

April 13, 2005

The Honorable Mark w. Everson  
Commissioner  
Internal Revenue Service  
1111 Constitution Avenue, N.W.  
Washington, D.C. 20224

Dear Commissioner Everson:

As April 15 approaches, I am writing to reiterate my strong concerns regarding the ability of current tax law to cope with the phenomenon of offshoring tax preparation and tax data processing by U.S. accountants and professional tax preparers without sufficient notice to taxpayers. There is dangerous growth potential for privacy abuse and identity theft if U.S. law continues to be based on assumptions which do not take into account the accelerating trend to by companies to move tax preparation offshore whether the client approves or not.

One year ago, you wrote to me that you shared my concerns about this problem, particularly the regulatory black hole associated with this burgeoning global phenomenon (see Everson letter to Markey, April 6, 2004.) Noting that “taxpayers rightfully expect that paid return preparers will keep their information confidential,” you asserted that “we must clearly understand these practices before we respond to them, and we are working diligently to gain that understanding.” Further, it is my understanding that you undertook a review of the practices identified in my initial letter (see Markey to Everson letter, February 23, 2004.)

One year hence, it is time to take action to protect the privacy of taxpayers when their data is shipped abroad for processing. As you know, it is my belief that taxpayers should be informed ahead of time if their sensitive tax information and their Social Security Numbers are sent overseas, and that the law should distinguish between countries which have adequate versus inadequate privacy protections. If the data is being sent to a country with adequate privacy protections, then the taxpayer should have to affirmatively “opt out” of the transfer. But where the proposed destination is a country that has inadequate privacy protections, the burden should shift to the tax preparer to justify such a shipment and no data should be shipped unless the taxpayer unequivocally “opts in.”

In preparation for the introduction of legislation to accomplish this goal, I would like the benefit of your investigations since April 2004. In particular, please provide any

information and/or recommendations you may have developed concerning the following issues raised in our previous correspondence:

1. How closely does the IRS track offshoring of tax payer information and tax preparers that offshore tax preparation? How many Americans have their taxes prepared overseas?
2. Has the IRS concluded how best to preserve the taxpayer expectations of privacy and the tax preparers obligation to honor those expectations when tax data processing or tax return preparation is shipped offshore? Please explain.
3. You noted in your letter that “taxpayers may have legitimate concerns about their ability to hold foreign individuals accountable for violations of privacy and confidentiality protections provided by U.S. law” and that you would “examine these concerns as part of our review of the reported practices.” Please provide the results of this review and any insights you may have gained with respect to taxpayer concerns and how to protect taxpayer privacy in the context of offshore tax preparation.
4. Section 7216 of the Internal Revenue Code permits a tax return preparer to disclose, without the taxpayer’s consent, confidential sensitive data to a third party that provides auxiliary services in preparing the taxpayer’s return. In your letter, you noted that the IRS was considering undertaking a project to revise this regulation to address the problems raised by offshore tax preparation. Did that project go forward? If not, why not? If so, please explain what was done, if anything, to restrict the transfer of confidential private information to third parties in foreign countries without the taxpayer’s consent.
5. What, if anything, has the IRS undertaken to assess the relative strength of privacy protections in foreign countries commonly used for preparation of U.S. tax returns? Please provide a list of foreign jurisdictions commonly used for such preparation by U.S. tax preparers and any analysis you may have done regarding the capacity of a taxpayer to protect his/her privacy in those foreign jurisdictions.
6. Have you ever assessed a penalty on a foreign return preparer? What mechanisms for enforcement are unavailable against a foreign return preparer as compared to a domestic return preparer?
7. You have noted that current law does not hold the U.S. tax return preparer responsible when a foreign person hired by the U.S. firm violates the protections against unauthorized disclosure or misuse contained in Sections 6713 and 7216 of the Internal Revenue Code. This would appear to be a gaping hole in the law. The foreign company clearly acts as an agent for the U.S. company by receiving and processing the information. Why should the tax law make it difficult for the taxpayer, or the IRS, to hold the principal responsible for the actions of its agent? In fact, this problem could act as a

significant incentive to move operations offshore, separate and apart from the attraction of lower wages. What, if anything, has the IRS done to close this loophole?

8. I note that the American Institute of Certified Public Accountants (AICPA) has published new rules which would require that, starting July 1, 2005, members of AICPA

- a. notify clients whenever accounting work is outsourced, such as bookkeeping, tax return preparation, consulting and attestation services, and
- b. enter into contractual agreements with outsourcers to maintain confidentiality of client data.

While such rules are helpful, they only apply to member CPAs and do not address enforceability. For purposes of putting this initiative in the context of the offshoring of tax return preparation, I would be interested in knowing what percentage of all tax returns are prepared by CPAs who are members of AICPA?

Thank you for your attention to these matters. I look forward to your response. If possible, I would appreciate receiving that response at the earliest opportunity, preferably by May 2, 2005. In the meantime, I urge you to take every step possible within your existing powers to protect the privacy of taxpayers.

Sincerely,

Edward J. Markey