

Area of Focus #3 **The Offshore Voluntary Disclosure (OVD) Programs Still Lack Transparency, Violating the *Right to Be Informed***

TAXPAYER RIGHTS IMPACTED¹

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

DISCUSSION

Beginning in 2009, the IRS established a series of Offshore Voluntary Disclosure Programs (OVDs), which allow certain people who have not reported all of their foreign assets and income to settle with the IRS by paying taxes, interest, penalties, plus a “miscellaneous offshore penalty” (MOP). It also established a “streamlined” program for those who could certify their violations were not willful. These programs are governed by frequently asked questions (FAQs) posted on the IRS website.² The Large Business and International (LB&I) Division Withholding and International Individual Compliance (WIIC) Director can approve minor changes to the FAQs, but the Commissioner or Deputy Commissioner must approve significant ones.³ IRS examiners interpret the FAQs with assistance from technical advisors and Small Business/Self-Employed (SB/SE) Counsel.⁴ They may also access training materials and job aids posted to a secure SharePoint intranet site.⁵

- 1 See Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC § 7803(a)(3)).
- 2 IRS, *Options Available for U.S. Taxpayers with Undisclosed Foreign Financial Assets*, <https://www.irs.gov/individuals/international-taxpayers/options-available-for-u-s-taxpayers-with-undisclosed-foreign-financial-assets> (last visited March 2, 2017) (providing links to all of the FAQs referenced in this discussion). For concerns about the Offshore Voluntary Disclosure Programs (OVDs), see, e.g., National Taxpayer Advocate 2017 Objectives Report to Congress 164-76 (discussing prior reports). Although the 2009 OVD was succeeded by the 2011 Offshore Voluntary Disclosure Initiative, for purposes of this discussion we refer to it as an OVD.
- 3 Large Business and International (LB&I) response to TAS information request (Apr. 18, 2017) (“Minor corrections or updates [to FAQs] may be authorized at the Director level. Modifications or additions impacting policy or materially changing existing guidance require authorization by the Deputy Commissioner/Commissioner with input from the Deputy Chief Counsel Operations. Recommendations for modifications, updates, or additions are worked by a cross functional team made up of management and executives from LB&I and [Small Business/Self Employed] SB/SE, a technical advisor/senior revenue agent, and SB/SE Counsel. For purposes of this response, we will refer to this group as the ‘Elevated Issues Team.’”).
- 4 *Id.* (“In general, case specific information is communicated via e-mail from the technical advisor to the revenue agent working the case. On rare occasion, SB/SE Counsel (field) assigned to the OVD Biweekly Team provides written input on specific cases. Guidance on routine issues raised by the field or a general issue not related to a specific case is typically discussed at monthly conference calls organized by PN [Practice Network] Senior Revenue Agents detailed to OVD. Occasionally, SB/SE Counsel (field) will participate in those calls.”).
- 5 *Id.*

The IRS Does Not Disclose Interpretations of OVDP Frequently Asked Questions (FAQs)

Chief Counsel Advice from (or coordinated with) national office attorneys must be disclosed under IRC § 6110.⁶ Other “instructions to staff” that affect the public must be disclosed under the Freedom of Information Act (FOIA).⁷ However, the IRS does not disclose its interpretations of FAQs. For example, when the IRS first established the 2009 OVDP, it did not disclose how it interpreted FAQ #35, which addressed how to compute the “offshore penalty.” The guidance memo was only disclosed in response to a Taxpayer Advocate Directive.⁸ Practitioners have highlighted other undisclosed and counterintuitive FAQ interpretations.⁹

While the IRS may be required to disclose FAQ interpretations under FOIA, it is generally not required to disclose legal advice regarding the OVDP FAQs under IRC § 6110. IRC § 6110 requires disclosure of certain advice provided by or coordinated with the national office, but legal advice concerning the interpretation of the FAQs is generally provided by an SB/SE attorney in the field who is an OVDP expert.¹⁰ Moreover, some of this advice may be privileged, even if it reveals principles that the IRS will apply in other cases.

The IRS’s lack of transparency about how taxpayers fare inside and outside the Offshore Voluntary Disclosure Programs makes it more difficult for anyone to recognize when the result in a particular case is outside the norm.

The IRS could voluntarily disclose important interpretations of OVDP FAQs, but does not. For example, 2012 OVDP FAQ #10 is particularly important because, like 2009 FAQ #35, it concerns the amount taxpayers must agree to pay under the OVDP. FAQ #10 describes an “alternative mark-to-market” (MTM) method that OVDP participants can only use to file or amend returns inside the program. Under this method, participants are taxed on unrealized gains reduced by unrealized losses. Notably, FAQ #10 does not inform participants that they cannot offset unrealized gains with unrealized losses from years for which the refund statute expiration date (RSED) has passed.¹¹ Rather, it implies the opposite by warning only that unused losses cannot be carried forward beyond the OVDP disclosure period. If unrealized losses can be claimed for some years during this period and not others (*i.e.*, because the RSED has passed), it is misleading not to include that warning as well. Yet, that is how the IRS interprets FAQ #10 — as not permitting taxpayers to offset unrealized gains with losses from years for which the RSED had passed. Members of the Tax Section of the American Bar Association — who somehow learned of the

6 IRC § 6110 (requiring disclosure of Chief Counsel Advice (CCA)); Chief Counsel Notice 2014-009 (Sept 22, 2014) (requiring disclosure of certain legal advice provided by or coordinated with the national office).

7 5 U.S.C. § 552(a)(2)(C) (generally requiring disclosure of “administrative staff manuals and instructions to staff that affect a member of the public”).

8 See Taxpayer Advocate Directive (TAD) 2011-1 (Aug. 16, 2011), <https://www.irs.gov/advocate/taxpayer-advocate-directives-and-related-documents>.

9 See, e.g., New York State Bar Association (NYSBA) Tax Section, *NYSBA Tax Section Comments on FAQ for 2011 Offshore Voluntary Disclosure Initiative*, 2011 TNT 153-13 (Aug. 9, 2011); Marie Saphire, *More Written Guidance Needed As OVDI Deadline Nears*, 132 TAX NOTES 1001 (Sept. 5, 2011).

10 LB&I response to TAS information request (Apr. 18, 2017) (“We are not aware of any written advice interpreting OVDP FAQs from any employee assigned to a national office component of Chief Counsel issued to any technical advisor, program manager, or other LB&I employee.... We are aware of written advice provided by one SB/SE Counsel (field) attorney to technical advisors, OVDP managers, and other IRS personnel... We are aware of no written interpretation of OVDP FAQs mentioned in our earlier responses being released to the public.”). LB&I later said that “several attorneys from SBSE Counsel and Headquarter Counsel provide assistance to OVDP.” LB&I response to TAS fact check (June 7, 2017). But, LB&I did not provide TAS with written advice from any other attorneys.

11 IRC § 6511(a).

IRS's undisclosed interpretation of FAQ #10 — suggested that the IRS is not legally required to deny offsets from barred years and that doing so is unnecessarily punitive.¹²

Although the IRS's interpretation of FAQ #10 may be implied by IRS training materials,¹³ these training materials were not posted to the IRS website, as seemingly required by FOIA. Rather, a private firm acquired them by making a FOIA request and then made them available to the public on its private website.¹⁴ They are not indexed or organized.¹⁵ The firm could remove them or impose an access charge at any time. Moreover, neither the public nor other IRS employees (*e.g.*, TAS employees) should have to search a private website for information about an IRS program.¹⁶

More Routine Disclosure of Advice Would Be Helpful

In the years before the IRS was required to release its private letter rulings and other legal advice to the public, a 1926 report found that:

[R]ulings were known only to insiders ... This system ha[d] created, as a favored class of taxpayers, those who ha[d] employed 'tax experts.' It ha[d] created a special class of tax practitioners, whose sole stock in trade [was] a knowledge of the secret methods and practices of the Income Tax Unit. Knowledge of secret precedents had made Bureau employees extremely valuable to corporate taxpayers, fostering a damaging rate of turnover. Only the regular publication of BIR [Bureau of Internal Revenue] decisions could halt this outflow and ensure equal treatment for all taxpayers.¹⁷

While the IRS is more transparent today, a lack of transparency in connection with undisclosed FAQ interpretations could present the same risks. To assess those risks, TAS reviewed a sample of ten items of undisclosed advice about OVDP FAQs issued between March 1, 2016 and March 8, 2017.¹⁸ According to the IRS, these documents were not checked or reviewed by any disclosure expert to determine if they should be disclosed.¹⁹ However, TAS's review uncovered information that could be helpful to taxpayers, such as following:

- When the MOP is assessed pursuant to a closing agreement, the tax year recited in the closing agreement is the tax year that controls the analysis of whether it is too late to issue a refund of the MOP (*i.e.*, if the refund statute of limitation under IRC § 6511 has expired). The tax year recited in these agreements is generally the last tax year in the disclosure period.

12 Letter from American Bar Association (ABA), to John Koskinen, Commissioner of Internal Revenue, *Comments on 2014 Offshore Voluntary Disclosure Program and the Streamlined Programs* 18 (Oct. 14, 2015), <http://www.americanbar.org/content/dam/aba/administrative/taxation/policy/101415comments.pdf> (“...in the context of OVDP, where the IRS makes rules, disallowing losses because of a closed statute serves little purpose other than being punitive. We believe the IRS should reconsider its position here ...”).

13 See Bragger Tax Law Group, *Previously Unreleased IRS Guidelines for FBAR Audits, Offshore Voluntary Disclosure Workshop Houston, TX 09/11*, 192 <https://www.bragertaxlaw.com/previously-unreleased-irs-guidelines-for-fbar-audits.html> (last visited Apr. 28, 2017).

14 See *id.* See also Andrew Velarde, *FOIA Response Shows Hints of IRS Thinking on OVDP*, 2015 TNT 192-1 (Oct. 5, 2015).

15 Under the Freedom of Information Act, if an item is not properly posted and indexed by the IRS, it may not be “relied on, used, or cited as precedent” by the IRS against a taxpayer unless the taxpayer has actual and timely notice of its terms. See 5 U.S.C. § 552(a)(2)(flush).

16 Some TAS employees gained access to LB&I's secure SharePoint site for the first time in 2017.

17 See Joseph J. Thorndike, *Annual Regulation of Business Focus: Reorganization of the Internal Revenue Service: Reforming the Internal Revenue Service: A Comparative History*, 53 ADMIN. L. REV. 717, 751 (2001) (Internal citations omitted).

18 The sample was drawn from a universe of only 16 items. LB&I response to TAS information request (Apr. 18, 2017).

19 LB&I response to TAS information request (June 1, 2017).

- If a taxpayer makes a payment for the MOP and then is removed from or opts out of the OVDP, the statute of limitation under IRC § 6511 for all tax years in the OVDP submission must be analyzed in determining if it is too late to issue a refund. If the period is open for any tax year in the submission, then a claim for refund of the MOP may be considered under IRC § 6511.
- When determining if the taxpayer had less than \$10,000 in U.S. source income, as necessary to qualify for the five percent penalty under 2012 OVDP FAQ #52, the IRS considers gross income (not net income). In limited circumstances where the taxpayer receives flow-through income from an entity not controlled by the taxpayer, however, the IRS may apply a cash flow analysis for purposes of determining if the taxpayer exceeds this \$10,000 threshold.
- The IRS is legally permitted to consider an offer in compromise before there is an assessment pursuant to a closing agreement in the OVDP.
- A Swiss “libre passage” account is not excluded from the OVDP penalty base when computing the MOP on the basis that it is a tax-favored retirement account under Swiss law.
- OVDP Hotline personnel can assist taxpayers in determining whether a foreign retirement account (other than a Canadian retirement plan) must be included in the OVDP offshore penalty base by collecting information and elevating the matter to an OVDP Coordinator for consideration.
- OVDP Hotline personnel can assist taxpayers who have signed a Form 906 closing agreement and are due a refund if the examiner who handled the certification is unavailable to assist (*e.g.*, has separated from service, is on maternity leave, etc.).
- OVDP Hotline personnel can assist taxpayers who erroneously omitted an account/asset from their original disclosure by collecting the information and elevating the taxpayer’s request to make a supplemental disclosure.

While taxpayers could glean some of this information from other sources (*e.g.*, a representative with significant OVDP experience), disclosing answers to questions about the FAQs — whether by disclosing internal training and guides or advice currently being provided to IRS employees by email — could help taxpayers (and practitioners) understand the OVDP even if they are unrepresented, reduce unnecessary calls to the Hotline, increase confidence that the IRS is handling cases consistently, reduce internal requests for advice, and reduce unnecessary requests for assistance from TAS.²⁰

The IRS Does Not Always Disclose the Basis for Its OVDP-Related Decisions

When an OVDP examiner makes an OVDP-related decision based on guidance from a field attorney, technical advisor, or committee, he or she is not required to explain the resulting “take it or leave it” decision to the participant or allow the participant to speak with the decision maker.²¹ For example, the IRS announced in 2014 that certain OVDP participants could apply to transition into a more favorable “streamlined” program if they certified their conduct was non-willful.²² However, it would only allow them into the program if technical advisors, and in some cases, a secret “Central Review Committee”

20 See, *e.g.*, Organization for Economic Co-operation and Development (OECD), *Update on Voluntary Disclosure Programmes: A Pathway To Tax Compliance* 18 (Aug. 2015), <http://www.oecd.org/ctp/exchange-of-tax-information/Voluntary-Disclosure-Programmes-2015.pdf> (“The terms of the [OVD] programme or initiative should be clearly set out in guidance accessible both to the eligible population and to others, to avoid both ambiguity and any charge of a lack of even-handedness on the part of the tax authority.”).

21 See, *e.g.*, 2014 OVDP FAQ #49.

22 IRS, *Transition Rules: FAQs*, <https://www.irs.gov/individuals/international-taxpayers/transition-rules-frequently-asked-questions-faqs> FAQ #7 (last visited Mar. 2, 2017).

agreed (*i.e.*, taxpayers did not know who was on the committee and could not communicate with it).²³ Participants would have no way to know if the examiner miscommunicated the facts to the technical advisor or to the committee, or what standards were being applied. Thus, a taxpayer had no way to know if the IRS's decision in his or her case was consistent with its decisions in other similar cases.

The IRS Does Not Release Summary Statistics

The IRS's release of certain statistics, such as the average or median tax, interest, and penalties paid inside and outside an OVDP could help assure taxpayers they are not being unfairly singled out and the programs are being administered in a rational manner. Both TAS and the Government Accountability Office have computed and publicly reported such statistics in the past.²⁴ However, LB&I recently stated that TAS should not publish an update.²⁵ LB&I computes OVDP results using a different methodology, which TAS has obtained and redacted (at LB&I's request) in the Appendix below. LB&I explained:

Statistics with details beyond those publicly released in press releases by the Commissioner (most recently in IR-2016-137) may impair tax administration and are exempt from release under FOIA. LB&I's response to FOIA request # [REDACTED] from [REDACTED] [REDACTED] limited the information provided under the request to high level statistics. TAS should not release statistics more granular than those provided by the Commissioner in press releases.

We disagree. "May impair tax administration" is not the legal standard for withholding information under FOIA.²⁶ Even if it were, the IRS has provided no basis to support its conclusion that releasing this data may impair tax administration. Moreover, if the IRS could prevent the National Taxpayer Advocate from publishing data more granular than data provided by the IRS Commissioner in press releases, her reports would be much less effective in highlighting problems, such as those caused by the IRS's initial one-size-fits all approach to the OVDPs.

In addition to penalties assessed inside OVDP-related programs, the Treasury Department also compiles a summary of the penalties assessed outside the OVDPs against those who failed to file a *Report of Foreign Bank and Financial Accounts* (FBAR) for reports to Congress.²⁷ However, the IRS has not disclosed this summary to the public, notwithstanding repeated requests by TAS.²⁸ After years of

23 IRS, *Transition Rules: FAQs*, <https://www.irs.gov/individuals/international-taxpayers/transition-rules-frequently-asked-questions-faqs> FAQ #8.

24 See, e.g., National Taxpayer Advocate 2017 Objectives Report to Congress 164-76; Government Accountability Office (GAO), GAO-13-318, *IRS Has Collected Billions of Dollars, but May Be Missing Continued Evasion* 13 (Mar. 2013).

25 IRS response to TAS information request (Apr. 18, 2017).

26 Under FOIA exemption 5 U.S.C § 552(b)(7)(E), the IRS can withhold information that "could reasonably be expected to risk circumvention of the law." Similarly, the IRS is generally required to withhold return information (not data) the disclosure of which would "seriously impair" federal tax administration. See IRC §§ 6103(c), (e)(7).

27 See Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act (USA PATRIOT Act) of 2001, Pub. L. No.107-56 § 361(b) (2001) (requiring the reports). The Financial Crimes Enforcement Network (FinCEN) initially published these reports on its website. See, e.g., Department of Treasury, *A Report to Congress in Accordance with § 361(B) of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001* (2004), http://www.fincen.gov/news_room/rp/files/fbar_report_2004.pdf.

28 TAS began advocating for the IRS to release these reports in 2013 and made its advocacy public in 2016. See National Taxpayer Advocate 2017 Objectives Report to Congress 164, 176.

working with the IRS to release these reports, the IRS recently stated for the first time to TAS that “Treasury is the owner of the annual FBAR report and thereby controls the release of that report.”²⁹

The IRS’s lack of transparency about how taxpayers fare inside and outside the OVDPs makes it more difficult for anyone to recognize when the result in a particular case is outside the norm. Moreover, this lack of transparency makes it impossible for impartial and independent observers to assess the effectiveness of the OVDPs.

CONCLUSION

According to a tax historian, “corruption, favoritism, secrecy, and taxpayer mistreatment” have prompted political leaders to try to restructure the IRS four times over the last 145 years.³⁰ Given the IRS’s history, it may be easier for taxpayers to believe that if the agency is not transparent, it must have something to hide. The IRS and Congress’s recent adoption of the Taxpayer Bill of Rights (TBOR) could help restore faith in the agency.

However, secrecy in the OVDPs violates the TBOR. The TBOR provides that taxpayers “have the *right to be informed* of IRS decisions about their tax accounts and to receive clear explanations of the outcomes.” Blindsiding only those taxpayers who do not have special access to the IRS’s undisclosed interpretations of FAQs is inconsistent with this right, as well as the *rights to quality service* and *to a fair and just tax system*. Similarly, when the IRS does not provide for any appeal or review of “take it or leave it” offers (or even provide an explanation of them), it erodes the *right to challenge the IRS’s position and be heard*.

Transparency could also promote efficiency by reducing disputes.³¹ When the IRS’s lack of transparency makes people feel singled out for arbitrary and capricious treatment, they are more likely to try to elevate the IRS’s determinations, delaying resolution of their cases. Although the IRS does not disclose how long it takes to resolve OVDP cases, the Treasury Inspector General for Tax Administration recently reported “the IRS has taken nearly two years to complete 20,587 [OVDP] case certifications, with 241 cases taking at least four years to complete.”³² Some cases are probably delayed because participants feel they are being treated unfairly. Moreover, trust for the IRS is correlated with voluntary tax

29 LB&I response to TAS information request (Apr. 18, 2017). LB&I subsequently stated: “IRS has consistently indicated the annual [FBAR] report to Congress must be cleared by Treasury before the report can be released. As clarification, IRS is delegated the authority to prepare the report. But Treasury releases the report. For example: FinCEN is responsible for issuing the annual FBAR report but FinCEN has delegated that authority to the IRS. The IRS prepares the annual FBAR report, coordinates with FinCEN, and then submits the reports to Main Treasury. Main Treasury is ultimately responsible for submitting the report to Congress.” LB&I response to TAS fact check (June 7, 2017).

30 See Joseph J. Thorndike, *Annual Regulation of Business Focus: Reorganization of the Internal Revenue Service: Reforming the Internal Revenue Service: A Comparative History*, 53 ADMIN. L. REV. 717, 718 (2001) (emphasis added).

31 For example, the Coalition for Effective and Efficient Tax Administration (CEETA) agrees with the statement in IRS Pub. 5125, *LB&I Examination Process* (2016), that examinations “can be efficient if the examination team and the taxpayer work together in a spirit of cooperation, responsiveness, and transparency.” CEETA, *CEETA Addresses Changes Under Way in LB&I Division*, 2016 TNT 140-13 (July 21, 2016). Similarly, the OECD has noted that to improve regulation, member countries should “[E]nsure that administrative procedures for applying regulations and regulatory decisions are transparent...” Regulatory and Policy Division of the OECD, *OECD Guiding Principles on Regulatory Quality and Performance* 5 (Apr. 25, 2005), <http://www.oecd.org/dataoecd/24/6/34976533.pdf>.

32 Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2016-30-030, *Improvements Are Needed in Offshore Voluntary Disclosure Compliance and Processing Efforts* 12 (June 2, 2016), <https://www.treasury.gov/tigta/auditreports/2016reports/201630030fr.pdf>.

compliance.³³ Thus, additional transparency could help restore faith in the IRS, promote consistent results, speed case resolutions, and promote voluntary compliance.

FOCUS FOR FISCAL YEAR 2018

In Fiscal Year 2018, TAS will:

- Advocate for the IRS to disclose all of the OVDP-related rules and procedures it is following, along with any interpretations of them (*e.g.*, the OVDP Hotline Guide, training materials, and IRS Counsel's responses to questions about the OVDP FAQs), even if disclosure is not legally required;
- Advocate for the IRS to allow taxpayers to communicate directly with decision makers (*e.g.*, OVDP Technical Advisors and the Central Review Committee) to verify that they have considered all of the relevant facts, and can articulate a reasonable basis for their decisions; and
- Advocate for the IRS to disclose detailed summary statistics for the OVDP and streamlined programs (*e.g.*, the FBAR report to Congress and the OVDP Closed Case Reports) to help taxpayers determine if they are being treated like everyone else and to help stakeholders evaluate these programs.

33 National Taxpayer Advocate 2012 Annual Report to Congress vol. 2, 1-70 (Research Study: *Factors Influencing Voluntary Compliance By Small Businesses: Preliminary Survey Results*).

APPENDIX A: OVD AND STREAMLINED DATA THAT THE IRS DOES NOT WANT TO RELEASE: RESULTS AS OF DECEMBER 5, 2016³⁴

	2009 OVDP (as of Nov. 2013)	2011 OVDP (as of Sept. 2016)	2012 OVDP (as of Sept. 2016)	2014 OVDI (July 2014 to Sept. 2016)	Subtotal	Streamlined (as of Oct. 18, 2016)	Total
Cases							
Taxpayers							
Returns							
Tax							
Interest							
Accuracy Penalty							
Offshore Penalty							
Total Assessed							
Total Collected on Closed Cases							
Total Collected on Open and Closed Cases							

³⁴ LB&I response to TAS information request (Dec. 5, 2016). TAS could not tie these figures to the amounts announced by the IRS Commissioner on October 21, 2016. IRS, IR-2016-137, *Offshore Voluntary Compliance Efforts Top \$10 Billion; More Than 100,000 Taxpayers Come Back into Compliance* (Oct. 21, 2016), <https://www.irs.gov/uac/newsroom/offshore-voluntary-compliance-efforts-top-10-billion-more-than-100000-taxpayers-come-back-into-compliance>. Because the IRS does not regularly update this data, the information above is still the most current available.