DEPARTMENT OF THE TREASURY
**INTERNAL REVENUE SERVICE**
**WASHINGTON, D.C. 20224**

AUG 30 2011

MEMORANDUM FOR STEVEN T. MILLER, DEPUTY COMMISSIONER
FOR SERVICES AND ENFORCEMENT

FROM: Heather C. Maloy Heather C Maloy
Commissioner, Large Business and International Division

Faris R. Fink Faris R. Fink
Commissioner, Small Business/Self-Employed Division

SUBJECT: Appeal of Taxpayer Advocate Directive 2011-1 (Implement 2009 Offshore Voluntary Disclosure Program FAQ #35 and comply with the Freedom of Information Act)

In accordance with IRM 13.2.1.6.2 (TAD Appeal Process), we appeal the above-referenced Taxpayer Advocate Directive (TAD), dated August 16, 2011. The TAD directed us to take certain actions within 15 business days. The actions were described as follows in the TAD:

1. Disclose the March 1, 2011, memo for Offshore Voluntary Disclosure Initiative (OVDI) Examiners that addresses the use of discretion in 2009 Offshore Voluntary Disclosure Program (OVDP) cases (the "March 1 memo") on IRS.gov, as required by the Freedom of Information Act (FOIA) (whether or not it is revoked).

2. Revoke the March 1 memo and disclose such revocation as required by FOIA.

3. Immediately direct all examiners that when determining whether a taxpayer would be liable for less than the "offshore penalty" under "existing statutes," as required by 2009 OVDP FAQ #35 (described below), they should not assume the violation was willful unless the taxpayer proves it was not. Direct them to use standard examination procedures to determine whether a taxpayer would be liable for a lesser amount under existing statutes *(e.g.,* because the taxpayer was eligible for (a) the reasonable cause exception, (b) a non-willful penalty because the IRS lacked evidence to establish its burden to prove willfulness, or (c) application of the mitigation guidelines set forth in the IRM) without shifting the burden of proof onto the taxpayer. Post any such guidance on IRS.gov.

4. Commit to replace the March 1 memo and all OVD-related frequently asked questions (FAQs) on IRS.gov with guidance published in the Internal Revenue

Bulletin, which describes the OVDP and OVDI. This guidance should incorporate comments from the public and internal stakeholders (including the National Taxpayer Advocate). It should reaffirm that taxpayers accepted into the 2009 OVDP will not be required to pay more than the amount for which they would otherwise be liable under existing statutes, as currently provided by 2009 OVDP FAQ #35. It should also direct OVDP examiners to use standard examination procedures to make this determination, as provided in item #3 (above); and

5. Allow taxpayers who agreed to pay more under the 2009 OVDP than the amount for which they believe they would be liable under existing statutes the option to elect to have the IRS verify this claim (using standard examination procedures, as described above), and in cases where the IRS verifies it, offer to amend the closing agreement(s) to reduce the offshore penalty.

Regarding Action 1, we agree to disclose the March 1, 2011, memo on irs.gov.

We disagree with and appeal Actions 2, 3, 4, and 5. These actions are interrelated and substantively originate from a single issue – the application of FAQ 35.

The 2009 Offshore Voluntary Disclosure Program (OVDP) was designed to provide a way for taxpayers with previously undisclosed assets and unreported income to resolve their tax problems. The OVDP offered a uniform penalty structure that required taxpayers to pay either an accuracy-related or delinquency penalty and, in lieu of all other penalties that may apply, an offshore penalty equal to 20 percent of the amount in foreign bank accounts/entities in the year with the highest aggregate account/asset value. Some of the penalties covered by the offshore penalty include: (1) a penalty for failing to file the Form TD F 90-22.1 (Report of Foreign Bank and Financial Accounts, commonly known as an "FBAR"); (2) a penalty for failing to file Form 3520, Annual Return to Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts; (3) a penalty for failing to file Form 3520-A, Information Return of Foreign Trust With a U.S. Owner; and (4) a penalty for failing to file Form 5471, Information Return of U.S. Person with Respect to Certain Foreign Corporations.

This provides taxpayers who made voluntary disclosures certainty regarding the resolution of their tax liabilities. If this resolution was not acceptable to a taxpayer, the taxpayer, in accordance with FAQ 35, could request that the case be referred for an examination of all relevant years and issues. The procedures that we have followed and the communications our examiners provided to taxpayers and their representatives clearly afforded the application of all examination procedures and appeal rights.

FAQ 35's answer states as follows:

"Voluntary disclosure examiners do not have discretion to settle cases for amounts less than what is properly due and owing. These examiners will compare the 20 percent offshore penalty to the total penalties that would otherwise apply to a particular taxpayer. Under no circumstances will a taxpayer be required to pay a penalty greater than what he would otherwise be liable for under existing statutes. If the taxpayer disagrees with the IRS's determination, as set forth in the closing agreement, the taxpayer may request that the case be referred for a standard examination of all relevant years and issues. At the conclusion of this examination, all applicable penalties, including information return penalties and FBAR penalties, will be imposed. If, after the standard examination is concluded the case is closed unagreed, the taxpayer will have recourse to Appeals."

The National Taxpayer Advocate asserts "total penalties that would otherwise apply" should refer to the total penalties that would be imposed after a standard examination. We disagree. The comparison should only involve issues that can be resolved using the information available during the certification of the voluntary disclosure. So, for example, if the period of limitations had run on the FBAR penalty for some of the years or the bulk of the offshore assets were not subject to the FBAR penalty, an agent could make a comparison that determined that the taxpayer's liability under OVDP was higher than that under existing statutes and could give the taxpayer the benefit of the lower liability.

The mitigation standards are part of the Examination IRM. The National Taxpayer Advocate states that taxpayers believed that IRS would apply these mitigation standards in part because they were applied under the Last Chance Compliance Initiative (LCCI). This is not logical since the language of the 2009 OVDP FAQs was demonstrably different than the guidelines of the LCCI. Had the IRS intended to apply the mitigation standards in the course of the verification, we would have used the LCCI language and we would have required that taxpayers submit the necessary documentation with their application. We did neither of these things.

That an examination during the OVDP verification process is not contemplated as part of the OVDP is signaled by the OVDP procedures and numerous FAQs, including FAQ 35 itself when it says that "If the taxpayer disagrees with the IRS's determination, as set forth in the closing agreement, the taxpayer may request that the case be referred for a standard examination of all relevant years and issues." FAQ 28 provides that "if any part of the penalty framework is unacceptable to the taxpayer, the case will be examined and all applicable penalties may be imposed." Similarly, FAQ 34 provides that "if any part of the penalty structure is unacceptable to a taxpayer, that case will follow the standard audit process. All relevant years and issues will be subject to a complete examination. At the conclusion of the examination, all applicable penalties (including information return and FBAR penalties) will be imposed."

The OVDP process also signals that examinations will not be a part of the program in that taxpayers are not requested to submit information regarding their level of knowledge—information that would be needed during an examination that would have to consider such things as whether a taxpayer had reasonable cause for failing to file an FBAR or whether a taxpayer was entitled to the FBAR mitigation provisions.

It therefore stands to reason that a taxpayer who filed a voluntary disclosure but believed he should owe less than the 20 percent offshore penalty should have expected that the route to that outcome would only come through a full examination, not solely through application of FAQ 35.

The Advocate claims that "opting out would leave a taxpayer worse off than if he or she had not entered the OVDP". We do not believe this assertion is based in fact and it is contrary to guidance issued by the Deputy Commissioner Services and Enforcement.

This guidance (Guidance for Opt Out and Removal of Taxpayers from the Civil Settlement Structure of the 2009 Offshore Voluntary Disclosure Program (2009 OVDP) and the 2011 Offshore Voluntary Disclosure Initiative (2011OVDI) states "The procedures have been designed to balance the interests at stake, to ensure fairness and consistency for all taxpayers in the 2009 OVDP and 2011 OVDI and to allow for flexibility where necessary". Further, the guidance states "It should be recognized that in a given case, the opt out option may reflect a preferred approach. That is, there may be instances in which the results under the applicable voluntary disclosure program appear too severe given the facts of the case."

The Advocate claims that taxpayers would be subjected to the possibility of "excessive civil penalties and criminal prosecution". We disagree. First, taxpayers who opt out do not lose the criminal protections afforded through the disclosure. Instead, only "to the extent that issues are found upon a full scope examination that were not disclosed, those issues may be the subject of review by the Criminal Investigation Division. " Moreover, a full scope examination requires determinations that are based upon the facts and circumstances of the case. Examiners cannot arbitrarily assert penalties nor pursue criminal fraud without a meritorious argument. Examination outcomes also follow normal procedural remedies for disagreement in the form of Appeal rights.

In conclusion, for the reasons set forth above, we respectfully appeal Actions 2, 3, 4, and 5. We request that the Deputy Commissioner rescind this TAD in accordance with the authority vested in him by Delegation Order 13-3.

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