

IRS Voluntary Disclosure Effects on Non-Filers

By

A principal feature of the U.S. tax system is self-assessment; taxpayers are expected to accurately report their income and pay the appropriate level of tax when due. The federal government has limited resources to ensure compliance, however, so it recognizes the crucial need to have a policy in place to encourage non-compliant taxpayers to “come in from the cold” and avoid the more severe criminal sanctions that can arise in cases of intentional non-compliance. Many states, as well as several foreign countries, utilize similar procedures.

The IRS has a policy which dates back to the early 1950’s of not recommending criminal prosecution for those non-filing taxpayers who come forward voluntarily and make a truthful, timely and complete disclosure to the government of their non-compliance. Although the policy has evolved over time, several basic requirements have remained constant. In a nutshell, a voluntary disclosure occurs when the taxpayer:

- Informs the IRS that he/she has not filed tax returns for one or more taxable periods or has filed false returns in which income has been omitted or deductions overstated
- Makes a truthful, timely and complete disclosure
- Has only legal sources of income
- Issues the disclosure before being contacted by the IRS
- Either files a true and correct tax return or cooperates with the IRS in ascertaining the correct tax liability; and
- Either makes full payment of the amounts due or makes bona fide arrangements to pay on a pre-approved payment plan (or according to a reasonable payment schedule) in cases where the taxpayer is unable to make full payment.

These requirements and other ground rules can be found in Internal Revenue Manual (“IRM”) Section 9.5.11.9 which is reprinted at the following link [\[CLICK HERE\]](#).

It is important to understand that the current IRS voluntary disclosure practice creates no substantive or procedural rights for taxpayers, and is provided solely for guidance to IRS personnel. As stated in the first two paragraphs of the IRM material, voluntary disclosure does not provide any grant of immunity, but rather is just one of several factors the IRS will look at in determining whether a referral for criminal prosecution will be made. In this regard, there are some cases where courts have held that taxpayers may not rely on this and other provisions of the IRM as granting substantive legal rights or rules the IRS is required to follow.

For non-filers looking to take advantage of the voluntary disclosure policy, IRS typically requires that returns for the past six years be filed. For taxpayers with undisclosed offshore accounts/holdings, a disclosure must generally be made to a Criminal Investigation Division (CID) representative which practitioners refer to as a “noisy” disclosure. Top IRS officials in CID have indicated that taxpayers trying to come clean on undisclosed offshore accounts/holdings cannot do this by a “quiet” disclosure (i.e., just sending in corrected returns and other filings to the Service Center and hoping to sneak this through without attracting much (if any) scrutiny).

With the federal government’s ever-increasing need for revenues and growing concerns over the perceived size of the tax gap, IRS is increasing its efforts to ferret out non-filers and also to go after taxpayers seeking to hide income or assets offshore. Indeed, several taxpayers who were customers of UBS with undisclosed offshore accounts have had their names disclosed to the government as a result of a deal UBS struck with the Justice Department to avoid further proceedings in a summons enforcement action and who have since plead guilty to criminal tax violations resulting in steep monetary fines and jail time.

Whether and how to make a good voluntary disclosure is something that requires careful consideration and the advice of an experienced tax professional as the stakes are exceedingly high. And if criminal sanctions are a possibility, a legal professional is often the preferred advisor, since accountants and other non-attorney professionals do not enjoy the same privileges as attorneys in these types of tax matters.