

ORAL ARGUMENT NOT YET SCHEDULED

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**No. 13-5061**

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**IN THE UNITED STATES COURT OF APPEALS  
FOR THE DISTRICT OF COLUMBIA CIRCUIT**

SABINA LOVING; ELMER KILIAN; and JOHN GAMBINO,  
*Plaintiffs-Appellees,*

v.

UNITED STATES OF AMERICA; INTERNAL REVENUE SERVICE; and  
DOUGLAS H. SHULMAN, (FORMER) COMMISSIONER OF INTERNAL  
REVENUE,  
*Defendants-Appellants.*

**ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES  
DISTRICT COURT FOR THE DISTRICT OF COLUMBIA**

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**BRIEF FOR *AMICI CURIAE* NATIONAL CONSUMER LAW CENTER AND  
NATIONAL COMMUNITY TAX COALITION IN SUPPORT OF  
DEFENDANTS-APPELLANTS AND ARGUING FOR REVERSAL OF THE  
DISTRICT COURT**

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Dated: April 5, 2013

**CERTIFICATE OF PARTIES, RULINGS, AND RELATED CASES**

A. *Parties and Amici.* The parties in the District Court and in this Court are Sabina Loving, Elmer Kilian, John Gambino, the United States of America, the Internal Revenue Service, and the Commissioner of Internal Revenue. The undersigned counsel understands that a group of five former Commissioners of the Internal Revenue Service (IRS) intend to file another *amici curiae* brief in this case in support of Defendants-Appellants.

B. *Rulings under review.* References to the rulings at issue appear in the Brief for the Defendants-Appellants.

C. *Related Cases.* To the best of their knowledge, counsel for the *amici curiae* are not aware of any previous or pending related cases in this Court.

DATED: April 5, 2013

Respectfully submitted,

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**CERTIFICATE OF CONSENT TO FILE AND NECESSITY OF  
SEPARATE AMICUS BRIEF**

The National Consumer Law Center and National Community Tax Coalition submit this *amicus curiae* brief in support of Defendants-Appellants with the consent of all parties. *Amici* filed their notice of intent to file this brief on March 25, 2013.

Pursuant to D.C. Circuit Rule 29(d), the undersigned counsel certify that they are submitting a separate brief from other *amici curiae* in this case in support of Defendants-Appellants due to the uniquely specialized nature of each *amici*'s distinct interests and expertise. This brief is submitted by advocates for low-income consumers and taxpayers, arguing for their interests and explaining how they have been victimized by the incompetence and abuse of paid tax preparers. Our understanding is that the other *amicus curiae* brief is being filed by five former IRS Commissioners based on their experience heading that agency, and focuses on the issue of the needs for efficient tax administration.

*Amici Curiae* National Consumer Law Center (NCLC) possesses a unique expertise and interest because of its many years of work on protecting consumers from abuses by the paid tax preparation industry. NCLC coordinated several of the mystery shopper tests discussed in this brief that revealed rampant and widespread incompetence and fraud amongst paid tax preparers.

*Amicus Curiae* National Community Tax Coalition (NCTC) advocates for the interests of low-income working families to secure greater financial stability and economic opportunity. Many members of NCTC are nonprofits that provide free tax preparation to low-income taxpayers, and as a result have extensive experience with the abuses perpetrated by paid preparers on these taxpayers.

Given the different purposes and expertise of the *amici curiae*, NCLC and NCTC certify that filing a joint brief would not be practicable.

DATED: April 5, 2013

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## **CORPORATE DISCLOSURE STATEMENT**

The National Consumer Law Center (NCLC) is a Massachusetts non-profit corporation established in 1969 and incorporated in 1971. It is a national research and advocacy organization focusing specifically on the legal needs of low-income, financially distressed and elderly consumers. NCLC operates as a tax-exempt organization under the provisions of §501(c)(3) of the Internal Revenue Code. It has no parent corporation and no publicly held company owns 10% or more of its stock.

The Illinois-based National Community Tax Coalition (NCTC) was founded in 2002 as a project of the nonprofit Center for Economic Progress (CEP) to focus on strengthening the financial security of low- to moderate-income working families, particularly through tax-time activities such as community-based, volunteer-assisted help with preparation and filing of tax returns. NCTC assumed limited liability corporation status in 2012 and is in the process of obtaining its own, nonprofit status as a tax-exempt organization under the provisions of § 501(c)(3) of the Internal Revenue Code. It has no parent corporation and no

publicly held company owns 10% or more of its stock.

DATED: April 5, 2013

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\*Authorities upon which we chiefly rely are marked with asterisks.

## **GLOSSARY OF ABBREVIATIONS**

IRS	Internal Revenue Service
GAO	Government Accountability Office
TIGTA	Treasury Inspector General for Tax Administration
USDOJ	U.S. Department of Justice
EITC	Earned Income Tax Credit
NCLC	National Consumer Law Center
NCTC	National Community Tax Coalition
FDNI	First Nations Development Institute
LITC	Low-Income Tax Clinic
RAL	Refund Anticipation Loan

## **STATUTES AND REGULATIONS**

Pertinent statutes and regulations are included in the Addendum to the Brief for the Defendants-Appellants.

## STATEMENT OF IDENTITY AND INTERESTS IN THE CASE

*Amicus curiae* National Consumer Law Center (NCLC) is a nonprofit organization that works for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the U.S. through its expertise in policy analysis and advocacy, publications, litigation, expert witness services, and training. NCLC frequently appears as *amicus curiae* in cases before trial and appellate courts throughout the country. For the past 11 years, NCLC has worked on combating refund anticipation loans (RALs) and other high cost tax-time financial products offered by paid tax preparers. As part of this work, NCLC has strongly supported preparer regulation, because it protects consumers from abuses and incompetence by tax preparers. Mystery shopper testing coordinated by NCLC has revealed examples of egregious problems with paid preparers.

*Amicus curiae* NCTC is the nation's largest, most comprehensive membership organization for community-based organizations offering free tax preparation and financial services to low-income working families. For its 2,400-plus members, NCTC is a critical source for information, training and resources; networking opportunities; and advocacy tools. NCTC and its members are voices united in the fight for increased access to community Volunteer Income Tax Assistance (VITA) programs; fair state and federal tax policies; and honest

financial services. Everything NCTC does is focused on the goal of helping hardworking, low-income families to secure greater financial stability and economic opportunity. To further this goal, NCTC strongly supports preparer regulation. Volunteers for NCTC member organizations and other VITA programs have long faced fundamental training and certification requirements. IRS, Pub. 1084 - IRS Volunteer Site Coordinator's Handbook 29 (Oct. 2012)(requiring that all “[v]olunteer preparers must pass at least the basic certification test. A minimum score of 80% is required for each certification test”). NCTC and its member organizations have gladly implemented these requirements for many years.

#### **STATEMENT OF AUTHORSHIP, AND FINANCIAL CONTRIBUTIONS**

*Amici* state that this brief was not authored in whole or in part by any party or its counsel, and that no person other than *Amici*, their members, or their counsel contributed any money that was intended to fund the preparation and submission of this brief.

## SUMMARY OF ARGUMENT

IRS regulation of paid preparers is critical to protect consumers. Without such regulation, consumers are at the mercy of an industry with no minimum training or competency standards for one of the most critical financial transactions that consumers engage in every year. Without preparer regulation, consumers may become the victims of incompetence or fraud by preparers through no fault of their own, yet taxpayers are ultimately responsible for wrongly prepared tax returns. Lack of regulation also allows “fringe” preparers to flourish, such as preparers who are primarily involved in payday lending or used car sales.

Unfortunately, fraud and incompetence are rampant in the paid preparation industry, especially by fringe preparers. “Mystery shopper” testing by consumer and advocacy groups, as well as government agencies, demonstrates high levels of errors and outright fraud. In some cases, the majority of returns in the testing were incorrect or fraudulently prepared, often leading to inflated refund claims.

On their own, enforcement actions by the IRS and other government agencies are simply inadequate to address this massive, rampant level of fraud. There are simply not enough resources to go after all of the bad actors. Preparer licensing is the only way to ensure that both consumers and the U.S. Treasury are adequately protected.

## ARGUMENT

### A. Regulation of Paid Preparers Helps Consumers, While Lack of Regulation Harms Them

A tax return is probably the most critical financial interaction that a consumer has with the federal government during the year. A wrongly prepared return can lead to dire economic consequences, or even criminal sanctions. And for many consumers, especially recipients of the Earned Income Tax Credit (EITC), their tax refund is the single largest sum of money that they receive all year.

For consumers who rely upon paid tax preparers, their financial lives - and their most sensitive financial information - are literally in the hands of this industry's practitioners. Yet if the District Court's decision is upheld, there will be no regulation for these critical actors in the vast majority of states, with only a handful of exceptions.<sup>1</sup> There will be no minimum educational, training, competency, or other standards for the businesses that could determine the consumer's financial fate for the coming year. More regulation is required of hairdressers in many states.

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<sup>1</sup> The exceptions are California, Maryland, New York, and Oregon. *See* Cal. Bus. & Prof. Code §§22250 to 22259; Md. Code §§21-101 to 21-502; N.Y. Tax §32; and Or. Rev. Stat. §§673.605 to 673.740. In addition, some states require registration of persons that offer RALs. *See* National Consumer Law Center, Model Refund Anticipation Loan Act, Appendix A (Dec. 2008)(summary of state RAL laws), *available at* [http://www.nclc.org/images/pdf/high\\_cost\\_small\\_loans/ral/model-refund-anticipation-loan-act.pdf](http://www.nclc.org/images/pdf/high_cost_small_loans/ral/model-refund-anticipation-loan-act.pdf).



Informed by years of experience with the abuses committed by certain paid preparers, advocates for consumers and taxpayers have long supported IRS regulation of tax preparers. *Amici* believe that ensuring tax preparers are competent, licensed, and bound by a code of ethics represents the minimum that should be done to protect consumers, who rely on this industry for advice and direction.

*Amici* disagree with the argument that IRS regulation of paid preparers harms consumers by encumbering the small businesses that engage in tax preparation. Opponents claim that regulation of paid preparers creates burdens for small businesses, which give rise to costs that are, in turn, passed along to consumers. However, the interests of consumers in obtaining competent, accurate and ethical tax preparation assistance far outweigh any increased marginal cost that is alleged.

Furthermore, IRS preparer regulation will not create greater costs to consumers. Preparers' compliance costs are minimal – for example, less than \$65 for a Preparer Tax Identification Number and less than \$120 for a competency exam. IRS, Registered Tax Return Preparer Test - Candidate Information Bulletin, Apr. 16, 2012, at 2-3. These costs are dwarfed by the hundreds of dollars in fees that some paid preparers charge. Also, it is worth noting that, tax preparation fees are entirely non-transparent. This is one of the few services for which consumers

typically cannot obtain a price before they incur the service. Tax preparers assert that they charge by the tax forms required in preparing a particular return, and cannot predict which forms will be generated until they actually finish the preparation process. Thus, consumers cannot obtain quotes to comparison shop. *See* Chi Chi Wu and Jean Ann Fox, NCLC and Consumer Federation of America, The Party's Over for Quickie Tax Loans: But Traps Remain for Unwary Taxpayers 14-16 (Feb. 2012), available at <http://www.nclc.org/images/pdf/pr-reports/report-ral-2012.pdf>.

As a result of this lack of transparency, low-income consumers face tax preparation fees that are already very high, and inflated, in many instances. Mystery shopper testing, discussed below, has documented preparation fees of \$400 or \$500 in some cases. Government enforcement actions also have revealed fees of up to \$1,000 for as little as 15 minutes worth of work. *See* Complaint, *United States v. Fesum Ogbazion*, Civil No. 3:12-cv-95 (S.D. Ohio. Mar. 28, 2012), ¶¶ 33-34. Thus, preparer regulation has more potential to lower costs than to increase them, by improving transparency and reducing abuses.

Finally, competent and ethical small-business tax preparers actually benefit from IRS regulation. Basic standards are important to protecting the integrity of an industry. Commercial preparers who are honest and ethical, investing in training

and education, are hurt when their competitors cut corners, commit outright fraud, and give tax preparation a bad name.

### B. Fringe Preparers Present Major Risks to Consumers

The tax preparation industry consists of three larger commercial chains (H&R Block, Jackson Hewitt, and Liberty Tax Service), a number of smaller chains, and many thousands of small or solo independent preparers. *See* Chi Chi Wu and Jean Ann Fox, NCLC and Consumer Federation of America, RALs, Tax Fraud, And Fringe Preparers 11 (Feb. 2009), *available at* [http://www.nclc.org/images/pdf/high\\_cost\\_small\\_loans/ral/2009-ral-appendix.pdf](http://www.nclc.org/images/pdf/high_cost_small_loans/ral/2009-ral-appendix.pdf).

There is a wide range of independent preparers, from licensed professionals -- such as attorneys, enrolled agents, and certified public accountants -- to businesses that primarily deal in another line of goods and services. Among the latter, there is a segment that is highly problematic -- the fringe preparer.

Fringe preparers include businesses that are historically associated with the exploitation of consumers, such as payday loan stores, check cashers, and used car dealers. Some retailers, such as jewelry and furniture stores, also act as fringe tax preparers.

In June 2008, the Government Accountability Office (GAO) conducted mystery shopper testing that focused on identifying types of businesses where refund anticipation loans (RALs) were marketed. Government Accountability

Office, Refund Anticipation Loans, GAO-08-800R, June 5, 2008, *available at* <http://www.gao.gov/new.items/d08800r.pdf>. Of the 27 paid preparers subject to testing, 13 were located in businesses that target low-income consumers, such as check cashers, payday loan vendors, rent-to-own stores, and pawn shops. Nine of the preparers in the GAO study offered incentives to encourage tax customers to spend their refunds on the businesses' primary goods and services. For example, an auto dealer told GAO investigators that if they didn't have enough money for the down payment on a car, they could get their taxes done by its tax preparer and use the refund as a down payment. Another preparer operated out of a shoe store, and offered a free pair of shoes with tax preparation.

A fundamental problem with fringe preparers is the questionable quality of tax preparation by a business that specializes in goods and services other than tax preparation. The mystery shopper tests discussed in the next section found several instances of incompetent tax preparation by fringe preparers. One particular example was an Alabama small loan company that prepared a tester's return to show a \$6,247 refund when the tester actually owed \$112 to the IRS. Impact Alabama, Impact Alabama Undercover Investigation of Commercial Tax Preparers in Alabama Results and Analysis, Jan. 2009.

There are even third-party vendors that specialize in providing software and back office support to fringe providers. One example is Tax Max, which

specifically caters to used car dealers. Tax Max advertises that it is “the leading tax consultant in the industry with a portfolio of over 3000 car dealerships nationwide.” Tax Max, About Us, at <https://www.taxmax.com/TRSTaxMax/AboutUs.aspx>. Tax Max informs car dealers that “[t]here is no experience required, and our web-based program was designed for use by someone who knows nothing about taxes.” Tax Max, FAQ, at <https://www.taxmax.com/TRSTaxMax/FAQ.aspx>

### C. Abuses Uncovered by Mystery Shopper Testing

As a result of the lack of regulation, abuses by tax preparers have flourished over the years. Mystery shopper testing by consumer and other advocacy groups have found examples of incompetency and fraud by preparers – a disturbingly high number, given the limited number of tests conducted. Preparer regulation is necessary to prevent this incompetence and fraud by ensuring that paid preparers meet minimum standards.

Some of the examples of this incompetence and fraud are:

#### *1. 2008 Mystery Shopper Testing*

In 2008, advocacy groups conducted 17 mystery shopper tests of paid tax preparers in Durham, NC and Philadelphia, PA. Chi Chi Wu, et al., NCLC, Community Reinvestment Association of NC, Community Legal Services of Philadelphia, Tax Preparers Take a Bite Out of Refunds: Mystery Shopper Test

Exposes Refund Anticipation Loan Abuses in Durham and Philadelphia (Apr.

2008), *available at*

[www.nclc.org/images/pdf/high\\_cost\\_small\\_loans/ral/shopper\\_report.pdf](http://www.nclc.org/images/pdf/high_cost_small_loans/ral/shopper_report.pdf). Testers

were instructed to have their returns prepared and to obtain RALs from commercial preparers. The original intent of the testing was to determine whether tax preparers were properly making disclosures concerning RALs. Unfortunately, the testing also uncovered repeated instances of serious tax errors and fraud.

The worst example involved a preparer at a small loan company in Durham, N.C., where the tester ended up having to withdraw because of the seriousness of the incompetence. According to this tester:

After sitting in the office for an hour or so, [the preparer] said that there was a problem that she did not know how to handle. The problem was that there was a \$5000 [fictional number] “dividend” that we must pay taxes on. With the dividend, our return would only return \$100. If she was to “ignore” it, then we would receive \$3000 in returns. She then called her “tax people,” whom told her that we do not need to report the dividends and just ignore it.

*Id.* at 9.

Essentially, this preparer had given the tester advice to commit tax fraud. Furthermore, it turns out that this tester had both dividend income plus profits from the sale of stock shares. The preparer completely missed the second source of income from the sale of stock shares. This tester concluded:

My experience with [the independent preparer] has been a scary one. I say that mainly because the lack of confidence in the preparer’s ability to competently complete our return even though she was generally nice.

*Id.* at 10.

In Philadelphia, a Jackson Hewitt preparer failed to include \$3,500 in unemployment income in the return of a married couple who were testers. This omission resulted in a refund that was \$600 greater than the couple was entitled to, and required them to file an amended return. This preparer also had never seen a mortgage interest Form 1098 and didn't know how to handle it.

An independent preparer in Philadelphia made numerous errors in dealing with education-related tax credits. Among other mistakes, the preparer incorrectly treated a taxable education award as though it were an exempt scholarship, resulting in an additional tax liability of \$66 and a loss of \$134 worth of Earned Income Tax Credit. Ultimately, the tester was forced to file an amended return.

At least two of the preparers in this 2008 testing were businesses that primarily sold other goods or services. One preparer was a small loan lender/payday lender, and the other preparer was in a store that primarily operated as a gift shop.

## *2. 2010 Mystery Shopper Testing*

In 2010, consumer groups conducted 19 mystery shopper tests in Arkansas, New York City, and Durham, NC. Chi Chi Wu, et al., National Consumer Law Center, *Arkansans Against Abusive Payday Lending*, NEDAP, Community Reinvestment Association of NC, *Tax Preparers Out of Compliance: Mystery*

Shopper Testing Exposes Violations of Refund Anticipation Loan Laws in

Arkansas, New York and North Carolina (Apr. 2010), available at

[www.nclc.org/images/pdf/high\\_cost\\_small\\_loans/ral/mystery\\_ral\\_report.pdf](http://www.nclc.org/images/pdf/high_cost_small_loans/ral/mystery_ral_report.pdf). As in

the 2008 testing, a number of testers became the victims of incompetent tax preparation or outright fraud.

The most disturbing example came from a tester in New York City who described how the preparer, when realizing the tester would receive only a \$1,000 federal refund and would owe state taxes, began making up deductions:

[The tester] reported that the tax preparer tried to entice her to commit tax fraud by showing her how much her federal refund would increase if she took deductions in excess of the standard deduction. [The tester] does not attend church, but the tax preparer included a \$2,000 church donation. The preparer also deducted the cost of work clothes and laundry, then showed [the tester] that her federal refund would increase to \$3,000 from about \$1,000. The preparer also tried to convince [the tester] to make up a dependent as she does not have any--showing her that her refund would go up to \$5,000 if she did so. The preparer also tried to qualify her for EITC even though she is not eligible. Finally, the tax preparer deducted \$400 in 2008 tax preparation costs even after [the tester] told the preparer that she did not pay for tax preparation last year.

*Id.* at 3.

Another example of attempted tax fraud by a preparer came from a tester in Arkansas who described how:

[The preparer] took the forms I had completed and requested my W2's which I gave them to him. He mistakenly thought that my 1099 was my tithing statement from my church. I told him it was my salary from my second job. He entered the amount and stated that I would be really disappointed if I knew the difference in my refund now that I have this



additional income reported. I asked what was the difference, he stated I went from around \$30?? [*i.e.* \$3,000] To only \$15?? [*i.e.*, \$1,500]. He wanted to know if I still wanted to report the additional income. I told him yes, I did because this income has already been reported to the IRS. Since I have been working this part time job, my refund has been less and I even have to pay State Taxes sometimes. He then told me how much I will owe the state for taxes. He again asked me if I was sure I wanted to report this. I told him again, yes, I do. I need to keep it clean. He said he had to ask because some people don't want them to report additional income because it lowers their refund amount. So he has to do what the customers tell him to do.

*Id.* at 3-4.

Other testers reported either fraud or incompetent preparation such as:

- A tester in New York reported that a Jackson Hewitt preparer advised her not to include \$300 in income for which the tester had not received a 1099 form.
- A tester who went to a small chain in Arkansas later had her tax return reviewed by a VITA volunteer. The VITA preparer found numerous errors, resulting in the tester being required to file an amended return and reimburse the IRS \$822.

Another outrageous example of preparer abuse came from a complaint in North Carolina against an independent preparer, Freedom Tax Services. This consumer could not participate in the testing as it turns out that her taxes already had been prepared for her by Freedom Tax Services without her permission.

Finally, there were several violations of requirements for tax preparers to provide certain documents to the taxpayers. The IRS Code requires preparers to

provide a copy of the tax return to the taxpayer no later than the time that the taxpayer signs it. I.R.C. §6107(a). Yet three of the 19 preparers did not provide a complete copy of the tax return at the time of filing, but instead withheld the copies until the refund was received and the preparer was paid from the refund.

IRS regulations also require preparers to provide certain privacy forms if they sell a financial product to a taxpayer. 26 C.F.R. §301.7216-3. Nine of the preparers did not provide the required privacy forms.

### *3. 2011 Mystery Shopper Testing*

In 2011, consumer groups conducted nine mystery shopper tests in New York City and Durham, NC. Chi Chi Wu, et al., NCLC, NEDAP, Community Reinvestment Association of NC, [Tax Time 2011: Mystery Shopper Testing In New York And North Carolina Finds Continuing Problems With Tax Preparers](#) (Apr. 2011), available at [www.nclc.org/images/pdf/pr-reports/report-mystery-ral-shopper-2011.pdf](http://www.nclc.org/images/pdf/pr-reports/report-mystery-ral-shopper-2011.pdf). As in the earlier rounds of testing, several testers were the victims of incompetent tax preparation or were encouraged to engage in tax fraud.

The most disturbing example in the 2011 testing came from a New York tester who went to a Liberty Tax office. The tester described how the preparer could not initially handle a 1099 form that she had received for a credit card debt that had been settled:

His boss came over to assist the tax preparer with the 1099. [The tester] asked if the 1099 would change her tax refund, and the preparer answered that they would “fix it.” The tax preparer and his boss proceeded to ask her a number of questions including: did she have money in the bank, valuables like jewelry, a 401k or other investments, or other debts. [The tester] answered that she had a 401k at work, some money in the bank as she recently deposited a substantial check for one of her daughters, and that she had about \$10,000 in combined credit card and student loan debt. She asked how they would “fix it.” The preparer responded that they needed to make it look like she had other debts that prevented her from affording the credit card debt that was forgiven (to make her look deserving of the forgiveness, was [the tester’s] understanding), and that she had no assets to sell. The preparer and his boss filled out a worksheet with her answers to their questions, but they did not provide her with a copy.

*Id.* at 3.

In addition, this preparer improperly claimed the EITC for one of the tester’s daughters. Finally, the tester observed that the preparer reported on the tax form that the tester did not know the whereabouts of her children’s father. However, the preparer never asked her that question, and the tester does know where her children’s father is.

Another example involved a Jackson Hewitt preparer in New York who gave some questionable advice to a tester who owed money to the IRS. The preparer told the tester that she “needed to get a kid” in order to get a bigger tax refund.

A third tester reported that she informed the preparer that she was no longer a student, but the preparer incorrectly claimed the New York State tuition credit. The tester also reported that the preparer incorrectly inputted student loan interest,

misspelled her address, and pressured her to sign the return without explaining the paperwork.

In North Carolina, a Jackson Hewitt preparer erroneously failed to claim Head of Household status for a tester. As a result, the tester's refund was smaller by \$269 for her federal refund and \$84 for her state refund, and she was forced to file an amended return.

Finally, three of the nine preparers did not provide a complete copy of the tax return or required privacy forms to the testers at the time of filing, in violation of I.R.C. §6107(a) and 26 C.F.R. §301.7216-3.

#### *4. 2011 First Nations Development Institute (FNDI) Mystery Shopper Testing*

FNDI conducted 12 mystery shopper tests in New Mexico, all in communities with a high Native American population and close to reservations.

Sara Dewees, First Nations Development Institute, [Tax Time Troubles: Mystery Shopper Testing Exposes Poor Quality Tax Preparation and Refund Anticipation](#)

[Check Abuses](#), Apr. 15, 2011, *available at*

[www.nmlegis.gov/lcs/handouts/IAC%20092412%20FNDI%20Taxtime%20Mystery%20Shopper.pdf](http://www.nmlegis.gov/lcs/handouts/IAC%20092412%20FNDI%20Taxtime%20Mystery%20Shopper.pdf).

In this testing, 10 of the 12 taxpayers encountered problems with inaccurate, illegal, or unprofessional behavior. In seven cases, the tax preparation process was stopped or changed to avoid having the paid preparer file an inaccurate tax return.

One of the worst errors was a preparer's failure to include unemployment insurance benefits as taxable income. This omission incorrectly qualified the taxpayer for the EITC, which could have significant ramifications. If the IRS caught the omission of the unemployment income, the refund would be lowered and the EITC would be denied. Moreover, a taxpayer can be disallowed from taking the EITC for 10 years if the credit is claimed but the taxpayer is later determined ineligible. This taxpayer was required to file an amended return. This same preparer lacked the knowledge to properly handle dividend income. This preparer also told the tester: "Oh, they are just forms. If I get \$4,000, I am not going to ask a lot of questions. I just want it!" *Id.* at 22.

Two preparers failed to report qualified student grant funds as taxable income. Both preparers became confused about Form 1098-T, which reports income from tuition. In the case of the first tester, her scholarship amount exceeded the qualified expenses and therefore the tester was required to report some income from the scholarship. The preparer for the first tester asked her supervisor what to do, and the supervisor incorrectly responded that the tester didn't have to report the income.

The second tester had a 1098-T that listed \$662.65 in line 4 (adjustment from prior year). The preparer became confused and stated “Technically I think I’m supposed to subtract \$662.65 from \$2,235, but I’m not sure. We can probably just leave it out because it’s highly unlikely that IRS can track it.” *Id.* at 7. Before completing the return she readdressed the issue again, asking the taxpayer for permission to just ignore the \$662.65.

Another tax preparer indicated she used her own bank account to receive direct deposits of taxpayers’ refunds, which is prohibited under the IRS Code. I.R.C. §6695(f). A tester asked this preparer what she did if someone could not afford to pay upfront. The preparer responded: “I just put my account number and routing number on the return and write the client a check when their refund comes in. I take my fee out before I write the check.” *Id.* at 10.

One tax preparer encouraged tax fraud by making up frivolous expenses for the Schedule A form. This preparer included numerous expenses for which taxpayers do not usually qualify for a deduction, *i.e.* clothing expenses, personal cell phones (calculated for 99% business use), and numerous commuter expenses that the taxpayer was not eligible to claim. She asked questions such as, “about how much did you spend on clothing?” and then recorded answers without asking for records of expenses. This same preparer told the tester, who was a tribal member, that he did not have to pay state income tax on income earned from

employment not on his reservation, which was incorrect under New Mexico law.

*Id.*

Other problems included preparers who:

- showed a lack of knowledge regarding how to properly file a Schedule C business return.
- told a tester that federal employees do not pay Social Security taxes because they have a good retirement plan (this has not been the case since 1984).
- didn't know how to handle paperwork associated with a rollover of a Roth IRA.

Finally, five of the 12 preparers did not provide a copy of the tax return to the testers at the time of signing, in violation of I.R.C. §6107(a).

*5. 2012 First Nations Development Institute (FDNI) Mystery Shopper Testing*

In 2012, FDNI conducted 10 mystery shopper tests in communities near Native American reservations in New Mexico. Benjamin Marks, et al., First Nations Development Institute, More Tax Time Troubles: Mystery Shopper Testing Exposes Refund Anticipation Loans in Reservation Border Towns, 2012, *available at*

[www.nmlegis.gov/lcs/handouts/IAC%20092412%20FNDI%20Taxtime%20V3.pdf](http://www.nmlegis.gov/lcs/handouts/IAC%20092412%20FNDI%20Taxtime%20V3.pdf)

Once again, this testing revealed poor quality service provided by tax preparers. All but one of the testers encountered some issue when filing their taxes. FDNI concluded “[w]hile our sample of participants was small, the frequency of these errors calls into question how many Native American taxpayers, and moreover, how many taxpayers across the country are being overcharged and underserved by paid tax preparers.” *Id.* at 3.

In one example, an inexperienced preparer miscalculated the total refund for the tester. A FDNI staffer who accompanied the tester noted:

Unfortunately, I had completely assumed the preparer correctly listed the daughter as a dependent because she asked so many questions, so I didn't catch the omission until reviewing the return later. I ended up having to write a whole new paper return, changing the filing status to Head of Household and listing the daughter as a dependent. This raised the refund from \$55 to \$70... missing a dependent standing next to a taxpayer across your desk is probably inexcusable.

*Id.* at 17.

Since all of the testers were Native American, they potentially qualified for the New Mexico state exemption for this community. Yet several preparers skipped over this step. In one case -- in which the tester was eligible for this exemption, yet the preparer missed it -- the tester had \$571 of state withholding from which she might have received some refund.

Finally, six of the 10 preparers did not provide a copy of the tax return to the testers at the time of signing, in violation of I.R.C. §6107(a).



### *6. Impact Alabama Testing*

Impact Alabama conducted mystery shopper tests of 13 tax preparers.

Impact Alabama, Impact Alabama Undercover Investigation of Commercial Tax Preparers in Alabama Results and Analysis, Jan. 2009. Testers described themselves to preparers as parents with one or two children who lived with them less than six months of the year, which would make them ineligible for the EITC.

The testing by Impact Alabama found that 11 of the 13 preparers nonetheless incorrectly claimed the EITC. In addition, 10 preparers did not report income from other jobs such as babysitting; nine preparers did not report interest income; and 11 allowed testers to claim “head of household” status without being qualified for it.

None of the testers should have qualified for refunds, but each preparer calculated a refund ranging from \$65 to \$6,247. Five preparers calculated a refund of \$6,247 for a taxpayer who actually owed \$112 to the IRS. These five preparers included a fringe preparer (a finance company), a Mo’ Money Taxes outlet, and three other independent preparers.

### *7. Testing by the Treasury Inspector General for Tax Administration (TIGTA)*

In 2008, TIGTA testers conducted mystery testing of 28 paid preparers - 12 commercial chains and 16 independent preparers. Treasury Inspector General for

Tax Administration, Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors, Reference Number: 2008-40-171, Sept. 3, 2008, *available at* [www.ustreas.gov/tigta/auditreports/2008reports/200840171fr.pdf](http://www.ustreas.gov/tigta/auditreports/2008reports/200840171fr.pdf).

The TIGTA testers found that only 11 of the 28 preparers prepared an accurate tax return. The other 17 preparers prepared the returns incorrectly. Six of these 17 preparers produced returns that contained misstatements and omissions TIGTA considered to have been willful or reckless. These six preparers engaged in conduct such as adding or increasing deductions without the testers' permission - in some situations after the testers had questioned whether they were entitled to receive the deductions. Examples included:

- When informed by the tester that s/he paid for babysitter expenses in cash, the preparer increased the child care expenses beyond what the tester stated s/he paid. In addition, the preparer instructed the tester to tell the babysitter to file a Schedule C with the inflated amount and deduct expenses for operating a home business equal to the inflated amount. The preparer also offered to change the expenses back to the original (real) amount if the babysitter did not agree to change his or her records. The preparer's actions increased the tester's refund by more than \$325.

- A tester completed an information worksheet showing children living in the home for less than one-half of the year. The preparer stated that he or she was going to show on the tax return that the children lived in the home with the tester for a full 12 months. The decision erroneously changed the tester's filing status from Single to Head of Household, increased the dependency exemptions, and qualified the tester for the Child Tax Credit and the EITC. The net effect was to increase the refund from \$100 to approximately \$6,000.
- Even though a tester informed the preparer s/he had no charitable contributions, the preparer included contributions on the return and did not inform the tester that they were being added. The preparer also added a deduction for property tax for a car without the tester's assertion or documentation. The effect was a refund of more than \$200, when the refund should have been less than \$140.

#### *8. Testing by the Government Accountability Office (GAO)*

In 2006, the GAO conducted mystery shopper tests of 19 paid preparers. Government Accountability Office, Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors, GAO-06-563T, April 4, 2006, *available at* [www.gao.gov/new.items/d06563t.pdf](http://www.gao.gov/new.items/d06563t.pdf). The GAO found errors that led to inflated refunds exceeding \$1,000 in six out of the 19 test cases.

These inflated refunds resulted from preparers not reporting business income in 10 of 19 cases and claiming an ineligible child for the EITC in five out of the 10 applicable cases.

#### D. Abuses Uncovered by Government Enforcement Actions

Enforcement actions by the USDOJ and state regulators have found numerous instances of fraud committed by preparers. Some of the most prominent actions include:

##### *1. U.S. Department of Justice (USDOJ) v. Jackson Hewitt*

A particularly notable tax fraud case was the civil enforcement action in April 2007 brought by the USDOJ against five Jackson Hewitt franchisees that operated 125 offices. *See* Complaint, United States v. Smart Tax of Georgia, Inc., 1:07CV-0747 (N.D. Ga. Apr. 2, 2007); Complaint, United States v. Smart Tax Inc., 07C-1802 (N.D. Ill. Apr. 2, 2007); Complaint, United States v. Sofar, Inc., Civ. No. 2:07-cv-11460 (E.D. Mich. Apr. 2, 2007); Complaint, United States v. Smart Tax of North Carolina, Inc., Civ. No. 5:07-cv-00125-FL (E.D.N.C. Apr. 2, 2007). All of the complaints are available at <http://www.usdoj.gov/tax/txdv07215.htm>.

The USDOJ brought the civil enforcement action against the five Hewitt franchisees for preparing fraudulent tax returns that falsely claimed \$70 million in tax refunds. The USDOJ alleged that the owners and managers of these franchisees created and fostered an environment in which fraudulent tax return preparation was

encouraged and flourished. Examples of fraud alleged by the USDOJ include filing false returns claiming refunds based on phony W-2 forms; using fabricated businesses and business expenses on returns to claim bogus deductions; claiming fuel tax credits in absurd amounts for customers clearly not entitled to any such credits; and massive fraud related to EITC claims.

### *2. USDOJ v. Instant Tax Service*

The USDOJ filed a lawsuit against the owner of the tax preparation chain Instant Tax Service in March 2012. Complaint, United States v. Fesum Ogbazion, Civil No. 3:12-cv-95 (S.D. Ohio. Mar. 28, 2012). The complaint alleged that Instant Tax franchisees intentionally prepared fraudulent tax returns to maximize customers' refunds in order to extract large tax preparation fees from these refunds. The USDOJ also alleged that Instant Tax Service issued guidance documents that encouraged franchisees "to lie to the IRS in the event of an audit." *Id.* at ¶¶ 27-28. The complaint states that the estimated tax losses from the allegedly fraudulent returns prepared in 2011 at Instant Tax locations in five cities exceeded \$16 million.

### *3. Illinois v. Mo' Money Taxes*

The Illinois Attorney General's Office sued Mo' Money Taxes for filing tax returns without consumers' authorization, filing erroneous tax returns, and charging undisclosed and exorbitant fees for tax preparation. *See* Complaint,

People v. Mo' Money Tax Service, Civil Ac. No. 12CH09136 (Cook Cty Cir. Ct. Mar. 14, 2012). The complaint alleged that Mo' Money used offers of RALs to lure consumers into providing their personal information, and signing a form that – unbeknownst to the consumer – gave Mo' Money the right to file tax returns on their behalf. Mo' Money would then file the consumers' tax returns and automatically deduct hundreds of dollars in undisclosed fees from their refunds – as much as \$700 per person. Many of these returns included incorrect information.

#### *4. Chicago Department of Business Affairs and Consumer Protection*

Investigators from this Chicago agency went undercover to investigate hundreds of tax preparers. They found more than 80 percent of them in violation of new City ordinances governing preparers. Pam Zekman, 2 Investigators: Tax Preparers May Be Ripping You Off, CBS Chicago, Feb 4, 2013, *available at* <http://chicago.cbslocal.com/2013/02/04/2-investigators-tax-preparers-violating-city-consumer-laws/>. One common violation was the failure to give consumers a required “Taxpayer Bill of Rights” and disclosure forms listing their services, the price for each service, and an estimate of the total charges. (This news article also cites the case of a Chicago consumer whose return was filed by a preparer who not only did not have authorization, but was expressly told by the consumer not to file his return).

### *5. New York Department of Department of Taxation and Finance*

A 2008 sting operation by this New York state agency found evidence of fraud among about 40 percent of the 85 tax preparers it visited. *See* Press Release, New York Department of Department of Taxation and Finance, Wall Street Journal Story Highlights Department's Efforts To Expose Crooked Tax Preparers, Dec. 4, 2008. According to a news media article about the sting, state officials were startled by the brazen nature of the fraud. In one case, a preparer told an undercover investigator: "I did not declare your full gross income from your business because you will pay a lot of taxes." *See* Tom Herman, New York Sting Nabs Tax Preparers, Wall Street Journal, Nov. 26, 2008.

#### E. Abuses Described in News Media Articles

Over the years, *Amici* have collected dozens of media articles describing instances of fraud and abuse by tax preparers. The following are just a few summaries of some of the most recent examples.

##### *1. South Carolina*

Two South Carolina women allegedly prepared thousands of fraudulent tax returns and defrauded the government of an estimated \$8.5 million over a four-year period. Florence Area Duo Accused of Tax Fraud, SCNOW.com, March 19, 2013, at [www.scnow.com/news/local/article\\_46056880-6686-11e2-87f3-0019bb30f31a.html](http://www.scnow.com/news/local/article_46056880-6686-11e2-87f3-0019bb30f31a.html). The IRS examined 32 returns prepared by one preparer for tax

years 2008 to 2010 and found all included overstatements of clients' refunds, resulting in an average excessive refund of \$2,859. For the other preparer, the IRS examined six returns prepared for tax years 2009 to 2010 and found they included similar inaccuracies, averaging an excessive refund of \$2,818.

### *2. St. Louis, MO*

This involved criminal action against a Mo' Money franchise that was separate from the aforementioned State of Illinois action against Mo' Money Taxes. Robert Patrick, Tennessee Man Admits Tax Crimes in St. Louis, St. Louis Post-Dispatch, Feb. 25, 2013. A Tennessee man admitted filing dozens of tax returns through a St. Louis Mo' Money franchise that falsely claimed the American Opportunity Tax Credit. He allegedly filed at least 47 returns that triggered more than \$53,000 in false refunds to be paid out. In all, the scheme caused \$352,000 in refunds to be falsely issued.

### *3. Memphis, TN*

The USDOJ alleged that the principals of Taxes-R-Us (also known as SuperFast Taxes and MG Services) prepared fraudulent returns through "a variety of schemes." Cole Epley, Memphis Tax Prep Service Sued by Justice Dept., Memphis Business Journal, Mar. 1, 2013. This fraud included alleged abuse of the EITC and the American Opportunity Tax Credit. The complaint alleges 90 percent of the latter credits claimed on clients' returns were false.



## F. Abuses Uncovered by Low-Income Tax Clinics

Amici provide a few recent examples of preparer fraud and abuse collected by attorneys at Low-Income Tax Clinics (LITCs). These examples typify the preparer fraud that LITC attorneys have observed in reviewing client cases.

### *1. Boston, MA*

The following case stories were provided by the LITC at Greater Boston Legal Services (GBLS):

I write to you regarding a case of mine in which the client (a recent immigrant who can neither read nor write) was a victim of tax preparer fraud.

In particular, the preparer falsely claimed refundable education tax credits on the return, took a large portion as her fee, and gave the rest to my client. Now the IRS wants its money back, and is seeking it from my client.

Email from Thomas Earl Crice, Attorney, LITC, GBLS, to Chi Chi Wu, Jan. 13, 2013.

Client 1 had a \$27,000 deficiency in Tax Court thanks to a preparer who is known to this office. This preparer simply inflated deductions and we knew that because the client showed me the list of expenses he had given the preparer and none the amounts matched the amounts in the return. This TP owned a small produce store and, along with his wife, worked his butt off to make it profitable. Instead, he ended up with serious health issues and a large debt.

This same preparer also completely made up the travel time for another client (TP 2), who also ended up in Tax Court. The TP supervised different sites and used his own car to do the work, no mileage reimbursement. Some of the travel was a legitimate deduction but the schedule the preparer made up included travel time on Saturdays and a fixed travel pattern. This TP did not have a fixed schedule (he went wherever needed and was on call) and never worked Saturdays.

Email from Luz Arevalo, Director, LITC, GBLS to Chi Chi Wu, Mar. 27, 2013.

## *2. Illinois*

The following case story was sent from an LITC in Rockford, Illinois:

“Client has a CP2000 notice stating that they need to repay education credits that were claimed in 2010. After investigating the case, the W&I transcript do not show 1098-T info, nor did the client attend college or in 2010. It is clear that the client is not eligible for the credit in 2010. Client used a paid preparer in 2010. I understand that preparers have been education credits as a form of obtaining bogus returns.”

Email from Andrew VanSingel, Director, LITC, Prairie State Legal Services, Inc. to American Bar Assoc. LITC listserv, Oct. 30, 2012.

### G. Why Enforcement Actions Alone are Not Adequate to Prevent Preparer Fraud and Abuse

The massive amount of fraud, incompetence, and abuse in the tax preparation industry is astounding. Just a handful of limited mystery shopper tests have consistently uncovered numerous instances of these problems, indicating that such problems are widespread and common in the tax preparation industry. This is not an anomaly or a handful of bad apples. There is an enormous level of corruption across the entire industry. The IRS regularly ranks “preparer fraud” highly among its “Dirty Dozen Tax Scams.” *See, e.g.,* IRS, IRS Releases the Dirty Dozen Tax Scams for 2013, Mar. 26, 2013.

Bringing enforcement actions one-by-one is simply inadequate as a response to this problem. While it would get rid of a few bad actors, relying on this

approach, alone, ignores tens of thousands of other violators. It is akin to only treating a skin lesion when the related disease has invaded a patient's entire body.

Protecting individual taxpayers and the U.S. Treasury from this massive amount of fraud and abuse demands some fundamental, common-sense standards. It calls for establishing baseline considerations for the practitioners who handle consumers' most sensitive information. It is not too much to ask that commercial preparers obtain basic training, pass competency exams, and seek continuing education to stay current on ever-changing tax laws.

## CONCLUSION

For the reasons cited herein, this Court should grant the Defendants-Appellants' Request for Relief.

DATED: April 5, 2013

Respectfully submitted,

/s/Charles Harak

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## CERTIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limitation of Fed. R. App. P. 29(d) and 32(a)(7)(B) because this brief contains 6,996 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii), that is, the tables of contents and citations, corporate disclosure statement, and certificates of counsel.
2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. 32(a)(6) because this brief has been prepared in a proportionally spaced typeface using Microsoft Word 2010 in Times New Roman 14 point.

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DATED: April 5, 2013

**CERTIFICATE OF SERVICE**

I hereby certify that on April 5, 2013, the foregoing “Brief for *Amici Curiae* National Consumer Law Center and National Community Tax Coalition in Support of Defendants-Appellants and Arguing for Reversal of the District Court” was filed and served upon all counsel of record electronically by filing a copy of the document with the Clerk through the Court’s ECF system.

/s/Charles Harak  
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