



TESTIMONY BEFORE THE IRS OVERSIGHT BOARD

Panel 2: The Congress is considering new legislation that would regulate the tax preparation industry, including registration, ethics and competency testing, continuing professional education requirements, public awareness campaign, and an enforcement component. If the legislation passes, how would you recommend that a program be created that is effective, yet revenue neutral, and what impact would increased regulatory fees have upon your clients and taxpayers in general?

February 19, 2008

Overview/background

The IRS Oversight Board is seeking comments on how an effective program could be created to regulate the tax preparation industry at minimum cost. The IRS states that it has insufficient resources to develop, administer and monitor federal regulation of all tax return preparers. The National Association of Tax Professionals (**NATP**) is pleased to provide input on the practical considerations for such a regulatory program.

NATP is an eclectic group of tax professionals. Our membership is comprised of attorneys, CPAs, EAs, CFPs, CSAs, BBAs, LLBs, MBAs, PhDs, as well as Associate degrees, those who have entered the profession as a second career and part-time professionals. Approximately half of our members are Circular 230 professionals. Therefore, we have no bias for any one group of tax professionals over another. Approximately 81% of our non-Circular 230 professionals have undergraduate or graduate degrees. **NATP's** 18,500+ members affect more than 11 million taxpayers.

NATP is a nonprofit professional association that is committed to the integrity of the tax administration system and the application of tax laws and regulations by providing education, research, and information to tax professionals. For almost 30 years, we have existed to serve professionals who work in all areas of tax practice. We provide our members with over 200 tax education offerings in over 95 cities throughout the United States, as well as webinars, online interactive, and self-study programs, a service

unmatched by any other national tax association. In addition, our 35 Chapters and National headquarters serve the public through regular news releases, client brochures and newsletters, and a designated taxpayer website. Our Chapters provide significant member involvement in local and state communities. Our headquarters with 42 employees are located in Appleton, Wisconsin.

Overview

The free-market environment in the United States has been a blessing to citizens and taxpayers of every type because competition has kept prices for goods and services reasonable and efficient. The price elasticity of supply and demand for services from the tax industry has provided niche opportunities for the delivery of those services.

Individuals and businesses with sizeable assets and complex transactions typically require the services of sophisticated specialists. Often the sheer scale requires the attention of large law and CPA firms. The prices these firms charge set the market for this demand. To the extent that there are fewer firms that can supply the demand for these services, pricing for the demand is often inelastic. This either causes other firms to enter the market, or it causes the individuals and businesses to examine alternatives.

This same experience takes place at every economic strata such that smaller businesses and individuals with lesser tax complexities need not hire larger law and CPA firms. They constitute another market "niche" serviced by smaller law firms, CPA firms, EAs and individuals capable in the field of taxation.

Some would argue that the farther down the strata of complexity of tax issues one goes, the lesser the "quality" of practitioner one needs and encounters in the marketplace. "Quality," in this instance, is a misnomer. It is true that there are various kinds of knowledge required for various taxpayers. There are also varied depths of tax knowledge required for various taxpayer circumstances. Large law firms and CPA firms, for example, rarely, if ever, prepare "W-2 only" tax returns, or returns with EITC. Small practitioners who perform services for a lesser price often have more knowledge and experience with "routine" returns or returns with specialized low-income considerations. Quality issues exist at every layer in the strata.

There is a large sector of the citizenship, the "average citizen," for which there is great competition. In general, lawyers charge the highest price for services, followed by CPAs, EAs and then non-circular 230

practitioners. Franchise tax service providers operated in the "*lower-priced*" echelons years ago, but now tend to price their services in the range of small law firms and CPA firms. A great many non-circular 230 practitioners pride themselves in offering the same or better level of expertise as small Circular 230 establishments for a lesser price. All of these groups will take clients of various levels of complexity if they can get their price for their services.

The challenge and the market battle to service the "*average*" citizen has been fought over the credentials a practitioner has and the price they charge. Credentials of various sorts have proliferated over the decades such that the taxpayer has a difficult time assessing whether or not the provider they have selected is indeed qualified. Many taxpayers have discovered that their tax professional is incompetent, despite credentials of various types. Many practitioners, especially those in more rural areas, have established their bona fides through relationship and reputation in their community. Bad tax professionals will not survive long on the main street of America.

Continued and increased passage of complex tax laws contribute dramatically to the growth in the use of tax professionals by taxpayers. The market has expanded to where over 60 percent of taxpayers today find it necessary to use the services of a tax professional. It has gradually increased upward from 40 percent in the 1980s, despite the proliferation of "*do-it-yourself*" tax preparation software. In a report to the Senate Finance Committee in October of 2003, the GAO stated:

"The evidence available does not allow a precise estimate of the extent of problems caused by paid preparers, but nothing suggests that the percentage of taxpayers affected is large. Nevertheless, even a small percentage of the over 72 million taxpayers who used paid preparers in 2001 translate into millions of taxpayers who are potentially adversely affected."

Enter the government to now require the registration, testing, continuing education, awareness and enforcement of laws and regulations respecting the tax preparation industry. There is recognition that Circular 230 practitioners are already regulated in this manner. Therefore the task ahead focuses mainly upon those individuals "*without credentials*."

Those "*without credentials*" include practitioners who have been preparing taxes for individuals and businesses for decades as well as those with Masters Degrees in Taxation and Doctoral work in the same field. In fact, our non-circular 230 members have an average 22 years of experience in preparing returns. Those "*without credentials*" include a vast array of competent accountants with Bachelors Degrees in business and accounting

with some tax coursework. Those "*without credentials*" include a solid base of long-standing compliant professionals who have never had a corrective action taken against them or their work in this field, even in cases where they've been challenged by the Internal Revenue Service.

The tax administration system enjoys its current rate of compliance - high as it is among free world nations - due in large part to the efforts, ethics and integrity of this group of practitioners. It would seem prudent, therefore, to recognize the contributions they make to the tax administration system, and to use caution so as not to cause an exit of their talents and knowledge from the marketplace. This prudence will call for well-thought-out transition. Credential-specific organizations will be zealous in their demands for requiring the attainment of knowledge levels comparable to those required to attain their specific credential, whether needed or not. Tax franchises will hold an iron in this competitive fire. There will be strong movements to put up barriers for small business tax preparers who have practiced their talents at "*economic pricing*" in the marketplace.

It is in the setting and background of the above that **NATP** will make some observations, comments, and suggestions concerning a practical, efficient and economic regulatory program for the tax industry.

Patience

The IRS has, for decades, poured resources into the modernization of its information technology with abysmal results. Senator Grassley, in commenting on the nomination of Douglas Shulman as Commissioner of the IRS, stated:

"The problems the IRS has with computers are legendary as well as a source of great consternation and government spending. The next Commissioner must do more to modernize the computer system used by the IRS, and spend the money to do it more effectively than has been done in the past."

Congress is skeptical of claims by the IRS that it is nearing breakthroughs in electronic database management and is reticent to fund needed requests for progress in this area. Despite that, the IRS is just a hair's breadth away from putting 1040 income tax returns on the .xml platform.

This platform revolutionized e-filing for businesses. In 2007, for example, General Electric Corporation was able to file its 24,000-page 2006 income tax return electronically. This provides the IRS with a huge data mine from which to target audit companies for accuracy, comparison rates, mistakes in application of law and fraud. The point to be made here is that business income tax returns only comprise six percent of all income tax

returns filed. The other 94 percent is comprised of individual income tax returns. When 1040 returns are electronically processed on the .xml platform, the IRS will have significantly more economic and efficient means to target audit individuals and determine the quality of work of their tax professionals. To spend significant resources setting up a systematized infrastructure for regulating the tax industry would be potentially wasteful at this point. Implementation of this proven technology is to roll out in 2009-2010 - not that far away. And, from what we hear, it's on schedule.

Do we suggest that nothing can or should be done at present then? On the contrary. The tax industry has been poised for some form of registration or licensure for more than 20 years. This is an opportunity for the Treasury and the Internal Revenue Service to embrace this group in a careful transition without creating an imbalance in the Tax Administration System.

Registration

NATP recommends a transition from being unregistered to becoming registered or licensed. There should be a reasonable phase-in period to allow current non-Circular 230 preparers to become registered before they are prohibited from preparing returns. To move too quickly has the potential to negatively affect the livelihood of thousands of small business owners and their employees who provide credible and reasonably priced service to millions of taxpayers who depend on them. It also has the potential to seriously and negatively impact the ability of the tax administration system if significant numbers of competent and legitimate tax return preparers currently servicing that system close their doors.

A successful program will first focus on "*getting its arms around*" all the preparers before any of them leave or "*go underground.*" **NATP** therefore recommends that a simple registration process be initiated first. As an incentive or encouragement to get preparers to register, those that come forward or who belong to a professional association could be granted a "*waiver*" period wherein they would not have to take a test. If, after a designated period during which they obtained CPE, they experienced no "*problems*" with returns they've prepared, testing may be permanently waived. Alternatively, preparers could be subject to testing at any point after they have demonstrated incompetence.

The IRS may easily build here on its existing Preparer Tax Identification Number system, also called PTIN, for initial registration. Utilizing this electronic system is one way to contain costs associated with a simple registration process. There is no need to purchase or design another

system to accomplish simple registration. It would be an economical way for the IRS to implement a registration process. A PTIN could be part of the preparers' signature on all returns, whether electronic or paper.

This measure, alone, would go a long way toward addressing the identification and remediation of some of the unscrupulous, unethical and incompetent tax return preparers, as well as the need for testing and education. For the American public, this measure makes all paid preparers accountable and recognizable unless they go "underground." Registration will not stop fraud, but it may indicate who and what is responsible for it.

Revenue neutrality would require that the IRS be enabled to charge a fee for registration, testing and monitoring that will cover its costs. Such costs will be passed on to taxpayers by the tax practitioner community. They will not likely be absorbed. The cost to be passed to the taxpayer can be minimal if the costs incurred by the IRS are kept to a minimum. This concept is discussed at length below.

Testing

NATP believes the administration of an ethics and competency examination, where required, should reflect the realities of the tax preparation industry. Testing needs to be flexible because many professionals specialize. Some do individual returns only (as previously mentioned, 94 percent of all income tax returns are individual returns). Some do fiduciary returns only. Some prepare all returns. Some do representation. An over-ambitious testing process, requiring knowledge in all facets of taxation would only be burdensome. It would increase costs to taxpayers and significantly reduce the number of otherwise competent and legitimate tax return preparers currently servicing the tax administration system. Such a requirement would be counter-productive.

The recently redesigned Special Enrollment Examination (SEE) demonstrates that it's possible to segment licensing into those who just want to do individual returns and those that want to do more. An initial competency examination demonstrates an individual's *minimum* competency level for entry at the point in time of the exam. It does not ensure the maintenance of that competency level nor does it ensure raising the bar from that level. Continuing Professional Education and experience does ensure the maintenance and growth of competency. It goes beyond the statement that one has met the minimum requirements to be proficient in the industry. It's a measure of what the professional does on an ongoing basis to maintain and improve those skills. It provides evidence that the

professional is keeping up with rule changes and the dynamics of taxation so that he/she can do the job well for the American public.

Flexibility in the testing of preparers should extend to the realities of how tax knowledge is obtained and utilized to determine the correct result. Any test should be "*open-book*" so preparers can demonstrate that they know where and how to find the right answers to tax problems and situations. They shouldn't be required to memorize the Code. That is an unrealistic and unnecessary barrier, considering there have been 16,000 amendments to the Code since 1986.

An ethics and competency examination should be administered to all identified "*problem preparers*." It should also be re-administered if preparers who initially passed the exam subsequently demonstrate a pattern of errors or problems in the returns they prepare. In the past, the IRS has had the ability to identify "*problem preparers*," those whose return preparation work results in repeated errors, negligence, other audit issues and outright fraud. At one time, the IRS published a list of such preparers. Registration and subsequent monitoring will enhance the tracking and remediation of "*problem preparers*." The implementation of the .xml platform to the electronic filing of Form 1040 will efficiently and economically enable extensive and rapid monitoring and reporting.

Prometrics has proven to be an excellent provider of testing services in so many fields of endeavor including the SEE mentioned above. This is yet another opportunity for the IRS to "*build on pieces it already has in place*." This company should be retained and negotiated with as a sole source provider so that it can economically provide this new testing service. This would simplify the burden on the IRS to administer this portion of the regulatory process, as it does for the admission of professionals as Enrolled Agents.

Fees will have to be charged to cover the cost of registration and testing above, as well as to cover any incremental cost of a public awareness campaign discussed briefly below. As already stated, these fees can be minimal if the Treasury and the IRS use the suggestions in this paper. We will illustrate with a brief example:

Consider a registration fee of \$50 per three-year renewal period. This mirrors the fee cycle for EAs. Such a fee will cause a small preparer (100 returns) to raise his price by less than 20 cents. That sounds negligible, but preparers who have not kept current in tax subjects will also incur the cost of continuing education (say 24 CPE hours at \$40/hour including travel costs). That will require a small preparer to raise his price an additional \$4 per return. That's still quite nominal. It's estimated that there are 600,000

to 800,000 tax return preparers in this category. The revenue to the IRS would be approximately \$30-\$40 million at such a fee.

Is it possible to operate this program with \$40 million? **NATP** understands that OPR administers approximately 400,000 Circular 230 professionals now with a budget of about \$6 million. If that's any indicator, given the economies of scale, it would seem possible to be revenue neutral at this fee structure and have a minimum impact on taxpayers. It's also a reasonable fee for tax preparers.

CPE Requirement

NATP believes that a commitment to continuing education is a great indicator of the tax professional's wisdom and competence. Anyone who practices in the field of taxation that is worthy of a client's trust knows from experience that you can never get too much technical education. At a minimum we suggest an annual CPE requirement of 24 hours.

Professionals should be required to pay for their education from whatever source to satisfy this requirement. They should be required to maintain records of completing this education and be prepared to show evidence thereof at any time to the regulators. We believe that monitoring this would not entail anymore activity than what OPR currently performs in the monitoring of Circular 230 professionals, aside from adding staff to meet the additional workload. The monitoring system should already be in place.

The provision of continuing education should be left to the myriad host of companies and associations that already deliver this service. There should be no need, cost, or other requirement for the IRS to enter or function in this arena to provide education for free or less than market price. It would mean utilizing tax dollars to unfairly compete with this business segment. Instead, the IRS should issue guidelines like other regulatory government agencies.

Public Awareness Campaign

The Senate has suggested the idea of a public relations campaign to promote a requirement that American taxpayers use Registered Income Tax Return Preparers (or some other appropriate designation) as part of the effort to regulate. **NATP** agrees that awareness will assist in the adoption of the utilization of registered preparers by the taxpaying public, but we see no need to create another costly process.

The IRS already has significant promotions for numerous campaigns, such as electronic return originators (EROs) and electronic filing. It spends

millions of dollars annually marketing and promoting awareness of "e-file" and "Authorized EROs." We believe the promotion of "Registered Income Tax Return Preparers" could easily and efficiently be combined into existing programs at little, if any, cost to the IRS or the American taxpayer.

NATP has noted that, whenever a "designation" or "title" to describe tax return preparers is proposed in Congress or mentioned through the IRS Office of Professional Responsibility, the term "enrolled" is used. We know that there are credential-specific organizations pushing and supporting such terminology to be used in the public relations campaign. The language contained in previously proposed legislation speaks to the use of the term "enrolled preparers" to describe tax return preparers to be "registered" under this program. This terminology, while known to professionals in the industry, is unknown and perplexing to the public.

A reference to any dictionary will reveal that the common use of the term "enroll" is to signify "signing up." Examples we retrieved from the Internet at Dictionary.com cite "enroll" to mean "to insert or enter in a list, catalog or roll" as in "enrolled the child in kindergarten" or "we enrolled in the Army." Contrast this with the term "licensed." It means "the official or legal permission to do a specified thing" or "to authorize." The public understands what it means to be "licensed" whether that concept is to be able to drive a vehicle, to sell real estate, to sell insurance, or to prepare tax returns.

We have thousands of Enrolled Agents in our membership. They are proud, and justifiably so, of their designation and accomplishment. Yet we continually hear from them that taxpayers do not know what an Enrolled Agent is or what they do. Enrolled Agents have been in existence since the Civil War, yet the public continues to be confused over whom they are and what they do. They have spent considerable sums trying to promote the concept of what being "enrolled" means, to little avail. Does this have to be repeated by the IRS/Treasury in its public awareness campaign?

The dubious success of such a campaign would be further compounded by an attempt to distinguish between "Enrolled Agents" and "Enrolled Preparers." We ought to learn from history and use terminology the public already understands and easily recognizes. To add "Enrolled Preparer" as a descriptor of tax return preparers when there already exists a federal credential of "Enrolled Agent" denoting those that represent taxpayers before the Treasury will only add to the confusion. Imagine the public trying to decide whether they needed to use an Enrolled Agent or an "Enrolled Preparer." We have a concern that this could detract from the value of the EA credential as well as tax professionals in general.

Some organizations are fearful and concerned about the creation of a new tax practice credential. There indeed has been a proliferation of "*credentials*" in this field, but the phenomenon is not isolated to the tax services industry. This method for somehow obtaining and retaining a preferred recognition status has proliferated in trades and services of every kind. The fact remains, however, that a new credential of some kind will indeed have to be created.

NATP serves a diverse population of tax professionals. We have a wide spectrum of constituents. The experience with "*enrolled*" terminology is that it is archaic and difficult to market to the taxpaying public. Our membership would be gravely concerned about its required use as it applies to them. Our EA members would be gravely concerned that the credential they worked so hard to obtain would be diluted or diminished.

There needs to be some way to easily identify qualified tax return preparers and inform the public of who will be authorized to prepare their tax returns if the intent of this program is to be effectively carried out. We strongly suggest that a term such as "*Registered Tax Return Preparer*" or "*Licensed Tax Return Preparer*" be used. Think of the need to conduct an effective, economical public awareness campaign: "*Be sure your federal tax return preparer is a Licensed Preparer, Attorney, CPA or Enrolled Agent.*" This message and the terminology used must be clear to the public, clear to the tax administration system and clear to the tax preparation community.

IRS Assertion That It Doesn't Have Enough Funding

We provided an example above to show that, if tax preparers were charged \$50 for registration, it would provide the IRS \$30 to \$40 million in revenue toward making this program revenue neutral. We trust that this sum of money would therefore keep the IRS from having to redeploy resources from other activities which would have a negative impact on current enforcement, service improvement and revenue collection efforts.

NATP has the utmost respect for the IRS, its leadership and for all it does in the interest of the American people. We have a valued, positive and mutually beneficial relationship with the IRS. At the same time, we find the assertion above disingenuous.

Should the IRS decide that it should undertake initial registration at no cost to the tax professional in an effort to encourage rapid and full participation, it appears to us that the project may be undertaken without duress and noticeable damage to the current activities engaged in. The figure we have suggested as an incremental cost of \$40 million is not out of the realm of reality given current OPR budget levels. That's an increase of

.35 percent to their \$11.6 billion budget. We find it difficult to believe that the Agency couldn't find this kind of efficiency in their processes. American businesses do it all the time, with greater rigor and success. A zero-based budget process may be in order.

We note that Senator Grassley, in a Senate Finance Committee hearing on January 29, 2008 on the nomination of Douglas Shulman as IRS Commissioner stated the following: *"I am concerned about information I have received, that while there are not enough IRS personnel working to enforce tax laws, the amount of time devoted by IRS employees to work for their union is greater than the average for the entire federal government."*

Enforcement

We believe we have already allowed for this item above in the staff up and budget amounts to OPR at three to four times its current budget. The problems with tax return preparers that Congress hopes to wipe out with the sweep of a piece of legislation already exist and have existed for decades. We concede that there could be some increased referrals from audit to OPR as a result of this program. Enforcement already exists and is being funded at higher levels every year.

We gather the enforcement being referenced for this paper has to do with ensuring that all non-Circular 230 preparers indeed register and comply. Registration and testing will only be undertaken by the lawful. It would seem to make sense that the non-compliant will not adhere to this or any other process. Therefore we see no significant incremental cost to the enforcement of this program upon those that are already non-compliant in other areas of the law and therefore are *"clients"* of the IRS enforcement effort already.

"Joint Licensing Board"

Some have recommended that a coalition of professional organizations join together to create a Joint Licensing Board to set licensing fees, testing fees and testing requirements...and to work with the IRS to set examination requirements. **NATP** does not see this as a realistic possibility...not unless the intended result is to limit entry into the industry.

Every professional organization with a credential (and there are quite a few of them) will want to have their specific credential recognized. They will want to bypass altogether organizations that have no credential. We are aware of organizations that have been diligently working toward a credential for just this purpose. The result we see is a lot of infighting, posturing, waste of time and resources, denigration and elimination of practitioners

who are eminently qualified to prepare returns. We see efforts and resources inefficiently used to determine equivalency of credentials or the lack thereof. We see competitive "*war*" between and among professional organizations. This has already been occurring as organizations lobby Congress for the passage of legislation to bring this regulation about. We think a group of experienced field auditors within the IRS would do a better and fairer job of setting licensure and testing standards.

What then? Must the IRS take this responsibility on and risk the likely misunderstanding that it is putting its "*good housekeeping seal of approval*" on the credential that will arise as a result of this program? Aren't there any other neutral alternatives? Yes, there are.

NATP believes Prometrics, or a similarly qualified organization, could easily and economically develop and administer testing. They could use and expand the process of involving the various professional organizations in the development of questions and tests utilizing experienced and recommended non-Circular 230 professionals.

We would also suggest that any "*joint licensing board*" that may arise out of this process would be represented by a diverse, objective panel of people affected by the industry:

- An industry association representative;
- A Business school academician from a University without a tax specialty degree
- A government representative from the IRS, probably from SBSE-audit
- A taxpayer without any particular ties to the industry
- A small business owner
- The Director of OPR or a designee, if the regulation of this license will fall under that jurisdiction. If not, an IRS executive from the jurisdiction licensing will fall under.
- An industry franchiser, such as H & R Block, Jackson-Hewitt, Liberty Tax, etc.
- A community banker
- A financial planner
- Other affected people

How would it work? We envision the creation of some type of "*agency-related*" non-profit organization, perhaps an adjunct organization under the control of the IRS or Treasury. It could be independent and voluntarily affiliated as well. The manner in which the above appointments would be made would have to be negotiated or, perhaps, set out by the IRS in the articles and bylaws of the organization. It would need to be a

transparent body with objective arbiters of problems brought to it by either Congress or the Treasury/IRS. It should be sleek, and uncomplicated, contracting with OPR for the purpose of providing suggestions and guidance...similar in duty to the IRS Oversight Board as it relates to the IRS.

Board members could be moderately compensated for their time and expenses, but the intent would be to meet and conduct business once a quarter at most. The duties of the Board would be to review problems and reports from OPR, make recommendations, hold hearings. Licensing would come under its authority, apart from the IRS or Treasury so there is not a "*government seal of approval*" by the IRS on the licensing designation. OPR would administer the entire licensure program, however, and set the parameters of licensees as it does for Circular 230 practitioners.

Thank you for your time and consideration in reviewing these comments by the **National Association of Tax Professionals (NATP)**.