



Section of Taxation

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July 24, 2009

Hon. Douglas Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: Internal Revenue Service Public Forum on Tax Return Preparer Review

Dear Commissioner Shulman:

Enclosed is the statement prepared for the Public Forum on Tax Return Preparer Review to be presented by Armando Gomez, Vice Chair Government Relations. The statement represents the views of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association, and should not be construed as representing the policy of the American Bar Association.

Sincerely,

A handwritten signature in black ink, appearing to read "Stuart M. Lewis".

Stuart M. Lewis
Chair-Elect, Section of Taxation

Enclosure

cc: Eric A. San Juan, Acting Tax Legislative Counsel, Department of the Treasury
Mark Ernst, Deputy Commissioner, Internal Revenue Service
Karen L. Hawkins, Director, Office of Professional Responsibility, Internal Revenue Service
Nina E. Olson, National Taxpayer Advocate, Internal Revenue Service
Clarissa C. Potter, Acting Chief Counsel, Internal Revenue Service

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STATEMENT ON BEHALF OF
AMERICAN BAR ASSOCIATION SECTION OF TAXATION
BEFORE THE IRS FORUM ON PREPARER REGULATIONS

July 30, 2009

Good morning. My name is Armando Gomez. I appear before you today in my capacity as Vice Chair for Government Relations of the American Bar Association Section of Taxation. This statement is presented on behalf of the Section of Taxation. It has not been approved by the House of Delegates or the Board of Governors of the American Bar Association. Accordingly, it should not be construed as representing the policy of the Association.

The Section of Taxation appreciates the opportunity to appear at this forum today to discuss proposals for ensuring that tax return preparers are both ethical and competent. Because tax return preparers play an important role in the efficient and effective administration of the tax laws, these proposals complement the efforts of the Internal Revenue Service (the "Service") to regulate tax professionals and increase the level of taxpayer compliance.¹

American Bar Association Section of Taxation

The Section of Taxation is comprised of more than 22,000 members. Our members include attorneys who work in law firms, corporations and other business

¹ This is a subject on which the Section of Taxation has commented previously. *See, e.g.*, Comments on the National Taxpayer Advocate's Preparer Licensing Proposal (Jan. 26, 2004), *available at*: <http://www.abanet.org/tax/pubpolicy/2004/0401stp.pdf>; Testimony of Kenneth W. Gideon on behalf of the American Bar Association Section of Taxation before the Subcommittee on Oversight of the House Ways & Means Committee (Jul. 20, 2005), *available at*: <http://www.abanet.org/tax/pubpolicy/2005/050720tes.pdf>.

entities, government, non-profit organizations, academia, accounting firms and other multidisciplinary organizations. As the nation's largest and broadest-based professional organization of tax lawyers, one of our primary goals is to make the tax system fairer, simpler and easier to administer.

Our members provide advice on virtually every substantive and procedural area of the tax laws, and interact regularly with the Service and other government agencies and offices responsible for administering and enforcing such laws. Many of our members have served in staff and executive-level positions at the Service, the Treasury Department, the Tax Division of the Department of Justice, and the Congressional tax-writing committees.

The Need for Tax Return Preparer Performance Standards

Recent studies indicate that a majority of taxpayers continue to pay a third party to prepare their individual income tax returns.² Paid preparers often advise taxpayers on issues for which guidance is unclear. They explain record-keeping and other requirements. Many taxpayers use them to navigate their way through overlapping or recently changed provisions. The complexity of many provisions applicable to ordinary taxpayers, such as the earned income tax credit, the dependent care credit, child credit, and education credits, create particular needs for preparer assistance.

² See, e.g., U.S. Government Accountability Office, *Oregon's Regulatory Regime May Lead to Improved Federal Tax Return Accuracy and Provides a Possible Model for National Regulation* (Aug. 2008); Treasury Inspector General for Tax Administration, *Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors* (Sep. 3, 2008); National Taxpayer Advocate, *2008 Annual Report to Congress* (Dec. 31, 2008); National Taxpayer Advocate, *Report to Congress on Fiscal Year 2010 Objectives* (Jun. 30, 2009); Treasury Inspector General for Tax Administration, *Inadequate Data on Paid Preparers Impedes Effective Oversight* (Jul. 14, 2009).

Despite the complexity of the Internal Revenue Code and the Treasury Regulations, paid return preparers are not subject to educational or other competency requirements. In contrast, attorneys and CPAs must complete prescribed courses of study and then pass State licensing exams to practice their professions. Enrolled agents who do not have prior experience working for the Service must pass a written examination to demonstrate their knowledge of tax law and procedure. In addition, attorneys, CPAs and enrolled agents (“Regulated Professionals”) are subject to ethical requirements and, in most jurisdictions, continuing professional education requirements.

Paid preparers in most States are not subject to regulation by State licensing authorities. Their situation contrasts with that of attorneys and CPAs, who are subject to oversight by the State bars and accountancy boards. In addition, Regulated Professionals are subject to oversight by the Office of Professional Responsibility with respect to their practice before the Service pursuant to Circular 230. By contrast, paid preparers are subject only to the Internal Revenue Code’s preparer penalties.³

Improving the quality of tax return preparation will benefit all taxpayers. First, individuals who use paid preparers will be less likely to file erroneous tax returns. Because erroneous returns result in unexpected tax liability, imposition of interest on back taxes, and time spent resolving problems, even inadvertent errors cause hardship. In addition, correcting erroneous returns diverts already limited Service resources from other taxpayer education and enforcement activities. Second, many of the taxpayers who consult return preparers are those who are least likely to understand complicated tax rules, *i.e.*, taxpayers with little education, recent immigrants and others having limited

³ See, *e.g.*, I.R.C. §§ 6694, 6695, 6700, 6701, 6713, 7201, 7206, and 7216.

comprehension of the English language and/or our tax system, or who are least likely to have ready access to electronic filing alternatives. Given their circumstances, such taxpayers – perhaps more so than others – need to know that their return preparer is competent and ethical.

The Section of Taxation supports efforts to establish minimum qualifications for return preparers. Such qualifications could include examinations to test technical knowledge, competency to prepare returns, and familiarity with the standards of tax practice required of preparers. Of course, examinations are not the only means for assessing competence. Regulated Professionals who already have demonstrated competence through education and licensing, as well as paid preparers who have satisfactorily completed competency examinations in States such as Oregon that administer such examinations as part of their preparer regulatory regimes, could be deemed to have demonstrated the minimum competence to prepare returns going forward.

To ensure that impediments are not created which adversely affect recruiting of new tax return preparers, interim qualifications might be provided for new return preparers who complete certain basic examinations (which could be available on-line) and who are subject to supervision by more experienced preparers or Regulated Professionals. For example, the Oregon system incorporates a two-tier licensing program under which less experienced preparers are required to work under the supervision of more experienced preparers until they have sufficient experience and are able to successfully complete a more comprehensive examination than is required for new entrants.

The Section of Taxation also supports mandatory continuing education in order to maintain the ability to prepare returns going forward. To the extent that Regulated Professionals already comply with continuing professional education requirements, no additional continuing education requirements should be required. For other paid preparers, however, continuing education will help ensure that they maintain skills demonstrated through the examination process, and that they learn about changes in the tax laws and other developments that impact tax compliance requirements. In addition, paid preparers found to have prepared multiple erroneous returns might be required to complete additional continuing education as a condition of continuing to be permitted to prepare returns.

The Need for Tax Return Preparer Registration

The Internal Revenue Code presently requires all paid tax return preparers to sign the returns that they prepare, to include their identifying number on such returns, and to maintain copies of the returns prepared (or lists of the taxpayers for whom the returns were prepared). Penalties of \$50 per failure may be imposed under section 6695 of the Code for paid preparers who do not comply with these requirements.

Notwithstanding the requirements presently set forth in the Code, recent reports by the National Taxpayer Advocate, the Government Accountability Office and the Treasury Department Inspector General for Tax Administration indicate that it is difficult for the Service to locate and review all returns prepared by a paid preparer when instances of willful or reckless conduct or intentional disregard of the rules and regulations are detected.

If, as the Section of Taxation recommends, minimum qualification and continuing education requirements are established for paid preparers, a uniform system of identifying paid preparers will be necessary to verify that a particular preparer meets those requirements.⁴ Accordingly, the Section of Taxation supports a registration program for tax return preparers who prepare a minimum number of returns for compensation.⁵ For example, registration might be required for any preparer who both prepares at least five tax returns for compensation in a calendar year and receives fees totaling at least \$1,000 per annum for the preparation of tax returns. The purpose of such numerical thresholds is to ensure that registration is targeted where it is needed most – on commercial preparers. While any initial registration thresholds could be revisited over time with experience, it is important that any registration program not burden or interfere with volunteer tax assistance programs, such as VITA, or other non-commercial tax return preparation for low-income taxpayers, relatives, civic groups, etc. (even if the preparer receives a modest payment or expense reimbursement).

The Need for Enforcement of Return Preparer Rules

Despite the existence of preparer penalties in the Code, the limited data available suggests that there continues to be an unacceptably high error rate with returns prepared by paid preparers. Even though implementation of the recommendations above to impose minimum qualification requirements and establish a registration requirement for paid preparers is likely to improve the quality of returns prepared for compensation, a

⁴ Presumably the Service could mandate the use of preparer tax identification numbers (“PTINs”) for this purpose, as has been recommended by the National Taxpayer Advocate.

⁵ Such registration should not be required for professionals who are “non-signing tax return preparers” (as defined in Treas. Reg. § 301.7701-15(b)(2)), as one of the main purposes of registration and use of registration numbers is to better enable the Service to associate a “signing tax return preparer” (as defined in Treas. Reg. § 301.7701-15(b)(1)) with a particular tax return.

strong and continued enforcement program is also critical to ensuring compliance with the return preparer rules.

The Section of Taxation encourages the Service to take the following steps to improve enforcement in this area. First, additional resources should be deployed to evaluate data from returns prepared by paid preparers so that trends can be identified and addressed. In this regard, we note that enforcement of a registration requirement that would require paid preparers to include a registration number on each return they prepare would better facilitate the ability of the Service to ascertain when errors are due to oversight, negligence, or intentional wrongdoing. Over time, the Service might use data collected to develop targeted education to paid preparers regarding recurring errors that are identified.

Second, the scope of “practice before the Service” under Circular 230 should be expanded to specifically include the preparation of returns for compensation (using the same thresholds as suggested above for registration of return preparers), but only for the limited purpose of preparing returns.⁶ It is ironic that Congress “clarified” in 2004 that a tax professional who renders a single written tax opinion to a taxpayer can be subject to regulation under Circular 230 for “practice before the Service” regardless of whether the tax opinion is ever disclosed to the Service, but that a tax return preparer who prepares hundreds of returns that are filed with the Service is not considered to be “practicing before the Service.” Ensuring that all paid preparers are subject to Circular 230 and its

⁶ Note that section 10.7(a)(viii) of Circular 230 already permits limited practice by return preparers to represent a taxpayer before a revenue agent, customer service representative or similar officer or employee of the Service during an examination of a return that they prepared, but does not permit return preparers to otherwise practice before the Service. Beyond expanding the scope of Circular 230 to permit the regulation of return preparation, as set forth herein, we do not advocate any further expansion of the types of practitioners who may practice before the Service in compliance with Circular 230.

ethical requirements would level the playing field and improve the quality of return preparation generally.⁷

These steps can and should be implemented administratively,⁸ and we encourage the Service to work promptly in this regard. We are of course aware that legislation has been introduced in Congress that would mandate changes along the lines recommended herein.⁹ However, we believe that current law provides the Service with ample tools to enforce a registration program. For example, section 6695(c) of the Code authorizes the Service to impose civil penalties for the failure of a preparer to include their identifying number on each return they prepare. Before expanding the scope of that or other penalties, the Service should take steps to ensure that current law is being enforced appropriately.¹⁰

Importantly, we do not believe that it is appropriate to create new penalties or expand existing penalty rules applicable to return preparers at this time. As has been documented in reports from the National Taxpayer Advocate, the Government Accountability Office, and the Treasury Department Inspector General for Tax

⁷ We would encourage the Service to consider whether further revisions to Circular 230 might be appropriate in connection with the recommendations described herein. For example, it may be appropriate to consider a provision setting forth “best practices” for paid return preparers, along the lines of the aspirational best practices for tax advisors set forth in section 10.33 of Circular 230.

⁸ Some modifications to existing regulations may be necessary to fully implement these steps. For example, Treas. Reg. § 301.7701-15(d) presently provides that “a person may be a tax return preparer without regard to educational qualifications and professional status requirements.” Likewise, the definitions of who may “practice before the Service” set forth in Circular 230 would need to be revised in order to ensure that tax return preparers are subject to regulation under Circular 230 going forward.

⁹ We also note that H.R. 3126, which was introduced in the House of Representatives on July 8, 2009, appears to include authority for a new “Consumer Financial Protection Agency” to regulate the provision of tax planning or tax preparation services.

¹⁰ The Section of Taxation recently published a white paper supporting reform of federal civil tax penalties, and encouraging the Service to compile and publish data on the application of penalties, a copy of which is available at: <http://www.abanet.org/tax/pubpolicy/2009/090421statemntciviltaxpenalties.pdf>.

Administration, the Service does not collect sufficient data in order to constructively analyze whether modifications to the penalty rules are necessary to modify behavior.¹¹

Concluding Observations

A well-designed and administered program that (i) establishes minimum qualifications and continuing education requirements for paid preparers, (ii) requires registration of all paid preparers, and (iii) enforces the rules imposed under the Code and Circular 230, will go a long way toward ensuring integrity in the tax system. Such efforts should lead to improvements in the quality of returns prepared for compensation, and thus should reduce the likelihood that such returns will include inadvertent or purposeful errors.

The Section of Taxation recognizes that the recommendations we make today will require dedicated resources, and we also recognize that the Service must carefully allocate its scarce resources among its many responsibilities. While certain aspects of these recommendations could be administered privately and funded with modest user fees, *e.g.*, registration and examinations, other aspects of these recommendations will need to be administered by the Service and its Office of Professional Responsibility, *e.g.*, oversight, examination and discipline.¹² We understand that budget constraints could be cited as a reason not to proceed, but that would be a mistake. It is clear that inaction

¹¹ Another advantage of collecting better data on paid return preparers and errors would be that such data could inform the need for revisions in tax forms, instructions or other publications, as well as due diligence requirements imposed on preparers with respect to the earned income tax credit under section 6695(g) of the Code.

¹² We believe that the present model employed for enrolled agents, under which testing and initial registration is outsourced, but where the Office of Professional Responsibility remains responsible for supervision and discipline, is an appropriate model for preparer regulation as well. Among other things, navigating the strictures of section 6103 of the Code and the inherently governmental functions of law enforcement necessarily dictate that the latter functions not be outsourced.

(which would result in continued erroneous returns and compliance problems for the Service to clean up) is costly, while significant benefits can be obtained by acting to address these problems now (because education and prevention typically costs less than retroactive enforcement). Further, while we believe that some modest user fees might be appropriate to help offset the cost of registration and examinations, it will be important that the costs passed through to return preparers – and thus their clients – not be so high as to establish barriers to entry into the business of return preparation or to dissuade taxpayers from seeking and obtaining competent assistance to prepare their returns.¹³ The American Bar Association has consistently supported adequate funding of the Service to support its missions of taxpayer service and enforcement of federal tax laws, and we will encourage Congress to provide sufficient funding so that the Service and its Office of Professional Responsibility can implement the recommendations we make today without sacrificing other important needs of tax administration.

Finally, the Section of Taxation encourages the Service to use public service announcements, its website, and other publicity to acquaint preparers and the public with the actions it implements to improve the quality of return preparation. For example, the Service could establish a system on its website through which taxpayers could verify whether their preparer is registered under this program. The Service might also use such publicity efforts to remind preparers of their obligations to sign the returns that they prepare and to include their registration numbers on those returns. And of course, the Service and its Office of Professional Responsibility should continue to use publicity of

¹³ In this regard, we understand that the user fees collected by applicants to take the enrolled agent examination largely fund the costs of the contractor that administers the examinations.

enforcement and disciplinary actions, when appropriate, to ensure that taxpayers and preparers understand that wrongful conduct will not go unpunished.

As always, the Section of Taxation appreciates the opportunity to contribute to this important discussion, and we stand ready to work with you on this important matter.