

(2) How Is Disclosure Made?

(a) Direct Disclosure (the “Noisy Disclosure”).

The policy specifically discusses direct disclosure by contact with the IRS which requires that it be referred to and discussed with CI. I refer to this as direct disclosure, although some call it the “noisy disclosure” for reasons that should be apparent.¹⁰⁵¹

Direct disclosure to CI usually proceeds as follows. The taxpayer’s counsel contacts the SAC of CI for the IRS area involved and arranges a conference. At the conference, the taxpayer’s counsel will provide a balanced, fair summary of the criminal conduct, but without identifying the taxpayer. This type of submission is often referred to as a “proffer.” The proffer will include facts otherwise bringing the taxpayer within the policy. The taxpayer’s counsel will then seek CI’s assurance not to prosecute if the taxpayer’s identity is disclosed. In some cases, particularly where the practitioner and the taxpayer’s counsel have had past dealings which has given the SAC confidence that he or she can rely upon taxpayer’s counsel the oral proffer can be made in the initial telephone call rather than a separate meeting. CI may want the “proffer” of the facts to be put in writing to set in concrete the conditions of the assurance. CI can then give the assurance that, provided the facts prove as stated in the proffer, CI will not forward the matter to DOJ Tax with a recommendation for prosecution. Taxpayer’s counsel then identifies the taxpayer. CI then conducts such investigation as it deems appropriate to assure itself that the proffer was a fair representation of the pertinent facts.

¹⁰⁵⁰ In these days of Enron-like hype and glitter in the IRS (masking deep internal problems), the revised voluntary disclosure policy brings the historic policy “into the 21st century, to ‘modernize and enhance it.’” Kevin A. Bell, *IRS BRINGING VOLUNTARY DISCLOSURE PRACTICE INTO THE 21ST CENTURY, OFFICIAL SAYS*, 2002 TNT 240-3 (12/31/02). The revision provides slightly more specificity than the prior policy, but it is not clear at all that it represents any material departure – or enhancement if that is the preferred word – from the prior policy. I believe that those familiar with the prior policy could have extrapolated the terms of the revision from the prior policy.

¹⁰⁵¹ E.g., Tom Herman, *Tax Report: Offshore-Account Holders Bite Their Nails*, Wall Street Journal (5/21/08, Page D1). Cute short-hand descriptions of the types of disclosure are problematic. Calling this type of disclosure a “noisy disclosure” invites calling the other form of disclosure as stealth disclosure or some similar off the radar disclosure which might suggest that the IRS would view the former more favorably than the latter. I am not sure that that is the case. For this reason, I prefer more neutral – less cute – descriptions of the types of disclosure.

In this procedure for direct disclosure, the IRM cautions that disclosure is not made until and unless the taxpayer is identified to the IRS. Hence, there is conceivably a window between the practitioner's initial contact with CI and the actual disclosure of the taxpayer's identity that the IRS could zero in on the taxpayer from independent sources and, strictly speaking, the policy would not apply. I think, however, that provided the policy would otherwise apply and there are no unreasonable delays from the taxpayer's side in making the required presentation to CI and then identifying the taxpayer, the IRS is not likely to cry foul simply because in that short interim period it starts an investigation.

(b) Filing Disclosure.

Another method to make the disclosure is to file with the service center (as opposed to filing with CI) an amended return correcting the deficiencies on the original return or a delinquent original return in case of failure to file. I refer to this as filing disclosure. **Although I have no empirical data on this, from my anecdotal experience and inquiries to others, I think most practitioners simply send in the amended return or delinquent original returns without any notice by cover letter or attachment to the return that it is intended to qualify for the nondisclosure policy.**¹⁰⁵²

Historically, most practitioners recommend filing disclosure. Obviously filing disclosure may not result in direct IRS substantive consideration of the disclosure, whereas direct disclosure will. Although the new policy, like the old policy, does not expressly approve or disapprove filing disclosure, I believe that, until and unless the IRS disapproves of filing disclosure (a practice well

¹⁰⁵² Others do provide some notice. For example, two authors report the following methodology for making the filing disclosure:

The transmittal letter with the amended tax returns should contain no admissions of wrongdoing or long-winded explanations about why the client has been evading U.S. taxes for so many years. Assuming the amended returns provide a complete disclosure of all previously unreported income for the prior six years, the transmittal letter should simply follow the Internal Revenue Manual and state that the client wishes to make a voluntary disclosure, along with the taxpayer's name, tax ID number(s), and mailing address. The practitioner should list the types of returns involved and the tax periods. The communication must also include a brief description of all omitted income, the tax "scheme" used by the taxpayer, and a dollar estimate of the total taxes owed. In most cases, the letter should simply say that the taxpayer is willing to cooperate with the IRS in determining the correct tax liability. Ideally, the client is in a position to make a full payment or significant partial payment.

Steven J. Mopsick and Betty J. Williams, Swiss Banks, Voluntary Disclosure and Reverse Eggshell Audits, 122 Tax Notes 733 (Feb. 9, 2009).

known to the IRS and the bar), filing disclosure remains a viable method for qualifying under the policy.¹⁰⁵³

As with the direct disclosure method, there will be a window between the time the taxpayer makes the decision to disclose and implements the disclosure by filing the amended return or delinquent original return. For example, an amended return may require that the taxpayer, his counsel and his tax return preparer undertake due diligence to pull together adequate information to file a reasonably correct – i.e., nonfraudulent – amended return. Sometimes this may take considerable time. In such a case, caution may dictate the direct disclosure method with implementation thereafter perhaps by the filing disclosure method if acceptable to CI. But where the return(s) can be prepared in a reasonable time frame, then the filing disclosure method is usually preferable. As with the direct disclosure method, there will still be a window which could be troublesome. In order to address that issue, upon the taxpayer making the decision to file, I document the decision in writing and then work with the taxpayer to insure that the return(s) is (are) prepared as expeditiously as possible. I believe that, should the IRS start an investigation in that interim, a persuasive argument can be made to the IRS that the policy should apply because the decision to make voluntary disclosure had been made and objective events – the taxpayer’s, the lawyer’s and the preparer’s – efforts toward that end can be shown.

(3) Which Type of Disclosure is “Better”?

Assessing which of the types of disclosure the taxpayer should pursue requires judgement seasoned with experience. Here are some of the issues that one should consider:

- The direct disclosure offers the possibility of giving the taxpayer some assurance that the disclosure works and the matter is closed. The taxpayer’s attorney communicated directly with IRS personnel about the specific issue. The IRS directly communicates acceptance of the disclosure with taxpayer’s counsel. By contrast, the taxpayer receives no direct assurance that filing disclosure will be honored as a

¹⁰⁵³ Indeed, I am advised that there is a process for CI agent review of amended returns or substantially delinquent original returns received in the service center. I suspect that the review is cursory in most cases and perhaps limited to certain material amount of tax being reported. My partner once spoke with the CI agent at the Austin service center who served this function and was advised by that CI agent that he had never referred an amended return or delinquent original return to CI for criminal investigation. I hope that you can see from the win-win features of the voluntary disclosure policy that it would be incredibly stupid for the IRS to discourage amended returns or delinquent original returns by investigating and prosecuting those who file them. Of course, it would be much nicer to have something in writing to offer a client other than just that the IRS can’t be that stupid. (We know anecdotally of instances in other areas where the IRS has been that stupid; nonetheless, the filing disclosure method appears to me to be quite viable.) Notwithstanding, the foregoing, in establishing the special voluntary disclosure initiative related to offshore credit cards (the OVCI initiative discussed below beginning on p. 471), the IRS indicated that it has developed certain new criteria to screen amended returns filed directly with service centers in order to insure that the OVCI initiative was not circumvented.

voluntary disclosure, so the taxpayer will go forward for some period into the future with some level of uncertainty. Even with this uncertainty which I think is minimal, my preferred method of disclosure is the filing disclosure, but it has recently been reported that some of the lawyers who are prominent in representing taxpayers with offshore accounts use the direct disclosure because the clients “want the comfort of sleeping well at night at the conclusion of the process without worrying about future IRS actions.”¹⁰⁵⁴

- The direct disclosure is more expensive than the filing disclosure. Both will require the preparation of amended returns, so that cost is fixed for both types of disclosure. Direct disclosure requires very careful preparation of the initial overture to CI and thereafter careful and intricate dancing with CI in order to obtain the assurance of non-prosecution (or, more precisely, non-referral to DOJ Tax). Lawyers are expensive, and the process may be quite a bit more costly than the direct disclosure method. (Heaven forbid that some attorneys might think it preferable for that reason.) And, given the only marginal benefit (absolute assurance directly from CI rather than reasonable assurance from the practitioner), the extra layer of lawyering and costs may not be cost effective for the client (as opposed to the lawyer), but that is a client choice.
- The direct disclosure will almost certainly result in the 75% civil fraud penalty for one or more of the years involved (depending upon whether made pursuant to an express initiative such as the OVCI or LCCI which gives relief). The filing disclosure may result – and in my anecdotal experience will result – result in only a 20% accuracy related penalty or, as recently the case, no civil penalty at all, particularly if the IRS does not (as is typically the case) want to develop a civil fraud investigation to assert the civil fraud penalty and the matter is viewed as a qualified amended return.¹⁰⁵⁵ This tilts the cost / benefit ratio substantially in favor of filing disclosure, but again the client wanting certainty may accept the additional cost for the additional benefit.

¹⁰⁵⁴ Tom Herman, Tax Report: Offshore-Account Holders Bite Their Nails, Wall Street Journal (5/21/08, Page D1) (quoting Mark Matthews, a prominent practitioner and former DOJ Tax Prosecutor and head of the IRS criminal investigation function).

¹⁰⁵⁵ Regs. § 1.6664-2(c)(2). The qualified amended return relief does not apply in the case of fraud, but unless the IRS undertakes some level of fraud investigation upon receipt of an amended return, it will have no basis for applying this exemption from penalty relief. And, extrapolating from my and others experiences that the IRS rarely, if ever, audits amended returns, the IRS will have no basis to assert fraud as a basis for exempting the filing disclosure and thus the filing disclosure will likely result in no penalties. Very nice indeed.