

**WRITTEN TESTIMONY
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HOUSE WAYS & MEANS
SUBCOMMITTEE ON OVERSIGHT
HEARING ON
RETURN PREPARER PROGRAM
JULY 28, 2011**

INTRODUCTION AND SUMMARY

Chairman Boustany, Ranking Member Lewis and Members of the Subcommittee, thank you for this opportunity to testify on the Internal Revenue Service's Tax Return Preparer program, one of the most important initiatives that the IRS has undertaken in recent memory.

For decades, most taxpayers prepared their own returns. However, over the past 20-30 years, the reality of tax filing in this country has changed dramatically and today, more than 8 out of 10 taxpayers use a tax preparer or tax software.

However, despite the fact that paying taxes is one of the largest financial transactions that the average American family has each year, there have been no basic competency requirements for tax return preparers. Practically anyone can prepare a federal tax return for any other person for a fee.

Through the Tax Return Preparer Program, the IRS is in the process of ensuring a basic competency level for tax return preparers and focusing our enforcement efforts on rooting out unscrupulous preparers.

To date, we have registered over 717,000 return preparers and next year will start requiring a competency test and annual continuing education for many preparers who are not a CPA, attorney or enrolled agent.

The goal is to ensure that taxpayers receive top quality service from this important industry, which is a key ally in the IRS' efforts to boost overall service and compliance. We want to help taxpayers file accurate returns from the start, thereby avoiding potentially time-consuming and costly problems further along in the tax filing process.

BACKGROUND

The role of third party assistance in tax return preparation in the United States has become increasingly important, particularly in light of growing tax law complexity and growing taxpayer confusion over how to comply with the tax code and meet their

responsibilities. With the increasing complexity of the tax laws, this trend will only continue.

For 2007 and 2008, more than 80 percent of all federal individual income tax returns were prepared by paid tax return preparers or by taxpayers using consumer tax preparation software.

It was in recognition of this tectonic change in our tax system that the IRS' 2009-2013 Strategic Plan emphasized the need to ensure that all tax practitioners, tax preparers, and other third parties in the tax system adhere to professional standards and follow the law.

The plan included three strategies related to this objective: (1) develop and implement a coordinated preparer plan across the IRS and the preparer community; (2) administer a fair, diligent, and effective system of sanctions and penalties for those who fail to follow the law; and (3) leverage research to identify fraudulent return preparers and other areas of abuse and noncompliance by return preparers.

QUALIFIED RETURN PREPARERS: AN IMPORTANT ALLY

There are a number of positives in the growing trend of taxpayers using qualified tax return preparers. One of the most important is that qualified return preparers can help taxpayers file accurate and timely returns from the start.

Working with the taxpayer, they can prevent inadvertent errors which can save both taxpayers and the IRS precious time and resources and keep taxpayers' interactions with the IRS to a minimum.

There are other tangible benefits. In a world of greater complexity qualified tax return preparers can assist taxpayers in understanding complex requirements and thereby increase compliance. They can also explain taxpayer rights and responsibilities.

Indeed, the IRS sees the professional return preparer community as a strong ally in our efforts to boost overall service and compliance.

INCONSISTENT OVERSIGHT

As noted in the introduction, an individual's or family's return filing is often one of their biggest financial transactions in any given year. However, many preparers do not have to meet any professionally-mandated competency requirements; any person can prepare a federal tax return for any other person for a fee.

It might surprise taxpayers to learn that the level of oversight of paid return preparers varies widely. There is little oversight of paid tax return preparers who are not attorneys, enrolled agents, and certified public accountants.

The Government Accountability Office (GAO), the Treasury Inspector General for Tax Administration (TIGTA) and our own research suggest that our tax system and a large number of taxpayers may be poorly served by some return preparers who engage in fraud.

Within this context it is important to note that it is the taxpayer who is legally responsible for penalties and interest if their return is not accurately prepared, or they claim deductions or tax credits, including refundable tax credits, to which they are not entitled.

TAX RETURN PREPARER REVIEW

Given the critical mass of issues building around paid tax return preparers, the IRS launched its review of the return preparer industry in June of 2009 with the hope of meeting two of the IRS' most important goals, while reflecting the Agency's commitment to working smarter.

First, the IRS wanted to strengthen its partnerships with tax practitioners, tax return preparers, and other third parties to ensure effective tax administration. Second, it wanted to ensure all preparers have a minimal level of competency and adhere to professional standards with an overarching objective of better service to taxpayers and increased compliance.

The IRS conducted three public forums to capture the views and recommendations of not only the return preparer community but all affected stakeholders and interested parties.

FINDINGS AND RECOMMENDATIONS

In January 2010, the IRS published the results of its six-month study (Publication 4832) and announced the return preparer initiative representing a monumental shift in the way the IRS will oversee paid tax return preparers. This new initiative provided for registration, competency testing and continuing education for paid tax return preparers. The new initiative also places all registered tax return preparers under the ethical umbrella of Circular 230 and gives the IRS disciplinary tools to address preparer misconduct.

The overarching goals are to significantly enhance protections and service for taxpayers; increase confidence in the tax system; and provide for greater compliance with tax laws.

For example, the Tax Return Preparer Initiative is expected to reduce Earned Income Tax Credit (EITC) fraud and error, as approximately 66 percent of EITC returns are prepared by paid tax return preparers.

Based on the results of the Return Preparer Review, the IRS recommended a number of steps that it plans to implement, including:

- Requiring all paid tax return preparers to register with the IRS and obtain a preparer tax identification number (PTIN). These preparers will be subject to a tax compliance check to ensure they have filed all required federal personal, employment and business tax returns and that the tax due on those returns has been paid.
- Requiring competency tests for all paid tax return preparers except attorneys, certified public accountants (CPAs), and enrolled agents who are active and in good standing with their respective licensing agencies.
- Requiring ongoing continuing professional education for all paid tax return preparers who are subject to competency testing.
- Extending the ethical rules found in Treasury Department Circular 230 to all paid preparers. This expansion will allow the IRS to suspend or otherwise discipline tax return preparers who engage in unethical or disreputable conduct.

STAGED IMPLEMENTATION PROCESS

The return preparer initiative has been undergoing a staged implementation process. We have worked with outside stakeholders on each step of the implementation process and have taken steps to minimize burden when possible. In September 2010, the IRS launched Phase 1 by issuing regulations requiring paid tax return preparers to register with the IRS to obtain a Preparer Tax Identification Number, or PTIN. PTINs are required for all individuals who are paid to prepare all or substantially all of a federal tax return or claim for refund.

Although PTINs have been available since 1998, they were optional. As part of the new registration process, PTINs are now mandatory for all paid tax return preparers and all preparers are required to apply for a PTIN under the new system, including those preparers who already possessed a PTIN.

A new online application system was set up for this process with a special toll-free telephone number for tax professionals needing assistance with the system. We developed an outreach plan that provided reminder notices to about one million tax return preparers that they must renew their Preparer Tax Identification Numbers if they are still paid preparers.

To date, over 717,000 PTINs have been issued, with 95 percent of the applications processed online. By issuing PTINs, the IRS not only receives information about the size of the tax preparer community, but also the mix of CPAs, enrolled agents and others in this practitioner universe. One data point rises to the top: 62 percent of PTIN holders are not attorneys, certified public accountants, or enrolled agents

AN IMPORTANT LINE OF SIGHT

More than an identification number, the PTIN registration process gives the IRS an important and better line of sight into the return preparer community than we have ever had before. We can leverage that information to help better analyze trends, spot anomalies and potentially detect fraud.

The PTIN process will also help the IRS build, in several years, a publicly-accessible database of those registered. This is an extremely important tool for consumers as they will be able to search the database to ensure that their preparer is registered. The database will confirm for the public which return preparers are properly registered with the IRS

PHASE TWO

The next phase of the return preparer initiative involves tailored requirements for different subsets of paid return preparers. For example, CPAs, attorneys, and enrolled agents must only renew their PTIN annually; there are no other requirements. They are exempt from competency testing and continuing education requirements because of similar professional standards already applicable to these groups.

The IRS also refined its rules and provided greater flexibility for people who work in a professional firm, such as an accounting or law firm, and prepare returns under the supervision of an accountant, enrolled agent or lawyer. These supervised preparers and other non-1040 preparers – who do not prepare any Form 1040 series returns – must renew their PTIN and satisfy the compliance and background checks. They too are exempt from competency testing and continuing education requirements.

All other paid return preparers must: (1) renew their PTIN annually; (2) satisfy the compliance and background checks; (3) pass a competency test; and (4) take continuing education courses annually. Those who meet these requirements will be designated as “Registered Tax Return Preparers”.

We estimate that background checks will begin in October 2011. We also estimate an October 2011 start date for competency testing. The test is only for those who prepare Form 1040 series returns (and who are not otherwise exempt).

The IRS recognizes there has been some discussion in the tax return preparer community about whether there is a need to extend the testing requirement to other types of returns. With 140 million individual income taxpayers filing Form 1040 and 60 percent using a preparer, our focus will be on dealing first and foremost with that group of preparers and returns.

As the roll out of the new requirements for paid tax return preparers is being phased in, for the 2011 filing season, the IRS issued “provisional” PTINs. The PTIN is provisional because these PTIN holders must satisfy additional obligations such as testing or fingerprinting. Provisional PTIN holders will have until the end of 2013 to meet these additional requirements.

Those who are required to take the competency test will also have a new annual education requirement beginning in 2012. The 15 hours of continuing education includes three hours of federal tax law updates, two hours of ethics and ten hours of federal tax law.

BUILDING A COMPREHENSIVE COMPLIANCE STRATEGY

Mr. Chairman, let me turn to compliance. We must also have a comprehensive compliance and enforcement strategy. We want return preparers to be competent and ethical in order to prepare the most accurate returns possible, and we also owe it to compliant tax preparers to make sure that everyone is on a level playing field.

To this end, the IRS sent out more than 10,000 letters to tax return preparers nationwide to remind them of their obligation to prepare accurate tax returns on behalf of their clients. These letters were sent to paid preparers who completed tax returns in which the IRS identified common errors. The letter included an enclosure that reminded tax return preparers of their responsibility to prepare accurate returns and the consequences of filing incorrect returns.

During the 2011 filing season, IRS representatives also visited approximately 2,500 tax return preparers who received these letters to further discuss their responsibilities as a return preparer and to verify their compliance with existing requirements.

The IRS continues to develop and enhance various internal filtering tools to detect egregious behavior and inaccurate return preparation. These tools will enable the IRS to look at all individual return information and extract unique characteristics, identifying likely questionable issues with a return preparer.

As previously noted, we are developing a comprehensive database to house all preparer information, with the goal of detecting unscrupulous return preparers and intervening early. This central database will enable the IRS to track preparers who try to avoid detection by changing locations and customers. The IRS is also designing a referral system to investigate and timely address taxpayer and stakeholder complaints surrounding return preparers. We are also developing an identification system for preparers who are being compensated to prepare returns, but who are not properly identifying themselves. These “ghost preparers” do not enter their name or PTIN on the returns they prepare.

Specifically regarding PTIN compliance, we performed an analysis after the recent filing season and identified over 100,000 instances of what appeared to be preparers who

entered an expired PTIN or their SSN on a return – which is no longer allowable. On July 7, we sent letters to these individuals advising them to obtain and begin using PTINs in the future if they are paid tax return preparers.

Components of our strategy also include: reviewing the personal tax compliance of return preparers; visiting preparers; reviewing a sampling of a preparer’s client returns where misconduct is suspected; and “e-file visits” where a revenue agent stops by and reviews whether a preparer is following all e-file rules.

These initial efforts are aimed at improving both the way in which IRS identifies problematic preparers and the methods used to bring them into compliance.

MEASURING PERFORMANCE

Measuring performance is a key component for any program, and the IRS must monitor how the new return preparer initiative is adding value to tax administration. We are developing long-term strategic measures that will enable the Service to assess the effect of the program. We are working to establish a baseline for measures in 2012 and to develop a more customized means to measure the tax administration impacts of the preparer program over the next two to three years.

Developing a comprehensive model for measuring the program's overall effect on compliance, in both the long and short term, is essential to determining future changes and improvements to the program, the processes and the underlying policies.

PROTECTING TAXPAYERS

Mr. Chairman, the return preparer initiative is already producing meaningful results that benefit both taxpayers and protect the integrity of our tax system. For example, the IRS is taking steps to stop tax preparers with criminal tax convictions from preparing tax returns.

By comparing the new PTINs with a database managed by the IRS’ Office of Professional Responsibility, the IRS was able to identify 19 tax preparers who applied for PTINs and either failed to disclose a criminal tax conviction or were permanently enjoined from preparing tax returns. The IRS sent letters to all 19 individuals proposing revocation of their PTINs.

As mentioned earlier, some preparers attempt to elude the new oversight program by not signing returns they prepare. In an effort to deal with these “ghost preparers,” the IRS is developing a strategy to educate taxpayers whose returns appear to have been prepared by a third party, but without a name or PTIN entered, to ensure that they are aware that all paid federal tax return preparers are required to sign and include PTINs on returns that they prepare for compensation.

The Return Preparer Office is also engaged in initial planning for the public database and a general public outreach campaign. As previously mentioned, the database will give the taxpaying public a resource to ensure their preparer is legitimately registered with the IRS or, for those taxpayers searching for a preparer, a tool to find an authorized person in their geographic area. We anticipate the database and outreach campaign will launch in 2013 around the deadline for testing and fingerprinting.

CONCLUSION

The return preparer initiative is one of the most important initiatives and defining actions that the IRS has taken in recent years. It strengthens partnerships with tax practitioners who are already regulated and tested, while ensuring that all return preparers are serving the American people well. As Commissioner Shulman has observed, this is a “point of leverage” where the IRS can maximize the use of our resources, while tapping into the experience, specialized knowledge, infrastructure, technology and activities of other players in the tax system and making them an integral part of our service and compliance strategies.