Answers to Senator Cruz's Questions for the Record by
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Subcommittee on Oversight, Agency Action, Federal Rights and Federal Courts
Opportunity Denied: How Overregulation Harms Minorities
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Questions

1. **Bureaucrats often justify new regulations by painting the pre-existing situation as completely unregulated. Was that true for tax preparers, before the IRS issued the new regulations that you successfully challenged? Were you operating in a vacuum without any oversight or regulation whatsoever?**

The idea that tax preparers are currently "unregulated" is a common misunderstanding actively promoted by those who want tax preparers to be licensed. Tax preparers are already regulated by a number of criminal and civil laws and regulations at the federal, state, and local levels.

Today, tax preparers are directly regulated by the IRS under a number of federal statutes and regulations. First, all tax preparers must register with the IRS by applying for a Preparer Tax Identification Number (PTIN) and paying the $63 PTIN fee.[1] (We did not challenge this registration requirement in our lawsuit.) That application process includes completing Form W-12, which includes questions about whether you have a felony record and your federal tax compliance. Tax preparers must include their unique PTIN (as well as their signature) on every tax return they prepare.[2]

In addition, as the district court explained in its opinion in *Loving v. IRS*: "Congress has already enacted a relatively rigid penalty scheme to punish misdeeds by tax-return preparers. Title 26, in fact, has at least ten penalties <u>specific to tax-return preparers</u>, each of which targets particular conduct related to preparing and filing tax returns, and each of which comes with a specific fine."[3] The IRS also has the authority to seek injunctions against tax preparers who fail to comply with legal requirements.[4] And those are just the statutes specific to tax-return preparers; many other federal statutes regulate the conduct of anyone involved in preparing or filing a tax return, including tax preparers.[5]

Tax preparers are also subject to state and local laws related to consumer protection, fraud prevention, and the like. Like any business, tax preparers can also be sued by their customers in civil court and found liable for any harm they cause their customers.

But business reputation is even more important than civil liability. At the end of the day, I answer to my customers. If I do anything to expose my customers to an audit or other troubles with the IRS, they won't come back next year, and I'll lose business to my competitors. That's why it is vitally important that the tax-return preparation market remain competitive. Taxpayers should have ample alternatives if they aren't satisfied with their current tax preparer.

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[1] *See* 26 U.S.C. § 6109(a)(4); 26 C.F.R. § 1.6109-2.
[2] *See* 26 U.S.C. § 6695(b)–(c).
[3] *Loving v. IRS*, 917 F. Supp. 2d 67, 76 (D.D.C. 2013). These penalties can be found in 26 U.S.C. §§ 6694, 6695, 6713, 7216.
[4] *See* 26 U.S.C. § 7407.
[5] *See, e.g.*, 26 U.S.C. §§ 6700, 6701, 6702, 6707A, 6713, 7201, 7206, 7207, 7213.

2. **Are there any other points or issues that were not explored (or adequately explored) during the hearing that you would like to bring to our attention?**

Yes. The IRS should be looking for ways to partner with independent tax preparers instead of alienating and demonizing us. After all, we are much more in touch with the taxpayer community at large. The real threats to consumers are more likely to be undocumented tax preparers, a.k.a. "ghost preparers," who do not register for a PTIN but who illegally prepare hundreds of thousand returns each year as if they were self-prepared.

The IRS's arbitrary and capricious enforcement of the EITC due-diligence requirement

One policy that has a particularly disparate impact on tax preparers (and their taxpayer clients) in low-income and minority areas is the arbitrary and capricious way the IRS enforces the Earned Income Tax Credit (EITC) due-diligence requirements, which impose a $500-per-return penalty on tax preparers.[6] In some low-income areas, tax preparers with numerous EITC-eligible clients are getting hit with tens of thousands of dollars in fines, even if the returns they prepare pass IRS review, because the IRS decides the preparer has not fully satisfied some aspect of the byzantine EITC due-diligence requirements, often the vague and arbitrary "Knowledge" requirement.

Tax preparers are not only required to complete the 27-question IRS Form 8867 (some questions need to be answered multiple times for each child) and ask for copies of documents substantiating the client's claims about their EITC eligibility, but they have to keep copies of all records, including: (1) a record of when and how (including from whom) the preparer got the information used to prepare the return; and (2) a record of any additional questions the preparer asked and the customer's answers.[7]

In addition, tax preparers are held responsible under a vague and subjective "Knowledge" requirement that the IRS can always determine is not satisfied. Tax preparers must "[n]ot know, or have reason to know, that any information used to determine if the taxpayer is eligible or to compute the amount of the credit is not correct, not consistent or not complete."[8] Under this standard, tax preparers "must ask [their] client additional questions if a reasonable and well-informed tax return preparer, knowledgeable in the law, would conclude the information furnished seems incorrect, inconsistent or incomplete."[9] If tax preparers think that the information provided by a client is incorrect, inconsistent, or incomplete, they "must document in [their] files the questions [they] asked and [their] client's answers."[10]

This presents a number of problems. First, this effectively deputizes preparers as front-line investigators for the IRS and puts preparers in an adversarial position with their clients. That can undermine the relationship that preparers have with their clients, and can actually lead to clients

[6] *See* 26 U.S.C. § 6695(g) (which fails to set any standards for these due diligence requirements); 26 C.F.R. § 1.6695-2.
[7] *See* IRS Publication 4687 (Rev. 7-2015), *The Due Diligence Must Do's*, https://www.irs.gov/pub/irs-pdf/p4687.pdf.
[8] *See id.*
[9] *See id.*
[10] *See id.*

not fully or honestly disclosing certain relevant facts to their preparer. Second, this puts the burden on tax preparers to anticipate what the IRS will determine that "a reasonable and well-informed tax return preparer, knowledgeable in the law, would conclude" in a wide variety of contexts involving different customers, some of whom the preparer may know much better than the IRS investigator who reviews the file. Third, this is an arbitrary standard that is impossible to satisfy; no matter how many additional questions a tax preparer asks (beyond the 27 questions on Form 8867), the IRS can always identify one or more additional questions that the preparer supposedly should have asked.

At the same time, those taxpayers who wish to falsify their EITC eligibility can simply self-prepare their tax return using tax software or go to a "ghost preparer" without a PTIN who will mark their return as self-prepared. Both of these options bypass all of the EITC due diligence requirements, which only apply to paid preparers (and which are only enforceable against preparers who put their name and PTIN number on the tax returns they prepare).

Thank you for this opportunity to supplement my answers at the hearing.