Neal Hannon, Editor

Will the IRS Be Next to Adopt XBRL?

BY NEAL J. HANNON

There's a new movement beginning to take hold in Washington that has nothing to do with Democrats and Republicans, lobbyists, or special interest groups. This movement is all about modernizing the way the government collects and processes regulatory data from our nation's businesses. Led by vocal advocates such as Terry Lutes, associate CIO for IT services at the Internal Revenue Service; Securities & Exchange Commission Chairman Christopher Cox; and Michael Bartell, CIO of the Federal Deposit Insurance Corporation (FDIC), the new mantra is for government agencies to collect "interactive" data.

Interactive data is data that is computer readable and reusable directly from the data's source regardless of the system from which it originates. For government agencies to collect interactive data from the thousands of various reporting entities, a common method of converting the data to an interactive format is required. The method of choice is the eXtensible Business Reporting Language (XBRL).

The recent success of the FDIC project (see "Making Clean Deposits" by Neal Hannon and Grant Trevithick on p. 24 of this issue) may be just the start of something very big in our federal government. Terry Lutes, who in the last decade spearheaded the IRS's move into electronic filing, has also been involved in the worldwide development of XML standards for use in government tax applications. As chair of the Organisation for Economic Co-operation and Development (OECD) technical subgroup on tax, Lutes has led efforts to search the world of international data standards to find the best available methods for exchanging tax data. The need in the U.S. is especially keen because the IRS has negotiated tax treaties with more than 100 countries.

Lutes also echoes a theme commonly expressed by regulatory agencies. Receiving data from reporting entities such as banks and corporations in a common data format makes the entire process faster and easier. "We are not talking about more data, just receiving the data that is useful right away," Lutes says.

Lutes's group concluded that the single, universal standard for reporting tax data that's best suited for the needs of the IRS is XBRL GL, the ledger taxonomy. The XBRL GL taxonomy is designed to detail any element normally reported through a general ledger. International by design, XBRL GL is well suited to capture required tax information from organizations in the U.S. and internationally. According to Lutes, using a common data standard such as XBRL GL for capturing data can lead to a single way of looking at the business reporting data across the company.

What's the Attraction?

As I detailed last month, the SEC is promoting the voluntary use of XBRL for all types of SEC filings.

Filings with the SEC are coded with XBRL for financial statements.

This means that specific tags are used for financial statement elements, such as balance sheet cash or cost of goods sold on the income statement. In contrast, the IRS's attraction to XBRL is different. "XBRL for financial statements does not go deep enough to support the tax administration audit process. XBRL GL has the detail to support tax specific information," Lutes notes.

XBRL GL represents the underlying data found in business, operational, and accounting systems so is well suited to provide the details required to support complex tax filing information. XBRL GL contains an indicator that signals if an account or detail line is an account that should be included in tax calculations. For example, tagging of data at the journal-entry level permits the inclusion of an indicator that can signal that a journal entry represents the difference between an income statement amount and an amount subject to federal tax.

Although XBRL GL may not be ideal for all applications, various federal agencies are looking for ways to use XBRL to help their data collection and analysis situations. The success of the FDIC project has peaked interest all around the D.C. beltway. A U.S. government XBRL users group was formed recently in Washington that includes people from the FDIC, the IRS, the SEC, U.S. Customs, and the Financial Management Services. Discussions began in late 2005 investigating how the agencies can learn from each other's XBRL experiences and how those experiences might be relevant to projects of their own. Ideas for additional pilot projects may come from these discussions.

IRS Preapproval?

One of the possibilities that Lutes is looking forward to when discussing XBRL GL is for many companies to have the IRS view a transaction and give a tax ruling *before* the transaction hits the books. Seventeen companies already have agreements with the IRS to send transactions to the Service before the issues are "discovered" in a tax filing. This way, companies can proceed with confidence that the IRS has full knowledge of the transaction, and any objections can be reconciled prior to the tax filing. The system is currently manual but has the potential to expand greatly with tax-aware XBRL GL.

Let's say a certain company wants expert advice on a transaction that will result in a tax liability. Before they file the return, they call the IRS. The IRS goes online, hooks up to the company's financial system, and, using XBRL GL, determines that the company may need to adjust what they plan to do in order to get a clean ruling. The company makes the necessary adjustments with full confidence that they are now in compliance with IRS regulations.

A new system that allows companies and the IRS to act in cooperation with each other, using XBRL GL as the common accounting translator, opens up a reinvention of tax administration. According to Lutes, such a system could:
● Provide better understanding of audit filing requirements,
● Substantially shorten audit cycles, and
● Provide faster settlement of issues.

The reason why XBRL GL plays such an important role in this process is that it can provide a common bridge from any company's internal accounting system to the tax filing data requested by the IRS. Once this data bridge is established, all the normal benefits of XBRL—speed, accuracy, and reduced cost—will be available to the tax administration process.

A few words of caution should be expressed here. XBRL is by no means mature enough today for any governmental agency to use off the shelf. The correct use of XBRL takes the cooperation of software vendors, regulatory filers, and government agencies to agree on how to represent data. Each application will take lots of hard work and dedication. The end result, however, will generate benefits for all parties involved.

Will other government agencies soon discover the benefits of XBRL? Yes. The question is when. ■

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