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IRS Tax Audits and Collections

IRS Voluntary Disclosure: History
Offshore Voluntary Disclosure Program 2012
IRS/OVDP 2012 Tax Compliance
IRS Voluntary Disclosure 2013: An Update
Ty Warner & the IRS Voluntary Disclosure Program

Prepared by:
Gary S. Wolfe
THE WOLFE LAW GROUP

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THE WOLFE LAW GROUP

Gary S. Wolfe has over 34 years of experience, specializing in IRS Tax Audits and International Tax Matters including: International Tax Planning/Tax Compliance, and International Asset Protection.

As of July 2016, Gary Wolfe has internationally published 15 books and 28 articles. Gary has received 14 international tax awards from five different Global expert societies in LONDON/UK including being voted one of the 100 leading world's law firms with votes from over 150,000 voters in over 160 countries with the following award: Global 100 (2016) (KMH Media Group) - CA/US International Tax Planning Law Firm of the Year.

For more information please visit our website: gswlaw.com

Gary S. Wolfe, A Professional Law Corporation
6303 Wilshire Blvd., Suite 201
Los Angeles, CA, 90048
Tel: 323-782-9139
Email: gsw@gswlaw.com

Part IV – IRS/OVDP

Chapter 24 - IRS Voluntary Disclosure: History

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.

Chapter 25 - Offshore Voluntary Disclosure Program 2012

The following is from IRS.gov

IRS Offshore Programs Produce $4.4 Billion To Date for Nation's Taxpayers; Offshore Voluntary Disclosure Program Reopens

WASHINGTON - Jan. 9, 2012 (Updated October 28, 2013) The Internal Revenue Service today reopened the offshore voluntary disclosure program to help people hiding offshore accounts get current with their taxes and announced the collection of more than $4.4 billion so far from the two previous international programs.

The IRS reopened the Offshore Voluntary Disclosure Program (OVDP) following continued strong interest from taxpayers and tax practitioners after the closure of the 2011 and 2009 programs. The third offshore program comes as the IRS continues working on a wide range of international tax issues and follows ongoing efforts with the Justice Department to pursue criminal prosecution of international tax evasion. This program will be open for an indefinite period until otherwise announced.

"Our focus on offshore tax evasion continues to produce strong, substantial results for the nation's taxpayers," said IRS Commissioner Doug Shulman. "We have billions of dollars in hand from our previous efforts, and we have more people wanting to come in and get right with the government. This new program makes good sense for taxpayers still hiding assets overseas and for the nation's tax system."

The program is similar to the 2011 program in many ways, but with a few key differences. Unlike last year, there is no set deadline for people to apply. However, the terms of the program could change at any time going forward. For example, the IRS may increase penalties in the program for all or some taxpayers or defined classes of taxpayers – or decide to end the program entirely at any point.

"As we've said all along, people need to come in and get right with us before we find you," Shulman said. "We are following more leads and the risk for people who do not come in continues to increase."

The third offshore effort comes as Shulman also announced today the IRS has collected $3.4 billion so far from people who participated in the 2009 offshore program, reflecting closures of about 95 percent of the cases from the 2009 program. On top of that, the IRS has collected an additional $1 billion from up front payments required under the 2011 program. That number will grow as the IRS processes the 2011 cases.

In all, the IRS has seen 33,000 voluntary disclosures from the 2009 and 2011 offshore initiatives. Since the 2011 program closed last September, hundreds of taxpayers have come forward to make voluntary disclosures. Those who have come in since the 2011 program closed last year will be able to be treated under the provisions of the new OVDP program.

The overall penalty structure for the new program is the same for 2011, except for taxpayers in the highest penalty category.

For the new program, the penalty framework requires individuals to pay a penalty of 27.5 percent of the highest aggregate balance in foreign bank accounts/entities or value of foreign assets during the eight full tax years prior to the disclosure. That is up from 25 percent in the 2011 program. Some taxpayers will be eligible for 5 or 12.5 percent penalties; these remain the same in the new program as in 2011.

Participants must file all original and amended tax returns and include payment for back-taxes and interest for up to eight years as well as paying accuracy-related and/or delinquency penalties.

Participants face a 27.5 percent penalty, but taxpayers in limited situations can qualify for a 5 percent penalty. Smaller offshore accounts will face a 12.5 percent penalty. People whose offshore accounts or assets did not surpass $75,000 in any calendar year covered by the new OVDP will qualify for this lower rate. As under the prior programs, taxpayers who feel that the penalty is disproportionate may opt instead to be examined.

The IRS recognizes that its success in offshore enforcement and in the disclosure programs has raised awareness related to tax filing obligations. This includes awareness by dual citizens and others who may be delinquent in filing, but owe no U.S. tax. The IRS is currently developing procedures by which these taxpayers may come into compliance with U.S. tax law. The IRS is also committed to educating all taxpayers so that they understand their U.S. tax responsibilities.

More details will be available within the next month on IRS.gov. In addition, the IRS will be updating key Frequently Asked Questions and providing additional specifics on the offshore program.

Chapter 26 - IRS/OVDP 2012 Tax Compliance

The IRS/OVDI program requires:

1. Filing complete and accurate Form 1040(x) amended federal income tax returns for all tax returns covered by the voluntary disclosure, with applicable schedules detailing the type and amount of previously unreported income from the account or entity (Schedule B for interest and dividends, Schedule D for capital gains and losses, Schedule E for income from partnerships, S Corporations, estates or trusts and the years after 2010, Form 8938, Statement of Specified Foreign Financial Assets).

2. File Form TDF 90-22.1 (Report of Foreign Bank and Financial Accounts, “FBAR Filings”) for all tax years covered by the voluntary disclosure.

3. Cooperate in the voluntary disclosure process, including providing information on offshore financial accounts, institutions and facilitators and signing agreements to extend the period of time for assessing Title 26 liabilities and FBAR penalties.

4. Payment in full of tax, interest and penalties due. Penalties include:

a. Failure to File a Tax Return—(IRC Sec. 6651(a)(1), 5% of the tax due per month, up to 25% (tax due).

b. Failure to Pay Tax Due—Shown on Tax Return (IRC Sec. 6651(a)(2), 5% of the tax due shown on return, per month, up to 25% (tax due).

c. Accuracy Related Penalty (IRC Sec. 6662)—Taxpayer may be liable for a 20% or 40% penalty. Under the IRC Sec. 6662(b)(7) and (j), a 40% accuracy-related penalty is imposed for any underpayment of tax that is attributable to an undisclosed foreign financial asset understatement.

d. Title 26 Penalty—27.5% of highest aggregate balance in foreign bank accounting/entities, or value of foreign assets, during the period covered by the voluntary disclosure.

Total penalties up to 70% of unpaid tax plus 27.5% of value of assets (total): aggregated foreign accounts and foreign assets (for the highest year’s aggregate value during the period covered by the voluntary disclosure).

5. Execute a closing agreement on final return income covering specific matters, Form 906.

6. Agree to cooperate with IRS offshore enforcement effected by providing information about offshore financial institutions, offshore service providers, and other facilitators.

Civil Fraud/Criminal Tax Evasion

Until such time as the U.S. taxpayer and the IRS execute a Form 906 closing agreement, the U.S. taxpayer may be still subject to both imposition of civil tax fraud penalties and prosecution for criminal tax evasion, if and when the IRS "disqualifies the U.S. Taxpayer" from the IRS/OVDI (2012) (as is the case with Israel's Bank Leumi's U.S. clients).

Civil Tax Fraud

Civil fraud penalties imposed under IRC Sec. 6651(f) or 6663, for either underpayment of tax, or a failure to file a tax return due to fraud, the taxpayer is liable for penalties of 75% of the unpaid tax.

Criminal Tax Evasion

U.S. taxpayers with undisclosed offshore bank accounts and unreported income face criminal charges for:

1. Tax Evasion (26 USC Sec. 7201) [5 years in jail; $250,000 fine];

2. Filing False Tax Return (26 USC Sec. 7206(1)) [3 years in jail, $250,000 fine];

3. Failure to File Tax Return (26 USC Sec. 7203); [1 year in jail, $100,000 fine];

4. Willful Failure to File FBAR or Filing False FBAR (31 USC Sec. 5322) [10 years in jail, fines up to $500,000].

In addition, the willful failure to file the FBAR has a civil penalty as high as the greater of $100,000 or 50% of the total balance of the foreign account per violation (31 USC Sec. 5321(a)(5).

Chapter 27- IRS Voluntary Disclosure 2013: An Update

Two recent cases demonstrate the great risk attendant to the IRS offshore Voluntary Disclosure Program (2012-forward) ("OVDP").

In the Bank Leumi case, dozens of U.S. taxpayers with accounts at Bank Leumi were in 2013 peremptorily disqualified from the IRS OVDP without explanation. The IRS has recently reversed this position and according to tax counsels have readmitted the disqualified U.S. taxpayers. Although the various tax counsels appear satisfied with the IRS reversal of position their "sighs of relief" fail to address the "dangers of the OVDP:

1) As of the 2012 OVDP a 27 1/2% penalty based on the value of the undisclosed offshore assets (in addition to the original income tax due plus interest plus penalties of up to 70% of the tax due.)

2) Waiver of Constitutional Protections against: self-incrimination (5th amendment), unreasonable search and seizure (4th amendment), excessive fines (8th amendment).

These "trifecta" of constitutional protections disappear once a U.S. taxpayer enters the IRS OVDP disclosing: their names, social security numbers, undisclosed income, undisclosed assets, names of the advisors/colleagues/3rd parties who facilitated their "offshore tax evasion."

It is a risky strategy to voluntarily contact the IRS to disclose multiple tax crimes (felonies which if prosecuted may lead to over 25 years in jail with additional 20 year sentences for each instance of money laundering, wire fraud, mail fraud, total jail time over 85 years, if the prosecutor "throws the book" at the taxpayer. If you commit federal crimes, is it advisable to go to the U.S. Attorney to confess your crimes and beg for leniency? If not, then why confess federal tax crimes to the IRS (who may refer the case to the U.S. Attorney since the taxpayer's voluntary disclosure has neither transactional or use immunity.

In the case of Ty Warner (Beanie Bag founder, a member of the Forbes 400 richest Americans, with $2.6 billion net worth) he entered the IRS OVDP only to be rejected (for unknown reasons).

The risk for Ty Warner is best exemplified by his recently disclosed IRS settlement $53million for 202 taxes (on unreported income from undisclosed UBS/Swiss Bank accounts). Ty Warner has agreed to pay $53million on an unreported $3.1million in income which tax would have been $885k (nearly 60x the amount of the original tax due). In addition, he faces charges of criminal tax evasion, with up to a 5 year jail sentence (he awaits arraignment).

The $53million in settlement was due to imposition of a 50% "FBAR" penalty on the $93million he held in his UBS Swiss Bank account. If you are Ty Warner, you have to ask yourself the following question, best expressed by Bob Dylan, "If you can't do the time, don't do the crime.

Chapter 28 - Ty Warner & the IRS Voluntary Disclosure Program

On 10/2/13, Ty Warner, billionaire creator of Beanie Baby Toys, pleaded guilty in U. S. District Court (Chicago) to a single count of tax evasion for failing to report $3.2 million in income on a secret UBS (Swiss) Bank Account (with $93.6million). He paid a $53.6 million civil tax penalty and is scheduled for sentencing on January 15, 2014 (for up to 5 years in jail for tax evasion).

In 2009, Ty Warner tried to avoid criminal prosecution by entering into the IRS Offshore Voluntary Disclosure Program but was denied and it appears the evidence he submitted to the IRS was used against him in the U.S. government criminal prosecution. Warner's plea is not binding on the IRS.

See article, "Beanie Baby Creator Pleads Guilty to Swiss Bank Tax Dodge."