



Consumer Federation of America

Protecting Consumers at Tax Time:

Federal and State Efforts to Address Common Problems
Associated with Paid Tax Preparation

January 2015

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Introduction

More than half of all tax returns are prepared by paid tax preparers. However, only 40 percent of paid tax preparers are subject to mandatory professional standards, raising concerns about the possibility of errors or fraud in the tax preparation process. Testing conducted by the General Accounting Office (GAO) and consumer groups confirm that errors are frequent and result in increased costs or incorrect tax return amounts.

Low-wealth tax payers and those tax payers with complex returns are more likely to turn to a paid tax preparer, but Federal efforts to expand licensing requirements for paid tax preparers that would protect these vulnerable populations have been unsuccessful, leaving states to address licensing requirements individually. To date, four states have enacted laws to regulate paid preparers and ensure that tax preparers meet minimum standards.

The following report summarizes existing research on the prevalence and problems with paid tax preparation and provides an overview of current federal and state legislation and recommendations to ensure that taxpayers, particularly low-wealth taxpayers claiming the Earned Income Tax Credit (EITC), receive the correct refund and are not exposed to fines or penalties resulting from an incorrect return.

Estimates of tax return error rates

Approximately 56 percent of individual tax returns were completed by a paid preparer in tax year 2011. Paid preparers were used more often for more complex tax returns and, in 2011, prepared 59 percent of returns claiming the EITC.¹ But only 40 percent of paid tax preparers—attorneys, Enrolled Agents, and Certified Public Accountants—are required to meet mandatory professional standards nationally.² That means most taxpayers are having their returns prepared by paid preparers that are not subject to licensing or certification.

This lack of oversight may contribute to errors and fraud in the tax preparation process.

In 2014, the GAO sent undercover investigators to 19 randomly selected tax preparer offices.

For these visits, the GAO developed two scenarios. The “Waitress Scenario”, used in ten visits, was a single mother with cash and non-cash tips, eligible for the EITC, with two children (one who lived at home) under 15, and with a deduction for student loan interest. The “Mechanic Scenario”, used in nine visits, had a married couple filing jointly with children aged 7-20 at home, itemized deductions, and non-form W-2 business income. Only two of the 19, or 11 percent, of the returns had the correct refund amount. The mistakes ranged from giving taxpayers \$52 less to \$3,718 more than they were entitled to.³ These errors mean that consumers may receive less than they are

entitled to or more than they are entitled to which they then may have to pay back to the Internal Revenue Service (IRS)—either scenario may create economic hardship for consumers.

Several advocacy groups, in conjunction the National Consumer Law Center (NCLC), have also conducted multiple rounds of mystery shopper tests of tax preparers and found instances of incompetence and even fraud (See Figure 1).⁴



The 2008 mystery shopper tests were conducted by:

- **Community Legal Services in Philadelphia (CLS):** Five tests were conducted in Philadelphia (2 testers had to withdraw). The testers had their returns prepared and obtained refund anticipation loans (RALs) from commercial preparers and then were interviewed by CLS staff who wrote up narratives (or some testers wrote their own).
- **Reinvestment Partners (formerly Community Reinvestment Association of North Carolina):** Eleven tests were conducted in Durham, NC—one tester withdrew because the quality of tax preparation was so low but his experience was discussed in the results. The testers had their returns prepared and obtained RALs from commercial preparers and a consultant developed interview form was used for testers to report their experiences.⁵

While testing originally focused on RALs, other issues including the quality of tax preparation emerged as a result of testing. Four out of 17 of these returns, or 24 percent, contained errors or fraud.⁶

The 2010 mystery shopper tests were undertaken by:

- **Arkansans Against Abusive Payday Lending (AAAPL):** Nine testers were asked to have their returns prepared and take out a RAL from independent preparers and large and small chains.
- **Neighborhood Economic Development Advocacy Project in New York City (NEDAP):** Seven testers were asked to have their returns prepared and note whether disclosures were made by independent preparers and large and small chains.
- **Reinvestment Partners:** Three testers had their returns prepared by Mo' Money Taxes where two testers took out RALs and one obtained a RAC.

As in the 2008 testing, this testing focused on RALs but issues with quality and the encouragement of fraud also emerged.⁷ Six out of 19 testers, or 32 percent, experienced incorrectly prepared returns or fraud.⁸

The 2011 mystery shopper tests were undertaken by:

- **NEDAP:** Four testers were asked to have their returns prepared and note if disclosures were made at Jackson Hewitt and Liberty Tax stores.
- **Reinvestment Partners:** Five testers were asked to secure RALs. Two were able to secure RALs and one obtained a refund anticipation check.

The testers were either interviewed or wrote a narrative of their experiences.⁹ While this was a smaller sample of testers than previous mystery shopper tests, four out of nine testers, or 44 percent, were encouraged to commit fraud or had their return prepared incorrectly.¹⁰

The impact of limited paid tax preparer oversight

There are considerable financial ramifications for taxpayers whose returns are filed improperly or contain exaggerated or fraudulent information. When the IRS detects a false return it is ultimately the taxpayer, not the tax preparer, that is responsible for any additional taxes, interest or penalties.¹¹ Lower income consumers who rely on the EITC tax credit can be particularly impacted as they can lose the credit for ten years if it was claimed but they are later found to be ineligible.¹²

Lack of Quality Control: Approximately 56 percent of individual tax returns were completed by a paid preparer in tax year 2011. Paid preparers were used more often for more complex tax returns and, in 2011, prepared 59 percent of returns claiming the EITC.¹³ This lack of oversight may

contribute to errors and fraud in the tax preparation process as is demonstrated by the several mystery shopper tests above.

Lack of Transparency: The price of preparing a tax return is often only disclosed to a consumer after the work is done. Mystery shopper tests by consumer groups have found fees as high as \$500 as well as unrealistically low estimates for the price or preparers refusing to give an estimate at all.¹⁴

Lack of regulation of refund anticipation instruments

Refund Anticipation Checks: With RALs no longer widely available, the number of refund anticipation checks (RACs) increased from 10 million in 2007 to 18 million in 2010. A RAC provides a temporary deposit account that allows a paid tax preparer to take their fee out of a taxpayer's refund—essentially a product to finance a paid return. Once a refund is in a RAC account, fees for the RAC (between \$30 and \$55 in 2013), the tax preparation itself, and any add on fees tax preparers charge (examples include document processing and e-filing) are taken out of the refund before it is disbursed to the tax payer. This process is no faster than filing electronically and having the IRS direct deposit a refund into a tax payer's account and is an expensive way to finance tax preparation fees.¹⁵ How these instruments are marketed, and how the fees are structured and disclosed should be part of any state or federal policy response.¹⁶

Refund Anticipation Loans: For many years, paid tax preparers offered taxpayers products that let them borrow against their projected tax return. RALs often carried fees that translated into triple digit interest rates. In 2010, however, the IRS announced that it would no longer provide lenders with the Debt Indicator which let banks know whether a taxpayer would receive their refund or if it would be offset to pay outstanding debts.¹⁷ That change, and increased regulatory oversight by the Federal Deposit Insurance Corporation¹⁸ and the Office of the Comptroller of the Currency,¹⁹ resulted in major RAL providers eliminating this high-cost and unnecessary product.

Previous efforts to improve oversight of paid tax preparers

Since, 2002, there have been a number of failed efforts or legislative recommendations to increase oversight of paid tax preparers.

Taxpayer Advocate Service: The National Taxpayer Advocate, since her 2002 Annual Report to Congress, has recommended increased oversight of paid preparers to address errors and misconduct and has recommended registration, testing and certification requirements for federal tax preparers.²⁰ The 2014 National Taxpayer Advocate Annual Report to Congress recommended that Congress “[e]nact a registration, examination, certification, and enforcement program for federal tax return preparers.”²¹

GAO: In 2006 the GAO recommended that the IRS research to what extent paid preparers file accurate and complete returns. In response to this recommendation, the IRS released a report on the quality of tax preparers and recommended increased oversight.²²

IRS: In a 2009 report on paid preparers, the IRS made a series of recommendations for increased oversight of paid preparers including mandatory registration, competency exams and continuing education.²³

Congress: As recently as January 2015 a proposed bill, **S.137**,²⁴ was introduced in the Senate to give the IRS the authority to regulate paid preparers.²⁵ And while none of these bills have become law, The National Taxpayer Advocate, in her 2014 testimony before the Senate’s Committee on Finance,²⁶ and in the 2014 National Taxpayer Advocate Annual Report to Congress²⁷, cited a number of Congressional attempts to regulate income tax return preparers:

- **S.1219**, The Taxpayer Protection and Assistance Act of 2007;²⁸ **H.R. 5716**, The Taxpayer Bill of Rights Act of 2008;²⁹ and **H.R. 5047** The Taxpayer Bill of Rights of 2010, would require testing and continuing education requirements for tax preparers;³⁰
- **S.3215**, the Taxpayer Bill of Rights Act of 2010 would have established two exams (one for individual returns, that would have to cover EITC issues, and the other for business income tax returns) with ethics components, and continuing education requirements;³¹
- **H.R. 6050**, the Taxpayer Bill of Rights Act of 2012³² and **S. 3355**³³ (also the Taxpayer Bill of Rights Act of 2012) would have required the Secretary to regulate tax preparers.
- **S.685**, the Low Income Taxpayer Protection Act of 2003,³⁴ and **H.R. 3983**, the Low Income Taxpayer Protection Act of 2004, would have only required registration of preparers³⁵.

Additionally, during the 108th and 109th Congresses, the Senate Finance Committee approved two proposals:³⁶

- **H.R. 1528**, Tax Administration Good Government Act (Engrossed Amendment Senate **S.882** Tax Administration Good Government Act) would have required tax preparers to pass an initial and recurring examination;³⁷ and
- **S. 1321**, Telephone Excise Tax Repeal Act of 2005 (incorporating **S. 832**, Taxpayer Protection and Assistance Act of 2005) would have required regulations mandating tests, licenses, and penalties for paid preparers.³⁸

Sustained Congressional interest over an eight year period and the approval of two proposals in the Senate is evidence that policymakers recognized the problem with paid preparer quality and the need for regulation—even before the 2010 IRS Tax Return Preparer Initiative.

IRS rule and court intervention

In response to concerns about errors and fraud in the tax preparation process raised by consumer groups, the GAO and others, the IRS launched the Tax Return Preparer Initiative in 2010.

After a review of, and a report on, the tax preparer industry, the IRS began implementing new regulations in 2011 which required:

- **Registration:** All paid tax preparers that prepare all or a substantial portion of a tax return³⁹ would have to have, and file the refund with, a Preparer Tax Identification Number (PTIN).⁴⁰
- **Competency exam for registered tax preparers:** Registered tax preparers that did not already have to meet mandatory professional standards (such as attorneys, Enrolled Agents, and Certified Public Accountants) would have to pass a written exam to demonstrate competency.⁴¹
- **Continuing education:** Registered tax return preparers would have to complete 15 hours of continuing education each year.⁴²

The testing phase began in 2011 and over 84,000 tests were administered with a pass rate of 74 percent. Testing had to cease in January 2013, however, due to an injunction from the U.S. District Court for the District of Columbia in *Loving v. IRS* where three independent tax preparers contended that the regulations exceeded the IRS' statutory authority.⁴³ In a February 2014 decision, the DC court of Appeals upheld the DC District Court's decision that the IRS lacks the

authority to regulate tax return preparers.⁴⁴ With the IRS' decision not to appeal the matter to the Supreme Court⁴⁵ rules mandating oversight of paid preparers are no longer possible without federal legislation.

Limits of a voluntary Federal certification standard

With the U.S. Court of Appeals for the District of Columbia's February 2014 decision that the IRS lacks the authority to regulate tax preparers,⁴⁶ the IRS will offer the voluntary Annual Filing Season Program for the 2015 tax season.⁴⁷ While the IRS urged Congress in 2014 to grant it explicit authority to regulate paid preparers (through a legislative proposal allowing regulation in the President's FY 2015 budget) it has, at the same time, pursued a voluntary standard to address common abuses.⁴⁸

Voluntary Annual Filing Season Program: For the 2015 filing season, preparers with a valid Preparer Tax Identification Number can receive a Record of Completion by completing 11 hours of continuing education from an IRS approved provider. To meet the voluntary standard, preparers must complete a six hour Annual Federal Tax Refresher course that includes three hours of federal tax topics and two hours of ethics and pass a comprehension test (minimum of 100 questions and 70 percent correct answers to pass).⁴⁹ Preparers must also consent to adhere to Subpart B (Duties and Restrictions Relating to Practice Before the Internal Revenue Service) and section 10.51 (Incompetence and disreputable conduct for which a practitioner may be sanctioned)⁵⁰ of Treasury Department Circular No. 230⁵¹. Since the requirements were prorated for the first filing season, 18 hours of continuing education will be necessary to receive a Record of Completion for subsequent years.⁵² Preparers with a Record of Completion will be listed in a public searchable data base that the IRS will implement in January 2015 and will have limited representation rights before the IRS.⁵³

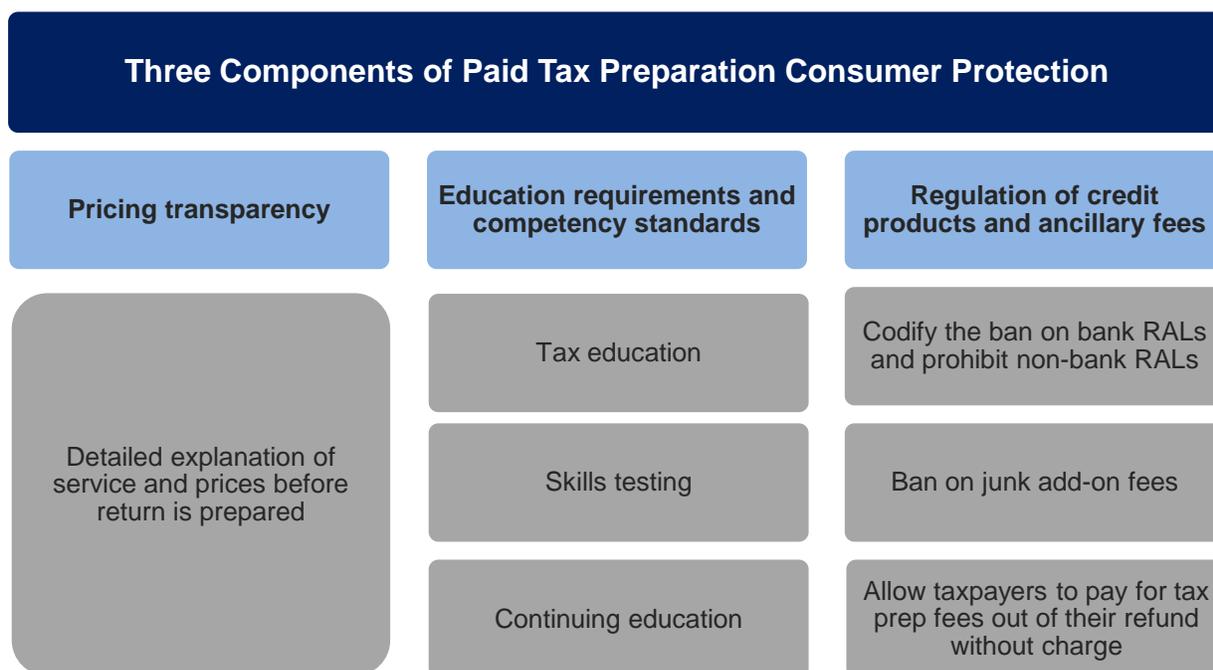
The American Institute of Certified Public Accountants sued the IRS to block the voluntary oversight proposal⁵⁴ but the case was dismissed in October.⁵⁵

A voluntary program is unlikely to reduce errors and fraud in the tax preparation process to the same extent as a mandatory standard, however. While some preparers may enroll in the voluntary program, it is likely that those preparers responsible for the highest rate of problem returns will not enroll.

Components of paid tax preparer reform

As Congress and state legislatures move forward with the oversight of paid tax preparation the following three consumer protection issues should be addressed: price transparency, education requirements and competency standards and the regulation of tax-time financial products such as RALs and RACs (See Figure 2).

Figure 2. Three Components of Paid Tax Preparation Consumer Protections



State efforts to regulate paid tax preparation

To date, four states have passed paid tax preparer reforms and two states have proposed reforms. California, Maryland, New York and Oregon have adopted requirements that paid preparers undergo training, recertify through continuing education courses or pass a skills test (Figure 3). Colorado and Ohio have also considered, but not adopted paid tax preparation pricing transparency requirements (Figure 4).

Figure 3. Four states have adopted paid tax preparation standards

State	Tax-Specific Education or Experience	Continuing Education	Minimum Education	Testing	Tax Payers Using Paid Preparers in TY 2012
California	60 hours of instruction within the previous 18 months. ⁵⁶	20 hours annually, including 15 hours in federal taxation and 5 hours in California taxation. ⁵⁷	No. ⁵⁸	No. ⁵⁹	9.3 million or 63 percent
Maryland	None	16 hours of continuing education activities every 2 years. ⁶⁰ Minimum of 4 hours on MD tax-related subjects. ⁶¹	High school diploma or equivalency exam ⁶²	Yes. ⁶³ (starting in 2014)	1.3 million or 50 percent
New York⁶⁴	If a preparer has less than 3 years experience preparing New York State tax returns a 16 hour basic tax course by the end of first year is required.	4 hours a year. ⁶⁵	High school diploma or equivalency exam. ⁶⁶	Yes. ⁶⁷	5.6 million or 65 percent
Oregon⁶⁸	Tax Preparer (Must be supervised): 80 hours of tax education. Tax Consultant (May prepare returns without supervision): In addition to the 80 hours of tax education, must show at least 1,100 hours during at least 2 of the last 5 years working as a tax preparer.	Must show 30 hours when annually renewing license. ⁶⁹	High school diploma or equivalency exam. ⁷⁰	Yes. Tax Consultants must pass a more stringent examination. ⁷¹	700,000 or 45 percent ⁷²

Figure 4. Recent proposals to improve oversight of paid tax preparers⁷³

State	Description	Pricing Transparency	Education requirements and competency standards	Regulation of credit product and ancillary fees	Current Status
Colorado (2014)	HB 1285 would require paid tax preparers to disclose to consumers qualifications, fees, year round contact information, and the preparer's obligation to sign any returns they prepare. ⁷⁴	Yes	No	No	Defeated by one vote in April 2014
Ohio (2013)	Policy Matters Ohio proposed that tax preparers must display a standardized disclosure box which would list the cost of services for particular tax forms, any fees such as for a RAC or audit protection, and what free refund options such as direct deposit, or paper check, are available. ⁷⁵	Yes	No	No	Not yet introduced

Policy recommendations

- 1) Federal legislation is needed to ensure that the IRS has the authority to issue minimum standards and require certification of paid tax preparers.
- 2) In the absence of Federal legislation to protect consumers, states should adopt legislation requiring pricing transparency, education requirements and competency standards and regulation of tax-related credit products and ancillary fees.

End Notes

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⁵⁷ Business and Professions Code Division 8 Sec. 22255(b). http://leginfo.legislature.ca.gov/faces/codes_displayText.xhtml?lawCode=BPC&division=8.&title=&part=&chapter=14.&article=

⁵⁸ FAQs from one approved education provider indicates that a High School Diploma is helpful but not necessary. <https://www.aboffice.com/Faq.aspx>

⁵⁹ See GAO examination of state laws, noting that while there is no examination requirement, preparers taking a self-study course for qualifying education must pass a final exam to show successful completion. Statement of James R. McTigue, Paid Tax Return Preparers, GAO, April 8, 2014. [http://www.finance.senate.gov/imo/media/doc/GAO%20Testimony%20\(McTigue\).pdf](http://www.finance.senate.gov/imo/media/doc/GAO%20Testimony%20(McTigue).pdf) See also, California Tax Education Council, Approved Education Providers <https://www.ctec.org/Preparer/ApprovedProvider> which notes that self-study courses qualify as continuing education only if they require a final exam.

⁶⁰ Business Occupations and Professions 21-309. <http://mgaleg.maryland.gov/webmga/frmStatutesText.aspx?article=gbo§ion=21-309&ext=html&session=2014RS&tab=subject5>

⁶¹ Code of Maryland Regulations 9.38.02(B). <http://www.dsd.state.md.us/comar/getfile.aspx?file=09.38.02.02.htm>

⁶² Business Occupations and Professions 21-302(d). <http://mgaleg.maryland.gov/webmga/frmStatutesText.aspx?article=gbo§ion=21-302&ext=html&session=2014RS&tab=subject5>

⁶³ Business Occupations and Professions 21-304. <http://mgaleg.maryland.gov/webmga/frmStatutesText.aspx?article=gbo§ion=21-304&ext=html&session=2014RS&tab=subject5> The Board of Individual Tax Preparers will offer a state examination in 2014. The deadline for passing the Maryland Examination has been pushed back to December 31, 2015. Maryland Department of Labor, Licensing and Regulation. <http://dllr.maryland.gov/license/taxprep/taxpreplic.shtml>

⁶⁴ Currently New York only requires registration of tax preparers, but new rules promulgated in November 2013 will phase in the education, continuing education and examination requirements above. Amendments to the Personal Income Tax Regulations and the Procedural Regulations. <http://www.tax.ny.gov/rulemaker/adoptions/procadmin/adoptprocadmin2013.htm#om112513a>

⁶⁵ 2600-2.2 Continuing Professional Education requirements. <http://www.tax.ny.gov/pdf/rulemaking/nov2513/taxpreparer/text.pdf>

⁶⁶ Section 2600-2.1(j) Minimum Age and Education Requirements. <http://www.tax.ny.gov/pdf/rulemaking/nov2513/taxpreparer/text.pdf>

⁶⁷ Section 2600-2.3 Competency examinations. <http://www.tax.ny.gov/pdf/rulemaking/nov2513/taxpreparer/text.pdf>

⁶⁸ ORS 673.625.

⁶⁹ ORS 673.655(1).

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⁷⁰ ORS 673.625(b).

⁷¹ ORS 673.625(3)(b).

⁷² Brookings Institution Interactive EITC Database Tax Year 2012, accessed 7/21/14.

<http://www.brookings.edu/research/interactives/eitc>

⁷³ At least one city, Chicago, has also regulated tax preparers by requiring fee disclosures and drafting a consumer bill of rights that tax preparers must give consumers before rendering any services. Chicago Municipal Code 4-44 Income Tax Preparers.

[http://www.amlegal.com/nxt/gateway.dll/Illinois/chicago_il/municipalcodeofchicago?f=templates\\$fn=default.htm\\$3.0\\$vid=amlegal:chicago_il](http://www.amlegal.com/nxt/gateway.dll/Illinois/chicago_il/municipalcodeofchicago?f=templates$fn=default.htm$3.0$vid=amlegal:chicago_il) See also Chicago Consumer Bill of Rights Tax Preparations Services.

<http://www.cityofchicago.org/content/dam/city/depts/bacp/ordinances/consumerbillofrightstaxpreparerf03192013.pdf>

⁷⁴ CO HB 1285 Taxpayer Protection Act. Disclosures.

http://www.leg.state.co.us/Clitics/CLICS2014A/csl.nsf/fsbillcont3/37EA9E654271D4AF87257C5500668645?Open&file=1285_ren.pdf

⁷⁵ David Rothstein, Improving Tax Preparations with a Model Fee Disclosure Box, Policy Matters Ohio, June 2013.

http://www.policymattersohio.org/wp-content/uploads/2013/06/FeeDisclosure_Jun2013.pdf