



The 2009 Offshore Voluntary Disclosure Initiative Increased Taxpayer Compliance, but Some Improvements Are Needed

September 21, 2011

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This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

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HIGHLIGHTS

THE 2009 OFFSHORE VOLUNTARY DISCLOSURE INITIATIVE INCREASED TAXPAYER COMPLIANCE, BUT SOME IMPROVEMENTS ARE NEEDED

Highlights

**Final Report issued on
September 21, 2011**

Highlights of Reference Number: 2011-30-118 to the Internal Revenue Service Deputy Commissioner for Services and Enforcement.

IMPACT ON TAXPAYERS

Taxpayers with undisclosed foreign accounts or assets who do not submit a voluntary disclosure run the risk of detection by the Internal Revenue Service (IRS). If caught, these taxpayers face the imposition of substantial penalties, including the fraud and foreign information return penalties, as well as an increased risk of criminal prosecution. By making an offshore voluntary disclosure, taxpayers can become compliant, avoid substantial civil penalties, and generally eliminate the risk of criminal prosecution.

WHY TIGTA DID THE AUDIT

This audit was initiated to determine whether the IRS's voluntary disclosure practices were effective, especially with the high volume of cases received, and to determine whether all cases have been appropriately assigned and worked. The audit is included in our Fiscal Year 2011 Annual Audit Plan and addresses the major management challenge of Globalization.

WHAT TIGTA FOUND

The IRS's voluntary disclosure practices were effective, and cases were being appropriately assigned and verified even with the unusually high volume of disclosure requests received and accepted. However, some improvements are needed.

Our review of 60 closed voluntary disclosure cases showed that 18 cases had no evidence of the taxpayers reconciling the unreported income in their offshore accounts to their amended or newly filed delinquent tax returns. In 28 cases, information from the taxpayers' financial accounts and promoters either was not captured or was incorrectly transcribed on the data collection system used for current and subsequent data mining efforts. In 31 cases, voluntary disclosure agreements were not printed on IRS watermarked paper or initialed by revenue agents on each page to ensure no alterations to the original document were made by taxpayers.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Commissioner, Large Business and International Division, implement a requirement for taxpayers to provide a detailed reconciliation of unreported income. The Commissioner, Large Business and International Division, and the Commissioner, Small Business/Self-Employed Division, should develop a quality review process to ensure all data relating to voluntary disclosures are properly transcribed for future data mining and require revenue agents to initial each page of the voluntary disclosure agreement before submitting it to taxpayers for their signature.

In their response to the report, IRS management agreed with two of the three recommendations. Management stated that a reconciliation of all unreported taxpayer income from offshore accounts is already a requirement of the 2011 Offshore Voluntary Disclosure Initiative. In addition, management plans to implement procedures to conduct a 100 percent review of inputs to the E-Trak Offshore Voluntary Disclosure Program system. However, management disagreed with our recommendation to require revenue agents to initial each page of the voluntary disclosure agreement before submitting it to taxpayers for their signature.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

September 21, 2011

**MEMORANDUM FOR DEPUTY COMMISSIONER FOR SERVICES AND
ENFORCEMENT**

FROM: (for) Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – The 2009 Offshore Voluntary Disclosure
Initiative Increased Taxpayer Compliance, but Some Improvements
Are Needed (Audit # 201130007)

This report presents the results of our review to determine whether the Internal Revenue Service's (IRS) voluntary disclosure practices were effective, especially with the high volume of cases received, and to determine whether all cases have been appropriately assigned and worked. This audit is included in our Fiscal Year 2011 Annual Audit Plan and addresses the major management challenge of Globalization.

Management's complete response to the draft report is included as Appendix VIII.

Please contact me at (202) 622-6510 if you have questions or Margaret E. Begg, Assistant Inspector General for Audit (Compliance and Enforcement Operations), at (202) 622-8510.



*The 2009 Offshore Voluntary Disclosure Initiative Increased
Taxpayer Compliance, but Some Improvements Are Needed*

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Abbreviations

CI	Criminal Investigation
ERCS	Examination Return Control System
FY	Fiscal Year
IRS	Internal Revenue Service
LB&I	Large Business and International
OECD	Organisation for Economic Cooperation and Development
OVDI	Offshore Voluntary Disclosure Initiative
PFIC	Passive Foreign Investment Company
SB/SE	Small Business/Self-Employed
U.S.	United States
VDP	Voluntary Disclosure Practice



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Background

All United States (U.S.) citizens and resident aliens are required to report and pay taxes on their worldwide income. Taxpayers who intentionally fail to report income earned on bank or financial accounts or undisclosed assets on their tax returns face significant penalties and possible criminal prosecution if discovered by the Internal Revenue Service (IRS).

By making a voluntary disclosure, taxpayers can generally eliminate the risk of criminal prosecution.

However, noncompliant taxpayers with unreported accounts or assets can become compliant again by voluntarily disclosing this information to the IRS and paying any taxes due.

The IRS has had a Voluntary Disclosure Practice (VDP) for many years. By making a voluntary disclosure, taxpayers can generally eliminate the risk of criminal prosecution. A voluntary disclosure occurs when communications between the taxpayer and the IRS's Criminal Investigation (CI) are truthful, timely,¹ and complete by the taxpayer:

- Showing a willingness to cooperate (and does in fact cooperate) with the IRS in determining his or her correct tax liability.
- Making a good faith arrangement with the IRS to pay, in full, the tax, interest, and any penalties determined by the IRS to be applicable.

On March 26, 2009, the IRS announced the 2009 Offshore Voluntary Disclosure Initiative (hereafter referred to as the OVDI or the Initiative)² that encouraged taxpayers with hidden offshore assets and income to come back into the tax system using the IRS's VDP. The 2009 OVDI offered a uniform penalty structure for taxpayers who made a voluntary disclosure and ensured that they received consistent treatment. The 2009 OVDI provides the opportunity to calculate, with a reasonable degree of certainty, the total cost of resolving all outstanding offshore tax issues related to the undisclosed foreign bank and financial accounts and assets.

Taxpayers with undisclosed foreign accounts and assets who do not submit a voluntary disclosure run the risk of detection by the IRS. If caught, these taxpayers face the imposition of

¹ A disclosure is considered timely if it is received before: 1) 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; 2) the IRS has received information from a third party (e.g., informant, other government agency, or the media) alerting the IRS to the specific taxpayer's noncompliance; 3) the IRS has initiated a civil examination or criminal investigation that is directly related to the specific liability of the taxpayer; or 4) the IRS has acquired information directly related to specific liability of the taxpayer from a criminal enforcement action (e.g., search warrant or grand jury subpoena).

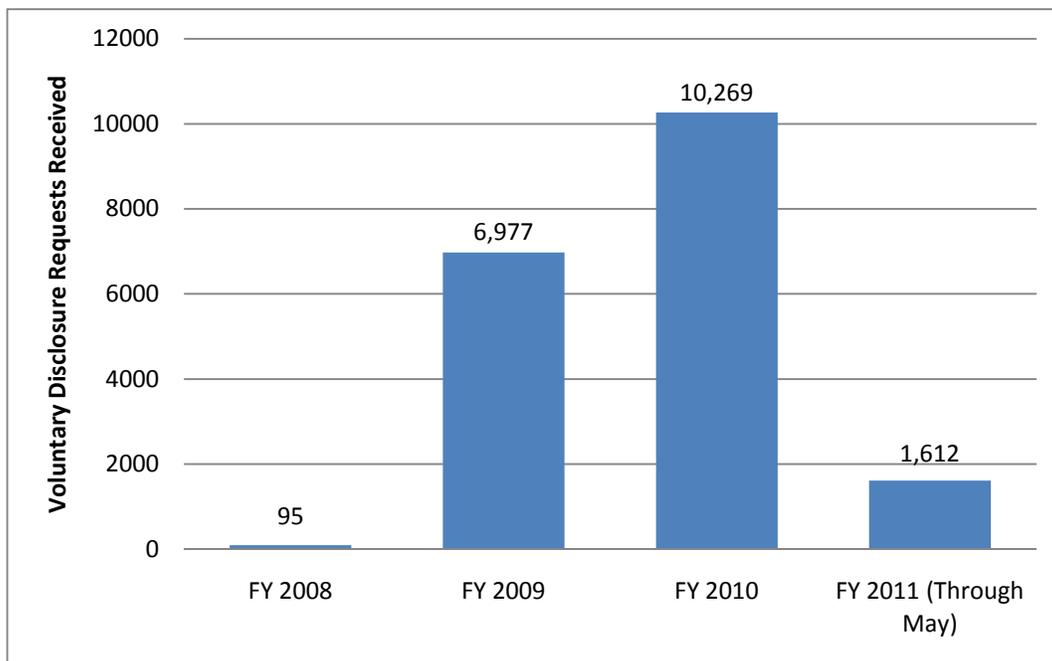
² Appendix VI has a detailed description of the 2009 OVDI steps.



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substantial penalties, including the fraud and foreign information return penalties, as well as an increased risk of criminal prosecution. As a result, the number of voluntary disclosures has increased due to the 2009 OVDI as well as recent IRS enforcement actions in the offshore area. Figure 1 shows the total number of all voluntary disclosures received by the IRS's CI for Fiscal Years (FY) 2008 to 2011 (through May 2011).

Figure 1: Total Voluntary Disclosure Requests Received by CI for FYs 2008 to 2011 (Through May 2011)



Source: Our analysis of an extract from the Criminal Investigation Management Information System of voluntary disclosures received by the IRS CI for FYs 2008 through 2010, and information provided by the IRS on the number of voluntary disclosures received by CI through May 2011.

Taxpayers who filed voluntary disclosure requests that were accepted by the IRS between March 23 and October 15, 2009, received a reduced penalty framework. This framework required taxpayers to pay back taxes, interest, and either an accuracy-related³ or delinquency-related penalty⁴ on up to 6 years (if applicable) of unreported income, including a miscellaneous offshore penalty equal to 20 percent of the amount in the foreign bank accounts in the year with the highest aggregate account or asset value.

³ Internal Revenue Code Section 6662 (2011) provides for an accuracy-related penalty that is generally equal to 20 percent of the portion of the underpayment attributable to negligence, substantial understatement, substantial valuation misstatement, or any undisclosed foreign asset understatement.

⁴ Internal Revenue Code Section 6651 (2011) provides for a delinquency penalty for failure to file or pay tax by the due date of the return.



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On February 8, 2011, the IRS announced the 2011 OVDI was available to taxpayers until August 31, 2011. However, this OVDI was different than the 2009 OVDI in that it required taxpayers to pay back taxes, interest, and either an accuracy-related or delinquency-related penalty on up to 8 years (if applicable) of unreported income instead of 6 years. In addition, the miscellaneous offshore penalty was also raised from 20 to 25 percent of the amount in the foreign bank accounts in the year with the highest aggregate account balance covering the Tax Years 2003 to 2010 time period. However, some taxpayers were eligible for a reduced rate of 12.5 percent for those offshore accounts or assets that did not surpass \$75,000 in any calendar year covered by the 2011 Initiative.

The Organisation for Economic Cooperation and Development (OECD),⁵ in a fairly recent report, made the point of the inherent benefit of an offshore voluntary disclosure program for governments.

Offshore voluntary compliance programmes offer the opportunity to maximize the benefits of improvements in transparency and exchange of information for tax purposes, to increase short-term tax revenues and improve medium-term tax compliance. To succeed, they need to tread a fine line between encouraging non-compliant taxpayers to permanently improve their compliance (a balancing act in itself) and retaining the support and compliance of the vast majority of taxpayers who are already compliant. To do this, they need to form part of wider voluntary compliance and enforcement strategies.⁶

This review was performed at the IRS Large Business and International (LB&I) Division Headquarters in Washington, D.C., in the Office of the Deputy Commissioner (International), and the IRS Campuses⁷ in Covington, Kentucky, and Memphis, Tennessee, during the period November 2010 through May 2011. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Detailed information on our audit objectives, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

⁵ The OECD is a unique forum where OECD and Non-OECD governments work together to address the economic, social, and environmental challenges of globalization. The OECD member countries are: Australia, Austria, Belgium, Canada, Chile, the Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, the Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States. The Commission of the European Communities takes part in the work of the OECD.

⁶ Organisation for Economic Cooperation and Development, *Offshore Voluntary Disclosure: Comparative Analysis, Guidance and Policy Advice* (September 2010).

⁷ The data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.



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Results of Review

The 2009 OVDI was an unprecedented effort within the IRS that required the combined resources and coordinated efforts of CI, the LB&I and Small Business/Self-Employed (SB/SE) Divisions, and the Office of Chief Counsel. The IRS's voluntary disclosure practices were effective and cases were being appropriately assigned and verified even with the unusually high volume of disclosure requests received. However, some improvements are needed to ensure continued taxpayer compliance among those accepted into the OVDI and that information gathered is sufficient and accurate for future data mining efforts for trending noncompliance.

Obstacles Were Overcome to Meet the Challenges of the 2009 Offshore Voluntary Disclosure Initiative

CI efficiently worked its voluntary disclosure requests inventory

To its credit, the IRS was able to overcome many of the obstacles associated with the 2009 OVDI. From an extract provided by CI, we selected and reviewed a random sample of 104 cases⁸ from a universe of 14,908 voluntary disclosure requests closed in FY 2010.⁹ We found that despite some minor documentation problems, all requests in our sample were properly evaluated and accepted by CI.

When the 2009 OVDI began, the IRS had originally planned for receiving approximately 1,000 voluntary disclosure requests. This estimate was based on a similar IRS effort, the Offshore Voluntary Compliance Initiative conducted in Calendar Year 2003, that had received disclosure requests from approximately 1,500 taxpayers. According to the First Quarter 2010 CI Business Performance Review, "The period to submit disclosures to qualify for the reduced penalty was extended from September 23 to October 15 [2009]. Criminal Investigation received in excess of 14,700 disclosures [voluntary disclosure requests], the majority of which (almost 9,900) were received during the extension period." Figure 2 shows the number of voluntary disclosure requests received during the 2009 OVDI by month.

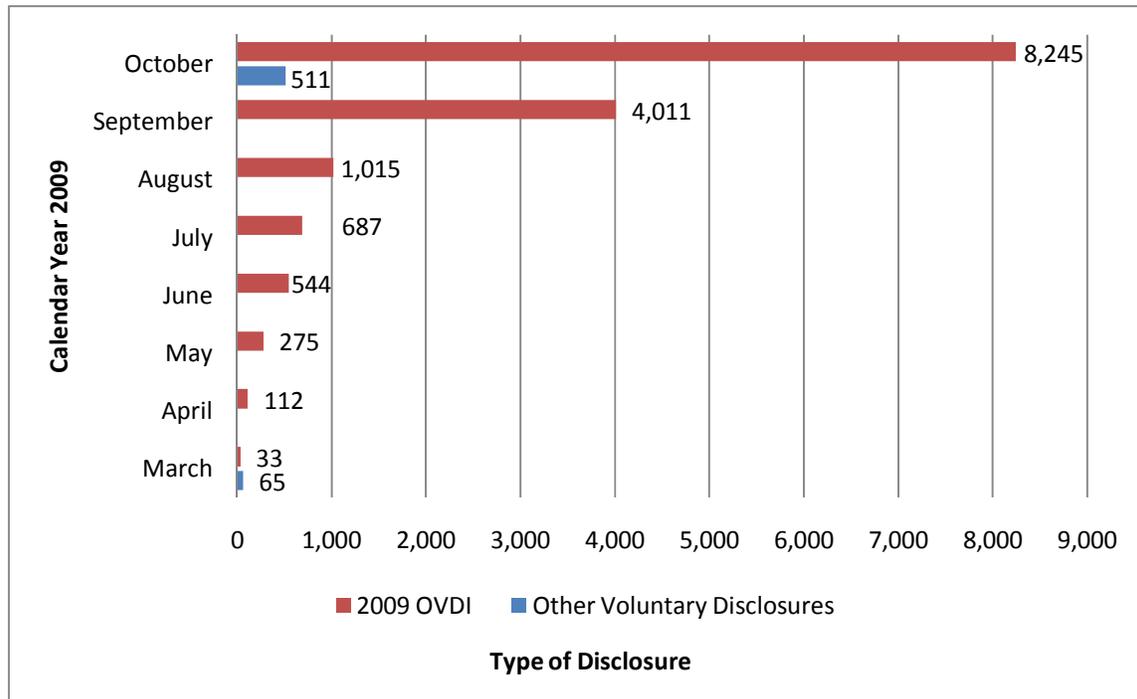
⁸ Our initial sample was for 106 voluntary disclosure requests closed by CI in FY 2010. However, CI was only able to provide us with 104 closed cases.

⁹ This included voluntary disclosure requests from the 2009 OVDI, as well as other voluntary disclosure requests closed in FY 2010.



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Figure 2: Voluntary Disclosure Requests Received by Month During the 2009 OVDI



Source: Our analysis of an extract from the Criminal Investigation Management Information System of voluntary disclosures received by CI from March through October 2009.

In addition, according to the IRS, of the 14,922 offshore voluntary disclosure requests received during the 2009 OVDI, more than 10,000 were incomplete as of December 1, 2009. Letters were sent to the affected taxpayers requesting that they provide additional information within 45 calendar days.

Internal Revenue Manual Section 9.5.11.9.7 requires that special agents¹⁰ evaluate each voluntary disclosure request to determine if the information provided by the taxpayer is truthful and complete and make a recommendation to the special agent in charge¹¹ as to whether or not the taxpayer has met all voluntary disclosure practice criteria. To timely evaluate the unexpected number of voluntary disclosure requests, CI took the following steps:

- 1) Assigned additional special agents to the evaluation process.

¹⁰ A special agent is a law enforcement employee who investigates potential criminal violations of the Internal Revenue laws and related financial crimes.

¹¹ A special agent in charge is responsible for directing, monitoring, and coordinating the criminal investigation activities of special agents within their assigned office's area of responsibility.



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- 2) Streamlined its processing procedures by eliminating the mandatory taxpayer interviews and replacing them with the optional offshore voluntary disclosure letter.¹² This should significantly reduce the number of voluntary disclosures requiring face-to-face interviews or personal contact.
- 3) Reduced some case documentation requirements.
- 4) Secured major case funding in the first quarter of FY 2010 to enable CI to scan and electronically search VDP documents for patterns relative to financial institutions, promoters,¹³ and countries. This system eventually became CI's Voluntary Disclosure Analysis Capability and is used for data mining to identify banks, financial institutions, promoters, and other professionals that have helped taxpayers hide income, assets, and foreign accounts overseas. Data gathered will be used to further the IRS's understanding of how foreign accounts and foreign entities are promoted to U.S. taxpayers as ways to avoid or evade tax, as well as to develop additional strategies to inhibit promoters and facilitators from soliciting new clients.

The Examination functions successfully overcame obstacles to verify the voluntary disclosure requests

Due to the high response rate as a result of the 2009 OVDI, the IRS had to rethink its voluntary disclosure verification process as it was required to absorb more than 55,000 unexpected high-priority income tax returns into the examination workflow for both the LB&I and SB/SE Divisions.¹⁴ At the time, this absorption constituted an increase of more than 10 percent to the revenue agent¹⁵ workload nationally. To meet the demand, the IRS recognized that it would need to train additional revenue agents in the subtleties of verifying an offshore voluntary disclosure case rather than conducting an income tax examination. As a result, revenue agents were reassigned, workloads were shifted, and training was provided to an additional 708 revenue agents, managers, attorneys, and other support personnel to augment the 649 employees previously trained.

The revenue agents, along with OVDI technical advisors and coordinators, were set up in centralized groups around the country to verify the offshore disclosure information provided by the taxpayers. Weekly teleconferences were held to ensure that cases, issues, and penalties were handled in a consistent manner throughout the country. One result of these teleconferences was

¹² See Appendix V for an example of an offshore voluntary disclosure letter.

¹³ Individuals who assist taxpayers in setting up elaborate financial schemes to subvert and evade tax laws.

¹⁴ The nearly 14,000 accepted offshore voluntary disclosure requests translated into nearly 11,000 accepted cases consisting of 55,501 income tax returns that needed verification.

¹⁵ Employees in the Examination function that conduct face-to-face examinations of more complex tax returns such as businesses, partnerships, corporations, and specialty taxes (e.g., excise tax returns).



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the identification of the Passive Foreign Investment Company (PFIC)¹⁶ issue. As a result, the Office of Chief Counsel was able to quickly act on this information, develop a solution related to PFIC income, and issue advice to the revenue agents on how to treat PFIC income reported under the disclosure, thereby ensuring consistent treatment of taxpayers with these types of issues.

An additional obstacle the IRS faced was how to process 6 or more years of income tax returns, many with barred statutes. In order to permit the review of these taxpayer cases, the IRS needed to create closing agreements tailored to each specific case that involved verifying amended tax returns, newly filed delinquent tax returns, and taxpayer documents. In spite of these obstacles, as of March 2011, the IRS has completed verification of 3,637 cases that included 18,494 tax returns involving additional revenues of approximately \$784 million including tax, penalties, and interest. The IRS expects to complete the verifications for the remaining 37,007 income tax returns involving 6,985 accepted cases by October 2011.

A key accomplishment of the 2009 OVDI was bringing thousands of U.S. taxpayers back into compliance by requiring them to properly report and pay their taxes on their offshore accounts. In addition, these taxpayers are also required to continue to properly disclose this income when submitting future income tax returns. In a speech on November 16, 2010, the IRS Commissioner stated:

We are finding that many of these voluntary disclosure cases involve significant amounts of previously unpaid tax. Account sizes and taxes vary considerably from case to case, but the closed cases so far have averaged more than \$200,000 in tax collections per case, which includes back taxes, interest and penalties. But collecting additional revenue for past misdeeds is not the only important consideration here — regardless of account size, it is important that we are bringing thousands of U.S. taxpayers back into the system so they properly report and pay their taxes for years to come on their offshore accounts.

On March 1, 2011, the IRS Commissioner reiterated this point in his written testimony before the House Appropriations Committee Subcommittee on Financial Services and General Government by stating:

However, collecting such substantial additional revenue for past misdeeds is not the only important consideration here. Regardless of dollar size, it is important that we are bringing thousands of US taxpayers back into the system so they properly report and pay their taxes for years to come on their offshore accounts.

¹⁶ A PFIC is a foreign investment company or mutual fund whose gross income is 75 percent or more from passive sources or holds at least 50 percent of its assets for the production of passive income. U.S. shareholders of a PFIC can elect to be taxed currently on their share of the PFIC's capital gains and ordinary income, or the shareholders can choose to defer U.S. taxation until the PFIC distributes income or the shareholder disposes of the PFIC stock. The economic benefit of deferral is eliminated in the latter case by taxing the shareholder using the highest tax rate in effect in the years in which the income was accumulated and charging interest on the tax over the deferral period.



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While the actual impact on the U.S. international Tax Gap¹⁷ is unknown, it appears the 2009 OVDI is having an immediate financial impact. However, the true impact of the OVDI may not be measurable for years as the information and intelligence derived from it may spawn future criminal and civil income tax investigations of banks, financial institutions, and tax haven promoters. In this respect, we found some improvements to the voluntary disclosure process are needed to ensure future taxpayer compliance.

A Majority of Tax Practitioners Participating in the 2009 Offshore Voluntary Disclosure Initiative Believed Taxpayers Were Treated in a Fair and Consistent Manner

Although the IRS overcame numerous obstacles to assist taxpayers, two prominent tax practitioners in a widely circulated article criticized the IRS for the voluminous paperwork required for this Initiative.¹⁸ To determine if this negative publicity was warranted and if tax practitioners believed the IRS properly verified cases, we conducted a survey of tax practitioners that were on record with the IRS as having Power of Attorney for the taxpayers involved in the 2009 OVDI.¹⁹

The survey was conducted between May and June 2011. We selected a random sample of 212 tax practitioners from a universe of 3,319 tax practitioners participating in the 2009 OVDI because we were targeting a 90 percent confidence interval with a random error rate of ± 5.5 percent. We received 68 responses²⁰ (32 percent) and recomputed our random error rate to be ± 10 percent.

Based on our survey, tax practitioners generally viewed the program as positive, and their responses to our survey appeared to refute some of the negative anecdotal information appearing in these tax articles. Specifically:

- Nearly 77 percent of the respondents agreed that their clients were treated in a fair and consistent manner throughout the OVDI process.
- Nearly 74 percent of the respondents agreed that the back taxes, interest, and penalties assessed to their clients were generally consistent with the IRS Penalty Framework for the 2009 OVDI.

¹⁷ The Tax Gap is the estimated difference between the amount of tax that taxpayers should pay and the amount that is paid voluntarily and on time.

¹⁸ Mark E. Mathews and Scott D. Michel, "Tax Evasion: IRS's Voluntary Disclosure Program for Offshore Accounts: A Critical Assessment after One Year," *BNA Daily Tax Report*, September 21, 2010.

¹⁹ See Appendix IV for the detailed results of our survey.

²⁰ The low response rate suggests a high risk that the results could be affected by a no-response bias. For surveys of this type, it is generally assumed that dissatisfied people are more motivated to take the survey than satisfied people. Although it is not possible to ascertain, it is more likely than not that the full population of practitioners are more favorable about the initiative than is reflected by these figures.



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- Nearly 68 percent of the respondents agreed that the OVDI process is working appropriately.

The survey results tend to refute the “voluminous paperwork” criticism. Specifically:

- More than 79 percent of tax practitioner respondents believed the initial taxpayer information requested by the IRS was necessary to adequately assess back taxes, interest, and penalties owed.
- Nearly 62 percent of tax practitioner respondents indicated that a new Power of Attorney and Declaration of Representation (Form 2848) was requested from the taxpayer after the case was transferred to the Examination function. In addition, approximately 40 percent of the tax practitioners found the request burdensome, while 41 percent did not find it burdensome.
- Nearly 81 percent of tax practitioner respondents indicated that a Consent to Extend the Time to Assess Tax (Form 872) was requested from their client, and nearly 56 percent did not believe it was burdensome to their clients.

Additional Oversight Is Needed to Ensure Information Obtained From Voluntary Disclosures Is Accurate and Complete

As stated in the U.S. Government Accountability Office’s *Standards for Internal Controls in the Federal Government*, “Internal controls are a major part of managing an organization. They are comprised of the plans, methods, and procedures used to meet the missions, goals, and objectives of an organization; as well as supports performance-based management.” During our review, we found three issues regarding the processing of future voluntary disclosures which we believe warrant management’s attention in order to protect the Federal Government’s interest.

A requirement for taxpayers to reconcile unreported income to their tax returns is needed for proper verification

As part of the voluntary disclosure verification process, revenue agents are required to certify that the taxpayer’s amended or newly filed delinquent tax returns are complete and accurate.²¹ To determine if revenue agents properly verified this information before accepting the voluntary disclosures, we selected and reviewed documentation from a judgmental sample of 60 closed voluntary disclosure cases. In 18 of these cases, there was no evidence of a reconciliation of unreported income in the offshore accounts to the schedule and line item on the amended or newly filed delinquent income tax returns submitted by the taxpayer.

²¹ See Appendix VII for a description of the revenue agent’s verification process.



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Although taxpayers and their representatives may find preparing such reconciliations burdensome, this information is necessary to ensure all transactions and exchange rates used by taxpayers are properly reported on their tax returns. Without this reconciliation, revenue agents cannot certify that taxpayers are in full compliance with their agreement. Although revenue agents are encouraged to obtain this information from the taxpayers, it is not required as part of the information document request process. Requiring this information prior to entering into a voluntary disclosure agreement would ensure taxpayers are fully disclosing all unreported income.

Procedures are needed to ensure closing agreements obtained from taxpayers have not been altered

Once the revenue agent determines that the amended or newly filed delinquent tax returns are complete and accurate, the next step is to compute the tax and penalties in preparation of completing the Closing Agreement on Final Determination Covering Specific Matters (Form 906). OVDI closing agreement procedures provided to revenue agents recommend:

Print the closing agreements on IRS watermarked paper or place your initials in blue ink on the lower-right corner on the back of each page of the closing agreements to insure that the closing agreements you receive back from the taxpayer or representative are the same agreements you sent to the taxpayer or representative.

Our review of 60 closed voluntary disclosure cases showed 31 of the cases had the Forms 906 returned by the taxpayers. However, the Form 906 was neither printed on IRS watermarked paper nor initialed by the revenue agent on the lower-right corner on the back of each page. Using watermarked paper or initialing each page of the agreement provides assurance to the validity of the document contents returned to the IRS for processing by providing reasonable assurance that no alterations were made to the original agreement. Although this procedure is recommended, it is not an existing requirement. Not ensuring the integrity of the closing agreement could result in taxpayers intentionally altering these documents for their own financial benefit.



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Data mining efforts could be hampered if information is not accurately transcribed during verifications

IRS officials described that the data gathering systems used for examinations (i.e., the Audit Information Management System²² and the Examination Return Control System(ERCS))²³ are not set up to capture all information obtained from the voluntary disclosure agreements. As a result, the IRS established the E-Trak Offshore Voluntary Disclosure Program system for the 2009 OVDI to control, monitor, and evaluate the success of the effort.

One of the important aspects of the system is that it allows the IRS to capture data related to banks, financial institutions, and tax haven promoters, as well as any tax professionals who assisted taxpayers during the voluntary disclosure process. Revenue agents working voluntary disclosure cases are instructed to update the E-Trak Offshore Voluntary Disclosure Program system during the entire review process and provide all necessary information before closing the cases.

However, our review found that, in 28 of 60 closed voluntary disclosure cases, financial accounts, promoter, and/or professional information was either not captured or incorrectly entered by revenue agents on the E-Trak Offshore Voluntary Disclosure Program system. There are no existing quality review procedures in place to ensure that the information is accurately captured in the system before the cases are sent to storage. The U.S. Government Accountability Office's *Standards for Internal Controls in the Federal Government* states, "Internal control and all transactions and other significant events need to be clearly documented, and the documentation should be readily available for examination. All documentation and records should be properly managed and maintained."

Complete and accurate electronic information is essential for future data mining efforts to identify patterns or trends of noncompliance. In a November 16, 2010, speech, the IRS Commissioner underscored the importance of these data by stating:

The VDP and UBS²⁴ matters are significant, but there is obviously more to come. We have been scouring the vast quantity of data we received from the VDP applicants and from various other sources. Although more data mining is still to be done, this

²² The Audit Information Management System is a computer system used by the IRS Examination functions to control returns, input assessments/adjustments to the Master File, and provide management reports. The Master File is the IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.

²³ The ERCS is an automated inventory management system used to requisition tax returns, assign returns to examiners, change codes such as status and project codes, and charge time. The ERCS can be used to control work that is not controlled on the Audit Information Management System, such as preparer penalties. The ERCS also provides real-time information in the form of screens and reports for management of the SB/SE and the LB&I Divisions.

²⁴ A Swiss global financial services company which provides investment banking, asset management, and wealth management services to clients worldwide.



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information has already proved invaluable in supplementing and corroborating prior leads, as well as developing new leads, involving numerous banks, advisors and promoters around the world.

Without sufficient and complete information, the IRS may miss opportunities to identify additional taxpayers and promoters who continue to defraud the Federal Government with their offshore activities.

Recommendations

Recommendation 1: The Commissioner, LB&I Division, should require taxpayers or their representatives to prepare a reconciliation of all unreported income from offshore accounts to the schedule and line item on the amended or newly filed delinquent income tax returns as part of the voluntary disclosure agreement process.

Management's Response: IRS management agreed with this recommendation and stated that this is already a requirement of the 2011 OVDI that was announced on February 8, 2011. In addition, examiners reviewing OVDI applications are required to verify the correctness of amended returns. The IRS believes the additional taxpayer submission requirements of the 2011 OVDI and the continuing requirement that examiners verify the amounts on amended returns are sufficient safeguards to ensure that taxpayers are fully disclosing all unreported income.

The Commissioner, LB&I Division, and the Commissioner, SB/SE Division, should:

Recommendation 2: Require revenue agents to initial the lower-right corner on the back of each page of the Form 906 before sending it to the taxpayer for signature.

Management's Response: IRS management did not agree with this recommendation. Their experience is that taxpayers and representatives rarely make hidden changes to documents prior to signing and returning them to the IRS for execution. Specifically, with regard to OVDI closing agreements, the IRS has not encountered a single closing agreement where the taxpayer or representative has altered an agreement before returning it. The IRS already recommends the initialing as a best practice to make it easy for reviewers to verify the original was signed; however, this is just one of several methods available to verify validity of the closing agreement. SB/SE Technical Services performs a second-level review of all taxpayer signed closing agreements. Therefore, the IRS does not believe it is a good idea to make the practice a requirement, because it will result in perfectly good closing agreements being returned to taxpayers for reexecution as taxpayers often sign and return photocopies of Form 906. The IRS believes there is an adequate review process in place to ensure the accuracy of closing agreements.



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Office of Audit Comments: After considering IRS management's response, we agree with their rationale and do not have any concerns with their disagreement.

Recommendation 3: Develop a quality review process to ensure that all taxpayer data relating to financial accounts, promoters, and professional information involving voluntary disclosures are properly transcribed into the E-Trak Offshore Voluntary Disclosure Program system.

Management's Response: IRS management agreed with this recommendation and plans to implement procedures to conduct a 100 percent review of inputs to the E-Trak Offshore Voluntary Disclosure Program system.



Appendix I

Detailed Objectives, Scope, and Methodology

Our overall objectives were to determine whether the IRS's voluntary disclosure practices were effective especially with the high volume of cases received, and to determine whether all cases have been appropriately assigned and worked. Specifically, we determined whether:

1) voluntary disclosure requests were properly evaluated and accepted by CI, 2) accepted voluntary disclosures were properly verified by the IRS's Examination functions, and 3) information obtained from the VDP was accurately captured for future use. To accomplish these objectives, we:

- I. Determined whether voluntary disclosure requests submitted by taxpayers were properly evaluated by CI.
 - A. Obtained an extract from the Criminal Investigation Management Information System.¹ We selected a random sample of 106 voluntary disclosure requests from a universe of 14,908 requests closed in FY 2010. We requested the supporting electronic case files for the 106 voluntary disclosure requests from CI, which was able to provide us 104 completed case files for review.
- II. Determined that accepted voluntary disclosures were properly verified by the IRS's Examination functions.
 - A. Selected a judgmental sample of 60 closed verifications cases, 30 each from the IRS Campuses² in Covington, Kentucky, and Memphis, Tennessee. A judgmental sample was used because the voluntary disclosure cases were still in process at the time of our review and a scientific sample was not practical because the total population of cases was still changing as cases were being put into process. The cases were reviewed against the criteria found in the Offshore Voluntary Disclosure Practice Job Aids found on the OVDI SharePoint site.
 - B. Obtained a list from the IRS of 3,319 tax practitioners who participated in the 2009 OVDI. Using a confidence interval of 90 percent, an expected error rate of 5.5 percent, and precision rate of ± 50 percent, we selected and surveyed a random

¹ The Criminal Investigation Management Information System is a database that tracks the status and progress of criminal investigations and time expended by special agents. It is also used as a management tool that provides the basis for decision of both local and national scope.

² The data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.



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sample of 212 tax practitioners to obtain their opinions of the OVDI. The survey was conducted between May 27 and June 29, 2011.

- C. Using computer data analysis of the Criminal Investigation Management Information System, the Audit Information Management System,³ the ERCS,⁴ and the Master File⁵ for FYs 2008 to 2010, compared the number of voluntary disclosure requests accepted by CI each year; the number of voluntary disclosure requests completed and ongoing; and the return, in the form of tax assessment, interest, and penalties, on completed verifications. To validate these data, we compared the data to other IRS databases residing at the Treasury Inspector General for Tax Administration Data Center Warehouse⁶ that included the Audit Information Management System, the ERCS, and the Master File.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined the following internal controls were relevant to our audit objectives: IRS policies, procedures, and practices for evaluating, verifying, and accepting voluntary disclosures. We evaluated these controls by reviewing source materials, interviewing management, surveying tax practitioners, and reviewing voluntary disclosure requests and closed verifications cases.

³ A computer system used by the IRS Examination functions to control returns, input assessments/adjustments to the Master File, and provide management reports.

⁴ An automated inventory management system used to requisition tax returns, assign returns to examiners, change codes such as status and project codes, and charge time. The ERCS can be used to control work that is not controlled on the Audit Information Management System, such as preparer penalties. The ERCS also provides real-time information in the form of screens and reports for management of the SB/SE and the LB&I Divisions.

⁵ The IRS database that stores various types of taxpayer account information. The database includes individual, business, and employee plan and exempt organization data.

⁶ The Data Center Warehouse provides data and data access services; centralizes storage, security, and administration of files; and develops uniform and user-friendly interfaces for users to access data.



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Appendix II

Major Contributors to This Report

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Appendix III

Report Distribution List

Commissioner C
Office of the Commissioner – Attn: Chief of Staff C
Chief Counsel CC
Chief, Criminal Investigation SE:CI
Commissioner, Large Business and International Division SE:LB
Commissioner, Small Business/Self-Employed Division SE:S
Deputy Commissioner (International) United States Competent Authority, Large Business and International Division SE:LB:IN
Deputy Commissioner (Operations), Large Business and International Division SE:LB
Deputy Commissioner, Small Business/Self-Employed Division SE:S
Division Counsel/Associate Chief Counsel (Criminal Tax) CC:CT
Division Counsel/Associate Chief Counsel (Large Business and International) CC:LB&I
Division Counsel/Associate Chief Counsel (Small Business/Self-Employed) CC:SB
Associate Chief Counsel (International) CC:INTL
Associate Chief Counsel (Procedure and Administration) CC:P&A
Director, Examination, Small Business/Self-Employed Division SE:S:E
Director, International Individual Compliance, Large Business and International Division SE:LB:IN
Director, Operations Policy and Support SE:CI:OPS
Director, Pre-Filing and Technical Guidance, Large Business and International Division SE:LB:PFTG
Director, Global Financial Crimes SE:CI:OPS:GFC
National Taxpayer Advocate TA
Director, Office of Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis RAS:O
Office of Internal Control OS:CFO:CPIC:IC
Audit Liaisons:
Chief Counsel CC
Deputy Commissioner for Services and Enforcement SE
Chief, Criminal Investigation SE:CI
Commissioner, Large Business and International Division SE:LB
Commissioner, Small Business/Self-Employed Division SE:S



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Appendix IV

Results of the Survey of Tax Practitioners

The following questions were included in a survey conducted by the Treasury Inspector General for Tax Administration. The surveys were mailed to 212 tax practitioners who represented taxpayers during the 2009 OVDI. The survey was conducted between May 27 and June 29, 2011. A total of 68 tax practitioners responded to the survey. The percentages reflected in the survey responses may not always equal 100 percent due to rounding.

**TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION
VOLUNTARY DISCLOSURE PROGRAM
PRACTITIONER QUESTIONNAIRE**

1. What is your profession (you may select more than one answer for this question)?

Number of Responses	Practitioner Answers	Percentage
31	Attorney	45.6
2	Attorney/Certified Public Accountant	2.9
1	Attorney/Public Accountant	1.5
26	Certified Public Accountant	38.2
1	Certified Public Accountant/Enrolled Agent/Public Accountant	1.5
3	Enrolled Agent	4.4
1	Public Accountant	1.5
2	Other	2.9
1	No response	1.5

2. How many years have you been in practice?

Number of Responses	Practitioner Answers	Percentage
5	0 to 5 Years	7.4
4	6 to 10 Years	5.9
14	11 to 20 Years	20.6
44	Over 20 Years	64.7
1	No response	1.5



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3. Are you or your firm currently representing any clients for the 2011 OVDI that began on February 8, 2011?

Number of Responses	Practitioner Answers	Percentage
28	Yes	41.2
40	No	58.8

4. Prior to the 2009 OVDI that began on March 23, 2009, have you or your firm ever represented any taxpayers requesting consideration under the IRS's VDP?

Number of Responses	Practitioner Answers	Percentage
21	Yes	30.9
47	No	69.1

5. Select the choice that best describes what you believe to be the purpose of the OVDI.

Number of Responses	Practitioner Answers	Percentage
51	The purpose of the OVDI is to permit taxpayers to profess to the IRS about previously underreported foreign earned income; provided the taxpayer's disclosure is truthful, timely, and complete and in exchange the IRS will not recommend criminal prosecution.	75.0
12	The purpose of the OVDI is to permit taxpayers to admit to a tax problem, pay a fine, and reenter the tax system as compliant taxpayers.	17.6
1	The OVDI is a tax amnesty without financial penalties or fines.	1.5
1	I do not know the purpose of the OVDI.	1.5
3	Other	4.4



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6. Were you familiar with the OVDI filing requirements prior to submitting your client's request to IRS CI?

Number of Responses	Practitioner Answers	Percentage
45	Yes	66.2
23	No	33.8

7. How many taxpayers did you or your firm represent during the 2009 OVDI that was announced on March 23, 2009?

Number of Responses	Practitioner Answers	Percentage
53	1 to 5	77.9
1	6 to 10	1.5
5	11 to 20	7.4
4	More than 20	5.9
5	No response	7.4

8. How many of the 2009 OVDI client requests that you or your firm represented were initially accepted by the IRS?

Number of Responses	Practitioner Answers	Percentage
58	All (100 percent)	85.3
2	90 to 99 percent	2.9
1	80 to 89 percent	1.5
0	70 to 79 percent	0.0
0	60 to 69 percent	0.0
1	50 to 59 percent	1.5
0	Less than 50 percent	0.0
6	No response	8.8



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9. For any client OVDI requests that were rejected by the IRS, please choose the factors below that best describe the reasons given by the IRS for rejecting them (you may select more than one answer for this questions).

Number of Responses	Practitioner Answers	Percentage
0	Truthfulness	0.0
4	Timeliness	5.9
0	Completeness	0.0
0	Reason was not provided	0.0
5	Other	7.4
59	No response	86.8

10. Did you access IRS.gov to find information on the VDP?

Number of Responses	Practitioner Answers	Percentage
65	Yes	95.6
3	No (If you responded no, please skip to Question #13)	4.4

11. Was the VDP information found on IRS.gov helpful to you?

Number of Responses	Practitioner Answers	Percentage
64	Yes	94.1
1	No	1.5
3	No response	4.4

12. Do you think that a webpage on IRS.gov that centralized all the VDP information, including the Internal Revenue Manual, news releases, and frequently asked questions would be helpful?

Number of Responses	Practitioner Answers	Percentage
63	Yes	92.6
2	No	2.9
3	No Response	4.4



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13. Do you think that the initial taxpayer information requested by the IRS on the Information Document Request (Form 4564) was necessary for them to adequately assess back taxes, interest, and penalties owed to the U.S. Government?

Number of Responses	Practitioner Answers	Percentage
54	Yes	79.4
12	No	17.6
2	No Response	2.9

14. Once the OVDI request was transferred from IRS CI to one of the Examination functions for verification, was a new Power of Attorney and Declaration of Representative (Form 2848) requested from the taxpayer?

Number of Responses	Practitioner Answers	Percentage
42	Yes	61.8
20	No	29.4
6	No response	8.8

15. Do you feel it was burdensome to the taxpayer that the IRS Examination function requested a revised power of attorney to protect both the taxpayer's and the U.S. Government's interests?

Number of Responses	Practitioner Answers	Percentage
27	Yes	39.7
28	No	41.2
13	No response	19.1

16. Once the OVDI request was transferred from IRS CI to one of the Examination functions, was a Consent to Extend the Time to Assess Tax (Form 872) requested from the taxpayer to extend the assessment statute of limitations on 1 or more tax years?

Number of Responses	Practitioner Answers	Percentage
55	Yes	80.9
8	No	11.8
5	No response	7.4



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17. Do you feel it was burdensome to your client(s) that the IRS requested consents to extend the assessment statute of limitations for open tax years in the event that the taxpayer did not complete the OVDI process?

Number of Responses	Practitioner Answers	Percentage
23	Yes	33.8
38	No	55.9
7	No response	10.3

18. Do you feel that the back taxes, interest, and penalties assessed to your client(s) were generally consistent with the IRS Penalty Framework to Voluntary Disclosure Requests Regarding Unreported Offshore Accounts and Entities?

Number of Responses	Practitioner Answers	Percentage
50	Yes	73.5
14	No	20.6
4	No response	5.9

19. Do you feel your client(s) were treated in a fair and consistent manner throughout the OVDI process?

Number of Responses	Practitioner Answers	Percentage
52	Yes	76.5
14	No	20.6
2	No Response	2.9

20. Do you feel the OVDI process is working appropriately?

Number of Responses	Practitioner Answers	Percentage
46	Yes	67.6
19	No	27.9
3	No response	4.4



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Appendix V

Offshore Voluntary Disclosure Letter

Offshore Voluntary Disclosures – Optional Format

*If taxpayer has domestic issues only, please have them contact their local Criminal
Investigation office for a traditional voluntary disclosure.*

<DATE>

**Internal Revenue Service
Criminal Investigation
ATTN: Voluntary Disclosure Coordinator
<CITY Field Office>
<Address>
<CITY, ST ZIP CODE>**

**Re: Taxpayer Name
Tax Identification Number
Taxpayer Date of Birth
Taxpayer Address**

Dear Voluntary Disclosure Coordinator:

To assist in a timely determination of my acceptance into the Voluntary Disclosure Program, (for *Voluntary Disclosures involving offshore accounts or assets*), I have addressed *all* of the following items:

- Please include your:
 - Complete name:
 - Social Security Number:
 - DOB:
 - Address:
 - Passport Number (and Country):
 - Current Occupation

- Taxpayer Representative and his/her contact information.

- Explain the source of the funds.

Revised 07-28-2009



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- Disclose if you or any related entities are currently under audit or criminal investigation by the Internal Revenue Service or any other law enforcement authority.
 - Has the IRS notified you that it intends to commence an examination or investigation? **Yes No**
 - Are you under criminal investigation by any law enforcement authority? **Yes No**
 - If yes, please explain.

- Do you believe that the IRS has obtained information concerning your tax liability? **Yes No**
 - If yes, please specify.

- Please check the box to estimate the annual range of the highest aggregate *value* of your offshore accounts/assets.

Highest Aggregate

Account/Asset Value	2003	2004	2005	2006	2007	2008
\$0 to \$100,000						
\$100,000 to \$1,000,000						
\$1,000,000 to \$2,500,000						
\$2,500,000 to \$10,000,000						
Greater than \$10,000,000						
Greater than \$100,000,000						

- Please check the box to estimate the potential total unreported *income* from the offshore account(s) during each disclosure period. If known, please enter exact amounts/assets.

Estimated Total

Unreported Income	2003	2004	2005	2006	2007	2008
\$0 to \$100,000						
\$100,000 to \$1,000,000						
\$1,000,000 to \$2,500,000						
\$2,500,000 to \$10,000,000						
Greater than \$10,000,000						

Revised 07-28-2009



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- For accounts or assets where you have control or are a beneficial owner of the account or asset, list any and all financial institutions and the country where the institution is located. For accounts, please also list the dates the accounts were opened and/or closed. Provide your point of contact at each financial institution.
- Explain the purpose for establishing the offshore account or assets. For example: Holocaust Compensation or Restitution; inherited account; account established prior to World War II, etc.; if tax non-compliance – please explain.
- List each person or entity affiliated with the account, their formal structure (i.e., if a corporation, foundation, or trust), and the nature of their relationship to the account (i.e. owner, power of attorney, parent entity of corporate account holder, etc.).
- Explain all face to face meetings, and any other communications you had regarding the accounts or assets with the financial institution(s). Also include face to face meetings or communications regarding the accounts or assets with independent advisors/investment managers not from the financial institution(s) where the funds are held. Provide the names, locations and dates of these meetings and/or communications.

To be included with all letters:

By signing this document, I certify that I am willing to continue to cooperate with the Internal Revenue Service, including in assessing my income tax liabilities and making good faith arrangements to pay all taxes, interest, and penalties associated with this voluntary disclosure.

Under penalties of perjury, I declare that I have examined this document and accompanying statements, and to the best of my knowledge and belief, they are true, correct, and complete.

Signature of Taxpayer

Print Name

Date

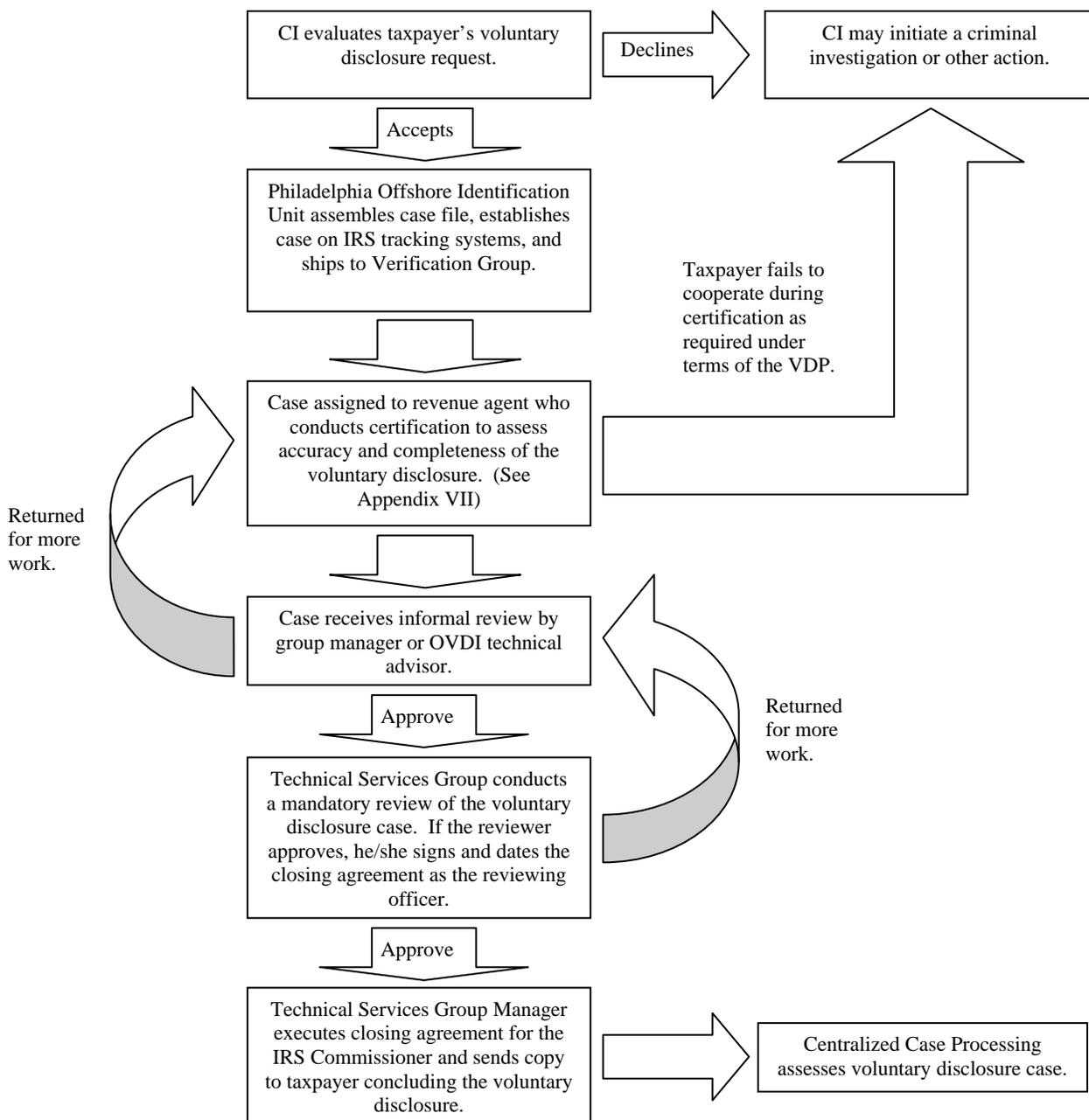
IRS reserves the right to make further contacts with the taxpayer to clarify his/her submission.



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Appendix VI

2009 Offshore Voluntary Disclosure Initiative Steps



Source: *Our analysis of Internal Revenue Manual Section 9.5.11.9 Voluntary Disclosure Practice, 2009 Offshore Voluntary Disclosure Program Job Aids, and other documentation.*

