

# A Plain Language Handbook on the IRS Voluntary Disclosure Practice



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This handbook provides an overview of the IRS voluntary disclosure practice (VDP) and answers common questions about the VDP in plain language. The handbook is not legal advice and should not substitute for a careful review of IRS instructions and policy statements relating to the VDP. If you are pondering using the VDP, this handbook may answer some of your questions. But it's not a substitute for the advice of an attorney!

Law Offices of Daniel N. Price, PLLC provides international and domestic tax solutions, IRS representation and defense, and much more. The managing member of the firm, Daniel N. Price, has considerable experience with the VDP, including extensive work in revising the VDP while at the IRS Office of Chief Counsel. Beyond his direct involvement in 2018 remodeling the VDP, Dan coordinated with all IRS operations involved in the VDP, including personnel at IRS Criminal Investigation's headquarters, civil revenue agents and analysts, and revenue officers involved with collecting tax liabilities. Dan also helped develop the application form for the VDP, Form 14457, *Voluntary Disclosure Practice Preclearance Request and Application* (including the related instructions) and assisted in drafting most of the IRS' internal guidance on the topic. Before leaving the government, Dan reviewed all closing agreements for VDP cases, provided training to IRS personnel on the VDP, and advised IRS personnel handling VDP cases.

For more information visit [www.pricetaxlaw.com](http://www.pricetaxlaw.com) or email [info@pricetaxlaw.com](mailto:info@pricetaxlaw.com) for a consultation.

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## **1. Introduction**

### **a. What is the IRS' Voluntary Disclosure Practice (VDP)?**

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

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

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

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

- Income taxes (both individual and corporate)
- Estate taxes
- Gift taxes
- Employment taxes
- Excise taxes

- International reporting issues including international information returns, treaty-based positions, and more
- Title 31 Foreign bank account report (FBAR) reporting issues
- Title 31 Form 8300 cash transaction reporting issues

### c. Why Make a Tax Voluntary Disclosure?

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

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

**Scope Example:** Mary is the sole shareholder of a subchapter C corporation, and the corporation fraudulently understated income by paying for Mary’s significant personal living expenses and deducting them as business expenses. Mary fraudulently understated her personal income by not reporting on her income tax return the personal items paid for by her corporation. Mary and her corporation understated their income taxes for more than 20 years. After a falling out with her longtime personal assistant, Mary is concerned that her personal assistant may become an IRS whistleblower. Assuming IRS-CI accepts Mary’s voluntary disclosure, Mary must submit amended returns for the most recent six years, and her corporation must also amend its most recent six years of corporate income tax returns.

**Years in VDP:** One fraud penalty will apply to the year with the highest tax liability at the individual level and at the corporate level, and no accuracy-related penalties will apply for the other five years.

**Years outside of VDP:** If the IRS uncovers Mary’s conduct and asserts fraud, the IRS may assert the civil fraud penalty under 26 U.S.C. § 6663 for the entire 20 year period.

**Penalty Example:** Axel is a self-employed IT consultant who stopped filing income tax returns after he filed his 2014 Form 1040 in April 2015. He failed to file tax returns for tax years 2015 through 2021. Assume the date is now July 2023 and Axel filed an extension of time to file his 2022 income tax return. The following table presents hypothetical numbers with 15% growth in tax liability per year. The table below uses estimates and is not meant for precision.

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

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

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

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

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

Motivations differ, but most taxpayers who make voluntary disclosures are at least partly influenced by a realization of the magnitude of tax issues and a desire to correct the

noncompliance before the IRS knocks on their door. Common catalysts for making a voluntary disclosure include:

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

#### **e. What Are the Risks and Costs of Making a Voluntary Disclosure?**

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

- A voluntary disclosure is an admission of potentially criminal conduct.
- An incomplete or not completely truthful voluntary disclosure may significantly increase the chances of criminal prosecution.
- Only crimes under the IRS' jurisdiction may be corrected through the VDP.
- A voluntary disclosure guarantees a civil examination or audit by IRS revenue agents (auditors), which will require an extension of the civil statute of limitation for assessment of tax and penalties.
- A voluntary disclosure requires prompt, full, and complete cooperation with IRS. This requires taxpayers to provide revenue agents everything they request,

including documents and witness interviews, and generally pay the full amount of tax due, plus interest and penalties required by the VDP.

- A voluntary disclosure to the IRS does not resolve state tax matters. If a taxpayer makes a voluntary disclosure to the IRS, the taxpayer should also make a state voluntary disclosure for any state income tax matters.

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

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

No! The [Department of Justice Tax Division's Corporate Voluntary Self-Disclosure Policy](#) (DOJ Tax VSD) is completely separate from the VDP. The DOJ Tax VSD is geared toward companies (and other business entities) where corporate personnel have committed tax crimes. In exchange for timely and full cooperation, the DOJ Tax VSD may provide a favorable criminal penalty framework.

**2. Key Steps Before Making a Voluntary Disclosure**

**a. Stop the Noncompliance**

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

**b. Consult Legal Counsel**

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



proceedings. You need an attorney to advise you under the confidentiality of the attorney-client privilege.

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

**c. Retain a Kovel accountant through legal counsel**

In general, attorneys routinely hire experts and service providers to assist in rendering legal advice and legal defense to clients. When an attorney hires an expert or service provider to assist in providing legal advice and legal defense, the expert or service provider may be protected under the umbrella of the attorney-client privilege. The case United States v. Kovel, 296 F.2d 918 (2d Cir. 1961) recognized that a lawyer could hire an accountant to perform accounting tasks to aid the lawyer in rendering legal services without waiving the attorney-client privilege. When attorneys hire accountants to assist them, the engagement is generally called a “Kovel engagement” and the accountants retained by the attorney are referred to as “Kovel accountants.”

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

**3. The IRS VDP Process**

**a. Overview**

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

**b. IRS Criminal Investigation (IRS-CI)**

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

other IRS forms, Form 14457 and its instructions are currently combined into one document.

### **i. Form 14457, Part I**

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

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

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

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

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

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

- List of all noncompliant financial accounts and digital assets.

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

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

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

Mailing address:

Internal Revenue Service  
Attn.: Voluntary Disclosure Coordinator  
2970 Market Street  
1-D04-100  
Philadelphia, PA 19104

Fax number: 844-253-5613

**ii. Form 14457, Part II**

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

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

- Estimates of unreported income;
- Specific information relating to voluntary disclosures involving unreported foreign bank accounts;
- A narrative including the following:

- A description of the taxpayer’s personal and professional background;
- A description of any professional advisors that rendered services to the taxpayer from the inception of the noncompliance, including attorneys, accountants, financial planners, private bankers, consultants, etc.
- A thorough discussion of all tax and tax related noncompliance, including specific information for noncompliance relating to offshore issues and virtual currency (see the instructions to Form 14457, part II for the specific information required)

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

As of mid-2023, IRS-CI has been providing some responses to Form 14457, part II within a few weeks. Assuming IRS-CI views the voluntary disclosure as complete, then IRS-CI issues a “preliminary acceptance letter.” Generally, a preliminary acceptance letter will include the following soft assurance concerning criminal prosecution: “A voluntary disclosure will not automatically guarantee immunity from prosecution; however, a voluntary disclosure may result in prosecution not being recommended.” The preliminary acceptance letter also emphasizes that the voluntary disclosure is not complete until the taxpayer resolves the civil examination process with the assigned civil auditor or revenue agent.

### **c. IRS Civil Functions**

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

#### **i. IRS Examination**

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

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

## **ii. Closing Agreement**

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

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

## **d. Expectations About Payment**

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

A taxpayer in the VDP who cannot fully pay the required amounts must provide detailed information on assets and income with supporting documents to IRS revenue officers. Reaching an agreement concerning inability to fully pay can be a painful process for taxpayers in the VDP. The IRS generally requires an agreement on inability to fully

pay to address all equity in assets. The IRS generally requires immediate payment of all equity in assets or payment of all equity in assets over a reasonable amount of time. The IRS may insist that taxpayers make lifestyle changes to reduce personal expenditures to make more income available as payments to the IRS. Working with an IRS revenue officer during a voluntary disclosure is illustrated by the example below:

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

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

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

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

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

- Contact by revenue officers does not by itself preclude making a voluntary disclosure. In other words, having a revenue officer hounding you for payment or delinquent tax returns does not by itself disqualify you from using the VDP.
- Taxpayers applying to use the VDP must fully cooperate with revenue officers while IRS-CI performs its analysis and, assuming that IRS-CI provides preliminary acceptance, must continue cooperating with revenue officers.

#### **4. Other Options**

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