December 6, 2011

Hon. Douglas Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: Proposed Regulations Changing Tax Preparer Due Diligence Standards Relating to the Earned Income Tax Credit (Reg. 140280-09)

Dear Commissioner Shulman:

Enclosed are comments on proposed regulations changing tax preparer due diligence standards relating to the earned income tax credit (Reg. 140280-09). These comments represent the views of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association, and should not be construed as representing the policy of the American Bar Association.

Sincerely,

William M. Paul
Chair, Section of Taxation

Enclosure

cc: Emily S. McMahon, Acting Assistant Secretary (Tax Policy), Department of the Treasury
William J. Wilkins, Chief Counsel, Internal Revenue Service
Steven T. Miller, Deputy Commissioner for Service and Enforcement, Internal Revenue Service
Deborah A. Butler, Associate Chief Counsel, Internal Revenue Service
Jeffrey Van Hove, Tax Legislative Counsel, Department of the Treasury
Karen L. Hawkins, Director, Office of Professional Responsibility, Internal Revenue Service
David Williams, Director, Return Preparer Office, Internal Revenue Service
ABA SECTION OF TAXATION
COMMENTS ON REG-140280-09 PROPOSED REGULATION
CHANGING TAX PREPARER DUE DILIGENCE STANDARDS
RELATING TO THE EARNED INCOME TAX CREDIT

These comments (“Comments”) are submitted on behalf of the American Bar Association Section of Taxation and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Joseph Barry Schimmel and George L. Willis of the Low Income Taxpayers Committee of the Section of Taxation. Additional contributions were made by committee members Nicole Appleberry and Dana Goldstein. The Comments were reviewed by T. Keith Fogg, Low Income Taxpayers Committee Chair. The Comments were further reviewed by Diana L. Leyden of the Section’s Committee on Government Submissions and by Alice G. Abreu, Council Director for the Low Income Taxpayers Committee.

Although the members of the Section of Taxation who participated in preparing these Comments have clients who might be affected by the federal income tax principles addressed by these Comments, no such member or the firm or organization to which such member belongs has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these Comments.

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Date: December 6, 2011
Background

On October 6, 2011, the Department of Treasury and the Internal Revenue Service (the “Service”) issued proposed regulations under section 6695(g) which propose modifications to the due diligence requirements imposed upon tax return preparers in preparing claims for the Earned Income Credit (“EIC”). These Comments address the possible effect of the proposed regulations on low income taxpayers. They do not address the impact upon tax return preparers or others.

The EIC is a refundable credit available to taxpayers who receive earned income and meet certain eligibility requirements. The Service has estimated that the overpayment rate for the EIC for fiscal year 2009 was 23 percent to 28 percent of all claims. An “overpayment” is defined as a claim for the EIC that is not substantiated. The Service assumes that a large portion of the overpayment rate for the EIC is due to mistakes made by paid tax return preparers. The proposed regulations seek to reduce preparer mistakes by requiring tax return preparers to file forms and keep information as a way of requiring more due diligence.

We have two policy concerns regarding the assumptions underlying the proposed regulations. First, the Service’s definition of overpayment does not distinguish between taxpayers who willingly and improperly claim the EIC and those who are simply unable to respond to the Service’s request for documentation to prove entitlement to the EIC. The Service categorizes both types of disallowed EIC claims as overpayments. Also, in its statistics on overpayments, the Service does not consider that as many as one in four eligible taxpayers do not claim the EIC. Second, imposing increased reporting and due

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1 Unless otherwise indicated, all section references are to the Internal Revenue Code (“IRC”) of 1986, as amended (the “Code”), and all references to “Proposed Regulations” or to “Prop. Reg.” are to the proposed regulations promulgated under the Code.
2 For the purposes of these comments, the term “tax return preparers” and “preparers” are used interchangeably.
4 I.R.C. § 32.
6 The proposed regulations incorporate the definition of the term “tax return preparer” under Reg. § 301.7701-15(a).
7 Hence, the proposed regulations only apply to tax return preparers (either individuals or firms) that are paid for preparing tax returns. As discussed infra, we are concerned that the proposed regulations’ requirements could push tax return preparers, who nevertheless get paid, not to sign returns and to indicate that the returns are “self-prepared.”
diligence on tax return preparers may have the unintended, and undesirable, effect of causing tax return preparers to go “underground,” still collecting fees from taxpayers, but reporting that their tax returns were “self-prepared.”

Taxpayers who do not qualify for the EIC should not unwittingly claim the credit because of inept or unethical tax return preparers. When an overpayment as large as the EIC is made to a low income taxpayer, it is often impossible for them to pay it back. The burdens imposed by the Service’s enforced collection procedures often create significant economic hardship for low income taxpayers and should be avoided up front whenever possible. As approximately two-thirds of tax returns claiming EIC refunds are completed by tax return preparers, to the extent that the proposed regulations cause greater due diligence on the part of tax return preparers, we believe that the proposed regulations will have a positive effect on low income taxpayers. However, these benefits may be substantially offset by additional return preparation costs and burdens that may result from the requirement to file Form 8867.

Comments

We submit the following in response to the request for comments on the proposed regulations under section 6695(g).

1. Although we question whether the proposed requirement that Form 8867 be submitted at the time of the filing of a return is necessary, we feel that the submission will cause tax return preparers to take more seriously their duty to make reasonable efforts to ensure that claims for the EIC are proper and accurate.

However, the proposed requirement that Form 8867 be filled out and filed with the tax returns may only have the effect of keeping already ethical and educated tax return preparers “honest.” In that case, it seems that the filing requirement does not add significant value to the tax administration system as a whole. Nevertheless, we support the submission of Form 8867 because it adds little burden since tax return preparers are already required to review documentation and complete Form 8867 (or otherwise record the information required by Form 8867) before claiming EIC on a return.

We do anticipate an unintended consequence of the form submission requirement, however. We are concerned that there will be a segment of the tax return preparer population who will opt not to make valid EIC claims for fear of violating the new requirements. Therefore, we encourage the Service to study and track whether or not the avoidance of tax return preparer penalties becomes a disincentive to making valid EIC claims.

Tax return preparers are already required to review documentation and complete Form 8867 (or otherwise record the information required by Form 8867) before claiming EIC on a return. To the extent that the proposed changes merely require the submission of Form 8867 (i.e., information that is already required to be noted in tax return preparer

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files), the change is not unduly burdensome. Thus, we believe that the Service’s estimates of the burden of the “form submission requirement” under Proposed Regulation section 1.6695-2(b)(1)(i) are fair insofar as they impact tax return preparers.

However, we do anticipate a burden on taxpayers that was not noted in the analysis of the proposed changes by the Service. The cost of preparing a return that includes a claim for EIC will likely increase, as many tax return preparers base their fees, at least in part, on the number and types of forms prepared and filed.

2. We have more serious concerns about the record retention burdens imposed on tax return preparers under the proposed revisions to Regulation section 1.6695-2(b)(4). The proposed changes to the regulation require that tax return preparers must also retain a copy of “any document that was provided by the taxpayer and on which the tax return preparer relied to complete Form 8867 [or other records].” This record retention requirement may not pose a significant burden for large or national tax return preparation firms and practitioners whom we would expect to have adequate access to photocopiers, scanners, and storage space. However, we foresee that the record retention requirement may impose a disproportionate burden on solo, small firm, or low-bono tax return preparers, who may not have access to the same resources. This, in turn, may impact low income taxpayers who are more likely to use low cost single office tax return preparers, and not large firms or national services. For example, such preparers might increase their fees to cover added costs and, in some cases, may withdraw from the market altogether.

We also note a potential unintended consequence that may result from the record retention requirement. It is possible that some tax return preparers will require that taxpayers provide copies of records far in excess of what is required to avoid due diligence penalties. This would be especially burdensome to low income taxpayers who may be asked to make repeated trips to gather substantiation that a tax return preparer deems sufficient, when it is not, in fact, necessary. In order to help ensure consistent treatment of taxpayers, we recommend that the IRS take steps to educate tax return preparers regarding the extent of required substantiation. There should be simple and clear guidance for tax return preparers akin to the guidance for taxpayers that is found in Form 886-H (EIC) as to what constitutes sufficient substantiating documentation so that taxpayers are not unduly burdened by overly zealous tax return preparers.

3. Regulation section 1.6695-2(b)(3) currently requires that a tax return preparer “make reasonable inquiries if the information furnished to the tax return preparer appears to be incorrect, inconsistent, or incomplete” and provides examples of situations in which information appears incomplete.

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11 The current regulation provides that the tax return preparer must retain: (1) a copy of Form 8867 (or a copy of the completed Eligibility Checklist or a copy of the Computation Worksheet or Alternative Computation Record) and (2) 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, and (3) include the identity of any person furnishing the information.

12 “Low-Bono” is a term of art used to describe those who provide legal services not for free, but at a discounted rate.
However, the current regulations are vague as to what information is required in order to meet the due diligence requirements. The proposed regulations make no attempt to clarify the requirements. We are concerned that without clear and simple guidance, the overly cautious tax return preparer will burden taxpayers with gathering either irrelevant information or the wrong type of information. This would especially affect low income taxpayers who may not have the ability to gather all information requested by the tax return preparer, which will thwart, or at a minimum, delay the filing of an EIC claim. As noted above, the Service should consider a form similar to Form 886-H (EIC) to educate tax return preparers as to what substantiation is acceptable. ¹³

4. Regarding compliance with the submission of Form 8867, we suggest that the Service not certify commercial tax return preparation software unless the software requires tax return preparers to complete and submit Form 8867 as part of the e-filing process. For paper returns, the software should also print the form in the proper sequence order as part of the tax return.

¹³ The Taxpayer Advocate, Nina Olson, has recognized the difficulty taxpayers have in providing written proof and suggested a list of alternative documentation that could be considered when determining EIC. See Improper Payments, supra, Appendix. Such a list could be incorporated as a possible checklist for documentation.