



Helpful Instructions for Filing Domestic and Foreign Voluntary Disclosures

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In April 2020, the IRS quietly updated Form 14457. Previously called the “Offshore Voluntary Disclosure Letter,” the form’s name was changed to “Voluntary Disclosure Practice Preclearance Request and Application.” It had been used in conjunction with the Offshore Voluntary Disclosure Program (OVDP) that ended Sept. 28, 2018.

The revised form is not limited to offshore disclosures but rather covers all voluntary disclosures to IRS Criminal Investigation—domestic income tax issues, offshore income tax issues, estate and gift taxes, employment taxes, virtual currency issues, or other taxes. Most importantly, the updated form is accompanied by expanded instructions, which provide helpful guidance on voluntary disclosure practice.

Background

Form 14457 is intended to be used by taxpayers whose willful noncompliance with relevant tax laws exposes them to criminal liability for tax and tax-related crimes. If the taxpayer’s actions do not rise to the level of a tax or tax-related crime, other options should be considered. As the instructions caution, a voluntary disclosure doesn’t automatically guarantee immunity from criminal prosecution but instead will count as just one factor in the consideration of whether to prosecute.

Part I of the Form

Form 14457 is split into two parts. In Part I, “Preclearance Request,” the taxpayer supplies certain information to the IRS so the IRS can determine if the taxpayer is eligible to make a voluntary disclosure. The instructions state that preclearance can take a minimum of 30 days but may take 60 days or longer.

The IRS will evaluate whether the income the taxpayer wishes to disclose is from a “legal source” and whether the disclosure is “timely”—that is, that the taxpayer is disclosing the

previously undisclosed income before the IRS has either commenced a civil examination or criminal investigation or received information about the taxpayer's noncompliance.

The information that taxpayers must provide in Part I includes personal identifying factors, as well as a list of all the entities the taxpayer owns, controls, or has a beneficial interest in that were involved in the noncompliant behavior. Plus, the taxpayer must disclose specific identification of all bank accounts that had unreported income.

The instructions also note that submitting a preclearance request does not prohibit the taxpayer from seeking other compliance options at the same time. Yet there are few practical alternatives, since only someone who believes they might have committed a tax or tax-related crime should be filing Form 14457.

Part II of the Form

Once taxpayers receive preclearance, they may complete Part II, "Voluntary Disclosure." If taxpayers do not believe they will eventually be able to fully pay the tax, interest, and penalties agreed to under this procedure, they need to submit [Form 433-A](#) and [Form 433-B](#) with Part II of Form 14457.

Generally speaking, the instructions provide that voluntary disclosure requires the taxpayer to—

- be "truthful, timely, and complete,"
- cooperate with the IRS in determining tax liability and in investigating professional enablers who aided in noncompliance, and
- make good-faith arrangements with the IRS to pay in full the tax, interest, and penalties determined to be applicable by the IRS.

Voluntary disclosure includes:

- the filing of amended or delinquent tax returns for the six most recent tax years (or, if taxpayer's noncompliance involves fewer than six years, the number of tax years involved), including information returns (note that unlike in the OVDP, taxpayers cannot claim that they simply abandoned a foreign entity to avoid filing an information return, but now must show proof that the entity was actually dissolved),
- a narrative setting forth "the whole story will favorable and unfavorable facts including the entire history of noncompliance through the present," and
- the identification of all professionals and facilitators that rendered services from the inception of the noncompliance related to the disclosure period, the types of services they provided, whether the taxpayer fully disclosed to them the taxpayer's noncompliance, and whether they helped facilitate that noncompliance.

If preliminary acceptance of a voluntary disclosure is granted, the case will be forwarded for civil examination. The IRS will then apply a civil fraud penalty equal to 75% of the taxes due in at least one of the tax years in the six-year disclosure period.

In addition, Report of Foreign Bank and Financial Accounts (FBAR) penalties will apply in all cases of FBAR noncompliance where the facts and law support the assertion of willful FBAR penalty. While this may sound harsh, the result could actually be highly favorable for some taxpayers.

For example, a high-income taxpayer that did not file tax returns could be subject to failure to file and failure to pay penalties of 47.5% for each year of the failure. Under voluntary disclosure, however, the penalty would be limited to one fraudulent failure to file penalty of 75% for the highest year of the six years in the disclosure period.

Notable Points

It's helpful to keep in mind the following key points:

- A Form 14457 may be used to disclose “legal source income” only. The instructions state that “illegal source income” includes income from sources determined to be legal under relevant state law but illegal under federal laws. For example, income from the sale of marijuana—where such income is legal under the relevant state law but is illegal under federal law—is not covered under the voluntary disclosure.
- Taxpayers who participated in the OVDP are ineligible to use the voluntary disclosure practice for any disclosure period that overlaps with one or more OVDP disclosure periods. So, for example, a taxpayer who participated in the OVDP and made disclosures with respect to their 2017 taxes would not be eligible to use the voluntary disclosure practice until 2024 to cover the years 2018 through 2023.
- The instructions state that the IRS does not ordinarily encourage voluntary disclosures on behalf of decedents. Nonetheless, they contain guidance for submitting a voluntary disclosure on behalf of a decedent or estate, acknowledging that there may be “extraordinary circumstances” where it is appropriate. One example is when the executor of the decedent’s estate is filing its own voluntary disclosure to avoid personal liability for violating a fiduciary duty. When a Form 14457 is submitted on behalf of a decedent or estate, the narrative is completed by the executor/personal representative; if applicable, that executor/personal representative must provide complete facts outlining their willful conduct and intent in administering the estate.

Because criminal liability depends on conduct and intent, it is possible that spouses might file a joint return, but only one of them committed a crime that warrants the filing of Form 14457. The instructions provide that either the willful spouse or both spouses may use the voluntary disclosure practice and advise that even if only one spouse is willful, using a single form will ease the administrative burden of the civil examination. In such a case, the narrative set forth in the Form 14457 should state which spouse was willful.

- A taxpayer can submit a voluntary disclosure without an employer identification number (EIN), but in that case must explain why they are lacking one.

Takeaway

Form 14457 and the accompanying instructions provide much-needed guidance for the use of the voluntary disclosure procedure—especially since this is the method now required to be utilized for all disclosures to Criminal Investigation, both domestic and foreign.

Obviously, this approach should not be utilized by all taxpayers; however, when you believe your client's actions may rise to the level of a tax or tax-related crime, serious consideration should be given to submitting a voluntary disclosure. Luckily, the instructions to Form 14457 provide helpful guidance in making that decision.

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