

[4830-01-u]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 602

[TD 8905]

RIN 1545-AW74

Preparer Due Diligence Requirements for Determining Earned Income Credit Eligibility

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations relating to the due diligence requirements under section 6695(g) of the Internal Revenue Code for paid preparers of Federal income tax returns or claims for refund involving the earned income credit (EIC). These regulations reflect changes to the law made by the Taxpayer Relief Act of 1997. The regulations provide guidance to paid preparers who prepare Federal income tax returns or claims for refund claiming the earned income credit.

DATES: Effective Date. These regulations are effective October 17, 2000.

Applicability Date. For dates of applicability, see §1.6695-2(d) of these regulations.

FOR FURTHER INFORMATION CONTACT: Andrea Tucker, (202) 622-4940 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

**Paperwork Reduction Act**

The collection of information in these final regulations has been reviewed and approved by the Office of Management and Budget

in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507) under control number 1545-1570. This information is required by the IRS to determine preparer due diligence compliance for purposes of the penalty imposed under section 6695(g). Responses to this collection of information are mandatory.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number assigned by the Office of Management and Budget.

The estimated annual burden per recordkeeper varies depending on individual circumstances. The estimated total annual recordkeeping burden: 507,136 hours with the estimated average annual burden hours per recordkeeper: 5 hours 4 minutes (40 minutes per return or claim for refund, 7.6 returns per preparer). The estimated number of recordkeepers: 100,000.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, OP:FS:FP, Washington, DC 20224, and to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Books or records relating to this collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax

returns and tax return information are confidential, as required by 26 U.S.C. 6103.

### **Background**

Section 6695(g) was added by section 1085(a)(2) of the Taxpayer Relief Act of 1997, Public Law 105-34 (11 Stat. 788, 955 (1997)) (the Act), effective for taxable years beginning after December 31, 1996. Section 6695(g) imposes a \$100 penalty for each failure by an income tax return preparer to meet the due diligence requirements set forth in regulations prescribed by the Secretary.

On December 22, 1997, the IRS published Notice 97-65 (1997-2 C.B. 326), in which the IRS set forth the preparer due diligence requirements for 1997 returns and claims for refund involving the EIC. To avoid the imposition of the penalty under section 6695(g) for 1997 returns and claims for refund, Notice 97-65 required preparers to meet four requirements: (1) complete the Earned Income Credit Eligibility Checklist attached to Notice 97-65 (Eligibility Checklist), or otherwise record the information necessary to complete the Eligibility Checklist; (2) complete the Earned Income Credit Worksheet (Computation Worksheet), as contained in the 1997 Form 1040 instructions, or otherwise record the computation and information necessary to complete the Computation Worksheet; (3) not know or have reason to know that any information used by the preparer in determining eligibility for, and the amount of, the EIC is incorrect; and (4) retain for three years the Eligibility Checklist and Computation Worksheet

(or alternative records), and a record of how and when the information used to determine eligibility for, and the amount of, the EIC was obtained by the preparer. This information may be retained as a paper record, in magnetic media format, or in an electronic storage media system, consistent with applicable IRS revenue procedures.

On December 21, 1998, temporary regulations (TD 8798, 1999-1 C.B. 804) under section 6695(g) were published in the **Federal Register** (63 FR 70339). A notice of proposed rulemaking (REG-120168-97, 1999-1 C.B. 809) cross-referencing the temporary regulations was published in the **Federal Register** (63 FR 70357) on that same date. The text of the temporary regulations served as the text of the proposed regulations. The requirements set forth in the temporary regulations were substantially similar to those in Notice 97-65.

The notice of proposed rulemaking solicited comments from the public. One comment was received, but no public hearing was requested or held. After consideration of the comment received, the proposed regulations under section 6695(g) are adopted by this Treasury decision, and the corresponding temporary regulations are removed.

#### **Summary of Comments**

The commentator expressed concern that requiring the completion of an eligibility checklist and a computation worksheet impose additional recordkeeping burdens on tax return preparers. The commentator did not suggest alternative due

diligence requirements.

The additional recordkeeping required by the regulations is necessary to implement congressional intent with respect to section 6695(g). The legislative history accompanying the Act explains that Congress "believes that more thorough efforts by return preparers are important to improving EIC compliance." H.R. Rep. No. 148, 105<sup>th</sup> Cong., 1<sup>st</sup> Sess. 512 (1997) and S. Rep. No. 29, 105<sup>th</sup> Cong., 1<sup>st</sup> Sess. 125 (1997). The additional information gathering and recordkeeping required by these regulations are intended to ensure that preparers are thorough when determining whether a taxpayer qualifies to claim the EIC credit. Further, the regulations allow preparers the flexibility to use either the prescribed forms or alternative records containing the same information as the prescribed forms to meet the due diligence requirements.

### **Special Analyses**

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. Further, it is hereby certified, pursuant to sections 603(a) and 605(b) of the Regulatory Flexibility Act, that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that

the amount of time necessary to record and retain the required information will be nominal for those income tax return preparers that choose to use the Alternative Eligibility Record and Alternative Computation Record. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking that preceded these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

#### **Drafting Information**

The principal author of these regulations is Andrea Tucker, Office of Associate Chief Counsel, Procedure and Administration (Administrative Provisions and Judicial Practice Division). However, other personnel from the IRS and Treasury Department participated in their development.

#### **List of Subjects**

##### 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

##### 26 CFR Part 602

Reporting and recordkeeping requirements.

#### **Amendments to the Regulations**

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

##### **PART 1--INCOME TAXES**

Paragraph 1. The authority citation for part 1 is amended by removing the entry for "Section 1.6695-2T" and adding an entry

in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Section 1.6695-2 also issued under 26 U.S.C. 6695(g). \* \* \*

Par. 2. Section 1.6695-2 is added to read as follows:

§1.6695-2 Preparer due diligence requirements for determining earned income credit eligibility.

(a) Penalty for failure to meet due diligence requirements.

A person who is an income tax return preparer (preparer) of an income tax return or claim for refund under subtitle A of the Internal Revenue Code with respect to determining the eligibility for, or the amount of, the earned income credit (EIC) under section 32 and who fails to satisfy the due diligence requirements of paragraph (b) of this section will be subject to a penalty of \$100 for each such failure. However, no penalty will be imposed under section 6695(g) on a person who is an income tax return preparer solely by reason of--

(1) Section 301.7701-15(a)(2) and (b) of this chapter, on account of having given advice on specific issues of law; or

(2) Section 301.7701-15(b)(3) of this chapter, on account of having prepared the return solely because of having prepared another return that affects amounts reported on the return.

(b) Due diligence requirements. A preparer must satisfy the following due diligence requirements:

(1) Completion of eligibility checklist. (i) The preparer must either--

(A) Complete Form 8867, "Paid Preparer's Earned Income

Credit Checklist," or such other form and such other information as may be prescribed by the Internal Revenue Service (IRS)(Eligibility Checklist); or

(B) Otherwise record in the preparer's paper or electronic files the information necessary to complete the Eligibility Checklist (Alternative Eligibility Record). The Alternative Eligibility Record may consist of one or more documents containing the required information.

(ii) The preparer's completion of the Eligibility Checklist or Alternative Eligibility Record must be based on information provided by the taxpayer to the preparer or otherwise reasonably obtained by the preparer.

(2) Computation of credit. (i) The preparer must either--

(A) Complete the Earned Income Credit Worksheet in the Form 1040 instructions or such other form and such other information as may be prescribed by the IRS (Computation Worksheet); or

(B) Otherwise record in the preparer's paper or electronic files the preparer's EIC computation, including the method and information used to make the computation (Alternative Computation Record). The Alternative Computation Record may consist of one or more documents containing the required information.

(ii) The preparer's completion of the Computation Worksheet or Alternative Computation Record must be based on information provided by the taxpayer to the preparer or otherwise reasonably obtained by the preparer.

(3) Knowledge. The preparer must not know, or have reason



to know, that any information used by the preparer in determining the taxpayer's eligibility for, or the amount of, the EIC is incorrect. The preparer may not ignore the implications of information furnished to, or known by, the preparer, and must make reasonable inquiries if the information furnished to, or known by, the preparer appears to be incorrect, inconsistent, or incomplete.

(4) Retention of records. (i) The preparer must retain--

(A) A copy of the completed Eligibility Checklist or Alternative Eligibility Record;

(B) A copy of the Computation Worksheet or Alternative Computation Record; and

(C) A record of how and when the information used to complete the Eligibility Checklist or Alternative Eligibility Record and the Computation Worksheet or Alternative Computation Record was obtained by the preparer, including the identity of any person furnishing the information.

(ii) The items in paragraph (b)(4) of this section must be retained for three years after the June 30th following the date the return or claim for refund was presented to the taxpayer for signature, and may be retained on paper or electronically in the manner prescribed in applicable regulations, revenue rulings, revenue procedures, or other appropriate guidance (see §601.601(d)(2) of this chapter).

(c) Exception to penalty. The section 6695(g) penalty will not be applied with respect to a particular income tax return or

claim for refund if the preparer can demonstrate to the satisfaction of the IRS that, considering all the facts and circumstances, the preparer's normal office procedures are reasonably designed and routinely followed to ensure compliance with the due diligence requirements of paragraph (b) of this section, and the failure to meet the due diligence requirements of paragraph (b) of this section with respect to the particular return or claim for refund was isolated and inadvertent.

(d) Effective date. This section applies to income tax returns and claims for refund due on or after October 17, 2000.

**§1.6695-2T [Removed]**

Par. 3. Section 1.6695-2T is removed.

PART 602--OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 4. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 5. In §602.101, paragraph (b) is amended by removing the entry for "1.6695-2T" and adding the following entry in numerical order to the table to read as follows:

§602.101 OMB Control numbers.

\* \* \* \* \*

(b) \* \* \*

CFR part or section where identified and described	Current OMB control No.
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1.6695-2 . . . . .	1545-1570
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Deputy Commissioner of Internal Revenue

Approved:

Acting Assistant Secretary of the Treasury