Jim Buttonow • Jul. 31, 2012

Practitioners are receiving letters now, penalties later

Tax practitioners are increasingly finding that tough economic times have qualified more of their clients for the Earned Income Tax Credit (EITC), a refundable credit for low-income taxpayers. Many practitioners are helping their clients claim this credit for the first time. For tax year 2010, the IRS received 142 million individual tax returns, 26.8 million of which claimed the EITC, a 14% increase since 2005.

Traditionally, the IRS has seen high error rates among EITC claims. To maintain oversight on EITC errors and abuse, the IRS implemented new due diligence requirements for 2011 individual tax returns. The most significant requirement is to file Form 8867, *Paid Preparer's Earned Income Credit Checklist*, with individual returns claiming the EITC. For 2011 tax returns filed in 2012, the IRS is now determining whether tax preparers have met the new requirements. The IRS also recently announced that it is sending warning letters to tax practitioners who did not submit Form 8867 with returns claiming the EITC.

IRS Tax Return Preparer Oversight

In the past three years, the IRS has implemented a strategy of registering and regulating tax return preparers to help close the $376 billion a year tax gap lost to underreporting of income and overstating deductions and credits, such as the EITC. Traditionally, EITC errors have accounted for a significant amount of filing inaccuracies. In tax year 2010, the IRS reported that 26.8 million returns claimed $59.5 billion in EITCs. According to the Treasury Inspector General for Tax Administration (TIGTA), there are errors on about one out of every four returns claiming the EITC. The Tax Policy Center notes that these erroneous claims cost the IRS between $11 billion and $13 billion annually.

Just before the start of the 2012 filing season, in December 2011, the IRS finalized its

penalty of $500 for every EITC return filed without Form 8867 for tax year 2012.

Additionally, firms with employees who have been assessed the penalty under IRC Sec. 6695(g), *Failure to Be Diligent in Determining Eligibility for Earned Income Credit*, may be subject to additional penalties under Treasury Reg. 1.6695-2(c). The IRS may assess this additional penalty if the firm knowingly disregards the due diligence requirements, fails to set up reasonable and appropriate procedures, or shows willfulness, recklessness or gross indifference in preparing the EITC return.

Understanding EITC Due Diligence Requirements

Avoid errors in filing EITC claims by following these due diligence requirements:

- **Complete Form 8867 and file it with the return.** For any tax return claiming the EITC, complete Form 8867, *Paid Preparer's Earned Income Credit Checklist*, based on information that you were provided or that you reasonably obtained. Include the completed Form 8867 with the return whether you're filing electronically or by paper.

- **Compute the credit accurately using Form 8867.** Form 8867 requires practitioners to calculate the EITC amount using the Earned Income Credit Worksheet on Form 1040, *U.S. Individual Income Tax Return*, or a self-constructed worksheet containing the same information.
- **Determine reasonableness of information furnished.** According to Form 8867, to comply with the knowledge requirements, you must not know or have reason to know that any information used to determine your client's eligibility for the EITC is incorrect. Also, you can't ignore the implications of the information furnished and must make reasonable inquiries if the information appears to be incorrect, inconsistent or incomplete. Document your inquiries and the responses.
- **Retain Form 8867 and supporting information for at least three years.** Keep completed copies of Form 8867, the Earned Income Credit Worksheet and records

about how and when you obtained the information.

including Form 8867, the Earned Income Credit Worksheet, and records of how and when you obtained the information used to complete due diligence. Retain these research records for at least three years, as required.
- Conduct firm training and communicate due diligence procedures. The IRS offers an online EITC Due Diligence Training Module to help practitioners file accurate returns.
- Modify your quality review process. A checklist can help your firm establish the proper review process for EITC due diligence requirements.

Many practitioners are claiming the EITC for their clients for the first time and may be unaware of the IRS' due diligence requirements. Follow the tips outlined here to help ensure that your firm is meeting compliance standards and filing accurate returns claiming the EITC.

About the Author

Jim Buttonow, CPA, CITP—Jim is Vice President of Product Development and Cofounder of the tax technology company New River Innovation. Jim's professional mission is to apply emerging technology to problems faced by tax professionals after they file.

Jim is a CPA and former IRS Large Case Team Audit Coordinator. He worked at the IRS for 19 years. Since leaving the IRS, Jim has represented many clients before the IRS. At New River Innovation, Jim is the chief architect of Beyond415 (Beyond415.com), an award-winning technology for tax practitioners to efficiently handle IRS issues, notices and audits. Through Beyond415, Jim also develops and presents CPE series on IRS practice and procedure for issues that arise after filing, such as audits, notices and discrepancies. Jim regularly speaks on compliance trends and post-filing practice efficiency strategies for CPA and accounting firms.