

Alerts and Updates

HSBC INDIA ACCOUNTS SOUGHT BY IRS: TIME RUNNING OUT FOR IRS VOLUNTARY DISCLOSURE BY HSBC INDIA CUSTOMERS

April 13, 2011

On April 7, 2011, the U.S. District Court for the Northern District of California issued an order authorizing the Internal Revenue Service ("IRS") to serve a "John Doe" summons requesting information from one of the world's largest banks, HSBC, regarding U.S. residents who may be using accounts at HSBC in India to evade federal income taxes. If HSBC produces these records, which is likely, it may be too late for U.S. taxpayers with undisclosed HSBC accounts to take advantage of the IRS Voluntary Disclosure Program for offshore accounts.

The Petition to Serve the Summons on HSBC

On April 7, 2011, the U.S. Department of Justice filed a petition in support of its request for authority to serve the summons. According to the petition, a federal grand jury in Newark, N.J., indicted an HSBC account holder, charging him with conspiracy to defraud the United States by using undeclared accounts in the British Virgin Islands and at HSBC India to evade his income taxes. According to the indictment, employees at HSBC Holdings plc and its affiliates operating in the United States assured the depositor that accounts maintained in India would not be reported to the IRS. The indictment further charged that HSBC India employees advised and assisted the customer in concealing his Indian accounts from the IRS by:

- dividing transferred funds into increments of less than \$10,000 in order to "stay below the radar";
- directing HSBC India to send Indian account statements to the depositor's father residing outside of the United States;
- transferring funds from other foreign accounts to HSBC India after converting the funds to non-U.S. dollar denominations to avoid using the U.S. banking system;
- withdrawing funds from HSBC India in amounts less than thresholds that would trigger reporting to governmental authorities; and
- falsely assuring the depositor that the Indian accounts would not be reported to the IRS.

In 2002, HSBC's website stated that HSBC India opened a "representative office" at an HSBC USA office in New York City to enable "nonresident Indians" ("NRIs"), living in the United States to open accounts in India. In 2007, HSBC India opened a second representative office at an HSBC office in Fremont, Calif., purportedly to make banking transactions more convenient for the NRI community based in California. According to the petition, NRI clients have told IRS investigators that NRI representatives in the United States assured clients that they could invest in accounts at HSBC India without paying

U.S. income tax on interest earned on the account, and that HSBC would not report the income earned on the HSBC India accounts to the IRS.

The Declaration Supporting the Petition for the Summons

The federal government's petition for leave to serve the John Doe summons is supported by the declaration of Daniel Reeves, a senior advisor and project manager of the IRS Office of Compliance Initiative Programs. He has specialized in offshore investigations since 2000. Reeves has been the lead investigator for the IRS's Offshore Credit Card Project, Offshore Private Banking Initiative and other offshore compliance initiatives since 2003.

Reeves' declaration states that the IRS is now investigating U.S. taxpayers who directly or indirectly have signatory authority over financial accounts at HSBC USA's affiliate foreign bank, HSBC India, and who may not be in compliance with the IRS's laws on reporting foreign financial accounts and income earned on those accounts. According to the declaration, U.S. clients of HSBC USA could transfer funds directly from their HSBC USA accounts to HSBC India. U.S. clients of HSBC India could transfer funds from their accounts at other U.S. banks to HSBC India by writing checks on their U.S. accounts and sending them to a designated "lockbox" maintained by HSBC USA / NRI Services in Pittsburgh, Pa. NRI Services would clear the checks through HSBC USA, which would then transfer the funds to HSBC India.

According to the declaration, in addition to offering "standard" banking services at HSBC India through its NRI Program, HSBC offered an enhanced personalized banking service for high net worth individuals called HSBC Premier. This service provided round-the-clock international services with worldwide access to account information, regardless of where the client was located. HSBC Premier is described as "relationship banking without boundaries" that "enables customers to access all of their local and international accounts from a single online view and provides free international funds transfers between the accounts." In order to open an HSBC Premier account, HSBC customers must maintain a minimum relationship balance (*i.e.*, cash deposits plus investments) through HSBC of at least \$100,000. Premier accounts could be managed from anywhere in the world through online integrated banking. Funds could be accessed and withdrawn anywhere and at anytime through the use of a linked Premier MasterCard debit card that could also serve as a credit card.

The declaration states that as a foreign bank, HSBC India had no obligation to—and does not in fact—issue IRS Forms 1099 reporting to its U.S. clients income paid in India. Nor does HSBC India file corresponding Forms 1099 with the IRS reporting the income earned by U.S. taxpayers on their HSBC India account.

While India is not considered a tax haven or a financial secrecy jurisdiction, the information obtained by the IRS as stated in the declaration suggests that U.S. account holders at HSBC India have not disclosed the existence of their accounts at HSBC India, nor have they reported income earned on those accounts. Instead, they have relied on the lack of third-party reporting to support their decision not to report the existence of those accounts, with the expectation that the IRS would not discover the accounts or omitted income.

IRS Asserts That HSBC India NRI Customers May Have Failed to Report Foreign Accounts and Income

According to the declaration, HSBC USA has advised representatives of the United States that, as of September 2010, there were approximately 9,000 U.S. residents who were "Premier" clients of HSBC and had NRI deposits at HSBC India. As of December 2009, according to HSBC USA, U.S. resident Premier clients had NRI deposits of nearly \$400 million. According to the IRS, for calendar year 2009—the most recent year in which information is available—there had been only 1,391 reports made by HSBC accountholders on an FBAR (TDF 90-22.1, Report of Foreign Bank and Financial Accounts)

disclosing a mere 1,921 accounts at HSBC India. According to the IRS, this indicates that thousands of U.S. taxpayers of Indian origin who maintain more than \$100,000 in accounts with HSBC may have failed to disclose HSBC India accounts to the U.S. government. It is also likely that those taxpayers may have failed to report income earned on those undisclosed accounts.

Internal Revenue Service agents have interviewed other U.S. clients of HSBC India who confirmed that NRI representatives in the United States assured them that they could invest in accounts at HSBC India without paying U.S. income tax on interest earned on the accounts and that HSBC would not report to the IRS income earned on the HSBC India accounts. The U.S. clients had deposits at HSBC India, ranging from \$700,000 to more than \$1 million.

The Information Sought by the IRS from HSBC

The documents sought by the summons are for each U.S. taxpayer who at any time during the years ended December 31, 2002, through December 31, 2010—directly or indirectly—had interests in or signature authority with respect to any financial accounts maintained by, monitored by or managed through HSBC India. The specific records sought include, but are not limited to:

- documents identifying each such client by name, address, telephone, date of birth and taxpayer identification number;
- documents pertaining to any foreign entities through which such client has an interest in the financial account;
- documents identifying any relationship managers, domestic and foreign, for each such client;
- documents pertaining to the opening of the account, for the establishment of the foreign entities created, including but not limited to account applications, signature cards, desk files or other records of the relationship manager's emails, facsimiles, memoranda of telephone conversations, memoranda of activity and other correspondence;
- documents, including monthly or periodic account statements and records of wire transactions and other compilations of such data reflecting the activity of the financial accounts; and
- copies of any communications, including correspondence, facsimiles, emails or records of oral or telephonic communications between HSBC Bank USA or HSBC India and such clients relating to the subject of the clients' tax and information reporting obligations with respect to the HSBC India accounts.

What Is Likely to Happen and What Can an HSBC Customer Do?

Although it cannot be stated with certainty, it is likely that HSBC will comply with the summons, just as UBS complied with the IRS summons served for the records of its U. S. customers. Compliance with the summons may result in perhaps more than 10 thousand HSBC customers' records being provided to the IRS. The IRS will examine these records to determine if each of the HSBC accountholders reported the account and its related income. If not, the HSBC accountholder could face the prospect of criminal prosecution by the U.S. Justice Department and the certainty of an examination by the IRS and the imposition of additional taxes, interest and penalties.

HSBC accountholders who want to avoid the excessive penalties that may be imposed by the IRS may consider the 2011 IRS Offshore Voluntary Disclosure Initiative ("OVDI") announced in February. We reported on this initiative in our February 9, 2011, *Alert*, "[IRS Announces New Voluntary Disclosure Program](#)," and in our March 31, 2011, *Alert*, "[IRS Voluntary Disclosure \"Penalty Framework\" for Offshore Accounts](#)." However, the OVDI is not for everyone; and in some instances, the penalties and taxes imposed by the OVDI will be higher than those otherwise available outside the OVDI.

Is Voluntary Disclosure Right for You?

The factors involved in determining whether a taxpayer should make a voluntary disclosure are numerous and complex. A taxpayer considering making a voluntary disclosure may want to discuss the matter with experienced legal counsel. Such a discussion with legal counsel would be protected from disclosure by attorney-client privilege, which is particularly vital in instances where the taxpayer ultimately decides not to make the disclosure. However, a consultation regarding the voluntary disclosure program with a non-attorney (including the taxpayer's accountant) is not a privileged communication. If the decision were made not to enter the OVDI, and the IRS discovers the foreign financial account, the taxpayer's accountant or other non-attorney could become a witness for the IRS against the taxpayer. This would not be the case if an attorney, rather than an accountant or other non-attorney, had been consulted.

A taxpayer contemplating a voluntary disclosure also may want to consider the differences in the financial consequences of participating in the OVDI, opting out of the OVDI or making a traditional voluntary disclosure. (It is not known at this time, but it appears the IRS may initially process all voluntary disclosures of offshore issues through the OVDI.) In many instances, the OVDI would involve more years, higher taxes and significantly larger penalties than a traditional voluntary disclosure. Taxpayers participating (willingly or not) in the OVDI may face an IRS unwilling to negotiate, notwithstanding facts supporting the reduction or elimination of penalties. Taxpayers who believe their situation warrants reduced penalties may be advised by the OVDI agents that they can opt out of the OVDI and take their chances in a full-blown examination. Before that decision is made, however, a taxpayer must perform a careful analysis of the facts surrounding the case. That analysis should be directed at determining:

- exactly what years are open under the statute of limitations (possibly less than the eight years under the OVDI);
- the magnitude of additional tax and interest due;
- what tax penalties are applicable (fraud, accuracy-related or none); and
- what additional information-return penalties may apply in cases involving foreign accounts, trusts, gifts, corporations and other business entities.

Key to this analysis are issues regarding negligence, fraud, willfulness, mitigation, burden of proof (on the taxpayer or on the IRS) and quantum of proof (clear and convincing, or mere preponderance of the evidence).

Only after a thorough review of an HSBC accountholder's particular situation should a decision be made regarding whether a voluntary disclosure should be made and, if so, whether it should be made pursuant to the inflexible OVDI or through potentially less-rigid traditional means.

For Further Information

If you would like more information about voluntary disclosure for offshore accounts, please contact [Thomas W. Ostrander](#), the author of this *Alert*; [Hope P. Krebs](#) or [Stanley A. Barg](#) in Philadelphia; [Jon Grouf](#) in New York; [Anthony D. Martin](#) in Boston; any member of the [International Practice Group](#); [Michael A. Gillen](#) of the [Tax Accounting Group](#) or the attorney in the firm with whom you are regularly in contact.

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