

Elder Client PLANNER

Preparer rules for disclosure and use of return information

PROCEDURE: The IRS has tightened the rules for disclosing and using your client's tax return information. You may be required to obtain your client's written consent before doing so.

By David M. Fogel, CPA

ECP Guest Contributor

By now, you have probably heard that last year, some new rules went into effect concerning the disclosure and use of tax return information by return preparers. What are these new rules? When did they go into effect? Where can you obtain sample consent forms? What are some of the common situations where you might run into the disclosure/use limitations? What are some of the misconceptions about these rules? This article will address these questions.

Background

In general, IRC §7216(a) imposes criminal penalties on a tax return preparer

who knowingly or recklessly makes an unauthorized disclosure or use of information furnished in connection with the preparation of an income tax return. A violation of this section is a misdemeanor, with a maximum penalty of up to one year imprisonment or a fine of not more than \$1,000, or both, together with the costs of prosecution.

IRC §6713(a) prescribes a related civil penalty for unauthorized disclosure or use of information furnished in connection with the preparation of an income tax return. The penalty is \$250 for each disclosure or use, not to exceed a total of \$10,000 for a calendar year. IRC §6713 essentially mirrors IRC §7216, except that it doesn't contain the "knowingly or recklessly" standard that is in IRC §7216.

IRC §7216(b) provides exceptions for disclosures made under both sections and authorizes the IRS to issue regulations prescribing permitted disclosures and uses.

See **Disclosure**, page 2

COBRA subsidy — more for some; payback for others

TAX & INSURANCE: Here's what you need to know for tax season.

By Lynn Freer, EA

Publisher

Congress extended the COBRA subsidy for individuals who lost their insurance coverage due to job loss or hour reductions.¹ However, high-income taxpayers may be surprised to learn they must repay their subsidies.

Recapture

High-income taxpayers who receive COBRA premium assistance must recapture all or part of the subsidized portion of the premium as an

addition to tax on their income tax returns.² "High-income" for these purposes is modified adjusted gross income of \$125,000 (\$250,000 for joint returns). There is a phase-in formula, and any premium assistance that is received by taxpayers with modified AGI of more than \$145,000 (\$290,000 for joint returns) is fully recaptured.

Computing the recapture

The amount of assistance received in the tax year is added to the taxpayer's income tax for the tax year according to a recapture phase-in percentage. The phase-in percentage is the ratio obtained by dividing the excess of the taxpayer's modified AGI over \$125,000 (\$250,000 for married filing joint) by \$20,000 (\$40,000 for married filing joint). This result is the percentage of the subsidy that is recaptured.

See **COBRA**, page 4

In this Issue

More on noncash contributions — establishing and substantiating value

An appraisal may be required and the requirements for the expertise of the appraiser and content of the appraisal are extensive.

Article on page 5

Payments to retiring partners

The form of payment plus the agreement among the partners may determine tax treatment of retirement payments.

Article on page 8

Estate and Gift Tax Nonfiler Gift Tax Initiative

The IRS is gathering real estate information to determine gift tax noncompliance.

Article on page 9

Installment agreements — a tool for surprised clients

Don't let an IRS bill go unpaid. Set up a payment plan or be subject to levy.

Article on page 10

An FLP with a legitimate purpose withstands IRS scrutiny

Stock transferred by a decedent to a family limited partnership was not included in his estate.

Article on page 10

Estate tax in limbo — retroactive change still possible

Congressional inaction is leading to bizarre tax consequences and macabre life choices.

Article on page 11

News Briefs

Article on page 12

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Elder Client
PLANNER

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Disclosure, continued from page 1

The final regulations

The final regulations¹ apply to disclosures or uses of tax return information occurring after December 31, 2008. They are broken down into three sections:

- Penalty for disclosure or use of tax return information;
- Permissible disclosures or uses without the taxpayer's consent; and
- Disclosures or uses permitted only with the taxpayer's consent.²

Treas. Regs. §301.7216-1 discusses the penalty and also defines the following terms:

“tax return”
 “tax return preparer”
 “business of preparing returns”
 “providing auxiliary services”
 “tax return information”
 “disclosure”
 “use”
 “hyperlink”
 “request for consent”

As expected, the definitions of a tax return, preparer, and tax return information are broad enough to encompass just about anyone and anything that relates to a tax return. “Auxiliary services” refers to the services of contractors performing support functions in tax preparation, such as persons who install software or maintain computers on which the software is installed.³

Permissible disclosures

Treas. Regs. §301.7216-2 provides that disclosures to others and uses of tax return information that may be made without the taxpayer's consent include:

- Disclosures to the IRS;
- Disclosures made to update tax return preparation software used by a taxpayer;
- Disclosures to another officer, member, or employee of the same firm that prepared the return;
- Disclosures to another tax return preparer that don't require the second preparer to provide a substantive determination affecting the taxpayer's tax liability;
- Disclosures to contractors who provide auxiliary services;

- Certain disclosures to related taxpayers;
- Disclosures required by a court order, summons, or subpoena;
- Certain disclosures made to secure legal advice in connection with an investigation or court action involving the preparer;
- Certain specified disclosures by attorneys or accountants (such as to provide other legal and accounting services for the taxpayer);
- Certain disclosures and uses by fiduciaries;
- Disclosures for preparation of state, local, or foreign tax returns;
- Uses of the taxpayer's return information to prepare other returns or to represent the taxpayer in an IRS audit;
- Uses of the taxpayer's return information to compile a mailing list to solicit tax return business;
- Uses of the taxpayer's return information to produce certain statistics;
- Disclosures needed for a quality or peer review;
- Disclosures necessary to report a crime; and
- Disclosures needed when the preparer becomes incapacitated or dies.⁴

Where disclosures are made to another officer, employee, or member of the same firm, they must not cross international boundaries (e.g. a firm's office in the U.S. to the same firm's foreign country office, or vice versa) or else a consent is required.

A preparer may also use tax return information to contact clients informing them of tax law changes, may disclose clients' names and addresses to the publisher of a newsletter soliciting additional tax preparation services, and may disclose tax return information to a professional liability insurance carrier to obtain or maintain coverage or to report or investigate a claim.⁵

Consent required

Treas. Regs. §301.7216-3 provides that unless the disclosure or use is one of the permissible disclosures or uses, the taxpayer's consent must be obtained.

This section also requires the consent to meet the following basic requirements:

- It must include the name of the taxpayer and the name of the preparer;

See **Disclosure**, page 3

Disclosure, continued from page 2

- It must specify the tax return information to be disclosed or used;
- It must identify the intended purpose of the disclosure or use and describe the particular use authorized;
- If it is for disclosure to others, it must identify the intended recipients;
- The taxpayer must sign and date the consent; and
- It may be in any format, including an engagement letter to a client.⁶ Some of the other rules in this section are:
 - The consent must be obtained before the disclosure or use occurs;
 - If a preparer wants to disclose or use the taxpayer's tax return information to solicit business unrelated to tax return preparation, the preparer must get the consent before providing the completed tax return to the taxpayer;
 - If a taxpayer declines to provide a particular consent, the preparer may not solicit the same consent again;
 - A U.S. preparer can't obtain a consent to disclose a taxpayer's Social Security number to a preparer outside the U.S. unless adequate

safeguards to protect the data have been made;

- The consent is valid for one year from the date signed unless it states otherwise;
- A single consent may include multiple disclosures or uses; and
- A copy of the consent must be provided to the taxpayer at the time it's signed.⁷

Consent forms

Rev. Proc. 2008-35⁸ provides guidance to tax return preparers regarding the format and content of consents to disclose and use tax return information in the 1040 series, including requirements pertaining to paper and font size for paper consents, requirements pertaining to electronic consents, mandatory statements, and other detailed matters.

On its Web site, the IRS has provided seven examples of forms that preparers may use to obtain the taxpayer's consent to disclose, or use, tax return information: www.irs.gov/efile/article/0,,id=201520,00.html.

The table below illustrates the situations described in the seven different consents.

Common situations

Here are a few common situations where you may need to consider whether you should obtain a consent to disclose your client's tax return information:⁹

Bank loan — After preparing the clients' tax return, they applied for a loan at a bank, and you received a request from the bank, signed by both spouses, to provide a copy of the return, but the request didn't contain the proper language required by Rev. Proc. 2008-35. To resolve this, solicit a consent from the clients that contains the proper language, or provide them with a copy of the return to give to the bank.

Financial planner/investment broker — similar to situation above, similar answer.

Deceased client — After preparing an elderly client's returns for several years, she died without a will and there will be no probate. Her son had been taking care of her affairs for several years before her death. The son refuses to provide copies of the returns to his brothers and sisters, so they request copies from you. You probably can't provide copies of the returns without a consent signed by someone who has been designated by a court to represent the decedent's estate.¹⁰

IRS audit — The IRS has selected the client's return for an audit, and you want to provide access to the taxpayer's

| Consent Number | Tax Return Info Will Be Disclosed to: | | Does Disclosure Include SSN? | Purpose / Context of Disclosure | | |
|----------------|---|-------------------|------------------------------|---------------------------------|------------------------|-------------------------------------|
| | Another U.S. Preparer | Non-U.S. Preparer | | Substantive Tax Advice | Tax Return Preparation | Services Other Than Tax Preparation |
| 1 | X | | | X | | |
| 2 | | X | No | | X | |
| 3 | | X | Yes | | X | |
| 4 | X | | | | | X |
| 5 | | X | No | | | X |
| 6 | | X | Yes | | | X |
| 7 | General consent to use (not disclose) a taxpayer's tax return information | | | | | |

See **Disclosure**, page 4

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Disclosure, continued from page 3

return information to another preparer (who doesn't work in your firm) who will represent the client in the audit. A consent must be obtained to disclose such information to the second preparer.¹¹

Tax research—In preparing a client's tax return, you decide to engage an individual outside the firm to conduct research regarding how to report a particular item on the return. A consent must be obtained to disclose the client's tax return information to the individual conducting the research.

Misconceptions about the rules

There are several misconceptions about the rules. Probably the one I've heard most often involves when to obtain the consent. Suppose that you prepared the clients' return, provided them with a copy, and they want you to send a copy to an investment broker. You are concerned that since you provided the clients with a copy of the return, it's now too late to obtain the consent.

This misconception results from a misreading of Treas. Regs. §301.7216-3(b)(2). Under this regulation, you are required to obtain the consent before providing the taxpayer with the completed return, but this applies only if you want to disclose or use the taxpayer's tax return information to solicit business that is unrelated to tax return preparation. It does not prevent you from getting the consent in the situation described.

Another misconception is that it's a violation to send a newsletter to a client after you have prepared the client's tax returns where the newsletter advertises other non-tax-related services. The regulations don't prohibit you from sending out the

newsletter. However, suppose that the client now wants you to provide these additional services. In that case, under Treas. Regs. §301.7216-3(b)(2), it's too late to ask for a consent. You'll just have to get the client to provide you with the tax return information you need in order to provide these additional services.¹²

A third misconception is that you can't use a client's tax return information to provide the client with other return-related services, such as revising a W-4, recalculating estimated tax, or calculating the required minimum distribution from an IRA. You don't need a consent in this situation.¹³

A fourth misconception is that e-filing a tax return through the manufacturer of the tax preparation software is a violation of the IRC §7216 regulations. Treas. Regs. §301.7216-2(d)(1) specifically authorizes this.

Conclusion

Before disclosing your client's tax return information to anyone else, or using the information for any purpose, you should ask yourself whether you need to solicit a consent from the client, and if so, determine the language to be used in the consent. The IRC §7216 regulations are complex, and were expanded by guidance provided in Rev. Proc. 2008-35. Several misconceptions about what you can and cannot disclose without the client's consent have made things worse. Hopefully, this article has clarified the rules and helped you understand the situations in which you should obtain your client's consent.

About the author

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- ¹ Treasury Decision 9375
- ² Treas. Regs. §§301.7216-1, -2, and -3
- ³ Treas. Regs. §301.7216-2(d)(2)
- ⁴ Treas. Regs. §301.7216-2(b) – (r)
- ⁵ See Rev. Ruls. 2010-4 and 2010-5
- ⁶ Treas. Regs. §301.7216-3(a)(3)
- ⁷ Treas. Regs. §301.7216-3(b) and (c)
- ⁸ Rev. Proc. 2008-35, 2008-29 I.R.B. 132, modifying and superseding Rev. Proc. 2008-12
- ⁹ Some of these common situations have been obtained from messages posted to www.taxalmanac.com
- ¹⁰ Although Treas. Regs. §301.7216-2(e) provides that tax return information may be disclosed, without the taxpayer's consent, to a non-adverse related party (such as the child of a parent), that disclosure may only be made if the preparer is using that tax return information to prepare the relative's return
- ¹¹ See Example 4 at Treas. Regs. §301.7216-2(d)(3)
- ¹² Perhaps you could hand the client your tax return preparation file and have the client hand it back to you. It sounds ridiculous, but that's what seems to work
- ¹³ See Treas. Regs. §301.7216-2(c)(2), and Example 2 at Treas. Regs. §301.7216-2(c)(4)

COBRA, continued from page 1

EXAMPLE 2-1: Tara worked on a fishing boat, making \$500,000 per year. On October 31, 2008, because overfishing has depleted fish populations, Tara's employer ceased operations and laid off all employees.

Tara was eligible for COBRA, but she did not initially elect to receive continued coverage. However, due to the new law, on March 1, 2009, she decided to elect her employer coverage under COBRA.

She accepted \$3,000 in premium assistance before getting a new job at which she now earns enough to report modified AGI of \$130,000 for 2009. Using the AGI phase-in percentage to determine recapture, Tara's recapture amount is \$750 ($\$130,000 - \$125,000 = \$5,000$; $\$5,000 \div \$20,000 = 25\%$; $\$3,000 \times 25\% = \750).

Reporting the recapture

Report the recapture amount on line 60 of Form 1040. Print "COBRA" to the left of the box. (Most major software companies provide an input box for the amount of the subsidy received.)

Medical expense deduction

As the premium subsidy is a payment of health insurance, it would seem that the

See **COBRA**, page 5