



## Whitepaper

# Electronic Document Delivery of Schedule K-1s under IRS Revenue Procedure 2012-17

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## PURPOSE:

This white paper is intended to provide the reader with a brief overview of relevant compliance, document security issues and technologies as they apply to the electronic communication of confidential financial information.

## BACKGROUND:

On February 13, 2012, the IRS issued guidance that allows partnerships to provide Schedule K-1, Partner's Share of Current Year Income, Deductions, Credits, and Other Items electronically. Certain entities, such as partnerships, are required annually to file K-1's with the IRS and provide a copy to their partners. K-1's typically contain personal information that could be used for identity theft.

A partnership or entity that is required to furnish a written statement on Schedule K-1 (furnisher) to a person or organization (recipient) may furnish the Schedule K-1 in an electronic format in lieu of a paper format. A furnisher who meets the IRS requirements will be treated as furnishing the Schedule K-1 in a timely manner and complying with the provisions of the revenue procedure.

Under the new rules, prior to, or at the time of, a recipient's consent, the furnisher must provide the recipient with a clear and conspicuous disclosure statement containing each of the disclosures described in the IRS revenue procedure.

The revenue procedure (Revenue Procedure 2012-17) addresses how the consent can be provided electronically — including secure electronic email and through the partnership's secure internet portal. The revenue procedure states that a failure to comply with the requirements may be deemed a failure to furnish the recipient a K-1 as required under IRC Section 6031(b), with the possibility of penalties under IRC Section 6722. The revenue procedure also addresses how recipients are to be informed about changes in software, defines how the partnership is to provide instructions about accessing and printing electronic statements and the partnership's responsibility if the K-1 is electronically undeliverable.

In summary, prior to, or at the time of, receiving the recipient's consent, a Schedule K-1 furnisher must inform the recipient:

1. that the Schedule K-1 will be furnished on paper if the recipient does not consent to receive it electronically,
2. of the scope and duration of the consent,
3. of the procedure to obtain a paper copy of the recipient's statement after providing the consent,
4. how to withdrawal consent,
5. of the conditions under which a furnisher will cease furnishing statements electronically,
6. of the procedures for updating the information needed by the furnisher to contact the recipient,
7. of the hardware and software required to access, print, and retain the Schedule K-1, and the date when the Schedule K-1 will no longer be available on the website,
8. that the Schedule K-1 may be required to be printed and attached to a Federal, State, or local income tax return.

## **OBTAINING CONSENT:**

The recipient of an electronic K-1 document must have affirmatively consented to receive the Schedule K-1 in an electronic format. The consent may be communicated electronically in any manner that reasonably demonstrates that the recipient can access the Schedule K-1 in the electronic format in which it will be furnished to the recipient. Alternatively, the consent may be communicated in a paper document if the consent is confirmed electronically by the recipient and that consent reasonably demonstrates that the recipient can access the Schedule K-1 in the electronic format in which it will be furnished to the recipient.

The consent requirement will not be satisfied if the recipient withdraws the consent and the withdrawal takes effect before the statement is furnished. The furnisher may provide that a withdrawal of consent takes effect either on the date it is received by the furnisher or on a subsequent date determined by the furnisher and communicated to the recipient within a reasonable period of time after the furnisher receives the withdrawal. The furnisher may also provide that a request for a paper statement will be treated as a withdrawal of consent.

Prior to, or at the time of, a recipient's consent, the furnisher must provide to the recipient a clear and conspicuous disclosure statement complying with the IRS revenue procedure. The statement may be electronic or on paper. The statement must provide instructions on how to access and print the statement.

The furnisher must inform the recipient that the Schedule K-1 will be furnished on paper if the recipient does not consent to receive it electronically.

The furnisher must inform the recipient of the scope and duration of the consent. For example, the furnisher must inform the recipient whether the consent applies to each Schedule K-1 required to be furnished after the consent is given until it is withdrawn or only to the first Schedule K-1 required to be furnished after the consent is given.

The furnisher must inform the recipient of any procedure for obtaining a paper copy of the recipient's statement after providing the consent and whether a request for a paper statement will be treated as a withdrawal of consent.

The furnisher must notify the recipient if the statement is posted on a website. The notice may be delivered by mail, electronic mail, or in person. The notice must provide instructions on how to access and print the statement. The notice must include the following statement in capital letters, "IMPORTANT TAX RETURN DOCUMENT AVAILABLE." If the notice is provided by electronic mail, the foregoing statement must be on the subject line of the electronic mail.

## **ELECTRONIC CONSENT:**

There are four main parts to compliant Electronic Consent;

1. The Consent itself – This is the verbiage that is to be displayed in plain text, HTML or PDF format to the recipient. For each Consent document, there is a reference to its version, file content, and the associated “Accept” and “Decline” button verbiage. The label on each button should be customizable by the furnisher and should correspond to the displayed, accepted and declined functions. The content should be versioned and stored in such a manner that the furnisher knows exactly which version of the Consent was presented to and possibly acknowledged by the recipient. It is also date and time stamped whenever it is modified, recording the furnisher credentials that performed the modification. All changes should be logged for audit purposes.
2. Recipient access to electronic documents – Whenever a recipient attempts to access an electronic document that requires Consent, a determination is made whether or not to display a Consent acknowledgement. Each time the recipient interacts, a log of each interaction should be recorded. The log includes the version of the Consent document that was acknowledged, the date and time it was acknowledged, the first and last name of the recipient and their IP or email address.
3. Consent delivery method and frequency – This is the set of rules that defines how and when a Consent will be presented to the recipient. Delivery may be via physical paper document, secure email, or a secure web portal. The delivery frequency determines when a recipient is presented with a Consent request. It could be upon initial access, at regular intervals, or periodically on as defined by the furnisher. For example, a Schedule K-1 may require annual Consent whereas other, less confidential documents may only require periodic Consent from the recipient. Furnishers can reset a recipient’s Consent status so the recipient must accept or decline at next access attempt.
4. Reporting – The reporting is designed around the recipient and furnisher interactions with the electronic documents, typically displayed chronologically. Activity reporting includes filters for recipient, date range, type of Consent, status (accepted, declined, displayed), and frequency of display. The reporting identifies which recipients have declined the electronic Consent as well as maintains detailed records of access to the electronic documents, an audit trail.

## **ELECTRONIC DOCUMENT DELIVERY:**

Once a furnisher has received affirmative Consent from the recipient, they have a fiduciary duty to ensure that the document content is delivered in a secure manner. This typically entails ensuring that the electronic communication between the furnisher and the recipient is encrypted in such a way that an unintended party cannot decipher the message. Encryption is considered an effective technique for managing document access.

The actual document delivery, such as a Schedule K-1, typically takes place via secure email or web portal technology. Most documents are delivered in PDF format and can contain document level passwords for additional security. Document access control maintains access rights and permissions assigned to an electronic document once it has been published and distributed. By applying security parameters to the individual document, furnishers gain greater assurance in the confidentiality, authenticity, and integrity of electronically communicated documents in addition to securing the communication line or storage location.

### **Secure email:**

Encrypting an electronic email message protects the privacy of the message by converting it from (readable) plaintext into (scrambled) cipher-text. Only the recipient who has the private key that matches the public key used to encrypt the message can decipher the message for reading. Any recipient without the corresponding private key would see only garbled text.

Sending and viewing encrypted electronic email messages requires both sender and recipient to share their digital ID, or public key certificate. This means you and the recipient each must send the other a digitally signed message, which enables you to add the other person's certificate to your contacts. Once both parties have shared certificates, sending and viewing encrypted electronic email messages between them is the same as with any other electronic email messages.

### **Secure portal:**

Secure portals, an electronic gateway to a collection of electronic information, offer an alternative to electronic email for communicating and collaborating with recipients and offer broader, clearer communications with increased efficiency. Privacy laws such as the Gramm–Leach–Bliley Act require that furnishers encrypt their clients' personally identifiable information that is sent online electronically. Other advantages of secure portals, as distinguished from secure email, include increased file size limitations and self-service access to sensitive personal financial information.

Portals typically use the Secure Sockets Layer (SSL) protocol to communicate between authenticated recipients and the furnisher's web portal. SSL provides for the encryption of the network communication between the furnisher and the recipient.