

Prepared Statement of John Sapp Drake Software

I appreciate the opportunity to contribute to the important topics of preparer regulation and the role that tax-preparation software plays in aiding paid preparers to complete accurate tax returns while meeting compliance and due-diligence requirements. As a tax professional for the past 22 years, I have had the opportunity to serve in multiple facets of the industry, as both a paid preparer and an executive at a professional tax software provider. The tax industry has come to a point where changes are necessary in the area of preparer regulation. It is vital to the success of the industry and our tax system that we appropriately identify and address the areas where changes are needed. However, in addressing the appropriate challenges and finding solutions, we must be careful not to cause harm to the systems that are already working.

In this statement, we recognize that, while tax software is integral to successful tax preparation and is a fundamental resource for many tax preparers, software cannot replace tax knowledge. Next, we discuss the need for preparer accountability and explore ways that such accountability, combined with use of quality tax software, can decrease fraud among preparers and positively affect the tax industry.

Tax Software Does Not Replace Tax Knowledge

Drake Software has provided software to preparers since 1977 and has been part of electronic filing since its inception. Currently, Drake has customers in over 30,500 locations across the U.S. and, to date, has processed over eight million IRS-accepted returns for 2009. Like other software providers, Drake offers tools to help a wide range of offices produce accurate and compliant tax returns; the preparers who use our professional tax software range from value offices who serve the lower-income taxpayer to CPA firms that serve the more complex end of the market. As a member of the tax software industry, we understand that software—no matter how good—does not replace preparer knowledge. Users of tax software must have an understanding of the tax law for the taxpayer demographics they serve.

Approximately 58% of individual taxpayers used paid preparers in 2007. This statistic alone demonstrates the need for preparer accountability. Most paid preparers are both competent and ethical; however, the tax code is complex and fluid, as are the interpretations of the tax law by the courts. An accurate and compliant return, then, requires more than merely entering data into a software product; it requires that the preparer apply his or her knowledge of the tax code and tax law. Because preparers cannot rely solely on tax software to generate an accurate tax return, most professional tax software developers support preparer accountability by providing continuing education as part of their services to the paid preparer.

Tax Software's Role in Tax Preparation

Although tax software cannot replace tax knowledge, the software itself, with its need to provide a quality product, still plays an integral part in contributing to the success of our tax system.

The tax software industry is self-governing; if your software is not accurate and compliant, your customers will find software that is. Software providers do not have room for excessive error. They must produce updated, improved versions of their products, within very tight time frames.

In general, tax software companies are diligent about releasing a product that generates accurate calculations and includes tools to help preparers meet compliance and due-diligence requirements. Software providers make significant monetary investments and spend years perfecting processes to ensure the quality of their product. Drake's programmers, for example, work closely with a wide range of subject matter experts in the areas of tax law, product management, and process management. Such a wealth of established resources helps to ensure that we produce the software that our clients need to succeed.

The software industry also works very closely with the IRS to implement recommended changes such as the Modernized e-File (MeF) initiative, December (as well as mid-season) legislative changes, and the EITC working group. We work closely with both CID and the Department of Justice in identifying and prosecuting fraudulent preparers. In addition, software providers like Drake typically support groups like the NATP, NACTP and CERCA to facilitate communication with the IRS.

Examples of How Software Can Aid Preparers

Tax software has been instrumental in increasing the accuracy and compliance of returns filed by paid preparers. In addition to accurate calculations, Drake and other providers offer tools, such as those listed below, that address the more subjective components of tax preparation.

- **IRS Regulation 7216:** Outreach and education leveraging multiple outlets to users on how Reg. 7216 affects their business practices and procedures; manual and electronic means in the software to help preparers meet their 7216 requirements
- **EITC Due Diligence:** Implementation of IRS/Software joint task force recommendations into the software to minimize erroneous EITC claims, increase participation by eligible taxpayers, and provide guidance to paid preparers on due-diligence requirements; outreach and education leveraging multiple outlets to users on their EITC due-diligence requirements
- **Document Management:** Paperless office program that allows preparers to store and maintain all legally required forms and work papers; Drake's comparable product, the Document Manager, is provided free of charge as part of the Drake tax package.

- **Education:** Various types of training in using the software; education on industry changes, annual updates, hot-button topics, etc.; live training in such topics as tax law changes, depreciation methods and due-diligence requirements
- **Research:** On-line resources for tax research, easily accessible while working in a return; resources generally include access to IRS code and regulations, publications, and form instructions.

Even though software providers work diligently to provide their customers with accurate, easy-to-use software, useful tools, and education as described above, good software is not enough. As stated previously, there is no substitute for tax knowledge on the part of the preparer. The remainder of this statement explores the need for preparer accountability and the methods by which such accountability, combined with use of tax-preparation software, can decrease fraud among preparers and have a positive effect on the tax industry.

Need for Preparer Licensing

Like most professionals, most tax return preparers are ethical, competent, and compliant in their chosen profession. However, the tax code is complex and ever-changing, as are the interpretations of tax law passed down from Congress, the judiciary, and the IRS. Knowledge is required because the tax code is complex; continuing professional education (CPE) is required because of the ever-changing interpretations and new law. In addition, preparers cannot rely on tax software alone to generate an accurate return; they must have a working knowledge of current tax law.

Preparer licensing may not deter certain individuals (those who intentionally prepare fraudulent returns or exercise gross negligence) from continuing to prepare returns. With or without preparer regulation, disreputable individuals will continue to attempt to exploit the system. They should not be the primary focus of preparer regulation.

The focus of preparer regulation, then, should be on accountability and education. The biggest benefit in preparer licensing lies in deterring a certain subset of preparers, such as those who want to make extra money “on the side,” or even as a small business, by preparing taxes, but who typically lack the necessary tax knowledge to do so. These preparers believe that data entry and a good software program are all they need to produce accurate and compliant tax returns. These preparers are not competent tax preparers; a legal requirement about tax knowledge would require them to become educated—or to no longer prepare returns.

Some professionals who provide tax preparation services have already completed widely accepted professional licensing that requires a working knowledge of tax law. In addition, they invest time and money to maintain a current working knowledge of tax law via CPE

requirements. The organizations that administer these professional licenses also maintain a code of ethics or standards to which license-holders are expected to adhere.

The unlicensed preparer does not have an oversight board/body, may or may not have the knowledge to prepare an accurate and compliant tax return, may or may not invest time and money to stay current with the ever-changing tax code, and does not have a governing standard code of ethics or conduct. If a minimum requirement as proof of competence and knowledge is instituted, taxpayers can have an increased level of assurance that the person they trust to complete one of their most important financial transactions is doing so accurately and correctly. With a greater percentage of tax preparers who are knowledgeable in the tax law, overall accuracy and compliance will naturally increase; this, in turn, can have a direct impact on the multi-billion dollar tax gap.

Methods of Ensuring that Preparers Meet Standards

There are numerous options for providing licensing and oversight of tax preparers. Selecting a single solution, however, is not likely to provide a blanket resolution. For knowledge and ethical standards, a multi-pronged approach below will present the best course for long-term success.

1. Tax competency testing

Drake Software fully supports testing for everyone. However, we do not believe a “one-size-fits-all” test is practical. A preparer’s required level of tax knowledge should be tied directly to the demographic and market being served. It would merely place undue hardship on a preparer to require knowledge of an area of the law that does not affect the tax returns he or she prepares. We believe that a multi-tiered competency test—one based on the types of returns for which a preparer provides services—is needed.

2. Continuing professional education (CPE)

Most professional licenses include a CPE requirement in order to maintain a current license. A licensed professional who does not meet the minimum CPE requirements is subject to having their license suspended or revoked. The minimum requirement should be extended to encompass all paid preparers. The requirement type should be tied directly to the level of accreditation received under the multi-tiered competence testing.

3. Improved approval process of electronic return originators (ERO)

Currently, only a small percentage of people who apply to be an ERO and obtain an electronic filer’s identification number (EFIN) are subject to a full criminal background check. A tax return, regardless of its complexity level, is the most important annual financial transaction that most taxpayers complete. They trust a paid preparer with their personal, demographic, and financial information. They should have a high level of

assurance that their trust is correctly placed. Ideally, all (or a higher percentage of) ERO applicants should be subject to the full criminal background check.

4. Standard preparer identification numbers

Currently, a paid preparer can use one of three identification numbers on the tax return:

- a. Social Security Number (SSN)
- b. Preparer Tax Identification Number (PTIN)
- c. Employer Identification Number (EIN)

The current acceptance of multiple identification numbers does not lend itself to a system that can easily identify someone as an accredited preparer. A single, uniform identification number should be required for all paid preparers. The preparer should be required to have this number on all returns he or she completes. Drake Software recommends that the IRS leverage the current PTIN system by requiring all paid preparers to obtain and use a PTIN.

A database of the identification numbers should then be developed to authenticate the return preparer on all returns (electronic or paper) submitted to the IRS by paid tax preparers.

5. Leveraging available data

The amount of preparer data available to the IRS through the tax return submission process (electronic or paper) could be gathered and maintained in a database that collects information about the return preparer and the tax return being filed. This data could be leveraged to help the IRS detect potential fraud, gross negligence, unlicensed paid preparers who have not obtained the applicable accreditation, and other red-flag indicators.

This preparer data could be used in monitoring paid preparer compliance with whatever methods are implemented as a result of the preparer-regulation process.

6. Extension of Circular 230

Drake Software fully supports ethics regulation and education for all paid preparers. Both the IRS and oversight boards of professional licenses provide codes of ethics and conduct for currently licensed tax professionals. However, these rules do not extend to cover non-affiliated preparers. In addition, the complexity and ambiguity of these rules can be confusing to even the most competent paid preparer. Compliance should be easy to understand and apply to daily processes and procedures.

Fraud occurs in basic tax returns (such as the 23% to 28% of erroneous EITC claims) as well as in complex tax returns (such as the recent USB tax fraud case). Fraud at all levels of tax preparation costs American taxpayers billions of dollars annually. Non-compliance with ethics rules should carry stiff penalties and have a very low threshold for tolerance. Those who willfully exploit the tax system will continue to do so, but ethics requirements combined with stiff penalties would usher in a new level of deterrence.

Conclusion: Drake Software Supports These Initiatives

Drake Software fully supports these initiatives and believes the timing is right for making these changes. Opportunities exist to have a positive impact on preserving the reputation of the tax profession, to work on closing the tax gap, and to make it more difficult for unscrupulous paid preparers to work “under the radar.” However, extreme caution must be exercised to ensure that preparer standards are implemented in a way that has a positive impact on the industry and does not negatively affect the function of paid preparers, the IRS, and others involved in making our tax-filing system successful. We applaud the IRS for offering the public and those involved in the tax industry the opportunity to contribute to making these decisions.