

IRS: Identity Theft Protection Services Tax-Free for Data Breach Victims

On August 13, the IRS issued guidance on the tax treatment of identity protection services for data breach victims. The guidance generally provides that the value of identity theft protection services provided at no cost to data breach victims by the organization experiencing the breach (including employers and their service providers) is not taxable and does not have to be reported on information returns such as Forms W-2 or 1099-MISC.

Background

High-profile data breaches — like that of the US Office of Personnel Management earlier this year— have potentially compromised the personal data of millions and garnered national attention. As computer hacking and cyberattacks have become more commonplace, companies have looked for ways to improve the security of their customers' and employees' nonpublic personal information. In situations where their records have been breached, companies have taken steps to provide assistance for individuals whose information may be vulnerable as a result of the breach. Among other things, companies have provided those individuals with credit and identity theft monitoring and protection services to mitigate the potential risks of identity theft.

IRS Guidance on Taxability of Identity Protection Services

In [Announcement 2015-22](#), the IRS addressed — for the first time — the federal tax treatment of credit reporting and monitoring services, identity theft insurance policies, identity restoration services or other similar services (collectively “identity protection services”) provided to data breach victims. The guidance provides some tax relief to individuals whose personal information may have been compromised in a data breach.

Specifically, the IRS stated that it will not assert that:

- An individual who may be affected by a data breach must include the value of the identity protection services provided by the organization that experienced the data breach in gross income.

What is an IRS Announcement?

An IRS announcement is a public statement that provides immediate or short-term guidance that would otherwise be covered by a regulation, Revenue Ruling or Revenue Procedure. Announcements are issued for many reasons, including to provide guidance for completing tax forms, for complying with regulations or procedures, or on matters of general interest.

- An employer providing identity protection services to employees who may have been affected by a data breach of the employer's (or employer's agent or service provider's) recordkeeping system must include the value of those services in the employees' gross income and wages.
- These amounts must be reported on an information return (such as Form W-2 or Form 1099-MISC) filed with respect to such individuals.

This relief does not apply to cash received in lieu of identity protection services, or to identity protection services received for reasons other than as a result of a data breach (such as identity protection services received as part of an employee's compensation or benefits package). Because the tax treatment of insurance recoveries is governed by existing law, it also does not apply to proceeds received under an identity theft policy.

Comment. Employers that provide identity theft protection to employees for reasons other than a data breach should consult their tax or legal advisors on the proper tax treatment based on the individual facts and circumstances of the program.

Finally, the Treasury Department and IRS invited comments by October 13 on whether: (1) organizations commonly provide identity protection services in situations where there has been no data breach; and (2) additional guidance on the tax treatment of the provision of those services would be helpful.

In Closing

To limit the potential damage following a data breach, companies are providing affected individuals with free credit monitoring and other identity protection services, often for a period of years. Until this month, the IRS had not addressed whether the value of such services were taxable to the individuals who receive them. The IRS has now clarified that, with certain limited exceptions, the value of services provided to data breach victims will not be taxable as income.

State Tax Treatment

While this guidance clarifies the federal tax treatment of identity protection services, companies will also want to confirm the state tax treatment with their tax advisors.

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