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Options for Correcting Mistakes and Omissions on Tax Returns

BY JOEL CROUCH

The federal tax system is a voluntary system that relies on taxpayers to file complete and accurate tax returns and other information with the IRS. However, sometimes after a tax return or other information is filed with the IRS, a taxpayer discovers it was incomplete or inaccurate. In order to avoid potential civil or criminal penalties, the taxpayer may want to act. This article discusses some of the options that taxpayers have for addressing incomplete or inaccurate tax filings.

In situations where there was a fraudulent position taken on a tax return and the taxpayer is concerned about potential criminal exposure, the taxpayer can make a voluntary disclosure to the IRS. Although voluntary disclosure to the IRS does not automatically guarantee immunity from prosecution, as a matter of practice the IRS will not pursue criminal charges against a taxpayer who meets the requirements of the voluntary disclosure program. A voluntary disclosure occurs when a taxpayer timely, truthfully, completely and voluntarily notifies the IRS about an inaccuracy in a tax return or other document filed with the IRS. A disclosure is timely only if it is made before the IRS has provided notice of its intent to initiate, or has initiated, a civil examination or criminal investigation of the taxpayer. In addition, any disclosure must be made before a third party alerts the IRS of the taxpayer's noncompliance. A taxpayer who is concerned that a former spouse, disgruntled employee, or former business partner may provide information to the IRS should consider making a voluntary disclosure before someone else contacts the IRS.

An IRS voluntary disclosure is initiated by completing and filing IRS Form 14457. If the IRS accepts the taxpayer's voluntary disclosure, the taxpayer must file all required returns and reports, and pay any additional tax and interest for the six most recent tax years. The returns will be assigned to an IRS examiner for review and the taxpayer must cooperate with the IRS examination. A taxpayer who fails to cooperate will be kicked out of the voluntary disclosure program and be subject to all available civil and criminal penalties. For most taxpayers in the program, the IRS will assess one 75 percent civil fraud penalty for the year with the highest tax liability. In cases involving undisclosed foreign bank accounts, the IRS will typically cap the penalty at 50 percent of the highest year's account balance.

In situations involving an inaccurate (but not fraudulent) tax return, a taxpayer can simply file an amended tax return that corrects any omission or inaccuracy and, in most cases, the amended return will be a Qualified Amended Return (QAR) and the IRS will not assess a penalty. A QAR is defined as an amended return filed after the due date of the original return and before (1) the taxpayer is first contacted by the IRS regarding an examination or (2) the date a summons is served on a third party with respect to an activity of the taxpayer for which the taxpayer directly or indirectly claimed a tax benefit.

Taxpayers who fail to report foreign financial assets and pay all tax due on those assets have the alternative of using the Streamlined Filing Compliance Procedure (SFCP). The SFCP procedure is available to taxpayers certifying that their failure to report foreign financial assets and pay all tax related to those assets did not result from willful conduct on their part. In addition to paying any additional tax due, a miscellaneous offshore penalty equal to five percent of the highest aggregate value of the taxpayer's unreported foreign financial assets may be applicable.

Taxpayers who have paid all their taxes, but who have not filed a required Report of Foreign Bank and Financial Accounts (FBAR) (FinCEN Form 114), can use the Delinquent FBAR Submission Procedure. The IRS will not impose any penalty if the taxpayer has not previously been contacted regarding an income tax examination or a request for delinquent returns for the years for which the delinquent FBARs are submitted.

Finally, taxpayers who have paid all of their taxes, but who have not filed one or more required international information returns, can use the Delinquent International Information Return Submission Procedures. The IRS will not impose a penalty for failure to file the delinquent international information returns if the taxpayer has reasonable cause for not timely filing the information returns and has not previously been contacted by the IRS about the delinquent information returns. **HN**

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