

HOW SECTION 7216 REGULATIONS AND REVENUE RULING 2010-4 MAY AFFECT YOUR MARKETING PROGRAM

On Jan. 1, 2009, new regulations under IRC Section 7216, Disclosure or Use of Information by Preparers of Returns, went into effect. The new regulations tighten restrictions on the sharing or use by tax preparers of their clients' confidential financial or contact information.

Violations can result in serious penalties. So it's important to understand when Sec. 7216 applies and how to comply. While this overview provides some guidance — and Revenue Ruling 2010-4 allows additional exceptions to Sec. 7216 regulations — we recommend that you consult an attorney with expertise in this area to make sure your firm is in compliance.

OLD DOG, NEW TEETH

Section 7216 has been on the books since 1971, when Congress imposed criminal penalties on tax return preparers who disclosed or used tax return information without authorization. But the new regulations give the law more bite to better protect the confidentiality of tax return information in today's technologically advanced business environment, where electronic theft and security data breaches are all too common.

The updated regulations generally prohibit tax return preparers from disclosing or using "tax return information" (defined below) from tax-return-only (TRO) clients for purposes other than tax return preparation without the clients' knowing, informed and voluntary consent. Furthermore, you must obtain the clients' consent *before* they sign their tax returns.

Fortunately, there are a number of exceptions, including several that have been clarified by Revenue Ruling 2010-4, issued Dec. 30, 2009. This ruling removes some of the barriers to sharing information with former tax return clients or with third party auxiliary service providers, so you can now have a third-party send out tax-related newsletters and marketing communications without taxpayer consent. (For the full text of the ruling, see <http://www.irs.gov/pub/irs-drop/rr-10-04.pdf>)

We'll discuss these exceptions in detail below. But first, it's important to understand how the new regulations redefine certain terms of Sec. 7216.

KEY TERMS REDEFINED

In keeping with the IRS's goal of increasing protection of confidential taxpayer information, the new regulations broaden the definition of two terms in Sec. 7216:

"Tax return preparer." This term now applies not only to those preparing tax returns, but also to anyone assisting with the preparation of a return, including casual preparers and electronic return originators or e-filers. Even administrative assistants are bound by the regulations if they help prepare returns for your office.

When you outsource work and provide subcontractors with tax return information, they're subject to the same provisions and penalties. So informing them in writing of the rules and penalties is mandatory.

"Tax return information." This term now includes any information received from the taxpayer or a third party (such as a financial institution) used in the preparation of a tax

return and any information obtained in connection with the preparation of the return. "Taxpayer" applies to any person or entity filing an income tax return. Naturally, documents, worksheets, compilations, correspondence and the like are protected, but so is basic contact information such as taxpayers' names, addresses and e-mail addresses.

WHEN CONSENT IS NOT REQUIRED

In cases like the following, the new regulations don't require you to obtain clients' consent for sharing or using certain information gathered in preparing their tax returns:

Providing tax-related information. Tax return preparers can make limited use of previous TRO clients' contact information (name, address, e-mail address, phone number) to offer tax information or additional tax return preparation services to them. Revenue Ruling 2010-4 specifies two exceptions to the consent requirement of the updated Sec. 7216 regulations:

- A tax preparer can use tax return information from former (as well as current) TRO clients to inform them of changes in tax law that could affect their tax liability on previous-year returns handled by the preparer.
- A tax preparer can use tax return information from previous and current TRO clients to inform them about how changes to tax rulings or regulations might affect their upcoming year's tax filing obligations, as long as the clients have not specifically informed the preparer that they do not wish to be contacted or will not be using the preparer for their upcoming year's taxes.

Using contact information obtained by other means. Disclosing or using information that doesn't fall under the Sec. 7216 definition of "tax return information" isn't prohibited by the regulations. Therefore, if you've gathered your clients' contact information from somewhere other than their tax return, such as documents connected with providing a non-tax related product or service, you may use that information for marketing purposes without getting their consent.

In reality, though, it may be difficult to determine exactly how you obtained contact information for a tax return client. You may have obtained it many times in different ways over the years. If you are in doubt about its source, or if the only documentation of where it came from is related to the tax return, you should get consent.

Using third-party auxiliary service providers. Revenue Ruling 2010-4 now allows tax preparers to disclose — without taxpayer consent — the names and mailing or e-mail addresses of tax-return clients to third-party service providers that create, publish or distribute tax-focused information. The ruling applies to print and electronic newsletters, bulletins, and similar communications that contain "tax information and general business and economic information or analysis for educational purposes or for purposes of soliciting additional tax return preparation services for the tax return preparer."

Consequently, you do not have to be concerned about using a mail service provider to send out a tax-related newsletter or about uploading your newsletter list to an e-mail distribution system. Revenue Ruling 2010-4 therefore facilitates the use of marketing newsletters to develop your tax practice.

But Sec. 7216 still prohibits you from using a list compiled from TRO client tax returns to solicit non-tax return preparation services to these taxpayers. Also, you will need consent when you share or market services for another company or firm entity to TRO clients. These include firms that have a financial planning practice separate from their tax and accounting entities.

Complying with legal or professional requirements. The new Sec. 7216 regulations do not require taxpayer consent to disclose tax return information to a third party when the tax return preparer:

- Must disclose the information to a tax return processor for purposes of preparing the client's return,
- Participates in a peer review, or
- Must comply with federal, state or local laws — for example, in response to a summons or subpoena.

In such instances, though, these third parties are generally prohibited from using or further disclosing the tax return information to other parties.

OBTAINING CONSENT

In situations where you do need to obtain consent to disclose or use tax return information, you must obtain such consent *before* the tax returns are provided to the client for signature. And you must obtain the client's signed and dated consent on paper or electronically *before* you can disclose tax return information to anyone.

Separate consents are required for separate disclosures and uses. Consents must:

- Identify the intended purpose of the disclosure or use,
- Identify the recipients and describe the particular authorized information to be disclosed or used, and
- Include the name of the tax return preparer and the name of the taxpayer.

The regulations under Sec. 7216 provide applicable mandatory language for the consent form. Essentially they require the form to say that:

1. Signing the consent isn't a requirement and that, if he or she does sign, a time period can be set for the duration of that consent — otherwise, the consent is effective for one year from the date signed, and
2. The Treasury Inspector General for Tax Administration can be contacted if the taxpayer believes that his or her tax return information has been disclosed or used improperly.

Note: When setting the time period for the duration of the consent, firms should set a definitive, realistic time frame (for example, three years). Setting indefinite time frames, such as "until our relationship ends," is not recommended.

If you are obtaining consent for an entity as opposed to an individual, you may include the applicable mandatory language in your standard tax return engagement letter for the client. However, your individual or "1040" clients must receive their consent forms separately from any engagement letter you send.

Keep in mind that retroactive consents are prohibited, and if the taxpayer doesn't consent (meaning they deny consent verbally or in writing), *you may not ask again*. However, if they simply do not return the consent form or do not otherwise respond, you may continue to ask for the consent to use or consent to disclose until you have provided the tax return for that year.

Electronic consents are also permitted, and are subject to rules that are analogous to hard copy consents. Specifically, electronic consents must be in the same type as the Web site's standard text, contain the client's affirmative consent (as opposed to an "opt-out" clause),

and be signed and dated by the client. You can find additional information about consent forms, and IRS-approved language, at "Aids to Preparing §7216 Consent Forms" (<http://www.irs.gov/efile/article/0,,id=201520,00.html>).

CONSEQUENCES OF VIOLATIONS

Although there are likely only limited circumstances where Sec. 7216 will apply to your newsletter and similar marketing communication efforts, it's critical to identify the situations where it does apply and obtain the necessary consent, because the consequences of violations can be severe.

Noncompliance is considered, under Sec. 7216, to be a criminal penalty punishable as a misdemeanor that could result in imprisonment for up to one year, a fine of not more than \$1,000, or both, for each violation. In addition to the criminal penalties, Sec. 6713(a) imposes civil penalties using the same criteria as Sec. 7216, including \$250 for each prohibited disclosure or use, not to exceed \$10,000 for a calendar year.

ENSURING COMPLIANCE

We've focused here on marketing communication issues related to the new Sec. 7216 regulations, as modified by Revenue Ruling 2010-4. But it's important to note that the regulations have much broader implications you need to be aware of. For example, if you use or consult with an offshore contractor in relation to tax return preparation, you must inform tax return clients that their tax return information may be disclosed to a tax return preparer located outside the United States and obtain a signed form consenting to the disclosure.

Also, although this overview is intended to provide some guidance, it's critically important that you understand how these regulations may apply to the particularities of your firm. As mentioned earlier, given the severity of penalties, we urge you to consult with an attorney before taking any actions that may create exposure for your firm under Sec. 7216. When in doubt about whether or not you should get consent, always get consent. This could save you from possible penalties and fines down the road.

In terms of marketing, keep tax-only contact data for clients from whom you require consent forms separate from contact information for clients for whom you do other work and who, therefore, aren't subject to the Sec. 7216 rules. This will help ensure that you don't use contact information subject to the rules to distribute newsletters or similar marketing communications without obtaining proper consent.



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