



CRIMINAL VOLUNTARY DISCLOSURE

Changes to the IRS's Criminal Voluntary Disclosure Practice Requirements May Be Reducing Voluntary Compliance and Negatively Impacting the Tax Gap

WHY THIS IS A SERIOUS PROBLEM FOR TAXPAYERS

Some of the most severe and potentially life-altering tax penalties are in the criminal arena. Taxpayers who are caught filing false or fraudulent returns or failing to file altogether can face extremely high penalties. These penalties can be far more severe than civil penalties and lead to criminal prosecution.¹ In addition to the financial burden, they can result in the loss of civil rights, the potential for asset forfeiture, and even imprisonment. This makes the stakes particularly high for taxpayers who are noncompliant.

To mitigate the impact of severe penalties and encourage noncompliant taxpayers to come forward, the IRS has established voluntary disclosure programs. These programs offer the possibility of reduced penalties for taxpayers who voluntarily disclose their noncompliance. Often, these taxpayers are ones the IRS would not find on its own and include some taxpayers living “under the radar” as they have failed to file returns that might alert the IRS to their existence.

While the IRS has had a criminal voluntary disclosure practice (VDP) for decades, the VDP in its current form is not working as effectively as intended and the IRS's inability to track the progress of the VDP program makes it nearly impossible to determine its effectiveness. Lack of enthusiasm for the program is partly due to recent changes the IRS has implemented that have made taxpayers and tax professionals wary of using the program and many professionals uncomfortable recommending it to taxpayers.² The changes have made the program less accessible and effective, which discourages taxpayers from participating. As a result, fewer taxpayers are coming forward, and the program is failing to achieve its goal of encouraging voluntary compliance. When taxpayers perceive penalties for noncompliance as too severe, they may not come forward, thus creating a paradox where taxpayers are so fearful of the consequences that they may avoid coming into compliance altogether.

1 Although still civil, the penalty amounts involved where the taxpayer's conduct is considered more culpable are considerably higher. For example, IRC § 6662(b)(1) imposes a penalty equal to 20 percent of the underpayment where the taxpayer was negligent while IRC § 6663 imposes a penalty equal to 75 percent of the underpayment in cases where the taxpayer's conduct was fraudulent.

2 Conversations with outside stakeholders (Aug. 21, 22, and 28, 2024).

EXPLANATION OF THE PROBLEM

The U.S. tax system relies on taxpayers self-reporting and paying the amount of tax they owe with the understanding that they may incur several different penalties for failing to do so. Encouraging compliance is therefore essential as taxpayers voluntarily and timely pay approximately 85 percent of all taxes due.³ But sometimes the potential penalties associated with noncompliance are so severe that they may actually deter noncompliant taxpayers from coming into compliance.⁴ To alleviate this problem, the IRS has established the VDP to encourage noncompliant taxpayers to come forward by lessening some of the more drastic penalties and other impacts that the taxpayer would otherwise incur. However, over time, changes made by the IRS have arguably eroded taxpayer interest in the program, and very few taxpayers currently participate. Specifically:

- Changes made by the IRS to its criminal VDP discourage voluntary compliance and leave taxpayers in a quandary over whether and how to come into compliance; and
- The IRS's current VDP is not effectively encouraging voluntary compliance and therefore it can exacerbate the overall tax gap making it harder for the IRS to collect the taxes owed.⁵

The IRS must comprehensively track and evaluate its VDP and craft a program that makes it more appealing and effective by encouraging noncompliant taxpayers to come into compliance. A more user-friendly and less intimidating VDP would likely lead to increased participation and ensure that more noncompliant taxpayers pay what they owe. The IRS must design a program that balances penalty reduction with effective enforcement, ensuring both compliance and fairness in the system.

ANALYSIS

Changes Made by the IRS to Its Criminal Voluntary Disclosure Practice Discourage Voluntary Compliance and Leave Taxpayers in a Quandary

Background

Voluntary disclosure has long been part of the IRS's Criminal Investigation (CI) arm, and it provides taxpayers who may have criminal exposure with a means to come into compliance, pay past due taxes, and potentially avoid criminal prosecution.⁶ Voluntary disclosure programs are purely administrative programs offered by the IRS; there is no statutory provision for voluntary disclosures, but they serve an important administrative function and contribute to reducing the tax gap.⁷ The related administrative programs, policies, terms, and

3 The IRS recently measured compliance for tax year (TY) 2022 and determined that the voluntarily compliance rate (VCR) was about 85 percent for all federal taxes due each year. The VCR is defined as the amount of tax paid voluntarily and timely divided by total true tax, expressed as a percentage. For TY 2022, this translates to just over \$3.9 trillion collected through voluntary compliance. See IRS, Pub. 5869, Tax Gap Projections for Tax Year 2022, at 10 (Oct. 2024), <https://www.irs.gov/pub/irs-pdf/p5869.pdf>.

4 For an in-depth discussion of the IRS's current civil penalty administration and the effects on voluntary compliance, see Most Serious Problem: *Civil Penalty Administration: The IRS's Administration of Penalties Is Often Unfair, Is Inconsistently Deterring Improper Behavior, Is Not Promoting Efficient Administration, and Thus Is Discouraging Tax Compliance*, *supra*.

5 The tax gap is a measure of overall tax noncompliance. The gross tax gap is the amount of true tax liability for a given tax year that is not paid voluntarily and/or timely. See IRS, Pub. 5456, 2024 Agency Financial Report 111 (Nov. 2024), <https://www.irs.gov/pub/irs-pdf/p5456.pdf>. The projected annual gross tax gap for TY 2022 is \$696 billion, consisting of 1) \$63 billion due to nonfiling (tax not filed and paid on time); 2) \$539 billion due to underreporting (tax understated on timely returns); and 3) \$94 billion due to underpayment (tax reported but not paid on time). See IRS, Pub. 5869, Tax Gap Projections for Tax Year 2022 (Oct. 2024), <https://www.irs.gov/pub/irs-pdf/p5869.pdf>.

6 Internal Revenue Manual (IRM) 9.5.11.9(1), Voluntary Disclosure Practice (Sept. 17, 2020), https://www.irs.gov/irm/part9/irm_09-005-011.

7 Part of the IRS's penalty policy provides that "[i]n limited circumstances where doing so will promote sound and efficient tax administration, the Service may approve a reduction of otherwise applicable penalties or penalty waiver for a group or class of taxpayers as part of a Service-wide resolution strategy to encourage efficient and prompt resolution of cases of noncompliant taxpayers." IRM 1.2.1.12.1(7), Policy Statement 20-1 (Formerly P-1-18), Penalties Are Used to Enhance Voluntary Compliance (June 29, 2004), https://www.irs.gov/irm/part1/irm_01-002-001. Voluntary disclosure programs are consistent with this.

conditions are completely at the IRS's discretion.⁸ Like civil penalty administration, criminal voluntary disclosure programs involve a difficult balancing of objectives.⁹ Although voluntary disclosure does not create substantive or procedural rights for taxpayers or guarantee amnesty or immunity, it has long existed as a key factor in determining whether the IRS will recommend criminal prosecution.¹⁰

VDP procedures were traditionally informal. The IRS's voluntary disclosure protocols did not require any particular format for voluntary disclosure communications, and taxpayers could make them orally or in writing as long as they met the voluntary disclosure requirements.¹¹ The IRS considered a taxpayer as making a voluntary disclosure when they made a communication that was truthful, timely, and complete and when they cooperated with the IRS in determining their correct tax liability and made good faith arrangements to pay in full the tax, interest, and any penalties determined by the IRS to be applicable.¹²

In practice, practitioners report that the VDP process was fairly simple: contact CI and if the taxpayer was not already on the IRS's radar, file true and correct tax returns and pay the taxes, interest, and penalties, if any. It is our understanding that in the past many practitioners simply followed the qualified amended return (QAR) rules of Treas. Reg. § 1.6664-2(c)(3) to satisfy the VDP requirements.¹³ Although the IRS had the ability to examine the returns, practitioners report that it audited few taxpayers and did not require the taxpayer to agree to the civil fraud penalty.¹⁴ The IRS processed the returns, cashed the checks, and got the taxpayers into the system. The program was accomplishing its long-standing goal of providing taxpayers with criminal exposure a means to come into tax compliance and potentially avoid criminal prosecution with the goal of past, present, and future compliance. The program had guardrails such as excluding those with illegal income, and it was conditioned on taxpayers making truthful, timely, and complete disclosures prior to the commencement of a civil examination, criminal investigation, or receipt of third-party information by the IRS.

8 For a discussion and history on the IRS's VDP and a recommendation for codification of the program, see Jay A. Soled, *The IRS's Voluntary Disclosure Program: Need For Codification*, 37 GA. ST. U. L. REV. 957 (2021).

9 See *id.* (stating that "[h]istorically, the voluntary disclosure program has had to strike a difficult balance between being attractive enough to entice tax scofflaws to participate and not being too attractive lest ordinary taxpayers feel that their compliance efforts were for naught"). For a discussion on the objectives of civil tax penalties and IRS's civil penalty administration, see Most Serious Problem: *Civil Penalty Administration: The IRS's Administration of Penalties Is Often Unfair, Is Inconsistently Deterring Improper Behavior, Is Not Promoting Efficient Administration, and Thus Is Discouraging Tax Compliance*, *supra*.

10 Prior to 1952, the Treasury Department refrained from recommending prosecution of taxpayers who voluntarily disclosed their tax violations if the disclosure was timely, truthful, and complete, and the taxpayer cooperated with the IRS in determining their correct tax liability. However, this policy was officially abandoned on January 10, 1952, and the IRS's practice became that which exists today – the IRS will consider a voluntary disclosure along with all other factors in the case in determining whether it will recommend criminal prosecution. See IRM 342.141, Background (Apr. 10, 1990) (as in effect Oct. 1997), 1997 WL 34656668. See also IRS News Release, IR-92-114, IRS Says Nonfilers Who Come Forward Are Not Prosecuted (Dec. 7, 1992), <https://www.unclefed.com/Tax-News/1992/Nr92-114.html> (stating that "[w]hile the IRS will not assure that it would never, under any circumstances, recommend the criminal prosecution of an individual who comes forward voluntarily to report the failure to file ... tax returns, the IRS' practice has been not to do so where the person: a. informed the IRS that he/she has not filed tax returns for one of more taxpayer periods; b. had only legal source income ...; c. made the disclosure prior to being contacted by the IRS ...; d. either filed a true and correct tax return or cooperated with the IRS in ascertaining the correct tax liability; and, e. either paid in full the amount due or, in those situations where the taxpayer was unable to make full payment, made *bona fide* arrangements to pay.").

11 IRM 9.5.11.9.1(1), Voluntary Disclosure Protocols (Sept. 9, 2004) (on file with TAS).

12 IRM 9.5.11.9(3), Voluntary Disclosure Practice (Sept. 9, 2004) (on file with TAS). Prior IRM provisions did not include the requirement regarding payment. See, e.g., IRM 342.142(3), Guidelines (Aug. 25, 1995) (as in effect Oct. 1997), 1997 WL 34656668.

13 Conversations with outside stakeholders (Aug. 22 and 28, 2024). A QAR is an amended return filed after the due date and before the date on which the IRS contacts the taxpayer regarding an examination; the IRS contacts any person described in IRC § 6700 (relating to tax shelters) about an examination for an activity which the taxpayer claimed any tax benefit under IRC § 6700(a)(1)(A); the IRS contacts a pass-through entity in connection with an examination of a return to which the pass-through item relates; or the IRS serves a John Doe summons under IRC § 7609(f) regarding the taxpayer's tax liability. Treas. Reg. § 1.6664-2(c)(3). The effect of a QAR is that the additional amount shown on the QAR is not subject to the IRC § 6662 accuracy-related penalty. Treas. Reg. § 1.6664-2(c)(2). While a QAR protects taxpayers against IRC § 6662 accuracy-related penalties on the underpayment disclosed in the return, it does not protect against fraud penalties if the underpayment relates to a fraudulent position on the original return. See Treas. Reg. § 1.6664-2(c)(2). Many tax practitioners advise their clients to file QARs if the client is not in danger of a criminal proceeding.

14 Conversations with outside stakeholders (Aug. 21, 22, and 28, 2024).

Targeted Voluntary Disclosure Programs

In the early 2000s, the IRS initiated targeted voluntary disclosure programs to address specific areas of noncompliance.¹⁵ In 2003, in response to increasing noncompliance due to unreported offshore income activities, it initiated an offshore voluntary compliance initiative specifically targeting taxpayers with credit cards linked to unreported offshore bank accounts.¹⁶ The IRS then administered other offshore voluntary disclosure programs (OVDs) in 2009, 2011, 2012, and 2014. These were formal programs with uniform requirements including specific procedures, a specified disclosure period, and a standard penalty structure. With each iteration, the program’s participation requirements generally increased along with the amount of the penalties. Figure 2.10.1 shows the requirements of the programs in 2009-2014 program.

FIGURE 2.10.1, Offshore Voluntary Disclosure Program Requirements and Proceeds, 2009, 2011, 2012, and 2014¹⁷

Year	Filing Requirements	Penalty Structure/Rate	Additional Details	Amounts Collected as of June 28, 2024
2009	Accurate filing of the prior six years of income tax returns and Reports of Foreign Bank and Financial Accounts (FBARs) (2003–2008)	Either an accuracy and/or delinquency penalty on all years AND miscellaneous offshore penalty of 20% of the amount in foreign bank accounts/entities in the year with the highest aggregate/account value	-	\$4.2 bil
2011	Accurate filing of the prior eight years of income tax returns and FBARs (2003–2010)	Either an accuracy or delinquency penalty on all years AND miscellaneous offshore penalty of 25% of the amount in foreign bank accounts/entities in the year with the highest aggregate/account value	-	\$2.5 bil

15 These targeted programs were in addition to the standard VDP. IRS News Release, IR-2003-5, IRS Unveils Offshore Voluntary Compliance Initiative; Chance for “Credit-Card Abusers” to Clear Up Their Tax Liabilities (Jan. 14, 2003), <https://www.irs.gov/newsroom/irs-unveils-offshore-voluntary-compliance-initiative-chance-for-credit-card-abusers-to-clear-up-their-tax-liabilities>.

16 *Id.* See also Government Accountability Office (GAO), GAO 13-318, *Offshore Tax Evasion: IRS Has Collected Billions of Dollars, But May Be Missing Continued Evasion* 36 (Mar. 2013), <https://www.gao.gov/assets/gao-13-318.pdf>.

17 Figure 2.10.1 uses information from the following sources: Jay A. Soled, *The IRS’s Voluntary Disclosure Program: Need For Codification*, 37 GA. ST. U. L. REV. 957, 975-977, 998 (2021); GAO, GAO 13-318, *Offshore Tax Evasion: IRS Has Collected Billions of Dollars, But May Be Missing Continued Evasion* (Mar. 2013), <https://www.gao.gov/assets/gao-13-318.pdf>; National Taxpayer Advocate 2014 Annual Report to Congress 79 (Most Serious Problem: *Offshore Voluntary Disclosure (OVD): The OVD Programs Initially Undermined the Law and Still Violates Taxpayer Rights*, https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/08/2014-ARC_VOL-1_S1_MSP-7-508.pdf; IRS, LB&I-09-1118-014, Memorandum For Division Commissioners Chief, Criminal Investigation, (Nov. 20, 2018), reprinted at *IRS Updates Voluntary Disclosure Practice*, TAX NOTES (Nov. 20, 2018), <https://www.taxnotes.com/research/federal/other-documents/other-irs-documents/irs-updates-voluntary-disclosure-practice/28mzj>; Memorandum from Linda E. Stiff, Deputy IRS Comm’r for Servs. & Enf’t, to Comm’r, Large & Mid-Size Bus. Div., and Comm’r, Small Bus./Self-Employed Div. (Mar. 23, 2009), https://www.irs.gov/pub/newsroom/memorandum_authorizing_penalty_framework.pdf; IRS News Release, IR-2011-14, Second Special Voluntary Disclosure Initiative Opens; Those Hiding Assets Offshore Face Aug. 31 Deadline (Feb. 8, 2011), <https://www.irs.gov/newsroom/second-special-voluntary-disclosure-initiative-opens-those-hiding-assets-offshore-face-aug-31-deadline>; IRS News Release, IR-2012-5, IRS Offshore Programs Produce \$4.4 Billion To Date for Nation’s Taxpayers; Offshore Voluntary Disclosure Program Reopens (Jan. 9, 2012), <https://www.irs.gov/newsroom/irs-offshore-programs-produce-4-4-billion-to-date-for-nations-taxpayers-offshore-voluntary-disclosure-program-reopens>. The amount collected is based upon an IRS response to TAS information request (Oct. 15, 2024). In the 2011, 2012, and 2014 programs, offshore accounts or assets that did not exceed \$75,000 in any of the applicable years would qualify for a 12.5 percent penalty in lieu of the miscellaneous offshore penalty. In limited situations taxpayers may qualify for a five percent penalty in lieu of the miscellaneous offshore penalty.

Most Serious Problem #10: Criminal Voluntary Disclosure

2012	Accurate filing of the prior eight years of income tax returns and FBARs	Either an accuracy or delinquency penalty on all years AND miscellaneous offshore penalty of 27.5% of the amount in foreign bank accounts/entities in the year with the highest aggregate/account value	No set deadline to apply and terms of the program can change at any time The IRS introduced a separate streamlined program that allowed qualifying taxpayers to resolve their tax issues with no penalties	\$3.7 bil
2014	Accurate filing of the prior eight years of income tax returns and FBARs	Either an accuracy or delinquency penalty on all years AND miscellaneous offshore penalty of 27.5% of the amount in foreign bank accounts/entities in the year with the highest aggregate/account value (or 50% in certain situations involving an IRS/ Department of Justice investigation)	The IRS expanded the streamlined program to include non-willful taxpayers residing in the United States and remove other eligibility requirements	\$2.0 bil

The 2014 OVDP was the last targeted voluntary disclosure program aimed solely at offshore noncompliance. Due to declining participation, the IRS closed the OVDP on September 28, 2018.¹⁸

Current Voluntary Disclosure Program

After the IRS terminated the 2014 OVDP, it announced new VDP guidelines that changed the traditional voluntary disclosure practice.¹⁹ These guidelines are applicable to all voluntary disclosures made after September 28, 2018, and do not target a specific area of noncompliance.²⁰ The objective of the VDP is “to provide taxpayers concerned that their conduct is willful or fraudulent, and that may rise to the level of tax and tax-related criminal acts, with a means to come into compliance with the law and potentially avoid criminal prosecution.”²¹ To this end, if a taxpayer makes a timely voluntary disclosure prior to the IRS identifying them, they may avoid criminal prosecution and mitigate exposure to civil tax penalties.²² As with the prior VDP, while a voluntary disclosure does not automatically mean immunity from prosecution, the IRS will consider the disclosure in deciding whether to recommend prosecution.²³

To participate in the VDP, taxpayers must make a timely, accurate, and complete voluntary disclosure regarding their noncompliance.²⁴ To be timely, taxpayers must make the disclosure before the IRS has information about their noncompliance (*i.e.*, before the IRS has started a civil or criminal examination, received information from a third party regarding their noncompliance, or received information directly related to their noncompliance from a criminal enforcement action such as a subpoena or search warrant).²⁵

18 IRS response to TAS information request (Oct. 15, 2024). The IRS recently initiated targeted voluntary disclosure programs with respect to abuses surrounding the Employee Retention Credit (ERC). As these are specifically targeted to ERC claims and are separate from the general VDP, we do not discuss them here. For a detailed discussion on the ERC, see Most Serious Problem: *Employee Retention Credit: IRS Processing Delays Are Resulting in Uncertainty and Are Harming and Frustrating Business Owners*, *supra*.

19 IRS, LB&I-09-1118-014, Memorandum For Division Commissioners Chief, Criminal Investigation, (Nov. 20, 2018), reprinted at *IRS Updates Voluntary Disclosure Practice*, TAX NOTES (Nov. 20, 2018), <https://www.taxnotes.com/research/federal/other-documents/other-irs-documents/irs-updates-voluntary-disclosure-practice/28mzl>.

20 *Id.*

21 *Id.* This encompasses domestic and/or offshore noncompliance.

22 *Id.* Mitigation of civil penalties occurs through the VDP penalty structure.

23 IRM 9.5.11.9(3), Voluntary Disclosure Practice (Sept. 17, 2020), https://www.irs.gov/irm/part9/irm_09-005-011. Stakeholders note that the IRS did not refer taxpayers they represented for prosecution if they completed the VDP. Conversations with outside stakeholders (Aug. 22 and 28, 2024). As a practical matter, if taxpayers fully cooperate and complete the program, the taxpayers and the IRS enter into a closing agreement for the tax years at issue, thus foreclosing the possibility of criminal prosecution except in the event of fraud. As of October 15, 2024, the IRS reports that it has not referred any taxpayers who applied to participate in the current VDP (*i.e.*, beginning in 2018) to CI for investigation. IRS response to TAS information request (Oct. 15, 2024).

24 See IRM 9.5.11.9(6), Voluntary Disclosure Practice (Sept. 17, 2020), https://www.irs.gov/irm/part9/irm_09-005-011.

25 See *id.*

The rationale for this is obvious – if the IRS already knows about a taxpayer or their discovery is anticipated or imminent, their disclosure is arguably not really voluntary. Taxpayers must submit (or amend) all returns and reports for the disclosure period, which generally includes the six most recent tax years, if applicable.²⁶ The IRS will examine the disclosure and determine all tax, penalties, and interest due. It will impose the 75 percent civil fraud penalty (either IRC §§ 6651(f)(1) or 6663) on the year with the highest tax liability; accuracy-related penalties (IRC § 6662) and failure-to-file and failure-to-pay penalties (IRC §§ 6651(a)(1) and (a)(2)) will not apply.²⁷ Taxpayers must also cooperate with the IRS to determine their tax liabilities and pay the tax, interest, and penalties they owe.²⁸

Taxpayers make a voluntary disclosure by submitting Part I – Preclearance Request, of Form 14457, Voluntary Disclosure Practice Preclearance Request and Application.²⁹ IRS CI reviews Part I and determines whether a taxpayer is eligible. If eligible, CI sends a preclearance letter to the taxpayer, but preclearance does not guarantee the IRS will accept a taxpayer into the VDP.³⁰ Taxpayers must then complete and submit Part II of the Form 14457 – Voluntary Disclosure within 45 days. After review, if CI approves the taxpayer to participate in the VDP, it sends a Preliminary Acceptance Letter and sends the case to the IRS’s civil section for examination.³¹ Preliminary acceptance means just that, however. The IRS can revoke the preliminary acceptance if it determines that a taxpayer fails to timely and fully cooperate with the civil examination.³² The IRS specifies that cooperation includes but is not limited to:

- Promptly and fully responding to all information document requests;
- Submitting to interviews and providing access to related party witnesses;
- Providing statute extensions or waivers as necessary for tax and tax-related issues;
- Providing signed delinquent or amended returns, information returns, supporting documents, workpapers, etc.;
- Providing unrestricted instructions to foreign banks to provide full and complete records (for offshore cases);
- Resolving all compliance matters covered by the disclosure agreement; and
- Full payment of all determined taxes, additions to tax, interest, and penalties; or entrance into a payment arrangement acceptable to the IRS.³³

If the IRS determines that a taxpayer has failed to meet any of the above conditions, the IRS examiner can request that CI revoke the taxpayer’s preliminary acceptance. If revoked, the taxpayer can no longer benefit from the VDP limited scope (*i.e.*, disclosure period) or penalty structure. Therefore, the IRS can expand the scope of the examination to all noncompliance years and assert the 75 percent fraud penalty against taxpayers for all years

26 See IRM 9.5.11.9(6), Voluntary Disclosure Practice (Sept. 17, 2020), https://www.irs.gov/irm/part9/irm_09-005-011; IRS, Instructions for Form 14457, Voluntary Disclosure Practice Preclearance Request and Application (Nov. 2024), <https://www.irs.gov/pub/irs-pdf/f14457.pdf>.

27 IRS, LB&I-09-1118-014, Memorandum For Division Commissioners Chief, Criminal Investigation, (Nov. 20, 2018), reprinted at IRS Updates Voluntary Disclosure Practice, TAX NOTES (Nov. 20, 2018), <https://www.taxnotes.com/research/federal/other-documents/other-irs-documents/irs-updates-voluntary-disclosure-practice/28mzl>. See also IRM 4.63.3.26.2, Penalty Framework (Apr. 27, 2021), https://www.irs.gov/irm/part4/irm_04-063-003r. The IRS will impose a willful FBAR penalty if applicable. While this is the general penalty structure, examiners still maintain discretion.

28 See IRM 9.5.11.9(6), Voluntary Disclosure Practice (Sept. 17, 2020), https://www.irs.gov/irm/part9/irm_09-005-011.

29 See IRS, IRS Criminal Investigation Voluntary Disclosure Practice, How to Disclose, <https://www.irs.gov/compliance/criminal-investigation/irs-criminal-investigation-voluntary-disclosure-practice> (Nov. 7, 2024); see also IRS, Form 14457, Voluntary Disclosure Practice Preclearance Request and Application (Nov. 2024), <https://www.irs.gov/pub/irs-pdf/f14457.pdf>.

30 See IRS, IRS Criminal Investigation Voluntary Disclosure Practice, How to Disclose, <https://www.irs.gov/compliance/criminal-investigation/irs-criminal-investigation-voluntary-disclosure-practice> (Nov. 7, 2024).

31 IRM 9.5.11.9.1, Voluntary Disclosure Process (Feb. 6, 2024), https://www.irs.gov/irm/part9/irm_09-005-011.

32 IRM 9.5.11.9.7, Revocation of Voluntary Disclosure (Sept. 17, 2020), https://www.irs.gov/irm/part9/irm_09-005-011.

33 See IRM 4.63.3.26.1(4), Voluntary Disclosure Practice Requirements (Apr. 27, 2021), https://www.irs.gov/irm/part4/irm_04-063-003r; IRS, Instructions for Form 14457, Voluntary Disclosure Practice Preclearance Request and Application (Nov. 2024), <https://www.irs.gov/pub/irs-pdf/f14457.pdf>.

of noncompliance.³⁴ As the VDP creates no substantive or procedural rights for taxpayers, “CI’s determinations, including but not limited to determinations concerning timeliness, completeness, truthfulness, rejection, and revocation decisions, are not subject to any administrative or judicial review or appeal process.”³⁵

The IRS’s Revisions to the Voluntary Disclosure Practice Have Made It Much Less Attractive to Taxpayers, Resulting in Fewer Participants Coming Into Compliance

Unfortunately, in 2018, the IRS incorporated many of the 2014 OVDP disclosure requirements into the IRS’s traditional VDP. These changes imposed severe unfavorable disclosure requirements on taxpayers willing to “come in from the cold” to file true and correct tax returns. In this regard, the IRS imposed a strict penalty structure and burdensome filing requirements not present in the prior VDP. Figure 2.10.2 shows the requirements of the current VDP announced in 2018.

FIGURE 2.10.2, Current VDP Requirements³⁶

Year	Filing Requirements	Penalty Structure/Rate	Additional Details	Amounts Collected as of June 28, 2024
2018	Accurate filing of the prior six years of income tax returns and FBARs	In lieu of accuracy-related and delinquency penalties, the civil fraud (IRC § 6663) or fraudulent failure-to-file (IRC § 6651(f)) penalty of 75% for the period with the highest tax liability will be applied; willful FBAR penalty if applicable	Program for voluntary compliance to provide taxpayers with criminal exposure a means to come into compliance with the law and potentially avoid criminal prosecution	No collection reports are generated for VDP

When compared to Figure 2.10.1, Figure 2.10.2 reflects that the requirements announced in 2018 changed the VDP from an informal program with no set disclosure period or penalties to one with strict procedures and timeframes and a penalty structure that is significantly harsher than any in the OVDPs. And where taxpayers could previously cooperate with the IRS to determine appropriate penalties based upon their individual circumstances under the prior VDP, taxpayers must accept a 75 percent civil fraud penalty on the year with the highest tax liability in the revised VDP.³⁷ This penalty is significantly higher than before and has caused many to question whether the program is worth entering. This one-size-fits-all penalty structure, which applies regardless of the taxpayer’s specific circumstances, is inappropriate. The 75 percent fraud penalty can be devastating, and for many taxpayers, the penalty is too severe to make participation in the program attractive.

The 2018 changes are significant departures from the prior VDP, and these new procedures and requirements are burdensome, which negatively impacts the program from the perspective of taxpayers and practitioners.³⁸ As the targeted OVDPs addressed a specific type of conduct, a one-size-fits-all penalty structure was arguably appropriate. However, that may not necessarily be the case in VDP. To encourage voluntary compliance, the IRS should review the current VDP, determine whether the penalty structure is deterring participation in the VDP, and reconsider the 75 percent civil fraud penalty with the goal of encouraging noncompliant taxpayers to enter the program without discouraging compliant taxpayers from maintaining their compliance.

34 See IRM 4.63.3.26.1(6), Voluntary Disclosure Practice Requirements (Apr. 27, 2021), https://www.irs.gov/irm/part4/irm_04-063-003r.
 35 IRM 9.5.11.9(4), Voluntary Disclosure Practice (Sept. 17, 2020), https://www.irs.gov/irm/part9/irm_09-005-011.
 36 See IRS, LB&I-09-1118-014, Memorandum For Division Commissioners Chief, Criminal Investigation, (Nov. 20, 2018), reprinted at *IRS Updates Voluntary Disclosure Practice*, TAX NOTES (Nov. 20, 2018), <https://www.taxnotes.com/research/federal/other-documents/other-irs-documents/irs-updates-voluntary-disclosure-practice/28mzj>; IRM 9.5.11.9.1(1), Voluntary Disclosure Practice (Feb. 6, 2024), https://www.irs.gov/irm/part9/irm_09-005-011; IRS, Instructions for Form 14457, Voluntary Disclosure Practice Preclearance Request and Application (Nov. 2024), <https://www.irs.gov/pub/irs-pdf/f14457.pdf>.
 37 See IRM 4.63.3.26.2, Penalty Framework (Apr. 27, 2021), https://www.irs.gov/irm/part4/irm_04-063-003r.
 38 Conversations with outside stakeholders (Aug. 22 and 28, 2024).

The Addition of a New Checkbox on the Voluntary Disclosure Practice Form Has Taxpayers Concerned Their Application Could Result in Criminal Culpability If the IRS Does Not Accept Them Into the Program

Changes to Form 14457 requirements only served to make the VDP even more formal and burdensome and less attractive to taxpayers, causing the program to lose much of its effectiveness.³⁹ One of the most controversial changes is the addition of the new “willfulness checkbox” on Form 14457. Since June 2024, taxpayers must explicitly admit under penalty of perjury that they were willful in their actions that led to their noncompliance. Taxpayers and practitioners describe this requirement as a game-changer for the program as they are concerned about the legal implications of making such an admission before the IRS accepts them into the program.⁴⁰

The IRS issued the first revision to Form 14457 used in the current VDP program in March 2019.⁴¹ It has revised the form several times since (most recently in March, June, September, and November 2024), added FAQs in March 2024, and updated its VDP website most recently in November 2024.⁴² Although the IRS made some significant changes to Form 14457, it made them quietly without public announcement, leaving many practitioners and taxpayers unaware.⁴³ This lack of transparency has created confusion and frustration and caused many taxpayers and practitioners to navigate a more complex and burdensome process without proper guidance. The IRS’s decision not to publicize the changes is concerning and impacts the taxpayer *right to be informed*.⁴⁴ More disturbing, however, is the perception from taxpayers and practitioners that the IRS is applying the changes retroactively, thus “changing the rules” on taxpayers midstream who entered the program in good faith prior to the changes.⁴⁵

The IRS steadfastly maintains that it has made “no changes” to the program since its inception in 2018, and accordingly, it is not applying anything retroactively.⁴⁶ However, the IRS cannot dispute that it made revisions to Form 14457.⁴⁷ Taxpayers and practitioners perceive that the effects of these revisions are resulting in changes to the program, both in theory and practice.⁴⁸ Instead of encouraging taxpayers to come forward voluntarily, the changes have made it harder for noncompliant taxpayers to make a successful disclosure. The increased complexity, higher penalties, and fear of criminal prosecution have created a deterrent effect, undermining the VDP’s goal of encouraging compliance and reducing the tax gap.

39 Conversations with outside stakeholders (Aug. 22 and 28, 2024). See discussions on changes, *infra*.

40 Conversations with outside stakeholders (Aug. 22 and 28, 2024).

41 IRS response to TAS information request (Oct. 15, 2024).

42 See IRS, IRS Criminal Investigation Voluntary Disclosure Practice, <https://www.irs.gov/compliance/criminal-investigation/irs-criminal-investigation-voluntary-disclosure-practice> (Nov. 7, 2024); IRS, Instructions for Form 14457, Voluntary Disclosure Practice Preclearance Request and Application (Nov. 2024), <https://www.irs.gov/pub/irs-pdf/f14457.pdf>.

43 Andrew Velarde, *Voluntary Disclosure Form Changes Could Threaten Practice*, TAX NOTES (Sept. 3, 2024), <https://www.taxnotes.com/tax-notes-today-federal/penalties/voluntary-disclosure-form-changes-could-threaten-practice/2024/09/03/715q9>.

44 See Taxpayer Bill of Rights (TBOR), <https://www.taxpayeradvocate.irs.gov/taxpayer-rights> (last visited Sept. 4, 2024). The rights contained in TBOR are also codified in IRC § 7803(a)(3).

45 Practitioners have cited instances where they believe that the IRS is applying the changes it made to the Form 14457 retroactively to taxpayers who had already received preliminary acceptance letters and has threatened to revoke the preliminary acceptance if taxpayers do not comply with the new requirements, including admitting willfulness and making full payment. Conversations with outside stakeholders (Aug. 22 and 28, 2024). See also Andrew Velarde, *Voluntary Disclosure Form Changes Could Threaten Practice*, TAX NOTES (Sept. 3, 2024), <https://www.taxnotes.com/tax-notes-today-federal/penalties/voluntary-disclosure-form-changes-could-threaten-practice/2024/09/03/715q9>.

46 IRS response to TAS information request (Oct. 15, 2024).

47 See Andrew Velarde, *Voluntary Disclosure Form Changes Could Threaten Practice*, TAX NOTES (Sept. 3, 2024), <https://www.taxnotes.com/tax-notes-today-federal/penalties/voluntary-disclosure-form-changes-could-threaten-practice/2024/09/03/715q9> (stating that “[t]he IRS told Tax Notes that the changes were made to address several issues the agency was seeing once taxpayers were approved to enter the VDP”).

48 Conversations with outside stakeholders (Aug. 22 and 28, 2024).

According to taxpayers and practitioners, the most significant change to the VDP process is requiring taxpayers to affirmatively confess to willfulness. Previously, the IRS only required the taxpayer to make a statement of facts surrounding their noncompliance.⁴⁹ However, in June 2024, the IRS added a checkbox requirement regarding willfulness. Taxpayers must now explicitly admit “I was willful in the actions that led to my tax noncompliance and understand that willfulness is a requirement to be considered for entry into the VDP.”⁵⁰ Taxpayers must make this admission “under penalties of perjury” before the IRS even preliminarily accepts them into the VDP. If they fail to check the box, the IRS will automatically deny acceptance into the VDP without appeal or reinstatement.⁵¹

While taxpayers and practitioners see this willfulness admission as a game-changer, the IRS maintains that this is not a change at all. Rather, the IRS states that willfulness has always been a requirement for participation in the VDP.⁵² The IRS does not define willful on Form 14457 and provides no assurances or expectations that it will accept the taxpayer into the program if they admit willfulness. However, the IRS added an FAQ to its website in March 2024 that states: “Willfulness is not simply making a mistake. It is the intentional, purposeful, deliberate act to hide income or assets and therefore evade filing requirements or payment of tax.”⁵³ According to the IRS, VDP is a compliance option only for those taxpayers “who have willfully failed to comply with tax or tax-related obligations or committed tax or tax-related crimes and have criminal exposure due to their willful violation of the law.”⁵⁴ Therefore, the IRS says if the violation of the law was not willful, taxpayers should not be in the VDP.⁵⁵

While the IRS maintains that it has always required admission of willfulness for entry into the VDP, taxpayers and practitioners are understandably wary of the implications of this new requirement to check the box. Taxpayers question if they are admitting to a civil or criminal standard of willfulness and if criminal, whether the IRS will use this admission against them in a potential criminal prosecution if it does not approve them for the program or it subsequently revokes their preliminary acceptance. Taxpayers also question the purpose of the admission if they are willing to come into compliance by voluntarily disclosing their potentially criminal noncompliance, filing their returns, and paying the liability. Should this not be the IRS’s overall goal with the VDP – to bring taxpayers into the system, reduce the tax gap, and encourage voluntary compliance?

TAS asked the IRS these questions, but the IRS’s responses probably will not quell the concerns of taxpayers and practitioners. TAS pointedly asked the IRS: “Does the IRS consider the willfulness standard to which taxpayers are required to admit [the] civil or criminal [standard]?” The IRS responded: “Intentional, purposeful, and or deliberate actions taken by the taxpayer that result in noncompliance are considered.”⁵⁶ This vague non-answer may only serve to reinforce taxpayer concerns regarding this affirmative admission. While the IRS did not clarify the nature of the willfulness standard of the required admission, it did confirm that it does use the taxpayer’s admission.⁵⁷ Specifically, the IRS stated that CI uses it to determine a taxpayer’s

49 See, e.g. prior Form 14457 (April 2020), Voluntary Disclosure Request Preclearance Request and Application, Part II - Voluntary Disclosure, 7.c. This remained unchanged in subsequent revisions in February 2022 and March 2024. While the *Non-Compliance Narrative* section stated: “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,” there was no requirement to affirmatively admit to willfulness.

50 See IRS, Form 14457, Voluntary Disclosure Practice Preclearance Request and Application (Nov. 2024), <https://www.irs.gov/pub/irs-pdf/f14457.pdf>. While the IRS added the willfulness box in June 2024, it has revised the form twice since then and retains the willfulness box as a requirement.

51 See *id.*

52 “Taxpayers have always been required to include in the narrative portion of Part II of Form 14457 an admission of their willful conduct.” IRS response to TAS information request (Oct. 15, 2024).

53 See IRS, IRS Criminal Investigation Voluntary Disclosure Practice, FAQ How Do I Know if I Was Willful in Not Complying With the Tax Laws? (added Mar. 20, 2024), <https://www.irs.gov/compliance/criminal-investigation/irs-criminal-investigation-voluntary-disclosure-practice>.

54 IRS response to TAS information request (Oct. 15, 2024).

55 *Id.*

56 *Id.*

57 *Id.*

eligibility for VDP, and the IRS’s civil section uses the affirmation in developing civil fraud and the willful FBAR penalty.⁵⁸ By affirming willfulness, taxpayers risk self-incriminating themselves, especially if the IRS decides to deny participation or revokes preliminary acceptance. Further, if it revokes a taxpayer’s preliminary acceptance, “the taxpayer remains under examination and the affirmation stays in the examination case file as direct evidence of willful conduct.”⁵⁹ Thus, it appears that the IRS does use this affirmation against taxpayers, and by making this affirmative admission of willfulness, taxpayers greatly simplify the IRS’s development of a fraud case against them.⁶⁰

The IRS asserts that it is not applying any program changes “retroactively” because it has not made any program changes. However, practitioners report that the IRS is applying this willfulness admission requirement retroactively and requiring the statement from taxpayers who were already in the VDP prior to the changes to Form 14457.⁶¹ The IRS is reportedly threatening taxpayers who are rightly balking at what they perceive to be a new program requirement with having their preliminary acceptance revoked (*i.e.*, removal from the VDP).⁶² It is not unreasonable for taxpayers to believe that in determining a taxpayer’s intent, a trier of fact in a criminal proceeding may likely attach more weight to the taxpayer’s affirmative admission of willfulness as evidenced by the checkbox compared to a response to a willfulness instruction on a narrative box buried on later pages of Form 14457. Requiring taxpayers to make an admission that could have serious legal implications without knowing the potential consequences is unfair, will certainly curtail the number of people willing to enter the VDP, and therefore is defeating the purpose of encouraging voluntary compliance.⁶³ In fact, practitioners have expressed their concerns that it may be borderline malpractice to recommend that their clients make this admission.⁶⁴ In light of this new requirement, many practitioners have expressed that they are less likely to recommend the VDP to clients as the changes add complexity and intimidation to the process. These changes have the opposite effect of compliance as it discourages taxpayers to comply and creates a situation where they are unsure whether coming forward is worth the potential consequences.⁶⁵

The willfulness admission may also have implications on penalty deviation. Prior to the 2018 changes to the VDP, there was no specific penalty structure. Under the 2018 changes, although there was a defined structure, taxpayers could request a deviation from it.⁶⁶ While this applied only in “exceptional” cases according to a

58 IRS response to TAS information request (Oct. 15, 2024).

59 *Id.*

60 The IRS bears the burden of proving fraud against a taxpayer. IRC § 7454(a). If a taxpayer affirmatively admits that their tax noncompliance was willful, the IRS’s burden is clearly much more easily met. As noted, since the affirmation remains in the file, it appears that the IRS could potentially use this admission in a criminal case if it revoked the taxpayer’s preliminary acceptance. Fraud has other implications besides the application of the 75 percent civil fraud penalty – it serves to keep the statute of limitations on assessment of tax open indefinitely. See IRC § 6501(c)(1), (2).

61 Conversations with outside stakeholders (Aug. 22 and 28, 2024).

62 *Id.* See also Andrew Velarde, *Voluntary Disclosure Form Changes Could Threaten Practice*, TAX NOTES (Sept. 3, 2024), <https://www.taxnotes.com/tax-notes-today-federal/penalties/voluntary-disclosure-form-changes-could-threaten-practice/2024/09/03/715g9> (quoting a practitioner who notes “many tax professionals discovered the willfulness change only after they had submitted a prior version of the form and were contacted during processing by an IRS employee asking for an admission of willfulness under threat of being removed from the VDP” and calling the process a “bait and switch”).

63 See Andrew Velarde, *Voluntary Disclosure Form Changes Could Threaten Practice*, TAX NOTES (Sept. 3, 2024), <https://www.taxnotes.com/tax-notes-today-federal/penalties/voluntary-disclosure-form-changes-could-threaten-practice/2024/09/03/715g9> (quoting a practitioner who notes that “[p]eople who were willful and have a fear of criminal prosecution are going to not want to come in because if there’s a risk that they don’t get accepted into the program, but they’ve checked the box that they’re willful now, they’re between a rock and a hard place”).

64 Conversations with outside stakeholders (Aug. 22 and 28, 2024).

65 *Id.*

66 For example, taxpayers could request application of the IRC § 6662 accuracy-related penalty rather than the IRC § 6663 fraud penalty. IRS, LB&I-09-1118-014, Memorandum For Division Commissioners Chief, Criminal Investigation, (Nov. 20, 2018), reprinted at *IRS Updates Voluntary Disclosure Practice*, TAX NOTES (Nov. 20, 2018), <https://www.taxnotes.com/research/federal/other-documents/other-irs-documents/irs-updates-voluntary-disclosure-practice/28mzl>.

prior IRS official, it did occur.⁶⁷ However, the new affirmative willfulness admission requirement appears to preclude the possibility of penalty deviation altogether. If taxpayers admit that they willfully failed to comply with the tax laws, it seems unlikely that they can then establish that their noncompliance was not willful for purposes of obtaining a lesser penalty.

The change also now leaves no gray area with respect to culpability. Taxpayers whose noncompliance was arguably negligent as opposed to criminal or who had justifiable defenses regarding their noncompliance arguably could enter the VDP in the past.⁶⁸ Now, however, if they do not admit that their noncompliance was willful, they cannot participate. Although taxpayers with offshore noncompliance issues have other options,⁶⁹ domestic taxpayers do not – they can either file their original or amended returns with the hope that the IRS does not examine them or do nothing and hope the IRS does not catch them. This results in disparate treatment for taxpayers with domestic noncompliance issues and taxpayers who were not willful being liable for far greater penalties than those who were actually criminal.⁷⁰ Thus, for VDP purposes, it appears that crime does pay as bad actors have a chance of getting a much better deal than less culpable taxpayers.

Not surprisingly, the IRS's new requirement that VDP applicants explicitly admit willfulness has already had a chilling effect on practitioners' perceptions of the VDP, eroded the program's goals, and discouraged voluntary compliance.⁷¹ The IRS should revise Form 14457 to remove the willfulness checkbox requirement for VDP.

Payment Inflexibility May Mean Fewer Taxpayers Can Afford to Participate in the Voluntary Disclosure Practice

Another significant concern raised by practitioners is the full payment requirement.⁷² Again, the IRS insists that this is not a change; the VDP always required taxpayers to fully pay the amount of tax, interest, and penalties the IRS determined due.⁷³ While the IRS has always expected taxpayers coming into the VDP to pay their liabilities in full, it acknowledged in the past that some taxpayers making voluntary disclosures

67 IRS, LB&I-09-1118-014, Memorandum For Division Commissioners Chief, Criminal Investigation, (Nov. 20, 2018), reprinted at *IRS Updates Voluntary Disclosure Practice*, TAX NOTES (Nov. 20, 2018), <https://www.taxnotes.com/research/federal/other-documents/other-irs-documents/irs-updates-voluntary-disclosure-practice/28mzl>. See also Andrew Velarde, *Voluntary Disclosure Form Changes Could Threaten Practice*, TAX NOTES (Sept. 3, 2024), <https://www.taxnotes.com/tax-notes-today-federal/penalties/voluntary-disclosure-form-changes-could-threaten-practice/2024/09/03/715g9> (wherein the former IRS official noted that they approved “several nonwillful no-fraud penalties during [the individual's] time at the agency”). While TAS requested the number of penalty deviations that the IRS granted, the IRS does not track the requests and recommendations for penalty deviations. IRS response to TAS information request (Oct. 15, 2024); IRS response to fact check (Nov. 21, 2024).

68 According to the IRS, VDP has always been only for taxpayers whose actions were criminal or who were willful in not complying with their obligations. IRS response to TAS information request (Oct. 15, 2024). Practitioners, however, report that taxpayers in this “gray” area previously participated in the program. Conversations with outside stakeholders (Aug. 22 and 28, 2024).

69 See, e.g., IRS, Delinquent FBAR Submission Procedures (Aug. 22, 2024), <https://www.irs.gov/individuals/international-taxpayers/delinquent-fbar-submission-procedures> (last visited Dec. 17, 2024); IRS Delinquent International Information Return Submission Procedures (Nov. 25, 2024), <https://www.irs.gov/individuals/international-taxpayers/delinquent-international-information-return-submission-procedures> (last visited Dec. 17, 2024); IRS, Streamlined Filing Compliance Procedures (July 9, 2024), <https://www.irs.gov/individuals/international-taxpayers/streamlined-filing-compliance-procedures> (last visited Sept. 21, 2024). See also Andrew Velarde, *Voluntary Disclosure Form Changes Could Threaten Practice*, TAX NOTES (Sept. 3, 2024), <https://www.taxnotes.com/tax-notes-today-federal/penalties/voluntary-disclosure-form-changes-could-threaten-practice/2024/09/03/715g9>.

70 For example, in the situation of a non-filer, the taxpayer will be liable for one civil fraud penalty at 75 percent for the highest tax year through VDP, in lieu of potential 20 percent accuracy-related penalties (IRC § 6662) each tax year and failure-to-file and failure-to-pay penalties totaling up to a combined 47.5 percent per tax year (IRC § 6651(a)(1) and (a)(2)) if they file delinquent returns outside of VDP. Depending on the amounts involved in the noncompliance, the financial implications of this can be staggering. Practitioners note that this lack of a viable alternative for taxpayers who wanted to resolve past tax noncompliance but whose noncompliance might not have risen to the criminal standard led them to VDP. However, the new willfulness admission requirement will most likely prevent these individuals from coming in now. See Andrew Velarde, *Voluntary Disclosure Form Changes Could Threaten Practice*, TAX NOTES (Sept. 3, 2024), <https://www.taxnotes.com/tax-notes-today-federal/penalties/voluntary-disclosure-form-changes-could-threaten-practice/2024/09/03/715g9>.

71 Conversations with outside stakeholders (Aug. 22 and 28, 2024).

72 *Id.* See also Andrew Velarde, *Voluntary Disclosure Form Changes Could Threaten Practice*, TAX NOTES (Sept. 3, 2024), <https://www.taxnotes.com/tax-notes-today-federal/penalties/voluntary-disclosure-form-changes-could-threaten-practice/2024/09/03/715g9>.

73 IRS response to TAS information request (Oct. 15, 2024).

would not have the ability to do so.⁷⁴ While the inability to fully pay was not fatal, the IRS noted that it was important for taxpayers to raise that issue early in the process.⁷⁵ Form 14457 reflects that taxpayers agreed to make “good faith arrangements to pay” all taxes, interest, and penalties. Consistent with this, in 2022, the IRS revised Form 14457 to include a checkbox for “Inability to pay in full” and instructions that specifically addressed the inability to pay in full.⁷⁶ While the June 2024 revision to Form 14457 still has the checkbox, the IRS deleted the “good faith” language from the signature section; and the IRS’s new FAQs state taxpayers must either pay in full or secure a full-pay installment agreement.⁷⁷ Further, practitioners report that the IRS is also applying this full pay requirement retroactively and threatening taxpayers who came into the program prior to the change to the payment language with removal if they cannot pay in full.⁷⁸

As with willfulness, there appears to be a disconnect between the IRS and taxpayers and tax practitioners regarding the requirements of the VDP. The IRS claims that the “inability to pay” means an inability to fully pay by the time that it completes the examination and that “full payment or an alternative full payment arrangement is required to close the case inside VDP with a Form 906 Closing Agreement.”⁷⁹ If taxpayers cannot pay in full and cannot reach an alternative full payment arrangement, the IRS revokes the taxpayer’s preliminary acceptance and closes the examination under standard examination procedures without consideration of the VDP settlement terms.⁸⁰ So, in the absence of full payment, taxpayers cannot benefit from the VDP’s limited scope (*i.e.*, disclosure period) or penalty structure. The IRS can expand the examination to all noncompliance years and assert the 75 percent fraud penalty against taxpayers for all years of noncompliance.⁸¹ The rationale behind this is unclear. If taxpayers are unable to pay the amount due under the VDP limited scope, how can they possibly pay even more? And how does this benefit tax administration if the IRS must invest more time and resources where it has already determined that it cannot collect? Would it not make more sense for the IRS to accept what the taxpayer can pay and get the taxpayer back into compliance for the future?

Whether or not this reflects a change, the full pay requirement gives the perception that the VDP is only for the wealthy or those that can afford it.⁸² Is this really a perception that the IRS wants to project? This policy serves to exclude taxpayers who want to come forward and resolve their tax noncompliance but are unable to fully pay their liability. This is not a policy that leads to voluntary compliance. Taxpayers outside of VDP have payment alternatives including partial payment installment agreements and offers in compromise.⁸³ Both of these programs acknowledge the reality that some taxpayers cannot pay their liabilities in full. While the IRS

74 See Andrew Velarde, *IRS Offers Insights on Voluntary Disclosure Cooperation*, TAX NOTES (Nov. 22, 2021), <https://www.taxnotes.com/taxpractice/penalties/irs-offers-insights-voluntary-disclosure-cooperation/2021/11/22/7cmbx>. This is especially true with respect to unpaid employment tax liabilities.

75 See Andrew Velarde, *IRS Offers Insights on Voluntary Disclosure Cooperation*, TAX NOTES (Nov. 22, 2021), <https://www.taxnotes.com/taxpractice/penalties/irs-offers-insights-voluntary-disclosure-cooperation/2021/11/22/7cmbx>; Nathan J. Richman, *IRS Updates Electronic Disclosure Form With Electronic Bent*, TAX NOTES (Feb. 21, 2022), <https://www.taxnotes.com/taxpractice/criminal-violations/irs-updates-voluntary-disclosure-form-electronic-bent/2022/02/21/7d6c8>.

76 See IRS, Instructions for Form 14457, Voluntary Disclosure Request Preclearance Request and Application 12 (Feb. 2022) (“A taxpayer who is unable to make full payment may request that the IRS consider other payment arrangements. . . . If the IRS determines that the inability to fully pay is genuine, the taxpayer must work out other financial arrangements, acceptable to the IRS, to resolve all outstanding liabilities. Additionally, any closing agreement resolving cases with less than [sic] full payment will require the waiver of collection due process rights.”).

77 IRS, *IRS Criminal Investigation Voluntary Disclosure Practice*, <https://www.irs.gov/compliance/criminal-investigation/irs-criminal-investigation-voluntary-disclosure-practice> (Nov. 7, 2024).

78 Conversations with outside stakeholders (Aug. 21, 22, and 28, 2024). See also Andrew Velarde, *Voluntary Disclosure Form Changes Could Threaten Practice*, TAX NOTES (Sept. 3, 2024), <https://www.taxnotes.com/tax-notes-today-federal/penalties/voluntary-disclosure-form-changes-could-threaten-practice/2024/09/03/715g9>.

79 IRS response to TAS information request (Oct. 15, 2024).

80 *Id.*

81 Outside of the VDP, the IRS could potentially also refer taxpayers for criminal prosecution.

82 Conversations with outside stakeholders (Aug. 22 and 28, 2024).

83 See IRS, Offer in Compromise, <https://www.irs.gov/payments/offer-in-compromise> (last updated Dec. 5, 2024); IRS, Additional Information on Payment Plans, <https://www.irs.gov/payments/payment-plans-installment-agreements> (last updated Nov. 12, 2024).

should continue to highly encourage full payment of all liabilities determined through VDP, it should also allow taxpayers to enter other non-full payment arrangements if they establish they cannot full pay all tax, penalties, and interest that the IRS determines is due.

To restore the effectiveness of the VDP and encourage voluntary compliance, the IRS should:

- Reevaluate the 75 percent civil penalty to determine if it is deterring participation and explore more flexible, case-by-case approaches to encourage more taxpayers to come forward;
- Remove the willfulness checkbox requirement or at least clarify its meaning and implications, ensuring it does not force taxpayers to make an admission that could have serious legal consequences;
- Increase transparency around any future changes to the VDP and its procedures, ensuring that taxpayers are well informed and can trust the process; and
- Consider more flexible payment options to make the program accessible to a wider range of taxpayers, particularly those who may not have the financial means to pay their full tax liability.

By addressing these issues, the IRS could make the VDP a more attractive and effective tool for encouraging tax compliance, ultimately reducing the tax gap.

Extensive Collection of Information About Digital Asset Transactions Is Burdensome

One additional notable change to the VDP procedures is the cryptocurrency reporting requirements. Part I, Line 13 of the updated Form 14457 requires taxpayers to provide significantly more information regarding digital assets than before.⁸⁴ The new requirements extend to transactions involving cryptocurrencies, stablecoins, and other digital assets, requiring taxpayers to report a far greater scope of activity than previously required. In addition to associated accounts or wallets, the IRS now requires “ALL domestic and foreign digital asset transactions related to tax noncompliance that you owned or controlled or were the beneficial owner of, either directly or indirectly” for the entire disclosure period.⁸⁵ The requirement to disclose every asset transaction and account associated with noncompliance for several years could amount to a huge volume of information that may take months to obtain and assemble.⁸⁶ Gathering this information, especially for taxpayers with extensive or complex cryptocurrency holdings, could be incredibly burdensome. The IRS requires this information prior to preclearance and acceptance into the program, which concerns taxpayers.⁸⁷ Providing such an extensive amount of potentially incriminating information at this stage will no doubt discourage taxpayers from coming into the VDP.⁸⁸ These changes, the harsh penalty structure, willfulness checkbox requirement, and rigid payment terms are significant deterrents.

The time this extensive information requires to gather could create delays in the VDP approval process, further discouraging taxpayers from coming forward. In some cases, taxpayers may decide that the process is too cumbersome and choose to stay out of the VDP altogether, which could lead to a greater exposure to

84 The IRS began requiring taxpayers to list virtual currency on the February 2022 revision to Form 14457. See, e.g. prior Form 14457, Voluntary Disclosure Practice Preclearance Request and Application (Feb. 2022).

85 IRS, Form 14457, Voluntary Disclosure Practice Preclearance Request and Application (Nov. 2024), <https://www.irs.gov/pub/irs-pdf/f14457.pdf>. Part 1, Line 13 of the form also requires taxpayers to list “all aliases, usernames, monikers, mobile phone numbers, and email accounts used by you (and your spouse if a joint disclosure) to facilitate acquisition or disposition or any tax noncompliant digital assets” and “assets held through entities you owned or controlled, or were the beneficial owner of, either directly or indirectly.”

86 Conversations with stakeholders (Aug. 22 and 28, 2024); see also Nathan J. Richman, *Voluntary Disclosure Tweaks May Chase Away Taxpayers With Crypto*, TAX NOTES (Sept. 23, 2024), <https://www.taxnotes.com/tax-notes-today-federal/criminal-violations/voluntary-disclosure-tweaks-may-chase-away-taxpayers-crypto/2024/09/23/7lmht>.

87 See Nathan J. Richman, *Voluntary Disclosure Tweaks May Chase Away Taxpayers With Crypto*, TAX NOTES (Sept. 23, 2024), <https://www.taxnotes.com/tax-notes-today-federal/criminal-violations/voluntary-disclosure-tweaks-may-chase-away-taxpayers-crypto/2024/09/23/7lmht>.

88 See *id.* (quoting one practitioner explaining “[t]he prospect that a taxpayer could disclose that data, be denied preclearance, and then have investigators use all that information could change the calculus for tax professionals considering recommending the program, let alone potential applicants”).

penalties and criminal prosecution. As the heavy burden of documenting cryptocurrency transactions may be discouraging taxpayers from entering the VDP, the IRS should consider a streamlined process for disclosing digital asset transactions and simplify the reporting requirements.

The IRS’s Current Voluntary Disclosure Practice Is Not Effectively Encouraging Voluntary Compliance and Therefore Fails to Effectively Reduce the Tax Gap

The goal of voluntary disclosure programs should be to bring noncompliant taxpayers into compliance both currently and in the future. Many noncompliant taxpayers are ones that the IRS would likely never find on its own – they include taxpayers that have failed to file returns and are not in the “system” so they are not easy to identify. Alternatively, the IRS may be aware of these taxpayers but does not have the resources to pursue them. By bringing these taxpayers into compliance, the IRS not only helps taxpayers resolve their tax issues, it also collects past due taxes and gets these taxpayers back into the system, thus increasing the chance that they will comply with their tax obligations in the future. This directly promotes voluntary compliance and contributes to reducing the tax gap.

The statistics from prior OVDPs reflect the success of voluntary disclosure programs and their contribution to reducing the tax gap. From fiscal years (FYs) 2009-2018 (*i.e.*, the period from October 1, 2008, through September 30, 2018), the IRS preliminarily accepted 51,231 taxpayers into the OVDPs.⁸⁹ As Figure 2.10.3 shows, the IRS has collected more than \$12.4 billion dollars as of June 28, 2024, through the 2009, 2011, 2012, and 2014 OVDPs.⁹⁰

FIGURE 2.10.3, Total Dollars Collected for 2009, 2011, 2012, and 2014 OVDPs

OVDP	Dollars Collected
2009 OVDP	\$4,172,380,918
2011 OVDP	\$2,512,681,467
2012 OVDP	\$3,689,453,141
2014 OVDP	\$2,033,114,224
Total Dollars Collected	\$12,407,629,750

There is obviously potential for increased compliance and additional taxes collected through voluntary disclosure. The value of voluntary disclosure programs is reflected by the fact that practically every state has one.⁹¹ While the OVDPs targeted specifically identified areas of noncompliance and therefore cannot be directly compared to the current VDP, the current VDP does not appear to be heading in the same direction. From FY 2019, the start of the current VDP, through FY 2024 (*i.e.*, the period from October 1, 2018, through September 30, 2024), only 1,626 taxpayers applied for the VDP, and the IRS preliminarily accepted only 1,188 of those taxpayers into the VDP.⁹² And as of August 31, 2024, only 161 VDP cases have been completed since the beginning of the current program on September 28, 2018.⁹³ It is unknown how much the IRS has collected from these VDP participants since it does not keep records of the amount it has collected.⁹⁴ Further, the IRS has not conducted any studies on the effect any of the OVDP or VDP programs have had on

89 IRS response to TAS information request (Oct. 15, 2024). The 2014 OVDP closed on September 28, 2018, which was the last business day of FY 2018. The IRS included all voluntary disclosures it received after that date in the current VDP.

90 IRS response to TAS information request (Oct. 15, 2024).

91 See Timothy P. Noonan, K. Craig Reilly and Brandon J. Bourg, *Charting the Course for Multistate Voluntary Disclosures*, TAX NOTES (Sept. 18, 2023), <https://www.taxnotes.com/special-reports/compliance/charting-course-multistate-voluntary-disclosures/2023/09/14/7h8gq>.

92 IRS response to TAS information request (Oct. 15, 2024).

93 *Id.*

94 *Id.*

compliance.⁹⁵ While the IRS’s goal through the VDP is “for taxpayers with criminal exposure to come forward voluntarily to resolve past noncompliance and remain in compliance with future tax obligations,” aside from verifying current compliance during the examination, the IRS does not follow up on compliance after taxpayers complete the program.⁹⁶

The National Taxpayer Advocate believes the IRS designed its new onerous requirements in the VDP for the truly bad actors, who are not the type of taxpayers who would even consider coming into the program. The IRS needs to design a program for taxpayers who have seen the error of their ways and see the benefits of coming clean. These are the taxpayers we want to encourage to do the right thing, pay their past tax liabilities, and be compliant going forward – in effect, give these taxpayers a second chance. Taxpayers who are aware of an underpayment on their tax return can avoid the imposition of an accuracy-related penalty by filing a QAR. If the taxpayer files a QAR, the IRS treats the amount of tax reported on the QAR as if it were reported on the original tax return. Thus, there is no underpayment for purposes of the accuracy-related penalty, but a QAR does not apply to civil or criminal fraud penalties.⁹⁷

The IRS should consider other civil disclosure programs to encourage voluntary and future compliance for emerging issues such as digital assets where noncompliance may not rise to the level of criminal fraud.⁹⁸ As it stands, people who are unwilling to admit that their actions were criminal will not come into compliance. Should the goal not be to encourage voluntary compliance for all noncompliant taxpayers, not just the criminals?

CONCLUSION AND RECOMMENDATIONS

Voluntary disclosure programs are critical tools for encouraging noncompliant taxpayers to voluntarily come forward and resolve their past noncompliance. The IRS’s VDP has significant potential to help close the tax gap, encourage future compliance, and bring additional revenue into the public fisc. However, as currently structured, the program has significant shortcomings that hinder its ability to encourage widespread voluntary compliance. The recent changes to the program – particularly those made in 2018 and 2024 – have made it more burdensome, reduced its attractiveness to many taxpayers, and caused many tax practitioners to hesitate to recommend it to their clients. While the IRS maintains that it has not made any changes to the VDP since 2018, and the changes to the IRM, forms, and website only clarify the practice, taxpayers and practitioners vehemently disagree. What is clear is that the changes from the traditional practice and the recent modifications to the forms and procedures are discouraging tax practitioners from recommending their clients enter the VDP. The changes to the eligibility criteria, the introduction of a 75 percent civil fraud penalty, the willfulness admission requirement, and increased documentation requirements have all contributed to decreased participation in the program.

With only 161 cases completed since the beginning of the current program on September 28, 2018, it is evident that the program in its current form is failing to achieve its intended goal of encouraging widespread voluntary compliance.⁹⁹ While it remains to be seen, based on initial comments from practitioners, it appears that fewer taxpayers will enter the current VDP due to the legal risk associated with the new disclosure

95 IRS response to TAS information request (Oct. 15, 2024).

96 *Id.*

97 A QAR is defined in Treas. Reg. Section 6664-2(c)(3).

98 Stakeholders also emphasize the need for programs to allow non-willful taxpayers to come into compliance. For example, the IRS Advisory Council highlights the need for “a streamlined compliance mechanism” to help taxpayers correct non-willful errors or omissions with respect to international information reporting requirements, emphasizing “[i]t is ... in both the IRS’s and taxpayers’ interests, for there to be options to resolve non-willful non-compliance.” IRS, Pub. 5316, Internal Revenue Service Advisory Council Public Report 155-156 (Nov. 2024), <https://www.irs.gov/pub/irs-pdf/p5316.pdf>.

99 IRS response to TAS information request (Oct. 15, 2024).

practice eligibility criteria changes.¹⁰⁰ This ultimately undermines the effectiveness of the program in reducing the tax gap and bringing taxpayers into compliance. VDP has tremendous possibility to be an effective program. It encourages voluntary compliance for taxpayers that the IRS might otherwise not find, conserves IRS resources, and helps close the tax gap. The IRS should also introduce mechanisms for tracking taxpayers' compliance after they have completed the VDP process. This would ensure that the program is contributing to long-term compliance, not just resolving past issues.

At a time when the tax gap is estimated at approximately \$696 billion, it is critical that the IRS reevaluate its approach to voluntary disclosures. While the VDP has the potential to be an effective mechanism for bringing noncompliant taxpayers into the system, the IRS needs to supplement it with other civil voluntary disclosure programs to ensure that it encourages all types of taxpayers – including those who are non-willful or negligent – to come forward without the fear of severe penalties. The IRS should work with stakeholders and not only focus on taxpayers who have committed criminal violations but also consider other voluntary disclosure programs that provide a fair path for those who may have made mistakes in evolving issues like cryptocurrency that may not rise to the level of criminal fraud. Reforming the program to reduce fear and provide a clear, fair pathway for compliance would better serve taxpayers and strengthen the overall tax system. By designing a more reasonable program, the IRS could better encourage noncompliant taxpayers to come forward and comply with the tax laws, thus reducing the tax gap and ensuring a fairer, more efficient tax system.

Administrative Recommendations to the IRS

The National Taxpayer Advocate recommends that the IRS:

1. Convene a working group with stakeholders to include tax practitioners, tax policy experts, and others to comprehensively review the current VDP and provide recommendations for reforming the program to make it more accessible and fair, and recommend narrowing the definition of illegal source income to the extent possible to encourage greater participation in the VDP and clarifying other terms such as non-willful.
2. Review the current VDP structure to determine whether the penalty structure is deterring participation in the VDP and reconsider the 75 percent civil fraud penalty with the goal of encouraging noncompliant taxpayers to enter the program without discouraging compliant taxpayers from remaining in compliance (similar to pre-2018 IRM 9.5.11.9, Voluntary Disclosure Practice).
3. Revise Form 14457 to eliminate the willfulness checkbox requirement for VDP.
4. Provide flexible payment options and allow taxpayers to enter alternative payment options, including partial payment installment agreements and offers in compromise, when they establish that they cannot full pay all tax, penalties, and interest.
5. Extend appeal rights to VDP participants who disagree with positions taken by the civil examination agent.
6. Evaluate shifting the internal ownership of the VDP after acceptance from CI to the Tax Compliance Office to ensure the program's administration focuses on compliance and taxpayer support rather than criminal enforcement.
7. Consider establishing other civil disclosure programs to encourage voluntary and future compliance for emerging issues such as digital assets where noncompliance may not rise to the level of criminal fraud.

100 Conversations with outside stakeholders (Aug. 21, 22, and 28, 2024). Attorneys for taxpayers expressed that it is more difficult than ever to recommend that a taxpayer enter the VDP with the new changes. See also Daniel N. Price, *Is the IRS Trying to Terminate the Voluntary Disclosure Practice?*, TAX NOTES (Nov. 19, 2024), <https://www.taxnotes.com/tax-notes-today-federal/criminal-violations/irs-trying-terminate-voluntary-disclosure-practice/2024/11/19/7n585> (stating “[t]he recent changes to the VDP threaten to effectively terminate the VDP”).

8. Begin collecting robust data on VDP participation to measure program effectiveness that includes at minimum the amount of money collected through the VDP.
9. Introduce mechanisms for tracking taxpayer compliance after taxpayers complete the VDP process to ensure that the program is contributing to long-term compliance.

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