

A Plain Language Handbook on the IRS Voluntary Disclosure Practice



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Revision date: September 27, 2025

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I. 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, endure 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.¹ 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. From March 2024 onward, the IRS began making major changes to restrict the use of the VDP, and the IRS has been retroactively applying the changes to VDP cases previously accepted.

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 a soft assurance that IRS Criminal Investigation (IRS-CI) will not refer them to the Department of Justice for criminal prosecution.² Taxpayers must confess to the IRS before the government becomes aware of their tax or tax-related noncompliance (known as "timeliness"). Additionally, the IRS only accepts certain matters; the IRS will not allow voluntary disclosures 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 the tax misdeeds. If IRS-CI accepts the confession, then IRS-CI passes 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

¹ *United States v. Tenzer*, 127 F.3d 222, 226 (2d Cir. 1997) (providing a brief history of the Treasury and the IRS' voluntary disclosure policy); *see also* IRS, Voluntary Disclosure Practice Examiner Guide Paper (Rev. 1/26/22), pg. 5 (providing very brief historical background of VDP).

² According to a press release from a law firm representing a taxpayer who made a voluntary disclosure, in one case although the IRS did not want the case prosecuted, an assistant US Attorney prosecuted the taxpayer after the taxpayer made a voluntary disclosure. *See* press release about *United States v. Richard Brasser*, No. 3:23-CR-6 (W.D.N.C.).

- 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 agreement with the IRS concerning a tax issue) specifying the taxes and penalties owed. *See* I.R.C. § 7121.

On the second point concerning potential economic benefits, the IRS’ VDP requires correcting only the last six years of income tax noncompliance.³ 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.

³ *See* I.R.M. 4.63.3.18.3 (04-21-2025) Disclosure 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. Mandatory Penalty Structure

Form 14457 and the I.R.M. provide some guidance on the penalty structures for most VDP cases.⁴ The IRS makes clear that a civil fraud penalty will be imposed in all VDP cases involving tax noncompliance. For cases involving FBAR noncompliance, the Form 14457 states on page 11 of 19: "Willful FBAR penalties will apply to all cases involving FBAR noncompliance where facts and law support the assertion of a willful FBAR penalty. Willful FBAR penalties will be computed in accordance with existing IRS penalty guidelines under IRM

⁴ See I.R.M. 4.63.3.18.2 (04-21-2025) Penalty Framework.

4.26.16 and 4.26.17.” The IRS will require payment of a 50% willful FBAR payment on all noncompliant foreign accounts.⁵ Will the IRS impose a civil fraud penalty and a willful FBAR penalty in every case where those penalties might be applicable? Yes, because the IRS has quietly changed its position since introducing the revised VDP in late 2018. We briefly discuss the IRS’ evolution on penalties for VDP cases.

When the revised VDP was introduced in late 2018, the IRS stated exceptions to the default penalty structure were possible. On November 20, 2018, Kirsten B. Wielobob, the IRS Deputy Commissioner for Services and Enforcement, issued a memorandum entitled “Updated Voluntary Disclosure Practice” (“2018 IG Memo”). The 2018 IG Memo stated:

Proper penalty consideration is important in these cases. A timely voluntary disclosure may mitigate exposure to civil penalties. Civil penalty mitigation occurs by focusing on a specific disclosure period and the application of examiner discretion based on all relevant facts and circumstances including prompt and full cooperation (see IRM 9.5.11.9.4) during the civil examination of a voluntary disclosure. Managers must ensure that penalties are applied consistently, fully developed, and documented in all cases.

2018 IG Memo at pg. 2.

The 2018 IG Memo makes clear that the IRS would evaluate each VDP case individually. The assurance that an IRS manager would ensure “penalties are applied consistently, fully developed, and documented in all cases” assured participating taxpayers that penalty mitigation requests would be addressed fairly within VDP, taking their individual facts and circumstances into account.

Even though most preliminary acceptance letters sent by IRS-CI still reference the 2018 IG Memo, the IRS has taken a rigid approach and no in practice longer allows what it calls “penalty deviations.”⁶ In other words, regardless of the facts, the IRS forces taxpayers to admit to and pay a civil fraud penalty, and if applicable, a willful FBAR penalty. In the context of VDP cases involving FBAR noncompliance, the IRS now appears to take the position that all FBAR violations are willful violations.⁷ The IRS’ practice in handling VDP cases does not align with Form 14457’s statement that “[w]illful FBAR penalties will be computed in accordance with existing IRS penalty guidelines under IRM 4.26.16 and 4.26.17.” Current VDP policy overrides

⁵ The IRS’ methodology for imposing the willful FBAR penalty in VDP cases is explained in the Voluntary Disclosure Practice Examiner Guide Paper (Rev. 3/8/2024), pg. 45. See Daniel N. Price, *Modifying VDP FBAR Penalties Will Promote Voluntary Compliance*, TAX NOTES FEDERAL (June 12, 2023) (offering critiques and recommendations for FBAR penalties in VDP).

⁶ See I.R.M. 4.63.3.18.2.1 (04-21-2025) Penalty Deviation.

⁷ The IRS has made inconsistent representations concerning FBAR penalty deviations in 2025. In one case, an IRS revenue agent stated requesting an FBAR penalty deviation constituted a lack of cooperation which could lead to removal from VDP. In another case, an IRS revenue agent stated the penalty deviation request was elevated and rejected. The IRS decisions makers who deny penalty deviation requests typically instruct revenue agents to not reveal their identities and refuse to engage with practitioners.

all Internal Revenue Manual provisions which require considering penalty mitigation, using examiner discretion, and considering the facts and law. VDP policy now essentially mandates willful FBAR penalties for all FBAR violations. No matter the reason for the FBAR violation or the taxpayer's intent concerning specific foreign bank accounts, at this time the IRS appears to impose only willful FBAR penalties in VDP cases. The following hypothetical illustrates current IRS VDP policy on FBAR violations.

VDP FBAR Penalty Example

Christina is a citizen of Singapore and long-term permanent resident in the U.S. Christina worked for a few years in Singapore before moving to the U.S. As a result of her employment in Singapore, a Central Provident Fund, a type of retirement account common in Singapore, was established for Christina. After she moved to the U.S., Christina filed FBARs to report her savings and checking accounts in Singapore.

Christina materially underreported her income on tax returns and willfully failed to report a Cayman bank account on FBARs. Because she was unable to currently take distributions from her Singapore Provident Fund, Christina failed to report her retirement account on FBARs; arguably her failure to report her Singapore Provident Fund was non-willful and due to her good faith misunderstanding of the law. However, in the context of VDP, the IRS will require Christina to pay a 50% willful FBAR penalty on both the Cayman bank account and the Singapore Provident Fund.

Practice tip: At this time, do not use the VDP and expect to negotiate penalties or ask for any deviation from the set penalty structure.

E. 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, 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.
- Foreign tax audits and investigations, including indications that a foreign tax administrator may make a request for information to the IRS under a bilateral income tax treaty, may motivate taxpayers to make voluntary disclosures.
- 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 they are required to make representations about tax compliance or before others ask about 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.

F. What are the risks and costs of making a Voluntary Disclosure?

Making a voluntary disclosure to the IRS involves some risks and costs. Some of the risks and costs include:

- The IRS may retroactively change the terms of the VDP without notice.
- The IRS may screen the voluntary disclosure for explicit admissions of willful conduct and reject those that include representations of non-willful conduct or reasonable cause.
- An incomplete or not completely truthful voluntary disclosure will 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 extensions of the civil statutes of limitation for assessment of tax and penalties.
- A voluntary disclosure requires prompt, full, and complete cooperation with IRS.⁸ Form 14457 states that cooperation includes but is not limited to:
 - promptly and fully responding to all information document requests
 - submitting to interviews and providing access to related party witnesses
 - providing statute extensions or waivers as necessary for tax and tax-related issues
 - providing signed delinquent or amended returns, information returns, supporting documents, workpapers, etc.
 - providing unrestricted instructions to foreign banks to provide full and complete records (for offshore cases)
 - agreeing to all adjustments the examiner makes to their income and deductions
 - resolving all compliance matters covered by the disclosure by agreement
 - fully paying all determined taxes, additions to tax, interest and penalties, or entering into full pay installment agreement

Practice tip: The I.R.M. states that a taxpayer must meet every element of cooperation listed above and more. Otherwise, the examiner may request that CI revoke preliminary acceptance.⁹

⁸ See I.R.M. 4.63.3.18.1(4) (discussing what cooperation includes).

⁹ I.R.M. 4.63.3.18.1(4) outlines what cooperation includes. The next subsection expands the concept of cooperation to include nearly any whim of an IRS revenue agent by saying: "If a taxpayer fails to

- 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 consider making a state voluntary disclosure for any state income tax matters. Some state voluntary disclosure programs offer very favorable terms.

Practice tip: Revenue agents handling VDP examinations may make extremely burdensome requests for business source documents, such as proof of payment for cost of goods sold or other tax return items. Prepare your clients for burdensome IDRs.

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 (or more) and will involve a guaranteed audit by the IRS. At times, IRS auditors handling VDP examinations make overly burdensome information document requests because they feel that cooperation has no limits. Simply stated, making a voluntary disclosure is a major financial and time commitment, and the process is like a lobster trap: once a taxpayer enters, the taxpayer cannot escape the process.

G. Changes the IRS Implemented Since 2024

On March 20, 2024, the IRS quietly updated its VDP “landing page” at www.irs.gov/vdp including adding several FAQs. The brief summary in this section highlights changes made by the IRS on its website, to Form 14457, and anticipated changes. The IRS is applying changes retroactively to some VDP cases previously preliminarily accepted by CI. In other words, the IRS has changed the rules for VDP and has made the new rules retroactive! This sets a dangerous precedent for all future VDP cases. Taxpayers need to be aware that the IRS may make future retroactively changes to the rules for VDP.

Admission of Willfulness: In 2024, the IRS made clear it only wants to see willful noncompliance in VDP. One FAQ added in 2024 asks “How do I know if I was willful in not complying with tax laws?” The answer follows:

Willfulness is not simply making a mistake. It is the intentional, purposeful, deliberate act to hide income or assets and therefore evade filing requirements or payment of tax. **When filing a voluntary disclosure practice application, you must state that you were willful in your actions.** This program is not for you if you simply made a math error or other mistake on your tax filings. Talk with a licensed professional and see [Voluntary disclosure not for you?](#) and look for other options to come into compliance.

cooperate during their civil examination, **including, but not limited to, meeting every element of cooperation listed above**, the examiner may request CI revoke the preliminary acceptance.” I.R.M. 4.63.3.18.1(5) (bold added).

www.irs.gov/vdp (bold added).¹⁰

Full Payment: Although the IRS historically pushed for full payment in VDP cases, it made exceptions in the past. For example, the IRS in the past allowed Offers in Compromise (OICs) for certain VDP cases where inability to fully pay was clearly established. But the IRS no longer makes any exceptions and now demands full payment in all cases. In the section of www.irs.gov/vdp under “What is the Voluntary Disclosure Practice (VDP)?” the IRS made explicit the full payment requirement (noting VPD requires you to “[p]ay in full or secure a full-pay installment agreement for the tax, interest and any applicable penalties you owe”). In several VDP cases where CI granted preliminary acceptance and full payment is impossible, IRS revenue agents handling audits have either proceeded with revocation requests resulting in CI revoking preliminary acceptance or threatened revocation of preliminary acceptance. *See infra* § 3.d. “Expectations about payment.”

Other changes:

- The IRS signaled some estates may not be welcome in VDP.
- Form 8938 omissions may be better handled through an amended income tax return. “If you mistakenly forgot to include an offshore account on your tax return, filing an amended return may be your best option.”
- The new FAQs also address housekeeping matters such as Forms 2848 and extensions to complete the Form 14457.

The IRS also quietly published updated versions of Form 14457 during 2024 and 2025. The current version of Form 14457 incorporates many of the changes announced on www.IRS.gov/VDP in March 2024. For example, the revised Form 14457:

- Reiterates full payment is required
- Requires that all amended or delinquent returns are prepared prior to making a voluntary disclosure

In summary, the IRS made significant retroactive changes to VDP without any public notice or warning to the practitioner community. Further, the IRS has resisted engaging with practitioners about these significant changes including applying changes retroactively. My personal speculation is that the IRS wants to restrict the use of VDP to reduce the burden on civil

¹⁰ As of the writing of this article in late July 2024, the question portion of this FAQ is still present on www.irs.gov/vdp, but the website will not display the answer. In 2024, the IRS also revised Form 14457 to include a mandatory checkbox requiring the taxpayer to admit the following: “I was willful in the actions that led to my tax noncompliance and understand that willfulness is a requirement to be considered for entry into the VDP.” *See* Form 14457 (Rev 11-2024). Due to widespread practitioner outcry and the work of the National Taxpayer Advocate, in 2025 the IRS agreed to remove the willfulness checkbox. <https://www.taxpayeradvocate.irs.gov/news/nta-blog/criminal-vdp-tas-reports-a-win-for-taxpayers-irs-agrees-to-remove-willfulness-checkbox-on-vdp-application-form/2025/06/> In July 2025, the IRS issued a revised Form 14457 with the willfulness checkbox removed. *See* Nathan J. Richman, *IRS Removes Derided Voluntary Disclosure Willfulness Affirmation*, TAX NOTES (Jul. 23, 2025).

examination resources. Regardless of the IRS' motivation, the 2024 changes to VDP reflect disregard for principles of sound tax administration and add to the difficulty of evaluating VDP as a compliance path for clients.

H. 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.

II. 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 will almost certainly be removed from VDP by having preliminary acceptance revoked. Getting kicked out of VDP will increase the chances of criminal prosecution.¹¹

Practice tip: Consider including in the client engagement letter the explicit necessity of prospective full tax compliance.

B. Counsel should handle VDP cases

Although enrolled agents and CPAs may practice before the IRS, an attorney should with experience navigating the VDP process should take the lead on all VDP cases. Taxpayers should never use an enrolled agent 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. Additionally, an attorney can evaluate other potential areas of liability and, where necessary, engage other professionals to assist in preparing the voluntary disclosure. An attorney should take point in helping a client navigate the process of submitting information to IRS-CI and dealing with IRS revenue agents and revenue officers.

¹¹ See Form 14457 page 9 of 19 (noting “Taxpayers must comply with U.S. law for all tax periods after the disclosure period and file returns according to standard filing procedures. Failure to remain in compliance for all tax periods after the disclosure period may result in the revocation of preliminary acceptance and possible criminal prosecution.”)

C. Counsel should retain a *Kovel* accountant for the client

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.

III. 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.¹²

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. Before beginning the VDP process, check www.irs.gov/vdp to verify you are using the most recent version of Form 14457.

1. 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.

¹² See I.R.M. 4.63.3.18.6 (04-21-2025) Overview of the Voluntary Disclosure Case Development Process (describing the general process including internal IRS steps for case movement and case preparation).

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. That National Taxpayer Advocate has recommended the IRS revisit the issue of prohibited sources of income,¹³ but I do not anticipate the IRS changing its perspective any time soon. 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.¹⁴

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.).

Practice tip: Since one timeliness factor focuses on receipt of information by the IRS, taxpayers have a window of opportunity to make a voluntary disclosure during the period after a court has authorized the service of a John Doe Summons and before the IRS receives information pursuant to the John Doe summons.

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;
- List of all tax noncompliant cryptocurrency transactions¹⁵;

¹³ See National Taxpayer Advocate Annual Report to Congress 2024, most serious problem no. 10 "Changes to the IRS's Criminal Voluntary Disclosure Practice Requirements May Be Reducing Voluntary Compliance and Negatively Impacting the Tax Gap," <https://www.taxpayeradvocate.irs.gov/reports/2024-annual-report-to-congress/>

¹⁴ *United States v. Knottnerus*, 139 F.3d 558 (7th Cir. 1998) (concluding attempt to make a voluntary disclosure was not timely after an IRS special agent contacted the taxpayer).

¹⁵ Form 14457, Part I requires significant, detailed disclosures for cryptocurrency noncompliance. The scope of information the IRS requires for cryptocurrency noncompliance has been criticized by many practitioners and essentially requires detailed admissions of noncompliance at the very beginning of the

- Information on law enforcement activity and whether income was from illegal sources; and
- List of all noncompliant financial accounts and digital assets.

Practice tip: For cases involving cryptocurrency noncompliance, carefully consider the admissions the IRS requires on Form 14457, Part I.

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, financial accounts, and digital assets 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 mid-2025, IRS-CI makes preclearance determinations quickly, often within a week.

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 faxed or emailed to IRS-CI. IRS-CI prefers email submissions. Do not send sensitive taxpayer information to IRS-CI by unencrypted email. Rather, legal counsel handling a VDP matter should pre-coordinate with IRS-CI to submit Form 14457 by encrypted email. For example, my firm has completed email encryption tests with IRS-CI to securely send and receive encrypted email.¹⁶

Fax number: 844-253-5613

Email address: vdp@ci.irs.gov

2. 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. The IRS will

VDP process. Clients with cryptocurrency noncompliance must be informed of the risks of making detailed admissions at the pre-clearance stage. Additionally, the IRS' requirements for cryptocurrency noncompliance violates the principle of horizontal equity among taxpayers. Only taxpayers with cryptocurrency noncompliance must provide transactional data when seeking preclearance.

¹⁶ Discuss implementing Microsoft Office Message Encryption with your IT staff if you want to seamlessly communicate with the IRS through encrypted email.

not provide additional extensions of time to provide Form 14457, Part II.¹⁷ 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 an explicit 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 digital assets (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 secure records, reconstruct income, and attempt to obtain evidence of fraud or willfulness. In other words, the narrative provides a confession and a roadmap for the IRS to collect evidence.

Practice Tip: Consider preparing the narrative using a word processor rather than trying to type it into the PDF Form 14457. Then, use “see attached” in the field for the narrative.

The current version of Form 14457 includes a check box just before the taxpayer signature lines:

- ☐ I have prepared and will hold all required documents to provide to the examiner upon initial contact including, but not limited to, delinquent and/or amended returns, bank statements and financial records

Form 14457 (Rev. 7-2025)

The checkbox must be interpreted in conjunction with the instructions on page 9 of 19. The instructions on page 9 of 19 clarify that taxpayers “should have their documents prepared, packaged and ready to provide to the examiner at initial contact.” In other words, the instructions are clearer about the future requirement of complete tax returns and documents as opposed to having everything ready at the time of submission of Form 14557 Part II. Since it is impossible to predict when the IRS will assign an examiner to a VDP examinations, the key takeaway is to prepare amended or delinquent returns as early as possible in the VDP process. Unfortunately, the IRS is increasing its

¹⁷ See www.irs.gov/vdp FAQ “I asked for an extension but still don’t have all the documents required. What do I do?”

demands while simultaneously not improving the timeline for assigning cases to civil examiners, especially in VDP cases with international issues.¹⁸

Practice tip: Out of an abundance of caution, consider adding a statement in the Form 14457 Part II narrative discussing your interpretation of the checkbox and whether all documents have been prepared or will be prepared.

Currently, IRS-CI provides responses to Form 14457, Part II promptly. 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.

During 2024, the IRS screened some prior VDP cases that received preliminary acceptance and retroactively revoked preliminary acceptance on the basis that the taxpayer failed to meet the willfulness requirement of VDP. The IRS’ retroactive application of the 2024 changes shows a clear disregard for fundamental fairness and arguably violates the U.S. Constitution’s guarantee of Due Process.

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.

1. 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 three 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 mandatory interviews. The IRS requires that ALL taxpayers submit to interviews. After interviews, revenue agents will send a “memorandum of interview” to the taxpayer requesting that the taxpayer sign the summary. Revenue agents also allow a taxpayer to correct the memorandum of interview, similar to the

¹⁸ Especially in VDP cases for taxpayers residing abroad the IRS may take several years to assign an examiner.

process of correcting a deposition transcript. Reviewing and correcting a memorandum of interview can be a time consuming and frustrating process.

Practice tip: IRS revenue agents are required to interview all taxpayers participating in VDP. In general, the purpose is to lock in admissions of fraud and willfulness. But the IRS may also use interviews to develop intelligence on emerging schemes, areas of enforcement interest, or advisors. IRS revenue agents do not allow recording of interviews conducted over the videoconference platform Microsoft Teams. Practitioners may only request to audio record in-person interviews with advanced written notice.

Full cooperation also requires full payment of all tax and interest due for the disclosure period, as well as all required penalties under VDP. The IRS takes cooperation seriously, and a failure to fully cooperate will prompt IRS Examination to request that IRS-CI revoke preliminary acceptance.

2. 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 (or a full payment installment agreement is entered into) 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 an Internal Revenue Code section for civil fraud. Under the current VDP, if a taxpayer fails to agree to the assessment of a fraud penalty, the IRS will request that IRS-CI revoke preliminary acceptance which may be colloquially referred to as “removal” from VDP.¹⁹

Some taxpayers have unique concerns about the use of the “F word” in closing agreements. For example, licensed professionals such as doctors, 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 experienced counsel before deciding how to proceed.

Practice tip: Consider showing your client template VDP closing agreement language before the client makes a voluntary disclosure.

¹⁹ See *Grinshpun v. Commissioner*, Tax Court docket. no. 12601-19 (order dated Sep. 27, 2022) (discussing the failure of the IRS and taxpayer to come to terms over the application of a fraud penalty in a VDP case which resulted in the issuance of a notice of deficiency); see also IRS, Voluntary Disclosure Practice Examiner Guide Paper (Rev. 3/8/2024), pg. 36 (discussing the process of revoking preliminary acceptance).

D. Expectations about payment

As mentioned earlier, the IRS expects that taxpayers who make voluntary disclosures fully pay all taxes, interest, and required penalties.²⁰ In the past the IRS allowed some cases to proceed within VDP despite the lack of full payment. The IRS even included a checkbox on Form 14457 to allow a taxpayer to indicate the inability to fully pay. But the IRS changed its policies in 2024 and has been retroactively applying its new policies to cases already accepted into the VDP.²¹

If a taxpayer now indicates an inability to fully pay, the IRS will demand full payment or a full pay installment agreement. The IRS will also 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 in a lump sum or enter into a viable full pay installment agreement. The involvement of an IRS revenue officer during an IRS audit can significantly increase the stresses of dealing with the IRS. A taxpayer in the VDP who desires a full pay installment agreement must provide detailed information on assets and income with supporting documents to IRS revenue officers. The 2024 changes prohibiting OICs and partial pay installment agreements in VDP are harsh. Taxpayers who have significant liabilities with few assets are left exposed to potential criminal liability and no avenue to try to proactively avoid criminal prosecution. The IRS changes may reflect a desire to refer more cases for prosecution under 26 U.S.C. § 7202 for the willful failure to pay over trust fund taxes.

Practice tip: If a client's ability to full payment of all taxes, interest, and penalties is in doubt, counsel the client against making a VDP submission.

The hypothetical “Barred from VDP” on the next page illustrates the situation.

²⁰ See generally *United States v. Tenzer*, 127 F.3d 222, 226-28 (2d Cir. 1997) (discussing the taxpayer's failure to comply with bona fide payment arrangements pursuant to then-existing IRS policies).

²¹ For a thorough discussion of the 2024 changes to VDP including the history of the IRS previously allowing less than full payment in VDP cases, see Daniel N. Price, *Is the IRS Trying to Terminate the Voluntary Disclosure Practice?* TAX NOTES (Nov. 25, 2024)

Barred from VDP: Tommy ran a business with many employees. During a business downturn three years ago, Tommy decided to stop 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 \$10 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 three year period, Tommy bought a vacation cabin in the mountains and a new Mercedes G Wagon to get to his cabin. Tommy also spent considerable funds traveling to various vacation destinations. In total Tommy borrowed \$5 million from the business during the period when trust funds were not remitted to the IRS. Tommy closed down the business this year and is going back to school for an MBA.

At present, Tommy's net equity in all assets is only \$300,000.00 (he has no savings; he has no 401(k) plan, and he has no other financial assets; he rents a condo as his primary residence; he took a loan against the vacation cabin; and he wrecked the G Wagon). Further, Tommy has zero prospects of borrowing funds to pay the taxes and penalties owed the IRS.

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 wants 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. Tommy is barred from the VDP.

According to the IRS' rules for VDP, Tommy cannot participate in the VDP.

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.

IV. Other Options

The VDP may not be the right path for a taxpayer to correct past tax mistakes or even past tax fraud. Other options include:

- a. Quite disclosure
- b. Prospective compliance

V. Recommended Reading for Practitioners Who Are Contemplating Their First Voluntary Disclosure

- a. Current version of Form 14457 and instructions
- b. Current portions of the I.R.M. that discuss VDP procedures
- c. Most recently disclosed version of the “Voluntary Disclosure Practice Examiner Guide Paper”
- d. Template closing agreements

VI. Resources and References

The following list provides links to key VDP guidance and resources:

- www.irs.gov/vdp
- [Form 14457](#)
- [I.R.M. 9.5.11.9](#) - relating to Criminal Investigation procedures
- [I.R.M. 4.63.3](#) - relating to civil procedures
- [C.C.D.M. 38.3.1](#) - discussion in the Chief Counsel Directives Manual – Criminal Tax
- <https://www.pricetaxlaw.com/services-offered/voluntary-disclosure-practice>