

## The Urgent Need for Basic Competency Standards for Paid Tax Preparers

David Newville, Director, Federal Policy  
Email: [dnewville@cfed.org](mailto:dnewville@cfed.org) Phone: 202.207.0147

Chad Bolt, Legislative Analyst  
Email: [cbolt@cfed.org](mailto:cbolt@cfed.org) Phone: 202.207.0151

### When It Comes to Consumer Protection, Tax Time Is a Can't-Miss Chance to Boost Financial Security

Tax time is a financial springboard for millions of Americans. Research and the experience of tax preparers has shown that tax time is one of the most critical moments in the financial lives of low- and moderate-income households.<sup>1</sup> Thanks to refundable tax credits, such as the Earned Income Tax Credit (EITC) and the Child Tax Credit (CTC), a substantial composite of low- and moderate-income households receive a tax refund every year.<sup>2</sup> For these American workers, their tax refund check can account for 30% or more of their entire annual income.<sup>3</sup>

Filing and processing returns accurately is a challenge for filers—and for the government. Fifty-six percent of tax filers earning less than \$30,000 annually seek professional tax preparation assistance.<sup>4</sup> Without an accurate return, tax filers do not receive the full benefit of tax credits to which they're entitled under law, undermining the significant boost to financial security that tax time provides. For the government, inaccurate returns waste time, resources and taxpayer dollars.

### Most Paid Tax Preparers are Entirely Unregulated

Only a minority of tax preparers are “enrolled” and required to meet basic competency standards. Paid preparers are tax service providers who assist in preparing federal or state tax returns or claims for refund filing. More than 137 million tax filers completed returns in the 2015 tax season, with 81 million paying for professional tax preparation services.<sup>5</sup> More than half (55%) of paid preparers are not required by their profession, state or organization to meet minimum basic competency standards.<sup>6</sup> In contrast, the Volunteer Income Tax Assistance (VITA) program, a free tax preparation service provided by volunteers that often have no background in tax preparation, uses a robust training and certification system to alleviate concerns that affect unregulated preparers.

The IRS estimates that there are over 1.2 million paid preparers across the country that fall into these two categories:

- Enrolled paid preparers include certified public accountants and attorneys, whose professional credentials are accepted by the IRS, and enrolled agents, who are preparers that are tested and certified by the IRS.<sup>7</sup> Tax preparers in this category have unlimited representation rights before the IRS, enabling them to represent clients on any IRS-related matter including audits, payment and collection issues, and appeals.
- Unenrolled paid preparers, who make up 55% of paid returns, are preparers without the above credentials but prepare federal tax returns for a fee and have limited representation rights. This includes preparers who work for national chains and solo practitioners, including those who volunteer to participate in the IRS Annual Filing Season Program that provides an annual continuing education course and a limited credential. With few exceptions, this group cannot represent clients before the IRS and cannot represent client appeals.

### Key Recommendations for Congress

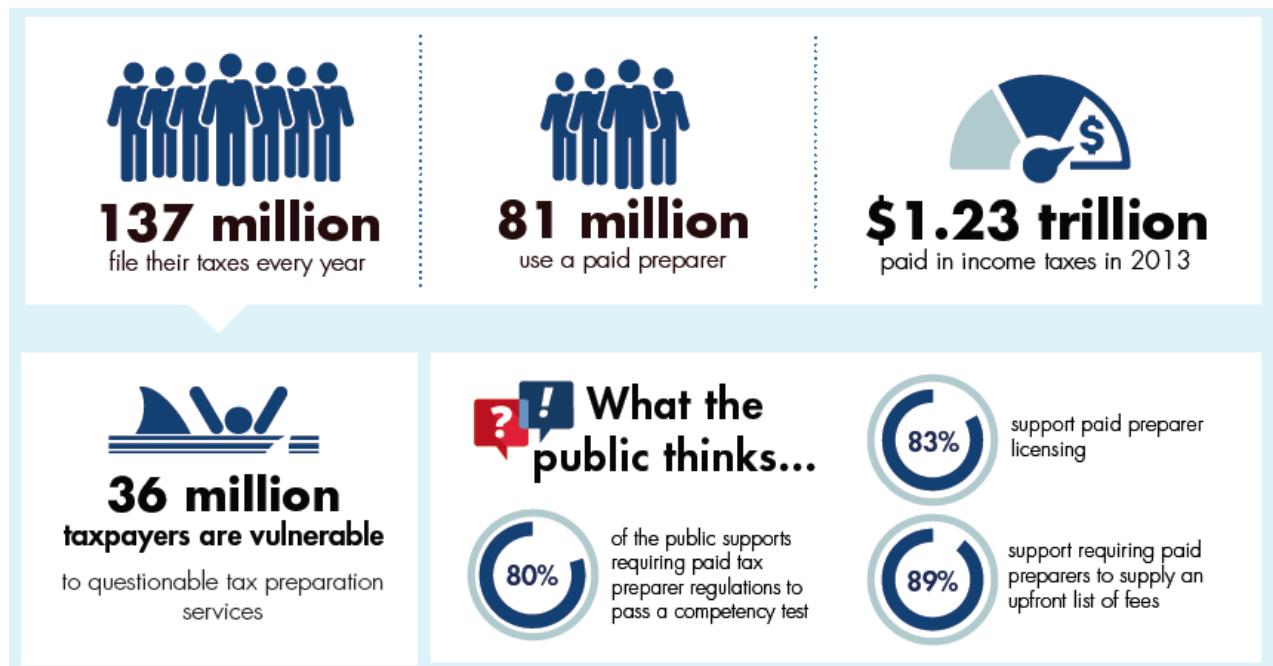
1. **Reduce preparation error rates** by developing basic competency and recertification standards that are commensurate with those required of Volunteer Income Tax Assistance (VITA) program volunteers.
2. Include among these competencies **identity and cybersecurity training** so that preparers know how to combat evolving threats.
3. **Increase transparency for tax filers** by requiring disclosure of fees and registration in a database that empowers tax filers to choose a preparer based on track record and competency.

The federal government and 46 states do not require basic competency standards for paid tax preparers. Only four states presently have paid preparer regulations, with varying academic requirements and fees. The only IRS requirement of paid preparers is that they have a Preparer Tax Identification Number (PTIN), which is included in an IRS registry after paying a \$50 fee and completing a basic personal background check. Having a PTIN is not an indication of training or ability, meaning this requirement has only a negligible effect on ensuring quality service for taxpayers or dissuading unregulated paid preparers from exploiting consumers.<sup>8</sup>

### Unenrolled Paid Preparers Have the Lowest Accuracy Rates

In the absence of basic competency standards, government spending on fraudulent refunds and errors has increased. While paid tax preparers have become more prevalent, tax errors and overpayments have grown as well. Between 2011 and 2014, the IRS denied more than 19 million suspicious tax returns but still paid \$5.2 billion in overpayments in the 2013 season, an enormous public cost resulting from the lack of basic competency standards.<sup>9</sup> Unenrolled paid tax preparers are more likely than any other type of tax preparer to file inaccurate returns.<sup>10</sup> A 2015 mystery shopper test of paid preparers found inaccuracies in as many as 90% of returns by paid tax preparers.<sup>11</sup> This burden costs the IRS and the Department of the Treasury immensely in staff time and resources.

Improving the accuracy of filings completed by preparers can significantly improve overall accuracy. For example, IRS studies indicate that unenrolled preparers make twice as many errors as VITA volunteers on certain returns. The Joint Committee on Taxation estimates that regulation of paid tax preparers would generate \$135 million in additional revenue over ten years.<sup>12</sup> More action is needed to protect filers and improve the integrity of the filing process as a whole.



Data from IRS SPEC and the Consumer Federation of America

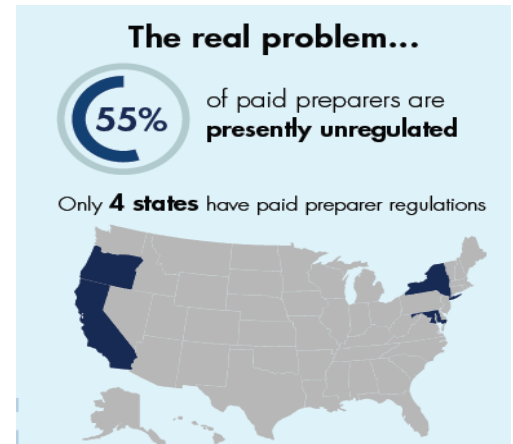
### Minimum Competency Standards Would Especially Benefit Lower-Income Filers

Tax filers of limited means are increasingly susceptible to predatory tax preparation practices. For tax year 2012, over 76% of the preparers filing EITC returns were not required to meet minimum competency standards.<sup>13</sup> For taxpayers using these services, like all taxpayers, no information is easily available to identify or compare the qualifications or previous track record of the numerous paid preparers available. This information vacuum creates an opportunity for unscrupulous tax preparers to enter the field of otherwise high-quality preparers and exploit low-income filers who are understandably hoping for a large, quick refund, with no faith that their return will be accurate.

## VITA Is a Model for Implementing Effective Minimum Competency Standards

VITA has had a robust, effective competency training system for over 40 years. VITA must meet strict federal standards to ensure returns are accurately and efficiently prepared. Unlike paid tax preparers, local VITA programs are held to a national standard for tax preparer training, site administration and quality of tax preparation. Local VITA programs train and prepare volunteers, who must become certified according to strict IRS standards. To prevent identity theft issues, valid federal or state identification is required of all filers. In 2015, the program helped more than two million lower-income Americans file their tax returns, returning \$2.2 billion to local communities.<sup>14</sup>

VITA's training and licensing system produces high-quality results. VITA's level of accuracy has been steadily increasing over the years, from 85% in 2009 to 94% in 2015, despite increased demand for VITA services and stagnant funding. The 94% accuracy rate is one of the highest of any category of tax preparation services, including CPAs and major tax preparation services companies, and proves that minimum competency standards can have a marked impact on the quality of tax preparation.<sup>15</sup>



## Congress Must Develop Competency Standards to Reduce Fraud & Protect Taxfilers

**Congress must take action to enact basic competency standards.** In 2012, the IRS established a program that required all federal tax return preparers to undergo registration, testing and continuing education in order to file tax returns. In 2014, the U.S. Court of Appeals for the District of Columbia decided in *Loving v. IRS* that the IRS does not have the statutory authority to regulate paid preparers, beyond registration, in the absence of congressional legislation providing that authority.<sup>16</sup> Due to this decision, Congress must act to reduce overpayments and inaccurate returns by allowing national basic competency standards for paid preparers. In 2015, the Chair and Ranking Member of the Senate Finance Committee agreed to a proposal that would establish these basic competency standards, but the Committee did not advance it. As Members of Congress consider how best to move forward in this area, they should ensure that any such legislation includes the following commonsense reforms.

### Ongoing Education Requirements

**Congress should ensure that preparers have basic competencies and are aware of important changes.** Annual continuing tax education through basic competency standards for all paid preparers would provide clear metrics to evaluate the performance and effectiveness of paid preparers nationwide. Paid tax return preparers who are not attorneys, certified public accountants or enrolled agents should be required to take a tax education course, pass an initial basic competency test and engage in continuing education to prove they have an understanding of existing tax filing requirements. Paid preparers should be held to the same high standards as VITA volunteers including undergoing annual training certification to ensure they are aware of new tax filing requirements and developments.

**Cyber and identity security training should be included in this competency test.** This would ensure that preparers responsible for maintaining the security of taxpayer information and transmitting information electronically to the IRS maintain the security of that information. These preparers need to maintain current knowledge and best practices as cyber and identity security threats to taxpayers evolve.

### Compliance and Taxpayer Protections

**Congress and the IRS should develop a complaint database linked to the PTIN registry to identify bad actors.** A basic database presently exists on IRS.gov that provides the names, credentials and addresses of registered paid

preparers. This database allows tax filers to search for preparers by their background, but it does nothing to identify the competency of these preparers. Congress and the IRS should reform this website, empowering tax filers to submit complaints and discover the disciplinary history of PTIN holders. Such a database would function similarly to state bar associations, which allows potential clients to look up a lawyer and see any prior history of public censure, or to the Consumer Financial Protection Bureau's (CFPB) complaint database, which consumers can use to submit or search for complaints about financial products or services. For this system to work effectively, the IRS should also develop a list of professional requirements and consequences for bad actors who do not uphold basic professional standards. A strong evaluation and enforcement mechanism to protect tax filers and identify improper actors would increase the quality of tax preparation services while providing a disincentive for preparers to violate these standards.

### Clarity in Tax Preparation Fees

**The IRS should require all paid preparers to visibly post cost structures and fees.** Tax filers often experience high preparation fees, as well as surprise ancillary expenses from paid tax preparers, such as warranties against filing errors, processing or electronic filing fees, and charges for submitting state returns.<sup>17</sup> This lack of clarity in fees from tax preparers prevents tax filers from understanding the overall costs for tax preparation and places particular burdens on those with limited financial understanding. Paid preparers should detail what is being offered and the cost for each product, securing the consent of the tax filer before taking action. In cases where clear fees cannot be provided until accessing the return, a good faith estimated range should be mandated based on the cost per form from a prior year's return or on standardized costs.

For example, the CFPB issued a final rule in 2016 requiring that fee disclosures on prepaid cards are presented to consumers in a standard format across products, improving consumer understanding and making it easier for consumers to comparison shop. This rule could serve as a model to empower tax filers with more transparency when considering paid preparers.

---

<sup>1</sup> Sarah Halpern-Meekin, Kathryn Edin, Laura Tach and Jennifer Sykes, *It's Not Like I'm Poor: How Working Families Make Ends Meet in a Post-Welfare World* (Berkeley: University of California Press, 2015).

<sup>2</sup> "2014 Filing Season Statistics," IRS, December 26, 2014.

<sup>3</sup> Meekin, Edin, Tach and Sykes, *It's Not Like I'm Poor*.

<sup>4</sup> "Briefing Book: Key Elements of U.S. Tax System," Tax Policy Center, 2014.

<sup>5</sup> *Results of the 2015 Filing Season* (Washington, DC: Inspector General for Tax Administration, U.S. Department of the Treasury, 2015).

<sup>6</sup> James R. McTigue, Jr., "Paid Tax Return Preparers In a Limited Study, Preparers Made Significant Errors," U.S. Government Accountability Office, April 8, 2014.

<sup>7</sup> Ibid.

<sup>8</sup> "PTIN Application Checklist: What You Need to Get Started," IRS, October 30, 2015.

<sup>9</sup> "Identity Theft: Additional Actions Could Help the IRS Combat the Large, Evolving Threat of Refund Fraud," U.S. Government Accountability Office, September 22, 2014.

<sup>10</sup> Kara Leibel, "Taxpayer Compliance and Sources of Error for the Earned Income Tax Credit Claimed on 2006-2008 Returns," IRS, August 2014.

<sup>11</sup> Chi Chi Wu, Alice Vickers, Amelia O'Rourke-Owens, Peter Skillern and Cara Williams, *Prepared in Error: Mystery Shoppers in Florida and North Carolina Uncover Serious Tax Preparer Problems* (Washington, DC: National Consumer Law Center, 2015); Chi Chi Wu and Michael Best, *Taxpayer Beware: Unregulated Tax Preparers and Tax Time Financial Products Put Taxpayers at Risk* (Washington, DC: National Consumer Law Center, 2015); Chi Chi Wu, *Riddled Returns: How Errors and Fraud by Paid Tax Preparers Put Consumers at Risk and What States Can Do* (Washington, DC: National Consumer Law Center, 2013).

<sup>12</sup> "Estimated Revenue Effects of a Bill to Prevent Identity Theft and Tax Refund Fraud," Joint Committee on Taxation, September 11, 2015.

<sup>13</sup> "IRS Steps to Create a Voluntary Program for Tax Return Preparer Standards," IRS National Taxpayer Advocate, 2014.

<sup>14</sup> "Quality Statistical Sample Review Results," IRS SPEC, June 30, 2015.

<sup>15</sup> Ibid.

<sup>16</sup> 742 F.3d 1013 (D.C. Cir. Feb. 2014).

<sup>17</sup> David Rothstein, *Improving Tax Preparation with a Model Fee Disclosure Box* (Cleveland: Policy Matters Ohio, 2013).