

Tax Trends

By Mark A. Luscombe

Living with the New Use and Disclosure of Tax Return Information Regulations

Code Sec. 7216, governing the use and disclosure of tax return information, has been part of the tax law since 1971. Yet, the discussions involving the proposed regulations issued at the end of 2005 that have now been finalized at the start of 2008 make it clear that some tax return preparation professionals are just starting to focus on the implications of Code Sec. 7216 for the first time. Certainly the new regulations raise the bar in several respects, particularly with respect to the form that the required consents must take. However, part of the problem is clearly that the final regulations are forcing tax return preparers to give serious considerations to requirements that often received at most lip service in the past.

While the new regulations only become applicable to disclosures or uses occurring on or after January 1, 2009, tax return preparers would do well to focus not only on the changes applicable next year but also the long standing requirements that are currently effective.

One somewhat unusual aspect to the comments received by the IRS with respect to the proposed regulations were the number of comments pushing for the regulations to be strengthened as compared to the number pushing for them to be relaxed. Consumer and privacy groups took an interest in the proposed regulations in addition to the usual interest of the tax professional community. Many of these groups have been pushing for no use of tax return information for other purposes. This balance of comments received on both sides of the issue may have been reflected in the fact that the final regulations do not on the whole make major changes from the proposed regulations, and what changes are made are as likely to be a tightening as a relaxation of the regulations.



Mark A. Luscombe, J.D., LL.M., CPA, is a Principal Analyst for Federal Tax at CCH, a Wolters Kluwer business.

Code Sec. 7216

Code Sec. 7216 is a criminal provision. It provides for fines and/or imprisonment of a tax return preparer who knowingly or recklessly either (1) discloses any information furnished for, or in connection with, the preparation of any such return; or (2) uses any such information for any purposes other than to prepare, or assist in preparing, any such return.

The statute provides exceptions for disclosures to comply with the Internal Revenue Code and court orders and for uses in connection with state and local tax returns and declarations of estimated tax. Specific statutory language also permits the IRS to provide for additional exceptions by regulations, including a specific reference to permitted disclosure or use for quality or peer reviews. The IRS has exercised this authority with prior regulations and with the new final regulations recently enacted.

What Is Old and What Is New

The definition of a “tax return preparer” has not been significantly modified, except that, due to a change in the definition of a return preparer in Code Sec. 7701(a)(36), a reference in the proposed regulations to a lack of uniformity in the definition of tax return preparer was deleted from the final regulations. The definition of tax return information is not significantly modified except to clarify the use of statistical compilations and to address return preparation software. The regulations do clarify that the privacy requirements of the Graham-Leach-Bliley rules are applied separately from the Code Sec. 7216 requirements.

Disclosures and uses permitted under the prior regulations without taxpayer consent included disclosures to others within the same firm performing services for the client, disclosures to fiduciaries and to parties related to the client unless the interests are adverse. Disclosures and uses permitted under the final regulations include disclosures to the IRS to assist in e-filing programs; to a contractor working with the software used in return preparation; to the client’s lawyer, accountant or investment advisor; to facilitate processing payments for services; and for use by another preparer within the same firm who is located in the U.S. for assistance in the preparation of the return or auxiliary services in connection with the return preparation. One of

the focuses of the final regulations is the requirement to obtain the consent of the client for use and disclosure of tax return information outside of the United States and outside of the jurisdiction of the IRS. The final regulations also clarify that a return preparer may disclose return information to the preparer’s attorney for the purposes of securing legal advice.

The Consent Requirements

Perhaps the most troublesome aspect of the final regulations will be the new requirements for the consents themselves. The consents will only be effective for one year unless a longer period is specified in the consent. 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.

The format for paper and electronic consents is specified. Paper consents must be on 8.5 x 11-inch or larger paper and in at least 12-point font. Similarly, electronic consents require standard size text, printer-friendly format and specific procedures for electronic signatures.

Both use and disclosure consents require specific statements, including the intended purpose of the disclosure, the recipients of the disclosure, the particular authorized disclosure or use, and boilerplate warning statements. Many of these statements are of a nature that would tend to give taxpayers some pause before signing the consents.

Although the final regulations generally prohibit the signing of the consents from being a condition to doing the return preparation work, an exception is provided where the consent involves having part of the return preparation work done outside of the United States. The final regulations also permit consents involving taxpayers not involved with Form 1040 series returns to have those consents be part of engagement letters. 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. The consent generally must not be requested after the preparer provides

a completed return to the taxpayer for signature. However, a preparer would not be prohibited from requesting consent to disclose the past three years tax returns to an attorney for preparing the taxpayer's estate plan. Much of the specific guidance on the form the consents must take, as well as the electronic signature requirements, has also been set forth in Rev. Proc. 2008-12.¹

Refund Anticipation Loans

Perhaps reflecting the influence of consumer groups in the regulation process, concurrently with the publication of the final regulations, the Treasury and the IRS requested comments on a proposed rule that would prohibit tax return preparers from using or disclosing tax return information for the purpose of soliciting, or the taxpayer obtaining, refund anticipation loans or certain other products.

Summary

The new disclosure and use consent requirements are effective for disclosures and uses on or after January 1, 2009. However, the discussions of Code Sec. 7216 and the proposed changes tend to indicate that many return preparers may not have been in full compliance with existing regulations. Tax return preparers should take the time now to make sure that compliance with the current standards is achieved as soon as possible and that compliance with the additional requirements can be achieved by the required date. While there has not been much evidence of Code Sec. 7216 enforcement activity in the past, the new regulations, combined with the fact that Code Sec. 7216 violations now also constitute violations of Circular 230, may cause the Office of Professional Responsibility to bring a new focus on Code Sec. 7216 compliance.

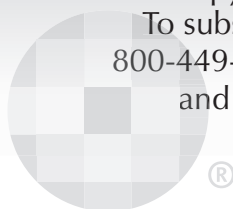
ENDNOTES

¹ Rev. Proc. 2008-12, IRB 2008-5, 368.

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