



*Most Tax Returns Prepared by a Limited  
Sample of Unenrolled Preparers Contained  
Significant Errors*

**September 3, 2008**

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This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

September 3, 2008

**MEMORANDUM FOR** COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED  
DIVISION

**FROM:** (for) Michael R. Phillips  
Deputy Inspector General for Audit

**SUBJECT:** Final Audit Report – Most Tax Returns Prepared by a Limited Sample  
of Unenrolled Preparers Contained Significant Errors  
(Audit #200840009)

This report presents the results of our review to determine whether taxpayers receive accurate preparation of their income tax returns when using unenrolled paid preparers. This audit was conducted as part of our Fiscal Year 2008 Annual Audit Plan.

*Impact on the Taxpayer*

Although taxpayers are ultimately responsible for the information reported on their tax returns, millions of taxpayers rely on preparers to prepare correct returns. Currently, there are no national standards that preparers are required to satisfy before selling tax preparation services to the public. Because more than one-half of all taxpayers use preparers to file their tax returns, preparers have a significant effect on taxpayer compliance. In a limited sample of unenrolled preparers, we found that most made significant errors when preparing tax returns.

*Synopsis*

In Calendar Year 2007, the Internal Revenue Service (IRS) processed approximately 83 million individual Federal income tax returns prepared by paid preparers. This is up more than 2 percent from the nearly 81 million tax returns prepared by paid preparers that the IRS processed in Calendar Year 2006. Anyone—regardless of training, experience, skill, or knowledge—is allowed to prepare Federal income tax returns for others for a fee.



## *Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors*

In February and March 2008, Treasury Inspector General for Tax Administration auditors posed as taxpayers in a large metropolitan area and paid to have 28 tax returns prepared at 12 commercial chain and 16 small, independently owned tax return preparation offices. Auditors paid commercial chains approximately \$2,800, averaging \$234 per tax return, and independently owned offices approximately \$2,100, averaging \$132 per tax return.

The preparers were unlicensed and unenrolled. That is, they were not practitioners (attorneys, certified public accountants, enrolled agents, or enrolled actuaries). Preparers often made substantial errors when completing tax returns and correctly prepared only 11 (39 percent) of the 28 tax returns (i.e., the tax returns showed the correct amount of taxes owed or refunds due). However, 17 tax returns (61 percent) were prepared incorrectly.

- 11 (65 percent) of the 17 contained mistakes and omissions we considered to have been caused by human error and/or misinterpretation of the tax laws.
- 6 (35 percent) of the 17 contained misstatements and omissions we considered to have been willful or reckless.

If these incorrect tax returns had been filed, the net effect to the Federal Government would have been \$12,828 in understated taxes (this is the net effect—there were instances in which tax liabilities and tax refunds were both overstated and understated). We discussed these issues with IRS officials, who stated that had these problems been discovered on real tax returns, the preparers could have been subject to penalties for such things as willful or reckless disregard of tax rules. We have referred matters that we encountered to the IRS, so that any appropriate followup actions can be taken.

The Internal Revenue Code includes requirements<sup>1</sup> that all preparers be diligent in determining taxpayer eligibility for the Earned Income Tax Credit, sign the tax return, furnish their identification number on the tax return,<sup>2</sup> and not improperly or recklessly disclose tax return information. However, none of the seven preparers required to exercise due diligence when determining whether auditors were eligible to receive the Earned Income Tax Credit did so. In addition, two preparers did not furnish the required identification numbers on the completed tax returns.

The IRS does not have one list or database that collects information on preparers such as the preparer's name, associated identifying numbers, or whether the preparer is a practitioner or unenrolled preparer. The IRS acknowledges that it does not know how many paid preparers exist and cannot determine the full extent of noncompliance and incompetence among

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<sup>1</sup> See Appendix IV for a list of Internal Revenue Code penalties applicable to paid preparers.

<sup>2</sup> Paid preparers must provide their Social Security Number, Practitioner Tax Identification Number, and/or Employer Identification Number on tax returns.



## *Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors*

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practitioners. This hinders the IRS' efforts to expand its outreach and education initiatives and to identify potentially problematic preparers and all the tax returns they prepared.

In Fiscal Year 2007, the IRS, including the National Taxpayer Advocate and the Director, Office of Professional Responsibility, participated in a Return Preparer Summit, which was claimed to be a first step toward creating an agency-wide preparer strategy. The Summit's goal was to have an organized, agency-wide strategy that would assist in making the most of IRS resources by focusing compliance and outreach efforts with tax professionals where it is most needed.

Pursuing abusive preparers is part of the IRS' strategy to reduce the tax gap, which researchers estimate to be \$290 billion based on 2001 data.<sup>3</sup> In February 2007 testimony before Congress, the IRS Commissioner stated that 68 percent of the tax gap is attributed to underreported taxes for individuals. Eleven (65 percent) of the 17 incorrect tax returns prepared for our auditors fell into this category.

Taxpayers are ultimately responsible for the information reported on their tax returns. However, taxpayers rely on preparers to prepare correct returns. In Fiscal Year 2007, legislation was introduced in Congress to regulate paid preparers.<sup>4</sup> A unique identification number would enable the IRS to use its current databases to identify and evaluate preparers' compliance. Being able to identify all preparers would allow the IRS to better pursue abusive or incompetent tax preparers in its stepped-up campaign against tax fraud and other forms of noncompliance.

### *Recommendation*

We recommended that the Commissioner, Small Business/Self-Employed Division, develop and require a single identification number to control and monitor all paid preparers.

### *Response*

IRS management agreed to study this issue. The Director, Examination, Small Business/Self-Employed Division, will commission a cross-functional team to study the feasibility and methodology associated with requiring a single identification number to control and monitor all paid preparers. Management will evaluate the results of the study to consider if it is feasible to implement. Management's complete response to the draft report is included as Appendix VII.

Copies of this report are also being sent to the IRS managers affected by the report recommendation. Please contact me at (202) 622-6510 if you have questions or

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<sup>3</sup> IRS, U.S. Department of the Treasury, *Reducing the Federal Tax Gap: A Report on Improving Voluntary Compliance* (Washington, D.C.: August 2, 2007); *The 2007 Taxpayer Assistance Blueprint Phase 2* (Washington, D.C.: 2007).

<sup>4</sup> S. 1219, Taxpayer Protection and Assistance Act of 2007, 110th Congress, 1st Session (2007).



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Michael E. McKenney, Assistant Inspector General for Audit (Wage and Investment Income Programs), at (202) 622-5916.



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## *Abbreviations*

IRS

Internal Revenue Service



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## *Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors*

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### *Background*

Every year, more than one-half of all taxpayers pay someone else to prepare their income tax returns. During Calendar Year 2007, the Internal Revenue Service (IRS) processed approximately 83 million individual Federal income tax returns prepared by paid preparers. This is up more than 2 percent from the nearly 81 million processed in Calendar Year 2006.

Currently, there are no national standards that a preparer is required to satisfy before selling tax preparation services to the public.

*Paid preparers can be self-employed or work for accounting firms, large tax preparation services, or law firms. They include the following:*

- Licensed professionals, such as attorneys and certified public accountants. These licensed professionals are regulated by the State licensing authority and related associations such as the American Bar Association and the American Institute of Certified Public Accountants.
- Enrolled agents. These professionals pass an IRS examination or present evidence of qualifying experience as a former IRS employee and have been issued an enrollment card. Enrolled agents are the only taxpayer representatives who receive their right to practice from the Federal Government.
- Unenrolled or unlicensed preparers. These individuals range from those who might receive extensive training to those with little or no training. Currently, only two States, California and Oregon, have requirements for unenrolled paid preparers. In these States, unenrolled paid preparers must register with State agencies and meet continuing education requirements.

Anyone—regardless of training, experience, skill, or knowledge—is allowed to prepare Federal income tax returns for others for a fee.

State regulation of paid preparers focuses on licensed practitioners, and, with the exception of California and Oregon, most States allow anyone to be a paid preparer regardless of education, training, or licensure. Unenrolled paid preparers are not required to demonstrate a minimum competency in tax law, nor are they required to satisfy any continuing education requirements in order to prepare Federal tax returns.

Paid preparers authorized to represent taxpayers in matters before the IRS are called practitioners and include attorneys, certified public accountants, enrolled agents, and enrolled actuaries. Practitioners can legally represent taxpayers. Therefore, they can serve as a conduit to the IRS on account-related matters. Examples include preparing and filing documents, communicating with the IRS, and representing taxpayers at meetings.

All paid preparers are subject to Internal Revenue Code penalties—both civil and criminal.<sup>1</sup> For example, civil penalties apply if paid preparers do not sign the tax returns they

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<sup>1</sup> See Appendix IV for a list of Internal Revenue Code penalties applicable to paid preparers.





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prepare, do not provide the taxpayers with copies of the tax returns, or deliberately understate a taxpayer's tax liability. Criminal penalties apply when a paid preparer willfully prepares or makes a false statement regarding a false or fraudulent tax return or knowingly provides fraudulent tax returns to the IRS.

However, other regulations depend on whether the preparer is an attorney, a certified public accountant, an enrolled agent, or an unenrolled preparer. For example:

- Attorneys, certified public accountants, and enrolled agents are regulated by the Internal Revenue Code, Treasury Department Circular 230,<sup>2</sup> and the individual States in which they practice. These authorities have established requirements, penalties, and disciplinary actions for noncompliance and/or issue licenses and require continuing education to maintain them.
- Unenrolled preparers are regulated by the Internal Revenue Code. However, neither Circular 230 nor individual State requirements, with the exception of the States of California and Oregon,<sup>3</sup> apply to them.

The IRS Office of Professional Responsibility regulates attorneys, certified public accountants, and enrolled agents who practice before the IRS. Practice is defined broadly in Treasury Department Circular 230 as comprehending all matters connected with a presentation to the IRS relating to a taxpayer's rights, privileges, or liabilities under laws or regulations administered by the IRS.

The IRS has additional regulations for any paid preparers who are authorized to file tax returns electronically. Applicants to the Electronic Filing Program must pass certain IRS checks, including background and credit history checks. Participants are also monitored.

### **Auditors posed as taxpayers to have tax returns prepared**

In February and March 2008, Treasury Inspector General for Tax Administration auditors posed as taxpayers in a large metropolitan area and paid to have 28 tax returns prepared at 12 commercial chain and 16 small, independently owned tax return preparation offices. The preparers were unlicensed and unenrolled (i.e., they were not attorneys, certified public accountants, enrolled agents, or actuaries).

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<sup>2</sup> *Regulations Governing the Practice of Attorneys, Certified Public Accountants, Enrolled Agents, Enrolled Actuaries, Enrolled Retirement Plan Agents, and Appraisers before the Internal Revenue Service* (Treasury Department Circular No. 230, (revised 4-2008)).

<sup>3</sup> California requires that paid preparers pass a 60-hour approved course and obtain a tax preparer bond to become registered. California also requires 20 hours of continuing education annually. Oregon requires that tax preparers be at least 18 years old, have a high school degree or equivalent, complete 80 hours of income tax law education, and pass a tax preparer examination. Oregon also requires 30 hours of continuing education annually. While Oregon requires enrolled agents to register, enrolled agents must meet far fewer registration requirements than unenrolled preparers must meet.



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Auditors developed 5 scenarios with income ranging from \$16,000 to \$85,000. The filing statuses were Single, Married Filing Jointly, or Head of Household. The issues included the following tax law topics:<sup>4</sup>

Additional Child Tax Credit	Education Credits
Business Income and Expenses	Filing Status
Capital Gains	Income from Wages
Charitable Contributions	Individual Retirement Account Distribution
Child and Dependent Care Credit	Interest Income
Child Tax Credit	Mortgage Interest Paid
Dependency Exemptions	Saver's Credit <sup>5</sup>
Earned Income Tax Credit	Self-Employment Tax and Deduction

The tax returns we had prepared by unenrolled preparers were not filed. Auditors explained that they would file the tax returns themselves. The five scenarios were not considered complex, and the tax topics were specific, straightforward, and not dependent on interpretation.

Scenario #1: Single divorced parent with one child under age 17 who lived with the taxpayer the entire year. The taxpayer is a wage earner, has a small amount of interest income, receives child support, and pays child care expenses for the child to enable him or her to work.

Scenario #2: Single parent with two children under age 17. The taxpayer's children lived with the taxpayer during school vacations (a total of 4 months). The taxpayer is a wage earner with a part-time job, attends college part time, and lives in a relative's home.

Scenario #3: Single parent who lives with a friend. The taxpayer and friend each have one child under age 17 who lived with them the entire year. The taxpayer is a wage earner, attends college part time, and took an early distribution from an Individual Retirement Account.

Scenario #4: Single parent with one child under age 17 who lived with the taxpayer the entire year. The taxpayer is a wage earner, owns a home, and made charitable contributions. The taxpayer took an early distribution from an Individual Retirement Account.

Scenario #5: Married parents with two children, one child under age 17 and one child over age 18 who is in college. One spouse is a wage earner, and one is self-employed. The taxpayers had capital gains from the sale of stock.

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<sup>4</sup> See Appendix V for definitions of each of the tax law topics.

<sup>5</sup> The Credit was formerly known as the Retirement Savings Contributions Credit.



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Scenarios #1 and #2 were used in the Treasury Inspector General for Tax Administration's filing season review of the IRS' Volunteer Program and required preparers to determine the taxpayer's eligibility for the Earned Income Tax Credit.<sup>6</sup>

This review was performed in a large metropolitan city<sup>7</sup> and discussions were held with IRS officials in Washington, D.C., during the period January through May 2008. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. This audit was limited to 1) analyzing data from various IRS computer systems to identify paid preparers and selected characteristics of taxpayers who pay them to prepare their tax returns, 2) reviewing laws and regulations that apply to preparers, and 3) having tax returns prepared by preparers. Because we selected a non-representative sample of preparers from one large metropolitan city for this review, it is not possible to generalize the results of our work and draw conclusions about all preparers. Detailed information on our audit objective, scope, and methodology is presented in Appendix I.

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<sup>6</sup> *Accuracy of Volunteer Tax Returns Continues to Improve, but Better Controls Are Needed to Ensure Consistent Application of Procedures and Processes* (draft report issued July 21, 2008).

<sup>7</sup> The name of the city is not disclosed to support the anonymity of the auditors and the paid preparers visited.



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## *Results of Review*

### **Preparers Often Made Substantial Errors When Completing Tax Returns**

Taxpayers who use unenrolled preparers might not always receive accurately prepared tax returns. Most tax returns prepared for auditors during this review contained errors that affected both the expected tax refunds and liabilities. In addition, some actions taken by preparers were considered willful or reckless.

During this audit, preparers correctly prepared 11 (39 percent) of the 28 tax returns (i.e., the tax returns showed the correct amount of taxes owed or refunds due). However, 17 tax returns (61 percent) were prepared incorrectly.

Of the 17 tax returns prepared incorrectly, 11 (65 percent) contained mistakes and omissions we considered to have been caused by human error and/or misinterpretation of the tax laws. However, 6 (35 percent) of the 17 returns contained misstatements and omissions we considered to have been willful or reckless. If these tax returns had been filed, the net effect to the Federal Government would have been \$12,828 in understated taxes (this is the net effect—there were instances in which tax liabilities and tax refunds were both overstated and understated). Although 5 (29 percent) of the 17 tax returns prepared incorrectly had small errors (less than \$200), the other 12 (71 percent) had errors that ranged from approximately \$340 to almost \$6,000.

**Preparers correctly prepared 11 of 28 tax returns. However, 17 tax returns (61 percent) were prepared incorrectly.**

Preparers did not prepare any of the business income and expense tax returns correctly. All preparers used commercial tax preparation software to prepare the tax returns. Figure 1 provides the breakdown of the effect that the 11 incorrectly prepared tax returns, containing mistakes and omissions, would have had on tax administration had they been filed.<sup>8</sup>

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<sup>8</sup> Appendix VI provides a detailed list of the accuracy of all 28 visits.



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**Figure 1: Errors on 11 Tax Returns Caused by Mistakes and Omissions**

<b>Condition</b>	<b># of Tax Returns</b>	<b>Effect</b>
Tax Liability Understated	5	-\$9,860
Refund Overstated	1	-164
Total Understated Tax		-\$10,024
Additional Tax Owed	5	6,843
Total Effect	11	-\$3,181

*Source: Tax returns prepared for our auditors by preparers.*

Figure 2 provides the breakdown of the effect that the six incorrectly prepared tax returns considered to have been prepared with willful or reckless conduct would have had on tax administration had they been filed.

**Figure 2: Six Tax Returns Considered to Have Been Prepared With Willful or Reckless Conduct**

<b>Condition</b>	<b># of Tax Returns</b>	<b>Effect</b>
Tax Liability Understated	1	-\$4,160
Refund Overstated	4	-6,442
Total Understated Tax		-\$10,602
Additional Tax Owed	1	955
Total Effect	6	-\$9,647

*Source: Tax returns prepared for our auditors by preparers.*

All preparers correctly reported income from savings account interest, wages, and self-employment. However, none of them correctly calculated the expenses relating to self-employment income. Figure 3 shows the number of tax topics per tax return and how often the tax law was applied correctly.



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**Figure 3: Results by Tax Law Topic**

Topic	Correct	Incorrect	Percentage Correct
Additional Child Tax Credit (28 tax returns)	24	4	86%
Business Income (6 tax returns)	6	0	100%
Business Expenses (6 tax returns)	0	6	0%
Capital Gains (6 tax returns)	5	1	83%
Child and Dependent Care Credit (12 tax returns)	10	2	83%
Child Tax Credit (28 tax returns)	22	6	79%
Dependency Exemptions (28 tax returns)	26	2	93%
Earned Income Tax Credit (12 tax returns)	10	2	83%
Education Credits (12 tax returns)	6	6	50%
Filing Status (28 tax returns)	27	1	96%
Income – Wages (28 tax returns)	28	0	100%
Individual Retirement Account Distribution (17 tax returns)	15	2	88%
Interest Income (28 tax returns)	28	0	100%
Itemized Deductions (5 tax returns) <sup>9</sup>	3	2	60%
Saver's Credit (23 tax returns)	18	5	78%
Self-Employment Tax and Deduction (12 tax returns)	1	11	8%

*Source: Tax returns prepared for our auditors by preparers.*

The following text provides examples of mistakes and omissions made by paid preparers during our anonymous visits.

**Earned Income Tax Credit and Dependency Exemptions**

In one instance, an auditor provided the preparer with a Distributions From Pensions, Annuities, Retirement or Profit Sharing Plans, IRAs,<sup>10</sup> Insurance Contracts, etc. (Form 1099-R) that showed a large early distribution from an Individual Retirement Account. The preparer failed to include the distribution as income. Because the distribution was not included as income, the auditor was qualified for the Earned Income Tax Credit. The preparer also did not allow a dependency exemption and miscalculated the Child Tax Credit. This error qualified the auditor for the Additional Child Tax Credit. The net effect was a refund of more than \$4,600 when the tax return should have resulted in a balance due of approximately \$500.

<sup>9</sup> Itemized Deductions tax law topics include mortgage interest paid and charitable contributions.

<sup>10</sup> IRA – Individual Retirement Account.



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### **Education Credits**

For 6 of the 12 tax returns with the Education Credits, auditors received the incorrect amount for the Education Credits. Preparers were not always sure how to treat Education Credits. In some instances, our auditors received a deduction from income for education expenses, and sometimes they received a credit that decreased their taxes. In every situation, the Education Credits should have been a reduction in taxes, not income.

### **Saver's Credit**

Auditors on two separate occasions failed to receive the Saver's Credit to which they were entitled. The preparers did not prepare the Credit for Qualified Retirement Savings Contributions (Form 8880) to calculate the Credit. The net effect was a reduced refund of more than \$100 for both tax returns.

### **Business Income, Expenses, and Self-Employment Tax**

Auditors did not receive correct tax returns for any of the six tax returns with business expenses. Preparers either duplicated or omitted allowable business expenses that resulted in the understatement of self-employment tax (three tax returns) and overstatement of income tax (three tax returns). For all six returns, there were also other tax law errors, including not allowing depreciation for equipment, failing to use the selling price from the sale of stock to calculate capital gains, and not allowing the Saver's Credit. The net effect on tax administration ranged from understating auditors' tax liabilities by more than \$600 to overstating them by approximately \$5,000.

### **Some preparers' actions could be considered willful or reckless**

Six preparers acted willfully or recklessly during the preparation of each of the five scenarios. These preparers added or increased deductions without the auditors' permission and in some situations after the auditors had questioned whether they were entitled to receive the deductions. Although our auditors knew when preparers were behaving recklessly, they were careful to remain independent in order to document their experiences. These efforts also ensured that auditors did not compromise their anonymity during the visits. Examples of paid preparers' conduct exhibited during anonymous visits included:

- An auditor explained to the preparer that he or she had babysitter expenses for a child. The preparer asked if the auditor paid the babysitter in cash, and the auditor replied yes. The preparer then increased the child care expenses. In addition, the preparer instructed the auditor to tell the babysitter to file a Profit or Loss From Business (Schedule C) and deduct expenses for operating a home business equal to the increased child care expenses. The preparer also offered to change the expenses back to the original amount if the babysitter did not agree to change his or her records. The preparer's actions increased the auditor's refund by more than \$325.



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- An auditor completed an information worksheet showing children living in the home less than one-half of the year. The preparer stated that he or she was going to show on the tax return that the children lived in the home with the auditor for 12 months so the auditor could receive all that he or she was entitled to. The decision erroneously changed the auditor's filing status from Single to Head of Household, increased the dependency exemptions, and qualified the auditor for the Child Tax Credit and the Earned Income Tax Credit. The net effect on tax administration from the preparer's actions increased the refund from \$100 to approximately \$6,000.
- An auditor received a deduction for charitable contributions to which he or she was not entitled. The preparer asked the auditor if he or she had charitable contributions and the auditor replied that there were no contributions. The preparer added the contributions and did not inform the auditor that they were being added. The preparer also added a deduction for property tax for a car without the auditor's assertion or documentation. The effect was a refund of more than \$200, when the refund should have been less than \$140.

According to IRS records, as of April 19, 2008, these 6 preparers had prepared 973 tax returns during the 2008 Filing Season. One of the 6 preparers prepared 733 (75 percent) of the 973 tax returns. We discussed these issues with IRS officials. They stated that if these problems had been discovered on real tax returns, the preparers could have been subject to penalties for such things as willful or reckless disregard of tax rules. We have referred matters that we encountered to the IRS so that any appropriate followup actions can be taken.

***The 6 preparers whose actions were considered willful or reckless prepared almost 1,000 tax returns during the 2008 Filing Season.***

**Preparers used several methods to obtain information to prepare tax returns**

Generally, most of the 28 preparers asked probing questions before and while preparing the tax returns. When probing questions were not asked, preparers tended to make assumptions or rely upon the tax return preparation software to determine eligibility determinations. For example, during one visit, a preparer did not ask any probing questions but prepared a correct tax return using the commercial software. Observations from the 28 visits showed:

- For 16 (57 percent) of the 28 visits, the preparers asked the auditors to complete an information worksheet<sup>11</sup> to prepare the tax returns. However, only 5 (31 percent) of the

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<sup>11</sup> An information worksheet is a document used to gather information such as the names, Social Security Numbers, and length of time children who could be claimed as dependents lived in the home. Also, the worksheet asked the client to circle all sources of income received or earned.





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16 instances when information worksheets were completed resulted in correctly prepared tax returns.

- For 11 (39 percent) of the 28 visits, the preparers asked for identification such as a driver's license or the auditors' and dependents' Social Security Administration cards.

**Some preparers' actions did not comply with Internal Revenue Code requirements**

Internal Revenue Code requirements<sup>12</sup> include that all preparers be diligent in determining taxpayer eligibility for the Earned Income Tax Credit, sign the tax return, furnish their identification number on the tax return,<sup>13</sup> and not improperly or recklessly disclose tax return information. The penalties for violation of the Code requirements range from \$50 per failure to up to \$1,000, or up to 1 year of imprisonment, or both and the cost of prosecution. Observations from the 28 visits showed:

- None of seven preparers exercised due diligence when determining whether the auditors were eligible to receive the Earned Income Tax Credit. All seven prepared the required Paid Preparer's Earned Income Credit Checklist (Form 8867) but did not ask any or all of the probing questions on the Form. One preparer complained that the tax return preparation software prompts slowed down the preparation process.
- 2 (7 percent) of the 28 preparers did not furnish their identification numbers on the completed tax returns.
- 3 (11 percent) of the 28 preparers did not adequately protect auditors' tax information or other clients' personal identification tax information. For example, preparers repeated auditors' Social Security Numbers aloud and disclosed the auditors' tax return information on the computer screen and the desk when others were present in the office. In two instances, preparers made visible other clients' tax information to the auditors.
- 5 (18 percent) of the 28 preparers did not sign the tax returns with a computer or original signature.

***Preparers must be diligent in determining taxpayer eligibility for the Earned Income Tax Credit, sign the tax return, furnish their identification number on the tax return, and not improperly or recklessly disclose tax return information.***

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<sup>12</sup> See Appendix IV for a list of Internal Revenue Code penalties applicable to paid preparers.

<sup>13</sup> Paid preparers must provide their Social Security Number or Practitioner Tax Identification Number and/or Employer Identification Number on tax returns.



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**Tax return preparation fees varied significantly for the same situation**

Tax return preparation can be costly. Auditors visited 12 commercial tax return preparation chains and were charged approximately \$2,800, an average of \$234 per tax return. The 16 independently owned offices charged approximately \$2,100, an average of \$132 per tax return. Figure 4 presents the tax return preparation fees the auditors were charged to prepare the returns.

**Figure 4: Tax Return Preparation Fees by Scenario**

Scenario #	Fees Charged					
Scenario #1	\$74*	\$150*	\$123	<u>\$200</u>	\$230	\$271*
Scenario #2	\$72*	\$107*	\$114*	\$161*	<u>\$248</u>	
Scenario #3	\$60*	\$93	\$169	\$200	<u>\$200</u>	\$252*
Scenario #4	<u>\$106</u>	\$144	\$180*	<u>\$211</u>	\$238*	
Scenario #5	\$100	\$130	\$150	\$155	<u>\$371</u>	\$402

*Source: Anonymous visits performed by our auditors. Figures designated by an \* = Correct tax returns. Figures underscoring = Tax returns considered to have been prepared willfully or recklessly.*

**Improved Data Are Needed to Enable the Internal Revenue Service to Control and Monitor Paid Preparers**

In most States, anyone can be a paid preparer regardless of education, training, or licensure. In some States, hairdressers and home inspectors must be licensed before they perform their services, but there is no such requirement for tax return preparers. In Fiscal Year 2007, the IRS, including the National Taxpayer Advocate and the Director, Office of Professional Responsibility, participated in a Return Preparer Summit, which was claimed to be a first step toward creating an agency-wide preparer strategy. The Summit's goal was to have an organized, agency-wide strategy that would assist in making the most of IRS resources by focusing compliance and outreach efforts with tax professionals where it is most needed. As of April 25, 2008, the strategy was still awaiting approval from the Department of the Treasury before being finalized.

In 2004, the National Taxpayer Advocate's Annual Report to Congress listed Oversight of Unenrolled Return Preparers as one of the most serious problems encountered by taxpayers. The National Taxpayer Advocate further cautioned the IRS that if it did not police the tax return preparation profession, taxpayers would be more likely to have bad experiences with unscrupulous or incompetent preparers that without question would taint their impressions of the system. The National Taxpayer Advocate recommended a Federal Government program to regulate unenrolled tax preparers.



*Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors*

The IRS responded to the recommendation with concerns about the cost of such a program. Instead of developing a Federal Government program, the IRS developed an agency-wide strategy, which included joint visitations and reviews of the Return Preparer Program activities, quarterly meetings, and development of a Preparer/Practitioner Database. The visitations provided some information, and the database never moved beyond the concept stage.

**The IRS has insufficient information on paid preparers**

Although paid preparers file the majority of income tax returns,<sup>14</sup> the IRS has limited information on them and insufficient means by which to track or monitor them. Preparers identify

**Preparers use three different types of numbers to identify themselves on income tax returns they prepare:**

- **Social Security Numbers**
- **Employer Identification Numbers**
- **Practitioner Tax Identification Numbers**

themselves on income tax returns they prepare by entering their Social Security Number, Employer Identification Number, or Practitioner Tax Identification Number. A Practitioner Tax Identification Number is used by a preparer who does not want to disclose his or her Social Security Number on tax returns he or she prepares. It is a nine-character alpha/numeric with the first character being “P” followed by

eight numbers. An Employer Identification Number is a unique nine-digit number used to identify a taxpayer’s business account on IRS records.

Figure 5 provides an excerpt of paid preparer identifier requirements on the U.S. Individual Income Tax Return (Form 1040).

**Figure 5: Excerpt From Form 1040, Paid Preparer Identifier Requirements**

<b>Paid Preparer's Use Only</b>	Preparer's signature	Date	Check if self-employed <input type="checkbox"/>	Preparer's SSN or PTIN
	Firm's name (or yours if self-employed), address, and ZIP code		EIN	
			Phone no. ( )	

Form **1040** (2007)

Source: IRS.gov, Form 1040.

The IRS does not have one list or database that collects information on preparers. For example, it does not have a list or database that shows the preparer’s name, associated identifying numbers, or whether the preparer is a practitioner or unenrolled preparer and/or an Electronic Return Originator.<sup>15</sup> Preparers could be self-employed and use their personal Employer

<sup>14</sup> See Appendix III for the demographic profile of taxpayers who used a paid preparer during the 2008 Filing Season.

<sup>15</sup> Electronic Return Originators originate the electronic submission of income tax returns to the IRS. An Electronic Return Originator electronically submits income tax returns that are either prepared by the Electronic Return Originator’s firm or collected from a taxpayer.



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## *Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors*

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Identification Number or employed and preparing tax returns as part of a tax preparation company. In the latter instance, the preparer could use the Employer Identification Number associated with the tax preparation company and his or her personal Social Security Number or Practitioner Tax Identification Number.

According to the Government Accountability Office, many preparers do not sign tax returns with the required identifying number or numbers.<sup>16</sup> This occurred during two of our visits. Because processing tax returns is a priority for the IRS, it accepts tax returns even if preparers' information is not provided or is inaccurate on tax returns. For example, limited tests showed that more than 9,000 preparers used their Employer Identification Numbers as Social Security Numbers to prepare more than 500,000 tax returns filed in Calendar Year 2008, thus creating additional challenges. These variables make it difficult not only to identify the number of preparers but also to identify all the tax returns they prepared.

The IRS maintains a database<sup>17</sup> of individuals authorized to represent taxpayers before the IRS. This database contains the name, complete address, and telephone number(s) of the individual and an assigned Centralized Authorization File number,<sup>18</sup> if one is assigned. In Fiscal Year 2003, the IRS attempted to use this database to determine the paid preparer population. The IRS resorted to using the names of preparers from the database to match with third-party data external to the IRS to identify Social Security Numbers to conduct matches against its internal databases. As a result, the IRS had to qualify the use of the data. Currently, when reporting the population of unregulated preparers, the IRS uses ranges.

The IRS does maintain another database of preparers who have applied and been approved to be an enrolled agent. The applicants are requested to provide their Practitioner Tax Identification Number, Social Security Number, or Centralized Authorization File number to be included in the database. During this audit, we faced challenges in using this database to match the preparers' identifying numbers to IRS internal databases containing tax return data because preparers are required to use only one of the three identifying numbers when applying to become an enrolled agent—and may use any of the three. Due to the use of multiple

***During this audit, auditors were unable to identify the total population of unenrolled paid preparers.***

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<sup>16</sup> *Fiscal Year 2009 Budget Request and Interim Performance Results of IRS's 2008 Tax Filing Season* (GAO-08-567, dated March 2008).

<sup>17</sup> This database contains information regarding the type(s) of authorization that taxpayers have given representatives for their various tax accounts.

<sup>18</sup> This number is assigned to a practitioner when a Power of Attorney and Declaration of Representative (Form 2848) or Tax Information Authorization (Form 8821) is submitted to the IRS. The number is maintained in a file that contains information regarding the type(s) of authorization that taxpayers have given representatives to represent them in matters before the IRS for the various tax years within their accounts.



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## *Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors*

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identifying numbers in IRS databases, we were unable to identify the total population of unenrolled paid preparers.

In addition, in a March 2006 audit,<sup>19</sup> the Treasury Inspector General for Tax Administration recommended that the IRS coordinate and develop a method to uniquely identify taxpayer representatives in the Centralized Authorization File to track paid preparers' noncompliance with their own tax obligations because the IRS could not systematically identify whether a delinquent taxpayer was also a licensed tax practitioner. The IRS agreed to the recommendation.

An integral component of any management information system is application controls to help ensure the validity, completeness, and accuracy of data. Moreover, the application controls will enable management to effectively monitor performance measures and could be useful to identify preparers for enforcement actions.

In March 2008, the Government Accountability Office also recommended that the IRS develop a plan to require a single identification number for paid preparers to track their performance.<sup>20</sup> It reminded the IRS of past documented problems with paid preparers filing accurate returns and recommended that the IRS conduct research to determine the extent of the problems. The IRS recently responded that it recognizes the operational enhancements a unique number would provide. However, it is considering other solutions and does not believe that requiring a unique number is the optimal solution.

### **Identifying the number of preparers will play a key role in IRS strategies to improve voluntary compliance, reduce taxpayer burden, and address the tax gap**<sup>21</sup>

Because approximately 83 million tax returns processed by the IRS in Calendar Year 2007 were prepared by paid preparers, tax returns preparers have a significant effect on taxpayer compliance. The IRS acknowledges that it does not know how many paid preparers exist and cannot determine the full extent of noncompliance and incompetence within the tax practitioner community. This hinders the IRS' efforts to expand its outreach and education initiatives and to identify potentially problematic preparers.

Pursuing abusive preparers is part of the IRS' strategy to reduce the tax gap, which researchers estimate to be \$290 billion based on 2001 data.<sup>22</sup> In the February 2007 testimony before Congress, the IRS Commissioner stated that 68 percent of the tax gap is attributed to

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<sup>19</sup> *The Office of Professional Responsibility Can Do More to Effectively Identify and Act Against Incompetent and Disreputable Tax Practitioners* (Reference Number 2006-10-066, dated March 2006).

<sup>20</sup> *Fiscal Year 2009 Budget Request and Interim Performance Results of IRS's 2008 Tax Filing Season* (GAO-08-567, dated March 2008).

<sup>21</sup> The IRS defines the gross tax gap as the difference between the estimated amount taxpayers owe and the amount they pay voluntarily and in a timely manner for a tax year.

<sup>22</sup> IRS, U.S. Department of the Treasury, *Reducing the Federal Tax Gap: A Report on Improving Voluntary Compliance* (Washington, D.C.: August 2, 2007).



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## *Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors*

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underreported taxes for individuals.<sup>23</sup> Eleven (65 percent) of the 17 incorrect tax returns prepared for our auditors fell into this category.

Taxpayers are ultimately responsible for the information reported on their tax returns. However, approximately 83 million taxpayers rely on preparers to prepare correct returns. In Fiscal Year 2007, legislation was introduced in Congress to regulate paid preparers.<sup>24</sup> The legislation includes requiring the IRS to license paid preparers who are not under a regulatory body and ensure that they obtain continuing education to maintain their licenses.

A unique identification number would enable the IRS to better use its current databases to identify and evaluate preparers' compliance. In addition, these actions will assist the IRS in making the most use of its resources. Being able to identify all preparers would allow the IRS to better pursue abusive or incompetent tax preparers in its stepped-up campaign against tax fraud and other forms of noncompliance.

### ***Recommendation***

***Recommendation 1:*** The Commissioner, Small Business/Self-Employed Division, should develop and require a single identification number to control and monitor all paid preparers.

***Management's Response:*** IRS management agreed to study this issue. The Director, Examination, Small Business/Self-Employed Division, will commission a cross-functional team to study the feasibility and methodology associated with requiring a single identification number to control and monitor all paid preparers. Management will evaluate the results of the study to consider if it is feasible to implement.

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<sup>23</sup> Oral Testimony of Commissioner of Internal Revenue Mark W. Everson Before the Senate Budget Committee on the FY 2008 IRS Budget and the Tax Gap. Washington, D.C., February 14, 2007.

<sup>24</sup> S. 1219, Taxpayer Protection and Assistance Act of 2007, 110th Congress, 1st Session (2007).



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*Most Tax Returns Prepared by a Limited Sample of  
Unenrolled Preparers Contained Significant Errors*

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## Appendix I

### *Detailed Objective, Scope, and Methodology*

The overall objective was to determine whether taxpayers receive accurate preparation of their income tax returns when using unenrolled paid preparers. To accomplish our objective, we:

- I. Determined what oversight the IRS provides to paid preparers and what data the Office of Professional Responsibility maintains on paid preparers. We also contacted the Office of Professional Responsibility and discussed oversight and strategies.
- II. Determined whether the IRS had an effective and efficient process to identify the number of unenrolled paid preparers who prepare and file individual tax returns by attempting to match the preparer identifying numbers from the IRS Enrolled Practitioner Program System to other IRS internal databases with tax return data.
- III. Determined whether unenrolled paid preparers accurately prepared tax returns.
  - A. Judgmentally selected 30 unenrolled preparers in a metropolitan city based on whether they were a large commercial chain or a small, independently owned tax preparation service. The IRS does not have reliable data to identify the number of unenrolled preparers. Therefore, we could not determine the total population of unenrolled preparers and could not select a statistical sample. We selected the 30 locations (40 percent large commercial chains and 60 percent small, independently owned tax preparation services) by using the Internet, using the telephone book, and driving in and around the metropolitan city.
  - B. Using 5 scenarios, anonymously visited 30 selected unenrolled paid preparers in a selected city to have tax returns prepared.
  - C. Calculated the accuracy rate of the tax returns prepared by the 28<sup>1</sup> selected unenrolled preparers, including trending and quantifying the individual errors.
- IV. Identified the demographics of taxpayers who used paid preparers to prepare tax returns during Calendar Year 2008 through analyses of taxpayer account data on the Individual Return Transaction File.<sup>2</sup>

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<sup>1</sup> We selected 30 preparers. However, two were eliminated because they were practitioners subject to a regulatory body.

<sup>2</sup> The Individual Return Transaction File is an IRS database containing personal, tax account, and other information that has been transcribed from tax returns and most related schedules filed by individual taxpayers.



*Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors*

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- A. Using the Individual Return Transaction File, identified taxpayers who used a preparer to file a tax return and analyzed the data for taxpayer demographics. We selected taxpayer accounts and verified the accuracy of the Individual Return Transaction File tax accounts by researching the IRS Integrated Data Retrieval System.
- B. Reviewed fields required for the U.S. Individual Income Tax Return (Form 1040) review. We reviewed a sample at the beginning of the year and performed run-to-run balancing<sup>3</sup> by comparing record counts in all logs showing that data were extracted from the IRS files to the location of data stored at the Treasury Inspector General for Tax Administration Data Center Warehouse. We reviewed fields in each cycle and checked Log Analysis and Reporting Systems on the IRS mainframe for reruns.
- C. Validated the data extracted to fill our electronic data processing requests. We conducted run-to-run balancing and ensured that the entire file was used with no gaps in the access or extraction of the data.
- V. Determined what activities are currently underway to provide oversight for all paid preparers and researched the status of the Taxpayer Protection and Assistance Act of 2007<sup>4</sup> and/or other legislation on the regulation of paid preparers.

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<sup>3</sup> Run-to-run balancing is an audit control system. It consists of programs, procedures, and files whose primary function is to account for the number of records passed between applications programs.

<sup>4</sup> S. 1219, Taxpayer Protection and Assistance Act of 2007, 110th Congress, 1st Session (2007).





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**Appendix II**

*Report Distribution List*

Commissioner C  
Office of the Commissioner – Attn: Chief of Staff C  
Deputy Commissioner for Services and Enforcement SE  
Commissioner, Wage and Investment Division SE:W  
Deputy Commissioner, Small Business/Self-Employed Division SE:S  
Deputy Commissioner, Wage and Investment Division SE:W  
Director, Customer Assistance, Relationships, and Education, Wage and Investment Division  
SE:W:CAR  
Director, Examination, Small Business/Self-Employed Division SE:S:E  
Director, Strategy and Finance, Wage and Investment Division SE:W:S  
Chief, Performance Improvement, Wage and Investment Division SE:W:S:PI  
Director, Examination Policy, Small Business/Self-Employed Division SE:S:E:EP  
Chief Counsel CC  
National Taxpayer Advocate TA  
Director, Office of Legislative Affairs CL:LA  
Director, Office of Program Evaluation and Risk Analysis RAS:O  
Office of Internal Control OS:CFO:CPIC:IC  
Audit Liaison: Senior Operations Advisor, Wage and Investment Division SE:W:S



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**Appendix III**

*Comparison of Taxpayers Who Used a Preparer to Taxpayers Who Did Not Use a Preparer for Calendar Year 2008<sup>1</sup>*

	<b>All Taxpayers Using Preparers</b>	<b>Percentage</b>	<b>All Taxpayers Not Using Preparers</b>	<b>Percentage</b>
<b>Age Segmentation</b>				
Under 25 Years	8,634,418	16%	10,688,724	25%
25-34 Years	11,669,759	21%	8,035,892	19%
35-44 Years	11,046,375	20%	7,398,658	18%
45-54 Years	9,797,824	18%	6,747,030	16%
55-64 Years	6,652,914	12%	4,559,716	11%
65 Years or Older	7,134,947	13%	4,491,439	11%
<b>Totals</b>	<b>54,936,237</b>	<b>100%</b>	<b>41,921,459</b>	<b>100%</b>
<b>Filing Status Segmentation</b>				
Single	21,321,541	39%	22,949,511	55%
Head of Household	12,563,125	23%	5,232,246	12%
Married Filing Jointly	20,268,808	37%	13,061,323	31%
Married Filing Separately	747,489	1%	659,031	2%
Widow(er) With Dependent Child	35,274	<1%	19,348	< 1%
<b>Totals</b>	<b>54,936,237</b>	<b>100%</b>	<b>41,921,459</b>	<b>100%</b>
<b>Income Segmentation</b>				
No Income <sup>2</sup>	756,243	1%	1,721,552	4%
\$1 to \$4,999	3,944,441	7%	4,486,945	11%
\$5,000 to \$14,999	10,379,640	19%	7,288,203	17%
\$15,000 to \$24,999	9,716,300	18%	6,053,506	14%

<sup>1</sup> Source of information in these tables is based on our analysis of IRS data files.

<sup>2</sup> These data represent taxpayers with no income because of business and investment losses and nontaxable sources of income.



*Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors*

	<b>All Taxpayers Using Preparers</b>		<b>All Taxpayers Not Using Preparers</b>	
		<b>Percentage</b>		<b>Percentage</b>
\$25,000 to \$39,783	9,876,984	18%	7,012,268	17%
\$39,784 to \$54,999	6,350,841	12%	4,705,352	11%
\$55,000 to \$74,999	5,488,347	10%	4,026,246	10%
\$75,000 to \$99,999	4,067,969	7%	3,220,752	8%
\$100,000 and over	4,355,472	8%	3,406,635	8%
<b>Totals</b>	<b>54,936,237</b>	<b>100%</b>	<b>41,921,459</b>	<b>100%</b>



*Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors*

**Appendix IV**

*Internal Revenue Code Preparer Penalties*

<b>Code Section</b>	<b>Description</b>	<b>Penalty</b>
6694(a)	Understatement of taxpayer's liability due to an unreasonable position	Greater of \$1,000 per tax return or 50 percent of the income derived
6694(b)	Understatement of taxpayer's liability due to willful or reckless conduct	Greater of \$5,000 per tax return or 50 percent of the income derived
6695(a)	Failure to provide copy of return to taxpayer	\$50 per failure up to a maximum of \$25,000
6695(b)	Failure to sign return	\$50 per failure up to a maximum of \$25,000
6695(c)	Failure to furnish identifying number	\$50 per failure up to a maximum of \$25,000
6695(d)	Failure to retain a copy or list of returns filed	\$50 per failure up to a maximum of \$25,000
6695(e)	Failure of employers to file correct information on each tax preparer employed	\$50 per failure up to a maximum of \$25,000
6695(f)	Negotiation of taxpayer's refund check	\$500 per check
6695(g)	Failure to be diligent in determining Earned Income Tax Credit eligibility	\$100 per failure
6701	Aiding and abetting understatement of tax liability	\$1,000 per person per period
6713	Improper disclosure or use of return information	\$250 per disclosure or use up to a maximum of \$10,000
7206	Willful preparation of or making a false statement regarding a false or fraudulent return or other document	Up to \$100,000, or up to 3 years' imprisonment, or both, together with the costs of prosecution
7207	Knowingly providing fraudulent returns or other documents to the IRS	Up to \$10,000, or up to 1 year of imprisonment, or both
7216	Knowingly or recklessly disclosing or using return information	Up to \$1,000, or up to 1 year of imprisonment, or both, together with the costs of prosecution
7407	Authority to enjoin income tax preparers	Civil action may be taken; preparer could lose the right to prepare tax returns

Source: *Internal Revenue Code.*



*Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors*

**Appendix V**

*Explanations of Tax Law Topics*

Topic	Explanations
Additional Child Tax Credit	A credit for certain individuals who get less than the full amount allowed for the Child Tax Credit. The Additional Child Tax Credit may result in a refund even if no tax is owed.
Business Income	Income from operating a small business reported on a Profit or Loss from Business (Schedule C) that accompanies the Form 1040. <sup>1</sup>
Business Expenses	Expenses from operating a small business reported on a Schedule C that accompanies the Form 1040.
Capital Gains	Purchased assets sold or traded and reported on a Capital Gains and Losses (Schedule D) that accompanies the Form 1040.
Child and Dependent Care Credit	A percentage of the amount of work-related child and dependent care expenses paid to a childcare provider.
Child Tax Credit	A credit that reduces the Federal income tax owed up to \$1,000 for each qualifying child under age 17.
Dependency Exemption	A deduction from income for each qualifying person such as a son, daughter, or parent claimed as a dependent.
Earned Income Tax Credit	A refundable credit for lower income workers based on earned income and other requirements such as filing status and qualifying dependents.
Education Credits	Tax credits such as Hope and Lifetime that help offset the costs of higher education by reducing the amount of income tax.
Filing Status	A requirement that indicates a taxpayer's marital or family situation for filing a Form 1040.

<sup>1</sup> U.S. Individual Income Tax Return (Form 1040).



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Topic	Explanations
Income from Wages	A payment to an individual usually of money for labor or services performed. It is reported on the Form 1040.
Individual Retirement Account Distributions and Penalty	Distributions from a trust or custodial account set up to benefit an individual and his or her beneficiaries. Withdrawals from the account before age 59½ are considered taxable income and could be subject to a 10 percent penalty.
Interest Income	Earnings on investments such as savings accounts, certificates of deposit, and seller-financed mortgages.
Itemized Deductions	Deductions from income for certain expenses such as mortgage interest and charitable contributions listed on an Itemized Deductions (Schedule A) that accompanies a Form 1040.
Saver's Credit <sup>2</sup>	A credit for contributions made to an employer-sponsored retirement plan or an Individual Retirement Account that is based on an individual's adjusted gross income.
Self-Employment Tax and Deduction	A tax on net earnings of \$400 or more from self-employment shown on a Self-Employment Tax (Schedule SE) that accompanies a Form 1040. The deduction is one-half of total self-employment tax and is an adjustment to gross income.

*Source: Explanations for tax law topics are from IRS publications.*

<sup>2</sup> Formerly the Retirement Savings Contributions Credit.



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**Appendix VI**

*Accuracy Results of 28 Anonymous Visits*

<b>Visit #</b>	<b>Scenario #</b>	<b>Accurately Prepared Tax Return</b>	<b>Preparation Fee</b>	<b>Correct Refund/ Balance Due (-)</b>	<b>Computed Refund/ Balance Due (-)</b>	<b>Effect on Tax Administration</b>
<u>2</u>	<u>1</u>	No	\$200.00	\$2,218.00	\$2,561.00	-\$343.00
1	1	Yes	\$271.00	\$2,218.00	\$2,218.00	\$0.00
19	1	No	\$230.00	\$2,218.00	\$2,093.00	\$125.00
16	1	Yes	\$74.00	\$2,218.00	\$2,218.00	\$0.00
23	1	Yes	\$150.00	\$2,218.00	\$2,218.00	\$0.00
14	1	No	\$123.00	\$2,218.00	\$2,093.00	\$125.00
<u>11</u>	<u>2</u>	No	\$248.00	\$98.00	\$6,061.00	-\$5,963.00
3	2	Yes	\$114.00	\$98.00	\$98.00	\$0.00
10	2	Yes	\$107.00	\$98.00	\$98.00	\$0.00
24	2	Yes	\$161.00	\$98.00	\$98.00	\$0.00
15	2	Yes	\$72.00	\$98.00	\$98.00	\$0.00
<u>4</u>	<u>3</u>	No	\$200.00	(\$543.00)	\$3,617.00	-\$4,160.00
18	3	Yes	\$252.00	(\$543.00)	(\$543.00)	\$0.00
21	3	No	\$200.00	(\$543.00)	\$4,675.00	-\$5,218.00
17	3	No	\$93.00	(\$543.00)	\$1,511.00	-\$2,054.00
5	3	No	\$169.00	(\$543.00)	\$369.00	-\$912.00
26	3	Yes	\$60.00	(\$543.00)	(\$543.00)	\$0.00
<u>28</u>	<u>4</u>	No	\$211.00	\$132.00	\$170.00	-\$38.00
<u>7</u>	<u>4</u>	No	\$106.00	\$132.00	\$230.00	-\$98.00
8	4	Yes	\$238.00	\$132.00	\$132.00	\$0.00
6	4	No	\$144.00	\$132.00	\$296.00	-\$164.00
25	4	Yes	\$180.00	\$132.00	\$132.00	\$0.00



*Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors*

Visit #	Scenario #	Accurately Prepared Tax Return	Preparation Fee	Correct Refund/ Balance Due (-)	Computed Refund/ Balance Due (-)	Effect on Tax Administration
<u>12</u>	<u>5</u>	No	\$371.00	(\$1,771.00)	(\$2,726.00)	\$955.00
22	5	No	\$402.00	(\$1,771.00)	(\$747.00)	-\$1,024.00
9	5	No	\$150.00	(\$1,771.00)	(\$1,119.00)	-\$652.00
27	5	No	\$130.00	(\$1,771.00)	(\$2,418.00)	\$647.00
20	5	No	\$100.00	(\$1,771.00)	(\$2,814.00)	\$1,043.00
13	5	No	\$155.00	(\$1,771.00)	(\$6,674.00)	\$4,903.00
<b>28</b>		<b>11</b>				<b>-\$12,828</b>

Source: Tax returns prepared for our auditors by preparers. Those underscoring = the tax returns we considered prepared willfully or recklessly.





*Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors*

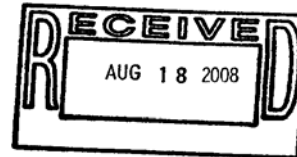
**Appendix VII**

*Management's Response to the Draft Report*



COMMISSIONER  
SMALL BUSINESS/SELF-EMPLOYED DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224



August 18, 2008

MEMORANDUM FOR DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Christopher Wagner  
Acting Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors (Audit 200840009)

Thank you for the opportunity to review the draft report titled *"Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors."*

The report recommends the development of and requirement for a single identification number to control and monitor all paid preparers. We agree to study the feasibility, effect, and potential benefits of implementing this type of identification number and will evaluate the results.

Attached is a detailed response outlining our corrective action. If you have questions or concerns, please contact me at (202) 622-0600 or Monica Baker, Director, Examination at (202) 283-2659.

Attachment



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*Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors*

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**Attachment**

**RECOMMENDATION 1:**

The Commissioner, Small Business/Self-Employed Division, should develop and require a single identification number to control and monitor all paid preparers.

**CORRECTIVE ACTIONS:**

We agree to study this issue. The Director, Examination (SB/SE Division) will commission a cross functional team to study the feasibility and methodology associated with requiring a single identification number to control and monitor all paid preparers. We will evaluate the results of the study to consider if it is feasible to implement.

**IMPLEMENTATION DATE:**

June 15, 2010

**RESPONSIBLE OFFICIAL:**

Director, Examination Policy (SB/SE Division)

**CORRECTIVE ACTION(S) MONITORING PLAN:**

The Director, Exam Policy will monitor the status and advise the Director, Examination of any delays in completing the corrective action.