



[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-103474-18]

RIN 1545-BO63

Tax Return Preparer Due Diligence Penalty under Section 6695(g)

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking, partial withdrawal of notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that amend portions of previously proposed regulations related to the tax return preparer penalty under section 6695(g) of the Internal Revenue Code (Code). These amendments to the previously proposed regulations are necessary to implement a recent law change that expands the scope of the tax return preparer due diligence penalty under section 6695(g) so that it applies with respect to eligibility to file a return or claim for refund as head of household. The proposed regulations affect tax return preparers.

DATES: Written or electronic comments and requests for a public hearing must be received by **INSERT DATE 30 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER**.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-103474-18), room 5207, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours

of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG-103474-18), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224, or sent electronically, via the Federal eRulemaking Portal at www.regulations.gov (IRS REG-103474-18).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Marshall French, 202-317-6845; concerning submissions of comments and requests for a public hearing, Regina Johnson, 202-317-6901 (not toll-free numbers).

Paperwork Reduction Act

The collection of information in current §1.6695-2 was previously reviewed and approved under control number 1545-1570. Control number 1545-1570 was discontinued in 2014, as the burden for the collection of information contained in §1.6695-2 is reflected in the burden for Form 8867, "Paid Preparer's Due Diligence Checklist," under control number 1545-1629.

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) under section 6695(g) of the Code regarding the tax return preparer due diligence requirements.

Prior to 2016, section 6695(g) imposed a penalty on tax return preparers who fail to comply with due diligence requirements set forth in regulations prescribed by the Secretary with respect to determining eligibility for, or the amount of, the earned income credit (EIC). For tax years beginning after December 31, 2015, the scope of section 6695(g) was expanded to apply the penalty to tax return preparers who fail to comply

with due diligence requirements with respect to determining eligibility for, or the amount of, the child tax credit (CTC)/additional child tax credit (ACTC) and the American opportunity tax credit (AOTC). See section 207 of the Protecting Americans from Tax Hikes Act of 2015, Div. Q of Pub. L. 114-113 (129 Stat. 2242, 3082 (2015)) (PATH Act). On December 5, 2016, final and temporary regulations (TD 9799, 81 FR 87444) with cross-referencing proposed regulations (REG-102952-16, 81 FR 87502) (2016 proposed regulations) were published in the **Federal Register** to reflect these changes.

Effective for tax years beginning after December 31, 2017, section 6695(g) was amended to further expand the scope of the penalty to tax return preparers who fail to comply with due diligence requirements with respect to determining eligibility to file as head of household (as defined in section 2(b)). See section 11001(b) of “An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018,” Pub. L. 115-97 (131 Stat. 2054, 2058 (2017)) (Act). This document contains proposed regulations to reflect this change.

Explanation of Provisions

The proposed regulations contained in this document withdraw paragraphs (a), (b)(3), and (e) of §1.6695-2 of the 2016 proposed regulations and propose in their place new paragraphs (a), (b)(3), and (e) of §1.6695-2 (amended paragraphs). The amended paragraphs update the 2016 proposed regulations to reflect the recent change in the law that expands the tax return preparer due diligence requirements under section 6695(g) to apply to determining eligibility to file as head of household. Accordingly, the proposed regulations contained in this document amend paragraphs (a) and (b)(3) of §1.6695-2 of the 2016 proposed regulations by adding a reference to determining

eligibility to file as head of household where reference is made to determining eligibility for, or the amount of, the EIC, the CTC/ACTC and/or the AOTC. In addition, Example 5 in paragraph (b)(3)(ii) of §1.6695-2 of the 2016 proposed regulations is revised to demonstrate how head of household due diligence requirements are intertwined with the rules for determining a taxpayer's eligibility for the CTC.

A new example is also added to §1.6695-2(a)(2) to illustrate how the penalty applies if there is a failure to satisfy the due diligence requirements with respect to determining eligibility to file as head of household in addition to a failure to satisfy the due diligence requirements with respect to one of the applicable credits. As explained in the preamble of the 2016 temporary regulations, the preparation of one return or claim for refund may result in the imposition of more than one penalty under section 6695(g). That is because under section 6695(g), each failure to comply with the due diligence requirements set forth in regulations prescribed by the Secretary results in a separate penalty. To illustrate this point, a new example, Example 3, is added to proposed §1.6695-2(a)(2) contained in this document.

The applicability date in §1.6695-2(e) is also updated to reflect the effective date of the addition of determining eligibility to file as head of household to the due diligence requirements. Accordingly, proposed §1.6695-2(e) contained in this document provides that §1.6695-2 applies to tax returns and claims for refund for taxable years beginning after December 31, 2015, that are prepared on or after the date of publication of the Treasury decision adopting the proposed rules as final regulations in the **Federal Register**. However, the rules relating to the determination of a taxpayer's eligibility to file as head of household under section 2(b) apply to tax returns and claims for refund

for taxable years beginning after December 31, 2017, that are prepared on or after the date of publication of the Treasury decision adopting the proposed rules as final regulations in the **Federal Register**.

As part of satisfying the due diligence requirements, the regulations under §1.6695-2 require tax return preparers to complete the Form 8867, “Paid Preparer’s Due Diligence Checklist,” and, in most cases, attach it to the relevant return or claim for refund as part of satisfying the section 6695(g) due diligence requirements. The Form 8867 underwent significant revisions for the 2016 tax year and is currently a single checklist to be used for all applicable credits (namely, the EIC, the CTC/ACTC, and the AOTC) on the return or claim for refund subject to the section 6695(g) due diligence requirements. It is anticipated that the IRS will revise the Form 8867 to include the head of household filing status in time for the 2019 filing season.

Proposed Applicability Dates

Proposed §1.6695-2(e) provides that the rules in this notice of proposed rulemaking with respect to determining eligibility to file as head of household under section 2(b) will apply to tax returns and claims for refund for taxable years beginning after December 31, 2017, that are prepared on or after the date the final regulations are published in the **Federal Register**.

Special Analyses

This regulation is not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Department of the Treasury and the Office of Management and Budget regarding review of tax regulations. Under the Regulatory Flexibility Act (RFA) (5 U.S.C. chapter

6), it is hereby certified that these proposed rules, if adopted, would not have a significant economic impact on a substantial number of small entities. When an agency issues a notice of proposed rulemaking, the RFA requires the agency to “prepare and make available for public comment an initial regulatory flexibility analysis” that will “describe the impact of the proposed rule on small entities.” (5 U.S.C. 603(a)). Section 605 of the RFA provides an exception to this requirement if the agency certifies that the proposed rulemaking will not have a significant economic impact on a substantial number of small entities.

The proposed rules affect paid tax return preparers who determine a taxpayer is eligible to file as head of household, in addition to those tax return preparers who determine eligibility for, or the amount of, the EIC, the CTC/ACTC, and/or the AOTC. The North American Industry Classification System (NAICS) code that relates to tax return preparation services (NAICS code 541213) is the appropriate code for tax return preparers subject to this notice of proposed rulemaking. Entities identified as tax return preparation services are considered small under the Small Business Administration size standards (13 CFR 121.201) if their annual revenue is less than \$20.5 million. The IRS estimates that approximately 75 to 85 percent of the 505,000 persons who work at firms or are self-employed tax return preparers are operating as or employed by small entities. The IRS has therefore determined that these proposed rules will have an impact on a substantial number of small entities.

The IRS has further determined, however, that the economic impact on entities affected by the proposed rules will not be significant. The current final and temporary regulations under section 6695(g) already require tax return preparers to complete the

Form 8867 when a return or claim for refund includes a claim of the EIC, the CTC/ACTC, and/or the AOTC. Tax return preparers also must currently maintain records of the checklists and computations, as well as a record of how and when the information used to compute the credits was obtained by the tax return preparer. The information needed to document a taxpayer's eligibility to file as head of household is information the preparer must gather to file the return. Even if certain preparers are required to maintain the checklists and complete Form 8867 for the first time, the IRS estimates that the total time required should be minimal for these tax return preparers. Further, the IRS does not expect that the requirements in these proposed regulations would necessitate the purchase of additional software or equipment in order to meet the additional information retention requirements.

Based on these facts, the IRS hereby certifies that the collection of information contained in this notice of proposed rulemaking will not have a significant economic impact on a substantial number of small entities. Accordingly, a Regulatory Flexibility Analysis is not required.

Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on the impact on small business.

Comments and Requests for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written and electronic comments that are timely submitted to the IRS as prescribed in this preamble under the **ADDRESSES** heading.

The Treasury Department and the IRS request comments on all aspects of the proposed rules. All comments will be available at www.regulations.gov or upon request.

A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is Rachel Gregory of the Office of the Associate Chief Counsel (Procedure and Administration).

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Partial Withdrawal of a Notice of Proposed Rulemaking

Accordingly, under the authority of 26 U.S.C. 7805, §1.6695-2(a), (b)(3), and (e) of the notice of proposed rulemaking (REG-102952-16) published in the **Federal Register** on December 5, 2016 (81 FR 87502) are withdrawn.

Proposed Amendments to the Regulations

Accordingly, 26 CFR Part 1 is proposed to be 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 1.6695-2 is amended by revising the section heading and paragraphs (a), (b)(3), and (e) to read as follows:

§1.6695-2 Tax return preparer due diligence requirements for certain returns and claims.

(a) Penalty for failure to meet due diligence requirements—(1) In general. A person who is a tax return preparer (as defined in section 7701(a)(36)) of a tax return or claim for refund under the Internal Revenue Code who determines the taxpayer's eligibility to file as head of household under section 2(b), or who determines the taxpayer's eligibility for, or the amount of, the child tax credit (CTC)/additional child tax credit (ACTC) under section 24, the American opportunity tax credit (AOTC) under section 25A(i), or 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 as prescribed in section 6695(g) (indexed for inflation under section 6695(h)) for each failure. A separate penalty applies to a tax return preparer with respect to the head of household filing status determination and to each applicable credit claimed on a return or claim for refund for which the due diligence requirements of this section are not satisfied and for which the exception to penalty provided by paragraph (d) of this section does not apply.

(2) Examples. The provisions of paragraph (a)(1) of this section are illustrated by the following examples:

Example 1. Preparer A prepares a federal income tax return for a taxpayer claiming the CTC and the AOTC. Preparer A did not meet the due diligence requirements under this section with respect to the CTC or the AOTC claimed on the taxpayer's return. Unless the exception to penalty provided by paragraph (d) of this section applies, Preparer A is subject to two penalties under section 6695(g): one for failure to meet the due diligence requirements for the CTC and a second penalty for failure to meet the due diligence requirements for the AOTC.

Example 2. Preparer B prepares a federal income tax return for a taxpayer claiming the CTC and the AOTC. Preparer B did not meet the due diligence requirements under this section with respect to the CTC claimed on the taxpayer's return, but Preparer B did meet the due diligence requirements under this section with respect to the AOTC claimed on the taxpayer's return. Unless the exception to penalty provided by paragraph (d) of this section applies, Preparer B is subject to one penalty

under section 6695(g) for the failure to meet the due diligence requirements for the CTC. Preparer B is not subject to a penalty under section 6695(g) for failure to meet the due diligence requirements for the AOTC.

Example 3. Preparer C prepares a federal income tax return for a taxpayer using the head of household filing status and claiming the CTC and the AOTC. Preparer C did not meet the due diligence requirements under this section with respect to the head of household filing status and the CTC claimed on the taxpayer's return. Preparer C did meet the due diligence requirements under this section with respect to the AOTC claimed on the taxpayer's return. Unless the exception to penalty provided by paragraph (d) of this section applies, Preparer C is subject to two penalties under section 6695(g) for the failure to meet the due diligence requirements: one for the head of household filing status and one for the CTC. Preparer C is not subject to a penalty under section 6695(g) for failure to meet the due diligence requirements for the AOTC.

(b) * * *

(3) Knowledge—(i) In general. The tax return preparer must not know, or have reason to know, that any information used by the tax return preparer in determining the taxpayer's eligibility to file as head of household or in determining the taxpayer's eligibility for, or the amount of, any credit described in paragraph (a) of this section and claimed on the return or claim for refund is incorrect. The tax return preparer may not ignore the implications of information furnished to, or known by, the tax return preparer, and must make reasonable inquiries if a reasonable and well-informed tax return preparer knowledgeable in the law would conclude that the information furnished to the tax return preparer appears to be incorrect, inconsistent, or incomplete. The tax return preparer must also contemporaneously document in the preparer's paper or electronic files any inquiries made and the responses to those inquiries.

(ii) Examples. The provisions of paragraph (b)(3)(i) of this section are illustrated by the following examples:

Example 1. In 2018, Q, a 22 year-old taxpayer, engages Preparer C to prepare Q's 2017 federal income tax return. Q completes Preparer C's standard intake questionnaire and states that she has never been married and has two sons, ages 10

and 11. Based on the intake sheet and other information that Q provides, including information that shows that the boys lived with Q throughout 2017, Preparer C believes that Q may be eligible to claim each boy as a qualifying child for purposes of the EIC and the CTC. However, Q provides no information to Preparer C, and Preparer C does not have any information from other sources, to verify the relationship between Q and the boys. To meet the knowledge requirement in paragraph (b)(3) of this section, Preparer C must make reasonable inquiries to determine whether each boy is a qualifying child of Q for purposes of the EIC and the CTC, including reasonable inquiries to verify Q's relationship to the boys, and Preparer C must contemporaneously document these inquiries and the responses.

Example 2. Assume the same facts as in Example 1 of this paragraph (b)(3)(ii). In addition, as part of preparing Q's 2017 federal income tax return, Preparer C made sufficient reasonable inquiries to verify that the boys were Q's legally adopted children. In 2019, Q engages Preparer C to prepare her 2018 federal income tax return. When preparing Q's 2018 federal income tax return, Preparer C is not required to make additional inquiries to determine the boys relationship to Q for purposes of the knowledge requirement in paragraph (b)(3) of this section.

Example 3. In 2018, R, an 18 year-old taxpayer, engages Preparer D to prepare R's 2017 federal income tax return. R completes Preparer D's standard intake questionnaire and states that she has never been married, has one child, an infant, and that she and her infant lived with R's parents during part of the 2017 tax year. R also provides Preparer D with a Form W-2 showing that she earned \$10,000 during 2017. R provides no other documents or information showing that R earned any other income during the tax year. Based on the intake sheet and other information that R provides, Preparer D believes that R may be eligible to claim the infant as a qualifying child for the EIC and the CTC. To meet the knowledge requirement in paragraph (b)(3) of this section, Preparer D must make reasonable inquiries to determine whether R is eligible to claim these credits, including reasonable inquiries to verify that R is not a qualifying child of her parents (which would make R ineligible to claim the EIC) or a dependent of her parents (which would make R ineligible to claim the CTC), and Preparer D must contemporaneously document these inquiries and the responses.

Example 4. The facts are the same as the facts in Example 3 of this paragraph (b)(3)(ii). In addition, Preparer D previously prepared the 2017 joint federal income tax return for R's parents. Based on information provided by R's parents, Preparer D has determined that R is not eligible to be claimed as a dependent or as a qualifying child for purposes of the EIC or CTC on R's parents' return. Therefore, for purposes of the knowledge requirement in paragraph (b)(3) of this section, Preparer D is not required to make additional inquiries to determine that R is not her parents' qualifying child or dependent.

Example 5. In 2019, S engages Preparer E to prepare his 2018 federal income tax return. During Preparer E's standard intake interview, S states that he has never been married and that his niece and nephew lived with him for part of the 2018 taxable

year. Preparer E believes S may be eligible to file as head of household and claim each of these children as a qualifying child for purposes of the EIC and the CTC. To meet the knowledge requirement in paragraph (b)(3) of this section, Preparer E must make reasonable inquiries to determine whether S is eligible to file as head of household and whether each child is a qualifying child for purposes of the EIC and the CTC, including reasonable inquiries about the children's residency, S's relationship to the children, the children's income, the sources of support for the children, and S's contribution to the payment of costs related to operating the household, and preparer E must contemporaneously document these inquiries and the responses.

Example 6. W engages Preparer F to prepare her federal income tax return. During Preparer F's standard intake interview, W states that she is 50 years old, has never been married, and has no children. W further states to Preparer F that during the tax year she was self-employed, earned \$10,000 from her business, and had no business expenses or other income. Preparer F believes W may be eligible for the EIC. To meet the knowledge requirement in paragraph (b)(3) of this section, Preparer F must make reasonable inquiries to determine whether W is eligible for the EIC, including reasonable inquiries to determine whether W's business income and expenses are correct, and Preparer F must contemporaneously document these inquiries and the responses.

Example 7. Y, who is 32 years old, engages Preparer G to prepare his federal income tax return. Y completes Preparer G's standard intake questionnaire and states that he has never been married. As part of Preparer G's client intake process, Y provides Preparer G with a copy of the Form 1098-T Y received showing that University M billed \$4,000 of qualified tuition and related expenses for Y's enrollment or attendance at the university and that Y was at least a half-time undergraduate student. Preparer G believes that Y may be eligible for the AOTC. To meet the knowledge requirements in paragraph (b)(3) of this section, Preparer G must make reasonable inquiries to determine whether Y is eligible for the AOTC, as Form 1098-T does not contain all the information needed to determine eligibility for the AOTC or to calculate the amount of the credit if Y is eligible, and contemporaneously document these inquiries and the responses.

* * * * *

(e) Applicability date. The rules of this section apply to tax returns and claims for refund for taxable years beginning after December 31, 2015, that are prepared on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**. However, the rules relating to the determination of a taxpayer's eligibility to file as head of household under section 2(b) apply to tax returns and claims for refund for taxable years beginning after December 31, 2017, that are prepared on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

Kirsten Wielobob

Deputy Commissioner for Services and Enforcement.

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