

Paul DeNard, Anthony Russo, Tien Do and Elizabeth Sweigart on
Leading Practices for Navigating the Information Document Request (IDR) Process for US-based Multinational Enterprises
2014 Emerging Issues 7264

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Summary

Over the course of the last few years, senior leadership at the Internal Revenue Service (IRS) has publicly articulated a desire to move toward a model of “cooperative compliance” in interactions between IRS personnel and taxpayers. Consistent with this goal, several recent initiatives, including the new information document request (IDR) process, aim to improve efficiency and transparency across the organization as a means of promoting better dealings with taxpayers.

Starting in early 2013, the Large Business & International (LB&I) Division of the IRS rolled out a comprehensive training to its examiners and specialists detailing the changes to the process by which it collects information from taxpayers during an examination and by which it enforces taxpayer compliance with those requests. Broken into two parts, the first section of the mandatory training covered the new requirements for IDR issuance while the second addressed the revised enforcement procedures.

The new IDR process is aimed at supporting a systematic, issue-focused approach to examinations — allowing LB&I examiners and specialists to obtain key data related to specific issues under review as well as improving the ability of LB&I examiners and specialists to timely gather information and reduce the need to enforce IDRs through summonses. The new process of IDR issuance applies to all IDRs issued after June 30, 2013, while the revised enforcement process went into effect March 3, 2014.

A year into the new IDR creation approach — and six months into the new enforcement process — the results in practice have been mixed for both taxpayers and the IRS. Although the process was intended to bring about standardization, it has not been applied consistently in the field and taxpayers do not necessarily fully understand and appreciate its nuances. As a result, it is critical for corporate tax personnel and their advisors to educate themselves on the new IDR issuance and enforcement procedures. In addition, certain leading practices have emerged that may enable taxpayers to benefit from the revised IDR process.

In Context. The new IDR drafting and enforcement process follows the implementation of the quality examination process (QEP), which was introduced to the field in 2010. Although QEP required a dialog between the IRS examiners and taxpayers with respect to IDRs, practitioners found that its application in the field was uneven.

In 2012, LB&I conducted a series of nationwide peer reviews that identified the IDR process as a problem area in examinations. Specifically, IDRs were not routinely discussed with taxpayers —

either before or after they were issued — and, in the case of a delinquency on the part of the taxpayer, enforcement procedures were applied inconsistently or, in some instances, not at all. Specifically, the review revealed that the IRS follow-up on partial or non-responses to IDRs ranged from 15 days to over six months in certain instances.

Following the reviews, an internal IRS design team was charged with developing an improved IDR process. Once developed and vetted by LB&I leadership, IRS examiners were trained in the new procedures starting in early 2013.

The stated objectives of the new IDR drafting and enforcement processes are better up front issue identification in the field, uniform enforcement across the LB&I organization, and improved expectation management on the part of both the taxpayer and the IRS. From the IRS's perspective, by identifying an issue early and engaging in a dialog with the taxpayer, the IRS exam team can increase efficiency by requesting and securing only relevant and useful documentation from the taxpayer, thereby improving audit efficacy and conserving resources on the part of both the IRS and the taxpayer.

Taxpayer engagement is at the heart of the new process, and LB&I leadership expressed the expectation that if the directives were not followed by IRS field personnel, taxpayers would elevate their concerns following LB&I's Rules of Engagement.

IDR Issuance Process. On June 18, 2013, the Acting Commissioner, LB&I issued directive LB&I-04-0613-004 announcing the mandate that all IDRs issued after June 30, 2013, must comply with the new IDR issuance process. The new process is comprised of 12 key requirements that broadly can be grouped into three categories: pre-issuance discussion, IDR preparation by examiner, and IDR delivery to taxpayer.

Pre-issuance Discussion. Before the IDR is drafted, the IRS examiner must have a discussion with the taxpayer to (1) discuss the issue related to the IDR, and (2) explain how the information requested is related to the issue under consideration and why it is necessary. The examiner should then use this communication to determine what information ultimately will be requested in the IDR.

The goal of these three steps — discuss, explain, determine — is to eliminate a scattershot approach to information gathering and replace it with a tactical, targeted method. By discussing the issue up front, the exam team can better explain to the taxpayer the information sought and understand from the taxpayer what information is available to address the issue and its format. Ostensibly, the result would be greater efficiency as an exam team may determine that the IDR they had planned to issue would not yield the desired data and take a different tack rather than waste time and effort in a fruitless and frustrating back-and-forth with the taxpayer.

IDR Preparation by Examiner. The next five required steps concern the drafting of the IDR form. Generally, the first IDR issued in connection with an examination is intended to capture general financial and operational information, such as downloads of general ledger accounts and background on the taxpayer's operations. Subsequent IDRs are now required to be focused on a

particular issue — such as withholding tax, transfer pricing, or accounting methods — and the IRS examiner must identify and state the issue that led to the proposed IDR prior to its issuance. IDRs must clearly note the issue being considered and only request information relevant to the stated issue. Further, the new process demands that each IDR should address only one issue. The remaining three drafting requirements relate to quality and direct the examiner to employ numbers or letters on the IDR for clarity, use clear and concise language, and customize the IDR to the taxpayer or the industry.

IDR Delivery to Taxpayer. The final four directions relate to the delivery of the IDR to the taxpayer. First, IRS examiners are instructed to provide a draft of the IDR and discuss its contents with the taxpayer. Generally, this draft review and discussion should be completed within 10 business days. Following the discussion, the examiner should determine — in consultation with the taxpayer — a reasonable timeframe for a response to the IDR. If the examiner and taxpayer cannot agree on a response date, the examiner has the authority to set a response date. When determining the response date, examiners are counseled also to commit to a date by which the IDR response will be reviewed and the taxpayer informed as to whether or not the information received satisfies the IDR. This examiner review and response date should be noted on the IDR.

IDR Enforcement Process. To address the ramifications of a taxpayer failing to meet the agreed-upon IDR response deadline, the Commissioner, LB&I released directive LB&I-04-1113-009 on November 4, 2013. This directive set out the new mandatory three-step IDR Enforcement Process: (1) a Delinquency Notice; (2) a Pre-Summons Letter; and (3) a Summons.

Although the prescribed enforcement process is mandatory without exception, IRS examiners have the discretion to grant an extension of up to 15 business days to allow a taxpayer to respond to the IDR. The extension may be granted under two scenarios: (1) the taxpayer provides a (satisfactory to the examiner) explanation for its failure to comply with the IDR within 5 business days of the IDR's due date, or (2) the taxpayer provides a (satisfactory to the examiner) explanation for its incomplete response to the IDR within 5 business days of the incomplete IDR response submission.

Delinquency Notice. In the event a taxpayer fails to comply, the examiner — in concert with the IRS Team Manager — moves to the first phase of the enforcement process, the Delinquency Notice (Letter 5077). Prior to issuing the notice, the examiner is to discuss the matter with the taxpayer to ensure that the taxpayer understands the next steps in the enforcement process if the information requested in the IDR is not provided by the response date established in the Delinquency Notice. Following this discussion, the examiner issues the Delinquency Notice signed by the IRS Team Manager to the taxpayer. Issuance of the Delinquency Notice should take place within 10 days of the commencement of the enforcement process. The Delinquency Notice should include a response date that is generally no more than 10 business days from the date of the Delinquency Notice; an IRS Territory Manager must approve any exception to the timing. Finally, the examiner must provide a copy of the Delinquency Notice and the IDR to the assigned IRS Counsel.

Pre-Summons Letter. If a taxpayer does not provide a complete response to an IDR by the Delinquency Notice response date, the next step is the Pre-Summons Letter (Letter 5078). Unlike the prior phase of the enforcement process, the examiner does not discuss the Pre-Summons Letter

with the taxpayer prior to its preparation. Rather, the examiner prepares the letter following a discussion with the IRS Team Manager, Specialist Manager, the respective Territory Managers, and Counsel. Then, it is the responsibility of the appropriate Territory Manager to discuss the Pre-Summons Letter with the taxpayer and ensure that the taxpayer understands the next step in the enforcement process as well as the potential penalties for continued noncompliance.

Next, the Pre-Summons Letter is signed by the appropriate Territory Manager and issued to the taxpayer. In terms of timing, issuance of the Pre-Summons Letter is to occur as quickly as possible but generally no later than 10 business days after the due date of the Delinquency Notice. The Pre-Summons Letter is addressed to the taxpayer management official that is at a level equivalent to the LB&I Territory Manager, generally a level of management above the taxpayer management official that received the Delinquency Notice. In some cases, this escalation could mean that the addressee would be the taxpayer's Chief Financial Officer or Chief Executive Officer.

Generally, the response date to the Pre-Summons Letter is 10 business days from its date of issuance. A Director of Field Operations (DFO) must approve any response date beyond the standard 10 business days. Regardless of whether an extension is requested, the examiner must inform the appropriate DFOs and discuss the Pre-Summons Letter with Counsel prior to issuance.

Summons. If a taxpayer does not provide a complete response to an IDR by the Pre-Summons Letter response date, a Summons will be issued in accordance with the guidance provided in the Internal Revenue Manual. Prior to issuing the Summons, the examiner will discuss the lack of response to the Pre-Summons Letter with the IRS Team Manager, Specialist Manager, the respective Territory Managers and DFOs, and Counsel and prepare the Summons. The examiner will also coordinate the issuance of the Summons with the assigned Counsel.

Ultimately, a taxpayer's failure to respond to a Summons may result in the Office of Chief Counsel seeking enforcement of the Summons via the Department of Justice.

Leading Practices. Although the new IDR process is mandatory, gaps still exist between the written policy and field implementation. As a result, it is critical for taxpayers to educate themselves as to the requirements and procedures and fully engage with the IRS examiner to achieve the best possible outcome.

Set Expectations at the Start of the Examination. All IRS examiners are required to discuss the new IDR process on all existing audits as well as new audits; however, such a dialog does not always take place in practice. Leading practices dictate that corporate tax personnel ask for an explanation of the IDR process from the IRS examiner at the outset of the exam — as opposed to assuming that the examiner is fully conversant with the requirements as understood by the taxpayer—to set expectations. Taxpayers are advised to make this request even if they have worked with an examiner previously.

In addition to overviewing the process, taxpayers should also query how the examiner has implemented the new IDR procedures in other examinations as well as share how the taxpayer has seen the process implemented, if appropriate. Taxpayers should feel free to ask whether an

examiner has observed any practices which may not specifically be mentioned as a procedural requirement, but which enhance the process.

Leverage Available Tools. Once an examination commences, it may be challenging for the taxpayer — and even the examiner — to keep track of all of the IDRs and their status. With the requirement that each IDR — after the initial general request — focus on a single issue, the number of total IDRs issued during the course of an examination is likely to be higher than in previous instances. As a result, taxpayers should look to leverage existing tools and proven techniques for managing the response process. Corporate tax personnel are well advised periodically to request a copy of the IDR log from the examiner and compare it with their own internal tracking system to ensure that all IDRs are accounted for and that the status of each IDR is agreed. It is standard practice for IRS examiners to maintain this log through the IRS's Issue Management System (IMS).

Refer Back to the Requirements. Continuous, open, and transparent communication is a critical success factor for the new IDR process. Often, gaps appear between the required steps in the process and the outcome in practice when communication between the examiner and the taxpayer breaks down.

Of special import is the initial discussion between the examiner and taxpayer covering how the information being requested is related to the issue under consideration and why that information is needed. Although it may seem expedient to gloss over this dialogue, corporate tax personnel are cautioned to avoid doing so and instead insist on a robust conversation to clarify the issue and communicate exactly what information can be provided to address it. The format in which the data is available also matters as some information may not be in a state that lends itself to efficient analysis; not every system simply exports the sought after data into a readily analyzable spreadsheet.

Taxpayers are cautioned to remember the guidance of seasoned litigators and only answer the question put to them in writing. Although it may be tempting to provide an IDR response including all but the proverbial kitchen sink, such an approach is neither pragmatic nor necessarily helpful. Similarly, taxpayers are within their rights to — and should — push back on an IDR request that is overbroad and not limited in scope to information responsive to the covered issue. Maintaining focus on the specific issue and providing a targeted response will help the examination remain on track and avoid irrelevant distractions.

A stated goal of the new process is to improve transparency which includes clear communication to the taxpayer concerning when the examiner or specialist will complete the review of the IDR response and provide feedback. Although an examiner may be resistant to putting this date in writing on the IDR, it is required and taxpayers should demand adherence. When the IRS exam team is held accountable for promptly reviewing the IDR response and communicating any needed follow ups, both sides can better manage the workload, scheduling, and coordination of the resources — including the human capital — involved in the IRS audit.

The Road Ahead. The new IDR process offers opportunities for taxpayers to benefit from increased transparency and avenues for two-way communication with the IRS during an examination.

However, to derive maximum value from the new system, corporate tax personnel must not only educate themselves on the new IDR issuance and enforcement procedures, but also fully engage with the exam team. By implementing leading practices — including setting expectations early in the exam, taking advantage of existing tools, and knowing the process requirements — taxpayers may achieve better outcomes by resolving issues through a timely, transparent, and efficient information exchange.

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