

## Text of Letter to Tax Return Preparers

### Prepare Accurate Individual Income Tax Returns

The Internal Revenue Service is taking a number of steps to contact paid tax return preparers to improve the accuracy and quality of filed tax returns and heighten awareness of preparer responsibilities. We are sending letters to and visiting a segment of the return preparer community to provide information on the kinds of errors we are seeing. This letter describes common errors made by taxpayers and return preparers and your general responsibilities as a return preparer.

We encourage you to review this information now to ensure you fulfill your responsibilities and avoid making these common errors. Beginning the last week of January, IRS representatives will visit many of the preparers who receive this letter to discuss their obligations as a return preparer.

### What Are Paid Return Preparers Required To Do?

As a paid return preparer, you must take all necessary steps to file accurate Federal individual income tax returns on behalf of your clients. These steps include reviewing the applicable tax law to ensure that all income has been reported on the return, and that only credits, expenses and deductions allowed under the Internal Revenue Code are taken. We describe below common errors we are finding on Form 1040 returns (Schedule C, Schedule A, the Earned Income Tax Credit and the First-Time Homebuyers Credit). Please review this information and ensure you are accurately applying the law to your clients' specific circumstances.

Common Schedule C Errors: Return preparers must ask sufficient questions and review sufficient taxpayer records to determine that income and expenses reported are correct and complete. For more information, consult IRS Publication 334, *Tax Guide for Small Business*.

- Gross receipts must be fully reported. Taxpayers should provide books and records to substantiate the fact they are conducting a business and the gross income received during the year, or you must receive sufficient information in the form of other documentation which enables you to reconstruct their income.
- Expenses claimed for the business must be ordinary and necessary for that type of business. Taxpayers should provide books and records to substantiate Schedule C expenses, or you must receive sufficient information in the form of other documentation which enables you to reconstruct their expenses.
- All expenses claimed must be paid or incurred during the taxable year and the allowable amount of the expense must be properly computed.

Common Schedule A Errors: Return preparers should ask sufficient questions to determine the taxpayer's correct itemized deductions. Taxpayers may not know the tax law and incorrectly believe they can claim deductions on Schedule A for nonqualifying expenditures. For more information, go to [www.irs.gov](http://www.irs.gov) and review Tax Topics 501 through 514.

- Unreimbursed Employee Business Expense, Form 2106. Taxpayers may only claim allowable unreimbursed expenses.
- Mileage claimed on Form 2106. Taxpayers must have documentation to support business miles claimed.
- Travel, meals, and entertainment expenses. Taxpayers must have documentation for the business purpose associated with the deduction, as well as receipts to support the expenses claimed.
- Charitable Contributions. Taxpayers must have receipts for all cash contributions and adequate documentation for all non-cash contributions. In some cases, an appraisal may be required to substantiate a large non-cash contribution.

**Earned Income Tax Credit (EITC) Common Errors:** Return preparers should ask sufficient questions and accurately complete appropriate worksheets or forms to ensure that the taxpayer is entitled to the credit. EITC return preparers are subject to additional due diligence requirements, including completion of certain documents, record-keeping requirements, and reasonable inquiry of taxpayers. For more information about these due diligence requirements, see the IRS's Due Diligence Continuing Professional Education module at [www.eitc.irs.gov/rptoolkit/main/ddmodule](http://www.eitc.irs.gov/rptoolkit/main/ddmodule). More detailed information on EITC eligibility criteria and EITC errors can be found at [www.eitc.irs.gov](http://www.eitc.irs.gov) or in Publication 596, *Earned Income Credit*. Common EITC errors are listed below.

- Claiming a child that is not a qualifying child. Taxpayers may only claim a child that meets the age, relationship, and residency requirements.
- Married taxpayers filing with an incorrect single or head of household filing status.
- Inaccurately reporting income.
- Using incorrect Social Security Numbers or incorrect last names.

**First-Time Homebuyers Credit (FTHBC) Common Errors:** Return preparers must ask sufficient questions and review sufficient taxpayer records to determine eligibility for any of the three versions of this credit and the accuracy of the amount of credit claimed. For more information on eligibility for the credit, go to [www.irs.gov](http://www.irs.gov) and select Tax Topics 611 and 612 and IR-2009-108. The most common errors noted on returns claiming the credit are listed below.

- Claiming the credit prior to closing or taking occupancy of home.
- Filing an incomplete or incorrect Form 5405, First-Time Homebuyer Credit.
- Claiming more than 10% of the purchase price.
- Failing to meet prior home ownership rules.
- Both spouses incorrectly claiming FTHBC when filing status is married-filing separate.
- Married taxpayers incorrectly claiming FTHBC when one spouse was a prior homeowner.

### **Your Responsibilities as a Paid Tax Return Preparer**

Return preparers are required to exercise due diligence in preparing tax returns. As a general rule of thumb, that means knowing the underlying substantive law affecting an item of income or deduction. Publication 470, Limited Practice Without Enrollment, and Treasury Department Circular 230 (if you are also a practitioner) outline your due diligence responsibilities.

- A return preparer must exercise due diligence in preparing or assisting in the preparation, approving, and filing of returns, documents, affidavits, or other papers relating to Internal Revenue Service matters.
- The return preparer must also exercise due diligence in determining (1) the correctness of oral and written representations made by the return preparer to the IRS, and (2) the correctness of representations made by the return preparer to the client with reference to any matter administered by the IRS.

### **Consequences of Filing Incorrect Returns**

Return preparers are expected to be knowledgeable in tax law and to prepare accurate returns. The consequences of preparing inaccurate returns can be severe and can extend to both you and your client. These consequences may include any or all of the following:

- If your clients' returns are examined and found to be incorrect, your clients may be subject to accuracy or fraud penalties plus accrued interest on any underpayment.
- Return preparers who prepare a client return for which any part of an understatement of tax liability is due to an unreasonable position taken on the return based on the preparer's advice, can be assessed a minimum penalty of \$1,000 (IRC section 6694(a)).
- Return preparers who prepare a client return for which any part of an understatement of tax liability is due to the return preparer's reckless or intentional disregard of rules or regulations

by the tax preparer, can be assessed a minimum penalty of \$5,000 (IRC section 6694(b)).

The assessment of return-related penalties against a return preparer may result in:

- Suspension or expulsion of the return preparer's firm from participation in IRS e-file;
- Injunctions barring the return preparer from preparing tax returns;
- Referral for criminal investigation; or
- Disciplinary action by the IRS Office of Professional Responsibility if the return preparer is also a practitioner.

#### **Where to Find More Information**

If you need additional information, visit our website at [www.irs.gov](http://www.irs.gov). The IRS provides educational material through the Tax Topics feature, as well as links to educational material for practitioners at [www.irs.gov/taxpros](http://www.irs.gov/taxpros).

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