



Earned Income Tax Credit Preparer Due Diligence

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A Balanced Approach

- Increase program participation
- Reduce erroneous payments



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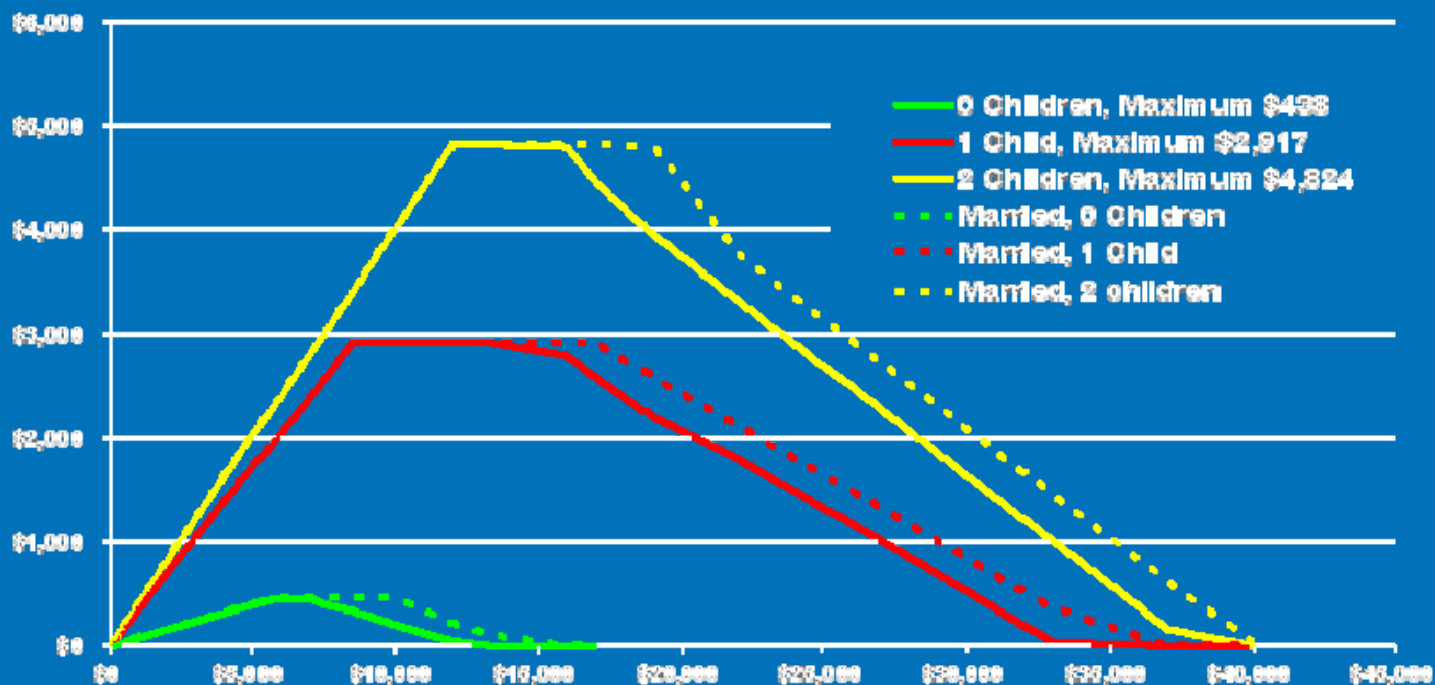
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EITC Facts

- For Tax Year 2006, over \$22M returns were credited with over \$43B in EITC
- The number of individuals claiming EITC is high, and erroneous payments are also high
 - Participation is estimated at 75 to 80%
 - 23 to 28% error rate according to current estimates



For 2008, the Maximum EITC is \$4,824



- ✓ Credit phases out as income increases
- ✓ Claiming children raises the limit on income eligibility and increases the value of the credit
- ✓ If married, income eligibility increases up to \$3,000

EITC Environment

**70% of EITC
Taxpayers
Use Paid
Preparers**

**Over 80% of EITC
Returns Filed
Electronically**

**Qualifying Children,
Filing Status &
Income Reporting
Errors =
Main Areas of
Noncompliance**

**\$10 – 12B in
Erroneous
Payments**

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Why Talk About Due Diligence?

- Preparer community's feedback regarding due diligence guidance
- GAO and external audit results
- Recent criminal cases and injunctions



A Balanced Approach to Addressing Due Diligence

Outreach and Education:

- Partnership with software developers to make enhancements
- Developing EITC training modules
- New IRS due diligence regulations

A Balanced Approach to Addressing Due Diligence

Compliance:

- Due Diligence Visits (DDV) / Audit Program
- E-file Sanctions
- Injunction Actions Barring Preparers from Return Preparation
- Criminal Prosecutions

EITC Due Diligence Is NOT Just A Checkmark On A Form!



8867
Form 8867 (Rev. December 2005)
Department of the Treasury
Internal Revenue Service

Paid Preparer's Earned Income Credit Checklist OMB No. 1545-1028

Do not send to the IRS. Keep for your records.

For the definitions of the following terms, see Pub. 596 for the year for which you are completing this form.
• Investment in a business that produces earned income

A Taxpayer's name _____

B If joint _____

Part I

You are completing this form ▶ _____

Are you filing separately? _____

If you checked "No" on line 1, stop; the taxpayer cannot take the EIC. Otherwise, continue.

Does the taxpayer (or the taxpayer and spouse if filing jointly) have a social security number that allows him or her to work for pay for tax purposes? See instructions for answering _____ Yes No

If you checked "No" on line 2, stop; the taxpayer cannot take the EIC. Otherwise, continue.

Did the taxpayer (or the taxpayer and spouse if filing jointly) have earned income for the year? _____ Yes No

If you checked "No" on line 3, stop; the taxpayer cannot take the EIC. Otherwise, continue.

6 Did the taxpayer's (or the taxpayer and spouse's if filing jointly) earned income for the year exceed the limit that applies to the year on line 3? _____ Yes No

If you checked "Yes" on line 6, stop; the taxpayer cannot take the EIC. Otherwise, continue.

7 Could the taxpayer, or the taxpayer and spouse if filing jointly, be claimed as a dependent on another person's tax return for the year on line 6? _____ Yes No

If you checked "Yes" on line 7, stop; the taxpayer cannot take the EIC. Otherwise, go to Part II or Part III, whichever applies.

For Paperwork Reduction Act Notice, see page 4. Cat. No. 25142H Form 8867 (Rev. 12-2005)

Internal Revenue Code § 6695(g) – Due Diligence Requirements

Checklist Completion



1

Credit Computation



2

Knowledge of Correct Taxpayer Information



3

Record Retention



4

Requirement #1-Form 8867, Paid Preparer's Earned Income Credit Checklist (or its equivalent)



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Form 8867 (Rev. 12-2006)		Page 3
Part III Taxpayers Without a Qualifying Child		
Part IV Due Diligence Requirements		
20	Did you complete Form 8867 based on information provided by the taxpayer or reasonably obtained by you?	<input type="checkbox"/> Yes <input type="checkbox"/> No
21	Did you complete the EIC worksheet found in the Form 1040, 1040A, or 1040EZ Instructions (or your own worksheet that provides the same information as the 1040, 1040A, or 1040EZ worksheet)?	<input type="checkbox"/> Yes <input type="checkbox"/> No
22	Did you comply with the knowledge requirements? (To comply with the knowledge requirements, you must not know or have reason to know that any information used to determine the taxpayer's eligibility for, and the amount of, the EIC is incorrect. You may not ignore the implications of information furnished to or known by you, and you must make reasonable inquiries if the information furnished appears to be incorrect, inconsistent, or incomplete.)	<input type="checkbox"/> Yes <input type="checkbox"/> No
23	Did you keep the following records? <ul style="list-style-type: none"> • Form 8867 (or your own form or files), • The EIC worksheet(s) or your own worksheet(s), and • A record of how, when, and from whom the information used to prepare the form and worksheet(s) was obtained <p>▶ If you checked "Yes" on lines 20, 21, 22, and 23, and keep the records described on line 23 for 3 years (see instructions), you have complied with all the due diligence requirements.</p> <p>▶ If you checked "No" on line 20, 21, 22, or 23, you have not complied with all the due diligence requirements and may have to pay a \$100 penalty for each failure to comply.</p>	<input type="checkbox"/> Yes <input type="checkbox"/> No

Requirement #2 – Credit Computation

OR

Form 1040—Lines 66a and 66b

Lines 66a and 66b—Earned Income Credit (EIC)

What is the EIC?
The EIC is a credit for certain people who work. The credit may give you a refund even if you do not owe any tax.

To Take the EIC:

- Follow the steps below.
- Complete the worksheet that applies to you or let the IRS figure the credit for you.
- If you have a qualifying child, complete and attach Schedule EIC.

For help in determining if you are eligible for the EIC, go to www.irs.gov/efile and click on "EIC Assistant." This service is available in English and Spanish.

⚠️ If you take the EIC even though you are not eligible and it is determined that your error or false information or intentional disregard of the law rules, you will not be allowed to take the credit for 2 years from the date you are determined eligible or for 10 years from the date the EIC was allowed to be taken for 10 years. See Form 5622, *Who must file to get the credit?* You must also have to pay penalties.

Step 1 All Filers

- Are you 2007:
 - 1. A childless level with you, in the amount on Form 1040, line 18, less than \$37,733 (\$30,763 if married filing jointly)?
 - Yes. Continue.
 - No. Skip question 2, go to question 4.
 - A child level with you, in the amount on Form 1040, line 18, less than \$37,733 (\$30,763 if married filing jointly)?
 - Yes. See Form 4797.
 - No. Skip question 2, go to question 4.
- Are you filing Form 4797 (relating to sales of business property)?
 - Yes. See Form 4797.
 - No. You cannot take the credit.
- Do any of the following apply to 2007?
 - You are filing Schedule E.
 - You are reporting income on a line from the credit of personal property and used as a trade or business.
 - You are reporting income on Form 1040, line 21, from Form 8879 (relating to election to report child's interest and dividends).
 - You are using Worksheet 1 in Pub. 208 as part of your tax return.

Step 2 Investment Income

- Add the amounts from Form 1040:

Line 8a	_____
Line 8b	_____
Line 8c	_____
Line 12F	_____

 Investment Income = _____
- If line 13 is a box, enter -0-.
 - Yes. Continue.
 - No. Skip question 2, go to question 4.

Step 3 In your 2007:

- Did you, and your spouse if filing a joint return, have a child or other dependent that allows you to work or to claim the EIC payment (see page 47)?
 - Yes. Continue.
 - No. You cannot take the credit.
- Are you filing a joint return?
 - Yes. You must use Worksheet 1 in Pub. 208 as part of your tax return.
 - No. Go to Step 3.

Need more information or forms? See page 82.

Form 1040—Lines 66a and 66b

Step 4 Filers Without a Qualifying Child

- Is the amount on Form 1040, line 18, less than \$12,500 (\$8,000 if married filing jointly)?
 - Yes. Continue.
 - No. Skip Step 4, go to line 66a.
- Could you, or your spouse if filing a joint return, be a qualifying child of another person in 2007?
 - Yes. Continue.
 - No. Skip Step 4, go to line 66a.
- Could you, or your spouse if filing a joint return, be a dependent on someone else's 2007 tax return?
 - Yes. Continue.
 - No. Skip Step 4, go to line 66a.
- Were you, or your spouse if filing a joint return, at least age 25 but under age 65 at the end of 2007?
 - Yes. Continue.
 - No. Skip Step 4, go to line 66a.
- Were you born, and your spouse if filing a joint return, in the United States for more than half of 2007? (Members of the military stationed outside the United States, see page 47.)
 - Yes. Go to Step 5.
 - No. You cannot take the credit. Enter "No" on the dotted line next to line 66a.

Need more information or forms? See page 82.

Step 4 How to Figure the Credit

- Do you use the IRS figure for the credit for you?
 - Yes. See Credit.
 - No. Go to Worksheet A, figure 2 for the IRS.

Definitions and Special Rules
(Used in alphabetical order.)

Adopted child. An adopted child is always treated as your own child. An adopted child includes a child lawfully placed with you for legal adoption.

Childless spouse. Determine how much the amount on Form 1040, line 18, was also reported on Schedule SE, line 1e, before that amount from that spouse on Form 1040, line 1, and report the result in the first space of Step 4, line 2. Do not use "Yes" in question 1 in Step 2.

Child. The following instructions apply to minors, members of religious orders who have not taken vows of poverty, and Christian Science practitioners. If you are filing Schedule SE and the amount on line 1e of that schedule includes an amount that was also reported on Form 1040, line 7:

- Enter "Step 1" on the dotted line next to Form 1040, line 18.
- Determine how much of the amount on Form 1040, line 7, was also reported on Schedule SE, line 2.
- Subtract that amount from the amount on Form 1040, line 18.
- Do not use answer "Yes" in question 1 in Step 2.

Childless spouse. If you were a member of the U.S. Armed Forces who served in a combat zone, certain pay is excluded from your income. See *Combat Zone Exclusion* in Pub. 1. You can elect to include this pay in your earned income when figuring the EIC. The amount of pay normally excluded pay should be shown in box 12 of Form 1042 with code Q. If you are filing a joint return and both you and your spouse received or received certain pay, you must attach both your own return.

Credit figured by the IRS. To have the IRS figure your EIC:

- Enter "EIC" on the dotted line next to Form 1040, line 66a.
- Do not use the nonrefundable credit pay you elect to include as earned income on Form 1040, line 66b. See *Combat Zone Exclusion* above.
- If you have a qualifying child, complete and attach Schedule EIC. If your EIC for a year after 1996 was reduced or disallowed, see Form 5622, *Who must file to get the credit?*

Need more information or forms? See page 82.



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Requirement #3-Knowledge Requirement

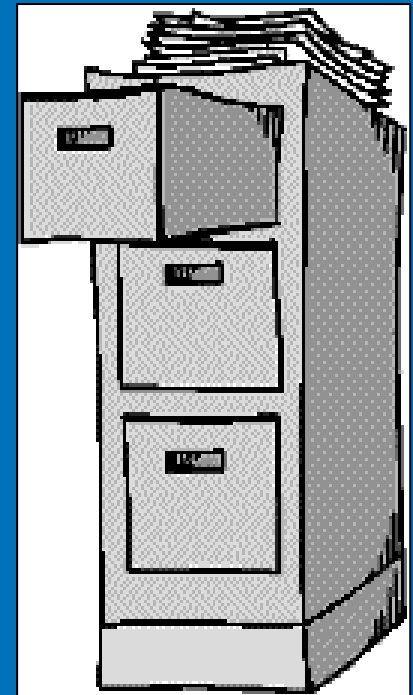
Requires tax return preparer to:

- Evaluate the information received from the client
- Apply a **consistency** and **reasonableness** standard to the information
- Ask additional questions when applicable
- Make reasonable inquiries if the information appears to be incorrect, inconsistent, or incomplete
- Document additional inquiries and the client's response

Requirement #4 - Recordkeeping

Tax Return Preparers Must Keep:

- Form 8867 or its equivalent
- EIC worksheet or its equivalent
- Record of how information was furnished and who furnished the information used to prepare EITC claim



The Knowledge Requirement is Addressed in New Proposed Regs. 1.6695-2

- A tax return preparer must make reasonable inquiries **if a reasonable and well-informed tax return preparer knowledgeable in the law** would conclude that the information furnished to the tax return preparer appears to be incorrect, inconsistent, or incomplete.
- The tax return preparer must also **contemporaneously document** what additional **inquiries** were made and the client **responses** to these inquiries.

Not as Easy as it Looks

I TAKE CREDIT

- 1 Must have earned income
- 2 Must have a valid Social Security number
- 3 Cannot file as married filing separately
- 4 Generally cannot be a nonresident alien
- 5 Cannot be a qualifying child of another person
- 6 Cannot be filing Form 2555 or Form 2555-EZ
- 7 Investment income amount is limited

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Department of the Treasury
Internal Revenue Service
www.irs.gov/eitc
Pub 41340EN038F1 (Rev. 6-09)
Catalog Number 37260Y

FO

3 Misreporting Income

4 Incorrect Social Security Numbers

Qualifying Children

RELATIONSHIP AGE

Is a son or daughter (including an adopted child or child placed for adoption),
At the end of the filing year was:
Younger than 19, or
Stepchild, the stepparent placed by an authorized placement agency or
younger than 24 and a full-time student, or
any age if permanently and totally disabled at
any time during the year
brother, sister, stepbrother, stepsister or a
descendant of any of them.

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Example Scene 1

- A client wishing to have her taxes prepared informs you:
 - She is separated from her spouse
 - Her child, who is 7 years old, lives with her and she wants to claim EITC



Does This Scenario Prompt You to Ask More Questions?

You ask...

- Are you still married?
- When did you separate from your husband?
- Did you move to separate homes, and if so, when?
- How long during the year did your child live with you?
- Did you live with anyone else ?

She says...

- Yes, I'm still married but separated
- January of last year
- Yes, in January of last year
- My child lived with me every day except every other weekend and two weeks in the summer
- No, I didn't live with anyone

You Say...

- It looks like you may qualify for EITC. I'll go through the rest of the questions and do the computations to make sure.

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Form 8867 Paid Preparer's Earned Income Credit Checklist OMB No. 1545-0047
Rev. December 2006
Department of the Treasury
Internal Revenue Service
Do not send to the IRS. Keep for your records.

For the definitions of the following terms, see Pub. 596 for the year for which you are completing this form.
■ Investment Income ■ Qualifying Child ■ Earned Income

Part I All Taxpayers

1 Year after 2005 for which you are completing this form: _____ Yes No

2 Is the taxpayer's filing status married filing separately? _____
If you checked "Yes" on line 2, stop; the taxpayer cannot take the EIC. Otherwise, continue.

3 Does the taxpayer (and the taxpayer's spouse if filing jointly) have a social security number (SSN) that allows him or her to work or is valid for EIC purposes? See the instructions before answering. _____
If you checked "No" on line 3, stop; the taxpayer cannot take the EIC. Otherwise, continue.

4 Is the taxpayer filing Form 2555 or Form 2555-EZ (relating to the exclusion of foreign earned income)? _____
If you checked "Yes" on line 4, stop; the taxpayer cannot take the EIC. Otherwise, continue.

5a Was the taxpayer a nonresident alien for any part of the year on line 1? _____
If you checked "Yes" on line 5a, go to line 5b. Otherwise, skip line 5b and go to line 6.

b Is the taxpayer's filing status married filing jointly? _____
If you checked "Yes" on line 5a and "No" on line 5b, stop; the taxpayer cannot take the EIC. Otherwise, continue.

6 Is the taxpayer's investment income more than the limit that applies to the year on line 1? See Pub. 596 for the limit. _____
If you checked "Yes" on line 6, stop; the taxpayer cannot take the EIC. Otherwise, continue.

7 Could the taxpayer, or the taxpayer's spouse if filing jointly, be a qualifying child of another person for the year on line 1? _____
If you checked "Yes" on line 7, stop; the taxpayer cannot take the EIC. Otherwise, go to Part II or Part III, whichever applies.

Form 8867 must be filed. Go to line 20.

	Child 1	Child 2
1	Yes <input type="checkbox"/> No <input type="checkbox"/>	Yes <input type="checkbox"/> No <input type="checkbox"/>
2	Yes <input type="checkbox"/> No <input type="checkbox"/>	Yes <input type="checkbox"/> No <input type="checkbox"/>
3	Yes <input type="checkbox"/> No <input type="checkbox"/>	Yes <input type="checkbox"/> No <input type="checkbox"/>
4	Yes <input type="checkbox"/> No <input type="checkbox"/>	Yes <input type="checkbox"/> No <input type="checkbox"/>
5	Yes <input type="checkbox"/> No <input type="checkbox"/>	Yes <input type="checkbox"/> No <input type="checkbox"/>
6	Yes <input type="checkbox"/> No <input type="checkbox"/>	Yes <input type="checkbox"/> No <input type="checkbox"/>
7	Yes <input type="checkbox"/> No <input type="checkbox"/>	Yes <input type="checkbox"/> No <input type="checkbox"/>
8	Yes <input type="checkbox"/> No <input type="checkbox"/>	Yes <input type="checkbox"/> No <input type="checkbox"/>
9	Yes <input type="checkbox"/> No <input type="checkbox"/>	Yes <input type="checkbox"/> No <input type="checkbox"/>
10	Yes <input type="checkbox"/> No <input type="checkbox"/>	Yes <input type="checkbox"/> No <input type="checkbox"/>
11	Yes <input type="checkbox"/> No <input type="checkbox"/>	Yes <input type="checkbox"/> No <input type="checkbox"/>
12	Yes <input type="checkbox"/> No <input type="checkbox"/>	Yes <input type="checkbox"/> No <input type="checkbox"/>
13	Yes <input type="checkbox"/> No <input type="checkbox"/>	Yes <input type="checkbox"/> No <input type="checkbox"/>
14	Yes <input type="checkbox"/> No <input type="checkbox"/>	Yes <input type="checkbox"/> No <input type="checkbox"/>
15	Yes <input type="checkbox"/> No <input type="checkbox"/>	Yes <input type="checkbox"/> No <input type="checkbox"/>
16	Yes <input type="checkbox"/> No <input type="checkbox"/>	Yes <input type="checkbox"/> No <input type="checkbox"/>
17	Yes <input type="checkbox"/> No <input type="checkbox"/>	Yes <input type="checkbox"/> No <input type="checkbox"/>
18	Yes <input type="checkbox"/> No <input type="checkbox"/>	Yes <input type="checkbox"/> No <input type="checkbox"/>
19	Yes <input type="checkbox"/> No <input type="checkbox"/>	Yes <input type="checkbox"/> No <input type="checkbox"/>
20	Yes <input type="checkbox"/> No <input type="checkbox"/>	Yes <input type="checkbox"/> No <input type="checkbox"/>

Page 9

use if filing jointly, in the active duty outside the period. See Pub. 596.) Yes No

the EIC. Otherwise, Yes No

25 but under age 65 at Yes No

the EIC. Otherwise, Yes No

med as a dependent on Yes No

the EIC. Otherwise, Yes No

less than the limit that Yes No

... If you checked "Yes" checked or disallowed for d. Go to line 20.

or reasonably obtained Yes No

the EIC instructions for your 040EZ worksheet? Yes No

dedge requirements, you the taxpayer's eligibility is of information furnished has furnished appears to Yes No

the form and worksheet(s) Yes No

... records described on line diligence requirements.

Form 8867 (Rev. 12-2006)

Form 8867 (Rev. 12-2006)

If you checked "No" on line 20, 21, 22, or 23, you have not complied with all the due diligence requirements and may have to pay a \$100 penalty for each failure to comply.

Scene 1--Take 2

You ask...

- Are you still married?
- When did you separate from your husband?
- When did you stop living in the same home?
- Are you going to file a tax return with your husband?

She says...

- Yes, I'm still married but separated
- November of last year
- I moved out when we separated in November
- No, I want my own refund

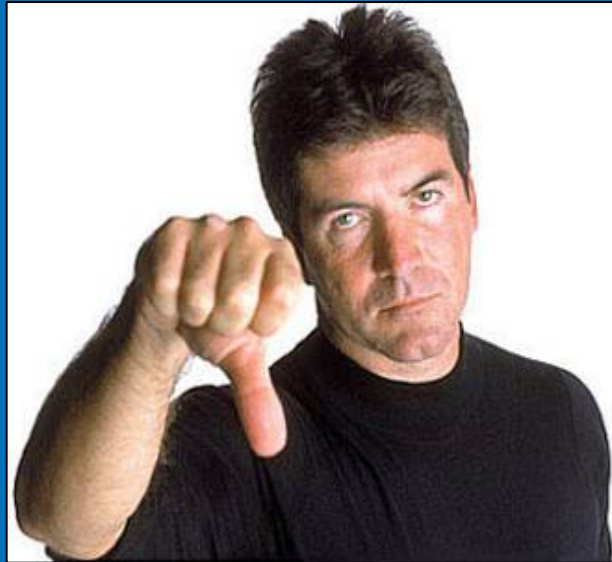
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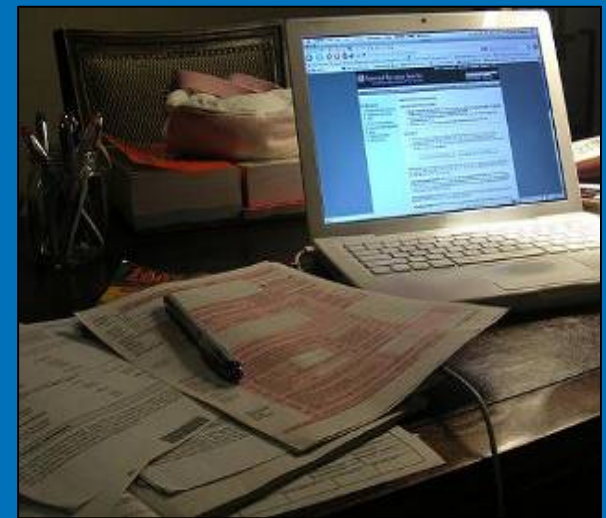
Does She Qualify for EITC?



- No
- Her filing status is:
 - Married Filing Separate

Example Scene 2

- A client walks into your office to have her taxes prepared and informs you:
 - She is 18 years old and never been married
 - She has a 2 year old daughter and lives with her parents
 - She has earnings of \$3,000 from a part-time job
 - She wants to claim EITC



Scene 2 -- Take 1

You ask...

- When did you move in with your parents?
- Did your daughter live with you all year?

She says...

- November last year
- No, she lived with my parents

Does She Qualify for EITC?



- No
- Why?
 - The child had to live with her for more than half the year, so she doesn't meet the Residency requirement

Scene 2 -- Take 2

You ask...

- When did you move in with your parents?

She says...

- I have always lived with my parents

You Say...

- You don't qualify for EITC because you are the qualifying child of your parents

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Scene 2 -- Take 3

You ask...

- When did you move in with your parents?
- Did your child live with you from January to November?

She says...

- I moved home in November last year. It was too hard raising my daughter on my own
- Yes

You Say...

- It looks like you may qualify for EITC. I'll go through the rest of the questions and do the computations to make sure.

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8867 Paid Preparer's Earned Income Credit Checklist OMB No. 1545-0047

Form 8867 (Rev. 12-2005)
Department of the Treasury
Internal Revenue Service

Do not send to the IRS. Keep for your records.
For the definitions of the following terms, see Pub. 506 for the year for which you are completing this form:
• Investment Income • Qualifying Child • Earned Income

A Taxpayer's name ▶
B If joint return, spouse's name ▶

Part I All Taxpayers

1 Year after 2005 for which you are completing this form ▶ Yes No

2 Is the taxpayer's filing status married filing separately? Yes No
▶ If you checked "Yes" on line 2, stop; the taxpayer cannot take the EIC. Otherwise, continue.

3 Does the taxpayer (and the taxpayer's spouse if filing jointly) have a social security number (SSN) that allows him or her to work or is valid for EIC purposes? See the instructions before answering. Yes No
▶ If you checked "No" on line 3, stop; the taxpayer cannot take the EIC. Otherwise, continue.

4 Is the taxpayer filing Form 2555 or Form 2555-EZ (relating to the exclusion of foreign earned income)? Yes No
▶ If you checked "Yes" on line 4, stop; the taxpayer cannot take the EIC. Otherwise, continue.

5a Was the taxpayer a nonresident alien for any part of the year on line 1? Yes No
▶ If you checked "Yes" on line 5a, go to line 5b. Otherwise, skip line 5b and go to line 6.

b Is the taxpayer's filing status married filing jointly? Yes No
▶ If you checked "Yes" on line 5a and "No" on line 5b, stop; the taxpayer cannot take the EIC. Otherwise, continue.

6 Is the taxpayer's investment income more than the limit that applies to the year on line 1? See Pub. 506 for the limit. Yes No
▶ If you checked "Yes" on line 6, stop; the taxpayer cannot take the EIC. Otherwise, continue.

7 Could the taxpayer, or the taxpayer's spouse if filing jointly, be a qualifying child of another person for the year on line 1? Yes No
▶ If you checked "Yes" on line 7, stop; the taxpayer cannot take the EIC. Otherwise, go to Part II or Part III, whichever applies.

Form 8867 must be filed. Go to line 20.

Form 8867 (Rev. 12-2005)

Page 2

	Child 1	Child 2
1	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
2	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
3	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
4	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
5a	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
5b	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
6	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
7	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No

Page 3

use if filing jointly, in the 2-year period outside the 2-year period. See Pub. 596.) Yes No

the EIC. Otherwise, Yes No

25 but under age 65 at Yes No

the EIC. Otherwise, Yes No

med as a dependent on Yes No

the EIC. Otherwise, Yes No

less than the limit that Yes No

.. If you checked "Yes" Yes No

chosen or disallowed for Yes No

st. Go to line 20.

or reasonably obtained Yes No

402E instructions (or your Yes No

402E worksheet?)

ledge requirements, you Yes No

the taxpayer's eligibility Yes No

is information furnished Yes No

tion furnished appears to

the form and worksheet(s) Yes No

requirements described on line Yes No

requirements.

▶ If you checked "No" on line 20, 21, 22, or 23, you have not complied with all the due diligence requirements and may have to pay a \$100 penalty for each failure to comply.

Example Scene 3

- The next client informs you:
 - He is 22 years old
 - He has two sons, ages 10 and 11
 - He wants to claim EITC

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Scene 3 -- Take 1

You ask...

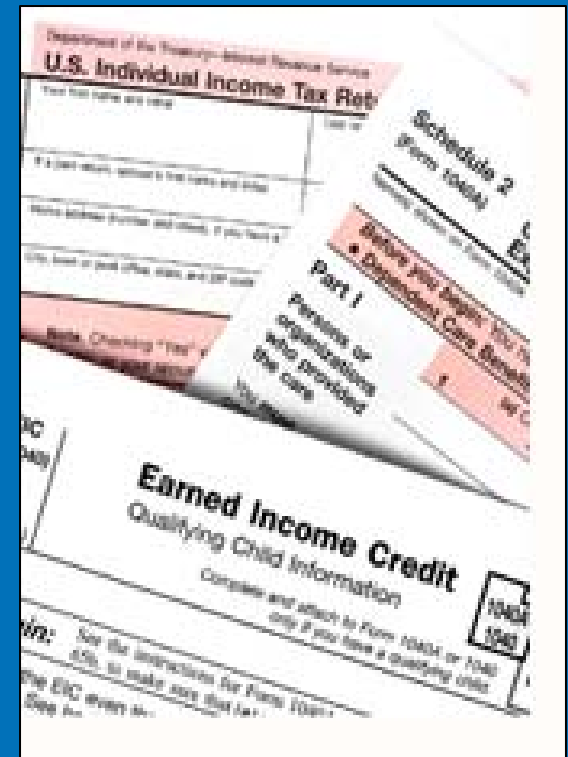
- What is your relationship to these children?
- Were you ever married to the mother?
- Were the children placed in your home for adoption or as foster children by a court or authorized agency?

He says...

- They're my girlfriend's sons but I paid all the bills
- No
- No

You Say...

- Sorry, you don't qualify for EITC because your girlfriend's sons do not meet one of the defined EITC relationships.



Scene 3 -- Take 2

You ask...

- What is your relationship to these children?
- Were you ever married to the mother?
- Did the mother live with you last year?
- When did she move in?
- How long did the children live with you?
- The IRS may ask for documentation, do you have any proof the children lived with you, such as school or doctor records?

He says...

- They're my girlfriend's sons but I paid all the bills
- Yes, but we divorced two years ago
- Yes, we got back together
- Late summer, August
- All year
- Yeah, both the doctor and school have my address, I pay all the bills

Example Scene 4

- A client tells you:
 - She is head of household and has 2 children ages 13 and 14
 - She was self-employed cleaning houses, earned \$12,000, and had no expenses

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The image shows a collage of tax forms. At the top right is a 2006 Form W-2 Wage and Tax Statement from the Department of the Treasury Internal Revenue Service. Below it is a 2006 Form 1040EZ, also from the Department of the Treasury Internal Revenue Service. At the bottom is a 2006 Form 1040 U.S. Individual Income Tax Return from the Department of the Treasury Internal Revenue Service. The forms are partially overlapping and show various fields and instructions.

Scene 4 -- Take 1

You ask...

- Are you or were you ever married?
- Did you live with anyone else besides your children?
- Do you have records of the amount of money you received from house cleaning?
- How much did you charge to clean a house?
- How many houses did you clean?
- Who provided the cleaning supplies?

She says...

- No
- No
- No, but I know what I earned
- 60 dollars per house
- I don't know. It wasn't always the same houses
- The home owner provided everything

Would You Prepare Her Tax Return?

- Probably not
 - You need to tell her that IRS requires a written record of amounts earnings and expenses—copies of receipts, invoices, etc.
- Unless,
 - She is able to reasonably reconstruct her income and expenses

Scene 4 -- Take 2

You ask...

- Are you or were you ever married?
- Did you live with anyone else besides your children?
- Do you have records of the amount of money you received from house cleaning?
- Did you need to buy any supplies?
- Do you have receipts for the expenses?

She says...

- No
- No
- Yeah, I make entries on my calendar each week and I have copies of the receipts I gave out
- Yes, I purchased cleaning products, sponges, dust cloths and a vacuum
- Yes

Would You Prepare Her Tax Return?

- Probably yes
 - She has invoices and receipts
 - But, you need to look at the reasonableness of her income and expenses

Example Scene 5

- You completed a client's tax return last year:
 - Last year, she filed single and claimed her child for the EITC
 - This year, she asks to claim 2 children for the EITC

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Scene 5

You ask...

- Last year you claimed one child, what changed?
- Is the child related to you?
- Did the child live with you?

She says...

- My friend has 3 children and only needs 2 for the EITC, so she said I could use her child
- No
- No

You Say...

- Your second child does not qualify because the child does not meet the:
 - Relationship test
 - Residency test
- Now, I have to ask you additional questions to verify your first child still qualifies you for EITC

How Does the IRS Ensure Due Diligence Compliance?

Due Diligence Visits

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EITC Due Diligence Visits

- Due diligence audits conducted annually
- Selection based on standard criteria applied to all EITC returns
- Due diligence visits are conducted between October and March

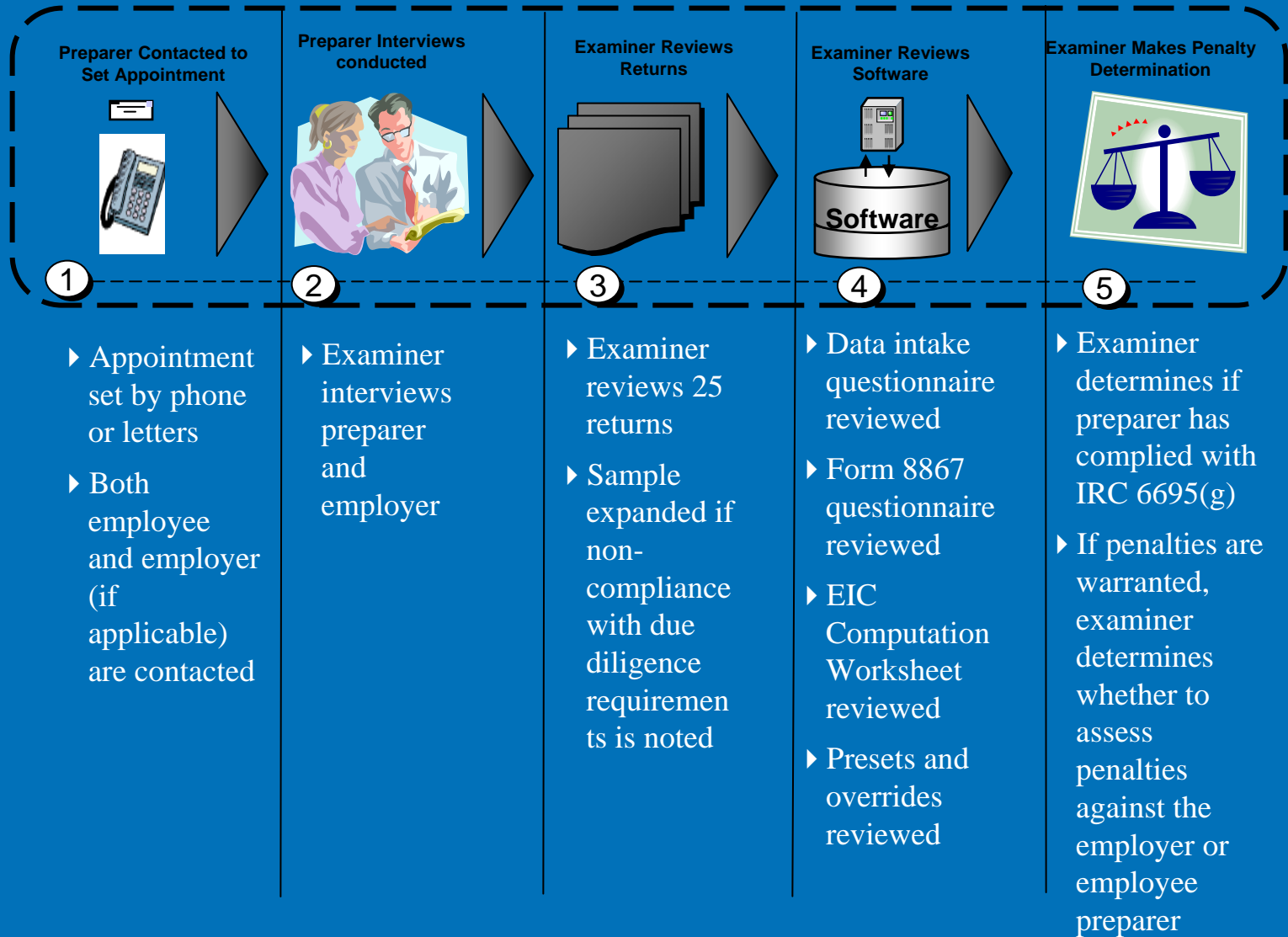


Key Facts About EITC Due Diligence Visit Program

- **Examination** to check paid preparer compliance with all 4 requirements of IRC §6695(g)
- General examination guidelines apply
- IRS requests appointments scheduled within 15 days of contact
- IRS will interview both the employee and employer
- Penalties are \$100 for each return where due diligence requirements are not met



What You Can Expect if You are Selected for an EITC Due Diligence Visit



Other Key Facts About EITC Due Diligence Visit Program

- If penalties are proposed you may
 - Agree and pay the penalties
 - Request an informal managerial hearing to discuss the issues
 - Choose to disagree with the penalties and receive 30-day letter
 - File a timely protest to request an Appeals hearing before penalties are assessed
- File Form 6118, Claim for Refund of Income Tax Return Preparer Penalties, after penalties are assessed and within 3 years from the date you pay the penalties

IRC §6695(g) Penalty Exceptions

- Preparer's normal office procedures are reasonably designed and routinely followed to ensure compliance
- Failure to meet the requirements on a return is isolated and inadvertent
- Key questions to determine whether exception may apply
 - Are preparers trained in EITC Due Diligence requirements?
 - Are there written instructions to employees on how to comply?
 - Is there a quality control process?

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In 2007, 90% of Due Diligence Penalties Were Assessed Due to Failure to Comply With the Knowledge Requirement

Most problems occur when:

**Filing status may be unclear
(e.g. separation)**

Qualifying child eligibility issues are apparent

Information appears inconsistent or unlikely

Summary

- EITC Due Diligence is not just a checkmark on a form
- Don't rely on software alone
- Know the EITC tax law
- Apply sound judgment and common sense to information provided
- Ask questions as needed and document the answers

EITC Resources

- On-Line Tools at irs.gov
 - EITC Website:
www.irs.gov/eitc
 - Tax Practitioner Toolkit:
www.eitcfortaxpreparers.com
 - EITC Assistant
 - Publications, Forms and Worksheets, including
 - Publication 596, Earned Income Credit
 - Form 8867, Paid Preparer's Earned Income Credit Checklist

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The screenshot shows the IRS website's EITC page. At the top, it says "Internal Revenue Service United States Department of the Treasury". Below that is a navigation menu with categories like "NEWVISITORS", "BUSINESS", "DISABLED & NON-PROFITS", "GOVERNMENT ENTITIES", "TAX PROFESSIONALS", "RETIREMENT PLANS COMMUNITY", and "TAX EXEMPT BOND COMMUNITY". A search bar is on the right. The main content area has a heading "It's easier than ever to find out if you qualify for EITC". Below this, there are sections for "Individuals Topics" (with links to "Answer Tax Questions", "Answer Tax Returns", "Taxpayer Rights", "Tax Exemption Rules", and "More Topics..."), "IRS Resources" (with links to "Compliance & Enforcement", "Customer Support Office", "File", "Forms and Publications", "Free-to-Call Questions", "News", "Taxpayer Advocates", and "Where To File"), "Childless Workers", "Will you qualify for EITC this year?", and "Special Rules".