

*Tax Practice***Earned Income Tax Credit Due Diligence Requirements Burdensome, Preparers Say**

The Internal Revenue Service's plan to impose liability on an entire firm for an individual tax preparer's failure to comply with earned income tax credit due diligence requirements has raised red flags for several tax-preparer-related organizations.

In a Nov. 10 comment letter, Tax Executive Committee Chairman Patricia Thompson said rules IRS proposed in October (REG-140280-09) would put standards in place for firm liability that vary significantly from the requirements traditionally found in Circular 230 Section 10.36(b) (195 DTR G-7, 10/7/11).

Generally, the practitioner with principal authority for overseeing a firm's return preparation is subject to discipline based on the Circular 230 violations of others only when a pattern or practice of willfulness, recklessness, or gross incompetence is involved, and the governing practitioner fails to correct it.

IRS's proposed rules would expand applicability of the penalty for failure to exercise due diligence in preparing EITC claims to the principals of a firm—whether or not they were responsible for the errors.

The IRS devised the rules to try to curb abuses in tax preparation of the credit, which has one of the highest rates of overpayment due to errors of any return. Error rates are often cited at from 23 percent to 28 percent. With penalties jumping from \$100 to \$500 for each failure to perform the EITC due diligence properly, tax preparers are intensely interested in lessening the new rule's impact.

Submission With Return. All of the companies and organizations said they support IRS's effort to crack down on erroneously filed claims, but said they do not necessarily agree with the way IRS is going about it.

Requiring that the Form 8867, the Paid Preparer's Earned Income Credit Checklist, be submitted as part of the tax return will undoubtedly increase scrutiny of it by the IRS, according to the National Society of Tax Professionals.

Before, the form was used basically as a worksheet to help the preparer evaluate the validity of an EITC claim and document the client's responses. It was to be kept by the tax preparer in the client's files.

Now the IRS will be examining the forms in conjunction with EITC claims and will use them to challenge preparers, Bill Horn, acting president of NSTP, said in his Nov. 10 letter. The group asked for language that clearly states a preparer is not required to independently verify EITC eligibility information given to the preparer.

H&R Block took a completely different view of this, advocating submission of the form. The company said it will prevent tax preparers from editing their records later to create the appearance that they complied with the due diligence requirements. However, H&R Block said IRS should allow it to be electronically filed. Also software developers have not prepared for filing of the form for tax years prior to Dec. 31, 2011, so the requirement to file it should not apply before then, it said.

The Legal Aid Society of Cleveland was also a fan of submitting it with the return. It said preparers might be

less inclined to facilitate their clients' noncompliance if they have to file the work sheet.

The tax system should impose "a more affirmative obligation" on tax preparers to ask questions "that place the responsibility for taxpayer actions squarely on the taxpayer's shoulders and discourage preparers from facilitating noncompliance by choosing not to ask relevant questions," Susan Morgenstern, senior attorney with Legal Aid, said Nov. 9. Preparers should be required to give a separate statement to taxpayers attesting to their compliance with the due diligence requirements. The form should focus on residency of the children, since it is the most common error, and require that all living arrangements be listed, she said.

Software Developers. Both the Computer & Communications Industry Association and the Software & Information Industry Association said implementation should be delayed until after the 2011 tax season. They suggested implementation for tax year 2012.

CCIA said the proposed rule is too broad. It would encompass tax professionals that tax preparation software companies hire to answer individuals' tax questions while they are preparing their own returns. The professionals are often CPAs, attorneys, or enrolled agents, Edward Black, president and chief executive officer, said in his Nov. 10 letter.

These practitioners could end up being penalized for simply conditionally advising taxpayers over the phone or via the internet that, under certain circumstances, they may be eligible for various deductions or credits, including the EITC. However, the professionals may never know when or if the return is ever filed. Therefore IRS should state that these particular tax advisers are not covered by the rules, the associations said.

Independent Verification. NSTP also attacked one of the main questions that has plagued the industry with regard to EITC—how much verification is required for a preparer to be able to say he or she has complied with the requirement of having had no knowledge that a taxpayer was not entitled to the credit.

"There is little IRS guidance on how far this duty extends," NSTP's Horn said. He wondered if preparers are required to independently investigate the claims of their clients. Many records relating to family relationships and client living arrangements could be involved, he said.

Meanwhile, IRS officials in various forums over the years have said that tax preparers who ask no questions, or accept pat answers from clients about eligibility for credits based on information that does not fit in with known facts about the clients' overall situation, are not performing due diligence.

BY DIANE FREDA

Texts of comment letters from American Institute of Certified Public Accountants, National Society of Tax Professionals, H&R Block, Legal Aid Society of Cleveland, Computer & Communications Industry Association, and Software & Information Industry Association are in TaxCore.