



*Inadequate Data on Paid Preparers Impedes
Effective Oversight*

July 14, 2009

Reference Number: 2009-40-098

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.

Redaction Legend:

1 = Tax Return/Return Information



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

July 14, 2009

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF EMPLOYED
DIVISION

Michael R. Phillips

FROM:

Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT:

Final Audit Report – Inadequate Data on Paid Preparers Impedes
Effective Oversight (Audit # 200840037)

This report presents the results of our review to determine whether the Internal Revenue Service (IRS) has complete, accurate, and reliable data on tax return preparers for efficient and effective tax administration. This audit was conducted as part of our Fiscal Year 2009 Annual Audit Plan.

Impact on the Taxpayer

More than one-half of all tax returns filed are prepared by paid preparers. However, the IRS cannot determine the population of preparers or if the preparers are compliant with their own tax obligations, as well as compliant with all tax laws and regulations. Tax return preparers have a significant effect on taxpayer compliance. A unique identifying number to control each preparer and an effective management information system are necessary for the IRS to facilitate tax administration and provide effective oversight of preparers.

Synopsis

Management information on paid preparers is incomplete and inconsistent. The IRS maintains significant data on paid preparers, but it is not feasible to use the data to track, monitor, or control preparers' activities and compliance because preparers use multiple identifying numbers when dealing with the IRS, data on preparers are decentralized to more than 20 different systems, and the systems are not integrated.



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Our analyses of tax returns prepared by preparers and submitted in Calendar Year 2008¹ showed preparers used approximately 1.1 million unique identifying numbers and prepared more than 80 million tax returns. Many of these may not be paid preparers because almost one-half of these tax returns were filed by preparers who filed fewer than six tax returns.

One of the IRS' key objectives in its 2009–2013 Strategic Plan is to ensure that preparers adhere to professional standards and follow the law. Currently, the IRS does not have a sufficient management information system to effectively achieve this goal, including a control to require that preparers have one unique identifying number. Test results from a statistical sample of 139 preparers demonstrated many of the challenges the IRS would face in attempting to identify the population of preparers and determine if they are regulated and compliant with their own tax obligations, as well as with all tax laws and regulations.

- Multiple identifying numbers were used by 93 (67 percent) of 139 preparers.
- The names of the 139 preparers in various systems were inconsistent 45 percent of the time.
- There were inconsistencies in 24 percent of the preparers' street addresses listed in the various systems, while telephone numbers varied 40 percent of the time.
- In 10 instances, IRS records showed the preparers were attorneys, although our research completed on State web sites showed only 2 preparers were members of that States' Bar Associations. Seven preparers were listed in the IRS records as both an attorney and Certified Public Accountant; we only verified that one held both designations.

Seven (5 percent) of the 139 preparers in the statistical sample were not compliant with their own tax obligations. Three preparers had delinquent tax returns; five owed taxes. There are currently no Federal laws or regulations requiring a preparer to be compliant with his or her own tax obligations before preparing tax returns for others.

Furthermore, nine preparers sampled used invalid identifying numbers on the tax returns they prepared.² These tax returns were submitted on paper. A review of ¹ of the nine³ paper tax returns showed

¹ [REDACTED]

Recent Treasury Inspector General for Tax Administration reports have addressed issues surrounding preparer management information, which included recommendations requiring

¹ These data were extracted for tax returns prepared by tax preparers and submitted to the IRS for Calendar Year 2008 through July 12, 2008.

² Two samples of 139 preparers were selected. The nine were from the first sample. See Appendix I for details of the sampling methodology.

³ We requested the nine tax returns from the IRS but received only ¹ [REDACTED]



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preparers to use unique identifying numbers.⁴ Currently, it is not feasible to effectively identify preparers and enforce the preparer requirements to sign tax returns and provide identifying numbers. Requiring a unique identifying number for all preparers would help provide the standardization the IRS needs to identify the preparer population and enforce tax laws and regulations. Developing a management information system around its current internal systems, with the ability to determine the designations of preparers, would allow the IRS to develop business rules to control, track, and monitor preparers.

Recommendations

We recommended that the Commissioner, Small Business/Self-Employed Division, revise the target completion date for its study on requiring preparers to use a single identification number when filing tax returns. This will ensure the IRS has a means to control and track preparer activities by the 2011 Filing Season. The Commissioner should develop a method to enforce Internal Revenue Code Section (§) 6695(c) that imposes a penalty on preparers who do not provide an identification number on tax returns they prepare. Finally, the Commissioner should develop a comprehensive data management system that allows the IRS, at a minimum, to determine the population of preparers by eliminating discrepancies and duplicates between systems. This system should include business rules that would allow the IRS to control, track, and monitor preparers' activities.

Legislative Recommendation

Establish a requirement that paid preparers be compliant with their own Federal tax filing requirements in order to be allowed to prepare tax returns for others for a fee.

Response

IRS management agreed with two recommendations and agreed in principle with two other recommendations. In its response to this report, the IRS stated that it has recently launched the Tax Return Preparer Review that is expected to cover a broad range of areas related to paid preparers. By the end of this calendar year, the IRS intends to propose a comprehensive set of recommendations designed to better leverage the tax return preparer community with the IRS' dual goals of increasing taxpayer compliance and ensuring uniform and high ethical standards of conduct for tax preparers.

⁴ *Information on the Centralized Authorization File Is Often Not Accurate or Complete* (Reference Number 2004-10-148, dated August 25, 2004) and *Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors* (Reference Number 2008-40-171, dated September 3, 2008).



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Relating to specific recommendations, IRS management agreed to develop a method to enforce Internal Revenue Code § 6695(c) that imposes a penalty on preparers who do not provide an identification number on tax returns they prepare. Management also agreed with our recommendation to develop a comprehensive data management system that allows the IRS, at a minimum, to determine the population of preparers by eliminating discrepancies and duplicates between systems. They added, however, that they were not in a position at this time to independently recommend a specific methodological approach to this issue.

IRS management agreed in principle that tax preparers should use a single identification number when filing tax returns. They also agreed in principle to require paid preparers to be compliant with their own Federal tax filing requirements. Management stated that the Tax Return Preparer Review team will be addressing these issues. Management also responded to a recommendation related to amending Internal Revenue Code § 6695(c) to impose a penalty on preparers who do not provide the required single identifying numbers when preparing tax returns; however, based on prior discussions with the IRS, we had agreed to remove this recommendation. The IRS stated that it can accomplish this without a legislative change. Management's complete response to the draft report is included as Appendix V.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. Because this report contains a legislative recommendation, we will provide a copy to the Assistant Secretary of the Treasury for Tax Policy. Please contact me at (202) 622-6510 if you have questions or Michael E. McKenney, Assistant Inspector General for Audit (Returns Processing and Account Services), at (202) 622-5916.



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Abbreviations

| | |
|-------------------------|---------------------------------------------------|
| IRS | Internal Revenue Service |
| <i>E-file (E-filed)</i> | Electronically file or Electronically filed |
| PTIN | Preparer Tax Identification Number |
| TIGTA | Treasury Inspector General for Tax Administration |



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Background

Every year, more than one-half of all taxpayers pay someone else to prepare their income tax returns. In Calendar Year 2008, the Internal Revenue Service (IRS) processed approximately 86.9 million individual Federal income tax returns prepared by paid preparers. This is up more than 4 percent from the nearly 83 million tax returns prepared by paid preparers that the IRS

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

- Licensed professionals, such as attorneys and Certified Public Accountants. These licensed professionals are regulated by the State licensing authority.
- 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 three States—California, Maryland, and Oregon—have requirements for unenrolled paid preparers. In these States, unenrolled paid preparers must register with State agencies and meet continuing education requirements.

processed in Calendar Year 2007. Currently, there are no national standards that a preparer is required to satisfy before selling tax preparation services to the public. 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, Maryland, 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, and Enrolled Agents. 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.

The IRS Office of Professional Responsibility regulates, for example, attorneys, Certified Public Accountants, and Enrolled Agents who practice before the IRS. Practice is defined broadly in



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Treasury Department Circular 230¹ 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.

Preparers can also be Electronic Return Originators. 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 firm or collected from taxpayers. Applicants to the Electronic Filing Program must pass certain IRS checks, including limited criminal background checks. Participants are also monitored.

This review was performed at the Detroit Computing Center in Detroit, Michigan, the Office of Professional Responsibility in Washington, D.C., the Wage and Investment Division Headquarters in Atlanta, Georgia, and the Small Business/Self-Employed Division in Lanham, Maryland, during the period July 2008 through February 2009. This review focused on preparers of individual tax returns [i.e., U.S. Individual Income Tax Return (Form 1040)] and did not include preparers of corporate, partnership, or estate income tax returns. 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. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

¹ *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)].



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Results of Review

Management Information on Paid Preparers Is Incomplete and Inconsistent

Because more than one-half of all tax returns filed are prepared by paid preparers, tax return preparers have a significant effect on taxpayer compliance. Although the IRS maintains extensive data on paid preparers, it is not feasible to use the data to track, monitor, or control preparers' activities and compliance because preparers use multiple identifying numbers when dealing with the IRS, data on preparers are decentralized to more than 20 different systems, and the systems are not integrated.

Foremost, the IRS cannot determine the population of preparers, which tax returns they prepared, or which taxpayers they represent. Additionally, it cannot determine if the preparers are compliant with their own tax obligations, as well as compliant with all tax laws and regulations.

Government Accountability Office standards require that there be sufficient management to effectively control operations and make decisions and should be an integral component of a system of internal controls. A unique identifying number to control each preparer and an effective management information system are necessary for the IRS to better facilitate tax administration and provide effective oversight of preparers.

The IRS does not currently require paid preparers to have a unique identifying number

The IRS maintains multiple lists, databases, and systems that contain preparer information; however, there are no data standards among these to easily match preparer information and preparers are not required to use one identifying number. In-depth analyses and judgmental decisions are required to match information on preparers from the various systems.

The IRS requires paid preparers to sign the tax returns they prepare and to identify themselves using *either* their Social Security Numbers or Preparer Tax Identification Numbers (PTIN).² If

² A PTIN 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 issued by the IRS beginning with the letter "P" followed by eight numeric digits.



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they are self-employed or a member of a firm, they are also to provide their Employer Identification Numbers.³

Figure 1 shows that there were approximately 1.1 million unique identifying numbers used to file the 80.5 million tax returns submitted by paid preparers in Calendar Year 2008.⁴

³ An Employer Identification Number is a unique nine-digit number used to identify a taxpayer's business account on IRS records. The IRS also requires that paid preparers enter their firms' information, if the preparers are part of a firm.

⁴ These data were extracted for tax returns prepared by tax preparers and submitted to the IRS for Calendar Year 2008 through July 12, 2008, and subsequent references to Calendar Year 2008 tax returns include only tax returns submitted to the IRS through July 12, 2008.



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**Figure 1: Treasury Inspector General for Tax Administration’s (TIGTA)
Attempt to Determine the Population of Preparers Who Submitted
Tax Returns in Calendar Year 2008**

| Identification Number Used | Number of Tax Returns | Identifying Numbers | Unique Identifying Numbers |
|--------------------------------------------------------------|--------------------------|------------------------|----------------------------------|
| Employer Identification Number Only | 3,076,291 | 32,690 | 32,690 |
| PTIN Only | 6,738,446 | 65,061 | |
| PTIN and Employer Identification Number | 49,789,637 | 287,905 | |
| Unique Preparer Tax Identification Numbers | | | 340,643 |
| Social Security Number Only | 4,835,614 | 79,118 | |
| Social Security Number and Employer Identification Number | 14,768,352 | 127,935 | |
| Unique Social Security Numbers | | | 202,206 |
| Total of All Unique Paid Preparers | | | 575,539 |
| Prepared Fewer Than Six Tax Returns ⁵ | 989,248 | 626,202 | 555,896 |
| No Identifying Number | 330,909 | | |
| Totals | 80,528,497 | 1,218,911 | 1,131,435 |

Source: Our analysis of the IRS’ Individual Return Transaction File.⁶

However, these may not be unique preparers. For example, Preparer John S. Doe could use multiple numbers—his Social Security Number to file some tax returns and his PTIN to file others. Additionally, he may not use any identifying number and he may sign the tax return using variations of his name, for example, John Doe, John S. Doe, or J. Doe.

Trying to identify the total number of unique preparers requires significant resources to collect preparer identifying numbers and other information from each IRS system, compare the information collected to identify discrepancies between the systems, and ultimately make a judgmental decision on which set of identifying numbers define a unique preparer.

⁵ Preparers who had prepared a low volume of tax returns may not be paid preparers.

⁶ The Returns Transaction File contains all edited, transcribed, and error-corrected data from the U.S. Individual Income Tax Returns (Form 1040 series) and related forms for the current processing year and 2 prior years.



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The IRS also does not validate preparers' identifying numbers (i.e., the Employer Identification Numbers, PTINs, or Social Security Numbers) listed in the paid preparers section of tax returns when processing them. Furthermore, no identifying numbers were provided on 330,909 tax returns. It is currently not practical to verify preparers' identifying numbers. The IRS allows preparers to use multiple numbers and it would have to access multiple systems to verify the numbers. This would delay the processing of tax returns.

No identifying numbers were provided on 330,909 tax returns filed by preparers in Calendar Year 2008.

Furthermore, tax returns filed without identifying numbers are not rejected because processing tax returns is a priority for the IRS. There is no law or regulation to reject or delay the processing of a tax return when no preparer identification number is provided. The Internal Revenue Code, however, does impose penalties on preparers who do not sign the tax returns or provide an identifying number. The penalty for failure to sign the tax return or furnish an identifying number on the tax return is \$50 per failure up to a maximum of \$25,000.

Some individuals may not be paid preparers and were excluded from the statistical sample

Almost one-half of the preparers with identifying numbers (555,896 of 1,131,435) submitted fewer than 6 tax returns in Calendar Year 2008 and were not included in the statistical sample. Twenty-seven percent (301,616 of 1,131,435) of these preparers provided only their Social Security Numbers.

Also, since these preparers had prepared a low volume of tax returns, they may not be paid preparers. For example, friends or relatives might have helped the taxpayers prepare their tax returns and mistakenly completed the preparer section of the tax form. They should not have completed this section of the tax return since they are not paid preparers.

Six percent of the preparers provided invalid identifying numbers

From a random sample of 139 preparers,⁷ 9 preparers (6 percent) could not be identified because the identifying numbers were invalid. Additionally, since the tax returns were submitted on paper, the names of the preparers were not recorded on the Individual Return Transaction File. When paper tax returns are transcribed, the names of the preparers are not included in the transcriptions.

A review of [redacted] of the nine⁸ paper tax returns [redacted]

[redacted] Since the IRS does not validate the information entered in the "Paid Preparer's Use Only" section of tax

⁷ Two samples of 139 preparers were selected. The nine were from the first sample. See Appendix I for details of the sampling methodology.

⁸ We requested the nine tax returns from the IRS but received only [redacted]



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returns or transcribe the names of the preparers when the returns are submitted on paper, it was not possible to identify these preparers.

Preparers' names and other identifying information are inconsistent among IRS systems

We selected a statistical sample of 139 preparers to analyze the information the IRS maintains on tax return preparers. Figure 2 shows the various combinations of identifying numbers used by the 139 preparers sampled. Ninety-three (67 percent) of the 139 preparers sampled were identified in various IRS systems using multiple identifying numbers.

Figure 2: Preparers Sampled Used Multiple Identifying Numbers to Prepare Tax Returns

| Identification Number Used | Number of Preparers |
|---------------------------------------------------------------------------------------------|----------------------------|
| Employer Identification Number Only | 1 |
| PTIN Only | 8 |
| PTIN and Employer Identification Number | 15 |
| Social Security Number Only | 12 |
| Social Security Number and Employer Identification Number | 10 |
| Various Combinations of Employer Identification Numbers, PTINs, and Social Security Numbers | 93 |
| Total | 139 |

Source: Our analysis of the IRS' various systems for the sample of preparers.

Three (2 percent) of the 139 preparers who used their Employer Identification Numbers also entered their Employer Identification Numbers as their preparer identifying number. For example, Employer Identification Number 12-3456789 was altered and entered as the Social Security Number 123-45-6789.

Additionally, between the systems reviewed, the names of the 139 preparers sampled were inconsistent 45 percent of the time. For example, in one system preparer information consisted of a first name, middle initial, and last name, but in another system only the last name was provided with the initials instead of the first and/or middle name. Twenty-four names (17 percent) were not listed on any of the IRS systems we researched. Furthermore, there were inconsistencies in 24 percent of the preparers' street addresses listed in the various systems, while telephone numbers varied 40 percent of the time. For 82 addresses (59 percent) and



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37 telephone numbers (27 percent), we could not determine if differences existed because not enough information was present.

Preparer designations cannot be determined using only IRS internal data

We could not determine from IRS internal sources which preparers were practitioners (regulated). Other than data obtained from the tax returns filed by preparers, the IRS maintains only the following on paid preparers:

- Preparers it regulates – Electronic Return Originators and Enrolled Agents.
- Preparers when they are either authorized to represent taxpayers in front of the IRS or receive information, such as taxpayer account information or notices, from the IRS on behalf of taxpayers.
- Practitioners who have allegations of misconduct or have had disciplinary actions taken against them.

Power of Attorney and Declaration of Representative (Form 2848)

Under penalties of perjury, the representative must declare on Form 2848 that he or she is not currently under suspension or disbarment from practice before the IRS, is aware of regulations contained in Circular 230, and is authorized to represent the taxpayer(s) for tax matter(s) as one of the following:

- 1) Attorney.
- 2) Certified Public Accountant.
- 3) Enrolled Actuary.
- 4) Enrolled Agent.
- 5) Enrolled Retirement Plan Agent.
- 6) Family Member.
- 7) Full-Time Employee.
- 8) Officer.
- 9) Student Attorney.
- 10) Student Certified Public Accountant.
- 11) Unenrolled Return Preparer.

The IRS maintains a database, the Centralized Authorization File, of individuals who complete a Power of Attorney and Declaration of Representative (Form 2848) and submit it to the IRS so they can represent taxpayers in tax matters before the IRS. This Centralized Authorization File contains the name, complete address, and telephone number(s) of the representative, as well as an assigned Centralized Authorization File number, if one is assigned. It also contains the representative's declaration stating he or she is 1 of 11 designations.

Figure 3 compares the designations of preparers per IRS records with the results of our research of preparer information captured in various IRS systems and State Internet web sites.



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**Figure 3: Comparison of Preparer Designations
per IRS Records and TIGTA Research**

| Designations | IRS Records | TIGTA Research | Percentage per TIGTA Research |
|-------------------------------------------------|------------------------|----------------|-------------------------------|
| Attorney | 3 | 1 | .7% |
| Attorney and Certified Public Accountant | 7 | 1 | .7% |
| Certified Public Accountant | 25 | 31 | 22% |
| Enrolled Agent | 5 | 5 | 4% |
| No Designation Found in IRS Records/Unregulated | 99 | 101 | 73% |
| Total | 139⁹ | 139 | 100% |

Source: The IRS' Centralized Authorization File and Enrolled Practitioner Program System,¹⁰ and our research of State Internet web sites.

In 10 instances, the Centralized Authorization File showed the preparers were attorneys. However, research completed on State web sites showed only two preparers were members of that States' Bar Associations. Seven preparers were listed in the Centralized Authorization File as both an attorney and Certified Public Accountant. We only verified that one held both designations. Resolving the discrepancies would require analyzing the Forms 2848 and conducting additional research to determine if the discrepancies were caused by employee input error, taxpayer and/or representative misunderstanding, or misrepresentation by the representative.

The IRS relies heavily on its employees to review the accuracy of a taxpayer representative declaration and forward identified irregularities for the appropriate disciplinary action(s). Field employees, such as Revenue Officers, should verify the accuracy of information on declaration forms when they accept them, but Centralized Authorization File employees do not verify the information before accepting the authorizations to represent taxpayers before the IRS.

Verifying designations manually is resource intensive. It is not clear whether automating the verification of designations would be feasible and/or cost effective. It would require interfacing with State Licensing Boards.

⁹ Sixty-one (44 percent) of 139 of the preparers were also Electronic Return Originators.

¹⁰ The Enrolled Practitioner Program System is used by the Office of Practitioner Enrollment, an entity of the Office of Professional Responsibility, to control Enrolled Agents.



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Using current IRS systems, it is possible to identify the tax returns prepared by preparers and identify those preparers who have been granted authorizations to represent taxpayers before the IRS

Although the 139 preparers sampled used multiple identifying numbers, we were able to determine how many and which tax returns were prepared by each of the preparers. The 139 preparers in our sample prepared almost 36,000 tax returns, of which 83 percent were electronically filed (*e-filed*) returns. Twelve (9 percent) of the 139 preparers sampled have current authorizations on the Centralized Authorization File.

The probability of correctly identifying preparers and the tax returns they prepare increases if the tax return is *e-filed*. To participate in the *e-file* Program, individuals are required to apply to the IRS and include their Social Security Numbers along with other addresses and professional designations. If they pass certain suitability checks, they are provided a unique Electronic Filing Identification Number that allows them to participate in the *e-file* Program.

All data in the “Paid Preparer’s Use Only” portion of tax returns are captured when a tax return is *e-filed*. Figure 4 provides an excerpt of paid preparer identifier requirements on the Form 1040.

**Figure 4: Excerpt From Form 1040,
Paid Preparer Identifier Requirements**

| | | | | |
|-----------------------------------------|------------------------------------------------------------------|------|-------------------------------------------------|------------------------|
| Paid Preparer's Use Only | 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.

When tax returns are submitted on paper and the return indicates it was prepared by a paid preparer, IRS employees input only a Preparer Code and transcribe the following three data fields: 1) PTIN or Social Security Number; 2) the Employer Identification Number; and 3) the telephone number. The name of the preparer is not transcribed nor is the name of the firm or if the preparer is self-employed. This makes it more difficult to identify the preparer if any of the identifying numbers are incorrect or illegible.

The 12 preparers sampled who have current authorizations on the Centralized Authorization File appear to represent 223 taxpayers. In addition, it appears that some taxpayers have more than one representative per tax period. In Fiscal Year 2004, the TIGTA reported that the Centralized Authorization File is not always accurate.¹¹ The records often contained incomplete or incorrect information. Therefore, to be certain that each authorization is current and that taxpayers had authorized more than one representative per tax period, we would have to test the accuracy of the

¹¹ *Information on the Centralized Authorization File Is Often Not Accurate or Complete* (Reference Number 2004-10-148, dated August 25, 2004).

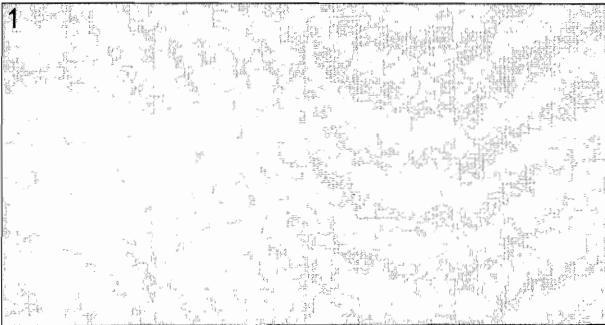
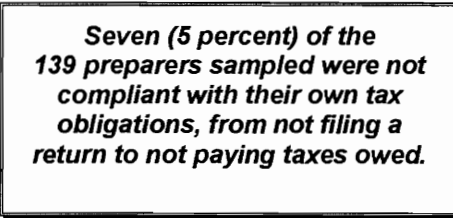




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Centralized Authorization File or examine each authorization. Resources did not permit us to conduct this additional research at this time.

Five Percent of Preparers Were Not Compliant With Their Own Tax Obligations

Seven (5 percent) of the 139 preparers sampled were not compliant with their own tax obligations; 5 owed taxes.

- 1 

- 3 had not filed a Tax Year 2006 return, 1 
- 3 had not paid all taxes owed and were in delinquency status.

These preparers prepared more than 2,000 tax returns, of which 605 returns (29 percent) were submitted on paper. Total income on the tax returns by these preparers ranged from no income to more than \$100,000, with the majority less than \$38,000. Three of the preparers claimed to be self-employed. 1 

There are currently no Federal laws or regulations requiring a preparer to be compliant with his or her own tax obligations before preparing tax returns for others

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.

Although there are no national standards that preparers are required to satisfy before selling tax preparation services to the public, all paid preparers are subject to Internal Revenue Code penalties, civil and criminal.¹² For example, civil penalties apply if paid preparers do not sign the tax returns they 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.

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



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In addition, practitioners governed by Circular 230 are subject to disciplinary actions if they fail to file a required Federal tax return or evade assessment or payment of Federal tax. This can prevent a practitioner from representing the taxpayer in tax matters before the IRS, but not from preparing tax returns for others.

In a Fiscal Year 2006 audit, we reported that the IRS had no method to identify practitioners who were not compliant with their own tax obligations.¹³ In a Fiscal Year 2009 audit, we reported that the Office of Professional Responsibility was unaware of a significant number of licensed tax practitioners who were assessed penalties, sentenced in a criminal proceeding, or enjoined for tax shelter violations.¹⁴ As a result, these tax practitioners were still eligible to represent taxpayers before the IRS.

One of the IRS' objectives in its Strategic Plan 2009-2013 is to ensure that all tax practitioners, tax preparers, and other third parties in the tax system adhere to professional standards and follow the law. Currently, the IRS does not have a sufficient management information system to effectively achieve this goal, including the control requiring that preparers have one unique identifying number.

Legislative Recommendation

Recommendation 1: Establish a requirement that paid preparers be compliant with their own Federal tax filing requirements in order to be allowed to prepare tax returns for others for a fee.

Management's Response: IRS management agreed in principle that paid preparers should be compliant with their own Federal tax filing requirements. Compliance checks are already performed by the Office of Professional Responsibility during the enrolled agent admission and renewal processes and by the Wage and Investment Division prior to acceptance of a preparer into the Electronic Return Originator Program. The Commissioner's Tax Return Preparer Review team will be making recommendations by the end of the year, in part, on how to ensure uniform and high ethical standards of conduct and competence for preparers. Accordingly, the IRS is not in a position at this time to independently recommend that such a requirement be established.

Office of Audit Comment: In its response, the IRS stated that it has recently launched the Tax Return Preparer Review that is expected to cover a broad range of areas related to paid preparers. By the end of this calendar year, the IRS intends to propose a comprehensive set of recommendations designed to better leverage the tax return preparer community with the IRS' dual goals of increasing taxpayer compliance and

¹³ *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 31, 2006).

¹⁴ *Tax Practitioners Promoting Abusive Tax Shelters Are Still Able to Represent Taxpayers Before the Internal Revenue Service* (Reference Number 2009-10-039, dated February 20, 2009).



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ensuring uniform and high ethical standards of conduct for tax preparers. Therefore, we agree that the IRS will be in a better position at that time to independently recommend that such a requirement be established.

The Internal Revenue Service Does Not Have a Sufficient Data Management System to Control Preparers to Allow It to Achieve Its Strategic Goals

In Fiscal Year 2008, the IRS began implementing a Return Preparer Strategy. The IRS states that the Return Preparer Strategy incorporates service, education, outreach, and enforcement activities that are based on data-driven decisions; recognizes the importance of feedback (both internal and external); and is supported by effective and efficient technology. The Strategy includes the following objectives:

- Enhance knowledge management to better understand and respond to preparer needs, preferences, and behaviors.
- Explore alternative compliance strategies with the goal of improving coverage of return preparers.
- Develop new research initiatives to identify fraudulent return preparers and other areas of potential abuse and noncompliance by return preparers.
- Create a data management strategy that connects return preparer information on an IRS-wide basis.

The Practitioner Information and Classification System was to interface with 22 existing IRS systems, in addition to interfacing with applications from States and other Federal Government agencies.

The Office of Professional Responsibility investigated the need for a database that could control and monitor all paid preparers, both practitioners and unregulated preparers. IRS officials stated that an initial estimate to create a single database to control preparers was \$100,000. However, after research was done, a new direction was taken, and in January 2007 a \$48 million data management system (called the Practitioner Information and Classification System) was proposed. This proposed System would integrate 22 existing IRS systems, connecting preparer return information on an IRS-wide basis. The proposed System was a centralized database of preparer information and would have created automated mechanisms to ensure that return preparers are adhering to professional standards of conduct and following the law. Developers stated that the system would facilitate quick and easy identification of return preparer trends, issues, and tax return filing histories. Because the estimated costs to develop and maintain the system for 10 years were \$48 million, the system was not approved for development.

The Office of Professional Responsibility recently purchased a commercial computer software application for about \$175,000 that will replace the Enrolled Practitioner Program System and is



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currently being configured to meet the needs of the Office of Professional Responsibility. The new application will control Enrolled Agents, Enrolled Retirement Plan Agents, and Enrolled Actuaries and will track enforcement cases of all Circular 230 practitioners. IRS officials stated that all preparers could be controlled on this system, but major modifications to the system would be required.


One of the IRS' key objectives in its current strategic plan is to ensure that preparers adhere to professional standards and follow the law

Currently, the IRS does not have a sufficient management information system to effectively achieve this goal, including a control to require that preparers have one unique identifying number. Test results from our sample of 139 preparers demonstrated many of the challenges the IRS would face in attempting to identify the population of preparers, determine if they are regulated and the taxpayers they represent, and if they are compliant with their own tax obligations. This information resides on various IRS systems, but because preparers do not have a unique identifying number and the systems are not integrated, the data are not useable to control, track, and monitor preparers.

A reliable management information system is vital for the IRS to achieve this goal. Additionally, systemic and management controls are necessary to help ensure the validity, completeness, and accuracy of system data. A management information system with related controls would enable IRS management to effectively monitor preparer activities and would be useful to identify preparers and issues for outreach and enforcement actions.

For example, from our statistical sample, we project that there are about 498,289 paid preparers who prepared and filed tax returns processed in Calendar Year 2008. Of these, approximately:

- 73 percent appear to be unregulated (i.e., are not attorneys, Certified Public Accountants, or Enrolled Agents). Unregulated preparers prepared about 65 percent of the tax returns.
- 39 percent are self-employed and prepared 48 percent of the tax returns.
- 37 percent were employed by a commercial chain and prepared 29 percent of the tax returns.



Eighty-three percent of all tax returns prepared by preparers in our sample were e-filed, compared to about 60 percent of all individual tax returns e-filed.

The 139 preparers sampled prepared almost 36,000 tax returns. Figure 5 provides a comparison of the number of tax returns for our sample of 139 preparers by comparing regulated to unregulated, self-employed to other employment statuses, and chain to independent preparer.



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**Figure 5: Comparison of the Number of Tax Returns Prepared
for the 139 Preparers in Our Statistical Sample**

| Category of Preparer | Total Number of Tax Returns Prepared | Percentage of Total Returns Prepared | Percentage of Tax Returns <i>E-Filed</i> |
|----------------------------|--------------------------------------------|-----------------------------------------------|------------------------------------------------|
| Regulated | 12,447 | 35% | 81% |
| Unregulated | 23,479 | 65% | 84% |
| Total Tax Returns | 35,926 | 100% | |
| Self-Employed | 17,200 | 48% | 78% |
| Other Employment Status | 18,726 | 52% | 88% |
| Total Tax Returns | 35,926 | 100% | |
| Chain | 10,534 | 29% | 95% |
| Independent | 25,392 | 71% | 78% |
| Total Tax Returns | 35,926 | 100% | |

Source: Our analysis of the IRS Return Transaction File.

Additionally, regulated preparers and preparers not affiliated with a commercial chain prepared most of the tax returns with income more than \$100,000. Commercial chain preparers prepared the least number of tax returns with income more than \$100,000. Figure 6 breaks down taxpayer income for the 139 preparers by the same categories as Figure 5.



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**Figure 6: Comparisons of Taxpayer Income
for the 139 Preparers in Our Statistical Sample**

| Category of Preparer | No Income | \$1 to \$14,999 | \$15,000 to \$38,646 | \$38,647 to \$74,999 | \$75,000 to \$99,999 | \$100,000 and More | Total |
|-----------------------------------|-----------|-----------------|----------------------|----------------------|----------------------|--------------------|---------------|
| Regulated | 227 | 2,249 | 2,891 | 3,404 | 1,434 | 2,242 | 12,447 |
| Unregulated | 439 | 6,881 | 9,009 | 5,054 | 1,244 | 852 | 23,479 |
| Total Tax Returns Prepared | | | | | | | 35,926 |
| Self-Employed | 335 | 3,902 | 5,555 | 4,365 | 1,444 | 1,599 | 17,200 |
| Other Employment Status | 331 | 5,228 | 6,345 | 4,093 | 1,234 | 1,495 | 18,726 |
| Total Tax Returns Prepared | | | | | | | 35,926 |
| Chain | 159 | 3,653 | 4,203 | 1,841 | 407 | 271 | 10,534 |
| Independent | 507 | 5,477 | 7,697 | 6,617 | 2,271 | 2,823 | 25,392 |
| Total Tax Returns Prepared | | | | | | | 35,926 |

Source: Our analysis of the IRS Return Transaction File.

Paid tax return preparers are a critical component and stakeholder in tax administration and represent an important intermediary between taxpayers and the IRS. They are also an important component in IRS efforts to close the tax gap. The tax return preparer community provides a unique opportunity to affect taxpayer behavior and compliance with the tax laws.

Recent TIGTA reports have addressed the issues surrounding preparer management information and a unique preparer number

Since Fiscal Year 2006, the TIGTA has been reporting that a unique identifying number for preparers would benefit the IRS. In a March 2006 audit report, we recommended the IRS develop a method of uniquely identifying representatives on the Centralized Authorization File that does not require representatives to use Social Security Numbers on Form 2848.¹⁵ The IRS agreed and responded that it would coordinate with the Department of the Treasury to develop a method to uniquely identify representatives on the IRS Centralized Authorization File. To date, a unique identifying number for practitioners has yet to be developed.

¹⁵ *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 31, 2006).



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In September 2008, we reported that the IRS had limited information on preparers and that a unique identification number would enable the IRS to better use its current databases to identify and evaluate preparers' compliance.¹⁶ The IRS agreed to study this issue by July 2010.

In February 2009, we reported that with its current processes the IRS cannot determine how many complaints against tax return preparers it receives, how many complaints are worked, and the total number of multiple complaints against a specific firm or preparer.¹⁷ We recommended and the IRS agreed to develop a database(s) or tracking system to efficiently control the complaints.

Requiring the use of PTINs could help the IRS move forward in its preparer strategy

The Practitioner Information and Classification System was to provide the IRS with an automated multi-functional system. However, IRS officials stated that its development required significant additional funding. Currently, Enrolled Agents, preparers with PTINs, and Electronic Return Originators are controlled on two IRS systems. Preparers with PTINs and Electronic Return Originators are controlled on the Third Party Data Store,¹⁸ while Enrolled Agents are controlled on the Enrolled Practitioner Program System (soon to be controlled on a new system). These two systems automate the application process, including renewals, and maintain an inventory of preparers.

In Fiscal Year 2003, the IRS attempted to use the Centralized Authorization File 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.

Requiring that all preparers use a unique identifying number would allow the IRS, for example, to use the PTIN application process and the Third Party Data Store to control all preparers and provide it with a means to identify the population of preparers. The Application for Preparer Tax Identification Number (Form W-7P) could be updated to include a preparer designation. System controls, much like those for Enrolled Agents or Electronic Return Originators, could be considered to verify the information on the Form W-7P. See Figure 7 for an excerpt of the Form W-7P.

¹⁶ *Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors* (Reference Number 2008-40-171, dated September 3, 2008).

¹⁷ *The Process Taxpayers Must Use to Report Complaints Against Tax Return Preparers Is Ineffective and Causes Unnecessary Taxpayer Burden* (Reference Number 2009-40-032, dated February 24, 2009).

¹⁸ The Third Party Data Store is an IRS system used to record and monitor the information on e-Providers. E-providers include Electronic Return Originators and others who use various IRS electronic services.



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Figure 7: Form W-7P

| Form W-7P (Rev. August 2007) Department of the Treasury Internal Revenue Service | | Application for Preparer Tax Identification Number | | |
|--------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------|---------------------------------------|---------------------|
| 1 Name (Type or print) | Last name | First name | Middle name/initial | |
| 2 Address (residence) | Street address. Use a P.O. box number only if the post office does not deliver mail to your street address. | | | |
| <input type="checkbox"/> Check here if address is new | City or town, state/province, and, if outside the U.S., country. Include ZIP or postal code where appropriate. Do not abbreviate name of country. | | | |
| 3 SSN and Date of Birth | SSN | Date of birth (month, day, year) | | |
| Sign Here | Your signature | | Date (month, day, year) MM DD YYYY | Phone number () |

Source: IRS.gov.

Since Fiscal Year 2005, the IRS' strategic plans have included an objective to ensure that accountants, attorneys, and other tax practitioners adhere to professional standards and follow the law. Since Fiscal Year 2006, the TIGTA has identified concerns that could prevent the IRS from effectively achieving this objective. Yet, it is still not feasible for the IRS to efficiently identify all preparers or enforce the requirement to sign the tax returns and or provide identifying numbers. Requiring a PTIN for all preparers would help provide the standardization the IRS needs to identify the preparer population and enforce the Internal Revenue Code. Using the PTIN application process would provide the IRS with the ability to determine the designations of preparers and to build business rules to control, track, and monitor preparers using its internal systems.

Recommendations

The Commissioner, Small Business/Self-Employed Division, should:

Recommendation 2: Revise the target completion date for its study on requiring preparers to use a single identification number when filing tax returns. This will ensure the IRS has a means to control and track preparer activities by the 2011 Filing Season—the current date of July 2010 could delay implementation beyond the 2011 Filing Season.

Management's Response: The IRS agreed in principle that preparers should use a single identification number when filing tax returns. The issue of PTINs for use by tax return preparers is on the Department of the Treasury 2008–2009 Priority Guidance Plan. The Department of the Treasury and the IRS are looking at the issue of requiring all paid return preparers to obtain and use a single identification number when preparing tax returns as part of that guidance project. The IRS is not proceeding with the study because this issue is being addressed through priority guidance. It will formally request



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cancellation of the feasibility study corrective action from our prior audit.¹⁹ Further, the Tax Return Preparer Review discussed in Recommendation 1 is expected to encompass this issue as part of the Commissioner's comprehensive recommendations. The IRS will provide a copy of the guidance once it is published.

Office of Audit Comment: In its response, the IRS stated that it has recently launched the Tax Return Preparer Review that is expected to cover a broad range of areas related to paid preparers, including the issue that preparers should use a single identification number when filing tax returns. Therefore, we agree that the IRS should cancel the feasibility study corrective action. We will review the guidance once it is published.

Recommendation 3: Develop a method to enforce Internal Revenue Code Section (§) 6695(c) that imposes a penalty on preparers who do not provide an identification number on tax returns they prepare.

Management's Response: The IRS agrees with this recommendation. The Director, Examination, Small Business/Self-Employed Division, will commission a cross-functional team to study the issue and to make recommendations on a plan to both educate paid preparers about their responsibilities under Internal Revenue Code § 6109 and a plan to enforce compliance by imposing Internal Revenue Code § 6695(c) when warranted.

Recommendation 4: Develop a comprehensive data management system that allows the IRS, at a minimum, to determine the population of preparers by eliminating discrepancies and duplicates between systems. This system should include business rules that would allow the IRS to control, track, and monitor preparers' activities.

Management's Response: The IRS agrees with this recommendation. The IRS stated that a comprehensive method to identify and track the population of tax return preparers is needed. The Tax Return Preparer Review discussed in Recommendation 1 is expected to encompass this issue as part of the Commissioner's comprehensive recommendations. Accordingly, the IRS is not in a position at this time to independently recommend a specific methodological approach to this issue.

¹⁹ *Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors* (Reference Number 2008-40-171, dated September 3, 2008).



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Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to determine whether the IRS has complete, accurate, and reliable data on tax return preparers for efficient and effective tax administration. To accomplish our objective, we:

- I. Determined what oversight the IRS provides paid preparers and what data the IRS maintains on paid preparers by meeting with various IRS officials.
- II. Determined if the IRS has sufficient accurate and reliable data on paid preparers.
 - A. Using the Individual Returns Transaction File,¹ determined that 83.8 million tax returns were submitted by preparers in Calendar Year 2008 through July 12, 2008. We removed approximately 3.3 million tax returns prepared by Volunteer Income Tax Assistance or Tax Counseling for the Elderly programs, resulting in 80.5 million tax returns. We grouped the tax returns by preparer identifying numbers and removed any duplicate numbers, which resulted in 1.1 million unique preparers.
 - B. Using the Individual Return Transaction File, we selected taxpayer accounts and verified the accuracy of the Individual Return Transaction File tax accounts by researching the IRS Integrated Data Retrieval System.² Personnel in our Data Center Warehouse performed run-to-run balancing³ by comparing record counts in all logs showing that data were extracted from the IRS files to the location of data stored at the TIGTA Data Center Warehouse.
 - C. Using attribute sampling with a 95 percent confidence level, 5 percent precision, and 10 percent error rate, we selected a sample of 139 preparers and determined that 28 (20 percent) could not be identified and/or prepared fewer than 6 tax returns. Nine of the 28 preparers could not be identified because the identifying numbers were invalid. To help ensure the statistical sample included only those preparers with the most likelihood of being paid preparers, we:
 1. Identified and eliminated 555,896 preparers who prepared fewer than 6 tax returns. We chose six as the criteria because the National Taxpayer Advocate has

¹ The Returns Transaction File contains all edited, transcribed, and error-corrected data from the U.S. Individual Income Tax Returns (Form 1040 series) and related forms for the current processing year and 2 prior years.

² IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records.

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



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previously defined a Federal Tax Return Preparer as someone, other than an attorney, Certified Public Accountant, or Enrolled Agent, who prepares more than five Federal tax returns in a calendar year.

2. Identified and eliminated 330,909 tax returns submitted with no preparer identifying number.
- D. From the population of 575,539 preparers, we selected a random stratified statistical sample of 139 preparers, using a 95 percent confidence Level, 5 percent precision, and 10 percent error rate. Using the IRS' Centralized Authorization File, Enrolled Practitioner Program System, Returns Transaction File, and the Third Party Data Store, we attempted to identify the following for the 139 preparers:
1. The names of the preparers.
 2. The identification number(s) of the preparers (i.e., Employer Identification Number, PTIN or Social Security Number).
 3. Their designations (i.e., if they are an attorney, Certified Public Accountant, Electronic Return Originator, or Enrolled Agent).
 4. Those taxpayers represented by the preparers and for what tax periods.
 5. The current compliance and/or enforcement actions for each preparer.
 6. The number of tax returns each preparer filed in Calendar Year 2008.



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Appendix II

Major Contributors to This Report

Michael E. McKenney, Assistant Inspector General for Audit (Returns Processing and Account Services)

Augusta R. Cook, Director

Frank Jones, Audit Manager

Wilma Figueroa, Acting Audit Manager

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James Allen, Information Technology Specialist

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Appendix III

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:S
Commissioner, Small Business/Self-Employed Division SE:S
Deputy Commissioner, Small Business/Self-Employed Division SE:S
Deputy Commissioner, Wage and Investment Division SE:W
Director, Office of Professional Responsibility SE:OPR
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, Program Evaluation and Improvement, Wage and Investment Division SE:W:S:PRA:PEI
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 Internal Control OS: CFO:CPIC:IC
Director, Office of Program Evaluation and Risk Analysis RAS:O
Audit Liaison: Chief, Program Evaluation and Improvement, Wage and Investment Division
SE:W:S:PRA:PEI



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Appendix IV

Internal Revenue Code Preparer Penalties

| Code Section | Description | Penalty |
|--------------|-------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------|
| 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.



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Appendix V

Management's Response to the Draft Report



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



June 22, 2009

MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

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

SUBJECT: Draft Audit Report - Inadequate Data on Paid Preparers
Impedes Effective Oversight (Audit #200840037)

Thank you for the opportunity to review the draft report titled "Inadequate Data on Paid Preparers Impedes Effective Oversight." Your report highlights priority issues that we have already begun to address and will continue to consider in the future. Our commitment to ensure that all tax preparers adhere to professional standards and follow the law is reflected in our Strategic Plan for 2009 – 2013.

Commissioner Shulman recently launched the Tax Return Preparer Review which will cover a broad range of areas related to paid preparers. By the end of this year, the Commissioner intends to propose a comprehensive set of recommendations designed to better leverage the tax return preparer community with the Service's dual goals of increasing taxpayer compliance and ensuring uniform and high ethical standards of conduct for tax preparers. The first part of this effort will involve fact finding and receiving input from a large and diverse constituent community that includes those that are licensed by state and federal authorities — such as enrolled agents, lawyers and accountants — as well as unlicensed tax preparers and software vendors. The effort will also seek input from and dialogue with consumer groups and taxpayers.

Your report contains recommendations generally aimed at strengthening our ability to identify paid preparers so that appropriate enforcement actions can be taken when needed. The Service agrees this is an area warranting continued attention and is committed to exploring all viable options for insuring minimum levels of competence and ethical conduct for tax return preparers.

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

Attachment



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Attachment

RECOMMENDATION 1:

Establish a requirement that paid preparers be compliant with their own Federal tax filing requirements in order to be allowed to prepare tax returns for others for a fee.

CORRECTIVE ACTION:

We agree in principle that paid preparers should be compliant with their own Federal tax filing requirements. Compliance checks are already performed by the Office of Professional Responsibility during the enrolled agent admission and renewal processes and by Wage and Investment prior to acceptance of a preparer into the electronic return originator program. Commissioner Shulman's Tax Preparer Review team will be making recommendations by the end of the year, in part, on how to ensure uniform and high ethical standards of conduct and competence for preparers. Accordingly, we are not in a position at this time to independently recommend that such a requirement be established.

IMPLEMENTATION DATE:

August 15, 2010

RESPONSIBLE OFFICIAL:

Director, Office of Professional Responsibility

CORRECTIVE ACTION MONITORING PLAN:

The Director, Office of Professional Responsibility, who is co-leading the Commissioner's Tax Return Preparer Review, will monitor the status and will advise the Deputy Commissioner for Services and Enforcement of any delays in completing the corrective action.

RECOMMENDATION 2:

Revise the target completion date for its study on requiring preparers to use a single identification number when filing tax returns. This will ensure the IRS has a means to control and track preparer activities by the 2011 Filing Season—the current date of July 2010, could delay implementation beyond the 2011 Filing Season.

CORRECTIVE ACTION:

We agree in principle that preparers should use a single identification number when filing tax returns. The issue of preparer tax identification numbers (PTINs) for use by tax return preparers is on the Department of Treasury 2008 – 2009 Priority Guidance Plan. The Department of Treasury and the IRS are looking at the issue of requiring all paid return preparers to obtain and use a single identification number when preparing tax returns as part of that guidance project. We are not proceeding with the study because this issue is being addressed through priority guidance. We will formally request cancellation of the feasibility study corrective action from audit 2008-40-171. Further, the Tax Return Preparer Review discussed above is expected to encompass



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this issue as part of the Commissioner's comprehensive recommendations. We will provide a copy of the guidance once it is published.

IMPLEMENTATION DATE:

Completed

RESPONSIBLE OFFICIAL:

N/A

CORRECTIVE ACTION MONITORING PLAN:

N/A

RECOMMENDATION 3:

Develop a method to enforce Internal Revenue Code (IRC) § 6695(c) that imposes a penalty on preparers who do not provide an identification number on tax returns they prepare.

CORRECTIVE ACTION:

We agree with this recommendation. The Director, Examination (SB/SE) will commission a cross functional team to study the issue and to make recommendations on a plan to both educate paid preparers about their responsibilities under IRC § 6109 and a plan to enforce compliance by imposing IRC § 6695(c) when warranted.

IMPLEMENTATION DATE:

July 15, 2010

RESPONSIBLE OFFICIAL:

Director, Examination Policy (SB/SE Division)

CORRECTIVE ACTION MONITORING PLAN:

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

RECOMMENDATION 4:

Develop a comprehensive data management system that allows the IRS, at a minimum, to determine the population of preparers by eliminating discrepancies and duplicates between systems. This system should include business rules that would allow the IRS to control, track, and monitor preparers' activities.

CORRECTIVE ACTION:

We agree that a comprehensive method to identify and track the population of tax return preparers is needed. The Tax Return Preparer Review discussed above is expected to encompass this issue as part of the Commissioner's comprehensive recommendations. Accordingly, we are not in a position at this time to independently recommend a specific methodological approach to this issue.



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IMPLEMENTATION DATE:

August 15, 2010

RESPONSIBLE OFFICIAL:

Director, Office of Professional Responsibility

CORRECTIVE ACTION MONITORING PLAN:

The Director, Office of Professional Responsibility, who is co-leading the Commissioner's Tax Return Preparer Review, will monitor the status and will advise the Deputy Commissioner for Services and Enforcement of any delays in completing the corrective action.

RECOMMENDATION 5:

If preparers are required to use a single identification number, IRC § 6695(c) would need to be amended to impose a penalty on preparers who do not provide the required single identifying numbers when preparing tax returns.

CORRECTIVE ACTION:

We do not agree legislation is needed. IRC § 6695(c) specifically provides that the failure to provide the number required by IRC § 6109(a)(4) is the basis for the penalty. Under IRC § 6109(a)(4), the Secretary of the Treasury may require that any return or claim for refund prepared by a tax return preparer bear an identifying number as may be prescribed for securing proper identification of the preparer. Therefore, if the regulations under IRC § 6109 are amended to require paid preparers to obtain and provide a single identifying number in connection with any return they prepare, the penalty under IRC § 6695(c) would apply if a preparer did not use such number.

IMPLEMENTATION DATE:

N/A

RESPONSIBLE OFFICIAL:

N/A

CORRECTIVE ACTION MONITORING PLAN:

N/A