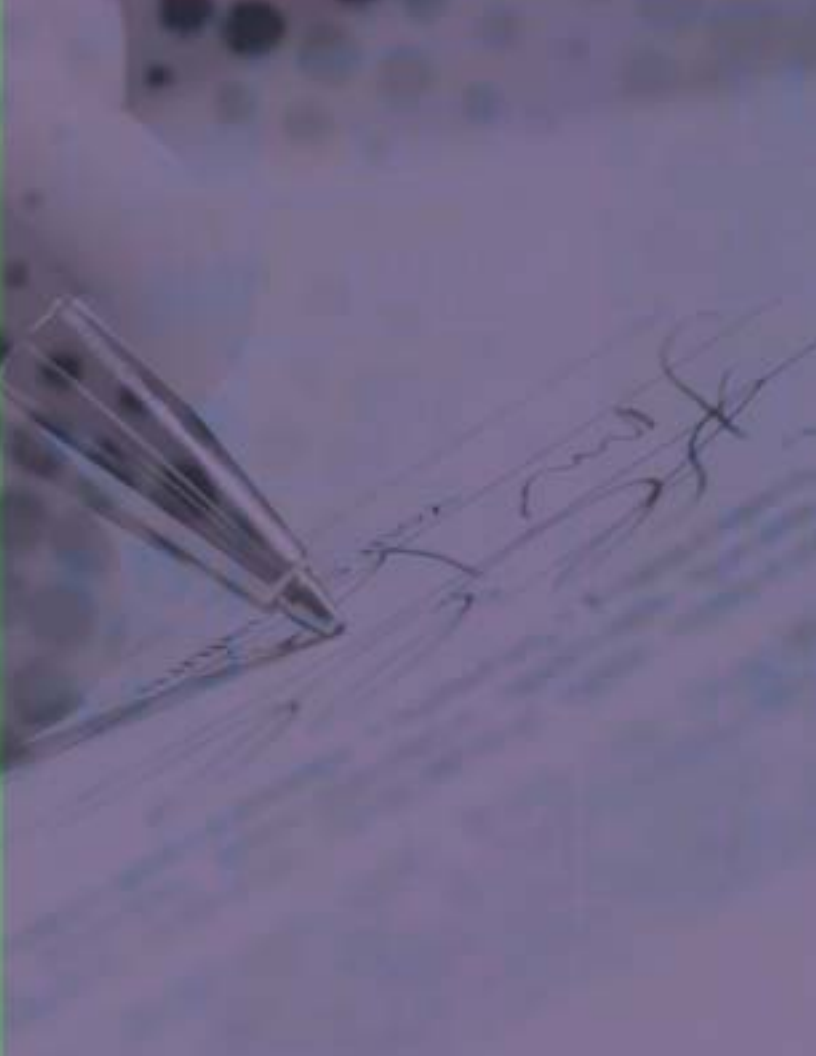


EITC

Earned Income Tax Credit
2002 Tax Professional Guide
(For Tax Year 2001 Returns)





Letter from the Commissioner

Dear Tax Professional,

You have just opened the 2002 Tax Professional Guide. It is intended for tax professionals who prepare tax returns claiming the earned income tax credit (EITC) for tax year 2001.

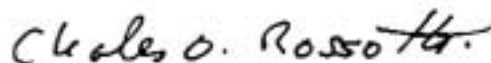
The Internal Revenue Service is committed to providing you with the tools necessary to prepare accurate and complete returns. We have designed this Tax Professional Guide to provide information on areas of the credit about which tax professionals like you have asked. Please take the time to carefully review this information and share it with your clients.

The guide contains information that will help you determine the eligibility of your clients for the EITC. It provides information on your due diligence responsibilities as required under the Taxpayer Relief Act of 1997. You will find that while there are no changes to the EITC tax laws for tax year 2001, several significant changes will go into effect for tax year 2002 EITC returns.

We hope you find this guide helpful as you assist your clients with filing their tax returns. Like you, we want to make certain that EITC returns are accurate so that taxpayers claim the proper amount of the credit to ensure timely refunds.

At the IRS, we are working to put service first as we make an earnest effort to meet the public's expectations. This Tax Professional Guide is a fundamental part of our service to you and to the American taxpaying public.

Sincerely,



Charles O. Rossotti
Commissioner
Internal Revenue

Notice To Tax Professionals

Important Note: *There are no changes to the EITC tax law for tax year 2001.*

Important Changes for tax year 2002

New definition of earned income: For tax years beginning after 2001, earned income will no longer include employee compensation that is nontaxable.

Elimination of modified adjusted gross income (AGI): For tax years beginning after 2001, taxpayers will no longer need to figure modified AGI. The EITC will be figured using AGI, *not* modified AGI.

New rules for persons with same qualifying child (tie-breaker rule): For tax years beginning after 2001, the tie-breaker rule will apply only when more than one taxpayer claims the EITC on the basis of the same qualifying child. In these cases, new rules will be used to determine which person can claim the EITC on the basis of that child.

New definition of qualifying child: For tax years beginning after 2001, the definition of a qualifying child will change. Specifically, in all cases the child will have to live with the taxpayer for more than half of the year.

Reduction of EITC by alternative minimum tax eliminated: For tax years beginning after 2001, the taxpayer's EITC will no longer be reduced by the amount of any alternative minimum tax shown on the return.

The changes above can be found in Publication 553, *Highlights of 2001 Tax Changes*.

In addition, for tax years beginning after 2001, the income amounts at which the phase-out begins and ends will increase by \$1,000 for joint filers.



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Introduction - The Earned Income Tax Credit (EITC)



The EITC is a tax break for people who work, but do not earn high incomes. Those who qualify could pay less federal tax or no tax, or even get a tax refund.

The EITC has no effect on certain welfare benefits. In most cases, any EITC payments your clients receive will not be used to determine whether they are eligible for Medicaid, supplemental security income (SSI), food stamps or low-income housing.

To qualify, your clients must meet certain rules and file a tax return, even if they do not owe any tax or did not earn enough money to file a tax return. However, your clients whose EITC is later disallowed may have to file Form 8862, *Information To Claim Earned Income Credit After Disallowance*, with their next tax return if they want to claim the credit. And, if they are subject to the two-year disallowance period because EITC errors were due to reckless or intentional disregard of the EITC rules or to the 10-year disallowance period because the error was due to fraud, they cannot claim the credit until that period is over.

Some of the EITC rules apply to everyone. There are, however, special rules for people who have children, for those who have no children, and for figuring earned income and modified adjusted gross income. Take a look at the chart on the following page that describes the EITC in a nutshell.

If you want free educational products about the EITC for yourself or to give to your clients, refer to the list in Appendix A. The IRS has developed items such as brochures, posters and payroll stuffers, some in Spanish, to help publicize the availability of the credit to those who are eligible.

The last page of this guide has an EITC eligibility checklist that you can use. You may consider offering copies to your clients. In addition, you can find details about the credit in IRS Publication 596, *Earned Income Credit*.

EITC information is available at www.irs.gov, the IRS Web site.

Rules for Everyone	Rules If You Have a Qualifying Child	Rules If You Do Not Have a Qualifying Child
You must have a valid Social Security number that allows you to work.	Your child must meet the relationship, age and residency tests.	You must be at least age 25 but under age 65.
Your filing status cannot be "married filing separately."	Your qualifying child cannot be the qualifying child of another person with a higher modified AGI.	You cannot be the dependent of another person.
You must be a U.S. citizen or resident alien during all of 2001.		You must have lived in the United States more than half of the year.
You cannot file Form 2555 or Form 2555-EZ (relating to foreign earned income).	<p>Figuring Earned Income and Modified Adjusted Gross Income (AGI)</p> <p>Your earned income and modified AGI for 2001 must be less than:</p> <ul style="list-style-type: none"> • \$32,121 if you have more than one qualifying child; • \$28,281 if you have one qualifying child; or • \$10,710 if you do not have a qualifying child. <p>For additional information on EITC rules and examples, see IRS Publication 596, <i>Earned Income Credit</i>.</p>	
Your investment income must be \$2,450 or less.		
You must have earned income.		
You cannot be a qualifying child of another person.		

Earned Income for the EITC

To qualify for the EITC, your clients must work and have earned income. If they are married and file a joint return, at least one spouse must work and have earned income. Earned income includes all of the income your clients get from working even if it is not taxable. Here are the most common types of earned income.

Earned Income Includes:

Taxable

- Wages, salaries and tips
- Net earnings from self-employment
- Gross income received as a statutory employee

Nontaxable

- This includes anything of value (money, goods or services) that is not taxable that you received for your work
- Salary deferrals, such as 401(k) plans, Federal Thrift Savings Plan (TSP)
- Salary reductions such as those under a cafeteria plan and not included in taxable income
- Mandatory contributions to a state or local retirement plan
- Basic housing and subsistence allowances, value of in-kind housing and subsistence, combat zone compensation for the military
- Meals and lodging provided for the convenience of the employer
- Housing allowance or rental value of a parsonage for the clergy
- Excludable employer-provided benefits such as dependent care, adoption and educational assistance benefits

Earned Income Does Not Include:

- Interest and dividends
- Pensions and annuities
- Social security and railroad retirement benefits
- Alimony and child support
- Welfare benefits
- Workers' compensation benefits
- Unemployment compensation
- (insurance)
- Veterans' benefits, including VA rehabilitation payments
- Certain workfare payments
- Earnings by one spouse treated as belonging to the other under community property laws
- Earnings while an inmate in



A Quick Glance at a Qualifying Child

A child must meet certain requirements to be your client’s qualifying child for the EITC. The following chart provides a quick glance at the three tests a child must meet: relationship, age and residency.

Relationship	<i>A qualifying child is a child who is your clients ...</i> son, daughter, adopted child, grandchild, great-grandchild, stepchild, eligible foster child <i>AND</i>
Age	<i>was at the end of 2001...</i> Under age 19, <i>OR</i> Under age 24 and a full-time student, <i>OR</i> Any age and permanently and totally disabled at any time during 2001 <i>AND</i>
Residency	<i>who...</i> Lived with your client in the United States for more than half of 2001 (if an eligible foster child, for all of 2001).

Sometimes a person meets the rules to be a qualifying child of more than one person. If your client and someone else have the same qualifying child, the person with the higher modified adjusted gross income is the *only* one who may be able to claim the EITC on the basis of that child. This is true even if that person does not claim the credit or meet all the rules to claim the EITC. However, if the other person is your client’s spouse and they file a joint return, this rule does not apply.

Your client cannot claim the EITC if he or she is the qualifying child of another person. In other words, if your client meets the qualifying child relationship, age and residency tests of another person, such as a parent, guardian or foster parent, your client cannot claim the EITC. This is true even if the person, of whom your client is a qualifying child, does not claim the credit or meet all the rules to claim it (for example, having income that exceeds the limit).

What You Will Need to Complete EITC Returns



In most cases, all you will need to complete your clients' EITC tax returns are the appropriate tax forms and instructions for Form 1040, 1040A or 1040EZ. Included in the instructions for each form is the worksheet needed to figure the amount of the credit. Paid preparers must also complete a Form 8867, *Paid Preparer's Earned Income Credit Checklist*, or otherwise record the same information for each EITC tax return.

In some cases, you may need the information contained in Publication 596, *Earned Income Credit*, to complete your clients' returns. Publication 596 includes EIC Worksheets A and B, specifically designed for use by taxpayers who cannot use the worksheets in their tax packages. Anyone can use them. If your clients are self-employed or filing Schedule C or C-EZ as statutory employees, you will need Worksheet B. It allows for Schedule C and Schedule F losses.

You must also complete and attach Schedule EIC, *Earned Income Credit, Qualifying Child Information*, to your client's return if the client is claiming the credit on the basis of a qualifying child. All the lines that apply for each child must be filled in. The correct Social Security number must be included.



If your client claims the EITC, each of the following individuals must have a valid SSN: (1) your client, (2) your client's spouse (if they file a joint return) and (3) any qualifying child listed on Schedule EIC. If your client (or spouse if filing a joint return) does not have a valid SSN, he or she cannot claim the EITC. Similarly, your client cannot claim the EITC on the basis of a qualifying child who does not have a valid SSN.

A valid SSN is an SSN issued by the Social Security Administration. Most SSNs are issued to U.S. citizens and to persons who have permission from the Immigration and Naturalization Service (INS) to work in the United States. Persons who are not permitted to work in the United States, but are entitled to receive an SSN receive a card with the legend **not valid for employment**. If a Social Security card contains this legend and the cardholder obtained the SSN to get a federally funded benefit, such as Medicaid, the SSN is not a valid SSN for EITC purposes.

If a client, spouse, or qualifying child has an SSN issued for non-work purposes and is now a U.S. citizen or permanent resident, the client or family member is probably entitled to obtain a new Social Security card from the SSA. The new card will contain the same SSN, but will not include the legend.

Other types of taxpayer identification numbers can prevent your clients from claiming the EITC. If, instead of an SSN, a client or spouse (if filing a joint return) has an individual taxpayer identification number (ITIN), issued by the IRS to noncitizens who cannot get an SSN, the client cannot claim the EITC. If a qualifying child has an ITIN or an adoption taxpayer identification number (ATIN), issued by the IRS for a child to adopting parents who cannot get an SSN for the child until the adoption is final, the taxpayer cannot get the credit on the basis of that child.

When the EITC is Disallowed

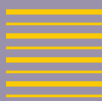


Deficiency Procedures

When completing your clients' EITC returns, you should ask if they have received any notices from the IRS. If you find that a client's EITC for a tax year after 1996 was denied or reduced by the IRS, you may need to fill out Form 8862, *Information To Claim Earned Income Credit After Disallowance*, so the client can again claim the credit if eligible.

You must complete this form and attach it to the returns of clients whose EITC was disallowed as a result of deficiency procedures (upon examination). The deficiency procedures are the rules the IRS must follow when examining an item claimed on a taxpayer's tax return, amended return or claim for refund using Form 843, *Claim for Refund and Request for Abatement*. The date on which the EITC is denied as a result of the deficiency procedures is the date of the assessment. The deficiency procedures do not apply to mathematical or clerical errors on the return.

Here's how the deficiency procedures work. Under these procedures, the IRS contacts the taxpayer in writing and asks for more information or documentation to support one or more items on the taxpayer's return. If the taxpayer does not provide all the necessary information, the IRS sends the taxpayer a report showing how the IRS proposes to adjust the return. If the taxpayer does not provide the remaining necessary information, the IRS sends a statutory notice of deficiency to the taxpayer by certified mail. This notice tells the taxpayer that the adjustment will be assessed unless the taxpayer files a petition in the Tax Court within 90 days. If the taxpayer does not file a petition within 90 days and does not otherwise reply to the IRS, the IRS makes the assessment and the EITC is denied.



About Form 8862

Form 8862 contains a series of questions designed to assist the IRS in determining whether the taxpayer is eligible to claim the EITC in the later year. Attach it to the first return on which your client claims the EITC after the credit has been denied as a result of the deficiency procedures.

If your client's EITC was denied or reduced as a result of a mathematical or clerical error, do not attach Form 8862 to the return. For example, if the arithmetic is incorrect, the IRS can correct it and adjust the return. If an SSN is incorrect and the client claims the EITC, the IRS can deny the credit and adjust the return. These kinds of errors are called mathematical or clerical errors.

If you are required to attach Form 8862 to your client's 2001 tax return, and you claim the EITC without attaching a completed Form 8862, an electronically filed return will be rejected. In the case of a paper return, the claim will be automatically denied under the mathematical or clerical procedures. Your client will not be permitted to claim the EITC without a completed Form 8862.

Prohibitions and Penalties

If the IRS determines that the taxpayer recklessly or intentionally disregarded rules or regulations when claiming the credit, it may assert an accuracy-related penalty, impose a 2-year ban or both when it denies the credit. The accuracy-related penalty is 20 percent of the underpayment of tax. The ban would prohibit your client from claiming the credit for the next two years. If a taxpayer is found to have fraudulently claimed the credit, the IRS could assert a fraud penalty, prohibit the taxpayer from claiming the credit for the next 10 years, or both.

You can find Form 8862 and the instructions on the following pages. Appendix B contains the IRS final regulation TD 8953, *Eligibility requirements after denial of the earned income credit*.

Information To Claim Earned Income Credit After Disallowance

OMB No. 1545-1619

Attachment
 Sequence No. **43A**

▶ **Attach to your tax return.** ▶ **See separate instructions.**

Name(s) shown on return

Your social security number

Before you begin:

See your tax return instructions for the year for which you are filing this form to make sure you can take the earned income credit (EIC) **and** to find out who is a qualifying child.

Part I All Filers

- 1 Enter the year for which you are filing this form (for example, 1999, 2000, etc.) ▶ _____
- 2 Were you, or your spouse if filing a joint return, a qualifying child of another person during the year entered on line 1? Yes No
- Next**, if you do not have a qualifying child, go to Part II. If you do have a qualifying child, go to Part III.

Part II Filers Without a Qualifying Child

Caution. See your tax return instructions for the year entered on line 1 to be sure you can take the EIC.

- 3a Enter the dates during the year shown on line 1 that your home was in the United States ▶ _____
- b If married filing a joint return, enter the dates during the year shown on line 1 that your spouse's home was in the United States ▶ _____

Part III Filers With a Qualifying Child or Children

Caution. If you have two qualifying children, complete lines 4–8 for one child **before** going to the next column. Be sure you list your children here in the same order as you did on **Schedule EIC**.

	Child 1	Child 2
4 Is the child your son, daughter, adopted child, grandchild, or stepchild?	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
Next , if you checked "Yes" for this child, go to line 5a. If you checked "No," go to line 6a.		
5a Did the child live with you in the United States for more than half of the year entered on line 1?	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
b Enter the address(es) where you and the child lived during the year entered on line 1		
c If the child attended school or day care, enter the name(s) of the school(s) or care provider(s)		
Next , go to line 7a on the back for this child.		
6a Are you related to the child or was the child placed with you by an authorized placement agency?	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
Next , if you checked "No" on line 6a for this child, go to line 6c. If you checked "Yes," continue.		
b Enter the child's relationship to you or the name of the placement agency. Enter both items if the child is related and was also placed with you by an agency		
c Did you care for the child as if he or she were your own child during the entire year entered on line 1?	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No

Part III Filers With a Qualifying Child or Children (Continued)

	Child 1	Child 2
d Did the child live with you in the United States for the entire year entered on line 1?	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
e Enter the address(es) where you and the child lived during the year entered on line 1		
f If the child attended school or day care, enter the name(s) of the school(s) or care provider(s)		
7a Did the child live with any other person for more than half of the year entered on line 1 (see instructions before answering)? Next , if you checked "No" on line 7a for this child, go to line 8a. If you checked "Yes," continue.	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
b Was this person the child's parent or grandparent? Next , if you checked "Yes" on line 7b for this child, go to line 7f. If you checked "No," continue.	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
c Did this person live with the child for the entire year entered on line 1 and care for the child as if the child were his or her own? Next , if you checked "No" on line 7c for this child, go to line 8a. If you checked "Yes," continue.	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
d Was this person related to the child or was the child placed with this person by an authorized placement agency? Next , if you checked "No" on line 7d for this child, go to line 7f. If you checked "Yes," continue.	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
e Enter the child's relationship to this person or the name of the placement agency. Enter both items if the child was related and was also placed with this person by an agency		
f Enter this person's name and social security number (see instructions)		
g Is your modified AGI (adjusted gross income) for the year entered on line 1 higher than the modified AGI of every person listed on line 7f?	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
8a Was the child under age 19 at the end of the year entered on line 1? Next , if you checked "Yes" on line 8a for this child, do not fill in lines 8b-8e for this child. If you checked "No," continue.	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
b Was the child under age 24 at the end of the year entered on line 1 and a student? Next , if you checked "No" on line 8b for this child, go to line 8d. If you checked "Yes," continue.	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
c If you checked "Yes" on line 8b, enter the name of the school(s), or the state, county, or local government agency if an on-farm training course, the child attended. Do not enter if shown on line 5c or 6f		
d If you checked "No" on line 8b, was the child permanently and totally disabled?	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
e If you checked "Yes" on line 8d, enter the name of the child's health care provider or social worker		

Instructions for Form 8862



Department of the Treasury
Internal Revenue Service

(Rev. November 2000)

Information To Claim Earned Income Credit After Disallowance

General Instructions

Purpose of Form

You **must** complete Form 8862 and attach it to your tax return if **both** of the following apply.

1. Your earned income credit (EIC) was reduced or disallowed for any reason other than a math or clerical error for a year after 1996.


2. You now want to claim the EIC.

However, **do not** file Form 8862 if, after your EIC was reduced or disallowed in an earlier year:

- You filed Form 8862 (or other documents) and your EIC was then allowed and
- Your EIC has not been reduced or disallowed again for any reason other than a math or clerical error.

Also, do not file Form 8862 or take the credit:

- For 2 years if it was determined that your error was due to reckless or intentional disregard of the EIC rules **or**
- For 10 years if it was determined that you fraudulently claimed the EIC.

 You must also attach **Schedule EIC** to your return if you have a qualifying child or children. In addition to filing Form 8862 and, if required, Schedule EIC, you may be asked to provide other information before any refund resulting from the EIC claimed on your return is issued.

Additional Information

For more details on the EIC, including the definition of a qualifying child and who is eligible to take the EIC, see your tax return instructions or **Pub. 596**, Earned Income Credit, for the year for which you are filing Form 8862.

Specific Instructions

Need More Space for an Item?

If you do, attach a statement that is the same size as Form 8862. Number each entry on the statement to correspond with the line number on Form 8862. Put your name and social security number on the statement and attach it at the end of your return.

Lines 3a and 3b

Please enter the information in the following order: month, day, year—month, day, year.

Example. You are single and are filing Form 8862 for 2000. Your home was in the United States for all of 2000. On line 3a, you would enter 01/01/2000—12/31/2000.

Members of the Military. If you were on extended active duty outside the United States, your home is considered to be in the United States during that duty period. Include

your active duty time on line 3a and your spouse's, if applicable, on line 3b. See Pub. 596 for the definition of extended active duty.

Line 5a

Temporary absences, such as for school, vacation, medical care, or detention in a juvenile facility, count as time lived at home.

Line 6d

Temporary absences, such as for school, vacation, medical care, or detention in a juvenile facility, count as time lived at home.

Line 7a

Check "No" if the only other person(s) who lived with the child was one of the following.

- Your spouse and you are filing a joint return.
- Your other child (or children) who meets the requirements to be your qualifying child.

If you checked "Yes" on line 7a and more than one other person lived with the child, complete lines 7a through 7g, if applicable, for each additional person. Show the required information on an attached statement. See **Need More Space for an Item?** on this page for details. Also, enter "See attached" next to line 7a.

Line 7f

If you checked "Yes" on—

- Line 7b, enter the name and social security number (SSN) of each parent or grandparent with whom the child lived for more than half of the year.
- Line 7c, enter the name and SSN of each person who lived with and cared for the child all year. **But** if the year entered on line 1 is after 1999 **and** you checked "No" on line 7d, **do not** fill in lines 7f through 8e for this child.

Line 7g

For the definition of modified AGI and how to figure it, see your tax return instructions or Pub. 596 if the year entered on line 1 is 1997 or 1998. Otherwise, see Pub. 596.

Line 8b

A **student** is a person who during any 5 months of the year entered on line 1—

- Was enrolled as a full-time student at a school or
- Took a full-time, on-farm training course given by a school or a state, county, or local government agency.

A **school** includes technical, trade, and mechanical schools. It does not include on-the-job training courses, correspondence schools, or night schools.

Line 8c

If the child attended more than one school or training course, attach a statement to your return with the name(s) of the school or government agency.

Line 8d

A person is **permanently and totally disabled** if **both** of the following apply.

1. He or she cannot engage in any substantial gainful activity because of a physical or mental condition.
2. A doctor determines the condition has lasted and can be expected to last continuously for at least a year or can lead to death.

Line 8e

Enter the name of the child's health care provider (such as a physician, registered nurse, clinic, etc.) or social worker.

Paperwork Reduction Act Notice. We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by Internal Revenue Code section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is:

Recordkeeping	52 min.
Learning about the law or the form	7 min.
Preparing the form	1 hr., 11 min.
Copying, assembling, and sending the form to the IRS	34 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. See the instructions for the tax return with which this form is filed.

Due Diligence

What to Do About Due Diligence



Tax Preparers' Due Diligence Requirements

The Taxpayer Relief Act of 1997 enacted a law concerning the EITC and preparers' due diligence in determining their clients' eligibility for the credit and the credit amount. Paid preparers who file EITC returns or claims for refunds for their clients must meet four due diligence requirements. Those who fail to do so can be assessed a \$100 penalty for each failure. Section 6695(g) of the Internal Revenue Code governs the application.

Here are the four due diligence requirements you must meet:

1. You must complete Form 8867, *Paid Preparer's Earned Income Credit Checklist*, or your own form as long as it provides the same information.
2. You must complete the appropriate EIC worksheet found in the Form 1040, 1040A or 1040EZ instructions or in Publication 596, or your own worksheet as long as it provides the same information.
3. You must have no knowledge that any of the information used to determine the taxpayer's eligibility for the credit and the credit amount is incorrect.
4. You must keep Form 8867 and the EIC worksheets (or your own equivalents of each), and a record of how, when and from whom the information used to prepare the form and worksheet(s) was obtained. You must keep these documents for three years from June 30th following the date the return or claim for refund was presented to the taxpayer.



Section 6695(g) Penalty and Appeal Rights

The due diligence requirements and the section 6695(g) penalty of \$100 are imposed on only those paid preparers who prepare the return claiming the EITC. In other words, you will not be assessed a \$100 penalty based on one of your client's returns that you did not prepare or that you merely filed electronically as an electronic return originator (ERO).

If the IRS determines that you failed to meet the due diligence requirements with respect to a return, you may avoid the \$100 penalty by demonstrating to the IRS that, considering all the facts and circumstances, your normal office procedures are reasonably designed and routinely followed to ensure compliance with the requirements, and the particular failure was isolated and inadvertent.

If the IRS determines that a preparer is subject to the IRC section 6695(g) penalty, an expedited pre-assessment Appeals process is available to those preparers who have allowed the IRS examiner access to their client files. The preparer receives a letter stating the amount of the proposed penalty and advising the preparer to agree or file a protest. The letter contains complete instructions on filing the protest. Once the protest is filed, it will receive priority consideration by Appeals and a hearing will be scheduled with the practitioner. That means that before you are actually assessed the penalty, you may be able to protest it under this expedited Appeals process.

You can see Form 8867 and its instructions on the following pages. Appendix C contains the IRS final regulation TD 8905, *Preparer Due Diligence Requirements for Determining Earned Income Credit Eligibility*.

Paid Preparer's Earned Income Credit Checklist

▶ **Do not send to the IRS. Keep for your records.**

For the definitions of the following terms, see **Pub. 596** for the year for which you are completing this form.

● **Investment Income** ● **Qualifying Child** ● **Modified AGI** ● **Earned Income** ● **Nontaxable Earned Income**

Caution: Taxpayers who file **Form 2555** or **Form 2555-EZ** cannot claim the earned income credit (EIC). Taxpayers who were nonresident aliens for any part of the year cannot claim the EIC unless their filing status is married filing jointly.

Part I All Taxpayers

- 1 Enter the taxpayer's name ▶
 and the year for which you are completing this form ▶
- 2 Is the taxpayer's filing status married filing jointly, head of household, qualifying widow(er), or single? **Yes** **No**
- 3 Does the taxpayer, and the taxpayer's spouse if filing jointly, have a social security number (SSN) that allows him or her to work? See the instructions before answering **Yes** **No**
Note: If you checked "No" on line 2 or line 3, stop; the taxpayer cannot claim the EIC. Otherwise, continue.
- 4 Is the taxpayer's investment income more than the limit that applies to the year on line 1? See Pub. 596 for the limit **Yes** **No**
- 5 Could the taxpayer, or the taxpayer's spouse if filing jointly, be a qualifying child of another person in the year on line 1? **Yes** **No**
Note: If you checked "Yes" on line 4 or line 5, stop; the taxpayer cannot claim the EIC. Otherwise, go to Part II or Part III, whichever applies.

Part II Taxpayers With a Qualifying Child

Caution: If there are two children, complete lines 6–11 for one child before going to the next column.

	Child 1	Child 2
6 Is the child— ● The taxpayer's son, daughter, or adopted child, or ● A descendant of the taxpayer's son, daughter, or adopted child, or ● The taxpayer's stepchild, or ● The taxpayer's eligible foster child?	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
7 If the child is married, is the taxpayer claiming the child as a dependent? (if the child is not married, check "Yes.")	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
8 Did the child live with the taxpayer in the United States for over half of the year, or the full year if the child is an eligible foster child?	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
9 Was the child (at the end of the year on line 1)— ● Under age 19, or ● Under age 24 and a full-time student, or ● Any age and permanently and totally disabled?	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
Did you check "Yes" on lines 6 through 9?		
<input type="checkbox"/> Yes. The child is the taxpayer's qualifying child. But the child may also be the qualifying child of one or more other taxpayers who could check "Yes" on lines 6 through 9. Go to line 10.		
<input type="checkbox"/> No. The child is not the taxpayer's qualifying child. If the taxpayer does not have a qualifying child, go to Part III on the back to see if the taxpayer can claim the EIC for taxpayers who do not have a qualifying child.		
10 Is the taxpayer's modified AGI higher than the modified AGI of all other taxpayers for whom the child is a qualifying child?	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
11 Does the qualifying child have an SSN? See the instructions before answering	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No

Did you check "Yes" on line 10 and line 11?

- Yes.** The taxpayer can claim the EIC if the taxpayer's earned income and modified AGI are each less than the limit that applies to the year on line 1. See Pub. 596 for the limit. Complete **Schedule EIC** and attach it to the taxpayer's return. If there are two qualifying children with SSNs, list them on Schedule EIC in the same order as they are listed here. Also, enter any **nontaxable earned income** on the appropriate line of the taxpayer's return for the year on line 1. If the taxpayer's EIC was reduced or disallowed for a year after 1996, see Pub. 596 to find out if **Form 8862** must also be filed.
- No.** The taxpayer cannot claim the EIC, not even the credit for taxpayers who do not have a qualifying child.

Part III Taxpayers Without a Qualifying Child

12 Was the taxpayer's main home, and the taxpayer's spouse if filing jointly, 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 during that duty period.) **Yes** **No**

13 Was the taxpayer, or the taxpayer's spouse if filing jointly, at least age 25 but under age 65 at the end of the year on line 1? **Yes** **No**

Note: If you checked "No" on line 12 or line 13, **stop**; the taxpayer **cannot** claim the EIC. Otherwise, continue.

14 Is the taxpayer, or the taxpayer's spouse if filing jointly, eligible to be claimed as a dependent on anyone else's Federal income tax return for the year on line 1?

No. The taxpayer can claim the EIC if the taxpayer's **earned income** and **modified AGI** are each less than the limit that applies to the year on line 1. See Pub. 596 for the limit. Also, any **nontaxable earned income** must be entered on the appropriate line of the taxpayer's return for the year on line 1. If the taxpayer's EIC was reduced or disallowed for a year after 1996, see Pub. 596 to find out if **Form 8862** must be filed.

Yes. The taxpayer **cannot** claim the EIC.

General Instructions**Purpose of Form**

Paid preparers of Federal income tax returns or claims for refund involving the earned income credit (EIC) must meet the due diligence requirements in determining if the taxpayer is eligible for, and the amount of, the EIC. Failure to do so could result in a \$100 penalty for each failure. See Internal Revenue Code section 6695(g).

Due Diligence Requirements. You will meet the due diligence requirements if **all four** of the following apply.

1. You complete Form 8867 (or your own form as long as it provides the same information as Form 8867).
2. You complete the EIC worksheet(s) in the Form 1040, 1040A, or 1040EZ instructions, or in Pub. 596 (or your own worksheet(s) as long as it provides the same information as the 1040, 1040A, 1040EZ, or Pub. 596 worksheet(s)).
3. You have no knowledge that any of the information used to determine if the taxpayer is eligible for, and the amount of, the EIC is incorrect.
4. You keep the following information for 3 years*:
 - Form 8867 (or your own form), **and**
 - The EIC worksheet(s) (or your own worksheet(s)), **and**
 - A record of how, when, and from whom the information used to prepare the form and worksheet(s) was obtained.

*For returns and claims for refund due after October 16, 2000, the 3-year period begins the June 30th following the date you give the return or claim to the taxpayer to sign.

Specific Instructions**Line 2**

If the taxpayer was married at the end of the year, he or she must usually file a joint return to claim the EIC. However, if the taxpayer and his or her spouse were not living together at the end of the year, the taxpayer may be eligible to be treated as unmarried. See **Pub. 596**, Earned Income Credit, for details.

Line 3

For purposes of taking the EIC, an SSN is a number issued by the Social Security Administration to a U.S. citizen or to a person who has permission from the Immigration and Naturalization Service to work in the United States. It does not include an SSN issued only to allow a person to apply for or receive Federally funded benefits. You may find it useful to look at the social security card.

Line 6

An **adopted child** includes a child placed with the taxpayer by an authorized placement agency for legal adoption even if the adoption is not final. An authorized placement agency includes any person authorized by state law to place children for legal adoption.

A **descendant** usually refers to a grandchild or great-grandchild of the taxpayer.

An **eligible foster child** is a child the taxpayer cared for as his or her own child and who lived with the taxpayer for the whole year. But see Pub. 596 for an exception if the child did not live with the taxpayer for the required time. **For years after 1999**, to be an eligible foster child a child must also be (a) a brother, sister, stepbrother, or stepsister of the taxpayer; (b) a descendant (such as a child, including an adopted child) of a brother, sister, stepbrother, or stepsister of the taxpayer; or (c) a child placed with the taxpayer by an authorized placement agency.

See Pub. 596 for more details on the relationship test for qualifying children.

Line 7

If the child is married and the child's other parent claimed him or her as a dependent under the special rules for children of divorced or separated parents, check "Yes."

Line 10

If no one else lived with the taxpayer and the child, check "Yes." Also check "Yes" if the taxpayer is married filing jointly and the only other person who lived with the taxpayer and the child was the taxpayer's spouse.

You must ask the taxpayer if his or her modified AGI is higher than the modified AGI of any other taxpayer for whom the child is a qualifying child. If necessary, you must explain to the taxpayer what modified AGI means. However, you do not have to verify the amount of any other taxpayer's modified AGI.

Line 11

See the line 3 instructions for the definition of an SSN. If the child does not have an SSN because he or she was born and died in the year entered on line 1, check "Yes."

Paperwork Reduction Act Notice. We ask for you to obtain the information on this form to carry out the Internal Revenue laws of the United States. You are required to obtain this information.

You are not required to obtain the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by Internal Revenue Code section 6103.

The time needed to complete this form will vary depending on individual circumstances. The estimated average time is: **Recordkeeping**, 13 min.; **Learning about the law or the form**, 8 min.; and **Preparing the form**, 24 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. You can write to the Tax Forms Committee, Western Area Distribution Center, Rancho Cordova, CA 95743-0001. **Do not** send the form to this address. Instead, keep it for your records.

FAQ's

Frequently Asked Questions About the EITC



General

1. What are the earned income and modified adjusted gross income (AGI) amounts for 2001?

To claim the EITC in 2001, your client's earned income and modified AGI must each be less than:

- \$32,121 with more than one qualifying child
- \$28,281 with one qualifying child
- \$10,710 without a qualifying child

2. What is modified AGI?

Modified AGI for most people is the same as AGI. AGI includes items such as taxable Social Security benefits and unemployment benefits. AGI is the amount on line 33 of Form 1040, line 19 of Form 1040A, and line 4 of Form 1040EZ.

You must add certain amounts to your client's AGI if your client:

- Shows a loss on Schedule C, C-EZ, D, E, or F,
- Claims a loss from the rental of personal property not used in a trade or business,
- Received any tax-exempt interest, or,
- Received any nontaxable distribution from a pension, annuity or individual retirement arrangement that was partly nontaxable.

Common Errors

3. What are the most common reasons for disallowance of the EITC?

Some of the more common reasons for disallowance are:

1. Taxpayers claiming a child who was not a qualifying child.
2. Taxpayers claiming a qualifying child who was also the qualifying child of someone else with a higher modified AGI.
3. Married taxpayers who should have filed under the *married filing separately* status, but who filed as *single* or *head of household* instead.
4. Income reporting errors.
5. Taxpayers or qualifying children who have mismatched or incorrect SSNs.

4. How can I determine whether a child meets the residency test?

If you have any reason to question whether the child lived with the taxpayer for the required period, you might find it useful to ask further questions. Additional questions might be necessary if, for example, the taxpayer states that the child lived with him or her for the entire year, but the taxpayer does not know the name of the child's school or care giver.

5. Must I review birth certificates to verify the age of the qualifying child?

No. However, if you have reason to question the child's age, you may want to look at the birth certificate.

6. What can I do if I experience a significant number of rejects on electronically filed returns?

If you experience a significant number of rejects, you should promptly discuss the situation with your local Senior Tax Specialist in the Wage & Investment, Shareholder Partnerships, Education and Communication (W&I, SPEC) Division, to ensure that any systemic problems are identified and quickly resolved. Call toll free 1-800-691-1894 for the closest specialist.

Recertification

7. What is EITC recertification?

EITC recertification refers to the requirement that a taxpayer whose EITC is denied or reduced for tax years starting after 1996 as a result of the deficiency procedures (upon examination) must attach a completed Form 8862, *Information To Claim Earned Income Credit After Disallowance*, to the next tax return on which he or she claims the EITC. For example, if a taxpayer's EITC for 2000 is denied before the taxpayer files a return for 2001, to claim the EITC for 2001, the taxpayer must attach Form 8862. If, however, the taxpayer's 2000 claim is denied after the taxpayer files a return for 2001 but before the taxpayer files a return for 2002, Form 8862 is not required for 2001, but the taxpayer must attach Form 8862 to his or her return for 2002 if he or she claims the EITC for that year. These recertification rules do not apply if the EITC was denied under the mathematical and clerical error procedures.

Frequently Asked Questions About the EITC (continued)

8. Is my client required to recertify when claiming the EITC for 2001?

If the EITC was denied or reduced for any tax year starting after 1996, a taxpayer should have received Letter 3094, *EIC Recertification Letter*, from the IRS after the examination was completed. Letter 3094 explains the requirement to file Form 8862. Even though the taxpayer attaches a properly completed Form 8862 to his or her return for 2001, the taxpayer may still be required to furnish documentation before a refund is released.

9. Is my client prohibited from claiming the EITC for a period of years?

Certain taxpayers may be prohibited from claiming the EITC for a 2- or 10-year period. The prohibition may be imposed when the EITC claimed for a year after 1996 is denied or reduced as a result of the deficiency procedures (upon examination) and the claim is determined to be due to reckless or intentional disregard of the EITC rules, or to fraud.

If the taxpayer's claim is due to the reckless or intentional disregard of the EITC rules and regulations, that taxpayer will be prohibited from claiming the EITC for the next two years. As with the Form 8862 requirement, the first year of the prohibition is the first year for which a return has not yet been filed.

If the taxpayer is found to have fraudulently claimed the EITC, the taxpayer will be prohibited from claiming the EITC for the next 10 years.

In both situations, after the prohibition period is over, the taxpayer must attach Form 8862 to the next return on which he or she claims the EITC.

Due Diligence

10. What do I need to do to meet the due diligence requirements of section 6695(g) of the Internal Revenue Code when preparing a return or claim for refund with the EITC?

Preparers of EITC returns and claims for refund (whether paper or electronically filed) are expected to exercise due diligence in getting accurate information to determine eligibility and in correctly computing the EITC amount. To meet your due diligence requirements, you must:

-
1. Complete Form 8867, *Paid Preparer's Earned Income Credit Checklist*, or otherwise record the information necessary to complete Form 8867 in your paper or electronic files (alternative checklist),
 2. Complete the appropriate earned income credit worksheet in the instructions for Form 1040, 1040A or 1040EZ, or in Publication 596, *Earned Income Credit*, or otherwise record the information necessary to complete the appropriate worksheet in your paper or electronic files (alternative worksheet),
 3. Have no knowledge or reason to know that any information you use in determining eligibility for, and the amount of, the EITC is incorrect, and
 4. Retain a copy of Form 8867 and the appropriate worksheets (or their alternatives) for three years after the June 30th following the date the return or claim for refund was presented to the taxpayer.

11. Must I use Form 8867, Paid Preparer's Earned Income Credit Checklist, as part of the due diligence process?

No, it is not necessary to use Form 8867 to meet the preparer due diligence requirements. However, you must either use Form 8867 or otherwise record the information necessary to complete Form 8867 in your paper or electronic files. Your electronic record must meet the requirements of Revenue Procedure 97-22, 1997-1 C.B. 652.

12. Is there a penalty for not meeting the preparer due diligence requirements?

Yes. Failure to meet the preparer due diligence requirements could result in a \$100 penalty for each failure under IRC section 6695(g). However, you may avoid the penalty with respect to a particular return or claim for refund if you can demonstrate to the satisfaction of the IRS that, given all the facts and circumstances, your normal office procedures are reasonably designed and routinely followed to ensure compliance with the due diligence requirements discussed above, and the failure to meet due diligence requirements with respect to the particular return or claim for refund was isolated and inadvertent.

Frequently Asked Questions About the EITC (continued)

Social Security Numbers (SSNs)

13. Must taxpayers and qualifying children all have SSNs?

Yes. There are several types of taxpayer identification numbers that can be used when filing a federal tax return, but only an SSN can be used when claiming the EITC. Moreover, if a Social Security card says *Not Valid for Employment*, the SSN generally cannot be used when claiming the EITC.

14. How can I tell if my clients and their children have the right kind of SSNs?

If the Social Security card does not contain the legend *Not Valid for Employment*, then the number can be used for EITC purposes. All U.S. citizens and all aliens who have been granted the status of permanent resident are entitled to receive an SSN from the Social Security Administration (SSA). Aliens who do not have permanent resident status generally cannot get an SSN unless they are entitled to certain federally funded benefits. For them, their Social Security card states that it is *Not Valid for Employment*.

15. Must I review Social Security cards?

No. However, because the IRS uses SSNs to identify taxpayers, it is important that you explain to your clients that all names must appear on the return exactly as they appear on the Social Security card.

16. How can I avoid mismatches of SSNs?

One of the primary reasons for the rejection of a return or a delay in processing a return is an incorrect SSN. It is important, therefore, that you check the accuracy of each SSN, as well as the spelling of the name associated with the number. Ask your client if he or she received a notice of an incorrect SSN for any prior tax year.

17. If there is a mismatch, what can I do to help?

If the problem is not yet resolved:

- Have your client check the Social Security card for accuracy of the name and number on the return.
- Ask if a name or other change has been reported to the SSA.
- Determine if the problem was due to an error in recording or transcribing the number.
- Refer your client to the SSA to resolve the problem before filing a return if you cannot determine the problem.

18. Where can I learn more about surname entry formats?

A detailed discussion of surname entry formats can be found in Publication 1346, *Electronic Return File Specifications and Record Layouts for Individual Income Tax Returns*. The specific references can be located in Part 1, Section 7 – Formats for Name Controls, Name Lines, and Addresses. If your software product “interprets” the name control from entries in the full name field, entries in the full name field should also conform to the name control format.

Reporting Suspicions

19. How do I report my suspicions if I think a client or another preparer is doing something questionable?

As a tax professional, you have a vested interest (as both a taxpayer and as a tax preparer) in the protection of the tax filing system. Report your suspicions by sending an e-mail to the IRS Office of Refund Crimes at HQ-ORF@ci.irs.gov or calling 1-800-829-0433.

You can also file Form 211, *Application for Reward for Original Information*, if you want to be considered for a reward for information leading to the detection of violations of the Internal Revenue Code.

Just A Reminder . . .

In General

- For years beginning with 2000, to be an eligible foster child for the EITC and the child tax credit, the child must be (1) your client's brother, sister, stepbrother or stepsister; (2) a descendant of your client's brother, sister, stepbrother or stepsister (including a niece, nephew, great-niece or great-nephew); or (3) a child placed with your client by an authorized placement agency. Also, your client must care for the child as his or her own child, and the child must live with your client for the whole year, except for temporary absences such as illness, school, business, vacation or military service.
- An adopted child is treated as a child by blood and includes a child placed with your client for adoption by an authorized placement agency, even if the adoption is not final.
- For tax years beginning in 2000, a client may be able to claim the EITC on the basis of a child who was kidnapped by a nonfamily member. Refer to Pub. 596, *Earned Income Credit*.
- A qualifying child for purposes of the EITC is **not** the same as:
 - A qualifying individual for the child and dependent care credit,
 - A qualifying child for the child tax credit,
 - An eligible child for the adoption credit, or
 - A dependent for the dependency exemption.You should check each one independently to determine your client's eligibility.
- To be eligible for the EITC, your clients, their spouses (if filing jointly), and their qualifying children listed on Schedule EIC must all have valid Social Security numbers (SSNs). The names and SSNs on tax returns must match those the Social Security Administration has on record. If they do not match, federal tax refunds could be delayed while the IRS works to straighten out the mismatch.
- When claiming the EITC, your client's filing status cannot be married filing separately. If married, your client usually must file a joint return to claim the EITC. If your client's spouse did not live in the home at any time during the last six months of the year, your client then may be able to file as head of household. To file as head of household, your client must have paid more than half the cost of keeping up the home for the year, and in most cases, must have a qualifying person living in the home for more than half the year. Publication 501, *Exemptions, Standard Deduction, and Filing Information*, has detailed information about filing as head of household.
- A taxpayer does not need a traditional home to claim the EITC. For example, if your client and his or her child lived together for more than half the year in one or more homeless shelters, the child meets the residency test.

-
- Your client's investment income must be \$2,450 or less. For most people, this is the total of their taxable interest, tax-exempt interest, dividend income and capital gain net income.

Taxpayer Advocate Service

The Taxpayer Advocate Service has independence from the IRS and increased staff and authority to help solve your clients' difficult tax problems. If you have attempted to deal with an IRS problem but were unsuccessful, do not hesitate to contact your local Taxpayer Advocate. You will be assigned your own personal advocate who is ready to listen and address your concerns quickly and fairly. Please call toll free 1-877-777-4778 for the Taxpayer Advocate Service.

IRS Services for You

You can access the IRS on your personal computer through the Internet. Our Web site at **www.irs.gov** can help you find answers to your questions. Some tax forms can now be filled in on line. You can also download forms and publications, and you can search publications by topic or keyword. At the *Tax Info For You* site, you can access Internal Revenue Bulletins and Cumulative Bulletins from the past few years, and at *Tax Regs in English* you can search regulations and the Internal Revenue Code (under the United States Code [USC]). While you are in the Web site, you can register to get our two e-mail newsletters — Digital Dispatch and IRS Local News Net.

The IRS provides various toll-free phone services. To order current or prior year tax forms and publications, call 1-800-829-3676. If you have a tax question, call 1-800-829-1040. To listen to pre-recorded messages covering various tax topics, call TeleTax at 1-800-829-4477. If you or a client has access to TTY/TDD equipment for the hearing impaired, call 1-800-829-4059 to ask tax questions or to order forms and publications.

Editor's Note

We designed the 2002 Tax Professional Guide while keeping in mind the needs of the tax professional. Please feel free to let us know whether we succeeded in addressing the areas of EITC that are of concern to you. More important, let us know what information you would like us to include in the next revision. We welcome your comments on how to make this a better guide in future years. Please send your comments to:

Internal Revenue Service

EITC Program Office – 3407 IR
Editor, 2002 Tax Professional Guide
1111 Constitution Avenue NW
Washington, DC 20224



Appendix A

EITC Products to Order

The IRS has developed the following free products to publicize the availability of the earned income tax credit (EITC). Please order as many as you need for your use or to help your clients learn about the EITC. Most of these products will be available in January 2002.

Call the IRS at 1-800-829-3676 to place your order. You can also download IRS forms, publications and other tax information materials from the IRS Web site at www.irs.gov.

Available in English and Spanish (add "SP" to the end of the publication number for Spanish versions)

EITC

- Publication 1495, EITC Poster (8 1/2" x 11")
- Publication 3211, EITC Q's and A's Brochure
- Publication 3535, Not Valid for Employment SSN Poster (11" x 17")
- Publication 3709, Eligible Foster Child Poster (11" x 17")
- Publication 962, EITC Payroll Stuffer

Advance EITC

- Publication 1235, Advance EITC Self-mailer with Form W-5
- Publication 1759, Advance EITC Poster (8 1/2" x 11")
- Publication 1762, Advance EITC Payroll Stuffer

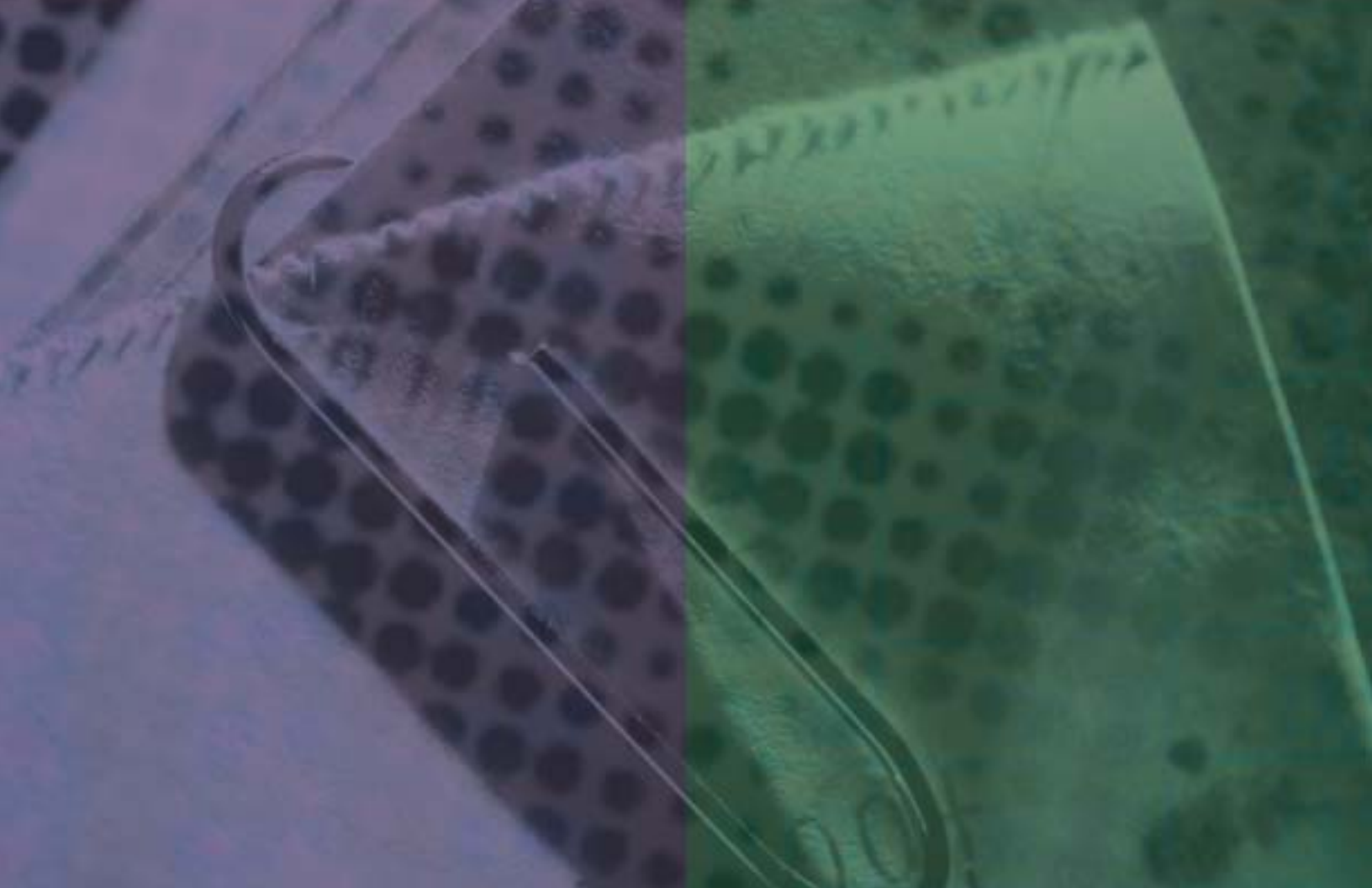
Available in English only

EITC

- Publication 1830, Sell-In Sheet of EITC Materials
- Publication 3523, EITC In A Nutshell Poster (8 1/2" x 11")
- Publication 3524, EITC Eligibility Checklist Poster (11" x 17")

Advance EITC

- Publication 1844, Advance EITC Brochure for Employers



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Appendix B

EIC Eligibility Requirements

[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 602

[TD 8953]

RIN 1545-AV61

Eligibility requirements after denial of the earned income credit

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations that provide guidance to taxpayers who have been denied the earned income credit (EIC) as a result of the deficiency procedures and wish to claim the EIC in a subsequent year. The temporary regulations apply to taxpayers claiming the EIC for taxable years beginning after December 31, 1997, where the taxpayer's EIC claim was denied for a taxable year beginning after December 31, 1996.

DATES: Effective date: These regulations are effective June 25, 2001.

Applicability dates: For dates of applicability, see §1.32-3(f) of these regulations.

FOR FURTHER INFORMATION CONTACT: Karin Loverud at 202-622-6080 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has 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 1545-1575. 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 burden is reflected in the burden of Form 8862.

Comments and suggestions for reducing the burden imposed by this regulation should be sent to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, W:CAR:MP: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 32(k) was added by the Taxpayer Relief Act of 1997. Section 32(k)(2) provides that, in the case of a taxpayer who is denied the EIC as a result of the deficiency procedures, no EIC is allowed for any subsequent taxable year unless the taxpayer provides such information as the Secretary may require to demonstrate eligibility for the credit. On June 25, 1998, temporary regulations (TD 8773) relating to earned income credit eligibility requirements under section 32(k)(2) were published in the **Federal Register** (63 FR 34594). A notice of proposed rulemaking (REG-116608-97) cross-referencing the temporary regulations was published in the **Federal Register** for the same day (63 FR 34615).

No written comments responding to the notice of proposed rulemaking were received. No public hearing was requested or held.

As part of an audit pertaining to the IRS's management of the EIC eligibility program, the Treasury Inspector General for Tax Administration recommended that the Treasury and the IRS reconsider (1) the time at which the taxpayer should be required to establish eligibility to claim the EIC, and (2) whether the eligibility requirement should pertain to the reason the EIC was denied. For example, under the temporary regulations, a taxpayer who is denied the credit on the basis of a child who is determined not to be a qualifying child must establish eligibility the next time the taxpayer claims the EIC, regardless of whether the taxpayer is claiming the credit on the basis of one or more qualifying children or on the basis of no qualifying children. Treasury and the IRS believe that the purpose of the eligibility requirement (to prevent erroneous claims) is better effectuated if the taxpayer establishes eligibility the next time the taxpayer claims the credit with one or more qualifying children, rather than the next time the taxpayer claims the credit.

The IRS is currently exploring whether, and to what extent, its system is capable of undertaking such a change. If a change is made, it would not affect the method of establishing eligibility, that is, the taxpayer would continue to be required to attach a completed Form 8862 to his or her tax return. The Treasury and the IRS do not expect any change will affect returns for tax year 2001.



If a change is made, the IRS expects to inform taxpayers of the change in two specific ways. First, the IRS would revise Letter 3094, which informs the taxpayer of the eligibility requirements. Second, the IRS would revise the instructions for Form 8862 to clarify the return to which it must be attached. In addition, the IRS would include information regarding the change in all IRS taxpayer publications that deal with the EIC eligibility requirements.

The proposed regulations under section 32(k)(2) are adopted as revised by this Treasury decision. The revisions are discussed below.

Explanation of Revisions

To permit the IRS to make changes to the EIC eligibility program as indicated above, §1.32-3(c) is revised to state that the Form 8862 instructions will instruct the taxpayer when to file Form 8862. A new sentence is added to §1.32-3(c) to the effect that, if the taxpayer attaches Form 8862 to an incorrect return, the taxpayer will nevertheless be required to attach Form 8862 to the correct return.

The IRS and Treasury will consider written comments pertaining to these revisions. Submissions should be sent to: CC:ITA:RU (TD8953), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:ITA:RU (TD 8953), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. 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 the IRS Internet site at http://www.irs.gov/tax_regs/regslst.html.

Special Analyses

It has been determined that these final regulations are 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.

It is hereby certified that 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 underlying statute applies only to individuals. 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 Code, the notice of proposed rulemaking preceding 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 Karin Loverud, Office of Division Counsel/ Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and the 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.

Adoption of 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 continues to read in part as follows:

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

Par. 2. Section 1.32-3 is added to read as follows:

§1.32-3 Eligibility requirements after denial of the earned income credit.

(a) In general. A taxpayer who has been denied the earned income credit (EIC), in whole or in part, as a result of the deficiency procedures under subchapter B of chapter 63 (deficiency procedures) is ineligible to file a return claiming the EIC subsequent to the denial until the taxpayer demonstrates eligibility for the EIC in accordance with paragraph (c) of this section. If a taxpayer demonstrates eligibility for a taxable year in accordance with paragraph (c) of this section, the taxpayer need not comply with those requirements for any subsequent taxable year unless the Service again denies the EIC as a result of the deficiency procedures.

(b) Denial of the EIC as a result of the deficiency procedures. For purposes of this section, denial of the EIC as a result of the deficiency procedures occurs when a tax on account of the EIC is assessed as a deficiency (other than as a mathematical or clerical error under section 6213(b)(1)).

(c) Demonstration of eligibility. In the case of a taxpayer to whom paragraph (a) of this section applies, and except as otherwise provided by the Commissioner in the instructions for Form 8862, "Information To Claim Earned Income Credit After Disallowance," no claim for the EIC filed subsequent to the denial is allowed unless the taxpayer properly completes Form 8862, demonstrating eligibility for the EIC, and otherwise is eligible for the EIC. If any item of information on Form 8862 is incorrect or inconsistent with any item on the return, the taxpayer will be treated as not demonstrating eligibility for the EIC. The taxpayer must follow the instructions for Form 8862 to determine the income tax return to which Form 8862 must be attached. If the taxpayer attaches Form 8862 to an incorrect tax return, the taxpayer will not be relieved of the requirement that the taxpayer attach Form 8862 to the correct tax return and will, therefore, not be treated as meeting the taxpayer's obligation under paragraph (a) of this section.



(d) Failure to demonstrate eligibility. If a taxpayer to whom paragraph (a) of this section applies fails to satisfy the requirements of paragraph (c) of this section with respect to a particular taxable year, the IRS can deny the EIC as a mathematical or clerical error under section 6213(g)(2)(K).

(e) Special rule where one spouse denied EIC. The eligibility requirements set forth in this section apply to taxpayers filing a joint return where one spouse was denied the EIC for a taxable year prior to marriage and has not established eligibility as either an unmarried or married taxpayer for a subsequent taxable year.

(f) Effective date. This section applies to returns claiming the EIC for taxable years beginning after December 31, 1997, where the EIC was denied for a taxable year beginning after December 31, 1996.

§1.32-3T [Removed]

Par. 3. Section 1.32-3T 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:

1. Removing the entry for 1.32-3T from the table.
2. Adding an entry for 1.32-3 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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1.32-3.....	1545-1575
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Robert E. Wenzel
 Deputy Commissioner of Internal Revenue
 Approved: June 20, 2001
 Mark Weinberger
 Assistant Secretary of the Treasury



Appendix C

Preparer Due Diligence Requirements for Determining Earned Income Credit Eligibility

[4830-01-u]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 602

Treasury Decision 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 record keeping 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, 105th Cong., 1st Sess. 512 (1997) and S. Rep. No. 29, 105th Cong., 1st Sess. 125 (1997). The additional information gathering and record keeping 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 record keeping requirements.

26 CFR Part 602

Reporting and record keeping 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.
* * * * *	
1.6695-2	1545-1570
* * * * *	

Deputy Commissioner of Internal Revenue
Approved:
Acting Assistant Secretary of the Treasury

EITC Eligibility Checklist

Yes No

You may claim the EITC if you answer YES to all the following questions.*

1. Do you, your spouse (if filing jointly) and your qualifying child listed on Schedule EIC each have an SSN?
2. Is your filing status married filing jointly, head of household, qualifying widow(er) or single? Caution: If you are a nonresident alien, answer YES only if your filing status is married filing jointly and you are married to a U.S. citizen or resident alien.
3. Answer YES if you are not filing Form 2555 or Form 2555-EZ. Otherwise, answer NO.
4. Is your investment income \$2,450 or less?
5. Is your total earned income at least \$1 but less than:
 - \$10,710 if you do not have a qualifying child,
 - \$28,281 if you have one qualifying child, or
 - \$32,121 if you have more than one qualifying child?
6. Is your modified adjusted gross income (AGI) less than:
 - \$10,710 if you do not have a qualifying child,
 - \$28,281 if you have one qualifying child, or
 - \$32,121 if you have more than one qualifying child?
7. Answer YES if you (and your spouse if filing a joint return) are not a qualifying child of another person. Otherwise, answer NO.

STOP: If you have a qualifying child, answer questions 8 and 9 and skip 10 through 12. If you do not have a qualifying child, skip questions 8 and 9 and answer 10 through 12*.

8. Does your child meet the age, residency and relationship tests for a qualifying child?
9. Is your child a qualifying child only of you? Answer YES if your qualifying child is also a qualifying child of another person but your modified AGI is higher than the other person's.
10. Was your main home (and your spouse's if filing a joint return) in the United States for more than half the year?
11. Were you (or your spouse if filing a joint return) at least age 25 but under age 65 at the end of 2001?
12. Answer YES if you (and your spouse if filing a joint return) cannot be claimed as a dependent on anyone else's return. Answer NO if you (or your spouse if filing a joint return) can be claimed as a dependent on someone else's return.

* *Persons who have a qualifying child:* If you answered YES to questions 1 through 9, you can claim the EITC. Remember to fill out Schedule EIC, *Earned Income Credit, Qualifying Child Information*, and attach it to your Form 1040 or Form 1040A. You cannot use Form 1040EZ.

* *Persons who do not have a qualifying child:* If you answered YES to questions 1 through 7, and 10 through 12, you can claim the EITC.

If you answered NO to any question that applies to you, you are not eligible for the EITC.





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