CIVIL AND CRIMINAL TAX ENFORCEMENT IMPLICATIONS OF THE UBS ENFORCEMENT INITIATIVE AND THE FUTURE OF V0LUNTARY DISCLOSURE

By Steven Toscher

After practicing tax law for more the more than thirty (30) years, one can look back and try to recall the transformative events in civil and criminal tax enforcement. The Restructuring Act of 1998 was a true game changer–codifying taxpayer rights and imposing restrictions and changes on the Internal Revenue Service ("IRS") that many practitioners–or at least this one–thought were unnecessary and indeed harmful to the tax system. The 1998 Act was transformative legislation brought about by aggressive IRS behavior and the politics of the day. It is actually surprising the IRS survived as it did.

The IRS enforcement action against aggressive high end tax shelters for which we are still writing the last chapters–has brought huge changes–mostly in the way taxpayers and tax professionals must address their obligations to the tax system. These changes include a reinvigorated IRS Office of Professional Responsibility and tax preparer regulation–to the ever increasing taxpayer disclosure obligations–from requirements to disclose "listed transactions" or something "substantially similar"–to now disclosing "Uncertain Tax Positions." We are definitely moving away from the idea that we often heard in jest– that a tax return is an "opening bid."

How does the IRS' enforcement action against UBS and its account holders fit in.

It too has been a game changer. The IRS action was a break out play and will have a lasting impact on tax enforcement–especially international tax enforcement. Indeed, when was the last time a major Operating Division of the IRS changed its name—from the "Large and Mid-Size Business" Division ("LMSB") to the "Large Business and International" Division. ("LB&I"). You know what they say, a name change is worth a thousand words. While IRS Commissioner Doug Shulman declared the end of active combat hostilities against UBS on November 16, 2010[1], there is no doubt the pendulum of IRS enforcement activity has now swung with a full force and fury beyond our borders.

This article will discuss the UBS enforcement activity and the implications it has had and will continue to have for tax compliance, enforcement and tax administration, including the IRS' long standing voluntary disclosure policy.

The UBS Enforcement Action

For purposes of this article, my reference to the UBS enforcement action or initiative includes the U.S. government's multi-agency and multi-prong effort–both civil and criminal–to convince United States taxpayers and their foreign bankers that the historical attitude that financial activity overseas can be hidden from the U.S. tax authorities with impunity will not stand any more in our ever globalizing economy.

[1] "Today, I'm pleased to announce the IRS has withdrawn the John doe Summons in the UBS AG matter...in light of our success in obtaining the account holder information we sought through the summons..." IRS Commissioner Doug Shulman Statement on UBS/Voluntary Disclosure Program (November 16, 2010).

"What happens in Zurich, will not stay in Zurich anymore." More likely, it may be broadcast on the front page of the *New York Times* or the *Wall Street Journal*.

I am not sure how the UBS enforcement action began. It started with a criminal grand jury investigation regarding the giant global bank which resulted in what is referred to as a "Deferred Prosecution Agreement," which cost UBS hundreds of millions of dollars in fines, penalties and taxes, but saved its ability to continue in the banking business the U.S. But what triggered the grand jury investigation? A good bet might be the Whistleblower Bradley Birkenfeld, a former UBS banker who decided to blow the whistle on UBS and its many U.S. customers who had "secret" or "undeclared" accounts with the banking giant.

Mr. Birkenfeld is currently serving a 40-month sentence in a federal prison for conduct *he* would likely describe as a service to U.S. tax administration. Indeed, it appears that of all the UBS related criminal defendants who have been convicted and sentenced, Mr. Birkenfeld has received the *highest sentence*--maybe more than all of 10 or 11 tax defendants to date who have been sentenced---*combined*. An odd result one might think–but that is a story for another day. Birkenfeld is also engaged in litigation with the U.S. as to whether he is entitled to a Whistleblower award in the hundreds of millions of dollars under Section 7623 of the Internal Revenue Code ("IRC"). As an aside–if the substantial possible reward under IRC Section 7623 was an inducement to Mr. Birkenfeld–up to 30 percent of the tax, penalties and interest recovered, perhaps the legislators who sponsored the new whistleblower provision can take credit for the UBS

enforcement action.

The Deferred Prosecution Agreement ("DPA") with UBS provided that in order for the IRS to obtain most of the names of the U.S. taxpayers, they would have to follow the "John Doe Summons" provisions of the Code. I say "most" because as part of the DPA, UBS turned over to the Department of Justice approximately 280 names of taxpayers–who we refer to as the "unlucky ones"–because for them it was too late to do a "voluntary disclosure" and avoid potential criminal prosecution.

The IRS was successful in its John Doe summons pursuit and with the assistance of the Swiss Federal Tax Administration and the Swiss Federal Courts, was able to navigate the limitations of the US-Swiss Tax Treaty and the rights provided to the U.S. taxpayers holding the so-called "undeclared accounts." As of today, the bank account information on the 4,450 U.S. taxpayers which the John Doe settlement agreed to divulge has been turned over to the IRS, who is busy doing what tax agents do when they have received a treasure trove of information.

The Voluntary Disclosure Initiative–An Amnesty?

In connection with the UBS enforcement action, in March of 2009, the IRS "announced" what amounted to the largest and most significant tax amnesty in U.S. tax history. Approximately 17,000 U.S. taxpayers with foreign accounts participated. While the "announcement" appears to have started as a leak to the press—and no formal IRS Notice was issued, the IRS soon formalized the Initiative with a comprehensive set of Frequently Asked Questions. Pay your back taxes, interest and the 20 percent accuracy

penalty on the unreported income for the prior 6 years (2003-2008) and a 20 percent "information reporting" penalty equal to 20 percent of the highest balance in the foreign bank account for the prior 6 years, and the tax sins of the past would be forgiven–for the most part.[2] This not only allowed taxpayers to avoid much larger and indeed draconian foreign information reporting penalties, but the big prize was the IRS announcement that they would treat those taxpayers coming forward as qualifying for a "voluntary disclosure" under the IRS long standing voluntary disclosure policy. While the policy says that a voluntary disclosure is just a "factor" which is considered in determining whether a taxpayer will be prosecuted, it has historically been applied as a "get out of jail free" card for those taxpayers who qualify. Indeed, Commissioner Shulman made it very clear in his public statements that as far as *criminal prosecution* was concerned–it was an amnesty.

While the IRS only recommends criminal prosecution of approximately 2,500 taxpayers a year, and no one thought the IRS and Department of Justice had the resources to go after the estimated 50,000 taxpayers with foreign bank accounts, why would a taxpayer take the chance on criminal prosecution, a felony conviction and prison time when the IRS Commissioner was offering a "pass"–just pay your back taxes, interest and

[2] See Voluntary Disclosure: Questions and Answers, http://www.irs.gov/newsroom/article/0,,id=210027,00.html

significant civil penalties? Many–more than 17,000--took advantage of the program–after all–the smart money was that there would really be hell to pay if the taxpayer was criminally investigated. It now was only money.

What is interesting is the large number of *people who did not* take advantage of the Initiative. Some may not have heard about it–although these could not have taxpayers who read the *New York Times* or *Wall Street Journal*–because it seems there was a new story on the UBS action at least once or twice a week. Some were too scared to go into the Initiative–afraid the government's promise of no criminal prosecution and leniency on penalties could not be trusted. Some–the so-called "unlucky ones"–already had their UBS information turned over to the IRS and for them it was too late.

No doubt the vast majority of taxpayers who did not come in from out of the cold did so because of yes–*the money*. The threat of getting caught and even going to prison was not a sufficient inducement for these people to come in. They could not bring themselves to depart with such a large portion of their wealth.

Some practitioners make a strong argument that the Commissioner's price tag was too high. In many of these cases the amount of unpaid taxes was quite small in comparison to the size of the bank account and the 20 percent "information reporting" penalty was way out of proportion to the tax loss. Some in the IRS felt that these taxpayers were getting away with murder–that no financial penalty was enough–they should have all been criminally prosecuted. Regardless of the merits of each side, the IRS needed a one size fits all approach that could be administered with limited

enforcement resources, that was faithful to its duty to enforce the laws written by the Congress and which fostered increased compliance by taxpayers.

While the Initiative is not without its critics and it has taken much longer to process these cases–it is approaching almost two year since it was announced–there is no question that the Initiative has been a major success and significant milestone in the history of tax enforcement. [3] The November 16, 2010 announcement by Commissioner Shulman made clear that while the focus on UBS-- the bank-- has ended, the focus on the UBS account holders who did not participate in the Initiative was just beginning. Moreover, the Commissioner promised "more to come"[4] and the word on the street is the IRS and Department of Justice Tax Division have their sites set on other banks and a second voluntary disclosure initiative may be announced in the near future. This is not the end; this is not even the beginning of the end; rather, as Sir Winton Churchill famously said, it is perhaps the end of the beginning. [5]

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[3] This is especially so when compared with past programs trying to increase voluntary compliance relating to foreign bank accounts—such as the "Offshore Voluntary Compliance Initiative" or the "OVCI" which occurred in 2003 or the follow-up–"Last Chance Compliance Initiative" or "LCCI," which followed it, both of which attracted few taxpayers–less than 2,000.

[4]The Commissioner said, "[w]e have been scouring vast quantity of data...[which] has already proved invaluable...in developing new leads, involving numerous banks, advisors and promoters from around the world. And this remains just the start."

[5] "Now this is not the end. It is not even the beginning of the end. But it is, perhaps, the end of the beginning." Sir Winston Churchill, *Speech in November, 1942*, speaking of the turn in the war effort against the Nazis.

Implications for Tax Compliance and Enforcement

The UBS enforcement initiative will have a wide ranging and significant impact on tax compliance and enforcement–with the IRS effect on the voluntary disclosure policy perhaps one of the more significant.

--Education of Tax Professionals and IRS

One of the effects of the UBS matter has been a penetrating and continuing education course in the complexities of our foreign reporting tax regime and the potential costly penalties for those who do not comply. Five years ago how many tax practitioners– CPAs, lawyers or others–even heard of an FBAR, a PFIC and CFC or the Form 3520 for foreign trusts–not many. Only foreign tax specialists knew. IRS Agents–forget it–only the few International Specialists had an understanding of these matters. Now, many IRS agents are trained in these matters.

--Understanding the Draconian Civil Penalties for Non-Compliance.

We have all now discovered–including the IRS–the amazingly punitive nature of the penalties which can be imposed for the failure to comply with the information reporting rules of the Code. Most of the penalties have been with us for years–but virtually untouched and not imposed by the IRS–no doubt due to the complexity of and lack of professional knowledge of the foreign reporting regimes. Rarely did a late filed Form 5471–relating to a Controlled Foreign Corporation, or a Form 3520 or 3520-A for a Foreign Trust or the so-called FBAR form for foreign bank accounts, draw a penalty. Now, the environment has changed–the UBS matter has put the foreign information

reporting penalties on the IRS radar screen and the IRS is having their way with taxpayers–to the displeasure of many tax practitioners who have long been able to avoid or mitigate these draconian penalties.[6] This is not too different than former Commissioner Mark Everson's so-called penalty initiative *circa* 2003, which put the accuracy related penalty on the radar screen of every Revenue Agent or at least Group Manager and substantially increased the assertion of those penalties against taxpayers.

---Understanding and the Use of Existing Code Tools in International Enforcement

The UBS action has focused many tax practitioners and Revenue Agents on extended statutes of limitations–well beyond the normal 3 year or possible 6 year statute for substantial omissions of income. Few practitioners and fewer Revenue Agents knew of IRC Section 6501(c)(8), which has been in the Code for many years. This Section has the effect of extending the statute of limitations forever with respect to adjustments arising out of many foreign transactions for which no foreign information form was filed. For example, if no Form 5471 is filed relating to a Controlled Foreign Corporation or no Form 3520 relating to a Foreign Trust is filed, there is no statute of limitations on assessment for items arising out of these unfiled forms.

The UBS action also should remind the IRS of the power of the Commissioner's

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[6] While the Congressional authorization for these penalties is impressive, most practitioners and even most IRS employees find the penalties offensive in their size given the tax conduct involved. These penalties can be so large and the IRS is applying them in some cases with such vigor that the IRS will no doubt be faced with substantial challenges to these penalties under the *Excessive Fines* Clause of our Constitution.. See, Toscher and Lubin, "When Penalties and Excessive...", *CCH Journal of Tax Practice and Procedure, (*December 2009-January 2010).

information gathering tools such as the so-called "John Doe Summons" used very effectively in obtaining the names of unknown U.S. taxpayers who had accounts with UBS. The legal threshold for obtaining information under a John Doe summons is quite low–no more than convincing a federal judge–in an ex parte proceeding–that there is a reasonable suspicion that the class of the unknown taxpayers may have not complied with the Code. The fact of a U.S. person having an account in Geneva or Zurich seems to easily meet that standard. We should anticipate the IRS using this tool for other banks which have a jurisdictional presence in the U.S.

--IRS Voluntary Disclosure Policy

Perhaps one of the most significant effects the UBS initiative may have on tax compliance and enforcement relates to the actions a taxpayer must take in order to comply with the Voluntary Disclosure Policy ("Policy")–in order to avoid criminal prosecution and get into compliance with his or her tax obligations.

Both the IRS and the Department of Justice Tax Division ("DOJ") have long standing Voluntary Disclosure Policies.[7] While the IRS and DOJ policies, *as written*, differ in a number of respects, the thrust of the voluntary disclosure policy is that if a taxpayer who has committed a tax crime comes forward in a *timely* manner—that is before the government is on to the problem and communicates that fact to the IRS and

[7] The current IRS Policy is contained in Internal Revenue Manual (IRM) 9.5.11.9 (rev. June 26, 2009) and the DOJ Policy is contained in the Tax Division's Criminal Tax Manual, (2008 ed.), Section 4.01 (Policy) and Section 3 (Tax Division Policy Directives and Memoranda), pp. 3-12 and 3-13.

cooperates in the determination and payment of the taxes (including interest and applicable penalties), the voluntary disclosure *"will be considered along with all other factors in the investigation in determining whether criminal prosecution will be recommended."*[8] That is a pretty weak statement of comfort for the taxpayer who wants to correct the sins of the past.

A taxpayer comes to see me about an undisclosed foreign bank account and with only that written statement of the Policy, confessing a prior tax crime with the prospect of losing their liberty–not to mention most of their money–does not seem like a good bet. Taxpayers can achieve disastrous results without the help of lawyers–and often do.

Fortunately, the practical application of the Policy over the years has provided taxpayers much more comfort. The practical result is that a taxpayer whose income was earned legally and that makes a *timely* voluntary disclosure is not criminally investigated or prosecuted. *They can be–but they are not*. Because of the importance of the Policy to tax administration and the manner in which it has been administered by the IRS, most practitioners experienced in this area of the law have come to the conclusion that this is a promise by Uncle Sam their clients can and should rely upon.

The Voluntary Disclosure Policy, absent extreme circumstances,[9] does not provide the taxpayer with any substantive legal rights. Notwithstanding the statements of

[8] IRM 9.5.11.9.

[9] There may be situations where the inducement of the taxpayer to voluntarily come in by the IRS and the IRS conduct implicates not only fairness, but Constitutional limitations on Government conduct.

Commissioner Shulman, it is not generally considered a legal amnesty nor does it confer an immunity from prosecution for past criminal tax behavior. It is, however, an extremely important governmental tax policy grounded on two fundamental and related premises. First, our tax system is one based on "voluntary compliance" and taxpayers should and need to be encouraged to correct prior tax misconduct without the fear that they will be criminally prosecuted if they come forward. *Without the ability to correct past behavior–future compliance is in jeopardy*. Second, criminal and civil tax enforcement has finite resources and cases need to be selected in a way which fosters maximum voluntary compliance by taxpayers and deters the general tax paying public from engaging in tax crimes.

We do not so easily forgive the bank robber who returns the money to the bank—why do we forgive the tax evader. *Because tax crimes are different*. The normal social policies of crime and punishment are modified because of the nature of the tax crime and for very important policies critical to our tax system–not to mention the need to raise revenue—the ultimate goal of any system of taxation. Many tax systems of foreign countries have similar voluntary disclosure policies–why--because it makes good sense.

Two additional points about the background of the voluntary disclosure policy should be made. First, it is, at its core, a *policy of prosecutorial discretion*–it has its guidelines and an element or predictability–but it is guided discretion. We hope those in the government whom we have vested this discretion exercise it fairly and with good judgment. Second, the voluntary disclosure policy is for the *truly guilty*–those who have

engaged in a serious tax crime and if caught–would be convicted and likely sent to prison. These are the people who really benefit from the policy–they are not the primary beneficiaries–which is the taxpaying public at large. These are nevertheless beneficiaries of the policy and from a defense lawyers perspective, it is truly a beautiful thing.

What the UBS Intitiative Has Done For Voluntary Disclosure

We turn now to the implications for the voluntary disclosure policy as a result of the UBS Initiative. One of the most prominent effects—a positive one—is bringing the voluntary disclosure policy out of the obtuse corners of tax enforcement and thrusting it into the everyday dialogue of tax professionals, the IRS and many of the public. While the IRS has not and cannot keep good records of voluntary disclosures for the reasons described below, the records available suggest there were only about 100 *formal* voluntary disclosures a year. The UBS initiative brought in approximately 17,000 wayward taxpayers. If the voluntary disclosure policy is good tax policy–and it is–then broadening its use is good for our tax system.

The UBS Initiative has brought a new focus to the IRS not only on international enforcement but also the importance of the voluntary disclosure policy to its core mission of fostering our voluntary compliance and as an investigative tool in determining the scope of non-compliance and focusing on resources to combat these targeted areas. Indeed, the recent 2011 Operational Priorities of the Internal Revenue Service's Criminal Investigation Division sets forth for the first time that voluntary disclosure is core priority– *"Criminal Investigation is the key entry point, through the voluntary disclosure*

program for noncompliant taxpayers to get back into the tax system." [10]

I will also say as an aside that many of the taxpayers who participated in the UBS voluntary disclosure initiative have been relieved of a dark little secret in their otherwise compliant tax life and that is good. While the economic cost to the taxpayers has been significant–and in many cases the penalties have been far too high for the conduct involved–these taxpayers have been given a clean bill of health and can go forward without having to continue the family's dark little secret–which as a by-product has caused generations of otherwise good honest people to become less than fully compliant taxpayers. This may be somewhat of a euphemism–but an important one. While there were some taxpayers who were real tax outlaws; most were not. They may have technically been violating the law and knowing it–but they were not doing it to save any significant amount of income taxes–UBS was not selling a good rate of return—they were selling secrecy and exploiting U.S. taxpayers' fear of getting caught. To be done with that type of arrangement—while perhaps costly–is a good thing.

Because historically the use of voluntary disclosures was a relatively unknown procedure, the manner of making a voluntary disclosure substantially differed among practitioners and varied among the different offices of the IRS. One very common and long accepted method was for a taxpayer to prepare accurate amended returns (and

[10] See Criminal Investigation 2011 Operational Priorities, http://www.irs.gov/compliance/enforcement/article/0,,id=180283,00.html

foreign information reports if required) and to file those returns with the appropriate IRS Service Center (now "Campus") and send in the tax and statutory interest and wait. This method of voluntary disclosure has been come to be known as the "*informal*" or "*quiet*" voluntary disclosure—or even in some circles–the "*stealth*" voluntary disclosure.

Normally–in most every case–the taxpayer would receive what I will refer to as a "thank you"–a processing notice from the IRS Service Center, reflecting the assessment of the additional tax and interest and any payment made and any balance still due.[11] Practitioners differed on the number of years a taxpayer should go back and file amended returns. Some followed the statute of limitations–and go back either 3 years or if there was a substantial omission of income–6 years. Other practitioners, such as myself, took a more conservative approach, and would file amended returns covering the criminal statute of limitations—6 years. It might cost more in back taxes, but it provided a measure of comfort–a primary taxpayer benefit to the taxpayer.

Just filing the returns or making an "*informal*" voluntary disclosure had at least one significant disadvantage–and that is *timing*. Under the voluntary disclosure policy it was critical that the disclosure be made *before* the IRS started an investigation or examination of the taxpayer. It normally could take some time for the past years accounting to be done and accurate tax returns prepared. If an audit started in the interim–the taxpayer would not qualify under the literal terms of the policy.

[11] In some cases, when payments were made with respect to tax years beyond the normal three (3) year statute of limitations, the IRS would offer to send the money back to the taxpayer.

The other method making the voluntary disclosure was the more "*formal*" or "*noisy*" disclosure where the taxpayers representative would contact the IRS, generally describe the situation and get some indication from the IRS whether the taxpayer qualified for voluntary disclosure for IRS prosecution purposes. While this had the benefit of getting in the door in a timely fashion–before anything else might happen, the more formal voluntary disclosure had its draw backs both for the taxpayer and the IRS.

As noted above, the best estimate is that there were no more than 100 *formal* voluntary disclosures in any year in recent history. We do not know how many *informal* voluntary disclosures there have been. Prior to the UBS action, based upon my understanding of which practitioners utilized formal disclosures and which ones employed a more informal disclosure, 100 voluntary disclosures a year has to be a very small fraction of the number of amended returns filed with the IRS which we might characterize as voluntary disclosures.

Many tax professionals executed voluntary disclosures in the *informal* way, filing amended returns, paying the additional taxes and interest, and in most all cases, the process was done. While there could be an IRS examination or even potentially a criminal investigation, such responses to an informal voluntary disclosure were virtually unheard of.

While pursuing a *formal* voluntary disclosure and getting the blessing of the Special Agent in Charge ("SAC") of the Criminal Investigation Division in writing could provide some more "sleep at night" factor to some taxpayers, the blessing was always

hedged with the lack of legal force and subject to restrictions, limitations and caveats which might make a taxpayer more nervous than not even hearing from the SAC. Nevertheless, many practitioners found *formal* voluntary disclosures, working with the local Criminal Investigation Division and/or the Examination Division to be quite a satisfactory program.

One of the other large benefits to the taxpayers engaged under the *informal* voluntary disclosure is that there would generally not be any penalties asserted. The income tax deficiency penalties which normally could be asserted could either be the 20% accuracy related penalty or the 75% civil fraud penalty. Neither of these penalties can be asserted without some sort of examination activity and deficiency proceedings. Thus, if there was no examination, there would be no assertion of these types of penalties.[12]

A taxpayer going in through a formal voluntary disclosure faced not only the uncomfortable scrutiny of the Criminal Investigation Division (the amount of scrutiny varied), but also at least in some cases, examination activities and the possible assertion of penalties for the taxpayer coming forward. While in many cases penalties were not asserted in *formal* voluntary disclosure cases, in some cases they were.

While there was no one right way to make the voluntary disclosure, the majority of voluntary disclosures were of the *informal* type. This substantially benefitted the IRS and tax administration. While the IRS, if they do not examine the returns, could not assert

[12] Penalties such as the delinquency penalty or other types of information reporting penalties which can just be assessed without deficiency proceedings could be another story and some, such as the delinquency penalty, were routinely asserted in the case of non-filers.

penalties and therefore would not collect them, they did get back taxes and interest and a taxpayer who is now in compliance. That is a very good thing for tax administration and government policy should not do anything to discourage that. Unfortunately, some of the perhaps unintended consequences of the UBS enforcement initiative throws into question how the government is going to treat an *informal* voluntary disclosure. This is a bad thing for tax administration.

In order to take advantage of the actual UBS Voluntary Disclosure Initiative which was announced in March 2009, the taxpayer needed to do a *formal* voluntary disclosure– that is go through the Criminal Investigation Division and any amended returns and filings would be subject to review by a Civil Examination Division. There was a very good reason for requiring the taxpayer to come to the IRS in a formal manner under the Initiative. This was a formal voluntary disclosure initiative announced by the IRS with uniform terms and standard penalties. Allowing taxpayers to do an informal voluntary disclosure concerning the subject matter of the Initiative would not seem right and the IRS said so.

The IRS basically said that if somebody tries to file amended returns and foreign information reports outside the program, it will not be considered a voluntary disclosure and bad things could happen to them. That should be enough to scare most conservative practitioners into the conclusion that their clients should follow the program as announced by the IRS which for the most part practitioners did. Practitioners and taxpayers who engaged in informal disclosures falling within the scope of the Initiative, i.e. foreign

based accounts, and who are caught may be in for some very strict IRS scrutiny and potentially the assertion of larger penalties–and some even raised the possibility of criminal prosecution.

Unfortunately, there have been some comments by IRS officials throwing in to question whether an *informal* voluntary disclosure after the closing of the formal Initiative on October 15, 2009–or even unrelated to a foreign account–will be considered a voluntary disclosure for purposes of the Policy. These were unfortunate comments given the fact that historically many people in the IRS, including high level officials, readily stated that filing amended returns and paying the tax and otherwise complying with the Policy would be considered a voluntary disclosure. There seems to have been some rethinking of that long standing commitment and in the author's judgment, that is bad tax policy.

–First, it is not good policy to casually throw off a practice and procedure of *informal* voluntary disclosures which has served both the IRS and the taxpayers at large. Requiring all voluntary disclosures to be formal voluntary disclosures will no doubt drop the number of voluntary disclosures significantly.

–Second, the Policy itself as written basically provides for the filing of the amended returns by the taxpayer as a proper method to make a voluntary disclosure.[13]

–Third, effective use of examination resources should also be considered by the

[13] See IRM 9.5.11.9, Example 6 a.

Government in insisting that all voluntary disclosures be of the *formal* type. Maybe there will not be an increase in investigative time devoted to voluntary disclosures because fewer people will make voluntary disclosures; but if that is the case then the Government and the taxpaying public lose. If the number of voluntary disclosures stay even close to their historical rate, why should precious examination resources be spent on examining tax returns of taxpayers who are voluntarily coming forward? Precious examination resources should be spent on ferreting out those taxpayers who have not come forward and those who are actively engaged in undermining the tax system, not those who decide to get into compliance. Our firm has been engaged in voluntary disclosures for many, many years and we will normally tell the taxpayer that the amended return needs to be "bullet proof." Even if audited and scrutinized, even perhaps by a Special Agent, the returns will pass muster. Perhaps that is not the way all taxpayers make voluntary disclosures, but I would think that if one has engaged in serious non-tax compliance and has decided to come forward, there should not be much audit potential there.

Conclusion

In making a voluntary disclosure today, there is no question the UBS Initiative has brought about a greater awareness of the voluntary disclosure policy within the IRS and its importance to tax administration–both in encouraging taxpayers to get back into the system and in investigating areas of non-compliance. It has, in the author's judgment,

made the Criminal Investigation Division more "user friendly" by establishing procedures–such as "pre-clearance" and the "optional voluntary disclosure letter" which has streamlined the process for both the IRS and the taxpayer. Ultimately, after the Criminal Investigation's review of the matter, if successful, the result of the *formal* voluntary disclosure is the SAC's letter,"conditionally accepting"[14] the taxpayer's voluntary disclosure.

While there may be limited legal effects of the SAC's letter, the substantial administrative effect both within the Internal Revenue Service and even with the Department of Justice Tax Division should not be under estimated. An official of the Criminal Investigation Division commented to me–in discussing *formal* vs *informal* voluntary disclosures, that in the case of the *formal* voluntary disclosure, you get "*the letter.*" We can all debate the legal significance of *the letter,* but we should all conclude that if *the letter* is important to Government, it should be important to the taxpayer and tax practitioners. The *formal* voluntary disclosure has become the "preferred" procedure–at least form the Government's perspective. There will however be a cost–both to the IRS in enforcement resources and to taxpayers in increased penalty exposure.

While there are potential benefits to the Government of requiring all voluntary

[14] The letter states that the voluntary disclosure has been "preliminarily accepted...conditioned upon the information provided...by the taxpayer being, and remaining, truthful, timely, and complete." It also reminds the taxpayer that "A voluntary disclosure will not automatically guarantee immunity from prosecution; however, a voluntary disclosure may result in prosecution not being recommneded."

disclosures to be *formal*--- the ability to additional collect tax penalties and increased intelligence, it will be the challenge of the IRS to balance these benefits against the costs in the new post -UBS voluntary disclosure environment. Penalties, especially for foreign information reporting, can be draconian and perhaps the recent UBS enforcement initiative has inspired the IRS. Most IRS employees do not relish penalizing taxpayers–especially those whom come forward voluntarily-- but I am sure that some do.

But we should not lose sight of the fact that penalties are there for a purpose and that is to deter taxpayers from engaging in tax misconduct in our voluntary compliance system. Punishment is secondary. When a taxpayer comes forward voluntarily, penalties should take a much less prominent role in tax administration. Sacrificing or limiting the potential for those penalties in order to foster voluntary compliance and more effectively use tax investigative resources seems like a good balance.

The Government should stop talking about requiring only *formal* voluntary disclosures and should make sure that practitioners and taxpayers know that if they do come forward voluntarily–*formally* or *informally*, and get right with their tax obligations, they will be treated fairly. For those within the IRS who advocate only *formal* voluntary disclosures, they should be careful what they ask for and keep in mind the "law of unintended consequences."[15]

[15] According to *Wikipedia*, the law of unintended consequences is an indiomatic warning that an intervention in a complex system always creates unanticipated and often undesirable outcomes–akin to "Murphy's Law."