

12-22-2014

When Helpers Hurt: Protecting Taxpayers From Preparers

Michelle L. Drumbl

Washington and Lee University School of Law, mdrumbl@wlu.edu

Follow this and additional works at: <http://scholarlycommons.law.wlu.edu/wlufac>

 Part of the [Taxation-Federal Commons](#), and the [Tax Law Commons](#)

Recommended Citation

Michelle L. Drumbl, *When Helpers Hurt: Protecting Taxpayers from Preparers*, 22 *Tax Notes* 1365 (2014).

This Article is brought to you for free and open access by Washington & Lee University School of Law Scholarly Commons. It has been accepted for inclusion in Faculty Scholarship by an authorized administrator of Washington & Lee University School of Law Scholarly Commons. For more information, please contact osbornecl@wlu.edu.

When Helpers Hurt: Protecting Taxpayers From Preparers

By Michelle Lyon Drumbl

Michelle Lyon Drumbl is an associate clinical professor of law and the director of the tax clinic at the Washington and Lee University School of Law. She thanks the participants of the 2013 University of Washington Tax Symposium for helpful feedback and Ilya Danilkevich for his research assistance. She is grateful to the Frances Lewis Law Center for research support. All errors are her own.

In this article, Drumbl explores return preparer regulation as a policy matter and questions what would be gained by applying Circular 230 to return preparers.

In 2011 return preparers assembled more than 78 million individual income tax returns.¹ Of those 78 million, more than half — 42 million — were prepared by unlicensed and unregulated return preparers.²

How and whether the return preparer industry can or should be regulated are fiercely debated questions and have been the subject of recent litigation.³ Following its 2009 return preparer review, the IRS established a program in 2011 that required return preparers to obtain a preparer tax identification number, pass a suitability check, complete competency testing, and take 15 credits of continu-

ing education courses annually.⁴ Through that program, the IRS intended Circular 230 to apply to those individuals under the theory that return preparation is “practice before the IRS.”⁵ Accordingly, the revisions to Circular 230 created a new category of practitioner: a “registered tax return preparer.”⁶ The return preparer regulations were supposed to “improve the accuracy, completeness, and timeliness of tax returns prepared by tax return preparers.”⁷ Regarding the application of Circular 230 to unlicensed preparers, the preamble stated:

This change will authorize the IRS to inquire into possible misconduct and institute disciplinary proceedings relating to registered tax return preparer misconduct under the provisions of Circular 230. . . . The availability of these sanctions will act as a deterrent to registered tax return preparers engaging in misconduct because disreputable or incompetent registered tax return preparers who are suspended or disbarred from practice will no longer be able to prepare tax returns, claims for refund, and other documents submitted to the IRS.⁸

In 2012 three unrelated return preparers brought suit to challenge that version of Circular 230 in *Loving v. IRS*. In January 2013 the U.S. District Court for the District of Columbia issued a permanent injunction barring the IRS from enforcing the registration scheme.⁹ After that setback, the IRS appealed, but in February the D.C. Circuit affirmed the judgment, agreeing with the district court that 31 U.S.C. section 330(a)(1) “cannot be stretched so

¹Section 7701(a)(36) defines return preparer as “any person who prepares for compensation . . . any return of tax imposed by this title.” See also reg. section 301.7701-15.

²IRS Compliance Data Warehouse, Individual Returns Transaction File and Return Preparers and Providers Database (tax year 2011). See generally Nina E. Olson, “More Than a ‘Mere’ Preparer: *Loving* and Return Preparation,” *Tax Notes*, May 13, 2013, p. 767. By unlicensed and unregulated, I am referring to a paid preparer who is not an attorney, a CPA, an enrolled agent, or someone subject to state regulation. Those unlicensed preparers work in a variety of settings, from large commercial preparation chains such as H&R Block and Jackson Hewitt to independent shops that prepare returns only seasonally.

³*Loving v. IRS*, 742 F.3d 1013 (D.C. Cir. 2014) (2014 WL 519224 (C.A.D.C.)), *aff’d* 917 F. Supp.2d 67 (D.D.C. 2013). See also *American Institute of Certified Public Accountants v. IRS*, No. 14-1190 (D.D.C. filed July 15, 2014).

⁴“Regulations Governing Practice Before the Internal Revenue Service,” 76 F.R. 32,286 (June 3, 2011).

⁵*Id.* at 32,288. The IRS maintains that Congress broadly granted it the authority to regulate preparers under its delegation to the secretary of the Treasury to “regulate the practice of representatives of persons before the Department of the Treasury.” 31 U.S.C. section 330(a)(1). See Brief for the Appellants, at 10, *Loving v. IRS*, No. 13-5061 (D.C. Cir. Mar. 29, 2013). See also Publication 4832, *Return Preparer Review* (rev. Dec. 2009), at 33 (“The IRS considers the preparation of a tax return for compensation as a form of representation before the agency”).

⁶See Circular 230, section 10.3(f).

⁷76 F.R. 32,286, *supra* note 4, at 32,294.

⁸*Id.* at 32,295.

⁹*Loving v. IRS*, 917 F. Supp.2d 67, 80 (D.D.C. 2013).

broadly as to encompass authority [for the IRS] to regulate tax-return preparers."¹⁰

While the IRS did not appeal the D.C. Circuit's decision, it has not given up on its quest for increased regulation of return preparers.¹¹ In June it unveiled a voluntary annual filing season program that seeks to accomplish many of the same objectives of return preparer regulation without mandating the registration program.¹² Now the IRS has been challenged again in the District Court for the District of Columbia — this time by the American Institute of Certified Public Accountants. In its complaint, the AICPA states that the annual filing season program "is an illegitimate exercise of government power, as it violates the APA [Administrative Procedure Act] and also represents an impermissible end run around *Loving v. IRS*."¹³

Loving was decided on statutory construction and administrative law doctrine,¹⁴ and the AICPA follows a similar approach in its complaint. This article, however, explores return preparer regulation as a policy matter. With the government's loss in *Loving*, this is an appropriate time to reconsider what would be gained by applying Circular 230 to return preparers. Would doing so protect taxpayers from their return preparers? Is the ability to sanction preparers under Circular 230 a meaningful deterrent to misconduct, or are existing mechanisms a sufficient deterrent? I address those questions in the context of low-income taxpayers, who

are among the most vulnerable people served by unregulated return preparers.

A. Harms to Low-Income Taxpayers

Return preparers can harm taxpayers if returns are not prepared correctly. Low-income taxpayers with children are especially vulnerable because their return may include a sizable refund claim based on refundable credits. Congress has chosen the tax code as the mechanism to deliver those social welfare benefits to taxpayers, yet the refundable credit provisions are complex; as a result, many low-income individuals rely on professional help in filing their returns.¹⁵ If the return is audited and the refund claim denied, the taxpayer is liable for the deficiency plus interest and may be subject to an accuracy-related penalty.¹⁶

Whether because of the differential in cost (real or perceived) or marketing efforts directed at them by unregulated preparers, taxpayers claiming the earned income tax credit are more likely to use an unregulated preparer than a CPA.¹⁷ Fringe preparers, or "businesses that are historically associated with the exploitation of consumers, such as payday loan stores, check cashers, and used car dealers,"¹⁸ prey on low-income taxpayers. National Taxpayer Advocate Nina Olson has described low-income taxpayers as "often the least educated and least financially sophisticated . . . thus, they become easy targets for marketing schemes of unregulated and unqualified so-called return preparers whose real interest in the tax return process is to push high-interest loans . . . and charge high fees."¹⁹

¹⁰*Loving v. IRS*, 742 F.3d 1013 (D.C. Cir. 2014) (2014 WL 519224 (C.A.D.C.), at *1). Note, however, that the preparer tax identification number regime was not challenged in *Loving*, and therefore, that requirement remains valid. See also *Brannen v. United States*, 682 F.3d 1316 (11th Cir. 2012) (upholding the PTIN regime).

¹¹Following the D.C. Circuit opinion, the IRS released the following statement: "As we assess the scope and impact of the court's decision and determine our way forward, our focus on improved competency will continue." See "IRS Statement on Court Ruling Related to Return Preparers" (Jan. 22, 2014). See Andrew Velarde and Jaime Arora, "U.S. Won't Take *Loving* Decision to Supreme Court," *Tax Notes*, May 19, 2014, p. 771 (Kathryn Keneally, Justice Department Tax Division assistant attorney general, announced at the May 2014 American Bar Association Section of Taxation meeting that the government would not seek certiorari in *Loving*). See also Larry Gibbs, "Recent Developments in the IRS Regulation of Return Preparers," *Procedurally Taxing*, May 21, 2014, available at <http://www.procedurallytaxing.com/recent-developments-in-the-irs-regulation-of-return-preparers/>.

¹²Rev. Proc. 2014-42, 2014-29 IRB 192. As noted in the revenue procedure, the Obama administration's fiscal 2015 revenue proposals ask Congress to give Treasury and the IRS legislative authority to regulate return preparers.

¹³Complaint at 2, *American Institute of Certified Public Accountants v. IRS*, No. 14-1190 (D.D.C. filed July 15, 2014).

¹⁴For a comprehensive analysis of the administrative law issues, see Steve R. Johnson, "*Loving* and Legitimacy: IRS Regulation of Tax Return Preparation," 59 *Vill. L. Rev.* 515 (2014).

¹⁵In tax year 2011, 59 percent of taxpayers claiming the earned income tax credit and 65 percent of taxpayers claiming the additional child tax credit used paid preparers. National Taxpayer Advocate, "2013 Annual Report to Congress," at 66 (Jan. 9, 2014). The numbers are not further broken down to reflect the type of paid preparer or whether the preparer was unregulated.

¹⁶For more on this issue, see Drumbl, "Those Who Know, Those Who Don't, and Those Who Know Better: Balancing Complexity, Sophistication, and Accuracy on Tax Returns," 11 *Pitt. Tax Rev.* 113 (2013).

¹⁷"Among those who reported using a particular type of paid preparer . . . EITC claimants are more likely to use an unenrolled return preparer (43 percent) or a preparer from a national tax return preparation firm (35 percent) than non-claimants (28 percent and 14 percent, respectively). In contrast, non-claimants for EITC are much more likely to use a CPA to prepare their return: 44 percent do so. This compares with just 10 percent for EITC claimants." Publication 5162, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns*, at 24 (rev. Aug. 2014).

¹⁸Chi Chi Wu, "Riddled Returns: How Errors and Fraud by Paid Tax Preparers Put Consumers at Risk and What States Can Do," National Consumer Law Center, at 4 (Nov. 2013).

¹⁹See Olson, *supra* note 2, at 770.

To assess whether the application of Circular 230 to unregulated return preparers is necessary to protect taxpayers, one must consider what risks return preparers pose to the community that relies on their services. Those risks are incompetence and unscrupulous behavior.²⁰

Much has been made of studies known as “mystery shopper scenarios,” conducted by the Treasury Inspector General for Tax Administration, the Government Accountability Office, and consumer advocacy groups such as the National Consumer Law Center. Those studies, while admittedly small in scale and scope, have revealed disturbing rates and examples of return preparer incompetence and unscrupulous behavior.²¹

The mystery shopper studies reveal two common fact patterns. The first is income omission; sometimes a return preparer does not include cash income on the return even though the taxpayer informs the preparer of it. The second fact pattern involves return preparers who claim ineligible children for the earned income tax credit, inflating the refund by a significant amount. Other documented examples of inflating a refund include return preparers inflating or inventing itemized deductions.²²

Those mystery shopper scenarios have been cited in calls for and in defense of the IRS return preparer regulation program.²³ Indeed, many of the incidents cited in the scenarios are disturbing, for example:

[The tester] reported that the tax preparer tried to entice her to commit tax fraud by showing her how much her federal refund would increase if she took deductions in excess of the standard deduction. [The tester] does not attend church, but the tax preparer included a \$2,000 church donation. The preparer also deducted the cost of work clothes and laundry, then showed [the tester] that her federal refund would increase to \$3,000 from about \$1,000. The preparer also tried to convince [the tester] to make up a dependent as she does not have any — showing her that her refund would go up to \$5,000 if she did so. The preparer also tried to qualify her for EITC even though she is not eligible. Finally, the tax

preparer deducted \$400 in 2008 tax preparation costs even after [the tester] told the preparer that she did not pay for tax preparation last year.²⁴

The calls for regulation presume that testing and certification can deter bad actors. Incompetence and unscrupulous behavior are two distinct phenomena, and I contend that it is naïve to expect that requiring testing and certification would meaningfully reduce either.

1. Incompetence. Incompetence is an important concern, especially in light of the code’s complexity. However, it is not a new problem, nor is it a problem limited to unregulated preparers. Attorneys and CPAs can be incompetent despite state regulation of both professions, requiring the passing of minimum competency exams and completion of annual continuing education requirements.

The IRS return preparer regulations sought to address competency through exam and continuing professional education requirements.²⁵ I am skeptical that those requirements would reduce incompetence. First, the new Circular 230 would not have required attorneys, CPAs, or enrolled agents to take the competency exam.²⁶ Because most attorneys have no training in return preparation, that doesn’t make sense. Although attorneys have passed a state bar exam and will likely complete several hours of continuing legal education per year, those requirements usually focus on nontax subjects and would not cover basic tax law. It’s true that attorneys have a duty to provide competent representation,²⁷ and therefore, a diligent attorney would be less inclined to prepare a return if it were not within his scope of knowledge. However, that presumes that the attorney appreciates the complexity of preparing a return. In fact, tax software may provide a false sense of confidence, resulting in the professionals who use it not recognizing the underlying complexities of the applicable provisions.

Further, a bad actor who intends to commit fraud is not necessarily incompetent. To the contrary, that person may understand the rules well, allowing him to know how to inflate a refund or omit income while minimizing the chances that the IRS would discover the scheme.

Finally, evidence suggests that the training the IRS contemplates does not ensure competency. Since 2004 TIGTA has performed an annual review of error rates in returns prepared through the IRS

²⁰See, e.g., 76 F.R. 32,286, *supra* note 4, at 32,295; Olson, *supra* note 2, at 767; and Brief of Former Commissioners of Internal Revenue, Amici Curiae Supporting Defendants-Appellants, at 14, *Loving v. IRS*, No. 13-5061 (C.A.D.C. Apr. 5, 2013).

²¹For a detailed compilation of “abuses uncovered by mystery shopper testing,” see Wu, *supra* note 18, at 5-13.

²²*Id.* at 7-8.

²³Brief for National Consumer Law Center and National Community Tax Coalition, Amici Curiae Supporting Defendants-Appellants, *Loving v. IRS*, No. 13-5061 (C.A.D.C. Apr. 5, 2013).

²⁴Wu, *supra* note 18, at 7-8.

²⁵Publication 4832, *supra* note 5, at 34-36.

²⁶*Id.* at 34.

²⁷ABA Model Rule 1.1.

volunteer program, which includes the volunteer income tax assistance (VITA) and the tax counseling for the elderly (TCE) programs.²⁸ VITA and TCE program volunteers are required to complete extensive training on tax issues common to individuals on Form 1040. That training culminates in a competency exam, and volunteers must obtain a minimum score to be certified as volunteer return preparers. Volunteers are not paid to prepare returns and thus fall outside the code's definition of tax return preparer.²⁹ They have nothing to gain from inflating taxpayer refunds, because no fee is charged and VITA and TCE sites do not sell products that are tied to tax refunds. Yet year after year, TIGTA has found high error rates in returns prepared by volunteers. In its most recent report, TIGTA described an overall accuracy rate of 51 percent.³⁰ TIGTA attributes the inaccuracy to "volunteers not obtaining sufficient information from the auditors to apply the tax law correctly and volunteers not always following intake/interview and quality review guidelines."³¹ Thus, the inaccuracy is not necessarily attributable to a lack of training in substantive tax law, but to an improper determination of the underlying facts, for example, failing to ask enough or the right questions, not understanding the taxpayer's answers, or making incorrect assumptions.

2. Unscrupulous behavior. Unscrupulous behavior is a threat to the fisc and taxpayers alike because, in many instances, the return preparer is the beneficiary of the wrongdoing. That is an important distinction from incompetence, in that an incompetent preparer is erring in favor of either the taxpayer or the government. There are many examples of unscrupulous preparers committing fraud and identity theft to profit from an inflated refund,³² including diverting the refund to their bank account.³³

Unscrupulous preparers pose a threat to unsophisticated low-income taxpayers in particular because they may be eligible for refundable credits, such as the earned income tax credit, that are intended by Congress to serve as social welfare

²⁸The most recent of those reports was released on September 16, 2013. TIGTA, "Inconsistent Adherence to Quality Requirements Continues to Affect the Accuracy of Some Tax Returns Prepared at Volunteer Sites," 2013-40-110 (2013).

²⁹Section 7701(a)(36); see also reg. section 301.7701-15(f).

³⁰See *supra* note 28. Note that this represents a small sample, as with other mystery shopper scenarios.

³¹See *supra* note 28, at 5.

³²See, e.g., Wu, *supra* note 18, at 13-15.

³³See generally National Taxpayer Advocate, "2012 Annual Report to Congress," at 68-79 (2012) (describing the four primary fact patterns in return preparer fraud cases that are seen by the Taxpayer Advocate Service).

benefits. When return preparers cheat taxpayers out of those benefits, the taxpayers are denied money that might have helped pay rent, feed and clothe their children, or pay for car repairs, or served as an emergency fund.³⁴ Instead, the taxpayers face administrative hurdles and delays in receiving the refund to which they are entitled because the IRS does not authorize the issuance of a replacement refund to a taxpayer who has been the victim of return preparer fraud through a misrouted direct deposit.³⁵

But is regulating return preparers the most appropriate solution to address unscrupulous behavior? There are plenty of preexisting statutory tools to combat unscrupulous preparers, ranging from civil injunctions to criminal enforcement. Moreover, Circular 230 empowers the IRS to censure, suspend, or disbar from practice before the IRS a practitioner who is incompetent or disreputable; who violates some standards of Circular 230; or who, with intent to defraud, willfully and knowingly misleads or threatens a client or prospective client.³⁶ If practice before the IRS included preparing returns, a return preparer who violated those standards would be barred from preparing future returns. But it's unclear that that adds to the existing statutory regime — section 7407 already provides a path for the government to seek injunctive relief against unscrupulous return preparers.

Unscrupulous preparers are motivated by their own financial gain. They have discovered how to manipulate a complex system to their advantage. To presume that they would be deterred by Circular 230 is to ignore that unscrupulous individuals are not motivated by ethics, reputation, or the right to provide a consumer service. If subjected to Circular 230, unscrupulous preparers will find a new way to operate in the shadows of the industry,³⁷ or they

³⁴For an interesting study of how earned income tax credit recipients use their refunds, see Sara Sternberg Greene, "The Broken Safety Net: A Study of Earned Income Tax Credit Recipients and a Proposal for Repair," 88 *N.Y.U. L. Rev.* 515 (2013).

³⁵"The IRS Harms Taxpayers by Refusing to Issue Refunds to Some Victims of Return Preparer Fraud," National Taxpayer Advocate, "Fiscal Year 2014 Objectives," at 1 (June 30, 2013). In contrast, a replacement refund will be issued for identity theft by a non-preparer or when a paper check refund is stolen. *Id.* at 3.

³⁶Circular 230, section 10.50(a).

³⁷Unscrupulous preparers are clearly not above lying on tax returns, and existing provisions requiring them to sign a return or use a PTIN are insufficient to prevent fraud. See, e.g., Complaint at 7, *United States v. Pernell*, No. 14-cv-1637 (N.D. Ill. Mar. 10, 2014) (documenting how Pernell signed false names on the preparer line and used other individuals' PTINs). See also "Black Market Tax Preparers Continue to Defy IRS," *Forbes.com*

(Footnote continued on next page.)

will find a new vulnerability to exploit, because it is exploitation — not return preparation — that is their true profession.

Would the application of Circular 230 to return preparers add anything new or more useful to the deterrence of unscrupulous return preparers? In a similar vein, would it meaningfully cure incompetence? Or would a new return preparer regulation scheme under Circular 230 merely burden independent and small-scale return preparers without creating new benefits for taxpayers?

B. Does Circular 230 Address Harms?

Circular 230 was promulgated to regulate practice before the IRS. Before the 2011 amendments that added registered tax return preparers to its scope, it applied to attorneys, CPAs, enrolled agents, and enrolled retirement plan agents. While return preparers outside those categories were not subject to Circular 230 before the amendments, they were and still are subject to statutory preparer penalty code provisions.³⁸

In its 2009 return preparer review report,³⁹ the IRS noted that all paid return preparers are subject to those code provisions, which provide both civil and criminal sanctions. Without describing how the provisions might be inadequate or too incomplete to protect taxpayers, the report noted that attorneys, CPAs, and enrolled agents (collectively referred to as “practitioners”) are subject to Circular 230. The report further said that Circular 230 provides that “practitioners who violate these standards of practice or who are shown to be incompetent or disreputable may be censured, suspended or disbarred from practice. The IRS Office of Professional Responsibility is charged with investigating allegations of Practitioner misconduct and conducting disciplinary proceedings, where warranted.”⁴⁰

The U.S. District Court for the District of Columbia commented on the potential redundancy of those regimes in *Loving*: “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 specific to tax-return preparers, each of which targets particular conduct related to preparing and filing tax returns, and each

of which comes with a specific fine.”⁴¹ The court said it was concerned that Circular 230 would allow the IRS “the discretion — with few restraints — to impose an array of penalties for this sort of conduct.”⁴² The court wrote that section 7407 permits the IRS to enjoin return preparers from practice while affording them the protection of judicial review; it noted that if Circular 230 applied to return preparers, that would allow the IRS to bar a return preparer from practice before it without the protections of section 7407.⁴³

Some law enforcement agencies have been successful in pursuing fraudulent preparer practices. The agencies relied on the code’s return preparer provisions to do so, rendering it irrelevant that many of the fraudulent return preparers were outside the scope of Circular 230.

1. Law enforcement agencies are finding success pursuing unscrupulous return preparers outside the scope of Circular 230. The IRS Criminal Investigation division, the Justice Department Tax Division, and U.S. attorney’s offices have worked together to prosecute return preparer fraud. The IRS CI division’s return preparer program investigates “the orchestrated preparation and filing of false income tax returns, in either paper or electronic form, by dishonest preparers who may claim: inflated personal or business expenses, false deductions, excessive exemptions, and/or unallowable tax credits. The preparers’ clients may or may not have knowledge of the falsity of the returns.”⁴⁴

As a result of those collaborative efforts, courts have issued permanent injunctions against some return preparation chains and individuals barring them from preparing returns.⁴⁵ Individuals have been sentenced to prison.⁴⁶ In many cases, the fraudulent preparers are ordered to pay restitution.⁴⁷

Those law enforcement efforts and successes are well publicized. For example, the Justice Department Tax Division issues frequent press releases describing its efforts and successes in combating

(Nov. 18, 2013), available at <http://www.forbes.com/sites/kellyphillips/b/2013/11/18/black-market-tax-preparers-continue-to-defy-irs/>.

³⁸See sections 6694, 6695, 6700, 6701, 6713, 7206, 7207, 7216, 7407, and 7408. Those include the provision authorizing a federal district court to enjoin a return preparer from preparing returns.

³⁹Publication 4832, *supra* note 5, at 17-18.

⁴⁰*Id.* at 18.

⁴¹*Loving v. IRS*, 917 F. Supp.2d 67, 75 (D.D.C. 2013).

⁴²*Id.* at 76.

⁴³*Id.* at 77-78.

⁴⁴IRS, “IRS-CI Fiscal Year 2013 Annual Business Report,” at 5 (2013).

⁴⁵See, e.g., Wu, *supra* note 18, at 14 (describing the case of *Justice Department v. Instant Tax Service*). At the time the injunction was issued, Instant Tax Service was the fourth largest commercial tax preparation chain in operation. *Id.*

⁴⁶See, e.g., Wu, *supra* note 18, at 14 (describing the case of *Illinois v. Mo’ Money Taxes*).

⁴⁷See, e.g., Justice Department release, “Staten Island, N.Y., Tax Preparer Sentenced to Prison for Preparing False Tax Returns,” 14-236 (Mar. 6, 2014).

COMMENTARY / VIEWPOINT

fraudulent return preparers.⁴⁸ At the start of the 2013 filing season, it issued a release noting that “in the last year, the division has obtained permanent injunctions against more than 60 preparers and promoters doing business all over the United States.”⁴⁹

Publicizing those cases and shutting down nationwide return preparation chains have a deterrent effect. Those actions put unscrupulous preparers on notice that the government will devote resources to protecting taxpayers. The Justice Department issues press releases not just when it wins cases, but also when it files a complaint. Criminal charges, jail time, and restitution arguably send a louder message than the threat of Circular 230 sanctions. The government would be better served by devoting more resources to those law enforcement efforts than to a new and redundant regulatory scheme for all return preparers.

Unscrupulous behavior is not limited to return preparers. Attorneys and accountants are capable of misbehavior. A highly publicized series of events led to the downfall of a tax attorney named Roni Lynn Deutch, known in television advertisements as the “tax lady.” Facing multiple lawsuits and allegations of fraud and document destruction, Deutch shut down her business, resigned from the California State Bar, and filed for bankruptcy. As an attorney, Deutch was subject to Circular 230, just as the IRS argues all return preparers should be. But although her alleged actions likely violated multiple provisions of Circular 230, those violations were not the cause of her downfall.

2. The downfall of the tax lady: Despite Circular 230’s application, state law carried the day. Deutch owned and operated a law firm with a staff of attorneys and a sales force that generated about \$25 million per year in annual revenue.⁵⁰ Purporting to specialize in tax debt resolution, the firm advertised on late-night television. Law enforcement agencies contended that the firm made false or misleading promises about the services it could provide, in-

cluding statements that the firm’s “success rate in resolving clients’ back tax liability with the IRS is as high as 99 percent.”⁵¹

Deutch’s firm was the subject of many consumer complaints.⁵² Law enforcement agencies pursued those complaints, not under U.S. law or Circular 230, but under local laws in New York City and state laws in California. The New York City Department of Consumer Affairs sued Deutch in 2005 for violations of the New York City Consumer Protection Law, alleging that statements made in the firm’s television commercials misled consumers.⁵³ Deutch settled that suit for \$300,000 in 2006, but larger legal problems loomed. In 2010 the California attorney general sued Deutch for \$34 million, alleging violations of state law, including making untrue or misleading representations with the intent to induce members of the public to purchase services⁵⁴ and engaging in unfair competition.⁵⁵

Following a court order for Deutch to repay her clients and preserve business records, the California attorney general’s office asserted that Deutch shredded documents and diverted personal and business assets to herself and her creditors.⁵⁶ In 2011 Deutch shut down her firm and surrendered her law license.

Circular 230 applied to Deutch’s actions, yet the authorities didn’t use it.⁵⁷ As in the examples of federal law enforcement efforts against return preparers, Circular 230 was not the most effective way to pursue the alleged wrongdoing in that case.

If Circular 230 is not the most effective way to address return preparer wrongdoing, what role can

⁵¹*Id.* at 6, 9.

⁵²Although her business has been shut down, a sampling of consumer complaints is still available online. See, e.g., <http://www.bbb.org/northeast-california/Business-Reviews/attorney-s-and-lawyers/roni-deutch-a-professional-tax-corp-in-north-high-lands-ca-33004338/complaints#breakdown>.

⁵³New York City Department of Consumer Affairs release, “Roni Lynn Deutch Agrees to Pay \$300,000 to Settle New York City’s Lawsuit for Deceptively Advertising Tax Services” (Dec. 20, 2006), available at http://www.nyc.gov/html/dca/html/pr2006/pr_122006.shtml.

⁵⁴Complaint at 22, *People v. Deutch*, PTC, No. 34-2010-00085933-CU-MC-GDS (Superior Court of the State of Cal. County of Sacramento (Aug. 24, 2010)) (Cal. Sup. Ct. Aug. 24, 2010).

⁵⁵*Id.* at 25.

⁵⁶“Tax Lady’ Roni Deutch Closing Law Firm,” *Sacramento Bus. J.* (May 12, 2011), available at <http://www.bizjournals.com/sacramento/news/2011/05/12/tax-lady-roni-deutch-closing-law-firm.html>.

⁵⁷For example, Circular 230, section 10.30(a)(1) provides: “A practitioner may not, with respect to any Internal Revenue Service matter, in any way use or participate in the use of any form of public communication or private solicitation containing a false, fraudulent, or coercive statement or claim; or a misleading or deceptive statement or claim.”

⁴⁸Justice Department Tax Division releases are available at <http://www.justice.gov/tax/taxpress2014.htm>. Recent press releases include news of criminal sentencing and civil injunction complaints filed.

⁴⁹Justice Department release, “Justice Department Highlights Ongoing Efforts to Protect the Public and Shut Down Fraudulent Tax Return Preparers and Promoters Nationwide,” 14-145 (Feb. 11, 2014).

⁵⁰Complaint at 4, *People v. Deutch*, PTC, No. 34-2010-00085933-CU-MC-GDS (Superior Court of the State of Cal. County of Sacramento (Aug. 24, 2010)) (Cal. Sup. Ct. Aug. 24, 2010).

it play in protecting taxpayers? Wrongdoing that is the result of incompetence cannot necessarily be cured through increased testing and mandatory continuing education, but there is value in applying Circular 230's ethical rules to return preparers. And they can apply without requiring burdensome testing and continuing education.

C. The Value of Circular 230

Circular 230 imposes several affirmative duties on those who practice before the IRS, many of which do not apply in preparing returns for low-income individuals.⁵⁸ Those provisions that apply are mostly redundant given the standards found in the code.

For example, the code's return preparer provisions require due diligence. Section 6694 penalizes preparers for understatements attributable to unreasonable positions or willful or reckless conduct. Section 6695(g) imposes specific due diligence requirements when determining a taxpayer's eligibility for the earned income tax credit. Those code provisions provide an incentive to return preparers to meet competency standards. They are fully consistent with the accuracy-related diligence in Circular 230, section 10.22 and standards of practice in Circular 230, section 10.34.

Regardless of any redundancy between the preparer provisions and Circular 230, there is value in applying Circular 230 to return preparers. Aggressive law enforcement may be the only way to curb unscrupulous return preparation, but applying Circular 230 to return preparers could instill a greater professional pride or duty to the system⁵⁹ (or at least a duty to the client) in those return preparers who are not unscrupulous.

⁵⁸Examples include Circular 230, section 10.23 (prompt disposition of pending matters) and section 10.37 (requirements for other written advice).

⁵⁹While tax attorneys are said to have a duty to the system, it is not settled whether return preparers have the same duty. For a thoughtful discussion of whether filing a tax return is an adversarial process, see Camilla Watson, "Legislating Morality: The Duty to the Tax System Reconsidered," 51 *U. Kan. L. Rev.* 1197 (2003).

As part of its return preparer review, the IRS considered options short of the burdensome regulatory scheme that it ultimately proposed. One alternative that it considered but did not adopt was:

To require all tax return preparers to comply with the ethical standards in Circular 230, but not to require any tax return preparer to pass an examination and complete continuing education courses. Under this alternative, the provisions of the rule clarifying that tax return preparers are subject to the ethical rules in Circular 230 would remain intact, but all of the other changes would not be adopted.⁶⁰

That alternative was rejected in favor of greater regulation since "the benefits resulting from this alternative would likely be less than the benefits resulting from these regulations because tax return preparers would not need to meet a minimum competency level and keep educated and up-to-date on Federal tax issues."⁶¹

I hope that the IRS will revisit that alternative in the wake of *Loving*. Return preparers who resent the cost and time of complying with certification and continuing education requirements would not be burdened by an additional layer of ethical standards, especially given that the Circular 230 standards are consistent with the code provisions that govern those return preparers. At the same time, applying the ethical standards of Circular 230 to that group may help emphasize the importance of its role to the taxpayer. Low-income taxpayers claiming earned income tax credits are twice as likely to be audited as the average taxpayer.⁶² If the return preparer fails to ask enough questions, it is the taxpayer who is ultimately responsible for the liability. Those taxpayers benefit to the extent that return preparers view themselves as professionals who, like attorneys and accountants, are charged with protecting their clients' interests.

⁶⁰76 F.R. 32,286, *supra* note 4, at 32,297.

⁶¹*Id.*

⁶²National Taxpayer Advocate, "2011 Annual Report to Congress," at 300 (2011).