Statement of Janet Spragens  
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Panel 4:  
Tax Practitioners and Professional Responsibility  
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Madame Chair and Members of the Board:  

Thank you for inviting me to testify today on issues and challenges facing the IRS involving tax practitioners and professional responsibility. As you know, I am a tax professor at the American University, Washington College of Law, and the Director of the American University Federal Tax Clinic. Our Clinic, which is staffed by 10 third year student-attorneys each semester, assists income qualified taxpayers on a pro bono basis who have controversies with the Internal Revenue Service. Although the student attorneys, as part of their course requirements, each contribute 20 hours of work to VITA (Volunteer Income Tax Assistance) during the filing season, the focus of the Clinic is post-filing assistance for our clients: that is, assistance with audits, litigation, and collections. Since the inception of our program in 1990, the American University Federal Tax Clinic has assisted over 1100 taxpayers with tax related matters. We have also been recipients of IRS Low Income Taxpayer Clinic grants every year since that program began in 1998.

In my testimony today, I would like to discuss return preparer issues that arise in connection with low income taxpayers, but I would also like to take the opportunity you have given me, of testifying before the Board today, to highlight some other current enforcement issues as well that I believe are related to the issue of return preparation and should be of concern to the Board.

The Role of the Tax Clinics

The American University Federal Tax Clinic is one of 140 IRS funded LITCs in the country. Together the clinics work to insure that fair resolutions are reached in all tax controversies with the IRS, not just for those involving wealthy or represented taxpayers. The Clinics are also helping to insure that low income taxpayers’ cases are adequately prepared and presented in both administrative and judicial arenas. Experience has shown that a Clinic’s
presence in a case assists rather than impedes timely resolution of the matter. The Tax Court’s processes as well have been enhanced by the presence of Clinic attorneys helping pro bono litigants. The Tax Court now regularly sends to unrepresented taxpayers on its docket notices of available clinic help in the taxpayer’s geographical area.

The Clinics are also safeguarding and representing low income taxpayers’ issues in legislative and policy debates. Tax clinic attorneys have been asked to testify before Congress as well as this Board on low income taxpayers issues. Clinic attorneys have submitted written comments to and testified before the IRS on administrative matters. And they have had a material impact on bringing the problems and concerns of low income taxpayers to the attention of policy makers and the rest of the tax profession. Since the clinics have been in existence Congress has written numerous provisions that focus on low income taxpayers. Clinic attorneys regularly participate in providing information and feedback in these processes and improving the resulting legislation.

The Tax Clinics are proud of the record of professional conduct and assistance we have built. The clinics’ contributions are respected by the IRS, the ABA Tax Section, the Congress, and the Courts who all understand the importance of tax justice at all income levels, and the Clinics’ contributions toward that goal. We welcome any scrutiny or questions from the Board as to what we are doing and the value added we believe we bring to the tax system.

**The Role of Tax Preparers**

Despite the post-filing nature of the Clinics’ work, or perhaps because of it, Clinic attorneys have a special prism through which they can observe and evaluate the work of the preparer community. As you may know, a startling 70% of EITC returns are prepared returns, and another 10% or more are likely prepared on a fee basis but are unsigned. Despite the cost of tax return preparation, low income taxpayers rely heavily on preparers to help them discharge their filing burdens, largely because they feel incapable of doing so on their own. The Clinics have seen firsthand the work of many incompetent or unscrupulous storefront preparers who prey on low income taxpayers, give them poor tax assistance and charge them high fees for tax preparation and other “products.” On the other hand, it is obvious to us that without a preparer community that serves this income demographic, many of these taxpayers would be nonfilers. Even if they could file their own returns, many would not take advantage of the various credits, deductions and other tax benefits Congress intended for them and which are brought to their attention through the tax preparation community. Tax preparers also play an important “intermediary” role in the system by answering substantive questions for their clients about the tax system; helping them file electronically (thereby speeding up their refunds); and advising them of their recordkeeping and other responsibilities under the system. So if the question is whether tax preparers are “part of the problem” or “part of the solution” the answer, I believe, has to be “both.”

Under the current system, tax preparers who serve the low income taxpayer community
are subject to no effective regulation or professional standards. There are no credentialing requirements, no minimum or continuing educational requirements, no registration procedures, and no professional disciplinary bodies to whom they must answer. Anyone can put up a sign as a “tax preparer”, and over the last several years, we have seen car dealers, furniture salesmen, and other so-called “storefront” preparers filling out large numbers of tax returns for poor people and using their refunds as downpayments on retail transactions. Low income taxpayers, with little knowledge of the law themselves, are not well suited to evaluate the qualification of these preparers and assess their professional competency. These preparers often make mistakes, overclaim transactions in reliance on the audit lottery, or engage in out-and-out fraud to enhance the size of the taxpayer’s refund (and their fee). When these errors on the return are caught, it is the taxpayer who is the one left holding the bag in terms of money due, time and stress expended, and potential loss of benefits in future years (See section 32(k) of the Internal Revenue Code).

In contrast to this unregulated “Wild West” economic arena that characterizes the low income tax preparation industry, tax professionals serving high income taxpayers and corporations are subject to extensive professional regulation and educational requirements – by state bar associations and other licensing associations, by Circular 230, by Sarbanes-Oxley, by Tax Court examination, and so forth. Yet these rules and disciplinary institutions have not eliminated abusive behavior and overreaching transactions orchestrated by this professional group. The problem would thus appear to be not the presence of rules but their enforcement. It is further noteworthy that currently both civil and criminal preparer penalties exist in the Internal Revenue Code and apply to all preparers but they are rarely enforced.

Significantly, within the last few weeks, the IRS announced the appointment of a prominent Washington DC attorney, Cono Namorato, as the new Director of Practice of the Office of Professional Responsibility. Mr Namorato is charged with closely monitoring the ethical conduct of professionals practicing before the IRS in connection with abusive shelters and other tax schemes. This is a welcome development.

With respect to tax preparers that serve the low income taxpayer community, in her FY 2002 Annual Report to the Congress, the National Taxpayer Advocate recommended that any unenrolled tax preparer who charges a fee for his or her services, and who prepares more than five federal tax returns per year, be required to register with the IRS and to meet minimum standards of competency, as determined by an annual examination testing technical knowledge. Once the preparer had passed the requisite examination, the IRS would certify them as a Federal Tax Return Preparer (using a Tier system). The IRS would regularly publish a list of such registered and certified preparers, as well as those preparers whose registration had been revoked. The Advocate further recommended a public education campaign to make the public aware of the certification system and to alert taxpayers to use only certified preparers.

I applaud the Advocate’s office for circulating this very thoughtful proposal, and for putting the issue of regulation of tax preparers in the public arena for debate. I also applaud her attempts to strengthen the professionalism of those who prepare tax returns for the nation’s
poorest citizens. Obviously the best assistance for low income taxpayers is at the earliest stages, when the return is prepared and filed. Qualified assistance at this stage can materially reduce the post-filing enforcement work of the Service and the Clinics; as well as avoid the stressful experiences and expense low income taxpayers are put through the tax controversy process.

The Advocate’s recommendations have much to recommend them, and they provide an important jumping off point for discussion of the issue. In my testimony today, I would like simply to offer a few observations as the debate over preparer regulation progresses:

1. Although it is clear that the oversight problems of regulating and insuring high professional standards among high income and low income tax professionals are not necessarily the same, it seems apparent that with respect to both, mere enactment of written standards of ethical behavior – or even the creation of minimum educational standards – will not alone solve the problems of unprofessional conduct. As noted earlier, based on experience with tax professionals who serve high income individual and corporate taxpayers, it seems clear that what is needed is not only the promulgation of ethical rules and standards of minimum competency, but also rigorous enforcement of those rules. There is undoubtedly a connection between the well publicized audit holiday given many high income taxpayers in the last few years, and the amount of overreaching and excesses on returns filed by those taxpayers – which return positions were in many cases suggested by and then also approved by different members of the professional community.

IRS enforcement resources are not unlimited. In respect of regulation proposals for low income tax preparers, unless the IRS is prepared to put extensive resources behind monitoring the practices of those tax preparers, as well as enforcing preparer penalties that are already on the books against them, it is not obvious how effective any preparer regulation proposal can be, no matter how well thought out.

2. The Advocate recommends not only certification, but also registration of tax preparers, presumably by assigning them some sort of identification number. Assumedly, this registration number would then be included, together with the preparer’s signature, on the tax returns that are filed with the IRS. It is unclear to me whether, under the Proposal, a preparer could be registered even if not certified, or whether the registration number is simply evidence that the tax preparer has met all qualifications and is certified.

If registration is a separate process, it could make the job of tracking tax returns prepared by registered preparers easier. Thus, once a return with significant errors that was prepared by a certain preparer has been identified, a registration number could lead the Service to other returns from the same preparer, perhaps with an eye to targeting erroneous returns, criminal prosecution of the preparer, and/or simply putting the preparer out of business. What is unclear, however, is whether the Service currently has the means of tracking the same information through other databases, for example, using the preparer’s name and address. If so, registration may lead to an unnecessary bureaucratic nightmare as preparers float in and out of the system each year, require numbers within short periods of time to enable them to prepare returns during the filing season,
and absorb resources of the Service in assigning, revoking, retiring, and keeping track of registration numbers that may be shared, borrowed, transferred, misstated, or lost.

If on the other hand a registration number is simply evidence that a tax preparer has been certified, and it is given out only at that point in the process, other issues are presented in addition to the above:

Annual examination and certification of low income tax preparers is a complicated issue. A first set of considerations is, of course, the cost and logistical demands of implementation. Tax preparation is a seasonal business, and storefront preparers typically do not stay in it for a career. Because so many people drift in and out of the business each year, the number of examinations, grading, and the certification process – in time for the filing season – seems exceedingly difficult to organize from a logistical standpoint. It is arguable that the benefit of having competent preparers, however, who have a minimum level of technical knowledge, would justify these costs and logistical challenges, and that is a fair position to take.

Certification, however, also raises another, potentially more serious problem, and that is that the certification process under the Advocate’s Proposal only deals with the issue of incompetent preparers, not unscrupulous ones who may nonetheless have education and technical proficiency in tax matters. Thus, testing low income tax preparers for technical knowledge would not deal with the issue of reining in fraudulent or unethical preparers who prepare overreaching or fraudulent returns. Indeed, such tests and certification procedures could well cause unsuspecting taxpayers to rely more confidently on a fraudulent preparer, since he or she had been “IRS certified.” It may or may not be impossible to require minimum training and educational standards without going so far as actual certification of the preparer. That option should be considered.

3. Neither registration nor certification addresses the very important problem of the paid preparer who does not sign the tax return. Indeed, this problem may become even more acute under a registration/certification program, as preparers who are denied these seals of approval go “underground.” This issue might well be addressed through a strong public education campaign (see paragraph 4, below).

4. Among The Advocate’s recommendations is a proposal for a public education campaign, and that is my favorite of her recommendations. Two years ago the ABA Section of Taxation published on its website a very helpful “10 Tips for Filing Your Return with a Tax Preparer”, which I helped write. I am attaching a copy of the “Tips” to this testimony, and believe that a comprehensive public education campaign based around the “Tips” (both in English and Spanish) – or perhaps even attaching a copy of the “Tips” to the 1040 instruction booklet – might offer an alternate approach to dealing with bad preparers. I recommend further study of the benefits and costs of direct appeals to and education of the public at large.

**EITC Pre-Certification and Tax Preparers**
In March, 2003, the IRS announced a forthcoming pre-certification plan which would require taxpayers claiming the earned income tax credit to send in documentation in advance of filing the tax return, which shows compliance with the residence requirement of the credit. Although currently being implemented only in a pilot format, when totally rolled out, the program will require 4 million low income taxpayers to “pre-certify” for the credit during the summer and fall months before the filing season.

Together with two Clinic colleagues, I have elsewhere submitted Comments to the IRS questioning (1) whether pre-certification will have an unacceptable chilling effect on participation rates in the credit by eligible taxpayers; (2) whether it reduce the rate of credit overclaims; and (3) whether it violates fundamental principles of vertical equity since no other pre-certification requirement exists for any other tax benefit in the Internal Revenue Code, no matter how high the misclaim rate with respect to that benefit or how much projected income is lost to the system through such erroneous claims. The Comments also raise questions whether the IRS, without any legislative or regulatory authority, has the ability to deny a tax benefit before it is even claimed on a tax return, and once it is denied, how the taxpayer can appeal the denial without a statutory notice of deficiency.

Whatever the outcome of the pre-certification debate, however, what appears certain is that taxpayers subject to the pre-certification requirement will want to turn to the preparer community for help. This raises several issues. First is the reality that to the extent the taxpayers obtain help from tax preparers, they will have to pay yet another additional professional fee to obtain the benefit of the credit, not counting the costs involved in obtaining the required documentation and/or time lost at work in doing so. The benefit of the credit will thus be that much more eroded. An equally significant issue, however, is whether the assistance will even be available, since, as noted above, tax preparation is a seasonal business and not generally available outside the filing season when the pre-certification forms will be due.

To the extent pre-certification is deemed “controversy assistance” and not “tax preparation” assistance, (and a reasonable case can be made for this) the 140 Tax Clinics across the country will no doubt try to help out in getting taxpayers pre-certified. But with 4 million taxpayers ultimately subject to pre-certification, the numbers will quickly overwhelm the capacity of the clinics.

Before the full pre-certification program is implemented, the Service needs to work with the institutional tax preparation services to accommodate the extra burdens it is putting on low income taxpayers and insure that when taxpayers seek out professional help in meeting their pre-certification burdens, that help will be available.

Remote Audits

As I testified to this Board last year, the transfer of IRS audit and collections functions to
centralized, remote locations, which has occurred under IRS Modernization, has intensified the
difficulties low income taxpayers have in navigating the tax controversy system and justifying
their return positions to the Service. Low income taxpayers do not have computers, email,
copiers and fax machines. They do not have funds for long distance telephone and fax
communications, or certified or Fed-Ex mail expenses. These taxpayers are not part of the sleek
electronic information age envisioned by the reorganization’s authors.

Moreover, many low income issues, such as the earned income tax credit, head of
household filing status, dependency exemptions, and child credits involve family status issues,
not always easily proved by documents. These issues are best resolved by taxpayers being able
to talk to an IRS agent in a face-to-face communication, answer questions, and describe often
complicated multi-generational or other living arrangements.

As I have previously testified to this Board, the story of low income taxpayers’ interface
with the tax controversy system is, under Modernization, one of deciphering gateway phone tree
options, waiting for long periods on hold, speaking to individuals looking at computer screens
rather than paper files, and receiving hard-to-understand form letters with faceless names and
phone numbers. The reorganizations’s virtual elimination of walk in offices, centralization of
functions, and use of computer screens (often times inaccurate or incomplete) as a basis for
administrative controversy resolution, has been an extreme burden for these taxpayers, many of
whom have no doubt conceded their cases and paid large amounts of money because of their
inability to master the system.

If these procedures are difficult for ordinary low income taxpayers, they are particularly
acute for the growing number of low income taxpayers who are ESL (English as a Second
Language). For these taxpayers, having to communicate even by telephone is immeasurably
more difficult than participating in a face-to-face meeting, perhaps accompanied by a son or
daughter or friend who is more fluent in English.

In prior testimony to this Board, I have asked the Members to investigate whether rank
and file taxpayers (particularly non-English speakers) who have controversies with the IRS are
being adequately served under “Modernization”. I renew that request today.

**Single Year Deficiency Notices**

Relevant to the issue of remote audits is the Service’s practice in recent years of issuing
single year notices of deficiency with no one individual having responsibility for a particular
taxpayer. The problems of this system are best illustrated by example.

Last semester, a client came to the American University Tax Clinic with a statutory
notice for the 2000 year. The issues being challenged were the earned income tax credit, head of
household filing status, dependency exemptions and the dependent care credit. After significant
work, the student-attorney was able to resolve the issue in taxpayer’s favor with a 100%
concession by the IRS. In the case, the taxpayer was a cab driver with 4 children. The mother of his children, whom he had divorced several years earlier, was a drug addict with a history of schizophrenia. The taxpayer had received custody of his children in the divorce, and although he received some public assistance, badly need the EITC refund. He was therefore thrilled when the student-attorney informed him of the IRS concession. However, it soon became clear that another roadblock stood in the way of the taxpayer’s receiving the money. Sometime before he came to the Clinic, the taxpayer had gotten a similar statutory notice for the year 1999, which he had ignored, even though the facts were the same as in 2000 and he was entitled to the 1999 refund. On the IRS books, the 1999 year stood as an unpaid deficiency, to which the 2000 year refund would be applied. The student-attorney is now seeking audit reconsideration for the 1999 year with a different IRS office. However, in addition to these two years, in the middle of our representation, the taxpayer brought in another letter from the Service – an audit notice for the year 2001 asserting the same issues. The 2001 year is being handled out of Sacramento by still another office and individual who has never been involved in the earlier years.

This story is not an uncommon one – we see it in different variations several times each semester. The root problem is that each tax year is treated as an independent matter, and so the taxpayer has the problem of continually bringing or mailing the same documentation to different offices who do not (apparently) relate to each other or share information. Many, many low income taxpayers are not capable of discharging these burdens, dealing with multiple offices simultaneously, and reaching correct resolutions in their cases in multiple years.

I have testified about this issue before, and again renew my request to this Board to investigate this matter further.

Conclusion

Low income taxpayers are an important segment of the tax paying public, and their issues are taking up much of the enforcement resources of the IRS today. It is important that their needs and concerns be given the same consideration as those of other taxpayers in the system. I appreciate the opportunity to testify before the Board today about these matters.
ABA TIPS FOR FILING YOUR RETURN WITH A TAX PREPARER

- **Pick a preparer who is honest and reputable.**

  Before you agree to let someone prepare your return for you, ask them some preliminary questions, such as: How long have they been preparing returns? How many returns have they prepared? Have they received any training courses in tax law? How many and when? And, will they be available to answer questions if the return is audited? You may also want to consider calling the Better Business Bureau to find out if any complaints have been lodged against the preparer.

- **Bring all your financial documents with you when you meet with the preparer.**

  Although this is not a complete list, these should include:
  - the tax package you received in the mail from IRS (if you received one);
  - your W-2 form that shows your income and taxes withheld;
  - any other forms (such as 1099s) that you’ve received at year end from banks or other institutions or individuals with whom you have had financial dealings during the year;
  - Social Security numbers of yourself, your spouse, and your dependents (If possible, bring the social security cards themselves, to avoid errors in transcription);
  - statements or receipts for tax related payments, such as mortgage interest payments, real estate tax payments, charitable gifts, entertainment expenses, and/or business related car expenses;
  - cancelled checks for tax deductible payments, such as for medical expenses, child care services, charitable gifts, business related moving expenses, and business travel;
  - a copy of your tax return for last year;
  - anything else you think you might need.

- **Discuss fees before you start.**

  Generally, fees are based on the complexity of the return. The more complicated the tax return, the higher the fee. **In no event, however, should the fee be based on the amount of the refund you expect to receive.** Ask the preparer whether there are any extra or optional fees, such as for Refund Anticipation Loans (RALs), follow-up submissions to the IRS, etc. Consider carefully whether you need these extra services.

- **Review your return for accuracy.**
Do not assume that your return is accurate just because it is professionally prepared. Before you sign it, read it over (including all schedules and attachments) and make sure everything on it is correct. If you are unsure about any part of your return, ask your preparer before filing it. Remember that you are signing the return under penalty of perjury, and that if there is a mistake, you, not your preparer, will be liable for the deficiency, interest, and penalties.

- **Sign and date your return before filing it. If it is a joint return, both spouses must sign.**
  
  An unsigned return will be returned, and your refund may be delayed. **Note:** If you use an electronic signature or PIN number, it is not necessary to have a paper signature.

- **Make sure the preparer signs and dates the return, and gives you a copy to take with you.**
  
  The law requires that a paid preparer must sign the tax return. If the preparer is reluctant to sign the return, take that as a warning. Keep the return and your supporting financial records in a safe place for at least 3 years.

- **Ask whether you should expect a refund and what the timetable might be.**
  
  Times for refunds to be issued vary. Ask about e-filing your return. An e-filed return will be rejected by the IRS computer if there are certain errors on it (such as erroneous Social Security numbers). Immediate correction of such errors can speed up your refund, and significantly reduce the likelihood of a future IRS contact.
  
  Remember, a refund anticipation loan is not a refund from the IRS, but rather a loan from the preparer that includes a fee and interest.

- **Even if you cannot pay the tax shown on the return, you must still file for the year.**
  
  In addition to late payment penalties, there are also penalties for late filing, which you can avoid if your return is timely filed. Ask your preparer about the rules for requesting an installment payment agreement with the IRS. He or she can help you file Form 9465.
- **Free tax preparation services are available nationwide.**

The IRS has free programs to help taxpayers file, including walk-in sites at IRS offices. Low-income taxpayers can receive tax preparation assistance from VITA (Volunteer Income Tax Assistance) programs at public libraries, and TCE (Tax Counseling for the Elderly) sites administered by the American Association of Retired Persons (AARP.) To find the location of the VITA and/or TCE site in your community, call toll-free (800) TAX-1040, or contact the IRS Taxpayer Education Coordinator at your local IRS office. The AARP also can direct you to the nearest TCE/Tax-Aide site by calling 1-888-227-7669.

- **Notify the IRS immediately of any change of address.**

This will speed up your refund check and make sure IRS correspondence to you is not lost or misdirected.

- **If it sounds too good to be true, it probably is!**

There are red flags that should alert you to potential problems with your preparer, especially if your preparer:
- Guarantees a refund (A good preparer can help you plan your withholding and estimate your credits so that you can have a refund in the future. Your actual refund will depend on your income, deductions, and credits for the year.)
- Promises a bigger refund than anyone else
- Asks you to sign a blank return
- Wants refund mailed directly to him or her