

OVDPs: The IRS Should Put Its Money Where Its Mouth Is

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FEATURED PERSPECTIVES

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The IRS recently announced major changes to its offshore voluntary disclosure program, with the modified program referred to as the 2014 OVDP.¹ Along with the 2014 OVDP, the IRS introduced the

¹The IRS issued guidance on the 2014 OVDP in the form of frequently asked questions, which were posted on the IRS website June 18, 2014. See “Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers,” available at <http://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers-2012-Revised>. See also “Streamlined Filing Compliance Procedures,” available at <http://www.irs.gov/Individuals/International-Taxpayers/Streamlined-Filing-Compliance-Procedures>.

streamlined filing compliance procedures² (the streamlined procedures). They present a significant new opportunity for certain categories of taxpayers to come forward and disclose their offshore assets without facing the draconian penalties that may have previously discouraged disclosure. As described by the IRS, the 2014 OVDP is not a new program, but rather an expansion of the 2012 OVDP. The streamlined procedures are designed to accommodate a broader group of U.S. taxpayers, specifically “taxpayers certifying that their failure to report foreign financial assets and pay all tax due in respect of those assets did not result from willful conduct on their part.”³

These new procedures are a big step in the right direction, creating a more nuanced approach that offers disclosure options for both willful and non-willful actors. They represent a much overdue acknowledgement by the IRS that prior OVDPs introduced in 2009, 2011, and 2012 (collectively, the past OVDPs) were too rigid and too focused on taxpayers who *willfully* failed to report income from foreign accounts.⁴ However, as we

²The streamlined offshore filing compliance procedures consist of the streamlined domestic offshore procedures (for U.S. residents) and the streamlined foreign offshore procedures (for non-U.S. residents). This article is focused exclusively on the domestic application of the procedures.

³See *supra* note 1.

⁴See Statement by IRS Commissioner John Koskinen regarding offshore account compliance (June 18, 2014), available at <http://www.irs.gov/uac/Newsroom/Statement-of-IRS-Commissioner-John-Koskinen> (“Over time, we discovered that there were people, including many here in the U.S., for whom the existing program penalties were too harsh or restrictive. These people had small enough issues that they didn’t really need the protection from criminal prosecution offered by the

(Footnote continued on next page.)

will discuss herein, the restricted application of the streamlined procedures significantly undermines principles of horizontal equity and voluntary compliance that are essential to our tax system. One of the IRS's long-held policies with respect to voluntary disclosures has been to promote consistency and fairness in the treatment of similarly situated taxpayers.⁵ In contrast, the streamlined procedures, as applied by the IRS, reward latecomers and penalize taxpayers whose conduct was not willful, but who previously entered one of the past OVDPs and paid, along with other financial penalties, an offshore penalty of 20 percent, 25 percent, or 27.5 percent, depending on when they came forward.

FBAR Filing Requirement and OVDPs

Under the Bank Secrecy Act, U.S. citizens, U.S. residents, and other persons must annually report their direct or indirect financial interest in, or authority (whether signatory or other comparable authority) over, any bank, securities, or other financial account maintained with a financial institution in a foreign country if, at any time during a calendar year, the aggregate value of all such foreign accounts exceeds \$10,000. Such report is made to the U.S. Department of the Treasury by filing Financial Crimes Enforcement Network Form 114, "Report of Foreign Bank and Financial Accounts."⁶

The 2009 Offshore Voluntary Disclosure Program

Beginning in 2008, after years of lax enforcement, the IRS, in cooperation with the U.S. Department of Justice, intensified its efforts to crack down on unreported offshore assets and accounts, and curb offshore tax evasion. As part of that endeavor, the IRS in 2009 instituted a special OVDP (the 2009 OVDP) to encourage taxpayers with unreported offshore accounts to come into compliance with the foreign bank account reporting requirements and pay back taxes. The 2009 OVDP provided for a six-year lookback period, a 20 percent offshore penalty calculated off of the highest aggregate balance/value of such taxpayer's foreign assets at any time during the six-year period covered by the voluntary disclosure, and a 20 percent accuracy-

OVDP. But they also didn't fit into the narrow criteria of the streamlined procedures, either. Our aim is to get people to disclose their accounts, pay the tax they owe and get right with the government. . . . [F]or important categories of these non-willful people with offshore issues, a compliance regime that is too harsh won't net the desired result." See also National Taxpayer Advocate, 2013 Annual Report to Congress, Vol. 1, 228, for a detailed discussion of how the offshore voluntary disclosure "settlement programs are a good deal for 'bad actors' but not for 'benign actors'."

⁵See, e.g., Internal Revenue Manual 4.26.16.4.6 (07-01-2008).

⁶For a more detailed discussion of FBAR requirements and the 2009 and 2011 OVDPs, see Pedram and Negeen Ben-Cohen, "IRS's Offshore Bait and Switch: The Case for FAQ 35," 46 DTR J-1 (Mar. 9, 2011).

related penalty.⁷ The 2009 OVDP also included a narrow provision for a reduced 5 percent offshore penalty based on specified non-willfulness criteria.⁸ In addition, the 2009 OVDP required all potential participants to undergo a criminal clearance process.⁹ This two-step process would:

- determine a taxpayer's eligibility to enter the program; and
- provide those taxpayers who ultimately entered the program protection against criminal penalties.

The IRS at that time anticipated that some taxpayers would still be reluctant to come forward, and instead might gamble on their ability to continue to avoid detection or on better terms being offered down the line.¹⁰ Accordingly, they issued guidance to the effect that those taxpayers who waited until the expiration of the 2009 OVDP period would run the risk of detection from stepped-up enforcement efforts, or disqualification from the voluntary disclosure practice, or that the uniform penalty structure would not be available.¹¹

The 2011 OVDP

While the 2009 OVDP expired on October 15, 2009, the IRS subsequently announced a 2011 offshore voluntary disclosure initiative (the 2011 OVDP) for U.S. persons who were unwilling or unable to come forward under the 2009 OVDP. The 2011 OVDP included a

⁷The IRS issued guidance on the 2009 OVDP in the form of FAQs, which were posted on the IRS website May 6, 2009. See "Voluntary Disclosure: Questions and Answers," available at <http://www.irs.gov/uac/Voluntary-Disclosure:-Questions-and-Answers>.

⁸See Linda E. Stiff, deputy commissioner for services and enforcement, Memorandum re Authorization to Apply Penalty Framework to Voluntary Disclosure Requests Regarding Unreported Offshore Accounts and Entities (Mar. 23, 2009), providing in part that if (a) the taxpayer did not open or cause any accounts to be opened or entities formed, (b) there has been no activity in any account or entity during the period of control by the taxpayer, and (c) all applicable U.S. taxes have been paid on the funds in the accounts/entities so only the earnings have escaped U.S. taxation, then the offshore penalty is reduced to 5 percent.

⁹Taxpayers would initially provide their basic personal information to the IRS Criminal Investigation division to request pre-clearance, meaning confirmation that the IRS did not already know the taxpayer had unreported foreign assets and was not under audit. The taxpayer would subsequently submit a voluntary disclosure letter providing all the relevant details of the taxpayer's offshore accounts and assets, which would necessarily include incriminating information. After receiving and reviewing this letter to its satisfaction, the IRS would issue a preliminary acceptance letter accepting the taxpayer into the program and providing the taxpayer protection against criminal penalties.

¹⁰See "Voluntary Disclosure: Questions and Answers," *supra* note 7, at FAQ 17 for discussion of risks of failure to come forward under the 2009 OVDP.

¹¹See *id.* at FAQ 17.

higher and less flexible overall penalty structure as compared with the 2009 OVDP. In particular, the 2011 OVDP provided for an eight-year lookback period, a 25 percent offshore penalty calculated off of the highest aggregate balance/value of such taxpayer's foreign assets at any time during the eight-year period covered by the voluntary disclosure, and a 20 percent accuracy-related penalty.¹² The 2011 OVDP included the same criminal clearance process as the 2009 OVDP.

However, the 2011 OVDP recognized that not all FBAR violations were willful, introducing two significantly reduced penalties available for limited categories of taxpayers who could meet specific criteria relating to non-willfulness or account values.¹³ The 2011 OVDP's non-willfulness analysis was more generous than that applied under the 2009 OVDP, allowing a broader range of taxpayers to meet the criteria and pay the reduced offshore penalties. The guidance issued by the IRS with respect to the 2011 OVDP provided that taxpayers making a voluntary disclosure under the 2011 OVDP who fall into three specific categories described therein, all of which establish that the taxpayer's failure to comply was non-willful, would qualify for a reduced 5 percent offshore penalty in lieu of the 25 percent penalty otherwise applicable under the program.¹⁴ The IRS guidance further provided that taxpayers whose highest aggregate account balance in each of the years covered by the program is less than \$75,000 would qualify for a reduced 12.5 percent offshore penalty.¹⁵

In the interest of fairness to those taxpayers who came forward earlier under the 2009 OVDP, the 2011 OVDP specifically provided that taxpayers who participated in the 2009 OVDP who believe they qualify for the 5 percent or 12.5 percent reduced penalty criteria of the 2011 OVDP, but whose cases already closed could petition for a new review of their case under the new criteria and a potential refund of amounts paid.¹⁶ As in 2009, the IRS issued a warning to taxpayers who would try to hold out for more favorable terms, stating in the guidance for the 2011 OVDP that continued noncompliance would result in a loss of the special

civil terms offered under the initiative, liability for all applicable civil penalties, including the willful FBAR penalty, and a civil resolution of their case that could extend to tax years prior to 2003.¹⁷

The 2012 OVDP

The 2011 OVDP expired on September 9, 2011. On January 10, 2012, the IRS reopened the OVDP, introducing the 2012 OVDP. While there are several changes from the 2011 OVDP, the 2012 OVDP maintains the same overall penalty structure as the 2011 OVDP, except for taxpayers in the highest penalty category.¹⁸ The 2012 OVDP did not have a specific expiration date, but the IRS could change the terms or terminate the program at any time.

The 2012 OVDP provided for an eight-year lookback period, a 27.5 percent offshore penalty calculated off of the highest aggregate balance/value of such taxpayer's foreign assets at any time during the eight-year period covered by the voluntary disclosure, and a 20 percent accuracy-related penalty.¹⁹ The 2012 OVDP included the same reduced 5 percent and 12.5 percent offshore penalties that were offered under the 2011 OVDP.²⁰ The 2012 OVDP also provided for the same criminal clearance process as the 2011 OVDP and 2009 OVDP.

As in 2009 and 2011, the IRS issued a warning to taxpayers concerning continued noncompliance, stating that foreign account information is increasingly available to the IRS through whistleblowers and cooperation between the IRS and foreign governments. The IRS further warned that such taxpayers risk detection by the IRS and the imposition of substantial penalties, including the fraud and foreign information return penalties, and an increased risk of criminal prosecution.²¹

Revised Compliance Procedures

As noted above, the 2014 OVDP is actually a continuation of the 2012 OVDP with modified terms, as opposed to a completely new program. Introduced alongside the 2014 OVDP are the streamlined procedures. These are a set of new procedures for taxpayers who certify under penalties of perjury that their

¹²The IRS issued guidance on the 2011 OVDP in the form of FAQs, which were posted on the IRS website February 8, 2011. See "Offshore Voluntary Disclosure Initiative Frequently Asked Questions and Answers," available at <http://www.irs.gov/Businesses/International-Businesses/2011-Offshore-Voluntary-Disclosure-Initiative-Frequently-Asked-Questions-and-Answers>.

¹³See *id.* at FAQs 52 and 53 for discussion of reduced offshore penalty.

¹⁴See *id.* at FAQ 52 for more detailed discussion of the 5 percent offshore penalty and criteria to qualify.

¹⁵See *id.* at FAQ 53.

¹⁶See *id.* at FAQs 52 and 53.

¹⁷See *id.* at FAQ 11.

¹⁸The IRS issued guidance on the 2012 OVDP in the form of FAQs, which were posted on the IRS website June 26, 2012. See "Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers," available at <http://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers>.

¹⁹See *id.* at FAQ 7.

²⁰See *id.* at FAQs 52 and 53.

²¹See *id.* at FAQ 4.

noncompliance with the FBAR reporting requirements and failure to pay taxes associated with their unreported foreign financial assets did not result from willful conduct on the part of the taxpayer.²² The 2014 OVDP also provides for a new 50 percent penalty if the government is investigating the foreign financial institution where the taxpayer's accounts are held.²³

The streamlined procedures provide an avenue parallel to, but distinct from, the 2014 OVDP itself for taxpayers to come into compliance with foreign reporting requirements. Once a taxpayer makes a submission under the streamlined procedures, the taxpayer may not participate in the 2014 OVDP.²⁴ Similarly, a taxpayer who submits a voluntary disclosure letter pursuant to the 2014 OVDP on or after July 1, 2014, is not eligible to participate in the streamlined procedures.²⁵

Once again, as in 2009, 2011, and 2012, the IRS is threatening that the punishment for continued noncompliance will only get worse, and warning that it has more sources of information on foreign accounts than ever before. In particular, foreign banks are expected to come forward with information on their U.S. clients pursuant to the reporting requirements of the Foreign Account Tax Compliance Act that went into effect on July 1, 2014.²⁶ The IRS has also drawn attention to a program under which Swiss banks are cooperating with the Department of Justice, as well as a new agreement with Credit Suisse.²⁷

Streamlined Procedures

The IRS guidance on the streamlined procedures provides that, for purposes of these procedures, "non-willful conduct is conduct that is due to negligence, inadvertence, or mistake or conduct that is the result of a good faith misunderstanding of the requirements of the law."²⁸ The IRS eliminated the reduced penalty structure introduced under the 2011 OVDP and continued under the 2012 OVDP (reduced 5 percent or 12.5

percent offshore penalties), while expanding upon the streamlined filing compliance procedures offered in 2012.²⁹

Taxpayers eligible for the streamlined procedures must:

- file amended tax returns, together with all required information returns, for each of the most recent three years;
- pay taxes and interest owed in connection with such amended returns;
- file any delinquent FBARs for each of the most recent six years; and
- pay a Title 26 miscellaneous offshore penalty equal to 5 percent of the highest aggregate year-end³⁰ balance or value, as applicable, of the relevant foreign financial accounts and/or assets during the covered tax return period and the covered FBAR period.³¹

Eligible taxpayers who use these procedures will be subject only to the aforementioned 5 percent offshore penalty, and will not be subject to accuracy-related penalties, information return penalties, or FBAR penalties.³² U.S. residents who have not timely filed tax returns in the past three years are not eligible for the streamlined procedures.

The streamlined procedures also appear to narrow the scope of the foreign assets subject to the offshore penalty. Under the past OVDPs, any foreign asset that generated even a dollar of income (for example, an apartment unit rented out by the taxpayer) would be subject to the offshore penalty. Under the streamlined procedures, that appears not to be the case. Instead, the 5 percent penalty applies only to assets that are required to be reported on the FBAR or on Form 8938.

²²The IRS posted guidance on the 2014 streamlined filing compliance procedures on the IRS website on June 18, 2014. See "Streamlined Filing Compliance Procedures," *supra* note 1.

²³See "Voluntary Disclosure: Questions and Answers," *supra* note 1, at FAQ 7.2.

²⁴See "Streamlined Filing Compliance Procedures," *supra* note 1.

²⁵*Id.*

²⁶See Koskinen statement, *supra* note 4.

²⁷*Id.*

²⁸See "U.S. Taxpayers Residing in the United States," available at <http://www.irs.gov/Individuals/International-Taxpayers/U-S-Taxpayers-Residing-in-the-United-States>; see also "U.S. Taxpayers Residing Outside the United States," available at <http://www.irs.gov/Individuals/International-Taxpayers/U-S-Taxpayers-Residing-Outside-the-United-States>.

²⁹ See "Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers," *supra* note 1, at FAQ 1.1, noting that the reduced penalty structure under former FAQs 52 and 53 has been eliminated due to the expansion of the streamlined procedures. See also "Streamlined Filing Compliance Procedures," *supra* note 1, explaining that the streamlined filing procedures introduced September 1, 2012, were more narrowly tailored, limiting eligibility to U.S. taxpayers living abroad with less than \$1,500 tax owed in each year under review, and imposing a compliance risk assessment process.

³⁰The 2012 OVDP and predecessor programs used the highest aggregate balance at any time during the year. The offshore penalties determined in the past OVDPs were rarely based on year-end balances, which means calculating the penalty based on year-end balances is another significant benefit of the streamlined procedures.

³¹See "U.S. Taxpayers Residing in the United States," *supra* note 28; see also "U.S. Taxpayers Residing Outside the United States," *supra* note 28.

³²*Id.*

An apartment unit rented out by the taxpayer would not be reported on such forms, and should therefore be excluded from the 5 percent offshore penalty calculation. Taxpayers in the past OVDPs incurred substantial penalties on the basis of such assets and income.

It is noteworthy that the streamlined procedures, unlike the past OVDPs, do not provide any type of criminal clearance.³³ Returns submitted under the streamlined procedures may be subject to IRS examination, additional civil penalties, and even criminal liability, if deemed appropriate. The IRS specifically advised that taxpayers who are concerned that their failure to comply with foreign reporting requirements was due to willful conduct, and who seek assurances that they will not be subject to criminal liability and/or substantial monetary penalties, should not use the streamlined procedures. They should instead consider participating in the 2014 OVDP, which includes a criminal clearance process and a predictable penalty regime.³⁴

Taxpayers considering whether to use the streamlined procedures should carefully consider the details of their cases. If a taxpayer decides to come forward under the streamlined procedures and makes the required certification as to non-willfulness but the claim to non-willfulness does not hold up on review, the consequences will not be pretty. For starters, if the IRS challenges the non-willfulness certification, the taxpayer will be ineligible for the streamlined procedures and for the 2014 OVDP. The taxpayer may be subject to the willful FBAR penalty (50 percent of the account values per year for up to six years),³⁵ civil fraud penalty (75 percent of the taxes owed),³⁶ and open statutes of limitations for income tax purposes. Even worse, the taxpayer will have given up the protection against criminal prosecution for past acts that is available under the 2014 OVDP, and will have provided the government with incriminating evidence, amended returns, and FBARs. Furthermore, the act of making a false certification claiming non-willfulness under penalty of perjury could itself be considered a criminal act. Accordingly, taxpayers should consult with a criminal tax attorney before participating in the streamlined procedures.

Taxpayer Eligibility

As it did upon introducing the 2011 OVDP, the IRS made some effort to avoid penalizing taxpayers who came forward earlier. In particular, the guidance for the streamlined procedures provides that a taxpayer who would be eligible for these procedures, and who submitted a voluntary disclosure letter under the 2012

OVDP (or any predecessor OVDP) before July 1, 2014, but who does not yet have a fully executed closing agreement, may request treatment under the applicable penalty terms available under these procedures.³⁷

Taxpayers seeking this “transitional treatment” need not opt out of the applicable OVDP, but will be required to submit the documentation and non-willfulness certification required under the streamlined procedures as described above.³⁸ The IRS will then consider the taxpayer’s request in light of the facts and circumstances of the taxpayer’s case and will decide whether to incorporate the reduced 5 percent offshore penalty of the streamlined procedures in the taxpayer’s voluntary disclosure closing agreement.³⁹ Taxpayers who receive transitional treatment and the 5 percent offshore penalty will still be subject to the other terms of the applicable OVDP, including the lookback period, accuracy-related penalty, and execution of a closing agreement.⁴⁰

Rewarding the Latecomers

Despite this concession for taxpayers with open cases, a major question remains: What about taxpayers who submitted voluntary disclosures under one of the past OVDPs, and who already received fully executed closing agreements? The U.S. tax system is based on principles of voluntary compliance and horizontal equity. Yet the circumstances created through the introduction of the streamlined procedures substantially undermine both of these principles and will be detrimental to the tax system.

Horizontal Equity

The concept of horizontal equity — meaning that taxpayers who are similarly situated should be treated and taxed equally and that tax burdens should be distributed fairly — has been a cornerstone of tax policy since the founding of the United States.⁴¹ The principle of horizontal equity is a basic yardstick used to gauge

³⁷See IRS guidance posted at <http://www.irs.gov/Individuals/International-Taxpayers/Streamlined-Filing-Compliance-Procedures>. See also “Transition Rules: Frequently Asked Questions,” posted on the IRS website on June 18, 2014, available at <http://www.irs.gov/Individuals/International-Taxpayers/Transition-Rules-Frequently-Asked-Questions-FAQs>.

³⁸*Id.* See also “Voluntary Disclosure: Questions and Answers,” *supra* note 1, at FAQ 1.3.

³⁹*Id.*

⁴⁰See “Transition Rules: Frequently Asked Questions,” *supra* note 37, at FAQ 9.

⁴¹See Alan J. Auerbach and Kevin A. Hassett, *A New Measure of Horizontal Equity* (NBER 1999); Brian Galle, “Tax Fairness,” 65 *Wash. & Lee L. Rev.* 1323 (2008); Michael Graetz, “Legal Transitions: The Case of Retroactivity in Income Tax Revision,” 126 *U. Pa. L. Rev.* 47, 79-83 (1977). “The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities” (Adam Smith, 1776).

³³See “Streamlined Filing Compliance Procedures,” *supra* note 1.

³⁴*Id.*

³⁵See 31 U.S.C. 5321(a)(5)(C).

³⁶See 26 U.S.C. 6663.

whether tax burdens are fairly distributed. The idea that tax policy should strive for horizontal equity is uncontroversial.⁴² It protects taxpayers against arbitrary discrimination and is also consistent with basic principles of equal worth. Some might also argue that horizontal equity comports with the principle of “equal protection under law” set forth in the United States Constitution.

It would violate the principle of horizontal equity to apply a tougher standard and more punitive penalties to taxpayers who came forward earlier and have closed their cases, than to similarly situated taxpayers whose cases remain open. This is especially true given that the timing for finalizing closing agreements is arbitrary and depends more on the efficiency and workload of IRS agents and attorneys assigned to a case than on anything in the taxpayer’s control.

There is no doubt that many taxpayers who came forward under the past OVDPs could have established that their conduct was non-willful and met the criteria applied under the streamlined procedures. Yet, as things stand, a taxpayer who held out and did not heed the warnings of the government that things will only get worse, and is only now coming forward, can expect a much more favorable outcome than those who stepped up earlier. The latecomers will face significantly fewer and lighter penalties, a narrower scope of assets subject to the offshore penalty, a shorter look-back period, and a less cumbersome review process. They will also incur significantly less legal and accounting fees. This will result in arbitrary and unfair outcomes for similarly situated taxpayers and would deter taxpayers from making voluntary disclosures or otherwise cooperating with the IRS in the future.

Some have pointed to the fact that taxpayers using the streamlined procedures will not be assured that they will not be subject to criminal liability as a countervailing consideration to suggest that the taxpayers who closed their cases have that certainty and are better off than those coming under the streamlined procedures. That rationale does not in any way address the matter of inequitable treatment and makes no sense. The taxpayers at issue are taxpayers who believe they can establish that their conduct was non-willful, so the risk of criminal exposure is not significant. The financial considerations certainly weigh more heavily under the circumstances, and given that those with closed cases have taken a relatively big financial hit with offshore penalties ranging from 20 to 27.5 percent, the streamlined procedures and the 5 percent penalty are a slap in the face.

In past statements regarding offshore activities and voluntary disclosures, the IRS repeatedly asserted that it established the OVDPs to ensure that taxpayers are

treated fairly, consistently, and predictably.⁴³ As discussed above, IRS precedent with respect to offshore assets stands for the principle of extending the benefit of subsequent new laws and reduced penalties to those taxpayers who voluntarily came into compliance earlier. As noted, the IRS previously attempted to remedy a similarly unfair situation by allowing taxpayers who participated in the 2009 OVDP, and whose cases had already been closed when the 2011 OVDP and its reduced penalty criteria were announced, to petition for a review of their cases under the new criteria and a potential refund of the higher penalty amounts previously paid.⁴⁴ The IRS should put its money where its mouth is and offer a similar review and penalty adjustment process here, allowing taxpayers who entered past OVDPs and paid higher offshore penalties an avenue to explain why their noncompliance was non-willful and to obtain refunds.

Voluntary Compliance

The U.S. tax system operates on the principle of voluntary compliance, a concept that is closely intertwined with horizontal equity. While the federal government has the power to levy taxes, the system relies on individuals to report their income freely and voluntarily, calculate their tax liability correctly, and file a tax return on time, all according to the rules established by the IRS.⁴⁵

There is no question that government action can be detrimental to voluntary compliance. If taxpayers view the system as unfair or arbitrary, or the IRS as imposing unjustified or draconian penalties, it can result in a loss of respect for the IRS and a decline in voluntary compliance.⁴⁶ The IRS itself is continually studying ways to improve voluntary compliance.⁴⁷ As discussed above, the situation the IRS has created with the

⁴³“We believe the [2009 OVDP] represents a firm but fair resolution of these cases and will provide consistent treatment for taxpayers. The goal is to have a predictable set of outcomes to encourage people to come forward and take advantage of our voluntary disclosure practice while they still can. . . . This gives taxpayers — and tax practitioners — certainty and consistency in how their case will be handled.” Statement from IRS Commissioner Douglas Shulman on offshore income (Mar. 26, 2009).

⁴⁴See “Offshore Voluntary Disclosure Initiative Frequently Asked Questions and Answers,” *supra* note 12, at FAQs 52 and 53.

⁴⁵For a discussion of voluntary compliance and measures thereof, see U.S. Government Accountability Office report, “Status of IRS’ Efforts to Develop Measures of Voluntary Compliance,” released June 18, 2001, available at <http://www.gao.gov/products/GAO-01-535>.

⁴⁶See National Taxpayer Advocate, *supra* note 4, at 234-236 (citing research suggesting that seemingly unfair procedures may increase tax evasion by Schedule C filers).

⁴⁷See, e.g., “Reducing the Federal Tax Gap: A Report on Improving Voluntary Compliance,” issued by the IRS, U.S. Department of the Treasury on August 2, 2007, available at http://www.irs.gov/pub/irs-news/tax_gap_report_final_080207_linked.pdf.

⁴²Richard Musgrave, “Horizontal Equity Once More,” *National Tax Journal* 43(2) (1990), 113-123.

streamlined procedures, resulting in unfair and arbitrary outcomes for similarly situated taxpayers, will deter taxpayers from entering into settlement programs or otherwise voluntarily cooperating with the IRS in the future. The IRS has a prime opportunity to make the system more fair, to restore respect for the agency, and to encourage voluntary compliance.

With every new OVDP, the official IRS guidance clearly stated that the terms would only get tougher, not more favorable, and that taxpayers would be ill-advised to wait to see what the future holds. In the

end, the holdouts are getting the best deal of all. The IRS's failure to address this issue will predictably damage its credibility with practitioners and taxpayers, and will certainly reduce voluntary tax compliance, as well as participation in any future settlement initiatives.⁴⁸ ♦

⁴⁸See National Taxpayer Advocate, 2011 Annual Report to Congress, Vol. 1, 250-251.