

# DEPARTMENT OF TAXATION

## 2018 Fiscal Impact Statement

1. **Patron** Janet D. Howell

3. **Committee** Senate Finance

4. **Title** Notification of tax return data breach

2. **Bill Number** SB 271

**House of Origin:**

           **Introduced**

  X   **Substitute**

           **Engrossed**

**Second House:**

           **In Committee**

           **Substitute**

           **Enrolled**

### 5. **Summary/Purpose:**

The Department of Taxation ("the Department") understands that the Patron will offer a substitute for this bill. This fiscal impact statement is drafted based on the substitute version.

This bill would require that any signing income tax return preparer who prepares Virginia individual income tax returns during a calendar year notify the Department of Taxation ("the Department") without unreasonable delay after the discovery or notification of unauthorized access and acquisition of unencrypted and unredacted return information maintained by that tax preparer, that compromises the confidentiality of such information and that creates a reasonable belief that an unencrypted and unredacted version of such information was accessed and acquired by an unauthorized person, and causes, or such preparer reasonably believes has caused or will cause, identity theft or other fraud.

The signing income tax return preparer would be required to provide the Department with the name and taxpayer identifying number of any taxpayer for whom the tax preparer is required to provide to the Department notice, as well as the name of the signing income tax return preparer, his preparer tax identification number, and such other information as the Department may prescribe.

An income tax return preparer would be required to complete such notification requirement on behalf of any of its employees who are signing income tax return preparers and who would otherwise be required to notify the Department.

The effective date of this bill is not specified.

**This is a Department of Taxation bill.**

6. **Budget amendment necessary:** No.

7. **No Fiscal Impact.** (See Line 8.)

## **8. Fiscal implications:**

### Administrative Costs

The Department considers implementation of this bill as routine, and does not require additional funding.

### Revenue Impact

This bill would allow the Department to avoid issuing approximately \$300,000 in unrecoverable fraudulent refunds annually, resulting in a positive General Fund revenue impact of \$300,000 in Fiscal Year 2019 and each fiscal year thereafter. No budget amendment is needed because the General Fund revenue impact is assumed in the Introduced Executive Budget.

During the first six months of Taxable Year 2017, the Department identified over 70 fraudulent returns that appear to have been attributable to seven tax return preparer data breaches. The Department estimates that there are likely many more tax return preparer data breaches that it is currently not aware of due to the lack of a reporting requirement. As it is usually impossible to recover the funds once issued, Virginia's tax revenue is reduced to the extent that refunds are issued based on fraudulent returns. When notified promptly by tax return preparers, the Department can take quick action to mitigate the risk and avoid issuing fraudulent refunds.

## **9. Specific agency or political subdivisions affected:**

Department of Taxation

## **10. Technical amendment necessary: No.**

## **11. Other comments:**

### Background

Data breaches are one of the largest risks related to identity theft and refund fraud. According to the Internal Revenue Service, cybercriminals are increasingly focusing on breaching the computer systems of businesses, including the systems of employers, payroll service providers, and tax return preparers. With the information stolen from such businesses, a criminal can file a fraudulent income tax return and receive a refund before the real taxpayer files his return. Fraudulent refund claims also have an economic and emotional cost on taxpayers whose identity has been stolen.

### Virginia's Database Breach Notification Law

Existing law requires an individual or entity who owns, maintains, or possesses computerized data that includes personal information of Virginia residents and who has a reasonable belief that such personal information, in unencrypted or unredacted form, was

accessed or acquired by an unauthorized person to report the breach to the Office of the Virginia Attorney General and to provide notification to each affected Virginia resident.

During its 2017 Session, the General Assembly modified this law to require certain employers and payroll service providers to notify the Office of the Attorney General without unreasonable delay after the discovery or notification of unauthorized access and acquisition of unencrypted and unredacted computerized data containing specified confidential tax information. The Office of the Attorney General is then required to notify the Department of such breaches.

Unlike employers and payroll service providers, tax return preparers are exempted from complying with Virginia's database breach notification law. Therefore, tax return preparers are not required to notify either the Department or the Office of the Attorney General ("OAG") of data breaches.

#### Income Tax Return Preparers under Virginia Law

Virginia law defines the term "income tax return preparer" as any person who prepares for compensation, or who employs one or more persons to prepare for compensation, any income tax return or any claim for refund of tax. For purposes of determining whether a person is an "income tax return preparer," Virginia law provides that the preparation for compensation of any portion of a return or claim for refund shall be treated as if it were the preparation of the return or claim for refund. However, Virginia law excludes from the definition of "income tax return preparer" any person who merely:

- Furnishes typing, reproducing, or other mechanical assistance;
- Prepares a return or claim for refund of the employer (or of an officer or employee of the employer) by whom he is regularly and continuously employed;
- Prepares as a fiduciary a return or claim for refund for any person; or
- Prepares an application for correction of an erroneous assessment or a protective claim for refund for a taxpayer in response to any assessment issued to the taxpayer or in response to any waiver of time limitation on assessment after the commencement of an audit of the taxpayer or another taxpayer if a determination in such audit of such other taxpayer directly or indirectly affects the tax liability of such taxpayer.

#### Tax Return Preparers under Federal Law

Federal law defines the term "tax return preparer" in a substantially similar manner as the term "income tax return preparer" is defined under Virginia law. Federal law also clarifies that the following persons are not "tax return preparers":

- An official or employee of the Internal Revenue Service ("IRS") performing official duties;

- Any individual who provides tax assistance under a Volunteer Income Tax Assistance ("VITA") program established by the IRS, but only with respect to those returns prepared as part of the VITA program;
- Any organization sponsoring or administering a VITA program established by the IRS, but only with respect to that sponsorship or administration;
- Any individual who provides tax counseling for the elderly under a qualifying federal program;
- Any organization sponsoring or administering a qualifying federal program to provide tax counseling;
- Any individual who provides tax assistance as part of a qualified Low-Income Taxpayer Clinic ("LITC");
- Any organization that is a qualified LITC;
- An individual providing only typing, reproduction, or other mechanical assistance in the preparation of a return or claim for refund;
- An individual preparing a return or claim for refund of a taxpayer, or an officer, a general partner, member, shareholder, or employee of a taxpayer, by whom the individual is regularly and continuously employed or compensated or in which the individual is a general partner;
- An individual preparing a return or claim for refund for a trust, estate, or other entity of which the individual either is a fiduciary or is an officer, general partner, or employee of the fiduciary;
- An individual preparing a claim for refund for a taxpayer in response to (1) a notice of deficiency issued to the taxpayer; or (2) a waiver of restriction on assessment after initiation of an audit of the taxpayer or another taxpayer if a determination in the audit of the other taxpayer affects, directly or indirectly, the liability of the taxpayer for tax; and
- A person who prepares a return or claim for refund for a taxpayer with no explicit or implicit agreement for compensation, even if the person receives an insubstantial gift, return service, or favor.

Federal law provides that there are two types of tax return preparers, (1) signing tax return preparers and (2) nonsigning tax return preparers. A signing tax return preparer is defined as the individual tax return preparer who has the primary responsibility for the overall substantive accuracy of the preparation of a return or claim for refund. Tax return preparers meeting this definition are "signing tax return preparers," whether or not they actually sign such returns. The nonsigning tax return preparer is any tax return preparer who is not a signing tax return preparer but who prepares all or a substantial portion of a return or claim for refund with respect to events that have occurred at the time the advice

is rendered. Examples of nonsigning tax return preparers are tax return preparers who provide advice (written or oral) to a taxpayer (or to another tax return preparer) when that advice leads to a position or entry that constitutes a substantial portion of the return.

### Proposed Legislation

This bill would require that any signing income tax return preparer who prepares Virginia individual income tax returns during a calendar year notify the Department of Taxation ("the Department") without unreasonable delay after the discovery or notification of unauthorized access and acquisition of unencrypted and unredacted return maintained by that tax preparer, that compromises the confidentiality of such information and that creates a reasonable belief that an unencrypted and unredacted version of such information was accessed and acquired by an unauthorized person, and causes, or such preparer reasonably believes has caused or will cause, identity theft or other fraud.

The signing income tax return preparer would be required to provide the Department with the name and taxpayer identifying number of any taxpayer for whom the tax preparer is required to provide to the Department notice, as well as the name of the signing income tax return preparer, his preparer tax identification number, and such other information as the Department may prescribe.

An income tax return preparer would be required to complete such notification requirement on behalf of any of its employees who are signing income tax return preparers and who would otherwise be required to notify the Department.

The term "return information" would be defined as a taxpayer's identity and the nature, source, or amount of his income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, assessments, or tax payments. "Return information" would not include information that is lawfully obtained from publicly available information, or from federal, state, or local government records lawfully made available to the general public.

The term "signing income tax return preparer" would be defined as an income tax return preparer, as defined under current Virginia law, who has the primary responsibility for the overall substantive accuracy of the preparation of a return or claim for refund.

The term "taxpayer identity" would be defined as the name of a person with respect to whom a return is to be filed and his federal taxpayer identifying number.

The effective date of this bill is not specified.

### Similar Bills

**House Bill 183** is identical to this bill.

cc : Secretary of Finance

Date: 1/15/2018 JJS  
SB271F161