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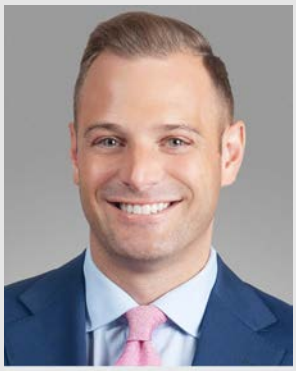

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In this article, Greenwald and Rietveld review the options available to voluntarily disclose foreign income and assets to the IRS, and they assess which programs and methods are the best fit for variously situated taxpayers.



On August 16, 2022, the Inflation Reduction Act (IRA, P.L. 117-169) was signed into law. The act's section 10301, "Enhancement of Internal Revenue Service Resources," appropriated approximately $80 billion to the IRS:

- *Tax Services*. For necessary expenses of the IRS to provide taxpayer services, including pre-filing assistances and education, filing and account services, taxpayer advocacy services, and certain other services — $3,181,500,000.
- *Enforcement*. For necessary expenses of tax enforcement activities of the IRS to determine and collect owed taxes, to provide legal and litigation support, to conduct criminal investigations (including investigative technology), to provide digital asset monitoring and compliance activities, to enforce criminal statutes related to violations of internal revenue laws and other financial crimes, and other services — $45,637,400,400.
- *Operations Support*. For necessary expenses of the IRS to support taxpayer services and enforcement programs, including rent payments, facilities services, printing, postage, and so forth — $25,326,400,000.
- *Business Systems Modernization*. For necessary expenses of the IRS's business systems modernization program, including development of callback technology and other technology to provide more personalized customer service — $4,750,700,000.

In addition to those appropriations to the IRS, on April 5, 2023, the new commissioner of the IRS, Daniel I. Werfel, issued the IRS's "Inflation Reduction Act Strategic Operating Plan":

> The plan is structured to achieve the following five objectives, which will be accomplished through a series of initiatives and projects aligned to each.
>
> 1. Dramatically improve services to help taxpayers meet their obligations and receive the tax incentives for which they are eligible.
>
> 2. Quickly resolve taxpayer issues when they arise.
>
> 3. *Focus expanded enforcement on taxpayers with complex tax filings and high-dollar noncompliance to address the tax gap.*
>
> 4. Deliver cutting-edge technology, data, and analytics to operate more effectively.

> 5. Attract, retain, and empower a highly skilled, diverse workforce and develop a culture that is better equipped to deliver results to taxpayers. [Emphasis added.]

Regarding the third objective, the plan further explains: "We will focus IRA enforcement resources on hiring accountants, attorneys, and data scientists needed to pursue high-income and high-wealth individuals, complex partnerships, and large corporations that are not paying the taxes they owe."

According to the plan, in relevant part, the IRS will:

- use improved analytics to aid in the selection of cases predicted to be at risk of noncompliance, choosing enforcement treatments that maximize opportunities to improve and sustain taxpayer compliance while ensuring fairness in selection;
- increase enforcement activities to help ensure tax compliance of large corporate taxpayers;
- expand enforcement for large partnerships;
- *expand enforcement activities to help ensure compliance of high-income and high-wealth individuals*;
- expand enforcement in areas where audit coverage has declined to levels that erode voluntary compliance;
- pursue appropriate enforcement for complex, high-risk, and emerging issues (including digital assets, listed transactions, and *certain international issues*); and
- promote fairness in enforcement activities. [Emphasis added.]

Of the nearly $80 billion of appropriations, more than half has been earmarked for expanded enforcement against taxpayers with complex filings and high-dollar noncompliance to address the tax gap.[1]

Apart from the IRA and the plan, the Senate Finance Committee investigation of Credit Suisse[2] included recommendations that the IRS use its new funds to strengthen enforcement of laws against offshore tax evasion. Specifically, the Democratic staff of the committee urged the IRS to bolster enforcement of foreign bank account report violations, provide updated guidance to Swiss banks, speed up processing of whistleblower claims, and consider restarting a voluntary disclosure program for offshore assets.[3]

It is axiomatic that a taxpayer wants to come to the IRS with a potential problem before the IRS finds the problem on its own and comes to the taxpayer. Perhaps now is the time to make that voluntary disclosure considering the significant funding that the IRS is receiving, including more than $45 billion earmarked for enforcement, coupled with a focus on large corporations and high-income earners/high-net-worth individuals, and compounded by calls from Congress to strengthen enforcement of offshore tax evasion.

Ahead of potential new, formal voluntary disclosure programs being put in place, below we identify the opportunities that large corporations with undisclosed foreign activities/income have to remedy their compliance gaps (for example, missed Forms 5471). We further identify the opportunities that high-income earners/high-net-worth individuals (for example, with undisclosed offshore bank accounts and missed Forms 3520) have to remedy their tax compliance gaps.[4]

[1] IRS, "Inflation Reduction Act Strategic Operating Plan — FY 2023-2031," at 129 (Apr. 5, 2023). The plan estimates the tax gap (the difference between taxes due and taxes paid, calculated based off the 2014-2016 tax years) to be approximately $496 billion. It predicts that the $80 billion of appropriations will allow the IRS to capture approximately $180 billion of that estimated amount.

[2] Democratic staff of Senate Committee on Finance, "Credit Suisse's Role in U.S. Tax Evasion Schemes" (Mar. 29, 2023).

[3] According to its report, the committee uncovered "major violations" of the $2.6 billion plea deal Credit Suisse reached with the Justice Department in 2014. Among other items, it cited "what may be an ongoing criminal conspiracy" involving almost $100 million in secret offshore accounts belonging to a family of dual U.S.-Latin American citizens. In a statement, Finance Committee Chair Ron Wyden, D-Ore., slammed "greedy Swiss bankers" who he said appear to be engaged in a "massive, ongoing conspiracy to help ultra-wealthy U.S. citizens to evade taxes and rip off their fellow Americans," despite Credit Suisse's promises. The committee also said several other Swiss banks — Union Bancaire Privée, PKB Privatbank AG, and Bank Leumi — received undeclared funds in 2012 and 2013 from the family.

[4] Besides the criminal and civil liabilities both groups of taxpayers may face, both should remember that under section 6501(c)(8) the statute of limitations does not begin to run until all required international tax information is provided to the IRS. *See* Lewis J. Greenwald and Eric J. Rietveld, "Why Timely and Accurate Filing of U.S. International Information Returns Is Critical," *Tax Notes Int'l*, Mar. 21, 2022, p. 1411.

**Table 1. IRA Allocations Financial Summary — FY 2022-2031**

| | Appropriations Account ($ Billions), Rounded | | | | | |
|---|---|---|---|---|---|---|
| **Transformation Objective** | **Taxpayer Services** | **Enforcement** | **Operations Support** | **Business Systems Modernization** | **Clean Energy** | **Total Proposed Investment** |
| 1. Dramatically improve services to help taxpayers meet their obligations and receive the tax incentives for which they are eligible | 1.5 | 0.1 | 2.1 | 0.7 | 0.0 | **4.3** |
| 2. Quickly resolve taxpayer issues when they arise | 0.1 | 1.8 | 0.7 | 0.6 | 0.0 | **3.2** |
| 3. Focus expanded enforcement on taxpayers with complex tax filings and high-dollar noncompliance to address the tax gap | 0.2 | 41.7 | 5.5 | 0.0 | 0.0 | **47.4** |
| 4. Deliver cutting-edge technology, data, and analytics to operate more effectively | 0.0 | 0.1 | 9.2 | 3.1 | 0.0 | **12.4** |
| 5. Attract, retain, and empower a highly skilled, diverse workforce and develop a culture that is better equipped to deliver results for taxpayers | 0.2 | 0.7 | 6.9 | 0.4 | 0.0 | **8.2** |
| Energy security | 1.2 | 1.3 | 0.9 | 0.0 | 0.5 | **3.9** |
| **Total IRA allocations** | **3.2** | **45.6** | **25.3** | **4.8** | **0.5** | **79.4** |

## The Voluntary Disclosure Programs

For the past 13 years, the IRS has offered some form of voluntary disclosure program for U.S. taxpayers with foreign assets and foreign income not previously disclosed on U.S. tax returns or other information reporting forms — commonly referred to as offshore voluntary disclosure programs (OVDPs).

### The 2009, 2011-2012, and 2014 OVDPs

In their various iterations, beginning in 2009, the OVDPs offered taxpayers the opportunity to resolve their past noncompliance issues regarding unreported financial assets and income and the failure to file certain foreign information returns in exchange for reduced (yet still significant) penalties. This was 20 percent of the highest value of the unreported foreign assets under the 2009 program, 25 percent under the 2011 program (which was extended into 2012), and finally 27.5 percent under the 2014 program.

## The Streamlined Procedures

In September 2012 the IRS introduced the streamlined filing compliance program.[5] Originally, the streamlined procedures were only available to taxpayers with less than $1,500 in unreported tax related to unreported foreign assets. However, in 2014 the IRS removed the $1,500 tax ceiling to make the streamlined procedures more widely available.

The streamlined procedures are available to two classes of U.S. taxpayers: (i) U.S. taxpayers residing outside the United States (the "streamlined foreign procedures"); and (ii) U.S.

[5] Importantly, for a short period of time in 2014, taxpayers that had previously entered the voluntary disclosure program could opt into the streamlined procedures. In most cases, the economic advantage of doing so was significant.

taxpayers residing in the United States (the "streamlined domestic procedures").[6] In both cases, U.S. taxpayers have an opportunity to report and pay all the U.S. taxes due on their unreported items. Under the streamlined foreign procedures there is no additional penalty; however, under the streamlined domestic procedures there is a penalty of 5 percent of the highest value of the unreported foreign assets during the streamlined procedures period. The streamlined procedures are *not* available to corporations or other entities.

From their inception, the streamlined procedures were only available to taxpayers that could certify that their failure to report foreign financial assets and income and their failure to file certain foreign information returns *was not the result of willfulness*. If the IRS has initiated a civil examination of a taxpayer's return for any tax year (regardless of whether the examination relates to undisclosed foreign assets or income), the taxpayer is ineligible for the streamlined procedures. Similarly, a taxpayer under IRS criminal investigation is also ineligible.

## Termination of the 2014 OVDP

On September 28, 2018, the IRS officially terminated the 2014 OVDP.[7] That said, the IRS clarified that it would continue to offer taxpayers the opportunity to make disclosures of previously undisclosed foreign assets and income through two methods: the streamlined procedures for individual U.S. taxpayers who owe additional U.S. tax connected to compliance failures, and the delinquent procedures for all U.S. taxpayers that do not owe additional U.S. tax in connection with their compliance failures.

## The Delinquent Procedures

After September 2018 the IRS directed taxpayers with delinquent U.S. international information returns (but who did not need to use the streamlined procedures because there was no unreported income from foreign assets) to use the so-called delinquent procedures. Under the delinquent procedures, the IRS directed taxpayers to file an amended return with the delinquent U.S. international information returns alongside a reasonable cause statement.[8] The IRS generally did not review the attached statement, so taxpayers often received automatic penalty notices necessitating a resubmission of their reasonable cause statements or a follow-up with IRS Appeals.[9]

On November 5, 2020, the IRS made official its unwritten policy of not reviewing reasonable cause statements by updating the delinquent procedures section of its website, which states:

> Taxpayers may attach a reasonable cause statement to each delinquent information return filed for which reasonable cause is being asserted. During processing of the delinquent information return, penalties may be assessed without considering the attached reasonable cause statement. It may be necessary for taxpayers to respond to specific correspondence and submit or resubmit reasonable cause information.[10]

That update clarifies that when filing delinquent U.S. international information returns under the delinquent procedures, it is all but certain that penalties will be assessed, and the taxpayer will need to resubmit the reasonable

[6] U.S. citizens, lawful permanent residents, and estates of U.S. citizens meet the nonresidency requirement if, in at least one of the three most recent tax years for which the U.S. tax return due date has passed (including those that have been extended), they did not have a U.S. abode and were physically outside of the United States for at least 330 full days. U.S. taxpayers that cannot meet the nonresidency requirements of the streamlined foreign procedures must use the streamlined domestic procedures.

[7] IR-2018-52.

[8] Reg. section 1.6038A-4(b)(2)(iii) provides that reasonable cause for failure to file a Form 5472 includes "circumstances that may indicate reasonable cause and good faith [and] include an honest misunderstanding of fact or law that is reasonable in light of the [taxpayer's] experience and knowledge." The regulations state that reliance on an attorney or accountant does not "necessarily demonstrate reasonable cause and good faith" and that reasonable cause is highly dependent on the facts and circumstances of the individual case. Further, under reg. section 1.6664-4, reasonable cause is determined case by case, with all relevant facts and circumstances taken into consideration. Thus, no one factor — including reliance on a tax professional — is dispositive. Reg. section 1.6664-4(c)(1) provides that the taxpayer's education, sophistication, and business experience are relevant in determining whether its reliance on tax advice was "reasonable and made in good faith" and that "reliance may not be reasonable or in good faith if the taxpayer knew, or reasonably should have known, that the advisor lacked knowledge in the relevant aspects of Federal tax law."

[9] *See, e.g.*, the American Bar Association Section of Taxation's comments on the voluntary disclosure practice and streamlined filing procedures (Sept. 24, 2021).

[10] IRS, "Delinquent International Information Return Submission Procedures" (last updated July 27, 2022).

cause statement. However, the Tax Court recently held in *Farhy*[11] that the IRS does not have authority to assess certain international information return penalties under section 6038(b) because the agency was not specifically authorized to treat these penalties as a tax or assessable penalty under the statute. Therefore, if the court's decision stands, the IRS will have to file a civil action to recover penalties instead of being able to reflexively assess them. Penalties covered by section 6038(b) include those concerning Form 5471, and like section 6038(b), other code sections covering penalties for failure to file international information returns would appear to be covered by the *Farhy* decision, including sections 6038A(d) (Form 5472), 6038B(c) (forms 926 and 8865), and 6038D(d) (Form 8938).[12]

In any case, it is vital that before filing any delinquent U.S. international information returns, the taxpayer articulates reasonable cause for failure to timely or accurately file.[13]

## Other Taxpayers

For corporate and other entity taxpayers (as well as individuals) that cannot use the streamlined procedures, and those for whom the delinquent procedures do not apply, the IRS directs them to use the general criminal investigation voluntary disclosure process, which is started by filing Form 14457 with the voluntary disclosure coordinator. Indeed, the website[14] for the 2014 OVDP FAQs directs taxpayers to Form 14457 to apply for the IRS's general voluntary disclosure.

Under the general voluntary disclosure, the IRS provides that while immunity from criminal prosecution is not guaranteed, a voluntary disclosure may result in prosecution not being recommended. Furthermore, for foreign reporting issues, there is no guaranteed reduction in penalty like the OVDP programs provided in the past. However, for FBAR violations, this is somewhat ameliorated by the recent Supreme Court decision in *Bittner*, which held that $10,000 non-willful FBAR penalties are imposed on a per-form basis as opposed to a per-account basis.[15] For example, a taxpayer with 10 unreported foreign accounts in a tax year is only subject to a $10,000 penalty per year for the unfiled FBAR rather than $100,000 ($10,000 per bank account on the unfiled FBAR).

## Conclusion

Given the looming compliance/enforcement initiative by the IRS regarding large corporations and high-income earners/high-net-worth individuals, and the heightened calls from Congress regarding U.S. international tax compliance, it is imperative that taxpayers exhaust every avenue to close their noncompliance tax gaps before the IRS identifies the noncompliance. Table 2 shows which of the above programs and methods are the best fit for variously situated taxpayers. For high-income earners/high-net-worth individuals, this may mean taking advantage of the streamlined procedures (to the extent that they qualify), while corporations and other high-income earners/high-net-worth individuals should take advantage of the delinquent procedures or the IRS's general criminal voluntary disclosure practice.

[11] *Farhy v. Commissioner*, 160 T.C. No. 6 (2023).

[12] It should be expected that the IRS will seek an appeal of this decision, and Congress may seek to act to amend the subject sections to provide the IRS with authority to make penalty assessments.

[13] *See* Greenwald and Rietveld, *supra* note 4.

[14] IRS, "Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers 2014" (last updated Feb. 19, 2021).

[15] *Bittner v. United States*, 143 S. Ct. 713 (2023).

**Table 2. Finding the Best Disclosure Fit**

| Type of Taxpayer | Streamlined Procedures | Delinquent Procedures | General Voluntary Disclosure |
|---|---|---|---|
| Non-willful individuals with unreported foreign income | Yes | No | No |
| Individuals with no unreported foreign income and reasonable cause for nonfiling of international information returns | No | Yes | No |
| Willful individuals with unreported foreign income/international information forms | No | No | Yes |
| Entities with unreported foreign income (whether willful or not) and willful nonfiling of international information returns | No | No | Yes |
| Entities with no unreported foreign income and reasonable cause for nonfiling of international information returns | No | Yes | No |

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