

# VOLUNTARY DISCLOSURE

Rob McCallum  
LeSourd & Patten, P.S.

- *Do you represent taxpayers who have failed to file tax returns or who have filed false tax returns?*
- *Do you want the taxpayer to avoid a criminal tax prosecution and dealing professionally with Bob Westinghouse, Chief, Criminal Division, U.S. Attorney's Office?*

## **I. Effect of a Voluntary Disclosure**

### **A. Possible Avoidance of Prosecution**

Current IRS policy is that a voluntary disclosure will be considered along with all other factors in determining whether to recommend criminal prosecution.

I.R.M. §9.5.11.9. A voluntary disclosure will not guarantee immunity from prosecution.

Id. Furthermore, IRS policy with regard to voluntary disclosures does not create any substantive or procedural rights on the part of taxpayers, but is a matter of internal IRS practice. Id. IRS policy states that a voluntary disclosure may result in no prosecution recommendation, but cautions that “taxpayers should be advised that they cannot rely on the fact that others may not have been prosecuted.” Id. The voluntary disclosure policy does not apply to taxpayers with illegal source income, e.g., drug income and embezzlement income(?).

Although a voluntary disclosure is no guarantee the IRS will not recommend prosecution, it is nonetheless doubtful that the IRS would recommend prosecution in the case of a disclosure that qualifies as a voluntary disclosure. If the IRS were to recommend prosecution in the case of a disclosure that qualifies as a voluntary disclosure, then few voluntary disclosures would be forthcoming. From 1946 through 1952, the IRS maintained an express policy under which a voluntary disclosure was an automatic shield against prosecution. This historical policy seems to have been followed for many years even after its formal abandonment in 1952. See *Disincentives to Voluntary Disclosure*:

*United States v. Hebel and Deleet Merchandizing Corp. v. Commissioner*, 3 Va. Tax Rev. 401, n.4 (1984).

Furthermore, a voluntary disclosure may create a practical disincentive for prosecution, by reducing the likelihood of conviction. Specifically, a voluntary disclosure may tend to undermine the prosecution's case on the issue of willfulness, at least in the eyes of a jury. Willfulness is an essential element of every tax crime.

While the IRS has recommended some cases for prosecution in spite of an attempted voluntary disclosure by the taxpayer, these cases typically involve situations in which the taxpayer has significantly failed to comply with the criteria for a voluntary disclosure. See, e.g., United States v. Tenzer, 127 F.3d 222 (2<sup>nd</sup> Cir. 1997), cert. denied, 523 U.S. 1096 (1998) (non-payment of tax by CPA/atty after making voluntary disclosure); United States v. Knottnerus, 139 F.3d 558 (7<sup>th</sup> Cir. 1998) (untimely disclosure after visit by IRS Special Agent).

**B. No Entitlement to Non-Prosecution**

The case law confirms that the current IRS policy on voluntary disclosure does not create any substantive or procedural rights on the part of the taxpayer. See United States v. Hebel, 668 F.2d 995 (8<sup>th</sup> Cir.), cert. denied, 456 U.S. 956 (1982). Crystal v. United States, 172 F.3d 1141 (9<sup>th</sup> Cir. 1999) (upholding IRS summonses from CID Los Angeles District, where taxpayers had disclosed facts of case to CID Southern California District and been told that they could fit within the voluntary disclosure policy, the taxpayers subsequently disclosed their identity, and CID Southern California District

afterward discovered that CID Los Angeles District had already started a criminal investigation but had failed to alert other offices in accordance with standard procedure).

**C. Release of Sensitive/Incriminating Information**

The immediate effect of any voluntary disclosure is to provide the IRS with information potentially sufficient to convict the taxpayer of a crime. A voluntary disclosure will generally require the filing of an amended return or the filing of delinquent returns for each year in question. If the taxpayer provides the IRS with information of this nature but fails to satisfy all the criteria for a voluntary disclosure, all the taxpayer achieves is self-incrimination. The taxpayer may have triggered a prosecution that would not have occurred without the taxpayer's assistance.

**D. Probable Civil Review**

A voluntary disclosure may very well trigger an audit. In a tax fraud case, the taxpayer may have to file amended returns, and the IRS is virtually certain to, at a minimum, review these returns, if not audit them. In addition, the IRS may become interested in returns filed by the taxpayer for other years not covered by the voluntary disclosure. In the case of a non-filer with a modest liability, the IRS might be more inclined to pass on the opportunity to examine delinquent returns.

**E. No Effect on Civil Liability**

A voluntary disclosure does not alter the taxpayer's civil liability. A taxpayer who makes a voluntary disclosure of tax fraud, for example, is potentially liable for the tax underpayment in the year of the fraud, plus the 75 percent fraud penalty or 20

percent accuracy-related penalty and interest. A nonfiler is potentially liable for the tax underpayment, plus the failure to file, failure to pay, and estimated tax penalties as well as interest. Many times, the IRS will limit the number of years a nonfiler is required to file delinquent returns.

**F. No Effect on Civil Statute of Limitations**

A voluntary disclosure (accompanied by an amended return) does not start the running of the statute of limitations on civil liability. In general, the limitations period for assessment of tax does not apply to a fraudulent return. Where a taxpayer's initial return is fraudulent, an amended return will not cure the fraud for purposes of the statute of limitations, and the IRS may assess tax and penalty at any time. Badaracco v. Commissioner, 464 U.S. 386 (1984).

**II. Criteria for a Voluntary Disclosure**

A communication to the IRS is considered a voluntary disclosure only if the communication satisfies each of the following criteria:

**A. Truthfulness**

It is essential that the information provided by the taxpayer is truthful. I.R.M. § 9.5.11.9. For practical purposes, truthfulness is necessary to elicit a tentative position from the IRS with regard to non-prosecution. Before the taxpayer commits to a voluntary disclosure, the taxpayer can convey the information to the IRS through an attorney, taking measures to preserve anonymity. The IRS may provide guidance as to its

probable course of action, and the taxpayer can decide whether to follow through. But the guidance from the IRS is useless if the information provided by the taxpayer is inaccurate. However, a voluntary disclosure cannot be done anonymously, the identity of the taxpayer must be disclosed to qualify as a voluntary disclosure.

**B. Timeliness**

Under the prior voluntary disclosure policy, the taxpayer's disclosure was considered timely if the IRS received the taxpayer's communication before either the IRS initiated an inquiry that is likely to lead to the taxpayer or some event occurred that is likely to cause an audit into the taxpayer's liabilities. I.R.M. § 9.5.11.9. The taxpayer's action was also considered timely if the taxpayer was reasonably thought to be unaware of any such inquiry or event.

Under the current voluntary disclosure policy (effective December 11, 2002), there is a bright line test as to whether the disclosure is timely. A disclosure is timely if it is received before:

- (1) the IRS has initiated a civil examination or criminal investigation of the taxpayer, or has notified the taxpayer that it intends to commence such an examination or investigation;
- (2) the IRS has received information from a third party (e.g., informant, other governmental agency, or the media) alerting the IRS to the specific taxpayer's noncompliance;
- (3) the IRS has initiated a civil examination or criminal investigation which is directly related to the specific liability of the taxpayer; or

- (4) the IRS has acquired information directly related to the specific liability of the taxpayer from a criminal enforcement action (e.g., search warrant, grand jury subpoena).

Timeliness is often problematic, because the taxpayer's desire to make a voluntary disclosure may be the result of contact from the IRS. Once the IRS has made contact, technically the taxpayer is too late to make a voluntary disclosure. See United States v. Knottnerus, 139 F.3d 558 (7<sup>th</sup> Cir. 1998) (special agent was photographing taxpayer's house, taxpayer approached the special agent, who identified himself, and taxpayer sped away in a truck; taxpayer later attempted to make a voluntary disclosure). The taxpayer is not precluded from making a voluntary disclosure if the IRS has simply written the taxpayer requesting delinquent returns or made assessments as a result of preparing substitute returns pursuant to I.R.C. Section 6020(b).

### **C. Completeness**

A voluntary disclosure must be complete. The taxpayer cannot expect to disclose some offenses and withhold information about others. The statute of limitations for prosecution of tax crimes is generally six years, and the voluntary disclosure ordinarily must track offenses back to the earliest open year. Sometimes voluntary disclosures do not cover all six years, even if there is a problem for each of the six years. In the case of a non-filer, generally a voluntary disclosure would include filing a return at least for the last six years, or as many of the last six years for which the taxpayer has not filed a return.

**D. Cooperation**

The taxpayer must show a willingness to cooperate in good faith with the IRS in determination of the taxpayer's correct tax liability, and the taxpayer must actually cooperate. In practice, this requirement often means the taxpayer must file an amended return and pay tax, interest, and applicable penalties, or make some arrangement to pay. An arrangement to pay could be an installment agreement or an offer in compromise accepted by the IRS.

**E. Special Agent Review**

The voluntary disclosure policy provides that a taxpayer who contacts the IRS in person or through a representative will be directed to the Criminal Investigation Division for evaluation of the disclosure. Special Agents are encouraged to consult with Area Counsel Criminal Tax on voluntary disclosure issues.

It should be noted that there is an ongoing debate as to whether a voluntary disclosure can be made to the Service Center or needs to be made to a Special Agent. There does not seem to be a consistent policy.





## Revised IRS Voluntary Disclosure Practice

### TAX CRIMES - GENERAL

IRM 9.5.3.3.1.2.1

#### Voluntary Disclosure Practice

(1) 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, but rather is 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.

(2) A voluntary disclosure will not automatically guarantee immunity from prosecution; however, a voluntary disclosure may result in prosecution not being recommended. This practice does not apply to taxpayers with illegal source income.

(3) A voluntary disclosure occurs when the communication is truthful, timely, complete, and when:

- a. the taxpayer shows a willingness to cooperate (and does in fact cooperate) with the IRS in determining his or her correct tax liability; and
- b. the taxpayer makes good faith arrangements with the IRS to pay in full, the tax, interest, and any penalties determined by the IRS to be applicable.

(4) A disclosure is timely if it is received before:

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

(5) Any taxpayer who contacts the IRS in person or through a representative regarding voluntary disclosure will be directed to Criminal Investigation for evaluation of the disclosure. Special agents are encouraged to consult Area Counsel, Criminal Tax on voluntary disclosure issues.

(6) Examples of voluntary disclosures include:

- a. a letter from an attorney which encloses amended returns from a client which are complete and accurate (reporting legal source income omitted from the original returns), which offers to pay the tax, interest, and any penalties determined by the IRS to be applicable in full and which meets the timeliness standard set forth above. This is a voluntary disclosure because all elements of (3). above are met.

b. a disclosure made by a taxpayer of omitted income facilitated through a barter exchange after the IRS has announced that it has begun a civil compliance project targeting barter exchanges; however the IRS has not yet commenced an examination or investigation of the taxpayer or notified the taxpayer of its intention to do so. In addition, the taxpayer files complete and accurate amended returns and makes arrangements with the IRS to pay in full, the tax, interest, and any penalties determined by the IRS to be applicable. This is a voluntary disclosure because the civil compliance project involving barter exchanges does not yet directly relate to the specific liability of the taxpayer and because all other elements of (3), above are met

c. a disclosure made by a taxpayer of omitted income facilitated through a widely promoted scheme regarding which the IRS has begun a civil compliance project and already obtained information which might lead to an examination of the taxpayer; however, the IRS has not yet commenced an examination or investigation of the taxpayer or notified the taxpayer of its intent to do so. In addition, the taxpayer files complete and accurate returns and makes arrangements with the IRS to pay in full, the tax, interest, and any penalties determined by the IRS to be applicable. This is a voluntary disclosure because the civil compliance project involving the scheme does not yet directly relate to the specific liability of the taxpayer and because all other elements of (3), above are met.

d. A disclosure made by an individual who has not filed tax returns after the individual has received a notice stating that the IRS has no record of receiving a return for a particular year and inquiring into whether the taxpayer filed a return for that year. The individual files complete and accurate returns and makes arrangements with the IRS to pay the tax, interest, and any penalties determined by the IRS to be applicable in full. This is a voluntary disclosure because the IRS has not yet commenced an examination or investigation of the taxpayer or notified the taxpayer of its intent to do so and because all other elements of (3), above, are met.

(7) Examples of what are not voluntary disclosures include:

a. a letter from an attorney stating his or her client, who wishes to remain anonymous, wants to resolve his or her tax liability. This is not a voluntary disclosure until the identity of the taxpayer is disclosed and all other elements of (3) above have been met.

b. a disclosure made by a taxpayer who is under grand jury investigation. This is not a voluntary disclosure because the taxpayer is already under criminal investigation. The conclusion would be the same whether or not the taxpayer knew of the grand jury investigation.

c. a disclosure made by a taxpayer, who is not currently under examination or investigation, of omitted gross receipts from a partnership, but whose partner is already under investigation for omitted income skimmed from the partnership. This is not a voluntary disclosure because the IRS has already initiated an investigation which is directly related to the specific liability of this taxpayer. The conclusion would be the same whether or not the taxpayer knew of the ongoing investigation.

d. a disclosure made by a taxpayer, who is not currently under examination or investigation, of omitted constructive dividends received from a corporation which is currently under examination. This is not a voluntary disclosure because the IRS has already initiated an examination which is directly related to the specific liability of this taxpayer. The conclusion would be the same whether or not the taxpayer knew of the ongoing examination.

e. a disclosure made by a taxpayer after an employee has contacted the IRS regarding the taxpayer's double set of books. This is not a voluntary disclosure even if no examination or investigation has yet commenced because the IRS has already been informed by the third party of the specific taxpayer's noncompliance. The conclusion would be the same whether or not the taxpayer knew of the informant's contact with the IRS.