

IRS/EITC Software Developers Working Group

FY 2010 Annual Report

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1. Introduction

The IRS/EITC Software Developers Working Group is a partnership between the IRS Earned Income Tax Credit (EITC) Office and various software industry representatives from within the membership of the National Association of Computerized Tax Processors (NACTP) and the Council of Electronic Revenue Communication Advancement (CERCA). Since this Working Group was formed in February 2008, working sessions have been held to identify issues, potential short-term and long-term best practices, and software enhancements that could improve the quality of EITC returns, increase EITC participation for eligible taxpayers and help preparers meet their due diligence requirements.

Recognizing 9 out of 10 taxpayers use a return preparer or tax preparation software, the Working Group plays a key role in improving the process and accuracy of the tax filing experience. Continuing their work in Fiscal Year (FY) 2010, the Working Group broadened their focus to issues surrounding the Schedule C, *Profit or Loss from Business*, the EITC Due Diligence Audit Process, other refundable credits including First-Time Home Buyer Credit (FTHBC) and the Adoption Credit, and the Servicewide Preparer Registration Initiative.

1.1. Purpose of Report

The purpose of this document is to acknowledge and document the recent and current efforts of the Working Group as well as to address the future initiatives identified by the Working Group during 2010 meetings.

1.2. Key Stakeholders

Although the primary audience of the Working Group recommendations is the tax software industry, this annual report will be shared with return preparers and the IRS community. Members of the Working Group are expected to socialize the information from the Working Group meetings to others within their companies and industry and provide feedback to the group. In order to obtain more information or provide feedback, contact Peter Maser (Peter.E.Maser@irs.gov) or a member of the Working Group.

1.3. Voluntary Implementation of Recommendations

The recommendations of the Working Group will be communicated to the software developer industry with the expectation that software companies will implement some or all of the recommendations. The implementation of these recommendations is voluntary and should not be interpreted as regulatory. In addition, the contents of this report do not constitute official IRS guidance.

2. EITC Due Diligence Software Enhancement Recommendations

For Tax Year (TY) 2008, the Working Group developed and facilitated the communication and implementation of a number of software enhancements designed to improve a preparer's ability to meet his EITC due diligence in accordance with the latest regulations. Based on user and client feedback, the Working Group members continue to refine the established software enhancements for each of their software products. Refinements include more customization to lengthen or shorten the online interviews based on preference settings and improving questions to avoid Yes/No answers. No new software enhancement recommendations were identified during 2010.

3. EITC Due Diligence and Income Reporting

3.1 Income Reporting and Schedule C Issues and Recommendations

Income reporting errors are among the three most common EITC errors and were highlighted during the 2010 Tax Forums through the *Tax Tales* due diligence videos. The videos are now available on EITC Central, <http://www.eitc.irs.gov/rptoolkit/ddvideos/>.

In 2009 meetings, the Working Group identified due diligence issues associated with the preparation of Schedule Cs. The FY 2010 proposed recommendations focused on additional training and guidance for tax preparers filing a Schedule C.

In order to correctly compute the allowable EITC, taxpayers filing a Schedule C must report the correct gross income and all allowable deductions on their return. Determining the correct income and deductions creates an issue for preparers who need to verify the income reported and expenses claimed in order to meet their due diligence requirements. The Working Group identified the following common income reporting issues:

- Questionable Schedule C income to qualify for EITC (i.e., taxpayers with no 1099);
- Questionable Schedule C losses that reduce other income and qualify taxpayers for EITC;
- Schedule C income, but the taxpayers have no records for income or expenses; and
- Income from Schedule C businesses, but no expenses when it is reasonable to expect the taxpayer incurred expenses.

The Working Group reviewed the common issues and proposed preliminary recommendations to address them and provide additional support and guidance to the EITC preparer community. The following proposed recommendations include new training material, form changes, and software enhancements:

- Develop training materials regarding preparer's EITC due diligence requirements on Schedule C returns
- Develop training materials regarding techniques to educate taxpayers about record reconstruction
- Add a "1099 Present" indicator to the form Schedule C
- Modify software to include an alert message for common issues

3.2 Addressing the Income Reporting and Schedule C Issues and Recommendations

Paid tax return preparers generally can rely on the taxpayer's 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.

The Working Group focused on the two training recommendations. The group developed a draft training module that provides due diligence guidance for a tax preparer preparing Schedule C returns claiming EITC. The training module provides a section on interviewing techniques, educating taxpayers on recordkeeping, and record reconstruction. The Working Group developed educational scenarios based on the common reporting issues identified on EITC returns.

The Working Group suggested the completed training module be made available on the EITC Toolkit and later be expanded into a qualifying Continuing Professional Education (CPE) module.

No formal request has been made to change the Schedule C form at this time. Many of the Working Group members indicated that their software supports the alerts when common issues are identified during return preparation.

4. Due Diligence Audit Procedures

Based on client feedback, the Working Group members demonstrated an interest in better understanding the procedures and preparer rights involved with an EITC Due Diligence Audit. The software companies wanted materials they could provide to their clients if they were selected for a Due Diligence Audit.

This year a paper was developed that covered the following topics related to the Due Diligence Audits:

- Overview and Purpose of the EITC Due Diligence Program
- What should you expect if you've been selected for an EITC due diligence audit?
- What will the examiner do at my office?
- What happens when the examination is complete?
- What do I do when I receive Letter 1125 package (30 day letter)?
- Appeals Process
- Why Penalties are Proposed

The paper will be available on EITC Central to help preparers understand their role and rights in the Due Diligence Audit Program.

5. Other Refundable Credit Recommendations

In FY 2010, the Working Group expanded their current scope beyond EITC to serve the tax preparer community in response to new refundable credits including the First-Time Home Buyer Credit and the Adoption Credit.

5.1. First-Time Home Buyer Credit Recommendations

Over the past year, the IRS has focused on the implementation of these various credits. For FY 2010, the focus has shifted to a recapture strategy for the credit. The software developers proposed the following enhancements to support preparers' efforts to calculate and properly report recapture of the credit:

- Development of an IRS.gov lookup tool for the credit claimed and repayment required by taxpayer
- Development of software triggers and help links to identify disposition changes

5.2. Adoption Credit Recommendations

Since the expanded adoption credit was expanded by the Affordable Care Act enacted in March 2010, the Working Group members provided suggestions on material the IRS could develop to assist taxpayers and preparers to properly compute the Adoption Credit.

The recommendations include development of online help links on the following topics:

- Types of adoptions
- When an adoption is considered final
- Substantiation requirements for returns claiming an adoption credit

6. Servicewide Preparer Registration Program

The IRS launched the Tax Return Preparer Initiative to strengthen the integrity of the tax system by ensuring uniform and high ethical standards for tax preparers through service and outreach and education and training.

The software developers discussed the following recommendations:

- IRS and software industry could format and require PTIN on all returns produced by professional software
- IRS could perform PTIN validation with reject code
- To identify non-signing tax return preparers, IRS could perform matching on IP address, MAC address, physical address, bank account number, or phone number

7. Future Working Group Initiatives

The Working Group expressed an interest in expanding their current scope to include two new areas:

- The Healthcare Credit
- Improving self-prepared return accuracy through software

Appendix – IRS/EITC Software Developers Working Group Members

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