



*Improvements Are Needed in  
Offshore Voluntary Disclosure  
Compliance and Processing Efforts*

**June 2, 2016**

**Reference Number: 2016-30-030**

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

### **IMPROVEMENTS ARE NEEDED IN OFFSHORE VOLUNTARY DISCLOSURE COMPLIANCE AND PROCESSING EFFORTS**

## Highlights

**Final Report issued on June 2, 2016**

Highlights of Reference Number: 2016-30-030 to the Internal Revenue Service Commissioner for the Large Business and International Division and the Chief, Criminal Investigation.

### **IMPACT ON TAXPAYERS**

The United States generally taxes its citizens and resident aliens on their worldwide income. Some taxpayers use offshore bank/financial accounts to hide assets and income outside the United States in an effort to evade their Federal tax obligations. Taxpayers who intentionally fail to report income earned on offshore accounts or who neglect to disclose foreign assets as required by law face significant penalties and possible criminal prosecution if discovered by the IRS. While giving noncompliant taxpayers the opportunity to resolve their potential tax delinquencies through the Offshore Voluntary Disclosure Program (OVDP), it is important for the IRS to ensure that these taxpayers actually become compliant with their tax obligations.

### **WHY TIGTA DID THE AUDIT**

This audit was initiated to assess how well the IRS is managing the OVDP and its efforts to improve taxpayer compliance and hold taxpayers who fail to report their offshore financial activities on their tax returns and Reports of Foreign Bank and Financial Accounts (FBAR) accountable.

### **WHAT TIGTA FOUND**

The IRS needs to improve its efforts to address the noncompliance of taxpayers who are denied access to or withdraw from the OVDP. TIGTA reviewed a stratified random sample of 100 taxpayers from a population of 3,182 OVDP requests that were either denied or withdrawn from the OVDP. Although 29 of these

100 taxpayers should have been potentially subject to FBAR penalties, the IRS did not initiate any compliance actions. Projecting the sample results to the population of denied or withdrawn requests, the IRS did not assess approximately \$21.6 million in delinquent FBAR penalties.

TIGTA also identified internal control weaknesses that led to delayed or incorrect processing of OVDP requests through poor communication among IRS functions involved in the OVDP. These weaknesses include the use of separate inventory controls and two separate IRS addresses for taxpayers to send correspondence, which contributed to incorrect processing of some taxpayer disclosure requests. In addition, the IRS does not have a process to determine the appropriate skill level needed for revenue agents to work OVDP request certifications. OVDP cases are not equivalent to audits of taxpayers' returns and generally do not require as much technical analysis as traditional tax audits.

### **WHAT TIGTA RECOMMENDED**

TIGTA recommended that the IRS: 1) review all denied or withdrawn offshore voluntary disclosure requests identified in this report for potential FBAR penalty assessments and criminal investigation; 2) develop procedures for reviewing denied and withdrawn cases for further compliance actions; 3) centrally track and control OVDP requests; 4) establish one mailing address for taxpayer correspondence; 5) ensure that employees adhere to timeliness guidelines throughout the entire OVDP process; and 6) classify OVDP certifications so that some can be worked by lower-graded revenue agents.

IRS management agreed with all six recommendations and has taken or plans to take corrective action on five of them. Although the IRS agreed with the potential value of establishing one mailing address for taxpayer correspondence, this recommendation has been put on hold until a decision is made about the future status of the OVDP.



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

June 2, 2016

**MEMORANDUM FOR** COMMISSIONER, LARGE BUSINESS AND INTERNATIONAL  
DIVISION  
CHIEF, CRIMINAL INVESTIGATION

**FROM:** Michael E. McKenney  
Deputy Inspector General for Audit

**SUBJECT:** Final Audit Report – Improvements Are Needed in Offshore Voluntary  
Disclosure Compliance and Processing Efforts (Audit # 201430028)

This report presents the results of our review to assess how well the Internal Revenue Service is managing the Offshore Voluntary Disclosure Program and its efforts to improve taxpayer compliance and hold taxpayers who fail to report their offshore financial activities on their tax returns and Reports of Foreign Bank and Financial Accounts accountable. This review is included in our Fiscal Year 2016 Annual Audit Plan and addresses the major management challenge of Globalization.

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

If you have any questions, please contact me or Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations).



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*Abbreviations*

CI	Criminal Investigation
CIMIS	Criminal Investigation Management Information System
FATCA	Foreign Account Tax Compliance Act
FBAR	Report of Foreign Bank and Financial Accounts
FinCEN	Financial Crimes Enforcement Network
FAQ	Frequently Asked Question
IRS	Internal Revenue Service
LB&I	Large Business and International
OVDI	Offshore Voluntary Disclosure Initiative
OVDP	Offshore Voluntary Disclosure Program
SB/SE	Small Business/Self-Employed
TIN	Taxpayer Identification Number



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## *Improvements Are Needed in Offshore Voluntary Disclosure Compliance and Processing Efforts*

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### *Background*

The United States (U.S.) generally taxes its citizens and resident aliens (hereafter referred to as taxpayers) on their worldwide income.<sup>1</sup> Some taxpayers use offshore bank/financial accounts to hide assets and income outside the United States in an effort to evade their Federal tax obligations. Taxpayers who intentionally fail to report income earned on offshore accounts or who neglect to disclose foreign assets as required by law face significant penalties and possible criminal prosecution if discovered by the Internal Revenue Service (IRS).

U.S. taxpayers can hold offshore accounts and foreign assets for a number of nontax reasons, including access to funds while living or working overseas, asset protection, investment portfolio diversification, enhanced investment opportunities, and to facilitate international business transactions. Taxpayers must report whether they have offshore accounts on Form 1040, *U.S. Individual Income Tax Return*, Schedule B, *Interest and Ordinary Dividends*, and pay taxes on any income earned from them.

Taxpayers with aggregate foreign financial account balances of more than \$10,000 are also required to report additional account information, such as the name and location of their bank, by filing Financial Crimes Enforcement Network (FinCEN) Form 114, *Report of Foreign Bank and Financial Accounts (FBAR)*. Starting in Tax Year 2011, under the Foreign Account Tax Compliance Act (FATCA), taxpayers are also required to file Form 8938, *Statement of Specified Foreign Financial Assets*, if they meet certain criteria.<sup>2</sup>

To assist noncompliant taxpayers in becoming current with reporting their offshore accounts and related income, the IRS implemented the 2009 Offshore Voluntary Disclosure Program (OVDP), the 2011 Offshore Voluntary Disclosure Initiative (OVDI), and the currently ongoing 2012 OVDP.<sup>3</sup> As of October 2015, the IRS reported that the three disclosure programs have resulted in more than 54,000 voluntary disclosure requests from taxpayers who have paid more

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<sup>1</sup> See Appendix V for a glossary of terms.

<sup>2</sup> To improve U.S. taxpayer compliance with reporting foreign financial assets and offshore bank accounts, Congress passed the FATCA in March 2010 as part of the Hiring Incentives to Restore Employment Act of 2010 (Pub. L. No. 111-147, 124 Stat. 71 (2010)). FATCA filing criteria are based on whether the taxpayer lives in the United States or abroad, the taxpayer's filing status, and the value of the foreign financial assets. For taxpayers living in the United States, single taxpayers are required to file Form 8938 if the aggregate fair market value of their foreign financial assets exceeds \$50,000 (\$100,000 for married joint filing taxpayers) on the last day of the taxable year or \$75,000 (\$150,000 for married joint filing taxpayers) at any time during the taxable year. Similarly for taxpayers living outside the United States, single taxpayers are required to file Form 8938 if the aggregate fair market value of their foreign financial assets exceeds \$200,000 (\$400,000 for married joint filing taxpayers) on the last day of the taxable year or \$300,000 (\$600,000 for married joint filing taxpayers) at any time during the taxable year. Filing criteria obtained from the instructions for Form 8938 (Oct. 2015).

<sup>3</sup> Hereafter, these programs are collectively referred to as the OVDP throughout this report.



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than \$8 billion from these programs. Figure 1 shows the differences in the duration and penalties between the three disclosure programs.

**Figure 1: Comparison of the 2009, 2011, and 2012 OVDPs**

	2009	2011	2012
Application Period	March 23, 2009, to October 15, 2009	February 8, 2011, to September 9, 2011	January 9, 2012, to present
Disclosure Period	Six tax years (Tax Years 2003 to 2008)	Eight tax years (Tax Years 2003 to 2010)	Eight tax years <sup>a</sup>
Principle Miscellaneous Offshore Penalty (OVDP Penalty)	20 percent	25 percent	27.5 percent 50 percent <sup>b</sup>
Reduced Offshore Penalty Rate	5 percent for passive account holders	5 percent for passive account holders, 12.5 percent for accounts valued less than \$75,000	5 percent for passive account holders, 12.5 percent for accounts valued less than \$75,000 <sup>c</sup>
Other Penalties	Accuracy-related penalty (20 or 40 percent of unpaid tax) <sup>d</sup> Failure to file penalty Failure to pay penalty		
<p><sup>a</sup> The voluntary disclosure period is the most recent eight tax years for which the due date has already passed (the last closed tax year, plus the previous seven tax years).</p> <p><sup>b</sup> A 50 percent offshore penalty applies to any voluntary disclosure from a taxpayer if the foreign financial institution (at which the taxpayer has or had an account) or the facilitator (who helped the taxpayer establish or maintain an offshore arrangement) has already been publicly identified as being under investigation or as cooperating with a Government investigation.</p> <p><sup>c</sup> As of July 1, 2014, due to the changes in the Streamlined Procedure, the reduced offshore penalty rate options for the 2012 OVDP are no longer available.</p> <p><sup>d</sup> A 40 percent accuracy-related penalty applies to underpayments that are determined to be a gross valuation of misstatements.</p>			

Source: *Frequency Asked Questions (FAQ)* published on [IRS.gov](http://IRS.gov).

To begin the offshore voluntary disclosure process, taxpayers or their representatives have the option to submit a preclearance request to the IRS's Criminal Investigation (CI) to determine if they are eligible for acceptance into the OVDP. This step is not required; however, if the taxpayer applies for preclearance, the request must include the taxpayer's name, date of birth, Taxpayer Identification Number (TIN), address, and telephone number. It must also include general information on the financial institutions and/or entities in which the undisclosed foreign financial assets are held.



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To apply to the OVDP, the taxpayer must send in a formal application to CI for determination of acceptance into the program.<sup>4</sup> CI is ultimately responsible for determining whether to accept or deny taxpayer applications into the OVDP.<sup>5</sup>

CI's general role for the OVDP is to research its information sources to evaluate whether there are any current investigations or other information (such as the unreported offshore funds are from an illegal source) that would affect whether the taxpayer should be accepted into the program. For example, CI may find there is an open criminal investigation by another Federal agency involving the taxpayer. These facts could affect whether the taxpayer would be considered eligible for the OVDP.<sup>6</sup>

If CI's research identifies information that would prohibit the taxpayer from entering the program, CI sends the taxpayer a denial letter explaining why he or she was denied acceptance into the OVDP. Taxpayers also have the option to withdraw their disclosure requests with CI, prior to acceptance into the OVDP.

If CI's research does not identify any information that would prevent the taxpayer's acceptance into the program, the taxpayer's application is referred to a supervisory investigative analyst recommending that the application be preliminarily accepted. If the supervisory investigative analyst agrees, a letter of preliminary acceptance is then sent to the taxpayer along with a list of additional documentation that the taxpayer must send to the Large Business and International (LB&I) Division's OVDP Unit.<sup>7</sup> At that time, CI scans the case files, including copies of all documents it received from the taxpayer, and loads the information onto a secure server. CI then notifies the OVDP Unit in Austin, Texas, that the taxpayer has been tentatively accepted into the program and that the CI case documentation is now available.

The OVDP Unit establishes case controls on the Audit Information Management System and the Examination Returns Control System for each tax module included in the taxpayer's offshore voluntary disclosure and builds the voluntary disclosure certification package for LB&I Division and Small Business/Self-Employed (SB/SE) Division revenue agents. The OVDP Unit does not have authority to accept or deny a taxpayer from the program or to make an assessment on a taxpayer's account. The OVDP Unit records the case in its case management database

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<sup>4</sup> Starting in July 2014, taxpayers file Form 14457, *Offshore Voluntary Disclosure Letter*, and Form 14454, *Attachment to Offshore Voluntary Disclosure Letter*, to request acceptance into the OVDP. Taxpayers can also skip the preclearance process and just submit Forms 14457/14454 directly to CI through the mail. The preclearance and application process is described in the OVDP FAQs.

<sup>5</sup> CI's International Lead Development Center in Philadelphia, Pennsylvania, controls and processes the initial offshore voluntary disclosure requests.

<sup>6</sup> Internal Revenue Manual 9.5.11.9 (Dec. 2, 2009).

<sup>7</sup> For all applicants, the required documentation that needs to be sent to the OVDP Unit for the tax years covered by the offshore voluntary disclosure are: copies of previously filed original Federal income tax returns; amended Federal income tax returns; a copy of the signed *Offshore Voluntary Disclosure Letter* submitted to CI; a foreign account or asset statement; a signed *Taxpayer Account Summary With Penalty Calculation*; signed agreements to extend the period of time to assess tax and FBAR penalties; the FBARs; and statements for all financial accounts.



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(E-TRAK), downloads the scanned files received from CI, handles receipt of the voluntary disclosure documentation from the taxpayer, and verifies whether all required information has been received. If information is missing or if the taxpayer has not responded to the tentative acceptance letter, the OVDP Unit would be responsible for following up with the taxpayer. When all required information is received from the taxpayer and the certification package is complete, the OVDP Unit holds the completed certification packages in batches and transfers the taxpayer cases to designated SB/SE Division Examination function groups on a monthly basis. If a taxpayer's case is scheduled to be worked by a LB&I Division revenue agent, the OVDP Unit ships the case when it is complete.<sup>8</sup>

Revenue agents in the LB&I and SB/SE Division Examination functions follow a checklist of tasks that need to be completed in order to determine whether a taxpayer's OVDP submission can be certified. The certification process significantly differs from an income tax audit.<sup>9</sup> A certification does not allow a taxpayer the same legal rights of an audit. For example, the taxpayer does not have the appeal rights inherent in the audit process. The revenue agent's role during a certification is to evaluate the accuracy and completeness of the voluntary disclosure by reviewing the documents submitted by the taxpayer and to obtain payment for all taxes, penalties, and interest that is determined to be due. When the verification is completed, the revenue agent will complete a Form 906, *Closing Agreement on Final Determination Covering Specific Matters*, to document the results of the certification and the taxpayer will sign the form signifying his or her agreement. Once the taxpayer's OVDP request is certified and the agreement is secured from the taxpayer, the OVDP case is then closed by recording the

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<sup>8</sup> The SB/SE Division Examination function works offshore voluntary disclosure requests in which the taxpayers reside in the United States, and the LB&I Division Examination function works offshore voluntary disclosure requests in which the taxpayers reside overseas.

<sup>9</sup> The IRS uses the FAQs (available at: <https://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers-2012-Revised>) to explain how the OVDP works. FAQ 27 in part addresses the differences between an examination and a certification.

**Question:** *Will my voluntary disclosure be subject to an examination?*

**Answer:** *Normally, no examination will be conducted with respect to an offshore voluntary disclosure made under this program, although the Service reserves the right to conduct an examination. The normal process is to assign the voluntary disclosure to an examiner to certify the accuracy and completeness of the voluntary disclosure. The certification process is less formal than an examination and does not carry with it all the rights and legal consequences of an examination. For example, the examiner will not send the usual taxpayer notices, the certification process will not constitute a "second examination" if one or more years in the voluntary disclosure has previously been examined, and the taxpayer will not have appeal rights with respect to the Service's determination. However, the examiner has the right to ask any relevant questions, request any relevant documents, and even make third-party contacts, if necessary, to certify the accuracy of the amended returns, without converting the certification to an examination.*



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assessment of all additional taxes, penalties, and interest required on the multiple tax modules involved.<sup>10</sup>

Because the OVDP is voluntary, taxpayers have the option to request to be removed, *i.e.*, opt out, from the program before the closing agreement is signed. However, once a taxpayer opts out after being accepted into the program, they are then subject to a full examination, including an evaluation of potential FBAR penalties to be applied on the now disclosed foreign financial assets.

In September 2012, the IRS initiated a Streamlined Procedure that enabled noncompliant U.S. taxpayers residing abroad, owing little or no delinquent taxes, the opportunity to voluntarily resolve their offshore account filing requirements while avoiding any OVDP penalties.<sup>11</sup> While the Streamlined Procedure had no disclosure penalty, taxpayers have to fill out a risk questionnaire and sign an agreement acknowledging that their tax returns remain subject to IRS examination, additional civil penalties, and even criminal liability if the IRS identifies in the future that the taxpayers had willfully hidden their offshore accounts.

In July 2014, the IRS made changes to the Streamlined Procedure allowing U.S. citizens or resident aliens living in the United States the opportunity to disclose their offshore accounts through the streamlined process.<sup>12</sup> These taxpayers will be subject to a 5 percent OVDP penalty and still may be subjected to harsher penalties if it is determined they willfully hid their offshore accounts. In lieu of the risk questionnaire, these taxpayers have to certify that their previous failure to disclose offshore accounts was due to nonwillful conduct. The updated Streamlined Procedure also removed limitations on the amount of delinquent taxes owed for the taxpayer to qualify. The IRS anticipates that these changes will provide taxpayers who are still delinquent with unreported offshore accounts a new incentive to come back into compliance with their tax obligations.

In addition, the IRS is in the process of implementing the FATCA, which will allow it to identify more noncompliant taxpayers with unreported offshore accounts through the mandatory third-party reporting required of foreign financial institutions. However, the OVDP currently has no end date and could continue in the foreseeable future to address offshore noncompliance or schemes not associated with certain foreign financial institutions.

This review was performed at the LB&I Division's International Individual Compliance OVDP Unit in Austin, Texas, and CI's International Lead Development Center in Philadelphia, Pennsylvania, during the period August 2014 through October 2015. 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,

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<sup>10</sup> While the offshore voluntary disclosure certification process with the assessment of taxes, penalties, and interest is similar to the IRS's traditional audit process, it is not considered an audit.

<sup>11</sup> IR-2012-65 (June 26, 2012).

<sup>12</sup> IR-2014-73 (June 18, 2014).



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appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.



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*Results of Review*

The IRS needs to improve its efforts to address the noncompliance of taxpayers who are denied access to or withdraw from the OVDP and improve control of the cases as they move through the certification process. While giving noncompliant taxpayers the opportunity to resolve their potential tax delinquencies through the OVDP, it is important for the IRS to ensure that these taxpayers actually become compliant with their tax obligations. In addition, the IRS could reduce the cost of working offshore voluntary disclosures by determining the appropriate grade level of examiners assigned to work the certifications.

***Compliance Actions Are Needed for Taxpayers With Denied or  
Withdrawn Offshore Voluntary Disclosures***

While we found that accepted offshore voluntary disclosure penalties were generally worked appropriately by revenue agents, the IRS has not adequately addressed the tax noncompliance of some taxpayers who were denied entry to or withdrew from the OVDP. Based on the results of a stratified random sample of 100 taxpayers from 3,182 who either were denied entry to or withdrew from the OVDP during CI's acceptance process, we estimate that approximately \$21.6 million in delinquent FBAR penalties should be potentially assessed against this population of taxpayers.<sup>13</sup>

***Withdrawn OVDP requests***

As part of the stratified random sample, we selected 50 taxpayers who withdrew their disclosure requests from a total population of 781 withdrawn OVDP requests.<sup>14</sup> Based on our sample, we found that 20 (40 percent) of the 50 taxpayers who withdrew their requests had either some form of compliance action taken against them (like an examination) or were accepted into the Streamlined Procedure.<sup>15</sup> Of the Streamlined Procedure cases that have closed, 10 taxpayers were assessed \$142,711 in penalties.

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<sup>13</sup> The population of 3,182 taxpayers included 781 taxpayers who withdrew from the OVDP and 2,401 who were denied access to the OVDP by CI. We selected 50 taxpayers from each stratum. The point estimate projections are based on a two-sided 95 percent confidence interval. We are 95 percent confident that the point estimate for the number of taxpayers is between 492 and 1,062 and the point estimate for the potential total FBAR penalty assessments is between \$13,672,734 and \$29,533,006.

<sup>14</sup> The taxpayers withdrew their offshore voluntary disclosure requests prior to CI determining their eligibility for participation in the OVDP. The sampling of withdrawn requests came from the 2009, 2011, and 2012 OVDPs.

<sup>15</sup> Two (4 percent) out of the 50 taxpayer cases could not be reviewed because the TIN was incorrect and their accounts could not be identified on the Master File.



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For the remaining 28 (56 percent) taxpayers who withdrew from the OVDP, we found no evidence that the IRS attempted to address their potential tax noncompliance. In addition, 19 of these taxpayers subsequently filed delinquent FBARs. While some filed amended tax returns claiming their foreign accounts after withdrawing from the OVDP, others did not claim their foreign accounts on their subsequently filed tax returns or have not filed one or more delinquent tax returns.<sup>16</sup> While the intent is unknown, these efforts may have been to purposely avoid the OVDP penalty and give the false impression of trying to become compliant in an attempt to avoid significant tax liabilities.

We estimate that, based on the available FBAR information, these 19 taxpayers may have been subject to approximately \$985,235 in OVDP penalties had they remained in the program. However, because these taxpayers withdrew from the OVDP, they may instead be liable for FBAR penalties totaling \$520,998, if the IRS calculated all the penalties based on nonwillful guidelines, or up to \$2,288,688, if the IRS determined that the nonreporting of the foreign assets was willful. In addition, these taxpayers may potentially be subject to criminal prosecution for not disclosing their foreign bank accounts and tax evasion.<sup>17</sup> Projecting our sample results to the total population of withdrawn offshore voluntary disclosure requests and assuming that the taxpayer noncompliance was not willful, we estimate that taxpayers who withdraw from the OVDP and have subsequently filed their FBARs should be assessed approximately \$8.1 million in FBAR penalties for their prior delinquencies.<sup>18</sup>

For the remaining nine taxpayers, we were unable to calculate any FBAR penalties due to the lack of available information on their foreign bank accounts because they still have not filed their delinquent FBARs. However, based on their history of noncompliance, the potential that these taxpayers are still noncompliant is high.

### **Denied OVDP requests**

As part of the stratified random sample, we reviewed 50 of the 2,401 taxpayers who had their OVDP requests denied by CI.<sup>19</sup> Based on our sample, we found that 12 (24 percent) of the

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<sup>16</sup> Taxpayers that filed amended tax returns claiming their foreign accounts after withdrawing from the OVDP would still be subject to FBAR and tax penalties because they did not initially report the foreign account information when the tax returns and FBARs were originally due.

<sup>17</sup> The FBAR penalty amount calculations were based on the IRS's mitigation guidelines for Tax Years 2009 through 2013. Internal Revenue Manual 4.26.16.4.6.2 – *Mitigation of the Non-willful FBAR Penalty* (July 1, 2008) and Internal Revenue Manual 4.26.16.4.6.3 – *Mitigation of the Willful FBAR Penalty* (July 1, 2008).

<sup>18</sup> The point estimate projection of \$8,138,004 is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the point estimate for the potential total FBAR penalty assessments is between \$5,322,182 and \$10,953,182.

<sup>19</sup> The taxpayers' offshore voluntary disclosure requests were denied by CI for various reasons, thereby prohibiting the taxpayer from participating in the OVDP. These included: no response from the taxpayer after initial contact, taxpayer currently under criminal investigation/examination, the IRS already aware of the taxpayer's unreported foreign account, program does not apply (account less than \$10,000), *etc.* The sampling of denied requests came from the 2009, 2011, and 2012 OVDPs.



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50 taxpayers who were denied participation in the OVDP were either subjected to further criminal investigation or examination efforts, or were deceased.<sup>20</sup> Although some of these cases still have open criminal investigations or examinations, of the cases that have been closed, these taxpayers so far have been assessed \$5,379,620 in penalties.

For the remaining 34 (68 percent) taxpayers who were denied participation in the OVDP, we found no evidence that the IRS attempted to address their potential tax noncompliance. In addition, 10 of these taxpayers subsequently filed delinquent FBARs. While some filed amended tax returns claiming their foreign accounts after being denied access to the OVDP, others did not claim their foreign accounts on their subsequently filed tax returns or have not filed one or more delinquent tax returns.<sup>21</sup>

We estimate that, based on the available FBAR information, these 10 taxpayers may have been subject to approximately \$1,690,433 in OVDP penalties if they had remained in the program. However, because these taxpayers were denied access to the OVDP, they may instead be liable for FBAR penalties totaling \$280,401, if the IRS calculated all the penalties based on nonwillful guidelines, or up to \$10,441,425, if the IRS determined that the nonreporting of the foreign assets was willful. In addition, these taxpayers may potentially be subject to criminal prosecution for not disclosing their foreign bank accounts and tax evasion. Projecting our sample results to the total population of denied offshore voluntary disclosure requests and assuming that the taxpayer noncompliance was not willful, we estimate that taxpayers who are denied access to the OVDP and have subsequently filed their FBARs should be assessed approximately \$13.5 million in FBAR penalties for their prior delinquencies.<sup>22</sup>

For the remaining 24 taxpayers, we were unable to calculate any FBAR penalties due to the lack of available information on their foreign bank accounts because they still have not filed their delinquent FBARs. Based on their history of noncompliance, the potential that these taxpayers are still noncompliant is high.

The IRS has not developed specific guidelines or procedures to determine whether compliance actions should be taken on taxpayers who either were denied access to or withdrew from the OVDP. The focus of the OVDP is to help bring noncompliant taxpayers with undisclosed foreign bank accounts back into compliance with U.S. tax laws. Therefore, it is critical that the IRS establish procedures for addressing potential noncompliance of these taxpayers who have been denied or withdrew from the OVDP process. By not acting on these cases, the IRS may

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<sup>20</sup> Four (8 percent) of the 50 taxpayer cases could not be reviewed because the TIN was incorrect and their accounts could not be identified on the Master File.

<sup>21</sup> Taxpayers that filed amended tax returns claiming their foreign accounts after being denied access to the OVDP would still be subject to FBAR and tax penalties because they did not initially report the foreign account information when the tax returns and FBARs were originally due.

<sup>22</sup> The point estimate projection of \$13,464,866 is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the point estimate for the potential total FBAR penalty assessments is between \$6,003,603 and \$20,926,128.



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have allowed some of the most noncompliant taxpayers to avoid significant civil and criminal penalties. If the noncompliance of taxpayers who are denied access to or withdraw from the OVDPs is not addressed, the important rationale for the program may be undermined.

### **Recommendations**

**Recommendation 1:** The Commissioner, LB&I Division, should have all denied or withdrawn offshore voluntary disclosure requests identified in this report reviewed for FBAR penalty assessments and possible referral to CI.

**Management's Response:** The IRS agreed with this recommendation. In November 2015, OVDP technical specialists reviewed all withdrawn or denied offshore voluntary disclosures identified in this report. Additional follow-up is being made on 17 withdrawn or denied cases.

However, the IRS disagreed with our potential outcome measure related to this recommendation that \$21.6 million in FBAR penalties were not assessed against taxpayers who withdrew from or were denied access to the OVDP. The IRS stated that FBAR penalty determinations are factual in nature and there was no consideration of the criteria outlined in the OVDP FAQ 17, which states that some late-filed FBARs may result in no penalties being assessed if the taxpayer resides outside the United States. Additionally, according to the IRS, taxpayers sometimes entered into the OVDP due to a lack of adequate counsel and misunderstanding of their tax situation, causing them to later realize it was in their best interest to withdraw from the program.

In addition, the IRS refers to the National Taxpayer Advocate's *2013 Annual Report to Congress*, which discusses a review done of 2,828 tax returns that were examined as a result of a withdrawal from or a denial of access to the OVDP. The FBAR penalty amount for these returns was \$4,069,795, resulting in approximately \$1,500 per return. As a result, the IRS believes a more accurate FBAR penalty estimate is \$1,165,500 (777 x \$1,500). The IRS also disagreed with 12 of the 29 exception cases in which the taxpayer withdrew from or was denied access to the OVDP. According to the IRS, these 12 cases were determined to be compliant in their filing requirements and/or did not warrant additional follow-up due to being low risk.

**Office of Audit Comment:** The OVDP enables taxpayers who are noncompliant with disclosing their foreign bank/financial accounts to correct prior omissions and meet their Federal tax obligations while mitigating potential penalties. The OVDP penalty is used in lieu of the higher rate of the FBAR penalty, thereby decreasing the potential penalties owed by the taxpayers. FAQ 17 states that nonresident taxpayers should review the *Filing Compliance Procedures for Nonresident U.S. Taxpayers*, which guides the taxpayer to the Streamlined Procedures. If eligible, the Streamlined Procedures waive all penalties, including the FBAR penalty. However, the 29 taxpayers in the exception cases



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either withdrew from or were denied access to the OVDP and were not part of the Streamlined Procedures; therefore, FAQ 17 would not apply.

In addition, FAQ 17 only applies to taxpayers that properly reported and paid tax on all taxable income whose only omission was not filing their FBARs when they were initially due. The 29 exception cases identified involve taxpayers who either amended their originally filed tax returns to claim their foreign accounts after withdrawing from or being denied access to the OVDP, did not claim their foreign accounts on their subsequently filed tax returns, or have not filed one or more delinquent tax returns. Thus, it appears clear that these taxpayers did not withdraw from the OVDP due to a misunderstanding of their tax situation. The IRS's determination of these cases as low risk is speculative, and due to the noncompliant nature of these taxpayers, a true determination of the risk could not be known until a full examination is conducted.

In addition, the numbers cited by the IRS from the National Taxpayer Advocate's *2013 Annual Report to Congress* were based on the number of tax returns, not the number of cases. An OVDP case could potentially have up to eight tax returns; therefore, the breakdown per case of \$1,500 would be an inaccurate value to use.

**Recommendation 2:** The Commissioner, LB&I Division, and the Chief, CI, should develop procedures to require the immediate review of any future denied or withdrawn offshore voluntary disclosure requests for further compliance actions.

**Management's Response:** The IRS agreed with this recommendation and will explore opportunities to review future denied or withdrawn offshore voluntary disclosure requests for compliance actions.

### **Benefits Would Be Realized From Centralizing Inventory Controls for the Offshore Voluntary Disclosure Process**

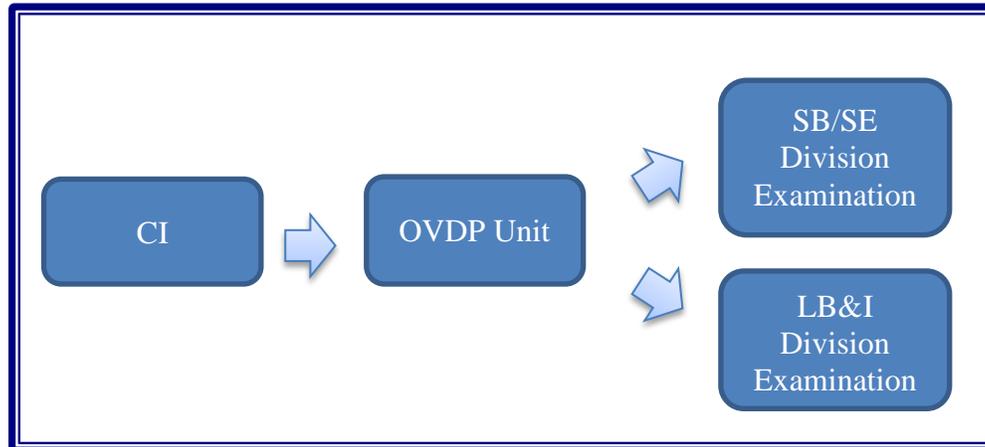
OVDP requests are individually controlled by CI, the OVDP Unit, and the various examination functions while each performs its own separate and necessary tasks. This complex process has led to information not being adequately shared between functions and delays in completing the certification process.

The OVDP process starts with taxpayers contacting CI requesting their inclusion into the program. Then, as Figure 2 shows, the cases will move through the OVDP Unit and on to either the LB&I Division or SB/SE Division Examination function to complete the voluntary disclosure certification process.



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**Figure 2: Offshore Voluntary Disclosure Case Movement**



Source: Treasury Inspector General for Tax Administration analysis of the IRS's OVDP process.

Under the current process, the IRS has taken nearly two years to complete 20,587 case certifications, with 241 cases taking at least four years to complete. While it is currently necessary for each separate function to control these cases, the overall time to complete the certifications could be reduced if a centralized point of control and additional procedures were implemented to control the necessary tasks and movement of the cases through all steps in the process.

### **Internal control weaknesses have led to poor communication between functions and long processing times**

While each function uses inventory controls while the case is in its possession, we identified that ineffective and/or the lack of controls in CI and the OVDP Unit hindered their ability to ensure that case information is processed and shared effectively. For example, CI has denied taxpayer disclosure requests for not providing documentation when that documentation had already been received by the OVDP Unit. Subsequent to this, CI stated that it received 17 taxpayer requests from the OVDP Unit over 11 months after the taxpayer sent in the documentation. CI stated that the taxpayers had sent the requests to the OVDP Unit in error. Having more than one address for submission of voluntary disclosure request documentation and separate controls of taxpayer correspondence appear to have contributed to confusion and incorrect processing of some taxpayer disclosure requests.<sup>23</sup>

CI allows a taxpayer 45 calendar days to mail the formal OVDP letter. CI guidelines state that, if it has not received the necessary documentation from the taxpayer within the 45 calendar days, the investigative analyst is required to send a follow-up letter allowing the taxpayer an additional

<sup>23</sup> The International Lead Development Center's address is in Philadelphia, Pennsylvania, and the OVDP Unit's address is in Austin, Texas.

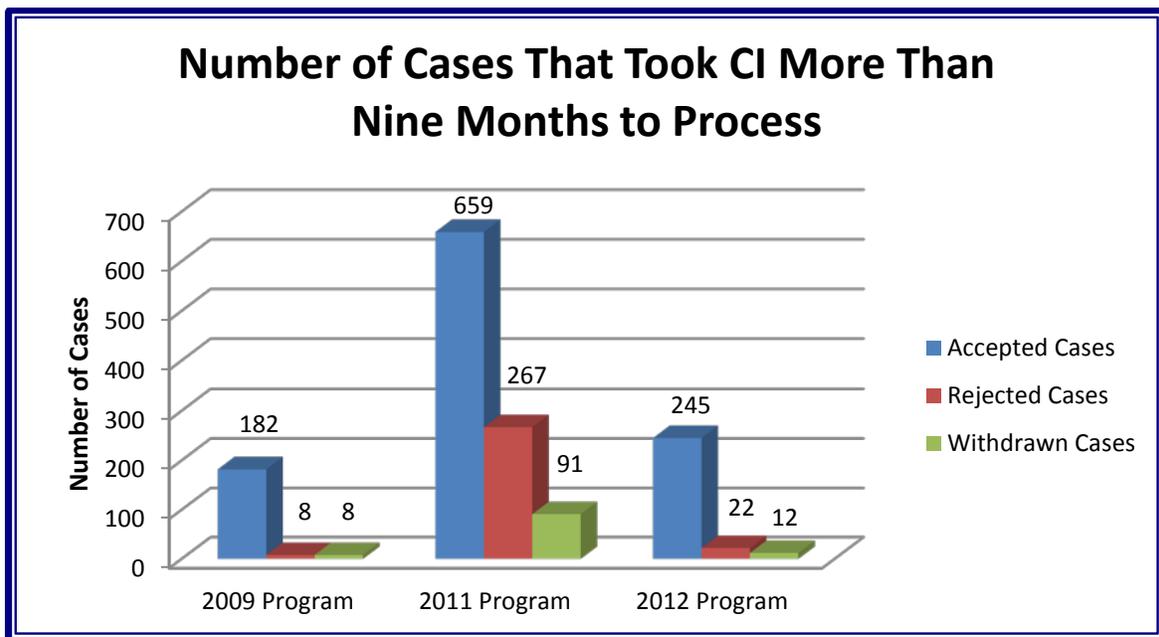


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30 calendar days.<sup>24</sup> CI procedures state that the analyst should deny the taxpayer's request for acceptance into the OVDP if the taxpayer does not respond within 45 calendar days of the follow-up letter.

As of October 2014, CI had processed more than 50,000 taxpayer OVDP requests, and its average overall processing time for the requests was 89 calendar days.<sup>25</sup> However, CI took more than nine months to conduct its research on 1,494 requests before deciding whether the taxpayer should be allowed to enter the program.<sup>26</sup> Figure 3 illustrates the volumes of cases for which CI processing took longer than nine months.

**Figure 3: Number of Cases That Took CI More Than Nine Months to Process**



Source: Treasury Inspector General for Tax Administration analysis of CI's processing time of cases that took more than nine months to process.

CI management stated that on many cases, if taxpayers requested it, they allowed taxpayers additional time to provide the required documentation for their requests because the IRS's main goal is to bring taxpayers into compliance. Given that CI's primary responsibility in the OVDP is to identify and determine whether there are reasons why a particular taxpayer should not be allowed into the program, CI does not need to be responsible for controlling OVDP inventory.

<sup>24</sup> CI's Desk Procedures for the Voluntary Disclosure Program (Oct. 7, 2014).

<sup>25</sup> The average time does not include the 3,839 pending cases.

<sup>26</sup> The population for each category of cases was 43,257 accepted cases, 2,401 denied cases, and 781 withdrawn cases, totaling 46,439 cases. In addition, there was a population of 3,839 pending cases that we did not include in the analysis.



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## *Improvements Are Needed in Offshore Voluntary Disclosure Compliance and Processing Efforts*

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CI has investigative research responsibilities in other IRS programs, such as the Return Preparer Program in which the IRS Examination function controls the return preparer case from the beginning through completion while involving CI to complete the investigative research needed to determine if there are conditions or activities that may conflict with starting an examination of the return preparer.

While CI has traditionally been responsible for initiating OVDP cases, the IRS could benefit from a centralized inventory control point for the entire process, from recording a taxpayer's request to be included in the OVDP through the certification and penalty assessment phases. The LB&I Division already uses E-Trak to record OVDP information after CI completes its preclearance approval process. In addition, the IRS uses E-Trak to track many types of activities across functional boundaries. If the IRS enhanced E-Trak and put the case and correspondence control in the OVDP Unit, it could reduce the risk of taxpayer documentation being lost between the two functions. The OVDP Unit would be responsible for coordinating with CI (similar to the coordination process used in the Return Preparer Program) to ensure that CI completes the preclearance investigative research required to determine the taxpayer's tentative acceptance into the program. If for some reason E-Trak cannot be modified to monitor the entire OVDP process, then the OVDP Unit could use other options to track the OVDP applications while CI conducts its preclearance investigative research.

An improved, centralized case control for OVDP requests would also help the OVDP Unit deliver the certification packages to the Examination functions more quickly. After CI has tentatively accepted the taxpayers into the program, the OVDP Unit begins to build the certification cases, which generally takes much more time to complete than the initial CI acceptance process. For 20,587 taxpayer offshore voluntary disclosure requests closed by the IRS between October 1, 2009, and September 30, 2014, we estimate that on average it took the OVDP Unit approximately 10 months to build each certification case. In addition, we found that for approximately 1,000 of these taxpayers, it took more than two years for the OVDP Unit to build its cases.

OVDP Unit guidelines state that a taxpayer has 90 calendar days from the date of the CI acceptance letter to submit his or her documents. However, an additional 90 calendar days are given automatically on the taxpayer's request. The OVDP Unit does not remind taxpayers that they need to respond (via a 30-calendar-day reminder letter) until the 180 calendar days is almost over. OVDP Unit management emphasized two reasons for the extended processing time. First, they want to allow taxpayers every opportunity to become compliant by providing the required documentation (delinquent tax returns, amended tax returns, FBARs, *etc.*) and, second, they are reliant on the Examination functions having the capacity to accept new cases.

While the actual certification time for LB&I Division and SB/SE Division revenue agents on each of the 20,587 offshore voluntary disclosure requests averaged 11 months, we did not find any significant control issues at that stage. The examination time can become lengthy because revenue agents must review many delinquent tax returns or amended returns with supporting



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documentation in order to identify any inaccuracies, correspond with the taxpayer when additional clarification is needed, and verify the accuracy of the OVDP penalty calculations.

In part due to the lengthy processes in CI and the OVDP Unit, the time to complete the entire OVDP process for the 20,587 voluntary disclosures averaged nearly two years. The long processing time of the OVDP cases may cause unnecessary burden on those taxpayers who are attempting to become compliant. In addition, taxpayers may have to potentially pay additional fees to their representatives due to delays in processing their offshore voluntary disclosure requests. The Taxpayer Advocate Service's *2013 Annual Report to Congress* reported that it assisted many taxpayers who have waited for extended periods of time to find out if they were accepted into the OVDP.

An effective centralized control of case activity from the initial receipt of the taxpayer's request through its certification would help ensure that documentation is better tracked and allow the status of each case to be monitored from one source. Specifically, a centralized database of the offshore voluntary disclosures with appropriate monitoring at each stage in the certification process would provide assurance that case documentation and case activities are adequately controlled. Better case controls, including centralizing the tracking of offshore voluntary disclosure requests and reasonable correspondence timeliness expectations will help decrease the extended taxpayer wait times for completion of their cases.

### ***Recommendations***

The Commissioner, LB&I Division, and the Chief, CI, should:

**Recommendation 3:** Centrally track and control taxpayer offshore voluntary disclosure requests in the OVDP Unit starting with the initial taxpayer request (preclearance) to join the program.

**Management's Response:** The IRS agreed with this recommendation. To improve the tracking and control of the OVDP requests, the IRS stated that CI will begin providing bi-weekly reports of case receipts to the LB&I Division for its use in tracking cases from the date of receipt by CI and to ensure that any taxpayer information that is erroneously received by either business unit is immediately routed to the appropriate unit.

**Recommendation 4:** Establish one mailing address for taxpayers to use for submitting their offshore voluntary disclosure requests and related documentation.

**Management's Response:** The IRS agreed with this recommendation, but is putting the recommendation on hold until a decision is made about the future status of the OVDP. While the IRS agreed with the potential value in this recommendation, at this time and in light of the nonpermanent status of the OVDP, it cannot commit the resources needed for making this change. However, the IRS stated that the procedure it plans to put



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in place in response to Recommendation 3 will lead to improved coordination in the routing of taxpayer documentation related to the OVDP across the IRS.

**Recommendation 5:** Ensure that employees adhere to established timeliness guidelines for taxpayers to respond to offshore voluntary disclosure-related correspondence and follow those guidelines during the initial eligibility determination, case building, and certification processes.

**Management's Response:** The IRS agreed with and has already implemented this recommendation. The IRS stated that its goal was to allow as many people as possible into the OVDP. The IRS allowed taxpayers additional time when requested, taking into account longer mailing time that occurs with international correspondence and other taxpayer needs on a case-by-case basis. Going forward, the IRS will monitor more closely the adherence to established guidelines.

### **Employee Skill Levels Should Be Correlated to the Complexity of the Offshore Voluntary Disclosure Certifications**

The IRS does not have a process to determine the appropriate skill level needed for revenue agents to work OVDP cases. For the majority of OVDP cases, the certification process involves the revenue agent simply working through a checklist to determine if all information is available to support the taxpayer's voluntary disclosure and to ensure that the taxpayer's calculations on the tax returns and the OVDP penalty are correct. Training materials for SB/SE Division revenue agents working taxpayer OVDP requests state that their role is to evaluate the accuracy and completeness of the taxpayer's disclosure, as well as obtain payment for all amounts due. The training guidance continues on to say that revenue agents "will not be expected to make any but the most minimal computations to test accuracy." While procedural guidance requires the revenue agent to have the necessary skills to adequately determine whether certain tax return items were correctly computed, many OVDP requests do not need the same level of expertise that would be needed if the IRS actually audited those tax returns.

In the population of the 20,587 OVDP taxpayers who completed the certification process during Fiscal Years 2010 through 2014, approximately 58 percent were worked by grade 13 or higher revenue agents. We reviewed a judgmental sample of 20 cases that were worked by grade 13 revenue agents and found that generally these cases could have been worked by lower-graded employees because there was limited revenue agent analysis beyond just the verification of the accuracy of the taxpayer's tax return and the OVDP penalty computations.<sup>27</sup> While some OVDP requests may include complex foreign investments that may warrant grade 13 revenue agent or higher involvement, our review indicated that most would not.

While many OVDP cases may have attributes which warrant the involvement of grade 13 revenue agents, the IRS should consider a classification process to determine the appropriate

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<sup>27</sup> A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.



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grade level needed to work each OVDP certification. The IRS already has a classification process for determining the appropriate level of expertise needed to audit specific tax returns. This analysis considers the complexity and compliance risks of the tax returns when making those decisions and includes determining a proper employee grade level for the case. Incorporating a similar methodology for the OVDP certification process could help increase efficiency and effectiveness by ensuring that higher-skilled employees are working the appropriate level cases requiring their expertise and ultimately addressing the tax returns with the higher compliance risk.

### ***Recommendation***

**Recommendation 6:** The Commissioner, LB&I Division, should coordinate with the Commissioner, SB/SE Division, to classify offshore voluntary disclosure requests so that some OVDP certifications can be worked by lower-graded revenue agents.

**Management's Response:** The IRS agreed with this recommendation. The IRS stated that the LB&I Division will continue to partner with the SB/SE Division to ensure that cases are assigned at the appropriate grade level and to examiners possessing the requisite skill set to work these issues.



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## **Appendix I**

### *Detailed Objective, Scope, and Methodology*

The overall objective was to assess how well the IRS is managing the OVDP and its efforts to improve taxpayer compliance and hold taxpayers who fail to report their offshore financial activities on their tax returns and FBARs accountable. To accomplish our objective, we:

- I. Determined the metrics the IRS uses to measure the OVDP and verify its accomplishments.
  - A. Interviewed IRS management in CI, and the LB&I and SB/SE Divisions to identify the metrics the IRS uses to measure the OVDP's accomplishments.
  - B. Obtained IRS reports and other documentation describing the metrics used to measure the OVDP.
- II. Evaluated the overall statistical data for working offshore voluntary disclosures to identify any trends that may indicate a need for program improvement.
  - A. Interviewed IRS officials in CI, and the LB&I and SB/SE Divisions and identified the applicable policies and procedures that apply to the 2009, 2011, and 2012 OVDPs.
  - B. Obtained and reviewed the policies and procedures for processing offshore voluntary disclosures for the International Lead Development Center and the OVDP Unit.
  - C. Obtained a download from the Criminal Investigation Management Information System (CIMIS) of offshore voluntary disclosures starting with the 2009 OVDP to October 2, 2014 (March 23, 2009, through October 2, 2014).<sup>1</sup> In addition, we obtained a download from CI's OVDI database of offshore voluntary disclosures from February 9, 2011, to October 29, 2014.
  - D. Using the data obtained in Step II.C., determined that 43,257 disclosure requests were accepted by CI, 781 requests were withdrawn (opted out) by the taxpayer, and 2,401 requests were denied from the OVDP by CI.
  - E. Assessed the validity of the CIMIS and OVDI data received following instructions in the Data Reliability Assessment template. We queried IRS computer files using the Integrated Data Retrieval System to ensure that the accepted cases have an OVDP project code and the denied/withdrawn cases do not. We completed the Data Reliability Assessment and documented the methodology for the data analysis completed.

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<sup>1</sup> See Appendix V for a glossary of terms.



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- III. Determined whether the IRS properly processed disclosures for taxpayers who successfully participated in the OVDP but did not receive an OVDP penalty.
- A. Using the CIMIS data obtained in Step II.C., identified the total population of taxpayers who were accepted (43,257 disclosures) into the OVDP.
  - B. Identified the unique TINs of the 38,419 taxpayers whose requests were accepted into the OVDP between March 23, 2009, and December 31, 2013.
  - C. Using a 95 percent confidence level, 5 percent error rate, and  $\pm 5$  percent precision, we computed an overall sample size of 73. However, in order to get a full representation of the three different programs, we expanded our sample size to 150, taking 50 from each program. The statistically valid random sample consisted of a total of 150 TINs from the total population of taxpayers identified in Step III.B.
  - D. Reviewed each sampled case using CIMIS data, OVDI data, Integrated Data Retrieval System queries, Correspondence Examination Automation Support data, and source documents to address the following steps:
    - 1. Determined if revenue agents were assessing the appropriate OVDP penalty amount, and any penalties and/or interest were fully paid.
    - 2. Determined if the taxpayer received a penalty in lieu of the OVDP penalty or if no penalty was assessed, and if the revenue agents appropriately processed the case.
- IV. Determined whether the IRS appropriately considered compliance actions for taxpayers who were denied or withdrew from the OVDP.
- A. Using the CIMIS data obtained in Step II.C., identified the total population of taxpayers who were denied (2,401 disclosures) and withdrew (opted out) (781 disclosures) from the OVDP.
  - B. Obtained a download of all FBAR data for Tax Years 2009 through 2013 from the FinCEN.
  - C. Using a 95 percent confidence level, 5 percent error rate, and  $\pm 5$  percent precision, computed an overall sample size of 72. However, in order to get a full representation of the two strata, we took 50 cases from each stratum of denied and withdrawn cases giving us a total of 100 cases in the sample. The stratified random sample consisted of 50 TINs from 2,401 taxpayers who were denied access to the ODVP and 50 TINs from the 781 taxpayers who withdrew (opted out) from the OVDP from March 23, 2009, through October 2, 2014, and identified disparities in taxpayer treatment.
    - 1. Reviewed each sampled case using CIMIS data, OVDI data, Integrated Data Retrieval System queries, FinCEN data, and source documents to address the following issues:



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- a. Determined the reason for being denied or withdrawing from the OVDP.
  - b. Determined if the taxpayer's disclosure information was investigated or examined. We documented the audit activity and results for any audit/investigation that has been started and/or closed on the taxpayer.
  - c. Reviewed all tax payments made by the taxpayer as part of the disclosure request to determine if the payments were posted to the taxpayer's account or to the excess collection account.
  - d. Analyzed the disposition of the taxpayer's payments to determine if they were applied to appropriate accounts or if the funds were refunded to the taxpayer.
  - e. Researched the taxpayer's tax accounts (for the tax periods covered in the OVDP and subsequent periods) to identify any change in tax filing behavior and to determine if conditions warrant compliance action. For example, has the taxpayer filed returns in a way to avoid paying the penalties prescribed by the OVDP?
  - f. Calculated a potential OVDP and FBAR penalty using the FBAR data provided by the FinCEN.
2. Discussed our observations with the Treasury Inspector General for Tax Administration's statistician for assistance in projecting our sample results.
  3. Discussed our observations on the actions taken on denied or withdrawn taxpayers and on the processing of taxpayers' payments with the IRS.
- V. Determined if the IRS is timely processing voluntary disclosure requests.
- A. Using the CIMIS data obtained in Step II.C., identified the total population of taxpayer voluntary disclosure requests received from March 23, 2009, through October 2, 2014. We identified how each case is classified by CI, *e.g.*, pending, accepted, denied, or withdrawn.
  - B. Evaluated the timeliness statistics for each category including the average number of days taken on the cases and the volume of cases taking an excessive amount of time to process. We determined that an excessive amount of time is anything over two years for time taken on each case.
    1. Evaluated the length of time to process the cases for the entire population, using the three strata: 1) withdrawn cases, 2) denied cases, and 3) accepted cases. We reviewed the amount of time captured on the CIMIS for the withdrawn and denied cases, and reviewed the CIMIS and the Data Center Warehouse Audit Information Management System files for the accepted cases to determine the length of time between the taxpayer and IRS communications to identify unnecessarily excessive delays by the IRS.



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2. For accepted cases, conducted an additional analysis of the length of time that cases were in the different stages of OVDP processing. To identify this population, we matched the accepted OVDP case population to the Audit Information Management System and identified 20,587 cases closed in Fiscal Years 2010 through 2014 that had OVDP project codes.
  3. Computed the time the case was in CI's control, the time between when CI closed its control and the Examination function opened the certification case, and the time to complete the certification process.
- VI. Determined whether the IRS has an effective process to ensure that OVDP certifications are worked by revenue agents with the appropriate skills by determining the number of cases worked by different grade-level revenue agents and reviewing a judgmental sample of OVDP certifications worked by grade 13 revenue agents to determine if the cases could be worked by lower-graded revenue agents.<sup>2</sup> Using the sample of accepted taxpayers identified in Step III.C., we reviewed a judgmental sample of 20 cases that were worked by grade 13 revenue agents.

### **Data validation methodology**

We were unable to independently validate the accuracy and reliability of CIMIS data. However, we validated data pertaining to the offshore voluntary disclosures in the CIMIS through the specific tests related to the case reviews included in this audit. In addition, due to the limited amount of information the IRS obtains related to FBAR data, we could not independently validate the account data provided by the FinCEN.

### **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 that the following internal controls were relevant to our audit objective: the IRS's policies, procedures, and practices relating to the processing of offshore voluntary disclosures. We evaluated these controls by interviewing IRS personnel; reviewing IRS policies, procedures, and guidelines; analyzing data; and selecting and reviewing samples of the offshore voluntary disclosure requests.

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<sup>2</sup> A judgmental sample is a nonprobability sample, the results of which cannot be used to project to the population.



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**Appendix II**

*Major Contributors to This Report*

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**Appendix III**

*Report Distribution List*

Commissioner  
Office of the Commissioner – Attn: Chief of Staff  
Deputy Commissioner for Services and Enforcement  
Commissioner, Small Business/Self-Employed Division  
Deputy Chief, Criminal Investigation  
Deputy Commissioner, Large Business and International Division  
Deputy Commissioner, Small Business/Self-Employed Division  
Director, Office of Audit Coordination



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## **Appendix IV**

### *Outcome Measure*

This appendix presents detailed information on the measurable impact that our recommended corrective action will have on tax administration. This benefit will be incorporated into our Semiannual Report to Congress.

#### **Type and Value of Outcome Measure:**

- Increased Revenue – Potential; 777 taxpayers and \$21.6 million in FBAR penalties not assessed against taxpayers who withdrew from or were denied access to the OVDP (see page 7).

#### **Methodology Used to Measure the Reported Benefit:**

In 29 of 100 requests in which the taxpayers either withdrew from or were denied access to the OVDP, the taxpayers filed delinquent FBARs for offshore accounts they had not disclosed previously. The IRS did not take any compliance actions on these taxpayers who are likely still liable for FBAR penalties.

As shown in Figure 1, we estimate that potentially 777 taxpayers (3,182 x 24.42 percent estimated population exception rate) may be liable for an FBAR penalty. Further, we estimate that \$21,603,708 in FBAR penalties (777 taxpayers x \$27,804 average estimated FBAR penalty) may have been missed by not taking compliance actions on the taxpayers who withdrew from or were denied access to the OVDP.<sup>1</sup>

Figure 1 provides the information on the taxpayers in each stratum used to compute the outcomes. We chose a conservative approach by applying the mitigating guidelines for nonwillful, nonreporting of offshore holdings to calculate the FBAR penalties.

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<sup>1</sup> The point estimate projections are based on a two-sided 95 percent confidence interval. We are 95 percent confident that the point estimate for the number of taxpayers is between 492 and 1,062 and the point estimate for the potential total FBAR penalty assessments is between \$13,672,734 and \$29,533,006.



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**Figure 1: Sample Parameters and Population Projections**

Sampling Element	Stratum 1	Stratum 2	Total
Type of Case	Withdrew	Denied	--
Stratum Population	781	2,401	3,182
Population Percent to Total	24.54%	75.46%	100%
Cases Reviewed	50	50	100
Number of Exceptions	19	10	29
Error Rate	38.00%	20.00%	--
Estimated Population Exception Rate	9.33%	15.09%	24.42%
Estimated Number of Exceptions in Population	296.8	480.2	777
Average Estimated FBAR Penalty Dollars Per Exception	\$27,421	\$28,040	\$27,804

Source: Treasury Inspector General for Tax Administration analysis of 100 denied or withdrawn OVDP requests.



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**Appendix V**

*Glossary of Terms*

Term	Definition
<b>Audit Information Management System</b>	An IRS computer system used by IRS Examination functions to control returns, input assessments/adjustments to the Master File, and provide management reports.
<b>Correspondence Examination Automation Support</b>	An IRS computer system that is a suite of web-based applications developed to enhance the correspondence examination process. The system provides a centralized database of documents such as examiner notes from conversations with the taxpayer, procedures used by the examiner, and other data the examiner obtained and used during the audit to support his or her conclusion about whether to assess additional tax.
<b>Criminal Investigation Management Information System</b>	A database that tracks the status and progress of criminal investigations and the time expended by special agents. It is also used as a management tool that provides the basis for decisions of both local and national scope.
<b>Data Center Warehouse</b>	A centralized storage and administration of files that provides IRS data and data access services to Treasury Inspector General for Tax Administration auditors.
<b>E-Trak</b>	A web-based document tracking system that assists the IRS with its ability to timely and effectively manage its responses to issues raised by stakeholders.
<b>Examination Returns Control System</b>	A system that provides detailed management information on returns under examination.
<b>Financial Crimes Enforcement Network</b>	A bureau of the U.S. Department of the Treasury. The FinCEN's mission is to safeguard the financial system from illicit use, combat money laundering, and promote national security through the collection, analysis, and dissemination of financial intelligence and strategic use of financial authorities.



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Term	Definition
<b>Foreign Account Tax Compliance Act</b>	Law passed in Calendar Year 2010 that targets tax noncompliance by U.S. taxpayers with foreign accounts. The law requires U.S. taxpayers to report certain foreign financial accounts and offshore assets. It also requires foreign financial institutions to report about financial accounts held by U.S. taxpayers or foreign entities in which U.S. taxpayers hold a substantial ownership interest. U.S. taxpayers and foreign financial institutions that do not report the required information will be subject to withholding.
<b>Integrated Data Retrieval System</b>	A system consisting of databases and operating programs that supports IRS employees working active tax cases within each business function across the entire IRS.
<b>Internal Revenue Manual</b>	Internal guidelines for personnel of the IRS.
<b>Master File</b>	The IRS database that maintains transactions or records of tax accounts.
<b>Resident Alien</b>	Any individual who is not a U.S. citizen or U.S. national. A resident alien is an alien who has passed either the green card test or the substantial presence test.
<b>Return Preparer Program</b>	A program that allows for the examination of returns prepared by a particular preparer if information indicates a pattern on noncompliance exists.
<b>Taxpayer Identification Number</b>	A nine-digit number assigned to taxpayers for identification purposes. Depending upon the nature of the taxpayer, the TIN is an Employer Identification Number, a Social Security Number, or an Individual Taxpayer Identification Number.



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**Appendix VI**

*Management's Response to the Draft Report*

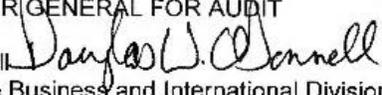


COMMISSIONER  
LARGE BUSINESS AND  
INTERNATIONAL DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, DC 20224

April 20, 2016

MEMORANDUM FOR MICHAEL E. MCKENNEY  
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Douglas W. O'Donnell   
Commissioner, Large Business and International Division

SUBJECT: Draft Audit Report – Improvements Are Needed in Offshore  
Voluntary Disclosure Compliance and Processing Efforts (Audit  
No. 2014-30-028)

Thank you for the opportunity to review and comment on the subject draft report. The IRS has the responsibility for ensuring taxpayer compliance for income earned on offshore accounts and foreign assets. Taxpayers must report whether they have offshore accounts on Form 1040, *U.S. Individual Income Tax Return*, Schedule B, *Interest and Ordinary Dividends*, and pay taxes on any income earned from them. Taxpayers with aggregate foreign financial account balances of more than \$10,000 are also required to report additional account information on Form 114, *Report of Foreign Bank and Financial Accounts (FBAR)*.

Some taxpayers use offshore accounts to hide assets and income outside the United States in an effort to evade their Federal tax obligations. The Foreign Account Tax Compliance Act (FATCA), enacted in 2010, represented an important development in U.S. efforts to improve tax compliance by U.S. persons holding investments in offshore accounts by requiring reporting to the IRS by taxpayers and foreign financial institutions on these accounts. Prior to the enactment of FATCA, the IRS implemented the Offshore Voluntary Disclosure Programs (OVDP) in 2009 (with program modifications in 2011 and 2012) to address non-compliance by U.S. taxpayers using foreign accounts. Under the OVDP, individuals who had evaded taxes were offered the opportunity to avoid criminal prosecution, pay civil penalties, and enter back into the tax system.

As of October 2015, more than 54,000 voluntary disclosure requests have been processed from taxpayers worldwide who have paid more than \$8 billion in these programs. The exceptional response to the program could not have been predicted with certainty nor could sufficient staffing be immediately arranged to meet the demands. Resources were redirected into the Offshore Voluntary Disclosure Unit in Austin where taxpayers submit records after being accepted into the program, and we have since hired permanent staffing at an appropriate level to address the needs of the program.



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## *Improvements Are Needed in Offshore Voluntary Disclosure Compliance and Processing Efforts*

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In addition to the billions of dollars of revenue that have been collected through the OVDP regime, the OVDP initiatives have provided several other key benefits to tax administration; including enhancing voluntary compliance, enabling the IRS to combat unreported income from offshore accounts using enforcement tools that are less resource intensive than traditional compliance activities, and providing data and intelligence on offshore non-compliance (such as promoters) that is used to further strengthen IRS' enforcement of this segment of non-compliance.

While OVDP initiatives have been successful in improving compliance with offshore accounts, OVDP was not intended to be a permanent program that would exist into perpetuity. FATCA data is expected to open new approaches for the identification and assessment of compliance risks, as well as support many existing IRS tax compliance programs, all of which will provide for greater tax compliance by this sector and constrict the opportunities for offshore tax evasion. While elements of FATCA have been in effect since 2011, the main elements of FATCA reporting began in 2015 and will continue to unfold over the next few years.

We note that we do not agree with the outcome measure as stated in Appendix IV and referenced throughout the TIGTA report. TIGTA identified 29 "exception" cases in which the taxpayer was denied access or withdrew from OVDP. IRS OVDP technical specialists reviewed all cases in the TIGTA sample and determined that only 17 cases needed additional review. The remaining 12 cases were determined to be compliant in their filing requirements or did not warrant additional follow-up.

In addition, we do not agree with the estimated penalty amount per case and the resulting projection. Penalty determinations are fact-intensive and must be made on a case-by-case basis rather than drawing general conclusions. Not every OVDP taxpayer will be subject to the FBAR penalty. If FAQ 17 criteria had been considered in the analysis by TIGTA, then some late-filed FBARs would have resulted in no penalty. Factual development is required to determine if the FBAR penalty is applicable and, if so, whether it is willful or non-willful. Taxpayers sometimes entered into OVDP due to a lack of adequate counsel and misunderstanding of their tax situation, causing them to later realize it was in their best interest to withdraw from the program. Thus, it is erroneous to conclude that every case including withdrawals will have the FBAR penalty assessed. As a result, the projection of increased revenue in FBAR penalties is overstated.

The corrective actions that the IRS will take to address the recommendations are more fully described in the attachment. If you have any questions, please contact me or members of your staff may contact Pamela Drenthe, Director, Withholding & International Individual Compliance, at (202) 515-4417.

Attachments



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*Improvements Are Needed in Offshore Voluntary  
Disclosure Compliance and Processing Efforts*

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1

**Attachment I**

**RECOMMENDATION 1:**

The Commissioner, LB&I Division, should have all denied or withdrawn offshore voluntary disclosure requests identified in this report reviewed for FBAR penalty assessments and possible referral to CI.

**CORRECTIVE ACTIONS:**

We agree with this recommendation. In November 2015, OVDP technical specialists reviewed all withdrawn or denied offshore voluntary disclosures identified in this report. Additional follow-up is being made on 17 withdrawn or denied cases.

**IMPLEMENTATION DATE:**

December 30, 2016

**RESPONSIBLE OFFICIAL(S):**

Director, Withholding & International Individual Compliance, Large Business and International Division.

**CORRECTIVE ACTION(S) MONITORING PLAN:**

We will monitor this corrective action as part of our internal management control system.

**RECOMMENDATION 2:**

The Commissioner, LB&I Division, and the Chief, CI, should develop procedures to require the immediate review of any future denied or withdrawn offshore voluntary disclosure requests for further compliance actions.

**CORRECTIVE ACTIONS:**

We agree with this recommendation, and will explore opportunities to review future denied or withdrawn offshore voluntary disclosure requests for compliance actions.

**IMPLEMENTATION DATE:**

September 30, 2016



*Improvements Are Needed in Offshore Voluntary Disclosure Compliance and Processing Efforts*

2

**RESPONSIBLE OFFICIAL(S):**

Director, Withholding & International Individual Compliance, Large Business and International Division and Chief, Criminal Investigation.

**CORRECTIVE ACTION(S) MONITORING PLAN:**

We will monitor this corrective action as part of our internal management control system.

**RECOMMENDATION 3:**

The Commissioner, LB&I Division, and the Chief, CI, should centrally track and control taxpayer offshore voluntary disclosure requests in the OVDP Unit starting with the initial taxpayer request (preclearance) to join the program.

**CORRECTIVE ACTIONS:**

The cost of the resources needed to make modifications to the E-Trak system, to allow the OVDP unit to track cases that are still being processed by CI, are not justified in light of the fact that OVDP is not a permanent program. However, to improve the tracking and control of the OVDP requests, CI will be providing bi-weekly reports of case receipts to LB&I for their use in tracking cases from the date of receipt by CI and to ensure any taxpayer information that is erroneously received by either business unit is immediately routed to the appropriate unit.

**IMPLEMENTATION DATE:**

September 30, 2016

**RESPONSIBLE OFFICIAL(S):**

Chief, Criminal Investigation

**CORRECTIVE ACTION(S) MONITORING PLAN:**

We will monitor this corrective action as part of our internal management control system.

**RECOMMENDATION 4:**

The Commissioner, LB&I Division, and the Chief, CI, should establish one mailing address for taxpayers to use for submitting their offshore voluntary disclosure requests and related documentation.



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*Improvements Are Needed in Offshore Voluntary  
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3

**CORRECTIVE ACTIONS:**

While we agree with the potential value in this recommendation, at this time and in light of the non-permanent status of the OVDP program, we cannot commit the resources needed for making this change. However, the procedure that we plan to put in place in response to recommendation 3 will lead to improved coordination in the routing of taxpayer documentations relating to OVDP across the Service. We will place this recommendation on hold in our internal management control system until a decision is made about the future status of the OVDP program.

**IMPLEMENTATION DATE:**

Hold.

**RESPONSIBLE OFFICIAL(S):**

Director, Withholding & International Individual Compliance, Large Business and International Division and Chief, Criminal Investigation.

**CORRECTIVE ACTION(S) MONITORING PLAN:**

We will monitor this corrective action as part of our internal management control system.

**RECOMMENDATION 5:**

The Commissioner, LB&I Division, and the Chief, CI should ensure that employees adhere to established timeliness guidelines for taxpayers to respond to offshore voluntary disclosure-related correspondence and follow those guidelines during the initial eligibility determination, case building, and certification processes.

**CORRECTIVE ACTIONS:**

The goal was to allow as many people as possible into the Offshore Voluntary Disclosure Program. IRS allowed taxpayers additional time when requested, taking into account longer mailing time that occurs with international correspondence and other taxpayer needs on a case-by-case basis. Going forward, adherence to established guidelines will be monitored more closely.

**IMPLEMENTATION DATE:**

This process has already been implemented.



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4

**RESPONSIBLE OFFICIAL(S):**

Director, Withholding & International Individual Compliance, Large Business and International Division and Chief, Criminal Investigation.

**CORRECTIVE ACTION(S) MONITORING PLAN:**

We will monitor this corrective action as part of our internal management control system.

**RECOMMENDATION 6:**

The Commissioner, LB&I Division, should coordinate with the Commissioner, SB/SE Division, to classify offshore voluntary disclosure requests so that some OVDP certifications can be worked by lower-graded revenue agents.

**CORRECTIVE ACTIONS:**

Although OVDP work involves certifications and not examinations, certifications still require training in international issues and OVDP procedures. Examiners must also understand the technical issue in order to certify its accuracy. Approximately 42% of OVDP cases are worked by grade 9, 11 and 12 examiners with the specialized training. IRS managers follow the standards outlined in IRM 1.4.40.4.6.1.2.1 - "Chart of Case Grading Factors". LB&I will continue to partner with SBSE to ensure that cases are assigned at the appropriate grade level to examiners possessing the requisite skill set to work these issues.

**IMPLEMENTATION DATE:**

September 30, 2016

**RESPONSIBLE OFFICIAL(S):**

Director, Withholding & International Individual Compliance, Large Business and International Division and Commissioner SB/SE Division.

**CORRECTIVE ACTION(S) MONITORING PLAN:**

We will monitor this corrective action as part of our internal management control system.



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*Improvements Are Needed in Offshore Voluntary  
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5

**Attachment II**

**OUTCOME MEASURE:**

*Increased Revenue – Potential; 777 taxpayers and \$21.6 million in FBAR penalties not assessed for which the IRS did not consider compliance action for taxpayers who withdrew or were denied from the OVDP.*

IRS Response: FBAR penalty determinations are factual in nature. There was no consideration of the criteria outlined in FAQ #17, foreign versus U.S. taxpayer. Late-filed FBARs could have been subject to the provisions of FAQ 17 resulting in no penalties.

We refer you to the 2013 TAS Annual Report to Congress, Most Serious Problem (MSP) #22. TAS tracked examinations of opt-out cases through September 2013. TAS reviewed 2,828 cases resulting in \$4,069,795 in FBAR penalties - approximately \$1,500 per case. Based on the TAS report, we believe a more accurate estimate is \$1,165,500 for 777 cases. However, please see below regarding disagreement over the number of exception cases which impacts this outcome measure.

*Methodology/Reliability of Information – In 29 of 100 requests in which the taxpayer either was denied access to or withdrew from the OVDP, the taxpayers filed delinquent FBARs for offshore accounts they had not disclosed previously. The IRS did not take any compliance actions on these taxpayers who are likely still liable for FBAR penalties.*

IRS Response: IRS OVDP technical specialists reviewed the cases in the TIGTA sample in November 2015. The conclusion of this review is that only 17 cases need additional review for potential follow-up action. All others in the sample were determined to be compliant in their filing requirements and/or low risk within the terms of FAQ 17 and do not warrant additional follow-up.