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Regulating Tax Return Preparation

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REGULATING TAX RETURN PREPARATION

JAY A. SOLED
KATHLEEN DELANEY THOMAS

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REGULATING TAX RETURN PREPARATION

JAY A. SOLED*

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Abstract: Annually, the U.S. government collects nearly \$3 trillion of income and employment taxes. With respect to these collections, Form 1040 (U.S. Individual Income Tax Return) seeks to ensure taxpayer accuracy. Currently, two sets of players dominate the Form 1040 preparation and submission process: tax return preparers and tax return preparation software companies. The former guides taxpayers through the entire tax return preparation and submission process, and the latter provides taxpayers with the necessary tools to complete and submit tax returns themselves. Tax return preparers and tax software companies thus stand as vital intermediaries between the government and taxpayers. Despite the key role that tax return submission plays in government function, Congress exercises virtually no oversight over the process. Currently, regardless of education, knowledge, or experience, any person can prepare tax returns for compensation; similarly, almost no checks exist to ensure the substantive accuracy of tax returns prepared with tax software. As a result of these shortcomings, taxpayers file millions of flawed tax returns each year. Faulty returns shortchange the government of necessary revenue, deprive some taxpayers of crucial government benefits, and leave others liable for back taxes and penalties. This Article is the first to propose comprehensive tax return preparation process reform. It urges Congress to regulate both tax return preparers and tax preparation software companies. Adoption of one or more of the proposed reforms should lead to more accurate tax returns, protect taxpayers, and ensure a fairer and more efficient tax system.

INTRODUCTION

Under current law, tax return preparers and the tax return preparation software industry endure little regulatory oversight.¹ Members of both groups

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¹ See, e.g., STAFF OF THE JOINT COMM. ON TAXATION, 113TH CONG., PRESENT LAW AND BACKGROUND RELATED TO THE REGULATION OF CONDUCT OF PAID TAX RETURN PREPARERS 4 (Comm. Print 2014) (“While the Code provides standards of return preparation, disclosure rules,

may essentially render their services or produce their products in any manner they please. If taxpayers were universally compliant, this laissez-faire approach on the part of Congress might be acceptable. Nevertheless, this is far from being the case. The nation's tax gap (the difference between what taxpayers owe and what they actually pay in tax)² is significant—last estimated to be \$458 billion annually³—and shows no immediate signs of abating. Institution of a set of reforms is in order because tax return preparers⁴ and the tax return preparation software industry⁵ play such vital roles in the tax administration process and, metaphorically speaking, are the nation's fiscal gatekeepers.

Consider the fact that tax return preparers and the tax return preparation software industry share the same objectives. They want to produce tax returns that simultaneously minimize taxpayers' tax burdens and do not attract Internal Revenue Service ("IRS") audit attention. The reason for achieving these shared objectives is simple: if this outcome is successfully delivered, it will generate repeat business, yielding more professional fees

and civil penalties, neither the Code nor the related Treasury regulations require paid tax return preparers to meet any qualifications or competency standards before preparing tax returns or claims for refund.”).

² See Nina E. Olson, *Minding the Gap: A Ten-Step Program for Better Tax Compliance*, 20 STAN. L. & POL'Y REV. 7, 8 (2009) (defining the “tax gap” as the difference between what taxpayers owe on their tax returns and the amount they voluntarily pay in a timely manner). There is a plethora of literature on the tax gap and its size. See JAMES M. BICKLEY, CONG. RESEARCH SERV., R42739, TAX GAP, TAX COMPLIANCE, AND PROPOSED LEGISLATION IN THE 112TH CONGRESS 2 (2012); JAMES M. BICKLEY, CONG. RESEARCH SERV., RL33882, TAX GAP AND TAX ENFORCEMENT 2 (2007); IRS & DEP'T OF THE TREASURY, REDUCING THE FEDERAL TAX GAP: A REPORT ON IMPROVING VOLUNTARY COMPLIANCE 1 (2007); OFFICE OF TAX POLICY, U.S. DEP'T OF THE TREASURY, A COMPREHENSIVE STRATEGY FOR REDUCING THE TAX GAP 2 (2006); Heather Bennett, *IRS Must Get Grip on Tax Gap, Taxpayer Advocate Says*, 106 TAX NOTES 531, 531 (2005); Dustin Stumper, *Everson Pledges to Narrow Growing Tax Gap*, 110 TAX NOTES 807, 807 (2006); George K. Yin, *JCT Chief Discusses the Tax Gap*, 107 TAX NOTES 1449, 1449 (2005).

³ *The Tax Gap: Tax Gap Estimates for Tax Years 2008–2010*, IRS (Apr. 28, 2016), <https://www.irs.gov/uac/the-tax-gap> [<https://perma.cc/RB2C-8TM8>].

⁴ See, e.g., U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-06-563T, PAID TAX RETURN PREPARERS: IN A LIMITED STUDY, PREPARERS MADE SIGNIFICANT ERRORS 8 (2014) (“According to IRS’s SOI data, an estimated 81.2 million or 56 percent of approximately 145 million individual tax returns filed for tax year 2011 were completed by a paid preparer.”). “The IRS estimates that there are between 900,000 and 1.2 million paid tax return preparers currently.” IRS, RETURN PREPARER REVIEW 8 (2009).

⁵ See, e.g., IRS, *supra* note 4, at 9 (“Taxpayers self-prepared and electronically filed 32 million tax returns using consumer tax preparation software during the 2009 filing season.”); U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-09-297, TAX ADMINISTRATION: MANY TAXPAYERS RELY ON TAX SOFTWARE AND IRS NEEDS TO ASSESS ASSOCIATED RISKS 1 (2009) (“In 2007, over 39 million income tax returns were prepared by individuals using commercial tax software such as TurboTax, TaxCut, or TaxAct, and more than 66 percent of those returns were then filed electronically. This volume makes commercial tax return preparation software a critical part of the tax administration system.”).

and corporate profits. Nevertheless, these objectives are not necessarily those of the government. Instead, the government wants citizens to pay the taxes that they owe and to take only those reporting positions that are supported by substantial legal authority.⁶

Additionally, consider the distribution of government benefits provided through the tax system, such as the earned income tax credit (“EITC”)⁷ or the child tax credit.⁸ The fact that these benefits are frequently delivered in the form of a tax refund⁹ provides an opportunity for return preparers to collect fees from taxpayers who would otherwise be unable to afford them. The common arrangement of deducting preparation fees from refunds, coupled with the lack of regulation in this area, has led to an explosive industry of paid preparers who lack expertise in tax law and target low-income taxpayers.¹⁰ These unregulated preparers often charge exorbitant and hidden fees¹¹ while frequently making tax return errors,¹² which, if detected by the IRS, leave the taxpayer responsible for repayment of taxes and interest. Thus, the government’s goal of maximizing benefits intended to reduce poverty and redistribute wealth¹³ stands squarely at odds with the private sector’s profit motive.

In considering the apparent tension between the objectives of those who assist in the tax return preparation process and those of the government, the latter’s objectives should prevail. The reason is simple: accurate tax return preparation is a fundamental need of every government, and the United States is no exception. In order to help taxpayers navigate their civic

⁶ See I.R.C. § 6662(a), (d)(2)(B) (2012) (establishing that to avoid the imposition of an accuracy-related penalty, the reporting position must be grounded in “substantial authority”; or, alternatively, the taxpayer must make adequate disclosure).

⁷ *Id.* § 32.

⁸ *Id.* § 24.

⁹ See THOMAS L. HUNGERFORD & REBECCA THIESS, THE EARNED INCOME TAX CREDIT AND THE CHILD TAX CREDIT: HISTORY, PURPOSE, GOALS, AND EFFECTIVENESS 2 (ECON. POL’Y INST., Issue Brief #370, Sept. 25, 2013), available at <http://www.epi.org/publication/ib370-earned-income-tax-credit-and-the-child-tax-credit-history-purpose-goals-and-effectiveness/> (“The EITC and CTC differ from most other tax credits in that they are partially or fully refundable.”).

¹⁰ See, e.g., CHI CHI WU & CHANTAL HERNANDEZ, NAT’L CONSUMER LAW CTR., MINEFIELD OF RISKS: TAXPAYERS FACE PERILS FROM UNREGULATED PREPARERS, LACK OF FEE DISCLOSURE, AND TAX-TIME FINANCIAL PRODUCTS, at i (2016) (“Paid preparers offer and promote financial products that can be unnecessary and expensive, such as refund anticipation checks (RACs).”).

¹¹ See *id.* at 8–9 (discussing “add-on” fees).

¹² See CHI CHI WU, NAT’L CONSUMER LAW CTR., RIDDLED RETURNS: HOW ERRORS AND FRAUD BY PAID TAX PREPARERS PUT CONSUMERS AT RISK AND WHAT STATES CAN DO 1 (2014) (discussing erroneous tax returns prepared by unregulated preparers).

¹³ See HUNGERFORD & THIESS, *supra* note 9, at 2 (“Both the EITC and the CTC significantly reduce taxes on low- and middle-income families with children.”).

obligations and to facilitate compliance, it is essential that Congress regulate the tax return preparation process.

This Article details the need for a comprehensive approach to regulating tax return preparers and the tax return preparation software industry and discusses why, in the absence of doing so, the integrity of the tax system is threatened.¹⁴ Part I explores how, to date, Congress has done little to regulate either industry.¹⁵ Part II discusses the implications of Congress's noninterventionist approach and makes an affirmative case for regulation of both tax return preparers and tax preparation software.¹⁶ Part III details the specific reforms that Congress should institute to enhance taxpayer compliance and strengthen accuracy in the delivery of government benefits.¹⁷

I. CONGRESS'S HANDS-OFF APPROACH TO TAX RETURN PREPARATION

Since the inception of the income tax in 1913,¹⁸ the tax return preparation process has become an integral part of the United States' fiscal fabric.¹⁹ At first, this "fabric" covered only a small sliver of the nation's upper economic echelon. In the aftermath of World War II with its fiscal demands, however, Congress transformed the income tax into a mass tax that required large-scale participation.²⁰ Tax return submissions thus became a cultural phenomenon, regularly featured in the popular press, television shows, and even in musical lyrics.²¹ And although Congress placed a premium on standardization (for example, the time period that constitutes a tax year,²² the due date by which taxpayers must submit their returns,²³ and the forms

¹⁴ See *infra* notes 18–255 and accompanying text.

¹⁵ See *infra* notes 18–97 and accompanying text.

¹⁶ See *infra* notes 98–174 and accompanying text.

¹⁷ See *infra* notes 175–255 and accompanying text.

¹⁸ Tariff Act of 1913, Pub. L. No. 63-16, 38 Stat. 114, 166 (1913) (current version at I.R.C. § 1(a)–(e) (2012)).

¹⁹ See generally LAWRENCE ZELENAK, *LEARNING TO LOVE FORM 1040: TWO CHEERS FOR THE RETURN-BASED MASS INCOME TAX* 121–22 (2013) (discussing the universality of the tax return filing experience).

²⁰ See Carolyn C. Jones, *Class Tax to Mass Tax: The Role of Propaganda in the Expansion of the Income Tax During World War II*, 37 *BUFF. L. REV.* 685, 685–86 (1988–1989) (pointing out that, prior to World War II, only a small sliver of the nation's population was subject to the income tax and that, in the war's aftermath, there was a dramatic increase of people subject to the income tax).

²¹ See ZELENAK, *supra* note 19, at ch. 6.

²² See Tariff Act, 38 Stat. at 168 (“The said tax shall be computed upon the remainder of said net income of each person subject thereto, accruing during each preceding calendar year ending December thirty-first.”).

²³ See *id.* (“On or before the first day of March, nineteen hundred and fourteen, and the first day of March in each year thereafter, a true and accurate return, under oath or affirmation, shall be made by each person of lawful age.”).

that taxpayers must employ²⁴), it did not put itself or the IRS at the helm of the tax return preparation process. Instead, taxpayers were charged with this responsibility. In response, taxpayers often turned to others and, more recently, to technology for assistance.

As the application of the income tax broadly expanded, a cottage industry quickly arose in the form of paid tax return preparers. For a fee, tax return preparers could alleviate much of the stress and anguish that taxpayers commonly endured in preparing their own tax returns. Many taxpayers apparently found this option attractive, and they routinely have availed themselves of this service.²⁵

Decades later, the ubiquity of the Information Era²⁶ and personal computers triggered the launch of the tax return preparation software industry. This industry tried to make the tax return preparation process accessible to all; it largely accomplished this feat by breaking down the tax return's complexity into digestible tidbits and delegating all challenging (and simple) math computations to computer programs.²⁷ The tax preparation software industry's efforts were well rewarded as sales of the industry's products catapulted skyward.²⁸

The vast majority of taxpayers (around ninety percent) now rely upon either tax return preparers or tax preparation software for assistance with their tax returns.²⁹ Indeed, for at least a quarter of the year (spanning from January to April 15) throughout the country, it's hard to drive down a city block, listen to the radio, conduct an Internet search, or watch TV without seeing or hearing advertisements for tax return preparation assistance.

²⁴ See *id.* (“[Requiring the submission of a] form as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe, setting forth specifically the gross amount of income from all separate sources and from the total thereof, deducting the aggregate items or expenses and allowance herein authorized” (alteration in original)).

²⁵ See IRS, *supra* note 4, at 9 (“With tax return preparers preparing almost 60 percent of all returns filed, their impact on tax administration is significant.”).

²⁶ For a concise description of the so-called Information Age, see generally NICHOLAS NEGROPONTE, *BEING DIGITAL* (1995) (discussing the defining characteristics of the Information Age).

²⁷ Jay A. Soled, *Computers, Complexity, and the Code: Dawn of a New Era*, 73 TAX NOTES TODAY 471, 472 (Oct. 28, 1996).

²⁸ See, e.g., U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 5, at 1 (concluding that the volume of tax returns submitted with the assistance of tax return preparation software makes that software an essential constituent of the tax return preparation apparatus).

²⁹ See *Protecting Taxpayers from Incompetent and Unethical Return Preparers: Hearing Before the S. Comm. on Finance*, 113th Cong. 1 (2014) [hereinafter *Hearing, Protecting Taxpayers*] (written testimony of John A. Koskinen, Comm'r, IRS) (“Each year, paid preparers are called upon by taxpayers to complete about 80 million returns, or about 56 percent of the total individual income tax returns filed, while another 34 percent of taxpayers use tax preparation software, for a total of 90 percent who seek some form of assistance.”).

Today, the tax return preparation process is pivotal to the government, collecting close to \$3 trillion annually in income and employment taxes.³⁰ Yet notwithstanding the vital importance of this process, Congress has, as the next two sections detail, essentially abdicated its oversight responsibilities, failing to regulate (A) tax return preparers and (B) the tax return preparation software industry.

A. Congressional Failure to Regulate Tax Return Preparers

Congress did enact legislation in the late nineteenth century allowing for regulation of “agents, attorneys, or other persons representing persons” before the Department of Treasury.”³¹ Under this statutory authorization, the Treasury Department promulgated regulations in the early part of the twentieth century intended to govern the conduct of certain tax practitioners like attorneys and certified public accountants (“CPAs”).³² Nevertheless, it was not until 2011 that the Treasury Department attempted to regulate *all* tax return preparers by requiring licensing and competency testing.³³ Nevertheless, as discussed further below, those regulations were short-lived: two courts found them to be outside of the scope of the enabling statute.³⁴ Thus, at present, tax return preparers who are not attorneys, CPAs, or “enrolled agents”³⁵ are generally free from any federal oversight.³⁶

1. Enabling Legislation

Whether Congress originally intended to give the Treasury Department authority to regulate tax return preparers is a subject of dispute.³⁷

³⁰ IRS, IRS DATA BOOK 2015, at 3 tbl.1 (2015).

³¹ See Horse Act of 1884, ch. 334, 23 Stat. 236, 258 (1884) (current version at 31 U.S.C. § 330(a) (2012)).

³² See Regulations Governing Practice Before the Internal Revenue Service, 76 Fed. Reg. 32, 285, 32,286 (June 3, 2011) (to be codified at 31 C.F.R. pt. 10).

³³ See *id.*

³⁴ See *infra* notes 62–65 and accompanying text.

³⁵ Enrolled agents are individuals who are authorized to represent taxpayers before the IRS on matters like audits or appeals. To earn this credential, one must pass a competency examination, adhere to ethical standards, and undergo continuing education. *Enrolled Agent Information*, IRS (Apr. 22, 2016), <https://www.irs.gov/tax-professionals/enrolled-agents/enrolled-agent-information> [<https://perma.cc/5ZGH-8CVD>].

³⁶ By electing to take a competency examination, tax return preparers may also gain limited rights to represent taxpayers before the IRS. See *Understanding Tax Return Preparer Credentials and Qualifications*, IRS (Mar. 23, 2016), <https://www.irs.gov/tax-professionals/understanding-tax-return-preparer-credentials-and-qualifications> [<https://perma.cc/8KFJ-QBAD>] (discussing the voluntary Annual Filing Season Program). There is, however, no competency requirement to prepare tax returns for compensation. See *id.*

³⁷ Compare Nina E. Olson, *More Than a ‘Mere’ Preparer: Loving and Return Preparation*, 139 TAX NOTES 767, 777 (May 13, 2013) (“The abuses Congress sought to regulate in 1884 are of

By way of background, in the immediate aftermath of the Civil War, the problem of horse wrangling and other monetary claims forced Congress to address the issue of who could represent taxpayers before the Treasury Department. More specifically, Congress was concerned that people who appeared before the Treasury Department might act unscrupulously when making claims on the behalf of others; in particular, citizens might fabricate claims that their horses and other property had been commandeered for Civil War use and, in conjunction with their advisers, seek undeserved compensation.³⁸ To address this concern, Congress passed legislation that enabled the Treasury Department to regulate “agents, attorneys, or other persons representing claimants before [the] Department.”³⁹

Over the ensuing years, Congress made a few cosmetic changes to this enabling legislation, but its substance has remained largely intact. The enabling statute presently reads as follows:

- (a) [T]he Secretary of the Treasury may—
 - (1) regulate the practice of representatives of persons before the Department of the Treasury; and
 - (2) before admitting a representative to practice, require that the representative demonstrate—
 - (A) good character;
 - (B) good reputation;
 - (C) necessary qualifications to enable the representative to provide to persons valuable service; and
 - (D) competency to advise and assist persons in presenting their cases.⁴⁰

2. Regulations Promulgated Under the Enabling Legislation

As discussed in this section, the Treasury Department narrowly construed the application of this enabling legislation initially.⁴¹ Over time, however, the agency gradually extended the breadth of its regulations,⁴²

the same type we see today regarding claims made on tax returns.”), *with Loving v. IRS*, 742 F.3d 1013, 1019 (D.C. Cir. 2014) (“The original language plainly would not encompass tax-return preparers.”).

³⁸ See Alex H. Levy, *Believing in Life After Loving: IRS Regulation of Tax Preparers*, 17 FLA. TAX REV. 437, 440 (2015) (“Section 330 can be traced to a little-known law called the Horse Act of 1884. That act, which predates the modern federal income tax by nearly 30 years, allowed the Treasury Department to crack down on agents who fraudulently claimed reimbursement for veterans whose horses were lost or killed in the Civil War.”).

³⁹ Horse Act of 1884, ch. 334, 23 Stat. 236, 258 (codified at 31 U.S.C. § 330(a)(2012)) (alteration in original).

⁴⁰ 31 U.S.C. § 330(a) (2012).

⁴¹ See *infra* note 45 and accompanying text.

⁴² See *infra* notes 46–49 and accompanying text.

most recently to cover tax return preparation.⁴³ Critics argued, though, that such a broad extension was beyond Congress's statutory authorization, and the judiciary agreed, subsequently voiding the expanded scope of these regulations.⁴⁴ Since that time, Congress has remained virtually silent on the issue, and the enabling legislation has not been expanded.

a. The Evolution of the Circular 230 Regulations

In 1921, the Treasury Department promulgated regulations (known as "Circular 230") under the enabling legislation that sought to regulate only those tax practitioners, namely, attorneys, and accountants who practiced before the agency.⁴⁵ Not only did Circular 230 apply to a small segment of the population, it seemingly only applied to those who had physical interactions (for example, meetings or adjudications) with government representatives.

In 1966, the Treasury Department broadened the ambit of Circular 230 and its application. Going forward, attorneys and accountants would be granted automatic permission to act as taxpayer representatives if they submitted a completed Form 2848 (Power of Attorney and Declaration of Representation) on their clients' behalf.⁴⁶ Noteworthy, too, was that the 1966 version of Circular 230 expanded, for the first time, the purview of those who could represent taxpayers to include tax return preparers. Thereafter, tax return preparers were allowed to represent taxpayers whose returns they had prepared "before revenue agents and examining officers of the Audit Division in the offices of District Directors."⁴⁷ The 1966 amendment thus subjected tax return preparers (who were not otherwise attorneys or CPAs) to Circular 230's disciplinary rules, but *only* when they represented taxpayers before the IRS; the act of tax return preparation itself was not covered.⁴⁸

Two decades later, in 1984, the Treasury Department once again re-crafted Circular 230. In another first, the agency sought to regulate those tax advisers who did not necessarily "practice" before it. The catalyst behind this change was the burgeoning growth of the tax shelter industry. In response, the Treasury Department promulgated § 10.33 of Circular 230, enti-

⁴³ See *infra* note 57 and accompanying text.

⁴⁴ See *infra* notes 62–73 and accompanying text.

⁴⁵ See Bryan T. Camp, 'Loving' *Return Preparer Regulation*, 72 TAX NOTES 457, 458 n.6 (July 29, 2013) ("The three basic regulatory efforts before 1921 were: Circular 13 (Feb. 6, 1886) (concerning internal taxes), Circular 94 (Oct. 4, 1890) (same), and T.D. 32974 (Nov. 30, 1912) (concerning Customs).").

⁴⁶ See Practice Before the Internal Revenue Service, 31 Fed. Reg. 10,773, 10,774 (Aug. 13, 1966) (to be codified at 31 C.F.R. pt. 10).

⁴⁷ *Id.* at 10,775.

⁴⁸ See Camp, *supra* note 45, at 459.

tled *Tax Shelter Opinions*. This section set forth standards for written tax opinions that opined about the legitimacy of aggressive tax return positions.⁴⁹ Going forward, tax professionals who provided clients with written advice about tax shelters were subject to Circular 230's rules regardless of whether they had any direct dealings with the IRS.

One decade later, in 1994, the agency made another monumental change to Circular 230, adding § 10.34. This section went well beyond regulating written opinions issued by the tax shelter industry. With a broad brushstroke applicable to all tax return preparation work, it required that a tax reporting position must always "have a realistic possibility of being sustained on its merits" or, alternatively, be adequately disclosed to the IRS.⁵⁰ Thus, although Circular 230 did not dictate who could become a tax return preparer, the amendment covered the substance of what was reported on a return by a preparer.

In 2004, the Treasury Department went a step further, adding § 10.35, § 10.36, and § 10.37 to Circular 230; these sections specified more elaborate standards of conduct that pertained to written tax advice, geared again toward the nonrepresentational behavior of practitioners rather than work before the agency.⁵¹

Despite the repeated expansion of Circular 230's ambit to include facets of tax return preparation, these amendments apparently did not go far enough to curb derelict behavior on the part of tax return preparers. Whether due to ignorance or malfeasance, the advice that many tax return preparers rendered continued to fall far short of the accuracy mark.⁵² A report prepared by the Treasury Inspector General for Tax Administration,⁵³ as well as two reports conducted by the Government Accountability Office ("GAO"),⁵⁴ supported

⁴⁹ Regulations Governing the Practice of Attorneys, Certified Public Accountants, and Enrolled Actuaries Before the Internal Revenue Service, 49 Fed. Reg. 6719, 6719 (Feb. 23, 1984) (to be codified at 31 C.F.R. pt. 10); see Dennis J. Ventry Jr., *No Joke: Circular 230 Is Here to Stay*, 111 TAX NOTES 1409, 1410 (2006) ("Treasury also articulated a specific antishelter strategy."); Dennis J. Ventry Jr., *The Reaction to the 1980 Proposed Amendments to Circular 230*, 111 TAX NOTES 1141, 1141 (2006) ("The amendments were designed to shut down the mass marketing of tax shelters to nonclient investors.").

⁵⁰ Regulations Governing the Practice of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries Before the Internal Revenue Service, 59 Fed. Reg. 31,523, 31,523 (June 20, 1994) (to be codified at 31 C.F.R. pt. 10). The new regulations also required that disclosed return positions not be frivolous. *Id.*

⁵¹ T.D. 9165, 2005-1 C.B. 359-63.

⁵² See TREASURY INSPECTOR GEN. FOR TAX ADMIN., MOST TAX RETURNS PREPARED BY A LIMITED SAMPLE OF UNCONTROLLED PREPARERS CONTAINED SIGNIFICANT ERRORS 3 (2008) ("Pursuing abusive preparers is part of the IRS' strategy to reduce the tax gap, which researchers estimate to be \$290 billion based on 2001 data.").

⁵³ See *id.*

⁵⁴ For the two studies, see generally U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-14-467T, PAID TAX RETURN PREPARERS: IN A LIMITED STUDY, PREPARERS MADE SERIOUS ERRORS

this indictment. Those reports also revealed that unsuspecting low-income taxpayers often were the targets of unregulated tax return preparers.⁵⁵ Because Circular 230 at that time did not require any specific qualifications to become a tax return preparer, there were no checks in place to ensure that only qualified, scrupulous individuals could prepare tax returns.

b. The 2011 Return Preparer Regulations

In 2009, the Treasury Department conducted a study that confirmed that ameliorative action should be undertaken to address return preparer competency.⁵⁶ In response to this study and on the basis of the enabling statute, the Treasury Department in 2011 promulgated new rules under Circular 230 aimed at regulating *all* tax return preparers,⁵⁷ declaring that unlicensed preparers would have to meet the following threefold conjunctive criteria: (a) pass a competency test related to Form 1040 and related schedules; (b) pass a “suitability” background check; and (c) obtain a preparer tax identification number.⁵⁸

In addition to fulfilling these three criteria, practitioners, once registered, would have to complete fifteen hours of continuing education each year.⁵⁹ Tax return preparers who were already licensed, such as attorneys, CPAs, and enrolled agents, were exempt from competency testing and continuing education requirements.⁶⁰ The driving force behind these regulations was straightforward: the Treasury Department sought to improve tax return preparers’ competency and strengthen their ethical moorings. By attempting to get tax return preparers in line, the Treasury Department hoped to achieve better tax return accuracy and thereby narrow the tax gap.⁶¹

(2014); and U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-06-563T, PAID TAX RETURN PREPARERS: IN A LIMITED STUDY, CHAIN PREPARERS MADE SERIOUS ERRORS (2006).

⁵⁵ See generally Olson, *supra* note 37 (expressing concern that the unprincipled actions of tax return preparers are exposing low-income communities to liability).

⁵⁶ See *IRS Launches Tax Return Preparer Review; Recommendations to Improve Compliance Expected by Year End*, IRS (June 4, 2009), <http://www.irs.gov/uac/IRS-Launches-Tax-Return-Preparer-Review-Recommendations-to-Improve-Compliance-Expected-by-Year-End> [<https://perma.cc/CX77-SQTN>].

⁵⁷ Regulations Governing Practice Before the Internal Revenue Service, 76 Fed. Reg. 33,685, 32,286 (June 12, 2014) (to be codified at 31 C.F.R pt. 10).

⁵⁸ *Id.* at 32,287.

⁵⁹ *Id.* at 32,290.

⁶⁰ *Id.* at 32,287. Testing and continuing education were also not required for return preparers employed by law firms or by certified public accounting firms. *Id.* at 32,298.

⁶¹ See generally Russell J. George, *TIGTA Discusses Enforcement Challenges Faced by the IRS*, TAX NOTES TODAY, Aug. 10, 2010, LEXIS, 2010 TNT 154-30 (acknowledging the need for the IRS to engage the tax return preparer community in an effort to reduce the tax gap).

c. *Loving and Ridgely: The Demise of the Return Preparer Regulations*

Not all tax return preparers welcomed the Treasury Department's expansive reading of the enabling statute and the new regulatory regime. Two lawsuits, *Loving v. IRS*⁶² and *Ridgely v. Lew*,⁶³ reflect the deep-seated animosity that some tax return preparers harbored toward the newly promulgated regulations; in both cases, the courts upheld the tax return preparers' challenges. Consider the facts and outcomes in each case.

In *Loving*, a case before the U.S. Court of Appeals for the D.C. Circuit in 2014, three tax return preparers sought to strike down the new licensing and testing regime as being beyond the scope of the enabling statute,⁶⁴ which, recall, allows for regulation of "practice of representatives of persons before the Department of the Treasury."⁶⁵ In affirming the district court, the D.C. Circuit Court of Appeals pointed out that tax return preparation involves assisting taxpayers, not representing them, and *assisting* and *representing* are not interchangeable terms.⁶⁶ Furthermore, the court found that preparing a tax return cannot be equated to "practice . . . before the Department of the Treasury," which it stated would probably "involve traditional adversarial proceedings."⁶⁷ On the basis of these and other findings,⁶⁸ the appeals court struck down the newly crafted regulations as being invalid.

In *Ridgely*, a case before the U.S. District Court for the District of Columbia in 2014, a CPA also sought to invalidate the expansion of Circular 230 to cover tax return preparers.⁶⁹ The plaintiff in that case did not challenge the new registration and testing regime as the plaintiffs had in *Loving* but, rather, challenged the fact that tax return preparation was now under the ambit of Circular 230 more broadly.⁷⁰ Specifically, Mr. Ridgely contended that Circular 230's prohibition on contingent fee arrangements for refund claims should not apply to him because, in merely preparing amended tax returns to claim the refunds, he was not actually "representing" the taxpayer.⁷¹ Just as it had in *Loving*, the IRS once again found itself on the losing side of a court battle. The same district court that had ruled in *Loving* ap-

⁶² *Loving*, 742 F.3d at 1015.

⁶³ *Ridgely v. Lew*, 55 F. Supp. 3d 89, 90 (D.D.C. 2014).

⁶⁴ *Loving*, 742 F.3d at 1015.

⁶⁵ 31 U.S.C. § 330(a)(1).

⁶⁶ *Loving*, 742 F.3d at 1017 ("The tax-return preparer certainly *assists* the taxpayer, but the tax-return preparer does not *represent* the taxpayer.").

⁶⁷ *Id.* at 1018, 1019.

⁶⁸ *See id.* at 1019–21. The appeals court cites three other rationales for its holding in the taxpayer's favor: the history of the enabling statute, the broader statutory framework, and the fact that such a major delegation of power was not explicitly provided for by Congress. *Id.*

⁶⁹ *Ridgely*, 55 F. Supp. 3d at 93.

⁷⁰ *Id.* at 91.

⁷¹ *See id.*

plied the identical rationale in *Ridgely*: the plaintiff CPA was merely “assisting” the taxpayer and was in no way representing him;⁷² as such, this foreclosed Circular 230’s application to the CPA’s fee arrangement. In the words of the court, those activities leading up to a tax return submission were not within the enabling statute’s ambit; instead, only if the IRS commenced an audit would “practice” before the agency begin, triggering the statute’s application and, by extension, Circular 230 oversight.⁷³

d. Current Environment: Lack of Oversight

In the aftermath of the *Loving* and *Ridgely* decisions, the Treasury Department has essentially lost its latitude to regulate tax return preparers. Put slightly differently, when it comes to congressional oversight of tax return preparers, there is none.⁷⁴ That being the case, anyone can claim to be a tax return preparer, set up shop, hang out a shingle, and start preparing tax returns. Historically, such broad latitude does not bode well for tax compliance.⁷⁵ The Treasury Department could thus redesign Form 1040 in a manner that would potentially help ensure better tax compliance; such efforts, however, would be almost entirely for naught if the financial gatekeepers of the income tax system—namely, tax return preparers—are ill-trained, unscrupulous, or simply ignorant.

B. Congressional Failure to Regulate the Tax Return Preparation Software Industry

In contrast to the saga over regulating paid tax return preparers, the history behind tax return preparation software is rather brief. Essentially, it is a story of free rein bestowed by both Congress and the Treasury Department on the tax return software industry from its inception.

Over the last several decades, the tax return preparation software industry has grown by leaps and bounds.⁷⁶ Despite this stupendous growth, Congress has exercised virtually no oversight over this multibillion-dollar

⁷² *Id.* at 95 (“CPAs . . . [without] any power of attorney possess[] no ‘legal authority to act on behalf of taxpayers.’ In *Loving*’s words, these individuals merely ‘assist[]’ the taxpayer. Thus, Section 330’s use of the term ‘representative’ excludes refund claim preparers, just as it did tax-return preparers in *Loving*.” (alteration in original) (quoting *Loving*, 742 F.3d at 1017)).

⁷³ *Id.* at 96.

⁷⁴ See STAFF OF THE JOINT COMM. ON TAXATION, *supra* note 1, at 4.

⁷⁵ See *IRS Launches Tax Return Preparer Review*, *supra* note 56 (announcing a review of tax preparers spurred by a study suggesting that the tax return preparer industry required ameliorative action).

⁷⁶ See, e.g., Beryl A. Howell, *Court Enjoins Proposed Merger Between H&R Block and TaxACT on Antitrust Grounds*, TAX NOTES TODAY, Nov. 14, 2011, LEXIS, 2011 TNT 219-10 (“Digital Do It-Yourself preparation is becoming increasingly popular.”).

industry.⁷⁷ To date, there are three areas of legislation that minimally shape the tax return preparation software industry. First, the Internal Revenue Code (“Code”) requires that the tax return preparation software industry design its software in a manner that permits e-filing.⁷⁸ Second, tax return software companies (along with tax return preparers) are forbidden from disclosing or using taxpayers’ personal information without authorization.⁷⁹ Finally, software companies are subject to privacy and safeguarding rules administered by the Federal Trade Commission.⁸⁰

Similarly, neither the Treasury Department nor the IRS has unilaterally sought to exercise much oversight over the tax return preparation software industry. Currently, the IRS requires software developers to annually verify that their products are electronically compatible with the IRS’s processing systems, that tax rates are updated, and that the software’s computations are correct.⁸¹ Apart from these minor verification requirements, tax return software companies are generally granted *carte blanche*. In fact, the IRS generally does not conduct any testing to determine whether the substantive guidance provided by tax return preparation software companies is accurate and whether the software prepares correct returns.⁸²

⁷⁷ See IRS, *supra* note 4, at 9–10 (“Despite large volumes of returns prepared using consumer and commercial tax preparation software, quality control over these products rests exclusively with the software publishers.”).

⁷⁸ See I.R.C. § 6011(e)(1) (2012) (providing the statutory basis for regulations governing e-filing). Annually, the IRS publishes specifications that provide software companies with appropriate guidelines. See generally IRS, HANDBOOK FOR AUTHORIZED IRS E-FILE PROVIDERS OF INDIVIDUAL INCOME TAX RETURNS (2014) [hereinafter IRS, AUTHORIZED E-FILE PROVIDERS] (guiding tax return preparers who e-file individual income tax returns); IRS, MODERNIZED E-FILE (MEF) GUIDE FOR SOFTWARE DEVELOPERS AND TRANSMITTERS (2016) [hereinafter IRS, SOFTWARE DEVELOPERS & TRANSMITTERS] (establishing technical specifications for tax preparation software developers and for those who transmit tax returns electronically).

⁷⁹ See I.R.C. § 6713 (civil penalty for disclosure or use of taxpayer information by return preparer); *id.* § 7216 (criminal penalty for same); see also 26 C.F.R. § 301.7216-1(b)(2)(i)(B) (2016) (including, for purpose of privacy rules, software developers in the definition of *tax return preparers*).

⁸⁰ See U.S. GOV’T ACCOUNTABILITY OFFICE, *supra* note 5, at 8 (discussing application of Gramm-Leach-Bliley Act to tax software companies).

⁸¹ See *id.* at 10 (“IRS requires tax software to pass its Participants Acceptance Testing System (PATS), which includes verifying that computations are correct, tax rate schedules are updated, and returns transmitted electronically are compatible with IRS systems.”); see also Rev. Proc. 2007-40, 2007 IRB LEXIS 567 (“This revenue procedure informs Authorized IRS *e-file* Providers of their obligations to the Internal Revenue Service (the Service), taxpayers, and other participants in the *e-file* Program”); IRS, AUTHORIZED E-FILE PROVIDERS, *supra* note 78, at 10 (specifying steps that software developers must take to ensure that the IRS is able to process taxpayer submissions); IRS, SOFTWARE DEVELOPERS & TRANSMITTERS, *supra* note 78, at 11 (providing technical directions for software developers).

⁸² See U.S. GOV’T ACCOUNTABILITY OFFICE, *supra* note 5, at 10 (“However, PATS does not go further in testing to determine, for example, whether the guidance tax software provides is sufficient in helping taxpayers prepare accurate tax returns.”); see also DEP’T OF TREASURY, NO. 2005-40-025, OPPORTUNITIES EXIST TO IMPROVE TAX SOFTWARE PACKAGES 2 (2005) (“The

Perhaps in an endeavor to avoid more substantial oversight, the tax return preparation software industry has imposed a modicum of self-regulation and has, in some circumstances, cooperated with the government. Consider two such instances.

First, bowing to congressional and public pressure, in 2002 the tax return software industry joined the IRS to form the “Free File Alliance.”⁸³ This program enables low- and moderate-income taxpayers to prepare their tax returns for free via the IRS website, using software programs provided by members of the alliance, which is made up of over a dozen tax return preparation software companies.⁸⁴ In exchange for the software companies agreeing to provide free filing services to at least seventy percent of taxpayers (those with adjusted gross incomes of \$60,000 or less for 2015), the IRS has agreed not to develop its own tax return preparation software to compete with the private industry.⁸⁵ Over the past decade, participation in the program has been quite low. In 2014, for example, approximately 2.8 million taxpayers took advantage of the program, which represented less than three percent of eligible taxpayers.⁸⁶ Only forty-six million people have used the program since its inception in 2003, which is anemic compared to the roughly one hundred million taxpayers who qualify *each year* to participate.⁸⁷ Some critics have pointed out that the available filing categories on the Free File Alliance website exclude many taxpayers in the under \$60,000 income range, such as seniors or taxpayers with certain types of deduc-

testing is intended to ensure *e-filed* tax returns can be initially processed much like tax returns submitted on paper. Nevertheless, the tests are not created to check for misapplication of the tax law.”).

⁸³ See *Free Online Electronic Tax Filing Agreement Signed*, IRS (June 16, 2016), <https://www.irs.gov/uac/free-online-electronic-tax-filing-agreement-signed> [<https://perma.cc/8SZR-3CZA>] (“On October 30, 2002, a public-private partnership agreement was officially signed between the IRS and the Free File Alliance, LLC, a group of tax software companies to make free online tax preparation and electronic filing services available to at least 60% of all individual taxpayers (i.e., 78 million).”). The IRS recently renewed its agreement with the tax software industry through 2020. See *IRS and Free File Alliance Reach New Agreement for Free Tax Software*, IRS (Mar. 17, 2015), <https://www.irs.gov/uac/newsroom/irs-and-free-file-alliance-reach-new-agreement-for-free-tax-software> [<https://perma.cc/D3DT-59GJ>] (“The Internal Revenue Service and Free File Inc., also known as the Free File Alliance, today announced a new five-year agreement that guarantees free, federal tax preparation software products for 70 percent of all taxpayers.”).

⁸⁴ *Free File: I Will Choose a Free File Software*, IRS, <https://apps.irs.gov/app/freeFile/jsp/index.jsp> [<https://perma.cc/55V5-NGGK>].

⁸⁵ See IRS, SEVENTH MEMORANDUM OF UNDERSTANDING ON SERVICE STANDARDS AND DISPUTES BETWEEN THE INTERNAL REVENUE SERVICE AND FREE FILE, INCORPORATED 4 (Mar. 6, 2015) (“[T]he federal government has pledged to not enter the tax preparation software and e-filing services marketplace.”).

⁸⁶ Laura Saunders, *Why ‘Free File’ for Taxes Isn’t So Popular*, WALL ST. J. (Jan. 30, 2015, 10:59 AM), <http://www.wsj.com/articles/why-free-file-for-taxes-isnt-so-popular-1422633546> [<https://perma.cc/V5CL-GX52>].

⁸⁷ FREE FILE ALLIANCE, <http://freefilealliance.org/> [<https://perma.cc/XP3U-UWWF>].

tions.⁸⁸ Others have pointed out that software companies like TurboTax advertise their own “free” offerings outside of the Free File Alliance website, which likely attract many taxpayers who are unaware of the IRS’s free-filing website.⁸⁹ The problem, commentators have noted, is that these alternative websites often surprise users with additional fees or suggest that they upgrade to a more costly software program.⁹⁰

A second example of cooperation is that tax software companies and the IRS have united to help combat identity fraud, a problem that has become epidemic.⁹¹ Insofar as tax return preparation is concerned, this problem is particularly acute because taxpayers must convey their most vital personal information, such as their Social Security numbers, home addresses, and bank account information, via regular mail or over the Internet. For identity theft predators, a tax return thus constitutes a treasure trove of information ready to be discovered and exploited.⁹² In recognition of this reality, the IRS and the tax return preparation software industry have decided to combine their resources and work together to minimize instances of identity theft.⁹³ Given that data breaches present a significant threat to the business

⁸⁸ See Saunders, *supra* note 86; Samantha Sharf, *You Call That Free? What TurboTax and the Free File Alliance Cost One Millennial*, FORBES (Feb. 8, 2016, 11:05 AM), <http://www.forbes.com/sites/samanthasharf/2016/02/08/you-call-that-free-what-turbotax-and-the-free-file-alliance-cost-one-millennial/#526257271615> [<https://web.archive.org/web/20160921152145/http://www.forbes.com/sites/samanthasharf/2016/02/08/you-call-that-free-what-turbotax-and-the-free-file-alliance-cost-one-millennial/#75ce8bb968ea>] (“It turns out that while all 13 members of the Free File Alliance offer free filing to some subset of people making as much as \$62,000 this year, they restrict that by age, state of residence or military status.”).

⁸⁹ See Sharf, *supra* note 88 (“[T]he TurboTax Federal Free Edition isn’t actually part of the Free File program, whereas the TurboTax Freedom Edition is.”).

⁹⁰ *Id.*; see also Jeremy Scott, *Why the Free File Alliance Is Bad for Taxpayers*, FORBES (Apr. 15, 2014, 9:42 AM), <http://www.forbes.com/sites/taxanalysts/2014/04/15/why-the-free-file-alliance-is-bad-for-taxpayers/#6b76295b651e> [<http://web.archive.org/web/20160304230204/http://www.forbes.com/sites/taxanalysts/2014/04/15/why-the-free-file-alliance-is-bad-for-taxpayers/#48607ea93246>] (“Even if a taxpayer qualifies for free filing, the FFA [Free File Alliance] will still offer many opportunities to spend money.” (alteration in original)).

⁹¹ See, e.g., J. Craig Anderson, *Identity Theft Growing, Costly to Victims*, USA TODAY (Apr. 14, 2013, 4:38 PM), <http://www.usatoday.com/story/money/personalfinance/2013/04/14/identity-theft-growing/2082179/> [<https://perma.cc/VU4P-YU3F>] (“Identity theft is expected to surpass traditional theft as the leading form of property crime.”).

⁹² See, e.g., Herb Weisbaum, *Identity Thieves Gear Up to Steal Your Tax Refund*, CNBC NEWS (Jan. 14, 2014, 8:00 AM), <http://www.cnbc.com/2014/01/14/identity-thieves-gear-up-to-steal-your-tax-refund.html> [<https://perma.cc/SYT8-TAGL>] (“Identity theft is already a serious problem—the No. 1 complaint to the Federal Trade Commission, and tax-related identity theft is a growing part of this crime spree. In 2010, about 15 percent of all identity theft complaints to the FTC dealt with tax returns. In 2013, that jumped to 43 percent.”).

⁹³ See, e.g., *Online Return Preparation Firm Joins Anti-Tax-Fraud Effort*, TAX NOTES TODAY, June 11, 2015, LEXIS, 2015 TNT 113-45 (explaining how the tax return preparation software industry is joining with the IRS to combat identity theft); *IRS, Industry, States Take New Steps Together to Fight Identity Theft, Protect Taxpayers*, IRS (June 11, 2015), <http://www.irs.gov/uac/Newsroom/IRS-and-Industry-and-States-Take-New-Steps-Together-to-Fight-Identity-Theft-and-Protect-Tax>

of tax preparation software companies,⁹⁴ it is perhaps unsurprising that those companies have voluntarily committed to work with the government to enhance the security of taxpayers' personal information.

The prophylactic strategy to self-regulate and periodically cooperate with the government has worked to the advantage of the tax return preparation software industry. Due to this strategy, any suggestion that the government prepare tax returns on behalf of taxpayers is either ignored or cast as an example of "Big Government" being too intrusive.⁹⁵ This hands-off approach is not the stance adopted by other industrial nations. For example, in many European nations, at least in select instances (primarily with respect to their low-income taxpayers), revenue oversight agencies prepare tax returns on behalf of the country's taxpayers.⁹⁶

Historically, the tax return preparation software industry has therefore been at liberty to design its software packages essentially in any way it pleases. The result is that the computer algorithms and queries that the tax return preparation software industry designs are not necessarily the same as those that the IRS would mandate.

The goal is to give its users a cost-efficient and, to the extent possible, enjoyable experience. This strategy has handsomely paid off as more taxpayers utilize the industry's products: according to an industry observer,

payers [<https://perma.cc/FMA4-5NEL>] ("The Internal Revenue Service joined today with representatives of tax preparation and software firms, payroll and tax financial product processors and state tax administrators to announce a sweeping new collaborative effort to combat identity theft refund fraud and protect the nation's taxpayers.").

⁹⁴ For example, regarding its annual public filing with the Securities and Exchange Commission, the owner of TurboTax, Intuit, has disclosed the following business risk: "We host, collect, use and retain sensitive and personal customer information and data. A security breach resulting in third party access to this information and data could materially disrupt our businesses, result in the disclosure of confidential information, significantly damage our reputation and cause material losses." Intuit Inc., Annual Report (Form 10-K) (Sept. 1, 2015).

⁹⁵ See, e.g., Lenny Goldberg, *Ready Return Program Advances in Assembly*, 40 ST. TAX NOTES 261, 261 (Apr. 21, 2006) ("The bill was opposed by Intuit, TechNet (representing the high-tech industry, including Intuit), the American Electronics Association, and the California Taxpayers' Association. Opponents argued that the state is unfairly competing with private enterprise in tax preparation; that the free file program, which directs moderate income taxpayers to proprietary Web sites, is sufficient; and that taxpayers would be intimidated by the tax authority, despite the voluntary nature of the program."); Liz Day, *How the Maker of TurboTax Fought Free, Simple Tax Filing*, PROPUBLICA (Mar. 26, 2013, 4:00 AM), <http://www.propublica.org/article/how-the-maker-of-turbotax-fought-free-simple-tax-filing> [<https://perma.cc/54YR-5FFG>] ("Intuit has spent about \$11.5 million on federal lobbying in the past five years—more than Apple or Amazon. Although the lobbying spans a range of issues, Intuit's disclosures pointedly note that the company 'opposes IRS government tax preparation.'").

⁹⁶ See Austan Goolsbee, *The 'Simple Return': Reducing America's Tax Burden Through Return-Free Filing*, TAX NOTES TODAY, July 1, 2006, LEXIS, 2006 TNT 144-42 ("The U.S. Department of the Treasury (U.S. Treasury 2003) observed that, in 1999, about 87 percent of tax filers in Denmark and 74 percent of filers in Sweden had their returns prepared through a [Tax Agency Reconciliation] system." (alteration in original)).

“[r]eturns filed professionally saw a 0.2 percent increase as of May 15, 2015, over the previous year, while self-prepared returns grew a whopping 5.8 percent. Overall, 49,195,000, or more than 40 percent of the total of 120,612,000 e-filed returns, were filed by taxpayers who prepared the returns themselves.”⁹⁷ The relative pleasantness of the tax return preparation experience, which presumably results in an increase in software sales, however, does not necessarily yield greater tax compliance and accuracy.

II. THE CASE FOR REGULATING TAX RETURN PREPARATION

Having explored the liberties that Congress has extended to tax return preparers and the tax return preparation software industry, this Part explores the consequences of this noninterventionist approach and makes an affirmative case for regulation in this context.⁹⁸

For much of the Code’s history, lack of regulation of the tax return preparation process made sense. Consider the fact that, in yesteryear, the majority of taxpayers routinely turned to the IRS for counsel and advice. Information regarding proper tax return submission was commonly dispensed vis-à-vis IRS publications that many taxpayers read, analyzed, and applied. In addition, the IRS commonly had well-staffed walk-in centers that, during the busy tax season, were inundated with inquisitive taxpayers. If the IRS needed to convey important information, it had the eyes, ears, and minds of taxpayers at its beck and call.

This is no longer the case. Instead, taxpayers now routinely rely upon tax return preparers and tax return preparation software for guidance.⁹⁹ The IRS, on the other hand, has experienced significant funding cuts in recent years that have forced it to shrink its workforce and reduce taxpayer services.¹⁰⁰ More recently, the IRS has announced plans to reduce face-to-face

⁹⁷ Roger Russell, *2015 Tax Software Update*, ACCOUNTING TODAY (Aug. 25, 2015), <http://www.accountingtoday.com/news/tax-practice/2015-tax-software-update-75597-1.html> [<https://perma.cc/E9ZN-P4GQ>].

⁹⁸ See *infra* notes 99–174 and accompanying text.

⁹⁹ See Susan Jones, *IRS: 90% of Taxpayers Seek Help in Preparing Their Tax Returns*, CNSNEWS.COM (Apr. 9, 2014, 6:09 AM), <http://www.cnsnews.com/news/article/susan-jones/irs-90-taxpayers-seek-help-preparing-their-returns> [<https://perma.cc/3VJA-LLGV>] (“According to [IRS Commissioner] Koskinen, about 80 million returns, or 56 percent of the total individual tax returns filed each year, are done by paid preparers. Another 34 percent of taxpayers use tax preparation software, making a total of 90 percent of taxpayers who seek some form of assistance.” (alteration in original)).

¹⁰⁰ See Chuck Marr & Cecile Murray, *IRS Funding Cuts Compromise Taxpayer Service and Weaken Enforcement*, CTR. ON BUDGET & POL’Y PRIORITIES (Apr. 4, 2016), <http://www.cbpp.org/research/federal-tax/irs-funding-cuts-compromise-taxpayer-service-and-weaken-enforcement> [<https://perma.cc/T7G2-4LRR>].

The Internal Revenue Service (IRS) budget has been cut by 17 percent since 2010, after adjusting for inflation, forcing the IRS to reduce its workforce, severely scale

and telephone interactions with taxpayers.¹⁰¹ At least insofar as the preparation and submission processes are concerned, the IRS has essentially been relegated to a wallflower. In an environment in which Congress gives carte blanche to tax return preparers and the tax return software preparation industry to do as they please, the emergence of these new information outlets has significant and far-reaching implications as detailed below. Section A focuses on the implications of failing to regulate paid tax preparers and argues that Congress must act to empower the Treasury Department to do so.¹⁰² Section B then focuses on tax return software companies and argues for regulation in that context as well.¹⁰³

A. The Need to Regulate Tax Return Preparers

Tax return preparers perform a vital function for many Americans: they assist taxpayers in fulfilling their legal obligation to report and pay taxes and may help taxpayers claim important government benefits like the EITC. Both the government and taxpayers have much at stake when it comes to accurate tax return preparation. Inaccurate tax returns may result in a significant revenue loss to the Treasury while also leaving taxpayers short on benefits or liable for back taxes, penalties, and interest.

Thus, it is imperative that the government takes steps to ensure that tax preparers are held to a standard that is commensurate with the importance of their role. Taxpayers apparently agree: a recently conducted poll showed that

back employee training, and delay much-needed upgrades to information technology systems. These steps, in turn, have weakened the IRS's ability to enforce the nation's tax laws and serve taxpayers efficiently, as the National Taxpayer Advocate, the Treasury Inspector General for Tax Administration, the IRS Oversight Board, and the Government Accountability Office have all documented.

Id.

¹⁰¹ See *Future State Initiative*, IRS (Feb. 22, 2016), <https://www.irs.gov/uac/newsroom/future-state-initiative> [<https://perma.cc/CSJ5-J8VM>] (noting that one goal of the Future State Initiative is to make taxpayer services more cost effective by shifting more of those services online); see also *The President's Fiscal Year 2017 Budget: Hearing Before the S. Comm. on the Judiciary*, 114th Cong. 3 (2016) (statement of John A. Koskinen, Comm'r, IRS) [hereinafter Koskinen Statement].

We need to be, and are, looking forward to a new, improved way of doing business that involves a more robust online taxpayer experience. This is driven, in part, by business imperatives; when it costs between \$40 and \$60 to interact with a taxpayer in person, and less than \$1 to interact online, we must reexamine how we provide the best possible taxpayer experience, in response to taxpayer expectations and demands.

Koskinen Statement, *supra*, at 3.

¹⁰² See *infra* notes 104–141 and accompanying text.

¹⁰³ See *infra* notes 142–174 and accompanying text.

eighty percent of the public supports regulations that would require paid tax return preparers to become licensed and pass a competency exam.¹⁰⁴

Among many reasons for regulating tax return preparers are that (1) tax return preparation involves complex legal rules; (2) unregulated tax return preparers are prone to making errors; (3) tax return preparation involves the distribution of vital government benefits to the poor; (4) relative to ex post regulation, ex ante regulation of preparers is likely more efficient; and (5) failure to regulate may diminish the public's faith in the government.

1. Complexity of Tax Return Preparation

At the heart of the 2014 *Loving v. IRS* decision was the U.S. Court of Appeals for the D.C. Circuit's finding that tax return preparation does not constitute the "practice" of representing taxpayers before the Treasury Department.¹⁰⁵ In making their case that the Treasury Department lacked authority to regulate tax return preparation, the plaintiffs and other groups that opposed the regulations argued that "merely" preparing a tax return was akin to being a bookkeeper, a job someone can do without giving substantive legal advice.¹⁰⁶

The fact is, however, that preparing tax returns involves interacting with an incredibly complicated set of legal rules.¹⁰⁷ The very reason that the majority of taxpayers turn to assistance in preparing their returns each year is because the process is difficult and intimidating.¹⁰⁸ Although some returns may be relatively simple (for example, taxpayers who earn only wage

¹⁰⁴ MICHAEL BEST & TOM FELTNER, CONSUMER FED'N OF AM., PUBLIC VIEWS ON PAID TAX PREPARATION: STRONG PUBLIC SUPPORT FOR NEW CONSUMER PROTECTIONS TO PREVENT ERRORS AND FRAUD 4 (2016) (reporting that 80% of people surveyed support tax return preparer testing and 83% of those surveyed support licensing). The foregoing report further indicates that 56% of those surveyed also thought tax return preparers needed special training but not a degree in tax preparation, while 40% thought a college degree was necessary; only 3% did not think training is necessary. *Id.* at 6.

¹⁰⁵ See *supra* notes 64–68 and accompanying text.

¹⁰⁶ See Brief of Plaintiffs-Appellees at 54, *Loving v. IRS*, 742 F.3d 1013 (D.C. Cir. 2014) (No. 13-5061) ("Merely preparing a tax return for a paying customer is not an act of representation; a tax-return preparer is no more a 'representative' than an outside bookkeeper who is hired annually to organize accounts[.]"); Brief for the Tax Foundation as Amici Curiae Supporting Plaintiffs-Appellees, *Loving*, 742 F.3d 1013 (No. 13-5061) ("[In many circumstances,] there is no advice given by the preparer to the taxpayer, no identification for the taxpayer of items or issues for which the law is unclear, and no informing of the taxpayer of the benefits or risks of positions taken on the return." (alteration in original)).

¹⁰⁷ See, e.g., *Grove v. Comm'r*, 490 F.2d 241, 242 (2d Cir. 1973) ("We are called upon again, to wrestle with the tangled web that is the Internal Revenue Code.").

¹⁰⁸ Cf. Olson, *supra* note 37, at 767 ("Taxpayers hire preparers because the tax code is hideously complex, return preparation is anything but straightforward, and a lot of money is on the line.").

income and claim the standard deduction),¹⁰⁹ the majority of returns involve complicating factors like itemized deductions, the EITC, or the alternative minimum tax, all of which mandate an understanding of complex, substantive tax rules. In many circumstances, tax return preparation goes well beyond the work of a “mere scrivener.”¹¹⁰

What’s more, there is nothing to stop an untrained tax return preparer from preparing the most complicated tax returns, whether they’re done accurately or not. Those undertaking such work surely should be trained in substantive tax law and have to demonstrate their proficiency. Yet, more than half of tax returns are prepared by unregulated preparers: that is, they are prepared by people who are *not* attorneys, CPAs, or enrolled agents.¹¹¹

2. Fiscal Consequences of Tax Return Preparer Incompetency

The most significant, and entirely predictable, consequence of Congress’s failure to regulate tax return preparers is that many tax return preparers make errors on taxpayers’ returns. As a result, large numbers of taxpayers pay less tax than they owe,¹¹² contributing to the tax gap’s girth. (Other taxpayers forfeit vital government benefits that were not properly claimed on their tax return.) For example, one study conducted by the GAO of commercial tax preparation chains found an incorrect refund claimed by seventeen of the nineteen preparers evaluated.¹¹³ Common errors included failing to report self-employment income and claiming an ineligible child for purposes of the EITC.¹¹⁴ Additionally, an IRS study showed that the overclaim rate on EITC returns prepared by uncredentialed tax return preparers during 2006 and 2007 was over fifty percent; by comparison, this rate was higher than the overclaim rate on self-prepared claims during that same time period.¹¹⁵

There are multiple reasons for so many erroneous tax returns. Some unscrupulous tax return preparers intentionally omit income from returns,

¹⁰⁹ See ZELENAK, *supra* note 19, at 121–22 (approximately 40% of taxpayers claim the standard deduction and earn only income that is subject to information reporting).

¹¹⁰ See Olson, *supra* note 37, at 770.

¹¹¹ See *id.* at 769 n.14 (citing IRS COMPLIANCE DATA WAREHOUSE, INDIVIDUAL RETURNS TRANSACTION FILE AND RETURN PREPARERS AND PROVIDERS DATABASE (2013)). In 2011, 42,154,527 out of 78,088,554 returns (approximately 54%) were prepared by “unregulated preparers,” meaning they were not attorneys, certified accountants, enrolled agents, enrolled actuaries, enrolled retirement plan agents, or preparers regulated by a state. See *id.*

¹¹² See *supra* note 2 and accompanying text (explaining the tax gap).

¹¹³ See U.S. GOV’T ACCOUNTABILITY OFFICE, *supra* note 4.

¹¹⁴ See *id.*

¹¹⁵ See IRS, COMPLIANCE ESTIMATES FOR THE EARNED INCOME TAX CREDIT CLAIMED ON 2006–2008 RETURNS 26 tbl.9 (2014). The study estimates that up to 54% of returns by “un-enrolled return preparers” were overclaims, compared to up to 47% of self-prepared returns. *Id.*

claim false deductions, or overclaim refundable credits like the EITC. Numerous “mystery shopper” tests conducted by advocacy groups across the country have uncovered such abuses by unregulated tax return preparers.¹¹⁶ For example, one tax return preparer in New York City fabricated a \$2000 church donation to increase the tester’s refund, another advised a tester not to report income that had not been reported on a Form 1099, and yet another fraudulently changed the tester’s filing status from single to head of household to increase the refund claimed from \$100 to \$6000.¹¹⁷ Not only does this type of misconduct shortchange the federal government of substantial amounts of tax revenue, but taxpayers will also be held accountable for back taxes, interest, and possibly penalties if the IRS detects their non-compliance.¹¹⁸ Further, taxpayers can be barred from claiming the EITC for a period of ten years if they are found to have fraudulently claimed it when ineligible; the ban is two years if their claim was found to be reckless but not fraudulent.¹¹⁹ Although the tax return preparers themselves are also liable for penalties for filing fraudulent tax returns,¹²⁰ many of them disappear after tax season and are virtually impossible for the IRS (or, for that matter, taxpayers) to track down.¹²¹

Other tax return preparers may stop short of outright evasion but encourage more aggressive reporting positions than taxpayers might otherwise take on their own. Many taxpayers, in turn, operate under the mistaken impression that if they use a tax return preparer, such reliance automatically insulates them from accuracy-related penalties,¹²² which may make them

¹¹⁶ See generally WU, *supra* note 12 (detailing results of “mystery shopper” testing by advocacy groups).

¹¹⁷ *Id.* at 7, 8, 13.

¹¹⁸ See *Tax Return Preparer Fraud*, IRS (July 16, 2014), <https://www.irs.gov/uac/tax-return-preparer-fraud-2> [<https://perma.cc/4GUV-89SE>] (“However, when the IRS detects the false return, the taxpayer—not the return preparer—must pay the additional taxes and interest and may be subject to penalties.”); Heather Somerville, *Tax Preparer Fraud Creates Big Refunds, Big Problems for Taxpayers*, MERCURY NEWS (Aug. 12, 2016, 7:38 PM), http://www.mercurynews.com/ci_22827278/tax-preparer-fraud-creates-big-refunds-big-problems [<https://perma.cc/5G5A-RVVJ>] (“The damage those tax preparers committed on the tax return is still the consumer’s problem to deal with.” (internal quotation marks omitted)).

¹¹⁹ I.R.C. § 32(k) (2012).

¹²⁰ See *id.* § 6694(b) (understatement due to willful or reckless conduct); *id.* § 6695(g) (failure to comply with EITC due diligence requirements); *id.* § 6701 (aiding and abetting understatement of tax liability); *id.* § 7206 (felony for assistance on fraudulent return); *id.* § 7207 (misdemeanor for delivery of fraudulent return); *id.* § 7407 (authority for district court to enjoin tax return preparer).

¹²¹ See Somerville, *supra* note 118.

¹²² Reliance upon tax professionals may insulate taxpayers from accuracy-related tax penalties if such reliance is found to be reasonable and the taxpayer acted in good faith. See I.R.C. § 6664(c)(1); Treas. Reg. § 1.6664-4(b)(1) (2003); see, e.g., *Estate of Goldman v. Comm’r*, 112 T.C. 317, 324–25 (1999), *aff’d*, *Schutter v. Comm’r*, 242 F.3d 390 (10th Cir. 2000) (relying upon an opinion letter prepared by experienced tax counsel, taxpayer demonstrated reasonable cause

more inclined to accept risky tax positions. Finally, it is inevitable that tax return preparers will make unintentional errors on tax returns, and this is particularly true for those who lack training and other qualifications. Even if these errors are innocent, they contribute to the tax gap all the same.

In addition to making mistakes or committing outright fraud, many unregulated tax return preparers charge exorbitant fees and high interest rates on taxpayer loans, which are often not disclosed up front to taxpayers.¹²³ For example, in 2012 the U.S. Department of Justice brought suit against a tax preparation service whose “junk fees typically average[d] more than \$400–\$500, and sometimes [ran] as high as \$1,000 for as little as 15 minutes of tax return preparation.”¹²⁴ Many tax return preparers also offer products like refund anticipation loans (“RALs”), which essentially allow taxpayers to borrow their tax preparation fee out of their refund at a high rate of interest, or refund anticipation checks (“RACs”), which allow taxpayers without a bank account to obtain a quicker refund in exchange for additional fees.¹²⁵ Customers claiming refunds are particularly vulnerable to high fees because the fees are deducted from their refund and are therefore not as salient or painful.¹²⁶ Additionally, some retailers like jewelry stores or car dealers double as tax return preparers and encourage their clientele to apply their refund toward a major purchase.¹²⁷ The targets of these predatory practices are usually low-income taxpayers,¹²⁸ who can least afford to squander their precious resources on faulty return preparation and unnecessary fees.

and good faith in deducting payments to his ex-wife as alimony); *Fowler v. Comm’r*, 84 T.C.M. (CCH) 281, 287 (2002) (holding that taxpayers who deducted losses from their rental properties were not liable for the negligence penalty where they relied on their return preparer, who was a CPA and tax partner in his firm); *Favia v. Comm’r*, 83 T.C.M. (CCH) 1876, 1878 (2002) (even though the claimed loss was disallowed, the Tax Court did not impose accuracy-related penalty because the taxpayer relied on the good-faith advice of a tax professional). Nevertheless, to assert a successful accuracy-related penalty defense, a taxpayer must show that a “competent professional who had sufficient expertise” gave the relied-upon advice. *Neonatology Assocs., P.A. v. Comm’r*, 115 T.C. 43, 99 (2000), *aff’d*, 299 F.3d 221 (3d Cir. 2002). Further, taxpayers who do not make a good-faith effort to ascertain the correctness of the advice rendered may not be able to assert a reasonable cause defense. *Treas. Reg.* § 1.6664-4(b)(1) ex.2.

¹²³ WU, *supra* note 12, at 15–16.

¹²⁴ *Id.* at 16 (alteration in original) (citing Complaint, *United States v. Ogbazion*, 2012 WL 4364306 (S.D. Ohio Mar. 28, 2012) (No. 3:12-cv-95)). The “junk fees” were those in addition to the tax preparation service fees and included things like data storage fees, processing fees, and filing fees. *Id.* at n.47.

¹²⁵ See WU & HERNANDEZ, *supra* note 10, at 2–3. Federal bank regulations have done away with RALs offered by major banks although some smaller businesses—like payday lenders—still offer them. *Id.* at 2, 5. RACs have largely replaced RALs as the “dominant tax-time financial product on the market.” *Id.* at 3.

¹²⁶ See WU, *supra* note 12, at 16; WU & HERNANDEZ, *supra* note 10, at 5.

¹²⁷ WU, *supra* note 12, at 4; see IRS, *supra* note 4, at 12.

¹²⁸ See IRS, *supra* note 4, at 11; WU & HERNANDEZ, *supra* note 10, at 3.

3. Administration of Government Benefits Through the Tax System

In failing to regulate tax return preparation, the government has more at stake than just lost tax revenue. The tax system also is used to administer social welfare programs that come in the form of refundable tax credits, such as the EITC,¹²⁹ the child tax credit,¹³⁰ and the recently enacted premium tax credit (covering health-care costs).¹³¹

The fact that unlicensed, untrained individuals can be in charge of dispersing government benefits to low-income taxpayers for a fee is astonishing when viewed in the context of other social welfare programs. Consider the disbursement of food stamps, Medicaid, and Temporary Assistance for Needy Families (i.e., welfare). Though funded with federal dollars, these benefits are generally disbursed by the states,¹³² often at the county level, by qualified professionals. In North Carolina, for example, a caseworker assigned to determine eligibility for food stamps, welfare, and/or Medicaid is a trained state employee who generally has a college degree or comparable experience and reports to a supervisor.¹³³ Yet, any person in any line of work or vocation—a car dealer, a pawnshop owner, or a furniture retailer¹³⁴—can prepare a tax return claiming an EITC refund worth thousands of dollars and command a hefty fee for doing so.

The government clearly has an interest in maximizing accuracy when it comes to delivery of funds through its social welfare programs. Yet, IRS data reveals that when unregulated tax return preparers help taxpayers claim the EITC, the returns are inaccurate in the majority of cases.¹³⁵ Tax returns that fail to claim valuable benefits deprive the taxpayer of much-needed assistance, and tax returns that overclaim those benefits shortchange the fisc. These issues further underscore the need for Congress to regulate tax return preparation.

¹²⁹ I.R.C. § 32 (2012).

¹³⁰ *Id.* § 24.

¹³¹ *Id.* § 36B.

¹³² See *Government Benefits*, USA.GOV, <https://www.usa.gov/benefits> [<https://perma.cc/8WM3-KUXG>] (listing the availability of social welfare programs and pointing out that most are administered at the state level).

¹³³ See, e.g., *Buncombe County: Income Maintenance Caseworker I*, N.C. SOC. SERVS. JOBS, <https://ssw.unc.edu/dssjobsnc/node/764> [<https://perma.cc/PM9Y-VVGX>] (college degree or relevant, comparable experience required); *Harnett County Job: Income Maintenance Caseworker I*, N.C. SOC. SERVS. JOBS, <https://ssw.unc.edu/dssjobsnc/index.php?q=node/406> [<https://perma.cc/2REM-EJEH>] (same).

¹³⁴ See, e.g., WU & HERNANDEZ, *supra* note 10, at 1, 18. For example, one online business offers a service called “Tax Max,” which specializes in helping auto dealers and payday lenders prepare tax returns. *Id.* at 20. Tax Max helps auto dealers estimate customers’ tax refunds in advance of the tax-filing season so that the customers can apply their refund toward a down payment on a car in November or December. *Id.*

¹³⁵ See IRS, *supra* note 115, at 26 tbl.9.

4. Ex Ante Versus Ex Post Regulations

Another argument asserted by the plaintiffs in *Loving* was that tax return preparer regulation is redundant given the array of civil and criminal penalties applicable to tax return preparers that are already at the IRS's disposal.¹³⁶ It is certainly true that shoddy tax return preparation is not without potential consequences. The government can fine and, at times, prosecute tax return preparers who prepare inaccurate, reckless, and/or fraudulent returns and can enjoin bad actors from engaging in future tax return preparation.¹³⁷

Although these penalties have been asserted against some preparers and no doubt carry a deterrent effect on many others, they come with significant limitations. First, the imposition of return preparer penalties requires that the IRS actually detect noncompliance on the taxpayer's return and that such noncompliance is attributable to the taxpayer's preparer. The IRS's limited budget, however, enables it to audit only a tiny percentage of returns each year,¹³⁸ which means that the vast majority of noncompliant returns will go undetected. Second, even if taxpayer noncompliance is detected, it is highly unlikely that the IRS will expend more resources to analyze tax return preparers and possibly commence criminal proceedings against them.¹³⁹ Third, even if taxpayers and their accountable tax return preparers are caught and prosecuted, such measures consume valuable government resources. Relying solely on an ex post regime to police noncompliant tax return preparers is thus costly and casts a very small net.

A much more efficient and robust regime would combine the current ex post penalty regime with an ex ante regime, i.e., licensing requirements that must be met before a person could prepare tax returns. An ex ante regime is a better use of government resources because the cost of administering requirements like licensing and testing would undoubtedly be far less burdensome than auditing and prosecuting bad actors on a case-by-case basis.

¹³⁶ See Brief of Plaintiffs-Appellees at 40–50, *Loving*, 742 F.3d 1013 (No. 13-5061). The *Loving* court viewed the existing penalty framework as carrying some weight in its decision to strike down the regulations. *Loving*, 742 F.3d at 1020 (“[W]e find at least some significance in the fact that multiple Congresses have acted as if Section 330 did not extend so broadly as to cover tax-return preparers.”).

¹³⁷ See *supra* note 120 (penalty provisions).

¹³⁸ See IRS, FISCAL YEAR 2015 ENFORCEMENT AND SERVICE RESULTS 2 (2015) (indicating that the individual audit rate was .84%). The audit rate for returns claiming the EITC is higher than the overall audit rate but is still under 2%. See IRS, *supra* note 30, at 23.

¹³⁹ In 2015, the IRS audited 1,228,117 individual returns and recommended prosecution for tax crimes in only 1762, or 0.14%, of those cases. See IRS, *supra* note 138, at 2, 5.

5. Potential Loss of Public Faith in the Government's Ability to Govern

Aside from revenue loss and inaccuracy in the delivery of government benefits, another implication of not regulating the tax preparation return industry is that it may produce a loss of faith in the government and its ability to govern. Consider the fact that in the twenty-first century there are sparse points of direct contact between individual taxpayers and the federal government. There is, for example, no compulsory military service, and, due to the Internet and e-mail, even interactions with the U.S. postal system have significantly dwindled.

The area of annual tax return submissions remains one of the few areas in which taxpayers' private and public lives regularly intersect. This presents Congress with the unique opportunity to foster both tax compliance and what at least one commentator labels our bonds of "fiscal citizenship," or "the important civic purpose of recognizing and formalizing the financial responsibilities of citizenship."¹⁴⁰ Nevertheless, if the annual tax-filing ritual is beset with unscrupulous tax return preparers who prey on low- and middle-income taxpayers, this does not bode well for fiscal citizenship. Furthermore, the bonds of fiscal citizenship are likewise weakened when the tax return preparation software industry habitually denigrates the federal government via statements that strongly imply that, if left to its druthers, Congress might abscond with citizens' tax dollars (for example, in advertising campaigns, asking, "Are you sure you're getting your full refund?").¹⁴¹

Another implication of Congress's *carte blanche* approach is that it may result in the nation revamping the way it raises revenue. From an administrative perspective, if the tax return preparation process is deemed too burdensome to maintain and produces flawed and inaccurate returns, taxpayers may force the government to choose an alternative way to raise revenue (for example, a national sales tax). What gets lost in the ongoing political debates regarding the income tax, however, is that if Congress were to regulate the tax return preparation process, such regulation might go a long way toward addressing and allaying taxpayers' concerns about the preparation and submission processes, as well as ameliorating compliance shortcomings.

B. The Need to Regulate Tax Return Preparation Software Companies

Many of the arguments discussed in the previous section regarding the need to regulate tax return preparers apply with equal force to tax return

¹⁴⁰ See ZELENAK, *supra* note 19, at 4.

¹⁴¹ Antony Young, *It's Tax Day: H&R Block vs. TurboTax*, ADVERTISING AGE (Apr. 14, 2009), <http://adage.com/article/media/tax-day-h-r-block-turbotax/135926/> [<https://perma.cc/GZC5-QJQU>].

preparation software. Like third-party preparers, software programs often stand as a vital intermediary between the taxpayer and the government, affecting both revenue collection and the distribution of government benefits. Although tax preparation software allows the taxpayer to complete her return without assistance from another person, the role of software is often nearly identical to that of a tax return preparer, making the government's regulatory interest equally compelling.

1. Function as a Return Preparer

When the Treasury Department enacted the now-defunct tax return preparer regulations in 2011, it did not include tax return preparation software in the new regime.¹⁴² That decision is somewhat understandable as the regulations focused on competency examinations and continuing education that would not necessarily be relevant in the context of software. Although the precise rules governing paid preparers versus tax return preparation software developers might need to be different, this does not mean that Congress does not have an equally vital interest in regulating tax return preparation software as a type of tax return preparer.¹⁴³

First, consider the fact that preparing one's own return with tax preparation software is, in many circumstances, not much different than paying a third party (who is likely to use the same or a similar software program) to prepare the return.¹⁴⁴ A taxpayer who walks into a national tax preparation chain is likely to be asked a series of questions while the preparer enters information into a computer program. Similarly, using tax preparation software at home generally involves reading through a series of interview-style questions. TurboTax, for example, offers users a guided experience: the program asks them about numerous items of income and deductions to determine what should be reported.¹⁴⁵ Taxpayers type in answers to the various questions, and the software transfers these responses, when relevant, to the appropriate tax return line items.

Most tax software programs are also capable of automatically importing entries from information returns like Form W-2 (wage income), Form

¹⁴² See *supra* notes 57–61 and accompanying text.

¹⁴³ The vast majority of tax return preparers use tax software as well. See Paul Bonner, 2015 *Tax Software Survey*, TAX ADVISER (Aug. 1, 2015), <http://www.thetaxadviser.com/issues/2015/aug/2015-tax-software-survey.html> [<https://perma.cc/EK5F-X9YB>].

¹⁴⁴ The major tax return preparation software companies offer software programs specifically for tax return preparers. See, e.g., INTUIT PROCONNECT, <https://taxpro.intuit.com/> [<https://perma.cc/57PV-J665>] (maker of TurboTax); TAXACT PROF., <https://www.taxact.com/professional/> [<https://perma.cc/8KW3-VEWE>].

¹⁴⁵ See, e.g., *How TurboTax Works*, TURBOTAX, <https://turbotax.intuit.com/best-tax-software/how-it-works.jsp> [<https://perma.cc/HF9N-EPPW>] (“Simply tell us what you do for a living, if you own a home, if you have any children, and about any charitable donations you made this year.”).

1099 (for example, interest income from a bank account), or Form 1098 (for example, deductible mortgage interest).¹⁴⁶ Once the software program imports the information, it is automatically transferred to the appropriate line on the taxpayer's return, arguably making the software program, not the taxpayer, the "preparer." Taxpayers with relatively simple tax situations (for example, those with W-2 income who claim the standard deduction) need only make a few keystrokes, and voilà, the tax return software does the rest and produces a tax return.

Second, there is some precedent for treating tax return preparation software developers as tax return preparers. For example, in Revenue Ruling 85-189, the IRS ruled that a tax software developer is considered a "tax return preparer" for purposes of § 7701(a)(36),¹⁴⁷ stating thus: "[The software developer] is considered a preparer with respect to [the taxpayer's] return because [the software developer's] computer program provides more than mere mechanical assistance. Substantive determinations are performed by [the] computer program concerning the application of . . . the Code."¹⁴⁸ In the same ruling, the IRS also concluded that the software developer could be potentially subject to a subset of penalties applicable to tax return preparers.¹⁴⁹

In a similar vein, some taxpayers have successfully defended themselves against civil penalties by asserting that they relied on tax return preparation software, invoking what has become known in common parlance as the "TurboTax Defense."¹⁵⁰ For example, in *Thompson v. Commissioner*,¹⁵¹ the IRS had disallowed the taxpayer's claimed business deductions and asserted a negligence penalty under § 6662(a). The negligence penalty can generally be avoided in those circumstances when taxpayers can demonstrate that they acted with reasonable cause and in good faith, which may include reasonable reliance on a tax adviser.¹⁵² The *Thompson* court agreed that the deduction should be disallowed but found that the taxpayer was not liable for a negligence penalty.¹⁵³ Although the court did not explicitly ad-

¹⁴⁶ *Id.* ("Automatically import your W-2 tax form information directly into your TurboTax return from over a million participating employers and financial institutions.").

¹⁴⁷ I.R.C. § 7701(a)(36) (2012) (defining "tax return preparer" as "any person who prepares for compensation, or who employs one or more persons to prepare for compensation, any return of tax imposed by this title or any claim for refund of tax imposed by this title").

¹⁴⁸ Rev. Rul. 85-189, 1985-2 C.B. 341 (alteration in original).

¹⁴⁹ *Id.* (software developer was potentially liable for penalty under § 7216 (unauthorized disclosure of information by return preparers) but not liable for understatement penalties because the software developer had "no involvement with the actual preparation of the return").

¹⁵⁰ See generally Rodney P. Mock & Nancy E. Shurtz, *The TurboTax Defense*, 15 FLA. TAX REV. 443 (2014) (explaining the logistics and tactics associated with utilizing this defense).

¹⁵¹ *Thompson v. Comm'r*, 94 T.C.M. (CCH) 24, 25 (2007).

¹⁵² See *supra* note 122.

¹⁵³ See *Thompson*, 94 T.C.M. (CCH) at 25.

dress the issue of whether tax preparation software constitutes a tax adviser, it found the taxpayer's reliance on software relevant for purposes of avoiding the negligence penalty, stating that the "petitioner made a reasonable attempt to comply with the internal revenue laws and exercised ordinary and reasonable care by obtaining software to aid him in the preparation of his 2002 Federal income tax return."¹⁵⁴

Given the substantial similarities between tax return preparers and tax preparation software, the need to regulate tax software companies is logical. Failing to regulate tax software, however, also presents additional, unique challenges to the tax system, which are discussed below.

2. Potential to Reduce Compliance

Tax return preparation software presents subtle but potentially significant compliance challenges for the government. On the one hand, the issues of fraud and incompetence related to unregulated preparers are largely irrelevant in this context. On the other hand, software companies, like paid preparers, operate with fees and repeat business in mind, which inevitably entails minimizing the taxpayer's bill or maximizing his refund. Thus, although the software companies may operate within fully legal boundaries, from a tax revenue standpoint, there are three troubling features associated with tax return preparation software.

First, tax return preparation software may encourage taxpayers to take aggressive reporting positions. One reason for such aggressive reporting might be that taxpayers believe that they can claim ignorance and/or rely on the TurboTax defense if their return is audited.¹⁵⁵ This problem is further exacerbated by the fact that tax return preparation software packages often have so-called "audit risk meters" that portend how likely a particular return is to be audited.¹⁵⁶ If the meter is green (indicating low audit risk), taxpayers may decide to take more aggressive positions or may feel emboldened to take intentionally false positions with the assurance that they are unlikely to

¹⁵⁴ *Id.* In *Olsen v. Commissioner*, the taxpayer also avoided a penalty based on software use. *Olsen v. Comm'r*, No. 11658-10S, 2011 WL 5885082, at *1 (T.C. Nov. 23, 2011). Nevertheless, other taxpayers have been unsuccessful in asserting the TurboTax defense. *See, e.g., Bunnay v. Comm'r*, 114 T.C. 259, 267 (2000) ("[T]ax preparation software is only as good as the information one inputs into it."); *see also Lam v. Comm'r*, 99 T.C.M. (CCH) 1347, 1349 (2010) ("We do not accept petitioners' misuse of TurboTax, even if unintentional or accidental, as a defense to the penalties on the basis of the facts presented.").

¹⁵⁵ *See supra* notes 150–154 and accompanying text.

¹⁵⁶ *See* Terry Savage, *New TurboTax Helps You Fly Under IRS Radar*, THESTREET (Feb. 10, 2008, 10:05 AM), <http://www.thestreet.com/story/10402683/1/new-turbotax-helps-you-fly-under-irs-radar.html> [<https://perma.cc/H5WC-N3P4>] ("This year, the popular software program has a new feature called the 'Audit Risk Meter,' which is designed to help you lessen the chance of your return being chosen for this extra scrutiny.").

get caught. It is particularly troubling that software companies are able to display information about low audit risk to taxpayers because regulated return preparers like CPAs and lawyers are ethically precluded by Circular 230 from considering audit risk in rendering their tax advice.¹⁵⁷ Furthermore, for an additional fee, tax return preparation software companies generally offer so-called “Audit Defense” from the IRS.¹⁵⁸ This kind of insurance can motivate taxpayers to take aggressive or false tax return positions even if their audit risk is not low, with the expectation that little or no financial harm can befall them.

A second problem is that tax return software programs often oversimplify the law,¹⁵⁹ enabling taxpayers to conceptualize favorable interpretations upon which they may seek to minimize their tax burden. Tax software is, in fact, intentionally designed to help taxpayers maximize their deductions without a symmetrical effort to maximize income reported.¹⁶⁰ Indeed, one recent empirical study showed that taxpayers who file their taxes online claim more itemized deductions and report lower effective tax rates.¹⁶¹ Although educating taxpayers about itemized deductions to which they are entitled is arguably a positive aspect of tax software, the government is still harmed from a revenue perspective if the net effect of software use is more deductions claimed but no increase in income reported.

Finally, displaying the taxpayer’s refund or balance due status continuously throughout the tax return preparation process may also cause more aggressive and/or less compliant tax reporting. The major tax software programs include a “prepayment-position status bar,” which shows the taxpayer’s expected refund or balance due on the top of the screen during the tax

¹⁵⁷ 31 C.F.R. § 10.37(a)(2) (2015).

¹⁵⁸ See Dan Caplinger, *Audit Insurance: Here’s Probably Why You Don’t Need It*, DAILY FIN. (May 15, 2014, 6:00 AM), <http://www.dailyfinance.com/2014/05/15/audit-insurance-you-dont-need-it/> [<https://perma.cc/ME2K-SZVL>] (describing what audit defense services provide).

¹⁵⁹ Joshua Blank & Leigh Osofsky, *Simplexity: Plain Language and the Tax Law*, 66 EMORY L.J. (forthcoming 2016) (manuscript at 1–2).

¹⁶⁰ For example, TurboTax advertises the following product: “TurboTax Deluxe: Maximize Your Deductions.” Among several features on the product’s website is the “Deduction Finder,” which states, “We’ll search for more than 350 tax deductions and credits to get you the biggest tax refund—guaranteed.” See TURBOTAX, <https://turbotax.intuit.com/personal-taxes/online/deluxe.jsp> [<https://perma.cc/74HC-PHQ5>]. A similar description on the website of TaxAct states, “Maximize your deductions and minimize your taxes with TaxAct Plus. All the forms & features you need are included so you get your guaranteed maximum refund.” See TAXACT, <https://www.taxact.com/individual-taxes/download/plus/> [<https://perma.cc/E56K-5C89>].

¹⁶¹ Samara Gunter, *Your Biggest Refund Guaranteed? Internet Access, Tax Filing Method and Reported Tax Liability 1* (May 11, 2016) (unpublished manuscript), available at <https://drive.google.com/file/d/0B4snyKeCkR6pRmJ5SVV4WUJyNkU/view> [<https://perma.cc/C6W7-HNAP>].

preparation process.¹⁶² As the taxpayer enters items of income or deductions, the refund or balance status continually changes. Thus, a taxpayer who enters information that causes her refund to shrink or the balance due to go up might delete that information if she does not like the result. Other taxpayers might experiment with multiple variations of reporting until they achieve the outcome they desire. In a recent empirical study, this behavioral response was observed. More specifically, the study found that taxpayers facing a balance due reported less income when they could observe a prepayment-position status bar as compared to those that could not continuously view their prepayment position.¹⁶³ Additionally, in a field study of small-business tax evasion, surveyed participants indicated that using tax preparation software helps them “back in” to their desired tax outcomes.¹⁶⁴

3. Potential to Mislead Taxpayers About Fees and Free Filing

In addition to having a potentially negative impact on tax compliance, tax return preparation software also presents consumer protection issues. Specifically, fees charged by tax return preparation software companies are often hidden, surprising, and confusing. When it comes to assessing fees, at a particular disadvantage are low-income taxpayers, who may attempt to use a “free” file service and then be unexpectedly charged fees that may have been avoidable. As discussed above in Part I.B., the Free File Alliance program ostensibly allows low-income taxpayers to file their returns for free by choosing a private software company service from the IRS’s Free File website.¹⁶⁵ Some taxpayers who use the Free File Alliance, however, are subsequently upsold on fee-based products, and most are charged fees for their state returns.¹⁶⁶ Other taxpayers may mistake separate fee-based

¹⁶² William Brink, *The Social Science of Tax Preparation Software*, SOC. SCI. SPACE (Apr. 8, 2016), <http://www.socialsciencespace.com/2016/04/the-social-science-of-tax-preparation-software/> [<https://perma.cc/Y4TW-QQFV>].

¹⁶³ See William D. Brink & Lorraine S. Lee, *The Effect of Tax Preparation Software on Tax Compliance: A Research Note*, 27 BEHAV. RES. ACCT. 121, 130–31 (2015) (by having subjects choose an amount of cash income to report, the study’s authors gauged aggressiveness and evasion: subjects were told that due to poor record keeping, tip income was uncertain but estimated to be somewhere in the range of \$6500 to \$10,000; subjects facing a balance due reported an average of \$859.06 more cash tip income when the prepayment-position status bar was absent compared to when it was present).

¹⁶⁴ Susan Cleary Morse et al., *Cash Businesses and Tax Evasion*, 20 STAN. L. & POL’Y REV. 37, 59 (2009).

¹⁶⁵ See *supra* notes 83–90 and accompanying text.

¹⁶⁶ See, e.g., Dennis J. Ventry, Jr., *Intuit’s Nine Lies Kill State E-Filing Programs and Keep ‘Free’ File Alive*, 57 STATE TAX NOTES 555, 561–62 (Aug. 30, 2010) (explaining how the Free File program operates in actual practice).

websites for the IRS's Free File site due to intentional marketing practices on the part of software companies.¹⁶⁷

Even taxpayers who don't qualify for free filing may be surprised by hidden fees. For example, one common practice of software companies appears to be to advertise a no-cost or low-cost service, allow taxpayers to begin preparing their tax returns, and then inform them midway through the tax return completion process that they must upgrade to a more expensive product to complete their return.¹⁶⁸

4. Power of the Tax Return Preparation Software Lobby

Finally, it is worth noting that the tax return preparation software industry has been a powerful lobby against tax reform in an area closely related to compliance: tax return simplification. Specifically, over the years, tax return preparation software companies like Intuit have successfully lobbied to prevent the government from developing its own, free tax return preparation software and from offering taxpayers the option to receive a prepopulated tax return, known as the "Simple Return."¹⁶⁹ Allowing those taxpayers with uncomplicated tax situations to avoid return preparation with a Simple Return would save an estimated 225 million hours of time and over \$2 billion in tax preparation fees each year.¹⁷⁰ Yet, measures in Congress to enact a Simple Return bill have all stalled.¹⁷¹

¹⁶⁷ See Sharf, *supra* note 88.

¹⁶⁸ See, e.g., Phil Villareal, *TurboTax Charged Me \$60 for Not-So-Free Online Taxes*, CONSUMERIST (Apr. 16, 2010), <https://consumerist.com/2010/04/16/turbotax-charged-me-60-for-not-so-free-free-online-taxes/> [<https://perma.cc/SA3P-ZMMV>] ("When filing my taxes last night, TurboTax online's 'Free' tax preparation and online filing ended up costing me about 60\$ [sic]. The first 30\$ [sic] fee was because I had to enter a separate form to include the sale of a stock. The second 30\$ [sic] was from the fee they charge you to prepare your free return if you don't pay with a credit card and are owed a refund." (internal quotation marks omitted)); see also Mitch Lipka, *Hidden TurboTax Charges Have Users Screaming*, CBS NEWS MONEY WATCH (Jan. 6, 2015, 4:45 PM), <http://www.cbsnews.com/news/users-upset-with-turbotax-changes/> [<https://perma.cc/96VY-R56T>] ("TurboTax users off to an early start on their tax returns are fuming in online reviews that the popular software has added a series of charges to use certain tax forms.").

¹⁶⁹ See, e.g., Day, *supra* note 95 ("Well, for one thing, it doesn't help that [Simple Returns have] been opposed for years by the company behind the most popular consumer tax software—Intuit, maker of TurboTax." (alteration in original)); Scott, *supra* note 90 ("Even if a taxpayer qualifies for free filing, the FFA will still offer many opportunities to spend money."); see also Austan Goolsbee, *The 'Simple Return': Reducing America's Tax Burden Through Return-Free Filing*, HAMILTON PROJECT 19–20 (2006) (arguing that instituting a Simple Return process would not infringe on private enterprise).

¹⁷⁰ See Goolsbee, *supra* note 169, at 5.

¹⁷¹ See, e.g., H.R. 1069, 112th Cong. (2011); Bipartisan Tax Fairness and Simplification Act of 2011, S. 727, 112th Cong. (2011). Senator Elizabeth Warren has introduced a bill in Congress that would require the government to develop free tax return preparation software and offer prepopulated returns to taxpayers with simple tax situations. See Tax Filing Simplification Act of 2016, S. 2789, 114th Cong. (2016).

These tax return preparation software industry campaigns to preserve the industry's economic turf have not stopped at the federal level but have extended to state legislatures as well. These legislative efforts include lobbying against California's "ReadyReturn" (a prepopulated state return)¹⁷² and free electronic filing in Virginia.¹⁷³ The software industry's efforts to torpedo tax return simplification measures at the state level have been intense, well-funded, and relentless.

Intuit's public financial disclosures indicate that free, government-provided tax preparation software is a significant threat to its business,¹⁷⁴ which explains why Intuit and other software companies have invested so much time and so many resources lobbying Congress and state legislatures to prevent free, simplified return filing measures. Such measures, however, are surely in the best interests of taxpayers and are likely in the government's best interest as well. If nothing more, the failed history of the federal Simple Return demonstrates the urgent need for congressional regulation of tax return software companies. When private industry is able to dominate both the tax return preparation process and the political process surrounding tax return preparation, the interest of the taxpaying public is undoubtedly wrongly subjugated.

III. REGULATING TAX RETURN PREPARATION

Clearly, the status quo regarding tax return preparation is rife with shortcomings, and over the past several years, a lack of IRS funding has exacerbated the implications associated with Congress's abdication of its oversight role. Recent cuts to the IRS budget have been dramatic and devastating.¹⁷⁵ This has resulted in long lines at service centers, telephone calls that go unanswered, and fewer audits being conducted.¹⁷⁶ With the IRS at an increasing loss to help taxpayers fulfill their civic duties, taxpayers have

¹⁷² See ZELENAK, *supra* note 19, at 122.

¹⁷³ See Scott, *supra* note 90 ("The [Free File Alliance] persuaded the Virginia Legislature to scrap [its electronic filing site] several years ago, replacing it with an FFA portal similar to that of the IRS's and causing some taxpayers to have to pay [concomitant fees.]" (alteration in original)).

¹⁷⁴ See *id.*

¹⁷⁵ See TREASURY INSPECTOR GEN. FOR TAX ADMIN., DEP'T OF THE TREASURY, REDUCED BUDGETS AND COLLECTION RESOURCES HAVE RESULTED IN DECLINES IN TAXPAYER SERVICES, CASE CLOSURES, AND DOLLARS COLLECTED (May 8, 2015) ("Since Fiscal Year 2010, decreases in the budget have resulted in the reduction of 21 percent of Automated Collection Service (ACS) contact representatives and 28 percent of Field Collection revenue officers.").

¹⁷⁶ See, e.g., Kevin McCoy, *Report: Budget Cuts Weaken IRS Operations*, USA TODAY (June 17, 2015), <http://www.usatoday.com/story/money/2015/06/17/irs-budget-cuts-hurt-services/28869343/> [<https://perma.cc/6NCZ-A5DT>] ("Since 2011, the personnel reductions resulted in a 25% drop in taxpayer phone calls answered by remaining IRS Automated Collection Service workers, the report said. . . . IRS Field Collection personnel collected \$3.02 billion in fiscal year 2014 revenue, a \$222 million or 7% drop from the \$3.244 billion collected in fiscal year 2011.").

had to increase their reliance upon tax return preparers and the tax return preparation software industry for guidance. When such guidance endures only minimal scrutiny, however, tax compliance and the delivery of government benefits are jeopardized.

In light of the numerous shortcomings of the current tax preparation process, which harms many taxpayers and costs the government significant sums of lost tax revenue, Congress must intervene. There is no reason to believe that this is a circumstance where the market will correct itself. Tax return preparation is far too complex and the delay between filing and audit is too long for taxpayers to be able to effectively evaluate the quality of various return preparers or tax return preparation software companies. Moreover, congressional action would not be an instance of the government inappropriately intervening in the private sphere. Tax return preparers and tax return preparation software developers do not simply deliver a marketplace good to private individuals; they also serve as a direct intermediary between millions of taxpayers and the government each year and assist individuals in fulfilling an important legal obligation. Therefore, it is unquestionable that the government has a vital interest in regulating the tax return preparation process. Accordingly, section A of this Part explores proposals for regulating tax return preparers,¹⁷⁷ and section B of this Part discusses proposals for regulating the tax return preparation software industry.¹⁷⁸

A. Expanding Tax Return Preparer Oversight

In lieu of preparing their own tax returns, many taxpayers turn to tax return preparers to complete their tax returns.¹⁷⁹ As discussed in Part I, tax return preparers generally fall within the scope of two broad categories. The first category is comprised of those who are specifically trained in the area of tax and include CPAs, lawyers, and enrolled agents who routinely prepare tax returns. The second category is comprised of those individuals who have no special tax training and who often dabble in the area, commonly operating tax return preparation businesses seasonally out of their homes, basements, or storefronts.¹⁸⁰

Under the *Loving v. IRS* and *Ridgely v. Lew* decisions,¹⁸¹ the Treasury Department, for all intents and purposes, currently lacks the ability to regulate those who prepare tax returns, whether they are trained in the area of tax or

¹⁷⁷ See *infra* notes 179–217 and accompanying text.

¹⁷⁸ See *infra* notes 218–255 and accompanying text.

¹⁷⁹ See *supra* note 4.

¹⁸⁰ NAT'L TAXPAYER ADVOCATE, 2013 ANNUAL REPORT TO CONGRESS 67 (Dec. 31, 2013) (“Without any regulation, we will continue to see a proliferation of return preparers showing up at check cashing places, pawnshops, used car dealerships, furniture stores, etc.”).

¹⁸¹ See *supra* notes 62–73 and accompanying text.

not.¹⁸² This basically means that anyone can hold himself out as a tax expert (even if he lacks tax training), claim that he is beyond moral reproach (even if he has a criminal record), and start preparing taxpayers' tax returns (even if he does so in a slipshod fashion) because the IRS lacks any viable means to sanction such tax preparers under Circular 230. This lack of congressional oversight is costly: millions of flawed tax returns are submitted,¹⁸³ the nation's coffers hemorrhage,¹⁸⁴ and low-income taxpayers often bear the brunt of this dystopian tax preparation world.¹⁸⁵

1. The Legislative Fix

Tax return preparer competency is a problem for which there is a simple solution. Because a significant percentage of individual taxpayers' tax returns are completed by tax return preparers, Congress would be wise to extend Circular 230's application to the tax return preparation and submission process and, in particular, to all tax return preparers.¹⁸⁶ To do so, Congress could easily revise § 330 of Title 31 to include one sentence declaring that practice before the Treasury Department includes tax return preparation and another sentence declaring that, in the process of tax return preparation, tax return preparers¹⁸⁷ act as taxpayers' de facto representatives.¹⁸⁸

¹⁸² Compare Steve R. Johnson, *How Far Does Circular 230 Exceed Treasury's Statutory Authority?*, 74 TAX PRAC. 55, 59 (Jan. 26, 2015) (assumes that *Loving* and *Ridgely* court decisions are either correct or, "even if incorrect, are likely to remain controlling"), with Camp, *supra* note 45, at 457 (arguing that the *Loving* analysis is critically flawed).

¹⁸³ See, e.g., IRS, IRS 2014 DATA BOOK 39 tbl.15 (2015) (indicating that for tax year 2013, for example, millions of tax returns contained mathematical errors).

¹⁸⁴ See *supra* note 2 (explaining the federal tax gap). In response to the size of the nation's tax gap, over the past decade, the National Taxpayer Advocate has strongly advocated that Congress regulate tax return preparers. NAT'L TAXPAYER ADVOCATE, *supra* note 180, at 63 ("Since 2002, the National Taxpayer Advocate has advocated for a system to regulate return preparers. Her proposals included a program to register, test, and certify unenrolled preparers, as well as increased preparer penalties and improved due diligence requirements.").

¹⁸⁵ See, e.g., Levy, *supra* note 38, at 445 ("With tens of billions in cash at stake—\$63 billion from the EITC program alone—it is no surprise that unethical preparers have descended on low-income communities to get a share of this money.").

¹⁸⁶ See NAT'L TAXPAYER ADVOCATE, 2015 REPORT TO CONGRESS 71 (Dec. 31, 2015) ("The National Taxpayer Advocate agrees that the only effective way to increase competency throughout the return preparer profession is for Congress to provide the IRS with the authority to implement a mandatory program substantially similar to the one already in place before *Loving*."); *New IRS Filing Season Program Unveiled for Tax Return Preparers: Voluntary Program to Focus on Continuing Education for Unenrolled Preparers*, IRS (June 30, 2014), <https://www.irs.gov/uac/newsroom/new-irs-filing-season-program-unveiled-for-tax-return-preparers> [<https://perma.cc/KS5G-QP4V>] ("The IRS continues to believe regulation of paid tax return preparers is important for the proper functioning of the U.S. tax system.").

¹⁸⁷ Section 7701(a)(36) of the Code defines *tax return preparer* as "any person who prepares for compensation, or who employs one or more persons to prepare for compensation, any return of tax imposed by this title or any claim for refund of tax imposed by this title." I.R.C. § 7701(a)(36)

Adding these two sentences would enable the Treasury Department to require all tax return preparers to (i) pass competency examinations; (ii) undertake continuing tax education courses; and (iii) submit a separate, signed statement acknowledging their involvement in the process. Furthermore, the Treasury Department would be able to sanction those tax return preparers who failed to uphold certain moral decency standards.¹⁸⁹ Tax professionals like CPAs, attorneys, and enrolled agents who are already licensed and trained would be exempt from the additional regulatory requirements. The combination of more competent tax practitioners at the helm of the tax return preparation process combined with newly devised tax preparation software (discussed below) would inevitably yield more accurate tax returns, thereby narrowing the nation's tax gap.

2. Precedent for Return Preparer Regulation

When it comes to regulating tax return preparers, the Treasury Department would not have to begin from scratch. For starters, with the congressional imprimatur, it could simply reinstate the 2011 regulations.¹⁹⁰ Additionally, the federal government can seize upon the experience of four states that have enacted tax return preparer regulatory regimes as successful models of regulation in this context. Specifically, California, Maryland, New York, and Oregon all regulate tax return preparers at the state level, albeit these states have taken somewhat different approaches.¹⁹¹

The states' approaches offer useful guidance about the most effective methods. By way of illustration, consider a study conducted by the GAO in

(2012). A new amendment to § 330(a)(1) of Title 31 might cross-reference this definition or, in the alternative, incorporate its own, similar definition.

¹⁸⁸ See Levy, *supra* note 38, at 467–68 (“The legislative fix is easy, and can be as short as one sentence: ‘Section 330(a)(1) of Title 31, United States Code, is amended by inserting, including compensated preparers of tax returns, documents, and other submissions.’ That is all it would take.” (internal quotation marks omitted)); Elaine Smith, Note, *Regulating Tax Preparers: Transforming Loving from a Stumbling Block to a Stepping Stone*, 83 UMKC L. REV. 1079, 1109 (2015) (“Given the number of past legal challenges to the IRS’s various registration and licensing programs, it is clear the IRS needs a strong legislative footing to create a meaningful program to carry out these objectives.”).

¹⁸⁹ There are several legislative initiatives designed to expand Circular 230’s ambit. See Taxpayer Protection and Preparer Proficiency Act of 2015, S. 137, 114th Cong. (2015); Tax Return Preparer Accountability Act of 2014, H.R. 4470, 113th Cong. (2014). Little congressional support exists to enact these proposed initiatives into law.

¹⁹⁰ See *supra* notes 57–61 and accompanying text.

¹⁹¹ See CAL. BUS. & PROF. CODE § 22253 (West 2016); MD. CODE ANN., BUS. OCC. & PROF. § 21-501 (West 2016); N.Y. TAX LAW § 32(b)(1) (McKinney 2016); OR. REV. STAT. § 673.615 (2015).

2008 comparing Oregon's regulatory approach with California's regime.¹⁹² The Oregon regulatory regime requires eighty hours of tax education, 1100 hours of work during two of the previous five years as a tax return preparer, thirty hours of annual continuing education, a high school diploma or equivalency exam, and competency testing.¹⁹³ In contrast, the California regulatory regime requires sixty hours of tax education in the previous eighteen months and twenty hours of annual continuing education but no competency testing.¹⁹⁴ Although the GAO's report found that California's regulatory regime did not appear to have a positive impact on tax compliance, it found that returns filed by Oregon taxpayers were on average \$250 dollars more accurate (for a total of \$390 million more in federal tax revenue) compared to the rest of the country.¹⁹⁵ Although many factors might affect the varying levels of compliance in these two states,¹⁹⁶ one highly plausible explanation for the dissimilar compliance outcomes between the two states is that requiring written competency exams—part of Oregon's regime¹⁹⁷ but not California's—is a crucial element of ensuring that tax return preparers are competent. Thus, any new federal regulatory regime should require that all covered tax return preparers submit to a written competency examination.

Additionally, the National Consumer Law Center, a consumer advocacy group, has published the Model Individual Tax Preparer Regulation Act ("Model Act"), which includes further suggested protections based on its research findings.¹⁹⁸ In addition to requiring sixty hours of tax training, fifteen hours of annual continuing education, and a written competency exam-

¹⁹² U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-08-781, TAX PREPARERS: OREGON'S REGULATORY REGIME MAY LEAD TO IMPROVED FEDERAL TAX RETURN ACCURACY AND PROVIDES A POSSIBLE MODEL FOR NATIONAL REGULATION 1 (2008).

¹⁹³ See OR. REV. STAT. § 673.625.

¹⁹⁴ See CAL. BUS. & PROF. CODE § 22255. Maryland and New York require fewer continuing education hours—sixteen hours every two years and four hours per year (for preparers with at least three years of experience), respectively—but both require competency testing. See MD. CODE ANN., BUS. OCC. & PROF. §§ 21-304, 21-309; N.Y. COMP. CODES R. & REGS. tit. 20, § 2600-2 (2015).

¹⁹⁵ See U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 192, at 3–4 (including both self-prepared and paid prepared returns). Additionally, "the odds that a return filed by an Oregon paid preparer was accurate were about 72 percent higher than the odds for a comparable return filed by a paid preparer in the rest of the country. Conversely, the odds that a paid preparer return in California was accurate were about 22 percent lower." *Id.* at 15.

¹⁹⁶ For example, the GAO report acknowledges that higher use of CPAs or attorneys could be responsible for more accurate returns in Oregon. *Id.* at 4.

¹⁹⁷ The GAO report also notes that Oregon's tests have low passing rates: 54% for licensed tax preparer exams and only 30% for licensed tax consultant exams. *Id.* at 12. A licensed tax preparer must work under the supervision of a licensed tax consultant, CPA, or attorney. *Id.* at 11.

¹⁹⁸ See CHI CHI WU, NAT'L CONSUMER LAW CTR., MODEL INDIVIDUAL TAX PREPARER REGULATION ACT 1 (2013).

ination, the Model Act also requires that preparers provide consumers with a written disclosure of their training and education, along with written disclosure of (i) the fee for each service offered, (ii) all miscellaneous fees like filing and processing fees, and (iii) an estimate of the total charge for the preparer's services.¹⁹⁹ In light of the predatory practices that have been observed in studies of unregulated tax return preparers with respect to their low-income clientele,²⁰⁰ the Treasury Department would be well advised to give special consideration to mandatory fee disclosures. Another consumer advocacy group has further suggested that tax return preparer regulations also explicitly ban predatory products like RALs, eliminate junk fees, and allow taxpayers to pay for tax preparation fees out of their refunds without incurring an additional charge.²⁰¹

3. Weighing the Potential Costs of Tax Return Preparer Regulation

Although critics have voiced objections to federal tax return preparer regulations, the regulatory regimes in California, Maryland, New York, and Oregon offer models of success that should allay many, if not all, of those concerns. For example, the plaintiffs in *Loving* argued that fees for testing and continuing education could cost over \$1000 per year and, as a result, would be unduly burdensome.²⁰² Regarding the Oregon and California regulatory regimes, however, the GAO's report indicates that costs are often significantly lower than that estimate: "[T]he cost of obtaining continuing education was sometimes very low, especially when continuing education was obtained through participation in professional associations."²⁰³ The report further noted that some preparers could obtain their continuing education at IRS forums costing \$179, and others could obtain it "from state-approved education providers in both classroom settings and over the internet."²⁰⁴

The *Loving* plaintiffs also argued that the costs of regulation would force them to charge higher prices to their customers or go out of business.²⁰⁵ The GAO's research in California, however, found that

The costs to obtain and maintain [registered preparer] status are fairly low and likely do not have much of an impact on prices

¹⁹⁹ *Id.* at 12–14.

²⁰⁰ See *supra* notes 123–128 and accompanying text.

²⁰¹ See MICHAEL BEST, CONSUMER FED'N OF AM., PROTECTING CONSUMERS AT TAX TIME: FEDERAL AND STATE EFFORTS TO ADDRESS COMMON PROBLEMS ASSOCIATED WITH PAID TAX PREPARATION 9 (2015).

²⁰² See Brief of Plaintiffs-Appellees at 15, *Loving v. IRS*, 742 F.3d 1013 (D.C. Cir. 2014) (No. 13-5061) (including potential travel and an exam preparation course in the cost estimate).

²⁰³ U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 192, at 20.

²⁰⁴ *Id.*

²⁰⁵ See Brief of Plaintiffs-Appellees at 15–16, *Loving*, 742 F.3d 1013 (No. 13-5061).

consumers pay, and . . . the requirements to become a paid preparer are not so great that the number of paid preparers in the state is being held lower than it would be without any regulation.²⁰⁶

Even if licensing and registration fees are passed on to consumers, it is unlikely that the cost would be more than a few dollars per return.²⁰⁷

Another cost to consider is that borne by the government in administering a tax preparer regulatory regime. Presumably, prior to the issuance of the 2011 regulations, the Treasury Department and the IRS had already undertaken a cost-benefit analysis and determined that a federal licensing regime would be beneficial from the government's perspective. Again, the experience of the states is informative and encouraging. The costs of administering competency testing are generally covered by the testing fees and do not require government funding.²⁰⁸ Additional administrative costs incurred by states, such as record keeping, maintaining a website, communicating with preparers, and instituting enforcement actions, are also paid for by the revenue generated by fees and penalties. For example, Oregon's 2007 administrative costs totaled \$490,000, which were paid for by a combination of registration fees and fines for operating without a license and/or violating Oregon laws; none of the concomitant administrative costs associated with this program came from Oregon's general revenue.²⁰⁹ The funding of the California program was similar, with no general revenue spent on administering the tax return preparer regulatory regime.²¹⁰

Admittedly, implementing a regulatory regime for tax return preparers is not without costs, but existing evidence indicates that these costs pale in comparison with the associated benefits. Additional charges incurred by taxpayers in the form of higher fees are likely to be modest (if not nonexistent), and fee disclosures might actually work to reduce certain types of fees charged by some preparers. The government's enforcement cost would likely be recouped through fees and fines, and narrowing the tax gap would result in significantly more revenue collected. Although some incompetent

²⁰⁶ U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 192, at 21 (alteration in original). Consistent with this is the fact that paid preparer use in California is higher than the national average. *Id.* at 22. The same is not true for Oregon, which has lower paid preparer use than the national average. *Id.* The report notes that Oregon's regime may restrict the number of preparers more than California's regime because Oregon requires that licensed tax preparers only work in offices managed by licensed tax consultants (the latter group possessing more qualifications), a restriction not present under the prior federal regime. *See id.* at 21–22.

²⁰⁷ *See* WU & HERNANDEZ, *supra* note 10, at 12.

²⁰⁸ *See* U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 192, at 18–19; WU & HERNANDEZ, *supra* note 10, at 12.

²⁰⁹ U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 192, at 19.

²¹⁰ *Id.* at 18.

tax preparers would likely be forced to exit the market, a minor reduction in the overall number of tax return preparers would be well worth the benefit of ensuring that the remaining preparers are trained, knowledgeable, and able to prepare accurate returns.

4. Alternative Regulatory Approaches

If Congress lacks the political appetite to enable the Treasury Department to regulate tax return preparers in a direct fashion (i.e., expanding Circular 230's ambit), it should supply more efficient tools to the agency to regulate tax return preparers in an indirect fashion. Numerous possibilities exist to deter dishonest return preparers, including (i) making it easier for the IRS to secure court injunctions against their ability to practice,²¹¹ (ii) enhancing their financial liability exposure,²¹² and (iii) strengthening criminal tax sanctions regarding their defalcations.²¹³ The addition of such measures would hopefully give serious pause to those tax return preparers who were contemplating being unscrupulous.

What Congress must bear in mind is that tax return preparers who are "bad apples" have a corrosive effect on the process, with the potential for spoiling part of or the entire barrel. In whatever way possible, Congress must give tools to the Treasury Department and the IRS to cull such tax return preparers from the system.

5. Strengthening Taxpayer Involvement in the Return Preparation Process

Once tax return preparers fulfill their mission and complete the preparation of taxpayers' tax returns, taxpayers should not be entirely absolved from having further responsibility. Taxpayers may knowingly or unknowingly contribute to errors on returns filled out by a preparer not only by failing to provide complete or accurate information but also by failing to review the return once completed.

²¹¹ See, e.g., *United States v. Cruz*, 611 F.3d 880, 882 (11th Cir. 2010) ("The District Court found that the defendants had engaged in deceptive practices in preparing tax returns and issued an injunction specifically prohibiting them from further engaging in any such conduct. It declined to completely bar them from operating as tax return preparers, as the Government requested, finding such an extreme measure was unwarranted under the circumstances of the case.")

²¹² See I.R.C. § 6694(b) (2012). The monetary fines associated with preparing flawed tax returns are fairly moderate. See *id.* (limiting the tax return preparer penalty to "the greater of (a) \$5,000 or (b) 50% of the income derived (or to be derived) by the income tax return preparer with respect to the return or claim").

²¹³ Walter T. Henderson, Jr., Comment, *Criminal Liability Under the Internal Revenue Code: A Proposal to Make the 'Voluntary' Compliance System a Little Less 'Voluntary'*, 140 U. PA. L. REV. 1429, 1434 n.24 (1992) (citing empirical studies that demonstrate the effectiveness of criminal sanctions in curtailing criminal behavior).

To better understand taxpayers' role in this context, consider the actual return submission process. First, the taxpayer supplies tax information returns and other relevant tax information (for example, filing status and the number of household dependents) to the tax return preparer; second, the tax return preparer asks the taxpayer a series of tax-related questions (for example, did you or someone in your family incur any medical expenses?); third, based upon the tax information returns and the taxpayer's responses to the questions posed, the tax return preparer will produce completed tax returns; fourth, the taxpayer will review his tax return; and, fifth, assuming the tax return proves satisfactory, the taxpayer will authorize submission of the return by the tax return preparer.

Notwithstanding this multistep nature of tax return preparation, the reality is that many taxpayers who rely upon the services of paid tax return professionals may cumulatively spend fifteen minutes or less annually immersed in the tax return submission process. How could such an intricate process take so little time to complete? The truth is that many taxpayers give the proverbial "shoe box" filled with tax information returns to their tax return preparers and then simply authorize the latter to submit the completed returns, sometimes even without reviewing them.²¹⁴ In these kinds of situations, the bonds of fiscal citizenship are obviously quite tenuous.

No doubt, when taxpayers retain tax return preparer services, they seek both expertise in tax and the administrative ease of delegating this responsibility to someone else. Put differently, the vast majority of taxpayers who retain the services of tax professionals purposefully eschew the Code's intricacies and are willing to pay sizable fees to avoid the labor that tax return preparation requires.²¹⁵ In these taxpayers' minds, the less they have to do with the preparation of their tax returns, the better. Viewed through the lens of this prism, members of Congress cannot impose too many additional responsibilities upon those taxpayers who rely upon tax return preparers without risking a fierce backlash, suggesting that they must proceed gingerly.

It is possible, however, to require taxpayers to be more deeply engaged in the return preparation process than they are currently, and such involvement should further promote tax compliance. Here is one tenable approach: before those taxpayers who utilize the services of a tax return preparer are

²¹⁴ See IRS, FORM 8879 (2015) (IRS e-file Signature Authorization) (taxpayers must simply sign and give this form to their tax return preparers, who may then handle the remainder of the return filing process on the taxpayer's behalf).

²¹⁵ See generally Laura Sanders, *What Tax Return Preparers Are Really Charging for 2014 Returns*, WALL ST. J. (Jan. 16, 2015, 2:58 PM), <http://blogs.wsj.com/totalreturn/2015/01/16/what-tax-preparers-are-really-charging-for-2014-returns/> [<https://perma.cc/W8G7-J9MR>] ("The national average fee for 2014 returns will be \$273, according to a survey by the National Society of Accountants.").

permitted to file their tax returns, they would be obligated to supply their tax return preparers with a signed, one-page declaration consisting of four parts, affirming (i) the importance of taxpayer honesty;²¹⁶ (ii) the advantages associated with the submission of a correct return, namely, by doing so, the government would have the financial resources to fulfill its role to provide public goods and services, such as maintaining national parks and sustaining the military; (iii) the disadvantages associated with the submission of an incorrect return, namely, the government would lack the financial resources to fulfill its role to provide public goods and services and, if audited, the taxpayer may be liable for additional tax, penalties, and interest; and (iv) gratitude expressed by the government for taxpayers fulfilling their civic duties.

In order for a tax return to be considered properly filed, the taxpayer would have to initial all four parts of this one-page declaration and sign and date the bottom of it, and the tax return preparer would then have to submit it simultaneously with Form 1040.

To bolster compliance, every year the government should change the content of this paperwork, its format, and possibly even its color scheme.²¹⁷ By constantly freshening up this declaration, the government would enhance the likelihood that the declaration would be carefully read and internalized. Failure to take this step would mean that after a year or two, taxpayers would treat this process in a rote and mindless fashion, quickly initialing, signing, and dating the proposed declaration without reading it. As a result, tax compliance may correspondingly ebb.

B. Expanding Tax Return Preparation Software Industry Oversight

Although regulation of tax return preparers should go a long way toward strengthening the integrity of the tax return preparation process, a significant number of tax returns would not be covered—namely, those that are self-prepared.²¹⁸ Congress should also empower the Treasury Department to regulate the tax return preparation software industry because most self-

²¹⁶ The taxpayer could be asked to initial a statement verifying that she has reviewed the entire return and that its contents are accurate.

²¹⁷ Each year, taxpayers could possibly select a new tax “hero,” an imaginary figure or real person who is representative of our country’s ideals, who could advocate on the government’s behalf that taxpayers be honest and forthright in their reporting practices.

²¹⁸ See *Millions Prepare for Tax Deadline*, IRS (Apr. 14, 2016), <https://www.irs.gov/uac/newsroom/millions-prepare-for-tax-deadline-use-free-file-or-direct-pay-to-get-a-6-month-tax-filing-extension-choose-direct-deposit-for-refunds> [<https://perma.cc/U8FN-D6LD>] (approximately 41,725,000 self-prepared by April 8, 2016).

prepared returns are completed using tax preparation software.²¹⁹ Specifically, in the realm of tax return preparation software, Congress should allow the Treasury Department to regulate both the content and format of tax preparation software in order to improve compliance and protect low-income taxpayers.

1. The Legislative Fix

As with regulating tax return preparers, Congress could easily authorize the Treasury Department to regulate the tax return preparation software industry with minor amendments to § 330(a) of Title 31. Specifically, Congress could add a new subparagraph (a)(3) to § 330 that would cover tax return preparation software.²²⁰ When combined with amendments for regulating tax return preparers, the new text of § 330(a) might read as follows (emphasis added for proposed new language):

- (a) [T]he Secretary of the Treasury may—
- (1) regulate the practice of representatives of persons before the Department of the Treasury, *including tax return preparation*;
 - (2) before admitting a representative to practice, require that the representative demonstrate—
 - (A) good character;
 - (B) good reputation;
 - (C) necessary qualifications to enable the representative to provide to persons valuable service; and
 - (D) competency to advise and assist persons in presenting their cases; and
 - (3) *regulate the content and format of any software or Internet program designed for use in the preparation of a federal tax return.*
- For purposes of this section, “representative” includes any tax return preparer as defined in 26 U.S.C. § 7701(a)(36).*

²¹⁹ Over one-third of taxpayers use tax preparation software, which is the majority of the approximately 40% of taxpayers who self-prepare. *See id.*; *see also Hearing, Protecting Taxpayers*, *supra* note 29, at 1 (34% of taxpayers use tax preparation software).

²²⁰ Although an alternative way to regulate software would be to simply include tax software developers in the definition of *tax return preparer* under § 7701(a)(36), this approach is likely too broad. Tax return preparers (as defined by § 7701) are subject to a number of provisions under the Code, such as criminal penalties for fraudulent tax return preparation, which will not necessarily be relevant for tax return preparation software developers. Thus, expanding § 330(a) of Title 31 to give the Treasury Department authority to regulate tax return preparation software is a preferable approach.

Amending § 330(a) of Title 31 in this fashion would give the Treasury Department leeway to develop a regulatory framework that focuses specifically on the issues presented by tax return preparation software. Although not an exhaustive list of possibilities, what follows is a discussion of potential avenues for such regulation, including mandatory screen content designed to improve compliance, removal of the prepayment-position status bar, and more transparent fee disclosure. From time to time, as technology evolves and commercial tax return preparation software companies continue to develop their products, the Treasury Department might update and amend software regulation, informed by empirical studies on the effect of tax return preparation software on compliance and the uptake of government benefits.

2. Mandatory Content

As discussed in section B of Part II, certain features of tax return preparation software encourage taxpayers to take more aggressive reporting positions than they might otherwise have taken on their own. Although there is certainly nothing nefarious about tax return preparation software helping taxpayers maximize their deductions and save taxes in a legitimate fashion, the lopsided approach of tax return preparation software (maximizing deductions without maximizing income reporting) likely results in a revenue loss to the government.

Accordingly, the Treasury Department should take steps to regulate the content of tax return preparation software to maximize income reporting and otherwise encourage honest, accurate filing by taxpayers. Computer screens with embedded salient information would ideally appear before taxpayers, requiring that users read them before they could progress to the next screen. Similar in nature to the recommended one-page declaration that must be signed by taxpayers who use the services of a tax return preparer, the proffered information could stress the importance of integrity and highlight salient tax compliance themes, including that of carrots, sticks, and gratitude.

a. Make Ethics Salient

In terms of encouraging integrity in tax return preparation, there is compelling empirical evidence supporting the proposition that people tend to be more honest when they are reminded of their ethical obligations immediately *before* they decide what to report.²²¹ For example, subjects in

²²¹ See Lisa L. Shu et al., *Signing at the Beginning Makes Ethics Salient and Decreases Dishonest Self-Reports in Comparison to Signing at the End*, 109 PROC. NAT'L ACAD. SCI. 15,197, 15,197 (2012) ("Using laboratory and field experiments, we find that signing before—rather than after—the opportunity to cheat makes ethics salient when they are needed most and significantly reduces dishonesty.").

studies who had to read and sign an honor code before taking a test cheated significantly less than subjects who were not presented with an honor code.²²² Similarly, in a study of car insurance consumers who had to self-report odometer mileage, significantly more miles were reported when consumers had to sign the form at the top (before they filled it out) as compared to when they signed it at the bottom (after they filled it out).²²³ The same result was observed in a recent study of government contractors, who reported more industrial funding fees when they had to e-sign an online form verifying the accuracy of the information reported before they reported it as opposed to after.²²⁴

Extrapolating from the findings of these studies, the importance of integrity should be stressed at the inception of the process, not at the end. The Treasury Department therefore should require tax return preparation software companies to inform their users at the commencement of the preparation process of their duty to report honestly. For example, when starting a new return, taxpayers might be presented with a screen that requires them to electronically sign a brief statement acknowledging that their return will be signed under “penalties of perjury” and/or to acknowledge a statement that reminds them of the paramount importance of being forthright.²²⁵ Given that taxpayers might prepare their return over a number of days by repeatedly saving their work and logging back in, these “honesty prompts” should be displayed each time taxpayers log in to continue work on their returns. If taxpayers are instead only told of the “penalties of perjury” standard at the end of the preparation process (as is currently the case), they will be more likely, based on the foregoing empirical evidence, to rationalize their actions, refusing to change their initial, less-than-candid responses.²²⁶

²²² See Nina Mazar et al., *The Dishonesty of Honest People: A Theory of Self-Concept Maintenance*, 45 J. MARKETING RES. 633, 636–37 (2008) (describing the outcome of their study).

²²³ See Shu et al., *supra* note 221, at 15,198 (consumers had a financial incentive to underreport their odometer miles because more miles driven causes higher insurance premiums).

²²⁴ See NAT’L SCI. & TECH. COUNCIL, EXEC. OFFICE OF THE PRESIDENT, SOCIAL AND BEHAVIORAL SCIENCES TEAM ANNUAL REPORT 15–16 (2015) (reporting that the industrial funding fee functions like a tax—it is a small percentage of the contractor’s sales that must be self-reported and paid to the government).

²²⁵ DAN ARIELY, *THE (HONEST) TRUTH ABOUT DISHONESTY* 47–48 (2012). This approach has drawn some media attention. See, e.g., *An Easy Way to Induce Honesty: Make People Sign at the Top of a Form Instead of the Bottom*, FORBES (Apr. 15, 2013, 11:27 AM), <http://www.forbes.com/sites/hbsworkingknowledge/2013/04/15/an-easy-trick-to-mitigate-tax-form-cheating/> [<http://web.archive.org/web/20160511202237/http://www.forbes.com/sites/hbsworkingknowledge/2013/04/15/an-easy-trick-to-mitigate-tax-form-cheating/#29e8e57746c9>]. For more suggestions regarding potential language to make ethics salient on tax returns, see Kathleen DeLaney Thomas, *The Psychic Cost of Tax Evasion*, 56 B.C. L. REV. 617, 648–49 (2015).

²²⁶ See Shu et al., *supra* note 221, at 15,197.

b. Require Affirmative Responses

In order to induce more honest reporting, the Treasury Department should also mandate that tax return preparation software companies require taxpayers to affirmatively indicate whether or not they have particular types of income or owe certain taxes.

A preliminary question is why some taxpayers lie on their tax returns in the first place. One obvious answer is wealth enhancement. Although robbing a bank would also enhance taxpayers' wealth, most do not resort to utilizing this option. This is because robbing a bank would require an investment of a lot of time, effort, and energy to commit the crime and would engender a big downside risk, namely, significant jail time. These factors cast a large dark shadow on the allure of this sort of wealth enhancement strategy. The same cannot be said about stealing from the U.S. Treasury: this crime does not require a detailed plan, a getaway car, and a place to wash the stolen funds; all a taxpayer has to do is strategically omit certain information from the tax return (for example, cash receipts for services rendered), and, in most instances, wealth enhancement likely will be achieved.²²⁷ As various psychological studies confirm, an act of omission (like failing to report income) costs individuals very little mental energy compared to an act of commission (like robbing a bank).²²⁸ Given the burgeoning tax gap,²²⁹ these psychological studies should be a lodestar in crafting software changes.

Under the current system, taxpayers using tax return preparation software may intentionally or unintentionally omit certain items when there are no specific prompts, or they may ignore less aggressive software prompts even when they are present. These tendencies could be mitigated by requiring tax return preparation software companies to include mandatory prompts that require a taxpayer to enter an amount of a particular type of income ("zero" if they did not have any such income) or to check a "yes" or "no" box indicating whether they had such income for the taxable year. The reformulation of tax return questions would not have to be universal. The mandatory prompts might be focused on a few areas that are particularly problematic

²²⁷ Under standard deterrence theory, taxpayers weigh the economic benefit of cheating on their taxes versus the potential downside economic cost of enduring penalties multiplied by the risk of being detected. Michael G. Allingham & Agnar Sandmo, *Income Tax Evasion: A Theoretical Analysis*, 1 J. PUB. ECON. 323, 324–25 (1972).

²²⁸ See Joseph Bankman et al., *Using the "Smart Return" to Reduce Tax Evasion* 6 (Stanford Pub. Law, Working Paper No. 2578432, 2015), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2578432 [<https://perma.cc/LSE5-QLKZ>] (citing two studies in support of this proposition: (i) Vincent van Veen et al., *Neural Activity Predicts Attitude Change in Cognitive Dissonance*, 12 NATURE NEUROSCI. 1469, 1472–73 (2009); and (ii) SUSAN T. FISKE & SHELLEY E. TAYLOR, *SOCIAL COGNITION* (2d ed. 1991)).

²²⁹ See *supra* note 3.

from a tax compliance perspective, such as nonreporting of cash income, lack of substantiation for ordinary and necessary deductions, suspect charitable deductions, or failure to report household employees.²³⁰ Forcing taxpayers to affirmatively lie on their return if they want to omit tax obligations should make them more reluctant to do so and thereby increase compliance.²³¹

Consider the following example. Tax returns currently ask taxpayers how much income they earn annually. Suppose a taxpayer who is a salaried teacher at a public school moonlights as a math tutor, earning \$10,000 annually in cash. On her income tax return, this taxpayer might selectively “forget” to include this dollar amount in her gross income. Suppose, however, that the soliciting tax return question were reformulated, asking instead, “Aside from your salaried income, did you earn or receive any additional income?” The software could then require the taxpayer to respond “yes” or “no” before proceeding. Under this question reformulation, if the taxpayer sought to avoid reporting her tutoring income, she would now have to perpetrate an outright lie—a feat that psychological studies indicate is much harder to do than simply omitting information.²³²

This suggestion for modifying tax return preparation software prompts is not without precedent. Years ago, when tax return preparation software asked taxpayers if they had foreign bank accounts, the programs would automatically fill in a default “no,” which the taxpayer was at liberty to change to “yes.” The IRS apparently requested the tax return preparation software industry to change this, so the software no longer automatically defaults to “no”; that being the case, taxpayers now proactively have to choose a response.²³³

Another approach to help bolster taxpayer compliance could be to require software companies to utilize question algorithms designed for each individual taxpayer.²³⁴ In the sphere of consumerism, the use of question

²³⁰ See, e.g., NAT'L TAXPAYER ADVOCATE, 2014 ANNUAL REPORT TO CONGRESS 423–527 (2014) (explaining, in the section of the report entitled “Most Litigated Issues,” those issues in which the IRS commonly challenges taxpayers’ reporting positions); see also Thomas, *supra* note 225, at 649.

²³¹ See Jay A. Soled, *Homage to Information Returns*, 27 VA. TAX REV. 371, 384 (2007); Thomas, *supra* note 225, at 649–50; Bankman et al., *supra* note 228, at 6.

²³² See Bankman et al., *supra* note 228, at 6.

²³³ U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 5, at 11. In this same report, the GAO stated thus: “IRS’s Earned Income Tax Credit (EITC) office worked with a group of tax software developers to ensure software used by paid preparers eliminated default answers where taxpayers’ answers are critical to return EITC accuracy, and incorporated a ‘note’ capability in the tax software enabling the preparer to record additional inquiries and taxpayer responses.” *Id.* at 12.

²³⁴ See Bankman et al., *supra* note 228, at 18 (“A key advantage to this approach is that by eliminating irrelevant questions, the taxpayer will feel that the questions that are being asked are more important: that importance should make it harder for the taxpayer to lie.”).

algorithms is standard fare.²³⁵ For example, when consumers shop online, based upon their responses to certain questions, they journey along different query paths that are presumably specific to their unique situations. As the questions are more directed to respondents' particular circumstances and tastes, consumers can convey relevant information more accurately. In the jargon of these studies, the consumer becomes intertwined with the process and thus more "invested" and, as such, more apt to participate in a meaningful fashion.²³⁶

These kinds of solicitation algorithms may be a viable platform that the Treasury Department should prod the tax return preparation software industry to employ in order to entice taxpayers to be more candid. Specifically designed questions could lead taxpayers down different (and individually suitable) decision paths.²³⁷ By offering taxpayers more meaningful online experiences, ones that appear geared to their particular circumstances, taxpayers would hopefully be candid in accurately reporting their income and allowable deductions.

c. Reduce Unintentional Errors

The Treasury Department could also identify specific areas of low compliance where reporting errors are likely caused by confusion and require software companies to provide taxpayers with additional clarification and guidance. Consider, for example, a 2008 GAO report describing the high misreporting rate among taxpayers holding rental real estate property, particularly with respect to deductions related to the property.²³⁸ The report concludes that one likely reason for high rates of noncompliance is the complexity associated with reporting rental real estate activities, pointing out that many taxpayers simply may not understand their reporting obligations.²³⁹ Among the report's recommendations for improving compliance in

²³⁵ See, e.g., Janice Denegri-Knott & Mike Molesworth, *Redistributed Consumer Desire in Digital Virtual Worlds of Consumption*, 29 J. MARKETING MGMT. 1561, 1561 (Oct. 2013) (explaining how computer software may shape consumer desire); Alexander Felfernig et al., *Knowledge-Based Recommender Technologies for Marketing and Sales*, 21 INT'L J. PATTERN RECOGNITION & ARTIFICIAL INTELLIGENCE 333, 333 (2007).

²³⁶ See, e.g., Lingyum Qiu & Izak Benbasat, *Evaluating Anthropomorphic Product Recommendation Agents: A Social Relationship Perspective to Designing Information Systems*, 25 J. MGMT. INFO. SYS. 145, 145 (2009) (describing how computer software, in an attempt to build a social relationship with a consumer visiting a website, tries to replicate the experience a customer may have with a salesperson in a store).

²³⁷ See Bankman et al., *supra* note 228, at 18.

²³⁸ See U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-08-956, TAX GAP: ACTIONS THAT COULD IMPROVE RENTAL REAL ESTATE REPORTING COMPLIANCE 9 (2008) ("At least an estimated 53 percent of individual taxpayers with rental real estate misreported their rental real estate activities for tax year 2001.").

²³⁹ *Id.* at 18–19.

the context of rental real estate is the suggestion that the IRS work with tax return preparation software companies to improve guidance to taxpayers by including additional information about reporting rental real estate in their programs.²⁴⁰ Going forward, the Treasury Department and the IRS could identify additional areas where clarification and amplification of the tax return submission requirements associated with specific tax return items could further bolster compliance. Additionally, subject to further empirical study, separate screens or embedded explanations might be included in software programs to improve uptake in government benefits like the EITC.

d. Carrots, Sticks, and Gratitude

Beyond stressing integrity, tax return preparation software should include important tax compliance themes: “carrots,” “sticks,” and gratitude.

Insofar as so-called carrots are concerned, one computer screen could inform taxpayers of the virtues of successfully completing and submitting an accurate tax return. Among the many things that this screen would indicate is how tax revenue is put to public use to sustain, for example, the nation’s military apparatus, judicial system, and public parks.²⁴¹ The computer screen could also indicate that mathematical accuracy and factual correctness essentially ensure the taxpayer of closure, precluding a subsequent IRS adjustment.

Another computer screen that might immediately follow the “carrot” screen would be a “stick” screen, consisting of a series of warnings. In this screen’s narrative, the Treasury Department could caution taxpayers that inaccurate tax return submissions could be costly and result in the imposition of additional tax, interest, and penalties. Moreover, items of particular concern (for example, the nondisclosure of foreign bank investments) could be highlighted in red.²⁴² Finally, the computer screen could point out that

²⁴⁰ *Id.* at 27, 30. The report also notes that guidance incorporated into software would also likely help paid preparers (who use software). *See id.* at 30.

²⁴¹ See Yair Listokin & David M. Schizer, *I Like to Pay Taxes: Taxpayer Support for Government Spending and the Efficiency of the Tax System*, 66 TAX L. REV. 179, 179–80 (2013) (arguing that compliance is better when people like how their tax dollars are spent); *see also Cutting Government Spending May Be Popular but There Is Little Appetite for Cutting Specific Government Programs*, HARRIS POLL (Feb. 16, 2011, 12:00 AM), http://www.theharrispoll.com/politics/Cutting_Government_Spending_May_Be_Popular_But_There_Is_Little_Appetite_For_Cutting_Specific_Government_Programs.html [<https://perma.cc/65ZF-U6ZV>] (reflecting study that taxpayers do not want cuts to popular programs such as Social Security and federal aid to education).

²⁴² The IRS estimates that, over the last decade, the government has lost billions of dollars of revenue from taxpayers’ failure to disclosed income earned overseas. *See, e.g.*, STAFF OF S. PERMANENT SUBCOMM. ON INVESTIGATIONS, 113TH CONG., OFFSHORE TAX EVASION: THE EFFORT TO COLLECT UNPAID TAXES ON BILLIONS IN HIDDEN OFFSHORE ACCOUNTS 3–4 (Comm. Print, Feb. 23, 2014) (estimating that taxpayers have hidden great amounts of wealth in overseas ac-

the IRS has a number of tools at its disposal to cross-check tax return accuracy (for example, tax information returns) and to monitor compliance (for example, its staff of field auditors). The bottom of the computer screen could emphasize that if a taxpayer's derelictions are fraudulent, such defalcations might ultimately result in the imposition of criminal sanctions.²⁴³

A final computer screen that the Treasury Department could require is one reflective of the nation's deep gratitude toward those taxpayers who faithfully fulfill their civic duty of preparing and submitting their tax returns and paying their taxes. For many taxpayers, submitting an accurate tax return is a painstaking ordeal; the government should recognize and applaud this effort, which would have the dual effect of expressing thanks and motivating taxpayers (via positive reinforcement) to fulfill their civic duty the following year.

3. Removing the Prepayment-Position Status Bar

Along with improving the content of software programs, the Treasury Department could reduce aggressive reporting by simply mandating that software programs remove the prepayment-position status bar from the top of the screen during the tax preparation process. Recall that the prepayment-position status bar displays the potential balance owed or refund due to the taxpayer at each stage of the tax preparation process.²⁴⁴ In light of the empirical evidence that taxpayers report more honestly when the status bar is absent,²⁴⁵ regulations could require that taxpayers not be informed of their refund or balance due until they complete the tax preparation process (and have reviewed the compliance-enhancing content described above). Although both tax return preparation software companies and taxpayers might shun such a requirement, it should be noted that this change simply puts taxpayers in the same position they would be in if they prepared their taxes without software or if they used a tax return preparer. In both of these circumstances, taxpayers are apprised of their refund or balance due at the end of the tax return preparation process. Although in either case taxpayers might go back to their return to make more favorable adjustments, they probably would be less inclined to do so, or unable to figure out how to do

counts, greatly contributing to the size of the tax gap). With a host of new compliance measures that Congress has instituted to bolster the IRS's oversight arsenal (for example, Foreign Account Compliance Tax Act, Hiring Incentives to Restore Employment Act of 2010, Pub. L. No. 111-147, § 501(a), 124 Stat. 71 (codified as amended in scattered sections of 26 U.S.C.)), Congress aspires to stem this revenue leakage. *See id.*

²⁴³ *See* I.R.C. §§ 7201–7241 (2012) (crimes).

²⁴⁴ *See supra* note 162 and accompanying text.

²⁴⁵ *See supra* notes 163–164 and accompanying text.

so, as compared to when they can see their refund or balance due fluctuate with each line item on the return.

4. Free Filing and Fee Disclosures

In addition to improving tax compliance and enhancing revenue collection, regulation of tax return preparation software could also aid low-income taxpayers and improve the delivery of government benefits.

First, the Treasury Department might consider intervening to improve access to free filing because currently only a small portion of taxpayers eligible to use the IRS's Free File site do so.²⁴⁶ Such regulation might require software companies to notify taxpayers of the Free File site when they visit the company website by providing a link to the site and clear, noticeable language about free filing. Although some taxpayers are able to file for free directly through private software company websites,²⁴⁷ others may be unwittingly lured to what they think is a free site and then forced to upgrade to a fee-based version of the software after they have already begun work on their return.²⁴⁸

Treasury could also mandate better up-front fee disclosures for all tax return preparation programs. For example, when a taxpayer visits a software company's website and clicks a link for putative "free" filing, she could be presented with a brief checklist to determine how complicated her return will be so that she can be notified in advance of the cost, if any. The checklist might ask questions about how much income is reported on her Form W-2, whether she operates her own business, whether she has received certain tax forms (for example, Form 1099-B), and whether she has a health savings account.²⁴⁹ Some taxpayers with simple tax situations would be able to file for free, and those who would be required to use a more expensive version of the software program could be informed of the cost before

²⁴⁶ See *supra* note 86 and accompanying text.

²⁴⁷ See, e.g., *TurboTax Federal Free Edition*, TURBOTAX, <https://turbotax.intuit.com/personal-taxes/online/free-edition.jsp> [<https://perma.cc/E8B4-3TNS>] (advertising the availability of free filing).

²⁴⁸ See *supra* notes 89–90 and accompanying text.

²⁴⁹ See Sharf, *supra* note 88 (explaining that TurboTax's Federal Free Edition forced her to upgrade to the Deluxe Edition for \$34.99 because she had a health savings account). Sharf also notes that although TurboTax's Federal Free Edition is not part of the Free File Alliance, TurboTax's Freedom Edition is, and the latter supports more tax forms. The Freedom Edition is not, however, displayed on the front page of TurboTax's website, although the Federal Free Edition is. *Id.* If a taxpayer unwittingly begins work using the Federal Free Edition and then later discovers the Freedom Edition (i.e., the version on the IRS's Free File website), the company will not allow for an automatic transfer of the taxpayer's information from one version to the other; instead, the taxpayer would have to start the return preparation process over. *Id.*

they proceed. Taxpayers should also be notified up front about the cost of each state tax return.

The reason for these suggestions is simple: knowledge is comforting. If taxpayers are aware of whether they truly qualify for free filing or, if not, have an accurate assessment of their anticipated preparation and submission fees, they will no doubt harbor a lot less anguish about and frustration toward the tax return filing process, boding well for compliance.

5. Collaboration with the Tax Return Preparation Software Industry

In many settings, the government has sought input from private industries that it regulates,²⁵⁰ and this context would not have to be different: the Treasury Department could similarly seek input from private software companies regarding regulation. Although there is an inherent tension between the interests of the tax return preparation software industry and the government, the two have collaborated in a productive manner in a number of prior settings. For example, as discussed above in section B of Part I, the tax return preparation software industry and the IRS have recently announced a partnership to work together to combat online identity theft.²⁵¹ Identity fraud negatively impacts both the government and the software industry, as well as the taxpaying public, and finding ways to reduce it should benefit all parties. The software industry has voluntarily collaborated with the government in other settings as well,²⁵² such as agreeing to help the Treasury Department conduct research on what kinds of software interventions might help improve compliance with respect to EITC claims.²⁵³

²⁵⁰ See, e.g., Federal Participation in the Development and Use of Voluntary Consensus Standards and in Conformity Assessment Activities, 77 Fed. Reg. 19,357, 19,358 (Mar. 30, 2012) (“Federal agencies and departments shall consult with voluntary, private sector, consensus standards bodies and shall . . . participate with such bodies in the development of technical standards.”); Steven Overly, *Government Seeks Input on Managing the Internet*, WASH. POST (Aug. 9, 2010), <http://www.washingtonpost.com/wp-dyn/content/article/2010/08/06/AR2010080605883.html> [https://perma.cc/9SGN-65HC] (“The Commerce Department is seeking input from the private sector on government policy for managing the Internet, as it seeks to update its approach for the first time in a decade.”). All federal regulations first must be published in the *Federal Register* in proposed form, after which they must undergo a notice and comment period during which any interested member of the public may submit comments. See OFFICE OF THE FED. REGISTER, A GUIDE TO THE RULE MAKING PROCESS, available at https://www.federalregister.gov/uploads/2011/01/the_rulemaking_process.pdf (last visited Nov. 12, 2016).

²⁵¹ See *supra* notes 91–93 and accompanying text.

²⁵² See *supra* note 233 and accompanying text (stating that the IRS works with tax preparation software companies to ensure that the companies include updates to the tax laws in their software).

²⁵³ See David Williams, *Intuit Chief Tax Officer Says Reducing EITC Errors Shouldn't Come on Backs of Poor*, FORBES (Mar. 6, 2015, 7:16 AM), [http://www.forbes.com/sites/procedurallytaxing/2015/03/06/intuit-chief-tax-officer-says-reducing-eitc-error-shouldnt-come-on-backs-of-poor](http://www.forbes.com/sites/procedurallytaxing/2015/03/06/intuit-chief-tax-officer-says-reducing-eitc-error-shouldnt-come-on-backs-of-low-income-taxpayers/#2aafd3d74bfd) [http://web.archive.org/web/20160304064630/http://www.forbes.com/sites/procedurallytaxing/2015/03/06/intuit-chief-tax-officer-says-reducing-eitc-error-shouldnt-come-on-backs-of-poor]

Given the preexisting relationship between the tax return preparation software industry and the government, the various types of regulation proposed here would not necessarily have to stem from a combative process. In fact, in many cases, working symbiotically would be advantageous to both sides (although the government must have the final say regarding how to regulate the tax return preparation process). The government might benefit from the technical expertise provided by the software industry, while the industry itself would benefit by coexisting alongside the IRS rather than being ultimately supplanted by universally available government-provided tax software. Further, in light of the highly publicized turmoil between the government and the tax return preparation software industry surrounding government-prepared tax returns,²⁵⁴ the software industry might even welcome regulation that tacitly acknowledges its continuing role in the tax return preparation process.

The whole exercise of regulating the tax return preparation software industry raises a more fundamental question: because tax return preparation is a major point of traction between taxpayers and their fiscal citizenship, shouldn't the government be the sole intermediary of this important public function? In other words, looming large in the background of the preceding discussion of tax return preparation software regulation is the highly salient question of whether the government's goals would be best achieved by simply taking over the tax preparation process.

Nevertheless, for the time being, Congress appears willing to delegate a hefty segment of the tax revenue collection process to tax return preparers and the tax return preparation software industry. Notwithstanding the merits of arguments for government-prepared tax returns,²⁵⁵ this Article's proposals acknowledge the reality that tax return preparers and tax return preparation software do not appear to be going away anytime soon. This delegation of responsibility by Congress, however, should be accompanied by an immense amount of circumspection in order to protect taxpayers and the government's revenue interest.

backs-of-low-income-taxpayers/#5471ef012761] ("This tax season, Intuit has partnered with Treasury this year to test an approach to improving EITC accuracy using behavioral economics principles.").

²⁵⁴ See *supra* notes 169–174 and accompanying text.

²⁵⁵ See generally Joseph Bankman, *Stanford Law Professor Testifies Before Tax Reform Panel*, TAX NOTES TODAY, May 16, 2005, LEXIS, 2005 TNT 95-50 (suggesting that the IRS should institute a "ReadyReturn" similar to that of California); Goolsbee, *supra* note 96 (proposing that the government adopt the "Simple Return"); Dustin Stamper, *Officials Debate Viability of Potential IRS Filing Program*, TAX NOTES TODAY, Oct. 4, 2007, LEXIS, 2007 TNT 194-9 (presenting benefits and challenges associated with IRS preparation of tax returns and creation of tax filing software); Joann M. Weiner, *Panelists Weigh Pros and Cons of Federal Ready Return Program*, TAX NOTES TODAY, June 11, 2008, LEXIS, 2008 TNT 114-7 (discussing the possibility that the government may adopt a "ready return" that includes prepopulated W-2 information).

CONCLUSION

Tax return preparers and the tax return preparation software industry have one agenda—namely, the generation of more professional fees and product sales; Congress and the IRS have another agenda—namely, revenue collection and accurate distribution of government benefits. As evidenced by the fact that the majority of taxpayers are tax compliant, these two agendas overlap in large part. Given the tax gap's size, however, the two agendas clearly are not coterminous.

One possible way to address the tax gap and to try to close it would be to improve upon the tax return submission process. Since the inception of the income tax, the IRS has played two major roles in the tax return preparation and completion process. The first role has consisted of disseminating tax returns and related instructions to the general populace, and the second role has consisted of assembling and processing the completed tax returns. Yet, tax return preparers and technological advancements in the form of tax preparation software essentially have eliminated the IRS's first role in the process, resulting in taxpayers placing their tax fate in the hands of third-party intermediaries.

To enhance tax compliance, Congress should regulate these third-party intermediaries. Congressional oversight is not without precedent: since the 1880s, Congress has successfully regulated practitioners who represented taxpayers before the Treasury Department. Furthermore, in other realms in which private industry performs important public functions (for example, telephone companies and their surveillance of telephone records), Congress plays an important regulatory oversight role.

There are many forms that regulatory oversight can take. This Article offers several, albeit not exhaustive, reform suggestions. Adoption of one or more of them would strengthen the bonds of fiscal citizenship and simultaneously help narrow the tax gap. If, however, Congress ignores its responsibilities, taxpayers' bonds of fiscal citizenship may become even more tattered and frayed—a plight that might further erode the tax base, causing the tax gap to grow even larger.