

Part III - Administrative, Procedural, and Miscellaneous

Income Tax Return Preparer Penalties -- 1997 Federal Income Tax Returns Due Diligence Requirements for Earned Income Credit (EIC)

Notice 97-65

PURPOSE

This notice sets forth due diligence requirements that paid preparers of federal income tax returns or claims for refund (preparers) that involve the Earned Income Tax Credit (EIC) must meet to avoid imposition of the penalty under § 6695(g) of the Internal Revenue Code for 1997 returns and claims for refund. The Treasury Department intends to issue temporary regulations under § 6695(g) that will incorporate the requirements set forth in this notice and that will apply to 1997 returns and claims for refund. However, these regulations may impose different due diligence requirements for returns and claims for taxable years beginning after 1997. Comments are requested regarding possible alternatives for meeting the due diligence requirements in the future.

BACKGROUND

Section 6695(g), as added by section 1085(a)(2) of the Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 111 Stat. 788 (August 5, 1997), imposes a \$100 penalty on a preparer with respect to any return or claim for refund for each failure to comply with the due diligence requirements imposed by regulations

with respect to determining a taxpayer's eligibility for the EIC or the amount of any allowable EIC. This new penalty is effective for taxable years beginning after December 31, 1996, and is in addition to any other penalty imposed under present law.

DUE DILIGENCE REQUIREMENTS FOR 1997

For each 1997 income tax return or claim for refund involving the EIC, a preparer will be liable for the § 6695(g) penalty unless all of the following due diligence requirements are met:

(1) The preparer must either (a) complete the "Earned Income Credit (EIC) Eligibility Checklist" (attached to this notice) or (b) otherwise record in the preparer's paper or electronic files the information that would be necessary to complete the Checklist ("alternate eligibility record"). The preparer's completion of the Checklist or alternate eligibility record must be based on information provided by the taxpayer to the preparer or otherwise reasonably obtained by the preparer. The alternate eligibility record may consist of one or more documents containing the required information.

(2) The preparer must either (a) complete the "Earned Income Credit Worksheet" in the 1997 Form 1040 instructions, 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 that computation ("alternate computation record"). The preparer's completion of the Worksheet or alternate

computation record must be based on information provided by the taxpayer to the preparer or otherwise reasonably obtained by the preparer. The alternate computation record may consist of one or more documents containing the required information.

(3) The preparer must not know or have reason to know that any information used by the preparer in determining the taxpayer's eligibility for the EIC or in computing 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) The preparer must retain (a) the completed Checklist (or alternate eligibility record); (b) a copy of the Worksheet (or alternate computation record); and (c) a record of how and when the information was obtained by the preparer, including the identity of any person furnishing such information. These items must be retained for three years after the June 30th following the date the return was presented to the taxpayer for signature, and may be retained on magnetic media consistent with Rev. Proc. 81-46, 1981-2 C.B. 621, or in an electronic storage media system consistent with Rev. Proc. 97-22, 1997-13 I.R.B. 9.

The § 6695(g) penalty will not be applied with respect to a particular return or claim for refund if the preparer can demonstrate to the satisfaction of the Service that, considering all the facts and circumstances, the preparer's normal office

procedures are reasonably designed and routinely followed to ensure compliance with the 1997 due diligence requirements, and the failure to meet the 1997 due diligence requirements with respect to the return or claim for refund in question was isolated and inadvertent.

REQUEST FOR COMMENTS ON FUTURE GUIDANCE

The Service and Treasury Department invite public comment on the due diligence requirements in § 6695(g) for tax years after 1997. Comments are requested by May 15, 1998. An original and eight copies of written comments should be sent to:

Internal Revenue Service

Attn: CC:DOM:CORP:R
Room 5228 (IT&A:Br4)
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044,

or hand delivered between the hours of 8:00 a.m. and 5:00 p.m.
to:

Courier's Desk
Internal Revenue Service
Attn: CC:DOM:CORP:R
Room 5228 (IT&A:Br4)
1111 Constitution Ave., N.W.
Washington, D.C.

Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home

Page, or by submitting comments directly to http://www.irs.ustreas.gov./prod/tax_regs/comments.html (the IRS Internet site). All comments will be available for public inspection and copying in their entirety.

PAPERWORK REDUCTION ACT

The collections of information contained in this notice have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1570.

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.

The collections of information in this notice are contained under the heading "DUE DILIGENCE REQUIREMENTS FOR 1997" in this notice. This information is required to implement § 6695(g), and verify that preparers have exercised due diligence in preparing any return or claim for refund for taxable year 1997 that involves the EIC. The likely recordkeepers are preparers.

In 1998, the estimated total annual recordkeeping burden will be 160,000 hours.

The estimated annual burden per recordkeeper will vary from 0 minutes to 16 minutes, depending on individual circumstances, with an estimated average of 8 minutes.

The estimated number of recordkeepers is 1,200,000.

Books or records relating to the collection of information in this notice must be retained for three years after the June

30th following the date the return was presented to the taxpayer for signature. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

DRAFTING INFORMATION

The principal author of this notice is Celia Gabrysh, Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this notice, contact Celia Gabrysh at (202) 622-4940 (not a toll-free number).

EARNED INCOME CREDIT (EIC) ELIGIBILITY CHECKLIST
For use by income tax return preparers in preparing
1997 tax returns and claims for refund

Taxpayer may claim the earned income credit if all the following questions are answered YES:

1. Do the taxpayer, spouse, and qualifying child each have a social security number?

YES NO

2. Is the taxpayer's total taxable and nontaxable earned income at least \$1 but less than:

* \$9,770 if the taxpayer does not have a qualifying child?

* \$25,760 if the taxpayer has one qualifying child?

* \$29,290 if the taxpayer has more than one qualifying child?

YES NO

3. Is the taxpayer's modified AGI less than:

* \$9,770 if the taxpayer does not have a qualifying child?

* \$25,760 if the taxpayer has one qualifying child?

* \$29,290 if the taxpayer has more than one qualifying child?

YES NO

4. Is the taxpayer's investment income \$2,250 or less?

YES NO

5. Is the taxpayer's filing status one of the following: married filing jointly, head of household, qualifying widow(er), or single?

YES NO

6. If the taxpayer is a nonresident alien, is the filing status married filing jointly? (If taxpayer is not a nonresident alien, answer YES).

YES NO

7. Answer YES if the taxpayer (and spouse if filing a joint return) is not a qualifying child of another person.

YES NO

8. Answer YES if the taxpayer (and spouse if filing a joint return) is not filing Form 2555 or Form 2555-EZ to exclude from gross income any income earned in foreign countries or to deduct or exclude a foreign housing amount.

YES NO

STOP: If the taxpayer has a qualifying child, answer question 9 and skip 10. If the taxpayer does not have a qualifying child, skip 9 and answer 10.

9. (a) Does the child meet the age, relationship, and residence tests for a qualifying child? See Form 1040 instructions for Line 56a.

YES NO

(b) Answer YES if the qualifying child is also a qualifying child for one or more other persons and the taxpayer's modified AGI is higher than each other person's. Answer YES if the child is a qualifying child only for the taxpayer.

YES NO

(c) If the qualifying child is married, is the taxpayer claiming the child as a dependent? (If the qualifying child is not married, answer YES.)

YES NO

OR

10. (a) Was the taxpayer's main home (and the spouse's if filing a joint return) in the United States for more than half the year? Military personnel on extended active duty outside the United States are considered to be living in the United States.

YES NO

(b) Was the taxpayer (or spouse, if filing a joint return) at least age 25 but under 65 at the end of 1997?

YES NO

(c) No one can claim the taxpayer (or spouse if filing a joint return) as a dependent on their return. If the taxpayer (and spouse if filing a joint return) is not eligible to be a dependent on anyone else's return, answer YES. If taxpayer (or spouse if filing a joint return) is eligible to be claimed as a dependent on someone else's return, answer NO.

YES NO

***PERSONS WITH A QUALIFYING CHILD:** If the taxpayer answered YES to questions 1 through 9(a), (b), and (c), the taxpayer can claim the credit. Remember to fill out Schedule EIC and attach it to the taxpayer's Form 1040 or 1040A.

***PERSONS WITHOUT A QUALIFYING CHILD:** If the taxpayer answered YES to questions 1 through 8 and 10(a), (b), and (c), taxpayer can claim the credit.

IF THE TAXPAYER ANSWERED NO TO ANY QUESTION, TAXPAYER IS NOT ELIGIBLE FOR THE CREDIT.