



COLORADO

**Department of
Regulatory Agencies**

**2015 Sunrise Review:
Paid Tax Preparers**

*Office of Policy, Research and Regulatory Reform
October 15, 2015*



COLORADO

Department of
Regulatory Agencies

Executive Director's Office

October 15, 2015

Members of the Colorado General Assembly
c/o the Office of Legislative Legal Services
State Capitol Building
Denver, Colorado 80203

Dear Members of the General Assembly:

The mission of the Department of Regulatory Agencies (DORA) is consumer protection. As a part of the Executive Director's Office within DORA, the Office of Policy, Research and Regulatory Reform seeks to fulfill its statutorily mandated responsibility to conduct sunrise reviews with a focus on protecting the health, safety and welfare of all Coloradans.

DORA has completed its evaluation of the sunrise application for the regulation of paid tax preparers and is pleased to submit this written report. The report is submitted pursuant to section 24-34-104.1, Colorado Revised Statutes, which provides that DORA shall conduct an analysis and evaluation of proposed regulation to determine whether the public needs, and would benefit from, the regulation.

The report discusses the question of whether there is a need for regulation in order to protect the public from potential harm, whether regulation would serve to mitigate the potential harm, and whether the public can be adequately protected by other means in a more cost-effective manner.

Sincerely,

Joe Neguse
Executive Director



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Background

Consistent, flexible, and fair regulatory oversight assures consumers, professionals and businesses an equitable playing field. All Coloradans share a long-term, common interest in a fair marketplace where consumers are protected. Regulation, if done appropriately, should protect consumers. If consumers are not better protected and competition is hindered, then regulation may not be the answer.

As regulatory programs relate to individual professionals, such programs typically entail the establishment of minimum standards for initial entry and continued participation in a given profession or occupation. This serves to protect the public from incompetent practitioners. Similarly, such programs provide a vehicle for limiting or removing from practice those practitioners deemed to have harmed the public.

From a practitioner perspective, regulation can lead to increased prestige and higher income. Accordingly, regulatory programs are often championed by those who will be the subject of regulation.

On the other hand, by erecting barriers to entry into a given profession or occupation, even when justified, regulation can serve to restrict the supply of practitioners. This not only limits consumer choice, but can also lead to an increase in the cost of services.

There are also several levels of regulation.

Licensure

Licensure is the most restrictive form of regulation, yet it provides the greatest level of public protection. Licensing programs typically involve the completion of a prescribed educational program (usually college level or higher) and the passage of an examination that is designed to measure a minimal level of competency. These types of programs usually entail title protection - only those individuals who are properly licensed may use a particular title(s) - and practice exclusivity - only those individuals who are properly licensed may engage in the particular practice. While these requirements can be viewed as barriers to entry, they also afford the highest level of consumer protection in that they ensure that only those who are deemed competent may practice and the public is alerted to those who may practice by the title(s) used.

Certification

Certification programs offer a level of consumer protection similar to licensing programs, but the barriers to entry are generally lower. The required educational program may be more vocational in nature, but the required examination should still measure a minimal level of competency. Additionally, certification programs typically involve a non-governmental entity that establishes the training requirements and owns and administers the examination. State certification is made conditional upon the individual practitioner obtaining and maintaining the relevant private credential. These types of programs also usually entail title protection and practice exclusivity.

While the aforementioned requirements can still be viewed as barriers to entry, they afford a level of consumer protection that is lower than a licensing program. They ensure that only those who are deemed competent may practice and the public is alerted to those who may practice by the title(s) used.

Registration

Registration programs can serve to protect the public with minimal barriers to entry. A typical registration program involves an individual satisfying certain prescribed requirements - typically non-practice related items, such as insurance or the use of a disclosure form - and the state, in turn, placing that individual on the pertinent registry. These types of programs can entail title protection and practice exclusivity. Since the barriers to entry in registration programs are relatively low, registration programs are generally best suited to those professions and occupations where the risk of public harm is relatively low, but nevertheless present. In short, registration programs serve to notify the state of which individuals are engaging in the relevant practice and to notify the public of those who may practice by the title(s) used.

Title Protection

Finally, title protection programs represent one of the lowest levels of regulation. Only those who satisfy certain prescribed requirements may use the relevant prescribed title(s). Practitioners need not register or otherwise notify the state that they are engaging in the relevant practice, and practice exclusivity does not attach. In other words, anyone may engage in the particular practice, but only those who satisfy the prescribed requirements may use the enumerated title(s). This serves to indirectly ensure a minimal level of competency - depending upon the prescribed preconditions for use of the protected title(s) - and the public is alerted to the qualifications of those who may use the particular title(s).

Licensing, certification and registration programs also typically involve some kind of mechanism for removing individuals from practice when such individuals engage in enumerated proscribed activities. This is generally not the case with title protection programs.

Regulation of Businesses

Regulatory programs involving businesses are typically in place to enhance public safety, as with a salon or pharmacy. These programs also help to ensure financial solvency and reliability of continued service for consumers, such as with a public utility, a bank or an insurance company.

Activities can involve auditing of certain capital, bookkeeping and other recordkeeping requirements, such as filing quarterly financial statements with the regulator. Other programs may require onsite examinations of financial records, safety features or service records.

Although these programs are intended to enhance public protection and reliability of service for consumers, costs of compliance are a factor. These administrative costs, if too burdensome, may be passed on to consumers.

Sunrise Process

Colorado law, section 24-34-104.1, Colorado Revised Statutes (C.R.S.), requires that individuals or groups proposing legislation to regulate any occupation or profession first submit information to the Department of Regulatory Agencies (DORA) for the purposes of a sunrise review. The intent of the law is to impose regulation on occupations and professions only when it is necessary to protect the public health, safety or welfare. DORA must prepare a report evaluating the justification for regulation based upon the criteria contained in the sunrise statute:¹

(I) Whether the unregulated practice of the occupation or profession clearly harms or endangers the health, safety, or welfare of the public, and whether the potential for the harm is easily recognizable and not remote or dependent upon tenuous argument;

(II) Whether the public needs, and can reasonably be expected to benefit from, an assurance of initial and continuing professional or occupational competence;

(III) Whether the public can be adequately protected by other means in a more cost-effective manner; and

(IV) Whether the imposition of any disqualifications on applicants for licensure, certification, relicensure, or recertification based on criminal history serves public safety or commercial or consumer protection interests.

¹ § 24-34-104.1(4)(b), C.R.S.

Any professional or occupational group or organization, any individual, or any other interested party may submit an application for the regulation of an unregulated occupation or profession. Applications must be accompanied by supporting signatures and must include a description of the proposed regulation and justification for such regulation.

Methodology

DORA has completed its evaluation of the proposal for regulation of paid tax preparers. During the sunrise review process, DORA performed a literature search, contacted and interviewed representatives of the applicant, reviewed licensure laws in other states, and conducted interviews of administrators of those programs. In order to determine the number and types of complaints filed against paid tax preparers in Colorado, DORA contacted representatives of the Denver/Boulder Better Business Bureau and the Office of the Attorney General Consumer Protection Section.

Profile of the Profession

For many consumers, filing their tax returns could be the most important financial transaction of the year.² Almost 60 percent of the approximately 142 million consumers across the United States who file an individual tax return with the Internal Revenue Service (IRS), seek the assistance of a paid tax preparer.³ In fact, the figures in Table 1, which includes IRS data, indicates that the ratio of consumers who seek assistance from paid tax preparers has remained close to 60 percent, while those who self-prepare is around 40 percent.⁴

Table 1
IRS Data Highlighting the Percent of Consumers Who Utilized Paid Tax Preparers in 2008-2012

Tax Season	2008	2009	2010	2011	2012
Paid-Preparer	86,515,114 (58%)	82,817,612 (60%)	81,040,615 (60%)	81,527,629 (59%)	82,192,985 (58%)
Self-Prepared	61,820,528 (42%)	55,149,802 (40%)	54,726,080 (40%)	56,659,609 (41%)	59,256,931 (42%)

The Code of Federal Regulations defines a paid tax preparer as,

any person who prepares for compensation, or who employs one or more persons to prepare for compensation, all or a substantial portion of any return of tax or any claim for refund of tax under the Internal Revenue Code.⁵

Generally, in order to operate as a paid tax preparer, the IRS requires an individual to obtain a preparer tax identification number (PTIN). To secure a PTIN, a person is required to create an online account, complete an application and pay the applicable fee, which is currently \$64.25 for new PTIN applicants and \$63 for renewals.

Additionally, persons seeking a PTIN from the IRS are required to disclose any felony convictions in the past 10 years and be in full compliance with federal tax laws.⁶

² H&R Block. *Tax Return Preparer Standards: An Important Tool to Improve Tax Return Accuracy, Combat Fraud & Protect Consumers*. Retrieved June 24, 2015, from <http://newsroom.hrblock.com/wp-content/uploads/2014/04/The-Tax-Institute-at-HR-Block-Return-Preparer-Report-April-2014-FINAL.pdf>

³ H&R Block. *Tax Return Preparer Standards: An Important Tool to Improve Tax Return Accuracy, Combat Fraud & Protect Consumers*. Retrieved June 24, 2015, from <http://newsroom.hrblock.com/wp-content/uploads/2014/04/The-Tax-Institute-at-HR-Block-Return-Preparer-Report-April-2014-FINAL.pdf>

⁴ H&R Block. *Tax Return Preparer Standards: An Important Tool to Improve Tax Return Accuracy, Combat Fraud & Protect Consumers*. Retrieved June 24, 2015, from <http://newsroom.hrblock.com/wp-content/uploads/2014/04/The-Tax-Institute-at-HR-Block-Return-Preparer-Report-April-2014-FINAL.pdf>

⁵ Cornell University Law School. *26 CFR 301.7701-15 - Tax return preparer*. Retrieved June 23, 2015, from <https://www.law.cornell.edu/cfr/text/26/301.7701-15>

⁶ H&R Block. *Tax Return Preparer Standards: An Important Tool to Improve Tax Return Accuracy, Combat Fraud & Protect Consumers*. Retrieved June 24, 2015, from <http://newsroom.hrblock.com/wp-content/uploads/2014/04/The-Tax-Institute-at-HR-Block-Return-Preparer-Report-April-2014-FINAL.pdf>

Under the federal Worker, Homeownership and Business Assistance Act, passed in 2009, all specified tax return preparers must electronically file (e-file) all income tax returns.⁷ A specified tax return preparer is any tax return preparer who reasonably expects to file more than 10 individual income tax returns during such calendar year.⁸

In order to file tax returns electronically, specified tax preparers are required to secure an Electronic Filing Identification Number (EFIN) from the IRS.⁹ Applicants for an EFIN must provide fingerprints to the IRS as well as pass a suitability check.¹⁰ The suitability check may include a criminal background check, a credit history check, a tax compliance check and a check for prior non-compliance with IRS e-file requirements.¹¹

Paid tax preparers work in a variety of settings. Most commonly, but not exclusively, they work for major tax preparation services. However, there are many paid tax preparers who operate their own businesses.

Annual Filing Season Program

The IRS created its annual filing season program (AFSP), which aims to recognize the efforts of non-credentialed tax return preparers who aspire to a higher level of professionalism.¹² The AFSP is a voluntary program, and requirements to receive a Record of Completion from the IRS include, but are not limited to, completing 18 hours of continuing education (CE) encompassing:¹³

- A six-hour Annual Federal Tax Refresher course, which covers filing issues and tax law updates;
- 10 hours of federal tax law topics; and
- Two hours of ethics.

⁷ H&R Block. *Tax Return Preparer Standards: An Important Tool to Improve Tax Return Accuracy, Combat Fraud & Protect Consumers*. Retrieved June 24, 2015, from <http://newsroom.hrblock.com/wp-content/uploads/2014/04/The-Tax-Institute-at-HR-Block-Return-Preparer-Report-April-2014-FINAL.pdf>

⁸ H&R Block. *Tax Return Preparer Standards: An Important Tool to Improve Tax Return Accuracy, Combat Fraud & Protect Consumers*. Retrieved June 24, 2015, from <http://newsroom.hrblock.com/wp-content/uploads/2014/04/The-Tax-Institute-at-HR-Block-Return-Preparer-Report-April-2014-FINAL.pdf>

⁹ H&R Block. *Tax Return Preparer Standards: An Important Tool to Improve Tax Return Accuracy, Combat Fraud & Protect Consumers*. Retrieved June 24, 2015, from <http://newsroom.hrblock.com/wp-content/uploads/2014/04/The-Tax-Institute-at-HR-Block-Return-Preparer-Report-April-2014-FINAL.pdf>

¹⁰ H&R Block. *Tax Return Preparer Standards: An Important Tool to Improve Tax Return Accuracy, Combat Fraud & Protect Consumers*. Retrieved June 24, 2015, from <http://newsroom.hrblock.com/wp-content/uploads/2014/04/The-Tax-Institute-at-HR-Block-Return-Preparer-Report-April-2014-FINAL.pdf>

¹¹ H&R Block. *Tax Return Preparer Standards: An Important Tool to Improve Tax Return Accuracy, Combat Fraud & Protect Consumers*. Retrieved June 24, 2015, from <http://newsroom.hrblock.com/wp-content/uploads/2014/04/The-Tax-Institute-at-HR-Block-Return-Preparer-Report-April-2014-FINAL.pdf>

¹² IRS. *Annual Filing Season Program*. Retrieved June 30, 2015, from <http://www.irs.gov/Tax-Professionals/Annual-Filing-Season-Program>

¹³ IRS. *General Requirements - Annual Filing Season Program*. Retrieved June 30, 2015, from <http://www.irs.gov/Tax-Professionals/General-Requirements-for-the-Annual-Filing-Season-Program-Record-of-Completion>

Upon completion of the aforementioned CE requirements and possessing an active PTIN, a candidate receives a Record of Completion from the IRS. One benefit to completing the AFSP is that the paid tax preparer is eligible to be included on the IRS's public directory of tax return preparers.¹⁴ In January 2015, the IRS launched a public education campaign, which encourages taxpayers to select paid tax preparers with professional credentials, such as the AFSP or other select qualifications.¹⁵

Another benefit to participating in the AFSP is that participants, beginning January 2016, will have limited representation rights, meaning they can represent clients whose returns they prepared and signed.¹⁶ Specifically, AFSP participants will be able to represent clients before revenue agents, customer service representatives and similar IRS employees, including the Taxpayer Advocate Service.¹⁷

Enrolled Agents

Enrolled agents are tax professionals who are licensed by the IRS. Enrolled agents, like attorneys and certified public accountants (CPAs) have unlimited practice rights. This means that they are unrestricted as to which taxpayers they can represent before the IRS.¹⁸ Enrolled agents also have unrestricted rights as to what types of tax matters they can handle.¹⁹ For example, enrolled agents are authorized to communicate with the IRS on behalf of a taxpayer regarding the taxpayer's rights, privileges or liabilities.²⁰

To become an enrolled agent, a candidate is required to secure a PTIN, pass the Special Enrollment Examination (SEE), and complete 72 hours of CE every three years.

The SEE is divided into three parts:

- Individuals;
- Businesses; and
- Representation, Practice and Procedures.

The "Individuals" portion of the SEE contains five sections and addresses a variety of competencies concerning individual tax returns, including but not limited to income, assets and itemized deductions.²¹

¹⁴ IRS. *General Requirements - Annual Filing Season Program*. Retrieved June 30, 2015, from <http://www.irs.gov/Tax-Professionals/General-Requirements-for-the-Annual-Filing-Season-Program-Record-of-Completion>

¹⁵ IRS. *General Requirements - Annual Filing Season Program*. Retrieved June 30, 2015, from <http://www.irs.gov/Tax-Professionals/General-Requirements-for-the-Annual-Filing-Season-Program-Record-of-Completion>

¹⁶ IRS. *Annual Filing Season Program*. Retrieved June 30, 2015, from <http://www.irs.gov/Tax-Professionals/Annual-Filing-Season-Program>

¹⁷ IRS. *Annual Filing Season Program*. Retrieved June 30, 2015, from <http://www.irs.gov/Tax-Professionals/Annual-Filing-Season-Program>

¹⁸ IRS. *Enrolled Agent Information*. Retrieved August 4, 2015, from <http://www.irs.gov/Tax-Professionals/Enrolled-Agents/Enrolled-Agent-Information>

¹⁹ IRS. *Enrolled Agent Information*. Retrieved August 4, 2015, from <http://www.irs.gov/Tax-Professionals/Enrolled-Agents/Enrolled-Agent-Information>

²⁰ IRS. *Publication 946 - Main Content*. Retrieved August 10, 2015, from http://www.irs.gov/publications/p947/ar02.html#en_US_201410_publink1000148594

²¹ Prometric. *IRS Special Enrollment Examination Part 1 - Individuals*. Retrieved August 4, 2015, from <https://www.prometric.com/en-us/clients/SEE/Documents/SEEPart1.pdf>

The “Businesses” section of the SEE contains three sections: businesses, business financial information and specialized returns and taxpayers.²²

The third part of the SEE, “Representation, Practice and Procedures,” contains four sections: practice and procedures, representation before the IRS, specific types of representation and completion of the filing process.²³

Each SEE consists of 100 multiple-choice questions.

²² Prometric. *IRS Special Enrollment Examination Part 2 - Businesses*. Retrieved August 4, 2015, from <https://www.prometric.com/en-us/clients/SEE/Documents/SEEPart2.pdf>

²³ Prometric. *IRS Special Enrollment Examination Part 3 -Representation, Practice and Procedures*. Retrieved August 4, 2015, from <https://www.prometric.com/en-us/clients/SEE/Documents/SEEPart3.pdf>

Proposal for Regulation

The Colorado Fiscal Institute (Applicant) has submitted a sunrise application to the Department of Regulatory Agencies (DORA) for review in accordance with the provisions of section 24-34-104.1, Colorado Revised Statutes (C.R.S.). The application identifies state licensure of paid tax preparers as the appropriate level of regulation to protect the public.

The sunrise application states that licensure should be required of paid tax preparers because completing tax returns is a sophisticated and complicated process that requires well-informed, competent practitioners. Further, the application states that tax return preparation should not be undertaken by anyone who is not educated on current tax laws and the preparation process.

Additionally, the sunrise application proposes to exempt certified public accountants, attorneys and enrolled agents from the proposed licensure requirement.

The Applicant also provided a mandatory continuing education application to DORA, in accordance with section 24-34-901, C.R.S., which requests continuing education of paid tax preparers. The application states that continuing education is necessary because the tax code is incredibly long and complicated. Since 2001, the federal tax code has implemented approximately 4,680 changes; therefore, requiring continuing education for paid tax preparers could enhance consumer protection.

Importantly, the continuing education application/proposal did not highlight the number of continuing education units that should be required or the time span (e.g., every two years) within which such units should be completed.

Summary of Current Regulation

The Federal Regulatory Environment

In 2010, the Internal Revenue Service (IRS) instituted a regulatory program requiring all individuals who prepare tax returns for compensation to meet certain minimum testing and continuing education standards.²⁴ However, in 2013, the U.S. District Court for the District of Columbia enjoined the IRS from enforcing the regulatory requirements for paid tax preparers.²⁵ On February 11, 2014, the U.S. Court of Appeals for the District of Columbia Circuit upheld the decision of the lower court in *Loving v. IRS*, finding insufficient statutory support for the IRS' regulation of tax preparers.²⁶

As a result, the IRS does not have regulatory oversight of paid tax preparers.

Although the IRS is not able to mandate regulation of paid tax preparers, the IRS has voluntary programs available, as highlighted in the "Profile of the Profession" section of this report.

Currently, there are several bills in Congress, including House of Representatives bill 1178 (H.R. 1178) and Senate bill 935 (S. 935) that would regulate paid tax preparers at the federal level. Both of these bills would amend the Internal Revenue Code to direct the Department of Treasury to establish a program to license or certify and regulate paid tax preparers.^{27 28}

Neither bill appears to be moving forward in the Congress.

The Colorado Regulatory Environment

The State of Colorado does not have a formal regulatory structure in place for paid tax preparers. However, the Colorado Department of Revenue provides oversight for issues such as tax evasion and fraud enforcement. Specifically, the Criminal Investigation/Tax Enforcement Section (CTE) investigates and assists in the prosecution of individuals and corporations that attempt to evade taxes, willfully fail to file returns, submit false tax forms and otherwise attempt to defraud taxpayers.²⁹

²⁴ IRS. *2014 Office of Professional Responsibility Report*. Retrieved July 31, 2015, from <http://www.irs.gov/Tax-Professionals/2014-Office-of-Professional-Responsibility-Report>

²⁵ IRS. *IRS Statement on Court Ruling Related to Return Preparers*. Retrieved July 31, 2015, from <http://www.irs.gov/uac/Newsroom/IRS-Statement-on-Court-Ruling-Related-to-Return-Preparers>

²⁶ IRS. *IRS Statement on Court Ruling Related to Return Preparers*. Retrieved July 31, 2015, from <http://www.irs.gov/uac/Newsroom/IRS-Statement-on-Court-Ruling-Related-to-Return-Preparers>

²⁷ Govtrack.us. *Summaries for the Tax Refund Protection Act of 2015*. Retrieved July, 29, 2015, from <https://www.govtrack.us/congress/bills/114/hr1178/summary>

²⁸ Govtrack.us. *Summaries for the Tax Refund Protection Act of 2015*. Retrieved July 29, 2015, from <https://www.govtrack.us/congress/bills/114/s935/summary>

²⁹ Colorado Department of Revenue. *Criminal Tax Investigations -- Tax Evasion and Fraud Enforcement*. Retrieved August 5, 2015, from <https://www.colorado.gov/pacific/tax/criminal-investigations>

Types of cases investigated by the CTE include failure to remit wage withholdings or sales tax collected, tax evasion and tax preparer fraud.³⁰

Regulation in Other States

Currently, there are four states that regulate paid tax preparers (California, Maryland, New York and Oregon).

California

In California, paid tax preparers are required to secure a registration prior to practicing. In order to receive a registration, a candidate is required to complete 60 hours of qualifying education: 45 hours specific to federal issues and 15 specific to California requirements.

After securing a registration, a practitioner is required to complete 20 hours of continuing education annually.

Practitioners in California are also required to secure a \$5,000 surety bond.

Currently, there are approximately 41,000 registered paid tax preparers in California.

Maryland

In Maryland, paid tax preparers are required to secure registration prior to practicing. In order to receive a registration, a candidate must possess a preparer tax identification number from the IRS. Also, beginning January 2016, candidates must pass an examination.

The examination will consist of 130 questions: 100 related to federal tax preparation issues, 25 related to State of Maryland issues and 5 control questions.

Registered practitioners are required to complete 16 hours of continuing education every two years.

Currently, there are approximately 4,100 registered paid tax preparers in Maryland.

³⁰ Colorado Department of Revenue. *Criminal Tax Investigations -- Tax Evasion and Fraud Enforcement*. Retrieved August 5, 2015, from <https://www.colorado.gov/pacific/tax/criminal-investigations>

New York

The State of New York requires paid tax preparers to become registered prior to providing services to consumers. Generally, paid tax preparers who prepared 10 or more tax returns in the previous year and will be paid to prepare one or more tax returns the following year, must secure a registration.³¹ Beginning 2017, paid tax preparers must pass an examination prior to practicing.³²

Paid tax preparers must also complete continuing education requirements. Paid tax preparers who completed more than 10 tax returns in 2011, 2012 and 2013 are required to complete four hours of continuing education coursework by the end of December 2015.³³ Paid tax preparers who completed fewer than 10 tax returns in 2011, 2012 and 2013 must take 16 hours of continuing education by the end of December 2015, followed by four hours at the end of each subsequent year.³⁴

In New York, there are approximately 43,000 registered paid tax preparers.

Oregon

Oregon offers two types of licenses related to paid tax preparers: tax preparer and tax consultant. A licensed tax preparer is authorized to prepare tax returns under the supervision of, among others, a tax consultant.³⁵

To become licensed as a tax preparer in Oregon, a candidate is required to complete an 80-hour tax course with a passing grade.³⁶ A candidate may also submit, for review, college coursework in specific course(s) in lieu of the 80-hour basic course.³⁷

³¹ The New York State Department of Taxation and Finance. *New York State Tax Preparer Registration*. Retrieved May 15, 2015, from <http://www.tax.ny.gov/tp/reg/tpreg.htm>

³² The New York State Department of Taxation and Finance. *New York State Tax Return Preparer Continuing Education Requirements*. Retrieved May, 15, 2015, from http://www.tax.ny.gov/tp/reg/cont_ed_req.htm

³³ The New York State Department of Taxation and Finance. *New York State Tax Return Preparer Continuing Education Requirements*. Retrieved May, 15, 2015, from http://www.tax.ny.gov/tp/reg/cont_ed_req.htm

³⁴ The New York State Department of Taxation and Finance. *New York State Tax Return Preparer Continuing Education Requirements*. Retrieved May, 15, 2015, from http://www.tax.ny.gov/tp/reg/cont_ed_req.htm

³⁵ State of Oregon. *General Information Booklet For Tax Consultant & Tax Preparer Applicants*. Retrieved July 29, 2015, from http://www.oregon.gov/obtp/docs/form/gen_info.pdf

³⁶ State of Oregon. *General Information Booklet For Tax Consultant & Tax Preparer Applicants*. Retrieved July 29, 2015, from http://www.oregon.gov/obtp/docs/form/gen_info.pdf

³⁷ State of Oregon. *General Information Booklet For Tax Consultant & Tax Preparer Applicants*. Retrieved July 29, 2015, from http://www.oregon.gov/obtp/docs/form/gen_info.pdf

Tax preparers are also required to pass an examination, which consists of 200 questions, and contains the following four parts:³⁸

- Oregon tax laws,
- Code of professional conduct,
- Federal income tax law, and
- Various state and federal forms.

Tax preparers must complete 30 hours of continuing education prior to license renewal, which is required each year.³⁹

In order to secure a tax consultant license, a candidate must complete at least 1,100 hours of tax preparation as a tax preparer during two of the last five years.⁴⁰ Candidates are also required to provide proof that they have completed a minimum of 15 hours of continuing education in personal income tax preparation in the past year.⁴¹

A candidate for a tax consultant license must also take and pass an examination, which consists of 200 questions.⁴² The examination covers the following information:⁴³

- Oregon and federal personal income tax law, theory and practice;
- Oregon practitioners' law;
- Code of professional conduct; and
- Rules for tax preparation businesses.

Once a candidate secures a tax consultant license, he or she is required to complete at least 30 hours of continuing education each year.⁴⁴

In Oregon, there are currently 1,575 licensed paid tax preparers and 1,822 licensed tax consultants.

³⁸ State of Oregon. General Information Booklet For Tax Consultant & Tax Preparer Applicants. Retrieved July 29, 2015, from http://www.oregon.gov/obtp/docs/form/gen_info.pdf

³⁹ State of Oregon. General Information Booklet For Tax Consultant & Tax Preparer Applicants. Retrieved July 29, 2015, from http://www.oregon.gov/obtp/docs/form/gen_info.pdf

⁴⁰ State of Oregon. General Information Booklet For Tax Consultant & Tax Preparer Applicants. Retrieved July 29, 2015, from http://www.oregon.gov/obtp/docs/form/gen_info.pdf

⁴¹ State of Oregon. General Information Booklet For Tax Consultant & Tax Preparer Applicants. Retrieved July 29, 2015, from http://www.oregon.gov/obtp/docs/form/gen_info.pdf

⁴² State of Oregon. General Information Booklet For Tax Consultant & Tax Preparer Applicants. Retrieved July 29, 2015, from http://www.oregon.gov/obtp/docs/form/gen_info.pdf

⁴³ State of Oregon. General Information Booklet For Tax Consultant & Tax Preparer Applicants. Retrieved July 29, 2015, from http://www.oregon.gov/obtp/docs/form/gen_info.pdf

⁴⁴ State of Oregon. General Information Booklet For Tax Consultant & Tax Preparer Applicants. Retrieved July 29, 2015, from http://www.oregon.gov/obtp/docs/form/gen_info.pdf

Analysis and Recommendations

Public Harm

The first sunrise criterion asks:

Whether the unregulated practice of the occupation or profession clearly harms or endangers the health, safety or welfare of the public, and whether the potential for harm is easily recognizable and not remote or dependent on tenuous argument.

Before moving forward in the analysis of harm concerning paid tax preparers, it is important to identify what constitutes harm to the public. The improper actions of paid tax preparers could result in financial and emotional harm. For example, the improper preparation of tax returns could trigger an audit by the Internal Revenue Service (IRS), and if the IRS determines that tax returns were improperly prepared, the consumer could be required to pay the IRS back taxes, penalties and interest.

Examples of Harm Submitted by Applicant

In order to determine whether regulation of paid tax preparers is necessary, the Department of Regulatory Agencies (DORA) requested that the sunrise applicant provide specific examples of harm to the public. The applicant provided numerous articles and news releases related to consumer harm from a variety of sources. For purposes of this sunrise review, DORA analyzed the examples that specifically affected Colorado consumers. The sources provided in this sunrise application include, but are not limited to:

- The United States Attorney's Office, District of Colorado;
- 9NEWS;
- *Denver Business Journal*;
- *Boulder Daily Camera*; and
- The IRS.

In 2014, the United States Attorney's Office, District of Colorado issued a press release highlighting instances where tax preparers in separate unrelated cases were prosecuted for filing fraudulent tax returns. The press release applies to examples 1 and 2.

Example 1

Two paid tax preparers in Colorado were arrested on charges of conspiracy to defraud the United States and preparing fraudulent tax returns. Each paid tax preparer was charged with one count of conspiracy to defraud the United States. One was charged with 30 counts of preparing fraudulent tax returns and the other was charged with 5 counts of preparing fraudulent tax returns.

Beginning March 2006 through 2010, the two conspired to defraud the IRS by preparing fraudulent income tax returns containing false income and deductions as well as business losses.

The paid tax preparers enlisted a third-party who had not prepared the fraudulent tax returns to act as the return preparer on the clients' tax returns. The paid tax preparers would then require the clients' tax refunds be deposited into the business' bank account, and after the deduction in tax preparation fees, the difference would be paid to the clients. However, the paid tax preparers, at times, failed to forward the refunds to their clients.

Analysis

In this example, the paid tax preparers knowingly attempted to subvert the IRS by fraudulently obtaining greater refunds for their clients. The example also highlights the fact that not only did the paid tax preparers complete fraudulent tax returns, they, at times, failed to forward the refunds to their clients. They presumably kept all of the available funds. The information provided in the press release reported that criminal charges would be filed.

In this example, the activities of the tax preparers resulted in criminal charges. It is certainly arguable that criminal prosecution is a stronger response to consumer harm than sanction by a regulatory board. Further, there is no evidence in the example of lack of competence by the tax preparers.

Example 2

In 2014, a paid tax preparer in Colorado pled guilty to one count of preparing a fraudulent tax return. From 2007 through 2009, this paid tax preparer prepared approximately 1,600 tax returns for which at least 18 clients had falsely inflated deductions, which increased their refunds from the IRS. False deductions included charitable contributions, unreimbursed business expenses and childcare expenses.

Analysis

This example demonstrates the paid tax preparer's openness to purposely overstate tax deductions to increase his clients' tax refunds.

This example does not provide information detailing harm to consumers; however, it can be inferred that at least some of his clients were required to repay the inflated portion of the refunds and possibly penalties and interest.

As in the previous example, the tax preparer faced criminal charges and there is no evidence that the tax preparer was not competent to practice.

Example 3

9NEWS article - A paid tax preparer in Colorado, who files an estimated 10,000 tax returns per year, prepared numerous fraudulent tax returns on behalf of his clients. For example, the paid tax preparer added nearly \$600 in education credits on a client's tax return, but neither the client nor her husband was attending school.

Analysis

The article claims, from interviews with the paid tax preparer, that he was aware that it was fraudulent activity to include the aforementioned information on the clients' tax forms. As such, he knowingly committed fraud by inflating the tax return for his client.

Again, the tax preparer engaged in purposeful, fraudulent activity. While the client asserted no knowledge of the activity, there is no reasonable interpretation of the events that would lead one to conclude that a state licensing scheme could have prevented such conduct. This example does not report that criminal charges were filed but, arguably, there does appear to be criminal exposure to the tax preparer.

Example 4

Denver Business Journal article - A paid tax preparer was sued by the United States Justice Department, alleging he made at least 141 claims for fraudulent refunds, which were made in 2008 and 2009, for clients in Arizona, California, Colorado and New Mexico, totaling more than \$55 million.

The complaint says that the paid tax preparer prepared tax returns for clients that fabricated the amount for federal income tax withheld. One refund request to the IRS totaled \$1.7 million.

Analysis

The information provided in this article illustrates the paid tax preparer's willingness to prepare fraudulent tax returns on behalf of his clients. The article, however, did not mention whether the IRS had contacted the clients and demanded repayment of the fraudulent refunds completed by the paid tax preparer.

Also, the article did not mention whether the clients had knowledge of the paid tax preparer's fraudulent actions or whether he was convicted of the alleged crimes.

This is another example of purposeful, fraudulent behavior by a tax preparer. This individual was sued by the federal government. Given that state regulation would not have prevented the activity, the action by the federal government is a stronger response than sanctions by a state licensing board.

Example 5

Boulder Daily Camera article - A paid tax preparer and her partner were sentenced in United States District Court for filing more than 400 false tax returns. Between 2002 and 2004, the paid tax preparer and her partner defrauded the IRS of \$550,191 and the Colorado Department of Revenue of \$111,495.

The paid tax preparer and her partner would file amended returns for prior tax years, and charge the clients up to 50 percent of the money they received from the IRS and/or the Colorado Department of Revenue. In addition to the criminal prosecution of the tax preparers, the clients were required to repay the refunds.

Analysis

The example presented above clearly demonstrates financial fraud perpetrated by unregulated paid tax preparers. Consumers who utilized the services of these paid tax preparers are responsible for paying back the refunds they received, which obviously is financially harmful to most consumers. It is unclear if the consumers were aware or complicit with the actions of the paid tax preparer.

The analysis of this example is essentially the same as the analysis of the preceding cases. One notable difference in this case is the harm caused to consumers due to repayment of the tax refunds obtained through fraudulent activity by the tax preparer. It is extremely unusual for a state regulator of a profession or occupation to have the authority to order any type of refund or restitution. Therefore, state regulation would have neither prevented the criminal activity nor made consumers whole.

Example 6

IRS article - In 2014, a paid tax preparer stole records consisting of personal information from clients after the business for which he worked ceased operations. The paid tax preparer used the records to produce counterfeit driver's licenses and counterfeit government photo identification cards. He then used these items to file false 2010 tax returns. He also created false Forms-W-2 Wage and Tax Statements (Form W-2). He received refunds ranging from \$7,000 to \$23,000 for each false claim filed.

Analysis

This example highlights an example of identity theft from a paid tax preparer. As mentioned above, the paid tax preparer received funds from the IRS, while using the stolen personal information. As a result, consumers sustained financial harm and identity theft.

Although this example includes no mention of criminal sanctions, there appears to be the commission of numerous potential crimes by the tax preparer. State licensing of the profession would not have prevented these activities and regulatory sanctions against the licensee would be a much weaker response than criminal prosecution.

Examples of Harm Reported by the Colorado Office of the Attorney General, Consumer Protection Section

Since 2012, the Consumer Protection Section has received 17 complaints (excluding those against certified public accountants and attorneys) against paid tax preparers.

Specifically, the Consumer Protection Section reported the following instances of paid tax preparer complaints, including but not limited to:

- Errors in tax preparation: nine
 - This category of complaints addresses concerns from consumers involving a paid tax preparer who had errors in tax preparation, including incorrect or incomplete tax calculations;
- Fraudulent business practices: five
 - Generally, these complaints allege that businesses have engaged in fraudulent activity, including collecting payment from consumers prior to completing the tax preparation;
- Privacy/compromised identity concerns: three
 - These complaints allege that paid tax preparers disclosed personal identifying information (e.g., social security numbers) to non-authorized individuals.

Analysis

The first bullet above highlights instances where paid tax preparers may have lacked competency to properly complete tax returns on behalf of consumers. Lacking competency when completing tax returns could have negative financial consequences to consumers because they may be placed in the position of having to repay taxes, possibly with penalties and interest.

State occupational licensing is a good vehicle to ensure that paid tax professionals possess the necessary training/education to practice at a minimal level of competence. Beyond that administrative function, state regulators typically have a number of disciplinary tools to employ should a practitioner violate the practice act.

Therefore, and keeping in mind that the cases in this example are allegations, it is reasonable to conclude that state occupational regulation may have prevented at least some of the nine examples of harm in the first bullet or could have responded with some type of disciplinary action after the harm had been proven and the licensee's due process rights afforded.

The second and third bullets illustrate that there are instances where paid tax preparers may be engaging in fraudulent activity and imposing financial harm on consumers as well as potentially compromising the personal identification information of consumers. While it is probable that a state regulatory authority would take some type of disciplinary action subsequent to a criminal conviction, the fact remains that state regulation, by evaluating competence at the front-end, can do nothing to prevent fraud and other criminal activity. In addition, administrative actions available to state regulators are not as forceful as criminal sanctions for fraud, theft and identity theft, among other crimes.

Examples of Harm Reported by the Denver/Boulder Better Business Bureau

DORA contacted the Denver/Boulder Better Business Bureau (BBB) and requested complaints filed against paid tax preparers, excluding attorneys and certified public accountants. The BBB reported that from 2011 to 2015, it received 66 complaints concerning tax preparation. The complaints varied in nature and included complaints related to competency.

Analysis

This information does support the proposal for regulation. However, the data are limited because there is no distinction between harm caused by lack of practitioner competence (which can be impacted by occupational licensing) and criminal or fraudulent behavior (for which administrative actions by a regulatory board are generally not as effective).

United States General Accounting Office Studied Paid Tax Preparers

The United States General Accounting Office (GAO) released a limited study in 2014 that identifies significant errors in tax preparation. In fact, the study found that only 2 of 19 paid tax preparers correctly prepared taxes for consumers.

The study identified refund errors, giving the taxpayer between \$52 less and \$3,718 more than the correct refund amount.⁴⁵ The quality and accuracy of tax preparation services by paid tax preparers was inconsistent.⁴⁶ Common errors identified in the study include:⁴⁷

- Not reporting non-Form W-2 income (e.g., cash tips) on 12 of the 19 tax returns,
- Claiming an ineligible child for the Earned Income Tax Credit on 3 of the 10 tax returns,
- Not asking the required eligibility questions for the American Opportunity Tax Credit, and
- Not providing an accurate preparer tax identification number.

The GAO report revealed issues of practitioner competence and found that only 2 of 19 paid tax preparers completed customer taxes without error.

The GAO report is convincing but must be evaluated on a continuum of harm that considers direct, documented harm to Colorado consumers as the strongest evidence to support occupational regulation in Colorado.

Need for Regulation

The second sunrise criterion asks:

Whether the public needs and can reasonably be expected to benefit from an assurance of initial and continuing professional or occupational competence.

This criterion addresses the proposition of whether the state should require a certain level of education and/or impose a requirement that paid tax preparers pass an examination before being licensed in Colorado.

In evaluating the need to impose regulation on paid tax preparers in Colorado, this sunrise review reveals nine complaints made to the Colorado Office of the Attorney General alleging errors by paid tax preparers. These nine complaints were made from 2012 through the time of the research for this review (spring 2015).

Similarly, the BBB reports 66 complaints against paid tax preparers from 2011 until the present. The number of complaints alleging competence issues is unknown.

Thus, the Colorado evidence supporting the need for new occupational regulation is not strong.

⁴⁵ U.S. GAO. *Paid Tax Return Preparers: In a Limited Study, Preparers Made Significant Errors*. Retrieved August 3, 2015, from <http://www.gao.gov/products/GAO-14-467T>

⁴⁶ U.S. GAO. *Paid Tax Return Preparers: In a Limited Study, Preparers Made Significant Errors*. Retrieved August 3, 2015, from <http://www.gao.gov/products/GAO-14-467T>

⁴⁷ U.S. GAO. *Paid Tax Return Preparers: In a Limited Study, Preparers Made Significant Errors*. Retrieved August 3, 2015, from <http://www.gao.gov/products/GAO-14-467T>

Alternatives to Regulation

The third sunrise criterion asks:

Whether the public can be adequately protected by other means in a more cost-effective manner.

As this sunrise review discussed earlier, a great deal of consumer protection is afforded under the federal Worker, Homeownership and Business Assistance Act (Act). This law establishes that all specified tax return preparers (defined as any tax return preparer who reasonably expects to file more than 10 individual income tax returns during a calendar year), must secure an Electronic Filing Identification Number (EFIN) from the IRS. Requirements for participation and the granting of an EFIN include education requirements as well as credit and criminal background checks as determined by the IRS.

In conclusion, this federal requirement offers a viable alternative to state occupational licensing. Further, it is reasonable to assume that a large segment of the paid tax preparer industry is subject to this federal oversight. While it is true that practitioners who prepare fewer than 10 tax returns annually are exempt, a significant potential for public harm is mitigated by the provisions of the Act.

Collateral Consequences

The fourth sunrise criterion asks:

Whether the imposition of any disqualifications on applicants for licensure, certification, re-licensure, or re-certification based on criminal history serves public safety or commercial or consumer protection interests.

The sunrise application did not delineate whether issues such as criminal history would be considered as a criterion for licensure as a paid tax preparer. However, the examples of harm identified in this sunrise review, including allegations of criminal conduct and actual convictions, may warrant careful consideration as to whether past criminal convictions should be a criterion for licensure.

Conclusion

The sunrise application requested licensure (the most restrictive type of regulation) of paid tax preparers. Further, the sunrise application, among other issues, states that licensure should be required of paid tax preparers as completing tax returns is a sophisticated and complicated process that requires well-informed, competent practitioners.

Importantly, the sunrise application excluded certified public accountants, attorneys and enrolled agents from the licensure proposal.

For most Coloradans, filing tax returns is a very important financial transaction. Although there has been an increase in the number of individuals who complete their own taxes, the majority of consumers throughout the country still rely on paid tax preparers to complete their taxes each year. As a result, paid tax preparers can have a tremendous impact on consumers' financial dealings.

Research conducted for this review was unable to determine an estimate of the number of paid tax preparers in Colorado. No doubt many factors contribute to this lack of data including the seasonal nature of the work which would lead to many tax preparers working part time. However, more than a million Colorado taxpayers paid someone else to complete their taxes in 2011.⁴⁸

There are many limitations in this information. As an example, the above figure almost surely includes certified public accountants. Even so, the enormous disparity between the size of the tax preparer market and the exceedingly small amount of consumer harm (some of the harm only alleged) argues strongly against state intervention in the marketplace. Thus, the regulatory proposal fails to meet the first sunrise criterion.

Still, the evidence that Colorado consumers are harmed by the lack of competence of tax preparers and the state must intervene to evaluate practitioners before they may enter the marketplace is not persuasive since only a smattering of complaints involve competency.

Occupational licensing does one thing very well: state regulators evaluate applicants against established criteria (educational requirements and completion of required examinations, as examples) in order to determine if an applicant can practice the regulated occupation competently. However, few studies have shown significant benefits of occupational regulation on the quality of service received by consumers or on the demand for service. Although policy makers may wish occupational licensing were a way to enhance quality, there is little evidence to support this assumption for consumers, even at the point of sale. On the other hand, several studies have found significant effects on the wages that licensed practitioners receive and on the prices that consumers face.⁴⁹

Sunrise reviews are directed by statute to identify more cost-effective approaches to consumer protection than the creation of a new regulatory program in state government. This analysis can also be extended to consider the cost to consumers since occupational licensing increases costs.

⁴⁸ Colorado Fiscal Institute. *Fact Sheet in Support of HB 14 - 1285: Taxpayer Protection Disclosure Act*. Retrieved September 8, 2015, from www.coloradofiscal.org

⁴⁹ Morris M. Kleiner, *Reforming Occupational Licensing Policies*, The Hamilton Project Discussion Paper, January 2015, p. 13.

The majority of the harm caused by tax preparers appears to be intentional, fraudulent actions. This type of harm is better addressed through the criminal justice system. In fact, that is precisely the response rendered in most of the examples of harm considered in this sunrise review.

Beyond criminal sanctions, the IRS administers a type of regulatory program with numerous requirements of paid tax preparers who meet the IRS threshold. This combination of involvement and oversight by government appears an adequate response to the harm identified in this review. The proposal therefore fails to meet the third sunrise criterion.

The professional function of paid tax preparers is complex and very important to the citizens of Colorado who do not prepare their own taxes. Furthermore, the sunrise applicants prepared a thorough application arguing for the need for regulation. While one might intuitively expect to find extensive examples of harm to consumers through incompetent practitioners or fly-by-night operators, there is simply not sufficient evidence to support the notion that state regulation is needed to ensure that only certain individuals be permitted to compete in the Colorado marketplace. In those instances involving criminal conduct, existing laws and law enforcement appear adequate to remove guilty parties from practice.

Recommendation – The General Assembly should not regulate paid tax preparers.