Tax loss after conversion of an asset management mandate

Topic: **Asset management** Case number: **2019/11**

> The very elderly client with a foreign residence had for many years had an asset management mandate with a smaller bank that focused on business with wealthy private clients. A few years ago, the client represented by her son had regularised the assets held with the bank for tax purposes in her country of residence. After meeting her tax obligations, the bank’s assets fell below one million Swiss francs. The bank then sold all assets and replaced them with a single in-house asset allocation fund. With the sale,considerable book profits that had accrued over the years were realised. As a result, the client incurred substantial taxes. The bank refused to participate in the tax loss, which the son claimed on behalf of his mother. In the ombudsman procedure, it was finally prepared to pay 50% of the taxes incurred due to the change in the asset management mandate.

The client’s son was particularly disturbed by the fact that he had received a visit from the new client advisor shortly before the changeover of the asset management mandate, but the advisor did not inform him about the planned measures. He also stated that the tax on the profits realised after the death of his already very elderly mother would not have accrued to the heirs and that the bank should therefore have waited for the changeover.

The Ombudsman then contacted the bank and asked it to comment on the case. In particular, he wanted to understand the motives behind the conversion of the asset management mandate, whether the clients had been informed about the changes and the associated risks, and whether any tax consequences had been taken into account in the considerations. The bank was of the opinion that, based on the asset management agreement and the guidelines of the Bankers’ Association for asset management contracts, it did not have to inform the client or his representative about the planned change, but was itself entitled to take the measures without further ado. The new client advisor’s visit to the client’s son had served to get to know him. A discussion of the investments had not been an issue. It had generally decided to no longer manage smaller custody accounts, i.e. those under one million Swiss francs, in the traditional way, but to sell the assets and use the proceeds to acquire a suitable in-house investment strategy fund, which was actively managed. This would be more efficient and also entail lower fees for clients.

Furthermore, the bank informed the Ombudsman that, due to its general terms and conditions, it was solely up to the customers to inform themselves about the tax consequences of the investments. In the context of asset management, the bank was not obliged to take the tax situation of its clients into account when making investment decisions. On the basis of the year-end statements, the client had been informed that considerable book profits had accrued in her securities account. Finally, it pointed out that about half of the changeover had already taken place in 2017 and that the corresponding year-end statement in which these measures were evident had not been contradicted.

The Ombudsman again intervened with the bank and had to inform it that he considered that its statements were largely incorrect and simply no longer up to date. He acknowledged that the bank was not obliged to provide tax advice to the client on the basis of the applicable contractual terms. However, in the absence of prior information, the latter had not been in a position to clarify the tax consequences of the changeover decided by the bank. The Ombudsman was also of the opinion that a bank with international private clients must be aware of the core elements of the tax systems applicable to its clients. In contrast to Switzerland, many countries have capital gains taxes for private individuals. These taxes differ in detail. However, the bank should have recognised that the changeover of asset management mandates could have serious tax consequences for clients subject to capital gains taxes, even if it was not obliged to clarify the client's individual tax situation. It must avoid administrative actions that are so damaging to tax that they jeopardise investment performance. This is part of its duties as an asset manager and has nothing to do with tax advice. In the case at hand, the client lost considerably more than 10% of her investment assets due to taxes alone.

After being confronted with these arguments, the bank showed itself willing to compensate the client for 50% of the taxes incurred as a result of the changeover. The Ombudsman considered this settlement proposal to be appropriate, as the client and her son had failed to object to the end-of-year statement for 2017 and thus prevent further damage. The customer representative accepted the settlement proposal with thanks.