

Tips For Dealing With IRS' New IDR Procedures

Law360, New York (June 25, 2014, 4:17 PM ET) --

The new Large Business & International (LB&I) information document request (IDR) operating procedures, outlined in a series of directives released within the last year,[1] have generated a tepid response from taxpayers and practitioners. Many suggest that the new approach will foster increased acrimony in the audit process and will ineluctably lead, in many if not most circumstances, to summons enforcement proceedings. The most recent directive, LB&I-04-0214-004 (Feb. 28, 2014), however, improves upon the perceived defects of the new IDR procedures, offering taxpayers opportunities to maneuver within the constraints of the regime and to respond to IDRs before and during escalation in the enforcement process.

Effective management of the new IDR process may be even more critical in light of the recent U.S. Supreme Court decision, *U.S. v. Clarke*, No. 13-301 (2014). There, the taxpayer challenged the IRS' summonses arguing that it had issued them in bad faith. The court clarified that taxpayers seeking to examine an IRS agent in a summons enforcement proceeding must set forth "specific facts or circumstances plausibly raising an inference of bad faith," including circumstantial evidence, but concluded that "[n]aked allegations of improper purpose are not enough." *Id.* at __ (slip. op., at 6).[2]

Taxpayers contemporaneously documenting their communications and interaction with an exam team during an audit will be in a better position to offer sufficient evidence and articulate specific instances of IRS bad faith. What is more, a robust documentation policy can also be used as a tool to thwart summons enforcement; neither the IRS nor the U.S. Department of Justice attorneys may want to confront well-documented allegations of bad faith or the examination of IRS officials.

IDR Process — Early Steps

A. Procedures

The IDR directives strongly encourage examiners and taxpayers to confer during the early stages of an audit. Examiners are instructed to identify and discuss the auditable issues with the taxpayer, explaining how the specific information requested relates to issues under consideration and how pursued evidence



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is necessary to the investigation. After determining the scope of relevant information, examiners will prepare an IDR for each reviewable issue. The issue-specific IDR paradigm is a core element of the new IDR regime.[3]

A formalized draft IDR is thereafter forwarded to the taxpayer. No return date is listed on the draft IDR, giving the taxpayer the opportunity to review its content. Following discussions with the taxpayer on substantive issues, which are supposed to be concluded within 10 business days,[4] the examiner will coordinate with the taxpayer to develop a reasonable time frame for a response to the IDR. If agreement on a response date cannot be reached, the examiner will unilaterally set the relevant date. During this process, the examiner will also commit to a date by which the response will be reviewed and a decision communicated to the taxpayer on whether the information received satisfies the IDR. This date will be noted on the IDR.[5]

B. Taxpayer Benefits: Taking Advantage of the New Process

The early stages of audit will likely prove to be the most critical period of the new IDR process. Importantly, this period presents a direct opportunity for taxpayers to both educate examiners and to co-structure the timelines by which the audit will proceed.

Taxpayers should approach an audit prepared to substantively engage IRS examiners with a thorough understanding of the auditable issues, the relevant law, and the mechanics of their document retention/archiving policies.

Communication between the IRS and the taxpayer should flow through designated individuals to avoid confusion and duplicative requests or responses. If the taxpayer is being audited by several IRS industry personnel at the same time, it may be beneficial to request that one IRS representative serve as the leader/filter for the various teams. The taxpayer should also suggest regular meetings with the IRS representative to gauge progress and develop a working relationship with the exam team.

As a best practice, taxpayers should prepare internal memos describing all meetings/dialogues with IRS personnel during the IDR process. These memos should be limited to establishing a factual record — written opinions regarding the IRS' positions should be avoided so that taxpayers may forward the relevant document to an IRS manager if escalation, discussed further below, is deemed necessary.

IDR response time negotiations require advanced due diligence. A clear burden is on LB&I taxpayers to determine, with some accuracy, the amount of time it will take them to survey data repositories, identify relevant documents and records, perform privilege review, convert such records into an understandable narrative or form, and make a full production to the IRS, at the inception of the examination.

Taxpayers (and IRS examiners) should appreciate that data collection efforts are not performed in a vacuum and complications often organically arise. Common external issues, such as third-party litigation and attendant discovery, may also materialize following the scheduling meetings and render impracticable otherwise reasonable production dates. It is critical that taxpayers anticipate and account for these variables when establishing a IDR timetable with IRS examiners.

Examiners may better appreciate these concerns if they are articulated in a well-crafted presentation or written narrative during this preliminary period. Taxpayers should consider either requesting a meeting with or submitting the explanatory document to the examiner following receipt of the draft IDR.

Taxpayers should assess requested information specified in the IDR drafts immediately upon receipt and begin identifying and marshaling evidence accordingly. The response time frame for the IDR is not established at this point so taxpayers may take advantage of this additional period to coordinate their data collection efforts.

As a starting point, taxpayers should identify and locate the personnel that were involved with the reviewed transaction(s) and determine their current status with the business. Thereafter, the taxpayer should organize meetings or calls to confer with the current and former employees to better understand the transactions and the universe of relevant documents that may be available.

Detailed planning memoranda should also be sent to relevant business units, affiliates, accounting, etc., describing specific collection objectives that should be accomplished in due course. Specific dates may be added to these memoranda when finalized IDRs are issued. As collection efforts begin in earnest, progress toward the objectives should be continually monitored and further documented.

Taxpayers should also review the substance of the draft IDR with some scrutiny. Specifically, taxpayers should assure that: (1) the IDR concerns only a single issue; (2) the information sought may be retrieved with reasonable efforts; and (3) the draft is written in clear, unambiguous language.

Identified issues should be relayed to the examiner along with any requests for clarification, if necessary. It may also be beneficial for taxpayers to suggest alternate wording to certain requests (i.e., narrowing an overly broad request or making clear any opaque language). As noted earlier, all correspondence with the IRS should be documented.

Extension Authority

A. Procedure

1. General

Examiners may grant taxpayers a one-time extension before enforcement processes begin. Extensions are permissible if either the taxpayer fails to provide a response or provides an incomplete response by the IDR due date. In either circumstance, the examiner is instructed to contact the taxpayer and discuss the matter within five business days of the IDR due date.[6]

In that same period, the examiner will determine whether an extension is warranted. If the examiner determines that the taxpayer's explanation justifies an extension, the examiner may grant an additional period of up to 15 business days, measured from the day time the extension determination is "made and communicated" to the taxpayer, to respond to the IDR.[7]

2. Timing

- If no response is received by the original IDR due date and no extension is granted, the IDR enforcement process begins on the date the extension determination is communicated to the taxpayer. Alternatively, if an extension is granted and no response is received by the extension due date, the IDR enforcement process begins as of the extended due date.

- If a response is received by the original due date, the examiner must determine whether the response is complete on or before the date specified in the IDR. If the response is considered complete upon review, the examiner must notify the taxpayer that the IDR is closed. If the IDR response is not complete, and no extension is granted, the enforcement process begins on the date the determination is communicated to the taxpayer.
- Alternatively, if the response received by the original due date is incomplete and an extension is granted, the enforcement period begins: (1) at the end of the extension period if no additional information is produced during such period; or (2) on the date the examiner notifies the taxpayer that the response remains incomplete if additional information is produced during the extension period.[8] If the response is deemed complete, the examiner should notify the taxpayer that the IDR is closed.

B. Taxpayer Benefits: Improving the Probability of an Extension

Even when unexpected difficulties — which will occur — render a response untimely, there are still opportunities for taxpayers to use this process proactively. Taxpayers should try to maintain frequent communication with IRS examiners during document identification and collection activity, apprising the examiner of difficulties associated with assembling and producing relevant information. This open dialogue should add credibility to any extension requests, facilitating a more seamless IDR extension process.

Taxpayers should also consider documenting difficulties as they occur and explain why such problems were unanticipated during the initial IDR timeline negotiation process. It goes without saying that examiners will be more receptive to granting extensions if taxpayers can demonstrate that such difficulties could not have been managed more effectively if the taxpayers operated with more foresight at the start of the audit.

When seeking an extension, taxpayers should specifically identify the information that remains outstanding, the amount of additional time needed to assemble and submit relevant records, and the extent of the taxpayer’s ongoing efforts to retrieve such data.

It also bears reiterating that the extension period (of up to 15 business days) begins when the extension determination is “made and communicated” to the taxpayer. The directive suggests that this “communication” should occur within five business days of the original IDR due date. The directive, however, fails to define the appropriate “communication” that initiates the extension period.

Although an oral communication of extension is sufficient to begin the period, it would be advisable for the taxpayer to request that any extension be documented and mailed. If the examiner is unwilling to do this, the taxpayer may consider sending an email to the examiner memorializing the extension. This provides form and clarity to the extension process and eliminates controversies that could arise from misinterpreted oral communications.

IDR Enforcement Process

The IDR enforcement process comprises three graduated steps: (1) a delinquency notice; (2) a pre-

summons letter; and (3) a summons. Examiners are not explicitly authorized to depart from the seemingly rigid enforcement process, creating a concern expressed by many practitioners that one taxpayer production failure will beget cascading failures, eventually leading to public summons enforcement actions. However, even if taxpayers are operating in the IDR enforcement process, there remain opportunities to extricate themselves from the process' inflexible guidelines.

A. Delinquency Notice (Letter 5077)

The first step in the IDR enforcement process is the delinquency notice. The directives instruct examiners to discuss the delinquency notice with the taxpayer and explain subsequent steps in the enforcement process if information is not provided by a response date. The examiner will issue the notice to the taxpayer within 10 days^[9] of the application of the enforcement process. The response date is generally no more than 10 business days from the date of the delinquency notice. Territory managers approve a date beyond 10 business days. A copy of the delinquency notice and IDR is forwarded to "assigned counsel".

B. Pre-Summons Letter (Letter 5078)

If the taxpayer does not provide a complete response to the IDR by the delinquency notice response date, pre-summons letter procedures commence. The IRS team manager, specialist manager, and relevant territory managers and counsel must first confer regarding the taxpayer's incomplete response. The group also prepares a pre-summons letter.

The relevant territory manager thereafter discusses the letter with the taxpayer, as well as subsequent steps if the taxpayer fails to fully respond by a response date in the letter. The letter is thereafter issued as soon as possible, but generally no later than 10 business days after the due date of the delinquency notice. The letter is addressed to "the taxpayer management official that is at a level equivalent to the LB&I territory manager." The response date in the pre-summons letter is generally 10 business days from the date of the letter. An IRS director of field operations (DFO) must approve any date beyond the 10 business days.^[10]

C. Summons

If the taxpayer does not provide a complete response to the IDR by the pre-summons letter response date, the team manager, specialist manager, relevant territory managers and DFOs, and IRS counsel discuss the taxpayer's failure and prepare a summons. Thereafter, the IRS begins its general summons procedures.

D. Tools for Dealing with the Enforcement Process

Taxpayers may encounter examiners that hold steadfast on certain "nonessential" or overreaching requests, or exam teams that misinterpret the completeness of an IDR response. In those situations, taxpayers may consider educating the exam team with presentations or submissions. Any such additional information offered to the IRS should be drafted in a thoughtful, deliberate manner, ensuring that the data presented does not unintentionally expand the scope of an audit.

If taxpayers recognize that they need additional time to respond to an IDR by either the delinquency notice or pre-summons letter response dates, and the relevant IRS personnel are unwilling to grant the request, taxpayers should escalate their concerns to a more senior IRS agent. Taxpayers, at that point,

should be prepared to articulate why an extended response date is in the best interest of both parties. Clearly, if the senior IRS agent is provided with documentation that describes taxpayer efforts and difficulties in complying with prior response dates, and explains matters of disagreement with IRS examiners, the agent may be more inclined to accede to a reasonable extension of time.[11]

If all efforts to fully respond to the IRS by relevant due dates fail, or IRS agents remain unwilling to characterize a response as complete, taxpayers may be summoned for such information. Taxpayers often approach summonses with considerable apprehension. Frequently, however, taxpayers can take steps to reduce this unease.

Until the government seeks to enforce a summons in district court, a summons remains an administrative tool the IRS uses to collect information.[12] Even then, the taxpayer need only comply if the court orders enforcement. Before it gets to this, however, the taxpayer can take additional measures to avoid enforcement.

For instance, the taxpayer (or its representative) can contact the IRS and indicate its willingness to comply with the summons and request a reasonable extension of time within which to comply. In such a situation, the IRS is supposed to refrain from seeking enforcement of the summons.[13] Accordingly, by maintaining frequent contact with the IRS during the examination process and keeping the examiner apprised of collection efforts and difficulties associated therewith, the taxpayer will significantly reduce the likelihood that the IRS will initiate an enforcement action.

As with other efforts to extend other production periods noted above, if the taxpayer submits detailed, contemporaneous records that document audit communications and ongoing collection efforts, the examiner will likely be more inclined to grant an extension to comply with the summons. As a result, outstanding summonses should not pose a significant impediment to legitimate document collection and production efforts.

Moreover, stated again, if the IRS decides to pursue an enforcement action and the taxpayer believes that the examiner is operating in bad faith, Clarke requires the taxpayer to first submit sufficient evidence (not simply allegations) that plausibly raise an inference of IRS bad faith before the taxpayer is permitted to examine the agent. It appears that the one way to satisfy this burden is to maintain records about communications with the IRS and the efforts the taxpayer made to respond to an IDR request.

Conclusion

The new IDR process represents a marked deviation from prior examination procedures. The constraints of the process, clearly delineated in the directives, present certain obstacles toward a smooth audit. Nonetheless, if a taxpayer approaches an exam with greater and earlier involvement, and maintains and documents communication with an examiner as the investigation unfolds, friction with the IRS and unnecessary complications can be managed or largely avoided.

And in those circumstances where taxpayers believe examiners have unjustifiably escalated an exam to summons enforcement procedures, taxpayers may use their prepared documentation to plausibly show an inference of bad faith on part of the examining agent or simply that the taxpayer has fully complied with the summons.

NEW IDR PROCESS FOR 2014: EXPLANATION & TIPS

Requirements For Issuing IDRs

Key Requirements For Agents

- Discuss the issue related to the IDR.
- Explain how information request relates to the issue and why it's necessary.
- Determine what information will ultimately be requested.
- Provide draft IDR to taxpayer and discuss contents. (Review is supposed to be completed w/in 10 business days)
- Ensure that the IDR states the issue and requests only information related to that issue.
- Issue only one IDR for each issue.
- Discuss a reasonable deadline for responding to the IDR; if no agreement on due date, the IRS must set a reasonable deadline.
- Commit to a date for IRS review of the response and decision on whether the information satisfied the IDR; put date on IDR.

Taxpayer Opportunities

Establish Regular Discussions:

- Establish working relationship with IRS (suggest regular meetings)
- Know your issues, the facts and the law, before you engage in substantive discussions.
- Understand the business reasons for the transaction.
- If you are unable to respond by the response date, inform IRS prior to due date. Examiner can grant you up to 15 additional business days to respond.

Limit IDR Scope:

- Educate the IRS via presentations and conversations. But anything you say may be used to justify greater scope.
- Review and suggest wording changes to draft IDR. Determine the amount of detail you provide in writing.

Establish Working Procedures:

- Identify lead taxpayer representative for all IDRs.
- Request IRS exam team identify leader for IDR process. When multiple IRS disciplines are involved ask them to appoint an IDR process leader.
 - If exam refuses, monitor whether uniform process is being followed by involved agents.

Consider Escalation Protocol:

- Establish a strategy for escalation early. If the agent is not following the spirit of the new IDR process, you can escalate to their manager.
 - Pros: Establish protocol to resolve issue sans argument. Early escalation may also support a later legal argument should the IRS seek summons enforcement.
 - Cons: Agent may perceive escalation negatively.

Keep Certain IDRs in Draft:

- Try to keep IDRs in draft form as the response time doesn't start until the IDR is issued. Identify time consuming IDRs in advance.

Have a Response Date In Mind:

- Plan ahead for problems and delays. Be specific about problems.
- Make sure the IRS commits in writing to review by a given date.

Internal Best Practices

Manage Your Boss:

- Proactively inform your boss of any issues. Encourage your boss to educate management.

Establish Planning Protocol:

- Identify sources of information early.
- Prepare IDR log. This should include:
 - Timeline for responses. Received date and due dates
 - Establish deadlines for sources of information, monitor statuses, prioritize responses, and document communications with IRS

Establish Planning Protocol:

- Keep your boss informed of progress and problems.
- Set deadlines for information sources and follow-up as needed.

Manage Your Sources:

- Prepare correspondence informing all sources, including tax, accounting, business units, affiliates etc., of the consequences of missing a deadline.
- Know your sources' schedules (don't plan a response when they're on vacation)
- Follow-up with sources. Consider educating sources and their bosses.

Documenting IRS Communications

Establish a gradual method of escalating communications with exam.

Internal Memo:

- Prepare an internal memo memorializing conversations with the IRS. Limit this memo to the facts as you might consider turning the memo over in a dispute.

Send Correspondence to Agent:

- Sending the agent correspondence memorializing what was agreed to in a conversation can be a good practice depending on the agent.
- Request the agent responds to your correspondence, if the agent disagrees with your factual recitation.

Copy Agent's Manager on Correspondence:

- Consider whether this will harm your relationship with the agent.

NEW IDR PROCESS FOR 2014: EXPLANATION & TIPS

The Enforcement Process

Enforcement Timeline	IDR Enforcement Process	Summons Authority
<p>Taxpayer may have between 45 and 60 business days from original IDR deadline until summons is issued.</p>	<p>Per IRS Notice, process is “mandatory and has no exceptions” and it has three “graduated steps.”</p> <p>1. Delinquency Notice (DN):</p>	<ul style="list-style-type: none"> •Summons are written orders from the IRS to produce a document or a witness. •The regulations give the IRS broad summons authority. •The standard is whether the data “may be relevant” to the correctness of a taxpayer’s return. •The Supreme Court wrote that this broad power is to “encourage effective tax investigations,” and summonses are “the centerpiece of that congressional design.” Arthur Young & Co., 465 U.S. 805, 815-816 (1984). •It is therefore difficult for a taxpayer to succeed in challenging a summons.
<p>Extension Authority</p> <p>Before the Enforcement Process is triggered the agent may grant you an additional 15 business days to respond.</p> <ul style="list-style-type: none"> •No response by due date: Agent will contact you w/in 5 business days of due date to discuss extension. •Response is incomplete: w/in 5 business days of due date agent and taxpayer are supposed to discuss an extension. •Tips <ul style="list-style-type: none"> •Keep agent informed if you anticipate needing extra time to respond. •Confirm with agent whether they would prefer an incomplete response on the due date. •Agent has discretion to grant extension, but consider escalating if you have a good reason for the delay. •Keep in mind other IDR obligations when asking for an extension. 	<p>If taxpayer misses an IDR date:</p> <ul style="list-style-type: none"> •The IRS must first discuss with the taxpayer [1] what information is missing, and [2] the IRS process on DNs. •The IRS Team Manager will issue the DN within 10 days [unclear if it is business days] of the IDR response date. •The DN “should” set a response date generally no more than 10 business days from the DN, unless Territory Manager approves response date beyond the 10 days. •Agents must send a copy of the DN to their assigned counsel. <p>Tips:</p> <ul style="list-style-type: none"> •Make sure that partial responses are properly “credited” to you and eliminated from the DN. •Remember the IRS later may use your explanations against you, including in Counsel’s enforcement proceeding. <p>2. Pre-Summons Letter (PS Letter):</p> <p>If taxpayer misses the DN date:</p> <ul style="list-style-type: none"> •The IRS agent must escalate the matter to IRS managers and executives. •An IRS Territory Manager must discuss the PS Letter with the taxpayer to advise taxpayer of IRS process on PS Letters. •An IRS Territory Manager must issue a PS Letter “as quickly as possible” and “generally no later than 10 business days” after the DN response date. •The PS Letter goes to a taxpayer executive at a level equivalent to a Territory Manager; this is likely the CFO. •The response date is “generally” 10 business days from the date of the PS Letter. •A Director of Field Operations must approve any date beyond the 10 business days. <p>3. Summons:</p> <ul style="list-style-type: none"> •If taxpayer misses the PS Letter response date: •The IRS examiner must coordinate with IRS managers and executives, including Counsel. •There is lack of detail here compared with the earlier two steps. •Counsel will have tremendous discretion in the timing and manner of enforcement proceedings. 	
<p>Examination Authority</p> <ul style="list-style-type: none"> •Congress has “authorized and required” the Secretary of the Treasury to “make the inquiries, determinations, and assessments of all taxes” imposed by the Internal Revenue Code. § 6201(a). •Under the Code, “The Secretary shall ... cause officers or employees of the Treasury Department to proceed, from time to time, through each internal venue district and inquire after and concerning all persons therein who may be liable to pay any internal revenue tax.” § 7601(a). •The Secretary delegated this authority to the IRS. Reg. § 301.7602-1(b). 		<p>Summons Enforcement</p> <ul style="list-style-type: none"> •Summons are enforced in district court, but a summonsed party can produce the witness or document sans court intervention. •Summons enforcement proceedings are used to determine if the court should use its judicial authority to enforce the summons. •To enforce a summons in court, the IRS must show (usually with an affidavit): <ol style="list-style-type: none"> 1. The investigation will be conducted with legitimate purpose. 2. The summons inquiry may be (not “is”) relevant to the purpose. 3. The IRS doesn’t already have the information. 4. The IRS has followed the Code’s administrative steps. •After that showing, the summonsed party has the burden of proof to disprove one of these factors or show that the enforcement would abuse the court’s process (because, for example, the IRS issues the summons for an improper purpose).

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[1] See LB&I-04-0613-004 (June 18, 2013); LB&I-04-1113-009 (Nov. 4, 2013); LB&I-04-0214-004 (Feb. 28, 2014).

[2] In *Clarke*, the court stated no view on whether a summons issued either (1) in close temporal proximity to a taxpayer's refusal to extend a statute of limitations period or (2) to arguably obtain discovery not permitted in Tax Court, could establish bad faith. *U.S. v. Clarke*, No. 13-301 (2014) (slip. op., at 7-9). On remand, the lower court may offer additional clarity on these significant points.

[3] The directives make clear that a general IDR may be issued at the outset of an exam requesting basic records and information relevant to the audited enterprise.

[4] An earlier directive used "calendar days" for all relevant periods. The most recently released directive clarifies that the operative measurement is "business days".

[5] Taxpayers should immediately alert the examiner if the final IDR does not include such date.

[6] The directive uses the phrase "of the IDR due date", which is somewhat unclear; however, when the relevant passage is read in context, it is clear that the directive is referring to five business days after the IDR due date. Unresolved is whether that 5 day period includes the IDR due date.

[7] But see Eliot, Amy S. "FAQs Coming on Revised IDR Enforcement Procedures" 2014 TNT 58-3 (Mar. 26, 2014) ("Although the directive provides that only one extension of up to 15 business days may be granted for each IDR, the actual length of the extension — and whether an extension is granted at all — is 'within the exam team's discretion'" quoting Linda Kroening, LB&I division counsel).

[8] The examiner's review of completeness should be completed "as soon as practical" but in most cases no more than 15 business days from the receipt of the response.

[9] The directive does not directly measure this period in "business days."

[10] IRS representatives must also discuss the pre-summons letter with counsel.

[11] A summons can only require an individual to appear on a given date to give testimony and to produce existing books, papers and records. It cannot require a party to prepare physical or computerized records that are not currently in existence. This is significant because IDRs are often drafted in a manner to elicit narrative or explanatory responses. Often testimony will not be as thorough or illuminating as a written product and will lead to added expenses for both parties. The DFO should be reminded of this point if the taxpayer reasonably asks for an extended response time in the pre-summons letter.

[12] See *Schultz v. IRS*, 413 F.3d 297, 298-99 (2d. Cir. 2005) (IRS summonses "apply no force to the target, and no punitive consequences can befall a summoned party who refuses, ignores or otherwise does not comply with an IRS summons until that summons is backed by a federal court order") clarifying 395 F.3d 463, 465 (2d Cir. 2005).

[13] Internal Revenue Manual (IRM) sec. 25.5.10.3 (Jan. 13, 2012). None of the directives indicate that this section of the IRM will be amended.

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