

## Voluntary Disclosures to the Internal Revenue Service *They're Not Limited to Offshore Accounts!*

By Brandon Mourges

In recent years, the Internal Revenue Service (IRS) and Department of Justice (DOJ) have diligently promoted the successes of the Offshore Voluntary Disclosure Program, Streamlined Filing Compliance Procedures, and other similar amnesty programs which address significant taxpayer non-compliance involving offshore accounts and assets. Although some taxpayers initially are taken aback at the potential penalties paid to the IRS to settle within these programs, the ability to avoid criminal referral by the IRS – and prosecution by the DOJ – is often too much to pass up. After all, most taxpayers would rather pay a portion of the penalty that could be imposed if they were criminally prosecuted and be assured that they will not face the possibility of years in prison, like [Dr. Baruch Fogel](#) and [Peter Canale](#).

While these offshore amnesty programs are relatively recent and have been extensively publicized by the government and various media outlets, many taxpayers and tax professionals remain unaware of these programs' predecessor: the Internal Revenue Service's Voluntary Disclosure Practice ("the Voluntary Disclosure Practice" or "the Practice"). The [Internal Revenue Manual](#), which details many of the IRS' procedural guidelines, also details the Voluntary Disclosure Practice and explains how a taxpayer can affirmatively disclose his tax misdeeds to the IRS to attempt to avoid a recommendation for criminal prosecution. See [Internal Revenue Manual 9.5.11.9 \(12-02-2009\)](#). For a discrete set of taxpayers, this Practice can be an invaluable tool to achieve a significant goal: mitigation of exposure to criminal penalties. **(Note: The Practice is not the same as simply filing amended returns and specific procedural requirements must be met. Also, as explained below, the Practice does not impact potential civil liabilities.)** As stated in the Internal Revenue Manual:

It is currently the practice of the IRS that a voluntary disclosure will be considered along with all other factors in the investigation in determining whether criminal prosecution will be recommended. This voluntary disclosure practice creates no substantive or procedural rights for taxpayers as it is simply a matter of internal IRS practice, provided solely for guidance to IRS personnel. Taxpayers cannot rely on the fact that other similarly situated taxpayers may not have been recommended for criminal prosecution.

While a voluntary disclosure does not necessarily create any legal rights for a taxpayer, a formal submission pursuant to the Voluntary Disclosure Practice can go a long way towards avoiding criminal prosecution – particularly if a taxpayer is aware that the IRS is likely to, or will, soon discover the issues to be disclosed. Although a taxpayer may be referred for prosecution after making a voluntary disclosure, it is less likely that the DOJ would ultimately prosecute the case, as there are many more attractive prosecutions available to the DOJ (i.e., taxpayers who did not try to resolve their tax non-compliance) and a court is more likely to sentence the offender who has voluntarily disclosed their misdeeds to minimal criminal penalties. If ultimately selected for a civil examination, a taxpayer making a formal disclosure through this Practice may be considered more favorably than a taxpayer who simply files amended returns.

In order to make a formal disclosure under the IRS' Voluntary Disclosure Practice, a taxpayer must meet all of the following conditions:

- The taxpayer must not have [illegal source income](#);
- The taxpayer must show a willingness to cooperate (and in fact cooperate) with the IRS in determining his/her correct tax liability;
- The taxpayer must make good faith arrangements with the IRS to pay in full, the tax, interest, and any penalties determined by the IRS to be applicable; and
- The disclosure must be made before: (1) the IRS initiates a civil examination or criminal investigation of the taxpayer, or notifies the taxpayer that it intends to commence such an examination or investigation; (2) the IRS receives information from a third party regarding the specific taxpayer's noncompliance; (3) the IRS initiates a civil examination or criminal investigation which is directly related to the specific liability of the

taxpayer; and (4) the IRS acquires information directly related to the specific liability of the taxpayer from a criminal enforcement action.

See Internal Revenue Manual 9.5.11.9(3-4). As the Practice is not limited to any specific type of tax non-compliance, many [taxpayers facing potential criminal liability](#) can make use of the Practice, such as (but not limited to):

<b><u>Situation</u></b>	<b><u>Potential Sources of Criminal Liability<sup>1</sup></u></b>
Non-filer	26 U.S.C. § 7201 (tax evasion); 26 U.S.C. § 7203 (willful failure to file); 26 U.S.C. § 7202 (failure to account for and pay over employment taxes)
Undisclosed domestic income	26 U.S.C. § 7201 (tax evasion); 26 U.S.C. § 7206 (fraud and false statements); 26 U.S.C. § 7207 (fraud and false statements)
Misstatement/misclassification of tax items	26 U.S.C. § 7201 (tax evasion); 26 U.S.C. § 7206 (fraud and false statements); 26 U.S.C. § 7207 (fraud and false statements)
Issuance of false tax documents	26 U.S.C. § 7201 (tax evasion); 26 U.S.C. § 7206 (fraud and false statements); 26 U.S.C. § 7207 (fraud and false statements)

<sup>1</sup> This is not intended to be an exclusive list and other criminal statutes could be applicable.

It should be noted that taxpayers with undisclosed foreign or offshore tax issues are ineligible for the Practice and must use the Offshore Voluntary Disclosure Program. It should also be noted that where a taxpayer does not have illegal source income (and is eligible for the Voluntary Disclosure Practice), a voluntary disclosure will not necessarily protect the taxpayer from prosecution for non-tax offenses.

While the Voluntary Disclosure Practice should be considered when addressing certain instances of non-compliance, it is not for every taxpayer. Prior to making any disclosure, or initiating any request to use the Practice, a careful evaluation of the taxpayer's criminal exposure and a determination of their eligibility for the Practice must be performed. Further, if the non-compliance is small in magnitude, is not of a recurring nature, was not a result of deliberate efforts of the taxpayer, or the risk of civil or criminal penalties is remote for other reasons, the Practice may be overly cumbersome or cause other unintended consequences to a taxpayer. In certain situations such as these, it may be in the best interest of the taxpayer to resolve the issue by other means, such as filing amended returns. Since these are often judgment calls with significant consequences involved, a tax professional should be consulted.

Assuming the Voluntary Disclosure Practice is the best means for addressing non-compliance, taxpayers should be advised that they will likely be subject to a subsequent civil examination – at least for the tax years or conduct being disclosed. Though the Practice may mitigate criminal exposure, it does not prevent or necessarily affect the IRS' decision-making with regard to the assessment of potentially significant additional taxes and penalties. Therefore, if the disclosure is not handled carefully, a taxpayer could unnecessarily expose themselves to a [civil fraud penalty](#) (75% of the tax assessed) instead of a [negligence or accuracy-related penalty](#) (20% of the tax assessed) or no penalty at all. It could also lead to the adjustment of tax items that are not necessarily a part of the disclosed conduct. This additional exposure could result from the disclosure of facts that are not necessarily required by the Practice, or might not otherwise be exposed in the subsequent civil examination, and could lead to a taxpayer owing a substantial amount to the IRS. In addition, a myriad of other civil penalties for submission of inaccurate or false information documents could also be assessed if a taxpayer does not disclose his non-compliance in the most efficient manner. Taxpayers need to be aware that the process does not simply end after the conduct has been disclosed and it may be a year (or longer) until the matter is resolved.

Finally, information from the closing of the civil examination with the IRS will often be shared by the IRS with state taxing authorities. Therefore, taxpayers must also consider addressing their related state tax non-compliance at the appropriate time. Depending upon the criminal exposure at the state level (if any), non-compliance can often be addressed through a parallel voluntary disclosure practice, by filing amended returns for the affected years, by addressing the issue prospectively, or through another means. As with the Voluntary Disclosure Practice, careful consideration must be made in addressing these issues as well.

***These descriptions are provided for informational purposes only. If you have past tax non-compliance, you should contact a tax attorney. For a free consultation, please contact Brandon Mourges at 410.951.1149 or [bmourges@rosenbergmartin.com](mailto:bmourges@rosenbergmartin.com).***