

Part 301

Section 7216.—Disclosure or Use of Information by Preparers of Returns

26 CFR: 301.7216-1: Penalty for disclosure or use of tax return information.
(Also § 6713; 301.7216-2.)

Rev. Rul. 2010-5

PURPOSE

This revenue ruling provides guidance on whether a tax return preparer is liable for criminal and civil penalties under Internal Revenue Code sections 7216 and 6713 when the preparer discloses tax return information under the circumstances described below.

ISSUES

(1) Is a tax return preparer liable for penalties under sections 7216 and 6713 when the preparer discloses to a professional liability insurance carrier tax return information required by the insurance carrier to obtain or maintain professional liability insurance coverage?

(2) Is a tax return preparer liable for penalties under sections 7216 and 6713 when the preparer discloses to the preparer's professional liability insurance carrier tax return information required by the insurance carrier to promptly and accurately report a claim or a potential claim against the tax return preparer, or to aid in the investigation of a claim or potential claim against the tax return preparer?

(3) Is a tax return preparer liable for penalties under sections 7216 and 6713 when the preparer discloses tax return information to the preparer's professional liability insurance carrier in order to secure legal representation under the terms of the insurance policy or to an unrelated attorney for the purpose of evaluating a claim or potential claim against the tax return preparer?

FACTS

Tax Return Preparer A prepared income tax returns during the 2009 filing season and expects to prepare income tax returns in the 2010 filing season. During 2010, A expects to disclose to insurance agents or other insurance company representatives tax return information required to obtain or maintain professional liability insurance coverage, including information necessary to obtain price quotes from the insurance companies. The disclosed information would include a list of client names and descriptions of the services A provided to those clients. A also expects to disclose to its professional liability insurance carrier tax return information required by the terms of the insurance policy to promptly and accurately report, and to aid in the investigation of, a claim or potential claim against A, including client names, descriptions of services A provided to the named clients, a description of the claim or potential claim of

professional negligence, misconduct, or fraud, and, when necessary, copies of tax returns relevant to the claim or potential claim. Finally, A expects to disclose to its professional liability insurance carrier tax return information required by the terms of the insurance policy to obtain legal representation provided by the insurance carrier under the terms of the insurance policy related to a claim or potential claim of professional negligence, misconduct, or fraud, or to an unrelated attorney for the purpose of evaluating a claim or potential claim of professional negligence, misconduct, or fraud.

All of the professional liability insurance carriers contacted by A, including their agents and representatives, are located within the United States or its territories or possessions, and all hold themselves out as providing professional liability insurance with respect to potential claims arising in connection with the preparation of tax returns. None of the insurance carriers provide substantive determinations or advice affecting the tax liability reported by taxpayers or the preparation of tax returns. The professional liability insurance carrier that issued the policy purchased by A is one these insurance carriers.

LAW

Section 7216(a) establishes a criminal penalty that is applicable to tax return preparers who knowingly or recklessly disclose or use any information furnished to them for, or in connection with, the preparation of tax returns for any purpose other than to prepare, or assist in preparing, any such returns.

Section 7216(b)(3) establishes an exception to the penalty for disclosures or uses of information which are permitted by regulations prescribed by the Secretary.

Section 6713(a) establishes a civil penalty that is applicable to tax return preparers who disclose or use any information furnished to them for, or in connection with, the preparation of tax returns for any purpose other than to prepare, or assist in preparing, any such returns.

Section 6713(b) provides that the rules of section 7216(b) shall apply for purposes of section 6713.

Section 301.7216-1(a) states that section 7216 imposes a criminal penalty for tax return preparers who “knowingly or recklessly disclose or use tax return information for a purpose other than preparing a tax return.”

Section 301.7216-1(b)(2)(i)(B) defines “tax return preparer” for purposes of section 7216 and the regulations thereunder as including “[a]ny person who is engaged in the business of providing auxiliary services in connection with the preparation of tax returns....”

Section 301.7216-1(b)(2)(iii) provides that a person is engaged in the business of providing auxiliary services in connection with the preparation of tax returns if, in the course of the person’s business, the person holds himself out to tax return preparers or to taxpayers as a person who performs auxiliary services, whether or not providing the auxiliary services is the person’s sole business activity and whether or not the person charges a fee for the auxiliary services.

Section 301.7216-2(d)(1) provides that a tax return preparer may disclose, without taxpayer consent, tax return information of a taxpayer to another tax return preparer located in the United States for the purpose of obtaining auxiliary services in connection

with the preparation of any tax return, so long as the services provided are not substantive determinations or advice affecting the tax liability reported by taxpayers.

Section 301.7216-2(g) provides that a tax return preparer may disclose, without taxpayer consent, tax return information to an attorney for the purpose of securing legal advice.

ANALYSIS

Issue 1. Obtaining and Maintaining Professional Liability Insurance.

Insurance companies offer professional liability coverage to tax return preparers to insure against potential claims arising from the tax return preparers' negligence, misconduct, or fraud in connection with the preparation or processing of tax returns. A tax return preparer may obtain professional liability insurance coverage in order to protect itself from such claims of negligence, misconduct, or fraud. A professional liability insurance carrier provides auxiliary services in connection with the preparation of tax returns because it provides liability coverage for claims or potential claims that relate directly to the tax returns prepared or processed by the tax return preparers it insures. In the course of obtaining professional liability insurance, various insurance companies may routinely offer, and tax return preparers may routinely receive, price quotes for such coverage in the ordinary course of their tax return preparation businesses. The tax return information required to be disclosed to an insurance provider in order to obtain and maintain insurance coverage (including obtaining a price quote) might include a list of client names and descriptions of the services provided to those clients by the tax return preparer.

The professional liability insurance policy purchased by A is an auxiliary service provided in connection with the preparation of tax returns, and the insurance carriers are tax return preparers within the meaning of § 301.7216-1(b)(2)(i)(B) and (iii). Under § 301.7216-2(d)(1), A may disclose to these insurance carriers, without taxpayer consent, the tax return information required to obtain and maintain the auxiliary services provided by the insurance carriers, including the information necessary to obtain price quotes from various professional liability insurance carriers. Disclosure by a tax return preparer of tax return information beyond that necessary to obtain or maintain insurance coverage would constitute a violation of sections 7216 and 6713 and would result in the tax return preparer's liability for penalties under those sections. The insurance carriers who receive a list of client names or any other tax return information from A are prohibited from the further use or disclosure of the tax return information for purposes other than those related to the provision of the auxiliary services to A or as otherwise expressly permitted under sections 7216 and 6713.

Issue 2. Reporting and Investigating Claims.

Services provided by a professional liability insurance carrier include investigation and management of claims or potential claims arising in connection with the preparation of tax returns by the covered tax return preparer. In order to request coverage for a claim or potential claim, a tax return preparer is required to promptly and accurately report claims or potential claims to its professional liability insurance carrier. In order to properly evaluate all claims or potential claims, aid in claim investigation and management, and process the payment of valid claims, a professional liability insurance

carrier may require the tax return preparer to disclose additional information, such as client names, descriptions of the services provided to the named clients containing tax return information, tax return information describing the circumstances of the claim or potential claim, and copies of tax returns relevant to a claim or potential claim.

Disclosure of tax return information in connection with these communications is required to allow A to obtain the auxiliary services provided by its professional liability insurance carrier, and is permitted without taxpayer consent under § 301.7216-2(d)(1), provided the information is necessary in order to obtain those services. Disclosure by a tax return preparer of tax return information beyond that necessary to obtain the auxiliary services would constitute a violation of sections 7216 and 6713 and would result in the tax return preparer's liability for penalties under those sections.

Issue 3. Obtaining Legal Advice or Representation.

A typical benefit provided to a tax return preparer by the terms of a professional liability insurance policy issued in connection with the preparation of tax returns includes the selection and engagement, by the insurance carrier, of an attorney to represent the preparer during the pendency of a claim investigation or litigation related to a claim, with the cost of the attorney paid for by the insurance carrier. When A seeks to have the professional liability insurance carrier provide this legal representation under the terms of the professional liability insurance policy, A does so for the purpose of obtaining auxiliary services in connection with the preparation of a tax return and may disclose relevant tax return information, without taxpayer consent, to the insurance carrier as an auxiliary services provider under § 301.7216-2(d)(1). Disclosure by a tax return

preparer of tax return information beyond the scope of the legal representation constitutes a violation of sections 7216 and 6713 and would result in the tax return preparer's liability for penalties under those sections. After the professional liability insurance carrier selects an attorney to represent A in relation to the claim or potential claim, A may disclose to that attorney tax return information related to the claim or potential claim without taxpayer consent under § 301.7216-2(g)(1).

When a tax return preparer seeks legal advice or representation in relation to any claim or potential claim of negligence, misconduct, or fraud from an attorney who is not a representative of the professional liability insurance carrier, the tax return preparer may disclose tax return information to that attorney without taxpayer consent under § 301.7216-2(g)(1).

HOLDINGS

(1) Tax Return Preparer A is not liable for penalties under sections 7216 and 6713 when A discloses to a professional liability insurance carrier tax return information required by the insurance carrier to obtain or maintain professional liability insurance coverage, including obtaining price quotes for such insurance coverage.

(2) Tax Return Preparer A is not liable for penalties under sections 7216 and 6713 when A discloses to A's professional liability insurance carrier tax return information relevant to a claim or potential claim of professional negligence, misconduct, or fraud that is required by the insurance carrier to promptly and

accurately report the claim or potential claim against A or to aid in the investigation of that claim or potential claim.

(3) Tax Return Preparer A is not liable for penalties under sections 7216 and 6713 when A discloses to its professional liability insurance carrier tax return information required by the insurance carrier in order to secure legal representation relating to a professional liability claim, or tax return information relevant to a claim or potential claim of professional negligence, misconduct, or fraud to the attorney selected by the insurance carrier or to an unrelated attorney for the purpose of evaluating a claim or potential claim against A.

DRAFTING INFORMATION

The principal author of this revenue ruling is Molly K. Donnelly of the Office of Associate Chief Counsel (Procedure & Administration). For further information regarding this revenue ruling, contact Ms. Donnelly at (202) 622-4940 (not a toll-free call).