

CRIMINAL PROSECUTION OF TAX RETURN PREPARERS

ABSTRACT

Over 61 percent of individual taxpayers, accounting for more than 76 million returns, utilized the services of paid preparers in 2005.¹ However, hiring a paid preparer does not assure the taxpayer that the return will be prepared correctly. Tax return preparer fraud generally involves the preparation and filing of false income tax returns by preparers who claim inflated personal or business expenses, false deductions, unallowable credits or excessive exemptions on returns completed for their clients. Preparers may also manipulate income figures to fraudulently obtain tax credits, such as the earned income tax credit.²

The Criminal Investigation (CI) division on the Internal Revenue Service (IRS) prosecutes the most serious cases of unscrupulous preparers suspected of criminal or fraudulent behavior and other related financial crimes. This article investigates the role of CI in prosecuting unscrupulous tax return preparers and analyzes the results of 377 published tax return preparer criminal tax cases from 2000 through 2005.

¹ IRS Tax Year 2005 Taxpayer Usage Study (May 6, 2006)

² FS-2006-16, February 2006

INTRODUCTION

Over 61 percent of individual taxpayers, accounting for more than 76 million returns, utilized the services of paid preparers in 2005.³ The estimated cost of tax preparation services exceeds \$15 billion.⁴ However, hiring a paid preparer does not assure the taxpayer that the return will be prepared correctly. While most taxpayers receive quality service from their preparers, some taxpayers will overpay or underpay their taxes due to preparer mistakes or unethical behavior. The Criminal Investigation (CI) division on the Internal Revenue Service (IRS) prosecutes the most serious cases of unscrupulous preparers suspected of criminal or fraudulent behavior and other related financial crimes.

Tax return preparer fraud generally involves the preparation and filing of false income tax returns by preparers who claim inflated personal or business expenses, false deductions, unallowable credits or excessive exemptions on returns completed for their clients. Preparers may also manipulate income figures to fraudulently obtain tax credits, such as the earned income tax credit.⁵ In many instances, the taxpayer does not realize that his/her return includes false information. However, the taxpayer is ultimately responsible for the additional taxes, interest and potentially penalties when the IRS adjusts the return.

The first part of this analysis reviews the methods available for identifying abusive tax preparers. The second part focuses on the statutes that the IRS uses in prosecuting abusive preparers. The third section discusses the different types of fraudulent return schemes. Finally, I

³ IRS Tax Year 2005 Taxpayer Usage Study (May 6, 2006)

⁴ U.S. Government Accounting Office. 2003. "Tax Administration: Most Taxpayers Believe They Benefit from Paid Tax Preparers, but Oversight for IRS Is a Challenge. GAO 04-70, October. Washington, D.C.; Government Printing Office.

⁵ FS-2006-16, February 2006

report the results of a review of 377 published tax return preparer criminal cases and provide conclusions and recommendations.

IDENTIFICATION OF ABUSIVE PREPARERS

Although prosecution of paid preparers was not a high priority for the CI division for many years, the number of criminal investigations remained fairly constant with 229, 206, and 248 investigations initiated in 2003, 2004, and 2005, respectively.⁶ CI raised the priority of identifying tax preparer abuse by adding an objective in the IRS Strategic Plan for 2005 through 2009 addressing this issue. The second goal in the Strategic Plan is to enhance tax law enforcement. One of the specific objectives under this goal is to “ensure that attorneys, accountants and other tax practitioners adhere to professional standards and follow the law.”⁷ The tools available to influence practitioner behavior include monetary sanctions, suspension or disbarment of those covered under Treasury Circular 230, and criminal prosecution.

Under the Return Preparer Program, CI screens suspected fraudulent returns through the fraud detection centers at each of the IRS campuses where tax returns are filed. The fraud detection center uses a fraud ranking system to determine which preparers should be investigated, ranking preparers by the number of suspected fraudulent returns.

A second function of the fraud detection center is to identify questionable refund returns. The Questionable Refund Program, established in 1977, identifies fraudulent returns, stops payment of the refund, and refers the scheme to CI. The Program utilizes the electronic fraud detection computer system to identify potential returns for investigation. When a series of returns are signed by the same return preparer or filed by the same electronic return originators, CI will extend the investigation to the return preparer.

⁶ FS-2006-16, February 2006

⁷ IRS Strategic Plan 2005-2009, pg. 21.

CI also uses an undercover program to identify abusive preparers. From 2001-2004, CI conducted over 400 undercover operations related to unscrupulous return preparers. Over 71 percent of the returns prepared for undercover agents contained false information.⁸ One of the goals of CI is to stop abusive tax preparers as quickly as possible. They accomplish this by pursuing parallel criminal and civil proceedings. The department obtains a civil injunction against the preparer, effectively stopping the fraudulent behavior, while proceeding with the criminal prosecution.

CRIMINAL PENALTIES

Criminal penalties can be brought against paid preparers under Title 26, U.S. Code, for:

- the willful attempt to evade or defeat tax (Section 7201);
- the willful making of false statements under penalties of perjury (Section 7206(1)); and
- the willful aiding and assisting in the preparation of a false tax return (Section 7206(2)).

The government also uses three sections under Title 18 of the U.S. Code to prosecute paid preparers. Those sections include:

- Section 286, Conspiracy to defraud the government with respect to claims,
- Section 287, False, fictitious or fraudulent claims, and
- Section 371, Conspiracy to commit offense or to defraud United States.

Table 1 summarizes the most common criminal statutes used to prosecute tax return preparers.

Section 7206(2), Fraud and False Statements

The CI division prosecutes most tax return preparers for aiding and assisting in the preparation of a false tax return under Section 7206(2). This statute requires three elements for conviction: (i) an act of aiding and assisting in the preparation of a return, affidavit, claim, or other document; (ii) material falsity; and (iii) willfulness.⁹

⁸ Statement of Nancy J. Jardini, Testimony Before the Subcommittee on Oversight of the House Committee on Ways and Means, July 20, 2005.

⁹ Criminal Tax Manual, 2001; See also *United States v. Searan*, 259 F.3d 434, 441 (6th Cir. 2001) for a description of the three elements.

To be convicted on aiding and assisting, an individual must take some affirmative action that encourages the taxpayer to mislead the IRS. This broad definition allows a conviction even if the person did not actually prepare the tax return.¹⁰ Liability under the statute attaches to any person who knowingly participates in preparation of a false tax return including tax preparers, accountants, lawyers, and clerical workers.¹¹

A false statement is material if it is essential to the accurate computation of taxes or causes the return to be inaccurate. A violation of Section 7206(2) occurs even when a false statement does not create a tax deficiency.¹²

Willfulness has the same meaning in Section 7206(2) cases as it does in other criminal tax violations. "The Court, in fact, has recognized that the word 'willfully' in these statutes generally connotes a voluntary, intentional violation of a known legal duty."¹³ It is not enough that the individual's purposeful conduct merely resulted in the filing of a false return; the false filing must also have been a deliberate objective of the defendant.¹⁴ Because § 7206(2) is not violated unless the preparer specifically intended to cause a false return to be filed, refuting the government's willfulness claim is generally the most effective defense.

Section 287, False, Fictitious or Fraudulent Claims

The purpose of §287 is to protect the government from false, fictitious, or fraudulent claims. Most tax false claims cases involve individuals who file multiple, fictitious income tax returns claiming tax refunds. The electronic filing (EF) of tax returns has led to a proliferation of

¹⁰ See *United States v. Nealy*, 729 F.2d 961, 963 (4th Cir. 1984) (upholding conviction of defendant who has no direct involvement in preparation of tax return but knowingly supplied false information for inclusion in return).

¹¹ See *United States v. Fletcher*, 322 F.3d 508,519 (8th Cir. 2003) (liability is not limited to return preparers, it attaches to all knowing participants of the fraud).

¹² See *United States v. Hutchison*, 22 F.3d 846, 852 (9th Cir. 1993) (holding even false taxpayer identification is material false statement).

¹³ *United States v. Bishop*, 412 U.S. 346, 360 (1973)

¹⁴ In *United States v. Salerno*, 902 F.2d 1429, 1433 (9th Cir. 1990), the court reversed the convictions because the government failed to show that a casino employee knew or understood that his embezzlement scheme would affect preparation of the casino corporate returns.

multiple defendant, multiple return cases. Many false claim for refund cases could be charged as violations of § 7206(1). However, the government prefers Sections 286 and 287 when one or more false claims for refund are made on false or fictitious income tax returns, most likely due to the longer prison terms and larger fines.

A violation under § 287 must contain the following elements:

1. The defendant made or presented a claim to a department or agency of the United States for money or property;
2. The claim was false, fictitious or fraudulent; and,
3. The defendant knew at the time that the claim was false, fictitious or fraudulent.

The government must prove that the preparer filed or caused to be filed a claim against the United States. A tax return seeking a refund is considered a claim against the United States. For paper returns, the claim is considered made by filing a return with the IRS. For an electronic filing, the violation is complete when the electronic portion of the return is received by the IRS. The law does not require the IRS to pay the refund.

Section 371, Conspiracy to Commit Offense or to Defraud United States

The criminal tax statutes do not include a statute for conspiracy, so tax-related conspiracies are prosecuted under Section 371, the general conspiracy statute. Under Section 371, if two or more persons conspire either to commit any offense against the U.S., or to defraud the U.S., or any agency thereof, in any manner or for any purpose, and one or more of such persons do any act to effect the object of the conspiracy, each shall be fined not more than \$10,000 or imprisoned not more than five years, or both.

Section 371 sets out two types of conspiracies. The first type, known as the "offense clause," prohibits conspiring to commit offenses that are specifically defined in other statutes. The second type, known as the "defraud clause," prohibits conspiring to defraud the United

States. To establish a violation of Section 371, the following elements must be proved beyond a reasonable doubt:

- The existence of an agreement by two or more persons to commit an offense against the U.S. or defraud the U.S.;
- The defendant's knowing and voluntary participation in the conspiracy; and
- The commission of an overt act in furtherance of the conspiracy.

Without an agreement there can be no conspiracy. The agreement is the essence of the crime; success of the conspiracy is irrelevant. For this reason, an individual may be charged with conspiracy as well as the substantive offense that served as the object of the conspiracy.

The second element requires the government to establish an individual's membership in a conspiracy. The government must prove that the individual knew of the conspiracy and that he/she intended to join it and to accomplish the object of the conspiracy. The third element requires the government to prove that the individual committed an overt act in furtherance of the conspiracy.

In criminal tax conspiracies, the object of the crime is usually to conceal income and expenses from the IRS. Overt acts include those that mislead or conceal. Thus, criminal tax conspiracies usually contemplate acts of concealment as part of the crime and, therefore, are admissible as overt acts.

A conspiracy to defraud the IRS is commonly referred to as a "Klein conspiracy".¹⁵

Klein defines a tax conspiracy as follows:

“[T]o defraud the United States by impeding, impairing, obstructing and defeating the lawful functions of the Internal Revenue Service of the Department of the Treasury in the ascertainment, computation, assessment, and collection of the revenue: to wit, income taxes.” (Klein, 247 F.2d at 915)

¹⁵ United States v. Klein, 247 F.2d 908, 915 (2d Cir. 1957).

In Klein, the Second Circuit upheld the government's use of the defraud clause to prosecute conduct that impeded the functions of the IRS. The court summarized twenty acts of concealment that qualified as efforts to impede the functions of the IRS. These acts included:

- Alteration of the books to make liquidating dividends appear as commissions;
- Alteration of the books to make a gratuitous payment of \$1,500,000 appear as a repayment of a loan;
- A false entry in the books disguising as commissions what was actually a dividend, which in turn was diverted to corporate nominees;
- A false statement in Klein's personal income tax return regarding the payment for a stock purchase;
- Klein's false answer to Treasury interrogatories seeking to identify the owners of various Cuban corporations;
- A return falsely reporting that stock was sold in 1950 for an immense profit;
- The evasive affidavit of Klein's secretary denying that he remembered altering certain books; and
- Income tax returns which falsely claimed a sale of stock.

Although not all cases will have evidence of acts as prominent as those in Klein, the government must introduce evidence confirming that the individual's intent was to impede the functions of the IRS. To prove intent the government must show that the individual knew one of the objectives of the scheme was to impede the functions of the IRS and the individual intended to join in the scheme to achieve that objective.¹⁶

Injunctive Relief

In addition to pursuing criminal penalties against abusive preparers, the IRS can also bring a civil action to seek an injunction to prohibit certain actions of paid preparers under Section 7407(a). Preparers who engage in practices that would subject them to preparer penalties under Sections 6694 and 6695, misrepresent their education or experience as an income tax preparer or their eligibility to practice before the IRS, engage in fraudulent or deceptive behavior, or guarantee the payment of a tax refund or the allowance of a tax credit may be enjoined from engaging in such practices under Section 7407(b). If the court determines that the

¹⁶ See *United States v. Shermetaro*, 625 F.2d 104, 109 (6th Cir. 1980).

preparer has repeatedly engaged in one of these practices, the court may also enjoin the preparer from acting as an income tax return preparer.

Although not part of this analysis, the IRS has stepped up its efforts to obtain civil injunctions against abusive preparers, especially those involved in illegal tax avoidance schemes. A 2005 IRS announcement indicates that the Service has obtained civil injunctions against 99 abusive preparers between 2001 and April 2005.¹⁷ The IRS uses the civil injunctions to go after schemes involving:

- Abusive trusts that shift assets out of a taxpayer's name with the taxpayer retaining control,
- Claims of personal housing and living expenses as business deductions,
- "Zero income" tax returns, and
- Abuse of the Disabled Access Credit.

TAX SCHEMES INVOLVING FALSE OR FRAUDULENT CLAIMS

Fraudulent refund schemes are prosecuted under two different set of statues. The first type of scheme involves returns prepared by the same individual or group of individuals based on similar return characteristics. These returns fall under the IRS's Questionable Refund Program (QRP) and involve violations under §286 and §287. The second type of scheme involves unscrupulous return preparers who knowingly add false expenses, deductions, credits, or exemptions to a client's tax returns to decrease that client's tax liability, resulting in a larger refund or significantly less tax, due and owing. These returns fall under the Return Preparer Program (RPP) and involve violations of §7206(1) and §7206(2).

Most false tax return schemes charged under §287 are based on false Forms W-2. Typically, a fictitious Form W-2 showing income tax withheld in excess of the tax liability is used to generate the false refund claim. In some cases, the Form W-2 may show a real employer and the proper employer identification number, while in other schemes both the employer and

¹⁷ FS 2005-15, April 2005

the identification number are fictitious. Although less common, some false returns are based on a fictitious Schedule C or a false corporate income tax return and fictitious estimated quarterly tax payments.

In some schemes, the preparer involved obtains names and social security numbers (SSN) of individuals who probably would not file a tax return, and use those names and SSNs on the fictitious returns. In other instances, the name and SSN of the taxpayer are fictitious. Usually the refunds are all directed to a common location.

Electronic filing schemes tend to be larger, more organized, and involve more participants than paper return schemes. Recruiters find individuals to act as "taxpayers." Someone involved in the fraud prepares false W-2s, using the individual's real name and SSN. The false W-2s usually indicate an income level that allows the individual to claim the Earned Income Credit.

The recruiter then takes the taxpayer to a tax return preparer's office, where the taxpayer has a return prepared from the fictitious W-2s. In some cases, the fraud participants actually prepare the return. In those cases, the recruiter takes the taxpayer to an electronic return originator (ERO) where the return is filed. Under either pattern, the individual applies for a refund anticipation loan. When the loan proceeds become available, the recruiter and the taxpayer pick up the check and cash it at a check cashing service. The taxpayer receives a portion of the loan amount and the participants split the remainder.

The Return Preparer Program (RPP) identifies preparers who knowingly add false expenses, deductions, credits, or exemptions to a client's tax returns to decrease that client's tax liability. In many instances, these preparers spend significant time convincing clients that they are entitled to the false deductions. For example, Vernard Wrotte, owner of Westlight Financial

Strategies, created fictitious businesses for his clients. He actually created a presentation binder to help persuade potential clients that they were entitled to deduct personal and/or non-existent expenses as “legitimate” business or farm expenses. Sometimes the presentations lasted four or five hours. During this time, he would determine what hobbies the client enjoyed and convince them that they in fact were already in business and could deduct the “business” expenses in the current year. When investigated, the agents found that he had filed over 500 false returns, costing the government over \$1,000,000 in tax revenues.¹⁸

A typical unscrupulous return preparer case involves a small tax return preparer, such as Raymond Dubuche, who deducted hundreds of thousands of dollars of false itemized deductions including state and local taxes, charitable contributions, and unreimbursed employee expenses on his clients’ returns. Most of his clients were Haitian immigrants who had little or no knowledge of tax law. In another case, Abraham McLeod, owner of McLeod’s Tax Service, took false deductions and credits, including charitable contributions, miscellaneous itemized deductions and child care credits, on client returns. In addition, he falsified receipts and incorrectly answered IRS questions when the IRS audited his clients. The total loss to the government exceeded \$7 million.¹⁹ The Results section later in the paper provides additional statistics on the “average” unscrupulous tax return preparer.

SENTENCING GUIDELINES

In 2005, the Supreme Court in *Booker*²⁰ declared the Federal Sentencing Guidelines unconstitutional. In its ruling, the Supreme Court found that the guidelines would be constitutional if they were advisory, rather than mandatory. The court ruled that judges must

¹⁸ “Westlight Financial Strategies Owner Sentenced for Conspiracy to Defraud the IRS.” US Department of Justice Press Release, October 25, 2001.

¹⁹ “Taxpayers Warned of Unscrupulous Preparers.” U.S. Treasury Department News Release, February 12, 2001.

²⁰ *United States v. Booker*, 543 U.S. 220; 125 S. Ct. 738.

take the guidelines into account when sentencing, but are no longer bound by the law to impose a sentence within the range prescribed by the guidelines. Although only advisory, the Guidelines continue to be relevant.

The Federal Sentencing Guidelines (2002) outline the steps for determining the sentencing range. The first step is to determine the “offense level.” For the tax crimes under Section 7206 (fraudulent or false returns), the base “offense level” is determined using the Tax Table provided in the Federal Sentencing Guidelines according to the amount of the tax loss. Table 2 reproduces the Tax Table for determining the base offense level. The Federal Sentencing Guidelines generally determine the sentencing of tax preparers convicted under Title 18, Section 371, Conspiracy, using the same base offense level from the Tax Table as individuals convicted under Section 7206.

Insert Table 2 here

If the return preparer is involved in false returns resulting in a tax loss of \$100,000, the base “offense level” from the Tax Table would be 16. After making allowed adjustments for items such as “sophisticated means” or “accepted responsibility,” the judge looks to the Federal Sentencing Table. Table 3 includes a portion of the Federal Sentencing Table. The table provides the range of months of imprisonment based on the offense level, adjusted for the criminal history points of the defendant. For example, a prior sentence of imprisonment exceeding one year and one month counts as three points, a sentence of at least 60 days counts as two points, and a sentence of less than 60 days counts as one point. Assuming the tax return preparer has no criminal history, the sentencing guideline for an offense level of 16 is 21 to 27 months.

Insert Table 3 here

Cases tried under Title 18, Sections 286 and 287, False, Fictitious or Fraudulent Claims, are subject to the sentencing guidelines under Section 2B1.1 of the Federal Sentencing Guidelines Manual.²¹ Since the maximum sentence under Section 286 and 287 is less than 20 years, the base offense level is 6. The base offense level is increased depending on the amount of loss exceeding \$5,000. Under Fleming²², the sentencing court is to calculate the “intended loss that the defendant was attempting to inflict ... if it is greater than the actual loss.” Table 4 provides a portion of the offense level increases for loss amount under Section 2B1.1 (b).

Insert Table 4 here

The criminal statutes provide maximum sentences ranging from 1 to 10 years. Table 5 includes the maximum sentence and fine under each statute. After obtaining a sentencing range from the Sentencing Table, the court must also consider the maximum sentence allowed under the statute in determining the actual sentence given a taxpayer. Sentencing options, depending on the offense level, include probation, supervised release, community confinement (e.g., halfway house) or home detention, and imprisonment. Time spent in community confinement and home detention count as imprisonment. Supervised release must follow imprisonment when more than one year of imprisonment is imposed.

Insert Table 5 here

FINES

The Federal Sentencing Guidelines provide that fines should be imposed for individual defendants except where the individual establishes that he/she is unable to pay and will not likely become able to pay any fine. Standards²³ outline the minimum and maximum fines based on

²¹ The Federal Sentencing Guidelines Manual is available at <http://www.ussc.gov/guidelin.htm>.

²² 128 F.3d 287 (6th Circuit, 1997)

²³ The Fine Table is on page 368 of the 2002 Federal Sentencing Guideline Manual available at <http://www.ussc.gov/2002guid/2002guid.pdf>.

offense level. For example, an offense level of six provides for a minimum fine of \$500 and a maximum fine of \$5,000. An offense level of 12 has a minimum of \$3,000 and a maximum of \$30,000. The criminal statutes provide maximum fines as summarized in Table 4.

RESULTS

Sample

I searched the Lexis Nexis database for criminal tax cases involving tax return preparers for the period January 1, 2000 to December 31, 2005. Once I identified a case through Lexis Nexis, additional information was obtained by searching various databases (including Lexis Nexis, ABI Inform, Factiva and a Google search) for newspaper articles discussing the case. The cases discussed on the IRS website, Criminal Investigation page and Department of Justice Press Releases are also included in the sample.

Descriptive Statistics

A total of 377 cases were identified. Of the 377 cases, 243 (64%) indicated the total amount of the fraud. The mean amount was \$5,173,467 and the median was \$415,813. The lowest amount was \$11,000 involving an employee of a tax return preparation business named Tax Max, Inc. The employee knowingly prepared false returns for clients including increased deductions and incorrect filing status to create inflated refunds. The largest amount was \$75,000,000 and involved false partnership losses. The preparer solicited clients to invest in “businesses” operating as partnerships that sustained tax losses. The individual prepared the clients’ tax return, charging a percentage of their tax refunds plus a return preparation fee. He prepared over 2,000 returns including fictitious “partnership” losses exceeding \$75 million. Figure 1 depicts the number of cases based on the dollar amounts involved in the fraud.

Only 24 cases (6% of 377) involved preparers who were certified public accountants. A majority of the preparers were either self-employed or owned the firm (271 out of 377, 72%). The remaining 106 individuals (28%) were employees of tax return preparation firms.

Of the 377 cases, 243 included the number of returns prepared. The average number of returns prepared was 944, ranging from one return to 16,000 returns. The 16,000 returns involved nine individuals working for Western Tax Service headed by Samuel DeAngelo. The preparers made up false deductions for employee business expenses, typically claimed charitable contributions equal to 10 percent of adjusted gross income (AGI), and deducted fictitious depreciation and tax expenses. All together, the firm prepared returns claiming over \$47 million in false deductions.

Over 70 percent of the cases (275 out of 377) discussed the types of items falsified on the returns. The largest percentage overstated itemized deductions (60%), followed by overstating Schedule C deductions (40%), falsifying W-2 information (20%), incorrectly claiming or calculating the earned income credit (20%), falsifying dependent information (17%), and reporting an incorrect filing status (11%). Preparers also omitted income, reported fictitious partnership and rental losses, and claimed false child care credits.

Table 6 summarizes the criminal statutes used to convict the preparers. The majority (67%) were convicted of filing false returns under Title 26, Section 7206. Conspiracy to commit fraud (Title 18, Section 371) was second (27%), followed by filing a false claim (16%) (Title 18, Section 287). Ninety (24%) cases included convictions under multiple offenses.

Sentencing and Fines

Most of the convictions were the result of a guilty plea by the defendant (218 out of 286, 76%) compared to only 68 convictions decided by a jury (24%). Of the 377 cases, information

regarding sentencing was available for 236 cases (63%). Including the cases where only probation was imposed, the average jail sentence was 31 months with a median of 24 months. The longest sentence was 235 months for 34 counts of aiding and assisting the preparation of false and fraudulent returns, one count of bank fraud, one count of making a false statement in connection with a loan application, and one count of making a false declaration in court. The returns involved the creation of sham business entities and transactions resulting in over \$10 million in fictitious losses. The terms of supervised release ranged from 6 to 156 months, with an average of 30 months and a median of 36 months.

Information regarding fines was available for 36 cases. For these cases, the average fine was \$48,319, with a median fine of \$7,500. The minimum fine imposed was \$400 and the maximum \$1,000,000. The \$1,000,000 fine was imposed in the same case with the 235 month prison sentence discussed in the previous paragraph.

RECOMMENDATIONS AND CONCLUSIONS

It is the responsibility of the IRS to oversee tax return preparers. In January 2003, the IRS created the Office of Professional Responsibility to enhance the oversight of tax professionals. This Office is responsible for licensing enrolled agents and investigating allegations of misconduct and negligence against agents, attorneys, accountants and other professionals representing taxpayers before the IRS.²⁴

As the case analysis shows, most unscrupulous return preparers are not attorneys and accountants, but other individuals that hold themselves out as tax return preparers. The question remains, what can be done to effectively discourage this type of behavior? Each proposed solution has advantages and disadvantages.

²⁴ IR-2003-3, Jan. 8, 2003

Bauman and Mantzke²⁵ review the recommendations of the National Taxpayer Advocate (NTA) with regard to unscrupulous return preparers and provide alternative recommendations, specifically education and enforcement. In her 2002 and 2003 Annual Reports to Congress, the NTA recommends a registration, examination, certification, and enforcement program for tax return preparers. Tax return preparers include individuals, other than an enrolled agents, CPAs or attorneys, who prepare more than five tax returns in a calendar year. The IRS identified six areas of concern with the NTA's proposal. Specifically, the IRS expressed concern about (1) the Federal government licensing professionals which has historically been a function of state government; (2) the public perception that registration by the IRS indicates endorsement of the preparer by the IRS; (3) the lack of resources to implement such a program; (4) the opportunity cost of diverting funds from other programs; (5) the lack of civil or criminal sanctions for failure to register; and (6) the increased cost for return preparation since preparer's will likely pass on the registration costs to clients.²⁶

Instead of regulation, Bauman and Mantzke recommend increased enforcement of existing preparer sanctions and increased taxpayer education. I agree with their recommendations. However, I also support increasing preparer penalties under Sections 6694(a) and (b), penalties for understatements due to unrealistic positions and penalties for intentional disregard of the rules and regulations, respectively. The current Section 6694(a) penalty is \$250 and the Section 6694(b) penalty is \$1,000. The dollar amounts of these penalties are not severe enough to discourage unscrupulous preparers from continuing to file false returns. The intentional disregard penalty needs to be substantially increased in order to eliminate the profit

²⁵ Bauman, C. and K. Mantzke. 2004. "An Education and Enforcement Approach to Dealing with Unscrupulous Tax Preparers." *Journal of Legal Tax Research*, Vol. 2, pgs. 49-60.

²⁶ National Taxpayer Advocate's 2003 Annual Report to Congress. http://www.irs.gov/pub/irs-utl/nta_2003_annual_update_mcw_1-15-042.pdf

the preparer realized from completing the return. Many of the sample preparers charged both a fixed fee for preparing the return and a percentage of the refund. If the total compensation for preparing the return exceeded \$1,000, then the preparer would still realize a profit even after paying the penalty. The NTA recommended increasing the Section 6694(a) penalty to \$1,000 and the Section 6694(b) penalty to \$5,000.²⁷ With a \$5,000 penalty, it is unlikely that a preparer will realize a net profit from preparing a false return if he/she is assessed the penalty. Raising the penalty amount, aggressively assessing and collecting the penalty, and publicizing the number of preparers being assessed the fine could deter some preparers from taking false deductions since it would eliminate their profits.

In addition to increasing and aggressively assessing the penalty, the IRS needs to collect the fines. The IRS's Small Business/Self-Employed Division is responsible for assessing and collecting penalties against paid preparers. In 2001 and 2002 they assessed approximately \$2.4 million in penalties, and collected approximately \$291,000 (12%) from about 44% of the penalized preparers.²⁸ The Internal Revenue Manual²⁹ indicates that these penalties are the key enforcement vehicle for noncompliant preparers. In order for the penalties to be effective, the IRS must improve their collection percentage. Otherwise, abusive preparers will not change their behavior.

Unscrupulous preparers undermine the voluntary compliance system. Most abusive preparers are not CPAs, attorneys, or enrolled agents. The IRS and its CI division must use all their tools (assessment of preparer penalties, disciplinary sanctions under Circular 230, suspension of electronic filing privileges, injunctive action and criminal prosecution) to encourage ethical behavior and deter non-compliance, focusing on the individuals who are not

²⁷ See supra note 24.

²⁸ See Supra note 2.

²⁹ Internal Revenue Manual, 4.10.6.8.2(1), Washington, D.C., May 14, 1999

subject to Circular 230. With increased penalties, strong collection efforts, and continued publicity about the consequences of misconduct, the IRS will make great strides toward their goal of “ensuring that attorneys, accountants and other tax practitioners adhere to professional standards and follow the law.”³⁰

³⁰ IRS Strategic Plan 2005-2009, pg. 18.

Table 1
Tax Preparer Criminal Statutes

Title & Section	Provisions
<i>Title 26 USC § 7206 (1)</i> - Fraud and false statements	Any person who ... (1) Declaration under penalties or perjury – Willfully makes and subscribes any return, statement, or other document, which contains or is verified by a written declaration that is made under the penalties of perjury, and which he does not believe to be true and correct as to every material matter; shall be guilty of a felony ...
<i>Title 26 USC § 7206 (2)</i> - Fraud and false statements	Any person who ... (2) Willfully aids or assists in, or procures, counsels, or advises the preparation or presentation under, or in connection with any matter arising under, the internal revenue laws, of a return, affidavit, claim, or other document, which is fraudulent or is false as to any material matter, whether or not such falsity or fraud is with the knowledge or consent of the person authorized or required to present such return, affidavit, claim, or document; shall be guilty of a felony . . .
<i>Title 26 USC § 7207</i> - Fraudulent returns, statements, or other Documents	Any person who willfully delivers or discloses to the Secretary any list, return, account, statement, or other document, known by him to be fraudulent or to be false as to any material matter
<i>Title 26 USC § 7212</i> - Attempts to interfere with administration of the Internal Revenue Laws	a) Corrupt or forcible interference. Whoever corruptly or by force or threats of force (including any threatening letter or communication) endeavors to intimidate or impede any officer or employee of the United States acting in an official capacity under this title, or in any other way corruptly or by force or threat of force (including any threatening letter or communication) obstructs or impedes, or endeavors to obstruct or impede the due administration of this title
<i>Title 18 USC § 286</i> - Conspiracy to defraud the Government with respect to claims	Whoever enters into any agreement, combination, or conspiracy to defraud the United States, or any department or agency thereof, by obtaining or aiding to obtain the payment or allowance of any false, fictitious or fraudulent claim, shall be fined under this title or imprisoned not more than ten years, or both.
<i>Title 18 USC § 287</i> – False, fictitious or fraudulent claims	Whoever makes or presents to any person or officer in the civil, military, or naval service of the United States, or to any department or agency thereof, any claim upon or against the United States, or any department or agency thereof, knowing such claim to be false, fictitious, or fraudulent, shall be imprisoned not more than five years, and shall be subject to a fine in the amount provided in this title.
<i>Title 18 USC § 371</i> - Conspiracy to commit offense or to defraud United States	If two or more persons conspire either to commit any offense against the United States, or to defraud the United States, or any agency thereof in any manner or for any purpose, and one or more of such persons do any act to effect the object of the conspiracy

Table 2
Federal Sentencing Guidelines
for Tax Crimes

<i>Tax Loss (Apply the Greatest)</i>	<i>Offense level</i>
\$2,000 or less	6
More than \$2,000	8
More than \$5,000	10
More than \$12,500	12
More than \$30,000	14
More than \$80,000	16
More than \$200,000	18
More than \$400,000	20
More than \$1,000,000	22
More than \$2,500,000	24
More than \$7,000,000	26
More than \$20,000,000	28
More than \$50,000,000	30
More than \$100,000,000	32

**Table 3
Federal Sentencing Table
(in months of imprisonment)**

<i>Offense Level</i>	<i>Criminal History Category (Criminal History Points)</i>		
	<i>I (0 or 1)</i>	<i>II (2 or 3)</i>	<i>III (4, 5, or 6)</i>
1	0-6	0-6	0-6
6	0-6	1-7	2-8
12	10-16	12-18	15-21
14	15-21	18-24	21-27
16	21-27	24-30	27-33
18	27-33	30-37	33-41
20	33-41	37-46	41-51
22	41-51	46-57	51-63
24	51-63	57-71	63-78
26	63-78	70-87	78-97
28	78-97	87-108	97-121
30	97-121	108-135	121-151
32	121-151	135-168	151-188

The above table includes portions of the Sentencing Table from the 2002 Federal Sentencing Guideline Manual. The complete Federal Sentencing Table is available at <http://www.uscourts.gov/2002guid/2002guid.pdf>, page 343.

**Table 4
Federal Sentencing Guidelines
Involving Fraud**

<i>Loss (Apply the Greatest)</i>	<i>Increase in Offense level</i>
More than \$5,000	add 2
More than \$10,000	add 4
More than \$30,000	add 6
More than \$70,000	add 8
More than \$120,000	add 10
More than \$200,000	add 12
More than \$400,000	add 14
More than \$1,000,000	add 16
More than \$2,500,000	add 18
More than \$7,000,000	add 20
More than \$20,000,000	add 22
More than \$50,000,000	add 24
The above table includes portions of Section 2B1.1(b) from the Federal Sentencing Guidelines Manual. The complete Federal Sentencing Guidelines Manual is available at http://www.ussc.gov/guidelin.htm	

**Table 5
Sentencing Information Included in Statutes**

Title and Section #	Section Title	Sentencing Information	
		<i>Maximum Imprisonment</i>	<i>Maximum Fine</i>
Title 26, Section 7206	Fraud and false statements	3 years	\$250,000
Title 26, Section 7207	Fraudulent returns, statements or other documents	1 year	\$100,000
Title 26, Section 7212	Attempts to interfere with administration of Internal Revenue laws	3 years	\$5,000
Title 18, Section 286	Conspiracy to defraud the Government with respect to claims	10 years	\$250,000 for individuals
Title 18, Section 287	False, fictitious or fraudulent claims	10 years	\$250,000 for individuals
Title 18, Section 371	Conspiracy to commit offense or to defraud United States	5 years	Yes – no \$ amount specified

Summarized based on information obtained from the United States Sentencing Commission website (<http://www.ussc.gov/GUIDELIN.HTM>) and Department of Justice, Criminal Tax Manual (<http://www.usdoj.gov/tax/readingroom/2001ctm>)

Table 6
Summary of Tax and Related Crimes Convictions

	<i>Section</i>	<i>Number of Cases</i>	<i>% of 377</i>
Filing false return	7206(2)	254	67%
Conspiracy to commit tax fraud	371 (Title 18)	99	27%
Filing a false claim	286/287 (Title 18)	59	16%
Tax Evasion	7201	18	5%
Impeding IRS investigation	7212	12	3%
Mail Fraud	1341 (Title 18)	11	3%
False Statements	7207	10	3%
Failure to file	7203	8	2%
Forgery	510 (Title 18)	7	2%
Others		5	1%
Total		483	
Cases with multiple convictions		90	
Sample Size (N)		377	

Figure 1
Dollar Amount of Tax Fraud



