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Should you opt-out of the IRS Offshore Voluntary Disclosure Program

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On June 2, 2011 the [IRS](#) issued a new series of Frequently Asked Questions (FAQ's 51.1-53) which provide advice on when it is better to "opt-out" of the Offshore Voluntary Disclosure Initiative ("OVDI") The FAQ's presume that the taxpayer has made a voluntary disclosure under the 2009 or 2011 programs. The purpose of the voluntary disclosure is to provide reasonable assurance to a taxpayer who comes forward, before an investigation is started, that if they truthfully disclose all facts and circumstances about their unreported account and all unreported income, they will be relieved of the risk of prosecution. The FAQ's provide guidance on when, in the opinion of the [IRS](#), taxpayers can or should the "opt-out" and when they should not. The missing element in the FAQ's is whether the taxpayer should or should not enter the OVDI program at all. Not entering the OVDI program is necessarily a very serious decision and should only be made with advice of counsel.

An example of someone who may consider not entering the OVDI is a "dual national" who lives abroad and has fully reported all income in the other country, and has filed U.S. tax returns and has omitted interest income earned in financial accounts held in the other country. If, after all tax credits are applied, there is no U.S. income tax due, then the risk of prosecution is likely to be low. This person may just want to file the unfiled FBAR's with a reasonable cause explanation.

Entering the 2011 OVDI program means that among other things, all applicants must pay the amount of tax, interest, and an accuracy related penalty (20%) and if applicable, failure to file penalties at the time of submission of the voluntary disclosure letter. A limited exception is provided if full payment cannot be made at the time of submission. All unfiled FBAR's and other unfiled information returns must also be filed. The miscellaneous civil penalty (also known as the FBAR penalty) will be determined by the revenue agent who audits the voluntary disclosure and submitted documents. The 2011 FBAR penalty is 25% of the highest single year aggregate value of the taxpayer's foreign financial assets. The FBAR penalty is proposed at the end of the audit and then the taxpayer has the option of agreeing or "opting out". It is worth a very careful consideration of the time and expense of getting to the "opt-out" point when making the decision to enter or not enter the OVDI program. In the right factual circumstances, the decision not to enter the program may be reasonable. An inappropriate "opt-out" can result in possible referral for prosecution, and in a willful case FBAR penalties of 50% of account balances per year and civil fraud penalties of 75% of the tax per year.

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