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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 602

[TD 8953]

RIN 1545-AV61

Eligibility requirements after denial of the earned income credit

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations that provide guidance to taxpayers who have been denied the earned income credit (EIC) as a result of the deficiency procedures and wish to claim the EIC in a subsequent year. The temporary regulations apply to taxpayers claiming the EIC for taxable years beginning after December 31, 1997, where the taxpayer's EIC claim was denied for a taxable year beginning after December 31, 1996.

DATES: Effective date: These regulations are effective June 25, 2001.

Applicability dates: For dates of applicability, see §1.32-3(f) of these regulations.

FOR FURTHER INFORMATION CONTACT: Karin Loverud at 202-622-6080 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1575. Responses to this collection of information are mandatory.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number assigned by the Office of Management and Budget.

The burden is reflected in the burden of Form 8862.

Comments and suggestions for reducing the burden imposed by this regulation should be sent to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, W:CAR:MP:FP, Washington, DC 20224, and to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Books or records relating to this collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

Section 32(k) was added by the Taxpayer Relief Act of 1997. Section 32(k)(2) provides that, in the case of a taxpayer who is denied the EIC as a result of the deficiency procedures, no EIC is allowed for any subsequent taxable year unless the taxpayer provides such information as the Secretary may require to demonstrate

eligibility for the credit. On June 25, 1998, temporary regulations (TD 8773) relating to earned income credit eligibility requirements under section 32(k)(2) were published in the **Federal Register** (63 FR 34594). A notice of proposed rulemaking (REG-116608-97) cross-referencing the temporary regulations was published in the **Federal Register** for the same day (63 FR 34615).

No written comments responding to the notice of proposed rulemaking were received. No public hearing was requested or held.

As part of an audit pertaining to the IRS's management of the EIC eligibility program, the Treasury Inspector General for Tax Administration recommended that the Treasury and the IRS reconsider (1) the time at which the taxpayer should be required to establish eligibility to claim the EIC, and (2) whether the eligibility requirement should pertain to the reason the EIC was denied. For example, under the temporary regulations, a taxpayer who is denied the credit on the basis of a child who is determined not to be a qualifying child must establish eligibility the next time the taxpayer claims the EIC, regardless of whether the taxpayer is claiming the credit on the basis of one or more qualifying children or on the basis of no qualifying children. Treasury and the IRS believe that the purpose of the eligibility requirement (to prevent erroneous claims) is better effectuated if the taxpayer establishes eligibility the next time the taxpayer claims the credit with one or more qualifying children, rather than the next time the taxpayer claims the credit.

The IRS is currently exploring whether, and to what extent, its system is capable of undertaking such a change. If a change is made, it would not affect the method of

establishing eligibility, that is, the taxpayer would continue to be required to attach a completed Form 8862 to his or her tax return. The Treasury and the IRS do not expect any change will affect returns for tax year 2001.

If a change is made, the IRS expects to inform taxpayers of the change in two specific ways. First, the IRS would revise Letter 3094, which informs the taxpayer of the eligibility requirements. Second, the IRS would revise the instructions for Form 8862 to clarify the return to which it must be attached. In addition, the IRS would include information regarding the change in all IRS taxpayer publications that deal with the EIC eligibility requirements.

The proposed regulations under section 32(k)(2) are adopted as revised by this Treasury decision. The revisions are discussed below.

Explanation of Revisions

To permit the IRS to make changes to the EIC eligibility program as indicated above, §1.32-3(c) is revised to state that the Form 8862 instructions will instruct the taxpayer when to file Form 8862. A new sentence is added to §1.32-3(c) to the effect that, if the taxpayer attaches Form 8862 to an incorrect return, the taxpayer will nevertheless be required to attach Form 8862 to the correct return.

The IRS and Treasury will consider written comments pertaining to these revisions. Submissions should be sent to: CC:ITA:RU (TD8953), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:ITA:RU (TD 8953), Courier's Desk, Internal Revenue Service,

1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.gov/tax_regs/regslst.html.

Special Analyses

It has been determined that these final regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations.

It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that the underlying statute applies only to individuals. Therefore, a regulatory flexibility analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required.

Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Karin Loverud, Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and the Treasury Department participated in their development.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 602

Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805. * * *

Par. 2. Section 1.32-3 is added to read as follows:

§1.32-3 Eligibility requirements after denial of the earned income credit.

(a) In general. A taxpayer who has been denied the earned income credit (EIC), in whole or in part, as a result of the deficiency procedures under subchapter B of chapter 63 (deficiency procedures) is ineligible to file a return claiming the EIC subsequent to the denial until the taxpayer demonstrates eligibility for the EIC in accordance with paragraph (c) of this section. If a taxpayer demonstrates eligibility for a taxable year in accordance with paragraph (c) of this section, the taxpayer need not comply with those requirements for any subsequent taxable year unless the Service again denies the EIC as a result of the deficiency procedures.

(b) Denial of the EIC as a result of the deficiency procedures. For purposes of this section, denial of the EIC as a result of the deficiency procedures occurs when a tax on account of the EIC is assessed as a deficiency (other than as a mathematical or clerical error under section 6213(b)(1)).

(c) Demonstration of eligibility. In the case of a taxpayer to whom paragraph (a) of this section applies, and except as otherwise provided by the Commissioner in the instructions for Form 8862, "Information To Claim Earned Income Credit After Disallowance," no claim for the EIC filed subsequent to the denial is allowed unless the taxpayer properly completes Form 8862, demonstrating eligibility for the EIC, and otherwise is eligible for the EIC. If any item of information on Form 8862 is incorrect or inconsistent with any item on the return, the taxpayer will be treated as not demonstrating eligibility for the EIC. The taxpayer must follow the instructions for Form 8862 to determine the income tax return to which Form 8862 must be attached. If the taxpayer attaches Form 8862 to an incorrect tax return, the taxpayer will not be relieved of the requirement that the taxpayer attach Form 8862 to the correct tax return and will, therefore, not be treated as meeting the taxpayer's obligation under paragraph (a) of this section.

(d) Failure to demonstrate eligibility. If a taxpayer to whom paragraph (a) of this section applies fails to satisfy the requirements of paragraph (c) of this section with respect to a particular taxable year, the IRS can deny the EIC as a mathematical or clerical error under section 6213(g)(2)(K).

(e) Special rule where one spouse denied EIC. The eligibility requirements set forth in this section apply to taxpayers filing a joint return where one spouse was denied the EIC for a taxable year prior to marriage and has not established eligibility as either an unmarried or married taxpayer for a subsequent taxable year.

(f) Effective date. This section applies to returns claiming the EIC for taxable years beginning after December 31, 1997, where the EIC was denied for a taxable year beginning after December 31, 1996.

§1.32-3T [Removed]

Par. 3. Section 1.32-3T is removed.

PART 602--OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION
ACT

Par. 4. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 5. In §602.101, paragraph (b) is amended by:

1. Removing the entry for 1.32-3T from the table.
2. Adding an entry for 1.32-3 to read as follows:

§602.101 OMB Control numbers.

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(b) * * *

CFR part or section where identified and described	Current OMB control No.
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1.32-3.....	1545-1575
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Robert E. Wenzel

Deputy Commissioner of Internal Revenue

Approved: June 20, 2001

Mark Weinberger

Assistant Secretary of the Treasury