRS Research, Analysis, and Statistics, 2009 IRS Research Conference, *Preliminary Results of the 2003/2004 National Research Program S Corporation Underreporting Study*, Slide 9 (July 2009); SB/SE Research, *FY 06 Nationwide Analysis: Electronic Tax Administration Business Master File Marketing Database*, Project BKN0045, Slide 39 (May 2006).

26 *See* Treas. Reg. 301.7701-15(b).

27 The National Taxpayer Advocate believes that such registration requirements should apply to all preparers who have direct substantive interaction with taxpayers (*e.g.*, face-to-face or telephonic meetings) and should not be limited only to the individual who signs the return. More specifically, the registration requirements should apply to individuals who perform the interviewing and return preparation functions but not to individuals who perform solely clerical or ministerial work.

28 31 C.F.R. part 10. Circular 230 governs the conduct of return preparers who practice before the IRS. Typically, in order to practice before the IRS, a practitioner needs to be an attorney, certified public accountant, enrolled agent, or enrolled actuary. However, the regulation also allows for limited practice before the IRS for return preparers who do not fit into one of the aforementioned categories. Circular 230, 31 C.F.R. Part 10, §§ 10.3, 10.7. Section 10.2(a)(4) of Circular 230 defines practice before the IRS as:

> [C]omprehending all matter connected with a presentation to the Internal Revenue Service or any of its officers or employees relating to a client's rights, privileges or liabilities under laws or regulations administered by the Internal Revenue Service. Such presentations include preparing and filing necessary documents, corresponding and communicating with the IRS, and representing a client at conferences, hearings and meetings.

29 In addition, 5 U.S.C §§ 500(b) & (c) grant attorneys and CPAs the authority to represent clients before federal agencies (upon submitting a written declaration stating qualifications). Thus, absent a statutory change, the IRS cannot require these practitioners to pass a test or complete continuing education before they are able to prepare returns.

The National Taxpayer Advocate's proposal has received widespread support from stakeholders and members of Congress.[30] The Senate Finance Committee has twice approved legislation to regulate federal income tax preparers,[31] with the full Senate also approving the legislation once.[32] In 2005, the House Ways and Means Subcommittee on Oversight held a hearing at which representatives of five outside organizations testified in support of regulating return preparers.[33] More recently, proposals to regulate return preparers were included in two separate bills during the 110th Congress – S.1219, the Taxpayer Protection and Assistance Act of 2007, and H.R. 5716, the Taxpayer Bill of Rights Act of 2008.[34] Both included provisions to equip preparers with the knowledge and skills to prepare accurate returns.

In addition, several states have experience in regulating return preparers. Oregon and California have established requirements that preparers must meet before preparing tax returns in those states. Maryland recently enacted legislation to regulate paid preparers, effective June 2010.[35] New York State recently enacted legislation requiring the registration of return preparers.[36]

California's return preparer program requires qualifying education and the completion of continuing education. Oregon has a two-tiered licensing program with the first tier requiring qualifying education, an examination, and continuing education, and the second tier requiring work experience and a second examination. The GAO evaluated both programs and determined the one in Oregon seemed to increase the accuracy of returns prepared in that state as compared to the rest of the country, whereas returns filed in California were *less* likely to be accurate than elsewhere in the country. While GAO was unable to draw firm conclusions due to the role of other factors, its findings lend support for requiring preparers to pass an initial examination in addition to taking continuing education.[37]

30 GAO, GAO-08-781, *Oregon's Regulatory Regime May Lead to Improved Federal Tax Return Accuracy and Provides a Possible Model for National Regulation* (Aug. 15, 2008).

31 H.R. 1528 (incorporating S. 882) (108th Cong.); S. 1321 (incorporating S. 832) (109th Cong.).

32 H.R. 1528 (incorporating S. 882) (108th Cong.).

33 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. (July 30, 2005).

34 S. 1219, § 4, 110th Cong. (2007); H.R. 5716, § 4, 110th Cong. (2008).

35 The Maryland Individual Tax Preparers Act establishes an eight-person Board of Income Tax Preparers and, effective June 2010, requires all preparers not specifically exempted to register, pay a fee, and take an examination modeled after the Special Enrollment Examination prepared by the IRS. The preparer must renew the registration every two years, at which time the preparer must pay a renewal fee and provide evidence of completion of continuing education requirements. Maryland Individual Tax Preparers Act, Senate Bill 817, Md. Code Business Regulation and Occupations, chap. 623 (May 22, 2008).

36 N.Y. Tax Law § 32. *See* N.Y. Dept. of Taxation and Finance, Office of Tax Policy Analysis, Taxpayer Guidance Division, Tax Preparer Registration Program, TSB-M-09(11)C, (9)I, (10)M, (3)MCTMT, (4)R, (15)S (Oct. 1, 2009), *available at* http://www.tax.state.ny.us/pdf/memos/multitax/m09_11c_9i_10m_3mctmt_4r_15s.pdf (last visited Oct. 18, 2009), Tax Preparer Registration Program; Statement of Jamie Woodward, Acting Commissioner, New York State Dept. of Taxation and Finance, IRS Tax Return Preparer Review Public Forum (Sept. 2, 2009), *available at* http://ftp.irs.gov/pub/irs-utl/ny_department_of_tax_statement.pdf (last visited Oct. 18, 2009).

37 GAO, GAO-08-781, *Oregon's Regulatory Regime May Lead to Improved Federal Tax Return Accuracy and Provides a Possible Model for National Regulation* (Aug. 15, 2008). *See* transcripts and submitted statements from the IRS Tax Return Preparer Review Public Forum (Sept. 2, 2009), *available at* http://ftp.irs.gov/taxpros/article/0,,id=212450,00.html.

A small number of stakeholders have expressed concern that competency exams could have the effect of excluding some preparers who would otherwise be preparing tax returns. We acknowledge that some level of exclusion is an inherent consequence of any examination requirement. High school students generally must pass certain examinations to graduate, motorists generally must pass an exam to obtain a license, and doctors, lawyers, and actuaries (among many others) must pass examinations to practice their professions. All of these tests are exclusionary, but are required because policymakers have decided that ensuring competence is a priority. In our view, the appropriate focus here should be on the level of difficulty of the test. The National Taxpayer Advocate believes the bar should be set high enough to ensure basic competency but not so high as to require unreasonable levels of knowledge and put large numbers of competent preparers out of business.

Governance of the Program

If the IRS decides to implement a system to regulate preparers, the next logical step is to determine the governance and infrastructure of the program. In light of the impact preparer practices have on every function in the IRS, it is important that an executive steering committee and a program office, both under the Deputy Commissioner (Services and Enforcement), assume responsibility for development of policies and procedures as well as continual monitoring duties regarding administration and technical interpretation of the tax provisions under Title 26. Thus, the cross-functional steering committee and program office would have oversight responsibility for Title 26 initiatives and programs, including but not limited to: (1) preparer penalties; (2) preparer audits; (3) a responsive regulation approach to enforcement; (4) shopping visits; (5) due diligence initiatives; and (6) outreach, education, and public awareness campaigns. TAS and the Office of Professional Responsibility (OPR) should have representation on the cross-functional steering committee along with affected business functions under the jurisdiction of the Deputy Commissioner (Operations Support). Ethical standards and standards of practice should continue to be handled by OPR. Thus, OPR would have oversight responsibility for registration, testing, CPE, and Circular 230 sanctions as it already does for enrolled agents (EAs).

Shortly after the IRS announced its return preparer review, it issued a Request for Proposal (RFP) for assistance in studying and standing up a self-regulating organization (SRO) to implement, maintain, and enforce a new regulatory regime. Examples of existing SROs include the Public Company Accounting Oversight Board (PCAOB) and the Financial Industry Regulatory Authority (FINRA).[38] The IRS quickly announced that the RFP had been issued in error and withdrew it. In the event the approach receives further consideration, however, we note several concerns about this potential type of oversight model. First, the IRS would face disclosure challenges if it uses an SRO model that do not exist in other industries, because enforcement actions would necessarily require access to confidential tax return information that the IRS generally may not disclose to outside parties. The IRS is

38 *See* Jeremiah Coder, *News Analysis: Will Self-Regulation of Preparers Take Root?* Tax Notes (July 6, 2009).

appropriately subject to restrictive disclosure rules in Internal Revenue Code (IRC) § 6103 to protect confidential taxpayer information, and we have significant concerns about loosening those restrictions. Second, the SRO model may not lend itself to this profession, given the broad spectrum of individuals who prepare returns. On one end are those who are completely untrained in tax law but provide tax preparation to lure customers in the door to buy their main products and services. At the other end are highly trained and dedicated preparers. An SRO may have difficulty overseeing such a wide variety of preparers with different motivations. Finally, the IRS does not use an SRO model to oversee enrolled agents, and there appears to be no persuasive reason to treat the two types of preparers differently.

To date, one obstacle to implementing a registration program has been concerns about cost. The IRS should consider charging user fees to defray the costs of administering the program, as the states that regulate preparers already do and the IRS currently does with the Enrolled Agent program. Moreover, without going as far as the SRO model, the IRS could contract with a third-party vendor to assist in administering the registration or testing process (while retaining enforcement responsibility within the IRS). Third parties experienced in running similar but smaller scale programs have proven that the program could be self-funded through registration fees.[39]

Enhancing Preparer Visibility

The first step for the IRS toward preparer oversight and a meaningful partnership with preparers is the ability to track preparers. The IRS Office of Professional Responsibility currently tracks only enrolled agents, enrolled retirement plan agents, and enrolled actuaries. The existing oversight model renders the IRS unable to accurately quantify the total number of preparers. The IRS estimates that between 800,000 and 1.2 million preparers submitted returns in TY 2006.[40] As the IRS has trouble merely estimating the total number of preparers, it cannot provide effective services to this population or identify problematic preparers and apply compliance treatments.[41]

Preparer Tax Identification Number Regulation Project

When a preparer prepares and signs a tax return, he or she must provide an identifying number.[42] Currently, preparers provide a Social Security number (SSN), Preparer Tax Identification Number (PTIN), or Employer Identification Number (EIN), if anything at all, on returns submitted to the IRS. The lack of consistency makes it difficult for the IRS to identify, quantify, and track preparers.

39 *See* transcript and statements from Sept. 2, 2009 IRS Tax Return Preparer Review Public Forum, *available at* http://ftp.irs.gov/taxpros/article/0,,id=212450,00.html (last visited Oct. 18, 2009). Both the California and Oregon programs were described as self-funded through registration fees.

40 IRS, *Return Preparer Strategy: Understanding and Partnering with the Return Preparer Community to Improve Voluntary Compliance* 3 (Mar. 31, 2008).

41 TIGTA, Ref. No. 2009-40-098, *Inadequate Data on Paid Preparers Impedes Effective Oversight* (July 14, 2009).

42 IRC § 6109.

The National Taxpayer Advocate asked the IRS and the Treasury Department to include a project on the 2008-2009 Priority Guidance Plan to revise the regulations under IRC § 6109, and it is our understanding that the project at this writing is still in progress.[43] We believe the regulation should be revised to eliminate the option under the existing regulation to use the individual preparer's SSN as an identifying number. In all cases, preparers should be required to provide a PTIN and, if applicable, an EIN as well.

The IRS would benefit greatly from an improved ability to track preparers through the use of a single identifying number. If implemented properly, a PTIN requirement would also enable the IRS to track preparers by type (attorney, CPA, enrolled agent, or unenrolled preparer). With comprehensive data about the preparer population, the IRS could better identify trends and problem preparers. In addition, the IRS could target outreach and education more effectively if it could sufficiently identify high error rates among certain categories of preparers with respect to certain issues.

To maximize the usefulness of PTINs, the IRS should systematically validate the identifying numbers on the returns (*i.e.*, where a preparer enters a number, the IRS should cross-check the preparer's TIN to determine its validity). Absent a validation process, a PTIN requirement would be difficult to enforce and would add limited value.

We note that eliminating the use of a preparer's SSN on tax returns would also benefit return preparers by reducing their susceptibility to identity theft.

Need for Continued Public Awareness Campaign

The National Taxpayer Advocate believes that, in conjunction with a system to register return preparers, the IRS should conduct a public awareness campaign over several years. Initially, the campaign should inform taxpayers of the significance of the return preparer's signature, PTIN, or registration requirements, as applicable. By delivering a strong public information campaign, the IRS would engage taxpayers in the enforcement of the preparer requirements.[44] As taxpayers become more accustomed to these messages and more knowledgeable about the IRS "brand," the IRS should consider changing its message and modifying penalty assessment procedures so taxpayers do not qualify for the reasonable cause exception for assessed penalties by reason of using a preparer who fails to meet signature, PTIN, or registration requirements, as applicable.[45]

43 The project to revise the regulations under IRC § 6109 has also been included on the 2009-2010 Priority Guidance Plan. *See* http://www.irs.gov/pub/irs-utl/2009_-_2010_priority_guidance_plan.pdf.

44 IRC § 6695(b).

45 The IRS waives the penalties under IRC §§ 6651 (Failure to File and Failure to Pay penalties) and 6662 (Imposition of Accuracy Related Penalty on Underpayments) if the taxpayer can establish reasonable cause.

Need to Increase Preparer Accountability

The third vital component of an effective return preparer program is holding preparers accountable for their actions. The IRS has many preparer enforcement initiatives,[46] the cornerstone of which is the assessment and collection of preparer penalties. However, it is clear that the IRS has a long way to go in developing a research-driven, servicewide, and effective return preparer strategy for enforcement.

Including Ethical Duties of Return Preparation in Circular 230

Attorneys, CPAs, enrolled agents, enrolled retirement plan agents, enrolled actuaries, and appraisers are subject to the requirements of Circular 230, which governs "practice" before the IRS. The regulations provide duties and restrictions to which practitioners must adhere in order to practice before the IRS. Preparation of a tax return is not currently considered practice before the IRS. In light of the impact of tax return preparation on the tax system, however, we believe it is in the best interests of taxpayers and tax administration to add a section that provides ethical duties, restrictions, best practices, and sanctions specific to preparers.

Researching Types and Causes of Preparer Noncompliance

Before the IRS can effectively discourage preparer noncompliance, it needs to understand what factors drive their noncompliance. For this purpose, research suggests that preparers can be grouped into three categories:

1. Type 1: The honest and risk-averse preparer;
2. Type 2: The cautious preparer who aims to minimize tax; and
3. Type 3: The preparer who is a creative and aggressive tax planner (which presumably includes preparers who cross the line).[47]

Each type of preparer has different motives and reasons for noncompliance. As such, the IRS should apply different treatments to each distinct type of preparer. It would also be useful to see how each type of preparer behaves when paired up with taxpayers who fit into each of the three above-discussed categories. This type of research lends itself well to a cognitive learning lab.[48]

46 For a discussion of the various enforcement initiatives, see IRS, *Return Preparer Strategy: Understanding and Partnering with the Return Preparer Community to Improve Voluntary Tax Compliance* 19-20 (Mar. 31, 2008).

47 National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 59 (Leslie Book, *Study of the Role of Preparers in Relation to Taxpayer Compliance with Internal Revenue Laws*); Yuka Sakurai & Valerie Braithwaite, *Taxpayer's Perceptions of the Ideal Tax Adviser: Playing Safe or Saving Dollars?*, Centre for Tax System Integrity, Working Paper No. 5 (May 2001), *available at* http://ctsi.anu.edu.au/publications/WP/5.pdf.

48 For a discussion of the various factors affecting the moral reasoning of tax practitioners, see Elaine Doyle, Jane Frecknall Hughes & Barbara Summers, *Cognitive Reasoning of Tax Practitioners: A Preliminary Investigation Using a Tax Specific Version of the Defining Issues Test* (*DIT*, (paper submitted for the 2009 IRS Research Conference, associated slides presented at the 2009 IRS Research Conference *available at* http://www.irs.gov/pub/irs-soi/09rescontaxprep.pdf (last visited Sept. 4, 2009)) and Most Serious Problem: *The IRS Needs an In-House Cognitive Research Lab to Understand Taxpayer Behavior and Test Products and Programs, infra*.

Assessment and Collection of Preparer Penalties

The following table summarizes enforcement of IRC §§ 6694 and 6695 preparer penalties between FY 2007 and FY 2009:

TABLE 1.3.1, Assessment and Collection of IRC §§ 6694 and 6695 Preparer Penalties[49]

Fiscal Year	Net Assessment	Net Collectible March 2009	% Collectible of Net Assessment	Penalties Collected	% of Net Collectible Actually Collected
2007	$2,527,625.00	$1,687,713	66.77%	$771,363	45.70%
2008	$3,235,317.00	$2,645,434	81.77%	$634,686	23.99%
2009	$2,409,085.00	$2,389,568	99.19%	$531,340	22.24%

Based on the information contained in the table, it appears that the collection of penalties remains low and leaves room for improvement. By failing to sufficiently assess and collect preparer penalties, the IRS is underutilizing one of the most effective tools available to discourage noncompliance. Assessments without collection, absent currently not collectible (CNC) determinations or other special circumstances, are assessments without teeth, and they send the wrong message. Moreover, potentially unscrupulous preparers undoubtedly notice the IRS's failure to assess and collect penalties and base their behavior on their assessment of the risk.[50]

Many preparers are also governed by Publication 1345, *Handbook for Authorized IRS e-file Providers of Individual Income Tax Returns*, the requirements of which are developed by the IRS's Office of Electronic Tax Administration and Refundable Credits and enforced through the e-file monitoring program in SB/SE. The program typically conducts annual enforcement visits to approximately one percent of the preparers subject to this regime. In 2008, the number of visits increased significantly and the number of sanctions imposed almost doubled.[51] Despite these inroads, GAO recently found that the IRS does not monitor compliance with established security and privacy standards.[52]

Addressing Preparer Errors

Effective oversight requires monitoring areas of substantial preparer noncompliance and researching and addressing the reasons behind errors. In addition to flagging errors through normal return screening, the IRS should institute so-called "mystery shopper"

49 "Net assessment" is the amount of penalties assessed minus the amount of penalties abated. "Net collectible" is the amount of net penalties assessed minus the amount deemed "currently not collectible." IRS, Enforcement Revenue Information System (ERIS) (Sept. 2009).

50 The National Taxpayer Advocate has made several legislative recommendations to increase IRC § 6695 preparer penalties as well as to impose more EITC due diligence responsibilities on preparers. These proposals included recommendations to impose a tiered penalty structure for IRC § 6695(g) penalties as well as a 100 percent penalty, similar to the Trust Fund Recovery Penalty (TFRP), against preparers who, by reason of willful and intentional misstatement, misrepresentation, fraud or deceit, prepare a return that causes a taxpayer a tax liability attributable to the EITC. National Taxpayer Advocate 2003 Annual Report to Congress 270-301.

51 IRS response to TAS research request (Aug. 25, 2008). In 2006, SB/SE conducted 1,129 visits and imposed 391 sanctions; in 2007 there were 1,299 visitations and 339 sanctions; and in 2008 there were 1,495 visits with 654 sanctions.

52 GAO, GAO-09-297, *Many Taxpayers Rely on Tax Software and IRS Needs to Assess Associated Risks* (Feb. 2009).

visits, both to learn more about challenges in the return preparation industry and to improve compliance.[53] Notably, the IRS already has experience performing shopper visits to gauge the quality of return preparation in the Volunteer Income Tax Assistance (VITA) program.[54]

Once the IRS determines an appropriate methodology and factual scenarios, local IRS employees in the Stakeholder Partnerships, Education and Communication (SPEC) organization of the W&I division and employees in the Stakeholder Liaison organization in SB/SE could perform standardized shopping visits in their communities. If a shopper observes a preparer making a certain error, the IRS could later contact the preparer to point out the mistake and educate the preparer about how to avoid the same error in the future. The IRS could then monitor that preparer, and if he or she continues to make the same error, the IRS could ramp up its efforts by transferring the case to its compliance functions.[55] If the IRS shopper were to see examples of recklessness or outright fraud during a shopping visit, it could similarly make appropriate referrals to SB/SE or the Criminal Investigation (CI) function.

Shopping visits would have both specific and general deterrence effects. Not only would a visit affect the behavior of the visited preparer, but compliance among other preparers will likely increase as word of IRS's shopping visits spreads. A preparer will be much less likely to offer to omit an item of gross income where no Form 1099 was issued or claim an ineligible child for purposes of the EITC if the preparer believes that the "taxpayer" sitting before him may be an IRS agent. The deterrent effect of taxpayer audits only operates if the IRS conducts enough of them – it conducted 1.4 million examinations in FY 2008[56] - and the deterrent effect of preparer shopping visits similarly will only work if the IRS conducts enough of them so that preparers reasonably believe they may be visited. For example, conducting 50 shopping visits a year (an average of one per state) is likely to have virtually no deterrent impact. We believe the number of visits should be in the range

53 For suggested characteristics of mystery shopper tests, see National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, 97 (Leslie Book, *The Need to Increase Preparer Responsibility, Visibility and Competence*).

54 SPEC Fact Sheet, *Understanding the Review Process* (Mar. 2008); SPEC response to TAS information request (Sept. 10, 2009) (SPEC has decided to discontinue its shopping-visits initiative at the end of FY 2009 due to limited resources).

55 Under the EITC Due Diligence Program, the IRS conducts due diligence visits where examiners are required to consider and apply the full suite of EITC penalties and sanctions, including e-file suspensions and return preparer penalties, if appropriate. In addition, these visits can serve as a means of detecting fraudulent activities that would result in fraud referrals and non-compliance that would result in recommendations for Return Preparer Program Action Cases (PACs). In 2000 and 2001, the IRS reached approximately 10,000 preparers through the EITC Preparer Outreach program. This program focused primarily on preparer outreach visits designed to educate preparers about the due diligence requirements with a small number of compliance visits. Despite these efforts, IRS did not see a decrease in the percentage of EITC overclaims. For FY 2004, the IRS had a two-part compliance strategy for the EITC Due Diligence Program, which included due diligence audits of 180 preparers and follow-up visits to those preparers who were assessed penalties to determine whether the due diligence visits changed the preparer's behavior. Due to problems with field resources and many inconsistencies, the IRS rendered the analysis of the program meaningless. IRS, Memorandum for Examination Executives, *2008 EITC Due Diligence Program Visitations* (Oct. 11, 2007); IRS, *FY 2008 EITC Due Diligence Training*. Thus, in conducting any future secret shopper or due diligence initiatives, the IRS must ensure it has rigorous strategy implementation and evaluation controls in place. Results from an evaluation of 2006 due diligence visits showed a return on investment (revenue protected to cost ratio of 39:1, which is seven times greater than the SB/SE EITC audits and produced a higher preparer penalty rate than EITC Program Action Cases). Finally, in FY 2009, SB/SE conducted 509 due diligence visits, which resulted in penalties in 53.4 percent (or 272) of the cases. In addition, W&I Research plans to analyze the change in behavior after the visits. IRS response to TAS research request (Oct. 2, 2009).

56 IRS, *Fiscal Year 2008 Enforcement Results*.

of 2,000 to 3,000 per year to start. The IRS should develop a research methodology to assess the results of the shopping visits both to measure the revenue impact of preparer-facilitated noncompliance and to evaluate the effectiveness of shopping visits at deterring noncompliance.

In the past, the IRS has expressed concerns about the costs of shopping visits. However, we believe the costs should be limited and the potential compliance gains could be significant. On the cost side, it is possible that six full-time equivalents (FTE) could conduct almost 3,000 shopping visits.[57] On the revenue side, the GAO, TIGTA and other studies showed consistently high levels of reckless and fraudulent errors that are likely costing the government tens of billions of dollars a year. For this reason, we believe that the return on investment (ROI) could substantially exceed the average ROI the IRS achieves on its enforcement spending.

Another step that should be taken to improve compliance is to impose additional due diligence requirements in areas of significant noncompliance. Currently, the EITC due diligence rules are limited by the difficulty of attributing knowledge to the preparer.[58] The same concept applies to other areas of substantial noncompliance. Thus, preparers should be required to ask taxpayers certain questions to avoid the "don't ask, don't tell" scenario. The IRS should impose affirmative obligations on preparers to ask specific and carefully designed questions to ferret out relevant facts. For example, preparers could be required to ask self-employed taxpayers: "Did you receive any other income during the year that was not reported on a Form 1099?"[59] Once the preparer poses the questions to the taxpayer, the cause of any inaccuracies shifts from being an error of omission to an error of commission.[60] Some taxpayers and preparers who are willing to cut some corners will not be willing to cross that line. To give the due diligence requirements more force, the IRS should require the preparer to submit a signed due diligence statement with the return. By signing the statement under penalties of perjury, the preparer becomes more accountable and is reminded of his or her duty to the taxpayer and the tax system. To facilitate this

57 The filing season generally runs from January 15 through April 15, or three months. There are about 60 work days in a three-month period. If an IRS employee were to visit one preparer in the morning and one preparer in the afternoon, the employee could conduct 120 visits during the three-month period. If 24 employees each conducted 120 visits, the total number of visits would be 2,880. Since each of these 24 employees would be conducting the visits for only three months, the hours translate to six FTE. In practice, additional costs would be incurred to create the program, develop and evaluate fact patterns, write up reports on the visits, cover travel expenses, etc. We cite this FTE data only to show that the costs should be manageable.

58 IRC §§ 6694(a)-(b), 6695(g). In 2003, the National Taxpayer Advocate made a legislative recommendation to increase the EITC due diligence requirements, including attaching a signed due diligence certification to the taxpayer's income tax return. *See* National Taxpayer Advocate 2003 Annual Report to Congress 270-301. The National Taxpayer Advocate also proposed that this issue be included on the 2009-2010 Guidance Priority List, but the IRS did not include it.

59 IRC § 6695(g) authorizes the IRS to impose due diligence requirements with respect to the EITC. The IRS should determine whether it has the legal authority to impose due diligence requirements in other areas or whether explicit statutory authorization would be required to do so. If legislation is required, the National Taxpayer Advocate recommends that Congress provide such authority.

60 National Taxpayer Advocate, *2009 IRS Research Conference* (June 2009); IRS Research Conference Papers: Elaine Doyle, *Cognitive Ethical Reasoning for Tax Practitioners: A Preliminary Investigation Using a Tax Specific Version of the Defining Issues Test (DIT)*; Leslie Book, *Increasing Preparer Responsibility, Visibility and Competence; Tax Preparers: Researchers Explore Tax Preparer Motives; More Due Diligence, Registration Urged*, BNA Daily Tax Report, July 10, 2009; National Taxpayer Advocate 2003 Annual Report to Congress 270-301; National Taxpayer Advocate 2008 Annual Report to Congress vol. 2, 82 (Leslie Book, *The Need to Increase Preparer Responsibility, Visibility and Competence*).

process, the preparer should be able to submit the statement electronically with an e-filed return.[61]

Alternative and Progressive Treatments

The National Taxpayer Advocate believes the IRS should apply research-driven alternative enforcement treatments. The above-discussed IRS servicewide Return Preparer Strategy included an objective to "explore alternative compliance strategies with a goal of improving coverage of return preparers."[62] A good example is the multi-faceted preparer plan administered by the EITC program office, which includes graduated enforcement treatments and coordinates with other organizations for support, especially in the area of abusive return preparers.[63] Applying this plan servicewide, the IRS could initiate an enforcement action by sending a soft notice to the preparer and gradually increase the aggressiveness of the treatments.[64]

The use of soft notices by the IRS has increased EITC compliance. After taxpayers received notices in tax year 2002 advising them that a qualifying child's SSN was used by more than one person to claim EITC, approximately 28.4 percent of the taxpayers involved dropped the duplicate qualifying child in TY 2003. This initiative protected revenue of approximately $63.5 million.[65]

Ability of Taxpayers and IRS Employees to Report Preparer Noncompliance

In her 2006 Annual Report, the National Taxpayer Advocate raised concerns about the process of reporting complaints about preparers to the IRS.[66] TIGTA recently evaluated this process and identified similar concerns.[67] TIGTA found the IRS cannot determine how many complaints against preparers it receives, how many complaints are worked, or the total number of complaints against a specific firm or preparer.[68] Thus, it is imperative that any new preparer strategy require the IRS to track the complaint data. In addition, the IRS

61 As noted above, TAS submitted a proposal to include a revision of Treas. Reg. 1.6695-2(b) on the Guidance Priority List. Such revision would require preparers to sign an EITC due diligence certification and attach it to the taxpayer's income tax return.

62 IRS, *Return Preparer Strategy: Understanding and Partnering with the Return Preparer Community to Improve Voluntary Tax Compliance* 19 (Mar. 31, 2008).

63 IRS response to TAS information request (Oct. 2, 2009). The EITC Preparer Program includes initiatives to identify effective treatments that align with a preparer's level of noncompliant behavior that can become part of a progressive suite of treatments. In FY 2009, the EITC office partnered with SB/SE to test the effectiveness of four treatments: (1) Due Diligence Visits, (2) Knock and Talk Visits, which occur right before the commencement of the filing season, (3) First Time Paid Preparer Initiative, which tested the effect of different types of compliance touches, and (4) Streamlined Injunctions.

64 IRS, *Return Preparer Strategy: Understanding and Partnering with the Return Preparer Community to Improve Voluntary Tax Compliance*, 19-20 (Mar. 31, 2008). A study conducted by Inland Revenue of the United Kingdom found that the agency can encourage compliance merely by presenting itself as more involved in tax collection and aware of preparation activities. Thus, sending a soft notice may result in increased compliance if the IRS shows that it is aware of the preparer's activities. John Hasseldine, *Persuasive Communications: Tax Compliance Enforcement Strategies for Sole Proprietors*, 24 Contemporary Accounting Research 171 (2007).

65 IRS, *W&I Research, Soft Notice for Duplicate TINS for Tax Years 2002, 2003 and 2004*, Project Number 6-05-12-2-030E. *See also* IRM 21.5.10.4.2

66 National Taxpayer Advocate 2006 Annual Report to Congress 197-221.

67 TIGTA, Ref. No. 2008-400-15, *The Process Taxpayers Must Use to Report Complaints Against Tax Return Preparers Is Ineffective and Causes Unnecessary Taxpayer Burden* (Feb. 24, 2009).

68 Hearing Before the Subcomm. on Oversight, H. Comm. on Ways and Means (Feb. 26, 2009) (statement of J. Russell George, TIGTA).

should publicize and streamline the process for reporting problem preparers to enable both IRS employees and the public to easily submit complaints.[69]

Need for a Preparer Compliance Database

In her 2007 Annual Report, the National Taxpayer Advocate recommended that the IRS develop a preparer database that would include the number of returns prepared by each preparer and how often client returns contain various types of errors. Maintaining this type of information would allow the IRS to better target outreach and education as well as improve audit selection. The drawback to this approach is that some aggressive preparers may stop providing identifying numbers on returns if they discover the IRS is "profiling" them. On the other hand, taxpayers may visit less aggressive preparers if they believe these preparers carry a higher risk of audit.[70] The IRS can minimize the number of preparers and taxpayers "crossing the line" by taking the following steps: (1) imposing appropriate sanctions on preparers caught not using identifying numbers; (2) educating taxpayers that their preparer needs to sign the return and enter his or her identifying number; and (3) informing taxpayers that they cannot rely on a preparer's advice for purposes of abating penalties due to the reasonable cause exception if they go to a preparer who fails to properly register, sign the return, and provide the identifying number.

Access to Enrolled Agent and Enrolled Preparer Databases

The OPR should make an enrolled agent database available to both IRS employees and the public. The database should also include any additional preparers who register with the IRS if and when the IRS expands preparer registration requirements. IRS employees, practitioners, and the public would greatly benefit from access to this information. The database should be searchable and include such information as the preparer's contact information, whether the preparer is in good standing, the preparer's designation, if applicable, and any final determinations on disciplinary actions. State licensing agencies make this information available for other types of practitioners. The IRS should follow suit.

Research and Audit Selection

To target its preparer compliance activities more effectively, the IRS should research the causes of preparer errors. This research should evaluate, among other things, whether errors on returns are due to the individual preparer's independent actions or are a symptom of a firm's policies. Further, some errors are outside the preparer's control, such as when the preparer relies on the word of the taxpayer. This review should also address how the IRS determines which of the preparer's cases to review and whether it makes sense to freeze all of the preparer's returns.

69 Such public awareness campaign should also include information about using either Circular 230 practitioners or registered preparers.

70 National Taxpayer Advocate 2007 Annual Report to Congress 35-64.

In addition, once the IRS examines a preparer and finds no substantial problems, the IRS should adopt procedures to ensure that it does not repeatedly target that preparer absent changed circumstances. Because the IRS reviews clients' returns in the process, the IRS would be unfairly damaging the preparer's business reputation, as well as harming clients by delaying their refunds, if it continually targets a particular preparer even though previous audits found no significant problems.

CONCLUSION

As the IRS's position on return preparer oversight enters a critical stage, we encourage the IRS to develop a comprehensive servicewide strategy for preparer competence, visibility, and accountability. The National Taxpayer Advocate strongly urges the IRS to support a program to register, test, and certify unenrolled preparers. The disturbing findings of several recent studies involving mystery shopping visits provide compelling evidence that oversight of the industry requires significant transformation and increased rigor. There is widespread support for such a program in the preparer industry as well as Congress. The Office of the Taxpayer Advocate looks forward to working with the IRS as it continues to evaluate this issue and develop recommendations for much needed change.

In light of our longstanding proposals and a few additional proposals, the National Taxpayer Advocate offers these preliminary recommendations:

1. Develop and implement a Servicewide Return Preparer Strategy.
2. Create an executive steering committee and a program office, both under the jurisdiction of the Deputy Commissioner (Services and Enforcement), to assume responsibility for development of policies and procedures as well as continual monitoring duties regarding administration and technical interpretation of the tax provisions under Title 26. The Taxpayer Advocate Service and the Office of Professional Responsibility (OPR) should have representation on the cross-functional steering committee along with the other business functions. OPR would have oversight responsibility for registration, testing, CPE, and Circular 230 sanctions as it already does for enrolled agents.
3. Require all persons who prepare tax returns to obtain and use a unique preparer identifying number (PTIN).
4. Develop a system to systematically validate PTINs on all tax returns.
5. Develop and implement a registration, examination, certification, and enforcement program for unenrolled preparers, including a periodic CPE requirement. Examinations should be given at two levels: (1) basic Form 1040 issues and (2) more complex Form 1040 issues and business returns. It is important that the second-level exam include topics germane to the preparation of business returns, including non-Form 1040 series returns, to address the high level of noncompliance on S corporation and other business returns. Both the exams and CPE courses should include ethics components.

6. Apply the registration, testing, and CPE requirements to any preparer who substantially interacts with a taxpayer and prepares the taxpayer's tax return. Limiting the requirements solely to preparers who sign returns would enable a significant (and growing) portion of the preparer population to prepare tax returns without registering, passing a test to demonstrate knowledge, or taking CPE courses to remain up-to-date on tax law changes.
7. Conduct strategic research to determine the various types of noncompliance as well as the reasons and appropriate treatment for each type of noncompliance.
8. Conduct a public awareness campaign over a period of years to inform taxpayers of preparer signature, PTIN and registration requirements, if applicable, as well as procedures to file complaints against preparers.
9. Make the enrolled agent database and any potential future registered preparer database available to both IRS employees and the public.
10. Implement a large-scale mystery shopper program, using scenarios carefully designed to incorporate fact patterns addressing areas of substantial noncompliance.
11. Impose due diligence requirements on preparers relating to identified areas of significant noncompliance. Such requirements should require preparers to sign due diligence statements and attach the statements to the taxpayers' returns, including e-filed returns.

IRS COMMENTS

In June 2009, the Commissioner launched a comprehensive review of return preparers in an effort to help the IRS better leverage this community with the twin goals of increasing taxpayer compliance and ensuring uniform and high ethical standards of conduct for preparers. This was a large undertaking by the Commissioner, who committed to this effort and focused a team of resources to review all input from outside stakeholders as well as within the IRS and other federal agencies. The National Taxpayer Advocate's office was included in this review and participated in the development of final recommendations that will be announced and issued by the Commissioner in the near future.

It was clear to the IRS that a Servicewide Return Preparer Strategy and an increase in the oversight of return preparers were warranted. Unethical and unqualified return preparers can harm taxpayers and challenge the integrity of the tax system.

Return preparers are key partners in tax administration. The IRS Strategic Plan for 2009 – 2013 documents the importance of return preparers in two objectives: 1) Strengthen partnerships with tax practitioners, tax return preparers, and other third parties in order to ensure effective tax administration, and 2) Ensure that all practitioners, tax return preparers and other third parties in the tax system adhere to professional standards and follow the law.

The review was comprehensive and gathered opinions and input from a broad range of external and internal stakeholders. Many organizations were represented in three public forums held with consumer groups, tax professional organizations, federal and state government agencies and other groups to provide opportunities for open dialogue. The IRS also requested public comments regarding possible oversight of tax return preparers. Approximately 500 comments were received via this method. Additionally, almost 600 comments were received from IRS employees and managers.

This review entailed reviewing all potential options around registration, testing, enforcement, ethics and education, as well as the comments received from the public and external stakeholders above. There was widespread consensus on the necessity for increased oversight of return preparers. Each of these issues will be addressed at length in the Commissioner's final report and recommendations which are scheduled for release in the near future.

Taxpayer Advocate Service Comments

In General

The National Taxpayer Advocate commends the IRS for conducting a comprehensive return preparer review for the purpose of strengthening oversight over return preparers. The Office of the Taxpayer Advocate played an active role in the review and agreed with many, although not all, of its final recommendations. Because the IRS has not formally issued its report at this writing, we will reserve detailed comments on the report until it is released.

As noted by the IRS, information gathered during the data collection stage of the review confirms widespread support for improving oversight of return preparers. In addition, the findings of several recent studies involving undercover shopping visits provide compelling evidence that such increased oversight would substantially benefit both taxpayers and tax administration.

The National Taxpayer Advocate reiterates her longstanding recommendation that the IRS develop and implement a program to register, test, and certify unenrolled return preparers and require that they remain current on tax law changes by completing periodic continuing professional education courses. Eligibility examinations should be offered at least at two levels – the first level should cover issues germane to preparing basic Form 1040 returns and the second level should cover more complex Form 1040 and business entity issues. The IRS should couple its oversight program with a comprehensive public awareness campaign targeted at both the taxpaying public and preparers subject to the new rules.

The New Rules Should Apply to All Persons Who Prepare Tax Returns – Not Merely to "Signing" Preparers.

The National Taxpayer Advocate believes that to be effective, registration requirements should apply to all tax return preparers and that testing and CPE requirements should apply to all unenrolled preparers who interact with taxpayers and prepare returns.[71] This is a critical point. At first blush, one might assume that a "comprehensive" tax return preparer strategy would automatically cover all tax return preparers, but that is not necessarily the case. Treasury regulations distinguish between a preparer who signs a tax return (a "signing tax return preparer") and a preparer who prepares "all or a substantial portion" of a tax return but does not sign it (a "nonsigning tax return preparer").[72]

In some tax return preparation businesses, one or a small number of preparers are designated to sign all returns, yet multiple preparers conduct substantive interviews and meetings with taxpayers and either prepare their returns or prepare reports of the interviews and the data upon which the returns are based. In these cases, the "signing tax return preparer" often will not have met with the taxpayer, had an opportunity to ask questions of the taxpayer, or reviewed the taxpayer's documentation. If the IRS regulates solely "signing tax return preparers," many individuals engaged in return preparation will not be subject to registration, testing, CPE, or other requirements. This would leave a gaping hole in the regulatory regime that could be widely and increasingly exploited and that could thereby undercut the effectiveness of the initiative.

There are significant, compelling reasons to require that all persons who prepare tax returns – including nonsigning preparers – be included within the scope of the new rules. Among these reasons are the following:

1. **It would enable the IRS to achieve the consumer protection objective of the initiative by requiring all unenrolled preparers to pass an entrance exam and take CPE courses.** Because unenrolled preparers currently do not have to satisfy any education or testing requirements to demonstrate that they possess basic knowledge about return preparation, the National Taxpayer Advocate has consistently recommended that they be required to pass an examination before preparing tax returns and that they then be required to take periodic CPE courses. Low income and limited English proficiency taxpayers are particularly likely to rely on unenrolled preparers. Thus,

71 We have not recommended that attorneys and CPAs be required to comply with testing and CPE requirements because they have completed professional education, have passed professional examinations, and typically must comply with ongoing CPE requirements. It is also our understanding that the IRS lacks the legal authority to require attorneys and CPAs to take examinations or CPE as a condition of practice. *See* 5 U.S.C. § 500(b) & (c). Similarly, we have not recommended that Enrolled Agents be required to comply with additional testing and CPE requirements because Enrolled Agents already must register with the IRS, pass an examination, and comply with CPE requirements.

72 Treasury regulations define a "nonsigning tax return preparer" as "any return preparer who is not a signing tax return preparer but who prepares all or a substantial portion of a return or claim for refund . . .". Treas. Reg. § 301.7701-15(b)(2). A "signing tax return preparer" is defined as "the individual tax return preparer who has the primary responsibility for the overall substantive accuracy of the preparation of such return or claim for refund." Treas. Reg. § 301.7701-15(b)(1). Thus, it is entirely permissible for someone who prepares "all" of a tax return to be considered a nonsigning preparer so long as someone else has the primary responsibility for the overall substantive accuracy of the return.

if unenrolled nonsigning preparers are excused from testing and CPE requirements, the requirements will fail to protect a significant and largely vulnerable segment of the taxpaying public. It is important to note that any new testing and CPE requirements are likely to apply *solely to* unenrolled preparers – not to attorneys, CPAs, and Enrolled Agents.[73] Therefore, the principal effect of exempting nonsigning preparers from the new rules would be to excuse *unenrolled* nonsigning preparers from examination and CPE requirements.

2. **It would strengthen the IRS's ability to detect preparer-facilitated noncompliance via automation.** A significant benefit of tracking preparers by PTIN is that it should allow the IRS to associate preparers with the returns they prepare using automated systems and thereby enable the IRS to identify preparers with disproportionately high risk scores. The results of the GAO and TIGTA studies cited above suggest that the revenue loss attributable to preparer-facilitated noncompliance amounts to billions of dollars, potentially tens of billions of dollars, each year. Some of the errors reflect negligence, while others are willful. If each person who prepares a tax return has a unique identifying number, the IRS will be much better able to identify preparers who submit consistently noncompliant returns.[74] As discussed more fully below, if only "signing tax return preparers" are required to register, an incentive will arise for more preparers to become "nonsigning tax return preparers." As a consequence, fewer returns will bear the PTIN of the individual who prepared them, reducing IRS's ability to detect and deal with noncompliant preparers.[75]

3. **It would allow the IRS to undertake a public information campaign with a simple message that taxpayers can understand.** The National Taxpayer Advocate believes that the IRS should issue certificates to all persons registered to prepare tax returns and make available a searchable, online database of registered preparers as well. If all preparers are required to register, the public message is simple: "Only persons who display an IRS certificate and are listed in the database are authorized to

73 As noted above, the IRS apparently lacks the legal authority to require attorneys and CPAs to take examinations or CPE as a condition of practice (see 5 U.S.C. § 500(b) & (c)), and Enrolled Agents already must register with the IRS, pass an examination, and comply with CPE requirements.

74 Assume, for example, that a return preparation business employs ten preparers. To avoid the costs and burdens associated with registration, testing, and CPE, the business arranges for one individual to become licensed to sign all returns and employs the other nine individuals as nonsigning preparers. Assume further that there are two preparers who consistently prepare inaccurate returns. If each of the ten preparers was registered, each preparer would be likely to sign the returns he himself prepared. That would make it much easier for the IRS to identify the two deficient preparers via automated compliance checks. But if the returns prepared by all ten preparers are submitted under the PTIN of the sole signing preparer, the signing preparer's risk score would reflect a blend of the return scores associated with the eight compliant preparers and the two noncompliant ones. As a result, the blended risk score may fall within the range of acceptable scores and the IRS will have missed an opportunity to identify the deficient preparers, potentially harming taxpayers and tax compliance.

75 Even if nonsigning preparers are required to obtain PTINs, there still will be some occasions where a nonsigning tax return preparer prepares a return but a signing tax return preparer assumes the responsibility for its substantive accuracy. At a CPA firm, for example, multiple CPAs may prepare returns, yet a limited number of partners may be authorized to assume responsibility for the overall accuracy of returns and therefore to sign them. If nonsigning preparers are required to register, however, we believe return preparers will sign the returns they themselves prepare in a much larger number of cases and we think the circumstances under which there is a separate signing preparer are less likely to be problematic. First, because nonsigning preparers would have to register with the IRS and meet whatever testing and CPE requirements are prescribed, the goal of ensuring competence and accountability would be achieved. Second, nonsigning preparers would be *eligible* to sign tax returns, so unlike in situations where a nonsigning preparer is not registered or authorized to sign a return, the signing preparer would not be signing the return simply because there is no other option. His signature would more likely reflect a management decision to make him the responsible person for reasons of competence and experience.

prepare your return." If the IRS exempts nonsigning preparers from the regulatory requirements, the message will be more complex and less likely to stick. ("The person who prepares your tax return does not have to be registered, but the person who signs your return, who may or may not be the person who prepares it and whom you may or may not meet, must display an IRS certificate"?)

4. **It would enable the IRS to enlist taxpayers in enforcing the registration requirement and reduce the ability of preparers to operate "underground."** Taxpayers should be the most effective and efficient enforcement agents of the new rules because if they decline to use unregistered preparers, the preparers will go out of business. This is critical, because the IRS lacks the resources to enforce the rules effectively on its own. However, taxpayers can only be effective enforcement agents if they have an easy way to distinguish a preparer who may legally prepare a return from a preparer who may not. If all preparers are required to display a registration certificate, taxpayers can be educated to avoid any preparer without one. By contrast, if nonsigning preparers are permitted to prepare returns without a registration certificate, the benefits of taxpayer enforcement would be largely lost. On a related note, the IRS should take steps to minimize the number of preparers who avoid the new requirements by operating "underground" (*i.e.,* preparing returns for a fee but leaving the signature line blank, thus remaining invisible to the IRS). Requiring all preparers to comply with the regulatory requirements and making clear to taxpayers that they should only use preparers who display a registration certificate and sign the return would limit the ability of unscrupulous preparers to operate outside the new rules.
5. **It would create a mechanism to prevent deficient preparers from moving from one job to another.** If all preparers are required to register and the IRS maintains a searchable database of authorized preparers, return preparation businesses could check a job applicant against the IRS database to confirm that the applicant is registered. If nonsigning preparers are permitted to prepare tax returns without registering, however, there will be no easy way for return preparation businesses to determine who has been subject to disciplinary action and who has not. As a consequence, deficient preparers could move from one job to another without being tracked.
6. **It would facilitate verification of due diligence requirements.** The National Taxpayer Advocate has recommended that preparers be directed to ask taxpayers a limited number of "due diligence" questions relating to high noncompliance areas when completing returns. For example, IRS research shows that a high percentage of sole proprietorship income is not reported. Therefore, the preparer of a Form 1040, Schedule C, *Profit or Loss From Business (Sole Proprietorship),* could be directed to ask the taxpayer: "Did you receive any other business income that was not reported to you on a Form 1099?" In our view, the preparer who conducts this "due diligence interview" should be directed to record the answers on a separate certification

form (which may be e-filed along with the return) and should be required to sign the certification form and include his PTIN – even if the overall return is to be signed by another preparer. Requiring the preparer who asks the due diligence questions to certify compliance will reduce instances where questions are either skipped or handled with a nudge and a wink. However, this requirement would not be practical if nonsigning preparers who meet with taxpayers and conduct due diligence interviews do not have a PTIN.

7. **It would facilitate IRS's ability to conduct effective undercover shopping visits.** As discussed above, the National Taxpayer Advocate has recommended that the IRS conduct preparer shopping visits. However, if an IRS employee visits a nonsigning preparer and the preparer does not display a certificate listing his name and PTIN, the IRS employee may not be able to identify the preparer. Even if the IRS employee does learn the preparer's name, there will be no easy way to identify other returns the preparer has completed in cases where compliance problems are identified.
8. **If nonsigning tax return preparers are excused from the new rules, we likely will end up with more nonsigning preparers.** If nonsigning preparers are excused from the new regulatory requirements, an incentive will arise for more return preparation businesses to adopt the model of using multiple nonsigning preparers. If preparers are required to pay user fees, pass an entrance exam, and comply with annual CPE or other requirements, the preparers (or their employers) will bear new costs and burdens. The IRS weighed the impact of these costs and burdens carefully in recent months and determined (correctly, in our view) that the public benefits of preparer regulation outweigh its costs. However, it is all but certain that more businesses will choose to use nonsigning preparers, if that is an available option, to reduce their costs and compliance burdens. And over time, as these businesses under-price their competitors, competitive pressures are likely to drive more tax preparation businesses to adopt this same model of using "nonsigning tax return preparers," which will result in a growing segment of the preparer population that operates outside any registration, testing, and CPE requirements.

For the foregoing reasons, we believe it is critical that the new rules apply to all tax return preparers, and we are concerned that excluding nonsigning preparers could create an exception that swallows the rule.

We Find the Arguments for Excluding All Nonsigning Preparers from the New Rules to Be Unpersuasive.

We have had many discussions about this issue and heard four arguments advanced for limiting the scope of the initiative to signing tax return preparers. We find the arguments unpersuasive and in some cases contradictory.

First: It has been argued that very few return preparation businesses are operating under the model of using one or several signing preparers and multiple nonsigning preparers.

While there is no way to quantify the extent of the practice, the National Taxpayer Advocate believes that the practice is fairly widespread. More important, we think this argument misses the point. On the one hand, if almost all return preparation businesses require the person who prepares a return to sign it, then the universe of "nonsigning" preparers who are preparing tax returns is very small and including such individuals in the regulatory regime would impose limited burden. On the other hand, if return preparation businesses are widely using a model that includes nonsigning preparers, then the need to include nonsigning preparers within the regulatory regime is even more important. Moreover, as noted above, the new regime will itself provide a strong incentive for return preparation businesses to move to that model to reduce costs and burden, so the IRS should act now to avoid creating a loophole.

Second: It has been argued that including nonsigning preparers in the regulatory regime will require more resources than the IRS can reasonably devote to this project. As a threshold matter, we note that the premise of this argument contradicts the prior argument. It cannot logically be argued both that (1) return preparation businesses do not use nonsigning preparers to prepare tax returns and (2) there are so many nonsigning preparers that it will overburden the IRS's resources to register and test them.

More to the point, the IRS is authorized to charge user fees to cover the costs of administering the return preparer program, and it can set the fees at whatever level is required to include nonsigning preparers within its scope.[76] To illustrate, assume that there are one million signing preparers and 200,000 nonsigning preparers. If the IRS includes nonsigning preparers within scope, it arguably will have to build systems that have 20 percent greater capacity, and it will have to hire 20 percent more employees in the program office to handle paper and related work. The IRS should be able to recover these additional costs through user fees. The user fee charged per preparer may even be lower if nonsigning preparers are included because the nonsigning preparers would also pay user fees, potentially resulting in economies of scale.

If there are significant program costs that the IRS cannot legally or practically recover through user fees, it should work with the Treasury Department and the Office of Management and Budget to request additional funding. It would be unfortunate if the desire to conserve resources leads the IRS to squander resources by developing an extensive registration, testing, CPE, and certification regime that fails to address the category of preparers that creates the largest risk for taxpayers and tax compliance (*i.e.,* unenrolled preparers and particularly nonsigning unenrolled preparers, who are invisible to the IRS).

Third: It has been argued that the IRS can effectively address problems associated with nonsigning preparers by holding their employers or the signing preparers accountable for mistakes. In our view, this would not be an effective approach for several reasons:

[76] *See* 31 U.S.C. § 9701.

- The signing preparer will not necessarily have access to complete information. For example, if the nonsigning preparer who met with the taxpayer has helped the taxpayer claim an ineligible child for purposes of the earned income tax credit or has encouraged a taxpayer to consider omitting items of gross income because no Form 1099 was issued and the IRS therefore will not be able to detect the omission, the signing preparer will have no way to identify those inaccuracies based on a review of the return. Significantly, these examples are not just theoretical. Both occurred during the GAO and TIGTA shopping visits described above.
- The IRS will only be able to detect and penalize a small percentage of problematic employers, because someone would have to report an employer to the IRS and the IRS would have to conduct a resource-intensive investigation. By contrast, the benefit of giving every preparer a PTIN is that the IRS could identify more preparers by automation and could therefore take more compliance actions at a lower cost.
- As discussed above, if nonsigning preparers are excused from the new rules, a nonsigning preparer penalized by the IRS or dismissed by one business for incompetence could walk across the street and apply for work at another business. Without a requirement that nonsigning preparers have a PTIN or certificate (which the IRS could revoke) and be listed on a searchable database of registered preparers, the second business will have no easy way to know that the individual is not qualified. As a consequence, incompetent or unethical preparers will have an easier time continuing to prepare returns by "hiding" as nonsigning preparers and moving from job to job.
- A signing preparer will not always have supervisory responsibility over other preparers in the business. For example, assume the owner of a return preparation business hires one person (whom he pays to register as a licensed tax return preparer) to serve as his "signing tax return preparer" and assume he hires multiple "nonsigning tax return preparers." If the signing tax return preparer is directed to sign returns for all other preparers as a condition of maintaining his job, he may well do it. The need for a job – particularly in the current economy – is a certain and immediate concern that is likely to outweigh the theoretical risk that the IRS may identify a compliance problem at some point in the future.

Fourth: It has been argued that the definition of a "nonsigning tax return preparer" is very broad and includes certain categories of practitioners who are not involved in return preparation, such as attorneys or CPAs who provide solely pre-transactional tax advice, or that the new rules could impose undue burden on law or accounting firms. We agree that it may not be appropriate to require everyone included within the definition of a "nonsigning tax return preparer" to register with the IRS as a preparer. However, the decision about whether to include nonsigning preparers within the scope of regulation need not be an all-or-nothing proposition. The IRS can easily write rules to include only a subset of "nonsigning tax return preparers." Specifically, the IRS could reasonably decide to include only preparers who actually prepare tax returns within the new regulatory regime. One way

to implement this approach would be to require registration by (1) all signing tax return preparers and (2) nonsigning tax return preparers who prepare all or a substantial portion of a tax return or claim for refund. Alternatively, if the IRS is concerned that the new rules would create undue burden for law or accounting firms, the rules could apply to (1) all signing tax return preparers and (2) all nonsigning tax return preparers except attorneys and CPAs.

Conclusion

On balance, we commend the IRS for undertaking this significant, far-reaching initiative regarding return preparer oversight. We believe it has the potential to provide significant protection and reassurance to the majority of the taxpaying public that relies on paid tax return preparers and to improve tax compliance as well. We look forward to continuing to work with the IRS toward these ends as the strategy is refined and implemented.

Our recommendations, formulated prior to the time the IRS finalized its return preparer strategy, are listed immediately below.

Recommendations

To increase preparer competence, visibility, and accountability, the National Taxpayer Advocate offers the following administrative recommendations:

1. Develop and implement a Servicewide Return Preparer Strategy.
2. Create an executive steering committee and a program office, preferably under the jurisdiction of the Deputy Commissioner (Services and Enforcement), to assume responsibility for development of policies and procedures as well as continual monitoring duties regarding administration and technical interpretation of the tax provisions under Title 26 relating to the return preparer strategy. The Taxpayer Advocate Service and the Office of Professional Responsibility (OPR) should have representation on the cross-functional steering committee along with other affected business functions. OPR should have oversight responsibility for registration, testing, CPE, and Circular 230 sanctions, as it already does for enrolled agents.
3. Require all persons who prepare tax returns to obtain and use a unique preparer identifying number (PTIN).
4. Develop a system to systematically validate PTINs on all tax returns.
5. Develop and implement a registration, examination, certification, and enforcement program for unenrolled preparers, including a periodic CPE requirement. Examinations should be offered at least at two levels: (1) basic Form 1040 issues and

(2) more complex Form 1040 issues and business returns. The second-level exam should include business issues arising both on Form 1040 exams (*e.g.,* Schedule C) and on other entity returns to address the high level of noncompliance on S corporation and other business returns. Both the exams and CPE courses should include ethics components.

6. Apply the registration, testing, and CPE requirements to any preparer who substantially interacts with a taxpayer and prepares the taxpayer's tax return. Limiting the requirements solely to preparers who sign returns would enable a significant (and growing) portion of the preparer population to prepare tax returns without registering, passing a test to demonstrate competence, or taking CPE courses to remain up-to-date on tax law changes.
7. Conduct strategic research to determine the various types of noncompliance as well as the reasons and appropriate treatment for each type of noncompliance.
8. Conduct a public awareness campaign over a period of years to inform taxpayers of preparer signature, PTIN and registration requirements as well as procedures to file complaints against preparers.
9. Issue a certificate to each certified preparer and create a searchable online database of all certified preparers to enable taxpayers (and potential employers) to readily identify them. The database should also include the preparer's status (*e.g.,* attorney, CPA, Enrolled Agent, or unenrolled preparer).
10. Implement a large-scale program of preparer visits, using scenarios carefully designed to determine the treatment of areas that typically result in high noncompliance rates.
11. Impose due diligence requirements on preparers relating to identified areas of significant noncompliance. Such requirements should require preparers to sign due diligence statements and attach the statements to the taxpayers' returns, including e-filed returns.