
MEMORANDUM

RE: UNREPORTED INCOME (IRS): VOLUNTARY DISCLOSURE

DATE: NOVEMBER 30, 2007

A tax crime is complete on the day the false return was filed.

Between 1945 and 1952, the IRS had a "voluntary disclosure" policy under which a taxpayer who failed to file a return or declare his full income and pay the tax due could escape criminal prosecution through voluntary disclosure of the deficiency, (so long as the voluntary disclosure was made before an investigation was started).

If the IRS determined that a voluntary disclosure had been made, no recommendation for criminal prosecution would be made to the Department of Justice.

Under current IRS practice, the review includes whether there was a true "voluntary disclosure" along with other factors in determining whether or not to recommend prosecution to the Department of Justice. (IRM, Chief Counsel Directive Manual (31) 330 (Dec. 11, 1989) (Voluntary Disclosure).

IRM 9781, Special Agents Handbook § 342.14, MT 9781-125 (Apr. 10, 1990) (Voluntary Disclosure). (although prosecution after voluntary disclosure is not precluded, the "IRS will carefully consider and weigh the voluntary disclosure, along with all other facts and circumstances, in deciding whether or not to recommend prosecution"). See also IRM 9131(1), MT 9-329 (Mar. 24, 1989). (Prosecution Guidelines).

IRS administrative practice recognizes that a taxpayer may still avoid prosecution by voluntarily disclosing a tax violation, provided that there is a qualifying disclosure that is (1) timely and (2) voluntary. A disclosure within the meaning of the practice

means a communication that is truthful and complete, and the taxpayer cooperates with IRS personnel in determining the correct tax liability. Cooperation also includes making good faith arrangements to pay the unpaid tax and penalties "to the extent of the taxpayer's actual ability to pay."

A disclosure is timely if it is received before the IRS has begun an inquiry that is (1) "likely to lead to the taxpayer" and (2) the taxpayer is reasonably thought to be aware" of that inquiry; or the disclosure is received before some triggering or prompting event has occurred (1) that is known by the taxpayer and (2) that triggering event is likely to cause an audit into the taxpayer's liabilities.

Voluntariness is tested by the following factors: (1) how far the IRS has gone in determining the tax investigation potential of the taxpayer; (2) the extent of the taxpayer's knowledge or awareness of the Service's interest; and (3) what part the triggering event played in prompting the disclosure (where the disclosure is prompted by fear of a triggering event, it is not truly a voluntary disclosure).

No voluntary disclosure can be made by a taxpayer if an investigation by the Service has already begun. Therefore, once a taxpayer has been contacted by any Service function (whether it be the Service center, office examiner, revenue agent, or a special agent), the taxpayer cannot make a qualifying voluntary disclosure under IRS practice.

A voluntary disclosure can be made even if the taxpayer does not know that the Service has selected the return for examination or investigation may be too restrictive. Consequently, if there is no indication that the Service has started an examination or investigation, Tax Counsel may send a letter to the Service stating that tax returns of the taxpayer have been found to be incorrect and that amended returns will be filed as soon as they can be accurately and correctly prepared. This approach has the advantage of putting the taxpayer on record as making a voluntary disclosure at a time when no known investigation is pending. However, neither the taxpayer nor the lawyer can be completely certain that the voluntary disclosure

will prevent the recommendation of criminal prosecution.

Where no IRS examination or investigation is pending a taxpayer's alternative is the preparation and filing of delinquent or amended returns. The advantage of filing delinquent or amended returns without a communication drawing attention to them is that the returns may not even be examined after being received at the Service center. In such an event, the taxpayer not only will have made a voluntary disclosure but will have avoided an examination as well. The disadvantage is that during the time the returns are being prepared, the taxpayer may be contacted by the Service and a voluntary disclosure prevented.

If a taxpayer who cannot make a qualifying voluntary disclosure nevertheless files amended or delinquent tax returns, these returns (1) constitute an admission that the correct income and tax were not reported and (2) if incorrect, may serve as an independent attempt to evade or as a separate false statement.

No formula exists, and a taxpayer must endure the uncertainty of the risk that a voluntary disclosure will not be considered truly voluntary by the Service. If so, an investigation that has already started but has lagged may be pursued more overtly and aggressively as a result of the disclosure.

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