



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
Washington, D.C. 20224

SMALL BUSINESS/SELF-EMPLOYED DIVISION

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MEMORANDUM FOR EXAMINATION AREA DIRECTORS

FROM: Shenita L. Hicks /s/ *Shenita L. Hicks*
Director, Examination

SUBJECT: Guidance on Usage of Electronic Accounting Software Records

SB/SE Examination now has the ability to accept and read data files from accounting software programs used by most small business taxpayers. This memorandum provides guidance on when to request electronic accounting software backup files during an examination, the limitations examiners have in reviewing these electronic records and the safeguarding of these records.

IRC Section 6001 provides that taxpayers must keep such records as the IRS prescribes. The requirement to keep records does not distinguish between paper or electronic records. If the taxpayer uses one of the accounting software products the IRS can read, examiners should generally request a copy of the taxpayer's original accounting software backup file. Examiners are reminded to use their professional judgment when deciding what paper and/or electronic records to request. For example, it may not be necessary to request the backup file in a limited scope audit of one expense item on the tax return. However, in broader scope audits, such as when verifying gross income, the backup file should be requested in the majority of audits.

Generally, backup files contain transactional data for tax years prior to and beyond the year(s) under examination because many of the software products do not provide for an option to create a backup for only a specified time period. Examiners should only review data relevant to the year(s) under examination. An exception may be reviewing transactions for the month prior to and the month after the tax year or the tax periods before and after the ones under examination, if the transactions in those timeframes are relevant to the data sought. Examiners may also review any transactional data created or changed during the tax year under examination. If the scope of the examination is expanded to include another tax period(s), the taxpayer should be notified in writing of the expansion, as provided in IRM 4.10.2.6.1(4).

In some situations, taxpayers may claim they cannot provide a copy of the original backup file because it contains privileged communications. The issue of privileged communications is the same whether IRS is asking for electronic or paper records. IRM 25.5.5.4.3 provides guidance to examiners when a claim of privileged

communication is made. Paragraph (2) of the IRM section states, “[p]rivileged communications cannot be obtained by issuing a summons.” The local Counsel office should be contacted for assistance if a taxpayer claims that records contain privileged communication or that a statute, such as the Health Insurance Portability and Accountability Act (HIPAA), prevents the taxpayer from complying with a request for the records. Generally, a customer list would not be privileged but there may be unusual circumstances in a particular case that could possibly make the information, when combined with other information, privileged.

There may also be instances where a practitioner raises an issue of privilege associated with an Information Document Request (IDR). In those situations, subpart B, section 10.20(a)(1) of the Circular 230 regulations states that “[a] practitioner must, on a proper and lawful request by a duly authorized officer or employee of the Internal Revenue Service, promptly submit records or information in any matter before the Internal Revenue Service unless the practitioner believes in good faith and on reasonable grounds that the records or information are privileged.” IRM 25.5.5.4.3 covers two types of privilege that may be asserted by a practitioner. Paragraph 1(a) of the IRM section covers attorney client privilege while the second type of privilege covered is that of a federally authorized tax practitioner and is covered in paragraph 1(b) of the IRM section. As noted above, when a taxpayer or his representative claims that the requested records contain privileged communications, the local Counsel office should be contacted.

Sensitive business data in a backup file is protected by strict federal disclosure laws just like all other books and records submitted to the IRS in an examination. IRC Section 6103 restricts IRS from making unauthorized disclosures of information obtained during the course of a tax examination.

IRS has the authority to summons a taxpayer to produce electronic records under IRC Section 7602(a)(2), if such electronic records are maintained by the taxpayer. A decision to issue a summons should be made on a case by case basis and after a discussion with the group manager. The procedures for issuing a summons for electronic records are the same as for summoning paper records. Recommended summons language for electronic accounting software records is available on the Electronic Records page of the MySB/SE intranet site.

The Electronic Records page of the MySB/SE site contain Frequently Asked Questions, job aids, sample Information Document Request (IDR), summons language, and more.

To assist in educating taxpayers and representatives, examiners may refer them to the IRS Headliner Volume 303 and the Frequently Asked Questions & Answers page on IRS.gov.

If you have any questions, members of your staff may contact Duane Gillen, Director, Exam Policy or Elmer Smith, Program Manager, Exam Special Processes.