

Update

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Swiss Federal Administrative Court hears Appeals in UBS Cases concerning Discretionary Trusts

Background

On August 19, 2009, the Swiss Confederation and the United States of America concluded an agreement relating to the exchange of information regarding 4,450 bank accounts held directly or indirectly at UBS AG by US persons (the "**UBS Agreement**").¹ Pursuant to the UBS Agreement, a special taskforce established by the Swiss Federal Tax Administration (the "**SFTA**") was charged with processing information received from UBS in order to determine whether the account information was covered by the UBS Agreement and was therefore to be provided to the U.S. Internal Revenue Service (the "**IRS**").

U.S. persons concerned had the right to file an appeal before the Swiss Federal Administrative Court (the "**SFAC**") against final decisions made by the SFTA concerning information to be provided under the UBS Agreement. Three hundred and eighty petitioners separately lodged such an appeal in order to prevent the transfer of their account information to the IRS. As of October 31, 2011, the SFAC

had rendered judgments in all but one of these appeals, the dispositions of which have been reported as follows:²

- > 100 appeals (26.3%) were allowed, entirely or in part, 12 of which were remanded to the SFTA, in large part due to a violation of the right to be heard
- > 94 appeals (24.7%) were dismissed
- > 111 appeals (29.2%) were withdrawn
- > 47 appeals (12.4%) were not considered for procedural reasons.

The SFAC's judgments address the varied criteria set out in Annex 10 of the UBS Agreement for identifying U.S. persons whose UBS account information was subject to transmission to the IRS under the UBS Agreement. Some of these judgments concerned appeals brought by beneficiaries of discretionary trusts who the SFTA had deemed to be "beneficial owners" of certain UBS accounts. In hearing these appeals, the SFAC employed a methodical approach to treaty interpretation in order to define key terms and also respected well-established principles of common law trusts. As will be seen below, these cases, while without broad precedential value, may indeed have long-term implications for assets held in Switzerland and which belong to foreign trusts.

¹ Agreement between the Swiss Confederation and the United States of America on the Request for Information from the Internal Revenue Service of the United States of America Regarding UBS AG, a Corporation Established under the Laws of the Swiss Confederation, August 19, 2009. Following a decision by the Swiss Federal Administrative Court which refused to grant certain assistance under the UBS Agreement, the UBS Agreement was revised by the Protocol Amending the Agreement between the United States of America and the Swiss Confederation, signed March 31, 2010.

² Press Release, Swiss Federal Administrative Tribunal, Administrative Assistance Proceedings in the UBS Case (October 31, 2011).

The Annex to the UBS Agreement

The Annex to the UBS Agreement (the "**Annex**") set out the criteria for granting assistance pursuant to the IRS's request for information under the UBS Agreement. Of particular relevance for trusts is paragraph 1(B), which provided that the general requirement to identify persons subject to the request for information was considered satisfied for the following individuals:³

U.S. persons (irrespective of their domicile) who beneficially owned "offshore company accounts" that have been established or maintained during the period of years 2001 through 2008 and for which a reasonable suspicion of "tax fraud or the like" can be demonstrated.

Leaving aside the requirement and related criteria set out in the UBS Agreement for determining "tax fraud or the like", paragraph 1(B) raised two particular definitional issues central to the SFTA's/SFAC's analyses: *first*, the definition of an "offshore company account" and *second*, the meaning of "beneficially owned" i.e., who may be deemed the "beneficial owner" of a relevant account.

"Offshore Company Account"

In interpreting the term "offshore company", the SFAC reached a fairly expansive definition. Though recognizing that the term "company" ordinarily refers to an entity with a legal personality, the SFAC considered that the adjective "offshore" – as used in the UBS Agreement – broadened the usual meaning to encompass also entities not necessarily having distinct legal personalities under Swiss or U.S. law. Offshore companies within the meaning of the UBS Agreement, according to the SFAC, were those entities that were able to maintain long-term client relationships with financial institutions and hold assets/property. Having reached this definition, the SFAC held that UBS accounts held by foreign trusts or foreign private interest foundations (or by foreign companies whose shares were held by foreign trusts) fell within the definition of an "offshore company account" under paragraph 1(B) of the Annex.⁴

"Beneficially Owned"

The Annex did not contain a definition of the term "beneficially owned" or "beneficial owner". Relying on previously decided cases and Swiss legal commentary, the SFAC recalled that the concept of "beneficial owner" must be viewed in light of the economic reality rather than any formal indication appearing in trust documentation or bank records (i.e., a "substance over form" approach). Taking into consideration the object and purpose of the UBS Agreement, the SFAC held that the term "beneficial owner" was to be read against an intention to identify instances in which an offshore company was used to circumvent disclosure obligations to the IRS or for the purposes of evading the imposition of U.S. tax. The determinative factor in assessing the notion of "beneficial owner", according to the SFAC, is thus whether and to which extent the U.S. person maintained power to dispose of and control the assets and income in the relevant UBS account. The greater the power and control, the more likely the U.S. person would be deemed the beneficial owner of an account. This assessment requires consideration of the facts and circumstances surrounding each particular case.⁵

Decision A-7013/2010 of March 18, 2011

In Decision A-7013/2010, a UBS account had been opened by a Trustee in its capacity as the Trustee of a Trust. The petitioner, a beneficiary of the Trust, was named the beneficial owner of the account on various bank documents submitted at the time the account was opened. In order to rebut this formal indication, the petitioner submitted several documents including the Declaration of Trust. The SFAC examined the Declaration of Trust and observed the following:

- > the Trust was established in June 1998 under the laws of a jurisdiction not disclosed in the decision available to the public
- > the Trust was stated to be irrevocable and discretionary
- > the Trustee did not have an obligation to distribute on a continuing basis the income of the Trust Fund to the beneficiaries, but instead had discretion – with the consent of the Trust Protectors – to accumulate the Trust's income and distribute its capital

³ Annex to the UBS Agreement, at para. 1(B).

⁴ Decision A-7013/2010 of 18 March 2011 at para. 5.2 *et seq.*, citing Decision A-6053/2010 of 10 January 2011 at para. 7.2 *et seq.*

⁵ Decision A-7013/2010 at paras. 5.2.2 to 5.2.3, citing Decision of 10 January 2011 at para. 7.3.2.

- > the beneficiaries of the Trust were the petitioner and his descendants, two other persons and their respective descendants, and a third person
- > two individuals served as Protectors of the Trust.

Guided by The Hague Convention on the Law Applicable to Trusts and on Their Recognition, the SFAC first recalled well-established trust principles concerning the rights of beneficiaries and notions of equitable ownership. The SFAC observed that in cases of discretionary trusts, beneficiaries do not have any rights over trust assets until and unless the trustee exercises its discretionary power in their favour; prior to such time, beneficiaries have only an expectation that the trustee might, at some point in the future, exercise its discretion in their favour. Viewed in this light, and taking account of the terms of the Declaration of Trust, the SFAC considered that the petitioner did not have the power to dispose of the assets or income of the Trust Fund during the period covered by the UBS Agreement. Accordingly, the SFAC held that the petitioner clearly and decisively refuted the contention that he beneficially owned the assets in the UBS account (or its income), allowed the appeal, and refused the transfer of information to the IRS.

Decision A-535/2011, A-539/2011, A-544/2011, A-547/2011 of 28 June 2011

In this consolidated judgment, the two petitioners were U.S. citizens and domiciled in the U.S. The petitioners were named beneficial owners on bank documents relating to one or more of four UBS bank accounts held in the name of four different companies. These four companies, according to the judgment of the SFAC, were incorporated in a jurisdiction referred to as a "tax haven". The companies were owned in different proportions by two trusts that were settled by the petitioners' mother. The petitioners and their descendants were named beneficiaries of both Trusts. In deciding on the appeal, the SFAC reviewed several documents including the Deeds of Settlement, Deeds of Amendment, Memoranda of Wishes, as well as the statutes of one of the companies holding one of the UBS accounts. The SFAC then took note of the following:

- > the Trusts were established on May 26, 2004 under the laws of a jurisdiction not disclosed in the decision available to the public
- > the Trusts were expressly stated to be revocable
- > the Settlor of the Trusts was the petitioners' mother, a Swiss resident

- > the Beneficiaries of the Trusts were the petitioners and their descendants
- > the Memoranda of Wishes for the Trusts indicated that the Settlor wished to be the principal beneficiary of both Trusts and that the petitioners would only be beneficiaries of the Trusts upon the death of the Settlor
- > several transfers of funds were made from each of the UBS accounts to other accounts belonging jointly or individually to the petitioners
- > the bank documents completed at the time the accounts were opened, which indicated the petitioners as the beneficial owners, had been subsequently modified in 2008 in order to provide only the mother as beneficial owner.

Following its established practice in such cases, the SFAC referred to fundamental trust principles concerning revocable trusts, noting that beneficiaries of revocable trusts do not have any rights over the assets or income of such a trust. Beneficiaries only acquire a right over the trust assets at the time such rights are free from conditions, and in the case of a revocable trust, at the time the trust becomes irrevocable following the death of the settlor, provided, however, that the trust is not a discretionary trust. The SFAC recalled that by retaining the power to revoke the trust, the settlor is not economically dispossessed of the trust assets and maintains paramount control over such assets. Consequently, the SFAC found that the petitioners were not vested with the power to dispose of the assets in the UBS accounts, nor did they have any power to control or maintain the trusts' assets and income during the relevant period. Moreover, the SFAC considered that it was the Settlor who, during her life, was the beneficial owner of the trusts' assets held in the UBS accounts. The appeal was therefore allowed and the SFTA was prevented from transmitting the petitioners' information to the IRS.

If you require additional information please do not hesitate to contact us.

Your Contacts

Geneva / Lausanne

Mark Barmes
mark.barmes@lenzstaehelin.com

Frédéric Neukomm
frederic.neukomm@lenzstaehelin.com

Jamar Brown
jamar.brown@lenzstaehelin.com

Telephone + 41 58 450 70 00

Zurich

Stefan Breitenstein
stefan.breitenstein@lenzstaehelin.com

Telephone +41 58 450 80 00

Our Offices

Geneva

Route de Chêne 30
CH-1211 Genève 17
Telephone +41 58 450 70 00
Fax +41 58 450 70 01
geneva@lenzstaehelin.com

Zurich

Bleicherweg 58
CH-8027 Zürich
Telephone +41 58 450 80 00
Fax +41 58 450 80 01
zurich@lenzstaehelin.com

Lausanne

Avenue du Tribunal-Fédéral 34
CH-1005 Lausanne
Telephone +41 58 450 70 00
Fax +41 58 450 70 01
lausanne@lenzstaehelin.com

www.lenzstaehelin.com

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