

# IRS Watch

*By Michael P. Dolan*

## Revised Code Sec. 7216 Regulations Present New Practitioner Challenges

**C**ode Sec. 7216 has long imposed criminal penalties on tax return preparers who knowingly or recklessly make unauthorized disclosures or uses of information furnished to them in connection with the preparation of an income tax return. Recently issued revisions to the regulations contain several significant provisions that may adversely impact the current work processes of some return preparers. The new regulations apply to disclosures or uses of tax return information occurring on or after January 1, 2009.

In December 2005, a notice of proposed rulemaking was published in the Federal Register<sup>1</sup> and the IRS published a proposed revenue procedure<sup>2</sup> designed to provide guidance to preparers about the form and content of required disclosures. A public hearing was held on April 4, 2006, during which numerous comments were received from a wide range of constituencies. On January 2, 2008, final regulations<sup>3</sup> and a related revenue procedure<sup>4</sup> concerning the disclosure and use of tax return information by return preparers were published.

### **Structure of the Regulations**

The regulations are organized into three main sections. The first section deals with overall rules and definitions (Reg. §301.7216-1). A second section addresses disclosures and uses which may be accomplished without the taxpayers explicit consent (Reg. §301.7216-2). The third section describes those situations in which disclosure and use may only occur if authorized by the taxpayer's explicit consent (Reg. §301.7216-3).

The definitions section of the regulations is revised to include roles and responsibilities associated with electronic filing within the definition of return prepa-



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ration. Examples included within the new definition of tax return information, subject to disclosure and use restrictions includes information that:

- the preparer derives or generates from the tax return information in connection with preparation of a return;
- the preparer receives from the IRS in connection with processing of returns; or
- is a statistical compilation of tax return information, even in a form that cannot be associated with, or otherwise identify, a particular taxpayer.

The regulations also make clear that information is considered “in connection with tax return preparation,” and therefore tax return information, if the taxpayer would not have furnished the information but for the intent to engage the tax return preparer to prepare the tax return.<sup>5</sup>

**Given the January 2009 effective date of the revised regulations, a narrow window exists during which the government can amend one or more of the problematic provisions.**

## Permissible Disclosures

In defining “permissible disclosures and uses,” Reg. §301.7216-2 contains several significant changes from the prior regulations. In particular, the regulations add new strictures to the process by which return preparers disclose taxpayer information to any other firm and, in particular, any firm of contractor outside the United States. Among the most significant of the changes in this section are the following:

- In recognition of the increased use and reliance on software for return preparation, a tax return preparer is permitted to use return information to update the taxpayer’s software for the purpose of addressing changes in IRS forms and e-file specifications.<sup>6</sup>
- Tax return preparers within the same firm in the United States may use or disclose information within the firm for purposes of assisting in the preparation of, or assist in providing auxiliary services in connection with, return preparation. However, any disclosure or use of tax return information outside the country requires the specific consents as defined under Reg. §301.7216-3.
- Disclosure may be made to another preparer located within the United States, so long as the services provided are not substantive determina-

tions or advice affecting the tax liability reported by the taxpayer. Responding to a commentator’s request for clarity, the regulations define substantive determination as one which “involves an analysis, interpretation, or application of the law.”<sup>7</sup> Nonsubstantive determinations will generally be those associated with ministerial type actions required to completed and process the tax return.

- Attorney/accountant rule, generally, a tax return preparer that is lawfully engaged in the practice of law or accountancy and prepares a tax return, may use the taxpayer’s information or disclose it to another member of the firm for purposes of providing other legal or accounting services to the taxpayer. Note, however, two significant differences from the prior regulations. This attorney-accountant provision only applies to disclosures and uses within the United States and the definition of a law or accounting firm does not include any related or affiliated firms.<sup>8</sup>
- A list of names, addresses, e-mail addresses and phone numbers of the return preparer’s clients may be compiled and maintain by the preparer for the sole purpose of offering tax information or additional tax return preparation services to such taxpayers.<sup>9</sup> Similarly, certain statistical compilations may be produced by return preparers as long as such information relates directly to the preparers return preparation business.<sup>10</sup> This rule appears to preclude some existing arrangements by which third party vendors develop broad gauged news letters for accounting firms and use the names and addresses (taxpayer information) of the accounting firms’ clients to distribute the newsletters.

## Disclosure and Uses Permitted Only with Taxpayer’s Consent

Unless disclosure or use is specifically authorized in some other section of the regulation, a tax return preparer may not disclose or use a taxpayer’s tax return information prior to obtaining a written consent from the taxpayer in the method described in Reg. §301.7216-3.

The general form and content of taxpayer consents is specified within the regulation. In addition

Rev. Proc. 2008-12 prescribes additional requirements for taxpayer consents that relate to Form 1040 series filers.

The Treasury and the IRS received many comments related to the disclosure of information outside the United States. Predictably, attorneys and accountants advanced the view that special consents should not be required. They argued that this is especially the case with multinational clients, since those clients enter an engagement with the expectation that their tax information will be disclosed and used in whatever means is required to fulfill the terms of the tax engagement. While the final regulation acknowledges this reality to some extent, it nonetheless incorporates two unique consent regimes—one for 1040 series filers and another for all other type returns—for any disclosures or uses outside the United States.

When required to obtain consent for disclosure or use of tax return information from a Form 1040 series filer, the consent must comply with the précised specifications set out in Rev. Proc. 2008-12. Among other things, those requirements list the following:

- A taxpayer's consent to each separate disclosure or use of tax return information must be contained on a separate written document which can be furnished on paper or electronically.
- A consent furnished to the taxpayer on paper must be of a size specified in the revenue procedure and all of the text of such consent must pertain solely to the disclosure or use for which consent is being granted. Similar rules are included for consents secured electronically.
- The specific purpose of a disclosure as well as the specific recipients of all disclosures must be identified.<sup>11</sup>

The revenue procedure also includes significant sections of mandatory language which must be included in all Form 1040 series consents. This language makes clear that nothing can be disclosed without the consent and that the taxpayer is not required to complete the consent. All consents must require the taxpayer's affirmative consent to a disclosure or use of tax return information—"opt-out" type provisions are not permissible.

The provisions applicable to consents for disclosure and use of return information from all other type returns are less prescriptive. Such consents

may generally be in any format, including an engagement letter to a client. In lieu of the requirement to identify specific recipients of intended disclosures, a consent related to a non-1040 series return may allow disclosure to a descriptive class

of entities engaged by a taxpayer or the taxpayer's affiliate for purposes of services in connection with the preparation of tax returns, audited financial statements or

other financial statements or financial information as required by a government authority, municipality or regulatory body.<sup>12</sup>

**Violation of the regulations can expose preparers to criminal sanctions.**

## **Consent May Not Be Provided to Return Preparers to Disclose Social Security Numbers Outside of the United States**

A provision not in the original proposed version of the regulations has caused concern for many in the return preparation industry. Under the final regulations, preparers may not obtain a taxpayer's consent to disclose their social security number (SSN) to a tax return preparer located outside the United States.<sup>13</sup> The provision requires the SSN to be redacted from any return information disclosed or used outside the United States. If, however, a tax return preparer located within the United States initially receives a taxpayer's SSN from another return preparer located outside the United States, the preparer within the United States may, without consent, retransmit the taxpayer's SSN to the return preparer outside the United States that initially provided the SSN.<sup>14</sup>

Preparers who serve expatriate clients or perform any part of the return preparation process outside the United States have expressed particular concern that a requirement to redact the SSN will pose various accuracy and security-related risks in and of itself. The provision was apparently motivated primarily by identify theft concerns of the IRS Taxpayer Advocate and other consumer advocacy groups. Because the SSN redaction provision was not in the proposed regulations, the government did not get the benefit of any comments on the rule. IRS and Treasury officials, however, have expressed a willingness to receive comments on this and other provisions which the return preparer community finds problematic.

Given the January 2009 effective date of the revised regulations, a narrow window exists during which the government can amend one or more of the problematic provisions. In the meantime, return preparers that engage affiliated firms or third-party vendors in

their businesses process or preparers that carry on any facet of return preparation outside the United States must carefully examine their operations in the light of the new regulations. Violation of the regulations can expose preparers to criminal sanctions.

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**ENDNOTES**

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- <sup>1</sup> REG-137243-02, 70 FR 72954 (Dec. 8, 2005).
- <sup>2</sup> Notice 2005-93, IRB 2005-52, 1204.
- <sup>3</sup> T.D. 9375, IRB 2008-5, 344 (Jan. 2, 2008).
- <sup>4</sup> Rev. Proc. 2008-12, IRB 2008-5, 368.

- <sup>5</sup> Reg. §301.7216-1(b)(3).
- <sup>6</sup> Reg. §301.7216-2(c)(1).
- <sup>7</sup> Reg. §301.7216-2(d).
- <sup>8</sup> Reg. §301.7216-2(h)(1)(ii).
- <sup>9</sup> Reg. §301.7216-2(n).

- <sup>10</sup> Reg. §301.7216-2(o).
- <sup>11</sup> See Reg. §301.7216-3(a)(3)(i)(B).
- <sup>12</sup> Reg. §301.7216-3(a)(3)(iii).
- <sup>13</sup> Reg. §301.7216-3(a)(4).
- <sup>14</sup> *Id.*

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