



Mobtown Beat

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Lax On Taxes

Little Regulation of Tax Preparers Makes Industry Prime For Fraud

by Edward Ericson Jr.

AM Tax Service on Read Street in Mount Vernon has three work stations, but on Jan. 16 the proprietress is the only one there waiting for customers. Since the store opened in early January she's blanketed the neighborhood with palm cards offering \$25 and \$30 discounts on tax-preparation services "starting as low as \$69," as well as refund-anticipation loans, short-term cash advances offered when you file your tax return.

Although unaffiliated with any of the big-three tax preparers--H&R Block, Jackson Hewitt, and Liberty Tax Services--the woman who runs AM Tax says she's worked for both H&R Block and Jackson Hewitt. She's willing to tell a reporter about some of the unsavory aspects of the tax-preparation business, but she's not willing to reveal more than her first name: Amanda. Her name is Amanda Toth, a reporter later discovers, and she is the former owner of the Custom House strip club on the Block.

Toth's tax-preparation business is not a corporation registered with the Maryland State Department of Assessments and Taxation. The state has no problem with that, says Joseph Rooney, deputy commissioner of the Maryland Department of Labor, Licensing, and Regulation, as long as a business is a sole proprietorship, which AM Tax Service is. But Toth's attempt at secrecy reveals an interesting quirk in Maryland regulation (and, in fact, the regulation in 48 other states as well): Tax preparers are not licensed or monitored by the state. That means when you bring the anonymous person in the corner store your W-2 forms, Social Security number, and the intimate details of your family and finances, you have no assurance that the person doing your taxes is competent, solvent, or even a U.S. citizen. Criminal background checks for tax preparers performed by the IRS are spotty at best.

According to Rooney, tax preparers in Maryland are not required to be accountants, certified or otherwise. There is no bond or insurance requirement tax preparers must meet, as there is with consumer lenders. There is no test that needs to be taken, and there's not even a roster of preparers' names and addresses.

"Maybe the IRS is tied into it somehow," Rooney suggests.

The woman at AM Tax says she has filed a form and given her fingerprints to the IRS, which authorized her to file other people's taxes electronically. She says fly-by-night preparers have been a problem in this region, with hustlers opening offices and grabbing refunds for people--and sometimes from them--and then disappearing. "This year they're cracking down," she says of the IRS, though there's little evidence that this is the case.

The IRS has known for more than five years that its oversight of tax preparers like Toth, known as electronic-return originators, who do people's taxes and file them to the IRS electronically, is lax. But so far it's done little about it.

In September 2007 the IRS Inspector General released a 43-page report titled "Better Screening and Monitoring of E-File Providers Is Needed to Minimize the Risk of Unscrupulous Providers Participating in the E-File Program."

The Inspector General released similar reports in 2002, 2003, and 2004 as well. "[C]redit checks are not performed and criminal background checks are limited," the 2007 report states. The IRS agreed to check the citizenship of its electronic tax preparers and "study the feasibility" of looking for patterns of criminal behavior among the 260,000 or so electronic-return originators in the nation.

"The sort of general overview is there is very little regulation of tax preparers," says Chi Chi Wu, a staff attorney with the Boston-based National Consumer Law Center, a nonprofit that has fought the refund-anticipation loan industry. "People tend to think you have to be a CPA or have a degree, but that's not true. As I like to say, my 8-year-old son can set up a card table and prepare tax returns."

Richard Rabicoff, a spokesman for the Maryland Association of Certified Public Accountants, breaks down the hierarchy of tax preparers. At the top are CPAs, he says, who are overseen by the state Board of Public Accountancy. Next are "enrolled agents," the IRS's designation for former employees and those who've passed a serious test. With narrow exceptions, only lawyers, CPAs, and enrolled agents can represent taxpayers before the IRS during an audit. "Then you've got everyone else, such as H&R Block and Hewitt and the others," Rabicoff says. "I think they're sort of answerable to the IRS. But how much that authority is exercised, I wonder."

Bob Kerr, senior director of government relations for the National Association of Enrolled Agents, agrees.

"The distinction is if you're enrolled you've demonstrated competency to someone," he says. "If you're not enrolled, it's by and large a highly unregulated industry, so all you need to do is hang out a shingle," Kerr says, adding that most states license hairstylists but not tax preparers. "Yet the consequences of a bad haircut are not as dire as going to an incompetent tax preparer."

According to the IRS, which opened a public inquiry into tax-preparation firms earlier this month, many refund-anticipation loan companies take advantage of poor taxpayers, sapping cash from those who can least afford it. Observers, including the National Consumer Law Center, the U.S. Public Interest Research Group, and the Association of Community Organizations for Reform Now (ACORN), lauded the action as the first baby step on the road to shutting down the refund-loan business. Refund-anticipation loans, these consumer groups point out, charge customers huge interest rates on short-term loans taken out against their anticipated tax refund.

H&R Block, the nation's largest for-profit tax preparer, has settled class-action lawsuits in at least four states for improperly promoting refund-anticipation loans, and in Illinois a judge held that a civil racketeering charge against the company had merit. This story line obscures a counternarrative, Toth says, in which the tax preparers sometimes conspire with their customers to rip off the government--and in which the customers often rip off the tax preparer and lender.

For example, Toth says, "selling Social Security numbers is big this time of year." It's not unknown, for example, for a parent to sell his or her kids' Social Security numbers for around \$300 to someone looking for a bigger refund because dependents can increase a refund \$1,500

to \$2,500. Toth says this adds up to big fraud because hundreds of returns from Baltimore City include bogus Social Security information.

Toth's story matches a civil lawsuit filed last April by the U.S. Department of Justice against the owners of more than 150 Jackson Hewitt offices in Atlanta, Chicago, Detroit and Raleigh-Durham, N.C. According to the government's complaint, the franchisee corporations "created and fostered a business environment in which fraudulent tax-return preparation is encouraged and flourishes."

The Jackson Hewitt franchisees settled the case last fall. They agreed not to prepare tax returns for five years and to sell their stores, mostly back to Jackson Hewitt. The New Jersey-based company has about 6,500 outlets across the United States and was not a party to the lawsuit, though in corporate filings last summer and fall it acknowledged that it paid about \$1.5 million to the IRS to resolve an audit. The company said it "did not find evidence of corporate employee participation in, or knowledge of, the allegedly fraudulent tax return preparation activities described" in the Justice Department's lawsuits. None of these actions took place in Baltimore.

About three years ago the big three tax preparers, led by Jackson Hewitt, started offering "holiday loans" to customers. Bring two pay stubs to a participating tax preparer's office in early December, and it will calculate your likely refund. The loans are small--usually up to \$500--but the marketing angle was that everyone who got a loan pledged to return to that tax preparer a month or two later to get his or her taxes done. It was a way for the tax preparer to lock in business months before tax season.

In 2006, competition between the big three heated up more than ever, and the companies began another loan program: Bring in another pay stub on Jan. 2 and we'll give you another loan. "So everybody on the second day of January runs down to Jackson Hewitt with their little pay stub and says, 'I want a loan, too.' Most of these people already had a holiday loan," Toth says. "Everybody was happy."

But all this money was loaned out on the mere promise by these taxpayers to return to get their taxes done. In effect, the big tax preparers--and their lenders--were making unsecured loans to people with very little money.

"So people didn't come back," Toth says. "They went to mom-and-pop tax preparer and got their money from the IRS and never paid back any loans."

Just how widespread this scam was in Baltimore is hard to determine. But since the start of 2007 there were nearly 100 cases filed in which HSBC of Nevada--H&R Block's partner--has sued city residents for amounts ranging from about \$600 to \$7,000. A call to the office of HSBC's Maryland lawyer, Stephen G. Peroutka, was not returned.

Last spring HSBC abruptly ended its holiday-loan program, citing losses. A story in American Banker magazine quoted industry founding father John Hewitt of Liberty (and formerly of Jackson Hewitt, which he founded after leaving H&R Block) suggesting a kind of truce among the big three, at least on this issue. "I've been saying for the last 13 or 14 months that I don't like those products at all," he said. "It's just too risky, too fraught with fraud, and just too many fees for the customer."

Toth estimates she'll do only a few dozen returns this year. She is trying to walk a thin line between drawing too much attention from rivals, and drawing too little attention to make her business a go.

"I think people deserve to be treated right," she says. "Even when I was doing these one- or two-day loans, I would tell them: Don't. Same thing with doing something that is slightly fraudulent--it's

going to come back to haunt you sooner or later, in some cases. And it's always going to happen when you're down. It never happens when you've just won the lottery."

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