Paid Preparer
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**

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BY law, if you are paid to prepare a tax return or claim for refund claiming one or more of the following tax benefits, you must meet four due diligence requirements. The tax benefits are the earned income tax credit (EITC), the child tax credit (CTC), the additional child tax credit (ACTC), the credit for other dependents (ODC), the American opportunity tax credit (AOTC), and head of household (HOH) filing status. The 2017 Tax Cuts and Jobs Act expanded the due diligence requirements to cover eligibility to file as head of household.

You must comply with the following four Due Diligence Requirements:

- Compute the Credits Based on the Facts
- Complete and Submit Form 8867
- Keep Records
- Ask All the Right Questions

These requirements focus on accurately determining your client's eligibility for each credit, computing the amount of each credit and determining your client's and eligibility to claim head of household filing status. Know the EITC, CTC/ACTC/ODC, AOTC, and HOH tax laws thoroughly. You must evaluate your client's personal situation, information and eligibility.

If you have a reason to doubt or question the correctness, consistency, or completeness of any information used 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
- Document in your files at the time of the interview the questions you asked and your client's answers

Compute the credits and complete the applicable worksheet(s) or your own worksheet(s) for any EITC, CTC/ACTC/ODC or AOTC claimed on the return or claim for refund. Most professional tax return preparation software includes the worksheets.

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 that claims the EITC, CTC/ACTC/ODC, AOTC, or HOH filing status.

- Make sure that your software includes Form 8867 and that you file the completed form with every electronic return 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 copies of the following either electronically or on paper for your records:

- Form 8867,
- The applicable worksheet(s) or your own worksheet(s) for the EITC, CTC/ACTC/ODC, or AOTC claimed on the return or claim for refund,
- Any taxpayer documents you may have relied on to determine eligibility for the credit(s) and/or HOH filing status or to compute the amount of the credit(s),
- A record of how, when, and from whom the information used to prepare Form 8867 and the applicable worksheet(s) was obtained, and

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 or claim for refund was presented to your client for signature
- If you are a non-signing tax return preparer, the date you submitted to the signing tax return preparer the part of the return for which you were responsible

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

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

- You, or a member of your principal management, participated in or, prior to the time the return was filed, knew of the failure to comply with the due diligence requirements; or
- Your firm failed to establish reasonable and appropriate procedures to ensure compliance with due diligence requirements; or
- Your 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 includes ignoring facts that would lead a person of reasonable prudence and competence to investigate further.

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

- A client wants to claim head of household filing status and claim his niece and nephew for the EITC and the CTC.
- You should ask enough questions to determine whether each child meets the requirements to be a qualifying child of your client, including reasonable inquiries about the children's residency, the client's relationship to the children, the children's income, the sources of support for the children, and the client's contribution to the payment of costs related to operating the household.
- An 18-year-old client with an infant has $8,000 in earned income and states she lived with her parents during part of the year. She wants to claim the infant as a qualifying child for the EITC and the CTC.
- This information seems incomplete because your 18-year-old client lives with her parents and earns $8,000. You must ask additional questions to determine whether your client is the qualifying child of her parents. Be sure to review all tests to determine who is eligible to claim each credit.
- 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 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.
- You must make additional reasonable inquiries regarding the relationship between your client and the children, because the age of the client seems inconsistent with the ages of the children claimed as your client's sons.
- 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 he 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 it does not contain all the information needed to determine eligibility for the credit or to compute the amount of the credit. You must also find out whether your client received any scholarships, how and when the expenses were paid, whether your client has a felony drug conviction, and whether your client claimed the AOTC or the Hope Credit previously and, if so, for how many years.
- A client wants to claim the ODC for his 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 whether each child is related to your client, meets the U.S. residency requirement, and has an ITIN issued on or before the due date of the return.

Due diligence promotes accurate claims of the EITC, CTC/ACTC/ODC, AOTC, and HOH filing status. Incorrect tax returns or claims for refund 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 to be incorrect, 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.
- If you fail to comply with the due diligence requirements, the IRS can assess a $500 penalty (adjusted annually for inflation) against you and 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. (IRC § 6695(g)).
- If you prepare a client's return or claim for refund 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 against you (IRC § 6694(a)).
- 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 and claims for refund.
- You can be subject to criminal prosecution.

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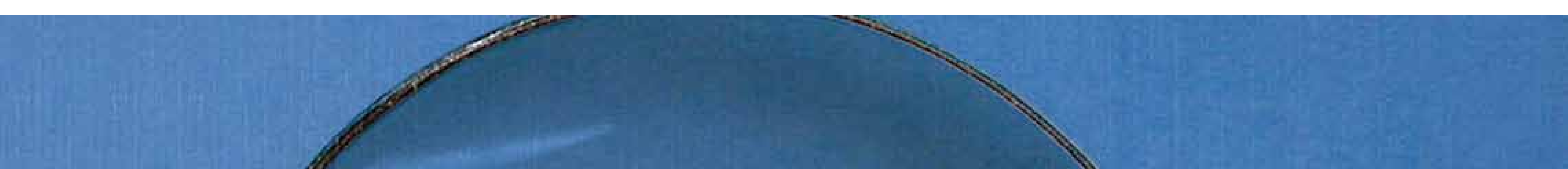

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Each credit and the HOH filing status have different eligibility rules. Take these simple steps to avoid errors:

- Know the tax law for each credit and for the HOH filing status, including eligibility rules
- Remember, software is not a substitute for knowledge of the tax law

Pay attention to the following issues to avoid errors in claiming the EITC, CTC/ACTC/ODC, or AOTC:

Common EITC Issues

- **Claiming the EITC for a child who does not meet the qualifying child requirements.** Make sure you find out whether the child meets the residency, relationship, and age tests. The child must have an SSN valid for employment issued on or before the due date of the return.
- **Filing as single or head of household when married.** Ask questions to find out if your client is or previously has been married under state law, including common law. 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 income or expenses.** Has your client provided you with all income? Be alert for questionable Forms W-2. 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, claims all income, and deducts all allowable expenses.

Common AOTC Issues

- **Claiming the 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 educational institution, the school must be able to participate in the U.S. Department of Education student aid program.
- **Claiming the AOTC for a student who didn't pay qualifying college expenses.** Education expenses must be allowable expenses paid or considered paid by your client, your client's spouse, or the student claimed as a dependent on the tax return.
- **Claiming the AOTC for a student for too many years.** The AOTC is only available for the first four years of post-secondary education and can only be claimed for four tax years per eligible student. This limitation includes any year(s) your client claimed the Hope Credit.

Common CTC/ACTC/ODC Issues

- **Claiming the CTC or ACTC for a child who does not meet the age requirements.** The child must be under the age of 17 at the end of the tax year. There are no exceptions.
- **Claiming the CTC or ACTC for a child who does not have an SSN valid for employment 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.
- **Claiming the ODC 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).
- **Claiming the CTC or ACTC or ODC for an individual who does not meet the dependency requirements.** The individual must be claimed as a dependent on your client's return and meet all the eligibility rules for a dependent.
- **Claiming the CTC or ACTC or ODC for a non-citizen who does not meet the residency requirement.** The individual claimed must be a U.S. citizen, U.S. national, or U.S. resident.

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

- Training opportunities, videos and training modules on topics such as Due Diligence, and Schedule C and Income and Expense Reconstruction
- Interview tips and best practices
- Frequently asked questions
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