

THE ROLE TAX PREPARERS PLAY IN TAXPAYER COMPLIANCE AN EMPIRICAL INVESTIGATION WITH POLICY IMPLICATIONS

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This paper underscores the growing need to shed better light on tax preparers and their effect on the tax system and its administration. To this end the paper undertakes an empirical analysis of U.S. individual tax returns looking at three main parameters. The two independent variables applied include: (1) tax return characteristics: by line item and type of return, and (2) preparation mode: whether the return is self or paid prepared; if paid – by which type of preparer. The third, dependent, variable is the compliance or noncompliance of the return examined. In a second stage of the analysis where noncompliance is found, a taxonomy of the errors identified will be explored to examine whether certain types of errors are associated with the independent variables. By offering a taxonomy of errors and forming a web of associations between these errors and the independent variables, the paper seeks to explore both the motivations behind and facilitators of tax noncompliance as well as the strategies to curb them so as to more effectively foster taxpayer compliance. The analysis draws from 3,457 tax returns where taxpayers claimed the Earned Income Tax Credit (EITC) for Tax Year 1999. These returns have all been subject to either face-to-face or correspondence audit and provide a uniquely thorough pool of data presently unavailable for the general population.

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TAX PREPARER ROLE AND USAGE

“[T]here is overwhelming evidence that tax fraud is [an] epidemic ... the main issue is whether the IRS can deploy its resources effectively to collect a larger share of taxpayers’ legal obligations...”¹

Each year tens of millions of taxpayers turn to tax professionals and agencies to prepare their returns. In the United States, approximately 72 million taxpayers in 2001 and 73 million taxpayers in 2002 paid professional preparers to complete their returns.² For tax year 2001, two-thirds of the 1040 Form returns submitted were signed by a preparer as well as almost three-fourths of electronic filings.³ Moreover, 21.1 percent of the 10.5 million simplest, one-page, 1040EZ Forms filed that same year were also signed by a paid preparer, representing over two million taxpayers.⁴

According to the Government Accountability Office, 77 percent of taxpayers who turn to a paid preparer believe they benefit from doing so and are confident they do not pay more in taxes than they legally owe.⁵ 87 percent of these taxpayers are likely to use a paid preparer again in the future.⁶ In fact, over the past decade U.S. paid preparers usage grew by a staggering 26.4 percent, compared with an overall growth of 13.7 percent in the number of returns filed.⁷

¹ Leonard E. Burman, *On Waste, Fraud, and Abuse*, Statement before the Committee on Ways and Means, United States House of Representatives 1 (July, 17, 2003).

² Marsha Blumenthal and Charles Christian, *Tax Preparers*, in *THE CRISIS IN TAX ADMINISTRATION 201*, 201 (Henry J. Aaron & Joel Slemrod eds., 2004); Kim M. Bloomquist, Michael F. Albert, and Ronald L. Edgerton, *Evaluating Preparation Accuracy of Tax Practitioners: A Bootstrap Approach*, PROCEEDINGS OF THE 2007 INTERNAL REVENUE SERVICE RESEARCH CONFERENCE 77, 77 (2007) (citing paid preparer usage data for Tax Years 1996-2005).

³ Blumenthal & Christian (2004), *supra note 2*, at 201.

⁴ *Id.*

⁵ General Accounting Office, *Tax Administration: Most Taxpayers Believe They Benefit from Paid Tax Preparers, but Oversight for IRS Is a Challenge*, GAO-04-07 3 (2003).

⁶ *Id.* (reporting findings using a survey method).

⁷ Eric Toder, *Changes in Preparation Methods, 1993-2003*, 107(6) TAX NOTES 759 (2005). Taxpayers exhausted about 15 billion dollar on preparation services and fees in Tax Year 2000, amounting to approximately 1.5 percent of the entire 2002 individual income tax liability. See Blumenthal & Christian (2004), *supra note 2*, at 203.

Taxpayers turn to paid preparers for a variety of reasons. With the growing complexity of the Tax Code, many taxpayers do not understand their filing requirements and face significant difficulties completing tax forms by themselves. Taxpayers therefore obtain professional assistance to meet their tax obligations and file accurate and compliant returns.⁸ Additional motives for taxpayer to hire a preparer include the lack of time and patience to self-prepare,⁹ belief that paid preparers minimize due taxes and/or facilitate the receipt of larger or quicker refunds¹⁰ or that preparers save taxpayers money more generally such as by reducing the probability of audits or penalties in the event of an actual audit.¹¹

The tax preparer community is not a homogeneous group. Based on their professional disposition, preparers generally belong to either one of two broad affiliations: (1) tax practitioners: a group comprised of certified public accountants (CPAs), attorneys, and enrolled agents; and (2) unenrolled preparers: representing all other paid preparers.¹² When it comes to the first group of tax practitioners, CPAs and attorneys prescribe to a heightened degree of scrutiny as they are professionally regulated and licensed by state agencies.¹³ Enrolled agents are those preparers who are not professionally licensed but who earn an IRS authorization to practice before it once they pass an examination on tax matters or

⁸ Julie H. Collins, Valerie C. Milliron and Daniel R. Toy, *Factors Associated with Household Demand for Tax Preparers*, 12(1) *The Journal of the American Taxation Association* 9 (1990); Peggy A. Hite and Garry A. McGill, *An Examination of Taxpayer Preference for Aggressive Tax Advice*, 45(4) *NATIONAL TAX JOURNAL* 389 (1992). For an insight into the complexity taxpayers face and its impact on their compliance with the tax law see, for example, Mark W. Everson, Written Testimony for the Committee on Finance Hearing, on *Bridging The Tax Gap* (July 21, 2004) ("We believe ... that a significant factor contributing to the tax gap is the enormous complexity of our tax law. For taxpayers, complexity makes it harder to understand and apply the tax law.")

⁹ GAO (2003), *supra note 5*, at 3 (finding that "[f]or example, a mother of four who operates her own business part-time and is finishing her degree at night said she simply does not have the time to do her own taxes.").

¹⁰ Internal Revenue Service, *Survey of Tax Practitioners and Advisers* (1987); Frances L. Ayres, Berry R. Jackson, and Peggy S. Hite, *The Economic Benefits of Regulation: Evidence from Professional Tax Preparers*, 64(2) *THE ACCOUNTING REVIEW* 300 (1989).

¹¹ Hite & McGill (1992), *supra note 8*; Anne L. Christensen, *Evaluation of Tax Services: A Client and Preparer Perspective*, 14 *THE JOURNAL OF THE AMERICAN TAXATION ASSOCIATION* 60 (1992).

¹² GAO (2003), *supra note 5*, at 2.

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demonstrate past IRS employment experience.¹⁴ The unenrolled preparer population is somewhat more diverse and significantly less supervised than tax practitioners, with some unenrolled agents well trained and experienced while others who are not.¹⁵ In addition, paid preparers may work in a variety of capacities and accordingly adhere to different professional norms, rules, and regulations. These include, among others, providing tax assistance in the context of large or mid-size accounting or law firms, through any of the national tax preparation chain services, in a mom-and-pop type of tax shop, or by way of self-employment.¹⁶

For Tax Year 1988 about 29 percent of taxpayers using a paid preparer turned to CPAs, 17 percent turned to national tax services, 2 percent hired attorneys, while most taxpayers (52 percent) engaged other preparers.¹⁷ As of March 2006, several hundred thousand CPAs and attorneys were authorized to practice before the IRS, and there were about 41,000 active enrolled agents.¹⁸ When it comes to unenrolled preparers, who based on the existing data represent the main source of preparation service for taxpayers, information is more obscure as these preparers may not necessarily partake in an official professional affiliation or registry. However, according to a National Taxpayer Advocate report, the number of unenrolled preparers ranged from 300,000 to 600,000 in 2003.¹⁹

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¹⁵ GAO (2003), *supra note 5*, at 2.

¹⁶ Id; General Accounting Office, Testimony before the Committee on Finance, U.S. Senate, *Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors*, Statement of Michael Brostek, Director, Strategic Issues GAO-06-563T 1 (2006).

¹⁷ Blumenthal & Christian (2004), *supra note 2*, at 204 (citing: Charles W. Christian, *Voluntary Compliance with the Individual Income Tax Results from the 1988 TCMP Study*, IRS RESEARCH BULLETIN (publication 1500., rev. 9-94, 1994, tbl. 7). The Taxpayer Compliance Measurement Program (TCMP) run for about two decades up until the late 1980s. It provides an incredibly detailed pull of data for that time. The newer National Research Program (NRP) was initiated in early 2001 and in some respects provides a narrower array of data than the TCMP. Among others, the NRP has yet to collect information on the use and distribution of paid preparers other than indicating whether a return is paid or self prepared. For a proposal to expand the data collected by NRP see, for example, National Taxpayer Advocate Report to Congress ().

¹⁸ GAO (2006), *supra note 16*, at 1 (citing “IRS Officials” as a source of reference).

¹⁹ National Taxpayer Advocate, U.S. Department of Treasury, *2003 Annual Report to Congress* (2003) (refraining from citing a source of reference). Since taxpayer compliance data suggests an upward trend of preparer usage these numbers are likely to be higher for 2011. See e.g., *supra note 7*.

TAX PREPARERS AS GATE KEEPERS: PROMISES AND CAVEATS

In aiding a growing number of taxpayers understand and meet their tax obligations, tax preparers perform a vital function. For many taxpayers, preparers become critical gatekeepers for the tax system and its administration.²⁰ However, relying on preparers to provide competent or otherwise reliable service might be easier in theory than in practice. In 2003, the Government Accountability Office (GAO) reported that taxpayers generally believe their preparers exercise sufficient due diligence to ensure accurate and compliant returns. Approximately 91 percent of taxpayers reported their preparers have had sufficient information about their circumstances to complete accurate returns, with an estimated 88 percent of these taxpayers required by preparers to present supporting documentation.²¹ Despite these optimistic indications, numerous infractions identified on paid prepared returns suggest reasons for concern.

At least 2 million taxpayers overpaid their 1998 taxes by approximately \$945 million because they claimed the standard deduction when it was more beneficial for them to itemize.²² About half of these taxpayers used a paid tax preparer.²³ Similarly, in about 230,000 returns filed by preparers in 2002 taxpayers appeared eligible for Additional Child Tax Credit they did not claim.²⁴ And, in Tax Year 1999 some taxpayers claimed about \$11 billion more in Earned Income Tax Credits (EITC) than they were legally entitled to while others under-claimed \$710 million.²⁵ Paid tax preparers filed approximately two thirds of all EITC returns.²⁶

²⁰ A survey of the IRS Oversight Board identified that the two key sources of reliance for taxpayers are: (1) IRS representatives and (2) Paid Tax Professionals. Interestingly, in both cases taxpayers exhibit identical rate of overall reliance (83 percent) with minor adjustments when it comes to the degree of reliance: whether taxpayers value the service provided very much (IRS Representatives – 52 percent; Paid Tax Professionals – 51 percent) or Somewhat (IRS Representatives – 31 percent; Paid Tax Professionals – 32 percent). See IRS Oversight Board, TAXPAYER ATTITUDE SURVEY (2003).

²¹ GAO (2003), *supra* note 5, at 4.

²² General Accounting Office, *Tax Deductions: Further Estimates of Taxpayers Who May Have Overpaid Federal Taxes by Not Itemizing*, GAO-02-509 (2002).

²³ *Id.*

²⁴ Treasury Inspector General for Tax Administration, *Analysis of Statistical Information for Returns with Potentially Unclaimed Additional Child Tax Credit* (2003).

²⁵ Internal Revenue Service, *Compliance Estimates for Earned Income Tax Credit Claimed on 1999 Returns* (2002).

In an effort to acquire better insight into the quality of service taxpayers receive from their preparers, the GAO conducted a field study where GAO employees visited with nineteen chain-affiliated paid tax preparers. These employees presented themselves to preparers as if they were shopping for professional assistance concerning their 2006 tax forms.²⁷ Strikingly, nearly all of the returns completed by preparers during the GAO site visits were incorrect to a certain degree. Some of the most serious problems involved incidents where preparers did not report side income (ten out of nineteen cases), did not ask where a child lived or ignored relevant information and claimed an ineligible child for the EITC (five out of ten cases), failed to take the most advantageous postsecondary education tax benefit (three out of nine cases), and failed to itemize deductions at all or to claim available deductions (seven out of nine cases).²⁸ These inaccurate returns translated to unwarranted refunds of up to almost two thousand dollar in five instances, while in two cases they cost the taxpayer over fifteen hundred dollar.²⁹ Many of the issues identified during the GAO field study put the preparer, taxpayer, or both at risk of IRS enforcement actions for such things as negligence and willful or reckless disregard of tax rules.³⁰

Chain preparers are notorious for their uneven standards of experience and training which may explain some of the deficiencies identified by the GAO.³¹ Chain affiliated preparers, however, are not the only group of preparers to exhibit disconcerting behavior. Using the Taxpayer Compliance Measurement Program (TCMP) database, Erard (1993) found that noncompliance is greater on paid, than self, prepared returns, with the highest predicted mean level of noncompliance occurring on CPA or lawyer-prepared returns.³² If a taxpayer's preparation mode changed from self to a CPA or lawyer prepared return, noncompliance increased

²⁶ Janet Holtzblatt and Janet McCubbin, *Issues Affecting Low-Income Filers*, in THE CRISIS IN TAX ADMINISTRATION 148, 159 (Henty J. Aaron & Joel Slemrod eds., 2004) (citing unpublished IRS data).

²⁷ GAO (2006), *supra* note 16.

²⁸ *Id.*, at 5, 16-23.

²⁹ *Id.*, at 5, 14.

³⁰ *Id.*, at 14.

³¹ See e.g., National Taxpayer Advocate, U.S. Department of Treasury, 2002 ANNUAL REPORT TO CONGRESS (2002) (recommending Congress to establish a minimum threshold of paid preparer competency in order to improve preparation services and enhance taxpayer compliance).

³² Brian Erard, *Taxation With Representation: An Analysis of the Role of Tax Practitioners in Tax Compliance*, 52(2) JOURNAL OF PUBLIC ECONOMICS 163 (1993) (analyzing TCMP data for TY 1979).

by a factor of about 4.5.³³ In contrast, the noncompliance of a taxpayer switching from self to a different type of preparer increased by only fifteen percent.³⁴ Unfortunately, Erard's analysis did not offer a coherent theory for its findings nor can it be interoperated to suggest clear insights for a typology of noncompliance among and within different categories of preparers, assuming such a typology exists.

More recently, the General Accounting Office reported a higher error rate on paid (56 percent)—as compared with self—prepared (47 percent) returns.³⁵ This disparity in error rates translates to a different dollar amount taxpayers owe after audit. For Tax Year 2001 taxpayers filing paid prepared returns were liable for a median of \$363 after audit, while those who self-prepared owed a median of \$185 per return.³⁶

Even a small percentage of the millions of taxpayers who rely on tax preparers and consequently file erroneous returns translate to large sums of unwarranted tax money. More troubling than the direct dollar loss caused by unscrupulous behavior, however, are the long term repercussions of such actions. What may start with a few bad apples on either the preparer or taxpayer end can easily spread to the broader taxpayer community, generating a much larger problem in both quality and scope.

John Braithwaite (2005) illustrates the role of tax advisors as the driving force behind what started as a supply-side tax shelter industry in Australia and the United States during the 1980s, and how advisors fueled this industry well into the 21st century.³⁷ Particularly, Braithwaite describes the epidemic like effect

³³ *Id.*, at 191.

³⁴ *Id.*; see also Internal Revenue Service, SURVEY OF TAX PRACTITIONERS AND ADVISERS (1987); Ayres et al. (1989), *supra* note 10. But *cf.* Andrew D. Cuccia, *The Effects of Increased Sanctions on Paid Tax Preparers: Integrating Economic and Psychological Factors*, 16(1) THE JOURNAL OF THE AMERICAN TAXATION ASSOCIATION 41 (1994); Richards G. Broody and John J. Masselli, *Tax Preparers: Whose Team Are They On?*, 41 THE NATIONAL PUBLIC ACCOUNTANT 18 (1996).

³⁵ General Accounting Office (2006) (for all income groups). As detailed above, the NRP data does not provide sufficient information to analyze taxpayers' returns based on preparer type other than whether the return is self or paid prepared. Accordingly, error rates identified using the NRP data are only for those two broad preparation modes. See *supra* note 16.

³⁶ *Id.* (the disparity in taxes owed exists for every income level except for the \$40,000-60,000 and \$60,000-80,000 ranges in which the differences were not statistically significant).

³⁷ John Braithwaite, *MARKETS IN VICE MARKETS IN VIRTUE* (2005).

aggressive tax practices can pose for the taxpayer community as noncompliance spreads from tax advisors to taxpayers via the shaping of compliance attitudes and behaviors.³⁸ Braithwaite's insight is consistent with Hite (2002) who found that taxpayers relying on professional tax assistance during IRS office audits exhibit more negative attitudes toward the tax system than those who self-prepare.³⁹

THE INSTIGATOR OF NONCOMPLIANCE: MIXED EVIDENCE AND ONE HYPOTHESIS

Although evidence to suggest problematic behavior by tax preparers exists in abundance, research to date remains inconclusive regarding who instigates this behavior, the taxpayer or preparer. Hite and McGill (1992), for example, find that taxpayers are likely to agree with their preparer's advice, whether conservative or aggressive, even though they may actually prefer conservative counsel.⁴⁰ Hite and McGill (1992) not only underscore the heavy reliance taxpayers place on their preparers but they also suggest that paid preparers are likely to be the leading force behind aggressive tax dispositions.⁴¹ In contrast, Schisler (1995) suggests that it is the taxpayer who instigates aggressive behavior. Schisler finds that taxpayers are generally more aggressive with taxes due, have lower equity perception of the tax system, and are particularly aggressive when ambiguous tax

³⁸ Id. Cf. James Andreoni, Brian Erard, and Jonathan Feinstein, *Tax Compliance*, 36(2) JOURNAL OF ECONOMIC LITERATURE 818 (1998).

³⁹ Peggy A. Hite, *The Preparer Effect on IRS Customer Satisfaction*, 14 ADVANCES IN TAXATION 159 (2002). See also Loretta J. Stalans, Karyl A. Kinsey, Kent W. Smith, *Listening to Different Voices: Formation of Sanction and Taxpaying Norms*, 21 JOURNAL OF APPLIED SOCIAL PSYCHOLOGY 119 (1991) (finding that third party's involvement can *increase* negative attributes). One key question is whether causation exists between third party's involvement and either an increase in taxpayer negative attitudes and/or actual behavior toward noncompliance or whether the link is such of correlation only. For the general literature finding causation between negative attitudes and actual noncompliant taxpayer behavior see (). For additional research into the plague like characteristics of tax noncompliance in the context of tax transactions and schemes also see Nina Olson, National Taxpayer Advocate, Written Testimony before the Senate Committee on Finance, on the *Tax Gap and Tax Shelters*, Appendix A (Abusive Schemes "Tipping Point" Study) (21 July 2004).

⁴⁰ Hite & McGill (1992), *supra* note 8 (finding that, on average, taxpayers do not have a preference for aggressive tax advice).

⁴¹ See also Lin Mei Tan, *Taxpayers' Preference for Type of Tax Advice from Tax Practitioners: A Preliminary Examination*, 20(4) JOURNAL OF ECONOMIC PSYCHOLOGY 431 (1999) (surveying a group of business taxpayers in New Zealand, Tan confirmed Hite and McGill's findings).

issues are involved.⁴² The inconclusiveness of existing studies, even if not optimal, appears less surprising when taking a closer look at the complexity of the taxpayer-preparer relationship.

Bearing a duty to act in their clients' interest while also upholding the law, tax preparers often face a dual agency problem. The manner in which preparers address this tension and whether they provide aggressive as opposed to more conservative, possibly compliant, service depend on various factors. Over the years the literature has identified more than two dozen variables. These include, among others, client payment status, client aggressiveness, preparer risk preference, client and/or preparer age and/or gender, perceived audit probability, importance of client, preparer experience level, previous success in revenue negotiations, and international versus national practices.⁴³ Notwithstanding the wealth of variables to potentially affect the aggressiveness of professional tax assistance, much of the literature emphasizes the key role of legal ambiguity. In particular, according to the seminal work of Klepper and Nagin (1989) and Klepper et al. (1991), tax professionals serve as exploiters of the law when the legal nature of items on their clients' returns is ambiguous but as enforcers of the law in those incidents where it is relatively clear.⁴⁴

⁴² Dan L. Schisler, *Equity, Aggressiveness, Consensus: A Comparison of Taxpayers and Tax Preparers* 9(4) ACCOUNTING HORIZONS 76 (1995). See also Ayres et al. (1989), *supra* note 10 & Cuccia (1994), *supra* note 34, for behavioral studies.

⁴³ E.g., Valerie C. Milliron, *A Conceptual Model of Factors Influencing Tax Preparers' Aggressiveness*, in CONTEMPORARY TAX RESEARCH 1 (Shane Moriarity and Julie H. Collins eds., 1988) (reviewing literature).

⁴⁴ Steven Klepper and Daniel Nagin, *The Role of Tax Preparers in Compliance*, 22 POLICY SCIENCES 167 (1989); Steven Klepper, Mark Mazur, and Daniel Nagin, *Expert Intermediaries and Legal Compliance: The Case of tax preparers*, 34 JOURNAL OF LAW AND ECONOMICS 205 (1991). Some suggest, however, that the enforcer-exploiter thesis falls short of adequately capturing the full range of the taxpayer-tax preparer relationship. This may be especially the case, the argument goes, with regard to line items where the application of the law is generally clear. For example, when it comes to income reported by sole-proprietors or the claiming of various tax credits, such as the EITC. Available compliance data suggests that sole-proprietor underreporting accounts for about \$68 billion of the tax gap and that close to one-third of the dollar amount claimed is for EITC is in error. While the law governing these two categories is complex, it is also generally unambiguous. See Leslie Book, *Study of the Role of Preparers in Relation to Taxpayer Compliance with Internal Revenue Laws*, in 2007 NATIONAL TAXPAYER ADVOCATE ANNUAL REPORT TO CONGRESS 48-49 (volume 2., 2007) (citing: Leslie Book, *Preventing the Hybrid from Backfiring*, WISCONSIN LAW REVIEW 1103, 1110-14 (2006). According to Book, in such circumstances efforts to increase compliance by imposing heightened requirements of legal

In addition, errors identified on tax prepared returns do not necessarily mean they are the result of preparers' misconduct. In advising clients and completing returns on their behalf, preparers must rely on the information their clients provide. If this information is incomplete or incorrect, the returns preparers file will not reflect the taxpayers' true tax liability.⁴⁵

THE ANALYSIS UNDERTAKEN

This paper underscores the growing need to shed better light on tax preparers and their effect on the tax system and its administration. Key issues to investigate include not only further exploring the quality of service taxpayers receive from those who prepare their tax forms but also the nature of this service and whether noncompliance can be linked more to preparers, or particular types of preparers, than to their clients.

To this end, the paper undertakes an empirical analysis of the return information collected by the IRS for the 1999 Earned Income Tax Credit (EITC) Compliance Study. The study includes data drawn from 3,457 returns.⁴⁶ These returns were selected among filers who claimed the EITC for Tax Year 1999 using the method of stratified random sampling detailed in Appendix A. Each return was initially audited by district examination staff, calling for at least one face-to-face meeting with the taxpayer. The initial audit was later reviewed by tax examiners with the Cincinnati Service Center. All initial audits and their reviews were then sent to an appropriate district office to be assigned within the examination division.

Utilizing the Statistical Analysis System application (SAS) to analyze the return information collected in the 1999 EITC Compliance Study, the paper employs three main parameters. The two independent variables include: (1) tax return

certainty may not have much effect if noncompliance is not related to the exploitation of legal ambiguity. Id.

⁴⁵ E.g., James Tackett, Joe Antenucci, and Fran Wolf, *Profiling Fictitious Tax Data*, 116 TAX NOTES 953 (2007).

⁴⁶ Of the 3,457 returns selected there were 191 cases in which the taxpayer did not appear for audit and/or the subsequent review. These cases are different than unlocateable taxpayers in that the IRS had a valid address for the taxpayer, but the taxpayer ultimately failed to respond or appear for the appointment. These 191 cases of "no show" were excluded from the analysis since any EITC amount claimed by the taxpayer was automatically disallowed with no further information captured in the database.

characteristics: by line item and type of return, and (2) preparation mode: whether the return was self or paid prepared; if paid – by which type of preparer. The dependent variable applied is the compliance or noncompliance of the return examined. This variable is assessed by comparing the information reported on the original tax return with the information concluded following the IRS audits and reviews.⁴⁷

The paper examines two primary groups of returns: the first represents the simpler 1040 family of returns; the second is the more notoriously complicated Schedule C form, involving information reported on profit or loss from sole proprietorships. In each family of returns several line items are explored. These lines include: AGI, Total Tax, EITC, Filing Status, and Total Exemption.⁴⁸ A breakdown of returns claiming itemized, as opposed to standard, deductions and the disposition of electronic filing among preparation modes are also included.

THE CASE OF EITC COMPLIANCE AND THE 1999 EITC COMPLIANCE STUDY DATABASE: STRENGTHS AND SHORTCOMINGS

The Earned Income Tax Credit (EITC or EIC) is a type of transfer subsidy administrated through the tax system.⁴⁹ Supplementing the income of individuals and families who work and earn low wages, the EITC means more money in the pockets of low-to-moderate income households. The program reduces the amount of tax EITC recipients owe the government and it gives back a refund when eligible taxpayers do not reach the minimum tax threshold.

Enjoying a relatively broad bipartisan support, the EITC program was enacted in 1975 as an initially modest credit and has since then been expanded by tax legislation several times.⁵⁰ The program represents one of the largest anti-poverty tools in the United States. In 2004 alone, almost twenty-one million households

⁴⁷ For our analysis we used the "Exam Recommended Amount" from the examined returns (e.g., the "Best and Final" audit and review results). One key qualification to keep in mind is that IRS perspective on the taxpayer's liability may not be the only plausible interpretation of the application of the law. This might be particularly of relevance when more experienced preparers are involved, such as CPAs and attorneys (-further develop implications-).

⁴⁸ For tax year 1999 \$2,750 was subtracted from adjusted gross income for each eligible exemption (spouse or dependent).

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⁵⁰ *E.g.*, 1986, 1990, 1993, and 2000.

received more than thirty-six billion dollar in refunds through the EITC, lifting more than five million households above the poverty line.⁵¹

Already in the 1980s, the Internal Revenue Service identified significant problems with EITC compliance, suggesting that approximately twenty-nine to thirty-seven percent of the total EITC dollar amount was claimed by taxpayers in error.⁵² Later studies for Tax Years 1993-4 and 1997-9 generated similar findings, with the IRS estimating an overpayment rate of about twenty-seven to thirty-two percent of EITC dollars for Tax Year 1999.⁵³ The 1999 estimates represent about nine to ten billion dollar in improper payments for that year alone.⁵⁴

In an effort to better understand and address noncompliance among EITC recipients, the IRS launched a series of EITC compliance studies during the 1990s. The 1999 EITC study is not only the most recent and complete database for EITC compliance than previous EITC studies, but it is also particularly detailed and thorough when compared with other data-gathering ventures the IRS has undertaken over the past three decades.⁵⁵ Most importantly, the EITC

⁵¹ For Tax Year 2010 an EITC claimant with one qualifying child is entitled to receive a maximum credit of \$3,050. For two or more qualifying children, the credit reaches up to \$5,036. A qualifying child can be up to and including the age of nineteen at the end of the tax year, up to and including the age of twenty-four if classified as a full-time student (for one long semester or the equivalent) or any age if classified as “permanently and totally disabled” (for one year or more). In addition to biological parents, grandparents, aunts, uncles, and siblings can also claim a qualified child provided they shared residency with the child for more than six months of the year. A foster child also counts if he or she has been officially placed by an agency or court. A maximum credit of \$457 is available for persons and couples without children. *See* IRS instructions for: EITC Income Limits, Maximum EITC Amount and the EITC-related Tax Law Changes: <http://www.irs.gov/individuals/article/0,,id=215766,00.html>; IRS Guidelines for the Earned Income Tax Credit Program (Questions & Answers) at: <http://www.irs.gov/individuals/article/0,,id=96466,00.html#QA2> (updated Dec.16, 2010). For more details *see* IRS publications 596 (Cant No. 15173A) and 501 (Cat No. 15000U).

⁵² George K. Yin, John K. Scholz, Jonathan B. Forman, and Mark J. Mazur, *Improving the Delivery of Benefits to the Working Poor: Proposals to Reform the Earned Income Tax Credit Program*, 11(2) AMERICAN JOURNAL OF TAX POLICY 225, 296 (1994) (discussing TCMP studies for Tax Years 1982, 1985, and 1988).

⁵³ 1999 Compliance Study, at 12 (the higher-bound figure assumes all “no show” cases overclaimed the EITC credit while the lower-bound figure assumes “no show”’s compliance was the same as that exhibited by the rest of the EITC claimants in the study).

⁵⁴ *Id.*, at 10 (the exact numbers are \$8.7 to \$9.9 billion in improper EITC payments for Tax Year 1999).

⁵⁵ In particular, the NRP does not conduct full audits for all the returns selected for the studies but rather use a screening mechanism to review only those (seemingly) most problematic returns.

compliance study is the only source of information to provide a breakdown of preparer type as part of return information collected by the IRS since the conclusion of the TCMP program in the late 1980s.⁵⁶ The breakdown of preparer type becomes indispensable when exploring the effect of preparation mode and type on taxpayer compliance.

Notwithstanding the benefits of the EITC compliance study database, two main shortcomings emerge when relying on this data. First, the database includes information of only those taxpayers who claimed the EITC and were subsequently selected for audit and review. Accordingly, some of the compliance trends and patterns identified in our analysis may be endemic to the entire tax system while others could be unique to EITC recipients. While there is evidence to suggest that much of the predicaments involving EITC compliance illustrate problems characteristic to the entire tax system,⁵⁷ without concrete evidence it is difficult to draw such firm conclusions.

Second, to date no standard preparer identification number exists for the tax administration.⁵⁸ Accordingly, return information often does not reveal the identity of the particular preparer involved nor does it allow assessing the effect this preparer has had on taxpayer compliance as based on the returns he or she filed. We therefore examine compliance trends and patterns by looking at preparer type as provided in the 1999 EITC compliance study. These types include: (1)

⁵⁶ While it is possible that future NRP studies may provide a breakdown of preparer type this is currently *not* the case.

⁵⁷ See e.g., Burman (2003), *supra* note 1 (). Also see (-discuss the case of extensive dependant allowance fraud identified during the 1980s and the subsequent need to match return information with the social security database as an effective enforcement measure-). Compliance with other credits, deductions and allowances is generally *not* verified by the IRS. Hence, it is difficult to conclude that EITC compliance is inherently different (e.g., less compliant) than other preferential treatments and provisions in the Code.

⁵⁸ Currently, three different identification numbers exist for paid preparers. These include (1) preparer social security number (SSN), (2) employer identification number (EIN), and (3) preparer identification number (PTIN). Preparers may use any of these three numbers to identify themselves on the returns they prepare. For recent efforts to establish a system for an all inclusive preparer identification number see Treasury Inspector General for Tax Administration, *Inadequate Data on Paid Preparers Impedes Effective Oversight*, 2009-40-098 (July 14, 2009); Internal Revenue Service, *Return Preparer Review*, Publication 4832 (Rev. 12-2009) (December 2009) (indicating that the IRS currently lacks resources to offer a unified preparer system and progress in that direction will have to be gradual).

CPA, (2) Attorney, (3) Enrolled Agent, (4) Large National Chain,⁵⁹ (5) Other Professional Tax Preparer, (6) Friend/Relative, (7) IRS/VITA/TCE,⁶⁰ (8) Other,⁶¹ and (9) Taxpayer.⁶² Nonetheless, information gathered on preparer type remains rather limited, with two categories: Large National Chains and Other Professional Tax Preparers, making up approximately 56 percent of all returns selected for the 1999 study. Additionally, the low number of returns in the Attorney and CPA categories made it necessary to group them together.

DATA ANALYSIS & DISCUSSION (-IN PROGRESS-)

While the mode of analysis of this paper is exploratory in nature, several predictions emerge from the literature to suggest areas that require special attention. For example, particular consideration is given to explore whether different types of preparers play different roles as facilitators of tax compliance and noncompliance.⁶³ Specifically, the paper examines whether lawyers and CPAs who are licensed and professionally trained may be more likely to engage in aggressive interpretation of the tax code when ambiguous tax issues are involved. Similarly, the analysis explores whether other types of preparers, such as chain preparers and those who are unenrolled agents, make compliance discrepancies in less complicated filing circumstance, which could be attributed to lack of sufficient knowledge or skill.

The analysis begins with the examination of the Adjusted Gross Income line (AGI) (Table 1). In what may initially appear as surprising results, the preparation modes to exhibit the *highest* number of returns with change to AGI are Enrolled Agents (61 percent), followed by CPA/Attorney (49.2 percent), and Other

⁵⁹ This category includes, specifically, HR Block and Jackson Hewitt.

⁶⁰ The Internal Revenue Service offers free assistance with tax return preparation and tax counseling using specially trained volunteers. The Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) programs assist seniors, individuals with low to moderate incomes, those with disabilities, and those for whom English is a second language.

⁶¹ See 2000 Earned Income Tax Credit Compliance Study Checksheet, Question #20 (on file with authors).

⁶² Meaning, self-preparation mode.

⁶³ E.g., Robert Kidder and Craig McEwen, *Taxpaying Behavior in Social Context: A Tentative Typology of Tax Compliance and Noncompliance*, in 2 TAXPAYER COMPLIANCE: SOCIAL SCIENCE PERSPECTIVE 47 (Jeffery Roth et al. eds., 1989); Yuka Sakurai and Valerie Braithwaite, *Taxpayers' Perceptions of Practitioners: Finding One Who is Effective and Does the Right Thing?*, 46(4) JOURNAL OF BUSINESS ETHICS 375 (2003).

Professional Preparers (44.5 percent). When the analysis examines the rate of change (either negative or positive) from claimed AGI as well as the net change categories, similar results emerge with the *highest* change rate identified on returns preparer by Other Preparers (36.3 percent change; 14.7 percent net change), Other Professional Preparers (33.5 percent change; 13.4 percent net change), CPA/Attorneys (32.2 percent change; 14.2 percent net change), and Enrolled Agents (27.1 percent change; 15.4 percent net change).

Interestingly, the preparation mode to exhibit relatively consistent compliant results is the Taxpayer, with 34 percent of returns with change to AGI; 23.7 percent of change from claimed AGI; and 8.6 percent net change. However, the average change of the dollar amount in the Taxpayer category is not trivial. The modes to exhibit the *most accurate* results are IRS/VITA/TCE and Large Chains, both displaying about half the rate of change from claimed AGI when compared with the categories of CPA/Attorneys and Enrolled Agents.

Table 1

Type of Preparer	Weighted Returns	% of Returns with Change to AGI	% Change from Claimed AGI (Net)	% Change from Claimed AGI	Weighted Average Change
CPA/Attorney	897,341	49.2%	14.2%	32.2%	4,191
Enrolled Agent	307,637	61.0%	15.4%	27.1%	3,875
Friend/Relative	1,656,610	31.1%	7.4%	24.3%	2,742
Large National Chains	4,542,802	37.5%	6.9%	19.8%	2,653
IRS/VITA/TCE	408,495	45.1%	6.4%	15.1%	1,493
Other	641,660	38.3%	14.7%	36.3%	4,506
Other Professional Tax Preparer	5,905,418	44.5%	13.4%	33.5%	3,990

Taxpayer	2,584,490	34.4%	8.6%	23.7%	3,444
Total	16,944,452				

It is possible that the financial circumstances of EITC claimants are sufficiently complex such that even the most trained preparers become confused about the application of the law.⁶⁴ Furthermore, paid tax preparers usage is believed to be more common among taxpayers with complicated returns which may go some way toward explaining higher rates of change on returns filed by preparers as opposed to taxpayers filing for themselves.⁶⁵ This might be particularly the case with taxpayers who turn to the most trained and experienced preparers such as those who are CPAs, Attorneys, and Enrolled Agents. This hypothesis is explored below by looking at the breakdown of preparation mode across Schedule C forms and those returns claiming itemized, as opposed to standard, deductions. As Table 2 indicates, the preparation modes of CPA/Attorney and Enrolled Agent emerge to handle a heavier load on both counts, possibly increasing the complexity and hence the risk for error in these categories.

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⁶⁵ See e.g., Erard (1993), *supra note* 32, at 187. See also Jeffrey A. Dubin, Michael J. Graetz, Michael A. Udell and Louise L. Wilde, *The Demand for Tax Return Preparation Services*, REVIEW OF ECONOMIC STATISTICS 74, 75-82 (1992).

Table 2

Preparer	% with Schedule C	% with Itemized Deductions
CPA_Attorney	32.5%	11.83%
Enrolled Agent	53.5%	13.84%
Friend/Relative	12.9%	5.51%
Large National Chains	12.9%	1.85%
IRS/VITA/TCE	5.1%	3.89%
Other	10.9%	4.56%
Other Professional Tax Preparer	22.8%	6.86%
Taxpayer	16.9%	5.09%

Next, the analysis narrows down to focus on Schedule C returns and examine whether looking exclusively at more ambiguous and complicated filing circumstances across preparation modes will alter the compliance results (Table 3). This time, the rate of returns with change to AGI appears consistently *high* among *almost all* preparation modes with *some decrease* in the IRS/VITA/TCE category.

Narrowing the analysis even further to explore the rate of change from claimed AGI, particularly among those returns subject to audit adjustment (e.g., to be inaccurate according to the IRS examiner) the returns completed by CPA/Attorneys and Enrolled Agents do not appear significantly more problematic than those completed by other preparation modes. In fact, subsequent to IRS/VITA/TCE, the CPA/Attorney category exhibits the *second lowest* change rate from claimed AGI (both net and among those returns with a change to AGI) with National Chains following closely behind. Enrolled Agents, however, while not radically different than other preparation modes, perform rather poorly overall with the *second highest* category of change rate from claimed AGI (net as well as

among those returns with change) and the *highest* average dollar amount change. In addition, when narrowing the analysis to explore Schedule C returns, the Taxpayer category does not appear more compliant than other preparation modes with the average dollar amount adjustment being *among the highest*.

Table 3

Type of Preparer	Weighted Returns With Sched C	% of Returns with a Schedule C	% of Returns with Change to AGI	% Change from Claimed AGI (Net)	% Change from Claimed AGI (Ret w/Change)	Weighted Average Change
CPA_Attorney	291,801	32.5%	71.1%	20.4%	33.3%	4,035
Enrolled Agent	164,479	53.5%	74.5%	32.0%	44.5%	6,035
Friend/Relative	213,033	12.9%	78.7%	23.9%	32.9%	3,009
Large National Chains	585,008	12.9%	73.1%	22.2%	30.5%	3,614
IRS/VITA/TCE	20,860	5.1%	66.7%	2.9%	4.2%	1,132
Other	69,813	10.9%	78.7%	25.0%	39.2%	4,260
Other Professional Tax Preparer	1,343,677	22.8%	74.9%	37.5%	52.3%	5,519
Taxpayer	436,572	16.9%	78.5%	28.8%	35.1%	5,248
Total	3,125,243	18.4%				

To build on the AGI findings, the analysis continues by examining the line item of Total Tax (Table 4). Here again the modes of CPA/Attorney and Enrolled Agent exhibit the *highest* percentage of returns where the IRS examiner recommended a change. However, the magnitude of the change made to returns prepared by CPA/Attorneys and Enrolled Agents, measured as the percentage change from that amount which was determined after IRS audit and review, were *among the lowest*, with only returns prepared by the Taxpayer showing a smaller percentage change.⁶⁶ The categories of Other, Other Professional Preparers, and Large National Chains perform *most inaccurately* (in that order).⁶⁷

Table 4

Type of Preparer	Weighted Returns	% of Returns with Change to Total Tax	% Change to Total Tax (Net)	% Change to Total Tax (Among Returns w/change)	Weighted Average Change (Among Returns w/change)
CPA_Attorney	897,341	46.7%	71.2%	118.3%	794
Enrolled Agent	307,637	57.4%	73.7%	112.0%	1,003
Friend/Relative	1,656,610	39.0%	84.3%	147.6%	509
Large National Chains	4,542,802	31.5%	92.8%	174.2%	769
IRS/VITA/TCE	408,495	27.5%	76.6%	200.0%	393
Other	641,660	37.6%	164.4%	305.0%	881
Other Professional Tax Preparer	5,905,418	38.7%	110.4%	195.4%	976
Taxpayer	2,584,490	36.0%	64.1%	111.5%	666
Total	16,944,452				

⁶⁶ Compliance in the self-preparation mode appears initially more pronounced on the Total Tax than AGI analysis.

⁶⁷ IRS/VITA/TCE results for change rate possibly misleading due to the small dollar amount in that category ().

When the analysis focuses on those returns that contain Schedule C (Table 5), the performance of CPA/Attorneys and Enrolled Agents is again much better, and in line with other preparers. Now, the returns prepared by the Taxpayer become *most likely* to have a change to Total Tax, and display the *largest* change as a percentage of the original amount claimed.

Table 5

Type of Preparer	Weighted Returns With Sched C	% of Returns with a Schedule C	% of Returns with Change to Total Tax	% Change to Total Tax (Net)	% Change to Total Tax (Ret w/change)	Weighted Average Change
CPA_Attorney	291,801	32.5%	64.5%	69.5%	100.0%	1,010
Enrolled Agent	164,479	53.5%	66.4%	78.8%	119.1%	1,387
Friend/Relative	213,033	12.9%	69.3%	109.6%	189.3%	852
Large National Chains	585,008	12.9%	68.0%	98.8%	184.7%	807
IRS/VITA/TCE	20,860	5.1%	43.0%	25.6%	32.7%	418
Other	69,813	10.9%	51.7%	48.2%	140.6%	776
Other Professional Tax Preparer	1,343,677	22.8%	67.7%	106.1%	155.5%	1,364
Taxpayer	436,572	16.9%	72.8%	166.6%	212.6%	1,327
Total	3,125,243	18.4%				

Exploring the line item of EITC (Table 6), the analysis reveals that CPA/Attorneys, Large Chains, and IRS/VITA/TCE staff have the *lowest* percentage of returns with change (either positive or negative) following IRS audit and review. The results remain fairly consistent when looking at the rate of change from claimed EITC, particularly the net change. These results are also consistent with Holtzblatt and McCubbin (2004) who concluded that the 1999 overclaim rate among EITC recipients using preparation services was 34.6 percent, while the overclaim rate among self-preparing taxpayers was a higher 37.8 percent.⁶⁸

According to Holtzblatt and McCubbin, paid preparer mode was more compliant than self, in particular, when the preparer was an Attorney, CPA, an Enrolled Agent, or other nationally recognized preparer. In these cases, the EITC overclaim rate was a low 25.2 percent compared with a 36.2 rate for all other (unenrolled) agents.⁶⁹ Similarly, a recent by study Hite and Hasseldine (2003) analyzed data from a random sample of 1998 IRS office audits to find that tax returns with CPA-preparer assistance had fewer audit adjustments and penalties than self-prepared returns.⁷⁰ CPA prepared returns were also associated with fewer audit adjustments than other paid preparers.⁷¹

These findings may offer evidence in contrast with Erard (1993) who suggested a higher incidence of noncompliance with CPA/Attorney prepared returns.⁷² Another possibility is that the findings indicate that CPAs and other well trained and regulated preparers are more compliant on certain problematic line items or returns, such as Schedule C and EITC, which have come to involve increased IRS scrutiny.⁷³ Alternatively, these findings could also suggest that there are different

⁶⁸ Holtzblatt & McCubbin (2004), *supra note 26*, at 170.

⁶⁹ *Id.*, at 171.

⁷⁰ Office audits target those returns that are identified by the IRS to be particularly problematic. See Peggy A. Hite and John Hasseldine, *Tax Practitioner Credentials and the Incidence of IRS Audit Adjustments*, 17 ACCOUNTING HORIZONS 1, 7 & 8-13 (2003).

⁷¹ *Id.*

⁷² *Supra note 32*. Erard (1993) analyzed data that is already three decades old. It is possible that this data choice might deem his findings to be outdated as well.

⁷³ This argument suggests that if there is a higher risk of detection and/or punishment for problematic line items and/or returns, better trained and regulated paid preparers may be more likely and capable to take proper care to avoid such administrative repercussions.

types of preparers who facilitate taxpayer compliance/noncompliance to various degrees.

Already three decades ago Kidder and McEwen (1989) theorized that two broad types of tax professionals exist: professionals who facilitate taxpayer compliance and those who linger more toward noncompliance.⁷⁴ More recently, drawing on a 2000 nation-wide survey of Australian taxpayers, Sakurai and Braithwaite (2003) placed tax advisors on a hypothetical compliance scale based on their inclination to facilitate noncompliance as opposed to more accurate and conservative tax reporting. The Sakurai-Braithwaite scale includes three groups of tax professionals. On the one end are those professionals who are honest and risk adverse, while on the other are those who are creative and aggressive. The third group, in the middle, includes cautious tax minimizers.⁷⁵ Sakurai and Braithwaite suggest that taxpayers are inclined to seek out advisors who share their values.⁷⁶ Their thesis is in line with Karlinsky and Bankman (2002) who find that sole proprietors interested to minimize their tax liability turn to tax professionals who could facilitate such aspirations.⁷⁷

Importantly, despite facing heightened regulatory and experience requirements, our analysis reveals that Enrolled Agents have the *highest* rate of returns subject to change in EITC (71.6 percent). Enrolled Agents also exhibit the *second highest* rate of net change from EITC claimed (43.9 percent), and *second highest* average change in EITC dollar amount claimed (\$1,099).

Adding to the problematic findings of Enrolled Agents are the analysis results for returns filed by preparers who under the existing legal regime are unregulated and without supervision. Other Preparers, Other Professional Tax Preparers and Friends/Relatives exhibit a *high* rate of returns subject to change in EITC (58.5,

⁷⁴ Robert Kidder and Craig McEwen, *Taxpaying Behavior in Social Context: A Tentative Typology of Tax Compliance and Noncompliance*, in 2 TAXPAYER COMPLIANCE: SOCIAL SCIENCE PERSPECTIVE 47 (Jeffery Roth et al. eds., 1989).

⁷⁵ Sakurai & Braithwaite (2003), *supra* note 63 (concluding that even though the aggressive advisor type is the least popular in terms of taxpayer preference, it is of a particular concern for the tax authority).

⁷⁶ *Id.*, at 22.

⁷⁷ Stuart Karlinsky and Joseph Bankman, *Developing a Theory of Cash Businesses Tax Evasion Behavior and the Role of their Tax Preparers*, PROCEEDINGS OF THE 5TH INT'L CONFERENCE ON TAX ADMINISTRATION 164 (2002).

57, and 56.6 percent, respectively) with Other Preparers and Friends/Relatives displaying the *highest* rate of change in EITC dollar amount claimed (73.8 and 62.2 percent).

The preparer type to show the *highest* average change to EITC claimed is Other Preparer (\$1,199) with Enrolled Agents, Other Professional Tax Preparers, Large Chains, and Friends/Relatives following closely behind (\$1,099, \$983, \$939, \$919 respectively). The preparer type CPA/Attorney displays the *lowest* average change in the EITC dollar amount claimed (\$497) with IRS/VITA/TCE and the Taxpayer also exhibiting fairly *moderate* changes (\$539 and \$623, respectively).⁷⁸

Table 6

Type of Preparer	Weighted Returns	% of Returns with Change to EITC	% Change from Claimed EITC (Net)	% Change from Claimed EITC	Weighted Average Change
CPA/Attorney	897,341	45.2%	(17.4%)	(37.0%)	(497)
Enrolled Agent	307,637	71.6%	(43.9%)	(59.5%)	(1,099)
Friend/Relative	1,656,610	56.6%	(35.4%)	(62.2%)	(919)
Large National Chains	4,542,802	46.3%	(22.5%)	(47.9%)	(939)
IRS/VITA/TCE	408,495	46.9%	(19.8%)	(56.8%)	(539)
Other	641,660	58.5%	(46.5%)	(73.8%)	(1,199)
Other Professional Tax Preparer	5,905,418	57.0%	(31.8%)	(57.4%)	(983)
Taxpayer	2,584,490	51.0%	(23.6%)	(46.3%)	(623)
Total	16,944,452				

⁷⁸ Address: correlation between preparation modes and EITC dollar amount eligibility as one explanatory variable for variations in the average dollar amount change ().

Narrowing the EITC examination to include Schedule C returns (Table 7), Enrolled Agents still exhibit problematic results, with Friends/Relatives and Other Professional Preparers and Other Preparers following closely behind.

Table 7

Type of Preparer	Weighted Returns With Sched C	% of Returns with a Schedule C	% of Returns with Change to EITC	% Change from Claimed EITC (Net)	% Change from Claimed EITC (Ret w/Change)	Weighted Average Change
CPA_Attorney	291,801	32.5%	71.1%	(18.7%)	(30.0%)	(370)
Enrolled Agent	164,479	53.5%	74.5%	(47.1%)	(59.0%)	(1,342)
Friend/Relative	213,033	12.9%	78.7%	(29.5%)	(39.4%)	(655)
Large National Chains	585,008	12.9%	73.1%	(15.7%)	(22.2%)	(455)
IRS/VITA/TCE	20,860	5.1%	66.7%	3.8%	27.0%	76
Other	69,813	10.9%	78.7%	(30.3%)	(43.8%)	(886)
Other Professional Tax Preparer	1,343,677	22.8%	74.9%	(33.1%)	(46.7%)	(814)
Taxpayer	436,572	16.9%	78.5%	(25.8%)	(34.1%)	(538)
Total	3,125,243	18.4%				

Compared with EITC eligibility requirements generally, determining the appropriate filing status of the taxpayer is a fairly straightforward and unambiguous task. Here, the taxpayer or preparer must follow a checklist of several key questions to conclude, among others, whether the taxpayer is entitled to claim the more advantageous Head of Household status.⁷⁹

Table 8 illustrates that while 21 percent of returns prepared by Enrolled Agents claim an incorrect filing status generally, the rate more than doubles (48 percent) for returns originally claiming Head of Household. This is also the case for CPA/Attorney and Taxpayers filing for themselves and could indicate a strategic awareness of the financially favorable implications of the Head of Household filing status.

When it comes to the rate of change in filing status generally, the CPAs/Attorney and Taxpayer categories exhibit the *most accurate* returns (11.4 and 16.9 change rate, respectively). Other Preparer, Other Professional Preparers and Friends/Relatives perform *most poorly* with 37.6, 30.7, and 29.9 percent change (in that order).

Examining those returns originally claiming Head of Household status, Other Preparer still perform *worse* than any other preparer type (56.6 percent change) with CPAs/Attorneys perform *most accurately* (23.6 percent change). The returns of taxpayers filing for themselves remain fairly accurate as well, with a 30.3 percent change, and Enrolled Agents perform *second least accurate* with 48.4 percent change. This is closely followed by Friends/Relatives and Other Professional Tax Preparers (46.3 and 46.2 percent change, respectively).

⁷⁹ The Head of Household filing status as defined in tax year 1999 “is for unmarried people who paid over half the cost of keeping up a home for a qualifying person, such as a child or parent. Certain married people who lived apart from their spouse for the last 6 months of 1999 may also be able to use this status.” The difference in the standard deduction for a person filing as a Head of Household vs. Single in 1999 was \$2,050 (\$6,350 vs. \$4,300). See 1999 Form 1040 Instructions.

Table 8

Percentage of Tax Returns with a Change in Filing Status		
Type of Preparer	Change Rate in Filing Status	Change Rate When Originally Claiming Head of Household
CPA/Attorney	11.4%	23.6%
Enrolled Agent	21.0%	48.4%
Friend/Relative	29.9%	46.3%
Large National Chains	24.7%	34.5%
IRS/VITA/TCE	22.2%	32.5%
Other	37.6%	56.6%
Other Professional Tax Preparer	30.7%	46.2%
Taxpayer	16.9%	30.3%

Table 9

Percentage of Tax Returns with a Change in the Exemption Amount				
Type of Preparer	Weighted Returns	% of Returns with Change to Exemption Amount	% Change from Exemption Amount	Weighted Average Change
CPA/Attorney	897,341	11.4%	(33.0%)	(2,818)
Enrolled Agent	307,637	28.5%	(35.4%)	(3,018)
Friend/Relative	1,656,610	30.1%	(31.7%)	(2,279)
Large National Chains	4,542,802	30.0%	(34.1%)	(2,831)
IRS/VITA/TCE	408,495	31.2%	(41.5%)	(3,421)
Other	641,660	45.0%	(24.5%)	(1,721)
Other Professional Tax Preparer	5,905,418	32.3%	(27.8%)	(2,188)
Taxpayer	2,584,490	24.4%	(20.1%)	(1,471)

FURTHER DISCUSSION & QUALIFICATIONS

SUMMARY & CONCLUSIONS (-IN PROGRESS-)

This paper explores ---.

By understanding the type of errors associated with preparer and client mode and characteristics, we may better understand the taxpayer-paid preparer relationship and how this relationship shapes taxpayer compliance. For example, errors driven by creative interpretation of ambiguous parts of the tax code may suggest the need for rules that emphasize greater oversight and lack of tolerance for noncompliance even when made in good faith. Furthermore, given that not all preparers are regulated, significant variance among the types of errors made by regulated and unregulated preparers could bear important implications for the desirable definition of who is a tax preparer and the rules governing preparation services more generally. These include not only those definitions, rules and regulations applied to individual and firms offering preparation assistance but also to preparation softwares that have come to dominant the tax preparation industry. The target and use of professional guilds themselves could also emerge as a solution if consistencies in errors preparers make materialize.

In other words, by offering a taxonomy of errors and advancing the formation of a web of associations between these errors and the independent variables measured in this paper, we may explore both the motivations behind and facilitators of tax noncompliance as well as the strategies to curb them to more effectively foster compliance. While additional research and data gathering efforts are needed to explore this important subset of taxpayer compliance, this paper seeks to advance the empirical side of the analysis and highlight existing data so as to take one practical steps in that direction.

Appendix A

Preparer Type	Number of Returns*
CPA/Attorney	314
Enrolled Agent	117
Friend/Relative	257
Large National Chains	707
IRS/VITA/TCE	52
Other	105
Other Professional Tax Preparer	1,226
Taxpayer	488
Null	191
Total	3,457

* Detailing the number and distribution of returns audited for the 1999 EITC compliance study. Any discrepancy in the amount claimed on the returns originally filed and that which was concluded by the IRS after audit and review was multiplied by the weighting factor identified in the random sample to infer results for the entire EITC population.

Appendix B

Preparer	% Electronic Filers
CPA_Attorney	32.1%
Enrolled Agent	29.9%
Friend/Relative	17.8%
Large National Chains	94.2%
IRS/VITA/TCE	46.1%
Other	43.2%
Other Professional Tax Preparer	53.0%
Taxpayer	27.0%

Appendix C

Type of Preparer	N	St Deviation EITC Difference	Min EITC Difference	Max EITC Difference	St Deviation AGI Difference
CPA/Attorney	897,341	757.867	(3,690)	3,790	9,356.253
Enrolled Agent	307,637	988.777	(3,816)	2,043	8,365.682
Friend/Relative	1,656,610	1,045.046	(3,816)	3,459	4,646.528
Large National Chains	4,542,802	924.185	(3,816)	3,226	6,272.922
IRS/VITA/TCE	408,495	666.540	(3,050)	811	2,128.170
Other	641,660	1,174.052	(3,816)	3,419	7,976.344
Other Professional Tax Preparer	5,905,418	978.137	(3,816)	2,620	7,909.715
Taxpayer	2,584,490	809.593	(3,816)	2,421	9,002.595
Total	16,944,452	936.379	(3,816)	3,790	7,691.385

Type of Preparer	Min AGI Difference	Max AGI Difference	St Deviation Exemption Difference	Min Exemption Difference	Max Exemption Difference
CPA/Attorney	(9,618)	85,955	1,076.235	(8,250)	2,750
Enrolled Agent	(10,590)	50,133	1,599.253	(8,250)	5,500
Friend/Relative	(12,516)	30,225	2,194.589	(8,250)	11,000
Large National Chains	(8,216)	65,350	2,244.909	(13,750)	8,250
IRS/VITA/TCE	(448)	10,910	2,159.259	(8,250)	2,750
Other	(4,512)	49,352	2,403.280	(8,250)	8,250
Other Professional Tax Preparer	(12,342)	83,294	2,156.406	(13,750)	11,000
Taxpayer	(17,873)	108,064	1,734.788	(11,000)	5,500
Total	(17,873)	108,064	2,035.411	(13,750)	11,000