

Tax Return Documentation

*Tax Executives Institute, Inc.
Midyear Conference
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Agenda

- Developing Record Maintenance and Retirement Policies
- What to Keep, Where, In What Format, and for How Long?
- Electronic Document Discovery

Panelists

- Christopher Riley, Moderator
Archer Daniels Midland Company
Decatur, Illinois
- Thomas Carlucci
Foley & Lardner LLP
San Francisco, California
- Kathleen Pakenham
White & Case LLP
New York, New York

The Basics

- “....any person subject to tax under subtitle A of the Code ... or any person required to file a return of information with respect to income, shall keep such permanent books of account or records, including inventories, as are sufficient to establish the amount of gross income, deductions, credits, or other matters required to be shown by such person in any return of such tax or information.”
- Treas. Reg. § 1.6001-1(a)

The Basics

- “The books or records required by this section shall be kept at all times available for inspection by authorized internal revenue officers or employees, and shall be retained so long as the contents thereof may become material in the administration of any internal revenue law.”
- Treas. Reg. § 1.6001-1(e)

The Basics

- “All records ... shall be kept, by the person required to keep them, at one or more convenient and safe locations accessible to internal revenue officers, and shall at all times be available for inspection by such officers.”
- Treas. Reg. § 31.6001-1(e)(1)

The Basics

- “The records required by the regulations in this part shall be kept accurately, but no particular form is required for keeping the records. Such forms and systems of accounting shall be used as will enable the district director to ascertain whether liability for tax is incurred and, if so, the amount thereof.”
- Treas. Reg. § 31.6001-1(a)

The Basics

- “Any person ... who ... claims a refund, credit or abatement, shall keep a complete and detailed record with respect to the tax, interest, addition to the tax, additional amount, or assessable penalty to which the claim relates....”
- Treas. Reg. § 31.6001-1(c)

The Basics

- “Except as otherwise provided in the following sentence, every person required by the regulations in this part to keep records in respect of a tax (whether or not such person incurs liability for such tax) shall maintain such records for at least four years after the due date of such tax return period to which the records relate, or the date such tax is paid, whichever is the later. The records of claimants required by paragraph (c) of this section shall be maintained for a period of at least four years after the date the claim is filed.”
- Treas. Reg. § 31.6001-1(e)(2)

Special Records Retention Requirements

- Check 6001-1 regulations for special rules, including:
 - Employment tax (withholding, FICA, FUTA)
 - Highway motor vehicle
 - Wagers
 - Railroad Retirement Tax Act

Best Practices

Best Practices

- Have a document retention policy
 - Limit retention to extent possible consistent with business needs and regulatory requirements
- Participation by Tax Department, Legal Department and IT
- Review and update regularly
- Educate employees about policy
- Follow policy consistently
 - Example: Arthur Andersen

Best Practices – Pre-Audit

- Maintain documents that support your position or would be material to an IRS audit
- Preserve software platforms for archived tapes
- Conduct a post-filing review
- Documents could make or break your case
 - Memories fade, but documents do not
- Example: Microsoft

Best Practices

- Once an audit is under way document retention duties change
- Establish your good faith
 - Consider a mandatory retention notice
 - If there is spoliation, you should be able to prove that it was inadvertent
- Spoliation (FRCP 37, TCR 104)
 - Courts can sanction to equalize the inadvertent or advertent destruction of seemingly material information
 - Dismissal, fines, and negative inferences are all possible results

Privileged Communications: Best Practices

- **Make sure clearly marked**
 - Identify privilege being asserted
 - Identify author and recipients by name and title
 - Keep an historic list of lawyers, CPAs
 - For electronic communications, put in heading of electronic media easier to search for and identify as privileged

Privileged Communications: Best Practices

- **Asserting privilege**
 - Only assert for truly privileged communications
 - No blanket assertions
 - Don't cc legal for protection -- you will lose protection for those "truly" privileged
- Limited or selected waivers are problematic

Privileged Communications: Best Practices

- **Waivers**
 - Beware of subject matter waiver – it extends beyond documents
 - Agreed non-waivers to government don't work
 - Limit scope of waiver

Record Disposal: Best Practices

- Documenting destruction – use of standard forms
- Witness
- Physical destruction
- Former personnel

Record Disposal: Best Practices

- 18 U.S.C. § 1519. Destruction, alteration, or falsification of records in Federal investigations and bankruptcy
- Whoever knowingly alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document, or tangible object with the intent to impede, obstruct, or influence the investigation *or proper administration of any matter within the jurisdiction of any department or agency of the United States* or any case filed under title 11, or in relation to or contemplation of any such matter or case, shall be fined under this title, imprisoned not more than 20 years, or both.

Retention Period: Best Practices

- Consider non-tax requirements
- Civil statutes of limitations:
 - 3 years
 - 6 years
 - No limit
- Criminal statutes

Electronic Records

Electronic Records

- Most records are electronic – by some estimates 90 percent of information is created in an electronic format
- What are electronic records?

Electronic Records

- Working definition: records that exist in a medium that can be read only through the use of computers.
- Examples:
 - Email
 - Web pages
 - Word processing files
 - Computer databases
 - Electronic media (cache memory, magnetic disks, optical disks, magnetic tapes)

Electronic Records

- Electronic records are discoverable and are increasingly sought by taxing authorities
- Reviewing and producing electronic records present challenges unique from producing paper records

Electronic Records

- “Chief among these differences is the sheer volume of electronic information. Emails have replaced other forms of communication besides just paper-based communication. Many informal messages that were previously relayed by telephone or at the water cooler are now sent by email. Additionally, computers have the ability to capture several copies (or drafts) of the same email, thus multiplying the volume of documents. All of these emails must be scanned for both relevance and privilege.”
- *Byers v. Ill. State Police*, 53 Fed. R. Serv. 3d 740 (N.D. Ill. 2002)

Electronic Records

Rule 34. Production of Documents and Things and Entry Upon Land for Inspection and Other Purposes

(a) SCOPE. Any party may serve on any other party a request (1) to produce and permit the party making the request, or someone acting on the requestor's behalf, to inspect and copy, any designated documents (including writings, drawings, graphs, charts, photographs, phonorecords, and other data compilations from which information can be obtained, translated, if necessary, by the respondent through detection devices into reasonably usable form), or to inspect and copy, test, or sample any tangible things which constitute or contain matters within the scope of Rule 26(b) and which are in the possession, custody or control of the party upon whom the request is served; or (2) to permit entry upon designated land or other property in the possession or control of the party upon whom the request is served for the purpose of inspection and measuring, surveying, photographing, testing, or sampling the property or any designated object or operation thereon, within the scope of Rule 26(b).

Special Problems of Electronic Records

- Locating/retrieving
- Organizing
- Duplicates
- Multiples versions/drafts
- Records saved on workstations
- Blackberries, text messages, electronically stored voicemail messages
- Preserve software platforms for archived tapes

Electronic Records: Best Practices

- Fed. R. Civ. P. 37(f) Electronically Stored Information.
- “Absent exceptional circumstances, a court may not impose sanctions under these rules on a party for failing to provide electronically stored information lost as a result of the routine, good-faith operation of an electronic information system.”

Electronic Records: Best Practices

- Rule 37(a) *does not* give a pass to destruction of records by the normal operation of an electronic information system, where there was a duty to refrain from destruction by the implementation of a “litigation hold” necessary by the reasonable anticipation of litigation.

Electronic Records: Best Practices

- New FRCP 26
- Two-tier system:
 - Producing party must identify electronically stored information that is “not reasonably accessible” because of undue burden or cost
 - Requesting party must show “good cause” to overcome a showing of undue burden or cost.
- Court must balance the interest and potentially share or shift the costs of production to the requesting party

Recommended Resources

- The Sedona Conference, E-Discovery & Digital Information Management (May 2005)
- The Sedona Principles: Best Practices Recommendations & Principles for Addressing Electronic Document Production (July 2005)
- The Sedona Guidelines: Best Practice Guidelines & Commentary for Managing Information & Records in the Electronic Age (September 2005)
- International Organization for Standardization, Information and documentation – Records Management (ISO 15489-1)
- ARMA International, Retention Management for Records and Information (2005)

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