

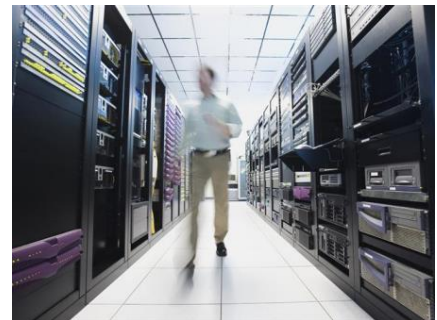
IRS Expands Tax Relief for Identity Protection Services

Last August, the IRS announced that the value of credit monitoring and other identity protection services provided to data breach victims by the organization that experienced the breach (including employers and their service providers) is neither taxable nor reportable on information returns such as Forms W-2 or 1099-MISC. On December 30, the IRS announced it would extend the same tax treatment to services provided to employees or other individuals where there has been no data breach. Given growing data security concerns and expanded tax relief, employers may wish to consider whether to offer identity protection services as part of their overall benefits and security strategies.

Background

As data breaches have become more widespread, companies have looked for ways to provide assistance to their customers and employees whose personal information may have been compromised. Among other things, companies have provided individuals who might be impacted with credit monitoring and other identity protection services to mitigate the risk of identity theft.

Last August, IRS [Announcement 2015-22](#) addressed 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. (See our [August 31, 2015 For Your Information.](#)) With certain limited exceptions, the guidance provided that the value of 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. The tax relief did not apply to cash received in lieu of identity protection services, proceeds received under an identity theft policy, and identity protection services received for reasons other than a data breach (including services received as part of an employee’s compensation or benefits package).



Pre-Breach Identity Protection Services Also Tax-Free

On December 30, IRS [Announcement 2016-02](#) extended the same preferential tax treatment previously afforded post-breach identity protection services to services provided to employees or other individuals where there has been no data breach. If an employer or other organization to which the individual provided personal information (such as name, social security number, bank or credit account numbers) makes identity protection services available before a breach occurs, the IRS generally will not assert that the value of those services is taxable or reportable. However, as in the case of data breach victims, the federal tax relief will not apply to cash received in lieu of identity protection services or to proceeds received under an identity theft insurance policy.

In Closing

The IRS has now clarified that, with certain limited exceptions, the value of credit monitoring and other identity protection services employers provide to employees will be tax-free regardless of whether a data breach has occurred. Employers that wish to provide such services at no cost to their employees may now do so without incurring additional federal payroll tax liability, but will still want to evaluate any state and local tax consequences of providing those benefits.

Benefit Offerings

Employers that wish to include identity protection benefits in their employee benefits programs may provide them at no cost to employees and/or offer them as a voluntary benefit, giving employees the opportunity to select and purchase those services with after-tax dollars. Because identity protection services are not a qualified benefit under Section 125, employees may not purchase coverage on a pre-tax basis through salary reduction.

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