Swiss Banks Move From Tax Havens To Tax Cops ---- By Deborah Ball

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ZURICH -- Swiss banks such as UBS AG are getting tougher with European clients they suspect of dodging home-country taxes, a move that could mark the beginning of the end of this country's mysterious yet lucrative global franchise.

Many Swiss banks conspicuously kicked out their American clients last year after U.S. authorities discovered employees at UBS were helping Americans avoid the tax man.

The banks, which have long allowed foreigners to evade taxes by hiding behind stiff Swiss bank-secrecy laws, weren't as rigorous with European clients who represent a much larger part of their business, industry experts say.

Now, other European governments appear bent on following the U.S. lead to break Switzerland's status as a tax haven. That pressure is prompting Swiss banks to become snoopier with clients in Europe -- even as such prying represents a change from the banks' legendary discretion and can cut their profitability.

"We are in the midst of a transformational period both culturally and operationally," says Ray Soudah, head of Millenium Associates, an adviser to private banks. "Tax-compliant wealth management will become the product in Switzerland, not bank secrecy and a tax haven."

German authorities are sifting through records in search of tax dodgers, after they earlier this year acquired stolen data on offshore accounts in Switzerland. Last year, the French government seized a stolen disc with details of 24,000 Swiss bank-account holders at HSBC Holdings PLC, and authorities there also are looking through the data for tax dodgers. HSBC has acknowledged the theft; criminal charges are pending in Switzerland against a former employee, who is fighting them.

Meanwhile, Italy and the U.K. have launched tax-amnesty programs aimed at flushing tax dodgers out.

Switzerland is home to more than a quarter, or $1.8 trillion, of the world's offshore money. As much as 80% of Europeans' offshore money via Switzerland is undeclared, amounting to hundreds of billions of francs, KPMG estimates. Americans in contrast make up no more than 5% of Switzerland's offshore-banking business, according to analysts.

Offshore accounts can be twice as profitable as onshore because noncompliant clients don't press their bankers as much on fees and are reluctant to shop around for better terms. Peter Thorne, an analyst with Helvea, a Swiss brokerage house, estimates that about a quarter of Switzerland's 4 trillion Swiss franc ($3.7 trillion) private-banking sector could be non-tax-compliant.

Some in the industry are skeptical about the ability of the compliance crackdown to stamp out tax avoidance.

"Who can be sure that someone is a client of only your bank and that what he is showing you in terms of tax compliance is everything he has?" says Konrad Hummler, the president of the Swiss Private Bankers Association and managing partner of Wegelin & Co., Switzerland's oldest private bank.

Compliance measures, he says, are "more about reputational concerns" for the banks. "But in terms of real proof, this is a very, very tricky thing."

UBS maintains it is pushing ahead on foreign tax compliance, even if it means a loss of clients and assets. The bank revamped compliance policies in the wake of the U.S. scandal and is now tightening the rules applied to Europe as well.

"We have to act and cannot just wait for a political solution," says Markus Diethelm, UBS's general counsel.

Adds UBS Chief Executive Oswald Grubel: "When you sharpen up compliance, you lose assets and you also restrict the flow of new clients."

The bank says it has seen clients withdraw hundreds of billions of Swiss francs over the last two years. It declines to estimate how big its noncompliant businesses are or quantify the loss of assets due to tighter compliance.

At UBS, if a client's money is held within structures such as trusts, foundations or companies based in traditional tax havens such as the British Virgin Islands, a UBS banker now must press him to ensure the structure isn't used to avoid taxes, according to Mr. Diethelm. The banker himself must sign a statement swearing the structure is for legitimate purposes.

If a banker suspects an offshore client isn't paying taxes on the money at home, he isn't allowed to travel to visit the customer. UBS bankers also must press clients to take up tax amnesties at home in order to regularize any undeclared money. The bank has tightened up procedures for its relocation department to make sure clients who take up residence in Switzerland in fact live there. If clients don't come clean, UBS could close the account, Mr. Diethelm says.

Elsewhere, Julius Baer, a midsize Swiss private bank, will this year present each offshore German client with an account tax statement, whether the client asks for it or not. The bank may expand the practice to other offshore account holders as well.

At Bank Sarasin & Cie AG, clients suspected of avoiding taxes -- for instance, by asking that account statements not be mailed to their home country -- will no longer be allowed to invest in the bank's full range of investment products and face limits on how actively their accounts can be traded.

When clients have refused to come clean after a certain period of time, the bank has closed their accounts, says a top executive there. Sarasin, which estimates that only 5% to 10% of its assets under management are non-tax-compliant, says it has lost up to about 300 million francs since it clamped down last year.

Tax lawyers say banks are making other unprecedented demands. When a wealthy individual wants to move a trust to a new bank, many banks are demanding that a third party -- for example a lawyer, an accountant or a family member named in the trust -- certify that the structure is tax compliant in his home jurisdiction before taking it on. In a few cases, banks are demanding to see signed tax returns, says Milan Patel, a tax lawyer with Sharp Kemm in Zurich.

"The banks want to say, 'We gave you what you needed to file a tax return,' " says Mr. Patel. "That way a client can't turn around and say the bank helped him avoid taxes. It mitigates the banks' exposure."

Justine Markovitz, head of the Geneva office of Withers LLP, says her law firm has seen an increase in European clients asking for help unwinding structures that banks won't accept any longer, and then building new ones that are fully transparent. She says she also has helped clients whose banks are putting them through fresh due-diligence procedures. To handle the increased business, Withers has raised the number of Geneva-based lawyers handling U.K. clients from two to six in the last several years. In Milan, it has added four lawyers in the past year.

Bank executives and headhunters have noted a slowdown in bankers jumping to a rival in recent months. They say bankers who have large noncompliant portfolios are finding it tough to move, knowing their clients wouldn't likely pass tougher due-diligence procedures.

"If we were to have a [banker] approach us with a noncompliant portfolio, there is no interest in hiring such a person," says Peter Fanconi, head of private banking at Bank Vontobel AG.