Hamlet's thoughts weighed heavily upon him. Should he suffer the slings and arrows of outrageous fortune, or take arms against a sea of troubles? For the young Prince of Denmark seeking to avenge his father's death, the choice was action or inaction, and ultimately life or death. Fortunately, most tax problems do not have such grave outcomes. Seemingly inconsequential tax errors can, however, lead to severe financial consequences. And, remote as it may seem, the prospect of imprisonment for tax crimes cannot be overlooked. When a past wrong is discovered, what should you do? Taking action—voluntarily disclosing the problem to the taxing authorities—can limit your direct monetary exposure for the specific problem but may have significant collateral consequences. Inaction—sweeping the problem under the rug and hoping for the best—may heighten your
exposure if the taxing authorities ever catch on. In deciding whether to disclose a potential tax problem, you must fully consider multiple issues. This article identifies and explores those issues and provides practical insights for those who may one day face the momentous question of whether to disclose or not to disclose.

**Something Is Rotten in the State of Bank Secrecy**

The era of bank secrecy is over. We now live in an era of international cooperation on tax and financial matters. For national and multinational companies, as well as for individuals, the likelihood that the Internal Revenue Service or other taxing authorities will learn of your tax problems has increased dramatically over the last decade. In a concerted effort to address tax avoidance through base erosion and profit shifting (BEPS), as well as combat willful tax evasion, taxing authorities around the world have been working together to exchange information, seeking to prevent the secrecy that allows income and assets to escape taxation. In the United States, the Foreign Account Tax Compliance Act (FATCA) has placed additional responsibility on foreign financial institutions to share information with the IRS, thus increasing the probability that undisclosed foreign accounts and assets will be discovered. And the U.S. Department of Justice has pursued criminal prosecutions of foreign financial institutions and related individuals, thereby increasing exponentially the pressure to end once common banking practices that shrouded foreign financial transactions in secrecy.

Not every taxpayer is eligible to participate in a voluntary disclosure program.

In conjunction with increased disclosure requirements and enforcement efforts, dozens of countries have implemented voluntary disclosure programs allowing taxpayers to disclose tax problems that, in the past, likely would have remained hidden. Encouraging taxpayers to resolve their tax problems by limiting their liability if they come forward and fix problems voluntarily should increase tax revenue and preserve scarce investigative resources. Consider the IRS’ Offshore Voluntary Disclosure Program (OVDP). Introduced in 2009, the OVDP encourages taxpayers with undisclosed foreign financial accounts to disclose those accounts by offering a limited lookback period, significantly reduced monetary penalties, and a promise not to recommend criminal prosecution. Since the inception of the OVDP, the IRS estimates that it has collected more than $10 billion in taxes, penalties, and interest from over 100,000 taxpayers, without expending significant investigative resources. Thus, while the chances that a taxing authority will learn of your tax problems have never been greater, governments around the world continue to see value in offering incentives for voluntary disclosures.

That said, not every taxpayer is eligible to participate in a voluntary disclosure program. Inaction upon one’s own discovery of a tax problem can lead to ineligibility if certain disqualifying events occur. Under the OVDP, a disclosure is considered timely only if it is made before: (1) the IRS has initiated a civil examination or criminal investigation of the taxpayer, or has notified the taxpayer that it intends to do so; (2) the IRS has received information from a third party (e.g., an informant, other governmental agency, or the media) alerting it 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.
Hamlet enjoyed the luxury of ample time to consider his actions. Today’s taxpayers do not, and he who hesitates may be lost. Rushing into a disclosure, however, without a full appreciation of potential collateral issues can have disastrous consequences.

**Though This Be Madness, Yet There Is Method In’t**

Will you really confess your tax problems to the IRS? Some would say that to do so is madness. After all, taxpayers are under no obligation to file an amended tax return even if they discover a significant mistake on their original return after it has been filed.⁸ And the Fifth Amendment to the U.S. Constitution provides significant protection against self-incrimination.⁹ So even if the IRS catches on, it may have a difficult time gathering the information and documents needed to accurately calculate any tax due or prove a violation of the internal revenue laws beyond a reasonable doubt. So why voluntarily confess anything to the IRS or other taxing authorities?

Although it may seem counterintuitive, disclosing a previously unknown tax problem to the IRS may be in the taxpayer’s best interest. But the decision—to disclose or not to disclose—is not easy. To make the right decision, taxpayers must fully consider all of the pros and cons.

**To Disclose: Pros and Cons**

**Pro: Avoiding Harsh Consequences of Discovery**

The IRS and other taxing authorities typically show little mercy when taxpayers fail to voluntarily disclose and correct their tax transgressions. If the taxpayer does not voluntarily disclose, the IRS typically seeks to impose maximum penalties and draws all inferences against the taxpayer. Thus, arguments that the error was unintentional, or attributable to an innocent misunderstanding or erroneous tax advice, will likely meet with skepticism or fall upon deaf ears. Furthermore, once the IRS or other taxing authorities discover an error, they are likely to audit prior and subsequent years and other issues to determine the scope of the noncompliance. In such circumstances, taxpayers will have little to no control over IRS efforts to expand an audit beyond the initial years and issues.

**Pro: Avoiding Continued Noncompliance**

Tax errors arise for a wide variety of reasons. An employee or outside tax advisor may have innocently misunderstood certain facts or tax obligations. Although valid reasons for the initial noncompliance may exist, there is no justification for continuing noncompliance after the error is discovered. Because fixing the problem going forward is critically important, it often behooves taxpayers to voluntarily disclose the problem to the IRS at or near the same time the problem is remedied on the current year’s return. Furthermore, tax filings are often presented to third parties in order to secure loans or raise capital. Continuing to rely on erroneous tax filings for nontax purposes compounds the initial noncompliance and could lead to allegations of bank or securities fraud. Voluntary disclosure programs provide taxpayers with the opportunity to clean up and avoid escalating past problems.

**Pro: Reduced Monetary Penalties, Possible Elimination of Criminal Exposure**

The IRS can impose severe penalties for relatively minor infractions. Consider the failure to file an information return reporting a foreign financial account. A taxpayer may owe no additional taxes, but the mere failure to report a foreign account can result in penalties of up to the greater of $100,000 or fifty percent of the balance of the account on the date of the violation, with a six-year statute of limitations on assessment.¹⁰ Thus, penalties
imposed over multiple years could easily exceed the monetary value of the undisclosed account. If a taxpayer underreports its income tax liability, the IRS can impose monetary penalties ranging from a negligence penalty of twenty percent of any understatement of tax due, to a civil fraud penalty equal to seventy-five percent of any understatement attributable to the fraudulent conduct. Lastly, in the United States, taxpayers can be imprisoned up to five years for each count of conviction of tax evasion, and up to ten years for willful failure to report a foreign financial account.

Taxpayers can dramatically reduce their monetary exposure and essentially eliminate their criminal exposure with respect to violations of the internal revenue laws by making a voluntary disclosure to the IRS. For example, under the OVDP, (1) the IRS requires taxpayers to file delinquent returns only for the most recent eight years regardless of how many years the foreign financial account was not reported; (2) the IRS agrees to impose a “miscellaneous offshore penalty” for only one year and caps the amount of the penalty at twenty-seven and a half percent of the highest aggregate balance in the undisclosed offshore accounts (or at fifty percent of the highest balance if the taxpayer’s foreign financial institution or advisor has been publicly identified by the IRS or the Justice Department as the subject of civil or criminal enforcement actions); (3) the IRS agrees to waive any accuracy-related penalties that might otherwise apply to unreported income; and, perhaps most important, (4) the IRS agrees not to recommend criminal prosecution.

In its most recent global survey of tax authorities, the Organisation for the Economic Co-operation and Development (OECD) confirms that voluntary disclosure programs remain a viable option for noncompliant taxpayers in numerous countries. For example, residents of the United Kingdom can avoid criminal prosecution and harsh civil penalties—up to 200 percent in cases involving offshore income—if they voluntarily disclose unreported income. The look-back period ranges from four years if the taxpayer exercised reasonable care, to six years if the taxpayer was careless, and up to twenty years if the taxpayer deliberately misled Her Majesty’s Revenue and Custom (HMRC). In Denmark, taxpayers who initiate voluntary disclosures can reduce civil penalties from 200 percent to fifty percent, but they are not guaranteed immunity from criminal prosecution. France’s offshore voluntary disclosure program provides for a limited lookback period but does not waive penalties, and it is not available to taxpayers who intentionally evade tax or engage in complex fraud. Australia reduces the applicable penalties depending on the timing of the voluntary disclosure, and Singapore may reduce or eliminate penalties, which can be as high as 400 percent of unreported tax if willful intent is present, depending on the timing of the disclosure and the nature of the conduct in question.

On December 15, 2017, Canada announced substantial changes to its voluntary disclosure program in response to the increase in tax evasion and aggressive tax avoidance. The revised program is effective March 1, 2018, and not only restricts eligibility but imposes additional conditions and rejects anonymous disclosures. For example, corporate taxpayers with gross revenue in excess of $250 million in at least two of the last five years, and taxpayers engaged in intentional violations, will avoid criminal prosecution but pay full penalties and interest. Taxpayers whose noncompliance is the result of a mistake may avoid penalties altogether. Under either approach, taxpayers must full pay the estimated tax due at the time of the disclosure.

In Israel, residents can take advantage of the new voluntary disclosure program announced by the Israel Tax Authority on December 12, 2017. In his press release, ITA Director Moshe Asher made specific reference to the information anticipated from Israel’s participation in the OECD Common Reporting Standards project and other sources, and described the program as “an opportunity for those who have not yet arranged their affairs
with the tax authority to provide full disclosure.” Israeli residents have until December 31, 2018, to anonymously disclose their unreported assets and income. Unlike the IRS OVDP, a taxpayer can negotiate the liability with the ITA and if no agreement is reached, walk away from the disclosure while still remaining anonymous.\(^{18}\)

If a known problem lurks in the shadows, the prospect of an IRS audit can be downright terrifying

In the United States, numerous states offer voluntary disclosure programs that reduce or eliminate penalties and provide for a limited lookback period. California, New York, Virginia, Maryland, and Michigan, among other states, offer substantial savings for taxpayers who voluntarily disclose. Taxpayers can participate in various state voluntary disclosure programs individually or, alternately, can participate in thirty-nine state programs simultaneously via the Multistate Voluntary Disclosure Program. Under the MVDP, which is maintained by the Multistate Tax Commission, taxpayers must file the delinquent returns, pay the appropriate taxes, and register with the respective states. In return, the MVDP offers a penalty waiver and a limited lookback period.\(^{19}\)

**Pro: Avoiding Damage to Reputation**

Additional taxes, penalties, and interest are not the only harms to consider. Taxpayers must also consider reputational harm that may arise if the IRS or other taxing authorities uncover a significant tax problem. Tax audits and investigations can take years to resolve. Lingering uncertainty over the outcome may cause stock values to decline or may negatively affect ongoing business needs, prompting shareholder lawsuits. Participating in a voluntary disclosure program provides the taxpayer with a vehicle to manage the problem and provides certainty with respect to potential damages.

**Con: Full Disclosure, Unintended Consequences**

A voluntary disclosure must be timely, accurate, and complete. A taxpayer cannot select which problems to disclose. Rather, because amended returns will be required, all errors and omissions on the original return must be corrected. If not, then the amended return will be yet another false return and will compound the original problem. And because information sharing agreements are in place among treaty partners as well as among federal, state, and local governments, a taxpayer should not cherry-pick the taxing authorities to which disclosure will be made. Full disclosure must be made to all relevant taxing authorities, which often look for amended filings when made aware of corresponding adjustments in other jurisdictions. Thus, fixing what was thought to be a relatively small tax problem can quickly grow into a substantial undertaking that requires filing multiple amended returns in multiple jurisdictions. While those other jurisdictions may also have voluntary disclosure programs in place, the administrative burden of full compliance can be daunting.

**Con: Employees and Officers Not Protected**

Eligible business entities that initiate a timely, accurate, and complete voluntary disclosure will avoid a recommendation for criminal prosecution, but the entities’ owners, officers and individual employees receive no such protection by virtue of the company disclosure. Moreover, while prosecutors may not be interested in pursuing criminal charges against business entities, because a corporation cannot be sent to prison, the same
does not hold true for individual actors. In fact, recent U.S. Department of Justice policy reminds federal civil trial attorneys and prosecutors of the need for individual accountability. Thus, a voluntary disclosure, while good for the business, may have severe consequences for those individuals involved in the false filings. When considering a voluntary disclosure, a corporate taxpayer must evaluate whether its individual employees and officers will need separate legal counsel to provide independent legal advice and to advise them of their rights during the course of an internal or government investigation.

**Not to Disclose: Pros and Cons**

**Pro: Avoid Significant Costs of Disclosure and Cooperation**

Voluntary disclosure programs have specific and often onerous participation requirements. Full compliance with these requirements can be costly and time-consuming, especially for businesses with complex international operations and tax requirements. For example, the IRS' OVDP program contains a list of specific submission requirements including complete amended income tax returns for all tax years covered by the disclosure, complete foreign account statements for each undisclosed foreign account or asset, a detailed penalty computation worksheet, agreements to extend applicable statutes of limitations for tax and penalty assessment, and a statement identifying all offshore entities held either directly or indirectly during the tax years covered by the voluntary disclosure.

Additionally, once a taxpayer makes a disclosure, there is no turning back. The disclosing taxpayer must bring itself into full compliance and, going forward, must continue to cooperate with requests from the IRS for information, documents, or assistance, including requests for in-person interviews. Taxpayers can expect the IRS and other taxing authorities to conduct thorough examinations if the compliance failure disclosed is significant. The costs and consequences of cooperating with such examinations must be factored into the cost of making the disclosure.

**Pro: Avoid the Consequences of Other Errors**

Under voluntary disclosure programs, the IRS and other taxing authorities ultimately determine the amount of tax, interest, and penalties due. Especially in the international arena, tax calculations can be notoriously complex. Thus, it is not uncommon for taxpayers to enter into voluntary disclosure programs believing they have accurately forecast their monetary exposure, only to find that the taxing authorities have determined a significantly higher amount. Taxpayers should be aware that once they disclose a tax problem, they may be liable for related errors, regardless of whether the taxpayer was fully aware of them.

Moreover, related errors might not be limited to tax. A voluntary disclosure may lead to the discovery of violations of securities laws, import-export regulations, or the Foreign Corrupt Practices Act. Every effort should be made to determine if nontax violations exist and, if they do, to quantify the exposure. Voluntary disclosure of a relatively minor tax issue may not be the best option if such a disclosure is likely to lead to the discovery of more significant nontax violations.

**Pro: Avoid Amending Foreign, State, and Local Returns**

An initial voluntary disclosure to the IRS does not end there. Taxpayers may also owe significant additional taxes, penalties, and interest to foreign, state, and local taxing authorities. As noted, the IRS is authorized to share information with all state taxing authorities, and most states require a taxpayer to file an amended state return if it has filed an amended federal return. And again, taxing authorities around the globe have been
working together to exchange information to prevent the secrecy that once allowed income and assets in foreign jurisdictions to escape taxation. As a consequence, multinational taxpayers that make a voluntary disclosure in one country will almost certainly face tax liabilities in other countries. One way to avoid amending multiple foreign, state, and local tax returns is to avoid the initial voluntary disclosure. Similar to the other benefits of choosing not to disclose, this “pro” only lasts as long as the taxpayer avoids a civil audit or criminal investigation of the years and returns at issue.

**Con: Continued Uncertainty**

Neither businesses nor individuals enjoy uncertainty, especially regarding tax matters. The prospect of an IRS audit, even when no significant exposure is anticipated, can be daunting. If a known problem lurks in the shadows, the prospect of an IRS audit can be downright terrifying. Attempting to wait out the applicable statute of limitations for the taxing authorities to conduct an audit and issue an assessment may be a fool’s errand. While the typical statute of limitations for the IRS to propose additional tax, penalties, and interest is three years from the date the return was filed, if the IRS alleges and can prove fraud by clear and convincing evidence, then there is time limit. 24 Similarly, the statute of limitations on assessment does not commence unless and until a taxpayer files all required international forms disclosing foreign interests, assets, arrangements, or transactions. 25

For the crime of tax evasion, the statute of limitations is typically six years from the last “affirmative act” of evasion, not six years from the date the tax return was filed. 26 Federal prosecutors often designate what may appear to be insignificant conduct as affirmative acts of evasion, thereby opening the door to charges related to tax periods outside the six-year window. Absent a voluntary disclosure, a plague of uncertainty may hang over a company’s business operations for years to come. For corporate officers and employees, such uncertainty may prove intolerable, leading to whistleblower claims. 27 The uncertainty may end only when the problem is involuntarily disclosed to the IRS or other taxing authorities.

**The Final Act**

In Shakespeare’s tragedy, Hamlet took action and avenged his father’s murder. But in doing so he paid the ultimate price of death. Fortunately, if individuals and businesses exercise caution when disclosing their tax transgressions, they stand a good chance of avoiding the most severe consequences. Although counterintuitive, voluntary disclosure can often be a prudent decision, providing a degree of amnesty and certainty, allowing businesses and individuals to normalize their affairs and plan for the future. However, the decision to make a voluntary disclosure should not be taken lightly. Taxpayers and their representatives should carefully evaluate all of the potential outcomes and collateral consequences that could arise before making the fateful decision to disclose, or not to disclose.

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Endnotes


7. Internal Revenue Manual § 9.5.11.9(4) (12-02-2009).

8. See Badaracco v. Commissioner, 464 U.S. 386, 393 (1984) ([“T]he Internal Revenue Code does not explicitly provide either for a taxpayer’s filing or for the Commissioner’s acceptance of an amended return; instead an amended return is a creature of administrative origin and grace”]; Broadhead v. Commissioner, TC Memo. 1955-328 (holding taxpayer is “not required by statute to file an amended return and if one had been tendered for filing [the IRS] could have declined to accept it”).

9. U.S. Const. amend. V.


13. See Internal Revenue Service, Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers 2014, November 8, 2017, [www.irs.gov/individuals/international-taxpayers/offshore-voluntary-disclosure-program-frequently-asked-questions-and-answers-2012-revised](http://www.irs.gov/individuals/international-taxpayers/offshore-voluntary-disclosure-program-frequently-asked-questions-and-answers-2012-revised). Note that the penalty is increased to fifty percent if either a foreign financial institution at which a taxpayer has or had an account or a facilitator who helped the taxpayer establish or maintain an offshore arrangement has been publicly identified as being under investigation or as cooperating with a government investigation. There is also a five percent penalty available under a streamlined procedure for U.S. taxpayers residing in the United States who certify that their conduct was nonwillful, but this recourse is available only to individuals.


22. I.R.C. § 6103(d) (“Returns and return information . . . shall be open to inspection by, or disclosure to, any State agency . . . which is charged under the laws of such State with responsibility for the administration of State tax laws for the purpose of . . . the administration of such laws . . .”).

23. See, e.g., California Rev. & Tax Code § 18622(a) (“If any item required to be shown on a federal tax return . . . is changed or corrected by the Commissioner of Internal Revenue . . . the taxpayer shall report each change or correction . . . within six months after the date of each final federal determination of the change or correction . . . and shall concede the accuracy of the determination or state wherein it is erroneous.”

24. I.R.C. §§ 6501(c)(1)& 6663.

25. I.R.C. § 6501(c)(8).


27. I.R.C. § 7623(b).