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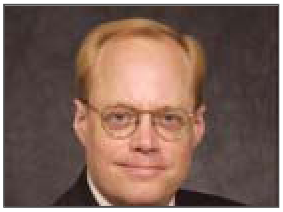

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FATCA Blues? Opt Out of IRS Offshore Program

Anyone with undisclosed foreign accounts or income should get some advice and consider how to address the problem. Violations are serious and can carry civil and criminal penalties. See Undisclosed Foreign Bank Accounts? They're Even More Explosive Now. The IRS Offshore Voluntary Disclosure Program (OVDP) may not be perfect for everyone, but it's one clean and finite way of getting beyond the fear of discovery and prosecution.

If you are evaluating the current 27.5% miscellaneous offshore penalty and cringing about how much it will hurt, what about opting out? There's much talk about opt-outs but relatively little data so far. It might be smart or might be going from frying pan to fire. It is clear the opt-out election is irrevocable and is typically made after the IRS has calculated a proposed miscellaneous offshore penalty.

The IRS says you may be better or worse off if you opt out. You can try for small penalties, but once outside the program, the IRS may assess the civil fraud penalty, information return penalties or even pursue criminal prosecution (although that has evidently not happened to anyone yet). According to the Taxpayer Advocate Service, about 310 taxpayers opted out of the 2009 and 2011 offshore voluntary disclosure programs.

One thing that meant was delays. For 2009 Offshore Volunteer Disclosure Initiative (OVDI) opt-outs, the IRS took approximately 550 days to close the case after the opt-out election. For 2010 OVDI opt-outs, the IRS took approximately 176 days. Most opt-outs so far appear to have involved small dollars, which seems counterintuitive. If there are large dollars at stake, the incentives to opt-out are higher.

Yet, potential FBAR penalties for larger accounts can be enormous. For example, if the maximum account balance to which an FBAR violation relates exceeds $1 million, a willful FBAR penalty under an opt-out could be the greater of $100,000 or 50% of the closing balance in the account as of the last day for filing the FBAR. You might assume that opting out should reduce your overall penalty exposure below the 27.5% range, but the statutory FBAR penalties after the opt-out might be the same or worse.

Of course, the taxpayer can argue that FBAR penalties are inappropriate after the opt-out election is made. However, the IRS can seek to impose FBAR penalties ***per account***, per year. The IRS may do what it sees as rough justice by calculating statutory FBAR penalties that end up approximating the 27.5% miscellaneous offshore penalty. Certain income tax calculations could be worse too.

If passive foreign investment company (PFIC) issues are involved, the amended tax returns submitted as part of the final OVDP packet will need to be modified to reflect the statutory PFIC computations (rather than the specialized mark-to-market computations within the OVDP). Some advisers believe the IRS may also be more likely to assert additional income tax penalties after an opt-out, such as civil fraud. Civil fraud can trump the statute of limitations, so if you opt-out, the IRS may examine tax years ***prior*** to the OVDP's 8-year disclosure period.

Plus, past admissions—and even the OVDP submission material themselves—can be used against the taxpayer during the opt-out examination. Thus, it is important to consider what you've told the IRS prior to making the opt-out election. Bottom line? Although there's a good deal of talk of "Oh you can always opt-out," there is no reward without risk.

Opting out can be going from the frying pan to the fire. The OVDP is designed to be predictable and that is one of its great features. In many cases, the potential risks of opting out may not offset the potential rewards. That makes individual advice about a particular case and its facts all the more important.

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