Indictment of Offshore Account Holder Portends A New Round of Aggressive Enforcement

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On Wednesday January 26, 2011, federal prosecutors in Newark, New Jersey indicted Mr. Vaibhav Dahake on charges of conspiracy to defraud the United States by concealing bank accounts in India and the British Virgins Island. This indictment appears to be the opening salvo in a new and likely aggressive enforcement action against Americans with undeclared foreign accounts, as well as their banks, bankers, and third party advisors.

Background of Indictment

Media reports within the last six months have alluded to letters being sent by the U.S. Justice Department's Tax Division to various members of the Indian business community in the United States, identifying them as potential targets of a criminal tax investigation relating to undeclared foreign accounts. The indictment last week appears to be the first criminal charges to emerge from this inquiry.

Mr. Dahake is originally from India but became a naturalized United States citizen in 2006 and now resides in Somerset, New Jersey. The charges against him relate to his relationship with an international bank,

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which several published reports claim is HSBC Holdings PLC, from 2001 until around 2010. The indictment alleges in detail certain activities between Mr. Dahake and five unnamed co-conspirators, all of whom were account managers at the international bank either in the United State or India.

According to the indictment, the bank solicited Mr. Dahake to open an Indian account through which he could transfer funds from the United States and undeclared bank accounts held in a British Virgin Island bearer share corporation to India without reporting the transactions to the United States and without paying U.S. taxes. The indictment claims that the bank, through a U.S. division named NRI Services, tailored this scheme specifically to U.S. citizens of Indian descent.

Sometime in 2001, Mr. Dahake allegedly met with a bank manager in New York City to discuss the advantages of opening an undeclared bank account in India. The indictment charges that the account manager informed Mr. Dahake that if he opened an account in India, he would not be required to file any U.S. forms or even provide his social security number. The manager claimed that the account was not taxable in India and that the bank would not file Form 1099 with the IRS reporting the interest income Mr. Dahake would receive.

Apparently, also on the advice of this account manager, Mr. Dahake transferred the funds required to open the account from the United States by writing several checks of $10,000 rather than one large check, in order "to stay below the radar." Mr. Dahake instructed the bank that all account statements were to be sent to his father's address in India rather than his own home address in the New Jersey.

The indictment alleges that a different U.S. account manager advised Mr. Dahake on how he could transfer funds from his BVI corporation to India without reporting or paying taxes on the transaction in the United States. Specifically, this account manager instructed Mr. Dahake to convert the funds to British pounds or euros before wire transferring them. He explained that by virtue of the bank being British and having correspondent banks around the world, the funds could be transferred without passing through the U.S. banking system.

The allegations involving the India account managers relate to the structuring strategy they purportedly recommended to enable Mr. Dahake to repatriate earnings from his account without reporting the income or paying taxes. This plan allegedly involved purchasing bank checks in India in the amount of $9,500 and opening a "Premier Account" in order to take advantage of online banking and use of a debit card linked to the account. A third U.S. account manager advised that Mr. Dahake and his wife should avoid coming back to the U.S. with more than $10,000 each. To this effect, he recommended that they each withdraw $2,000 of cash from the account in India and additionally that they each purchase traveler's checks in the amount of $7,000. (It is a felony in the United States to "structure" transactions in order to avoid the requirement to report international movements of more than $10,000 in cash.)

Federal prosecutors also allege that bankers dissuaded Mr. Dahake from repatriating all of his money in India to the United States after he became concerned that the Swiss bank UBS had entered into a deferred prosecution agreement with the U.S. Department of Justice ("DOJ"). The third U.S. bank account manager apparently assured Mr. Dahake that the bank did not intend to comply with U.S. reporting requirements regarding the account and that the IRS was focused primarily on accounts maintained in the Caribbean. The account manager allegedly also offered to introduce Mr. Dahake to bankers in Singapore and Hong Kong if he wished to move his funds there.

Federal prosecutors claim that as part of the conspiracy Mr. Dahake filed "false and fraudulent" income tax returns and failed to file required forms (FBARs) with the Department of Treasury with respect to his undeclared bank accounts.

Implications of Indictment

It appears from the timing of this indictment that the criminal prosecution of Mr. Dahake sets the stage for the DOJ and IRS to attack the

culture of secrecy apparently promoted by certain HSBC bankers, much as it did with UBS earlier. In all likelihood, the DOJ will follow the same road map that proved successful in penetrating UBS's bank secrecy. Specifically, expect the DOJ to engage in a three-front attack.

(*a*) *Criminal Investigation and Likely Disposition*

The first approach arises directly from the criminal indictment of Mr. Dahake — a criminal investigation of the bank, again possibly HSBC, itself. This is precisely what occurred with UBS. In 2007, a wealthy Los Angeles area real estate developer provided information regarding his UBS private banker in exchange for a plea deal. The banker, Bradley Birkenfeld, was then arrested and cooperated with authorities by providing his client list as well as documents reflecting a decade-long set of marketing practices by UBS aimed at encouraging U.S. account holders to commit tax fraud. In response to these disclosures, UBS publicly expressed willingness to cooperate with American investigators and subsequently notified all its American clients with undeclared accounts that their private banking arrangements would be terminated unless they agreed to convert their accounts to "declared" status.

The DOJ did not stop there. The paper trail led to a senior UBS bank official, who was indicted on one count of criminal conspiracy. After implicating a senior manager in criminal activity, the DOJ had grounds under U.S. principles of corporate criminal liability to prosecute UBS itself. This of course led to UBS entering into a now famous deferred prosecution agreement whereby UBS paid $780,000,000 and agreed to disclose the names and information of over 250 U.S. persons holding undisclosed accounts in exchange for resolving all criminal and most civil issues arising from the bank's involvement in facilitating U.S. tax evasion.

There is no public indication that Mr. Dahake has entered into a plea agreement with U.S. authorities, but the level of detail in the indictment suggests that he may be cooperating already. If he does plead guilty, Mr. Dahake will continue to turn over information regarding the five identified co-conspirators, their bank employers, and other third parties. Such information, and likely cooperation from others, could provide the United States with sufficient evidence to indict the bank itself. Such an action would have far-reaching effects in the global financial system, suggesting that the parties are likely, as in the UBS case, to reach a deferred prosecution disposition. HSBC has already publicly denounced "tax evasion" and proclaimed its support in the "U.S. efforts to promote appropriate payment of taxes by U.S. taxpayers." As with UBS, any deferred prosecution agreement that the bank enters into to avoid criminal and civil charges is likely to include a provision requiring the bank to identify U.S. accountholders to the IRS and DOJ.

(*b*) *John Doe Summons and Treaty Proceedings*

While engaging on the criminal front, the IRS served on UBS offices in Florida a John Doe Summons, which sought the identities and account files of all American clients of UBS in Switzerland who may have held assets in undeclared accounts. This led to protracted summons enforcement litigation and negotiations between the U.S. and Swiss governments to revise treaty provisions in order to facilitate information exchange. Ultimately, in August 2009, the IRS, UBS, and the Swiss government agreed that the bank, using applicable treaty procedures, would turn over 4,450 names of U.S. accountholders that met certain criteria.

Similarly, we expect the IRS to issue a John Doe Summons on the bank at issue in the Dahake case, seeking production of the records of all accounts that it maintained during a particular period for U.S. customers who instructed the bank not to disclose their identities to the IRS. If the bank is in fact HSBC, which has a significant presence in the United States, the IRS could seek to enforce the summons by judicial order, and if the bank fails to comply a court could impose confiscatory financial sanctions for civil contempt.

If this occurs, it is likely that such a case would settle, possibly along the lines of the August 2009 agreement among the IRS, UBS, and the Swiss government, whereby the Swiss agreed to produce names and account information under treaty procedures. If the United States does not already have information sharing agreements

with other countries believed to be harboring undisclosed U.S. accounts, it may use the leverage of this case to bring such countries to the negotiating table.

(c) *Whistleblowers and a New Settlement Initiative*

In 2006, Congress created a new Whistleblower Office in the IRS, to attract informants seeking a reward in exchange for providing information about U.S. tax evasion. Since the beginning of the UBS case, the Whistleblower Office is believed to have attracted tips and informants from private bankers around the world. Similarly, as more information arising from the Dahake indictment comes in, and as the DOJ pursues more indictments, it is likely that other bankers will come forward as whistleblowers in exchange for non-prosecution and the possibility of a financial reward.

During the UBS case, moreover, the IRS instituted a settlement initiative for U.S. accountholders who wanted to make a "voluntary disclosure" of previously undisclosed income and foreign accounts. The initiative was a stunning success, with over 15,000 Americans coming forward to disclose previously undeclared accounts and pay tax, interest, and penalties. It is noteworthy that the indictment of Mr. Dahake was announced only weeks after the IRS Commissioner announced that the Service would soon implement a second settlement initiative for U.S. accountholders to make a "voluntary disclosure" of previously undeclared foreign accounts. This is certainly not a coincidence. Some knowledgeable persons believe the timing of the Dahake indictment is the start of a series of 'clubbed invitations' for American citizens with undisclosed accounts to enter the forthcoming new settlement initiative or risk prosecution.

Conclusion

The template used by the IRS and DOJ in the UBS case worked. We anticipate the same arsenal will now be brought to bear on the bank or banks involved in the Dahake matter. There are likely other account holders under investigation for similar conduct, and there will no doubt be additional indictments or guilty pleas. The result will be series of aggressive steps aimed at both extracting the names and account information of American citizens and residents holding undisclosed foreign bank accounts and pursuing those banks, bankers, and other third parties alleged to be co-conspirators, aiders, and abettors in such conduct. There is little doubt that the IRS and DOJ will pursue all available methods to penetrate the veil of secrecy that allows international bankers to work in the shadows and enabled American citizens and residents to conceal substantial income and wealth.

Anyone who believes they have an account that may be disclosed as a result of this new investigation should immediately consult with a tax attorney and consider making a voluntary disclosure of any undisclosed foreign accounts. Delay, or "hiding and hoping," is not a valid option — once the IRS receives a name disclosure is no longer "timely" and will be denied, subjecting the account holder to potential criminal prosecution, jail, and confiscatory civil money penalties. As this article was going to press, on February 8 the IRS announced a second Offshore Voluntary Disclosure Initiative, valid until August 31, 2011, and offering a new opportunity for U.S. persons with undeclared foreign accounts to escape criminal prosecution and benefit from a set of capped civil monetary penalties.

The looming investigations will not be the last into American citizens and residents having undeclared foreign bank accounts. The continuing influx of whistleblowers, the government's aggressive enforcement tactics and now, the imminent application of the Foreign Account Tax Compliance Act ("FATCA") reporting requirements will soon make American accounts transparent worldwide. Generally, under FATCA, most foreign entities will be required to enter into agreements with the IRS whereby they agree to produce information regarding their U.S. accountholders and U.S. owners. If they fail to do so, any payment of interest, royalties, dividends, or most other income or gross proceeds from the United States will be subject to a 30% withholding tax. It is likely that most entities will comply with the disclosure requirements in order to avoid withholding and, as a result, the IRS will have access to information regarding most of the worldwide foreign accounts held by American citizens and residents. Bank secrecy, at least for this class of persons, will be a thing of the past.