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69701-3

NO. 69701-3 (consolidated with 70190-8-1)

COURT OF APPEALS STATE OF WASHINGTON  
DIVISION I

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DOUGLAS M. DEWAR,

Respondent,

v.

KENNETH SMITH and JANE DOE SMITH, husband and wife, and their  
marital community composed thereof; TRANER SMITH & CO. PLLC, a  
Washington professional limited liability company,

Appellants.

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PETITIONERS' OPENING BRIEF

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## I. INTRODUCTION

Plaintiff/Respondent Douglas Dewar (Dewar) alleges that Defendants/Petitioners Ken Smith and Traner Smith & Co., PLLC's (collectively Traner Smith), a CPA firm, assisted Brad Beddall (Beddall) in diverting Beddall's 2009 federal income tax refund checks that Beddall had agreed to give to Dewar pursuant to a Property Settlement Agreement between Dewar and Beddall. Dewar has alleged that Traner Smith was negligent, committed negligent misrepresentation by silence, and breached a third-party beneficiary contract with Dewar.

The trial court agreed with Dewar that, pursuant to *Trask v. Butler*, 123 Wn.2d 835, 872 P.2d 1081 (1994), Traner Smith owed Dewar a duty of care to disclose Beddall's tax information to Dewar, and that Traner Smith's failure to do so constituted negligent misrepresentation by silence. As a proximate cause of Traner Smith's negligence, the trial court found that Dewar had suffered damages totaling \$1,375,930.86, the approximate value of Beddall's tax refund, plus interest. The trial court denied Traner Smith's motion to dismiss the third-party beneficiary claim.

Whether a CPA owes a duty of care to a third party to disclose the confidential tax information of its client is a matter of first impression in this state. The trial court's reliance on *Trask v. Butler* to establish Traner Smith's duty of care was both novel and misguided. Federal law defines a

CPA's duty, and ability, to disclose its client's tax information to third parties, and preempts state law on this point. If Traner Smith had disclosed Beddall's tax information to Dewar, it would have violated federal law. Moreover, Dewar failed to present evidence supporting the *Trask v. Butler* multi-factor test. Most notably, Dewar failed to present any evidence of Traner Smith's or Beddall's intent for Dewar to be the direct beneficiary of their (Traner Smith and Beddall's) engagement.

Traner Smith owed no duty to Dewar to disclose Beddall's tax information, so the trial court erred in finding negligent misrepresentation by silence. However, and in any event, there are at least genuine issues of material fact precluding a finding of negligent misrepresentation. The evidence did not support a finding that Dewar's alleged reliance on Traner Smith to disclose Beddall's tax information was reasonable or justified. Dewar is a CPA. He is, or should be, aware of Traner Smith's duty of confidentiality imposed by federal law.

There are genuine fact questions regarding proximate cause and damage. Dewar has never disputed that Beddall's tax refund, which forms the basis for Dewar's claim for damages, was illegitimate. Relying on tax information and advice provided by Dewar, (who had been Beddall's CPA for several years), Traner Smith requested Beddall's 2009 refund. However, the information and advice provided by Dewar was

wrong; and in reality, Beddall was not entitled to the tax refund. As Beddall was not entitled to the refund, Dewar has no legal right to the refund as damages in this lawsuit.

Finally, there has never been any dispute that Dewar was, at best, an incidental, rather than direct and intended beneficiary of Traner Smith's and Beddall's engagement. Therefore, the trial court's failure to dismiss Dewar's third-party beneficiary claim on summary judgment was error.

## **II. ASSIGNMENTS OF ERROR**

1. Whether the trial court committed reversible error in granting Dewar's motion for partial summary judgment on the issues of duty and negligent misrepresentation, where:

- a. Federal law preempts the trial court's finding that Traner Smith, a CPA, owed a duty to disclose its client's confidential tax information to a third-party, Dewar;
- b. The trial court incorrectly relied on *Trask v. Butler* to establish duty because the *Trask* analysis does not apply to the duties of a CPA, and the evidence at summary judgment did not support the *Trask* elements;
- c. Dewar failed to present clear, cogent, and convincing evidence supporting a claim for negligent misrepresentation; and
- d. The trial court inappropriately decided fact issues as to duty,

Partial Summary Judgment – Duty Owed as a Matter of Law and Negligent Misrepresentation. CP 215-218. The trial court held that, pursuant to *Trask v. Butler*, 123 Wn.2d 835, 872 P.2d 1081 (1994), Traner Smith owed a duty to disclose Beddall’s confidential tax information to Dewar and that its failure to do so constituted negligent misrepresentation. *Id.*; CP 766-78. On the same day, the trial court denied Traner Smith’s Motion for Partial Summary Judgment to Dismiss Contract Claims. CP 219-21. On December 10, 2012 Traner Smith moved this court for discretionary review of those two orders. CP 204-12.

On March 20, 2013 the trial court granted Dewar’s Motion for Partial Summary Judgment – Damages Sum Certain Arising From Defendants’ Negligent Misrepresentation. CP 15-18. On April 1, 2013, Traner Smith moved this court for discretionary review of that order. CP 7-12. On April 4, 2013, Traner Smith moved pursuant to RAPs 1.2(a), 2.4(b), and 18.8(a) to consolidate the hearings for discretionary review of the November 9 and March 20 orders and to reset the hearing date on these orders. On April 24, the commissioner of this court granted Traner Smith’s motion and set a consolidated hearing for June 14, 2013. On May 22, the trial court struck the trial date pending appellate review of the issues before this court. CP 1-3. Also on May 22, Dewar voluntarily dismissed all of his claims, save for negligence, negligent

misrepresentation, and breach of third-party beneficiary contract. CP 4-6. The commissioner of this court held the hearing on June 14 and on August 2, 2013 granted discretionary review.

**B. Dewar and Beddall were business partners for several years before a dispute over the Lea Hill Condominiums Project.**

Dewar and Beddall were joint venturers for many years on many projects and developments. CP 70-71. Beddall was a real estate developer; Dewar was, essentially, his financier. *Id.*; CP 72 at 20, ll. 1-12. Dewar and his CPA firm, Dewar, Meeks & Ekram (Dewar Meeks) had been Beddall's and his businesses' accountant for many years and had prepared Beddall's tax returns for several years prior to 2009. *Id.*; CP 69-70, 73-74; CP 28 ¶ 2.

In or around 2006 Beddall, as developer/project manager, and Dewar, as financier/accountant/participant, undertook a condominium-conversion project, the Lea Hill Condominiums ("Project"). CP 72-73; CP 345-73.

By mid-2009 the local and national real estate markets had significantly declined, and the Project was losing large amounts of money. CP 73-74. In July 2009, Beddall approached Dewar and informed him that he wanted out of the Project and all related contractual obligations and debts arising therefrom owed to Dewar. *Id.* Dewar would not release

Beddall from the Project or his debts to Dewar and on December 23, 2009 served Beddall with a lawsuit for breach of loan documents related to the Project. *Id.*; CP 285 at ¶ 7.5.

On about December 23, 2009, the parties commenced negotiations that contemplated that Beddall would seek a tax refund which would be applied against his obligations to Dewar in exchange for a partial release. CP 76 at 33-34; CP 283-87 (*see* ¶¶ 4, 7.5, and 10). Dewar, who had been the accountant for the Project, believed that Beddall was entitled to a large tax refund arising from the debts associated with the Project. *Id.*

In March 2010, the parties executed a Property Settlement Agreement (Agreement) that provided that Beddall agreed to transfer title to the project property (“Lee Hill Property”) to Dewar and engage Traner Smith to prepare Beddall’s 2009 federal income tax return and request a refund. CP 281-93, 431-71. Beddall agreed that his tax refund would be worth at least \$1,000,000. *Id.* Traner Smith was never involved in the negotiations between Dewar and Beddall that culminated in the Agreement and was not and never has been a party to the Agreement or any other agreement between Beddall and Dewar. CP 28, ¶ 2; *see also* CP 281-93, CP 431-71.

**C. The parties had no Agreement before the end of 2009.**

When the first draft of the Agreement was circulated on or about

December 29-31, 2009, several material terms were still in dispute, such as the value of the tax refund, and how and when the Lea Hill Property would be sold/transferred/conveyed to Dewar. CP 78 at 44, ll. 24-25; CP 79 at 45-46; CP 345-96; CP 398-401. Beddall refused to guarantee a tax refund of \$1 million. *Id.* In late February 2010, the draft Agreement still provided for a tax refund of at least \$1 million “or such sum established by preparing the 2009 tax return[.]” *Id.*

More importantly, the Lea Hill Property was not transferred until January 2010. CP 78 at 44, ll. 7-23; CP 426-29. The parties executed a quitclaim deed in January 2010 but back-dated the deed in the mistaken belief that such backdating would make the transfer effective in 2009 rather than 2010. *Id.*; CP 79 at 45-46. Traner Smith played no role in providing tax advice as to the effectiveness of such deed. CP 28 at ¶ 2.

The Agreement was not fully executed until March 30, 2010. CP 431-71; CP 78 at 44, ll. 7-23; CP 426-29; CP 375-96. The Agreement included a Special Power of Attorney and an IRS Form 2848 Special Power of Attorney each of which purported to assign or transfer Beddall’s rights related to the tax refund to his attorney John Hatch. CP 291-93.

**D. Beddall, not Dewar, engaged Traner Smith to prepare Beddall’s 2009 federal income tax return and to request a refund related to that return.**

In January 2010, while Dewar and Beddall were still negotiating

the Agreement, Dewar began providing Traner Smith with tax information for Beddall and several Beddall business entities. CP 28 at ¶¶ 2-3; CP 280 at 51, ll. 13-25; 52, ll. 1-2. In February 2010, while Dewar and Beddall continued to negotiate the Agreement, Beddall formally retained Traner Smith to prepare Beddall's 2009 federal income tax return, CP 27 at ¶ 1, and Beddall Properties Inc., a subchapter S corporation, retained Traner Smith to prepare its 1120s forms. *Id.*

The terms of the engagements for the individual return and for the subchapter S 1120s form, are substantively identical as to the rights and obligations of the parties to be bound: Traner Smith and Beddall. CP 515-20. Traner Smith agreed that it would prepare the relevant tax documents and not disclose Beddall's tax information to any third party for any purpose, other than to prepare the return, without Beddall's consent. *Id.* Beddall agreed to pay Traner Smith for its services, including 15% monthly interest on invoices outstanding for 30 days. *Id.* According to the engagement letters, Beddall was responsible for penalties associated with violations of disclosure standards or with a tax understatement. Beddall bore all risk to the IRS and ultimately paid Traner Smith for its services. *Id.* The engagements do not mention Dewar, the lawsuit, or the Agreement or state any intention of Beddall or Traner Smith to undertake any duties other than those stated therein. *Id.*

At the outset of Traner Smith's engagement, Beddall explicitly permitted Traner Smith to work with Dewar to prepare the return. CP 28-29 at ¶ 3. Beddall initially permitted Traner Smith to communicate with Dewar and Hatch about his return because Dewar had intimate knowledge of Beddall's financial and tax matters, and because, by that time, Beddall engaged Traner Smith, Beddall had moved to Thailand and was difficult to reach. *Id.*; CP 65 at 47-48.

Before the return was filed, Dewar asked to review it. CP 32 at ¶¶ 11-12. Traner Smith initially refused, because Beddall had not given permission to disclose this tax information. *Id.* Hatch contacted Beddall to get approval, and Beddall agreed to let Traner Smith give Dewar a copy of the return to review. *Id.*; CP 57 at 14, ll. 11-22. After receiving that approval, Traner Smith provided the return for Dewar's review. *See id.*

Dewar alleges that, after he reviewed the 2009 tax return, he "insisted" that the address be changed from Beddall's address to Hatch's address. CP 1064 at ¶ 8. Dewar's "insistence" was irrelevant to Traner Smith. CP 32 at ¶ 12. Ken Smith of Traner Smith changed the address only later, when Beddall approved his doing so. *Id.* The return was filed April 15, 2010. *Id.*

**E. After the return was filed, Beddall directed Traner Smith not to disclose confidential tax information.**

Shortly after the return was filed, Beddall directed Traner Smith to cease discussing the return with Hatch. CP 33 at ¶ 14; CP 60 at 26-27; CP 61 at 32, ll. 22-25; CP 62 at 33, ll. 1-21. Beddall directed that Traner Smith communicate with no one but Beddall about the return. *Id.* As a matter of federal law, Traner Smith could not divulge Beddall's tax information to anyone, including Dewar and Hatch. *Id.*; *see also* 26 U.S.C. § 7216; 26 U.S.C. § 6713. Doing so would have been a criminal offense, exposed Traner Smith to civil liability and disbarment, and constituted a violation of Traner Smith's duties to its client, Beddall. *See id.*; *see also* CP 515-20; 31 C.F.R. §§ 10.50-.51; AICPA Ethical Rules 54, 92.05, 301; AICPA Rule Interps. 102-2, 301-3. Traner Smith did not know why Beddall had revoked his authority to communicate with Hatch and Dewar about his tax information, CP 33 at ¶ 14; was not a party to any agreement among Beddall/Hatch/Dewar, CP 431-71; and had no knowledge regarding any of the dealings between Hatch/Dewar/Beddall. *Id.*; CP 28 at ¶ 2.

**1. Beddall changed the address on the return.**

As filed, the return provided that the refund checks be sent to Hatch. CP 33 at ¶ 15. However, in May 2010, Beddall changed the address on the return from Hatch's address to Traner Smith's address. *Id.*

Beddall asked Smith, about the status of the refund. *Id.*; CP 59 at 24; CP 60 at 25. Smith replied that Smith could reach an IRS agent through Traner Smith's practitioner hotline, and then Beddall could ask about the refund for himself, but Smith could not check for him. *Id.* Other than dialing the IRS phone number and sitting through the conference, Smith did not participate at all in Beddall's call with the IRS. *Id.* During the call, Beddall asked that the IRS agent change the address on the return from Hatch's address to Traner Smith's address. *Id.* Smith did not request the change, assist in making it, or talk to Beddall about the change at any time. *Id.* By this time, Beddall's instruction that Smith not communicate with Dewar and Hatch about his tax information prohibited Smith from informing them. *Id.* CP 33-34 at ¶¶ 14-15; CP 60 at 26-27; CP 61 at 32, ll. 22-25; CP 62 at 33, ll. 1-21; *see also* 26 U.S.C. § 7216.

Beddall later instructed Traner Smith to deliver the refund check(s) to his son-in-law, Ron Rubin; in July 2010 Traner Smith did so. CP 35-36 at ¶ 20. On August 16, 2010 Beddall sent an email to Dewar and Hatch in which he stated that he had taken the refund money to Thailand. CP 36 at ¶ 21; CP 522. Beddall forwarded this email to Traner Smith. *Id.* This was the first time that Traner Smith learned that Beddall did not intend to provide or actually provide the tax refund to Dewar or Hatch. *Id.*; CP 63 at 39, ll. 10-13. After receiving the email, Traner Smith withdrew from

Beddall's engagement. CP 36 at ¶ 21. Months later, Dewar commenced this action. CP 1153-77.

**F. The tax refund was inappropriate, so Dewar has no damages.**

Beddall's 2009 tax refund was requested based on various loan documents by and between Dewar and Beddall and on information and tax advice that Dewar provided to Traner Smith. CP 28-29 at ¶ 3; CP 30-31 at ¶¶ 8-9. However, as described in greater detail below, the tax information and tax advice that Dewar provided to Traner Smith was incorrect, and the loan documents that supposedly showed Beddall's losses, do not give Beddall tax basis so as to realize those losses. So it does not matter whether Beddall agreed to give the tax refund to Dewar, and whether Dewar would have received the refund checks is irrelevant, because the tax refund arose from losses that Beddall had no right to take, and Dewar had no right to receive.

**1. Beddall guaranteed the debt of his S corporation, Beddall Properties, Inc.**

Beddall Properties, Inc. (BPI) wholly owned Lea LLC. CP 350 at ¶ 1. BPI was taxable as an S corporation under the Internal Revenue Code. CP 295-344. Beddall owned 100% of the stock of BPI. *Id.* Lea LLC appears to have been formed to develop the Lea Hill Condominium conversion project. CP 353-69. Cascade Bank financed the Project with

an \$18,000,000 loan and had a first-priority deed of trust. CP 353 at ¶ B. As a condition for the bank loan, Dewar put up an additional \$2,050,000. *Id.* at ¶¶ C-D; CP 72 at 20, ll. 1-18. This was accomplished via promissory note (“Note”) between Dewar, as “Lender,” and Lea LLC as “Borrower.” CP 353 at ¶¶ C-D; CP 371-73. Beddall personally guaranteed the Note. *See id.* The Note was secured by a second-position deed of trust and a collateral assignment of interest in the Lea Hill Property. *Id.*

The Lea Hill Condominium loan documents describe Dewar’s and Beddall’s relative responsibilities and interests in the Project. The Note was one component of the contract and loan documents between Dewar and Beddall for the Project. Those documents included: (a) the Note, CP 371-73; (b) a Credit Agreement, which further described the conditions of the loan Note, CP 353-69; (c) a Collateral Assignment of Membership Interest for Security, which assigned BPI’s interest in Lea LLC to Dewar as collateral for the Note, CP 350-51; and (d) an Account Management Agreement, which described BPI/Lea LLC’s role in managing the Project and Dewar’s role in providing financing and “accounting services” related to the Project, CP 345-48. These “Loan Documents” were executed in December 2006. *See id.* In the Credit Agreement, Note, and Collateral Assignment of Membership Interest, Dewar is described as the “Lender”

and Lea LLC is described as the “Borrower.” *See id.* Beddall is always referred to as the “guarantor.”<sup>1</sup> *See id.* Finally, pursuant to the Credit Agreement, Dewar is entitled to participate in the “net proceeds” of the Project. CP 359 at ¶ 4.2.

**2. The basis for the large tax refund was, supposedly, Beddall’s loss arising from guaranteeing the Note.**

As described above, on December 6, 2006 Lea LLC executed the Note to Dewar in the amount of \$2,050,000. CP 371-73. BPI was the sole owner of Lea LLC, and Beddall was the sole shareholder of BPI. CP 348; CP 351; CP 323; CP 468. For tax purposes, single-member LLCs are disregarded, and losses (and profits) flow through to the member/owner, in this case BPI. *See* Treas. Reg. § 301.7701-3(b)(1)(ii). For a shareholder of an S corporation to take a pass-through loss on his tax return, the shareholder must have funded that loss. *See* 26 U.S.C. § 1366(d). In short, an S corporation cannot fund its own losses, and its shareholder must make either a loan or a capital contribution to the S corporation to have any tax basis therein. *See id.*

With this in mind, Dewar hypothesized that the Note to Lea LLC, (which is owned by BPI), and personally guaranteed by Beddall, gave

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<sup>1</sup> Beddall may also be a “co-maker” of the Note, though the distinction is immaterial for purposes of this appeal.

Beddall tax basis in BPI for the amount owed on the Note. CP 30-31 at ¶¶ 8-9; CP 473. As Dewar and Dewar Meeks were Beddall's and BPI's accountant for several years, as well as providing "accounting services" relative to the Project, Dewar had a thorough understanding of Beddall's and BPI's financial picture and tax history. CP 30-31 at ¶¶ 8-9; CP 350-51. During his deposition, Dewar testified that in order for Beddall to receive a large refund, which Dewar estimated at more than \$1,000,000, Beddall needed to realize his losses in the 2009 taxable year. CP 33-34; 39-40. This is because, in 2009, the tax code allowed for a five year carry-back of losses realized in that year. *Id.* And here, Beddall had experienced great gains in the five years prior to 2009, so, if he could report great losses for 2009, those losses could be carried back to "wipe out" those previous gains, thus generating a tax refund for 2009. *See id.* Dewar testified that, prior to December 23, 2009, Beddall had no idea that he could stand to receive a large refund. *See id.*

**a. Beddall made no payments on the Note.**

Between December 2006 and December 2009 neither Beddall, BPI, nor Lea LLC made any payments on the Note. CP 480-84. According to Lea LLC's preliminary 2009 financial statements (which Dewar Meeks provided to Traner Smith, presumably under Dewar's supervision), Lea LLC owed Dewar \$6,975,922.09 and owed Beddall

\$44,000. CP 480. As of December 31, 2009, Lea LLC's 2009 preliminary financial statement specifically provides: "Note payable – DMD \$6,975,922.09." *Id.* Beddall's personal profit and loss statements (which Dewar Meeks provided to Traner Smith) do not indicate that Beddall owed any money on the Note, made any payments on any loan or the Note, or loaned BPI any money. CP 483-84. According to BPI's 2008 1120s, under "Loans from shareholders," no balance is shown, both at the beginning and end of the year. CP 489.

All of the tax, financial, and Loan Documents provide that Beddall made no payment on the Note, did not loan BPI any money, and made either negligible or no capital contributions to BPI. On around January 22, 2010 Smith recognized that the tax and financial records did not indicate that Beddall had tax basis in the Note. CP 30-31 at ¶¶ 8-9. Dewar informed Smith that, in substance, the parties always treated the Note as a loan by Dewar to Beddall. *Id.*; CP 473. Dewar believed that, if Beddall entered into a stipulated judgment for the amount of the Note, the debt could be converted from BPI's obligation to Beddall's personal obligation.

*Id.* In an email to Smith, Dewar set forth his position:

The recourse second mortgage debt of Lea passes through to Beddall Properties. By agreeing to a stipulated personal judgment as of 12/29/09 Brad converts the recourse debt to either a loan from a shareholder or capital contribution. Because Brad's guarantee has been called, the

corporate/LLC debts has been converted to Brad's personal debt. We do need to be careful with our documentation.

CP 473. Dewar apparently had conducted tax and/or legal research on the issue before providing this advice to Smith. *Id.* Dewar was himself a CPA for more than 20 years, and the accountant for the Project, so Traner Smith relied on Dewar's tax advice.<sup>2</sup> CP 31 at ¶ 9. To that end, Beddall's 1040 tax return, and 1045 application for refund, reflected a loss of approximately \$4.1 million to Beddall, (which was reported as either shareholder loan or capital contribution to BPI), that was carried back five years, wiping out Beddall's previous gains. *Id.*; CP 295-344. As a result, Traner Smith requested, and Beddall received a refund of approximately \$1.2 million. *Id.*

**3. In April 2010 Beddall entered into a stipulated judgment for the amount of the loan, but has never made any payments pursuant thereto.**

As part of the Agreement, Beddall agreed to enter into a stipulated judgment for the amount of the Note. The judgment, which was entered on April 22, 2010 provides:

Bradley E. Beddall stipulates to liability as guarantor of the loan by Douglas M. Dewar to Lea, LLC, a Washington limited liability Company ("LEA"), pursuant to that certain

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<sup>2</sup> Pursuant to 26 U.S.C. § 6694(a), Treas. Reg. § 1.6694-1, and Treas. Reg. § 1.6694-2, Traner Smith is permitted to rely on the advice, and/or tax information of third parties and other tax return preparers. In this case, it is undisputed that Traner Smith reasonably relied on the advice and direction of Dewar in preparing Beddall's return and request for refund.

Promissory Note dated December 6, 2006 in the original principal amount of \$2,050,000 (the "Note"), which Note is in Default. This is not a judgment on the Note and does not satisfy the primary obligations of LEA as to payment or performance under the Note.

Douglas M. Dewar shall have a judgment against Brad Beddall in the principal amount of \$3,975,922.09 together with accrued interest at eighteen percent (18%) from January 1, 2010 through the date of the judgment, March 8, 2010 in the amount of \$133,193.39, for a total judgment in the amount of \$4,109,115.48.<sup>3</sup> This judgment shall bear interest at the rate of 18% per annum until paid in full. Judgment Creditor shall be entitled to collect all accrued interest charges, reasonable attorneys' fees and costs incurred in enforcing this judgment.

CP 502-08. Beddall and Lea LLC agreed to remain jointly and severally liable to Dewar on the Note, though the judgment indicates that Dewar will first look to Lea LLC for payment. *Id.* Additionally, pursuant to the Agreement, Dewar agreed that he would not pursue Beddall for his guaranty. CP 286-87 at ¶ 10. In any event, there is no dispute that Beddall did not, and has never, made any payment on the Note or pursuant to the stipulated judgment. *See generally*, CP 281-93; CP 293-344; CP 480-84; CP 502-08.

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<sup>3</sup> The \$4.1 million loss associated with the Note is the exact amount of the stipulated judgment. According to Lea LLC's financial statements, and the amortization schedules for the Note, by the end of 2009 the Note was worth approximately \$6.9 million. CP 373. However, for the purposes of the parties' settlement, some of this amount was either forgiven or negotiated down. CP 284-85 at ¶ 7.7.

#### IV. SUMMARY OF THE ARGUMENT

Federal law preempts the trial court's finding of duty in this case. Beddall's change of address, and his receipt of the refund money is "tax return information" that Traner Smith could not disclose to anyone, including Dewar, without violating federal law.

Even if federal law did not preempt Traner Smith's duty to Dewar in this case, Dewar failed to present sufficient evidence or argument supporting a finding of duty under *Trask v. Butler*. Most importantly, because Dewar presented no proof of Traner Smith's or Beddall's **intent** to directly benefit Dewar by their engagement, as a matter of law, Traner Smith owed no duty under *Trask*.

Dewar's negligent misrepresentation claim should fail because Traner Smith owed him no duty. However, and in any event, Dewar failed to present clear, cogent and convincing evidence of Traner Smith's alleged negligent misrepresentation by silence that could justify the trial court's order. Dewar does not dispute that, as a CPA, his reliance on Traner Smith to disclose the confidential tax information of Beddall, was neither reasonable nor justified. Moreover, a jury may determine that, whether or not Traner Smith could have disclosed Beddall's tax information to Dewar, Beddall was the proximate cause of Dewar's alleged damages for taking the money to Thailand; or that Dewar was the proximate cause of

his own damages for providing bad tax advice and for drafting an Agreement that gave him no protection from Beddall's bad acts. And under *Tegman*, Traner Smith is not liable for the intentional acts of Beddall.

There is no dispute that the tax information and advice Dewar provided to Traner Smith for the preparation of Beddall's return and request for refund was incorrect. It did not support the ultimate conclusion that Beddall had sufficient tax basis in the instruments relied upon to generate the refund. Thus, Dewar's alleged damages are illusory because Beddall was never entitled to a tax refund.

Finally, Dewar has never presented any evidence of any **intent by Traner Smith or Beddall** to create a third-party beneficiary contract for Dewar. At best, Dewar was an incidental, rather than direct beneficiary of the Traner Smith/Beddall engagement, which is insufficient to support a third-party beneficiary claim. The trial court erred in failing to grant Traner Smith's motion to dismiss the third-party beneficiary claim.

## V. ARGUMENT

### A. **This court reviews the trial court's summary judgment orders de novo.**

This court reviews summary judgment orders on a de novo basis, engaging in the same analysis as the trial court. *Cummins v. Lewis County*, 156 Wn.2d 844, 852, 133 P.3d 458 (2006). On a motion for

summary judgment, the court does not try the issues of fact; the court determines only whether or not factual issues are present which should be tried. *Graves v. P.J. Taggares Co.*, 94 Wn.2d 298, 616 P.2d 1223 (1980). Where the existence of duty “depends on proof of facts that are disputed” then summary judgment is inappropriate. *Hymas v. UAP Distribution, Inc.*, 167 Wn. App. 136, 150, 272 P.3d 889 (2012) (citing *Afoa v. Port of Seattle*, 160 Wn. App. 234, 238, 247 P.3d 482 (2011))

**B. Federal law preempts the trial court’s holding that Traner Smith owed Dewar any duty.**

Federal law preempts state statutory or common law by “(1) **express preemption**, where congress explicitly defines the extent to which its enactments preempt laws; (2) **field preemption**, where local law regulates conduct in an area the federal government intended to exclusively occupy; and (3) **conflict preemption**, where it is impossible to comply with both local and federal law.” *City of Seattle v. Burlington Northern R. Co.*, 145 Wn.2d 661, 667, 41 P.3d 1169 (2002) (citing *S. Pac. Transp. Co. v. Pub. Util. Comm’n*, 9 F.3d 807, 810 (9th Cir. 1993)) (emphasis added); *Pioneer First Fed. Sav. & Loan Ass’n v. Pioneer Nat. Bank*, 98 Wn.2d 853, 856-57, 659 P.2d 481 (1983) (federal law will preempt state statutory or common law).

In granting Dewar’s motion for partial summary judgment

establishing duty as a matter of law, the trial court relied on the analysis set forth in *Trask v. Butler* and held (1) that Traner Smith owed a duty to Dewar to disclose that Beddall had changed the address on the return, and (2) that Beddall had the refund money. CP 215-18, 766-78. However, a CPA's duty to keep "tax return information" confidential is defined and governed by federal law. 26 U.S.C. §§ 6713, 7216; Treas. Reg. § 301.7216-1; 31 C.F.R. §§ 10.50-51; CP 39-43.<sup>4</sup> And in this case, had Traner Smith disclosed this information to Dewar or Hatch, as the trial court's order would require, it would have been in violation of federal law. *Id.* Thus the trial court's order establishing Traner Smith's duty to disclose tax information is preempted by the doctrine of "conflict preemption."

**1. The trial court's order requires disclosure "tax return information" in violation of federal law.**

Federal law defines "tax return information" very broadly to include: "information furnished or received to [the tax return preparer] for, or in connection with, the preparation of any such return," 26 U.S.C. §§ 6713(a), 7216(a); "information received by the tax return preparer from the IRS in connection with the processing of such return," Treas. Reg. § 301.7216-1(b)(3); and "any information, including but not limited to, a

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<sup>4</sup> Washington law also regulates a CPA's duty of confidentiality and in substance mirrors the federal prohibition against disclosure. WAC 4-30-048; WAC 4-30-050(3).

taxpayer's name, address, or identifying number, which is furnished in any form or manner for, or in connection with, the preparation of a tax return of the taxpayer." Treas. Reg. § 301.7216-1(b)(3)(i); *see also* CP 39-43. According to the American Institute of CPAs (AICPA), which sets industry-practice standards for CPAs, confidential information includes "information obtained from the client that is not available to the public." AICPA Ethical Rule 92.05; CP 43 at ¶ 10, ¶ 5.

Therefore, there is no dispute that the change of address on the return, and Beddall's receipt of the refund money, (and his direction to Traner Smith to have the funds delivered to Ron Rubin), is "tax return information" as defined under federal statute. As a "tax return preparer,"<sup>5</sup> Traner Smith was bound by federal law to keep Beddall's "tax return information" confidential, and Traner Smith could not disclose Beddall's tax return information to any third-party absent Beddall's consent, or pursuant to some statutorily enumerated exception. 26 U.S.C. §§ 6713, 7216; Treas. Reg. §§ 301.7216-1(a), 301.7216-3(a), 301.7216-2; 31 C.F.R. §§ 10.50, 10.51. 26 U.S.C. § 6713 and 26 U.S.C. § 7216 impose civil and criminal penalties on a tax return preparer, such as Traner Smith, for disclosing tax "return information." 31 C.F.R. §§ 10.50 and 10.51 allow

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<sup>5</sup> There is no dispute that Traner Smith is a "tax return preparer." *See* Treas. Reg. § 7701(a)(36); Treas. Reg. § 301.7216-1(b)(2).

for the suspension or censure of a CPA who discloses confidential tax return information. Therefore, Traner Smith could not disclose Beddall's tax return information to Dewar, Hatch, or anyone else absent consent from Beddall, or some other exception set forth in 26 U.S.C. § 7216(b).

**2. The doctrine of “conflict preemption” preempts the trial court’s order.**

“The doctrine of preemption has its roots in the constitutional maxim that the laws of the United States are the supreme law of the land.” *Pioneer First Fed. Sav.*, 98 Wn.2d at 856 (citing U.S. Const. art. 6, cl. 2). Where state law “require[s] a private party to violate federal law,” the state law is preempted, and is “without effect.” *Mutual Pharmaceutical Co., Inc. v. Bartlett*, 133 S. Ct. 2466, 2473, 186 L. Ed. 2d 607, 81 USLW 4538 (2013) (quoting *Maryland v. Louisiana*, 451 U.S. 725, 746, 101 S. Ct. 2114, 68 L. Ed. 2d 576 (1981)). “Under conflict preemption, Congress’s intent to preempt state law is implied to the extent that federal law actually conflicts with any state law.” *Hillsborough County v. Automated Med. Labs., Inc.*, 471 U.S. 707, 713, 105 S.Ct. 2371, 85 L.Ed.2d 714 (1985). Federal law will preempt state statutory or common law where “[t]he ... conflict [between the two acts] is so ‘direct and positive’ that the two acts cannot ‘be reconciled or consistently stand together’ ... and the reviewing court can therefore infer a congressional

purpose to preempt state law.” *Pioneer First Fed. Sav.*, 98 Wn.2d at 857 (quoting *State v. Williams*, 94 Wn.2d 531, 538, 617 P.2d 1012 (1980)).

In this case, Traner Smith could not comply with the federal prohibition against disclosure of tax return information, and still disclose Beddall’s change of address or the disposition of the refund money to Dewar, as the trial court’s order would require. The trial court’s reliance on *Trask v. Butler* to establish Traner Smith’s duty to disclose to Dewar forces Traner Smith to violate federal law in order to comply with state common law. Therefore, the court’s ruling is “without effect.” *Mutual Pharmaceutical*, 133 S. Ct. at 2473.

The trial court’s order establishing duty as a matter of law and negligent misrepresentation was error, and these issues should be remanded for further proceedings. Alternatively, to the extent this court determines that federal law preempts Dewar’s claim that Traner Smith owed him a duty of care to disclose Beddall’s tax information, Dewar’s negligence claims should be dismissed in their entirety as a matter of law. RAP 12.2 grants this court discretion to “take any action as the merits of the case and interests of justice may require.” Further proceedings related to the negligence claims would be futile, and a waste of judicial resources where Traner Smith owes Dewar no duty of care.

**C. The trial court improperly applied *Trask v. Butler* to establish a CPA's duty of care to third parties.**

As described above, federal law precluded Traner Smith from disclosing Beddall's tax return information to Dewar. However, and in any event, at summary judgment Dewar failed to present any authority or evidence for the application of the *Trask* multi-factor test to CPAs and Traner Smith. *See* CP 766-78; CP 238-43.

In *Trask*, the Washington Supreme Court reviewed and clarified earlier cases that addressed non-client claims for legal malpractice against attorneys. The Court undertook to clarify *Bohn v. Cody*, 119 Wn.2d 357, 363-67, 832 P.2d 71 (1992). The Court considered two principal approaches adopted by leading jurisdictions across the country. The Court first addressed the "multi-factor balancing test" adopted by the California appellate courts in *Goldberg v. Frye*, 217 Cal. App.3d 1258, 266 Cal. Rptr. 483 (1990). The Court also considered the "third party beneficiary test" adopted by the Illinois Supreme Court in *Pelham v. Griesheimer*, 92 Ill.2d 13, 440 NE.2d 96 (1982). The *Trask* Court adopted what it viewed as the best elements from each of these tests in establishing controlling law in Washington. To show that an attorney owes a duty to a non-client, Washington courts will look at the following elements:

1. The extent to which the transaction was intended to benefit the plaintiff;

2. The foreseeability of harm to the plaintiff;
3. The degree of certainty that the plaintiff suffered injury;
4. The closeness of the connection between the defendant's conduct and the injury;
5. The policy of preventing future harm; and
6. The extent to which the profession would be unduly burdened by finding of liability.

Thus, under the modified multi-factor balancing test, the threshold question is whether the plaintiff is an intended beneficiary of the transaction to which the advice pertained. While the answer to the threshold question does not totally resolve the issue, no further inquiry need be made unless such an intent exists.

*Trask*, 123 Wn.2d at 842-43.

Dewar cannot get past the threshold inquiry. In *Trask*, the relevant transaction was the relationship between the attorney and the personal representative of the estate. *Id.* at 845. Here, the transaction at issue is Traner Smith's engagement with Beddall, and its preparation of Beddall's 2009 tax return. There is no evidence that Traner Smith intended to benefit Dewar with this transaction. Indeed, at summary judgment, Dewar conceded that whether *Trask* applied to CPAs was a matter of first impression. CP 771.

1. **There was no evidence that Dewar was the intended beneficiary of the Traner Smith-Beddall engagements to prepare tax returns.**

Dewar presented no evidence that Traner Smith or Beddall

**intended** to benefit Dewar with the engagements. CP 238-43; CP 766-78 CP 1060-66. To show a legal duty under *Trask*, Dewar must present evidence that the two parties (Beddall and Traner Smith) intended the third-party (Dewar) to be the primary beneficiary of the transaction (*i.e.* the engagement). *Trask*, 123 Wn.2d at 842-43. Without such proof, there is no duty. *Id.* Dewar offered no proof of Traner Smith's or Beddall's **intent**. CP 238-43; CP 766-78 CP 1060-66. On the other hand, by his engagement with Traner Smith, Beddall stood to gain a tax refund and release of liability from Dewar. CP 283 at ¶ 4. Any argument that Beddall was not the primary beneficiary of his engagement with Traner Smith defies logic, and lacked any supporting proof on summary judgment.

Rather than present proof of Traner Smith's or Beddall's intent, on summary judgment Dewar offered only the terms of the Agreement, Traner Smith's knowledge of those terms, and the inappropriate declaration of his expert John Clees as evidence that Traner Smith undertook some duty. CP 238-43; CP 766-78 CP 1060-66; *see Tortes v. King County*, 119 Wn. App. 1, 13-14, 84 P.3d 252 (2003) (experts may not offer opinion on ultimate legal issue in negligence action). Any reliance by the trial court on Mr. Clees's opinions or the terms of the Agreement to impose a duty on Traner Smith was in error, unsupported by

the evidence, and a misapplication of the *Trask* factors. The Agreement's terms cannot be imposed against Traner Smith. *See Gall v. McDonald*, 84 Wn. App. 194, 201-02, 926 P.2d 934 (1996); *State v. Antoine*, 82 Wn.2d 440, 444-45, 511 P.2d 1351 (1973) (overruled on other grounds). Dewar did not dispute this, or present argument to the contrary. CP 238-43.

**2. The evidence does not support a finding of foreseeability.**

Under *Trask*, a duty may arise where (a) the transaction was intended to benefit the plaintiff, and (b) the harm to the plaintiff was foreseeable. *Trask*, 123 Wn.2d at 842-43. Therefore, this foreseeable harm must be the harm that the plaintiff may suffer through negligent performance of the transaction entered into for his benefit. It cannot, however, refer to harm arising from the non-performance of another transaction to which the defendant was never a party. *See id.* Here, Dewar never alleged that Traner Smith failed to perform under its engagement with Beddall. CP 238-43; CP 766-78. Even if he had, he would have no standing to enforce its terms: he was not a party to it, and there is no proof of any intent by Traner Smith or Beddall that Dewar benefit from it. Nor is there any proof that any failure by Traner Smith to perform its obligations under the Beddall engagements could foreseeably cause damage to Dewar.

**3. Traner Smith did not cause harm to Dewar.**

There are clear fact disputes whether Traner Smith caused any damage to Dewar. Dewar's burdens to prove proximate cause and damage under *Trask v. Butler* and to prove his negligent-misrepresentation claim rely on the same evidence and argument. Detailed discussion of Dewar's claims of proximate cause and damages are set forth at § V. D and E., *infra*.

**4. The trial court's order encourages a policy of divided loyalties and overburdens the profession.**

"The policy considerations against finding a duty to a nonclient are the strongest where doing so would detract from the attorney's ethical obligations to the client." *Trask*, 123 Wn.2d at 844. "This occurs where a duty to a nonclient creates a risk of divided loyalties because of a conflicting interest or of a breach of confidence." *Id.* The trial court's order creates duties from a CPA to third parties, while subordinating the duties a CPA owes to its client. The order also forces CPAs to violate federal law by disclosing confidential tax information absent consent from the client, or evidence supporting an enumerated exception. 26 U.S.C. §§ 6713, 7216; Treas. Reg. §§ 301.7216-1(a), 301.7216-3(a), 301.7216-2; 31 C.F.R. §§ 10.50, 10.51; AICPA Ethical Rule 301, 54 and 92.05; *see also* WAC 4-25-640 (4).

Finally, the Agreement between Dewar and Beddall was a device

of Dewar's own making. By the terms of the Agreement, Dewar's ability to receive the tax refund always depended on Beddall's willingness to perform as he had agreed to under the Agreement. CP 283 at ¶ 4. By granting Dewar's motion, the trial court effectively excused Dewar's failure to protect his own rights and shifted Dewar's burden to live with the consequences of the deal that he cast, in the form that he devised, to Traner Smith. The trial court's order promotes, on the one hand, a policy under which a CPA must have divided loyalties between clients and non-clients, and on the other hand, a policy where sophisticated developers can shift their risk and losses onto third parties without any consideration.

The evidence did not support any legal duty under *Trask v. Butler*. This court should reverse the trial court's order establishing duty and negligent misrepresentation and either dismiss Dewar's negligence-based claims in their entirety or remand for further proceedings.

**D. Dewar failed to present clear, cogent and convincing evidence to prove negligent misrepresentation.**

The elements of negligent misrepresentation claims are: (1) supplying false information; (2) which the defendant knew or should have known would guide the plaintiff in the transaction; (3) the defendant was negligent in obtaining or communicating the false information; (4) the plaintiff relied on the false information the defendant supplied; (5) the

plaintiff's justifiably relied on the false information; and (6) the false information proximately caused the plaintiff's damages. *Lawyers Title Ins. Corp. v. Baik*, 147 Wn.2d 536, 545, 55 P.3d 619 (2002); *ESCA Corp. v. KPMG Peat Marwick*, 135 Wn.2d 820, 826, 959 P.2d 651 (1998). Each element of a negligent misrepresentation claim must be proven by clear, cogent, and convincing evidence. *Havens v. C & D Plastics, Inc.*, 124 Wn.2d 158, 179, 876 P.2d 435 (1994).

Here there was no proof, let alone clear, cogent, and convincing evidence, of negligent misrepresentation. See CP 238-43; CP 766-78 CP 1060-66. Dewar alleges that Traner Smith committed misrepresentation by "silence," CP 775-78, but failed to establish that Traner Smith had any duty to disclose. A party may base a claim for misrepresentation on silence, but **only** where there is a duty by the defendant to disclose, and any reliance on said silence is reasonable and justified. *Consulting Overseas Management, Ltd. v. Shtikel*, 105 Wn. App. 80, 89, 18 P.3d 1144 (2001); *Lawyers Title Ins. Corp.*, 147 Wn.2d at 545; *ESCA Corp.*, 135 Wn.2d at 827-28; *Havens*, 124 Wn.2d at 181.

As described above, federal law preempts any duty of care by Traner Smith to Dewar. Even if federal law did not prohibit Traner Smith's disclosure of Beddall's tax information to Dewar, there is no evidence to support a finding that Dewar's reliance on Traner Smith's

“silence” was either justified or reasonable. *Lawyers Title Ins. Corp.*, 147 Wn.2d at 545; *ESCA Corp.*, 135 Wn.2d at 827-28; *Havens*, 124 Wn.2d at 181. Dewar does not dispute that, as a CPA, he knew, or should have known, that Traner Smith could not disclose Beddall’s confidential tax information to anyone absent consent. CP 238-43; CP 766-78 CP 1060-66. As a CPA, Dewar had no reasonable expectation that Traner Smith could or would disclose anything to him. *See* CP 38-47. Moreover, Dewar could have requested at any time that Hatch, either directly or through his own counsel, check on the status of the refund. *See* CP 291-93. If Dewar truly believed that the Form 2848 and/or Special Power of Attorney served any purpose, he did not require anything from Traner Smith. There is no evidence that Dewar made any effort to determine the status of the refund on his own, despite opportunity to do so. And now, Dewar would have this court hold that his reliance on Traner Smith, a non-party to the Agreement, to fulfill Beddall’s contractual obligations was justified. There is no support for this position, and this court should reject it.

Finally, as discussed in greater detail below, there are fact disputes (1) whether Dewar suffered any damages and (2) whether Traner Smith’s alleged silence was the proximate cause of Dewar’s alleged damages. In granting Dewar’s motion establishing negligent misrepresentation, the trial

court disregarded federal law and Dewar's obligation to present clear, cogent, and convincing evidence, and ostensibly tried issues of fact regarding duty, causation, and damages. Therefore, this court should reverse the trial court's order establishing negligent misrepresentation as a matter of law, and either remanded for further proceedings or dismiss Dewar's claim.

**E. This court should reverse the trial court's erroneous order establishing proximate cause and damages.**

In granting Dewar's Motion for Partial Summary Judgment – Damages Sum Certain Arising From Defendants' Negligent Misrepresentation, the trial court ignored clear federal and state law on the issues of confidentiality, the illegitimacy of the tax refund and Dewar's right to receive it. In so doing, the court inappropriately determined genuine issues of material fact on the issues of causation and damages that should have precluded summary judgment.

**1. Fact disputes preclude summary judgment on the issue of proximate cause.**

Proximate cause may be determined as a matter of law only when reasonable minds could reach but one conclusion. *Versuslaw, Inc. v. Stoel Rives, LLP*, 127 Wn. App. 309, 328, 111 P.3d 866 (2005) (citing *Kim v. Budget Rent A Car Systems, Inc.*, 143 Wn.2d 190, 203-04, 15 P.3d 1283 (2001)).

**a. A jury must determine the cause in fact of Dewar's alleged damages.**

A defendant's actions are the cause in fact of a plaintiff's injuries where, but for the defendant's actions, the plaintiff's injuries would not have occurred. *See Schooly v. Pinch's Deli Market, Inc.*, 134 Wn.2d 468, 477-78, 951 P.2d 749 (1998). But for the fact that Beddall diverted the refund money, and took the refund money to Thailand, Dewar would not have suffered any of his alleged damages. *See* CP 522. The trial court's order ignores Beddall's role in breaching his Agreement with Dewar and taking the money to Thailand. *See* CP 15-18. A jury may very easily find that Beddall was the sole cause of Dewar's alleged damages. Similarly, in light of Dewar's role in drafting the Agreement and generating the refund, a jury may find that Dewar is at fault for his own damages, if any.

Even if Traner Smith had informed Dewar or Hatch about the address change or that Beddall had the refund, Dewar produced no proof that it would have made any difference. CP 238-43; CP 766-78 CP 1060-66. The Power of Attorney Form 2848 did not give Hatch the right to receive the tax refunds or absolve Beddall of any of his rights as to the refund. CP 291-93; *see also* 26 U.S.C. § 6695(f); and 31 C.F.R. § 10.31. Beddall did not need Traner Smith, or anyone else, to change the address on the return or receive the refund money. *Id.* The trial court's order

precludes a jury from finding whether Traner Smith's failure to inform or Beddall's actions was a cause in fact of Dewar's alleged harm.

**b. There is no proof to support legal causation.**

Legal cause "involves the question of whether liability should attach as a matter of law, even if the proof establishes cause in fact." *Versuslaw*, 127 Wn. App. at 328 (citing *Seattle v. Blume*, 134 Wn.2d 243, 251, 947 P.2d 223 (1997)). Even if federal law did not prevent Traner Smith from informing Dewar and/or Hatch about the address change or that Beddall had the refund money, it was ultimately Beddall's responsibility to provide the money to Dewar. CP 283. The undisputed evidence demonstrates that Traner Smith was not party to the Agreement, was not involved in any negotiations either before or after the Agreement was entered into, and had no idea that Beddall would not give the money to Dewar. *Id.*; CP 76 at 36, ll. 16-17; CP 28 at ¶ 2; CP 29-30 at ¶ 5; CP 33-34 at ¶ 15; CP 35-36 at ¶ 20. Therefore, the trial court's determination of legal causation was error.

Moreover, whether Traner Smith was the "legal cause" of Dewar's alleged damages depends upon the existence of certain disputed facts. Such as: Traner Smith's and Beddall's intent to benefit Dewar; whether, in this case, there was evidence of an exception to the federal prohibition

against disclosure of confidential tax information to third parties that would allow Traner Smith to disclose Beddalls' tax information to Dewar; and whether Dewar's harm was foreseeable. Therefore, the trial court's order was reversible error because a jury may very well find that Beddall was the legal cause of Dewar's alleged damages, despite Traner Smith's alleged wrongdoing. *See Hymas*, 167 Wn. App. at 150 (where the existence of a legal duty depends on disputed facts, summary judgment is inappropriate).

**2. The *Tegman* rule precludes a finding that Dewar's damages are a "sum certain" as a result of Traner Smith's alleged negligence.**

A jury must determine proximate cause, and segregate those damages caused by the intentional acts of Beddall, from those caused by the allegedly negligent acts of Traner Smith. *See Tegman v. Acc. & Med. Investigations Inc.*, 140 Wn.2d 102, 75 P.3d 497 (2003). Here, it appears that Beddall's intentional acts, and Traner Smith's alleged negligence, resulted in an indivisible injury to Dewar. Dewar does not dispute that Beddall changed the address on the return, and took the refund check to Thailand. *See* CP 238-43; CP 766-78 CP 1060-66. Damages arising from these intentional acts must be segregated from damages, if any, arising from Traner Smith's alleged negligence. *Tegman*, 140 Wn.2d at 115; *Rollins v. King County Metro*, 148 Wn. App. 370, 199 P.3d 499 (2009);

*Doe v. Corp. of President of Church of Jesus Christ of Latter-Day Saints*, 141 Wn. App. 407, 439-40, 167 P.3d 1193 (2007).

Dewar is responsible for proving those damages Traner Smith's negligent acts supposedly caused, and the trial court improperly decided issues of fact as to whether Beddall's intentional acts were the sole proximate cause of Dewar's alleged damages. *Id.* Traner Smith is not jointly and severally liable for the harm caused by Beddall's intentional acts. *Id.* And Traner Smith does not bear the burden of proving segregation. *Id.*

As a result, the trial court erred in granting Dewar's motion for summary judgment because Dewar's alleged damages are necessarily uncertain because a jury must determine and segregate between damages caused by Beddall from those allegedly caused by Traner Smith. *See Tegman*, 140 Wn.2d at 115.

**3. Dewar has no damages, because Beddall was never entitled to a refund.**

**a. No taxable event occurred in 2009.**

Generally, losses are deductible only in the year they are realized or sustained. 26 U.S.C. § 165; CP 30 at ¶ 7. Here, the Lea Hill Property deed was not transferred from Beddall to Dewar until March 2010, when it was both executed and delivered. CP 70-79 at 44-66; CP 426-29. The stipulated judgment was not entered until April 2010. CP 502-07.

Beddall and Dewar did not agree to material terms of the Agreement until well into 2010, including specifically that the amount of the refund would be at least \$1 million. CP 78-79 at 44-46; CP 375-96; CP 398-424. An “agreement to agree” is insufficient to establish a valid contract in 2009. *Keystone Land & Dev. Co. v. Xerox Corp.*, 152 Wn.2d 171, 175-76, 94 P.3d 945 (2004). Thus, if the loss in this case were allowed it would have occurred in 2010, not 2009. This is significant because in 2010 the carry-back rules changed from five years to three years. CP 76 at 34-35; 39-40; CP 30-31 at ¶ 8. So, if the loss occurred in 2010, the potential refund would be worth much less, if anything. *Id.*

No proof exists to show that Beddall was ever entitled to the refund related to any loss in 2009. As a result, Dewar could have suffered no damage as to a refund that never existed. In fact, Dewar has never disputed that the refund was illegitimate. *See* CP 238-43; CP 766-78 CP 1060-66. The trial court’s order establishing Dewar’s alleged damages, and Traner Smith’s responsibility for them, was error and should be reversed, and the issues of proximate cause and damages should be remanded for further proceedings.

**b. Beddall’s guarantee of the Note, or S corporation (BPI) debt, does not give Beddall tax basis for a deductible loss.**

Recall that Lea LLC executed the Note to Dewar in the amount of

\$2,050,000 on December 6, 2006. CP 71-73. BPI was the sole owner of Lea LLC, and Beddall was the sole shareholder of BPI. *Id.*, CP 323, 348, 351, 468. For tax purposes, single-member LLCs are disregarded, and losses (and profits) flow through to the member/owner, in this case BPI. Treas. Reg. § 301.7701-3(b)(1)(ii).

For a shareholder of an S corporation to take a pass-through loss on his tax return, he must have basis in the S corporation, and the shareholder must have funded the loss. 26 U.S.C. 1366(d); *Salem v. C.I.R.*, T.C. Memo. 1998-63, at \*5, 75 T.C.M. (CCH) 1798 (1998); *Harris v. United States*, 902 F.2d 439, 443 (5th Cir. 1990); *Estate of Leavitt v. Commissioner*, 875 F.2d 420, 422-23 (4th Cir. 1989), (affirming 90 T.C. 206, at 216). Shareholders in S corporations may deduct losses of the S corporation only to the extent of their basis in the S corporation. *See* 26 U.S.C. § 1366. A shareholder guarantee does not provide basis. *Id.*; *Lawrence Uri, Jr. v. Commissioner*, 949 F.2d 371, 373-74 (10th Cir. 1991); *Harris*, 902 F.2d at 442-43; *Brown v. Commissioner*, 706 F.2d 755, 754 (6th Cir. 1983); *Estate of Leavitt*, 875 F.2d at 422-23. 26 U.S.C. § 1366(d)(1) specifically provides:

The aggregate amount of losses and deductions taken into account by a shareholder under subsection (a) for any taxable year shall not exceed the sum of (A) the adjusted basis of the shareholder's stock in the S corporation ... and (B) the shareholder's adjusted basis of any indebtedness of

the S corporation to the shareholder.

The law is clear that “[g]enerally, in order to qualify as “indebtedness” under section 1366(d), the indebtedness of the S corporation to the shareholder must have arisen as a result of an actual economic outlay by the shareholder.” *Salem, T.C. Memo.* 1998-63, at \*5 (citing *Harris*, 902 F.2d at 443). Indeed, “no form of indirect borrowing, be it guaranty, surety, accommodation, or otherwise, gives rise to indebtedness from an S corporation to the shareholders unless and until the shareholders pay part or all of the indebtedness.” *Id.* (citing *Estate of Leavitt*, 875 F.2d at 423 (quoting *Raynor v. Commissioner*, 50 T.C. 762, 770-71 (1968))). Thus, if a shareholder is “called” on a co-made or guaranteed note, the corporation may become indebted to the shareholder, thereby creating a taxable loss to the shareholder. *See In re Estate of Bean v. C.I.R.*, 268 F.3d 553, 559 (8th Cir. 2001). However, a shareholder is only “called” on an S corporation debt to the extent the shareholder makes actual payment, or makes some “economic outlay.” *Id.*; *Salem, T.C. Memo.* 1998-63, at \*5; *Leavitt*, at 875 F.2d at 422; *Harris*, 902 F.2d at 443. A mere guarantee or promise to pay is insufficient to create basis, there must be actual payment or economic outlay. *See id.*; *Brown*, 706 F.2d at 756; *Goatcher v. U.S.*, 944 F.2d 747, 751-52 (10th Cir. 1991).

Beddall was either a co-maker of the Note, or he guaranteed the S

corporation debt. *See* CP 345-73. However, a shareholder's basis is equal only to either his stock in the S corporation and/or loans he makes to the corporation. 26 U.S.C. 1366(d); *In re Estate of Bean*, 268 F.3d at 558-59; *Brown*, 706 F.2d at 756 (6th Cir. 1983); *Goatcher v. U.S.*, 944 F.2d 747, 751-52 (10th Cir. 1991); *Harris*, 902 F.2d at 443. Merely guaranteeing a debt (or signing as a co-maker on a note) is insufficient to constitute stock in the S corporation or a loan to the S corporation. *Id.*; *Salem, T.C. Memo.* 1998-63 at \*5; *Estate of Leavitt*, at 875 F.2d at 422.

Here, the entry of the stipulated judgment against Beddall does not create basis, because Beddall never actually made any payments under the note or judgment. *See Bergman v. U.S.*, 174 F.3d 928, 932-33 (8th Cir. 1999) (citing *Putnam v. Commissioner*, 352 U.S. 82, 85, 77 S. Ct. 175, 1 L.Ed.2d 144 (1956)); *Reser v. Commissioner*, 112 F.3d 1258, 1264 (5th Cir.1997). The judgment specifically states that Dewar will look first to Lea LLC, not Beddall, to repay the debt. CP 502-07. It is undisputed that Beddall has not made any actual payment on the Note that would give rise to basis in BPI and therefore could not deduct the loss associated or arising from the Note. *Id.*; CP 480-84.

**c. Dewar and Beddall are bound to the agreements they made.**

There can be no argument that "in substance" Dewar and Beddall

treated the guaranteed Note like anything other than a guarantee. Because Dewar and Beddall drafted all of the documents which formed the basis for the tax loss, they will be held to the form of the transactions that they themselves cast. *See Estate of Leavitt, supra* at 423; *Don E. Williams Co. v. Commissioner*, 429 U.S. 569, 579-80, 97 S. Ct. 850, 51 L.Ed.2d 48 (1977); *Gray v. Commissioner*, 561 F.2d 753, 761 (9th Cir. 1977). In other words, the documents will be construed against the drafters, Dewar and Beddall. Thus, there can be no argument that Beddall, who is identified as a guarantor in virtually every document related to the disputed transaction, was in substance treated differently. This is particularly true where, in substance, Beddall appears to have been treated exactly like a guarantor. *See id.*; *Rite Aid Corp. v. U.S.*, 255 F.3d 1357, 1360 (Fed. Cir. 2001).

Because Beddall made no loans to BPI, did not contribute capital to BPI, made no payment on the Note, and otherwise spent nothing with respect to the Note or BPI's debt, he had no increased basis in BPI and cannot deduct the value of the Note as a pass-through loss from the S corporation. Beddall was never entitled to receive a refund related to the Note. Dewar therefore is not entitled to recover from Traner Smith the amount of a refund that never existed. As discussed in greater detail below, the fact that the IRS paid it is immaterial. At minimum, a jury

must determine whether Dewar is entitled to any damages, and whether his own fault in devising the ill fated plan precludes his recovery.

**d. Beddall was not “at risk” pursuant to 26 U.S.C. § 465 and so had no increased basis in BPI.**

The Loan Documents between Dewar and Beddall and the Beddall and BPI financials do not suggest that Beddall was “at risk” when he guaranteed the Note, so he cannot rely on the loss related to the Note for the purposes of a tax refund. *See* CP 345-73.

To deduct losses, a shareholder not only must have basis but also must be “at risk.” 26 U.S.C. § 465. A shareholder of an S corporation will not be considered to have any funds “at risk” to the extent he borrows from a lender with interest in the profits of the venture for which the funds were borrowed. *Id.* In general, pursuant to 26 U.S.C. § 465 a taxpayer is treated as being “at risk” for the amounts borrowed with respect to a business if “he is personally liable for the repayment of such amounts” or if he has pledged property as security for the borrowed amount. 26 U.S.C. § 465(b)(2). However, “borrowed amounts, even if recourse, are not considered at risk with respect to an activity if the lender has an interest in the activity other than as a creditor.” *Waddell v. Commissioner*, 86 TC 848, 914-15 (U.S. Tax Ct. 1986) (lender who has 50% interest in profits is treated as having an interest in the activity other than as a creditor).

Lenders are treated as having interest other than as creditors if they have interest in the “net profits of the activity,” Treas. Reg. § 1.465-8(b)(1), even if the lender has no incidents of ownership. Treas. Reg. § 1.465-8(b)(3).

In this case, the Note ultimately served as the basis for the tax loss related to the Project. CP 353 at ¶ C-D; CP 473. The Note was made in furtherance of the Project and was incorporated into the parties’ Credit Agreement related to the Project. *Id.* The Credit Agreement describes that Dewar is to receive 50% of the profits from the project. CP 359 at ¶ 4.2. The money “borrowed” by Beddall, *i.e.* the Note, is not considered “at risk” under 26 U.S.C. § 465, because he borrowed from a lender with interest in the profits of the activity for which the money was borrowed. Therefore, Beddall could not deduct the loss allegedly arising from the Note. *See* 26 U.S.C. § 465(b); Treas. Reg. § 1.465-8(b)(1); *Waddell*, 86 TC, at 914-15. Because Beddall could not deduct that loss, he was never entitled to any resulting tax refund. Dewar cannot now look to Traner Smith to compensate him for a refund that did not exist, and to which he was not entitled. The trial court’s order setting Dewar’s damages should be reversed, and the issue remanded for further proceedings.

**4. Dewar cannot make a claim for damages to which he was never entitled.**

Dewar has never disputed that the tax refund was improper. *See* CP 238-43. Washington law prohibits recovery of illusory damages. A plaintiff may not recover damages to which he was never legally entitled. *Sorenson v. Pyeatt*, 158 Wn.2d 523, 523-33, 538, 146 P.3d 1172 (2006); *Omicron Co., Inc., v. Cent. Sur. & Ins. Corp.*, 23 Wn.2d 135, 139, 160 P.2d 629 (1945) (*Omicron II*); *Omicron Co., Inc., v. U.S. Fid. & Guar. Co.*, 21 Wn.2d 703, 707, 152 P.2d 716 (1944) (*Omicron I*). And where the refund was improper, Dewar cannot claim that he suffered any actual or compensatory damages as it relates to the tax refund check.

Regardless of whether the IRS paid the refund, under Washington law, Dewar must have a legal right to it in order for a jury to award him damages at trial. There is at least an issue of material fact whether the refund should have ever been issued, and therefore a question as to whether Dewar could be entitled to it.

**F. Because Dewar was not a direct beneficiary of the engagement agreement between Beddall and Traner Smith, his claim for breach of third-party-beneficiary contract fails as a matter of law.**

A third-party-beneficiary contract “requires that the parties intended that the promisor assume a direct obligation to the intended beneficiary at the time they entered into the contract.” *Postlewait v. Great*

*American, Ins. Co.*, 106 Wn.2d 96, 99, 700 P.2d 805 (1986). Merely incidental, indirect or inconsequential benefits to a third party are insufficient to demonstrate an intent to create a third-party beneficiary contract. *McDonald Const. Co. v. Murray*, 5 Wn. App. 68, 70, 485 P.2d 626 (1971). Intent is determined by construing the terms of the contract “in light of the circumstances under which it was made,” and there must be evidence of intent that “the performance under the contract would necessarily and directly benefit the third party.” *Id.* (citing *Lonsdale v. Chesterfield*, 99 Wn.2d 353, 361-62, 662 P.2d 385 (1983)). Intent is determined by construing the terms of the contract “in light of the circumstances under which it was made.” *Id.*

Beddall was clearly the direct and intended beneficiary of the engagement between Traner Smith and Beddall. Beddall stood to gain a large refund, and potentially absolve himself of liability to Dewar if he handed his refund over to Dewar. CP 283 at ¶ 4. Additionally, Beddall bore all of the risk associated with the return. CP at 515-20. (Traner Smith could have been subject to preparer penalties. Ultimately, Traner Smith’s liability, if any, was to Beddall.) Thus, Dewar’s “benefit” was at least one step removed from Beddall’s, and “derived from the intervening” Agreement between Beddall and Dewar. *McDonald Const.*, 5 Wn. App. at 68-71. That Beddall took the extra step and agreed to give Dewar his tax

refund does make Dewar a **direct** beneficiary of the engagement between Beddall and Traner Smith. Moreover, and in any event, Traner Smith's "intent" cannot be imputed to it from a contract, (*i.e.* Agreement), to which it was not a party, played no part in drafting, and was not obligated under. *See Gall*, 84 Wn. App. at 201-02.

As a matter of law, Dewar cannot derive a direct benefit from the engagement between Traner Smith and Beddall, because the law prohibits assignment of tax refunds. *See* 26 U.S.C. § 6402; Treas. Reg. § 301.6402-2(f); Form 2848; Treas. Reg. § 601.504(a)(5); 31 U.S.C. § 3727 (refund checks are issued only in the name of the taxpayer, may not be assigned, and can only be endorsed by the taxpayer). Performance by Traner Smith under the engagement could necessarily benefit only Beddall. *See id.*

There is simply no evidence supporting the existence of a third-party-beneficiary contract. This court should reverse the trial court's error in failing to dismiss the third-party beneficiary claim.

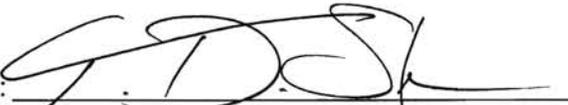
## VI. CONCLUSION

For the reasons set forth herein, this court should reverse trial court order establishing duty as a matter of law, and negligent misrepresentation, and either dismiss Dewar's negligence claims, or and remand for further proceedings. Similarly, this court should either dismiss, or reverse and remand for further proceedings, the trial court

order regarding causation and damages. Finally, this court should dismiss Dewar's claim for breach of third-party-beneficiary contract.

Respectfully submitted this 7<sup>th</sup> day of November, 2013.

LEE SMART, P.S., INC.

By: 

Sam B. Franklin, WSBA No. 1903  
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Of Attorneys for Petitioners

## APPENDICES

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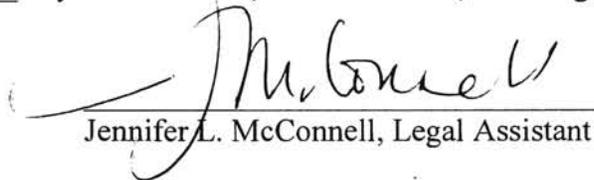
**DECLARATION OF SERVICE**

The undersigned certifies under penalty of perjury under the laws of the State of Washington, that on November 7, 2013, I caused service of the foregoing pleading on each and every attorney of record herein:

**VIA LEGAL MESSENGER**

Law Offices of Robert B. Gould  
Mr. Robert B. Gould  
Sparling Technological Center  
4100 194th Street SW, Suite 215  
Lynnwood, WA 98036

DATED this 7<sup>th</sup> day of November, 2013 at Seattle, Washington.

  
Jennifer L. McConnell, Legal Assistant

# Appendix 1

AICPA Code of Professional Conduct · Section 100 - Independence, Integrity, and Objectivity · ET  
Section 102 - Integrity and Objectivity

## ET Section 102 Integrity and Objectivity

**.01 Rule 102—Integrity and objectivity.** In the performance of any professional service, a member shall maintain objectivity and integrity, shall be free of conflicts of interest, and shall not knowingly misrepresent facts or subordinate his or her judgment to others.

[As adopted January 12, 1988.]

### Interpretations under Rule 102—Integrity and Objectivity

**.02 102-1—Knowing misrepresentations in the preparation of financial statements or records.** A member *who shall be considered to have knowingly misrepresented facts in violation of rule 102 [ET section 102.01] when he or she knowingly—*

- a. Makes, or permits or directs another to make, materially false and misleading entries in an entity's financial statements or records shall be considered to have knowingly misrepresented facts in violation of rule 102 [ET section 102.01]; or*
- b. Fails to correct an entity's financial statements or records that are materially false and misleading when he or she has the authority to record an entry; or*
- c. Signs, or permits or directs another to sign, a document containing materially false and misleading information.*

[Revised, effective May 31, 1999, by the Professional Ethics Executive Committee.]

**.03 102-2—Conflicts of interest.** A conflict of interest may occur if a member performs a professional service for a client or employer and the member or his or her firm has a relationship with another person, entity, product, or service that could, in the member's professional judgment, be viewed by the client, employer, or other appropriate parties as impairing the member's objectivity. If the member believes that the professional service can be performed with objectivity, and the relationship is disclosed to and consent is obtained from such client, employer, or other appropriate parties, the rule shall not operate to prohibit the performance of the professional service. When making the disclosure, the member should consider Rule 301, *Confidential Client Information* [ET section 301.01].

Certain professional engagements, such as audits, reviews, and other attest services, require independence. Independence impairments under rule 101 [ET section 101.01], its interpretations, and rulings cannot be eliminated by such disclosure and consent.

The following are examples, not all-inclusive, of situations that should cause a member to consider whether or not the client, employer, or other appropriate parties could view the relationship as impairing the member's objectivity:

- A member has been asked to perform litigation services for the plaintiff in connection with a lawsuit filed against a client of the member's firm.

- A member has provided tax or personal financial planning (PFP) services for a married couple who are undergoing a divorce, and the member has been asked to provide the services for both parties during the divorce proceedings.
- In connection with a PFP engagement, a member plans to suggest that the client invest in a business in which he or she has a financial interest.
- A member provides tax or PFP services for several members of a family who may have opposing interests.
- A member has a significant financial interest, is a member of management, or is in a position of influence in a company that is a major competitor of a client for which the member performs consulting services.
- A member serves on a city's board of tax appeals, which considers matters involving several of the member's tax clients.
- A member has been approached to provide services in connection with the purchase of real estate from a client of the member's firm.
- A member refers a PFP or tax client to an insurance broker or other service provider, which refers clients to the member under an exclusive arrangement to do so.
- A member recommends or refers a client to a service bureau in which the member or partner(s) in the member's firm hold material financial interest(s).

The above examples are not intended to be all-inclusive.

[Replaces previous interpretation 102-2, *Conflicts of Interest*, 1995, effective August 31, 1995.]

**.04 102-3—Obligations of a member to his or her employer's external accountant.** Under rule 102 [ET section 102.01], a member must maintain objectivity and integrity in the performance of a professional service. In dealing with his or her employer's external accountant, a member must be candid and not knowingly misrepresent facts or knowingly fail to disclose material facts. This would include, for example, responding to specific inquiries for which his or her employer's external accountant requests written representation.

[Effective November 30, 1993.]

**.05 102-4—Subordination of judgment by a member.** Rule 102 [ET section 102.01] prohibits a member from knowingly misrepresenting facts or subordinating his or her judgment when performing professional services. Under this rule, if a member and his or her supervisor have a disagreement or dispute relating to the preparation of financial statements or the recording of transactions, the member should take the following steps to ensure that the situation does not constitute a subordination of judgment:<sup>1</sup>

1. The member should consider whether (a) the entry or the failure to record a transaction in the records, or (b) the financial statement presentation or the nature or

omission of disclosure in the financial statements, as proposed by the supervisor, represents the use of an acceptable alternative and does not materially misrepresent the facts. If, after appropriate research or consultation, the member concludes that the matter has authoritative support and/or does not result in a material misrepresentation, the member need do nothing further.

2. If the member concludes that the financial statements or records could be materially misstated, the member should make his or her concerns known to the appropriate higher level(s) of management within the organization (for example, the supervisor's immediate superior, senior management, the audit committee or equivalent, the board of directors, the company's owners). The member should consider documenting his or her understanding of the facts, the accounting principles involved, the application of those principles to the facts, and the parties with whom these matters were discussed.
3. If, after discussing his or her concerns with the appropriate person(s) in the organization, the member concludes that appropriate action was not taken, he or she should consider his or her continuing relationship with the employer. The member also should consider any responsibility that may exist to communicate to third parties, such as regulatory authorities or the employer's (former employer's) external accountant. In this connection, the member may wish to consult with his or her legal counsel.
4. The member should at all times be cognizant of his or her obligations under interpretation 102-3 [ET section 102.04].

[Effective November 30, 1993.]

**.06 102-5—Applicability of rule 102 to members performing educational services.**

Educational services (for example, teaching full- or part-time at a university, teaching a continuing professional education course, or engaging in research and scholarship) are professional services as defined in ET section 92.10, and are therefore subject to rule 102 [ET section 102.01]. Rule 102 [ET section 102.01] provides that the member shall maintain objectivity and integrity, shall be free of conflicts of interest, and shall not knowingly misrepresent facts or subordinate his or her judgment to others.

[Effective March 31, 1995.]

**.07 102-6—Professional services involving client advocacy.** A member or a member's firm may be requested by a client—

1. To perform tax or consulting services engagements that involve acting as an advocate for the client.
2. To act as an advocate in support of the client's position on accounting or financial reporting issues, either within the firm or outside the firm with standard setters, regulators, or others.

Services provided or actions taken pursuant to such types of client requests are professional services [ET section 92.10] governed by the Code of Professional Conduct and shall be performed in compliance with Rule 201, *General Standards* [ET section 201.01], Rule 202,

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*Compliance With Standards* [ET section 202.01], and Rule 203, *Accounting Principles* [ET section 203.01], and interpretations thereof, as applicable. Furthermore, in the performance of any professional service, a member shall comply with rule 102 [ET section 102.01], which requires maintaining objectivity and integrity and prohibits subordination of judgment to others. When performing professional services requiring independence, a member shall also comply with rule 101 [ET section 101.01] of the Code of Professional Conduct.

Moreover, there is a possibility that some requested professional services involving client advocacy may appear to stretch the bounds of performance standards, may go beyond sound and reasonable professional practice, or may compromise credibility, and thereby pose an unacceptable risk of impairing the reputation of the member and his or her firm with respect to independence, integrity, and objectivity. In such circumstances, the member and the member's firm should consider whether it is appropriate to perform the service.

[Effective August 31, 1995.]

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<sup>1</sup> A member in the practice of public accounting should refer to the Statements on Auditing Standards. For example, see SAS No. 22, *Planning and Supervision*, which discusses what the auditor should do when there are differences of opinion concerning accounting and auditing standards.



# Appendix 2

AICPA Code of Professional Conduct · Section 90 - Rules: Applicability and Definitions · Section 92 - Definitions

## Section 92 - Definitions

As adopted,  
January 12, 1988,  
unless otherwise  
indicated

*[Pursuant to its authority under the bylaws (BL § 3.6.2.2) to interpret the Code of Professional Conduct, the Professional Ethics Executive Committee has issued the following definitions of terms appearing in the code effective November 30, 1989.]*

**.01 Client.** (This replaces the previous definition of "Client" at paragraph .01.) A client is any person or entity, other than the member's employer, that engages a member or a member's firm to perform professional services or a person or entity with respect to which professional services are performed. For purposes of this paragraph, the term "employer" does not include—

- a. Entities engaged in the practice of public accounting; or
- b. Federal, state, and local governments or component units thereof provided the member performing professional services with respect to those entities—
  - i. Is directly elected by voters of the government or component unit thereof with respect to which professional services are performed; or
  - ii. Is an individual who is (1) appointed by a legislative body and (2) subject to removal by a legislative body; or
  - iii. Is appointed by someone other than the legislative body, so long as the appointment is confirmed by the legislative body and removal is subject to oversight or approval by the legislative body.

[Revised December, 1998.]

**.02 Council.** The Council of the American Institute of Certified Public Accountants.

**.03 Enterprise.** (This replaces the previous definition of "Enterprise" at paragraph .03.) For purposes of the Code, the term "enterprise" is synonymous with the term "client."

**.04 Financial statements.** A presentation of financial data, including accompanying notes, if any, intended to communicate an entity's economic resources and/or obligations at a point in time or the changes therein for a period of time, in accordance with generally accepted accounting principles or a comprehensive basis of accounting other than generally accepted accounting principles.

Incidental financial data to support recommendations to a client or in documents for which the reporting is governed by Statements on Standards for Attestation Engagements and tax returns and supporting schedules do not, for this purpose, constitute financial statements. The statement, affidavit, or signature of preparers required on tax returns neither constitutes an opinion on financial statements nor requires a disclaimer of such opinion.

[Revised May, 1996.]

**.05 Firm.** A form of organization permitted by state law or regulation whose characteristics conform to resolutions of Council that is engaged in the practice of public accounting, including the individual owners thereof.

[Revised January, 1992.]

**.06 Institute.** The American Institute of Certified Public Accountants.

**.07 Interpretations of rules of conduct.** Pronouncements issued by the division of professional ethics to provide guidelines concerning the scope and application of the rules of conduct.

**.08 Member.** A member, associate member, or international associate of the American Institute of Certified Public Accountants.

**.09 Practice of public accounting.** (This replaces the previous definition of "Practice of public accounting" at paragraph .09.) The practice of public accounting consists of the performance for a client, by a member or a member's firm, while holding out as CPA(s), of the professional services of accounting, tax, personal financial planning, litigation support services, and those professional services for which standards are promulgated by bodies designated by Council, such as Statements of Financial Accounting Standards, Statements on Auditing Standards, Statements on Standards for Accounting and Review Services, Statement on Standards for Consulting Services, Statements of Governmental Accounting Standards, and Statements on Standards for Attestation Engagements.

However, a member or a member's firm, while holding out as CPA(s), is not considered to be in the practice of public accounting if the member or the member's firm does not perform, for any client, any of the professional services described in the preceding paragraph.

[Revised April, 1992.]

**.10 Professional services.** (This replaces the previous definition of "Professional services" at paragraph .10.) Professional services include all services performed by a member while holding out as a CPA.

**.11 Holding out.** In general, any action initiated by a member that informs others of his or her status as a CPA or AICPA-accredited specialist constitutes holding out as a CPA. This would include, for example, any oral or written representation to another regarding CPA status, use of the CPA designation on business cards or letterhead, the display of a certificate evidencing a member's CPA designation, or listing as a CPA in local telephone directories.



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# Appendix 3

**ET Section 54****Article III—Integrity**

*To maintain and broaden public confidence, members should perform all professional responsibilities with the highest sense of integrity.*

.01 Integrity is an element of character fundamental to professional recognition. It is the quality from which the public trust derives and the benchmark against which a member must ultimately test all decisions.

.02 Integrity requires a member to be, among other things, honest and candid within the constraints of client confidentiality. Service and the public trust should not be subordinated to personal gain and advantage. Integrity can accommodate the inadvertent error and the honest difference of opinion; it cannot accommodate deceit or subordination of principle.

.03 Integrity is measured in terms of what is right and just. In the absence of specific rules, standards, or guidance, or in the face of conflicting opinions, a member should test decisions and deeds by asking: "Am I doing what a person of integrity would do? Have I retained my integrity?" Integrity requires a member to observe both the form and the spirit of technical and ethical standards; circumvention of those standards constitutes subordination of judgment.

.04 Integrity also requires a member to observe the principles of objectivity and independence and of due care.

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# Appendix 4

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## ET Section 301 - Confidential Client Information

### .01 Rule 301 - Confidential client information.

A member in public practice shall not disclose any confidential client information without the specific consent of the client.

This rule shall not be construed (1) to relieve a member of his or her professional obligations under rules 202 [ ET section 202.01] and 203 [ ET section 203.01], (2) to affect in any way the member's obligation to comply with a validly issued and enforceable subpoena or summons, or to prohibit a member's compliance with applicable laws and government regulations, (3) to prohibit review of a member's professional practice under AICPA or state CPA society or Board of Accountancy authorization, or (4) to preclude a member from initiating a complaint with, or responding to any inquiry made by, the professional ethics division or trial board of the Institute or a duly constituted investigative or disciplinary body of a state CPA society or Board of Accountancy.

Members of any of the bodies identified in (4) above and members involved with professional practice reviews identified in (3) above shall not use to their own advantage or disclose any member's confidential client information that comes to their attention in carrying out those activities. This prohibition shall not restrict members' exchange of information in connection with the investigative or disciplinary proceedings described in (4) above or the professional practice reviews described in (3) above.

[As amended January 14, 1992.]

### Interpretations Under Rule 301

#### *Confidential Client Information*

[.02] [301-1]—[Deleted]

[.03] [301-2]—[Deleted]

.04 301-3—Confidential Information and the purchase, sale, or merger of a practice.

Rule 301 [ ET section 301.01] prohibits a member in public practice from disclosing any confidential client information without the specific consent of the client. The rule provides that it shall not be construed to prohibit the review of a member's professional practice under AICPA or state CPA society authorization.

For purposes of rule 301 [ ET section 301.01], a review of a member's professional practice is hereby authorized to include a review in conjunction with a prospective purchase, sale, or merger of all or part of a member's practice. The member must take appropriate precautions (for example, through a written confidentiality agreement) so that the prospective purchaser does not disclose any information obtained in the course of the review, since such information is deemed to be confidential client information.

Members reviewing a practice in connection with a prospective purchase or merger shall not use to their advantage nor disclose any member's confidential client information that comes to their attention.

[Effective February 28, 1990.]

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# Appendix 5

United States Code Annotated

Title 26. Internal Revenue Code (Refs & Annos)

Subtitle F. Procedure and Administration (Refs & Annos)

Chapter 75. Crimes, Other Offenses, and Forfeitures

Subchapter A. Crimes

Part I. General Provisions (Refs & Annos)

26 U.S.C.A. § 7216

§ 7216. Disclosure or use of information by preparers of returns

Currentness

(a) **General rule.**--Any person who is engaged in the business of preparing, or providing services in connection with the preparation of, returns of the tax imposed by chapter 1, or any person who for compensation prepares any such return for any other person, and who knowingly or recklessly--

(1) discloses any information furnished to him for, or in connection with, the preparation of any such return, or

(2) uses any such information for any purpose other than to prepare, or assist in preparing, any such return,

shall be guilty of a misdemeanor, and, upon conviction thereof, shall be fined not more than \$1,000, or imprisoned not more than 1 year, or both, together with the costs of prosecution.

(b) **Exceptions.**--

(1) **Disclosure.**--Subsection (a) shall not apply to a disclosure of information if such disclosure is made--

(A) pursuant to any other provision of this title, or

(B) pursuant to an order of a court.

(2) **Use.**--Subsection (a) shall not apply to the use of information in the preparation of, or in connection with the preparation of, State and local tax returns and declarations of estimated tax of the person to whom the information relates.

(3) **Regulations.**--Subsection (a) shall not apply to a disclosure or use of information which is permitted by regulations prescribed by the Secretary under this section. Such regulations shall permit (subject to such conditions as such regulations shall provide) the disclosure or use of information for quality or peer reviews.

**Credits**

(Added Pub.L. 92-178, Title III, § 316(a), Dec. 10, 1971, 85 Stat. 529; amended Pub.L. 94-455, Title XIX, § 1906(b)(13)(A), Oct. 4, 1976, 90 Stat. 1834; Pub.L. 98-369, Div. A, Title IV, § 412(b)(10), July 18, 1984, 98 Stat. 792; Pub.L. 100-647, Title VI, § 6242(b), Nov. 10, 1988, 102 Stat. 3749; Pub.L. 101-239, Title VII, § 7739(a), Dec. 19, 1989, 103 Stat. 2404.)

Notes of Decisions (3)

26 U.S.C.A. § 7216, 26 USCA § 7216

Current through P.L. 112-207 (excluding P.L. 112-199, 112-202, 112-203, and 112-206) approved 12-7-12

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End of Document

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# Appendix 6

Code of Federal Regulations

Title 26. Internal Revenue

Chapter I. Internal Revenue Service, Department of the Treasury

Subchapter F. Procedure and Administration

Part 301. Procedure and Administration (Refs & Annos)

Crimes, Other Offenses, and Forfeitures

Crimes

General Provisions

26 C.F.R. § 301.7216-1, Treas. Reg. § 301.7216-1

§ 301.7216-1 Penalty for disclosure or use of tax return information.

Effective: January 7, 2008

Currentness

**(a) In general.** Section 7216(a) prescribes 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. A violation of section 7216 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. Section 7216(b) establishes exceptions to the general rule in section 7216(a) prohibiting disclosure and use. Section 7216(b) also authorizes the Secretary to promulgate regulations prescribing additional permitted disclosures and uses. Section 6713(a) prescribes a related civil penalty for disclosures and uses that constitute a violation of section 7216. The penalty for violating section 6713 is \$250 for each prohibited disclosure or use, not to exceed a total of \$10,000 for a calendar year. Section 6713(b) provides that the exceptions in section 7216(b) also apply to section 6713. Under section 7216(b), the provisions of section 7216(a) will not apply to any disclosure or use permitted under regulations prescribed by the Secretary.

**(b) Definitions.** For purposes of section 7216 and §§ 301.7216-1 through 301.7216-3:

**(1) Tax return.** The term tax return means any return (or amended return) of income tax imposed by chapter 1 of the Internal Revenue Code.

**(2) Tax return preparer--(i) In general.** The term tax return preparer means:

(A) Any person who is engaged in the business of preparing or assisting in preparing tax returns;

(B) Any person who is engaged in the business of providing auxiliary services in connection with the preparation of tax returns, including a person who develops software that is used to prepare or file a tax return and any Authorized IRS e-file Provider;

(C) Any person who is otherwise compensated for preparing, or assisting in preparing, a tax return for any other person; or

(D) Any individual who, as part of their duties of employment with any person described in paragraph (b)(2)(i)(A), (B), or (C) of this section performs services that assist in the preparation of, or assist in providing auxiliary services in connection with the preparation of, a tax return.

**(ii) Business of preparing returns.** A person is engaged in the business of preparing tax returns as described in paragraph (b)(2)(i)(A) of this section if, in the course of the person's business, the person holds himself out to tax return preparers or taxpayers as a person who prepares tax returns or assists in preparing tax returns, whether or not tax return preparation is the person's sole business activity and whether or not the person charges a fee for tax return preparation services.

**(iii) Providing auxiliary services.** A person is engaged in the business of providing auxiliary services in connection with the preparation of tax returns as described in paragraph (b)(2)(i)(B) of this section 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. Likewise, a person is engaged in the business of providing auxiliary services if, in the course of the person's business, the person receives a taxpayer's tax return information from another tax return preparer pursuant to the provisions of § 301.7216-2(d)(2).

**(iv) Otherwise compensated.** A tax return preparer described in paragraph (b)(2)(i)(C) of this section includes any person who--

(A) Is compensated for preparing a tax return for another person, but not in the course of a business; or

(B) Is compensated for helping, on a casual basis, a relative, friend, or other acquaintance to prepare their tax return.

**(v) Exclusions.** A person is not a tax return preparer merely because he leases office space to a tax return preparer, furnishes credit to a taxpayer whose tax return is prepared by a tax return preparer, furnishes information to a tax return preparer at the taxpayer's request, furnishes access (free or otherwise) to a separate person's tax return preparation Web site through a hyperlink on his own Web site, or otherwise performs some service that only incidentally relates to the preparation of tax returns.

**(vi) Examples.** The application of § 301.7216-1(b)(2) may be illustrated by the following examples:

**Example 1.** Bank B is a tax return preparer within the meaning of paragraph (b)(2)(i)(A) of this section, and an Authorized IRS e-file Provider. B employs one individual, Q, to solicit the necessary tax return information for the preparation of a tax return; another individual, R, to prepare the return on the basis of the information that is furnished; a secretary, S, who types the information on the returns into a computer; and an administrative assistant, T, who uses a computer to file electronic versions of the tax returns. Under these circumstances, only R is a tax return preparer for purposes of section 7701(a)(36), but all four employees are tax return preparers for purposes of section 7216, as provided in paragraph (b) of this section.

**Example 2.** Tax return preparer P contracts with department store D to rent space in D's store. D advertises that taxpayers who use P's services may charge the cost of having their tax return prepared to their charge account with D. Under these circumstances, D is not a tax return preparer because it provides space, credit, and services only incidentally related to the preparation of tax returns.

**(3) Tax return information--(i) In general.** The term tax return information means any information, including, but not limited to, a taxpayer's name, address, or identifying number, which is furnished in any form or manner for, or in connection with, the preparation of a tax return of the taxpayer. This information includes information that the taxpayer furnishes to a tax return preparer and information furnished to the tax return preparer by a third party. Tax return information also includes information the tax return preparer derives or generates from tax return information in connection with the preparation of a taxpayer's return.

(A) Tax return information can be provided directly by the taxpayer or by another person. Likewise, tax return information includes information received by the tax return preparer from the IRS in connection with the processing of such return, including an acknowledgment of acceptance or notice of rejection of an electronically filed return.

(B) Tax return information includes statistical compilations of tax return information, even in a form that cannot be associated with, or otherwise identify, directly or indirectly, a particular taxpayer. See § 301.7216-2(o) for limited use of tax return information to make statistical compilations without taxpayer consent and to use the statistical compilations for limited purposes.

(C) Tax return information does not include information identical to any tax return information that has been furnished to a tax return preparer if the identical information was obtained otherwise than in connection with the preparation of a tax return.

(D) Information is considered "in connection with tax return preparation," and therefore tax return information, if the taxpayer would not have furnished the information to the tax return preparer but for the intention to engage, or the engagement of, the tax return preparer to prepare the tax return.

**(ii) Examples.** The application of this paragraph (b)(3) may be illustrated by the following examples:

**Example 1.** Taxpayer A purchases computer software designed to assist with the preparation and filing of her income tax return. When A loads the software onto her computer, it prompts her to register her purchase of the software. In this situation, the software provider is a tax return preparer under paragraph (b)(2)(i)(B) of this section and the information that A provides to register her purchase is tax return information because she is providing it in connection with the preparation of a tax return.

**Example 2.** Corporation A is a brokerage firm that maintains a Web site through which its clients may access their accounts, trade stocks, and generally conduct a variety of financial activities. Through its Web site, A offers its clients free access to its own tax preparation software. Taxpayer B is a client of A and has furnished A his name, address, and other information when registering for use of A's Web site to use A's brokerage services. In addition, A has a record of B's brokerage account activity, including sales of stock, dividends paid, and IRA contributions made. B uses A's tax preparation software to prepare his tax return. The software populates some fields on B's return on the basis of information A already maintains in its databases. A is a tax return preparer within the meaning of paragraph (b)(2)(i)(B) of this section because it has prepared and provided software for use in preparing tax returns. The information in A's databases that the software accesses to populate B's return, i.e., the registration information and brokerage account activity, is not tax return information because A did not receive that information in connection with the preparation of a tax return. Once A uses the information to populate the return, however, the information associated with the return becomes tax return information. If A retains the information in a form in which A can identify that the information was used in connection with the preparation of a return, the information in that form is tax return information.

If, however, A retains the information in a database in which A cannot identify whether the information was used in connection with the preparation of a return, then that information is not tax return information.

(4) **Use--(i) In general.** Use of tax return information includes any circumstance in which a tax return preparer refers to, or relies upon, tax return information as the basis to take or permit an action.

(ii) **Example.** The application of this paragraph (b)(4) may be illustrated by the following example:

**Example.** Preparer G is a tax return preparer as defined by paragraph (b)(2)(i)(A) of this section. If G determines, upon preparing a return, that the taxpayer is eligible to make a contribution to an individual retirement account (IRA), G will ask whether the taxpayer desires to make a contribution to an IRA. G does not ask about IRAs in cases in which the taxpayer is not eligible to make a contribution. G is using tax return information when it asks whether a taxpayer is interested in making a contribution to an IRA because G is basing the inquiry upon knowledge gained from information that the taxpayer furnished in connection with the preparation of the taxpayer's return.

(5) **Disclosure.** The term disclosure means the act of making tax return information known to any person in any manner whatever. To the extent that a taxpayer's use of a hyperlink results in the transmission of tax return information, this transmission of tax return information is a disclosure by the tax return preparer subject to penalty under section 7216 if not authorized by regulation.

(6) **Hyperlink.** For purposes of section 7216, a hyperlink is a device used to transfer an individual using tax preparation software from a tax return preparer's Web page to a Web page operated by another person without the individual having to separately enter the Web address of the destination page.

(7) **Request for consent.** A request for consent includes any effort by a tax return preparer to obtain the taxpayer's consent to use or disclose the taxpayer's tax return information. The act of supplying a taxpayer with a paper or electronic form that meets the requirements of a revenue procedure published pursuant to § 301.7216–3(a) is a request for a consent. When a tax return preparer requests a taxpayer's consent, any associated efforts of the tax return preparer, including, but not limited to, verbal or written explanations of the form, are part of the request for consent.

(c) **Gramm–Leach–Bliley Act.** Any applicable requirements of the Gramm–Leach–Bliley Act, Public Law 106–102 (113 Stat. 1338), do not supersede, alter, or affect the requirements of section 7216 and §§ 301.7216–1 through 301.7216–3. Similarly, the requirements of section 7216 and §§ 301.7216–1 through 301.7216–3 do not override any requirements or restrictions of the Gramm–Leach–Bliley Act, which are in addition to the requirements or restrictions of section 7216 and §§ 301.7216–1 through 301.7216–3.

(d) **Effective/applicability date.** This section applies to disclosures or uses of tax return information occurring on or after January 1, 2009.

#### Credits

[T.D. 7310, 39 FR 11538, March 29, 1974; T.D. 9375, 73 FR 1067, Jan. 7, 2008]

SOURCE: 32 FR 15241, Nov. 3, 1967; T.D. 9610, 78 FR 5994, Jan. 28, 2013, unless otherwise noted.

AUTHORITY: 26 U.S.C. 7805.; Section 301.1474-1 also issued under 26 U.S.C. 1474(f).; Section 301.6011-2 also issued under 26 U.S.C. 6011(e).; Section 301.6011-3 also issued under 26 U.S.C. 6011.; Section 301.6011-5 also issued under 26 U.S.C. 6011.; Section 301.6011-6 also issued under 26 U.S.C. 6011(a).; Section 301.6011-7 also issued under 26 U.S.C. 6011(e).; Section 301.6033-4 also issued under 26 U.S.C. 6033.; Section 301.6036-1 also issued under 26 U.S.C. 6036.; Section 301.6037-2 also issued under 26 U.S.C. 6037.; Section 301.6050M-1 also issued under 26 U.S.C. 6050M.; Section 301.6061-1 also issued under 26 U.S.C. 6061.; Section 301.6081-2 also issued under 26 U.S.C. 6081(a).; Section 301.6103(c)-1 also issued under 26 U.S.C. 6103(c).; Section 301.6103(j)(1)-1 also issued under 26 U.S.C. 6103(j)(1).; Section 301.6103(j)(1)-1T also issued under 26 U.S.C. 6103(j)(1).; Section 301.6103(j)(5)-1 also issued under 26 U.S.C. 6103(j)(5).; Section 301.6103(k)(6)-1 also issued under 26 U.S.C. 6103(k)(6).; Section 301.6103(k)(6)-1T also issued under 26 U.S.C. 6103(k)(6).; Section 301.6103(k)(9)-1 also issued under 26 U.S.C. 6103(k)(9) and 26 U.S.C. 6103(q).; Section 301.6103(l)-1 also issued under 26 U.S.C. 6103(q).; Section 301.6103(l)(14)-1 also issued under 26 U.S.C. 6103(l)(14).; Section 301.6103(m)-1 also issued under 26 U.S.C. 6103(q).; Section 301.6103(n)-1 also issued under 26 U.S.C. 6103(n).; Section 301.6103(n)-2 also issued under 26 U.S.C. 6103(n).; Section 301.6103(n)-2 also issued under 26 U.S.C. 6103(q).; Section 301.6103(n)-2T also issued under 26 U.S.C. 6103(n).; Section 301.6103(p)(2)(B)-1 also issued under 26 U.S.C. 6103(p)(2).; Section 301.6103(p)(2)(B)-1T also issued under 26 U.S.C. 6103(p)(2).; Sections 301.6103(p)(4)-1 and 301.6103(p)(7)-1T also issued under 26 U.S.C. 6103(p)(4) and (7) and (q).; Section 301.6104(a)-6(d) is also issued under 5 U.S.C. 552.; Section 301.6104(b)-1(d)(4) is also issued under 5 U.S.C. 552.; Section 301.6104(d)-1(d)(3)(i) is also issued under 5 U.S.C. 552.; Section 301.6104(d)-2 also issued under 26 U.S.C. 6104(d)(3).; Section 301.6104(d)-3 also issued under 26 U.S.C. 6104(d)(3).; Section 301.6104(d)-4 also issued under 26 U.S.C. 6104(e)(3).; Section 301.6104(d)-5 also issued under 26 U.S.C. 6104(e)(3).; Section 301.6109-1 also issued under 26 U.S.C. 6109 (a), (c), and (d).; Section 301.6109-3 also issued under 26 U.S.C. 6109.; Section 301.6111-1T also issued under 26 U.S.C. 6111.; Section 301.6111-2T also issued under 26 U.S.C. 6111(f)(4).; Section 301.6111-3 also issued under 26 U.S.C. 6111.; Section 301.6111-3T also issued under 26 U.S.C. 6111.; Section 301.6112-1T also issued under 26 U.S.C. 6112.; Section 301.6114-1 also issued under 26 U.S.C. 6114.; Section 301.6222(a)-1T also issued under 26 U.S.C. 6230(k).; Section 301.6222(a)-2T also issued under 26 U.S.C. 6230(k).; Section 301.6222(b)-1T also issued under 26 U.S.C. 6230(k).; Section 301.6222(b)-2T also issued under 26 U.S.C. 6230(k).; Section 301.6222(b)-3T also issued under 26 U.S.C. 6230 (i) and (k).

Section 301.6223(a)-1T also issued under 26 U.S.C. 6230(k).; Section 301.6223(a)-2T also issued under 26 U.S.C. 6230(k).; Section 301.6223(b)-1T also issued under 26 U.S.C. 6230 (i) and (k).; Section 301.6223(b)-2T also issued under 26 U.S.C. 6230(k).; Section 301.6223(c)-1T also issued under 26 U.S.C. 6223(c) and 6230 (i) and (k).; Section 301.6223(e)-1T also issued under 26 U.S.C. 6230(k).; Section 301.6223(e)-2T also issued under 26 U.S.C. 6230 (i) and (k).; Section 301.6223(f)-1T also issued under 26 U.S.C. 6230(k).; Section 301.6223(g)-1T also issued under 26 U.S.C. 6223(g) and 6230 (i) and (k).; Section 301.6223(h)-1T also issued under 26 U.S.C. 6230 (i) and (k).; Section 301.6224(a)-1T also issued under 26 U.S.C. 6230(k).; Section 301.6224(b)-1T also issued under 26 U.S.C. 6230 (i) and (k).; Section 301.6224(c)-1T also issued under 26 U.S.C. 6230 (i) and (k).; Section 301.6224(c)-2T also issued under 26 U.S.C. 6230(k).; Section 301.6224(c)-3T also issued under 26 U.S.C. 6230 (i) and (k).; Section 301.6226(a)-1T also issued under 26 U.S.C. 6230(k).; Section 301.6226(b)-1T also issued under 26 U.S.C. 6230(k).; Section 301.6226(e)-1T also issued under 26 U.S.C. 6230(k).; Section 301.6226(f)-1T also issued under 26 U.S.C. 6230(k).; Section 301.6229(c)(2)-1 is also issued under 26 U.S.C. 6230(k).; Section 301.6229(c)(2)-1T is also issued under 26 U.S.C. § 6230(k).; Section 301.6231(a)(6)-1T also issued under 26 U.S.C. 6230(k).; Section 301.6231(a)(7)-1 also issued under 26 U.S.C. 6230 (i) and (k).; Section 301.6231(a)(7)-2 also issued under 26 U.S.C. 6230 (i) and (k).; Section 301.6231(a)(12)-1T also issued under 26 U.S.C. 6230(k) and 6231(a)(12).; Section 301.6231(c)-1 also issued under 26 U.S.C. 6231(c)(1) and (3).; Section 301.6231(c)-2 also issued under 26 U.S.C. 6231(c)(1) and (3).; Section 301.6231(c)-3T also issued under 26 U.S.C. 6230(k) and 6231(c).; Section 301.6231(c)-4T also issued under 26 U.S.C. 6230(k) and 6231(c).; Section 301.6231(c)-5T also issued under 26 U.S.C. 6230(k) and 6231(c).; Section 301.6231(c)-6T also issued under 26 U.S.C. 6230(k) and 6231(c).; Section 301.6231(c)-7T also issued under 26 U.S.C. 6230(k) and 6231(c).; Section 301.6231(c)-8T also issued under 26 U.S.C. 6230(k) and 6231(c).; Section 301.6231(d)-1T also issued under 26 U.S.C. 6230(k).; Section 301.6231(e)-1T also issued under 26 U.S.C. 6230(k).; Section 301.6231(e)-2T also issued under 26 U.S.C. 6230(k).; Section 301.6231(f)-1T also issued under 26 U.S.C. 6230 (i) and (k) and 6231(f).; Section 301.6233-1T also issued under 26 U.S.C. 6230(k) and 6233.; Section 301.6241-1T also issued under 26 U.S.C. 6241.; Section 301.6245-1T also issued under 26 U.S.C.

6245.; Section 301.6311-2 also issued under 26 U.S.C. 6311.; Section 301.6323(f)-(1)(c) also issued under 26 U.S.C. 6323(f)(3).; Section 301.6325-1T also issued under 26 U.S.C. 6326.; Section 301.6343-1 also issued under 26 U.S.C. 6343.; Section 301.6343-2 also issued under 26 U.S.C. 6343.; Section 301.6402-3 also issued under 95 Stat. 357 amending 88 Stat. 2351.; Section 301.6402-7 also issued under 26 U.S.C. 6402(i) and 6411(c).; Section 301.6404-2 also issued under 26 U.S.C. 6404.; Section 301.6404-3 also issued under 26 U.S.C. 6404(f)(3).; Section 301.6621-1 also issued under 26 U.S.C. 6230(k).

Section 301.6689-1T also issued under 26 U.S.C. 6689(a).; Section 301.7216-2, paragraphs (o) and (p) also issued under 26 U.S.C. 7216(b)(3).; Section 301.7216-3T also issued under 26 U.S.C. 7216.; Section 301.7502-1 also issued under 26 U.S.C. 7502.; Section 301.7502-2 also issued under 26 U.S.C. 7502.; Section 301.7507-1 also issued under 26 U.S.C. 597.; Section 301.7507-9 also issued under 26 U.S.C. 597.; Section 301.7508-1 also issued under 26 U.S.C. 7508(a)(1)(K).; Section 301.7508A-1 also issued under 26 U.S.C. 7508(a)(1)(K) and 7508A(a).; Section 301.7605-1 also issued under Section 6228(b) of the Technical and Miscellaneous Revenue Act of 1988.; Section 301.7623-1 also issued under 26 U.S.C. 7623.; Section 301.7624-1 also issued under 26 U.S.C. 7624.; Sections 301.7701(b)-1 through 301.7701(b)-9 also issued under 26 U.S.C. 7701(b)(11).; Section 301.7701(i)-1(g)(1) also issued under 26 U.S.C. 7701(i)(2)(D).; Section 301.7701(i)-4(b) also issued under 26 U.S.C. 7701(i)(3).; Section 301.9000-1 also issued under 5 U.S.C. 301 and 26 U.S.C. 6103(q) and 7804.; Section 301.9000-2 also issued under 5 U.S.C. 301 and 26 U.S.C. 6103(q) and 7804.; Section 301.9000-3 also issued under 5 U.S.C. 301 and 26 U.S.C. 6103(q) and 7804.; Section 301.9000-4 also issued under 5 U.S.C. 301 and 26 U.S.C. 6103(q) and 7804.; Section 301.9000-5 also issued under 5 U.S.C. 301 and 26 U.S.C. 6103(q) and 7804.; Section 301.9000-6 also issued under 5 U.S.C. 301 and 26 U.S.C. 6103(q) and 7804.; Section 301.9100-1T also issued under 26 U.S.C. 6081.; Section 301.9100-2T also issued under 26 U.S.C. 6081.; Section 301.9100-3T also issued under 26 U.S.C. 6081.; Section 301.9100-4T also issued under 26 U.S.C. 168(f)(8)(G).; Section 301.9100-7T also issued under 26 U.S.C. 42, 48, 56, 83, 141, 142, 143, 145, 147, 165, 168, 216, 263, 263A, 448, 453C, 468B, 469, 474, 585, 616, 617, 1059, 2632, 2652, 3121, 4982, 7701; and under the Tax Reform Act of 1986, 100 Stat. 2746, sections 203, 204, 243, 311, 646, 801, 806, 905, 1704, 1801, 1802, and 1804.; Section 301.9100-8 also issued under 26 U.S.C. 1(i)(7), 41(h), 42(b)(2)(A)(ii), 42(d)(3), 42(f)(1), 42(g)(3), 42(i)(2)(B), 42(j)(5)(B), 121(d)(9), 142(i)(2), 165(l), 168(b)(2), 219(g)(4), 245(a)(10), 263A(d)(1), 263A(d)(3)(B), 263A(h), 460(b)(3), 643(g)(2), 831(b)(2)(A), 835(a), 865(f), 865(g)(3), 865(h)(2), 904(g)(10), 2056(b)(7)(c)(ii), 2056A(d), 2523(f)(6)(B), 3127, and 7520(a); the Technical and Miscellaneous Revenue Act of 1988, 102 Stat. 3324 [So in original; probably should read "102 Stat. 3342"]., sections 1002(a)(23)(B), 1005(c)(11), 1006(d)(15), 1006(j)(1)(C), 1006(t)(18)(B), 1012(n)(3), 1014(c)(1), 1014(c)(2), 2004(j)(1), 2004(m)(5), 5012(e)(4), 6181(c)(2), and 6277; and under the Tax Reform Act of 1986, 100 Stat. 2746, section 905(a).; Sections 301.9100-9T, 301.9100-10T and 301.9100-11T also issued under 26 U.S.C. 1103 (g) and (h) and 6158(a).; Sections 301.9100-13T, 301.9100-14T and 301.9100-15T also issued under 26 U.S.C. 108(d)(8) and 1017(b)(3)(E).; Section 301.9100-16T also issued under 26 U.S.C. 463(d).

Notes of Decisions (2)

Current through April 18, 2013; 78 FR 23456.

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# Appendix 7

Code of Federal Regulations  
Title 26. Internal Revenue  
Chapter I. Internal Revenue Service, Department of the Treasury,  
Subchapter F. Procedure and Administration  
Part 301. Procedure and Administration (Refs & Annos)  
Crimes, Other Offenses, and Forfeitures  
Crimes  
General Provisions

26 C.F.R. § 301.7216-2, Treas. Reg. § 301.7216-2

§ 301.7216-2 Permissible disclosures or uses without consent of the taxpayer.

Effective: December 28, 2012  
Currentness

**(a) Disclosure pursuant to other provisions of the Internal Revenue Code.** The provisions of section 7216(a) and § 301.7216-1 shall not apply to any disclosure of tax return information if the disclosure is made pursuant to any other provision of the Internal Revenue Code or the regulations thereunder.

**(b) Disclosures to the IRS.** The provisions of section 7216(a) and § 301.7216-1 shall not apply to any disclosure of tax return information to an officer or employee of the IRS.

**(c) Disclosures or uses for preparation of a taxpayer's return--(1) Updating Taxpayers' Tax Return Preparation Software.** If a tax return preparer provides software to a taxpayer that is used in connection with the preparation or filing of a tax return, the tax return preparer may use the taxpayer's tax return information to update the taxpayer's software for the purpose of addressing changes in IRS forms, e-file specifications and administrative, regulatory and legislative guidance or to test and ensure the software's technical capabilities without the taxpayer's consent under § 301.7216-3.

**(2) Tax return preparers located within the same firm in the United States.** If a taxpayer furnishes tax return information to a tax return preparer located within the United States, including any territory or possession of the United States, an officer, employee, or member of a tax return preparer may use the tax return information, or disclose the tax return information to another officer, employee, or member of the same tax return preparer, for the purpose of performing services that assist in the preparation of, or assist in providing auxiliary services in connection with the preparation of, the taxpayer's tax return. If an officer, employee, or member to whom the tax return information is to be disclosed is located outside of the United States or any territory or possession of the United States, the taxpayer's consent under § 301.7216-3 prior to any disclosure is required.

**(3) Furnishing tax return information to tax return preparers located outside the United States.** If a taxpayer initially furnishes tax return information to a tax return preparer located outside of the United States or any territory or possession of the United States, an officer, employee, or member of a tax return preparer may use tax return information, or disclose any tax return information to another officer, employee, or member of the same tax return preparer, for the purpose of performing services that assist in the preparation of, or assist in providing auxiliary services in connection with the preparation of, the tax return of a taxpayer by or for whom the information was furnished without the taxpayer's consent under § 301.7216-3.

(4) **Examples.** The following examples illustrate this paragraph (c):

**Example 1.** Preparer P provides tax return preparation software to Taxpayer T for T to use in the preparation of its 2009 income tax return. For the 2009 tax year, and using T's tax return information furnished while registering for the software, P would like to update the tax return preparation software that T is using to account for last minute changes made to the tax laws for the 2009 tax year. P is not required to obtain T's consent to update the tax return preparation software. P may perform a software update regardless of whether the software update will affect T's particular return preparation activities.

**Example 2.** T is a client of Firm, which is a tax return preparer. E, an employee at Firm's State A office, receives tax return information from T for use in preparing T's income tax return. E discloses the tax return information to P, an employee in Firm's State B office; P uses the tax return information to process T's income tax return. Firm is not required to receive T's consent under § 301.7216-3 prior to E's disclosure of T's tax return information to P because the tax return information is disclosed to an employee employed by the same tax return preparer located within the United States.

**Example 3.** Same facts as Example 2 except T's tax return information is disclosed to FE who is located in Firm's Country F office. FE uses the tax return information to process T's income tax return. After processing, FE returns the processed tax return information to E in Firm's State A office. Because FE is outside of the United States, Firm is required to obtain T's consent under § 301.7216-3 prior to E's disclosure of T's tax return information to FE.

**Example 4.** T, Firm's client, is temporarily located in Country F. She initially furnishes her tax return information to employee FE in Firm's Country F office for the purpose of having Firm prepare her U.S. income tax return. FE makes the substantive determinations concerning T's tax liability and forwards T's tax return information to FP, an employee in Firm's Country P office, for the purpose of processing T's tax return information. FP processes the return information and forwards it to Partner A at Firm's State A office in the United States for review and delivery to T. Because T initially furnished the tax return information to a tax return preparer outside of the United States, T's prior consent for disclosure or use under § 301.7216-3 was not required. An officer, employee, or member of Firm in the United States may use T's tax return information or disclose the tax return information to another officer, employee, or member of Firm without T's prior consent under § 301.7216-3 as long as any disclosure or use of T's tax return information is within the United States. Firm is required to receive T's consent under § 301.7216-3 prior to any subsequent disclosure of T's tax return information to a tax return preparer located outside of the United States.

(d) **Disclosures to other tax return preparers--(1) Preparer-to-preparer disclosures.** Except as limited in paragraph (d) (2) of this section, an officer, employee, or member of a tax return preparer may disclose tax return information of a taxpayer to another tax return preparer (other than an officer, employee, or member of the same tax return preparer) located in the United States (including any territory or possession of the United States) for the purpose of preparing or assisting in preparing a tax return, or obtaining or providing 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. A substantive determination involves an analysis, interpretation, or application of the law. The authorized disclosures permitted under this paragraph (d)(1) include one tax return preparer disclosing tax return information to another tax return preparer for the purpose of having the second tax return preparer transfer that information to, and compute the tax liability on, a tax return of the taxpayer by means of electronic, mechanical, or other form of tax return processing service. The authorized disclosures permitted under this paragraph (d)(1) also include disclosures by a tax return preparer to an Authorized IRS e-file Provider for the purpose of electronically filing the return with the IRS. Authorized disclosures also include disclosures by a tax return preparer to a second tax return preparer for the purpose of making information concerning the return available to the taxpayer. This would include, for example, whether the return has been accepted or rejected by the IRS, or the status of the taxpayer's refund. Except as provided in paragraph (c) of this section, a tax return preparer may not disclose tax return information to another tax return preparer for

the purpose of the second tax return preparer providing substantive determinations without first receiving the taxpayer's consent in accordance with the rules under § 301.7216-3.

**(2) Disclosures to contractors.** A tax return preparer may disclose tax return information to a person under contract with the tax return preparer in connection with the programming, maintenance, repair, testing, or procurement of equipment or software used for purposes of tax return preparation only to the extent necessary for the person to provide the contracted services, and only if the tax return preparer ensures that all individuals who are to receive disclosures of tax return information receive a written notice that informs them of the applicability of sections 6713 and 7216 to them and describes the requirements and penalties of sections 6713 and 7216. Contractors receiving tax return information pursuant to this section are tax return preparers under section 7216 because they are performing auxiliary services in connection with tax return preparation. See § 301.7216-1(b)(2)(i)(B) and (D).

**(3) Examples.** The following examples illustrate this paragraph (d):

**Example 1.** E, an employee at Firm's State A office, receives tax return information from T for Firm's use in preparing T's income tax return. E makes substantive determinations and forwards the tax return information to P, an employee at Processor; Processor is located in State B. P places the tax return information on the income tax return and furnishes the finished product to E. E is not required to receive T's prior consent under § 301.7216-3 before disclosing T's tax return information to P because Processor's services are not substantive determinations and the tax return information remained in the United States at Processor's State B office during the entire course of the tax return preparation process.

**Example 2.** Firm, a tax return preparer, offers income tax return preparation services. Firm's contract with its software provider, Contractor, requires Firm to periodically randomly select certain taxpayers' tax return information solely for the purpose of testing the reliability of the software sold to Firm. Under its agreement with Contractor, Firm discloses tax return information to Contractor's employee, C, who services Firm's contract without providing Contractor or C with a written notice that describes the requirements of and penalties under sections 7216 and 6713. C uses the tax return information solely for quality assurance purposes. Firm's disclosure of tax return information to C was an impermissible disclosure because Firm failed to ensure that C received a written notice that describes the requirements and penalties of sections 7216 and 6713.

**Example 3.** E, an employee of Firm in State A in the United States, receives tax return information from T for use in preparing T's income tax return. After E enters T's tax return information into Firm's computer, that information is stored on a computer server that is physically located in State A. Firm contracts with Contractor, located in Country F, to prepare its clients' tax returns. FE, an employee of Contractor, uses a computer in Country F and inputs a password to view T's income tax information stored on the computer server in State A to prepare T's tax return. A computer program permits FE to view T's tax return information, but prohibits FE from downloading or printing out T's tax return information from the computer server. Because Firm is disclosing T's tax return information outside of the United States, Firm is required to obtain T's consent under § 301.7216-3 prior to the disclosure to FE. As provided in § 301.7216-3(b)(5), however, Firm may not obtain consent to disclose T's social security number (SSN) to a tax return preparer located outside of the United States or any territory or possession of the United States.

**Example 4.** A, an employee at Firm A, receives tax return information from T for Firm's use in preparing T's income tax return. A forwards the tax return information to B, an employee at another firm, Firm B, to obtain advice on the issue of whether T may claim a deduction for a certain business expense. A is required to receive T's prior consent under § 301.7216-3 before disclosing T's tax return information to B because B's services involve a substantive determination affecting the tax liability that T will report.

**(e) Disclosure or use of information in the case of related taxpayers.** (1) In preparing a tax return of a second taxpayer, a tax return preparer may use, and may disclose to the second taxpayer in the form in which it appears on the return, any tax return information that the tax return preparer obtained from a first taxpayer if--

(i) The second taxpayer is related to the first taxpayer within the meaning of paragraph (e)(2) of this section;

(ii) The first taxpayer's tax interest in the information is not adverse to the second taxpayer's tax interest in the information; and

(iii) The first taxpayer has not expressly prohibited the disclosure or use.

(2) For purposes of paragraph (e)(1)(i) of this section, a taxpayer is related to another taxpayer if they have any one of the following relationships: Husband and wife, child and parent, grandchild and grandparent, partner and partnership, trust or estate and beneficiary, trust or estate and fiduciary, corporation and shareholder, or members of a controlled group of corporations as defined in section 1563.

(3) See § 301.7216-3 for disclosure or use of tax return information of the taxpayer in preparing the tax return of a second taxpayer when the requirements of this paragraph are not satisfied.

**(f) Disclosure pursuant to an order of a court, or an administrative order, demand, request, summons or subpoena which is issued in the performance of its duties by a Federal or State agency, the United States Congress, a professional association ethics committee or board, or the Public Company Accounting Oversight Board.** The provisions of section 7216(a) and § 301.7216-1 will not apply to any disclosure of tax return information if the disclosure is made pursuant to any one of the following documents:

(1) The order of any court of record, Federal, State, or local.

(2) A subpoena issued by a grand jury, Federal or State.

(3) A subpoena issued by the United States Congress.

(4) An administrative order, demand, summons or subpoena that is issued in the performance of its duties by--

(i) Any Federal agency as defined in 5 U.S.C. 551(1) and 5 U.S.C. 552(f), or

(ii) A State agency, body, or commission charged under the laws of the State or a political subdivision of the State with the licensing, registration, or regulation of tax return preparers.

(5) A written request from a professional association ethics committee or board investigating the ethical conduct of the tax return preparer.

(6) A written request from the Public Company Accounting Oversight Board in connection with an inspection under section 104 of the Sarbanes–Oxley Act of 2002, 15 U.S.C. 7214, or an investigation under section 105 of such Act, 15 U.S.C. 7215, for use in accordance with such Act.

**(g) Disclosure for use in securing legal advice, Treasury investigations or court proceedings.** A tax return preparer may disclose tax return information--

(1) To an attorney for purposes of securing legal advice;

(2) To an employee of the Treasury Department for use in connection with any investigation of the tax return preparer (including investigations relating to the tax return preparer in its capacity as a practitioner) conducted by the IRS or the Treasury Department; or

(3) To any officer of a court for use in connection with proceedings involving the tax return preparer (including proceedings involving the tax return preparer in its capacity as a practitioner), or the return preparer's client, before the court or before any grand jury that may be convened by the court.

**(h) Certain disclosures by attorneys and accountants.** The provisions of section 7216(a) and § 301.7216–1 shall not apply to any disclosure of tax return information permitted by this paragraph (h).

(i) A tax return preparer who is lawfully engaged in the practice of law or accountancy and prepares a tax return for a taxpayer may use the taxpayer's tax return information, or disclose the information to another officer, employee or member of the tax return preparer's law or accounting firm, consistent with applicable legal and ethical responsibilities, who may use the tax return information for the purpose of providing other legal or accounting services to the taxpayer. As an example, a lawyer who prepares a tax return for a taxpayer may use the tax return information of the taxpayer for, or in connection with, rendering legal services, including estate planning or administration, or preparation of trial briefs or trust instruments, for the taxpayer or the estate of the taxpayer. In addition, the lawyer who prepared the tax return may disclose the tax return information to another officer, employee or member of the same firm for the purpose of providing other legal services to the taxpayer. As another example, an accountant who prepares a tax return for a taxpayer may use the tax return information, or disclose it to another officer, employee or member of the firm, for use in connection with the preparation of books and records, working papers, or accounting statements or reports for the taxpayer. In the normal course of rendering the legal or accounting services to the taxpayer, the attorney or accountant may make the tax return information available to third parties, including stockholders, management, suppliers, or lenders, consistent with the applicable legal and ethical responsibilities, unless the taxpayer directs otherwise. For rules regarding disclosures outside of the United States, see § 301.7216–2(c) and (d).

(ii) A tax return preparer's law or accounting firm does not include any related or affiliated firms. For example, if law firm A is affiliated with law firm B, officers, employees and members of law firm A must receive a taxpayer's consent under § 301.7216–3 before disclosing the taxpayer's tax return information to an officer, employee or member of law firm B.

(2) A tax return preparer who is lawfully engaged in the practice of law or accountancy and prepares a tax return for a taxpayer may, consistent with the applicable legal and ethical responsibilities, take the tax return information into account, and may act upon it, in the course of performing legal or accounting services for a client other than the taxpayer, or disclose the information to another officer, employee or member of the tax return preparer's law or accounting firm to enable that other officer, employee or member to take the information into account, and act upon it, in the course of performing legal or accounting services for a client other than the taxpayer. This is permissible when the information is, or may be, relevant to the subject matter of the legal or accounting services for the other client, and consideration of the information by those performing the services is necessary for the proper performance of the services. In no event, however, may the tax return information be disclosed to a person who is not an officer, employee or member of the law or accounting firm, unless the disclosure is exempt from the application of section 7216(a) and § 301.7216-1 by reason of another provision of §§ 301.7216-2 or 301.7216-3.

(3) **Examples.** The application of this paragraph may be illustrated by the following examples:

**Example 1.** A, a member of an accounting firm, renders an opinion on a financial statement of M Corporation that is part of a registration statement filed with the Securities and Exchange Commission. After the registration statement is filed, but before its effective date, B, a member of the same accounting firm, prepares an income tax return for N Corporation. In the course of preparing N's income tax return, B discovers that N does business with M and concludes that the information given by N should be considered by A to determine whether the financial statement opined on by A contains an untrue statement of material fact or omits a material fact required to keep the statement from being misleading. B discloses to A the tax return information of N for this purpose. A determines that there is an omission of material fact and that an amended statement should be filed. A so advises M and the Securities and Exchange Commission. A explains that the omission was revealed as a result of confidential information that came to A's attention after the statement was filed, but A does not disclose the identity of the taxpayer or the tax return information itself. Section 7216(a) and § 301.7216-1 do not apply to B's disclosure of N's tax return information to A and A's use of the information in advising M and the Securities and Exchange Commission of the necessity for filing an amended statement. Section 7216(a) and § 301.7216-1 would apply to a disclosure of N's tax return information to M or to the Securities and Exchange Commission unless the disclosure is exempt from the application of section 7216(a) and § 301.7216-1 by reason of another provision of either this section or § 301.7216-3.

**Example 2.** A, a member of an accounting firm, is conducting an audit of M Corporation, and B, a member of the same accounting firm, prepares an income tax return for D, an officer of M. In the course of preparing the return, B obtains information from D indicating that D, pursuant to an arrangement with a supplier doing business with M, has been receiving from the supplier a percentage of the amounts that the supplier invoices to M. B discloses this information to A who, acting upon it, searches in the course of the audit for indications of a kickback scheme. As a result, A discovers information from audit sources that independently indicate the existence of a kickback scheme. Without revealing the tax return information A has received from B, A brings to the attention of officers of M the audit information indicating the existence of the kickback scheme. Section 7216(a) and § 301.7216-1 do not apply to B's disclosure of D's tax return information to A, A's use of D's information in the course of the audit, and A's disclosure to M of the audit information indicating the existence of the kickback scheme. Section 7216(a) and § 301.7216-1 would apply to a disclosure to M, or to any other person not an employee or member of the accounting firm, of D's tax return information furnished to B.

(i) **Corporate fiduciaries.** A trust company, trust department of a bank, or other corporate fiduciary that prepares a tax return for a taxpayer for whom it renders fiduciary, investment, or other custodial or management services may, unless the taxpayer directs otherwise--

(1) Disclose or use the taxpayer's tax return information in the ordinary course of rendering such services to or for the taxpayer; or

(2) Make the information available to the taxpayer's attorney, accountant, or investment advisor.

**(j) Disclosure to taxpayer's fiduciary.** If, after furnishing tax return information to a tax return preparer, the taxpayer dies or becomes incompetent, insolvent, or bankrupt, or the taxpayer's assets are placed in conservatorship or receivership, the tax return preparer may disclose the information to the duly appointed fiduciary of the taxpayer or his estate, or to the duly authorized agent of the fiduciary.

**(k) Disclosure or use of information in preparation or audit of State or local tax returns or assisting a taxpayer with foreign country tax obligations.** The provisions of paragraphs (c) and (d) of this section shall apply to the disclosure by any tax return preparer of any tax return information in the preparation of, or in connection with the preparation of, any tax return of the taxpayer under the law of any State or political subdivision thereof, of the District of Columbia, of any territory or possession of the United States, or of a country other than the United States. The provisions of section 7216(a) and § 301.7216-1 shall not apply to the use by any tax return preparer of any tax return information in the preparation of, or in connection with the preparation of, any tax return of the taxpayer under the law of any State or political subdivision thereof, of the District of Columbia, of any territory or possession of the United States, or of a country other than the United States. The provisions of section 7216(a) and § 301.7216-1 shall not apply to the disclosure or use by any tax return preparer of any tax return information in the audit of, or in connection with the audit of, any tax return of the taxpayer under the law of any State or political subdivision thereof, the District of Columbia, or any territory or possession of the United States.

**(l) Payment for tax preparation services.** A tax return preparer may use and disclose, without the taxpayer's written consent, tax return information that the taxpayer provides to the tax return preparer to pay for tax preparation services to the extent necessary to process or collect the payment. For example, if the taxpayer gives the tax return preparer a credit card to pay for tax preparation services, the tax return preparer may disclose the taxpayer's name, credit card number, credit card expiration date, and amount due for tax preparation services to the credit card company, as necessary, to process the payment. Any tax return information that the taxpayer did not give the tax return preparer for the purpose of making payment for tax preparation services may not be used or disclosed by the tax return preparer without the taxpayer's prior written consent, unless otherwise permitted under another provision of this section.

**(m) Retention of records.** A tax return preparer may retain tax return information of a taxpayer, including copies of tax returns, in paper or electronic format, prepared on the basis of the tax return information, and may use the information in connection with the preparation of other tax returns of the taxpayer or in connection with an examination by the Internal Revenue Service of any tax return or subsequent tax litigation relating to the tax return. The provisions of paragraph (n) of this section regarding the transfer of a taxpayer list also apply to the transfer of any records and related papers to which this paragraph applies.

**(n) Lists for solicitation of tax return preparation business.** (1) A tax return preparer, other than a person who is a tax return preparer solely because the person provides auxiliary services as defined in § 301.7216-1(b)(2)(iii), may compile and maintain a separate list containing solely items of tax return information. The following items of tax return information are permissible: The names, mailing addresses, email addresses, phone numbers, taxpayer entity classification (including "individual" or the specific type of business entity), and income tax return form number (for example, Form 1040-EZ) of taxpayers whose tax returns the tax return preparer has prepared or processed. The Internal Revenue Service may issue guidance, by publication in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii)(b) of this chapter), describing other types of information that may be

included in a list compiled and maintained pursuant to this paragraph. This list may be used by the compiler solely to contact the taxpayers on the list for the purpose of providing tax information and general business or economic information or analysis for educational purposes, or soliciting additional tax return preparation services. The list may not be used to solicit any service or product other than tax return preparation services. The compiler of the list may not transfer the taxpayer list, or any part thereof, to any other person unless the transfer takes place in conjunction with the sale or other disposition of the compiler's tax return preparation business. Due diligence conducted prior to a proposed sale of a compiler's tax return preparation business is in conjunction with the sale or other disposition of a compiler's tax return preparation business and will not constitute a transfer of the list if conducted pursuant to a written agreement that requires confidentiality of the tax return information disclosed and expressly prohibits the further disclosure or use of the tax return information for any purpose other than that related to the purchase of the tax return preparation business. A person who acquires a taxpayer list, or a part thereof, in conjunction with a sale or other disposition of a tax return preparation business falls under the provisions of this paragraph with respect to the list. The term list, as used in this paragraph (n), includes any record or system whereby the types of information expressly authorized for inclusion in a taxpayer list pursuant to the terms of this paragraph (n) are retained. The provisions of this paragraph (n) also apply to the transfer of any records and related papers to which this paragraph (n) applies.

**(2) Examples.** The following examples illustrate this paragraph (n):

**Example 1.** Preparer A is a tax return preparer as defined by § 301.7216-1(b)(2)(i)(A). Preparer A's office is located in southeast Pennsylvania, and Preparer A prepares federal and state income tax returns for taxpayers who live in Pennsylvania, New Jersey, Maryland, and Delaware. Preparer A maintains a list of taxpayer clients containing the information allowed by this paragraph (n). Preparer A provides quarterly state income tax information updates to his individual taxpayer clients by email or U.S. mail. To ensure that his clients only receive the information updates that are relevant to them, Preparer A uses his list to direct his outreach efforts towards the relevant clients by searching his list to filter it by zip code and income tax return form number (Form 1040 and corresponding state income tax return form number). Preparer A may use the list information in this manner without taxpayer consent because he is providing tax information for educational or informational purposes and is targeting clients based solely upon tax return information that is authorized by this paragraph (n) (by zip code, which is part of a taxpayer's address, and by income tax return form number). Without taxpayer consent, Preparer A also may deliver this information to his clients by email, U.S. mail, or other method of delivery that uses only information authorized by this paragraph (n).

**Example 2.** Preparer B is a tax return preparer as defined by § 301.7216-1(b)(2)(i)(A). Preparer B maintains a list of taxpayer clients containing the information allowed by this paragraph (n). Preparer B provides monthly federal income tax information updates in the form of a newsletter to all of her taxpayer clients by email or U.S. mail. When Preparer B hires a new employee who participates or assists in tax return preparation, she announces that hire in the newsletter for the month that follows the hiring. Each announcement includes a photograph of the new employee, the employee's name, the employee's telephone number, a brief listing of the employee's qualifications, and a brief listing of the employee's employment responsibilities. Preparer B may use the tax return information described in this paragraph (n) in this manner without taxpayer consent because she is providing tax information for educational or informational purposes to provide general federal income tax information updates. Preparer B may include the new employee announcements in the form described because this is considered tax information for informational purposes, provided the announcements do not contain solicitations for non-tax return preparation services. Without taxpayer consent, Preparer B also may deliver this information to her clients by email, U.S. mail, or other method of delivery that uses only information authorized by this paragraph (n).

**(o) Producing statistical information in connection with tax return preparation business. (1)** A tax return preparer may use tax return information, subject to the limitations specified in this paragraph (o), to produce a statistical compilation of data described in § 301.7216-1(b)(3)(i)(B). The purpose for and disclosure or use of the statistical compilation requiring data acquired during the tax return preparation process must relate directly to the internal management or support of the tax return preparer's tax return preparation business, or to bona fide research or public policy discussions concerning state or federal taxation. A tax return preparer may not disclose the statistical compilation, or any part thereof, to any other person unless

disclosure of the statistical compilation is anonymous as to taxpayer identity, does not disclose an aggregate figure containing data from fewer than ten tax returns, and is in direct support of the tax return preparer's tax return preparation business or of bona fide research or public policy discussions concerning state or federal taxation. A statistical compilation is anonymous as to taxpayer identity if it is in a form which cannot be associated with, or otherwise identify, directly or indirectly, a particular taxpayer. For purposes of this paragraph, marketing and advertising is in direct support of the tax return preparer's tax return preparation business provided the marketing and advertising is not false, misleading, or unduly influential. This paragraph, however, does not authorize the disclosure or use in marketing or advertising of any statistical compilations, or part thereof, that identify dollar amounts of refunds, credits, or deductions associated with tax returns, or percentages relating thereto, whether or not the data are statistical, averaged, aggregated, or anonymous. Disclosures made in support of fundraising activities conducted by volunteer return preparation programs and other organizations described in section 501(c) of the Internal Revenue Code (Code) in direct support of their tax return preparation businesses are not marketing and advertising under this paragraph. A tax return preparer who produces a statistical compilation of data described in § 301.7216-1(b)(3)(i)(B) may disclose the compilation to comply with financial accounting or regulatory reporting requirements whether or not the statistical compilation is anonymous as to taxpayer identity or discloses an aggregate figure containing data from fewer than ten tax returns.

(2) A tax return preparer may not sell or exchange for value a statistical compilation of data described in § 301.7216-1(b)(3)(i)(B), in whole or in part, except in conjunction with the transfer of assets made pursuant to the sale or other disposition of the tax return preparer's tax return preparation business. The provisions of paragraph (n) of this section regarding the transfer of a taxpayer list also apply to the transfer of any statistical compilations of data to which this paragraph applies. A person who acquires a statistical compilation, or a part thereof, pursuant to the operation of this paragraph (o) or in conjunction with a sale or other disposition of a tax return preparation business is subject to the provisions of this paragraph with respect to the compilation.

(3) **Examples.** The following examples illustrate this paragraph (o):

**Example 1.** Preparer A is a tax return preparer as defined by § 301.7216-1(b)(2)(i)(A). In 2009, A used tax return information to produce a statistical compilation of data for both internal management purposes and to support A's tax return preparation business. The statistical compilation included an aggregate figure containing the information that A prepared 32 S corporation tax returns in 2009. In 2010, A decided to embark upon a new marketing campaign emphasizing its experience preparing small business tax returns. In the campaign, A discloses the aggregate figure containing the number of S corporation tax returns prepared in 2009. A's disclosure does not include any information that can be associated with or identify any specific taxpayers. A may disclose the anonymous statistical compilation without taxpayer consent.

**Example 2.** Preparer B is a tax return preparer as defined by § 301.7216-1(b)(2)(i)(A). In 2010, in support of B's tax return preparation business, B wants to advertise that the average tax refund obtained for its clients in 2009 was \$2,800. B may not disclose this information because it contains a statistical compilation reflecting average refund amounts.

**Example 3.** Preparer C is a tax return preparer as defined by § 301.7216-1(b)(2)(i)(A) and is a volunteer income tax assistance program. In 2010, in support of C's tax return preparation business, C submits a grant application to a charitable foundation to fund C's operations providing free tax return preparation services to low- and moderate-income families. In support of C's request, C includes anonymous statistical data consisting of aggregated figures containing data from ten or more tax returns showing that, in 2009, C provided services to 500 taxpayers, that 95 percent of the taxpayer population served by C received the Earned Income Tax Credit (EITC), and that the average amount of the EITC received was \$3,300. Despite the fact that this information constitutes an average credit amount, C may disclose the information to the charitable foundation because disclosures made in support of fundraising activities conducted by volunteer income tax assistance programs and other organizations described in section 501(c) of the Code in direct support of their tax return preparation business are not considered marketing and advertising for purposes of § 301.7216-2(o)(1).

**Example 4.** Preparer D is a tax return preparer as defined by § 301.7216-1(b)(2)(i)(A). In December 2009, D produced an anonymous statistical compilation of tax return information obtained during the 2009 filing season. In 2010, D wants to disclose portions of the anonymous statistical compilation from aggregated figures containing data from ten or more tax returns in connection with the marketing of its financial advisory and asset planning services. D is required to receive taxpayer consent under § 301.7216-3 before disclosing the tax return information contained in the anonymous statistical compilation because the disclosure is not being made in support of D's tax return preparation business.

**(p) Disclosure or use of information for quality, peer, or conflict reviews.** (1) The provisions of section 7216(a) and § 301.7216-1 shall not apply to any disclosure for the purpose of a quality or peer review to the extent necessary to accomplish the review. A quality or peer review is a review that is undertaken to evaluate, monitor, and improve the quality and accuracy of a tax return preparer's tax preparation, accounting, or auditing services. A quality or peer review may be conducted only by attorneys, certified public accountants, enrolled agents, and enrolled actuaries who are eligible to practice before the Internal Revenue Service. See Department of the Treasury Circular 230, 31 CFR part 10. Tax return information may also be disclosed to persons who provide administrative or support services to an individual who is conducting a quality or peer review under this paragraph (p), but only to the extent necessary for the reviewer to conduct the review. Tax return information gathered in conducting a review may be used only for purposes of a review. No tax return information identifying a taxpayer may be disclosed in any evaluative reports or recommendations that may be accessible to any person other than the reviewer or the tax return preparer being reviewed. The tax return preparer being reviewed will maintain a record of the review, including the information reviewed and the identity of the persons conducting the review. After completion of the review, no documents containing information that may identify any taxpayer by name or identification number may be retained by a reviewer or by the reviewer's administrative or support personnel.

(2) The provisions of section 7216(a) and § 301.7216-1 shall not apply to any disclosure necessary to accomplish a conflict review. A conflict review is a review undertaken to comply with requirements established by any federal, state, or local law, agency, board or commission, or by a professional association ethics committee or board, to either identify, evaluate, or monitor actual or potential legal and ethical conflicts of interest that may arise when a tax return preparer is employed or acquired by another tax return preparer, or to identify, evaluate, or monitor actual or potential legal and ethical conflicts of interest that may arise when a tax return preparer is considering engaging a new client. Tax return information gathered in conducting a conflict review may be used only for purposes of a conflict review. No tax return information identifying a taxpayer may be disclosed in any evaluative reports or recommendations that may be accessible to any person other than those responsible for identifying, evaluating, or monitoring legal and ethical conflicts of interest. No tax return information identifying a taxpayer may be disclosed outside of the United States or a territory or possession of the United States unless the disclosing and receiving tax return preparers have procedures in place that are consistent with good business practices and designed to maintain the confidentiality of the disclosed tax return information.

(3) Any person (including administrative and support personnel) receiving tax return information in connection with a quality, peer, or conflict review is a tax return preparer for purposes of sections 7216(a) and 6713(a). Tax return information disclosed and used for purposes of a quality, peer, or conflict review shall not be disclosed or used for any other purpose.

**(q) Disclosure to report the commission of a crime.** The provisions of section 7216(a) and § 301.7216-1 shall not apply to the disclosure of any tax return information to the proper Federal, State, or local official in order, and to the extent necessary, to inform the official of activities that may constitute, or may have constituted, a violation of any criminal law or to assist the official in investigating or prosecuting a violation of criminal law. A disclosure made in the bona fide but mistaken belief that the activities constituted a violation of criminal law is not subject to section 7216(a) and § 301.7216-1.

(r) **Disclosure of tax return information due to a tax return preparer's incapacity or death.** In the event of incapacity or death of a tax return preparer, disclosure of tax return information may be made for the purpose of assisting the tax return preparer or his legal representative (or the representative of a deceased tax return preparer's estate) in operating the business. Any person receiving tax return information under the provisions of this paragraph (r) is a tax return preparer for purposes of sections 7216(a) and 6713(a).

(s) **Effective/applicability date.** Paragraphs (n), (o), and (p) of this section apply to disclosures or uses of tax return information occurring on or after December 28, 2012. All other paragraphs of this section apply to disclosures or uses of tax return information occurring on or after January 1, 2009.

### Credits

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AUTHORITY: 26 U.S.C. 7805.; Section 301.1474-1 also issued under 26 U.S.C. 1474(f).; Section 301.6011-2 also issued under 26 U.S.C. 6011(e).; Section 301.6011-3 also issued under 26 U.S.C. 6011.;; Section 301.6011-5 also issued under 26 U.S.C. 6011.;; Section 301.6011-6 also issued under 26 U.S.C. 6011(a).; Section 301.6011-7 also issued under 26 U.S.C. 6011(e).; Section 301.6033-4 also issued under 26 U.S.C. 6033.;; Section 301.6036-1 also issued under 26 U.S.C. 6036.;; Section 301.6037-2 also issued under 26 U.S.C. 6037.;; Section 301.6050M-1 also issued under 26 U.S.C. 6050M.;; Section 301.6061-1 also issued under 26 U.S.C. 6061.;; Section 301.6081-2 also issued under 26 U.S.C. 6081(a).; Section 301.6103(c)-1 also issued under 26 U.S.C. 6103(c).; Section 301.6103(j)(1)-1 also issued under 26 U.S.C. 6103(j)(1).; Section 301.6103(j)(1)-1T also issued under 26 U.S.C. 6103(j)(1).; Section 301.6103(j)(5)-1 also issued under 26 U.S.C. 6103(j)(5).; Section 301.6103(k)(6)-1 also issued under 26 U.S.C. 6103(k)(6).; Section 301.6103(k)(6)-1T also issued under 26 U.S.C. 6103(k)(6).; Section 301.6103(k)(9)-1 also issued under 26 U.S.C. 6103(k)(9) and 26 U.S.C. 6103(q).; Section 301.6103(l)-1 also issued under 26 U.S.C. 6103(q).; Section 301.6103(l)(14)-1 also issued under 26 U.S.C. 6103(l)(14).; Section 301.6103(m)-1 also issued under 26 U.S.C. 6103(q).; Section 301.6103(n)-1 also issued under 26 U.S.C. 6103(n).; Section 301.6103(n)-2 also issued under 26 U.S.C. 6103(n).; Section 301.6103(n)-2T also issued under 26 U.S.C. 6103(n).; Section 301.6103(p)(2)(B)-1 also issued under 26 U.S.C. 6103(p)(2).; Section 301.6103(p)(2)(B)-1T also issued under 26 U.S.C. 6103(p)(2).; Sections 301.6103(p)(4)-1 and 301.6103(p)(7)-1T also issued under 26 U.S.C. 6103(p)(4) and (7) and (q).; Section 301.6104(a)-6(d) is also issued under 5 U.S.C. 552.;; Section 301.6104(b)-1(d)(4) is also issued under 5 U.S.C. 552.;; Section 301.6104(d)-1(d)(3)(i) is also issued under 5 U.S.C. 552.;; Section 301.6104(d)-2 also issued under 26 U.S.C. 6104(d)(3).; Section 301.6104(d)-3 also issued under 26 U.S.C. 6104(d)(3).; Section 301.6104(d)-4 also issued under 26 U.S.C. 6104(e)(3).; Section 301.6104(d)-5 also issued under 26 U.S.C. 6104(e)(3).; Section 301.6109-1 also issued under 26 U.S.C. 6109 (a), (c), and (d).; Section 301.6109-3 also issued under 26 U.S.C. 6109.;; Section 301.6111-1T also issued under 26 U.S.C. 6111.;; Section 301.6111-2T also issued under 26 U.S.C. 6111(f)(4).; Section 301.6111-3 also issued under 26 U.S.C. 6111.;; Section 301.6111-3T also issued under 26 U.S.C. 6111.;; Section 301.6112-1T also issued under 26 U.S.C. 6112.;; Section 301.6114-1 also issued under 26 U.S.C. 6114.;; Section 301.6222(a)-1T also issued under 26 U.S.C. 6230(k).; Section 301.6222(a)-2T also issued under 26 U.S.C. 6230(k).; Section 301.6222(b)-1T also issued under 26 U.S.C. 6230(k).; Section 301.6222(b)-2T also issued under 26 U.S.C. 6230(k).; Section 301.6222(b)-3T also issued under 26 U.S.C. 6230 (i) and (k).

Section 301.6223(a)-1T also issued under 26 U.S.C. 6230(k).; Section 301.6223(a)-2T also issued under 26 U.S.C. 6230(k).; Section 301.6223(b)-1T also issued under 26 U.S.C. 6230 (i) and (k).; Section 301.6223(b)-2T also issued under 26 U.S.C. 6230(k).; Section 301.6223(c)-1T also issued under 26 U.S.C. 6223(c) and 6230 (i) and (k).; Section 301.6223(e)-1T also

issued under 26 U.S.C. 6230(k);; Section 301.6223(e)-2T also issued under 26 U.S.C. 6230 (i) and (k);; Section 301.6223(f)-1T also issued under 26 U.S.C. 6230(k);; Section 301.6223(g)-1T also issued under 26 U.S.C. 6223(g) and 6230 (i) and (k);; Section 301.6223(h)-1T also issued under 26 U.S.C. 6230 (i) and (k);; Section 301.6224(a)-1T also issued under 26 U.S.C. 6230(k);; Section 301.6224(b)-1T also issued under 26 U.S.C. 6230 (i) and (k);; Section 301.6224(c)-1T also issued under 26 U.S.C. 6230 (i) and (k);; Section 301.6224(c)-2T also issued under 26 U.S.C. 6230(k);; Section 301.6224(c)-3T also issued under 26 U.S.C. 6230 (i) and (k);; Section 301.6226(a)-1T also issued under 26 U.S.C. 6230(k);; Section 301.6226(b)-1T also issued under 26 U.S.C. 6230(k);; Section 301.6226(e)-1T also issued under 26 U.S.C. 6230(k);; Section 301.6226(f)-1T also issued under 26 U.S.C. 6230(k);; Section 301.6229(c)(2)-1 is also issued under 26 U.S.C. 6230(k);; Section 301.6229(c)(2)-1T is also issued under 26 U.S.C. § 6230(k);; Section 301.6231(a)(6)-1T also issued under 26 U.S.C. 6230(k);; Section 301.6231(a)(7)-1 also issued under 26 U.S.C. 6230 (i) and (k);; Section 301.6231(a)(7)-2 also issued under 26 U.S.C. 6230 (i) and (k);; Section 301.6231(a)(12)-1T also issued under 26 U.S.C. 6230(k) and 6231(a)(12);; Section 301.6231(c)-1 also issued under 26 U.S.C. 6231(c)(1) and (3);; Section 301.6231(c)-2 also issued under 26 U.S.C. 6231(c)(1) and (3);; Section 301.6231(c)-3T also issued under 26 U.S.C. 6230(k) and 6231(c);; Section 301.6231(c)-4T also issued under 26 U.S.C. 6230(k) and 6231(c);; Section 301.6231(c)-5T also issued under 26 U.S.C. 6230(k) and 6231(c);; Section 301.6231(c)-6T also issued under 26 U.S.C. 6230(k) and 6231(c);; Section 301.6231(c)-7T also issued under 26 U.S.C. 6230(k) and 6231(c);; Section 301.6231(c)-8T also issued under 26 U.S.C. 6230(k) and 6231(c);; Section 301.6231(d)-1T also issued under 26 U.S.C. 6230(k);; Section 301.6231(e)-1T also issued under 26 U.S.C. 6230(k);; Section 301.6231(e)-2T also issued under 26 U.S.C. 6230(k);; Section 301.6231(f)-1T also issued under 26 U.S.C. 6230 (i) and (k) and 6231(f);; Section 301.6233-1T also issued under 26 U.S.C. 6230(k) and 6233;; Section 301.6241-1T also issued under 26 U.S.C. 6241;; Section 301.6245-1T also issued under 26 U.S.C. 6245;; Section 301.6311-2 also issued under 26 U.S.C. 6311;; Section 301.6323(f)-(1)(c) also issued under 26 U.S.C. 6323(f)(3);; Section 301.6325-1T also issued under 26 U.S.C. 6326;; Section 301.6343-1 also issued under 26 U.S.C. 6343;; Section 301.6343-2 also issued under 26 U.S.C. 6343;; Section 301.6402-3 also issued under 95 Stat. 357 amending 88 Stat. 2351;; Section 301.6402-7 also issued under 26 U.S.C. 6402(i) and 6411(c);; Section 301.6404-2 also issued under 26 U.S.C. 6404;; Section 301.6404-3 also issued under 26 U.S.C. 6404(f)(3);; Section 301.6621-1 also issued under 26 U.S.C. 6230(k).

Section 301.6689-1T also issued under 26 U.S.C. 6689(a);; Section **301.7216-2**, paragraphs (o) and (p) also issued under 26 U.S.C. 7216(b)(3);; Section **301.7216-3T** also issued under 26 U.S.C. 7216;; Section 301.7502-1 also issued under 26 U.S.C. 7502;; Section 301.7502-2 also issued under 26 U.S.C. 7502;; Section 301.7507-1 also issued under 26 U.S.C. 597;; Section 301.7507-9 also issued under 26 U.S.C. 597;; Section 301.7508-1 also issued under 26 U.S.C. 7508(a)(1)(K);; Section 301.7508A-1 also issued under 26 U.S.C. 7508(a)(1)(K) and 7508A(a);; Section 301.7605-1 also issued under Section 6228(b) of the Technical and Miscellaneous Revenue Act of 1988;; Section 301.7623-1 also issued under 26 U.S.C. 7623;; Section 301.7624-1 also issued under 26 U.S.C. 7624;; Sections 301.7701(b)-1 through 301.7701(b)-9 also issued under 26 U.S.C. 7701(b)(11);; Section 301.7701(i)-1(g)(1) also issued under 26 U.S.C. 7701(i)(2)(D);; Section 301.7701(i)-4(b) also issued under 26 U.S.C. 7701(i)(3);; Section 301.9000-1 also issued under 5 U.S.C. 301 and 26 U.S.C. 6103(q) and 7804;; Section 301.9000-2 also issued under 5 U.S.C. 301 and 26 U.S.C. 6103(q) and 7804;; Section 301.9000-3 also issued under 5 U.S.C. 301 and 26 U.S.C. 6103(q) and 7804;; Section 301.9000-4 also issued under 5 U.S.C. 301 and 26 U.S.C. 6103(q) and 7804;; Section 301.9000-5 also issued under 5 U.S.C. 301 and 26 U.S.C. 6103(q) and 7804;; Section 301.9000-6 also issued under 5 U.S.C. 301 and 26 U.S.C. 6103(q) and 7804;; Section 301.9100-1T also issued under 26 U.S.C. 6081;; Section 301.9100-2T also issued under 26 U.S.C. 6081;; Section 301.9100-3T also issued under 26 U.S.C. 6081;; Section 301.9100-4T also issued under 26 U.S.C. 168(f)(8)(G);; Section 301.9100-7T also issued under 26 U.S.C. 42, 48, 56, 83, 141, 142, 143, 145, 147, 165, 168, 216, 263, 263A, 448, 453C, 468B, 469, 474, 585, 616, 617, 1059, 2632, 2652, 3121, 4982, 7701; and under the Tax Reform Act of 1986, 100 Stat. 2746, sections 203, 204, 243, 311, 646, 801, 806, 905, 1704, 1801, 1802, and 1804;; Section 301.9100-8 also issued under 26 U.S.C. 1(i)(7), 41(h), 42(b)(2)(A)(ii), 42(d)(3), 42(f)(1), 42(g)(3), 42(i)(2)(B), 42(j)(5)(B), 121(d)(9), 142(i)(2), 165(l), 168(b)(2), 219(g)(4), 245(a)(10), 263A(d)(1), 263A(d)(3)(B), 263A(h), 460(b)(3), 643(g)(2), 831(b)(2)(A), 835(a), 865(f), 865(g)(3), 865(h)(2), 904(g)(10), 2056(b)(7)(c)(ii), 2056A(d), 2523(f)(6)(B), 3127, and 7520(a); the Technical and Miscellaneous Revenue Act of 1988, 102 Stat. 3324 [So in original; probably should read "102 Stat. 3342"]., sections 1002(a)(23)(B), 1005(c)(11), 1006(d)(15), 1006(j)(1)(C), 1006(t)(18)(B), 1012(n)(3), 1014(c)(1), 1014(c)(2), 2004(j)(1), 2004(m)(5), 5012(e)(4), 6181(c)(2), and 6277; and under the Tax Reform Act of 1986, 100 Stat. 2746, section 905(a);; Sections 301.9100-9T, 301.9100-10T and 301.9100-11T also issued under 26 U.S.C. 1103 (g) and (h) and 6158(a);; Sections

301.9100-13T, 301.9100-14T and 301.9100-15T also issued under 26 U.S.C. 108(d)(8) and 1017(b)(3)(E).; Section 301.9100-16T also issued under 26 U.S.C. 463(d).

Notes of Decisions containing your search terms (0)

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Current through April 18, 2013; 78 FR 23456.

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# Appendix 8

Code of Federal Regulations  
Title 26. Internal Revenue  
Chapter I. Internal Revenue Service, Department of the Treasury  
Subchapter F. Procedure and Administration  
Part 301. Procedure and Administration (Refs & Annos)  
Crimes, Other Offenses, and Forfeitures  
Crimes  
General Provisions

26 C.F.R. § 301.7216-3, Treas. Reg. § 301.7216-3

§ 301.7216-3 Disclosure or use permitted only with the taxpayer's consent.

Effective: December 16, 2008  
Currentness

**(a) In general--(1) Taxpayer consent.** Unless section 7216 or § 301.7216-2 specifically authorizes the disclosure or use of tax return information, a tax return preparer may not disclose or use a taxpayer's tax return information prior to obtaining a written consent from the taxpayer, as described in this section. A tax return preparer may disclose or use tax return information as the taxpayer directs as long as the preparer obtains a written consent from the taxpayer as provided in this section. The consent must be knowing and voluntary. Except as provided in paragraph (a)(2) of this section, conditioning the provision of any services on the taxpayer's furnishing consent will make the consent involuntary, and the consent will not satisfy the requirements of this section.

**(2) Taxpayer consent to a tax return preparer furnishing tax return information to another tax return preparer.**

**(i)** A tax return preparer may condition its provision of preparation services upon a taxpayer's consenting to disclosure of the taxpayer's tax return information to another tax return preparer for the purpose of performing services that assist in the preparation of, or provide auxiliary services in connection with the preparation of, the tax return of the taxpayer.

**(ii) Example.** The application of this paragraph (a)(2) may be illustrated by the following example:

**Example.** Preparer P, who is located within the United States, is retained by Company C to provide tax return preparation services for employees of Company C. An employee of Company C, Employee E, works for C outside of the United States. To provide tax return preparation services for E, P requires the assistance of and needs to disclose E's tax return information to a tax return preparer who works for P's affiliate located in the country where E works. P may condition its provision of tax return preparation services upon E consenting to the disclosure of E's tax return information to the tax return preparer in the country where E works.

**(3) The form and contents of taxpayer consents--(i) In general.** All consents to disclose or use tax return information must satisfy the following requirements--

**(A)** A taxpayer's consent to a tax return preparer's disclosure or use of tax return information must include the name of the tax return preparer and the name of the taxpayer.

(B) If a taxpayer consents to a disclosure of tax return information, the consent must identify the intended purpose of the disclosure. Except as provided in § 301.7216-3(a)(3)(iii), if a taxpayer consents to a disclosure of tax return information, the consent must also identify the specific recipient (or recipients) of the tax return information. If the taxpayer consents to use of tax return information, the consent must describe the particular use authorized. For example, if the tax return preparer intends to use tax return information to generate solicitations for products or services other than tax return preparation, the consent must identify each specific type of product or service for which the tax return preparer may solicit use of the tax return information. Examples of products or services that must be identified include, but are not limited to, balance due loans, mortgage loans, mutual funds, individual retirement accounts, and life insurance.

(C) The consent must specify the tax return information to be disclosed or used by the return preparer.

(D) If a tax return preparer to whom the tax return information is to be disclosed is located outside of the United States, the taxpayer's consent under § 301.7216-3 prior to any disclosure is required. See § 301.7216-2(c) and (d).

(E) A consent to disclose or use tax return information must be signed and dated by the taxpayer.

**(ii) The form and contents of taxpayer consents with respect to taxpayers filing a return in the Form 1040 series--guidance describing additional requirements for taxpayer consents with respect to Form 1040 series filers.** The Secretary may issue guidance, by publication in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii)(b) of this chapter), describing additional requirements for tax return preparers regarding the format and content of consents to disclose and use tax return information with respect to taxpayers filing a return in the Form 1040 series, *e.g.*, Form 1040, Form 1040NR, Form 1040A, or Form 1040EZ.

**(iii) The form and contents of taxpayer consents with respect to all other taxpayers.** A consent to disclose or use tax return information with respect to a taxpayer not filing a return in the Form 1040 series may be in any format, including an engagement letter to a client, as long as the consent complies with the requirements of § 301.7216-3(a)(3)(i). Additionally, the requirements of § 301.7216-3(c)(1) are inapplicable to consents to disclose or use tax return information with respect to taxpayers not filing a return in the Form 1040 series. Solely for purposes of a consent issued under § 301.7216-3(a)(3)(iii), in lieu of identifying specific recipients of an intended disclosure under § 301.7216-3(a)(3)(i)(B), a consent may allow disclosure to a descriptive class of entities engaged by a taxpayer or the taxpayer's affiliate for purposes of services in connection with the preparation of tax returns, audited financial statements, or other financial statements or financial information as required by a government authority, municipality or regulatory body.

**(iv) Examples.** The application of § 301.7216-3(a)(3)(iii) may be illustrated by the following examples:

**Example 1.** Consistent with applicable legal and ethical responsibilities, Preparer Z sends its client, a corporation, Taxpayer C, an engagement letter. Part of the engagement letter requests the consent of Taxpayer C for the purpose of disclosing tax return information to an investment banking firm to assist the investment banking firm in securing long term financing for Taxpayer C. The engagement letter includes language and information that meets the requirements of § 301.7216-3(a)(3)(i), including: (I) Preparer Z's name, Taxpayer C's name, and a signature and date line for Taxpayer C; and (II) a statement that "Taxpayer C authorizes Preparer Z to disclose the portions of Taxpayer C's 2009 tax return information to the firm retained by Taxpayer C necessary for the purposes of assisting Taxpayer C secure long term financing." The engagement letter satisfies the requirements of § 301.7216-3(a)(3) for the disclosure of the information provided therein for the specific purpose stated.

**Example 2.** Consistent with applicable legal and ethical responsibilities, Preparer N sends its client, a corporation, Taxpayer D, an engagement letter. Part of the engagement letter requests the consent of Taxpayer D for the purpose of disclosing tax return information to Preparer N's affiliated firms located outside of the United States for the purposes of preparation of Taxpayer D's 2009 tax return". The engagement letter includes language and information that meets the requirements of § 301.7216-3(a)(3) (i), including: (I) Preparer N's name, Taxpayer D's name, and a signature and date line for Taxpayer D; (II) a statement that "Taxpayer D authorizes Preparer N to disclose Taxpayer D's 2009 tax return information to Preparer N's affiliates located outside of the United States for the purposes of assisting Preparer N prepare Taxpayer D's 2009 tax return"; and (III) a statement that, in providing consent, Taxpayer D acknowledges that its tax return information for 2009 will be disclosed to tax return preparers located abroad. The engagement letter satisfies the requirements of § 301.7216-3(a)(3) for the disclosure of the information provided therein for the specific purpose stated.

**(b) Timing requirements and limitations--(1) No retroactive consent.** A taxpayer must provide written consent before a tax return preparer discloses or uses the taxpayer's tax return information.

**(2) Time limitations on requesting consent in solicitation context.** A tax return preparer may not request a taxpayer's consent to disclose or use tax return information for purposes of solicitation of business unrelated to tax return preparation after the tax return preparer provides a completed tax return to the taxpayer for signature.

**(3) No requests for consent after an unsuccessful request.** With regard to tax return information for each income tax return that a tax return preparer prepares, if a taxpayer declines a request for consent to the disclosure or use of tax return information for purposes of solicitation of business unrelated to tax return preparation, the tax return preparer may not solicit from the taxpayer another consent for a purpose substantially similar to that of the rejected request.

**(4) No consent to the disclosure of a taxpayer's social security number to a return preparer outside of the United States with respect to a taxpayer filing a return in the Form 1040 Series--(i) In general.** Except as provided in paragraph (b)(4)(ii) of this section, a tax return preparer located within the United States, including any territory or possession of the United States, may not obtain consent to disclose the taxpayer's social security number (SSN) with respect to a taxpayer filing a return in the Form 1040 Series, for example, Form 1040, Form 1040NR, Form 1040A, or Form 1040EZ, to a tax return preparer located outside of the United States or any territory or possession of the United States. Thus, if a tax return preparer located within the United States (including any territory or possession of the United States) obtains consent from an individual taxpayer to disclose tax return information to another tax return preparer located outside of the United States, as provided under §§ 301.7216-2(c) and 301.7216-2(d), the tax return preparer located in the United States may not disclose the taxpayer's SSN, and the tax return preparer must redact or otherwise mask the taxpayer's SSN before the tax return information is disclosed outside of the United States. If a tax return preparer located within the United States initially receives or obtains a taxpayer's SSN from another tax return preparer located outside of the United States, however, the tax return preparer within the United States may, without consent, retransmit the taxpayer's SSN to the tax return preparer located outside the United States that initially provided the SSN to the tax return preparer located within the United States. For purposes of this section, a tax return preparer located outside of the United States does not include a tax return preparer who is continuously and regularly employed in the United States or any territory or possession of the United States and who is in a temporary travel status outside of the United States.

**(ii) Exception.** A tax return preparer located within the United States, including any territory or possession of the United States, may obtain consent to disclose the taxpayer's SSN to a tax return preparer located outside of the United States or any territory or possession of the United States only if the tax return preparer within the United States discloses the SSN to a tax return preparer outside of the United States through the use of an adequate data protection safeguard as defined

by the Secretary in guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2)(ii)(b) of this chapter) and verifies the maintenance of the adequate data protection safeguards in the request for the taxpayer's consent pursuant to the specifications described by the Secretary in guidance published in the Internal Revenue Bulletin.

**(5) Duration of consent.** A consent document may specify the duration of the taxpayer's consent to the disclosure or use of tax return information. If a consent agreed to by the taxpayer does not specify the duration of the consent, the consent to the disclosure or use of tax return information will be effective for a period of one year from the date the taxpayer signed the consent.

**(c) Special rules--(1) Multiple disclosures within a single consent form or multiple uses within a single consent form.** A taxpayer may consent to multiple uses within the same written document, or multiple disclosures within the same written document. A single written document, however, cannot authorize both uses and disclosures; rather one written document must authorize the uses and another separate written document must authorize the disclosures. Furthermore, a consent that authorizes multiple disclosures or multiple uses must specifically and separately identify each disclosure or use. See § 301.7216-3(a)(3)(iii) for an exception to this rule for certain taxpayers.

**(2) Disclosure of entire return.** A consent may authorize the disclosure of all information contained within a return. A consent authorizing the disclosure of an entire return must provide that the taxpayer has the ability to request a more limited disclosure of tax return information as the taxpayer may direct.

**(3) Copy of consent must be provided to taxpayer.** The tax return preparer must provide a copy of the executed consent to the taxpayer at the time of execution. The requirements of this paragraph (c)(3) may also be satisfied by giving the taxpayer the opportunity, at the time of executing the consent, to print the completed consent or save it in electronic form.

**(d) Effective/applicability date.** This section applies to disclosures or uses of tax return information occurring on or after January 1, 2009.

#### Credits

[T.D. 7310, 39 FR 11540, March 29, 1974; T.D. 9375, 73 FR 1073, Jan. 7, 2008; T.D. 9409, 73 FR 37806, July 2, 2008; T.D. 9437, 73 FR 76217, Dec. 16, 2008]

SOURCE: 32 FR 15241, Nov. 3, 1967; T.D. 9610, 78 FR 5994, Jan. 28, 2013, unless otherwise noted.

AUTHORITY: 26 U.S.C. 7805.; Section 301.1474-1 also issued under 26 U.S.C. 1474(f).; Section 301.6011-2 also issued under 26 U.S.C. 6011(e).; Section 301.6011-3 also issued under 26 U.S.C. 6011.; Section 301.6011-5 also issued under 26 U.S.C. 6011.; Section 301.6011-6 also issued under 26 U.S.C. 6011(a).; Section 301.6011-7 also issued under 26 U.S.C. 6011(e).; Section 301.6033-4 also issued under 26 U.S.C. 6033.; Section 301.6036-1 also issued under 26 U.S.C. 6036.; Section 301.6037-2 also issued under 26 U.S.C. 6037.; Section 301.6050M-1 also issued under 26 U.S.C. 6050M.; Section 301.6061-1 also issued under 26 U.S.C. 6061.; Section 301.6081-2 also issued under 26 U.S.C. 6081(a).; Section 301.6103(c)-1 also issued under 26 U.S.C. 6103(c).; Section 301.6103(j)(1)-1 also issued under 26 U.S.C. 6103(j)(1).; Section 301.6103(j)(1)-1T also issued under 26 U.S.C. 6103(j)(1).; Section 301.6103(j)(5)-1 also issued under 26 U.S.C. 6103(j)(5).; Section 301.6103(k)(6)-1 also issued under 26 U.S.C. 6103(k)(6).; Section 301.6103(k)(6)-1T also issued under 26 U.S.C. 6103(k)(6).; Section 301.6103(k)(9)-1 also issued under 26 U.S.C. 6103(k)(9) and 26 U.S.C. 6103(q).; Section 301.6103(l)-1 also issued under 26 U.S.C. 6103(q).; Section 301.6103(l)(14)-1 also issued under 26 U.S.C. 6103(l)(14).; Section 301.6103(m)-1 also issued under 26 U.S.C. 6103(q).; Section 301.6103(n)-1 also issued under 26 U.S.C. 6103(n).; Section 301.6103(n)-2 also issued under 26

U.S.C. 6103(n); Section 301.6103(n)-2 also issued under 26 U.S.C. 6103(q); Section 301.6103(n)-2T also issued under 26 U.S.C. 6103(n); Section 301.6103(p)(2)(B)-1 also issued under 26 U.S.C. 6103(p)(2); Section 301.6103(p)(2)(B)-1T also issued under 26 U.S.C. 6103(p)(2); Sections 301.6103(p)(4)-1 and 301.6103(p)(7)-1T also issued under 26 U.S.C. 6103(p)(4) and (7) and (q); Section 301.6104(a)-6(d) is also issued under 5 U.S.C. 552; Section 301.6104(b)-1(d)(4) is also issued under 5 U.S.C. 552; Section 301.6104(d)-1(d)(3)(i) is also issued under 5 U.S.C. 552; Section 301.6104(d)-2 also issued under 26 U.S.C. 6104(d)(3); Section 301.6104(d)-3 also issued under 26 U.S.C. 6104(d)(3); Section 301.6104(d)-4 also issued under 26 U.S.C. 6104(e)(3); Section 301.6104(d)-5 also issued under 26 U.S.C. 6104(e)(3); Section 301.6109-1 also issued under 26 U.S.C. 6109 (a), (c), and (d); Section 301.6109-3 also issued under 26 U.S.C. 6109; Section 301.6111-1T also issued under 26 U.S.C. 6111; Section 301.6111-2T also issued under 26 U.S.C. 6111(f)(4); Section 301.6111-3 also issued under 26 U.S.C. 6111; Section 301.6111-3T also issued under 26 U.S.C. 6111; Section 301.6112-1T also issued under 26 U.S.C. 6112; Section 301.6114-1 also issued under 26 U.S.C. 6114; Section 301.6222(a)-1T also issued under 26 U.S.C. 6230(k); Section 301.6222(a)-2T also issued under 26 U.S.C. 6230(k); Section 301.6222(b)-1T also issued under 26 U.S.C. 6230(k); Section 301.6222(b)-2T also issued under 26 U.S.C. 6230(k); Section 301.6222(b)-3T also issued under 26 U.S.C. 6230 (i) and (k).

Section 301.6223(a)-1T also issued under 26 U.S.C. 6230(k); Section 301.6223(a)-2T also issued under 26 U.S.C. 6230(k); Section 301.6223(b)-1T also issued under 26 U.S.C. 6230 (i) and (k); Section 301.6223(b)-2T also issued under 26 U.S.C. 6230(k); Section 301.6223(c)-1T also issued under 26 U.S.C. 6223(c) and 6230 (i) and (k); Section 301.6223(e)-1T also issued under 26 U.S.C. 6230(k); Section 301.6223(e)-2T also issued under 26 U.S.C. 6230 (i) and (k); Section 301.6223(f)-1T also issued under 26 U.S.C. 6230(k); Section 301.6223(g)-1T also issued under 26 U.S.C. 6223(g) and 6230 (i) and (k); Section 301.6223(h)-1T also issued under 26 U.S.C. 6230 (i) and (k); Section 301.6224(a)-1T also issued under 26 U.S.C. 6230(k); Section 301.6224(b)-1T also issued under 26 U.S.C. 6230 (i) and (k); Section 301.6224(c)-1T also issued under 26 U.S.C. 6230 (i) and (k); Section 301.6224(c)-2T also issued under 26 U.S.C. 6230(k); Section 301.6224(c)-3T also issued under 26 U.S.C. 6230 (i) and (k); Section 301.6226(a)-1T also issued under 26 U.S.C. 6230(k); Section 301.6226(b)-1T also issued under 26 U.S.C. 6230(k); Section 301.6226(e)-1T also issued under 26 U.S.C. 6230(k); Section 301.6226(f)-1T also issued under 26 U.S.C. 6230(k); Section 301.6229(c)(2)-1 is also issued under 26 U.S.C. 6230(k); Section 301.6229(c)(2)-1T is also issued under 26 U.S.C. § 6230(k); Section 301.6231(a)(6)-1T also issued under 26 U.S.C. 6230(k); Section 301.6231(a)(7)-1 also issued under 26 U.S.C. 6230 (i) and (k); Section 301.6231(a)(7)-2 also issued under 26 U.S.C. 6230 (i) and (k); Section 301.6231(a)(12)-1T also issued under 26 U.S.C. 6230(k) and 6231(a)(12); Section 301.6231(c)-1 also issued under 26 U.S.C. 6231(c)(1) and (3); Section 301.6231(c)-2 also issued under 26 U.S.C. 6231(c)(1) and (3); Section 301.6231(c)-3T also issued under 26 U.S.C. 6230(k) and 6231(c); Section 301.6231(c)-4T also issued under 26 U.S.C. 6230(k) and 6231(c); Section 301.6231(c)-5T also issued under 26 U.S.C. 6230(k) and 6231(c); Section 301.6231(c)-6T also issued under 26 U.S.C. 6230(k) and 6231(c); Section 301.6231(c)-7T also issued under 26 U.S.C. 6230(k) and 6231(c); Section 301.6231(c)-8T also issued under 26 U.S.C. 6230(k) and 6231(c); Section 301.6231(d)-1T also issued under 26 U.S.C. 6230(k); Section 301.6231(e)-1T also issued under 26 U.S.C. 6230(k); Section 301.6231(e)-2T also issued under 26 U.S.C. 6230(k); Section 301.6231(f)-1T also issued under 26 U.S.C. 6230 (i) and (k) and 6231(f); Section 301.6233-1T also issued under 26 U.S.C. 6230(k) and 6233; Section 301.6241-1T also issued under 26 U.S.C. 6241; Section 301.6245-1T also issued under 26 U.S.C. 6245; Section 301.6311-2 also issued under 26 U.S.C. 6311; Section 301.6323(f)-(1)(c) also issued under 26 U.S.C. 6323(f)(3); Section 301.6325-1T also issued under 26 U.S.C. 6326; Section 301.6343-1 also issued under 26 U.S.C. 6343; Section 301.6343-2 also issued under 26 U.S.C. 6343; Section 301.6402-3 also issued under 95 Stat. 357 amending 88 Stat. 2351; Section 301.6402-7 also issued under 26 U.S.C. 6402(i) and 6411(c); Section 301.6404-2 also issued under 26 U.S.C. 6404; Section 301.6404-3 also issued under 26 U.S.C. 6404(f)(3); Section 301.6621-1 also issued under 26 U.S.C. 6230(k).

Section 301.6689-1T also issued under 26 U.S.C. 6689(a); Section 301.7216-2, paragraphs (o) and (p) also issued under 26 U.S.C. 7216(b)(3); Section 301.7216-3T also issued under 26 U.S.C. 7216; Section 301.7502-1 also issued under 26 U.S.C. 7502; Section 301.7502-2 also issued under 26 U.S.C. 7502; Section 301.7507-1 also issued under 26 U.S.C. 597; Section 301.7507-9 also issued under 26 U.S.C. 597; Section 301.7508-1 also issued under 26 U.S.C. 7508(a)(1)(K); Section 301.7508A-1 also issued under 26 U.S.C. 7508(a)(1)(K) and 7508A(a); Section 301.7605-1 also issued under Section 6228(b) of the Technical and Miscellaneous Revenue Act of 1988; Section 301.7623-1 also issued under 26 U.S.C. 7623; Section 301.7624-1 also issued under 26 U.S.C. 7624; Sections 301.7701(b)-1 through 301.7701(b)-9 also issued under 26 U.S.C.

7701(b)(11).; Section 301.7701(i)-1(g)(1) also issued under 26 U.S.C. 7701(i)(2)(D).; Section 301.7701(i)-4(b) also issued under 26 U.S.C. 7701(i)(3).; Section 301.9000-1 also issued under 5 U.S.C. 301 and 26 U.S.C. 6103(q) and 7804. ; Section 301.9000-2 also issued under 5 U.S.C. 301 and 26 U.S.C. 6103(q) and 7804. ; Section 301.9000-3 also issued under 5 U.S.C. 301 and 26 U.S.C. 6103(q) and 7804. ; Section 301.9000-4 also issued under 5 U.S.C. 301 and 26 U.S.C. 6103(q) and 7804. ; Section 301.9000-5 also issued under 5 U.S.C. 301 and 26 U.S.C. 6103(q) and 7804. ; Section 301.9000-6 also issued under 5 U.S.C. 301 and 26 U.S.C. 6103(q) and 7804. ; Section 301.9100-1T also issued under 26 U.S.C. 6081. ; Section 301.9100-2T also issued under 26 U.S.C. 6081. ; Section 301.9100-3T also issued under 26 U.S.C. 6081. ; Section 301.9100-4T also issued under 26 U.S.C. 168(f)(8)(G).; Section 301.9100-7T also issued under 26 U.S.C. 42, 48, 56, 83, 141, 142, 143, 145, 147, 165, 168, 216, 263, 263A, 448, 453C, 468B, 469, 474, 585, 616, 617, 1059, 2632, 2652, 3121, 4982, 7701; and under the Tax Reform Act of 1986, 100 Stat. 2746, sections 203, 204, 243, 311, 646, 801, 806, 905, 1704, 1801, 1802, and 1804. ; Section 301.9100-8 also issued under 26 U.S.C. 1(i)(7), 41(h), 42(b)(2)(A)(ii), 42(d)(3), 42(f)(1), 42(g)(3), 42(i)(2)(B), 42(j)(5)(B), 121(d)(9), 142(i)(2), 165(l), 168(b)(2), 219(g)(4), 245(a)(10), 263A(d)(1), 263A(d)(3)(B), 263A(h), 460(b)(3), 643(g)(2), 831(b)(2)(A), 835(a), 865(f), 865(g)(3), 865(h)(2), 904(g)(10), 2056(b)(7)(c)(ii), 2056A(d), 2523(f)(6)(B), 3127, and 7520(a); the Technical and Miscellaneous Revenue Act of 1988, 102 Stat. 3324 [So in original; probably should read "102 Stat. 3342".], sections 1002(a)(23)(B), 1005(c)(11), 1006(d)(15), 1006(j)(1)(C), 1006(t)(18)(B), 1012(n)(3), 1014(c)(1), 1014(c)(2), 2004(j)(1), 2004(m)(5), 5012(e)(4), 6181(c)(2), and 6277; and under the Tax Reform Act of 1986, 100 Stat. 2746, section 905(a).; Sections 301.9100-9T, 301.9100-10T and 301.9100-11T also issued under 26 U.S.C. 1103 (g) and (h) and 6158(a).; Sections 301.9100-13T, 301.9100-14T and 301.9100-15T also issued under 26 U.S.C. 108(d)(8) and 1017(b)(3)(E).; Section 301.9100-16T also issued under 26 U.S.C. 463(d).

Current through April 18, 2013; 78 FR 23456.

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# Appendix 9

United States Code Annotated

Title 26. Internal Revenue Code (Refs & Annos)

Subtitle F. Procedure and Administration (Refs & Annos)

Chapter 68. Additions to the Tax, Additional Amounts, and Assessable Penalties

Subchapter B. Assessable Penalties

Part I. General Provisions

26 U.S.C.A. § 6713

§ 6713. Disclosure or use of information by preparers of returns

Currentness

**(a) Imposition of penalty.**--If any person who is engaged in the business of preparing, or providing services in connection with the preparation of, returns of tax imposed by chapter 1, or any person who for compensation prepares any such return for any other person, and who--

(1) discloses any information furnished to him for, or in connection with, the preparation of any such return, or

(2) uses any such information for any purpose other than to prepare, or assist in preparing, any such return,

shall pay a penalty of \$250 for each such disclosure or use, but the total amount imposed under this subsection on such a person for any calendar year shall not exceed \$10,000.

**(b) Exceptions.**--The rules of section 7216(b) shall apply for purposes of this section.

**(c) Deficiency procedures not to apply.**--Subchapter B of chapter 63 (relating to deficiency procedures for income, estate, gift, and certain excise taxes) shall not apply in respect of the assessment or collection of any penalty imposed by this section.

**CREDIT(S)**

(Added Pub.L. 100-647, Title VI, § 6242(a), Nov. 10, 1988, 102 Stat. 3749, § 6712, and renumbered § 6713, Pub.L. 101-239, Title VII, § 7816(v)(1), Dec. 19, 1989, 103 Stat. 2423.)

26 U.S.C.A. § 6713, 26 USCA § 6713

Current through P.L. 113-36 approved 9-18-13

# Appendix 10

Code of Federal Regulations

Title 31. Money and Finance: Treasury

Subtitle A. Office of the Secretary of the Treasury

Part 10. Practice Before the Internal Revenue Service (Refs & Annos)

Subpart C. Sanctions for Violation of the Regulations (Refs & Annos)

31 C.F.R. § 10.51

§ 10.51 Incompetence and disreputable conduct.

Effective: August 2, 2011

Currentness

(a) **Incompetence and disreputable conduct.** Incompetence and disreputable conduct for which a practitioner may be sanctioned under § 10.50 includes, but is not limited to--

(1) Conviction of any criminal offense under the Federal tax laws.

(2) Conviction of any criminal offense involving dishonesty or breach of trust.

(3) Conviction of any felony under Federal or State law for which the conduct involved renders the practitioner unfit to practice before the Internal Revenue Service.

(4) Giving false or misleading information, or participating in any way in the giving of false or misleading information to the Department of the Treasury or any officer or employee thereof, or to any tribunal authorized to pass upon Federal tax matters, in connection with any matter pending or likely to be pending before them, knowing the information to be false or misleading. Facts or other matters contained in testimony, Federal tax returns, financial statements, applications for enrollment, affidavits, declarations, and any other document or statement, written or oral, are included in the term "information."

(5) Solicitation of employment as prohibited under § 10.30, the use of false or misleading representations with intent to deceive a client or prospective client in order to procure employment, or intimating that the practitioner is able improperly to obtain special consideration or action from the Internal Revenue Service or any officer or employee thereof.

(6) Willfully failing to make a Federal tax return in violation of the Federal tax laws, or willfully evading, attempting to evade, or participating in any way in evading or attempting to evade any assessment or payment of any Federal tax.

(7) Willfully assisting, counseling, encouraging a client or prospective client in violating, or suggesting to a client or prospective client to violate, any Federal tax law, or knowingly counseling or suggesting to a client or prospective client an illegal plan to evade Federal taxes or payment thereof.

(8) Misappropriation of, or failure properly or promptly to remit, funds received from a client for the purpose of payment of taxes or other obligations due the United States.

(9) Directly or indirectly attempting to influence, or offering or agreeing to attempt to influence, the official action of any officer or employee of the Internal Revenue Service by the use of threats, false accusations, duress or coercion, by the offer of any special inducement or promise of an advantage, or by the bestowing of any gift, favor or thing of value.

(10) Disbarment or suspension from practice as an attorney, certified public accountant, public accountant or actuary by any duly constituted authority of any State, territory, or possession of the United States, including a Commonwealth, or the District of Columbia, any Federal court of record or any Federal agency, body or board.

(11) Knowingly aiding and abetting another person to practice before the Internal Revenue Service during a period of suspension, disbarment or ineligibility of such other person.

(12) Contemptuous conduct in connection with practice before the Internal Revenue Service, including the use of abusive language, making false accusations or statements, knowing them to be false or circulating or publishing malicious or libelous matter.

(13) Giving a false opinion, knowingly, recklessly, or through gross incompetence, including an opinion which is intentionally or recklessly misleading, or engaging in a pattern of providing incompetent opinions on questions arising under the Federal tax laws. False opinions described in this paragraph (a)(13) include those which reflect or result from a knowing misstatement of fact or law, from an assertion of a position known to be unwarranted under existing law, from counseling or assisting in conduct known to be illegal or fraudulent, from concealing matters required by law to be revealed, or from consciously disregarding information indicating that material facts expressed in the opinion or offering material are false or misleading. For purposes of this paragraph (a)(13), reckless conduct is a highly unreasonable omission or misrepresentation involving an extreme departure from the standards of ordinary care that a practitioner should observe under the circumstances. A pattern of conduct is a factor that will be taken into account in determining whether a practitioner acted knowingly, recklessly, or through gross incompetence. Gross incompetence includes conduct that reflects gross indifference, preparation which is grossly inadequate under the circumstances, and a consistent failure to perform obligations to the client.

(14) Willfully failing to sign a tax return prepared by the practitioner when the practitioner's signature is required by the Federal tax laws unless the failure is due to reasonable cause and not due to willful neglect.

(15) Willfully disclosing or otherwise using a tax return or tax return information in a manner not authorized by the Internal Revenue Code, contrary to the order of a court of competent jurisdiction, or contrary to the order of an administrative law judge in a proceeding instituted under § 10.60.

(16) Willfully failing to file on magnetic or other electronic media a tax return prepared by the practitioner when the practitioner is required to do so by the Federal tax laws unless the failure is due to reasonable cause and not due to willful neglect.

(17) Willfully preparing all or substantially all of, or signing, a tax return or claim for refund when the practitioner does not possess a current or otherwise valid preparer tax identification number or other prescribed identifying number.

(18) Willfully representing a taxpayer before an officer or employee of the Internal Revenue Service unless the practitioner is authorized to do so pursuant to this part.

(b) **Effective/applicability date.** This section is applicable beginning August 2, 2011.

**Credits**

[Dept. Circ. 230, Rev., 31 FR 10773, Aug. 13, 1966, as amended at 35 FR 13205, Aug. 19, 1970; 42 FR 38353, July 28, 1977; 44 FR 4946, Jan. 24, 1979; 49 FR 6723, Feb. 23, 1984; 57 FR 41095, Sept. 9, 1992; 59 FR 31528, June 20, 1994; 67 FR 48774, July 26, 2002; T.D. 9359, 72 FR 54550, Sept. 26, 2007; T.D. 9527, 76 FR 32308, June 3, 2011]

SOURCE: Department Circular 230, Revised, 31 FR 10773, Aug. 13, 1966; 67 FR 48774, July 26, 2002; 69 FR 75841, Dec. 20, 2004; T.D. 9527, 76 FR 32300, June 3, 2011, unless otherwise noted.

AUTHORITY: Sec. 3, 23 Stat. 258, secs. 2–12, 60 Stat. 237 et seq.; 5 U.S.C. 301, 500, 551–559; 31 U.S.C. 321; 31 U.S.C. 330; Reorg. Plan No. 26 of 1950, 15 FR 4935, 64 Stat. 1280, 3 CFR, 1949–1953 Comp., p. 1017.

Notes of Decisions (32)

Current through April 18, 2013; 78 FR 23456.

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# Appendix 11

Code of Federal Regulations

Title 31. Money and Finance: Treasury

Subtitle A. Office of the Secretary of the Treasury

Part 10. Practice Before the Internal Revenue Service (Refs & Annos)

Subpart C. Sanctions for Violation of the Regulations (Refs & Annos)

31 C.F.R. § 10.50

§ 10.50 Sanctions.

Effective: August 2, 2011

Currentness

**(a) Authority to censure, suspend, or disbar.** The Secretary of the Treasury, or delegate, after notice and an opportunity for a proceeding, may censure, suspend, or disbar any practitioner from practice before the Internal Revenue Service if the practitioner is shown to be incompetent or disreputable (within the meaning of § 10.51), fails to comply with any regulation in this part (under the prohibited conduct standards of § 10.52), or with intent to defraud, willfully and knowingly misleads or threatens a client or prospective client. Censure is a public reprimand.

**(b) Authority to disqualify.** The Secretary of the Treasury, or delegate, after due notice and opportunity for hearing, may disqualify any appraiser for a violation of these rules as applicable to appraisers.

**(1)** If any appraiser is disqualified pursuant to this subpart C, the appraiser is barred from presenting evidence or testimony in any administrative proceeding before the Department of Treasury or the Internal Revenue Service, unless and until authorized to do so by the Internal Revenue Service pursuant to § 10.81, regardless of whether the evidence or testimony would pertain to an appraisal made prior to or after the effective date of disqualification.

**(2)** Any appraisal made by a disqualified appraiser after the effective date of disqualification will not have any probative effect in any administrative proceeding before the Department of the Treasury or the Internal Revenue Service. An appraisal otherwise barred from admission into evidence pursuant to this section may be admitted into evidence solely for the purpose of determining the taxpayer's reliance in good faith on such appraisal.

**(c) Authority to impose monetary penalty--(1) In general.** **(i)** The Secretary of the Treasury, or delegate, after notice and an opportunity for a proceeding, may impose a monetary penalty on any practitioner who engages in conduct subject to sanction under paragraph (a) of this section.

**(ii)** If the practitioner described in paragraph (c)(1)(i) of this section was acting on behalf of an employer or any firm or other entity in connection with the conduct giving rise to the penalty, the Secretary of the Treasury, or delegate, may impose a monetary penalty on the employer, firm, or entity if it knew, or reasonably should have known, of such conduct.

**(2) Amount of penalty.** The amount of the penalty shall not exceed the gross income derived (or to be derived) from the conduct giving rise to the penalty.

**(3) Coordination with other sanctions.** Subject to paragraph (c)(2) of this section--

(i) Any monetary penalty imposed on a practitioner under this paragraph (c) may be in addition to or in lieu of any suspension, disbarment or censure and may be in addition to a penalty imposed on an employer, firm or other entity under paragraph (c)(1)(ii) of this section.

(ii) Any monetary penalty imposed on an employer, firm or other entity may be in addition to or in lieu of penalties imposed under paragraph (c)(1)(i) of this section.

**(d) Authority to accept a practitioner's consent to sanction.** The Internal Revenue Service may accept a practitioner's offer of consent to be sanctioned under § 10.50 in lieu of instituting or continuing a proceeding under § 10.60(a).

**(e) Sanctions to be imposed.** The sanctions imposed by this section shall take into account all relevant facts and circumstances.

**(f) Effective/applicability date.** This section is applicable to conduct occurring on or after August 2, 2011, except that paragraphs (a), (b)(2), and (e) apply to conduct occurring on or after September 26, 2007, and paragraph (c) applies to prohibited conduct that occurs after October 22, 2004.

#### **Credits**

[31 FR 10773, Aug. 13, 1966, as amended at 35 FR 13205, Aug. 19, 1970; 57 FR 41095, Sept. 9, 1992; 59 FR 31528, June 20, 1994; 67 FR 48774, July 26, 2002; T.D. 9359, 72 FR 54549, Sept. 26, 2007; T.D. 9527, 76 FR 32308, June 3, 2011]

SOURCE: Department Circular 230, Revised, 31 FR 10773, Aug. 13, 1966; 67 FR 48774, July 26, 2002; 69 FR 75841, Dec. 20, 2004; T.D. 9527, 76 FR 32300, June 3, 2011, unless otherwise noted.

AUTHORITY: Sec. 3, 23 Stat. 258, secs. 2–12, 60 Stat. 237 et seq.; 5 U.S.C. 301, 500, 551–559; 31 U.S.C. 321; 31 U.S.C. 330; Reorg. Plan No. 26 of 1950, 15 FR 4935, 64 Stat. 1280, 3 CFR, 1949–1953 Comp., p. 1017.

Current through October 31, 2013; 78 FR 65488

# Appendix 12

Code of Federal Regulations  
Title 26. Internal Revenue  
Chapter I. Internal Revenue Service, Department of the Treasury  
Subchapter A. Income Tax  
Part 1. Income Taxes (Refs & Annos)  
Normal Taxes and Surtaxes  
Deferred Compensation, Etc.  
Methods of Accounting  
Taxable Year for Which Deductions Taken

26 C.F.R. § 1.465-8, Treas. Reg. § 1.465-8

§ 1.465-8 General rules; interest other than that of a creditor.

Currentness

**(a) In general--(1) Amounts borrowed.** This section applies to amounts borrowed for use in an activity described in section 465(c)(1) or (c)(3)(A). Amounts borrowed with respect to an activity will not increase the borrower's amount at risk in the activity if the lender has an interest in the activity other than that of a creditor or is related to a person (other than the borrower) who has an interest in the activity other than that of a creditor. This rule applies even if the borrower is personally liable for the repayment of the loan or the loan is secured by property not used in the activity. For additional rules relating to the treatment of amounts borrowed from these persons, see § 1.465-20.

**(2) Certain borrowed amounts excepted. (i)** For purposes of determining a corporation's amount at risk, an interest in the corporation as a shareholder is not an interest in any activity of the corporation. Thus, amounts borrowed by a corporation from a shareholder may increase the corporation's amount at risk.

**(ii)** For purposes of determining a taxpayer's amount at risk in an activity of holding real property, paragraph (a)(1) of this section does not apply to financing that is secured by real property used in the activity and is either--

(A) Qualified nonrecourse financing described in section 465(b)(6)(B); or

(B) Financing that, if it were nonrecourse, would be financing described in section 465(b)(6)(B).

**(b) Loans for which the borrower is personally liable for repayment--(1) General rule.** If a borrower is personally liable for the repayment of a loan for use in an activity, a person shall be considered a person with an interest in the activity other than that of a creditor only if the person has either a capital interest in the activity or an interest in the net profits of the activity.

**(2) Capital interest.** For the purposes of this section a capital interest in an activity means an interest in the assets of the activity which is distributable to the owner of the capital interest upon the liquidation of the activity. The partners of a partnership and the shareholders of an S corporation are considered to have capital interests in the activities conducted by the partnership or S corporation.

**(3) Interest in net profits.** For the purposes of this section it is not necessary for a person to have any incidents of ownership in the activity in order to have an interest in the net profits of the activity. For example, an employee or independent contractor any part of whose compensation is determined with reference to the net profits of the activity will be considered to have an interest in the net profits of the activity.

**(4) Examples.** The provisions of this paragraph may be illustrated by the following examples:

**Example 1.** A, the owner of a herd of cattle sells the herd to partnership BCD. BCD pays A \$10,000 in cash and executes a note for \$30,000 payable to A. Each of the three partners, B, C, and D, assumes personal liability for repayment of the amount owed A. In addition, BCD enters into an agreement with A under which A is to take care of the cattle for BCD in return for compensation equal to 6 percent of BCD's net profits from the activity. Because A has an interest in the net profits of BCD's farming activity, A is considered to have an interest in the activity other than that of a creditor. Accordingly, amounts payable to A for use in that activity do not increase the partners' amount at risk even though the partners assume personal liability for repayment.

**Example 2.** Assume the same facts as in Example 1 except that instead of receiving compensation equal to 6 percent of BCD's net profits from the activity, A instead receives compensation equal to 1 percent of the gross receipts from the activity. A does not have a capital interest in BCD. A's interest in the gross receipts is not considered an interest in the net profits. Because B, C, and D assumed personal liability for the amounts payable to A, and A has neither a capital interest nor an interest in the net profits of the activity, A is not considered to have an interest in the activity other than that of a creditor with respect to the \$30,000 loan. Accordingly, B, C, and D are at risk for their share of the loan if the other provisions of section 465 are met.

**Example 3.** Assume the same facts as in Example 1 except that instead of receiving compensation equal to 6 percent of BCD's net profits from the activity, A instead receives compensation equal to 6 percent of the net profits from the activity or \$15,000, whichever is greater. A is considered to have an interest in the net profits from the activity and accordingly will be treated as a person with an interest in the activity other than that of a creditor.

**(c) Nonrecourse loans secured by assets with a readily ascertainable fair market value--(1) General rule.** This paragraph shall apply in the case of a nonrecourse loan for use in an activity where the loan is secured by property which has a readily ascertainable fair market value. In the case of such a loan a person shall be considered a person with an interest in the activity other than that of a creditor only if the person has either a capital interest in the activity or an interest in the net profits of the activity.

**(2) Example.** The provisions of this paragraph (c) may be illustrated by the following example:

**Example.** X is an investor in an activity described in section 465(c)(1). In order to raise money for the investment, X borrows money from A, the promoter (the person who brought X together with other taxpayers for the purpose of investing in the activity). The loan is secured by stock unrelated to the activity which is listed on a national securities exchange. X's stock has a readily ascertainable fair market value. A does not have a capital interest in the activity or an interest in its net profits. Accordingly, with respect to the loan secured by X's stock, A does not have an interest in the activity other than that of a creditor.

**(d) Nonrecourse loans secured by assets without a readily ascertainable fair market value--(1) General rule.** This paragraph shall apply in the case of a nonrecourse loan for use in an activity where the loan is secured by property which does not have a readily ascertainable fair market value. In the case of such a loan a person shall be considered a person with an interest in the activity other than that of a creditor if the person stands to receive financial gain (other than interest) from the activity or from the sale of interests in the activity. For the purposes of this section persons who stand to receive financial gain from

the activity include persons who receive compensation for services rendered in connection with the organization or operation of the activity or for the sale of interests in the activity. Such a person will generally include the promoter of the activity who organizes the activity or solicits potential investors in the activity.

(2) **Example.** The provisions of this paragraph (d) may be illustrated by the following example:

**Example.** A is the promoter of an activity described in section 465(c)(1). As the promoter, A organizes the activity and solicits potential investors. For these services A is paid a flat fee of \$130x. This fee is paid out of the amounts contributed by the investors to the activity. X, one of the investors in the activity, borrows money from A for use in the activity. X is not personally liable for repayment to A of the amount borrowed. As security for the loan, X pledges an asset which does not have a readily ascertainable fair market value. A is considered a person with an interest in the activity other than that of a creditor with respect to this loan because the asset pledged as security does not have a readily ascertainable fair market value, X is not personally liable for repayment of the loan, and A received financial gain from the activity. Accordingly, X's amount at risk in the activity is not increased despite the fact that property was pledged as security.

(e) **Effective date.** This section applies to amounts borrowed after May 3, 2004.

**Credits**

[T.D. 9124, 69 FR 24079, May 3, 2004; 69 FR 26305, May 12, 2004]

SOURCE: T.D. 6500, 25 FR 11402, Nov. 26, 1960; 25 FR 14021, Dec. 21, 1960, unless otherwise noted.

Notes of Decisions (40)

Current through October 31, 2013; 78 FR 65488

# Appendix 13

United States Code Annotated

Title 26. Internal Revenue Code (Refs & Annos)

Subtitle A. Income Taxes (Refs & Annos)

Chapter 1. Normal Taxes and Surtaxes (Refs & Annos)

Subchapter E. Accounting Periods and Methods of Accounting

Part II. Methods of Accounting

Subpart C. Taxable Year for Which Deductions Taken

26 U.S.C.A. § 465

§ 465. Deductions limited to amount at risk

Effective: January 1, 2005

Currentness

**(a) Limitation to amount at risk.--**

**(1) In general.--**In the case of--

**(A)** an individual, and

**(B)** a C corporation with respect to which the stock ownership requirement of paragraph (2) of section 542(a) is met,

engaged in an activity to which this section applies, any loss from such activity for the taxable year shall be allowed only to the extent of the aggregate amount with respect to which the taxpayer is at risk (within the meaning of subsection (b)) for such activity at the close of the taxable year.

**(2) Deduction in succeeding year.--**Any loss from an activity to which this section applies not allowed under this section for the taxable year shall be treated as a deduction allocable to such activity in the first succeeding taxable year.

**(3) Special rules for applying paragraph (1)(B).--**For purposes of paragraph (1)(B)--

**(A)** section 544(a)(2) shall be applied as if such section did not contain the phrase “or by or for his partner”; and

**(B)** sections 544(a)(4)(A) and 544(b)(1) shall be applied by substituting “the corporation meet<sup>1</sup> the stock ownership requirements of section 542(a)(2)” for “the corporation a personal holding company”.

**(b) Amounts considered at risk.--**

**(1) In general.--**For purposes of this section, a taxpayer shall be considered at risk for an activity with respect to amounts including--

(A) the amount of money and the adjusted basis of other property contributed by the taxpayer to the activity, and

(B) amounts borrowed with respect to such activity (as determined under paragraph (2)).

**(2) Borrowed amounts.**--For purposes of this section, a taxpayer shall be considered at risk with respect to amounts borrowed for use in an activity to the extent that he--

(A) is personally liable for the repayment of such amounts, or

(B) has pledged property, other than property used in such activity, as security for such borrowed amount (to the extent of the net fair market value of the taxpayer's interest in such property).

No property shall be taken into account as security if such property is directly or indirectly financed by indebtedness which is secured by property described in paragraph (1).

**(3) Certain borrowed amounts excluded.**--

(A) **In general.**--Except to the extent provided in regulations, for purposes of paragraph (1)(B), amounts borrowed shall not be considered to be at risk with respect to an activity if such amounts are borrowed from any person who has an interest in such activity or from a related person to a person (other than the taxpayer) having such an interest.

(B) **Exceptions.**--

(i) **Interest as creditor.**--Subparagraph (A) shall not apply to an interest as a creditor in the activity.

(ii) **Interest as shareholder with respect to amounts borrowed by corporation.**--In the case of amounts borrowed by a corporation from a shareholder, subparagraph (A) shall not apply to an interest as a shareholder.

(C) **Related person.**--For purposes of this subsection, a person (hereinafter in this paragraph referred to as the "related person") is related to any person if--

(i) the related person bears a relationship to such person specified in section 267(b) or section 707(b)(1), or

(ii) the related person and such person are engaged in trades or business under common control (within the meaning of subsections (a) and (b) of section 52).

For purposes of clause (i), in applying section 267(b) or 707(b)(1), "10 percent" shall be substituted for "50 percent".

**(4) Exception.**--Notwithstanding any other provision of this section, a taxpayer shall not be considered at risk with respect to amounts protected against loss through nonrecourse financing, guarantees, stop loss agreements, or other similar arrangements.

**(5) Amounts at risk in subsequent years.**--If in any taxable year the taxpayer has a loss from an activity to which subsection (a) applies, the amount with respect to which a taxpayer is considered to be at risk (within the meaning of subsection (b)) in subsequent taxable years with respect to that activity shall be reduced by that portion of the loss which (after the application of subsection (a)) is allowable as a deduction.

**(6) Qualified nonrecourse financing treated as amount at risk.**--For purposes of this section--

**(A) In general.**--Notwithstanding any other provision of this subsection, in the case of an activity of holding real property, a taxpayer shall be considered at risk with respect to the taxpayer's share of any qualified nonrecourse financing which is secured by real property used in such activity.

**(B) Qualified nonrecourse financing.**--For purposes of this paragraph, the term "qualified nonrecourse financing" means any financing--

(i) which is borrowed by the taxpayer with respect to the activity of holding real property,

(ii) which is borrowed by the taxpayer from a qualified person or represents a loan from any Federal, State, or local government or instrumentality thereof, or is guaranteed by any Federal, State, or local government,

(iii) except to the extent provided in regulations, with respect to which no person is personally liable for repayment, and

(iv) which is not convertible debt.

**(C) Special rule for partnerships.**--In the case of a partnership, a partner's share of any qualified nonrecourse financing of such partnership shall be determined on the basis of the partner's share of liabilities of such partnership incurred in connection with such financing (within the meaning of section 752).

**(D) Qualified person defined.**--For purposes of this paragraph--

(i) **In general.**--The term "qualified person" has the meaning given such term by section 49(a)(1)(D)(iv).

(ii) **Certain commercially reasonable financing from related persons.**--For purposes of clause (i), section 49(a)(1)(D)(iv) shall be applied without regard to subclause (I) thereof (relating to financing from related persons) if the financing from the related person is commercially reasonable and on substantially the same terms as loans involving unrelated persons.

**(E) Activity of holding real property.**--For purposes of this paragraph--

**(i) Incidental personal property and services.**--The activity of holding real property includes the holding of personal property and the providing of services which are incidental to making real property available as living accommodations.

**(ii) Mineral property.**--The activity of holding real property shall not include the holding of mineral property.

**(c) Activities to which section applies.**--

**(1) Types of activities.**--This section applies to any taxpayer engaged in the activity of--

**(A)** holding, producing, or distributing motion picture films or video tapes,

**(B)** farming (as defined in section 464(e)),

**(C)** leasing any section 1245 property (as defined in section 1245(a)(3)),

**(D)** exploring for, or exploiting, oil and gas resources as a trade or business or for the production of income, or

**(E)** exploring for, or exploiting, geothermal deposits (as defined in section 613(e)(2)).

**(2) Separate activities.**--For purposes of this section--

**(A) In general.**--Except as provided in subparagraph (B), a taxpayer's activity with respect to each--

**(i)** film or video tape,

**(ii)** section 1245 property which is leased or held for leasing,

**(iii)** farm,

**(iv)** oil and gas property (as defined under section 614), or

**(v)** geothermal property (as defined under section 614),

shall be treated as a separate activity.

**(B) Aggregation rules.--**

**(i) Special rule for leases of section 1245 property by partnerships or S corporations.--**In the case of any partnership or S corporation, all activities with respect to section 1245 properties which--

**(I)** are leased or held for lease, and

**(II)** are placed in service in any taxable year of the partnership or S corporation,

shall be treated as a single activity.

**(ii) Other aggregation rules.--**Rules similar to the rules of subparagraphs (B) and (C) of paragraph (3) shall apply for purposes of this paragraph.

**(3) Extension to other activities.--**

**(A) In general.--**In the case of taxable years beginning after December 31, 1978, this section also applies to each activity--

**(i)** engaged in by the taxpayer in carrying on a trade or business or for the production of income, and

**(ii)** which is not described in paragraph (1).

**(B) Aggregation of activities where taxpayer actively participates in management of trade or business.--**Except as provided in subparagraph (C), for purposes of this section, activities described in subparagraph (A) which constitute a trade or business shall be treated as one activity if--

**(i)** the taxpayer actively participates in the management of such trade or business, or

**(ii)** such trade or business is carried on by a partnership or an S corporation and 65 percent or more of the losses for the taxable year is allocable to persons who actively participate in the management of the trade or business.

**(C) Aggregation or separation of activities under regulations.--**The Secretary shall prescribe regulations under which activities described in subparagraph (A) shall be aggregated or treated as separate activities.

**(D) Application of subsection (b)(3).--**In the case of an activity described in subparagraph (A), subsection (b)(3) shall apply only to the extent provided in regulations prescribed by the Secretary.

**(4) Exclusion for certain equipment leasing by closely-held corporations.--**

**(A) In general.**--In the case of a corporation described in subsection (a)(1)(B) actively engaged in equipment leasing--

(i) the activity of equipment leasing shall be treated as a separate activity, and

(ii) subsection (a) shall not apply to losses from such activity.

**(B) 50-percent gross receipts test.**--For purposes of subparagraph (A), a corporation shall not be considered to be actively engaged in equipment leasing unless 50 percent or more of the gross receipts of the corporation for the taxable year is attributable, under regulations prescribed by the Secretary, to equipment leasing.

**(C) Component members of controlled group treated as a single corporation.**--For purposes of subparagraph (A), the component members of a controlled group of corporations shall be treated as a single corporation.

**(5) Waiver of controlled group rule where there is substantial leasing activity.**--

**(A) In general.**--In the case of the component members of a qualified leasing group, paragraph (4) shall be applied--

(i) by substituting "80 percent" for "50 percent" in subparagraph (B) thereof, and

(ii) as if paragraph (4) did not include subparagraph (C) thereof.

**(B) Qualified leasing group.**--For purposes of this paragraph, the term "qualified leasing group" means a controlled group of corporations which, for the taxable year and each of the 2 immediately preceding taxable years, satisfied each of the following 3 requirements:

(i) **At least 3 employees.**--During the entire year, the group had at least 3 full-time employees substantially all of the services of whom were services directly related to the equipment leasing activity of the qualified leasing members.

(ii) **At least 5 separate leasing transactions.**--During the year, the qualified leasing members in the aggregate entered into at least 5 separate equipment leasing transactions.

(iii) **At least \$1,000,000 equipment leasing receipts.**--During the year, the qualified leasing members in the aggregate had at least \$1,000,000 in gross receipts from equipment leasing.

The term "qualified leasing group" does not include any controlled group of corporations to which, without regard to this paragraph, paragraph (4) applies.

**(C) Qualified leasing member.**--For purposes of this paragraph, a corporation shall be treated as a qualified leasing member for the taxable year only if for each of the taxable years referred to in subparagraph (B)--

- (i) it is a component member of the controlled group of corporations, and
- (ii) it meets the requirements of paragraph (4)(B) (as modified by subparagraph (A)(i) of this paragraph).

**(6) Definitions relating to paragraphs (4) and (5).**--For purposes of paragraphs (4) and (5)--

**(A) Equipment leasing.**--The term "equipment leasing" means--

- (i) the leasing of equipment which is section 1245 property, and
- (ii) the purchasing, servicing, and selling of such equipment.

**(B) Leasing of master sound recordings, etc., excluded.**--The term "equipment leasing" does not include the leasing of master sound recordings, and other similar contractual arrangements with respect to tangible or intangible assets associated with literary, artistic, or musical properties.

**(C) Controlled group of corporations; component member.**--The terms "controlled group of corporations" and "component member" have the same meanings as when used in section 1563. The determination of the taxable years taken into account with respect to any controlled group of corporations shall be made in a manner consistent with the manner set forth in section 1563.

**(7) Exclusion of active businesses of qualified C corporations.**--

**(A) In general.**--In the case of a taxpayer which is a qualified C corporation--

- (i) each qualifying business carried on by such taxpayer shall be treated as a separate activity, and
- (ii) subsection (a) shall not apply to losses from such business.

**(B) Qualified C corporation.**--For purposes of subparagraph (A), the term "qualified C corporation" means any corporation described in subparagraph (B) of subsection (a)(1) which is not--

- (i) a personal holding company (as defined in section 542(a)), or

(ii) a personal service corporation (as defined in section 269A(b) but determined by substituting "5 percent" for "10 percent" in section 269A(b)(2)).

**(C) Qualifying business.**--For purposes of this paragraph, the term "qualifying business" means any active business if--

(i) during the entire 12-month period ending on the last day of the taxable year, such corporation had at least 1 full-time employee substantially all the services of whom were in the active management of such business,

(ii) during the entire 12-month period ending on the last day of the taxable year, such corporation had at least 3 full-time, nonowner employees substantially all of the services of whom were services directly related to such business,

(iii) the amount of the deductions attributable to such business which are allowable to the taxpayer solely by reason of sections 162 and 404 for the taxable year exceeds 15 percent of the gross income from such business for such year, and

(iv) such business is not an excluded business.

**(D) Special rules for application of subparagraph (C).**--

(i) **Partnerships in which taxpayer is a qualified corporate partner.**--In the case of an active business of a partnership, if--

(I) the taxpayer is a qualified corporate partner in the partnership, and

(II) during the entire 12-month period ending on the last day of the partnership's taxable year, there was at least 1 full-time employee of the partnership (or of a qualified corporate partner) substantially all the services of whom were in the active management of such business,

then the taxpayer's proportionate share (determined on the basis of its profits interest) of the activities of the partnership in such business shall be treated as activities of the taxpayer (and clause (i) of subparagraph (C) shall not apply in determining whether such business is a qualifying business of the taxpayer).

(ii) **Qualified corporate partner.**--For purposes of clause (i), the term "qualified corporate partner" means any corporation if--

(I) such corporation is a general partner in the partnership,

(II) such corporation has an interest of 10 percent or more in the profits and losses of the partnership, and

(III) such corporation has contributed property to the partnership in an amount not less than the lesser of \$500,000 or 10 percent of the net worth of the corporation.

For purposes of subclause (III), any contribution of property other than money shall be taken into account at its fair market value.

**(iii) Deduction for owner employee compensation not taken into account.**--For purposes of clause (iii) of subparagraph (C), there shall not be taken into account any deduction in respect of compensation for personal services rendered by any employee (other than a non-owner employee) of the taxpayer or any member of such employee's family (within the meaning of section 318(a)(1)).

**(iv) Special rule for banks.**--For purposes of clause (iii) of subparagraph (C), in the case of a bank (as defined in section 581) or a financial institution to which section 591 applies--

(I) gross income shall be determined without regard to the exclusion of interest from gross income under section 103, and

(II) in addition to the deductions described in such clause, there shall also be taken into account the amount of the deductions which are allowable for amounts paid or credited to the accounts of depositors or holders of accounts as dividends or interest on their deposits or withdrawable accounts under section 163 or 591.

**(v) Special rule for life insurance companies.**--

(I) **In general.**--Clause (iii) of subparagraph (C) shall not apply to any insurance business of a qualified life insurance company.

(II) **Insurance business.**--For purposes of subclause (I), the term "insurance business" means any business which is not a noninsurance business (within the meaning of section 806(b)(3)).

(III) **Qualified life insurance company.**--For purposes of subclause (I), the term "qualified life insurance company" means any company which would be a life insurance company as defined in section 816 if unearned premiums were not taken into account under subsections (a)(2) and (c)(2) of section 816.

**(E) Definitions.**--For purposes of this paragraph--

(i) **Non-owner employee.**--The term "non-owner employee" means any employee who does not own, at any time during the taxable year, more than 5 percent in value of the outstanding stock of the taxpayer. For purposes of the preceding sentence, section 318 shall apply, except that "5 percent" shall be substituted for "50 percent" in section 318(a)(2)(C).

(ii) **Excluded business.**--The term "excluded business" means--

(I) equipment leasing (as defined in paragraph (6)), and

(II) any business involving the use, exploitation, sale, lease, or other disposition of master sound recordings, motion picture films, video tapes, or tangible or intangible assets associated with literary, artistic, musical, or similar properties.

(iii) **Special rules relating to communications industry, etc.--**

**(I) Business not excluded where taxpayer not completely at risk.--**A business involving the use, exploitation, sale, lease, or other disposition of property described in subclause (II) of clause (ii) shall not constitute an excluded business by reason of such subclause if the taxpayer is at risk with respect to all amounts paid or incurred (or chargeable to capital account) in such business.

**(II) Certain licensed businesses not excluded.--**For purposes of subclause (II) of clause (ii), the provision of radio, television, cable television, or similar services pursuant to a license or franchise granted by the Federal Communications Commission or any other Federal, State, or local authority shall not constitute an excluded business by reason of such subclause.

**(F) Affiliated group treated as 1 taxpayer.--**For purposes of this paragraph--

**(i) In general.--**Except as provided in subparagraph (G), the component members of an affiliated group of corporations shall be treated as a single taxpayer.

**(ii) Affiliated group of corporations.--**The term “affiliated group of corporations” means an affiliated group (as defined in section 1504(a)) which files or is required to file consolidated income tax returns.

**(iii) Component member.--**The term “component member” means an includible corporation (as defined in section 1504) which is a member of the affiliated group.

**(G) Loss of 1 member of affiliated group may not offset income of personal holding company or personal service corporation.--**Nothing in this paragraph shall permit any loss of a member of an affiliated group to be used as an offset against the income of any other member of such group which is a personal holding company (as defined in section 542(a)) or a personal service corporation (as defined in section 269A(b) but determined by substituting “5 percent” for “10 percent” in section 269A(b)(2)).

**(d) Definition of loss.--**For purposes of this section, the term “loss” means the excess of the deductions allowable under this chapter for the taxable year (determined without regard to the first sentence of subsection (a)) and allocable to an activity to which this section applies over the income received or accrued by the taxpayer during the taxable year from such activity (determined without regard to subsection (e)(1)(A)).

**(e) Recapture of losses where amount at risk is less than zero.--**

**(1) In general.**--If zero exceeds the amount for which the taxpayer is at risk in any activity at the close of any taxable year--

(A) the taxpayer shall include in his gross income for such taxable year (as income from such activity) an amount equal to such excess, and

(B) an amount equal to the amount so included in gross income shall be treated as a deduction allocable to such activity for the first succeeding taxable year.

**(2) Limitation.**--The excess referred to in paragraph (1) shall not exceed--

(A) the aggregate amount of the reductions required by subsection (b)(5) with respect to the activity by reason of losses for all prior taxable years beginning after December 31, 1978, reduced by

(B) the amounts previously included in gross income with respect to such activity under this subsection.

#### CREDIT(S)

(Added Pub.L. 94-455, Title II, § 204(a), Oct. 4, 1976, 90 Stat. 1531; amended Pub.L. 95-600, Title II, §§ 201(a), (c)(1), 202, 203, Title VII, § 701(k)(2), Nov. 6, 1978, 92 Stat. 2814, 2816, 2906; Pub.L. 95-618, Title IV, § 402(d), Nov. 9, 1978, 92 Stat. 3202; Pub.L. 96-222, Title I, § 102(a)(1)(A) to (D), Apr. 1, 1980, 94 Stat. 206-208; Pub.L. 97-354, § 5(a)(31), Oct. 19, 1982, 96 Stat. 1695; Pub.L. 98-369, Div. A, Title IV, § 432(a) to (c), Title VII, § 721(x)(2), July 18, 1984, 98 Stat. 811-814, 971; Pub.L. 99-514, Title II, § 201(d)(7)(A), Title V, § 503(a), (b), Title X, § 1011(b)(1), Oct. 22, 1986, 100 Stat. 2141, 2243, 2389; Pub.L. 101-508, Title XI, §§ 11813(b)(15), 11815(b)(3), Nov. 5, 1990, 104 Stat. 1388-555, 1388-558; Pub.L. 108-357, Title IV, § 413(c)(7), Oct. 22, 2004, 118 Stat. 1507.)

Notes of Decisions (59)

#### Footnotes

1 So in original. Probably should be "meets".

26 U.S.C.A. § 465, 26 USCA § 465

Current through P.L. 113-36 approved 9-18-13