



*Return Preparer Coordinators Could Improve
the Selection of Problematic Paid Preparers
for Further Enforcement Actions*

August 27, 2014

Reference Number: 2014-30-050

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.



HIGHLIGHTS

RETURN PREPARER COORDINATORS COULD IMPROVE THE SELECTION OF PROBLEMATIC PAID PREPARERS FOR FURTHER ENFORCEMENT ACTIONS

Highlights

Final Report issued on August 27, 2014

Highlights of Reference Number: 2014-30-050 to the Internal Revenue Service Commissioner for the Small Business/Self-Employed Division.

IMPACT ON TAXPAYERS

In Calendar Year 2013, nearly 60 percent of all individual taxpayers paid someone else to prepare their income tax returns. Paid preparers' impact on tax compliance can be significant. Some paid preparers have intentionally manipulated tax return information to generate excessive refunds for taxpayers, modified tax returns after the taxpayers signed them to steal the refunds, or used taxpayer identities to create fictitious returns to generate fraudulent refunds.

The Return Preparer Office coordinates the IRS's strategy to provide oversight of noncompliant paid preparers with patterns of preparing inaccurate tax returns. Return Preparer Coordinators in the Area Offices are the key control to ensure that the Examination function implements its part of the IRS's Return Preparer Strategy.

WHY TIGTA DID THE AUDIT

With the growing Tax Gap, the accuracy of tax returns prepared by paid preparers is a concern. The overall objective of this review was to determine if opportunities exist to enhance the compliance efforts of the Small Business/Self-Employed Division's Return Preparer Coordinators.

WHAT TIGTA FOUND

Return Preparer Coordinators effectively managed most of the paid preparer activities under their control and provided good audit leads for further enforcement actions. However, more actions could be taken to ensure that the Return Preparer Coordinators timely review referrals with allegations of inappropriate paid preparer behavior and that the referrals and complaints are shared among the various functions responsible for reviewing them.

TIGTA reviewed 2,134 paid preparer referrals received by three Area Offices during Fiscal Years 2010 through 2012 and found that the Return Preparer Coordinators had not evaluated 722 referrals (34 percent) to determine if a preparer case was warranted. This resulted primarily from limited resources and ineffective controls. In addition, due to a lack of guidance, many of the complaints processed by the Return Preparer Office are not shared with the Return Preparer Coordinators.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS develop inventory controls and timeliness standards for the referral process to help ensure that problematic paid preparers are identified and considered for further enforcement actions. In addition, TIGTA recommended that the Small Business/Self-Employed Division work with the Return Preparer Office to develop a methodology for sharing information on paid preparer referrals and complaints to improve the identification of the most egregious paid preparers for further enforcement actions.

In their response to the report, IRS officials agreed with both recommendations and plan to take appropriate corrective actions.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

August 27, 2014

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED
DIVISION

FROM:

Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT:

Final Audit Report – Return Preparer Coordinators Could Improve the
Selection of Problematic Paid Preparers for Further Enforcement
Actions (Audit # 201230021)

This report presents the results of our review to determine if opportunities exist to enhance the compliance efforts of the Small Business/Self-Employed Division's Return Preparer Coordinators. The review is included in our Fiscal Year 2014 Annual Audit Plan and addresses the major management challenge of Tax Compliance Initiatives.

Management's complete response to the draft report is included as Appendix VI.

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations. If you have any questions, please contact me or Bryce Kisler, Acting Assistant Inspector General for Audit (Compliance and Enforcement Operations).



Return Preparer Coordinators Could Improve the Selection of Problematic Paid Preparers for Further Enforcement Actions

Table of Contents

Background	Page 1
Results of Review	Page 3
Return Preparer Coordinators Support the Return Preparer Strategy	Page 3
Return Preparer Coordinators Could More Timely Review Referrals to Identify the Most Egregious Paid Preparers for Further Enforcement Actions	Page 4
<u>Recommendation 1:</u>	Page 9
Improved Sharing of Referral Data Would Allow for Better Paid Preparer Case Selection	Page 9
<u>Recommendation 2:</u>	Page 11
Appendices	
Appendix I – Detailed Objective, Scope, and Methodology	Page 12
Appendix II – Major Contributors to This Report	Page 15
Appendix III – Report Distribution List	Page 16
Appendix IV – Return Preparer Site Visitation Programs	Page 17
Appendix V – Glossary of Terms	Page 18
Appendix VI – Management’s Response to the Draft Report	Page 21



*Return Preparer Coordinators Could Improve the Selection of
Problematic Paid Preparers for Further Enforcement Actions*

Abbreviations

IRS	Internal Revenue Service
RPC	Return Preparer Coordinator
SB/SE	Small Business/Self-Employed
TIGTA	Treasury Inspector General for Tax Administration
U.S.	United States



Return Preparer Coordinators Could Improve the Selection of Problematic Paid Preparers for Further Enforcement Actions

Background

In Calendar Year¹ 2013, the Internal Revenue Service (IRS) processed approximately 81.5 million individual Federal income tax returns prepared by paid tax return preparers (hereafter referred to as paid preparers). This represents nearly 60 percent of all individual income tax returns. Because most paid preparers prepare tax returns for multiple taxpayers, inappropriate actions can have a significant impact on tax compliance. These actions can include intentional manipulation of tax return information to generate excessive refunds for taxpayers, modifying tax returns after the taxpayers have signed them to steal the refunds, or using taxpayer identities to create fictitious tax returns to generate fraudulent refunds.

In February 2014, the IRS reported Return Preparer Fraud issues as numbers four and five in its annual list of the 12 most common tax scams known as the “Dirty Dozen.”² The report noted that unscrupulous paid preparers have been known to steal their clients’ refunds, charge inflated fees for tax return preparation services, and attract new clients by promising or guaranteeing inflated refunds. The IRS also identified identity theft as the number one tax scam in its Dirty Dozen list, sometimes with paid preparers as the perpetrators.³ In addition, Congress has expressed concerns about the increase in identity theft related to taxes. This issue was the topic of several congressional hearings during Fiscal Years 2012 and 2013.

The IRS’s Return Preparer Office is charged with addressing paid preparers with patterns of preparing inaccurate tax returns. The Return Preparer Office is also responsible for coordinating the IRS’s Return Preparer Strategy. The Return Preparer Office is tasked with developing policies and carrying out the compliance program objectives to:

- Detect paid preparers misusing or not using a Preparer Tax Identification Number.
- Plan and direct Servicewide enforcement actions targeted toward noncompliant paid preparers.
- Identify and address paid preparers with patterns of preparing inaccurate tax returns.

The Return Preparer Office uses the Small Business/Self-Employed (SB/SE) Division’s Examination function to make site visitations to paid preparers and to conduct audits of tax

¹ See Appendix V for a glossary of terms.

² *The “Dirty Dozen” Tax Scams for 2014; Identity Theft, Phone Scams Lead List* (Reference IR-2014-16, dated February 19, 2014).

³ A typical scheme involving identity theft is the preparation of fraudulent tax returns using the names and Social Security Numbers of other individuals. The perpetrators use names and Social Security Numbers of individuals who would not normally file tax returns (*e.g.*, deceased taxpayers and unemployed individuals).



Return Preparer Coordinators Could Improve the Selection of Problematic Paid Preparers for Further Enforcement Actions

returns signed by paid preparers who were identified for further review.⁴ Return Preparer Coordinators (RPC) in the SB/SE Division Area Offices are the key control to ensure that the work completed by the Examination function meets the needs of the Return Preparer Office. The RPCs also coordinate the completion of any additional preparer cases identified by the SB/SE Division's Examination function for audit.

This review was performed at three SB/SE Division Area Offices⁵ (Western (Denver, Colorado); Gulf States (Houston, Texas); and California (Los Angeles, California)) and with information obtained from the SB/SE Division Headquarters in Washington, D.C., and the Return Preparer Offices in Washington, D.C., and Chesterfield, Missouri, during the period September 2012 through February 2014. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

⁴ The grouping of tax return audits related to one paid preparer's clients is hereafter referred to as a preparer case.

⁵ After completion of our site visits, the SB/SE Division realigned the geographical regions for which each Area Office is responsible. For the purpose of this report, we are addressing the Area Offices' geographical responsibility and associated paid preparer referrals at the time of our site visits.



Return Preparer Coordinators Could Improve the Selection of Problematic Paid Preparers for Further Enforcement Actions

Results of Review

In its oversight role, the IRS generally monitors whether paid preparers are compliant with their responsibilities to prepare accurate tax returns and are not taking advantage of the system for personal gain. RPCs effectively managed most of the paid preparer activities under their control and provided good audit leads for further enforcement actions. However, more could be done to ensure that referrals of inappropriate paid preparer behavior received by the RPCs are timely reviewed to identify the most egregious paid preparers for further enforcement actions and that the referrals and complaints are shared among the various functions responsible for reviewing them.

Return Preparer Coordinators Support the Return Preparer Strategy

During our review, we visited three of the seven SB/SE Division Area Offices to evaluate the RPCs' efforts in meeting their responsibilities. Through discussions with the RPCs and a review of documentation pertaining to their responsibilities, we found that the RPCs in these three Area Offices supported the Return Preparer Strategy in several program areas. The RPCs generally:

- Planned and coordinated compliance activities related to paid preparers with other functions, Area Offices, and campuses. In two of the three Area Offices, the RPCs chaired the Preparer Steering Committee. These committees are comprised of representatives of the various IRS functions in the Area Office involved in oversight of paid preparer compliance and meet to review the progress of the oversight activities.
- Monitored the completion of and evaluated the results of the client audits included in preparer cases. The RPCs we visited maintained documentation showing the results of client audits completed on each paid preparer, including any preparer penalties asserted.
- Reviewed proposed preparer penalties to ensure that SB/SE Division examiners properly developed the penalty cases and that there was uniformity in the penalty determination process. The RPCs also provided feedback and guidance to the examiners when additional work was needed to fully support the assertion of the penalties.
- Monitored and guided the paid preparer visitations selected by the Return Preparer Office and the Wage and Investment Division. The Wage and Investment Division assisted with the Integrated Earned Income Tax Credit strategy by selecting paid preparers for visitations. These visitations, made by SB/SE Division examiners, were completed as part of several different initiatives covering paid preparer behavior involving the Earned Income Tax Credit, Individual Taxpayer Identification Numbers, paid preparer electronic



Return Preparer Coordinators Could Improve the Selection of Problematic Paid Preparers for Further Enforcement Actions

filing requirements, and other issues. Appendix IV provides descriptions of the various visitation programs.

The three RPCs we visited were also effective in monitoring the paid preparer visitations completed by the SB/SE Division examiners. We reviewed the documentation provided for the site visitations completed in Fiscal Year 2012 and found that more than 99 percent of the site visitations were completed. The RPCs provided the results of each visitation to the originating function, which then determines whether there may be a need for further education or enforcement actions on the paid preparer.

In addition to the site visits, SB/SE Division examiners also work preparer cases under the following two programs.

- Mandatory – Directed by the Return Preparer Office.
- Discretionary – Developed by each Area Office RPC from the referrals received and evaluated locally.

Both types of preparer cases require substantial examination resources. Each preparer case requires audits of at least 30 client tax returns completed and signed by the paid preparer. The RPCs maintained documentation that summarized the number and results of the audits completed in each preparer case.

In addition, the preparer cases developed by the Return Preparer Office and from referrals handled by the RPCs provided good leads for identifying potential promoters of abusive tax schemes for civil and criminal investigations. During Fiscal Years 2011 through 2013, 76 of the SB/SE Division's preparer cases for all RPCs in the seven Area Offices were converted to civil promoter/preparer investigations⁶ approved by the SB/SE Division's Lead Development Center. During that same time period, these RPCs also referred 25 paid preparers to Criminal Investigation.

Return Preparer Coordinators Could More Timely Review Referrals to Identify the Most Egregious Paid Preparers for Further Enforcement Actions

Although the RPCs that we visited were generally monitoring the SB/SE Division's Return Preparer Strategy processes effectively, we found that the RPCs were not always evaluating paid preparer referrals received in the Area Offices. There are steps that could be taken to ensure that the most egregious paid preparers are timely identified for further enforcement actions.

⁶ These investigations determine if individuals are promoting abusive tax schemes and would be subject to the penalties in Internal Revenue Code Sections 6700, 6701, 7407, and 7408.



Return Preparer Coordinators Could Improve the Selection of Problematic Paid Preparers for Further Enforcement Actions

Specifically, if the IRS timely reviewed paid preparer referrals and made better use of available IRS data, it would be better able to identify paid preparers with the most egregious issues.

Limited resources and ineffective controls led to many paid preparer referrals not being evaluated for audit potential

The Internal Revenue Manual lists more than a dozen sources of referrals on questionable paid preparers that could eventually lead to the creation of a preparer case. These referrals can come from external (e.g., taxpayers and other return preparers) and internal (e.g., IRS examiners and collection employees) sources.

We reviewed 2,134 paid preparer referrals received by the three Area Offices during Fiscal Years 2010 through 2012 and found that the RPCs had not evaluated 722 referrals (34 percent) to determine if a preparer case was warranted.⁷ Figure 1 shows the volume of referrals received and not evaluated for the three Area Offices.

Figure 1: Total Paid Preparer Referrals Received and Not Evaluated for Potential Audit Selection by the Three Area Offices⁸

	Area Office A ⁹		Area Office B		Area Office C		Total for the Three Area Offices	
Fiscal Year	Referrals	Not Evaluated	Referrals	Not Evaluated	Referrals	Not Evaluated	Referrals	Not Evaluated
2010	134	93	471	39	203	88	808	220
2011	56	29	558	73	202	158	816	260
2012	130	82	263	110	117	50	510	242
Total Referrals	320	204	1,292	222	522	296	2,134	722
Percentage Not Evaluated		64%		17%		57%		34%

Source: Data provided by Area Offices B and C and actual referrals reviewed by the Treasury Inspector General for Tax Administration (TIGTA) for Area Office A.

⁷ We determined that a referral was not evaluated if there was no evidence that any action was taken to research/evaluate the referral for preparer case potential.

⁸ These are referrals received by the Area Offices during Fiscal Years 2010 through 2012. The referral databases for Area Offices B and C were current as of November 2012. For Area Office A, we relied on the referrals obtained during our February 2013 site visit. We used the databases for these years because they provide the most accurate count of referrals received during this three-year period since one Area Office's record retention policy purges referral records if they are not pursued within three years of receipt.

⁹ The Area Offices will be referred to using generic titles throughout this report.



Return Preparer Coordinators Could Improve the Selection of Problematic Paid Preparers for Further Enforcement Actions

The evaluation of some paid preparer referrals was not completed because the Internal Revenue Manual does not provide timeliness guidelines for evaluating them. As a result, the RPCs had not developed controls to ensure that every referral was evaluated.

In addition, the RPCs in the Area Offices we visited informed us that the limited audit resources to work the preparer cases affected which referrals they evaluated. For example, the RPCs in two Area Offices reviewed paid preparer referrals when they found time to work them. However, the third RPC only evaluated referrals when an examination group needed inventory and would then only focus on paid preparers working in that group's specific geographic location. This would result in some referrals in other geographical areas being overlooked.

As shown in Figure 1, the three Area Offices never evaluated 220 of the 808 referrals received during Fiscal Year 2010 for preparer case potential. We focused on this population to look at trends for these paid preparers after the referral was received. Through analysis of these 220 referrals, we found that paid preparers may have used various schemes to falsify tax return data. Many of the tax returns completed by some of these paid preparers showed common issues. For example, the referred issues in Fiscal Year 2010 for 47 of the 220 paid preparers involved questionable expenses, unsubstantiated income amounts, and/or deductions claimed on Schedule A, *Itemized Deductions*, Schedule C, *Profit or Loss From Business (Sole Proprietorship)*, or other schedules. While we found that some of these referrals were vague as to the actual income or deduction line items involved, certain common conditions on many of the tax returns raise concerns of possible inaccurate reporting of income, deductions, and/or credits. For example:

- Several of these paid preparers were involved in preparing tax returns with Schedule Cs reporting income that allowed the taxpayers to receive inflated refunds by claiming excessive refundable credits, such as the Earned Income Tax Credit. For a majority of the questionable tax returns, there were no expenses claimed on the Schedule Cs, which has been determined by the IRS as a typical occurrence on returns manipulated to claim inflated refundable tax credits.
- Some paid preparers had claimed certain deductions or credits at rates that were from nine to 50 times higher than the rate for all individual tax returns claiming the same deductions and credits that the IRS received in Processing Year 2009. Referrals reporting that the paid preparers included overstated deductions or credits on the tax returns they completed combined with the fact that the rate of occurrence of these items was well above the rate for all individual tax returns indicates that these paid preparers should be further evaluated.

We researched the IRS's Individual Return Transaction File and identified that these 47 paid preparers signed a total of 52,675 tax returns processed by the IRS during Processing Years 2009 through 2012. This amounts to an average of approximately 280 tax returns prepared by each of



Return Preparer Coordinators Could Improve the Selection of Problematic Paid Preparers for Further Enforcement Actions

these individuals for each processing year. As of September 2013, the IRS has not worked the referrals or opened preparer cases on any of these 47 referred paid preparers.

While there were many reasons why these paid preparers were referred to the RPCs we visited, these examples show that, through prompt analysis of paid preparer referrals, the RPCs can identify potentially problematic paid preparers and take action to halt potentially unscrupulous preparers that would continue to harm taxpayers and the Government.

Evaluation and action on referrals may prevent paid preparers from continuing to commit tax fraud related to identity theft

The U.S. Department of Justice has reported numerous convictions recently of paid preparers committing identity theft by stealing the identities of individuals who would not normally file tax returns (*e.g.*, deceased taxpayers and unemployed individuals) to file false returns or stealing children's identity information to generate false dependents. For example, an April 2014 Department of Justice press release described the actions of a paid preparer who was convicted of preparing and filing nearly 1,000 false tax returns using stolen identities and of conspiracy to file false claims in connection with using stolen identities of children to claim false dependents on his clients' tax returns. The paid preparer was involved in these schemes from Calendar Years 2008 through 2013. The paid preparer collected \$1,000 per return from his clients for claiming the stolen identities of children as dependents. The crimes resulted in a loss to the Federal Government of more than \$1.5 million.

Review of the paid preparer referrals received in Area Offices may provide for more prompt action on paid preparers who are committing identity theft. TIGTA reported¹⁰ in July 2012 that tax fraud by individuals filing fictitious tax returns in Processing Year 2011 with false income and withholding is significantly larger than the 938,664 tax returns the IRS detected that involved identity theft. While the IRS prevented the issuance of approximately \$6.5 billion in fraudulent tax refunds related to these returns, TIGTA identified an additional 1,492,215 tax returns with similar characteristics as confirmed identity theft cases, with potentially fraudulent tax refunds issued to taxpayers totaling in excess of \$5.2 billion.

We matched the paid preparers associated with the 1,492,215 tax returns that TIGTA determined had identity theft characteristics to the 2,134 paid preparer referrals received by the three Area Offices during Fiscal Years 2010 through 2012. We found 294 referred paid preparers were associated with 3,419 of the tax returns that TIGTA determined had identity theft characteristics. The RPCs had reviewed the referrals for 158 of these paid preparers and, as a result, started 35 preparer cases. However, referrals for the remaining 136 paid preparers had not been reviewed by the RPCs. The tax return data for the clients of the 136 paid preparers showed that 33 of the paid preparers had signed at least 10 tax returns identified by TIGTA with identity theft

¹⁰ TIGTA, Ref. No. 2012-42-080, *There Are Billions of Dollars in Undetected Tax Refund Fraud Resulting From Identity Theft* (July 2012).



Return Preparer Coordinators Could Improve the Selection of Problematic Paid Preparers for Further Enforcement Actions

characteristics. In addition, eight of these paid preparers each prepared more than 50 tax returns potentially involving identity theft.

With increasing concern from IRS stakeholders and taxpayers regarding identity theft, it is critical that the IRS reviews all the referrals it receives and uses the information available to determine which paid preparers to take further enforcement actions upon. In addition, as more potentially unscrupulous paid preparers are indicted and prosecuted, the attention may help deter other paid preparers from completing fraudulent tax returns using stolen identities.

Better control and timely evaluation of paid preparer referrals would help ensure that the most productive cases are developed

In addition to referrals that were not being reviewed by the RPCs, other weaknesses over the control of paid preparer referrals were identified during our visits to the three Area Offices. The RPCs for Area Offices B and C record paid preparer referrals in their own locally developed databases, while the RPC for Area Office A manages the process manually, keeping referrals in multiple filing cabinets and on shelves and carts with no specific inventory controls.

With no formal tracking of paid preparer referrals, the RPC for Area Office A was not able to provide us with an accurate volume of referrals received during a fiscal year. We attempted to review and catalog the referrals we found on hand, but due to time constraints and a pending RPC office move, we were not able to catalog all referral receipts for Area Office A. However, based on the number and type of paid preparer referrals we reviewed at Area Office A, we were able to adequately evaluate the RPC's efforts in evaluating referrals.

Each Area Office we visited developed unique processes to control paid preparer referrals based on its needs because the Internal Revenue Manual does not provide guidance on when the RPC should evaluate the referrals, what should be tracked, and how to track them. The Internal Revenue Manual simply directs the RPCs to:

- *Accumulate and maintain files on potentially abusive preparers from referrals received from [A]rea [O]ffice functions, Electronic Return Originator site visits, Earned Income Tax Credit Due Diligence Visits, campus compliance and Criminal Investigation, both [Area Office] and campus.*
- *Evaluate referral information for development of [preparer cases].*

According to the Federal Government's *Management's Responsibility for Internal Control*,¹¹ information should be relevant, reliable, and timely. Control activities such as policies, procedures, and mechanisms should be in place to help ensure that the agency's objectives are met. Improved policies and procedures would provide the means to better control referrals so that the most egregious paid preparers are identified for further enforcement actions.

¹¹ U.S. Office of Management and Budget, OMB Circular No. A-123 (Revised) (Dec. 2004).



Return Preparer Coordinators Could Improve the Selection of Problematic Paid Preparers for Further Enforcement Actions

In addition, timeliness controls help ensure that action is taken when it can provide the most impact. The IRS has set timeliness standards for making decisions on enforcement actions in various compliance areas. For example, Criminal Investigation has a 30-day standard for making a decision for accepting or declining to work a referral for a criminal investigation. Similarly, the SB/SE Division's Examination Program Fraud Coordinators must make a decision on whether to accept a civil fraud referral within 21 days of receipt. A similar timeliness requirement is needed to ensure that the most problematic paid preparers are timely acted on to prevent them from continuing to negatively affect additional taxpayers.

Recommendation

Recommendation 1: The Commissioner, SB/SE Division, should develop 1) uniform inventory controls for the referrals received by the RPCs and 2) timeliness standards for the review of referrals to help ensure that the most egregious paid preparers are identified and considered for further enforcement actions.

Management's Response: IRS management agreed with this recommendation. They will evaluate existing inventory controls and timeliness standards on reviewing paid preparer referrals received by the SB/SE Division. Additional guidance will be issued, as appropriate.

Improved Sharing of Referral Data Would Allow for Better Paid Preparer Case Selection

While various IRS functions are involved in implementing the Return Preparer Strategy, much of the referral and complaint data gathered is not shared between the Return Preparer Office and the SB/SE Division or even shared among each Area Office's RPC. Each function could make better decisions on prioritizing compliance actions on potentially problematic paid preparers by having all referral/complaint information that the IRS has received on the paid preparers be made available to them.

Thousands of complaints processed by the Return Preparer Office are not used by RPCs when considering enforcement actions on paid preparers

The Return Preparer Office and the SB/SE Division's Examination function have separate programs aimed at identifying questionable paid preparers for potential enforcement actions. They each use referrals or complaints of paid preparer misconduct from various sources to help identify these paid preparers. While the referrals received by the RPCs generally come from internal sources, the Return Preparer Office processes complaints received from the public (e.g., taxpayers and other paid preparers) on Form 14157, *Complaint: Tax Return Preparer*, and other communications.



Return Preparer Coordinators Could Improve the Selection of Problematic Paid Preparers for Further Enforcement Actions

The Return Preparer Office received 7,968 complaints in Calendar Year 2012¹² and 6,334 complaints through June 2013 in Calendar Year 2013. The Return Preparer Office records these complaints in its Return Preparer Office Complaint Database and reviews them as part of its responsibility in deciding what actions to take on questionable paid preparers. The issues identified from complaints against paid preparers received on Forms 14157 are similar to those seen in the referrals handled by the RPCs in that they inform the IRS about potential paid preparer misconduct involving several types of issues: theft of a refund, failure to provide a copy of a tax return, failure to sign a tax return, false exemptions or dependents included on a tax return, or any other action taken by the paid preparer that may be suspicious. However, the Return Preparer Office shares complaint data with the SB/SE Examination function only when it has received at least three complaints against a specific paid preparer.

The complaint information reported on Forms 14157 may have been helpful for RPCs to identify which paid preparers to select for further enforcement actions. We matched the 2,134 paid preparer referrals received by the three Area Office RPCs during Fiscal Years 2010 through 2012 with the 14,302 complaints handled by the Return Preparer Office during Calendar Year 2012 and through June 2013 for Calendar Year 2013 and identified 78 paid preparers on both lists. Noting that these 78 are only for matches to referrals received in three of the seven Area Offices, the existence of multiple complaints against paid preparers may have helped the RPCs make their decisions on prioritizing which preparer cases should be developed. Similarly, knowledge of the paid preparer referrals received by the RPCs could help the Return Preparer Office in making its program action decisions.

In addition, each Area Office could benefit from having paid preparer referral information from the other Area Offices. The RPCs we interviewed mentioned that some paid preparers complete tax returns in multiple locations or may move from one Area Office jurisdiction to another. Sharing referral information between Area Offices would provide a more complete picture of the paid preparer's behavior. This would also assist the RPCs in prioritizing the most egregious paid preparers for further enforcement actions.

There is no guidance in the Internal Revenue Manual on the sharing of complaint/referral data between the Return Preparer Office and the RPCs. However, sharing the complaint/referral data would provide both the Return Preparer Office and the RPCs more complete information to make decisions on which noncompliant paid preparers to select for further enforcement actions. In addition, the pooling of complaint/referral data on paid preparers may be helpful for other IRS compliance programs. For example, referrals or complaints accusing a paid preparer of stealing taxpayer identities and submitting fraudulent tax returns would also be useful to the Identity Theft Program Office as well as to Criminal Investigation.

¹² The Return Preparer Office started recording the complaints in February 2012.



Return Preparer Coordinators Could Improve the Selection of Problematic Paid Preparers for Further Enforcement Actions

In the current climate of limited resources for IRS programs, it is critical that the IRS improve its efforts in identifying the most egregious paid preparers for further enforcement actions. Paid preparers generally prepare tax returns for many clients, and if they choose to manipulate client returns to generate excessive refunds, they could have a significant negative impact on taxpayer compliance and the Tax Gap.

Recommendation

Recommendation 2: The Commissioner, SB/SE Division, should work with the Return Preparer Office to develop a methodology for sharing information on paid preparer referrals and complaints to improve the identification and selection of the most egregious paid preparers for further enforcement actions. This methodology should also allow for the sharing of referral data among Area Office RPCs.

Management's Response: IRS management agreed with this recommendation. The SB/SE Division and the Return Preparer Office will work jointly to improve the process of identifying paid preparers for enforcement action. This includes making appropriate changes to the preparer referral process, including guidance on distributing paid preparer referrals to the Area Office RPCs.



Return Preparer Coordinators Could Improve the Selection of Problematic Paid Preparers for Further Enforcement Actions

Appendix I

Detailed Objective, Scope, and Methodology

Our objective was to determine if opportunities exist to enhance the compliance efforts of the SB/SE Division's RPCs.¹ To accomplish our objective, we:

- I. Reviewed the IRS's policies and guidance governing the RPC's responsibilities and the Return Preparer Strategy.
- II. Assessed the effectiveness of the RPCs' efforts and whether they are meeting the needs of the Return Preparer Strategy. We conducted site visits at the California, Gulf States, and Western Area Offices and accomplished the following:
 - A. Interviewed the RPCs regarding issues such as:
 - Activities and actions taken in implementing the Return Preparer Strategy, Area Office responsibilities, and workload priorities.
 - Tracking and evaluating paid preparer referrals received.
 - Processes and procedures for initiating discretionary preparer cases.
 - Monitoring of mandatory and discretionary preparer cases, including associated client tax return examinations.
 - Monitoring and reviewing preparer penalty cases closed by the compliance functions.
 - Planning and coordinating with other functions, Area Offices, and campuses on compliance activities related to paid preparers.
 - Monitoring the paid preparer visitations directed by the Return Preparer Office.
 - Referring paid preparers for promoter or criminal investigations.
 - B. Obtained a copy of the paid preparer referral and preparer case databases for Area Offices B and C. Area Office A did not have a database, so we relied on the referrals obtained during our February 2013 site visit.
 - C. Analyzed the paid preparer referrals that the three Area Offices received during Fiscal Years 2010 through 2012 and identified those for which the RPCs had not reviewed the referrals for preparer case potential. For the Fiscal Year 2010 referrals

¹ See Appendix V for a glossary of terms.



Return Preparer Coordinators Could Improve the Selection of Problematic Paid Preparers for Further Enforcement Actions

- that had not been evaluated, we categorized the type of issues being referred and the number of tax returns that the referred paid preparers were associated with during Processing Years 2009 through 2012.
- III. Obtained and analyzed a copy of the Return Preparer Office Complaint Database for complaints received in Calendar Years 2012 and 2013 (through June 2013) and its referral criteria.
 - IV. Identified additional opportunities for RPCs to identify and select problematic paid preparers for further enforcement actions.
 - A. Matched the three Area Offices' paid preparer referrals to the Return Preparer Office Complaint Database for complaints received in Calendar Years 2012 and 2013 (through June 2013) to identify problematic paid preparers that had been referred to each office, but the RPCs had not taken any action on the referrals.
 - B. Matched the referred paid preparers received by the three Area Offices during Fiscal Years 2010 through 2012 to the paid preparers associated with tax returns that TIGTA determined had identity theft characteristics similar to IRS-detected identity theft returns filed during Processing Year 2011.

Data validation methodology

During this review, we validated the data used in our analysis as follows:

Paid Preparer Referrals – Each of the three Area Offices we visited maintained its own referral records. Two factors during our site visits limited our ability to fully validate the referral data they provided. For Area Office A, there were no electronic referral data maintained, so we relied on the actual physical referrals we reviewed. For Area Office B, we were not able to sufficiently validate to source documents that were in storage while the Area Office support function was in temporary space. However, we determined through discussions and review of the data that the data were sufficiently reliable to perform our audit analysis.

Preparer Cases – We validated the Fiscal Year 2013 preparer case listings for the three Area Offices by matching records to the IRS's Individual Return Transaction File maintained by the TIGTA Data Center Warehouse and determined that the data were sufficiently reliable to perform our audit analysis.

Return Preparer Office Complaint Database – We validated the accuracy of the Return Preparer Office Complaint Database for Calendar Years 2012 and 2013 by matching a selected sample of electronic referral records to the actual hardcopy complaints. As a result, we determined that the data were sufficiently reliable to perform our audit analysis.



Return Preparer Coordinators Could Improve the Selection of Problematic Paid Preparers for Further Enforcement Actions

TIGTA Identity Theft Data – The validation of this data was performed during the previous TIGTA review² relying on tax return and tax account data extracted from IRS electronic data files. We relied on that data validation for the purposes of this audit.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined the following internal controls were relevant to our audit objective: IRS policies, procedures, and processes for identifying referred paid preparers for further enforcement actions. We evaluated these controls by reviewing internal documents and policies, interviewing the RPCs, reviewing paid preparer tracking and selection methodology, researching current criteria on management's responsibility for internal controls, and conducting data analyses using the IRS's various paid preparer databases.

² TIGTA, Ref. No. 2012-42-080, *There Are Billions of Dollars in Undetected Tax Refund Fraud Resulting From Identity Theft* (July 2012).



Return Preparer Coordinators Could Improve the Selection of Problematic Paid Preparers for Further Enforcement Actions

Appendix II

Major Contributors to This Report

Margaret Begg, Assistant Inspector General for Audit (Compliance and Enforcement Operations)
Nancy Nakamura, Assistant Inspector General for Audit (Compliance and Enforcement Operations)
Ranee Cook, Acting Assistant Inspector General for Audit (Compliance and Enforcement Operations)
Bryce Kisler, Acting Assistant Inspector General for Audit (Compliance and Enforcement Operations)
Frank Dunleavy, Director
Michelle Philpott, Acting Director
Alan Lund, Audit Manager
Julia Tai, Lead Auditor
Todd Anderson, Senior Auditor
Jean Kao, Senior Auditor
Ashley Weaver, Auditor



*Return Preparer Coordinators Could Improve the Selection of
Problematic Paid Preparers for Further Enforcement Actions*

Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Deputy Commissioner for Services and Enforcement SE
Deputy Commissioner, Small Business/Self-Employed Division SE:S
Director, Return Preparer Office SE:RPO
Chief Counsel CC
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Internal Control OS:CFO:CPIC:IC
Audit Liaison: Commissioner, Small Business/Self-Employed Division SE:S



Return Preparer Coordinators Could Improve the Selection of Problematic Paid Preparers for Further Enforcement Actions

Appendix IV

Return Preparer Site Visitation Programs

As part of the IRS's Return Preparer Strategy,¹ SB/SE Division examiners conduct site visits to paid tax return preparers as part of the following programs:

- **Integrated Earned Income Tax Credit Strategy** – Field examiners correspond with and visit paid preparers who have met certain criteria specific to Earned Income Tax Credit issues to help improve the quality of the preparation of returns and to identify paid preparers who may need injunctive action.
- **Return Preparer Visitation Program** – Field examiners visit paid preparers who fell into defined high-risk categories and had received letters from the IRS in prior years concerning specific return preparer activities.
- **Certifying Acceptance Agent and Individual Taxpayer Identification Number Project** – Field examiners visit a sample of Certifying Acceptance Agents to ensure their compliance with the rules, procedures, and applicable laws related to the submission of Form W-7, *Application for IRS Individual Taxpayer Identification Number*.
- **E-Filing² and Preparer Tax Identification Number Compliance Project** – Field examiners visit paid preparers concerning problems identified with electronic filing and with Preparer Tax Identification Number compliance.

¹ See Appendix V for a glossary of terms.

² E-filing is the electronic filing of tax returns.



Return Preparer Coordinators Could Improve the Selection of Problematic Paid Preparers for Further Enforcement Actions

Appendix V

Glossary of Terms

Term	Definition
Area Office	A geographic organizational level used by IRS business units and offices that helps their specific types of taxpayers understand and comply with tax laws and issues.
Campus	The data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.
Certifying Acceptance Agent	An individual or entity authorized by the IRS to assist alien individuals and other foreign persons who are ineligible or unable to receive a Social Security Number in obtaining an Individual Taxpayer Identification Number from the IRS.
Criminal Investigation	Serves the American public by investigating potential criminal violations of the Internal Revenue Code and related financial crimes in a manner that fosters confidence in the tax system and compliance with the law.
Earned Income Tax Credit	A refundable Federal tax credit for low-income working individuals and families.
Examination Function	The SB/SE Division function that conducts examinations of individuals, partnerships, and corporations that occur either at the taxpayer's place of business or through interviews at an IRS office.
Fiscal Year	Any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.
Individual Return Transaction File	An IRS database that maintains data transcribed from initial input of the original individual tax returns during return processing.
Individual Taxpayer Identification Number	A nine-digit number issued by the IRS to individuals who are required to have a Taxpayer Identification Number but do not have, and are not eligible to obtain, a Social Security Number.



Return Preparer Coordinators Could Improve the Selection of Problematic Paid Preparers for Further Enforcement Actions

Term	Definition
Internal Revenue Code	The Federal statutory tax law, enacted as Title 26 of the U.S. Code, is organized according to topic and covers all relevant rules pertaining to income, gift, estate, sales, payroll, and excise taxes. The IRS is the implementing agency.
Internal Revenue Manual	The primary official source of instructions to staff relating to the organization, administration, and operation of the IRS.
Lead Development Center	A function in the IRS that centralizes the receipt and development of internal and external leads on individuals and entities that promote or aid in the promotion of abusive tax schemes.
Post of Duty	The official worksite that has been approved for the performance of IRS officially assigned duties.
Preparer Steering Committee	A group formed to identify patterns of paid preparer abuse, recommend the initiation of preparer cases, and monitor the progress of preparer cases. Its members are from multiple functions and include RPCs, Criminal Investigation representatives, and others.
Preparer Tax Identification Number	An identification number that all paid tax return preparers must use on U.S. Federal tax returns or claims for a refund submitted to the IRS.
Processing Year	The calendar year in which the tax return or document is processed by the IRS.
Return Preparer Coordinator	A designated staff member from the SB/SE Division Examination function responsible for coordinating all compliance aspects of the Return Preparer Program.
Return Preparer Office	The IRS created the Return Preparer Office in Calendar Year 2010 to oversee the registration, testing, and suitability of Federal paid tax return preparers. Its mission is to improve taxpayer compliance by providing comprehensive oversight and support of tax professionals.
Return Preparer Office Complaint Database	The database that the Return Preparer Office uses to track complaints received on paid preparers. The database captures information such as the paid preparer's identification, alleged issues, and the complaint disposition.



Return Preparer Coordinators Could Improve the Selection of Problematic Paid Preparers for Further Enforcement Actions

Term	Definition
Return Preparer Strategy	A program that allows for outreach to paid preparers and the examination of tax returns prepared by a particular paid preparer if information indicates that a pattern of noncompliance exists. The examinations are useful in identifying erroneous entries on tax returns and determining if penalties are warranted against the paid tax return preparer.
Social Security Number	A nine-digit number issued by the Social Security Administration. The primary purpose is to track individuals' wages and self-employed earnings for Social Security benefit purpose.
Tax Gap	The Tax Gap is the estimated difference between the amount of tax that taxpayers should pay and the amount that is paid voluntarily and on time.
Tax Year	A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.
TIGTA Data Center Warehouse	The Data Center Warehouse is a collection of IRS databases containing various types of taxpayer account information that is maintained by TIGTA for the purpose of analyzing data for ongoing audits.



Return Preparer Coordinators Could Improve the Selection of Problematic Paid Preparers for Further Enforcement Actions

Appendix VI

Management's Response to the Draft Report

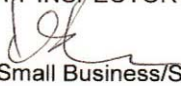


COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

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

JUL 18 2014

MEMORANDUM FOR MICHAEL E. MCKENNEY
ACTING DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Karen Schiller 
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – Return Preparer Coordinators Could Improve the Selection of Problematic Paid Preparers for Further Enforcement Actions (Audit #201230021)

Thank you for the opportunity to review your draft report titled: "Return Preparer Coordinators Could Improve the Selection of Problematic Paid Preparers for Further Enforcement Actions." We appreciate your recognition of the support our Area Return Preparer Coordinators (RPCs) provide for the Return Preparer Strategy. They play a critical role in IRS efforts to improve voluntary compliance by ensuring consistent application of return preparer provisions.

During filing season, our RPCs effectively coordinate thousands of visits to paid preparers identified in high risk categories. These visits improve taxpayer compliance by providing comprehensive oversight, education, and support of tax professionals on topics such as e-signature availability, Earned Income Tax Credits, fraud identification, identity theft, Circular 230 compliance, and abusive tax treatments. Through our monitoring visits, we gain insight to enhance our processes and consistently offer compliance support to the tax community.

We agree with your recommendations. Based on your suggestions, we will identify and make appropriate revisions to improve sharing, tracking, and organization of data surrounding referrals. As reported, limited resources have impacted our ability to timely acknowledge and deliver referrals to the areas. The development of inventory controls and timeliness standards for the referral process will focus our limited resources on efforts to timely address the most egregious paid preparers.

We have attached a response outlining our planned corrective actions. If you have any questions, please contact me, or a member of your staff may contact Shenita Hicks, Director, Examination, Small Business/Self Employed Division at 240-613-2849.



Return Preparer Coordinators Could Improve the Selection of Problematic Paid Preparers for Further Enforcement Actions

Attachment

Recommendation 1:

The Commissioner, SB/SE Division, should develop 1) uniform inventory controls for the referrals received by the RPCs and 2) timeliness standards for the review of referrals to help ensure that the most egregious paid preparers are identified and considered for further enforcement actions.

Corrective Action:

We will evaluate inventory controls and timeliness standards for review of return preparer referrals. We will revise requirements, as needed, and assess the need for further guidance and/or tools to appropriately control and monitor return preparer referrals received by SB/SE Examination.

Implementation Date:

September 30, 2015

Responsible Official:

Director, Examination Planning and Delivery, SB/SE

Corrective Action Monitoring Plan:

The IRS will monitor this corrective action as part of our internal management system of control.

Recommendation 2: The Commissioner, SB/SE Division, should work with the Return Preparer Office to develop a methodology for sharing information on paid preparer referrals and complaints to improve the identification and selection of the most egregious paid preparers for further enforcement actions. This methodology should also allow for the sharing of referral data amongst Area Office RPCs.

Corrective Action:

We will develop a methodology, in concert with the Return Preparer Office, to improve the identification of paid preparers for enforcement action and make appropriate revisions, as needed, to the preparer referral process. This includes improving tools and guidance for the distribution of referrals to the Area Office RPCs.

Implementation Date:

September 30, 2015

Responsible Official(S):

Director, Examination Policy, SB/SE
Director, Return Preparer Office

Corrective Action Monitoring Plan:

The IRS will monitor this corrective action as part of our internal management system of control.