

FOCUS: Hopes For Deal In IRS' UBS Case Rise As Trial Nears

By Katharina Bart

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ZURICH (Dow Jones)--Hopes are mounting that UBS AG (UBS) and the U.S. Internal Revenue Service will reach an out-of-court settlement to the tax authority's demand for details on 52,000 account holders who are suspected of dodging taxes.

Those hopes were underpinned by comments from an anonymous U.S. official who told the New York Times that the case may be halted. While the Department of Justice quickly denied it would drop its case against UBS, the denial leaves the door open for a settlement between the two parties.

After Switzerland clinched a double-taxation pact with the U.S. last week, UBS' prospects of settling with the IRS before the case makes it to a Miami courtroom July 13 are looking up. One potential solution could be the handover of a limited amount of client information by UBS, legal and banking experts said. The IRS would then probably use a potential settlement as precedent in dealing with other banks with so-called offshore operations catering to wealthy Americans, the experts added.

The recent U.S.-Swiss taxation deal - the sixth clinched by Switzerland of 12 targeted by the end of the year - is the most tangible indication so far that a UBS settlement could be in the offing.

"Merely by the fact that the U.S. and Switzerland have reached a double-tax agreement which doesn't foresee the automatic exchange of information, logic would infer that the two sides discussed UBS as well at some point, and may have sketched out possible solutions," said Alfred Mettler, associate professor at Georgia State University's Robinson College of Business.

That is because turning over what the IRS seeks - confidential data - would essentially violate Swiss securities law, which forms the heart of UBS' defense. The fundamental difference also means that the court case between IRS and UBS inevitably becomes a matter of state interest.

The Swiss side has been particularly active: Several Swiss business lobbies have stepped up to plead the bank's case, and early in negotiations with the U.S. on a double-taxation pact, Switzerland had hoped it could link the two, but eventually struck a deal without including UBS.

More recently, authorities for both Switzerland and the U.S. have been at pains to separate the recent double-taxation deal, the contents of which haven't been made public, from the UBS case because there is no formal link between the two.

For Switzerland, much more is at stake than UBS' well-being. The U.S. has already said it plans to pursue other offshore banks it believes help tax dodgers. A decision on UBS has implications for other Swiss banks - many of which have sharply curbed business for and with U.S. clients, even those living in Switzerland.

The uncertainty linked not only with UBS but with what a settlement or ruling may mean for other banks is toxic for Switzerland's financial industry, which has long flourished on stability, secrecy and consistency.

So the IRS has leverage it can use to get at the undeclared funds it's ultimately seeking as the July 13 trial date nears.

"I think the IRS has already understood that the problem is not so much with UBS, the problem is with U.S. taxpayers who are committing a crime in the United States and UBS is being used as a scapegoat in this trial," said Arturo Bris, professor of finance at the Lausanne-based IMD business school.

The IRS isn't likely to want to sift through 52,000 sets to client data because it simply doesn't have the staffing and resources to find the worst offenders. That is why the IRS, if indeed willing to settle at all, is likely to hold off as long as possible, or even allow the trial to go forward.

"By keeping the pressure on UBS, the U.S. can increase the number of UBS customers coming forward voluntarily," Deutsche Bank analyst Matt Spick said. Lawyers specializing in tax declaration said clients have emerged in droves to come clean with the IRS.

To be sure, recent history would suggest the IRS has a strong case, and as a result may feel confident enough to see it through the courts. UBS already paid \$780 million in a deferred prosecution earlier this year and - in an unprecedented move - handed over data on 250 clients to avert an indictment. The Swiss financial regulator found evidence of wrongdoing at UBS' offshore arm and ordered the handover.

UBS declined to comment on the court case.

Company Web Site: <http://www.ubs.com>

-By Katharina Bart, Dow Jones Newswires; +41 43 443 8043; katharina.bart@dowjones.com

(Arden Dale in New York contributed to this story.)