TORRES TRADE LAW

INTERNATIONAL TRADE & NATIONAL SECURITY

Voluntary Self-Disclosure Handbook

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Torres Trade Law, PLLC is an international trade and national security law firm that assists clients with the import and export of goods, technology, and services. The firm has extensive experience with the various regimes and agencies governing trade such as the Directorate of Defense Trade Controls, the Bureau of Industry and Security, the Office of Foreign Assets Control, the U.S. Customs and Border Protection and others. Our group provides clients with full support for all trade law issues, including U.S. export control and sanctions laws, industrial security, the Foreign Corrupt Practices Act, anti-boycott laws, and customs law.

This Voluntary Self-Disclosure Handbook has been prepared as an industry reference only, and is not official direction or instruction, nor does it constitute legal advice. It is not intended to be used in place of any U.S. Government statute, regulation, authorization, or guidance. This Voluntary Self-Disclosure Handbook is intended to provide a reference as of the date of publication and is not meant to be a comprehensive review of the pros and cons of filing disclosures. Please ensure that you consider any updates to U.S. Government statutes, regulations, or guidance that may have occurred since publication when you use this Torres Trade Law Voluntary Self-Disclosure Handbook.

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I. INTRODUCTION

A. What are VSDs?

A voluntary self-disclosure ("VSD") (also known as voluntary disclosures or prior disclosures depending on the governing agency) is a narrative account with supporting documentation that describes violations or suspected violations of import, export, economic sanctions, or anti-corruption regulations, and ideally, describes a party's efforts to mitigate the harm caused by such violations or efforts to remediate the causes of such violations. Most government agencies permit companies to file an Initial Notification of the VSD before submitting a full or final VSD. In general, the Initial Notification serves as a notice to the regulatory and enforcement agencies of the general nature and extent of the potential violations.

B. Why file a VSD?

Filing a VSD offers several benefits with respect to mitigating potential consequences associated with violations of U.S. trade laws. A VSD can:

- Reduce the likelihood and severity of an enforcement action by the relevant agencies, including the likelihood of prosecution when submitted to the U.S. Department of Justice ("DOJ").
- Act as a mitigating factor when determining the amount and severity of penalties for violations.
- Help establish a positive relationship with the regulatory agencies.
- Reduce the likelihood of future violations.
- Help to avoid directed disclosures (disclosures required by a regulator, which limit ability to mitigate penalties for any violations).
- Reduce reputational harm.

C. What are the risks of a VSD?

Filing a VSD does entail some risk to the filer. Consult with qualified legal counsel prior to deciding to file a VSD to effectively assess these risks, which can include, but are not limited to:

- A VSD is an admission of improper conduct.
- A VSD creates knowledge of violations, which could create liability should "knowing" violations occur after disclosure.
- A VSD can lead to loss of confidentiality and waiver of privilege.
- Regulatory authorities may require waiver of certain defenses or extension of time period (tolling) of statute of limitations on violations.
- Additional questions may follow, as well as increased regulatory scrutiny.
- Violations may involve other laws (beyond those related to international trade compliance), and criminal violations may be referred to the DOJ for prosecution.

II. KEY STEPS PRIOR TO FILING A VSD

A. Stop Any Potential Ongoing Violations

To the extent that specific potential violations have been identified (for example, items exported without a required export license), it is critical that steps are taken to stop similar additional violations. This may require institution of "stop-ship" orders, changes to physical or electronic access to technical data/technology, application to regulators for licenses or agreements, or other remedial measures designed to stop ongoing violations and prevent, in the near term, future violations.

B. Start Further Investigation Promptly

As described below, it is also critical that upon filing an initial disclosure, further investigation of the nature, scope, cause, and impact of the potential or apparent violations is undertaken promptly and thoroughly documented. A thorough investigation plan should be prepared by the investigator and key witnesses, or potential interviewees identified.

C. Consult Counsel to Establish Legal Privilege Regarding Any Investigation

It is strongly recommended that the investigation of potential or apparent violations as part of a disclosure be conducted by, or at the direction of, an attorney, in order to preserve attorney-client privilege regarding advice and materials produced as a result of the investigation.

D. Issue Legal Holds

A legal hold (or litigation hold) must occur to preserve data potentially relevant to anticipated, pending, or active litigations, investigations, or other legal disputes. Issuing a legal hold is an essential early step in the discovery or investigation process, and crucial to showing defensible and good faith efforts to preserve evidence. The goal of preserving information is to ensure that the information's evidentiary integrity is maintained for potential use in the case.

E. *Upjohn* Rights

In an internal investigation an attorney acts on behalf of the corporation, which may have differing interests than the directors, officers, and employees through whom the corporation functions. One of the most important steps in reducing risk of a conflict is the *Upjohn* warning, which involves corporate counsel advising individual employees that counsel represents only the corporation and not the individual. Providing the *Upjohn* warning can avoid hazards for the corporation, the individuals, and counsel.

III. UNDERSTAND WHICH GOVERNMENT REGULATORS MAY BE INVOLVED IN A VSD

Various U.S. government agencies have different regulations, policies, and official guidance regarding the ability of parties to file VSDs, how such VSDs are assessed, and the impact such VSDs may have on enforcement actions.

For purposes of this handbook, we will focus on the U.S. Department of Justice; the U.S. Department of Commerce, Bureau of Industry and Security ("BIS"); the U.S. Census Bureau ("Census"); the U.S. Department of State, Directorate of Defense Trade Controls ("DDTC"); and the U.S. Department of the Treasury, Office of Foreign Assets Control ("OFAC").

Keep in mind that other U.S. government agencies (and foreign agencies) involved in regulating other aspects of international trade may also have jurisdiction over the activities being disclosed – for example, the Bureau of Alcohol, Tobacco, Firearms and Explosives ("ATF") or the Food and Drug Administration ("FDA") – and the risks of disclosure should also be assessed in this light as well.

It is common to file multiple disclosures amongst various agencies simultaneously to ensure that one agency does not share evidence of a potential or apparent violation with another agency before the disclosing party does (in which case a party may lose "credit" for the disclosure being "voluntary").

The DOJ also has voluntary disclosure programs permitting submission of voluntary self-disclosures directly to a relevant DOJ component for potential criminal violations of the export control and sanction laws. The DOJ has indicated that such disclosures may "significantly" reduce criminal penalties, including "a non-prosecution agreement ("NPA"), a reduced period of supervised compliance, a reduced fine and forfeiture, and no requirement for a monitor." As described below, companies typically submit initial disclosures to the regulatory agencies followed up by final disclosures at a later date, and the agencies have the discretion to refer criminal matters to DOJ during this period. In this case, companies may have to consider early in their investigation whether the circumstances demonstrate a potential benefit to filing a VSD with DOJ concurrently with self-disclosures with the other regulatory agencies.

IV. VSD PROCESSES AND CONSIDERATIONS FOR KEY U.S. REGULATORS

As described below, each regulatory or enforcement agency has different procedures and requirements regarding how disclosures must be filed, what information must be provided, and the process for evaluating regulatory or enforcement actions based on such disclosures. As noted above, evaluating the potential risks and benefits of filing a disclosure should be determined with respect to each regulatory or enforcement agency based on the specific facts of the case and with consultation of upper management and legal counsel.

A. U.S. Department of Commerce, BIS

The Department of Commerce, BIS is primarily engaged in regulating the transfer, export, and reexport of commercial items and technology having dual commercial and military applications controlled under the Export Administration Regulations ("EAR").

1. Initial Notification 15 C.F.R. § 764.5(c)(2)

The Initial Notification should be made to BIS, Office of Export Enforcement ("OEE") in writing as soon as possible after violations are discovered. This notification should include:

- Name of the person making the disclosure and a brief description of the potential violation.
- A contact person with business address, email, and phone number.
- A description of the general nature and extent of the potential violations.

The Initial Notification is considered valid as of the date that the notification is received by OEE. Final narrative account is due 180 days from OEE's receipt of the Initial Notification.

2. Extensions of Time to Submit Final Narrative Account 15 C.F.R. § 764.5(c)(2)(iv)

OEE can grant an extension at its discretion. In order to be considered, a request must show:

- Review was started promptly after discovery of violations.
- Review and preparation of narrative had been conducted expeditiously, completely, and accurately.
- Interim compliance procedures have been considered/identified to prevent further violations.
- A reasonable need for the extension.
- A timeline for completion and submission of the narrative; designate a contact person and provide contact person's business address, email address, and telephone number; and provide additional information that person making the request reasonably believes is pertinent.

3. Final Narrative Account 15 C.F.R. § 764.5(c)(3)

After the Initial Notification, a thorough review should be conducted for all export-related transactions involving the suspected violations. OEE recommends that the review cover a period of five years prior to the date of the Initial Notification (the statute of limitations for export violations is five years). After review, a narrative account must be submitted to OEE describing the nature of review conducted, suspected violations, and measures taken to minimize violations and prevent future violations. The narrative must include:

- The type of violation—for example, describing exports of hardware that occurred without a required export license and deemed exports of technology to foreign person employees.
- Explanation of when and how violations occurred—for example, identifying the period of time during which unauthorized exports occurred and the causes of the violations, such as misclassification of items.
- Complete identities and addresses of all individuals and organizations involved in activities giving rise to violations—this may include subsidiaries, affiliates, and third parties.
- License numbers—licenses associated with any unauthorized exports that are being disclosed.
- Description, quantity, value (U.S. dollars), and Export Control Classification Number or other classification of the items involved.
- Description of mitigating circumstances—as described in more detail below, these may include such factors as:
    - The size and sophistication of the party having committed the violations.
    - Existence of a compliance program designed to identify potential violations.
    - Efforts to remediate issues that lead to violations.
    - Likelihood that any unauthorized exports would have been licensed.
    - Cooperation with the agency.
    - Regulatory/criminal history of the party.

Additional Information for Final Narrative

- Supporting Documentation § 764.5(c)(4)
    - Along with the narrative, copies of licensing documents, shipping documents, and other documents such as invoices, purchase orders, or communications.
    - Any other relevant documents should also be included.
- Certification § 764.5(c)(5)
    - Must certify that all of the representations made in connection with the VSD are true and correct to the best of person's knowledge and belief.
- Oral Presentations § 764.5(c)(6)
    - An oral presentation to OEE can be requested but is not necessary.

4. VSD Submission

VSDs can be submitted electronically to BIS_VSD_INTAKE@bis.doc.gov. VSDs may also be submitted via delivery to the following address:

Director, Office of Export Enforcement
1401 Constitution Ave., Room H4514
Washington, D.C. 20230.

5. Potential Action by OEE 15C.F.R. § 764.5(d)

OEE will issue a formal acknowledgement of receipt of the disclosure. OEE may then take any of the following actions:

- VSDs involving minor "technical" violations will be "fast-tracked." A letter of no-action or warning will be issued within 60 days of final disclosure.
- More serious VSD cases will be assigned a field agent and an attorney from the Office of the Chief Counsel.
- Issue a proposed charging letter and attempt to settle;
- Issue charging letter (if settlement not reached);
- Administrative actions, including denial of, or restriction on, export/import privileges; and/or
- Refer to DOJ for criminal prosecution (rare in VSD cases).

It should be noted that on April 18, 2023, OEE announced policy changes relating to VSDs. Pursuant to these policy updates, BIS will now consider the failure to voluntarily disclose a significant possible violation as an aggravating factor. In addition, where a company discloses violations committed by another company, and such disclosure results in an enforcement action against that other company, the disclosure will be considered as a mitigating factor in any future enforcement action (even if unrelated) brought against the disclosing company.

B. U.S. Department of State, DDTC

DDTC is primarily engaged in the regulation of the export/import of defense articles, technical data, and defense services controlled under the International Traffic in Arms Regulations ("ITAR").

1. Initial Notification 22 C.F.R. § 127.12(c)(1)

An initial notification of a Voluntary Disclosure (DDTC refers to a disclosure as a "VD") should be made to DDTC in writing immediately after violations are discovered. A notification will be considered filed upon receipt by DDTC. A new disclosure will be assigned a DDTC case number typically within 5-10 days and DDTC will notify the disclosing party of such action via email.

2. Full Disclosure 22 C.F.R. § 127.12(c)(1), (2)

A final VD must be submitted within 60 days of the initial notification; extensions may be granted in some circumstances. If not timely filed or no extension is requested, then DDTC may choose not to consider the VD as a mitigating factor. The VD should be in writing and contain the following elements (will be similar in scope to that described for disclosures to the Department of Commerce, BIS):

- Precise nature and extent of the violations. Circumstances of the violations.
- Identities and addresses of all persons involved.
- Department of State license numbers, exemptions citations, or description of any other authorization (if applicable).
- U.S. Munitions List category and subcategory, product description, quantity, and characteristics of the hardware, technical data, or defense service involved.
- Description of corrective actions already taken and how actions are designed to deter future violations. Name and address of person making disclosure and point of contact.
- Mitigating factors, including but not limited to:
    - No prior violations.
    - Whether person had knowledge of laws and regulations.
    - Compliance/remedial measures.
    - Review of export transactions.
    - Whether violations are systemic or intentional.

Additional Information for Final VDs

- Documentation § 127.12(d)
    - The VD should be accompanied by substantiating documents, including:
        - Licensing documents, exemption citation, or other authorization description;
        - Shipping documents; and any other relevant documents.
- Certification § 127.12(e)
    - Certification stating that all representations made are true and correct to the best of that person's knowledge and belief and should be executed by an empowered official or senior officer.
- Oral Presentations § 127.12(f)
    - Oral presentations are not required but can be requested in writing, if desired.

3. VD Submission

VDs can be electronically submitted to the Office of Defense Trade Controls Compliance, Directorate of Defense Trade Controls via email to DTCC-CaseStatus@state.gov. VDs may also be submitted by delivery to one of the relevant addresses listed below:

By Courier:

U.S. Department of State
PM/DDTC, SA-1, 12th Floor
2401 E Street, NW
Washington, D.C. 20037

By mail:

PM/DDTC, SA-1, 12th Floor
Directorate of Defense Trade Controls
Bureau of Political-Military Affairs,
U.S. Department of State
Washington, D.C. 20522

4. Potential Action by DDTC

DDTC may take a range of actions in response to a VD, including:

- Close-out letter;
- Follow up questions or document requests;
- Recommended compliance actions (*e.g.,* appointment of independent auditor);
- Issue charging letter;
- Civil consent agreement (typically involving a monetary penalty and compliance monitor);
- Referral to DOJ for criminal prosecution (rare in VD cases).

C. U.S. Department of Commerce, Census

Census regulates filings related to imports to, and exports from, the United States covered under the Foreign Trade Regulations ("FTR").

1. Voluntary Self-Disclosures 15 C.F.R. § 30.74

- VSDs are only considered voluntary if submitted before Census or another agency learns of the information.
- VSDs are mitigating factors but can be outweighed by aggravating factors.
- Senior management must have full knowledge and authorization of the disclosure.
- Conduct a thorough review of all export transactions for past five years and notify Census of the violations.

2. Initial Notification 15 C.F.R. § 30.74(c)(2)

- The Initial Notification must be in writing and sent to the proper address.
- Include the name of the person making the disclosure and a brief description of the potential violations (general nature, circumstances, and extent of violations).
- If the person making the disclosure subsequently completes the narrative account, the disclosure will be deemed to have been made on date of the Initial Notification.

3. Narrative Account 15 C.F.R. § 30.74(c)(3)

- Review period should cover a period of five years prior to date of the Initial Notification.
- Narrative must sufficiently describe nature and gravity of suspected violations; must also include nature of review conducted and measures taken to minimize the likelihood of future violations.
- Additionally, the narrative should include:
    - Type(s) of violations involved;
    - Describe data not reported or reported incorrectly;
    - How and when violations occurred;
    - Identities and addresses of all individuals and organizations involved in activities giving rise to the violations;

- Mitigating circumstances;
- Corrective measures taken;
- Internal Transaction Numbers ("ITNs") of missed or corrected shipments; and
- Electronic Export Information: In a Census VSD you will be required to correct EEI filings with errors. Report all data required by the Foreign Trade Regulations that was not reported, or corrections for all data reported incorrectly.

4. VSD Submission

VSDs may be submitted electronically by emailing a password-protected file to emd.askregs@census.gov or by secure fax at 301-763-8835. VSDs may also be submitted by delivery to the address below:

Chief, Economic Management Division
U.S. Census Bureau
4600 Silver Hill Road, Room 6K064
Suitland, MD 20746 (if sent by courier) or Washington, D.C. 20233 (if sent by mail)

5. Potential Action by Census 15C.F.R. § 30.74(d)

Census does not have its own enforcement branch, so it relies on "CBP" and OEE to enforce penalties for FTR violations. After a final VSD is submitted, Census may take the following actions:

- Upon receipt of the narrative, Census will notify CBP, Immigration and Customs Enforcement ("ICE"), and OEE of the VSD and will acknowledge the disclosure by letter.
- Provide a point of contact to the person who disclosed the potential violations.
- Take actions it deems appropriate, which may include:
  - Inform the organization or individual that submitted the VSD of the action to be taken.
  - Issue a warning letter or letter setting forth corrective measures required.
  - Refer the matter to OEE.

D. U.S. Department of the Treasury, OFAC

OFAC is primarily responsible for regulating and enforcing U.S. economic sanctions laws.

1. Voluntary Self-Disclosures 31 C.F.R. Appendix A to Part 501, (I)

- A VSD must be self-initiated (not directed or requested by OFAC or as a result of a third-party report of a blocked or rejected transaction) and include, either initially or within a reasonable time period, a report of sufficient detail to afford complete understanding of the circumstances of the apparent violations of specified statutes, Executive Orders, or regulations.
- A VSD will not be considered valid if it contains false or misleading information, is materially incomplete, or is made without knowledge or authorization of senior management.

- A VSD should address the nature, scope, and cause of apparent violations as well as potentially mitigating factors, including:
    - Willfulness or recklessness – whether the conduct was intentional or demonstrates intentional disregard.
    - Concealment – whether there were efforts to conceal the violations.
    - Pattern of conduct – whether there were multiple related violations.
    - Awareness – whether there was awareness of the violations.
    - Management involvement in conduct that resulted in the violations.
    - Whether the violations resulted in harm to sanctions program objectives.
    - An existing sanctions compliance program in place.
    - Appropriate remedial response to prevent additional violations.
    - History of violations.
    - Cooperation with OFAC in disclosure and any subsequent investigation.

2. VSD Submission

OFAC requests that all VSDs be submitted electronically by email to OFACDisclosures@treasury.gov.

3. Potential Action by OFAC

- No action.
- Request for additional information.
- Cautionary letter warning of potential for misconduct.
- Finding of violation without penalty.
- Civil monetary penalty (typically the result of a settlement agreement)—OFAC may determine whether a civil penalty is warranted by first issuing a pre-penalty notice, and providing an opportunity to respond, prior to issuance of a penalty notice.
    - Cases deemed “egregious” may be given the largest fines (half of applicable statutory maximum penalty if VSD submitted; without a VSD, the maximum penalty may be applied).
- Referral to DOJ for criminal prosecution.
- Administrative actions such as license denial, cease and desist order, etc.

E. Department of Justice, Criminal Division, Corporate Enforcement and Voluntary Self-Disclosure Policy

The DOJ’s Criminal Division handles corporate criminal matters, including, but not limited to, cases involving the Foreign Corrupt Practices Act (“FCPA”).

1. Voluntary Self-Disclosure

- To receive full credit under the Criminal Division’s policy, a disclosing party must submit a VSD, fully cooperate, and implement timely and appropriate remedial measures.

- A VSD must be made "within a reasonably prompt time" after the company becomes aware of the misconduct and "prior to an imminent threat of disclosure or government investigation."
- A VSD must contain all relevant facts known to the company at the time of the disclosure, including the identity of individuals substantially involved in, or responsible for, the misconduct.
- Full cooperation requires timely disclosure (within the VSD or via subsequent updates to the Criminal Division) of all non-privileged facts relevant to the misconduct at issue, including:
    - All relevant facts gathered during a company's independent investigation;
    - Attribution of facts to specific sources where such attribution does not violate the attorney-client privilege, rather than a general narrative of the facts;
    - Timely updates on a company's internal investigation, including but not limited to rolling disclosures of information;
    - All facts related to involvement in the criminal activity by the company's officers, employees, or agents.
- Production of documents, witnesses for interviews, including overseas documents and employees and agents may be required.
- The VSD should include remediation steps including a root cause analysis, implementation or enhancement of a compliance and ethics program, and disciplinary measures.
- Aggravating factors include involvement of senior executives in the misconduct, significant profit from the misconduct, pervasiveness of the misconduct within the company, and whether the company is a repeat offender.

2. VSD Submission

Individuals and companies wishing to disclose information about potential FCPA violations are encouraged to contact the FCPA unit at the telephone number or email address below.

DOJ Contact Information:

Deputy Chief (FCPA Unit), Fraud Section, Criminal Division
Bond Building
1400 New York Avenue, N.W.
Washington, D.C. 20005

Phone: 202.514.7023; Email: fcpa.fraud@usdoj.gov

3. Potential Action by DOJ

- Where a company submits a VSD, fully cooperates, and implements timely and appropriate remedial measures, there will be a presumption that the company will receive a Declination of prosecution (absent aggravating circumstances).
- In the event that a criminal fine is imposed, DOJ will recommend a 50 percent reduction off the bottom end of the sentencing guidelines.
- Guilty plea is generally not required unless there are particularly egregious or multiple aggravating circumstances.
- Monitor requirement (unless company has implemented an effective compliance program)

F. Department of Justice, National Security Division ("NSD"), Enforcement Policy for Business Organizations

The DOJ's NSD oversees criminal violations related to U.S. export controls and sanctions.

1. Voluntary Self-Disclosure

- To receive full credit under the NSD's policy, a company must (1) submit a VSD to the NSD, (2) fully cooperate, and (3) timely and appropriately remediate the violations.
- A VSD must be submitted to the NSD "within a reasonably prompt time" after the company becomes aware of the misconduct and "prior to an imminent threat of disclosure or government investigation."
- A VSD must contain all relevant facts known to the company at the time of the disclosure, including the identity of individuals substantially involved in, or responsible for, the misconduct.
- Full cooperation requires timely disclosure (within the VSD or via subsequent updates to the NSD) of all non-privileged facts relevant to the misconduct at issue, including:
    - All relevant facts gathered during a company's independent investigation;
    - Attribution of facts to specific sources where such attribution does not violate the attorney-client privilege, rather than a general narrative of the facts;
    - Timely updates on a company's internal investigation, including but not limited to rolling disclosures of information; All facts related to involvement in the criminal activity by the company's officers, employees, or agents;
    - All facts known or that become known to the company regarding potential criminal conduct by all third-party companies.
- Witnesses for interviews (and deconfliction of witness interviews), production of documents, including overseas documents, and employees and agents may be required.
- The VSD should include remediation steps including a root cause analysis, implementation or enhancement of a compliance program, and disciplinary measures.
- Aggravating factors include: exports of items controlled for nuclear nonproliferation or missile technology reasons to a proliferator country; exports of items known to be used in the construction of weapons of mass destruction; exports to Foreign Terrorist Organizations or Specially Designated Global Terrorists; exports of military items to a hostile foreign power; repeated violations, including similar administrative or criminal violations in the past; and knowing involvement of upper management in the criminal conduct.

2. VSD Submission

The Enforcement Policy for Business Organizations notes that VSDs covered under the Policy should be emailed to NSDCES.ExportVSD@usdoj.gov.

3. Potential Action by DOJ

- Presumption that a company will receive a Non-Prosecution Agreement and will not pay a fine when there is a VSD to NSD, full cooperation, and timely and appropriate remedial action (absent aggravating factors).
- Guilty plea (generally when particularly egregious or multiple aggravating factors are present), or Deferred Prosecution Agreement.
- Capped fine at an amount equal to the gross gain or gross loss.
- Monitor requirement (unless company has implemented an effective compliance program).
- Companies will be responsible for disgorgement, forfeiture, and/or restitution resulting from the misconduct at issue.

G. Department of Justice, U.S. Attorney's Offices ("USAO"), Voluntary Self Disclosure Policy

This policy sets a nationwide standard for all USAOs. A company may choose to submit a VSD of criminal conduct to any USAO. If another DOJ component is involved in prosecuting the case, or if the violations are covered by another DOJ component's VSD policy, the USAO will coordinate with the relevant DOJ component and may apply a provision of an alternate VSD policy when necessary.

1. Voluntary Self-Disclosure

- A VSD must be voluntary and cannot be made pursuant to a preexisting obligation to disclose.
- A VSD must be made "within a reasonably prompt time" after the company becomes aware of the misconduct and "prior to an imminent threat of disclosure or government investigation."
- A VSD must contain all relevant facts known to the company at the time of the disclosure. If certain relevant facts are not known at the time of disclosure, the disclosing party should state that its disclosure is based on a preliminary investigation or assessment. If an internal investigation is conducted, the disclosing party should provide factual updates to the USAO as the investigation progresses.
- A company should move in a timely fashion to preserve, collect, and produce relevant documents and factual information to the USAO.
- The VSD should include timely measures taken by the company to remediate the criminal conduct, including the implementation or enhancement of a compliance program.
- Aggravating factors include: misconduct that poses a grave threat to national security, public health, or the environment; the presence of deeply pervasive misconduct throughout the company; and/or executive management involvement in the misconduct.

2. VSD Submission

In general, a VSD may be submitted to the U.S. Attorney's Office in the district where the misconduct occurred. The USAO VSD Policy does not provide specific instructions on how to submit a VSD to a USAO. A disclosing party should consult the relevant USAO's website to find contact information for the office.

3. Potential Action by DOJ

- Declination, Non-Prosecution Agreement, or Deferred Prosecution Agreement (absent aggravating factors).
- Guilty plea with reduced fines (when aggravating factor(s) is present).
- Reduced fines, or, in some cases, no issuance of fines.
- Monitor requirement (unless company has implemented an effective compliance program).
- Companies will be responsible for disgorgement, forfeiture, and/or restitution resulting from the misconduct at issue.

H. Department of Justice, Mergers & Acquisitions Safe Harbor Policy

Announced on October 4, 2023, this policy sets Department-wide standards for voluntary disclosures in the mergers and acquisitions ("M&A") context. Under this policy, an acquiring company may receive a presumption of declination when it discloses misconduct discovered at an acquired entity within the Safe Harbor period, cooperates with the related investigation, and takes timely remedial measures. The implementation of this policy may differ between the various DOJ components. However, each component will apply the policy consistent with the following points:

- Companies must disclose misconduct discovered at an acquired entity within six months of the closing date regardless of whether the misconduct is discovered before or after the acquisition.
- Companies will have one year from the date of closing to fully remediate the reported misconduct.
- The deadlines for disclosure and remediation are subject to a reasonableness analysis and may be extended by the DOJ depending on the facts or circumstances of a specific case.
- Aggravating factors present at the acquired company will not affect the acquiring company's ability to receive a declination. In addition, misconduct disclosed by an acquiring company under this policy will not be treated as past violation in any future recidivist analysis for the acquiring company.

I. Department of Homeland Security, U.S. Customs and Border Protection

CBP is responsible for enforcing the import laws of the United States.

1. Prior Disclosure ("PD") 19 U.S.C. § 1592(c)(4) / 19 C.F.R. § 162.74

Information marked with an asterisk (*) can be found in CBP Directive No. 5350-020A, Processing Prior Disclosure Submissions. This Directive serves as internal guidance for relevant CBP offices and suggests a policy toward the standardization of PD practices throughout CBP offices.[1]

[1] Directives issued by CBP do not change PD requirements listed in 19 U.S.C. § 1592(c)(4) or 19 C.F.R. § 162.74; however, the noted Directive provides helpful insight into the logistics and internal practices related to PD submissions.

- A valid PD must be submitted to CBP before, or without knowledge of, the commencement of a formal investigation by CBP, ICE, or Homeland Security Investigations ("HSI").
- A PD discloses the circumstances of a violation of 19 U.S.C. § 1592, which prohibits the entering of merchandise into the commerce of the United States through fraud, gross negligence, or negligence resulting in a material and false statement or a material omission.
    - Examples of 19 U.S.C. § 1592 violations include incorrect valuation, misdescription of merchandise, misclassification, evasion of antidumping/countervailing duty orders, improper country of origin declarations or markings, or improper claims for preferential tariff treatment under a free trade agreement or other duty preference program.
- A valid PD reduces penalties for 19 U.S.C. § 1592 violations.
- A PD may be submitted by any party involved in the business of importing into the United States, including but not limited to importers, customs brokers, exporters, shippers, and foreign suppliers/manufacturers.
- The disclosing party must tender the duty loss to CBP for the PD to be considered valid if the PD involves duty loss violations.
    - Disclosing party may make tender at the time of PD submission, or within 30 days after the party is notified by CBP of the amount to be tendered;
    - CBP personnel will forward payments made with submissions of PD to local cashier within two days of receipt*;
    - Cashier will deposit payment within one day after receipt of payment and will send notification of deposit to disclosing party*;
- Four elements must be included in a PD submission:
    - The type of merchandise involved;
    - The entry number, or each relevant Customs port and the approximate entry dates;
    - The materially false statements, omissions, or acts, and an explanation of how they occurred; and
    - The true information that should have been provided instead of the materially false or omitted information.
- The disclosing party must provide any information unknown at the time of the PD submission within 30 days of the initial disclosure date. Extensions of the 30-day period may be requested by the disclosing party from the concerned Fines, Penalties, and Forfeitures officer. No more than one period of 60 business days shall be granted as an extension to perfect a PD.*

2. PD Submission

PDs may be submitted to the appropriate CBP Center for Excellence and Expertise ("CEE") or any port of entry where the disclosed violation occurred. If violations occurred at a number of ports of entry, the disclosing party should list all affected ports in the PD. The PD should be addressed to the Commissioner of CBP and have the words "Prior Disclosure" conspicuously printed on the face of the envelope.

If the PD is submitted via registered or certified U.S. Mail, return-receipt requested, the PD shall be deemed to have been made at the time of mailing. If the PD is submitted by any other method, the PD will be deemed to have been made at the time of receipt by CBP. PDs can now also be submitted via email to the relevant point of contact at the CEE or to Fines, Penalties, and Forfeitures.

3. Potential Action by CBP

- CBP will review a PD submission and inform the disclosing party whether the PD is valid or invalid.
    - If the PD is valid, CBP will issue a request for payment of the mitigated penalty amount, if applicable.
    - If the PD is not valid on the basis of a formal investigation commenced prior to the PD submission, CBP will commence a penalty proceeding under 19 U.S.C. § 1592.

      Offsetting will not be allowed where the disclosing party (i) has overpaid as a result of failure to establish a duty allowance or preference; (ii) a § 1592 violation was made knowingly or intentionally; or, (iii) where over-payment was made to violate a law.
    - A PD that attempts to apply offsetting will be referred to Regulatory Audit and Agency Services ("RAAAS")[2] for audit. An offsetting determination will be communicated to the disclosing party at the time of the PD acceptance or denial decision*;
- Under a valid PD, the penalty reduction is different depending on the whether the violation involved negligent, grossly negligent, or fraudulent conduct.
    - For fraudulent violations with a PD, the penalty shall not exceed (1) an amount equaling 100% of the lawful duties, taxes, and fees of which the U.S. is deprived, or (2) 10% of dutiable value if the violation did not affect duty assessment.
    - For negligent and grossly negligent violations with a PD, the penalty shall not exceed the interest on the amount of lawful duties, taxes, and fees.
- For criminal violations, CBP is legally obligated to refer the information to the U.S. Attorney's Office, which will make a decision on whether or not to prosecute the alleged criminal violation.
- CBP may find no violation of 19 U.S.C. § 1592.

[2] RAAAS is comprised of field offices throughout the United States that provide auditing services in collaboration with U.S. Customs and Border Protection. The audits generally focus on compliance, a violation, or specific concerns raised by CBP. RAAAS audits are typically initiated via a referral from CBP.

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BONUS APPENDIX

Bonus Appendix: A Plain Language Handbook on the IRS Voluntary Disclosure Practice

The handbook in this Appendix has been contributed by Daniel N. Price, Managing Member of the Law Offices of Daniel N. Price, PLLC.

The handbook provides an overview of the IRS voluntary disclosure practice (VDP) and answers common questions about the VDP in plain language. The handbook does not constitute legal advice and should not substitute for a careful review of IRS instructions and policy statements relating to the VDP.

I. INTRODUCTION

A. What is the IRS' Voluntary Disclosure Practice (VDP)?

In a nutshell, the IRS's voluntary disclosure practice (VDP) allows some taxpayers to approach the IRS, confess potentially criminal tax noncompliance, go through an audit, and pay back taxes in exchange for a pass on criminal prosecution. The concepts underlying the VDP are not new. The Department of the Treasury (Treasury) and the IRS have a long history of not recommending criminal prosecution for taxpayers that voluntarily come forward to reveal tax crimes before those tax crimes are known to the government. Treasury established formal policies in the 1950s. Later, the IRS assumed responsibility for the VDP and formalized its own practice in 1961. The IRS' policies have changed over the decades and were significantly overhauled in 2018 with a focus on national consistency.

The VDP provides taxpayers with potentially criminal tax noncompliance an avenue to come clean and avoid criminal prosecution. In other words, the VDP provides a path for taxpayers to confess their tax crimes to the IRS in exchange for an assurance that IRS Criminal Investigation (IRS-CI) will not refer them to the Department of Justice for criminal prosecution. Taxpayers must confess to the IRS before the government becomes aware of their tax or tax-related noncompliance (known as "timeliness"). Additionally, the type of unreported income matters to the IRS; the IRS will not allow a voluntary disclosure for certain types of illegal income. If a taxpayer meets the timeliness requirement and does not have income from certain illegal activities, then the taxpayer provides a written confession to the IRS outlining their tax misdeeds. If IRS-CI accepts the confession, then IRS-CI hands the case to IRS civil functions for an audit. At the end of the audit, the IRS excepts full payment of all taxes, interest, and penalties.

B. What types of tax and tax-related matters can be corrected through a Voluntary Disclosure?

A taxpayer may use VDP to correct anything under the IRS' enforcement jurisdiction. Examples of noncompliance that may be corrected by a voluntary disclosure include:

- Income taxes (both individual and corporate)
- Estate taxes
- Gift taxes
- Employment taxes
- Excise taxes
- International reporting issues including international information returns, treaty-based positions, and more.
- Title 31 Foreign bank account report (FBAR) reporting issues
- Title 31 Form 8300 cash transaction reporting issues

C. Why Make a Tax Voluntary Disclosure?

First, a taxpayer making a tax voluntary disclosure to the IRS may avoid criminal prosecution for tax and tax-related crimes. Second, a voluntary disclosure may prove economically beneficial compared to the maximum civil penalties the IRS may assert outside of the VDP. Third, a successful voluntary disclosure provides closure and finality for both the taxpayer and the government; the end result of a successful voluntary disclosure involves the taxpayer and government entering into a "closing agreement" (a type of binding contract with the IRS concerning a tax issue) specifying the taxes and penalties owed.

On the second point economic benefits, the IRS' VDP requires correcting only the last six years of income tax noncompliance. Sometimes major tax issues extend for decades. The following examples illustrate the potential benefits of making a voluntary disclosure.

1. **Scope Example:** Mary is the sole shareholder of a subchapter C corporation, and the corporation fraudulently understated income by paying for Mary's significant personal living expenses and deducting them as business expenses. Mary fraudulently understated her personal income by not reporting on her income tax return the personal items paid for by her corporation. Mary and her corporation understated their income taxes for more than 20 years. After a falling out with her longtime personal assistant, Mary is concerned that her personal assistant may become an IRS whistleblower. Assuming IRS-CI accepts Mary's voluntary disclosure, Mary must submit amended returns for the most recent six years, and her corporation must also amend its most recent six years of corporate income tax returns.
    - **Years in VDP**: One fraud penalty will apply to the year with the highest tax liability at the individual level and at the corporate level, and no accuracy-related penalties will apply for the other five years.
    - **Years outside of VDP**: If the IRS uncovers Mary's conduct and asserts fraud, the IRS may assert the civil fraud penalty under 26 U.S.C. § 6663 for the entire 20 year period.

2. **Penalty Example:** Axel is a self-employed IT consultant who stopped filing income tax returns after he filed his 2014 Form 1040 in April 2015. He failed to file tax returns for tax years 2015 through 2021. Assume the date is now July 2023 and Axel filed an extension of time to file his 2022 income tax return. The following table presents hypothetical numbers with 15% growth in tax liability per year.

The table below uses estimates and is not meant for precision. The table demonstrates the rough potential economic benefits of making a voluntary disclosure for a nonfiler when comparing the failure to file penalties under 26 U.S.C. § 6651(a)(1) and the failure to pay penalties under 26 U.S.C. 6651(a)(2) to the penalty structure under the VDP (a single fraudulent failure to file penalty on the year with the highest tax liability in the six-year lookback period). The hypothetical does not include the penalty for failure to make estimated tax payments under 26 U.S.C. § 6654 because that penalty applies both inside and outside of the VDP.

		2015	2016	2017	2018	2019	2020	2021
	Tax	$100,000	$115,000	$132,250	$152,088	$174,901	$201,136	$231,306
Non-VDP Penalty Structure	Failure to file 6551(a)(1)	$22,500	$25,875	$29,756	$34,220	$39,353	$45,256	$52,044
	Failure to pay 6651(a)(2)	$25,000	$28,750	$33,063	$38,022	$34,980	$28,159	$18,504
VDP Penalty Structure	Fraudulent failure to file 6651(f)							$173,480

- **Nonfiler penalties outside of VDP:** $455,481 + 26 U.S.C. § 6654
- **Nonfiler penalties in VDP:** $173,480 + 26 U.S.C. § 6654

Under this example, the net difference in penalties comes to approximately $282,001. If the IRS discovered Axel's noncompliance and asserted the fraudulent failure to file penalty for 2015 through 2021, the penalties would be significantly higher. The penalty structure of VDP and other factors, may be sufficient to motivate Axel to make a voluntary disclosure.

D. What are some common motivations for making a Voluntary Disclosure?

Motivations differ, but most taxpayers who make voluntary disclosures are at least partly influenced by a realization of the magnitude of tax issues and a desire to correct the noncompliance before the IRS knocks on their door. Common catalysts for making a voluntary disclosure include:

- Indications that the IRS may investigate a particular type of tax noncompliance. For example, press releases indicating the IRS is focusing on a certain industry or transaction, a John Doe Summons, an IRS compliance campaign, or an IRS treaty request to a foreign government may alert taxpayers that the IRS will soon uncover their tax noncompliance.
- A guilty conscience or changing circumstances may motivate taxpayers to self-correct. For example, an anticipated run for office or appointment to a government position may motivate taxpayers to self-correct before others probe into their tax compliance.
- Age and health may motivate taxpayers to make voluntary disclosures. For example, taxpayers, their future executors, or their future heirs may want to avoid claims of the United States post-death under 31 U.S.C. § 3713.
- The possibility that disgruntled employees, spurned lovers, or personal enemies might become IRS whistleblowers.
- The need for financing or refinancing may require taxpayers to file delinquent or amended returns.
- During the sale of a privately held business, a seller may reveal to his CPA, business broker, or anticipated buyer previously unreported income or personal items classified as business expenses in order to secure a higher business valuation and sales price.
- Civil litigation may uncover tax noncompliance. An opponent in civil litigation can easily become an IRS informant or whistleblower.

E. What Are the Risks and Costs of Making a Voluntary Disclosure?

Making a voluntary disclosure to the IRS involves some risks and costs. Consult with qualified legal counsel before making a voluntary disclosure. Some of the risks include:

- A voluntary disclosure is an admission of potentially criminal conduct.
- An incomplete or not completely truthful voluntary disclosure may significantly increase the chances of criminal prosecution.
- Only crimes under the IRS' jurisdiction may be corrected through the VDP.
- A voluntary disclosure guarantees a civil examination or audit by IRS revenue agents (auditors), which will require an extension of the civil statute of limitation for assessment of tax and penalties.
- A voluntary disclosure requires prompt, full, and complete cooperation with IRS. This requires taxpayers to provide revenue agents everything they request, including documents and witness interviews, and generally pay the full amount of tax due, plus interest and penalties required by the VDP.
- A voluntary disclosure to the IRS does not resolve state tax matters. If a taxpayer makes a voluntary disclosure to the IRS, the taxpayer should also make a state voluntary disclosure for any state income tax matters.

Making a voluntary disclosure is a time-consuming process, requiring significant professional fees and involvement. The IRS estimates that simply preparing the necessary form, Form 14457, to *begin* the process takes 50 hours on average! And that estimate understates the time required to begin the process for complex cases. The process from start to finish will typically take several years and will involve a guaranteed audit by the IRS. Simply stated, making a voluntary disclosure is a major financial and time commitment, and the process is like a lobster trap: once you are in, you can't escape the process.

F. Is the IRS' VDP the same as the Department of Justice Tax Division's Corporate Voluntary Self-Disclosure Policy?

The Department of Justice Tax Division's Corporate Voluntary Self-Disclosure Policy (DOJ Tax VSD) is completely separate from the VDP. The DOJ Tax VSD is geared toward companies (and other business entities) where corporate personnel have committed tax crimes. In exchange for timely and full cooperation, the DOJ Tax VSD may provide a favorable criminal penalty framework.

II. KEY STEPS BEFORE MAKING A VOLUNTARY DISCLOSURE

A. Stop the Noncompliance

From the moment a taxpayer decides to make a voluntary disclosure, the taxpayer must ensure full compliance in both paying and reporting tax going forward. The VDP is designed to correct past noncompliance. Using the VDP guarantees an audit, and IRS revenue agents will verify compliance for all periods after a voluntary disclosure begins. So prospectively, all tax matters must be clean and tidy. Otherwise, the taxpayer can be "kicked out" of the VDP by having preliminary acceptance revoked. Getting kicked out of VDP may increase the chances of criminal prosecution.

B. Consult Legal Counsel

Determining whether you are eligible to use the VDP to come into compliance requires counsel with experience navigating the VDP process. Never use an accountant or CPA to evaluate whether you are eligible or should make a voluntary disclosure, because the tax practitioner privilege under 26 U.S.C. § 7525 does not apply to criminal proceedings. You need an attorney to advise you under the confidentiality of the attorney-client privilege.

Additionally, legal counsel can evaluate other potential areas of liability and, where necessary, engage other professionals to assist in preparing the voluntary disclosure. Counsel will also help you navigate the process of submitting information to IRS-CI and dealing with IRS revenue agents and revenue officers.

C. Retain a Kovel Accountant Through Legal Counsel

In general, attorneys routinely hire experts and service providers to assist in rendering legal advice and legal defense to clients. When an attorney hires an expert or service provider to assist in providing legal advice and legal defense, the expert or service provider may be protected under the umbrella of the attorney-client privilege.

The case United States v. Kovel, 296 F.2d 918 (2d Cir. 1961) recognized that a lawyer could hire an accountant to perform accounting tasks to aid the lawyer in rendering legal services without waiving the attorney-client privilege. When attorneys hire accountants to assist them, the engagement is generally called a "Kovel engagement" and the accountants retained by the attorney are referred to as "Kovel accountants."

An attorney who assists a client in navigating the VDP will generally retain a Kovel accountant to analyze books and records, perform forensic accounting, prepare workpapers, and prepare draft amended or delinquent income tax returns. In general, a Kovel accountant should have no prior relationship with the taxpayer. Hiring a Kovel accountant with a prior relationship with the client introduces risks of the government penetrating the attorney-client privilege.

III. THE IRS VDP PROCESS

A. Overview

The VDP process involves two main IRS functions: IRS-CI and civil examination personnel. The gatekeeping function for the VDP is performed by IRS-CI. IRS-CI first determines whether a taxpayer may make a voluntary disclosure and then evaluates the disclosure. Assuming IRS-CI preliminarily accepts the voluntary disclosure, IRS-CI then sends the case to the IRS' civil functions for audit.

B. IRS Criminal Investigation (IRS-CI)

IRS-CI uses Form 14457 for its two-step process. First, IRS-CI uses Form 14457, part I to determine whether a taxpayer may make a voluntary disclosure. Then, IRS-CI uses Form 14457, part II to evaluate the substance of the disclosure. Always verify on IRS.gov that you have the most recent version of Form 14457 and its instructions. Unlike other IRS forms, Form 14457 and its instructions are currently combined into one document.

1. Form 14457, Part I

The first step in making a voluntary disclosure involves seeking preclearance from IRS-CI. Preclearance focuses on the timeliness of the voluntary disclosure and screening for income from illegal sources.

Taxpayers with income from illegal sources may not use the IRS' VDP. Classic examples of illegal source income include income from drug trafficking, human trafficking, weapons trafficking, underground gambling, and the like. The IRS notes that income "from activities determined to be legal under state law but illegal under federal laws is considered illegal source income…" for purposes of the VDP. So the IRS views income from marijuana operations that are legal under state law as illegal source income for purposes of the VDP. Consult with counsel familiar with the IRS' VDP to determine whether the IRS may consider other sources of income as illegal sourced income and ineligible for the VDP.

Timeliness involves IRS-CI evaluating whether the taxpayer came forward before the IRS was aware of the taxpayer's noncompliance. According to the IRS, a disclosure is considered timely if it is received before:

- The IRS has commenced a civil examination or criminal investigation;
- The IRS has received information from a third party (e.g., informant, whistleblower, other governmental agency, John Doe summons, etc.) alerting the IRS to the specific taxpayer's noncompliance; or
- The IRS has acquired information directly related to the specific noncompliance of the taxpayer from a criminal enforcement action (e.g., search warrant, grand jury subpoena, etc.).

IRS-CI requires considerable information for it to make a timeliness determination and provide "preclearance." IRS-CI communicates preclearance in writing by fax to the taxpayer's counsel. Form 14457, part I requires the following key information, in addition to other details:

- Type of disclosure;
- Taxpayer name, SSN, DOB, alias, address, citizenship(s), passport number(s), occupation, telephone number;
- List of all entities associated with tax noncompliance and all entities owned or controlled regardless of tax noncompliance;
- Information on law enforcement activity and whether income was from illegal sources; and
- List of all noncompliant financial accounts and digital assets.

Upon receipt of Form 14457, part I, IRS-CI establishes a case in its database and uses the information provided to check IRS records and other federal law enforcement databases to see if the taxpayer or the taxpayer's entities and financial accounts are already under investigation or connected to known tax noncompliance. For example, IRS-CI will conduct database searches to determine whether a whistleblower already provided information on the taxpayer or whether the taxpayer is already under investigation for some other reason. Given the scope of data provided on Form 14457, part I, it takes IRS-CI considerable time to verify timeliness. As of June 2023, IRS-CI averages 85 days to evaluate Form 14457, part I and make a preclearance determination.

The current form preclearance letter from IRS-CI begins with the following: "Thank you for your interest in participating in the Voluntary Disclosure Practice. After reviewing your preclearance request (Form 14457- Part I) submitted to IRS-CI on [date] we have determined that you are precleared to make a Voluntary Disclosure."

To request pre-clearance, Form 14457, part I must be completed and either mailed or faxed to IRS-CI using the addresses below. IRS-CI prefers fax submissions.

Mailing address:
Internal Revenue Service
Attn.: Voluntary Disclosure Coordinator
2970 Market Street
1-D04-100
Philadelphia, PA 19104
Fax number: 844-253-5613

2. Form 14457, Part II

Assuming that a taxpayer receives preclearance, the taxpayer must complete Form 14457, part II within 45 days of notification of preclearance. IRS-CI will grant an additional 45-day extension to submit part II if a written request is made by the taxpayer's counsel. All of the information submitted on Form 14457, part II is provided to IRS-CI under the penalties of perjury.

Form 14457, part II requires in essence, a written confession of tax crimes including the following:

- Estimates of unreported income;
- Specific information relating to voluntary disclosures involving unreported foreign bank accounts;
- A narrative including the following:
  - A description of the taxpayer's personal and professional background;
  - A description of any professional advisors that rendered services to the taxpayer from the inception of the noncompliance, including attorneys, accountants, financial planners, private bankers, consultants, etc.
  - A thorough discussion of all tax and tax related noncompliance, including specific information for noncompliance relating to offshore issues and virtual currency (see the instructions to Form 14457, part II for the specific information required).

The narrative provides a story to the IRS and an audit trail. For example, the IRS requires identifying all professional advisors regardless of their knowledge of the taxpayer's tax issues. Why does the IRS require that information? If a taxpayer stops cooperating with the IRS, the IRS will issues summonses to professionals to reconstruct income and other facts. So the narrative provides a confession and a roadmap for the IRS to collect evidence.

As of mid-2023, IRS-CI has been providing some responses to Form 14457, part II within a few weeks. Assuming IRS-CI views the voluntary disclosure as complete, then IRS-CI issues a "preliminary acceptance letter." Generally, a preliminary acceptance letter will include the following soft assurance concerning criminal prosecution: "A voluntary disclosure will not automatically guarantee immunity from prosecution; however, a voluntary disclosure may result in prosecution not being

recommended." The preliminary acceptance letter also emphasizes that the voluntary disclosure is not complete until the taxpayer resolves the civil examination process with the assigned civil auditor or revenue agent.

C. IRS Civil Functions

All voluntary disclosures that are accepted into the VDP will involve a civil audit or examination. For purposes of this brief discussion, we will refer to the civil function of the IRS handling an examination or audit as IRS Examination.

1. IRS Examination

It is difficult to predict with certainty how long it will take for IRS Examination to begin an audit of a VPD case. Based on observations of past cases, it can take from six months to two years for a VDP case to reach IRS Examination. Once a case is assigned to an IRS revenue agent (auditor), the revenue agent will (1) confirm the years included in the voluntary disclosure and (2) request initial documents and information including delinquent or amended income tax returns, supporting records, and schedules explaining return positions. IRS Examination will also request extensions of the applicable statutes of limitation.

Taxpayers are required to fully cooperate with IRS Examination including providing all requested records, making witnesses available, and submitting to interviews when requested. Full cooperation also requires full payment of all tax and interest due for the disclosure period, as well as all required penalties under VDP. A taxpayer can enter into a payment arrangement to cover these amounts, but the payment arrangement must be on terms acceptable to the IRS. The IRS takes cooperation seriously, and a failure to fully cooperate will prompt IRS Examination to request that IRS-CI revoke preliminary acceptance.

2. Closing Agreements

The IRS rewards full cooperation throughout the VDP process with written finality. At the end of the civil audit, the IRS calculates tax, interest, and required penalties. If the taxpayer agrees, then the IRS and the taxpayer enter into a special type of contract under 26 U.S.C. § 7121 called a closing agreement. Once full payment is made and a closing agreement is signed by both sides, the voluntary disclosure case is complete. Absent fraud, malfeasance, or misrepresentation of a material fact, the tax matters covered in a closing agreement are forever resolved. Closing agreements benefit both the IRS and the taxpayer by wrapping up the voluntary disclosure with finality.

Closing agreements for VDP cases contain the "F word" – fraud. The IRS requires that closing agreements explicitly include a civil fraud penalty, using both the word "fraud" and the Internal Revenue Code section for civil fraud. Some taxpayers have unique concerns about the use of the "F word" in closing agreements. Some licensed professionals such as doctors and lawyers and those working in regulated financial industries may have concerns about signing an agreement with the IRS that explicitly imposes a penalty for fraud. If you have those concerns, talk to experienced counsel before deciding how to proceed.

D. Expectations About Payment

As mentioned earlier, the IRS expects that taxpayers who make voluntary disclosures fully pay all taxes, interest, and required penalties. But in some cases, taxpayers do not have the assets to fully pay. In those cases, the IRS will assign collection personnel, known as revenue officers, to the voluntary disclosure case during the civil audit to determine whether a taxpayer truly cannot fully pay. The involvement of an IRS revenue officer during an IRS audit (in addition to one or more revenue agents) is like having an upper GI exam and a lower GI exam performed simultaneously.

A taxpayer in the VDP who cannot fully pay the required amounts must provide detailed information on assets and income with supporting documents to IRS revenue officers. Reaching an agreement concerning inability to fully pay can be a painful process for taxpayers in the VDP. The IRS generally requires an agreement on inability to fully pay to address all equity in assets. The IRS generally requires immediate payment of all equity in assets or payment of all equity in assets over a reasonable amount of time. The IRS may insist that taxpayers make lifestyle changes to reduce personal expenditures to make more income available as payments to the IRS. Working with an IRS revenue officer during a voluntary disclosure is illustrated by the example below:

1. **Collection Example:** Tommy runs a business with many employees. During a business downturn two years ago, Tommy stopped remitting to the IRS tax withholding from his employees' paychecks and instead used those funds to pay various business expenses including rent and utilities for his office building. This continued for two years, and the business failed to remit $7 million of income taxes withheld from employee paychecks. Although Tommy did not remit withholding to the IRS, he paid himself a salary and "borrowed" from the business. With his "loans" from the business over that two year period, Tommy bought a small vacation cabin in the mountains and a new Mercedes G Wagon to get to his cabin. Tommy also has a young child in a private school with very high tuition that offers unique sports training.

   Tommy's attorney advised him that the IRS will likely view his conduct as criminal willful failure to pay tax under 26 U.S.C. § 7202. Tommy decided to use the VDP to come into compliance. However, Tommy is not able to fully repay the $7 million of trust fund taxes and other taxes and penalties that will be determined during the audit.

   IRS revenue officers will likely file notices of federal tax lien and will demand Tommy to liquidate the cabin and G Wagon and remit the proceeds to the IRS. The revenue officers will almost certainly demand Tommy pay to the IRS any equity from his personal residence. The revenue officers will also require Tommy to recalibrate his lifestyle including reducing personal expenditures such as eliminating the expensive private school tuition. Unless Tommy makes major changes, the IRS will not support an agreement involving less than full payment in his VDP case. And the IRS may revoke preliminary acceptance if Tommy doesn't fully cooperate.

The collection example above may seem harsh, but keep the alternative in mind, a potential criminal prosecution for the failure to pay tax under 26 U.S.C. § 7202.

Some taxpayers contemplating making a voluntary disclosure may already have revenue officers pursuing past taxes. For those taxpayers, we note:

- Contact by revenue officers does not by itself preclude making a voluntary disclosure. In other words, having a revenue officer hounding you for payment or delinquent tax returns does not by itself disqualify you from using the VDP.

- Taxpayers applying to use the VDP must fully cooperate with revenue officers while IRS-CI performs its analysis and, assuming that IRS-CI provides preliminary acceptance, must continue cooperating with revenue officers.

IV. OTHER OPTIONS

The VDP may not be the right path for you to correct past tax mistakes or even past tax fraud. Talk to an experienced tax attorney to discuss other options, which may include filing of amended returns and other strategies.

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For more information on the IRS Voluntary Disclosure Practice visit www.pricetaxlaw.com or email info@pricetaxlaw.com for a consultation.

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