MSP #24 EARNED INCOME TAX CREDIT (EITC): The IRS's EITC Return Preparer Strategy Does Not Adequately Address the Role of Preparers in EITC Noncompliance

RESPONSIBLE OFFICIALS

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TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Be Informed*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to a Fair and Just Tax System*

DEFINITION OF PROBLEM

The Earned Income Tax Credit (EITC) is one of the primary forms of public assistance for low income working taxpayers. To receive the benefits, the taxpayer must have earned income and file a tax return.[2] The determination of EITC eligibility is very complex and is difficult to navigate by taxpayers who are more likely to have lower literacy rates, to speak English as a second language, and to have a nontraditional family structure (where the child is not the biological child of the taxpayer claiming the credit). Fifty-five percent of returns claiming EITC were prepared by paid return preparers in tax year (TY) 2013.[3] Equally important, one IRS study showed unenrolled return preparers had the highest frequency and percentage of EITC overclaims, with 49 percent of those EITC returns containing an overclaim, and overclaims amounting to 33 percent of the total EITC claimed on those returns.[4]

Despite the involvement of so many paid preparers, the EITC suffers from a high noncompliance rate.[5] The problem of noncompliant return preparers contributing to the EITC error rate is well documented.

1 *See* Taxpayer Bill of Rights, *available at* www.TaxpayerAdvocate.irs.gov/taxpayer-rights.

2 The design of the EITC contains a phase-in, plateau, and phase-out state. Generally as the amount of income increases, the amount of EITC increases. At a certain point the EITC amount plateaus in relation to the amount of income (the taxpayer's income can increase while he or she receives the maximum amount of EITC) and then phases out as the EITC decreases with a decrease in income. In tax year (TY) 2014, taxpayers filing a joint return with three or more kids were ineligible for the EITC with earnings of $53,269. Rev. Proc. 2014-61, 2014-47 I.R.B. 860.

3 *The National Taxpayer Advocate's 2014 Annual Report to Congress: Hearing Before the Subcomm. on Government Operations of the H. Comm. on Oversight and Reform*, 114th Cong. 28, *Figure 4: Taxpayers Claiming Refundable Credits, Claim Amounts, and Preparer Usage, Tax Years 2010-2013* (2015) (written statement of Nina E. Olson, National Taxpayer Advocate).

4 IRS, Research, Analysis & Statistics, *Compliance Estimates for the Earned Income Tax Credit Claimed on 2006-2008 Returns* 26 (Aug. 2014). These numbers represent the lower bound estimates. This measure is likely to be low because it does not account for preparers who do not sign the returns they prepare. *The National Taxpayer Advocate's 2014 Annual Report to Congress: Hearing Before the Subcomm. on Government Operations of the H. Comm. on Oversight and Reform*, 114th Cong. 28 (2015) (written statement of Nina E. Olson, National Taxpayer Advocate).

5 The current improper payment rate of 27 percent has increased slightly from the improper payment rate in 2004, which measured 25 percent. Treasury Inspector General of Tax Administration (TIGTA), Ref. No. 2015-40-044, *Assessment of Internal Revenue Service Compliance With the Improper Payment Reporting Requirements in Fiscal Year 2014* 9 (Apr. 27, 2015).

In 2014, the Government Accountability Office (GAO) conducted 19 undercover visits to randomly selected tax preparer offices. Only two of the 19 tax returns showed the correct refund amount.[6]

Since 2002, the National Taxpayer Advocate has highlighted the need to protect taxpayers from noncompliant return preparers.[7] Based on a review of the IRS's existing EITC Return Preparer Strategy, the National Taxpayer Advocate has identified several concerns:

- Preparers who do not sign the returns and preparers who are the subject of complaints to the IRS Return Preparer Office (RPO) are not incorporated into the EITC Return Preparer Strategy;
- The public does not have access to the IRS's measures for evaluating the effectiveness of the strategy; and
- The EITC Return Preparer Strategy does not sufficiently focus on the unenrolled preparer population which, combined with a comprehensive public education campaign, is critical to improving EITC noncompliance.

Moreover, the EITC Return Preparer Strategy group does not partner with TAS, despite our extensive research into the role of return preparers in facilitating compliance, and our role as overseer of Low Income Taxpayer Clinics (LITC), which have keen insights and evidence of return preparer conduct with respect to EITC.

ANALYSIS OF PROBLEM

Background

The EITC and Refundable Credits Policy and Coordination (ERCPC) unit is charged with "developing and coordinating delivery of the EITC Return Preparer Strategy" within the Wage and Investment (W&I) Division.[8] ERCPC lists many key IRS partners and stakeholders, including W&I Chief Counsel, Criminal Investigation Refund Crimes, W&I Campus Compliance, W&I Research & Analysis (WIRA), the RPO, and TAS.[9] However, the IRS has not involved TAS in the development or implementation of the EITC Return Preparer Strategy.

6 GAO, *Paid Tax Preparers: In a Limited Study, Preparers Made Significant Errors* 9 (Apr. 8, 2014). The National Consumer Law Center also conducted similar "mystery shopper" testing in 2010 and found "incompetence and fraud" in about 30 percent of the tests. *Protecting Taxpayers From Incompetent and Unethical Return Preparers, Hearing Before the S. Comm. on Fin.*, 113th Cong. 39 (2014) (statement of Chi Chi Wu, staff attorney, National Consumer Law Center).

7 National Taxpayer Advocate Fiscal Year 2015 Objectives Report to Congress 71-78; National Taxpayer Advocate 2013 Annual Report to Congress 61-74 (Most Serious Problem: *Regulation of Return Preparers: Taxpayers and Tax Administration Remains Vulnerable to Incompetent and Unscrupulous Return Preparers While the IRS Is Enjoined From Continuing Its Efforts to Effectively Regulate Unenrolled Preparers*); National Taxpayer Advocate 2009 Annual Report to Congress 41-69 (Most Serious Problem: *The IRS Lacks a Servicewide Return Preparer Strategy*); National Taxpayer Advocate 2008 Annual Report to Congress 504-12 (Most Litigated Issue: *Accuracy-Related Penalty Under Internal Revenue Code Sections 6662(b)(1) and (2)*); National Taxpayer Advocate 2006 Annual Report to Congress 197-221 (Most Serious Problem: *Oversight of Unenrolled Return Preparers*); National Taxpayer Advocate 2005 Annual Report to Congress 223-37 (Most Serious Problem: *Regulation of Electronic Return Originators*); National Taxpayer Advocate 2004 Annual Report to Congress 67-88 (Most Serious Problem: *Oversight of Unenrolled Return Preparers*); National Taxpayer Advocate 2003 Annual Report to Congress 270-301 (Legislative Recommendation: *Federal Tax Return Preparers: Oversight and Compliance*); National Taxpayer Advocate 2002 Annual Report to Congress 216-30 (Legislative Recommendation: *Regulation of Federal Tax Return Preparers); Protecting Taxpayers From Incompetent and Unethical Return Preparers, Hearing Before the S. Comm. on Fin.*, 113th Cong. 7 (2014) (statement of Nina E. Olson, National Taxpayer Advocate); *Fraud in Income Tax Return Preparation: Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways and Means*, 109th Cong. (2005) (statement of Nina E. Olson, National Taxpayer Advocate).

8 Internal Revenue Manual (IRM) 1.1.13.6.4.2(3) (Oct. 7, 2013).

9 IRS response to TAS information request (June 24, 2015). Though TAS is listed on the response as a stakeholder, it has not been included in any meetings since inception of the EITC Return Preparer Strategy.

Prior to fiscal year (FY) 2012, the EITC Return Preparer Strategy primarily focused on treating preparers through methods described below after the filing season. Beginning in 2011, the IRS implemented a "real time" preparer intervention program. Instead of waiting until the end of the filing season to identify and treat preparers, preparers are also scored on a daily basis and treatments are administered in real time.[10] Once prior year compliance activities conclude and the analysis is complete, the Refundable Credits Administration (RCA) office, WIRA, and Office of Compliance Analytics (OCA) meet to score and select preparers for the next fiscal year's pre-filing season treatments.[11] Once the filing season starts, filing season treatments begin and preparers whose scores meet the threshold and who have a given volume of EITC returns prepared are selected daily for the filing season treatments.[12] The scoring is based on four criteria that relate to breaking a Dependent Database (DDb) rule related to the amount of the EITC relative to the number of qualifying children or a DDb rule related to disabled qualifying children.[13]

The EITC Return Preparer Strategy Office says that it is "always striving for improvement in all areas of the program" by implementing prior year lessons and testing new ideas.[14] The EITC Return Preparer Strategy uses a "test and learn" approach that involves experimenting with different combinations of new and traditional compliance tools that are reviewed on an annual basis.[15] For instance, in its FY 2015 annual report, the Strategy described an iterative "pre-filing season treatment delivery process" that increased the contact rate from approximately 70 percent to nearly 95 percent.[16]

The EITC Return Preparer Strategy uses various tools at its disposal for preparers of questionable EITC claims, referred to as "treatments."[17] Preparers are identified in the pre-filing season and, if there are no signs of improvement, then more intensive treatment continues into the filing season.[18] Treatments include:

- *Reaching out to preparers via letter and phone contact* – letters are sent both during the pre-filing season and filing season as a warning and to educate preparers;
- *"Knock and talk" visits* – educational visits conducted by an SB/SE agent and a special agent from Criminal Investigation (CI);
- *Visits and audits for preparer due diligence* – audits of high risk preparers conducted by SB/SE employees to ascertain compliance with due diligence requirements under Internal Revenue Code (IRC) § 6695(g);[19] and

10 IRS response to TAS information request (June 24, 2015).

11 IRS response to TAS information request (Oct. 21, 2015). These meetings occur in mid-summer and the pre-filing season activities generally start on October 1. *Id*.

12 *Id*.

13 IRS response to TAS information request (June 24, 2015). The DDb addresses non-compliance relevant to the EITC and other tax benefits related to the dependency and residency of children. The IRS claims the DDb consistently applies the tax laws to a return claiming EITC as well as other tax issues, such as dependent exemptions, filing status, Child and Dependent Care Credit, Child Tax Credit, and education benefits, are addressed concurrently. IRM 4.19.27.2.3, *Dependent Database (DDb)* (Mar. 19, 2015). However, it is possible that a return could break a DDb rule but the taxpayer could still be eligible for the EITC. *See The Public Does Not Have Access to the IRS's Measures for Evaluating the Effectiveness of the EITC Return Preparer Strategy*, *infra*.

14 IRS response to TAS information request (June 24, 2015).

15 *Id*.

16 WIRA, *Fiscal Year 2015 EITC Return Preparer Analysis Summary* 2 (June 15, 2015).

17 IRS, Refundable Credits Administration Return Integrity and Compliance Services, *Overview of EITC Return Preparer Program* 3 (May 7, 2015).

18 *Id*.

19 IRS response to TAS information request (June 24, 2015).

- *Injunctions against paid preparers* – the Department of Justice (DOJ) may seek an injunction against a preparer, which prevents that individual from "engaging in specified misconduct or from preparing tax returns for others."[20]

For the purpose of the EITC Return Preparer Strategy, an EITC preparer is a return preparer who files 25 or more EITC returns.[21] All preparers who meet this definition are scored. Based on this score, the preparer may receive a compliance treatment.[22] Allocation of resources and geographical limitations are also considered when determining treatments.[23]

Reaching Out to Paid Tax Preparers by Letter

Figure 1.24.1 shows the types and number of letters sent to preparers for FYs 2013 through 2015.

FIGURE 1.24.1, Pre-Filing and Filing Season Education and Compliance Letters for FYs 2013–2015[24]

Letter Number	Type	FY 2013	FY 2014	FY 2015
Pre-Filing				
4833	Compliance	10,673	10,892	7,261
4833-A	Educational	n/a	n/a	8,473
5138	Compliance	n/a	n/a	1,734
5025-C	Educational	985	2,856	479
5025-D	Educational	n/a	1,351	572
5025 (no alpha)	Educational	966	994	644
5025-Q	Educational	953	522	2,182
Filing				
4858	Compliance	1,866	2,272	3,796
5138	Compliance	736	867	1,015
5364/Alert	Missing Form 8867 Letter & e-File Alert	6,667	6,526	15,935
Total Number Sent		**22,846**	**26,280**	**42,091**

Pre-filing season letters are sent to preparers who prepared questionable EITC returns during the previous year. Filing season letters are sent to preparers whose due diligence compliance does not improve while the filing season is underway.[25] Preparers who do not receive their pre-filing season letter because it was

20 See Dep't of Justice, *Program to Shut Down Schemes and Scams*, *available at* http://www.justice.gov/tax/injunctions.htm. The DOJ can also pursue criminal prosecution. Since this is not an area worked by the EITC Preparer Strategy, it will not be covered in this discussion.

21 This amount is through cycle 26 of the current tax year. An EITC return is defined as a tax return "with at least one dollar claimed and/or received in EITC based on at least one qualifying child for a tax year." IRS response to TAS information request (June 24, 2015).

22 IRS response to TAS information request (June 24, 2015).

23 *Id*. By limiting compliance treatments only to preparers who prepare 25 or more returns, the pool of preparers who do not sign returns will not receive a compliance treatment, an issue discussed in more detail below.

24 IRS response to TAS information requests (June 24, 2015 and Oct. 26, 2015).

25 IRS response to TAS information request (June 24, 2015).

undeliverable, will receive a follow up phone call.[26] Undelivered letters do pose a problem for an effective treatment. In FY 2012, the non-delivery rate for Letter 4833 was 24 percent and the rate rose to 36 percent in FY 2014.[27] The Strategy has attempted to resolve this by recommending such things as the use of an internal database to reduce outdated addresses and sending uncertified letters.[28]

When developing educational and compliance letters, the IRS should look to the concept of "responsive regulation," which is explained by Australian researcher Valerie Braithwaite to mean that regulators, such as the IRS, should be "responsive to the conduct of those they seek to regulate in deciding whether a more or less interventionist response is required."

Currently, the EITC Return Preparer Strategy intends to use educational letters to inform less egregious preparers of due diligence requirements and possible consequences of filing inaccurate EITC returns.[29] Compliance letters are intended to emphasize the penalty and consequences that may result from returns with EITC errors.[30] There are opportunities to make these letters more effective, as described in more detail below.

When developing educational and compliance letters, the IRS should look to the concept of "responsive regulation," which is explained by Australian researcher Valerie Braithwaite to mean that regulators, such as the IRS, should be "responsive to the conduct of those they seek to regulate in deciding whether a more or less interventionist response is required."[31] Braithwaite uses a "regulatory pyramid" that includes the least intrusive actions at the bottom and most intrusive at the top.[32] The idea is that taxpayers generally will comply at the least intrusive step but if not, more intrusive actions can be taken. Applying this theory to the Strategy's current letters demonstrates some deficiencies.

For instance, Letter 4858, *Return Preparer Filing Season - 2015*, a compliance letter, informs preparers that a review of current year returns filed by the preparer "indicates you may have prepared inaccurate returns for your clients," but does not provide information on the exact nature of the errors being made by the preparer, thus limiting its effectiveness in getting preparers to avoid these errors in the future.[33] There is no reason why "compliance" letters should not be educational. In fact, to get preparers to modify their behavior, the letter should inform the preparer of the errors they are making.

The 5025 series of letters informs the preparer of the reason for noncompliance in a very general manner. If the primary issue identified is questionable income and expenses on Schedule C, *Profit or Loss from Business*, the preparer may receive Letter 5025-C, *You May Have Prepared Inaccurate EITC Returns with Self-Employment Income*. When the primary issue identified involves claiming children who are permanently or totally disabled, the preparer may receive Letter 5025-D, *You May Have Violated Tax Law By Preparing Inaccurate EITC Returns*. If the primary issue is claiming qualifying children, the preparer may receive Letter 5025-Q, *You May Have Prepared Inaccurate EITC Returns Based on Questionable Qualifying*

26 IRS, Refundable Credits Administration Return Integrity and Compliance Services, *Overview of EITC Return Preparer Program* 3 (May 7, 2015).

27 WIRA, *Fiscal Year 2014 EITC Return Preparer Analysis Summary* 29 (June 20, 2014). The primary reasons for being undeliverable include the letter being unclaimed and the address being outdated. *Id.*

28 *Id.* at 30.

29 IRS response to TAS information request (Nov. 5, 2015).

30 *Id.*

31 Valerie Braithwaite, *Responsive Regulation and Taxation: Introduction*, 29 Law & Pol'y 3, 4 (Jan. 2007).

32 *Id.*

33 IRS, Letter 4858, *Return Preparer Filing Season – 2015* (Nov. 2015).

The lack of distinction between educational and compliance letters indicates the IRS does not have a comprehensive strategy with respect to letters. In most instances the IRS has not designed the letters to make clear what behavior the preparer should change going forward. It also has not designed the letters so that successive letters make clear to the preparer that the stakes for noncompliance are being raised.

Children. However, the preparer will not learn what particular error he or she is making.

There also appears to be little difference between compliance and educational letters. Without a clear distinction between education and compliance, preparers may not realize they are receiving a communication meant to ramp up their regulation (and consequences). For instance, Letter 4833 was the "compliance" letter most frequently mailed during the pre-filing season in FY 2015. The language in Letter 4833 is similar in many aspects to Letter 4833-A, which was the primary "educational" letter sent during the filing season in FY 2015. The opening section of both letters informs the preparer that the IRS has reviewed returns they prepared and the review "indicates you may have prepared inaccurate returns for your clients. Intentionally disregarding EITC tax laws could result in penalties and other consequences for you as the paid preparer and for your clients." Letter 4833-A, the educational letter, contains additional information to explain to the preparer that if inaccurate returns continue to be prepared, the preparer may face a penalty or an audit and his or her clients could face repercussions.

Figures 1.24.2 and 1.24.3 compare the language in Letters 4833 and 4833-A.

FIGURE 1.24.2[34]

IRS Letter 4833, *EITC Return Preparer Pre-Filing Season Alert,* page 1 and Letter 4833-A, *EITC Tax Return Preparer Alert*, page 1

Department of the Treasury
Internal Revenue Service
NDC/EITC
1201 N. Mitsubishi Motorway
Bloomington, IL 61705

Date:
12/21/2015
Contact telephone number:
855-379-0440 (toll free)

Dear [Name]:

Our review of the 2013 tax returns you prepared that claimed the Earned Income Tax Credit (EITC) indicates you may have prepared inaccurate returns for your clients. Intentionally disregarding EITC tax law could result in penalties and other consequences for you as the paid preparer and for your clients.

Paid return preparers' responsibilities
- Know the tax law
- Inform clients of EITC requirements so you can determine if the taxpayer qualifies for the EITC
- Meet all four due diligence requirements before preparing an EITC claim for a taxpayer
  - Complete Form 8867, *Paid Preparer's Earned Income Credit Checklist*, and submit it with every EITC return you prepare
  - Complete an EITC worksheet
  - Question the taxpayer if any information appears to be incorrect, inconsistent or incomplete and document your questions and the taxpayers' responses
  - Keep all required records

Paid return preparers who prepare inaccurate EITC returns
Preparers who don't meet due diligence requirements on EITC returns face a penalty of $500 per return.

Additional information on EITC requirements including EITC due diligence
- Review the enclosed Publication 4687, *EITC Due Diligence*
- Visit our website at **www.eitc.irs.gov/rptoolkit/main/**
- Call the toll-free number listed at the top of this letter
- Visit **www.eitc.irs.gov/EITCCentral/SP_L4833.doc** to view this letter in Spanish

Letter 4833 (Rev. 8-2014)
Catalog Number 58627F

Department of the Treasury
Internal Revenue Service
Wage & Investment - NDC/EITC
1201 North Mitsubishi Motorway
Bloomington, IL 61705

Date:

Contact us by e-mail at:
wi.eitcpreparerletterresponse@irs.gov
Preparer ID number:

Dear [Name]:

Our review of your 2014 tax year returns claiming the earned income tax credit (EITC) indicates you may have prepared inaccurate returns for your clients. Intentionally disregarding EITC tax laws could result in penalties and other consequences for you as the paid preparer and for your clients.

Paid preparers must:
- Know the tax laws.
- Inform clients of EITC requirements to determine if each qualifies for the EITC.
- Interview clients every year, as their circumstances may change and you must use current information when determining eligibility for, and the amount of, EITC.
- Not rely on tax return preparation software; it is only a guidance tool, not a substitute for knowledge of the tax law.
- Meet your four due diligence requirements when preparing an EITC claim:
  1. Complete Form 8867, *Paid Preparer's Earned Income Credit Checklist,* and submit it with every EITC return you prepare.
  2. Complete an EITC worksheet, or its equivalent, showing how you computed the EITC.
  3. Question the client if any information appears to be incorrect, inconsistent, or incomplete and document your questions and the client's responses. Failure to adequately question the client and document the responses is the most common reason we assess penalties.
  4. Keep all required records, including copies of any documents you relied upon to determine eligibility for, or the amount of, EITC.

Paid preparers who prepare inaccurate EITC returns:
- May face $500 penalty per return if they can't prove they met their EITC due diligence requirements.
- May receive a due diligence audit; have your and/or your firm's e-filing privileges suspended or terminated; or may be referred to the Department of Justice or IRS Criminal Investigation.

Letter 4833-A (Rev. 9-2015)
Catalog Number 67183W

34 IRS, Letter 4833, *EITC Return Preparer Pre-Filing Season Alert* (Aug. 2014); IRS, Letter 4833-A, *EITC Tax Return Preparer Alert* (Sept. 2015).

FIGURE 1.24.3[35]

IRS Letter 4833, *EITC Return Preparer Pre-Filing Season Alert*, page 2 and Letter 4833-A, *EITC Tax Return Preparer Alert*, page 2

We will continue to monitor the EITC returns you prepare. If the accuracy of these EITC returns does not improve, you may be subject to special follow-up procedures, including the possibility of an on-site audit.

Thank you for your cooperation.

Sincerely,

Michael C. Beebe
Deputy Director
Return Integrity & Compliance Services

Enclosures:
Publication 4687

Letter 4833 (Rev. 8-2014)
Catalog Number 58627F

Your clients:

- May be audited after we issue their refunds. If we determine your clients don't qualify for the EITC, they must repay the overpayments, plus interest.
- May be unable to claim the EITC for 2 years if the claim was due to reckless or intentional disregard of the EITC rules, or 10 years if the claim was due to fraud.

For additional information:

- Review Publication 4687, *EITC Due Diligence Brochure,* at www.irs.gov/formspubs.
- Visit our website at www.eitc.irs.gov and click on "Tax Preparer Toolkit."
- Visite www.eitc.irs.gov e ingrese las palabras claves "Letter 4833-A(SP)" para leer esta carta en español.

We will continue to monitor future EITC returns you prepare to ensure you're meeting your EITC due diligence requirements.

This letter is for your information only. You don't need to respond.

If you have questions, you can contact us via e-mail at the address listed above. For security purposes, don't include any client information if you contact us by e-mail. Include your telephone number and the hours we can reach.

Please note that we're unable to provide you with the specific returns that appear to be questionable.

Sincerely,

Steven C. Klingel
Director, Refundable Credits
Policy & Program Management

Letter 4833-A (Rev. 9-2015)
Catalog Number 67183W

35 IRS, Letter 4833, *EITC Return Preparer Pre-Filing Season Alert* (Aug. 2014); IRS, Letter 4833-A, *EITC Tax Return Preparer Alert* (Sept. 2015).

In order for this correspondence stage of the EITC Return Preparer Strategy to be effective, there should be a distinct difference when the preparer receives a compliance letter after receiving an educational letter. Letter 5138, a compliance letter, comes closest to accomplishing this goal. It informs the preparer that some of their clients are being audited for their EITC claims and reminds the preparer that "failure to comply with the due diligence requirements when preparing client returns for EITC claims can adversely affect you and your clients."[36]

Letter 5364 is not categorized as either educational or compliance. This letter informs the preparer that he or she failed to attach Form 8867, *Paid Preparer's Earned Income Credit Checklist*, and may be subject to penalties and other actions.[37] Most importantly, it provides the preparer with a list of incomplete returns. Thus, the letter warns the taxpayer of *specific* consequences for failing to comply with his or her *specific* obligations under the law, and alerts the preparer to *specific* returns the IRS considers incomplete. This gives the preparer clear information with which to modify behavior; moreover, failure to modify behavior in the face of such information and warning is a good indicator that the preparer is negligent. This would set up the next stage of the compliance strategy, namely Due Diligence penalties. However, it will only be effective if the IRS follows up with those preparers who ignore the letter.

The lack of distinction between educational and compliance letters indicates the IRS does not have a comprehensive strategy with respect to letters. In most instances the IRS has not designed the letters to make clear what behavior the preparer should change going forward. It also has not designed the letters so that successive letters make clear to the preparer that the stakes for noncompliance are being raised.

As described above, the IRS will send a pre-filing season letter to a preparer based on the previous year's returns.[38] Additional letters are sent if the preparer does not improve.[39] It was not possible for TAS to determine precisely how the IRS determined which letters would be sent each year. TAS assumes a process is in place since the approach taken between FYs 2013 and 2015 has changed. A TAS review of unpublished EITC Return Preparer Strategy reports shows that the Strategy does conduct reviews that cover distinct issues related to various letters. However, TAS has not been able to locate a year-to-year review of the effectiveness of all letters, or any analysis of whether single letters or a sequence of letters are more or less effective in improving EITC compliance. Without such an analysis, it is impossible to determine the effectiveness of the IRS's EITC letter strategy.

Due Diligence Requirements

Congress has recognized the role that paid preparers play in EITC compliance by imposing a penalty on preparers if they fail to comply with due diligence requirements.[40] IRC § 6695(g) provides that any tax return preparer who files a return or claim of refund involving the EITC and who fails to comply with due diligence requirements, will be liable for a penalty of $500 for each failure.[41] To meet the due diligence requirements, the preparer must complete Form 8867, *Paid Preparer's Earned Income Credit*

36 IRS, Letter 5138, *Return Preparer EITC Client Audit Notification* (Sept. 2015).

37 IRS, Letter 5364, *Warning to EITC Return Preparers - Missing Forms 8867* (Dec. 2015).

38 IRS response to TAS information request (June 24, 2015).

39 *Id*.

40 IRC § 6695(g). This duty also extends to determining the correct amount of credit allowed. *Id*. Recently, a law was enacted which would require the IRS to conduct a study of the effectiveness of the return preparer due diligence requirements on EITC claims (in addition to Child Tax Credit and American Opportunity tax credit claims). Consolidated Appropriations Act, 2016, Pub. L. No. 114-113 § 207 (2015).

41 The United States-Korea Free Trade Agreement Implementation Act, Pub. L. No. 112–41, § 501, 125 Stat. 428, amended IRC § 6695(g) by increasing the amount of the penalty from $100 to $500 for returns filed after December 31, 2011.

Checklist, and include it with the return.[42] The form is to be completed based on information provided by the taxpayer or "otherwise reasonably obtained" by the preparer.[43] TAS first recommended requiring a signed Form 8867 be attached to each tax return back in 2003.[44] The IRS finally adopted this recommendation for tax returns filed after December 31, 2011.[45]

To meet the knowledge requirement on Form 8867, the preparer must attest that he or she did not know or have reason to know that any information he or she relied on to determine eligibility for the EITC (and the amount of credit) is incorrect. The preparer is instructed to not ignore implications of any information provided and to ask questions if any of the information provided seems to be "incorrect, inconsistent, or incomplete."[46]

"Knock and Talk" Visits

A more advanced treatment for noncompliance attributable to a return preparer is the "knock and talk" visit. This treatment consists of an educational visit by a team made up of a revenue agent and a criminal investigator.[47] During these visits the IRS employees discuss EITC laws and due diligence requirements.[48] As shown in figure 1.24.4, the number of Knock and Talk visits has decreased from 109 in FY 2013 to 94 in FY 2015.

FIGURE 1.24.4, EITC Preparer Compliance Treatments, FY 2013–2015[49]

	FY 2013	FY 2014	FY 2015
Preparer Penalty Cases			
Due Diligence Audits	734	601	815
Missing Form 8867	771	224	130
Number of Returns Resulting in Proposed Preparer Penalties			
Due Diligence Audits	35,886	51,034	62,914
Missing Form 8867	26,655	5,688	4,191
KTV and DDV Conducted			
Due Diligence Audits	867	736	956
Knock and Talk Visits	109	96	94

Audits of Preparer Due Diligence

As mentioned above, IRC § 6695(g) provides that any tax return preparer who files a return or claim of refund involving the EITC and who fails to comply with due diligence requirements, will be liable for a

42 Treas. Reg. § 1.6695-2.

43 *Id.*

44 National Taxpayer Advocate 2003 Annual Report to Congress 272. *See also* National Taxpayer Advocate 2009 Annual Report to Congress 56.

45 Treas. Reg. §§ 1.6695-2(b)(1) and 1.6695-2(e).

46 IRS Form 8867, *Paid Preparer's Earned Income Credit Checklist* 3 (2013).

47 IRS, Refundable Credits Administration Return Integrity and Compliance Services, *Overview of EITC Return Preparer Program* 3 (May 7, 2015).

48 *Id.*

49 IRS response to TAS information requests (June 24, 2015 and Oct. 26, 2015).

penalty of $500 for each failure. Beginning in FY 2013, the IRS also began proposing penalties for EITC returns submitted without Form 8867, *Paid Preparer's Earned Income Credit Checklist*.[50]

The EITC Return Preparer Strategy includes audits on preparers' adherence to due diligence requirements. When the examiner determines that the preparer did not comply with the due diligence requirements, the due diligence penalty is assessed.[51] Figure 1.24.4 shows that the number of returns resulting in a proposed penalty has increased from 35,886 in FY 2013 to 62,914 in FY 2015.

The Treasury Inspector General for Tax Administration (TIGTA) conducted a review of due diligence audits in 2010. Its findings highlighted several areas for improvement, including inadequate case documentation and potentially ineffective reviews by group managers.[52] The IRS reports that case reviews are conducted annually to identify areas of improvement and training materials are revised to address problem areas.[53] One example is training material for SB/SE examiners covering EITC due diligence visits, which emphasized the need for adequate workpapers to support the conclusions in the case.[54]

When compared to Knock and Talk visits, a due diligence audit is more burdensome for both the IRS and the preparer. According to the idea of "responsive regulation," the Strategy generally should apply the less burdensome approach first. However, the Strategy has reduced the amount of Knock and Talk visits while increasing due diligence audits. An internal review of the Strategy's annual reports shows that the IRS annually tracks the "effectiveness" of each treatment. However, as discussed in more detail below, the IRS's measures of "effectiveness" may not be the best ones for tracking preparer compliance. Before the Strategy decides to forego a less intensive form of treatment, it should fully study long term preparer compliance associated with each treatment to ensure it is efficiently achieving a change in preparer behavior.

Tracking EITC Return Preparer Improvement After Treatment

The EITC Return Preparer Strategy maintains a database of every preparer who has received a treatment (or attempted treatment) since FY 2012.[55] The progress of individual preparers does not appear to be the emphasis when measuring the change in tax return preparer behavior. In order to quantify the benefit of treatments, WIRA applies the same four criteria used in the scoring process.[56] WIRA compares the change in performance of a control group with that of the treated preparers from one filing season to the next.[57] The difference in the year-to-year change in performance between the two groups is attributed to the treatments.[58] This analysis is conducted on each treatment type to determine its effectiveness.[59]

One concern with this approach is that once in the treatment system, not all preparers continue to be tracked. While the EITC Return Preparer Strategy maintains that it monitors all preparers who receive treatment, this monitoring only applies if the preparer continues to show up as a preparer. An

50 IRS response to TAS information request (June 24, 2015).

51 Preparers have the right to appeal a proposed penalty assessment. IRM 20.1.6.19.1, *Pre-Assessment Appeal Rights—IRC 6694, IRC 6695, IRC 6707A, and IRC 6713* (May 16, 2012). Between TYs 2008 and 2013, Appeals abated approximately $1.7 million in penalty assessments. IRS response to TAS information request (Dec. 2, 2015).

52 TIGTA, Ref. No. 2010-40-116, *Actions Can Be Taken to Improve the Identification of Tax Return Preparers Who Submit Improper Earned Income Tax Credit Claims* 10 (Sept. 14, 2010).

53 IRS response to TAS information request (June 24, 2015).

54 IRS response to TAS information request (Oct. 21, 2015).

55 *Id.*

56 *Id.*

57 The control group is randomly assigned amongst the preparers in each treatment stream. *Id.*

58 *Id.*

59 *Id.*

unscrupulous preparer may "go underground" once they receive a high level of treatment. Such a preparer would no longer be tracked by the EITC Return Preparer Strategy. While it may be resource intensive, the EITC Return Preparer Strategy should continue to track all preparers who have received treatment while introducing new preparers each year. As discussed in more detail below, the EITC Return Preparer Strategy should not just focus its measure of success on return on investment and dollars saved, but actual long term improvement in preparer compliance.

Given the Stagnant EITC Improper Payment Rate, Several Areas of the EITC Return Preparer Strategy Can Be Revised to Improve Its Effectiveness

As mentioned above, the percentage of EITC improper payments remains practically unchanged over the last decade.[60] The current improper payment rate of 27 percent has increased slightly from the improper rate in 2004, which measured 25 percent.[61] Based on a review of the existing EITC Return Preparer Strategy, the National Taxpayer Advocate has identified several concerns discussed in detail below.

Preparers Who Do Not Sign the Returns and Preparers Who Are the Subject of Complaints to the IRS Return Preparer Office Are Not Incorporated into the EITC Return Preparer Strategy

The EITC Return Preparer Strategy currently only reaches the pool of paid tax return preparers who prepare more than 25 EITC returns that contain errors.[62] Not all errors are committed by a known preparer. As Senate Finance Committee Chairman Wyden points out: "[i]n some egregious cases, preparers calculate a taxpayer's refund in person and skip the line that shows who did the work. Then, after the taxpayer leaves, the preparer falsifies the math to boost the refund, files the return, and pockets the difference."[63] In this situation, since the preparer did not sign the return, the preparer would not receive treatment through the EITC Return Preparer Strategy but might be discovered through a complaint by a taxpayer or other party (including IRS employees) to the IRS.

In FY 2014, the EITC Return Preparer Strategy identified 1,152 preparers misusing preparer identification.[64] [redacted]

60 For information on how the EITC audit process is not effectively reducing the improper payment rate, see Most Serious Problem: *Earned Income Tax Credit (EITC): The IRS Is Not Adequately Using the EITC Examination Process as an Educational Tool and Is Not Auditing Returns With the Greatest Indirect Potential for Improving EITC Compliance*, *supra*.

61 TIGTA, Ref. No. 2015-40-044, *Assessment of Internal Revenue Service Compliance With the Improper Payment Reporting Requirements in Fiscal Year 2014* 9 (Apr. 27, 2015). The lowest improper payment measurement was 23 percent, which occurred in 2012. *Id*.

62 IRS response to TAS information request (June 24, 2015).

63 *Protecting Taxpayers From Incompetent and Unethical Return Preparers, Hearing Before the S. Comm. on Fin.*, 113th Cong. 2 (2014) (statement of Ron Wyden, Chairman, Committee on Finance).

64 WIRA, *Fiscal Year 2014 EITC Return Preparer Analysis Summary* 2 (June 20, 2014).

65 [redacted] The IRS has identified the information discussed is this paragraph as "official use only" and therefore we are not at liberty to disclose it.

66 [redacted] The IRS has identified the information discussed in this paragraph as "official use only" and therefore we are not at liberty to disclose it.

In 2012, the RPO began sharing referrals with the ERCPC.[67] The ERCPC independently identified and treated only 37 percent of the referred preparers, finding that most did not meet the program's selection criteria.[68] Given limited resources, using referrals as a criterion for compliance treatment could be effective in identifying noncompliant preparers, particularly those who are operating invisibly and highly likely to be harming taxpayers. If someone, either a taxpayer, a preparer, or an internal IRS employee, refers a preparer, that should be a selection criterion heavily weighted for at least an education, if not compliance, treatment.

The Strategy currently is not equipped to address preparers who do not sign returns. [redacted] However, the Strategy is aware of the impact these preparers have on EITC noncompliance. In its 2014 annual report, the Strategy reported developing a systemic methodology to identify "ghost preparers" as part of its long term strategic plan.[70] The report stated that the effort required would be high but the potential impact would also be high.[71]

Given limited resources, using referrals as a criterion for compliance treatment could be effective in identifying noncompliant preparers, particularly those who are operating invisibly and highly likely to be harming taxpayers. If someone, either a taxpayer, a preparer, or an internal IRS employee, refers a preparer, that should be a selection criterion heavily weighted for at least an education, if not compliance, treatment.

A possible method for identifying ghost preparers is to track preparers after they fall off the radar and are no longer tracked. The EITC Return Preparer Strategy could obtain a preparer inventory listing, which shows every return prepared by a preparer, for the year before the preparer falls off the radar.[72] The EITC Return Preparer Strategy could review that list and compare it to some or all of the current year returns. If there is a pattern of similar mistakes on the current year returns, or if a large portion of the current taxpayers now appear to prepare their own returns, the EITC Return Preparer Strategy may want to interview the taxpayers to see who prepared their returns. If there is a trend with the new returns, it is possible that the preparer has gone underground.

The EITC Return Preparer Strategy could partner with SB/SE and its Return Preparer Program (RPP) to identify the preparers who fall off the radar.[73] Under the RPP, the IRS can create program action cases (PAC), which are "preparer investigations where clients of questionable preparers are examined to determine whether preparer penalties and/or injunctive actions against the preparers are warranted."[74] PACs are limited to "situations where information indicates a return preparer has engaged in a widespread practice of making material errors that demonstrates intentional misconduct or clear incompetence in preparing tax returns."[75] This type of situation would capture the

67 IRS response to TAS information request (June 24, 2015).

68 *Id.*

69 [redacted] The IRS has identified the information discussed in this paragraph as "official use only" and therefore we are not at liberty to disclose it.

70 WIRA, *Fiscal Year 2014 EITC Return Preparer Analysis Summary* 10 (June 20, 2014).

71 *Id.*

72 Return preparer coordinators have access to listings of returns prepared by preparers using an internal IRS database. Perhaps the EITC Return Preparer Strategy would have to partner with such coordinators to obtain this listing if they cannot obtain it on their own. IRM 20.1.6.6, *Program Action Cases Overview* (Sept. 10, 2013).

73 For information on the RPP, see IRM 4.1.10.1, *Overview of Return Preparer Program* (Jan. 14, 2011).

74 IRM 4.1.10.3, *Program Action Cases Overview (PAC)* (Jan. 14, 2011).

75 IRM 4.1.10.3(2) (Jan. 14, 2011).

actions of an unscrupulous EITC return preparer. In fact, the EITC Due Diligence program is already a priority for the RPP.[76]

The Public Does Not Have Access to the IRS's Measures for Evaluating the Effectiveness of the EITC Return Preparer Strategy

The ERCPC issues an annual report that evaluates the success of the EITC Return Preparer Strategy but these reports are not available for public inspection.[77] In fact, since the population of preparers receiving treatment constantly changes, the IRS looks at the return on investment of the program to measure success.[78] Return on investment (and therefore success of the program) is measured by the amount of EITC bad returns and dollars saved divided by the cost of treatment.[79] The cost of each treatment is easy to ascertain. However, as discussed below, the measurement for "bad" EITC returns and dollars saved may not be accurate. Since FY 2012, the EITC Return Preparer Strategy estimates it has protected $2.4 billion in EITC claims.[80] However, because there is no public report that discloses or describes the return on investment for the EITC Return Preparer Strategy, the public has no way of ascertaining the accuracy of IRS claims of success or the overall effectiveness of the IRS EITC Return Preparer Strategy. As discussed below, the IRS's methodology likely overstates the program's revenue protection amount.

…because there is no public report that discloses or describes the return on investment for the Earned Income Tax Credit (EITC) Return Preparer Strategy, the public has no way of ascertaining the accuracy of IRS claims of success or the overall effectiveness of the IRS EITC Return Preparer Strategy.

An erroneous EITC return is defined as a return that contains the same errors used in the scoring process.[81] If the return breaks one of the filters in the scoring process, it is deemed a "bad" return and any credit dollars attributed to it is considered revenue protected.[82] Thus, if a return is categorized as potentially erroneous, both the entire amount of EITC claimed as well as the entire amount of Child Tax Credit (CTC) and Additional Child Tax Credit (ACTC) claimed are identified as potentially erroneous.[83] However, these returns do not undergo an audit by the IRS prior to this designation. As a result, there may be instances where a return deemed erroneous is actually accurate or at least partially accurate. For instance, there could be a return where the taxpayer claimed a child who is not a qualifying child, but the taxpayer is still eligible for the childless EITC. Alternatively, the child could be a "qualifying relative" of the taxpayer, which could be determined by reviewing documentation in an audit.[84] There could also be an issue with identify theft that affected a taxpayer's initial eligibility.

76 IRM 4.1.10.1.2, *Return Preparer Program Priorities* (Jan. 14, 2011).

77 IRS response to TAS information request (June 24, 2015).

78 Minutes for meeting via telephone between TAS employees and IRS employees responsible for implementation of the EITC Return Preparer Strategy (Nov. 20, 2015) (on file with the National Taxpayer Advocate).

79 *Id*.

80 This amount does not include the additional revenue generated from audits and due diligence visits but does include money protected for Child Tax Credit and Additional Child Tax Credit claims. IRS response to TAS information request (June 2, 2015). Since FY 2012, the EITC Preparer Strategy has a total program value of $1.7 billion. IRS response to TAS information request (Oct. 20, 2015); IRS, *FY 2015 EITC Return Preparer Strategy Analysis Summary, Executive Summary* (June 2015).

81 IRS response to TAS information request (Oct. 21, 2015).

82 Minutes for meeting via telephone between TAS employees and IRS employees responsible for implementation of the EITC Return Preparer Strategy (Nov. 20, 2015) (on file with the National Taxpayer Advocate).

83 IRS response to TAS information request (Oct. 21, 2015).

84 For information on what constitutes a qualifying relative, *see* IRC § 152(d). In many aspects, the documentation needed to prove eligibility for qualifying relative status is similar to proving a qualifying child. IRM 4.19.14.5.6, *Personal Exemptions and Dependents* (Jan. 01, 2015).

To calculate dollars protected, the EITC Return Preparer Strategy compares the change in potentially erroneous dollars of the control group to the treated group from one year to the next.[85] The change between the two groups is considered a benefit of the treatments.[86] The EITC Return Preparer Strategy measures the impact for each treatment type separately.[87] A TAS review of internal EITC Return Preparer Strategy reports indicates that each treatment type is tracked annually to show its return on investment and the bad dollars saved attributed to it.

One way in which the EITC Return Preparer Strategy could improve its analysis is to adopt a consistent approach to each year's work. For instance, since FY 2012, the EITC Return Preparer Strategy has introduced new key questions to be answered and objectives each year.[88] Such an approach does not allow for a year-to-year comparison. It also does not require the EITC Return Preparer Strategy to focus on one consistent goal. Instead, the EITC Return Preparer Strategy should adopt a core set of questions and objectives that guide the process and introduce new topics as they are identified.

As described above, not all individual preparers are tracked each year. Some may not prepare 25 returns after receiving a treatment and as a result, they will not return to the test sample.[89] We believe the EITC Return Preparer Strategy should create a core set of preparers who are tracked over time and introduce new preparers as they are identified.

Last, the current measurements for success, which include dollars protected and the return on investment, may not be the best measure to capture an increase in preparer compliance. In particular, the basis for the calculation may not be accurate as not all returns deemed "potentially erroneous" are actually erroneous, or are only partially in error. Once this calculation is improved, it will make the return on investment measurement more accurate. An improved return on investment measurement in addition to long-term tracking of a core group of preparers will show a more accurate picture of preparer compliance and the impact of IRS "touches" on that compliance.

Thus far, the IRS has shared only basic information about the EITC Return Preparer Strategy with the public. Given the importance of the EITC and the large number of preparers contributing to EITC noncompliance, transparency is extremely important. The ERCPC unit should release the annual analysis for the EITC Return Preparer Strategy to the public, including the measures used to evaluate the effectiveness of the strategy.

The EITC Return Preparer Strategy Does Not Sufficiently Focus on the Unenrolled Preparer Populations, Which Combined With a Comprehensive Public Education Campaign, Is Critical to Improving EITC Noncompliance

The low income population is particularly vulnerable to unskilled and unethical preparers and as numerous studies have shown, these preparers operate in the areas and communities where low income persons

85 IRS response to TAS information request (Oct. 21, 2015).

86 *Id*. As an example, the Strategy calculated that the average preparer receiving a treatment improved $15,000 after treatment, whereas the average preparer in the control group improved by $5,000. So the impact of treatments is estimated to be $10,000 on average. The total impact of treatments is then calculated by multiplying the average savings by the number of preparers in the test group. *Id.*

87 *Id*.

88 WIRA, *Fiscal Year 2015 EITC Return Preparer Analysis Summary* 3 (June 15, 2015).

89 Derived from IRS response to TAS information request (June 24, 2015). The IRS reports that it will continue to monitor every preparer after they are initially identified. However, TAS is unable to ascertain what this monitoring entails.

reside.[90] The ERCPC data show that compared to attorneys and Certified Public Accountants (CPA), unenrolled preparers receive the vast majority of compliance treatments. Between FYs 2012 and 2015, an average of 94 percent of all due diligence audits were performed on unenrolled preparers while four percent of the due diligence audits were conducted on enrolled agents, 1.6 percent on CPAs, and less than one percent were performed on attorneys, as shown on Figure 1.24.5.[91] The IRS should determine if due diligence audits are the most effective way to address unenrolled preparers. Based on current analysis, the Strategy measures its effectiveness of each treatment on return on investment and dollars saved. As mentioned above, these measurements may be flawed. Given the unique characteristics of the unenrolled population, the Strategy should ensure that the due diligence audit is more effective than the less costly knock and talk visit.

FIGURE 1.24.5, Due Diligence Audits by Preparer Enrollment, FYs 2012–2015[92]

Fiscal Year	CPA	Attorney	Enrolled Agent	Unenrolled
2012	1.3%	0.0%	2.4%	96.3%
2013	2.2%	0.1%	5.7%	92.0%
2014	1.3%	0.0%	2.7%	96.0%
2015	1.8%	0.1%	4.8%	93.3%
Average	**1.7%**	**0.05%**	**3.9%**	**94.4%**

The EITC Return Preparer Strategy does not have a way to identify if a preparer is unenrolled and instead relies on the preparer to self-identify during EITC due diligence audits.[93] Since the EITC Return Preparer Strategy already coordinates with the RPO and RPO attends the Strategy meetings, RPO could share preparer types and geographical location with the Strategy, if the preparer is in the RPO database.[94] If the preparer is not in the RPO database, then by definition that preparer is an unenrolled preparer or not in compliance with the requirement to obtain a preparer tax identification number (PTIN).[95] Currently the Strategy receives complaints about preparers from RPO but only treats 37 percent of these referrals because "most of the referral complaints are for preparers who file less than 25 EITC returns, are for issues that cannot be addressed with our current compliance tools, or are sole complaints from a single taxpayer concerning his/her preparer."[96] If the Strategy is not going to incorporate all of these referrals into its treatment cycle, it could at least glean information about the unenrolled population from the referrals.

Since the EITC Return Preparer Strategy cannot identify unenrolled preparers on its own, it offers information on due diligence requirements in the form of presentations and webinars and on social media to enrolled and unenrolled agents alike.[97] Sharing educational information is a good start, however,

90 For a chilling inventory of studies showing the predatory practices and abuses in this area, see Brief of Amici Curiae, National Consumer Law Center and National Community Tax Coalition in Support of Defendants-Appellants, *Loving v. Internal Revenue Service*, No. 13-5061 (D.C. Cir. 2014.)

91 IRS response to TAS information request (June 24, 2015).

92 IRS response to TAS information requests (June 24, 2015 and Oct. 26, 2015).

93 IRS response to TAS information request (Oct. 21, 2015).

94 IRS response to TAS information request (June 24, 2015).

95 Unenrolled preparers may wish to "voluntarily increase their knowledge and improve their filing season competency." They can do this by taking 18 hours of continuing education, obtaining a PTIN, and agreeing to certain terms of Circular 230, *Regulations Governing Practice before the Internal Revenue Service*. IRS, *General Requirements*, *available at* https://www.irs.gov/Tax-Professionals/General-Requirements-for-the-Annual-Filing-Season-Program-Record-of-Completion.

96 IRS response to TAS information request (June 24, 2015).

97 *Id.*

a tailored approach that directly focuses on unscrupulous unenrolled preparers in the neighborhoods where they operate and where the potential victims reside, is essential to improving EITC compliance. For instance, when the RPO office shares individual complaints received from a single taxpayer with the EITC Return Preparer Strategy, these referrals do not become part of the treatment stream. However, the referrals could be investigated to learn more about where the unenrolled preparers concentrate their work. More compliance-driven educational material could be provided in these areas specifically to target unenrolled preparers. This material would focus on the consequences of disregarding due diligence requirements and filing bad returns, up to and including prosecution. This could be done by using preparer information provided in the referrals from RPO. The EITC Return Preparer Strategy could also partner with the LITC program and consumer rights groups to gain a better understanding of how these preparers operate.

In 2015, the IRS announced an online public directory of tax return preparers, which taxpayers can search to find a preparer with specific credentials or qualifications, including attorneys, CPAs, enrolled agents, and those who have taken the voluntary annual IRS filing season training.[98] Unenrolled preparers are not included in this database, but use of this directory should be advertised in the neighborhoods where unenrolled preparers practice to empower taxpayers to make educated decisions. Since 2002, TAS has recommended that taxpayer outreach be part of the EITC compliance strategy.[99] Presumably, many improper payments could have been saved if the IRS had followed through with this recommendation in 2002 to educate taxpayers. In 2002, TAS also proposed a legislative recommendation to allow Congressional authority and funding for "an extensive public awareness campaign" targeted at taxpayers.[100] The marketing campaign would include a simple message to inform taxpayers about the preparer registration process so that taxpayers could make educated decisions.

The marketing campaign could use internal information that the Strategy has based on referrals to target the message to certain geographic areas. The campaign should also utilize partners, such as LITCs, Volunteer Income Tax Assistance (VITA) programs, and local organizations providing services to the affected taxpayer populations.[101] The partners would help to develop the outreach as well as to deliver the information to a target audience. The information should include information on the due diligence requirements, so that taxpayers know what to expect when they visit a preparer. It should also include information on how to figure out if the preparer is reputable.

A public education component to the EITC Preparer Strategy would empower taxpayers to avoid some of the problematic preparers upfront. For instance, TAS created a poster and pamphlet in 2013 to educate taxpayers who rely on preparers.[102] By helping the taxpayer be an educated consumer, the public information campaign could reduce the amount of EITC noncompliance, while also decreasing costs associated with compliance treatments and resolving erroneous refunds.

98 IRS, IR-2015-22, *IRS Launches Directory of Federal Tax Return Preparers; Online Tool Offers New Option to Help Taxpayers*, *available at* http://www.irs.gov/uac/Newsroom/IRS-Launches-Directory-of-Federal-Tax-Return-Preparers (last visited Sept. 30, 2015).

99 National Taxpayer Advocate 2002 Annual Report to Congress 73.

100 *Id.* at 229.

101 For example, CA$H is a collaboration of ten state coalitions, made up of more than 50 non- and for-profit partners with the goal of helping low-to moderate income people "make the most of their money." For more information, see CA$H Maine, *About CA$H*, http://www.cashmaine.org/about (last visited Sept. 15, 2015).

102 TAS, Publication 5074, *Protect Your Tax Refund* (2013); TAS, Publication 5074-A, *Protect Your Tax Refund* (Mar. 2015). For more information on this educational material, *see* National Taxpayer Advocate 2013 Annual Report to Congress 70-71.

The EITC Preparer Strategy Does Not Collaborate With TAS

The Strategy benefits from many IRS partners and stakeholders. For instance, ERCPC is the owner and primary driver of the EITC Return Preparer Strategy, but collaborates with communication functions, research, and counsel.[103] TAS is listed as a stakeholder, however, the only time TAS was invited to participate in the EITC Return Preparer Strategy was a phone call in December 2013.

The IRS does not currently include TAS in planning for its EITC Return Preparer Strategy. However, the National Taxpayer Advocate has dedicated many resources to studying problems associated with the EITC and proposing solutions.[104] The National Taxpayer Advocate has also testified before Congress numerous times to highlight issues related to the EITC.[105] EITC cases consistently rank in the top ten of all TAS case receipts.[106] Last, the National Taxpayer Advocate also administers the LITC program, which provides legal representation in numerous EITC cases.[107] The LITCs see firsthand the problems taxpayers experience with preparers, often before the issues surface with the IRS. Given TAS's extensive knowledge, research, and affiliations, TAS should be involved in the IRS's EITC Return Preparer Strategy from the start, as well as to fine tune its focus and to develop quantifiable measures of strategy effectiveness.

CONCLUSION

The National Taxpayer Advocate commends ERCPC for its efforts to address the role that preparers play in EITC errors. However, the IRS is not effectively using the resources at its disposal, such as collaborating with TAS, other internal and external stakeholders and partners, and using referrals made about problematic preparers. Additionally, a creative and targeted outreach to unenrolled preparers and a comprehensive education campaign for taxpayers, including both localized campaigns targeted at areas where ghost or otherwise noncompliant preparers are operating, and nationwide public service advertisements, could augment the online public directory of tax return preparers. Success of the campaign would be measured not just by a reduction in bad returns and consideration of return on investment, but it would consider what types of errors are occurring by certain geographic areas. The strategy could focus efforts to study this over the longterm since sustained change in behavior for both preparers and taxpayers takes time.

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103 IRS response to TAS information request (June 24, 2015).

104 *See, e.g.*, National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 71-104 (*Study of Tax Court Cases In Which the IRS Conceded the Taxpayer was Entitled to Earned Income Tax Credit (EITC)*); National Taxpayer Advocate 2009 Annual Report to Congress vol. 2, 75-104 (*Running Social Programs Through the Tax System*); National Taxpayer Advocate 2007 Annual Report to Congress vol. 2, 94-117 (*IRS Earned Income Credit Audits—A Challenge to Taxpayers*); National Taxpayer Advocate 2004 Annual Report to Congress vol. 2, 1-80 (*Earned Income Tax Credit (EITC) Audit Reconsideration Study*).

105 *See, e.g.*, *Protecting Taxpayers From Incompetent and Unethical Return Preparers, Hearing Before the S. Comm. on Fin.*, 113th Cong. 7 (2014) (statement of Nina E. Olson, National Taxpayer Advocate); *The National Taxpayer Advocate's 2014 Annual Report To Congress, Hearing Before the Subcomm. on Government Operations of the H. Comm. on Oversight and Reform*, 114th Cong. 28 (2015) (statement of Nina E. Olson, National Taxpayer Advocate).

106 A review of TAS case receipts since FY 2010 shows that EITC cases ranked ninth in 2010 (11,198 cases), tenth in FY 2011 (8,729 cases), seventh in FY 2012 (7,441 cases), fourth in FY 2013 (11,980 cases), third in FY 2014 (13,450 cases), and fourth in FY 2015 (10,880 cases). Data obtained from TAMIS (Oct. 1, 2010; Oct. 1, 2011; Oct. 1, 2012; Oct. 1, 2013; Oct. 1, 2014; Oct. 1, 2015).

107 LITCs represent individuals with limited income or low income. *Low Income Taxpayer Clinics Program Report* (Dec. 2014). In 2014, EITC cases were 12 percent of the LITC caseload. LITC Program 2014 Year End Report.

RECOMMENDATIONS

The National Taxpayer Advocate recommends that the IRS:

1. Release the annual analysis for the EITC Return Preparer Strategy to the public, including the measures used to evaluate the effectiveness of the strategy.
2. Include TAS as a member of the EITC Return Preparer Strategy team.
3. In collaboration with TAS and other IRS functions, and based on this annual analysis, determine where to focus resources and how to measure success with a multiyear analysis.
4. Incorporate preparer referrals, both from internal and external sources, and preparers who misuse PTINs, as a selection criterion for compliance treatment in the EITC Return Preparer Strategy.
5. Use measures for evaluating the effectiveness of the strategy on an annual basis that are not limited to measuring protected dollars or return on investment, but also include a year-to-year analysis of the preparer's behavior following treatment.
6. Tailor outreach specifically to the unenrolled preparer population that addresses due diligence requirements and is presented where these preparers operate. This outreach should incorporate TV and radio as well as social media.
7. Conduct a creative, geographic-based public education campaign in conjunction with other internal and external stakeholders including public service advertisements, videos, and tweets in order to educate taxpayers on how to select a competent preparer, what the rules of due diligence require, and the consequences of using an unskilled or unscrupulous preparer, including identity theft. Different marketing approaches should be tested and studied to track EITC compliance over the years.

APPENDIX A, Letter 5025 Series

LETTER 5025, *You May Have Prepared Inaccurate EITC Returns With Questionable Qualifying Children and Self-Employment Income*

Department of the Treasury
Internal Revenue Service
Wage & Investment
NDC/EITC
1201 North Mitsubishi Motorway
Bloomington, IL 61705

Date:
10/28/2015
Contact us by e-mail at:
wi.eitcpreparerletterresponse@irs.gov
Preparer ID number:

You May Have Prepared Inaccurate EITC Returns with Questionable Qualifying Children and Self-Employment Income

Dear [Name]:

Our review of your 2014 tax year returns claiming the earned income tax credit (EITC) indicates you may have prepared inaccurate returns for your clients. Intentionally disregarding EITC tax law could result in penalties and other consequences for you as the paid preparer and your clients. The primary issues we identified on the tax year 2014 returns you prepared are:

- Qualifying children for the EITC who don't appear to meet the relationship, residency, age, and joint return requirements.
  - A permanently and totally disabled child is considered to meet the age requirement. A child is considered permanently and totally disabled for EITC if the child can't engage in any substantial gainful activity because of a physical or mental condition, and a doctor determined the condition has lasted or can be expected to last continuously for at least one year or can be expected to lead to death.
- Questionable income and expenses on Schedule C, *Profit or Loss from Business.*

EITC due diligence requirements for paid preparers:
As a paid preparer, you must take extra steps to ensure your EITC returns are complete and correct.

Paid preparers must:

- Know the tax laws.
- Inform clients of EITC eligibility requirements to determine if each client qualifies for the EITC.
- Interview clients every year as their circumstances may change and you must use current information when determining eligibility for, and the amount of, the EITC.
- Not rely on tax return preparation software; it is only a guidance tool, not a substitute for knowledge of the tax laws.
- Meet all four due diligence requirements when preparing an EITC claim:
  1. Complete Form 8867, *Paid Preparer's Earned Income Credit Checklist,* and submit it with every EITC return you prepare.
  2. Complete an EITC worksheet, or its equivalent, showing how you computed the EITC.

Letter 5025 (Rev. 9-2015)
Catalog Number 59926H

LETTER 5025C, *You May Have Prepared Inaccurate EITC Returns With Self-Employment Income*

Department of the Treasury
Internal Revenue Service
Wage & Investment - NDC/EITC
1201 North Mitsubishi Motorway
Bloomington, IL 61705

Date:

Contact us by e-mail at:
wi.eitcpreparerletterresponse@irs.gov
Preparer ID number:

You May Have Prepared Inaccurate EITC Returns with Self-Employment Income

Dear [Name]:

Our review of your 2014 tax year returns claiming the earned income tax credit (EITC) indicates you may have prepared inaccurate returns for your clients. Intentionally disregarding EITC tax law could result in penalties and other consequences for you as the paid preparer, and your clients. The primary issues we identified on the tax year 2014 returns you prepared are questionable income and expenses on Schedule C, *Profit or Loss from Business*.

EITC due diligence requirements for paid preparers:

As a paid preparer, you must take extra steps to ensure your EITC returns are complete and correct.

Paid preparers must:

- Know the tax laws.
- Inform clients of EITC requirements to determine if each qualifies for the EITC.
- Interview clients every year, as their circumstances may change and you must use current information when determining eligibility for, and the amount of, EITC.
- Not rely on tax return preparation software; it is only a guidance tool, not a substitute for knowledge of the tax law.
- Meet your four due diligence requirements when preparing an EITC claim:
  1. Complete Form 8867, *Paid Preparer's Earned Income Credit Checklist,* and submit it with every EITC return you prepare.
  2. Complete an EITC worksheet, or its equivalent, showing how you computed the EITC.
  3. Question the client if any information appears to be incorrect, inconsistent, or incomplete and document your questions and the client's responses. Failure to adequately question the client and document the responses is the most common reason we assess penalties.
  4. Keep all required records, including copies of any documents you relied upon to determine eligibility for, or the amount of, EITC.

Letter 5025-C (Rev. 9-2015)
Catalog Number 59927S

LETTER 5025D, *You May Have Violated Tax Law by Preparing Inaccurate EITC Returns*

Department of the Treasury
Internal Revenue Service
NDC/EITC
1201 North Mitsubishi Motorway
Bloomington, IL 61705

Date:
10/28/2015
To contact us toll free:
1-855-379-0440

You May Have Violated Tax Law
By Preparing Inaccurate EITC Returns

Dear [xxxxx]:

Our review of the Tax Year 2013 Earned Income Tax Credit (EITC) returns you prepared indicates you may have prepared inaccurate returns for your clients. Intentionally disregarding EITC tax law could result in penalties and other consequences for you as the paid preparer and your clients**.** The primary issues we identified on your TY 2013 returns is a high percentage of EITC returns that claim qualifying children who may not be permanently or totally disabled.

A child is considered permanently and totally disabled if both of the following apply:

- The child can't engage in any substantial gainful activity because of a physical or mental condition
- A doctor determines the condition has lasted or can be expected to last continuously for at least a year or can lead to death

If You Prepare Inaccurate EITC Returns

Your client may face:

- An audit during which we will hold his or her refund until we can determine EITC eligibility. We can also conduct an audit after we issue the refund. If we determine that your client doesn't qualify for EITC, he or she must repay any overpayment, plus interest.
- A ban for 2 or 10 years from claiming the EITC, if we determine your client's EITC claim was due to reckless or intentional disregard of the EITC rules or fraud

You may face:

- **A $500 penalty** for each failure to comply with EITC due diligence requirements (Section 6695(g) of the Internal Revenue Code)

Letter 5025-D (Rev. 8-2014)
Catalog Number 64087J

LETTER 5025Q, *You May Have Prepared Inaccurate EITC Returns Based on Questionable Qualifying Children*

Department of the Treasury
Internal Revenue Service
Wage & Investment - NDC/EITC
1201 North Mitsubishi Motorway
Bloomington, IL 61705

Date:

Contact us by e-mail at:
wi.eitcpreparerletterresponse@irs.gov
Preparer ID number:

You May Have Prepared Inaccurate EITC Returns Based on Questionable Qualifying Children

Dear [Name]:

Our review of your 2014 tax year returns claiming the earned income tax credit (EITC) indicates you may have prepared inaccurate returns for your clients. Intentionally disregarding EITC tax law could result in penalties and other consequences for you, as the paid preparer, and your clients.

The primary issues we identified are questionable qualifying children who may not meet the residency or relationship tests, and/or questionable qualifying children who may not be permanently and totally disabled.

- A child is a qualifying child if he or she meets the relationship, age, residency, and joint return tests.
- A permanently and totally disabled child is considered to meet the age requirement. A child is considered permanently and totally disabled for EITC if the child can't engage in any substantial gainful activity because of a physical or mental condition, and a doctor determined the condition has lasted or can be expected to last continuously for at least one year or can be expected to lead to death.

EITC due diligence requirements for paid preparers:

As a paid preparer, you must take extra steps to ensure your EITC returns are complete and correct.

Paid preparers must:

- Know the tax laws.
- Inform clients of EITC requirements to determine if each qualifies for the EITC.
- Interview clients every year, as their circumstances may change and you must use current information when determining eligibility for, and the amount of, EITC.
- Not rely on tax return preparation software; it is only a guidance tool, not a substitute for knowledge of the tax law.
- Meet your four due diligence requirements when preparing an EITC claim:
  1. Complete Form 8867, *Paid Preparer's Earned Income Credit Checklist,* and submit it with every EITC return you prepare.
  2. Complete an EITC worksheet, or its equivalent, showing how you computed the EITC.

Letter 5025-Q (Rev. 9-2015)
Catalog Number 59928D