

# Code Section 7216 Practice Alert

## 7216 Compliance Resource Center

### NEW RULES AND RESTRICTIONS UNDER CODE SEC. 7216

On January 1, 2009, tax return preparers became subject to a dramatically more stringent set of additional rules regarding the use and disclosure of their clients' tax return information. These new rules and restrictions create everyday problems in their application by complicating a practitioner's ability to use and/or disclose return information.

*This Practice Alert explains the most significant new disclosure and use rules and restrictions under Code Sec. 7216 and key issues surrounding the new rules. It does so in "checklist" style that allows the practitioner and his or her firm to conduct quick, due-diligence reviews at each critical point under the new regime.*

### NEW RULES PROVIDE SIGNIFICANT CHANGES

The new rules, effective for returns prepared on or after January 1, 2009, include the following changes:

- Multiple consents to disclose are permitted on one consent form
- Multiple consents to use are permitted on one consent form
- Consent form format requirements have changed
- Certain mandatory language and warnings are now required in consent forms
- Electronic consent forms and electronic signatures on consent forms are expressly permitted
- Disclosure of Social Security numbers outside the U.S. must satisfy special requirements
- Expansion of the definition of "return preparer"
- Tightened rules on disclosures permitted with the taxpayer's consent

### PENALTIES

The new rules have been given teeth. Criminal as well as civil penalties can apply. Further, violations can be sanctioned by restriction on a practitioner's right to practice before the IRS.

**Civil penalty.** A civil penalty is imposed under Code Sec. 6713(a) for unauthorized disclosures or uses of information furnished in connection with the preparation of an income tax return. The penalty for violating Code Sec. 6713 is \$250 for each disclosure or use, not to exceed a total of \$10,000 for a calendar year. The exceptions to the criminal penalty under Code Sec. 7216 also apply to the civil penalty Code Sec. 6713.

**Criminal penalty.** Code Sec. 7216 imposes a criminal penalty on tax return preparers who knowingly or recklessly make an unauthorized use or disclosure of tax return information provided to them in connection with the preparation of an income tax return. A maximum \$1,000 fine or imprisonment of no more than one year, or both, may be imposed for each violation.

## CONSENT AND DISCLOSURE

The basic rules for obtaining consents to use and disclose are found in Treas. Reg. §301.7216-3, accompanied by Revenue Procedure 2008-35. Rev. Proc. 2008-35 provides guidance on the format and content of consents to disclose and consents to use a taxpayer's tax return information.

Consents to disclose or use your client's tax return information – paper or electronic – must contain certain specific information. Every consent form must include:

- Your name and the taxpayer's name
- The nature of the disclosure(s)
- To whom the disclosures will be made
- Details on the information being disclosed
- The particular use authorized
- The product or service for which the tax return information will be used.

## WHO IS A "RETURN PREPARER"?

The new rules apply only to "return preparers." Tax return preparers for this purpose are broadly defined, however, as persons who participate in the preparation of tax returns for taxpayers. These include, but are not limited to:

- Return preparers who are in business or hold themselves out as preparers, including volunteer preparers that participate in programs like Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE)
- Casual preparers who are compensated for their services
- E-file providers
- Electronic return originators and electronic return transmitters
- Intermediate service providers
- Software developers
- Reporting Agents

The definition of a "return preparer" also now extends to those who assist you in preparing returns, such as your employees who perform auxiliary services in connection with the preparation of a tax return, and those individuals outside your office who perform auxiliary services in connection with the preparation of return.

The regulations permit two types of disclosures:

1. Disclosures requiring taxpayer consent; and
2. Certain permissible disclosures that do not require taxpayer consent, such as disclosure to the IRS, courts, other taxing jurisdictions such as state taxing authorities, disclosures to other U.S.-based tax return preparers that assist in preparing the return, and disclosures requiring taxpayer consent.

Return preparers must obtain a client's consent to use and/or disclose their tax return information *before* preparing the return. You cannot ask for a client's consent to use return information for purposes *after* the completed return has been provided to the client.

### **Mandatory language and required information**

The new rules require consent forms – both paper and electronic – to include certain mandatory language, information and warnings for clients – even down to the size of the paper and font.

Mandatory language in the consent form informs your clients that they are not required to sign the consent; that if they sign the consent, federal law may not protect their information from further disclosure; and that if they sign the consent, they can set a time period for the duration of that consent. If clients do not set a time period, the consent is valid for a maximum of one year.

The mandatory language and information is described in Reg. §301.7216-3(a)(3) and Rev. Proc. 2008-35. There are seven situations – six for disclosure and one for use of tax return information – that call for specific consent form requirements and mandatory language. Reg. §301.7216-3 and Rev. Proc. 2008-35, section 6, provide more information on these situations and examples of appropriate consent forms.

This required language and warnings must be included in every consent form, no matter what type of consent or disclosure form it is.

### **Consent for each use and disclosure now required**

You must obtain a client's consent to use tax information *before* preparing his or her return. The regulations specifically provide that you cannot ask for a client's consent to use tax return information *after* a completed return has been provided to the client.

One of the most significant new requirements is that the consent form must specifically identify each use of tax return information to which the client is consenting. Although a single consent form can cover more than one use of tax return information, the client must affirmatively select those uses he or she is consenting to. The new rules do not permit "opt-out" consent forms that enable clients to deselect the uses he or she is not consenting to. If a client declines a request for consent to your use of tax return information, you will not be permitted to ask again for a purpose substantially similar to that of the rejected request.

Additionally, a single consent form cannot authorize uses and disclosures of tax return information. One document must be used to authorize uses and a separate document must be used to authorize disclosures.

### **Services unrelated to tax return preparation**

You can not engage in tax planning or consultation services without the specific, written consent of the taxpayer. You must obtain a taxpayer's authorization to use the taxpayer's tax return information to provide other requested tax-related services, outside the actual preparation and filing of a tax return, such as consulting and or financial planning services.

If your client declines to provide consent for an unrelated tax preparation disclosure or use request, the preparer cannot make a similar consent request. This rule is intended to prevent preparers from making their clients feel pressured with repeated consent requests.

### **Client lists**

The new regs allow you to compile a separate list containing only the names, addresses, e-mail addresses, and phone numbers of clients whose tax returns you have prepared or processed. However, you can only use the list to contact the clients in order to offer tax information or additional tax return preparation services; it cannot be used to offer other services, such as financial planning services. In order to offer such services or any other "use" of a client's tax return information would require his or her consent. Moreover, there are strict new requirements for such consents.

### **Preparers outside the U.S.**

A taxpayer must consent to the disclosure of his or her tax return information if another return preparer assisting in the preparation of their return, or providing auxiliary services, is located outside the U.S. — although disclosing return information to another preparer in the U.S. who is assisting in the preparation of the return, the taxpayer's consent is not required.

Additionally, the new rules require a taxpayer's Social Security number (SSN) on a return provided to a non-U.S. preparer to be redacted or otherwise masked. However, there is an exception which provides that the SSN can be disclosed to the preparer outside the U.S. if the taxpayer's consent is obtained and both the sending and receiving preparers have adequate data protection safeguards in place (which are defined in Rev. Proc. 2008-35).

## 7216 COMPLIANCE MASTER CHECKLIST

This master checklist may be used to help the practitioner to comply with all aspects of the new law:

- Create and maintain a database for different types of consents to use and consents to disclose.
- Ensure that each consent form includes the mandatory language and warnings set forth in Rev. Proc. 2008-35 and Reg. §301.7216. Each consent form must include the following, which is mandatory:
  - The name of the tax return preparer and the name of the taxpayer;
  - The intended purpose of the disclosure and the specific recipient(s) of the tax return information; and
  - A specific description of the tax return information to be disclosed or used by the preparer.
  - Any applicable mandatory language set forth in section 4.04(a)-(c) of Rev. Proc. 2008-35 that informs the client that he or she is not required to sign the consent form and that if he or she signs the consent, he or she can set a time period for the duration of the consent;
  - Any mandatory language set forth in section 4.04(d) of Rev. Proc. 2008-35 that refers the client to the Treasury Inspector General for Tax Administration (TIGTA) if he or she believes that his or her tax return information has been disclosed or used improperly.
  - If in paper form, it must be in 12 point type font, on 8 ½ x 11 inch paper.
  - Make sure electronic consents are in the same type as the website's standard text.
- Ensure that forms for multiple consents to use are not included on the same form as multiple consents to disclose, and vice versa.
- Make sure clients sign and date forms before you receive any tax return information.
- Make sure that disclosure authorization forms for other services such as financing planning, insurance, investment advising, etc., are signed by the client before receiving any tax return information.
- Make sure all tax return information is not disclosed outside the U.S. without the proper advance consent from the taxpayer and redaction or other masking of the taxpayer's Social Security number (SSN).
- Ensure sure that lists for solicitation of tax return business are compiled and maintained separately; and that they only contain the names, addresses, email addresses, and phone numbers of taxpayers whose return you have prepared or processed.
- Create and maintain a database to manage when consents expire and need to be re-signed by clients. Under the law, unless a client has explicitly established on the signed consent form a different time for the consent to expire, consents lapse one year after the day after the client signs the form.