United States General Accounting Office

GAO

Report to the Committee on Finance, U.S. Senate

October 2003

TAX ADMINISTRATION

Most Taxpayers Believe They Benefit from Paid Tax Preparers, but Oversight for IRS Is a Challenge

GAO-04-70

October 2003

TAX ADMINISTRATION

Most Taxpayers Believe They Benefit from Paid Preparers, but Oversight Is a Challenge for IRS

GAO Accountability • Integrity • Reliability

Highlights

Highlights of GAO-04-70, a report to the Chairman and Ranking Minority Member, Committee on Finance, United States Senate

Why GAO Did This Study

Over 55 percent of the nearly 130 million taxpayers in tax year 2001 used a paid tax preparer. However, using a preparer may not assure that taxpayers pay the least amount due. Last year, GAO estimated that as many as 2 million taxpayers overpaid their 1998 taxes by $945 million because they failed to itemize deductions and half of these used preparers.

GAO was asked to (1) obtain the views of taxpayers about paid preparers and examples of preparer performance including any problems and (2) describe the Internal Revenue Service's (IRS's) oversight of problem preparers; the challenges facing IRS in dealing with problem preparers, especially the Office of Professional Responsibility; and the efforts to address those challenges. To obtain the views of taxpayers who used preparers, GAO surveyed a national representative sample of taxpayers.

What GAO Recommends

Because making decisions about IRS's role is a policy matter and data to determine the efficacy of current oversight efforts would be difficult to develop, whether to expand IRS's role in regulating paid preparers is a judgment that Congress and IRS must make and GAO is not making recommendations in this report. In commenting on a draft of this report, the IRS Commissioner generally concurred with our findings.

www.gao.gov/cgi-bin/getrpt?GAO-04-70

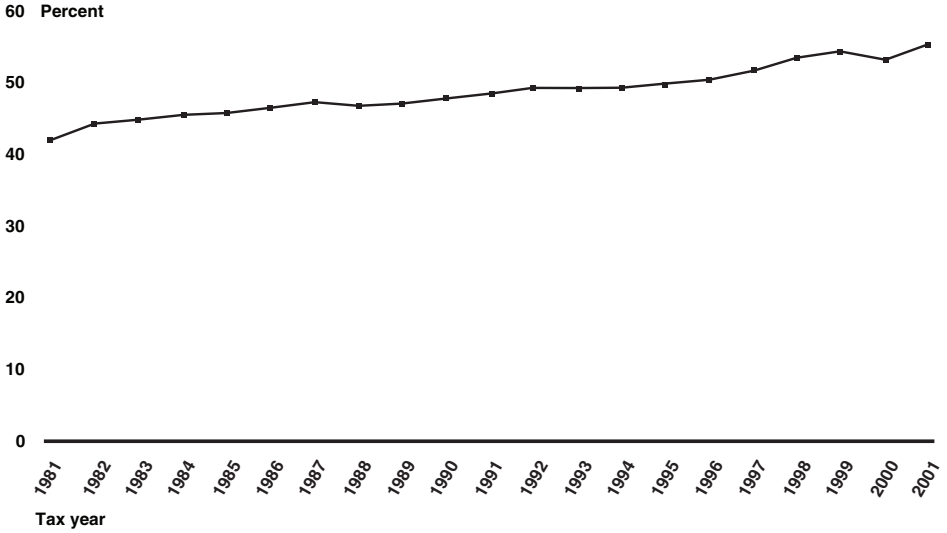
To view the full product, including the scope and methodology, click on the link above. For more information, contact Jim White at (202) 512-5594 or Whitej@gao.gov.

What GAO Found

GAO estimates that most of the taxpayers who used a paid preparer believe they benefited from doing so. Many taxpayers told us they believed they would have great difficulty filling out their own tax forms because they do not understand their filing requirements. At the same time, some taxpayers are poorly served when paid preparers make mistakes, causing taxpayers to over-or underpay their taxes or pay for services, such as short-term loans called Refund Anticipation Loans (RALs), without understanding their costs and benefits. The evidence available does not allow a precise estimate of the extent of problems caused by paid preparers, but nothing suggests that the percentage of taxpayers affected is large. Nevertheless, even a small percentage of the over 72 million taxpayers who used paid preparers in 2001 translates into millions of taxpayers who are potentially adversely affected.

IRS has several offices responsible for taking action against problem paid preparers, including the newly formed Office of Professional Responsibility. These offices sanction preparers for violating standards of conduct; assess monetary penalties for violating tax laws when preparing returns; monitor and, if justified, sanction problem preparers offering electronic filing and RALs; and investigate fraudulent preparer behavior. However, balancing resources devoted to such efforts against those devoted to other IRS priorities is a challenge. In addition to IRS, other federal agencies, state and local governments, and professional organizations have a role in regulating paid preparers. At least two proposals exist to expand IRS's oversight of paid preparers. Consideration of such proposals is complicated by the difficulty of developing reliable estimates of the number of taxpayers affected by problem preparers or the effectiveness of the actions taken against them.

Percentage of Returns with a Paid Preparer's Signature



Source: IRS.

Contents

Abbreviations

CI	Criminal Investigation Division
EIC	Earned Income Credit
ERO	Electronic Return Originator
FTC	Federal Trade Commission
IRS	Internal Revenue Service
ODP	Office of Director of Practice
OPR	Office of Professional Responsibility
RAL	Refund Anticipation Loan
SB/SE	Small-Business/Self-Employed Division
TAS	Taxpayer Advocate Service

GAO
Accountability * Integrity * Reliability

United States General Accounting Office
Washington, D.C. 20548

October 31, 2003

The Honorable Charles E. Grassley
Chairman
Committee on Finance
United States Senate

The Honorable Max Baucus
Ranking Minority Member
Committee on Finance
United States Senate

Filing a correct tax return can be a daunting task for taxpayers. Many taxpayers do not understand their filing requirements and would have great difficulty filling out their tax forms without the assistance of paid preparers. IRS's most recent estimates are that in tax year 2001 more than 55 percent of the nearly 130 million individual filers paid someone to prepare their tax returns, and in tax year 2000, taxpayers paid almost $15 billion for individual tax preparation services. However, using a paid preparer does not always assure that taxpayers will pay the least amount of taxes that are legally due. For example, last year we estimated that as many as 2 million taxpayers overpaid their 1998 taxes by $945 million because they claimed the standard deduction when it would have been more beneficial to itemize, and half of these taxpayers used a paid preparer.[1]

Concerned that some paid preparers might not be diligent when completing tax returns, you asked us to (1) obtain the views of taxpayers who used paid preparers and provide examples of paid preparer performance, including what is known about the extent of problems caused by paid preparers and (2) describe IRS's efforts to prevent, detect, and take action against problem paid preparers; the management challenges facing IRS offices that interact with paid preparers, especially the Office of Professional Responsibility; and the efforts to address those management challenges.

To address the objectives, we surveyed a nationwide random sample of taxpayers who used paid preparers. While this sample is representative of

[1]U.S. General Accounting Office, *Tax Deductions: Further Estimates of Taxpayers Who May Have Overpaid Federal Taxes by Not Itemizing*, GAO-02-509 (Washington, D.C.: Mar. 29, 2002).

all taxpayers who used paid preparers, it has some limitations and must be interpreted carefully because it is based on taxpayer perceptions. Taxpayers responding to our survey may not understand the tax laws well enough to evaluate whether they received quality service from their paid preparers, resulting in inflated satisfaction levels. In addition, we conducted in-depth interviews with a smaller judgmental sample of taxpayers who provided examples of paid preparer performance, but we were unable to independently verify the facts in the taxpayers' examples. We also interviewed paid preparers, representatives of professional organizations, various IRS officials, and low-income tax clinic directors. We presented our survey and interview findings at a Finance Committee hearing on April 1, 2003.[2] In addition, we conducted a review of IRS's closed case files on paid preparers investigated for fraud or other misconduct and reviewed IRS's paid preparer penalty collection data. A more detailed discussion of our scope and methodology, including the potential effect of our taxpayer survey's 46 percent response rate, may be found in appendix I.

Results in Brief

Based on projections from our survey, most of the taxpayers who used a paid preparer believe they benefited from doing so and would use a paid preparer in the future. The taxpayers we interviewed in-depth identified a variety of advantages in using paid preparers. Some said they did not understand the tax laws or lacked the time or patience to complete returns on their own. However, when paid preparers make mistakes or exhibit other problematic behavior, the consequences for taxpayers can be significant. While available evidence does not allow a precise estimate of how extensive the problem is, none of the evidence suggests that the percentage of poorly served taxpayers is large. Nevertheless, even a small percentage of the over 72 million taxpayers who used paid preparers in 2001 translates into millions of taxpayers who potentially overpaid or underpaid their taxes due to preparer mistakes or other problematic behavior. In addition, IRS's National Taxpayer Advocate—who heads the program that helps resolve taxpayers' tax problems with IRS and recommends changes to mitigate taxpayer problems—and other knowledgeable observers have concerns about how well taxpayers understand the costs and benefits of the short-term Refund Anticipation Loans (RALs) offered by some preparers.

[2] U.S. General Accounting Office, *Paid Tax Preparers: Most Believe They Benefit, but Some Are Poorly Served*, GAO-03-610T (Washington, D.C.: Apr. 1, 2003).

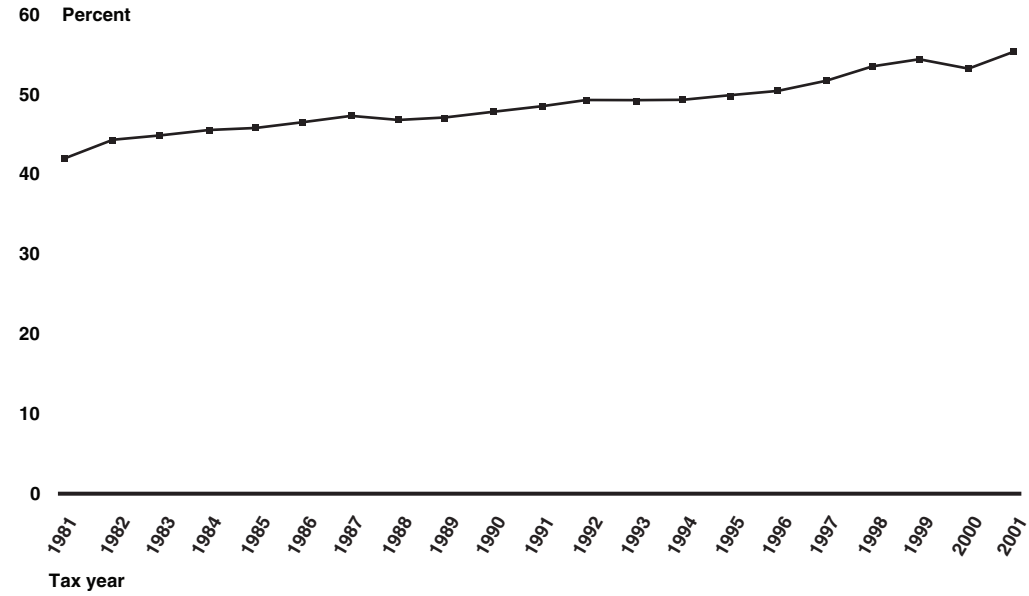
IRS has several offices responsible for taking action against problem paid preparers, but balancing resources devoted to such efforts against those devoted to other priorities is a challenge. The newly formed Office of Professional Responsibility (OPR) enforces professional standards and is beginning to address management problems that made its predecessor office ineffective. Many changes are still being implemented, so it is too soon to know the impact of the changes. IRS's Small Business/Self-Employed (SB/SE) and Criminal Investigation (CI) divisions may penalize or recommend prosecuting problem preparers, but generally focus on only the most serious cases because of their other enforcement priorities. This is a challenge because of the lack of firm data about the extent of problematic paid preparer behavior and the effectiveness of actions to combat it.

While most taxpayers may receive quality service from their preparers, problematic behavior by some preparers raises the question of whether IRS should be more active in overseeing paid preparers. Internal and external proposals have been made to expand IRS's oversight of paid preparers. However, the lack of information on the overall extent of problems with paid preparers and the effectiveness of the actions taken against them make this a judgment that Congress and IRS management must make. We are not making any recommendations in this report.

Background

Paid preparers aid taxpayers in the completion of their tax returns for a fee. They range from licensed professionals, such as attorneys, certified public accountants, and enrolled agents, to those lacking formal training who complete tax returns part-time. Paid preparers authorized to represent taxpayers in matters before IRS are called practitioners and include attorneys, certified public accountants, and enrolled agents. Preparers work for a variety of enterprises including accounting firms, large tax preparation services, and law firms. Some are self-employed. IRS estimates that in 1999 there were 1.2 million paid preparers, although the actual number is unknown because some paid preparers do not sign the returns they prepare. The percentage of returns with a paid preparer's signature has been steadily increasing over the past 20 years, as shown in figure 1.

Figure 1: Percentage of Returns with a Paid Preparer's Signature



Source: IRS.

Paid preparers provide a variety of tax-related services besides tax preparation, including tax and estate planning and services that help clients receive funds quickly, such as electronic filing and RALs.

Taxpayers Believe They Benefit by Using Paid Preparers but Some Are Poorly Served

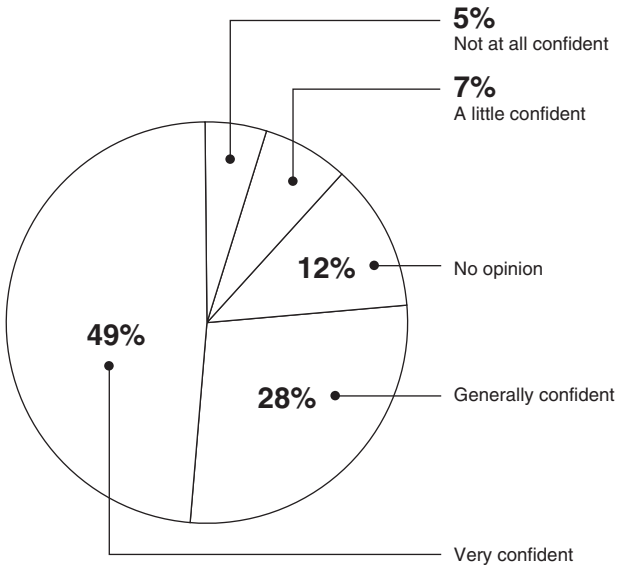
Based on projections from our national survey, most taxpayers who used a paid preparer believe they benefited from doing so and would use a paid preparer in the future. Taxpayer surveys and studies of returns suggest that some taxpayers are poorly served by their paid preparers, but they do not allow a very precise estimate of the extent of the problem.

Most Taxpayers Believe They Benefit From Using Paid Tax Preparers

Based on projections from our national survey, most taxpayers who used a paid preparer believe they benefit from doing so. We estimate that 77 percent of the taxpayers who used a paid preparer in 2002 were very or generally confident that they did not pay more in taxes than was legally required, as shown in figure 2, and that 87 percent would use one again in

the future.[3] These data suggest that paid tax preparers are providing needed services to taxpayers.

Figure 2: Paid Preparer Users' Confidence That They Did Not Overpay Taxes



Source: GAO nationwide survey of taxpayers using a paid preparer in 2002.

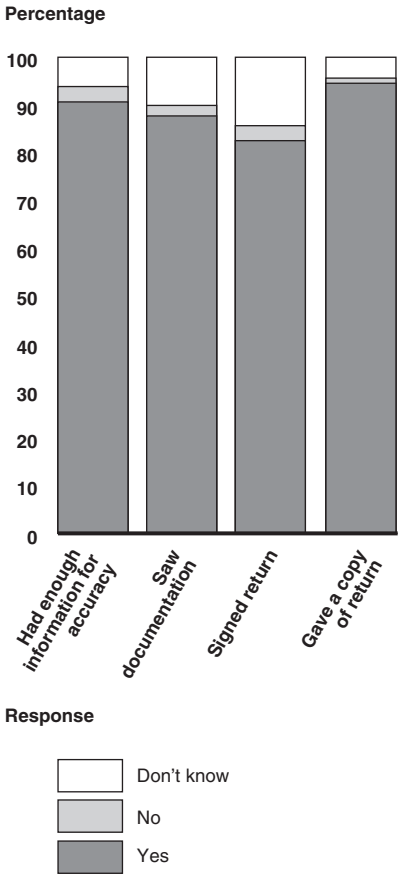
Note: The estimates have a 95 percent confidence interval of plus or minus 5 percent or less. Percentages total more than 100 percent due to rounding.

The results of our taxpayer survey must be interpreted carefully—it is based on taxpayer perceptions, and taxpayers may not understand the tax laws well enough to evaluate the performance of their paid preparers. For example, most of the taxpayers we talked to in-depth said they used a paid preparer because they found IRS tax forms and documents too complicated or they were confronting an unusually complicated tax situation. If taxpayers lack the technical expertise needed to identify preparer errors, their survey responses may underestimate the extent of problems caused by paid preparers.

[3]We are 95 percent confident that the percentage estimates of our survey are within +/- 5 percentage points or less of what we would have obtained if we had surveyed the entire study population.

With that caveat in mind, taxpayers in our nationwide survey said that their preparers did sufficient probing or took other steps to ensure an accurate return. We estimate that about 91 percent of taxpayers believe their preparers had enough information about their personal circumstances to accurately prepare their tax returns. We also estimate that 88 percent of taxpayers using paid preparers were asked for supporting documentation. Most of the preparers we talked to said they ask their clients to provide documentation to support claimed income, deductions, and credits, such as W-2 forms from employers or 1099 forms from financial institutions, to ensure the accuracy and completeness of the information reported on returns. In addition, paid preparers are required by law to take certain steps when filling out returns for their clients, including signing the return and giving their clients copies of the completed returns. We estimate that the vast majority of taxpayers who used a paid preparer in 2002 were provided a signed copy of their return, as shown in figure 3.

Figure 3: Client Perceptions on Aspects of Paid Preparer Performance



Source: GAO nationwide survey of taxpayers using a paid preparer in 2002.

Note: The estimates have a 95 percent confidence interval of plus or minus 5 percent or less.

Taxpayers choose to use paid preparers for a variety of reasons. As already noted, many of the taxpayers we interviewed in-depth told us they used a paid preparer because they did not understand the tax laws. According to the National Taxpayer Advocate, many taxpayers rely upon the expertise of a paid preparer to complete their returns since they are faced with a complex set of tax laws and a multitude of requirements for deductions, exemptions, and credits. One taxpayer, for example, said she began using a paid preparer 9 years ago to help her with estate tax issues following the death of her father because she needed help from a tax professional in dealing with complicated estate tax issues. Other taxpayers said they

lacked the time or patience to complete their returns on their own. For example, a mother of four who operates her own business part-time and is finishing her degree at night said she simply does not have the time to do her own taxes. Other taxpayers stated that they paid someone to prepare their taxes in hopes of obtaining a larger and/or quicker refund.

Some of the paid preparers we spoke to agreed that educating taxpayers about the tax laws is an important component of their practice. For example, one preparer who works primarily with immigrants said he and his staff spend considerable time explaining to their clients that paying taxes is part of the civic responsibilities they assumed in immigrating to this country. Other preparers told us they often have to educate taxpayers on more complex concepts, such as computing the basis (the investment made in a property) to determine how much of a real estate sale would be taxable. Another preparer told us he found that a taxpayer had overpaid his taxes by more than $6,200 over a 3-year period because the taxpayer had overlooked earned income and child tax credits. Still another preparer told us how he helped a taxpayer receive a refund in excess of $19,000 when he found out that the taxpayer, who had moved twice in less than 2 years, had missed out on deductions for moving expenses due to job relocations.

Some Taxpayers Are Poorly Served by Paid Preparers

When paid preparers make mistakes or exhibit other problematic behavior, the consequences for taxpayers may be significant. Examples provided by low-income tax clinic[4] representatives and paid preparers include:

- A taxpayer who overpaid his taxes over a period of years by roughly $3,500 to $5,000. The taxpayer had received notices for several years from IRS stating that he may be eligible for the Earned Income Credit (EIC).[5] Each year, he took the notices to his preparer, but the preparer took no action.

[4]Low-income tax clinics are organizations that receive a matching grant from IRS to represent low-income taxpayers involved in controversies with IRS or to provide tax education and outreach to taxpayers who speak English as a second language or who have limited English proficiency.

[5]The EIC is a refundable federal income tax credit for low-income working individuals and families. The credit reduces the amount of federal tax owed and can result in a refund check when the EIC exceeds the amount of taxes owed.

- One preparer told his elderly client to provide him with the checks to make her quarterly estimated payments. Although he claimed these payments on the client's tax return, he never gave the checks to IRS—he kept them for himself. After receiving notices from IRS, the taxpayer visited the paid preparer who told her that IRS must have made a mistake. The preparer was sent to jail.

- Another preparer incorrectly advised a married couple with two children to each file separately as head of household so that they could claim two EICs. The couple ended up owing taxes, interest, and penalties.

- A paid preparer let a taxpayer file for the EIC for 2 years although the taxpayer lacked the appropriate documentation and was ineligible for the credit. The taxpayer received a tax refund he was not entitled to receive, resulting in a tax liability of $3,300.

As with all anecdotal evidence, these examples are not necessarily representative of the kinds of problems taxpayers encounter when dealing with problematic paid preparers. Also, taxpayers may have contributed to these problems by either providing incomplete information to their preparers or being actively complicit in avoiding taxes that are legitimately owed.

In addition to over- or underpaying their taxes, IRS officials and others told us that sometimes taxpayers are poorly served by paying for services that accelerate the receipt of refunds, including RALs. The primary benefit of RALs is that they allow clients to receive funds quickly, sometimes in just a few minutes, rather than the 10 days it typically takes taxpayers who file electronically to receive their tax refunds. The ability to quickly receive funds makes RALs appealing to low-income taxpayers who often want or need their refund quickly. In addition, as the National Taxpayer Advocate pointed out in the fiscal year 2002 *Annual Report to Congress*, many low-income clients who lack bank accounts find that RALs are the only way to electronically file a return and receive their refunds quickly. For these and other reasons, RALs are becoming more popular. Based on IRS data, the

National Consumer Law Center estimates that 12.1 million RALs were taken out in 2001, up from 10.8 million in 2000.[6]

Although this suggests that many taxpayers find value in using RALs, IRS officials and others have raised concerns about whether taxpayers are fully aware of the costs involved and their tax filing alternatives. For example, a recent New York City investigation found that some paid preparers fail to disclose the costs of RALs and the availability of alternatives to the loans.[7] The investigation found that only 27 of the 43 preparers visited mentioned the annual percentage rate and other fees associated with RALs. New York City's investigation also found that electronic filing was not strongly publicized as an alternative way for clients to receive their tax refunds quickly. According to a low-income tax clinic director, many paid preparers fail to fully explain to taxpayers that accepting a RAL carries a certain risk—if refunds are delayed or denied, taxpayers may be liable for additional charges and fees. Without clear information about the costs and risks, taxpayers cannot always weigh the costs against the benefits that they might receive.

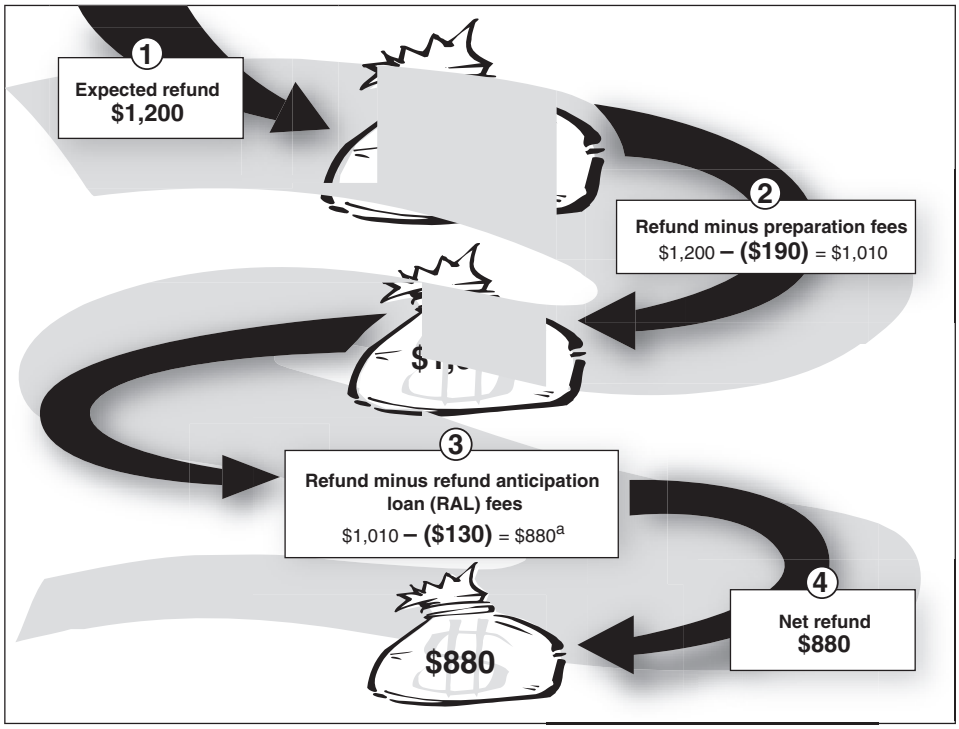
Also, based on information we gathered, fees for RALs and other services that accelerate the receipt of refunds vary widely. For example, while some preparers charge nothing for electronic filing services, one preparer we spoke to (while we were posing as a potential client) said he would charge us between $210 and $250 to file electronically. Another preparer said he would charge $174 for a RAL on a $700 refund, which equates to an annual interest rate of over 900 percent, assuming a loan period of 10 days, while another preparer quoted us a RAL fee of $130 on a $1,200 refund, which equates to an annual interest rate of about 400 percent, assuming the same loan period. These examples are not necessarily representative of all preparer fees; the exact amounts of preparer fees for accelerated refunds depend on various individual circumstances, such as the financial institution the preparer uses to finance the loan and the amount of refund due.

[6]National Consumer Law Center/Consumer Federation of America, *The High Cost of Quick Tax Money: Tax Preparation, 'Instant Refund' Loans, and Check Cashing Fees Target the Working Poor* (Boston, Mass.: January 2003).

[7]New York City Council Investigative Division, *Tax Preparers: Taking Advantage By Not Disclosing* (New York, N.Y.: February 2003).

The RAL fees, when combined with tax preparation fees, may considerably reduce a taxpayer's refund. For example, the preparer mentioned above who quoted a RAL fee of $130 on a $1,200 refund also quoted a tax preparation fee of $190 in addition to the RAL fee. As shown in figure 4 below, the fees would have reduced the refund by more than 25 percent.

Figure 4: Example of Paid Preparer Fees



Source: GAO.

[a] The $130 RAL fee consists of $80 in financing charges and $50 in bank fees.

In another example, a low-income tax clinic director informed us of a disabled taxpayer who was due a refund of $1,230 on a simple return. After paying various fees, such as return preparation and a RAL, she received a check from her preparer for $414—about 34 percent of her expected refund.

Little Authoritative Evidence Regarding Problematic Paid Preparers

A variety of evidence, including the above examples and our nationwide survey, shows that some taxpayers are poorly served by their paid preparers. While this evidence does not allow a precise estimate due to methodological limitations, none of it suggests that the percentage of poorly served taxpayers is large. However, even a small percentage of the more than 72 million taxpayers who used paid preparers in 2001 can translate into millions of affected taxpayers.

Taxpayer surveys show that some taxpayers had problems with the quality of the service provided by their paid preparer. Based on the results of our nationwide survey, we estimate that 5 percent of paid preparer users had no confidence that they had not overpaid their taxes, and another 7 percent had little confidence, as shown in figure 2. We also estimate that 3 percent of paid preparer users did not believe that their preparer had enough information to accurately complete their return, as shown in figure 2. Our survey results are similar to a 1997 *Consumer Reports* nonrandom survey of 26,000 of its readers, in which 6 percent said they discovered an error made by their preparers.[8] As discussed earlier, taxpayer survey results need to be interpreted carefully because they reflect taxpayer perceptions and may misstate the extent of the problem.

Studies of filed returns also suggest that some paid preparers do not exercise due diligence in filing returns. For example, we have already mentioned that last year we estimated that as many as 2 million taxpayers overpaid their 1998 taxes by $945 million because they claimed the standard deduction when it would have been more beneficial to itemize, and half of these taxpayers used a paid preparer.[9] Similarly, a recent report by the Treasury Inspector General for Tax Administration estimated that there were approximately 230,000 returns filed by paid preparers where taxpayers appeared eligible for but did not claim the Additional Child Tax Credit.[10] In addition, a 2002 IRS study of the EIC for tax year 1999 returns estimated that some taxpayers claimed about $11 billion more than they

[8]Consumers Union of U.S., Inc., "Tackling Your Taxes," *Consumer Reports*, vol. 62. no. 3 (1997). This percentage represents *Consumer Reports* subscribers who responded to the survey and is not necessarily representative of taxpayers in general.

[9]GAO-02-509.

[10]Treasury Inspector General for Tax Administration, *Analysis of Statistical Information for Returns With Potentially Unclaimed Additional Child Tax Credit* (Washington, D.C.: January 2003).

were entitled to while others claimed $710 million less than they were entitled to.[11] The IRS reported that paid preparers filed more than 65 percent of all EIC returns. None of these studies tried to determine how many errors were the fault of the preparer and how many were the fault of the taxpayer. However, based on our earlier examples of paid preparer performance, it seems likely that preparers bear responsibility for at least some of the over- or underpayments. Taxpayers could be at fault if they provide the preparer with incorrect information.

IRS and Others Act Against Problem Paid Preparers, but Balancing Taxpayer Protection Against Other Priorities Is a Challenge

Several IRS offices have responsibility for problem paid preparers, but balancing resources devoted to taxpayer protection with resources devoted to other priorities is a challenge. Proposals have been made for expanding IRS's oversight of the paid preparer industry. Consideration of such proposals is complicated by a lack of data on the extent of the problem and the effectiveness of IRS's actions and by the involvement of other agencies, state, and local governments as well as professional organizations.

New Office of Professional Responsibility (OPR) Beginning to Address Problems Overseeing Practioners

The newly formed OPR enforces professional standards for those paid preparers authorized to represent taxpayers in matters before IRS. These authorized preparers, called practitioners, include attorneys, certified public accountants, and enrolled agents.

Treasury Department Circular No. 230 imposes standards of professionalism and conduct for practitioners and authorizes IRS to institute proceedings against practitioners who violate the regulations.[12] Depending on the seriousness of the violation, OPR can sanction practitioners through private reprimand, censure (a public reprimand), suspension, or disbarment. For example:

[11]Department of the Treasury, Internal Revenue Service, *Compliance Estimates for Earned Income Tax Credit Claimed on 1999 Returns* (Washington, D.C.: Feb. 28, 2002).

[12] Federal regulations, 31 CFR Part 10, published in pamphlet form as Treasury Department Circular No. 23, delegate the Treasury Secretary's authority over taxpayer representatives to IRS. Circular 230 requires an administrative law judge to conduct some disciplinary proceedings.

- As a result of an OPR investigation, OPR accepted a practioner's offer of consent to suspension for almost 3 years for violation of the requirement of due diligence as to accuracy in preparing corporate tax returns for 3 years. The practitioner underreported income by over $50,000 in 1 year, and claimed unsubstantiated expenses of over $25,000 in the other 2 years. The practitioner also overstated a real estate tax deduction by over $30,000 in 1 year.

- In another case, a practitioner was disbarred from practice for giving false or misleading information to IRS. The practitioner signed a power of attorney as being licensed when the license had not been renewed, thereby making the practitioner ineligible to practice before IRS.

As part of IRS's modernization effort, IRS hired an outside management consulting firm to make high-level recommendations concerning the staffing, organization, technology, and operating procedures of the Office of Director of Practice (ODP), the office OPR replaced. Table 1 summarizes the consultant's findings.

Table 1: Key Findings in the Office of Director of Practice

Area	Key findings
Mission and strategy	Office is not strategically focused.
	Narrow interpretation of jurisdiction (covering practitioners only) leaves major problems unaddressed and contradictions within system.
	Awareness and confidence in ODP processes within IRS is low.
	Operation of office is reactive to incoming workload.
Business processes	Business processes are lengthy.
	Decision authority is not delegated to lead program staff.
	Guidelines for business process decisions do not exist in a written form.
	Procedures emphasize practitioner rights.
	Communication internally and externally is limited.
Organization and staffing	Organization lacks structure.
	Relationships with external stakeholders are weak.
	Staffing pattern and deployment does not align skills to functions.
	Management practices are underdeveloped.

(Continued From Previous Page)

Area	Key findings
Technology	Information systems are separate, and do not provide adequate functionality for administrative and program needs.
	Systems are undocumented.
	Staff is untrained to fully utilize existing functionalities.

Source: IRS consultant.

According to the OPR Director, IRS took the high-level findings of the consultant's report and drew on its management and staff's expertise to develop a plan to make needed improvements. For example, IRS reorganized the office, renaming it OPR, and has started to implement several other changes. As an initial step, OPR contacted various tax professional organizations in January 2003 and laid out the following priorities for the balance of 2003:

- enhance the visibility of OPR internally as well as externally,
- increase the capacity and capability of OPR,
- process the workload in a shorter time frame,
- ensure that Circular 230 sanctions are applied fairly and consistently,
- identify and implement organizational performance measures, and
- establish and maintain an effective working alliance with the tax professional organization community.

While IRS has already made some improvements, according to the OPR Director, the following efforts are on-going:

- hiring and training a significantly expanded staff of attorneys and support personnel;
- improving and documenting operational practices and procedures;
- implementing performance measures;
- communicating the OPR mission and progress internally and externally through speaking engagements, newsletters, and Web sites;

- working with IRS Chief Counsel and Treasury Department Tax Policy personnel to make beneficial amendments to Circular 230; and

- maintaining an open door policy with respect to the practitioner community in order to learn of their concerns and their suggestions.

Also, the OPR director said it is going to take some time to make all the needed changes. We did not try to assess OPR's on-going improvements because some are not yet complete and others are too new to have produced the desired improvements.

SB/SE Faces Challenges Balancing Paid Preparer Compliance Actions With Other Enforcement Priorities

IRS's SB/SE division has responsibility for assessing and collecting monetary penalties against any paid preparers who do not comply with tax laws when filing returns. SB/SE assessed about $2.4 million in penalties in calendar years 2001 and 2002, and collected about $291,000 or 12 percent, including all or some portion of penalties from 44 percent of the preparers penalized. According to IRS officials, collecting paid preparer penalties has not been a priority in the division's overall collection efforts due to other higher priority work, such as abusive tax schemes.

According to an SB/SE representative, there are currently no plans for SB/SE to make collecting paid preparer penalties a priority. The representative stated that their priorities include abusive tax schemes, and they cannot afford to make these low dollar paid preparer cases a priority given their responsibility for addressing billions of dollars in uncollected taxes. Also, IRS does not currently have a system in place to identify paid preparer penalties separately from other assessments once a case is assigned for collection, and to do so would require a labor-intensive computer programming effort.

However, the monetary amounts of these penalties, which are small relative to IRS's other compliance efforts, may not reflect how important the penalties are as a deterrent to problematic paid preparers. According to the Internal Revenue Manual,[13] penalty assertion is the key enforcement vehicle for noncompliant preparers. As mentioned earlier, IRS has no data on the extent of the problems with paid preparers or how effective its enforcement efforts are in deterring problematic preparer behavior. In

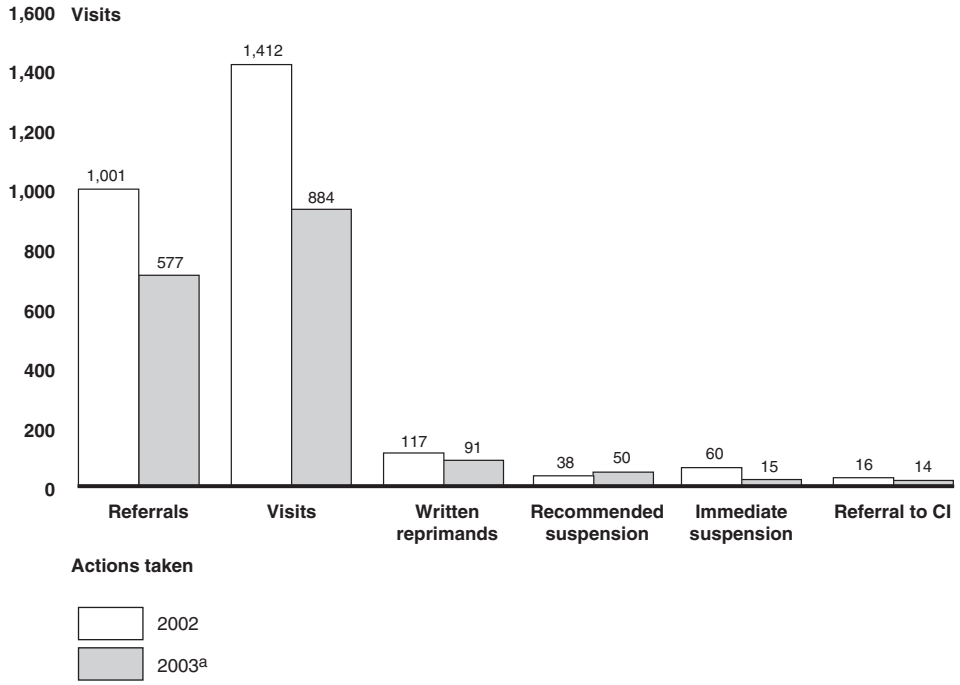
[13]*Internal Revenue Manual*, 4.10.6.8.2(1) (Washington, D.C.: May 14, 1999).

assessing but not collecting these penalties, IRS may be sending preparers a mixed message about whether poor performance by preparers will be tolerated. For example, several paid preparers and low-income tax clinic officials we interviewed said that IRS was not providing enough paid preparer oversight and that it should be increased. IRS has made changes to its fiscal year 2003 compliance program guidance to place a higher priority on assessing penalties against problem preparers. However, collecting paid preparer penalties will continue to be part of the regular collection process because they are not to be given any special treatment as a priority.

IRS Monitors Preparers Who Offer Electronic Filing but Has Limited Role in Monitoring RALS

IRS has broad authority to monitor and sanction Electronic Return Originators (ERO) whom IRS authorizes to file tax returns electronically. IRS's monitoring is to ensure ERO compliance with provisions of any revenue procedures, publications, or notices that govern IRS's e-file program, including RALs. Through random and mandatory visits, the ERO monitoring program offices monitor the activities of EROs to ensure compliance with IRS's e-file program and to investigate allegations and complaints against EROs. In 2001, IRS established a goal of visiting 1 percent of all EROs each year. IRS met its goal in 2002, visiting more than 1,400 EROs and sanctioning 215 of them for violating IRS guidelines. Figure 5 shows the number of EROs visited and sanctions issued by degree of seriousness, for fiscal year 2002, and for two thirds of fiscal year 2003, based on the most recent data available through May 2003.

Figure 5: Visits and Actions by the ERO Monitoring Program



Source: IRS.

[a] Cumulative through May 23, 2003.

However, while IRS does impose some requirements on paid preparers offering RALs, its role is limited and the requirements serve in part to ensure that RALs are presented to taxpayers as loans and not as an accelerated tax refund. For example, IRS's Publication 1345 prohibits EROs from basing their fees on a percentage of the refund amount or computing their fees using any figure from tax returns.

CI Division Investigates Criminal and Fraudulent Preparer Behavior

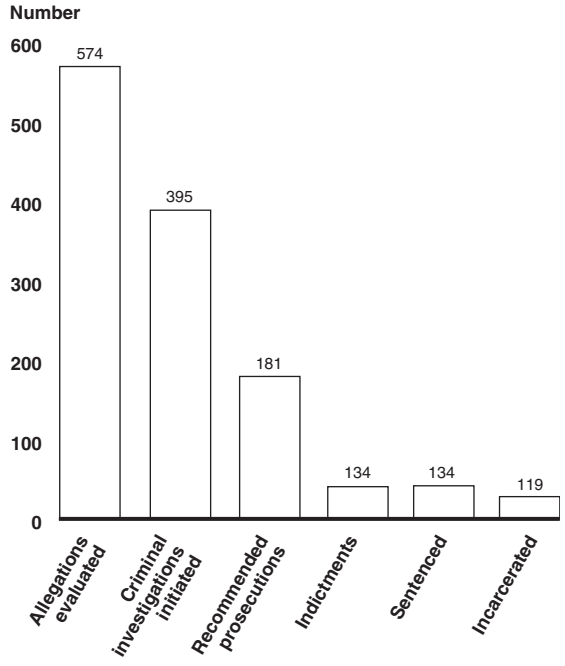
IRS's CI division investigates paid preparers suspected of criminal or fraudulent behavior and other related financial crimes. However, according to CI officials, they have a system using indicators developed from prior cases to identify and work only the most egregious cases due to overall resource limitations, leaving some cases unworked. Nevertheless, according to IRS, CI is increasing its investigations of criminal and fraudulent paid preparers. For example, according to IRS it more than doubled the number of paid preparer criminal investigations in 2002

compared to 2001 and experienced a significant increase in the number of investigations referred for prosecution in the first quarter of fiscal year 2003.

CI officials told us that to prioritize its work, CI identifies and investigates the most egregious criminal behavior using a fraud ranking system that determines which preparers should be investigated. Officials said the ranking is based on information developed from individual returns provided by fraud detection centers. Fraud detection centers are CI offices collocated at IRS campuses that attempt to detect fraud by scanning paper and electronic returns. The system ranks preparers by the number of suspected fraudulent filed returns by applying criteria that have proven in the past to be successful in prosecution of fraud cases. However, as mentioned earlier, IRS has no data on the extent of the problem with paid preparers, including those who are fraudulent, or the effectiveness of CI's deterrent actions against them.

Two programs provide much of the organizational framework for CI's actions against criminal paid preparer behavior. The division's Return Preparer Program identifies and investigates criminal paid preparers while the Questionable Refund Program identifies fraudulent tax returns. Once identified, the program stops payment on fraudulent tax refunds and refers fraudulent tax schemes to CI field offices for further investigation. Figure 6 shows that in 2001 and 2002, CI evaluated 574 referrals of possible criminal paid preparer behavior and initiated 395 criminal investigations against paid preparers.

Figure 6: Paid Preparer Criminal Investigations for Calendar Years 2001 and 2002



Source: IRS Division of Criminal Investigation.

According to CI, criminal paid preparer behavior varies. Some criminal preparers create false forms such as W-2s and file returns on behalf of deceased taxpayers. Others buy social security numbers and the names of dependents from taxpayers with multiple children in order to allow others to claim dependent related tax credits, such as the EIC. According to CI officials, most criminal preparers are investigated for aiding and abetting a false tax return. For example, during 2001 to 2002, more than 91 percent of CI's initiated investigations against paid preparers involved preparers who helped prepare false or fraudulent tax returns. One investigation resulted in a preparer pleading guilty for assisting in the preparation of false tax returns and sentenced to 38 months in prison and assessed a $10,000 fine. The preparer owned and operated a tax preparation business and among her criminal activities regularly advised clients to claim fraudulent tax credits for dependents and child care, even though the clients had no dependents. The preparer's actions from 1997 to mid-2000 resulted in a loss to the Treasury of between $1.5 and $2.5 million. From 2001 to 2002, CI

investigations resulted in the indictment and sentencing of 134[14] paid preparers, of which 119 were incarcerated.

Anecdotally, several preparers we spoke to stated that publishing examples of convictions against preparers may help deter future criminal preparer behavior. However, IRS does not have quantitative information about the size of the problem with paid preparers or the extent to which convictions against paid preparers are a deterrent to other preparers. Information on deterrence would be difficult, perhaps impossible to develop.

Others Believe More IRS Oversight Is Needed

While IRS provides some oversight of paid preparers, others believe that it should provide additional oversight. The Low Income Taxpayer Protection Act of 2003, S. 685 proposed in the 108th Congress, would require the licensing and registration of paid preparers and RAL providers. The proposal would also require all preparers to abide by the rules of conduct that currently govern practitioners and contains provisions aimed at discouraging the use of RALs, including regulating the fees charged for RALs.

The National Taxpayer Advocate recommended a similar proposal requiring the registration of paid preparers in her 2002 *Annual Report to Congress*. The proposal would require paid preparers to be registered with IRS, pass a certification examination, and maintain annual educational requirements. In a previous report to the Congress, the National Taxpayer Advocate stated that while paid preparers are subject to monetary penalties if they prepare returns negligently, many preparers are not subject to standards of conduct, licensed by any state regulatory agency, or required to participate in continuing education programs. Thus, according to the Advocate, the only course of action that can be taken to enjoin a paid preparer is the initiation of a civil action by the Secretary of the Treasury against the preparer in A District Court of the United States. According to the Advocate, such action is costly, time consuming, and leaves questionable income tax preparers free to remain in business and

[14] The 134 preparers indicted are not necessarily the same preparers sentenced. Some preparers indicted were not sentenced during the period and some of those sentenced may have been indicted in a prior period.

potentially harm taxpayers if they continue to prepare income tax returns during the legal process of the civil action.[15]

Some of the paid preparers and officials from low-income tax clinics and professional organizations we interviewed said that IRS could provide additional oversight of paid preparers, although several said that it would be difficult for IRS to undertake such efforts. Several of the preparers we interviewed said that IRS's current oversight of paid preparers needed improvement and most of the paid preparers, low-income tax clinics, and professional organizations we interviewed told us they supported the licensing or registration of paid preparers as a way to provide additional oversight of paid preparers. For example, one preparer said he felt paid preparer oversight was not in IRS's order of priorities and that paid preparers should be licensed so that IRS could enforce education and conduct standards. Others told us that IRS should impose a registration or licensing requirement on paid preparers although some expressed reservations. For example, a representative from the National Society of Accountants said that it would be an arduous task for IRS to create a system to license hundreds of thousands of people and then set up the mechanisms to discipline them. Officials from a low-income tax clinic also expressed concerns, saying that such a proposal may increase the cost of tax preparation by reducing the supply of available preparers.

Any consideration of whether to change IRS's responsibilities for overseeing paid preparers would likely take into account several factors. One, obviously, is the benefits and costs to taxpayers who use paid preparers. However, as highlighted in this report, data are lacking about the extent of problematic paid preparer behavior and the effectiveness of existing IRS actions, which makes it difficult to assess the tradeoff between benefits and costs. Another factor is that regulating the paid preparer industry, a private sector industry, is a form of consumer protection. IRS's major functions, which include processing tax returns, responding to taxpayer questions, and enforcing compliance with the tax laws, give it little experience in providing consumer protection. Still another factor is the implication for IRS resources. Recently we have reported on declines in IRS's enforcement programs, including declines in resources allocated to those programs. We have also reported that needs in other IRS programs have often been met at the expense of resources devoted to enforcement.

[15]National Taxpayer Advocate, *FY 2001 Annual Report to Congress* (Washington, D.C.: December 2001).

IRS Is Not Alone in Providing Some Preparer Oversight

Any consideration of whether to increase IRS paid preparer oversight or consumer protection must also recognize that IRS is not alone in providing such oversight. Other federal agencies, such as the Federal Trade Commission (FTC), state and local governments, and professional organizations engage in efforts to prevent, detect, and take action against problem paid preparers. For example, FTC has taken action against paid preparers pursuant to its authority to enforce the provisions of the Federal Trade Commission Act.[16] FTC's primary mission is to protect consumers by enforcing federal consumer protection laws that prevent fraud, deception, and unfair business practices. This protection extends to taxpayers using paid preparers for tax preparation and other related services.

In addition, at least six states and one city have laws that provide paid preparer oversight or consumer protection regarding RALs. These laws range from requiring registering or licensing of paid preparers to requiring disclosure statements for RALs. For example, the City of New York requires a separate disclosure statement for RAL agreements that must be provided in English or Spanish. New York City's law also requires paid preparers to provide an oral explanation of the law's required written disclosure in language understood by the taxpayer. In addition to government entities, professional organizations, such as the American Institute of Certified Public Accountants and the American Bar Association, also impose general standards of conduct on the actions of their members, including those representing taxpayers before the IRS and preparing tax returns. We did not attempt to identify all federal, state, and local governments or professional organizations that have a paid preparer or RAL oversight role in addition to IRS. Table 3 shows examples of some tax preparation and RAL oversight in addition to that provided by IRS.

[16] 15 U.S.C. Sections 41-58.

Table 2: Some Examples of Paid Preparer and RAL Oversight Efforts by State and Local Government

	Tax preparation oversight			RAL oversight	
Government	License/ register preparers	Exam to be licensed/ registered	Continuing education required	Register	Disclose
State					
California	x		x		
Illinois					x
Minnesota					x
North Carolina				x	x
Oregon	x	x	x		
Wisconsin					x
Local					
New York City					x

Source: GAO

Three of these seven oversight efforts shown in the table above were passed or enacted within the past year. To date, none of the state or local governments responsible for the efforts has evaluated the effectiveness of these efforts. The absence of such data further complicates any consideration about changing IRS's role. Without data, IRS management cannot determine how much these other government entities will provide paid preparer oversight or consumer protection.

Concluding Observations

Paid tax preparers are critical to the functioning of our tax system. Many taxpayers do not understand their filing requirements and would have great difficulty filling out their tax forms without the assistance of paid preparers.

While most taxpayers may receive quality services from their preparers, problematic behavior by some preparers raises the question of whether IRS should be more active in overseeing paid preparers. Since paid tax preparation is a private sector industry, this can be viewed as a question about the extent to which the nation's tax administrator ought to be involved in consumer protection. On the one hand, the complexity of the tax code is at least partly responsible for the existence of the paid tax preparation industry. As a consequence, IRS might be viewed as properly

having some responsibility for oversight of the industry. On the other hand, IRS's mission is tax administration and the agency may not have the expertise or the regulatory culture for successfully carrying out consumer protection responsibilities. In addition, unless given a budget increase IRS would have to divert resources from other priorities in order to carry out expanded industry oversight responsibilities. In recent years IRS has often met such resource needs by decreasing staffing of its enforcement activities.

At least two proposals exist for legislative action, one from the Taxpayer Advocate and the other, the Low Income Taxpayer Protection Act of 2003, S. 685, proposed in the108th Congress. Unfortunately, there is not much reliable information about the tradeoffs associated with changing IRS's role. Examples of problematic preparer behavior are easy to find but reliable estimates of the number of taxpayers affected by the problems do not exist and would be difficult, perhaps impossible, to develop. Such data would be needed to properly evaluate proposals for changing IRS's role. While the federal government and some state and local governments have taken actions intended to address problematic preparer behavior, the effectiveness of the actions is not known. Because making decisions about IRS's role is a policy matter and because data are not available to determine the efficacy of IRS's current oversight efforts, whether to expand IRS's role in ensuring taxpayers receive quality service from paid preparers is a judgment that Congress and IRS management must make. We are not making recommendations in this report.

Agency Comments and Our Evaluation

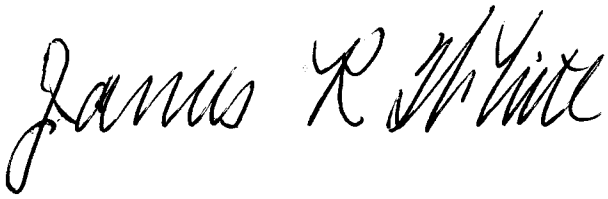
The Commissioner of Internal Revenue provided written comments on a draft of this report in an October 28, 2003, letter, which is reprinted in appendix III. The Commissioner agreed with the information presented in our report and noted that IRS will continue its efforts to provide oversight of paid tax preparers and is developing new initiatives to ensure the ethical responsibility of preparers. These efforts include continuing to develop the Office of Professional Responsibility, considering changes to Circular 230, coordinating with professional tax associations, increasing compliance efforts, forming a multifunctional work group to improve communications within IRS, and developing a national paid preparer strategy.

The Commissioner said that, based on the information in our report, IRS will undertake an analysis of whether IRS can take additional steps to increase the impact of its efforts to assess penalties against paid tax preparers. In response to our observation that penalties assessed against

paid preparers are not a collection priority, the Commissioner noted, and we agree that preparer penalty cases are included in IRS's collection priority system. Our point is that they are not a collection priority because of their relatively low dollar value and we noted that IRS collected only 12 percent of the penalties assessed in calendar years 2001 and 2002. The Commissioner commented that it might be a better reflection of IRS's collection efforts to point out that during this period, the agency collected all or some portion of penalties from 44 percent of the SB/SE preparers who were assessed a penalty and we changed our draft to show the percentage collected. We were aware that some paid preparers voluntarily pay the penalties assessed against them but, as indicated by the Commissioners' response, more than half of paid preparers paid nothing. Since uncollected preparer penalties represent about 88 percent of the value of penalty assessments, we said that IRS may be sending the paid preparer community a mixed message about whether poor performance by preparers will be tolerated. At the same time, we recognize that collecting paid preparer penalties has not been a priority due to other higher priority work, such as abusive tax schemes.

As agreed with your offices, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from its date. At that time we will send copies to the Secretary of the Treasury, the Commissioner of Internal Revenue, and other interested parties. We will also make copies available to others on request. In addition, the report will be available at no charge on the GAO Web site at http://www.gao.gov.

This report was prepared under the direction of Jonda Van Pelt, Assistant Director. Other major contributors are acknowledged in appendix IV. If you have any questions about this report, contact me on (202) 512-9110.



James R. White
Director, Tax Issues

Objectives, Scope, and Methodology

The objectives of this report were to (1) obtain the views of taxpayers who used paid preparers and provide examples of paid preparer performance, including what is known about the extent of problems caused by paid preparers and (2) describe IRS's efforts to prevent, detect, and take action against problem paid preparers; challenges facing IRS offices that interact with paid preparers, especially the Office of Professional Responsibility; and efforts to address those challenges.

Objective 1: Obtaining Taxpayer Views, Examples of Paid Preparer Performance, and What Is Known about the Extent of Problems Caused by Paid Preparers

To obtain the views of taxpayers who used paid preparers about the quality of service the preparers provided, we conducted (1) a representative nationwide survey and (2) in-depth interviews with a small judgmental sample of the individuals who participated in our nationwide survey. We also searched for studies that talked about the extent of problems caused by paid preparers.

Methodology for the Taxpayer Survey Regarding Use of Paid Preparers

To determine taxpayer views of their paid preparers, we contracted with the Marist College Institute for Public Opinion of Poughkeepsie, New York to include our questions at the beginning of their multisubject telephone survey of the United States conducted between February 5 and 24, 2003. Interviews were completed with 917 of the estimated 1,996 eligible sampled individuals for a response rate of 46 percent.[1] The results presented in our report are based on the 429 interviews with respondents who reported they paid someone to prepare their federal personal tax returns for their 2001 income.

Study Population and Sample Design

We sought to obtain information about the views of the adult population of the United States. The study procedures yield a sample of members of the

[1]Based on the RR3 response rate convention defined by the American Association of Public Opinion Research (http://www.aapor.org/default.asp?page=survey_methods/standards_and_best_practices/standard_definitions).

noninstitutional population of the United States (50 states and the District of Columbia) who are 18 years or older, speak English, and reside in a household with a land-based telephone (cellular telephone numbers were not included in the sample).

Random Digit Dial Equal Probability Selection Methods were followed to identify households. Survey Sampling International (SSI) of Fairfield, Connecticut provided the probability sample of telephone numbers. These were drawn from active telephone blocks of telephone exchanges with listed numbers and excluded numbers that SSI identified as being business numbers or not in service (e.g., disconnected). At least eight calls were made to each telephone number to attempt to identify a respondent.

A member within each household was initially randomly chosen by selecting the individual whose birthday most recently preceded the date of the telephone contact. Once the selection of a household member was made, two attempts were made to complete the interview with that individual. If, after two contacts, including scheduled appointments, the selected member could not be reached or refused to complete the survey, a second adult member of the household was asked to participate. If a household refused twice, it was not contacted until the final week of data collection at which time a monetary incentive was offered for completion of the interview.

Survey respondents are weighted in our analyses so that age, gender, and regional estimates from our survey will match U.S. data on these demographic characteristics. The U.S. data come from county-level estimates from Census 2000 that were projected forward by SCAN/U.S., Inc. to July 1, 2002.

Sources of Error

As with all sample surveys, this survey is subject to both sampling and nonsampling errors. The effects of sampling errors, due to the selection of a sample from a larger population, can be expressed as confidence intervals based on statistical theory. The effects of nonsampling errors, such as nonresponse and errors in measurement, may be of greater or lesser significance but cannot be quantified on the basis of the available data.

Sampling errors arise because we used a sample of individuals to draw conclusions about the much larger population. The study's sample of telephone numbers is based on a probability selection procedure. As a

result, the sample was only one of a large number of samples that might have been drawn from the total telephone exchanges from throughout the country. If a different sample had been taken, the results might have been different. To recognize the possibility that other samples might have yielded other results, we express our confidence in the precision of our particular sample's results as a 95 percent confidence interval. For all the percentages presented in this report, we are 95 percent confident that when only sampling errors are considered the results we obtained are within +/- 5 percentage points or less of what we would have obtained if we had surveyed the entire study population. In addition to the reported sampling errors, the practical difficulties of conducting any survey introduce other types of errors, commonly referred to as nonsampling errors. For example, questions may be misinterpreted, some types of people may be more likely to be excluded from the study, errors could be made in recording the questionnaire responses into the computer-assisted telephone interview software, and the respondents' answers may differ from those who did not respond.

To test the understanding of the questions, we pretested the survey by conducting 57 interviews. To ensure that responses were correctly recorded in the computer-assisted telephone interview software, trained interviewers were used who had been specifically briefed on the study, and interviewer supervisors regularly monitored, evaluated, and provided feedback to the interviewing staff who worked from a centralized telephone facility.

For this survey, the 46 percent response rate is a potential source of nonsampling error; we do not know if the respondents' answers are different from the 54 percent who did not respond. Both GAO and Marist took steps to maximize the response rate—the questionnaire was carefully designed, at least eight telephone calls were made at different times of day on different days of the week to try to contact each telephone number, the interview period extended over 20 days, respondents were informed that their responses were anonymous, suspended interviews and refusals were recontacted at least once, and respondents were provided with a toll-free number to either call back at a more convenient time or to obtain further information about the survey.

Because we did not have information on those taxpayers who chose not to participate in our survey, we could not estimate the impact of the nonresponse on our results. Our findings will be biased to the extent that the people at the 54 percent of the telephone numbers that did not yield an

interview have different experiences with paid tax preparers than did the 46 percent of our sample who responded. Knowing that the survey would concern tax issues could not have created large biases because only about 1.6 percent of the eligible households in the sample (31 individuals) refused after the interview began (i.e., after they could have known the interview would address tax issues.) The remaining nonresponding units (about 52 percent of the sample) did not know that the interview would address tax issues. The 52 percent is comprised of about 18 percent (356) who refused before the interview could be started, about 14 percent (274) where an eligible respondent was identified in the household, and about 21 percent (estimated 418) where no one was contacted at the telephone number but the household was assumed to be eligible. This estimate of 418 uncontacted, but eligible, households is derived assuming that the percentage of eligible households among all our 704 uncontacted households would be the same (59.14 percent) as the percentage of eligible households among households for which the eligibility status was determined.

To obtain examples of paid preparer performance, we conducted in-depth interviews with 18 taxpayers from our nationwide survey of taxpayers. In addition, we discussed paid preparer performance and received examples of paid preparer performance from various IRS offices, some paid preparers, some low-income tax clinics, and IRS's Taxpayer Advocate Service. To obtain information on the fees charged by paid preparers for electronic filing and refund anticipation loans we contacted seven preparers posing as potential clients and also gathered loan cost schedules from the Web sites of two lenders. We also reviewed closed case files in IRS offices, including the Office of Professional Responsibility (OPR), Small Business/Self-Employed (SB/SE) division, and Criminal Investigation (CI) division.

A copy of the survey is in appendix II.

In-depth Interviews with Taxpayers

As part of our nationwide survey of taxpayers, we asked the individuals we contacted if they would be willing to participate in an in-depth interview regarding their experiences with paid tax preparers. For those taxpayers who agreed, we used a structured questionnaire that covered, for example, how taxpayers found their paid preparers and investigated the credentials of the preparer, the type of preparer used, why the taxpayer used a paid preparer, and how extensively the preparer probed the taxpayers' personal

tax circumstances and asked for documentation. We interviewed 18 taxpayers in-depth.

Studies Discussing the Extent of Problems Caused by Paid Preparers

To obtain studies discussing the extent of problems caused by paid preparers, we relied upon studies mentioned in interviews with IRS officials and through periodical searches. We also used a 1997 *Consumer Reports* survey of their readership concerning paid preparers, a report by the Treasury Inspector General for Tax Administration regarding potentially unclaimed child tax credits, a Department of Treasury study regarding earned income tax credits, and a previous GAO report that estimated the number of taxpayers eligible to itemized deductions who used the standard deduction instead.

Objective 2: Describe IRS's Oversight of Problem Paid Preparers; Management Challenges Facing IRS's Offices that Provide Oversight; and Efforts to Address Management Challenges

To describe IRS's efforts to prevent, detect, and take action against problem paid preparers, we interviewed officials from IRS offices including OPR, SB/SE, CI, and the Taxpayer Advocate Service (TAS). IRS officials said these offices interact the most with preparers. We also reviewed various documents used by these offices to provide paid preparer oversight.

To describe challenges facing IRS offices that interact with paid preparers, especially OPR, and efforts to address those challenges, we interviewed officials from OPR, including its new Director, as well as officials from other IRS offices discussed above, such as SB/SE and CI. We also used documents from OPR, including a consulting firm report on the office of Director of Practice and documents from other IRS offices.

To examine IRS's efforts to assess and collect penalties against paid preparers, we interviewed officials from IRS's SB/SE division, reviewed collection data, and examined division documents. To determine the percentage of assessed fines collected and uncollected by SB/SE we relied upon a SB/SE analysis of collections data extracted from IRS's Enforcement Revenue Information System. To assess the reliability of these data, we reviewed existing documentation related to the data sources and interviewed officials knowledgeable about the data. We determined that the data were sufficiently reliable for the purposes of this report.

To obtain information about IRS's efforts to register and monitor Electronic Return Originators (ERO), we interviewed officials from SB/SE's ERO

Monitoring Program and reviewed IRS Publication 1345 covering requirements for EROs. To determine the number of EROs, monitoring visits, and sanctions issued, we relied upon IRS's e-file Provider Monitoring Report. In addition, we reviewed various other documents including a recent report by the Treasury Inspector General for Tax Administration.

To describe IRS's efforts to investigate criminal and fraudulent paid preparer behavior, we interviewed officials from CI and reviewed case file information. We used data from the CI Management Information System and interviewed CI officials to determine statistics on the cases worked. To assess the reliability of these data, we reviewed existing documentation related to the data sources and interviewed officials knowledgeable about the data. We determined that the data were sufficiently reliable for the purposes of this report.

To examine efforts suggested by IRS's Taxpayer Advocate Service to provide additional IRS oversight of paid preparers or provide more consumer protection, we interviewed officials from the Advocate's office about a proposal to license paid preparers. We also reviewed the 2001 and 2002 National Taxpayer Advocate's reports to Congress where the Advocate's proposals are explained and discussed.

To provide examples of actions taken against problem paid preparers by other federal, state, and local governments, we relied upon interviews and reports from a variety of sources including paid preparers, professional and consumer organizations, officials from several states, and some federal agency representatives. Based on these interviews and reports, we examined state and local laws that create oversight of certain aspects of paid preparer behavior. We did not attempt to identify all federal, state, and local governments or professional organizations that have a paid preparer or RAL oversight role. Those discussed are only examples of what we found during our research and there may be others.

The data cited from IRS for the estimated number of individual filers in 2001 that paid someone to prepare their tax returns, the amount paid in 2000 for tax preparation, the number of paid preparers in 1999, and the number of RALs taken out in 2001 and 2000 are considered background information. As such, we did not verify these numbers.

We conducted our work from April to October 2003 in accordance with generally accepted government auditing standards.

Final Survey Results Weighted to the U.S. Population

Survey Results[1]

"We have a few questions about your experiences last year in completing your federal income tax return. We are interested in whether or not you paid someone last year to fill out your 2001 income tax return."

"Did you pay someone to prepare your tax return last year?"

__47__ YES *(Continue with Question 2)*

__51__ NO *(Stop)*

__1__ NOT SURE

__1__ REFUSED

"For the rest of the questions, we'll refer to this person as the paid preparer. Was the paid preparer who filled out your tax return: A) A tax preparation service such as H & R Block or Jackson-Hewitt, B) An accountant, CPA or lawyer, C) Someone else, or D) do you not know?"

__35__ A. A TAX PREPARATION SERVICE

__52__ B. AN ACCOUNTANT, CPA, OR LAWYER

__9__ C. SOMEONE ELSE

__4__ D. DON'T KNOW

"Who worked directly with the paid preparer, was it only yourself, both yourself and someone else, or only someone else?"*

__46__ ONLY YOURSELF

__35__ BOTH YOURSELF AND SOMEONE ELSE

__17__ ONLY SOMEONE ELSE

__1__ NOT SURE/REFUSED

[1] We are 95 percent confident that the percentage estimates of our survey are within +/- 5 percentage points or less of what we would have obtained if we had surveyed the entire study population.

* Percents do not add to 100 due to rounding.

"Next, we ask about some of the practices that paid preparers sometimes follow. For each one, please tell me whether you know if it is something your paid preparer did do or did not do or whether you do not know."

"First, did your paid preparer give you a copy of your completed tax return, not give you a copy or do you not know?"

__95__ YES, GAVE COPY

__1__ NO, DIDN'T GIVE COPY *(skip to 4c)*

__4__ DON'T KNOW *(skip to 4c)*

"Did your paid preparer sign your copy of your completed tax return as the preparer, not sign your copy, or do you not know?"

__83__ YES, SIGNED COPY

__3__ NO, DIDN'T SIGN COPY

__14__ DON'T KNOW

"Did your paid preparer see any documents that showed the income you received or any deductions or tax credits that you might have claimed? That is, did the paid preparer see the documents, not see them, or do you not know?"

__88__ YES, SAW DOCUMENTS

__2__ NO, DIDN'T SEE DOCUMENTS

__10__ DON'T KNOW

"For the next question, I want you to think about everything about you that affects the amount of taxes you pay, such as whether or not you have children at home, earn interest from a bank account, or pay a mortgage. Do you believe that your paid preparer had enough information about your situation to accurately prepare your income tax return, didn't have enough information, or don't you know?"

__91__ YES, HAD ENOUGH INFORMATION

__3__ NO, DIDN'T HAVE ENOUGH INFORMATION

__6__ DON'T KNOW

"How confident are you that you did not pay more in taxes than was legally required last year? Would you say that you are very confident, generally confident, a little confident, not at all confident or that you have no opinion?"*

___49_ VERY CONFIDENT

___28_ GENERALLY CONFIDENT

____7_ A LITTLE CONFIDENT

____5_ NOT AT ALL CONFIDENT

___12_ NO OPINION

* Percents do not add to 100 due to rounding.

"Has the IRS sent you any type of notice saying that any part of your tax return from last year had to be changed, or has the IRS not contacted you, or do you not know whether you have been contacted?"

____8 YES, IRS SENT NOTICE

___86_ NO, IRS NOT CONTACTED

____6_ DON'T KNOW

"Now think about your new 2002 tax return that is due soon. Do you think you will use a paid preparer again or not use a paid preparer for this new tax return?"

__87_ YES, USE A PREPARER AGAIN

___7_ NO, NOT USE A PREPARER *(stop)*

___6_ DON'T KNOW *(stop)*

"The U. S. General Accounting Office is doing research on peoples' opinions and experiences with their paid preparers. Would it be okay with you if someone from the General Accounting Office telephoned you in the next month for a research interview?"

__45_ YES (NOT REWEIGHTED TO U.S.

__54_ NO (stop) POPULATION)

Comments from the Internal Revenue Service

COMMISSIONER

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

October 28, 2003

Mr. James R. White
Director, Tax Issues
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. White:

I reviewed your report entitled, "Tax Administration: Most Taxpayers Believe They Benefit From Paid Tax Preparers, But Oversight For IRS Is A Challenge" (GAO-04-70). We appreciate your recognition of our efforts to regulate paid preparers, and we recognize the importance of our role. Although you did not provide recommendations, we are continuing our efforts in this area by developing initiatives to ensure the ethical responsibility of preparers.

We agree with your observations regarding IRS efforts to revitalize and refocus the Office of Professional Responsibility. We are moving rapidly towards realizing our authorized staffing level for this office. Performance measures have been established and implemented, and a clear agenda has been defined. We consider members of the tax professional community to be partners in tax administration. As such, it is important that they adhere to the standards of practice outlined in Treasury Circular 230, which the Office of Professional Responsibility administers.

As I explained in recent Congressional testimony, some of our accountants, lawyers, investment bankers and other professionals, including individuals from our country's very best firms, have lost track of some fundamental professional obligations they owe to shareholders, employees, and the general public. Circular 230 establishes standards of ethical conduct required of professionals who practice before the IRS. The Treasury and the IRS believe that changes should be made to Circular 230, pursuant to our existing authority, to help curb abusive tax shelters. Among the subjects we are closely examining are the standards used in legal opinions that are used by taxpayers in connection with abusive tax shelters.

To leverage our efforts in this area, the Office of Professional Responsibility will coordinate its efforts with the associations of tax professionals in dealing with representatives who fail to meet the standards of professional conduct. Tax professional organizations are close working partners with the IRS, and they understand the problems that result when members abuse the tax system. The creation of this office is a direct result of the concerns of the professional organizations.

Additionally, we formed a multi-functional work group to improve communications between functions and develop a national return preparer strategy. The group includes

the Office of Professional Responsibility, SB/SE Division, Wage and Investment (W&I) Division, Criminal Investigation Division, and the Campus Lead Development Centers. Each function will share information on actions taken and results achieved in the Return Preparer Program (RPP). These meetings will be conducted on a regular basis.

The Small Business/Self Employed (SB/SE) Division also recently issued comprehensive guidance to SB/SE Division Area Directors and Planning and Special Programs (PSP) Managers on program objectives and initiatives. The memorandum addressed the priority of increasing RPP compliance efforts. As a part of our RPP strategy, we will continue our efforts in the Electronic Return Originator (ERO) Monitoring Program. Starting in Fiscal Year 2004, we will also be responsible for conducting Earned Income Tax Credit (EITC) due diligence compliance visits.

Your report states that IRS does not include penalties assessed against paid preparers as a Collection priority. Preparer Penalty cases are part of the Master File Transcript (MFT) 55 assessments and the assessment and collection of these penalties are included in our Collection priority system. All MFT 55 assessments are currently being worked in the compliance centers and in the Automated Collection System (ACS) work streams in both the W&I and SB/SE Divisions.

Your report references that 12 percent of the preparer penalties assessed in calendar years 2001 and 2002 by SB/SE are collected. However, the percentage of preparers from whom we collect may be a better reflection of the collection results than is the percentage of penalties collected. This is because a small number of preparers are assessed large penalty amounts. We collect all or some portion of penalties from 44 percent of all SB/SE preparers who are assessed a preparer penalty. Based on information you provided in your report, we will be performing analyses to determine whether additional steps can be taken to improve our performance.

The IRS has several efforts underway to better align its casework to the most appropriate work streams. Assessing the feasibility of the systemic identification of preparer penalty cases on ACS is part of the proposal that will be considered in the workload realignment effort.

If you have any questions, or if you would like to discuss this response in more detail, please contact Joseph R. Brimacombe, Deputy Director, Compliance Policy, at (202) 283-2200.

Sincerely,

for Mark W. Everson

GAO Contacts and Staff Acknowledgments

GAO Contacts

James White (202) 512-9110
Jonda Van Pelt (415) 904-2186

Acknowledgments

In addition to those named above, Vince Balloon, Larry Dandridge, Katherine Davis, Michele Fejfar, Evan Gilman, Tre Forlano, Brittni Milam, Libby Mixon, Cheryl Peterson, and Peter Rumble made key contributions to this report.

GAO's Mission

The General Accounting Office, the audit, evaluation and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

Obtaining Copies of GAO Reports and Testimony

The fastest and easiest way to obtain copies of GAO documents at no cost is through the Internet. GAO's Web site (www.gao.gov) contains abstracts and full-text files of current reports and testimony and an expanding archive of older products. The Web site features a search engine to help you locate documents using key words and phrases. You can print these documents in their entirety, including charts and other graphics.

Each day, GAO issues a list of newly released reports, testimony, and correspondence. GAO posts this list, known as "Today's Reports," on its Web site daily. The list contains links to the full-text document files. To have GAO e-mail this list to you every afternoon, go to www.gao.gov and select "Subscribe to e-mail alerts" under the "Order GAO Products" heading.

Order by Mail or Phone

The first copy of each printed report is free. Additional copies are $2 each. A check or money order should be made out to the Superintendent of Documents. GAO also accepts VISA and Mastercard. Orders for 100 or more copies mailed to a single address are discounted 25 percent. Orders should be sent to:

U.S. General Accounting Office
441 G Street NW, Room LM
Washington, D.C. 20548

To order by Phone: Voice: (202) 512-6000
TDD: (202) 512-2537
Fax: (202) 512-6061

To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Web site: www.gao.gov/fraudnet/fraudnet.htm
E-mail: fraudnet@gao.gov
Automated answering system: (800) 424-5454 or (202) 512-7470

Public Affairs

Jeff Nelligan, Managing Director, NelliganJ@gao.gov (202) 512-4800
U.S. General Accounting Office, 441 G Street NW, Room 7149
Washington, D.C. 20548

United States
General Accounting Office
Washington, D.C. 20548-0001

Official Business
Penalty for Private Use $300

Address Service Requested

Presorted Standard
Postage & Fees Paid
GAO
Permit No. GI00