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IRS Closing Offshore Account Amnesty, Here's How To Cut Huge Penalties

Undisclosed foreign accounts or income can trigger big civil penalties, conceivably even criminal prosecution. Since 2009, many foreign accounts and income came within the IRS's enormous offshore enforcement efforts. Nearly 10 years on, not everyone has entered the IRS Offshore Voluntary Disclosure Program (OVDP). The program is closing, but there is still time to get in under

the wire. The OVDP involves a formulaic deal where at least the penalties are capped. The program isn't perfect, but it is a finite way of getting beyond the fear of discovery and prosecution. And with FATCA, the IRS now has an easy time finding just about anyone's account, no matter how cleverly hidden. That's why stepping forward before it is too late is safest.

For most people, paying the taxes, interest and penalties, even on up to 8 years as the OVDP requires, is not so bad. It is the bigger *account-based* penalty in the OVDP that is the hardest to swallow. It can be either 27.5% or 50% of the highest value of your account over the 8 year period. That penalty is simply part of the OVDP. Yet if you enter the OVDP, the prospect of opting out can be worth considering, before you pay all the penalties and sign the closing agreement. Enter the program to opt out? It sounds odd, and it certainly isn't for everyone. But on the right facts, it can make a world of difference to the bottom line.

The opt-out election is irrevocable, and is typically made after the IRS has calculated a proposed miscellaneous offshore penalty. That might be a year or more after you enter the program. By then, you will have fully complied and fixed all of your errant reporting. You have also paid all the taxes and interest you owed, plus penalties on your under-reporting. But the biggest penalties are based on the size of your account, and that is what can be at stake in an opt out. Of course, an opt out carries risks too. The IRS may assess civil fraud penalties or information return penalties. The IRS can also interview the taxpayer, although most interviews are over the phone.

According to the Taxpayer Advocate Service, over 1,000 taxpayers opted out of the 2009 and 2011 offshore voluntary disclosure programs. One thing it meant was delays. For 2009 opt-outs, the IRS took about 590 days to close the case after the opt-out election. For 2010 OVDI opt-outs, the IRS took a more streamlined 129 days. Most reported opt-outs involved small dollars, which seems counter-intuitive. For some tax lawyers, the situation is the reverse, where most opt outs they handle involve big money. After all, the incentives to opt-out seem much higher if large dollars are at stake.

If you might pay a $50,000 penalty in the OVDP, opting out probably can't save you too much, even if you end up with non-willful penalties. A $500,000 penalty within the OVDP, however, may make opting out hard to resist, particularly if you have good facts and no evidence of willfulness or evasion. If you face a $1M penalty or higher, it may be even more compelling. On the other hand, potential FBAR penalties can be high. If the maximum account balance exceeds $1 million, a willful FBAR penalty could be the greater of $100,000 or 50% of the account balance. The taxpayer can argue that FBAR penalties are inappropriate after opting-out. However, the IRS can conceivably seek FBAR penalties per account, per year.

If there are passive foreign investment company (PFIC) issues, the amended tax returns submitted as part of the OVDP may need to be modified to reflect

statutory PFIC computations, not the OVDP's mark-to-market computations. Some advisers believe the IRS may be more likely to assert additional income tax penalties after an opt-out. But this has not been our experience. Indeed, the opt out results can be quite dramatic on the right facts. Past admissions, even OVDP submissions themselves, can be used against the taxpayer if he or she opts-out. Thus, it is important to consider what you’ve told the IRS prior to making the opt-out election.

Bottom line? The OVDP is predictable. Opting out is much less so, but the time and expense can pay huge dividends. If you have no evidence of willfulness, the sheer numbers may make opting out attractive. Individual advice about the particular facts is important. And facts that might suggest willfulness may be especially so. How about moving money from one bank to another when the banks turned away undisclosed American accounts? That does not always spell willfulness. Some taxpayers do not understand what their advisers or bankers are doing. Even legal entities, shell companies set up to hide someone's identity, do not necessarily preclude opting out. For those with the right facts and a willingness to endure some risk, opting out can sometimes save large dollars. It can be worth evaluating carefully, in some cases even as one enters the program.

For alerts to future tax articles, email me at Wood@WoodLLP.com. This discussion is not legal advice.