

Beyond Information Document Requests: Tools the IRS Uses to Obtain Information from Foreign Countries

Many U.S. taxpayers express bravado with respect to their records in foreign countries, commonly exclaiming "the IRS can't get that—it's overseas" in strategy conferences with their tax attorneys. However, these taxpayers are misguided. In addition to the traditional method of obtaining information via Information Document Requests, the International Examiners of the IRS have numerous tools at their disposal to acquire information from abroad.

Before reviewing these tools, an initial problem confronting U.S. taxpayers is that most of their foreign offices do not have records that are in a usable format, as records are often prepared in foreign languages. Must a U.S. taxpayer spend a large amount of time and money translating the documents into English for the IRS?

This issue was confronted in the case of *Nissei Sangyo America, Ltd.*¹ Nissei involved the audit of a U.S. subsidiary of a Japanese parent. In response to an IRS summons, the U.S. subsidiary had randomly selected documents relating to the issue under examination and provided full translations. The Japanese parent had also randomly selected and translated documents. In addition, the U.S. subsidiary translated the subject matter headings or titles of 1,441 pages of Japanese correspondence and prepared English translation keys for the travel expense authorization forms. The IRS demanded that all documents described in the summonses be translated to English, which the company estimated would cost from \$850,000 to \$1.5 million. The court held that the IRS could not compel the translation of documents that were not relevant to the tax liability or that the IRS already had in its possession.²

Most cases do not involve translation costs of \$1 million, but just as there are subtle nuances of meaning in the definitions in the Internal Revenue Code, there are subtle nuances of meaning in the translation of languages. Considering the diverse army of employees that the IRS has to consult with for translations, the taxpayer should be advised to engage a translator who will resolve any ambiguities in meaning in the taxpayer's favor. Although Nissei involved summons enforcement, this lesson is applicable to any type of information

POSTED:

May 4, 2014

RELATED PRACTICES:

[Tax](#)

<https://www.reinhartlaw.com/practices/tax>

RELATED SERVICES:

[International](#)

<https://www.reinhartlaw.com/services/international>

RELATED PEOPLE:

[Robert J. Misey, Jr.](#)

<https://www.reinhartlaw.com/people/robert-misey-jr>

gathering tool the IRS may use.

The primary authority for record keeping requirements of a taxpayer is Code Sec. 6001 , giving the IRS the specific authority to examine any books, papers, records or other data that may be relevant or material to ascertaining the correctness of any tax liability.

The IRS typically exercises its authority in an Information Document Request (IDR). An IDR requests information or documents from taxpayers when there are voluminous records to be examined or when it is desirable to document requests. Requested on Form 4564, an IDR provides the IRS a convenient means to request information and simultaneously yields a permanent record of what was requested, received and returned to the taxpayer. After reviewing the information gathered from an initial IDR, the International Examiner will focus on those areas with the largest potential for possible adjustments. As the examination progresses, IDRs generally become more narrow in scope and tend to focus on specific items or transactions.

In addition to this authority, an International Examiner of the IRS can employ several procedural tools to obtain information beyond that obtained via IDRs. These tools include summonses, designated summonses, foreign plant visits, Formal Document Requests, and exchanges of information under treaties.

The Summons Power

Used both domestically and internationally under the general authority to examine, the IRS has the power to compel a taxpayer or any other person to produce records and to testify under oath. This compulsory process authorizes the IRS to issue an administrative summons.³ The IRS may summon any person to appear at a time and place named in the summons for the purpose of giving testimony under oath and producing books, papers, records or other data. The IRS has generally delegated the authority to Internal Examiners to issue summonses.⁴

When auditing a corporation, the IRS may direct the summons to either a specific corporate officer or the corporation itself.⁵ The summons should indicate the officer's corporate title. When a corporation receives a summons, the IRS must serve an officer, director or managing agent.

After serving the summons, the International Examiner prepares and signs a certificate of service on the reverse side of the Form 2039 retained by the IRS, which certifies the date, time and manner of service. The signed certificate of

service is evidence in any proceeding to enforce the summons.⁶ The compliance date the summons requires cannot be less than 10 days from the date of issuance.⁷

Pursuant to the standards of *Powell*,⁸ to enforce a summons, the IRS must show that:

- the IRS has a legitimate purpose for the investigation;
- the material sought is relevant to that purpose;
- the material sought is not already within the IRS's possession; and
- the IRS followed those administrative steps that are required by the Internal Revenue Code.

Taxpayers have objected to the use of administrative summonses by the IRS during Tax Court proceedings as circumventing the restrictive Tax Court discovery rules. This often occurs in transfer pricing matters, where the functions performed and risks assumed typically change little from year to year.

The Tax Court has held that it would be an unfair advantage to allow the IRS in a pending case to use evidence obtained via a summons.⁹

More specifically, in *Ash*,¹⁰ the Tax Court set forth guidelines to determine whether it should issue a protective order when the IRS uses a summons during litigation. Where Tax Court litigation has commenced and a summons is then issued for the same taxpayer and tax year involved in the litigation, the Tax Court will issue a protective order to prevent the IRS from using any of the summoned evidence in the litigation.¹¹ However, the Tax Court will not issue a protective order if the IRS can show that the summons was issued for a sufficient reason that was independent of the pending litigation.

In those cases where the IRS issues the summons before the taxpayer files a Tax Court petition, the court will not issue an order for any information obtained as a result of the summons. The Tax Court, in *Ash*, explained that before filing a petition, the Tax Court has no jurisdiction and there is no basis for viewing the summons as an attempt to undermine the Tax Court's discovery rules.¹²

Finally, where litigation has commenced and the IRS issues an administrative summons with regard to a different taxpayer or a different tax year, the Tax Court normally will not issue a protective order.¹³ However, the Tax Court stated that it would issue a protective order if the taxpayer could show the IRS lacked an independent and sufficient reason for the summons.

Contrary to popular belief, a summons does not extend the statute of limitations, which encourages taxpayers to delay.

- **Example 1.** ForCo sells gadgets to its wholly owned U.S. subsidiary, US-Co. US-Co files its 2010 U.S. tax return deducting a cost of goods sold for the transfer price US-Co pays to ForCo for the gadgets on September 15, 2011. In early 2014, the International Examiner that has been auditing US-Co requests US-Co to extend the statute of limitations beyond September 15, 2014. US-Co refuses. Consequently, the International Examiner issues a summons on August 15, 2014, that US-Co ignores. When the IRS seeks a court order enforcing the summons on September 20, 2014, the court refuses enforcement because the statute of limitations has expired. See Diagram 1.

Designated Summonses

In lieu of issuing a summons, which does not extend the statute of limitations, the IRS may issue a designated summons.¹⁴ A designated summons tolls the running of the statute of limitations during the period in which judicial enforcement proceedings are pending and for either 30 or 120 days thereafter, depending on whether or not the court orders compliance with the summons. The legislative history indicates Congress was concerned that taxpayers responded slowly to IRS requests for information without extending the statute of limitations.

Congress did not intend to extend the statute of limitations in a large number of cases, but to encourage taxpayers to provide requested information on a timely basis by realizing that the IRS had this tool available. In addition to satisfying the aforementioned *Powell* standards, the internal procedures the IRS personnel must follow to issue a designated summons greatly impede their issuance. Both the LB&I Division Commissioner and Division Counsel-LB&I ¹⁵ must approve the issuing of a designated summons, which the IRS must issue at least 60 days before the expiration of the statute of limitations.

- **Example 2.** ForCo sells gadgets to its wholly owned U.S. subsidiary, US-Co, during 2010. US-Co files its 2010 U.S. tax return deducting a cost of goods sold for the transfer price US-Co pays to ForCo for the gadgets on September 15, 2011. US-Co refuses to extend the statute of limitations beyond September 15, 2014. Concerned about the possibility that the statute of limitations will expire, the International Examiner issues a designated summons on July 1, 2014. The designated summons tolls the statute of limitations during enforcement proceedings and for 30 or 120 days thereafter.¹⁷ See Diagram 2.

Foreign Plant Visits

International Examiners have taken an increased interest in foreign site visits and plant tours.¹⁸ While IRS budget constraints and internal administrative requirements may occasionally affect the number or duration of such visits, taxpayers should expect such requests and prepare to respond. The taxpayer should remember that it is a request, not an order, and that it can negotiate the request in terms of choosing the facility to visit (the taxpayer may want to substitute a domestic plant for a foreign one), the duration of the visit, the timing of the visit and the number of IRS employees involved.

The hot issues resulting in foreign plant tours are the manufacturing exception to foreign base company sales income of Subpart F and transfer pricing (determining the functions performed abroad). Accordingly, International Examiners have instructions on how to analyze the activities of foreign plants.¹⁹

Careful planning of any plant trip may result in an opportunity to present, in effect, key facts supporting the taxpayer's position. The taxpayer should prepare the plant personnel for the visit and may consider pre-screening the tour to determine if the tour covers processes or procedures relevant to the audit cycle and pre-interviewing all involved personnel to sensitize them to the potential issues. The taxpayer's counsel will have the opportunity to plan as the internal levels of IRS approval the International Examiner must obtain usually take a long time.

Formal Document Requests

The IRS may also issue a Formal Document Request (FDR). Congress did not intend the IRS to use the FDR as part of a routine examination, but instead as a tool for securing information that the IRS could not obtain through normal request procedures.²⁰ The "Formal Document Request" arrives on Letter 2261 by registered or certified mail and provides:

- the time and place for the production of the documentation;
- the reason the documentation previously produced (if any) is insufficient;
- the description of the documentation being sought; and
- the consequences to the taxpayer of the failure to produce the documentation sought.²¹

If the taxpayer does not furnish the requested information within 90 days of the

mailing of the FDR, the taxpayer cannot later introduce the requested documentation at trial. Foreign-based documentation is "any documentation which is outside the United States and which may be relevant or material to the tax treatment of the examined item."²² Therefore, the IRS has broad authority to request virtually any relevant information as long as the request satisfies the aforementioned *Powell* standards.²³ The purpose of this procedure is to discourage taxpayers from delaying or refusing disclosure of certain foreign-based documentation.

To avoid the later exclusion of documents, the taxpayer must substantially comply with the FDR, which depends on all the facts and circumstances. For example, if the taxpayer submits nine out of ten requested items and the court believes the missing item is the most substantial, the taxpayer could be found to have failed to comply substantially with the FDR. Accordingly, a court could prevent the taxpayer from later introducing the missing document.

Any taxpayer that receives an FDR has the right to begin proceedings to quash the request within 90 days after the IRS mailed the FDR. The standard for quashing a FDR is the same *Powell* standard for quashing a summons.²⁴ Moreover, the taxpayer may contend, for example, that the information requested is irrelevant, that the requested information is available in the United States, or that reasonable cause exists for the failure to produce the information. Reasonable cause does not exist where a foreign jurisdiction would impose a civil or criminal penalty on the taxpayer for disclosing the requested documentation.²⁵

In a proceeding to quash, the IRS has the burden of proof to show the relevance and materiality of the information requested. During the period that a proceeding to quash or any appeal from that proceeding is pending, the statute of limitations is suspended.²⁶

The legislative history to Code Sec. 982 details three factors to consider whether there is reasonable cause for failure to furnish the requested documentation: (1) whether the request is reasonable in scope; (2) whether the requested documents are available within the United States; and (3) whether the reasonableness of the requested place of production within the United States.²⁷

An example of unreasonable scope may be a request "for all the books and records and all the supporting documents for all the entries made in such books or records" for all foreign entities controlled by the taxpayer. However, a request for the general ledger, an analysis of an account, and supporting documents for a

particular transaction of such foreign entity would be reasonable in scope. Moreover, the place of production of records is generally at the taxpayer's place of business or the International Examiner's office. The key to the reasonableness of the place for production is its mutual convenience to both the taxpayer and the International Examiner. As a result, requesting the production of records in New York City by a taxpayer that resides in and engages in a trade or business in Los Angeles may be considered unreasonable.

Exchanges of Information Under Treaties

The United States has tax treaties with approximately 65 foreign countries. Under the exchange of information article in most treaties, the IRS can generally request information from a foreign country that is either in the foreign country's possession or available under the respective tax laws of that foreign country. These provisions generally do not require an exchange of information that would disclose any trade or business secret. The IRS will not request information from another country unless:

- there is a good reason to believe that the information is necessary to determine the tax liability of a specific taxpayer;
 - the information is not otherwise available to the IRS; and
 - the IRS is reasonably sure that requested information is in the possession of, or available to, the foreign government from whom the information is being requested.
- **Example 3.** A distributor of frozen concentrated orange juice, US-Sub is a subsidiary of ForParent. US-Sub buys the frozen concentrated orange juice from ForParent and resells it in the United States. After US-Sub fails to respond to an IDR requesting all agreements between US-Sub and ForParent, the IRS requests the information from the tax authority of ForParent's country pursuant to the exchange of information article in the tax treaty. See Diagram 3.

The IRS's internal guidelines require that information sought from another country must specifically describe the information desired and the reason why the information is necessary.²⁸

Conclusions

The IRS has numerous tools to acquire information that a taxpayer may have abroad. The prudent tax professional should advise the U.S. taxpayer that having records in the hands of a foreign affiliate will not keep those records from the IRS.

Taking a cavalier approach can result in disastrous consequences.

¹ *Nissei Sangyo America, Ltd.*, DC-IL, 95-2 USTC ¶ 50,327. The internal procedures of the IRS require the IRS to request documents, review them and then specify the documents to be translated. Reg. § 1.6038A-3(b)(3).

² See the general summons standard of *M. Powell*, S. Ct., 64-2 USTC ¶ 9858, 379 US 48, *infra*.

³ Code Sec. 7602(a)(2).

⁴ T.D. 6421, 1959-2 CB 433; Delegation Order No. 4.

⁵ IRM 25.5.2.3.

⁶ Code Sec. 7603.

⁷ Code Sec. 7605(a). A longer period is required for third-party recordkeeper summonses.

⁸ *M. Powell*, SCt, 64-2 USTC ¶ 9858,379 US 48,85 S. Ct. 248.

⁹ Tax Court Rule 103.

¹⁰ *M.K. Ash*, 96TC 459, Dec. 47, 221 (1991).

¹¹ The Tax Court issued such an order in *Universal Manufacturing Co.*, 93TC 589, Dec. 46, 154(1989).

¹² *Bennett*, DC-TX, 2000-2 USTC ¶ 50,717 .

¹³ In an earlier case involving this type of situation, the issuance of a protective order was justified by the "compelling facts." *Westreco, Inc.*, 60 TCM 824, Dec. 46, 882(M), TC Memo. 1990-501.

¹⁴ Code Sec. 6503(j).

¹⁵ Reg. § 301.6503(j)-(c)(1)(i) .

¹⁶ Code Sec. 6503(j)(2)(A).

¹⁷ *K.T. Derr*, CA-9, 92-2 USTC ¶ 50,369, 968 F2d 943.

¹⁸ I.R.M. 4.46.3.10.2 through 4.46.3.10.5.

¹⁹ *IRS International Continuing Professional Education materials*, Chicago, Illinois, May 2005; see also IRM Exhibit 4.61.3-1. These include the following:

- Obtain information about departmental cost sheets or schedules.
- Learn the training requirements of each type of production employee.
- Obtain any records regarding sales to all customers.
- Ascertain the extent of product development performed at the plant.
- Interview plant employees. Plant interviews will bring a sense of reality to the case. Interviews should flush out the employee's ability to alter the production process and the technical training each production employee received.
- If the company is a controlled foreign corporation, determine how and to whom

it sells its products.

- Obtain all company manuals regarding the operations of the plant.
- Obtain all job descriptions prior to the plant tour.
- Obtain all annual evaluations of the employees to be interviewed.
- Obtain all company "programmer" manuals. This manual offers guidance to the programmer to construct the program, so that software can be readily translated and localized.

²⁰ See Joint Committee on Taxation, General Explanation of the Tax Equity and Fiscal Responsibility Act of 1982, HR 4961, 97th Cong., 2d Sess. 246-247.

²¹ Code Sec. 982(c)(1).

²² Code Sec. 982(d)

²³ *B.V. Yujuico*, DC-CA, 93-1 USTC ¶150,097, 818FSupp 285.

²⁴ *Flying Tigers Oil Co., Inc.*, 92 TC 1261, Dec.

45,764(1989); *Yujuico*, *supra* note 23.

²⁵ Code Sec. 982(e).

²⁶ Code Sec. 982(e).

²⁷ Conference Committee Report on P.L. 97-248, The Tax Equity and Fiscal Responsibility Act of 1982.

²⁸ IRM 4.60.1.2.4.2.

This article is reprinted with the publisher's permission from the JOURNAL OF TAX PRACTICE & PROCEDURE, a bi-monthly journal published by CCH, a part of Wolters Kluwer. Copying or distribution without the publisher's permission is prohibited. To subscribe to the JOURNAL OF TAX PRACTICE & PROCEDURE or other CCH, a part of Wolters Kluwer Journals please call 800-449-8114 or visit CCHGroup.com. All views expressed in the articles and columns are those of the author and not necessarily those of CCH, a part of Wolters Kluwer or any other person.

These materials provide general information which does not constitute legal or tax advice and should not be relied upon as such. Particular facts or future developments in the law may affect the topic(s) addressed within these materials. Always consult with a lawyer about your particular circumstances before acting on any information presented in these materials because it may not be applicable to you or your situation. Providing these materials to you does not create an attorney/client relationship. You should not provide confidential information to us until Reinhart agrees to represent you.