GRAY REED

IRS Announces "Quiet Disclosures" No Longer Accepted

August 28, 2009

Voluntary disclosures have been with us for many, many years. It is a procedure by which a person who has committed a tax crime, either failure to file tax returns or income tax evasion, or any of the other tax crimes, has a chance to avoid criminal prosecution by complying with whatever the rules at the time were for making a voluntary disclosure.

These have through the years been handled by tax attorneys typically with criminal tax experience going in and meeting with the criminal investigation division of the IRS and producing, normally on a hypothetical basis, some facts to see if it was even something on which they would even consider doing a voluntary disclosure. If that was given an affirmative answer, the amended returns had to be prepared and produced to Internal Revenue.

One of the problems always was that if an investigation had been started (whatever an investigation meant at the particular time period), even though the taxpayer did not know about it, they would refuse to do the voluntary disclosure. This meant the taxpayer was at risk once he or she had given the facts to criminal investigation until they could “run their traps” and determine whether there was any investigation of any type that might lead to the taxpayer under way.

Years ago, there was a squad of IRS special agents assigned to the service center whose job was to review all delinquent returns and amended returns that met a certain criteria; this was to pick up any returns that might have criminal potential. About 15 or 20 years ago, the IRS really lost interest in failure to file cases, because they could not get the Justice Department to handle prosecutions since they were normally misdemeanors. As word spread over a period of time that this was going on, the use of voluntary disclosures began to drop off. I do not think tax attorneys ever quit using voluntary disclosures, but CPAs did.

Instead of referring clients to a tax attorney with criminal tax experience to do a voluntary disclosure, the practice began of CPAs simply mailing in the delinquent returns (perhaps in separate envelopes for each year so that no pattern was observed) and mailing in amended returns in case of tax evasion and paying the tax. This practice became quite widespread and became known as “quiet disclosures.” This even became acceptable to Internal Revenue as long as all the requirements were met as to something being a “voluntary disclosure.”

The world has now turned upside down again. At a meeting of the ABA Tax Section in Washington, D.C. in May, the Chief for the Criminal Investigation Division announced that “quiet disclosures” would no longer be accepted.

On June 26, 2009, the Internal Revenue Manual, Section 9.5.11.9 was amended as it relates to the voluntary disclosure practice.

Under the amendment, it is currently the practice of the IRS that a voluntary disclosure will be considered along with all of the factors in the investigation in determining whether criminal prosecution will be recommended. This voluntary disclosure practice creates no substantive or procedural rights to taxpayers, but rather is a matter of internal IRS practice, provided solely for guidance to IRS personnel. Taxpayers cannot rely on the fact that other similarly situated taxpayers may not have been recommended for criminal prosecution.

A voluntary disclosure will not automatically guarantee immunity from prosecution; however, a voluntary disclosure may result in prosecution not being recommended. This practice does not apply to taxpayers with illegal source income.

A voluntary disclosure occurs when the communication is truthful, timely, complete, and when:

a. the taxpayer shows a willingness to cooperate (and does in fact cooperate) with the IRS in determining his or her correct tax liability; and

b the taxpayer makes good faith arrangements with the IRS to pay in full, the tax, interest, and any penalties determined by the IRS to be applicable.

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).

The IRS normally expects the disclosure to be in the form of a letter explaining everything and identifying the taxpayer.

What does this mean for the CPA professionally? It means that the practice that has been going on for many years of making "quiet disclosures" has come to an end. A CPA who makes a quiet disclosure will run the risk of subjecting himself or herself to a malpractice case or an ethics violation before the State Board of Public Accountancy or before the IRS under Circular 230.

If a person comes in to visit you who has not filed the necessary returns or has filed fraudulent returns, you should not question them about the facts, but simply refer them to a tax attorney, preferably one who has criminal tax experience. The tax attorney will normally employ you to work for him or her in preparation of the returns under the terms of a “Kovel” letter to cover your work with his or her attorney/client privilege and work product privilege.

Suppose you recommend a voluntary disclosure to the client and the client refuses to move forward? What are your obligations under Circular 230? The IRS expects a taxpayer to seek qualified legal advice and representation in connection with considering and making a voluntary disclosure. If a taxpayer seeks advice of a tax practitioner, but nonetheless decides not to make a voluntary disclosure, despite the taxpayer’s noncompliance with United States tax laws, Circular 230, Section 10.21, requires a practitioner to advise the client of the fact of the client’s noncompliance and the consequences of the client’s noncompliance as provided under the Code and Regulations.

If the client refuses to follow your advice to do a voluntary disclosure, do not use the old procedure of doing a quiet disclosure. If you do decide to do a quiet disclosure and mail in the returns without doing a voluntary disclosure, and the client subsequently is indicted, you could find yourself on the wrong end of a substantial accounting malpractice case. It is simply not worth the risk.

In accordance with IRS Circular 230, the information on this web site is not intended or written to be used, and cannot be used as or considered a "covered opinion" or other written tax advice and should not be relied upon for the purpose of avoiding tax-related penalties under the Internal Revenue Code; promoting, marketing, or recommending to another party any transaction or tax-related matter(s) addressed herein; for IRS audit, tax dispute or other purposes.

About the Author: *Claude R. Wilson, Jr. is a tax attorney with the law firm of Gray Reed & McGraw He is a past president of the Texas Society of CPAs, and was formerly the Senior Trial Attorney nationally for the Internal Revenue Service in Washington, D.C. He is a member of the TSCPA Federal Tax Policy committee and the Relations with IRS committee.*