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September 24, 2021

Hon. Charles P. Rettig
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Comments Concerning the Voluntary Disclosure Practice and the Streamlined Filing Compliance Procedures

Dear Commissioner Rettig:

Enclosed please find comments on the Voluntary Disclosure Practice and the Streamlined Filing Compliance Procedures. These comments are submitted on behalf of the Section of Taxation and have not been reviewed or approved by the House of Delegates or the Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

The Section of Taxation would be pleased to discuss these comments with you or your staff.

Sincerely,

Julie A. Divola
Chair, Section of Taxation

Enclosure

cc: Hon. Lily Batchelder, Assistant Secretary (Tax Policy), Department of the Treasury
Mark Mazur, Deputy Assistant Secretary (Tax Policy), Department of the Treasury
Krishna P. Vallabhaneni, Tax Legislative Counsel, Department of the Treasury
William M. Paul, Acting Chief Counsel, Internal Revenue Service
James C. Lee, Chief, Criminal Investigation Division, Internal Revenue Service
James Robnett, Deputy Chief, Criminal Investigation Division, Internal Revenue Service
Nikole Flax, Commissioner, Large Business and International Division, Internal Revenue Service

AMERICAN BAR ASSOCIATION
SECTION OF TAXATION

Comments Concerning the Voluntary Disclosure Practice and the Streamlined Filing Compliance Procedures

These comments ("**Comments**") are submitted on behalf of the American Bar Association Section of Taxation (the "**Section**") and have not been reviewed or approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Laura Gavioli and John Nail of the Section's Committee on Civil and Criminal Tax Penalties. Substantive contributions were made by Daniela Calabro, Caroline Ciraolo, Matt Cooper, Eric Green, Mitchell Horowitz, Edward J. Leyden, Eli S. Noff, and Lawrence A. Sannicandro. These Comments were reviewed by John M. Colvin of the Section's Committee on Government Submissions and by Kurt L. Lawson, the Section's Vice Chair for Government Relations.

Although members of the Section may have clients who might be affected by the federal tax principles addressed by these Comments, no member who has been engaged by a client (or who is a member of a firm or other organization that has been engaged by a client) to make a government submission with respect to, or otherwise to influence the development or outcome of one or more specific issues addressed by, these Comments has participated in the preparation of the portion (or portions) of these Comments addressing those issues. Additionally, while the Section's diverse membership includes government officials, no such official was involved in any part of the drafting or review of these Comments.

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Date: September 24, 2021

I. INTRODUCTION AND BACKGROUND

The following comments are submitted in response to the request for comments made by the U.S. Department of the Treasury ("**Treasury**") and the Internal Revenue Service (the "**Service**") in the Federal Register dated July 7, 2021,[1] as corrected and amended on July 26, 2021 (the "**Amended Notice**").[2] The Amended Notice requests comments on IRS Forms 14457, *Voluntary Disclosure Practice Preclearance Request and Application*, 14653, *Certification by U.S. Person Residing Outside of the United States for Streamlined Foreign Offshore Procedures*, and 14654, *Certification by U.S. Person Residing in the United States for Streamlined Domestic Offshore Procedure*.

The Amended Notice invites comments relating to the forms on: (a) whether the collection of information is necessary for the proper performance of the functions of the agency, including whether the information shall have practical utility; (b) the accuracy of the agency's estimate of the burden of the collection of information; (c) ways to enhance the quality, utility, and clarity of the information to be collected; (d) ways to minimize the burden of the collection of information on respondents, including through the use of automated collection techniques or other forms of information technology; and (e) estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

Form 14457 relates to the Service's Voluntary Disclosure Practice ("**VDP**"). The VDP is a longstanding practice of IRS Criminal Investigation ("**CI**") that takes timely, accurate, and complete voluntary disclosures under consideration when determining whether to recommend criminal prosecution. Forms 14653 and 14654 relate to the Service's Streamlined Filing Compliance Procedures ("**SFCP**"). The SFCP, which were first offered on September 1, 2012, provide taxpayers who failed to report foreign income, assets, accounts, or investments, or pay all tax due in respect of those assets, but certify that the failure did not result from willful conduct, with a streamlined procedure for filing amended or delinquent returns, and terms for resolving their tax and penalty obligations. The SFCP comprise the Streamlined Domestic Offshore Procedures (for non-foreign residents) and the Streamlined Foreign Offshore Procedures (for foreign residents), as well as the Delinquent International Information Return Submission Procedures ("**DIIRSP**"). The Amended Notice observes that the VDP and the SFCP offer "two very different compliance paths to two very different populations of taxpayers."

Individuals in the Section also received verbal requests from the Service for comments on employment tax issues under the VDP.

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[1] 86 Fed. Reg. 35,868 (July 7, 2021).

[2] 86 Fed. Reg. 40,138 (July 26, 2021). The Amended Notice explained that the original notice was inadvertently titled "Offshore Voluntary Disclosure Program (OVDP)," a program which was closed in 2018, *see* IR-2018-52 (March 13, 2018), and included Forms 14452, 14453, 14454, 144657 [sic], and 14708, which have been discontinued. We assume the Amended Notice intended to refer to Form 14467, not Form 144657.

We would like to thank the Service for the opportunity to comment on Forms 14457, 14653, and 14654, and the VDP and SFCP to which they relate. The VDP and the SFCP have been remarkably successful, both for the taxpayers participating and the Government. However, as explained below, we think they could be improved in various respects to make the information-gathering process less onerous for taxpayers and the Service, to ensure they are applied fairly and equitably, and encourage eligible taxpayers to participate in them.

These Comments address primarily the updated VDP and Form 14457, which the Service revised in April 2020. They address issues specific to the VDP for employment taxes in a separate section. They also address the interaction between the VDP and SFCP. Our recommendations are set forth in the body of the Comments.

II. ADMINISTRATION OF THE VDP

The VDP requires taxpayers to make a truthful, timely, and complete voluntary disclosure, in which taxpayers cooperate with the Service, submit required returns for the relevant disclosure period, and make good faith arrangements to pay the tax, penalties and interest determined to be due.[3] The timeliness element requires taxpayer to come forward before:

- The Service has commenced a civil examination or criminal investigation of the taxpayer or has notified the taxpayer that it intends to commence such an examination or investigation;

- The Service has received information from a third party (*e.g.*, informant, other governmental agency, or the media) alerting the Service to the taxpayer's noncompliance; or

- The Service has acquired information directly related to the noncompliance of the taxpayer from an enforcement action (*e.g.*, search warrant, summons, grand jury subpoena).

The Instructions to Form 14457 indicate that the Service expects to process preclearance requests in a timely manner, with the processing taking "a minimum of 30 days" but recognizing that it "*may* take 60 days or longer."[4] There often are significant delays between the submission of Part I of Form 14457 and receipt of the Service's decision on the preclearance request. In some cases, the Service has taken up to two years to process preclearance requests. In other cases, practitioners have submitted multiple requests for the same taxpayer after receiving no response from CI. Follow-up inquiries by taxpayers and/or their representatives often go unanswered, requiring representatives to follow-up repeatedly and through various sources, such as the Service's

[3] Internal Revenue Manual ("I.R.M.") 9.5.11.9(7); Instructions for Form 14457 (Rev. 4-2020) at 7.

[4] Instructions for Form 14457 (Rev. 4-2020) at 11 (emphasis added).

voluntary disclosure email address, hotlines, the National Taxpayer Advocates, and other professional contacts.

These delays discourage taxpayers from using the VDP. An essential part of the appeal of a voluntary disclosure procedure is the ability to obtain certainty, *e.g.*, certainty as to non-prosecution with respect to criminal violations of the tax laws, the applicable penalty structure (civil and criminal), and the relevant lookback period. Delays in processing VDP submissions create significant uncertainty for taxpayers, especially those whose current-year filings depend on the Service's confirmation of eligibility to pursue a voluntary disclosure for prior years. To address this, we recommend that the Service:

- Prioritize VDP submissions to speed up the entire voluntary disclosure process, and, at a minimum, provide the taxpayer and his or her representative with timely confirmations of receipt when it receives either Part I or Part II of Form 14457; and

- Allocate additional resources to the unit of CI reviewing VDP submissions to reduce the bottleneck caused by the review process.

- Consider moving some of the detailed disclosures of account information from Part I to Part II of Form 14457 to reduce the amount of information required to obtain preclearance in the VDP. As discussed further in Sections IV.A and VI below, the Service's processing of the substantial level of detail required in Part I of the form might be a factor contributing to the delays in obtaining preclearance.

The Amended Notice specifically requests feedback on the "accuracy of the agency's estimate of the burden of the collection of information[.]" Form 14457 includes an estimate of six hours for recordkeeping, three hours for learning about the applicable law, fifty hours for preparing the form, and fifteen minutes for submitting the form to the Service.[5] We believe these estimates are lower than the actual time spent by taxpayers and practitioners. The VDP now requires a substantial amount of factual disclosures in Parts I and II of Form 14457, and these disclosures require significant due diligence and factual exploration prior to seeking preclearance and preliminary acceptance in the VDP. This effort often includes seeking records from financial institutions, advisors, and fiduciary companies domestically and internationally, interviewing witnesses, and engaging with accountants to provide accurate estimates of unreported income. To address this, we recommend that the Service:

- Update the estimate of the time required to complete Form 14457 to reflect a total of one hundred hours for recordkeeping, learning about the applicable law, and preparing the form.

Many taxpayers using the VDP are individuals who are unfamiliar with the structure of the Service's website, including where various forms are located. Some taxpayers also have reported problems opening and downloading Form 14457 and its

[5] Instructions for Form 14457 (Rev. 4-2020) at 14.

instructions even once they are located. In practice, downloads through Internet Explorer work as intended. However, through other web browsers, such as the widely used Google Chrome, Form 14457 does not download in all instances.[6] To address this, we recommend that the Service:

- Separate Form 14457 and the instructions into two documents; and
- Create links to both documents on its website related to the VDP and ensure that the links populate in a webpage rather than require the document to be downloaded.

III. UNCERTAINTY REGARDING DISCLOSURE PERIODS AND PENALTY REGIMES IN THE VDP

As noted in Section II above, an essential part of the appeal of a voluntary disclosure procedure is the ability to obtain certainty as to the applicable penalty structure (civil and criminal) and the relevant lookback period. In addition to the general uncertainty noted above caused by delays in processing VDP submissions, the current incarnation of the VDP does not provide certainty on these two issues, which may frustrate, not facilitate, voluntary tax compliance.

Specifically, the VDP provides examiners with significant discretion regarding a taxpayer's applicable disclosure period (normally six years) and the assertion of civil, monetary penalties. The Instructions for Form 14457 create an exception to the general six-year disclosure period, permitting the examiner to include the full duration of a taxpayer's noncompliance and assert maximum penalties under the law if the examiner determines that the taxpayer has not cooperated during the civil examination.[7] The I.R.M also creates an exception to the single-year penalty framework for the civil fraud penalty or fraudulent failure to file penalty if the taxpayer does not fully cooperate.[8] Even if the taxpayer has cooperated, the examiner has discretion to consider the application of penalties for the failure to file information returns, penalties relating to excise taxes, and other penalties.[9]

The Section recognizes (and agrees) that the Service needs the ability to deal with taxpayers who fail to cooperate with the examiner in completing their voluntary disclosure. But we believe the broad discretion provided by the I.R.M. is excessive and risks significantly undermining the certainty taxpayers expect to receive when making a voluntary disclosure. For example, if an examiner has discretion to extend the lookback period and assess additional civil penalties during the required audit, how can a taxpayer reasonably attest to their ability to pay all tax, penalties, and interest that will be assessed

[6] Some taxpayers have reported problems opening and downloading other forms, as well.

[7] Instructions for Form 14457 (Rev. 4-2020) at 9.

[8] I.R.M. 4.63.3.26.2(8).

[9] *See* I.R.M. 4.63.3.26.13.2(1); I.R.M. 4.63.3.26.14.3(1); I.R.M. 4.63.3.26.14.4(1).

in Part II of Form 14457, which must be signed under penalties of perjury and submitted prior to any examiner being assigned? To address this, we recommend that the Service:

- Remove the discretion afforded to an examiner to change the lookback period and to assert additional/greater penalties under the VDP or, alternatively, subject the exercise of such discretion to review by a committee of senior Service personnel;

- Limit the decision to expand the lookback period and/or impose additional penalties to those cases where the taxpayer clearly failed to cooperate; and

- Guarantee that the disclosure period will not be longer than six years without taxpayer consent,[10] and commit to following the single-year penalty framework (*e.g.*, a 75% fraud penalty for the year with the highest tax liability), in each case as long as CI has not revoked a taxpayer's preliminary acceptance.

In addition to benefiting taxpayers by giving them greater certainty, we believe this approach will benefit the Service by avoiding inevitable disputes resulting from changes to the terms of a voluntary disclosure months or years into the process. If the Service opts to continue to confer broad discretion on its agents, we recommend that it swiftly issue guidance providing examples of the situations in which the Service deems it appropriate to assert (and not assert) other penalties in connection with a voluntary disclosure.

IV. NEED FOR ADDITIONAL GUIDANCE

The Service initially announced its revised VDP in November 2018 with the Interim Guidance Memorandum (IGM) LB&I-09-1118-014. The Section recognizes and appreciates that the Service has worked diligently to issue guidance to assist interested parties, including taxpayers, practitioners, and the Service's employees.[11] In doing so, the Section recommends that the Service prioritize guidance on the following topics.

A. Guidance regarding the definition of a reportable account

The Instructions for Form 14457 indicate that Part I requires a taxpayer to disclose "all noncompliant financial accounts" that the taxpayer "owned or controlled or were the beneficial owner of, either direct or indirectly."[12] The Instructions further indicate that a noncompliant financial account is any account that: (1) generated income and the income was not reported for federal income tax purposes; (2) received previously untaxed funds; or (3) was required to be reported on an information return or report (*e.g.*, IRS Form 8938, *Statement of Specified Financial Foreign Assets* or FinCEN Form 114,

[10] The Section recognizes that the disclosure period could be shorter than six years to avoid wasting resources in cases where the noncompliance at issue involves fewer than the six most recent tax years. *See* Instructions for Form 14457 (Rev. 4-2020) at 9.

[11] *See, e.g.*, Form 14457 (Rev. 04-2020); Instructions for Form 14457 (Rev. 04-2020); I.R.M. 9.5.11.9; I.R.M. 4.63.3.26.

[12] Instructions for Form 14457 (Rev. 4-2020) at 12 (emphasis in original).

Report of Foreign Bank and Financial Accounts ("**FBAR**")) and was not reported.[13] To clarify these points:

- We recommend that the Service issue additional guidance regarding what constitutes a reportable account that taxpayers must disclose as part of the VDP. Specifically, we recommend that the Service adopt and adhere to the guidance that the Financial Crimes Enforcement Network (FinCEN) has issued regarding the definition of an "account." Among other benefits of this approach, expressly adopting the FinCEN guidance would clarify that, under the VDP, the term "account" also includes assets that are not financial accounts, such as direct or indirect interests in entities that have "accounts." If the Service does not adopt the FinCEN guidance, we urge it to clarify the meaning of "account" with respect to cryptocurrency, gambling accounts, and accounts held by nominees, alter egos, and transferees, all of which have been perplexing to practitioners handing voluntary disclosures in these areas.

- We recommend that the Service remove item #10 from Part I (requiring the disclosure of noncompliant accounts) and move it to Part II of Form 14457, so that the disclosure of the noncompliant accounts is made after (1) the taxpayer is precleared to make a voluntary disclosure and (2) the practitioner has time to conduct due diligence with respect to items that may constitute noncompliant accounts. The goal of preclearance is for the Service to determine that a taxpayer is "eligible for making a voluntary disclosure, including establishing unreported income is from legal sources and that the timeliness requirements are met."[14] We do not believe the bank account information is required to make such a preclearance determination. Requesting identification of, and information on, noncompliant accounts in advance of the preclearance determination requires the taxpayer to disclose incriminating information before he or she is cleared to proceed with disclosure. This deters taxpayers from using, and practitioners from recommending, the VDP.

B. Guidance with respect to penalty relief

I.R.M. 4.63.3.26.2 provides that "in rare and extraordinary cases, taxpayers may request the imposition of the accuracy related or failure to file penalties under sections 6662, 6651(a)(1) and (2), and the non-willful FBAR penalty, in lieu of the one-year civil fraud or fraudulent failure to file income tax penalty and the willful FBAR penalty."[15] To qualify for this relief, the taxpayer must present "clear and convincing evidence to the satisfaction of the Service to deviate from the established penalty framework."[16] The Service indicates that this type of relief will be "exceedingly rare," but does not provide

[13] *Id.*

[14] *Id.* at 11.

[15] Unless otherwise indicated, references to a "section" are to the Internal Revenue Code of 1986, as amended (the "**Code**").

[16] Instructions for Form 14457 (Rev. 4-2020) at 11.

any guidance on what constitutes "clear and convincing evidence" or the circumstances that justify this type of relief. To clarify this point, we recommend that the Service:

- Provide guidance on when the Service would consider the reduced penalty request and include specific examples in the guidance.

We believe that this will benefit the Service by reducing the number of submissions that request relief from the established penalty framework.

C. Guidance regarding available collection alternatives

Under I.R.M. 9.5.11.9.7, if a taxpayer fails to fully cooperate with the civil examination, the examiner may request that CI revoke the taxpayer's preliminary acceptance.[17] "Cooperation" in the VDP context requires "full payment of all determined taxes, additions to tax, interest, and penalties, or entering into a payment arrangement acceptable to the [Service]."[18] Similarly, I.R.M. 9.5.11.9(6) indicates that, as part of making a truthful, timely, and complete disclosure, a taxpayer must "[m]ake good faith arrangements with the [Service] to pay in full, the tax, interest, and any penalties determined by the [Service] to be applicable."

We believe that the focus of the VDP should be on determining the correct tax and an appropriate civil, monetary penalty, and that the ability to rectify tax noncompliance voluntarily should not be conditioned on a person's ability to pay. That determination leads to the assessment of a tax liability that should then be collected by Service employees with specialized training and experience in collection. The Section understands that the Service recognizes these principles by allowing taxpayers who are unable to pay to enter into payment arrangements, and by assigning Field Collection personnel to disclosures involving an inability to pay. However, conditioning a taxpayer's "cooperation" on full payment or entering into a payment arrangement "acceptable to the Service" might deter taxpayers from rectifying tax noncompliance if they are unable to fully pay the tax, penalties, and interest resulting from the voluntary disclosure based on the undefined phrase "acceptable to the Service." To address this issue, we recommend that the Service:

- Provide additional guidance and examples regarding the types of payment arrangements that it will consider acceptable and unacceptable for taxpayers entering the VDP; and

- In issuing this guidance, refer to existing authorities and I.R.M. provisions regarding collection alternatives to provide taxpayers with certainty regarding the availability and scope of such arrangements.

[17] *See also* I.R.M. 4.63.3.26.9.

[18] *See* Instructions for Form 14457 (Rev. 4-2020) at 9; I.R.M. 4.63.3.26.1(4)g.

D. Guidance regarding the timeliness of a disclosure

The definition of timeliness with respect to Form 14457 and the more general definition of timeliness for voluntary disclosures under the I.R.M. are slightly different. Under the Instructions for Form 14457, a disclosure is not timely if the Service "has acquired information directly related to the specific noncompliance of the taxpayer from a *criminal* enforcement action."[19] The I.R.M., however, indicates that a disclosure is not timely if the Service "has acquired information directly related to the noncompliance of the taxpayer from an enforcement action."[20] This can create confusion for taxpayers and practitioners.

Additionally, both the Instructions for Form 14457 and the I.R.M. indicate that a disclosure is not timely if the Service has received information (1) "alerting the [Service] to" the taxpayer's noncompliance, or (2) "directly related to" the taxpayer's noncompliance.[21] These phrases are vague and open to differing interpretations as to when the Service acquires such information.

Finally, the meaning of "related entity" for purposes of Form 14457 also is not clear. Line 9 of Part I requires taxpayers to disclose whether "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."[22] The Instructions for lines 8 and 9 say that "related entities" are "identified in line 7,"[23] but do not expressly state that these are the only related entities to which line 9 applies.

To address these concerns, we recommend that the Service:

- Either make the definitions of timeliness consistent, or clarify any difference between the definitions;
- Provide additional guidance with examples to clarify when a taxpayer is not eligible to make a voluntary disclosure, and clarify that the date on which the taxpayer submits Part I of Form 14457 is the date by which the disqualifying information must have been received, not weeks or months thereafter; and
- Clarify whether the meaning of "related entities" for purposes of Line 9 of Form 14457 is limited to the entities identified in Line 7 or has a broader meaning.

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[19] Instructions for Form 14457 (Rev. 4-2020) at 11 (emphasis added).

[20] I.R.M. 9.5.11.9(7)c.

[21] Instructions for Form 14457 (Rev. 4-2020) at 11; I.R.M. 9.5.11.9(7)c.

[22] Form 14457 (Rev. 4-2020), Part I, Line 9.a.

[23] Instructions for Form 14457 (Rev. 4-2020) at 12.

V. VDP FOR EMPLOYMENT TAX ISSUES

The current guidance in the I.R.M. and Form 14457 for the VDP do not address certain specialized situations, creating uncertainty for taxpayers and potentially disincentivizing them from participating. In particular, we believe the applicability of the VDP to employment taxes would benefit greatly from additional guidance from the Service. We understand that guidance is forthcoming and recommend that it prioritize guidance on the following topics.

A. Penalty structure for employment tax voluntary disclosures

I.R.M. 4.63.3.26.14.2 states that "employment tax voluntary disclosures will be subject to penalties with a structure similar to income tax penalties. Further guidance is pending." Without that further guidance, the ultimate determination is left to the Service's discretion and leaves the taxpayer potentially liable for an unpredictable (and potentially enormous) amount of penalties. To address this concern, we recommend that:

- The employment tax penalty structure mirror the income tax penalty framework under the VDP—*i.e.*, one section 6663 or 6651(f) fraud penalty on the highest-balance reporting period (*i.e.*, one quarterly federal tax period).

B. Disclosure period for employment tax

As noted in Section III above, the VDP normally requires a six-year lookback. For employment taxes, this translates into 24 separate reporting periods (and a corresponding number of State returns in each jurisdiction in which the employer has employees). Furthermore, retroactive correction in the employment tax context—generally unlike the income tax context—affects all employees and other taxpayers who might have had a reporting relationship with the employer during that period. To address these unique complexities, we recommend that the Service:

- Cap the lookback period at six years without taxpayer consent in the employment tax context, and not give the examiner the discretion to expand this period, even if the Service does not adopt our recommendation in Section III above to do so more broadly; and

- Consider shortening the lookback period to four years (16 reporting periods) in the employment tax context, to further reduce complexities and incentivize voluntary disclosures.

C. Requirements of an employment tax voluntary disclosure

An employer's preparation and filing of delinquent or corrected IRS Forms W-2 and W-3 in connection with an employment tax voluntary disclosure, and the resulting impact the issuance of those forms will have on employees' own amended income tax filing obligations, can impose significant burdens on employers, employees, and the Service.

Many employers try to limit the burden on their employees and ensure they are not harmed, by, for example, paying tax services to help them prepare their amended returns. Many employers also are willing to do more, including paying the employees' required income taxes and employee share of FICA taxes. An employer's payment of the employee share of FICA taxes appears to extinguish the employee's FICA tax liability (and result in additional income if the taxes are not withheld from other income of the employee).[24] It is less clear that an employer's payment of an employee's income taxes (other than via withholding) will extinguish the employee's income tax liability[25] (or result in additional income[26]). We believe that can discourage helpful initiatives by employers on behalf of their employees and create a possibility of double taxation. To address these issues in the case of under-reported income, we recommend that the Service:

- Require the employer to prepare and file delinquent or corrected IRS Forms W-2 and W-3, and pay the employer share of FICA taxes and any FUTA taxes on the income;

- Collect the employees' required income taxes and the employee share of FICA taxes from the employees or from the employer (up to the employer's withholding obligation), but not both, permit the employer to pay those taxes on behalf of the employees, and treat doing so as extinguishing the employees' tax liabilities to the same extent; and

- Permit the employer to give copies of the delinquent or corrected IRS Forms W-2 to employees with notice that all tax has been paid and that no additional reporting is required.

VI. PART II OF IRS FORM 14457 – SWORN TAXPAYER STATEMENT

The Service's historical voluntary disclosure procedure typically has required the taxpayer to disclose the underlying facts leading to the taxpayer's failure to file accurate returns and pay the required amount of tax due. Before 2009, this practice was not standardized. Frequently, at the regional level, the Service's Special Agent in Charge would review a statement of facts, sometimes partially anonymized, from the taxpayer's designated representative in order to make a determination about whether a taxpayer

[24] Rev. Rul. 86-111, 1986-2 C.B. 176 (appearing to assume so if section 3509 does not apply); *Karagozian v. Commissioner*, 106 T.C.M. (CCH) 22 (2013), *aff'd*, 595 F. App'x 87 (2d Cir. 2015) (noting that the Service "may collect the tax from either the employer or the employee").

[25] AOD 2014-01 (Aug. 29, 2014), 2014-38 I.R.B. 546, announces that the IRS will not follow the Tax Court's holding in *Dixon v. Commissioner*, 141 T.C. 173 (2013), that an employer may designate tax payments not withheld at the source to a specific employee's income tax liability. The AOD explained that "[p]ursuant to sections 3402 and 31(a), an employee may only get a credit for income taxes withheld at the source. If the income tax is not withheld at the source, a later payment by the employer of its liability for the tax it should have withheld will not result in a credit to the employee."

[26] *See* PMTA 2018-015 (June 25, 2018) ("[t]o the extent GCM 39577, (February 21, 1986), indicates that the employer's payment of its income tax withholding liability under section 3403 in a subsequent calendar year is additional compensation to the employee, it is in error.").

would be allowed to make the voluntary disclosure. This model, akin to an attorney proffer in the criminal context, depended upon the taxpayer representative's ethical obligations under Circular 230 to ensure that the statement of facts was based upon sufficient due diligence and reasonable assumptions and representations.

Under the evolving standards of the Service's offshore voluntary disclosure initiatives since 2009, the Service has required an increasing amount of information directly from the taxpayer—rather than through their representative—before making a determination regarding preclearance or preliminary acceptance into the VDP.

In terminating the Offshore Voluntary Disclosure Program ("**OVDP**") in September 2018[27] and replacing it with the current VDP, the Service made a significant change. Part II of Form 14457, released in 2020, now requires the taxpayer to sign under penalties of perjury and confirm that all information contained therein is true, correct, and complete, to the best of the taxpayer's knowledge and belief. Part II of the form further requires disclosure of the source of unreported funds, an estimate of the unreported income, an estimate of the high balance in offshore accounts, a list of professional advisors, and a detailed narrative which "must include a thorough discussion of all Title 26 and Title 31 willful failures to report income, pay tax, and submit all required information returns and reports."

The Section recognizes that prior iterations of the OVDP also required taxpayers to sign detailed factual narratives under penalties of perjury for purposes of preliminary acceptance into the program, with similar levels of detail. Also, the current SFCP require signed taxpayer certifications. By accelerating the timing of information disclosure over time, the Service has indicated that it needs substantial detail very early in the voluntary disclosure process to make appropriate determinations regarding preclearance and acceptance. The Section recognizes the importance of this goal.

The key difference in Part II of Form 14457 is that, unlike the prior offshore initiatives where criminal willfulness was not a given, the Service has made clear that the VDP is reserved for those with risk of criminal prosecution due to their reporting failures. Part II of Form 14457 requires taxpayers to admit to willfulness, either directly or by implication, on multiple occasions.[28] Moreover, prior to preliminary acceptance in the

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[27] *See* note 2 above.

[28] *See* Form 14457 (Rev. 4-2020), Part II, Line 7.b ("Identify all individuals who aided in your willful noncompliance"); *id.*, Line 7.c ("The Noncompliance narrative must include a thorough discussion of all Title 26 and Title 31 willful failures to report income, pay tax, and submit all required information returns and reports.").

Also, the Instructions to Form 14457 repeatedly state that the practice is reserved for willful conduct, suggesting that the taxpayer's act of applying to the practice itself could be construed as an admission. *See, e.g.,* Instructions for Form 14457 at 6 ("Objective. The IRS-CI Voluntary Disclosure Practice provides taxpayers whose conduct involved willful tax or tax-related noncompliance with a means to come into compliance with the tax law and avoid potential criminal prosecution . . . . You should consider applying for the IRS-CI Voluntary Disclosure Practice if you engaged in willful noncompliance that exposes you to criminal liability for tax and tax-related crimes"); *id.* at 7 ("When. Form 14457 should

VDP, the taxpayer enjoys no protection from criminal prosecution for the information described in Form 14457. While the Section is not aware of any instances where the Service or the Department of Justice ever have sought to use narrative information provided by the taxpayer on a Form 14457 against the taxpayer when the Service has declined to issue a preliminary acceptance, the Service's policy statements and the Justice Manual similarly provide no assurances that the form's sworn narrative section could not be used against the taxpayer as an admission of guilt if the Service rejects the voluntary disclosure. In short, the Section believes that the sworn statement required in Part II of Form 14457 potentially raises Fifth Amendment concerns regarding self-incrimination.

Further, I.R.M. 9.5.11.9.1(5) elaborates upon the Instructions to Form 14457 and provides that taxpayers "who fail to submit complete narratives that include every element addressed in the Instructions to Form 14457 will not be given an opportunity to supplement their submissions." This strikes us as unduly strict and as failing to take into account the common occurrence of innocuous, minor errors in the narratives, particularly for voluntary disclosures with conduct that might span decades and factual situations where other actors were involved (*e.g.*, estates).

To address the above concerns:

- We recommend that the Service assure taxpayers who submit Part II of Form 14457 that it will not withhold preliminary acceptance into the VDP if the taxpayer has obtained preclearance and provides complete and accurate information in Part II of the form. If the Service insists that the currently required level of detail is necessary prior to preliminary acceptance, we recommend that it provide assurances regarding what uses the federal government may make of the sworn taxpayer statement in the event the Service rejects a voluntary disclosure. At present, we believe the lack of such assurances is a significant deterrent for entry into the program.

- We recommend that the Service give taxpayers the opportunity to address perceived errors or omissions in Form 14457 after submission of Part II.

VII. BORDERLINE CASES FALLING BETWEEN THE VDP AND THE SFCP

As the Amended Notice observes, the "IRS offers two very different compliance paths to two very different populations of taxpayers." First, the VDP provides a method for those taxpayers with criminal exposure to make a "timely, accurate and complete" voluntary disclosure to try to avoid criminal prosecution. Second, the SFCP are available for those taxpayers with non-willful failures to report foreign financial assets and pay tax related to the same.

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be filed when you have determined you have <u>willful conduct</u> that you believe may rise to the level of tax and tax-related crimes and wish to come into compliance to try and avoid potential criminal tax prosecution") (emphasis in original).

For those taxpayers who fall within these two extremes, the Service offers several other paths to compliance. Taxpayers who have failed to timely or accurately file one or more income tax returns may simply file amended or delinquent returns.[29] Taxpayers who can establish reasonable cause for noncompliance with international information return reporting obligations may file amended or delinquent returns or forms (*e.g.*, Forms 3520 or 3520-A) via the DIIRSP.[30] Finally, taxpayers seeking to rectify noncompliance under Title 31 may file amended or delinquent FBARs through the Delinquent FBAR Submission Procedures.[31]

Identifying a taxpayer's most appropriate path of compliance can be a very difficult task. The determination of whether a taxpayer has committed a "tax or tax-related crime" is not a binary one, and criminal risk lies on a spectrum. The Service and practitioners often strongly disagree over whether the facts of a particular case give rise to criminal liability. Moreover, even taxpayers who violated a known tax or reporting obligation might, nonetheless, as a practical matter have little criminal exposure due to their specific facts and circumstances. Examples include a 90-year-old taxpayer with mental infirmities; a non-U.S. citizen with modest income who resides outside of, and has no intention of traveling to, the United States; or a taxpayer whose failure to report a foreign account is treated as "willful" for civil FBAR reporting purposes due to constructive knowledge of the reporting requirement based solely on checking the box "no" on schedule B.

A taxpayer who is civilly willful based on the existing case law, but does not have a material risk of criminal prosecution, is left unsure how to come into compliance, particularly if the taxpayer is seeking a limited lookback period and a reasonable penalty framework.

Finally, an additional cohort is not well-served by the current framework: taxpayers who do not qualify for SCFP because they do not have unreported income related to their offshore accounts. Unreported income remains a requirement of eligibility for the SCFP.[32] Taxpayers in this situation are left with the option of using the DIIRSP. But the DIIRSP presents significant deterrents for taxpayer participation because of its current method of administration. Under the current DIIRSP, certain information return penalties are assessed automatically with little or no consideration given in the first instance to taxpayers' reasonable cause submissions. At present, the result is that taxpayers with unreported income gain more certainty and may obtain a better result by using the SCFP because of the penalty protections available under that procedure. In comparison, taxpayers who had no unreported income due to their

[29] *See* Instructions to Form 14457 at 8.

[30] *See id.*

[31] *See id.*

[32] *See* Form 14653 (Rev. 10-2017) at 1 ("Certification . . . I failed to report income from one or more foreign financial assets during the above period."); Form 14654 (Rev. 9-2017) (same).

compliance failures in certain instances are penalized on a near-automatic basis and must deal with substantial administrative hurdles and delays to come into compliance.

To address these issues, we recommend that the Service:

- Issue additional guidance (perhaps with examples) clarifying the compliance options available to taxpayers who fall into the compliance gap referenced above, or alternatively, develop an additional compliance alternative to address this cohort of taxpayers;[33] and

- Open the SCFP as an option for taxpayers with no unreported income in offshore accounts, or, alternatively, cease automatic assessment of international information return penalties for delinquent submissions under the DIIRSP that contain valid reasonable cause statements.

[33] We would welcome the opportunity to work with Service personnel on developing additional compliance alternatives.