Client Alert.

May 17, 2010

Integrity of the Voluntary Disclosure Program Confirmed

By Joseph K. Fletcher, III and Robert A.N. Cudd

Recently, practitioners have suggested that the Internal Revenue Service engaged in certain "bait-and-switch" techniques with respect to voluntary disclosure, in that it was prosecuting persons who participated in their voluntary disclosure. (*See* BNA Daily Tax Report 5/6/2010 containing the text of a letter by certain practitioners to The Honorable Douglas H. Shulman, Commissioner, Internal Revenue Service.) We have confirmed with high-ranking officials of the IRS that this is not the case, and that the integrity of the voluntary disclosure program remains intact.

The IRS is prosecuting persons who have already been identified prior to submitting a purported voluntary disclosure. The ability of the IRS to prosecute persons who have been identified prior to a purported voluntary disclosure should come as no surprise to practitioners. Indeed, both the special voluntary disclosure program with respect to previously undisclosed foreign bank accounts (which ended October 15, 2009), and the general voluntary disclosure program under Internal Revenue Manual Section 9.5.11.9 permit voluntary disclosure only in situations in which the taxpayer has not been identified and in which the funds at issue are not from illegal sources. I.R.M. 9.5.11.9(4) provides:

> (4) A disclosure is timely if it is received before:
>
> a. the IRS has initiated a civil examination or criminal investigation of the taxpayer, or has notified the taxpayer that it intends to commence such an examination or investigation;
>
> b. the IRS has received information from a third party (*e.g.*, informant, other governmental agency, or the media) alerting the IRS to the specific taxpayer's noncompliance;
>
> c. the IRS has initiated a civil examination or criminal investigation which is directly related to the specific liability of the taxpayer; or
>
> d. the IRS has acquired information directly related to the specific liability of the taxpayer from a criminal enforcement action (*e.g.*, search warrant, grand jury subpoena).

If a taxpayer is considering voluntary disclosure under Section 9.5.11.9, having their attorney submit identifying information for "pre-clearance" will clarify whether the taxpayer has been identified. In the pre-clearance process, the attorney provides the Criminal Investigation Division ("CID") with identifying information of the taxpayer and requests a determination as to whether the taxpayer has been identified. If CID confirms that the taxpayer has not been identified, the taxpayer is then eligible for voluntary disclosure, provided that the income at issue is not from illegal sources. If the taxpayer does not utilize pre-clearance, the CID will verify if the taxpayer is eligible for voluntary disclosure and will send a letter to the taxpayer informing them of their eligibility.

Taxpayers who enter into the voluntary disclosure program should be mindful that they must be truthful, complete, and

accurate as part of the voluntary disclosure. Because a failure to be completely truthful may result in prosecution, it is important that the taxpayer and their representative not "shade" facts. Further, any amended returns that are filed must restate all items on those returns. For that reason, if the IRS requests amended returns (as it is in situations where the taxpayer is disclosing previously undisclosed foreign bank accounts) any and all errors in the original returns must be corrected on the amended returns, including errors unrelated to the subject of the voluntary disclosure. The taxpayer's complete cooperation is required as part of any voluntary disclosure.

A taxpayer who has been identified should consult with a criminal attorney with respect to the potential implications of disclosure.

About Morrison & Foerster:

We are Morrison & Foerster—a global firm of exceptional credentials in many areas. Our clients include some of the largest financial institutions, Fortune 100 companies, investment banks and technology and life science companies. Our clients count on us for innovative and business-minded solutions. Our commitment to serving client needs has resulted in enduring relationships and a record of high achievement. For the last six years, we've been included on *The American Lawyer*'s A-List. *Fortune* named us one of the "100 Best Companies to Work For." We are among the leaders in the profession for our longstanding commitment to pro bono work. Our lawyers share a commitment to achieving results for our clients, while preserving the differences that make us stronger. This is MoFo. Visit us at www.mofo.com.

Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations.