<u>Gather the following documents before you work on your tax return</u>

- If you have someone prepare your tax return, bring the documents to your preparer to make sure your tax return is prepared correctly.
- Social security cards and social security number verification letter or other us government document verification for all persons you may list on the return
- Birth dates for all persons you may list on the return
- A copy of last year's federal and state returns, if you have them
- All income statements: Forms W-2 and 1099, Social security, unemployment and other statements, such as pensions, stocks, interest and any documents showing taxes withheld. If you own or run a business or farm, collect records of all your income
- All records of expenses such as tuition mortgage interest or real estate taxes. If you own or run a business or farm collect records of all your expenses
- Bank routing numbers and account numbers to direct deposit any refund
- Dependent child care information: name and address of paid caretakers and either their social security number or other tax identification number
- If you purchased coverage through the health insurance marketplace form 1095-a health insurance marketplace statement

Who is self-employed?

- You are self-employed if you carry on a trade or business with a profit motive as a sole proprietor or as an independent contractor
- An individual who performs services on a part time bases or do occasional odd jobs and receives compensation for that work may be self-employed. An individual doesn't need to have a business name or a formal business structure in order to be self-employed is required to report the income and related expenses from selling goods or performing services for others for money

How is self-employment reported on a tax return?

- Income received from all sources in a self-employed taxpayers business must be reported unless it is excluded by law
- All ordinary and necessary expenses incurred in a self-employed taxpayers business must also be reported. See IRC 1402a
- Form 1040, schedule C profit or loss from business is used to report the activity on the individual's tax return

Why are schedule C's an EITC issue?

- IRS estimates that between 22.1% and 25.9% of the EITC claims or between $13.3 and $15.6 billion were paid in error in 2013
- Income reporting errors are among the top three common eitc errors that account for more than 60% of the dollars paid in error annually
- The most common schedule C errors which fall into the income category noted on EITC returns are:
    - Schedule C's with losses or over stated expenses to bring income down to qualify for eitc
    - Inflated schedule C income to maximize the amount of EITC and
    - Bogus schedule C income to qualify for or maximize the amount of EITC
- Approximately 21 million schedule C forms are filed each year. Most of these represent small often home based businesses. Approximately one third of the annual tax gap is a result of under reported income or overstated deductions on schedule C businesses

What is EITC due diligence?

- EITC due diligence is a law that requires paid preparers of EITC returns to take additional steps to ensure that the return information impacting EITC eligibility is correct
- The EITC due diligence regulations can be found at www.eitc.irs.gov/tax-preparer-tookit/dd/lawandregs
- Basically EITC due diligence requires you as a paid preparer to:
  - Evaluate the information received from the client
  - Apply a consistency and reasonableness standard to the information
  - Make additional reasonable inquiries when the information appears to be incorrect, inconsistent, or incomplete
  - Document additional inquiries and the client's response

How does EITC due diligence apply to schedule C claims prepared by tax practioners?

- EITC due diligence IRC 6695(g), requires paid tax return preparers to make additional inquiries of taxpayers who appear to be making inconsistent, incorrect or incomplete claims related to their self-employment when the tax return includes the earned income tax credit
- All additional inquiries made to comply with EITC due diligence and the clients responses must be documented.
- The statute requires the EITC return preparer to be reasonable, well informed, and knowledgeable in the tax law
- Paid tax return preparers generally can rely on the taxpayers representations, but EITC due diligence requires the paid preparer to take additional steps to determine that the net self-employment income used to calculate the amount of or eligibility for EITC is correct and complete
- Tax preparers should ensure that the amount of net self-employment income reported is correct
- Taxpayers sometimes want to over report or under report income to qualify for or maximize the amount of EITC
- The preparer should ask sufficient questions of clients claiming self-employment income to be satisfied that:
    - The client is actually conducting a business
    - The client has records to support income and expenses or can reasonably reconstruct income and expense records and
    - The client has included all income and related expenses on the schedule C profit or loss from business (sole proprietorship)

What are consequences for not meeting your due diligence and filing incorrect EITC returns?

- Incorrect EITC returns may adversely affect both you and your clients. The consequences may include:
  - Your clients may be subject to accuracy or fraud penalties and be banned from claiming eitc for a period of 2 or 10 years depending on the reason the earned income tax credit was disallowed
  - Return preparers who fail to comply with eitc due diligence requirements can be assesses a $500 penalty for each failure. The most common reason for assessing due diligence penalties is failure to meet the knowledge requirement. Refer to the internal rev code section 6695(g) and treasury regulation 1.6695-2
- Other return preparer penalties ranging from $1000 to $5000 may also be assessed for negligence or intentional disregard of the rules and regulations when preparing EITC returns.
- The assessment of return related penalties against a tax preparer may result in:
  - Suspension of the preparer from participation in IRS e file and preparer registration
  - Injunctions barring the preparer from preparing taxes
  - Referral for criminal investigation
  - Disciplinary action by the IRS office of professional responsibility
- It is important to note that all registered preparers are held to the ethical standards defined in Circular 230 and are subject to consequences if the standards are not upheld. This could include revocation of your PTIN

What schedule C situations should raise a red flag for you as a tax preparer?

- Schedule C income in round numbers
- Schedule C cash businesses as the only income on a return claiming EITC
- Schedule C with little or no expenses when expenses would be expected
- Schedule C taxpayers with little or no records for income and expenses
- Any schedule C income that brings the taxpayer to the maximum EITC
- Schedule C without a form 1099

What techniques can be used to obtain information from your client.

- Conduct a thorough and in-depth interview with your client about the business activity.
- When the basic question/answer format does not seem to be creating a clear and consistent picture, asking your client to describe daily and weekly activities can provide a great deal of information
- Casual conversations about business practices may be insightful
- Return preparers should take the time to educate their clients on the need for record keeping and the consequences of failure to keep records. Thought should be given to reaching out to existing clients at the beginning of the tax year to educate them and to help them to establish a good record keeping system so that come the next filing season they will have a much easier time of filing an accurate return.
- Form 11652 questionnaire and supporting documentation form 1040, schedule C (profit or loss from business) used during IRS examinations of schedule C, provides a starting point for addressing clients record keeping. www.eitc.irs.gov./eitccentral/f11652.pdf
- Reviewing supporting material:
    - If supporting material is not provided, return preparers should inform their clients that the IRS may audit them. In that event the client would need to provide receipts to support the figures. Taxpayer claims of having supporting documentation is not sufficient to meet tax preparer due diligence. Preparers should inquire how income and expenses were computed and document the responses. In circumstances where you feel the information is not accurate or the supporting material is sufficient, you may ask to see the supporting material.

Important things to know about schedule C income