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In this article, Noked urges the IRS to adopt permanent voluntary disclosure procedures that incorporate specific features of the latest offshore voluntary disclosure program and correct some of its flaws.

I. Introduction

The IRS in March announced that the 2014 offshore voluntary disclosure program will close on September 28.[1] It is unclear what rules will apply to taxpayers who make voluntary disclosures after that date. If the IRS does not provide new voluntary disclosure procedures for willful noncompliance, taxpayers will face uncertain penalties under so-called quiet disclosures and the traditional voluntary disclosure practice outlined in the Internal Revenue Manual (IRM disclosures). That uncertainty — and the potential for inconsistent treatment of similarly situated taxpayers — would increase the costs of becoming compliant and ultimately discourage taxpayers from making voluntary disclosures.

This article thus calls for the IRS to adopt permanent voluntary disclosure procedures. They would be permanent in the sense that there would always be a way for taxpayers to disclose their noncompliance and receive a predictable, reduced penalty. However, the specific rules under those procedures would be subject to change by the IRS. As detailed later, the permanent procedures could incorporate efficiencies of the 2014 OVDP while correcting some of its flaws, including the problematic aspects of the program's penalty policy.

II. A Brief History of Voluntary Disclosure Policies

A. Pre-OVDP: Quiet and IRM Disclosures

Although the United States had federal voluntary disclosure programs in the first half of the 20th century, from 1952 to 2009 there was no formal policy on how to regularize offshore tax evasion, except for a three-month program in 2003 that had limited success.[2] Before the introduction of the 2009 OVDP, taxpayers who failed to report offshore assets or income had only two options for correcting that noncompliance: quiet disclosures or IRM disclosures.

Quiet disclosures are made by filing amended returns for applicable open years, and paying related additional tax and interest, without otherwise notifying the IRS. Although a quiet disclosure provides no formal protection against criminal and civil penalties, most quiet disclosures went undetected by the IRS before 2008.[3]

IRM disclosures entail sending the amended tax returns and an explanatory letter to IRS Criminal Investigation and making "good faith arrangements . . . to pay in full, the tax, interest, and any penalties determined by the IRS to be applicable."[4] IRM section 9.5.11.9(2) states that this type of voluntary disclosure "may result in prosecution not being recommended" if it is made before the IRS receives information about the

[1] IR-2018-52.

[2] *See* Dominika Langenmayr, "Voluntary Disclosure of Evaded Taxes Increasing Revenue, or Increasing Incentives to Evade?" 151 *J. Pub. Econ.* 110 (2017).

[3] Travis A. Greaves and T. Joshua Wu, "Quietly Finding a Home in the Voluntary Disclosure World," *Tax Notes*, July 13, 2015, p. 207.

[4] IRM section 9.5.11.9.

taxpayer or initiates a civil or criminal investigation of the taxpayer.[5]

B. 2009-2014 OVDPs

The IRS announced the 2009 OVDP in March 2009 and closed it in October 2009,[6] and the 2011 OVDP was in existence between February and September of 2011. The IRS announced the 2012 OVDP in January 2012 with no set deadline.[7] The 2012 OVDP was amended by the IRS in June 2014, and the most recent terms are still referred to as the 2014 OVDP. According to the IRS, more than 56,000 taxpayers have participated in the OVDPs, resulting in the overall payment of $11.1 billion in back taxes, interest, and penalties.[8] The number of voluntary disclosures reached its annual peak in 2011 (18,000). The number of participants has since declined, and in 2017 only 600 disclosures were made.[9]

All versions of the OVDP have provided a structured way for eligible taxpayers[10] with unreported offshore income and assets to become compliant without criminal penalties and with predictable civil penalties.[11] Under the 2014 OVDP, participants must:

- provide information about the undeclared offshore financial assets and the relevant financial institutions and facilitators;[12]
- file accurate tax returns and foreign bank account reports for the eight most recent tax years for which the due date has already passed;[13]
- pay the tax, interest, and applicable penalties[14] due for those returns; and
- pay a miscellaneous offshore penalty equal to either 27.5 percent or 50 percent of the highest aggregate value of the taxpayer's previously undeclared foreign financial assets during the relevant period.[15]

Participants must also correct any noncompliance involving domestic issues.[16] However, the offshore penalty structure resolves only liabilities and penalties related to offshore noncompliance, and the domestic part of a voluntary disclosure is subject to examination and potential additional penalties.[17] Taxpayers with purely domestic noncompliance issues cannot participate in the OVDP, but they can file an IRM disclosure.

The 2014 OVDP has solved practical difficulties that many taxpayers face when they prepare their returns. Notably, it has provided an optional simplified method to calculate the tax liability for passive foreign investment companies, which helps taxpayers who cannot obtain the historical information for the statutory PFIC computation.[18] Other positive features include the pre-clearance process and a defined reporting period.

C. Streamlined Procedures and Delinquent Filings

Taxpayers whose failure to report offshore financial assets and income was non-willful can use the streamlined filing compliance procedures.[19] The IRS defines non-willful conduct as "conduct that is due to negligence,

[5]Greaves and Wu observe that "despite these strict requirements, [they] are not aware of any taxpayer who was prosecuted after filing a complete and truthful [IRM] disclosure in good faith." Greaves and Wu, *supra* note 3, at 208.

[6]*See generally* Shu-Yi Oei, "The Offshore Tax Enforcement Dragnet," 67 *Emory L. J.* 655, 676 (2018).

[7]IR-2012-64.

[8]IR-2018-52.

[9]*See id.*

[10]To be eligible to participate in the OVDPs, a taxpayer must not be under civil examination or criminal investigation, and the relevant funds must be from legal sources. *See* IRS, "Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers 2014," Q&As 12-14.

[11]*See* Greaves and Wu, *supra* note 3, at 208.

[12]The participating taxpayers must provide the information required in IRS Form 14457, "Offshore Voluntary Disclosure Letter," and Form 14454, "Attachment to Offshore Voluntary Disclosure Letter."

[13]The 2009 OVDP required six years, and the 2011 OVDP extended the lookback period to eight years.

[14]The relevant penalties may include an offshore penalty, an accuracy-related penalty, a failure-to-file penalty, and a failure-to-pay penalty. Other penalties, including the fraud penalty (75 percent) and the information return penalties, generally do not apply to OVDP participants. *See* FAQs, *supra* note 10, at Q&A 4, 7.

[15]The higher rate of 50 percent applies if the taxpayer had financial assets in a financial institution or a facilitator that is under public investigation by the IRS or the Justice Department. *See id.* at Q&A 7.2. The IRS publishes a list of these financial institutions and facilitators.

[16]FAQs, *supra* note 10, at Q&A 7.1.

[17]*See id.*

[18]*Id.* at Q&A 10.

[19]Under the initial rules from 2012, the streamlined procedures were available only for taxpayers residing overseas who owed no more than $1,500 in tax for any of the relevant years and passed a risk assessment process. In 2014 the IRS eliminated the $1,500 threshold and the risk assessment process and extended the eligibility to taxpayers residing in the United States. IRS, "Streamlined Filing Compliance Procedures."

inadvertence, or mistake or conduct that is the result of a good faith misunderstanding of the requirements of the law."[20] Participants in the streamlined procedures must submit a statement, signed under penalty of perjury, certifying that their failure to report foreign financial assets and pay tax on those assets "did not result from willful conduct on their part."[21]

Eligible participants must file tax returns for the most recent three years for which the due date has passed, pay the required tax and interest, and file FBARs for the most recent six years for which the FBAR due date has passed. Eligible taxpayers who do not reside in the United States are not subject to any civil penalty.[22] However, taxpayers who reside in the United States are subject to a 5 percent miscellaneous offshore penalty on the highest aggregate balance of their foreign financial assets during the covered FBAR period.[23]

The streamlined procedures do not provide protection against criminal penalties. But there is practically no risk of criminal prosecution for eligible, non-willful taxpayers who participate in the streamlined procedures, since criminal tax statutes require willfulness.[24]

The low or nonexistent penalties make the streamlined procedures much more attractive than the OVDP. There have been concerns that some of the conduct of participants in the streamlined procedures has actually been willful.[25] The Justice Department announced in 2016 that it intended to examine and prosecute taxpayers who falsely certified that their conduct was non-willful.[26]

D. FBARs and Information Returns

The IRS also gives taxpayers procedures for filing delinquent FBARs and international information returns if specified requirements are satisfied.[27] Taxpayers who follow these procedures do not need to use either the OVDP or the streamlined procedures.

As with the OVDP and the streamlined procedures, taxpayers cannot use these procedures if they are under civil examination or criminal investigation, or if they have been contacted by the IRS regarding delinquent FBARs or information returns. Also, taxpayers must have reasonable cause for not timely filing the information returns.

E. The IRS Approach to Quiet Disclosure

After adopting the OVDP and the streamlined procedures, the IRS's approach to quiet disclosure has become negative. Its position is that taxpayers should use the OVDP for willful noncompliance and the streamlined procedures for non-willful noncompliance.[28] The main problem with quiet disclosures is that taxpayers who would be subject to penalties under the formal programs might be able to avoid them if they file a quiet disclosure and their case is not audited within the limitations period. Nevertheless, data on the increase in taxpayers reporting offshore assets indicates that many of them likely reported their foreign accounts through quiet disclosures.[29] This suggests that the IRS's negative approach to quiet disclosures has had little effect.

III. The Expected End of the 2014 OVDP

The IRS has given the following reasons for closing the 2014 OVDP:

> While the program has been successful in the past, there has been a significant decline in the number of taxpayers participating as well as an increase in awareness of offshore tax and reporting obligations. The IRS has previously stated

[20] *See id.*

[21] *See* IRS, "U.S. Taxpayers Residing in the United States."

[22] A taxpayer is considered "residing outside the United States" if she does not have a U.S. abode and was outside the United States for at least 330 full days in one or more of the most recent three years for which the U.S. tax return due date has passed. *See id.*

[23] *Id.*

[24] *See* Greaves and Wu, *supra* note 3, at 209.

[25] *See* Oei, *supra* note 6, at 705.

[26] *See id.*; and Allison Bennett, "U.S. DOJ Cracking Down on Offshore Disclosure Tax Cheats," *BNA International Tax Monitor*, Nov. 14, 2016.

[27] *See* IRS, "Delinquent FBAR Submission Procedures"; and IRS, "Delinquent International Information Return Submission Procedures."

[28] The IRS in the FAQs encouraged taxpayers who have already made quiet disclosures to participate in the OVDP "to avail themselves of the protection from criminal prosecution and the favorable penalty structure offered under the OVDP." It warned that "quiet disclosures provide no protection from criminal prosecution and may lead to civil examination and the imposition of all applicable penalties." *See* FAQs, *supra* note 10, at Q&A 15.

[29] *See* Oei, *supra* note 6, at 704.

publicly that the 2014 OVDP would close at some time. Taxpayers have had the opportunity to participate in OVDP since 2009.[30]

The IRS said that "stopping offshore tax noncompliance and evasion remain top priorities" of the agency and that it uses information received under the Foreign Account Tax Compliance Act and other sources, such as the Swiss bank program, to enforce compliance with tax and FBAR requirements.[31]

It is unclear how taxpayers will be able to remedy willful offshore noncompliance after September 28. The IRS has stated that information on how to make disclosures after that date will be posted in the future.[32] The streamlined procedures will remain available;[33] however, the IRS said that "all quiet disclosures will be reviewed and will be subject to civil or criminal penalties as determined under existing law."[34] The agency has invited tax practitioners and members of the public to submit suggestions about future voluntary disclosure practice procedures.[35]

An IRS official recently indicated that the agency does not plan to offer a new OVDP and that it will instead provide "additional clarity for a traditional program."[36] Thus, the IRS might be planning to release more comprehensive guidance on the rules for IRM disclosures.

IV. The Future of Voluntary Disclosure

Any discussion about the future of voluntary disclosure must begin with an acknowledgement that the problem of tax noncompliance has not been solved. There are still noncompliant taxpayers and there always will be. Although FATCA makes it harder to commit some types of offshore tax evasion, it achieves only incomplete tax transparency.[37] Some taxpayers might use loopholes and noncompliance opportunities to avoid FATCA reporting,[38] and some valuable assets — especially nonfinancial assets, such as real property and artwork — are not covered by FATCA. Moreover, new technologies might allow taxpayers to circumvent reporting, as was made apparent in the recent enforcement efforts concerning cryptocurrencies.[39] Thus, FATCA reporting has not solved the problem of offshore tax evasion.

Further, some taxpayers fail to comply with their tax obligations for various reasons, and the IRS might consider their failure willful, even when it is unclear whether they intended to evade tax. For example, taxpayers who immigrated to the United States and Americans who live overseas may mistakenly file tax returns reporting only their U.S. income. Omitting the foreign income and bank accounts might be considered willful noncompliance, thus making these taxpayers ineligible for the streamlined procedures.

In general, giving noncompliant taxpayers a way to voluntarily correct their tax affairs can be beneficial for society.[40] As shown by Louis Kaplow and Steven Shavell, an optimal law enforcement scheme that includes self-reporting (that is, a way for noncompliant people to voluntarily disclose their noncompliance and pay a reduced penalty) is superior to an optimal law enforcement scheme without self-reporting.[41] Under an optimal voluntary disclosure scheme, participants will pay a sanction equal to, or slightly less than, the penalty that would apply if they got caught, multiplied by the probability of their being caught. Such a scheme has several advantages. First, it reduces enforcement costs because fewer

[30] FAQs, *supra* note 10, at Q&A 2.

[31] *Id.* at Q&A 4.

[32] *Id.* at Q&A 5 ("Taxpayers will continue to have existing avenues to disclose offshore noncompliance after September 28, 2018. Additional information on how to make disclosures after September 28, 2018 will be posted on irs.gov.").

[33] *Id.* at Q&A 6.

[34] *Id.* at Q&A 8.

[35] *Id.* at Q&A 10.

[36] Emily L. Foster, "Offshore Voluntary Disclosure Program Won't Repeat, IRS Says," *Tax Notes Int'l*, June 11, 2018, p. 1350.

[37] *See* Noam Noked, "Tax Evasion and Incomplete Tax Transparency," 7 *Laws: Special Issue on International Tax Law and Policy* (2018).

[38] *See* Noked, "FATCA, CRS, and the Wrong Choice of Who to Regulate," 22 *Fla. Tax Rev.* (2018).

[39] *See, e.g.*, *United States v. Coinbase Inc.*, No. 3:17-cv-01431 (N.D. Cal. 2017).

[40] According to the OECD, a "carefully drafted" regularization program can benefit everyone involved: taxpayers participating in the program, the general population of compliant taxpayers, and the government. OECD, "A Framework for Successful Offshore Voluntary Compliance Programmes," 7 (2009).

[41] Kaplow and Shavell, "Optimal Law Enforcement With Self-Reporting of Behavior," 102 *J. Pol. Econ.* 583 (1994).

resources are needed to identify and prosecute the people who self-report their noncompliance. Second, risk-averse people benefit from paying a known penalty.[42] And third, self-reporting may reduce the social harm from tax evasion.[43]

Although a few tax scholars have raised concerns about the perception of fairness and the costs of tax amnesties from long-term noncompliance effects,[44] those costs would be reduced if the penalties for people who self-report their noncompliance were higher.[45] If the penalties are set correctly, as suggested by Kaplow and Shavell, providing voluntary disclosure procedures would benefit society. As proposed by this article, the procedures should be offered on a permanent basis as part of the general tax enforcement scheme. The exact rules, including the penalties, may change from time to time if the IRS finds them suboptimal.

It is expected that the IRS will continue allowing taxpayers to self-report their past noncompliance in exchange for reduced penalties (especially criminal penalties), although the applicable penalties might be uncertain and unpredictable. The discussion below explores possible approaches for voluntary disclosure after termination of the OVDP.

A. Criminal Liability

The IRS is expected to continue the long-standing practice under which taxpayers who file complete, timely (that is, the taxpayer is not under civil examination or criminal investigation), and truthful voluntary disclosures in good faith will be unlikely to face criminal penalties. As noted earlier, the termination of the OVDP does not affect IRM disclosures. Noncompliant taxpayers who file an IRM disclosure will be able to avoid criminal liability after the termination of the OVDP. If the IRS adopts new voluntary disclosure procedures, it is very likely that the participants will not face criminal charges. The IRS should consider adopting a voluntary disclosure policy that gives those who follow the prescribed procedures certainty that they will be protected from criminal charges. The IRS should also consider the appropriate approach for those who file quiet disclosures.

1. Certainty and pre-clearance.

Guaranteeing that criminal charges will not be filed against taxpayers who file a complete, timely, and truthful voluntary disclosure would benefit risk-averse filers and create a stronger incentive for voluntary disclosure. Because the IRS rarely (if ever) prosecutes taxpayers who make a complete, timely, and truthful voluntary disclosure, it is unclear what the benefit is from uncertainty about potential criminal charges.[46] The 2014 OVDP's policy of providing participants who follow the program rules certainty that they will not face criminal charges should also apply to IRM disclosures[47] and to any new voluntary disclosure procedures.

As a related matter, the IRS should consider keeping the OVDP's pre-clearance process as part of any future voluntary disclosure procedures. Under the pre-clearance process, the taxpayer (or her representative) sends CI a fax with the taxpayer's information, a list of all the financial institutions where the taxpayer has undisclosed OVDP assets, and all the entities through which the taxpayer holds undisclosed OVDP assets.[48] The IRS gets back to the taxpayer or the representative within 30 days with a decision on

[42] *See id*.

[43] *See* A. Mitchell Polinsky, "The Theory of Public Enforcement of Law," National Bureau of Economic Research working paper 11780, at 52 (2005).

[44] *See* Craig M. Boise, "Breaking Open Offshore Piggybanks: Deferral and the Utility of Amnesty," 14 *Geo. Mason L. Rev.* 667, 701-705 (2017). Boise notes that tax amnesties are potentially detrimental to compliance because (1) amnesties may undermine the perceived fairness of the tax system among taxpayers; (2) amnesties may diminish the perception of tax evasion as a serious offence; and (3) taxpayers may expect that the government will offer more tax amnesties in the future, which may undermine the incentives for tax compliance. *See also* Leandra Lederman, "The Use of Voluntary Disclosure Initiatives in the Battle Against Offshore Tax Evasion," 57 *Villanova L. Rev.* 499, 527 (2012) (applying Boise's analysis to the OVDP).

[45] *See* Lederman, *supra* note 44, at 524.

[46] According to Lederman, *supra* note 44, at 526-527, willful tax evaders who are "risk-takers" are the least likely to voluntarily disclose their noncompliance. It appears that this uncertainty regarding criminal penalties for taxpayers who voluntarily disclose noncompliance harms risk-averse taxpayers whose noncompliance is less willful and problematic, and they are less likely to be indicted anyway.

[47] As noted earlier, the IRM provides that filing a voluntary disclosure "*may* result in prosecution not being recommended" (emphasis added). IRM section 9.5.11.9(2).

[48] *See* FAQs, *supra* note 10, at Q&A 23.

whether the taxpayer is eligible to make an offshore voluntary disclosure.[49] After receiving a favorable pre-clearance decision, the taxpayer must file the OVDP forms within 45 days. A taxpayer who received a positive pre-clearance result knows with confidence that she will not face criminal charges if she complies with the terms of the OVDP.

As noted by the American Bar Association Section of Taxation, some taxpayers may be concerned that giving the IRS information through the pre-clearance process might incriminate them in an examination or investigation if the pre-clearance is unsuccessful.[50] The IRS should consider issuing guidance providing that the information may not be used against the taxpayer, as suggested by the ABA tax section.

2. Quiet disclosure and criminal liability.

It is unclear what the IRS's approach would be concerning the criminal liability of filers who make quiet disclosures. The statement that after the termination of the OVDP, "all quiet disclosures will be reviewed and will be subject to civil or criminal penalties as determined under existing law"[51] may indicate that the IRS will start prosecuting filers of quiet disclosures. If that is the case, noncompliant taxpayers who want to correct their tax affairs should file an IRM disclosure or another type of disclosure prescribed by the IRS. However, the IRS has made statements discouraging quiet disclosures before and, as noted, rarely (if ever) has it prosecuted filers of complete, timely, and truthful quiet disclosures.

From a policy perspective, it is unclear how quiet disclosures should be treated. According to Shu-Yi Oei, "quiet disclosures may be appropriate for taxpayers with '*de minimis* foot faults' because they obviate the need to enter onerous, costly, and regressive OVDP procedures. But for willful taxpayers with higher dollar offenses, allowing quiet disclosures is unfair to taxpayers who have voluntarily disclosed past offenses."[52]

There are reasons why the IRS should not prosecute the filers of quiet disclosures. When choosing between filing a quiet disclosure, filing an IRM disclosure, or participating in the OVDP, noncompliant taxpayers have faced a trade-off between the risks of criminal and civil liabilities. From the taxpayers' perspective, filing a quiet disclosure has been perceived as involving a lower risk of high civil penalties but a lower certainty regarding protection against criminal liability. There are two ways to change this trade-off and eliminate the advantage of quiet disclosure: either (1) increase the risk of criminal penalties for filers of quiet disclosures or (2) impose similar civil liability on filers of quiet disclosures, IRM disclosures, and other types of disclosures.

The latter approach is more appealing. It is easy to justify a policy of similar penalties for filers of quiet disclosures and IRM disclosures (or other disclosure procedures for willful noncompliance) because taxpayers with similar conduct should be subject to similar penalties regardless of how they voluntarily disclose their noncompliance. It is harder to justify why criminal charges should potentially be brought only against the filers of quiet disclosures while taxpayers with similar (or worse) noncompliance who file under different procedures are exempt from criminal liability. Because the IRS can presumably detect filers of quiet disclosures through its IT systems, the different treatment of different types of filers cannot be justified by any difference in the likelihood of detection.[53] If the IRS begins to scrutinize quiet disclosures for civil liability the same way it scrutinizes filings under other disclosure procedures, quiet disclosures will offer no advantage over other types of disclosures, and there will be no incentive to file

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[49] As noted earlier, to be eligible to participate in the OVDP, the taxpayer must not be under civil examination or criminal investigation, and the relevant funds must be from legal sources.

[50] *See* ABA tax section, "Comments on the 2014 Offshore Voluntary Disclosure Program and the Streamlined Procedures," at 20-21 (May 2, 2018).

[51] *See* FAQs, *supra* note 10, at Q&A 8.

[52] *See* Oei, *supra* note 6, at 704-705.

[53] In past decades, the IT capabilities were less developed, so the IRS may not have been able to easily detect the filing of quiet disclosures. However, today's technology should enable the agency to detect quiet filings at a very low cost.

quiet disclosures, even if criminal penalties are not imposed on those filers.

If criminal charges are brought against filers of quiet disclosures, the charges are less likely to be successful when the conduct involves only "*de minimis* foot faults" as described by Oei.[54] As a result, the IRS would prosecute only willful tax evaders who committed the worst offenses.[55] That, however, might not deter taxpayers with less problematic noncompliance from filing quiet disclosures.[56]

Thus, instead of prosecuting filers of quiet disclosures, the IRS should focus on ensuring that they are subject to the same civil penalties as other filers. That would be consistent with the IRS's policy of not prosecuting taxpayers who file a complete, timely, and truthful voluntary disclosure. It would also reduce the incentive to make quiet disclosures. Moreover, this policy would enhance the perception of fairness because taxpayers with similar noncompliance would be treated similarly.

B. Civil Liability

1. Certainty and predictability.

One of the OVDP's main advantages is that it has provided near certainty to participants about applicable civil penalties. Filers of IRM disclosures and quiet disclosures, by contrast, cannot predict whether specific penalties (such as the 75 percent fraud penalty) will apply and what the amount of an FBAR penalty will be. For willful FBAR nonreporting, although 2015 internal IRS guidance states that "in most cases, the total penalty amount for all years under examination will be limited to 50 percent of the highest aggregate balance of all unreported foreign financial accounts during the years of examination,"[57] examiners can still recommend a penalty of up to 100 percent of the highest aggregate balance during the relevant period.[58]

The lack of predictability and certainty regarding the penalties stems from the lack of clear guidance on how these penalties should apply to taxpayers who file a voluntary disclosure other than through the OVDP or the streamlined procedures. Because there is no clear guidance, different IRS agents may impose different penalties on taxpayers with similar facts.

If the OVDP is terminated with no replacement, that uncertainty will likely have some harmful effects. As discussed earlier in the context of criminal penalties, uncertainty over civil penalties creates unnecessary costs for risk-averse taxpayers. Some noncompliant taxpayers might decide to remain noncompliant if they think the risk associated with doing so is lower than the risk associated with filing an IRM disclosure or a quiet disclosure. Although this uncertainty might create stronger ex ante deterrence, which could reduce the incentive to engage in noncompliance, the extent of that deterrent effect could be limited, especially for the risk-averse taxpayers who are the most harmed by the uncertainty over civil penalties. Another potential problem is that willful noncompliant taxpayers might have a stronger incentive to certify that they are non-willful and participate in the streamlined procedures to avoid the risk of high penalties associated with the filing of an IRM disclosure or quiet disclosure. Therefore, there is a compelling case for adopting voluntary disclosure procedures that determine with certainty the civil penalties that apply to the voluntary disclosures of willful noncompliance, similar to the OVDP.

Certain and predictable penalties might be undesirable if they are too high. Some participants in the OVDP opted out of the program's penalty scheme because they expected the otherwise applicable penalties to be lower (although they ran the risk that the non-OVDP penalties would be higher). Any new voluntary disclosure procedures could provide predicable maximum penalties, which would generally apply, but also give IRS agents discretion to reduce or waive the penalties on a case-by-case basis in appropriate situations involving low levels of culpability.

[54] *See* Oei, *supra* note 6, at 704-705.

[55] *See* Lee A. Sheppard, "Nerds and Cops, Part 2: IRS CI Looking for a Few Good Cases," *Tax Notes*, Apr. 30, 2018, p. 595.

[56] For a discussion on policy implications of the "worst-first" enforcement policy, see Leigh Osofsky, "Concentrated Enforcement," 16 *Fla. Tax Rev.* 325 (2014).

[57] SBSE-04-0515-0025.

[58] *Id.* at Attachment 1, section (2).

2. The magnitude of penalties.

As noted earlier, under Kaplow and Shavell's ideal voluntary disclosure policy, the penalties for a participant would equal (or be slightly less than) the penalties that would apply if she got caught, multiplied by the probability of her being caught.[59] Because it is impractical to make this calculation for each individual taxpayer, there must be some grouping of taxpayers with similar characteristics of noncompliance, detection risks, and likely penalties if they get caught.

One group is tax evaders who intentionally lie on their tax returns and hide their assets and income from the IRS. If tax evaders are caught, the penalties would likely be high and possibly include criminal penalties. The likelihood of being caught depends on the sophistication of each tax evader and on other factors such as governmental policies (for example, information exchange policies), information leaks, and whistleblowers. Looking at what penalties should apply after termination of the OVDP, it appears unlikely that the IRS will reduce the current penalties for such willful tax evaders.[60] However, those penalties may be too high and thus provide suboptimal incentives for voluntary disclosure.[61]

The IRS should reconsider the 50 percent penalty that applies to taxpayers who hold financial accounts with blacklisted financial institutions. As suggested by the ABA tax section, that penalty should be limited to the balance in the accounts maintained in the blacklisted financial institutions — not to all the taxpayer's unreported offshore financial assets — and a de minimis exception should be provided.[62]

Another relevant group is noncompliant taxpayers whose conduct may not qualify as non-willful for purposes of eligibility for the streamlined procedures but whose noncompliance is more inadvertent than willful. Many of these taxpayers fall within the following groups: American expatriates, immigrants, "accidental" Americans, and heirs who inherited foreign assets.[63] If caught, these taxpayers are less likely to be subject to criminal penalties.

The likelihood of being caught varies among these taxpayers. The financial account information of American expats will probably be reported to the IRS under FATCA, so there is a good chance that the nonreporting will be detected. Immigrants who do not report their foreign assets are less likely to be caught because the records in the foreign financial institutions may not indicate that the account holder is a U.S. person. Oei makes a compelling case that these taxpayers should be subject to the lower range of penalties that apply to willful tax evaders.[64] That is because their conduct involves a lower level of culpability and a lower risk of double nontaxation. Moreover, according to Oei, these taxpayers might have less knowledge and limited access to tax advice, and their personal circumstances subject them to disproportionate and unjustifiable risks from failing to report offshore income and assets.[65]

When designing future voluntary disclosure procedures, the IRS should consider imposing a lower FBAR penalty or a miscellaneous offshore penalty on taxpayers who fall within one of the more-inadvertent-than-willful groups and who did not provide false information to the financial institutions that maintain their financial assets.[66] For example, the penalty could be 5 percent for taxpayers residing outside the United States and 10 percent for taxpayers residing within the United States. This would create a penalty bracket that is higher than the penalties that apply to non-willful taxpayers who file through the streamlined procedures and lower than the penalties that apply to people who commit willful acts of tax evasion. And, as discussed earlier, IRS agents should have discretion to reduce or waive the penalties prescribed under the voluntary

[59] *See* Kaplow and Shavell, *supra* note 41, at 583-585.

[60] Lederman, *supra* note 44, at 524, notes that "the IRS has raised the general penalty level with each voluntary disclosure initiative, which should help discourage non-compliers inclined to wait for a better 'deal.'"

[61] *See* Sheppard, *supra* note 55, at 612 ("OVDP is ending in September because the penalties are so high it has become unpopular.").

[62] *See* ABA tax section, *supra* note 50, at 20-21.

[63] *See* Oei, *supra* note 6, at 698-699.

[64] *See id.* at 695-702.

[65] *See id.*

[66] If a person provides a self-certification for FATCA purposes in which she hides that she is a U.S. person, that conduct should be considered willful tax evasion.

disclosure procedures in appropriate cases in which the level of culpability is low.

C. Other Design Considerations

Any future voluntary disclosure procedures should provide guidance on the required reporting period. There is no such guidance for IRM disclosures and quiet disclosures. To ensure that the disclosure is complete, filers of IRM disclosures or quiet disclosures whose noncompliance might be considered willful by the IRS might be required to file tax returns for all years in which they did not report income or assets.[67] For some taxpayers, obtaining the information needed to complete tax returns for many years back might be impossible or very costly. Those taxpayers might be discouraged from voluntarily disclosing their noncompliance if their failure to file returns for all past years would deem their disclosure incomplete and thus subject them to high penalties. The OVDPs provided certainty regarding the required reporting period by setting a clear lookback period: tax returns and FBARs should be filed for the most recent six years (under the 2009 OVDP) or eight years (under the later OVDPs) for which the due date has already passed. The IRS should consider including a similar lookback period in future voluntary disclosure requirements.[68]

Future voluntary disclosure procedures should also adopt some other features of the OVDP that were developed to address practical problems. One useful feature is the optional simplified computation method for tax liability from PFIC investments. The IRS stated:

> A lack of historical information on the cost basis and holding period of many PFIC investments makes it difficult for taxpayers to prepare statutory PFIC computations and for the Service to verify them. As a result, resolution of voluntary disclosure cases could be unduly delayed. Therefore, for purposes of this program, the Service is offering taxpayers an alternative to the statutory PFIC computation that will resolve PFIC issues on a basis that is consistent with the Mark to Market (MTM) methodology authorized in IRC section 1296 but will not require complete reconstruction of historical data.[69]

This practical solution reduces compliance costs without materially changing the tax liability. The IRS should consider offering this optional computation method as part of any future voluntary disclosure procedures.

D. Tax Administration Considerations

One advantage of the OVDP is that it has been administered by agents who gained expertise handling issues common among the program's participants. A centralized administration of voluntary disclosure cases by specialized agents should be cheaper because they can handle these cases more efficiently. It would also be fairer since the penalty policy would more likely be implemented consistently. The IRS should therefore consider assigning all voluntary disclosure cases to one center to retain the core expertise and to handle voluntary disclosure cases fairly and efficiently.

E. Domestic Noncompliance

The OVDP is unavailable to taxpayers with only domestic noncompliance issues.[70] Taxpayers with a combination of offshore and onshore noncompliance issues must correct all their affairs, but the certainty regarding civil penalties applies only to the offshore noncompliance issues.[71]

Before FATCA, unreported offshore holdings were harder to detect. That was the justification for imposing harsher reporting requirements and penalties on taxpayers with offshore holdings.[72] The OVDP was provided to relieve taxpayers who voluntarily disclosed their offshore

[67] There is no limitations period for a fraudulent return with the intent to evade tax, when no return has been filed, and when the taxpayer willfully attempted to defeat or evade tax. *See* section 6501(c). FBAR filing is required only for the past six years.

[68] The ABA tax section, *supra* note 50, supports adopting a six-year lookback period.

[69] *See* FAQs, *supra* note 10, at Q&A 10.

[70] As discussed earlier, those taxpayers can file IRM disclosures.

[71] *See* FAQs, *supra* note 10, at Q&A 10.

[72] *See* Oei, *supra* note 6, at 694.

noncompliance from those harsh penalties. In the FATCA era, as the likelihood of detection of offshore tax evasion has increased, onshore tax evasion may pose a more serious problem than offshore tax evasion. Yet the penalties and the voluntary disclosure policies have remained unchanged. It is time to reconsider those policies.

The same considerations discussed above concerning the advantages of voluntary disclosure are relevant to the voluntary disclosure of onshore tax noncompliance. Thus, the IRS should consider including voluntary disclosure of onshore tax noncompliance in permanent voluntary disclosure procedures. The penalties under voluntary disclosure procedures for onshore tax noncompliance should be different from those for offshore tax noncompliance because, under Kaplow and Shavell's calculation, the detection risk and the penalties if caught might be different. The IRS likely has information and estimates that should enable it to calculate the optimal penalties.

In addition to domestic noncompliance, there are other common types of noncompliance. For example, some individuals who expatriated did not know they had to file Form 8843, "Statement for Exempt Individuals and Individuals With a Medical Condition," and some people with a closer connection to another country than to the United States may not know that they had to file Form 8840, "Closer Connection Exception Statement for Aliens." There are no clear procedures for making a late filing of those forms. Thus, the IRS should consider providing disclosure procedures for these and similar common types of noncompliance.

V. Conclusion

After years of temporary OVDPs, it is time for the IRS to consider a long-term policy for voluntary disclosure. Relying on IRM disclosures or quiet disclosures would be inefficient and problematic. A better approach would be to adopt voluntary disclosure procedures that draw on the rules of the latest OVDP, especially its features that enhance certainty and reduce implementation and compliance costs. The new voluntary disclosure policy should also correct the flaws of the OVDP, including the problematic aspects of the penalty policy. ■