

**STATEMENT OF JEFFREY W. YABUKI  
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H&R BLOCK  
BEFORE THE SENATE FINANCE COMMITTEE  
ON TAX RETURN PREPARERS  
APRIL 1, 2003**

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Thank you for the opportunity to present our views on how to assure that taxpayers receive competent and honest preparation of their returns when they use a professional return preparer.

Thirty years ago, Henry Bloch testified on tax preparer integrity and quality. He addressed issues such as competence, confidentiality, advertising practices, and the stability of tax preparation firms. Many reforms he proposed were enacted. But additional reforms may still be needed.

Today, I'd like to discuss the tax preparation field generally and describe some of the things we do to ensure quality and integrity.

### **Taxpayers Need Help**

Good tax preparers help millions of Americans comply with a complex and dynamic tax system and ease the burden and anxiety most Americans feel at tax time. Studies show many Americans inadvertently overpay their taxes. Varying levels of knowledge and skill – theirs or their return preparers – are one reason.

- A GAO report done for Senator Grassley showed missed deductions and credits alone may have caused over 2 million Americans to overpay their Federal taxes by an average of over \$400 each.
- A Treasury report found 600,000 low-income taxpayers didn't claim the refundable portion of the child credit, costing them an average of \$390 each.

H&R Block Inc. ([www.hrblock.com](http://www.hrblock.com)) is a diversified company with subsidiaries that deliver tax services and financial advice, investment and mortgage products and services, and business accounting and consulting services. As the world's largest tax services company, H&R Block served nearly 23 million clients during fiscal year 2002 at approximately 10,400 H&R Block retail offices worldwide and with award-winning software and online services. It is the only major tax services and financial services company that focuses primarily on helping middle-income Americans achieve their financial objectives. At 9,300 U.S. offices, over 100,000 employees and franchisees deliver tax services including preparation of one out of seven individual tax returns filed with the IRS and half the returns electronically-filed by tax professionals. H&R Block tax schools trained 250,000 students including 84,000 enrolled in our 66-hour basic tax course. H&R Block served 3.4 million tax clients through its *TaxCut*<sup>®</sup> software and through online tax preparation services. Investment services and securities products are offered through H&R Block Financial Advisors Inc., member NYSE, SIPC. H&R Block Inc. is not a registered broker-dealer. H&R Block Mortgage Corp. offers retail mortgage products. Option One Mortgage Corp. offers wholesale mortgage products and a wide range of mortgage services. RSM McGladrey Inc., with 100 offices nationwide and affiliates in 75 countries, serves mid-sized businesses with accounting, tax and consulting services.

- H&R Block found that one out of 20 of the half-million taxpayers who took our “Double Check Challenge” allowing us to review past tax returns, was able to file an amended return recovering an average tax refund of \$1,300 each.
- And our studies show that 83 percent of Americans have never heard of the Saver’s Credit. It can be worth up to \$1,000 for low- to middle-income taxpayers who contribute to a qualified retirement account before April 15, 2003. This year, we’ve helped more than 1 million clients save an average of \$169 each with the credit.

### **Better Regulation and Enforcement**

The IRS has said, “The vast majority of return preparers are honest and reputable.” We agree. We do not have good measurements of the degree to which incompetence or fraud afflicts the field. But consumers who pay for help deserve some assurance of competence, which is why we support meaningful minimum standards for tax return preparers.

Thirty years ago, Henry Bloch proposed IRS registration of paid tax preparers. We renew that call today and go further. We believe IRS certification of paid tax return preparers — which would require validation of applicable tax knowledge, criminal and tax-filing background checks, and minimum levels of continuing tax education — would benefit the public.

To succeed, however, this or any program depends on preliminary studies to carefully define problems, and on public education, industry cooperation, adequate funding, and effective enforcement.

The new program would join with existing regulation. All preparers today are subject to laws covering fraud, negligence, diligence, misrepresentation, and unauthorized disclosure, and can be enjoined from misconduct. And practitioners who represent taxpayers before the IRS on post-filing issues — attorneys, CPAs, and Enrolled Agents — are regulated by IRS Circular 230. There are also additional rules to cover Electronic Return Originators including background checks and tax filing verifications.

Enforcement is needed, though a clear challenge. Over 70 million taxpayers pay for help from an estimated million tax practitioners in a compact 10 week period. We applaud the IRS’s recently doubling of investigations of return preparers and upgrading the Office of Professional Responsibility. But the overall record in recent years shows much room for improvement. We strongly recommend stepped-up IRS enforcement.

### **Consumer Diligence Still Essential**

Even the best regulatory “Good Housekeeping Seal,” however, is no substitute for consumers exercising basic diligence and being alert to red flags. Some common-sense consumer “Do’s and Don’ts” include:

- Checking a preparer’s training, experience, reputation, and references, and expecting clear disclosure of all fees and services.

- Avoiding preparers promising the biggest refund, charging fees on the basis of a specific tax result, asking you to sign a blank return, failing to sign the return himself, asking that the refund be mailed directly to him, or being vague about his availability in case of follow-up IRS notices or audit.

### **H&R Block Training and Quality Control**

Let me say a word about our own training, self-regulation, and quality control. Today, 100,000 H&R Block employees and franchisees prepare 1 in 7 of individual tax returns filed with the IRS, or 17 million, at 9,300 U.S. offices including 43 in Montana and 137 in Iowa – where our RSM McGladrey subsidiary is also the largest accounting firm.

Through our tax schools, we are one of the largest adult educators in the country, training 250,000 students annually in a variety of tax classes and seminars, including 84,000 that enroll in our basic tax course with 66 hours of classroom instruction and homework generally requiring at least another 66 hours.

Our tax professionals, at a minimum, must take our basic tax course and receive a passing test grade to be eligible for hiring. To be rehired, our professionals take at least 24 hours of continuing education each year and are also trained on systems, products, policies, and procedures, which requires an additional 20-35 hours in class. About 5,000 are Enrolled Agents or CPAs.

Advanced training is tied in stages to an internal certification program as our tax preparers move up the ladder from Tax Associates to Master Tax Advisors, who must also meet the rigorous IRS exam to become an Enrolled Agent.

Our professionals work with a state-of-the-art computer program that checks and double checks calculations, theory, and accuracy. There are approximately 10,000 diagnostics in our software that warn tax professionals that there may be something to review, error diagnostics that won't let the user file unless they are corrected, and other diagnostics that check all of the IRS error codes. We also utilize a second review by another professional for many of our tax returns. Nearly 90% of our returns are electronically filed.

Information Technology, Tax Research, and Training groups at our headquarters provide support to the tax professionals including on-demand help for clients and customized research of complex tax questions.

### **Work Guaranteed**

For clients who are audited, we help to prepare them and, if they so choose, will accompany them as a witness to explain how the return was prepared, but do not act as their representative. For all clients, we guarantee that we will pay any interest or penalties in the event we have made an error on their tax return. For those who want more, we allow them to purchase a Peace of Mind extended guarantee in which we will also pay any additional tax liability up to \$5,000 in the event that we make an error on their tax return.

Our training and culture are clear on one critical point: We play it straight. Our interpretations of the tax code are grounded in consistent interpretation and solid

research. We assist our clients in determining their correct tax liability to pay precisely what they owe, no more and no less.

Mr. Chairman, for nearly a half-century, H&R Block has built its reputation as the trusted tax advisor to Middle-America, and, more recently, as a tax and financial partner to our clients. Our practices and Code of Ethics reflect a longstanding commitment to integrity and professionalism.

Let me highlight, finally, four aspects of the current tax season that reflect our commitment to quality tax services.

### **Financial Planning and Federal Benefits Alerts**

First, we are providing more tax and financial planning advice to our clients. Many of them see the tax filing experience as a once-a-year financial check-up.

For low- and moderate-income clients, we alert them not only to tax benefits like the EITC or child credit, but also to their eligibility for--

- state-sponsored health insurance programs (like Iowa's *hawk-i*);
- Food Stamps;
- Women, Infants, and Children Nutrition Programs;
- School Lunches; and
- for seniors, private-sector prescription drug discounts.

In Des Moines, we refer eligible unbanked clients to the Institute for Social and Economic Development's "Bank On It" program, funded by the Treasury's First Accounts Program, to open low-cost checking or savings accounts and strengthen credit and family finances while taking a course in personal finance.

### **Helping America Save**

Second, we are showing taxpayers how to use tax-advantaged savings opportunities Congress enacts but that are still poorly understood by taxpayers.

Many Americans have never heard of the new Saver's Tax Credit or other tax-advantaged savings opportunities in the Tax Code. The Saver's Credit can be worth up to \$1,000 for low- to middle-income taxpayers who contribute to a qualified retirement account before April 15, 2003.

In some cases, there can be a triple benefit to opening an IRA, thereby increasing EITC eligibility, and getting the Saver's Credit too. This year, we've helped more than one million clients save an average of \$169 each with the credit and helped many others start savings programs for retirement, education, or buying a first home.

### **Free File Alliance**

Third, our focus on preparers shouldn't obscure the growth of tax software and online filing that millions of taxpayers are using, such as our own TaxCut® software. We're one of 17 firms participating with the IRS in an innovative public-private Free File Alliance

this year. It permits 60% of taxpayers and all EITC recipients to file free securely online through the Internet. It's been successful for the IRS and for 2.5 million taxpayers who will file free this year.

The partnership approach avoided a government-only plan that could have put the IRS into competition with the software industry despite the stated desire of IRS leaders not to enter the software business. These issues will continue to be discussed during the three-year term of the agreement.

### **EITC Concerns**

Finally, since two-thirds of EITC returns are completed by paid preparers, they have an important role to play in reducing unacceptably high non-compliance rates.

More can be done and should be done. But we are concerned about the IRS plan to require 45,000 recipients this year, and eventually several million, to pre-qualify by securing affidavits to verify relationships or residence in advance of the tax-filing season (starting from July to December 2003). As initially outlined, the plan is likely to create confusion, administrative logjams, and delayed refunds. We hope the IRS will work with others to improve the program before it is launched and to consider alternatives to ensure efficient administration.

### **Submissions for the Record**

For the record, Mr. Chairman, I'd like to submit some material on-- tax preparer regulation, our training programs, our special efforts to link low-income clients with government benefits, and our annual top 10 tax simplification recommendations.

We appreciate the chance to testify, Mr. Chairman, and would be happy to respond to your questions.

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## Appendix

### Regulation of Tax Return Preparers

According to IRS 2002 preliminary filing season data, 59.4% of individual tax returns filed were prepared by a paid professional. The tax preparation industry has no minimum education or experience requirements for the preparation of tax returns. Although aspects of current regulation address issues related to fraud, abuse, ethical behavior, and intentional or unintentional errors, there is no cohesive interaction of these existing forms of regulation.

Regulation of the tax industry currently takes these forms: Tax Code penalties; electronic return originator (ERO) regulations; and Circular 230 rules.

#### IRC Penalties

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Although many penalties apply primarily to taxpayers, some IRC penalties apply specifically to paid preparers. These preparer penalties range from a \$50 penalty for failing to sign a return to fines and imprisonment for fraudulent activity. (See chart)

IRS assessments of these penalties have steadily decreased over the past six years. Section 6695 penalty assessments decreased from 207 in 1996 to a total of 137 in 2001.<sup>1</sup> The fact that there are over one million preparers and so few penalty assessments raises questions as to the enforcement capabilities of the IRS.

#### Paid Preparer Penalties

Code section	Description	Penalty	Abatement/Exception
6694(a)	Understatement of tax liability, no realistic possibility of being sustained on its merits. Position not disclosed.	\$250 per return or claim.	Reasonable cause and preparer acted in good faith.
6694(b)	Willful or reckless conduct, understatement of taxpayer's tax liability.	\$1,000 per return or claim. Penalty is reduced to extent a penalty is paid under § 6694(a).	Proof that no rule or regulation was intentionally or recklessly disregarded.
6695(a)	Failure to retain a completed copy of tax returns or claims, or to maintain a list of taxpayer names and ID numbers. Failure to make a copy or list available upon request by the Secretary. (IRC § 6107)	\$50 per failure, not to exceed \$25,000 per calendar year.	Reasonable cause. No willful neglect.
6695(b)	Failure to sign return.	\$50 per failure, not to exceed \$25,000 per calendar year.	Reasonable cause. No willful neglect.
6695(c)	Failure to furnish identifying number. (IRC § 6109(a)(4))	\$50 per failure, not to exceed \$25,000 per calendar year.	Reasonable cause. No willful neglect.
6695(e)	Failure to file correct information returns. (IRC 6060)	\$50 per failure, not to exceed \$25,000 per calendar year.	Reasonable cause. No willful neglect.
6695(f)	Negotiation of check.	\$500 per check.	Deposit of check into account held for benefit of the taxpayer.

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<sup>1</sup> IRS data on penalty assessments.

6695(g)	Failure to be diligent in determining eligibility for EITC.	\$100 per failure.	
6701	Aiding and abetting the understatement of tax liability.	\$1,000 (\$10,000 for corporate returns or documents).	Burden of proof is on the IRS.
6713	Improper disclosure or use of information furnished for or in connection with tax preparation.	\$250 per disclosure or use, not to exceed \$10,000 in any calendar year.	
7216	Improper disclosure or use of tax return information	Misdemeanor—\$1,000, 1 year imprisonment or both	

## Electronic Return Originators

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The advent of electronic filing created a new service provider, the electronic return originator (ERO). To limit the possibility of fraud, prevent abuse, and to protect taxpayers, strict application procedures and compliance programs were instituted. Rev. Proc. 2000-31 outlines these rules and the 100-page handbook for e-filers provides additional rules (IRS Publication 1345). An ERO must always seek to recognize and prevent fraud and abuse of the IRS e-file Program, including confirmation of taxpayer identities and TINs. EROs are required to be on the lookout for altered taxpayer information documents and exercise due diligence in the preparation of returns involving the Earned Income Tax Credit (EITC), which has become a popular target for fraud and abuse schemes.

### Application Process

To become an ERO, a firm must identify its principals and at least one responsible official. Principals of partnerships include each partner with a five-percent or more interest, or those individuals who are authorized to act for the partnership in legal and/or tax matters. Principals of a corporation include the president, vice-president, secretary, and treasurer. The responsible official has authority over the firm's e-file program and is responsible for ensuring that the firm adheres to all e-file program requirements.

An application for ERO status may be denied for various reasons, including but not limited to:

1. Conviction of any criminal offense under the revenue laws of the United States or of a state or other political subdivision;
2. Failure to file timely and accurate federal, state, or local tax returns, including returns indicating that no tax is due (unless the applicant did not have a legal filing requirement);
3. Failure to timely pay any federal, state, or local tax liability;
4. Assessment of penalties;
5. Suspension/disbarment from practice before the Service or before a state or local tax agency;
6. Disreputable conduct or other facts that would reflect adversely on the IRS e-file Program;
7. Misrepresentation on an application;
8. Suspension or denial of participation from the program in a prior year;
9. Unethical practices in return preparation;
10. Assessment against the applicant of a penalty under section 6695(g) of the Internal Revenue Code;
11. Stockpiling returns prior to official acceptance into the IRS e-file Program;

12. Knowingly and directly or indirectly employing or accepting assistance from any firm, organization, or individual prohibited from applying to participate in the IRS e-file Program or suspended from participating in the IRS e-file Program. This includes any individual whose actions resulted in the denial, suspension, or expulsion of a firm from the Form 1040 ELF Program or the IRS e-file Program; or
13. Knowingly and directly or indirectly accepting employment as an associate, correspondent, or as a subagent from, or sharing fees with, any firm, organization, or individual prohibited from applying to participate in the IRS e-file Program or suspended or expelled from participating in the IRS e-file Program. This includes any individual whose actions resulted in the denial, suspension, or expulsion of a firm from the Form 1040 ELF Program as well as the IRS e-file Program.

### ERO as Return Preparer

An ERO is not a return preparer if his or her services are limited to “typing, reproduction, or other mechanical assistance in the preparation of a return or claim for refund.” If an ERO, intermediate service provider, transmitter, or software product alters the return in a way other than “mechanical assistance,” penalties that apply to an income tax return preparer can apply.

If an ERO, intermediate service provider, transmitter, or the product of a software developer alters the return information in a nonsubstantive way, this alteration will be considered to come under the mechanical assistance exception described in section 301.7701-15(d). A nonsubstantive change is a correction or change limited to a transposition error, misplaced entry, spelling error, or arithmetic correction.

If an ERO, Intermediate Service Provider, Transmitter, or the product of a software developer alters the return information in a way that does not come under the mechanical assistance exception, the Authorized IRS e-file Provider may be held liable for income tax return preparer penalties.

### Summary of Penalties

These penalties can be applied to an ERO:

- **Level One Infractions.** Violations that have little or no impact on the integrity of the e-file Program or the quality of electronically filed returns. Letter of reprimand.
- **Level Two Infractions.** Violations that have an adverse impact on the e-file Program or the quality of electronically filed returns, including continued level one infractions after the e-file provider has been notified of the infraction. Restricted participation or suspension from the Program for the remainder of the calendar year plus the next calendar year.
- **Level Three Infractions.** Violations that have a significant impact on the e-file Program or the quality of electronically filed returns, including continued level two infractions after the e-file provider has been notified of the infraction. Suspension for the remainder of the calendar year plus the next two calendar years. Fraudulent or criminal conduct can result in expulsion. Suspension or expulsion can occur prior to review of level three infractions.
- **Preparer Penalties.** Any authorized e-file Provider who meets the definition of a return preparer is subject to all available preparer penalties.

Under section 301.7216-2(h), disclosure of tax return information among Authorized IRS e-file Providers for the purpose of electronically filing a return is permissible. For example, an ERO may pass on tax return information to an Intermediate Service Provider and/or a Transmitter for the purpose of having an electronic return formatted and transmitted to the Service.



## Circular 230

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Treasury Circular 230 contains rules that govern attorneys, CPAs, enrolled agents, and other persons who represent clients before the Internal Revenue Service. These rules concentrate on representation rather than tax preparation. Anyone authorized under the rules of Circular 230 may represent a taxpayer before the IRS.

Because only 0.57% of the 129,445,000 returns filed in 2001 were audited and only about a tenth of these were appealed, the vast majority of taxpayers do not require representation in proceedings before the IRS.

The IRS Restructuring Commission suggested in an appendix to its report that all preparers be subject to Circular 230, but said the Commission “does not envision complex and cumbersome registration procedures or requirements, simply a system to capture preparers information already provided on the tax forms for a database of preparers.” In recent comments to the IRS Advanced Notice of Proposed Rulemaking on whether to regulate unenrolled preparers under Circular 230, representatives of the American Bar Association questioned whether there was authority to do so without Congressional authorization. (*BNA Daily Tax Report*, March 21, 2003)

Practice before the IRS includes all matters connected with a presentation to the IRS relating to a client’s rights, privileges, or liabilities under laws or regulations administered by the IRS. These presentations include preparing and filing necessary documents, corresponding and communicating with the IRS and representing a client at conferences, hearings and meetings.

Any attorney who isn’t currently under suspension or disbarment from practice before the IRS may practice before IRS upon filing a written declaration that he or she is currently qualified as an attorney and may represent the particular party on whose behalf he or she acts.

Any certified public accountant (CPA) who isn’t currently under suspension or disbarment from practice before the IRS may practice before the IRS upon filing a written declaration that he or she is currently qualified as a CPA and is authorized to represent the particular party on whose behalf he or she acts.

Any person enrolled as an agent may practice before the IRS, including attorneys and CPAs who meet the eligibility requirements for enrolled agent status. Circular 230 specifies rules on eligibility for enrollment, application procedures, and continuing education requirements.

Under Circular 230, practitioners must exercise due diligence in:

- preparing or assisting in the preparation of, approving, and filing returns, documents, affidavits, and other papers relating to IRS matters;
- determining the correctness of oral or written representations made by them to the IRS; and
- determining the correctness of oral or written representations made by them to clients with reference to any matter administered by the IRS.

Under Circular 230, a practitioner would be presumed to have exercised due diligence for the above purpose if the practitioner relies on the work of another person and the practitioner used reasonable care in engaging, supervising, training, and evaluating the person, taking proper account of the nature of the relationship between the person and the practitioner. Exceptions relating to tax shelter opinions and advising with respect to tax return positions would apply.

A practitioner governed by Circular 230 may not sign a return as a preparer if the practitioner determines the return contains a position that doesn’t have a realistic possibility (defined below) of being sustained on its merits (the realistic possibility standard), unless the position isn’t frivolous (defined below), and is adequately disclosed to IRS. A “return” includes an amended return and a claim for refund.

A position is considered to have a realistic possibility of being sustained on its merits if a reasonable and well-informed analysis by a person knowledgeable in the tax law would lead that person to conclude the position has approximately a one in three, or greater, likelihood of being sustained on its merits.

The “substantial” authorities (the reliance on which avoids the substantial underpayment penalty) described in Reg § 1.6662-4(d)(3)(iii) (i.e., the Code, regulations, public and private rulings, etc.) can be taken into account for purposes of this analysis. These authorities don’t include interpretations in secondary source materials (such as articles in professional tax publications), but practitioners may rely in preparing returns on applicable authorities underlying the conclusions in secondary sources.

The possibility that a position might not be challenged by IRS (e.g., because the taxpayer’s return might not be audited or because the issue might not be raised on audit) may not be taken into account.

A frivolous position is one that is patently improper.

The disclosure rules in Circular 230 are patterned after Code Sec. 6694 and therefore a practitioner who signs a return must actually disclose (rather than merely advise disclosure of) nonfrivolous return positions that don’t satisfy the realistic possibility standard. Practitioners who don’t sign a return must advise their clients of any opportunity to avoid the penalties by disclosure, but aren’t required to actually disclose the position.

A practitioner who advises a client to take a position on a return, or who prepares or signs a return as a preparer, must advise a client of the penalties reasonably likely to apply to the client, with respect to the position advised, prepared, or reported by the practitioner. The practitioner must also inform the client of any opportunity to avoid the penalties by disclosure, and of the requirements for adequate disclosure. This rule applies even if the practitioner isn’t subject to a penalty with respect to the position.

A practitioner advising a client to take a position on a tax return, or preparing or signing a return as a preparer generally may rely without verification on information furnished by the client for purposes of the rules regulating practice before IRS. However, the practitioner may not ignore the implications of the information furnished to, or actually known by, the practitioner, and must make reasonable inquiries if the information appears incorrect, inconsistent or incomplete. Proposed Circular 230 would make it clear that information would appear “inconsistent” if it were inconsistent with an important fact or other factual assumption.

Under Circular 230:

- A practitioner who knows a client hasn’t complied with the tax law must advise the client of the noncompliance. In addition, the practitioner must advise the client how corrective action may be taken and the possible consequences on not taking corrective action.
- A practitioner can’t represent conflicting interests without express consent of the parties after full disclosure has been made.
- Return preparers are prohibited from endorsing or negotiating any check issued by the government, which is issued to a taxpayer other than the practitioner.
- Practitioners can’t charge unconscionable or, with certain exceptions, contingent fees.
- Practitioners who provide tax shelter opinions must comply with detailed requirements.
- Practitioners can’t employ disbarred or suspended persons in any IRS matter.
- Practitioners must not unreasonably delay the disposition of matters pending before IRS.
- Practitioners must promptly submit nonprivileged records or information to IRS on request.
- Practitioners can’t act as notaries with respect to IRS matters in which they have an interest.

Additional rules apply to advertising, solicitation (including targeted mail solicitation), and dissemination of fees.

Circular 230 provides for suspension, disbarment, or censure for disreputable conduct or for failure to comply with the practice requirements.

Certain persons, including attorneys, CPAs, and certain former IRS employees are automatically eligible for enrollment. Everyone else must pass the Special Enrollment Examination, a two-day test of tax knowledge covering the taxation of individuals, corporations, trusts, and partnerships. The fee for the test is \$55.

Persons eligible for enrollment must pay an \$80 fee for enrollment. The enrollment period is three years. During each three-year enrollment period, the enrolled agent must complete 72 hours of continuing tax education.

IRS has been considering outsourcing the development and administration of the Special Enrollment Examination. It is possible that outsourcing may substantially increase the costs of the examination.

## **Regulation at the State Level**

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Two states, California and Oregon, regulate tax preparers. California began regulating tax preparation in 1973. It deregulated the industry in 1996. The California Senate subcommittee that studied the effect of deregulation of the California tax preparation industry stated (April 24, 1995): “The Tax Preparer Program has gone in and out of existence twice since 1973, resulting in no perceivable harm to consumers.”

But rather than eliminate professional requirements, the legislature retained the statutes governing conduct of preparers and also included the following provisions:

- Requirement of a minimum of 20 hours of continuing education per year.
- A \$1,000 civil penalty to recover the cost of enforcement actions.
- A misdemeanor (criminal) offense with up to a \$1,000 fine, one year imprisonment, or both fine and imprisonment for violations of the tax preparer law.

Oversight of the California preparer industry has been in the hands of a tax-exempt organization since 1997.

Oregon began regulation of preparers in 1973. A review of Oregon disciplinary actions over the two-year period May 1, 2000 and May 1, 2002, shows that final orders were issued in 16 cases. Of these cases, only two involved preparer misconduct other than preparing returns without a license. Both of the individuals were cited for failing to return client documents. One of the preparers was cited for accepting fees to prepare returns but failing to file those returns.

In comments on preparer regulation to the IRS Commissioner’s Advisory Group in 1994, the Oregon State Board of Tax Examiners said it found it “difficult if not impossible to measure” whether licensing improved preparation quality. However, the IRS Taxpayer Advocate’s 2002 annual report advocating preparer licensing finds error rates 30-60% lower in Oregon compared to similarly sized states.

The chart on the following page compares the two states’ approaches to regulation.

**Comparison of Regulation in California and Oregon**

	<b>California</b>	<b>Oregon</b>
<b>Credential</b>	Registered tax preparer	Tax preparer/Tax consultant
<b>Age/education</b>	18 or older with high school diploma or equivalent	18 or older with high school diploma or equivalent
<b>Entry-level education</b>	60 hours basic personal income tax law, theory, and practice (15 must be in state taxes) or two years of equivalent work experience	80 hours basic personal income tax law, theory, and practice.
<b>Bond required</b>	Yes - \$5,000.	No
<b>Examination</b>	None required.	Tax preparer/Tax consultant. The tax consultant exam is more "exacting in nature" and requires "higher standards of knowledge."
<b>Work experience</b>	None required.	At least 780 hours as preparer or consultant. Hours can be cumulative in two of last five years.
<b>Continuing education</b>	20 hours. (12 federal, 4 state, 4 either)	30 hours in subjects related to income tax preparation.
<b>Exempt individuals</b>	CPAs, attorneys, EAs and anyone employed by these individuals.	EA need only pass Oregon tax law and ethics portion of exam.
<b>Exam fee</b>	Not applicable.	\$40 tax preparer \$70 tax consultant
<b>Registration/renewal fee</b>	\$25 Annually	Biennial renewal: \$55 tax preparer \$75 consultant
<b>Business registration</b>	Not applicable.	\$95 \$120 combined business and preparer or consultant
<b>Available sanctions</b>	<ul style="list-style-type: none"> <li>• \$1,000 civil penalty.</li> <li>• Misdemeanor offense: Up to \$1,000 fine, up to one year in prison or both</li> <li>• Suspension</li> <li>• Revocation</li> </ul>	<ul style="list-style-type: none"> <li>• Civil penalty: Up to \$5,000 per violation</li> <li>• Additional penalty up to \$5,000 per violation depending on severity and prior violations</li> <li>• Restitution</li> <li>• Suspension</li> <li>• Revocation</li> </ul>

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### H&R Block Courses Required by Certification Level

<b>Title</b>	<b>To Achieve Certification Level</b>	<b>Required Seminars And Elective Hours</b>	<b>Minimum Hours Required</b>
Tax Associate	Tax Associate	H&R Block Income Tax Course	66
Tax Specialist	Tax Specialist 1	<ul style="list-style-type: none"> <li>• Everyone's Return – 21 hours</li> <li>• Employee Business Expense – 12 hours</li> </ul>	30
	Tax Specialist 2	<ul style="list-style-type: none"> <li>• Employee Compensation –15 hours</li> <li>• Dispositions of Assets, Part 1- 15 hours</li> </ul>	30
	Tax Specialist 3	<ul style="list-style-type: none"> <li>• The Retired Taxpayer – 24 hours</li> <li>• Alternative Minimum Tax – 6 hours</li> </ul>	30
Tax Advisor	Tax Advisor 1	<ul style="list-style-type: none"> <li>• Taxpayers in Financial Distress Part 1 – 15 hours</li> <li>• Electives – 15 hours</li> </ul> <p style="margin-left: 20px;">4 Qualifying electives include Tax Update and any seminar(s) not previously taken in the <i>Individual 2, Investments, and Business 1</i> specialties</p>	30
	Tax Advisor 2	<ul style="list-style-type: none"> <li>• Taxpayers in Financial Distress Part 2 – 15 hours</li> <li>• Electives – 15 hours</li> </ul> <p style="margin-left: 20px;">4 Qualifying electives include Tax Update and any seminar(s) not previously taken in the <i>Individual 2, Investments, and Business 1</i> specialties</p>	30
	Tax Advisor 3	<p>Tax Professional selects either the <i>Investments or Business 1</i> specialty.</p> <p><i>Investments</i> Specialty:</p> <ul style="list-style-type: none"> <li>• Investment Income, Part 1 – 18 hours</li> <li>• Electives – 12 hours</li> </ul> <p><i>Business 1</i> Specialty:</p> <ul style="list-style-type: none"> <li>• Sole Proprietorships – 18 hours</li> <li>• Electives – 12 hours</li> </ul> <p style="margin-left: 20px;">4 Qualifying electives for both specialties include: Tax Update and any seminar(s) not previously taken in the <i>Individual 2, Investments and Business 1</i> specialties</p>	30

<b>Title</b>	<b>To Achieve Certification Level</b>	<b>Required Seminars And Elective Hours</b>	<b>Minimum Hours Required</b>
	Tax Advisor 4	<p><i>Investments</i> Specialty:</p> <ul style="list-style-type: none"> <li>• Rental Real Estate – 21 hours</li> <li>• Electives 9 hours</li> </ul> <p><i>Business 1</i> Specialty:</p> <ul style="list-style-type: none"> <li>• Dispositions of Assets, Part 2 – 18 hours</li> <li>• Employment Tax – 6 hours</li> <li>• Electives – 6 hours</li> </ul> <p>4 Qualifying electives for both specialties include: Tax Update and any seminar(s) not previously taken in the <i>Individual 2, Investments and Business 1</i> specialties</p>	30
Senior Tax Advisor	Senior Tax Advisor 1	<p>Tax Professional concentrates on the <i>Investments</i> or <i>Business</i> specialties not selected as a Tax Advisor.</p> <p><i>Investments</i> Specialty:</p> <ul style="list-style-type: none"> <li>• Investment Income, Part 1 – 18 hours</li> <li>• Electives – 18 hours</li> </ul> <p><i>Business 1</i> Specialty:</p> <ul style="list-style-type: none"> <li>• Sole Proprietorships – 18 hours</li> <li>• Electives – 18 hours</li> </ul> <p>4 Qualifying elective seminars for both specialties include: Tax Update and any seminar(s) not previously taken in the <i>Individual 2, Investments and Business 1</i> specialties and any seminars in the <i>International</i> and <i>Wealth Transfers</i> specialties</p>	30
	Sr. Tax Advisor 2	<p><i>Investments</i> Specialty:</p> <ul style="list-style-type: none"> <li>• Rental Real Estate – 21 hours</li> <li>• Electives – 9 hours</li> </ul> <p><i>Business 1</i> Specialty:</p> <ul style="list-style-type: none"> <li>• Dispositions of Assets, Part 2 – 18 hours</li> <li>• Employment Tax – 6 hours</li> <li>• Electives – 6 hours</li> </ul> <p>4 Qualifying elective seminars for both specialties include: Tax Update and any seminar(s) not previously taken in the <i>Investments</i> and <i>Business 1</i> specialties and any seminars in the <i>International</i> and <i>Wealth Transfers</i> specialties</p>	30
	Sr. Tax Advisor 3	Any combination of seminars from <i>Business 2, International, or Wealth Transfers</i> specialties	30

<b>Title</b>	<b>To Achieve Certification Level</b>	<b>Required Seminars And Elective Hours</b>	<b>Minimum Hours Required</b>
	Sr. Tax Advisor 4	Any combination of seminars from <i>Business 2, International, or Wealth Transfers</i> specialties	30
	Sr. Tax Advisor 5	Any combination of seminars from <i>Business 2, International, or Wealth Transfers</i> specialties	30
Master Tax Advisor*	Taxpayer Representative	<ul style="list-style-type: none"> <li>• The Taxpayer Representative – 18 hours</li> <li>• Electives – 12 hours</li> </ul> <p style="margin-left: 40px;">4 Qualifying electives include seminar(s) from any level</p>	30

## The H&R Block Tax Professional Certification Program

We are pleased to announce our tax professional certification program that begins in calendar year 2001. This program will allow tax professionals to identify career paths and to become specialists in areas of tax law that are especially interesting to them. In connection with the certification program, position titles will be changed to reflect individuals' progress in the program. More information about certification is provided below in a question and answer format.

### Background Information

#### Why certification?

Many tax professionals have indicated an interest in having a career path with opportunities to become specialists in certain tax topics. A program with defined levels of certification provides a way of meeting this expressed interest and allows tax professionals to advance as far as they desire.

In addition, other organizations such as the National Society of Accountants and the National Association of Enrolled Agents are bringing pressure to bear on government agencies to license tax professionals and to require the use of other providers' materials for the licensing process. We want to be able to meet their proposed standards within the framework of our own curriculum.

#### What is the purpose of the certification program?

For tax professionals, certification in specialized areas of taxation means greater earnings potential in those specialized areas. Also, as you may know, the IRS and many state taxing agencies are exploring the pros and cons of requiring all tax return preparers to be licensed or have some credential as a tax professional. By beginning our tax professional certification now, we at H&R Block hope to be ahead of the curve by being able to show that we certify that our tax professionals are indeed qualified to prepare the returns they are certified to do.

#### Is there a time limit for being certified in a given specialty or at a specific level?

No — we *want* people to certify, no matter how long it takes.

#### Are tax professionals required to participate?

No, the certification program is voluntary; however, we hope that every tax professional will seriously consider participating in the certification program. This program does not affect the current 24-hour requirement for rehire. H&R Block

courses and seminars taken to meet the 24-hour rehire requirement will count toward the certification process. Likewise, courses and seminars taken for certification will count toward the 24-hour rehire requirement.

#### Did the change in terminology from tax preparer to tax professional also change any of the certification titles?

No. However, we did make a related change. The seminar specialty group formerly known as "The Tax Professional" is now known as "The Taxpayer Representative."

#### Have the certificates of completion been changed to reflect the seminar specialties under the certification program?

Because we have not announced the change to the specialties in our upper-level TTS catalog, we left the certificates as they were last year. Refer to the catalog for Supply Order Template 101 for a listing of the courses and seminars that appear on each completion certificate.

#### Will courses and seminars be produced as Web-based training (WBT), computer-based training (CBT), or in some other alternate delivery format this year?

No. We're going to try to produce some of the courses and seminars in alternative formats in the future.

#### What specialties are included in the program?

The specialties are similar to the general categories in the current curriculum:

1. Individual 1
2. Individual 2
3. Investments
4. Business 1
5. Business 2
6. International
7. Wealth Transfers
8. The Taxpayer Representative

The seminars included in each specialty are listed beginning on page 9 of this document.

#### What are the requirements for certification?

To receive certification for any one group of seminars, a tax professional will need to attend a minimum number of the core-curriculum hours available for the group of seminars, attend the specified number of elective hours for the group, and pass exams on the seminars taken with a specified minimum grade.



- The attendance requirement is 80 percent of the total core-curriculum hours offered for a specialty. For example, the Investments specialty group has a total of 66 core-curriculum class hours. To achieve the attendance requirement for this specialty, the participant must attend at least 53 of the core-curriculum hours identified for the specialty. The remaining 13 hours could come from any combination of other seminars within and outside the specialty. (Specific examples are provided later.)
- The passing score for the exam requirement for seminars is 80 percent. Exams may be taken as many times as necessary to pass. There will be several alternative exams for each seminar in future years.

### **When is a tax professional's certification level determined?**

A tax professional's certification level is determined as of December 31 of each year. However, because some districts hold Tax Update the first week of January, Tax Update taken before January 10, may be considered as having been taken by December 31 of the previous year.

### **What are the new job titles and to which specialties do they relate?**

Tax professionals who currently have the job title *Tax Preparer I* will have the title *Tax Associate I*. Tax professionals who complete the H&R Block Income Tax Course will have the title *Tax Associate II*.

When a tax professional completes the requirements for any one specialty, he or she will have the title *Tax Specialist*. When individuals earn the *Tax Specialist* title, they will have completed Level 1 of the certification process.

Tax professionals who meet the requirements for both Individual groups (Individual 1 and 2) and Investments or Business 1 will have the title of *Tax Advisor* and will have completed Level 2 of the certification process.

Tax professionals who meet the requirements for both Individual groups (Individual 1 and 2), Investments, Business 1, and one other group of their choice will have the title of *Senior Tax Advisor* and will have completed Level 3 of the certification process.

Tax professionals who meet the requirements for all specialties and have enrolled agent status will have the title Master Tax Advisor and will have completed Level 4 of the certification process.

### **Do tax professionals need to complete all the required core hours in one specialty before beginning to study seminars in another specialty?**

No, all required core hours in a given group of seminars do not have to be completed before a student takes seminars in another group. For example, a student focusing on one of the Individual group seminars could also take seminars in the Investments or Business 1 group before completing all of the required core hours in the Individual group.

If a core seminar from one specialty is chosen to complete the requirement of another specialty, the hours will count toward both specialties. For example, if a tax professional chooses Investment Income, Part 1, to satisfy the remaining hours requirement for the Individual 1 specialty, the Investment Income, Part 1, hours may be counted as core hours for the Investments specialty and as elective hours for the Individual 1 specialty.

### **Do prior associates have to retake the H&R Block Income Tax Course for certification purposes?**

No, priors who were at least Tax Preparers II need not take the Income Tax Course again for certification purposes.

### **Tests**

#### **How will the tests be made available?**

The tests will be posted to the Training page on BlockNet as they become available. We plan to have all of the initial tests posted by September 4.

#### **Are there going to be level tests or seminar tests?**

Seminar tests.

#### **Will there be more than one version of the exam for retakes?**

Not in 2001, but eventually, yes. We will initially post only one test per course or seminar series.

#### **What is the format of the exams?**

Each exam will consist of true/false or multiple choice questions.

#### **How many questions are on the exams?**

Tests will have no more than 35 questions. Shorter seminar series will have fewer questions.

#### **How much time will be allowed for the test?**

There is a strict time limit that will vary by exam based on the complexity of the subject and the number of questions.

#### **Is there time allowed in the last session of the seminars to take the exam?**

No. Because of the voluntary nature of the exams, we're recommending that they be totally separate from class. DMs can choose to have 5170 labor proc-

tor the tests during regular business hours, schedule additional evening sessions for those who can't come in during the day, etc. See the Administering Certification Exams section on page 12 of this document.

**Will tests be given at the end of all seminars now to meet the 24-hour rehire requirement or will the requirement still be based on attendance?**

No. The exams are voluntary – they are required only for certification purposes. We feel that tax professionals will quickly realize the benefits of being certified as specialists in the areas of tax they really enjoy.

**Is there any course or seminar that doesn't have an exam?**

Tax Update, which counts as an "open" elective (meaning it generally can be applied to any specialty), has no exam. All other courses and seminars, even those that are only three or six hours long, will have exams. However, there is no separate exam for the Enrolled Agent Exam Preparation Course – the exams that are part of the course are considered exams for testing purposes.

**Which seminars are contained in each of the specialties?**

- On pages 9–10, the core and elective topics, along with their hours, are identified for each specialty. Following the total hours are calculations showing the minimum core hours required and the additional hours needed to attain certification. The additional hours can come from electives within the specialty or from any seminars (core or elective) in other specialties.
- Note that some seminars have not yet been developed and their hours have been estimated.

**Will tax professionals get credit for seminars and courses taken in the past?**

H&R Block seminars taken in 1998, 1999, and 2000 will count toward certification for tax professionals who pass the final exams for those seminars with a score of at least 80 percent. Courses taken prior to 1998 will not count toward certification.

Currently, only H&R Block courses and seminars qualify for certification. In the future, we may enter into agreements with other providers and approve their offerings for our certification program.

**Testing Out**

**Will tax professionals be allowed to test out of courses taken during 1998–2000 after this year?**

No. The opportunity to test out is available only this year.

**Who is eligible to test out of seminars taken in 1998, 1999, and 2000?**

Tax professionals who successfully completed one or more courses or seminars in those years may take the test for that (those) seminar(s). Tax professionals who were in class for at least 50 percent of the total seminar hours in those prior years are considered to have successfully completed those seminars.

**Will associates be able to test out of seminars for credits if they have not taken the class?**

No

**Are exams take-home, or are they completed in a controlled setting?**

All exams are to be administered in a controlled setting, which could be the office or a classroom (if someone is available to proctor outside of class hours).

**Can an associate achieve certification in any area if he or she takes only the exams, or must the associate have both the hours and the test results?**

Only those who have completed the hours (currently or under the grandfather provisions) are eligible to take the exams.

**Are there separate tests for test-out and post-class purposes?**

No. At least for this year, there will be one exam for each seminar series; the exam is used both for those who are eligible to test out of the seminar and for those who are completing the seminar in 2001 (or future years) and want certification credit for it.

**According to the original certification document, a tax professional may take the certification test for a given seminar series as many times as necessary to pass. Is this also true for tax professionals who are testing out under the 1998 -2000 attendance provision?**

No, for test-out purposes, a tax professional may take the test for a particular seminar series only twice. If he or she fails the test twice, he or she must attend that seminar series.

**Is any automatic credit given for seminars attended in 1998–2000, or must tax professionals take the exams for those courses attended to receive certification for them?**

Associates must take the exams for courses and seminars attended in those years, and they may take the exams only twice before being required to repeat the class for certification purposes.

**If a tax professional fulfills the 80 percent attendance requirement for a specialty by attending just one or two seminars in a longer seminar series, must he or she take the exam for that seminar series?**

Tests must be on file for all required core hours. Therefore, in this situation the tax professional would need to take the exam to be credited with completing all required core hours.

**If a tax professional chooses to take a core course from one specialty to fulfill elective requirements in another, what testing is required?**

To receive credit for a seminar as either a core or elective, the tax professional must pass the exam for the seminar. An exception is for Tax Update, an elective that requires no final exam.

**Does the DM have to have a test on record to give associates credit for seminars taken previously?**

Yes.

**If a DM has just transferred to a district where the education or attendance records are incomplete, how should the DM determine eligibility for test-out?**

The DM should use the existing records for the 1998 - 2000 period to the extent possible. He or she may need to ask each tax professional which classes the tax professional attended in that three year period. If so, instructors and TTS coordinators should be asked to corroborate the information given by the tax professionals. Give the tax professionals the benefit of the doubt when information can't be corroborated.

**Counting the Hours**

**May a tax professional "double dip" and count the same seminar hours toward core hours in one specialty and elective hours in another?**

Yes, but each seminar series may be counted only once in its core group and once as an elective in any specialty. For example, someone who chooses to take Taxpayers in Financial Distress, Part 2 (from Individual 2) as an elective toward fulfilling the remaining hours requirement of Individual 1 may count the Taxpayers in Financial Distress hours as core hours for the Individual 2 specialty and as an elective for the Individual 1 specialty. However, he or she may not also apply those hours as an elective toward any other specialty.

**What exactly are "required core hours?"**

For each specialty, the Tax Training department determined which courses and seminars contain the basic — or core — knowledge a tax professional needs in that specialty. This gave us the total number of hours for each specialty. However, because it's

not feasible that everyone will be able to attend every seminar session, we have allowed some hours to be made up from electives. The required core hours are 80 percent of the total hours for the specialty. The remaining hours can come from any other H&R Block course or seminar series (except the H&R Block Income Tax Course or Fundamentals of Income Tax Preparation, Part I or II).

**How does the 80 percent requirement work? Can a student attend less than 80 percent of the class hours for a given seminar series and still be okay?**

The 80-percent requirement applies to the specialty, so as long as the student attends enough other seminars in a chosen specialty, he or she can meet the overall requirement. However, an individual who attends less than the total number of hours for a seminar series must pass the exam for that series to receive credit for the sessions attended.

**If a tax professional is not able to attend all of the sessions of a seminar series in one year, can he or she spread their attendance over a two year period and receive full attendance credit for the entire series?**

Yes. Attendance in a seminar series may be spread over a two year period. However, the tax professional will not receive credit for the full number of hours until he or she has attended all of the sessions. For example, suppose that a tax professional needs 12 core hours to complete the 80 percent attendance requirement in the Individual 1 specialty and enrolls in the Employee Business Expense seminar series. After attending the first session he or she is unable to complete the series in that year. Attendance credit is given for the 3 hours attended. If the individual attends the remaining 9 hours the next year and passes the exam, the individual will be given credit for the those hours, and will have completed the 12 hours needed to complete the 80 percent attendance requirement for the specialty.

**Can a student get partial credit for the seminar hours if he or she does not attend the entire three hour session?**

A student must attend at least 2 1/2 hours of the three hour session to receive credit for the entire class session.

**Some of the required core hours aren't multiples of three, but all of our seminars are three hours long and tax professionals don't get credit unless they are in class for at least 2 1/2 hours. If the required core hours are completed by part of a seminar, what happens to the remaining one or two hours?**

The additional hours can be credited toward elective hours for any specialty.

**If a student did not attend all sessions of a seminar attended in the 1998 - 2000 period but meets the 50-percent attendance requirement for test out, how many certification hours does the student receive credit for?**

If the student successfully tests out, he or she is credited for the entire seminar series based on the current number of hours in the seminar (listed on pages 9 and 10). As an example, a student who attended 6 hours of a 12-hour class gets 12 hours after test-out.

**What if a student misses two sessions of a 21-hour seminar series? Is he or she “sunk” as far as that class is concerned?**

No. As long as the overall attendance in the specialty's core courses is at 80 percent, the student can make up the remaining time through electives and be certified in the overall specialty. **Note:** We strongly encourage 100 percent attendance for the earlier courses (for example, Everyone's Return) so that the student retains the option of skipping a later class. If that student has to miss two sessions of Everyone's Return, he or she can achieve the 80 percent by attending the other sessions in the specialty.

Electives

**Is there any limitation on where the elective hours for a specialty come from? Can any course or seminar series count as an elective?**

Elective hours must come from an H&R Block course or seminar series and they can't have already been used as elective hours for another specialty. A course or seminar session used as core hours from one specialty may also be used as an elective for one other specialty.

**Can core course hours from one specialty be used as elective hours for other specialties?**

Each session of a core course in one specialty may be used as an elective for one other specialty.

**Does Tax Update count toward certification?**

Yes, as an elective, with no final exam required.

**Do the IRA Skills Seminars count toward certification?**

They count as electives. The final exams posted with the seminars (including the summary exercise in IRA Skills, Part 1) serve as the certification exams.

**Do locally produced seminars count toward certification?**

It depends on the topic and whether the seminar has been approved for presentation by the Tax Training department. Approved seminars that deal with federal issues count toward certification. Because semi-

nars that deal only with state and local issues would not count for enrolled-agent certification, they also won't count for certification purposes. (We allow these seminars to count toward the 24-hour rehire requirement, though.)

**What if the tax professional needs just a few hours to complete the total required hours for a specialty? Can he or she split hours from a seminar series and apply only the needed hours?**

For elective purposes, the hours from one class session (usually three hours) may be applied wherever they're needed. Hours from that single session can't be split, however.

Self-Study / Group-Study

**How can tax professionals in locations that do not have large enough enrollments to justify holding certain classes meet the certification requirements?**

In these circumstances, with prior approval by the district manager (or franchise owner), tax professionals may receive credit towards certification for seminars not offered by their district or franchisee during any given year by participating in a study group or doing individual preparation and passing the exam for the seminar(s) studied with a minimum grade of 80 percent.

**Under the certification provisions, self-study and group-study is allowed. Do self-study and group-study hours count for purposes of the 24-hour rehire rule?**

No. Subject to the manager's prior approval, a tax professional may take as many courses and seminars by self-study and/or group-study as the tax professional wishes.

However, the self-study hours and group-study hours do not count towards his or her 24-hour rehire requirement. The hours also do not count for enrolled agent CPEs because H&R Block is not an authorized provider of self-study CPE.

**Can anyone just decide to complete certification hours through self-study and group-study?**

No, a student must obtain his or her manager's approval prior to beginning self-study or group-study.

**Do hours from self-study or study-group classes count toward the 80-percent attendance requirement?**

Yes. If a tax professional completes a course or seminar series on his or her own or in a small group setting, the tax professional will be considered to have completed 100 percent of the hours for

that course or seminar series. (This is different from the 24-hour rehire requirement – self-study and group-study hours do not count toward the 24-hour rehire total.) Reminder: tax professionals must have manager approval before taking any self-study or group-study courses or seminars.

**Does self-study and group-study automatically give the student the hours of attendance for the class?**

Yes, but only for certification and only after the exam is passed. Self-study hours and group-study hours don't count for the 24-hour rehire requirement.

**Is there a limit to how much self-study or group-study a student can participate in?**

Self-study and group-study is at the district manager or franchisee's discretion and can occur whenever the DM or franchisee gives permission.

**Can self-study and group-study be year-round?**

Yes. However, self-study and group-study generally should not be allowed during tax season when we want tax professionals focusing on their clients. If you do allow a tax professional to do self-study or group-study during tax season, be careful not to violate any wage and hour requirements.

**Is self-study or group-study allowed only if a class isn't being offered, or can a person do self-study and/or group-study if a class meets at a time the student can't attend?**

Each of these situations describes a potentially valid reason for allowing self-study or group-study. Managers should use their discretion in determining who is allowed to study on his or her own or in a group.

**Do self-study and group-study hours qualify for the 24-hour rehire requirement?**

No. We have no way of monitoring the actual number of hours the student devotes to studying the material.

**Is there a time limit for a self-study or group-study course?**

The allowed time should be equivalent to the number of sessions in the seminar (a seven-session seminar should be completed in seven or eight weeks). However, the actual limit may be set or changed at the DM's discretion.

**Does someone need to be available to answer questions from students studying on their own or in groups?**

When deciding who can do self study or group-study, DMs and franchisees should take into account how much "hand-holding" the student(s) will need. Students who need to ask a lot of questions really need to be in a class. But for the occasional question, the

student(s) should just call the district or Premium office (wherever the manager decides).

**Does the DM need to monitor the work of those who participate in self-study or group-study?**

No, but again, DMs need to think carefully about whom they allow to study alone or in small groups.

**Grandfather Provisions for Enrolled Agents**

**Explain the certification grandfather rules for EAs. What if an EA hasn't had all of the courses and seminars in each specialty?**

EAs in good standing as of May 1, 2001, are automatically certified as Senior Tax Advisors, regardless of their longevity. They need to take only the Representation course (and pass its exam) to achieve Master Tax Advisor status.

Tax professionals who pass the EA exam in 2001 and later years will have to meet the requirements of the certification program to reach any of the specialty classifications or to advance from one certification level to the next. These tax professionals will not automatically receive the Senior Tax Advisor title.

**What about tax professionals with other credentials (CPA, for example)? Do they get special grandfather privileges?**

No. At this time, we are recognizing only the Enrolled Agent credential for such privileges.

**If someone is enrolled in the EA class this year and passes the test, will he or she automatically become a Senior Tax Advisor even if the other classes for Tax Advisor and Senior Tax Advisor have not been completed?**

At this time, those who become EAs after May 1, 2001, have no grandfather rights, so they'll need to work through the various certification levels.

**Can someone who passed the EA exam in 2000 but whose application is pending on May 1, 2001, take the Representation course?**

Anyone who qualified for the reduction of the \$3,000 floor on a provisional basis based on passing the EA exam in 2000 qualifies under the EA grandfather rules until and unless he or she is informed that his or her EA application has been denied.

**Can someone who has taken and passed our EA class, but did not take (or pass) the IRS exam, be credited for it and be certified at that level?**

No. The tax professional must be an EA in good standing, or have an EA application pending prior to May 1, 2001, to grandfather in at the Senior Tax Advisor level.

**May tax professionals with credentials that are specifically in the representation arena grandfather in as Master Tax Advisors?**

No. While we applaud the tax professionals' efforts and achievements outside of H&R Block, the credentialing would be based on external classes and seminars, which we are not allowing for certification credit at this time.

**Do EAs who become Senior Tax Advisors under the certification grandfather rules have to go back and take any of the exams in the other levels?**

No. They take only the Representation exam.

**Can a first-year associate who is an EA be a Master Tax Advisor or does he or she have to test out of all the classes?**

If the associate was an EA on May 1, 2001, he or she is a Senior Tax Advisor and will be a Master Tax Advisor after taking and passing Representation. The fact that the associate has only worked for us for one year isn't determinative.

**Instructor Issues**

**How will instructors qualify for certification?**

We recognize that instructors may find it difficult to attend classes as well as devote time to their instructor duties. Consequently, instructors may meet the certification requirements as follows:

- Complete the annual 24-hour rehire requirement: instructors may count the full number of classroom hours taught in courses not previously taught and count 50 percent of the classroom hours in courses previously taught toward the 24-hour rehire requirement. Any remaining hours must come from attending seminars or courses; alternatively, the instructor may take the Alternative H&R Block Income Tax Course final exam.
- If instructors do not have time to attend scheduled courses and seminars for certification purposes, they may study seminar materials on their own or in study groups and take the exams.
- To be certified in a seminar the instructor has taught, he or she must pass an exam on the seminar material with a minimum grade of 80 percent.

**What is the timeframe for considering a seminar series as something an instructor has taught previously?**

Three years.

**How can instructors possibly fulfill all the requirements necessary for both the 24-hour re-**

**hire requirement and the certification requirements?**

For certification purposes, instructors may study on their own and take the finals. For purposes of the 24-hour rehire requirement, we are changing the rule that instructors must get their hours only from teaching or attending classes. They may also take the alternative H&R Block ITC final for rehire purposes.

**Do instructor-preparation hours qualify for certification or the 24-hour rehire requirement?**

Only actual in-class instruction hours count toward certification or the 24-hour rehire requirement.

**Why can't instructors take the alternative H&R Block ITC final for rehire purposes?**

We're changing this requirement. Instructors are also eligible to take the alternative final for their 24 hours.

**Other EA Issues**

**Are enrolled agents required to complete the attendance and test requirements?**

Enrolled agents who are in good standing as of May 1, 2001, are not required to meet the attendance and test requirements for the first three levels. They will be automatically certified as Senior Tax Advisors. After meeting the attendance and test requirements for the representation course that will be available in 2001, they will be certified as Master Tax Advisors.

**Does a tax professional have to be an enrolled agent to take the Representation seminars?**

Yes.

**In order to qualify for the EA grandfather provisions for certification, does the tax professional have to a) pass the EA Exam Preparation Course b) pass the IRS exam or c) become an enrolled agent?**

Only those who are EAs in good standing (or whose application is pending with the IRS) as of May 1, 2001, grandfather in as Senior Tax Advisors.

**Do EAs in good standing (or have an application pending) as of May 1, 2001 have a time limit for taking the Representation seminars for purposes of the certification grandfather rule?**

Yes. Master Tax Advisor status will be grandfathered only for EAs who complete the Representation seminars on or before December 31, 2002. EAs who do not meet this time requirement will be certified at their actual certification level based on seminars attended and tests completed.

**Do EAs who are grandfathered have to test out of the EA Exam Preparation course to qualify as Master Tax Advisors?**

No. The EA Exam Preparation course is an elective for the level, not a requirement.

**If non-EA summer staff goes on audits, why can't these associates take Representation?**

Certification-wise, we're trying to offer something that distinguishes the top level from the other levels. And while a non-EA on summer staff can accompany the taxpayer to the audit, he or she can't represent the taxpayer unless he or she actually prepared the return. So, as the class is actually about representation, we feel it makes sense to offer it only to the audience who can actually use the information.

(Also, if we open it to other tax professionals, we run the risk of someone assuming he or she can achieve Master status without fulfilling all of the requirements.)

**Other Questions**

**Are there continuing education requirements for the certification program?**

To maintain certification, tax professionals will need to take at least three hours in each of their certified specialties during each three-year cycle following the cycle in which certification was earned. This requirement can be met as part of the 24-hour rehire requirement.

**Is our three-year cycle different from the EA renewal cycle?**

Only in that we follow a strict calendar year instead of a February to January cycle. In other words, we're ending a cycle on December 31, 2001 (the current EA renewal cycle ends January 31, 2002). However, because some districts hold Tax Update the first week of January, Tax Update taken before January 10, may be considered as having been taken by December 31 of the previous year.

**Will tax professionals need to take full courses and seminar series to maintain their certifications under the three-hour-per-specialty/per-cycle requirement?**

The maximum number of hours needed to retain certification is 18 (three per specialty) during each three-year cycle following the cycle in which certifi-

cation was earned. Tax professionals will be able to attend single seminars to fulfill the requirement; we will also, as appropriate, state when Tax Update fulfills this requirement for one or more specialties.

**Is there an education level that an AMP/ADM/DM is expected to have?**

No.

**Will textbook files be available for downloading on BlockNet?**

At this point, we have no plans to upload the files to BlockNet – they're just too big. (For example, even in pdf AND compressed, the H&R Block Income Tax Course files fill four CDs).

**Is there any other visible recognition that will show the tax professional's status such as the old bronze, silver or gold plaques we used to use or will we be able to put something on business cards?**

The titles are appropriate for business cards. Please forward any suggestions for other tasteful means of recognition to Maggie Doedtman in the Tax Training department.

**How do non-H&R Block classes associates take count towards certification?**

At this point, we're not accepting outside classes for certification. Outside classes still count for the 24-hour rehire requirement, though.

**Will we be able to order individual texts and workbooks for those who want to self-study or participate in group-study?**

Not yet, but we're considering this possibility.

**What recordkeeping provisions are being made for the certification program?**

Forms are being developed for recordkeeping purposes. The forms will be posted to BlockNet in September.

**In addition to attending a class, self-study, and group-study, are there other options for participating in the certification process?**

No, not at this time. We are currently looking into developing other delivery options, such as web- and CBT-based courses.

## RECOMMENDED PROGRESSION OF STUDIES

The recommended course of study for tax professionals is to complete the *H&R Block Income Tax Course* and then the *Everyone's Return* seminar series. Tax professionals are encouraged to complete the seminars listed on this page before moving on to the seminars listed on page 10.

### H&R Block Curriculum — Specialties

<b>Individual 1</b>			
<i>Core Curriculum Seminar Series</i>	<i>Hrs</i>	<i>Elective Seminars</i>	<i>Hrs</i>
Everyone's Return	21	None	
Employee Business Expense	12		
Employee Compensation	15		
Dispositions of Assets, 1	15		
The Retired Taxpayer	24		
<b>Core Total</b>	<b>87</b>	<b>Elective Total</b>	<b>0</b>
Required core hours (87 x 80%)		70	
Remaining hours needed for certification		17	
<b>Individual 2</b>			
<i>Core Curriculum Seminar Series</i>	<i>Hrs</i>	<i>Elective Seminars</i>	<i>Hrs</i>
Taxpayers in Financial Distress, Part 1	15	Introduction to Wealth Transfers	6
Taxpayers in Financial Distress, Part 2	15	Amended Returns	3
Alternative Minimum Tax	6		
Research Techniques*†	6		
Ethics	3		
<b>Core Total</b>	<b>45</b>	<b>Elective Total</b>	<b>9</b>
Required core hours (45 x 80%)		36	
Remaining hours needed for certification		9	
<b>Investments</b>			
<i>Core Curriculum Seminar Series</i>	<i>Hrs</i>	<i>Elective Seminars</i>	<i>Hrs</i>
Investment Income, Part 1	18	Natural Resources	9
Investment Income, Part 2	12	Financial Planning*†	6
Rental Real Estate	21	Rental Real Estate: Credits Seminar	3
Schedules K-1	15		
<b>Core Total</b>	<b>66</b>	<b>Elective Total</b>	<b>18</b>
Required core hours (66 x 80%)		53	
Remaining hours needed for certification		13	
<b>Business 1</b>			
<i>Core Curriculum Seminar Series</i>	<i>Hrs</i>	<i>Elective Seminars</i>	<i>Hrs</i>
Sole Proprietorships	18	The Creative Taxpayer	12
Dispositions of Assets, 2	18	Commercial Fishing*	3
Employment Tax	6	Farms*	9
Introduction to Business Entities	18	Clergy	3
Basic Accounting Principles*†	6	Change of Accounting Methods*†	6
<b>Core Total</b>	<b>66</b>	<b>Elective Total</b>	<b>33</b>
Required core hours (66 x 80%)		53	
Remaining hours needed for certification		13	

\*Not available in the 2001 curriculum.

†Hours estimated; seminar not yet developed.



<b>Business 2</b>			
<i>Core Curriculum Seminar Series</i>	<i>Hrs</i>	<i>Elective Seminars</i>	
Partnerships	21	Corporations, Part 2*†	9
Corporations, Part 1	18	Exempt Organizations*	3
<b>Core Total</b>	<b>39</b>	<b>Elective Total</b>	<b>12</b>
Required core hours (39 x 80%)		31	
Remaining hours needed for certification		8	
<b>International</b>			
<i>Core Curriculum Seminar Series</i>	<i>Hrs</i>	<i>Elective Seminars</i>	<i>Hrs</i>
U.S. Citizens/Residents	18	Tax Law of Other Countries*†	6
Aliens and U.S. Possessions	12		
<b>Core Total</b>	<b>30</b>	<b>Elective Total</b>	<b>6</b>
Required core hours (30 x 80%)		24	
Remaining hours needed for certification		6	
<b>Wealth Transfers</b>			
<i>Core Curriculum Seminar Series</i>	<i>Hrs</i>	<i>Elective Seminars</i>	<i>Hrs</i>
Trusts and Estates	18	Charitable Remainder Trusts*†	6
Gifts*	15	Form 706*†	6
		Estate Planning*†	6
<b>Core Total</b>	<b>33</b>	<b>Elective Total</b>	<b>18</b>
Required core hours (33 x 80%)		26	
Remaining hours needed for certification		7	
<b>The Taxpayer Representative</b>			
<i>Core Curriculum Seminar Series</i>	<i>Hrs</i>	<i>Elective Seminars</i>	<i>Hrs</i>
Representation	18	EA Exam Preparation Course	39
<b>Core Total</b>	<b>18</b>	<b>Elective Total</b>	<b>39</b>
Required core hours (18 x 80%)		14	
Remaining hours needed for certification		4	

\*Not available in the 2001 curriculum.

†Hours estimated; seminar not yet developed.

**LEVELS**

**Level 1**

Complete the H&R Block Income Tax Course or the curriculum for at least one specialty.

**Level 2**

Complete Individual 1 and 2 and Investments or Business 1.

Individual 1 and 2 Investments

Individual 1	Hours
Core	70
Other	17
Individual 2	
Core	36
Other	9
Investments	
Core	53
Other	13
Maximum Hours	198

Individual 1 and 2 and Business 1

Individual 1	Hours
Core	70
Other	17
Individual 2	
Core	36
Other	9
Business 1	
Core	53
Other	13
Maximum Hours	198

**Level 3**

Complete Individual 1 and 2, Investments, Business 1, and one other specialty of the tax professional's choice.

Individual 1 and 2, Investments, Business 1, one other specialty

Individual 1	Hours
Core	70
Other	17
Individual 2	
Core	36
Other	9
Investments	
Core	53
Other	13
Business 1	
Core	53
Other	13
Subtotal	264

Business Returns 2	Hours
Core	31
Other	8
International	
Core	24
Other	6
Wealth Transfers	
Core	26
Other	7
The Taxpayer Rep	
Core	14
Other	4

Maximum required hours with:

Business 2	$264 + 39 = 303$
International	$264 + 30 = 294$
Wealth Transfers	$264 + 33 = 297$
Taxpayer Representative	$264 + 18 = 282$

**Level 4**

Complete the requirements for all four levels.

Maximum required hours after the H&R Block Income Tax Course has been completed:

Individual 1	87
Individual 2	45
Investments	66
Business 1	66
Business 2	39
International	30
Wealth Transfers	33
Taxpayer Representative	<u>18</u>
Total	384

## Administering Certification Exams

The tax professional certification exams are (or will be) posted to BlockNet under Training: Tax Services. The answers are posted separately.

The district manager (or his or her delegee) determines when and where the exams will be given. Each exam is open-book but has a strict time limit; exam takers should be encouraged to answer the questions they know before looking up those they don't. Regarding the open-book resources:

- Publications 17, 225, and 334 for the just-completed tax season should be available in the exam area.
- Exam takers must furnish any other materials (limited to H&R Block materials) they want to consult. Specifically, although all exam takers may bring in their H&R Block texts and workbooks, exam takers who are testing out need not be given the current-year textbooks for the seminars they want to test out of.

Follow the steps below to administer the exams for those tax professionals seeking certification credit.

1. Download the exam and the generic answer sheet and make copies as necessary. (One fill-in answer sheet is used for all of the exams.) Also download the exam's answer key and make copies as needed for those who will be grading the exam.
2. Determine who will proctor the exam.\* **Note:** The exams are not part of the regular course/seminar curriculum; instructors should not give the exams during regular class time! Examples of ways to administer/proctor the exams include (but aren't limited to) the following:
  - Ask exam takers to stop by the district office during regular business hours and have your off-season staff serve as proctors.
  - Schedule evening sessions or sessions in alternative locations for exam takers who can't come in during regular business hours. Have salaried associates proctor these exams or pay off-season staff (at their regular wage) to do so.
  - If instructors agree, schedule sessions before or after class during which the instructors can proctor the exam. Pay the instructors at their training/meeting wage for the extra time.
  - An instructor for one seminar could proctor the exam for another seminar during class time. For example, a *Sole Proprietorships* instructor could proctor the *Everyone's Return* exam during one of the *Sole Proprietorships* sessions. However, because of the time limits, such proctoring will detract from the regular class, so this option should be used **only** for exam takers who absolutely can't come in at any other time. The instructor would receive no additional compensation for these exams.
3. Inform potential exam takers of the available exam time and locations.
4. The proctor gives each exam taker the appropriate exam and a copy of the answer sheet. The proctor informs the exam taker of the time limit for the exam and explains that all answers are to be placed on the answer sheet. (If the exam has fewer than 35 questions, the proctor may explain that the exam taker should fill in only as many blanks as there are questions.)
5. When the exam taker has finished or the time limit has been met, the proctor collects both the exam and the answer sheet. **Note:** No exam taker may remove the exam from the testing area.
6. Grading the exam. The decision on who should grade the exam should be based on the same criteria as the decision on proctors.\* To score the exam, compare the exam taker's answer sheet with the answer key. To get the percentage score, divide the number of correct answers by the total number of questions. For example, if the exam taker misses one question on a 35-question exam, the percentage score is 97% (34 / 35). If the exam taker misses two questions on a 20-question exam, the percentage score is 90% (18 / 20). Exam takers must have at least an 80 percent to receive certification credit for the exam.

7. Exam retakes. The rules for retaking the exam depend on whether the exam taker is attempting to test out of a seminar series taken in 1998 – 2000 or has just completed a new seminar series.
    - For test-out purposes, an exam may be taken only twice. If the exam taker does not receive at least an 80 percent on either occasion, he or she must attend the seminar series again before taking the exam again.
    - Those who are completing a seminar series in 2001 or future years may take the exam as many times as needed to pass it.
- \* Factors involved in the decision are how "helpful" the proctor will be — each exam has a strict time limit and answers are not to be shared with exam takers — and whether the proctor plans to take a particular exam. If a would-be proctor wants to test out of a class or has taken a class and wants certification credit, he or she should take the exam before being allowed to proctor/grade it.

During the 2003 tax season, H&R Block will notify low- and moderate-income clients when they qualify for underutilized government benefit programs, prescription-drug discounts, key tax credits and savings opportunities.

These benefits can be worth thousands of dollars to families with incomes of up to \$63,350.

### ***Block Advantage***

The benefits alert is part of *Block Advantage*, tips and advice tailored to the circumstances of each tax client and delivered as a customized print-out with the final tax return at Block's 9,000 U.S. locations. *There's no additional charge for this service, which is focused on objective advice, not sales.*

### ***Financial Education***

In addition, Block will test a program of more complete, enriched financial and tax planning advice and education for clients at 130 offices. This enriched help, delivered with workbooks by specially trained professionals, will cover over 30 government benefit programs.

The aim is to customize advice for clients as they move up the financial scale from concern about cash flow and basic needs, to budgeting, to saving for emergencies, to saving for goals, to investing and, finally, to building wealth.

H&R Block's mortgage subsidiaries already support homeownership financial literacy programs like *Borrow Smart* and *Don't Borrow Trouble*.

### ***Government Benefits Alert***

The four government programs covered in the national alert are aimed at health and nutrition assistance. For a family of four, they are:

■ **Health Insurance for Children.** Free or low-cost health insurance worth about \$1,500 per child yearly is available for families with incomes up to about \$36,000 through State Children's Health Insurance Programs (SCHIP) and Medicaid.

Standards, which vary by state, may be more generous than expected. In New Jersey, for example, families with incomes up to \$63,350 may be eligible (350% of the federal poverty line).

Nearly five million eligible children are still not enrolled in such programs. Over 15% of eligible children in Alaska, Arizona, Idaho, Louisiana, Montana, Nevada, New Mexico, Oklahoma, and Texas don't participate. Overall, more than 4.6 million children now receive health insurance under SCHIP and over 20 million children receive health insurance under Medicaid.

■ **Food Stamps.** Free assistance purchasing food of up to \$452 a month, or \$5,424 yearly, is available for families with incomes up to \$23,500 through the Food Stamp Program. Eligibility and benefits vary by family size.

Over two million working American families—57% of those eligible—don't receive food benefits to which they're entitled. Less than half of eligible individuals in Colorado, California, Arizona, Wisconsin, Texas, New Hampshire, Idaho, Massachusetts, Kansas, and Nevada receive benefits. Overall, more than 19 million Americans now receive food stamp benefits.

■ **Nutrition Aid for Women, Infants and Children.** Free assistance purchasing food averaging \$70 monthly, or \$840 yearly, is available to at-risk pregnant or postpartum women, infants and children up to age five in families with incomes of up to \$33,500 through the Women, Infants and Children Program.

As many as 1.5 million families may be missing benefits, although estimates vary. Overall, about 7.5 million women, infants and children now receive WIC benefits. One in four new mothers participates in WIC, and a third of WIC participants receive no other federal aid. WIC reduces infant mortality, develops healthier babies, and reduces later health care costs.

■ **School Lunches.** Free or reduced-price meals are available for children whose families have incomes up to \$33,500 through the National School Lunch Program. Many schools also provide breakfast and after-school snacks. Half of all elementary and secondary students in the United States—27 million children—now participate in the program.

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### **Tax Credit Alerts**

H&R Block already notifies its clients of their eligibility for two important tax programs that aid low- and moderate-income families: the Earned Income Tax Credit and the Child Tax Credit.

■ **The Earned Income Tax Credit.** The Earned Income Tax Credit (EITC) is a refundable credit that provides as much as \$4,140 yearly for working families with incomes up to \$34,178. The average EITC is \$1,650.

About a quarter of eligible taxpayers don't get EITC benefits to which they are entitled—4.3 million Americans lose \$2.7 billion in benefits annually. About 38% of households with three or more qualifying children failed to claim the credit in 1999, according to a recent government study. The program provides more than \$31 billion in benefits to 20 million working households annually. Sixteen states have state EITCs based on the federal credit.

■ **Child Tax Credit.** The Child Tax Credit, worth up to \$600 for each dependent child under age 17, was expanded in 2001 to provide an additional refund to taxpayers who earn over \$10,350 in 2002 but who have little or no income tax liability.

Many low-income parents who claim children as dependents but who don't qualify for the EITC may not realize they can qualify for the Child Tax Credit. The Treasury Department reports that 611,560 eligible families lost an average of \$390 each, or \$238 million, by not claiming the credit for 2001. Of them, 74% had incomes of less than \$25,000.

### **Drug Discounts for Seniors**

H&R Block will also alert low-income clients over age 65 or disabled to private-sector discounts on prescription drugs.

■ **Prescription-Drug Discounts.** Cards offering discounts of 10%-40% on prescription drugs are available for seniors or those disabled from health-care providers, chain drug stores, and groups such as AARP. One program, for example, covers those with annual incomes under \$28,000 for individuals and \$38,000 for couples. Eligibility and cost vary by program; some offer free cards.

Health officials estimate that almost 10 million out of the 40 million seniors covered by Medicare could save as much as \$600 a year through such cards. About a third of Americans over age 65 have no prescription drug coverage. The average senior obtains 30 prescription drugs annually. Average retail prescription prices have doubled in the last decade. Medicines are for conditions such as diabetes, hypertension, high cholesterol, cancer, arthritis, and depression.

### **Incentives to Save**

A 2001 Consumer Federation report found that the typical low- to moderate-income household has net financial assets of less than \$1,000. About 64% of moderate-income households (\$20,000-\$50,000) and 79% of low-income households (under \$20,000) live paycheck to paycheck.

Since millions of Americans are in debt or don't save enough, clients will receive information on debt management and

opportunities to build assets through saving for education, homeownership, retirement and other goals.

■ **Education Savings.** H&R Block helps eligible clients use Education Savings Accounts, Qualified State Tuition Programs, and the Hope and Lifetime Learning Credits.

■ **Retirement Savings.** In 2002, H&R Block clients in 14 states used their tax refunds to open 130,000 Individual Retirement Accounts. These *Express IRAs* are invested in a FDIC-insured money-market account provided through H&R Block Financial Advisors. That test will be broadened in 2003. Clients also receive help with Keogh, SEP, and SIMPLE retirement plans, as well as 401(k) and other employer plans.

■ **Savers Credits.** H&R Block will help eligible taxpayers claim a nonrefundable credit for up to \$1,000 in annual contributions to IRAs or other retirement plans. Credits for tax years 2002-6 are available to joint filers with up to \$50,000 adjusted gross income (AGI), head of household filers with up to \$37,500 AGI, and other filers with up to \$25,000 AGI; the credit phases down near the top income ranges. The 2002 credit, available until April 15, 2003, strengthens incentives to start or expand an IRA. H&R Block supports making the credit refundable so more low-income taxpayers will be eligible.

■ **Individual Development Accounts.** H&R Block has joined with nonprofit groups in urging passage of legislation for Individual Development Accounts to provide financial education and matching federal funds of up to \$500 yearly to help millions of low-income Americans save. About 20,000 IDA accounts have already been established through local programs in 350 communities with 100 more starting.

■ **Access to Banks.** Over 10% of Americans do not have a bank account, making savings and borrowing difficult. In May, 2002, the U.S. Treasury's First Accounts Program awarded \$8.4 million in grants to 15 nonprofit groups to subsidize basic bank accounts and provide financial education for 35,445 "unbanked" low- and moderate-income citizens. H&R Block is cooperating with the Institute for Social and Economic Development in Des Moines (which received a Treasury grant) by referring eligible clients, who are interested in starting bank accounts, to the *Bank On It!* program.

### **Free Online Tax Preparation and Filing**

In 2003, H&R Block will participate in a unique public-private partnership to reduce the cost and burden of tax preparation on many low- and moderate-income taxpayers and to help the IRS achieve its goal of 80% of all tax returns filed electronically by 2007. An IRS-industry alliance will offer 60% of taxpayers, including most EITC recipients, free online tax preparation and filing through [www.irs.gov](http://www.irs.gov). H&R Block's *Online Tax Program* is among the programs featured.

***These initiatives in 2003 reflect H&R Block's continuing efforts to fulfill our mission to help our clients achieve their financial objectives by serving as their tax and financial partner.***

## TAX SIMPLIFICATION PROPOSALS: 2003

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Since 1997, H&R Block has annually sent lawmakers, Treasury and IRS officials 10 suggestions for federal tax simplification. The recommendations were developed by H&R Block's Training and Research Department which serves more than 80,000 H&R Block tax professionals who assist over 16 million clients at 9,000 U.S. offices. The proposals, distilled from over a million inquiries, are illustrative, not comprehensive. They complement those of the AICPA, ABA, and TEI, as well as those in annual reports of the IRS's Taxpayer Advocate, and those in the three-volume study by the staff of Congress' Joint Committee on Taxation (2001).

Many of our past recommendations have been adopted. In deference to the excellent work of the JCT and the Taxpayer Advocate, our 2003 proposals support many of their recommendations as well as express independent views. Our focus is on problems faced by average taxpayers.

To help ease tax burdens, we have also testified before Congress on simplification and tax reform, proposed legislation to restructure payroll taxes, helped the IRS develop simpler forms and clearer instructions, led efforts to increase the number of electronically-filed returns, and suggested improvements in earned income tax credit compliance.

Several points help keep the issue of tax code simplification in perspective<sup>1</sup>:

- The burden of complexity falls most sharply on about 20% of taxpayers, the small but significant fraction with higher incomes and more complicated financial lives—the self-employed, small business owners, those with income from passive activities or in the form of capital gains, rent, and pension or annuity disbursements. Low-income taxpayers who claim an earned income tax credit (16%) also face unusual complexity.
- For many other Americans, the tax system is relatively simple. Over 80% of tax code provisions relate to business, not individual tax returns. Two-thirds of individual filers take a standard deduction and do not itemize. About 40% of individual filers are able to use simplified, 1-2 page, short forms—1040EZs and 1040As.
- The main reasons for complexity arise from defining income, rewarding favored activities, and meeting budget needs, not from multiple progressive tax brackets.
- Much complexity stems from the legislative process which involves compromise, pressured last-minute drafting, and tailoring tax provisions to fit the funds available, resulting in phase-ins, sunsets, eligibility restrictions, etc. Simplification usually loses out to competing political needs as many voices press for complicating adjustments while there is little constituency for simplification.
- Some complexity makes the tax code fairer by finely tuning laws to individual circumstances and avoiding a one-size-fits-all model. Some complexity comes from using the code to advance non-tax social or economic policies, encouraging activities like education, retirement savings, child care, home ownership, charity, etc. Some complexity helps reduce the taxes we pay.
- The IRS is easing complexity administratively by revising forms, notices, and instructions.
- Technology and tax software dramatically reduce the burden of complexity. Over half of tax filers use professional tax preparers who use computers. Millions of other returns are prepared using online services or software like H&R Block's *TaxCut*®. Reasons include convenience, faster refunds, and financial planning, as well as complexity.
- Through a private-sector partnership with the IRS, over 60% of taxpayers are eligible for free tax preparation and e-filing online. The Free File Alliance expects to file 2.5 million returns in 2003.
- Through the IRS, 15 million taxpayers are eligible to file 1040EZ returns free by telephone and aid is available at 400 IRS sites. Volunteer groups assist another 4 million low-income or elderly taxpayers.

## EXECUTIVE SUMMARY

### Family Issues

1. Definition of Qualifying Child. Unify the definition of qualifying child for the dependency exemption, head of household filing status, and applicable credits.
2. Child Tax Credit. Make the child tax credit fully refundable.

### Education Issues

3. Qualified Education Expenses. Unify the definition of qualified education expenses.
4. Education credits. Combine the Hope and Lifetime Learning credits.
5. Higher Education Deduction. Eliminate the Higher Education deduction.

### Investments and Retirement Savings

6. Long-term Capital Gains. Simplify the calculation of tax on long-term capital gains by reducing the number of tax rates or replacing the various tax rates with a capital gain deduction.
7. Home mortgage interest. Allow points paid to refinance a home to be deducted in the year paid.
8. Deductible IRA Contributions. Eliminate income phaseouts that restrict the number of taxpayers who can make deductible contributions to an IRA.
9. Early Withdrawal Penalties. Unify the exceptions to the penalties for early withdrawals from IRAs and employer retirement plans.

### Alternative Minimum Tax

10. AMT. Reform the alternative minimum tax by increasing the exemption amount and/or by repealing adjustment for common deductions.

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## H&R BLOCK'S 2003 TAX LAW SIMPLIFICATION PROPOSALS

### 1. Simplify the Definition of a Qualifying Child

**Proposal:** Conform age, relationship, and member of household tests for all definitions of qualifying child. Change the definition of custodial parent to mean the parent with whom the child resided for the greatest period of time during the year. Retain the provision that allows the custodial parent to waive the right to claim a qualifying child's dependency exemption.

**Current law:** Five commonly-used provisions benefit taxpayers with children, but each has its own definition of qualifying child:

- The dependency exemption.
- The child tax credit.
- The earned income credit.
- The dependent care credit.
- Head of household filing status.

**Discussion:** A common definition of qualifying child would greatly simplify the application. Certain exceptions to the uniform definition will still be required, such as age limitations for the various credits.

Unifying the various definitions of qualifying child has been suggested by many commentators. For example, the JCT staff recommended a uniform definition of qualifying child that would eliminate several tests such as the joint return test and the gross income test that appear in only one or two definitions of qualifying child. The JCT staff recommended that any child below a specified age that has a specified relationship to the taxpayer and lives with the taxpayer more than one half of the taxable year is a qualifying child for each of these five benefits.

### 2. Simplify the Child Tax Credit Calculation

**Proposal:** Make the child tax credit fully refundable. Use a phase-in and/or phase-out rule to minimize the revenue effect.

**Current law:** Current law provides for a \$600 per child nonrefundable credit for eligible dependents under age 17 (gradually increasing to \$1,000 per child by 2010). For 2002, the credit is phased out at modified AGI of \$75,000 for singles, heads of household, and qualifying widowers, \$110,000 for joint filers, and \$55,000 for married taxpayers filing separately.

The child tax credit is a nonrefundable credit. However, some or all of the child tax credit may be refundable to taxpayers whose tax liability is too low to use the full amount of the otherwise allowable credit.

For tax years beginning after December 31, 2000 as much as 10% of earned income in excess of \$10,350 is refundable. The refundable amount is limited to the excess of the tentative credit (\$600 x number of qualified children) less the amount allowed as a nonrefundable credit. Families with 3 or more qualifying children may use this calculation or an alternate calculation involving the excess of social security taxes over the EITC.

**Discussion:** The basic idea of the child tax credit is simple – allow a credit of \$600 per qualifying child. Making part of the credit refundable adds an incredible amount of complexity. The current rules require the nonrefundable credits to be taken in a certain order when none of the child tax credit is refundable and most situations where a portion of the credit is refundable. However, a different order applies if a portion of the child tax credit is refundable and the taxpayer is eligible for the adoption credit, the mortgage interest credit, or the D.C. first-time homebuyers credit.

Taxpayers who are eligible for one or more of the adoption credit, the mortgage interest credit, or the DC first-time homebuyer’s credit must complete an additional worksheet to determine the amount of their refundable credit. This worksheet is extremely complex. The Treasury Inspector General reported that 700,000 eligible families failed to claim the refundable child credit because they did not complete the worksheet.

At first glance, this appears to be a very expensive proposal. However, it should be possible to limit the revenue cost with appropriate phase-in or –out rules.

#### 4. Establish a Single Definition for Qualified Education Expenses

**Proposal:** Adopt a uniform definition of qualified higher education expenses for all education incentives. The uniform definition would include expenses for tuition, books, fees, supplies, and equipment required for enrollment or attendance, and room and board for students who are attending school at least half-time. Qualified expenses would not include expenses with respect to any course or other education relating to sports, games, or hobbies other than as part of a degree program.

**Current law:** Several provisions of the Internal Revenue Code refer to “higher education expenses.” These provisions include the Hope and Lifetime Learning credits, Coverdell education savings accounts, qualified tuition programs, the exclusion from income for interest on EE bonds, the student loan interest deduction, the exception to the early withdrawal penalty for distributions from IRAs, and the new tuition and fees deduction.

Incentive	Tuition/Fees	Room/Board	Books	Other
Hope Credit	X*			
Lifetime Learning Credit	X			
Education Savings Account	X	X	X	Primary/secondary expenses, Internet connection computers, etc.
Section 529 Plan/ “QTP”	X	X	X	
EE Bond Interest Exclusion	X			ESA and QTP contributions
Student Loan Interest Deduction	X	X	X	

IRA – exception to early withdrawal penalty	X	X **	X	
Tuition and Fees Deduction	X			

\*Degree requirement

\*\*Provided student is enrolled at least half-time

**Discussion:** Establishing a single definition for qualified education expenses reduces confusion because taxpayers will no longer have to decipher differences in the tax treatment of various expenses. Eliminating multiple definitions reduces the possibility of inadvertent errors by taxpayers and tax professionals.

## 5. Hope and Lifetime Learning Credits

**Proposal:** Combine the Hope and Lifetime Learning credits into one education credit. The new credit would be 20% of qualified education expenses (using a proposed uniform definition). The maximum credit would be \$2,000 *per-student*, based on maximum eligible expenses of \$10,000.

**Current Law:** The Hope Credit is a nonrefundable credit against Federal income taxes. The maximum credit amount is \$1,500 per student, representing 100% of the first \$1,000 of qualified tuition and related expenses and 50% of the next \$1,000 of qualified expenses. The credit is phased-out for modified adjusted gross incomes above \$40,000 (\$80,000 for joint returns). The credit is available for two taxable years, provided that the student has not completed the first two years of post-secondary education before the beginning of the second taxable year. The student must be enrolled at least half-time in a degree, certificate, or other program leading to a recognized educational credential at an eligible educational institution.

The Lifetime Learning credit is also a nonrefundable credit but it varies in several ways from the Hope credit. The Lifetime Learning credit is equal to 20% of qualified tuition and related expenses. The maximum credit is \$1,000 *per return* (\$2,000 for expenses paid after Dec. 31, 2002). The educational expenses must be paid to an eligible educational institution. The Lifetime Learning credit is not based on a student's workload and there is no limit as to the number of years for which the credit can be taken. The credit is phased out over the same range as the Hope credit. The Hope and Lifetime Learning credits cannot be taken in the same year for the same student.

**Discussion:** The education credits serve similar purposes, but they apply different percentages to different base amounts. The Hope credit can be taken for no more than two years. In addition, the Hope credit is available on a per-student basis and the Lifetime Learning credit on a per-return basis. Currently, a student eligible for the Hope credit will always receive a larger credit under the Hope provisions. However, because the Hope credit may only be claimed for two years, taxpayers must often make a choice whether to claim the credit for the first year (which often includes only one semester of expenses) or wait and take the credit for the following two years. After 2002, when the amount of qualifying expenses for the Lifetime Learning credit increases to \$10,000, many families will need to calculate both credits to determine which is more advantageous. Combining the credits will eliminate all of these issues. Families with two or more qualifying students could benefit substantially.

## 6. Higher Education Deduction.

**Proposal:** Eliminate the higher education deduction, and increase the phase-out range for the unified education credit to include those taxpayers who are currently eligible for the higher education deduction.

**Current Law:** The higher education deduction, a provision included in EGTRRA, first became effective in 2002. This deduction primarily benefits taxpayers who are in or beyond the phase-out limits for the education credits. Current law allows a deduction of up to \$3,000 for qualified tuition and fees for taxpayers with a modified AGI of \$65,000 or below (\$130,000 or below for MFJ filers).

**Discussion:** The tuition and fees deduction allows more taxpayers to claim a benefit for their higher education expenses. It also introduced yet another choice that taxpayers must make concerning incentives intended to provide similar benefits. Eliminating the deduction and expanding the eligibility for a unified education credit eliminates the need to make the choice while providing a comparable benefit.

This deduction is scheduled to expire after 2005.

## 6. Simplify the Treatment of Long-term Capital Gains

**Proposal:** Replace multiple capital gains rates with a deduction.

**Current Law:** In 2001, long-term capital gains may be taxed at a maximum rate of 8, 10, 20, 25, or 28% depending on the holding period and the type of investment. A taxpayer could have gains on a single year's return taxed at several of these rates. In addition, an 18% rate will be available in 2006.

**Discussion:** Calculation of the tax on capital gains required 36 lines on the tax year 2000 Schedule D. As a result of the addition of the 8% rate for tax year 2001, the IRS has moved several pieces of the calculation to separate worksheets. Thus, the tax calculation on the 2002 Schedule D requires only 22 lines, but several additional worksheets may be required. If the various capital gains rates are replaced with a capital gains deduction, Schedule D will be much shorter. A capital gains deduction would also simplify the foreign tax credit calculation.

## 7. Simplify the Home Mortgage Interest Deduction

**Proposal:** Allow a deduction for all home mortgage points in the year paid.

**Current law:** Points paid to buy, build or improve a personal residence are deductible in the year paid. Points paid to refinance a mortgage on a personal home must be amortized over the life of the new mortgage.

**Discussion:** Taxpayers, and even some tax professionals, are not aware of the limitation on deducting points for refinanced loans. This change is particularly relevant in light of the current level of refinancing.

## 8. Eliminate Phaseouts for Deductible IRA Contributions

**Proposal:** Remove income limitations for contributions to IRAs.

**Current law:** The allowable deduction for contributions to an IRA is limited for “active participants” in a qualified retirement plan. The deduction is also limited for individuals who are not active participants but who are married to active participants. Individuals who are not active participants and who are not married to active participants do not have an income limitation. The chart below summarizes the 2002 limitations (based on modified adjusted gross income) that apply depending on filing status and which spouse is an active participant.

Filing Status	Phaseout Range Active Participant	Phaseout Range: Nonactive Participant
Single/Head of Household	\$34,000 - \$44,000	N/A
Married Filing Jointly	\$54,000 - \$64,000	\$150,000 - \$160,000
Married Filing Separately – spouses lived together at any time during the year	\$0 - \$10,000	\$0 - \$10,000
Married Filing Separately – spouses lived apart all year	\$34,000 - \$44,000	N/A

**Discussion:** The rules are extremely complex. The definition of active participant can be confusing. The phaseout limits generally begin at relatively low incomes. Keeping track of nondeductible basis is also a burden that could be eliminated for future contributions.

## 9. Unify Exceptions to the Penalties for Early Retirement Plan Distributions

**Proposal:** Unify the exceptions to the penalties for early withdrawals from IRAs and employer retirement plans.

**Current law:** Taxable distributions from IRAs and from qualified retirement plans made before age 59½ are subject to an additional 10% tax unless they qualify for an exception. Some exceptions, such as distributions on account of death or disability, apply to all tax-favored retirement plans. However, the exceptions for distributions for higher education expenses and for first-time homebuyers apply only to IRAs. The exception for distributions made after separation from service after age 55 applies only to pension plans.

**Discussion:** Eliminates a source of confusion and frustration which traps unwary taxpayers. For example, if an individual retires under a qualified retirement plan at age 55, distributions from that plan are not subject to the early withdrawal penalty. If that individual rolls his money into an IRA and then begins taking distributions before age 59½, the distributions are subject to an early withdrawal penalty (unless another exception applies).

## 10. Reform the Alternative Minimum Tax

**Proposal:** Reform the alternative minimum tax increasing the exemption amount and simplifying the rules.

**Current Law:** The minimum tax — a separate, alternative tax system within the income tax code — is a major source of complexity. The current version was designed to ensure that “no taxpayer with substantial economic income should be able to avoid all tax liability by using exclusions, deductions and credits.”<sup>2</sup> The AMT is imposed to the extent that a taxpayer’s tentative minimum tax exceeds his or her regular tax liability. AMT income is the taxpayer’s taxable income increased by certain adjustments and preference items. Adjustments include disallowance of such mundane tax benefits as the standard deduction and personal exemptions. Preference items include such things as accelerated depreciation and gain on incentive stock options. The tentative minimum tax is computed using the amount of alternative minimum taxable income in excess of a phased-out exemption amount. The exemption amount has been slightly increased for tax years 2001 – 2004, but otherwise has remained unchanged since 1993.

The AMT was originally intended to ensure that high-income individuals do not unduly benefit from tax breaks not available to the average taxpayer such as deductions from passive investments. Under current law, however, families whose only “undue tax benefit” is the fact that they have several dependent children can be hit with AMT.

**Discussion:** Repeal of the individual AMT system would remove a major source of complexity but be very costly. Increasing the exemption amount, indexing it for inflation, simplifying the rules, and allowing personal credits to offset regular tax liability would eliminate some of the problems associated with the current system—complex calculations, definitional problems, unintended results, and a perception that the system is both unfair and irrational—while minimizing revenue loss and maintaining the goal of ensuring that taxpayers with substantial economic income incur some tax liability.

One problem that has caused a great deal of concern in the last year is taxation of unrealized gains associated with incentive stock options. Although these gains are exactly the kinds of “substantial economic gains” the current AMT regime is intended to tax, many taxpayers suffered unintended hardships because they were unable to convert their paper economic gains into realized gains.

Some modification is needed to halt expected sharp increases in the number of affected taxpayers over the next decade. Increasing the AMT floor and /or allowing common deductions for AMT purposes would reduce the number of taxpayers affected by AMT and refocus the tax on the higher-income individuals it was originally intended to affect.

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<sup>1</sup> For earlier H&R Block views on tax code simplification, see “*Statement of Robert A. Weinberger, Vice President, Government Relations, H&R Block, on Tax Code Simplification*,” before the Subcommittee on Oversight of the House Committee on Ways & Means, including H&R Block’s 1998 simplification proposals, June 23, 1998 [Serial 105-46]; and “*Statement of Kathy T. Burlison, Tax Research and Training Associate, H&R Block, on Complexity of the Individual Income Tax*,” before the Senate Committee on Finance, April 15, 1999.

<sup>2</sup> Joint Committee on Taxation, *General Explanation of the Revenue Provisions of the Tax Equity and Fiscal Responsibility Act of 1982* (JCS-38-83), December 31, 1982, at 17-18.