



PROGRAM MATERIALS

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The Future of IRS Voluntary Disclosures in a Post-OVDP World

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The Future of IRS Voluntary Disclosures in a Post-OVDP World

July 18, 2019

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Matthew D. Lee is a former U.S. Department of Justice trial attorney who concentrates his practice on all aspects of white collar criminal defense and federal tax controversies. He has extensive experience in advising clients on issues regarding foreign bank account reporting (FBAR) obligations, the Foreign Account Tax Compliance Act (FATCA), and the Internal Revenue Service's 2009 Offshore Voluntary Disclosure Program, 2011 Offshore Voluntary Disclosure Initiative, and 2012 Offshore Voluntary Disclosure Program. He has represented hundreds of U.S. taxpayers with undisclosed foreign bank accounts. Mr. Lee has published numerous articles regarding the IRS voluntary disclosure programs and FBAR and FATCA reporting obligations and speaks frequently on these topics.

He has also represented clients in all stages of proceedings before the Internal Revenue Service, including audits, appeals, and collections, and Tax Court and district court litigation. Mr. Lee also has experience in conducting corporate internal investigations and advising clients as to corporate compliance issues involving the Bank Secrecy Act, the USA Patriot Act, FATCA, and anti-money laundering laws and regulations.

Mr. Lee has represented both corporations and individuals in criminal investigations involving tax, money laundering, health care, securities, public corruption, and fraud offenses, and has significant experience in handling all stages of federal litigation including trials and appeals.

Mr. Lee is the author of *Foreign Account Tax Compliance Act Answer Book* (Practising Law Institute) and publishes a blog entitled *Tax Controversy and Financial Crimes Report* ([\(\(https://taxcontroversy.foxrothschild.com\)\)](https://taxcontroversy.foxrothschild.com)).



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Obligation to Report Worldwide Income

- United States law has always obligated U.S. citizens (including dual citizens) and U.S. residents to declare and pay taxes on all of their worldwide income, regardless of where those earnings have been derived.
- Historically, some U.S. taxpayers have attempted to avoid or evade reporting income earned outside of the U.S. because of the U.S. government's inability to identify those earnings from overseas banks and other financial institutions.



Why the Focus on International Tax Compliance?

- IRS/DOJ have intense focus on curtailing offshore tax avoidance
 - U.S. Tax Gap: \$450 billion
 - U.S. Senate PSI Report (2/26/14): Offshore tax schemes cause \$150 billion in lost tax revenue per year
- How?
 - Using traditional “carrot and stick” approach
 - Carrot: voluntary disclosure/amnesty programs
 - Stick: unprecedented enforcement (criminal and civil)



The End of OVDP: What's Next for Voluntary Disclosures?

- Offshore Voluntary Disclosure Program (OVDP) ended on September 28, 2018, following highly successful 2009, 2011, and 2012 iterations:
 - Provided participating taxpayers with amnesty from criminal prosecution by filing of amended tax returns and payment of taxes, interest, and penalties.
 - More than 56,000 voluntary disclosures since 2009 (versus 100 on average annually under traditional voluntary disclosure program).
 - More than \$11.1 billion in back taxes, interest, and penalties collected.



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Other Voluntary Disclosure Options

- Streamlined Filing Compliance Procedures:
 - Approximately 65,000 submissions since 2014.
- Delinquent FBAR Submission Procedures;
- Delinquent International Information Return Submission Procedures;
- Traditional voluntary disclosure practice:
 - Criteria described in Internal Revenue Manual § 9.5.11.9.
- “Quiet” disclosures.



The Stick: Unprecedented Enforcement

- “Those who underestimate the ability of the United States to pursue offshore tax evasion do so at their own peril.” (DOJ Tax January 29, 2016)
- “Today’s agreements reflect the Tax Division’s continued progress towards reaching appropriate resolutions with the banks that self-reported and voluntarily entered the Swiss Bank Program. The department is currently investigating accountholders, bank employees, and other facilitators and institutions based on information supplied by various sources, including the banks participating in this Program. ***Our message is clear – there is no safe haven.***” (DOJ Tax May 29, 2015)
- “These four additional bank agreements signal a change in terrain for offshore banking. No longer is it safe to hide money offshore and expect that it will not be discovered. IRS CI Special Agents will continue to follow the money to find those who circumvent the offshore disclosure laws and hold them accountable.” (IRS-CI May 29, 2015)



New Voluntary Disclosure Regime

- Announced November 20, 2018;
- Applies to both offshore and domestic voluntary disclosures post-September 28, 2018;
- Six-year covered period;
- New penalty framework:
 - Civil fraud penalty will ordinarily be applied for to the one year with the highest tax liability (but could apply to all six years).
 - Willful FBAR penalties will apply for undisclosed offshore assets, subject to mitigation guidelines in IRM.
- Taxpayers have the right to request Appeals Conference.



New Voluntary Disclosure Regime

- Process:
 - Preclearance still available
 - New Voluntary Disclosure Letter will need to be submitted (Form 14457)
 - Besides tax returns, no other documents will be submitted.



Voluntary Disclosure Hypothetical 1

- Taxpayer 1 is a US citizen who lives in California, but he was born in Italy and lived in Italy for parts of his adult life. Taxpayer 1 has several bank accounts in Italy and a Swiss bank account established by his grandfather's estate for Taxpayer 1's inheritance. Taxpayer 1 accessed the Swiss account and never informed the Swiss bankers of his US citizenship. Taxpayer 1 had no interests in or control over any foreign entities. He intentionally did not tell his return preparer about his foreign bank accounts and checked "no" to the question about having foreign bank accounts on Schedules B filed with his tax returns.
- Taxpayer 1 fully cooperates with the civil examination. The examiner asserts the civil fraud penalty for one year and a willful FBAR penalty totaling 50% of the highest aggregate balance in all foreign bank accounts.



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Voluntary Disclosure Hypothetical 2

- Taxpayer 2 owns a restaurant in Dallas as a sole proprietorship. Taxpayer 2 reports all credit card receipts, but only 20% of cash receipts. Taxpayer 2 kept a second set of books tracking his actual income. Taxpayer 2 had no other tax or information reporting noncompliance. Taxpayer 2 used the unreported cash to pay various personal expenditures and to buy gold bullion. Taxpayer 2 accumulated \$2 million in gold bullion in his personal safety deposit box over the last 10 years with his cash skimming scheme. In Taxpayer 2's voluntary disclosure letter to CI he expresses willingness to sell his bullion to pay all outstanding tax liabilities if he doesn't have sufficient liquid assets to pay his taxes. Taxpayer 2 fully cooperates including providing his second set of books tracking his actual income to the examiner.
- The examiner asserts the civil fraud penalty for one tax year.



Voluntary Disclosure Hypothetical 3

- Taxpayer 3 is a US citizen who lives in New York. Taxpayer 3, through nominees, owned 100% of a Panamanian corporation that help several foreign financial accounts in Singapore and interests in two businesses in China. Taxpayer 3 willfully and fraudulently failed to disclose his ownership of the CFC and his control over the foreign financial accounts. Taxpayer 3 actively traded securities and help mutual funds in one of the foreign financial accounts. During the course of the examination, Taxpayer 3 and the IRS cannot agree on the proper PFIC tax calculations for the last three years of the six-year disclosure period and transition tax under Section 965. Taxpayer 3's positions on the issues are made in good faith and are non-frivolous. The examiner and her manager coordinated the issues internally and disagree with Taxpayer 3. Although agreement is not reached on those years, Taxpayer 3 fully cooperates throughout the examination including providing all documents requested and answering questions in an interview. Taxpayer 3 requests review by the Office of Appeals.
- The examiner asserts the civil fraud penalty for the last three years of the disclosure period and a willful FBAR penalty totaling 65% of the highest aggregate balance in all foreign bank accounts.



Streamlined Domestic Offshore Procedures

- Penalty of 5%.
- Look back period of three years for amended returns and six years for FBARs.
- Penalty is on assets which are reportable on FBAR or Form 8938 during the relevant lookback period.
 - Includes value of foreign bank accounts, foreign securities accounts, foreign stock, etc.
 - Does not include signature authority accounts or assets not reportable on FBAR or 8938 (e.g., income producing real estate).
- Best Option For:
 - U.S. residents for last three years; and
 - Filed U.S. income tax returns last three years; and
 - Need to pick up taxable income on an amended return from a foreign asset; and
 - Needs to file an FBAR, 8938 or other information return; and
 - Acted non-willfully.



Penalty Calculation

- Included in Penalty Base:
 - For each of the six years in the covered FBAR period, all foreign financial accounts (as defined in the instructions for FinCEN Form 114) in which the taxpayer has a personal financial interest that should have been, but were not reported, on an FBAR;
 - For each of the three years in the covered tax return period, all foreign financial assets (as defined in the instructions for Form 8938) in which the taxpayer has a personal financial interest that should have been, but were not, reported on Form 8938.
 - For each of the three years in the covered tax return period, all foreign financial accounts/assets (as defined in the instructions for FinCEN Form 114 or IRS Form 8938) for which gross income was not reported for that year.
- Once the assets in the penalty base have been identified for each year, enter the value of the taxpayer's asset as of December 31 of the applicable year. Once the asset values have been entered on the form, add up the totals for each year and select the highest aggregate amount as the base for the 5-percent penalty.



How to Determine Willfulness

- Unreported income in the offshore account;
- Use of structure/entity to hold offshore account;
- Use of non-U.S. identification to open account;
- Checking the box “no” on Schedule B;
- Failing to advise return preparer of existence of offshore account;
- Transferring offshore funds to another institution or safe deposit box to avoid detection;
- Sophistication of taxpayer;
- Hold mail instruction;
- Willful blindness to tax/FBAR reporting obligations.



Required Certification of Non-Willfulness

- “My failure to report all income, pay all tax, and submit all required information returns, including FBARs, was due to non-willful conduct. I understand that non-willful conduct is conduct that is due to negligence, inadvertence, or mistake or conduct that is the result of a good faith misunderstanding of the requirements of the law.”
- “I recognize that if the Internal Revenue Service receives or discovers evidence of willfulness, fraud, or criminal conduct, it may open an examination or investigation that could lead to civil fraud penalties, FBAR penalties, information return penalties, or even referral to Criminal Investigation.”
- “Under penalties of perjury, I declare that I have examined this certification and all accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete.”



Facts to Include in Narrative

- Provide specific reasons for your failure to report all income, pay all tax, and submit all required information returns, including FBARs.
- Include the whole story including favorable and unfavorable facts.
- Specific reasons, whether favorable or unfavorable to you, should include your personal background, financial background, and anything else you believe is relevant to your failure to report all income, pay all tax, and submit all required information returns, including FBARs.
- Additionally, explain the source of funds in all of your foreign financial accounts/assets.
- For example, explain whether you inherited the account/asset, whether you opened it while residing in a foreign country, or whether you had a business reason to open or use it.
- And explain your contacts with the account/asset including withdrawals, deposits, and investment/management decisions.
- Provide a complete story about your foreign financial account/asset



Facts to Include in Narrative

- We realize that many taxpayers failed to acknowledge their financial interest in or signature authority over foreign financial accounts on Form 1040, Schedule B. If you (or your return preparer) inadvertently checked “no” on Schedule B, line 7a, simply provide your explanation.
- We realize that some taxpayers that owned or controlled a foreign entity (e.g., corporation, trust, partnership, IBC, etc.) failed to properly report ownership of the entity or transactions with the foreign entity. If you (or your return preparer) inadvertently failed to report ownership or control of the foreign entity or transactions with the foreign entity, explain why and include your understanding of your reporting obligations to the IRS and to foreign jurisdictions.
- If you relied on a professional advisor, provide the name, address, and telephone number of the advisor and a summary of the advice. Also provide background such as how you came into contact with the advisor and frequency of communication with the advisor.
- If married taxpayers submitting a joint certification have different reasons, provide the individual reasons for each spouse separately in the statement of facts.



Streamlined Foreign Offshore Procedures

- No Penalty.
- Look back period of three years for amended returns and six years for FBARs.
- Best Option For:
 - U.S. taxpayer who was a non-resident for one of the last three years; and
 - Needs to pick up taxable income on an amended return from a foreign asset; and
 - Needs to file an FBAR, 8938 or other information return; and
 - Acted non-willfully.



Delinquent FBAR Submission Procedures

- No Penalty
- No designated look back period; recommended to file 6 years of FBARs.
- To use this procedure, taxpayers should file the delinquent FBARs according to the FBAR instructions and include a statement explaining why the FBARs are filed late.
- Designed for taxpayers who picked up all income but failed to file FBARs.
- FBARs will not be automatically subject to audit but may be selected for audit through the existing audit selection processes that are in place for any tax or information returns.
- Best option for:
 - Taxpayer properly reported on U.S. tax returns, and paid all tax on, the income from the foreign financial accounts reported on the delinquent FBARs; **and**
 - Taxpayer has not previously been contacted regarding an income tax examination or a request for delinquent returns for the years for which the delinquent FBARs are submitted; **and**
 - Taxpayers have no taxable income that is required to be picked up on an amended return.



Delinquent International Information Return Submission Procedures

- No penalty
- No designated look back period; recommended look back period will depend on the facts and circumstances of the case.
- Designed for taxpayers who have reported all foreign income, but failed to file certain international information returns.
- Best option for:
 - Taxpayer properly reported on U.S. tax returns, and paid all tax on, all foreign income; **and**
 - Taxpayer has not previously been contacted regarding an income tax examination or a request for delinquent information returns for the; **and**
 - Taxpayers have no taxable income that is required to be picked up on an amended return.



QUIET DISCLOSURE?

- Subject to penalties on failing to file FBARs, 8938s and other information returns
 - Non-willful up to \$10,000 per account per year for FBAR. 5471 and 8938 have separate penalties as well.
 - Willful penalty up to 50% of account value per year. See Zwerner.
- No designated look back period; recommended look back period will depend on the facts and circumstances of the case.
- Best option for:
 - Highly fact dependent, and only occasionally recommended. Certainly the taxpayer will need to have acted non-willfully.



Questions?

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The New IRS Voluntary Disclosure Regime: Worth the Price of Admission?

By Matthew D. Lee and Marissa Koblitz Kingman

Following the termination last fall of its immensely successful Offshore Voluntary Disclosure Program (OVDP), the Internal Revenue Service (IRS) has announced a new regime to govern all voluntary disclosures regarding tax noncompliance. These new procedures apply to both domestic and offshore voluntary disclosures, and in many ways they replicate the procedures under the now-shuttered OVDP.

In other ways, the new procedures are significantly different, particularly the new civil penalty framework. Taxpayers who now take advantage of the updated voluntary disclosure program will potentially face a 50 percent penalty on their undisclosed offshore financial assets, and a 75 percent civil fraud penalty on the unpaid taxes, and both of these penalties can, in certain circumstances, be applied for multiple years. In addition, the new procedures place greater emphasis on taxpayer cooperation during the voluntary disclosure process, and make clear that non-cooperative taxpayers may face greater penalty exposure. This significantly more stringent penalty framework may well cause some taxpayers to question whether the new program is worth the price of admission, especially when other voluntary disclosure options continue to exist.

Voluntary Disclosure Background

The IRS has for years maintained a self-disclosure regime whereby taxpayers can voluntarily disclose instances of noncompliance with the tax laws and in most cases avoid criminal prosecution. The critical underlying principal of voluntary disclosure is that the taxpayer must self-disclose before the IRS learns of the noncompliance; if the IRS already knows of the taxpayer's noncompliance from whatever source (for example, from third-party reporting or a whistleblower), the taxpayer is ineligible to make a voluntary disclosure.

In March 2009, following the landmark agreement regarding offshore tax evasion struck by the United States with Switzerland's largest bank, UBS AG, the IRS unveiled its now-famous "Offshore Voluntary Disclosure Program." This was a specially-designed voluntary disclosure program – premised upon the IRS's longstanding voluntary disclosure practice – for taxpayers with secret foreign bank accounts and other types of offshore financial assets. Participating taxpayers were required to file eight years of amended tax returns and to pay all back taxes, interest, and a "miscellaneous" offshore penalty calculated at 20 percent of the aggregate highest balance of undisclosed offshore financial assets. The IRS subsequently announced various modifications to the OVDP in 2011, 2012 and 2014, with the primary change each time consisting of an elevation of the penalty rate, which ultimately reached 27.5 percent in the 2014 iteration. In addition, under certain circumstances, the miscellaneous penalty could be elevated to 50 percent if the taxpayer maintained an account at a financial institution, or did business with an offshore service provider, identified on a list maintained by the IRS.

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The OVDP was designed for taxpayers with exposure to potential criminal liability or substantial civil penalties due to a willful failure to report foreign financial assets and pay all tax due associated with those assets. The OVDP provided taxpayers with such exposure potential protection from criminal liability and terms for resolving their civil tax and penalty obligations. Taxpayers with unfiled returns or unreported income who had no exposure to criminal liability or substantial civil penalties due to willful noncompliance could come into compliance using other options, including the Streamlined Filing Compliance Procedures, the delinquent FBAR submission procedures, or the delinquent international information return submission procedures.

By the time the OVDP ended in September 2018, more than 56,000 taxpayers successfully completed the program, paying more than \$11.1 billion in back taxes, penalties and interest. The total number of taxpayer disclosures under the OVDP peaked in 2011, when about 18,000 individuals came forward. In addition, more than 65,000 taxpayers took advantage of the Streamlined Filing Compliance Procedures, a related voluntary disclosure initiative unveiled in 2014 as an alternative to OVDP for taxpayers whose conduct was non-willful. Collectively, the OVDP and the Streamlined Filing Compliance Procedures represented the most successful voluntary disclosure program ever offered by the IRS, far eclipsing all prior initiatives. Participation in OVDP declined in recent years, however, with only 600 disclosures occurring during 2017, prompting the IRS to announce that the program would close as of September 28, 2018.

Highlights of the New Voluntary Disclosure Regime

On November 20, 2018, the IRS announced the new voluntary disclosure procedures by releasing publicly a five-page internal guidance memorandum. These new procedures are effective for all voluntary disclosures – both offshore and domestic – received after September 28, 2018. The objective of the new voluntary disclosure practice is to provide taxpayers concerned that their conduct is willful or fraudulent, and that may rise to the level of tax and tax-related criminal acts, with a means to come into compliance with the law and potentially avoid criminal prosecution. The guidance emphasizes that taxpayers who did not commit any tax or tax related crimes and do not need the voluntary disclosure practice to seek protection from potential criminal prosecution can continue to correct past mistakes using the Streamlined Filing Compliance Procedures or by filing an amended or past due tax return.

Preclearance by IRS-Criminal Investigation

As with the OVDP, IRS-Criminal Investigation will screen all voluntary disclosure requests (whether domestic or offshore) to determine if a taxpayer is eligible to make a voluntary disclosure. To do so, the IRS will require all taxpayers wishing to make a voluntary disclosure to submit a preclearance request on a forthcoming revision of Form 14457. Internal Revenue Manual section 9.5.11.9 will continue to serve as the basis for determining taxpayer eligibility. If IRS-CI determines that the taxpayer satisfies the voluntary disclosure requirements, it will issue a “preclearance letter” to the taxpayer.

For all cases where IRS-CI grants preclearance, taxpayers must then promptly submit all required voluntary disclosure documents using a forthcoming revision of Form 14457. This form will require information related to taxpayer noncompliance, including a narrative providing the facts and circumstances, assets, entities, related parties, and any professional advisors involved in the noncompliance. Once IRS-CI has received and preliminarily accepted the taxpayer’s voluntary disclosure, it will notify the taxpayer of preliminary acceptance by letter and simultaneously forward the voluntary

disclosure letter and attachments to the IRS Large Business & International unit in Austin, Texas, for case preparation before examination. As with the OVDP, IRS-CI will not process tax returns or payments.

Civil Processing and Case Development

Once the LB&I Austin unit receives information from IRS-CI, it will route the case for audit. If a taxpayer or representative wishes to make a payment prior to case assignment with an examiner, payments may be remitted to the LB&I Austin unit. The LB&I Austin unit will select the most recent tax year covered by the voluntary disclosure for examination and then forward cases for case building and field assignment to the appropriate Business Operating Division and Exam function for civil audit. All voluntary disclosures will follow standard audit procedures. Examiners will be required to develop cases, use appropriate information-gathering tools (such as Information Document Requests and summonses, as appropriate), and determine proper tax liabilities and applicable penalties.

Six-Year Disclosure Period in Most Cases

In general, voluntary disclosures will include a six-year disclosure period, which means that participating taxpayers will be required to file corrected tax returns for the most recent six-year period, even if their tax noncompliance covered a greater period of time. However, IRS agents have the discretion to expand the disclosure period to cover additional years – including what the IRS calls “the full duration of the noncompliance” – if the taxpayer refuses to resolve the audit by agreement. In addition, cooperative taxpayers may be allowed to expand the disclosure period to include additional tax years in the disclosure period for various reasons (such as correcting tax issues with other tax authorities that require additional tax periods, correcting tax issues before a sale or acquisition of an entity, or correcting tax issues relating to unreported taxable gifts in prior tax periods).

Importance of Taxpayer Cooperation

The new voluntary disclosure procedures are notable for the emphasis they place on taxpayer cooperation, and perhaps more importantly, the consequences to taxpayers of non-cooperation. The IRS’s historical voluntary disclosure process has always required taxpayer cooperation, specifying that “[a] voluntary disclosure occurs when the communication is truthful, timely, complete, and when . . . the taxpayer shows a willingness to cooperate (and does in fact cooperate) with the IRS in determining his or her correct tax liability.” Similarly, the OVDP required taxpayer cooperation as a condition of participating in the program, which included making full disclosure of all offshore assets; agreeing to extend the applicable statutes of limitations; and fully paying all back taxes, interest, and penalties, or making satisfactory payment arrangements.

Under the new procedures, taxpayer cooperation takes on greater significance, and by “cooperation” the IRS means more than just making full disclosure of offshore assets, extending the time to assess, and arranging for payment. Rather, the extent of a taxpayer’s cooperation (or lack thereof) will have a direct bearing on the type and magnitude of penalties to be asserted. The new guidance states that the IRS expects that voluntary disclosures will be resolved by agreement with full payment of all taxes, interest, and penalties for the disclosure period. In other words, taxpayers are expected to assent to all adjustments that result from the audit, and not to exercise their legal rights to contest audit adjustments and seek review by IRS Appeals. In particular, taxpayers are warned that in cases that are not resolved by agreement (and the taxpayer exercises his or her right to take the case to Appeals), the agent “may assert maximum penalties under the law with the approval of management” and may expand the disclosure period beyond six years. Also, if a taxpayer fails to cooperate with the civil

examination, the examiner may request that IRS-CI revoke preliminary acceptance, potentially triggering the opening of a criminal investigation.

Penalty Framework

The new voluntary disclosure procedures make clear that the nature and extent of penalties to be assessed will in large part be a function of the taxpayer's cooperation during the process. As noted above, taxpayers whose cases that are not resolved by agreement can face "maximum penalties under the law." On the other hand, taxpayers who provide "prompt and full cooperation during the civil examination of a voluntary disclosure" are entitled to civil penalty mitigation.

The following penalty terms will be applied to taxpayers who make timely voluntary disclosures and who fully cooperate with the IRS during the voluntary disclosure process:

Civil Fraud Penalty

The civil penalty under I.R.C. § 6663 for fraud or the civil penalty under I.R.C. § 6651(f) for the fraudulent failure to file income tax returns will apply to the one tax year with the highest tax liability. In limited circumstances, the IRS may apply the civil fraud penalty to more than one year in the six-year scope (up to all six years) based on the facts and circumstances of the case, for example, if there is no agreement as to the tax liability. The IRS may assert the civil fraud penalty beyond six years if the taxpayer fails to cooperate and resolve the examination by agreement. The new procedures provide that taxpayer may request imposition of accuracy-related penalties under I.R.C. § 6662 instead of civil fraud penalties, although granting such requests is expected to be exceptional. Where the facts and the law support the assertion of the civil fraud FBAR penalty, a taxpayer must present convincing evidence to justify why such penalty should not be imposed.

FBAR Penalty

Willful FBAR penalties will be asserted in accordance with existing IRS penalty guidelines contained in the Internal Revenue Manual, which include mitigation guidelines that permit the IRS to reduce FBAR penalties if certain criteria are met. Taxpayers may request that the IRS impose non-willful FBAR penalties, but granting such requests is expected to be exceptional, and taxpayers must present convincing evidence to justify lower penalties.

Information Return Penalties

The new voluntary disclosure procedures provide that penalties for failure to file information returns will not be automatically imposed. This is a positive development for taxpayers, as the penalties for not filing information returns such as Forms 5471 (requiring disclosure of ownership of foreign corporations), Forms 8938 (requiring disclosure of foreign financial assets), and Forms 3520 (requiring disclosure of information regarding foreign trusts), can be significant, especially if the taxpayer's noncompliance spans multiple years. The procedures provide that agents will exercise discretion as to these types of penalties and will take into account the application of other penalties (such as the civil fraud penalty and the willful FBAR penalty) and the extent of the taxpayer's cooperation.

Other Penalties

Other types of penalties, such as those relating to excise taxes, employment taxes, and estate and gift taxes, will be handled based upon the facts and circumstances with IRS agents coordinating with appropriate subject matter experts.

Ability to Request an Appeal

In a break from prior practice under the OVDP, the new voluntary disclosure procedures provide that taxpayers retain the right to request an appeal with the IRS Office of Appeals. Taxpayers accepted into the OVDP were not permitted to request an appeal under any circumstances; the only recourse for taxpayers who did not wish to accept the OVDP civil resolution terms was to “opt-out” of the program and face a full-scope audit. The ability to take an appeal is another positive development for taxpayers under the new voluntary disclosure procedures, but this is a double-edged sword. It appears that taxpayers who exercise their appeal rights – one of the fundamental rights enumerated in the “Taxpayer Bill of Rights” – will be deemed non-cooperative and can face imposition of greater penalties than taxpayers who agree to resolve their voluntary disclosure cases and do not appeal.

Application of the New Civil Penalty Framework

As noted, the new voluntary disclosure procedures are described in a five-page internal guidance memorandum released in November. The IRS has not yet published any additional guidance on how the new program will work in practice, such as Frequently Asked Questions which were a large part of the OVDP and largely helpful to taxpayers and practitioners.

At the American Bar Association’s National Institute on Criminal Tax Fraud and National Institute on Tax Controversy in December 2018 – held only a few weeks after the IRS issued the new voluntary disclosure guidance – an attorney from the IRS Office of Chief Counsel presented the following three scenarios to illustrate how the new voluntary disclosure penalty framework will be applied to various fact patterns.

Hypothetical 1

Taxpayer 1 is a US citizen who lives in California, but he was born in Italy and lived in Italy for parts of his adult life. Taxpayer 1 has several bank accounts in Italy and a Swiss bank account established by his grandfather’s estate for Taxpayer 1’s inheritance. Taxpayer 1 accessed the Swiss account and never informed the Swiss bankers of his US citizenship. Taxpayer 1 had no interests in or control over any foreign entities. He intentionally did not tell his return preparer about his foreign bank accounts and checked “no” to the question about having foreign bank accounts on Schedules B filed with his tax returns.

Taxpayer 1 fully cooperates with the civil examination. The examiner asserts the civil fraud penalty for one year and a willful FBAR penalty totaling 50% of the highest aggregate balance in all foreign bank accounts.

This scenario represents what appears to be a relatively straightforward case of willful conduct by the taxpayer, as evidenced by the taxpayer’s deliberate concealment of his offshore accounts from his return preparer and his “no” answer to the question about foreign bank accounts on Schedule B. The taxpayer is cooperative during the examination, and presumably resolves the audit by agreement (and does not request an appeal). Because the taxpayer’s conduct was willful, the IRS revenue agent asserted a one-year civil fraud penalty and a one-year willful FBAR penalty.

Hypothetical 2

Taxpayer 2 owns a restaurant in Dallas as a sole proprietorship. Taxpayer 2 reports all credit card receipts, but only 20% of cash receipts. Taxpayer 2 kept a second set of books tracking his actual income. Taxpayer 2 had no other tax or information reporting noncompliance. Taxpayer 2 used the unreported cash to pay various personal expenditures and to buy gold bullion. Taxpayer 2 accumulated \$2 million in gold bullion in his personal safety deposit box over the last 10 years

with his cash skimming scheme. In Taxpayer 2's voluntary disclosure letter to CI he expresses willingness to sell his bullion to pay all outstanding tax liabilities if he doesn't have sufficient liquid assets to pay his taxes. Taxpayer 2 fully cooperates including providing his second set of books tracking his actual income to the examiner. The examiner asserts the civil fraud penalty for one tax year.

This scenario, which involves solely domestic conduct, demonstrates the value that the IRS will place on taxpayer cooperation during the voluntary disclosure process. The scenario presents numerous examples of fraudulent conduct by the taxpayer, including a typical "cash skim," maintaining a second set of books, payment of personal expenses, and accumulation of a "cash hoard" (albeit in the form of gold bullion). Outside of the voluntary disclosure process, an IRS agent would undoubtedly assert the civil fraud penalty for multiple years. Because this is a voluntary disclosure case, the civil fraud penalty is limited to a single year, a significant concession to the taxpayer.

Hypothetical 3

Taxpayer 3 is a US citizen who lives in New York. Taxpayer 3, through nominees, owned 100% of a Panamanian corporation that held several foreign financial accounts in Singapore and interests in two businesses in China. Taxpayer 3 willfully and fraudulently failed to disclose his ownership of the CFC and his control over the foreign financial accounts. Taxpayer 3 actively traded securities and held mutual funds in one of the foreign financial accounts. During the course of the examination, Taxpayer 3 and the IRS cannot agree on the proper PFIC tax calculations for the last three years of the six-year disclosure period and transition tax under Section 965. Taxpayer 3's positions on the issues are made in good faith and are non-frivolous. The examiner and her manager coordinated the issues internally and disagree with Taxpayer 3. Although agreement is not reached on those years, Taxpayer 3 fully cooperates throughout the examination including providing all documents requested and answering questions in an interview. Taxpayer 3 requests review by the Office of Appeals. The examiner asserts the civil fraud penalty for the last three years of the disclosure period and a willful FBAR penalty totaling 65% of the highest aggregate balance in all foreign bank accounts.

This scenario presents the most objectionable application by the IRS of the new voluntary disclosure penalty framework. The taxpayer's conduct in this hypothetical is unquestionably willful, as evidenced by the taxpayer's use of nominees to hold offshore accounts in tax haven countries and deliberate concealment of ownership of a controlled foreign corporation and control over foreign accounts. During the audit, the taxpayer fully cooperates but cannot reach an agreement with the agent as to a technical issue relating to application of the highly complex passive foreign investment company (PFIC) rules. The audit is resolved on an unagreed basis, and the taxpayer exercises his legal right to review by IRS Appeals. Despite the taxpayer's assertion of a good faith, non-frivolous position regarding the PFIC issue, the IRS agent asserts a whopping array of penalties consisting of three years of civil fraud (a 225-percent penalty in total) and multiple willful FBAR penalties that total 65 percent in the aggregate. Taxpayers should not be punished for asserting good-faith legal positions and seeking review by IRS Appeals, but this scenario makes clear that taxpayers who do so will face what can only be described as retaliatory penalty assertions by IRS agents.

Other Voluntary Disclosure Options Still Exist

It is important to note that the new voluntary disclosure regime unveiled in November is not the only pathway for noncompliant taxpayers. Other viable, and less expensive, voluntary disclosure options still

remain available depending, of course, on individual facts and circumstances. As noted, the highly-popular Streamlined Filing Compliance Procedures may still be used by taxpayers whose conduct was non-willful. For taxpayers whose only noncompliance was omission of certain information returns, the Delinquent FBAR Submission Procedures and the Delinquent International Information Return Submission Procedures are good options. Finally, although the IRS discourages the practice, taxpayers may still make so-called “quiet” disclosures by filing amended tax returns and following the procedures described in section 9.5.11.9 of the Internal Revenue Manual.

Conclusion

The new IRS voluntary disclosure regime is a mixed bag for taxpayers and practitioners. On the one hand, they should be welcomed by taxpayers and practitioners because they make clear that voluntary disclosure practice for both domestic and offshore issues is alive and well despite closure of the OVDP. On the other hand, the new procedures dramatically increase the range of available penalties as compared to OVDP and authorize IRS revenue agents ostensibly to punish non-cooperating taxpayers by significantly ratcheting up the potential penalty exposure, even when taxpayers assert good faith positions and/or seek to exercise their appeal rights. The increased price of admission may well discourage taxpayers from making formal voluntary disclosures and instead drive taxpayers into using other options, such as the Streamlined Filing Compliance Procedures or quiet disclosures.

Department of the Treasury—Internal Revenue Service
**Voluntary Disclosure Practice
Preclearance Request and Application**

Note: Use Part I of this form to make a preclearance request to determine whether you are eligible to use the voluntary disclosure practice. Only submit Part 1 of this form for preclearance. If you receive preclearance, proceed with submitting Part II to request preliminary acceptance. Submitting the information requested in Part I of this form does not guarantee acceptance. **All answers and attachments must be in English.**

Mailing Address: Internal Revenue Service
Attn.: Voluntary Disclosure Coordinator
2970 Market Street
1-D04-100
Philadelphia, PA 19104

Fax Number: 267-466-1115

Part I - Preclearance Request (Mail or FAX Part I Only to Above)

1. Part I submission date	2. Person submitting disclosure (check box that applies) <input type="checkbox"/> Individual(s) <input type="checkbox"/> Partnership <input type="checkbox"/> Corporation <input type="checkbox"/> Trust <input type="checkbox"/> Executor			
3. Disclosure special features (check all that apply) <input type="checkbox"/> Domestic Issues <input type="checkbox"/> Estate & Gift Issues <input type="checkbox"/> Virtual Currency Issues <input type="checkbox"/> Offshore Issues <input type="checkbox"/> Employment Tax Issues <input type="checkbox"/> Other Issues (briefly describe) Briefly describe issue				
4a. Taxpayer name		b. Identification number (SSN/ITIN/EIN)		c. Date of birth
d. Telephone number		e. Number, street, and room or suite number		
f. City or town		g. State or province	h. ZIP/Foreign postal code	i. Country
j. Occupation		k. Passport information (list all passport numbers and countries)		
5a. Spouse name (if joint disclosure)		b. Identification number (SSN/ITIN)		c. Date of birth
d. Telephone number		e. Number, street, and room or suite number (complete 5d through 5i if different than 4d through 4i)		
f. City or town		g. State or province	h. ZIP/Foreign postal code	i. Country
j. Occupation		k. Passport information (list all passport numbers and countries)		
6a Representative's name (attach Form 2848, if applicable)		<input type="checkbox"/> Check if no representative		b. Telephone number
c. FAX number		d. Number, street, and room or suite number		
e. City or town		f. State or province	g. ZIP/Foreign postal code	h. Country
7. List any entities (corporations, partnerships, etc.) for which you are making a disclosure, include EIN if applicable. Further identification information for these entities will be required in Part II of this application				

8. Do you believe that the IRS has obtained information concerning your tax liability ☐ Yes ☐ No
If "Yes," specify

9. Disclose if you, your spouse or any related entities are currently under audit or criminal investigation by the Internal Revenue Service or any other law enforcement authority and if any income is sourced from an illegal activity

	Taxpayer		Spouse			Related Entities		
	Yes	No	Yes	No	N/A	Yes	No	N/A
a. Has the IRS notified you, your spouse or any related entities that it intends to commence an examination or criminal investigation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. Are you, your spouse or any related entities under criminal investigation by the Internal Revenue Service	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. Are you, your spouse or any related entities under criminal investigation by any law enforcement authority	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
d. Do you, your spouse or any related entities have income sourced from an illegal activity	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

If "Yes" to any, explain

10. Schedule of financial accounts

- List ALL noncompliant financial accounts you owned or controlled or were the beneficial owner of, either directly or indirectly.
 - The listings must cover the entire disclosure period as outlined in the [Updated Voluntary Disclosure Practice Memorandum](#) dated November 20, 2018.
 - This includes opened and closed accounts which held unreported funds during the disclosure period.
 - This includes accounts held through entities you owned or controlled or were the beneficial owner of, either directly or indirectly. **Note:** The entities will be further identified in Part II of this application.
- Disclose all account numbers held at each financial institution.
 - Organize the account numbers in order of who held the account. Jointly held accounts should be identified as such and only listed once.
 - Account holders must match the disclosing taxpayer(s) from Lines 4 and 5, or an entity on Line 7 that will be subsequently disclosed in more detail in Part II after pre-clearance is received
 - If an account is closed, mark it with a "(CL)" after the account number.
- Detailed Example: John Smith – 2023245454534, 342345845454 (CL), 3423423434343
 Jane Smith – 3423233443232, 523124523123
 Joint (John and Jane Smith) – 23124523163,23453232326
 ABC Ltd – 3433423343344
- Click "Add Financial Account" button below for additional financial institutions.

Financial Institution 1

Financial institution name (complete bank legal name, including all suffixes (e.g., Inc., A.G., S.A., etc.), DBAs and pseudonyms)

Telephone number	Number, street, and room or suite number		
City or town	State or province	ZIP/Foreign postal code	Country

Accounts numbers

Add Financial Account
Hide Part II

Important:

- **CI will provide a case control number that is required to submit Part II.**
- **Only submit Part II and attachments after preclearance is received.**
- **Do not send returns and/or remit payments with this form. No returns or payments will be accepted by IRS-Criminal Investigation.**
- **Complete all fields. If you cannot complete a field, attach a statement explaining why.**
- **Wait for contact from IRS examiner who will request additional documentation.**

Part II - Voluntary Disclosure (Mail or FAX Part II to Address or FAX Number on Page 1)

Taxpayer name	Identification number	Telephone number
Spouse name (if joint disclosure)	Identification number	Telephone number
Representative's name (attach Form 2848, if applicable)	<input type="checkbox"/> Check if no representative	Telephone number
1. Part II submission date	2. Case control number (required from preclearance approval)	

3. Identify the source of funds (check all that apply and explain below)

- ☐ U.S. source ☐ Foreign source ☐ Illegal source ☐ Gift/Inheritance ☐ Virtual Currency ☐ Other

4. During the disclosure period, have you taken a position that you were a bona fide resident of a U.S. territory (e.g., American Samoa, the Commonwealth of the Northern Mariana Islands, Guam, Puerto Rico, or the U.S. Virgin Islands) or did you file an income tax return with a U.S. territory ☐ Yes ☐ No

If "Yes," list the territory and tax years

5. Provide estimated total annual **unreported income** during the disclosure period (for fields 5 and 6, input all amounts in U.S. Dollars using year-end exchange rates AND provide the most recent 6 years unless the noncompliance was for a shorter period)

Tax year	Unreported income	Tax year	Unreported income	Tax year	Unreported income
Tax year	Unreported income	Tax year	Unreported income	Tax year	Unreported income

6. Provide estimated annual range of the highest aggregate value of your offshore holdings (**Offshore Issues Only**)

Tax year	Highest aggregate account/Asset value	Tax year	Highest aggregate account/Asset value
Tax year	Highest aggregate account/Asset value	Tax year	Highest aggregate account/Asset value
Tax year	Highest aggregate account/Asset value	Tax year	Highest aggregate account/Asset value

7. Offshore issues only (check appropriate boxes)

	Taxpayer		Spouse	
	Yes	No	Yes	No
a. Has anyone, including a foreign government or a foreign financial institution, advised you that your offshore account records, which are the subject of this voluntary disclosure, were susceptible to being turned over to the U.S. Government pursuant to an official request	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
b. If 7a is "Yes," did you or anyone on your behalf submit documents in opposition	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
c. If 7b is "Yes," were copies of those documents provided to the Attorney General of the United States as required by 18 USC §3506	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

8. Schedule of entities

- List ALL entities you owned or controlled or were the beneficial owner of, either directly or indirectly for which you reported noncompliant financial accounts in the Part I preclearance request.
- The listings must cover the entire disclosure period as outlined in the [Updated Voluntary Disclosure Practice Memorandum](#) dated November 20, 2018.
- Click "Add Entity" button below for additional entities.

Entity 1

Entity name (including all DBAs and pseudonyms)		Identification number	Country of incorporation
Telephone number	Number, street, and room or suite number		
City or town	State or province	ZIP/Foreign postal code	Country

Add Entity

9. Narrative (Your narrative must truthfully and fully explain your noncompliance from inception to the present. Organize the narrative with the following headings: (1) Noncompliance, (2) Taxpayer Background and (3) Professional Advisors. "Noncompliance" must include a complete and thorough discussion of all Title 26 and Title 31 failures to report income, pay tax, and submit all required information returns and reports. Address the source of all unreported income. Explain the use of nominees, alter egos, and any other methods used to conceal your noncompliance. Completely identify all entities involved in your noncompliance. "Taxpayer Background" must include all aspects of personal and professional history. "Professional Advisors" must include complete details on attorneys, accountants, financial planners, private bankers, etc. that rendered services to you from the inception of the noncompliance to the present, regardless of their connection to or knowledge of your noncompliance. If your disclosure involves offshore issues, provide a complete story about your foreign financial assets. The field below will automatically expand to accommodate your narrative.)

Note: You must provide specific facts on this form or on a signed attachment providing a complete story about your tax fraud and willful noncompliance. Any submission that does not contain a narrative statement of facts will be considered incomplete.

By signing this document, I certify that I am willing to continue to cooperate with the Internal Revenue Service, including in assessing my income tax liabilities and making good faith arrangements to pay all taxes, interest, and penalties associated with this voluntary disclosure.

Under penalties of perjury, I declare that I have examined this document and accompanying schedules and statements and to the best of my knowledge and belief, they are true, correct, and complete.

Signature of taxpayer	Name (print/type)	Date
Signature of taxpayer's spouse	Name (print/type)	Date

Signature must be original (must be mailed), preferably in blue ink. Photocopied, facsimile, or electronic signatures are not acceptable. The power of attorney may not sign the voluntary disclosure letter on behalf of the taxpayers.

IRS reserves the right to make further contacts with the taxpayer to clarify his/her submission.

Privacy Act and Paperwork Reduction Act Notice

We ask for the information on this foreign account or asset statement to carry out the Internal Revenue laws of the United States. Our authority to ask for information is sections 6001, 6109, 7801, 7803 and the regulations thereunder. This information will be used to determine and collect the correct amount of tax under the terms of the offshore voluntary disclosure program. You are not required to apply for participation in the offshore voluntary disclosure program. However, if you choose to apply you are required to provide all the information requested on the offshore voluntary disclosure letter.

You are not required to provide the information requested on a document that is subject to the Paperwork Reduction Act unless the document displays a valid OMB control number. Books or records relating to a document or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103. Section 6103, however, allows or requires the Internal Revenue Service to disclose or give this information to others as described in the Internal Revenue Code. For example, we may disclose this information to the Department of Justice to enforce the tax laws, both civil and criminal, and to cities, states, the District of Columbia, and U.S. commonwealths or possessions to carry out their tax laws. We may also disclose this information to other countries under a tax treaty, to federal and state agencies to enforce federal nontax criminal laws, or to federal law enforcement and intelligence agencies to combat terrorism. Failure to provide this information may delay or prevent processing your application. Providing false information may subject you to penalties.

The time needed to complete and submit the foreign account or asset statement will vary depending on individual circumstances. The estimated average time is: 2 hour.

If you have comments concerning the accuracy of this time estimate or suggestions for making the foreign account or asset statement simpler, we would be happy to hear from you. Comments should be sent to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224.

Hide Part I