

Effective Management of IRS Information Document Requests (IDRs)



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THE STANDARD TOOL for Internal Revenue Service (“IRS” or “Service”) auditors is the “Information Document Request” or “IDR” or Form 4564. Effectively managing the receipt of and responses to IDRs can heavily influence the prospects for the successful resolution of the IRS audit. Taxpayers are required to maintain documentation to support the positions taken on the return and generally bear the burden of proof in disputes with the IRS. The Service has broad authority to request documents from a taxpayer, even if not relevant to the return, but such authority is not absolute. Thus, the normal dynamic is for the IRS to request certain information or particular documents and for the taxpayer to respond, typically in writing, with the information and documents. Inevitably, follow-up questions ensue until the IRS is satisfied that it knows the facts or the IRS simply gives up.

The group within the IRS that audits the largest taxpayers, known as the Large Business & International (LB&I) operating division, recently embarked on a peer review process that included an assessment of the effectiveness of the IDR process. Not surprisingly, LB&I found the IDR process largely broken. Some taxpayers interact with the Service in a cooperative and transparent manner to ascertain the facts even if the parties disagree as to the legal/tax implications of those facts. Other taxpayers fight the IRS tooth and nail at every turn. Most taxpayers fall somewhere in between. Similarly, IRS auditors spanned the spectrum of reciprocating a taxpayer’s cooperation and transparency to those who viewed every taxpayer action with a jaundiced eye.

In order to improve the process, LB&I embarked on two initiatives. First, LB&I adopted an IDR enforcement

process through which recalcitrant taxpayers can be compelled to comply with information or document requests through a summons. The idea appears to be that the threat of the big stick at the back end of the process will yield a more cooperative approach at the front end, making the responses from taxpayers more responsive. The second initiative was the revisions to an IRS publication describing the audit process and detailing best practices for both taxpayers and the IRS in the IDR process.

Below we describe each of the initiatives in greater detail with an eye toward showing how LB&I expects the IDR process to unfold. We also suggest some additional best practices in managing the IDR process, especially in light of what appears to be LB&I's perspective. Finally, we highlight some common types of requests and discuss the strategic considerations that could influence how a taxpayer might respond to these requests.

NUTS AND BOLTS OF THE IRS'S INFORMATION GATHERING PROCESS •

The IRS's statutory authority to conduct examinations lies in sections 7601 and 7602 of the Internal Revenue Code. In practice, the IRS exercises this authority by conducting examinations. The IRS uses a wide range of tools to gather information from taxpayers during the course of an examination. In addition to the information taxpayers provide in annual returns and other mandatory filings, the IRS may seek to interview individuals, inspect facilities, and request documents in conducting an examination.

In the IRS's view, IDRs are "[t]he primary method of obtaining information." IRM 4.46.4.1(2). The IRS may use IDRs to request documents or pose questions aimed at understanding relevant facts or a taxpayer's substantive position relating to an issue under examination. In a complex examination, taxpayers may expect to receive hundreds of IDRs and each one may pose multiple questions. The burden on taxpayers faced with responding to IDRs can be significant.

IDRs are administrative requests to which taxpayers cannot be compelled to respond. To compel a taxpayer to respond to a request in an IDR, the IRS would formalize its request in the form of a summons seeking documents or testimony and then, if the taxpayer does not voluntarily comply, file suit in a U.S. federal district court to enforce it. Section 7602 authorizes the IRS to issue summonses in the course of an examination.

The government's threshold for prevailing in a summons enforcement suit is rather low. Under *United States v. Powell*, 379 U.S. 48, 57-58 (1964), the Supreme Court outlined the following four factors that the government must show to enforce a summons:

- The summons is issued for a legitimate purpose;
- The summons seeks information that may be relevant to that purpose;
- The summons seeks information that is not already within the IRS's possession; and
- The summons satisfies all administrative steps required by the Internal Revenue Code.

In response to a summons, a taxpayer cannot be required to prepare or create documents that do not currently exist. *See, e.g.*, IRM 5.17.6.1(3). It is important for taxpayers to be mindful of the IRS's summons power when facing IDRs—the extent to which the requested information could be obtainable by the IRS through a summons can sometimes dictate the degree of cooperation by a taxpayer to the more informal IDR. The prospect of the IRS pursuing a summons can also be a factor in the degree of cooperation. As further described below, in March 2014 LB&I revised its IDR procedures to require the audit team to consider the issuance of a summons after a series of escalation phases if an IDR goes unanswered.

As a practical matter, taxpayers typically respond to IDRs voluntarily. In most cases, taxpayers are well served by maintaining a positive working relationship with their audit team, and

responding to IDRs is an ordinary and expected part of an IRS examination. As discussed below, there may be some instances in which it may be in a taxpayer's interest to resist responding to an IDR, but such decisions should be carefully considered because it would likely escalate tensions with the audit team.

The IDR Process: Requirements for Issuing an IDR

The IRS intends for the current IDR process to “encourage collaboration between the taxpayer and IRS personnel to agree on and provide information needed to support an examination.” IRM 4.46.4.5(1). As part of the IRS's procedures for issuing IDRs, LB&I examiners are required to take the following steps:

1. Discuss the issue related to the IDR with the taxpayer;
2. Discuss how the information requested is related to the issue under consideration and why it is necessary;
3. After this consultation with the taxpayer, determine what information will ultimately be requested in the IDR;
4. Ensure the IDR clearly states the issue that is being considered and that the IDR only requests information relevant to the stated issue. An IDR issued at the beginning of an examination that requests basic books and records and general information about a taxpayer's business is not subject to this requirement. Once this initial IDR has been issued, subsequent IDRs must state an issue to be in compliance with this requirement;
5. Only one issue should be addressed on each IDR;
6. Utilize numbers or letters on the IDR for clarity;
7. Ensure that the IDR is written using clear and concise language;
8. Ensure that the IDR is customized to the taxpayer or industry;

9. Provide a draft of the IDR and discuss its contents with the taxpayer. Generally this process should be completed in 10 business days;
10. After this discussion is complete, determine with the taxpayer a reasonable timeframe for a response to the IDR;
11. If agreement on a response date cannot be reached, the examiner or specialist will set a reasonable response date for the IDR; and
12. When determining the response date, ensure that the examiner or specialist commits to a date by which the IDR response will be reviewed and a response provided to the taxpayer on whether the information received satisfies the IDR. Note this date on the IDR. IRM Exhibit 4.46.4-1.

The process for issuing IDRs gives rise to a number of opportunities for taxpayers to interact with the audit team, and each such interaction provides the opportunity to better understand the direction of the audit. For example, the process requires the audit team to engage in discussions with taxpayers before the IDR is issued. The audit team must discuss with the taxpayer the issue related to the IDR, how the requested information relates to that issue, the contents of a draft of the IDR, and a reasonable timeframe for a response. Taxpayers can benefit from these discussion opportunities by gaining an understanding of the audit team's position on the issue under audit and the IDR's objectives. In addition, the IDR process requires the audit team to tell the taxpayer whether it considers the taxpayer's response complete. This kind of required feedback from the audit team may provide insight into the audit team's progress in developing the substantive issue.

IDR Enforcement Process

As noted above, a key feature of the new IDR process is that after discussing the request with the taxpayer, the audit team must determine a reasonable response date for the IDR. In the event the taxpayer fails to respond by that due date,

the IRS's enforcement process has three levels of escalation that could ultimately lead to the issuance of a summons. In general, the IRS personnel involved in the IDR enforcement process have limited discretion to issue extensions to the taxpayer. This increases the importance of cooperation and communication before the issuance of the IDR. As further described below, each phase of the escalation process involves progressively higher levels of IRS management and greater involvement by counsel.

First, when the taxpayer has failed to timely respond to an IDR, the IRS will issue a delinquency notice signed by the Team Manager and specify a new response date. The new response date should be no more than 10 business days from the date of the delinquency notice, but a Territory Manager may approve a later date. The audit team will provide a copy of the delinquency notice to IRS counsel.

Second, if the taxpayer does not meet the delinquency notice's new response date the IRS will issue a pre-summons letter. The Territory Manager will discuss the delinquent IDR response with the taxpayer and establish a new response date. The new response date should be no more than 10 business days from the date of the pre-summons letter, but a Director of Field Operations may approve a later date. The audit team will discuss the pre-summons letter with IRS counsel.

Finally, if the taxpayer does not respond to the IDR by the date identified in the pre-summons letter, the audit team will coordinate with IRS counsel to consider issuing a summons. Whether a summons will be issued at this point in the enforcement process is an internal IRS decision with no set timeframes.

THE UPDATED AUDIT PROCESS • In February 2016, the IRS released Publication 5125 which made effective new changes to LB&I's examination process. Publication 5125 identified the following best practices for its audit teams and for taxpayers:

LB&I Audit Team

1. Work transparently in a collaborative manner with the taxpayer to understand their business and share the issues that have been identified for examination.
2. Engage the taxpayer in the development of the audit steps and potential timeline appropriate for the issues selected in the examination plan; provide a final copy to the taxpayer.
3. Follow the IDR procedures by:
 - a. Discussing the IDRs with the taxpayer before issuing to ensure that requests identify the issue and are properly focused.
 - b. Timely reviewing IDR responses and providing feedback to taxpayers regarding the adequacy of their response.
 - c. Following the LB&I IDR enforcement process if complete responses are not received by the agreed date.
4. Keep the taxpayer informed of the status of each issue on a regular basis.
5. Provide written documentation of all relevant facts, seek taxpayer acknowledgement, and if the issue is unagreed, appropriately document all disputed facts.
6. Apply the law to the facts in a fair and impartial manner.
7. Prepare well-developed Notices of Proposed Adjustment, Forms 5701/Forms 886-A.
8. Resolve issues at the earliest appropriate point using the appropriate issue resolution tool.

Taxpayers (or their Representatives)

1. Work transparently with the exam team by providing a thorough overview of business activities, operational structure, accounting systems, and a global tax organizational chart.

2. Identify personnel for each issue with sufficient knowledge who can provide input when establishing initial audit steps, timelines, and actively assist in the development of the issues selected by the exam team.
3. Follow the IDR procedures by:
 - a. Reviewing and discussing IDRs with the issue team before issuance to ensure that they are properly focused and identify the issue.
 - b. Working with the issue team to reach a reasonable response date for each IDR.
4. For issues identified for examination, provide work papers and supporting documents requested, including those the taxpayer relied on when preparing the return.
5. Collaborate with the issue team to arrive at an acknowledgment of the facts for unagreed issues; provide support for any additional or disputed facts.
6. To foster early resolution, respond timely to each Form 5701 by providing a written legal position for issues in dispute.
7. Resolve issues at earliest appropriate point using an issue resolution tool.

In addition to the best practices identified above, Publication 5125 required the audit team to seek the taxpayer's input on the IRS's view of the relevant facts, placed time limits on informal refund claims, and reiterated a commitment to apply the IDR issuance and enforcement procedures described above. The updated examination process places significant emphasis on taxpayers and audit teams working together to plan and complete an audit. The IRS has updated the Internal Revenue Manual to reflect many of the updates to the examination process and the IDR process.

BEST PRACTICES FOR MANAGING THE IDR PROCESS • A taxpayer's IDR responses form the foundation of the IRS's factual record

upon which the law is applied. Taking into account LB&I's views as to the best practices for taxpayers and audit teams, this section summarizes a number of best practices from the taxpayer's perspective for negotiating and responding to IDRs. The IRS's publications and directives include many elements that are beneficial for taxpayers. Taxpayers should use these opportunities to learn about what their audit team is looking for and explore avenues toward reaching a favorable resolution.

Best Practices Before the IDR Is Issued

The mechanical nature of the IDR enforcement process places great emphasis on discussions with the audit team before the IDR is issued. Below is a summary of some best practices that have helped taxpayers manage the IDR process successfully.

Understanding the Audit Team's Rationale

Taxpayers should try to obtain as much information as possible from the audit team about each IDR and the single issue to which it relates. Understanding the rationale behind an IDR request may allow taxpayers—who typically have more knowledge of their facts than the audit team—to suggest more efficient fact development approaches. This may help persuade an audit team to shape IDR requests in a manner that is appropriately tailored and likely to lead to relevant information. The insights gained from discussions with the audit team may also help taxpayers steer the examination toward a favorable resolution.

Shape the IDR Request in the Drafting Process

Taxpayers should work with the audit team to develop IDR requests that are clearly written and reasonable in scope. IDRs must be issue-specific and clearly written. Taxpayers should be prepared to push back on requests for "any and all" documents related to a particular issue. If the audit team is nonetheless interested in issuing an exceedingly broad request, the taxpayer should explore breaking the request into separate IDRs. The request could be broken into separate phases, with the audit team assessing each IDR response before issuing the next IDR, if necessary.

Taxpayers should also confirm that the audit team shares their interpretation of the request. Many IDR requests contain terms that may have multiple interpretations. Such ambiguities could dramatically change the time and resources that a taxpayer must devote to responding to a request. A common understanding at the outset may help to avoid disputes or disagreements after the IDR is issued.

Set Reasonable Due Dates

Taxpayers should work with their audit team to set reasonable due dates. This can begin as early as the opening conference with the audit team. Taxpayers should be prepared to outline any resource constraints or internal processes relevant to establishing the overall audit schedule. Taxpayers should be prepared to emphasize similar considerations (e.g., year-end closing periods, unavailability of key personnel, burden involved in searching voluminous records, time required to review documents for potential privilege issues, etc.) in discussions relating to specific IDRs. Being judicious in raising concerns with the audit team will help a taxpayer's credibility in the event the audit team's cooperation is needed to deal with unexpected challenges.

The IDR enforcement process triggers a series of escalation steps if the taxpayer does not respond by the initial response due date. A shared understanding of an IDR request's scope helps taxpayers to accurately estimate the required amount of time and resources. Taxpayers should also consider maintaining a log of all IDR requests and responses jointly with the audit team to ensure that both sides are on the same page throughout the audit.

Document Interactions with the Audit Team

Taxpayers should keep organized records of their communications with their audit team. A robust record may help a taxpayer in at least two respects. First, a taxpayer may point to its records in the event it needs to elevate an IDR-related issue to IRS management. Second, a taxpayer may also use its records to support potential arguments in a later summons enforcement proceeding. In a

summons enforcement proceeding, a taxpayer would typically bear the burden of showing the IRS did not satisfy the *Powell* factors described earlier. A taxpayer may also seek an evidentiary hearing in a summons enforcement proceeding to question an IRS agent. *United States v. Clarke*, 134 S. Ct. 2361 (2014). In *Clarke*, the Supreme Court held that a taxpayer is entitled to examine an IRS agent if it can point to specific facts or circumstances plausibly raising an inference of bad faith. A taxpayer's IDR-related records may prove useful in making such a showing.

BEST PRACTICES AFTER THE IDR IS ISSUED • Taxpayers should carefully respond to IDRs because they will likely form an important part of the foundation for the factual basis of the IRS's position. Below is a summary of some best practices that have helped taxpayers in responding to IDRs.

Answer the Question Presented

Taxpayers should limit their responses to the question posed in the IDR. In some instances, an IDR request may seek documents that are misleading, incomplete, or slanted toward the IRS's position on an issue. Taxpayers may be tempted to provide non-responsive documents in the interest of providing context or balance. In some cases, the better approach is for taxpayers to simply answer the question posed in each IDR. Taxpayers can present the examination team with additional facts or documents during the course of an audit. But, instead of voluntarily providing additional documents on an ad hoc basis, taxpayers should make this strategic decision after careful consideration of the audit's lifecycle and the overall factual record developed by the audit team.

To the extent an IDR calls for the production of documents, taxpayers should provide copies of responsive documents instead of originals. Although responding to IDRs with copies of responsive documents will typically suffice, where the request calls for a particularly voluminous response, the taxpayer may consider granting access to original documents under controlled, supervised circumstances if the audit team insists.

Respond to IDRs in a Consistent Manner

The audit team will issue numerous IDRs and may well issue multiple IDRs relating to a single issue. In developing IDR responses, taxpayers may find themselves making judgment calls on how expansively to respond. Such judgment calls should be made consistently unless there is very good reason to take inconsistent interpretations. Responding to some IDRs expansively while being curter in response to other inquiries without good reason may reduce a taxpayer's credibility with its audit team. More dangerously for the taxpayer, curter responses will likely be viewed by the audit team as reflecting an area that the taxpayer wants to avoid.

Keep the IRS's Summons Power in Mind

The IRS's power to compel a response to an IDR ultimately rests in the summons power. Taxpayers should consider the limits of the IRS's summons power when developing responses to IDRs. IDRs may request a wide range of documents, some of which may be protected from disclosure under the attorney-client privilege, tax-practitioner privilege, work product doctrine, or some combination of these protections. Taxpayers asserting such protections in a summons context would be entitled to withhold or redact such documents. Similarly, taxpayers facing IDRs may also assert such protections against disclosure. Because disclosure to the IRS would result in a waiver of any of the aforementioned protections, in most cases, it is in the taxpayer's interest to assert such protections and withhold or redact documents in IDR responses.

Keep Good Records

For complex issues, an audit team may issue hundreds of IDRs over the course of multiple years. Maintaining a robust record of IDR responses can help taxpayers identify potential blind spots or trends in an audit team's fact-development process. In the event an issue is headed for Appeals or litigation, a thorough understanding of the information provided to the IRS will be integral in preparing for such proceedings.

Common IDR Scenarios

Taxpayers should be prepared for a number of common scenarios that arise in the IDR process. Each scenario carries strategic considerations that taxpayers should weigh before responding to such IDRs.

Requests for Summaries

An IDR may request a summary of existing documents or information. For example, instead of requesting a taxpayer's detailed accounting data and doing their own analysis to isolate relevant information in that data set, the audit team may ask for a summary of the data that is relevant to an issue under examination. Taxpayers faced with such a request should remember that the IRS would not be able to compel the preparation of documents in the summons context, so resisting such a request may be an option. Taxpayers should not, however, resist such requests simply because they are able to do so. Factors such as the current status of the relationship with the audit team, the amount of time and effort required to prepare the requested summary, the likelihood that the information may facilitate issue resolution, and whether other information may be provided more expeditiously should be considered. In short, there may be good reason to create and provide a summary in response to an IDR, but taxpayers should carefully consider whether it makes sense given their particular circumstances.

Requests for Voluminous Documents

An IDR request may be overly broad and seek voluminous documents. For example, an IDR may request all copies of Forms W-2, Forms 1099, board of director meeting minutes, board presentations, and internal audit reports. Taxpayers should not hesitate to resist such requests, including elevating these concerns to higher levels of IRS management. If an IDR appears to be a fishing expedition, taxpayers should press the audit team to identify the substantive issue under consideration and the connection between that issue and the IDR. In some cases, requests for voluminous documents could be revised to seek samples, with the possibility of applying statistical sampling techniques.

Taxpayers faced with requests for voluminous documents may also consider responding with any responsive documents identified through a reasonable search conducted by the due date (or shortly before). In such cases, taxpayers may describe their approach in the IDR response so the audit team is aware that the response may be incomplete despite the taxpayer's good-faith efforts.

Acknowledgement of Facts IDR

As provided for in IRS Publication 5125, the audit team must request a taxpayer confirm its findings of fact. This request is referred to as an Acknowledgment of Facts (AOF) IDR. The purpose of the AOF IDR is to ensure that all relevant facts, whether favorable to the taxpayer or to the IRS, were considered before a Form 5471, Notice of Proposed Adjustment (NOPA), is issued. Upon receiving the AOF IDR, the taxpayer may agree to the facts as written, provide additional relevant facts and supporting documentation, identify disputed facts and provide clarification or supporting documentation, or decline to respond. A taxpayer's failure to respond to an AOF IDR will not be subject to the IDR enforcement process, but it will be noted in the Form 886-A when the NOPA is issued.

AOF IDRs present important strategic issues. First, taxpayers should consider whether the audit team has shared its legal analysis for the relevant issue. Taxpayers will likely find it difficult to evaluate a set of facts for completeness or accuracy without the benefit of such analysis. Thus, taxpayers should be exceedingly cautious in responding to an AOF IDR if the audit team's legal position is unclear. An appropriate response may well be to correct or clarify any facts noted in the AOF IDR, but the taxpayer may also note that it cannot comment on whether or not there are any additional relevant facts until the taxpayer sees the audit team's legal analysis. Second, taxpayers should weigh the advantages and disadvantages of correcting factual errors or providing additional facts. On the one hand, a potential disadvantage inherent in correcting factual errors or providing additional facts is that it may afford the audit team an opportunity

to conduct additional fact development to bolster its desired position. On the other hand, a taxpayer may benefit in some circumstances if the factual correction or additional facts provided causes the IRS to reconsider its pursuit of the issue.

An AOF IDR should be viewed in the context of the IRS's Appeals Judicial Approach and Culture (AJAC) project. Under the AJAC project, Appeals serves in a quasi-judicial role and will not consider issues that have not been fully factually developed at audit. In general, a taxpayer raising a new issue or introducing significant new facts for the first time at Appeals will result in Appeals sending the issue back for further examination. Taxpayers desiring Appeals consideration have at least two opportunities to provide additional facts toward the end of the audit team's consideration of the issue. First, as discussed above, the taxpayer could simply respond to the AOF IDR. Second, the taxpayer could correct or provide additional facts in its protest. This approach would be consistent with the aims of the AJAC project because the audit team still has the opportunity to respond to any new facts in a rebuttal prior to the case being submitted to Appeals.

CONCLUSION • A taxpayer's effective management of the IDR process is critical to maintaining a constructive relationship with the audit team. Under the IRS's current IDR and examination processes, taxpayers that actively engage their audit team in the IDR process may gain insights into the IRS's position on specific issues or requests, which can help reach favorable resolutions to their issues. Taxpayers should also be prepared to assert themselves and push back when IDR requests are overbroad, not issue-specific, or require the creation of new documents. Taxpayers should strive to resolve most matters associated with the IDR process through discussions and negotiations with the audit team, particularly in cases where there is a constructive professional relationship. But in cases where it is difficult to reach agreement, the IRS's summons power is an important reference point for taxpayers when considering draft IDRs or their own IDR responses.