



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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INTERNAL REVENUE SERVICE NATIONAL OFFICE TECHNICAL ASSISTANCE

MEMORANDUM FOR TINA K. BYRD
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LMSB, PREFILING AND TECHNICAL GUIDANCE

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FROM: Barbara A. Felker
Chief, CC:INTL:BR3

SUBJECT: Permissible use of tax return preparation computer software
under section 7612(c)

This Technical Assistance responds to your memorandum dated April 26, 2000. Technical Assistance does not relate to a specific case and is not binding on Examination or Appeals. This document is not to be used or cited as precedent.

ISSUES

1. Whether the Service's use of computer software executable code obtained in the course of an audit is permissible under section 7612(c)(2)(A) of the Internal Revenue Code in the following three situations.

- a. The Service uses the computer software executable code and the taxpayer's data files to perform "what if" computations, making changes to the taxpayer's data, and the computer software executable code is used to determine the tax consequences of those changes;
- b. The Service uses the computer software executable code and the taxpayer's data files and adjusts those files to incorporate proposed adjustments to the amount or classification of items of income or expense.

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The computer software executable code is then used to compute proposed tax adjustments and a revised Form 1118 (foreign tax credit computation) and related schedules; and

c. The Service uses the computer software executable code and the taxpayer's data files to generate input data files and output reports, which are then used by the Service for its examination of the taxpayer's return using a software program that the Service has developed internally, or which the Service has purchased or licensed from a third party.

2. Would those uses cause the Service to be using the commercial vendor's computer software executable code without a license or other authorization?

3. Should the Service secure permission from the foreign tax credit commercial vendors to use their computer software executable code as described in the three scenarios?

CONCLUSIONS

All of the activities described in issue #1 above are within the scope of section 7612(c)(2)(A) of the Code, and are therefore permissible uses of the computer software executable code. Such uses would not require a license from the software vendor, and it would not be necessary to obtain the vendor's permission to use the computer software executable code in the manner described.

LAW AND ANALYSIS

As part of the IRS Restructuring and Reform Act of 1998, Congress enacted special rules to address a potential conflict between the intellectual property rights of the developers and owners of computer software programs and the Service's right under section 7602 of the Code to obtain access to such programs in connection with the examination of a taxpayer's return. Congress was concerned that the examination of computer programs (executable code) and source code by the Service could lead to the diminution of intellectual property rights through the inadvertent disclosure of trade secrets, that special protection against inadvertent disclosure should be established, and that access to source code should be restricted. As a result of these concerns, Congress added new section 7612 to the Code with respect to summonses of computer software source code used for tax accounting, tax return preparation, tax compliance and tax planning, and protection of both computer software executable code and source code used for those purposes in the hands of the Service.

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A. Summons of computer software executable code and source code. Section 7602(a)(1) of the Code authorizes the Service to examine any books, papers, records, or other data (including tax accounting, tax preparation and tax planning software) that may be relevant or material in connection with the examination of a taxpayer's return. Section 7602(a)(2) authorizes the Secretary to issue a summons to obtain access to this material should the taxpayer refuse to give the Service access or if the taxpayer places unreasonable restrictions on the Service's access. Section 7612 does not restrict the right or modify the limitations on the right of the Service to summons the executable code of tax accounting, tax preparation and tax planning software, including foreign tax credit, foreign sales corporation or other specialized programs. The Service must satisfy the four *Powell* standards, *i.e.*, the examination to which the summons relates must be conducted pursuant to a legitimate purpose, the summons must seek information that may be relevant to the examination, the Service does not already have the information sought by the summons, and the Service has followed the administrative steps set forth in the Code, with regard to the summons. *Powell v. U.S.*, 379 U.S. 48, 57-8 (1964). Section 7612(b)(1) provides additional requirements the Service must meet in order to obtain computer software source code by issuing a summons or enforcing a summons to produce or analyze any tax related computer software source code.

B. Safeguards to ensure protection of trade secrets and other confidential information. In addition to any court-issued protection order, section 7612(c)(2) sets forth specific safeguards that must be taken by the Service with regard to both computer software executable code and source code that it receives, through summons or otherwise, in the course of any examination of any taxpayer. The specific safeguards which apply to both computer software executable code and source code are as follows:

- i. The software and related documents may be used only in connection with the examination of the taxpayer's return, any appeal by the taxpayer to the Service's Office of Appeals, any judicial proceeding (and any appeals from those proceedings) and any inquiry into any offense connected with the administration or enforcement of the internal revenue laws;
- ii. The Service shall provide, in advance, to the taxpayer and the owner of the software a written list of the names of all individuals who will analyze or otherwise have access to the software and related documents;
- iii. The software and related documents shall be maintained in a secure area or place, and, in the case of computer software source code, shall not be removed from the owner's place of business unless the owner permits, or a court orders, such removal. The owner is required to make available any necessary equipment or materials for analysis of the computer software source code required to be conducted on the owner's premises;

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- iv. The software and related documents shall not be copied, except as necessary to perform analysis, and the Service shall number all copies made and certify in writing that no other copies have been (or will be) made;
- v. At the end of the period during which the software and related documents may be used under paragraph i, above -
 - a. The software and related documents and all copies thereof shall be returned to the person from whom they were obtained and any copies thereof made under paragraph iv., above, on the hard drive of a machine or other mass storage device shall be permanently deleted; and
 - b. The Service shall obtain from any person who analyzed or otherwise had access to such software and related documents a written certification under penalty of perjury that all copies and related materials have been returned;
- vi. The software shall not be decompiled or disassembled;
- vii. The Service shall provide to the taxpayer and the owner of any interest in such software, a written agreement, between the Service and any person who is not an officer or employee of the United States and who will analyze or otherwise have access to such software, which provides that such person agrees not to-
 - a. Disclose such software and related documents to any person other than persons to whom such information could be disclosed for tax administration purposes under section 6103 of the Code; or
 - b. Participate for two years in the development of software which is intended for a similar purpose as the software examined; and
- viii. The software and related documents shall be treated as return information for purposes of section 6103.

Each of the three scenarios you describe falls within the scope of section 7612(c)(2)(A) as set forth in paragraph i, above, and are therefore permissible uses of the computer software executable code. The Service is not required to obtain

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from the software vendor either a license or the vendor's permission to use the computer software executable code in the manner described.

Please call (202) 622-3850 if you have any further questions.

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