Return Preparers who fail to comply with the EITC due diligence requirements can be assessed a $100 penalty for each failure. (IRC section 6695(g)) The assessment of return-related penalties against a tax preparer may result in disciplinary action by the IRS Office of Professional Responsibility, suspension or expulsion of the preparers's firm from participation in IRS e-file, and injunction proceedings resulting in barring the practitioner from preparing tax returns.

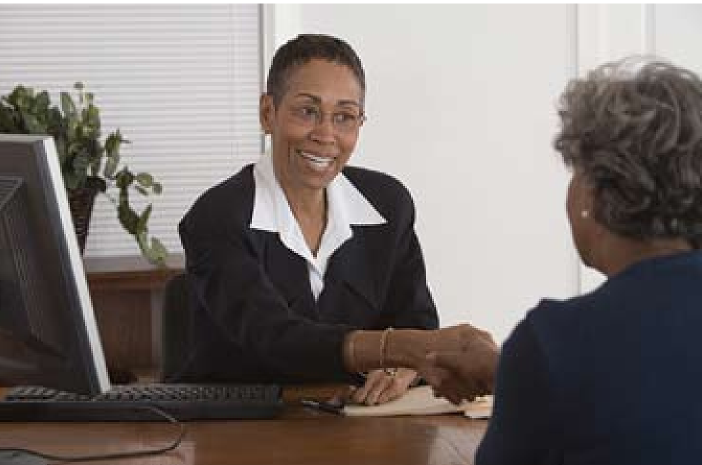
There are three simple steps the practitioner can take to avoid the issues that cause 80 percent of EITC errors:

The steps are:

1. Know the EITC tax law and eligibility rules. Software is not a substitue for tax preparer knowledge of EITC tax law.
2. Review Social security cards for all individuals on the return.
3. Practice EITC Due Diligence.

The following four issues caused 80 percent of EITC errors:

1. Claiming a child who is not a qualifying child.
2. Filing as single or head of household when married.
3. Incorrectly reporting income.
4. Using an incorrect Social Security Number or incorrect last name.



For more information about EITC and EITC Due Diligence, see:

- www.irs.gov/taxpro
- www.irs.gov/eitc
- Publication 596, Earned Income Credit

EARNED
INCOME
TAX
CREDIT

IRS Department of the Treasury Internal Revenue Service
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EITC

due diligence is more than a check mark on a form or clicking through tax preparation software…

- **Know the requirements**
- **Avoid possible penalties**
- **Get the facts**

earned income tax credit

PERSONS who prepare tax returns claiming the Earned Income Tax Credit (EITC) are subject to four due diligence requirements focused on accurately determining the taxpayer's eligibility for, and computation of the credit.

Three of the requirements address form completion and recordkeeping issues. The fourth, and most challenging, requires paid preparers to thoroughly understand the EITC tax laws and ask reasonable questions.

To meet the due diligence requirements, EITC tax return preparers must:

1. Complete Form 8867, Paid Preparer's Earned Income Credit Check List, or equivalent document with the same information.
   - Parts I-III of Form 8867 contains 19 questions covering basic EITC qualifications.
   - The subsections are divided by:
     i) All taxpayers
     ii) Taxpayers with a qualifying child
     iii) Taxpayers without a qualifying child.
   - Preparers must ask and explain each of the applicable questions in Parts I-III to every EITC client.
   - Preparers must also personally answer the four due diligence questions in Part IV.
2. Complete the EITC worksheet, or one with the same information, found in the Form 1040 series instructions and IRS Publication 596.
   - The EITC worksheet reflects the computations for self-employment income, total earned income, investment income and adjusted gross income.
   - Most tax preparation software includes an EITC worksheet.
3. Keep Form 8867, the EITC worksheet (or the equivalent of each), and a record of how, when and from whom the information used to prepare the return was obtained. These documents must be kept for three years from the June 30th following the date the return or claim for refund was presented to the taxpayer for signature.
   - The when aspect is documented by the tax return
   - The who and how aspects are generally documented by either the interview software or a paper intake sheet completed by client
   - Preparers can keep these records in either paper or electronic format.
4. Not know or have reason to know that any information used to determine the taxpayer's eligibility for or the amount of the credit is incorrect. Preparers must make reasonable inquiries of their clients if the information appears incorrect, incomplete or inconsistent.
   - The preparer must use common sense to evaluate client-provided information.
   - More than 90 percent of due diligence penalties are assessed for failure to comply with this requirement.

To comply with the knowledge requirement, tax preparers should:

- Apply a common sense standard to client provided information;
- Evaluate whether the information appears to be complete and identify any missing facts;
- Determine whether the information is consistent; recognize contradictory statements or statements that are inconsistent with what you know to be true;
- Conduct a thorough, in-depth interview with every client, every year;
- Ask questions when client information appears to be incomplete, incorrect or inconsistent. Ask enough questions to ensure the return is correct and complete.

Examples where additional inquiries must be made to meet the due diligence knowledge requirement include:

A. A client states that she is separated from her spouse. A child lives with her and she wants to claim EITC as Head of Household. In reviewing the client's records it is apparent she earns a minimal income, which appears insufficient to support a household – pay rent/mortgage, electric, water, food, clothing, school supplies, etc.

The return preparer should ask appropriate questions to determine the client's correct filing status and determine how long the child lived with each parent during the year and probe for any additional sources of income. Such as is the taxpayer divorced or legally separated? Did the spouse live in the home with the taxpayer during the last half of the year? How long did the child live with each parent?

B. An 18 year old client mentions that she and her daughter live with her parents. She earned $3,000 from a part-time job and wants to claim EITC.

The return preparer should ask appropriate questions to determine if this taxpayer is a qualifying child of her parents and therefore ineligible to claim EITC.

C. Client Smith is 22 years old and claims to have two sons ages 10 and 11 that are his qualifying children for EITC.

Since the ages of the children appear inconsistent with the client's age, the return preparer should ask appropriate questions to determine if the children are really his qualifying Childeren.

D. Client Jones states that she is head of her household and has two children ages 13 and 14. She states that she earned $12,000 as a self-employed hairdresser, but had no expenses.

Since it is unusual to incur no expenses in the production of income, it appears the client may be providing incomplete information. The return preparer should ask appropriate questions to determine whether a business exists and what, if any, expenses were incurred.