

MEMORANDUM

“How new disclosure rules stack up against the old”

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Code Section 7216 governs the disclosure and use of tax return information by tax return preparers. Late last year, in Notice 2005-93, the Internal Revenue Service issued a proposed revenue procedure purportedly to update the disclosure rules to account for changes in return filing, particularly to account for the growing use of electronic filing and electronic signatures and the foreign outsourcing of tax preparation work.

The proposals have set off some apparently unexpected protest from several consumer protection groups, basically concerned that the proposals make it too easy for taxpayers to unknowing grant permission for disclosure of their tax information.

There have even been suggestions that the proposed revenue procedure was influenced by lobbying from major tax return preparation companies.

Initial responses from the IRS have been that this position represents a misunderstanding of the current state of the law, and that the opposition to the proposed revenue procedure is misguided. This column will try to sort out the current state of the issue.

Current law

Code Section 7216(a) established a general rule prescribing a criminal penalty for tax return preparers who knowingly or recklessly disclose or use tax return information for a purpose other than preparing tax returns. The penalty is a maximum of one year in prison and a fine of \$1,000, plus costs.

Code Sec. 7216(b) provides for exceptions to the general rule. The statutory exceptions for disclosures made pursuant to another provision of the code and pursuant to a court order. The statutory exceptions for use of the tax information are the preparation of state and local returns and declarations of estimated tax.

Code Section 7216(b)(3) also authorizes the Secretary of the Treasury to promulgate additional disclosure and use exceptions to the general rule, which exceptions are to include disclosure or use of the tax return information for quality or peer reviews.

The Treasury Department long ago acted on that regulatory authority to provide an additional list of exceptions to the general rule. These additional exceptions include:

- ❖ Disclosure for preparation of the return of a related party whose interests are not adverse to the first party;
- ❖ Disclosure not only pursuant to a court order but also a grand jury subpoena, administrative order or demands from federal or state agencies regulating preparers;
- ❖ Disclosure to the preparer’s attorney or the IRS in connection with an investigation of the preparer;
- ❖ Disclosure to or use by another member of the firm of a preparing attorney or accountant to perform legal or accounting services for the taxpayer; or to take such information into account in performing legal or accounting services for another taxpayer;
- ❖ Disclosure or use by a corporate fiduciary estate or duly authorized agent after the taxpayer’s death, incapacity or insolvency;
- ❖ Disclosure to a return processor to compute tax liability;
- ❖ Disclosure to a member of the preparer firm to assist in the return preparation;
- ❖ Disclosure of information also obtained independently other than through services for the taxpayer;
- ❖ Use in connection with the preparation of another return for the taxpayer;

- ❖ Use of a list of taxpayers for solicitation of tax return business;
- ❖ Disclosure to report a crime; and,
- ❖ Disclosure due to the preparer's death or incapacity.

In addition to this list of statutory and regulatory exceptions to disclosure and use that do not require taxpayers consent, the regulations also provide for disclosure and use that can be made with the taxpayer's written consent. These disclosures and uses requiring writing consent include:

- ❖ For the preparer or an affiliate of the preparer to solicit the taxpayer for additional business that the preparer or its affiliated customarily provide to the public;
- ❖ For the tax preparer to disclose the information to third parties as directed by the taxpayers; and,
- ❖ For Disclosure or use in connection with the preparation of another taxpayer's tax return.

Each disclosure requires a separate consent signed by the taxpayer.

The proposed rules

The proposed rules focus on the disclosures requiring consent under the existing regulations and the form of that consent. They do not affect the general penalty rule or the disclosures and uses permitted without consent.

The proposed rules distinguish between paper and electronic consent and devote a special section to the requirements for electronic consent. The proposed rules expand upon the consent requirement in the existing regulations to require a more clear statement of the disclosure or use being consented to, identification of the tax return information to be disclosed or used, contact phone numbers at the Treasury Inspector General for suspected unauthorized use or disclosure of tax return information, and a series of mandatory statements to be required in the consent document.

One of the mandatory statements is specifically required if the consent could permit the tax preparer to outsource information to a foregoing entity.

The issues

Critics of the proposal, including the U.S. Public Interest Research Group, the National Consumer Law Center and the Consumer Federation of America, focus on the possibility that taxpayers very often do not read every document that is put before them in the tax preparer's office. One can think of the real estate closing where the borrowers often sign document after document without reading them based primarily on a one-sentence oral explanation of what the document is designed to do. They are concerned that taxpayers will be unwittingly signing away disclosure of some of their most confidential personal and financial information.

However, it is difficult to see how the proposed rules are more lenient than the current rules, except perhaps for the creation of the possibility of electronic consent where only written consent is contemplated in the existing regulations. The disclosures required to be made in the proposed consent form appear to be much more rigorous than required under current regulations.

Rep. Ed Markey, D-Mass., who had raised concerns about taxpayer privacy issues with the service concerning the outsourcing of tax return information, praised the IRS for taking this action to further protect taxpayer's privacy rights.

If the concern about informed consent is valid, it would appear to be an even more valid concern under the current regulations than under the proposed regulations.

That may, however, be what critics are saying: If the IRS is going to revise the regulations, it should be thinking of restricting or eliminating the ability of a taxpayer to give consent to disclosure or use, not just taking steps to make sure that consent is more informed in an electronic age.

Preparer planning

Tax preparers should follow the outcome of this debate and make sure they understand what is required by the final regulations. Preparers might also want to take this opportunity to review their current practices. Many preparers have probably been somewhat lax about the use of return information, especially when approaching existing tax return clients about other services they offer.

As clients become more sensitive to misuse of personal information, tax preparers should make sure that they do not fall into the trap of getting caught for ignoring either the existing Code Section 7216 requirements or the additional requirements or the additional requirements that may be imposed when the new revenue procedure is finalized.