WITH THE STROKE OF A PEN

Policy Recommendations for Holding Paid Tax Preparers Accountable

States have many incentives to ensure that filers can turn to tax preparers who are reliable and accurate. In 2013, 43 states plus the District of Columbia collected over $290 billion in individual income tax revenue.¹ To understand the magnitude of this figure, for the majority of states, individual income tax accounts for 23-57% of total state tax revenue.² Given states’ dependence on income tax revenue, ensuring that all filers, especially low-income filers, have access to reputable, quality preparers is critical and requires more oversight of both the tax preparation process and paid tax preparers.

The federal government and 46 states do not require basic competency standards for paid tax preparers; only a minority of tax preparers, such as certified public accountants (CPAs), Internal Revenue Service (IRS)-licensed “enrolled agents” and state-licensed attorneys, are subject to the U.S. Treasury Department’s standards of practice.³ “Unenrolled agents” include a wide variety of tax preparers who may own small businesses, open seasonal pop-ups in temporary locations like garages and vacant storefronts, or work for commercial chains (e.g., H&R Block, Liberty Tax Service). Tax preparers can be substantially different in terms of their education, training and quality of work, but may be similarly susceptible to a variety of improprieties like overcharging customers or falsifying income.

The lack of basic competency standards for paid preparers opens the door for increased filing errors and, worse, predatory practices like hidden fees, which are especially damaging to tax filers with limited incomes and taxpayers of color. Tax preparation error and abuse drain wealth not only from state budgets as a whole, but more alarmingly, from low-income households and households of color.

³ An enrolled agent is a person who has earned the privilege of representing taxpayers before the Internal Revenue Service by either passing a three-part comprehensive IRS test covering individual and business tax returns, or through experience as a former IRS employee. Enrolled agent status is the highest credential the IRS awards. Individuals who obtain this elite status must adhere to ethical standards and complete 72 hours of continuing education courses every three years.
Paid Tax Preparers need to be held accountable due to:

- Costs to states from tax preparer error and overpayments
- Exorbitant and non-transparent tax preparation fees
- Exploitation of low-income workers who are eligible for tax credits (accountability will help deter “bad actors”)

Which states have already taken action?

- California
- Maryland
- New York
- Oregon

States should adopt the following policies:

- Education requirements that include both competency testing and continuing education
- Accountability to track the fulfillment of education requirements and accuracy of tax returns
- Transparency about fees about fees, the status of one’s taxes and the reputability of paid tax preparers

Consequences of Not Overseeing Paid Tax Preparers

The status quo serves as a detriment, both to the state and to individual taxpayers, in a variety of ways. Although individuals can report tax preparer misconduct to the IRS or state departments of taxation, individual taxpayers are held legally responsible for the accuracy of their returns. Once a taxpayer signs a fraudulent or incorrect tax return, that taxpayer is legally responsible for any additional tax liability, regardless of the tax preparer’s counsel. Most states do not even require paid tax preparers to place their federal tax identification numbers on state returns, making it very difficult for states to track non-compliant preparers and gives no incentive for preparers to ensure accuracy and ethical conduct.

*Additional Costs to States Due to Tax Errors and Overpayments.* The Government Accountability Office’s 2014 study of paid tax preparation revealed issues of practitioner competence and a 60% error rate. Common errors included guiding taxpayers to not report cash tips, claiming an ineligible child for the Earned Income Tax Credit (EITC), not asking required eligibility questions for other tax credits, not choosing the most advantageous deduction option (i.e., itemized or standard) and not signing the tax return. Another study, conducted in 2015 using “mystery shoppers,” found inaccuracies in as many as 90% of returns by paid preparers.

---

In addition to the challenges these inaccuracies create for taxpayers, inaccurate filing can also cost state governments additional money in lost revenue as well as mediation and legal fees for tax disputes. Using federal taxes as an example, The Joint Committee on Taxation estimates that regulation of paid tax preparers would generate $135 million in additional revenue for the federal government over ten years.\(^7\) One can assume a similar impact for state governments that collect income taxes. Unfortunately, tax preparer error and misconduct are widespread, as evidenced by the number of questions taxpayers post on online forums and the abundant news stories covering these cases.\(^8\) Examples include a couple who owed several hundred dollars in penalties and interest because of an income reporting error,\(^9\) a couple forced to pay penalties despite having previously provided all relevant documents to their tax professional,\(^10\) and a couple almost losing their business due to their preparer’s accounting errors,\(^11\) just to name a few.

Further, the ease with which paid tax preparers can fraudulently claim tax credits for their clients (with the goal of increasing their own fees) can actually hurt clients who are truly eligible for the credits. Fraud cases cast doubt over the legitimacy of tax credits and the people who claim them. For example, a new law in 2017 required the IRS to delay issuing tax refunds in an effort to increase processing times to verify incoming tax returns. The refund delay hurt financially strapped taxpayers who rely on receiving their tax refunds at a certain time each year to manage cash flow. Therefore, tax credit fraud harms legitimate EITC-eligible taxpayers both in terms of their finances and their reputation.

**Exorbitant and Non-Transparent Fees.** Aside from costs to the state, lack of oversight of the paid tax preparer industry often has more immediate and alarming impacts on low-income taxpayers. Taxpayers who experience errors on their returns often face hundreds, and sometimes thousands, of dollars in penalties and interest. While some professional preparers absorb the cost of penalties, none are required to do so. Although taxpayers of all income levels are liable for their tax preparers’ mistakes, those with lower incomes who are eligible for various tax credits are at a higher risk of being on the hook for penalties they cannot afford since they are more likely to be targeted by, and reliant on, predatory tax preparers. EITC-eligible taxpayers also end up paying much higher rates for tax preparation services. While the average fee for preparing an itemized Form 1040 with Schedule A and state tax return is $273,\(^12\) workers eligible for the EITC pay an average of $400 at national tax preparation chains.\(^13\) Even worse, tax preparers are not required to disclose their fees before completing their services, so taxpayers cannot adequately prepare for the costs associated with filing their taxes. The Progressive Policy Institute found that on average, low-income taxpayers spend 13-22%

---

\(^7\) “Estimated Revenue Effects of a Bill to Prevent Identity Theft and Tax Refund Fraud,” Joint Committee on Taxation, September 11, 2015.

\(^8\) e.g., “Time Magazine, Fat Wallet, Just Answers, Tax Almanac, Bogleheads.”


of the average EITC refund just to file their taxes, thereby diminishing a substantial portion of the cash windfall on which they often rely.

**Exploitation of Low-Income Workers.** Until regulatory action was taken starting in 2010, unscrupulous tax preparers exploited the fact that low-income workers often live paycheck to paycheck by offering them high-cost Refund Anticipation Loans (RAL) to receive their refunds sooner by offering a loan in the amount of their refund with annual percentage rates of 50-500%. An analysis of 2006 tax data found that non-EITC recipients in African American communities were 3.6 times more likely to use a RAL than were other non-EITC tax filers statewide. Such predatory practices drain wealth from communities of color that could be otherwise spent on improving a family’s financial well-being. As offering RALs became riskier due to lack of IRS data to underwrite the loans, many preparers began offering Refund Anticipation Checks (RAC) that allow filers to pay the cost of their preparation directly from their anticipated refund. Unfortunately, preparers often charge exorbitant additional fees above the cost of preparation. For taxpayers who qualify for free tax preparation services, even interest-free products to get their refunds sooner can entice consumers to pay for tax preparation services they would otherwise receive for free.

**State Policies to Date**

Given that Congress is unlikely to pass legislation granting the IRS the authority to regulate taxpayers on a national level, the onus is on states to adopt regulations and remedy the issues described above. Currently, only California, Maryland, New York and Oregon have mandatory standards for those paid tax preparers who are not already credentialed as enrolled agents, attorneys or Certified Public Accountants (CPAs). Meanwhile, seven states (Arkansas, Connecticut, Illinois, Maine, Maryland, Minnesota and New York) prohibit add-on fees for tax-time products such as RACs. Each state has taken a slightly different approach to regulation, but all regulations involve some level of required education and state registration. Oregon, which in 1973 became the first state to regulate all tax return preparers, employs a “two-tier” licensing system for apprenticeship licenses and supervisory-level licenses. The requirements also include a high school diploma or GED certificate, 80 hours of tax law education and an exam with a passing grade of at least 75%. Maryland’s regulations are similar to Oregon’s, with a required exam to qualify for registration and to continue providing services. New York’s program, like Oregon’s and Maryland’s, requires annual continuing education and passing a competency test for registration with the additional qualifier that anyone delinquent in child support payments is denied a license. California also requires education and registration, but does not have a qualifying exam.

Some states have pursued initial steps to at least tie paid tax preparers to their completed tax returns, but such efforts are wholly inadequate in terms of protecting consumers. One such example is the basic requirement that paid tax preparers include their IRS-mandated Preparer Tax Identification Number (PTIN) on all state tax returns, which would create a uniform way to track tax preparers in case of questionable returns. An Illinois law (P.A. 99-0641) that went into effect at the beginning of 2017 requires tax

---


15 Ibid.

preparers to include their PTIN on all Illinois Business Income Tax returns. Alabama also proposed a similar law during the last legislative session. However, while these laws should make it so that preparers are held accountable, in practice, they only make preparers trackable and do nothing to ensure their adherence to standards. Further, most commercial tax preparation software automatically includes PTIN information on state tax returns, so these laws do little to change the status quo.

The “Three-Legged Stool” of Strong Paid Preparer Regulations

Preventing incompetence and fraud by paid tax preparers requires a “three-legged stool” of mutually reinforcing policies that (1) support the prevention of disreputable conduct through education requirements, (2) ensure accountability for the quality of tax returns and (3) enforce standards of practice to support transparent fee structures and services. Taken together, the requirements discussed in this section create the sturdy stool of education, transparency and accountability.

*Education Requirements.* Some may argue that education is the most meaningful element of adequate paid tax preparer regulations. Education requirements should include both competency testing that requires passing a test administered by the state and continuing education to stay current on changes to the tax code. The requirements may also include completing two hours of IRS continuing education for ethics, which is required for enrolled agents, as well as all tax preparers in California, Maryland and Oregon. The course covers ethical issues involving the possession of tax records, charging of fees and protocol for tax practitioners acting in a disreputable or incompetent manner.

*Taxpayers should have an objective way to know that the preparer they select, for what may be their most significant financial transaction of the year, is not only competent to accurately prepare their returns, but also trustworthy with the taxpayer’s personal information. Minimum standards for paid tax preparers is the most obvious way to protect consumers from incompetent and unethical tax preparers, and to help reduce improper payments and fraudulent tax returns.*

- Jeremy Stohs, H&R
Competency testing can provide an objective way to evaluate a tax preparer’s reputation. States that pursue competency testing can either create their own test, adopt a test used for professional licensure or adopt the certification test used by the Volunteer Income Tax Assistance program. Critics have argued that state-based testing would add costs for tax preparers who would in turn pass the costs onto taxpayers. However, early IRS proposals suggested charging only $116 per exam as part of its minimum testing standards.\(^7\)

In conjunction with competency testing, ongoing education is necessary to account for changes to the tax code. So far in 2017, ten states have instituted changes to either their sales, income, gas, corporate or marijuana taxes.\(^8\) California, Oregon, Maryland and New York require a wide range of continuing education hours, from only four hours annually in New York to 30 hours annually in Oregon (for Licensed Tax Consultants). Not only does this benefit the paid tax preparer community and the taxpayers themselves, but these standards also reduce the need for redress in the court system, thereby alleviating the strain on already limited state resources. Creating clear continuing education requirements also helps clarify and make transparent the knowledge required for licensing.

**Accountability.** The second “leg” of the stool is accountability – the mechanism by which the fulfillment of education requirements and other requirements is tracked. As noted earlier, requiring paid tax preparers to include their PTINs on all state returns would create a uniform way to track tax preparers in case of questionable returns, but is not adequate on its own. States should also create an accountability board or registration program to deal with preparers with high error rates or multiple complaints.

Another option for ensuring accountability is state registration, which refers to the creation of a separate regulatory scheme to credential paid tax preparers. Tax attorneys, public accountants and Certified Public Accountants (CPAs) are typically exempt from registration. Opponents of state registration systems argue that separate state regulatory requirements would be costly and burdensome. However, a few states have successfully implemented state registration at zero cost to taxpayers and minimal cost to tax preparers. For example, tax preparers in New York are assigned a New York Tax Preparer Registration Identification Number (NYTPRIN), which is listed on each return and on all refund-related documents. Likewise, Oregon employs an effective “two-tier” licensing system that differentiates between

---


apprenticeship licenses and Licensed Tax Consultants who have met stricter competency standards and are more experienced. State registration is also helpful for quickly dispersing information about changes to the tax code or new education requirements.

Inherent in these recommended options is the idea that the state would be able to effectively enforce noncompliance through appropriate disciplinary actions. For example, in New York, the State Tax Department can refuse, suspend or cancel a preparer’s registration or order the preparer to attend remedial educational classes. In California, the penalty for not registering with the California Tax Education Council is initially $2,500, which increases to $5,000 if the preparer is found to be unregistered after the initial penalty. The Maryland State Board of Individual Tax Preparers is also authorized to determine disciplinary actions including denying or revoking registration and assessing appropriate civil penalties. Regardless of the precise disciplinary action, the state must have strategies and resources to enforce regulations and deal with questionable preparers.

Transparency. Lastly, greater transparency about fees, the status of one’s taxes and the reputability of paid tax preparers is crucial for ensuring that all taxpayers pay a fair fee. Transparency is key at three different levels—between various government agencies to ensure information about “bad actors” is well-circulated, between tax preparers and clients to ensure clients understand potential fees, and between the state government and taxpayers to help taxpayers take control of potential state tax liabilities.

To begin with, states must expand information-sharing mechanisms between the IRS and state departments of revenue to notify each other and other jurisdictions of actions taken against specific “bad actors.” For example, the Illinois Tax Return Preparation Task Force recommended expanding the communications infrastructure between the IRS and states utilizing PTIN numbers. The Task Force stated that the Illinois Department of Revenue should establish a process with the IRS “to notify each other and other jurisdictions of any action taken against specific tax preparers.” This would help the agencies perform compliance audits on returns prepared by certain tax preparers and pursue repeat offenders. As of 2014, the IRS had 88 information sharing agreements with state and municipal government agencies. By sharing information about inaccurate tax returns, the IRS can double-check returns completed by preparers with a history of completing faulty state returns. Further, instituting information-sharing agreements between various state departments of revenue could help them determine patterns of delinquent behavior by tax preparers that complete state tax returns across different states.

Second, states should require paid tax preparers to make information about fees, licensing and track records for past accurate tax returns available to tax filers as transparently as possible so potential clients have the ability to comparison shop. Clients shopping for other services, such as home improvement services, are able to research whether or not a contractor is licensed in state databases before committing to a certain price, and the same should be true for tax preparers. Studies have found that paid tax preparer clients often are given an overall cost, rather than an itemized breakdown of

---

how costs are calculated.\textsuperscript{20} States can recommend fee disclosures similar to the Consumer Financial Protection Bureau’s “Know Before You Owe” rules for unemployment prepaid cards. These rules provide consumers with standard, easy-to-understand, upfront information about potential fees. Alternatively, or in addition to the recommended fee disclosures, states could set up a public consumer complaint database to help taxpayers learn from each other’s experiences and allow the state department of revenue to identify issues and intervene when necessary.

States should also consider promoting transparency between the government and taxpayers by creating a dedicated unit within the state department of revenue specifically to support taxpayers and tax preparers. Staff could address specific questions about tax preparation through either a hotline or a website to help taxpayers directly access information about the status of their tax return and whether they owe other debts. This would better enable taxpayers to take control of their taxes and be less reliant on tax preparers for important information. Tax preparers would also be able to better serve their clients by following up on potential preparation mistakes.

**Anticipated Costs of the “Three-Legged Stool”**

Holding tax preparers accountable does come at a cost, but so does erroneous filing. Looking at specific states, California’s program administration costs were about $29 per preparer, while Oregon’s was about $123 because Oregon has a two-tiered licensing system and California does not require examinations. The GAO estimates that the total annual cost of the Oregon program, including state costs and costs to preparers, is about $6 million but this number is outweighed by program benefits.\textsuperscript{21} The program has increased taxpayer accuracy, as evidenced by the fact that the average Oregon return required changes in tax liability that were $250 less than the average return in the rest of the nation. The $6 million total includes the cost of the Oregon Board of Tax Practitioners’ full-time investigator and costs related to litigation.

California’s total annual costs added up to approximately $1.2 million in FY 2007 with the majority of funds coming from the $25 registration fees paid by tax preparers. Additional funding came from late registration fees and fees paid by California Tax Education Council (CTEC) education providers. The state did not use any funds from state tax revenues for administering or enforcing paid preparer laws.\textsuperscript{22}

**Lessons Learned from Maryland: What Can Advocates Do?**

The Maryland Individual Tax Preparers Act was signed into law in 2008, creating a new licensing and regulatory program specifically for paid tax preparers. The advocates that helped push this legislation through offered the following lessons learned from their own experience:

- **Identify all relevant stakeholders.** Specifically, the associations that cover some part of the tax preparation industry and represent commercial tax preparers, enrolled agents, CPAs and tax attorneys should be identified and considered


\textsuperscript{21} According to the GAO study, program administrators and preparer community representatives in California and Oregon said that there are intangible benefits from the regulations, but there are no studies quantifying the outcomes.

in the earliest parts of the advocacy process. Take the time to find the contact information for each association’s local chapter and schedule individual meetings with these groups to understand their current viewpoints. Do they view the lack of regulations as an issue? Do they have solutions in mind? Are they open to collaboratively finding a solution?

- **Research everything you can.** Conduct research related to the target groups, seeking to understand whether or not the issue is already on their radar, if they’ve commented publicly about it before and whether their group’s national entity has a strong stance on the issue. Although local partners can sometimes have differing viewpoints from their national counterpart, being aware of potential points of tension beforehand is key. Make sure to hash out internal debates and agree upon a clear, unified vision before engaging state agencies.

- **Schedule individual meetings with state agencies.** Meet with agencies that could be involved with the actual implementation of regulations, such as the state’s office of the comptroller, department of taxation and finance, or division of licensing, among other possibilities. Meet with each agency separately to better understand the pros, cons and challenges they anticipate with the proposed plan. Tailor the case-making materials and messaging based on the priorities of each agency, but frame the issues in a manner that enables them to build broad coalitional support. Determine the best ‘home’ for governing the regulations, and how all relevant agencies may work together.

- **Build relationships with long-term advocates.** This is essential because long-time advocates will help provide credibility for the proposal. Find policy advocates who understand which legislators are likely to support the idea based on their past voting records and the impact regulations will have on their constituents.

- **Know your ask.** When meeting with a legislator, walk through the precise process that the state should mirror. Bring a copy of another state’s legislation or the National Consumer Law Center’s model legislation to ensure that the proposed bill language is as close to the ideal as possible before any hearings. Attempt to find a sponsor before the start of the legislative session.

The steps above may differ based on a number of factors, such as whether or not the state already has a strong advocate in the legislature and whether or not the state can adopt regulations through an administrative process. However, the general tactics of identifying stakeholders, conducting research and being strategic in meetings with individual state entities still stand.

**Conclusion**

Ultimately, regulating paid tax preparers is in the best interest of all taxpayers, ethical tax preparers and state budgets. Oregon’s history actually shows that tax preparers who are able to complete the mandatory education requirements and exam tend to earn higher wages than preparers in other states.23 Just like we expect architects and engineers to

---

have a certain level of education and training before we entrust them with designing the stability of our buildings, so too should tax preparers have a certain level of education before we trust them with our financial stability. Paid tax preparers should be required to undergo a standard amount of training, meet minimum requirements for tax knowledge and adhere to a professional code of ethics.

To quote Michael Best, Senior Policy Advocate at the Consumer Federation of America:

“The extensive use of paid preparers; the high instance of problems with paid preparers; the public support of, and the misperception of many that such protections already exist; means that the time has long passed for minimum standards in this industry.”

Tax preparation error and abuse is not a victimless practice. The lack of government oversight for paid tax preparation has contributed to the systematic stripping of wealth from low-income households and households of color. The onus of creating basic competency standards for paid tax preparers must fall on either states or the federal government (see Prosperity Now’s Federal Policy Brief about the same subject), but in the absence of action on the horizon on the part of Congress, the time is now for states to improve paid tax preparer education, transparency and accountability.

---

RELATED RESOURCES

- Model Individual Tax Preparation Regulation Act (National Consumer Law Center, 2013)
- Regulations Governing Practice Before the Internal Revenue Service (IRS, 2011)

ACKNOWLEDGMENTS

The authors would like to extend our appreciation to Chi Chi Wu, Staff Attorney at the National Consumer Law Center and Robin McKinney, CEO of the CASH Campaign of Maryland for their guidance and expertise. We would also like to thank members of the Taxpayer Opportunity Network for their insights.

ABOUT WITH A STROKE OF A PEN

With a Stroke of a Pen is a series of briefs that feature guidance for advocates on state and local policies that are meaningful, manageable and moveable.

ABOUT PROSPERITY NOW

Prosperity Now (formerly CFED) believes that everyone deserves a chance to prosper. Since 1979, we have helped make it possible for millions of people, especially people of color and those of limited incomes, to achieve financial security, stability and, ultimately, prosperity. We offer a unique combination of scalable practical solutions, in-depth research and proven policy solutions, all aimed at building wealth for those who need it most.