IRS Issues Directive Revising the Information Document Request Enforcement Process for LBI Examinations

IRS Large Business and International Division Revises and Expands Earlier Directive on Requirements for Revenue Agents Who Issue Information Document Requests

SUMMARY

The Commissioner of the Internal Revenue Service ("IRS") Large Business and International Division ("LBI") issued a directive on November 4, 2013 (the “November Directive”), to revenue agents responsible for audits conducted by LBI. LBI oversees audits of corporations and partnerships with assets in excess of $10 million, as well as certain high net-worth individuals.

The November Directive expands upon an earlier directive issued on June 18, 2013 (the “June Directive”).¹ The June Directive listed a number of requirements that revenue agents must follow before issuing an information document request ("IDR"), including (i) discussing the underlying issue and content of the IDR with the taxpayer and (ii) discussing the appropriate deadline for responding to the IDR with the taxpayer. The June Directive also noted that the IRS would announce changes to the IDR enforcement process in the coming months.

The November Directive expands upon the June Directive’s requirements for revenue agents to follow before issuing IDRs. But more importantly, the November Directive provides for the mandatory issuance of Delinquency Notices, Pre-Summons Letters and summonses (each described in further detail below) in the event a taxpayer fails to deliver a full response to an IDR by the applicable deadline.
Significantly, the November Directive removes a revenue agent’s discretion to extend the deadline after an IDR has been issued. This means that taxpayers will have to negotiate IDR deadlines very carefully in advance. Due to the consequences of missing an IDR deadline, taxpayers should negotiate for more time to respond to IDRs even if the relevant documents are readily available. The central role of early negotiations in establishing deadlines for IDRs, and the requirement of informal discussions between taxpayers and revenue agents before revenue agents issue IDRs, also make it more important that taxpayers maintain a good working relationship with the revenue agent assigned to their audits.

**DISCUSSION**

**A. THE JUNE DIRECTIVE**

In the June Directive, the IRS reiterated several requirements that are set forth in the LBI Guide for Quality Examinations (the “Quality Exam Guide”), which can be found in the Internal Revenue Manual and on the IRS website. Specifically, the June Directive required that prior to issuing an IDR, the revenue agent had to (i) identify and state the issue that led to the IDR, (ii) discuss the content of the IDR with the taxpayer and (iii) determine a reasonable deadline for responding to the IDR in consultation with the taxpayer.

The June Directive noted that the foregoing requirements were intended to make the IDR process more efficient and to reduce the need to enforce IDRs through the summons process. However, the June Directive also made clear that, when necessary, IDRs should be swiftly and efficiently enforced. Towards that end, the June Directive stated that additional guidance on the IDR enforcement process would be issued in the coming months.

**B. THE NOVEMBER DIRECTIVE**

The November Directive includes an expanded list of requirements for revenue agents to follow when issuing IDRs. However, in contrast to the June Directive, which provided that revenue agents “must” follow the requirements set forth therein, the November Directive provides only that revenue agents “should” follow the requirements set forth therein. The expanded list of requirements, which is effective immediately, generally relates to the three requirements set forth in the June Directive: (i) revenue agents should discuss the issue relating to each IDR with the taxpayer under audit and explain how the information requested relates to the particular issue under examination, (ii) revenue agents should discuss each draft IDR with the taxpayer under audit and (iii) revenue agents should discuss each IDR deadline with the taxpayer under audit. It is notable that although revenue agents are required to discuss the contents of each draft IDR with the taxpayer, there is no requirement for revenue agents to consider taxpayers’ points or to reflect those points in the final, issued IDR. Similarly, if an agreement on an IDR deadline cannot be reached, a revenue agent may unilaterally set a “reasonable response date” for the IDR.
The November Directive also contains guidance on the IDR enforcement process that will be used by the IRS when a taxpayer fails to timely respond to an IDR. Importantly, the November Directive provides for an enforcement process that "is mandatory and has no exceptions." The enforcement process consists of three steps: (1) a Delinquency Notice (Letter 5077), (2) a Pre-Summons Letter (Letter 5078) and (3) a summons.

If the taxpayer does not provide a complete response to an IDR by the response date, the revenue agent must discuss the IDR with the taxpayer and identify the missing information. The revenue agent must also discuss with the taxpayer the Delinquency Notice and the next steps in the enforcement process. Finally, the revenue agent must issue a Delinquency Notice to the taxpayer within 10 days of the IDR deadline. The Delinquency Notice must include a response date that is generally no more than 15 days from the date of the Delinquency Notice. An IRS territory manager must approve any response period in excess of 15 days. A copy of the Delinquency Notice must also be provided to IRS counsel.

If the taxpayer does not provide a complete response to an IDR by the response date specified in the Delinquency Notice, the revenue agent must prepare a Pre-Summons Letter. Before issuing the Pre-Summons Letter, the IRS territory manager must discuss the Pre-Summons Letter with the taxpayer. When the Pre-Summons Letter is issued, it must be sent to an employee of the taxpayer at a management level that is higher than the regular taxpayer contact (certain tax practitioners have referred to this provision as an "I'm going to tell your mom" provision). In addition, the revenue agent must discuss the Pre-Summons Letter with IRS counsel. The Pre-Summons Letter must be issued "as quickly as possible" but generally no later than 14 days after the due date of the Delinquency Notice. The Pre-Summons Letter will generally provide 10 days for the taxpayer to respond with the information requested in the IDR. An IRS director of field operations must approve any response period in excess of 10 days.

If the taxpayer does not provide a complete response to an IDR by the response date in the Pre-Summons Letter, the revenue agent must prepare and issue a summons. A summons is a document that statutorily compels the specified individual to appear before the IRS to testify (under oath if required by the IRS) regarding the matter under investigation. A summons may be enforced by a U.S. district court, generally in the jurisdiction in which the individual resides. An individual that fails to appear after a summons has been enforced in district court can be held in contempt of court, and may be arrested.

In sum, assuming that the steps required by the November Directive are followed in a timely manner and the relevant IRS territory manager and IRS director of field operations do not approve any extensions, the taxpayer has, at most, 49 days from the IDR deadline until a summons is issued. The revenue agent who issued the IDR may not alter this timetable for any reason.

This new enforcement procedure is effective January 2, 2014, and applies to all IDRs that have been issued in accordance with the requirements in the November Directive. IDRs that were not issued in
accordance with the requirements in the November Directive must be reissued. However, because the provisions of the November Directive are advisory and generally expand on the mandatory provisions in the June Directive, it is possible that the enforcement procedures could apply to IDRs issued in accordance with the requirements in the June Directive. As a practical matter, this means that taxpayers that are delinquent on IDRs that comply with the requirements set forth in the June Directive may become subject to these revised enforcement procedures as of January 2, 2014. However, as part of the transition to the new enforcement regime, revenue agents will not issue Delinquency Notices before February 3, 2014.

C. IMPACT OF THE NEW IDR ENFORCEMENT REGIME ON AUDITS

Taxpayers and tax practitioners have generally responded negatively to the removal of revenue agents’ discretion to extend IDR deadlines. Taxpayers should consider a number of possible consequences of the November Directive:

- Because revenue agents are unable to change an IDR deadline once the IDR has been issued, negotiations regarding a deadline that would have previously occurred after an IDR is issued will need to occur earlier. Furthermore, taxpayers should be careful to seek IDR deadlines that taxpayers are certain they will be able to meet.

- Employees who handle tax audits should also keep senior management apprised of the audit process. As discussed earlier, Pre-Summons Letters will be sent to a management level that is higher than the regular taxpayer contact, so senior management should be notified and prepared to receive such a letter if it is expected.

- The June and November Directives require revenue agents to limit each IDR to a single issue. While previously it might have been possible for taxpayers to respond to a long, multi-issue IDR by quickly addressing some issues, thereby retaining the flexibility to take longer with other issues, the new IDR procedures eliminate this extra leeway.

- In proposing an IDR deadline, taxpayers should consider not only the amount of time it takes to retrieve and review the relevant documents for the IDR, but also whether critical employees will be taking vacation and the possibility that a needed employee may get sick. It is also possible that material will have to be reviewed for possible claims of privilege, which could increase the amount of time needed to prepare the response to the IDR.

- In our experience, revenue agents usually offer only 15 to 30 days to respond to an IDR, unless taxpayers can explain why the requested information is difficult to find. Given the potentially serious consequences of missing an IDR deadline, taxpayers should press for extended deadlines even in the case of IDRs that request easily accessible information. In the case of IDRs for material that is not readily available, taxpayers will feel even more pressure to obtain an extended IDR deadline.
There is no indication in the November Directive that the default IDR deadlines will be extended to account for the more rigid IDR enforcement process.

- If a revenue agent is being unreasonably intransigent about a proposed IDR deadline, taxpayers should consider raising the matter with the agent’s manager (or above) before the IDR is issued. Recently, IRS officials have encouraged taxpayers to go up the chain of authority to resolve conflicts. For example, LBI Division Commissioner Heather Maloy, in discussing the audit process, noted that “if you don’t think it's going the way it should be going, you need to raise your hand.”

- In the course of negotiating for an extended IDR deadline, taxpayers should maintain a written contemporaneous record of the negotiations, which can be used later in the process. A record would be helpful in showing that the taxpayer was realistic in requesting an IDR deadline and was aware in advance of how much time it would take to obtain the requested information. Such a record could be used to convince an IRS territory manager or director of field operations to grant the taxpayer more time to respond, or to defend against a subsequent summons enforcement proceeding in court.

- The pressure to negotiate aggressively for extended IDR deadlines must be balanced with taxpayers’ need to maintain a good working relationship with revenue agents, which is even more important under the new enforcement regime. Informal conversations between taxpayers and revenue agents previewing draft IDRs will be a crucial tool for taxpayers to influence IDRs and receive advance notice regarding the documents they may have to produce. In addition, a revenue agent may set an IDR deadline unilaterally if an agreement on the deadline cannot be reached with the taxpayer, so it is important that taxpayers maintain open lines of communication with the revenue agents running the audits.

- According to LBI Division Commissioner Heather Maloy, the November Directive reflects a new LBI approach to audits that will focus more closely on issues and the resources available at the time of the examination. This new approach will ultimately replace the Quality Exam Guide, which was introduced in June 2010 and provides a useful and comprehensive guide for taxpayers involved in LBI audits. Retiring the Quality Exam Guide will introduce a substantial amount of uncertainty into the audit process.

- One way to avoid the problem of missing IDR deadlines might be for taxpayers and revenue agents to keep an IDR in “draft form” and issue the IDR only after the relevant documents have been gathered. Even though this approach reduces taxpayer protections (because a draft IDR can be revised and issued at any time), reliance on a draft IDR avoids the risk of triggering the strict deadlines required by the new enforcement regime.

- The requirement that a copy of the Delinquency Notice be shared with, and the Pre-Summons Letter be discussed with, IRS counsel may cause IRS counsel to get involved in the issues under
consideration earlier than counsel otherwise would have gotten involved (if counsel would have been involved at all). This may assist in narrowing the focus of the revenue agent's questions or resolving issues sooner. On the other hand, the additional set of eyes provided by counsel may result in a lengthier audit process.

- More generally, while the November Directive provides a timetable for enforcing delinquent IDRs, the directive does not include any reciprocal commitment by the IRS to accelerate its response to documents that the taxpayer produces. For example, although the November Directive provides that IDRs should include a date by which the revenue agent will review the IDR response and inform the taxpayer whether the information received satisfies the IDR, the November Directive provides no deadline for a revenue agent to (i) accept the taxpayer's documentation as having resolved an issue, (ii) issue additional IDRs and/or (iii) issue a notice of proposed adjustment that formalizes the revenue agent’s disagreement with the taxpayer on an issue. It is therefore possible that revenue agents may be delayed in responding to taxpayer documents. If such delays occur, revenue agents may run up against deadlines set by upper-LBI management for completing the examination (so that the examination team will be compliant with LBI’s “currency initiative”). This not-uncommon situation could lead to cases being sent to IRS Appeals before those cases are fully developed.

Clients that have questions or concerns regarding the application of either the June Directive or the November Directive to a potential or ongoing IRS audit are welcome to contact any of the lawyers listed at the end of this publication.

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ENDNOTES

1 A discussion of the June Directive can be found in the Sullivan & Cromwell LLP publication entitled “IRS Issues Internal Directive On Best Practices For Revenue Agents To Follow When Preparing Information Document Requests” (June 20, 2013), which can be obtained by following the instructions at the end of this publication.

2 Internal Revenue Manual, Part 4.46.

3 An IRS territory manager is “[a] mid-level manager in LB&I who supervises team managers within his/her territory.” Internal Revenue Manual, Exhibit 4.46.1-1. A team manager is “[a] front line manager in LB&I who supervises LB&I examiners and cases.” Id.


5 An IRS director of field operations is “[a]n LB&I executive who supervises territory managers within his/her area of responsibility.” Internal Revenue Manual, Exhibit 4.46.1-1.

6 The statutory authority for the IRS to issue summonses is Section 7602 of the Internal Revenue Code (the “Code”).

7 Section 7402(b) of the Code. Although rare, the IRS can also seek to have the individual charged under Section 7210 of the Code, which makes it a crime to neglect to appear pursuant to a summons.

8 Section 7604 of the Code.


10 A number of IRS officials have stated that revenue agents will not use generic time frames to set deadlines for IDRs but will rather tailor each IDR deadline to the taxpayer. For example, see speeches by Cheryl Claybough, IRS Director, Communications, Technology & Media Industry, on November 5, 2013 (quoted in Tax Notes Today, 2013 TNT 215-2), and Sunita Lough, Director, Pre-Filing & Technical Guidance, on November 5, 2013 (quoted in BNA Daily Tax Report, 215 DTR G-8).

11 Speech by Heather Maloy, LBI Division Commissioner, on October 28, 2013 (quoted in BNA Daily Tax Report, 209 DTR G-1).

12 Id.
ABSTRACT

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