



H&R BLOCK®

April 18, 2011

REG-120168-97. T.D. 8798
Yvette B. Lawrence
Internal Revenue Service
Room 6129
1111 Constitution Avenue NW
Washington, DC 20224

Submitted to: www.regulations.gov

Dear Ms. Lawrence:

H&R Block appreciates the opportunity to comment on the earned income credit due diligence and documentation process.

H&R Block is one of the world's largest tax services providers. H&R Block filed 4,215,292 tax returns claiming the earned income credit for tax year 2009, and is well positioned to offer an informed perspective on rules affecting preparers and the tax industry as a whole.

H&R Block respectfully submits the enclosed comments for your consideration. H&R Block offers recommendations that it believes will increase the efficiency and effectiveness of the earned income credit due diligence and documentation process.

Please do not hesitate to contact me if you need further clarification or explanation.

Sincerely,



Kathy Pickering,
VP - Government Relations and Executive Director of The Tax Institute

Enclosure

H&R Block Comments on Regulation 120168-97 - EIC Due Diligence Paperwork Reduction

I. Introduction

For tax year 2009, H&R Block (HRB) filed 4,215,292 million returns claiming the earned income credit (EIC). These EIC returns made up approximately 32% of all returns filed by H&R Block (HRB) for the 2009 tax year. The IRS estimates that the total annual burden spent on EIC due diligence is 507,135 hours for preparers during the season. As a company, HRB spent a minimum of 1,053,823 measurable hours¹ on documentation necessary to comply with the EIC due diligence requirements for tax year 2009.

Accordingly, HRB is well situated to provide comments about the amount of time required to comply with the EIC due diligence requirements and the general preparation challenges that EIC returns pose. HRB believes that the IRS underestimates the amount of time that it takes preparers to comply with the EIC due diligence requirements. HRB offers these comments on the length of time required to complete due diligence requirements and offers recommendations on how to make the EIC due diligence process more efficient and effective.

II. Background

Section 6695(g) gives the IRS authority to impose a penalty on preparers who fail to comply with the preparer EIC due diligence requirements. The due diligence requirements were put in place to ensure that preparers exercise care when determining a taxpayer's eligibility for EIC and the amount of EIC claimed. The due diligence requirements imposed under Reg. § 1.6695-2(b) are made up of four separate items:

- 1) Checklist. Preparers are required to complete Form 8869, Paid Preparer's Earned Income Credit Checklist (or another comparable form), or keep records sufficient to complete the checklist in the preparer's paper or electronic file.
- 2) Worksheet. Preparers are required to complete the Earned Income Credit Worksheet contained in the Form 1040 Instructions or keep records sufficient to complete the worksheet in the preparer's paper or electronic file.
- 3) Knowledge. Preparers must not know or have a reason to know that any information being used by the preparer to determine the taxpayer's eligibility for EIC or the amount of EIC is incorrect, inconsistent, or incomplete. Preparers may not ignore the implications of any information known by the preparer or given to the preparer that appears to be incorrect, inconsistent, or incomplete. Preparers have the duty to make a reasonable inquiry if a reasonable and well-informed preparer would conclude the information was incorrect, inconsistent, or incomplete.
- 4) Record retention. Preparers are required to retain the records discussed above.

¹ 4,215,292 x 15 minutes = 63,229,380 / 60 minutes = 1,053,823 hrs / 100,364 preparers = 10.5 hrs per preparer

To verify compliance with the due diligence requirements, the IRS conducts EIC due diligence audits on preparers to ensure that records are being kept and documentation exists to demonstrate compliance with the above rules. If the IRS determines that the due diligence requirements were not met, the preparer is subject to a penalty of \$100 per return. This penalty will not be assessed if the preparer can demonstrate that when all facts and circumstances are considered, the normal office procedures are designed and routinely followed to ensure compliance with the due diligence requirements and the failure to meet the requirements is an isolated, inadvertent incident.

III. Comments on Regulation 120168-97

A. The IRS underestimates the burden imposed by the EIC due diligence requirements and the corresponding documentation necessary to comply.

The IRS request for comment indicates that it takes return preparers 5 hours and 4 minutes (5.07 hours²) over the course of a tax season to complete the EIC due diligence process and document properly. However, 5 hours and 4 minutes is an underestimate of the time required for the average HRB preparer to complete the EIC due diligence process.

It takes HRB return preparers 9 - 24 minutes per return to thoroughly comply with the documentation requirements imposed by the EIC due diligence requirements – the length of time depends largely on number of questions a preparer must ask in order to fulfill the knowledge requirement. The knowledge requirement requires tax return preparers to:

- Evaluate the information received from the taxpayer
- Apply a consistency and reasonableness standard to the information
- Ask additional questions when applicable
- Make reasonable inquiries if the information appears to be incorrect, inconsistent, or incomplete
- Document additional inquiries and the client's response³

The IRS has provided preparers with what it considers the most salient triggers/issues that need to be addressed to fulfill the knowledge requirement during the preparation of EIC returns. In performing audits of preparers, the IRS focuses on and expects that these triggers/issues are addressed by preparers during the preparation of EIC returns. Failure to address any one of these issues can and has resulted in the preparer being penalized.

For tax year 2009, the average HRB preparer prepared 42 EIC returns – each return requiring 15 minutes on average to comply with the EIC due diligence documentation requirements. Of the 4,215,292 EIC returns filed by HRB preparers in 2009, 69% had at least one area where tax return preparers had to make additional inquiries in order to satisfy the knowledge requirement.

² (4 minutes / 60) + 5 minutes = 5.07 hours

³ <http://www.eitc.irs.gov/rptoolkit/dd/revisedregs/>

If the average preparer spends 15 minutes completing the EIC due diligence documentation requirements on 42 returns he or she will spend 10.5 hours⁴ over the course of a tax season solely on EIC due diligence documentation. This is more than double the 5.07 hours per preparer estimated by the IRS. In addition, tax return preparers spend an immeasurable amount of undocumented time during the tax return preparation process explaining EIC compliance to taxpayers and conducting the verbal interview that forms the basis of the EIC due diligence documentation.

Further, the IRS recently provided additional training tools which instruct preparers to assist taxpayers in reconstructing their income and expenses from self-employment when taxpayers do not have records to support self-employment income and expenses. The training material/tool then requires the preparer to document the methodology used to reconstruct income and expenses. This requirement will serve to substantially increase the time it takes a preparer to satisfy the due diligence requirements when self-employment income impacts eligibility for EIC. The additional time necessary to comply with the burdensome EIC due diligence requirements increases the preparation costs of EIC returns.

Recommendation: IRS should acknowledge the amount of time necessary for preparers to ensure thorough compliance with the EIC due diligence requirements. The IRS should also realize the administrative burden on preparers who meet EIC due diligence requirements results in higher preparation costs which impacts individual taxpayers.

B. Taxpayers do not share any of the responsibility for complying with EIC due diligence requirements with tax preparers.

HRB supports the preparer EIC due diligence requirements. However, HRB believes that taxpayers should share responsibility for the substantiation and documentation required for EIC claims. Substantiation in support of information contained in the tax return is the responsibility of the taxpayer not the preparer. When preparing a return, preparers ask many questions designed to identify any potential EIC triggers/issues – these triggers/issues do not differ year over year. Taxpayers should also bear the responsibility for honestly and accurately answering questions asked by preparers. Return preparers are in compliance with EIC due diligence requirements when taxpayers give credible and complete answers to their questions, even if reality may prove otherwise. Therefore, it is important that preparers and taxpayers share responsibility for EIC due diligence compliance.

HRB believes the IRS could utilize the modernized e-file (MeF) system to help gather substantiation and documentation from taxpayers before paying out EIC to improve taxpayer accountability for EIC due diligence. MeF could be programmed to return a CP75, *EIC Portion of Refund Delayed*, notice to the taxpayer at the time the return is filed and accepted. The CP75 notice should state that the taxpayer's return has been accepted, but the EIC portion of the refund is being held until the taxpayer provides sufficient substantiation to the IRS that proves eligibility for EIC. The CP75 notice should list the types of documentation that the IRS generally accepts for the specific EIC triggers/issues present in the return. The CP75 notice would not need to be issued with every return, but instead could be issued for returns that present the most salient EIC triggers/issues such as AGI, self-employment income, or male head of

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household. The IRS would have the power to identify which triggers/issues are the most salient each year. The preparer would then have the ability to provide the CP75 notice to the taxpayer while explaining the notice and how the taxpayer should respond before the taxpayer leaves the office.

In addition, using the MeF system to provide CP75 notices at the time of filing would reach all taxpayers (including those who prepare their own returns) and not just those taxpayers that have their returns done by a paid preparer. At present, taxpayers who choose to file their own returns through software or online products or who do not use paid preparers are not subjected to any kind of EIC due diligence. The online and software products could provide taxpayers a written explanation of the notice and how to respond when they print the return. Taxpayers using these filing methods would also have the ability to print the CP75 notice at the time they print the return.

Using the MeF system to issue CP75 notices to a subset of taxpayers who claim EIC would ensure that all taxpayers claiming EIC are held to the same standard whether they file using a paid preparer or file their own returns using a software or online product. This would increase consistency across the entire tax system. This procedure could benefit the IRS by decreasing the number of erroneously, wrongfully, or fraudulently paid instances of EIC. Taxpayers would also benefit because the instance of erroneous, wrongful, or fraudulent EIC payouts would be greatly reduced and taxpayers would not be forced to find a way to repay EIC claims.

Recommendation: The MeF system should be utilized to provide a CP75 notice to a subset of EIC taxpayers at the time their returns are filed, explaining what additional documentation the IRS will need before paying out the refund attributable to EIC.

C. The IRS may impose a penalty on a preparer regardless of whether the EIC was rightfully claimed by the taxpayer.

When conducting an EIC audit, the IRS agent will review the EIC documentation that was input in the tax preparation software or otherwise documented by the preparer. The agent then has the authority to impose a penalty on the preparer for failing to meet the due diligence standards without ever knowing if EIC was rightfully claimed by the taxpayer. Thus, it is possible that a preparer may be penalized for failing to document proper due diligence in instances where taxpayers rightfully received EIC.

Recommendation 1: The IRS should be required to show that the return as filed is inaccurate with regards to EIC as a pre-requisite to assessing penalties against the preparer.

Recommendation 2: The IRS should not penalize preparers or should reverse penalties in instances where taxpayers rightfully received EIC.

D. EIC due diligence audit guidelines are not available to preparers.

During a preparer audit, the IRS will come in and look mostly at the records the preparer kept documenting the EIC due diligence process to determine if the preparer complied with the due diligence requirements. However, the auditor has sole discretion to determine if the preparer went deep enough

and asked the right questions during the due diligence process – these are highly subjective judgments and differ between auditors.

HRB has seen many different standards imposed by auditors in determining application of penalties. Whether a preparer asked enough additional questions and/or the questions the auditor believed were necessary to probe deep enough is subjective and open to interpretation by each individual auditor. This subjectivity has resulted in penalties being assessed in cases where a preparer made a good faith effort to comply with EIC due diligence requirements. Additionally, this makes it difficult for the tax preparation community to implement processes that would ensure that all aspects of the audit standards are covered when preparing the return.

Recommendation 1: The IRS should create industry-wide auditor standards and publish these to the tax preparation industry to reduce the subjectivity of the EIC due diligence and documentation audit process.

Recommendation 2: The IRS should seek input from the tax preparation industry when developing these industry-wide standards.

E. EIC due diligence requirements are inconsistently implemented throughout the tax preparation community.

The EIC due diligence requirements are interpreted differently throughout the tax preparation community. As a result, tax return preparers are taking different approaches towards compliance with EIC due diligence requirements.

Recommendation: The IRS should work with the tax preparation industry groups to build industry-wide standards to increase consistency.