

# Don't Start Filing Season Without Checking out Code Sec. 7216 Updated Rules for Tax Preparers

By *Claudia A. Hill*

Claudia Hill examines the Code Sec. 7216 updated rules for tax preparers.

Code Sec. 7216 is a criminal provision enacted by the U.S. Congress in 1971 that prohibits preparers of tax returns from knowingly or recklessly disclosing or using tax return information. Reg. §301.7216 had been substantially unchanged for over 30 years and did not address the modern return preparation marketplace, particularly electronic filing and the cross-marketing of financial and commercial products and services during the return preparation experience. The new regulations become effective January 1, 2009.

The statute limits tax return preparers' use and disclosure of information obtained during the return preparation process to activities directly related to the preparation of the return. The regulations describe how preparers, with the informed written consent of taxpayers, may use or disclose return information for other purposes. The regulations also describe specific and limited exceptions that allow a preparer to use or disclose return information without the consent of taxpayers.

Rev. Proc. 2008-35<sup>1</sup> supplements the regulations, in particular Reg. §301.7216-3, and provides specific form and content guidance to tax return preparers for obtaining consents to disclose and consents to use taxpayer data in both the paper and electronic environments. Generally, tax preparers must obtain the signed consent of the taxpayer on paper or electronically before

they can disclose taxpayer return information to anyone or use it for any purpose other than in the context of preparing and filing the return. Separate consents are required for disclosure(s) and use(s). Consents must:

- identify the intended purpose of the disclosure or use;
- identify the recipient(s) and describe the particular authorized information to be disclosed or used;
- include the name of the tax return preparer and the name of the taxpayer;
- include the applicable mandatory language set forth in section 4.04(a)–(c) of Rev. Proc. 2008-35 that informs the taxpayer that he is not required to sign the consent and if he signs the consent, he can set a time period for the duration of that consent;
- include the mandatory language set forth in section 4.04(d) of Rev. Proc. 2008-35 that refers the taxpayer to the Treasury Inspector General for Tax Administration if he believes that his tax return information has been disclosed or used improperly
- where applicable, include the appropriate mandatory statement set forth in section 4.04(e) of Rev. Proc. 2008-35 that informs the taxpayer that his tax return information may be disclosed to a tax return preparer located outside the United States;
- be in 12-point type on 8 1/2-by-11-inch paper. Electronic consents must be in the same type as the Web site's standard text;

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- contain the taxpayer's affirmative consent (as opposed to an "opt-out" clause); and
- be signed and dated by the taxpayer.

The updated regulations apply to paid preparers, software developers, Electronic Return Originators, and other persons or entities engaged in tax return preparation services or services that are auxiliary to return preparation. They also apply to most volunteer tax preparers, for example Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) volunteers and employees and contractors employed by tax preparation companies in a support role.

Code Sec. 7216 is a criminal provision that prohibits preparers of tax returns from knowingly or recklessly disclosing or using tax return information. A convicted preparer may be fined not more than \$1,000 or imprisoned not more than one year or both, for each violation.

There's also a civil penalty statute. Code Sec. 6713 imposes a civil penalty of \$250 on any person who, for compensation, prepares a return for another person, and discloses any information furnished to him for, or in connection with, the preparation of any such return, or uses any such information for any purpose other than to prepare, or assist in preparing, any such return. Imposition of the penalty under Code Sec. 6713 does not require that the disclosure be knowing or reckless.

## Definitions

**Tax return preparers** are persons that participate in the preparation of tax returns for taxpayers, including but not limited to the following:

- Return preparers that are in business or hold themselves out as preparers, including volunteer preparers that participate in programs like VITA and TCE
- Casual preparers that are compensated
- e-File providers, including electronic return originators, electronic return transmitters, intermediate service providers, software developers and Reporting Agents

The definition also extends to those that assist others in preparing returns or performing auxiliary services in connection with preparing returns, or are employed by preparers and perform auxiliary services in connection with the preparation of tax returns. The regulations also clarify that contractors receiving tax return information from tax return preparers are considered tax return preparers subject to the same provisions and penalties. Tax return preparers that

engage contractors and disclose tax return information to them are required to inform contractors of the rules and consequences in a written notice.

**Tax return information** is all the information tax return preparers obtain from taxpayers or other sources in any form or manner that is used to prepare tax returns or is obtained in connection with the preparation of returns. It also includes all computations, worksheets and printouts preparers create; correspondence from IRS during the preparation, filing and correction of returns; statistical compilations of tax return information; and tax return preparation software registration information. All tax return information is protected by Code Sec. 7216 and the regulations.

**Disclosure of tax return information** is the act of making tax return information known to any person in any manner whatsoever. The regulations authorize two types of disclosures:

- Certain permissible disclosures without taxpayer consent, e.g., disclosures to the IRS, other taxing jurisdictions or the courts; disclosures to other U.S.-based tax return preparers that assist in preparing the return; and disclosures for the purpose of obtaining legal advice
- Disclosures requiring taxpayer consent

All other disclosures not specifically authorized require tax return preparers to secure from taxpayers advance signed consents authorizing the disclosures.

**Uses of tax return information** are occurrences where tax return preparers refer to, or rely on, tax return information as the basis to take or permit actions. The regulations authorize two types of uses:

- Certain permissible uses without taxpayer's prior written consent under certain circumstances (e.g., to create lists for solicitation of tax return business; to produce statistical information in connection with tax return preparation business)
- All other uses not specifically authorized require tax return preparers to secure from taxpayers advance signed consents authorizing the uses

**Consents to disclose or use tax return information** are paper or electronic documents that contain certain specific information including the names of the tax return preparer and the taxpayer and that specify the nature of the disclosure(s), to whom the disclosures will be made and details on the data to be disclosed. Consents to use tax return information must describe the particular use authorized, identify the product or service for which the tax return information will be used, and detail the data to be used.

Tax return preparers must obtain consent to disclose tax return information before returns are provided to the taxpayer for signature and before tax return information is disclosed. Consents are valid only if they are made by the taxpayer knowingly and voluntarily and are signed and dated by the taxpayer in pen-and-ink or electronically. Consent forms must include certain language and warnings.<sup>2</sup> Consents to disclose or use tax return information have expiration dates. The taxpayer and tax return preparer may agree to specify the period of time the consent will be effective and include the period in the consent form. If no period is specified the regulations state that the consent will be effective for a period of one year from the date the taxpayer signed the consent.

## Notable Changes

The Treasury believes taxpayers should be alerted to the significant difference between consenting to disclosures to third parties and consenting to uses of tax return information by their tax return preparers. For that reason, the proposed regulations provide that a single document cannot authorize both uses and disclosure. One document must authorize uses and another separate document must authorize disclosures.

While the basic rules related to restrictions on disclosures and uses are still provided by Reg. §301.7216-3, the new rules include the following notable 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 prescribed language and warnings are now required
- Electronic consent forms are expressly permitted
- Electronic signatures on consent forms are expressly permitted
- Disclosure of social security numbers outside the United States must satisfy special requirements

Disclosing tax return information to another tax return preparer that is assisting in the preparation of the return or providing auxiliary services in connection with preparing the return generally does not require the consent of the taxpayer. However, if the other tax return preparer is located outside the United States or any territory or possession of the United States, the taxpayer must agree and sign a form consenting to the disclosure.<sup>3</sup>

Generally, tax return preparers may not obtain consents to disclose social security numbers to tax return preparers located outside the United States or any territory or possession of the United States. If social security numbers are included in documents for which the tax return preparer has obtained the consent of the taxpayer to disclose the tax return preparer must redact or mask any social security number before disclosing the tax return information to a return preparer outside the United States. There is an exception. Social security numbers may be disclosed to tax return preparers located outside the United States if taxpayer consent is obtained and both the sending and receiving tax return preparers maintain adequate data protection safeguards defined in Rev. Proc. 2008-35, section 4.07. An adequate data protection safeguard is a data security program, policy, and practice that meets or conforms to one of the privacy or data security frameworks listed in the revenue procedure. Rev. Proc. 2008-35, section 4.04(1)(e)(ii) contains specific language that must be included in the consent form.

Additionally, uses and disclosures must be in two separate consent documents and each use and disclosure must be separately identified. A consent authorizing disclosure of all return information must explain why a more limited disclosure is unsatisfactory. The taxpayer must receive a copy of the executed consent at the time of execution. Consents may not be a condition to doing the return preparation work, except where part of the return prep work is done outside of the United States. Consents involving non-1040 taxpayer returns may be part of engagement letters.

## Disclosure or Use of Information in the Case of Related Taxpayers

In preparing a tax return of a second taxpayer, a tax return preparer may use, and may disclose to the second taxpayer ... any tax return information that the tax return preparer obtained from a first taxpayer if—

- (i) The second taxpayer is related to the first taxpayer;
- (ii) The first taxpayer's tax interest in the information is not adverse to the second taxpayer's tax interest in the information; and
- (iii) The first taxpayer has not expressly prohibited the disclosure or use.

A taxpayer is related to another taxpayer if they have any one of the following relationships: husband and

wife, child and parent, grandchild and grandparent, partner and partnership, trust or estate and beneficiary, trust or estate and fiduciary, corporation and shareholder, or members of a controlled group of corporations as defined in Code Sec. 1563.

## **Timing Requirements and Limitations**

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No retroactive consent is permitted. A taxpayer must provide written consent before a tax return preparer discloses or uses their tax return information.

A tax return preparer may not request a taxpayer's consent to disclose or use tax return information for purposes of solicitation of business unrelated to tax return preparation after the tax return preparer provides a completed tax return to the taxpayer for signature. Generally, multiple requests for consents to the same use or disclosure are prohibited after the taxpayer initially declines to consent, but this would not prohibit responding to a subsequent inquiry from the taxpayer independently asking about the disclosure or use.

## **Special Exception Carved out for Attorneys and CPAs Who Also Prepare Tax Returns**

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Reg. §301.7216-2(h) acknowledges an expanded view of tax services related to return preparation work offered by state-regulated attorneys and accountants and provides an exception to rules requiring a use consent when related work for the client is provided after the return is completed. Unfortunately they overlooked federally regulated Enrolled Agents and the additional tax preparation related services they might offer. This places EAs and all other tax preparers in the untenable position

of needing signed consents prior to responding to questions or requests for transactional consultation services after a tax return is prepared if information obtained in the preparation engagement is used. In essence, "don't open that file and peek at the client's data" until a consent to use is signed!

## **Challenge to Tax Return Preparers**

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Shortly after the beginning of 2009, practitioners will come face to face with the not-so-easy reality of implementing these regulations. A client will call with a request to provide a copy of their return to their financial advisor, legal advisor, loan broker or student financial aid facilitator. The practitioner may not respond until their client has signed a consent conforming to the new requirements of Reg. §301.7216, including the mandatory language contained therein.

The next reality check will be the presentation for return preparation of clients contemplating dissolution of their marriage (but wishing you to prepare a joint return), or previously married clients who each want return preparation services. In these situations, the Circular 230 preparer will need to disclose to the taxpayers the potential conflict of interest offering them services presents, and then obtain their signatures to consent documents that will meet the requirements of both Circular 230 Section 10.29 and Code Sec. 7216. By the way, Code Sec. 7216 violations now also constitute violations of Circular 230.

### **ENDNOTES**

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- <sup>1</sup> Rev. Proc. 2008-35, IRB 2008-29, 132.
- <sup>2</sup> Refer to Reg. §301.7216-3(a)(3) and Rev. Proc. 2008-35 for complete information.
- <sup>3</sup> See Rev. Proc. 2008-35, section 4.04(1)(e) for specific language that must be included in the consent form.

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