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RIDDLED RETURNS
How Errors and Fraud by Paid Tax Preparers Put Consumers at Risk and What States Can Do

EXECUTIVE SUMMARY

A tax return is one of the most critical financial events for many consumers during the year. Over half of these consumers rely on paid tax preparers, putting their financial lives in the hands of these practitioners. Yet there is no regulation for most tax preparers in the vast majority of states. There are no minimum educational, training, competency, or other standards. In 47 states, there are more regulatory requirements for hairdressers than tax preparers.

Because of this lack of regulation, incompetence and abuses by tax preparers have flourished over the years. Mystery shopper testing by consumer groups, other advocacy organizations, and government agencies has found frequent examples of this incompetency and outright fraud — a disturbingly high number, given the limited number of tests conducted. Some of the examples uncovered in this testing were:

- Intentional omission of income;
- Falsifying information to make the taxpayer eligible for various credits and deductions, such as charitable deductions, job-related or business expenses, and the Earned Income Tax Credit (EITC);
- Inability to properly deal with education-related credits and income;
- Misclassifying filing status; and
- Data entry errors resulting in incorrect refunds.

These numerous examples of fraud and incompetence, comprising a significant percentage of the preparers tested, shows that this problem is not isolated or the case of a few bad actors. Instead, it is an endemic problem and regulation is urgently needed to protect both taxpayers and public treasuries.

Another problem faced by taxpayers is the inability to comparison shop or predict how much tax preparation will cost them, because many tax preparers claim they cannot give a quote or give inaccurate ones. As a result of this lack of transparency, consumers face tax preparation fees that are very high, and sometimes inflated – up to $400 or $500 in some cases.

The IRS attempted to address fraud and improve preparer competency by developing a system to regulate tax preparers. However, in early 2013, this effort was blocked by a federal court, which invalidated the regulations as exceeding the IRS's statutory authority. Thus, it may be up to Congress or the states to institute a system of preparer regulation.

To assist states toward this goal, this report includes the **Model Individual Tax Preparer Regulation Act**, which a state legislature can enact for the regulation of tax preparers, based in large part on three existing state laws, as well as the IRS regulations.

The Model Act requires paid tax preparers to:

- Obtain a registration unless they fit into one of the handful of exceptions,
- Pass a basic competency exam,
- Have 60 hours of initial education and 15 hours per year of continuing education, and
- Provide a standardized disclosure of their fees.

For consumers, an incorrectly prepared tax return can lead to dire economic consequences or even criminal sanctions. This is especially true for low-income EITC recipients, of whom over 60% — or 16 million families — pay for tax preparation. For these consumers, especially EITC recipients, their refund is the single largest sum of money that they will receive during the entire year. Passage of the Model Act will allow these consumers to be confident that the tax preparer that they rely upon has the basic skills and knowledge needed to prepare their tax returns correctly.