THE CONSTITUTIONALITY OF THE INEVITABLE REGULATIONS OF ALL TAX RETURN PREPARERS

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Abstract

Complying with the labyrinthine federal tax code is a complicated business. Each year millions of Americans must present to the Internal Revenue Service (IRS) a sincere and accurate statement of their income, applicable deductions and exemptions, and the total tax owed or refund claimed. Failure to do so potentially results in stringent and expensive penalties. Thus, it is reasonable to expect that the professionals or other individuals who assist these millions of Americans in preparing their tax returns be knowledgeable, careful and honest. However, studies show that many tax return preparers are operating outside an acceptable standard of professional responsibility. Although the IRS maintains strict regulation of certain kinds of tax preparers *via* the famous "Circular 230," until recently a large industry of unregistered tax preparers has operated largely unrestricted. This paper examines the contextual evolution of the IRS's regulation of unregistered tax preparers, including its historical exercise of judicial and statutory remedies, the extension in 2011 of Circular 230's application to *all* tax return preparers and the objections to regulation raised by some unregistered tax preparers and their supporters. In light of the strong arguments in favor of regulation, this paper concludes that the IRS's ultimate regulation of all tax return preparers is basically inevitable.

INTRODUCTION

Collection of federal income taxes in the 21st century is far more complicated than it was when the United States first authorized Congress, through passage of the Sixteenth Amendment in 1913, to levy taxes on income "from whatever source derived…" (U.S. Const., amend. XVI). In the ensuing one hundred years the laws governing federal taxation have been clarified, expanded, modified and enhanced to eventually become the modern Internal Revenue Code (IRC) that is familiar, albeit sometimes vaguely, to almost all working adults in the US. The IRC today is notorious for being "hideously complex" (Olson, 2013). Thus, it is no wonder that most taxpayers in recent years have opted to pay a tax return preparer for assistance in preparing and filing their tax returns.

The frequent use of paid tax return preparers means that the paid preparer industry is now a very big business: the IRS recently estimated the total number of paid tax preparers assisting Americans to be between 900,000 and 1.2 million (Tolan, 2012). This number includes all the various types of paid tax preparers, including attorneys, Certified Public Accountants (CPA), enrolled agents, actuaries, as well as other paid preparers who are not otherwise certified or credentialed. The tax preparer industry serves a pressing public need by offering assistance to millions of individuals who otherwise would either make errors on their tax returns or not bother to file them at all. However, certain studies by both academics and government entities have shown that paid preparers do not always file returns that are accurate, complete or honest (Leviner & Richison, 2011; Government Accountability Office [GAO], 2006). The accidental and/or intentional errors made by paid tax preparers are costly to both the individual taxpayer, who might either incur a hefty penalty for underpayment or pay more taxes than they owe, and the government, which expends vast resources attempting to collect the full amount of taxes owed each year and essentially relies upon timely and accurate reporting of each taxpayer's obligations.

The importance of providing competent and ethical tax preparation assistance to a taxpayer has been recognized for quite some time by Congress and is reflected in the existence of several federal statutes and regulations that apply to all tax return preparers, who are defined generally as "any person who prepares for compensation, or who employs one or more persons to prepare for compensation, any return of tax…or claim for refund of tax…" (26 U.S.C. § 7701(a)(36)). However, these statutes and regulations merely create the lowest bar for conduct: violation by the tax return preparer is grounds for monetary sanctions and, in extreme cases, court ordered prohibition of certain conduct or from engaging in tax return preparation at all. The belief that more regulation is needed is apparent by the fact that attorneys, CPAs, enrolled agents, actuaries and certain other professionals certified by the IRS have long been subject to additional heightened standards of professionalism. These tax professionals are generally required to demonstrate an acceptable level of knowledge and skill as well as comply with myriad ethical rules that are implemented through the regulations of applicable self-governing bodies, such as the American Bar Association (ABA), the American Institute of Certified Public Accountants (AICPA) and the National Association of Enrolled Agents (Tolan, 2012). In addition, the Treasury Department imposes further standards of ethics and professionalism on these already highly regulated groups through the set of formal regulations, issued by the IRS, commonly known by tax professionals as "Circular 230" (31 C.F.R. § 10).

Until recently, however, one large group of paid tax return preparers has escaped any additional professional regulation. This group, which consists of paid preparers who are not trained as attorneys, CPAs, enrolled agents, actuaries or other IRS certified professionals, are known as unregistered preparers and are subject to neither the regulations of a self-governing industry group nor the IRS's regulations in Circular 230. The perceived disparity between the heightened regulation of certified and credentialed tax professionals and the large group of unregistered preparers has generated much discussion over the last several years with many prominent commentators advocating for more frequent and stricter regulation preparers (Cords, 2009; Olson, 2009; Tolan, 2012). These discussions, together with research conducted by the GAO, led to IRS's attempt in 2011 to amend Circular 230 to apply professional and ethical standards to *all* tax preparers and to provide a comprehensive administrative framework for regulating those previously unregulated preparers.

The IRS's implementation of the amended Circular 230 was a watershed moment in the evolution of the tax preparer industry—and the IRS's oversight of it. As is usual with monumental change, fierce opposition from some unregistered tax preparers (and their supporters) has arisen. Although opponents to the change present a compelling legal argument as to why the IRS's amendments to Circular 230 are legislatively improper, ultimately they will be unable to stop stricter regulation of the entire tax return preparer industry. This paper will illuminate the reasons why a permanent change in the regulation of all tax return preparers by the IRS is inevitable. Starting with a review of the research and findings that justify stricter regulations, this paper will analyze the IRS's historic methods of regulating unregistered tax preparers, its efforts to expand regulation through amendments to Circular 230 and the objections raised by opponents to stricter regulation of unregistered tax preparers. This paper will conclude with a discussion of the possible forms a permanent change in regulation of the tax return preparer industry will take.

The Case for Regulating Tax Preparers

In order to fully understand the effect tax returns have on the administration of the IRC, it is important to know about how the tax system basically works. US tax laws are enforced, and taxes are collected, through the "voluntary compliance" of individual taxpayers. This means the federal government relies upon each taxpayer to comply with their yearly obligation to file a tax return that truthfully states their income, any applicable deductions or exemptions and the final amount of the tax owed or refund claimed. Although modern data tracking allows the IRS to gather information about an individual's wages and investment income, most of the information needed to complete a tax return—such as applicability of certain deductions or exemptions, cash income amounts and eligibility for a variety of government benefits that are administered through the IRC—is exclusively held by the taxpayer (Olson, 2013). In the event a taxpayer owes taxes, again the onus is on them to timely remit the required amount to the IRS. As is well known, the IRS' primary enforcement mechanism against individual taxpayers who underreport, or do not report at all, the extent of their income is the infamous audit. But what is less well known is that the amount of individual tax returns being subjected to an audit each year is less than 8% (p. 773). Thus, a large majority of all filed tax returns, and their respective assessments of how much tax is owed, are accepted at face value.

The Gap in Compliance

Not surprisingly, some tax returns do not accurately or honestly state an individual taxpayer's tax liability, whether through a misstatement of the amount of income subject to tax or the provision of other false information involving a tax payer's eligibility for deductions or exemptions. In light of the low audit rate, it is obviously tricky to exactly determine the amount and extent of an individual taxpayer's misstatements on their tax return. Still, the IRS occasionally conducts extensive analyses of tax and financial data to generate an estimate of what is known in tax literature as the "tax gap" (www.irs.gov). Olson (2009) explains the tax gap in simple terms as "the difference between what the IRS things taxpayers owe and what taxpayers pay voluntarily and timely." While the IRS eventually collects a portion of the gross tax gap through enforcement and collection efforts, most of it remains forever unpaid (the amounts that are never collected are known as the "net tax gap"). By the IRS's most recent estimate (www.irs.gov), which is based on tax year 2006 liabilities, the net tax gap is a daunting $385 billion—more than half the amount of the bailout fund that was allocated by Congress for the rescue of troubled banks in 2009 (Lobdell, 2009). Based on the information collected the IRS also determined the vast majority of the 2006 tax gap was due to underreporting taxable income (84%) as opposed to not filing at all (6%) or underpaying amounts owed (10%).

The enormity of the amount of uncollected tax each year has caused many observers, as well as the GAO, to investigate the reasons underlying noncompliance in an effort to reveal ways to increase taxpayer compliance and close the tax gap. The results of research by academics and the government have shown precisely why all tax return preparers must be subject to increased regulation. The selected studies discussed here not only illuminate the relationship between tax preparers and the accuracy and honesty of tax returns, but also indicate that stricter regulation will likely lead to greater compliance.

Tax Return Preparers Make Errors and Are Sometimes Dishonest

Private researchers and government entities have both conducted investigative studies of the effect tax return preparers have on taxpayer compliance. Some of the most comprehensive research results can be found in a study reported by Leviner and Richison (2011), who stated in their paper their clear objective to "shed better light on tax preparers and their effect on the tax system…" (p. 53). The data Leviner and Richison examined consisted of information collected by the IRS from more than 3,000 income tax returns that were audited in 1999; the information included any changes made to the tax return following the audit, presumably after being confronted and/or penalized by the IRS. In the study, the existence of a post-audit change in certain tax return line item amounts—specifically, adjusted gross income, earned income tax credit (EITC) and total tax due—represented an error on the tax return (pp. 13-14, 20, 30). Leviner and Richison did not distinguish between inadvertent and intentional errors, but instead focused on (i) the incidence of errors attributable to distinct groups of tax preparers and (ii) the percent change from the original claimed amount, in other words, the size of the error (p. 16). The groups of tax preparers were categorized separately as CPAs and attorneys, enrolled agents, friends and relatives, free tax preparer services, individuals preparing their own tax returns and two groups of unregulated paid tax preparers, large national chains and all "other paid professional tax preparers." The incidence and size of the errors attributed to each category of tax preparers presented a general picture of taxpayer compliance for that year.

The distinction between the groups analyzed formed the basis of one of Leviner and Richison's core research question, which was "whether compliance differences exist among returns" filed by the different kinds of tax preparers (p. 6). Leviner and Richison considered each group together because of certain predictable characteristics that might affect the return's compliance. For example, CPAs and attorneys are able to more creatively construe tax laws and therefore could possibly lead to greater noncompliance. The two groups of unregulated tax preparers were further subdivided as separate categories because of another relevant distinction: large national chain preparers often provide their employees with internal training and standards (considered "self-regulation" by the authors), while the "other" group often consists of individuals and businesses that offer tax preparation services without any oversight whatsoever. What Leviner and Richison found was compelling: returns prepared by "other paid professional tax preparers" showed consistently higher incidences and sizes of error than all other groups (p. 42). Thus, the results not only answered their research question in the affirmative, they also showed that unregulated tax return preparers had the most significant effect on noncompliance. Interestingly, the results also showed that returns submitted by large national chain preparers generally did not contain higher incidences and sizes of error, and sometimes showed lower incidences and sizes of error than other formally regulated groups (such as CPA's, attorneys and enrolled agents). This led Leviner and Richison to their conclusion that regulation of preparers—even the minimum industry standard training such as that followed by large national chain preparers—will enhance taxpayer compliance (p. 46).

Unfortunately, despite their research results, Leviner and Richison may have been too optimistic regarding the supposed benefit of the self-regulating industry standards of large national chain preparers. In 2006, the GAO conducted a study that showed disturbing levels of errors made by certain (unnamed) commercial chain preparers located in several large metropolitan areas. Rather than a statistical analysis, the GAO conducted a live study by sending agents pretending to be legitimate taxpayers seeking assistance with preparing their tax return to visit more than a dozen outlets of the commercial preparers (p. 14). The results showed that every one of the prepared returns contained errors. While some of the errors seemed to arise from lack of knowledge and skill, many of them were advised to the agent-taxpayer. For example, in one situation the hypothetical taxpayer discussed her cash income amount with the preparer and was informed that she did not have to report it because the IRS does not know about cash income if it is not reported (p. 19).

The intentional and accidental documented errors variously affected both the taxpayer and the government: in 2 of the returns the taxpayer overpaid taxes by $1,500 (due to incorrect itemization of deductions) and in 5 others the taxpayer received an unwarranted refund of up to $2,000 (for example, due to failing to report business cash income, improperly claiming the EITC or taking improper deductions) (p. 1). Presenting the summary of the study's results, the GAO noted that many paid preparers "undoubtedly do their best" to provide their clients with tax returns that comply with all tax laws and accurately reflect income and applicable deductions or exemptions. However, the GAO ultimately concluded that the incidence of errors they encountered in their anonymous visits are probably occurring on a regular basis; therefore, it is a problem that must be addressed (p. 29).

Regulations Positively Affect Tax Return Preparation

On the other (and more positive) hand, several researchers have found that tax preparer conduct can be influenced towards greater compliance through imposing regulations. Hansen and White (2012) examined the impact on tax preparer conduct of certain statutory regulations enacted in 2007. Their method was to elicit over one hundred case studies from a variety of tax return preparers who were apprised about the newly enacted regulations and asked how they intended to handle their current clients' tax returns (pp. 137, 147).

The regulations subjected to review in Hansen and White's study—which affect all tax return preparers and operate as the minimum regulatory framework applicable to otherwise unregulated tax preparers—were amendments to the federal statutes mentioned above (and which will be further discussed below). The amended regulations included: (i) an increase in the amount of penalty charged when a tax preparer recommends the taxpayer take a tax position that is ultimately found by the IRS or a tax court to be unsupported by law and (ii) a change in the standard a tax preparer must follow (known as the "reporting standard") in order to avoid a penalty from a "realistic possibility" that the tax position will be sustained by the IRS or a tax court to a "more likely than not possibility" (pp. 140-141).

The study participants were each asked whether, in light of the increased penalty and the "more likely than not" standard, they would be willing to either recommend an aggressive tax position to their clients (defined as one that does not meet the requirements of the new reporting standard (p. 138)) or sign a tax return that contains an aggressive tax position (p. 147). Hansen and White weighed a variety of other influences on tax preparer conduct, such as the special relationship with loyal clients and the advocacy role tax preparers play, but their study basically found the regulatory changes enacted in 2007 led to a decrease in aggressiveness evidenced by the participating tax preparers' decreasing willingness to sign a tax return containing an aggressive tax position and increasing willingness to comply with the heightened reporting standard (pp. 158-159). In other words, the regulations effected a change on the tax preparers' decision-making in the exercise of their professional duties.

Bolt-Lee and Moody (2009) reached a similar conclusion when they explored the likely effect on tax preparer conduct of the IRS's increased regulation of attorneys, CPAs, enrolled agents, actuaries and other registered tax professionals (but not other *unregulated* tax preparers) through amendments to Circular 230 in 2004 and 2005. Although Bolt-Lee and Moody did not conduct their own study, they offered a comprehensive review of research conducted by others involving the varying reasons underlying aggressive and/or unethical conduct by tax preparers. Based on the results found in numerous studies, Bolt-Lee and Moody concluded that although the extended regulations would be costly, in that they require the tax preparer to research more fully a client's potentially aggressive tax position, they would likely lead to more compliant tax returns being filed (pp. 22-23).

Existing Regulation of Tax Preparers

As mentioned above, many tax return preparers, such as attorneys, CPAs, actuaries and enrolled agents, are held accountable under the rules imposed by applicable governing organizations, industry standards and additional IRS regulations (as contained in the infamous Circular 230, explained below). In addition, several federal statutes that impose certain sanctions and other injunctive penalties are applicable to all tax return preparers. This means that the level of regulation is quite high for tax professionals who are attorneys, CPAs, actuaries, enrolled agents or tax preparers who have voluntarily registered with the IRS. By contrast, the only regulations that govern the professional conduct of the remaining (rather large) group of unregistered tax return preparers are the applicable federal statutes.

The most notable of the federal statutes governing tax preparer conduct are the ones that have teeth, in other words, the ones that impose significant penalties on tax return preparers for prohibited conduct. Under a few of these statutes, the government, *via* the IRS and/or the Tax Division of the U.S. Department of Justice (www.justice.gov/tax), can utilize the federal courts to enforce the contemplated standards of conduct against all tax return preparers. Among these enforcement statutes are provisions permitting two types of penalties: monetary sanctions and preliminary or permanent injunctions.

Monetary sanctions are assessed in specific instances of delinquent behavior, for example, understating a taxpayer's liability (26 U.S.C. §6694) or failing to comply with the requirement to provide the tax preparer's identifying information or a copy of the tax return to the taxpayer (26 U.S.C. § 6695). In general, the government assesses a penalty for each instance of a tax preparer's violation of the applicable statute; in some circumstances, such as those involving willful and reckless conduct where the penalty per violation is substantially higher, a sizeable monetary sanction operates as a sufficient deterrent against future violating behavior by the tax preparer.

The most stringent penalty that can be imposed on a tax preparer pursuant to the enforcement statutes is a court ordered injunction, which can be utilized to prohibit particular conduct, such as creating false exemptions or deductions, omitting income, altering documents, embezzling taxpayer refunds or misrepresenting the tax preparer's professional status, or to prevent the tax preparer from practicing tax preparation at all (26 U.S.C. §§ 7407-7408). The injunction against all forms of tax preparation could be temporary, for example, a period of five years. However, where the tax preparer's conduct is severe and repetitive, the statute permits the court to issue a permanent injunction forever barring the tax preparer from engaging in tax preparation (26 U.S.C. § 7407). The permanent injunction is the most severe penalty available to punish misbehavior by tax preparers; because it prevents the tax preparer from the ability to engage in the profession of tax preparation, it is known among tax professionals as the "death penalty" (Smith, 2011). Of course, the severity of the penalty corresponds to the extent and nature of the wrongdoing, and the tax preparer death penalty is generally exercised only in cases of blatant fraud. According to the IRS, this most severe penalty has been meted out 175 times since 2003, to both individuals and small businesses engaged in the practice of tax preparation, which greatly assists the IRS's stated goal to enhance "compliance in the return-preparer community" (www.irs.gov).

While the ultimate decision regarding whether, and in what form, to impose an injunction on a delinquent tax preparer rests with the federal district court where the case is brought, the government very often is successful in obtaining the injunction order it proposes (Smith, 2011, p. 1287). However, in recent years certain federal courts have limited the government's ability to obtain the death penalty-permanent injunction, thus demonstrating that the government's enforcement under the applicable statutes is not unlimited. For example, in *U.S. v. Stenline* (2010) the Northern District of Texas observed that permanently enjoining the defendant from preparing tax returns is a draconian remedy that should not be administered lightly. The court in *U.S. v. Stenline* denied the government's request for a permanent injunction and instead issued an injunction for a term of fifteen years, which it deemed sufficient to accomplish the objective of both preventing and penalizing tax preparer misconduct (p. 872).

In another case, *U.S. v. Cruz* (2011), the Eleventh Circuit affirmed a decision by the Southern District of Florida that denied the government's request to permanently enjoin the defendant from operating as a tax return preparer because it determined a less than permanent injunction would be sufficient as a penalty. The Eleventh Circuit's reasoning was based on the fact the defendant had produced evidence he had reformed his practices and no longer engaged in the complained of fraudulent conduct after implementing new business policies and taking relevant continuing education courses (p. 886). Recognizing the potential beneficial influence education courses can have on tax preparer conduct, the *U.S. v. Cruz* holding suggests the permanent injunction should not be ordered absent unapologetic and continuous fraud.

Although the above explained holdings represent a sharp curtailment of the government's ability to regulate the most delinquent tax return preparers, they also hint at the areas where the IRS should be directing more of its regulatory energy: educational programs regarding the tax laws applicable to both tax payers and tax return preparers. The federal courts in *U.S. v. Stenline* and *U.S. v. Cruz* appear to presume that very few tax return preparers are engaging in outrageously blatant fraud and that much of the fraud the government seeks to prevent can be ameliorated through effective educational outreach to tax preparers, along with the IRS's monitoring of tax return preparers' business policies and procedures.

Circular 230

Increasing oversight of previously unregulated tax return preparers through education and monitoring is precisely what the IRS began through application—and modification—of a preexisting regulatory framework that is contained in the well-known Circular 230. Although Circular 230 originally applied only to certain tax professionals who were certified by the IRS to represent taxpayers in administrative proceedings involving taxes and tax returns (such as enrolled agents and actuaries), in 2007 it was amended to extend regulation to tax related activities and advice rendered by lawyers, accountants or other tax professionals who assist taxpayers in navigating complicated tax laws. In fact, it was the 2007 amendment to Circular 230 that created the now alarming scenario of one particular group of tax professionals—unregistered tax preparers—being exempt from a growing industry level consensus of professional standards that are necessary to ensure compliance with all tax laws.

In light of the results of studies conducted by the GAO (as described above), as well as the anecdotal evidence apparent from its own data collection and enforcement mechanisms, the IRS determined that unregulated tax return preparers could no longer escape the same level of professional scrutiny accorded to other tax professional groups under Circular 230 (Olson, 2013, p. 769). Bringing all tax return preparers under one umbrella of regulation thus became a strategic priority for the IRS starting in 2009 (Keenan, Petronchak & Lagun, 2010, p. 240). After holding numerous public forums, during which each type of tax professional contributed its opinions and ideas regarding potential standards for measuring tax return preparer work performance, the IRS eventually proposed a plan for implementing a set of new regulations that would apply to the remaining group of tax return preparers, thereby finally achieving consistency in the regulation of all tax professionals.

In 2011, Circular 230 was further amended to issue new regulations applicable to all tax return preparers in accordance with the IRS's proposed plan. The amended Circular 230 creates a process through which the individual preparer can apply for "registration" with the IRS, thereby creating a new designation of "registered tax return preparers" for this previously unregulated group. The application for registration consists of three parts. First, the applicant must pass a competency examination, which tests the individual's knowledge and understanding of tax laws and procedures (p. 9). Next, the applicant is subjected to a "suitability check" that inquires into the individual's own compliance with the tax laws (such as filing all required tax returns and paying all owed tax debts). The suitability check also examines whether the applicant has engaged in any disreputable conduct. Finally, if the applicant surmounts the first two steps, then they must pay a user fee and obtain a "preparer tax identification number" (PTIN). Upon successful completion of the registration application process, the tax preparer will receive a registration certificate and PTIN, which must be renewed annually. To maintain active status with the IRS, the registered tax preparer will need to complete fifteen credits of continuing education each year, in addition to paying the annual user fee to renew the PTIN (pp. 11-12).

The framework envisioned by the new regulations in Circular 230 broadly encompasses the two previously discussed areas of importance in relation to the tax preparer industry: monitoring and education. By requiring every tax return preparer to apply for and obtain a PTIN, which under the regulations must be furnished, along with a signature, on any tax return over which they have the primary responsibility for preparing, the IRS has created a method to quickly and efficiently identify the name and contact information of the individual who prepared questionable tax returns. The requirement that the individual applicant first pass a competency exam and suitability check also permits the IRS to monitor the knowledge, experience and ethical track record of the individuals who will be assisting taxpayers with the preparation of their returns in any given year. After the application process, the continuing education requirements, which are linked to the registered tax preparers' ability to renew the PTIN each year, will ensure that tax preparers are continually aware of any new changes in tax laws and procedures. The hope, as expressed by the IRS and commentators who support the amendments to Circular 230 (Olson, 2013, p. 778; Tolan, 2012, p. 543), is that the new framework sorts the good from the bad among tax return preparers, keeps them up to date and aware of any changes to tax laws and ultimately leads to a greater level of compliance that closes (or at least narrows) the troublesome tax gap.

Opposition to Regulation of Previously Unregulated Tax Return Preparers

As with any monumental change from past practices, the new requirements in amended Circular 230 have been met with vigorous objections from commentators and the tax return preparers themselves. Some of the objections appear to be the typical complaints that arise any time a large change is imposed upon a group of people (*i.e.*, no change is good or likeable). However, a number of valid objections regarding the form of the requirements have been raised. In addition, a small group of tax return preparers filed a federal lawsuit that that raises a challenging statutory and constitutional issue; their argument not only elaborates on the basic objections raised by others but also calls into question the authority of the IRS to implement the new requirements in Circular 230 at all (as explained below, the new requirements are currently on hold in light of the lawsuit). Importantly, the responses to each of the objections discussed here—whether from the IRS or the federal court—will have far reaching effects on the success of the new regulations and the IRS's strategic goal to increase oversight and regulation of this particular group of tax return preparers.

Basic Objections to the New Regulations

There is much commentary involving the tax preparer industry's reaction to the new regulatory framework issued in Circular 230. In a comprehensive review of industry opinions, Tolan (2012, pp. 513-521) identified three basic objections: first, it is too costly; second, the requirements are redundant and unnecessary; and third, it does not actually ensure either competence or compliance.

According to Tolan, the biggest complaint "by far" is the first one, *i.e.*, that the process of becoming a registered tax return preparer—including the application fee, training for the competency exam, sitting for the competency exam, attending continuing education courses each year and paying an annual renewal fee—is far too expensive. Many tax preparers and their advocates, such as the National Association of Tax Professionals (NATP), have communicated the concern that the costs of obtaining and maintaining registration will be unaffordable for many tax professionals and might put them out of business, particularly for small business or solo practitioner preparers. The NATP aptly concludes why this would be an unwelcome effect of the new regulations when it states "putting practitioners out of business with high costs does nothing to further the effectiveness of the tax system" (as quoted by Tolan, 2012, p. 514). This objection is probably the most troubling for the IRS because it would be a shocking waste of time and resources if the effect of the new requirements were to create *less* compliance by taxpayers who are forced to file their tax returns without assistance.

The second objection discussed by Tolan is that the competency exam and continuing education requirements are unnecessary because many of the large tax return preparers already adequately train their employee tax preparers with programs that achieve basic levels of knowledge and competence (p. 515). This objection carries a lot of weight, because of the size and influence of large business chain tax preparers, but it does not affect the underlying rationale for the requirements, namely, that many tax preparers do not possess acceptable levels of understanding and skill making a monitoring system to identify untrained preparers, and prevent them from assisting taxpayers in negligent or intentionally deceptive ways, necessary. Whether the large business chain preparers adequately train their own employees or not has no bearing on the need to monitor all of the other preparers who do not undergo such professional preparation.

The third objection discussed by Tolan is closely related to the second objection but is also much broader: many opponents of the regulatory changes assert that the educational and registration requirements will not actually achieve greater compliance (p. 515). This is because, according to the opponents, the continuing education requirements are too generic to result in a standard level of competence. Indeed, everyone knows that basic continuing education courses are places where "people attend [courses] but read the newspaper instead of listening" (as quoted by Tolan, p. 516). Further, the registration requirements will not effectively weed out incompetent or unscrupulous tax preparers because those preparers can simply avoid the regulations by becoming "ghost preparers" who prepare a tax return but do not provide their identifying information or signature (p. 519). Or, in the worst cases, the registration requirement will not prevent a dishonest tax preparer from engaging in practice because "much like gun control laws, criminals won't feel compelled to comply" with the obligations in Circular 230 (as quoted by Tolan, p. 518). Although this objection approaches the border between valid complaint and simple resistance to change, there is an element of good reason in it, especially in light of the costs associated with the educational and registration requirements that will be absorbed by the tax preparers themselves. It is difficult to justify these costs if the requirements do not achieve what is intended, which is to monitor tax preparers' level of competence and honesty, and to maintain that level through continuing education about tax laws.

The three basic objections described by Tolan have not gone unheard. In fact, the IRS "has been sensitive to the interests of the preparer community as it phases in the new requirements..." (p. 521). Immediately following the issuance of the requirements, it appeared the IRS was diligently responding to the issues raised by the tax preparer industry and in some instances contemplating tweaking the requirements to address the objections. However, it remains to be seen whether all of the IRS's efforts, in both implementing the new regulatory framework and engaging the tax preparer industry during the transition, will be obviated by the federal lawsuit filed by a group of three individual tax preparers in which they challenge the constitutional authority of the IRS to regulate tax preparers in the first place.

Loving v. IRS

Shortly after the new requirements were issued in Circular 230, in March 2012, three independent tax preparers commenced a lawsuit against the IRS in the U.S. District Court for the District of Columbia (DDC). The three preparers (including Sabina Loving whose name leads the case caption, *Loving v. IRS*) are supported, and advocated for, by the Institute of Justice (IJ), a national civil liberties law firm that believes the IRS's new regulations are "typical government protectionism" that is unnecessary and burdensome on hardworking tax preparers (www.ij.org/irs-tax-preparers). While the arguments made by the IJ on behalf of the three preparers involve a complex statutory and constitutional analysis, the impetus behind the lawsuit appears to derive from the three basic objections discussed in the preceding section of this paper. In short, the new regulatory framework contains requirements that are unfair, inappropriate and unjustifiable in the current economic and demographic condition of the tax preparer industry.

In order to achieve their goal to revoke the new requirements, however, the IJ decided to focus on the argument that the IRS's issuance of amended Circular 230 should be declared an illegal exercise of administrative power under the Administrative Procedure Act (APA). The APA is the statutory basis for a court to hold an administrative agency (such as the IRS, which is a division of the Treasury Department) accountable for the decisions they make with respect to rules and regulations that are applicable to the public at large. When asked to review a rule or regulation under the APA, a court must "hold unlawful and set aside agency action, findings, and conclusions found to be…[*inter alia*]…in excess of statutory jurisdiction, authority, or limitations, or short of statutory right…" (5 U.S.C. § 706(2)).

In *Loving v. IRS*, the IJ, on behalf of the plaintiff tax preparers, argued that the IRS's issuance of the new requirements exceeded its statutory jurisdiction and authority to regulate, and that the IRS's abuse of authority has damaging consequences on the work lives of the plaintiffs and other tax preparers like them. Of course, the IRS disagreed and argued its newly issued requirements are both well within the ambit of its statutory authority and completely necessary in light of the strong public policy to prevent preparers from performing their work dishonestly or incompetently.

The crux of the argument—and the basis of the dispute between the *Loving* plaintiffs and the IRS—is found in a short provision within the statute governing the organization and administration of the Treasury Department: the Secretary of the Treasury may "regulate the practice of representatives of persons before the Department of the Treasury" (31 U.S.C. § 330). As a division of the Treasury Department, this statutory provision also applies to the IRS; in other words, the IRS is permitted to issue rules and regulations governing those persons who "practice" before the IRS. According to the IJ and the *Loving* plaintiffs, the IRS impermissibly issued rules and regulations (as part of Circular 230) that attempt to regulate tax return preparers who cannot be considered persons that "practice" before the IRS because they do not assist in the presentation of a taxpayer's case, but rather, merely engage in the collection of information in order to fill out tax return forms.

The IRS argues quite the opposite, *i.e.*, that tax preparers most certainly do "practice" before the IRS and have done so for a long time under "limited practice rights" granted in previously issued regulations. Thus, the argument boils down to a basic disagreement between the parties over the definition of "practice" as intended by the applicable statute (and the interpretation permitted by the APA).

The DDC decided that the definition presented by the *Loving* plaintiffs (and the IJ) was the correct one. On January 18, 2013, the DDC issued an order granting the *Loving* plaintiffs request to bar the IRS from continuing the implementation of the new requirements; its well-reasoned opinion explained that the text of the statute permitting the IRS to regulate the practice of tax professionals does not permit the IRS to include tax return preparers in that definition, regardless of the possibly compelling policy justifications for the IRS's decision to regulate them (*Loving v. IRS*, p. 590). In response to the decision, which put an immediate halt to all of the IRS's efforts to implement the new regulatory framework in Circular 230, the IRS filed a motion in which it requested the DDC to stay the effect of its decision pending the IRS's planned appeal and raised a question about the extent of the DDC's order. The DDC declined the IRS's request for a stay but issued a clarification that its order did not apply to the IRS's requirement that all tax return preparers obtain a tax identification number (the PTIN). However, the DDC reiterated that the IRS was not permitted to require tax return preparers to pay any fee or undertake competency testing and continuing education. Thus, the DDC's decision and order halted all of the IRS's intended regulation of the tax preparer industry (although it left intact the basic mechanism for identifying the contact information for a particular tax preparer).

Unsurprisingly, the IRS quickly filed an appeal in the D.C. Circuit Court of Appeal (DC Circuit). In their opening appellate brief, the IRS argues that the DDC's affirmation of the *Loving* plaintiffs' narrow interpretation of the term "practice" was erroneous because that term is not clearly defined in the statute so as to exclude the kinds of services that tax preparers provide to individuals. Under the APA, where a statute leaves open any area of ambiguity, then the relevant agency is permitted to interpret that ambiguity in accordance with its rulemaking regulatory authority. According to the IRS, the statute in question—31 U.S.C. § 330—grants broad regulatory authority and leaves the definition of what constitutes "practice" open to interpretation; therefore, the IRS's decision to regulate tax preparers, which was based on valid research and analysis, was appropriate under the statute.

The IRS's argument has been bolstered by two *amici curiae* (*i.e.*, "friends of the court") briefs filed in support of the IRS's appeal. One of the *amici* briefs was jointly filed by the National Consumer Law Center and National Community Tax Coalition while the second one was filed by a group of five former Commissioners of Internal Revenue. Because *amici* filers are not parties to the lawsuit, and therefore are not bound to the analysis parameters developed by the parties in the lower court, such briefs often contain the policy reasons supporting a particular position. In this case, to further support the IRS's position that its regulations should be permitted, the National Consumer Law Center and National Community Tax Coalition presented evidence of recorded abuses by tax preparers (that were discovered in various "mystery shopper" tests taking place subsequent to the previously discussed studies by the GAO) and argued that regulation of tax preparers by the IRS is necessary to avoid further harm to consumers.

The *amici* brief filed by the group of five former Commissioners of Internal Revenue addressed a different policy justification for the regulations: the need for increased compliance with tax laws. The Commissioners explained what appears to be a basic misconception about the exact nature of a tax preparer's work. Whereas the *Loving* plaintiffs argued, and the DDC agreed, that a tax preparer does nothing more than collect information and assist the taxpayer to fill out tax return forms, the Commissioners point out that, actually, a tax preparer assists taxpayers in making administrative determinations about their eligibility not just for a variety of tax exemptions and deductions, but also numerous non-tax entitlements that are administered through the tax system (the most easily recognized examples being the earned income and child tax credits).

The Commissioners' brief sums up the argument in favor of the IRS's expanded definition of "practice" under the statutes where it states "Congress's willingness to use its tax power to effectuate public policies….has fundamentally changed the roles of the tax return and tax return preparers" (p. 4).

In their responding brief, the *Loving* plaintiffs reiterate their argument that the definition of "practice" in 31 U.S.C. § 330 does not include tax return preparers and therefore the IRS's interpretation of its regulatory authority under the statute is unlawful. In addition, an *amici curiae* brief in support of the *Loving* plaintiffs was filed by the Tax Foundation together with a group of individual tax preparers whose particular practice and plight under the halted regulatory framework are described in detail. The *amici* brief focuses on the policy reasons weighing against regulation of tax preparers, specifically, that it imposes an unjustifiable burden on individual tax preparers' ability to conduct a viable business because there is little correspondence between the harm the regulations are intended to prevent and the practical effect of the regulations. In other words, these *amici curiae* argue that the IRS's attempt to regulate tax preparers is patently unreasonable.

After the IRS filed the final brief—its reply to the *Loving* plaintiffs' response—an oral argument before the DC Circuit was scheduled for September 24, 2013. With strong arguments and reasoning supporting both sides, it is far from certain how the DC Circuit will decide and whether the *Loving* plaintiffs or the IRS will choose to bring their arguments to the Supreme Court if the DC Circuit decides against them. In the meantime, the IRS's regulatory framework remains on hold and the large group of tax return preparers affected by the amendments to Circular 230 continue to operate without any form of oversight or professional quality control.

Which Way Forward?

Whether the DDC's *Loving* decision is upheld or overturned, it is inevitable that the group of tax return preparers targeted by the IRS will eventually be regulated. If the DC Circuit accepts the statutory and policy arguments made by the IRS and supporters of its amendments to Circular 230 (and the Supreme Court either affirms or declines to review the case), the story ends there with the regulatory framework envisioned by the IRS in Circular 230 being put back in place. However, if the IRS is permanently barred from regulating tax return preparers then an alternate route toward a solution to the problem of dishonest and/or incompetent preparers must be charted. After all, not even the *Loving* plaintiffs have argued that the claimed abuses in the tax preparer industry do not exist. The problem will continue until it is effectively addressed whether by the IRS, the federal or states legislatures or, perhaps, the tax preparers themselves through a professional self-regulating body. The remainder of this paper offers a short discussion of these possibilities.

Federal Legislation

In the event the decision by the DDC in *Loving v. IRS* is upheld, and given its reasoning that the federal statute permitting the IRS to regulate tax practitioners does not permit the IRS to regulate tax preparers, the easiest solution would be for Congress to enact legislation enabling the IRS to implement its rules and regulations against tax preparers. Indeed, members of Congress are aware of the halt to the IRS regulatory framework caused by the *Loving* decision, and certain members are anticipating a possible final defeat for the IRS in the DC Circuit or Supreme Court while at the same time recognizing that tax preparers should be subject to IRS regulation. With this knowledge, on April 15, 2013, Representative Cedric Richmond proposed the Taxpayer Protection and Preparer Fraud Prevention Act of 2013 (Preparer Act), which is a short bill that simply proposes to amend 31 USC § 330 to specifically include "tax return preparers who do not practice as representatives of persons" as those individuals whom the IRS is permitted to regulate. Although this simple change would solve a large problem, successfully enacting a piece of legislation is never easy due to various political reasons. Also, with budget balancing and related issues on the top of Congress' agenda, it is unlikely the Preparer Act will be presented for a vote anytime in the near future.

Another, more complicated, possibility is for Congress to enact its own regulating legislation to be applied to all tax return preparers. While federal regulation of particular localized industries is not common, Congress is permitted to exercise its authority under the Commerce Clause (U.S. Const., art. 1 § 8) when an industry's business activity affects interstate commerce. From a perspective of constitutional analysis, the power of Congress to regulate an industry pursuant to the Commerce Clause must always be balanced with the individual state's rights to regulate the industry themselves. Therefore, Congress is often times moved to act when the states are either unable or unwilling to regulate an industry that is affecting the nation as a whole. Certain industries, such as aviation, financial institutions and railroads, are obviously regulated by Congress because of their national scope. Regulation in other industries is not so obvious and indicates a determination that federal legislation was necessary to either standardize varying state laws or fill in a void left by the states. For example, Congress has passed legislation to regulate the activities of meat-packers and slaughterhouses (Packers and Stockyards Act), apprentices (Fitzgerald Act), and boxers (Professional Boxing Safety Act).

Still, as many commentators have noted, Congress' power to regulate under the Commerce Clause is not unlimited, and within the last 25 years several pieces of legislation have been declared unconstitutional, and thus overturned, by the Supreme Court (Hopkins, 2005, p. 683). The fact that Congress has enacted previous statutes that impose monetary and injunctive penalties on tax preparers when they engage in certain misconduct or malfeasance (as discussed above), suggests that Congress deems regulation of tax preparers an important issue. However, it is far from certain whether Congress will be able to enact comprehensive legislation that creates a regulatory scheme similar to the form attempted by the IRS in Circular 230. Even if Congress does enact legislation, the one thing that is certain is that some of the affected tax preparers, and their advocates, will challenge the constitutionality of the legislation under the Commerce Clause.

State Legislation

If federal regulation proves to be too difficult, or it becomes impossible to surmount statutory and constitutional hurdles, then state governments can also attempt to achieve effective regulation of tax preparers. A few states already regulate tax preparers, but the extent of regulation ranges widely. For example, in New York tax preparers are simply required to register annually with the state and obtain an identification number, which can be used to trace the tax preparer (N.Y. Tax § 32). In addition, New York law prohibits a variety of conduct related to the preparation of tax returns, as well as to the tax preparer's advertisements regarding their services, and assesses a penalty of $500 for each violation. By contrast, in California, tax preparers are required to register with the Tax Education Council, which is the designated governmental entity that enforces California's additional requirements that tax preparers complete sixty hours of instruction in basic income tax law (or an equivalent amount of work experience) prior to engaging practice and then at least twenty hours of continuing education each year (Cal. Business & Professions Code ch 14, §§ 22250-22259). Registration with the Tax Education Council is contingent on the tax preparer demonstrating completion of the required initial and continuing education courses. Practicing tax return preparation without registration (in addition to engaging in the types of conduct similarly prohibited in New York and by federal statutes) can lead to a misdemeanor conviction and a penalty of up to $5,000.

The most notable state legislated regulatory regime is found in Oregon where tax preparers must be licensed by the State Board of Tax Practitioners prior to engaging in practice (Oregon Rev. Statutes §§ 673.625-673.710). To obtain a license each tax preparer must complete at least eighty hours of educational training and pass an examination that measures the preparer's knowledge of Oregon and federal income tax law, theory and practice. The license must be renewed each year, and to do so the tax preparer must complete an annual continuing education requirement of at least thirty hours. A tax preparer's violation of federal or Oregon state laws relating to tax return preparation and licensing, including the code of professional conduct prescribed by the State Board, is addressed through a disciplinary proceeding in which the State Board may suspend or revoke a license, issue a reprimand or assess civil penalties.

The licensing regime in Oregon represents by far the most stringent application of regulations to unregistered tax preparers anywhere in the country and it clearly served as a model for the regulation framework proposed by the IRS in Circular 230 (although the IRS regulations stop short of calling the program "licensing" and the required educational hours are around half of what is required in Oregon).

The stringent Oregon regulations also appear successful—the GAO conducted an analysis of Oregon tax returns and found they were more likely to be accurate compared to returns from other states (GAO, 2008). Thus, in the event the IRS regulations do not survive challenge and Congress does enact separate legislation, then the Oregon model presumably can serve as a model for legislation in other states. However, there is no guarantee that each state will actively seek regulatory legislation and a scenario in which inconsistent regulation leads to wild differences in tax law compliance across the country would certainly be an undesirable outcome. Still, using Oregon as a success story should energize activists and legislators to create a standardized method of quality control over the tax preparation industry.

Self-Regulation

A final possibility would be to rely on the creation of a national body (or a serious of regional ones) dedicated to the harmonization and perpetuation of heightened norms of professional conduct among tax preparers. Ideally, tax preparers can organize themselves similar to the American Bar Association (ABA), which is a voluntary association of lawyers that provides education, resources and advisory opinions on (among many other topics) matters related to professional standards and ethics in the practice of law (www.americanbar.org).

Although the National Association of Tax Professionals referenced above includes tax preparers, together with enrolled agents, CPAs, certified financial planners, accountants and attorneys, as part of the constituency it serves through events, education and networking opportunities (www.natptax.com), unregulated tax preparers could be better educated and held accountable to professional standards particular to their practice through a separate organization solely devoted to tax preparers (whether they are registered with the IRS or not).

Such an organization could operate as the "American Association of Tax Preparers" in order to offer educational resources and advisory opinions regarding tax preparer norms of conduct; it could even create and disseminate a "code of professional conduct" that might serve as a model for regulatory authorities and educational institutions monitoring the tax preparation industry all over the country. The possibility of a tax preparer association exerting positive influence on the entire industry—similar to the way the ABA influences the legal profession—is encouraging and tax preparers, their advocates and others concerned with the effect tax preparers have on individual taxpayers ought to pursue it.

Conclusion

For many years now, a large group of unregistered tax return preparers has conducted business without the need to comply with a comprehensive set of regulations. The lack of oversight, or ability to hold tax preparers accountable for the effects of their work, has resulted in alarming instances of tax preparer dishonesty and incompetence. The negative consequences of a tax return that does not contain an accurate or honest statement of a taxpayer's income, deductions and exemptions inure to both the individual and the government. For this reason, many people have argued for greater regulation of these unregistered tax preparers. Although the IRS's attempt to implement a watershed regulatory framework has been halted, the groundwork has been laid and it is unlikely tax preparers will continue to operate with minimal regulation for much longer. Through one method or another, all tax return preparers will eventually be subject to stricter regulation. It is just inevitable.

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