Office of Chief Counsel
Internal Revenue Service

memorandum

CC:LM:CTM

date: Apr 1 2002

to: Examination Division - San Jose
Attn: Sherry Larsen, Revenue Agent

from: Associate Area Counsel, IP
(Communications, Technology, and Media)

---

subject: **NONDISCLOSURE AGREEMENTS**

This memorandum responds to your request for advice on whether Examining Agents should enter into nondisclosure agreements in order to receive tax related computer software as described in I.R.C. Sec. 7612. In accordance with I.R.C. Sec. 6110(k)(3), this memorandum should not be cited as precedent.

CONCLUSION

The Service should not enter into nondisclosure agreements with owners of tax software or examined taxpayers referred to in I.R.C. Sec. 7612 since the current statutory framework offers sufficient protections to such owners and taxpayers.

LEGAL ANALYSIS

I.R.C. Sec. 7612(a)(2)provides specified protections for any software and related materials provided in an audit which produce or analyze tax related software source code. These protections are enumerated in I.R.C. Sec. 7612(c)and include authorization to Courts to issue protective orders in summons enforcement proceedings to protect trade secrets, limitation on use of software to a single taxpayer's return for which it was produced, maintenance of software in a secure place, limitations on copying, and treatment of the software as return information under I.R.C. Sec. 6103.

Where the Service provides software access to a nonemployee, additional safeguards are imposed to protect both the owner of the software and the taxpayer whose return is being audited using that software. Under I.R.C. Sec. 7612(c)(2)(G), the Service must provide the taxpayer and the owner with a copy of a written agreement between the third party having access and the Service, which agreement binds the third party not to disclose the

software information to anyone not entitled to the information under Sec. 6103 and to further agree not to participate in the development of similar software for 2 years. Pursuant to I.R.C. Sec. 7612(c)(2), the owner of the software is considered a party to the aforementioned agreement.

If either an I.R.S. employee or third party expert made an unlawful disclosure in violation of Sec. 6103, the taxpayer would have legal recourse under I.R.C. Sec. 7431.

If an employee has made the illegal disclosure, the taxpayer may sue the U.S. for damages under I.R.C. Sec. 7431(a)(1). If the third party expert has made the unlawful disclosure, the taxpayer could sue him for damages directly under I.R.C. Sec. 7431(a)(2). The taxpayer could recover actual damages proximately caused by such disclosure as well as costs pursuant to I.R.C. Sec. 7431(c).

We note that I.R.C. Sec. 7431 only empowers a taxpayer to sue for damages resulting from an unlawful disclosure. Thus, this section would provide no protection to the wronged owner of the software. However, since I.R.C. Sec. 7612(c)(2)(G) makes the owner a party to a written agreement between a third party expert and the Service precluding unlawful disclosure and ensuring non competition, any breach of such provision by the third party would provide the owner with a breach of contract cause of action against him.

Further, while I.R.C. 7431 provides an owner with no redress should an employee of the Service illegally disclose, the Federal Tort Claims Act may provide some relief if the owner could establish tort claims against the United States under circumstances where the United States, if a private person, would be liable to the claimant in accordance with the law of the place where the act or omission occurred. 28 U.S.C. 1346(b).[1] We note that many states have Trade Secret Acts, which might provide the tort base for such relief. We caution that whether such relief would lie would depend upon the State where the act occurred and

---

[1]We are aware that the Federal Tort Claims Act precludes any claim with respect to the collection or assessment of tax. 28 U.S.C. Sec. 2680(c). However, a suit by the owner would not arise out of the assessment and collection of his tax, but rather a misuse of his software. We are also aware that I.R.C. Sec. 7431 provides the exclusive remedy for violations of I.R.C. Sec. 6103. However, that section only permits suits by wronged taxpayers, not third parties. Thus, we believe the FTCA would be the only possible recourse of the owner against the United States.

the facts of each particular case.

We also note that there are staunch criminal penalties which provide a powerful incentive to both employees and third party experts to comply with Sec. 7612 and the disclosure laws.

I.R.C. Sec. 7213 provides that any federal employee or contractor to whom tax information has been disclosed for tax administration purposes, who willfully discloses return information in violation of I.R.C. Sec. 6103 shall be guilty of a felony punishable by a fine of up to $5000 and imprisonment for up to five years.

I.R.C. Sec. 7213(d) also makes it a felony punishable by fine of up to $5000 and imprisonment for up to 5 years to willfully disclose software in violation of I.R.C. Sec. 7612. 00

Thus, based on the fact that adequate protection against misuse of tax software exists, we recommend that no separate agreements be entered into with owners of the software or taxpayers being examined under it since such agreements might conflict with the statutory scheme of protections and might create inconsistent treatment of like situated parties.

By:_____
BARBARA M. LEONARD
Associate Area Counsel, IP
Large and Mid-Size Business