Due diligence promotes accurate EITC, CTC and AOTC claims. Incorrect tax returns and failure to comply with the due diligence requirements can adversely affect you and your client:

- The IRS can examine your client's return, and if it is found incorrect, can assess accuracy or fraud penalties on your client. The IRS can also ban your client from claiming EITC, CTC and AOTC for 2 or 10 years.
- If you fail to comply with the EITC, CTC and AOTC due diligence requirements, the IRS can assess a $500 penalty (adjusted for inflation) against you and your employer for each failure. IRS can assess you up to three penalties to a return that claims all three credits. (IRC § 6695(g)).
- If you prepare a client's return and any part of an understatement of tax liability is due to an unreasonable position, the IRS can assess a minimum penalty of $1,000 (IRC § 6694(a)) against you.
- If the understatement is due to reckless or intentional disregard of rules or regulations, the minimum penalty is $5,000 (IRC § 6694(b)).
- You and your firm can face suspension or expulsion from participation in IRS e-file.
- You can be barred from preparing tax returns.
- You can be subject to criminal prosecution.

Each refundable credit has different eligibility rules. Take these simple steps to avoid errors:

- Know the tax law for each refundable credit including eligibility rules
- Remember, software is not a substitute for knowledge of the tax law
- Follow the Due Diligence Must Do's

Pay particular attention to the following issues to avoid EITC, CTC or AOTC claim errors:

Most Common EITC Errors

- **Claiming EITC for a child who does not meet the qualifying child requirements.** Make sure you find out if the child lived with your client for more than half the year, is related to him or her and meets the age test. You must ask how long the child lived with your client, at what address, and did anyone else live with the child for more than half the year. Also, find out how the child is related – by blood, by marriage or by law. Age is a bit easier; but if the child is a student or permanently and totally disabled, make sure your client has the documents needed to show the IRS if audited.
- **Filing as single or head of household when married.** Ask the questions to find out if your client is married under state law, including common law, or was ever married. Also, if your client is married, make sure your client did not live with his or her spouse at any time during the last six months of the year.
- **Incorrectly reporting institution income or expenses.** Does the Form W-2 look similar to the Forms W-2 of other clients who have the same employer? Is your client saying they own a business but not claiming any business expenses? Ask enough questions to make sure your client has a true business and claims all income and deducts all allowable expenses.

Most Common AOTC Errors

- **Claiming AOTC for a student who didn't attend an eligible educational institution.** The AOTC is for post-secondary education, which may include education at a college, university or technical school. To be an eligible institution, the school must be able to participate in the student aid program administered by the U.S. Department of Education (note: they don't have to participate but must be eligible to participate).
- **Claiming AOTC for a student who didn't pay qualifying college expenses**. Educational expenses must be paid or considered paid by your client, your client's spouse or the dependent student claimed on the tax return.
- **Claiming AOTC for a student for too many years**. The AOTC is only available for the first four years of post-secondary education and your client can only claim it for four tax years per eligible student. This limitation includes any year(s) your client claimed the Hope Credit.

Most Common CTC/ACTC Errors

- **Claiming the CTC/ACTC a child who does not meet the age requirement.** The child must be under the age of 17 at the end of the tax year. There are no exceptions to this rule.
- **Claiming the CTC/ACTC a child who does not meet the dependency requirements.** The child must be claimed as a dependent on your client's return and meet all the eligibility rules for a dependent.
- **Claiming the CTC/ACTC a child who does not meet the residency requirement.** The child must be a U.S. citizen, U.S. national or a U.S. resident alien and the child must have lived with your client for more than half the year. If the qualifying child uses an ITIN, Individual Taxpayer Identification Number, the child must meet the substantial presence test to qualify.

The Tax Preparer Toolkit on EITC and Refundable Credits Central, eitc.irs.gov, is your place for more information on Refundable Credit Due Diligence.

- Training opportunities, videos and training modules such as the Refundable Credit Due Diligence, Schedule C and Record Reconstruction
- Interview tips and best practices
- Frequently asked questions
- More

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IRS

Refundable Credits Due Diligence

is more than a check mark on a form

The Due Diligence Must Do's

- Know the law
- Apply your knowledge
- Ask all the right questions
- Get all the facts
- Document as you go and keep records

BY law, if you are paid to prepare tax returns claiming one or more of the Earned Income Tax, the Child Tax or the American Opportunity Tax credits, you must meet four due diligence requirements. The 2015 PATH Act extended the due diligence requirements from EITC, Earned Income Tax Credit, to both the CTC, Child Tax Credit, and the AOTC, American Opportunity Tax Credit. These requirements focus on accurately determining your client's eligibility for and the amount of each credit.

The first three requirements have to do with completing forms and keeping records. **The fourth, the one most often missed, is the knowledge requirement. It requires you to:**

- Know the EITC, CTC and AOTC tax laws thoroughly
- Evaluate your client's information
- Ask questions based on your client's information to determine each client's personal situation and eligibility
- Document the questions you ask and your client's answers

To meet your four due diligence requirements, you must:

1. Complete Form 8867, *Paid Preparer's Due Diligence Checklist*, and submit this completed form to the IRS with every electronic or paper return or claim for refund you prepare with the EITC, CTC or AOTC.
   - Make sure your software includes the Form 8867 and that it is transmitted with every electronic return and included with every paper return you prepare with the EITC, CTC or AOTC.
   - Answer each question on the form based on information from your client and information you know is true.
   - You must also personally answer question 12, *Credit Eligibility Certification*.
2. Complete the applicable worksheet(s), or your own worksheet(s) with the same information, for any EITC, CTC and AOTC claimed on the return.
   - Most professional tax return preparation software includes the worksheets.
3. Keep copies of the following either electronically or on paper for your records:
   - Form 8867
   - The applicable worksheet(s) for EITC, CTC and AOTC claimed on the return
   - Any documents you relied on to complete the Form 8867 or to determine eligibility for and the amount of the credit(s)
   - A record of how, when, and from whom the information you obtained to prepare the tax return and worksheet(s)
   - A record of any additional questions you asked to determine eligibility for and the amount of the credits and your client's answers.

   Keep these documents for three years from the latest of:
   - The due date of the tax return.
   - The date the tax return was electronically filed.
   - For a paper return, the date the return was presented to your client for signature.
   - If you are a non-signing tax return preparer, the date you give the part, for which you are responsible to the signing tax return preparer.

   You can keep these records in either paper or electronic format but you must produce the records if IRS requests them. You should keep a backup of these records in a separate, secure location.
4. Not know, or have reason to know, that any information used to determine if your client is eligible for or to compute the amount of the credit(s) is not correct, not consistent or not complete.
   - 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.
   - At the time of the interview, you must document in your files the questions you asked and your client's answers.

The IRS assesses most due diligence penalties for failure to comply with the knowledge requirement. To meet the knowledge requirement, you should:

- Apply a common sense standard to the information provided by your client
- Evaluate whether the information is complete and gather any missing facts
- Determine if the information is consistent; recognize contradictory statements and statements you know are not true
- Conduct a thorough, in-depth interview with each client, every year
- Ask enough questions to know the return is correct and complete
- Document in the file at the time it happens any questions you asked and your client's responses

An employer may be penalized for an employee's failure to exercise due diligence, if any of the following apply:

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

Following are examples of situations when you should ask additional questions to meet your due diligence knowledge requirement:

- A client and spouse want to claim the CTC and the AOTC. Your client is a resident alien with one child and has higher education expenses.
  You should ask enough questions to determine if the child and spouse are citizens, resident aliens, or non-resident aliens. You should also ask enough questions to determine if your client is eligible for the AOTC.
- A client wants to claim his niece and nephew for EITC
  You should ask enough questions to determine whether each child is a qualifying child of your client. You should also ask enough questions to find out if the child is the qualifying child of another person. And, if so, will the other person claim the child. If more than one person claims the same child, the IRS will apply the tiebreaker rules.
- An 18 year-old client with an infant has $3,000 in earned income and states she lives with her parents. She wants to claim the infant as a qualifying child for the EITC.
  This information seems incomplete and inconsistent because your 18-year-old client lives with her parents and earns very little income. You must ask additional questions to determine if your client is the qualifying child of her parents. If she is the qualifying child of her parents, she is not eligible to claim the EITC.
- A 22 year-old client wants to claim two sons, ages 10 and 11, as qualifying children for the EITC.
  You must make additional reasonable inquiries regarding the relationship between your client and the children since the age of the client seems inconsistent with the ages of the children claimed as your client's sons.
- A client has two qualifying children and wants to claim the EITC.
  She tells you she had a Schedule C business and earned $10,000 in income and had no expenses. This information appears incomplete because it is unusual that someone who is self-employed has no business expenses. You must ask additional reasonable questions to determine if the business exists and if the information about her income and expenses is correct.
- A 32-year-old client indicates he's been going to college for many years and would like to claim the AOTC. He provides a Form 1098-T, Tuition Statement, showing $4,000 received for tuition and that your client was at least a half-time undergraduate student.
  You must ask more questions. The Form 1098-T is a good indicator that your client is eligible for the AOTC but does not contain all the information needed to determine eligibility or to compute the amount of the credit. You must also find out if your client received any scholarships, how and when the expenses were paid, if your client has a felony drug conviction, and if your client claimed AOTC or the Hope Credit previously and if so, for how many years.
- A client wants to claim the CTC for three children. Your client is a resident alien. The children all have ITINs and lived part of the year outside the U.S.
  You must ask questions to determine that each child is related to your client and meets the residency requirements for the CTC. You must also complete Part 1 of Schedule 8812 for each child with an ITIN to show the child meets the residency test.