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HSBC India Jettisons U.S. Clients to Avoid the Wrath of the IRS

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International Banks Now Wary of the Kind of IRS Action that Penalized UBS.

On July 6, The Hong Kong and Shanghai Banking Corp. of India (HSBC India) began sending letters to its U.S. customers informing them that it is terminating all "private banking services to U.S. Persons and certain trusts and non-operating companies connected to U.S. persons." The letter goes on to state that the customer is forthwith given 30 days from the date of the letter to close out their account with the bank. All investment accounts, credit cards and banking activities must likewise be terminated. The letter concludes by advising the recipient to consult with a tax advisor, and refers to the IRS voluntary disclosure program that ends on August 31, 2011, for most filers.

The letter comes on the heels of an April 7 Department of Justice request that a federal judge issue a "John Doe" summons on HSBC India that would require the bank to produce all the names of U.S. persons with accounts in India. The DOJ and IRS suspect that these residents may be using HSBC India accounts to evade U.S. taxes.

The DOJ/IRS action marks a further step in its pursuit of those who would evade paying U.S. taxes, along with the foreign banks who might be, knowingly or not, providing places to hide money. Such an aggressive move resulted in the Swiss banking giant UBS being forced to turn over the names of thousands of U.S. account holders in 2008. For its part in the business, UBS was fined \$780 million in 2009. Obviously, HSBC wants to divorce itself from any similar taint or liability.

It is estimated that over 9,000 accounts belonging to U.S. citizens are on the books of HSBC India. HSBC is required to comply with the U.S. demands under international law and the U.S.-India Income Tax Treaty that provides for mutual assistance when either government requests information. This latest development is further evidence of the IRS being aggressive in pursuing noncompliant taxpayers with accounts outside the U.S.

HSBC has long established business relationships with many Americans of Indian origin (AIOs), including active operating companies. The bank's sudden announcement presents a significant challenge to many investors and business executives, given the short notice of termination.

The HSBC letter is similar to the correspondences from the Swiss banks to their U.S. customers in 2008, although the harshness and tone of HSBC's missive has all the subtlety of a sledge hammer. Unfortunately, while the reaction relates to some Americans that haven't properly complied with U.S. tax laws, the action of HSBC is to throw all U.S. persons out on the street.

The Repercussions Are Many.

With the closing of investment accounts as well as bank accounts, many of these funds will be moved to the U.S. The change in taxpayer profiles in the IRS computers is likely to create tax audits for many AIOs. If they are audited, and the individual has not previously reported the

foreign accounts, the IRS can impose a 50% per year penalty on the balances in the accounts. If HSBC turns over all the U.S. names, the IRS will not even need the computer profiling. The IRS will receive their "hit" list directly from the HSBC.

If the noncompliant individuals volunteer to participate in the Offshore Voluntary Disclosure Initiative (which expires August 31) and confess their sins, the FBAR penalties would be limited to 25% of the maximum amount in their foreign accounts (plus the value of certain assets) for the past eight years, plus the tax, interest and penalties on any unreported income. The individual will also be subject to having his returns from these years audited.

Example of penalties:

YRS	CASH BALANCE	IF AUDITED 50% PENALTY PER YR	IRS VOLUNTARY DISCLOSURE PROGRAM 25% NON-NEGOTIABLE PENALTY
1	\$300K	\$150K	
2	\$300K	\$150K	
3	\$400K	\$200K	\$400K x 25% = \$100K FBAR penalty
4	\$200K	\$100K	
5	\$200K	\$100K	
6	\$200K	\$100K	
Total penalties		\$800K	\$100K

If the U.S. person moves the account to another foreign bank and does nothing to correct the deficiencies of past years, and should the IRS ultimately obtain all the names and follow up, such movement of funds may constitute criminal tax evasion if the IRS interprets such actions as constituting active concealment.

What Are the Taxpayers' Alternatives?

We have been advising many individuals about these rules over the past two years, since the first voluntary disclosure program was announced in March 2009. The IRS pressure on HSBC and the 30-day timeline for persons to make decisions in this area will create significant disruption to many U.S. persons who have filed correctly and have nothing to fear. For individuals that have not complied, the decisions and actions they take in this area will likely have significant financial impact and should not be made without proper advice.

When the 2009 volunteer disclosure program was announced, we forwarded our own concerns and questions about the program to the IRS. We expressed concern about the lack of clarity in the rules, and determined that the IRS program was not the best alternative for many taxpayers; and we asked that the Service clarify how penalties would be determined.

Unfortunately, many advisors encouraged their clients to immediately notify the IRS and to participate in the program. As the rules and penalty regime within the program became clear, it became evident that the cost and penalties assessed in the program were excessive, and that participating in the volunteer disclosure program for many was a poor decision.

The 2011 program that will expire on August 31 may provide a safe haven for those who have exposure to criminal prosecution. However, advisors today are somewhat less eager to pitch their clients into the IRS program, given that many individuals have reasonable cause for their past years' oversight. The 25% penalties being levied in IRS program are non-negotiable even though individuals often meet what is established case law that defines "reasonable cause" that should result in the abatement of such penalties. The IRS is taking a particularly narrow and

harsh interpretation of reasonable cause. For this reason, many U.S. persons in the program are now considering withdrawing from the 2009 program. If they withdraw, they take their chances at the local level to have their return and facts audited in the normal course.

Today, tax professionals are often advising their clients not to go into the volunteer disclosure program. Instead, many of these clients are being advised to file amended returns and late FBARs (Foreign Bank Account Reports) and to only pay the taxes due on unreported income. Depending on the circumstances, this may be the right path to take, in order to come back into compliance without the often inequitable 25% penalty imposed by going through the IRS program. Since each person's facts are unique, it's best to seek qualified advice before taking action.

Corporate Action Required

Another aspect of the FBAR reporting often overlooked is the corporate reporting requirements where U.S. persons (officers and directors) have signature authority over foreign accounts in the name of a U.S. company, or a foreign affiliate. It's not yet clear whether the IRS will pursue corporate violations with the same vigor and intensity as with personal oversights, but companies need to consider their own liability and the potential liability for their officers and directors that have signature authority or interests in foreign accounts.

The IRS had extended the due date for companies to catch up on corporate oversights to June 30, 2011. While this date has passed, companies should nevertheless catch up on past delinquencies, and notify impacted individuals to minimize the risk of penalties or potential employee liabilities down the road. It's clear that the IRS will continue to pursue delinquencies in this area for some time to come.

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