

When Is Consent Enough? Tax Return Information in the Uncharted AI Landscape

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In this article, Taylor examines the code provisions and regulations governing the disclosure and use of tax return information, along with the practical implications of the consent requirement for artificial intelligence platforms.

I. Introduction

Recent advancements in artificial intelligence have enabled businesses to activate large amounts of data to improve core operations and create new business functions.¹ Tax practitioners are developing methods involving AI to streamline processes, increase efficiency, and provide additional value for their clients. One method garnering substantial attention and capital investment involves using AI to analyze tax return information. This innovation raises important issues for taxpayers who want to keep their identity, finances, and other information private.

The protection of sensitive taxpayer information is something Congress and the IRS take very seriously. Several large tax return preparation businesses, including TaxAct, TaxSlayer, and H&R Block, have come under fire

¹ Amanda Iacone, "EY Global Fees Climb to \$49 Billion, Capping Tumultuous Year," *DTR*, Sept. 13, 2023 (noting that Ernst & Young Global Ltd. recently invested \$1.4 billion in an AI platform).

recently because of alleged unauthorized disclosures of tax return information to Google and Meta Platforms Inc. (formerly known as Facebook).² In July 2023 the Senate Finance Committee released a report criticizing those disclosures.³ However, many claim this is simply an accepted industry practice.

Restrictions on both the disclosure and use of tax return information are critical for tax practitioners to consider. This article discusses the main IRS rules regarding the disclosure and use of tax return information and issues involving consent in the AI context.

II. Two Key IRC Provisions

Congress enacted two key laws that prohibit tax return preparers (TRPs) from disclosing and using tax return information without taxpayer consent.⁴ Section 6713 imposes civil penalties of \$250 per violation, for any unlawful disclosure or use, up to \$10,000 per year.⁵ Section 7216 imposes criminal penalties for knowing or reckless violations, including imprisonment of up to one year, a fine of up to \$1,000, and repayment of the costs of prosecution.⁶ Both sections include enhanced penalties for disclosures or uses in the context of an identity theft crime.⁷ Section 7216

² See release from the office of Rep. Adam B. Schiff, D-Calif., "Schiff Urges Investigation Into Disclosure of Taxpayers' Personal, Financial Information to Facebook" (Feb. 2, 2023); and Bailey Schultz, "Tax Prep Firms Like H&R Block Shared Taxpayer Data With Facebook and Google, Lawmakers Say," *USA Today*, July 12, 2023.

³ Offices of Sen. Elizabeth Warren, D-Mass., et al., "Attacks on Tax Privacy: How the Tax Prep Industry Enabled Meta to Harvest Millions of Taxpayers' Sensitive Data" (July 2023).

⁴ Sections 6713(a) and 7216(a).

⁵ Section 6713(a)(2).

⁶ Section 7216(a) (flush language).

⁷ Sections 6713(b) and 7216(a) (flush language).

and the corresponding regulations provide several exceptions in which consent for disclosure and use is not required,⁸ and section 6713 explicitly adopts the regulations under section 7216.⁹ Therefore, these code provisions and regulations work hand in hand.

III. Disclosure and Use

It is no surprise that the IRS defined the operative terms broadly. The disclosure of tax return information is any act making that information known to any person.¹⁰ In addition to sending tax return information to a third party directly by email, transmission using a hyperlink can also constitute a disclosure.¹¹

The use of tax return information is any circumstance in which a TRP refers to or relies on tax return information as the basis to take or permit an action.¹² For example, if a TRP analyzes tax return data to determine whether the taxpayer can make an IRA contribution, the TRP is using taxpayer information.¹³

IV. Qualification as a TRP

Generally, a TRP is any person¹⁴ who prepares a tax return or employs another person to prepare a tax return.¹⁵ Section 7216 expands the definition to include any person who (1) prepares or assists with the preparation of a tax return for compensation, (2) is engaged in the business of preparing tax returns, (3) is engaged in the business of providing auxiliary services in connection with the preparation of tax returns, or (4) provides services that assist with tax return preparation or auxiliary services.¹⁶ Importantly, a person is not a TRP by virtue of providing services that only incidentally relate to tax return preparation.¹⁷

According to now-archived IRS FAQs, TRPs include:

- return preparers who are in business or hold themselves out as TRPs;
- casual preparers who are compensated;
- electronic return originators;
- electronic return transmitters;
- intermediate service providers;
- software developers; and
- reporting agents.¹⁸

The most common category of TRP is persons who prepare or assist with the preparation of a tax return for compensation.¹⁹ The person does not need to actually operate a tax return preparation business.²⁰ This means that a TRP includes any person who is compensated for casually helping with tax return preparation for a relative, friend, or other acquaintance.²¹

A person is engaged in the business of preparing tax returns if that person holds themselves out as a person who prepares or assists with the preparation of tax returns.²² It does not matter whether it is the person's sole business activity or whether the person charges a fee for the services.²³

Similarly, a person is engaged in the business of providing auxiliary services if that person holds themselves out as a person who performs or assists with the performance of auxiliary services.²⁴ And it does not matter whether the auxiliary services are the person's sole business activity or whether the person charges a fee.²⁵ This qualification also covers contractors who receive tax return information from another TRP for the purpose of providing auxiliary services in connection with programming, maintenance, repair, testing, or procurement of equipment or software used for tax return preparation.²⁶

⁸ Section 7216(b); reg. section 301.7216-2.

⁹ Section 6713(c).

¹⁰ Reg. section 301.7216-1(b)(5).

¹¹ *Id.*

¹² Reg. section 301.7216-1(b)(4)(i).

¹³ Reg. section 301.7216-1(b)(4)(ii), Example 1.

¹⁴ Section 7701(a)(1) defines a person as an individual, trust, estate, partnership, association, company, or corporation.

¹⁵ The general definition is in section 7701(a)(36).

¹⁶ Section 7216(a); reg. section 301.7216-1(b)(2).

¹⁷ Reg. section 301.7216-1(b)(2)(D)(v).

¹⁸ IRS, "Section 7216 Frequently Asked Questions," at FAQ 3 (historical content).

¹⁹ Reg. section 301.7216-1(b)(2)(C).

²⁰ Reg. section 301.7216-1(b)(2)(D)(iv).

²¹ Reg. sections 301.7216-1(b)(2)(D)(iv) and 301.7216-2(d)(2).

²² Reg. section 301.7216-1(b)(2)(D)(ii).

²³ *Id.*

²⁴ Reg. section 301.7216-1(b)(2)(D)(iii).

²⁵ Reg. section 301.7216-1(b)(2)(D)(ii).

²⁶ Reg. section 301.7216-1(b)(2)(D)(iii).

The regulations include limited guidance about the types of services that might qualify a person as a TRP. In addition to the person who actually prepares the tax return, a TRP can include a person who gathers information for tax return preparation purposes, a secretary who enters tax return data into a computer, and an administrative assistant who electronically files a tax return.²⁷ Providing access to tax return preparation software might qualify a person as a TRP. Examples include companies that sell return preparation software to taxpayers²⁸ and brokerage firms that provide free access to their own return preparation software.²⁹

The regulations are clear on activities that do not automatically qualify a person as a TRP. This includes (1) leasing office space to a TRP, (2) furnishing credit to a taxpayer whose tax return is prepared by a TRP, (3) furnishing tax return information to a TRP at the taxpayer's request, (4) furnishing access to a separate person's tax return preparation website through a hyperlink on their own website, and (5) providing services that only incidentally relate to the preparation of tax returns, as mentioned above.³⁰ The regulations leave the rest up to a facts and circumstances analysis, which provides little certainty for businesses performing services that are not clearly addressed.

V. Tax Return Information

Tax return information is any information that is furnished for, or in connection with, preparation of a tax return.³¹ The regulations mention examples such as a taxpayer's name, address, and identifying number (that is, Social Security number, employer identification number, etc.).³² But the regulations cast a wide net by including all information a taxpayer would not have otherwise furnished without the intent that the TRP prepare a tax return.³³ That includes

information on the tax return such as income, credits, expenses, and deductions. It also includes preparer-created computations, worksheets, and printouts; correspondence from the IRS; and registration information for tax return preparation software.³⁴

Tax return information includes information received by a TRP directly from the taxpayer and from third parties, including the IRS.³⁵ However, it does not include identical information already provided to the TRP outside the scope of tax return preparation.³⁶

Tax return information also includes derivative information. First, it includes information the TRP derives or generates from tax return information in connection with the preparation of the tax return.³⁷ Second, it includes statistical compilations of tax return information, even if the compilations cannot be used to identify a taxpayer directly or indirectly.³⁸ However, in some circumstances, tax return information does not include information in a database that cannot be linked to preparation of a tax return.³⁹

VI. The Consent Requirement

TRPs are generally not authorized to disclose or use tax return information without consent unless specifically allowed by an exception⁴⁰ in section 7216 or the corresponding regulations.⁴¹ Therefore, it is prudent to obtain express written consent from each taxpayer before disclosing and using tax return information.⁴²

Consent must be knowing and voluntary.⁴³ Generally, a TRP cannot condition services on the taxpayer providing consent to share tax return information with third parties.⁴⁴ However, a TRP can require that a taxpayer consent to disclosing

²⁷ Reg. section 301.7216-1(b)(2)(D)(vi), Example 1.

²⁸ Reg. section 301.7216-1(b)(3)(D)(ii), Example 1.

²⁹ *Id.* at Example 2.

³⁰ Reg. section 301.7216-1(b)(2)(D)(v).

³¹ Reg. section 301.7216-1(b)(3)(i).

³² *Id.*

³³ Reg. section 301.7216-1(b)(3)(i)(D).

³⁴ IRS, *supra* note 18, at FAQ 5 (historical content).

³⁵ Reg. section 301.7216-1(b)(3)(i)(A).

³⁶ Reg. section 301.7216-1(b)(3)(i)(C).

³⁷ Reg. section 301.7216-1(b)(3)(i).

³⁸ Reg. section 301.7216-1(b)(3)(i)(B).

³⁹ Reg. section 301.7216-1(b)(3)(ii)(B), Example 2.

⁴⁰ The exceptions are outside the scope of this article.

⁴¹ Reg. section 301.7216-3(a)(1).

⁴² *See* reg. section 301.7216-3(a)(1).

⁴³ Reg. section 301.7216-3(a).

⁴⁴ Reg. section 301.7216-3(a)(1).

tax return information to another TRP providing supporting services.⁴⁵

Taxpayers and TRPs are free to negotiate the scope of consent. A section 7216 consent document authorizing the disclosure and use of tax return information can specify the duration of the taxpayer's consent.⁴⁶ If the duration is not mentioned, the default period is one year from the date the taxpayer signs the consent document.⁴⁷

Consent to disclose or use tax return information has certain limitations. A taxpayer must provide written consent *before* a TRP discloses or uses tax return information.⁴⁸ There is no authority for retroactive permission. After completing a tax return,⁴⁹ a TRP cannot request consent to disclose or use tax return information for business solicitation purposes that do not relate to tax return preparation.⁵⁰ Interestingly, the regulations do not specify whether permitted solicitation can relate to any tax return preparation business or whether it must be the business of the requesting TRP.

If a taxpayer rejects a request to provide consent for the purpose of soliciting business unrelated to tax return preparation, the TRP cannot make another substantially similar request.⁵¹ Regarding the Form 1040 tax return series, a TRP in the United States cannot request consent to disclose a taxpayer's SSN to another TRP located outside the United States unless the disclosing TRP in the United States uses adequate data protection safeguards.⁵²

VII. Taxpayer Consent Document

Fortunately, the code and regulations provide guidance on the content of a consent document. All taxpayer consent documents under section 7216 must:

- include the name of the TRP and the name of the taxpayer;⁵³
- identify the intended purpose of the disclosure;⁵⁴
- identify the specific recipients of the tax return information;⁵⁵
- describe the particular use of the tax return information;⁵⁶
- specify the tax return information to be disclosed or used;⁵⁷
- identify whether tax return information will be disclosed to TRPs outside the United States;⁵⁸ and
- be signed and dated by the taxpayer.⁵⁹

The rules discourage blanket consent documents. A single consent document cannot authorize both uses and disclosures.⁶⁰ Instead, a taxpayer must sign separate consent documents for uses and for disclosures.⁶¹ When requesting consent to disclose an entire tax return, the consent document must give the taxpayer the option to request a more limited scope of disclosure.⁶²

A consent document can be transmitted to a taxpayer in paper or electronic format.⁶³ This means a physical letter, an email, or a web-based consent document. If agreed to, the TRP must provide the taxpayer with a fully executed copy of the consent document.⁶⁴

For tax returns other than the Form 1040 series, the rules covering the format of the consent document are flexible. A consent document must simply meet the above criteria. It can take any

⁴⁵ Reg. section 301.7216-3(a)(2)(i).

⁴⁶ Reg. section 301.7216-3(b)(5).

⁴⁷ *Id.*

⁴⁸ Reg. section 301.7216-3(b)(1).

⁴⁹ See Rev. Proc. 2013-14, 2013-3 IRB 283. A TRP does not need to obtain an executed section 7216 consent document from a taxpayer simply to prepare a tax return if no additional services will be provided.

⁵⁰ Reg. section 301.7216-3(b)(2).

⁵¹ Reg. section 301.7216-3(b)(3).

⁵² Reg. section 301.7216-3(b)(4)(i) and (ii).

⁵³ Reg. section 301.7216-3(a)(3)(i)(A).

⁵⁴ Reg. section 301.7216-3(a)(3)(i)(B).

⁵⁵ *Id.*

⁵⁶ *Id.*

⁵⁷ Reg. section 301.7216-3(a)(3)(i)(C).

⁵⁸ Reg. section 301.7216-3(a)(3)(i)(D).

⁵⁹ Reg. section 301.7216-3(a)(3)(i)(E).

⁶⁰ Reg. section 301.7216-3(c)(1).

⁶¹ *Id.*

⁶² Reg. section 301.7216-3(c)(2).

⁶³ Reg. section 301.7216-3(a)(1).

⁶⁴ Reg. section 301.7216-3(c)(3).

format, such as an engagement letter, a stand-alone form, or an electronic authorization, as long as it meets the listed criteria.⁶⁵

For tax returns in the Form 1040 series, the rules governing the content and format of consent documents are more strict.⁶⁶ These requirements include language that must be included in consent documents under different situations.⁶⁷ When drafting a consent document in connection with the Form 1040 series, practitioners should consult the regulations and Rev. Proc. 2013-14, 2013-3 IRB 283.

VIII. Lack of Guidance Addressing AI

AI platforms use data science to build machine learning algorithms, models, and systems that can interpret data, produce solutions, and evolve through the input of additional data. There are three main types of AI platforms: end-to-end, open-source, and self-built. Some companies, such as Google Cloud Platform, Microsoft Azure, and Amazon Web Services, are already selling prepackaged end-to-end platforms. Open-source platforms, like ChatGPT, on which the public can transfer and use data, are available on the internet for free and on a subscription basis. Finally, developers can create self-built platforms for specialized uses.

With the recent emergence of AI, tax practitioners and businesses have little guidance on permitted disclosures and uses of tax return information. The code and regulations are wholly inadequate. Section 7216 was enacted in 1971. Congress has not updated the regulations under section 7216 since 2012.⁶⁸ The result is a vast number of unanswered questions.

IX. Practical Considerations

Let's take a scenario in which an accountant who qualifies as a TRP transfers tax return information to an AI platform, and the platform processes the data. At first glance, it appears that

the accountant needs to obtain consent from the taxpayer before transferring the tax return information and before any use by the AI platform. But this might depend on who owns, controls, or has access to the AI platform; who uses or is able to use the data; and how the data is used or might be used in the future.

A. Consent Factors

If only the accountant owns, controls, and has access to the AI platform — for example, if the accountant purchases an end-to-end AI platform or creates a self-built platform — the transfer of tax return information into the platform might not constitute a disclosure at all. An applicable analogy occurs when tax return information is uploaded into an accounting firm's cloud-based file-sharing platform.

If a third party owns, controls, or has access to the AI platform — for example, if the accountant uses an open-source platform like ChatGPT — the accountant would likely need to obtain consent from the taxpayer before the transfer of tax return information. This is because the transfer is a clear disclosure to a third party.

B. Use Factors

Another important issue is how the data is used. If only the accountant uses the tax return information in an end-to-end or self-built platform, the accountant could conceivably obtain consent from the taxpayer. In that case, it would be important for the consent document to specify whether the data will be used to assist with a tax return preparation business, to market nontax services, to benefit other taxpayers, to train other AI platforms, or more.

If the accountant transfers tax return information to an AI platform used by a third party, obtaining consent for the specific uses is imperative. This means consent for use by the accountant and potentially consent for use by the third party, depending on whether the third party uses the data and qualifies as a TRP. The consent documents must address the use of both tax return information and derivative data. Consent in this scenario is even more complex because of the inherent uncertainty of identifying all the parties that could use the tax return information and derivative data.

⁶⁵ Reg. section 301.7216-3(a)(3)(iii); Rev. Proc. 2013-14.

⁶⁶ See reg. section 301.7216-3(a)(3)(ii) and Rev. Proc. 2013-14.

⁶⁷ See generally Rev. Proc. 2013-14.

⁶⁸ The most recent amendments were to reg. section 301.7216-2 in 2012 (T.D. 9608), reg. section 301.7216-1 in 2008 (T.D. 9375), and reg. section 301.7216-3 in 2008 (T.D. 9437).

C. Third-Party TRP Status

Particular uses or services might qualify a third party as a TRP, such that the third party is also liable under sections 6713 and 7216. One must determine whether the third party is using the data in furtherance of tax return preparation or auxiliary services. As expected, the code leaves this primarily to a facts and circumstances analysis.

It is unclear what uses or services performed by a third party through an AI platform might be considered tax return preparation or auxiliary services. Some examples of direct services that come to mind are using tax return information to prepare workpapers or supporting statements, to provide business recommendations, to calculate estimated tax payments, and to recommend additional services.

But what about indirect uses or services? Does the use of an AI platform built on tax return information from other taxpayers require consent between each taxpayer and each third-party user? Can indirect services make the third party a TRP?

When a transmitting accountant and a receiving third party are both TRPs, each party will likely need to obtain consent from the taxpayer to disclose and use the tax return information. The case becomes more complex when hundreds or even thousands of taxpayers are involved. The regulations do not address whether a TRP, such as an accountant, can include language in the consent document covering the disclosure or use by a third party.

This article addresses only the application of sections 6713 and 7216 to TRPs. Even when the third party is not a TRP, other state, federal, and international data privacy laws still apply.

D. Building an AI Platform

Many of the scenarios above contemplate transferring data to an AI platform that already has algorithms in place derived from previous analysis of tax return information. But how can a developer build an AI platform using tax return information in the first place?

To design and operate an AI platform using tax return information, someone has to transfer initial data to the platform, and the platform has to run algorithms on the data to complete the

machine learning process. These are clear disclosures and uses that need to be repeated during the life cycle of the AI platform. Drafting a consent document to cover continual disclosures and uses with new parties creates its own challenges.

X. Conclusion

The scenarios above highlight just a few issues that might arise when tax practitioners and businesses seek to use AI analysis of tax return information. A study of section 6713, section 7216, and the regulations shows that the IRS needs to publish updated regulations addressing the disclosure and use of tax return information in the AI space. The issues involving sections 6713 and 7216 vary depending on whether the AI platform is end-to-end, open-source, or self-built. Maybe one day ChatGPT can help us find these solutions. Until then, those seeking to disclose or use tax return information should seek the advice of experienced tax professionals. ■