Documenting Due Diligence

Using Preparer Notes® is a good way to document due diligence during return preparation.

Good notes record what the preparer asked and what the taxpayer answered and/or provided during return preparation.

As an added step to ensuring due diligence is practiced in your office, you can set Red Flags to stop specific returns so that you can check to make sure that your preparers are documenting the due diligence they undertake when preparing a return.

From the IRS training available on EITC, there are a number of scenarios that require special attention to documenting due diligence.

Keep in mind:

- Checkbox selections and notes entered on a tax form or check sheet, such as Page 4 of the IRS Form 8867, do not carry to Preparer Notes
- Each client situation is unique and you should confirm information even if you think you know the answer
- Unless you are personally aware of the specifics of a situation, it is important to ask and document the due diligence you undertake
- Keep copies of any documents you rely upon to determine eligibility for or amount of EITC
- There is no script to follow, each taxpayer and their situation is unique so the questions and answers will be as well

The following scenarios are highlighted in the IRS EITC Due Diligence training as situations that warrant special attention to practicing due diligence. We include some ideas of the types of things to ask, but nothing can replace preparer judgment, knowledge, common sense, and good follow-up questions. When it comes to due diligence … document, document, document!

**EITC WITH NON-STANDARD DEPENDENTS**

Ask why the parent is not claiming the child and how the taxpayer is related to the child.

*Recent audit statistics seem to indicate that single men claiming children, even their own, are at a higher risk of IRS scrutiny and audit since most young children are raised by their mothers. In this scenario, you should ask why the mother is not raising the child or if the taxpayer has help with the child and document your questions and the client’s answers.*

If you see school or medical records, and they help you determine eligibility for EITC, be sure to keep a copy of the documents with the taxpayer’s file.

**EITC WITH LOW INCOME**

Ask how the taxpayer(s) were able to support living expenses on reported income. Note any support they received from relatives, government or charitable assistance.
EITC WITH DEPENDENT OVER THE AGE OF 24 YEARS OLD

Ask about the actual disability and when it was declared and who declared it (ie doctor, health care provider, social services, other). You can also ask the client about the Social Security Disability Benefit payments or records.

EITC WITH SCHEDULE C

Ask questions about the business, for example when it was started.

If you see a 1099-MISC, a logbook showing income/expense, cancelled checks, or other types of receipts for their expenses, be sure to indicate what you saw in the notes. If you didn’t see them indicate what you used to determine that it was a valid business. Again, if you relied upon any documents for EITC then you must make a copy of that document and keep it with the file.

A Schedule C with no expenses is rare. It is important to document why a business did not have expenses. For returning customers who filed a Schedule C last year, there should at least be expenses related to tax preparation. A note saying, “TP has all documentation” is not enough; instead a note stating what type of documentation and the specifics in the documentation would be better.

HIGH SCHEDULE A DEDUCTIONS COMPARED TO AGI

Ask what receipts the client has and document why they are high compared to income. Ask about insurance reimbursements. For job expenses, ask about employer reimbursements and why the expenses were necessary for the job.

HIGH VEHICLE MILEAGE – Schedule C Business Activity or Schedule A

Ask the client about a logbook, mileage summary sheet, job tickets, or create a statement regarding how the taxpayer calculated their mileage to ensure accurate calculations. Also ask if their employer provided any reimbursement.

CORRECTING A RETURN THAT RECEIVED AN IRS REJECT 506/507

Ask what information changed and when, if it is a new dependent but not born in the current tax year add documentation as to why the person was not on the original return?

In the case of data entry, indicate what error was made and that is simply being corrected.

EDUCATION CREDITS

Ask for the Form 1098-T. If you do not have the form, then you can ask what school was attended, by who, if any scholarships were received (make appropriate adjustments) and when they expect to graduate. As always, be sure to add notes regarding the questions and answers.