

by Sandra R. Brown

Tax Tips

The IRS's Current Voluntary Disclosure Practice

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The tax system of the United States is often described as one of “voluntary compliance.”¹

However, there is very little about the filing of required tax returns and fully paying (on time) amounts legally due and owing to the Internal Revenue Service (IRS) that is truly voluntary.² The reality is that taxpayers have a “legal duty” to comply with U.S. tax laws and, for those who fail to do so, whether by intent or not, the federal laws provide the IRS with the ability to pursue the imposition of a wide array of sanctions, which may be not only civil in nature but also criminal.³ It is the IRS's tax enforcement, be it civil (the carrot) or criminal (the stick), that often drives overall tax compliance. Once a taxpayer has fallen out of compliance, the path forward can be both legally challenging and emotionally daunting.

For the IRS to impose criminal tax penalties, there needs to be a successful criminal tax prosecution. In the majority of cases, for there to be a successful criminal tax prosecution, the Department of Justice (DOJ) needs the

IRS to first initiate a criminal tax investigation.⁴ The IRS has long recognized that, for those who have failed to comply with their tax or tax-related obligations, historical noncompliance is often also an impediment to current and future “voluntary tax compliance.” This is where the IRS's voluntary disclosure practice comes into play. For non-compliant taxpayers, especially those who have intentionally violated their tax obligations, whom the IRS has not yet “gone after”, the IRS's voluntary disclosure practice permits taxpayers to come into compliance with some level of confidence that the IRS will not, as a general matter, seek to have that taxpayer face criminal prosecution. The IRS's voluntary disclosure practice does not, however, guarantee immunity

from criminal prosecution for the commission of a federal tax crime.

It is important to recognize that the IRS's voluntary disclosure program is primarily intended for tax cheats. This recognition brings a clearer understanding as to why this internal policy only provides a limited, but more often than not extremely valuable, measure of protection from criminal tax prosecution. It is this inherent value of the IRS's voluntary disclosure policy which is critical to not only understanding the seeming harshness of the current program but also accepting, and in some ways swallowing, the conditions and consequences of formally coming forward. It is not unique for the IRS to stay away from providing willful taxpayers with a guar-



antee of amnesty. Amnesty, more aptly known as immunity from prosecution, is after all, by law in the purview of the DOJ.⁵

Thus, as a matter of law, the IRS simply does not have the authority to grant immunity from prosecution and, arguably, therefore should not be making promises it has no legal authority to make. That, however, has not always been the case.

Historical Snapshot

On August 21, 1945, then Secretary of Treasury Frederick M. Vinson announced the IRS's first public voluntary disclosure policy, stating: "The Commissioner of Internal Revenue does not recommend criminal prosecution in the case of any taxpayer who makes a voluntary disclosure of omission or other misstatement in his tax return or of failure to make a return."⁶

This announcement was not a matter of happenstance. The Bureau of Internal Revenue, as the IRS was then known, simply sought to increase tax revenues with minimal cost to the government. As stated by the bureau's chief counsel, John Philip Wenchel:

In excusing the man from criminal prosecution, we are merely taking a sensible step to produce the revenue called for by law with the minimum cost of investigation. The man who makes a voluntary disclosure saves us a lot of money in investigating. In return, we can spare him a term in jail. This is good business from his standpoint and it is good business from the Government's standpoint.⁷

At that time, there was no special form required for making the disclosure.⁸ Thus, since at least 1945, the Treasury Department has, in one iteration or another, had in place a public policy by which a taxpayer could largely avoid prosecution in return for fully disclosing his or her tax fraud, so long as the disclosure was deemed by the IRS to be timely, i.e., before any civil or criminal tax investigation against the taxpayer had begun.

For over 75 years, the IRS's voluntary disclosure practice has been the subject of both internal and external contention. For example, prior to 1952, the formal policy in place made clear that a taxpayer who timely came into the program would not be referred for prosecution to the DOJ. In light of the statutory confidentiality protections afforded to a taxpayer, and despite the

IRS's lack of legal authority to provide immunity, this policy was, in practice, the equivalent of an amnesty program.⁹ By 1952, as the result of Congressional hearings finding laxity in enforcement and corruption, the formal policy was discontinued only to be reprised in 1961, but this time with only the promise that the IRS would "consider" a timely disclosure by a taxpayer to be one of the factors that would be weighed against recommending prosecution.¹⁰ In 1974, the IRS shifted its

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voluntary disclosure program even further, essentially, taking the position that, while entitled to some weight, a voluntary disclosure would no longer be a basis for declining a prosecution as well as redefining "voluntary" to not simply mean timeliness but also to involve consideration of the taxpayer's motivation.¹¹ Consequently, by the 1990s, faced with subjective uncertainty, taxpayers found little comfort in "coming in from the cold" to voluntarily disclose historical noncompliance with, and willful violations of, the tax laws. For the next several years, the IRS ping-ponged back and forth as to whether a timely disclosure would or would not earn the IRS's stated intention of non-recommendation of criminal prosecution to the DOJ.

Things shifted significantly in the 2000s as the IRS found itself with an unprecedented focus on offshore tax compliance as a direct result of the landmark investigation and deferred prosecution agreement entered into by the DOJ with Switzerland's largest bank, UBS AG, which provided a window of opportunity for the IRS to access what had previously been largely viewed as otherwise secret offshore bank activity. In response to the untold number of taxpayers with previously

undeclared foreign bank accounts and a wide array of individualized circumstances ranging from ignorance to deliberate deception, the IRS created its offshore voluntary compliance initiative, which, by 2014, was formally known as the Offshore Voluntary Disclosure Program (OVDP).¹² In March 2018, the IRS announced that it would end the OVDP on September 28, 2018,¹³ which it did, leaving in place only the Internal Revenue Manual (IRM) provisions¹⁴ on voluntary disclosure until the IRS's issuance of Interim Guidance (IG) on November 20, 2018.¹⁵ The gist of the IG was: (1) voluntary disclosure would continue to be centralized with IRS Criminal Investigation (IRS-CI) in Philadelphia; (2) IRS-CI would require preclearance for all voluntary disclosures; and, (3) a two-step process, delineated on IRS Form 14457, would be the centerpiece of the IRS's voluntary disclosure process.¹⁶

IRS's current voluntary disclosure practice is arguably more tenuous than prior iterations because it does not guarantee that the IRS will not recommend criminal prosecution to the Justice Department of a taxpayer who, prior to an investigation by the IRS, voluntarily discloses the commission of a tax or tax-related crime.

What the IRS "promises" under the its current voluntary disclosure practice is very specific: "If you have willfully failed to comply with tax or tax-related obligation submitting a voluntary disclosure may be a means to resolve your noncompliance and limit exposure to criminal prosecution."¹⁷ In return for that "promise" the IRS has now imposed a clear list of its expectations from taxpayers seeking, not only entry, but a final closing agreement under the current policy.

Voluntary Disclosure Policies

On September 17, 2020, the IRS updated the IRM provision that speaks directly to the IRS's voluntary disclosure practice.¹⁸ (See sidebar on page 16 for some of the highlights.)

All voluntary disclosures must meet the requirements contained in subsection 9.5.11.9 of the IRM. Also, taxpayers must utilize Form 14457—the Voluntary Disclosure Practice Preclearance Request and Application—to participate in the voluntary disclosure practice. In addition to the updates to the applicable IRM provisions and the required Form

14457, the IRS took steps to advertise its voluntary disclosure updates by creating a new landing page specifically for voluntary disclosures.¹⁹

Criminal Investigation Program

The IRS's voluntary disclosure practice is an IRS-CI program; it is not, as it may

have been viewed and utilized by both taxpayers and the IRS in the 2010s, an offshore bank account penalty program. The IRS's current voluntary disclosure program is essentially notice that the IRS is returning to its pre-OVDP days when the IRM's voluntary disclosure program was focused primarily on tax cheats. The

IRS has not been shy about this fact. At every opportunity, the IRS has taken the time to affirmatively state that the IRS's current voluntary disclosure program is only for the truly willful who have criminal liability, further noting that taxpayers who do not have criminal liability should avail themselves of one of the IRS's other compliance options to correct past errors and oversights. As set forth in the Form 14457 instructions, "[a] voluntary disclosure will not automatically guarantee immunity from prosecution," but it will be considered along with all other facts and circumstances in determining whether criminal prosecution will be recommended. The objective is to provide taxpayers whose conduct involved willful tax or tax-related noncompliance with a means to come into compliance with the tax law and avoid potential criminal prosecution.

In return for the IRS's consideration of a taxpayer's voluntary disclosure as part of its determination whether to recommend prosecution or not, the IRS's voluntary disclosure program obligates a taxpayer to fully cooperate. Full cooperation in this situation includes: promptly and fully responding to all information document requests, submitting to interviews and providing access to related party witnesses, providing statute extensions or waivers as necessary for tax and tax-related issues, providing delinquent or amended returns, information returns, supporting documents, work papers, etc., providing bank secrecy waivers (for offshore cases), submitting all required returns, reports, and schedules for the disclosure period to the assigned examiner once the civil examination commences, and an expectation of a full payment of all unpaid taxes, penalties, and interest. Taxpayers should expect to pay not only 6 years of unpaid tax deficiencies but also a 75 percent civil fraud penalty for the largest tax debt among the 6 years as well as interest on both the total unpaid tax and the additional penalty. The IRS also has made clear that the statements made in both Part I, the preclearance request, and Part II, the voluntary disclosure application, of Form 14557 can be used as investigatory leads and admissions in any civil or criminal tax matter, subject only to limitations imposed by Section 6103.²⁰

Legal and Practical Considerations

The IRS's voluntary disclosure policy is found in the IRM. While the IRM

VOLUNTARY DISCLOSURE POLICIES HIGHLIGHTS

- The voluntary disclosure practice is a long-standing practice of the IRS that provides taxpayers with criminal exposure a means to come into tax compliance and potentially avoid criminal prosecution.
- The voluntary disclosure practice is a compliance option for taxpayers who have committed tax or tax-related crimes and have criminal exposure due to their willful violation of the law. If the violation of the law was not willful, taxpayers should consider other options including correcting past mistakes by filing amended or past due returns.
- A voluntary disclosure will be considered along with all other factors in determining whether criminal prosecution will be recommended. A voluntary disclosure does not guarantee immunity from prosecution.
- The voluntary disclosure practice creates no substantive or procedural rights for taxpayers. Taxpayers cannot rely on the fact that other similarly situated taxpayers may not have been recommended for criminal prosecution. The determinations of IRS-CI, including, but not limited to, determinations concerning timeliness, completeness, truthfulness, rejection, and revocation decisions are not subject to any administrative or judicial review or appeal process.
- The voluntary disclosure practice is not available to taxpayers with illegal source income. Income from activities determined to be legal under state law but illegal under federal laws is considered illegal source income for purposes of the IRS-CI voluntary disclosure practice, e.g., lawful state cannabis businesses will not qualify because they involve illegal source income.
- A voluntary disclosure occurs when the communication is truthful, timely, and complete.

The practice also requires taxpayers to:

- cooperate with the IRS in determining their tax liability and compliance reporting requirements,
- cooperate with the IRS in investigating any professional enablers who aided in the noncompliance,
- submit all required returns, information returns, and reports for the disclosure period, and
- make good faith arrangements with the IRS to pay in full the tax, interest, and any penalties determined by the IRS to be applicable.

A disclosure is timely if it is received before:

- the IRS has commenced a civil examination or criminal investigation of the taxpayer or has notified the taxpayer that it intends to commence such an examination;
- the IRS has received information from a third party (e.g., informant, other governmental agency, or the media) alerting the IRS to the taxpayer's noncompliance; or
- the IRS has acquired information directly related to the noncompliance of the taxpayer from an enforcement action (e.g., search warrant, summons, grand

provides taxpayers and tax practitioners with a robust roadmap of what it can expect from the IRS in most interactions, generally speaking, the IRM is primarily intended to serve as the single official compilation of the agency's policies, procedures, and guidelines for the administration and operation of the IRS. It is noted, however, that the simple fact that the IRS has adopted an internal procedure, in writing, in a manual, does not mean that the provision per se provides an independent due process protection to taxpayers. Rather, the courts look to whether a particular provision of the IRM guarantees a substantial right to the individual or is merely a set of internal administrative procedures that govern the affairs of the agency in determining whether such provision can be independently enforced by a taxpayer.²¹ Only if the IRM procedures involve the former, will a taxpayer be afforded the opportunity to challenge the IRS's noncompliance with its procedures in court.²² This legal analysis is what is known as the *Caceres Doctrine*.²³ The *Caceres Doctrine* looks to whether, by federal statute or the Constitution, due process and the law confer independent legal rights on the individual in analyzing whether a particular internal administrative policy should be afforded the force and effect of law as having been promulgated for the benefit of taxpayers.²⁴

Practically speaking, despite the IRS's unwillingness and inability to provide immunity, as history has shown, not every tax cheat gets prosecuted. As history also has shown, when it comes to the selection of cases referred and accepted for prosecution, the IRS-CI and the DOJ want to prosecute tax cases that not only have the greatest likelihood of conviction, i.e. evidence and jury appeal but also cases that are most likely to achieve a sentence of deterrence, i.e. significant prison time. Prosecuting a taxpayer who has come in from the cold before the IRS began an investigation and who then proceeds to cooperate and pay his or her tax debt is rarely, if ever, the kind of criminal tax case that achieves either, let alone both, goals. As former Commissioner of Internal Revenue Dana Latham stated:

[I]t should be borne in mind that in determining whether or not an evader should be prosecuted, the existence of a true voluntary disclosure is an important element taken



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into consideration by Regional Counsel, Intelligence, and the Department of Justice. The Department of Justice has learned by what may be termed the “hard way” that evidence of a truly penitent spirit weighs heavily with a jury.... This does not mean that no evader who has made a voluntary disclosure will not be prosecuted. But it is, nevertheless, a very important element to be considered by you as practitioner....²⁵

To be clear, the current conditions of the IRS’s voluntary disclosure program are not for the faint of heart, but then again, neither is facing years in prison and a restitution order that is enforceable for up to 40 years, as a result of being prosecuted and convicted of tax fraud. ■

¹ *Flora v. United States*, 362 U.S. 145, 176 (1960) (“Our system of taxation is based upon voluntary assessment and payment, not upon distraint.”)

² The requirement to file an income tax return is not voluntary and is clearly set forth in the Internal Revenue Code. 26 U.S.C. §§6011(a), 6012(a), 6072(a). *See also* Treas. Reg. §1.6011-1(a). Likewise, the requirement to pay taxes is not voluntary. *See* I.R.C. §§1, 11, each of which respectively imposes a tax on the taxable income

of individuals, estates, trusts, and corporations. The obligation to pay tax is described in I.R.C. §6151, which requires taxpayers to submit payment with their tax returns. I.R.C. §7608 provides the initial authority for investigating crimes under the Internal Revenue laws.

³ *Helvering v. Mitchell*, 303 U.S. 391, 399 (1938) (“In assessing income taxes, the Government relies primarily upon the disclosure by the taxpayer of the relevant facts...in his annual return. To ensure full and honest disclosure, to discourage fraudulent attempts to evade the tax, Congress imposes [either criminal or civil] sanctions.”)

⁴ I.R.M. 9.5.12.4 (rev’d July 25, 2007).

⁵ 18 U.S.C. §6001.

⁶ *United States v. Pack*, 140 F. Supp. 121, 123 (D. Del. 1956).

⁷ *Proposals for Strengthening Tax Administration: Hearings Before a Subcommittee of the Committee on Ways and Means*, 82nd Cong. 147 (1952).

⁸ *Id.* at 146.

⁹ 26 U.S.C. §6103.

¹⁰ *United States v. Tenzer*, 127 F. 3d 222, 226 (2d Cir. 1997) (quoting *Shotwell Mfg. Co. v. United States*, 371 U.S. 341, 349 (1963)).

¹¹ *Tax Controversies – Audits, Investigations, Trials at 14-4* (citing I.R.M. (31) 330(2)(b)(ii) (since repealed)).

¹² IRS, *Options Available For U.S. Taxpayers with Undisclosed Foreign Financial Assets*, available at <http://www.irs.gov/Individuals/International-Taxpayers/Options-Available-For-U-S-Taxpayers-with-Undisclosed-Foreign-Financial-Assets> (last accessed Jan. 29, 2021).

¹³ I.R.S., IRS: Offshore Voluntary Compliance Pro-

gram to end Sept. 28, available at <https://www.irs.gov/newsroom/irs-offshore-voluntary-compliance-program-to-end-sept-28> (last accessed Jan. 29, 2021).

¹⁴ I.R.M. 9.5.11.9 (Sept. 17, 2020).

¹⁵ I.R.M. 9.5 Interim Guidance; LB&I-09-1118-014 (Nov. 20, 2018).

¹⁶ *Id.*

¹⁷ I.R.S., IRS Criminal Investigation Voluntary Disclosure Practice, available at <https://www.irs.gov/compliance/criminal-investigation/irs-criminal-investigation-voluntary-disclosure-practice> (last accessed Jan. 29, 2021) [hereinafter IRS-CI Voluntary Disclosure Practice].

¹⁸ *See* IRM 9.5.11.9 (09-17-2020).

¹⁹ IRS-CI Voluntary Disclosure Practice, *supra* note 17.

²⁰ *Id.*

²¹ *United States v. McKee*, 192 F. 3d 535, 540 (6th Cir. 1999) (courts “must initially address whether a taxpayer may properly base a challenge to a tax conviction on the IRS’s alleged noncompliance with the procedures of its Manual”).

²² *Id.* at 540-41.

²³ *United States v. Caceres*, 440 U.S. 741 (1979).

²⁴ *Crystal v. United States*, 172 F. 3d 1141, 1148 (9th Cir. 1999) (noting courts are of the view that internal rules of agency procedure confer no substantive rights on taxpayers).

²⁵ Dana Latham, *Comments of Dana Latham, Commissioner of Internal Revenue, Before the Section of Taxation, American Bar Association, at Miami Beach, Florida, August 23, 1959: Current Administrative Problems of the Internal Revenue Service*, 13 A.B.A. BULL. (TAXATION SEC.) 1 (1959), at 7-16.

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