PAID PREPARER
Due Diligence

more than a check mark on a form

IRS

DUE DILLIGENCE MUST DO’S

By law, you must meet four specific due diligence requirements if you are paid to prepare a tax return or claim for refund claiming any of these tax benefits. Failing to meet the four due diligence requirements can result in penalties assessed against you under Internal Revenue Code §6695(g).

1 Earned income tax credit (EITC)

2 Child tax credit (CTC)
Additional child tax credit (ACTC)
Credit for other dependents (ODC)

3 American opportunity tax credit (AOTC)

4 Head of household (HOH) filing status

DUE DILIGENCE REQUIRES YOU TO:

These requirements under Treasury Regulation §1.6695-2 focus on accurately determining your client's eligibility for each credit and head of household filing status and computing the amount of each credit. Know the EITC, CTC/ACTC/ODC, AOTC, and HOH tax laws thoroughly, and carefully evaluate each client's personal situation, information and eligibility.

- [ ] Know the Facts
- [ ] Compute the Credits Based on the Facts
- [ ] Complete Form 8867
- [ ] Keep Records for Three Years

KNOWLEDGE

Ask all the right questions to get the relevant facts.

If you have a reason to doubt or question any information provided to you or known to you to determine your client's eligibility for the credit(s) or HOH filing status or to compute the amount of the credit(s) you must:

- Ask your client additional questions if a reasonable and well-informed tax return preparer, knowledgeable in the law, would conclude the information furnished seems incorrect, inconsistent, or incomplete.
- Not know or have a reason to know the information provided is incorrect, inconsistent or incomplete.
- Document in your files at the time of the interview the questions you asked and your client's answers (see Keep Records below).

CREDIT COMPUTATION

Based on the facts, complete the applicable worksheet(s) or your own worksheet(s) to compute the EITC, CTC/ACTC/ ODC or AOTC claimed on the return or claim for refund.

Most professional tax return preparation software includes the appropriate worksheets.

FORM 8867

Complete Form 8867, Paid Preparer's Due Diligence Checklist, and submit it to the IRS with every electronic or paper return or claim for refund you prepare claiming the EITC, CTC/ACTC/ODC, AOTC, or HOH filing status.

- Make sure your software includes Form 8867 and file the completed form with every electronic return or claim for refund or provide the completed form with every paper return or claim for refund you prepare that claims the EITC, CTC/ACTC/ODC, AOTC, or HOH filing status.
- Answer each question on the form based on information from your client and information you know is true.
- You must also personally complete Part VI, Eligibility Certification.

KEEP RECORDS

Keep a record of the following:

- Form 8867 (see Form 8867 above)
- Applicable worksheet(s) (see Credit Computation above)
- A record of how, when, and from whom the information used to prepare Form 8867 and the applicable worksheet(s) was obtained
- Any taxpayer documents provided to you that you relied on to determine eligibility for the credit(s) or HOH filing status or to compute the amount of the credit(s). Due diligence rules do not require you to review specific client documents. However, if any were provided to you and you relied on them, you must keep copies of them.

The records can be kept in electronic or paper format, and you must produce the records if the IRS requests them. You should keep a backup of these records in a separate, secure location.

Keep these records for three years from the latest of:

- The date the return is due (without extensions)
- The date the return or claim for refund was electronically filed
- The date the return or claim for refund was presented to your client for signature, if not filed electronically
- The date you submitted to the signing return preparer the part of the return or claim for which you were responsible, if you are a non-signing return preparer

FIRMS EMPLOYING PREPARERS

A firm employing a preparer may be penalized for an employee's failure to exercise due diligence if any of the following apply:

- A member of the firm's principal management participated in or, prior to the time the return was filed, knew of the failure to comply with the due diligence requirements.
- The firm failed to establish reasonable and appropriate procedures to ensure compliance with due diligence requirements.
- The firm disregarded its reasonable and appropriate compliance procedures in the preparation of the return or claim for refund through willfulness, recklessness, or gross indifference. This includes ignoring facts that would lead a person of reasonable prudence and competence to investigate further.

POTENTIAL CONSEQUENCES

If you fail to comply with the due diligence requirements, the IRS can assess a $500 penalty (adjusted annually for inflation) against you and if applicable, against your employer for each failure. The IRS can assess up to four penalties for a return or claim for refund that claims all three credits and HOH filing status.

If the IRS examines your client's return and it is found to be incorrect, the IRS can assess accuracy or fraud penalties against your client. The IRS can also ban your client from claiming the EITC, CTC/ACTC/ODC, or AOTC for 2 or 10 years if the facts and circumstances indicate reckless or intentional disregard of rules and regulations or fraud.

Examples: knowledge requirement

You must carefully consider and understand all relevant information for each tax benefit claimed, such as the facts about your client's income, personal living and household circumstances and any post-secondary education undertaken. Inquire further if any information you obtain or know, or have reason to know, seems incorrect, inconsistent, or incomplete, and document your additional inquiries and the client's responses.

For each of the following examples, you must make a clear record of whether and what supporting client documentation was provided and keep a copy of any client document you relied on, including the identity of any person furnishing the information. Keep a copy of the completed Form 8867.

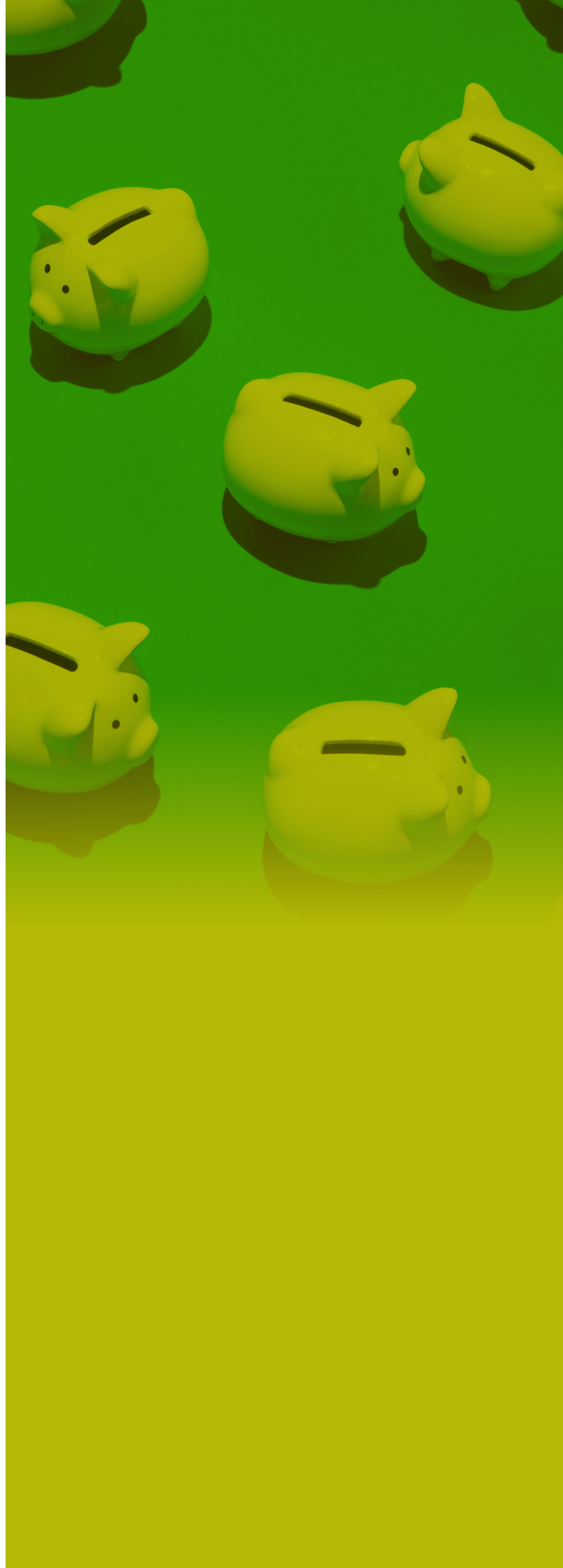
EITC AND CTC

A client wants to claim his niece and nephew for the EITC and CTC.

This information seems incomplete because it is common for a child to live with at least one parent. You must make reasonable inquiries to get the facts about your client's living circumstances, such as finding out who the children's parents are and where they lived, whether anyone else can claim the children as dependents/qualifying children and the dates the children lived with your client.

An 18-year-old client earned $8,000 and states she lived with her parents during part of the year. She wants to claim her newborn biological child for the EITC and CTC.

You must ask additional questions to determine whether your client or her baby is the qualifying child of your client's parents. Be sure to review all eligibility tests and the tie-breaker rules to determine who is eligible to claim each credit.



EITC

A client has two qualifying children and wants to claim the EITC. She tells you she earned $20,000 in income from her Schedule C business and had no business expenses.

This information appears incomplete because it can be unusual for someone who is self-employed to have no business expenses. You must ask additional reasonable questions to determine whether your client is carrying on a business and whether the information about her income and expenses is correct.

A 22-year-old client wants to claim two sons, ages 10 and 11, as qualifying children for the EITC.

This information appears inconsistent because the children's ages are so close to the client's age. You must make additional reasonable inquiries about the children's relationship to your client.

ODC

A client wants to claim the ODC for his three children. The children all have ITINs and lived part of the year outside the United States.

Because ITINs are only issued to non-citizens, you must ask additional questions to determine whether each child meets the tests to be a resident of the United States.

HOH

Two clients indicate they live together with their 2 minor children. Each client wants to file as HOH. Based on the information they provided, are they eligible to claim HOH?

The information appears incomplete or inconsistent as only one client can pay more than 50% of the household expenses for the household that they live in together. You must ask more questions to determine the amount each client paid towards keeping up the home. You also must document the client's responses to the questions that you ask.

HOH (CONT.)

A new client who filed jointly with her spouse last year states she is no longer married. For the current tax year, she wants to file as head of household because her niece and nephew lived with her part of the year.

The information is incomplete so far. You must inquire further to get a clear picture of the client's personal living circumstances such as who the children's parents are and where they lived, whether anyone else can claim the children as dependents or as qualifying persons for HOH, the dates the children lived with your client, who else may have lived in the same home with your client and the amount each person paid towards keeping up the home.

Additional questions to consider:

- Does your client have legal custody of the niece & nephew and how long did they live with the client during the year in question?
- Did your client receive financial/governmental assistance to support the niece & nephew?
- When was the divorce was finalized.?
- Was your client responsible for maintaining the household, and did they provide more than 50% of that support?

HOH (CONT.)

A client is claiming head of household with a parent as their qualifying person and provided support for the parent.

The information is incomplete so far. You must inquire further whether the parent can be claimed as a dependent or as a qualifying person for HOH.

- Was the parent's income below the threshold to be claimed as a dependent?
- How much support/income did the taxpayer and the parent provide?
- Is the parent a U.S. citizen, U.S resident alien, US national, or a resident of Canada or Mexico?
- Was the parent is living in the home with the taxpayer or if the taxpayer is supporting the parent outside the home?

For more information on Head of Household filing status refer to **Publication 501**, Dependents, Standard Deduction, and Filing Information.

Avoid Common Errors

- EITC claimed for a child who is not a qualifying child. Find out whether the child meets the relationship, age, residency and joint return tests. Consider tie-breaker rules if a child is the qualifying child of more than one taxpayer.
- EITC claimed for a child who does not have a valid SSN. An SSN is valid for the EITC unless it was issued after the due date of the return (including extensions) or it was issued solely to apply for or receive a federally funded benefit and does not authorize the holder to work.
- Claiming the EITC when married. Ask questions to find out if your client is married under state law, including common law. If your married client does not file a joint return make sure your client meets the additional rules to claim the EITC.
- Incorrectly reporting income or expenses. Has your client provided you with all sources and amounts of income? Be alert for questionable Forms W-2. Ask your self-employed client enough questions to make sure they have a true business, and if so, that they report all business income and deduct all allowable expenses.
- CTC or ACTC claimed for a child who does not meet the age requirement. The child must be under the applicable age limit at the end of the tax year. There are no exceptions.
- CTC or ACTC claimed for a child who does not have the required SSN. The SSN must be valid for employment and issued before the due date of the tax return (including extensions). The only exception is for a dependent child who was born and died before the end of the year.
- ODC claimed for an individual who does not have a taxpayer identification number (SSN, ITIN or ATIN) issued on or before the due date of the tax return (including extensions) unless applying for an ITIN or ATIN.
- CTC, ACTC or ODC claimed for an individual who does not meet the dependency requirements. The individual must meet all the eligibility rules for a dependent (unless the special rule for divorced or separated parents applies) and be claimed as a dependent on your client's return. Consider tie-breaker rules if a dependent is the qualifying child of more than one taxpayer.

- CTC, ACTC or ODC claimed for a non-citizen dependent who does not meet the residency requirement. A non-citizen individual claimed must be a U.S. national or resident.
- AOTC claimed for a student for more than four tax years.
- AOTC claimed for attendance after the year the individual completed four years of post-secondary education.
- Student didn't attend an eligible educational institution. The AOTC is for post-secondary education, which may include a college, university or technical school. To be eligible, a school must be able to participate in the U.S. Department of Education student aid program.
- Student didn't pay qualifying educational expenses. Expenses must be paid or considered paid by your client, your client's spouse, or a student claimed as a dependent on the tax return. Only amounts paid for tuition, required fees and course materials for an academic period beginning in the tax year or the first three months of the following tax year are qualified expenses.
- Student was not enrolled at least half-time in a program leading to a degree or other recognized educational credential. If the student did not attend at least half time or was not pursuing a degree or other credential, your client cannot claim the AOTC on behalf of the student. Consider your client's eligibility to claim the lifetime learning credit rather than the AOTC.
- HOH claimed for a client who did not pay more than half the cost of keeping up a home. Did charities, the government, or others contribute to the cost of keeping up the home? Only an individual who paid over half the upkeep costs can claim HOH filing status.
- HOH claimed when your client's correct filing status is married filing jointly or separately. Your married client must meet specific eligibility rules to be considered unmarried for HOH filing status.
- HOH claimed when a qualifying person did not live in your client's home for more than half the tax year. Note: There are specific rules for a dependent parent living in a separate home.

The online Tax Return Preparer Toolkit at EITC.IRS.gov is your resource for information on meeting the paid preparer due diligence requirements for the EITC, CTC/ACTC/ODC, AOTC, and HOH filing status.

Preparer continuing education

Client interview tools and tips

Answers to frequently asked questions

Due diligence video scenarios

Best practices for challenging situations

News and Updates for Paid Preparers

Form 8867 guidance

Educational letters, phone calls and compliance visits

Eligibility rules for due diligence tax credits

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