National Taxpayer Advocate

Report to Congress

Fiscal Year 2012 Objectives

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TAXPAYER ADVOCATE SERVICE

YOUR VOICE AT THE IRS

June 30, 2011

in the volume of applications and would impact processing of all new exempt organization applications, not just reinstatements.[131]

Consequently, TAS is concerned about possible delays in processing. An organization that does not receive a determination on its application for exempt status within approximately nine months of filing has a right to file suit for a declaratory judgment regarding its exemption status.[132] However, a court procedure could be practically inaccessible to small charities. It is unclear if the *pro bono* bar and the judiciary itself would have adequate capacity if demand is voluminous. Accordingly, the pressure is on the IRS to provide taxpayer service through timely application processing.

Moreover, TAS is aware of certain issues raised by previous waivers of filing for certain classes of organizations, especially quasi-public entities.[133] As it has done previously, the IRS could achieve a measure of efficiency by resolving common issues all at once, rather than solely on a case-by-case basis.[134] In other words, reinstatement could be accomplished for certain classes of organizations all at once. For instance, the IRS recently announced transitional relief for certain small organizations allowing reinstatement retroactive to the automatic revocation date.[135] This is a good example of relief for a class of organizations.

K. IRS's Inconsistency and Failure to Follow Its Published Guidance Damaged Its Credibility With Practitioners Involved in the Offshore Voluntary Disclosure Program

U.S. persons are generally required to report foreign accounts on Form TD F 90–22.1, *Report of Foreign Bank and Financial Accounts* (FBAR) and to report income from such accounts on U.S. tax returns. The IRS "strongly encouraged" taxpayers who failed to file these and other similar returns to participate in the 2009 Offshore Voluntary Disclosure Program (OVDP), rather than quietly filing amended returns and paying any taxes due.[136] It warned that those making "quiet" corrections could be "criminally prosecuted." OVDP participants would generally be subject to a 20 percent "offshore" penalty in lieu of various other

131 *See* IRS Exempt Organizations, *Ann'l Rep't* FY 2010, 3 (charting volume of annual determinations of applications for tax exemption) as 89,448, 85,927, 83,835, 89,703, 90,812, 84,225, 77,309, and 65,590 in 2003-2010).

132 *See* IRC § 7428 (providing that an organization can request a declaratory judgment regarding qualification for tax-exempt status from the United States Tax Court, the United States Court of Federal Claims, or the district court of the United States for the District of Columbia 270 days after applying for tax-exempt status).

133 *See* Rev. Proc. 95-48, 1995-2 C.B. 418 (waiving requirement to file for certain governmental units and affiliates).

134 *See* IRS Pub. 4839, *Annual Form 990 Filing Requirements for Tax-Exempt Organizations Forms 990, 990-EZ, 990-PF and 990-N (e-Postcard)* (indicating that a revoked organization must reapply for exempt status).

135 Notice 2011-43 (posted June 8, 2011) at http://www.irs.gov/pub/irs-drop/n-11-43.pdf.

136 *See* IRS, *Voluntary Disclosure: Questions and Answers,* http://www.irs.gov/newsroom/article/0,,id=210027,00.html (last visited June 6, 2011) (Feb. 9, 2011) (first posted May 6, 2009) (hereinafter OVDP "FAQ"). According to FAQ #10 ("Taxpayers are strongly encouraged to come forward under the Voluntary Disclosure Practice. Those taxpayers making "quiet" disclosures should be aware of the risk of being examined and potentially criminally prosecuted for all applicable years. The IRS will be closely reviewing these returns to determine whether enforcement action is appropriate.").

penalties.[137] The IRS announced, however, that "[U]nder no circumstances will a taxpayer be required to pay a penalty greater than what he would otherwise be liable for under existing statutes."[138] Taxpayers who would not be subject to significant penalties because their violations were not willful, or because they qualified for the "reasonable cause" exception, believed this statement applied to them.

On March 1, 2011, more than a year after the 2009 OVDP ended, the IRS "clarified" its seemingly unambiguous statement.[139] It would no longer consider whether taxpayers in the 2009 OVDP would pay less under existing statutes on the basis of non-willfulness or reasonable cause. Such taxpayers could either agree to pay more than they believed they owed or withdraw from the 2009 OVDP and face the possibility the IRS would assert massive civil penalties and seek criminal prosecution. Both options were problematic. Withdrawal would waste all of the resources already expended on the 2009 OVDP application and would not bring the taxpayer closure or certainty, as advertised. Moreover, in any future examination the IRS might have to request and review the items that were before the examiner processing the 2009 OVDP submission.[140]

Pressuring taxpayers who would pay less under existing statutes to remain in the program and pay more than they believe they owed was even worse. It violated longstanding IRS policy along with most conceptions of fairness and due process.[141] The IRS's inconsistency and failure to follow its published guidance damaged its credibility with practitioners and could be subject to legal challenge.[142] In 2011, TAS will continue to communicate with taxpayers and practitioners to determine the impact of the IRS's apparent reversal, advocate for the IRS to abide by the plain language of the original terms of the OVDP (as reasonably interpreted by the public and many of the IRS's examiners), and document our findings in the National Taxpayer Advocate's 2011 Annual Report to Congress.[143]

137 OVDP FAQ #12.

138 OVDP FAQ #35 (stating "[V]oluntary 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.**") (Emphasis added.).

139 Memorandum from Director, SB/SE Examination, and Director, International Individual Compliance, for all OVDI Examiners, *Use of Discretion on 2009 OVDP Cases* (Mar. 1, 2011). This reversal was not properly disclosed to the public as required by the Freedom of Information Act. *See* 5 U.S.C. § 552. IRS revenue agents had to deliver the bad news to practitioners one at a time. This must have been particularly uncomfortable for agents who had agreed to settle on the previously more favorable terms with the practitioners' other clients just the week before.

140 In our view this contradicted the portion of FAQ #35, which stated "[T]hese examiners [the OVDP examiners] will compare the 20 percent offshore penalty to the total penalties that would otherwise apply to a particular taxpayer."

141 Policy Statement 4-7; IRM 1.2.13.1.5 (Feb. 23, 1960).

142 *See, e.g.*, Pedram Ben-Cohen, *IRS's Offshore Bait and Switch: The Case for FAQ 35*, 46 DTR J-1 (Mar. 9, 2011).

143 We note that President Barack Obama recently signed the *Plain Writing Act of 2010* (H.R. 946), Pub. L. 111-274, Oct. 13, 2010, 124 Stat. 2861 (5 U.S.C. 301 note), to "improve the effectiveness and accountability of Federal agencies to the public by promoting clear Government communication that the public can understand and use." *Id.* It defines "plain writing" as writing that is "clear, concise, well-organized, and follows other best practices appropriate to the subject or field and intended audience." *Id.*

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