

The New Voluntary Disclosure Practice: A Fair Compromise?

December 3, 2018

On November 29, 2018, the IRS released updated Voluntary Disclosure Practice (VCP) procedures applicable to both offshore and domestic voluntary disclosures. The new VCP supersedes in part the IRS's longstanding voluntary disclosure practice and fills the gap left in the absence of the Offshore Voluntary Disclosure Program (OVDP), which ended on September 28, 2018 (see prior alert [here](#)). The VCP will now apply to all voluntary disclosures, both domestic and offshore, submitted after September 28, 2018, and the IRS may, in its discretion, apply the VCP guidelines to unresolved domestic voluntary disclosures submitted on or before that date. ***Taxpayers who did not enter the OVDP or who have non-offshore compliance issues must now evaluate whether the VCP is the proper avenue for rectifying prior tax and reporting noncompliance and addressing their criminal exposure.***

For decades, the IRS has followed an informal voluntary disclosure practice, set forth in the Internal Revenue Manual, which allowed taxpayers with potential criminal exposure for prior tax and reporting issues, to voluntarily resolve those issues with the IRS in exchange for payment of tax, interest, and any civil penalties that the IRS determined to be applicable, as well as protection from criminal prosecution if they make their disclosure in a timely manner. This voluntary disclosure practice was only a matter of IRS internal policy—there was no particular format for making a voluntary disclosure and no set penalty structure.

In 2009, the IRS introduced the Offshore Voluntary Disclosure Program, an issue-specific voluntary disclosure program for taxpayers with previously unreported offshore assets. Unlike the voluntary disclosure practice, the OVDP established formal procedures for participation in the program, a uniform civil penalty structure, and a promise of no criminal prosecution. When the program ended on September 28, 2018, practitioners and taxpayers questioned whether the IRS would establish a permanent program or simply continue to follow its informal practice. The VCP combines elements of both, providing uniform procedures for both domestic and offshore voluntary disclosures and a flexible, but in comparison to OVDP, more open-ended penalty structure.

Similar to the OVDP, the VCP provides formal procedures for participation in the program. Taxpayers wishing to make a voluntary disclosure must submit a preclearance request to the IRS Criminal Investigation Division and, upon acceptance, promptly submit the facts and circumstances, and identify their assets, entities, related parties and any professional advisors involved in the noncompliance on Form 14457 (forthcoming). The VCP covers a six-year disclosure period (shorter than the eight-year OVDP period), but allows a taxpayer to expand the disclosure period if desired (e.g., to correct other tax issues, such as those involving other governments, relating to a sale or acquisition of an entity, closing an estate, or to unreported taxable gifts in prior periods). Participants must submit tax returns and make full payment of all taxes, penalties and interest for the disclosure period. At the completion of the IRS examination of the disclosure package, participants enter into a closing agreement with the IRS. A new feature is that those who cannot reach an agreement on taxes and penalties have the right to appeal the results of the examination with the IRS Office of Appeals.

The VCP penalty regime differs from both the OVDP and the longstanding voluntary disclosure practice: it

provides general penalty guidance to IRS examiners, while still leaving them with substantial discretion. Taxpayers participating in VCP should anticipate:

- A fraud penalty equal to 75% of the unpaid income tax on the noncompliant year with the highest income. Examiners retain discretion to impose a fraud penalty for other years.
- A willful FBAR penalty equal to 50% of undisclosed assets' value for taxpayers disclosing foreign financial assets.
- The potential to present evidence to attempt to mitigate the fraud and willful FBAR penalties. However, obviously recognizing that people who enter the VCP have concerns about criminal liability, the guidelines make clear that a grant of such relief would be an exception to the general rule.
- Penalties for failure to file foreign information returns will not be automatically applied. The amount of the penalty varies by return, and examiners retain discretion in implementing any such penalties, taking into account the application of other penalties.
- Penalties in connection with estate and gift taxes, employment taxes, and excise taxes based on the facts and circumstances of the particular case.

Although the penalty regime is more uncertain, and in most cases potentially more severe, than in the OVDP (and certainly more onerous than our prior experience with non-OVDP cases), the IRS makes clear that the VCP is geared toward taxpayers with possible criminal exposure, and for many in that category, that is its primary benefit.

Taxpayers who do not have criminal exposure have other options to rectify prior noncompliance, offshore or domestic, through other established IRS procedures, such as Streamlined Filing Compliance Procedures, the Delinquent FBAR or International Information Returns Submission Procedures, or by simply filing amended or delinquent tax returns. Taxpayers contemplating these options should seek legal counsel to evaluate the best approach with respect to their specific facts and circumstances.

Attorneys in [Caplin & Drysdale's Tax Controversy Group](#) have handled thousands of voluntary disclosures, tax investigations, and examinations, both civil and criminal. Further, we have decades of expertise in unwinding complex structures and advising U.S. persons of their proper tax and reporting obligations. For more information, please contact any of the attorneys below:

[Zhanna A. Ziering](#)
212.379.6075
zziering@capdale.com

[Dianne C. Mehany](#)
202.862.5068
dmehany@capdale.com

[Arielle M. Borsos](#)
202.862.5097
aborsos@capdale.com

[Scott D. Michel](#)
202.862.5030
smichel@capdale.com

[Mark E. Matthews](#)
202.862.5082
mmatthews@capdale.com



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For more information, please visit us at www.caplindrysdale.com.

Washington, DC Office:

One Thomas Circle NW
Suite 1100
Washington, DC 20005
202.862.5000

New York, NY Office:

600 Lexington Avenue
21st Floor
New York, NY 10022
212.379.6000

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