**Who Will Regulate Tax Preparers?**

**States Can Fill this Role**

**By**

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Abstract

The issue of regulation of tax return preparers has been a controversial topic in the United States in recent years. The IRS has attempted to regulate tax return preparers, but this has been met with great opposition from many accounting professionals, as well as, in the courts. The purpose of this paper is to discuss why states should regulate tax return preparers. We will summarize the events that have occurred in recent years regarding regulation of tax return preparers to heighten awareness of this issue, as well as, to serve as a foundation for future empirical research in this area. Finally, a review of current state regulation of tax preparers will be presented. The broad topic of regulation should also be of interest to all disciplines in business and economics.

**Submitted to the Journal of Business, Industry and Economics**

**January 29, 2015**

**Resubmitted – February 14, 2017**

# Introduction

The issue of regulation of tax return preparers has been a controversial topic in the United States in recent years. In recent years, approximately 140 million tax returns have been filed on an annual basis. Of the 142 million tax returns filed in the US in 2011, approximately 70 million of those were filed by a paid tax return preparer (Zajac, 2014). With such a large volume of tax return filings to prepare and file each year, the question has been raised in recent years as to whom, if any group should be given responsibility and authority for the regulation of tax return preparers? Each state’s Board of Public Accountancy governs who can be granted a license to practice as a Certified Public Accountant (CPA) in that state. CPAs are one major group of professionals who provide tax preparation services, while attorneys also provide tax preparation services. Attorneys must pass the Bar exam before being granted a license to provide legal services, which can include tax-related services. In addition to these two groups of professionals, there are many unlicensed tax return preparers, who prepare and file a large percentage of all tax returns each year. This is the primary group at issue in this paper.

# Overview

In 2011, the Internal Revenue Service (IRS) began issuing Preparer Tax Identification Numbers (PTIN) in an effort to increase compliance with tax laws by regulating tax return preparers. The IRS desired to require preparers to meet minimum quality standards and pay an annual fee keep their PTIN active. This attempt by the IRS to regulate tax-return preparers has received substantial opposition from various groups representing the accounting profession. The legality of the IRS’s attempt to regulate return preparers has been challenged in court. In a recent court ruling, the court has established that the IRS does not control the manner in which yearly tax returns are completed. The court ruled in favor of nearly 700,000 unlicensed tax preparers. The court said that the IRS did not have the right to stretch a law that was enacted by Congress in 1884 as the “Horse Act” to cover the regulation of tax preparers.

However, this ruling was disappointing to the nation’s largest tax preparation company, H&R Block, as well as other major tax preparation companies. When William Cobb, Chief Executive Officer of H&R Block, commented on the recent court ruling he stated that it was “a blow to honest taxpayers.” Cobb asserted “Something is out of whack when you are better protected when getting your hair cut than when sitting across the desk from a tax preparer” with access to personal data. This statement was based on the amount of regulations a hair dresser has compared to that of a tax preparer (Zajac, 2014). But should taxpayers not have the freedom to pick who they want to prepare their taxes? The battle of who is right continues.

# Why Does the IRS Want Regulation?

The IRS has long called for regulation of tax preparers. The intent of the preparer program is to help the IRS have greater control over who is submitting tax related information to them. But why is the IRS so concerned with who is preparing the tax returns? One reason is the IRS believes a well regulated tax preparer will help the agency accomplish its job despite the reduction in the number of agents. In 2011, federal funding to the IRS was cut by approximately $305 million resulting in the loss of thousands of IRS workers, leaving the IRS shorthanded. The IRS believes that greater regulation of tax return preparers will help the understaffed IRS achieve the mission of taxpayer compliance (Buttonow, 2013).

The second reason that the IRS believes greater regulation of tax return preparers will be beneficial is they feel that tax return preparers hold the key to their client’s successful and accurate tax return. The IRS considers this to be true because of the constantly changing tax laws. Congress enacts changes to various sections of the tax law every year making it more difficult for taxpayers to prepare their own taxes. To illustrate the amount of changing laws, it is estimated that since 2001 there have been 4,680 tax code changes. It is critical for the tax return preparer to always have knowledge of the law changes, and without regulation and required continuing education, it is uncertain how many of the tax preparers will be familiar with the current law.

A survey was conducted in 2008 to test the accountability of unlicensed tax preparers. A random sample of 28 unlicensed tax preparers’ returns was taken. When the results were analyzed, 17 of the returns were inaccurate (just over 60%), and six of the documents (just over 21%) were considered to have been prepared recklessly or willfully inaccurate.

In 2009 an IRS study confirmed that 94% of taxpayers take the advice given to them by the preparer. With so many taxpayers taking advice and such a high rate of inaccurate returns, this alone gives the IRS a reason to be uncomfortable with the unlicensed tax preparers (Buttonow, 2013).

And finally, the IRS states that tax return preparers are the answer to the small business dilemma. In 2012, the IRS conducted a study related to the underreporting of income by small businesses. The IRS estimates that 57% of all small businesses understate their income, resulting in a loss of tax revenues of approximately $141 billion per year. The IRS also estimates that approximately 80% of small business tax returns are completed and filed by paid tax return preparers. The IRS suggests that with the proper training of tax return preparers, the total amount of loss of small businesses could be significantly reduced. With the IRS currently only able to audit around 1% of all tax returns submitted because of staffing issues, it is thought that the more training the tax return preparers have, the higher the level of compliance with the IRS laws and regulations that will occur (Buttonow, 2013).

# What was the “Horse Act” of 1884?

When the Obama administration decided they wanted to have some type of control over the tax return preparer industry, they took this power under what is known as the Horse Act of 1884, instead of going through the United States Congress. The Horse Act was enacted in 1884, (which was 29 years prior to the initiation of income taxes), to help with fraudulent loss claims filed after the Civil War. Many people at this time were trying to get compensation from the government through the Treasury of State for items and animals that were taken or killed during the Civil War. Many people at that time were thought to be lying about their losses and allegedly filed claims for items and animals they never owned. Others were telling the government that their rare and expensive horse was killed when it was really only a worn out work horse that was lost. The Horse Act was passed to help protect the government from fraudulent claims. (Gordon, 2014).

# How Does the Horse Act Relate to Tax Preparers?

In the post-Civil War era, an industry sprang up of agents who would submit the claims for a fee, usually based on a percentage of the claim collected. In an effort to combat fraudulent claims, the Horse Act of 1884 was passed. This act allowed the United States government to regulate the agents submitting the Civil War claims. Honest agents were certified as “enrolled agents”, and hence the beginning of a title that is still used today by people who represent clients in matters before the IRS. This is the link the IRS is using to stretch their authority to regulate all tax preparers today.

The IRS claims that since the Horse Act created what we know today as enrolled agents, it would have the power to regulate all tax preparers. However, the difference between the enrolled agent and the tax preparers is the enrolled agent represents the client while the tax preparer is only performing a paid service for the client, and has no authority to represent the client in front of the IRS (Temple-West, IRS Rides 1884 'Dead Horse' Law To Defense of Tax Preparer Rules, 2013).

# Registered Tax Return Preparer Exam, Fees, and Continuing Education

Regulations promulgated by the IRS included an exam, fees, and continuing education. The IRS invested more than 50 million dollars into the testing aspect. The exam to regulate the tax preparers is designed for those other than Certified Public Accountants, attorneys, or Enrolled Agents. Once the tax preparer has passed the exam, the payment of an annual fee would be required along with the completion of 15 hours of continuing education (Zajac, 2014). The requirement to pass a standardized exam and complete annual continuing education will help ensure that paid tax preparers have the updated knowledge needed to complete returns accurately.

# Analysis of the Registered Tax Return Preparer Exam

The exam consisted of seven parts that test preliminary work and collection of taxpayer data (15% of test value), treatment of income and assets (22%), deductions and credits (22%), other taxes (11%), completion of the filing process (10%), practices and procedures (5%), and finally ethics Circular 230 (15%). The preliminary work and collection of data section focused on material such as reviewing the prior year return, determining filing status, determining all taxable and nontaxable income, comparing standard deduction versus itemized deduction, and recognizing items that will affect future returns.

The next section, treatment of income and assets, included the four main topics of income, retirement income, property (real and personal), and adjustments to income. The third section, deductions and credits, consisted of two major parts: itemized deduction and general credits. Another section dealt with other taxes including alternative minimum tax, self-employment tax, early distributions from retirement plans, and repayment of first-time home buyer credit.

The fifth section of the exam covered completion of the filing process, which would test completeness and accuracy of the completed return, explanation and review of tax return, explanation of the record keeping requirements, and understanding estimated tax payment requirements. The next section of the exam covered practices and procedures. This section included penalties assessed by the IRS for negligent returns, appropriate use of Paid Preparer’s Earned Income Credit Checklist Form 8867, compliance with e-file procedures, and safeguarding taxpayer information.

The final section tested the tax preparer on ethics under Circular 230. This section would consist of preparer due diligence, limits of registered tax return preparers, requirements to furnish information to the IRS, rules regarding fees, and responsibility of those who have authority over a firm's tax practice (The IRS Registered Tax Return Preparer (RTRP) Exam Specification - Optional Exam). The exam was designed to test broad areas of taxation with substantial detail on the specified topics.

# IRS is Challenged in Court

When the IRS announced their new regulations on tax preparers, three independent tax preparers fought back. The three tax preparers were: Sabina Loving of Chicago, Illinois; John Gambino of Hoboken, New Jersey; and Elmer Kilian of Eagle, Wisconsin. Together they make up the lead plaintiffs in Loving V. IRS, which was filed on March 13, 2012. The three plaintiffs sought representation from Dan Alban through the Institute for Justice. In January 2013, U.S District Court Judge James E. Boasberg issued an opinion siding with the three tax preparers. Once the verdict was reached, the IRS appealed the court ruling (Erb, 2013).

# Why Did the Courts Rule for No Regulation by IRS?

In January of 2013, a panel of three judges in the U.S. Court of Appeals for the District of Columbia voted to uphold a lower court’s decision stating that the IRS did not have the right to regulate tax preparers. The judges stated that the IRS did not have the right to extend its authority so broadly to control those who prepare the tax returns. The IRS was unsuccessful in its assertion that it had the right to regulate the tax return preparers under the “Horse Act” of 1884. The U. S. Court of Appeals found that the IRS was created as a tax collection agency, and when it attempted to regulate those who prepare the returns, it went beyond its assigned duties. While the IRS does not have the power to dictate to tax preparers, each individual state does have the right to regulate tax preparers in its state. Currently, California, Maryland, Oregon, and New York have regulations over tax preparers. If the IRS is unable to control regulations for tax preparers, some experts think state by state “patchwork” will cause a massive dysfunction (Temple-West, Appeals Court Quashes IRS Tax-Return Preparer Crackdown, 2014). However, it is common for individual states to license or regulate organizations or persons working in many fields including

attorneys, CPAs, health care workers, teachers, social workers, barbers and beauticians. So it seems a logical extension for each state to assume responsibility for protecting its tax payers by regulating tax return preparers.

**State Regulation of Tax Return Preparers**

Since the IRS is now prohibited from requiring competency testing, several states including California, Maryland, Oregon, and New York have developed regulations to protect taxpayers who hire tax preparers. The establishment of requirements for registered paid tax return preparers in these states should result in an increase in the level of competence and ethical consciousness of the tax preparers, a decrease in errors and omissions on the tax returns, and a decrease in fraud.

The state requirements for paid tax return preparers typically address

* exempt preparers
* minimum qualifications and initial registration requirements
* continuing education requirements

Paid tax return preparers who are generally exempt from the state registration requirements are certified public accountants, enrolled agents (EAs), attorneys who are members of a state bar, and some fiduciaries including banking or trust officials. The minimum age and general education requirements for paid tax return preparers are consistent across the regulating states. Registered paid tax preparers are required to be at least 18 years of age and be a high school graduate or possess the equivalent of a high school diploma.

First-time registrants are required to attain or demonstrate knowledge of tax law and tax return preparation procedures by completing tax education or passing a competency exam in order to be initially registered by the state. In addition, registered tax return preparers are required to meet continuing education requirements in order to renew their registration. The education or examination competency requirements by state follow

* California – In order to become a California Tax Education Council (CTEC) registered tax preparer, one must have completed a 60-hour qualifying education course within the past 18 months. Annual renewal of the CTEC registration requires a minimum of 20 hours of continuing education which must include 15 hours of federal tax curriculum and 5 hours of California tax curriculum. No competency exam is required for registered tax preparers in California.
* Maryland – The Maryland Board of Individual Tax Preparers began offering the Maryland Registered Tax Return Preparer Exam to candidates on October 1, 2014. Registered tax preparers at that time had until December 31, 2015 to pass the Maryland exam with 70 percent being the minimum passing score. Beginning in 2016, one must have passed the exam in order to apply for registration. Maryland registered tax preparers are required to complete at least 16 hours of continuing education every two years. Four of the 16 hours must be in Maryland state tax-related subjects.
* Oregon - The Oregon State Board of Tax Practitioners has both an education and examination requirement for licensed tax preparers. The candidate must complete an 80-hour basic tax course or its equivalent and must pass the tax preparer exam with a score of 75 percent or higher. Licensed tax preparers are required to complete 30 hours of continuing education related to tax law and tax preparation each year.
* New York – In March 2014, New York Governor Andrew M. Cuomo lauded the state’s new regulations for paid tax preparers as a significant means of protecting the consumer. New York commercial tax return preparers will be required to pass a state competency examination and take four hours of annual continuing education. Beginning tax return preparers with less than three years of experience in preparing New York State tax returns must complete 16 hours of education to meet the initial registration requirements.

# Proposal to Regulate Tax Preparers in Alabama

In recent years, the State of Alabama has considered regulating tax return preparers. Representative Tammy Irons and Senator Quinton Ross wrote a bill that would require a board to regulate all commercial tax preparation, as well as, require an annual registration from those who are charging a fee for the tax preparation service. The provisions of the 2009 bill were very similar to the now existing regulations in the states of California, Maryland, Oregon, and New York including exemption of CPAs, enrolled agents, and lawyers already required to obtained licenses. The proposed bill would have also required commercial tax return preparers to meet a continuing education requirement.

Representative Irons sponsored the bill on behalf of Impact Alabama, a non-profit group. Impact Alabama founder Stephen Black said “To do hair in Alabama you have to get a license. (To do) the most important document families sign all year? Nothing.” (Lyman, 2009).

Impact Alabama has set up an organization called SaveFirst to help low income families get their tax returns prepared correctly. This organization consists of college student volunteers who have completed IRS training and who apply their knowledge to prepare tax returns for low income families at no charge.

The proposed bill introduced by Ms. Irons did not include regulation of organizations such as SaveFirst, since they are a voluntary service (Lyman, 2009). Even though the bill failed to become a law, the problem of unregulated tax preparers and unprotected consumers remains.

# Resilient IRS Advances Voluntary Program

Once it was determined that the IRS would not be able to regulate tax preparers, they immediately initiated their next move which is the voluntary preparer certification program, now known as the Annual Filing Season Program. With this program, the IRS is attempting to train those who are not CPAs, attorneys, or Enrolled Agents. The way to receive the certification in this “voluntary” program is to take a total of 18 hours of continuing education classes. Within the 18 hours, the preparer must complete a six hour refresher course for the upcoming tax season, ten hours of federal tax law topics, and two hours of ethics.

Additionally, the preparers must comply with the duties and requirements of Circular 230. The Circular 230 is a United States Treasury publication that states how those who are preparing tax returns or giving tax advice should go about doing this job. Once the tax return preparers have completed these requirements, they will be included on the IRS website as having completed the Annual Filing Season Program. Along with the names of those who have successfully completed the volunteer program will be those who have received higher qualifications including attorneys, CPAs, Enrolled Agents, and Enrolled Actuaries. Unlike the IRS’s previous attempt, the voluntary program will not require those who wish to be certified to take a test.

More than 62,000 tax preparers successfully completed the Registered Tax Return Preparer exam required by the previous regulation before the examination process was stopped by the United States Court of Appeals. For those preparers, the IRS is now allowing them to seek the voluntary certification, without having to complete the six hour tax refresher course. The IRS claims that this Annual Filing Season Program will help tax preparers. Additionally, the IRS believes that this program will encourage those who are in the tax preparation industry to continue their education in the ever changing field of tax (Schreiber, 2014).

# Could This Be the Answer?

When the IRS created the Annual Filing Season Program, it was a quick fix for the tax preparer regulations that had been struck down by the court just months before. The theory behind this voluntary program was, if they can’t regulate the preparers, they will try to educate them. This program seems like a good way for the IRS to ensure that as many people as possible are educating themselves, but is it as effective as it should be? The IRS is attempting to regulate and educate tax return preparers to reduce the amount of fraudulent returns that are prepared and filed each year. With education, the preparer will have better knowledge about the forms they are completing and filing, but this does not mean they will feel compelled to prepare them correctly. Barry Melancon and Jeffery Porter, both members of the American Institute of Certified Public Accountants (AICPA), wrote a statement saying; “As a practical matter, any voluntary regime constructed would still not address the problems with unethical and fraudulent tax return preparers”. They added, “We are concerned that the IRS is rapidly moving forward without widely disseminating the proposal or seeking public comments.” (Stanek, 2014). This shows that the voluntary certification program has no obligations that would discourage those who take part in the program not to produce fraudulent returns.

# AICPA Loses Suit Against IRS

In July 2014, the AICPA filed suit against the IRS asking the court to halt the Annual Filing Season program. The AICPA viewed the program as an illegitimate use of government power. The AICPA case was dismissed for “lack of standing” in October 2014. There are several criteria related to a plaintiff’s alleged injury that must be met in order for the plaintiff to have standing in federal court, including there must have been actual or imminent injury. The court found no actual harm or injury to CPAs and thus dismissed the case (Nevuis, 2014).

# Checking Your Tax Preparer

The IRS is encouraging taxpayers to look carefully into the tax preparer they plan to use. On the IRS website, key points are listed for taxpayers to examine. The main topics the IRS is emphasizing include: check the person’s qualifications, check the preparer’s history, find out about their service fees, ask if they offer electronic filing, make sure the preparer is accessible, provide all records and receipts needed to prepare your return, never sign a blank return, review the entire return before signing, and make sure the preparer signs the form and includes his or her PTIN.

At the top of this list is checking the person’s qualifications or title. When a taxpayer reads the information below this title, it tells of the different types of tax preparers including CPA, Enrolled Agent, and Attorney (Tips For Choosing A Tax Return Preparer, 2012). Even though the regulation of tax preparers was stricken by the court system and the exam is no longer in existence, the IRS continued to list the Registered Tax Return Preparer as an “officially” certified tax preparer on its website. This can be confusing to taxpayers who look to this website in search of a certified tax preparer.

# Conclusion

When the IRS sought to regulate tax return preparers without consent of Congress, they overstepped their legal authority. This statement was supported when three tax preparers challenged the IRS in Loving V. IRS. The United States District Court judge and the three United States Appeals Court judges all agreed that IRS was trying to “beat a dead horse”. The issue of proper regulation of unlicensed tax return preparers does need to address. We believe that a plan similar to the one proposed by Tammy Irons would be a good model to follow. We believe that regulation of unlicensed tax return preparers should be governed by each state. The models implemented by the states of California, Maryland, Oregon and New York should be reviewed by other states considering implementing similar forms of regulation. Tax preparers who sign-up for “voluntary training” are probably not the ones preparing and filing fraudulent tax returns. The primary purpose of this paper was to raise awareness of the issue of regulation of tax preparers. A logical next step in this research would be to gather data from professional tax return preparers and analyze this data to gain knowledge of attitudes towards regulation of tax return preparers.

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